SPONSORED COMMENTARY

Exploiting recovery opportunities in Southern Europe

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THE PERIPHERAL EUROPE INVESTMENT CASE

At Generali Investments Europe S.p.A. SGR we believe that peripheral Europe will lead the upturn of the European economies. Southern European markets are having so far a remarkable beginning of the year - especially true for the Italian and Portuguese indices. In fact, the positive effects of the falling oil prices and the announcement of the ECB were, and will continue to be in our opinion, the main drivers of the Eurozone recovery.

Southern Europe was harshly affected by the financial crisis three years ago with Greece, Italy, Spain and Portugal being under financial markets' scrutiny over their sovereign debts. However the economic recovery has already started and we believe that the very positive U-turn of the European peripheral economies will continue, backed by both macroeconomic events (such as QE and economic reforms) and stronger company fundamentals following of substantial years of cost-cutting.

Generali Investments Europe's (GIE) "European Recovery Equity" strategy reflects the above investment **philosophy** and, within that **favourable macroeconomic backdrop**, is purely **based on a bottom-up, stock-picking process** exploiting investment opportunities in Southern European markets. Our open-ended Luxembourg based SICAV invests in equity securities issued by companies listed on EMU regulated markets that will benefit from Southern European recovery and structural reforms driven by supranational organizations (IMF, ECB, EU...) with a main focus on **Spain, Italy, Portugal and Greece**.

Even if there is still a lot of uncertainties around Greek public debt and the current political situation leading to increased volatility, markets are responding well to the latest Greek news. Therefore, we believe that the country holds very appealing investment opportunities.

We are confident that the Spanish economy and financial markets will continue their recovery and will outperform the Eurozone financial markets backed by still favourable valuations and strong fundamentals, despite the far-left party Podemos. We consider the Podemos effect as a minor short term phenomenon which will not have a long term impact on the country's economy, while reforms implemented since 2012 are beginning to bear fruit in Spain.

Similarly to Spain, fundamental reforms implemented in Portugal have helped the country's economy to get back on to the right track. Therefore, some very attractive investment opportunities can be found within the country, backed by political and economic stability.

The Italian market will also be sustained by the reforms and the restructuring of the economy; this is especially true for the banking sector but also for the labour market as a whole.

Our view on the Eurozone equity markets is overall positive, and we believe that, over the next quarters South Europe will also benefit from the following main factors:

- Weaker Euro should help exporters and many European companies have already regained some competitiveness against international peers;
- Weaker oil price is helping profitability of companies;
- Quantitative Easing will allow capital injection to South Europe, and sustains nascent growth;
- Stronger rebounding of the GDP compared to the rest of Europe.

The above factors provide a good rationale for the Southern European Recovery Investment Case. Finally, being one of the largest investors in Southern Europe, GIE has an extensive experience in these markets.

GREECE - EXPLOITING THE UNCERTAINTIES

Greece is undoubtedly a high risk/high return investment with many names trading on cheap valuations compared to their earnings. In our opinion, the high volatility of the Athens stock exchange is due to uncertainties related to the new, inexperienced and radical government. We believe however that Syriza needs both financial help from Europe and economic growth to end its program.

Economic growth will require capital investments via foreign capital injections into the economy. We strongly believe that this will not happen until investors are reassured about the country's political stability and the sustainability of the public sector debt.

As such, we believe that tensions within the rest of European countries over the Greek debt should not persist as Greece will have no other choice but to pay back its debt over several decades (possibly on a longer timeframe than the current agenda, following a potential restructuring of the public sector debt). On the top of that, 75% of the Greek population is in favour in staying in the Eurozone, conscious of the fact that Europe is investing in their debt. In conclusion, discussions about a potential "Grexit" remain very premature.

Most investors are usually focusing on Greece's massive (175%) Government debt to GDP ratio, while GIE prefers to look at the real yearly cash impact of the Greek debt which we consider to be a more affordable level (i.e. Net Greece interest expenditure is already sustainable: 2.6% of GDP (source: Bruegel Institute), less than Italy or Spain, just above France and Germany).

The average duration of Greek debt is above 15 years vs. less than 10 years for all other European economies, and duration could very much be extended further, removing uncertainties on its sustainability.

Lastly, the newly created government is maneuvering whilst realizing that their political and economic program is unsustainable.

In line with the above views, we have decided to keep our exposure below 15% to both capture mid to long term investment opportunities but also avoid excessive volatility.

OUR INVESTMENT PROCESS REFLECTS OUR FUNDAMENTAL BOTTOM-UP STOCK PICKING CAPABILITY

The GIS European Recovery Equity fund follows a pure stock-picking approach via a very structured investment process. We define our investment philosophy as being based on strategic and detailed analysis, together with active and rigorous buy & sell discipline.

Investment decisions are driven by **strong** long-term **convictions** and detailed company selection based on key inputs from in-house macroeconomic and equity research teams. The result is a highly concentrated, high conviction, mid to long term investment portfolio with around 35-45 core stocks, with a low turnover.

The strategy is **unconstrained** in terms of market capitalization of securities, but due to South European markets' structure, it has a clear mid-cap bias.

The fund manager aims to identify and exploit high return potential investment opportunities over 3-5 years offered by Southern European stocks with the following characteristics:

- strong assets base
- strong management track record
- high operational leverage
- clear strategy (pricing power; market positioning, barriers at entry/exit…)
- growth potential

Stock picking is therefore our main alpha driver.

COMPANY PROFILE

Generali Investments Europe S.p.A SGR (GIE) is the main asset management arm of Generali Group, one of the largest and most respected insurance companies in the world with over 180 years of providing a solid, stable and highly professional service. With AUM of €372.2 billion GIE is one of the leading European asset managers recognised for delivering consistent results through proven risk-based investment solutions. Active internationally with a strong European presence, GIE operates out of 3 main hubs: Germany, Italy & France, with a team of 390 customer-focused experts with deep knowledge of local markets and asset classes. (Data as at 31.12.2014)