Is the comeback of Value Investing made to last ?

By Léon KIRCH, CEO, European Capital Partners

Equity Management is divided into two main styles whose merits are often confronted: the Value style focuses on the company's intrinsic value as well as on its capacity to generate earnings with its current production capacity. At the opposite, the Growth style centres its attention on the future development opportunities of companies. Over time, these two styles of investment have alternatively competed for the favours of investors.

Mark Twain one's famously said: "**History doesn't repeat itself, but it does rhyme**". As long-term investors, we have the luxury to take a step back and analyse the current market conditions in an historical view. This is, from our point of view, a key strength as it helps us to gain perspective and make sure our portfolios are positioned for the long-term.

Historically, investment styles have moved in long cycles. After a prolonged period of underperformance, we have since last summer perceived some interesting signs pointing towards a return in favour of Value Investing.

To us, it is tempting to analyse the history and latest value/growth cycle in order **to assess if we are currently experiencing a strong long-term trend reversal** leading to a consistent outperformance of Value investment strategies vs. Growth **or if it is just a short-term relief for Value investors**.

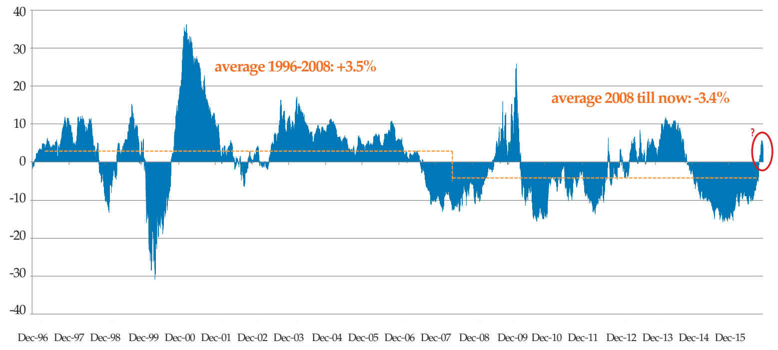
The last Value cycle began in March 2000 right after the bursting of the Tech bubble. In 1998, the financial markets entered into a period of economic uncertainty with the Asian crisis and the collapse of LTCM. As a consequence, investors rushed into perceived quality and growth stocks, mainly in Technology and momentum stocks.

In 2000, macro conditions were stabilised while valuations of those glamour stocks were unduly inflated leading to the burst of this Tech Bubble. This marked a renewed interest from investors for companies' fundamentals and valuations. This return in favour of the Value investment style lasted until 2007.

Then came 2008 where we faced what was probably the biggest financial crisis since WWII with a lot of collateral damage not only in the banking sector but also in the real economy. After initial paralysis, European Equity markets troughed in March 2009 and went for a formidable rebound more than doubling as of today. As it happened during the previous cycle, investors rushed first into perceived quality and growth.

This difficult time for Value investing is mainly explained by the current low rate environment resulting from the massive injection of liquidity by Central Banks. As an example, the rate of the German 10 Y Government Bond has passed from +3% in 2009 to negative levels at the end of the third quarter of 2016. Thus, in a rather gloomy economic environment, investors have embarked on an insatiable quest for yield and chased companies with predictable earnings growth at nearly any price. That increased valuations of some of these companies to record levels. These perceived safe haven assets could mainly be found in Large Caps, for example Mega Cap Consumer and Growth stocks appearing to offer a certain stability of earnings in uncertain times. A prominent illustration of this trend in the US was the huge stock market success of the so-called FANG companies (Facebook, Amazon, Netflix and Google).

Performance difference between MSCI Europe Value and MSCI Europe Growth on a 12 year rolling period (27/12/1995 30/11/2016)



At European Capital Partners (ECP), We remained faithful to our convictions and are convinced that even if, on a medium-term basis, interest rates will remain low, the Value style should regain its prestige: investors cannot indefinitely ignore the importance of valuations.

