Equity Strategy

Wider Credit Spreads Push Equities to NEUTRAL

AUTHORS

Cosimo Recchia
Senior Equity Strategist
cosimo.recchia@animasgr.it

Francesco Ponzano
Junior Equity Strategist
francesco.ponzano@animasgr.it

We move to a tactical NEUTRAL stance on global equities *(from LONG). The earnings reporting season is proving more challenging than expected, while credit conditions have tightened materially. High-yield spreads have widened to levels last seen at the outbreak of the Iran war and around Liberation Day.* ***The move is therefore consistent with our view that widening credit spreads, rather than the level of interest rates, alone weighs on equities****.*

We adopt a more cautious asset-class stance while maintaining that the broader bullish case remains intact*. We expect range-bound trading to persist until after the US midterm elections. A Democratic "blue sweep" appears increasingly plausible and, in our view, could prove the least favourable outcome for near-term market performance.*

Our valuation model identifies real yields and credit spreads as the key sensitivities, with spreads making the strongest independent explanatory contribution*. The four-factor specification explains approximately 58% of the variation in monthly changes in the logarithm of the forward P/E ratio over the most recent five-year window. A 50-basis-point increase in real yields is associated with a roughly 2% decline in the multiple, while a 100-basis-point widening in HY credit spreads is associated with a decline of around 6.6%, all else being equal. Declining leverage, stronger interest coverage and resilient profitability underpin our expectation that spreads will remain contained. Stable credit spreads and lower yields would ease the valuation pressure for which earnings growth must compensate.*

Regionally, we move to NEUTRAL across all major areas*. Ongoing geopolitical tensions in the Gulf keep us from turning LONG Europe, despite its relative insulation from AI-related market volatility. In Emerging Markets, expected US dollar weakness could partly offset the headwinds from AI-related uncertainty. We downgrade the US to NEUTRAL (from LONG), reflecting its high exposure to the AI theme and idiosyncratic political risks. We upgrade Japan to NEUTRAL (from SHORT).*

At sector level, we adopt a more cautious and defensive stance, moving away from our previous cyclical tilt*. We downgrade Banks and Semiconductors to NEUTRAL (from LONG). Banks are increasingly exposed to wider credit spreads, which could weaken credit quality and earnings expectations. Within Semiconductors, divergent fundamentals across AI computing, foundries, networking, analog and memory support selectivity over a broad sector position. We upgrade Media & Entertainment to LONG (from NEUTRAL), supported by its quality characteristics, strong cash generation and improving earnings momentum.*

Strategically, we maintain our rolling 12-month OVERWEIGHT stance*. Earnings delivery, cash generation and disciplined capital allocation remain central to the returns outlook. AI investment continues to absorb financial capacity unevenly, but improving free-cash-flow conversion through 2028 could gradually create greater scope for shareholder distributions.*

The main risks are further earnings disappointment, additional credit-spread widening and persistent geopolitical tensions*.*

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Turning NEUTRAL

We move to a tactical NEUTRAL stance on global equities (from LONG). The reporting season is proving more challenging than expected, while credit conditions have tightened materially. High-yield spreads have widened to levels last seen at the outbreak of the Iran war and around Liberation Day, reinforcing our view that widening credit spreads, rather than the level of interest rates alone, weigh on equities (**Figure 1**).

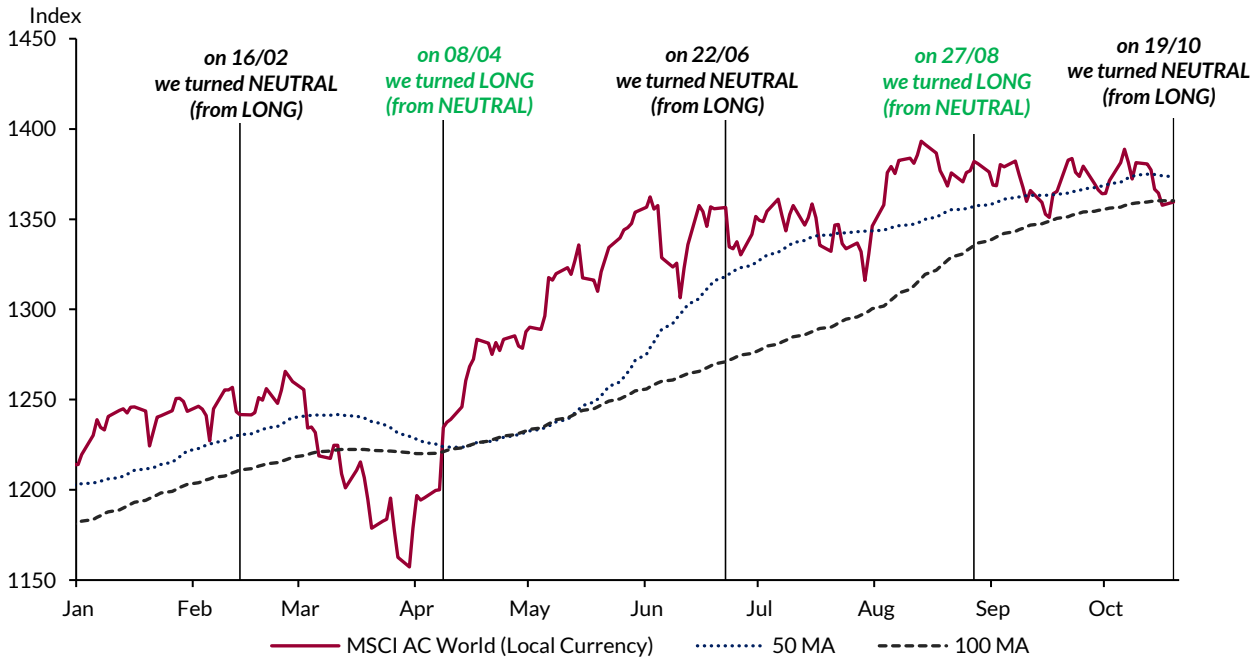
The broader bullish case remains intact, but we expect markets to remain range-bound through the US midterm elections. Earnings delivery, cash generation and disciplined capital allocation continue to support the medium-term outlook. However, with earnings expectations still demanding, forward guidance on demand, margins and capital expenditure will be crucial in assessing the durability of earnings momentum.

Risks appears finely balanced: further earnings disappointments, additional credit-spread widening (**Figure 2** and **3**) and renewed geopolitical or inflationary pressures could weigh on risk appetite. Conversely, a more favourable interest-rate environment, provided it does not reflect a material deterioration in economic growth, and more reassuring earnings reports from Big Tech could provide further support to equity prices (**Figure 4**).

We will look for clearer evidence on earnings and credit conditions before adopting a more constructive tactical stance. In the meantime, we remain selective and cautious as markets navigate the election period.

