GENERALI ASSET MANAGEMENT

Dive-In

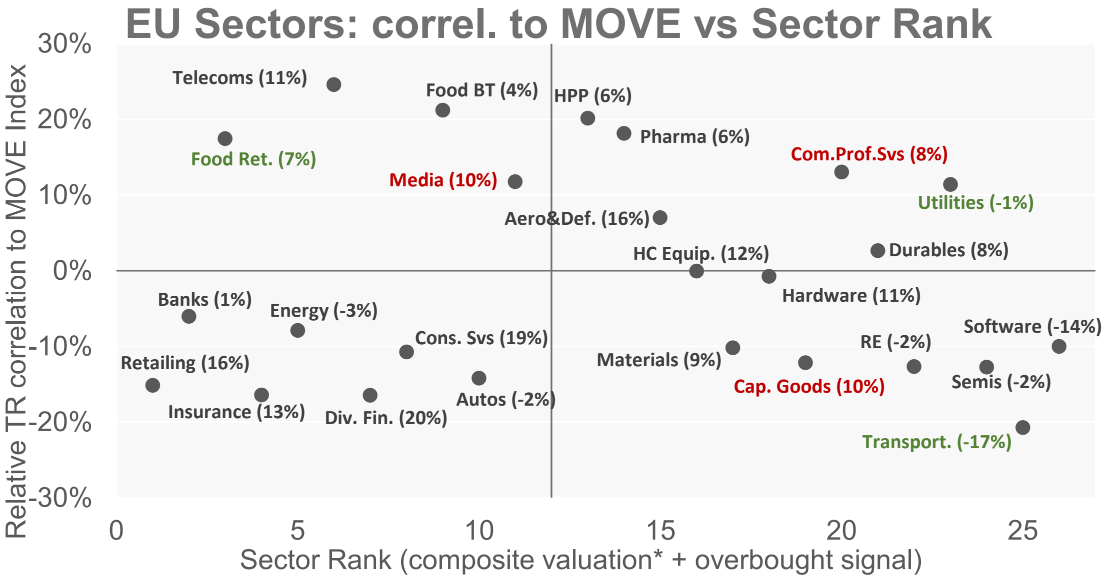
Sector Views: favour cyclical laggards and undervalued sectors

GenAM Macro & Market Research

Sector views: maintain a tilt on cyclical laggards and undervalued sectors

OWs: Banks, Durables, Energy, Food Bev. Tob., Health Care, Aerospace & Defense, and Materials

- Maintain a tilt on **cyclical laggards** and **undervalued sectors**. Overall, we are neutral **cyclical/defensive**.
- Higher global PMIs support cyclical earnings momentum, albeit some cyclical sectors look crowded and dear, anticipating an activity bounce.
- We prefer **Small vs Large cap**: they look undervalued from different angles (mkt multiples, PEG, CAPE, PBV/ROE). With the peak in interest rates behind us, global economic data expected to improve and M&A cycle to pick up, small caps should outperform.

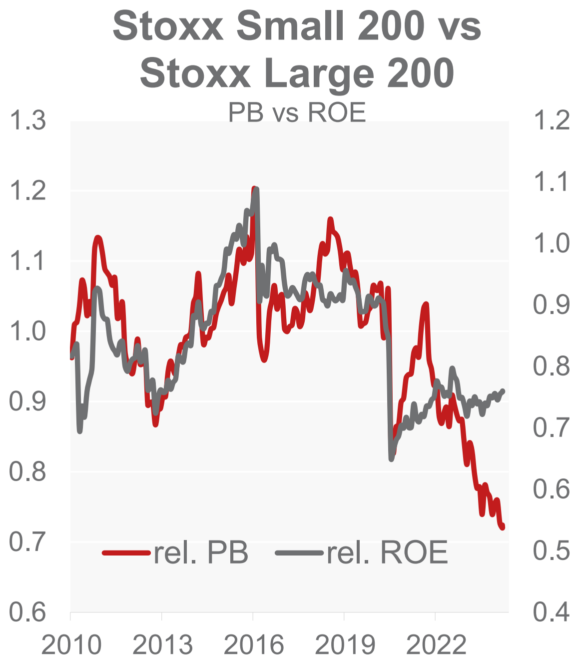


*includes Fed Model gap, exp. TR, PEG adj. (for ROE and COE), Shiller PE, 3-stage EPS growth model, mkt multiples, PE vs hist. avg. excl. bubble years. 12m EPS growth = 12m fwd EPS vs 12m trailing EPS

