

GIAM Macro & Market Research - Market Commentary

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Incorporating quant signals into EU equity sector/style strategy: maintain a tilt to cyclicals and value

- We present an update of our proprietary equity valuation tool, based on quant models. It provides indications of over- or undervaluation for different sectors and styles of European equities, which is further enriched by our qualitative analysis.
- Currently, among European equity sectors, financials, energy, telecoms, and autos look undervalued while Pharma, utilities and software appear overvalued.
- Among European equity styles, undervaluation is indicated for large cap value and small cap while growth, quality, and momentum look particularly expensive.
- That said, incorporating also non-quant signals coming from our qualitative analyses, we recommend having a tilt to cyclicals and value: Overweight insurance, diversified financials, capital goods, semiconductors, tech hardware and food. Underweight transportation, media and telecoms.

At the end of 2019 we published the Focal Point [“Quant signals for EU equity sectors and styles”](#) where we introduced our proprietary equity valuation tool to yield indications of over- or undervaluation for different sectors and styles of European equities. The regression-based models use macro- and financial variables to produce fair value estimates of the ratio between the MSCI Europe Sector/Style index and the broad MSCI Europe index.

With this publication, we want to provide an update of current models' indications of over- and undervaluation for the sectors and styles covered.

In and of itself these indications of relative over- or undervaluation are not sufficient to make investment decisions, as the models use current inputs of the macro- and financial variables, without making considerations of how they can develop going forward. Still, the results are useful as they allow limiting the number of sectors/styles to be further analyzed, using a more qualitative assessment and bottom-up analysis.

The table below summarizes current signals for all sectors/styles covered along with some additional descriptive statistics of how they have performed (in total return terms) over the recent past.

The last column added on the right includes a different approach to modeling, leveraging on a genetic algorithms process based on machine learning (ML) principles, i.e. evolutionary learning module. Of course, even this approach is based on historical series of data and is influenced by the big drawdown and volatility experienced this year.

The signals are taken from both **quant models**.

Undervalued: financials, energy, telecoms (slightly), auto

Overvalued: Pharma, utilities, software

Mix result (divergent): Industrials, materials, staples, IT

Equity Quant Models Signals

Index	Current ST. DEV.	Over/Undervalued OV/UV	%TR YTD	%TR From Peak (Feb. 19)	Lehman Crisis ST.DEV.		ST.DEV. From ML models
					MIN	MAX	
MSCI Europe	-	-	-10.9	-14.5	-	-	-
Financials ^o	-3.32	Strong UV	-29.6	-32.4	-2.5	0.8	-5.00
Banks ^o *	-4.47	Strong UV	-43.5	-43.9	-1.7	1.4	-4.62
Insurance ^o *	0.69	-	-23.1	-27.5	-1.0	2.1	-5.03
Industrials	-1.14	UV	-4.6	-8.0	-2.2	1.8	3.83
Capital Goods	-1.66	UV	-6.5	-9.5	-1.3	1.5	1.80
Health Care	1.51	OV	0.0	-7.3	-2.2	2.0	3.27
Pharmaceuticals	1.90	OV	-0.5	-7.8	-2.2	2.1	1.71
Energy ^o	-6.02	Strong UV	-48.3	-45.0	-0.8	2.9	-5.28
Telecommunications	-1.45	UV	-19.5	-22.2	-1.3	2.6	0.32
Utilities	4.63	Strong OV	5.0	-11.0	-1.6	1.9	0.90
Materials	2.73	Strong OV	-1.4	-0.6	-0.4	3.2	-1.09
Consumer Staples ^o	-1.54	UV	-5.0	-9.2	-1.5	1.0	3.89
Consumer Discretionary ^o	0.74	-	-6.4	-6.8	-0.9	1.9	3.60
Automobiles	-3.03	Strong UV	-10.7	-4.9	-1.6	2.1	-2.49
Information Technology ^o	3.09	Strong OV	9.4	-0.6	-1.8	0.9	-1.51
Software ^o **	0.41	-	4.3	-2.7	-1.7	0.3	1.23
Cyclical ^o	1.14	OV	-11.9	-14.8	-2.0	1.7	
Defensive ^o	0.64	-	-9.5	-14.2	-1.1	1.7	
Value	-0.32	-	-23.1	-24.4	-1.4	1.2	
Growth	3.71	Strong OV	1.7	-4.7	-0.6	2.1	
Quality ^o	3.50	Strong OV	-0.4	-6.1	-0.9	3.5	
Momentum ^o	2.01	Strong OV	6.7	-2.4	-0.3	2.3	
Large Cap	0.15	-	-12.3	-15.7	-1.8	1.8	
Large Cap Value	-4.14	Strong UV	-23.9	-25.2	-1.8	0.9	
Small Cap	-1.47	UV	-8.2	-11.9	-2.0	1.5	
Small Cap Growth	2.99	Strong OV	3.9	-1.5	-1.8	2.2	
Low Leverage ^o	1.70	OV	-7.4	-10.4	-2.3	2.3	
Min Volatility ^o	-0.47	-	-6.0	-12.5	-1.5	1.9	

* Banks and Insurance vs Financials; ** Software vs IT ; ^o Higher scoring models in the out-of-sample tests

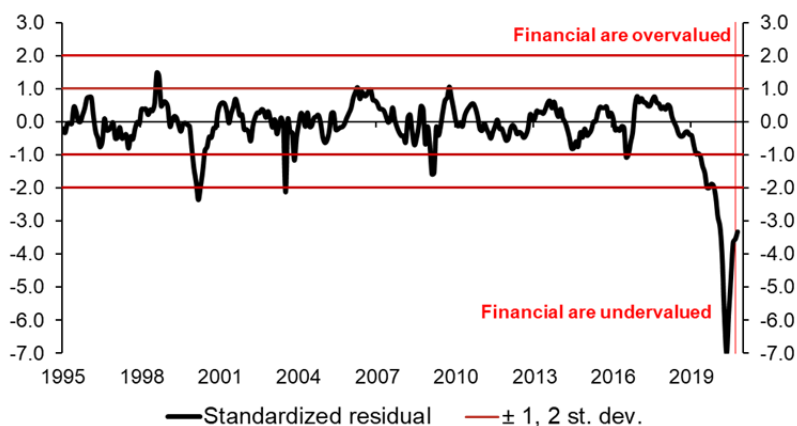
UV = Undervaluation OV = Overvaluation

Last Update: 19/10/2020

Source: Thomson Reuters, own calculations

Financial vs MSCI Europe: Model valuation

distance from fair value model, in standard deviations



Qualitative analysis.

