Goldman Sachs | Portfolio Strategy Research

11 January 2021 | 6:05AM GMT

Strategy Matters

Europe Equity: Questions for 2021

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- **Q: How much of the recovery is priced in?** Europe STOXX has rallied 20% since October and trades on a 12m forward P/E of 17.9x – a high outside the Tech bubble era. However, policy support remains in place and at 6.5% the ERP remains elevated. We expect a strong inflection in growth, with EPS up 40% and 12% in 2021 and 2022, slightly above consensus. We forecast SXXP at 430 at end-2021, just shy of the peak in February 2020.
- **Q: Will Value outperform**? Yes, we continue to expect Value and some cyclical areas to outperform driven by the turn in global growth (our economists expect 6.5% in 2021), rising bond yields and investor under-positioning.
- **Q: Which Value areas do you prefer?** We are OW Banks, Oil and Basic Resources in Europe; we also like DAX and FTSE 100. Our Recovery basket (GSSTRCOV) and Fiscal Infrastructure basket (GSSTFISC) both look well-placed to gain from the turn in growth in 2021. We remain UW Consumer Staples.
- **Q: Will flows into Europe finally pick up?** Europe equity remains unloved – most of 2020 saw outflows. We think 2021 will prove a better year: global growth and the 'Value' trade support a reallocation to Europe. It is not just flows from equity investors that matter: multi-asset funds have been shifting into equity – they have been buyers in recent quarters, and we expect this to continue.
- **Q: Will the UK finally outperform?** Yes, FTSE 100 looks attractive with a dividend yield above most other developed markets. The index also has high exposure to Commodities, where we remain constructive.
- **Q: Is the stronger Euro a risk?** We expect EUR/USD to rise to 1.28 over the next 12 months, but do not see this as an impediment to performance; in recent years a stronger Euro has been associated with positive equity returns. We find Small Caps benefit most from a rise in the Euro.
- **Q: Can Renewables continue to outperform?** We think so. This has been Europe's star performer: our Renewables basket (GSSBRNEW) was up 50% in 2020, and now trades on a 70% premium to the market. This is high versus history but supported by revenue and EPS growth almost 2x that of the market overall, strong ESG fund flows and an attractive cost of capital; we remain OW.

Question 1: How much of the recovery is priced in?

A: Valuations are extended in absolute terms, but not relative to other assets. We expect earnings to take over as the key driver of returns in 2021; we expect 40% and 12% EPS growth in 2021 and 2022, above bottom-up consensus.

Relative to bonds, equities remain good value

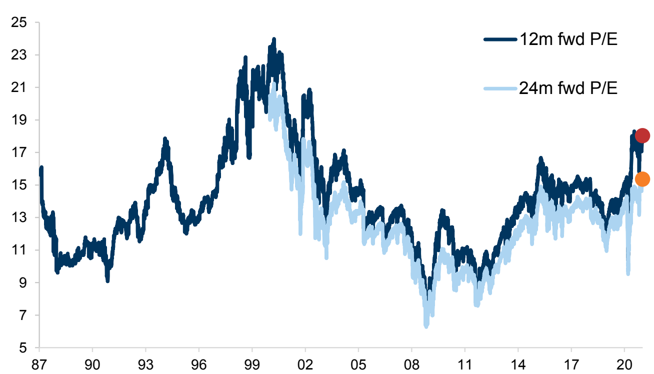
The strong rally since March last year, combined with falling EPS estimates through most of 2020, has pushed up absolute valuations. STOXX Europe trades on 17.9x 2021 consensus EPS – a high outside of the Tech bubble (Exhibit 1).

But, earnings momentum has started to turn positive – EPS estimates were revised up 6pp in the last three months – and we find equities continue to offer substantial value relative to bonds and other assets. The ERP at around 6½% remains high versus its longer-term history (Exhibit 2). We think the recovery in market prices can continue, and we forecast SXXP at 430 by end-2021. This forecast is just shy of the peak achieved in February 2020.

This means that we no longer expect absolute valuations to rise, and that we expect earnings growth to take over as the main driver of returns as we transition from the 'Hope' to the 'Growth'-driven phase of the cycle. We forecast 40% EPS growth in 2021 and 12% in 2022, slightly above the bottom-up consensus; see *2021 in the starting blocks*, January 8, 2020.

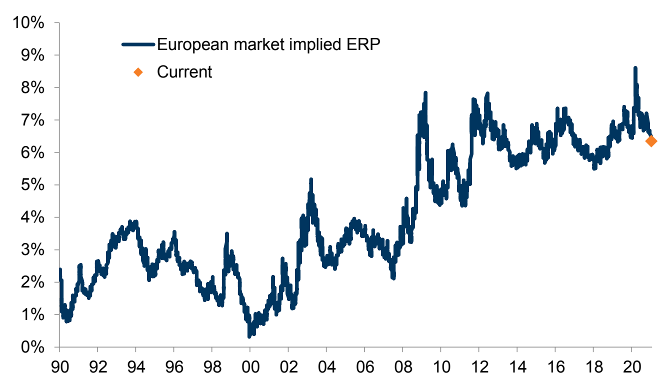
While the bear market in 2008 was much deeper, the policy easing this time has been much more aggressive. Equally, the financial crisis was what we would describe as a 'structural' bear market (preceded by large imbalances and asset bubbles and followed by a banking crisis), whereas the coronavirus triggered an 'event-driven' bear market which, supported by policy easing, is likely to have resulted in far less structural economic damage.

Exhibit 1: Valuation at the top of the range ...
STOXX Europe 600 12m and 24m fwd P/E



Source: I/B/E/S, STOXX, Datastream, Goldman Sachs Global Investment Research

Exhibit 2: ... But the ERP remains elevated
Pan-Europe



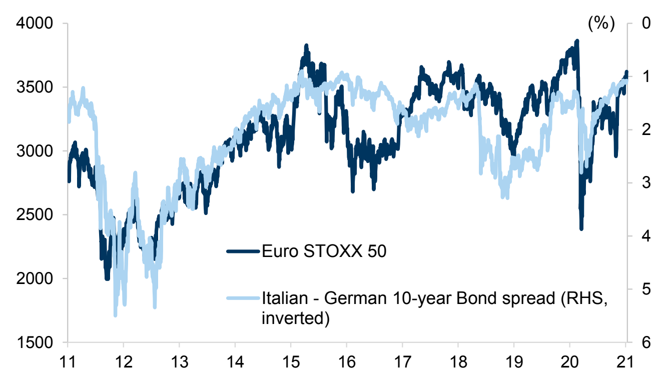
Source: Goldman Sachs Global Investment Research

Risks associated with Europe have diminished

Europe has in our view seen an 'institutional' upgrade partly as a result of the pandemic. The EU Recovery Fund, proposed back in May, is now being ratified across Europe's parliaments. It mutualises some of the cost and debt generated by this pandemic. In addition, the ECB has proven fast and effective in providing liquidity to banks and to the broader market. At the outset of the pandemic, there was genuine fear of another sovereign crisis but Italian sovereign spreads have now tightened. The European equity market correlates well with this move in spreads – indeed, equity valuations are roughly consistent with the tightness in spreads we see across Europe (Exhibit 3 and Exhibit 4).

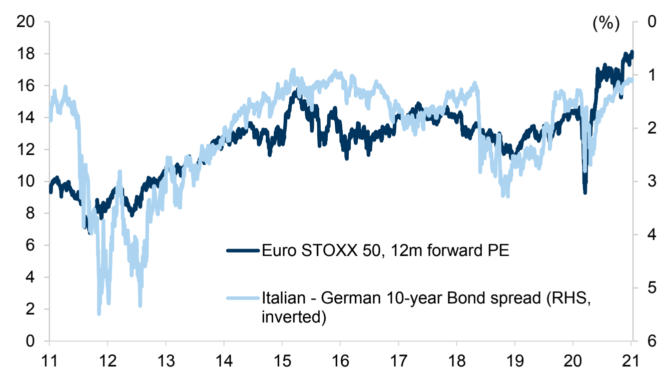
The 2021 political agenda is quite light, but we will keep an eye on the general election in Netherlands in March and the German federal election in November, which will see Chancellor Angela Merkel leave office after 16 years. In Italy, the ECB's QE programme should keep spreads tight until the next presidential elections in 2022 and parliamentary elections in 2023, although the coalition has only a razor-thin majority in the Senate and recently entered a new phase of political friction.

Exhibit 3: European equity market prices correlate well with Italian bond spreads ...
Index price level



Source: STOXX, Datastream, Goldman Sachs Global Investment Research

Exhibit 4: ... As does the European equity market 12m fwd P/E ratio



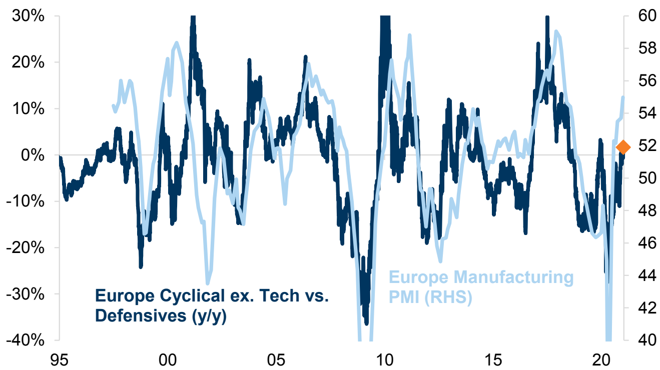
Source: STOXX, Datastream, Goldman Sachs Global Investment Research

Another way to consider pricing is to look below the surface. Here again, we see no evidence that the market has overpriced the recovery; if anything, there is more to go. Cyclicals' performance has been slightly shy of the improvements we have seen in the PMI data (Exhibit 5).

Cyclical stocks' performance suggest there is more to go

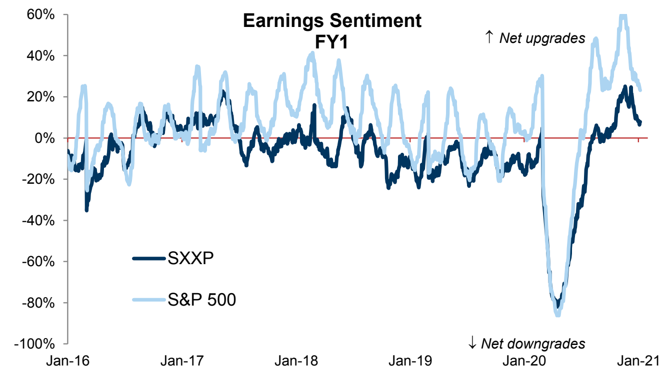
A near-term risk is clearly that these improvements retrace in 1Q 2021 as the new wave of the virus – with potentially more contagious strains – is hitting parts of Europe particularly hard. That said, we think that economies are more resilient to lockdowns than in the first wave, and we view this as a temporary hit to growth rather than something more worrisome. Our economists have downgraded UK 1Q GDP but also expect more policy support in response.