Green/Red name = positive/negative machine learning (ML) models

in (X%): 12m EPS growth

Source: Refinitiv, GenAM calculations as of 06/03/2024



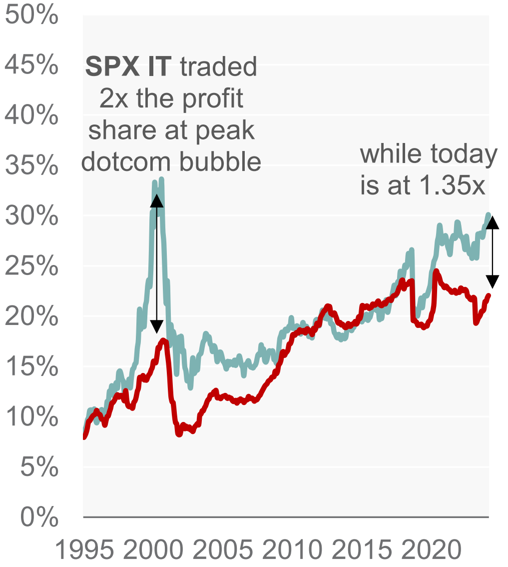
Source: Datastream, GenAM calculations

- **OWs: Banks** (valuation, attractive if cycle turn for the better: easing in credit concerns and better financial condition + pick-up in economic activity), **Durables** (resilient earnings, high upside risk if China starts to spend again), **Energy** (lagged oil prices move, which remains well supported by supply-demand dynamics, strong FCF generation, cheap valuation), **Food Bev. Tob.** (strong underperformance to reverse, negative correlation with rates and inflation), **HC** (lower yields and a stronger dollar remain supportive in the near term + upside potential to earnings, with new drugs in the pipeline, and patent expiry risk only at the end of the decade), **Aero&Defense** (A&D, see next slide), **Materials** (positive eps revisions, providing a good cyclical hedge).
- **UWs: Auto** (very tight credit spread, refinancing pose a risk, peaking margins and growth to flatten), **Comm. Prof. Services**, **Insurance** (negative correlation with yields), **Media**, **RE** (rates still too high, refinancing risk elevated), **Software** (high valuation, performance overshooting eps revisions), **Telecoms.**

AI / US Tech: are markets irrationally exuberant? Still far from dotcom levels…

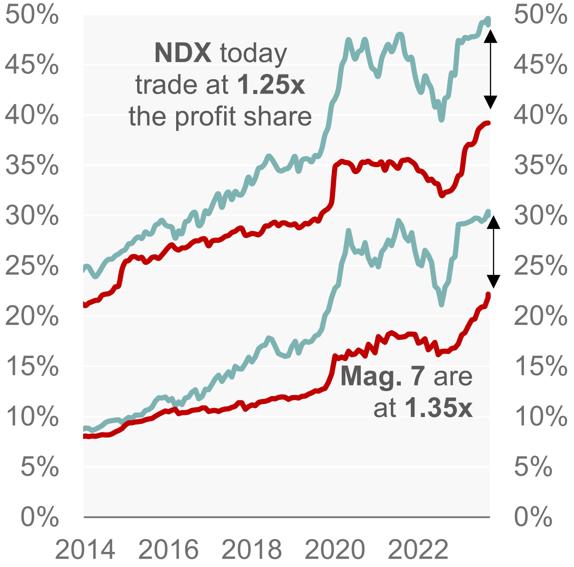
Tech is taking up a bigger market cap share in SPX, but this reflects a comparable higher profits share

SPX IT market cap & profit share (vs. S&P 500)



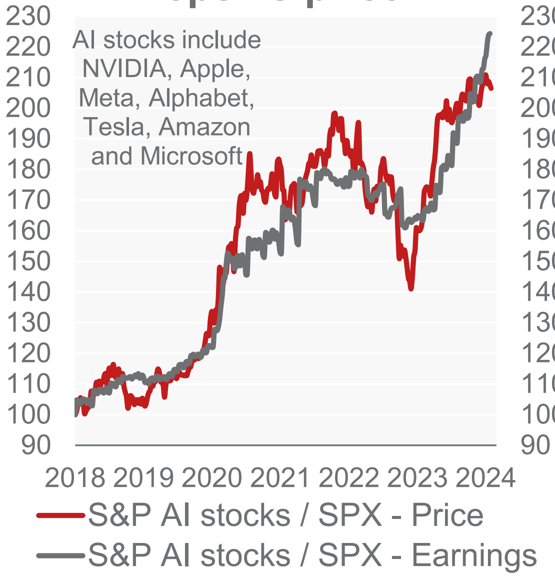
Source: Refinitiv, GenAM calculations

US Tech market cap & profit share (vs. S&P 500)



