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Amundi
ASSET MANAGEMENT

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Covid-19 will redesign sector opportunities amid gradual normalisation and focus on earnings

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Key insights

- ***Current assessment:*** *The spread of coronavirus in Europe and the United States triggered a worldwide stock market crash in March, followed by a partial rebound. Many questions -- such as the length of the pandemic and the extent of the consequent recession -- remain unanswered. We outline three scenarios to analyse the situation. In a rosy scenario, a U-shaped recovery could begin in Q3, whereas in our central scenario (50% probability), a U-shaped recovery would have a lower and a longer bottom, and a recovery would not occur until Q4. In a risk scenario, the pattern would be L-shaped and the initial stages would be very weak. According to our analysis of three different scenarios of potential index returns for US (S&P 500) and European equities (Eurostoxx 50), each index level would be 2,450 and 2,550, respectively, in a bearish scenario, 2,780 and 3,100 in a central case, and 3,000 and 3,500 in an optimistic situation.*
- ***Comparison with 2008 GFC and 1987 crash:*** *A recession is already under way, despite the quick and massive stimulus enacted. Going forward, in a rosy scenario with an economic recovery from Q3, a 1987-style recovery would be possible. If a recovery does not take place until the end of 2020 or even by Q1 2021 (our central scenario), the 2008 crisis could be a better reference point. From a market perspective, in both the above crises, stock markets converged to around 20% below their pre-crash levels one year after the start of the crash. Based on these simulations, a first reference point was reached with the first large downward move. It remains possible that the equity markets will go down one more step. Meanwhile, investors who started to build long-term positions on this type of level during the crisis of 1987 or 2008 would have ended up with attractive performance over a reasonable time horizon.*
- ***Risks and opportunities:*** *The fall in European EPS could be equivalent to or much worse than that recorded in the 2008 crisis, given the unprecedented confinement measures. It is key to keep a strong focus on stock selection and a clear tilt towards quality. Investors should evaluate companies from a bottom-up perspective to identify solid businesses with forecastable business models, trading at significant discounts to their intrinsic fair values. Balance sheet strength is critical. While there are opportunities within healthcare, consumer staples/discretionary and utilities, we are cautious on energy, and financials. There are also selective opportunities arising from the historical valuation disconnect between value and growth in Europe.*
- ***Permanent disruption and resilient stories as a result of crisis:*** *We could see a 'lasting impact' on certain industries, given that governments are increasing their roles through significant fiscal stimulus. Debt accumulation will be significant and interest rates will remain low. Companies that are helped during the crisis by governments could have to carry a larger social burden and face more regulation. However, not all companies will be supported by governments. Therefore, from investors' perspectives, it will be critical to distinguish companies and sectors that can survive the crisis (better positioned) from those that cannot withstand the downturn. This is possible through a case-by-case analysis of balance sheet sustainability and individual business models. Investors need to be careful about their exposure to disrupted business models, and allocate resources to names that will be able to transform themselves. On the other hand, what was expensive and good quality before the crisis is now more affordable. So, this can be another area of opportunity for long-term investors.*
- ***Impact on ESG evolution:*** *As the crisis evolves, there is a potential for fiscal stimulus to be targeted at the 'green deal', especially in Europe, on initiatives such as the energy transition from fossil to renewable fuel. An increasing role of governments could be positive for areas such as employment, wages and health. This could result in some rebalancing of the three pillars, with 'S' gaining prominence. ESG remains an integral part of stock selection.*

Market correction due to Covid-19 crisis

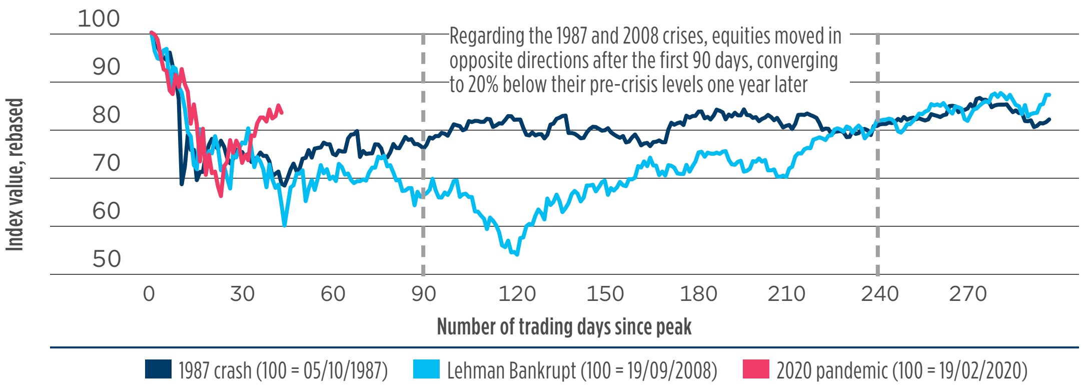
The spread of coronavirus outside China to the rest of the world, notably Europe and the United States (the two collectively represent 75% of MSCI ACWI) triggered a worldwide stock market crash, with falls ranging from 30% to 40% across the world in just 16 days. The rebound that followed has been significant but still partial. At the time of writing, many questions remain unanswered: how long will the pandemic last? How deep will the recession be and how long will it last? We use three scenarios to depict the situation. Under the **rosy scenario (30% probability)**, we forecast a U-shaped recovery that could begin in the third quarter. The **central scenario (50% probability)** also calls for a U-shaped recovery, but with a lower and longer bottom, and a recovery that would not occur until the fourth quarter or even the first quarter of next year. Finally, a **risk scenario (20% probability)** has a pattern that would appear to be L-shaped and a recovery would be weak initially.