Total return (TR) break up (year-to-date): investors are less impressed by **valuation** (strong policy action helping to offset high market multiples) and more by **earnings momentum** (i.e. good earnings growth YTD mirrored by good TR, and vice versa).

Total Return decomposition, PE expansion and Risk Measures from 31/12/2019 to 19/10/2020

Index	%TR	%PR	%DY	%EPS	%PE	5Y Beta
MSCI Europe	-10.9	-13.0	2.1	-22.6	17.9	1.0
Banks	-43.5	-43.4	-0.1	-41.9	2.3	1.3
Real Estate	-20.6	-23.6	3.0	-12.9	-7.9	0.8
Utilities	5.0	2.0	3.0	-5.0	12.6	0.8
Auto & Components	-10.7	-12.9	2.2	-38.5	48.7	1.3
Capital Goods	-6.5	-8.0	1.5	-22.9	25.2	1.2
Consumer Durables	-2.4	-3.1	0.8	-26.4	38.1	1.1
Consumer SVS	-29.5	-30.4	0.9	-58.8	77.1	1.1
Div. Financials	-4.6	-7.0	2.4	-9.8	8.1	1.3
Energy	-48.3	-50.9	2.6	-58.3	23.6	1.3
Food, Bev. & Tobacco	-9.2	-11.6	2.4	-12.7	6.3	0.7
Food & Staples Retailing	-5.0	-8.2	3.2	-4.0	0.3	0.6
HC Equip. & Services	2.0	1.4	0.7	-9.5	17.5	0.8
Household & Pers. Prod.	5.7	3.5	2.1	-6.7	16.5	0.7
Insurance	-23.1	-26.9	3.8	-9.3	-15.4	1.2
Materials	-1.4	-4.8	3.4	-10.6	11.9	1.1
Media & Entertainment	-23.8	-25.3	1.5	-34.8	20.3	1.0
Pharma	-0.5	-3.4	2.9	1.0	0.4	0.7
Retailing	6.2	6.2	0.0	-28.6	56.1	1.0
Semiconductors	21.7	21.0	0.8	-8.4	38.7	1.2
Tech Software & Serv.	-1.6	-2.7	1.1	-22.1	31.1	1.0
Telecom Services	-18.1	-20.6	2.5	-15.3	-1.6	0.9
Tech Hardware & Equip.	22.4	21.5	0.9	4.6	21.8	1.0
Transportation	4.0	2.4	1.7	-38.8	75.5	1.0
Comm. & Prof. Services	-1.6	-3.5	1.9	-16.0	20.6	1.0

Earnings are 12-months forward; PE = Price/Earnings 12M forward; DY is estimated as %TR - %Price

Source: Thomson Reuters

As said, the **quantitative analysis is extended with various valuation metrics** (which are a mix of value and growth approach to valuation), recent **historical performance** data - proxy for **positioning** - as well as the analysis of trends between earnings/sales **revisions** and sector prices (both relative to the MSCI Europe).

Valuation: we take into consideration **Shiller PE** discount, expected **total return** (calculated as the sum of DY and next years' earnings growth), average **PEG ratio adjusted** for RoE and cost-of-equity, gap from three-stage earnings growth model (8-year history), **market multiples** gap vs history and current **PE** vs historical average **excluding bubble years** (1987-1996, 2003-2007, 2009-2019).

We give weights to different methodologies in order to avoid 100% bias towards a “value” approach (expected Total Return and PEG adjusted have more a “growth” bias, having both a weight of 64%).

