EY Market essentials

Market overview as of 30 June 2023

Reliance Restricted

25 July 2023

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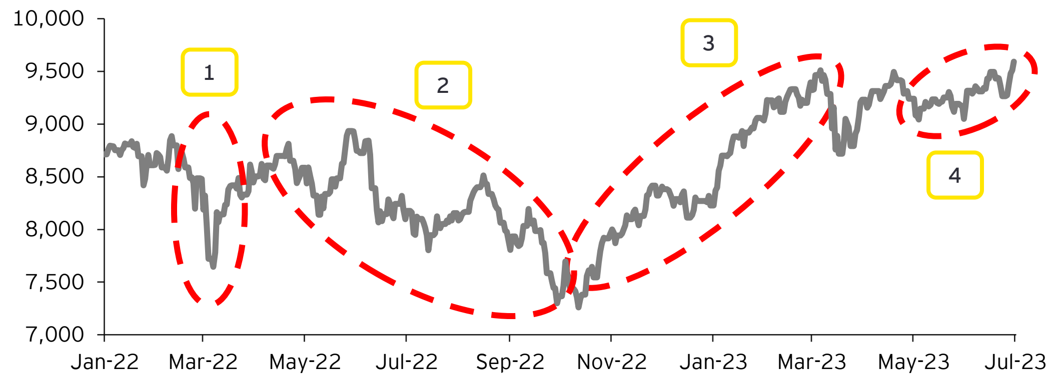
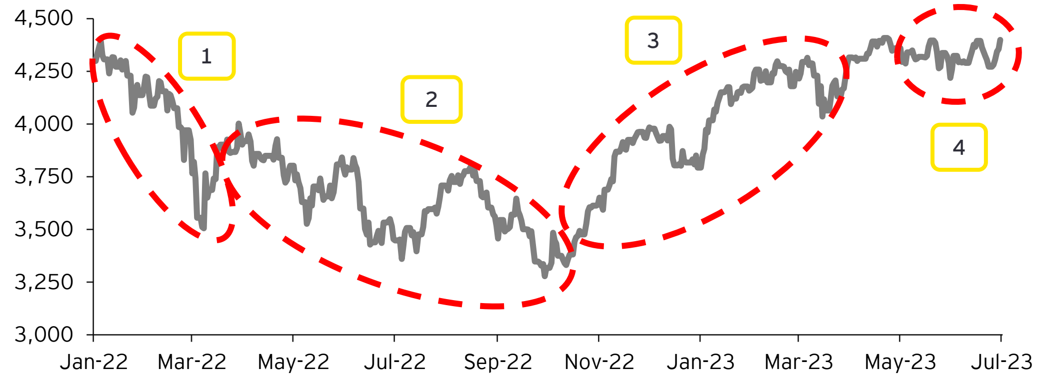
01 Indices

A | Madrid Ibex 35



Source: Capital IQ

B | Euro STOXX 50



Source: Capital IQ

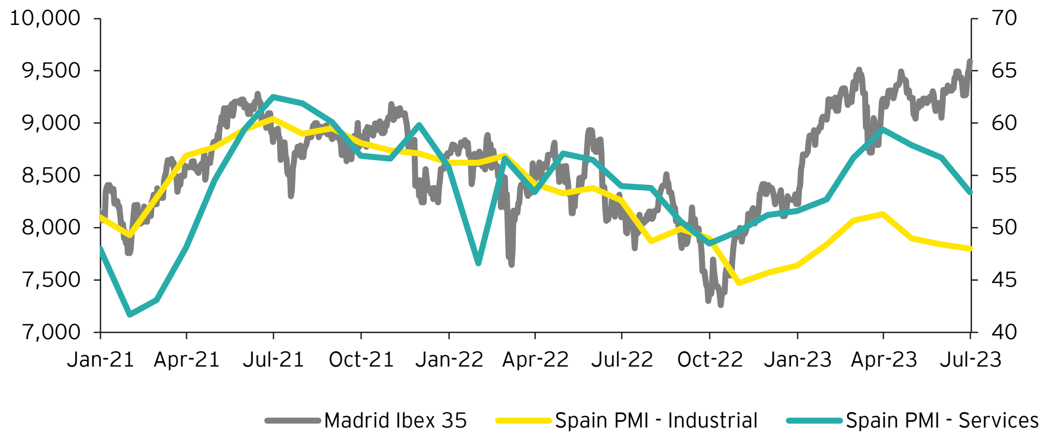
C | S&P 500 and NASDAQ composite – Base 100

Source: Capital IQ

1. **Russia-Ukraine conflict:** The negative shock of the start of the conflict in Ukraine derived in a sharp decline in financial markets.
2. **Bond yields increase** and **tightening monetary policy** worldwide as inflation soars, led to a decline in Equity markets.
3. **Soft landing scenario:** investors started to discard worst case scenarios given resilience of certain macroeconomics indicators.
4. **Steady rise:** stock indices kept rising during Q2 2023 driven by still positive financial and macroeconomic outlook, lower inflation and a decrease in risk aversion. Technology and AI companies have been pushing US stock indices up, creating a dual performance in S&P 500 (Tech vs. Non-tech).

