DIVAS EUROZONE VALUE

Monthly Report February 2021

Marketing material for professional clients

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Market environment

In February, Eurozone equities gradually ground higher, driven by strong Q4 results from cyclicals and financials and in reflection of constructive news on the vaccination front. For the third quarter in a row, a record 88% of our companies beat market expectations, most of them by a wide margin. The strongest beats came once again from our retail banks with expectations being massively exceeded on core capital build by dint of much lower-than-expected loan-loss provisions.

In February, inflation came roaring back, showing its ugly or beautiful face (depending on the respective positioning of investors), driving the 10-year bund yield sharply higher. The monthly 1.2% spike in core CPI to 1.4% was somewhat distorted by a reversal of the German VAT cut (+35bps) and the introduction of the German emissions trading scheme (+16bps). Given that 50-70% of their revenues are derived from net interest income, retail banks will be the major beneficiaries of rising yield curves.

Laboratory trial results from Pfizer and BioNTech built the case that their COVID-19 vaccine will protect against the new variant of the coronavirus that emerged in the UK. Moderna's laboratory tests demonstrated that its vaccine produced antibody protection against the strain first identified in the U.K at levels comparable with older versions of the virus. Neutralising antibodies produced against the South African variant were however much lower. Despite that decreased efficacy, the company announced that its vaccine should protect against either strain. Results published by Texas Medical Branch, showed that antibodies in the blood of people who had been vaccinated were able to neutralise a version of the mutant virus that was created in the lab.

Forward inflation expectations rose 4 basis points to 1.35%. The 10-year Bund yield, which had lagged rising inflation expectations for months, finally caught up by spiking 26 basis points to a level of minus 26 basis points, as core Eurozone CPI skyrocketed from +0.2% to +1.4%. The Swiss Franc succumbed to constant positive news flow on vaccine availability and gradually declining infection rates, to sell-off 1.49% to 1.0970. Having unsuccessfully tried 10 times over the course of the last 12 months to break the technically important chart level of 1.0850, it finally succeeded. In a healed world, the Swiss Franc will eventually lose its utility as a safe haven currency. Next stop 1.20.

The commodity complex continued to rally, driven by the persistent V-shaped recovery in global manufacturing and construction. Brent crude oil spiked 18%. Nickel rose 5%, while iron ore jumped 15%, as strong demand continued to reduce global inventories. All industrial commodities, other than crude oil, are in deficit.

The February Markit Eurozone Composite PMI rose to 48.1 versus 47.8 previously. Weakness on the service side of the economy, on prevailing lock-down measures, is temporarily holding back the index from rising above the key level of 50, which indicates broad economic expansion. The manufacturing side is booming evident in the Markit Germany Manufacturing PMI jumping to 60.6 from 57.1 previously. The February US ISM Manufacturing PMI rose to 60.8 from 58.7 previously, displaying strength in the prices paid, new orders and employment sub-indices. The February Caixin China Manufacturing PMI softened to 50.9, versus 51.5 previously.

Performance

In February, the MSCI EMU Index rose 3.59%. The fund's euro I-shares jumped 11.55%, outperforming the MSCI EMU Index (net dividends reinvested) by 796 basis points.

Performance contributors

- Eramet outperformed the market by 33% on reporting strong Q4 numbers and announcing the potential disposal of its loss-making Aubert & Duval business.
- Eurozone retail banks outperformed across the board on delivering huge Q4 core capital beats on lower-than-expected loan loss provisions and rising yield curves. Société Générale (63% pre-tax beat) outperformed the market by 28%. In a similar vein, ING, BNP Paribas, Banco Santander, Banco BPM, UniCredit and ABN AMRO Bank outperformed by 20%, 19%, 15%, 13%, 9% and 6% respectively.
- Aegon outperformed the market by 12% on reporting a very strong set

of Q4 results, with underlying pre-tax profit of EUR1.03 billion versus market expectations of EUR798 million. Similarly, operational capital generation (before holding costs) amounted to EUR1 billion, compared to analyst expectations of 625 million, reflecting a lower COVID-19 related impact on US mortality.

- AXA outperformed the market by 9% on reporting a Solvency II capital ratio of 200%, compared to market expectations of 189% on very strong operational capital generation in Q4. Holding Company cash stood at a very comfortable level of EUR4.2 billion. AXA confirmed the EUR1.43 dividend.
- ENI outperformed the market by 9%, driven by a strong set of results and a sharply rising oil price.

Performance detractors

- Anheuser-Busch underperformed the market by 12%, despite the company reporting much better organic growth of +4.5% compared to market expectations of just +1.8%. However, weaker margins reflected temporarily higher commodity costs (stemming from a COVID-related shortage of cans), transactional FX headwinds, negative channel/pack mix and higher freight costs in the US.
- Despite reporting a core operating income of EUR4.6 billion, which was ahead of consensus expectations of EUR4.34 billion, Engie underperformed the market by 9% on general weakness in utilities.
- Even though Bayer announced a formal agreement with plaintiffs' class counsel on a class plan designed to manage and resolve future Roundup (glyphosate) cases, it underperformed the market by 3%. As part of the agreement, the company would be committed to pay up to $2bn (the provision for which was already made in 2020) to support the claims and programs covered by the class plan. Subject to the judge's approval, plaintiffs would have 150 days to opt out of the agreement, with the Science Panel expected to start in 2022.

Positioning

In February, the fund reduced its position in Eramet, up 68% since purchase in August 2019 and having outperformed the market by 52%. This facilitated an increase in its holding in Telecom Italia.

Outlook

At the end of February, Johnson & Johnson's one-shot vaccine was cleared for distribution by the US Center for Disease Control and Prevention, while European Drug authorities indicated they may approve the product within the next two weeks. J&J's vaccine worked across all regions. In locations where more transmissible variants have spread, the single shot was 85% effective in preventing severe disease after 28 days. Furthermore, it demonstrated complete protection against all COVID-19-related hospitalisations and deaths. Despite its somewhat lower efficacy it has major advantages compared to other approved products. Only one dose needs to be administered and the vaccine can be stored for months in a regular refrigerator. Ideal for effectively logistically roll-out vaccinations in Emerging Markets. J&J being the giant it is, a rapid large-scale roll-out is very feasible.

Even though investors are increasingly talking about reflation, no-one is positioned for it. The 10-year Bund yield is now a stone's-throw away from breaking the all-important -20 basis points level. This was the low of February 2016, when rates, for the first time since the sixties, had turned negative. A break above this level would be the trigger for the USD 3 trillion machine to aggressively buy value in general and banks in particular.

In order to generate the 40 percentage points of alpha, we have generated (without any support from the value factor) since the crash low of 16 March 2020, we have had to work very hard. With the nascent rotation, for the first time since the last occurrence in 2009, we are starting to get a tailwind from the value factor. If history is any guide, delivering the next 50%+ alpha should be a reasonably easy undertaking.

This rotation back into value will not only last for 6-12 months. Even the most bullish voices in the market credit this rotation a life of barely 2-3 months. To unwind only a fraction of that USD3 trillion momentum (proxy for growth, yield and low volatility sensitivity) positioning built over the course of the past 12 years, will take at least 2-3 years. This will wreak havoc across all product categories (in particular on absolute return products). The only factor that is negatively correlated to the momentum factor is value.

NAV: EUR 107.51
ISIN I shares: LU1975716835
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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.