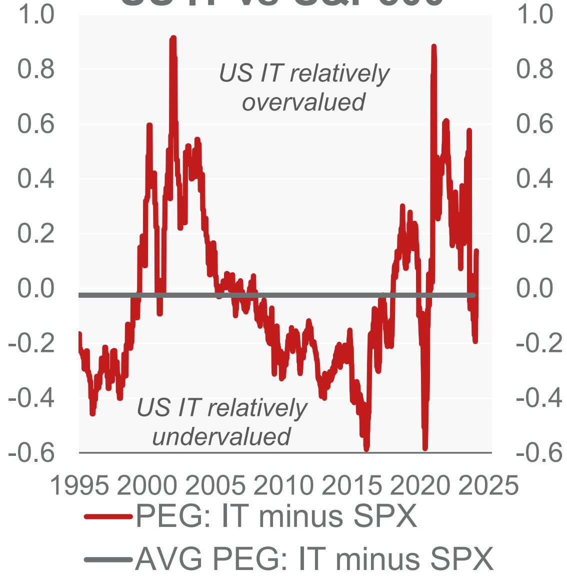
Source: Refinitiv, GenAM calculations

S&P 500: AI stocks vs SPX, eps vs price



Source: Datastream, GenAM

PEG (PE / LT eps growth): US IT vs S&P500



Source: Datastream, GenAM

- The S&P 500 reached its highest level. This movement was mostly driven by **strong earnings delivery from AI stocks**, NVIDIA above all. But this AI outperformance resulted in a **strong concentration** (top 10 stocks = ~ 35% tot. mkt cap).
- That said, we are still **far from reaching dotcom bubble levels**: at the peak (2000), the tech sector traded at **2x its profit share** in the S&P 500 index, compared to roughly **1.35x today**. The Magnificent 7 are also trading at a similar multiple, just like the Nasdaq 100.
- Markets are also **pricing-in higher growth**. While US Tech PE looks stretched, **PEG** (Price / Earnings over long-term – 3-5y – earnings growth) **does not look exuberant** (near avg). Indeed, expected long-term earnings growth for the tech sector (20%) is higher than that of the market (15%).
- **3-yr fwd PE**: the sector is at much lower levels than those reached in the dotcom bubble: 1.3x the S&P 500, compared to 2x in Mar 2000.

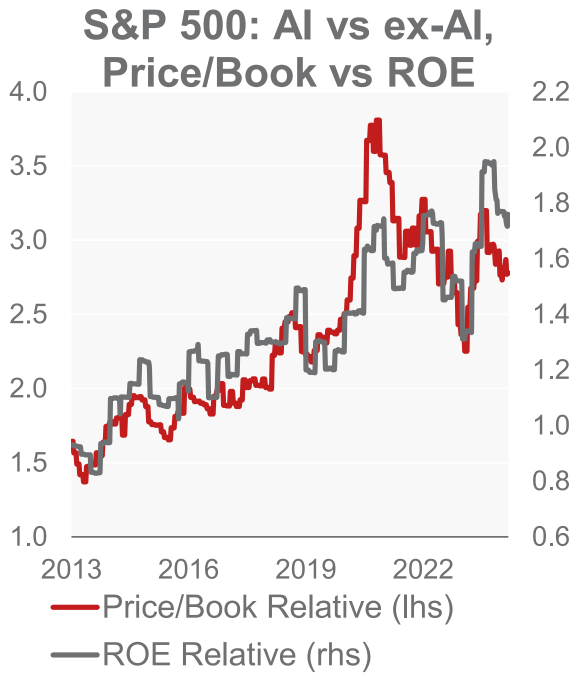
… but getting neutral short-term. Good news are priced-in, leaving room for downside risks

Risks coming from anti-trust, geopolitics, and trade interventions. Diversify outside AI: countries, EU Growth, HC, Defense

