METROPOLE Gestion ODDO BHF ASSET MANAGEMENT

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Geopolitical risks are also driving the current regime shift

The election of Donald Trump signalled, counter to the prevailing trend, a return to protectionism in the US and strong support for local production. This policy, retained by his successor, was aimed mainly at middle and working-class America and its sense of social inequity in the face of globalisation. Even the economic world, and the corporate sphere in particular, is now beginning to call into question "the benefits of globalisation"[1]. The recent pandemic harshly spotlighted the fragility of globalised production chains, a fact that the recent conflict between Russia and Ukraine only underscores. It also underlines, in addition to the risks posed by disruption, the risks of energy and food dependence, undermining the main economic theories on which the movement towards globalisation was founded. Whilst not arguing that these events sound the death knell for globalisation, we are nevertheless noticing a change in the message emerging from numerous companies. A re-think is under way, based on a restructuring of production models, no doubt to be organised closer to local markets. Such changes coming with positive impacts on society and the environment, but they mark a break with the tendency of recent years and are contributing to a major regime shift also marked by the return of inflation.

The automotive sector, standard-bearer of globalisation, sums up in itself all the challenges that so many industries must now face. The ever more insistent quest for economies of scale, access to low-cost labour and a "zero inventory" strategy forced the sector to develop global value chains of systemic complexity. The pandemic revealed their fragility. The shortage of semiconductors triggered by the Covid crisis, and which so seriously disrupted production lines, has now been followed by a shortage of electrical cables. The closure of factories in Ukraine, which previously supplied 30% of European auto manufacturers' cable requirements, has dealt another blow to the industry's prospects for an upturn in volumes. From topping the leader board for stock market performance prior to Russia's invasion of Ukraine, the European automotive sector[2] plunged by 24% as risk aversion peaked[3], whereas European indices[4] overall fell by 9%. At the end of March, the automotive sector reported one of the worst sector performances since the beginning of the year. Does this latest crisis mean we should turn away from an industry already overburdened with regulation and facing profound changes? That comes down to adopting an old and apparently sensible precept: "When you don't know, you don't buy". When faced with uncertainty, we for our part try to envisage the worst-case scenarios and match them against valuations. This is the principle that has guided our investment decisions in times of almost total lack of visibility, and particularly in the first quarter of 2020 with the emergence of the pandemic. At that point, we massively increased our investment in the automotive sector.

Before the crisis in Ukraine began, IHS Markit, the reference source of production forecasts for the sector, was predicting a 9% increase in volumes on the global market for light vehicles in 2022. This forecast was downgraded by 5 points over the course of the month to +4%. This is modest growth for a sector still suffering from low volumes, down 19% from the peak of 2017[5]. To explain the recent decline in the sector's capitalisation would require a slump in volumes as drastic (-16%) as that last seen during the 2008 financial crisis[6]. Global GDP at that time had collapsed, reflecting an economic shock far more extreme than the risk of stagflation increasingly being cited as justification for the losses suffered by cyclical stocks over the last few weeks. Rising raw materials and energy costs seem just as likely reasons for the sector's recent decline. It is worth noting that despite a threefold increase in the price of steel over the past 20 years - a component that accounts for 40% of the material costs of a vehicle – the European automotive sector still managed to grow its margins. Just as impressive, and despite all the difficulties on production chains encountered in recent months, many European auto manufacturers have still managed to achieve record operating margins. The Volkswagen, BMW and Mercedes Benz stocks in our portfolio are extremely undervalued, even in a scenario that anticipates lower margins.

Faced with rapid change and countless disruptions over recent months, Europe's automotive industry has shown great resilience, demonstrating its capacity to absorb and accelerate the far-reaching transformations that lie before it. Despite a recent dip, the sector has produced one of the strongest performances since the European equities market first began to bounce back at the end of Q1 2020, shortly after the pandemic took hold. Taking advantage of market exaggerations, at the height of uncertainty, whilst picking the companies best equipped to adapt to long-term trends and the sweeping transformations ahead, is an integral part of our work. Our portfolios are positioned on undervalued stocks with high upside potential and the capacity to contend with a shift in regime that is still only just getting started.

Sources:

1. *"La mondialisation heureuse", Alain Minc.*
2. *Stoxx Europe 600 Automobiles & Parts NRT index (SXAR).*
3. *Between 23 February (eve of the invasion) and 8 March (recent low recorded on equity markets).*
4. *Stoxx Europe 600 NRT index (SXXR).*
5. *At end 2021, production volumes were 77.20 million compared to 95.15 in 2017 – Source: IHS Markit.*
6. *Source: IHS Markit.*

Disclaimer

Please note: None of the aforementioned companies constitutes an investment recommendation. Past performance is not a reliable indication of future return and is not constant over time. The strategy is exposed to a risk of capital loss.

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