"During the 1987 and 2008 crises, equities were very volatile for around three months before moving in the opposite direction. This time, market direction would depend largely on the evolution of the healthcare crisis".

A comparison with the 2008 GFC and the 1987 market crash

The current stock market panic, which started on 20 February 2020, is of the same order as the crash of October 1987 and the Lehman moment in September 2008, with reference to the S&P 500, which lost 30% in a short time span. The two historical shocks present differences: 1987 did not lead to a recession, whereas the bankruptcy of Lehman Brothers prolonged the subprime crisis, which started in 2007, and led to a recession. However, there are also some similarities. **In both cases, equities were very volatile for around three months before moving in the opposite direction**. This duration is interesting to note because it is about the same time it took for China to contain the current Covid-19 outbreak. **If we draw a parallel, as we write, equity markets would be within this volatile period**.

Figure 1. S&P 500 crash, 1987 vs 2008



Source: Amundi, Datastream as of 21 April 2020.

"In a rosy scenario, with a recovery from Q3, a 1987-style rebound would be possible. If a recovery does not take place until the end of this year or even by Q1 2021, the 2008 crisis could be a better reference point".

It is a given that a recession will take shape in the first half of 2020, despite fiscal support measures. These measures — above 3% of global GDP — and the monetary policy responses have been much stronger and quicker than in 2008. But, the direction that markets take will depend largely on the evolution of the healthcare crisis. In a rosy scenario, with an economic recovery from the third quarter, a 1987-style recovery would be possible. However, if a recovery does not take place until the end of the year or even by the first quarter of 2021 (our central scenario), the 2008 crisis could be a better reference point. In November 2008, the US Treasury, under the TARP, stepped up and took direct stakes in the capital of the most fragile financial institutions[1] . **But this did**

[1]TARP: Troubled Asset Relief Program was a plan of the US government to purchase toxic assets and equity from financial institutions to strengthen the country's financial sector during the 2008 crisis.

"Irrespective of the path taken by equities during the two previous crises, stock markets converged to around 20% below their pre-crash levels one year after the crash started".

not prevent markets from repeating a downward move of a further 25% vs. the lows reached after the crash, before eventually finding a bottom on 9 March 2009. **Regardless of the path taken by equities during the two previous crises, stock markets converged to around 20% below their pre-crash levels one year after the crash started**. When we transpose this to the current context, it roughly corresponds to a level of 2,700 for the S&P 500.

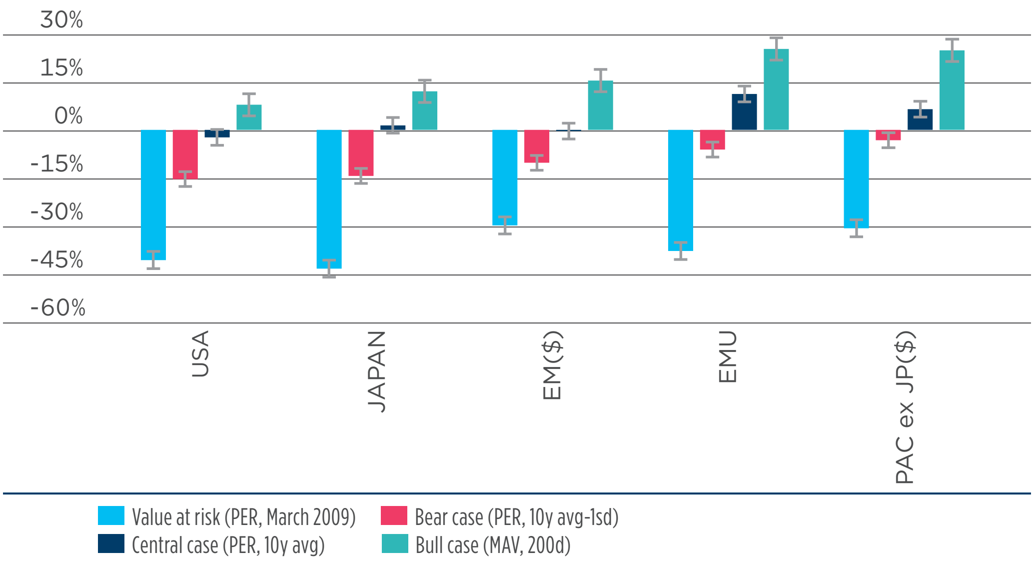
Based on these simulations, we conclude that in the present situation, a first reference point was reached with the first large downward move. It remains possible that equity markets will go down one more step. **At the same time, investors that started to build long-term positions on this type of level during the crises of 1987 or 2008 would have ended up as winners over a reasonable time horizon**.

