GIAM Macro & Market Research - Market Commentary

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Equity quant models: Cyclicals and Value still with legs but discrimination needed

- **Our proprietary equity valuation tool, based on quant models, provides indications of over- or undervaluation for European sectors and styles, further enriched by our qualitative analysis.**
- **Banks, insurance, energy, software and tech hardware look undervalued while retail, commercial & professional services, telecoms, utilities, materials and semiconductors appear overvalued.**
- **Among European styles, undervaluation is indicated for defensive, large cap and min volatility. Low leverage and cyclicals look expensive, needing more sector selectivity.**
- **Incorporating also non-quant signals coming from our qualitative analyses, we continue to recommend having a tilt to cyclicals and value. Overweight positions are financials, energy, materials, and software. Underweight media, telecoms, transportation, and household & personal products. We bring semiconductors and food retail to neutral due to stretched quant model results.**
- **Since the end of December, the rotation into Value has not materialized yet (performed in line with Growth - probably due to activity restrictions) and only the cyclicals outperformed. In our view, rotation is only postponed, and we stick to Value which – together with commodity sectors - also represents a hedge against surprise spike in bond yields.**

At the end of 2019 we introduced our proprietary equity valuation tool "Quant signals for EU equity sectors and styles" 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 analysed, 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 2nd and 3rd columns in the table show numbers from a different approach to modelling, **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 types of **quant models**.

Undervalued: banks, insurance, energy, software and tech hardware

Overvalued: retail, commercial & professional services, telecoms, utilities, materials and semiconductors

Equity Quant Models Signals

Index	ML Approach		Classic Approach		Performances	
	Current ST. DEV.	Over/Undervalued OV/UV	Current ST. DEV.	Over/Undervalued OV/UV	%TR YTD	%TR From Peak (Feb. 19)
MSCI Europe	-	-	-	-	2.9	-4.0
Banks	-1.21	UV	-1.64	UV	5.7	-24.7
Insurance	-1.43	UV	-0.56	N	0.4	-12.9
Div. Financials	0.30	N	-	-	5.9	3.3
Capital Goods	1.04	OV	0.98	N	4.2	5.0
Transportation	-1.13	UV	-	-	1.7	12.8
Comm. & Prof. Services	3.35	Strong OV	-	-	0.4	-8.0
Pharma	-1.53	UV	0.16	N	2.0	-7.6
HC Equip. & Services	1.64	OV	-	-	7.9	3.4
Energy	0.70	N	-2.46	Strong UV	3.5	-26.6
Telecom. Services	2.92	Strong OV	-	-	2.9	-14.8
Media & Entertainment	0.85	N	-	-	0.9	-12.4
Utilities	0.35	N	3.70	Strong OV	-1.8	-6.4
Materials	2.81	Strong OV	1.57	OV	4.8	16.2
Food & Staples Retailing	1.71	OV	-	-	3.6	-3.7
Food, Beverages & Tobacco	-0.64	N	-	-	-1.3	-10.7
Household & Pers. Products	-2.50	Strong UV	-	-	-4.1	-6.4
Cons. Durables and Apparel	-	-	-	-	2.2	10.5
Cons. Services	1.26	OV	-	-	6.5	-11.7
Retailing	4.04	Strong OV	-	-	8.1	18.8
Automobiles & Components	-0.04	N	-1.27	UV	5.5	18.5
Software	-3.25	Strong UV	-0.65	N	3.1	-13.5
Tech. Hardware & Equipment	-2.28	Strong UV	-	-	9.8	22.2
Semiconductors	2.69	Strong OV	-	-	16.5	49.2
Cyclicals	1.95	OV	1.83	OV	4.2	-0.1
Defensive	-2.44	Strong UV	-2.80	Strong UV	0.7	-10.2
Value	1.33	OV	1.61	OV	2.7	-11.5
Growth	-0.62	N	0.93	N	3.1	2.8
Quality	-0.13	N	1.95	OV	2.0	2.0
Momentum	-0.12	N	0.71	N	4.0	6.2
Large Cap	-0.22	N	-1.82	UV	2.7	-5.8
Large Cap Value	1.15	OV	-1.86	UV	2.5	-12.9
Small Cap	0.95	N	-0.12	N	5.3	6.1
Small Cap Growth	-	-	1.62	OV	5.4	15.6
Low Leverage	2.54	Strong OV	4.26	Strong OV	3.4	2.6
Minimum Volatility	-1.14	UV	-2.23	Strong UV	1.3	-8.5

UV = Undervaluation OV = Overvaluation
Last Update: 09/02/2021
Source: Eikon, own calculations

Qualitative analysis.

Total return (TR) breakdown (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). The latter is still in a good shape as we expect **earnings to rebound significantly in the next 2 years** thanks to GDP growth, higher capacity utilization and ROE, and policy support: for the euro area (EA) we expect 40% in 2021 and +14% in 2022, with risks on the upside. **The Q4 reporting season should see positive surprises** albeit less strong than in Q3. Chinese recovery should in particular benefit results for **material, industrials, semiconductors and luxury**.

Continuing low yields, policy support and strong earnings growth will back the extension of equity outperformance vs bonds.

