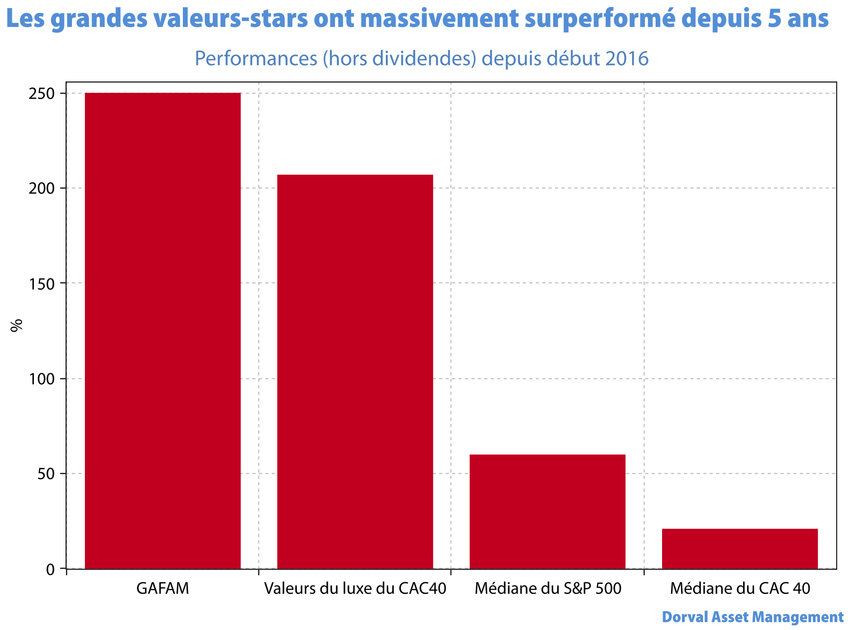
Exposure rates of the Dorval Asset Management Range – 20th November 2020

Dear Clients and Partners,

Stock-market performances have been extremely focused on large iconic so-called growth stocks over recent years, including digital heavyweights in the United States and luxury goods companies in France. However, well may we wonder whether the markets have taken these star stocks' rerating too far: while the other question looming is whether the much-anticipated end to the coronavirus crisis will divert investors' attention away from these investments and send them flocking towards other market segments.

Large star stocks have massively outperformed over past five years
Performances (excl. dividends) since start of 2016



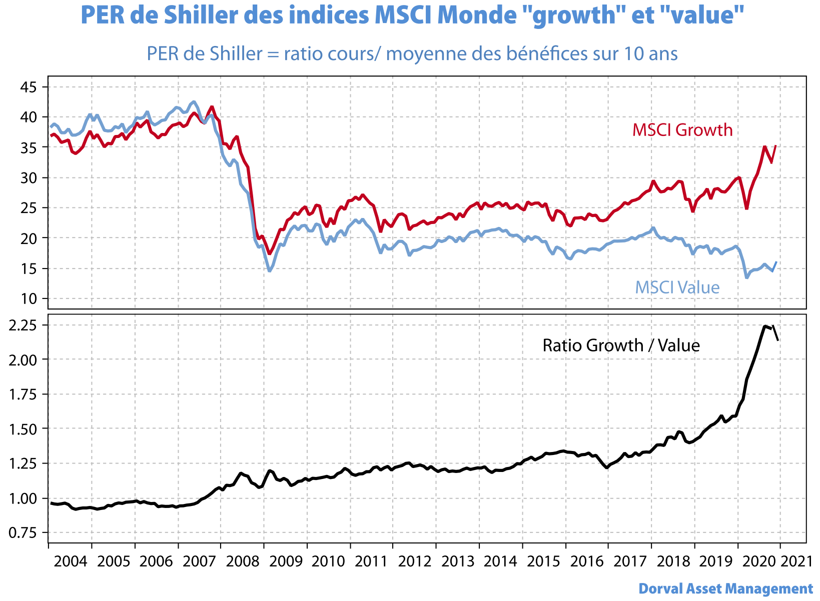
- *GAFAM / Luxury goods stocks on CAC40 / Median on S&P500 / Median on CAC40*

GAFAM stocks have soared on average 250% since the start of 2016 vs. a median gain of 60% for stocks on the S&P 500. Meanwhile on the CAC40, luxury goods stocks have surged on average 207% over the same period vs. a median rise of 21% for the index (cf. chart 1). These star stocks posted winning performances in two ways, with both hefty earnings and stellar stock-market valuations, notching up much higher profitability than other stocks for a variety of reasons, including the development of a digital economy based on near monopolies, as well as the emergence of a huge middle class in China. GAFAM stocks have recorded an annual 15-20% jump in profits over the past ten years, while large French luxury stocks also reported similar gains vs. growth of around 5% each year for more standard companies.

