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Italian Equity Research – Strategy Report

Italian Equity Strategy Monthly

Equity Markets Stay Strong as Growth Weakens

by Intermonte Research Team

Italian Equity Market

- **Market outlook.** Stock markets in April posted strongly positive performances, with investors falling back in love with AI investments. S&P and Nasdaq delivered the best performances, while European markets were less buoyant due to concerns on growth, stemming from the outlook in many sectors being burdened by energy prices.
- **Investment strategy.** There still seems to be no clear roadmap for resolution of the Middle East conflict. While the spike in energy costs is beginning to have a tangible impact on inflation, European countries have limited fiscal levers and the proposed EU support package does not seem to be significant. The ECB held interest rates steady, as expected; the base case remains for three hikes this year, but this could be adjusted to a more expansionary stance if growth were to deteriorate. The FED has appointed its new Chair, but the Board looks split on when and how to reduce rates. The disconnection between equity markets and economic trends is not new, but it is becoming more prominent, exacerbating risks of a correction as some valuations look hard to justify without strong faith in long-term earnings growth projections. The US administration has relaunched some tariffs on Europe (i.e. 25% on car imports) in retaliation for a lack of support on Iran. The most relevant event in the coming month is likely to be Trump's trip to China on 14/15 May, which could set the tone for markets in the near future and see some progress on the conflicts in the Middle East and Ukraine. Finally, the UAE's decision to step out of OPEC represents a significant development for the future of oil and energy markets.
- **Corporate newsflow.** 1Q reporting season is now underway, and has got off to a positive start overall, especially for stocks and sectors exposed to investment megatrends in AI and Data Centres. Financial stocks are expected to report solid results, while there are lingering concerns on consumers, healthcare and the automotive sector. Estimates are largely holding up thanks to upward revisions for energy sector stocks, while the trend is decidedly less positive for most other sectors. A buoyant dividend season is on the way, with €46bn in dividends due to be paid by stocks we cover, a figure that is currently expected to rise by a further 7% in 2027. Financials and utilities represent the lion's share of dividend distribution and look set to continue to deliver. Italian financial sector consolidation is also ongoing, and could offer attractive opportunities in the coming months, with some of the largest financial institutions potentially getting involved in extraordinary deals. We still believe some players in luxury and digital are worth watching, as current valuations look attractive vs. our expectations and historical multiples. The overall Italian stock market is trading at ~12x earnings, still at a discount vs. peers and aligned with historical levels: it will be interesting to test earnings momentum in light of the upcoming reporting season. The uncertainty surrounding input costs, a new round of tariff threats and the rising cost of debt is a source of concern, but the real issue remains demand trends, with a strong concentration in favour of AI-related sectors and weakness in other parts of the economy. After the strong performance of AI investments related stocks we suggest to start looking at companies that could have tangible cost benefits from AI roll-out in sectors such as financials and manufacturing.

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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 between 5.5% - 6.0% are being used.
Frequency of research: quarterly.
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A draft copy of each report may be sent to the subject company for its information (without target price and/or recommendations), but unless expressly stated in the text of the report, no changes are made before it is published.
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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;
SELL: stock expected to underperform the market by over 25% over a 12 month period.
Prices: The prices reported in the research refer to the price at the close of the previous day of trading

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NEUTRAL:	29.63%
UNDERPERFORM:	00.00%
SELL:	00.00%

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