PARALLEL WORLDS

ITALY, FIRST CHOICE

Interviews by Igor Pakovic

Volkswagen scandal, China, the Fed, opportunities on the stock and bonds markets and, above all, Italy: these are the topics we examined with four multi-asset managers this month

Uncertainty. That's probably the keyword reflecting the mood of the global economy this autumn.

There are several hot topics right now. One school of thought sees the rising trend in the stock market from the lows of 2009 as coming to an end, and any technical recovery is too late to change the direction of travel. "Investors in stocks fear that the central banks' capacity to respond to negative shocks is limited", says Keith Wade, chief economist at Schroders. Interest rates are already near zero, and a further injection of liquidity by the central banks would be of little use.

So maybe our old friend, the bond market, can provide a firm footing in the midst of uncertainty? Not exactly. "I expect higher bond yields, a greater credit spread and increased volatility. It's crucial to be prudent". Speaking is Arif Husain, head of international fixed income at T. Rowe Price.

Also feeding these October doubts are the after-effects of the Volkswagen scandal, the Fed's hesitant policy on raising rates and, of course, the great Chinese shadow falling diametrically over all the markets.

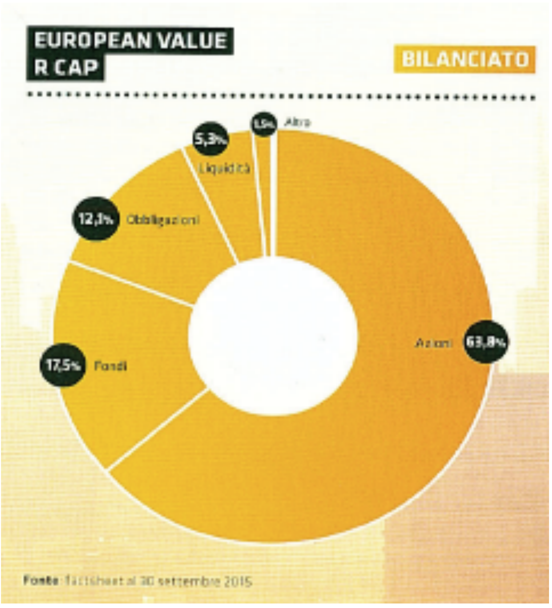
We talked about this with the people who can invest in all of the assets classes available on the market, the multi-asset managers: Gianluca Ferretti of Anima, Giacomo Mergoni of Banor, Pierluca Beltramelli of Gestielle and Giovanni Brambilla of AcomeA.

THE DIFFERENT FACES OF THE ITALIAN RECOVERY
There may be uncertainty on the markets, but when you speak about Italy there's a certain consensus on the recovery there. Less so, however, when you try to identify the sector that's most beneficial to the recovery of our economy and so the sector to bet on. As Giacomo Mergoni, a Citywire A-rated manager for Banor SICAV's European Value fund, explains, "Stocks like Terna, Snam or Eni benefit from a cost and earnings structure and a competitive position that can offset –and sometimes benefit from, with respect to competitors – the effects of the fall in oil prices".

For Gianluca Ferretti, on the other hand, another Citywire A-rated manager, with the Anima Visconteo fund, the focus is more on the banking sector, which is one of the most popular outside Italy too. “We expect the fall in provisions on loans to offset the negative impact of low rates and the pressure on interest income”. But also on a sector that traditionally has not featured so much in portfolios: media. Because, says Ferretti, “we believe that the recovery in consumption will soon be reflected in an increased appetite for advertising spending”.

Giovanni Brambilla, Citywire +, manager of the AcomeA Patrimonio Aggressivo product, is also keeping his eye on the Italian financial sector. “We’re looking, for example, at MPS. Although it’s had some rough times, after the latest recapitalisation it could be a stock to hold in your portfolio”.

Gestielle’s Pierluca Beltramelli, rated Citywire +, is of a different view. “In Italy, but at the European level too, one investment area that might be worth looking at is infrastructure development. Not just roads and bridges, but telecoms and then utilities, gas and electricity networks”.

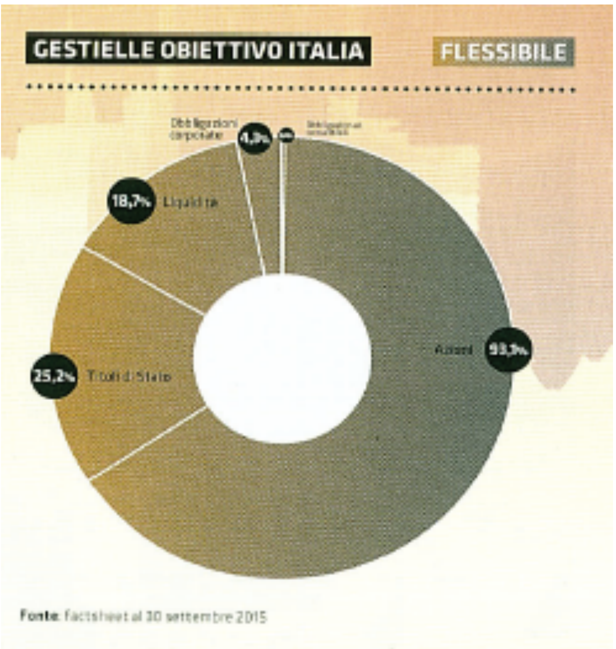


Almost paradoxically it’s Beltramelli, manager of the Obiettivo Italia fund and so with greater exposure in Italy, who isn’t altogether sure of the Italian financial sector. Indeed, he prefers the rest of Europe’s. “There are European banks dealing with higher discount rates and who have more business than the Italian banks. And we haven’t really bought into the idea that with the M&A activity right now there will be premiums. In our view, the market has priced this potential too high”.

