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- **Europe remains structurally disadvantaged, in our opinion.**
- **However, COVID-19 containment and greater collaboration among national governments are two recent positives.**
- **We recently added to European stocks and are now roughly neutral to global benchmarks.**

Cohesion from Crisis? Adding to Europe

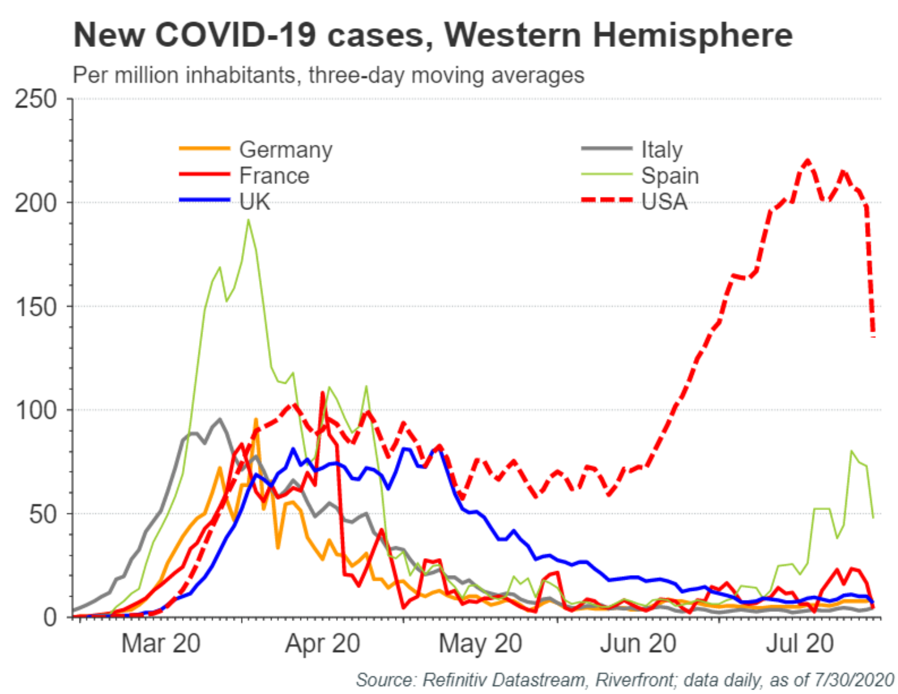
STILL A TROUBLED REGION, BUT SOME IMPORTANT RECENT POSITIVES

Last week, our longer-horizon, more risk-tolerant portfolios increased their weighting to European stocks, including a specific allocation to Germany. While this only brought the portfolios up to a roughly neutral weighting in Europe relative to our global benchmarks, it represents a meaningful evolution in our view on European stocks.

While we have long believed European assets possess attractive long-term mean reversion potential relative to US stocks, our cautious view in recent years has centered on what we view as compromised fundamentals. Structurally, many headwinds remain in Europe, including the Brexit fight between the UK and the European Union, and national political strife in Italy, Spain and others. Europe also must contend with low levels of productivity, high tax rates, rigid labor laws, and other structural issues– an issue we wrote about extensively in the 'Reform – The 4th R' section of our [2020 Outlook.](2020 Outlook) This underachievement has led to anemic corporate earnings throughout Europe for the last decade, leading to disappointing relative stock performance to the US. **Despite these longer-term issues, several tactical factors have conspired recently to turn our nearer-term view on Europe more constructive, including significant action from Europe's policymakers**.

EUROPE GETS HIGH MARKS ON COVID-19 CONTAINMENT

First, Europe continues to fare relatively well on COVID-19 containment measures, despite being the early virus epicenter of the Western hemisphere. We believe that this may allow European economies to open faster than in the US, where COVID-19 transmission rates are still unfortunately much higher.