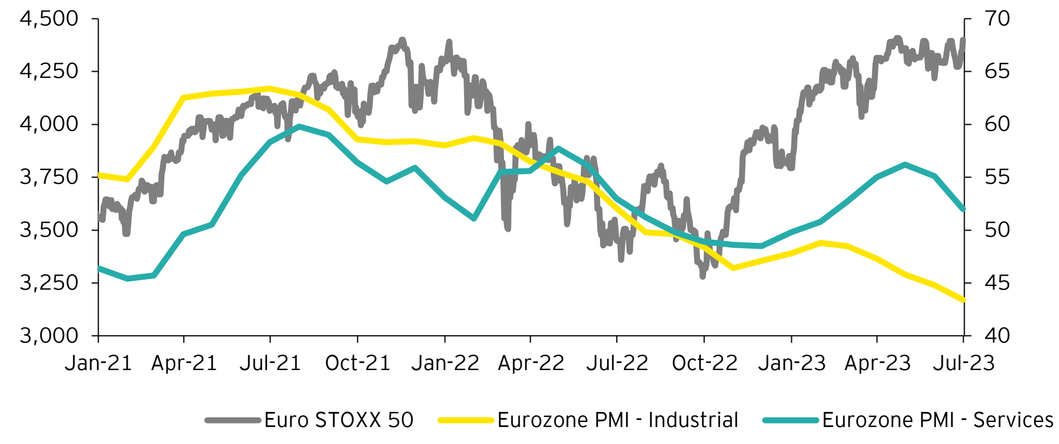
02 Fundamentals

A | Spain PMI[1] vs Madrid Ibex 35



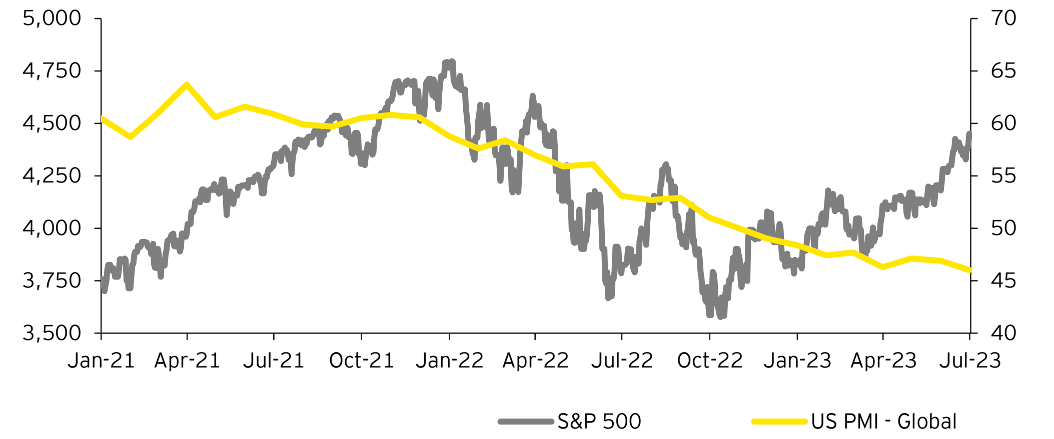
Source: Bloomberg

B | Eurozone PMI vs Euro STOXX 50



Source: Bloomberg

C | US PMI vs S&P 500



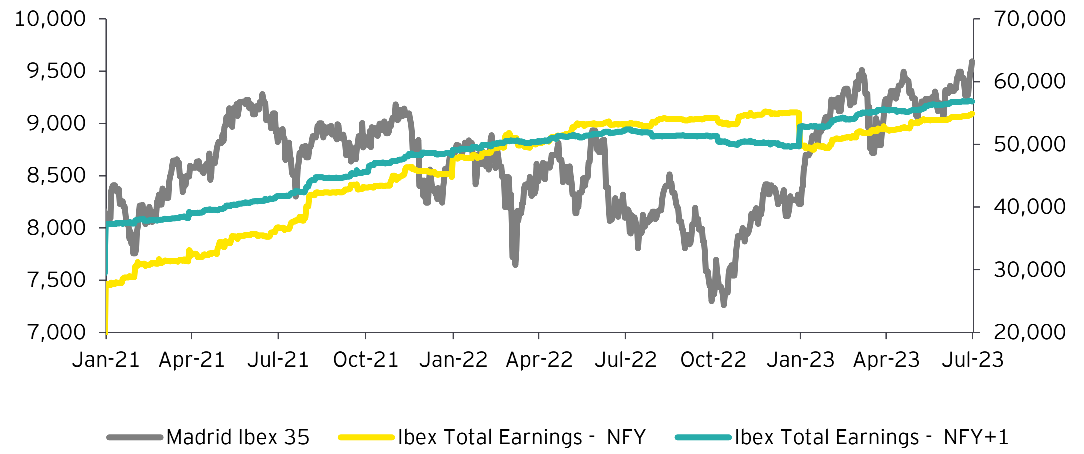
Source: Capital IQ

- Through 2022, deteriorating PMIs led Ibex, Euro STOXX and S&P down due to lower expectations of activity and cash flows.
- Services expectations initially had deteriorated less than Industrials, due to Ukraine conflict effects more significant for industrials, even with higher CPI and weaker consumer spending.
- Q4 2022 and Q1 2023 PMIs in Europe showed some growth from the lows in Q3 2022, pushing stocks up.
- As of Q2 2023 the PMI upward trend is reversed in Spain and Europe, even though the PMI services still maintains its level above 50. The **industrial PMI** still **lags behind** mainly due to negative shock of energy prices and interest rates hike. US PMI global fell into contraction zone during 2022, and generalized downward trend continues in Q2 2023.

Note: [1]PMI - Manufacturing Purchasing Managers Index

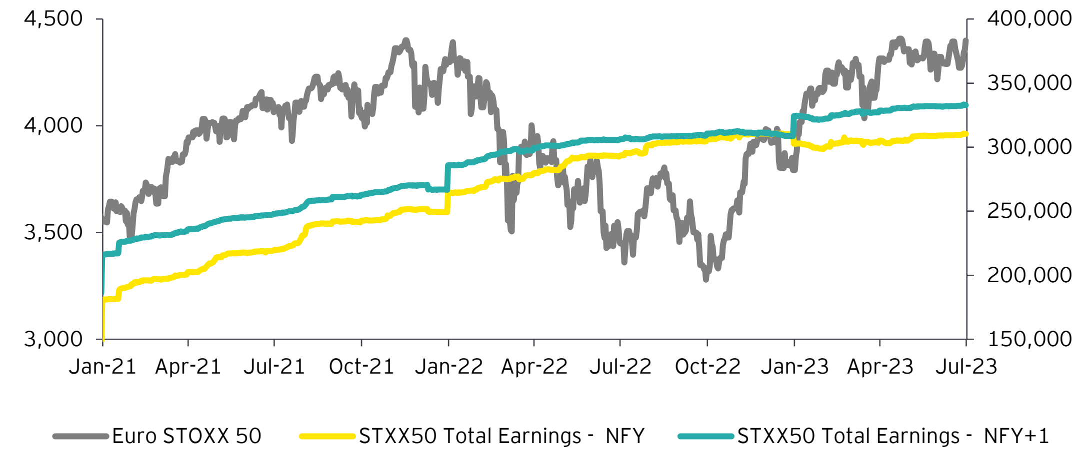
03 Indices vs Total Earnings and EPS (NFY and NFY+1)

A | Madrid Ibex 35 vs Total Earnings NFY/NFY+1



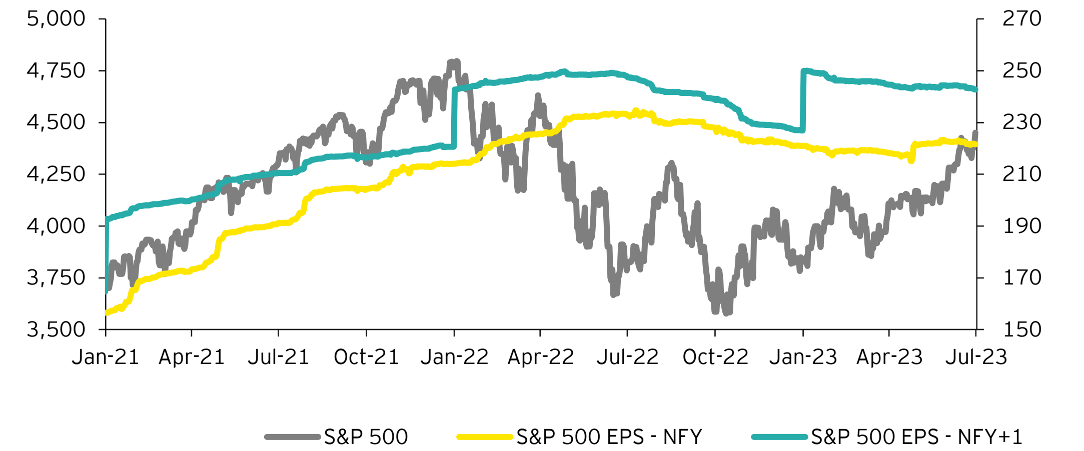
Source: Capital IQ

B | Euro STOXX 50 vs Total Earnings NFY/NFY+1



Source: Capital IQ

C | S&P 500 vs EPS NFY/NFY+1



Source: Capital IQ

- From January 2022 onwards, the Indices fell while the **total earnings and EPS increased in Spain and Europe**. Therefore, the Indices fall was mainly driven by an increase in expected **total market risk and return.**
- A worsening of the macroeconomic outlook started to be reflected in analysts' forecasts during H2 2022, mainly in the US, determining lower expectations in total earning and EPS, due to higher OPEX and financial costs, which is still reflected by Q1 2023.
- As of Q2 2023, spanish **NFY earnings** and **NFY+1 earnings** show an increase, specially **NFY+1,** whereas in Europe expectations are shown more conservative. In general terms, it seems that long-term earning expectatios are once again higher than short-term expectations as analysts might expect improved business margins in the mid-term.

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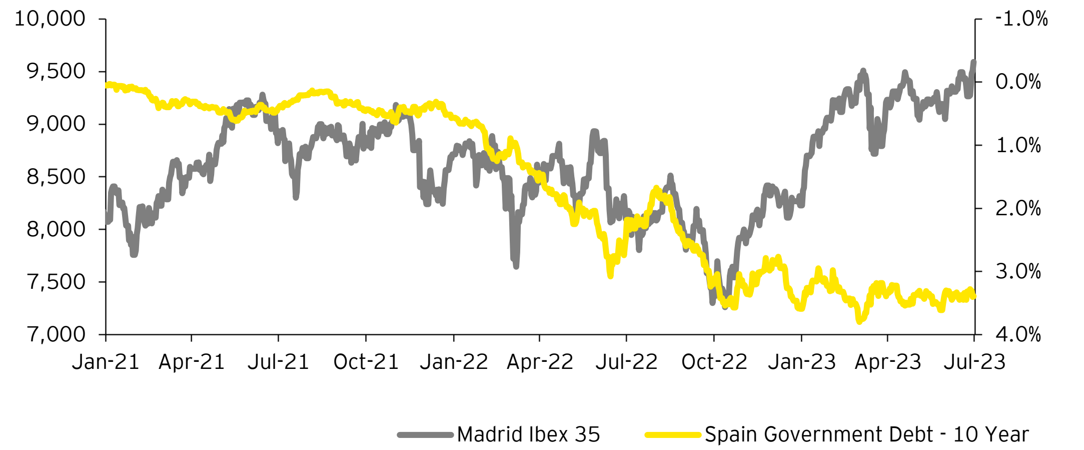
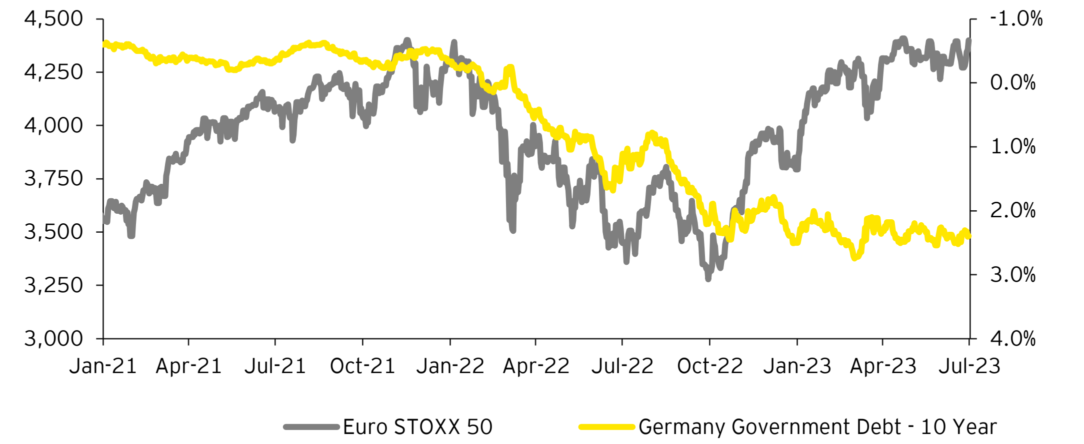
04 Indices vs Bonds

