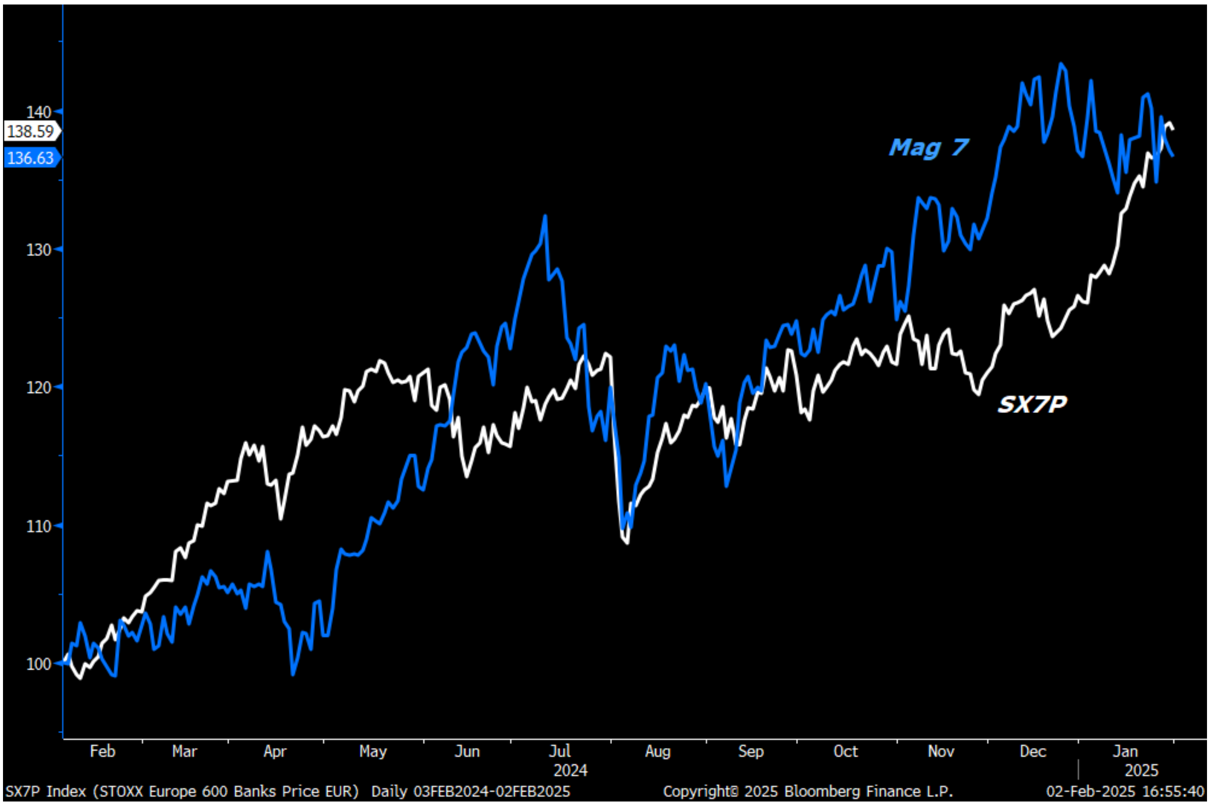
3rd February 2025

Summary

European Banks have accelerated higher over the last 3mths and have now outperformed the Mag 7 over the last 1yr. Qi's MFERM captured rising macro importance for the sector through the last year into November. However, since then, returns have been harder to explain by macro with idiosyncratic drivers dominating. The macro exposures of the sector reflect a reflationary posture – it wants a stronger EUR, higher real yields and copper alongside tight credit spreads and low vol. However, the disconnect between the spot and factor returns has now become much more evident. Unnervingly, this decline in macro importance is at the lows of the last 3yrs – just as fears of trade wars have accelerated on this weekend's news. Trump made clear that he will "*absolutely*" impose tariffs on the EU. Needless to say, any worsening of credit owing to economic impacts from trade war escalation will have an oversized impact on banks.

