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## Investors can't ignore the eurozone

STIRLING LARKIN THE AUSTRALIAN MAY 23, 2015 12:00AM



Investors are looking again at Germany, France and the UK. Source: AFP

### Professional investing and trading in markets can be a mercurial business at times.

Like the protagonist in any number of Shakespearean plays, we can fall in and out of love with a character or community just as quickly as the plot thickens.

When it comes to the dramatic years following the global financial crisis, Europe and, more specifically, the eurozone — the group of EU nations whose currency is the euro — has been one such example of a love and hate relationship.

Whether we chose, as investors, to have discounted them until now, or to have remained smitten with their many alluring prospects, it would be difficult to find any professional investor who has not suffered cognitive dissonance when presented with eurozone investment decisions over the past seven years.

Cognitive dissonance is one of the core concepts within the relatively new sciences of behavioural and cognitive economics.

It reflects a state in which one has dual and contradictory thoughts, beliefs or attitudes, exhibited at the same time, towards the same piece of information or subject.

This internal tension following the crisis years has persisted because, no matter how bad the European and eurozone predicament became, this region — whether we liked it or not — remained a significant part of the global economy.

It also remained one of the few developed markets that not only harboured capital, industry and know-how but underpinned many key global institutional participants that root our intertwined international system.

The eurozone, in particular, has always led world's best practices in capital goods, oil and gas sciences, pharmaceuticals and technology.

These include globalised investment banks, insurance and reinsurance conglomerates and technology doyens such as Thales Group, Airbus and Safran, to name but a very few.

While the region continues to remain a very unpopular investment thematic among many investment communities, what is interesting is that some wholesale and ultra high net worth global investors have, in recent weeks, taken a fresh look at eurozone investment markets, even during a time when the German bund (bond) market experienced a nasty volatility spike.

The graph could be interpreted in many different ways, but what is clear is US equity market investments have outperformed those in the eurozone significantly since 2010.

The tradecraft, however, in professional UHNW investing is picking when trends may not yet have begun but are only a matter of time away, and then making the decision to take tactical positions now in anticipation.

Some in the wholesale investment communities are making those decisions at present with respect to eurozone equity markets.

What we now know, with the luxury of hindsight, is that the unconventional monetary mechanism of quantitative easing, during modern times, has a positive and inflationary effect on listed equity markets in its own economies.

What we also know, looking back on history and the experiences of unconventional monetary policies of the mid-1930s, is that there also exists an embedded rider to this mechanism.

This rider or caveat — witnessed during the 1930s when economies broke from the gold standard and went about reinflating their respective economies — was that the first mover enjoyed the best results while subsequent followers enjoyed a diminished effect. Put into the context of present global QE, the US, which began these mechanisms, enjoyed the best results possible.

Those who followed — the Japanese, British and Swiss — had either to be more aggressive or assertive in their purchases of QE-appropriate assets to equal the effects seen during US QE.

Why this is significant is that the European Central Bank's QE program has to do more than previous central bank programs to yield the same inflationary effects.

This was best illustrated on Tuesday when eurozone and British equity markets rallied to near multi-year highs after senior ECB policymaker Benoit Coeure said the central bank would be adjusting its bond-buying program in response to the recent bund market volatility.

He confirmed that the ECB would increase its buying in May, June and possibly out as far as September. Given this explicit resolve, Australian UHNW investors are joining those global investors,

who are considering whether now may be a time to re-enter eurozone equity markets.

What is important in these considerations — as has been discussed in this column in stories about Japan, China and Mexico — is that current economic and future investment market outcomes are not confused when deciding the timing of a new market investment entry.

There is little dispute that eurozone companies tend to have lower profit margins than their US counterparts, that demographics and labour mobility remain a significant issue and that high levels of sovereign, corporate and household debt, outside Germany, will inevitably continue to hamper any real economy recovery in the region.

Complicating this decision further are renewed concerns regarding a Greek exit, or “Grexit”, from the bloc, coupled with the prospect of Britain seceding from the EU, referred to as “Brexit”.

The threat of a Brexit, in particular, has prompted Britain’s largest business lobby group, the Confederation of British Industry, to warn this week of the dire consequences to the world’s fifth-largest economy if it were to proceed. Deutsche Bank went one step further and said it would cut its British presence in the event of a Brexit.

When all is considered, any smart, tactical, prescient investment decision must be cognitive of the visible risks and be wary of the yet unforeseen unknowns.

However, what makes any investor successful is anticipating the time when one may still be hated by many but is about to become very much loved by all.

Larkin Group is a Wholesale Wealth Adviser focusing on high yielding global investments.

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