A | Madrid Ibex 35 vs Spain Gov. Bond 10y



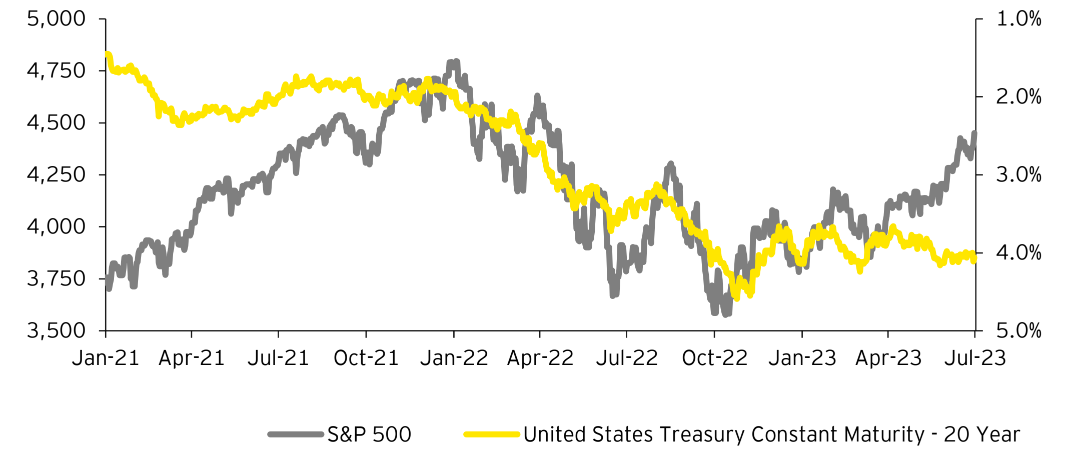
Source: Capital IQ

B | Euro STOXX 50 vs Germany Gov. Bond 10y



Source: Capital IQ

C | S&P 500 vs US Gov. Bond 20y

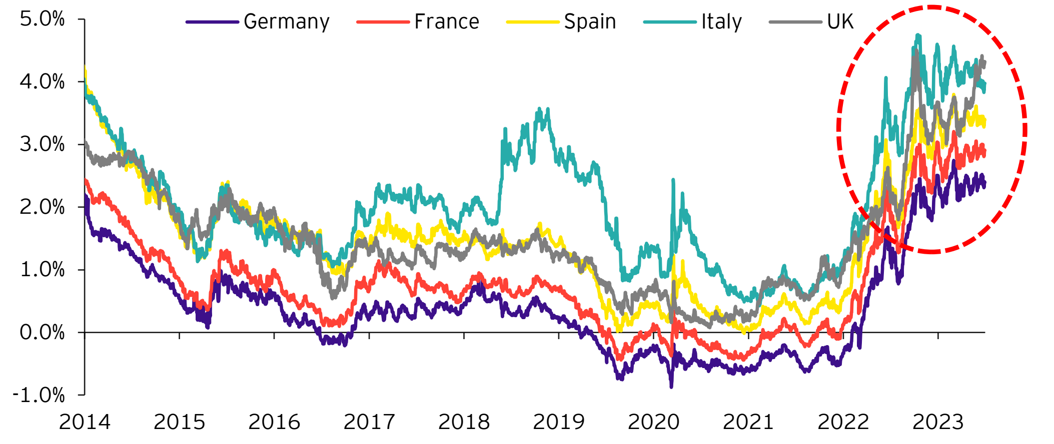


Source: Capital IQ

- In 2021, the Indices' performances were driven by an **accommodative monetary policy.** Government bond yields remained stable at historic low levels, keeping the Cost of Capital also below historical averages.
- From Q4 2021 onwards, **as inflation sharply increased**, the monetary policy changed becoming more restrictive and **government bond yields soared**, increasing the Cost of Capital and pushing Equity indices down.
- During 2023, government bond yields remained steady and Equity indices have been pushed upwards, leading to a greater gap among fixed income and Equity indices, showing a lower Equity Risk Premium.
- The lack of certainty regarding the closing in on end of rate hiking cycle by central banks is leading to a lateral trend in bond yields, while Equity Indices keep soaring.

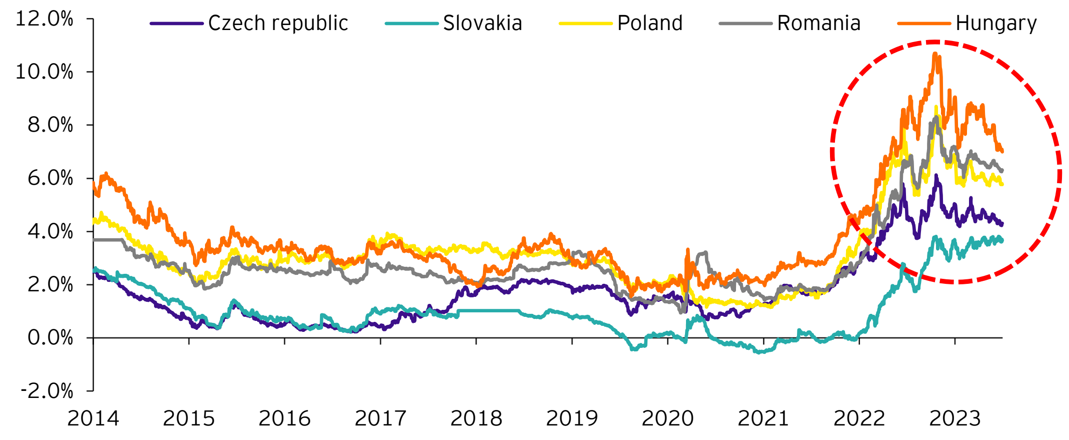
05 Western Europe, Eastern Europe and LATAM yields

