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After the rebound

The health crisis is gradually easing in the Western world, in the United States and particularly in Europe where the **situation is drastically improving**. With regard to the economy, the damages caused to the private sector are evident in most segments.

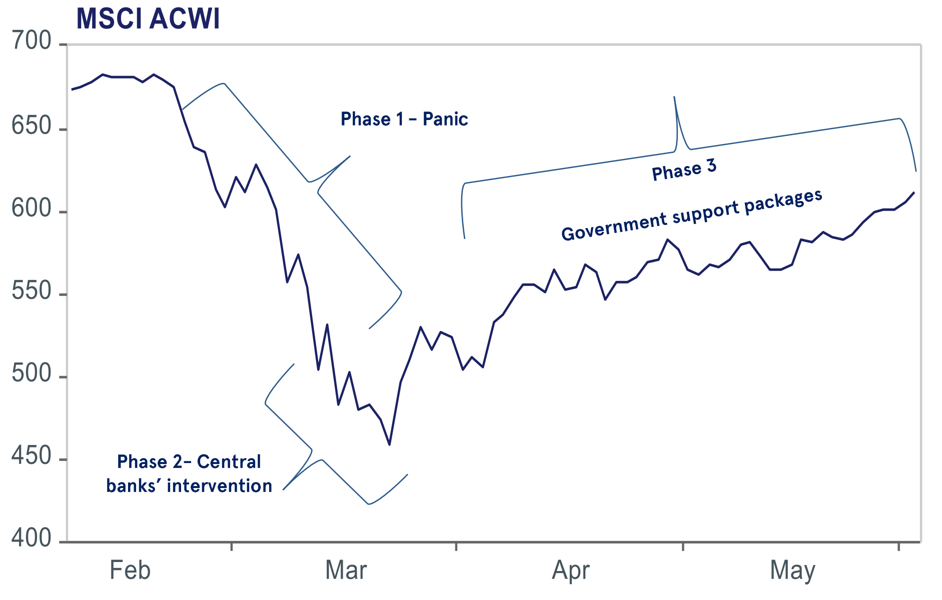
However, **the interventions of historic magnitude** conducted by central banks and governments **supported markets** and enabled a significant recovery of all risky assets. The losses recorded in 2020 on the main equity indices are not comparable to those of major economic crises. This rebound is evidently supported **by the inflow of liquidities**, but also **by the substantial decrease in interest rates in the US**, and by **the conviction that central banks and government will not limit the scope of their interventions** to deal with the current situation and potentially upcoming corrections.

This "macro" approach will now need to be confirmed by the real economy and constitutes, in our view, a new phase of the financial aspect of the Covid-19 crisis.

A financial crisis of historic proportions – phases I to III

Equity markets recorded their sharpest fall, with a 33.8 % drop on the € MSCI World Net TR between 19/02/2020 and 23/03/2020[1].

Significant interventions by central banks helped stabilize the financial markets, which strongly recovered (most significant rebound ever observed, +43.5% on the € MSCI World Net TR between 23/03/2020 and 08/06/2020) once investors were convinced that government support packages were sufficient to save the economy.



