Fund update on R-co Conviction Club

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We started the year with a scenario of a continued economic recovery that began in September 2019 after several months marked by uncertainty surrounding the end of the cycle, with the fall in leading indicators at the global level from October 2018 and the vicissitudes of the Sino-American trade negotiations. Until the emergence of the pandemic, the signals were rather green confirming the recovery on both sides of the Atlantic.

An extremely strong but temporary shock

Unfortunately, the pandemic has undermined this improvement with an unprecedented global containment situation leading to a sudden and extremely fast fall in markets. Recession is now certain in 2020. Economists are beginning to factor in declines in activity of 3% to 5% in Europe and slightly less in the United States. Strategists anticipate earnings decreases of between 20% and 30%, in line with the declines observed in previous recessions, which usually translate into equivalent market declines. It is difficult to know at this stage whether we have hit the lower points as there are still some uncertainties regarding the management of the health crisis in the United States. Nevertheless, the scale and speed of the monetary and fiscal measures put in place by governments and Central banks constitute an unprecedented support factor that should make it possible to create the conditions for a rebound by limiting contagion from the real to the financial sphere, and the destruction of productive capacities. Other measures could still be announced and lessons have been learned from the crises of 2008 and 2011, which is very reassuring, particularly for Europe, which historically had suffered too much from these governance problems, especially at the time of the sovereign crisis.

Our new central scenario includes a violent but temporary shock, and we have taken advantage of this volatile period to maintain a cyclical and financial positioning that will be most likely to outperform significantly in the rebound phase. Analysis of the various crises shows that, on average, twelve months after a sudden shock, cyclical stocks rebound by 45% on average, while defensive stocks by only 28%.

What are the impacts on R-co Conviction Club

R-co Conviction Club's performance was affected by its high exposure to equities, particularly on cyclical and financial components that suffered from concerns about the cycle and record revisions to the business and earnings growth outlook.

In this period of severe turbulence, we have kept equity exposure stable at around 73% and have:

- Bought futures on the DJ Euro Stoxx 50 index against the general sell-off. Indeed, Europe seems particularly attractive to us:
  - Market levels are similar to that of the fall of 2008 or 1998.
  - Even with earnings cut by 25%, valuations are close to the levels observed during previous crises and are all the more attractive as interest rates are now historically low and the risk premium has returned to the highest levels. Some sectors particularly affected by concerns about the cycle have returned to the lows of 2008, notably in the Banking, Energy and Automotive sectors.
  - The area benefits from a sector component that is more likely to outperform in case of recovery with a strong cyclical bias of the Eurostoxx index compared to the U.S. market, which has a more defensive bias and plays the role of a safe haven asset in times of stress, as we have seen with the appreciation of the dollar.

- Europe is further ahead in the containment strategy and could follow the example of the Chinese market, which outperformed global indices when the number of new contaminations fell sharply from the beginning of February.

- Opportunistically strengthened certain stocks that posted significant declines, particularly in the cyclical and oil segments (Peugeot, Total, Deutsche Post, Airbus, etc.) and thus maintained our cyclical and financial bias, which presents:
  - A valuation gap between “value” and historical “growth” themes
  - Unprecedented underperformance
- Maintained bond modified duration levels at around -1 at the portfolio level, with German 10-year yields reaching extreme levels at -0.85% on March 9.
- We have not added any credit risk at this stage.

Even if the timing remains difficult to determine as it is largely dependent on the evolution of the health crisis, R-co Conviction Club seems well positioned to take advantage of the stock market rebound when the pandemic risk will show signs of stabilization.

The history of the last major world crises has shown that the stronger the fall of the markets, the more violent the rebound that follows.

In addition, R-co Conviction Club offers a distinct positioning within an asset allocation by reacting very favorably to a rise in interest rates on both equity and bonds, as it has demonstrated on several occasions in 2013, 2016 and more recently between September and December 2019.

Completed writing on 31 March 2020

Recommended investement period: 5 years

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