Market comment
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"Volatility at historical highs and European opportunities"

The markets are gradually returning to health after a spate of severe volatility across all asset classes at the start of the year. However, monetary risks (Fed), political uncertainty (Brexit, elections in Spain and US) and economic hazards (China) still remain.

Fears on worldwide growth have not entirely faded due to difficulties in a number of emerging markets, which are running up against domestic crises or problems of industrial capacity surpluses.

European equities have not escaped this negative sentiment, despite the economic recovery in the Eurozone. Their valuations are admittedly close to historical averages, but EPS projections are somewhat lackluster.

Against a backdrop of all-time low interest rates, returns on equities provide an unquestionable support. This is why European equities should continue to be favored as they are set to benefit from ongoing economic growth potential in the Eurozone.

The international equity markets have suffered their worst start to the year in almost 30 years. We have witnessed increasing numbers of downgrades to world growth projections since summer 2015 and their impact on earnings estimates for listed companies are a reflection of a whole range of concerns, primarily on Asia, Latin America and the USA. However, China has been the main source of concern for the markets since 2015. Each fresh round of fears of a hard landing for China, which would lead to a structural deterioration in the economy's productivity in the country, spreads to the world economy as a whole. The government's current moves to adjust the industrial apparatus in order to reduce excess capacities is leading to downward pressure on commodities prices and on manufactured goods orders worldwide. The PBoC's accommodating monetary policy also seems to have run up against its limitations in a country where the combined debt of private and public sector economic players could begin to reach unsustainable levels.

Concerns on US growth are beginning to unsettle the macroeconomic balance worldwide, particularly in the wake of Q1 2016 figures. According to the latest estimates, GDP growth finally slowed down to +0.80% (Source : US Bureau Of Economic Analysis, Bloomberg) in the first quarter of this year, and over the full year, US growth potential dropped to +1.40% according to some economists, (Source : recherche économique de JP Morgan) which is well below past potential figures. However, judging by recent real estate, unemployment and consumer spending statistics, the second quarter of the year is set to display an improvement. We should not underestimate the potential consequences of a high-risk election where unconventional candidates (Trump and Sanders) were the focus of attention during the primaries. Lastly, the Fed recently set the stage for a potential interest rate hike sooner rather than later, and an umpteenth policy shift in this ongoing saga would spark off doubt among investors.

Against this backdrop, European equities remain the most attractive asset class. Europe is set to post the highest positive growth among the world's main economic zones in 2016. The Eurozone is expected to expand around 1.8% in 2016, vs. +1.6% in 2015 (Source : Factset Economic Aggregates). Credit provision, to households and corporates, reflects the relative momentum of economic trends. This positive impetus implies that corporate earnings growth potential is stronger in the Eurozone, and the potential for increased transaction volumes in services, capital goods, etc. via retail sales and corporate investment is therefore still intact in the Eurozone. The uptick in volumes, which is beginning to materialize, even in the construction sector, which has traditionally been the longest to show signs of recovery, will enable companies to reap the benefits of their operating leverage at last: operating leverage was reinforced by management teams during the financial crisis and right through the tough period from 2010 to 2015 when the euro crisis and the slowdown in China dragged down world trade.

Europe is admittedly not entirely sheltered from external shocks, but intrinsic growth factors are certainly visible. The increased pace of growth in Q1 to +0.60% (Source : Eurostat) (driven by France and Spain), outstripping expectations, went alongside increased support from the ECB, with private bond purchases from June onwards. However, the Brexit referendum on June 23 in the UK, to decide whether the UK will remain in the EU is dampening investor sentiment. Any renewed political credibility in Europe will provide a boost for the equity asset class. The pessimistic consensus on profit margins in Europe looks somewhat excessive. The market consensus is overly cautious, forecasting an EPS

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decline of almost 1.50% for the Eurostoxx 50 vs. an increase of close to 13% in 2015 (Sources : Factset Estimates Aggregates), on the basis of economic growth projections of close to 2% for the Eurozone. Quarterly earnings reports and a positive stance from corporates contradict this most negative view of the Eurozone.

The valuation shortfall between US and European equities reveals a discount of around 20% in favor of European equities while economic momentum can be found moreso in Europe. A relative risk premium of these proportions has never been seen since the Eurozone crisis, while European fundamentals are improving. Barring any major political earthquake (Brexit, break-up of Spain) that would reignite investor fears, the market should end up correcting this anomaly eventually.

Text completed on June 3, 2016, by Augustin Picquendar, Fund manager.

About DNCA:

DNCA is a French asset management company set up in 2000 by wealth-management specialists acting on behalf of private and institutional investors. With a defensive slant, the company seeks to optimize the risk/return ratio on its portfolios. With a team of more than 98 staff, DNCA has developed expertise in European and international equities (long only and absolute return), diversified fund management, convertible bonds and Eurozone bonds. The quality of the company's investment management, which regularly wins awards from the financial press, has enabled the company to enjoy swift growth over the past fifteen years. AUM currently stand at €19.7bn (as at 05/31/2016).

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