Draghi Rally Drains Europe of Bargains as BBVA Doubles

March 18 (Bloomberg) -- Almost $3 trillion has been restored to European share values since Mario Draghi vowed to save the euro two years ago. Investors coming to the market now are finding a dwindling list of bargains.

All 19 groups in the Stoxx Europe 600 Index and about 85 percent of its companies have climbed since July 2012, when the European Central Bank president made his pledge, according to data compiled by Bloomberg. Gains such as Banco Bilbao Vizcaya Argentaria SA's 100 percent advance have sent shares with the lowest valuations closer to those with the highest than any time on record, the data show.

With the market trading near a four-year high relative to earnings, the lack of cheap shares is poised to halt a bull market that has lifted the Stoxx 600 in five of the last six quarters, said Francois Savary, who helps oversee $9.7 billion as chief investment officer of Reyl & Cie. While economic growth in Europe is picking up speed, valuations may be anticipating an even stronger expansion, Savary said.

"The broad rally is over," Savary said by phone on March 12. "It's very difficult now to justify some valuations. You can't just purchase everything any more. You need to discriminate and differentiate."

Shares in the region have rallied 31 percent since July 2012 as the euro area ended its longest-ever recession and gross domestic product in the U.S. expanded for 11 straight quarters. The Stoxx 600 jumped 1.8 percent in the past two days after retreating the most in seven weeks as tension rose between Russia and Ukraine.

Rate Cuts

Draghi cut the ECB's main interest rate twice last year and reiterated his pledge to keep borrowing costs low at every central-bank meeting since July. The policy has helped restore about 2.1 trillion euros ($2.9 trillion) in value to the Stoxx 600 since July 2012, when he said he'd do whatever is needed to preserve the currency union. Companies in the gauge are worth 8.3 trillion euros, close to the most since December 2007, data compiled by Bloomberg show.

European stocks trade at 19.4 times earnings, near the highest level since December 2009. Gains in the last 20 months have lifted the average price-earnings ratio for the cheapest 20 percent of companies in the Stoxx 600 to 10.3, compared with 32.5 for the most expensive fifth, data compiled by Bloomberg show. The gap is the narrowest since at least 2002.

Finding Value

"It's harder to find value in Europe," Graham Secker, a strategist at Morgan Stanley in London, said in a

March 14 phone interview. "Valuations are pricing a stronger recovery than we might get. Investors don't want to buy any more of what they already have, but at the same time they can't find anything else to buy. So there's a bit of a stalemate in the market."

Economists forecast the euro area will expand 1.1 percent this year from a 0.5 percent contraction in 2013, according to the median estimate in a Bloomberg News survey. While that would mark the first annual growth since 2011, it's below the average 1.4 percent expansion since 1992, the data show.

Converging valuations are leaving fewer options for fund managers who focus on value stocks, or those with the lowest prices relative to profits, according to Andrew Lapthorne, a quantitative strategist at Societe Generale SA.

"When everything has repriced, you end up with everything trading at similar valuations," Lapthorne said March 13 from London. "It becomes very difficult to differentiate."

BBVA Doubles

The valuation for BBVA, Spain's second-biggest lender, more than doubled since July 2012, to 24.2 times earnings, data compiled by Bloomberg show. The company's profit fell in five of the past six years. That contrasts with Svenska Handelsbanken AB, the best-capitalized major European bank, whose valuation has climbed to 14.9 from 11.3 and has reported four straight years of rising earnings.

Renault SA saw its valuation jump more than fivefold since July 2012. The price-earnings ratio for the French carmaker that has posted three consecutive years of declining profit reached a record high relative to Bayerische Motoren Werke AG on Feb. 25, data compiled by Bloomberg show. Net income at the German company has climbed every year since 2010.

"Now that valuations are higher than long-term averages, the key question is: When will the market start rewarding companies with good business models?" said Tom Stubbe Olsen, who helps oversee about 1.4 billion euros as founder of European Value Partners AG in Zollikon, Switzerland. He recently bought shares of Unilever NV, Atlas Copco AB, and Novo Nordisk A/S.

Stocks Jump

The Stoxx 600 rallied to a six-year high on Feb. 25. The last time it reached this level, it went on to lose 54 percent, wiping out 4.2 trillion euros in market value as the financial crisis pushed the world's largest economies into a recession.

Didier Duret, who oversees about 168 billion euros as chief investment officer at ABN Amro Private Banking, said investors who are willing to do extra work to locate bargains can still make money in

Europe.

“It’s not too late to get into the market, you simply need to be more selective,” Duret said by phone on March 12 from Amsterdam. “There are still some areas you can look at to get in at low or reasonable value. This year you really need to roll up your sleeves and look at the fundamentals of a company.”

Investors can still find bargains in companies linked to commodities after they lost 9.2 percent on average in the past year, Duret said. Mining companies in the Stoxx 600 trade at 12.3 times estimated earnings for the next year, 14 percent lower than the broader gauge, data compiled by Bloomberg show.

Profit Gains

Profit at Stoxx 600 companies will increase 9 percent this year and 12 percent in 2015, according to analysts’ projections. They climbed 5.5 percent in 2013 after contracting 7.2 percent in 2012 and 1.4 percent in 2011.

The rally will end, unless companies begin posting higher profits, according to Yves Maillot, who manages 22.2 billion euros as head of European equities at Natixis Asset Management. A total of 505 stocks in the Stoxx 600 advanced in 2013, the most since 2009, when 530 companies gained and 109 fell. The winning streak has slowed this year, with 338 stocks up for 264 down, data compiled by Bloomberg show.

“Europe has already been played as a broad value and recovery story,” Maillot said in a phone interview from Paris yesterday. “Last year’s performance was so impressive that the market is not cheap anymore. If multiples remain at these levels, we really need both economic and earnings improvement to justify this. You really have to focus on the details and look at individual companies this year.”

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