2016 could be seen as a turning point: the first months of the year have shown signs of a trend reversal. And despite a short-term slowdown of the process due to the Brexit turbulences, the trend has turned again more favourable to value companies. Hence, over the summer, investors have, for the first time since the Financial crisis of 2008, moved back into value stocks on a bigger scale. This shift is evidenced by the fact that, since end September 2016, the MSCI Europe Value outperformed the MSCI Europe Growth by more than 10%.

This move appears to us a very logical reaction as valuations in some of these quality names are not fully justified by their fundamentals while the macroeconomic environment is progressively stabilising. In this context, value names appear to offer a better risk-reward profile.

So you will certainly ask: **could this not be again a false dawn for value investors?** We do not think so for the very simple reason that to us, **valuations are the same to markets than the law of gravity to physics**. Great companies are not necessarily great investments if the price paid by the investors is too high. Finish with a quote, this time from Warren Buffet: "Only when the tide goes out, do you discover who's been swimming naked".

At the end of the day, it is the price you pay for the earnings you get that matters most in investing. From that perspective, we would need to see an earnings recovery in Europe in order to fully confirm this Value trend. Our view is that, despite all the current political noise (Brexit, Italy, France elections, etc.), there are reassuring factors, like as illustration industrial production data, which are showing that European corporates are on a "rocky" road towards earnings recovery while the ECB continues its accommodative policy.

Thanks to a disciplined investment approach which puts valuations and fundamentals at the forefront of the analysis process, value investors have been able to generate over time superior returns at lower risks since Benjamin Graham, the father of value investing has built the concepts at the beginning of the 30's.

ECP is committed to capitalizing on this long-term legacy: by remaining focused on the undervalued earnings capacity regardless of fads and maintaining our long-term investment horizon, we avoid us falter and stay the course towards a strong long-term consistent performance based on the quality of fundamentals and intrinsic value of the companies we invest in.

Agri call ?

By Stéphane SOUSSAN, Senior Thematic Equities Portfolio Manager, CPR AM

The market environment for agriculture equities has been influenced by relatively strong grain productions over the last three years. November is usually the end of the harvesting period in the USA. Corn and soybean production should reach record level, up 12% and 11% respectively in 2016 compared to last year. In Brazil, planting is progressing well and soybean and corn production could increase by 6% and 25% in 2017 compared to 2016. In this environment grain prices have been under pressure.

We break down the agriculture value chain into six segments: Agricultural Products (grain, sugar producers for instance), Fertilizers, Agrichemicals (seeds and crop protection), Farm Machinery, Agricultural Services (infrastructure, trading, processing of agricultural products) and Livestock.

Agricultural Products are of course sensitive to soft commodity prices, but Farm Machinery, Fertilizers and Agrichemicals are also sensitive to soft commodity prices as demand for those

segments will be impacted by farmers' profitability. Agricultural Services are mainly sensitive to volumes and need good harvests to achieve a high utilization rate for their infrastructure and processing assets. Livestock is inversely correlated to grain prices as lower grain prices mean lower feed-costs and higher margins.

Therefore, in the current environment of strong grain production and pressure on grain prices, Agricultural Services and Livestock should fare better than the other segments. These two segments represent 50% of the Amundi Funds Global Agriculture portfolio.

As regards the other segments of the agriculture value chain, some positive news could emerge in 12-18 months, whatever the trend in soft commodity prices. After three years of decline, the farm machinery market should be down again in 2017 but marginally. We may therefore be close to the trough of this market. The fertilizer market has also been negatively impacted by significant capacity increase over the last few years.

However, capacity additions should be limited from 2018 for urea and from 2019 for potash. Finally, the concentration of the agrichemical market could support this segment. The merger between Dow Chemical and Dupont, the acquisition of Monsanto by Bayer and of Syngenta by Chemchina have not yet been approved by antitrust authorities but could translate into material cost and revenue synergies.

Looking beyond the next 12-18 months, the long term investment case for agriculture equities is based on a structural imbalance between supply and demand. Demand will be supported by population growth and the impact of rising income on eating habits, especially in emerging markets. Indeed, meat (and more broadly animal protein) consumption has been growing in emerging markets.

