Italian Equity Strategy Monthly

Decline in Earnings to Continue. Will Liquidity Be Enough?

by Intermonte Research Team

Italian Equity Market

- **Market outlook.** The Italian stock market closed the month slightly positive (better than Eurostoxx at -2.6% and in line with main US indexes) and is up ~13% YTD with earnings estimates down 12% YTD leading to a stunning re-rating of ~27%!
- **Investment strategy.** At long last, the US presidential election is but a few days away with the latest odds in favour of Trump but the race still very tight, including for Congress. Possible market reactions are broad, with more volatility ahead for markets and a list of Italian stocks exposed to the US and US$ that could react. However, the main point will be future fiscal policies and tariffs as well as yields. In our view, strategic sectors like tech, defence and pharma need monitoring. Financial markets have shown remarkable solidity in a very uncertain geopolitical scenario and despite waning earnings momentum. This is more likely linked to a continuing, favourable liquidity environment, which seems to remain a positive catalyst for the coming months. We cannot rule out some profit taking after the US elections, the level of market complacency looks increasingly high as, despite earnings headwinds, the overall sentiment on equities still looks constructive.
- **Corporate newsflow.** 3Q results season kicked off with mixed indications and some relevant misses, leading to downwards earnings revisions and negative stock reactions. We are expecting sound results from financials and utilities, and weakness among industrials and consumers as well as for stocks exposed to China. On aggregate, our estimates point to a ~17% YoY decline in earnings in 2024 but with big sector swings (financials, utilities up; industrials and energy down). The focus is shifting swiftly towards 2025. We expect a mid-single-digit increase in earnings with pretty modest visibility: development of expectations on next year's trends will be a major driver of sectorial and individual stock performances. In our view, some sectors are close to their cyclical trough, but with still relevant uncertainties like regulation and tariff issues for autos. Among financials, we like asset gatherers trading at decent valuations and with good prospects for inflows and earnings; on a selective basis banks, which are showing strong operating trends and, so far, no credit quality stress. Among industrials and consumers, we like specific names in sectors facing challenges but where the best managed / positioned companies could have a considerable edge.
- **Portfolio selection**: our portfolio slightly underperformed the market, suffering from the recovery of some industrial names and bad performances by some ideas. We are making some changes but confirm the preference for defensive names within utilities and, selectively, financials, while keeping a cautious view on consumers and industrials.
  Our list of favourite over/underweight stock picks is detailed on page 4 of the report.
  <ins>Large caps to overweight:</ins> we add Pirelli after a recent upgrade as we see the company as better equipped in this uncertain phase for autos. We confirm A2A and Enel among utilities, on expectations of positive results and updates on plans; Saipem remains the top pick in the energy space. We stay selective on luxury and consumers, with our preference list including Cucinelli, Diasorin. Campari has been a pain, but current prices factor no growth while the company is still consistently outperforming the sector. Among banks, we are lifting Intesa Sanpaolo on solid expectations and confirm our preference for BMED in the asset gathering universe.
  <ins>Mid/small caps to overweight</ins>: we include MFE in our most preferred stocks thanks to positive results expectations and the potential M&A angle. We are taking TIP out of the selection. We add Buzzi instead of Cementir as a more visible play on US spending.
  <ins>Stocks to underweight</ins>: we add Inwit to the least preferred stocks list (no short/term catalysts) while removing Tenaris, which has more favourable prospects ahead, and Terna, where we see limited downside.

Italian Equity Market - Asset Allocation by Sector

Positive	Neutral	Negative
UTILITIES	BANKS	CONSUMERS
ASSET MANAGEMENT	ENERGY	INDUSTRIALS
MEDIA	TELECOM	
	INSURANCE	

Source: Intermonte SIM

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The main methods used to evaluate financial instruments and set a target price for 12 months after the investment recommendation are as follows:

- Discounted cash flow (DCF) model or similar methods such as a dividend discount model (DDM)
- Comparison with market peers, using the most appropriate methods for the individual company analysed: among the main ratios used for industrial sectors are price/ earnings (P/E), EV/EBITDA, EV/EBIT, price /sales.
- Return on capital and multiples of adjusted net book value are the main methods used for banking sector stocks, while for insurance sector stocks return on allocated capital and multiples on net book value and embedded portfolio value are used
- For the utilities sector comparisons are made between expected returns and the return on the regulatory asset base (RAB)

Some of the parameters used in evaluations, such as the risk-free rate and risk premium, are the same for all companies covered, and are updated to reflect market conditions. Currently a risk-free rate of 4.0% and a risk premium of 5.5% are being used.

Frequency of research: quarterly.

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BUY: stock expected to outperform the market by over 25% over a 12 month period;

OUTPERFORM: stock expected to outperform the market by between 10% and 25% over a 12 month period;

NEUTRAL: stock performance expected at between +10% and – 10% compared to the market over a 12 month period;

UNDERPERFORM: stock expected to underperform the market by between –10% and -25% over a 12 month period;

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Prices: The prices reported in the research refer to the price at the close of the previous day of trading

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BUY:	28.24 %
OUTPERFORM:	48.09 %
NEUTRAL:	23.67 %
UNDERPERFORM	00.00 %
SELL:	00.00 %

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