Conversely, at the same time, key sectors such as banks and automotive have suffered from implementation of regulation that severely penalizes their profitability. Furthermore, what some economists refer to as secular stagnation – the trend towards weaker nominal growth in the economy – has pushed investors towards the rare few stocks that were able to hold up amidst this decline. Investors now see these various factors as long-term trends, in turn driving a hefty swell in stock-market valuations, which accelerated swiftly during the Covid-19 crisis.

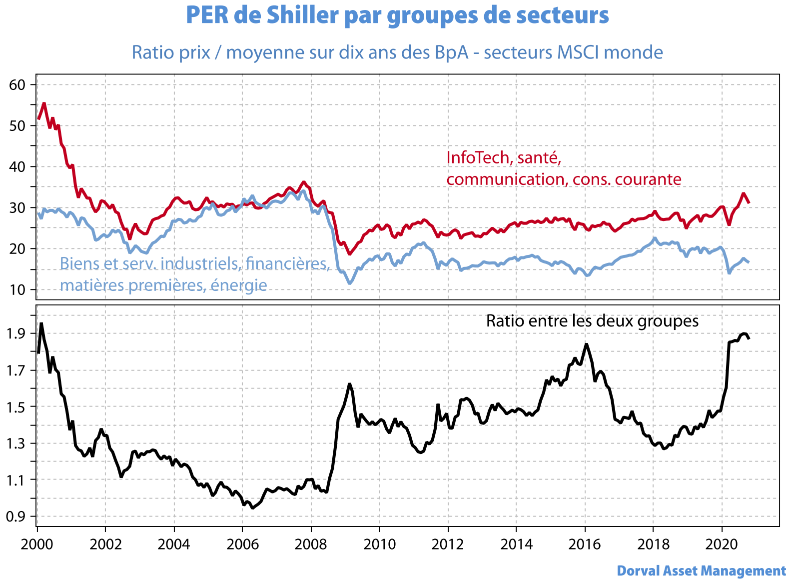
Shiller P/E for MSCI World Growth and Value

Shiller P/E = multiple of share price/average earnings over 10 years



The Shiller P/E for the MSCI World Growth – comprising growth stocks worldwide – comes out at around 35x average earnings for the past ten years (cf. chart 2), which is on a par with figures over 2003-2007 and much lower than the peak witnessed during the bubble in 2000, which is fairly reassuring. However in relative terms, this adjusted P/E of 35x compares with 20x for the world market as a whole and 15x for the value investment universe. We have never seen a differential of this extent in favor of growth stocks, even during the 1999/2000 bubble. Meanwhile, if we take a sector-based approach, we can also see that popular or highly resilient sectors (IT, healthcare, consumer staples) are trading at around twice the level of more cyclical sectors (industrial goods and services, financials and materials) based on the Shiller P/E, which is in line with the record difference witnessed briefly in 2000 (cf. chart 3).

Shiller P/E by sector groups
Multiple of price/average EPS over 10 years – MSCI World sectors



- *Industrial services and goods, financials, materials, energy*
- *Information technology, healthcare, communication services, consumer staples*
- *Ratio between two groups*

In addition to the structural factors already mentioned, the concentration of performances on star stocks was also fueled by cyclical factors that drove investors away from sectors that are more affected by the economic slowdown that kicked off in 2018, along with threats to world trade and of course the Covid-19 crisis. Yet recently announced medical progress – along with state support and monetary stimulus – should help the economy vigorously make up its lag throughout 2021 and 2022.

Earnings growth should become much more prevalent, and this will alter investors' views on sectors that currently carry the steepest discounts, such as industrials and materials, financials, tourism, leisure and transport. We often see a strong outperformance for the most cyclical stocks at the start of an economic recovery, just as we witnessed in 2003/04, 2009/10 and 2017, as they benefit from very buoyant profit growth during the early stages of an upturn.

Against this backdrop, investors are likely to further diversify their portfolios. However, star stocks have taken on a considerable weighting in the main stock-market indices, so this quest for diversification requires a move away from these indices and into more active strategies.

Our exposure rates are as follows:

- **Dorval Convictions**: Our exposure rate is 99%.

DORVAL ASSET MANAGEMENT

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