Valuation metrics

weights used in the calculation of rank

9%

32%

32%

9%

9%

9%

Sectors (Europe)	Shiller PE, discount	Exp. TR = DY + next years' EPS growth	average PEG*	average PEG adj.*	LT earnings growth	DY - 10Y yield	LT DEV gap (the higher = the cheaper)	ST DEV gap (the higher = the cheaper)	Market multiples, discount to history	PE vs. hist. avg. excl. bubble years	Price vs earnings performance since 1995	Rank 1= most under-valued
Market	-23%	8%	4.8	5.6	6.2%	3.4%			14%	38%	22%	11
Auto and Components	-35%	6%	7.1	12.5	-0.1%	3.0%	0.0	0.6	-13%	141%	-21%	21
Banks	-50%	3%	15.6	14.5	-0.6%	6.1%	4.5	5.4	-26%	-11%	-14%	19
Capital Goods	5%	5%	13.7	14.5	3.8%	2.6%	-2.8	-4.4	27%	57%	33%	23
Commercial/Professional Services	6%	6%	7.6	7.8	4.6%	2.2%	-2.9	-3.8	45%	54%	45%	20
Consumer Durables and Apparel	7%	5%	11.8	12.7	3.4%	1.9%	-3.5	-4.2	40%	106%	52%	22
Consumer Services	-1%	2%	15.6	14.5	-0.8%	1.6%	-0.8	0.4	47%	212%	52%	25
Diversified Financials	-24%	13%	1.6	3.1	12.2%	3.0%	-0.3	-1.1	4%	20%	32%	5
Energy	-59%	7%	9.0	11.1	1.4%	7.2%	6.6	6.3	-31%	66%	-9%	12
Food and Staples Retailing	-28%	6%	5.7	6.2	1.8%	3.8%	2.9	2.9	-14%	-11%	0%	10
Food, Beverages and Tobacco	1%	6%	7.0	7.2	3.9%	3.1%	-0.7	1.7	5%	22%	34%	14
Health Care Equipment and Services	11%	10%	3.2	3.7	10.7%	1.5%	-1.6	-1.2	9%	41%	46%	9
Household and Pers. Products	-20%	5%	9.5	9.7	2.9%	2.6%	-1.3	-1.2	16%	7%	20%	18
Insurance	-56%	13%	1.7	2.7	7.3%	6.5%	2.6	4.6	-32%	-31%	-114%	2
Materials	-6%	6%	6.7	7.7	2.8%	3.7%	-2.0	-3.1	11%	50%	30%	16
Media	-35%	4%	7.4	8.3	2.2%	3.0%	2.6	1.8	2%	-26%	6%	15
Pharmaceuticals, Biotechnology and Life S	-13%	11%	2.1	2.2	9.4%	3.1%	-0.6	-0.9	13%	3%	13%	6
Real Estate	-50%	5%	15.6	14.5	1.6%	4.5%	3.3	4.9	-9%	-22%	-19%	17
Retailing	-11%	27%	2.2	3.0	33.6%	1.3%	-1.8	-1.8	88%	217%	62%	3
Semi-Conductor and Semi-C. Equipment	63%	21%	1.8	2.3	20.0%	1.0%	-4.3	-3.7	58%	10%	-	4
Software and Services	24%	9%	4.0	4.5	9.1%	1.2%	-2.8	-3.1	44%	-1%	-7%	13
Technology Hardware and Equipment	115%	15%	1.7	2.2	13.2%	1.9%	1.1	-0.8	24%	-70%	21%	7
Telecommunication Services	-41%	16%	1.7	2.2	15.5%	5.6%	3.7	4.2	-26%	-68%	-13%	1
Transportation	-38%	9%	15.6	14.5	11.6%	2.2%	-4.7	-5.9	43%	409%	50%	24
Utilities	-19%	11%	2.9	3.4	4.6%	4.8%	-0.5	-3.3	11%	33%	27%	8
Median	-19%	7%	6.7	7.2	4.6%	3.0%	-0.6	-1.0	10.8%	21.8%	22%	
Average	-11%	9%	7.0	7.6	7.2%	3.2%	-0.1	-0.2	14.0%	49.8%	15%	
<i>st. dev.</i>	38%	6%	5.0	4.7	7.7%	1.7%	2.9	3.4	30%	103.7%	37%	
a) Discretionary+Transp. average	-20%	9%	9.3	10.2	7.4%	2%	-0.8	-0.9	28%	150%	29%	
b) = (a) -food retail, retail and C.serv.	-25%	6%	10.5	12.0	4.3%	2.6%	-1.4	-1.9	17.9%	157.3%	22%	

Note: The discretionary sectors = auto, consumer durables, consumer services, media, retailing.

fwd **PEG** is 12m fwd PE divided by expected EPS long-term growth. EPS = 12m fwd earnings. **Trailing PEG** = trailing PE divided by earnings growth F0-F3.

Average PEG is the average of fwd PEG and trailing PEG. **PEG adj.** (higher = expensive): PEG is modified by the ratio COE/ROE which signals the ability to produce a return on capital higher than the cost of it. COE = cost of equity = 10yr gov't bond rate + 6% mkt risk premium x country Beta versus MSCI WORLD (monthly returns over the last 10 yrs).

DEV gap = three-stage discounted earnings based valuation vs. MSCI Europe (higher positive gap = cheaper valuation).

Mkt Multiples (PE, PB, PCF, and DY) are based on 12m forward estimates. PEs are since 1987, the rest is since 2003.

Shiller PE: Price earnings ratio based on average inflation-adjusted earnings from the previous 10 years.

The rank is derived from the valuation score, which is calculated as a sum of standardized expected total return (32%), average PEG ratio adj. (for ROE and COE) (32%),

Shiller PE discount (9%), gap from 8 year three-stage earnings growth model (9%), market multiples discount taken from 2004 (9%), and PE vs. hist. avg. excl. bubble years (9%).

Starting from valuation (80%) we add then **positioning** (with a weight of 20%) which is proxied by the **relative performance** achieved in the last 6/12 months.

Valuation + positioning

Sectors (Europe)	(1) Valuation score (80%) (lower=better)	(2) avg rel. performance (20%) (lower=better)	rel. perf. - 6M (TR)	rel. perf. - 12M (TR)	Beta 5 yr	R2 (Beta 5y)	Style	Rank (1) + (2)
Telecommunication Services	-1.1	-13.8	-11.4	-16.2	0.8	49%	Value	1
Insurance	-1.0	-7.0	-3.6	-10.3	1.3	80%	Value	2
Retailing	-0.9	18.5	17.2	19.9	1.1	60%	-	3
Diversified Financials	-0.6	8.4	6.6	10.3	1.3	76%	-	4
Pharmaceuticals, Biotechnology and Life	-0.5	2.3	-8.4	13.1	0.6	39%	-	5
Energy	0.0	-38.0	-32.3	-43.8	1.0	46%	Value	6
Semi-Conductor and Semi-C. Equipment	-0.6	31.9	19.2	44.5	1.2	48%	Growth	7
Food and Staples Retailing	-0.2	-4.7	-10.3	1.0	0.5	23%	-	8
Technology Hardware and Equipment	-0.4	17.6	15.4	19.8	0.8	32%	-	9
Utilities	-0.3	11.0	8.2	13.7	0.6	32%	Value	10
Health Care Equipment and Services	-0.3	6.2	2.2	10.2	0.8	56%	Growth	11
Market	-0.1	0.0	0.0	0.0	1.0	100%	-	12
Food, Beverages and Tobacco	0.1	-6.3	-7.9	-4.7	0.5	40%	-	13
Media	0.1	-7.9	1.9	-17.6	1.1	73%	-	14
Software and Services	0.0	8.6	6.3	11.0	1.1	71%	Growth	15
Banks	0.4	-22.8	-13.9	-31.8	1.6	75%	Value	16
Real Estate	0.3	-7.3	-4.1	-10.5	1.0	56%	Value	17
Materials	0.2	14.1	12.3	15.8	1.1	73%	-	18
Household and Pers. Products	0.3	6.3	3.3	9.3	0.6	37%	Growth	19
Commercial/Professional Services	0.4	6.2	4.3	8.0	0.9	68%	Growth	20
Auto and Components	0.4	12.2	22.0	2.4	1.6	74%	-	21
Consumer Durables and Apparel	0.9	10.9	8.6	13.2	1.1	71%	Growth	22
Capital Goods	0.9	11.7	14.4	9.0	1.3	89%	-	23
Consumer Services	1.1	-8.5	4.0	-21.1	1.2	76%	Growth	24
Transportation	0.9	24.1	26.4	21.8	1.1	71%	Growth	25

