# European equities: the peak of pessimism is behind us

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- The world is going to change in 2021! We will have had Brexit, there will be a new president in the White House, and Covid-19 vaccines will be in roll-out. So, while headwinds from 2020 still need to play out, we can be optimistic. Expect a big rebound from corporate earnings crushed by the virus, and support from fiscal stimulus, good money availability and recovering companies and consumers.

- Europe has a huge range of strong companies: with robust franchises, they are globally competitive and have fantastic pricing power and great management. Earnings will rebound and the survivors that were oversold in 2020 will bounce. But there are some which won't survive or will be hobbled by the crisis. So, laggards and leaders – performance, as ever, needs to come from stock selection.

- Brexit could disrupt European as well as UK businesses. Although at the time of writing a deal is yet to be agreed, whatever the final outcome, potential disruptions could still lurk.

- Joe Biden could set a common global agenda in 2021 with the UN Climate Change Conference, and with a new US stance on climate change. This, together with China's recent announcement of net zero carbon emissions by 2060, could herald a consistent global policy – so it is crucial to reassess environmental positioning globally.

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**There are reasons for optimism in 2021. Forget a U-shaped recovery; the letter we look for in 2021 is V, which stands for vaccine. Our baseline scenario is that vaccines roll out across Europe in early 2021, allowing business and consumer activity to start to return to normal. But even if there are delays and further lockdowns, the economic impact of Covid-19 should ease markedly in 2021.**

Expect a big rebound from corporate earnings crushed by the virus, and support from Europe-wide fiscal stimulus, injections of money from central banks, and recovering companies and consumers.

Unemployment is expected to be higher, but among those who have retained their jobs, many European consumers have been building cash reserves – in the second quarter of 2020 the household savings rate in the euro area hit a record high of 24.6%.[1] The European Union has agreed a €750 billion stimulus package[2] to combat the pandemic, while quantitative easing and record low interest rates from the European Central Bank, the Bank of England and other European central banks should continue throughout 2021.

A lot of European companies have cut costs and improved operational efficiencies in the wake of Covid-19. So, our central case is European equities to be well supported. However, we expect there are some companies which won't survive, or will be hobbled by the crisis. So, laggards and leaders – performance, as ever, needs to come from stock selection.

We believe the European winners in 2021 will fall into two categories. The first is globally competitive companies with robust franchises, strong management teams and excellent pricing power – often these companies have business models which meant earnings did not suffer the hit in 2020 and even – within healthcare and technology, for example – derived some benefits from the new normal environment.

> ***There will be laggards and leaders in European equities – performance, as ever, needs to come from stock selection***

The second is stocks that did see earnings decline, but the share prices were savaged – by year-end they were heavily oversold, and some did not deserve to be so heavily punished. We expect many of these stocks to enjoy strong earnings rebound in 2021. And as 2020 draws to a close, many companies in Europe are so cheap that we expect a surge in mergers and acquisitions.

[1] European Commission, https://ec.europa.eu/eurostat/documents/2995521/10663666/2-02102020-BP-EN.pdf/f30ab193-3e6d-2bfb-8916-dd058322105e 2 October 2020.
[2] Bloomberg, https://www.bloomberg.com/news/articles/2020-07-21/eu-leaders-reach-deal-on-750-billion-euro-virus-recovery-fund 21 July 2020.

So as in 2020, stock selection is key and will play to the core strengths of Columbia Threadneedle Investments, where investment decisions are backed by an extensive team of experienced sector analysts.

Aside from the vaccine, two other themes will influence European equity markets as we start 2021: the outcome of the Brexit trade negotiations with the EU, and the impact Joe Biden will have as the new US president.

On Brexit, at the time of writing a deal is yet to be agreed. Whatever the final outcome, there could be potential trade disruptions for both UK and European businesses next year as supply chains are reworked. However, given the goodwill on both sides to iron out any issues, we expect major problems to be short lived.

President-elect Biden, meanwhile, has already had a positive impact on global markets: stock indices rose strongly in the wake of the US elections and as senior nominations in his administration were announced. Renewed global impetus on climate change may well follow, especially with the looming UN Climate Change Conference and China's promise to achieve net zero carbon emissions by 2060.[3] This bodes well for strategies which follow environmental, social and governance (ESG) standards.

> ***As 2020 draws to a close, many companies in Europe are so cheap that we expect a surge in mergers and acquisitions***

2020 has been a challenging year for investors. From peak to March's lockdown trough, at the height of pessimism, the Euro Stoxx 50 Index was down almost 40%.[4] But as we enter 2021 the pessimism is behind us. And this means that, for equity investors, there are gains to be made.

[3] BBC.co.uk Climate change: China aims for 'carbon neutrality by 2060', 22 September 2020.
[4] Bloomberg, April 2020.

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