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Global Markets Are On a Tear. These Stocks in Europe and Japan Are Still Bargains.

Causeway's Sarah Ketterer likes AstraZeneca and Gucci's parent company, Kering. Where else she's picking up bargains.

By Ian Salisbury

Sarah Ketterer hunts the globe for out-of-favor value stocks. It's a strategy that requires patience—not least in the past few years, when the market relentlessly rewarded U.S. growth stocks.

That may be changing. Policy uncertainty in Washington is weighing on the U.S. market while foreign shares leap ahead. The S&P 500 is up just 0.9% this year while the MSCI EAFE index of developed countries has vaulted ahead 17%. A weaker dollar is fueling gains for foreign stocks when translated into U.S. currency, but other tailwinds are helping.

U.S. stocks are still pricey at 25 times next year's earnings for the S&P 500, versus 17 for the MSCI EAFE. Much of the premium is due to pricey tech stocks in the S&P 500, comprising roughly 33% of the index. But foreign stocks could be in a sweet

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Sarah Ketterer, CEO of Causeway Capital Management, at Causeway Capital Management in Dallas.

spot: They're still relative bargains and could get a bounce from fiscal stimulus in Europe and other plans to juice economic growth.

Barron's caught up with Ketterer, CEO of Causeway Capital Management, to get her take on foreign stocks and bargains she's finding. Based in Los Angeles, Causeway oversees $49 billion in assets and is known for ferreting out deep-value gems. The firm's flagship mutual fund, Causeway International Value, has returned an annualized 7.8% over the past 15 years, putting it in the top 10% of funds in Morningstar's Foreign Large Cap Value category.

An edited version of the conversation follows.

***Barron's:* International stocks seem to be on fire. How much further can they go?**

Sarah Ketterer: The U.S. market has benefited enormously from a valuation-multiple rerating. This is in part due to superior sales and earnings growth versus non-U.S. markets over the past decade. But the price-to-earnings rerating did a lot to extend the U.S.'s valuation premium—in December, it breached three standard deviations over its long-term average going back to the 1970s. Will some of that rerating abate or reverse? It's possible.

Non-U.S. markets, particularly Europe, have been cautious in their fiscal spending, in contrast to the U.S., where from 2020 we spent with abandon. It was necessary to revitalize our economy from the pandemic. But then we kept going, and we spent quite a bit on healthcare, green initiatives, and so forth.

Germany was very cautious. They now have room fiscally to spend hundreds of billions of euros a year. They found a way to circumvent their "debt break." And they have been reacting to the partial withdrawal, and the threat of further withdrawal, of military defense from the U.S.

The Trump administration has ushered in a new era for Europe that involves more self-sufficiency. That means more fiscal stimulus. If it works the same way it did in the U.S., it may lead to more economic activity in the region and potentially a multiple rerating upward.

You own some European pharmaceutical stocks. Aside from Novo Nordisk with its weight-loss drugs, much of the sector has underperformed. Where are you finding bargains?

I think our favorite is AstraZeneca, based in the U.K., but we like several of them, including Roche Holding and Sanofi.

Why has the sector lagged behind? It's partly due to tariffs and other political pressure—over 40% of revenue from Europe's largest drug companies comes from North America. And it's partly due to the product-cycle gap—that's when a drug company has a major product that's generating significant revenue that is coming off a patent, and the market just assumes there will be no replacement. It's the typical product-cycle problem where the market can't see the next drug coming; it can't see the next big revenue generator, and it just de-rates the pharmaceutical company.

Those product-cycle issues have been a big drag on AstraZeneca. The company derives about 70% of its revenue growth from oncology drugs, and the market is worried about the current blockbuster Tagrisso. But it's likely to be replaced by novel drugs for breast cancer and cardiovascular disease.

What about European luxury stocks? They've struggled, as we noted in a recent story. But Kering is one of your top holdings.

We were very opportunistic and went for one of the most bombed out. Kering has a $25 billion market capitalization—but it should be $50 billion.