This trend has a multiplying effect on grain consumption as 7kg of grains are needed to produce 1 kg of beef for instance. While demand will rise, there are constraints on supply as arable land growth has been lower than population growth. Urbanization, soil degradation, water stress and climate change are constraining arable land growth.

Massive investments will be needed to help supply meet demand by adding new arable land and associated infrastructures and by optimizing land yield thanks to rationalization and mechanization of farms, progress on seed and crop protection technologies, development of precision farming. These massive investments should support growth for the agriculture sector and agriculture equities.

MiFID II au premier rang des transformations réglementaires à anticiper

Selon la nouvelle enquête publiée en novembre par State Street Corporation (NYSE : STT), près des trois quarts (73%) des gérants d'actifs se disent préoccupés par les difficultés que soulève MiFID II. L'enquête, menée auprès de 100 gérants d'actifs et gérants alternatifs dans le monde, évalue leur degré de préparation à l'entrée en vigueur de la réglementation MiFID II en janvier 2018.

Conçue pour accroître la protection des investisseurs, la réglementation prévoit de nouvelles exigences en matière de communication sur les coûts et les frais, de nouvelles conditions pour la conception et la distribution d'instruments financiers, ainsi que des contraintes de transparence pré- et post-trade pour différents types d'actifs : actions, titres apparentés et autres titres. L'enquête révèle que plus de la moitié (59%) de l'ensemble des participants et plus des trois quarts (77%) des gérants de hedge funds estiment que la transparence des transactions pré/post-trade pour les instruments concernés aura de fortes répercussions sur leur entreprise.

«L'industrie est en train de s'adapter à un environnement plus strictement régulé» déclare Sven Kasper, directeur EMEA des Affaires réglementaires, publiques et gouvernementales chez State Street. «Tous les intervenants sur le marché doivent, plus que jamais, comprendre les mesures proposées et rester suffisamment souples pour maîtriser les changements affectant la liquidité du marché».

Concernant l'impact des conditions de transparence et de reporting post-trade exigées par MiFID II, Kim Newell-Chebator, directrice EMEA de State Street Global Markets, commente : «Le niveau de reporting exigé représente un engagement majeur en termes de données et les outils qui facilitent cette tâche suscitent un intérêt croissant chez nos clients. MifID II accompagne également une transition vers les plateformes électroniques. Si cette évolution est bienvenue à l'heure de la modernisation des échanges boursiers, les plateformes de négociation devront s'assurer qu'elles disposent de protections et de systèmes efficaces pour demeurer conformes et sous contrôle».

Commentant l'impact de MiFID II sur les fonds indiciels cotés, Rory Tobin, co-directeur mondial des ETF SPDR® (branche de State Street Global Advisors), ajoute : «La transparence accrue qu'exige MiFID II sur les transactions ETF et la liquidité sous-jacente contribuera vraisemblablement à renforcer la confiance des investisseurs, et par conséquent l'engouement pour ces produits. A ce titre, c'est un développement positif».

Les réglementations comme MiFID II—bien que cette dernière ne soit attendue que pour 2018—affectent déjà les entreprises. 78% des participants à l'enquête indiquent une augmentation du temps consacré aux discussions réglementaires avec la direction et les conseils d'administration. L'enquête révèle un besoin de conseils de qualité chez la plupart des participants : 76% d'entre eux notent que des démarches éducatives aideraient à préparer leur entreprise à mettre en œuvre les changements nécessaires. L'enquête montre également que près de 60% des participants estiment que de meilleurs outils de traitement et d'analyse des données les aideraient à surmonter les difficultés liées à la mise en œuvre des évolutions réglementaires dans un environnement de plus en plus complexe.

Pour aider les investisseurs dans ce contexte réglementaire difficile, State Street a développé une gamme de produits et de solutions dans l'ensemble de l'organisation, que vous pouvez découvrir sur le lien suivant : http://www.statestreet.com/ideas/articles/regulations-to-be-ready-for.html