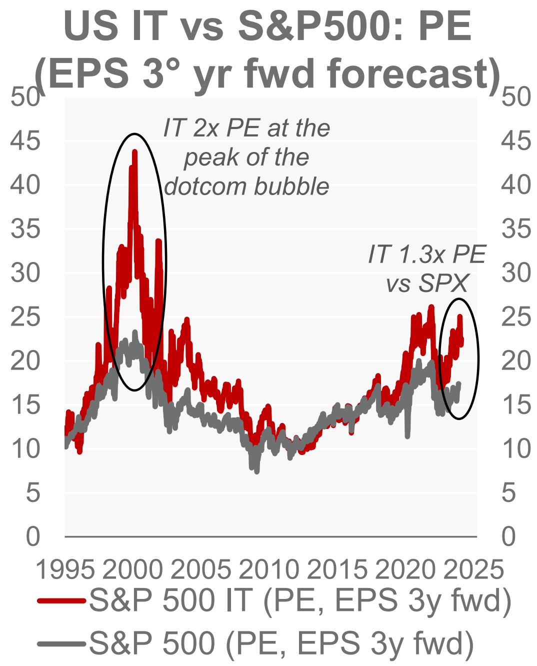
as of 13/03/2024	2024 EPS growth	2025 EPS growth	12m fwd PE	2025 PE	Avg 12m fwd PE since 1995
S&P 500	10%	14%	20.5	19.1	16.7
S&P 500 (median)	7%	11%	18.5	16.6	17.5
Mag. 7 (median)	17%	16%	28.8	26.0	26.3
S&P 493 (median)	7%	11%	18.3	16.3	17.3
MSCI US IT	16%	18%	28.3	26.0	21.3
MSCI EMU	2%	10%	13.0	12.5	14.4

PE are Price / 12m fwd EPS and 2025 YE EPS. Median values are computed on the individual components of the index or index subset, considering current S&P 500 members. Values for the indexes are computed on consensus index estimates.