A | Western Europe Government bonds



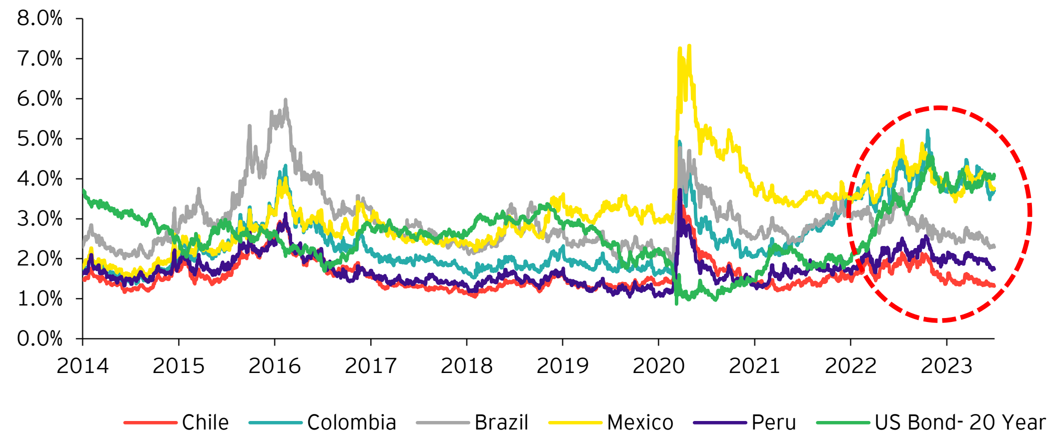
Source: Capital IQ

B | Eastern Europe Government bonds



Source: Bloomberg

C | LATAM EMBIs vs US Government bonds

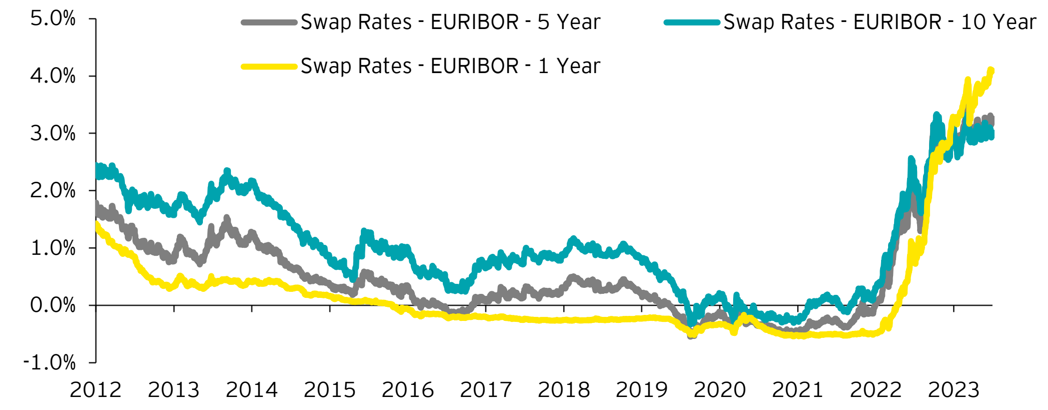


Source: EMBI - Emerging Markets Bonds Index

- Increasing yield trend established in Europe since the beginning of 2022 has led to government bond yields aligned with historical series before Quantitative Easing era (2014) since **they are no longer backed by the Bank of England and the European Central Bank's expansive monetary policy.**
- The countries **closest to Ukraine were more affected** than the others increasing the country risk premium. However, by Q2 2023 a declining trend took place and now convergence is more significant.
- Following the increase in LATAM EMBIS in 2022 due to the strength of USD and higher interest rates in the US, EMBIS have gone down in 2023 after lower CPI expectations in the US and less restrictive monetary policy.

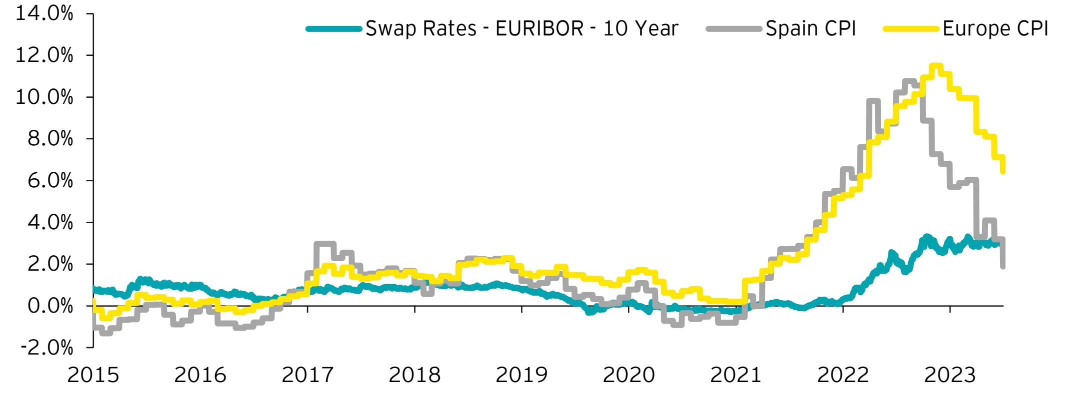
06 Euribor vs CPI[1]

A | Euribor



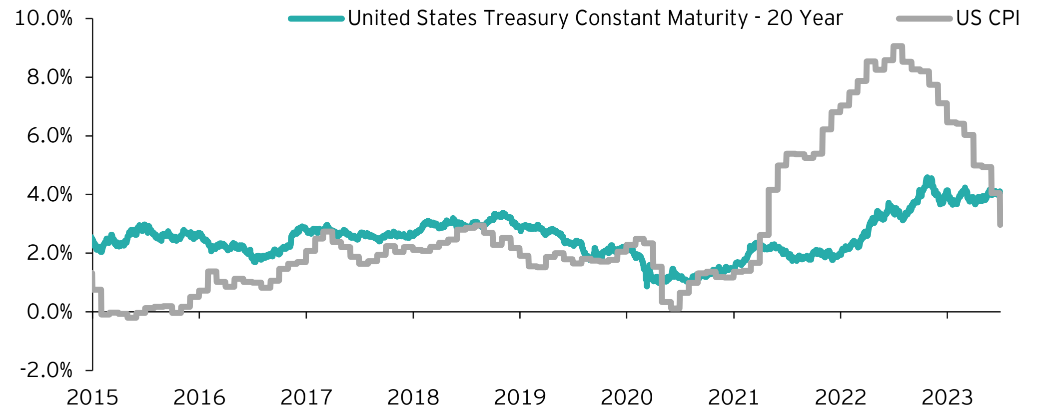
Source: Capital IQ

B | Euribor 10y vs Spain CPI (YoY%) and Europe CPI (YoY%)



Source: Capital IQ

C | US Gov. Bond 20y vs US CPI (YoY%)



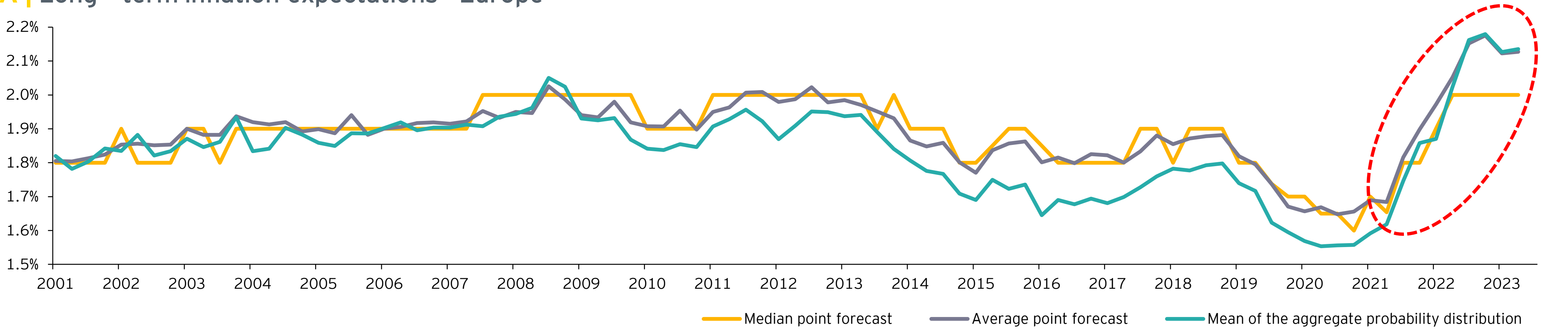
Source: Capital IQ

- During 2022, **CPI** (YoY%) sharply increased both in Europe and US as a result of different factors such as shortage of supply, increase in commodities prices, high levels of liquidity in the market, etc.
- The increase in CPI involves an outstanding increase in Euribor and long-term swap yield curves, among other effects. During Q4 2022, the Spanish spread between CPI and Euribor yield curves began to decline, as well as in the US.
- As of Q2 2023, both the US CPI and the Spanish CPI have completely converge to the base borrowing rate, obtaining intereses rates closer to zero or even positive in real terms, as is the case in Spain. Although the European CPI still lags behind, a downward trend is perceived, getting closer to the Euribor – 10 year.

