GENERALI INVESTMENTS

Key Investment Themes for 2022

Views from around Generali Investments

2021 saw investors contend with pivotal changes in the macro environment, big developments in ESG (Environmental, Social & Governance) policy, and the shifting uncertainties of the pandemic.

Against this backdrop, we are pleased to present the latest views from the specialist asset management firms across the Generali Investments platform, as they look ahead to the risks and opportunities that 2022 may present.

The Big Picture

The Macro Research team at Generali Insurance Asset Management introduce the key themes they're monitoring for 2022.

Inflation: a persistent headache

The bounce in energy prices should flatten out but supply chain bottlenecks in shipping and semiconductors are likely to prove more sticky, and consumers continue to sit on high excess savings. Risks of overshooting inflation are most acute in the US and UK where labour markets are tighter. The reshoring of supply chains, the energy transition, the political backlash against inequality, and Sino-American tensions may add to longer-term energy price uncertainties.

Withdrawal of policy support: can risks assets hold up?

The Federal Reserve aim to complete tapering by Q3 2022 but given lingering high inflation our baseline is for an earlier rate hike than Q4. A rate hike from the ECB is still a distant prospect. We expect bond yields to rise moderately. Euro credit remains underpinned by ECB support, good financing conditions and investor demand. Emerging market credit could experience higher volatility amid rising core yields. Equities should weather Fed tapering given low real yields and solid earnings growth, but with a more volatile risk premium.

ESG transition: substantial policy and market changes

We expect the swing from ecological awareness towards ecological dominance in policy and markets to gain momentum. Private investors will continue to shun sectors like oil and tobacco. The ECB will tweak their corporate bond purchases towards green assets while the EU will issue up to €250bn of green bonds until 2026. An overhaul of the EU's Stability and Growth Pact in 2022 may include some permanent support to businesses engaged in the green transition. However, fossil fuel supply may struggle to meet still-high demand during the transition period.

China: sticking to tighter regulation

China's focus on stricter regulations and 'common prosperity' is likely to continue. This includes deleveraging policies for the shadow banking sector, tighter regulation of real estate, and limiting the power of technology firms. Policymakers are willing to tolerate short-term pain but we expect Beijing will carefully contain collateral damage. Continued deleveraging of real estate implies more stress for weak corporate bond issuers, which should weigh on Asian high yield. Equities are starting to look cheap as China's policy support could differ from other emerging markets that are constrained by rising inflation and limited fiscal leeway.

Geopolitics: risks abound

US-China tensions have not abated and the risk of an escalation in Taiwan is high. Russia-West relations remain strained with potentially severe market implications, as shown by the spike in gas prices. Key elections in Italy (February) and France (April) will add to uncertainties.

Please note this is the opinion of Generali Insurance Asset Management S.p.A. Società di gestione del risparmio ("Generali Insurance Asset Management") as at December 2021 and it may evolve over time, without prior notice.

Investment Outlooks

Experts from across the Generali Investments platform share their outlooks for a range of asset classes, from active equity, fixed income and multi-asset, to liquid alternatives and real assets.

Each asset management firm's investment approach is fully autonomous, with their own distinct focus and investment philosophy. This plurality of thought is a key strength of our platform, aiming to help investors unlock new investment solutions and possibilities.

GENERALI INVESTMENTS

Generali Investments Partners

Locating pockets of value in risk assets

Despite the uncertain picture regarding inflation, the new Covid variant and the higher risk of central banks tightening policy, there are nevertheless several investment strategies and themes that we believe deserve attention.

First, we expect that inflation will persist next year, placing a gradual upward pressure on rates. Consequently, our asset allocation is prudent in the core government bond space, especially in the longest end of the curves, which are currently quite compressed.

However, riskier assets are still supported by good fundamentals and abundant liquidity. A careful selection of sectors can offer investment opportunities as long as real rates do not rise in a violent and disordered way.

In fixed income, it is worth noting that several countries, mainly in emerging markets, have already begun to normalize monetary policies. These markets could represent an interesting investment opportunity in 2022 if their central banks pause their tightening activity, when, at the same, time core countries will probably be closer to increasing rates. Central and Eastern Europe markets, including Hungary, Poland, Czech Republic, are just a few examples.