Exhibit 5: Cyclicals tend to rally when growth accelerates
y/y total return



Source: Datastream, Worldscope, Goldman Sachs Global Investment Research

Exhibit 6: Earnings sentiment has sharply improved in recent months
Earnings sentiment: Number of upgrades - number of downgrades) / Total number of analyst estimates



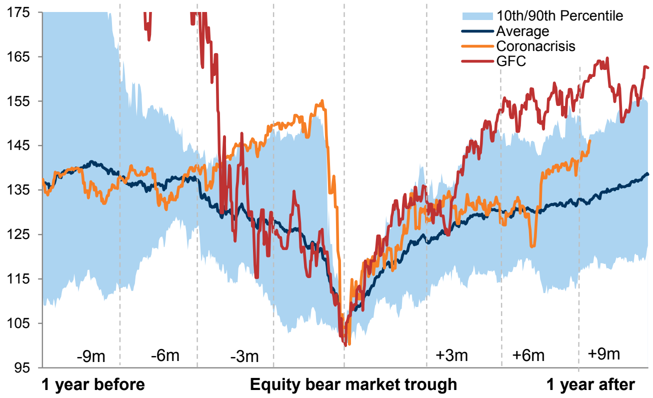
Source: STOXX, FactSet, Goldman Sachs Global Investment Research

Question 2: Will Value outperform?

A: Yes, as we discuss in Time for Value, update: why there is further to go, we continue to expect Value and some select cyclical areas to outperform driven by the turn in global growth (we expect 6.5% global GDP growth in 2021), rising bond yields and under-positioning in Value areas.

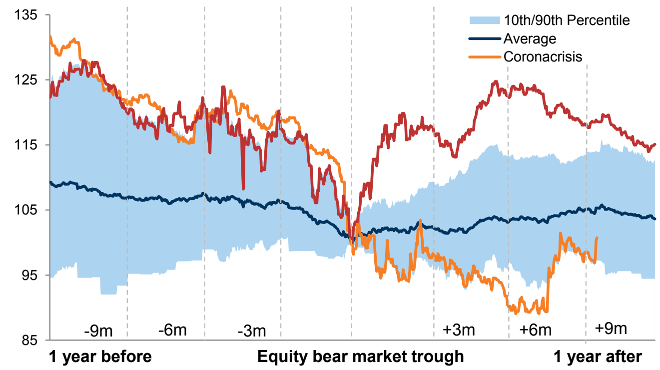
The European equity market experienced one of the sharpest bear markets in history early last year, but has since had one of the fastest recoveries, driven by policy support (Exhibit 7). The 'Value vs. Growth' trade also saw its sharpest underperformance but, unlike the market, Value did not really outperform following the trough of the crisis. The initial rebound in the equity market from the March low in 2020 was still dominated by Technology and Growth stocks. As the orange line in Exhibit 8 shows, the relative performance of Value vs. Growth has been very different to the experience around most market troughs.

Exhibit 7: A sharp recovery, comparable to post the GFC
STOXX 600 around bear markets (data since 1975)



Source: Datastream, STOXX, Goldman Sachs Global Investment Research

Exhibit 8: The underperformance of Value stocks has been very different to the GFC recovery
MSCI Europe Value vs. Growth around bear markets (data since 1975)



Source: Datastream, Goldman Sachs Global Investment Research

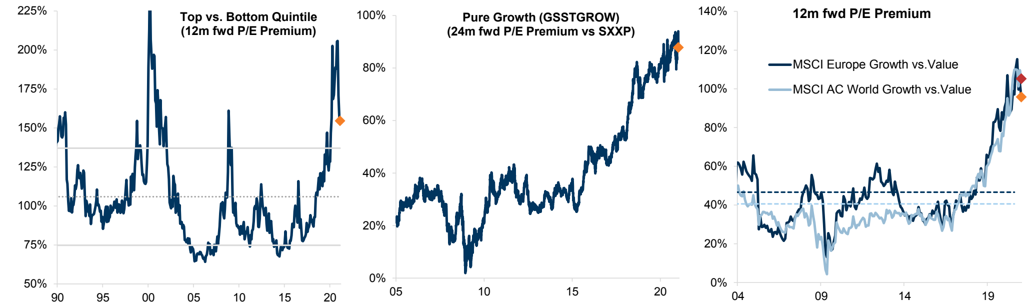
The positive vaccine news in November last year triggered some rotation; cyclical stocks in particular and, to some extent, value parts of the market have outperformed. Nonetheless, Growth and defensive parts of the market have generally continued to perform well in absolute terms, although they have underperformed on a relative basis.

We highlight 10 reasons why the rotation into Value is likely to continue:

1. **Faster vaccine distribution and better treatments**
2. **Stronger GDP growth**
3. **Restored consumption given high consumer saving ratios**
4. **Supportive financial conditions** (QE, rates at the zero bound or below)
5. **Supportive fiscal policies** (coronavirus packages, EU Green Deal, US 'Blue wave')
6. **Improving inflation** but no hike before 2025 in Europe and 2024 in the US
7. **Steepening yield curves**
8. **Higher commodities prices**
9. **Positive earnings revisions**
10. **Extreme discount of Value vs. Growth stocks**

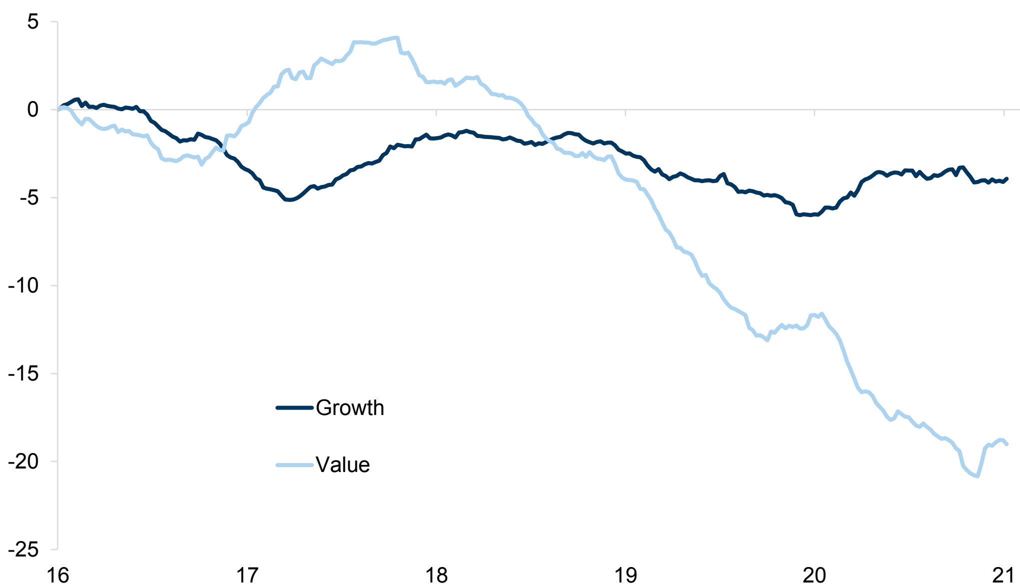
The valuation discount of Value vs. Growth has become more extreme than at almost any time in the past (Exhibit 9). We calculate the rating of the highest quintile of companies versus the lowest by P/E. The premium for the top quintile is around 150%. The premium for our High Sales Growth basket (GSSTGROW) versus the market is 90%, close to an all-time high. Looking at MSCI Growth versus Value alone shows that the gap between the two has reached an extreme.

Exhibit 9: The premium for Growth has risen and now looks extreme
Europe



Source: FactSet, Datastream, STOXX, Goldman Sachs Global Investment Research

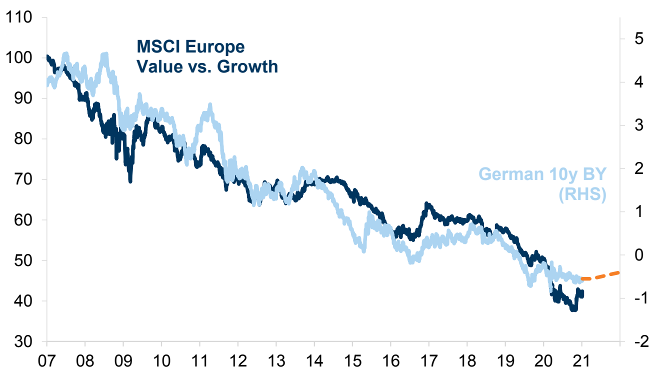
Exhibit 10: Substantial outflows from Value-style funds; the last time we saw inflows was 2016/17
Cumulative flows into style European equity funds, USD bn



Source: EPFR, Goldman Sachs Global Investment Research

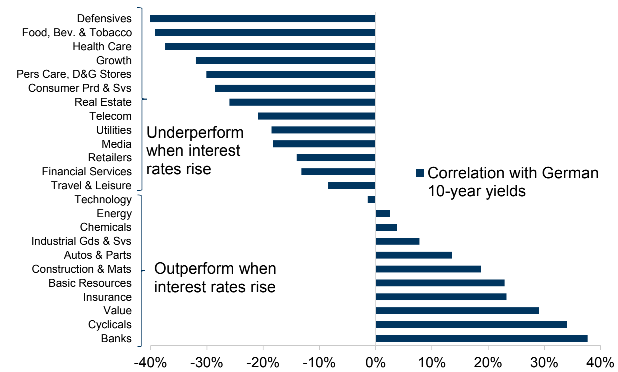
The two most important contributors to a reversal would be a rise in inflation expectations/bond yields and a rise in growth expectations. Over the past decade, lower bond yields have weighed on Value stocks (Exhibit 11). In the period since the financial crisis, Defensive areas of the market, such as Real Estate, Food, Tobacco, Beverages, Utilities and Consumer Staples, have benefited most from falling interest rates, while at the other extreme a Cyclicals basket, Financials, Industrials and a Value basket have been the most positively correlated with bond yields (Exhibit 12).

Exhibit 11: Lower bond yields weigh on Value stocks
Orange line: GIR forecast



Source: Datastream, Goldman Sachs Global Investment Research

Exhibit 12: Growth and Defensive sectors are the most negatively correlated with bond yields, while Cyclicals and Value are the most positively correlated
Correlations since 2007 based on weekly performance vs. SXXP in EUR



Source: STOXX, Datastream, Goldman Sachs Global Investment Research

With the prospect of 6.5% real GDP growth globally in 2021 (4.6% in 2022), policy rates at the zero bound (or below), strong forward guidance, negative real interest rates, record loose US financial conditions, further likely easing of fiscal policy and rising commodity prices, we have a set of conditions that is far more supportive to more cyclical, and often lower valuation companies.

Two caveats or risks to this:

1. Near term, the new variants of the virus that have emerged in the UK and South Africa, which appear to be more transmissible, represent a threat to near-term growth given that more punitive or longer lockdowns may become necessary. That said, we think economies are now good at mitigating the impact of lockdowns.

2. Longer term, the structural issues facing economies – low inflation, underwhelming productivity improvement and, in Europe, declining working-age populations – have not disappeared, and if anything the large increase in government indebtedness will exacerbate these problems.

Question 3: Which Value areas do you prefer?

A: We remain OW Banks, Oil and Basic Resources in Europe; we also like DAX and FTSE 100, both of which should benefit from the Cyclical/Value upswing.