Note: Rank is derived from valuation (80%) and the average relative performance (20%) (which considers 6m and 12m relative performance of each sector vs the MSCI Europe). The valuation score is calculated as a sum of standardized expected total return (32%), average PEG ratio adj. (for ROE and COE) (32%), Shiller PE discount (9%), gap from 8 year three-stage earnings growth model (9%), market multiples discount taken from 2004 (9%), and PE vs. hist. avg. excl. bubble years (9%).

A sector is "Value" when its contribution to the MSCI EU Value index is at least 4 times higher than its contribution to the Growth index.

Most negative valuation score = cheapest = highest valuation rank (1); lowest perf. = highest perf. rank

Average PEG is the average of fwd PEG and trailing PEG. fwd PEG is 12m fwd PE divided by expected EPS long-term growth. EPS = 12m fwd earnings.

Trailing PEG = trailing PE divided by earnings growth F0-F3.

Overall, our final decision (OW/UW) is derived from:

- **quant signals and earnings/sales revisions momentum**
- **final score obtained through valuation and performance,**
- **macro view - point of the cycle considerations - tilt we want to give to sector allocation - plus policy action support expected.**

Summary table

Sectors (Europe)	Rank (valuation + performance) (1=best)	QUANT / ML* Current ST. DEV. (lowest = best)	QUANT / ML* (Over/Under-valued OV/UV)	Earnings / sales revisions TREND	Earnings / sales revisions GAP	DECISION
Market	12					
Auto and Components	21	-3.0 / -2.5	both Strong UV	+	-	
Banks	16	-4.5 / -4.6	both Strong UV	-	+	
Capital Goods	23	-1.7 / 1.8	mixed	+	-	+
Commercial/Professional Services	20	- / -	-	+	=	
Consumer Durables and Apparel	22	- / -	-	+	-	
Consumer Services	24	- / -	-	=	=	
Diversified Financials	4	- / -	-	-	+	+
Energy	6	-6.0 / -5.3	both Strong UV	-	+	
Food and Staples Retailing	8	- / -	-	+	+	+
Food, Beverages and Tobacco	13	- / -	-	+	=	+
Health Care Equipment and Services	11	- / -	-	=	-	
Household and Pers. Products	19	- / -	-	=	-	
Insurance	2	0.7 / -5.0	mixed	=	=	+
Materials	18	2.7 / -1.1	mixed	+	-	
Media	14	- / -	-	=	-	-
Pharmaceuticals, Biotechnology and Life	5	1.9 / 1.7	both OV	-	+	
Real Estate	17	- / -	-	+	=	
Retailing	3	- / -	-	=	-	
Semi-Conductor and Semi-C. Equipment	7	- / -	-	-	-	+
Software and Services	15	0.4 / 1.2	- / OV	=	=	
Technology Hardware and Equipment	9	- / -	-	-	-	+
Telecommunication Services	1	-1.4 / 0.3	mixed	-	=	-
Transportation	25	- / -	-	+	-	-
Utilities	10	4.6 / 0.9	Strong OV / -	-	-	

* ML: results based on machine learning approach

Conclusions: we want to preserve a tilt to cyclicals and value but, as for the latter, we do not want to rush into structurally damaged value sectors.

So, we maintain an OW exposure to:

- ✓ **capital goods** – while exuberant on valuation we think their earnings could continue to flow nicely,
- ✓ **diversified financials**: good score and gap to revisions,
- ✓ **food and food retail**: our hedge. Revisions look bottoming, relative score is also good,
- ✓ **insurance**: value, good score and quant signals, more defensive than banks, revisions flat,
- ✓ **semis**: highly cyclical, very good score, albeit revisions not supportive at the moment,
- ✓ **tech hardware**: good score, cyclical, revisions also not too supportive.

