Portfolio Manager Interview

HSBC GIF Euroland Equity

European equity markets: bounce or real recovery?

For professional investors as defined by MIFID

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Key points:

- Pfizer's vaccine announcement triggered a spectacular turnaround in trends established since the Covid crisis first broke.
- Europe's equity markets, which had already put on nearly 7% in the first week of November, nearly repeated the feat, rising 5.4% last week.
- With vaccines on the horizon, the prospect of a synchronised global economic recovery in 2021 looks much more credible. Investors may therefore continue reweighting towards marked-down companies over coming months.
- We think European equity markets still have upside in the next twelve months.
- Cyclicals are growing earnings fastest, often at twice or three times the pace of quality and growth stocks.
- Since the start of November 2020, the performance of HSBC GIF Euroland Equity has been boosted by Pfizer's announcement and a resurgence in risk appetite.

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Source : HSBC Global Asset Management (France), as of 13 November 2020.

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European equity markets mounted a big rally at the start of the week. What happened?

Europe's equity markets were already heading upward since the start of November (MSCI Europe dividends reinvested up 6.9% in euros between 30 October and 6 November) on an unexpectedly strong Q3 earnings season and the likely shape of the next US administration, despite lingering doubts.

Then, in the week after 6 November 2020 markets near doubled their gains, adding 5.4%. On Monday, Pfizer and BioNTech announced their Covid-19 vaccine had achieved excellent results in the first phase of pre-marketing analysis and could be on the market before New Year.

The news revived credible hopes of a synchronised recovery by the world's big economies in 2021, hopes that had taken a bashing from the second wave over recent weeks. This triggered a spectacular turnaround in trends established since the Covid crisis first broke. In three days, the oil price rose by 10% a barrel, US long yields widened more than 15 bp and out-of-favour sectors rallied more than 10% (banks and oil +18%, insurance and leisure +12%) leaving 2020's star performers trailing in their wake (online retail, pharma, food retail, semis). Some stocks went through the roof: in commercial property (Klépierre +43.5%), in oil (Repsol +33%), in banking (Banco Santander +31.5%) and in aerospace (Airbus +24%).

We have seen bounces by out-of-favour stocks in the past. Why is today's situation any different? Can the rebound last?

With vaccines on the horizon, the prospect of a synchronised global economic recovery in 2021 looks much more credible. Investors may therefore continue reweighting towards marked-down companies over coming months.

Investors' positioning, both between and within sectors, shows expectations are deeply polarised, giving rise to historically high differences in valuation. Global investors are currently uninterested in Europe, which they see as a complicated low-growth market left behind by the digital transition. They have also neglected sectors undergoing structural transition (finance, energy, telephony, media, etc.) concentrating instead on those rare stocks that can offer both growth and visibility. Such stocks now have little appeal. P/E multiples on Europe's 10% most expensive stocks are close to 40x, near double their 20-year average of 23x and four times that of the cheapest 10%.

The scale and strength of the bounce we have seen reflects this highly consensual positioning favouring growth and quality plays. The rebalancing of recent days has probably only mildly corrected this situation. However, investors can expect more reassuring newsflow on the health and economic fronts. Close to a dozen vaccines and an estimated 11 billion doses will become available to health systems over the next 12 months: enough to vaccinate three-quarters of the world's human beings. Unprecedented stimulus packages from the world's monetary and fiscal authorities will finally bear fruit.

Expectations of a sharp bounceback in earnings next year (consensus reckons around +38%), after the 33% squeeze in 2020, look a lot more credible if the health situation gets back to near-normal. Cyclicals are growing earnings fastest, often at two or three times the rate of quality and growth companies. Why pay four times the P/E multiple for a company that might only offer weaker earnings growth for several quarters to come?

True, cheap ("value") stocks were underperforming even before the Covid crisis and its economic consequences. They also have to deal with structural factors such as unusually low interest rates and the impact of digital transition on Western economic and environmental models. That said, we think such effects could be outweighed, at least in the next few months, by the return of economic and earnings growth. Central bankers seem reluctant to move policy rates much further. Likewise, we are seeing strong reactions from companies threatened by the transformation of their economic model (consolidation, restructuring, repositioning). Public policy and regulators too are responding to concerns about the natural monopolies that are bidding to replace them.

Source: HSBC Global Asset Management, as of 13 November 2020.

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Europe's equity markets are back to just 5% below their year-start level. Can they go further and what sectors will drive such a rise?