We continue to prefer Cyclical and Value areas and are Underweight Defensives (Exhibit 13). As discussed in the previous Questions, we still see room for further gains in 2021 if our economic forecasts prove to be on the mark. In 2020, Value underperformed Growth by -18% in Europe, and these companies continue to look cheap (even after the rally).

We also like some of the likely longer-term winners – Renewables (GSSBRNEW), Healthcare and Luxury goods (GSSBLUXG). In terms of indices, we continue to recommend FTSE 100 and DAX. That said, the convergence of risk premia across regions, together with less beta, should narrow the difference in index returns moving forward, making stock-picking, irrespective of location, more important.

Exhibit 13: Our recommendations

Strategy Sector and Subsector Recommendations		
Overweight	**Neutral**	**Underweight**
Autos and Parts (SXAP)	Chemicals (SX4P)	Food, Bev and Tob (S600FOP)
Banks (SX7P)	Financial Svs (SXFP)	Pers. Care, Drug and Grocery Stores (S600PDP)
Basic Resources (SXPP)	Industrial G&S (SXNP)	Retailers (SXRP)
Construct. and Mat. (SXOP)	Insurance (SXIP)	Telecoms (SXKP)
Consumer Prods and Services (S600CPP)	Media (SXMP)	Utilities - Regulated (GSSBUTRE)
Energy (S600ENP)	Real Estate (SX86P)	
Healthcare (SXDP)	Technology (SX8P)	
Civil Aerospace (GSSBCIVA)	Travel and Leisure (SXTP)	
Luxury Goods (GSSBLUXG)	Utilities (SX6P)	
Renewables (GSSBRNEW)		

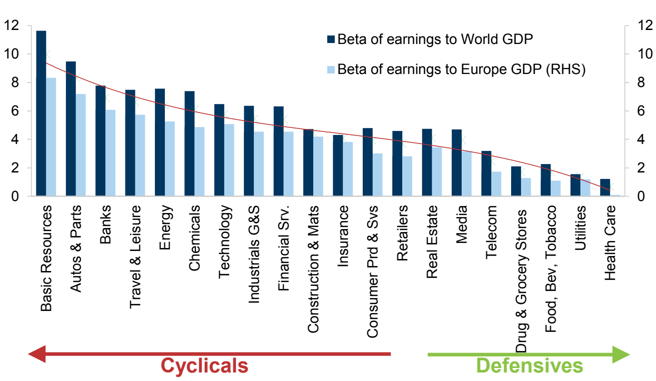
Trade Recommendation
Fiscal infrastructure (GSSTFISC) vs. STOXX Europe 600
Recovery (GSSTRCOV) vs. STOXX Europe 600
DAX vs. STOXX Europe 600
FTSE 100 vs. STOXX Europe 600

Source: Goldman Sachs Global Investment Research

Exhibit 14 shows the beta of European earnings to GDP for each sector. The more cyclical slices of the market, with higher sensitivity to growth and greater operational leverage, have most to gain from an acceleration in economic activity. Cyclicals also tend to outperform Defensive parts of the market as growth momentum indicators accelerate.

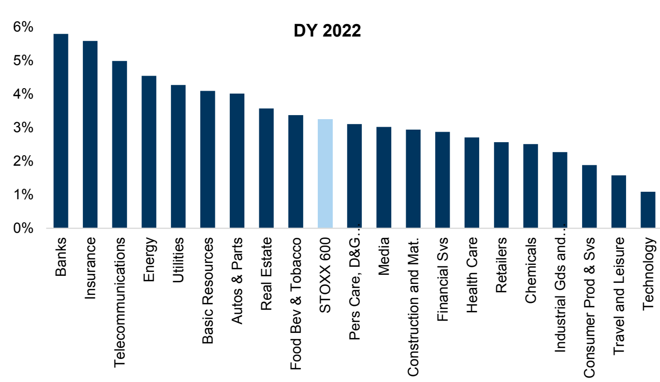
Exhibit 14: The sensitivity of European equity sectors to economic activity

Beta of yoy % changes since 1993



Source: Worldscope, Datastream, Goldman Sachs Global Investment Research

Exhibit 15: Financials and Commodity areas in Europe have a high Dividend Yield



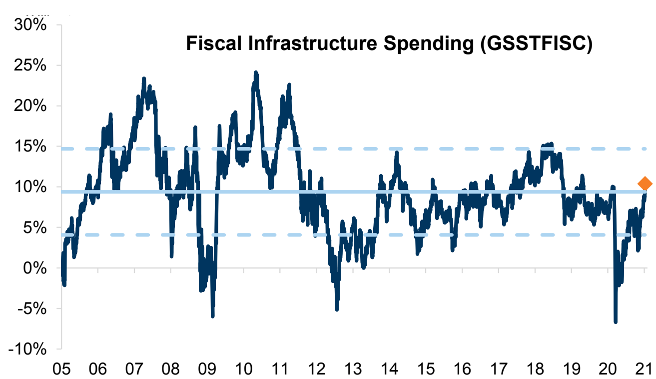
Source: I/B/E/S, Datastream, STOXX, Goldman Sachs Global Investment Research

We especially like the areas of the market that offer good cyclical upside and high yields (value): we remain OW Banks, Energy and Basic Resources. Our Commodity strategists expect Brent prices to rise by 16% to US$63/bbl in the next 12 months. Our Oil sector equity analysts see further upside for the sector supported by 5 'Rs': (a) Macro Recovery, (b) Positive earnings Revisions, (c) Restructuring and self-help, (d) Returns to shareholders with the rising prospect of buybacks in 2021 and (e) Re-Imagining Big Oils as they transform their business in the era of climate change.

In terms of thematic trades (see the Appendix for basket constituents):

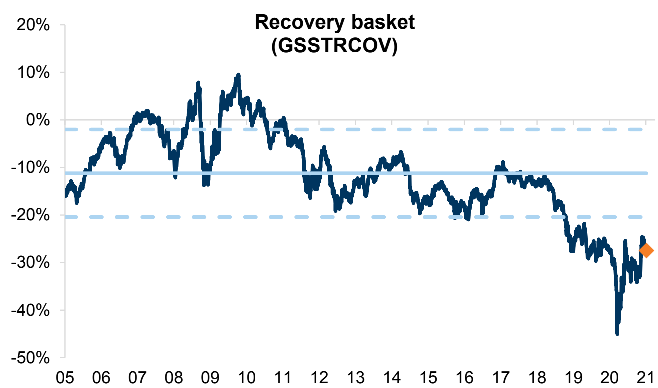
- **We continue to recommend a long on our Fiscal Infrastructure basket (GSSTFISC)**. It includes companies from Europe ex-UK that generate more than 30% of their revenue in Europe and are in sectors that governments have specifically targeted for investment and/or our economists expect to be targeted. Looking at the correlation with different factors, our GSSTFISC basket is correlated with cyclical companies and has a bias towards Industrials and Germany. Given that Germany has, in our view, most scope for additional fiscal spending, we are happy with this sensitivity.
- **For investors looking for a more aggressive economically geared strategy, we would highlight our Recovery basket (GSSTRCOV)**. These are Value companies with high operating leverage and high financial leverage. We remain OW this basket. It is up 77% since the market trough in March but is still 11% below its pre-crisis peak and trades on a 30% discount to the market.

Exhibit 16: Our Fiscal Infrastructure spending basket (GSSTFISC) trades in line with the market
24m fwd P/E Premium(Discount) vs. STOXX Europe 600



Source: FactSet, STOXX, Goldman Sachs Global Investment Research

Exhibit 17: Our Recovery basket (GSSTRCOV) is still on a discount
24m fwd P/E Premium(Discount) vs. STOXX Europe 600

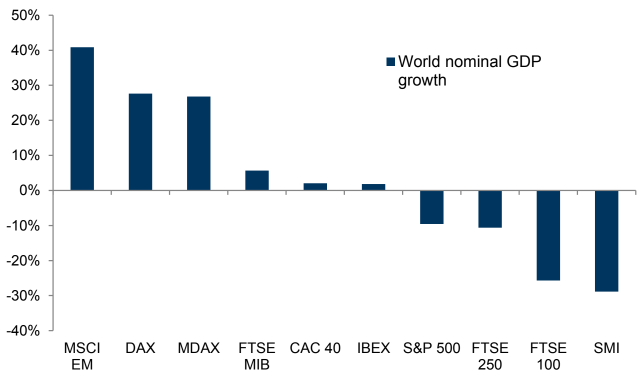


Source: FactSet, STOXX, Goldman Sachs Global Investment Research

The combination of growth acceleration and easy policy we discussed in the previous questions should be particularly supportive for the DAX. The German index is one of the more cyclically geared indices in Europe and it should benefit from improved economic activity. Exhibit 19 breaks down the composition of European indices across Cyclical and Defensive sectors, ranking then by their relative 'cyclical weight'.

Exhibit 18: DAX and MDAX (along MSCI EM) are correlated to a global pick-up in growth

Correlation of relative performance to MSCI World with yoy change in Nominal GDP, quarterly from 2001 to 2019



Source: Datastream, Goldman Sachs Global Investment Research

Exhibit 19: The DAX is one of the more cyclically geared indices in Europe

Weights of Cyclical vs. Defensive sectors in European indices

	Market cap. weight		
	Cyclicals	Defensives	Cyclicals - Defensives
DAX	76%	22%	54%
CAC	61%	20%	41%
Euro Stoxx 50	62%	24%	38%
MDAX	57%	27%	30%
OMX Stockholm	53%	32%	21%
MIB	44%	27%	17%
STOXX 600	49%	36%	13%
AEX	45%	33%	12%
FTSE 100	40%	38%	2%
OBX Oslo	24%	28%	-4%
IBEX	24%	38%	-14%
SMI	38%	62%	-24%
OMX Copenhagen	18%	66%	-47%

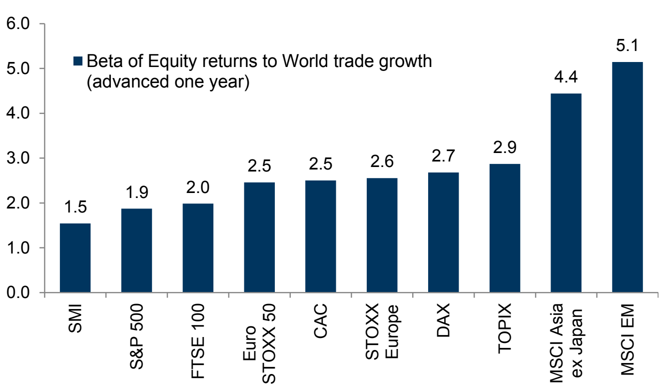
Source: Datastream, STOXX, Goldman Sachs Global Investment Research

The DAX is strongly geared to global growth. More than 65% of its revenues are generated outside of the Euro area, which makes it one of the most international indices. We find that 19% of sales are to Asia-Pacific, but we believe this underestimates the exposure to China (e.g., car manufacturers' sales in China are made via joint ventures that are not reported in the top line). We continue to expect a strong recovery in Asia and other EM. The DAX is also one of the most sensitive index to global trade. We expect an improvement in global trade with the reopening of the economies post-Covid and the fading of US trade tensions under a Joe Biden-led administration (Exhibit 20).

