BlackRock

Q2 2022

European Equity Barometer

Insights from the Fundamental Equities Team

The first quarter of 2022 proved immensely challenging for fundamental investors. A sharp, top-down positioning rotation was quickly followed by the most significant geopolitical conflict Europe has witnessed in recent history. Both have consequences for near-term company operations in Europe, as well as the long-term dynamics of the region.

Market rotation and geopolitical conflict have created clear valuation opportunities

Consumer confidence has dropped, but spending remains resilient supported by low unemployment

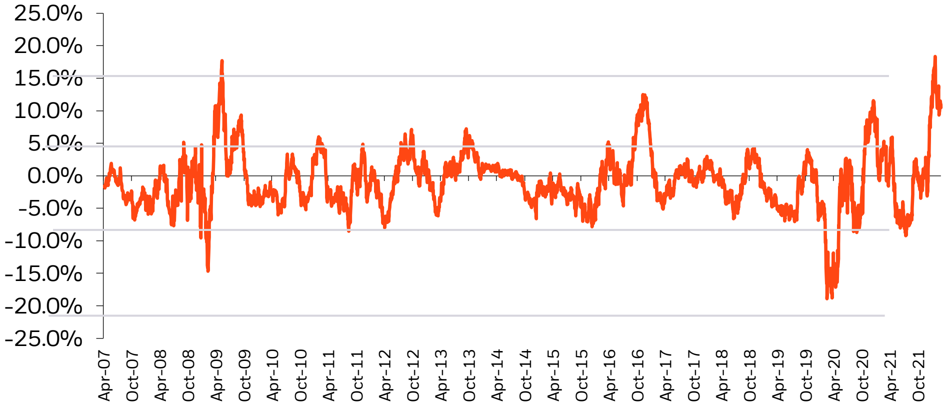
Current energy costs could be tough to bare, but clear plans for spending should accelerate Europe's transition to renewables

Market overview and outlook

The sharp market rotation that welcomed 2022 saw the European value factor outperform to a greater extent than we've seen since the immediate recovery of the Global Financial Crisis. The subsequent Russian invasion of Ukraine compounded the effect with a market sell-off and resulted in a substantial multiple de-rating of many of Europe's best businesses. This was against a backdrop of these companies reporting strong earnings results during the Full Year 2021 reporting season as well as strong outlook statements for 2022. We see the multiple de-rating, driven by interest rate changes, as largely done.

There are near- and long-term impacts to consider as a result of the Russian invasion of Ukraine. Namely, industrial output in the face of cost inflation, the impact on consumer confidence and, in the long-term, energy security, particularly in the context of an economy in transition.

A significant rotation: European Value vs European Growth performance

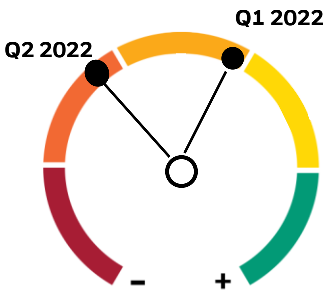


Source: BlackRock, Bloomberg March 2022, MSCI Europe Growth and MSCI Europe Value Index performance. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** You cannot invest directly in an Index.

BlackRock's Fundamental European Equity team

20 Investors
1 Data scientist
> 250 years of experience

Conviction gauge



We have devised a schematic to illustrate the current strength of our conviction on the market and how that has changed since last quarter. Far right is the strongest, or most positive, reading and far left the weakest, or most negative, reading. The middle position equals neutral.

1 Industrial implications

With the Russian invasion of Ukraine, there are clear first order implications on energy and other raw material cost inputs for industrial companies. For European Industrials, it is estimated total energy costs, including that sourced outside of Europe, accounts for ~1% of sales (source: Goldman Sachs, March 2022). Following the further pressure this conflict has put on prices, we've noted some data which shows relatively meaningful declines in energy consumption across European economies as well as requests by governments to draw up contingency plans in the event gas requires rationing. A shortage of commodity resources creates clear production issues, which has been highlighted in commentary from the likes of autos, trucking and certain crane companies. We have observed some significant differences, however, in company accessibility to raw materials. Those with more favourable supply terms, and in some cases flexible contracts that protect pricing, are in a stronger position to continue production and protect profitability.

We also note emerging differences in the demand outlook within the industrial economy. Whilst we have already seen a handful of companies warning on the demand potential for 2022, other areas of the market are proving significantly more resilient. Notably, speciality and construction chemicals businesses have provided very confident outlook statements, supported by growing visibility in order demand. With such potential differences in business fortunes emerging, both with respect to production capacity and demand outlook, we believe selectivity within industrials will be hugely important as we move through 2022.