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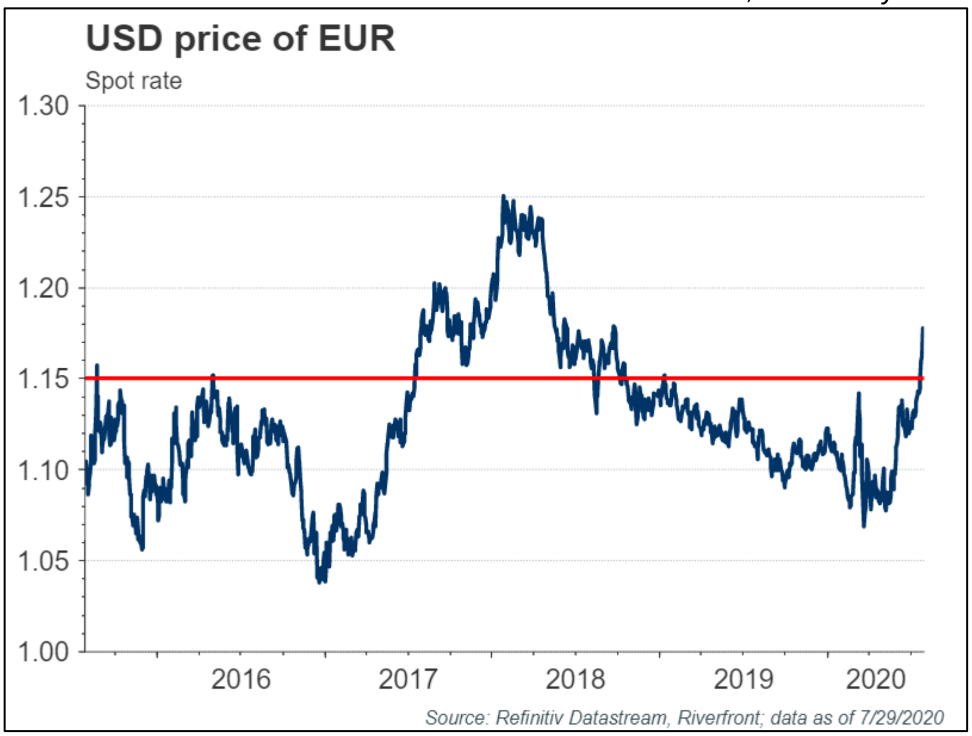
COVID-19 CRISIS HAS MANAGED TO DRIVE EURO GOVERNMENT COLLABORATION

While the European Central Bank has long sought to underwrite a Euro recovery via aggressive monetary policy - which continues unabated - the recent COVID-19 relief funding announcement from the EU suggests a greater commitment to the European experiment by the national governments themselves.

The recovery fund – which includes grants to poorer countries as well as loans, funded under the auspices of an EU bond – is an important step forward for the region, in our opinion. The stimulus size is meaningful – roughly 5% of EU GDP, according to research from Alpine Macro – but the signal it sends around shared responsibility for the financial health of the EU is perhaps more important than its size. The structure of this recent announcement may eventually pave the way towards pan-European debt issuance, the lack of which has been a partial cause of the rolling crises that have engulfed the Eurozone numerous times since 2008. We believe these actions, necessary but politically unpopular in northern Europe, demonstrates that the 'rich' countries of the Eurozone are incrementally more willing to help underwrite the rest of the region than before.



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Some of these positive near-term fundamental signals are manifesting themselves in the recent strength of the euro (EUR) relative to the US dollar, which has in our opinion broken important technical support to the upside around 1.15 (see red line on chart, right). While too much strength in the EUR could prove to be a headwind for Euro stocks in local terms, as US dollar-denominated investors we benefit from a stronger Euro. So far, we believe the EUR is not nearly strong enough for that tailwind to become a headwind for European companies exporting outside the region.

It's worth noting that we remain more constructive on the Euro area than the UK, where continued Brexit-related uncertainty threatens to bog down the region economically as well as put pressure on the pound.

WHY WE PREFER GERMANY WITHIN EUROPE

Germany, in our view, represents one of the more stable parts of the Euro area. Germany boasts a budget surplus, low overall levels of debt relative to GDP, relatively low unemployment and more stable politics compared to most other euro bloc countries. In a world still fraught with pandemic uncertainty, Germany has also been a standout, with a very low current viral transmission rate as compared to the US and Latin America. We also believe that Germany's economy is disproportionately exposed to the Chinese and global economic cycle via the export orientation of its many of its companies– we view this as a positive given the recent rebound in the Chinese economy.

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