

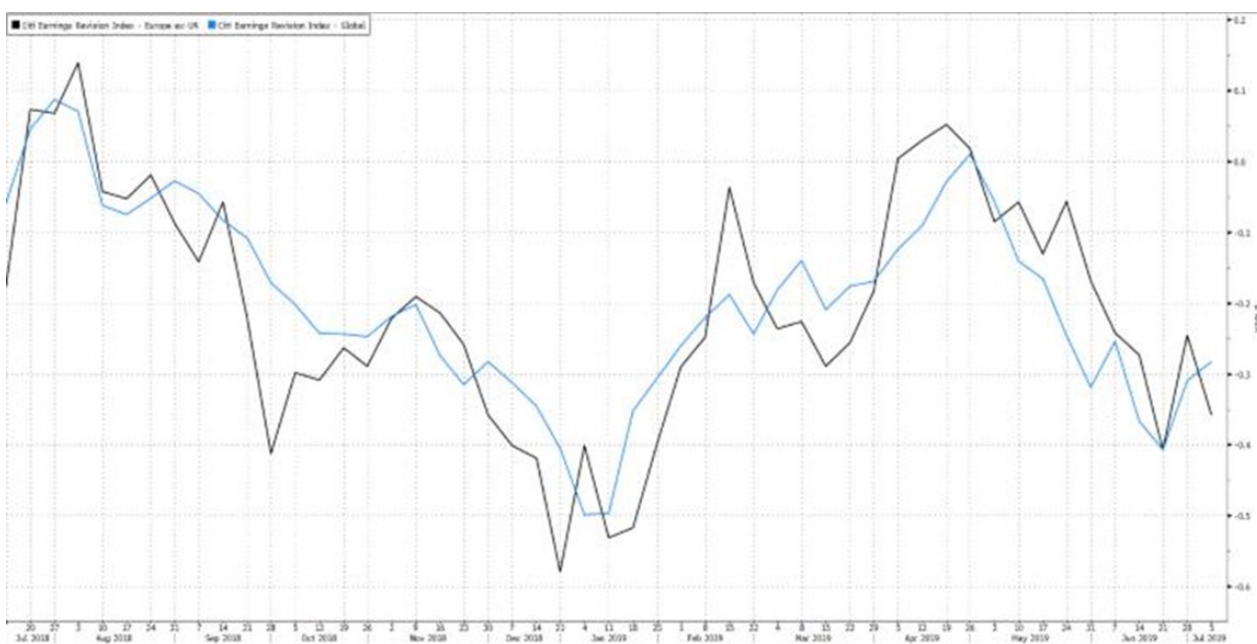


Friday Morning Coffee

Nr. 65 — Canaries in the Coal Mine

We are now entering the Q2 result season. As usual, we are not overly nervous as long term investors as we are not reading too much into 3 months of business activity. Our investment cases are based on the long term ability of our portfolio companies to generate discretionary free cash flows. We are not in the game of taking investment decisions based on our view on the next quarterly earnings, not positioned against any possible disappointments or surprises at results publication. Over the years, we found that companies, and particularly their IR departments, became better and better at massaging consensus estimates towards actual results and hereby managing analyst expectations.

While we are not in an earnings recession in Europe as earnings are still expected to grow by 4.2% in 2019 and 9.4% in 2020, consensus earnings have continued to be revised downwards since May. This can be seen on the graph below that shows the Citigroup earnings revision index that tracks the ratio of earnings upgrades compared to earnings downgrades by sell-side analysts.



The culprits for this increased pessimism range from disappointing Euro-area economic data, for example with manufacturing surveys showing a pessimistic mood due to global trade tensions and incoming orders in the German machinery industry falling 7% in real terms in May alone. Low bond yields are of course also not helpful for financial stocks, still the largest sector representing 18% of MSCI Europe.

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.

Friday Morning Coffee Nr. 65 — Canaries in the Coal Mine

In our world, quarterly results are important for other reasons. They are a good opportunity for us to evaluate if our investment cases are still intact, get a flavor on the current operating environment the companies are facing and hear from management how they assess their end markets. Some clear early warning signs on the current operating environment are being heard currently out of the corporate world. According to Bloomberg, there have been no less than 20 profit warnings of large caps in Europe since June, coming mostly out of the more cyclical companies like consumer discretionary, materials and industrials. The chemicals industry is sometimes called the “mother of all industries” as chemical companies supply products to many other industries from pharma to automotive and farming. That’s why we should listen carefully when a leading company like BASF warns of a potential 30% EBIT drop in 2019 due to “considerably weaker-than-expected business development in the second quarter and the slowdown in global economic growth and industrial production, mainly due to the trade conflicts”.

In our European portfolio, we are currently not invested in any materials company. In industrials, our main holdings are of less cyclical nature like G4S or ISS. We own several consumer discretionary companies, however their investment cases are less dependent on the economic cycle than on company-specific factors. **All our portfolio companies have solid balance sheets and competitive positions that enable them to weather any possible upcoming storm. As one canary just stopped breathing, we will however continue to watch the situation closely and be particularly attentive in this result season.**

I wish you a nice weekend,

Léon

Léon Kirch, CFA
Partner & Chief Investment Officer
July 12th, 2019

European Capital Partners (Luxembourg) SA (“ECP”) is responsible for the publication of this promotional document. ECP is an asset management company based in Luxembourg, registered at JF Kennedy avenue 35a, L-1855 Luxembourg (RCS Luxembourg, B 134.746) authorized as an Alternative Investment Fund Manager (“AIFM”) of the Luxembourg law of 12 July 2013 and supervised by the Commission de Surveillance du Secteur Financier (CSSF). This document is published for information purposes only and gives the opinion of the Investment team at the time of the publication. It does not constitute an offer to buy or sell financial instruments or investment advice and does not confirm any transaction unless expressly agreed otherwise. Although ECP carefully selects the data and sources used, errors or omissions cannot be excluded a priori. ECP cannot be held liable for any direct or indirect damage resulting from the use of this document. The intellectual property rights of ECP must be respected at all times; The contents of this document may not be reproduced without prior written consent. Any investment involves risks, such as the risk of loss of initial capital. Please read the Prospectus of Selected Funds, their Key Investor Information Documents (KIIDs) and financial reports before making an investment decision to understand their specific risks, costs and conditions. Those documents are available on www.ecp.lu. Past performance does not guarantee future performance. Please refer to an independent tax advisor for country tax information that can change at any time and analyze the tax impacts of any investment on your personal situation.