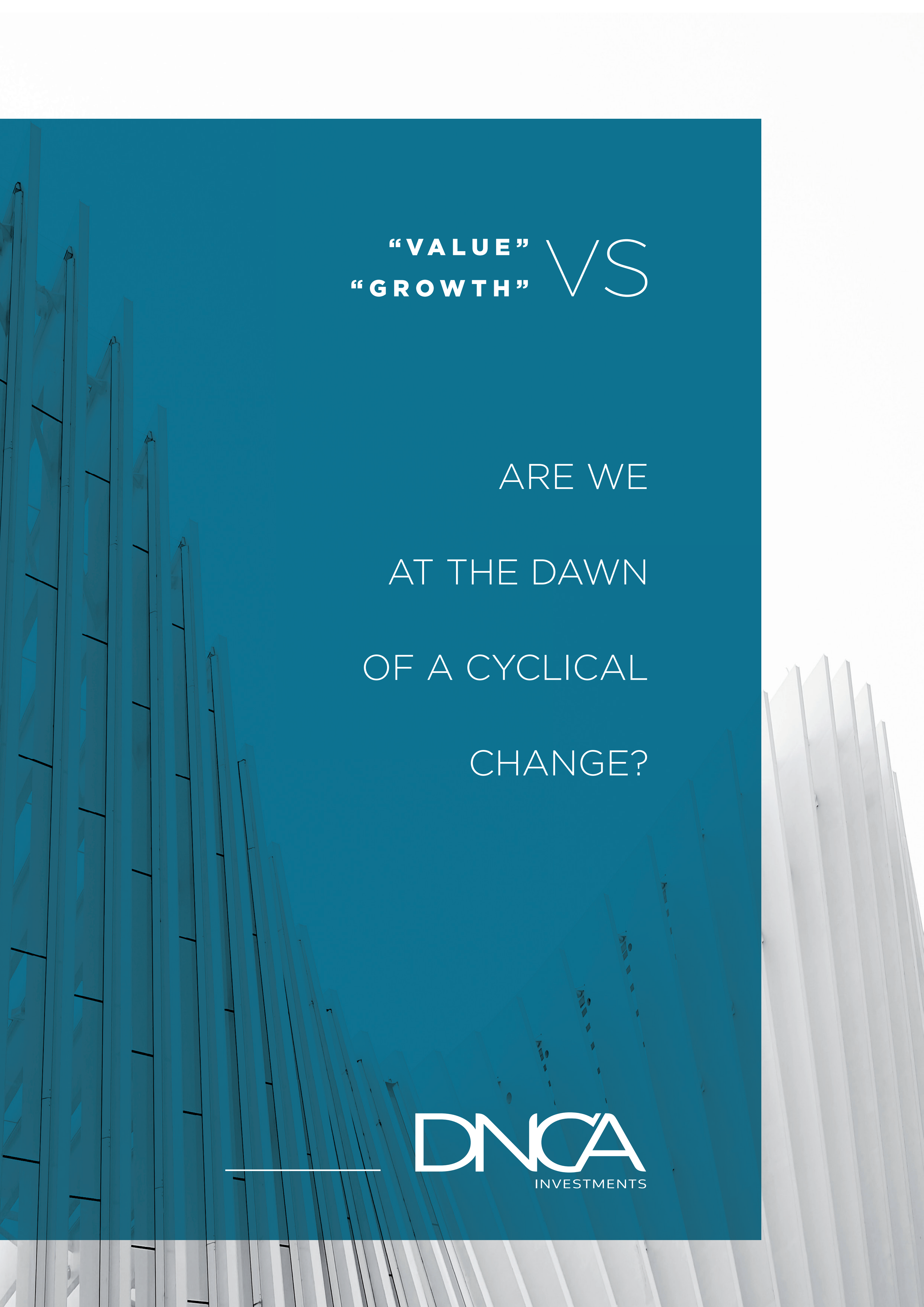


"VALUE" VS "GROWTH"

ARE WE AT THE DAWN OF A CYCLICAL CHANGE?

DNCA INVESTMENTS

ARE WE AT THE DAWN OF A CYCLICAL CHANGE?