Source: Datastream, IBES Estimates, GenAM calculations



Source: Datastream, GenAM

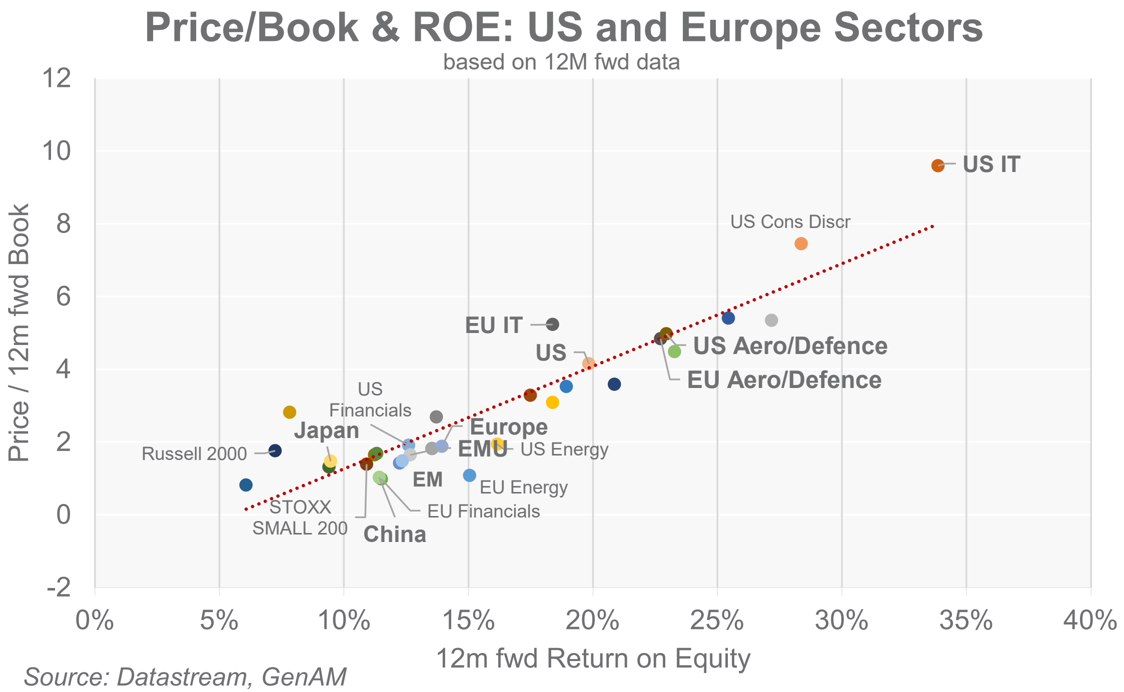


Source: Datastream, GenAM

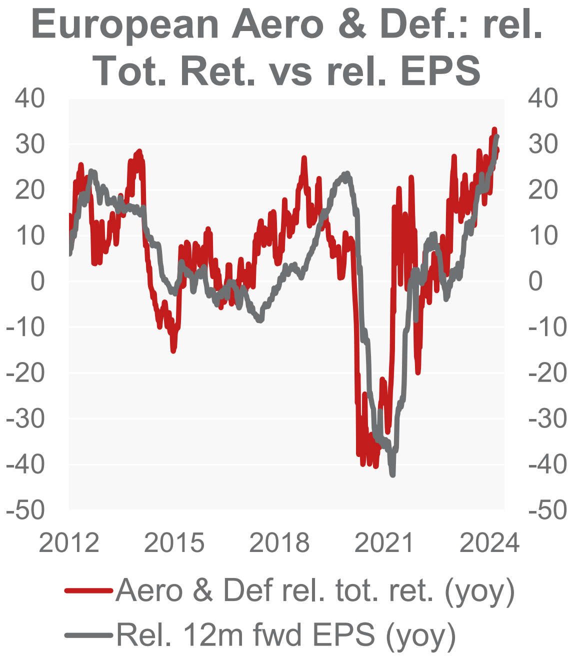
- More than just NVIDIA: **Cloud spending has strong long-term growth perspective**, as computing workloads migration will continue to be a dominant theme influencing the sector. Among the Mag. 7, Amazon, Microsoft and Alphabet will be the main beneficiaries.
- If opportunities are high in the AI space, so are risks: markets are already pricing-in very high growth, putting a lot of pressure on AI companies, which may fail to deliver. Additional sources of concern are represented by **anti-trust** and **geopolitical risks**.
- Furthermore, the number of **harmful trade intervention** in high tech is **strongly up** in the past years. The introduction of new tariffs or import/export limitations (with China in particular) may have negative impacts to revenues and earnings growth (i.e. Apple).
- **Diversify outside of AI**: EU Growth, like HC, Defense and through countries (see Trump dive-in and first page Equity Strategy).

Aerospace & Defense: a long-term structural trend – higher EU defense spending ahead

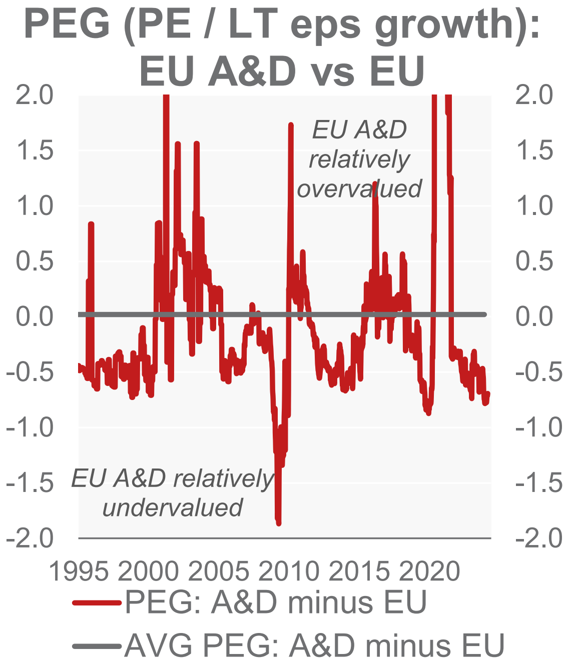
Continued support over the next few years as NATO countries reverse decades of defense underspending