Note: [1]CPI - Consumer Price Index

07 Long - term inflation expectations

A | Long – term inflation expectations - Europe

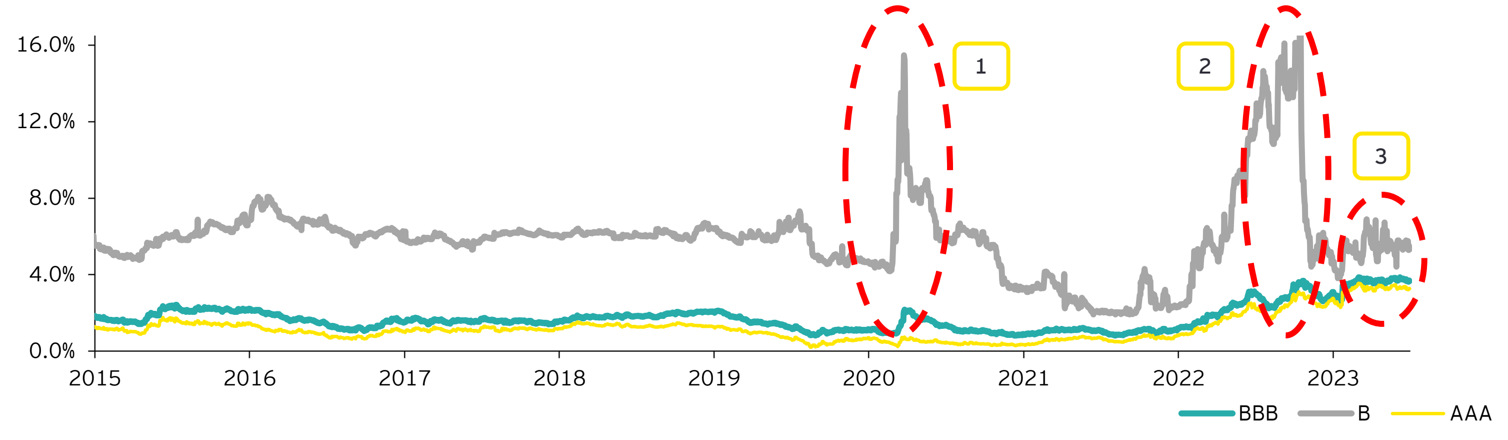


Source: ECB

- European Central Bank's main goal is price stability. Therefore, monetary policy measures are set to comply with inflation at **2% target.**
- Historically, there has been a fluctuation around 2% of long-term inflation expectations in the European zone, as seen in the above chart.
- As of Q2 2021, long-term inflation expectations trended upwards, reaching 2% and above in Q2 2022, due to the reasons discussed in previous slides.
- Accordingly, perpetual growth rates considered in most companies' business plans are expected to be affected by a significant **increase in long-term inflation expectations.**
- Despite the steady rise experienced by long-term inflation expectations from early 2021, a **stabilization** and **a convergence towards 2.0%** can be appreciated during 2023.

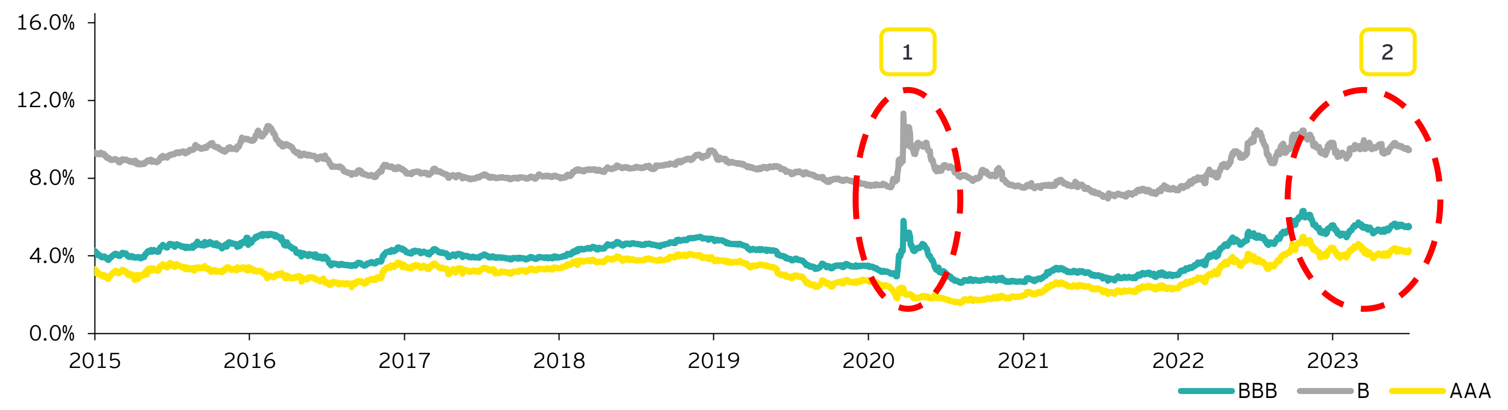
08 Spread corporate bonds

A | Spread corporate bonds Europe - 10y



Source: Capital IQ

B | Spread corporate bonds US - 10y



Source: Capital IQ

1 Events such as the Covid pandemic or the Russia-Ukraine conflict bring uncertainty to the financial markets, **triggering a widening spread effect** between investment-grade and high-yield bonds.

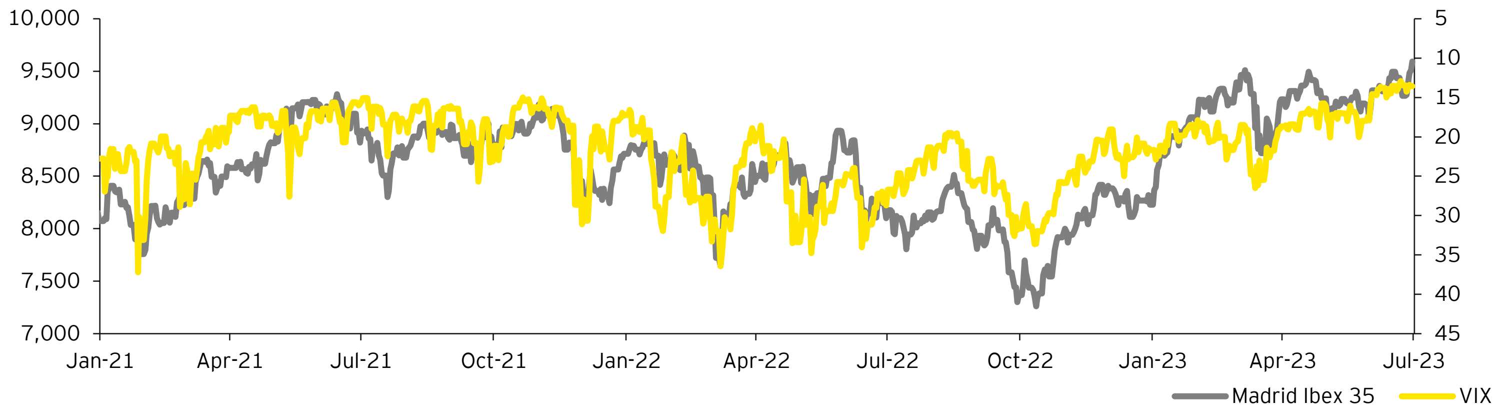
2 As shown in the charts, this is more marked in Europe than in the US, due to the lower liquidity of European debt market compared to the US market.

- During Q4 2022, high yield corporate bonds' spread has returned to normalized yield levels due to:
- Liquidity: European Market is characterized by less liquidity than US market, resulting in higher volatility.
- Re-rating effect: the companies in this tranche that were affected by the poor macroeconomic situation were downgraded to lower ratings, reducing the spread of B corporate bond over investment grade yields.

3 During late 2022 and 2023, B rated yields returned to normalized levels, although still affected by the increase in volatility experienced this year (e.g. bank turmoil).

