Market Commentary

March 26, 2021

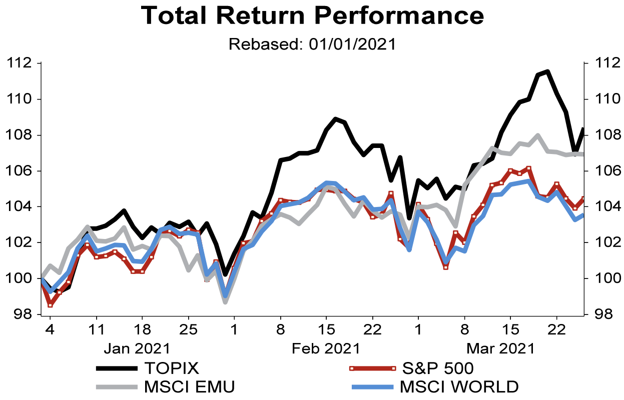
Macro & Market Research, Generali Insurance Asset Management S.p.A. SGR

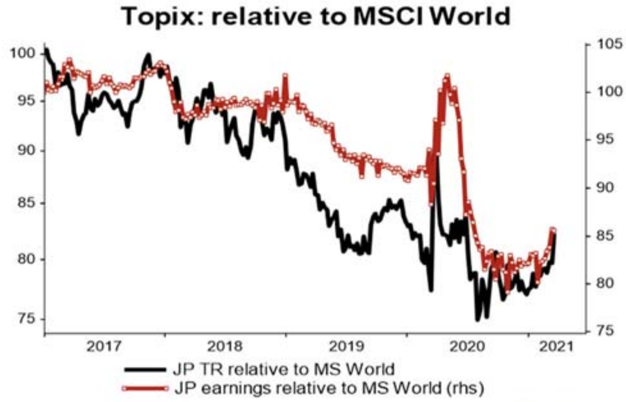
Remain positive on Topix despite recent weakness

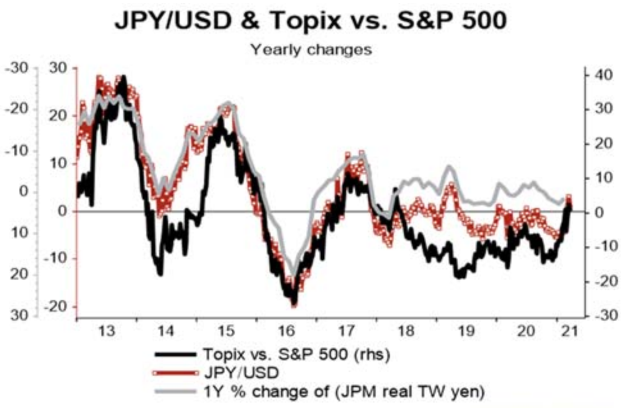
- **The good YTD Topix performance has recently been halted. In part this is due to a higher risk aversion and pause in rotation into Value and Cyclical sectors.**
- **This pause is also due to the BoJ's affirmation of its yield curve control (YCC) policy which will maintain the 10-year yield at bay, representing a limiting factor for Japanese banks and Value-Cyclical sectors in general.**
- **Finally, by the end of the month, firms will release dividends, but retailers are anticipating capital gains realisation in order to maximise tax advantages.**
- **Such issues may eventually prolong the weakness, but we think the Topix rally still has legs. The Value-Cyclical rotation is advanced but not exhausted yet and the BoJ in the end aims to ensure a complete reflation of the economy before letting yields rise. It will also start buying Topix ETF instead of Nikkei ones.**
- **A further rise in US yields, a still strong GDP momentum and higher inflation expectations represent a positive mix for a Value-Cyclical index as the Topix.**
- **Valuations are still attractive in relative terms and our proprietary country score based on expected earnings growth (among other valuation measures) still places Japan as one of the best globally.**
- **In sum, we recommend maintaining an overweight position on the Topix.**