While not a catalyst, we also factor in the valuation discount of the DAX (Exhibit 21). We reiterate our long recommendation on the DAX vs. STOXX Europe 600 (Exhibit 13).

A strong Euro likely to be a headwind for the DAX. That said, we showed that Equity and FX move in tandem, as improving GDP has the potential to offset Euro appreciation.

Exhibit 20: DAX is relatively high beta to global trade (although not as much as EM or Asia)



Source: Datastream, Goldman Sachs Global Investment Research

Exhibit 21: The DAX trades on a discount to the Euro STOXX

24m fwd P/E Premium (Discount)

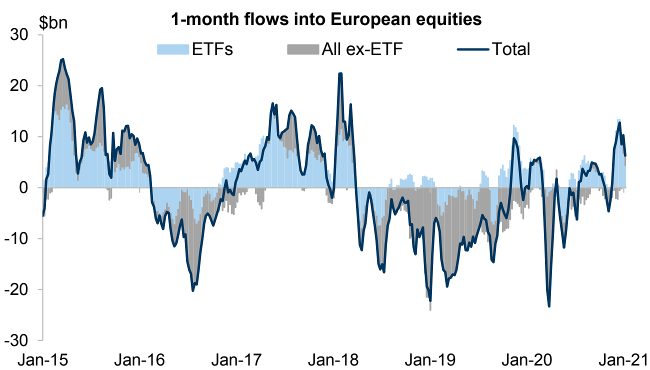
Source: I/B/E/S, Datastream, STOXX, Goldman Sachs Global Investment Research

Question 4: Will flows into Europe finally pick up?

A: Flows improved in 4Q 2020; we expect buying from both mutual investors and other sources: M&A, buybacks, private equity and multi-asset funds reallocating to equity. On the flip side there should also be more capital raised, with our Equity analysts expecting a large pipeline of IPOs this year.

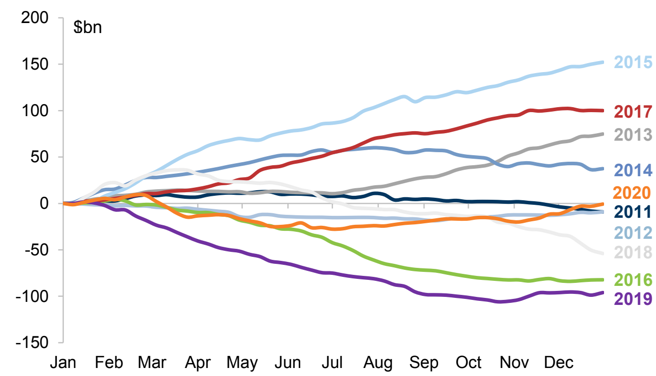
Flows picked up in November and December (Exhibit 22 and Exhibit 23) – although generally they were lacklustre through the year.

Exhibit 22: 1m flows from Global investors into European equity funds
Weekly flows



Source: EPFR, Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 23: Calendarised flows from Global investors into European equity funds

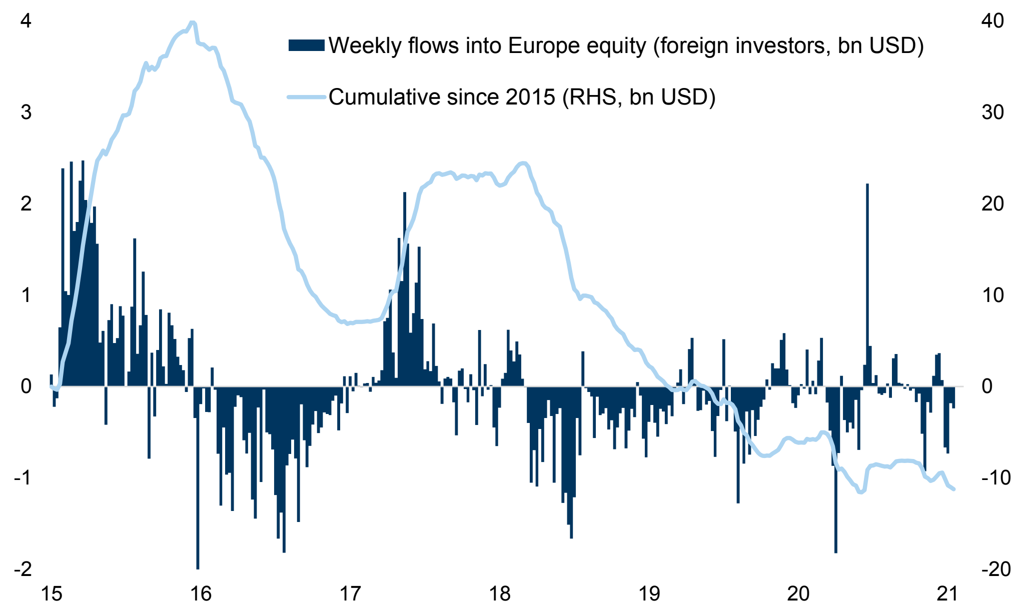


Source: EPFR, Haver Analytics, Goldman Sachs Global Investment Research

We think that for flows to improve we need to see a clearer and more sustained pick-up in business and consumer confidence. Consumer confidence in particular remains low in Europe, and vaccine rollout and the end of lockdowns will clearly be key in changing this.

Flows by foreign investors – which we find are more correlated with equity market moves than domestic investor flows – have not yet clearly swung into European equities (Exhibit 24). Again, more confidence in the European recovery is probably needed for foreign investors to increase allocations. The last time we saw clear buying from US investors was late 2016/early 2017 when President Macron was elected in France and growth was improving.

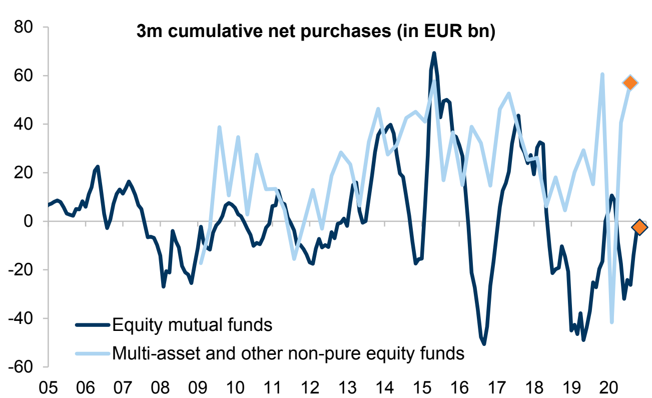
Exhibit 24: Foreign outflows have been sharp in recent years



Source: EPFR, Goldman Sachs Global Investment Research

It is not just flows from equity investors that matter: as we have highlighted before, several other buyers of European equities matter as much if not more. **Multi-asset funds and non-traditional equity investors have been large buyers (via both flows and reallocation) into European equity.** Flows into European equities from non-traditional equity investors have been bigger in recent years than equity fund flows (Exhibit 25). The gap between the dividend yield on equity and bond yields in Europe continues to provide an incentive to reallocate to equities (provided there is confidence in economic growth).

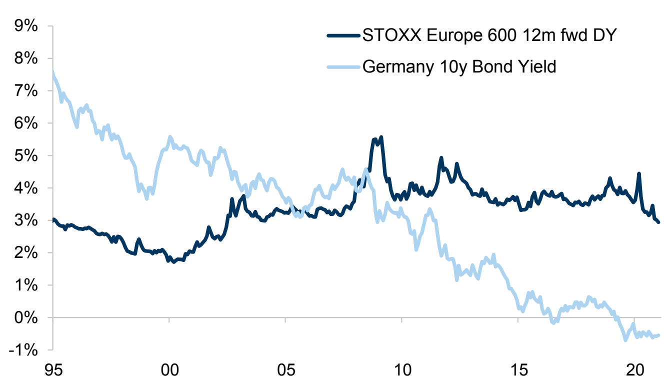
Exhibit 25: Flows into European equities from non-traditional pure equity investors have been bigger ...



Note : Multi-asset and other non-pure equity funds: last data point Q3 2020

Source: ECB, EPFR, Goldman Sachs Global Investment Research

Exhibit 26: ... and for these investors, the high dividend yield in equity (and lack of yield in bonds) creates an incentive to reallocate

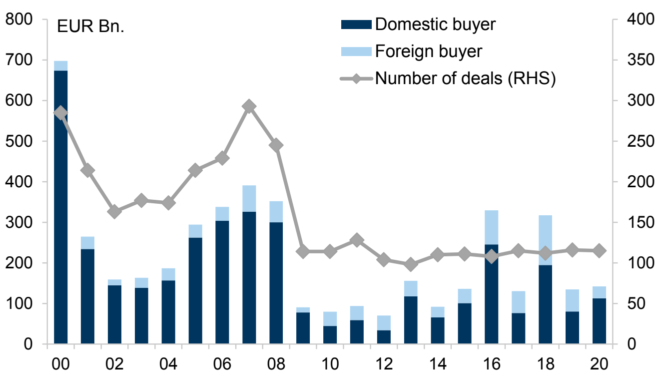


Source: Datastream, STOXX, Goldman Sachs Global Investment Research

M&A activity has been lacklustre in recent years, but this year our Equity analysts expect M&A to pick up as economic growth improves, given low funding costs and given that many managements are using this as a time to reassess businesses. The incentives for M&A have been lacking this year given volatile markets, weak aggregate demand, uncertain outlooks, but this is already starting to change. See European M&A: Positioning for Revival - rebalancing GSTRACQN, December 14, 2020.

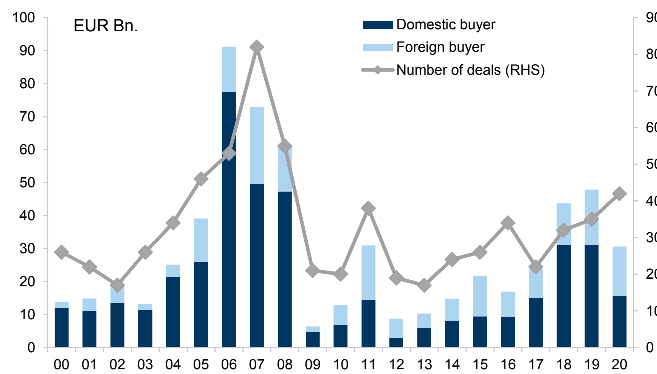
Private equity deals in Europe are also likely to rise for the same reasons – stronger economies, low rates and lots of dry powder. Our Tactical Research team argue that global P/E dry powder is at its highest level since the GFC (at US$1.5trn), suggesting ample firepower for more leveraged buyout activity.