Sectors	PE		PB		PCF		DY		Avg. Discount, %	PEG adj. *
	12m f	Discount	12m f	Discount	12m f	Discount	12m f	Discount		
Europe	16.5	27.5	1.6	-4.4	9.1	19.3	3.3	-12.7	13.8	3.5
Auto and Components	10.6	-18.5	0.7	-30.9	3.6	-13.9	3.0	-10.6	-13.2	-67.1
Banks	8.7	-13.7	0.4	-59.5	4.8	-9.8	6.0	21.6	-26.2	-11.7
Capital Goods	19.8	36.9	2.7	19.8	12.4	31.3	2.5	-18.7	26.7	6.0
Commercial/Prof.Services	24.3	47.6	6.6	59.7	17.3	50.3	2.2	-21.3	44.7	5.5
Consumer Durables & Apparel	27.3	67.2	3.0	24.1	18.2	50.1	1.9	-20.3	40.4	9.0
Consumer Services	29.4	81.4	2.6	-3.6	16.2	58.7	1.6	-50.9	46.8	-36.1
Diversified Financials	15.0	34.1	1.0	-18.5	6.6	-18.8	3.0	-18.3	3.8	2.8
Energy	12.8	12.4	0.7	-51.9	3.4	-39.0	7.2	44.9	-30.8	11.1
Food and Staples Retailing	13.2	-4.2	1.3	-24.8	5.8	-12.4	3.8	13.5	-13.8	8.0
Food, Beverages and Tobacco	19.1	13.4	3.0	-10.0	14.3	11.7	3.1	-4.2	4.8	5.2
Health Care Equip.and Services	24.1	23.8	2.7	-9.8	14.6	13.1	1.4	-8.9	9.0	2.8
Household and Pers. Products	23.3	21.7	5.1	30.6	18.0	17.2	2.5	4.8	16.2	8.2
Insurance	8.8	-8.1	0.9	-23.5	10.8	-63.7	6.5	32.9	-32.0	2.2
Materials	16.7	30.2	1.7	4.5	8.7	21.1	3.6	12.7	10.8	7.0
Media	16.7	9.4	1.5	-35.5	9.5	9.8	3.0	-23.5	1.8	8.3
Pharmaceuticals, Biotech. and LS	16.3	13.1	3.7	12.4	14.0	17.6	3.0	-10.6	13.4	1.9
Real Estate	15.9	-12.5	0.8	-11.8	14.4	-9.8	4.5	0.3	-8.6	11.1
Retailing	38.2	122.8	4.1	35.5	27.3	130.6	1.3	-64.9	88.4	2.0
Semis	30.2	16.3	5.9	111.6	22.8	88.1	1.0	-14.3	57.6	2.1
Software and Services	27.3	48.0	4.8	42.5	23.0	53.1	1.1	-34.3	44.5	3.5
Tech. Hardware and Equipment	19.6	18.3	2.6	14.9	16.1	26.9	1.8	-37.3	24.3	2.0
Telecommunication Services	12.7	-36.6	1.1	-27.3	2.9	-38.1	5.6	1.7	-25.9	1.4
Transportation	27.6	88.8	2.4	26.0	8.2	24.4	2.2	-31.7	42.7	5.1
Utilities	15.9	22.0	1.7	5.2	6.3	7.7	4.8	-8.1	10.7	4.0

Note: Discount in % to long-run norm; 12m f = expected in 12 months. Multiples are since 2004. In case of DY, a discount means the market had a higher DY, meaning the market is at premium for this multiple.

PEG adj. (higher = expensive): PEG (12m fwd PE / earnings growth over 2-5 yrs) is modified by the ratio COE/ROE, which signals the ability to produce a return on capital higher than the cost of it. COE = cost of equity = 10yr gov't bond rate + 6% mkt risk premium x country Beta versus MSCI WORLD (monthly returns over the last 10 yrs).

Source: Thomson Reuters Datastream, IBES estimates.

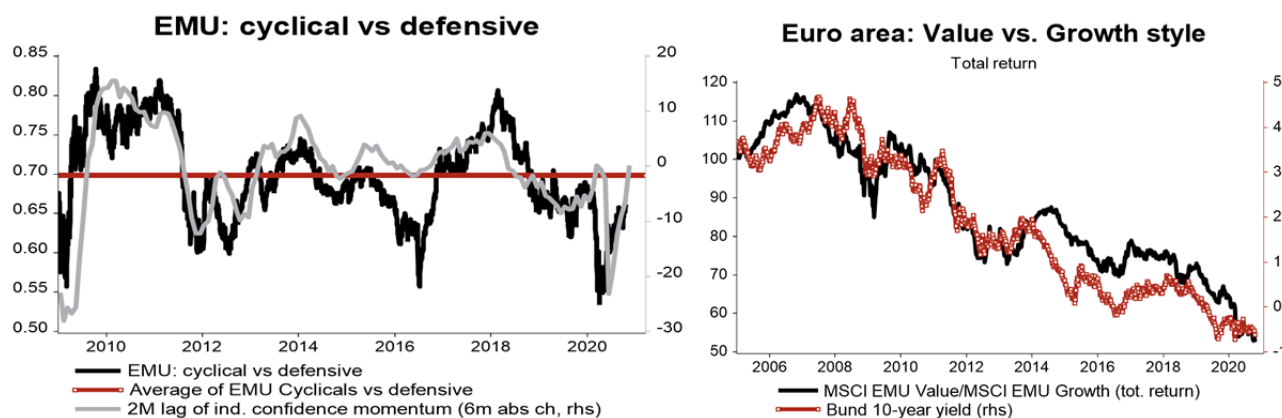
In what follows we provide insight on some selected sectors and styles.

Tilt to cyclicals

The **global economy** is recovering. The ISM and the IFO indicators remain high and overall supportive for the continuation of the earnings recovery (Q3 reporting season is doing well, in the US especially). Policy action will remain well supportive.

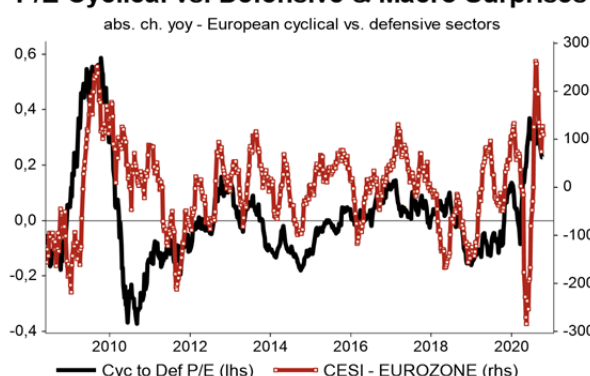
Yields have probably exhausted their downward momentum and, albeit remaining very low (not fully supportive for Value) now look more stable with **US yield curve** steepening and also in the EA ahead (the EUR 10yr30yr spread).

Such "recovery" phases tend to favor cyclical assets and value ones. As for the latter we try not to OW businesses which have structural issues: banks, telecom and energy, in particular.