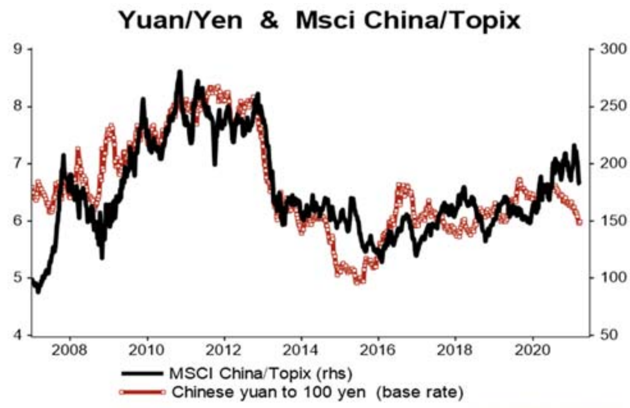
The Topix had a strong start into the year, outperforming both the S&P500 and the MSCI EMU. Since March 17th this strong performance slowed down, in part due to a **pause in the rotation into Value and Cyclicals** which had negative spillovers into Topix.

In this respect, the **BoJ reaffirmed its long-end yield curve control (YCC)** which will maintain the 10-year yield at bay, representing a limiting factor for Japanese banks and value-cyclical sectors in general.





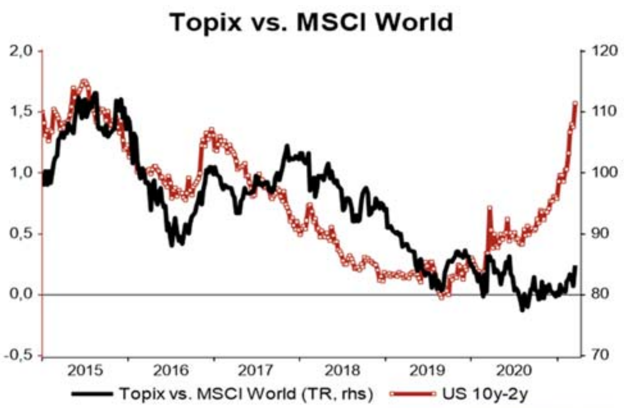




Finally, by the end of the month, firms will release **dividends**, but retailers are anticipating capital gains realisation in order to maximise tax advantages (HFs are positioned as takers and not active while retailers are selling as div. tax is 20% vs 12% of capital gains).

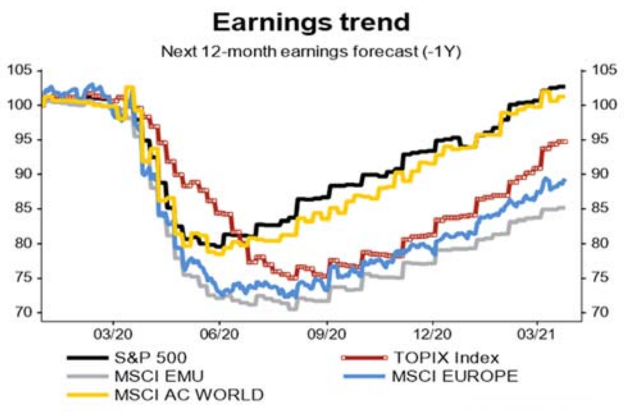
Such issues could eventually prolong the weakness, but we think the Topix rally still has legs. The Value-Cyclical rotation is advanced but not exhausted yet and the BoJ in the end aims to ensure a complete reflation of the economy before letting yields rise.

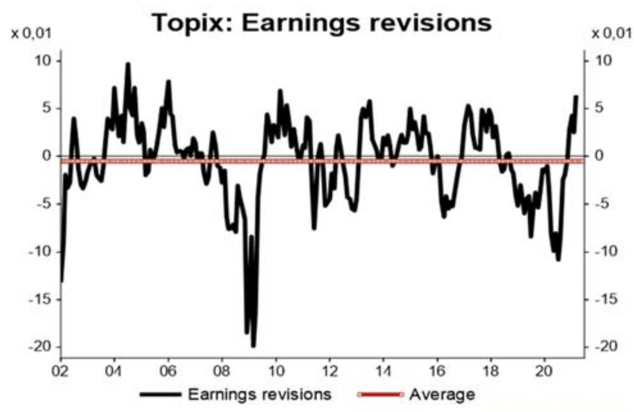
It will also start **buying Topix ETF instead of Nikkei ones**.
On the positive side, we see higher US yields in 12 months, which together with a still strong GDP momentum and higher inflation expectations represent a positive mix for a Value-Cyclical index such as the Topix.