Source: Datastream, GenAM



Source: Datastream, GenAM



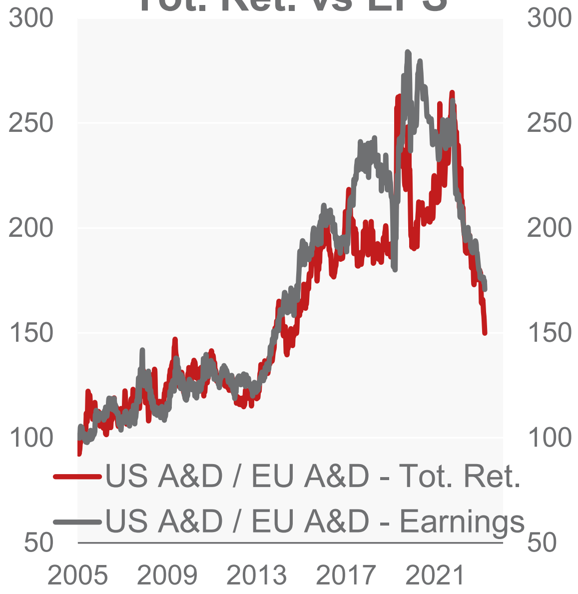
Source: Datastream, GenAM

- **Defense**: after decades of relatively low spending, the industry is back on the global agenda. While the sector in Europe already outperformed considerably, we see continued support to orders going forward as countries look to increase past spending trends.
- On March 5th, the EU Commission unveiled a new **European defence industrial strategy** to achieve industrial readiness, encouraging EU countries to invest more and providing **€1.5 bn in funding** (from the EU budget over the 2025 - 2027). By 2030 EU countries should spend at least **half of their defense procurement budget** on **products made in Europe** and trade at least 35% of defense goods between EU countries.
- Judging by multiples, the EU sector looks expensive (PE = 22X), but the **3-5y forward EPS growth (36%) is much higher than market (10%)**. The sector has a lower PEG (PE/eps growth), even when adjusted by ROE / COE and Beta (see next slide, where the PEG uses FY3 EPS at the nominator).
- **Composite valuation**: both **US & EU A&D sectors score better than the overall US Market**. **P/BV vs ROE**: the two sectors look fair valued.

A&D: subdued US defense spending growth in '25. But increasing RPKs a positive for Aerospace

ESG: controversial weapons a key concern, companies involved mostly excluded due to international treaties / national laws

US vs EU Aero & Defense: Tot. Ret. vs EPS

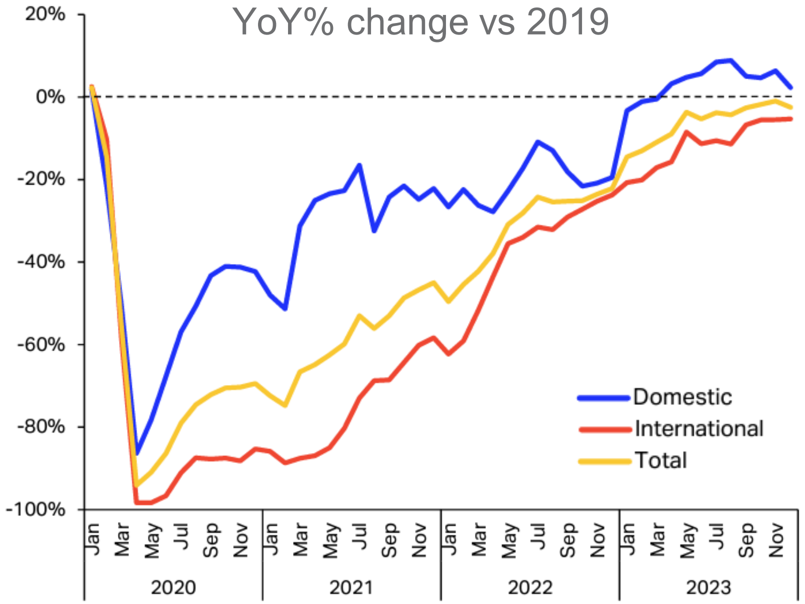


Source: Datastream, GenAM

Sectors Europe & US	Exp. Tot. Ret. (DY + eps grw)	PEG adj. (with FY3 EPS) low=cheap	Comp. Valuation Rank 1 = cheap 52 = expensive
US Aero&Def.	23%	1.6	13
MSCI Europe	10%	1.8	19
EU Aero&Def.	21%	1.0	28
MSCI US	14%	1.6	36
US Semis	31%	1.3	38
US IT Hardware	18%	1.8	39
US Software	16%	1.9	41
EU Durables	11%	2.3	44
EU Software	0%	1.8	49

Note: Exp. Tot. Ret. is derived using DY, next year's exp. eps growth, ROE and payout ratios. PEG adj. is FY3 PE divided by expected long-term EPS growth (3-5yrs), modified by the ratio COE/ROE.

Global domestic and international RPKs



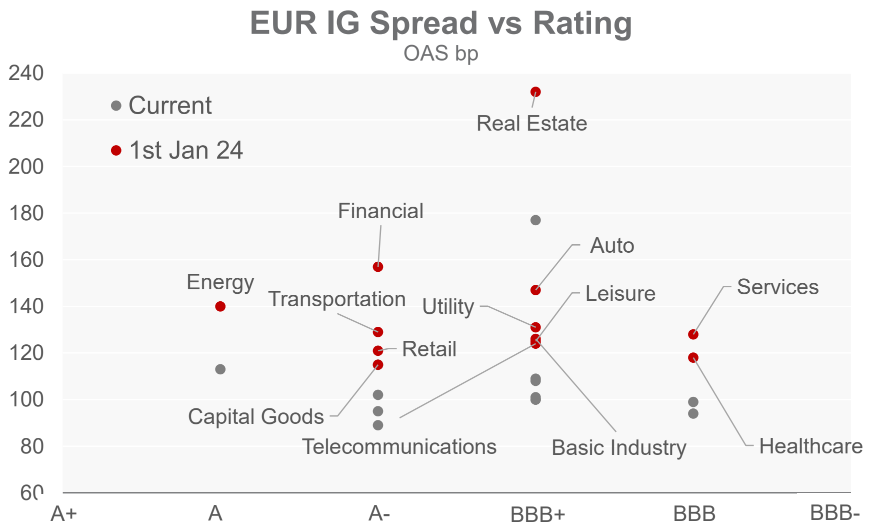
RPK = revenue passenger - kilometres
Sources: IATA Sustainability and Economics, IATA Monthly Statistics

