EQUITY MARKETS: WE KEEP OUR 'BUY ON DIPS' RECOMMENDATION

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Based on our expectation that global economic activity will pick up in the second half of the year, we stick to our 'buy on dips' recommendation. That said, we must expect volatility to remain high in the coming weeks and months. Our sector preferences remain energy, financials, and more generally stocks that pay high and relatively secure dividends, or provide exposure to themes relating to the environment, human capital, e-commerce, 5G and innovation in health care.

Coronavirus: latest update

The total number of infected people exceeds 87,000 and the number of deaths is more than 3,000. There have been more Covid-19 deaths in two months than there were during the 9 months of the SARS syndrome (2002-2003), although the 3.5% mortality rate is well below that of SARS (9.5%). While the number of cases has stabilised in China, it continues to grow outside the country. On Friday, the World Health Organization raised its estimate of a 'high' to 'very high' risk level.

Stock markets reconnect with reality

Until the beginning of last week, the behaviour of stock markets had diverged from that of bond markets, gold and currency markets. The latter expressed fears about the economic climate while equity markets favoured the medium-term outlook. The increase in coronavirus cases outside China has brought stock markets back to reality. They lost more than 10% last week.

A month ago, we had opted for a 'buy on dips' recommendation due to over-optimism, and negative technical signals. The aim was to take advantage of price declines towards the 200-day moving average before making any further purchases. Stock market indices have fallen below this moving average. So should we adjust our opinion?

The recovery is postponed but not derailing

Our base-case assumes a rapid recovery in activity in the second half of the year, and continued growth in 2021. In other words, current events are deemed transitory. Meanwhile, leading indicators will soften, as illustrated on Saturday by China's manufacturing PMI, which plummeted from 50 to 35.7 and the non-manufacturing PMI, which nose-dived from 54.1 to 29.6. These falls are much sharper than economists' expectations, and represent all-time lows. Today, China's Caixin PMI index, comprising smaller companies, has also fallen sharply, from 51.1 to 40.3.

In the coming weeks, economic data and earnings estimates will be revised downwards. Depending on the developments of the epidemic and its ensuing impact on the economy, central banks and governments may be called upon to come to the rescue, as already discussed by the Federal Reserve and the Bank of Japan. Reassuring comments from these two central banks drove the stock market rally this morning. Our approach to the equity markets remains anchored in a strategy of buying on dips.

The lowest levels have probably not yet been reached, but our view is that the bulk of price declines are behind us. We expect an extended period of volatility due to the economic backdrop described above and remain bullish during downturns. We believe that additional downside risks are low, not only because of our positive view on the economy, but also because the main alternative asset class, i.e. bonds, is extremely expensive.

Dividend yields are offering a major support to equities. Although we continue to expect price gains to be limited throughout 2020, the choice of sectors, stocks and themes will play a crucial role in delivering an outperformance compared with indices. We expect a wide dispersion of returns at this late stage of the economic cycle and bull market.

The best way of judging when the window of buy opportunity is about to close is to watch transactions that are showing increasing insensitivity to bad news flow.

We would need to see a significant increase in the risk of recession before reassessing our recommendation on equity markets.

Impact on our sector and thematic preferences

The uncertain (deflationary) context of a delayed economic recovery has hit a number of sectors that we previously considered discounted and highlighted. Energy in particular (oil and gas) fell sharply last week following the relatively uncontrolled spread of the disease, especially in Iran and the Middle East in general.

EUROPEAN PERFORMANCES 31/12 - 28/2	
MSCI EUROPE :	**-9,89%**
MSCI UTILITY	5,15%
MSCI HEALTH CARE	-5,06%
MSCI INFORMATION TECHNOLOGY	-5,49%
MSCI REAL ESTATE	-7,78%
MSCI CONSUMER STAPLES	-8,32%
MSCI COMMUNICATION SERVICES	-9,74%
MSCI INDUSTRIALS	-9,92%
MSCI FINANCE	-12,04%
MSCI CONSUMER DISCRETIONARY	-13,08%
MSCI MATERIALS	-14,43%
MSCI ENERGY	-21,91%

US PERFORMANCES 31/12 - 28/2	
MSCI USA :	**-8,26%**
MSCI INFORMATION TECHNOLOGY	-3,87%
MSCI UTILITY	-4,84%
MSCI REAL ESTATE	-5,02%
MSCI COMMUNICATION SERVICES	-5,75%
MSCI CONSUMER DISCRETIONARY	-5,79%
MSCI CONSUMER STAPLES	-8,04%
MSCI HEALTH CARE	-9,08%
MSCI INDUSTRIALS	-9,22%
MSCI FINANCE	-13,76%
MSCI MATERIALS	-14,34%
MSCI ENERGY	-24,60%

