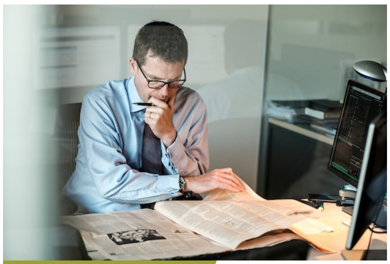


European Capital Partners

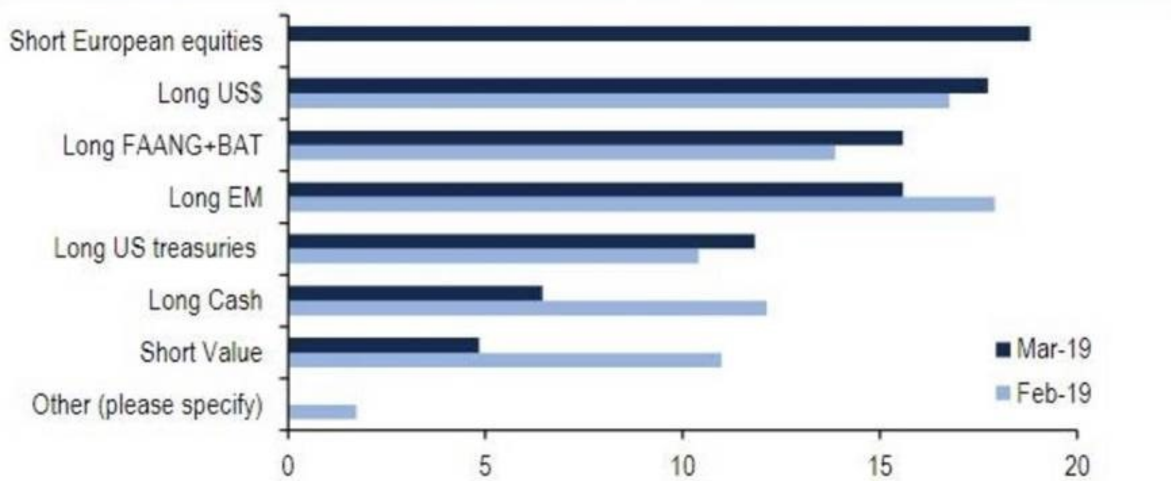
Friday Morning Coffee

Nr. 50 — The most crowded trade

BofA Merrill Lynch conducts on a monthly basis a Fund Manager survey where they poll the largest fund managers on their current portfolio positioning and beliefs. The survey currently comprises the views of 186 participants managing 557 bn USD in assets. We believe this analysis gives us quite a good understanding of the current sentiment amongst institutional investors.

The March outcome of the poll caught our interest as it carried both good and the bad news for us as value investors into European equities. Let's start with the good news: the "short value" trade is finally getting less popular amongst investors. In our opinion, this can be seen as an early indication that one of our main convictions as a Firm, namely that value will make a return as an investment style, is finally starting to unfold. **The idea that made the success of momentum strategies, namely that valuations do not matter in the long run and that growth companies can be bought at any price even in a low interest rate world, is finally being put into question by investors.** A closer look at the exhibit below however tells us also that the long Facebook, Amazon, Apple, Netflix, Google (FAANG) and Baidu, Alibaba, Tencent (BAT) trade is still the third most popular trade and its popularity has even been growing amongst investors since February. So value is being shorted less but the technology champions are even bought more. For the record, according to Bloomberg, Amazon currently trades at 65 times this year's estimated earnings !

Exhibit 26: What do you think is currently the most crowded trade?



Source: BofA Merrill Lynch Global Fund Manager Survey

Now comes the worrying part of the survey. In March, Wall Street traders saw a new "most crowded trade", one which had never appeared previously in the survey: namely Short European Equities. From an international perspective, it is clear European equities do not have a lot speaking in their favor for the moment. **The political noise level remains particularly high with the Brexit drama unfolding, Italy and France remaining politically uncertain and an important European election coming up.**

At the same time, the business activity has been slowing noticeably as shown with the falling PMI's over the last 12 months. The ECB is slowing their efforts to progressively withdraw the exceptional measures of quantitative easing the central bank put in place after the financial crisis to kickstart the European economies and preserve the common currency during the Eurocrisis. The German 10 year yield is now in negative territory and the ECB deposit rate has been negative since June 2014 eating into the profit margin of an already weakened banking sector.

The good news here is that this negative view appears already baked into the expectations of the investors. With such low expectations and many investors shorting the Eurozone, it does not take much to move the needle to the positive side. As we have stressed before, valuations are low and companies continue to grow their earnings in Europe despite the headwinds. I also think we need to take account the fact that the export driven European economies will certainly get a boost once global trade improves. There are early indications for this to happen : the China PMI composite New export Orders for example has already been improving since January and is slowly getting out of contraction area. I would not bet the house on shorting European equities.

I wish you a nice weekend,

Léon Kirch, CFA
Partner & Chief Investment Officer
March 29th, 2019