Details

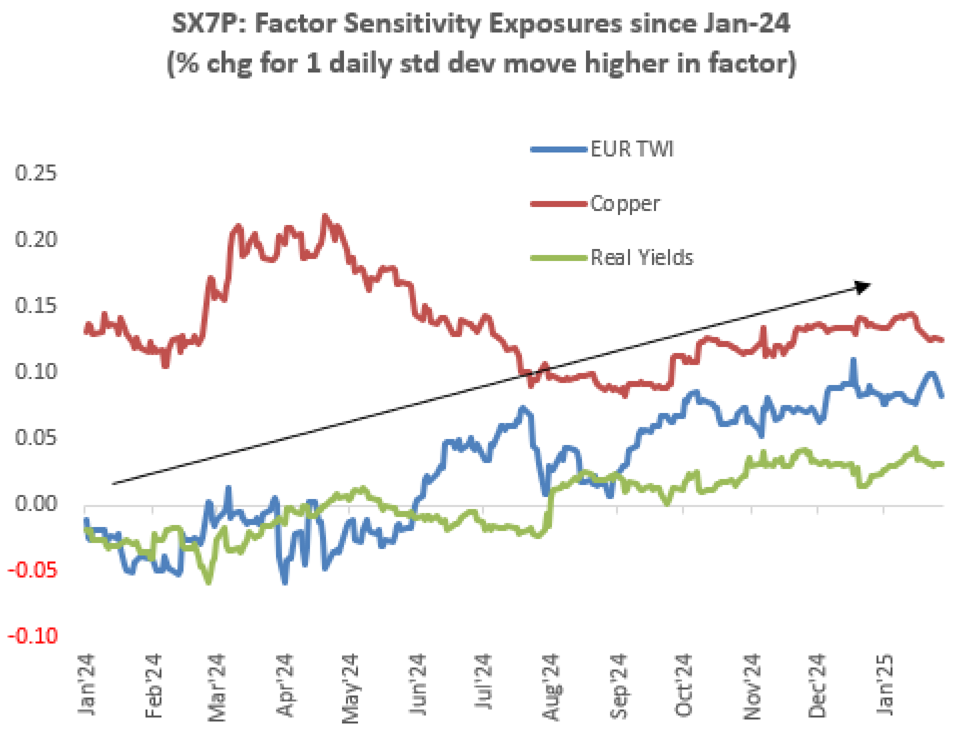
Over the last year, European Banks (SX7P) have outperformed the Magnificent 7:



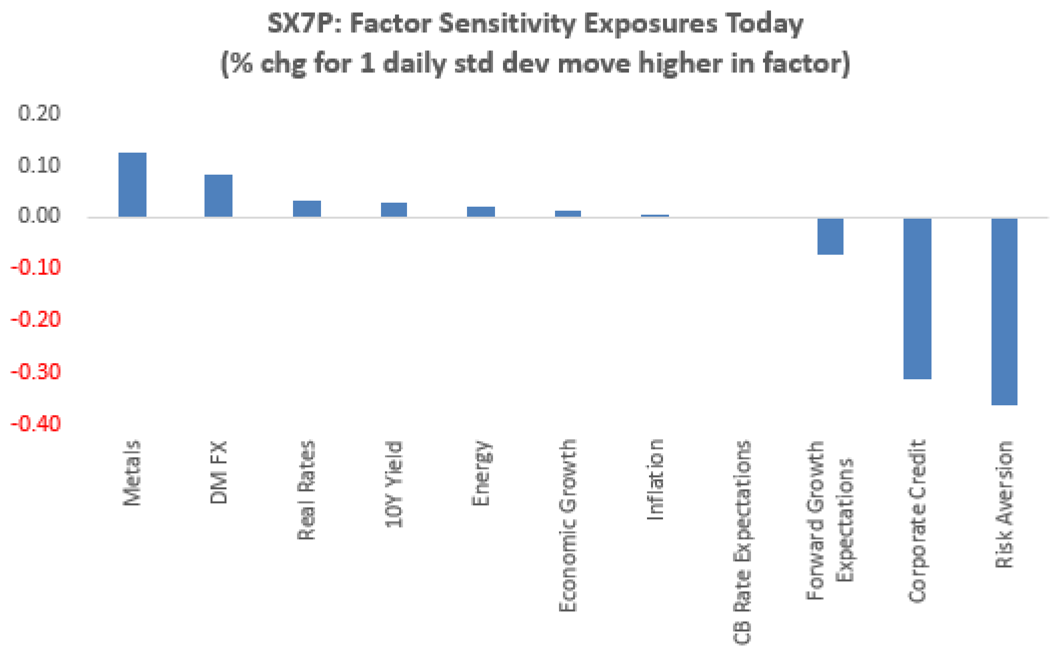
Through the last year, the following factor exposures dominate:

