BAFFI CAREFIN
Center for Applied Research on International Markets, Banking, Finance and Regulation

Università Commerciale Luigi Bocconi

Does Investing in Italian Capital Markets Pay? The Past Decade Perspective *

by **Stefano Caselli, Carlo Chiarella, Stefano Gatti** and **Gimede Gigante**
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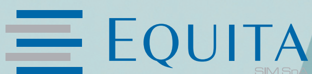

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Does Investing in Italian Capital Markets Pay?
The Past Decade Perspective

Foreword

by EQUITA SIM

During the last few years, Italian companies have increased their access to international capital markets (debt and equity), both to refinance their existing bank debt and to fund future growth. This is a welcome development, a direct consequence of the financial crisis in Italy since 2008 and of the reduced ability of the banking system to act as the sole source of funding for Italian companies. And this is particularly important within the Italian economic environment which has been historically characterised by the excessive weight of conventional bank credit as compared to alternative funding sources. The continuing difficulties of our banking system have further reinforced the importance of capital markets, to the extent that, for the first time in many years, these have also become central in the economic policymaking of our recent governments.

Within this context, we are delighted that a set of tax incentives aimed at increasing the number of domestic investors in equity and debt securities, were passed in the 2017 budget law, and that such initiatives, for the very first time, incentivise long term investment for both retail and institutional investors. We expect these measures to have a significant impact on our capital markets and are sincerely grateful to the government for taking such decisive action.

As Italian capital markets increase their relevance and new long-term investors are created, it is therefore a real pleasure for Equita to renew our partnership for another three years with Università Bocconi, aimed at analysing the debt and equity markets and at proposing initiatives to make them grow and become more efficient for Italian companies.

Within this context, together with Bocconi, we thought it useful to develop a further initiative whereby we will jointly summarise the state of the Italian capital markets in an annual "Osservatorio", that will be presented at the same time as the main position paper, in 2017 for the first time. We all believe this will be an additional important contribution to the general understanding of the key dynamics of this highly important area of the Italian economy.

During the first 3 years of our partnership, we have jointly analysed the key actors of the Italian capital markets, investment banks and investors, and we have subsequently compared the Italian and UK capital markets with the aim of drawing lessons from the most successful example in Europe:

- *Investors are a key ingredient for efficient capital markets and the recent tax initiatives, partly inspired by the UK and French experiences, clearly show that they have also become central to the government policy making.*
- *On the contrary, sadly, Italian investment banks continue to be a source of weakness for our financial system: they are over-regulated, over-taxed and mostly neglected by Italian institutions which are primarily concerned about the state of conventional banks. We truly hope that institutions will soon realise that actions must be taken immediately to support the Italian investment banking industry which is currently at serious risk.*

The comparison with the UK is all the more important after Brexit, which will clearly increase the level of competition among different capital markets and will make it essential for Italian and European markets to be efficient and user friendly.

After framing adequately the Italian capital markets and the operators that play the key roles, we then asked ourselves the following: was it worthwhile for investors to allocate their resources to Italian companies during the last 10 years? How did those investment perform, in the middle of a major recession and the strongest ever financial crisis in Italy?

This is the focus of Bocconi's 2017 positioning paper, which we believe is a very interesting one in the context of a general perception that Italy was a very poor choice for any wise investor. But as a matter of fact, as we will see, a lot if Italian companies have actually performed quite well and securities issued by them during the least 10 years have been a source of sizeable profits for investors. Companies listed on our stock markets, or others who have issued bonds or have been purchased by private equity firms, have grown, increased their international footprint, strengthened their balance sheets and have, largely, shown resilience and success in the context of a very difficult environment.

It was the banks, most financial institutions and some of the industrial companies operating in declining sectors that really showed poor performance, but the Italian companies that accessed the capital markets were very often highly profitable and a good choice for investors.

We collectively need to take action, to ensure that these successful companies will continue to prosper and be able to access efficient capital markets to fund their growth. These actions must include, for example:

- *A widespread publicity of the good performance of Italian companies as investments, to ensure that more international and domestic long term investors will focus on Italy, benefitting also from the recently approved tax benefits for long term investment*
- *A further improvement and simplification of regulations (including tax), to ensure that Italian companies, including the smaller ones, are incentivised to use the capital markets*
- *The promotion of the Italian management industry and further development of new sizeable domestic investors, with a particular attention to the ones focussing on the smaller companies accessing the markets, for example through the development of specific long-term funds dedicated to Italian small caps*
- *A coordinated action with the European authorities to modify or remove recent regulatory initiatives such as Mifid 2 and the Market Abuse Regulation ("MAR") which impact dramatically Italian and European investment banks and issuers, in the face of increasing competition from UK, US and Asian capital markets, and a renewed effort to abolish the Tobin Tax in Italy, which has proven to be inefficient and damaging.*
- *The development of a strategy to support investment banks operating in Italy, again with particular focus on the ones which also assist small and mid-size companies, ranging from the removal of conflicts of interest of lending banks when dealing with corporate finance clients (as currently taking place in the UK) to the tax incentivisation of dedicated research efforts*

We sincerely hope that our institutions will continue to focus on this important area of policy making and we thank once again Bocconi University for its high quality contribution to the analysis and the debate regarding Italian capital markets.

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Stefano Caselli is Dean for International Affairs and a Full Professor of Banking and Finance in the Department of Finance at Bocconi University. He is a member of the Board of Directors of SDA Bocconi School of Management, where he served as the Director of Executive Education Custom Program for Banks and Financial Institutions from 2006 to 2012. He is conducting research at domestic and international level developing several publications on private equity, SME and family business financing, corporate finance, banking strategy and corporate governance. He is a member of the scientific committee of: CER (Centro Europa Ricerche in Rome), ECMI (European Capital Market Institute in Brussels), EVCA (European Private Equity and Venture Capital Association for PEREP Group in Brussels). He is currently serving as independent director on the boards of several corporations and financial institutions: SIAS S.p.A., Generali Real Estate SGR, and Santander Consumer Bank. Moreover he supports many companies and institutions as a strategic consultant. He acts as a columnist and opinion maker for several newspapers and on radio and television programs; among the most prominent: Corriere Economia, TG1 Economia, Rai Radio 1, and Class CNBC Network. He graduated with a degree in Business Administration from the University of Genoa in 1993 and he holds a Ph.D. in Financial Markets from the University of Siena.

Stefano Gatti is Director of the Full Time MBA at SDA Bocconi School of Management. He has been the Director of the B.Sc. of Economics and Finance at Università Bocconi, where he has also acted as Director of the International Teachers' Programme. His main areas of research are corporate finance and investment banking. He has authored papers in these areas including publications in the Journal of Money, Credit and Banking, Financial Management, the Journal of Applied Corporate Finance and the European Journal of Operational Research. Professor Gatti has published a variety of texts on banking and finance, and has acted as a consultant to several financial and non-financial institutions, as well as for the Italian Ministry of the Economy, the Financial Stability Board, the InterAmerican Development Bank and the OECD/Group of G20. He is financial advisor of the Pension Fund of Health Care Professions, a member of the Committee for Compliance Risk of Deutsche Bank and is a member of the Board of Directors and Board of Auditors of several Italian industrial and financial corporations.

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Gimede Gigante, PhD, is contract Professor of Financial Markets and Institutions at Università Bocconi. He has held visiting positions at the Finance Department of Columbia Business School, and at the Salomon Brothers Center (Stern School of Business, NYU). Chartered Accountant and professional auditor, he earned a business degree from Bocconi Universityand a PhD in Banking & Finance from the University of Rome. He holds the ITP qualification (International Teachers' Program) from SDA.[1]

[1] The authors would like to thank Andrea Locatelli for his assistance and support.

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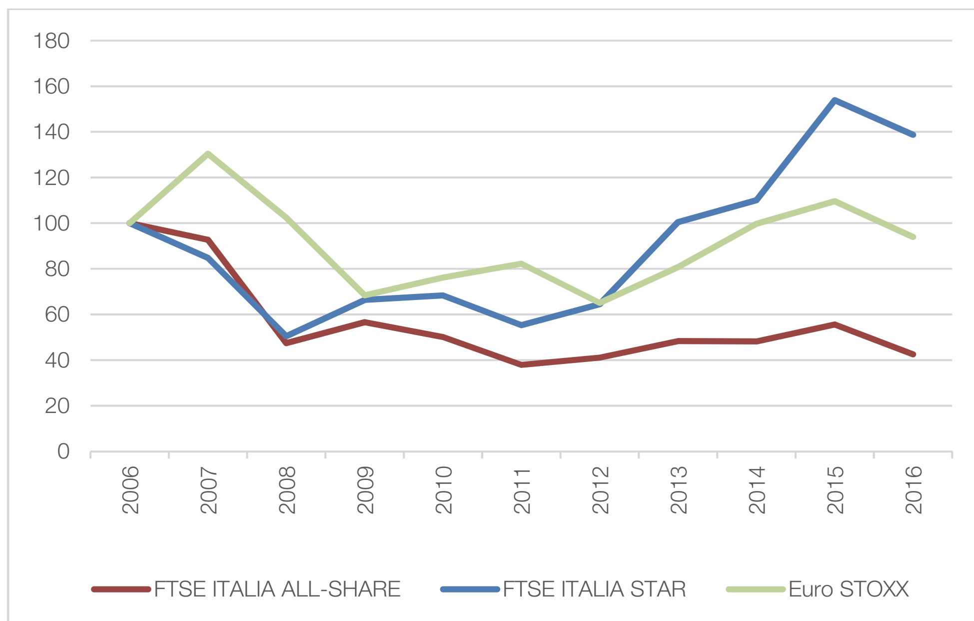
Introduction

Over the past few years, investments in Italy have grown at different speeds, both in stock markets and debt markets.

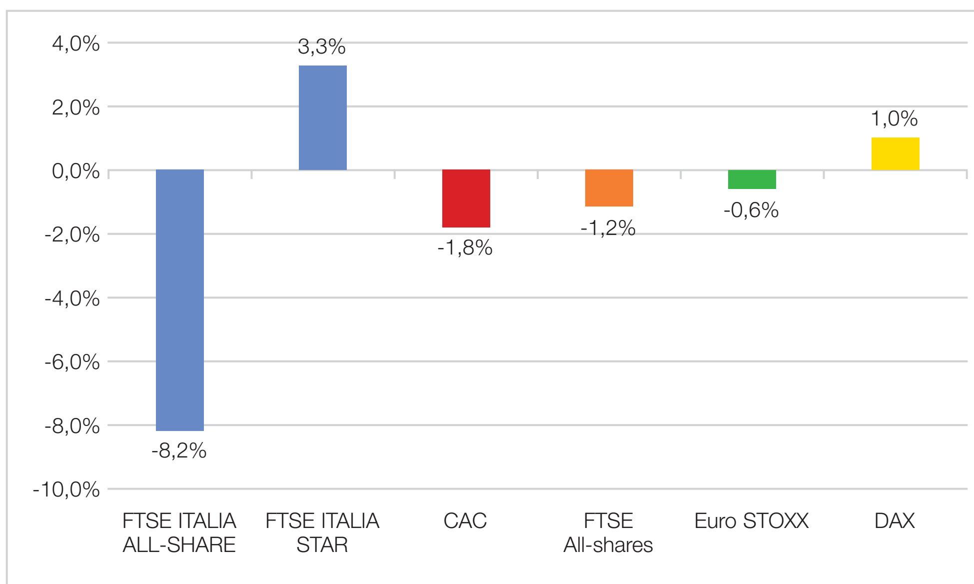
On the stock market, industrial firms (in particular the ones listed in the STAR segment) have been performing well, in line with the best equity indices in Europe. On the other hand, the stock market as a whole, heavily loaded down by bank stocks, has underperformed. This emerges clearly in *Figure 1* and *Figure 2*, which compare the stock performance of the FTSE Italia All-shares and the FTSE Italia STAR indices with the Euro Stoxx Index and major European indices.

Indeed, Italian banks and insurance companies, whose performance since the financial crisis has been dismal, accounted for 31.8% and 12.3% respectively of the total market capitalization of Borsa Italiana in 2006, according to Mediobanca's annual statistical survey on indices and data on investments in listed securities. Many factors concur to explain the loss of approximately 68% of the total market capitalization of bank stocks between 2006 and 2016. Since the bankruptcy of Lehman Brothers and the eruption of the financial crisis strong headwinds have buffeted bank stocks. First, increased supervision and tougher regulation resulted in higher capital requirements and compliance costs. With the profitability (ROE) of deleveraging banks dropping, their stocks have done the same. Then, the sovereign debt crisis put at risk the solidity of banks' balance sheets, due to their large holdings of government bonds. More recently, new threats to the resiliency of banks have emerged from the surge of non-performing loans, which are currently at historically high levels. Added to this is a new European framework for bank resolution aimed at increasingly shifting the burden of bank rescues from taxpayers to equity and debt stakeholders, which has driven investors away from bank stocks. Finally, expansive monetary policy and quantitative easing have eroded intermediation margins and reduced banks profitability even more. As a consequence of their relatively poor performance, the weight of banks in the stock market has constantly declined from 2006 to 2016. Nonetheless, these institutions still represent approximately one-fourth of total market capitalization and consequently have a huge impact on overall stock market performances in Italy. The influential role of banks and their declining performance are reflected in the evolution of equity issues in Italy in recent years. As shown in the Capital Markets Monitor, rights issues have had a predominant role, due to many capital increases needed to restore the stability of financial intermediaries in turmoil.



Source: Stoxx; Borsa Italiana

FIGURE 1
Stock market performance 2006-2016: buy and hold returns for FTSE Italia All-shares; FTSE Italia STAR and Euro Stoxx Index.



Source: Stoxx; Borsa Italiana; Bloomberg

FIGURE 2
Stock market performance (2006-2016): annualized compound returns for FTSE Italia All-shares and FTSE Italia STAR vs. Euro Stoxx Index, CAC, FTSE, DAX.

