Don’t Fight the Euro Central Bank: Stay Calm and Carry On with These Three Compelling Dividend Paying Investments!

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It’s no coincidence that our stock market has more than tripled in the last six years, since our Federal Reserve depressed interest rates to near zero in late 2008. Although a higher stock market is certainly not the primary goal of central bankers, nearly all economists and bankers recognize that a bull market has salutary effects.

In the US, the low interest rates have worked so well that the stock market is trading at abnormally high valuations, despite a somewhat sluggish economy, a slowdown in corporate earnings, and weakness overseas. The pessimists fear the party is over, now that Janet Yellen and the Federal Reserve have ended the aggressive bond buying to reduce interest rates and promised to raise the benchmark Federal Funds rate.

The Upshot

The focus on the Federal Reserve’s plans to raise interest rates may be overlooking the renewed vigor of Europe’s quantitative easing. This overseas money printing is not just confined to Europe as most non-US central banks have indicated they are nowhere near ready to raise rates.

In our global world, Europe’s cheap money policy is likely to keep interest rates lower longer Stateside; any US rate higher than Europe’s will keep money flowing to our shores. Further, Europe’s desire to keep rates depressed is likely to give the Fed pause before raising rates here.

As a result investors should stay the course in stocks, but tilt their portfolios to franchise stocks, boasting of sizeable cash flows, above average dividends, and to out of favor sectors.

Don’t Doubt the ECB’s Resolve!

The European Central Bank (ECB) is the continental counterpart to our Federal Reserve. It lagged relative to the Fed in response to the sub-prime mortgage crisis, reasoning that the problem was lax real estate lending standards Stateside, not in Europe. In addition, the memory of runaway inflation last century in Europe has traditionally given pause to the use of monetary tools to spur the economy.

However, as European economic conditions deteriorated, pressure mounted for US style quantitative easing to generate growth and reflate the economy. The initial step was “jaw boning:” In July of 2012, Mario Draghi, the ECB’s head, promised to do “whatever it takes” to preserve the Euro, saying “believe me, it will be enough.”

By the start of this year, full blown quantitative easing plans were instituted, with the ECB promising to buy $60 billion worth of bonds monthly. Markets responded, with the Euro sinking in

March to a 12 year low and German interest rates plunging below zero. Euro bourses enjoyed their best Q1 in 17 years.

More recently, investors challenged the ECB, questioning whether it would stay the course with its monetary easing. Bond yields backed up, with the yield on the German sovereign 10 year retracing its descent, climbing from near 0 to over 70 basis points. The Euro also reversed its decline, rising from close to 104 to nearly 115.

Euro officials came back swinging. Benoit Coeuré advised that the ECB would front load the summer's planned bond purchases, allegedly to get ahead of an anticipated lack of liquidity during the summer vacation months.

For good measure, yet another ECBer, Yves Mersch, underscored there was no plans to end quantitative easing early, which is currently scheduled to last at least until September of 2016. Currency and bond speculators got the message and started selling the Euro and buying up bonds, reducing interest rates yet again. US stock markets set new all-time records.

Bottom line: The ECB is very far off from ending QE; the lower longer interest rate backdrop is benign for stocks.

Investors now have to wonder whether our Federal Reserve will indeed move in the opposite direction of their counterparts overseas. To do so would make the ECB's job more difficult, cause our Dollar to soar, and cool our economy, despite a complete absence of inflation. Bearishness based on anticipation of higher rates sooner may be misplaced.

How to Play It

In any event, with a sufficiently long horizon, invest in companies that dominate their markets, have a long record of profitability, and are only lightly leveraged. Screen for dividend yields that are not only greater than the ten year Treasury, but run rings around the much lower Euro rates, and are likely to grow over the next decade.

It is also important to look at sectors that have lagged, that still offer value, and provide reason for better times ahead.

Diageo (DEO): Disdain For Non S&P 500 Euro Stocks Provides Opportunity for the Owner of Some of the World's Best Brands

European stocks have been out of favor for a long time and are just now starting to show signs of life. Screen for European-headquartered companies that do business globally. You want a Euro valuation with exposure to stronger non Euro economies.

London based Diageo is by far the largest alcoholic beverage purveyor in the world, some 65% bigger than its nearest competitor, Pernod Ricard. With a 27% global market share and seven of the world's top beverage brands (including Johnny Walker, Smirnoff, and Guinness), it boasts product loyalty, economies of scale, and high margins.

The drinks category is somewhat resistant to economic fluctuations; people imbibe in good times and bad. However, Diageo's brands will benefit from an improving economy, as greater incomes help put their prestigious, aspirational brands within reach.

Diageo has been a wonderful long term investment, outperforming most indices yet with less volatility.

Dollar strength, coupled with weak non domestic economies, has reduced investor expectations for the company. However, that now seems priced into the stock, as it trades nearly 20% off of last summer's price. Meanwhile, you receive a three percent dividend yield, about four times the yield on the German 10 year bond. If the ECB pushes interest rates down further, that can only enhance Diageo's attractiveness.

MetLife (MET): The World's Largest Life Insurer Is a Diamond In the (Financial) Rough!

Financial stocks continue depressed. Alleged culprits of the 2008 mortgage crisis, these companies are now burdened with more regulation, continued litigation, and low interest rates. The opportunity is that prices reflect this malaise, litigation should lessen, and interest rates are poised to rise.

On a risk to reward basis, MetLife is quite attractive. It is the largest life insurance provider in the country, so boasts substantial economies of scale. It is the go to choice for the Fortune 100, with a 90% market share.

Recent acquisitions in Asia provide additional opportunities. Earnings should increase once interest rates rise, offering a greater return on its assets backstopping its obligations.

MetLife has been held back by concerns over plans to regulate the company as a systemically important financial institution. Should this occur, it may well be able to shed its problematic operations, similar to what General Electric is doing, to reduce this regulatory burden.

MetLife's stock is attractively priced, trading below book value, while its dividend yield, 2.7%, exceeds sovereign bond yields on both sides of the Atlantic.

Chevron (CVX): When the Going Gets Tough in the Energy Patch, Look For the Strong to Thrive

Energy has been pummeled but prices have already stabilized and profits continue. Crude oil prices were nearly $110 per barrel last summer, crashing to just $43 per barrel in January amid concerns of a supply glut. Most blamed the low prices on new fracking technologies, although some pundits saw price manipulation designed to harm producers such as Russia and Iran.

Despite energy bears' calls for prices to decline to just $20, prices have rebounded to $60, amid a large reduction in drilling activity. Economics 101, low prices discourage supply, seems to be alive and well in energy land.

Chevron, down some 20% since last July, seems to be an outstanding investment no matter where energy prices go. Certainly, as the second largest energy company in the US, it will profit mightily should prices rise.

But a sideways market can also work. Chevron's geographical reach and diversification into refining and chemicals can help mitigate weaker revenue growth. Its capital expenditures annually

exceed many smaller outfits, giving it tremendous cost cutting opportunities and staying power until the next energy bull market.

While you wait, enjoy the 4%+ dividend, with a stock price less than 8 times cash flow and just one times revenue. That dividend is six times what an investor will receive in a German 10 year bond, and about twice the US 10 year Treasury. That dividend has more than doubled over the last decade.

A sign of confidence was John Stumpf's purchase of $19 million of Chevron stock in the last month. He's the CEO and chairman of America's largest bank, Wells Fargo, and sits on the Chevron's board. This is the largest insider buy since Chevron acquired Texaco in 2001.

His purchase was at $108/share. The stock now sits at $104. Chevron offers investors outstanding long term value.