- V2X & Itraxx Xover as proxies of risk sentiment
- Copper & EU GDP Nowcast as proxies of growth expectations, albeit less so than earlier in 2024
- EUR TWI and real yields as proxies of Eurozone confidence, which have risen in importance through the year

A few of these factor sensitivity exposures over time are highlighted below:



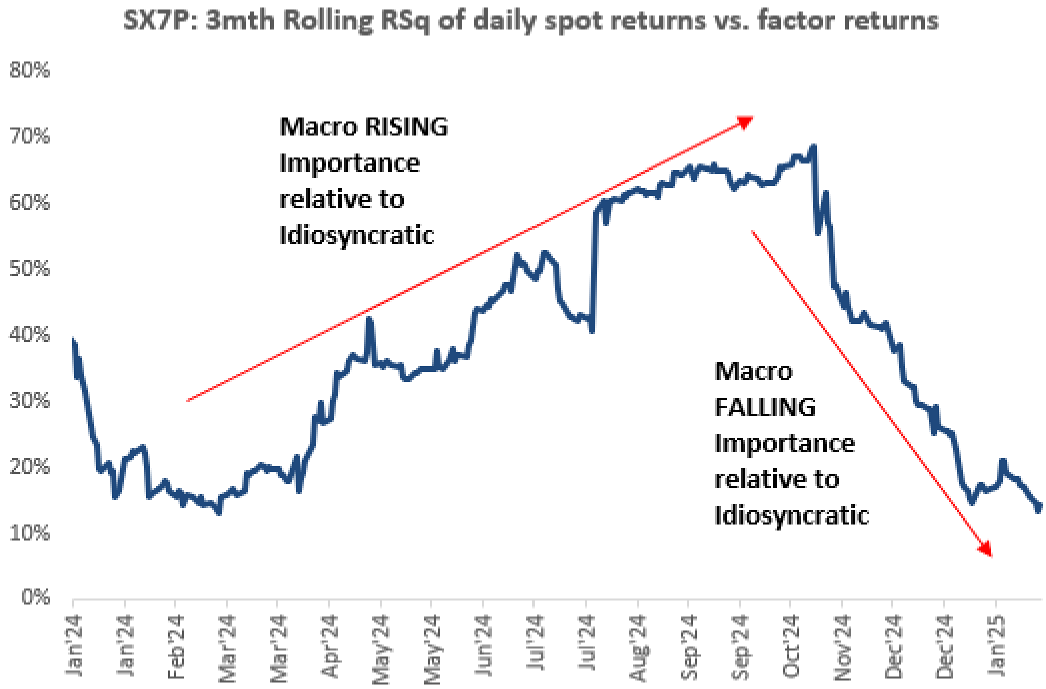
Indeed today, the ranked exposures also reflect the above – a clear desire for a reflationary regime:



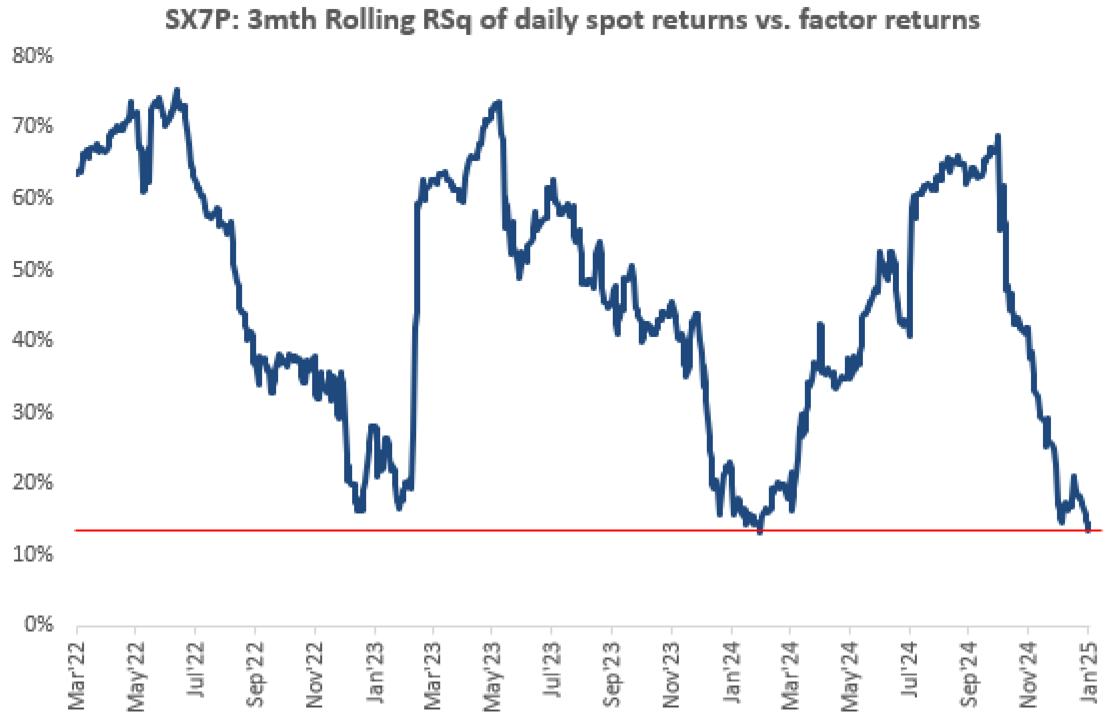
The importance of macro for the SX7P's returns was rising through the majority of 2024.

BUT that importance relative to idiosyncratic drivers peaked at start of November.

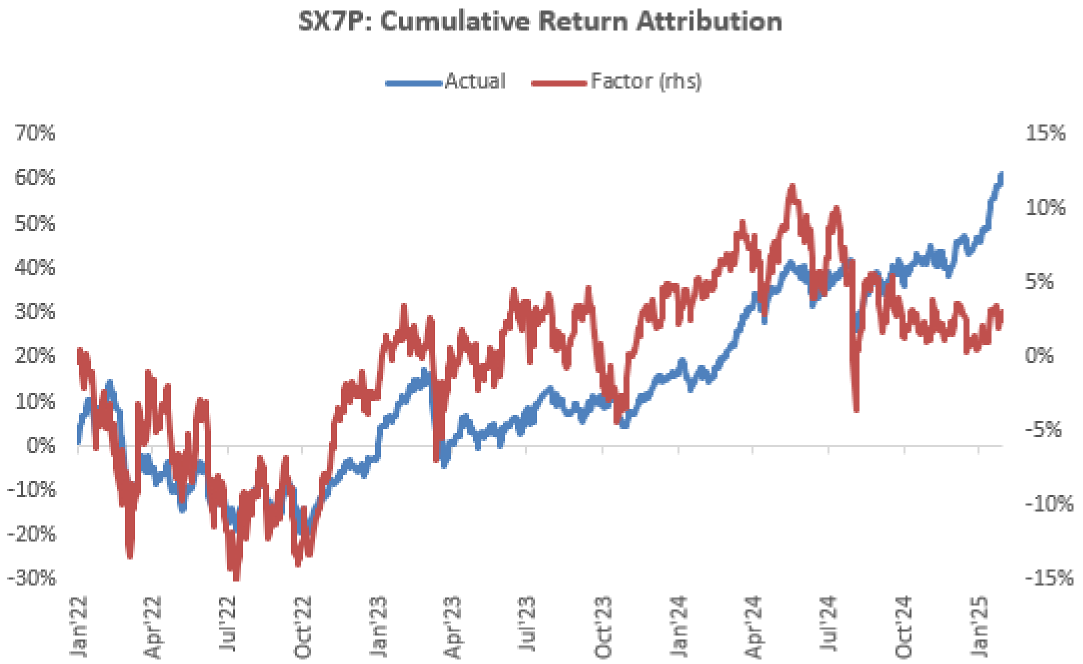
This is illustrated below by a 3mth rolling RSq of the daily spot returns of the index vs. the daily attributable factor return as determined by Qi's Risk Model.



