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Rania (Banor): “London Calling: the hows and wherefores for a return to investing in the United Kingdom”

16 December 2019 by **Eugenio Montesano**

3 min

“The worry you see in Italy or in other countries about what is actually happening is far greater than is justified by reality”. The opinion of the European equity specialist

Gianmarco Rania, Head of Equities at Banor Capital in London and Asset Manager of the European Value Fund focusing on the European stock market

From his privileged point of view regarding Brexit, Gianmarco Rania, Head of Equities at Banor Capital in London and Asset Manager of the European Value Fund focusing on the European stock market, believes that at the level of the economy, as well in relation to financial markets, Brexit is being managed "in an orderly fashion. If we look at real estate, a market to which we are all directly or indirectly exposed, housing prices have fallen, but they have not collapsed in either the residential or in the commercial market. Indeed, in the latter case, we are witnessing the first revaluations".

Since the beginning of the year, London’s main stock market index, the FTSE 100, has registered a return of 9.29% (in GBP, source: Bloomberg.com). This morning, the London stock exchange has accelerated further (FTSE 100 +2.4%). The return on 1-year government bonds remained unchanged at 0.62%, while the ten year bonds fell to 0.751%, and the pound sterling rose above the 1.33 dollar mark and is stable at 1.2 euro.

With Brexit now imminent after premier Boris Johnson’s electoral success last Thursday, according to Rania listings in the UK will do even better in 2020.

And does this mean that it is “Business as usual” for Great Britain?

If we look at employment and GDP data, there has been no collapse. And it is for this reason that we are pushing the issue of exposure to UK domestic securities with the clientèle invested in portfolio management. Domestic, because one of the effects of a possible resolution of Brexit will be the pound sterling rally which damages big international conglomerates like GSK-

GlaxoSmithKline or Unilever, that have very little turnover in the UK. On the other hand, investing in domestic securities which are exposed to the leisure and secondary goods markets – we're thinking of bus companies, trains, restaurant chains or even real estate – protects you from appreciation of the pound sterling which, on the contrary, we exploit to our advantage.

See also: "Brexit lights up the Christmas rally"

What is your reading of the electoral result?

In this election, Boris Johnson has gained a solid majority, with which he should be able to implement some structural reforms, such as easing fiscal pressure, and this could certainly boost the economy. Moreover, his strong endorsement averts the danger of a hard Brexit. On 31 January, the United Kingdom should leave the EU on the basis of the agreement that was negotiated last 17 October.

And now let us look at the rest of the continent. Do you have a positive outlook for European equity after a difficult year?

Very positive in absolute and relative terms. Let us consider the Stoxx index with respect to the S&P of the United States. We are at levels of underperformance that are the lowest since the indices started. The currency gap between Europe and America is at an all-time high. All in all, the European situation is stabilizing from a political point of view, and from a macroeconomic view point, while data indicates a general slow-down, countries like France are holding up well.

On which sectors are you focusing?

We are very positively orientated towards the financial sector, including insurance companies. Following years of stress testing, not to mention the requirements imposed by Basel II, European banks are very well capitalized and, today, they have an attractive valuation with significant dividends. The return from European equities dividends today is around 4-4.5%, while in America, it is below 2%. There is an element of both income as well as capital appreciation.

But precisely because we have done our homework well, isn't the mechanism through which banks lend money to companies in Europe a bit stuck today?

In truth lending growth is not high, but neither is it negative. The factor inside banks that gave us a positive outlook is the fact that interest rates will be normalized. For each additional 100 Euribor basis points (it had reached negative territory), net profit for a bank like Intesa will go from 4 to 5 billion. And so, given that the income statement of a bank today has been totally cleaned up because costs are under control, provisions for credit loss have been reduced, loans register a non-negative growth, what is missing is turnover growth, the famous "top line". A normalization of interest rates can lead to enormous operational leverage at the level of banks' profits. Even if it is just the Bund that reaches 0.10-0.20% by the end of the first quarter of next year, the banks can grow their profits by 30% – that is at the level of Amazon. With better valuations, given that they are all being traded below their book values, at very low price to earnings ratios and they are well capitalized. We also appreciate insurance companies like Axa, Munich Re, and Allianz, which is one of the major positions in the European Value fund.

We are living in a world of zero or negative interest rates. What should this normalization of interest rates favour, given that Lagarde seems to be as much a dove of peace as Draghi was?

When I talk of normalization, I do not mean interest rates at 3 or 4%. We mean a closing of the negative gap, which is happening, with a forecast for interest rates in the 0.2-0.3% range for the coming year. Obviously a further increase in interest rates will be linked to the fact that, in any case, European economies will begin to stabilize, and that there will be a minimum of growth. But operational leverage, for some sectors like the financial one, that makes a change even if only from -0.7% to +0.1% would be so extraordinary that the benefits will be immediately tangible. And let us not forget that there are Scandinavian countries like Sweden and Denmark where central banks have started to discuss the usefulness of negative interest rates. Central banks have started to understand that the job they had to do has now been done.

What changes will you introduce to the portfolio in 2020 to reduce the benchmark gap?

I took over the management of the fund in August, and I immediately started to implement my strategy, which is not only aimed at selecting securities, but also includes an overlay of derivatives. We are currently making a fairly strong bet on the fact that there can be a minimum correction by the end of 2019-beginning of 2020, and so we have adopted a very cautious and defensive stance for the portfolio, and this will enable us to recover most of the gap with respect to the index. In any case, the strategy will never be 100% long for the European market, but between 70 and 80%. Together with a philosophy of asset management, we will probably also change the way we look at the benchmark. Moreover, European Value is a product that provides for reinvestment or the cashing of a coupon, for an amount that is clearly greater than its market value, and therefore ideal for those who want to be exposed to the equity market, albeit in a defensive manner, and ideal for those who want to enjoy the benefits of a coupon flow.