

Eurozone: A Self-Sustaining Recovery



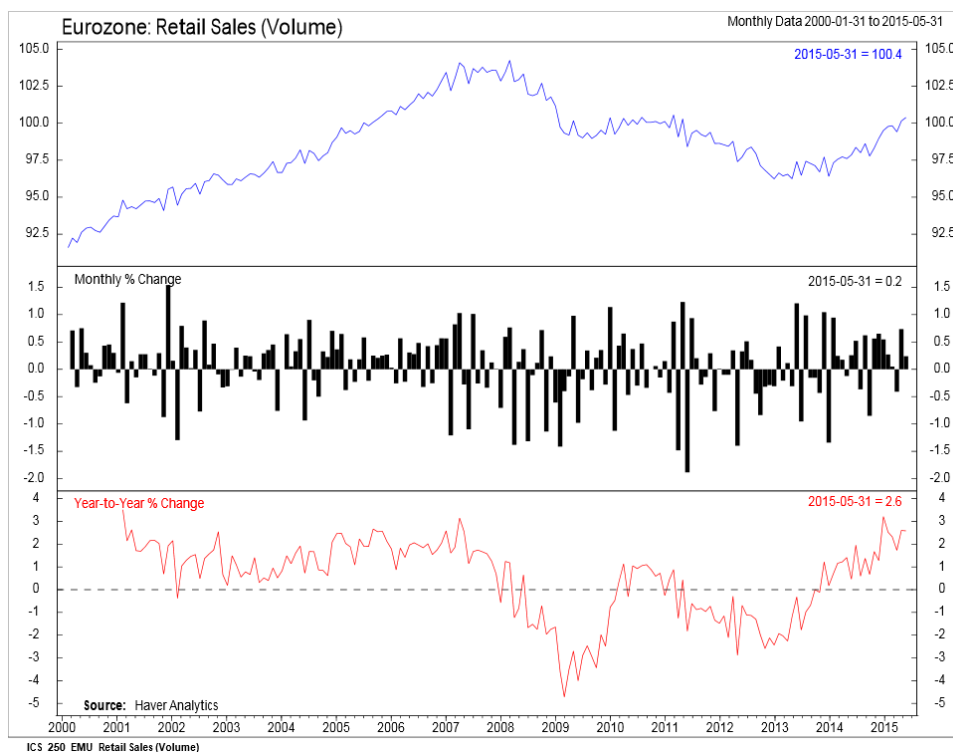
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After two recessions in seven years, we believe the evidence supports the beginning of a long, slow-growth expansion in the eurozone. As we have seen in the US, we believe that this expansion signals a strong environment for stock investors: profit margins rise, central bank policy remains very supportive and investors are pleasantly surprised by both earnings and economic data because expectations are low. Below is some key data supporting our view.

- Car sales are up 7.5% year-over-year in June and have plenty of scope to continue to grow. At 800,000 last month, they are still well below the 950,000 average of the 1998–2008 timeframe.
- The OECD’s Euro Area Composite Leading indicator has been in expansion territory for 18 months, and money supply is expanding as is the Purchasing Managers Index (PMI).
- Retail Sales, having fallen from a high in 2008, have now been growing for 18 months at a rate consistent with the pre-2008 expansion.

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The major economic difference between the eurozone and the US is the lag in the start of the former’s recovery. If we are right, and a slow expansion is now becoming established, then it should be accompanied by a prolonged earnings cycle, right at the time when US companies are struggling to deliver more than low single-digit earnings growth. This seems to be the case in 2015, as the table below indicates. We believe eurozone earnings are likely to outpace those in the US for several years. In addition to owning a portfolio of multinational companies,

we have recently been adding to more domestic names, especially those with lower volatility and higher dividend yields, which we believe will benefit from a prolonged period of very low interest rates. *Dividends are not guaranteed and are subject to change or elimination.*

2015 Earnings Per Share Growth Expectations by Region*	
MSCI World	1.6%
S&P 500	1.3%
Euro Stoxx 50	13.2%
Tokyo Stock Price Index (Topix)	18.6%

* Estimates by International Brokers' Estimate System for 2015 (March 2016 for Japan)

Source: JP Morgan Chase, data as of 7/30/2015. Individual investors cannot directly purchase an index.

One of the factors boosting earnings growth in both the eurozone and Japan has been the weakness of their currencies. We believe the majority of the yen's weakness has probably occurred, but we still expect further weakness in the euro. Technically, the euro seems to be consolidating the significant decline from a peak of 1.4 in May 2014 to 1.05 in March of this year. Since then, the euro has traded between 1.05 and 1.15, a fairly minimal retracement, and it closed last week in the middle of that range.

We have sometimes referred to such trading ranges as "decision boxes," where investors are trying to decide whether the euro's weakness is over or just pausing before another down leg. Given our view that the eurozone economy is now recovering, we do not expect further euro weakness to be so sharp, but with the European Central Bank maintaining its bond buying program (Quantitative Easing) and the US now offering higher long-term interest rates than even Italy and Spain, we think that when the euro breaks out of the decision box it will be to the downside.

THE WEEKLY CHART: EURO IN A "DECISION BOX"



Source: FreeStockCharts.com, RiverFront Investment Group. Past performance is no guarantee of future results.

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Euro STOXX 50 Index covers 50 stocks from 12 eurozone countries: Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain. It provides a Blue-chip representation of supersector leaders in the eurozone.

MSCI World Index is a stock market index of 1,500 stocks of all the developed markets in the world, as defined by MSCI. The index includes securities from 24 countries but excludes stocks from emerging and frontier economies.

Standard & Poor's (S&P) 500 Index measures the performance of 500 large cap stocks, which together represent about 75% of the total US equities market.

Tokyo Stock Price Index (TOPIX) is a capitalization-weighted index of all companies listed on the First Section of the Tokyo Stock Exchange. The index is supplemented by the subindices of the 33 industry sectors.

Purchasing Managers Index (PMI) is based on five major indicators: new orders, inventory levels, production, supplier deliveries and employment environment.