Valuations are still ok in relative terms and our proprietary country score based on expected earnings growth (among other valuation measures) still places Japan as one of the best globally.

Earnings trend and revisions still point to a strong rebound in 2021-2022.



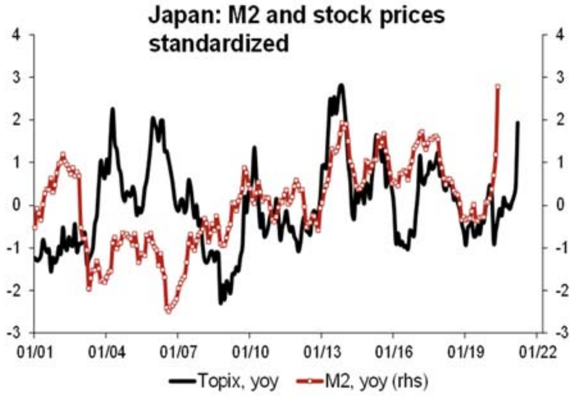


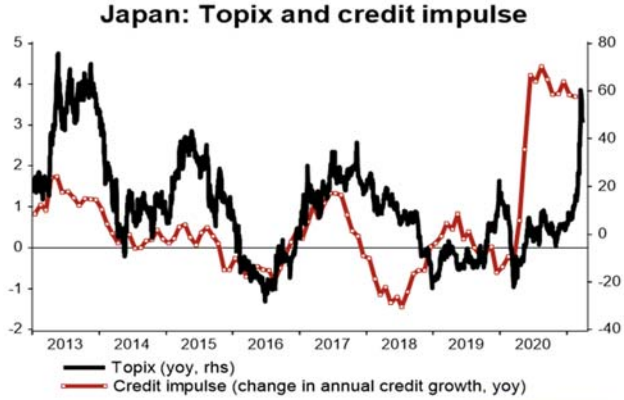
EARNINGS FORECAST BY *IBES*

25-Mar-2021

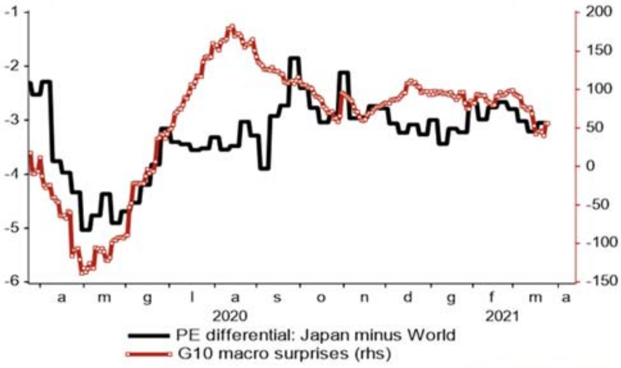
	A12FE vs 2020	2021 / 2020	2022 / 2021	2023 / 2022
MSCI AC WORLD	34.4%	**29.9%**	13.9%	**8.4%**
MSCI WORLD	33.1%	**28.6%**	13.6%	**10.3%**
S&P 500 COMPOSITE	31.5%	**25.9%**	15.1%	**10.9%**
FTSE-100	58.8%	**53.7%**	13.6%	**9.3%**
TOPIX	42.5%	**42.0%**	15.0%	
SWISS MARKET INDEX	10.9%	8.4%	9.8%	**8.3%**
MSCI EUROPE	37.8%	**33.0%**	14.4%	**9.7%**
MSCI EMU	43.2%	**37.1%**	17.8%	**11.0%**
STOXX 50 (EURO)	29.6%	**25.5%**	13.1%	**8.4%**
EURO STOXX 50	32.7%	**27.5%**	16.0%	**9.9%**
MSCI EM	41.6%	**37.1%**	15.6%	2.4%
MSCI CHINA	21.9%	17.8%	17.5%	-13.8%
SHANGHAI A	21.1%	17.6%	12.6%	-24.1%
MSCI KOREA	65.0%	**56.0%**	**23.3%**	7.1%
MSCI BRAZIL	128.5%	**129.2%**	-1.3%	-8.9%
MSCI TAIWAN	22.2%	**18.9%**	10.7%	2.7%
MSCI SOUTH AFRICA	63.5%	**57.5%**	11.6%	4.3%
MSCI INDIA	34.7%	**34.6%**	18.5%	**24.9%**
MSCI MEXICO	119.0%	**113.1%**	11.2%	**8.5%**
MSCI RUSSIA	78.1%	**71.8%**	14.6%	7.4%
MSCI MALAYSIA	80.8%	**91.1%**	-6.4%	0.8%
MSCI INDONESIA	37.2%	**30.2%**	**21.5%**	**14.5%**
MSCI THAILAND	55.1%	**46.7%**	**20.6%**	**14.5%**
MSCI TURKEY	58.4%	**46.5%**	**32.3%**	**21.9%**
MSCI POLAND	20.7%	18.5%	7.5%	**9.9%**
MSCI PHILIPPINES	59.3%	**50.8%**	**22.7%**	**17.4%**