Real rates – the rate of interest minus inflation – are crucial for risk assets. If central banks succeed in smoothing the path of real rates, it is reasonable to expect that risk assets will continue to benefit from strong fundamentals. In equity markets it is worth considering that sectors sensitive to higher prices and yields will benefit not only financials but also value sectors like industrials or capital goods that underperformed growth names during 2021. Long term thematic investments into areas such as the energy transition, digitalization and sustainable mobility remain crucial components of our strategies given the strong momentum for greater ESG investment and the rich supply pipeline ahead, although valuations are already quite tight.

Credit valuations, like equities, are stretched and investment grade is unlikely to offer much value, but selected opportunities, such as ESG issuance, corporate hybrids and selected banking and insurance subordinated bonds, can still be found with thorough credit analysis. High yield has proved to be quite resilient during the risk-off phases of the past year; this resilience adds a benefit of providing structural lower duration making high yield still relevant going into 2022, at least for the first half of the year.

Salvatore Bruno*, Head of Investments*

Look to responsible companies to avoid bubble trouble

Looking at global equity markets today, I see many worrying signs of bubble-like behaviour that urge caution, from the high valuations of 'glamour' stocks, to the SPAC frenzy, to the ever-increasing dominance of the biggest mega-cap stocks in major indexes. As we know, a decade of low interest rates and exceptionally loose monetary policy have fuelled this behavior and numbed markets to risk. But the entrance of inflation signals a new phase in the cycle.

I suspect many economists and central banks are underestimating the risk of inflation lasting longer than the current consensus. Higher living costs are beginning to place pressure on wages to increase, and many of the companies I've engaged with over the past year have raised this. Other factors like decarbonisation will also weigh on energy prices. Equity markets appear to be complacent about the risk of a shift in monetary policy.

Despite the wider euphoria, as highly active investors with a rigorous ESG focus, we find there are still plenty of places to find good companies at attractive valuations and avoid the riskier, overcrowded areas of the market. Through our proprietary investment framework, we identify companies that are genuinely transforming their business models in environmental, social and governance terms to meet the challenges of a rapidly changing world. These are the companies that we believe are best-placed and resilient enough to withstand volatility over the long term.

As bottom-up stock-pickers, we find pockets of opportunity across all sectors, although there are a few that we think are particularly exciting going into 2022. Firstly, pharmaceuticals and healthcare will continue to be an increasingly important theme given the ageing world and rapid innovation in the sector. Secondly, the energy sector continues to be compelling given the energy transition. This goes beyond just renewables (although that is key as well): mobility, renovation and construction, the circular economy and ecosystem-stewardship are other themes that we use to identify businesses that will enable the green transition. Finally, financials should continue to deliver. The trend towards greater financial participation should benefit not only fintech but more traditional life insurers as the necessity for financial planning grows, particularly in emerging markets with rising middle classes.

Emeric Préaubert*, Founding Partner and Co-CIO*

Eyes on inflation, China and the global energy transition in 2022

The new era of inflation and financial repression calls for an entirely new investment approach to deliver returns. That is why we implement our investment ideas using a five-strategy approach, rather traditional top-down asset allocation. This lens aims to find idiosyncratic opportunities that deliver specific performance outcomes. Looking ahead to 2022, we remain cautiously constructive confirming our view on a recovery with inflationary pressures.

Pressure on interest rates with a controlled increase in the long end of the curve will, in our view, remain a characteristic of the coming months, encouraging a zero-duration approach focusing instead on spread duration. The increase in spreads could create new buying opportunities in some parts of credit with short- to medium-term maturities and predominantly high yield; as well as non-cyclical sectors and banking, which are less exposed to inflation dynamics.

Generally, macro growth in the year ahead looks set to be driven by the US and no longer by China. In our opinion, a material improvement in terms of supportive fiscal and monetary policy to bolster the real estate sector and wider growth won't happen until at the second quarter of 2022. However, we view China as offering a strong buying opportunity. Domestic Chinese equities is one area we believe should benefit from a gradual economic recovery over next year.