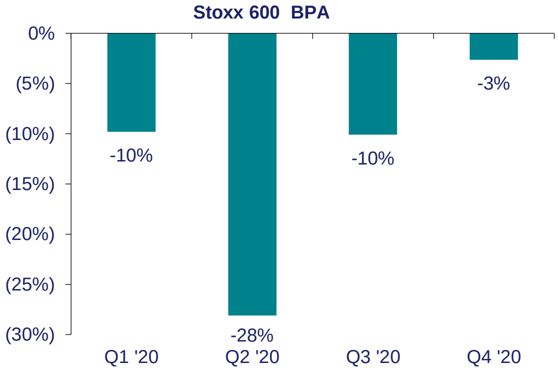
Source: FactSet Prices

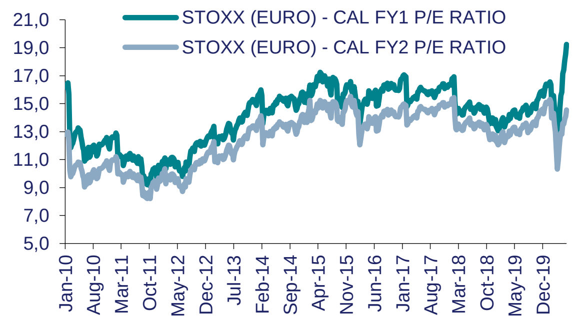
[1] Bloomberg

Phase IV – back to the fundamentals

We very much welcomed those monetary stimulus packages which contained risks on the credit market whilst impressive fiscal measures have limited the deterioration of companies' financial results to levels comparable to those of "a normal" recession. However, the fourth phase, which has just started, will be crucial and will be more heavily influenced by economic fundamentals.

The deconfinement took place without major friction and investors are increasingly confident that the economic recovery will be rapid and will take a "V" shape. This has allowed the market to rebound significantly since the end of March.



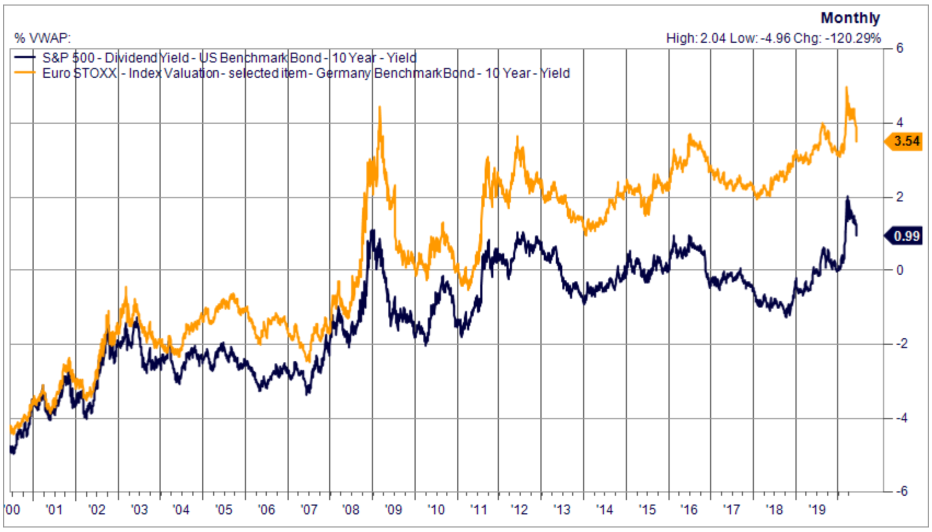


Source: Exane, June 2020

Although high frequency data (car traffic, occupation of shopping centres, data linked to deconfinement..) currently points towards a rapid recovery, particularly in those sectors which have been most affected by the crisis, such as restaurants, retail, hotels, air transport and the automotive industry, we ought to bear in mind **that current market levels are close to historic highs.**

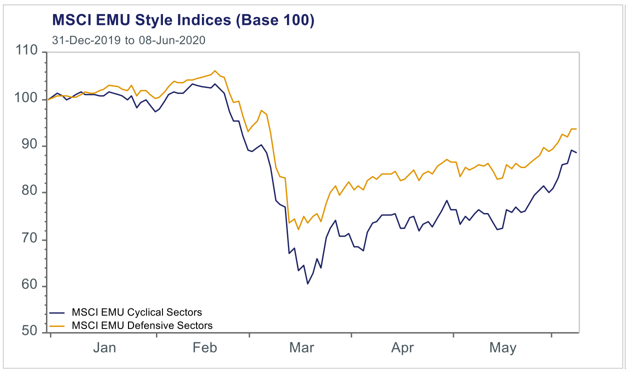
Analysts expect earnings per share to drop by nearly 30% in the second quarter and to then normalize rapidly. This hypothesis of a rapid resumption of economic activity could turn out to be too optimistic if the measures of social distancing prevent economic agents from returning to their normal habits or if a second wave of infection occurs later in the year. Too little is known concerning new operating processes, especially in terms of additional costs, to be able to comment on the levels of profit expected in a few months. Although consumption seems to be slowly resuming, the repercussions of unemployment are difficult to estimate.

