

# EUROPEAN RESILIENCE

## EUROPEAN EQUITIES FEND OFF VIRUS TROUBLES

March 22, 2021

**European equities have outperformed global markets this year, overcoming vaccine hiccups and re-imposed regional lockdowns. Why is Europe outperforming with these negative pandemic trends? Because there are larger forces at play. Tailwinds from cyclical exposure, global revenues, monetary policy support and political developments keep us positive on Europe.**

**Delay does not equal disruption.** Europe's economic recovery has been delayed with more COVID-19 cases, increased hospitalization that spurred localized lockdowns, and a limited vaccine supply. Several European countries briefly halted the use of the AstraZeneca vaccine because of potential side effects. Meanwhile, in the U.S. new cases have trended down and vaccinations have ramped up. As a result, the U.S. economic recovery has outpaced Europe's. However, it's important to note we view Europe's virus-driven setbacks as temporary. Europe's vaccine rollout should improve over the next few months and a robust economic recovery in the second half of the year is still our base case. Investors appear to agree. European equities are up 6.9% this year (4.9% in U.S. dollar terms) versus a 5.4% return in global equities (4.6% in U.S. dollar terms terms).

**Cyclical and global revenue exposure.** European equities are benefitting from economically-sensitive cyclical stocks that have rallied this year on the back of the global recovery. Investors have rotated into cyclicals such as financials and energy and out of technology stocks and more defensive sectors. European equity markets are more heavily weighted to cyclical "winners" from this rotation. As Exhibit 1 shows, 44% of European equities reside in cyclical sectors versus 33% of global equities. Also important

Northern Trust  
Global Asset Allocation

**Wouter Sturkenboom, CFA**  
Chief Investment Strategist EMEA & APAC  
ws65@ntrs.com

**Colin Cheesman, CFA**  
Investment Analyst  
cc327@ntrs.com

**Jim McDonald**  
Chief Investment Strategist  
jxm8@ntrs.com

### EXHIBIT 1: SECTOR COMPOSITION SUPPORT

Europe's heavier weighting toward outperforming cyclicals, and lower weight to technology, has aided performance.

Europe sector weights (%)			Global sector weights (%)			Global year-to-date total returns (%)		
Defensive (32)	Secular (24)	Cyclical (44)	Defensive (24)	Secular (43)	Cyclical (33)	Defensive	Secular	Cyclical
Health Care 14	Tech 8	Financials 17	Health Care 11	Tech 21	Financials 15	Health Care 0.5	Tech 0.9	Financials 14.1
Staples 12	Cons Disc 12	Industrials 15	Staples 7	Cons Disc 13	Industrials 10	Staples (1.4)	Cons Disc 3.9	Industrials 8.9
Utilities 4	Comm Serv 4	Materials 8	Utilities 3	Comm Serv 10	Materials 5	Utilities (1.5)	Comm Serv 8.9	Materials 8.1
Real Estate 1		Energy 5	Real Estate 3		Energy 3	Real Estate 6.1	Global Equities 5.0	Energy 19.8

Source: Northern Trust Asset Management, Bloomberg. Europe equities are proxied by MSCI Europe Index, global equities are proxied by MSCI ACWI Index. Total returns in local currency. Data as of 3/18/2021.

is that Europe's listed companies derive more than 50% of their revenues from outside the region, by far the highest percentage among the major regions. This makes investors more confident that the improving global outlook will directly benefit Europe.

**Supportive monetary policy, better behaved yields.** Another tailwind for European equity markets has been the European Central Bank's direct action against rising government bond yields with maturities longer than five years. As a result, Eurozone yields have risen about half as much as U.S. yields. Also, only 8% of the European equity market is in the more interest-rate sensitive technology sector versus 21% of global equities. The sector has returned an underwhelming 0.9% year-to-date (0.4% in USD terms), so Europe's underweight to technology has helped relative performance.

**Firming political leadership.** Despite Europe's vaccine struggles and accompanying political fallout, we recently decided to upgrade Europe's political leadership score. This decision was made on the back of Mario Draghi stepping into the prime minister role in Italy and the prospect of more steady leadership in Germany as Chancellor Angela Merkel's Christian Democratic Union party chose a more moderate candidate to succeed her. Also, the surge in popularity of the Green Party bodes well for future fiscal stimulus in Germany. These longer-term improvements trump the short-term vaccine headwinds.

**Market implications: Don't let temporary setbacks cloud your vision.** It is important to not get too distracted by near-term virus and vaccine struggles. The pandemic will pass and the economic recovery will pick up the pace later this year. Even more, we expect Europe will continue to benefit from its cyclical orientation, global revenue exposure, easy monetary policy and firming political leadership. As such, we have a moderate tactical overweight to developed ex-U.S. equities in our global portfolio.

What do you think of this commentary? **Click one:** [Like it](#) — [Just okay](#) — [Don't like it](#)

© 2021 Northern Trust Corporation. Head Office: 50 South La Salle Street, Chicago, Illinois 60603 U.S.A.

**IMPORTANT INFORMATION. For Asia-Pacific markets, this information is directed to institutional, professional and wholesale clients or investors only and should not be relied upon by retail clients or investors.** The information is not intended for distribution or use by any person in any jurisdiction where such distribution would be contrary to local law or regulation. Northern Trust and its affiliates may have positions in and may effect transactions in the markets, contracts and related investments different than described in this information. This information is obtained from sources believed to be reliable, and its accuracy and completeness are not guaranteed. Information does not constitute a recommendation of any investment strategy, is not intended as investment advice and does not take into account all the circumstances of each investor. Opinions and forecasts discussed are those of the author, do not necessarily reflect the views of Northern Trust and are subject to change without notice.

This report is provided for informational purposes only and is not intended to be, and should not be construed as, an offer, solicitation or recommendation with respect to any transaction and should not be treated as legal advice, investment advice or tax advice. Recipients should not rely upon this information as a substitute for obtaining specific legal or tax advice from their own professional legal or tax advisors. Information is subject to change based on market or other conditions.

Northern Trust Asset Management is composed of Northern Trust Investments, Inc. Northern Trust Global Investments Limited, Northern Trust Fund Managers (Ireland) Limited, Northern Trust Global Investments Japan, K.K, NT Global Advisors Inc., 50 South Capital Advisors, LLC, Belvedere Advisors LLC and investment personnel of The Northern Trust Company of Hong Kong Limited and The Northern Trust Company.