EUROPEAN PERFORMANCES 19/02 - 28/2	
MSCI EUROPE :	**-13,27%**
MSCI UTILITY	-10,48%
MSCI REAL ESTATE	-11,00%
MSCI HEALTH CARE	-12,00%
MSCI CONSUMER STAPLES	-12,43%
MSCI COMMUNICATION SERVICES	-12,73%
MSCI INDUSTRIALS	-12,87%
MSCI CONSUMER DISCRETIONARY	-13,28%
MSCI MATERIALS	-13,69%
MSCI INFORMATION TECHNOLOGY	-14,09%
MSCI FINANCE	-15,49%
MSCI ENERGY	-15,77%

US PERFORMANCES 19/02 - 28/2	
MSCI USA :	**-12,80%**
MSCI CONSUMER STAPLES	-10,13%
MSCI REAL ESTATE	-10,82%
MSCI HEALTH CARE	-11,10%
MSCI COMMUNICATION SERVICES	-11,23%
MSCI UTILITY	-11,81%
MSCI INDUSTRIALS	-12,39%
MSCI MATERIALS	-12,94%
MSCI CONSUMER DISCRETIONARY	-13,25%
MSCI INFORMATION TECHNOLOGY	-13,96%
MSCI FINANCE	-14,76%
MSCI ENERGY	-16,43%

NB: 19/2 was the peak of the stock markets before the correction

Share prices of the oil majors have already fallen below their 2016 levels. At the time, the barrel of Brent had declined to $30 while today it is rebounding above $50. In addition, the oil majors' cash flows and balance sheets are much stronger today than they were in 2016. But until the peak of fear has been reached, it is possible that the barrel of Brent will fall further, dragging down the sector's stocks, which are already heavily discounted.

The expected economic slowdown, albeit temporary in our view, is obviously hitting most cyclical stocks, especially tourism and travel-related sectors, hence transportation, but also luxury and, to some extent, other consumer spending. We prefer to remain cautious on these sectors in the short term.

Many companies will streamline their investments, which will hit the industrial sector in general (negative view). China, however, has announced that many factories impacted by the virus are now increasing production again thanks to their workers returning to work. But the situation remains unclear at this stage.

Companies including Microsoft and Apple announced they had suffered problems with supply chains. So we continue to recommend being selective in tech stocks, still with a preference for European tech, which is usually cheaper than US tech. Moreover, the election debates in the

United States could lead to measures aimed at reducing the power of the dominant tech giants (Alphabet, Amazon, Apple, Facebook, Microsoft, etc.).

We are very cautious on consumer staples (negative view), especially the beverage sector which is heavily exposed to Greater China. A number of companies have given gloomy forecasts for 2020. Other consumer segments (retail sales, luxury goods and other consumer discretionary, etc.) are also at risk but continue to benefit from strong consumption in the US. In the coming weeks we will watch to what extent the virus derails the US economy (or not as the case may be).

A better-protected consumer segment, which could even benefit from the present crisis, is e-commerce, as people will increasingly stay isolated, at home, and spend more time on the internet to keep themselves occupied. As a reminder, e-commerce is one of our investment themes for 2020.

Given persistent and high uncertainty (particularly as to when the overall peak in the disease will be reached), we are reluctant to fundamentally change our sector preferences at this stage. We continue to believe that the global economy will recover this year and that political and monetary authorities will do whatever is necessary to support it. China, for example, has already implemented an array of measures in this area.

Sectors that are most discounted, 'Value', and exposed to the cycle should then rebound strongly. In addition to energy, we believe that financials in general now have strong potential. These sectors are also among those that offer the highest dividends in the market.

For the reasons mentioned above, other cyclical and less discounted sectors are likely to take longer to recover.

Of course, in this context, defensive stocks outperformed in early 2020, particularly utilities. This was due to relatively healthy balance sheets and a resumption in growth linked to the environment, especially cleaner energy (electricity), waste treatment, water, etc. This is another theme we highlight for 2020.

Turning to the health care sector (neutral recommendation), we are more cautious than last year, following the rallies at the end of 2019. Mr Sanders' success at the first Democrats' caucus meetings is intensifying the risk of price pressure in the sector, and even of deep reforms hurting prices of large capitalisation stocks. On the other hand, companies innovating in treatments, laboratories, diagnostics, etc., should feel a softer blow. Therefore, we like this segment, which is another of our investment themes for 2020.

To sum up, considering on the one hand the growing uncertainty, but on the other hand, the temptation to return to the equity market after the sharp selloff, we believe that several sectors and themes that we highlighted at the beginning of the year provide some good entry points, i.e. energy, financials, and more generally, stocks that pay high and relatively secure dividends, or provide exposure to themes relating to the environment, human capital, e-commerce, 5G and innovation in health care.

Confidence would return more rapidly if politicians decided to vote in favour of large stimulus packages (that the markets have long been hoping for), and take other necessary measures to stem the virus that is beginning to take a toll on the global economy.

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