Figure 1

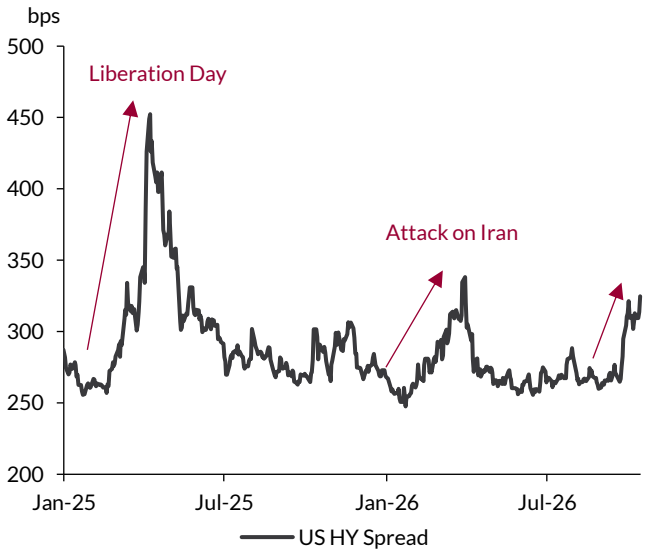
MSCI AC World and Equity Strategy Positioning in 2026



Source: MSCI, ANIMA Research. Prices are as at 19 October 2026.

Figure 2

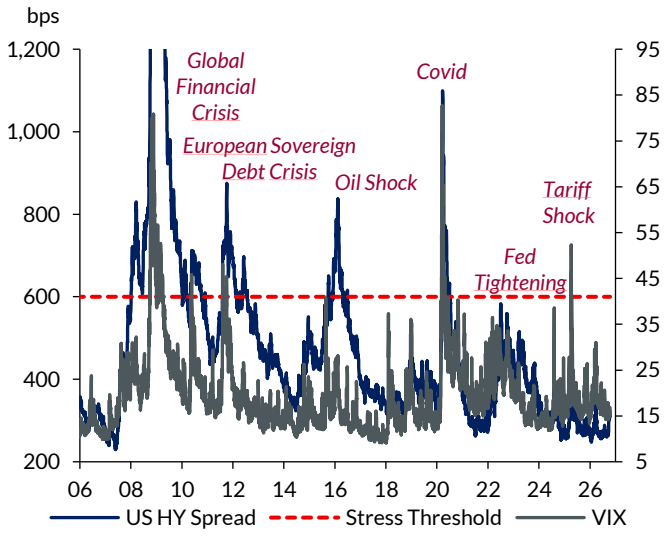
US High Yield Spread



Source: Bloomberg, ANIMA Research. Prices are as at 19 October 2026.

Figure 3

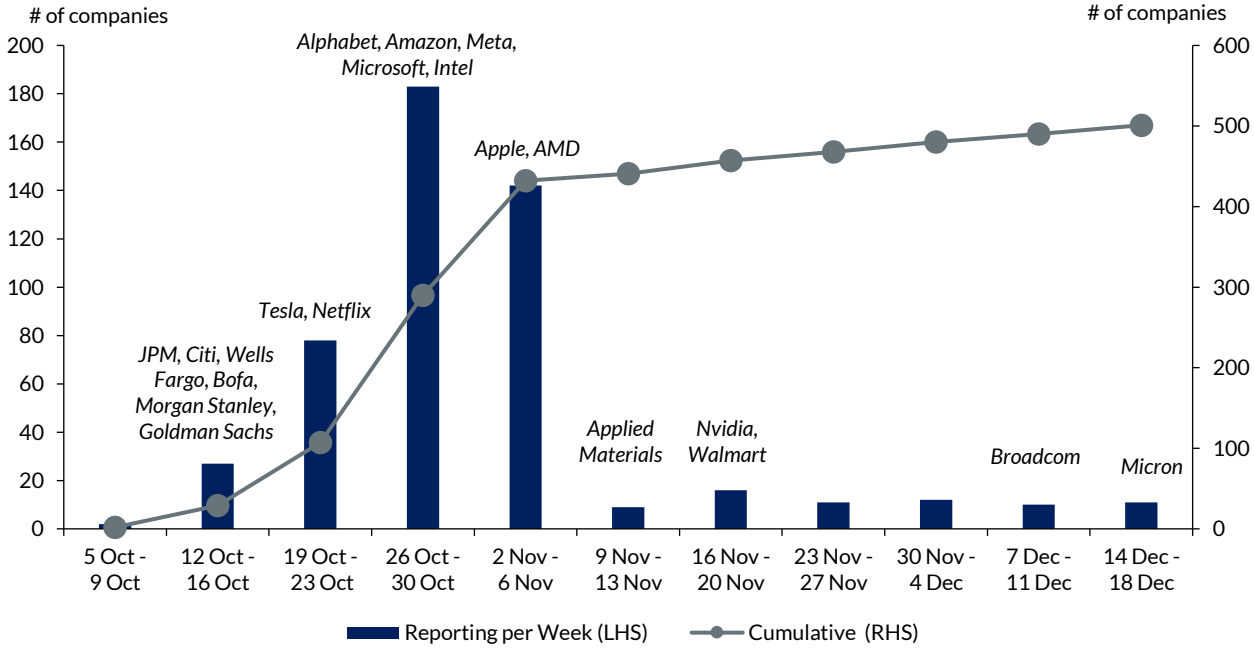
US HY Spread and VIX



Source: Bloomberg, ANIMA Research. Prices are as at 19 October 2026.

Figure 4

US Q3 reporting season - Timeline



Source: Bloomberg, ANIMA Research.

Higher yields absorbed. Lower yields welcomed

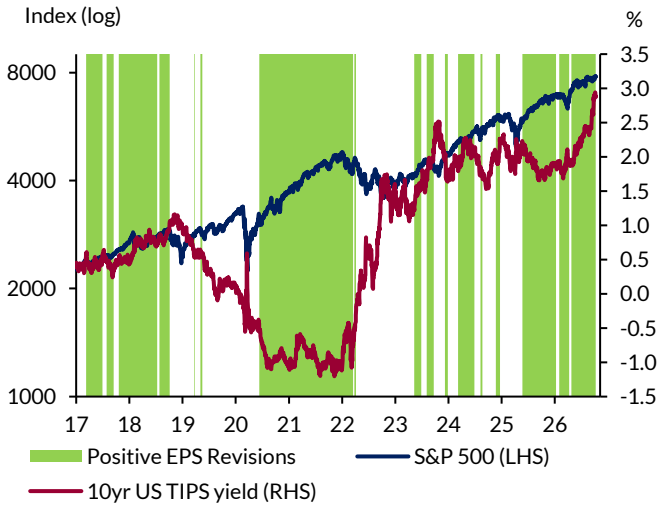
Last month, we argued that resilient earnings could support equities despite elevated yields. We now examine how that resilience translates into market behaviour: how much upward pressure on real yields equities can absorb, how they respond when yields fall, and where interest-rate sensitivity remains evident in valuations and sector performance.

The ten-year historical comparison between the S&P 500 and US 10-year real yields provides a broader context (**Figure 5**). **The market's advance has occurred across different real-yield environments,** illustrating that falling yields are not a prerequisite for rising equity prices. The direction of real yields alone is therefore insufficient to explain movements in the index.

The shorter-horizon evidence adds an important qualification: the magnitude of the yield move matters. In the sample shown, equities delivered an average return of 0.26% when real yields rose by 0–5 basis points and 0.33% when they increased by 5–10 basis points. When real yields increased by10–20 basis points, however, the average equity return was −1.05%. Moderate increases in real yields have been absorbed more comfortably than larger moves. Declines in real yields were associated with positive average equity returns across all three ranges, suggesting a favourable response to easing discount-rate pressure (**Figure 6**).