Turning to the US, there are exceptionally strong macro conditions, from Biden's $1.2 trillion infrastructure bill[1], to the reappointment of Jerome Powell as Federal Reserve Chair, to record levels of household savings. Other key factors include household leverage, inventories, and loan-to-deposit ratios all being at record-lows, providing a strong driver for credit growth. All sources of demand are aligned, but we remain extremely cautious because we believe investors are underestimating inflation risk and tapering from central banks. We don't believe inflation is transient – it's more likely that we are entering a period of normalisation where the previous ceiling of 2% inflation becomes the new floor. Even if we see a temporary relief when pandemic base effects fade away, the basic demand drivers (consumption, public expenditure and investments) will continue to put pressure on prices. Given the power of inflation as a debt-reduction tool for governments, we expect continued negative real rates – the rate of interest minus inflation – in developed markets for some time to come, with central banks guarding a rates threshold of around 2-2.5%.

Finally, the global energy transition is providing a number of exciting investment opportunities, both across commodities like copper, hydrogen and platinum, and in companies that facilitate the storage and creation of new energy grids. Overall, we maintain a positive macro stance approaching 2022 but we are aware of extended valuations and disruptions in the global production chain.

***Mauro Ratto**, Co-Founder and Co-CIO*

Please note this is the opinion of Plenisfer Investments as at December 2021 and it may evolve over time, without prior notice. [1.] Source: Financial Times, 15 November 2021.

Emerging Markets | Peter Marber, CIO Emerging Markets

Emerging Markets offer the best value since 2000

In 2021, investors saw the global economy bounce back strongly from the pandemic-driven recession, the world's worst since the 1930s. However, the pace of recovery has remained uneven amid a surge in Covid-19 variants and slower rate of vaccinations, especially across Emerging Markets (EM). This was mirrored in asset prices. With the US leading the pandemic recovery, dollar strength and earnings momentum left most EM equity and bond indices lagging advanced markets. The exceptions were EM commodity exporters, particularly those with dollar-linked currencies. For 2022, firm commodity prices should continue to support EM exporting countries and companies, however, countries that depend on travel and tourism dependent issuers may take longer to recover.

Investors might consider rotating out of higher priced assets into cheaper EM equity and credit. EM equities are now at the cheapest relative value to the US since the early 2000s. With a rising interest rate environment in the US and stocks at record highs, it may be a good time to begin building exposure to EM risk assets. China might be the big focus; it's now the EM's largest economy and second overall in the world.

Corporate Credit | Simon Thorp, CIO Credit

Will Goldilocks save the day in 2022?

Most major financial markets are in rarified territory from a pricing standpoint. Such that, a Goldilocks economic and political outcome may be the only way to save them from negative returns in 2022. I believe any major sell-off is likely to be the result of one of the following:

Inflation. Almost certainly the key to understanding macro developments in 2022 will be the inflation profile as the year unfolds. If higher for longer we should expect a central bank response that will have negative connotations for most asset classes. The opposite is also the case unless weaker inflation comes in tandem with recession.

Energy Prices. Currently the market is split between those that think the price of oil in the mid $80s will be the peak (as production increases and demand wanes) and those who see the potential for an energy price shock. Predictions of prices for oil well in excess of $100 are not rare as winter approaches in the Northern Hemisphere, demand remains robust and inventories low. Oil below $50pb (recession) or above $100pb (inflation) will likely be negative for risk markets.

China. A threat from both an economic (possible recession) and a geopolitical standpoint (Taiwan/South China Sea). Concerns will probably be misplaced if growth can remain acceptable and a property price collapse avoided.

QE. Investors have bought the confidence trick so far (of printing money). This may not last, especially if inflation becomes entrenched at an elevated level. If so, watch for currency debasement and potential collapse, the classic EM playbook manifesting itself in DM countries.