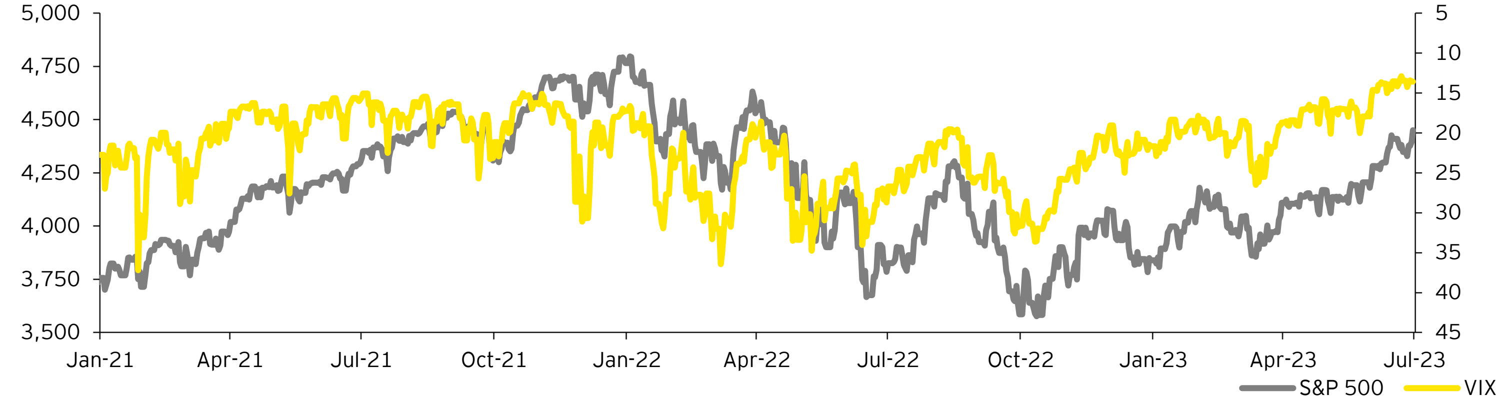
09 VIX[1] vs Indices

A | VIX vs Madrid Ibex 35



Source: Capital IQ

B | VIX vs S&P 500



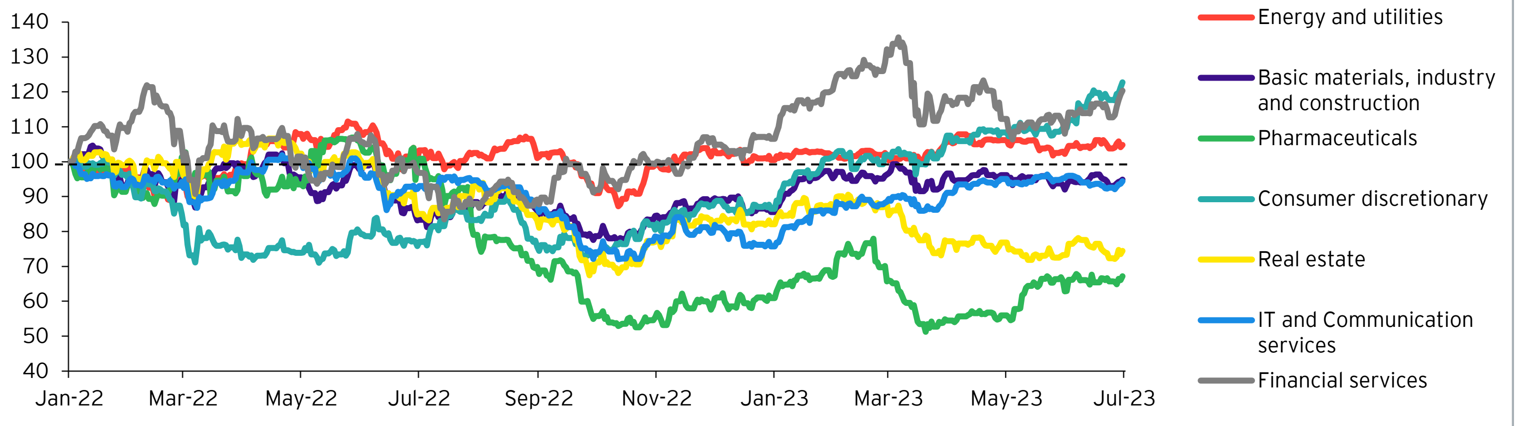
Source: Capital IQ

- As shown in the charts, there is a tight inverse correlation between the **VIX** and the **Indices trends.**
- The increase in volatility implies a higher required return for holding equities vs risk-free assets.
- The VIX is the standard measure of volatility risk for investors in the U.S. stock market. It is often considered a way to measure market sentiment and in particular the degree of fear among market participants.
- **During Q2 2023, the steady decrease in the VIX pushed Equity indices upwards.**

Note: [1]VIX - Chicago Board Options Exchange Volatility Index

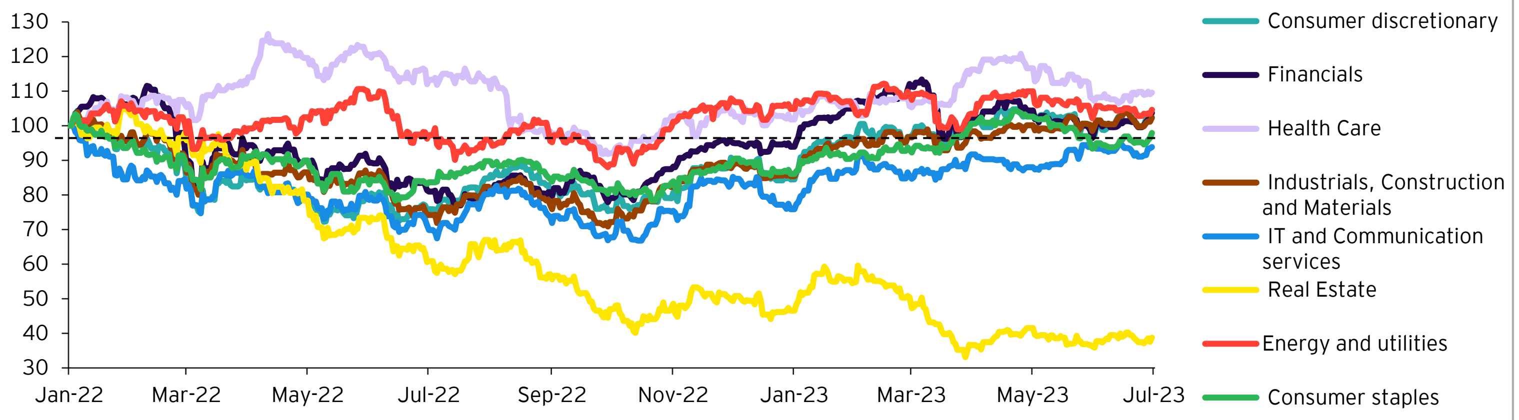
10 Breakdown by industries - Market Capitalization

A | Madrid Ibex 35 by industries



Source: Capital IQ

B | Euro STOXX 50 by industries



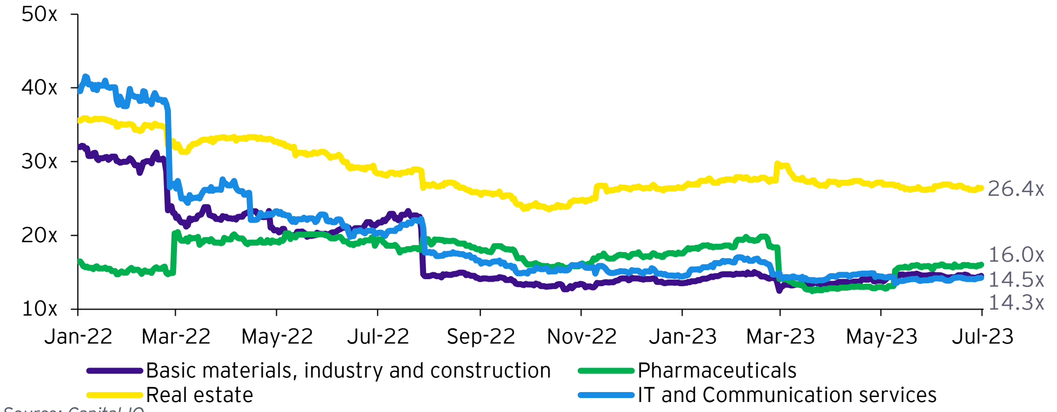
Source: Capital IQ

- The **market capitalization** of majority of sectors has **declined** since the beginning of 2022 both in Spain, and in the Euro area.
- As of Q2 2023, sectors in Spain such as Energy and Financial services show resilience due to the **rise** in **energy prices** and the **increase** in **base interest rates**, respectively. The rest of the sectors still remain below the beginning of 2022, except Consumer Discretionary sector with an extraordinary increase observed in this last quarter.
- In Europe, however, by Q2 2023 most of the sectors show convergence towards the early 2022. Highlighting the Healthcare and Energy sector throughout the whole period.
- As observed, the decline of the **Real Estate sector** remains in Europe as a consequence of high interest rates, a decline that is also happening in Spain as of Q2 2023.