2 Consumer confidence

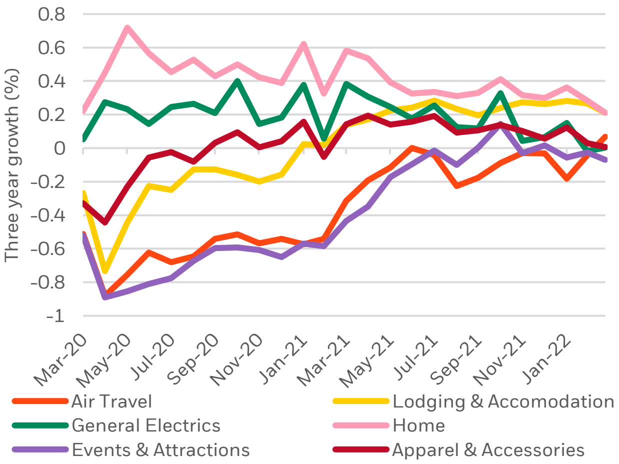
Last quarter, we touched on our concerns for the resilience of consumer demand in 2022. Not only as certain segments of spending begin to slow following the 'revenge spend' witnessed after lockdowns lifted, but as issues around affordability – owing to inflationary forces, energy costs and in some instances tax increases – hit the consumer. This concern has only been amplified through the first quarter with the further increasing costs of energy, although in Europe some of this has been offset by government windfall taxes, and the fear around the Russian invasion of Ukraine. With this backdrop, the latest consumer confidence data in the Euro area recorded the second-largest drop on record (Haver Analytics, March 2022). We are therefore using our alternative data insights to track consumer spending patterns closely. So far, we can observe clear declines in spending for homewares and electronics, however this is broadly offset by a pick up in spending for travel and leisure (see chart below). There is little evidence as yet of a more material slowdown in aggregate spending. We think spending will, to an extent, be supported by excess savings built up through the pandemic, although note these are skewed towards higher income households and retirees. Support will also come from the lower unemployment rate, where in the Eurozone the economy is forecast to hit 6.5% by year end, significantly below the 10-year average of 10% (Eurostat, March 2022). However, should there be reticence to run down savings in the face of higher energy and inflation costs, we could see a more meaningful downturn in economic growth assumptions.

We retain a preference for higher quality consumer cyclicals, such as luxury goods companies which continue to see record demand for their products. We are cautious on growth rates for big ticket items for the home and to an extent mass market products given the greater disposable income contraction in lower quintiles of earners.

3 Taking note of valuation

Against the backdrop of the Russian invasion of Ukraine, as well as rising rates, European markets both rotated and fell through the first quarter. Valuation at the index level now sits below the long-run average, whilst some intra-market valuations look even more compelling. We view companies with higher earnings visibility and quality across a breath of end markets from health care to industrial cyclical as offering attractive entry opportunities. Selectively, following a sharp pull back in March, we view European banks as more attractive, especially in the context of mortgages being re-priced higher, with the German 2 year also almost at zero, a rate last witnessed in 2014.

Offset spending: services spending taking over the decline in goods



Source: BlackRock, Earnest Research Data, US spending, March 2022

Mortgages repricing

German 10 and 15yr fixed rates

Source: Interhyp, March 2022

Energy security and the transition

One of the clearest reactions to Russia's invasion of Ukraine has been the decisive, united action by the Western community. The use of sanctions have been far greater than the market would have envisioned and the response of Western brands pulling out of Russia altogether is also significant. What has also been of significance are the concerns this conflict has raised around energy security. Per the chart below, Russia's supply of energy significantly outstrips that of the Euro area, leaving the region reliant on Russia, amongst other countries, as a source of energy. Europe imports 90% of its gas consumption, with 45% of that from Russia (Eurostat, March 2022). The result of this energy shock sees Europe facing its highest energy cost burden (as a share of GDP) since 1981 (Blackrock, March 2022).

This has led the European Commission to propose a plan to make Europe independent from Russian fossil fuels before 2030, staring with gas. "REPowerEU" will look to diversify gas supplies, speed up the roll-out of renewable gases and replace gas in heating and power generation.