Given these risks, an active and nimble approach is key to find mispriced opportunities that are uncorrelated to overall markets. For example, spots of high yield continue to offer relative value, such as in the travel and leisure sector where deep credit analysis is critical but rewarding

European Equities | Anis Lahlou, CIO Equity

Innovation remains the deflationary force

After almost a decade and a half of low interest rates, the cheap access to financing has benefited innovation and inventiveness. As we enter the reversal phase of tapering and higher rates, innovation adoption should continue at pace: global EV penetration is still in the low single digits for example, 5G Open RAN for enterprises is in its early days and we are only just getting acquainted with the 'metaverse', to name just a few examples.

As the consensus narrative starts to build a wall of worry about rampant inflation, this adoption of multiple innovations inevitably accelerating should continue to act as a deflationary force, this time helpfully counterbalancing rising costs. In the first nine months of 2021 for example, American factories and industrial users ordered a record 29,000 robots valued at $1.48 billion. This is more than the previous pre-pandemic peak set in 2017, according to data compiled by the Association for Advancing Automation[2].

Inflation and rising rates generally hit growth stocks the hardest. However, stocks where revenue growth is financed with negative earnings and/or cash flows are likely to face an even higher hurdle rate, especially if they require further funding to establish sustainable margins. In what can be considered the growth segment, this is an area where Europe seems particularly cheap with less than 15% of the MSCI Europe IMI Growth index having loss-making stocks vs. over 60% of US Russell 3000 Growth stocks[3].

Please note this is the opinion of Aperture Investors as at December 2021 and it may evolve over time, without prior notice. [2.] Source: BusinessWire, November 2021. [3.] Source: GMO, Aperture Investors as of November 2021.

Positioning for a year of divergence and recovery

Investing in an inflationary environment

With markets gradually realizing that inflation may not be wholly transitory, equities are set to be a beneficiary in such a scenario of rising nominal rates as long as real rates continue to be relatively low and there is no perception that central banks have lost control of the monetary policy. In a rising rate environment, financials and real assets would benefit, while demand for private debt would remain strong as a less interest rate sensitive segment of fixed income.

The big question is, will central banks lose control of inflation and be forced to tighten conditions? In this uncertainty, inflation hedges will remain in demand, with inflation swaps being a more effective tool than inflation linkers. Negative or poor fixed income returns would likely arise in this scenario. However, less favourable financial conditions would lead to greater dispersion of returns and decompression across the corporate bonds rating spectrum, creating a healthy environment for active managers to seek uncorrelated returns. Hedging credit markets using credit default swaps or options would be a useful tool in this environment. We are cautious on emerging markets and rate sensitive companies with weak balance sheets and those at risk of margin squeeze.

Appetite for duration may resurface, supporting ultra-long tenors. Some large LDI portfolios are, reportedly, still running duration gaps. In addition, the Solvency 2 review will lead to an increasing sensitivity of insurance liabilities beyond the 'last liquid point' (20 years). The steepening of curves can therefore have limited room to progress further.

Beam me up: Next Generation EU

The first tranche of the Next Generation EU €800 billion recovery fund is set to be deployed over the next few months. We expect this will benefit green infrastructure assets and digital infrastructure, and expect Italy and Spain to see a sharper benefit over Germany and other core European countries.

The green industrial revolution, digitalization and cloudification

We estimate over $150 trillion[4] globally will have to be deployed over the next 30 years to achieve the 2050 net zero emissions targets. This will create incredible investment opportunities for companies that enable the transition. Renewable energy, digital infrastructure, green industrials, efficient transportation, hydrogen producers, electric vehicle producers, and carbon capture storage are a few areas that we're excited about. Digitalisation and cloudification are related strong secular trends, and capex intentions within IT are on the rise and well above 2019 levels.

A new dawn for Italy

After years of outflows, the domestic Italian market is gaining traction with foreign investors, attracted by greater political stability and being the top beneficiary of the EU Recovery fund, with €210 billion to be deployed in Italy over the next few years, akin to a new Marshall Plan. In light of this, playing the FTSE MIB (Milano Indice di Borsa) both in absolute terms and relative to other European markets would seem prudent.

Giuliano Gasparet, Head of Equity

Sebastiano Chiodino, Head of Fixed Income

 [4] Source: BofAML Global Research, 12 October 2021.