11 Breakdown by industries - Multiples EV/EBITDA LTM[1] (Weighted Avg. based on Market Cap.)

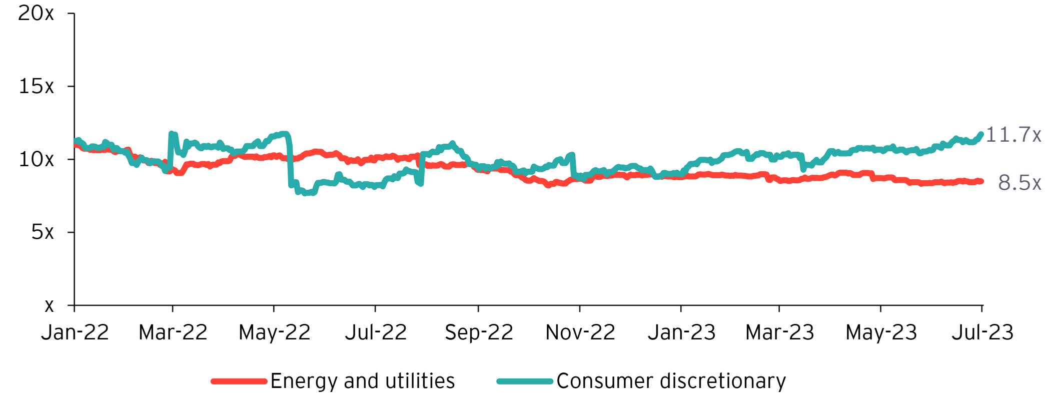
A | Madrid Ibex 35

Industries with Higher Multiples



Source: Capital IQ

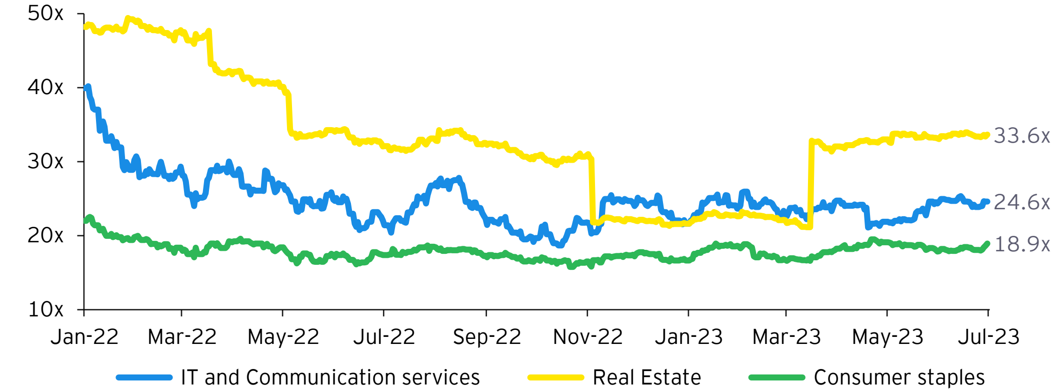
Industries with Lower Multiples



Source: Capital IQ

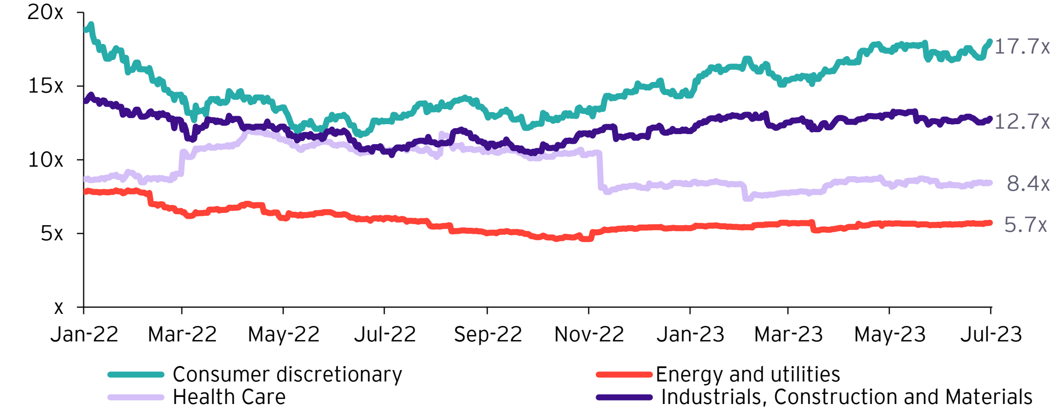
B | Euro STOXX 50

Industries with Higher Multiples



Source: Capital IQ

Industries with Lower Multiples



Source: Capital IQ

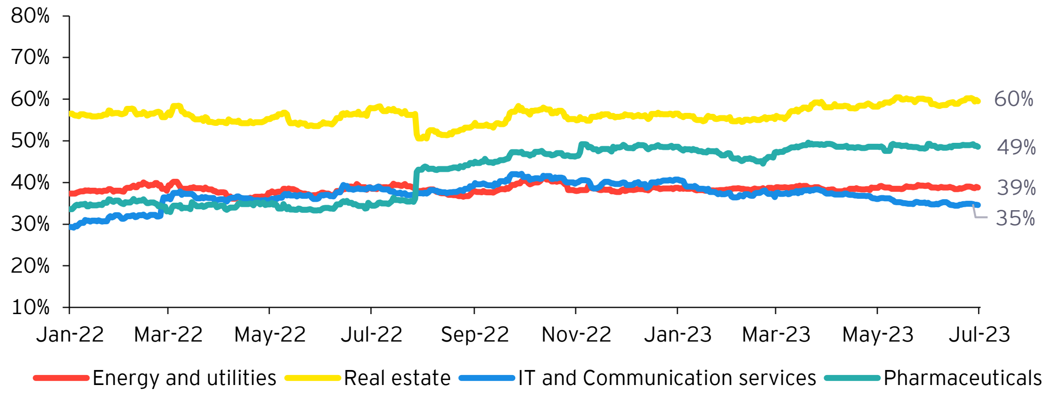
Financial services not included.

Note: [1]LTM – Last twelve months

Breakdown by industries - Debt Capital Structure[1] (Weighted Avg. based on Market Cap.)

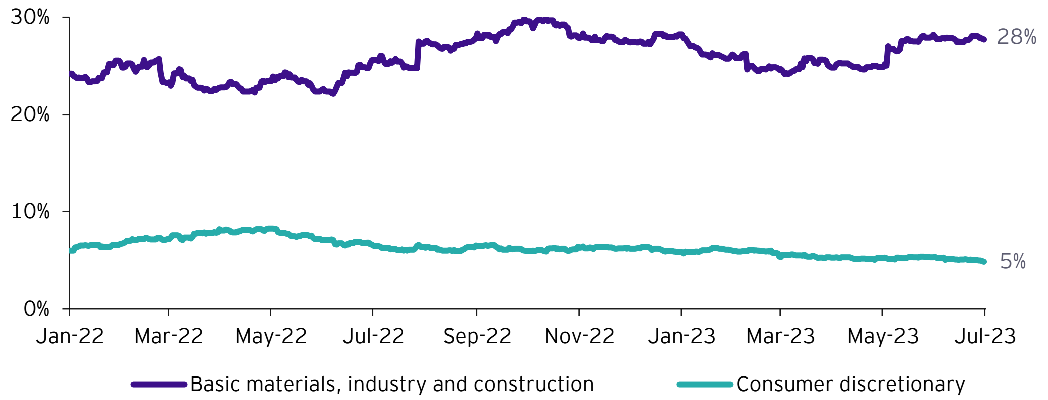
A | Madrid Ibex 35

Industries with Higher Debt Capital Structure



Source: Capital IQ

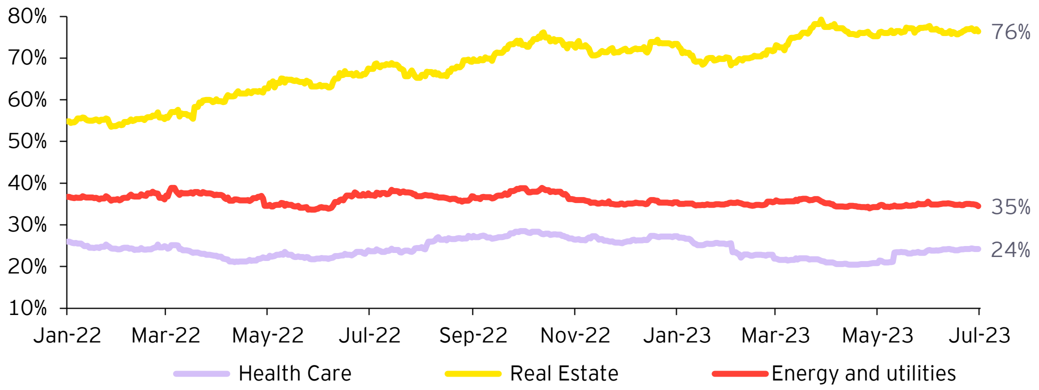
Industries with Lower Debt Capital Structure