Value and Cyclicals: whereas our models do not backup the story of value/cyclicals, we expect them to continue outperforming Growth and Defensive as recovery's momentum goes on and yields, especially US ones, are pressured on the upside (shorter duration assets outperforming longer duration ones, see our recent Focal Point). In particular, the macro momentum still holds well (with GDP and firms' margins increasing) and should remain underpinned thanks to the policy support and cited lingering low real rates. For Value sectors, we see relatively strong earnings momentum vs the market: financials, energy and materials. **Value continues to be laggard probably as the big Covid cases defer the strong momentum in GDP recovery**. For the same reason, the Tech sector is doing well. We deem the full rotation to be only postponed thanks to vaccines which even with some difficulty will continue to be delivered in the western countries. Furthermore, the Value style represents **a good hedge against surprise spike in bond yields, at least till positioning is not outright stretched (which is not the case yet)**.

Total Return decomposition, PE expansion and Risk Measures from 31/12/2020 to 9/2/2021

Index	%TR	%PR	%DY	%EPS	%PE	5Y Beta
MSCI Europe	**2.9**	2.8	0.1	**4.6**	**-2.8**	**1.0**
Banks	**5.7**	5.7	0.0	**5.8**	**-1.2**	**1.4**
Real Estate	**-4.2**	-4.3	0.1	**0.4**	**-5.8**	**0.8**
Utilities	**-1.8**	-2.2	0.5	**1.4**	**-4.7**	**0.8**
Auto & Components	**5.5**	5.5	0.0	**9.4**	**-4.7**	**1.3**
Capital Goods	**4.2**	3.9	0.3	**3.9**	**-1.2**	**1.2**
Consumer Durables	**2.2**	2.1	0.0	**6.2**	**-5.0**	**1.1**
Consumer SVS	**6.5**	6.5	0.0	**10.2**	**-4.4**	**1.1**
Div. Financials	**5.9**	5.9	0.0	**7.2**	**-2.4**	**1.3**
Energy	**3.5**	3.0	0.5	**13.3**	**-10.2**	**1.3**
Food, Bev. & Tobacco	**-1.3**	-1.3	0.0	**0.9**	**-3.3**	**0.7**
Food & Stales Retailing	**3.6**	3.6	0.0	**3.2**	**-0.8**	**0.6**
HC Equip. & Services	**7.9**	7.9	0.0	**-0.7**	**7.4**	**0.8**
Household & Pers. Prod.	**-4.1**	-4.1	0.0	**-0.2**	**-5.1**	**0.7**
Insurance	**0.4**	0.4	0.0	**0.8**	**-1.5**	**1.3**
Materials	**4.8**	4.8	0.0	**13.2**	**-8.5**	**1.1**
Media & Entertainment	**0.9**	0.9	0.0	**2.4**	**-2.6**	**0.9**
Pharma	**2.0**	2.0	0.0	**0.4**	**0.4**	**0.7**
Retailing	**8.1**	8.1	0.0	**6.3**	**0.6**	**0.9**
Semiconductors	**16.5**	16.5	0.0	**8.8**	**5.8**	**1.2**
Tech Software & Serv.	**0.6**	0.6	0.1	**0.9**	**-1.4**	**1.0**
Telecom Services	**2.9**	2.9	0.0	**5.3**	**-3.4**	**0.9**
Tech Hardware & Equip.	**9.8**	9.8	0.0	**1.9**	**6.6**	**1.0**
Transportation	**1.7**	1.7	0.0	**12.5**	**-10.6**	**1.0**
Comm. & Prof. Services	**0.4**	0.4	0.1	**2.4**	**-3.1**	**0.9**