Impact on valuation

At a time when visibility is low, building scenarios in terms of valuations and mean reversion could offer some objectivity. **A central scenario could retain the hypothesis of a mean reversion of the 12-month trailing PER to its 10-year average**[2]. A bearish scenario would use the assumption of a return to the average minus one standard deviation. Finally, an optimistic scenario forecasts a return of indices to their 200-day moving average.

"According to our central case, we could see a mean reversion of the 12-month trailing PER to its 10-year average, whereas under a bearish scenario, PER would return to its 10-year average minus one standard deviation".

Figure 2. MSCI indices' potential returns, PERs according to mean reversion scenarios



Source: Amundi Research, 21 April 2020, EMU: European Monetary Union, Bull case: 200- day moving average.

These mechanical scenarios would target 2,450 for the S&P 500 (bearish scenario), 2,780 (central) and 3,000 (optimistic). **It is interesting to note that this central scenario result corresponds approximately to the same level as the ones mentioned above in parallel with 1987 and 2008**. Applying the same logic to the Eurostoxx 50, the result would be 2,550 (bearish), 3,100 (central) and 3,500 (optimistic), respectively.

We can also model an extreme case (value at risk in the chart). What would happen if the shares were paid for at as cheap a rate as at the market bottom on 9 March 2009? In this case, the S&P 500 had reached a 12-month trailing PER of 10.5x, which would correspond today — all other things being equal — to around a 1,710 index level. Of course, such a perspective cannot be excluded completely from our discussion; it would require a second-round impact with a more-entrenched-than-expected coronavirus pandemic and/or a large wave of company defaults, although this is what policymakers are trying to avoid with their strong commitments. While this could be a scary outcome in the short term, if we were to follow the 2008 pattern, such a further decline would likely only be temporary.

[2]Price-Earnings Ratio.

Focus: Assessing European earnings growth and how this would respond to the current crisis

In terms of earnings growth, depending on the scenario — optimistic, central or bearish — we foresee declines in year 1 (2020) by 35%, 60% or 110%, respectively. Then, in year two (2021), earnings should rebound to their initial level in the rosy scenario, 10% below that in the central one, and 60% below in the pessimistic scenario.

"Given current uncertainty, we cannot completely rule out a new surge in market stress, especially if the pandemic were to last. Further, alternatively, we cannot completely ignore the possibility that in one year, earnings could start to rebound".

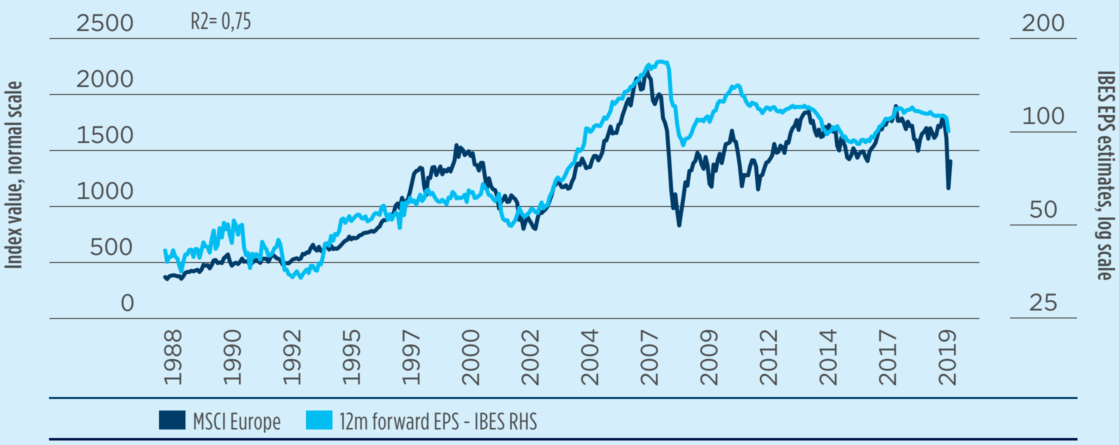
Table 1. European EPS growth forecasts under different scenarios

Scenario	2019 (base year)	2020 (%)	2021 (%)
Optimistic	100	-35%	0%
Central	100	-60%	-10%
Bear	100	-110%	-60%

Source: Amundi Research, as of 1 April 2020.

A regression between forward profits and the level of the MSCI Europe index suggests that the market is already pricing a 35% drop in for 2020 EPS, in line with the rosier scenario (-35%), but less than in the 2008-09 period and also less than our central forecast of -60%. This calls for two concluding remarks: on the one hand, **we cannot rule out a new surge in market stress, especially if the pandemic were to last or if there is a second-wave of infections. However, another interpretation would be that in one year, earnings could start to rebound, even in our darker scenario and the market will anticipate**. Therefore, it is appropriate to say that while volatility scares investors in the short term, it could also bring long-term opportunities.