Don’t ignore the volatility of the energy transition

Lumyna is one of the largest Alternative UCITS providers in Europe. They select best-of-breed hedge fund managers to bring investment opportunities to the European market via regulated, liquid and transparent UCITS vehicles. This outlook focuses on two trends they think will be interesting to watch next year.

ESG investing has been gathering steam among investors, regulators, policy makers and businesses for several years already and capital continues to seek out ways of having a positive impact while also earning market-beating returns.

One particularly compelling opportunity set is related to global warming – decarbonisation and a carbon free economy; the `energy transition’ theme or investing in companies supporting the transition and helping to accelerate the migration from a fossil-based energy system to a greener, sustainable and more efficient renewable one.

While the benefits of investing in leading sustainable companies are clear, the energy transition looks set to be turbulent. The impact on oil and gas markets for example will create higher and more volatile prices in the coming years as the amount of capital available for the exploration and production of these traditional energy sources diminishes.

Furthermore, the energy transition theme is high growth in nature, with an emphasis on new technologies – there will be winners and losers, so taking a considered approach to the allocation of capital will be crucial. It is certainly possible to target high growth companies that generate real and growing earnings as well as positive cash flow but as with any high growth area of the market, they can be prone to sudden and quick mean reversion as well as high levels of volatility.

We believe that accessing the energy transition opportunity through tried and tested investment specialists, who pursue a strategy with a strong fundamental underpinning and have the ability to take advantage of stock level dispersion and a willingness to increase or decrease risk in line with the attractiveness of the opportunity set would be a prudent approach.

The democratisation of private markets

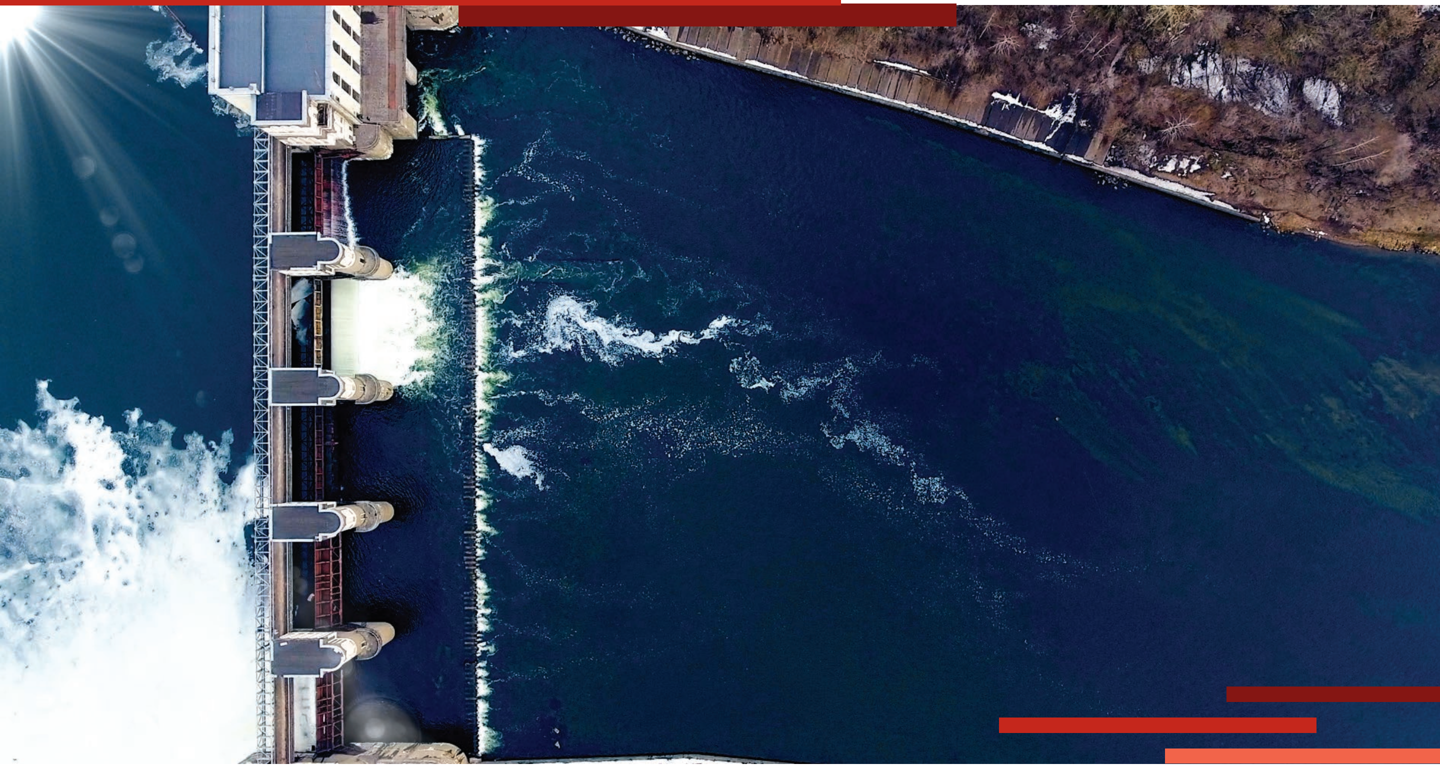
The democratisation of private markets is an emerging theme with enormous potential for generating attractive risk-adjusted returns from equity as well as debt.

