Press release

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"GROWTH, INFLATION, EQUITIES"

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"Each year, the nightingale dresses with new feathers, but it keeps the same song" Frédéric Mistral, French Occitan writer and winner of the Nobel Prize for literature in 1904.
Even moreso than in previous years, we are convinced that allocation into European Value stocks and particularly French stocks will be beneficial for investors in 2017.*
We analyze the situation in five key points.

1 A more favorable macro-economic context than in 2016

All business and consumer surveys are pointing the same way: world growth is stepping up a gear as developed countries continue to display robust figures, although admittedly weaker than in the past, while the situation in emerging markets is improving with hopes of a recovery for commodity-producing countries (Russia and Brazil) and a Chinese economy under control. Meanwhile, the deflationary theme is dwindling, although at this stage we can hardly talk about an inflationary trend. We should keep a close eye on wage indicators, particularly in economies with full employment.

2 Monetary policy on the road to normalization

After displaying extreme caution right throughout 2016 with only one increase in its key rate, the Fed is apparently going to make three rate hikes in 2017. After more than three decades of falling interest rates, the bond world could be faced with a normalization of monetary policy, in a context of economic recovery with inflationary risk. The European Central Bank got on the track to soft tapering**, maintaining its accommodative policy. However, the height of its action is past and its asset purchase program should come to an end in 2018.

3 Euro severely undervalued

Despite record current account surpluses, the euro is at a 15-year low against the dollar, although this situation admittedly reflects the dollar's strength more than the euro's weakness. Exchange rate risk incurred by Eurozone residents when leaving the euro investment universe should be factored in. Unless there is a deterioration in the political situation within the zone, an upturn in the euro may be possible in the second half of the year.

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4 Which naturally point to a focus on European equities

Stronger and more inflationary growth is a near-ideal scenario for equity investment, on condition that this has a concrete knock-on effect on corporate earnings. The spectacular rally on the equity markets since November, attributed to the election of Donald Trump, is also a reflection of this change in environment that is good news for equities and bad news for bonds. But in the US, investors have already largely priced in the implementation of aggressive economic and fiscal policies and their ensuing positive impact for US corporates. However, with continued rising bond yields ahead, Wall Street offers only limited upside at current levels. Conversely, Europe is still out of favor in asset allocation and could provide the pleasant surprise of 2017. Wariness on the Eurozone due to the number of political and electoral events coming up looks blown out of proportion. Contrary to an opinion that is very widespread internationally, the probability of a shock vote looks low in both France and Germany. Investors should take advantage of the political discount carried by the markets in the zone, without waiting for the result of the elections, which could be catalysts for a rally as was the case in 2016. Furthermore, unlike previous years, corporate earnings could throw out some pleasant surprises: earnings projections in the Eurozone have been on an uptrend for the past three months and are for a 14% rise in 2017 (10% excluding financials).

5 With a preference for Value style

After a decade of underperformance, the Value fund management approach began to return to favor in September, with a sharp rebound for financials. Value stocks have been catching up and this trend is set to continue for such times as the valuation gaps with quality and growth stocks remains wide. Stripping out loss-making companies, the Euro Stoxx Value is only valued at 13.6x earnings for the current year with expected yield of 4.3%.

To conclude, the Value fund management approach, which is widely under-represented in portfolios in Europe, which itself is structurally underweighted by international investors while the euro is severely undervalued, could prove to be one of the winning areas for 2017.

Text completed on January 2, 2017 by Jean-Charles Mériaux, Chief Investment Officer at DNCA Finance.

** Value: value fund management involves investing in stocks that are undervalued at any given time.*
*** Soft tapering: gradual reduction in amount of asset purchases.*

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