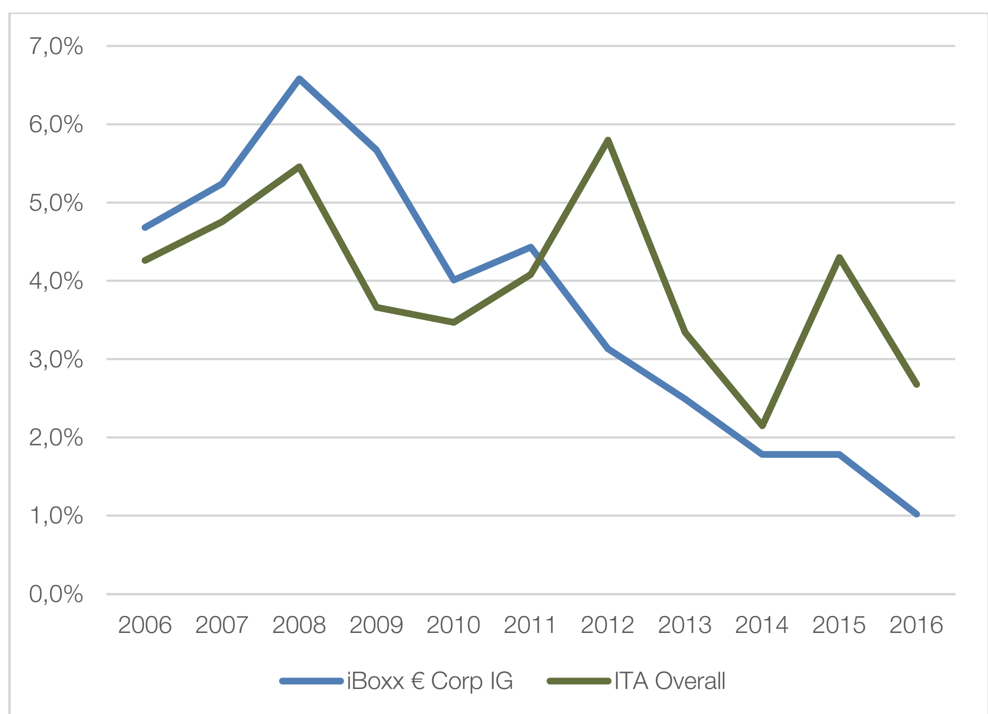
Corporate debt accounts for a minor portion of the debt capital markets in Italy, which are dominated instead by sovereign debt. According to Mediobanca's annual statistical survey on indices and data on investments in listed securities, in 2006 corporate debt represented just 2.9% of total debt outstanding, mostly issued by banks and insurance companies (78%). This is a consequence of the bank-centrism of the funding model of Italian corporations. Indeed, while Italian firms are in general more leveraged than their euro area counterparts (45% vs 40%), the structure of their liabilities reflects a disproportionate reliance on bank loans rather than market-based sources of funds (89% vs 11%).[2]

[2] Caselli, Chiarella, Gatti and Gigante, (2016), Benchmarking the UK Market: A way to create an efficient and effective capital market in Italy?, BAFFI-CAREFIN position paper.

During the past decade, the corporate debt share of total debt outstanding has ticked up only slightly (to 3.4% in 2015) but the relative contribution of industrial issuers, banks and insurance companies to corporate debt has progressively re-equilibrated to reach an equal balance, as shown in Mediobanca's annual statistical survey on indices and data on investments in listed securities. This is consistent with a progressive disintermediation of corporate funding due to the fall in bank lending following the financial crisis and the emergence of the deleveraging and recapitalization needs of banks. Indeed, firms that have been cut off from bank lending have tried to fill their funding gaps with disintermediated debt instruments. This, in addition to exceptionally favourable conditions in debt market for issuers, has boosted the proportion of bonds to total debt funding, which is now almost double compared to 2006.[3]

Also in this case, then, the performance of Italian corporate debt in the last decade disproportionally reflects the poor track record of banks, heavily loaded down by government debt and non-performing loans. *Figure 3* compares the average effective yield of a group of corporate bonds listed on Borsa Italiana with that of the IBOXX Euro Corporate Investment Grade Bond Index over the period 2006-2016. As we can see, corporate bond yields have progressively and almost constantly dropped from pre-financial crisis peaks in response to extraordinary monetary policy measures and increased demand from yield starving investors. Yet, the average yield offered by Italian corporate bonds has spiked during the European sovereign debt crisis of 2011 and has since remained above the euro area average. Still, *Figure 4* shows that among Italian corporate bonds, the yields on those issued by non-financial firms have mirrored their European counterparts for most of the last decade, rising markedly only in 2015 but then falling back again after the ECB announcement to expand its asset purchase program to include corporate debt.

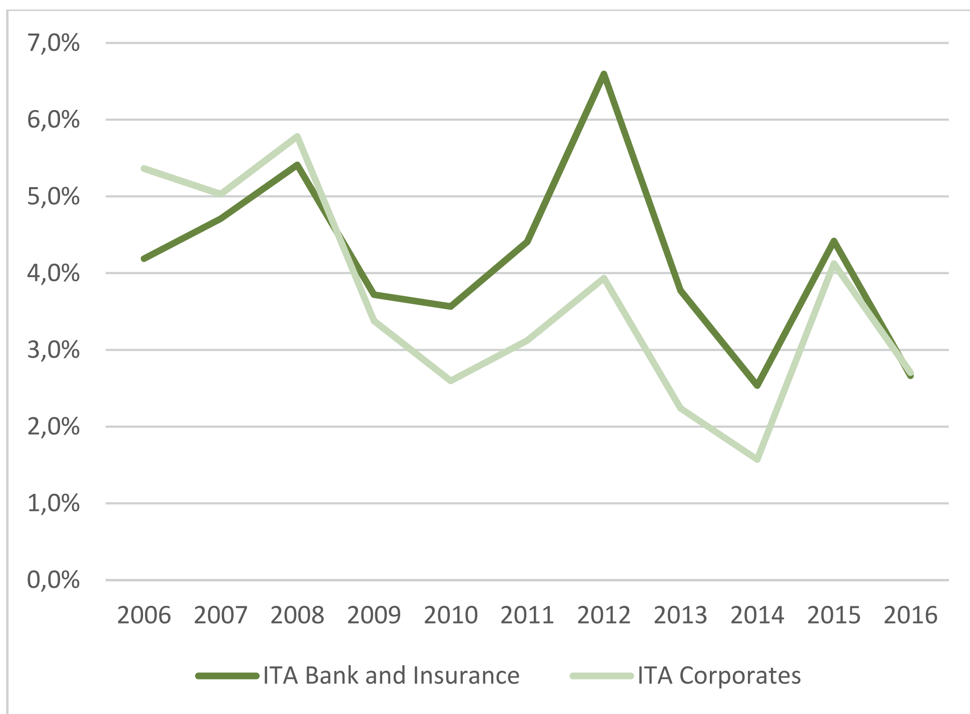
FIGURE 3
Corporate debt performance (2006-2016): bond yields for the IBOXX Euro Corporate Investment Grade Bond Index and for a group of corporate bonds listed on Borsa Italiana and selected by Mediobanca on the basis of volumes and residual maturity[4]



Source: Authors' rendering of data from Mediobanca and Markit

[3] See footnote 2.

[4] For more information on the selection criteria see Mediobanca, (2016), Rendimento effettivo medio di un gruppo di titoli di Stato e obbligazioni.



Source: Authors' rendering of data from Mediobanca

FIGURE 4
Corporate debt performance (2006-2016): bond yields for bank and insurance vs. non-financial corporate bond issuers traded on Borsa Italiana and selected by Mediobanca on the basis of volumes and residual maturity

In light of this preliminary evidence that financial and industrial firms in Italy have been growing at two very different speeds, our aim is to further investigate if it would have paid off over the last decade to invest in Italian capital markets. In particular, we explore whether Italian non-financial companies would have represented a profitable investment while financial companies suffered.

The remainder of this paper is organized as follows: In the next section we compare stock market returns across various industries and look for the fundamental drivers of positive performances. Then in the following section we focus on corporate debt by studying how the yields and the credit quality of issuers have changed over time. We then conclude by showing how easier access to debt finance has affected the fundamentals of small and medium enterprises.

Our findings confirm that when banks, and financial firms in general were floundering, this was detrimental for the overall performance of the Italian stock market. But closer analysis indicates that returns for investors varied substantially across industries. While some sectors performed dismally, others were able to provide investors with positive returns. Indeed, by focusing on industries where we can find the typical excellences of the Italian economy, investors could have obtained buy-and-hold returns from 14% to 120% over the investment horizon, or average compound annualized returns between 1% and 8% not considering dividend yield which were on average 4% for non-financial firms. In particular, we find that divergent performances are mostly explained by the uneven paces at which firms in various industries have been recovering from the crisis rather than their resilience during the downturn. More specifically, all industries with a positive performance over

the time horizon in question share certain traits: an improvement in financial fundamentals (CAGR for Sales, EBITDA, and EBIT), a consistent deleveraging and an increased percentage incidence of exports over total sales. In an attempt to generalize these findings across industries, we observe that growing EBITDA margins, reduced leverage and conservative investment policies have been the drivers of superior stock performances in the post-financial crisis period (i.e. from 2009 onwards). In line with the findings for listed stocks, also investing in private equity in Italy would have offered over the period we considered good chances to pay off. According to the data compiled by AIFI and KPMG, the average gross IRR over the past 10 year horizon was 8.8%. This, taking into consideration the sharp reduction in risk premia following quantitative easing, made private equity an appealing asset class over the past decade for investors willing to target Italy.

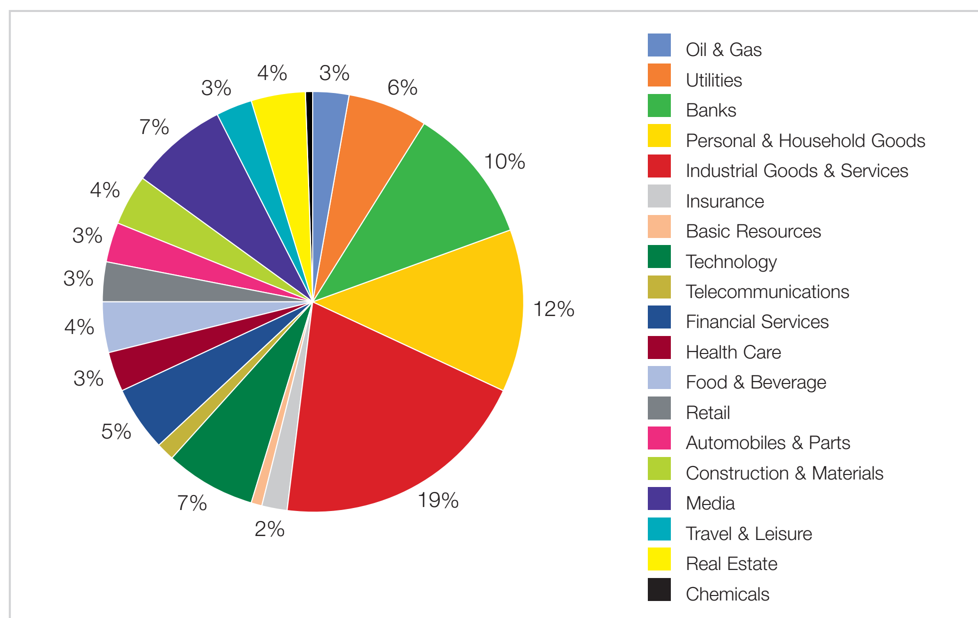
Turning our attention to debt capital markets, over the sample period the general trend for corporate bonds as an asset class was a drop in the yield, for diverse issuer types and across classes of ratings. In particular, while falling to historical low levels, yields on corporate debt were higher for non-financial issuers. Moreover, from 2010 onwards the yield spread between high yield and investment grade issues narrowed significantly. This contrasts with the progressive deterioration of the credit quality of Italy and the consequent downgrading of Italian issuers. Indeed, only one default occurred over the period we considered (i.e. that of Waste Italia who missed a coupon payment and whose debt is being restructured), but rating transitions were dominated by downgrades, which in any case have not prevented the yields to continue on their downward trend. Expansionary monetary policy and quantitative easing played a determinant role in this respect. Still, investors in different countries of the euro area were not all affected equally. In absolute terms the total returns generated by Italian corporate debt issues (5.7%) were higher than those offered by German firms (4.6%) but lower than those of French ones (6,5%). However, Italian corporate debt issues were especially appealing to investors when we consider relative performances with respect to domestic sovereign issues (7.4% in Italy versus 4.5% in France and -0.3% in Germany). Finally, looking at new forms of listed, yet illiquid, corporate debt (minibonds) we find that improved access to debt finance has benefited small and medium enterprises, funding their growth and improving their profitability. More specifically, we observe that issuers experience superior growth in revenues compared to non-issuers, and for all but smallest issuers, this increase is accompanied by a superior growth in EBITDA as well.

Investing in the stock market

In this Section, we focus on investments in the stock market. We compare stock returns across different portfolios of Italian stocks and look for the fundamental drivers of positive performances

We analyze all firms listed in Borsa Italiana between 2006 and 2016 that have financial information available on Bloomberg. Our sample includes 230 individual firms. The number of stocks we consider per year varies from 173 in 2006 to 219 in 2016, as a consequence of new listings, de-listings, mergers and a few missing observations. Approximately, 30% of the shares in our sample are listed on the STAR segment and 22% are issued by financial companies (10% banks, 2% insurance companies, 5% financial services firms and 4% real estate companies, as shown in *Figure 5*). Still, on average, during the period we considered, the former accounted for approximately 4% of total market capitalization, while the latter contributed 64%.

FIGURE 5
Italian stocks listed on Borsa Italiana (2006-2016): breakdown by sector

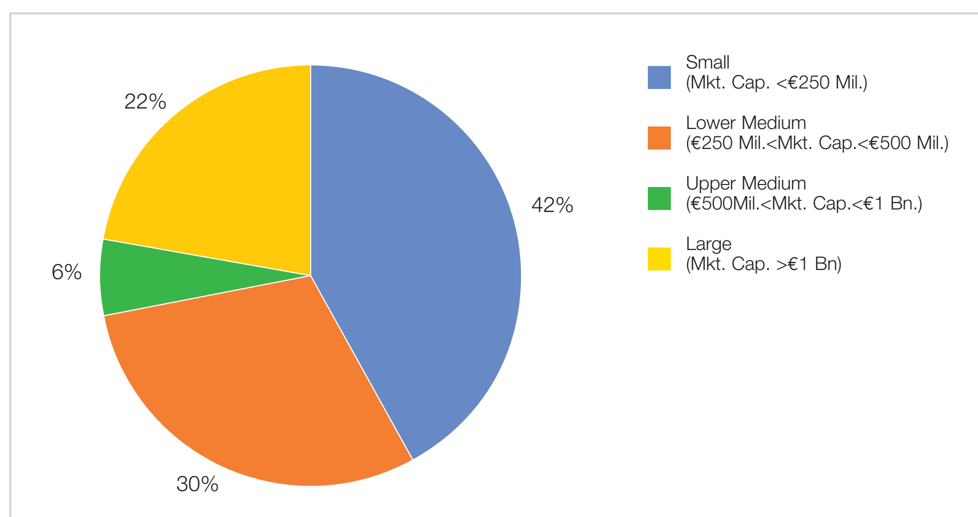


Source: Data collected on Bloomberg or provided by Equita

The total market capitalization of the stocks in our sample varied in the period in question from as high as €689 billion in 2007 to as low as €311 billion in 2013, only partially recovering since then up to €527 billion at the end of June 2016. The average capitalization is €2.3 billion. Figure 6 reports the breakdown of the stocks we analysed by size.[5] In general, 42% have a market capitalization of less than €250 million (Small), 30% run between €250 and €500 million (Lower Medium), 6% fall in the range above €500 million and below €1 billion (Upper Medium), and 22% have market capitalization in excess of €1 billion (Large). Then, despite an average market capitalization of €2.3 billion, 72% of firms listed on Borsa Italiana have a capitalization under €500 million. This is a direct consequence of the Italian economic framework, which is based on SMEs and on a more fragmented organisation.