Private markets have seen an big expansion in recent years and assets have more than tripled to over $9tn over the last decade[5] as institutional investors diversify away from more traditional markets. With this growth has come a significant shift in the capital formation process of companies. According to Goldman Sachs[6], the median company now goes through three equity funding rounds pre-IPO (up from just one in 2011), and on average raises nearly twice as much capital pre-IPO versus a decade ago. The effect of these dynamics on valuations has been dramatic: ten years ago, there were just nine unicorns (private companies valued at >$1bn); today there are now almost four hundred.

No longer just for the most sophisticated institutional investors, private markets are coming within reach of smaller investors. Interest in private equity is fuelled by relatively low volatility and the fact that private companies remain private for longer. On the private debt side, the hunt for yield makes the floating rate nature of these loans attractive as they keep private debt investors relatively insulated from rate hikes, and offer higher yield relative to existing fixed rate debt.

***Rasmus Soegaard**, Head of Investments*

Please note this is the opinion of Lumyna Investments Limited as at December 2021 and it may evolve over time, without prior notice. 5. Source: www.preqin.com as at November 2021. 6. GS Prime Services Hedge Fund Insights & Analytics, Going Private (Sep 2021)



Decarbonisation, digitalisation and M&A will drive infrastructure in 2022

Funding the Covid-19 Recovery

The infrastructure sector is central to the pandemic economic recovery – and is one of the main beneficiaries of the EU's €1.8 trillion 'Recovery plan for Europe' which seeks to invest in 'making Europe greener, more digital and more resilient'. While the allocation of funds follows individual country plans, our review suggests that, depending on the country in question, between 25-50% of the amount will be allocated to key infrastructure themes such as digitisation (fibre, 5G), the green transition (renewables, energy efficiency, electricity network upgrades) and public transportation (green mobility, rail and mass transit).

Precisely how the funds will be deployed should become more evident during the course of 2022, and while a substantial proportion may come in the form of direct government investment, there will also surely be allocations towards new support schemes for private sector investments.

The move to net zero

The exact legacy of COP26 at Glasgow may remain unfold for several years to come, but there is undisputable momentum in the growth of decarbonisation opportunities, most notably within the energy transition theme (i.e. the shift from fossil fuels in electricity production and mobility in favour of low carbon alternatives). This will benefit well-established ‘green’ segments (like solar and wind energy, electric rail), but will increasingly also address the infrastructure needs of an increasingly complex energy system characterised by the trend towards electrification. As such we expect to see a diversification of sub-sectors within the energy transition theme to include new areas of focus such as smart grids, e-mobility and EV charging, energy efficiency and battery storage. Green hydrogen projects and hydrogen-ready infrastructure are also likely to generate market excitement as commercial strategies develop further and ‘first mover’ investment opportunities arise.