Figure 3. MSCI Europe and IBES forward EPS index



Source: Amundi, Datastream data in a common currency, 21 April 2020. 12-month forward EPS.

"The effect of Covid-19 crisis on earnings could be worse than in 2008 because the outbreak points to a severe recession, given the unprecedented confinement measures affecting demand, supply and solvency".

Impact of the crisis on earnings growth

In order to have some benchmarks, we look at the earnings dynamic during the GFC of 2008-09. At that time, MSCI Europe EPS fell by 20% in 2008, out of which -60% was in Q4 (-12% and -33%, respectively, for the MSCI ACWI)[3]. Then, European EPS nosedived by -47% in 2009 (-43% for ACWI). All in all, by end-2009, European EPS were 57% lower than their pre-crisis level of end-2007. By sector, on the same timeframe, the worst drops were registered by autos (-114%) and financials (-99%), whereas utilities (+2%), telecom (+6%), healthcare (+11%) and consumer staples (+24%) proved more resilient.

Compared to the GFC, the impact of the Covid-19 crisis on EPS could be even worse. This is because the outbreak of the pandemic points to a severe recession. We foresee 2020 real GDP growth ranging between -1% and -4% in the Eurozone and 0% to -2% globally. In 2019, European and global growth were +1.2% and +3.1%, respectively; in 2009, they hit -4.2% and -0.1%. The expected range for 2020 growth is unusually large as it depends very much on **the longevity of the virus outbreak, the severity of the lockdowns, and the depth of the economic disruption** and its impact on corporate default rates.

To illustrate that, in France, the National Institute of Statistics and Economic Studies (INSEE) has estimated that French GDP is contracting at a pace of around 35% during the lockdown. In other words, each month under lockdown would shave approximately 3% off French GDP. The EU has given similar indications of a reduction of 2% per month, as the lockdown is less stringent in the northern part of Europe. Ultimately, each passing week brings us closer to the bottom of the forecast.

"As per our central scenario for European earnings, with the pandemic peaking in Europe by Q2, with some normalisation in Q3 and acceleration afterwards, we could see a 60% decline in 2020 EPS".

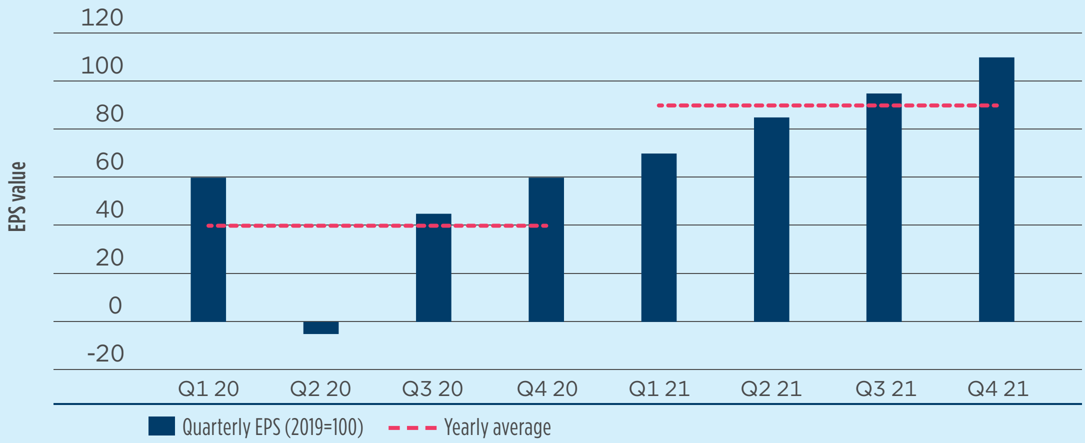
In 2009, European EPS dropped by 47% vs 2008 and by 57% compared to 2007. **This time, the EPS fall should be equivalent — or even worse —** given that the unprecedented confinement measures affect supply, demand and solvency. Furthermore, **the drop should be concentrated in a single year** whereas in the GFC, the fall was spread between 2008 and 2009. On top of that, beyond the Covid-19 issue, the oil crisis will also leave its mark on EPS growth, and not to forget the plummeting buybacks. The peak of the freefall should occur around March-April, when the lockdown will be the most acute.

The real unknown relates to the second half of the year. Our European forecasts have been developed around three scenarios. According a central scenario, with the pandemic peaking by Q2 in Europe, some normalisation seen in Q3, and acceleration thereafter, we could see a 60% decline in 2020 EPS with a quarterly sequence as shown in the chart below.

[3]MSCI ACWI = MSCI All Country World Index.

"In a more negative scenario, we could see a delay in economic normalisation, with 2020 EPS falling by 110%. However, an optimistic case would see an overall EPS drop of c.35% in 2020".