Exhibit 27: M&A activity has been lacklustre in the last year but may pick up as economic growth improves
M&A target: European listed companies. M&A volumes aggregated by announced completion date



Source: Bloomberg, Goldman Sachs Global Investment Research

Exhibit 28: Private equity deals in Europe are also likely to rise
P/E target: European public company, deal size > $100mn. Aggregated by announced completion date



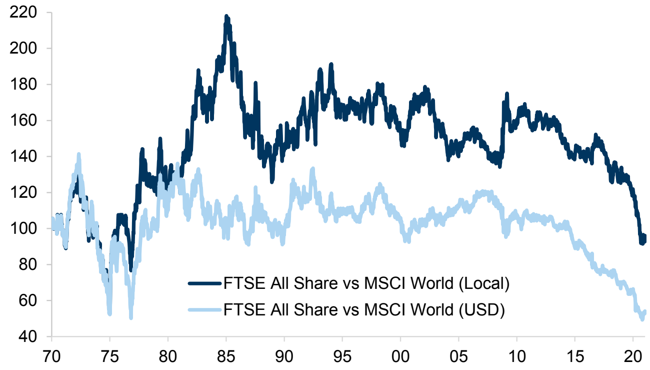
Source: Bloomberg, Goldman Sachs Global Investment Research

Question 5: Will the UK finally outperform?

A: Yes, the UK offers one of the highest dividend yields of the developed market indices globally; with global growth improving and Brexit uncertainty no longer a concern, we see the value gap closing.

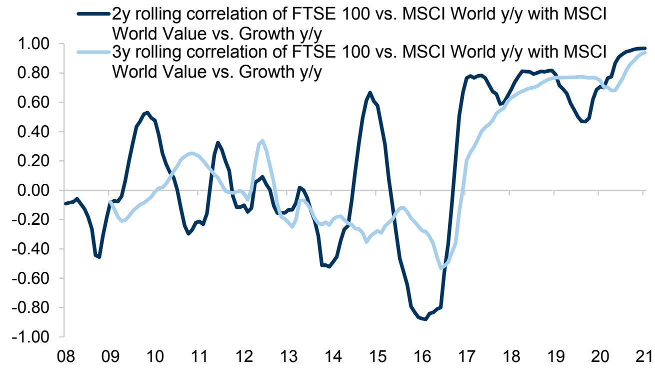
For many decades the FTSE All Share performed similarly to MSCI World (Exhibit 29). Sharp underperformance is only a relatively recent phenomenon. We see the underperformance of UK equities over the past couple of years as primarily driven by the secular trend out of Value and into Growth stocks, more so than the impact of Brexit. Around a third of FTSE 100 market cap is in Value sectors (Financials, Commodities); in contrast, the UK index has very little Tech exposure.

Exhibit 29: FTSE All Share used to performed similarly to MSCI World
Rebased price performance, 1970 = 100



Source: Datastream, Goldman Sachs Global Investment Research

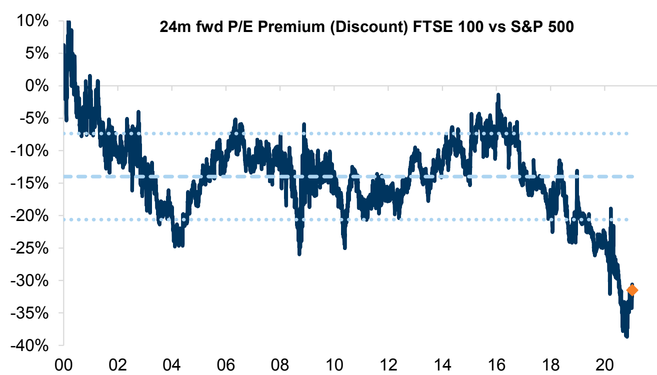
Exhibit 30: FTSE 100 performance is increasingly tied to the Value trade
Correlation of UK vs. World with Value vs. Growth



Source: Datastream, Goldman Sachs Global Investment Research

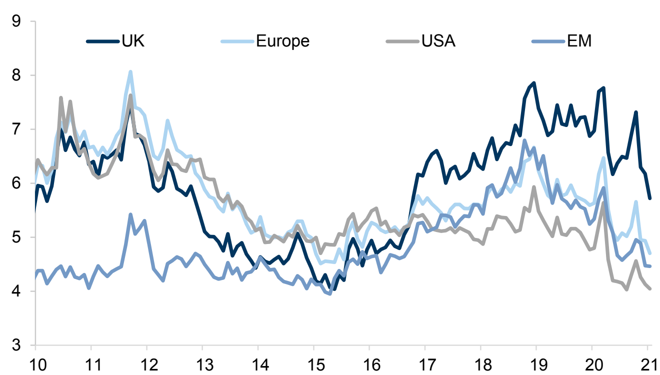
FTSE 100 trades on a sharp discount to the S&P 500 and a more modest discount to the rest of Europe (Exhibit 31). The FCF yield of the UK market is the highest of all regions (Exhibit 32).

Exhibit 31: FTSE 100 looks cheap compared with the S&P 500



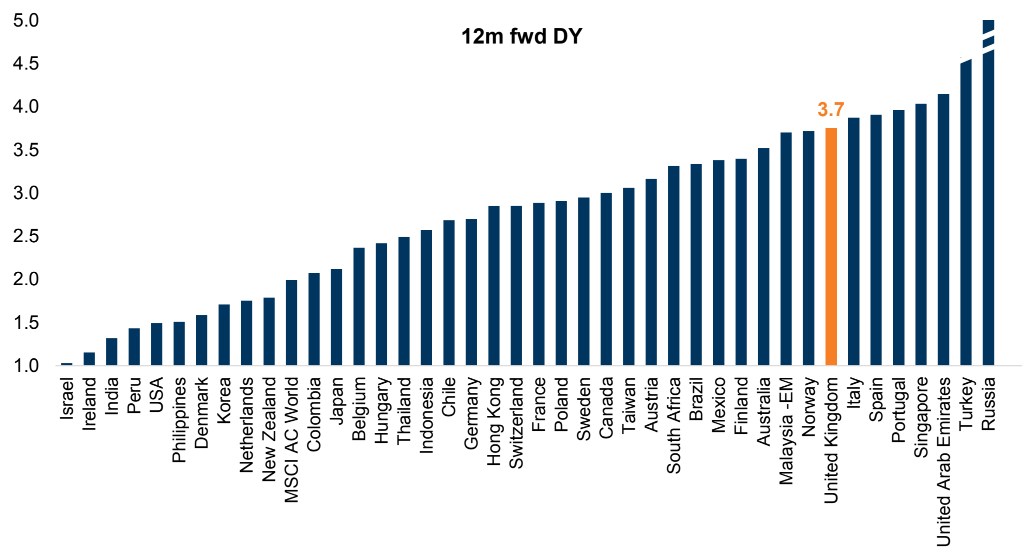
Source: FactSet, Goldman Sachs Global Investment Research

Exhibit 32: UK companies display superior FCF yield
12m fwd FCF yield



Source: FactSet, Goldman Sachs Global Investment Research

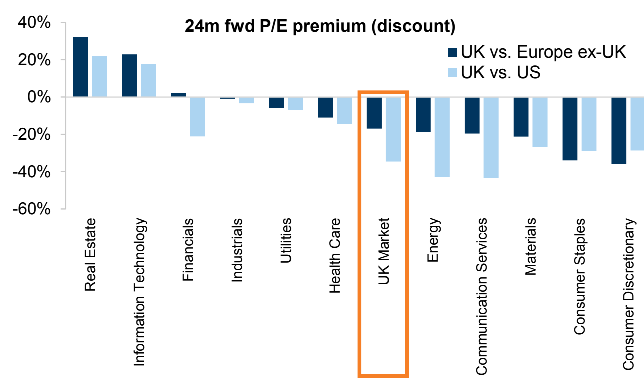
Exhibit 33: UK offers one of the highest 2021E DY of all large DMs



Source: FactSet, Goldman Sachs Global Investment Research

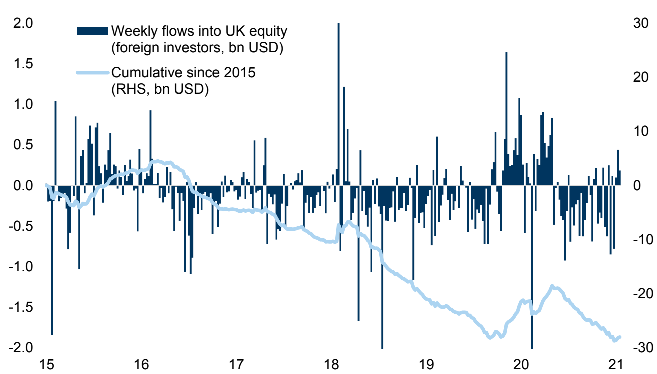
Some of the discount is down to sector exposure but, looking sector by sector, most UK sectors are on a substantial discount to both Europe and the US. We think this reflects two factors: under-positioning in UK indices by global investors (Exhibit 35), and diminished holdings of UK equities by UK pension funds and insurance companies as they continue to switch into bonds.

Exhibit 34: Most UK sectors are on a substantial discount to both Europe and the US
MSCI Indices, GICS Level 1 sectors



Source: FactSet, Goldman Sachs Global Investment Research

Exhibit 35: UK equities have seen outflows from global investors since the EU referendum



Source: EPFR, Goldman Sachs Global Investment Research

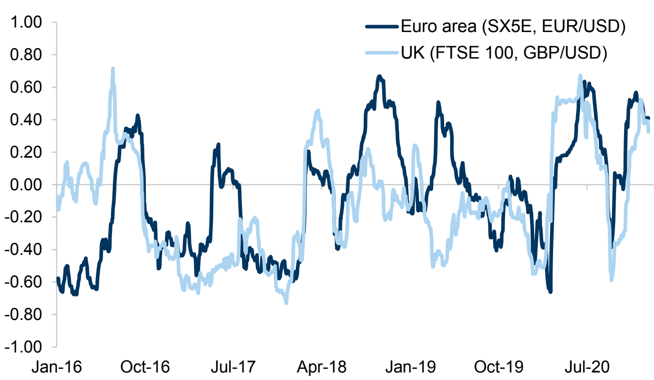
Question 6: Is the stronger Euro a risk?

A: No. A stronger EUR has in recent years been associated with positive equity performance. We think GDP growth – and to a lesser extent commodity prices – matter much more for earnings than FX moves.

In the last year EUR/USD has risen 9%, more than half of which has occurred in the past two months. Our FX strategists recently raised their forecasts and now expect EUR/USD at 1.28 over 12m. Given that European companies make more than half their sales outside of Europe, a strong currency should weigh on earnings and returns, all else equal.

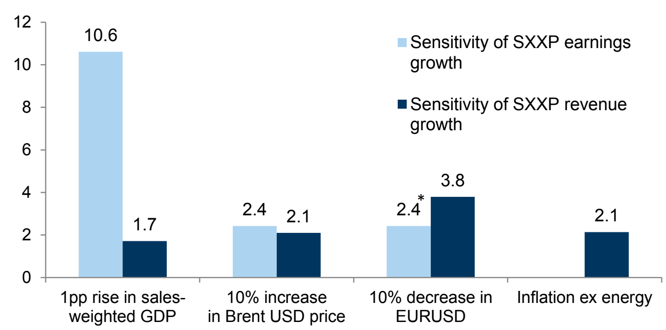
But all else is rarely equal. Empirically there is no clear or consistent relationship between the Euro and European stock market returns. Exhibit 36 shows recent months have seen a positive correlation between SX5E returns and the EUR/USD. On a longer-term history the correlation has been positive, as often as it has been negative.

