DORVAL ASSET MANAGEMENT
FLEXIBLE PAR CONVICTION

Macroeconomic Press Release – 12 June 2018

How to reconcile the dynamism of companies and questions about the cycle

Prosperous companies and a healthy market

As a form of economic prosperity settles in, a majority of listed companies are capable of generating double digit profit growth. In the euro zone, the median lies at +12% earnings per share growth over the past 12 months. Furthermore, the excessive optimism noted at the beginning of the year – which had led Dorval Asset Management to great prudence in its asset allocation – has given way to **a normalization of market sentiment** and to the reconstruction of risk premium, which is somewhat healthy.

Stock market gains, however, are limited by the maturity of the cycle

Specific factors could, however, continue to limit the stock market gains. First, valuations remain high, with a median PER (price / projected earnings ratio) of nearly 17x on non-financial stocks within European markets. This level is admittedly less extreme than that seen at the end of the 90s, but it is as high as in 2006-2007. **Given that we are further along in the cycle, an increase in the PER does not seem justified.**

In addition, the exceptional fundamentals favoring equities will be difficult to improve, which gives less velocity to the markets. Brakes will start to appear, in particular in the form of a **partial normalization of monetary policies**. The central bankers will admittedly show caution, dreading to produce an economic slowdown which could bring to waste the gains made in their fierce struggle against deflation. Be that as it may, the American Federal Reserve has already put an end to its expansionist policy, and the ECB prepares to announce an extinction of its bond-buying program from September 2018, before the first increase in rates often anticipated for 2019. These adjustments forcibly lead to questions about the remaining length of the cycle, as shown by investors' consideration about developments among wage and price inflation numbers.

Political noise could take some time to dissipate

Dorval Asset Management considers the political risk premium that surfaced this year as opportunities for investors, even if those risks could take some time to dissipate. The establishment of an improbable political government in Italy has given rise to fears of a confrontation with the euro zone institutions. **We think that Italy has a little room to maneuver to sustain its internal demand, as did Portugal**, but it will need to avoid a big downgrade of its rating. The main risk is that a sustainable pressure of the Italian bond markets must be necessary to assuage the projects of the government coalition. Lastly, Donald Trump's activism on all commercial and geopolitical fronts will be harder to cool down before the November mid-term elections. A « Trump risk premium » is, therefore, going to persist, even if calling the trend in globalization into question – from which « Corporate America » has so much benefitted - lacks credibility.

Emerging market vulnerability to persist? Not so sure.

Certain emerging countries such as Argentina and Turkey have seen their currencies dive in the first half of 2018, stirring fears of a domino effect on the entire zone. **The recent weakness in emerging markets is often explained by their vulnerability to increasing US interest rates, in a context of excessive indebtedness. This is not our analysis**. If we exclude China, whose debt does not pass through the international financial system, emerging market debt has only moderately increased over time, reflecting a progressive and normal financialization of the economy. Moreover, the increase in US interest rates does not inevitably drag down the emerging currencies, as the counter-examples of 2017 and 2004-2006 have demonstrated. Furthermore, **the great adjustment of most emerging economies already took place between 2011 and 2016, making them less vulnerable today**.

Foreign exchange and oil price, dispersion factors of profits

Among the principal dispersion factors of company results, **the foreign exchange and price (commodities) effects could moderate in the second half** due to base effects. Also, it seems that OPEC and Russia are as of now satisfied with the current price of the barrel, which should lead to price stabilization. As for the Euro, it is under conflicting pressures, between a world economic prosperity which is somewhat unfavorable to the dollar (the dollar indeed is a safe haven), and the political risks in Italy as well as an interest rate differential with the United States which weighs on the Euro.

Moderate optimism on the market, flexibility and diversification honored

We think that **the overall diagnostic justifies a moderately positive attitude and a flexible and diversified approach to equity markets.** They are still underpinned by excellent fundamentals, and by the low probability, in the short term, of an end of cycle scenario. Company results are good and should remain so. Moreover, political risks also create opportunities.

Flexibility continues, nevertheless, to prevail because the period remains conducive to potential violent market movements. The exposure rate to equities of our flexible European fund (Dorval Convictions) should continue to evolve in a range of 40-60% most of the time. As for diversification, it continues to produce positive effects in the risk management, as indicated by the ongoing fall in correlation between markets, sectors and companies.

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Themes anchored in a promising economic cycle

Our European and international themes remain anchored to the promising world cycle, with **an always weak weight given to the defensive sectors vulnerable to interest rate increases**. In our international fund (Dorval Global Convictions) we capture the American domestic market, Europe, and Japan, and remain invested in emerging market shares and bonds, as well as in the bonds of the euro zone periphery. **The digitization of the economy theme remains key**, in particular in our European stock-picking.

About Dorval Asset Management

Dorval Asset Management: Flexibility with conviction

Dorval Asset Management is a management company recognised in the areas of flexible wealth management strategies and stock-picking in European equities. These strategies aim to safely navigate stock market cycles and to perform in the long term. Approved by the French Financial Markets Authority (AMF) since 1993, 50.1% of its capital is held by Ostrum Asset Management and 49.9% by its employees. Dorval Asset Management implements conviction-based wealth management, characterised by active management removed from indices.
With the conviction that a flexible approach is needed to provide high-quality management for its clients in the current market environment, the management team offers flexible wealth management, reflecting its corporate DNA. Dorval Asset Management offers a range of seven complementary funds: a European equities range made up of Dorval Manageurs, Dorval Manageurs Europe, and Dorval Manageurs Small Cap Euro, and a flexible range made up of Dorval Convictions, Dorval Convictions PEA, Dorval Global Convictions, and Dorval Emerging Market Convictions. Thanks to its partnership Dorval Asset Management's products and services are marketed by Natixis Investment Managers international distribution platform and the BPCE Group's French banking networks. Dorval Asset Management had 3 billion in assets under management at 31 May 2018.

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1 Cerulli Quantitative Update: Global Markets 2017 ranked Natixis Investment Managers (formerly Natixis Global Asset Management) as the 15th largest asset manager in the world based on assets under management as of December 31, 2016.

2 Net asset value as of September 30, 2017

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