Figure 4. MSCI Europe quarterly EPS absolute value, central scenario



Source: Amundi Research. Data as of 1 April 2020. Index value in base year 2019=100.

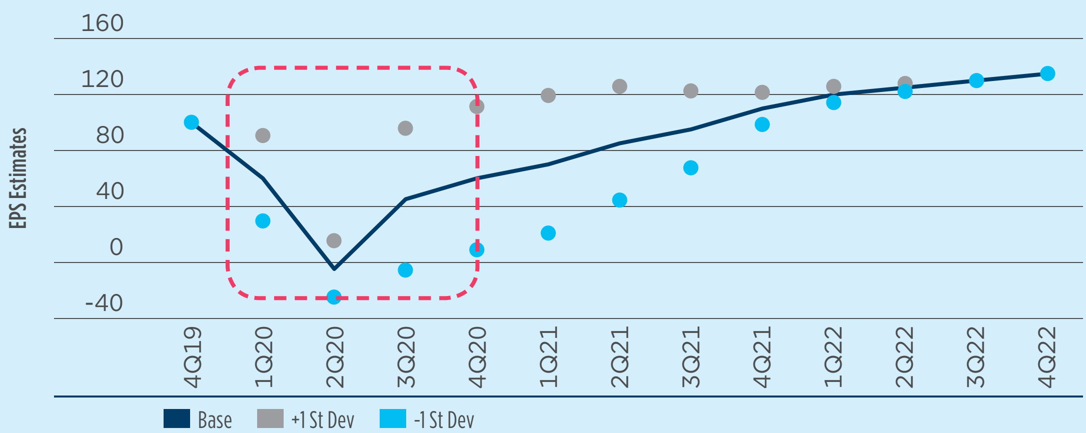
EPS growth should be -40% in Q1, with further losses in Q2, a sequential improvement in Q3, but not on a year-on-year basis (-55% year-on-year in Q3), and -40% in Q4. Given the base effect, in 2021, we could see a massive rebound (above 100%), although 2021 EPS would probably remain lower than 2019 EPS, given the lack of pricing power and the rise of restructuring charges and goodwill depreciation.

Under a more negative scenario, we could see a delayed normalisation of the economy due to risks of resurgence of the epidemic post the initial confinement measures. In this case, 2020 would be in red, with a 110% EPS decline, and losses could extend until Q1 2021. **Finally, in a more optimistic scenario**, we could witness rapid availability of a treatment, with stabilisation from end-May. EPS would be down 70% in H1 and almost stable over H2. This would result in an overall EPS drop of around 35% in 2020, before a very strong rebound in 2021.

"Looking at the distribution of changes in EPS growth over 2019-22, the bulk of the uncertainty occurs between Q3 2020 and Q2 2021, but not in Q2 2020".

Counterintuitively, looking at the distribution of changes in EPS growth over 2019-22, the bulk of the uncertainty occurs between Q3 2020 and Q2 2021, but not in Q2 2020, as shown in the chart below.

Figure 5. Volatility of MSCI Europe quarterly EPS estimates



Source: Amundi Research. Data as of 1 April 2020. Standard deviation based on of EPS estimates for central, dark and optimistic scenarios.

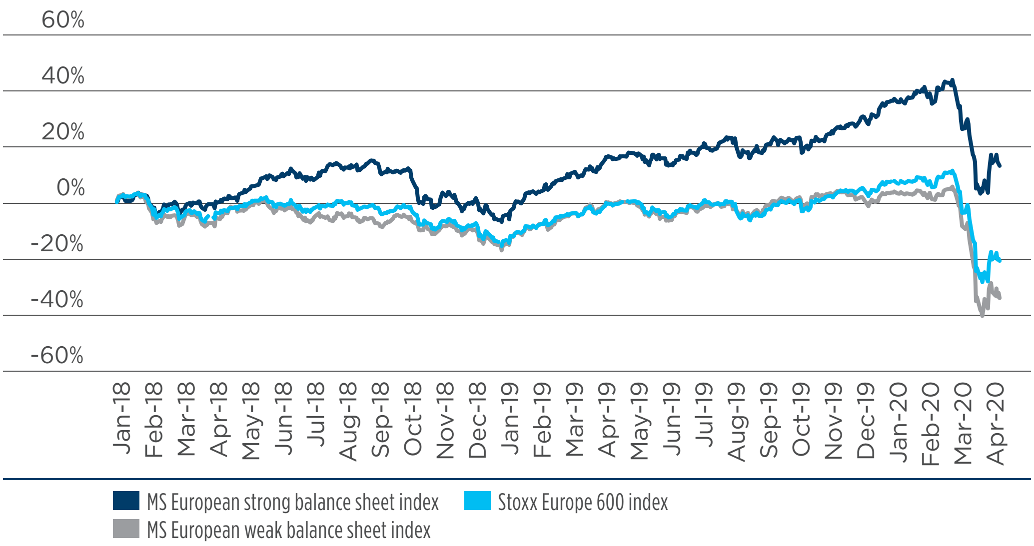
To summarise, depending on the scenario — optimistic, central or dark — we foresee declines in year 1 (2020) of 35%, 60% or 110%, respectively. In year two (2021), earnings should rebound to their initial levels in the rosy scenario, 10% below in the central one, and off 60% in the pessimistic scenario.

