6 Financial flows and European equity markets

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Eurozone equities have performed very well year-to-date, outperforming those of other regions as well as other asset classes. However, with their past results still mediocre and their valuation tightening, how can we explain such a situation? **Whereas in last month's Cross Asset we stated we were on the verge of a significant rebound in earnings[1], this time we are leaning toward financial flows to distinguish their role in market appreciation.**

Before delving into these flow concepts, let us step back a little to the previous discussion on earnings. The conviction that eurozone profits should rebound powerfully in 2015 now seems more and more accepted. Thus, according to the Ibes Consensus, the net-up ratio of Sell-Side analysts – a ratio that measures the net index of upward earnings revisions – is not only back in positive territory for the first time in 37 months and at a 60-month high, but has also pulled ahead of all the other regions.

As regards flows, first we will discuss the trends in Europe between major asset classes (equities and bonds) since early 2013, **and then we will concentrate on equities alone, using an increasingly detailed regional prism.**

Thus, regarding the major asset classes, Graph 1 shows that cumulatively over the entire period, **equities and bonds have both benefited from positive flows,** for a total of $116 billion for equities and $85 billion for bonds, **i.e. a net balance of more than $30 billion in favour of equities.** Yet in addition to the overall balance, which gives equities the edge, it is most important to focus on the different sequences in time.

Thus we can clearly see **that the big starting signal for inflows on European equities was given by the Fed (!),** when, in May 2013, Ben Bernanke began mentioning the impending slowdown in asset buying (pre-tapering). By suggesting that US growth was becoming solid enough to consider a gradual tightening, the former Fed Chairman not only gave US equities a helping hand, implying that rate risks were becoming asymmetrical, but also spurring on eurozone equities, given the difference in agendas between the two central banks[2] and the then-massive undervaluation of the eurozone markets. The same graph on US assets, which we are making available to our readers, shows that the initial impulse for US equities had been combined with a simultaneous outflow on bonds, while no such thing happened in Europe; bonds there stayed reasonably attractive, with rates falling steadily.

Graph 1 also shows that the buzz over European equities lasted until summer 2014 before turning around abruptly, then ultimately regaining momentum beginning in mid-January 2015.

First off, this characteristic tempo corresponds to **the piling-up of concerns**, between the unexpected slowdown in the **core of the eurozone**, the worsening of **geopolitical tensions**, and the questions over the post-tapering phase in the autumn of 2014. The drop in the IFO index and of industrial output in Germany has itself raised many questions since the delayed impact of the Q1 2014 slowdown in the US, not to mention the misfires of the Chinese economy. In addition, the fact that the questions were directly about Germany, and no longer just the periphery, has given even more attention to events in Ukraine (the annexation of Crimea, the Donbass uprising, the destruction of the Malaysia Airlines airplane near Russia), since Kiev is barely an hour's flight from Berlin.

After a tricky second half of 2014, when the debate over the failed recovery and a return to deflation loomed, **the ecb ultimately freed the markets**

[1] *Article 8 of the April 2015 issue of Cross Asset Investment Strategy: Listed companies' earnings and foreign exchange rates: currencies will play a decisive role in 2015*

[2] *Meanwhile, ECB Chairman Mario Draghi had decreed in July 2012 that every effort would be made to save the euro.*

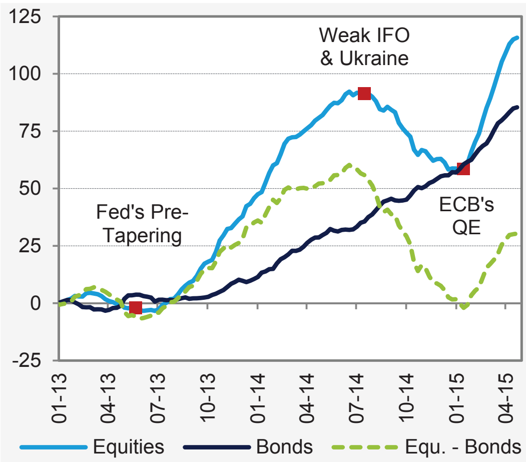
The essential

In Europe, the true starting signal for equity inflows was given not by Draghi in July 2012, but by Bernanke in May 2013, when he began mentioning the impending slowdown in asset buying (pre-tapering).

