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Portugal stocks lure with high divs, Africa exposure

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* Emerging market exposure favours Galp, Jeronimo

* CDS, bond yields signal more upbeat sentiment

* Still cautious on domestic-focused companies

By Sergio Goncalves and Toni Vorobyova

LISBON/LONDON, Feb 17 (Reuters) - A steep sell-off in Portuguese equities has opened opportunities for the risk-seeking investor to cheaply cash in on high dividends or gain exposure to fast growing emerging markets, while avoiding domestic-focused stocks.

After sinking 28 percent in 2011, the benchmark Lisbon stocks index, PSI-20, has risen 5.5 percent since the start of February, outperforming a 4.3 percent increase on the pan-European FTSE Eurofirst 300 and heading for its first monthly gain in a year.

Portugal's economy is expected to contract by some 3 percent this year and is kept afloat by the 78 billion euro EU/IMF bailout it received last May. It is also seen as the next weakest link in the euro zone if Greece ultimately defaults.

But its lenders say the country is meeting its performance targets under the rescue programme. Since a spike late last month, the cost of insuring against a Portuguese default has fallen by 27 percent, while the spread between Portugal's 10-year sovereign bonds and those of safe-haven Germany has narrowed by a third, though remains a high 10 percentage points.

"I don't think that anyone feels that Portugal is a safe zone (but) if there is a bit of a better risk appetite ... I am sure there are opportunities in Portugal," said Gary Baker, head of European equity strategy at Bank of American Merrill Lynch.

Portugal meets two of the currently most popular investment criteria - a steady income stream from high dividends and exposure to fast growing emerging markets.

Led by generous payer Portugal Telecom, the net dividend yield on the PSI 20 this year is forecast at 6.6 percent versus 4.2 percent for the pan-European market. Portugal ranks fifth in terms of emerging markets exposure out of 16 Western European countries - beating Germany, France and Britain - according to Citi research. Greece ranks 10th.

"Despite the current crisis, the Portuguese companies are in a better funding situation than those of Greece and the Portuguese market has one foot in emerging and fast growing markets, providing better perspectives for international investors" Diogo Teixeira, fund manager at Lisbon's Optimize Investment Partners, said.

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With Portugal in its deepest recession since the 1970s, investors are focusing on companies which make money elsewhere. Analysts' target prices imply an 8 percent share price rise for supermarket chain Jeronimo, which generates 58 percent of its sales in solidly-growing Poland.

Fuel and oil company Galp Energia is rated a 'buy' or 'strong buy' by 16 analysts against just one 'sell' recommendation, according to Reuters data, with the average price target implying its shares will rise some 30 percent.

Galp, which works in West Africa and Brazil, has underperformed the European oil and gas sector by around 10 percent over the past year, despite offering a return on equity of 15.6 percent versus sector median of 12.7 percent.

"In some cases ... (investors) don't want anything listed in that particular market but it creates opportunities if you can pick stocks which are not related to the domestic economy, but are more international," said Luca Armandola, European equities portfolio specialist at Morgan Stanley Investment Management, which holds Galp as part of its European Alpha Fund.

"It's more of an exposure to West Africa ... Exposure to the Portuguese economy is not in our interest. There are some concerns on a top-down level on the sustainability of debt, whether they will need additional help."

Foreigners account for around 64 percent of the volume on the NYSE Euronext Lisbon, according to its CEO Luis Laginha de Sousa, up from 50 percent in 2009.

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Lisbon has once again started to move in line with other European bourses, suggesting investors no longer view it as an outlier.

Its correlation with the FTSE Eurofirst has risen back to its long-term average of a positive 70 percent from a negative 46 percent at the start of the month.

"Some sectors are showing signs of structural medium-term buying," Tiago Ribeiro, fund manager at Carregosa Technical Trading, said. "The banking sector had massive falls, seems to have incorporated all the impairments and all the bad news, and now banks can restart their business."

Portuguese banks have performed almost perfectly in line with European rivals so far in 2012, but are still underperforming by some 40 percent over the past year.

The recent gains have brightened the technical outlook for the PSI-20 as a whole, which traded up 0.2 percent at 5,616.92 points on Friday.

"The medium term (outlook) is about to turn positive. We need a clear beak above 5,710, ideally a weekly close above that level. This would signal a recovery towards 6,150 to 6,350," said Valerie Gastaldy, technical analyst at Day By Day in Paris. (Graphics by Scott Barber, editing by Nigel Stephenson)

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