Exhibit 36: Equity and FX markets have recently moved in tandem
3m rolling correlation



Source: Datastream, Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 37: GDP growth is the main driver of profit growth: each 1pp rise in growth adds about 11pp to annual SXXP profit growth
Elasticities derived from our EPS and revenue multivariate regression models for SXXP



* Elasticity derived from beta of earnings to sales
p<0.01 for all variables, except oil prices for earnings where p<0.10

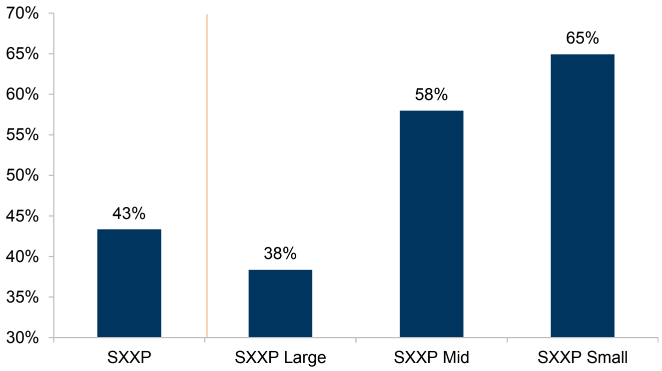
Source: Goldman Sachs Global Investment Research

Furthermore, although the EUR has risen, this has largely been versus the US Dollar – in trade-weighted terms the move has been very small, as is also the case for Sterling. We would argue that the declines in the Dollar reflect in part improved expectations for global growth, and we expect this to continue.

As we show in Exhibit 37, European earnings are much more sensitive to GDP expectations shifting than to moves in FX. Based on EPS modelling, the rise in oil prices – up 40% since November – will also have far outweighed any drag the Euro might cause.

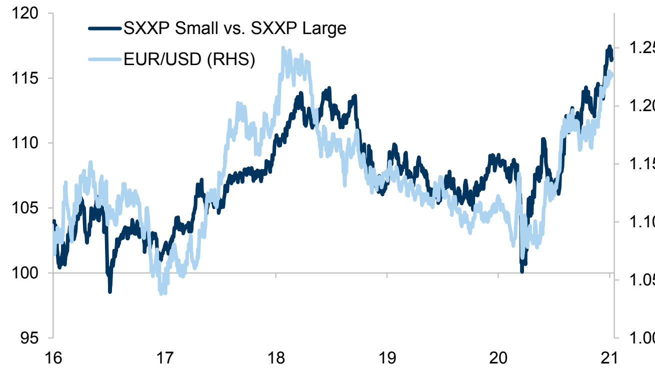
Some slices of the European equity market benefit from a stronger Euro. Small Cap companies generally have more domestic sales exposure than large companies. We find that SXXP Large and Euro STOXX 50 have a revenue exposure of c.40% to Europe, while SXXP Small and Mid Cap have a revenue exposure of about 60% or more to Europe (Exhibit 38). As a result, Small and Mid Cap tend to outperform when a strong Euro penalises large international companies (Exhibit 39).

Exhibit 38: Revenue exposure to Europe



Source: Goldman Sachs Global Investment Research

Exhibit 39: Small Caps tend to outperform when a strong Euro penalises large international companies



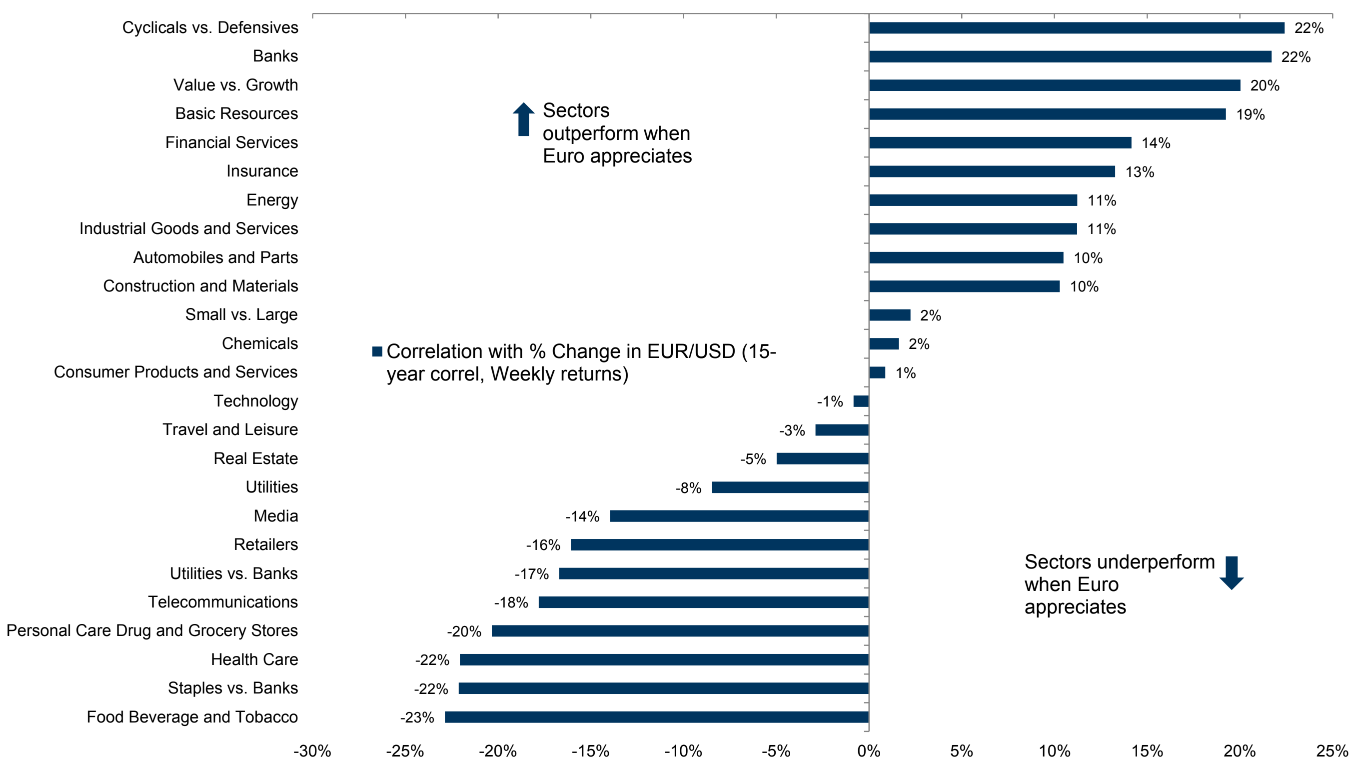
Source: Datastream, STOXX, Goldman Sachs Global Investment Research

In recent years a strong Euro (and a 'soggy Dollar') has been combined with stronger growth and/or risk-on environments. These factors support Cyclicals: even those for which a rise in the EUR would be damaging, all other things equal.

Exhibit 40 shows the correlation of weekly moves in EUR/USD with sector relative performance. We find it is the cyclical or risk-on environment that dominates. The most positively correlated sectors to the stronger EUR tend to be domestic Cyclicals, even those with high overseas exposure such as Basic Resources.

The sectors with a slight negative correlation to EUR moves tend to be domestic Defensives such as Utilities, Telecoms and Retail (although Utilities has a slight positive correlation). The sectors most negatively affected by a rising EUR are the international Defensives: Food, Beverages & Tobacco, Healthcare and other Consumer Staples.

Exhibit 40: Cyclicals, Financials, Value and Small Caps tend to be positively correlated to rises in EUR
Relative performance with SXXP, unless otherwise stated



Source: Datastream, STOXX, Goldman Sachs Global Investment Research

Of course, the exact ordering of the sector sensitivities changes over time. But the key point is that any attempt at an exact formulation translating the currency move into an EPS impact –and hence a share price move – is thwarted by the driver of the currency in the first place. We would also note that the absolute levels of these correlations are generally low: for most sectors, it is between -20% and +20%. By comparison, moves in bond yields or break-even inflation tend to have both much clearer and larger relative sector implications.

Question 7: Can Renewables continue to outperform?

A: Yes, we continue to like our Renewables (GSSBRNEW) basket (Exhibit 41). Green priorities could have fallen victim to the coronacrisis. Instead, the economic downturn, and resultant low rates, have enabled governments to increase their fiscal spending and direct funds towards their net zero carbon ambitions.

We estimate that the global climate transition has the potential to drive $1-2trn pa of green infrastructure investments over the next 10 years. By 2030, the addressable market of renewables could double in size (Exhibit 42). Our Utilities analysts recently upgraded the EU Green Deal plan estimate by c.+50% to €10trn cumulatively by 2050.

Companies exposed to the energy transition are likely to deliver unprecedented growth over the coming decades. Our European Renewable Energy basket (GSSBRNEW) gathers the companies which are the most exposed to the transition from fossil fuels to renewable energy (solar, wind and hydro). They include, for example, Utilities stocks with a large share of income from renewables, Industrials that manufacture turbines and cables, Energy companies that produce biofuels, and Chemical companies that offer solutions to the renewable ecosystem. These companies should benefit from attractive regulatory frameworks, technological innovations, creative financial innovations and consistent flows into ESG funds.

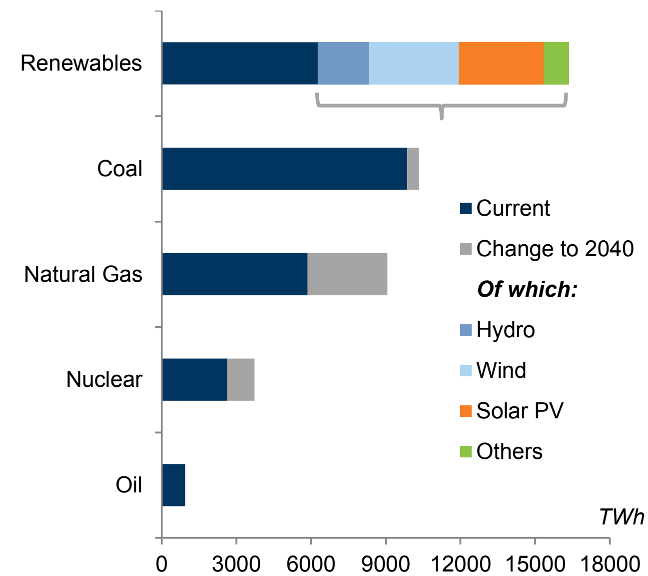
Exhibit 41: Our Europe Renewables basket (GSSBRNEW) offers sustainable growth

