Bocconi Students Investment Arena was born in 2022 from the idea of bringing together students of different degrees and experience, but all with the same ardent passion for finance. Through dedicated competitions, masterclasses, and a members' forum, we aim to develop a community of students that fosters quantitative and qualitative skills like in-depth practical investments and valuation skills, teambuilding, and analytical skills.

The uniqueness of this association is that members would be able to put their investment knowledge into practice by competing against each other in two main events: portfolio competition and company valuation competition.

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Hedge Funds Shorting Italian Debt

By Guillermo Silva

Shorting Italian Debt

In August, the total value of short positions against Italian debt reached its highest level since 2008, with S&P Global Market Intelligence estimating the market value at more than 29 billion euros (FT). Behind these numbers are hedge funds using Futures to bet against the Italian economy. Mark Dowding, the CIO of BlueBay Asset Management (Assets $106bn), a firm with a short position against Italian debt, explained that he chose Italy because of its exposure to gas prices and challenging politics. Moreover, he has defended his position by stating that the European economic situation has rendered the ECB unlikely to buy Italy's debt back. Whereas Decio Nascimento, the CIO of Norbury Partners, a firm that has stayed away from the trade, has compared the trade to "playing a game of chicken with the ECB".

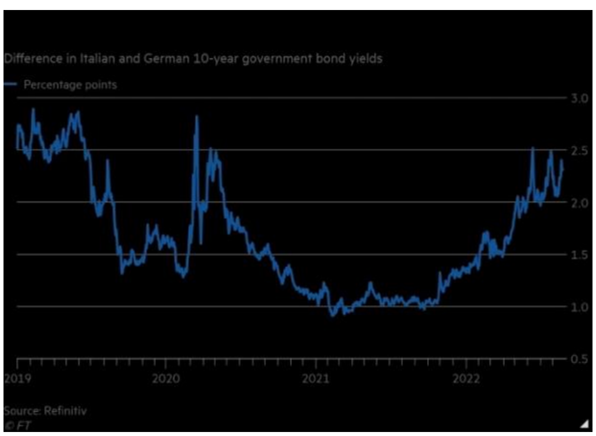

Figure 1: Source FT

This comes after investors have started to grow concerned about European countries' ability to ignore public debts, which have increased during the pandemic and have become more expensive to refinance following the ECB's September interest rate hike (Euractiv). Italy is one of the most indebted countries worldwide, with a public debt accounting for 154.20% of the country's GDP in 2021 (Statista). Financial uncertainty for the southern European nation stems from several crises.

Climate Crisis

One crisis that has challenged Italy started in mid-July, as Italy was forced into a state of emergency to deal with a climate crisis causing droughts across the country. The nation recorded a lack of rain and record- high temperatures during the summer, with droughts in northern and central regions estimated to set back Italy's economy by 0.2% in the third quarter of 2022, as they have affected the country's agriculture and energy sector.

Italy has set aside 36.5 billion euros in relief to drought- stricken areas (Bloomberg). Direct impacts aren't expected to be devastating to the country's economy, but droughts add to the risk of holding Italian sovereign debt.

Energy Crisis

Moreover, the heat wave has also strained Italy's power grids and infrastructure, putting energy security plans at risk, and further complicating an existing and already delicate energy situation due to the Russo- Ukrainian War (Bloomberg). In late August, Russia shut the Nord Stream 1 pipeline to Europe five months after having threatened to do so if western nations failed to withdraw their support for Ukraine (The Guardian). This reduction in gas supply has sent global gas prices soaring (BBC), and

Bank of Italy Governor Ignazio Visco had warned in July of a recession in Italy if Moscow were to fully halt flows (Bloomberg). Visco's warning stood in stark contrast to a statement made earlier in April in which he labeled the conflict in Ukraine a "terrible event" but dismissed concerns for a Recession in Italy stemming from it as "unlikely" (Bloomberg).

