WEEKLY MARKET COMMENTARY

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# BUY JAPAN, HOLD U.S., SELL EUROPE

Jeffrey Buchbinder, CFA, *Chief Equity Strategist*
Jeffrey Roach, PhD, *Chief Economist*

Recent data suggests economic conditions in Europe are deteriorating, removing a key element of LPL Research's positive view of the attractively valued developed international equities asset class. Previous U.S. dollar weakness and strong earnings momentum, which were other key reasons why we became more interested in European investing earlier this year, have reversed and suggest looking elsewhere for investment opportunities. Another international market to consider is Japan, which is also attractively valued with better fundamentals than Europe, in our view.

## OUTLOOK FOR EUROPE IS WORSENING

Recent data in Europe, such as the purchasing managers' index (PMI) data, shows that the European economy is weakening. In fact, the Eurozone Composite PMI in August reflected the deepest contraction in nearly three years, while nearly every economy in the region reported weaker readings, led by Germany. As shown in **Figure 1**, the Eurozone Composite PMI fell to 46.7 in August, the fourth straight monthly decline and below the U.S. (50.2), Japan (52.6), and even China (51.7).

Turning to a more commonly used economic measure, Eurozone GDP for the second quarter was revised down to a 0.1% expansion from the previous 0.3% estimate, which pales in comparison to what the U.S. (+2.1% annualized) and Japan (+4.8%) produced during the second quarter. So, while growth is also expected to slow in the U.S. and Japan, Europe has much less economic momentum to help carry the region through the next six to 12 months as the impact of tighter monetary policy is increasingly felt. As a result, economic activity in the Eurozone will likely be subdued for the rest of the year and into 2024.

Getting more granular and taking a look at individual countries, we see the outlook is hazy for countries like the United Kingdom (U.K.) and Germany. The U.K.'s economy contracted 0.5% month over month in July. This pace of contraction is the worst seen in seven months, with every major sector of the economy declining during the month. Although still suffering from prolonged inflation and higher borrowing costs, labor action took a heavy toll as education and health employees went on strike. Investors should know that such a sharp contraction raises the possibility of a potential recession in the U.K. as 2023 draws to a close.

Moving over to Germany, the ZEW Economic Sentiment Index showed investors are still not confident in an economic turnaround in the next six months. September's index fell to -11.4, well below the 0 threshold that separates bullish and bearish sentiments. Investors cited instability caused by conflict and unusual climate episodes, as well as inflation and decreased manufacturing output. Near-term risks are rising for the biggest economy in Europe.