SYCOMORE
ASSET MANAGEMENT

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PRESS RELEASE

DO MARKETS STILL MAKE SENSE?

Paris, April 7th 2016.

MARKETS LACKING DIRECTION

The bear market that hit European stock exchanges at the beginning of the year turned out to be short lived. After a substantial correction between mid-April 2015 and mid-February 2016, when markets lost -25% (see our Market Flash of February 10th, *A Frog in the Fog: making sense of things*), European equities rebounded sharply and gained 13% between mid-February and the end of March. This rise came with a concomitant drop in volatility and a reduced dispersion of returns, which nevertheless remain at relatively high levels. However this bullish episode was marked by a strong sector and style rotation; cyclical stocks – oil, mining, automotive, financial companies – largely outperformed, while defensive stocks – healthcare, consumer goods and services, technology, telecoms – tumbled. This was a total turnaround compared to the performances recorded in the preceding 12 months.

AN EXCESS PESSIMISM LIFTED?

Oil prices have rebounded sharply (up 30% between mid-February and the end of March) and equity markets remain highly correlated to the price of crude oil, which is both surprising and counterintuitive. But more fundamentally, strong indicators helped reassure the most pessimistic investors.

In the U.S., the purchasing managers' index for the manufacturing sector has rebounded since January, after falling steadily during all of 2015, while household consumer spending and the labour market remain robust. Fears of a slowdown, or even of a recession, have been partly lifted.

In China, the depreciation of the Yuan and the dramatic drop in foreign currency reserves now seem to be under control, and the slowdown in the industrial sector has stabilised.

In the Eurozone, purchasing managers' intentions and consumer confidence remain high despite a decline over the past three months, while credit activity levels seem well on the road to recovery. The earnings season has recently come to a close, with companies reporting annual earnings that are slightly above expectations – albeit with strong disparities between individual companies and industries.

The steep market decline in the first weeks of the year – when the Eurostoxx index shed 17% between January 1st and February 11th – may have seemed excessive, paving the way for the recent rebound. This is particularly true as central banks remain at work: the ECB announced a new round of initiatives and the Fed has taken a more dovish stance, suggesting that interest rate hikes in 2016 may be much more gradual than first anticipated.

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NO PERFORMANCE WITHOUT EARNINGS GROWTH?

Since the beginning of the year, expected earnings growth for European companies in 2016 has been quickly and sharply revised downwards – from +10% to +4% in the Eurozone and from -7% to +1% in Europe. Earnings growth expectations are now at a 5-year low at this time of the year, and could therefore prove reasonable, or even conservative. EPS growth will remain a key driver for stock market performance in the quarters to come, notably as valuations, albeit reasonable, are no longer cheap.

RISKS THAT SHOULD NOT BE OVERLOOKED…

Markets continue to face several headwinds: the slowdown in emerging markets, combined with the demographic trends in developed countries, should lead to a lower structural global growth over the next few years. In addition, the recent appreciation of the Euro relative to the dollar weighs on exporting companies; inflation remains weak; central banks seem to be running out of ammunition; and structural reforms are lacking.

Furthermore, a number of political developments with highly uncertain outcomes are looming on the horizon. These include the referendum in the U.K. over a possible Brexit on June 23rd and the primaries in the U.S., which will come to a close during the Republican and Democrat National Conventions in July.

… HOWEVER POSITIVE FACTORS DO SUPPORT EUROPEAN EQUITIES

Several positive factors argue in favour of European equities: advanced indicators remain relatively strong (purchase intentions, consumer confidence, credit conditions); unemployment has been falling over the past three years across the Eurozone and in all of the main countries, except France; fiscal policies have eased and could even become supportive factors; contrary to the situation in the U.S., margins are still far from their cyclical peaks and could therefore benefit from significant operational leverage if the recovery in the Eurozone materialises; valuations and returns are compelling relative to other asset classes and to U.S. equities.

AVOIDING THE PITFALLS

To navigate this complex, uncertain and volatile environment, it is essential to make a clear distinction between fundamentals and market noise and to stay the course with an active and conviction-driven investment approach. We believe that the current environment, marked by recurring volatility peaks and high valuation dispersions – not only between sectors but also between individual stocks within a given sector – is particularly favourable to a stock picking approach.

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We favour stocks that benefit from specific growth drivers and margin improvement levers, with compelling or at least reasonable valuations. We continue to focus on companies with domestic European exposure, small and mid-caps, and selected stocks within the technology, business services, consumer, healthcare, and automotive supplier industries. However, we steer clear of cyclical companies that appear to be trading at a discount but could turn out to be *value traps* – for instance within the mining and oil sectors. This position may have negatively impacted ou relative performance during the recent market rebound; however we maintain our conviction, as we believe that the valuation discounts do not adequately reflect the severity of the cyclical and structural challenges faced by these companies.

FLEXIBLE, REACTIVE AND NIMBLE

Our flexible funds' market exposure - which had been increased between mid and end-February consistently with their respective risk profiles - was later slightly reduced in the wake of the market rebound. This was particularly the case for Sycomore Partners (41% exposure at the end of March) and Sycomore Allocation Patrimoine (25% equities, 33% high-yield, 9% investment grade). The market exposure of our "long only" funds ranges between 90% and 95%.

As far as credit is concerned, spreads have tightened sharply since mid-February, after widening substantially early in the year. Our Sycomore Sélection Crédit portfolio displays an aggregate yield of 4.4%. Although down from the peak of over 5% reached mid-February, the yield nevertheless remains at attractive levels.

About Sycomore Asset Management

Founded in 2001, Sycomore Asset Management is an entrepreneurial investment firm majority-owned by its founding partners and specialised in the analysis of European stocks. Rated "High Standard" by Fitch Ratings since 2008, Sycomore AM manages 3.5 billion euros in mutual funds and segregated mandates. Sycomore AM works with institutional clients (private and public pension funds, insurance companies, banks, corporations) and distribution partners (IFAs, fund distribution platforms...) located in France and abroad.

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