INVESTMENT INSIGHTS

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EURO2016: NO BREXIT IN SIGHT…

Editorial View

Building our Euro2016 Dream Team

- The European Football Championship will soon monopolize attention
- Soccer and investing both rely on smart forecasting and team-building
- Based on our quantitative analysis, the winner is… England!

The Euro2016 kicking off in France around ten days from now will monopolize the media stage for the next month. For once, however, we won't be complaining about the media focusing too much on secondary news. Not just because we are soccer fans, but also because we see a clear link between the championship and investing, especially when matches occur during market hours! In the coming weeks, we will of course hear countless wild forecasts that would make an octopus look clever, but, as with investing, we believe the process is far from random. In fact, soccer tournament dynamics echo our two-stage investment process.

First, ranking national team relies on a "top-down" approach: information on the fundamental strengths to determine the likelihood of their team performing well. These findings are then compared with the odds already priced by other participants. As such, our macro selection is built on economic growth (levels and trend), business attractiveness (investment, human capital, and global competitiveness), and financial risk (debt, financing conditions, and political stability). Based on this analysis, our winner is England!

Second, football and investing both use a "bottom-up" approach to select the best possible players from a large number of contenders. Team-building and portfolio construction are both highly rewarding exercises. It is therefore no surprise that the Champions' League has been dominated by coaches for the past decade, with the likes of Mourinho, Guardiola, Ancelloti, Del Bosque, Ranieri, and more recently Zidane. Despite Ronaldo and Messi, the dominance of star players has progressively waned.

Choosing great players is not enough. The first pitfall is overpaying for talent. The second is attaching too much importance to a long, brilliant track record and thus acquiring players who have exhausted their potential. The third and most important is focusing on the players rather than the team. Each new player has to make sense relative to the team as a whole. These caveats – the latter especially – also apply to stock selection. Any new stock we add should help to diversify the existing portfolio. Using our multifactor screening models, we have picked the best stocks among qualified countries to come up with our "Euro2016 Dream Team"!

Chart of the Month

Decalia European Dream Team

Global Strategy

ECONOMICS & ASSET ALLOCATION

Betting for further improvements

- Global activity shows signs of acceleration, Q3 could surprise on the upside
- The USD has resumed its appreciation, but at a slow pace
- The Federal Reserve is back with a legitimate threat of rate tightening

On the surface, markets seemed relatively stable this past month, but a lot happened outside stock markets; most notably, crude oil gained 6% and the dollar reverted upward. For once, markets are consistent with fundamental developments as most US economic indicators have improved, the ISM remains above 50, and the oil exploration sector is finally showing signs of life. That offers both better prospects for profits and ammunition for the Federal Reserve to proceed with its planned rate hike this summer, a likely bullish signal for the USD but a mixed one for equity investors.

The turmoil in emerging markets is also receding. China seems be avoiding the hard landing scenario as several successive Yuan devaluations have eased competitive pressure. Meanwhile, the rebound in oil prices provides evidence of renewed demand from energy-intensive emerging economies. This price recovery should generate a positive feedback loop for commodity producers such as Russia, Brazil, and the Gulf region, while halting financial outflows. Although investors have already started to price in such developments, there is still a large potential for recovery in these depressed market, in our view. Needless to say, this is far from a sure bet, as risks remain elevated given the unpredictability of oil prices.

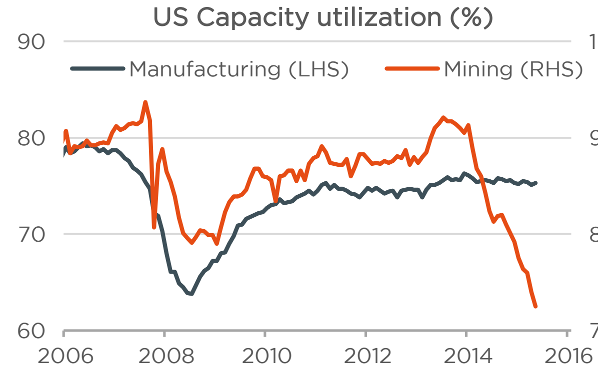
In Europe, growth remains on track, though not at a fast pace. Fortunately, France and Britain are taking a break from tedium: on one side of the Channel, strikes against measures to increase job market flexibility are putting the government under pressure, while on the other, the question of whether to leave the EU is dividing the country. Although we expect the Brexit to be rejected, the ECB will still be under pressure to reduce uncertainty and clarify the details of its purchase program.

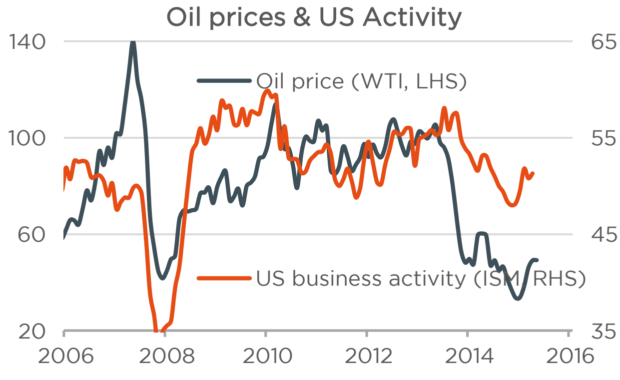
Reassuringly, recent earnings reports suggest some improvement on the corporate front. In May, global earnings revisions ratios ticked up for the third month in a row. Considering the rebound in energy and commodity prices, it was no surprise to see Materials and Energy sectors (but not only) paving the way. Meanwhile, investors continue to exit equity funds/ETFs, showing that they remain cautious. This scenario is consistent with our prior expectations, hence supporting our overall neutral positioning on asset allocation for now. Having said that, we have become more constructive in recent weeks as some key uncertainties have eased.