[5] More specifically, we classify each stock in our sample on the basis of its average capitalization over the period.

FIGURE 6
Italian stocks listed on Borsa Italiana (2006-2016): breakdown by size



Source: Data collected on Bloomberg or provided by Equita

Did Italian non-financial companies represent a profitable investment while financial companies suffered?

In order to address this question we replicate the performance of an investor that formed value weighted equity portfolios of Italian stocks at the end of June 2006 and then consistently rebalanced them annually until June 2016.[6]

In particular we consider 26 portfolios: one including all shares listed on Borsa Italiana, one formed only by non-financial firms, one with only the stocks listed on the STAR segment of Borsa Italiana, then four portfolios based on the market capitalization of stocks (according to the ranges in *Figure 6*), and finally, nineteen industry portfolios (according to the Supersectors classification by Borsa Italiana).

Table 1 reports the summary statistics of the portfolios. We observe considerable disparity across portfolios, in terms of EBITDA margins, financial leverage, and firm growth rates (proxied by capital expenditures over total assets). Given these differences, we expect dissimilar performances across portfolios. Compared to the overall market, in particular non-financial stocks, firms listed on the STAR segment show a better average EBITDA margin (17.1% vs. 9.5%) and reduced leverage (3.2% vs 4.4%). Looking at company size, we can see that the average EBITDA margins decrease with the market capitalization: from 25.7% for large firms to 2.9% for smaller ones. This is consistent with the economies of scale of larger firms and their bigger market share, but also depends on different business models. Average EBITDA margins differ substantially across industries. Among non-financial firms, as a rule we find the highest EBITDA margins in the Food and Beverages industry, an Italian field of excellence, while the lowest margins emerge in Retail and Utilities. Not surprisingly, leverage on average is highest for financial firms and varies among non-financial sectors from 2.2x in Health Care and Telecom to 8.2x in Travel and Leisure. Investment requirements also fluctuate a great deal across industries. Oil and Gas or Utilities industries demand more annual capital expenditures in proportion to total assets than for example, the Media or Retail.

[6] We require annual rebalancing of the portfolios in order for them to maintain their distinctive features over the entire investment horizon. Our goal is in fact to identify the link between specific company characteristics and stock performances. Note that we do not take into account the transaction cost that the actual implementation of this investment strategy would require.

TABLE 1
Summary statistics of portfolios

	Average Number of shares	Total Market Capitaliz. (€ Mil.)	Average Market Capitaliz. (€ Mil.)	Average EBITDA Margin (%)	Average Financial Leverage	Average Capex to Assets (%)
All shares	202	455,789	2,288	16.0	5.9	1.3
Star	61	16,137	267	17.1	3.2	1.0
ex-financials	157	292,320	1,892	9.5	4.4	1.4
Small	89	7,578	87.0	2.9	5.0	1.2
Lower Medium	56	6,710	357	11.0	3.4	1.7
Upper Medium	15	10,966	736	16.6	4.7	1.4
Large	34	267,067	7,900	25.7	3.5	1.6
Automobiles & Parts	6	2,701	467	10.6	5.6	1.1
Banks	19	116,696	6,260	-	13.8	0.1
Basic Resources	2	18,595	9,298	17.7	3.0	1.0
Chemicals	1	70	70	9.2	3.3	1.2
Constr. & Materials	9	7,009	779	11.6	3.1	1.3
Financial Services	9	6,885	734	-	3.5	0.7
Food & Beverage	7	7,077	956	29.0	2.4	1.2
Health Care	6	4,043	740	9.4	2.2	1.0
Ind. Goods & Services	37	32,015	857	15.9	4.2	1.5
Insurance	5	33,488	6,698	-	15.6	0.5
Media	13	10,031	795	16.7	5.7	0.8
Oil & Gas	6	89,108	16,172	12.2	5.0	2.1
Pers. & House. Goods	20	23,000	1,159	8.0	5.3	1.3
Real Estate	9	3,363	374	17.6	8.0	1.2
Retail	5	1,310	276	1.7	3.3	0.9
Technology	15	9,278	644	9.6	3.6	1.2
Telecommunications	3	22,012	7,142	17.7	2.2	1.4
Travel & Leisure	7	3,256	465	10.2	8.2	1.1
Utilities	13	63,842	5,091	4.3	3.6	2.0

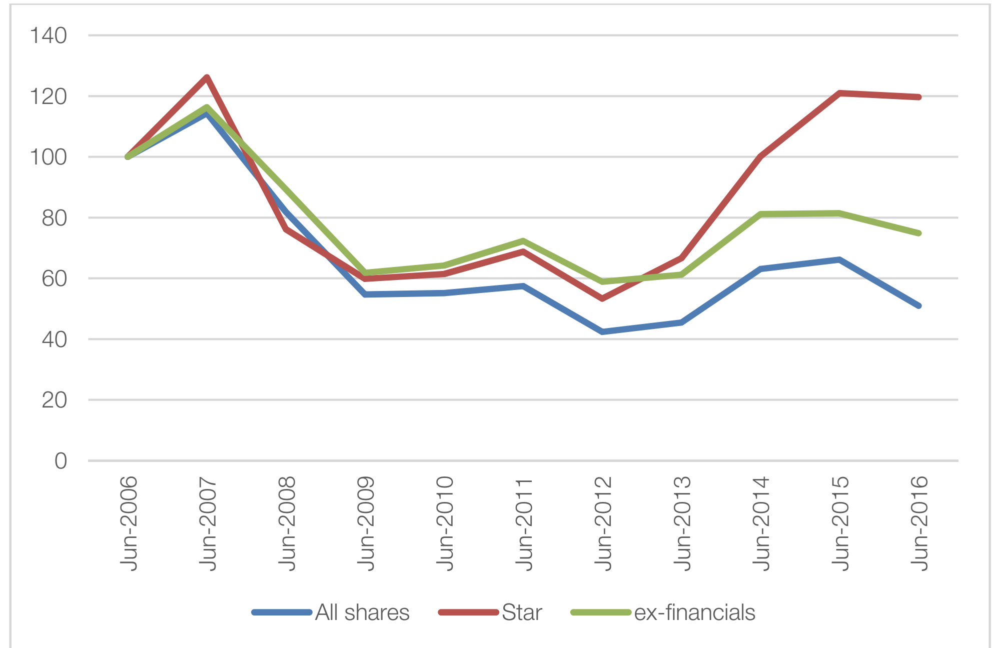
Source: Data collected on Bloomberg or provided by Equita

We compare in a "horse race" the performance of the different portfolios from June 2006 to June 2016 in terms of buy-and-hold returns and annualized compound returns for the holding period. *Figure 7* and *Figure 8* compare the performance of a portfolio including all shares listed on Borsa Italiana with one formed only by non-financial firms and a third with only the stocks listed on the STAR segment.

While it is true that the bad performance of banks, and financial firms in general, was detrimental for the overall performance of the Italian stock market, investors in Italy who avoided financial stocks would still have achieved poor performances over the investment horizon we considered. On average losses would have amounted to 3% a year, leaving investors with approximately 74.9% of their initial investment. These performances however do not take into account dividend yields. More than €181 billion were returned to investors in the form of dividends in the period between 2006 and 2015, about 30% of which coming from banks (21.7%) and insurance companies (8.7%). More specifically, banks and insurance companies offered on average an annual dividend yield of respectively 3.4% and 2.7%, while non-financial firms returned 4%. Remarkably, then, the total return of an investor that had invested in Italy avoiding financial stocks, would be positive when dividends are considered as dividend yields were able to offset capital losses on average.

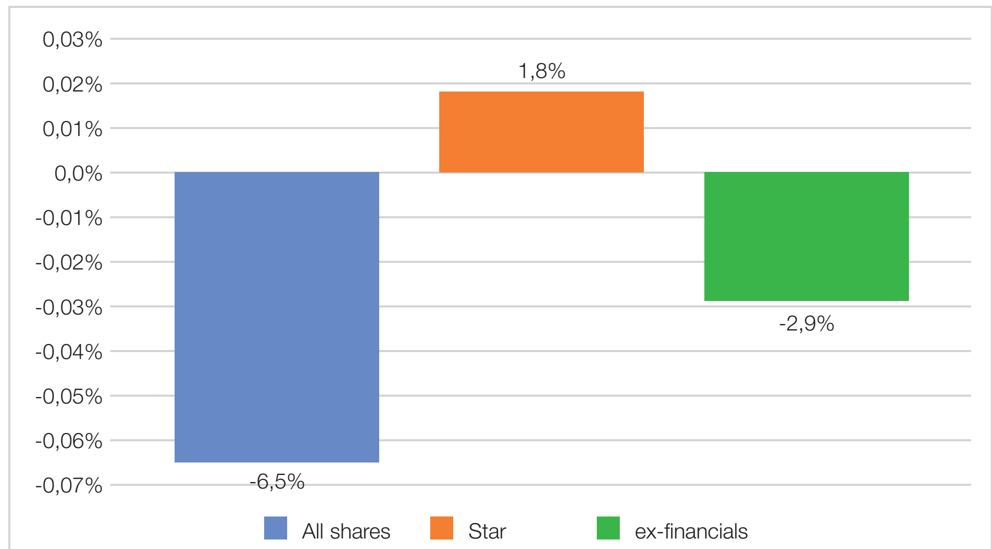
Only investors who focused on the STAR-listed stocks would have generated value (20%) and obtained positive returns (2% a year on average). Yet, also in this case, these figures underestimate the total return of an investor that had invested only on companies listed on STAR. Indeed, they accounted for almost 3% of the total dividends paid over the entire period we consider and offered on average an annual dividend yield of 2.7%, which is lower than the market average but consistent with the reinvestment needs of growth stocks.

FIGURE 7
Portfolio Performances (2006-2016): buy and hold returns



Source: Data collected on Bloomberg or provided by Equita

FIGURE 8
Portfolio Performances (2006-2016): Annualized compound returns



Source: Data collected on Bloomberg or provided by Equita

So what is then so special about firms listed on STAR? Apart from the higher transparency standards required by this segment of Borsa Italiana, can we find a common driver of positive performance among the companies listed here? Their average market capitalization is €267 million, almost one-tenth of the market capitalization of the average firm listed on Borsa Italiana. Indeed, 47% of the stocks listed on STAR have a market capitalization of less than €250 million, 38% track between €250 and €500 million, 6% fall in the range above €500 million and below €1 billion and just 9% have market capitalization in excess of €1 billion. Moreover, financial companies represent only 10% of the stocks listed on STAR, which is mostly populated by industrial and technology companies.

So is smaller size a driver of better performances?

We address this question by assigning each stock in our sample to a specific portfolio according to its market capitalization. *Figure 9* and *Figure 10* compare the performance of four portfolios including only small, lower medium, upper medium and large stocks respectively. Investing in Italian stocks with a market capitalization of either less than €250 million or more than €1 billion would have been a losing strategy. In fact, both small and large stocks performed poorly in the past decade, losing on average 6% and 3% a year respectively. In terms of buy-and-hold returns, this corresponds to a loss of more than 40% of the initial investment for small stocks and upwards of 20% for large ones. The best performers, generally speaking, were medium size stocks, in particular those issued by companies with a market capitalization in excess of €500 million. Indeed, investors focusing on upper medium size stocks alone would have achieved a buy-and-hold return of almost 15% over the investment horizon, or an average positive annual return of 1.4%.

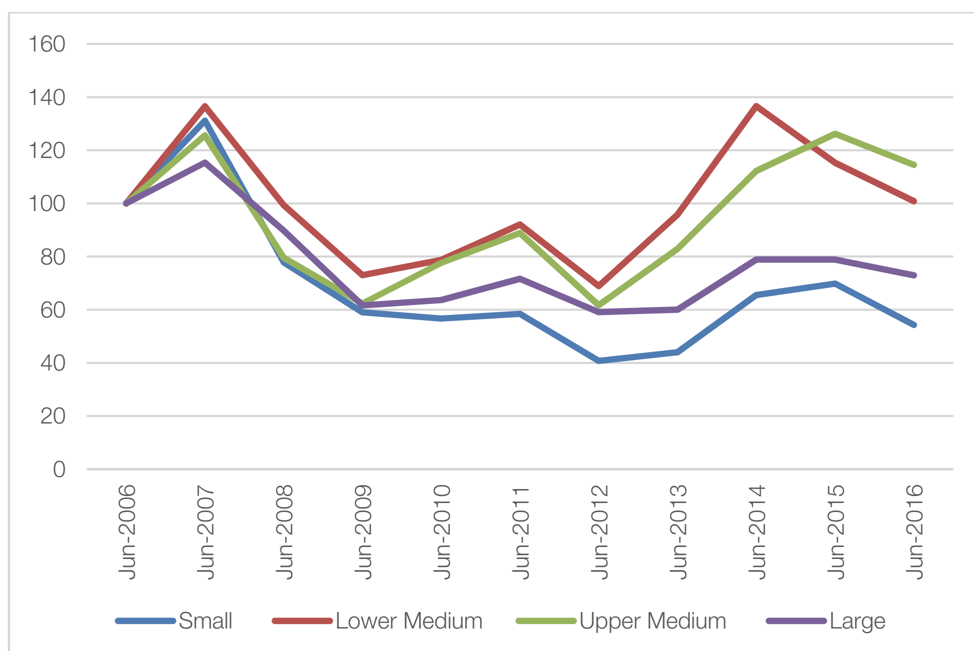
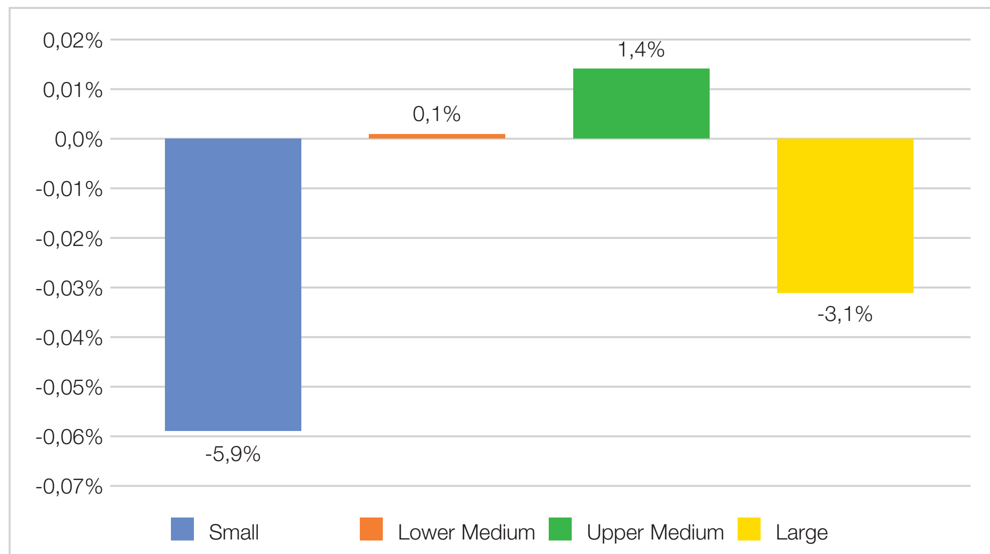


FIGURE 9
Portfolio Performances (2006-2016): buy-and-hold returns

Source: Data collected on Bloomberg or provided by Equita

FIGURE 10
Portfolio Performances (2006 – 2016): annualized compound returns



Source: Data collected on Bloomberg or provided by Equita

Still, upper medium size companies represent only 6% of the stocks listed on STAR. So, size alone can not explain better returns. Are, then, industry factors drivers of superior performance instead?

