

## ANNUAL 2022 COMMENTARY

# Evolve European Banks Enhanced Yield ETF

This ETF invests in equity securities of the largest European banks on an equally-weighted basis, with the added value of a covered call strategy applied on up to 33% of the portfolio. Covered call options have the potential to provide extra income and help hedge long stock positions.

TSX

EBNK

ETF TICKERS: EBNK, EBNK.B (UNHEDGED), EBNK.U (USD)

After nearly a decade of negative interest rates, the European Central Bank (ECB) raised rates by 0.50% to 0.00% on July 27th, 2022. The ECB followed the rate announcement with a 0.75% rate hike in September, another 0.75% rate hike in November, and a 0.50% hike in December.<sup>1</sup> In fact, Europe ended 2022 with interest rates at 2.00%, their highest level since December 2008, marking the end a painful decade that Europe's lenders have endured waiting for interest rates to rise. Bank profits are usually positively correlated with higher interest rates because the net margins on their loan book increases. However, this has not necessarily been reflected in the share prices of European Banks. This is because just as central banks finally start to move interest rates into positive territory, the long-awaited earnings windfall is being threatened by a looming recession, high inflation rates, and fears that cash-strapped European governments might hit lenders with new taxes. The parallel dynamics of beneficial rate hikes and the challenging macroeconomic environment have split opinions on how Europe's banks will fare after a decade that has seen their earnings stagnate and their share prices dramatically underperform their U.S. peers.<sup>2</sup> In fact, European banks are currently trading at a discount relative to the broader European market, and to other banking sectors across the globe. It is also noteworthy that European banks are entering this year's potential economic downturn in much better health than 2008, 2012 or 2020.

European Banks faced another risk during the year, with the Russian-Ukraine conflict increasing financial stability risks in the Euro-zone. The conflict triggered elevation and volatility in prices for commodities and energy, which has caused some stress in the derivatives markets for these products. The ECB has warned that some assets remain at risk of further corrections should the growth outlook weaken further and/or inflation turn out to be significantly higher than expected.<sup>3</sup> Of the European banks, UniCredit and Intesa Sanpaolo, both holdings in this Fund, were most exposed to Russia. However, European banks such as these are actively managing their exposure to Russia. More specifically, UniCredit has been working to cut its exposure to Russia by swapping assets to reduce its cross-border loan book, which totalled €3 billion at the end of March.<sup>4</sup> While in November, Intesa Sanpaolo reported that they had reduced their Russian exposure by about 65% during the third quarter of 2022.<sup>5</sup>

Higher official interest rates have played a key role in helping major European banks post stronger than expected third quarter results.<sup>6</sup> BNP Paribas, a holding in this Fund, reported third quarter 2022 earnings for the period ended September 30, 2022, on November 3, 2022. The French bank reported net income of €2.76 billion up 10% as compared to the same period in the year previous, attributing the growth to their wealth and asset management units.<sup>7</sup> BNP Paribas also

reported earnings per share (EPS) of €2.24 per share, up from €2.01 in the third quarter of 2021. Both revenue and EPS surpassed analyst estimates by 2.3% and 9.8%, respectively.<sup>8</sup> Italy's biggest bank, Intesa Sanpaolo, reported strong third quarter earnings in November when they announced that profit in the full year would be at the upper end of the range it had previously provided. Net interest income for the period totaled €930 million, down 5% from a year earlier, but beating analyst estimates of €829 million.<sup>9</sup> UBS Group, another holding in this fund, reported third quarter results in late October citing net income of \$1.7 billion for the quarter. Although net income was lower compared with \$2.3 billion in the same quarter of 2021, it was slightly above analyst expectations driven by lower costs and rising interest income helping to mitigate the impact of turbulent financial markets. The Swiss lender also stuck a confident tone on October 25th, when it announced more share buybacks during the year, saying that they are aiming for \$5.5 billion in buybacks in 2022.<sup>10</sup>

## Performance Attribution

For the twelve month period ending December 31, 2022, CaixaBank S.A. made the biggest contribution to the Fund, followed by Svenska Handelsbanken AB and UniCredit Bank AG. By weight, the Fund's largest holdings were KBC Group, ING Group, and Standard Chartered PLC.

## Sources:

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10. <https://www.reuters.com/business/finance/ubs-third-quarter-profit-slides-beat-expectations-2022-10-25/#:~:text=The%20bank%2C%20which%20reaffirmed%20its,around%20%245.5%20billion%20this%20year.>

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