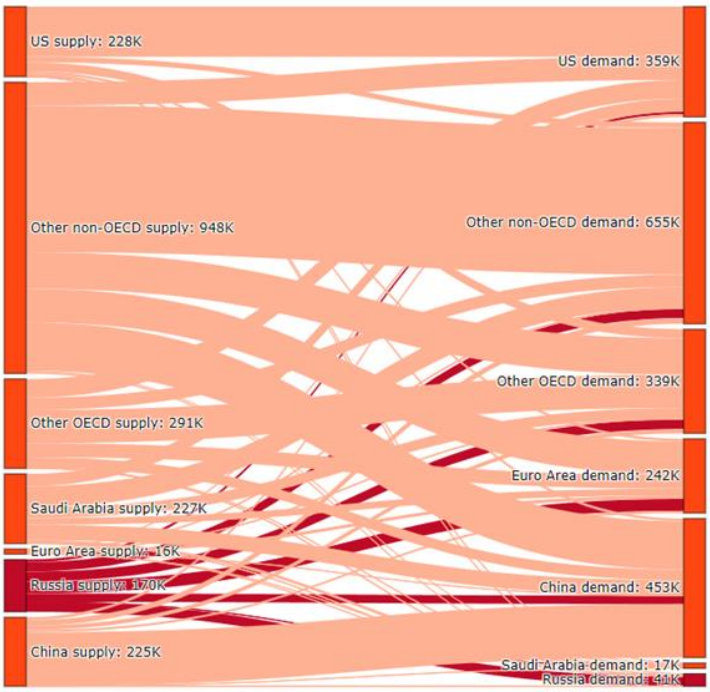
This will be a complex, and likely costly, task with the need to see faster growth than ever before in the likes of heat pump sales, as well as solar and wind installations. Positively, capex in this area (as the figure shows), is significant. This comes both from renewable players as well as big oil as the levelized cost of energy falls, and is predicted to fall further with technology improvements, along with scale and industrial efficiencies.

In the near-term, these dynamics lead us to see a greater role for energy stocks in portfolios, as their cash flows improve as the global stock of energy is effectively reduced in light of lower reliance on Russia. As well as large cap oil & gas majors, we've also favoured more specialist players in the oil services industry, for example Tenaris which produces steel pipes for US oil and gas companies and with strong competitive dynamics, and years of under-investment, now faces a sweet spot in the cycle for pricing and profitability.

In the longer-term, we note the European Commission's "REPowerEU" plan also requires significant improvement in energy efficiencies. Roughly 75% of the EU building stock is energy inefficient (Eurostat, Feb 2022). In addition to the retrofitting of heat pumps and solar panels, older buildings will be refurbished and rebuilt; while large parts of the industrial economy will need to be electrified. This provides a long-term and compelling opportunity for businesses offering smart construction materials, and those with leading positions in electrification and automation.

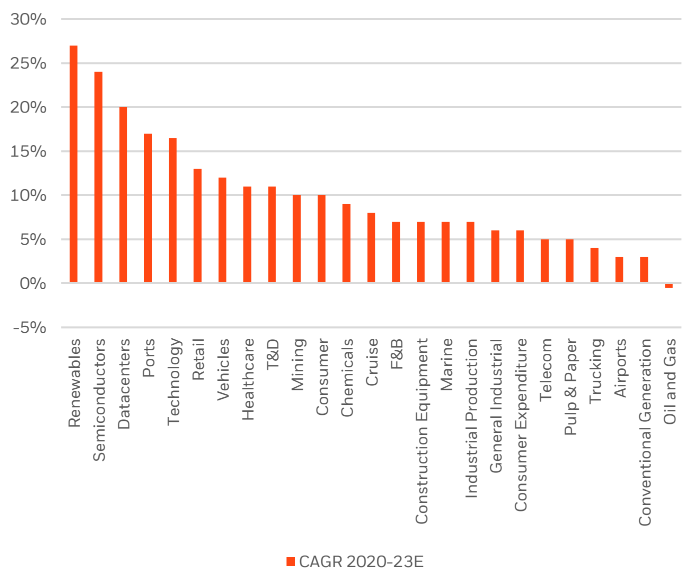
As well as a desire to reduce our need for energy in the home, these events and spending plans may also act to further catalyse the adoption of alternative forms of transport, namely Electric Vehicles. As the chart below also highlights, semiconductors, which have significant content application within EVs, are another area enjoying strong capex growth. We see this as sustaining through 2022, not only due to the continued shortages in auto manufacturing, but the broader end market demand for both memory and logic. We continue to favour the higher quality players in this industry, some of which are supported by order book visibility spanning well beyond a year.

Sources (left) and Uses of Energy Value Added (2018 USDmn)



Source: BlackRock, OECD TiVA database, 2022

Goldman Sachs Capex Tracker end markets



Source: Goldman Sachs, January 2022

Expert insights from the European Equity Team

Read Sarah Thomas' thoughts on European Health Care post an industry road show

Read Simon Hunter's thoughts on the impact of EV transition on Europe's OEMs

Fundamental Equities

α Expert **insight**

People	Profound curiosity, deep conviction
Purpose	Active edge, sustainable outcomes
Perspective	Astute, diverse, panoramic
Performance	Long-term lens, risk-aware results

Want to know more?

blackrock.com

Risks

Capital at risk. The value of investments and the income from them can fall as well as rise and are not guaranteed. The investor may not get back the amount originally invested.

Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy.

Changes in the rates of exchange between currencies may cause the value of investments to diminish or increase. Fluctuation may be particularly marked in the case of a higher volatility fund and the value of an investment may fall suddenly and substantially. Levels and basis of taxation may change from time to time.