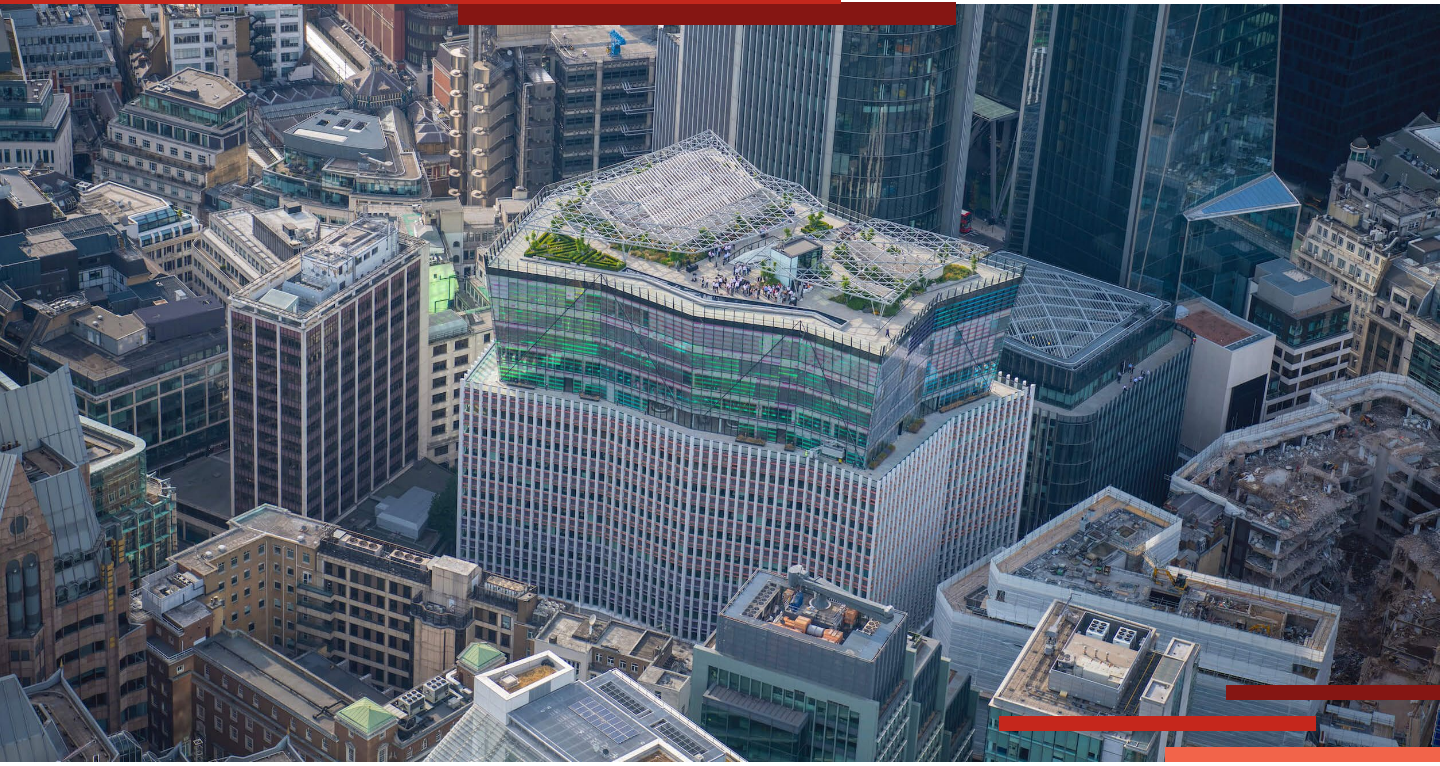
Digitalising Europe

Full fibre broadband roll-out was a key investment theme in 2021 and is expected to continue in strength during 2022, underpinned both by strong commercial rationale and by EU and government mandated coverage targets. Europe experienced subscriber growth in fibre broadband of 16.6% during 2020 but while growth has meant that 183 million European homes can access fibre, similar numbers are currently not served by the network. A European Commission target for all European households to be covered by a gigabit network by 2025 (offering connection speeds of 100 mbps to households and 1 gbps to socio-economic drivers including hospitals, schools, business and transport hubs), guarantees continued growth of the sector. Meanwhile, sustained high growth in data and bandwidth consumption will mean high demand for fibre coverage, as well as for the booming data centre segment and, increasingly, for 5G.

