ADVERTISING COMMUNICATION

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Bilan 2023 & Perspectives 2024
R-co Conviction Equity Value Euro

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1/ The equity markets suddenly took off in late in 2023. Why?

In early 2023, investors were still concerned about inflation and the growth impact of hawkish monetary policies. Many of them had accordingly reduced their equity allocations early in the year while raising their bond market exposures against a backdrop of rising interest rates.

In fact, equities ultimately ended up outperforming all other asset classes on the year, with the EuroStoxx up by 18.6%, vs. 3.3% by the money market, 7.2% by sovereign bonds, and 8.2% by corporate bonds[1].

Consumer spending held up throughout the year, especially in the US, driven by a strong job market, despite the tightening of credit conditions. Although investors cast a wary eye at the resiliency of core inflation[2] in August to October, once inflation continued to accelerate downward in the fourth quarter they began to subscribe to the soft landing scenario. They then priced in the fact that the Fed would succeed in its gamble of reducing inflation while preserving growth. This sent 10-year US yields down by more than 100 bp, from 5% in October to less than 4% at yearend[3]. The Fed's more accommodative language after its December FOMC[4] meeting lent further credence to this scenario, and the markets are now pricing in six rate cuts in 2024. In other words, within a few weeks we went from a "higher for longer" scenario to a scenario of Fed rate cuts as early as next March.

This expectation has driven equity markets steeply upward since early November to all-time highs at yearend. Meanwhile, lower rates late in the year triggered tentative net inflows into equities. All in all, and amidst resiliency in the economy, risky assets played their role well and it was therefore time to take on equity exposure.

2/ How did the Value style fare in this context?

We have already mentioned the correlation that has long existed between the Value's relative performance and interest rates.

After a robust outperformance since 2021, Value took a hit from the steep volatility in interest rates in 2023. Then, after underperforming early in the year and hitting a low during the March banking crisis[5], Value got a boost from central banks' "higher for-longer" language, and it outperformed significantly from June to September. As the year comes to a close, the steep drop in interest rates has once again hit it hard. Value ultimately ended the year up +17.4%, just under a point below the index[6].

While Value has outperformed since its 2020 lows, driven by inflation's comeback and the steep rebound in interest rates, it still did not fare as well as might have been hoped in light of extent of the rebound in interest rates. Among other things, this was due to the underperformance by cyclical Value stocks, which took a hit from recessionary fears borne of the downturn in leading indicators and the tightening in credit conditions. Moreover, China's current difficulties have hit some sectors especially hard, such as commodities (broadly defined).

(1) Source: Bloomberg, December 2023.
(2) ex food and energy.
(3) Source: Fed, December 2023/
(4) Federal Open Market Committee.
(5) Source: Bloomberg, 15 December 2023.
(6) Source: Rothschild & Co Asset Management 15 December 2023.

3/ What are valuations and earnings growth forecasts like now?

Despite this yearend rally, European equity markets are still very attractively priced, at a P/E[7] of 12.8x. This is below their 20-year historic median of 13.1%. This discount is especially apparent when looking at the valuation gap by style. Value is currently trading at 9.1x, close to its all-time lows, whereas Growth[8], at 20.4x, is close to its all-time highs[9]. In other words, if, as expected, lower rates do trigger a rerating of equities, such already seems to have been priced into Growth stocks but not yet at all into Value stocks. We are even more comfortable with Value stock valuations as earnings growth forecasts are very low. For example, in the three lowest-priced sectors (automotive, energy and banks), 2024 EPS[10] growth forecasts are between -5% for autos and +4% for energy. This compares with an overall growth forecast of 6% for the European market. In contrast, in the three highest rated sectors (consumer goods, technology and healthcare) EPS growth is forecast at between 10% and 13%[11].

Low valuations, combined with modest earnings growth forecasts make Value especially attractive as the new year gets under way, especially as, over the past 12 reporting seasons, Value has surprised on the upside in a greater proportion than growth has.

4/ What environment do you expect for 2024?

Regarding economic growth, we obviously had some good surprises throughout the year. This was especially true in the US, where the job market is starting to slow down but real wages are still rising, something that is driving consumer spending despite the fact that US households have already dug very deep into their surplus savings. This pace of growth – more than 4.9% at an annualised pace in the third quarter[12] – will nonetheless be hard to maintain. Even so, the scenario of a mere slowdown in growth, thanks to an easing in credit conditions, looks credible.

In Europe, economic activity looks close to bottoming out. This is showing up in particular in PMI[13] indices, which appear to have hit a trough in both manufacturing and services, as well as in indices of economic surprises, momentum in which has been headed in the right direction for three months now. Here again, receding inflation has restored household purchasing power, and that should generate at least weak growth or, in a worst-case scenario, a mere technical recession. China remains challenging, but we are seeing some signs of improvement, particularly in retail sales, and real-estate prices are levelling off. An eagerly awaited stimulus plan could help the economy to rebound.

