« Equities remain at the very centre of our investment portfolios »

DNCA presents its macroeconomic outlook for the Eurozone and reiterates its conviction that equities should be at the very core of the investment portfolio.

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After a particularly tough and anxiety-filled start to the year, when investors overreacted to various economic and political uncertainties, the markets have taken a turn for the better again as a flat dollar, rising commodities prices, easing fears on Chinese growth, and fresh support measures from the ECB have turned investor sentiment around. Against this backdrop, our preference still goes to the Eurozone and companies based in the area as they offer the greatest sources of investment and best hopes for success.

Despite the world economic slowdown, the Eurozone offers attractive prospects

All economic areas worldwide are converging towards a weaker pace of growth. China is slowing and is displaying its poorest economic growth in 25 years. While the 6.7% growth in Q1 this year admittedly remains high, some figures (electricity use, confidence indicators, real estate prices) point to much weaker economic growth than suggested by the ambitious figures announced by the Chinese authorities. After a disappointing start to the year in the US, growth is now poised to come out at around 2%, still hampered by a strong dollar and dwindling investment in the oil sector. Lastly, Europe does seem to have embarked on a true recovery, but this rebound still remains fragile (1.5%) and growth figures could be downgraded in the event of a fresh external shock. For the moment, the Eurozone is still enjoying the most positive context: abundant monetary liquidity, low interest rates, falling unemployment, cheap oil, current account surpluses.

European equity markets offer a twofold advantage

A comparison of US and European equity markets is particularly striking: bond markets in the Eurozone look pricey compared to their US counterparts, while equity markets in the Eurozone look fairly reasonably priced. In view of absolute interest rates in the Eurozone (0.6% for sovereign debt as a whole and 1.3% for corporate bonds), investors can no longer invest the majority of their assets in purely bond-based strategies alone in order to avoid disappointments and volatility. Meanwhile, weak yields have a negative impact on private income. However, European equity valuation levels are deceptive, as they may look pricey to the bearers of doom and gloom who are predicting the end of the world, but seem like good value for optimists who are hoping for earnings growth for companies across all sectors. The truth probably lies somewhere between the two, so it is vital to adopt a cautious approach when selecting equity investment themes, by focusing on domestic sectors in Europe as well as sectors that carry discounts to their valuations. These holdings can provide capital gains, while carrying these stocks for a length of time allows for generous dividend yield (3-3.5%).

European corporates' earnings pulling off positive surprises

The first two months of the year were characterized by excessive pessimism, prompting analysts to make a hefty downgrade to earnings growth projections for 2016. Earnings growth for stocks in the EuroStoxx is now expected at 4% vs. estimates of 12% at the start of the year and as a result, the large majority of companies are pulling off pleasant surprises with encouraging earnings reports for Q1. Obviously, one swallow doesn't make a summer and Europe will still have to deal with a number of political issues (UK, Spain) that could hamper the economic recovery, but we are still far from the scenario of an economic relapse that many had envisaged.

Focus on fundamental and conviction-based equity investment strategies

Against this persistently complex economic backdrop worldwide and in view of the US's about-turn on monetary policy, we still think that European equities at current levels are the key performance driver in investors' portfolios in the Eurozone. In this respect, our two diversified funds with measured volatility are invested in equities as follows: 29% for DNCA Invest Eurose with its asset quality-based management approach (maximum 35% for its equity compartment), and 58% (+6% in Long/Short UCITS), for DNCA Invest Evolutif, which has a more flexible fund management strategy. Our expertise on absolute return funds invested on the equity cash market and with no leverage, was rounded out with DNCA Invest Velador, a fund that is eligible for French equity savings plan PEA, where net equity exposure can vary between 0% and 50%. Aimed at delivering steady yield with moderate volatility, it offers an attractive investment alternative to standard bond investments in today's current low interest rate context. For a more ambitious risk-taking approach, we recommend pure equity funds, invested in Europe, either with a value slant, such as DNCA Invest Value Europe (EU country equities), and DNCA Invest South Europe Opportunities (equities in the Southern European markets), or with a growth focus, such as DNCA Invest Europe Growth (European growth stocks at a reasonable price), where a combination of performance along with controlled risk is at the heart of our investment decisions. Value funds are now severely undervalued after several years of underperformance, so if we hold with a scenario of a continued European recovery, these are most definitely the ones to focus on. Whatever category of financial product investors select, with its ensuing risk, we are convinced that our microeconomic approach, which focuses on each company's individual profile and characteristics, offers a key advantage in creating value for our clients and keeping volatility under control in the medium term. On the basis of this European stock-picking expertise, and with the cautious approach that is characteristic of our fund management approach, we aim to continue enhancing the value of our investors' portfolios now and going forward.

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Figures as at April 29, 2016. Source: DNCA Finance.

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