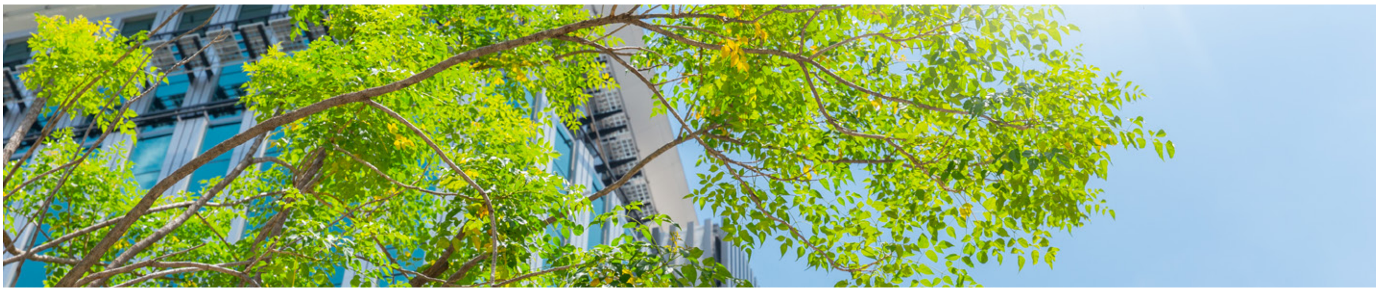
R-co Conviction Equity Value Euro
It is not too late!



Market news emphasises the "value" style(1) and (perhaps) marks the start of its catching up with "growth". The announcement of a probable vaccine was a real "stress test" for the markets, showcasing the potential of the "value" style should normalisation of the health situation occur. At the end of October, the "growth"(2) style outperformed the "value" style by 21.5%, since the start of the year. We witnessed the beginning of a reversal of this trend. Over the past week (9 to 13 November 2020), the "value" leaped by 12.6%, while the "growth" increased by 3.6%, thus reducing the year-to-date outperformance gap to 18.6%.

Anthony Bailly
European Equities
Fund manager

Vincent Iméneuraët
European Equities
Fund manager

"If not now, when?"

This sentence of Goldman Sachs' strategist reflects on the state of mind of many brokers (JP Morgan, UBS, Morgan Stanley, Exane, etc.), who are convinced that the time to shift towards "value" has arrived. Obviously, two major events caused the market downturn and the outperformance of the "value" style:

- The announcement by Pfizer and BioNtech (then Moderna) of very encouraging results on Phase 3 of the clinical trials for their vaccines. This news enabled the market to overlook the recent increase in Covid-19 cases, giving it the visibility it lacked for 2021.
- Meanwhile, the result of the US elections probably provides the best of both worlds for the market. A Republican majority in the Senate should allow not to reverse the pro-business measures introduced by Donald Trump. Joe Biden's presidency should be marked by a major stimulus plan and is expected to alleviate trade tensions, thus reducing market volatility.

Why could the rebound in "value" last?

In the short term, the momentum of health news should continue over the following weeks, mainly helped by new positive results on vaccines (AstraZeneca, GSK/Sanofi in particular). Its spread around the world will follow, with large vaccination campaigns, that we are starting to hear about now, and which will be the prerequisite for a definitive normalisation of the health situation.

In the medium term, the earning momentum should provide a solid support for "value" companies. Companies beat expectations in Q3, by 13% on earnings per share in Europe, which was the highest percentage of positive surprises in more than a decade! Even if the 4th quarter will be under pressure due to lockdowns implemented in various countries, the comparables will be particularly attractive for 2021 results (as soon as Q1), in particular in the event of a procyclical recovery. This rebound potential is obviously much greater for cyclical and financial stocks than for other stocks.

In the long term, the yield curve could also favour the "value" style. The correlation between rates and the "value" style is well established.

1) The "value" style is used when the investor is looking for companies that are undervalued by the market at a given time, i.e. whose the stock market valuation is lower than it should be in relation to the company's results and the value of its assets. Value investors select stocks with low price-to-book ratios or high dividend yields.

(2) The growth style investor focuses primarily on the earnings growth potential of companies. Hoping that the growth in turnover and results will be higher than that of its sector or the market average.