On the inflation front, we believe the markets are pricing in too fast of a return to central banks' 2% objective. New inflationary forces are here (the climate transition and deglobalisation, in particular) and, while the peak is now behind us, core inflation will probably take time to recede, especially as its services component seems to be stuck. Accordingly, investors' anticipation of six Fed rate cuts next year looks a little too optimistic, unless the US economy suddenly slips into a serious recession, something that is not in our scenario.

As we have already said, the market appears to have already factored these rate cuts into growth stocks' multiples. And that makes growth stocks risky, given the uncertainty still hovering above rate cuts. But such is not the case of Value, particularly for cyclical Value stocks, whose valuations already price in a slowdown in the economy. Cyclical Value stocks are the ones that are likely to benefit from a soft landing scenario, should one come to pass.

5/ How did the fund fare in 2023 and how is it positioned as the new year begins?

R-co Conviction Equity Value Euro fared well, outperforming its index by 50 bps despite Value stocks' underperformance. The fund was driven solely by good stock-picking, particularly in the food & beverages, energy and retailing sectors.

We continue to overweight energy and banks, whose fundamentals still look solid and whose valuations and dividend yields are especially attractive. The soft landing environment is likely to dispel the uncertainties that continue to push down valuations, and this will certainly be the first lever of performance. Regarding the second lever – earnings growth – expectations are very low. The delayed impact of interest rate shifts and the easing of credit should allow banks to once again report positive surprises. And regarding energy, oil prices are likely to be supported on the demand size by ongoing satisfactory economic activity, and, on the supply side, by Saudi Arabia's insistence on keeping prices high.

Late in the year, we also added to our exposure of certain cyclical stocks, such as ArcelorMittal, earnings revisions of which already reflect a significant downgrade in economic activity.

Based on our assumption that interest rates have peaked, we also added to our holdings in sectors whose valuations had been hit hard by high interest rates, such as real estate and utilities. In our defensive pillar, we also continue to overweight telecoms, as higher margins, combined with lower capex in fibre and 5G should allow the sector to improve its FCF[14].

(7) Source: Morgan Stanley Earnings Tracker Price/Earnings.
(8) Growth investors focus mainly on companies' growth potential, hoping that revenues and earnings will increase more than the sector's or the market average.
(9) Source: Bloomberg, 15 December 2023.
(10) Earnings per share.
(11) Source : Goldman Sachs Global Investment Research, Factset, "European Weekly Kickstart du 15/12/2023.
(12) Source : Bloomberg, 21 December 2023.
(13) Purchasing managers index, an indicator reflecting their confidence in the manufacturing or services.
(14) The flow of available cash generated from operations after subtracting the investments needed for maintaining or developing production facilities.

On the other hand, we are steering clear of growth sectors (such as consumer goods and technology), which already appear to have priced in the ongoing normalisation of interest rates and forecasts for which are not shielded from some disappointments.

In the looming environment of normalising rates, style biases are likely to be less marked. However, stock-picking on the basis of transversal thematics (rate cuts, integration of an economic slowdown scenario, etc.) is likely to make much more sense and become the main driver of performance in 2024.

Completed writing on 3 January 2024

Performances	2023	2022	2021	2020	2019	2018	10 ans	1-year volatility
R-co Conviction Equity Value Euro C EUR(1)	19.1%	-9.6%	26.3%	-9.9%	17.6%	-18.0%	40.9%	15.6%
R-co Conviction Equity Value Euro I EUR(2)	19.8%	-9.1%	27.1%	-9.2%	18.5%	-17.4%	51.3%	15.6%
Euro Stoxx ® NR(3)	18.5%	-12.3%	22.7%	0.2%	26.1%	-12.7%	85.0%	14.8%

(1) Inception date: 20/05/2005.
(2) Inception date: 30/12/2009.
(3) Benchmark.
Source: Rothschild & Co Asset Management, 29/12/2023.

Synthetic risk indicator : 5 out of 7

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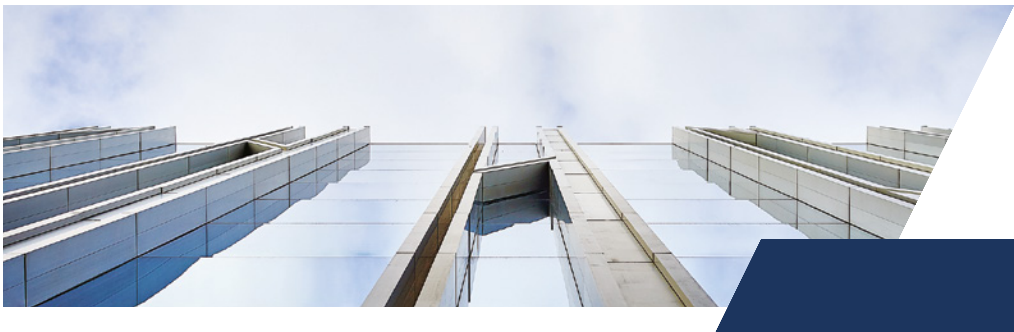

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