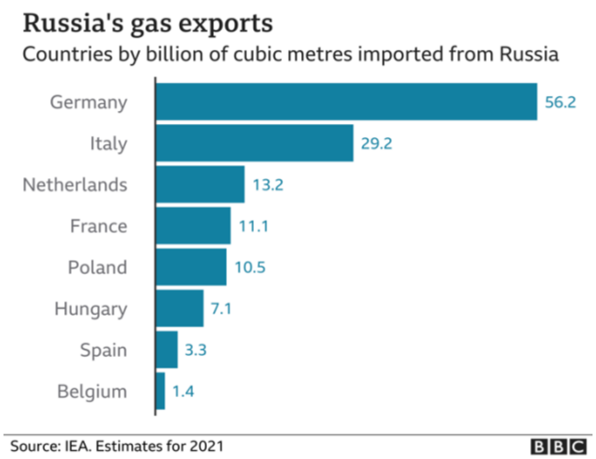

Figure 2: Source BBC

The graph above ranks Italy as one of the most exposed countries to potential gas supply disruptions in the EU. However, since 2021, Italy has reduced exposure by cutting Russian gas imports from about 40% at the start of the year to 25% (Bloomberg), with gas flows from Algeria now doubling those coming from Russia. The Italian government has already allocated 33 billion euros to shield families and businesses from higher energy bills (Bloomberg), and it's already working on a separate aid package worth as much as 8 billion euros. The Italian government aims to refinance this expenditure by issuing more debt (Bloomberg), The European Commission introduced the Repower EU Plan (EUR-Lex), where it stated its intentions to reach complete independence from Russian fossil fuels well before the end of the decade through diversifying supplies, reducing demand, and increasing the production of green energy in the EU (European Commission). However, forecasts estimate that the EU's plan to replace Russian gas will fall short, with its proposition to replace 80% Russian gas by 2022 proving too optimistic already in late Q3. The plan has attracted public criticism and was labeled as "wildly optimistic" by news outlet CNBC back in June (CNBC).

Political Crisis

Italy is preparing for elections in September after having experienced political turmoil at the beginning of the third quarter, which involved the rejection of the resignation of Italian Prime Minister Mario Draghi. With past credentials including serving as President of the ECB, Draghi has been critical in securing 190 billion euros in EU recovery funds for Italy. In July 2012, during his time in office at the ECB, he was credited for decreasing Italian bond yield spread by more than 300 bps by promising to buy bonds of troubled countries in response to the Eurozone debt crisis (KfW). In 2021, investors welcomed Draghi's arrival in Rome, and his cabinet was described as "better than expected" (CNBC). Draghi held the majority's approval for his time in office, was backed by most main political parties, and provided a strong sense of security for Italian politics (Euractiv).

In July 2022, Draghi's resignation was met with concern from investors, as the selloff of Italian debt intensified with the yield on Italian bonds rising over 27 pbs in just the following couple of days (FT). Moreover, Italian bonds later plunged in September following the ECB's first hike in interest rates since 2011 (FT), after having already sunk following Draghi's resignation in July (FT). Uncertainty around the future funding of Italy, the abandonment of Draghi's long-term plans and incertitude around policies under the new ad- ministration are all prospects that have investors worrying about Italy's economic future (CNBC).

Increasing European Central Bank Rates

By Marcello Fagotto

On the ECB increasing rates

The European Central Bank is likely to raise interest rates by 0.75 percentage points for the first time in its history next month ahead of a further move in December. “We will do what we have to do” ECB president Christine Lagarde told during Atlantic Council event in Frankfurt, adding that the bank’s “first destination” was to lift rates to the “neutral” one that neither boosted nor restricted growth. However, what are the reasons behind this decision, and will it be effective in slowing down inflation?

Understanding inflation

Inflation is a rise in prices, which can be translated as the decline of purchasing power over time impacting the cost of living for the common public which ultimately leads to a deceleration in economic growth. The consensus view among economists is that sustained inflation occurs when a nation’s money supply growth outpaces eco- nomic growth, but this can also be played out through different mechanisms in the economy that may not be directly linked with the actions of the monetary authorities. This is the reason why Eurozone and US inflation are fueled by different factors.