We address this question by assigning each stock in our sample to a specific industry portfolio. Performance varied substantially across industries. While some sectors recorded disastrous performances, namely Banks, Real Estate, Chemicals and Media, other industries were able to provide investors positive returns. This is the case of Automobiles & Parts, Food & Beverages, Personal & Household Goods, Financial & Services,[7] Retail, Health Care. In fact, investors focusing on these would have obtained buy-and-hold returns from 14% to 120% over the investment horizon, or average annual returns between 1% and 8%. *Figure 11* and *Figure 12* show the absolute and relative performances of the industries that performed better than the overall market (i.e. Winners), while *Figure 13* and *Figure 14* report the performances of the industries that performed worse (i.e. Losers).

Among the top performers we can find the typical excellences of the Italian economy: firms operating in Fashion, Food & Beverages and Automobiles Production, along with some emerging players in the e-commerce field as well. We examine the relationship between return performance and financial fundamentals in depth in the analysis that follows, but here we can start noting some common behaviours. All industries with a positive performance over the horizon in our analysis (except Food & Beverages) show positive growth measures (CAGR for Sales, EBITDA, and EBIT), a consistent deleveraging and an increased percentage incidence of Export on total sales. However, due to the effects of the economic crisis, profitability measures (EBITDA %, EBIT %, Net Income % and in particular ROE) have fallen significantly, even for industries showing positive returns. This margins compression holds for every industry except for Health Care and Financial Services, which only register a boosted ROE.

[7] For example, Exor, DeA Capital, M&C and Mittel

These performances however do not take into account dividend yields, which also varied substantially across industries, mitigating in some cases the negative performances of some industries. In particular, among industries which offered the highest average annual dividend yields we find Utilities (5.2%), Oil and Gas (4.9%), Retail (3.5%), Telecommunications (3.3%) and Industrial Goods and Services (3.1%)

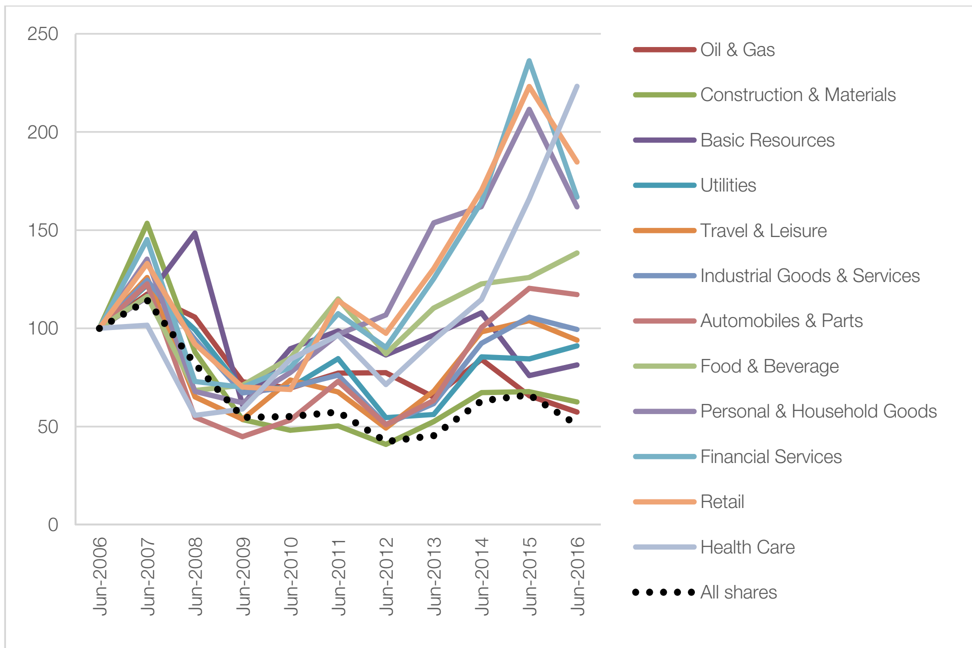


FIGURE 11
Performances of Winners (2006-2016) vs. all-shares (dotted line): Buy-and-hold returns

Source: Data collected on Bloomberg or provided by Equita

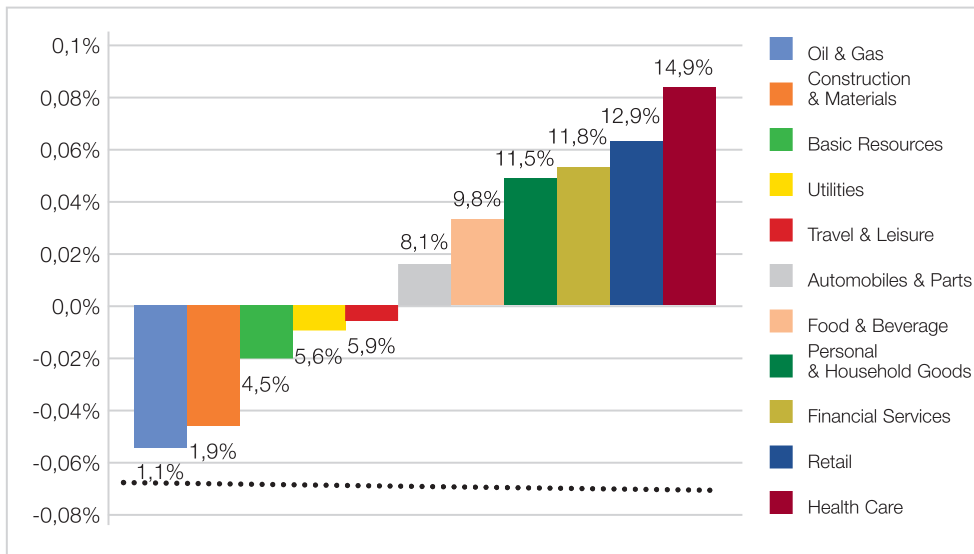
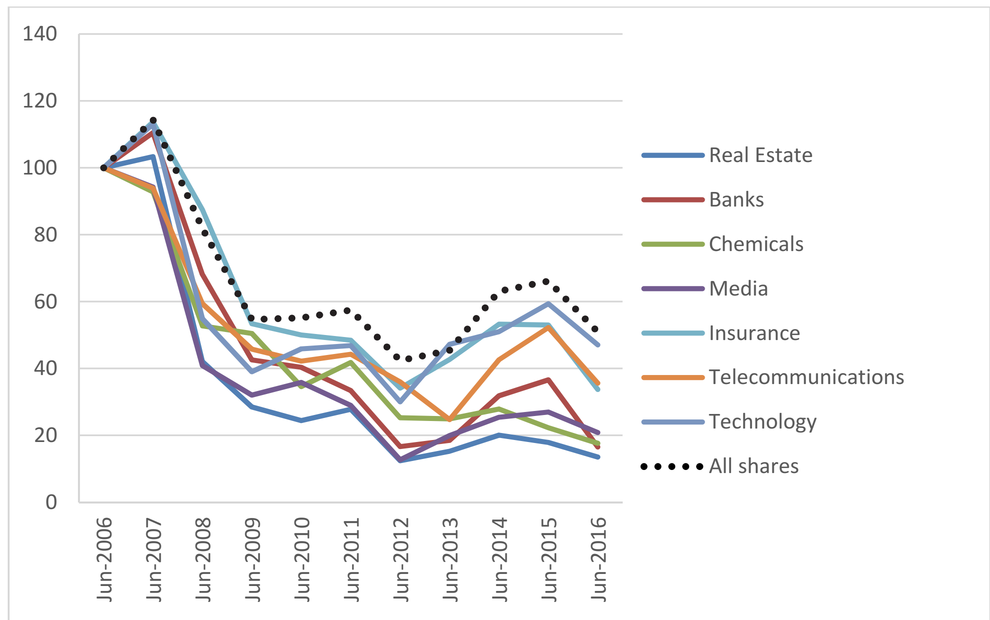


FIGURE 12
Performances of Winners (2006-2016) vs. all-shares (dotted line): Annualized compound absolute returns (vertical axis) and relative returns (bar labels)

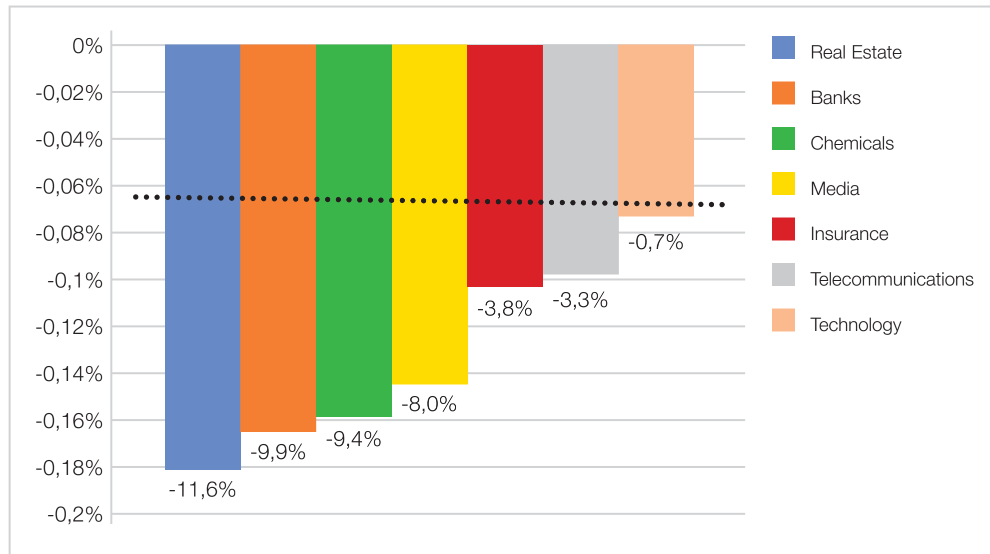
Source: Data collected on Bloomberg or provided by Equita

FIGURE 13
Performances of Losers (2006-2016) vs. all-shares (dotted line): Buy and hold returns



Source: Data collected on Bloomberg or provided by Equita

FIGURE 14
Performances of Losers (2006-2016) vs. all-shares (dotted line): Annualized compound absolute returns (vertical axis) and relative returns (bar labels)



Source: Data collected on Bloomberg or provided by Equita

What were the main drivers of good performances at the industry level?

Given that only a few industries have provided positive returns over the investment horizon, we now analyse their intrinsic characteristics in an attempt to link overperfoming industries to changes in fundamental financial variables.

In particular, we compute Pearson's correlations between the compound annualized return of our nineteen industry portfolios and the corresponding industry level changes in several indicators of financial fundamentals. More specifically, we consider four dimension:

- **Growth**: sales, EBITDA, net income and exports (CAGR)
- **Profitability**: EBITDA margins, EBIT margin, net income margin (% change)
- **Capital Structure**: Financial leverage and Net debt/EBITDA (% change)
- **Investments**: ROE and capital expenditures/assets (%change)

Common to all industries with a positive performance over the analysed horizon is an improvement in financial fundamentals (CAGR for Sales, EBITDA, and EBIT), a consistent deleveraging and an increased percentage incidence of exports on total sales. *Table 2* reports Pearson's correlations between industry annualized compound returns and industry level changes in fundamental variables. We find that industry stock performance is positively linked to growth in Sales, EBITDA and EBIT. Furthermore, enhanced profitability margins, especially in terms of EBITDA and net Income, are also associated with superior stock returns. As far as deleveraging, this is related with better performances, as is growth in exports (both in absolute value and in incidence on total sales). In terms of investment policy, then, firms which experienced a smaller ROE contraction are the ones that performed better.

TABLE 2
Drivers of Industry Performance: Pearson's Correlations between industry annualized compound returns and changes in fundamental variables (2006-2016)

Industry Portfolio CAR – Growth

	Sales	EBITDA	EBIT	Net Income	Exports
Correlation	0.74***	0.58**	0.59**	-0.45	0.53**
p-value	(0.0007)	(0.0196)	(0.0128)	(0.1209)	(0.022)

Industry Portfolio CAR – Profitability Margins

	EBITDA	EBIT	Net Income	Exports
Correlation	0.10**	0.31	0.43*	0.49**
p-value	(0.0204)	(0.2277)	(0.0853)	(0.0435)

Industry Portfolio CAR - Financial Leverage

	Leverage	Net Debt /EBITDA
Correlation	0.23	0.41*
p-value	(0.2086)	(0.0931)

Industry Portfolio CAR – Investments

	ROE	Capex /Assets
Correlation	0.50**	-0.08
p-value	(0.0400)	(0.7057)

Note: *,**,*** denote statistical significance at the 10%, 5% and 1%-level respectively

Source: Data collected on Bloomberg or provided by Equita

Our analysis shows that changes in financial fundamentals are linked to stock performances at the industry level. In an attempt to generalize these findings we investigate whether changes in profitability, financial leverage and investment policy could be common drivers of superior stock performances across industries.

