DIVAS EUROZONE VALUE

Monthly Report August 2021

Marketing material for professional clients

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Market environment

In the first half of August, Eurozone equities gradually rose 4% before sharply selling off on renewed Delta virus worries, to finally close up some 2.5%.

Data from Israel showed a significant divergence in severe case growth between vaccinated and unvaccinated people. Severe cases per 100'000 patients were over five times higher for the latter. Definitely a motivation for the unvaccinated to get the job done.

Johnson & Johnson claimed a booster of its COVID vaccine provided a rapid and strong increase in antibodies, supporting use of a second shot among people who previously received its single-dose immunisation. A second dose of the J&J vaccine led to a ninefold increase in COVID-fighting antibodies compared with the levels among participants 28 days after getting their first shot.

Early data on the impact of the Pfizer booster suggests that vaccine efficacy had increased to 86% only 7 days after the injection. This study was based on a sample of some 150'000 triple-jabbed people over 60.

At the end of August, the EU announced the achievement of a major milestone with 70% of its adult population fully vaccinated against COVID.

The consistent positive news flow on data related to the efficacy of the boosters to beat the Delta virus seems to be a strong indication that there is no need for incremental lock-down measures.

Germany is seeing its biggest surge in imported inflation since the early 1980s, putting a price tag on the difficulties businesses are facing to secure inputs amid a worsening supply squeeze. In July, goods arriving in the country from abroad were 15% more expensive than a year ago, as data published in late August showed. The cost of basic goods increased about 19% and energy jumped nearly 90%. Manufacturers in particular are increasingly passing on higher costs to customers, which will help push inflation higher.

Bundesbank President Jens Weidmann said European Central Bank officials shouldn't disregard the risk that inflation could accelerate faster than currently anticipated, adding his voice to an intensifying debate ahead of the institution's policy meeting next week. He cited supply-chain bottlenecks which are raising costs for manufacturers and the large amount of household savings as possible sources of higher prices. If these factors lead to higher inflation expectations and an increase in wages, inflation could accelerate on a more durable basis. Both the Austrian policy maker Robert Holzmann and his Dutch colleague Klaas Knot argued that bond purchases should be reduced given how far advanced the euro area's recovery is.

Meanwhile FED Chairman Jerome Powell stated at the Jackson Hole symposium in late August that "clear progress" has been made in the Labour market and highlighted the desire of the FOMC to engineer a low-volume tapering.

In August, 5-year forward inflation expectations rose 2 basis points to 1.69%. Actual inflation spiked to 3% (versus 2.2% previously), in line with peak inflation seen at the very top of the 2011 growth cycle, when the 10-year Bund yield traded at +2%!

The 10-year Bund yield rose 8 basis points to -39 basis points, while the Swiss Franc depreciated 0.56% to 1.081.

Brent crude oil traded down 4% while Nickel was unchanged. Meanwhile iron ore dropped 12%, as the market feared China might restrict steel output to somewhat cool off overheating commodity markets.

The August Markit Eurozone Composite PMI softened to 59.5, following the all-time high of 60.2 seen in July. The August China Manufacturing PMI moderated to 50.1 versus its preceding reading of 50.4. Conversely, the August US ISM Manufacturing PMI rose to 59.9 from 59.5 previously.

Performance

In August, the MSCI EMU Index rose 2.46%. The fund's euro I-shares appreciated 4.58%, outperforming the MSCI EMU Index (net dividends reinvested) by 212 basis points.

Year-to-date the fund is up 28.11%, outperforming the benchmark by 846 basis points. This despite the fact that this year the value factor has underperformed the blend benchmark by 205 basis points. Accordingly, we managed to generate an asymmetric Alpha of 1051 basis points.

Performance contributors

- ABN AMRO Bank outperformed the market by 18% on reporting blow-out numbers, beating analyst expectations by 100%, on much better loan loss provisions (LLPs) higher fees and great cost control. This drove its CET1 ratio up a whopping 90 basis points to 18.3%. This allows the company to pay a 2021 dividend of 68c (6.4% dividend yield). The market expected no dividend payment for 2021!
- Aegon outperformed the market by 17%, on reporting a very strong set of numbers with a group Solvency ratio of 208% versus market expectations of 198%. This enabled the company to raise its interim dividend by 33%.
- Banco BPM outperformed the market by 8%, on reporting a net attributable profit 75% above market expectations on higher net interest income (NII), fees and trading income. The company's CET1 ratio rose 20 basis points to 12.9% versus market expectations of 12.6%.
- AXA outperformed the market by 6%, on reporting a set of numbers, comfortably beating analyst expectations. Its Solvency II ratio rose to 212% versus market expectations of 210%.
- Société Générale outperformed the market by 5%, on reporting an attributable net profit of 1.44bn, beating market expectations by 70%. The bank achieved a pronounced revenue beat across all divisions and reported much lower than expected LLPs.

Performance detractors

- Bayer underperformed the market by 8% after reporting revenues ahead of expectations but with Crop business EBITDA margins somewhat below market expectations.
- ArcelorMittal underperformed the market by 6% on lower iron ore prices. With the share price up fivefold since mid-March 2020, some of the underperformance can surely be attributed to profit taking.
- Despite reporting a strong set of results and upping its LFL EBIT growth guidance from >10% to +18%, Holcim underperformed the market by 4%, on market worries about a potential negative impact on EM growth from the Delta virus.

Positioning

In August, the fund reduced its position in HeidelbergCement and Aegon, up 31% and 18% respectively, to increase its holdings in Repsol and Bayer.

Outlook

A third COVID vaccination shot appeared to significantly curb a Delta-led surge in cases and prevented severe illness, according to a study published in Israel at the end of August, the first country to offer boosters to seniors. Twelve days after a booster dose of vaccine made by Pfizer and BioNTech, the risk of a confirmed infection decreased 11.4-fold relative to people given only two jabs. A third dose was associated with at least a 10-fold reduction in the risk of falling seriously ill.

Following 14 years of balance sheet tightening, the vast majority of our companies in the eurozone are now completely deleveraged or have even net cash positions. The inconceivable buy-back activity we had seen over the last 12 years in the US (on average some USD 500 billion per annum) is only just starting in Europe. This buy-back dynamic in Europe is going to see over EUR85 billion of buybacks authorised for the first time in a decade. Come October 1, eurozone banks will join the party.

Q2 results of our companies displayed the highest ever beat in my 35 years of experience with 84% of our companies beating market expectations, most of them considerably (+20-100%). Even though the fund is up 28% year-to-date our portfolio is, thanks to the some +65% positive earnings revisions, today 20% cheaper than at the end of 2020 and pays a dividend yield of 3.8% versus 2.1%. Come October 1, 2020, with banks allowed to pay incremental final dividends, this yield is likely to rise to some 4.5%.

Comparing this to the negative 0.39% reaped by investing in the 10-year Bund, makes the fund a quite compelling investment. With August eurozone inflation at 3%, in line with peak inflation seen at the very top of the 2011 growth cycle, when the 10-year Bund yield, absent Central Bank intervention (QE) that prevailed since mid-2015, traded at +2%, any tapering is likely to start normalising global yield curves. A very long way to go and the ultimate booster for the value factor!

NAV: EUR 124.16
ISIN I shares: LU1975716835
Valor I shares: 47229643

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