In Eurozone this is happening for three main reasons:

- Pandemic-related changes
- Higher energy prices
- Base effect

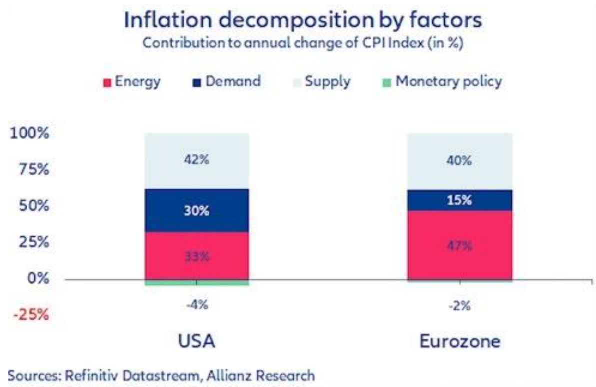

Figure 3: Source Allianz Research

Pandemic- related changes primarily account for these increases. European economies reopened slowly in 2021 as more restrictions were lifted. People started traveling again and spending some of the money they did not spend during the lockdowns. But logistics are not moving at the same time.

Companies are finding it difficult to keep up with rapidly rising demand as they rebuild supply chains that were badly hit by the pandemic. Challenges, such as a shortage of shipping containers, means transporting goods has become more difficult and more expensive companies will pass these costs on to their customers in the form of higher prices. In the same way energy prices increased as oil and gas production lagged behind a return of consumer demand coming out of the pandemic. In addition, to measure inflation, the change in price is measured from one year to the next. As prices were exceptionally low at the height of the pandemic, comparing today’s higher prices to those very low levels means differences will seem larger and this is referred to as the “base effect”.

What is the ECB doing?

Date (with effect from)		Deposit facility	Main refinancing operations		Marginal lending facility
			Fixed rate tenders Fixed rate	Variable rate tenders Minimum bid rate	
2022	14 Sep.	0.75	1.25	-	1.50
2022	27 Jul.	0.00	0.50	-	0.75
2019	18 Sep.	−0.50	0.00	-	0.25
2016	16 Mar.	−0.40	0.00	-	0.25
2015	9 Dec.	−0.30	0.05	-	0.30
2014	10 Sep.	−0.20	0.05	-	0.30
	11 Jun.	−0.10	0.15	-	0.40
2013	13 Nov.	0.00	0.25	-	0.75

Figure 4: Source Google

The ECB is trying to make borrowing more expensive, but because monetary policy works with some delay, it can't help against short-lived spikes in prices. For this reason, Governing Council of the ECB is intervening on resetting the key interest rates for the euro area:

- The interest rate on the main refinancing operations (MRO), which provide the bulk of liquidity to the banking system.
- The rate on the deposit facility, which banks may use to make overnight deposits with the Eurosystem.
- The rate on the marginal lending facility, which offers overnight credit to banks from the Eurosystem.

Tips for the investor

Inflation is a natural occurrence in the market economy, however there are many ways to hedge against inflation. A disciplined investor should plan for inflation by investing in asset classes that outperform the market during inflationary climates, but like any strong portfolio, diversification is key. Common anti-inflation assets include:

- **Gold**: It has often been considered an anti-inflation asset; however, it is not a true perfect hedge against inflation. Holding an asset like gold that pays no yields is not as valuable as holding an asset that does, particularly when rates are higher, meaning yields are higher.
- **Commodities**: Commodities and inflation have a unique relationship, where commodities are an indicator of inflation to come but their price is highly volatile.
- **Portfolio allocation**: A 60/40 stock/bond portfolio is considered to be a safe but compared to an all-equity portfolio, a 60/40 portfolio will underperform over the long term.
- **Real estate income**: As inflation rises, so do property values, and so does the amount a landlord can charge for rent. This results in the landlord earning a higher rental income over time and keeps pace with the rise in inflation. On the other hand this asset exposes the investor to considerably higher costs of transactions and liquidity risk.

On the Looming Energy Crisis

By Xiaoyue He

The Current Economic Situation in Europe After the Russian Invasion of Ukraine

The progress of the eurozone economy is gradually slowing down, increasing the likelihood of a recession. GDP data shows that the euro area grew by 0.7% and the EU by 0.6% in the second quarter of 2022 compared to the previous quarter. The most intuitive part of this is reflected in the prices, still on the rise in most countries, driven by the increased disruption in the global energy market due to the Russian invasion of Ukraine. Indeed, European gas prices are ten times higher than the average level in the last ten years, hovering around 200 euros per megawatt, over six times the level one year ago. In addition, even the prices of daily necessities such as fresh fruits and vegetables have been affected. Below are the current annual inflation rates for different commodities from Eurostat. Euro area annual inflation, July 2022, from a country perspective, inflation rates have increased significantly in all European Countries.