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 approaches to valuation), recent **historical performance** data - proxy for **potential technical reversal** - 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 earnigns growth (3yr fwd vs cur-rent year)**	**LT earnings growth (3-5yr)**	**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 perfor-mance since 1995**	**Rank 1= most under-valued**
Market	-6%	8%	4.5	5.2	3.6%	6.8%	3.1%			21%	56%	24%	13
Auto and Components	-11%	10%	3.0	6.6	8.3%	5.0%	3.3%	-0.5	-0.2	-12%	110%	-41%	9
Banks	-29%	3%	37.7	41.2	-4.8%	-0.2%	**5.3%**	2.7	2.7	-10%	10%	2%	25
Capital Goods	28%	5%	17.9	18.8	1.2%	3.7%	2.2%	-3.4	-5.7	44%	126%	40%	22
Commercial/Professional Services	23%	6%	7.2	7.4	3.1%	4.4%	2.2%	-1.8	-1.8	43%	57%	44%	20
Consumer Durables and Apparel	34%	8%	6.7	7.7	4.3%	8.7%	1.9%	-3.4	-3.9	45%	145%	52%	19
Consumer Services	25%	16%	37.7	41.2	0.1%	30.1%	1.3%	-2.6	-2.0	77%	523%	64%	23
Diversified Financials	-6%	15%	1.3	2.6	11.4%	13.1%	2.6%	-0.1	-1.3	11%	20%	34%	4
Energy	**-44%**	**5%**	**37.7**	**41.2**	-0.5%	0.4%	**5.1%**	**4.1**	**3.4**	**-10%**	**259%**	**-4%**	24
Food and Staples Retailing	-20%	9%	2.9	3.3	4.9%	5.2%	3.7%	3.3	3.5	-10%	-2%	4%	5
Food, Beverages and Tobacco	6%	6%	9.0	9.3	1.7%	3.4%	3.1%	0.3	3.6	7%	25%	34%	14
Health Care Equipment and Services	17%	10%	3.8	4.3	6.1%	11.0%	1.3%	-1.6	-1.5	20%	55%	50%	12
Household and Pers. Products	-7%	5%	10.6	10.8	1.8%	2.7%	2.7%	0.7	2.5	11%	2%	16%	17
Insurance	-44%	11%	2.2	3.2	4.5%	6.5%	**5.6%**	1.2	2.3	-20%	-16%	-90%	3
Materials	18%	10%	2.7	3.5	8.4%	5.3%	3.7%	-1.4	-2.0	14%	52%	22%	11
Media	-22%	4%	5.0	5.9	-0.3%	3.7%	2.5%	2.3	1.8	14%	-9%	16%	15
Pharmaceuticals, Biotechnology and Life	-12%	10%	2.4	2.6	6.2%	8.6%	3.0%	0.6	1.3	15%	4%	14%	6
Real Estate	-45%	5%	13.8	15.2	1.6%	1.1%	3.8%	3.4	4.6	3%	-7%	-6%	16
Retailing	4%	23%	2.4	3.3	21.5%	21.6%	1.2%	-2.0	-2.0	90%	248%	62%	2
Semi-Conductor and Semi-C. Equipment	130%	20%	2.3	2.8	21.4%	16.6%	0.8%	-5.7	-5.2	103%	28%	-	7
Software and Services	32%	6%	11.5	11.9	1.6%	8.3%	1.1%	-2.3	-2.3	44%	-3%	-2%	21
Technology Hardware and Equipment	214%	15%	1.7	2.2	11.3%	15.5%	1.8%	0.4	-1.8	33%	-70%	31%	8
Telecommunication Services	-31%	15%	**2.1**	**2.7**	5.4%	13.8%	5.2%	3.5	3.8	-19%	-59%	-4%	1
Transportation	-13%	16%	11.4	14.5	5.1%	21.4%	2.3%	-3.8	-4.0	38%	555%	41%	18
Utilities	-3%	10%	**3.3**	**3.8**	7.7%	4.1%	4.4%	0.2	-1.5	20%	42%	32%	10
Median	**-6%**	**10%**	**4.5**	**5.9**	**0.0**	**6.5%**	**2.7%**	**0.0**	**-1.4**	**15.5%**	**27.9%**	**23%**	
Average	**9%**	**10%**	**9.6**	**10.8**	**0.1**	**8.8%**	**2.9%**	**-0.2**	**-0.2**	**22.8%**	**86.0%**	**18%**	
st. dev.	*56%*	*5%*	*11.4*	*12.3*	*0.1*	*7.5%*	*1.4%*	*2.6*	*3.0*	*32%*	*158.0%*	*34%*	
a) Discretionary+Transp. average	**0%**	**12%**	**9.9**	**11.8**	**0.1**	**13.7%**	**2%**	**-0.9**	**-1.0**	**34%**	**224%**	**28%**	
b) = (a) -food retail, retail and C.serv.	-3%	9%	**6.5**	**8.7**	**0.0**	**9.7%**	**2.5%**	**-1.3**	**-1.6**	**21.2%**	**200.3%**	**17%**	

Note: The discretionary sectors = auto, consumer durables, consumer services, media, retailing.
fwd **PEG** is 12m fwd PE divided by expected long-term EPS growth (3-5yrs). EPS = 12m fwd earnings. **Trailing PEG** = trailing PE divided by earnings growth (3yr fwd vs current year).
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 **a measure of potential technical reversal** (with a weight of 20%) which is proxied by the **relative performance** achieved in the last 6/12 months.

Valuation + potential technical reversal

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	-0.9	-6.8	-5.6	-8.0	0.8	52%	-	1
Insurance	-0.6	-4.6	-0.3	-8.9	1.4	79%	Value	2
Diversified Financials	-0.6	6.8	3.9	9.6	1.3	77%	-	3
Retailing	-0.7	17.9	11.0	24.7	1.0	46%	-	4
Pharmaceuticals, Biotechnology and Life	-0.4	-8.5	-12.8	-4.3	0.5	31%	-	5
Food and Staples Retailing	-0.4	-4.4	-10.4	1.6	0.5	25%	-	6
Utilities	-0.2	-1.1	-5.1	3.0	0.7	30%	Value	7
Health Care Equipment and Services	-0.1	1.6	-4.7	7.8	0.7	47%	-	8
Technology Hardware and Equipment	-0.2	12.9	-1.5	27.3	0.7	22%	-	9
Market	-0.1	0.0	0.0	0.0	1.0	100%	-	10
Materials	-0.2	13.8	6.8	20.7	1.1	75%	-	11
Food, Beverages and Tobacco	0.0	-8.3	-8.6	-8.0	0.5	38%	-	12
Real Estate	0.1	-11.6	-9.1	-14.1	1.0	56%	Value	13
Auto and Components	-0.2	23.7	23.6	23.8	1.5	69%	-	14
Media	0.0	-4.1	3.2	-11.5	1.1	74%	-	15
Household and Pers. Products	0.1	-10.1	-15.9	-4.3	0.5	27%	Growth	16
Semi-Conductor and Semi-C. Equipment	-0.3	45.5	32.4	58.7	1.1	39%	Growth	17
Commercial/Professional Services	0.3	-4.4	-6.0	-2.8	0.8	62%	Growth	18
Transportation	0.1	11.7	7.4	16.0	1.2	68%	-	19
Software and Services	0.4	-11.2	-15.4	-6.9	1.1	61%	Growth	20
Consumer Durables and Apparel	0.3	14.6	15.2	14.0	1.1	70%	Growth	21
Energy	0.9	-11.4	1.5	-24.3	1.4	50%	Value	22
Capital Goods	0.8	8.0	7.2	8.7	1.3	90%	-	23
Banks	1.0	-5.9	11.1	-22.8	1.7	72%	Value	24
Consumer Services	0.9	5.2	17.7	-7.3	1.2	76%	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	Comment	DECISION
Market	10						
Auto and Components	14	-1.3 / 0.0	UV / N	=	+		
Banks	24	-1.6 / -1.2	UV / UV	+	+/=		+
Capital Goods	23	1.0 / 1.0	N / OV	-	-		
Commercial/Professional Services	18	- / 3.3	- / Strong OV	-	=		
Consumer Durables and Apparel	21	- / -	- / -	+	=		
Consumer Services	25	- / 1.3	- / OV	+	--		
Diversified Financials	3	- / 0.3	- / N	+	+		+
Energy	22	-2.5 / 0.7	Strong UV / N	+	=		+
Food and Staples Retailing	6	- / 1.7	- / OV	-	+		
Food, Beverages and Tobacco	12	- / -0.6	- / N	-	-		
Health Care Equipment and Services	8	- / 1.6	- / OV	=/-	+		
Household and Pers. Products	16	- / -2.5	- / Strong UV	-	=		-
Insurance	2	-0.6 / -1.4	N / UV	=/+	=/+		+
Materials	11	1.6 / -	OV / -	=	=		+
Media	15	- / 0.8	- / N	+	-		-
Pharmaceuticals, Biotechnology and Life :	5	0.2 / -1.5	N / UV	-	=		
Real Estate	13	- / -	- / -	-	-		
Retailing	4	- / 4.0	- / Strong OV	-	=/-		
Semi-Conductor and Semi-C. Equipment	17	- / 2.7	- / Strong OV	+	=/-		
Software and Services	20	-0.7 / -3.3	N / Strong UV	-/=	=/+		++
Technology Hardware and Equipment	9	- / -2.3	- / Strong UV	-	=		
Telecommunication Services	1	0.7 / 2.9	N / Strong OV	=/+	=		--
Transportation	19	- / -1.1	- / UV	=/-	-		-
Utilities	7	3.7 / 0.4	Strong OV / N	=/+	=		

