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EUROPEAN MARKET COMMENT: SO, WHERE ARE THE BETS?

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So, Where Are The Bets?

Where are global equity fund managers placing their bets today? Are overweight positions simply defensive—lesser evils in an environment hostile to risk taking? The following exhibit, showing the geographic allocations of selected global equity fund managers, suggests that there are no major themes being pursued by most managers, nor any strong consensus as to where best to allocate money today.

It is worth noting, however, that all six are underweight Europe ex U.K., while five are overweight U.K. equities. Only the Dutch fund manager, Robeco (which pursues a bottom-up stock selection approach) is underweight the United Kingdom relative to the benchmark. In general, fund managers have recently increased their U.K. exposure at the expense of continental European equities: in a world that has rediscovered the perils of momentum investing and the relationship between "value" and valuations, the more defensive U.K. market may well hold greater appeal than most European bourses, where investors are still reeling from the bust in technology and telecom stocks.

Moreover, earnings forecasts for U.K. companies have suffered fewer downward revisions than has occurred in other markets. For example, I/B/E/S consensus 2001 earnings growth estimates for France and Italy have been slashed from 17.6% and 13.0% in March to 12.6% and 7.7%, respectively, in April, whereas estimates for the I/B/E/S UK Universe have fallen only marginally, from 12.9% to 12.1%.

There is modest disagreement about Asian equities, but none of these managers seems prepared to place a major bet for or against the Pacific region, although there are significant differences when it comes to individual countries. Japan, the second largest market in the total index, is underweighted by five of these six managers, and the sixth is at market weight. In two cases, ABN-AMRO and (more aggressively) Baring, Hong Kong is heavily favoured at Japan's expense.

At the end of the day, however, it is their weighting in the United States that will determine which managers outperform their peers. Since the United States is by far the largest market (51.4% of the total index, with Japan a distant second at 11.1%), getting the United States right is undoubtedly the key to success. And there is substantial disagreement on this score among these managers: Morgan Stanley and Baring are significantly underweight the United States, by 10.1 and 12.2 percentage points, respectively, while each of the other four managers are overweight the United States to a greater or lesser extent.

Among these representative managers, two may be characterised as having a bias towards value stocks (Morgan Stanley and Brandes) and three to growth stocks (Dresdner RCM, ABN-AMRO, and Robeco), but this does not illuminate the country allocation distinctions among them. Similarly, a manager like Robeco pays more attention to economic sectors and to individual companies than to the countries in which those companies happen to be domiciled, whereas top-down country allocation plays a key role in portfolio construction at, say, Baring. Again, however, this distinction does not lead to useful generalisations across the board. The only three general conclusions that seem warranted from these data are that most managers now favour the United Kingdom, perhaps in part for defensive reasons, are modestly underweight Europe ex U.K., and remain distinctly unenthusiastic about Japan.