Friday Morning Coffee

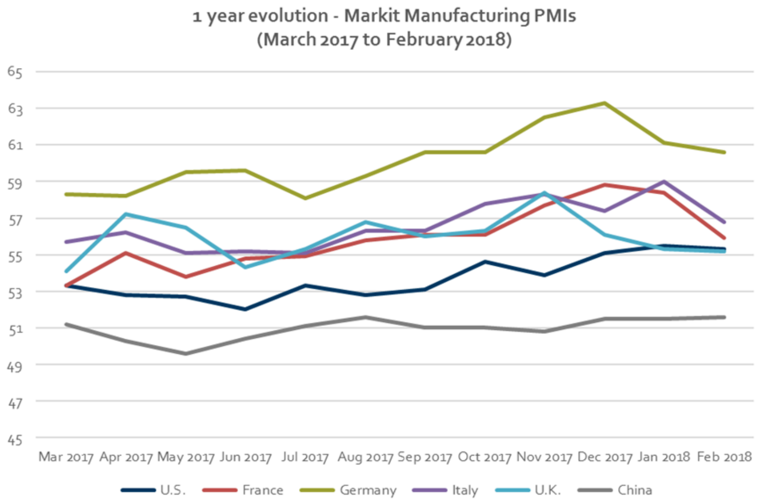
Nr. 1 — *The Calm Before The Storm?*

In our last publications, I have repeatedly expressed my positive view on European equities on the basis of increased economic activity, growing earnings and reasonable valuations compared to their own history and the US.

At the beginning of February, we then experienced some profit taking in European equities in sympathy to Wall Street. US investors were concerned about central banks taking away the punch bowl of ultra-easy monetary policies quicker than expected. As a consequence, volatility spiked from unusually low levels before the market recovered half of its losses during the remainder of the month.

Is this the calm before the storm?

It is hard to deny that there are some clouds on the horizon in Europe that start to take their toll on the buoyant and improving business climate that has been prevailing since beginning 2017. European PMI's, while still above 50 so showing economic expansion, have been declining from record levels this year.



Source: Bloomberg

The main culprits of why the climate is now deteriorating are easy to identify: on the one hand the weak USD and the protectionist sabre rattling by Trump could take their toll on European exporting companies and secondly the overall political climate in Europe remains fragile as shown by the recent Italian elections and the difficulty to make real progress in the Brexit negotiations.

The following note gives the opinion of the Investment team at the time of the publication. Please refer to important notice at the end of the document.

At the company level, we are now in the midst of the earnings season which appears to be positive. Hence, the companies in our portfolio have not disappointed us not only in terms of results but also in terms of management's guidance. Some of our holdings even came out with outstanding numbers.

For example, *Elekta*, the Swedish radiation therapy provider, improved its profitability thanks to adequate efficiency measures and benefits from a growing order book while the launch of its new product combining imaging and radiation is finally on track. Similarly, *Rolls Royce* has successfully implemented a cost cutting program and should be able to generate healthy cash flows going forward. For us, these 2 examples are anecdotal evidence that European companies are still delivering the goods investors have been expecting.

2017 was the first year for a long time where analysts did not need to revise expected earnings growth for the year downwards month after month to finish in negative territory. Despite the short-term turbulences, we are currently not seeing any concrete evidence on why the earnings of European corporates would start to shrink again in 2018.

While we certainly expect volatility increasing compared to the low levels of the recent past, we are convinced that the engine of European equities, i.e. the profits, are far from broken.

We brace for more waves on the sea but not for a full-fledged storm.

More than ever, the main line of defense in such an environment should be the implementation of a consistent investment approach focusing on earnings capacity that invests into solid franchises with strong balance sheets and of course at the low valuations we expect as value investors.

Have a great weekend,

Léon Kirch, CFA
Partner & Chief Investment Officer