* 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:

- ✓ **banks:** earnings momentum, Value style, Value laggard, benefit from upside pressure on yields
- ✓ **diversified financials**: good score and gap to revisions,
- ✓ **energy**: undervalued, strong earnings momentum vs market,
- ✓ **insurance**: value, good score and quant signals, more defensive than banks, revisions flat,
- ✓ **materials**: have valuation slightly below average but should benefit from GDP recovery.
- ✓ **software**: good positive potential indicated by quant model and gap to revisions.

We bring semiconductors to neutral due to stretched valuations and performance. Food retail are now neutral due to stretched quant model and weak revisions.

Sectors	PE		PB		PCF		DY		Avg.	PEG adj. *
	12m f	Discount	12m f	Discount	12m f	Discount	12m f	Discount	Discount, %	
Europe	17.0	30.8	1.8	7.7	9.7	26.7	3.1	-19.3	21.1	3.3
Auto and Components	9.1	-30.0	0.9	-17.6	3.9	-4.9	3.3	-2.5	-12.5	5.4
Banks	10.2	0.8	0.6	-45.4	5.8	9.6	5.2	5.2	-10.1	-51.1
Capital Goods	22.3	52.9	3.2	42.8	14.2	49.4	2.2	-29.4	43.6	7.0
Commercial/Prof.Services	23.9	43.5	6.7	59.7	17.3	48.9	2.2	-20.3	43.1	5.6
Consumer Durables & Apparel	27.2	64.8	3.3	37.5	18.8	54.0	1.8	-23.4	44.9	4.0
Consumer Services	38.7	132.8	3.4	22.5	19.6	89.5	1.2	-62.0	76.7	3.8
Diversified Financials	15.4	37.2	1.1	-7.0	6.6	-17.9	2.5	-30.6	10.7	2.5
Energy	13.4	17.2	1.0	-31.9	4.1	-24.3	5.1	2.0	-10.3	41.2
Food and Staples Retailing	13.7	-0.6	1.4	-17.2	5.9	-12.0	3.7	10.7	-10.1	3.1
Food, Beverages and Tobacco	19.2	13.7	3.0	-8.9	15.0	16.4	3.0	-5.4	6.6	5.9
Health Care Equip.and Services	26.2	34.3	3.0	1.5	16.2	25.4	1.3	-16.9	19.5	2.9
Household and Pers. Products	22.1	15.3	4.9	24.8	17.7	14.5	2.6	9.4	11.3	8.3
Insurance	9.9	3.4	1.0	-10.5	11.6	-60.7	5.6	13.2	-20.3	2.5
Materials	15.2	17.7	2.0	23.2	9.1	26.4	3.6	13.1	13.6	3.7
Media	18.6	21.7	1.7	-29.1	11.1	27.1	2.4	-37.3	14.3	5.9
Pharmaceuticals, Biotech. and LS	16.6	14.8	3.9	16.1	14.1	18.1	2.9	-12.9	15.5	2.1
Real Estate	17.9	-1.6	0.9	-1.8	16.3	1.8	3.8	-14.9	3.4	17.1
Retailing	38.4	119.0	4.7	53.5	26.7	121.1	1.2	-66.7	90.1	2.6
Semis	38.7	48.3	8.1	183.9	30.2	143.5	0.7	-35.8	102.9	2.8
Software and Services	28.7	53.7	4.5	32.6	23.1	52.4	1.1	-36.2	43.7	3.9
Tech. Hardware and Equipment	22.3	33.6	2.9	24.9	17.4	36.6	1.8	-38.1	33.3	1.9
Telecommunication Services	13.8	-30.7	1.2	-19.3	3.2	-31.5	5.1	-7.0	-18.6	1.6
Transportation	23.5	58.2	2.6	36.6	8.4	26.3	2.2	-31.0	38.0	4.2
Utilities	17.3	31.7	1.8	14.9	6.9	17.9	4.3	-16.4	20.2	4.7

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 = expensve): 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.