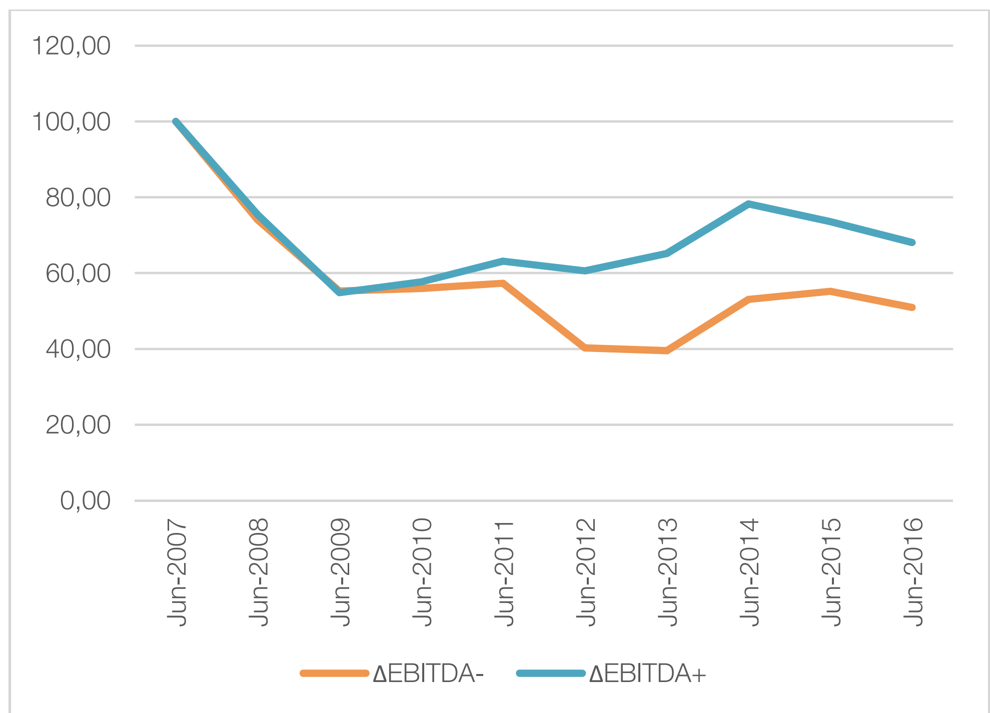
What kind of performance would a portfolio of Italian companies have achieved if they were selected on the basis of changes in their financial fundamentals?

We replicate the performance of an investor that formed value weighted equity portfolios of Italian stocks based on reported changes in EBITDA margins, financial leverage or capital expenditures respectively. The portfolios were first created at the end of June 2007 by picking stocks listed on Borsa Italiana that reported, for the most recent fiscal year, the largest annual rise (top-tercile) or drop (bottom-tercile) in EBITDA margins, financial leverage and capital expenditures respectively. Portfolios were then consistently rebalanced annually.

We compare in a "horse race" their performances in terms of annual buy-and-hold returns and of compound annual returns for the holding period. We posit that the explanation of the dissimilarities that emerge centres mainly on the speed of post-crisis recovery (i.e. from 2009 onwards), which varies from industry to industry, rather than on resilience in the downturn. In particular, we observe that growing EBITDA margins, reduced leverage and conservative investment policies were drivers of superior stock performances after the financial crisis.

Figure 15 and *Figure 16* report the performances of portfolios formed on the basis of changes in EBITDA margins. Portfolio ΔEBITDA+ (in light blue) includes the stocks of firms that reported the largest annual increase in EBITDA margins (top-tercile), while portfolio ΔEBITDA- (in orange) is made up of stocks issued by firms reporting the largest drops (bottom-tercile).[8] Improvements in EBITDA margins were drivers of superior performances only from 2009 onwards. Over the entire investment horizon, even if companies with growing margins overperfomed with respect to those with declining margins by almost 20% on average, both the former and the latter handed investors substantial losses. Indeed, the buy-and-hold returns over the entire period for the portfolios investing in stock which experienced the worst declines and the largest improvements in EBITDA margin were -32% and -49% respectively. This corresponds to average annual returns of -7.22% and -4.18%.

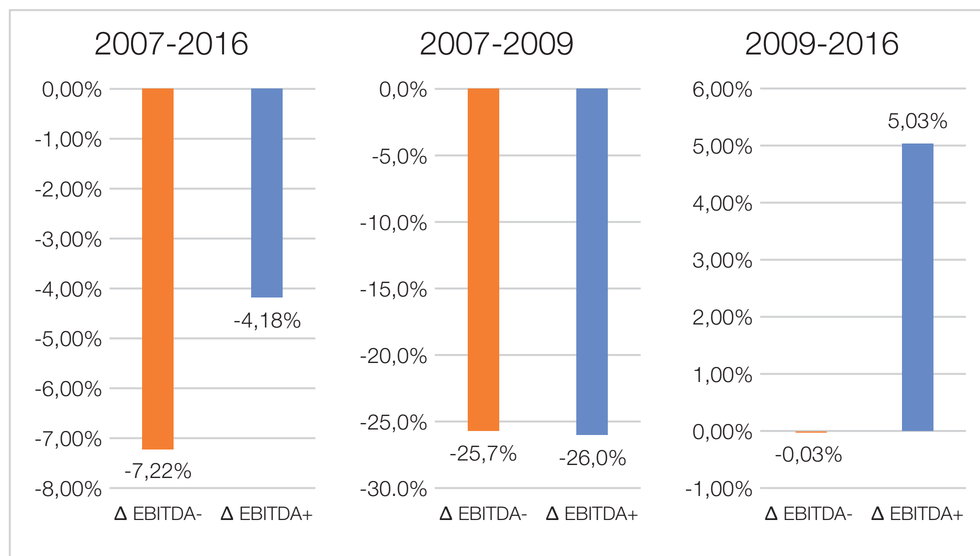
FIGURE 15
Portfolios formed on the basis of changes in EBITDA margins (2007-2016): Buy and hold returns



Source: Data collected on Bloomberg or provided by Equita

[8] Note that in 2007, 2008, 2011 and 2012 the 66th-percentile of the distribution of shifts in EBITDA margins is still slightly negative, -1%. ΔEBITDA+ includes a few stocks of firms whose EBIDA margins have actually declined, albeit relatively less than the general market downtrend.

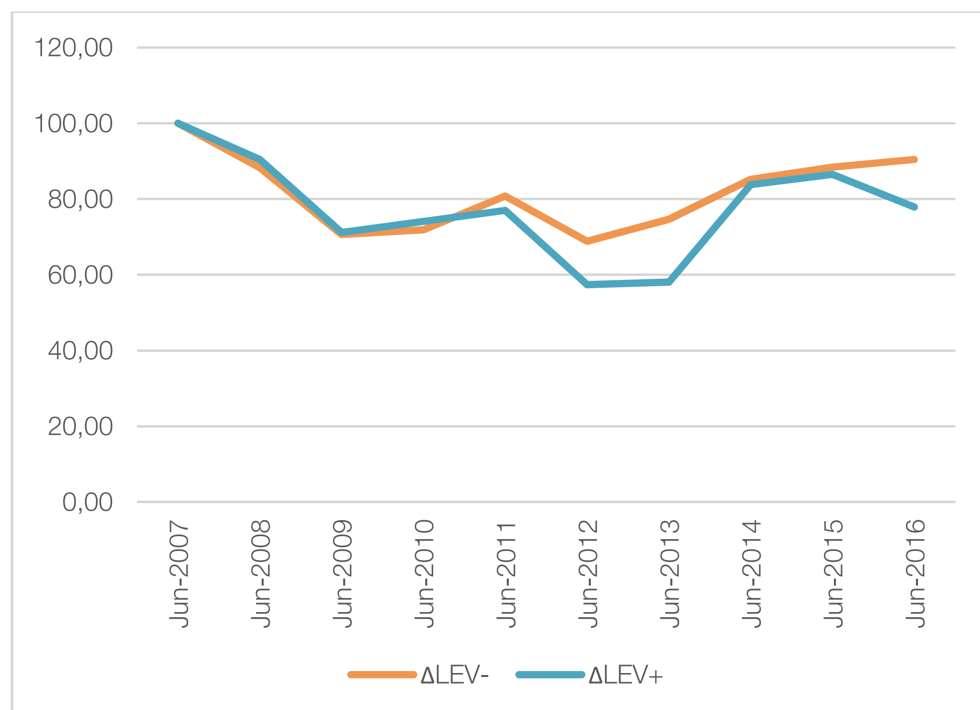
FIGURE 16
Portfolios formed on the basis of changes in EBITDA margins (2007-2016): Compound annualized returns



Source: Data collected on Bloomberg or provided by Equita

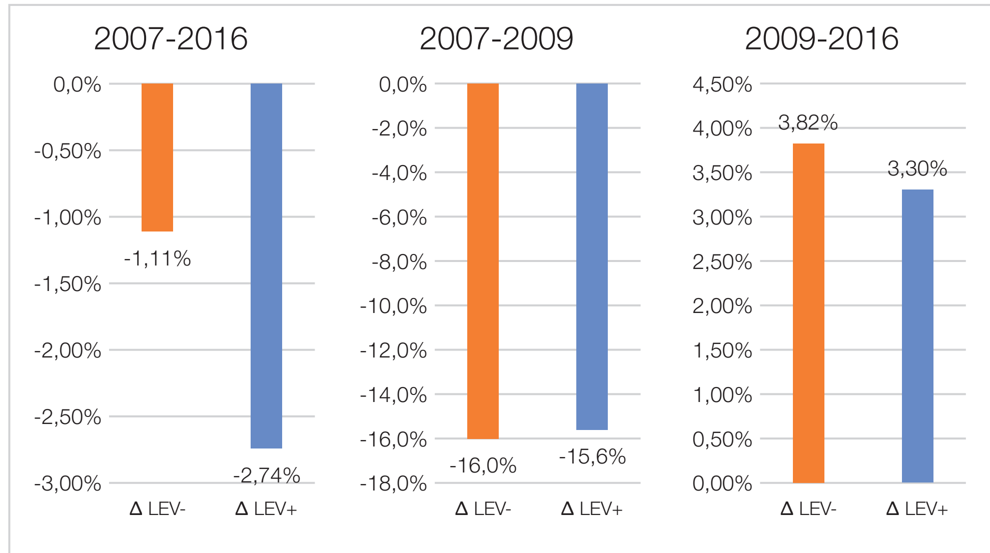
Figure 17 and *Figure 18* report the performances of portfolios formed on the basis of changes in leverage. Portfolio **Δ**LEV+ (in blue) includes the stocks of firms that reported the largest annual increase in financial leverage (top-tercile), while portfolio **Δ**LEV- (in red) is made up of stocks issued by firms reporting the largest drops (bottom-tercile). Companies that reduced their leverage overperformed with respect to firms that did the opposite. Also in this case, the benefits of investing in deleveraging companies rather than those leveraging-up would have started to pay-off only from 2009 onwards. The buy-and-hold returns over the entire period for the portfolios investing in stocks which experienced respectively the largest declines and the largest surges in financial leverage were -9.5% and -22%. This corresponds to average annual returns of -1.11% and -2.74%.

FIGURE 17
Portfolios formed on the basis of changes in leverage (2007-2016): Buy and hold returns



Source: Data collected on Bloomberg or provided by Equita

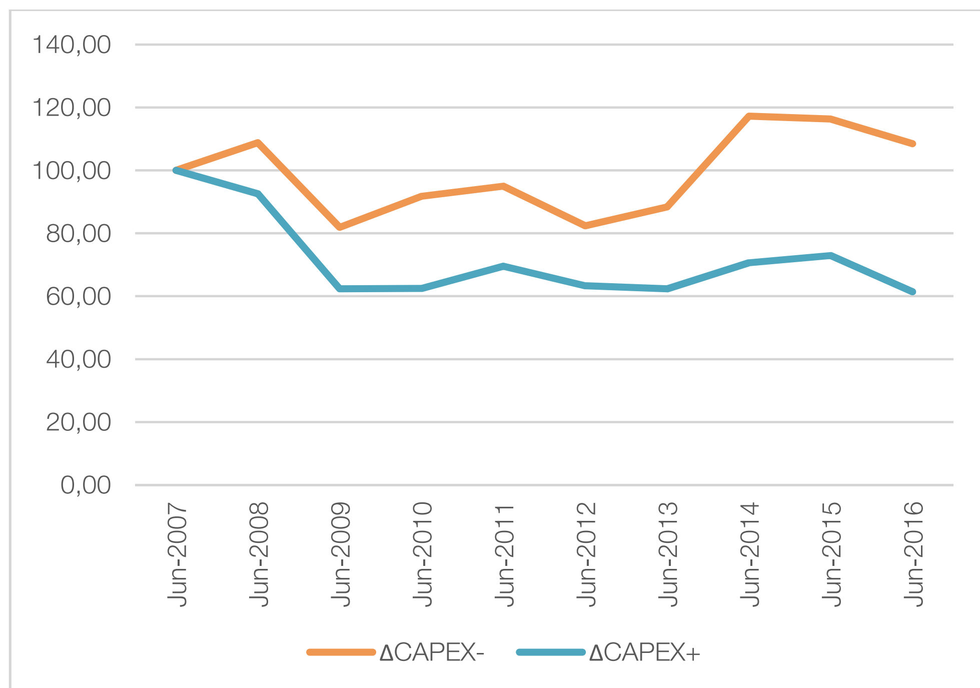
FIGURE 18
Portfolios formed on the basis of changes in leverage (2007-2016): Compound annualized returns