MSCI CZECH REPUBLIC	70.9%	**65.1%**	14.1%	**25.1%**
MSCI HUNGARY	52.3%	**46.0%**	17.1%	**14.3%**
MSCI GREECE	55.1%	**49.0%**	10.0%	**16.6%**
MSCI ARGENTINA	-	**-**	**88.5%**	-24.1%
MSCI AUSTRALIA	32.7%	**21.9%**	9.9%	1.9%
MSCI CHILE	74.3%	**68.0%**	15.0%	5.4%
MSCI COLOMBIA	180.9%	**154.6%**	**41.4%**	**9.4%**
MSCI HONG KONG	36.8%	**33.3%**	10.4%	**9.0%**
MSCI PERU	382.9%	**358.6%**	**21.2%**	**17.7%**
MSCI SINGAPORE	47.9%	**43.5%**	16.1%	**11.2%**

M2 yoy momentum is also supportive for Topix performance.





Japan: PE relative vs. G10 macro surprises



Topix: Value indicator

Topix: LT Growth & total return vs S&P 500

Our proprietary country score based on valuation and recent performance shows **Japan to be quite attractive**.

Valuation: we take into considertion **Shiller PE** discount, expected **total return** (calculated as the sum of DY and next years' earnings growth), average **PEG ratio adjusted** for RoE and cost-of-equity, gap from three-stage earnings growth model (8-year history), **market multiples** gap vs history and current **PE** vs historical average **excluding bubble years** (1987-1996, 2003-2007, 2009-2019).

We give weights to different methodologies in order to avoid 100% bias towards a "value" approach (expected Total Return and PEG adjusted have more a "growth" bias, having both a weight of 64%).

Starting from valuation (80%) we add then **a measure of potential technical reversal** (with a weight of 20%) which is proxied by the **relative performance** (vs MSCI World) achieved in the last 6/12 months (the lower the relative performance the more positive the score).

