

Green shoots emerge for European Banks

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European financial stocks¹ have posted a strong price recovery (+82%²) since reaching a record low on 21 April last year. The macro backdrop in 2021 is in sharp contrast to the prior year, evident from improving economic data at the start of a cycle, a stronger euro, and rising bond yields. Europe's recovery is benefitting from the gradual reopening of the economy, rebounding global export demand, and stronger household balance sheets. We also expect fiscal policy to remain supportive over the next few years via the proposed EU recovery fund until growth returns to pre-COVID levels. Despite a strong run, we still see further upside for European Financials based on four catalysts:

Earnings Momentum

European equity markets delivered a strong breadth of Earnings Per Share (EPS) beats in the recent fourth quarter (4Q) of 2020. An improvement in the macro environment coupled with effective cost management have raised the earnings estimates for European corporates in 2021 and 2022 meaningfully. The European financial sector posted among the broadest beat of earnings, with 71% of the sector beating on EPS consensus estimates.

Resumption of Dividends and buybacks

The coronavirus pandemic resulted in an unexpected record 32% decline in European dividends in 2020. However, the resumption of dividend and buyback programs announced in the latest Q4 2020 earnings season is lending buoyancy to the earnings recovery story for 2021. European financial stocks are likely to offer the highest Dividend per Share (DPS) momentum compared to other sectors. The chart below illustrates the improvement of dividend expectations among European banks after facing a sharp contraction last year.

Figure 1: EuroStoxx Banks Dividend Index Futures

Source: Bloomberg (Ticker: DBEZ3 Index), WisdomTree, data available as of close 08 April 2021.

Historical performance is not an indication of future performance and any investments may go down in value.

Favourable Valuations

Despite the recent rally, European banks valuation continues to look attractive. European banks are trading at a Price to Book (P/B) ratio of 0.58 compared to its long-term average³ of 0.88, which suggests further upside ahead.

Rising Bond Yields

European financials are likely to be a key beneficiary of rising bond yields.

1 European Financial stocks tracked by EuroStoxx Banks Index, a gauge of euro-area banking stocks.

2 Performance of EuroStoxx Banks Index (Bloomberg Ticker: SX7E Index) from 21 April 2020 to 7 April 2021

3 Average Price to Book Ratio of EuroStoxx Bank Index from 7 July 2005 to 7 April 2021

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