Source: Data collected on Bloomberg or provided by Equita

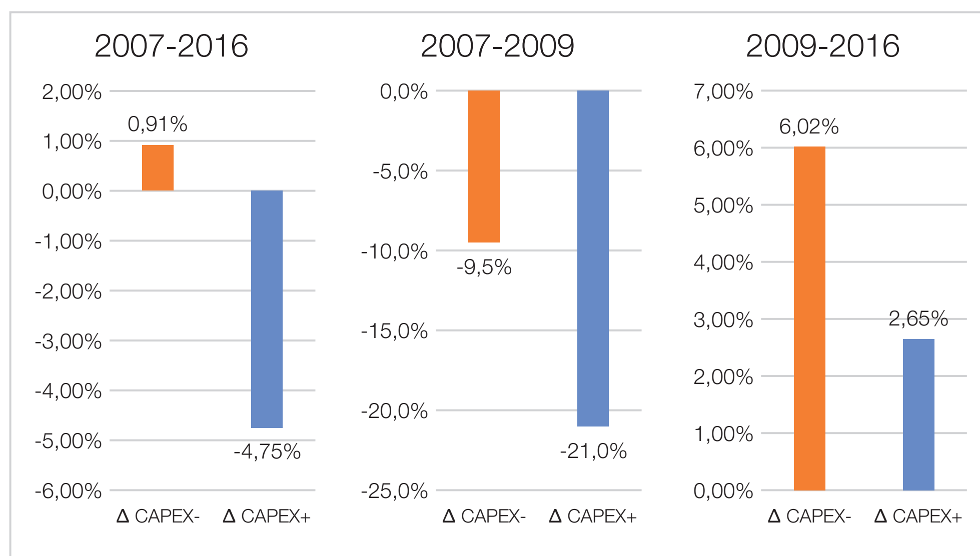
Figure 19 and *Figure 20* report the performances of portfolios formed on the basis of changes in capital expenditures. Portfolio ΔCAPEX+ (in blue) includes the stocks of firms that reported the largest annual increase) in capital expenditures as a fraction of total assets (top-tercile, while portfolio ΔCAPEX- (in red) is made up of stocks issued by firms reporting the largest drops (bottom-tercile). Companies that reduced their investment overperformed with respect to firms that took the opposite tack. The former obtained average annual returns of approximately 1% along the entire investment horizon, while the latter lost -4.75%. Over the period in question, for the portfolio investing in companies that retreated from investment the most, the buy-and-hold returns were 8.51%. Instead for the portfolio of firms that boosted their investments, returns were negative, almost -40%. This result seems rather counter-intuitive. The reasons behind it can be linked to the macroeconomic situation of recent years. The margin compression due to the economic slowdown resulted in low returns on new investments compared to the cost of capital; this situation awarded firms that invested less. So the crisis caused a surge of short-termism among economic agents. Moreover, post quantitative easing (QE), as yield on fixed income securities dropped to historical lows, investors increasingly looked for dividend-paying stocks as a substitute. This may be another reason why low-capex (high-dividend) stocks have outperformed their high-capex counterparts.

FIGURE 19
Portfolios formed on the basis of changes in capital expenditures (2007-2016): Buy and hold returns



Source: Data collected on Bloomberg or provided by Equita

FIGURE 20
Portfolios formed on the basis of changes in capital expenditures (2007-2016): Compound annualized returns



Source: Data collected on Bloomberg or provided by Equita

How does the performance of listed stocks compare with investing in private equity in Italy?

In line with the findings for listed stocks, also investing in private equity in Italy would have offered over the period we considered good chances to pay off. According to the data compiled by AIFI and KPMG, the average gross IRR over the past 10 year horizon was 8.8% (or 9% for the top quartile by invested amount) and 25.3% in the top quartile by performance. This was achieved in the context of rising write-offs, more complex divestures due to the high entry multiples fuelled by the ease of financing at the beginning of the period in question, longer holding periods and increased competition for targets. Taking into consideration the sharp reduction in risk premia following quantitative easing, private equity represented therefore an appealing asset class over the past decade for investors willing to target Italy.

Investing in corporate debt

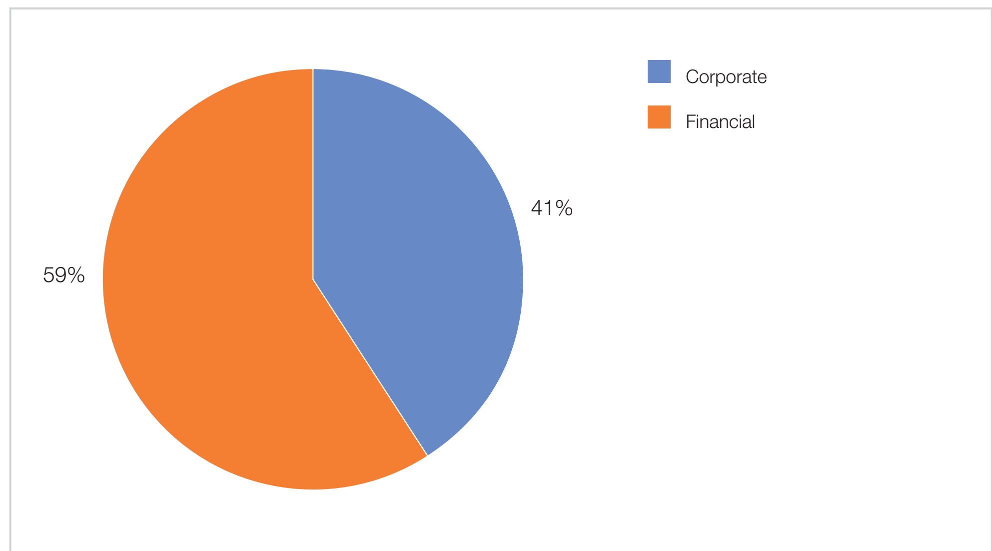
In this Section, we focus on investments in corporate debt. We study the yields offered by bonds issued by Italian corporates from 2006 to 2016, as well as the evolution of the credit quality of Italian issuers. Then we take a closer look at whether small and medium enterprises (SMEs) have benefited from improved access to debt capital markets to fill their funding gaps by means of dedicated instruments, such as minibonds.

The size of the Italian corporate debt market is constrained by the bank-centrism of the corporate funding model of Italian firms. Indeed, while bank funding is predominant across all Europe, the contribution of market-based sources of funding to corporate financial debt varies significantly from country to country. For example, while in the UK and France, corporate debt securities account for 30% and 22% of corporate financial debt respectively, in Italy this figure is 11% - well below the 20% EU average.[9]

We consider all public issues of debt instruments by Italian companies over the period 2006-2016, with information available on Bondradar. Our sample includes 824 public debt issues by 134 different corporate issuers for a total amount of more than €584 billion. The number of issues per year varies from 27 in 2008 to 112 in 2006, with an average of about 75 issues a year. Issuers are generally large firms from mature industries.

Approximately 60% of these bonds are issued by financial companies, although the exact proportions vary from year to year, as shown in *Figure 21*.

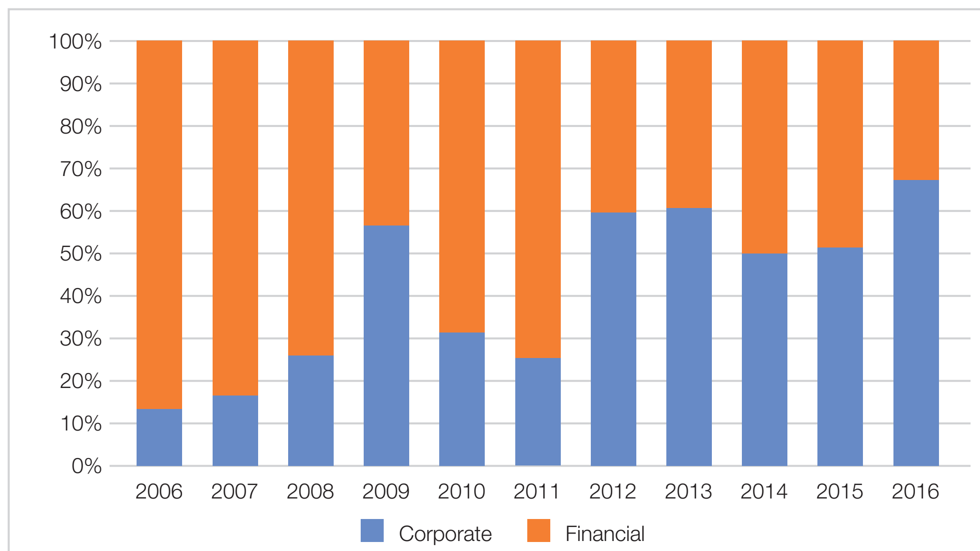
FIGURE 21
Italian corporate bond issuers (2006-2016): financial vs. non-financial



Source: Bondradar data supplemented by Equita

[9] See for example Societe Generale, (2016), In the mood for loans, Global Asset Allocation, Cross Asset Research, April. Or, Standard & Poor's, (2015), Banking disintermediation in Europe – A slow growing trend.

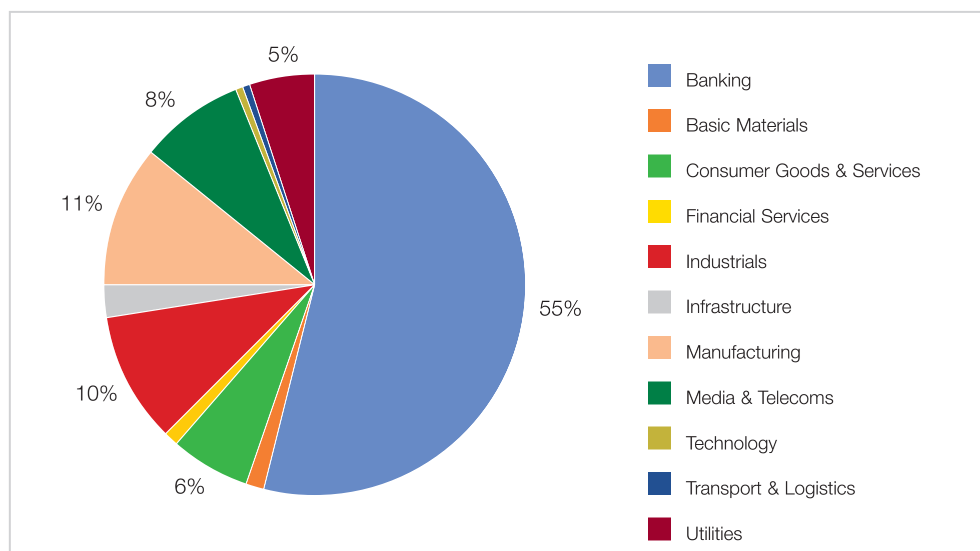
FIGURE 21 BIS



Source: Bondradar data supplemented by Equita

More specifically, *Figure 22* shows the sectorial breakdown of Italian corporate bond issuers in the period between 2006 and 2016. The biggest players operate in sectors such as Banking, Industrial Goods and Products, Manufacturing, Media and Telecom, Technology, and Utilities. *Table 3* reports the top ten issuers in terms of total volumes for the period in question. Among them we find five banks (Intesa Sanpaolo, Unicredit, Banca Monte dei Paschi di Siena, UBI Banca and Banca Popolare di Milano). The other five the top ten issuers are non-financial firms; one is a utility (Enel), one is a manufacturing firm (Fiat/FCA), one operates in the Oil and Gas sector (Eni) and two operate in the sector of Media and Telecom (Telecom Italia and Wind).

FIGURE 22
Italian corporate bond issuers (2006-2016): breakdown by sector



Source: Bondradar data supplemented by Equita

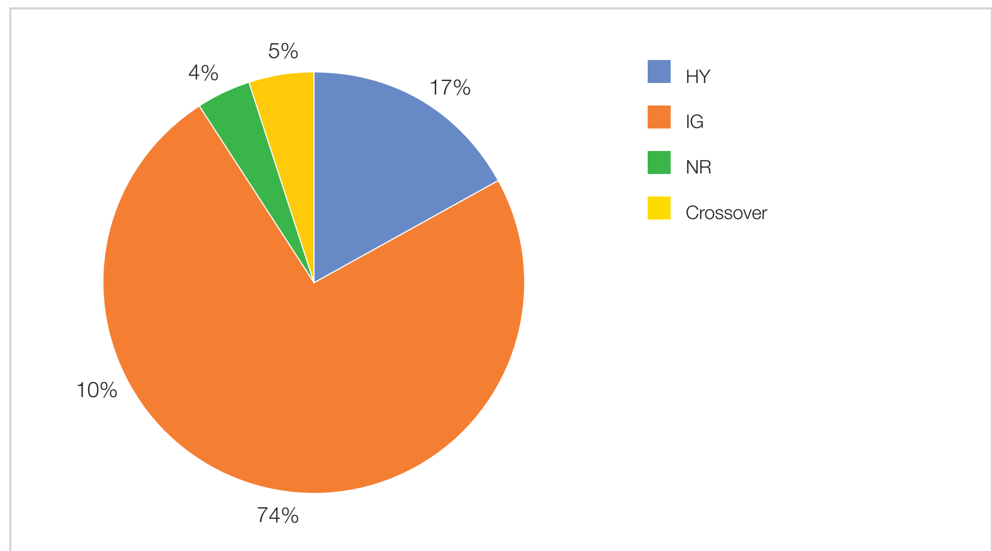
TABLE 3
Italian corporate bond issuers (2006-2016): Top 10 issuers by volume

	Ranking	Total Issue Volume (€ Billion)
Intesa Sanpaolo	# 1	99.6
Unicredit	# 2	72.4
Enel	# 3	39.3
Banca Monte dei Paschi di Siena	# 4	27.9
Telecom Italia	# 5	27.3
UBI Banca	# 6	25.6
Fiat/FCA	# 7	23.3
Banca Popolare di Milano	# 8	14.5
Generali	# 9	14.4
Snam	# 10	12.4

Source: Bondradar data supplemented by Equita

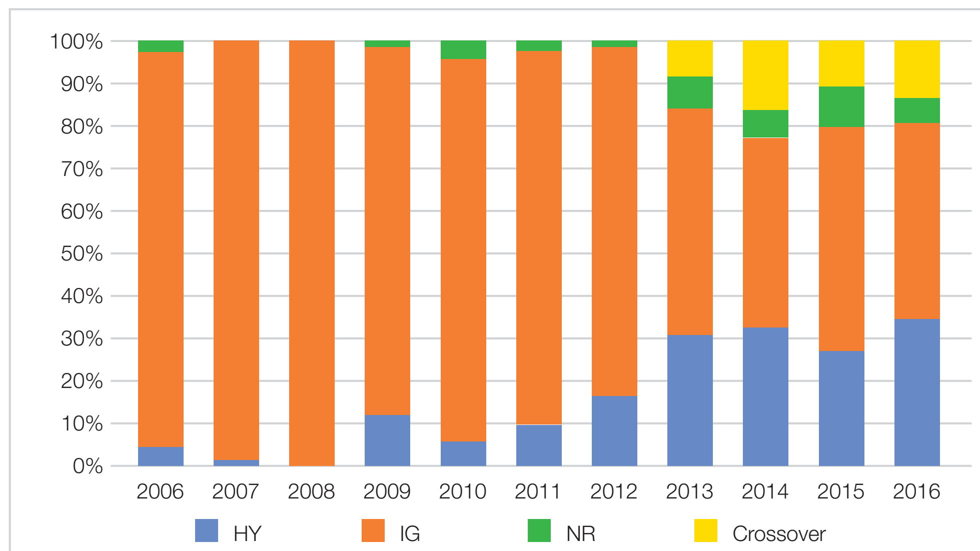
With regard to the credit quality of the issues in our sample, *Figure 23* shows that approximately 70% are investment grade. Only 17% have a high yield rating and just 4% are not rated. The exact proportions do not vary significantly over time. Still, as our Capital Market Monitor reveals, non-investment grade issues are concentrated in the most recent years, following quantitative easing (QE). This trend is common across Europe, and is facilitated by the progressive narrowing of the yield spread between high yield and investment grade issues. This is the outcome, on the one hand, of an increased demand of high yield bonds by yield starving investors. When, on the other hand, sub-investment grade issuers more frequently turned to market-based sources of debt in response to the bank credit crunch following the sovereign debt crisis.