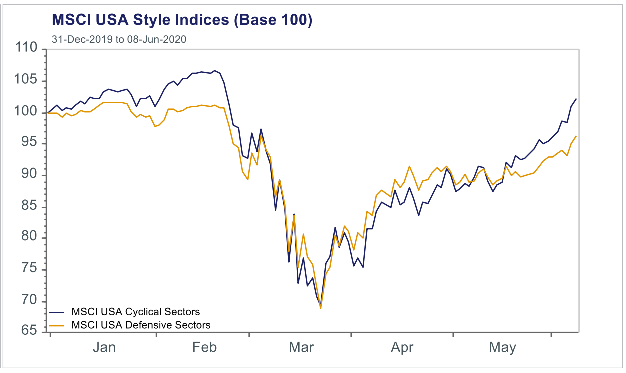
Since we currently fail to fully understand the impact upon short- or medium-term results, **analysing companies individually or collectively proves to be complicated**: valuation levels seem very high on the basis of 2020 but appear much less excessive based on 2021 profits.



Source: Factset, June 2020

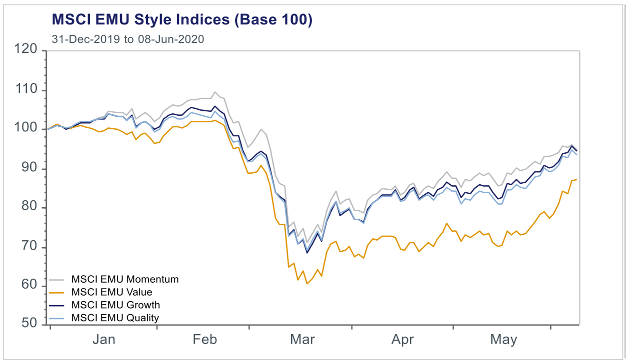
In terms of **market valuation, one of the most reliable indicators has been dividend yield relative to the return of fixed income securities such as bonds**. If we consider nominal returns, the equity market seems undervalued compared to historical dividend yields. However, current levels suggest that investors anticipate dividend forecasts to be excessively optimistic and expect companies to favour maintaining high cash levels. Once again, a rapid exit from the crisis would have to be confirmed to fully restore confidence.





Source: Factset, June 2020

In the eurozone, **cyclical sectors are still significantly lagging behind** defensive ones **and have therefore considerable room to catch up** relative to the US market.
A confirmation of a rapid economic recovery or the launching of major accommodative programs such as the Green Deal for Europe could accelerate the recovery of cyclical stocks.



Source: Factset, June 2020

Style rotation is more advanced in the euro zone even if the "**value" style** (discounted stocks) did not follow the rest of the market throughout the rebound. While the **"growth" style** (stocks that tend to increase in capital value, year after year) is fundamentally favoured by the current macroeconomic environment, since a large part of their value comes from profits which should materialize over the long term, making them sensitive to changes in the discount rate but less sensitive to short-term profit declines. Current growth stocks tend to be tech companies, which clearly benefitted from the Covid-19 crisis.

The economic crisis caused by the pandemic is not a liquidity crisis as evidenced by the high volume of IPOs and bond issuance. **The absence of a banking crisis along with ample liquidity levels make stock market valuation levels sustainable, unless the economy recovery is not confirmed, or a second wave of infection occurs.** In the short term, we consider **the eurozone to have more potential than the US** with greater potential to catch up, a more imminent cyclical recovery resulting from a more advanced deconfinement, and lower valuations. Higher risk taking will take place along with the announcements of positive health developments.

The period of corporate publications during the summer will be key, not to see the damage caused by the confinement but rather to gauge the speed of the recovery.

Investors' cautious stance along with the absence of new flows on equity markets over the past quarters, could enable market to display an upward trajectory similar to that of the beginning of the year which, as we recall, was fuelled by enthusiasm regarding the development of the US- China trade war.

Risk factors to consider are the **Brexit negotiations**, the **support plans launched by France and Germany, the US presidential elections** and their impacts upon the relation with China.

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