Admittedly, rates remained at low levels or even fell in 2020. It is, moreover, very likely that short-term interest rates will remain at low levels, in order to monetise government debts and finance future stimulus plans. But an increase in inflationary expectations for European bonds, as seen in US bonds, could be a powerful driver for "value". In this context, the level of rates should, at worst, no longer be the headwind it has been in recent years, while at best it can be a driver of overperformance for the "value" style. These low rates, which had favoured "growth" stocks, could, should they recover, allow "value"[(3)] stocks to benefit from a re-rating potential, which is almost non-existent for "growth" companies.

In addition, the violent sector rotation that we witnessed is also and mainly the result of the unwind of technical positions, particularly in hedge funds (or alternative funds). This reflects the first step in the integration by the market of a return to normalisation. With a way out of the health crisis, it now seems much more difficult to short sell "value" securities.

Finally, Europe, particularly affected by the pandemic and more exposed than the United States to the "value" theme, both in terms of the sector weightings and the valuation of securities, could also benefit from strong renewed interest, should this style rotation take place on both sides of the Atlantic. In addition, a definitive and favourable "Brexit" outcome would remove long-standing uncertainty for the old continent, and could encourage the return of international investors.

The fund's performance in this context

In this market configuration, R-co Conviction Equity Value Euro responded well, posting a 19.1% bounce back since the beginning of November, thus outperforming its benchmark by 4.7% (as of 13 November 2020.)

Particularly neglected sectors, such as banks and energy, posted the strongest rebounds, with stocks that reflected a scenario of marked recession.

The fund's positioning, built around 4 themes, enabled it to take advantage of this market increase:

- Companies with strong international exposure, to take advantage of the Chinese "V" recovery, which is already in place,
- Cyclical stocks, posting historically-low entry points, with a solid balance sheet, allowing them to get through the crisis and to be the post-health crisis winners in their sector,
- Positions in sectors facing structural challenges, but which display very attractive valuations with short-term catalysts, such as banks and energy,
- Defensive stocks with a "value" aspect, to limit the decline in the event of a prolonged deterioration of the health situation.

Over a longer period, this positioning has enabled the fund to outperform its benchmark index by nearly 4.4% between 31 May 2020 and 13 November 2020, while, since that date, the "value" and "growth "are virtually equal.

Movements made after the end of the summer

We made an arbitrage within the auto sector, by reducing Daimler and further strengthening Peugeot. The group's organic growth increased year-on-year by 1.2% in Q3, thanks to a price/mix effect, which made it possible to more than offset the drop in volumes, and its balance sheet continued to strengthen. This does not appear to us to be reflected in the share valuation (0,14x EV/sales 2021). Following this movement, Peugeot becomes the main overweighted position in the portfolio.

We strengthened our position in Total, the only player in the sector which has maintained its dividend (posting a 9% yield), and which should benefit from a potential rebound in oil prices when the crisis ends (linked to the rebound in demand, in a context of limited production). The sector did not bounce back initially as investors feared the impact on future cash flows of forthcoming investments to transform the business model of companies in the sector towards a model with more renewable energy. Total's strategic plan to achieve this necessary transition seems credible and more reasonable to us than those of other players in the sector.

Despite low-interest rates, we are maintaining our overweight in the banking sector by strengthening BNP Paribas: (i) the valuation is at an all-time low (0.4x P/TBV), (ii) the solvency ratios are high, despite the crisis that we are going through (CET1 at 13.1%), (iii) the payout of dividends should return from 2021, offering a significant yield and (iv) cost reductions which continue to preserve margins, in a context of low-interest rates. But this will not be enough for some players and, given the valuation levels, it could lead to a wave of domestic consolidation which could be a catalyst for the sector.