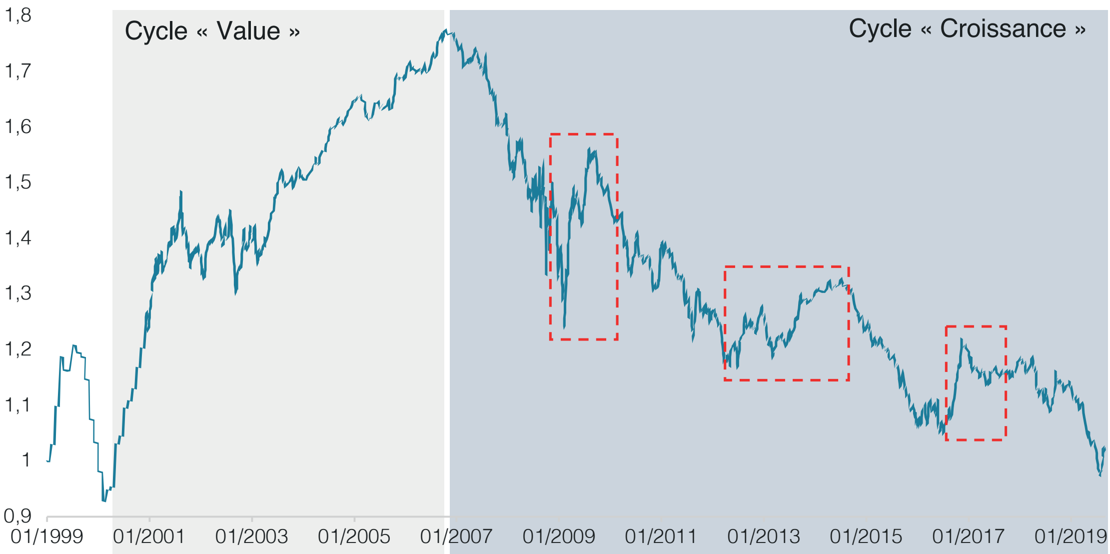
Since the financial crisis of 2008, Value Equities have posted historical levels of underperformance compared to Growth Equities. Geopolitical uncertainty, sluggish economic growth and negative real bond yields go a long way to explaining such underperformance. Yet has the long growth cycle that started in 2007 now reached its peak? Should we expect value to return to favour in the medium term?

A growth cycle of unprecedented duration succeeded the value cycle of the early 2000s

The highly favourable cycle for Value Equities that began in 2000 and ended in 2007 was driven by the globalisation of trade and sustained growth rates. Sectors sensitive to economic cycles such as commodities, manufacturing, construction and financial services profited from such positive catalysts. Commencing the period at extremely low valuations, these sectors enjoyed a spectacular turnaround in the stock markets in just a few years.

Since the financial crisis of 2008, the climate of uncertainty dragging down the global economy, successive crises in the eurozone, low interest rates and relatively lacklustre economic growth have favoured so-called "growth" companies that are the principal beneficiaries of falling interest rates.

FIGURE 1
GROWTH AND VALUE CYCLES
(MSCI Europe Value NR € / MSCI Europe Growth NR €)



Source: DNCA Finance and Bloomberg as at 30/09/2019

The growth cycle that has persisted over the past 12 years has also been interrupted by three rebounds in Value Equities, driven by an improved economic outlook:

- between 2009 and 2010, regained optimism about the economic climate led to a significant contraction of risk premiums;
- in 2012 and 2013, a second rebound occurred on conclusion of the sovereign debt crisis and on improved forecasts for European economic growth;
- a rally occurred in the second half of 2016 in response to expectations of reflation.

This data indicates that periods characterised by overestimation of the risks of recession and by high levels of political uncertainty represent the right time to switch to Value Equities.

The discounts applied to the Value style reach historic levels

The valuation difference between Growth Equities and Value Equities is at a historically high level. It is close to the peak during the dot-com bubble of 2000, offering significant catch-up potential.

FIGURE 2
THE GAP BETWEEN "VALUE" AND "GROWTH" P/E RATIOS IS WIDENING...