Things went terribly wrong with their Gucci brand; they've recently replaced the creative director. I recently presented this at a value conference in London, and one of the audience members asked me, "Well, what if it doesn't work? What if this creative director can't revitalize the brand?" My response was, "I don't really care."

Here's the reason: You hardly pay anything for Gucci now. Kering also owns all these other brands—what they call luxury houses—Bottega Venata, Balenciaga, their eyewear. We did a breakup calculation, where you take all the different luxury houses and put some conservative multiple on their sales. We added all those up and compared the value to Kering's current share price.

The exercise suggested the market was valuing Gucci at something like 1.7 times enterprise value to sales, while the industry trades at around three to four times. It's a 60% discount to the average valuation of a luxury stock. In other words, Kering is trading as if Gucci will never recover.

The stock could just sit around this level and you collect your 3.4% dividend yield, and they'll continue to improve their balance sheet, and they'll just sort of come along—or it could go up 130%.

Despite being known for deep value, you aren't afraid of tech. It's 15% of Causeway International Value, about double the category average. Where do you see value there?

We are advocating anything to do with automotive-related semiconductors. The automotive area is under so much pressure due to tariffs, supply-chain issues, and slack consumer demand, which may become worse if prices go up. Maybe the only glimmer of hope is in Chinese electric vehicles, but the market has de-rated some of the world's best automotive semiconductor stocks to some of the lowest valuations we've seen in the full cycle.

One example is a Japanese company called Renesas Electronics. It's got a $22 billion market cap. It makes the microcontrollers for autos in battery management, and microprocessors for advanced driver assistance and safety systems. Our point with companies like Renesas is that the intensity—the amount of content per vehicle—is rising because autos are becoming more like software.

We used to think of cars as hunks of steel. Now they're highly sophisticated and on their way to becoming more electric, if not fully autonomous, which is why semiconductor content is rising so rapidly. My car—which is an electric Audi—is the nanny state. It tells me if I'm swerving or it wants to change lanes for me, and pretty soon I'll be sitting in the back reading.

Renesas also makes semiconductors for industrial automation, data centers, EV-charging facilities. So they're not entirely auto related, but it makes up probably 45% of their revenue.

Right now, the stock is at a cyclical low. Although the company has managed its inventories well, its orders are just fairly weak right now, and we expect that. But we think the stock has bottomed and is going to pick up.

The stock is currently trading at 1749 yen, which is about 15 times trailing 12-month earnings. But we think those earnings will recover rapidly, meaning there is a lot of potential upside without the multiple increasing dramatically. We see it trading at a slightly higher multiple of 15.5 two years from now, with a price target of 3200 yen.

Any U.S. stocks you like?

Here is a name that's higher risk, but when I think about it on a risk-adjusted return basis, it's also very, very high reward. This is Whirlpool, which has fallen about 32% year to date. It has about $4 billion of market cap. I would call it a small-cap at this point—with a 9% dividend, which indicates that the dividend is at risk.

And yet it isn't subject to a lot of tariff risk. They produce 80% of their products—all the so-called white goods, like washing machines—in the U.S., with the remainder split between Asia and Mexico.

Now, they do face the risk that the U.S. economy will slow. If we go into a prolonged economic slump, that is going to be tough for the stock. But Whirlpool has opportunities, too. They have been struggling with the housing market. U.S. housing turnover is at 30-year-lows. But we think that will turn around. When we get through this tariff uncertainty, that will make employers more confident, which should be helpful. And cities around the country are now thinking very carefully about how they can solve housing shortages.

Meanwhile, Whirlpool also has one largest new product slates they've had in a decade. They've got some debt, but we expect them to be able to generate cash flow to repay that debt. As the debt comes down, the equity value should improve considerably.

It's a deep value stock. It currently trades at a mid- to high-single digit P/E multiple, and we expect only a modest multiple increase. But our investment thesis assumes this heavily indebted company will grow earnings 25% in two years from 2025 levels. We think it can lead to a total return of 70%.

Thanks, Sarah.

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