Important information

This material is for distribution to Professional Clients (as defined by the Financial Conduct Authority or MiFID Rules) only and should not be relied upon by any other persons.

In the UK and Non-European Economic Area (EEA) countries: this is Issued by BlackRock Investment Management (UK) Limited, authorised and regulated by the Financial Conduct Authority. Registered office: 12 Throgmorton Avenue, London, EC2N 2DL. Tel: + 44 (0)20 7743 3000. Registered in England and Wales No. 02020394. For your protection telephone calls are usually recorded. Please refer to the Financial Conduct Authority website for a list of authorised activities conducted by BlackRock.

In the European Economic Area (EEA): this is Issued by BlackRock (Netherlands) B.V. is authorised and regulated by the Netherlands Authority for the Financial Markets. Registered office Amstelplein 1, 1096 HA, Amsterdam, Tel: 020– 549 5200, Tel: 31-20-549-5200. Trade Register No. 17068311 For your protection telephone calls are usually recorded.

For qualified investors in Switzerland: This document is marketing material. This document shall be exclusively made available to, and directed at, qualified investors as defined in Article 10 (3) of the CISA of 23 June 2006, as amended, at the exclusion of qualified investors with an opting-out pursuant to Art. 5 (1) of the Swiss Federal Act on Financial Services ("FinSA"). For information on art. 8 / 9 Financial Services Act (FinSA) and on your client segmentation under art. 4 FinSA, please see the following website: www.blackrock.com/finsa

BlackRock.

Want to know more?

blackrock.com

Important information

The information contained in this document is intended strictly for sophisticated institutions who meet the description of a Professional Client under the Conduct of Business (COB) Module of the Dubai Financial Services Authority (DFSA) Rulebook, and who are: in the Kingdom of Saudi Arabia – Exempt Persons, Authorised Persons or Investment Institutions, as defined in the relevant implementing regulations issued by the Capital Markets Authority (CMA) of the Kingdom of Saudi Arabia; in the United Arab Emirates (other than the Dubai International Financial Centre (DIFC) and the Abu Dhabi Global Market (ADGM) financial free zones) – non-natural Qualified Investors as defined by the Securities and Commodities Authority (SCA) Chairman Decision No. 3/R.M. of 2017 concerning Promoting and Introducing Regulations; The information contained in this document, does not constitute and should not be construed as an offer of, invitation, inducement or proposal to make an offer for, recommendation to apply for or an opinion or guidance on a financial product, service and/or strategy. Whilst great care has been taken to ensure that the information contained in this document is accurate, 58 no responsibility can be accepted for any errors, mistakes or omissions or for any action taken in reliance thereon. You may only reproduce, circulate and use this document (or any part of it) with the consent of BlackRock. The information contained in this document is for information purposes only. It is not intended for and should not be distributed to, or relied upon by, members of the public. The information contained in this document, may contain statements that are not purely historical in nature but are "forward looking statements". These include, amongst other things, projections, forecasts or estimates of income. These forward looking statements are based upon certain assumptions, some of which are described in other relevant documents or materials. If you do not understand the contents of this document, you should consult an authorised financial adviser. None of the various financial regulatory authorities in the jurisdictions above (the "Authorities") are responsible for reviewing or verifying any information contained within this document or any other materials in connection with this document. Accordingly, the none of the Authorities have approved this document or any other associated documents, nor have taken any steps to verify the information set out in this document and have no responsibility for it. Blackrock Advisors (UK) Limited - Dubai Branch is a DIFC Foreign Recognised Company registered with the DIFC Registrar of Companies (DIFC Registered Number 546), with its office at Unit 06/07, Level 1, Al Fattan Currency House, DIFC, PO Box 506661, Dubai, UAE, and is regulated by the DFSA to engage in the regulated activities of 'Advising on Financial Products' and 'Arranging Deals in Investments' in or from the DIFC, both of which are limited to units in a collective investment fund (DFSA Reference Number F000738).

For investors in Israel: BlackRock Investment Management (UK) Limited is not licenced under Israel's Regulation of Investment Advice, Investment Marketing and Portfolio Management Law, 5755-1995 (the "Advice Law"), nor does it carry insurance thereunder.

South Africa:
Please be advised that BlackRock Investment Management (UK) Limited is an authorised Financial Services provider with the South African Financial Services Board, FSP No. 43288.

Any research in this document has been procured and may have been acted on by BlackRock for its own purpose. The results of such research are being made available only incidentally. The views expressed do not constitute investment or any other advice and are subject to change. They do not necessarily reflect the views of any company in the BlackRock Group or any part thereof and no assurances are made as to their accuracy.

This document is for information purposes only and does not constitute an offer or invitation to anyone to invest in any BlackRock funds and has not been prepared in connection with any such offer.

FOR MORE INFORMATION: blackrock.com

BlackRock