Update: 'No' vote in Italian constitutional referendum

Key take-aways

Opponents of the constitutional reform have gained the upper hand, and in the meantime Italian Prime Minister Renzi has handed in his resignation. It remains to be seen whether the next step will consist of a technocratic caretaker government, or whether the Italians will go to the ballots straight away. The Italian president will do everything within his power to achieve the former scenario, against the will of the anti-establishment movement of Beppe Grillo, who favours the latter scenario. In any case, the odds of early elections are quite high, even after the technocratic caretaker government has adapted the electoral law.

What does it mean for Europe?

The outcome is not favourable to European political cohesion. This means that the structural reforms which Germany has been pressing for, will be harder to implement. Structurally the Eurozone remains in dire straits, although the economic recovery momentum has been picking up in the past two years. The willingness to gradually shift national decision powers to the European level, has been eroding in recent years. The Italian no-vote does not fundamentally alter this. The worst-case scenario would be for the failed referendum to trigger an Italian exit from the monetary union, but we are not there yet by any stretch. For the time being, there is no majority support for this scenario among the Italian population.

Impact on strategies and asset classes

<u>Fixed Income</u>

We were prepared as a NO vote was our base case scenario. The market expected this result as well explaining the tepid response. However following our preparation we concluded that Italian BTP exposure would be diversified by an underweight towards France. Sure, politically the European construction find itself in heavy waters. We do assess that the current ECB QE purchase programme will take away most of the stress that might surface in European Government Bond markets. The positive side effect of the continuation of the purchase program might be a further external devaluation of the Euro currency versus that of its main trading partners. That would provide the necessary support to the current positive, though modest, growth revival we witness in the EU periphery.

Below you find a summary of our exposure to Italian government bonds and credits across strategies:

1. **EUR Government bonds**: across main benchmarked strategies we carry an overweight in Italian exposure between 3.5% and 5% (nominal and inflation linked bonds). The benchmark weight of Italian Government Bonds stands at 24%. Against this overweight the funds are positioned very defensively (underweight up to 10%) towards France, which has a benchmarked weight of 23.5%.

2. **Inflation linked bonds**: Italian exposure sits at 5.00% (benchmark 4.5%) for a duration of 8.5. Given the international diversification the fund we are prepared to weather uncertainty.

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3. **Emerging Market debt**: no exposure to Italian assets.

4. **EUR Investment Grade**: the main funds (Corporate EUR IG and EUR Quality) have an exposure of 6% and 5 %; financials count for 1.5% and 3% respectively (40bp and 80bp are invested in Generali Subordinated bonds).

5. **High Yield**: Underweight Italian exposure of 11% in the Euro Corp HY vs. 15.40% benchmark; within the Global Higher Yield a modest 7.3% exposure is taken across defensive Higher Yield names; the Corporate EUR Opportunities is exposed for 17.7% across a diversified high quality selection.

6. **Global Unconstrained**: Italian exposure of 8.2% of AuM. Exposure of 4.4% was accumulated to Italian government bonds over the summer and autumn at attractive levels versus Bunds and OAT. The remainder of 3.8% is invested in investment grade Enel, Fiat Bank and senior 5 year Intesa San Paolo credits. Overall our interest rate exposure to Italy, Spain (government bonds) and Portugal (EDP utility) is hedged through short French OAT futures. We carry an overall exposure of 17% to EU periphery.

<u>Fundamental Equity</u>

- **Very limited impact**: we consider the outcome of this election as having a very limited impact on the investment case for European equities. This does not alter our positioning. Overall, in terms financials exposure, we have a limited position in Mediobanca, which is not your typical retail bank and is more active in corporate banking and private banking. Hence, the business model of this bank is completely different from the banks seeking to raise their capital. Overall we avoid undercapitalized financial stocks throughout Europe. We continue to see value in European equities overall thanks to their attractive valuations, dividend yields and financial health. Overall rising USD will be beneficial to dollar earners.

<u>Quant/Asymmetric Equity</u>

- In **Europe Behavioral Value** we have an overweight of 3.67% versus the benchmark in Italy, but it should be noted that this overweight position is solely the result of bottom-up security selection, not of top-down decisions. Hence, the Italian securities we have in portfolio, meet the stringent value criteria we have in the portfolio. Hence, we are by no means invested in undercapitalized Italian banks. With regards to financials, we do have a position in Mediobanca (see explanation above) and positions in well-established value stocks like Telecom Italia, Enel and Fiat Chrysler.

- **In EMU Behavioral Value**, the overweight position in Italy versus the benchmark amounts to 4.9%. The reasoning behind this is identical to the one in the European fund (please see above).

<u>Asymmetric Diversified/Patrimonial</u>

- **Asymmetric Diversified** had started the week of December 5th with a positive return, with the fund profiting from rising equity markets and a strengthening US dollar, via respectively its ca. 28%

equities and a 15% US dollar exposure. With regards to bonds, most of the fund's interest rate sensitivity relates to US interest rates, so the sensitivity to EUR rates is small, and the exposure to Italian rates is negligible.

- Regarding the **Patrimonial strategies**, the fund has a limited exposure to Italian rates. 0.08 years of modified duration in BPT(i) and 0.03 years of modified duration coming from Italian Credit (0.11 on a total of 2.94). On the equity side the managers have built a smaller position in Mediobanca. Mediobanca has no NPLs and is the largest investment bank in Italy. There is a beta with other Italian financials, but the main drivers of performance are not directly linked to BMPS, Intesa, Unicredit. It would benefit from a rise in corporate actions (an investment bank) in Italy. Performance of the fund early in the week is positive as it benefits from 20% equity exposure and duration of 2.94 (mainly US+EM, only 0.6 in EUR) and just under 30% FX exposure.