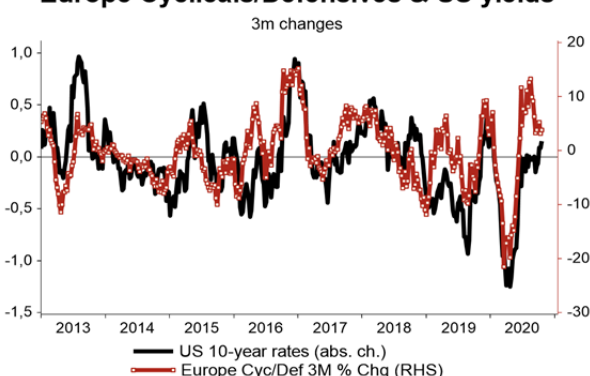


EA macro surprises are stalling but at a very high level; **US yield curve is supportive:**

P/E Cyclical vs. Defensive & Macro Surprises

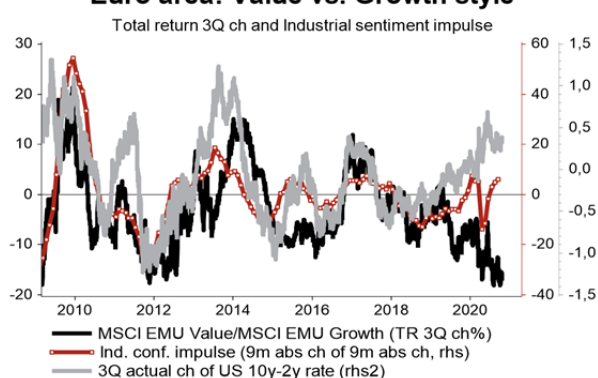


Europe Cyclical/Defensives & US yields



Uncertainty and low yields cannot support strongly the **Value** style but industrial sentiment momentum and US yield curve could trigger some better performance ahead:

Euro area: Value vs. Growth style

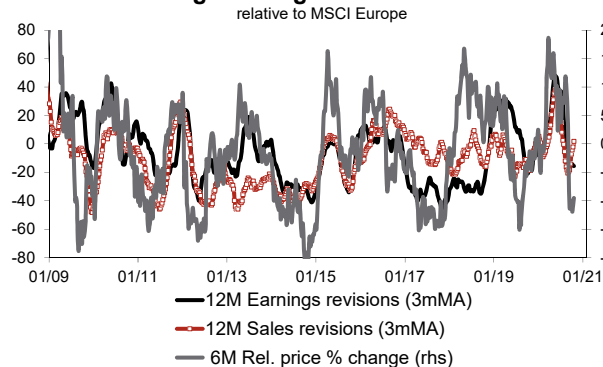


We have now put **food** sectors on OW, it is our hedge: The food and staples retailing has a below-average valuation and has been lagging other sectors in terms of recent performance (6m and 12m).

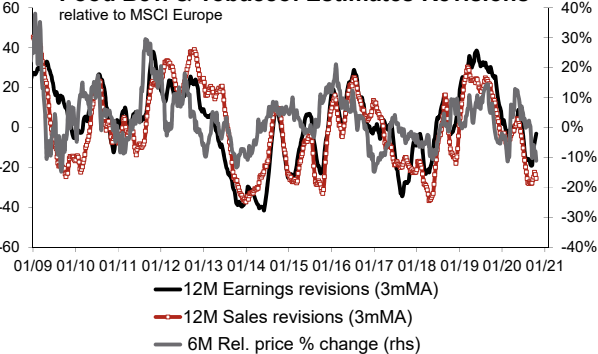
The revisions trend (both earnings and sales) for the food retailing is pointing up, while the sector has a positive gap between price and revisions changes in relative terms to the MSCI Europe.

For the FBT, while its valuation is about average, the other arguments hold as well.

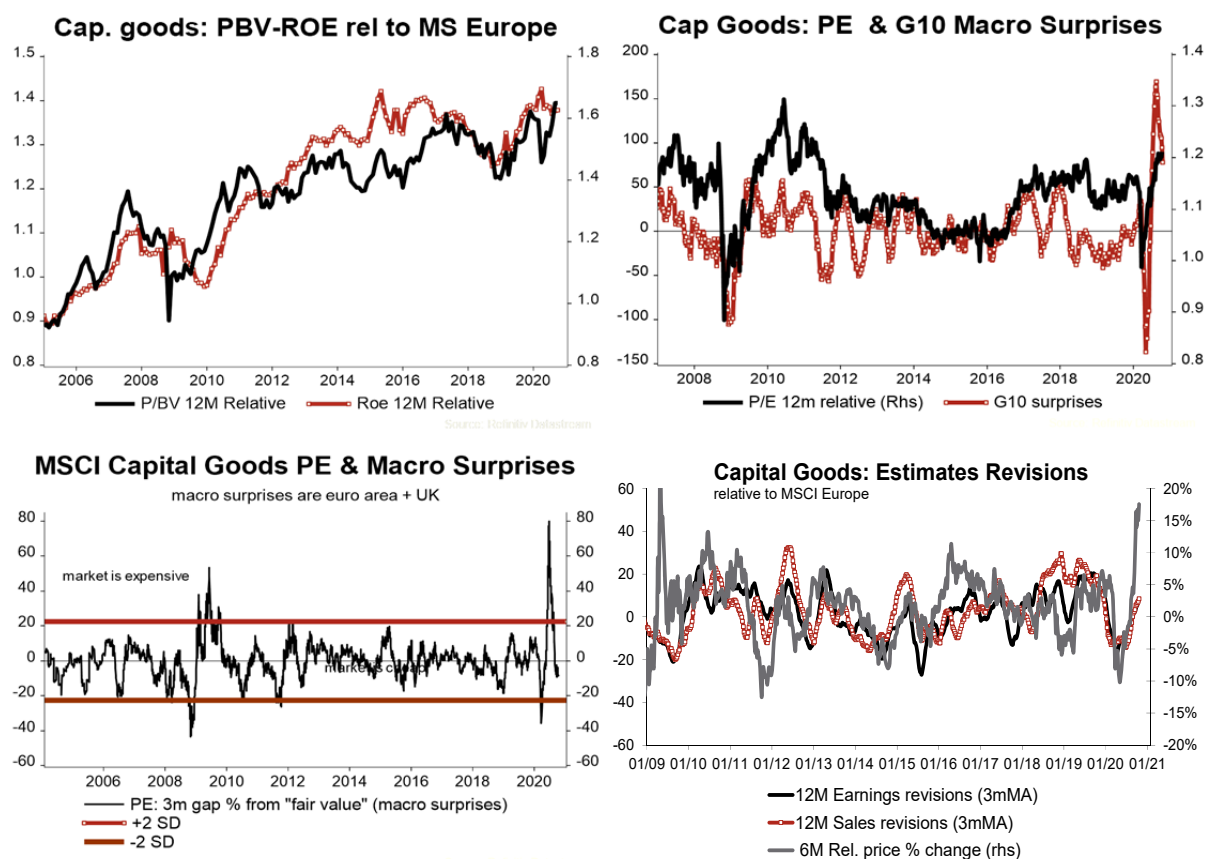
Food drug retailing: Estimates Revisions