The performance of stock markets in 2020 worried investors who saw too great a disconnect with the realities of the economy. This paradox was most evident in the USA where the leading index put on nearly 13% in dollar terms (S&P 500 performance, net dividends reinvested at 13 November) compared to a near 6% drop in European markets in euros. But the latter figure masks huge variations, depending on whether, for instance, you are in the oil sector (down 40% this year) or semi-conductors (up 26%).

For us, Europe's equity markets still have plenty of upside in the next twelve months. Short term, markets will have to digest the 15% rally since end-October. Looking further ahead, the feeble yields on offer in other asset classes, likely pick-up in the economy and profits, and valuation multiples in line with historical averages suggest the market could generate around ten percentage points of upside by next summer

Driving the rally will be first and foremost the sectors that stand to gain most from the looming recovery, basically cyclicals. We may also see nice gains by some heavily discounted stocks. The relaxation of economic, health and political risk premiums coupled with the prospect of fast-growing earnings in 2021 in some neglected sectors (finance, energy, leisure, media, telephony) should be enough to sustain the process of normalisation we have seen over recent days. Also, we need to keep some exposure to stocks or sectors in the throes of restructuring/consolidation processes, which are ultimately intended to improve their structural profitability. With the market awash in cash and economic prospects looking up, such deals have every chance of success. Finally, while keeping a close eye on value, we continue to favour stocks that are seriously committed to improving the sustainability of their economic model.

How has HSBC GIF Euroland Equity done since the Pfizer announcement?

The fund's approach focuses on discounted stocks. This natural value bias cost it dear in 2020. By the end of October the value theme was underperforming the wider market by nearly 8%.

Since the start of November, though, performances have been boosted by Pfizer's announcement and a resurgence in risk appetite. At close of trading on 13 November 2020, the fund had gained 17.9% in November compared to around 14.5% for the market. The biggest contributors were our overweights to banking (+29.6% in November), insurance (+22.8%), oil (+25.5%) and capital equipment (+18.1%) and low exposure to retail, cosmetics, luxury and semi-conductors. Stock picking accounted for two-thirds of the outperformance and contributed positively in all sectors except auto (Michelin), consumer durables (Seb) and transportation (Deutsche Post). Note, though, that despite lagging in November all three of these stocks are beating the market YTD.

Getting specific, our positions in Axa (performance of +33% in November), Elis (+35%), Thales (+34%), Crédit Agricole (+27%), Santander (+39%), ING (+27%), Erste (+27%), Repsol (+36%), Allianz (+26%), Societe Generale (+34%) and Unicredit (+27%) were the month's top contributors to relative performance.

Source: HSBC Global Asset Management, as of 13 November 2020.

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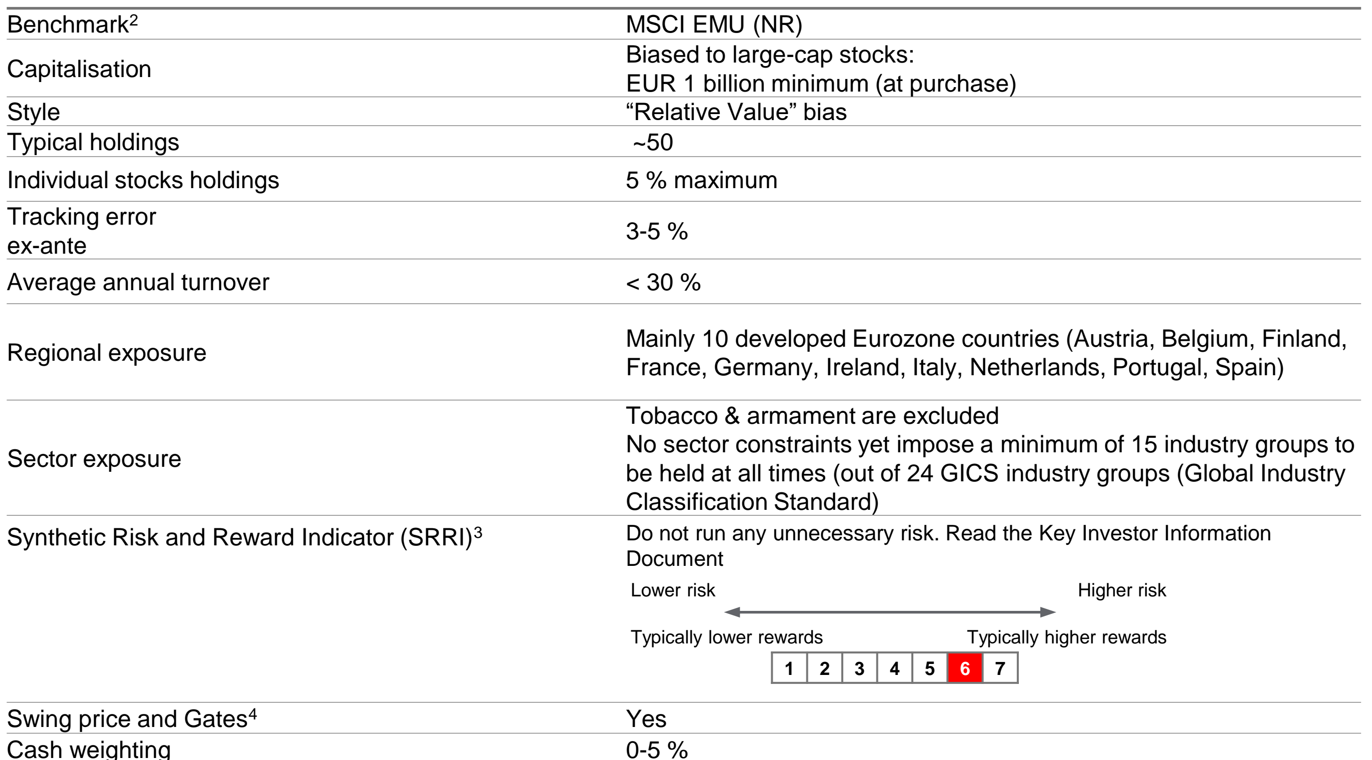
Representative overview of the investment process, which may differ by product, client mandate or market conditions.