BETS BEING PLACED GLOBALLY, BUT NOT ON THE UNITED STATES

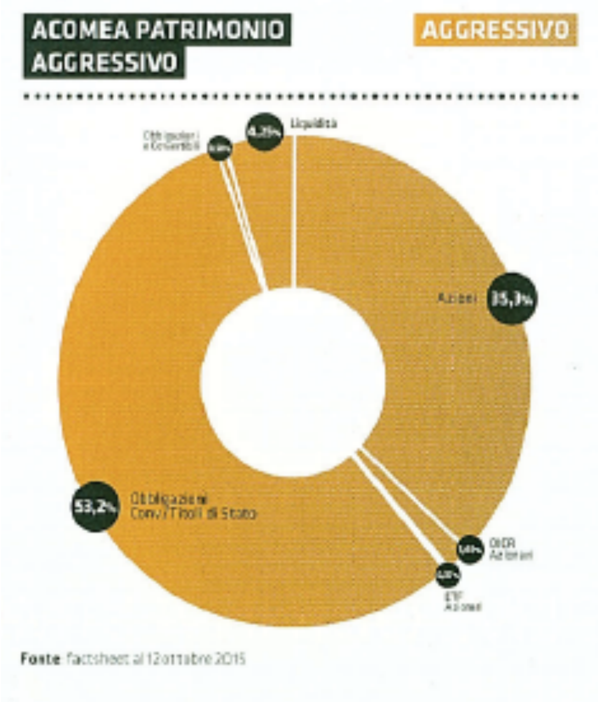
So what are the investment choices outside of Italy in the four multi-asset categories? Regarding the bond market, Ferretti comments that Europe has benefited from the confirmation of Alexis Tsipras as Greek leader. Portfolios, he feels, “are too heavily weighted towards government bonds of peripheral European countries, since the ECB ‘cap’ remains firmly in place. And from a medium-term perspective inflation-linked securities, especially BTP and Bonos, once again look interesting, given the possible increase in QE by the ECB”.

“In Europe”, explains Banor’s Mergoni, “we feel that there’s still a great deal of value, although investors need to concentrate more on stock-picking than on market trends”. Essentially, says Mergoni, less beta and more alpha. “This view is expressed in our conservative position, with exposure to defensive stocks like health (Sanofi, Roche) and under-exposure to European bank stocks”.



For Brambilla, one interesting sector could be commodities, from oil to gold to precious metals. “In my opinion, it’s an area where there’s been a lot of stress, because there’s an obvious slowdown in China. That said, and without paying too much attention to extreme cases like Glencore, if you look at stocks like Petrobas, the values we’re trading at right now are interesting. In addition”, Brambilla continues, “we’re also looking with some interest at the repositioning of Japan’s domestic sector, especially financial stocks, where we’ve made profits in recent months”.

One of the countries that doesn’t seem to have attracted a significant increase in exposure is the United States. “In recent months we’ve struggled to find value, especially on the principal market, the US”, says the AcomeA manager. “On average, in the first six months the American part of the fund didn’t exceed 8% of exposures. And Patrimonio Aggressivo is a compartment that at present sees 30% of its investment in the stock market and could potentially arrive at 100% exposure in equity”.



This cautious approach to investing in the United States is echoed by Ferretti. “The short-term view on American government bonds remains prudent and exposure within our bond funds portfolios will be reduced in relation to the short-term part (two years), at least until it’s clear to what extent the FOMC [Federal Open Market Committee] decides to raise rates”.

FED, UNDESIRED EFFECTS: VOLATILITY

Ferretti’s words suggest that this wary approach towards the US market arises from the Fed’s failure to raise interest rates on 17 September, and that in 2016 the American bond market will see a trend to increased volatility, “as has historically been the case during the initial increases by the Fed”. However, as Anima’s fund manager explains, this trend should remain locally circumscribed. “While in the past a rise by the Fed was a significant event for the markets at the global level, this time it should have more of a regional impact. In other words, it should mainly affect America and the emerging economies”.

Beltramelli agrees that the US central bank’s decision will cause market volatility. “The Fed was mistaken in delaying the rate rise, because it has fed uncertainty with respect to global growth potential. Moreover, the negative impact of not increasing is higher than the negative impact of a rise of 0.25%, which at these levels are just a few basis points’.

