2018 Macroeconomic Outlook

Capture economic prosperity while facing the challenge of optimism

After years of often exaggerated pessimism about global growth, **the return to economic prosperity is confirmed**. Global GDP grew close to +4% at the end of 2017, and no OECD country is today in recession. Since the end of summer 2016, growth forecasts for the Euro-zone have been revised to the upside nearly every month, and reached levels greater than 2%, a robust level that nearly nobody dared hope. At the same time, the perception of European political risks has crumbled, feeding a wind of optimism with respect to governance of the Euro.

Capturing the Return to Prosperity: the Dorval AM' Approach

For Dorval Asset Management, the year 2017 has marked the end of a long period of evangelizing. **Everybody now understand that one needs European stocks, and that in Europe one needs to favor active management over stock market indexing**. The big question is now less one of « why », and more of « how »: How can we participate in the benefits of the newfound economic prosperity amid an atmosphere of optimism that is both supporting and challenging?

To meet this challenge, Dorval Asset Management employs a rigorous investment process with a proven track record. **Faithful to our flexibility moto, the management team adapts its portfolio to the rhythms of the markets**, defined by the superposition of the macro and microeconomic, monetary, and behavioral cycles. From the four pillars – the macro economy, asset valuation, market dynamics, and the micro-economy – we define a central scenario from which we derive both our exposure rate to market risks and our investment themes.

Our central scenario remains positive for risky assets, particularly in Europe, with median earnings per share growth of at least 10% in 2018 in the Euro Zone, powered by world economic prosperity. **The European countries that have lagged the most in this cycle, such as France and Southern European countries, could create a positive surprise in 2018 as they catch up**. Rating agencies will likely hike their ratings among the peripheral countries, and the European Central Bank is likely to maintain its support to limit upward pressures on the euro.

Manage risk asymmetry on fairly valued markets

On another note, the fund managers do not believe that, at this stage, a sharp hike in interest rates is probable, insofar as the central banks' objective remains to raise the rate of inflation. **More than interest rate hikes, the main driver of risk is the asymmetrical risk created by the return of investor optimism**: on markets that are pretty expensive, bad news could have more impact than good news, as the latter are already expected.

Although our positions could be altered at any moment, **we have opted since October 2017 for an exposure to stocks of between 40% and 60% in our main flexible European portfolio (Dorval Convictions' strategy)**, against an exposure nearly systematically comprised between 60% and 100% after the famous speech by Mario Draghi in July 2012. For Dorval Asset Management, this is a progressive turning point which takes into account the maturity of the American stock market cycle, the higher valuations, the upward pressure on the Euro, and the market asymmetry.

In addition, **we progressively diminish our exposure to less liquid assets so as to have more room to manoeuver in case of a market turnaround**. This does not however prevent us from continuing to benefit from the momentum of small and mid-caps, which still keep the leadership of profits in Europe.

Finally, we are henceforth less focused only on the European recovery theme, and thus more diversified among various themes. **Our research in point of fact shows that the well-known virtues of diversification have become much more beneficial** today than during the past two decades. **Our investment themes remain, however, in step with a promising world cycle: the digitization of the economy, the stabilization of emerging countries, the improvement of perspectives in certain sectors linked to commodities, and the financial stocks**.

In our international strategy designed to preserve and grow capital (Dorval Global Convictions' strategy), we also invest in Japanese mid-capitalizations, and in those bond markets that keep a relative value, of which especially the Southern European countries, and certain emerging markets like Brazil, India and Mexico.

On its value selection, Dorval Asset Management considers that we will need more selectivity on each investment case, and so a higher profitability hurdle. Therefore, the managers choose the values which benefit from economic growth but at reasonable prices, with for the most part, earnings expectations that will be superior to the forecasts of the consensus of analysts.

Conclusion of investment policy: Increased flexibility, diversification and selectivity on markets

With an increase of corporate profits which should continue to meet expectations, and long-term interest rates perhaps only a little higher in 2018 than in 2017, the fundamentals of the stock market seem solid. High valuations and increased investor optimism justify, however, active risk management through increased flexibility and great selectivity.

For savers, the implications of the pronouncement of economic prosperity by the management team are in the end quite simple: Dorval AM' strategies are managed without any reference to the composition of the indices. Instead the investment team's choices are based on strong convictions among the most promising themes. For the more risk-averse savers, we offer more flexible management solutions which aim to adapt to the economic and financial environment. We believe that is a better solution.

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