Markets
& Convictions

September 2023

RJ Management

Equity markets have rebounded strongly, driven not by earnings growth but by the expansion of multiples. At the same time, this investor enthusiasm has been compounded by a more complex economic reality, as illustrated by the number of corporate bankruptcies. We are more than convinced of our "energies" theme, with very low valuations and buoyant earnings growth prospects. Our economic scenario remains unchanged, with structural inflation set to take hold, an inevitable economic slowdown, and central banks which, for the time being, will have no choice but to keep their key rates high.

Macro

- The stock markets are exiting the summer with points nearly identical to last June, following a significant correction in August; their Year to Date performance: S&P500 +17.61% / Nasdaq +34.06% / Europe Stoxx600 +7.82% / SMI +3.22% / CSI300 0.69%.
- The frenzy of the American tech sector concerns only a very limited number of stocks and themes.
- The 7 mega-cap companies (Alphabet - Amazon - Apple - Microsoft - Meta - Nvidia - Tesla) alone explain 70% of the S&P500's performance this year!!!
- For Nvidia and Meta, the market anticipates strong profit growth for 2023 and 2024, yet for all other stocks, declines are expected, and yet these stocks show largely positive performances this year... Is this justified?
- The long-awaited recession does not seem to have arrived, as seen in European indices (especially the French), which have been supported by the luxury sector.
- Unemployment remains historically low (3.8% in the US / 6.4% in the Eurozone), and inflation appears contained (US @ 4.7% / Eurozone @ 5.3%).
- However, the situation is not as rosy, except for luxury and tech. The rapid rise in interest rates and hence the cost of debt imposes an economic slowdown desired by our central banks (latest speech by J Powell at Jackson Hole).
- Germany, the flagship economy of Europe, focused on industry and exports, is already experiencing a recession.
- During COVID, Western consumers largely benefited from the transfer of wealth from states to their savings accounts... This is clearly not the case in China, which has not seen a post-COVID rebound.
- Last spring, 10-year USD rates were at 3.3%, and they have now returned to their high point at 4.2%.
- This reflects a more active economy with long-term inflationary pressures that seem to be anchoring further.
- The inflation phenomenon has allowed many companies to significantly increase their prices at the end of the production chain, creating the illusion of positive nominal growth.

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Convictions

- Since 2021, we have had a very defensive view of the financial markets in general.
- This allowed us to withstand the sharp decline in 2022 and also explains our positioning in 2023.
- We observe this rally in some US tech stocks, noting that it is almost exclusively due to an expansion of multiples and not profit growth.
- The P/E ratio of the S&P500 has increased from 16X in 2022 to over 20X currently.
- This reflects a euphoric market that clearly does not anticipate a recession and barely foresees a mild slowdown.
- We do not share this positioning.
- Our conviction revolves around a profound paradigm shift.
- For the past 20 years, our economies have benefited from a significant growth cycle driven by three essential factors: very low capital costs, a consistently available workforce with low wages, and abundant and affordable energy.
- These three variables have fundamentally changed:

    o Energy: Massive underinvestment in new resources over the past 10 years, exacerbated by geopolitical crises, will force commodity prices to remain much higher to stimulate new investments to meet growing demand.

    o Labor: Our aging populations, sparing nothing of the world's factory (China), will exert structural pressure on wages.

    o Interest Rates: For the two reasons mentioned earlier, we are convinced that the inflation phenomenon is structural and not cyclical. It will not return below 2%, and our economies will have to live with a sustainably high cost of debt.

- In his recent speech, J Powell was clear: the FED desires an economic slowdown, stating, "Getting inflation sustainably back down to 2 percent is expected to require a period of below-trend economic growth as well as some softening in labor market conditions."
- The market builds its convictions on index analysis. Some are surprised to see soaring interest rates while at the same time a reduced cost of debt for the S&P500 index.
- Yes, the seven largest tech companies, representing over 25% of its market capitalization, have significant net positive cash reserves, explaining why they fully benefit from the rise in interest rates (and consequently, the S&P 500 by extension).
- But these seven companies do not represent the real situation of our economies; bankruptcies are increasing significantly.
- Regarding our strong conviction in energy for over 2 years, we remain just as constructive.
- Unlike the tech or luxury sectors, our convictions (TotalEnergies, Shell, BP, ENI) have shown very strong performance over the past 2 years but with multiples that have remained the same (PE ratios between 5x and 7x).
- It is, therefore, the significant growth in their profits that explains their stock performance.
- As for their future profits, we have a strong conviction that the price of oil will settle around a new floor of USD 90 - USD 100.
- Economic slowdown or not, our economies are completely dependent on these energies, and the consumption of emerging countries has become more significant than that of Western countries.
- The Americans have depleted their strategic reserves since 2021, so it is a depleted source of supply.
- OPEC+ has made significant progress and will make it clear to the world that they will only seek oil if it is profitable (therefore, more expensive).
- We are convinced that the energy transition is very poorly managed by our politicians, as seen in Germany (the first country to rush into the anti-nuclear and pro-renewable energy wave), which has just decided to dismantle wind turbines in favor of a coal mine!!

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- But the energy transition is, above all, a necessity and an investment opportunity. We participated in the launch of the Volta fund last May; our latest interview with the manager is available.
- On the bond side, we still favor short maturities, except for the USD, where when the 2-year Treasury rate exceeds 5% per annum, we find the yield interesting (vs. time risk).
- For the past 18 months, we have taken a very cautious approach to all assets that heavily rely on debt (Real Estate, Private Equity/Debt); the environment of sustained high-interest rates has and will significantly impact the valuation of these assets.
- The spectacle of American politics will return to the forefront, with a "tired" Biden and an active Trump on social media.
- We are closely observing the reactions of Chinese authorities to revitalize their economy.

Our conviction regarding 'energy companies' since 2021 is no less impressive than the famous American tech sector (including dividends)

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