capital at work
Wealth Management Foyer Group

Dear Madam, dear Sir,

Allow us to start by surprising you. For the first time since 2011 we are witnessing a coordinated global upturn in economic growth. Europe has finally joined the pack. Notwithstanding the shallow and superficial criticism often received by the ECB, we definitely have to thank them, and not our politicians, for 2% real GDP growth in the € zone. As well as for the benign 2% inflation, instead of what could have been a devastating deflation.

Again maybe surprisingly, this uptick in Global and European growth, needs to be regarded and considered with a healthy dose of realism, when it is linked to the performance of equities and bonds trading in the liquid financial markets. There is a good side to this story, which allows for a healthy dose of optimism, but there is the flipside as well that needs to be monitored closely.

Let's start with the good side of the story. Stronger economic growth (+4%) creates a great environment for our selected companies, your investments, to grow their revenue. And to translate this growth in revenue in even bigger growth in earnings. Also for the first time since 2011, there will be earnings growth for the rest of the world, this is for non-US companies. For the first time since 2011! US equities have been the stellar performer since the end of the crisis of 2008-2009. This was underpinned and based on solid earnings growth by US companies. Conditions are there for the other equity markets for some catch-up. Global growth and our global approach will grudgingly continue to work to your profit. Bear in mind that, looking through our selected companies, 30% of their revenues are generated in Europe, 35% in the US, and another 35% in greater Asia. Our equity investments have had a very good start of the year, driven by really outstanding results from our companies for the final quarter of 2016, which were published over the past weeks.

The flipside of stronger economic growth can be that inflation picks up, which puts pressure on central banks to raise interest rates. This needs to be monitored, because valuations in all financial markets are impacted by interest rates. Falling interest rates over the past 35 years have driven up valuations in financial markets. This is very perceivable in fixed income markets, where long-term government bond yields are very low, and correspondingly bond prices high. And, also very perceivable in real-estate where rental rates are low and prices high. Ultimately, interest rates are also important for equity markets. Prices in equity markets are based on future cash flows. When interest rates rise, the current value for those future cash flows ends up lower.

Taking all this into account, there are several reasons why we continue to view equities as the preferred asset-class. The main reason is that interest rates would have to rise considerably from current levels, especially in Europe, before they will impact equity prices. It is tough to pin levels to interest rates where that could happen, but we would not worry too much before we see US 10 year government bond rates at 3.5% (currently at 2.5%) or German 10 year government rates at 2.5% (currently 0.5%). It is encouraging in that perspective that the recent comments from the ECB and the FED point to a very slow path of rising official central bank rates the next few years.

In this environment we have constructed well balanced portfolios for you. We invest for you in some of the most successful companies in the world. Balanced because we are strong believers in diversification. We diversify by investing in bonds and equity of companies all over the world and in various sectors. And we diversify by investing also in government bonds from countries that we belief will ultimately repay their debt, where we belief that the saying "my word is my bond" will hold true. This way we have constructed a portfolio of bonds for you that has a current yield of 2%. At the same time, that figure is the best indication for the average performance of the bonds in your portfolio for the next few years. For the years thereafter, that will depend on the trajectory of interest rates until then. Much in the same diversified way, we have constructed an equity portfolio for you with free cash flow yields of 6% on average for our companies, or for that matter, for you as a the shareholder. This 6% is a good starting point to be able to expect decent returns for the patient investor in equities.

We will close with a potential source for active management. May 7 we will know who will become the next French president. An election of Marine Le Pen would in a first instance not be welcomed by investors. We will then have to evaluate whether markets are overreacting or not. Because the likelyhood of a referendum on an eventual Frexit, even with Le Pen as president, is close to zero, because unconstitutional. The end of the € project is still far off, very far off. The positive view depicts a Europe at the end of the year with pro-Europe and sensible politicians like Macron or Fillon and Merkel or Schulz in the driving seats. The challenges for Europe are immense, but there is a real opportunity for reforms and further strengthening of European institutions. There is no ground for blind optimism, but Europe deserves maybe a little bit more respect from investors given the relative youth of the € (since 1999), and the direction given by young institutions like the ECB and strong politicians like Angela Merkel.

We will end with a quote that could be useful to bear in mind for future times ahead:

"Widespread fear is your friend, personal fear is your enemy."

(Warren Buffett, 2017 Berkshire Hathaway annual report)

Yours faithfully,

The Management of Capital*at*Work Foyer Group