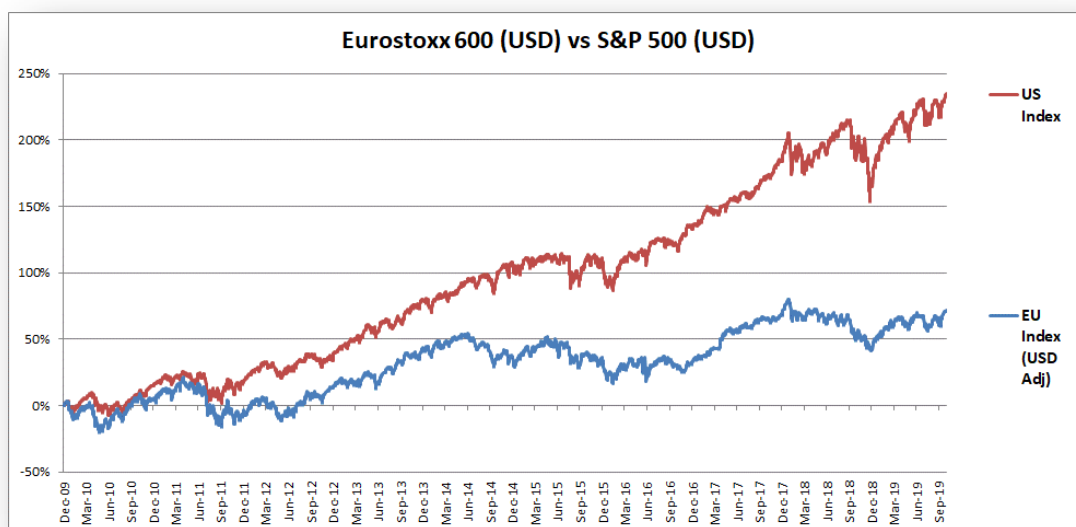


Europe vs the US: Is it all about sector exposures?

In [America's Decade](#), we highlighted¹ the very similar returns provided by the MSCI Europe and S&P 500 from 1980 through 2009, and the very different returns since. Many commenters (accurately, mind you) wondered if the difference this past decade has had at least something to do with sector exposures in each region. The next question, of course, is if the performance of the sectors in each region was also different.

Before proceeding, let's get in the right frame of mind. Below are the total returns of the S&P 500 (red) and the Eurostoxx 600 (blue) so far this decade. From December 31, 2009 through October 31, 2019, the US index has generated total returns of ~234% while the European index has mustered only 70%.



This first table shows the average sector weights from January 2010 through this month. These “average weights” can be misleading (more on that below) but the table will give you a general sense of the differences in sector exposures, geographically. And yes, as many suspected, the US has been relatively overweight Tech and Comms, while Europe has been relatively overweight Financials, Materials, and Consumer Non-Cyclicals.

Even within these sectors, we can see that the constituents of each sector matter as well. The next table shows the annualized returns of each of these sectors.

As an example, in the US, the communication sector has companies like Netflix, Amazon, Google, and Facebook. Europe doesn't. Europe has Netfonds, Amadeus, Goodwin and Facephi².

So even with the same weights, the annualized returns of the communications sector in the US trounced the same sector returns in Europe.

Average Sector Weights	31-Dec-2009 31-Oct-2019		
	Europe	US	Difference
Consumer, Non-Cyclical	27.82%	21.86%	5.95%
Basic Materials	8.05%	2.75%	5.30%
Financial	19.70%	16.89%	2.80%
Utilities	5.06%	3.04%	2.02%
Consumer, Cyclical	11.04%	9.15%	1.90%
Industrial	9.96%	9.97%	-0.01%
Diversified	0.17%	0.00%	0.17%
Energy	8.13%	9.06%	-0.93%
Communications	7.56%	13.99%	-6.43%
Technology	2.52%	13.07%	-10.55%

Annualized Sector Performance	31-Dec-2009 31-Oct-2019		
	Europe	US	Difference
Communications	3.16%	15.94%	12.78%
Utilities	2.64%	13.84%	11.21%
Financial	1.42%	11.42%	9.99%
Basic Materials	2.35%	8.18%	5.82%
Industrial	7.82%	13.58%	5.76%
Consumer, Non-Cyclical	9.13%	13.22%	4.09%
Consumer, Cyclical	10.10%	13.66%	3.56%
Technology	13.25%	15.89%	2.64%
Energy	2.50%	3.48%	0.97%
Diversified	1.60%	0.41%	-1.19%

¹ <https://www.albertbridgecapital.com/drew-views/2019/11/5/americas-decade>

² No offense to any of these guys. Their names, unfortunately for them, just happened to match up.

Over nearly ten years, these annualized differences did their geometric thing, and compounded their face off.

Cumulative Sector Performance		31-Dec-2009	31-Oct-2019
	Europe	US	Difference
Communications	36.46%	338.88%	302.42%
Utilities	29.71%	265.64%	235.92%
Financial	15.18%	194.80%	179.63%
Industrial	112.23%	257.19%	144.95%
Consumer, Non-Cyclical	139.63%	246.14%	106.52%
Consumer, Cyclical	161.82%	259.83%	98.01%
Basic Materials	26.20%	119.47%	93.27%
Technology	247.04%	336.90%	89.87%
Energy	28.05%	40.73%	12.68%
Diversified	17.21%	4.20%	-13.01%

Even in the sectors where Europe is overweight (like the Financials, Utilities and Consumer Non-Cyclicals noted above), the performance of similar US sectors has been markedly better. They were getting upgrades, and the Europeans weren't. This in turn begs the top-down question (has macroeconomic policy – e.g. aggressive QE – made a big difference here, perhaps influencing factor performance and investor appetite); or are US companies in these sectors just better?

The folks at SAP and Oracle or Airbus and Boeing might have different answers, but this gets back to the question we initially asked: **Why did all these multinationals perform similarly for 30 years, and why has that decoupled since?**

And getting back to the initial question about overall sector exposures, we've made the following observations³:

- Using US sector weights, the Eurostoxx 600 USD returns would have been 85% vs actual returns of 70%.
- Using European sector weights, the S&P 500 returns would have been 213% vs actual returns of 239%.
- Returns in the US were 26% better than if the S&P were sector-weighted like the Eurostoxx 600.
- Returns in Europe were 15% worse than if the Eurostoxx 600 were sector-weighted like the S&P.
- **The final observation is that even if the US had European sector-weights, and Europe had US sector-weights, the US still would have outperformed by 128% (213% vs 85%)**

So yes, the sector exposures did have an impact, but probably not as high as many believed. **The sector constituents mattered more (much more) than the sector bet**, which gets us back to the initial question. Knowing that it wasn't primarily sector differences is illuminating, but it doesn't explain the "why" of the relative returns.

³ And this is with a lot of fudging and plugging. We only have EoM weights, so if companies come into an index (or leave) mid-month, we have slippage. There are a million other things that give us slippage, including projection of total returns based on average sector exposures. This is not CRISP data. To tie the end-result up with actual index returns, we've inserted a plug and applied it proportionally. So, take none of these numbers as anything other than a general guide to the geographic differences in sector contributions. We're merely comfortable enough here saying that we're in the ballpark.

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