Fundamental investing amid the Covid-19 outbreak

"In this phase of uncertainty and of a sudden economic shocks, markets have distinguished companies with strong balance sheets from those with weaker ones".

The first correction phase was indiscriminate, with stocks falling across the board and even assets such as gold, considered to have safe-haven status, declining. We saw a 'liquidation' phase as investors sold out of even the most liquid assets to limit portfolio volatility or face redemption pressure. The second phase was more discriminate as central banks stepped in and investors became more selective, favouring companies with strong balance sheets and resilient business models, as shown below.

Figure 6. Stocks with robust balance sheets have outperformed those with weaker ones



Source: Amundi, Morgan Stanley, Bloomberg. Data as of 3 April 2020. Normalised data from 1 Jan 2018.

Still, equities look vulnerable overall. While there has been a significant sell-off, the economic impact of the current health crisis is also significant and its severity still uncertain. Visibility for companies is extremely low. Multiples have de-rated, but earnings estimates have not yet been cut sufficiently, in our view. Uncertainty remains very high.

"Equities look vulnerable, but as active, bottom-up investors, we focus on companies with strong balance sheets and resilient business models trading at a significant discounts to their fair values".

We evaluate companies from a bottom-up perspective to identify solid businesses with forecastable business models, trading at significant discounts to their intrinsic fair values. Market environments like these typically create opportunities for long-term active bottom-up investors, and the current environment is no exception. Good opportunities look to be available in both defensives and cyclicals, but the common denominator is that we prefer companies with **strong balance sheets and cash flows, and resilient/non-disrupted business models**. For instance, the luxury sector appears interesting in the long run, as the inventory is not perishable and customers could return after the crisis.

However, **some weaker companies in weak industries** may not survive the current economic situation and avoiding these will be critical. National incumbents in the auto and airlines sectors look very vulnerable, and some are likely to require debt guarantees, equity issuance and potentially nationalisation in a matter of months. We consider telecoms and utilities to be less exposed to this trend.

Certain structurally appealing and resilient sectors, which were previously very expensive, now look compelling. In this area, we see new opportunities in healthcare, consumer staples and luxury within consumer discretionary. Technology also remains on our radar.

Value also presents some idiosyncratic opportunities due to attractive valuation. Value has never been this cheap relative to growth in Europe. Bond yields and PMIs are holding back an overall reversal of the value underperformance, but great idiosyncratic opportunities exist within value, particularly in materials and industrials. In contrast, other parts of value look like they could continue to be vulnerable, such as energy, media and autos at this stage. All in all, we maintain a bias towards quality and financial solidity.

A first assessment of the long-term implications of Covid-19

"There is potential for fiscal stimulus to be further targeted at the 'green deal', especially in Europe, on initiatives such as the energy transition from fossil to renewable fuel. A rollback of environmental legislation, if at all, will be temporary".

There are concerns about the permanent impact of the crisis in certain industries. It seems evident that the role of governments may be bigger as they are implementing significant fiscal stimulus measures. Consequently, debt accumulation is significant, and at some point, this has to be addressed. We see a world of lower rates and ultimately some form of debt monetisation. This is important: equities overall look to be positioned well longer term.

Companies that are helped during the crisis by governments will likely have to carry larger social burdens and face more regulation. We are already seeing a wave of dividend cancellations at the recommendation of regulators as a first sign of this. We are also debating whether there will be an increase in de-globalisation as a result of this, with changing supply chains, shifting consumer behaviour in travel and leisure, different working patterns with more remote working, or different levels of public investments in healthcare.

An immediate result of the crisis may be to roll back some environmental legislation in an effort to support economies. If this were to happen, we think changes would be temporary only. There is potential for fiscal stimulus to be further targeted at the 'green deal', especially in Europe, on initiatives such as the energy transition from fossil to renewable fuel. The current low oil prices are unlikely to materially affect this push towards a greener economy. In addition, and as noted earlier, the immediate impact of the crisis may be a further increase in the role of governments. This could support the social pillar in areas such as employment, wages and health. Overall, the need to focus on ESG is as strong as ever — the issues are structural and growing — for long-term investors.

Luc
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Head of European Equity Research

"Luxury companies and sporting goods manufacturers are areas of opportunity, while the retail and automotive sectors remain more challenging".