Source: Capital IQ

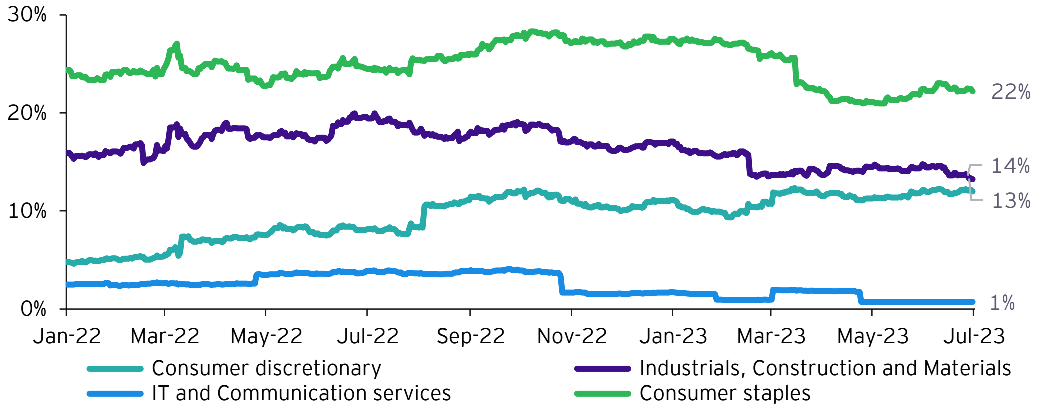
B | Euro STOXX 50

Industries with Higher Debt Capital Structure



Source: Capital IQ

Industries with Lower Debt Capital Structure



Source: Capital IQ

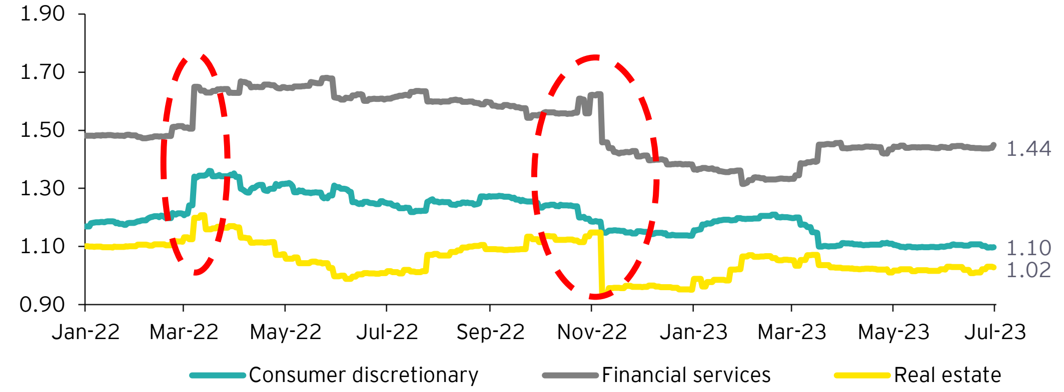
Financial services not included.

Note: [1]Debt Capital Structure - Net debt to total EV (Market Cap. + Net Debt)

13 Breakdown by industries – Equity Beta[1] (Weighted Avg. based on Market Cap.)

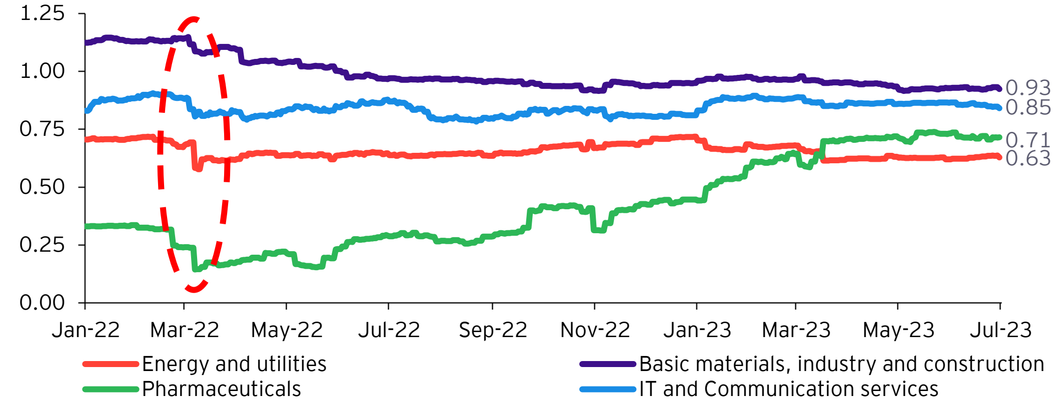
A | Madrid Ibex 35

Industries with Higher Betas



Source: Capital IQ

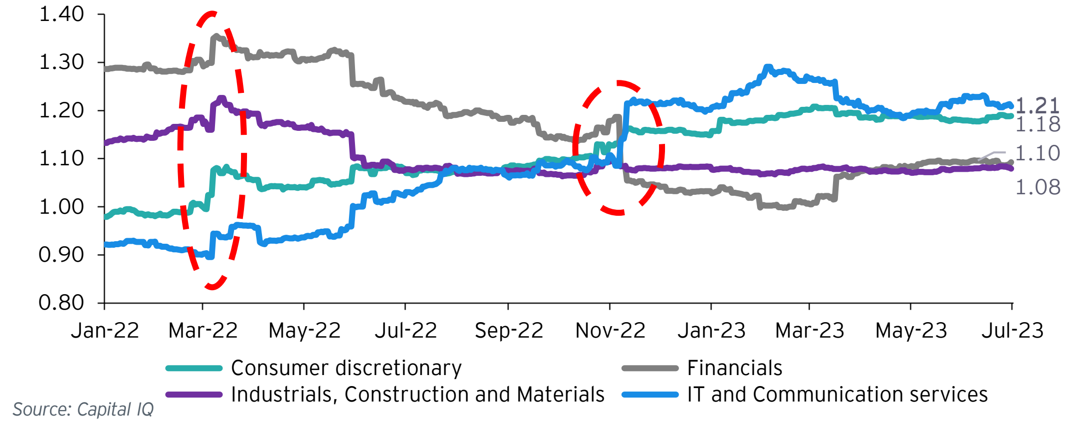
Industries with Lower Betas



Source: Capital IQ

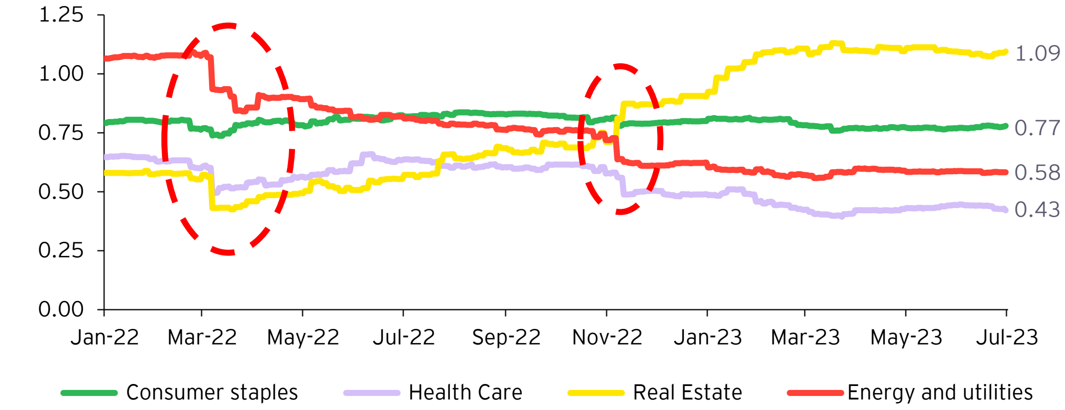
B | Euro STOXX 50

Industries with Higher Betas



Source: Capital IQ

Industries wither Lower Betas



Source: Capital IQ

Financial services not included.

Note: [1]Equity Beta – Levered Beta

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14 Discount rate in Spain: main parameters Q2 2023

B | 31 March 2023

Ke

3.27% + 6.00% = **9.27%**

Risk-free rate + Equity risk premium = **Total market return**

Kd

3.03%

Base borrowing rate

Source: Capital IQ

A | 30 June 2023

Ke

3.39% + 5.75% = **9.14%**

Risk-free rate + Equity risk premium = **Total market return**

Kd

3.10%

Base borrowing rate

Source: Capital IQ

- Components of Total Market Return as of 30 June 2023 are now experiencing a decline since March 2023. This is mainly driven by the decrease of ERP by 25 bps, which offsets the increase in the Risk Free by 12 bps, resulting in a slightly lower Total Market Return as of 30 June 2023.
- Base Borrowing Rate (Euribor 10Y SWAP) has increased 7 pbs since March 2023.

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