Financial Newsflash

Brussels, January 2019

capital at work
Wealth Management Foyer Group

Turbulent times, but promising news coming up

For the first time in many years, investors are facing negative returns as the global equity market has fallen sharply. 2018 turned out to be a very difficult year for European and Asian stocks. More recently, the major American indices fell by more than 10%. With such negative movements, it is inevitable that your portfolio has been adversely affected. To indicate how exceptional the past year was, we rest on two key observations:

- For the first time since 1994, holding cash was more profitable than owning shares and bonds.
- For the first time since 1969, holding cash yielded a positive return while owning shares and bonds yielded negative returns.

In such a turbulent period, we believe that most of the bad news have already been integrated in the prices, which is encouraging looking forward. The now famous list, a.k.a. the "wall of worry", will not sound unfamiliar to you. The following features are currently standing out.

- Starting with the trade war, we entered a crucial 90-day period following the G20 summit in Buenos Aires in which the United States and China have agreed to find a deal. The financial markets assume that this fog hanging over the markets will not immediately disappear. A lucrative deal for both side would be an incredibly positive outcome.

- A second major concern is the "uninvestability" of Europe. The 4 largest European economies have to deal with economic, political and social problems that put the cohesion of the European Union under pressure. Do not forget that the European elections are coming next May and that Brexit still has to be completed by then. The situation therefore remains tangled. The only merit that the complexity of Brexit exhibits is how dangerous it is to leave the European solidarity. In our eyes, however, it is clear that international diversification of our portfolio is an absolute necessity.

- This brings us to the last major obstacle to a more positive stock market climate: Trump's United States. Concerning tax reforms and incentives, the maximum feasible has been reached. It is impossible to do more. The tax cut has already given the American economy a huge boost. Furthermore, the monetary stimulus has disappeared now that the FED has raised its interest rates 9 times and people still fear a slowdown of the American economy.

Ultimately, the stock market is a reflection of future profits and the price that investors are willing to pay for them. Firstly, while we believe uncertainty is hovering over forecasted profitability, we do not believe that the world is entering a global recession. We therefore would expect companies' earnings to stabilize rather than drop. Secondly, when mentioning the pricing of the market, displaying some figures helps illustrate the current state.

1. First of all, interest rates are still exceptionally low, especially in Europe. In the United States, even the current 2% to 3% interests can be considered as low and yet, many factors are indicating that this trend is there to stay. For example, the anchor point for the valuation of all assets in Europe is the risk-free interest rate. This is defined as the 10-year German state interest rate in Europe, which currently stands at 0.25%. Clearly not an attractive alternative.

2. Today, investors pay about 15 times the profits of listed companies. Many of the companies we own are now a lot cheaper. The return on investment of these companies amount approximately to 6,7%. Part of it (~ 2.5%) is paid out in the form of a dividend. The other part is used by the company for reinvestments.

3. Subtracting the risk free rate of 0.25% to the return on investment of 6,7%, or 6,5%, provides the risk premium, or the extra return that you receive by investing in shares. This extra compensation for equity investments is indeed very high. The ones currently buying shares are gradually gaining an insight on attractive future returns. The likelihood of better returns with long term equity investments is thus particularly high.

This strategy is based on long term future forecast of positive returns. In the short term, we have taken a few measures to protect the assets of our customers. First of all, we increased the weight of government bonds to more than 60% of our fixed income securities. We invested in government bonds from strong countries such as Germany, the Netherlands, Norway, Canada, Australia, and the United States. Second, we strived to increase the quality of our corporate bonds by selecting only companies with healthy balance sheets and sustainable debt repayment structures. Thirdly, we have significantly reduced the dollar risk in our bond portfolios from 30% to around 10%. This shift has enabled us to hedge a part of our portfolio from the appreciation of the dollar this year. We don't want to jeopardize this. Finally, we have a little bit reduced the volatility (of a part of your equity investments) through an option strategy.

Moving stock prices, and an increased volatility are often a bad barometer for risk. However, we can take advantage of that negative situation and opportunistically buy higher future returns today. The true risks inherently linked to investing are non-recoverable losses such as bankruptcies. Short term fluctuation in the stock market should not be considered as risks as, in the long run, those are "noises". What matters is that your portfolio is invested according to our strategy, in companies with healthy balance sheets generating strong cash flows. Companies that innovate and invest in the future.

CapitalatWork is an active asset manager whose investment process is not built around investing in stock market indices and other risky structured financial products. We have a distinct bottom-up process in which we invest in companies that we know and have analyzed entirely. We have a geographic and sectorial diversification. We remain faithful to this philosophy that has guided us for more than 25 years through the many market turbulences we have experienced. We are convinced that our focus on healthy balance sheets and cash flow generation will be a winning future strategy.

Yours sincerely,

The management of CapitalatWork Foyer Group