Food Bev. & Tobacco: Estimates Revisions



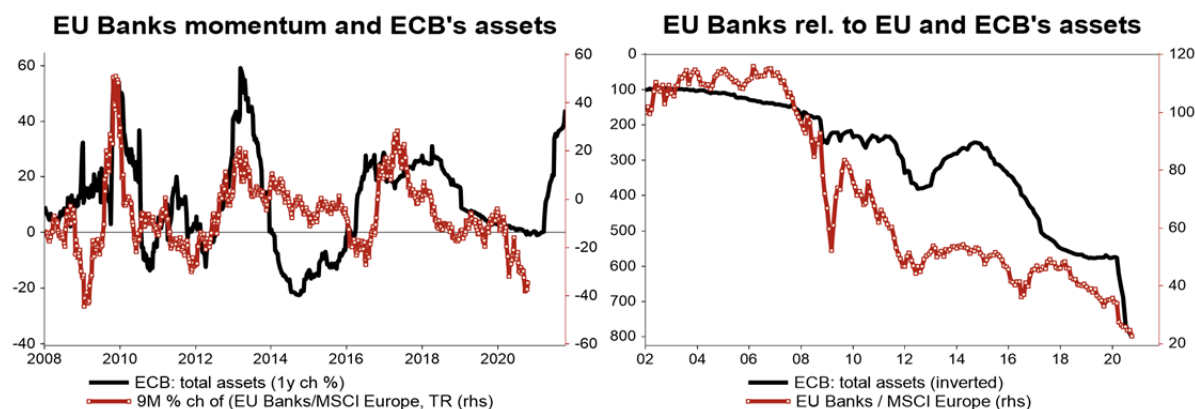
Capital goods: we lowered its overweight due to its high **valuation** but it still deserves a slight overweight as **earnings could continue to flow** and some measures (PBV-RoE, PE and macro surprises) are not in overbought territory yet. Earnings/sales **revisions** are trending up. The sector has a global exposure and should benefit from global recovery and higher beta.



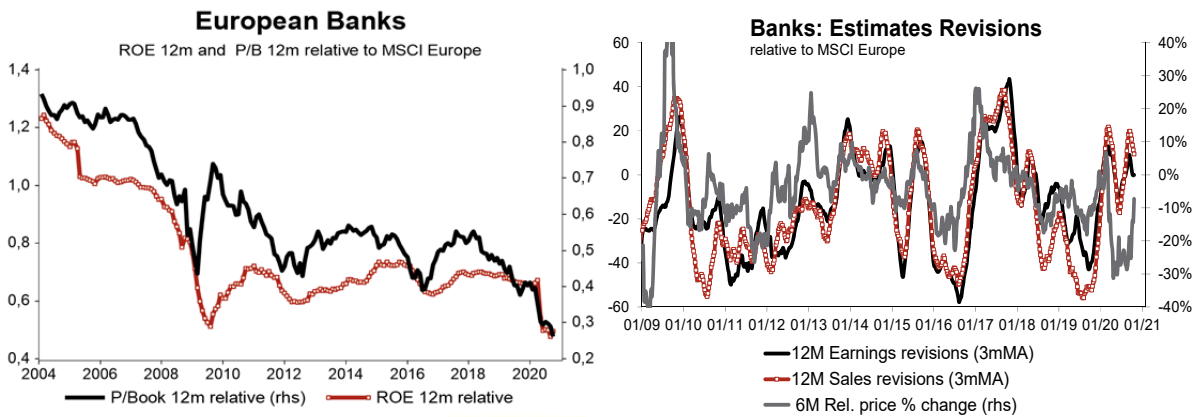
So far, **financials** have had a strong underperformance in 2020 and reached a record level of undervaluation at -3.3 standard deviations.

In particular, among financials, **banks** are the one to suffer the most, with a performance of -45% from the peak. **Low yields and uncertainty** on the economic recovery remains the key driver of underperformance.