<u>**In what follows** we provide insight on some selected sectors and styles.</u>

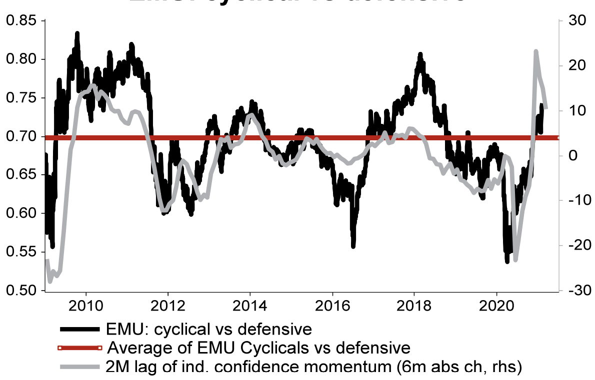
Tilt to cyclicals

The **global economy** is recovering. The ISM and the IFO indicators remain high and overall supportive for the continuation of the earnings recovery (Q4 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) they should increase this year, with **US yield curve** steepening and also in the EA going forward (the EUR 10yr30yr spread).

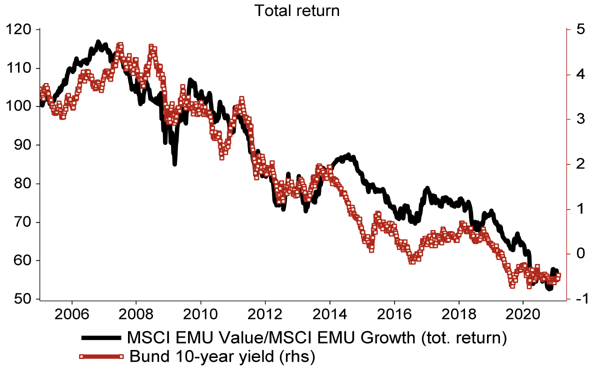
Such "recovery" phase tends to favour cyclical assets and value ones.

EMU: cyclical vs defensive

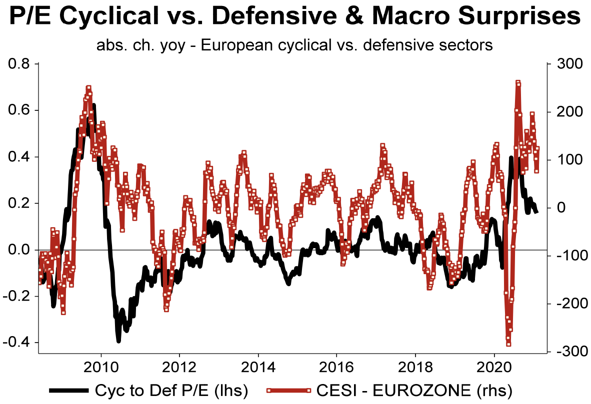


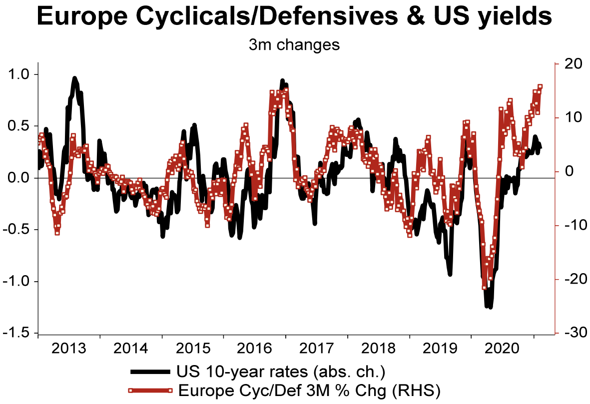
Euro area: Value vs. Growth style

Total return

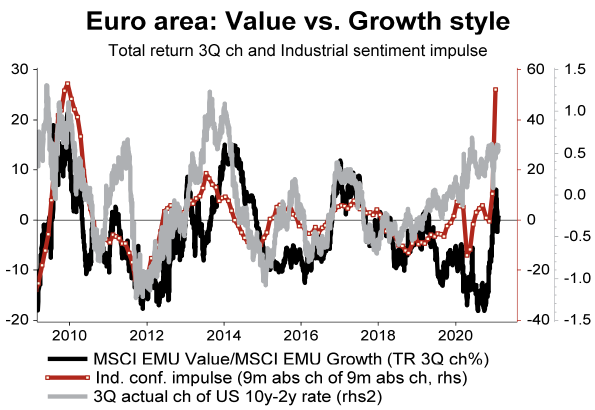


EA macro surprises are stalling but at a very high level. **US yields' momentum is supportive**:

