MARKET UPDATE
11 FEBRUARY 2016

Making sense of things

Since the beginning of the year, the equity markets have been in free-fall, with the Eurostoxx down [16%] and the S&P 500 slipping [10%]. Since the peaks of spring 2015, the correction has been even more substantial. At least in Europe, it meets the usual definition of a bear market (Eurostoxx [-25%], S&P 500 [-13%], MSCI Emerging Markets [-31%]). This has occurred amidst high volatility, with major dispersion between sectors and stocks and sometimes severe market fluctuation.

Risks that should not be underestimated

Numerous fears are dampening investor sentiment, including concerns about global growth (especially in China and the emerging economies, but also related to the risk of recession in the United States), the impact of the collapse in energy and commodity prices (not limited to a few countries but also on the banking sector and the risk of contagion), tensions on the bond market (spreads widening toward record levels seen in 2008 and 2012), the drastic fall of a number of emerging currencies and difficulties faced by some emerging countries in coping with their USD-denominated debt, China's ability to keep control of its monetary policy and currency in the face of massive capital outflows and shrinking currency reserves, elections in the United States, the referendum in the United Kingdom and geopolitical risks.

No capitulation yet

Despite the sharp decline on the equity market, we have not yet witnessed investor capitulation. While sovereign funds from countries exposed to oil and commodities have begun liquidating some of their foreign investments, particularly in European equities, stock transaction volumes are still moderate and European equity flows have been positive for several months (the opposite of the United States). If panic were to set in and investors capitulated, the correction could initially swell before potentially reaching its end.

Excessive concern?

The scale of the decline and volatility on the markets and the early stages of panic they have generated are more a reflection of investor sentiment than of a significant deterioration of fundamentals at this stage. In the United States, the labour market, consumer spending and consumer confidence remain strong. In the Eurozone, the slow recovery seems to be continuing, with leading indicators (buying intentions, consumer confidence, loan applications) remaining positive and pointing to a slight acceleration of economic growth.

Earnings publications in Europe, which are still ongoing, are also proving to be largely in line with expectations, although major disparities exist between sectors and companies. Finally, valuations of European equities, while not substantially discounted like in 2011, have reached attractive levels, particularly in relation to US equities, provided that profit growth stays on track in 2016.

What is the right approach in this adverse environment?

Against this backdrop, some securities have reached attractive entry points. Accordingly, we have gradually reinvested in our long-only funds, prioritising European domestic exposures and growth sectors and themes such as healthcare, telecommunications, technology (particularly the "digital transformation"), business services and consumer goods. Conversely, we continue to steer clear of commodities, oil and gas, capital goods exposed to these end markets and banking stocks.

As we write these lines, we have maintained a cautious stance in our flexible funds, whose primary objective is to withstand periods of difficulty, and thus far we have retained relatively moderate exposure to equities (Sycomore Partners: 42%, Sycomore L/S Opportunities: 41%, Sycomore Allocation Patrimoine: 22% equities, 30% High Yield, 17% Investment Grade), unlike in August 2015, when we significantly increased our exposure following the surprise devaluation of the yuan.

However, we took advantage of recent market movements to begin reinvesting in certain stocks which had been excessively penalised, such as Roche, Wirecard, Air Liquide, Com Hem, Accor, Store Electronic Systems, Solutions 30, Criteo, DS Smith plc and Carrefour. Conversely, we scaled back investments in some more cyclical stocks such as Schneider Electric, Arkema, DaimlerChrysler, Wienerberger and Rexel.

A continued market decline and a capitulation with more significant seller outflows and volumes could provide us with the opportunity to significantly but gradually increase the exposure on our flexible funds.

In credit, we are back to attractive yields: more than 5% in aggregate on our Sycomore Sélection Crédit fund, a record since the fund was created in 2012.

Our approach to navigating this complex and uncertain environment is based on agility, responsiveness and selectivity and taking advantage of the opportunities offered by market volatility.