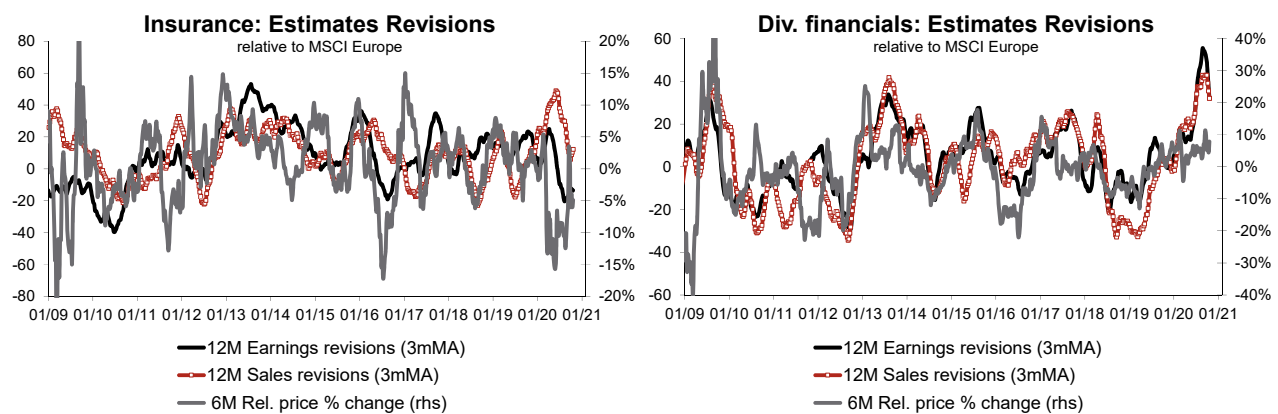
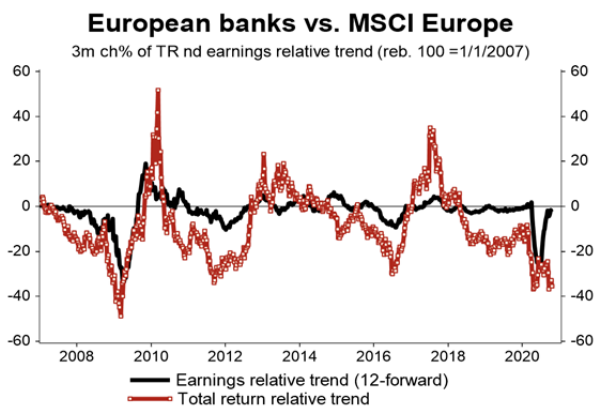
Furthermore, while short term **QE** could be reassuring also for banks, historically a **structural increase in ECB's assets** is not a particularly welcome outcome for banks in the long run.



Bank's RoE is still subdued and relative **revisions** are at a cyclical peak:

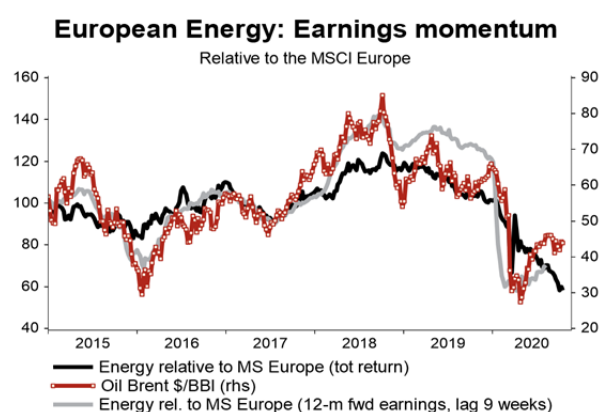
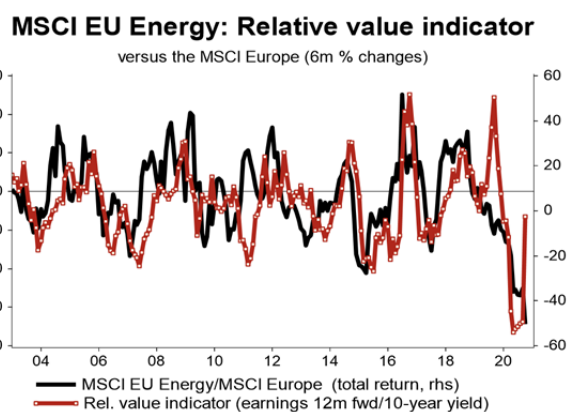
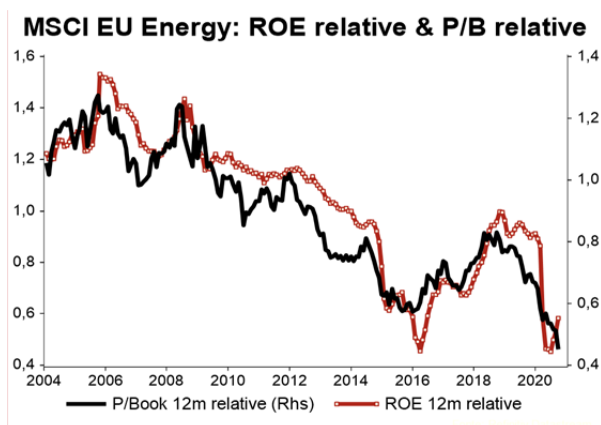


But **relative 12-month earnings momentum** (3m ch) looks less horrible now with prices discounting further gloomy scenario with regulator and M&A news flow supportive at the margin. But for us it is still risky to go outright OW. We favor Diversified financials and Insurances.

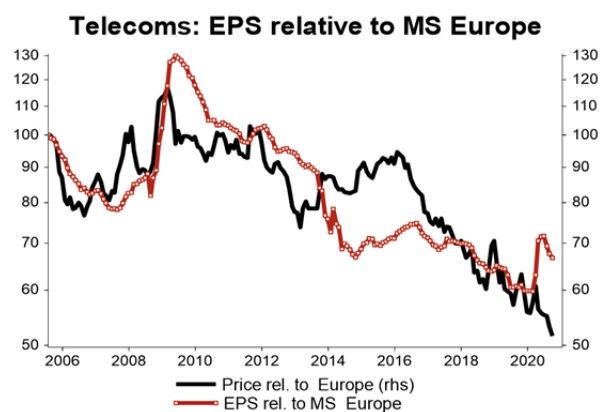


Energy sector

The pandemic and efforts to contain it have triggered an unprecedented collapse in oil demand and a crash in oil prices. ESG flows and dividend ban are not helping, too. We are currently neutral on the sector. We notice some rebound in **ROE** relative (from lows comparable to 2016 ones) which is mirrored by our **Value momentum** relative to Europe:



Telecoms score well on different parameters (see tables above) but earnings are still not in a clear uptrend vs the market. From this point of view, only a short-term catch up seems possible.



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