Fund details[1]



Benchmark[2]	MSCI EMU (NR)
Capitalisation	Biased to large-cap stocks: EUR 1 billion minimum (at purchase)
Style	"Relative Value" bias
Typical holdings	~50
Individual stocks holdings	5 % maximum
Tracking error ex-ante	3-5 %
Average annual turnover	< 30 %
Regional exposure	Mainly 10 developed Eurozone countries (Austria, Belgium, Finland, France, Germany, Ireland, Italy, Netherlands, Portugal, Spain)
Sector exposure	Tobacco & armament are excluded No sector constraints yet impose a minimum of 15 industry groups to be held at all times (out of 24 GICS industry groups (Global Industry Classification Standard)
Synthetic Risk and Reward Indicator (SRRI)[3]	Do not run any unnecessary risk. Read the Key Investor Information Document Lower risk — Higher risk Typically lower rewards — Typically higher rewards 1 2 3 4 5 **6** 7
Swing price and Gates[4]	Yes
Cash weighting	0-5 %

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2. Index given for comparative and illustrative purposes only. The fund has no official benchmark, its performance may differ materially from that of the benchmark.
3. he rating is based on price volatility over the last five years, and is an indicator of absolute risk. Historical data may not be a reliable indication for the future. The value of an investment, and any income from it, may fall as well as rise, and you may not get back the amount you originally invested. The rating is not guaranteed to remain unchanged and the categorisation may shift over time. The lowest rating does not mean a risk-free investment.
4. The fund uses the swing principle calculation method which determines the net asset value of the fund. Swing pricing allows investment funds to pay the daily transaction costs arising from subscription and redemptions by incoming and outgoing investors. The aim of swing pricing is to reduce the dilution effect generated when, for example, major redemptions in a fund force its manager to sell the underlying assets of the fund. These sales of assets generate transaction costs and taxes, also significant, which impact the value of the fund and all its investors. The fund has a redemption threshold (gate), the level at which the manager of an undertaking for collective investment in transferable securities can stagger the redemption of securities instead of proceeding immediately.

Key risks

The value of an investment in the portfolios and any income from them can go down as well as up and as with any investment you may not receive back the amount originally invested.

- **Capital loss risk:** It is important to remember that the value of investments and any income from them can go down as well as up and is not guaranteed.
- **Discretionary Management**: Discretionary management is based on anticipating the evolution of different markets and securities. There is a risk that the fund will not be invested at any time in the most efficient markets and securities.
- **Equity risk**: Funds that invest in securities listed on a stock exchange or market could be affected by general changes in the stock market. The value of investments can go down as well as up due to equity markets movements.

For more detailed information on the risks associated with this fund, investors should refer to the prospectus of the fund.

Source: HSBC Global Asset Management, as of 13 November 2020.

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