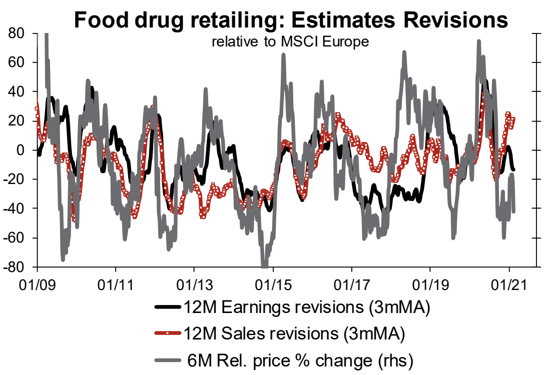


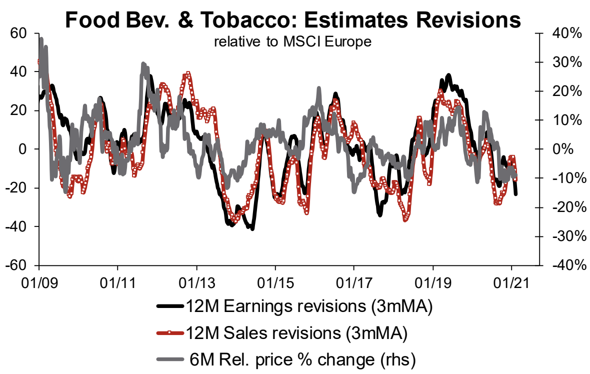


Persisting Covid uncertainty cannot support strongly the **Value** style, but firm industrial sentiment momentum and US yield curve should trigger some better performance ahead:



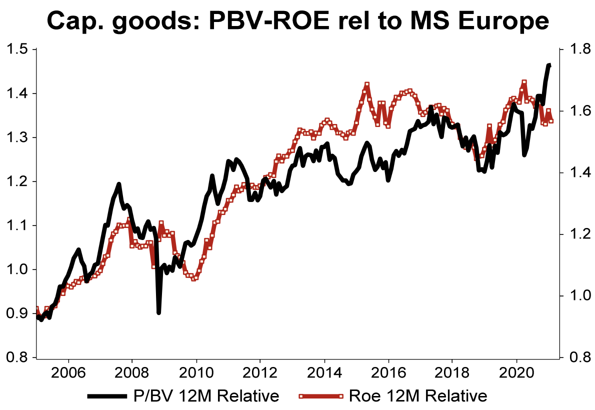
Food retail is now neutral due to stretched quant model and weak revisions. Likewise, the FBT revisions have been falling, while it is still not reflected in prices relative to the MSCI Europe.

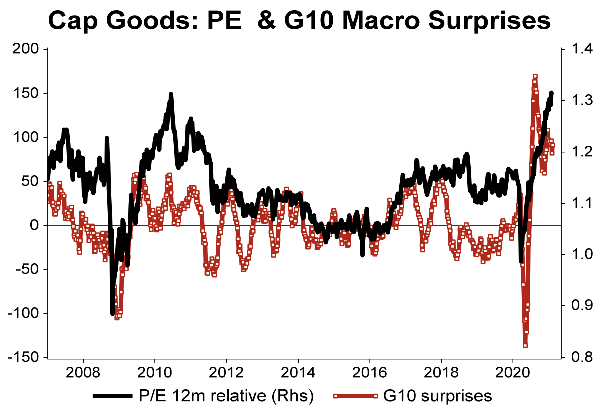


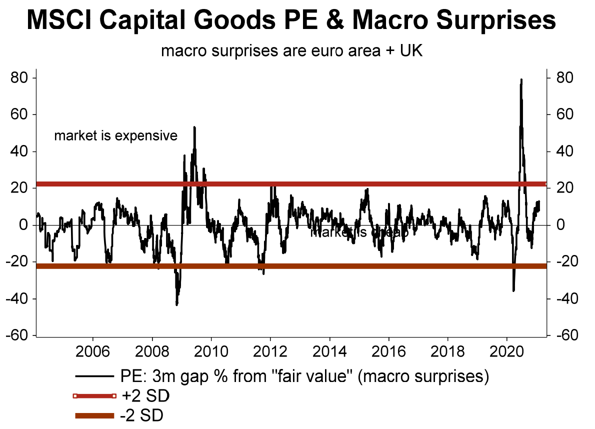


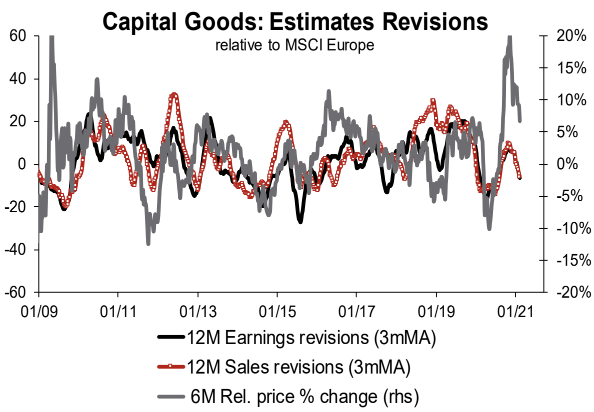
Capital goods: we recommend to stay neutral due to its low internal score and high **valuation.** It is also not attractive, when looking at measures PBV-RoE and PE vs macro surprises.

Revisions are trending down and the gap between prices and revisions is significantly negative. Having said this, we maintain them as neutral due to possible positive earnings surprises as the recovery is at an early stage.