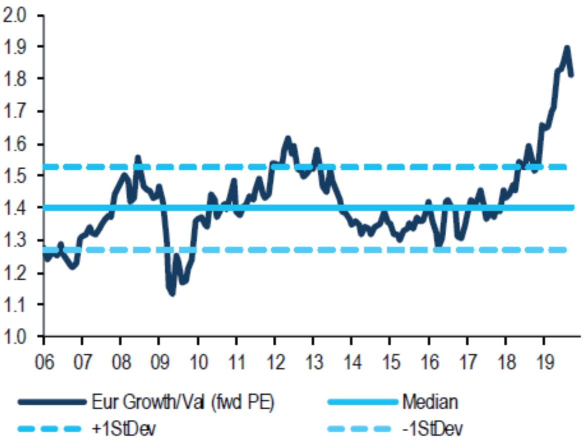
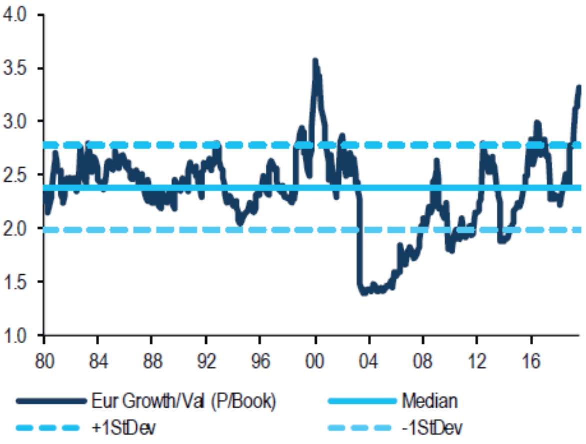


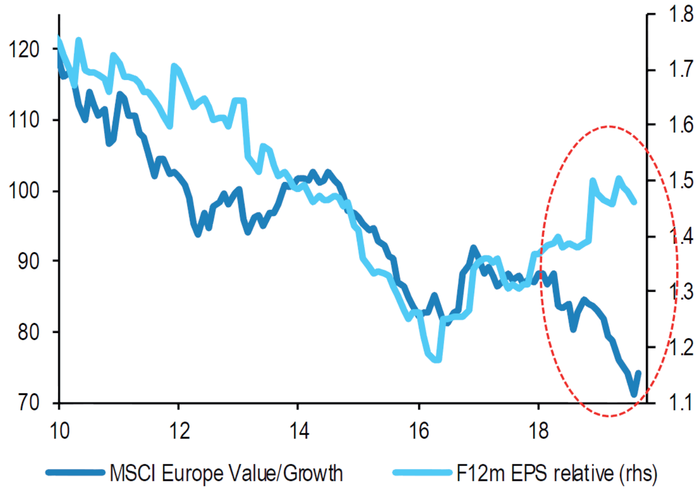
FIGURE 3
... JUST LIKE P/BOOK RATIOS



Sources: Barclays, Datastream and IBES as at 18/09/2019

The relative changes in earnings per share (EPS) are already showing a positive trend for the Value style, with EPS for Growth Equities having been significantly revised downwards to meet those of Value Equities.

FIGURE 4
EARNINGS PER SHARE, “VALUE” VS “GROWTH”



Source: Barclays as at 28/06/2019

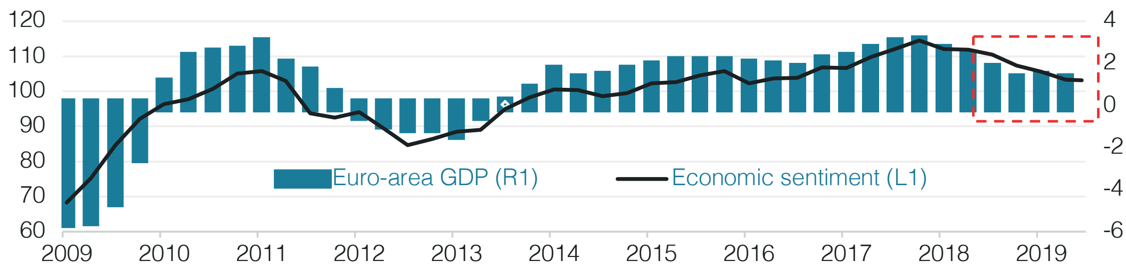
Growth Equities are currently being traded at historically high multiples (P/E 18.7x for MSCI Europe Growth NR as at 24/10/2019), despite a slowdown in profit growth. Investors therefore appear to be paying a high price for Growth Equities due to their safe harbour status rather than for anticipated growth in future profits.

What factors are pleading in favour of a change in style?

