DNCA INVESTMENTS

Market comment
March 2016

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"The ECB is stepping up its accommodating monetary policy to foster European growth. China remains the main source of concern for the markets."

The doomsday macro-economic scenario of a worldwide recession envisaged at the start of the year is now looking less likely. Europe continues it recovery, although it is hampered by the situation in emerging markets. Meanwhile, there are various political risks that should not be ignored, such as Brexit and the migrant crisis. The so-called widespread deflation that supposedly reigns in this area is in fact running into the economic realities of growth, falling unemployment and increased bank loans. The US economy is displaying sound health, which is reflected by a solid labor market. However, China continues to attract concern on both the pace of its growth and the management of its financial (im)balances: the markets will pay close attention to this over the months ahead.

Europe ticks all the boxes of a growing economic zone. It can now rely on more solid consumer spending and increasing employment, along with support from a central bank that is willing to go all-out to fuel activity and ensure that the financial system runs smoothly.

The recent earnings reporting season was characterized by a fairly reassuring stance from management at European companies. More domestic-oriented sectors, such as telecoms, construction and media, pulled off sound performances. We would also draw particular attention to a sector that is admittedly more international, and which is benefiting from current manifold geopolitical tensions: defense. New vehicle registrations across the five largest European markets soared 15% in February, testifying to a recovery in the sector. Despite these various factors, the main sectors that make up the indices, oil and banks, dragged down the earnings outlook.

The ECB announced a host of fresh measures to bolster economic activity and financing of the European economy. However, the Brexit debate is set to make economic performances in Europe harder to assess, and create widespread concerns on the survival of the European Union as an

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SIRET 432 518 041 00046 | Ape 6630z | N° de TVA intracommunautaire : FR 73 43 25 18 041
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institution, as well as the Eurozone. Yet, if we manage to overcome this obstacle, European equities could continue to play their part as the sole investment alternative over the medium term.

The latest figures on underlying inflation, job creation and unemployment still do not give the impression that the US economy is struggling, despite pressures on the industrial sector.

An inflationary scenario is beginning to take root in the US, as underlying inflation is stepping up a pace, giving the Fed some justification for its new rate hike policy. The core PCE index is up 1.7% over the year, which is close to the 2% target. This is perhaps due to the initial effects of wage pressure, which could dent corporate profitability. Meanwhile, unemployment continues to fall, hitting 4.9% on the back of job creation.

The US economy and consumers in particular are benefiting from current positive economic conditions, with low oil prices and attractive financing conditions. However, a swift rise in short-term rates could have a knock-on effect on the long end of the yield curve and receive a poor welcome from households and the markets.

China remains the main source of concern for investors and could throw the entire financial world off-kilter if the capital flight continues or currency depreciation spirals out of control.

At the Communist party's latest convention, Chinese leaders announced that they now expect growth of 6.5% to 7% out to 2020. Chinese exports plummeted 25.4% in February, suffering their greatest decline since 2009, while imports fell for the 16th month in a row, shedding 13.8%.

China is now facing a twofold challenge, both economic and financial, and the outcome will influence the political equation in this one-party country. If China is unable to curb the outflow of investment, which came to $30bn last month, and if its currency suffers unchecked depreciation, it is in for a period of turmoil. This is why the central bank of this the world's second-largest economy will do everything in its power to avoid unsettling its main (im)balances.

Text completed on March 10, 2016 by Igor de Maack, spokesperson for DNCA Investments' fund management team.

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