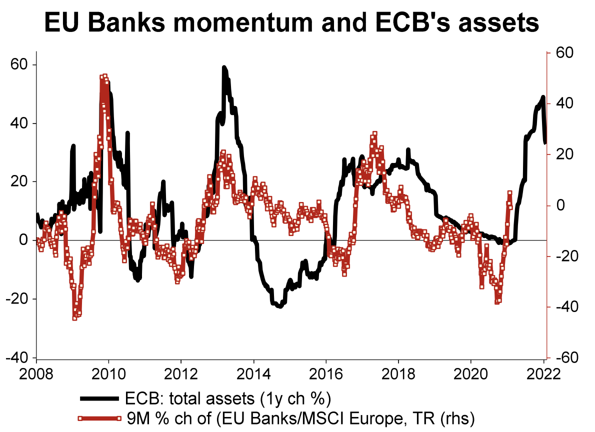


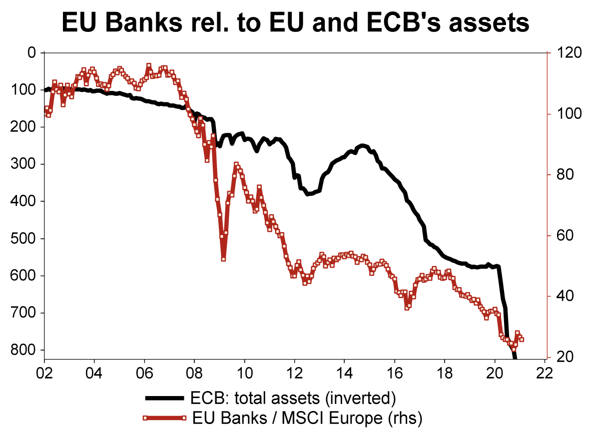




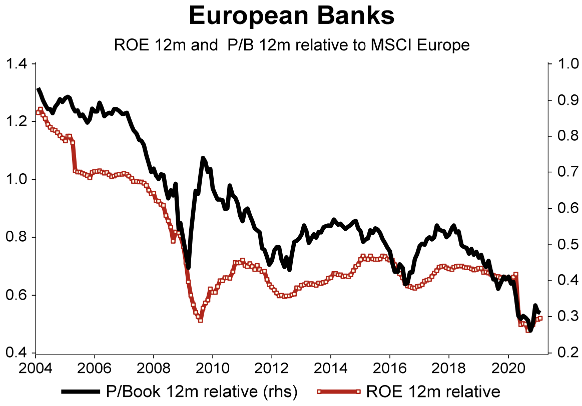
Among financials, **banks** have suffered the most, with a performance of -25% from the peak. **Low yields and activity restrictions** remain the key driver of underperformance.

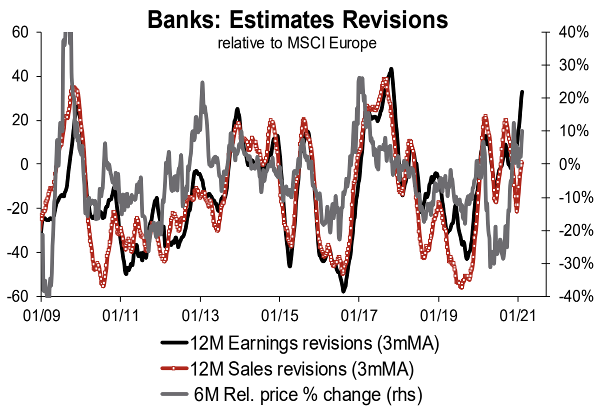
Furthermore, while short term **QE** reassures also for banks, historically a **structural increase in ECB's assets** is not a particularly welcome outcome for banks in the long run.





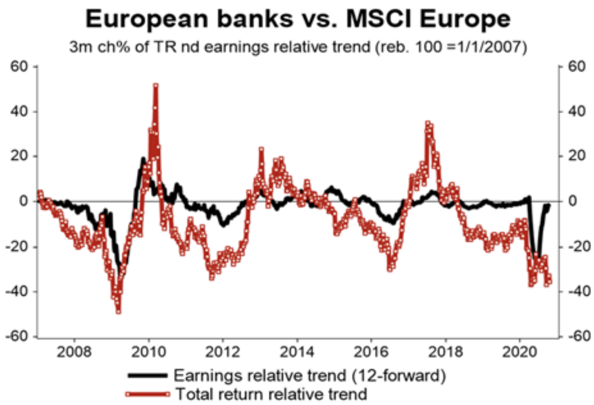
That said, for the time being, the cost of risk looks manageable and safer banks are starting to be more active on buybacks and dividends. **Bank's RoE** is increasing and earnings revisions have improved, building a positive gap to the prices relative to the MSCI Europe.

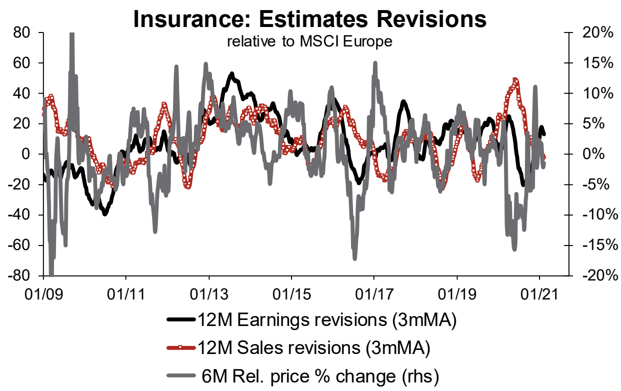


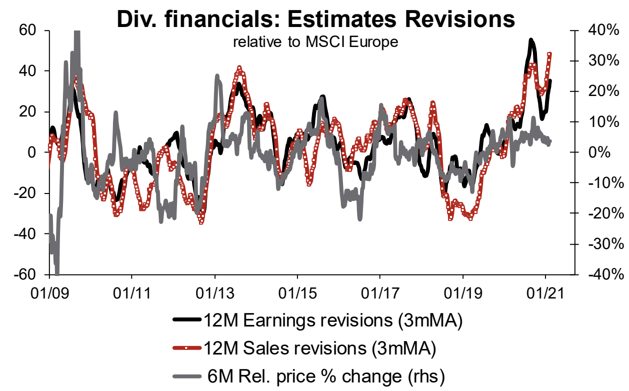


Finally, relative 12-month earnings momentum (3m ch) looks encouraging.