FIGURE 23
Italian corporate bond issues (2006-2016): Ratings at issue



Source: Bondradar data supplemented by Equita

FIGURE 23 BIS



Source: Bondradar data supplemented by Equita

Finally *Table 4* reports some comparative statistics on the issues in our sample, classified according to issuer types and classes of rating. While the average issue size progressively shrunk over the sample period, it is still quite large (€647 million), especially for investment grade issues (€845 million). The average time to maturity is longer for financial issuers than corporate ones, with an overall average of 6.6 years.

TABLE 4
Italian corporate bond issues (2006-2016): Summary statistics

	Total Number of Issues	Total Issue Volume (€ Mil.)	Average Issue Size (€ Mil.)	Average Time to Maturity (years)
All sample	824	584,267	647.2	6.6
Corporate	339	229,947	710.2	9.4
Financials	485	354,320	785.0	6.6
Investment Grade	613	455,324	844.9	7.2
High Yield	138	82,633	636.9	7.0
Not Rated	34	12,215	283.2	5.6
Crossover	39	34,096	307.3	4.8

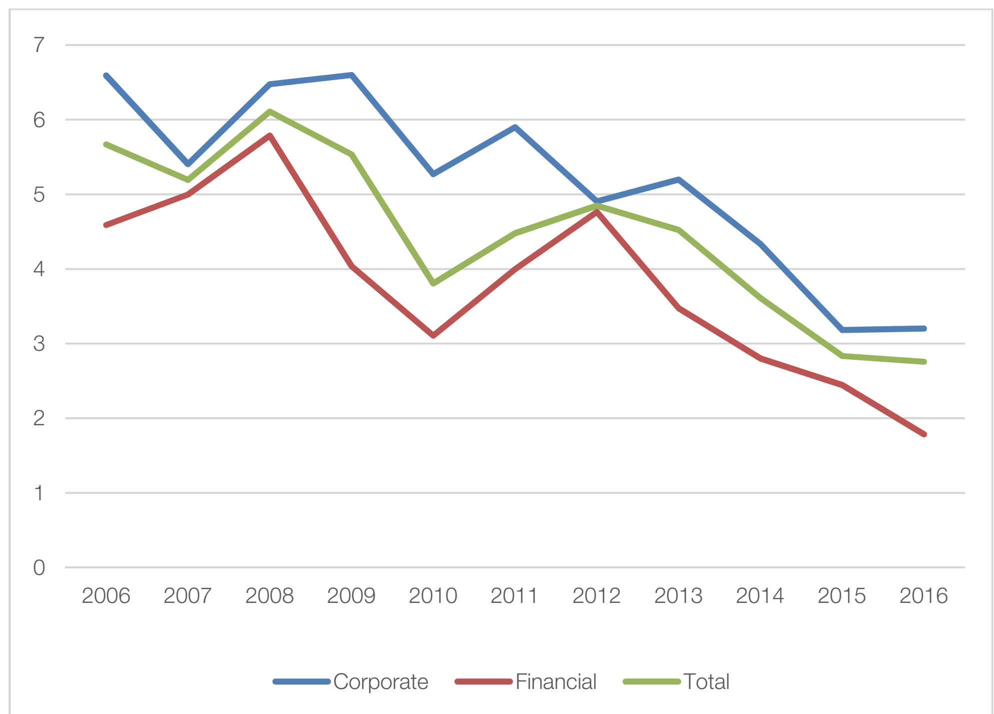
Source: Bondradar data supplemented by Equita

How has corporate debt performed as an asset class?

To address this question we evaluate the performance of corporate debt on the basis of the effective yields offered by the bonds in our sample when they were first issued. Our aim is to replicate the returns for investors who bought these bonds at the issue date to keep them until maturity while reinvesting all the proceeds. We first assess the performance of corporate debt as an asset class and then we break it down across different types of issuers and different classes of ratings.

The general trend was a drop in the yield for corporate bonds as an asset class, as a consequence of the extraordinary monetary policy measures in place over the sample period. This is consistent with the overall tendency across Europe. Indeed, yields on corporate debt reached historical low levels, for diverse issuer types and across classes of ratings (*Figure 24* and *Figure 25*, respectively). The yield offered by corporate issuers was higher than financial issuers throughout the period we considered, reflecting investors' expectations of bank bailouts. In particular, the spread between the yields of non-financial and financial issuers widened substantially between 2008 and 2010, when investors learned about an implicit safety net as struggling banks in several European countries were rescued in a coordinated public effort. This spread has narrowed only more recently, following the sovereign debt crisis, the surge in non-performing loans and the adoption of the new European Bank Recovery and Resolution Directive. While the first two factors represented greater likelihood of banks ending up in financial distress, the latter increasingly shifted the burden of the costs of possible bank distress on bank's debtholders (bail-in).

FIGURE 24
Italian corporate bond issues (2006-2016): Average effective yields for different issuer typesTitolo



Source: Bondradar data supplemented by Equita

Moreover, the yield spread between high yield and investment grade issues shrunk significantly as a consequence of quantitative easing, consistent with the overall tendency at the European level. Once again, this outcome can be explained by to factors: a greater appetite for high yield bonds among yield-starving investors, and an increased demand for to market-based sources of debt by sub-investment grade issuers following the bank credit crunch triggered by the sovereign debt crisis.

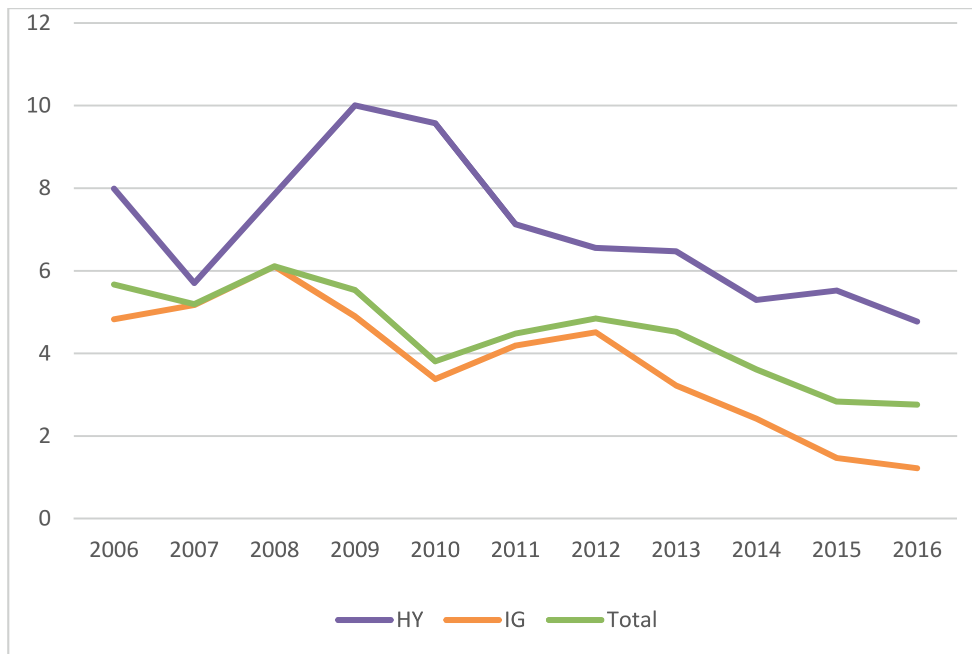


FIGURE 25
Italian corporate bond issues (2006-2016): Average effective yields for different rating classes.

Source: Bondradar data supplemented by Equita

Has the credit quality of Italian corporate debt issuers evolved accordingly?

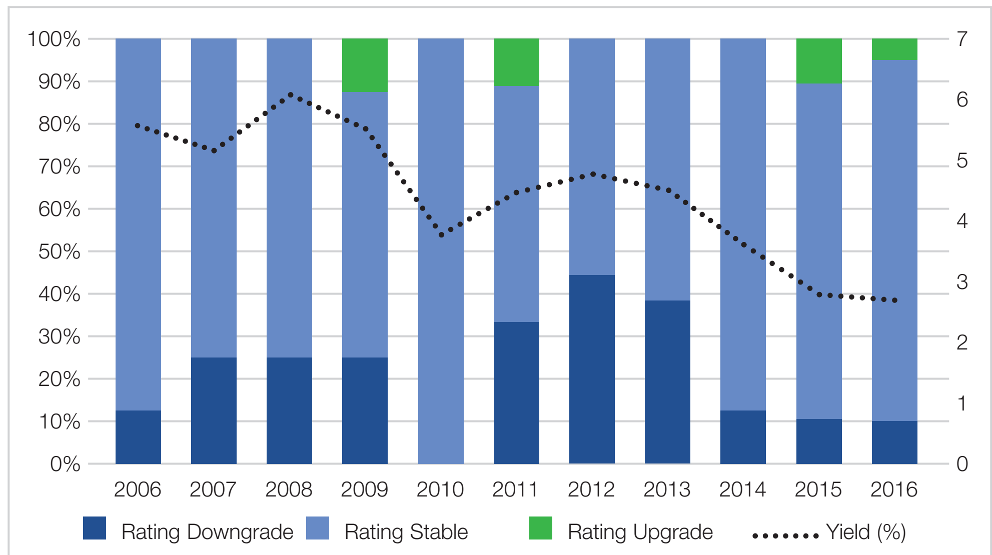
A decline in bond yields should indicate, under normal circumstances, an improvement of the credit quality of issuers. Still, although only one default occurred over the investment period that we considered, namely that of Waste Italia who missed a coupon payment and whose debt is now under restructuring,[10] both financial and non-financial issuers were hit by strong headwinds. The former suffered losses on their government bond holdings and their loan portfolios, while the latter had to face the challenges of a credit crunch followed by several years of recession.

At this point, we attempt to link the evolution of the rating quality of Italian issuers to average yields by analyzing rating transitions in a sample of 20 issuers with Fitch rating. These issuers taken together represent 21% of the number of issues in our sample and 25% of the total amounts issued.

Looking at the rating history of this subset of issuers we observe how the progressive deterioration of the credit quality of Italy over the period in question has negatively affected Italian issuers, with a total of 25 rating downgrades between 2006 and 2016 and only 5 rating upgrades. *Figure 26* and *Figure 27* provide an annual comparison of the frequency of transitions in credit ratings and credit outlooks respectively. Both negative rating revisions and outlook changes are reflected in yields. In particular, while we observe an overall declining trend, yields surge in years when rating downgrades are more frequent.

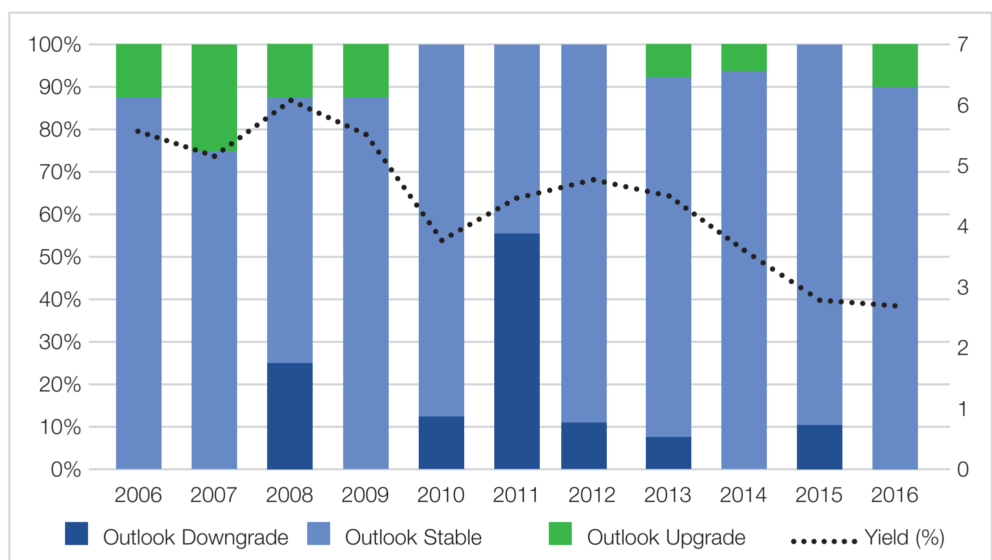
[10] Note that the yield that this bond offered at the issue date was approximately 12%, already reflecting a considerable probability of default.

FIGURE 26
Italian corporate bond issuers (2006-2016): Credit rating transitions



Source: Data collected by Fitch Ratings

FIGURE 27
Italian corporate bond issuers (2006-2016): Credit outlook changes



Source: Data collected by Fitch Ratings

The fact that falling yields did not combine with an improvement of the credit quality of issuers suggests the huge impact that quantitative easing has had on debt capital markets. In an attempt to shed light on the extent of the repercussions of the extraordinarily loose monetary policy on the returns of investors in corporate debt, we take a closer look at investment grade issues in 2015 by Italian, French and German non-financial firms with maturities ranging from 5 to 10 years. In particular, we compare the average total return offered by 17 bonds by Italian issuers, from their issue date up to the end of November 2016, with returns on 49 German and 42 French issues. *Figure 28* shows that, in absolute terms, the total returns generated by Italian corporate debt were higher than those of German firms but lower than French ones. Specifically, investors focusing on investment grade

issues by Italian non-financial firms in 2015 with 5 to 10 years maturities would have achieved on average a 5.7% total return. Instead, investors who opted for similar issues by French or German companies would have obtained 6.5% and 4.6%, respectively. Italian corporate debt has been especially appealing to investors in light of relative performances with respect to domestic sovereign issues. While the return on bonds offered by German and French issuers were respectively -0.3% and 4.5%, compared to their corresponding sovereign issues, those issued by Italian companies offered on average total returns that were 7.4% higher than domestic government bonds.