- **US Defense outlook more muted**: FY2025 DoD budget was released on March 11th, with an expected 1% growth. There is still no 2024 budget, as Congress operates under a continuing resolution. This is potentially unattractive for the sector, which typically outperform when defense investment budgets rise in real terms.
- After decades of **US vs EU outperformance**, the past 2-years have been more positive for the EU sectors. That said, despite high multiples for both, the **sectors score positively in EU and US** thanks to higher expected growth, potentially offering an alternative to tech
- **ESG:** the sector is not excluded a priori, but rather exclusions focus on companies involved in **controversial weapons** (directly and indirectly). Currently, no member of the MSCI EU A&D sector is subject to exclusion. Instead in the US, 7 companies out of 12 (~80% of the mkt cap) are restricted.*
- The **public opinion** on the sector as a whole – despite highly volatile and dependant to the geopolitical situation – is **rather benign. Investors predominantly exclude controversial weapons** (both due to international treaties and/or national laws – i.e. L220).

* For more info on ESG-matters please refer to Francesca Albino & Lorenzo Angeletti

Credit Sector Allocation – European Credit market IG + BB

Sector	Industry Group	Credit Research	XAQ
Communication Services	Media & Entertainment	UW	Neutral
	Telecommunication Services	Neutral	UW
Consumer Discretionary	Automobiles & Components	UW	Neutral
	Consumer Discretionary Distribution & Retail	Neutral	Neutral
	Consumer Durables & Apparel	Stg UW	UW
	Consumer Services	Neutral	UW
Consumer Staples	Consumer Staples Distribution & Retail	Neutral	Neutral
	Food, Beverage & Tobacco	UW	Neutral
	Household & Personal Products	Stg UW	UW
Energy	Energy	Neutral	UW
Health Care	Health Care Equipment & Services	Neutral	Neutral
	Pharmaceuticals biotechnology & life sci	Neutral	UW
Industrials	Capital Goods	UW	UW
	Commercial & Professional Services	Neutral	Neutral
	Transportation	Neutral	Neutral
Information Technology	Semiconductors & Semiconductor Equipment	OW	OW
	Software & Services	Neutral	Neutral
	Technology Hardware & Equipment	UW	OW
Materials	Materials	UW	UW
Real Estate	Real Estate Management & Development	OW	OW
	Equity Real Estate Investment Trusts (REITs)	OW	Neutral
Utilities	Utilities	Neutral	OW
Financials	Banks	OW	OW
	Financial Services	Neutral	Neutral
	Insurance	OW	OW



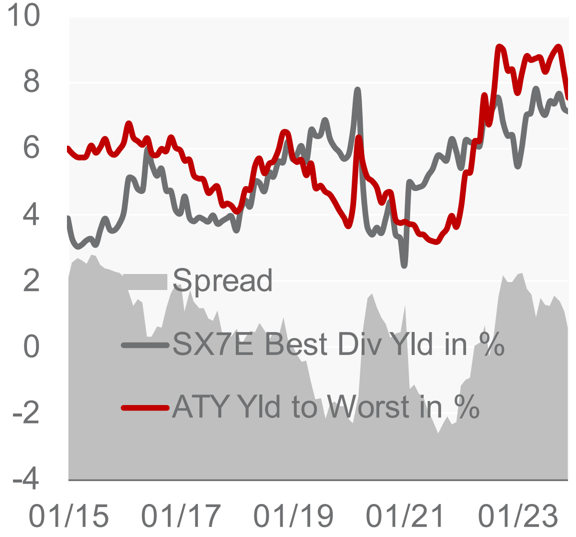
Source:Bloomberg, BofAML indices, GenAM own calculations

- **We like Utilities** for its defensiveness, **Banks** and **Insurance** as it is currently benefitting from higher rates and heavy supply in dollars vs euros, **Technology** and **Real Estate** as we believe the compression is not over as long as risky assets are performing.
- Conversely, **we underweight**, **Telcos** on weak fundamentals, **Consumer discretionary** and **services**, **HH & personal products**, **Energy**, **Cap goods**, **Materials** and **Pharma** on expensive valuations especially versus wider defensive sectors like Utilities.