This buzz over European equities extended through the summer of 2014, before reversing abruptly under the build-up of worries on the economic, geopolitical and monetary fronts. After a tricky second half of 2014, in mid-January 2015, this time it was the ECB that freed the European equity markets by announcing a massive asset-buying programme.

> In May 2013, the Fed had given the starting signal for equity inflows

1 **Europe Flows by Asset Class cumul from 1-1-2013 to 22-4-2015 ($ Bn)**



Source: EPFR, Amundi Research

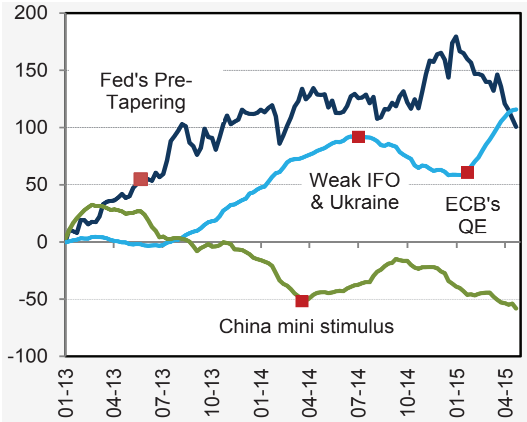
by resorting to a massive and potentially open-ended asset-buying programme in mid-January 2015. Investors reacted instantly, from mid-January to April 22, 2015, by putting $57 billion in additional flows toward European equities, more than twice what they put toward bonds ($25 billion), although bonds had far outpaced equities in the second half of 2014.

From a geographical standpoint, Graph 2 shows that European equities have been in a counter-current with US equities since last summer. Thus, in the second half of 2014, when the latter were still on their winning streak, generating some $50 billion and +4% in additional increases for the MSCI United States, Europe's take fell by more than $30 billion, and the MSCI Europe lost 2%. Conversely, beginning in mid-January, European equities took off again, with +$57 billion in gains against -$64 billion for US equities and a +15% gain vs. +5%.

With the spotlight on this rebound in European equities' appeal, the question is **who profited most**. Graph 3 clearly shows that **while Japan and Europe were evenly matched in gains** and the US and the Emerging Markets suffered some losses, **the situation in Europe was not uniform**. For example, within Europe, we can differentiate between countries according to their central bank's policy and the exchange rate. Thus, **the eurozone and Sweden, where the central banks have been more accommodating, had greater flows than Great Britain or Switzerland**, where the currency appreciated. Finally, within the eurozone, **the concept of core/periphery seems to be fading**; Germany, France, Spain and Italy are all posting high inflows, with a slight adavantage for Spain.

After such a rebound in volumes on European equities, can it go further, or should we consider that the movement is nearing its end? Although, in the short term, between the threats of Brexit and Grexit, the fleeting disappointment over US growth and, from there, the euro's rebound, we should certainly be more prudent, on a 12-month horizon the inflows on European equities should continue apace. Technically, after years of outflow, the scope of volumes on equities ultimately remains limited. On the monetary front – so important to the direction of flows – even though the Fed, which is faced with disappointing US growth in the first quarter, should be in no hurry to tighten its policy, the ECB presents even greater visibility with a purchasing timetable until September 2016 at least. With rates determined to stay low for a long time, and a euro that will remain competitive, European equities, which are offering dividends of around 3% as well as solid earnings outlooks, should continue to be a draw.

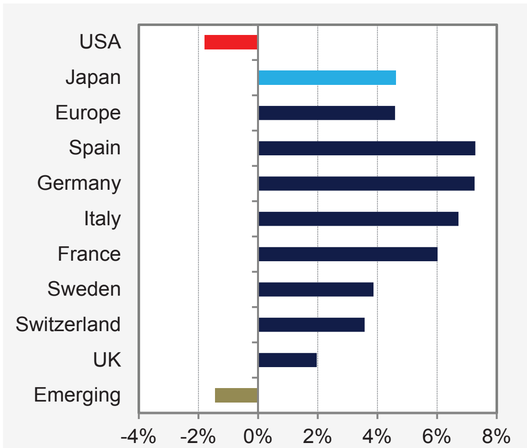
2 **Equity Fund Flows by Region cumul from 1-1-2013 to 22-4-2015 ($ Bn)**



Source: EPFR, Amundi Research

> After six undecided months, the ECB freed the equity markets in mid-January 2015

3 **Equity Country Flows YTD from 1-1 to 22-4-2015 in % NAV**



Source: EPFR, Amundi Research

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