Even though Value Equities are currently significantly undervalued and posting relatively low P/E ratios (10.9x for the MSCI Europe Value NR as at 24/10/2019) and high yields, it is difficult to declare the emergence of a new value trend in the short term. However, a certain number of indicators militate in favour of a rebound in the medium term.

At the macroeconomic level, the economic climate appears to be less precarious than investors’ pessimism would suggest. Growth in the eurozone is stabilising close to its long-term potential despite the admittedly less promising international dynamics.

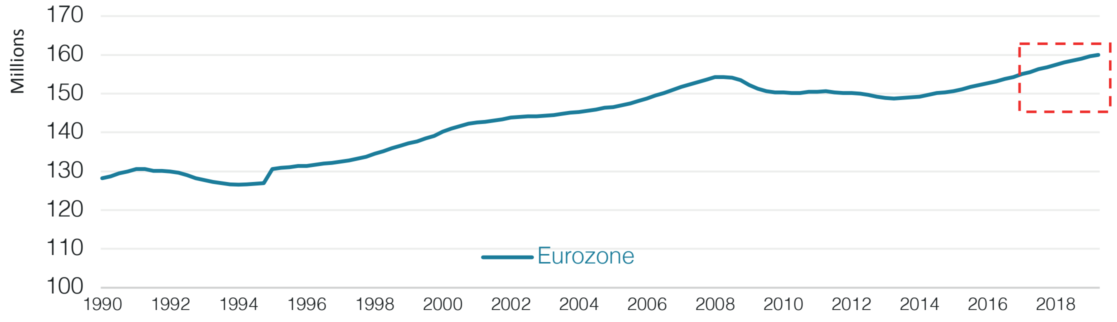
FIGURE 5
GROWTH AND ECONOMIC SENTIMENT IN THE EUROZONE



Source: DNCA Finance as at 30/09/2019

FIGURE 6

CHANGES IN THE TOTAL NUMBER OF JOBS IN THE EUROZONE

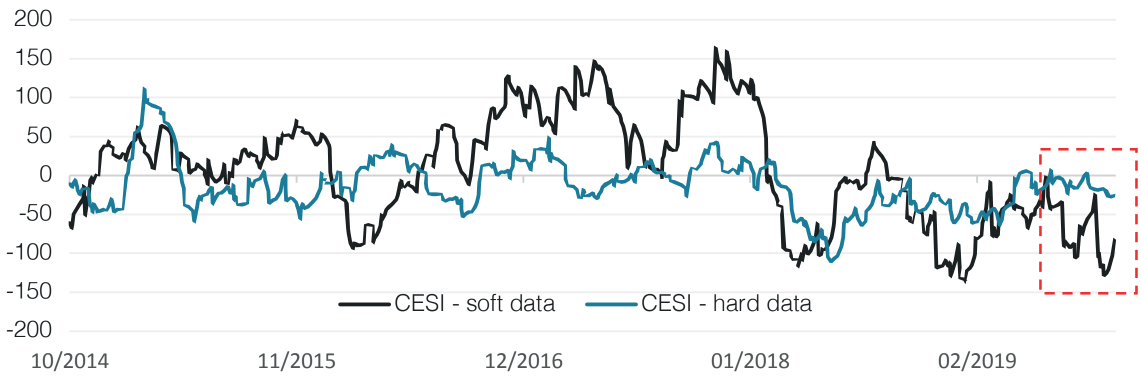


Source: DNCA Finance as at 30/09/2019

Data is also reassuring on the employment front and does not corroborate a scenario of imminent recession. This rude health in the job market could in the long term lead to a return of inflation, which could negatively affect Growth Equities and ultimately contribute to a return of the value style.

FIGURE 7

CHANGE IN THE ECONOMIC SURPRISE INDEX IN THE EUROZONE (CESI)



Source: Citigroup Economic Surprise Index (CESI) as at 30/09/2019

Comparing macroeconomic statistics[1] with investors' expectations[2], the economic surprise index for the eurozone reveals pessimism without any real grounds. The economic indicators rather reveal an economic climate in the eurozone superior to that anticipated by investors. A reversion to the mean could be positive for the value style.

