



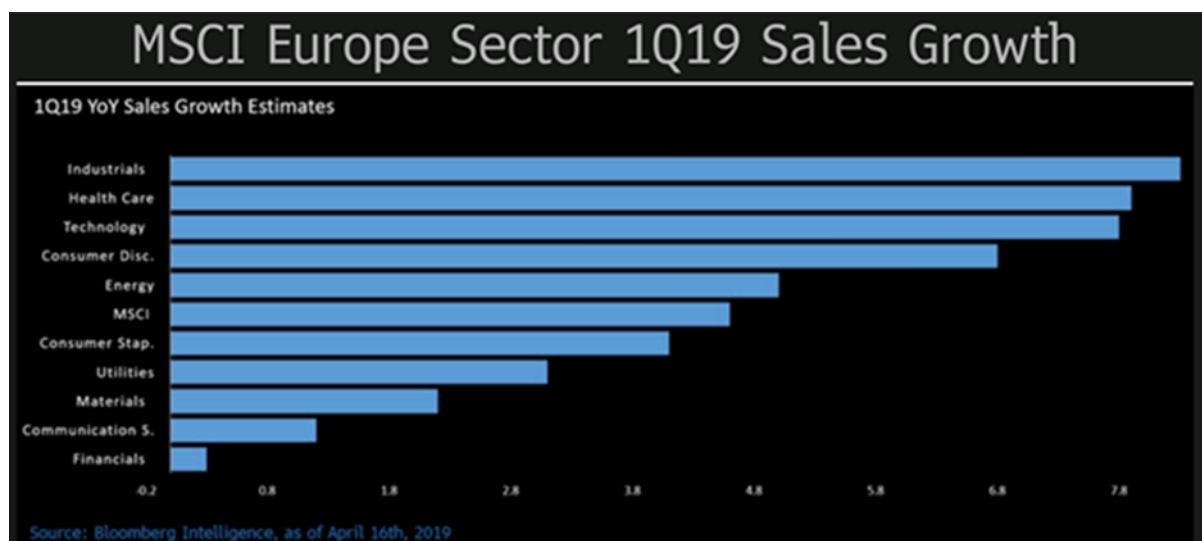
## Friday Morning Coffee

### Nr. 53 — Retiring from the frost to the sunny beaches!

The narrative economists use in their explanations can be very colorful and entertaining. Albert Edward for example, the famous perma-bear strategist from Société Générale, has been warning regularly of an imminent economic Ice-Age. He hereby means that markets in the West were about to follow the example set by Japan, suffering violent deflation, bond yields heading to zero and a collapse in equity values similar to what happened when the Japanese bubble burst at the end of the 1980s. Interestingly enough, he holds that view for some 25 years now ...

I could not help thinking of the Ice-Age theory when looking at the current economic environment in Europe and at the retirement of Mario Draghi at the end of October after an eight-year term at the helm of the ECB. Draghi will probably go down in history as the savior of the common currency during the Euro crisis. He will probably also be remembered as a leader of the ECB who took uncharted monetary policy actions to fight deflationary pressures in Europe. In 2019, deflation is no longer considered a major existential threat to the Eurozone. We have also not seen a Japanese style collapse in equity values. Bond yields in Germany have however turned negative. Economic growth remains anemic and the ECB needs to remain on a dovish route. It is therefore fair to conclude the current environment does not qualify as a full-fledged Ice-Age. However it is also fair to conclude that the temperatures in Europe remain frosty.

Where does this leave us as value investors? **We have been making the point on many occasions that value as an investment style needs higher interest rates to come back into favor. We remain convinced that it will happen over time as economic activity picks up again. We also believe the felt temperature in Europe is painting a more negative picture of the actual underlying conditions. This is partly due to the extremely high political noise level.** One telling example is the repeated investor's concerns around earnings recession in Europe. While earnings estimates have been coming down in line with the slowing economic activity, companies continue to grow in positive territory. For example, sales in the first quarter of 2019 are estimated to have grown by 4.8% as shown in the graph below :



Source: Bloomberg

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Interestingly enough it is not only the defensive sector but also, and foremost, the cyclical sectors like industrials and consumer discretionary, are expected to show sustained growth. **The weakness of the EUR may have played its part here, but this also shows that companies continue to operate in a healthy environment.** With inflation still contained in Europe, corporate margins should also not be pressured. So we can look forward to the upcoming earnings season with a reasonable confidence.

I get the question quite often from prospects and investors when exactly will value return in favor as an investment style. While it is hard to predict exactly when, I believe we need the following conditions to be filled:

1. Absence of an ice age
2. Absence of an earnings recession
3. Pick-up in economic activity

There are several green shoots appearing that make me optimistic that these 3 conditions start to be fulfilled. **Given the fact that value is now 42% cheaper than growth in terms of price earnings, it does not take a lot to move the needle once economic activity picks up. Let's hope Mr Draghi is a value investor to finance his retirement in the sun.**

I wish you a good Easter,

Léon Kirch, CFA  
Partner & Chief Investment Officer  
April 19<sup>th</sup>, 2019

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