

## Focus

### Towards a normalisation of market environment?

February 9<sup>th</sup>, 2018

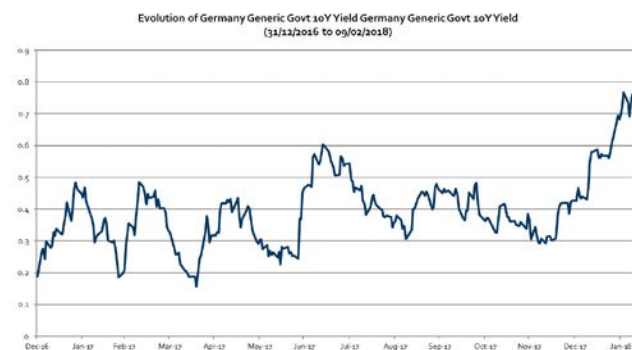
In our last quarterly report, we expressed our belief that, sooner or later, volatility should rebound and that, as economic growth was confirmed, central banks should progressively phase out of their quantitative easing programs.

What we did not anticipate, as indeed the majority of market participants, was that, in the US market, the pendulum swing will be so quick and with such amplitude.

#### A more technical than fundamental correction

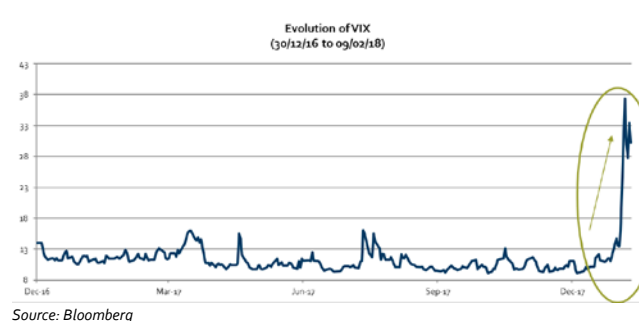
After a (too) euphoric start of the year, the US stock market literally collapsed, the S&P500 losing more than 10% between January 26<sup>th</sup> and February 6<sup>th</sup>. European equity markets, through a contagion effect, followed the trend albeit to a lesser extent.

The correction stems from fears of an overheated US economy (stimulated by a new tax reform and an expected increase in public spending), the spectre of inflation (illustrated by the strong salary growth in the US) and how the new Chairman of the Fed, Jerome Powell, will manage to gradually exit of a prolonged period of very low interest rates. And indeed we are witnessing a rise in interest rates which is reflected on the 10 years Treasury yield which went from 2.4% at the beginning of the year to 2.8%. the same trend is also observed in Europe with a rise in yields on the 10 years German Government Bonds.



<sup>1</sup> Source : ECP, Bloomberg, Net of fees performance of ECP Flagship European Value A EUR share class. Note that past performance is no guarantee of future returns.

This market downturn was largely amplified by technical factors, linked to the many investment strategies put in place to take advantage of this low volatility environment. As a result, investors were forced to buy back large short positions on the volatility index (VIX)



#### Which impact on our investment strategies?

Our **“Core”** strategy has been affected by this correction but has managed to slightly outperform the market (-4.84% vs. 5.45 for the MSCI Europe Net Return from 31/01/2018 to 08/02/2018 and -1.59% vs. -2.12% from 05/08/2018 to 08/08/2018)<sup>1</sup>.

Our proprietary hedging model having detected an increase in volatility, the net exposure to equity risk of our **hedged portfolio** has been reduced to 22.9% on February 5<sup>th</sup> which enabled our hedged strategy to reduce the losses.

Hence, it has returned -1.27% since the beginning of the month and has even generated a slightly positive performance (+0.17%) since the beginning of the week<sup>2</sup>.

<sup>2</sup> Source : ECP, Bloomberg, Net of fees performance of ECP Flagship European Value Hedged A EUR share class. Note that past performance is no guarantee of future returns.



## And now?

Fundamentally, the market environment remains unchanged.

Global economic growth is solid even if the US are probably more advanced in the cycle.

In Europe, valuation are still reasonable and earnings season is expected to be positive.

**What is happening, both in terms of interest rates and volatility, is ultimately only the logical consequence of a normalisation of the market environment following a pick-up of growth after many lean years. Keeping interest rates so low is no longer justified!**

We are confident in the capacity of the central banks to operate smoothly this transition in order not to put growth at risk.

We also believe that **investors will have to adapt to a more volatile market environment**; those not wishing to assume those risks will thus have to redirect their assets to more conservative strategies able to reduce volatility and downside risk.

**In terms of portfolio positioning**, the current market environment offers a multitude of opportunities for stock pickers like us but it also has dangers. We seek to invest in companies combining the following characteristics: stable business, low balance sheet risk and low valuation. However, it is now difficult to identify undervalued quality companies.

This is reflected in our portfolio by the gradual reduction of cyclical companies that have appreciated significantly in the recent months and are now offering little upside potential in view of the high risk of profit taking in the event of disappointing results.

We reinvest the proceed in out of favor companies such as G4S, Ontex, Kier Group or Mc Carthy and Stone.