EUROZONE EQUITIES

Eurozone retail banks are the last undervalued global equity: + rated PM

However, Hansueli Jost said that the business models of UBS and Credit Suisse are in structural decline.

by FERGUS HORSFALL
Posted 5 MAY, 2021 AT 11:39

'The last truly undervalued space globally in equities is eurozone retail banks,' Citywire + rated Hansueli Jost, lead manager of the Divas Eurozone Value fund, said in the fund's monthly report.

He added: 'Having suffered 14 years of inconceivable underperformance, outright excluded as an investment category at many investment managers, never in history have they been as attractively valued, as healthy and as overcapitalised as they are today. The beauty is that no one has any meaningful exposure to this treasure.'

75/93 in
Equity - Eurozone
(Performance over 3 years)

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Jost said that this only applies to retail banks, as they keep accumulating surplus core, tier-one equity capital that they do not need and start returning this to shareholders in the form of dividends and aggressive share buybacks from October. By contrast, he has a negative outlook on Switzerland's two largest banking groups.

'When we are talking about banks, we are not referring to the UBS and Credit Suisse of this world, hybrid business models of investment banking and wealth management, both businesses in structural decline.'

He wrote that retail banks, with 50-70% of revenue at recessionary levels, are trading at depressed earnings multiples of 7x.

'Banks, having cyclical business models, historically traded at some 16-18x trough earnings and some 10x peak earnings, ie, current valuations are completely off the mark.'

Jost expects a normalisation of yield curves is on the horizon, contributed to by quantitative easing being partially disbanded and massive stimulus programmes.

'The 10-year bund yield is at this very moment in the process of breaking the all-important technical level of -20 basis points. Should that level break, it is highly likely to unleash a buying panic in eurozone retail banks. It's the buy signal for the $3bn momentum machine.'

His fund currently has a 45% exposure to financials, but Jost warned that investment managers will struggle to persuade clients to invest in banks directly.

'The problem is that client psychology does not allow investment managers to gain outright exposure to banks, neither through segregated stocks (as independent asset managers tend to do) nor through passive banking ETFs as the rest of the industry would do.

'Above all, because they have incessantly told their clients throughout the last decade how structurally challenged and therefore uninvestable eurozone banks have become. Even the most courageous have given up a long time ago since the need for explanation towards clients for holding a bank is just unbearable.'

He sees this as part of a wider problem, which is that after strong performance by growth stocks, too many investors are reluctant to buy large-cap cyclical stocks. He adds that many of these players have aggressively moved into small and mid-cap stocks, and this space is consequently crowded and overvalued.

'Looking at current equity investments/positioning of market participants, ranging from small independent asset managers to large global financial institutions, there is a striking similarity; they are all positioned alike.'

Jost believes that retail banks will begin to significantly outperform, and considering their large weighting, those who avoid them will underperform

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without them and eventually have to start investing in this asset class.

‘The earlier they move, the lesser the pain,’ he said.

He said that investing in an actively managed value fund, like his own, is the easiest way to give clients exposure to this sector despite their reluctance to invest in it.

His Divas Eurozone Value fund is ranked 75th out of 93 funds with a performance of 1.5% in the last three years but third out of 112 in the last year with performance of 82.7%.

Jost, who joined Divas after leaving GAM, previously spoke to *Citywire Switzerland* to discuss how his fund’s rivals had ‘become extinct’.

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