In a similar fashion, within the construction sector, we reduced our positions in Saint Gobain and Wienerberger, which benefited from the renovation theme and stimulus plans, and we entered Eiffage in the portfolio. The stock was down nearly 40% at the end of October, impacted by the drop in motorway traffic (usually very stable) during the lockdowns. The market did not welcome the return to an almost normal level of traffic during the summer, but the

(3) Securities which are undervalued by the market at a given time, i.e. whose market valuation is lower than it should be with regard to the company's results and the value of its assets.

announcement of a medical solution should allow normalisation in 2021, which is not priced in. In addition, the possible 2-year extension of the APRR concession contract against additional investments (in particular through the financing of electric charge points on motorway areas) would allow an extension of the concession period, which would be an additional catalyst. Despite this, the stock has the most attractive valuation in the sector, at 7.8x EV/EBITDA 2021.

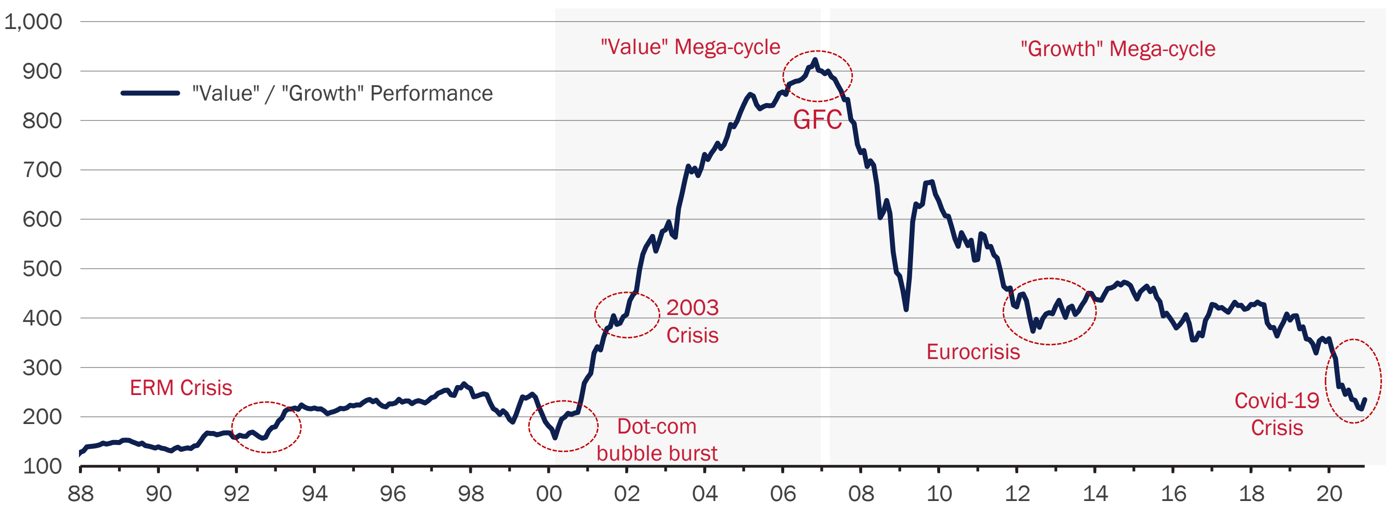
In more defensive sectors, following reassuring earnings, we also strengthened our positions in Anheuser-Busch InBev and Orange. Anheuser-Busch InBev posted a return to organic growth with + 4% YoY in Q3, of which 1.9% is related to the volume effect. Orange benefited from strong demand for optical fibre in France, and the end of the price war in mobile telephony. The group announced the reinstatement of the dividend, showing a yield of nearly 7%.

Finally, we reduced our position in Nokia after a good run since the beginning of the year. Our investment decision was based on 3 elements: (i) the implementation of restructuring measures, which should allow an improvement in margins, (ii) the constitution of a duopoly with Ericsson, following the ban of Huawei in several countries and (iii) the speculative aspect of a possible acquisition by an American player. Samsung's win of the Verizon contract (more than €6bn) calls into question the hoped-for duopoly with Ericsson, and the Finnish sovereign fund's increase in Nokia's capital calls into question a possible M&A deal on the stock.

Conclusion

Even though the recent shift has been violent, we are only at the start of the turnaround, and the potential for a rebound remains very significant given the underperformance accumulated over several years, as shown in the chart below.

"Value" vs "Growth" long term performance



Source: UBS European Equity Strategy, DataStream, FTSE, IBES, November 2020.

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