Figure 5

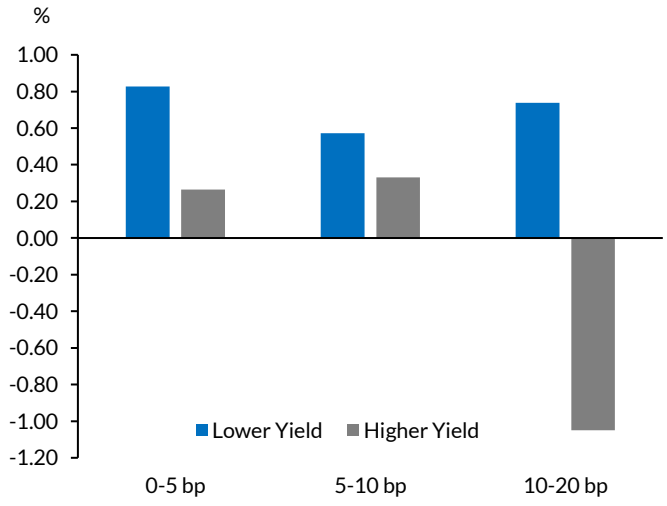
S&P 500 and US 10-year TIPS yield



Source: Bloomberg, ANIMA Research. Prices are as at 19 October 2026.

Figure 6

Average equity returns by direction and magnitude of changes in US 10-year real yields



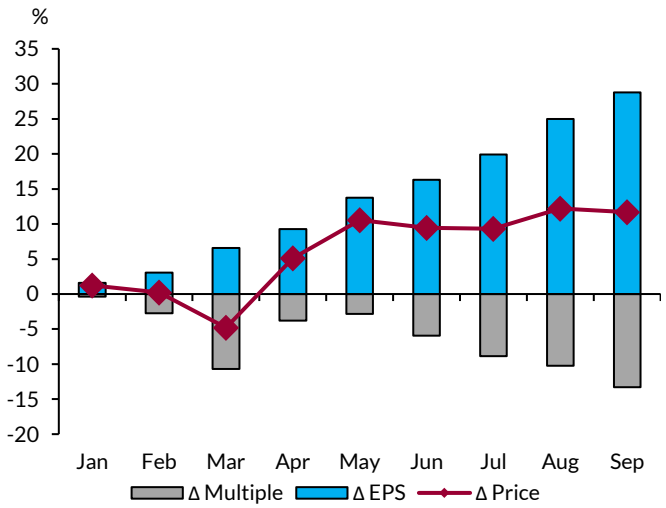
Source: Bloomberg, ANIMA Research. Prices are as at 19 October 2026.

A rising market can conceal valuation compression. Between the end of December 2025 and September 2026, equity prices rose by around 12%, while implied forward EPS increased by approximately 29% and the forward P/E ratio declined by about 13% (**Figure 7**). Investors are effectively paying less for each dollar of expected earnings, even as the index rises: growth in forward earnings has more than offset the contraction in the valuation multiple. This pattern extends beyond the US, with

earnings growth outpacing price gains across major regional equity markets (**Figure 8**). This also raises an important question about the next phase of the rally: if multiples continue to contract, further gains will require sufficient growth in forward earnings to offset that compression. Conversely, a stabilisation in valuations would allow earnings growth to translate directly into price appreciation. The decomposition does not, however, establish the underlying drivers of the decline in the multiple. To assess the role of real yields, we next examine their relationship with monthly changes in valuations, controlling for other macro-financial factors.

Figure 7

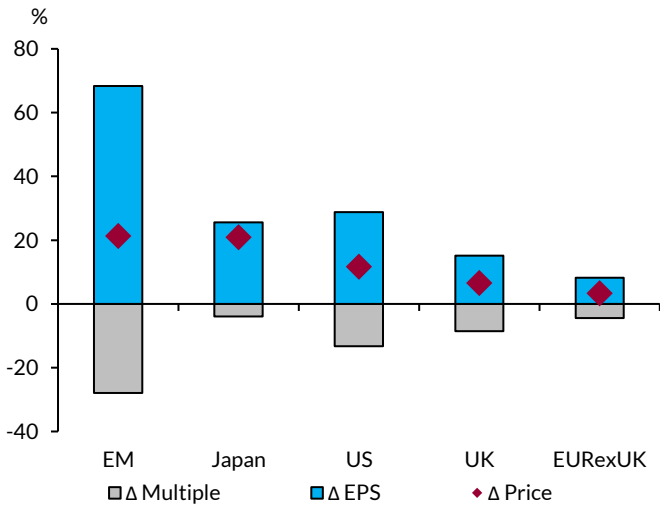
US Equities: Cumulative YTD Performance



Source: Bloomberg, ANIMA Research. Prices are as at 30 September 2026.

Figure 8

Major Equity Regions: YTD Performance



Source: Bloomberg, ANIMA Research. Prices are as at 30 September 2026.

Real yields remain relevant for equity valuations

The resilience of equity index prices does not imply that higher real yields have no impact on valuations. To examine this valuation channel, we model monthly changes in the forward P/E ratio as a function of four explanatory variables: real yields, breakeven inflation, expected earnings growth and credit spreads.

$$\Delta\log(P/E) = \alpha + \beta r\ \Delta\text{Real Yield} + \beta b\ \Delta BE + \beta g\ \Delta\text{EPSgrowth} + \beta s\ \Delta\text{HY Spread} + \varepsilon$$

Here, (PE_t) denotes the 12-month forward P/E ratio, (r_t) the US real yield, (BE_t) breakeven inflation, (g_t) the 12-month forward EPS growth measure, and (HY_t) the high-yield option-adjusted spread. Changes in all explanatory variables are measured in percentage points.

Using monthly data starting in January 1994, we estimate the model using rolling five-year windows, generating a time series of coefficients beginning in January 1999. Each estimation uses the preceding 60 monthly observations, with standard errors adjusted to account for heteroskedasticity and serial correlation. The coefficients capture conditional contemporaneous associations rather than causal effects.

Real yields continue to weigh on valuation multiples. The most recent five-year estimate shows a negative relationship between changes in real yields and changes in the forward P/E multiple, controlling for the other three factors (**Figure 9**). The real-yield coefficient is −0.041, implying that a 50-basis point increase is associated with approximately a 2.0% decline in the multiple, all else being equal. The coefficient is

statistically significant, with a p-value of 0.006 and a 95% confidence interval that excludes zero.

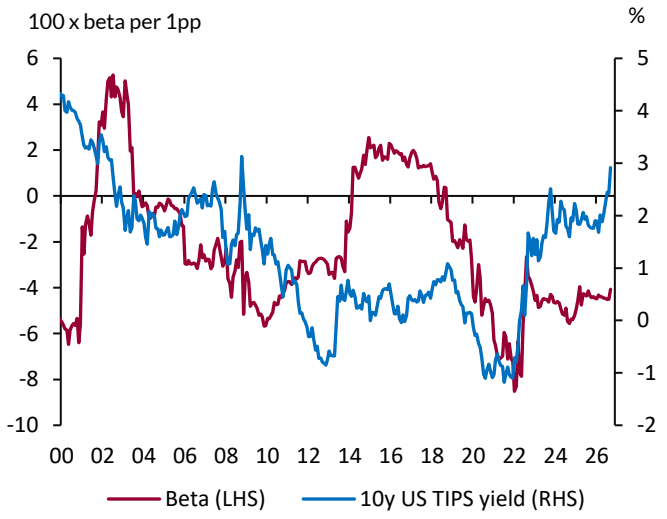
The rolling estimates nevertheless show substantial variation over time, including periods in which the coefficients were positive. The evidence therefore supports a negative relationship between real yields and valuations in the recent period, rather than a stable relationship across different market environments. Changes in the rolling coefficient may reflect evolving economic relationships, shifts in the estimation sample or the influence of specific market episodes; they do not, in themselves, establish a structural regime change.