With low representation within portfolios, Value Equities therefore currently appear to be undervalued. They are also suffering from the climate of geopolitical uncertainty weighing down on the economy: hard or soft Brexit, US-China trade war, tensions between Teheran and Washington... in addition to expectations of a possible global recession. Even though these securities could still be penalised in the short term, the risks have already been widely priced in by the markets. Patient investors can find some real bargains given the current discount.

(1) CESI Hard Data.

(2) CESI Soft Data.

DEEPER ANALYSIS

Value and Growth – just a question of style?

"Value" investors above all seek companies judged to be undervalued by the market whose stock prices do not reflect their intrinsic value(3), i.e. their real value. The reasons for such undervaluation can be multiple: controversy, disappointing results, reorganisation, difficult environment, low growth... Investors then enjoy the opportunity of investing at a "good price" in the companies they judge to be of high quality yet which are being brushed aside by the market in the short term. Driving forces such as change of management, reorganisation, new strategic plan and new shareholders may ultimately lead to a higher stock price.

"Value" companies are generally "established" companies that regularly distribute generous dividends, which is of significant benefit in periods of low and even negative interest rates. They are to be found in sectors such as finance, energy, commodities, telecoms, manufacturing and, more generally, in stock market scenarios characterised by prices significantly below underlying values.

Examples of Value Equities

Saint Gobain*	Bouygues*	Sanofi*
Specialising in the production and distribution of construction materials, the group is undergoing comprehensive transformation through two major projects: decentralisation to local business units and the sale of its least profitable assets detracting from the group's results. The management is in the process of successfully concluding the process and at less than 10x 2020 results with the dynamic renovation markets, the upside potential of Saint Gobain appears to us to be significant.	The group is active in 3 sectors: construction, telecoms via Bouygues Telecom and media via TF1. The telecoms business appears to us to have the greatest potential. After 7 years of deflation, no operator has expired and all must improve their cash generation to finance upcoming investments (fibre optic, 5G, spectrum). Mobile subscription prices are finally rising at both entry level and in the premium market. This should ultimately translate into higher ARPU and, therefore, cash generation. Bouygues' stock is trading at 12.3x 2020 P/E with cash generation of 7.2%.	The pharmaceuticals firm is entering a new phase of growth and the management has been completely renewed. Such growth will be driven by multiple divisions: vaccines, rare diseases, emerging markets and the Dupixent drug. Furthermore, at a CMD in December, the new management will decide on maximising new product launches, cost control and the future scope of the group's operations. The outlook for the group in the medium and long term appears to us to be poorly reflected in its valuation: the group is trading at 13.1x 2020 P/E with free cash flow generation of 6.2%.

**Equities in the DNCA Finance portfolios as at 28/10/2019*

"Growth" investors are interested in companies whose development (measured via revenue or earnings) is above average. Such companies are generally traded at a high price that reflects their future development potential and generally reinvest a significant proportion of their profits in the financing of growth.

Technology, biotech and healthcare are the growth sectors *par excellence.*

In summary, the growth investor is interested in the development potential of a company whereas the value investor seeks companies that are undervalued by the market.

(3) Present value of future cash flows.

	Value Equities	Growth Equities
Characteristics	Companies whose revenue and earnings growth is below the mean and is reflected in its valuation(4). Such companies generally make significant dividend payments.	Companies whose revenue and earnings growth is above the mean, reflected in a higher valuation(5).
Risks	The company's business is in structural decline and its stock price will never reflect its intrinsic value.	The growth anticipated by the market is overestimated and the slightest incident causes its stock price to fall.

Value and Growth - just a question of cycle?

In general:

The Growth style outperforms:

— when economic growth is low;

— when interest rates are low;

— during periods of high innovation.

During equity bull markets, Growth Equities tend to amplify market increases.

The Value style outperforms:

— when economic growth is high and profits are rising sharply;

— when inflation is on the rise (reflation);

— when real interest rates are rising.

During equity bull markets, Value Equities tend to profit from the rises although less than other share classes. Conversely, during bear markets, they exhibit more of a cushioning effect due to the existing discount.

(4 and 5) Measured by the price-to-earnings (P/E) and price-to-sales (P/S) ratios

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An asset management company approved by the *Autorité des Marchés Financiers*
under the number GP 00-030, dated 18 August 2000
A French SCS with share capital of €1,508,488.04
A non-independent financial investment advisor within the meaning of MiFID II

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