Valuation + potential technical reversal

Markets	(1) Valuation score (80%) (lower=better)	(2) avg rel. performance (20%) (lower=better)	rel. perf. - 6M (TR)	rel. perf. - 12M (TR)	Beta 5 yr (USD based vs MSCI World)	R2 (Beta 5y)	Rank (1) + (2)
TURKEY	-0.9	-11.8	-4.9	-18.8	0.8	19%	1
POLAND	-0.7	-15.8	-8.9	-22.6	1.2	60%	2
MALAYSIA	-0.5	-18.1	-12.7	-23.4	0.7	53%	3
GREECE	-0.5	-13.1	-5.5	-20.8	1.2	38%	4
UK	-0.3	-12.6	-3.5	-21.6	1.0	85%	5
JAPAN	-0.4	-4.9	-1.3	-8.6	0.8	80%	6
RUSSIA	-0.4	-3.4	2.2	-8.9	1.1	58%	7
COLOMBIA	-0.4	-2.9	-3.0	-2.8	1.8	73%	8
BRAZIL	-0.4	-2.6	-4.2	-1.0	1.2	32%	9
PERU	-0.3	-6.7	-3.2	-10.2	1.1	54%	10
SOUTH AFRICA	-0.4	-2.2	-2.0	-2.4	1.3	67%	11
GERMANY	-0.3	-5.8	-4.5	-7.0	1.0	75%	12
EM	-0.4	2.2	1.9	2.4	0.9	71%	13
KOREA	-0.7	14.2	13.1	15.3	1.0	59%	14
MEXICO	-0.2	-4.5	7.0	-16.0	1.1	49%	15
SPAIN	-0.2	-6.9	6.0	-19.9	1.0	58%	16
CHINA (A-shares)	0.1	-17.6	-13.2	-22.1	0.6	38%	17
NORWAY	-0.2	-0.8	2.2	-3.7	1.3	77%	18
CANADA	-0.1	-4.7	-2.1	-7.3	1.2	91%	19
SWITZERLAND	0.2	-14.3	-9.5	-19.1	0.7	75%	20
HONG KONG	0.0	-5.9	0.1	-11.9	0.8	57%	21
WORLD	-0.1	0.0	0.0	0.0	1.0	100%	22
PHILIPPINES	0.1	-12.1	-8.6	-15.6	1.0	52%	23
INDONESIA	-0.1	-0.8	0.3	-1.9	1.5	63%	24
CZECH REPUBLIC	0.0	-1.5	11.1	-14.1	1.0	55%	25
ITALY	0.0	-1.9	6.0	-9.9	1.0	51%	26
HUNGARY	-0.1	2.7	19.4	-14.0	1.0	41%	27
US	0.0	-0.4	-0.5	-0.2	1.0	97%	28
THAILAND	0.1	-3.6	4.3	-11.4	1.0	57%	29
INDIA	-0.2	11.6	7.7	15.6	1.1	61%	30
EA	0.0	0.6	2.3	-1.2	1.0	78%	31
UK250	0.0	0.3	5.7	-5.2	1.3	84%	32
AUSTRALIA	0.2	-6.7	-2.7	-10.6	1.3	84%	33
CHINA	0.2	-8.3	-7.5	-9.1	0.8	46%	34
TAIWAN	-0.1	12.9	11.1	14.7	0.8	55%	35
SINGAPORE	0.2	-5.8	4.2	-15.8	0.9	64%	36
CHILE	0.0	9.5	14.4	4.6	1.3	63%	37
PORTUGAL	0.4	-13.3	-4.3	-22.3	0.9	58%	38
DENMARK	0.4	-10.1	-11.7	-8.5	0.8	57%	39
SWEDEN	0.2	0.6	2.1	-1.0	1.0	77%	40
NETHERLANDS	0.3	-0.6	5.1	-6.3	0.9	83%	41
FRANCE	0.3	-4.1	3.4	-11.5	1.0	74%	42
FINLAND	0.5	-1.2	-3.6	1.2	1.0	77%	43
BELGIUM	0.7	-6.9	1.3	-15.1	1.0	69%	44
IRELAND	0.8	1.2	-0.6	2.9	1.1	78%	45
ARGENTINA	2.8	4.6	-3.1	12.2	1.4	30%	46

Note: Rank is derived from valuation (80%) and the average relative performance (20%) (which considers 6m and 12m relative performance of each market vs the MSCI World). The valuation score is calculated as a sum of standardized expected total return (35%), average PEG ratio adj. (for ROE and COE) (35%), Shiller PE discount (10%), market multiples discount taken from 2004 (10%), and PE vs. hist. avg. excl. bubble years (10%).
Most negative valuation score = cheapest = highest valuation rank (1); lowest perf. = highest perf. rank
Average PEG is the average of fwd PEG and trailing PEG. fwd PEG is 12m fwd PE divided by expected EPS long-term growth. EPS = 12m fwd earnings.
Trailing PEG = trailing PE divided by earnings growth F0-F3.