Credit spreads provide a clearer recent signal. Credit spreads also help explain monthly changes in valuations (**Figure 10**). The most recent HY coefficient is −0.068 and statistically significant. A 100-basis point widening in spreads is associated with approximately a 6.6% decline in the forward P/E multiple, holding the other factors constant.

The historical coefficient estimates remain negative across all available rolling windows, although their magnitude and statistical precision vary. This underscores the importance of monitoring credit conditions alongside real yields when assessing valuation pressure. HY spreads reflect a combination of credit risk, liquidity conditions and market risk appetite, rather than serving as a direct measure of the equity risk premium.

Figure 9

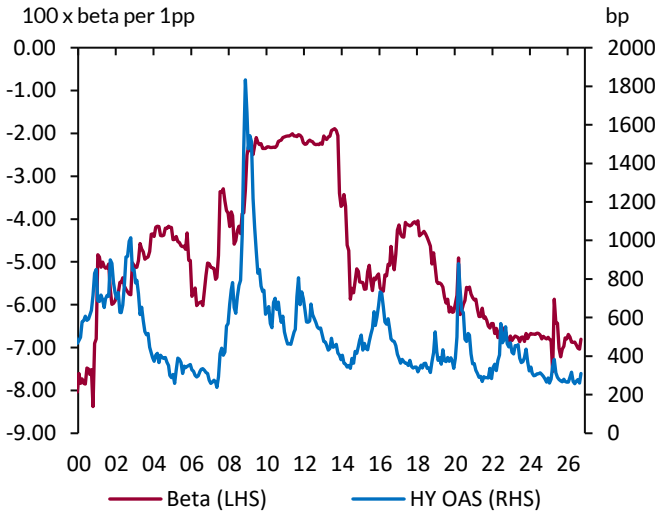
Real yields — rolling five-year coefficient



Source: Bloomberg, ANIMA Research. Prices are as at 30 September 2026[1].

Figure 10

HY credit spreads — rolling five-year coefficient



Source: Bloomberg, ANIMA Research. Prices are as at 30 September 2026.

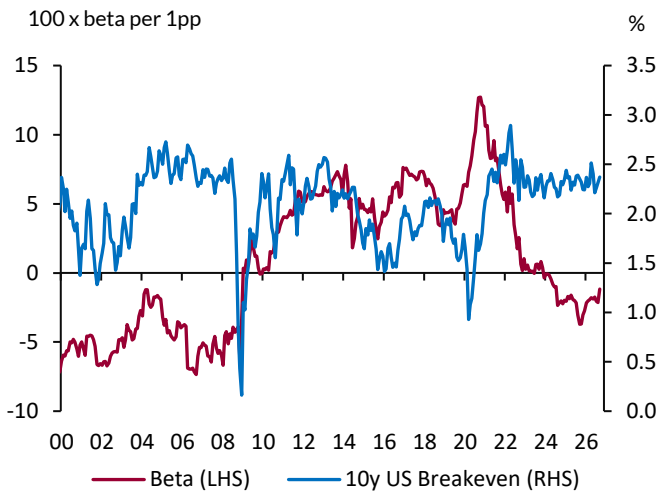
Breakevens and expected earnings growth provide weaker independent signals. The most recent coefficients for breakeven inflation and expected EPS growth are not statistically significantly different from zero (**Figures 11** and **12**). Their independent explanatory power for monthly changes in valuation multiples is therefore less clearly established than that of real yields and credit spreads over the most recent estimation window.

[1] All coefficients are jointly estimated using rolling 60-month regressions. For real yields, breakeven inflation, EPS growth and HY spreads, 100 × β approximates the percentage change in the valuation multiple associated with a one-percentage-point increase in the respective factor. The most recent estimates are based on data from October 2021 to September 2026.

The earnings result requires an important distinction. The regression assesses whether changes in expected EPS growth explain changes in the valuation multiple after controlling for the other factors. It does not capture the full contribution of earnings to equity prices. As the earlier decomposition illustrates, an expanding forward earnings base can sustain equity index gains even when changes in the expected EPS growth measure have little independent explanatory power for changes in valuation multiples.

Figure 11

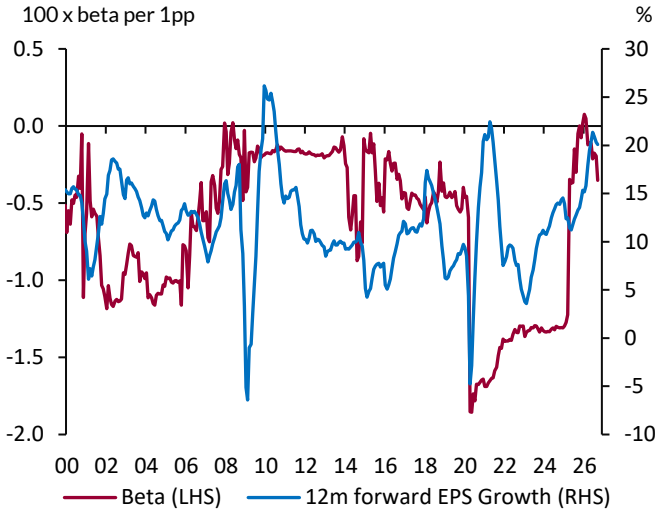
Breakeven — rolling five-year coefficient



Source: Bloomberg, ANIMA Research. Prices are as at 30 September 2026.

Figure 12

Exp. EPS growth — rolling five-year coefficient



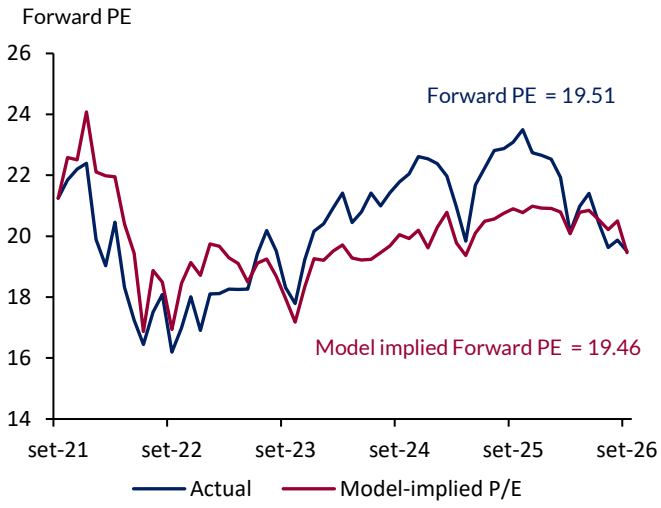
Source: Bloomberg, ANIMA Research. Prices are as at 30 September 2026.

