Macroeconomy press release – June 23, 2020

Recovery first and foremost

The world economy is now picking up after being forced into an induced coma mid-way through the first half of the year. Moves to reopen the economy are already driving a clear upturn, but a number of uncertainties still remain on the outcome for our ailing patient and warrant some shock treatment. The world economy has every chance of recovering over the quarters ahead, as it is powerfully shored up by income guarantees from steadfast central banks, along with massive fiscal stimulus programs. This recovery momentum now sets the foundations for Dorval Asset Management's current portfolio organization.

Part of recovery momentum profile will hinge on developments in virus

The pace, extent and profile of the recovery will of course be fashioned by developments in the Covid-19 pandemic, as well as by progress on medical aspects i.e. vaccines, treatments, and care protocols. The virus is still circulating, as shown by the re-emergence of clusters in some parts of the world, so the scenario of a second surge in the epidemic in the fall cannot be ruled out. This would obviously be bad news on a short-term basis, but all evidence points to a much smaller economic effect than the impacts we witnessed in the first half of the year: populations worldwide are now familiar with the virus, and logistical readiness is a far cry from the situation at the start of the year; on the medical front, a number of vaccines will already be in the advanced stages of phase III trials; lastly, economic, social and even health risks resulting from lockdown point to the need for a much less disruptive approach, and any potential second wave is unlikely to lead to the systematic closure of production facilities and building sites for example.

Economic reopening and stimulus plans point to strong recovery

Regardless of whether a second surge in the virus emerges, the public debate is already dominated by talk of recovery and making up for up lost ground in the economic arena. Economic projections from various bodies – OECD, ECB, Fed, etc. – are all obviously characterized by an extremely high degree of uncertainty, yet they do concur on two key aspects: firstly, the worst of the economic fallout of the Covid-19 crisis is behind us, and secondly the shock from the outbreak can only be reversed by sustained, effective and massive public action. This process is ongoing, even in Europe despite initial doubts surrounding the euro area institutions' flaws. So on the back of these factors, and with the economy now opening up again, countries may catch up more quickly than current – naturally cautious – projections anticipate (by way of example, the OECD only expects world GDP to revisit 4Q 2019 levels in 2022). May's sharp uptick in US retail sales corroborates this, with a 17.7% jump vs. April. Lastly, the mobilization of budgets in Europe and elsewhere to promote more environmentally sustainable growth could also set the stage for fresh investment prospects over the medium and long term.

Risks from politicization of the crisis

Looking beyond Covid-19 itself, other sources of uncertainty and risk include the consequences of the sharp surge in public and private debt, inflationary risks or conversely unemployment dragging on. However, it is still too early to come up with answers to these complex questions, and jump-starting the economy remains the priority for now. Yet risks could also emerge from the excessive politicization of the crisis, as reflected by renewed US-China tension, and the reticence to stand together in a joint approach in Europe. The highly tense US election campaign is paving the way for this type of risk, while in Europe, the outcome of negotiations on the future EU-UK relationship is also hazy, although a compromise looks likely by end-October.

Equity markets have already made a steady rebound, but the cycle is buoyant

The equity markets' strong rebound raises questions over a possible disconnection between the markets and the economy: this is a legitimate question in some cases, but Dorval Asset Management does not hold with the latest theory of the moment that investors have become complacent on the economic outlook. Worldwide equity prices do not seem significantly disjointed from projected GDP trends, while stocks and sectors that are most exposed to the economic and financial shock have fallen back considerably. In the euro area, a third of listed companies are still down more than 25% YTD, and this figure is 40% for small caps as at June 15, 2020. Lastly, strong showings from indices – including but not restricted to the S&P500 – were largely a result of a flattering sector breakdown. The four winning sectors, or those that held up well in the crisis – IT, healthcare, everyday consumer products and utilities – account for 47% of the worldwide market capitalization as represented by the MSCI World. Meanwhile, if we add in communication services heavyweights (including Google and Facebook), this figure comes out above 50%, but these sectors have suffered virtually no drop in their 2021 EPS.

Valuation dispersion raises fundamental questions for asset allocation

However, in light of this observation, portfolio managers are considering one of the risks that Dorval Asset Management had already singled out at the start of the year, i.e. excessive enthusiasm for some new economy stocks, or even growth stocks in general. Interest rates, earnings momentum and structural changes – including the digitalization of the economy and momentum for the new Asian middle class – can no doubt account for some of the reratings notched up. Additionally, multiples on growth stocks are not yet comparable to figures during the 1998/2000 bubble, but the now record gap to the rest of the market is becoming uncomfortable, and the speed at which some stocks are gaining value can sometimes sow the seeds of doubt.

Maintain structural themes, but bolster weighting of cyclicals

Our portfolio managers here at Dorval Asset Management do not think that this observation should prompt investors to leap lock, stock and barrel into a purely value investment style, and they continue to invest in buoyant themes related to the new economy and its extension. However, in view of the prospects of catch-up momentum for the world economy and stimulus programs, they direct a hefty portion of investments towards the most cyclical sectors. Construction and industry feature well in their portfolios, and particularly stocks that benefit from the energy transition. Tactical opportunities also sometimes emerge in the financial sector, while some strategic openings are appearing among stocks that are hardest hit by the tourism crisis. Lastly, after the investor exodus from European small- and mid-caps since 2018, we now seem to be embarking on a new chapter. They believe that the risk premium that emerged on this asset class over these past two years could narrow on the back of the economic recovery – this recovery is thus their primary theme.

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About Dorval Asset Management

Dorval Asset Management: Flexibility with conviction

Dorval Asset Management is a management company recognized 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, 11.3% of its capital is held by Natixis Investment Managers and 88.7% by its employees. Dorval Asset Management implements conviction-based wealth management, characterized 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 ten complementary funds: a European equities range made up of Dorval Manageurs, Dorval Manageurs Europe, Dorval Manageurs Euro and Dorval Manageurs Small Cap Euro, Dorval Manageurs Smid Cap Euro and a flexible range made up of Dorval Convictions, Dorval Convictions PEA, Dorval Global Convictions, Dorval Global Convictions Patrimoine, 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 close to 1.6 billion in assets under management as at 31 December 2019.

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1 Cerulli Quantitative Update: Global Markets 2019 ranked Natixis Investment Managers as the 17th largest asset manager in the world based on assets under management as of December 31, 2018.
2 Net asset value as of September 30, 2019 is $1.004 billion. Assets under management ("AUM"), as reported, may include notional assets, assets serviced, gross assets, assets of minority-owned affiliated entities and other types of non-regulatory AUM managed or serviced by firms affiliated with Natixis Investment Managers.

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