

## Turning away from cyclical stocks?

Moves in equity markets can sometimes be disconcerting. The considerable rally of stock market indices in January wiped out the exceptional decline seen in December 2018 even though geopolitical risks are not dispelled and while signs of an economic slowdown are accumulating in Europe. Faced with an economic environment that has become uncertain, causing investors to fear the risk of a recession in 2019, we reassessed the relevance of holding cyclical stocks in the portfolio hence ignoring the very damaging performances in 2018.

From the strict viewpoint of company valuations, a fair number of cyclical stocks have already priced in a recession scenario similar to 2012, and sometimes 2009, i.e. a decline of earnings along with a contraction of margins and valuation multiples. This is the case with stocks in the automotive and construction sectors, such as **BMW** and **Saint Gobain**, as well as banks including **Banco Santander**, **BNP Paribas**, **Société Générale**, **Unicredit** and **Intesa Sanpaolo**, that we already mentioned and which valuation ratios are at historical lows.

But on its own, valuation is not enough. It's also necessary to minimize the risk of buying too soon. At this stage, investing in cyclical stocks may seem premature if we refer to the profit growth estimates that are just starting to be adjusted downward by financial analysts. As such, we note that the profit growth forecast for 2019 for the MSCI Europe index, estimated at +8.8% a year ago, is currently standing at +7.6%. More specifically for Saint Gobain, the consensus is still expecting 7% profit growth in 2019, which appears unrealistic if Europe goes into recession.

Experience from past cycles has nevertheless taught us

that waiting for the low point of profit estimates, should it be known with certainty, would not be the best time to purchase the most cyclical stocks. For example, the Swedish ball bearing specialist **SKF**, whose business is highly cyclical with very low visibility, posted a 60% earnings decline between 2011 and 2013. The share price, however, hit its low point in September 2011 even though the profit estimates had only been adjusted downward by 5%. This is also the case of temporary work companies such as **Randstad**, **Adecco** and **Hays**, which we recently introduced in our portfolios. In 2008, Randstad's estimated profit for 2009 was adjusted downward by 46%. Operational earnings ended up falling by 56% and net profits by 88% in 2009. The share price nevertheless rose by +140% in 2009.

More generally, it is worth noting that the prices of cyclical stocks hit their low point when their valuation has built in a recession scenario after a strong decline, with profit estimates beginning to be adjusted downward, which corresponds with a low estimated PE ratio, as is currently the case. Markets anticipate turnarounds of the economic cycle way before they actually occur, and the markets can even get it wrong at times. The imminent start of a recession is far from given. Historically speaking, recession years are some of the best performing stock market years.

Stock market performances during periods of economic recession

Recession year	Stoxx Europe 600 dividends reinvested
2012	+18.2%
2009	+32.4%
2003	+15.9%
1993	+40.7%

Source: Bloomberg

### Performances\*

PERFORMANCES	2019	2018	2017	2016	2015	2014	1 yr.	3 yrs.	5 yrs.	10 yrs.	Since inception	Volat. Vol. bench NAV
<b>EUROPEAN AND EUROZONE EQUITIES</b>												
<b>METROPOLE SELECTION A</b>												
FR0007078811	4.49%	-18.25%	8.03%	-0.53%	9.19%	-0.02%	-17.51%	-0.19%	-1.01%	113.74%	171.94%	13.59%
STOXX Europe Large 200 NR	5.96%	-10.53%	8.92%	1.88%	7.70%	7.09%	-6.71%	12.01%	23.81%	133.21%	126.63%	13.07%
Performance gap	-1.47	-7.71	-0.89	-2.42	1.50	-7.11	-10.81	-12.21	-24.82	-19.47	45.31	543.88
<b>METROPOLE EURO SRI A</b>												
FR0010632364	4.62%	-16.28%	4.27%	2.93%	6.73%	1.24%	-16.29%	1.96%	1.00%	103.37%	43.78%	13.79%
Euro STOXX Large NR	6.15%	-12.85%	10.81%	3.97%	8.66%	4.30%	-10.45%	13.67%	24.13%	108.85%	38.00%	13.87%
Performance gap	-1.52	-3.43	-6.54	-1.04	-1.93	-3.06	-5.84	-11.71	-23.13	-5.49	5.78	287.56
<b>METROPOLE AVENIR EUROPE A</b>												
FR0007078829	4.90%	-24.11%	13.26%	3.64%	9.49%	-1.70%	-21.04%	1.86%	-0.44%	161.70%	190.70%	14.32%
STOXX Europe Small 200 NR	7.93%	-12.88%	18.10%	0.52%	15.68%	4.93%	-7.81%	21.44%	36.07%	244.67%	327.56%	13.68%
Performance gap	-3.03	-11.23	-4.84	3.12	-6.20	-6.64	-13.24	-19.58	-36.51	-82.97	-136.87	581.39
<b>METROPOLE FRONTIERE EUROPE A</b>												
FR0007085808	2.24%	-10.14%	15.33%	0.89%	6.19%	-1.86%	-12.18%	16.52%	11.26%	64.94%	94.30%	10.08%
STOXX Europe Large 200 NR	5.96%	-10.53%	8.92%	1.88%	7.70%	7.09%	-6.71%	12.01%	23.81%	133.21%	141.06%	13.07%
Performance gap	-3.72	0.39	6.41	-0.99	-1.50	-8.95	-5.48	4.50	-12.55	-68.27	-46.75	388.61
<b>BONDS &amp; CONVERTIBLES</b>												
<b>METROPOLE CONVERTIBLES A</b>												
FR0007083332	0.38%	-7.98%	-0.67%	1.98%	2.88%	0.71%	-8.49%	-4.53%	-4.05%	41.59%	57.44%	3.52%
ECl-EURO	2.25%	-5.18%	6.99%	-0.21%	6.08%	3.06%	-3.48%	7.57%	13.53%	64.06%	83.15%	4.63%
Performance gap	-1.87	-2.80	-7.66	2.18	-3.20	-2.34	-5.01	-12.10	-17.58	-22.47	-25.71	314.88
<b>METROPOLE CORPORATE BONDS A</b>												
FR0010695874	0.50%	-2.64%	0.26%	0.51%	0.96%	3.78%	-2.00%	-1.26%	2.47%	46.47%	49.62%	2.89%
FTSE MTS 3-5 Y	0.37%	-0.24%	0.14%	1.46%	1.39%	5.93%	0.51%	1.08%	7.77%	30.20%	31.18%	2.27%
Performance gap	0.13	-2.40	0.12	-0.95	-0.42	-2.15	-2.51	-2.34	-5.31	16.27	18.44	299.24

Past performances are not necessarily indicative of future results. The mutual funds may lose value.

\*Data as of 31 January 2019

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9, rue des Filles Saint-Thomas 75002 Paris – France -Tel +33 (0)1 58 71 17 00 – Fax : +33 (0)1 58 71 17 93  
[www.metropolegestion.com](http://www.metropolegestion.com) - E-mail : [metropoleg@metropolegestion.fr](mailto:metropoleg@metropolegestion.fr)  
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