M&A activity will remain strong

The prevalence of infrastructure equity funds continues to strengthen, which is itself driving an increase in M&A transactions. A couple of trends are visibly supporting this. Firstly, with high valuations supported by the low rate environment, strategic corporates such as utilities and telecom operators are capitalising through sales of infrastructure-focused business units. Secondly, portfolio recycling by funds – when reaching the end of their life, funds dispose of their assets – is leading to M&A transactions and related debt investment opportunities.

***Philippe Benaroya**, CEO and Managing Partner*



Four real estate accelerators set to continue in 2022

In the real estate sector, the pandemic has been a strong accelerator, rather than a disruptor. We have identified four themes that visibly emerged and that we believe have momentum to continue in 2022 and offer long-term growth.

Gateway cities are solid investments for the future of real estate

Major European cities are continuing to grow. Most of the time, this growth is stronger than their respective nation overall, and it is a qualitative, demographic growth since cities are continuing to attract talent and younger generations. Since they are correlated to GDP growth, real estate investments in gateway cities offer a number of benefits.

First, they are more liquid, as more investors are looking to deploy money with a focus on quality. Second, they are a solid inflation hedge, because in a growing environment demand from tenants pushes rents up, even above inflation, and therefore real estate values are following the same trajectory. Finally, they are less volatile as both tenants and investors adopt a 'fly to quality' behavior even during a crisis, with a preference for major cities rather than secondary locations.

***Alberto Agazzi**, CEO and General Manager*

High quality, well-located offices confirmed their role as a resilient real estate sector

We are certainly all familiar with remote working and its benefits by now, but it's also become clear that homeworking cannot be the only way – especially when it comes to creating a company culture, developing new ideas and innovating. Offices have now been re-framed with a stronger focus on wellbeing, creating more amenities, meeting rooms and collaborative areas. High quality offices in attractive locations with strong ESG credentials are now considered an important business tool, closer to core business strategy rather than just a facility. This underpinned the resiliency of high quality, well-connected prime offices, even during the pandemic, confirming the sector's role on the main stage of the real estate market[7].

***Nicholas Garattini**, Head of Business Development and Investor Relations*

E-Commerce and supply chain reshoring is creating demand for warehouse space

Logistics experienced strong demand and performance in the past couple of years, not due to the pandemic, but to two structural factors: e-commerce growth and the reshoring of supply chains. Online sales across Europe reached around 16% of total sales in 2020 and are on a growing trajectory for years to come. It is important to note that e-commerce lacks the physical stores that can act as storage and so need three times more the space of 'bricks & mortar' retail. This is creating a long-term structural demand for warehouse space[8]. Meanwhile, producers and businesses are reshoring supply chains, as the disruptions caused by pre-Covid 'just-in-time' supply chains are becoming increasingly untenable. That means even more goods have to be stocked in warehouses, creating more demand.

***Pierre-David Baylac** , Head of Logistics Europe*

Commercial real estate ('CRE') debt as an alternative to traditional fixed income yields

While real estate is continuing to attract strong interest from institutional investors, the banking sector is not growing at the same pace and is struggling to match financing demand mostly due to regulatory pressure and the need to diversify exposure. In the light of this, senior debt margins have been stable despite a compression in interest rates and yields on equity markets. Alternative lenders are now entering the market and given high demand they can diversify their portfolio and select the best opportunities with a strong pace of deployment. Senior CRE debt therefore represents a valid alternative to traditional sovereign debt exposure in terms of credit quality and duration, while granting substantially higher yields.

***Nunzio Laurenziello**, Head of Debt Investments*

Please note this is the opinion of Generali Real Estate as at December 2021 and it may evolve over time, without prior notice. [7] Data Source: KPMG 2012 CEO Outlook August 2021. [8] Data source: Prologis white paper – "Accelerated retail evolution could bolster demand for well-located logistics space" June 2020.

Contact us

Please contact us if you have questions or suggestions regarding the product and services of Generali Investments

info@generali-invest.com
www.generali-investments.com