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Press Release

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End of the bond rally, time for shares!
Euro area will pick up on global recovery

Avoiding a European recession and ratcheting up inflation: those are ECB President Mario Draghi's New Year resolutions for 2015. The US will take the helm of the global economic recovery. And, after nine years of ever-looser monetary policy, the first American interest-rate hike is now on the horizon. This will result, in our view, in a positive but volatile stock market year, with an absolute top performance by the dollar. Bond investors should be on their guard.

2014 was supposed to be a recovery year for the euro area, while the United States was looking at a year of accelerated growth. Neither of these happened. US growth got off to a false start due to an exceptionally cold winter, and the anticipated growth turned into an economic contraction during the first quarter. The world breathed a sigh of relief when the second quarter's strong figures made it clear that the interim dip had been down to the polar vortex – the stream of cold air that afflicted the US for weeks. The economy bounced back further, creating jobs at a rate of more than 200 000 a month for the past half year.

Europe stuck in the mud

The euro area went in the opposite direction. The year got off to a relatively good start and numerous merchant bankers actually raised their growth forecasts in May. Everything then went downhill. The Ukraine crisis weighed on sentiment – first on the part of businesses, then of consumers. Waning confidence translated into fewer investments and orders. Even the German locomotive narrowly avoided recession in the third quarter. The euro area grew 0.2%, thanks to the reforms in countries like Portugal, Spain, Ireland and also the Netherlands.

The former failures will be the mainstays of 2015, while countries that have so far only dabbled with reform, such as France, Italy and Belgium, risk being left to muddle on. The problem is illustrated by the fact that the Italian economy is barely as large today as it was in 2000. Talk about a lost decade! No growth without reforms. No gain without pain. And that goes for Belgium too.

No triple dip

Our belief that the euro area will avoid a third recession – two successive quarters of negative growth – since 2008 is based on a variety of factors. First and foremost, a sustained fall of 10% in the oil price will boost economic growth by 0.2 percentage points. A similar fall in the value of the euro against key trading partners' currencies would have a cumulative positive effect of one percentage point over a three-year period.

The headwind of European spending cuts will blow less fiercely. The cuts planned for the next four years amount to barely a third of those carried out over the past four years. What's more, the stress test and balance-sheet scrutiny the ECB has performed on Europe's banks is finally unblocking the flow of credit. More robust capital positions will allow more lending. Now it's a question of waiting for greater demand for investment on the part of businesses.

The investment fund the European Commission set up recently might be helpful in that regard. Because a structural recovery in the euro area will only be possible if the investment cycle is restarted. Government investment will entice private investment, resulting in higher employment, consumer spending and capacity utilisation, and triggering fresh investment.

Ultra-low interest

Growth will keep the high level of debt manageable. It should also result in higher inflation. The ECB is therefore doing everything in its power to give that growth and that inflation an opportunity to revive. The key rate cut to 0.05% means the bottom has been reached in that regard. All that remains is a fall in the value of the euro to ratchet up growth and inflation. How can that be done? When there's plenty of something, demand is weak. Consequently, the more euros that are created, the less attractive the currency will become.

Hence the ECB's plan to increase its balance sheet by a net 1 000 billion euros by the end of 2016. The buying up of government bonds – the Germans are ever-more isolated with their 'Nein' – is an integral part of the plan. We expect this to be announced officially in the first quarter of 2015.

Go for shares!

The choice of strategy is not simple against a backdrop like this. But then again... Can investing in bonds be justified when a rise in Belgian ten-year yields from the current level of 1% to 1.15% would wipe out the entire annual return (an increase in yield implies a fall in price)? What's more, Super Mario Draghi has indicated that he will do everything he can to get inflation back up towards the 2% target as quickly as possible. That being so, is it realistic to expect average inflation in Belgium to remain below a yield of 1% for the next ten years?

In other words, TINA (There Is No Alternative) is back! Meanwhile, a dividend yield of 2.5% (world equity index) to 3.25% (European equities) looks good compared to bonds. The European economy is indeed starting to recover. Until further notice, however, the United States, together with the growth markets, will remain the engine of global growth. Forecast earnings growth therefore remains a robust 5-10% for the US and 10-15% for the euro area in 2015. Earnings growth will be boosted in both regions by falling energy costs and by companies with surplus cash and a lack of attractive investment projects buying back their own shares. The low euro will deliver an extra shot in the arm in our region.

Stable growth

Specifically with regard to the equity portfolios, stability, growth and an eye to protection are the watchwords in terms of strategy. To achieve that stability, we will focus on businesses with high profit distribution. Which offers the best protection against the risk of inflation over ten years (unless you believe that money creation will go unpunished forever...): a fixed return of 1%? Or a dividend of 3.25% with annual growth in that dividend of 5–10%?

We're certainly not forgetting the growth element right now. The cyclical element – the revival of the European economy – ought to be the engine of the equity market in the period ahead. Cyclical shares therefore deserve to be first on the selection sheet. We are placing Germany, the euro area's economic locomotive, on a pedestal. What's more, the German stock market is also the most cyclical of the entire EMU. Protection is possible, lastly, via capital protection or floor-monitoring formulas.

And what about the dollar?

Buy that currency. The growth differential between the US and the euro area is steadily widening. The same goes for the interest-rate gap, which will increasingly play to America's advantage. And for the ECB, a weaker euro is the only remaining option for further relaxing monetary policy. It's highly likely that the dollar will appreciate from 1.24 dollars to the euro to 1.15 by the end of 2015. A return of 10% in a period when your savings account is barely returning anything is worth a little diversification.

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