Mergoni takes a diametrically opposite view. “Janet Yellen took an understandable decision”, he says, “for the wrong reasons. The ‘manual’ would have suggested a slight rise, because the American economy is in good health. However, it also suggests that what counts isn’t whether the rise take place, but clarity on the beginning and pace of the increases. On this point, I hope Yellen won’t disappoint us”. As for the effects of this decision, the Banor manager explains that the most obvious impact to be expected is on the American banks’ income statements, which will finally begin to benefit from income from services”.

As for Brambilla, he sides with the majority opinion on the Fed’s decision, that the markets have already absorbed its effects. “If a central bank makes a surprise move then it can have a significant impact on the market, as in 2008. But we’ve been talking about this rate rise for a year now, and whatever the Fed decided, from a market reaction perspective not much would have changed”.

DIESEL-GATE, A GEO-POLITICAL TRIP-UP?

What might change on the stock markets, especially after the Volkswagen scandal, is one of the hottest topics of the moment, and one whose outcome is hard to predict.

“I don’t believe”, says Brambilla, “that what happened will change consumers’ attitudes regarding their choice of car. What might happen is that people will trust VW, and German cars in particular, less, for the simple fact that they feel they’ve been betrayed”. In one

sense, he continues, "it's like being betrayed by a faithful wife that you don't expect to behave that way". Nonetheless, and contrary to appearances, "Diesel-Gate" could prove to be an appetising opportunity for the rest of the automobile sector. "Stocks like Peugeot and Fiat could again be possibilities in terms of rebalancing portfolios", underscores Brambilla.

A negative impact – but not excessively so – is expected for the sector. According to Beltramelli, "We're undoubtedly talking about an unforeseeable event, and the impact of any fines or class action are hard to estimate. We expect a negative impact, but we also need to understand that the market shakes off these slowdowns very quickly, and so the sector as a whole has already moved forward".

For Ferretti, while the consequences are still hypothetical, we should take a cautious approach. "The lack of certainty as to the true number of manufacturers involved and the number of vehicles that will need to be recalled means that in coming months the volatility in the sector will continue, without considering that the legal effects of diesel-gate will continue for years".

Mergoni takes a very different view of the subject. "The VW affair is very serious and mustn't be underestimated". The greatest impact, says Mergoni, will be on the German economy, "but more as a result of the slowdown in automobile production than of any image problems". And lastly, concludes the multi-asset manager, there is also a clear geopolitical aspect. "The USA have once again struck at and sunk a European industry and a weakened Germany that should be more docile with respect to the ECB's expansionary policies".

CHINA, A TSUNAMI THAT DOESN'T AFFECT US

The background to all these topical questions is and remains the Chinese giant, and the Fed's decision not to raise interest rates is proof of that. It is now accepted that China is going through a transitional economic phase in which domestic consumption will become increasingly important. So the question is, what else can we expect from this on-going metamorphosis, and what further impact will the Chinese transformation have in the rest of the world, Europe first and foremost?

For Ferretti, Anima's approach in this area remains cautious and neutral. With the performance of commodities and the devaluation of the Chinese currency affecting trends and inflation expectations in the euro area, "further reductions in long-term inflation could lead to more interventionism by the European Central Bank".

In Beltramelli's opinion, from an Italian perspective the impact remains limited. "If I look at China's 'weight' in terms of nominal exports, we're talking about 3%". If anything, we're witnessing a structural change that we've already seen in other countries like Japan, and "we need to take a cautious approach to stocks that are too closely linked to China's growth and which also had very high multiples".

For Mergoni too, the effect on Italy and on Europe will be fairly modest. More specifically, it will only affect "the accounts of many Italian and European exporting companies" in the luxury goods and industrial sectors.

Giovanni Brambilla closes on a note of pragmatic optimism. "China is a region which we've been buying again over the last three months in the presence of significant adjustments. Because, especially in the area of Chinese stocks listed in Hong Kong, valuations are fairly low and they're being traded with discounts of as much as 40-50% with respect to the same companies listed in Shanghai or Shenzhen. In my opinion", concludes the manager, "we simply need to be patient".

WHERE WE'RE PLACING OUR BETS

GIACOMO MERGONI EUROPEAN VALUE R CAP	BALANCED

"In Europe we're continuing to focus on defensive, high-dividend stocks and non-discretionary consumption, like Nestlé, BAT or Vodafone".

PIERLUCA BELTRAMELLI GESTIELLE OBIETTIVO ITALIA	FLEXIBLE

"There will be an increase in the telecommunications sector, with an end to the recent decline in data traffic. We're at a turning point in which the sector is repositioning itself, over a medium-term timescale".

GIOVANNI BRAMBILLA ACOMEA PATRIMONIO AGGRESSIVO	AGGRESSIVE

"On the government bonds side, Brazil, Indonesia, South Africa and to some extent Turkey are the regions we're looking at with most interest to increase the position we already have in the case of further significant movement".

GIANLUCA FERRETTI PRUDENT
ANIMA VISCONTEO

"In the light of the divergence between the ECB and the Fed's monetary policies we prefer the European market to the American Treasury".