CNBC

This fund manager says there's a 'value gap' in European markets. Here's how he's playing it.

By Samantha Subin
Feb 7, 2020

There's a "value gap" in European markets, and that's creating a unique opportunity for investors to buy up top-notch financial and industrial names at a bargain, according to David Herro, chief investment officer of international equities at Harris Associates.

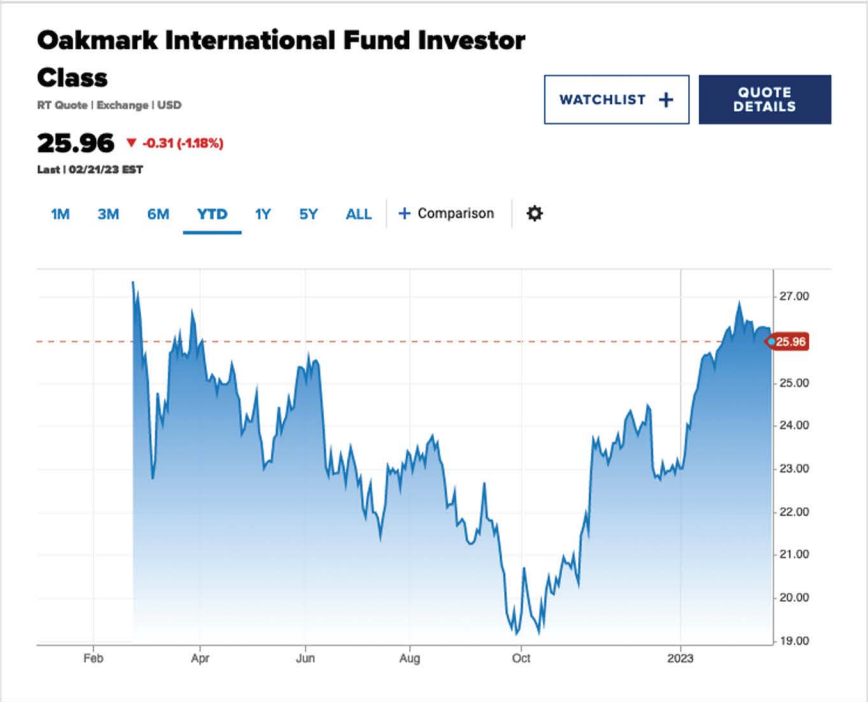
"When you look at valuations — and as long term value investors this is exactly what we do — the hunt for value really does begin in Europe because the market sold off quite aggressively last year," the value investor told CNBC's "Squawk on the Street" on Tuesday.

European markets dropped sharply last year as war concerns mounted in Ukraine, energy prices surged, and the Chinese economy struggled.

But even as share prices dropped, earnings continued improving, opening up what Herro calls a value gap. Many of these companies now trade at low valuations — and cheaper to the U.S. — but should continue increasing their profit and cash flow growth.

"This is exactly why we're finding opportunity, because the companies keep earning money and now we've seen energy prices plunge in Europe and the Chinese economy reopening," he said.

When it comes to international markets, Herro's got the credentials to support this type of declaration. For more than three decades, he's managed the Oakmark International Investor fund with a solid 15-year track record of 5.7% annualized trailing returns, according to Morningstar. This year, the fund is up 14%.



The fund is already up about 14% in 2023

One sector prevalent in the portfolio, and an area Herro is overweight in, is European financial stocks. He expects this sector to benefit from a "triple positive" of rising rates, an improving European economy and strong capital positions.

"Just about every one of the major European financials is over capitalized, and distributing that money back to shareholders positions," Herro told CNBC.

Herro highlighted Allianz, Intesa Sanpaolo, BNP Paribas and Lloyds Banking Group as some of the "blue-chip names" he's betting on. These stocks accounted for some Oakmark International's top holdings as of the end of December, according to Morningstar.

The fund manager also sees value in automobile manufacturing names like Mercedes Benz and BMW, which offer 13% to 14% free cash flow yield, trade up to four times cash flows and offer solid cash on their balance sheets to protect their businesses in a downturn.

A diversified business model, with operations and customers across Asia and North America also positions these companies well.

"They've learned a little lesson, by the way, during the pandemic," he said. "You just don't spit out volumes for volumes sake, because they have taught themselves to be able to protect their margins."