	23/19 CAGR			
	Sales	EBITDA	EBIT	EPS
Acciona	2.6	3.8	5.8	7.5
Air Liquide	2.6	2.4	7.1	7.1
EDP	5.3	2.9	1.0	2.9
EDP Renovaveis	8.8	8.0	5.5	14.7
Encavis	2.2	3.1	4.7	7.3
Enel	-1.1	0.8	0.8	2.1
Engie	2.1	2.5	2.4	9.1
Erg	4.1	6.3	6.8	6.1
Iberdrola	2.9	4.6	5.9	7.9
Linde	0.4	4.4	6.6	7.8
Nel	39.4	57.3	0.0	0.0
Neoen	25.5	23.8	22.1	24.3
Neste	3.2	2.9	4.0	4.8
Nexans	9.7	5.7	7.3	22.7
Nordex	10.7	29.9	30.2	213.2
Orsted	-2.6	11.5	13.0	21.7
Prysmian	2.5	3.6	6.2	12.2
Rwe	9.1	3.1	2.7	-7.6
Scatec	37.8	37.4	42.2	119.3
Siemens Energy*	4.1	56.7	36.5	28.5
Siemens Gamesa Renewable Energy	5.9	17.1	21.9	53.1
Solaria	62.8	58.9	74.4	48.5
SSE	3.4	3.3	1.5	3.5
Verbund	4.9	8.2	8.4	7.7
Vestas	8.6	10.9	12.3	12.4
Wacker Chemie	2.2	5.8	23.4	24.3
Basket Median	**4.1**	**5.8**	**6.7**	**8.5**
SXXP Median	2.5	4.6	4.7	4.8

**23/20 CAGR*

Source: FactSet, Goldman Sachs Global Investment Research

Exhibit 42: Sustainable growth in renewables
World electric generation by technology

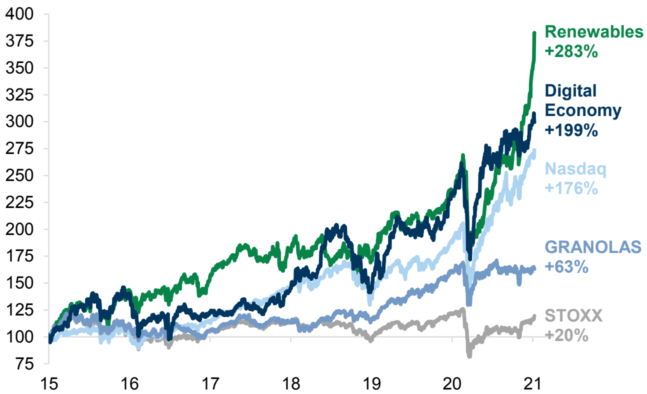


Source: IEA, Goldman Sachs Global Investment Research

In 2020, our renewable basket outperformed the market by more than 50%: GSSBRNEW was up +47%, while the STOXX 600 was down -4% (Exhibit 43). With 26 liquid constituents, GSSBRNEW is a well-diversified implementation of this secular growth theme and a pure implementation of the Green & ESG trend. Our basket is positively correlated with ESG indices, and we think it should continue to benefit from strong inflows into ESG.

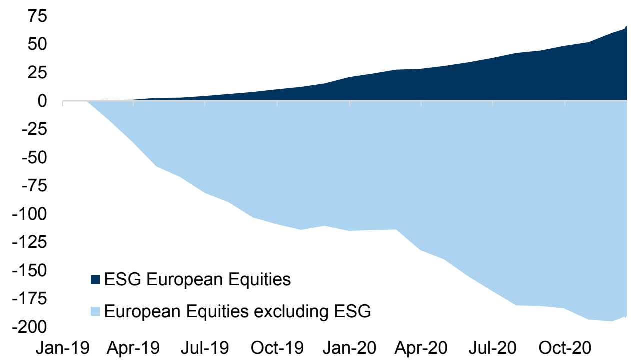
Since January 2019, ESG (or SRI) funds have invested $66bn from all investors globally into European equities (Exhibit 44). In contrast, non ESG equity funds (active + passive) saw a net outflow of $190bn.We think this trend is set to continue. In 2020, 50% of new equity mutual funds globally were referenced as ESG funds, according to EPFR. A recent study from PwC shows that, in Europe, ESG funds' AuM could account for 50% of all European mutual fund assets by 2025.

Exhibit 43: Impressive growth and where to find it in Europe
Price performance



Source: Bloomberg, STOXX, Goldman Sachs Global Investment Research

Exhibit 44: Flows from ESG funds are growing steadily
USD bn

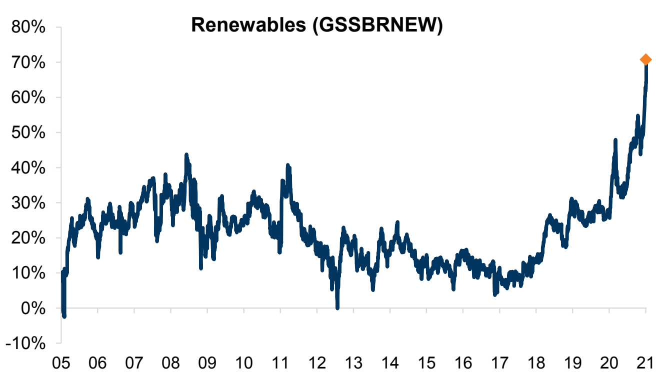


Source: EPFR, Goldman Sachs Global Investment Research

The main headwind for this basket is likely to be its valuation, which is at an all-time-high in absolute terms and relative to the market. Indeed, GSSBRNEW trades on a P/E multiple of 26x (24m fwd earnings), a 70% premium to the market (Exhibit 45).

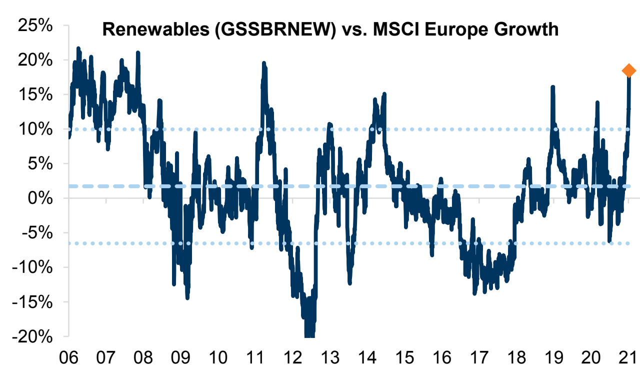
That said, we find that it is not uncommon for growth companies to be expensive (see Question 3). GSSBRNEW trades on a 16% premium to Growth stocks (Exhibit 46). Companies that are investing (as these are) tend to trade on higher P/Es partly as costs are higher and partly as they are yet to reap the rewards of that investment. This is a rare long-term structural growth theme. Our Equity analysts expect their earnings to grow at a high single-digit CAGR over the next decade.

Exhibit 45: Our Renewables basket (GSSBRNEW) trades on a large premium to the market...
24m fwd P/E Premium(Discount) vs. STOXX Europe 600



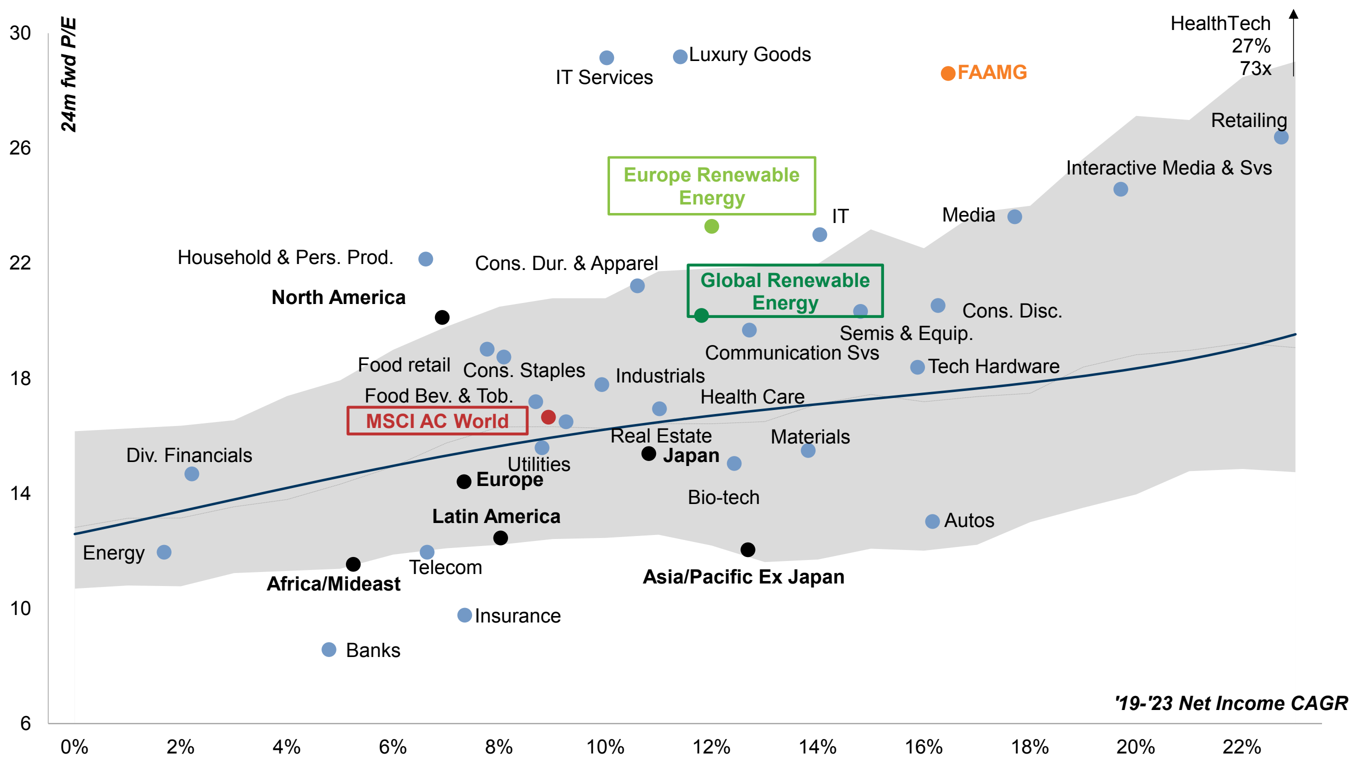
Source: FactSet, STOXX, Goldman Sachs Global Investment Research

Exhibit 46: ...and even against Growth stocks
12m fwd PE Premium/Discount



Source: FactSet, STOXX, Goldman Sachs Global Investment Research

Exhibit 47: Global Renewable Energy offers Growth At Reasonable Price (GARP)



grey shaded area: inter-tercile range. In this chart, our Renewable Energy baskets are market cap weighted.