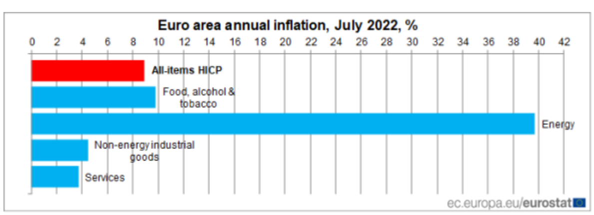

Figure 5: Source Eurostat

Due to their heavy dependence on imports to meet the needs of their industrial production, the Baltic countries have experienced the worst inflation following the energy crisis, such as Estonia, where the inflation rate has reached 25.2%. For dealing with this situation, the Kremlin has clearly intended to retaliate against the Western countries' sanctions by manipulating gas flows. This strong determination has been shown by Putin: "The bottom line is, if you have an urge, if it's so hard for you, just lift the sanctions on Nord Stream 2, which is 55 billion cubic meters of gas per year, just push the button and everything will get going,". He also insisted that Russia will continue to meet its energy obligations and attributed the decline in energy supplies to "the green agenda". The EU is taking action to curb the impact of soaring energy prices on people's lives. There is still a "critical energy situation," which indicates that the peak of inflation has not yet been reached. Furthermore, a more critical situation is shown in the forecast made by TRADING ECONOMICS, where it is proven that the inflation rate will reach 9.4% at the end of September, compared to 9.1% in August.

The Increasing Interest Rates as a Response to Growing Inflation

Central Banks of Sweden, Norway, Canada, South Ko- rea, and Australia have recently increased interest rates to reduce the impact of inflation. At the same time, the U.S. Federal Reserve raised interest rates twice by 0.75 percentage points, achieving the most significant increase since 1994. In this terms it became important dealing with recession: usually defined by economists as two consecutive quarters of negative GDP growth. In the case of the U.S., after nearly 1.6% negative growth in the first quarter and a 0.9% contraction between April and June, it's hard not to worry about a recession in the U.S. In addition to high inflation, what is worrisome is that in August 2022, prices increased by 8.3% from August

2021, according to the monthly inflation rate for goods and services in the United States. As for now, a recession in the United States seems inevitable. By looking at the EU side again the stage is not that different: the European Central Bank (ECB) raised interest rates by three-quarters, which directly lifted the benchmark rate to 0.75 in 19 eurozone countries; it is the first time ECB has raised interest rates since July 2011. Below you can see the current state of inflation in EU countries in August from Eurostat statis- tics, which may give you a deeper understanding of the ECB's urgency to raise interest rates. Eurozone inflation annual rate in August 2022.

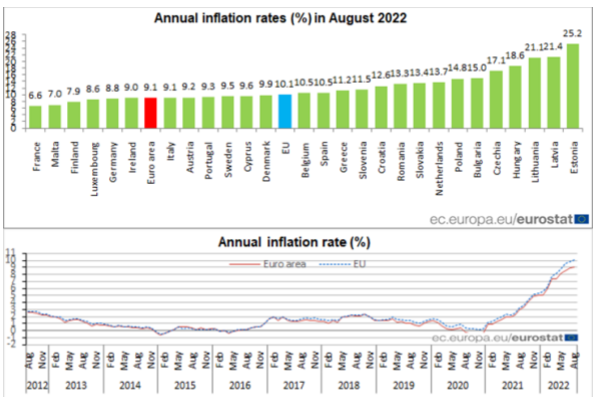

Figure 6: Source Eurostat

Central banks around the world, even in the face of an impending recession, are taking drastic interest rate hikes and other radical measures to maintain social stability on a tightrope. It is worth noting that the EU can also draw inspiration from the status quo after the US interest rate hike to curb hyperinflation. The problems faced by the US today will probably also be faced by the EU tomorrow. But the recent price spikes are mainly from unexpected events like the Russian invasion of Ukraine. Its impact will gradually decline, after which these conditions may be improved. In addition to raising interest rates, the EU has made efforts in other areas. The proposals of the EU energy sector's recent Austerity Conference also included several conservation measures, including introducing "mandatory" ones during peak periods and restrictions on excess revenues for electricity generators using non-chemical fuels. In addition, the EU has announced plans to raise funds from the "abnormally high profits" of energy companies (windfall taxes) which will be used to provide subsidies and relief for people who