What is striking, is that this decline in macro importance is at the lows of the last 3yrs – just as fears of trade wars have accelerated on this weekend's news.



With respect to returns, this breakdown in recent correlation is reflected in the below return attribution chart – we show SX7P's cumulative return since 2022 alongside the factor return. Recall, we show the factor return on the rhs axis – unlike stocks, macro factors do not trend with equity vol like returns and exposures are dynamic over time with some factors propellers and others drags. This has the impact of muting the size of factor returns over long periods. The size of the factor return will in part depend on how aggressively the factors themselves are moving. That said, it is clear that we observe a recent disconnect:



To empirically see this disconnect, below we simply plot SX7P vs. copper and real yields.

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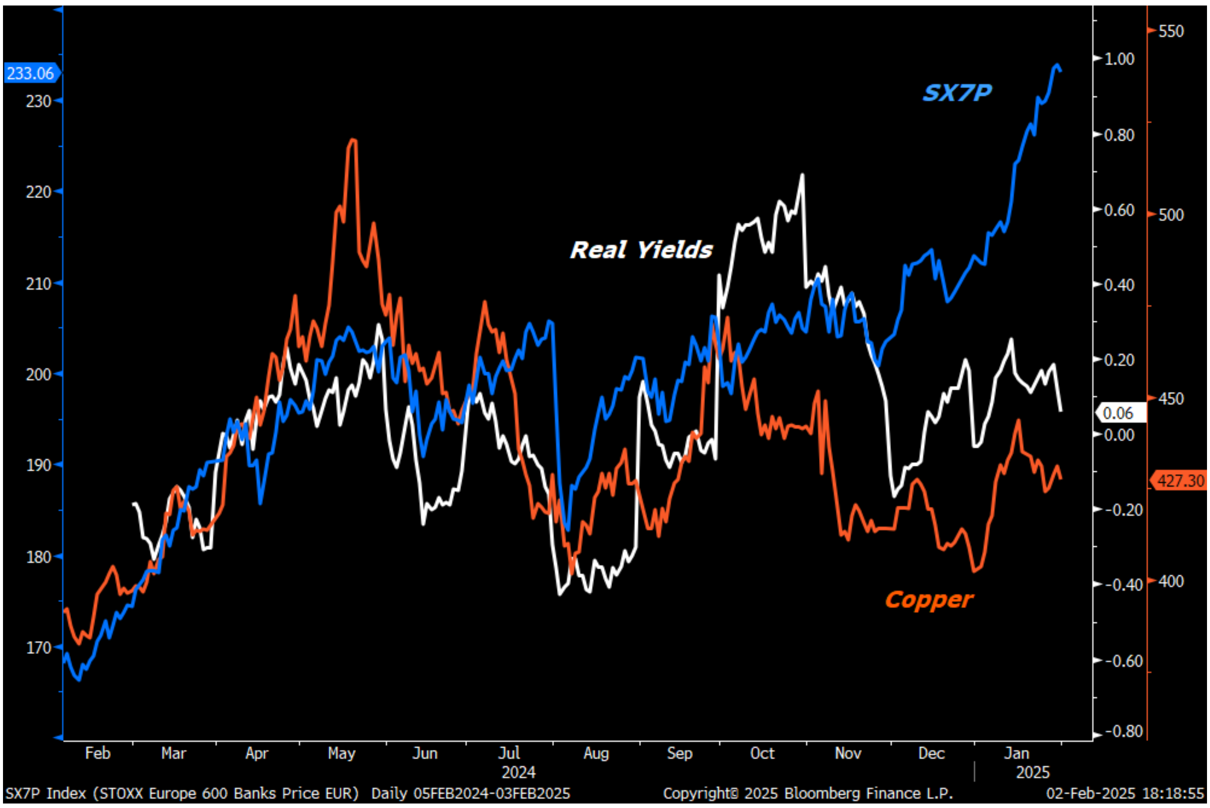

Quant insight

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