Equities: Neutral; our few regional bets, such as Switzerland primarily result from a sectoral bias.

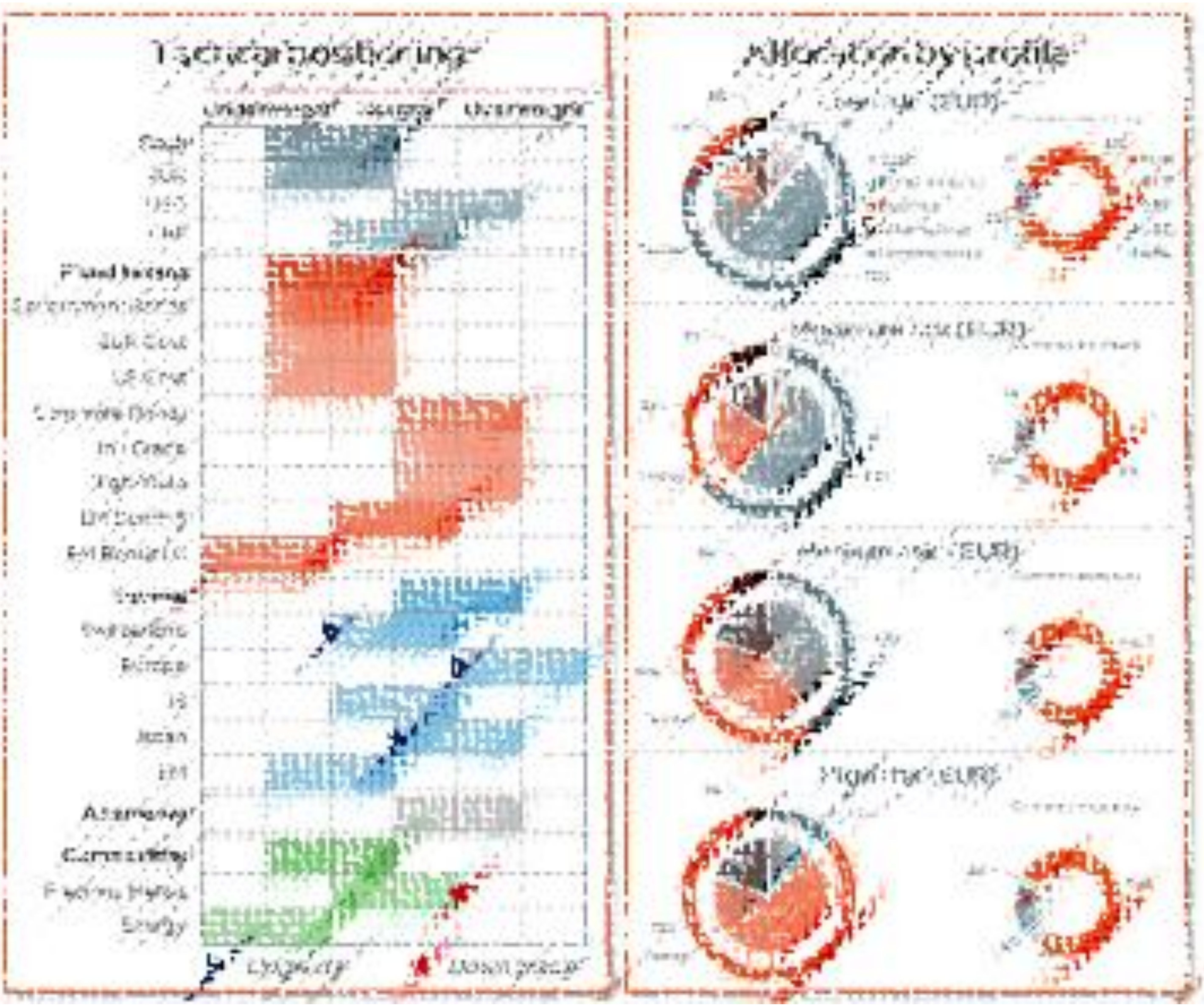
Bonds: Negative on duration and slightly positive on corporate, with credit favored vs. high yield, and an upgrade of EM debt.

Currencies: We expect major currencies to stay range-bound and the USD to slowly appreciate.





Asset Allocation



- Still Neutral on Equities – Keeping an opportunistic approach
- Reduce duration on European government bonds
- Favor credit and increase High Yield & EM local debt

Contacts

DECALIA Asset Management SA

31, rue du Rhône
Case postale 3182
CH – 1204 Genève

Tél. +41 22 989 89 89
Fax +41 22 310 44 27
info@decaliagroup.com

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