Sector opportunities amid Covid-19 crisis

Consumers: cheap names could prove costly

Current assessment	In the consumer sector, we remain constructive on opportunities in China for the luxury companies. We believe the largest **luxury companies** will be able to limit to low double digits the declines in 2020 earnings, despite the adverse market conditions experienced in China in Q1 and in other developed markets during Q2. We also see **opportunities in leading sporting goods manufacturers**, where valuations have fallen to attractive levels, presenting interesting long-term opportunities for what we see as a strong secular growth area with solid pricing power. Within the consumer staples space, we have **a preference for basic food and household staples** over the more discretionary beverages and cosmetics, which will struggle due to a high reliance on premium mix sold through the air travel market, and even beer companies, which will be impacted by the closure of licensed premises and the absence of sporting events. Within the food space, there will be a mix shift from 'out of home' to domestic consumption, and we believe investors should seek to minimise exposure to the former theme. We believe that the **retail market will remain challenging**, as although supermarkets are benefitting from some temporary consumer stocking, this is coming at extra cost for retailers and we expect pressure on consumer spending to emerge as the year progresses. We remain **cautious on the automotive sector** and expect all companies to report sharp declines in earnings for 2020 on the back of the current factory closures and a 15% decline in global demand, with uncertainty over the extent of the recovery in 2021 on big ticket items, purchase of which can be deferred.
Long-term impact after the Covid-19	Longer term, we believe the luxury segment of the consumer sector will benefit from the growth of the Asian consumer, with the Chinese remaining the most important driver of the sector. We anticipate that **luxury good companies** will report a strong earnings recovery in 2021, although the strength is predicated on a recovery in international travel. Similarly, a recovery in international travel is a precondition for the luxury beverage companies to return to growth. Ultimately, we expect a **recovery in the 'out-of-home' food segment**, but the **speed of the recovery is likely to be choppy**, and **large food companies** should benefit from improved volume growth. We believe that the current crisis will **pressure the retail sector and lead to continued growth of home shopping** and delivery services.

"Med-tech names with resilient business models and innovative pharmaceutical companies should be able to withstand the short-term volatility".

Health care: focus on resilient, innovative businesses

Current assessment	The European healthcare sector is broadly divided into pharmaceutical and medical technology (med-tech) companies and the impact of Covid-19 will vary across these categories. We believe **pharmaceutical companies should be relatively well protected**, given that most products are used to treat chronic conditions and/or are life-saving in nature. We could see a deferral of elective medical procedures, such as dental implants, purchase of hearing aids, hip/knee replacements, etc., in the short term. As a result, **pharmaceutical companies have outperformed the med-tech sector**. However, we focus on those med-tech names where we believe the **business models should be resilient** in the medium term. We like companies involved in hospital-based procedures, which cannot be deferred indefinitely and where earning should quickly normalise. We also look at businesses related to hearing aids where the resilience of pensioners' incomes will prevent any deferral of purchase in the medium term.
Long-term impact after Covid-19	Companies engaged in unified communication-driven headset business should see a boost in demand, **driven by increases in remote working**. Likely **price pressure** from governments will be negative for the pharmaceutical sector. Therefore, we focus on companies that offer true innovation/differentiation. A **potential reduction in routine visits to general practitioners** could impact pharmaceutical companies' abilities to launch new products.

"De-carbonisation, growth in renewables and efficient transport will remain key trends. For airlines and aerospace, although there is less visibility on a recovery, we believe long-term drivers for air travel demand are intact".

Cyclicals: bottom-up selection in uncertain times

Current assessment	The sector has seen a large divergence in performance at the stock level since the beginning of the year and through the crisis. This has created significant uncertainty in near-term operations for almost all end-markets. The outlook for near-term **earnings growth remains uncertain** and varies significantly across the various end-markets, geographies and business models. As a result, we **focus on bottom-up opportunities** in companies where we see long-term structural drivers for growth, good competitive positions, and relatively sound balance sheets. We are discussing with industry experts and corporate management teams on a regular basis to better understand how they are mitigating risks from the outbreak, keeping employees safe and healthy, and preparing for the eventual re-acceleration.
Long-term impact after Covid-19	Post Covid-19, we see most of the identified structural drivers for our end-markets as being largely unchanged. We believe **de-carbonisation, building efficiency, growth in renewables and efficient transport would remain key trends for the sector**, driven by global agendas. In addition, rising investment in **digital manufacturing** will become a focus for investment after the current crisis. However, we have somewhat **less visibility** on the timing of recovery for the **airline and aerospace sectors** but believe that the key long-term drivers behind airline demand remain intact. The recent turmoil in the oil sector makes us sceptical about the sustainability of cash generation for large integrated players. Therefore, we are exploring more **defensive business models** in the space.

"The crisis will shake out banks with weak balance sheets, so we look for quality banks with strong capital levels. In diversified financials, ethical-social approaches to investment/savings propositions will be even more critical".