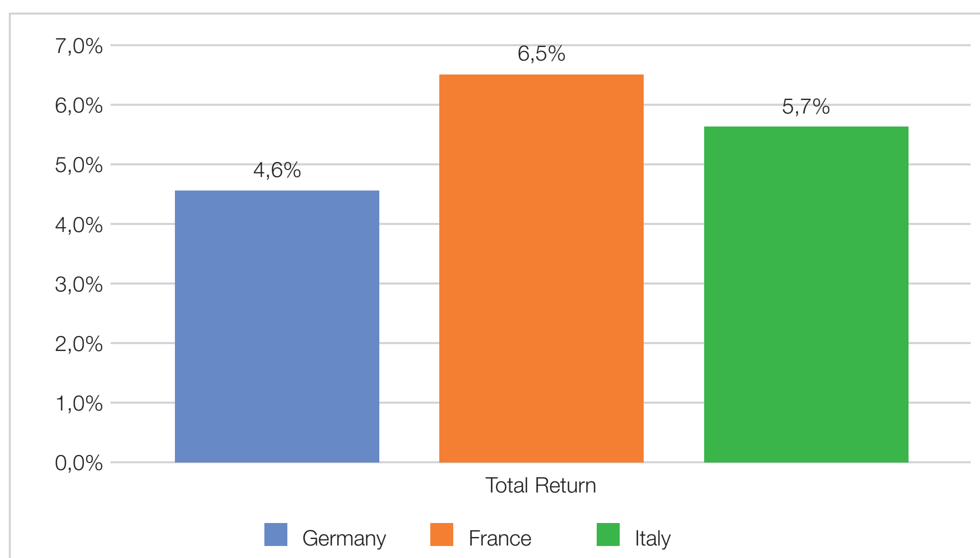


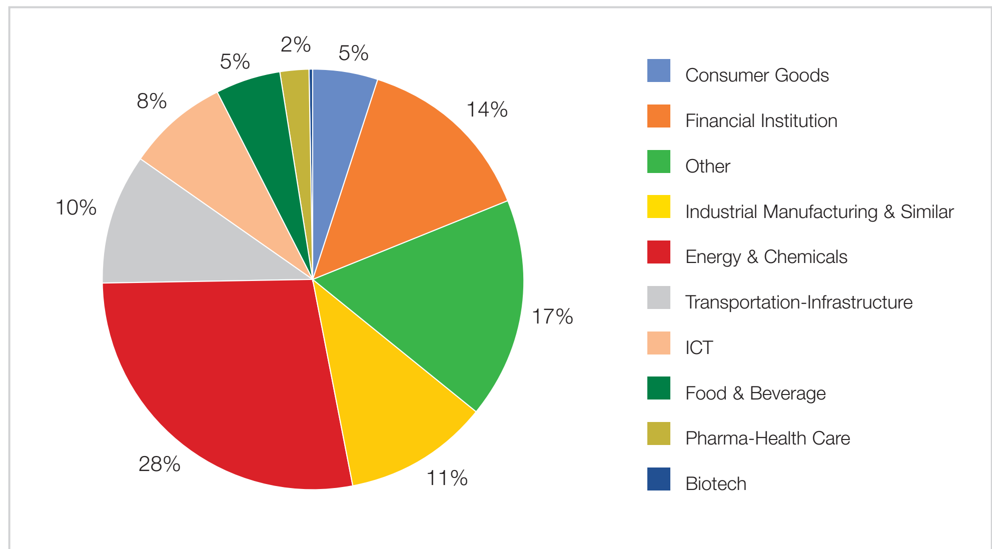
FIGURE 28
Italian corporate bond issuers (2006-2016): Average total return of investment grade issues in 2015 by Italian, French and German non-financial firms with maturities ranging from 5 to 10 years

Source: Data provided by Equita

Has improved access to debt finance benefited small and medium enterprises?

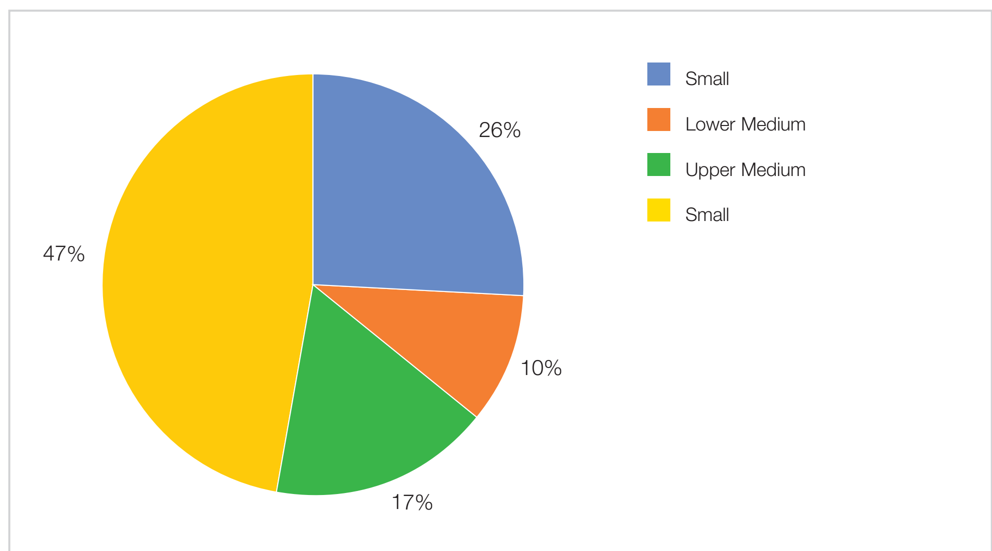
Given the exceptionally favorable conditions for issuers in corporate debt capital markets in terms of yields, we conclude our analysis by changing our perspective and by taking a closer look at whether SMEs have benefited from better access to debt capital markets by means of dedicated instruments, such as minibonds. To do so, we consider all minibond issues on the ExtraMot Pro segment of Borsa Italiana since 2013, and compile a sample comprising 115 issues valued at approximately €1.3 billion. A broad and balanced set of industries is represented, as shown in *Figure 29*. Issuers are small and medium enterprises, as we can see in *Figure 30* which illustrates the breakdown by size and shows that no issuer reports revenues in excess of €300 million. On the contrary, for almost 50% of the issuers in our sample, revenues fall in the range of €20 million to €50 million. The average issue size is €11.7 million and the average maturity is approximately 6 years. The yield offered by these issues is on average 5.83% and varies across industries from as low as 5% in Biotech to as high as 7.1% in Pharma and Health Care. These relatively high yields reflect the risk of these type of issues, but also the fact that while they are listed, they are mostly illiquid.

FIGURE 29
Minibond Issuers (2013-2016): Breakdown by sector



Source: Data provided by Equita

FIGURE 30
Minibond Issuers (2013-2016): Breakdown by size



Source: Data provided by Equita

Also in this case, for our analysis we classify issuers in terms of size and industry. We then take the compound annual growth rates (CAGR) of their revenues, profitability, leverage and debt tenor over the period from 2013 to 2015 and compare these figures to the changes in the same variables across a sample of non-issuing firms (we obtained these figures by aggregating data across all firms belonging to the same sectors and revenue classes of the issuers, for whom data was available in AIDA).

Table 5 reports differences between issuers and same-sector same–size non-issuers. We find that facilitated access to debt finance has benefited SMEs, funding their growth and improving their profitability. More specifically, we observe that issuers experience superior growth in revenues compared to non-issuers, and for all but smallest issuers, this increase is accompanied by a superior growth in EBITDA as well.

TABLE 5
Minibond issuers vs non-issuers: Growth, Profitability and Leverage (CAGR 2013-2015)

	Revenues	EBITDA	EBIT	Net Income	Leverage	Short Term Debt	Long Term Debt
Consumer Goods	4.6%	-7.4%	6.7%	5.8%	-15.9%	-7.7%	7.7%
Financial Institution	6.2%	4.1%	2.5%	15.7%	31.7%	-24.2%	24.2%
Industrial Manufacturing	4.9%	17.6%	28.7%	33.2%	-13.6%	-20.8%	20.8%
ICT	6.8%	-3.2%	-22.4%	n.a.	-3.6%	-10.7%	10.7%
Transportation-Infrastructure	2.8%	-7.4%	-19.9%	-13.5%	-10.0%	-3.6%	3.6%
Other	-8.5%	6.0%	12.3%	6.8%	-55.3%	-13.6%	13.6%
Pharma-Health Care	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Energy & Chemicals	n.a.	n.a.	n.a.	n.a.	n.a.	-9.2%	9.2%
Food & Beverage	5.8%	2.1%	2.4%	-25.1%	-19.3%	-12.5%	12.5%
Lower Medium							
Consumer Goods	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Financial Institution	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Industrial Manufacturing	3.7%	11.0%	24.4%	21.9%	-1.3%	-7.5%	7.5%
ICT	-0.2%	10.5%	7.1%	-31.5%	-43.2%	-3.8%	3.8%
Transportation-Infrastructure	8.3%	7.7%	2.3%	0.0%	-36.3%	-7.0%	7.0%
Other	-1.7%	4.6%	0.1%	13.4%	-19.8%	-44.5%	44.5%
Pharma-Health Care	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Energy & Chemicals	-0.2%	11.1%	20.9%	n.a.	-11.9%	-46.9%	46.9%
Food & Beverage	12.7%	11.8%	16.9%	n.a.	-15.2%	-6.4%	6.4%
Upper Medium							
Consumer Goods	2.6%	11.3%	19.0%	6.1%	-42.7%	n.a.	17.7%
Financial Institution	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Industrial Manufacturing	5.7%	-8.2%	-12.4%	-15.1%	13.4%	-11.7%	11.7%
ICT	3.2%	4.5%	-2.9%	n.a.	-21.8%	-9.8%	9.8%
Transportation-Infrastructure	5.4%	-0.5%	-19.9%	9.7%	19.2%	-9.7%	9.7%
Other	5.1%	n.a.	21.9%	n.a.	-39.2%	-9.0%	9.0%
Pharma-Health Care	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Energy & Chemicals	3.0%	14.3%	25.0%	n.a.	-24.9%	-3.4%	3.4%
Food & Beverage	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Medium							
Consumer Goods	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Financial Institution	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Industrial Manufacturing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
ICT	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Transportation-Infrastructure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Other	9.2%	n.a.	30.7%	n.a.	-78.1%	-2.2%	2.2%
Pharma-Health Care	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Energy & Chemicals	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Food & Beverage	0.3%	1.8%	6.6%	30.1%	4.6%	-13.4%	13.4%

Source: Aida data supplemented by Equita

Conclusions and Recommendations

From the perspective of a domestic or international investor willing to invest in Italian equities or corporate bonds, the picture that emerges from our analysis is one characterized by lights and shadows. Our study suggests that even against the headwinds of prolonged adverse market conditions, investing in Italian capital markets over the past decade through a careful security selection could have paid off.

On the equity side, our results confirm that the overall performance of the Italian stock market suffered from flailing banks and floundering financial firms. However, returns for investors varied substantially across industries. While some sectors posted dismal numbers, others managed to provide investors with positive returns. Indeed, by focusing on industries which represent the fortes of the Italian economy, investors could have obtained buy-and-hold returns from 14% to 120% over the investment horizon we considered, or average compound annualized returns between 1% and 8% not considering dividend yield which were on average 4% for non-financial firms. What explains these variations is not the resilience of firms in different industries during the recent economic downturn. Instead, the key in most cases is their rate of recovery from the crisis, which has fluctuated from sector to sector. More specifically, what all industries with a positive performance over the time horizon we analysed share is an improvement in financial fundamentals (CAGR for Sales, EBITDA, and EBIT), a consistent deleveraging and an increased percentage incidence of exports on total sales. In an attempt to generalize these findings across industries, we observe that growing EBITDA margins, reduced leverage and conservative investment policies were the drivers of superior stock performances post-financial crisis (i.e. from 2009 onwards). In line with the findings for listed stocks, also investing in private equity in Italy would have offered over the period we considered good chances to pay off. According to the data compiled by AIFI and KPMG, the average gross IRR over the past 10 year horizon was 8.8%. This, taking into consideration the sharp reduction in risk premia following quantitative easing, made private equity an appealing asset class over the past decade for investors willing to target Italy.

Turning to the debt capital markets, the general trend over the sample period for corporate bonds as an asset class was a drop in the yield for various issuer types and across different classes of ratings. In particular, while falling to historical lows, yields on corporate debt were higher for non-financial issuers. What's more, since 2010 the yield spread between high yield and investment grade issues has shrunk significantly. This contrasts with the progressive deterioration of the credit quality of Italy and the consequent downgrading of Italian issuers. Indeed, only one default occurred over the period we considered (i.e. that of Waste Italia who missed a coupon payment and whose debt is being restructured), but rating transitions were dominated by downgrades, which in any case have not prevented the yields to continue on their downward trend. Expansionary monetary policy and quantitative easing played a determinant role in this respect. Still, investors in different countries of the euro area were not affected equally. Indeed, in absolute terms the total returns offered by Italian corporate debt issues (5.7%) were higher than those offered by German firms (4.6%) but lower than their French counterparts (6.5%). But Italian corporate debt issues have been especially appealing to investors in light of relative performances with respect to domestic sovereign issues (7.4% in Italy versus 4.5% in France and -0.3% in Germany). Finally, looking at new forms of listed, yet illiquid, corporate debt (minibonds) we find that simplified access to debt finance has benefited small and medium enterprises, funding their growth and improving their profitability. More specifically, we observe that issuers experience superior growth in revenues compared to non-issuers, and for all but smallest issuers, this increase is accompanied by a superior growth in EBITDA as well.

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Notes

With this new paper, BAFFI CAREFIN Center for Applied Research on International Markets, Banking, Finance and Regulation and Equita SIM start their new three year partnership to analyze the major characteristics of the Italian financial capital markets. This paper accompanies a newly created Italian Capital Markets monitor that, every year, will present trends and characteristics of the investors, issuers and intermediaries. In this paper, we look at the performance of italian equity and debt capital markets in the past decade. Our findings indicate that, contrary to conventional wisdom that sees italian markets underperforming other european markets, a careful asset allocation by investors on some selected segments and financial instruments could have led to a significant performance.

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