LA FRANÇAISE
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Press release

Outlook and convictions for 2017

Despite generally positive expectations of growth in 2017, we should bear in mind certain factors that indicate uncertainty: President Trump's protectionist tendencies and the potential difficulties to realize his proposed program, the European elections, and the consequences of Brexit.

Nevertheless, global growth seems to continue at a faster pace, which is still moderate at this stage, but sustained by several positive signals:

- **Improved macroeconomic indicators;**
- **The strong recovery in inflation expectations.**
- **Increased interest rates;**

Accordingly, the United States is experiencing rapid expansion – consistently driven by domestic consumption – whereas China **is controlling the expected slowdown in its growth while also rebalancing export and consumption trends within its economy.**

Although the eurozone is still threatened by the possibility of a negative outcome in the upcoming elections, it shows signs of improvement. The consistent decline in unemployment rates will bolster household income, thereby establishing a solid basis for growth through consumption. Lastly, **the United Kingdom has shown astonishing resilience faced with the prospect of Brexit.**

Last month, the US Federal Reserve, to some extent, reinforced these positive expectations with a planned acceleration, in 2017, in the normalization of US monetary policy.

The **ECB, on the other hand, has announced a major turning point in its monetary policy**. The reduction – albeit conservative – of its asset purchases is a first step towards the reorientation of its Quantitative Easing programme, which should show a gradual decline over the next two years.

In light of these considerations, Jean-Luc Hivert, CIO Fixed Income & Cross Asset and Laurent Jacquier Laforge, CIO Equities share their convictions for 2017.

1/ Attractive bond segments despite a difficult year ahead

"In this global environment, our negative convictions for 2016 continue into 2017 for government bond rates in the United States and in Europe. Although yields in Q4 2016 showed a significant increase and we are reaching long-term theoretical levels, especially in the United States, inflation and monetary policies are still key determinants and will be poorly oriented in 2017 for the government bond market," said Jean-Luc Hivert.

"Due to our caution with respect to government bond rates and our conviction that inflation will accelerate, we have a strong preference for bond exposure via inflation-indexed securities," he added.

The appeal of high-yield asset classes

Many stakeholders will need asset classes likely to increase the returns of their investments, such as credit, emerging bonds and financial subordinated debt.

The year 2016 had started well for **emerging sovereign bonds** with significant purchasing flows. The increase in American interest rates and the rise in the dollar in early November stopped this trend and cut the earnings for the year. "The violence of these interest-rate and currency fluctuations is probably a thing of the past, and given that global growth is strengthening, the risk premiums for many emerging companies seem attractive for 2017," argued Jean-Luc Hivert.

The high-yield market performed very well in 2016. "It would seem, however, that this market still has untapped potential, with unwavering demand. The first Q3 results published by companies are positive and the default rates remain reassuring, especially in Europe," added Jean-Luc Hivert.

The European banking sector was heavily penalised in 2016. The very low and flat yield curve and restrictive regulations generated deep concerns about the sector's profitability and even viability. These two factors will relieve their pressure in 2017, and the regulations should be amended after certain adverse effects have come to light. "The subordinated debt market, in particular **bank loans, is still one of our strongest recommendations**. The asset class offers even more attractive yields and the possibility of delivering solid performance, even in an environment of gradually increasing interest rates," added Jean-Luc Hivert.

"Over the last two years, the beginning of each year has heralded a difficult 12 months for bond assets. This year will be no exception, based on our analysis of slightly increased government bond rates. There are, however, some bond segments with attractive profiles. Our preference for 2017 is geared towards inflation-indexed bonds and high-carry bonds that should continue to benefit from consistently low interest rates, especially in Europe," continued Jean-Luc Hivert.

2/ 2017 Equity Market: driven mainly by profit growth

Profit growth gains credibility.

Following the release of Q3 2016 results, the consensus for 2017 was revised upwards, resulting in profit growth expectations of around 12%. This expectation was met in every major world region for the first time since 2011. "In our opinion, this expected improvement in corporate earnings is essential," stressed Laurent Jacquier Laforge.

The first reason is due to the **combined rise in stock market indices over the last few years and decline in results across most geographical regions**. Accordingly, the price to profit ratio – one of the measures most commonly monitored by investors – has increased to historically high levels, thereby creating a high-risk valuation zone, in any event an uncompromising one.

Another reason is due to the fact that profits were stable or showed a decrease in absolute value over the last few quarters in the US and over the last six years in Europe. A return to growth would mark **a key turning point in this downward trend** and, finally, allow companies to recover from the crisis.

Lastly, these newly positive expectations in terms of profit growth would confirm the macro-economic elements that have been established for several months (see section 1).

A negative equity/interest rate correlation

"The equity/interest rate correlation has been highly negative over the last few months, with increased interest rates (drop in bond pricing) leading to an upward trend in the equity market. This configuration favours an expected recovery in business activity and profit growth," said Laurent Jacquier Laforge. It has marked sectoral effects with a rotational movement in favour of cyclicals, banking services, commodities, and at the expense of defensives and yield. "From a sectoral perspective, **commodities, financials and oil are the industries that recorded the greatest increases in profit growth expectations** whereas consumption, telecoms and health continue to record slight downward adjustments," added Laurent Jacquier Laforge.

A geographic allocation that favours the eurozone

"In our opinion, the eurozone offers **the strongest performance driver linked to accelerated global growth**, given its openness to global trade. Moreover, from a technical perspective, it is a region that is under-owned in global institutional portfolios." It is also most positively impacted by the rising US dollar, offering delayed performance. "The reasons for this under-performance of the euro market are due primarily to a busy and uncertain political calendar in 2017, which weighs on the zone, and to consistent uncertainties related to the banking system (particularly in Italy). Each uncertainty resolved this year could strengthen its positions," explained Laurent Jacquier Laforge.

Neutral with respect to the American market

"We remain neutral with respect to the American market. We consider the market to be optimistic, and accordingly, it is mostly positive post-electoral news that has been absorbed by asset prices." Nonetheless, this neutrality takes into account three technical elements that will influence the results of American companies: (i) the decline in corporate income tax – each percentage drop in tax represents a 1% increase in the S&P500 results for 2017 –, (ii) the repatriation of some of the funds held abroad, generally estimated at $2,500 trn, and (iii) US employment safeguard measures. "In the United States, we favour the oil, banking and technology sectors," said Laurent Jacquier Laforge.

Caution with respect to emerging markets

"We are cautious with respect to emerging equity markets due to the rising dollar, and despite there being room for growth in these assets. Following the recent upward spike, we no longer have a strong bias towards the dollar. However, as in 2016, the performance of equity markets should remain highly influenced by currency movements," commented Laurent Jacquier Laforge.

"Growth has rebounded more strongly, with room for positive revisions; inflation and interest rates are getting back to normal, and there is much room for the reallocation of assets. Although recent price gains in the latter part of 2016 tell a positive story of recovery, reducing the scope for error, we think the rebound in profit growth – especially in the eurozone – should accelerate and support positive performance in equity markets and more particularly European markets." concluded Laurent Jacquier Laforge.

About La Française

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La Française has a multi-affiliate business model organized around four core activities: securities, real estate, investment solutions and direct financing. The group caters to institutional and private clients throughout the world.

With 559 professionals and offices in Paris, Frankfurt, Geneva, Greenwich (CT, USA), Hong Kong, London, Luxembourg, Madrid, Milan, Seoul and Singapore, La Française manages over €58 bn* in assets.

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*as at 30/11/2016

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