Focusing on the valuation component of our country score, Japan looks rather attractive both in terms of valuations and expected total return (DY + earnings growth).

Valuation metrics

Markets	Shiller PE, discount	Exp. TR = DY + next years' EPS growth	average PEG*	average PEG adj.*	LT earnings growth	DY - 10Y yield	Market multiples, discount to history	PE vs. hist. avg. excl. bubble years	Price vs earnings perfor-mance since 1995	BETA (vs MSCI EMU)*
	since 1993									
weights used in the calculation of rank	10%	35%		35%			10%	10%		
WORLD	27%	18%	1.4	2.0	14.4%	1.5%	39%	42%	21%	0.68
US	45%	18%	1.4	1.9	16.5%	-0.1%	46%	62%	43%	0.61
JAPAN	-21%	17%	1.3	2.2	14.4%	2.0%	16%	-43%	-250%	0.75
UK	-11%	19%	1.4	2.3	7.1%	3.0%	6%	39%	17%	0.68
UK250	5%	42%	1.6	3.2	6.8%	1.7%	23%	114%	-	0.79
SWITZERLAND	14%	12%	1.9	2.4	8.4%	3.4%	15%	12%	-	0.67
EA	15%	17%	1.7	2.6	7.8%	2.8%	30%	50%	20%	1.00
EM	-9%	22%	0.9	1.9	22.5%	-1.5%	27%	24%	-13%	0.68
CHINA	1%	16%	1.2	2.1	22.9%	-1.7%	38%	47%	-	0.58
CHINA (A-shares)	-40%	10%	1.4	2.2	14.7%	-0.7%	-1%	-12%	-	0.31
Median	**1%**	**18.3%**	**1.49**	**2.54**	**8.9%**	**1.5%**	**15.9%**	**40.1%**	**20%**	0.79

Our long-term (LT) models point to an average valuation above 2,000 and our final 1-year target is 2,100, as we expect further positive earnings revisions.

Long-term models	PEs 12m: 21X for US, 18.5X for SMI, 17.3X for EMU & Japan, 14x for UK	fair value (12-m EPS/10-year yield)	eq./bond yield gap	DDM	Gordon 3 stage DEV	Current average valuation in 1 year	Current average price up/downside by next 12 m	DY 12m	TR 12m (incl. Bback)
Weights	40.0%	15.0%	15.0%	15.0%	15.0%	100.0%	**LT Models**		
S&P 500	**4,390**	**3,598**	**3,598**	**3,526**	**3,443**	**3,881**	**-2.3%**	**1.5%**	**0.7%**
Weights	40.0%	15.0%	15.0%	15.0%	15.0%				
MSCI EMU	**210**	**206**	**206**	**183**	**169**	**199**	**3.2%**	**2.9%**	**6.1%**
Weights	40.0%	15.0%	15.0%	15.0%	15.0%				
MSCI EUROP	**1,732**	**1,783**	**1,793**	**1,632**	**1,486**	**1,697**	**5.8%**	**3.1%**	**8.9%**
Weights	40.0%	15.0%	15.0%	15.0%	15.0%				
FTSE 100	**7,023**	**8,224**	**8,503**	**8,170**	**6,954**	**7,587**	**12.2%**	**3.9%**	**16.1%**
Weights	40.0%	15.0%	15.0%	15.0%	15.0%				
SMI	**12,271**	**11,436**	**10,874**	**9,381**	**9,738**	**11,123**	**1.8%**	**3.1%**	**4.9%**
Weights	40.0%	15.0%	15.0%	15.0%	15.0%				
TOPIX	**2,226**	**1,898**	**1,844**	**2,130**	**1,748**	**2,033**	**2.5%**	**2.0%**	**4.5%**

In sum, notwithsanding some possible weakness (also due to good performance achieved so far) we **maintain the Topix on overweight**.

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