A useful framework for valuation sensitivities. The comparison between the actual and model-implied forward P/E ratios illustrates how valuations have evolved relative to changes in the four macro-financial factors (**Figure 13**). Starting from the observed multiple in September 2016, we construct the model-implied trajectory by cumulatively applying estimated monthly changes, with coefficients updated each month using the preceding five years of data. Each monthly estimate therefore uses coefficients estimated using data up to the previous month, alongside changes in the explanatory factors observed in the current month. The model's explanatory power is assessed based on monthly changes, rather than the level of the reconstructed P/E ratio. In the most recent five-year estimation window, covering October 2021–September 2026, the four factors jointly explain approximately 58% of the variation in monthly changes in the logarithm of the forward P/E ratio, with an adjusted R^2 of 55%. These are in-sample measures for the most recent estimation window, rather than performance metrics for the ten-year rolling reconstruction. They indicate significant explanatory power while leaving substantial variation unexplained by the model.

To identify which factors make the greatest independent contributions, we calculate the partial R^2, which measures the proportion of residual variance explained by adding each variable to a model that already includes the other three (**Figure 14**). HY credit spreads rank first, at 33.5%, followed by real yields at 9.5%. Expected EPS growth and breakeven inflation contribute considerably less incremental explanatory power, with partial R^2 values of 1.0% and 0.2%, respectively. These figures should not be interpreted as additive contributions to the model's overall R^2. Standardised coefficients, which account for differences in factor volatility, confirm the same ranking. The reconstructed path uses observed factor changes and should therefore be interpreted as a conditional valuation benchmark, rather than an ex-ante forecast or an absolute fair-value estimate.

Figure 13

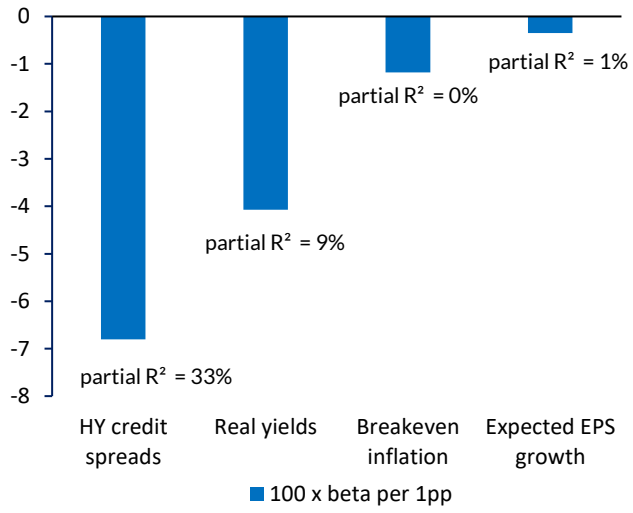
Forward PE: Actual and Model-implied



Source: Bloomberg, ANIMA Research. Prices are as at 30 September 2026.

Figure 14

Valuation sensitivities and partial R² - latest five-year window

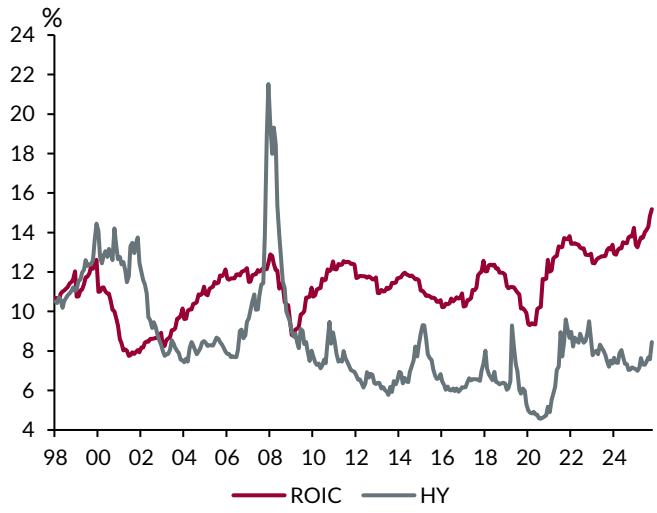


Source: ANIMA Research. Prices are as at 30 September 2026. Bars represent 100 × unstandardised coefficients; labels indicate partial R² values. Bar heights reflect valuation sensitivity, rather than relative explanatory importance.

Given the importance of credit spreads in our model, the outlook for spreads is central to assessing valuation risk. Last month, we highlighted declining leverage and improving interest coverage ratios as reasons to expect spreads to remain contained. Strong profitability provides an additional buffer against higher borrowing costs. **Figure 15** provides a complementary perspective: S&P 500 return on invested capital (ROIC) has risen to around 15%, while HY yields remain well below corporate operating returns. The spread between ROIC and HY yields currently stands at around 6.7 percentage points. The average differential over the most recent highlighted period has risen to approximately 5.4 percentage points, compared with 3.9 percentage points in the preceding period (**Figure 16**). **The recent widening of the differential appears to be driven primarily by improving profitability, suggesting that corporate resilience extends beyond favourable financing conditions**. Although the comparison covers different corporate universes and does not directly measure debt-servicing capacity, it complements the balance sheet evidence underpinning our expectation that credit spreads will not widen significantly, provided profitability remains resilient. Stable credit conditions would, in turn, help mitigate a potential source of downward pressure on equity valuation multiples.

Figure 15

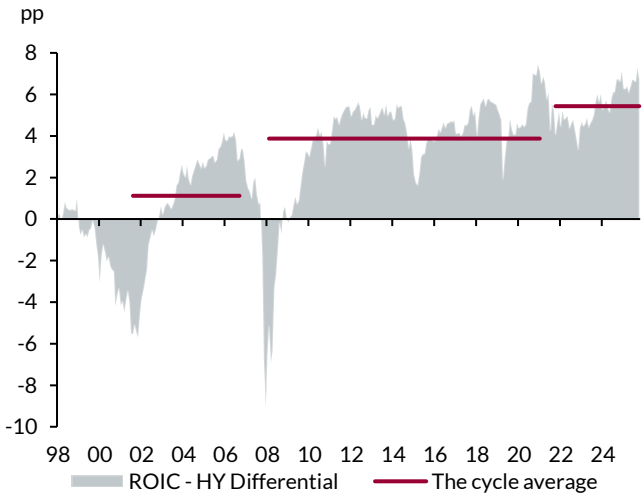
S&P 500 ROIC and US HY yield



Source: Bloomberg, ANIMA Research. Prices are as at 30 September 2026.

Figure 16

Profitability cushion



Source: ANIMA Research. Prices are as at 30 September 2026.

Recommendations

A. Regional Allocation

We move to NEUTRAL across all major regions, removing our previous directional calls. Earnings visibility remains important, but the regional outlook is also shaped by geopolitical tensions, AI-related uncertainty and currency trends (**Figure 17**).

We downgrade the US to NEUTRAL (from LONG). The market's high exposure to the AI theme leaves it vulnerable to any reassessment of the pace or returns of AI investment. Idiosyncratic political risks add to the uncertainty, making us more cautious despite the resilience of US earnings and the country's energy independence. We will look for clearer evidence of earnings durability and the broader market impact of AI investment before turning more constructive.

We upgrade Japan to NEUTRAL (from SHORT). While monetary policy normalisation and currency movements remain relevant risks, we no longer see sufficient grounds to maintain a negative regional stance.