Financials: balance sheet strength is key

Current assessment	**Banks** are once again in the eye of the storm within this crisis. However, this time round, they are expected to be part of the solution. While the sector is likely to support businesses and consumers that face cash flow difficulties, **we believe**, the sector itself will be affected, as low rates impact revenues and asset quality deterioration causes higher loan losses. Nonetheless, **we expect this crisis to be an earnings event** for strong banks, with limited dilution risks outside of the smaller, weaker players. Trading on c.0.5x price to tangible value (P/TNAV), the sector's valuations have already priced in a lot of distress. **We also note the risk of increased government intervention**, as the crisis evolves, to ensure credit remains freely flowing. **We look for quality banks** — trading at attractive valuations — that have diversified business models, superior profitability and strong capital levels. **Among insurers**, Covid-19 will lead to lower (year-on-year) earnings growth in 2020 due to losses from claims (travel, business continuity and event cancellation), but the losses should be manageable and offset by lower frequency and severity in car and home insurance. The recent sell-off has led to **compelling valuations for the sector and it represents a great entry point for long-term investors**. In addition, credit defaults and migration, which are a risk for insurers, should pose lower threats to profitability now, given insurers' investment in credit portfolio management and the backstop provided by the Fed and the ECB. **We focus on long-term structural winners with robust balance sheets**, deep liquidity buffers, diversified businesses and strong corporate governance. **The diversified financial services** sector has been affected by cyclical drivers such as market sentiment, volatility, risk appetite and low interest rates. Some areas, such as volumes-driven **infrastructures (exchanges)**, are affected positively over the short term, at least in secondary markets and mostly by derivatives, as volumes rose on the back of increases in market velocity. As a result, earnings revisions are positive/flat year-to-date for them. **However, regarding investment platforms/factories**, cyclical drivers have negatively affected earnings (outflows and lower market values) which are down on average 20-30% across 2020-21 and multiples have partially de-rated. Impacts from cyclical drivers could revert in the medium term.
Long-term impact after the Covid-19	**We believe bank profitability is likely to be affected** by the high risk of tail provisioning (loan repayment forbearance) and the crisis could shake out the weaker players, leading to a pick-up in consolidation when we exit the downturn. This crisis presents an opportunity for the sector to enhance its reputation depending on how it supports economies and generates investor returns. **The current pandemic will create opportunities for insurers** to expand coverage, particularly in Asia and South America, as globally there is a huge gap in both P&C and life insurance. The sector's balance sheet strength and liquidity will allow it to capitalise on any opportunities and to continue to perform its key risk transfer role in society. In **diversified financials, ESG, or the ethical-social approach** to investment/savings propositions, will be even more critical. The importance of quality, fairness of advice in proposing investment/pension solutions, in particular to retail clients, will rise and so will regulatory pressures. Here, **we focus on companies that have one-stop solution models** with integrated channels, mobile-access and in-house digital capabilities that can be leveraged to capture structural trends. Among asset managers, we like names that are well placed to benefit from a gradual recovery and are well diversified in terms of asset classes AUM exposure.

"We are looking for large, geographically diversified telecom companies; in IT, we believe businesses operating around connectivity-related themes will benefit".

TMT: size matters in telecom; new avenues emerge in IT

Current assessment	**Telecoms are relatively defensive**. We believe that only roaming revenues should see a hit from travel bans (around 1-2% of sector revenues). Other services are generally sold in bundles, so there is less reliance on consumption now than there was in previous downturns. B2B exposure is around 25% of sector revenues and we expect this area to see a late-cyclical softening when a number of SMEs start to experience financial issues. Leverage is relatively high vs the market, but in general balance sheets are well managed, with long maturities and healthy liquidity on hand. For the most part, **IT** is a cyclical sector and will see order cuts and project postponements, and subsequently revenues will come under pressure. That said, European tech tends to be more B2B-focused. So, our expectation is that some of the more **critical areas of technology spending will see a quicker resumption** than other, more consumer-exposed sectors. Leverage is low and companies have generally made quick and structured responses to downturns, allowing them to protect earnings somewhat. We see **software names as being more protected** on the downside and semiconductors offering more upside. Media is the most cyclical of the three sectors and the one that is already seeing very sharp cuts in spending, mainly advertising-related. We believe **broadcasters, out-of-home and exhibitions** will see the greatest hit, followed by agencies. Therefore, we are **generally defensive** on the sector, with some exceptions.
Long-term impact after the Covid-19	**Telecoms are likely to be seen as a more critical to the 'public good' compared to the past**, when regulations had a single focus (offering the lowest price to consumers). We believe this will promote larger, better-invested players across Europe. As a result, our focus is on **large and geographically diversified names** across the region that can withstand the downturn. In **IT**, structural growth areas (such as electrical vehicles, 5G, Internet of Things, digitalisation and cloud) should continue to perform. We believe that **connectivity-related themes will gain** from a boost in spending as businesses and governments focus on IT infrastructure resilience, tracking/monitoring, remote-working, mobility, etc. Semiconductor and semiconductor-capital-equipment-related stocks should benefit in this environment. Within **media**, the current crisis is likely to accelerate the shift to digital advertising channels. So, TV broadcasters and advertising agencies will likely emerge weaker from this. **We see interesting long-term business models around music streaming, video games and exhibitions**.

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