Still OW subordinated financials but less steam from here

But we still favour AT1 to single Bs and callable Tier 2 to bullets

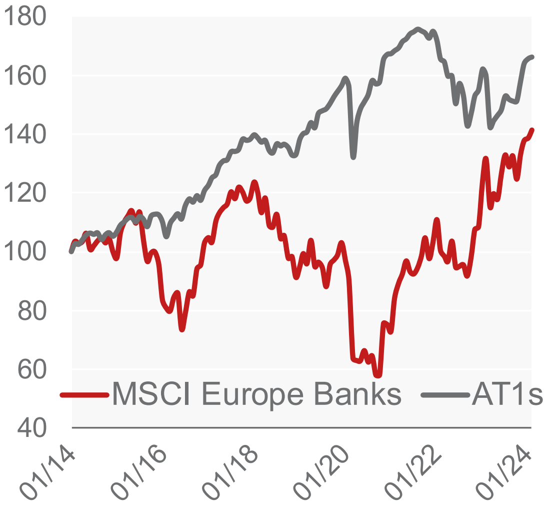
European banks AT1 yield vs dividend yield



Source:Bloomberg, BofAML indices, GenAM own calculations

AT1 vs MSCI Europe Banks

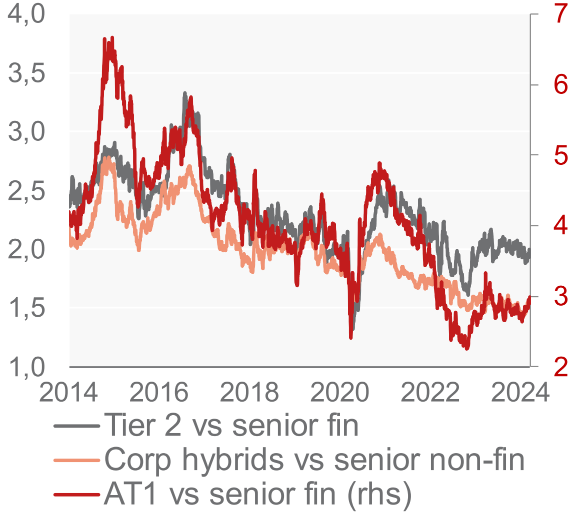
Total return base 100 : 01/01/2014



Source:Bloomberg, BofAML indices, GenAM own calculations

Tier 2, AT1 & Corp hybrids valuation ratios

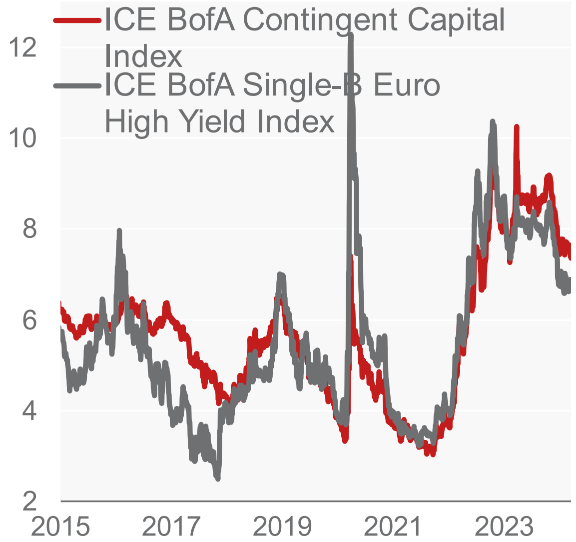
in Govt OAS terms



Source:Source:Bloomberg, BofAML Indices, GenAM own calculations

AT1 vs HY Bs

yield to worst, %



Source:Bloomberg, BofAML Indices, GenAM own calculations

- **Subordination risk overall preferred to credit risk :** AT1 preferred to single B, Tier 2 preferred to BBS and corporate hybrids
- **UW Senior Preferred :** Convergence toward Senior Non-preferred will continue
- **OW Senior Non-Preferred :** Thanks to extra carry vs Non-Fins
- **Neutral Tier 2** but prefer Banks over Insurance and callable over non-callable
- **OW AT1 :** Both Euro and Dollars on valuation and fundamental grounds bot as usual selectivity remains key

APPENDIX – IMPRINT

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