DIVAS EUROZONE VALUE

Monthly Report March 2021

Marketing material for professional clients

Hansueli Jost
Lead Manager
DIVAS Asset Management AG

Market environment

Despite disappointing news on the vaccination front with the messy roll-out of the European vaccination program, and incremental lock-down measures announced across the continent, Eurozone equities gradually ground higher during March, driven by continued major positive surprises from leading indicators and record inflows into global equity funds.

With the reflation trade starting to gain traction, 5-year forward inflation expectations jumped to 1.54% compared to 1.35% in February, experiencing their fastest monthly hike.

US vaccine data published by AstraZeneca in late March showed that EU efficacy worries were misplaced. The shot developed in conjunction with the University of Oxford was 76% effective in preventing COVID-19 and an independent monitoring board found no safety concerns. All those immunized were protected from severe disease and death in a study of more than 30,000 volunteers. However, news on certain blood clotting occurrences did not help confidence in the firm's vaccine.

Despite the massive hike in 5-year forward inflation expectations, the 10-year Bund yield experienced a roller-coaster ride, initially rising to -26 basis points, before selling off to -39 basis points on vaccination and incremental lock-down concerns, to finally close down 3 basis points at -29 basis points. Continued strong positive surprises from leading indicators caused the Swiss Franc to weaken 0.9% to 1.1070.

Following the massive rally over the last 12 months, the commodity complex took a breather. Brent crude oil declined 2%, nickel dropped 14% and iron ore depreciated by 7%.

Despite incremental lock-down measures, the March Markit Eurozone Composite PMI spiked to 52.5 versus 48.8 previously. The manufacturing side is booming, evident in the Markit Germany Manufacturing PMI sky-rocketing to a new all-time high of 66.6 from 60.7 previously. The March US ISM Manufacturing PMI spiked to 64.7 from 60.8 previously, while the March China Composite PMI jumped to 55.3 versus its preceding reading of 51.6.

Performance

In March, the MSCI EMU Index rose 6.59%. The fund's euro I-shares jumped 9.27%, outperforming the MSCI EMU Index (net dividends reinvested) by 268 basis points.

Performance contributors

- Volkswagen pref. outperformed the market by 29% on announcing an aggressive and credible capex plan for their EV transition. Based on this strategy the company would by next year already be selling more EV vehicles than Tesla. If the market were to apply multiples similar to those of Tesla and Nio Inc. to Volkswagen's battery-electric vehicle business, it would be worth some EUR195 billion. The current market cap for Volkswagen's entire business stands at EUR140 billion, i.e., the 10 million combustion engine car production effectively comes for free.
- ArcelorMittal outperformed the market by 19%, as analysts tried to catch up with reality, by aggressively upping their earnings estimates.
- HeidelbergCement outperformed the market by 10% on announcing final Q4 results that triggered positive earnings revisions.
- Telecom Italia outperformed the market by 10%, as they managed to agree with unions on 1'300 additional job cuts for 2021 and enjoyed analyst recommendation upgrades.

Performance detractors

- Notwithstanding continued positive earnings revisions, Covestro underperformed the market by 11%, as the stock took a breather, following its stunning outperformance in the preceding 7 months.
- Royal Dutch Shell underperformed the market by 7%. This constituted profit-taking following its 50% outperformance over the last 5 months.
- Aegon underperformed the market by 4%, following the 70% outperformance seen since last September.

Positioning

In March, the fund switched TechnipFMC and AB InBev into Repsol and Sanofi. Furthermore, it reduced its position in Volkswagen pref., up 64% since purchase in May 2019 and having outperformed the market by 45%.

Outlook

The European Central Bank might be able to start discussions on how to unwind its unprecedented monetary stimulus later this year if countries make sufficient progress on vaccinations, according to Governing Council member Klaas Knot. “We wanted to prevent yield increases from being far ahead of the improvement in economic growth and inflation that we expect in the second part of this year,” Knot said. “That’s why we thought it wise to do a bit of frontloading, and to provide some counter-pressure in the coming months. But when the recovery really manifests itself as we expect, this reason will be obsolete”. This combined with the fact that the Governing Council did not consider it necessary to expand the overall size of their EUR1.85 trillion emergency bond-buying program seems to be a clear indication that bond yields have ample room to rise.

5-year forward inflation expectations finally caught up to reflation reality and spiked to 1.54%. There are still two asset categories that have not yet adjusted to the new paradigm and are miles off fair value: 1) eurozone banks and 2) the 10-year Bund yield. To put this into perspective, the last time 5-year forward inflation expectations traded at current levels back in 2015, the 10-year bund yield traded at +75 basis points compared to today’s -29 basis points. A very long way to go! As experienced in April 2015 such normalisation moves can unfold very rapidly. Back then, the 10-year Bund yield, within a matter of just 3 weeks, sky-rocketed from -10 basis points to +99 basis points. Once we break above the all-important level of -20 basis points, which was the low back in February 2016 (when rates for the first time since the 1960s moved into negative territory), the USD3 trillion machine will start to aggressively buy eurozone banks.

21 years ago, the tech bubble (TMT) burst. Since hardly anyone seems to properly remember the sequence of events, and conventional wisdom dictates that value would follow in the wake of a technology bust, it is worth revisiting the details. In the TMT crash back in 2000 that lasted 7 ½ months, the index heavyweight Deutsche Telecom crashed 63% and the mid-small caps, most market players were exposed to privately and seem to painfully remember, lost 90-100%. The Value space on the other hand ratcheted up 8.8% in absolute terms and the value factor outperformed the blend benchmark by 22 percentage points over the same period. For us, having back in 2009 generated 115% alpha out of a 11.5% value factor tailwind, a comparable scenario seems to be quite feasible.

In our December 2020 monthly, we indicated that value stocks would ultimately start to display momentum sensitivities. Since the machine’s definition of momentum has neither to do with fundamentals nor sectors, but is simply a collection of the 100 best performing stocks over the last 100 days, certain cyclical companies have mutated to become momentum stocks. ArcelorMittal, up fourfold over the last 12 months, is probably the most prominent of this newly emerging group.

Since the value factor is the only factor negatively correlated to the momentum factor, only the value space offers a hedge against rising interest rates and a diversification for momentum portfolios.

NAV: EUR 117.48
ISIN I shares: LU1975716835
Valor I shares: 47229643

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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.