Source: FactSet, Goldman Sachs Global Investment Research

Appendix

Exhibit 48: Recovery (GSSTRCOV)

Recovery (GSSTRCOV)											
Company Name	**Basket weight**	**Market Cap (EUR Bn)**	**NTM P/E**	**Altman z-score FY0**	**DOL 20y med.**	**Company Name**	**Basket weight**	**Market Cap (EUR Bn)**	**NTM P/E**	**Altman z-score FY0**	**DOL 20y med.**
Automobiles and Parts	**4%**					Volvo B	2%	33.2	15.9	2.2	2.8
Volkswagen	2%	30.6	6.9	1.0	5.5	Aena Sme	2%	20.9	42.9	2.2	1.5
Renault	2%	11.3	NM	0.4	6.2	Bae Systems	2%	17.8	10.3	1.5	1.7
Basic Resources	**4%**					Thales	2%	15.9	12.8	1.2	3.1
Arcelormittal	2%	22.9	15.5	1.5	2.5	Cnh Industrial	2%	15.0	22.3	1.8	5.5
Voestalpine	2%	5.6	34.0	1.7	4.1	Smurfit Kappa Group	2%	10.5	16.4	2.2	2.5
Chemicals	**12%**					Kion Group	2%	10.0	19.9	1.3	3.7
Basf	2%	62.8	19.5	2.4	3.9	Prysmian	2%	8.3	21.7	1.9	2.6
Evonik Industries	2%	12.6	15.3	1.8	3.0	Metso Outotec	2%	7.2	19.8	3.9	2.7
Solvay	2%	10.8	15.6	1.7	2.0	Smith	2%	6.2	14.9	1.5	1.9
Covestro	2%	10.5	18.9	2.5	4.3	Rexel	2%	4.3	13.5	2.0	2.2
Arkema	2%	7.4	15.4	2.2	3.2	Rheinmetall	2%	3.8	11.8	2.0	2.7
Lanxess	2%	5.6	16.4	1.7	2.5	Leonardo	2%	3.5	6.3	0.9	1.8
Construction and Materials	**6%**					Valmet	2%	3.5	14.2	2.3	3.1
Heidelbergcement	2%	13.5	10.0	1.4	1.9	**Media**	**2%**				
ACS	2%	8.6	11.5	1.3	1.6	Wpp	2%	11.1	11.5	1.2	1.9
Eiffage	2%	7.9	11.5	0.9	3.6	**Retailers**	**2%**				
Consumer Products and Services	**2%**					Dufry	2%	3.9	NM	0.9	1.5
Electrolux	2%	5.6	13.5	2.0	3.6	**Technology**	**4%**				
Energy	**6%**					Atos	2%	7.2	8.8	1.7	2.7
Repsol Ypf	2%	14.0	11.5	1.3	1.6	Ams	2%	5.3	23.8	2.1	2.6
Aker Bp	2%	8.0	22.4	0.8	1.9	**Telecommunications**	**8%**				
Sbm Offshore	2%	3.1	10.5	1.2	2.0	Orange	2%	27.4	9.5	0.7	3.4
Food, Beverage and Tobacco	**6%**					Nokia	2%	18.3	15.6	1.2	2.3
Anheuser-Busch Inbev	2%	98.9	22.2	1.1	1.9	Ses Fdr	2%	3.0	20.6	0.5	1.6
British American Tobacco	2%	71.0	8.1	1.6	1.4	Eutelsat Communications	2%	2.2	8.0	0.9	1.8
Coca-Cola Hbc	2%	9.7	19.4	1.9	2.2	**Travel and Leisure**	**6%**				
Health Care	**4%**					Intl.Cons.Airl.Gp.	2%	8.6	NM	1.2	1.2
Glaxosmithkline	2%	77.7	12.0	1.4	1.8	Deutsche Lufthansa	2%	6.0	NM	1.1	5.7
Bayer	2%	51.4	8.3	1.1	1.1	Easyjet	2%	4.0	NM	0.2	2.7
Industrial Goods and Services	**32%**					**Utilities**	**2%**				
Airbus	2%	70.3	28.5	1.0	3.3	RWE	2%	24.9	18.7	0.6	2.4
Deutsche Post	2%	51.2	15.5	2.3	1.8						
Median		**10.3**	**15.4**	**1.4**	**2.5**						

Source: Datastream, Factset, Goldman Sachs Global Investment Research

Exhibit 49: Fiscal Infrastructure Spending (GSSTFISC)

Fiscal Infrastructure Spending (GSSTFISC)											
Company Name	**Sub-sector**	**Basket weights**	**Europe exposure**	**Market Cap (EUR Bn)**	**NTM P/E**	**Company Name**	**Sub-sector**	**Basket weights**	**Europe exposure**	**Market Cap (EUR Bn)**	**NTM P/E**
Automobiles and Parts		**1.8%**									
Hella	Automobiles & Parts	1.8%	58%	6.0	20.5	Knorr Bremse	Railroad Equipment	1.8%	37%	18.8	30.1
Basic Resources		**1.8%**				Thales	Defense	1.8%	49%	15.9	12.8
Umicore	Renewables	1.8%	39%	10.5	28.8	Alstom	Electrical Components	1.8%	50%	14.0	21.7
Chemicals		**3.6%**				Schindler	Industrial Machinery	1.8%	31%	9.1	30.0
Air Liquide	Renewables	1.8%	31%	64.6	25.2	Prysmian	Electrical Components	1.8%	38%	8.3	21.7
Wacker Chemie	Renewables	1.8%	36%	6.2	23.9	Gea Group	Industrial Machinery	1.8%	34%	5.3	20.8
Construction and Materials		**23.6%**				Trelleborg	Industrial Machinery	1.8%	48%	4.6	15.4
Vinci	Construction	1.8%	77%	51.9	18.0	Georg Fischer	Industrial Machinery	1.8%	42%	4.5	26.5
Sika	Building Materials	1.8%	36%	32.8	39.2	Rexel	Electrical Components	1.8%	50%	4.3	13.5
Crh	Building Materials	1.8%	32%	30.4	16.8	Andritz	Industrial Machinery	1.8%	28%	4.0	14.7
Saint Gobain	Building Materials	1.8%	57%	22.6	12.7	Rheinmetall	Defense	1.8%	55%	3.8	11.8
Assa Abloy	Building Materials	1.8%	33%	22.2	23.1	Leonardo	Defense	1.8%	45%	3.5	6.3
Geberit	Building Materials	1.8%	82%	19.7	32.1	Oc Oerlikon Corporation	Industrial Machinery	1.8%	55%	2.9	27.4
Bouygues	Construction	1.8%	72%	13.6	13.3	Nexans	Renewables	1.8%	47%	3.0	20.0
Heidelbergcement	Building Materials	1.8%	34%	13.6	10.1	**Technology**		**5.5%**			
Kingspan Group	Building Materials	1.8%	60%	12.2	30.2	Sap	Technology	1.8%	41%	129.4	22.0
Skanska	Construction	1.8%	49%	8.6	16.5	Capgemini	Technology	1.8%	59%	20.9	16.8
Eiffage	Construction	1.8%	93%	7.9	11.5	Atos	Technology	1.8%	56%	7.2	8.8
Acciona	Renewables	1.8%	51%	6.9	23.0	**Utilities**		**21.8%**			
Signify	Building Materials	1.8%	31%	5.0	11.2	Enel	Renewables	1.8%	74%	89.2	16.4
Energy		**9.1%**				Iberdrola	Renewables	1.8%	57%	78.0	20.8
Neste	Renewables	1.8%	78%	49.4	37.2	Orsted	Renewables	1.8%	97%	76.6	56.8
Vestas	Renewables	1.8%	33%	42.4	42.8	Engie	Renewables	1.8%	73%	31.8	12.7
Siemens Gamesa Renew.	Renewables	1.8%	54%	26.2	77.1	Rwe	Renewables	1.8%	92%	25.1	18.9
Solaria	Renewables	1.8%	92%	3.9	119.9	E On	Renewables	1.8%	94%	24.2	13.4
Nordex	Renewables	1.8%	40%	3.1	NM	Edp Energias De Portugal	Renewables	1.8%	70%	22.1	23.2
Industrial Goods and Services		**32.7%**				EDP R	Renewables	1.8%	54%	22.5	52.3
Abb	Electrical Components	1.8%	30%	53.0	25.1	Fortum	Renewables	1.8%	69%	18.7	14.9
Safran	Aerospace	1.8%	37%	46.4	30.1	Verbund	Renewables	1.8%	93%	12.9	45.2
Worldline	Technology	1.8%	79%	21.5	31.5	ERG	Renewables	1.8%	95%	3.8	29.6
Legrand	Electrical Components	1.8%	37%	21.3	24.8	Encavis	Renewables	1.8%	100%	3.4	55.2
Median			**51%**	**14.0**	**21.9**						

Source: Datastream, Company data, Goldman Sachs Global Investment Research

Exhibit 50: Renewables (GSSBRNEW)

GSSB						Weight		Market cap.	3M ADV
Name	Ticker	Currency	Company name	Bloomberg	SEDOL	STOXX	GSSB	(US$, bn)	(US$, mn)
Renewables	GSSBRNEW	EUR	Linde	LIN GY	BYWD9S5	28.4%	3.8%	141.2	217.1
			Enel	ENEL IM	7144569	15.0%	3.8%	111.1	218.7
			Iberdrola	IBE SQ	B288C92	17.1%	3.8%	97.1	204.8
			Air Liquide	AI FP	B1YXBJ7	16.9%	3.8%	79.4	139.9
			Orsted	ORSTED DC	BYT16L4	5.9%	3.8%	93.4	84.8
			Neste	NESTE FH	B06YV46	6.5%	3.8%	58.9	61.9
			Vestas Wind Systems	VWS DC	5964651	8.6%	3.8%	51.8	122.2
			Engie	ENGI FP	B0C2CQ3	6.3%	3.8%	39.6	82.0
			RWE	RWE GY	4768962	5.8%	3.8%	32.0	95.5
			Verbund	VER AV	4661607	2.0%	3.8%	33.2	14.9
			EDP	EDP PL	4103596	3.5%	3.8%	27.3	37.9
			Siemens Gamesa Renewable Energy	SGRE SQ	B01CP21	1.7%	3.8%	31.0	48.0
			Siemens Energy	ENR GR	BMTVQK9	4.7%	3.8%	30.2	56.7
			EDP R	EDPR PL	B39GNW2	0.8%	3.8%	27.3	17.5
			SSE	SSE LN	0790873	4.1%	3.8%	22.8	41.9
			Prysmian Spa	PRY IM	B1W4V69	0.7%	3.8%	10.0	30.7
			Acciona	ANA SQ	5579107	1.0%	3.8%	8.6	18.4
			Wacker Chemie	WCH GF	B11Y568	NA	3.8%	7.8	0.1
			Scatec Solar	SCATC NO	BQSSWW3	NA	3.8%	7.5	20.6
			Neoen	NEOEN FP	BGV7F95	NA	3.8%	7.1	11.1
			Nel	NEL NO	B02NR83	0.8%	3.8%	5.8	39.8
			Erg	ERG IM	5337093	NA	3.8%	4.6	5.8
			Encavis	ECV GY	5491966	NA	3.8%	4.3	12.5
			Nexans	NEX FP	7130836	NA	3.8%	3.7	4.2
			Solaria Energia Y Medio Ambiente	SLR SM	B1YVKJ4	NA	3.8%	4.1	24.2
			Nordex	NDX1 GY	B06CF71	NA	3.8%	3.7	16.9

Source: Bloomberg, Company data, Goldman Sachs Global Investment Research

Disclosure Appendix

Reg AC

We, Sharon Bell, Guillaume Jaisson, Peter Oppenheimer, Lilia Peytavin and Andrea Ferrario, hereby certify that all of the views expressed in this report accurately reflect our personal views, which have not been influenced by considerations of the firm's business or client relationships.

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