cannot afford high bills. Countries have also taken some other measures to reduce energy consumption, such as the Eiffel Tower in Paris, where the lights were switched off from 1 a.m. to 11:45 p.m., and in Milan, where about 50 public fountains were shut down.

King Dollar: the Domination of the USD

By Stefano Dalla Torre

The surge in the US Dollar since mid-2021 is one of the most persistent trends observed in financial markets in recent years. The dollar has been constantly rising in large part because the FED is on track to increase interest rates faster than other major countries.

Figure 7: Dollar vs Euro (Source Google Finance)

The central bank started to lift interest rates in March after keeping them at near zero for much of the pandemic and carried out another big rate increase recently raising rates by 75 basis points. Higher interest rates make the dollar more attractive to investors, since it means they would get a bigger return, therefore investors sell debt denominated in other currencies in favor of the better premiums on US Treasuries. The yield on the two-year Treasury note in fact, which moves with interest rate expectations, recently hit its highest level since 2007, at 3.497 per cent. Russia's invasion of Ukraine has also strained European economies and made natural gas prices skyrocket, making the US economy look healthier in comparison. A stronger dollar is favorable not only for Americans traveling abroad but also companies that pay to import goods from other countries like big-box re- tailers such as Walmart, Target, Home Depot, and Dollar Tree. On the other hand, a soaring dollar can hurt U.S. exporters since it makes goods more expensive to foreign buyers, dampening demand. Between January and May of this year, the top U.S. exports by end-use included crude oil and petroleum products, mostly due to the massive increase in crude prices. Other top exports included pharmaceuticals, industrial machinery, semiconductors, automotive parts and accessories, fuel oil, automobiles, natural gas, and plastic materials, according to Bureau of Economic Analysis (BEA) data. Is this the only drawback?

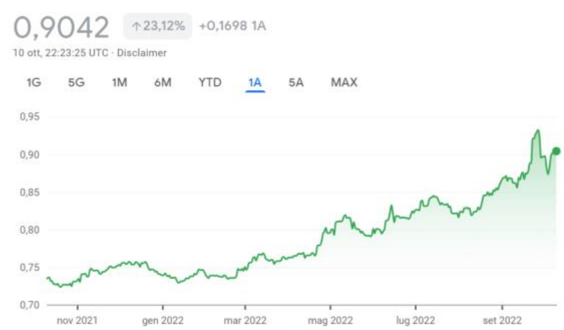

Figure 8: Dollar vs Pound (Source Google Finance)

A strong dollar hurts dramatically also emerging market economies. This is partly because of the flow of capital away from their as- sets into dol- lars, but also because many emerging market countries hold debt denominated in dollars. A stronger dollar means higher debt payments for those countries, which has prompted some investors to predict a wave of defaults. As the US Federal Reserve hikes interest rates, other central banks must raise their own rates to remain competitive and defend their currency. In other words, investors must be given a reason (higher returns) to invest in an EM rather than move their money into less-risky US assets. This presents a conundrum. On one hand, a central bank obviously wants to protect foreign investment in the domestic economy. But, on the other hand, rate hikes increase the cost of domestic borrowing and have a dampening effect on growth as well. In the short term, a strong dollar can also weight on trade. The greenback dominates international transactions. Firms operating in nondollar economies use it to quote and settle trades. Just look at key commodities like oil, which are bought and sold in dollars. In addition, many developing economies are price-takers (their policies and actions don’t impact global markets) and are largely dependent on global trade; a strong dollar can have major impacts on them, domestically, including spiking inflation. As the dollar strengthens imports become expensive (in domestic currency terms), thus forcing firms to reduce their investments or spend more on crucial imports.