We remain NEUTRAL on Continental Europe and the UK. Ongoing geopolitical tensions in the Gulf keep us from adopting a more positive stance on Europe, despite the region's relative insulation from AI-related market volatility. In the UK, we see selective opportunities, but not enough to justify a directional regional position.

We maintain a NEUTRAL stance on Emerging Markets. These markets have direct exposure to AI-related demand, but uncertainty around the sustainability of that momentum argues against a broader regional upgrade. Expected US dollar weakness could partly offset these headwinds.

Figure 17

Tactical Regional Recommendations - November 2026

LONG	NEUTRAL	SHORT
US	EM	Japan
	Continental Europe	
	UK	

Source: ANIMA Research. Markets in green have been upgraded, while those in red have been downgraded since the last Strategy Focus.

B. Sector Allocation

We adopt a more cautious and defensive sector stance, moving away from our previous cyclical tilt. We downgrade Banks and Semiconductors to NEUTRAL (from LONG). For Banks, wider credit spreads could weaken credit quality and earnings expectations. In Semiconductors, divergent fundamentals across AI computing, foundries, networking, analog and memory argue for selectivity rather than broad sector exposure. AI infrastructure remains a structural growth theme, but we see greater uncertainty around the timing and distribution of returns across the value chain (**Figure 18** and **19**).

We upgrade Media & Entertainment to LONG (from NEUTRAL), supported by its quality characteristics, strong cash generation and improving earnings momentum. We also upgrade Food & Staples Retailing to LONG (from SHORT), adding exposure to a sector with relatively stable demand and resilient earnings.

We downgrade Utilities, Insurance and Materials to SHORT. In Utilities, potential valuation support from lower yields is offset by capital intensity, financing needs and regulatory frameworks governing returns. In Insurance, peaking yields could gradually moderate the boost from reinvestment income, while we see fewer catalysts for relative outperformance. For Materials, we favour sectors with stronger earnings momentum amid a more uncertain growth and credit backdrop.

We remain LONG Capital Goods and Energy, which provide exposure to structural investment themes and a hedge against geopolitical disruption and renewed pressure on energy supplies. Within Capital Goods, we favour companies exposed to power generation, grid infrastructure, automation and data centres, with an emphasis on order conversion, pricing power and cash generation. In Energy, disciplined capital allocation and strong cash flow remain key selection criteria.

Figure 18

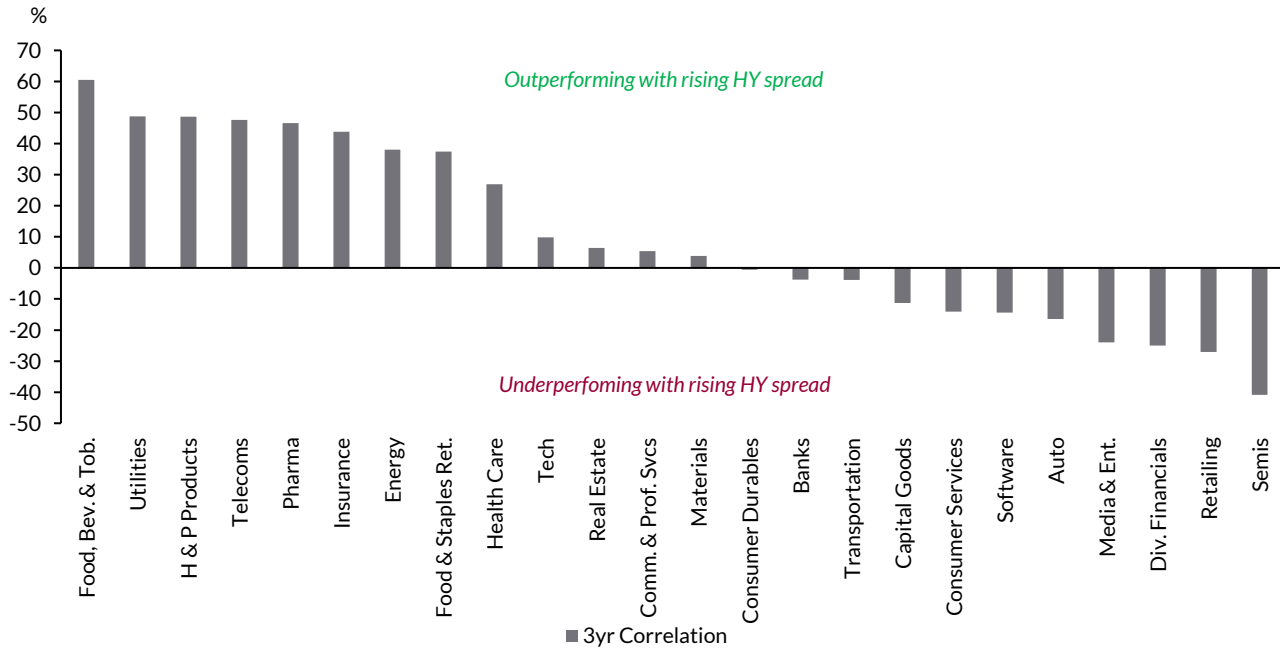
Tactical Sector Recommendations - November 2026

LONG	NEUTRAL	SHORT
Tech Hardware & Equip.	Retailing	Transportation
Capital Goods	Health Care Equip. & Svcs	Consumer Durables & Apparel
Pharma, Biotech & Life Sciences	Diversified Financials	Telecoms
Energy	Software & Services	Consumer Services
Food, Beverage & Tobacco	Semis & Semi Equip.	Commercial & Professional Svcs
Media & Entertainment	Banks	Household & Personal Products
Food & Staples Retailing		Real Estate
		Automobiles & Components
		Utilities
		Insurance
		Materials

Source: ANIMA Research. Markets in green have been upgraded, while those in red have been downgraded since the last Strategy Focus.

Figure 19

Relative sector performance and HY Spread



Source: MSCI, Bloomberg, ANIMA Research.

Strategically OVERWEIGHT

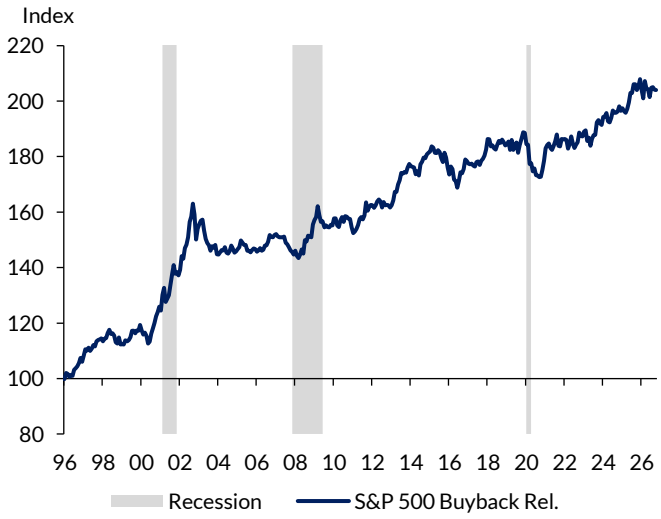
Strategically, we maintain our rolling 12-month OVERWEIGHT stance. Even if bond yields decline from current levels, our outlook for equity returns rests primarily on earnings delivery, cash generation and disciplined capital allocation, with multiple expansion offering potential additional upside. **Our medium-term outlook remains constructive.** We continue to expect resilient economic growth, solid corporate profitability and a sustained investment cycle, with S&P 500 EPS growth projected at around 13% in 2027. While elevated yields are likely to constrain multiple expansion and result in a more moderate and volatile return profile, positive earnings growth should continue to support equity returns, supplemented by dividends and share buybacks. Against this backdrop, companies' ability to convert earnings into cash and allocate capital efficiently becomes an increasingly important driver of per-share value creation.