We remain OW on Diversified financials and Insurances, too: cyclical-value style, attractive valuation and revisions.



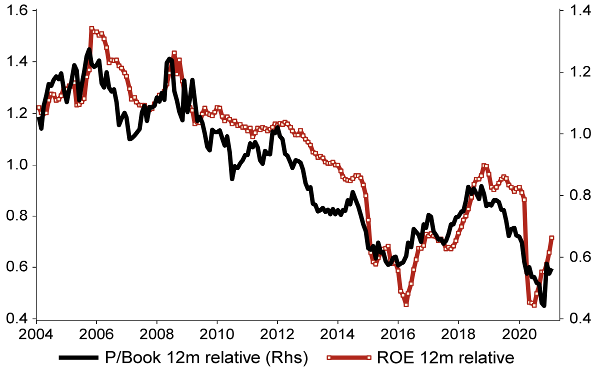




Energy sector

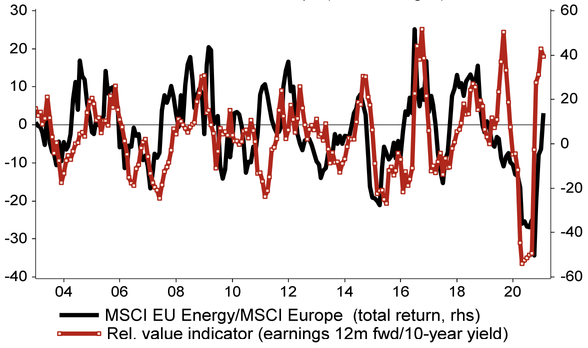
We see relatively strong earnings momentum vs the market. Rebounding **ROE** relative (with the gap to P/B) is beneficial for the energy sector. Our **Value momentum** relative to Europe is positive, too.

MSCI EU Energy: ROE relative & P/B relative



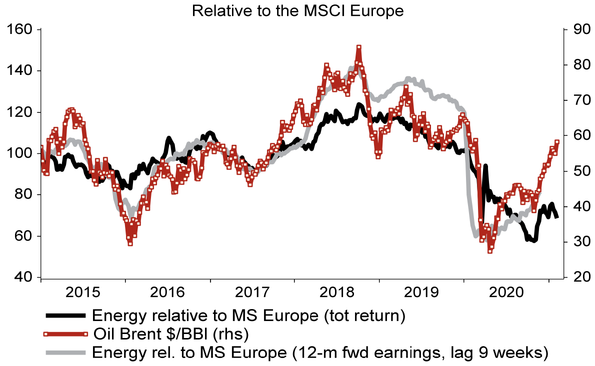
MSCI EU Energy: Relative value indicator

versus the MSCI Europe (6m % changes)



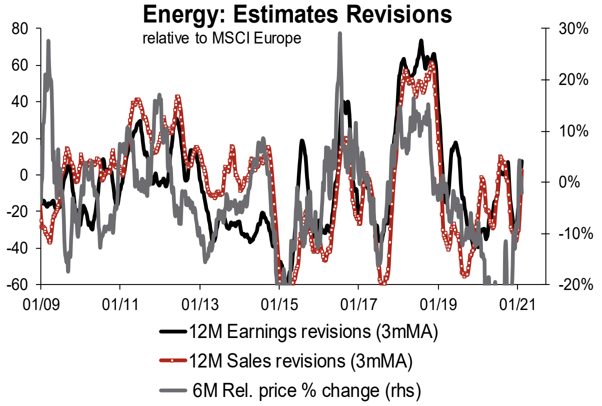
European Energy: Earnings momentum

Relative to the MSCI Europe



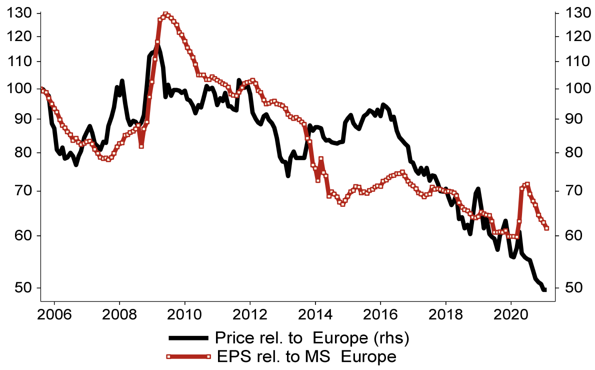
Energy: Estimates Revisions

relative to MSCI Europe



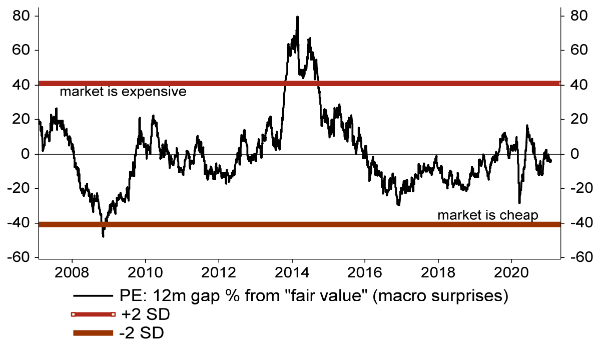
Telecoms score well on different parameters (see tables above) but earnings are still not in a clear uptrend vs the market. From this point of view, only a short-term catch up seems possible. Our ML quant model indicates a strong negative potential.

Telecoms: EPS relative to MS Europe



MSCI Telecom PE & Macro Surprises

macro surprises are euro area + UK



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