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European automakers set to outperform other cyclical shares

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- * European auto stocks emerge as top performers for 2013
- * Sector still looks cheap against other cyclicals
- * Auto earnings momentum beats all other sectors-Datastream

By Tricia Wright

LONDON, Sept 16 (Reuters) - Investors are piling into shares in European auto makers to benefit from improving global growth and prospects that analysts now see as more promising than for some other cyclical sectors.

Over the last three months, car makers have overtaken the rest of the market in year-to-date performance, showing a 28 percent rise. They have attracting investors who want to venture out of defensive plays and switch into stocks that are more exposed to the economic cycle.

Car makers are among the first stock market sectors to see analyst earnings forecast upgrades. At the Frankfurt motor show this month, some signalled that sales in Europe looked to be stabilising after five years of decline.

Strategists are betting on a natural replacement cycle in Europe, where people, strapped for cash during the recession, delayed buying new cars.

At the same time, China, the world's largest car market, has put a floor under a protracted economic slowdown, while data showed that August U.S. car sales surged to near six-year highs.

Of the cyclical sectors - those best placed to benefit from the economic recovery - autos offer the most compelling reasons to buy, analysts say.

Mining companies, classic cyclical stocks, are hampered by fears some commodities may swing into oversupply, while banks are still vulnerable to regulatory uncertainty.

Analysts' perceptions have recently proved most positive for the auto sector. On average, it is experiencing the biggest increase in 12-month forward earnings per share estimates, according to Thomson Reuters Datastream.

Earnings momentum - upgrades minus downgrades as a percentage of the total - turned positive for autos in July, making them second sector to do so this year, after insurers, and contrasting with continued downgrades for the broader STOXX Europe 600 index.

GEARED TOWARDS RECOVERY

"The auto sector is very geared towards a possible European recovery and looks technically amazing," said Lex van Dam, hedge fund manager at Hampstead Capital, who sees the sector definitely continuing to outperform its cyclical peers.

Even though the STOXX Europe 600 Automobiles & Parts index already trades at record highs, technical analysts anticipate more gains given the strength of the uptrend. Valerie Gastaldy, head of technical analysis firm Day By Day, saw scope for a 20 percent rise in coming months.

The charts also show potential for autos to outpace other cyclical sectors, with Charles Stanley technical analyst Bill McNamara seeing no reversal signals for them.

"The banks absolutely don't have that, and the miners' recovery has been choppy to say the least," he said.

The improving economy in Europe underpins a positive view on autos from JPMorgan, whose research shows a very strong correlation between Purchasing Managers' Indexes (PMIs) and earnings in cyclical stocks.

Earnings of companies in the autos sector have the strongest relationship to improvement in PMIs, followed by banks, JPMorgan's data shows.

"Fundamentally we think there is significant value to buy sectors that have been exposed to recession in Europe over the last few years, which provides some kind of leverage for a pick-up in activity," said Emmanuel Cau, strategist at JPMorgan.

JPMorgan, whose "overweight" positions among the cyclical sectors are in autos and banks, likes Volkswagen, Renault and Daimler.

Given the regulatory concerns that dog the banks, Neil Veitch, investment director at SVM Asset Management, sees autos as a "cleaner" way to tap into a cyclical rally and has recently bought into BMW.

Despite their strong rally, autos are still good value. The sector trades on 8.7 times its expected 12-month earnings against banks on 10.4 times, miners on 12 times, and chemicals on 14 times, Datastream shows.

Attractive valuations alongside a more buoyant global economic backdrop have seen Kevin Lilley, manager of the Old Mutual European Equity fund, lift his exposure to European autos as he cut back on consumer staples.

Lilley, who owns Volkswagen, BMW, and Renault, has most recently added to his position in auto suppliers Faurecia and Continental, while selling out of food group Nestle, a typical defensive stock.

He cited a strong Chinese market, a pick-up in the U.S. market, signs of recovery in Europe and the likelihood of the replacement cycle there as reasons for his positive view.

"Is that priced in? I don't think it is," he said, anticipating double-digit gains in the medium term.

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