This makes buybacks particularly relevant in the current environment. When multiple expansion becomes a less reliable driver of returns, companies with strong cash generation and balance sheet flexibility retain an additional means of supporting per-share fundamentals and shareholder returns.

Historically, companies with a high buyback intensity have delivered strong relative performance. The S&P 500 Buyback Index strategy has materially outperformed its equal-weighted benchmark over the long term, while also demonstrating notable resilience during several recessionary periods (**Figure 20).** The Buyback Index has also outperformed the S&P 500 Dividend Aristocrats Index over the period under review, although differences in sector composition, profitability and valuation make it difficult to attribute this relative performance solely to payout policy (**Figure 21**).

Figure 20

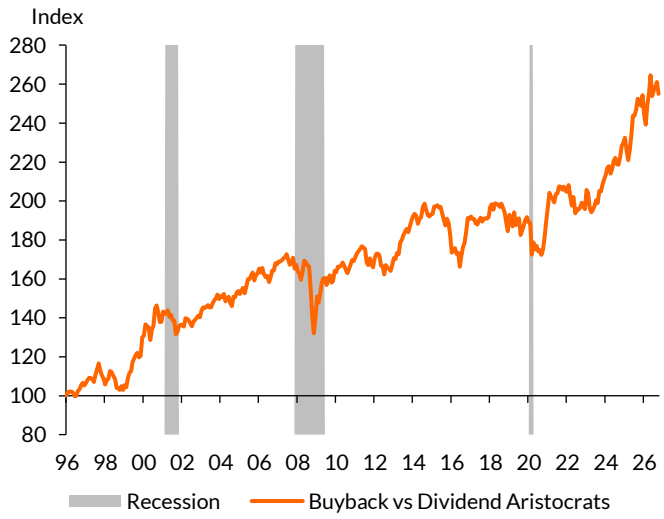
S&P 500 – Buyback Index vs Benchmark



Source: S&P, ANIMA Research. Prices are as at 19 October 2026.

Figure 21

S&P 500 – Buyback Index vs Dividend Aristocrats Index



Source: S&P, ANIMA Research. Prices are as at 19 October 2026.

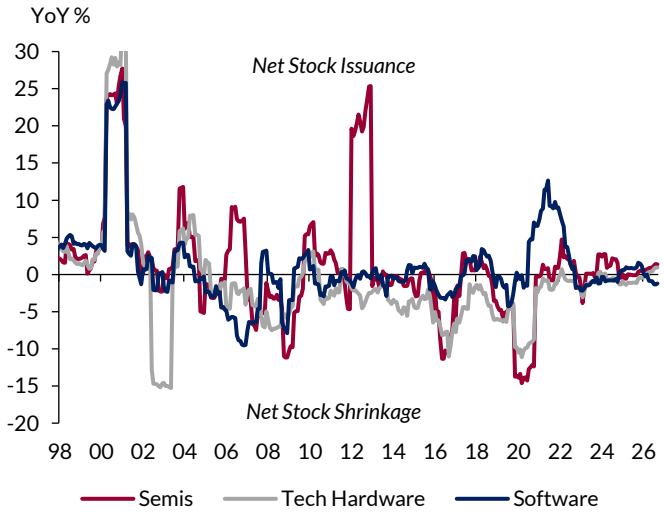
Historical buyback outperformance does not necessarily depend on an outright reduction in share count. Companies can simultaneously repurchase shares and issue new shares through share-based compensation, employee share schemes or

mergers and acquisitions (M&A). Changes in index divisors provide an imperfect indication of net share issuance, as they also reflect changes in index constituents and corporate actions. Within the Technology sector, the current picture is consistent with modest net issuance in Semiconductors and Technology Hardware, but not in Software (**Figure 22**). Importantly, however, issuance remains far below the peaks observed around the dot-com bubble and during 2020–2021, when equity issuance surged across several growth-oriented industries. Financials exhibit a similar pattern, with recent readings much closer to neutral levels than during previous episodes of pronounced share issuance or share-count reduction (**Figure 23**).

This distinction is important. Even when buybacks do not result in an outright reduction in share count, they remain an important tool available to companies, allowing them to offset some of the dilution that would otherwise weigh on per-share fundamentals and EPS growth. At the same time, sustained buyback activity is often associated with strong cash generation and balance sheet flexibility, reinforcing its role as both an indicator of financial strength and a mechanism for returning capital to shareholders.

Figure 22

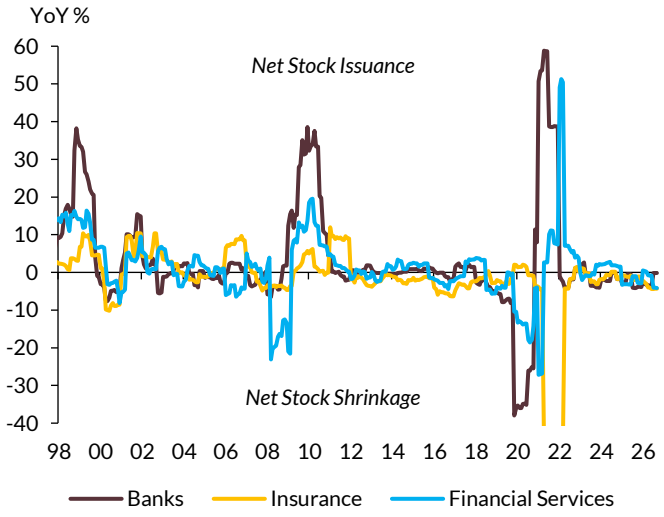
US Tech Sectors – Index Divisor YoY Change



Source: MSCI, ANIMA Research. Data are as at 30 September 2026.

