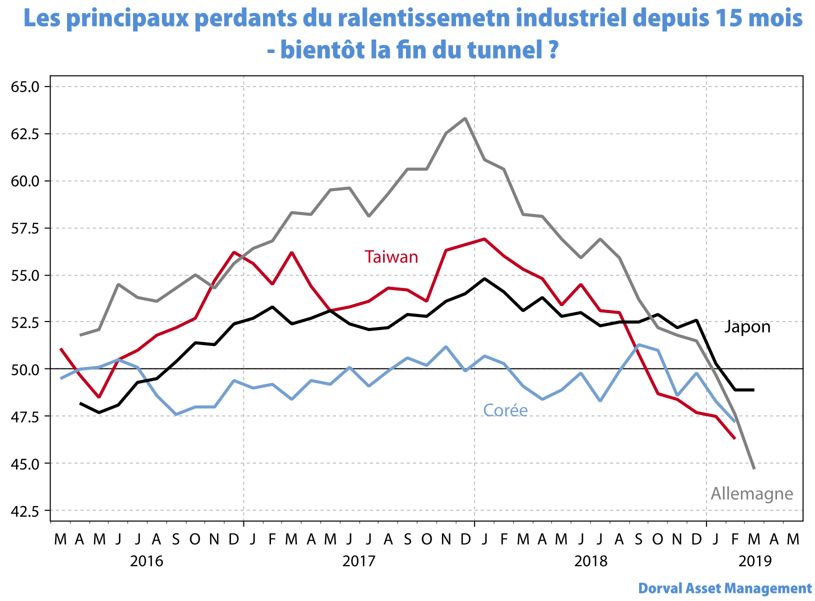
Exposure rates of the Dorval Asset Management Range – 22nd March 2019

Dear Clients and Partners,

US monetary policy is now crystal clear – the Fed will not hike interest rates this year and has adopted an expansionary slant – so the future for the equity markets now hinges more on the cyclical outlook than monetary policy. The latest indications show that the trend seen over the past few months continued in March, with an overall slowdown fuelled primarily by industry.

In this respect, the overall situation shares some features with 2015, when a sharp slowdown in China severely hampered world growth, with a particularly strong impact for certain segments of the economy: at that time, the main collapse was in the commodities sector. The main losers in today's scenario are companies and countries that are most exposed to international trade, as well as those with a reliance on the automotive and semi-conductor sectors. Brazil, Russia and Indonesia fell into recession in 2015, while in 2018 and at the start of 2019, the main victims are Germany, Japan, Korea and Taiwan (cf. chart 1).

Main losers in industry slowdown over past 15 months – is the end of the tunnel in sight?

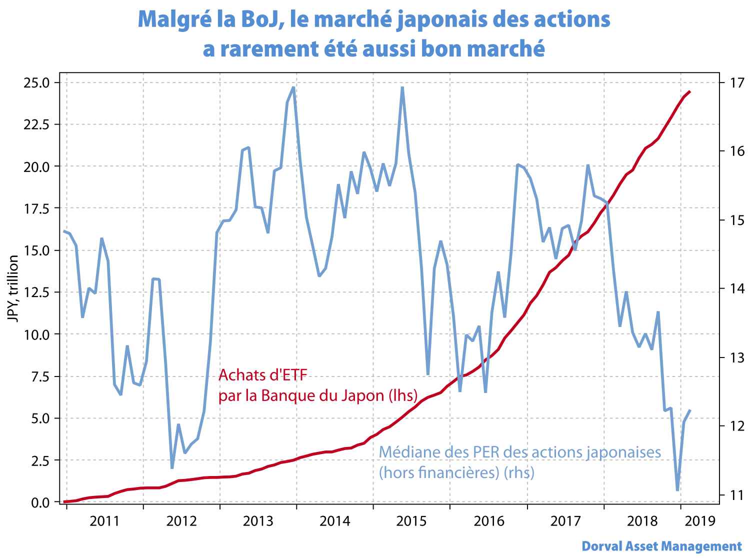


Japan / Taiwan / Korea / Germany

After 15 months of industrial slowdown worldwide, a recovery is expected. China has started to stage an economic recovery, with significant progress made in inventory adjustments in the automotive and semi-conductor sectors. More accommodative monetary policies will also help, as will continued purchasing power gains across most advanced economies. Assuming that the outcomes for the current Brexit negotiations as well as trade talks do not trigger fresh major disruption, the trough in the world industrial cycle should not be too far off.

If this scenario comes off, the most cyclical equity markets are then set to recover sharply, and in this respect, the Japanese market stands out particularly, as it is now by far the cheapest of all developed markets with a median P/E multiple of 12x. The country's undervaluation contradicts the deep-rooted belief that central bank intervention kept equity valuations artificially high: how can Japanese equities be so cheap when the Bank of Japan continues its massive quantitative easing policy and is now one of the ten largest shareholders of 40% of listed Japanese companies (cf. chart 2)?

Despite the BOJ, the Japanese equity market has rarely been so cheap



Bank of Japan's ETF purchases – LHS / Median P/E for Japanese equities (excl. financials) - RHS

One of the main reasons for the record undervaluation for Japanese equities is that this market has a much more extensive range of industrial companies than other countries, so the slowdown in the manufacturing sector and the US-China trade war acted to push valuations down to extreme levels. Japan is admittedly set to increase its VAT rate in October, which is probably dragging down the market, but this cannot explain why large Japanese exporters are trading on only 10x projected earnings. These stocks should enjoy a strong rebound when the world industrial cycle starts to take an upturn, or even before then if the US and China reach an agreement on trade.

Our exposure rates are as follows:

- **Dorval Convictions**: Our exposure rate is 50%.

DORVAL ASSET MANAGEMENT

Public limited company with share capital of €303,025 Paris Trade and Companies Register No. B 391392768 - APE 6630 Z - AMF accreditation no. GP 93-08
Registered office: 1 rue de Gramont - 75002 Paris
Tel +33 1 44 69 90 44 - Fax +33 1 42 94 18 37
www.dorval-am.com