

EUROPE'S CHALLENGE: LEGACY CAPITALISM

Ask the PORTFOLIO MANAGER

Why are you no longer enthusiastic about Europe?

Transcript of a video recorded on May 30, 2018.

There's a consensus reflex with respect to the non-U.S. markets, which goes something like this: The U.S. expansion looks old, the market looks highly valued. Therefore, it must be time to move money overseas, to Europe and the emerging economies.

That view is flawed because it doesn't take account of the profitability regime that exists in some of these other markets. For example, throughout this cycle, U.S. growth stocks have led because they've led in profitability terms.

If you look at Europe today, there is no catch-up in Europe with respect to profitability vis-à-vis the U.S. Europe, after exports, has no other source of domestic profitability that it can turn to when that portion of the economy is under pressure.

Although political risk is a subjective concept and very unreliable, it probably does apply to Europe. Europe is caught in a deflationary structure with poor demographics that can perhaps be simplified as bad governance. Most of the companies that comprise the major equity benchmarks in Europe are what I describe as legacy capitalism.

They're not growth businesses. They are overregulated, overtaxed, deeply protected businesses that are in effect rentier-like type companies. That explains why Europe is unable to develop the same sort of profitability growth as the U.S.

Europe's composition of companies is also very value in nature as an investment style, and our view is that value is unlikely to perform in a sustained way until we get into the next investment cycle. As long as this bull market is led by growth stocks, it's very, very hard for Europe to compete.

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