Figure 23

US Financials – Index Divisor YoY Change

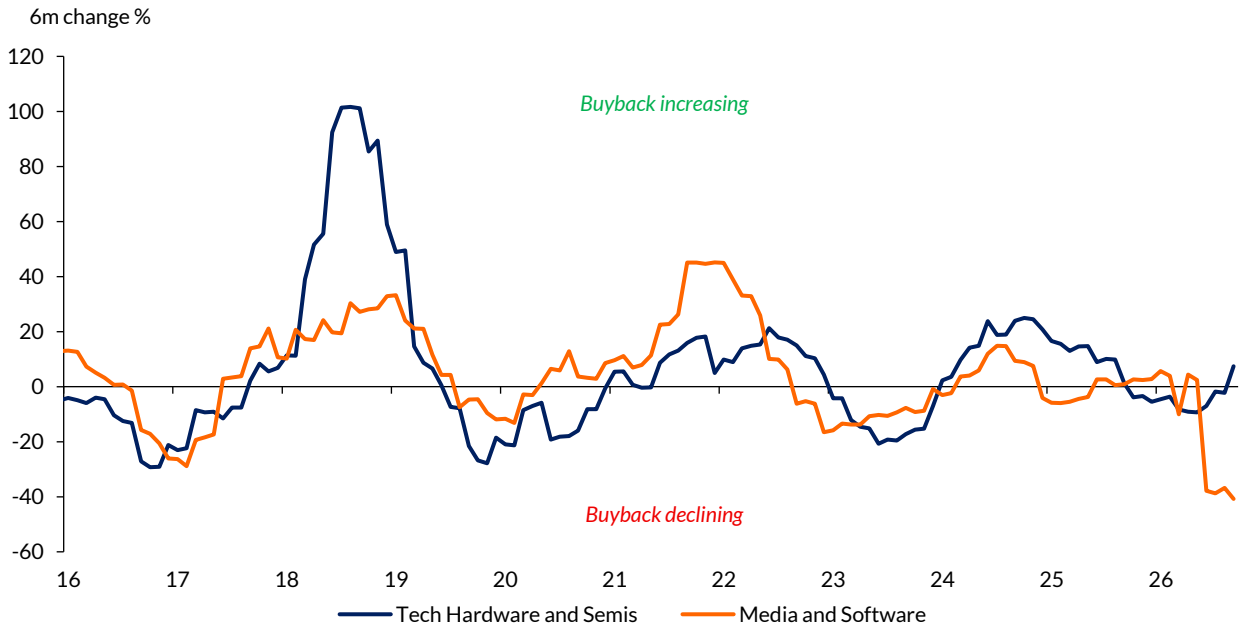


Source: Bloomberg, ANIMA Research. Data are as at 30 September 2026.

AI investment has constrained, but not eliminated, buyback capacity. The more relevant question today is whether elevated capital expenditure (capex) - particularly in the context of the ongoing AI investment cycle - is reducing companies' capacity to return cash to shareholders. Recent buyback trends indicate increasing divergence across the Technology sector. The six-month change in buybacks in Technology Hardware and Semiconductors appears to be stabilising and has recently returned to positive territory, following a prolonged slowdown. By contrast, Media and Software remain under greater pressure, with buyback activity continuing to contract (**Figure 24**). We would be cautious about attributing this divergence solely to AI capex, but it is consistent with diverging investment and capital allocation cycles across these industries.

The key point is that a slowdown in share buybacks does not necessarily imply a structural deterioration in companies' capacity to return capital to shareholders. Rather, for several companies, elevated capital expenditure requirements appear to have temporarily shifted the balance towards growth investment and away from shareholder distributions.

Figure 24



Source: Bofa, ANIMA Research. Data are as at 30 September 2026.

Cash conversion is projected to improve through 2028, although the recovery remains uneven. Bottom-up analyst estimates reinforce this view. We use free-cash-flow conversion, defined as FCF as a percentage of EBITDA, to assess how efficiently operating profitability is converted into cash after capital expenditure and other cash requirements. Higher conversion therefore indicates greater internally generated funding capacity and, potentially, greater scope for shareholder distributions.

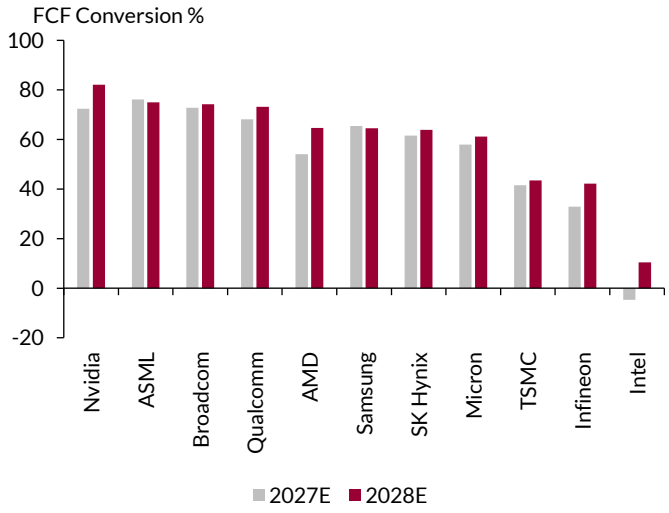
Among semiconductor companies, dispersion remains significant. Asset-light companies such as Nvidia, Broadcom and Qualcomm continue to exhibit strong FCF conversion, while ASML also compares favourably. By contrast, more capital-intensive manufacturers such as TSMC, Micron and Intel exhibit structurally lower conversion, reflecting the substantial capital expenditure requirements associated with advanced semiconductor manufacturing and memory production. Importantly, however, FCF conversion is expected to improve for most companies through 2028, suggesting that financial flexibility could increase as the investment cycle matures (**Figure 25**).

The picture remains more challenging for hyperscalers. In 2027, elevated AI-related capital expenditure requirements place significant pressure on cash conversion, with Meta and Alphabet projected to report negative FCF conversion and Amazon also expected to remain below zero based on current estimates. The outlook improves materially by 2028: Amazon is expected to return to positive territory, Meta and Alphabet are projected to approach breakeven, while Microsoft is expected to record further improvement (**Figure 26**).

Improving FCF conversion should gradually alleviate funding constraints, although the scope for additional shareholder distributions remains company-specific, particularly for companies where free cash flow is projected to remain negative.

Figure 25

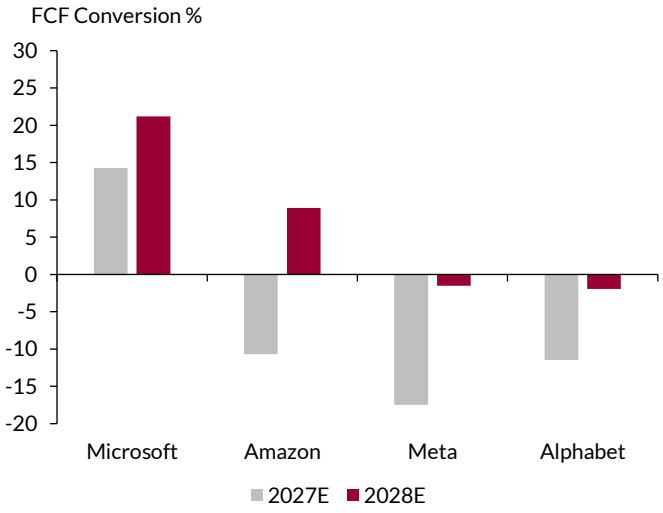
Global Semis Stocks – FCF Conversion Estimates



Source: Bofa, ANIMA Research. Data are as at 30 September 2026.

Figure 26

Hyperscalers – FCF Conversion Estimates



Source: Bofa, ANIMA Research. Data are as at 30 September 2026.

ANIMA INVESTMENT RESEARCH

FABIO FOIS
Head of Investment Research & Advisory
fabio.fois@animasgr.it

CHIARA CREMONESI
Senior Rates Strategist
chiara.cremonesi@animasgr.it

COSIMO RECCHIA
Senior Equity Strategist
cosimo.recchia@animasgr.it

MATTEO GALLONE
Macroeconomist
matteo.gallone@animasgr.it

FRANCESCO PONZANO
Junior Equity Strategist
francesco.ponzano@animasgr.it

MATTIA BANIN
Junior Macro Analyst
mattia.banin@animasgr.it

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