DIVAS EUROZONE VALUE

Monthly Report July 2022
Marketing material for professional clients

Hansueli Jost
Lead Manager
DIVAS Asset Management AG

Market environment

July offered the perfect storm for eurozone value stocks, even surpassing in severity the Covid crash month of March 2020, underperforming growth by 912 basis points. Culminating recession fears, combined with the market pricing in a eurozone type systemic crisis - based of the Italian government falling apart - wreaked havoc. Consistent with such a scenario, the Euro hit new lows against the Dollar and the Swiss Franc and Bund yields tumbled.

In June growth in Chinese automobile production (in volume terms) surged to +26.8% year-on-year from -4.8% in May, as auto supply chains continued to improve after Shanghai's reopening.

July Eurozone inflation continued to accelerate to yet another new all-time high, with the headline inflation rising to +8.9%, compared to +8.6% previously. Similarly, the all-important core rate reached a new record level, rising to +4% from +3.7% previously.

The ECB's response followed promptly and appropriately, hiking the main refinancing rate, the marginal lending facility rate and the deposit facility rate by 50 basis points each to +0.5%, +0.75% and 0% respectively.

According to new forecasts from the European Union executive arm seen by Bloomberg mid-July, eurozone GDP is likely to advance 2.6% this year and 1.4% in 2023, down from May predictions of 2.7% and 2.3% respectively. The downward revisions allow for surging prices crimping demand and the danger of winter energy shortages draining confidence.

The European Union is planning a set of urgent actions across the entire economy, including reductions to heating and cooling use and some market-based measures, to mitigate the impact of a possible natural gas supply cut-off by Russia, its biggest source of imports. Italy has been the most proactive country, reducing its dependency on Russian gas from 40% to 25%, while Germany managed to move from 45% to 35%.

In July, 5-year forward inflation expectations rose 2 basis points to 2.08%.

On the back of eurozone bond markets pricing in a eurozone type systemic crisis, comparable to the one seen in 2011, the 10-year Bund yield moved opposite to forward inflation expectations, tumbling 52 basis points to +0.81%.

Accordingly, the Swiss franc spiked another 2.8% to a new high of 0.973.

In July, Brent crude oil declined 2%, while nickel rose 4%. Iron ore declined by 4%.

The July, eurozone Composite PMI slowed to 49.9 compared to market expectations of 49.4, on weakness in Germany, the country most exposed to Russian gas curtailment. The July China Composite PMI slowed to 52.5 from 54.1 previously. The July US ISM Manufacturing PMI softened to 52.8 compared to market expectations of 52.

Performance

In July, the MSCI EMU Index jumped 7.3%. The fund's euro I-shares rose 3.86%, underperforming the MSCI EMU Index (net dividends reinvested) by 344 basis points. Year-to-date the fund declined by 1.87%, while the market tanked 12.76%, thus outperforming the benchmark by 10.89%. Since the Covid crash low of March 16, 2020, the fund is up 132.17%, outperforming the blend benchmark by 72.66%. To put this into perspective: since the crash low, the value factor has only outperformed the blend benchmark by 0.67%, i.e., had you bought a passive value ETF, you would have generated an excess return of just 0.67%, while our active approach generated 72.66%.

Performance contributors

- Renault outperformed the market by 14% on reporting a robust set of results and strongly upping its guidance by raising its full-year outlook for its consolidated group operating margin to over 5% from some 3% and its FCF to over EUR1.5 billion (19% FCF yield) from "positive".
- ArcelorMittal outperformed the market by 4%, on reporting a solid set of results, with EBITDA of USD5.2 billion, a strong FCF of USD1.7bn versus market expectations of USD1.37bn and announcing a new share buy-back program of USD1.4billion.

DIVAS EUROZONE VALUE

Monthly Report July 2022

Marketing material for professional clients

Performance detractors

- Banco Santander, Banco BPM and ABN AMRO Bank underperformed the market by 17%, 15% and 14% respectively, as the market started to price in a eurozone type systemic crisis.
- AXA and Aegon underperformed the market by 4% respectively on tanking bund yields.

Positioning

The fund switched its positions in Henkel pref. and Engie, having outperformed the market by 3% and 13% respectively into Covestro and ENI. Similarly, the fund disposed of its holding in Continental, having underperformed the market by 24%. in favour of Faurecia. Furthermore, it reduced its positions in Prosus, Randstad and Philips, having outperformed the market by 36%, 0% and 6% respectively to increase its holdings in Aegon, Mercedes-Benz and Banco BPM.

Outlook

Russia is likely to continue to constrain gas exports to maintain a strong negotiating hand when it decides it has met its objectives. According to ECB forecasts, a complete ban would have a negative impact on eurozone GDP of some 1.7%. There may be some second-round effects from the impact on corporate confidence and supply-chain disruption which could magnify that economic impact. With cyclicals appearing to price in a manufacturing new orders PMI of 43, which equates to 0% GDP growth, at least part of such a scenario seems to be priced in. As always, should a complete ban effectively be announced, it would trigger some additional short-term weakness.

According to Bloomberg Economics, conditions on the European Central Bank's targeted longer-term refinancing operations will allow banks, whether they reach their lending targets or not, to make a sizable profit from borrowing at lower rates than they can get from depositing money at the central bank over the coming years. The current 50-basis point gap between the deposit and main refinancing rates helps to reduce the subsidy to banks that don't reach their targets and increases the incentive to lend vigorously to the economy.

Gaining exposure to our strategy today provides you with access to a portfolio growing its earnings in the low teens for the next three years, valued on 7x earnings and paying you a rich and growing dividend yield of 5.1%.

NAV: EUR 129.62
ISIN I shares: LU1975716835
Valor I shares: 47229643

DIVAS EUROZONE VALUE

Monthly Report July 2022

Marketing material for professional clients

Currency Risk – Non-Base Currency Share Class: Non-based currency share classes may or may not be hedged to the base currency of the Fund. Changes in exchange rates will have an impact on the value of shares in the Fund which are not denominated in the base currency. Where hedging strategies are employed, they may not be fully effective.

Equity: Investments in equities may be subject to significant fluctuations in value.

Capital at risk: All financial investments involve an element of risk. Therefore, the value of the investment and the income thereof will vary, and the initial investment amount cannot be guaranteed.