DECALIA

INVESTMENT INSIGHTS

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REDESIGN, REUSE, REDUCE

Editorial View

REDESIGN, REUSE, REDUCE

- Growing population & scarcer natural resources - Tomorrow's world biggest challenge!
- Transition from linear to circular now underway - The end of the world as you know it
- Not just good for the ecosystem, but also for the economy & early business adopters

Take, make and waste… the old linear economic model has run its course. Increasing population, depleting natural resources, and a degrading environment are key sustainability issues today. As President Kennedy said more than 50 years ago: "Our most basic common link is that we all inhabit this planet. We all breathe the same air. We all cherish our children's future." These words now seem more timely than ever.

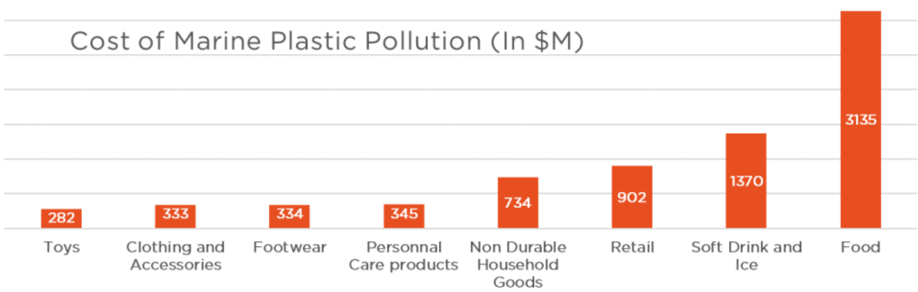
With 9 billion people likely to inhabit our planet by 2030, meeting increasing demand for both goods & services will be a key challenge for future generations. Meanwhile, the use of natural resources is also expected to double by 2050, adding to the strain on Earth our current economic model already puts. In fact, according to leading environmental institutes, more than 2 planets would be required in order to continue living as Europeans do today, or more than 4 if we all embraced the American way of life. Needless to say, this is unlikely to happen as we (still) have only one planet! From an environmental standpoint, plastic islands, smog, polluted waters and climate change have all become major issues today with an increasing number of governments, organizations and even private companies sounding the alarm. And all proposed solutions point to a same direction: more circular economy.

A circular economy entails a revolutionary way of thinking about resource management, production and consumption. Indeed, in a circular world, production factors flow into the economy endlessly without producing material waste. While renewable inputs are used to minimize the environmental impact and improve business performance, products are built in a more efficient way, repaired, re-used and ultimately reconditioned. Mother nature is the best example of circularity. In the living world, there is no landfill with one species waste being the other one's food. Living organisms grow, die, become nutrients and finally return to the soil. As such, not only does circularity work for the environment but it can also provide a valid operating business model.

According to European Commission estimates, transitioning to a circular economy could add 7% extra GDP growth by 2030. As of today, only 9% of the world's economy can be deemed as circular, hence suggesting still ample room to grow. With the exception of fossil fuels, which are bound to be replaced by renewables, all major sectors of the economy should eventually benefit from such a transition. Indeed, circular business models tend to create positive spillover effects triggering a virtuous cycle for the entire system. For instance, *sharing platforms* that increase the life & usage of products are likely to be key beneficiaries just as less resource-intensive *smart & green materials,* which are used as alternatives to traditional ones.

Governments & international organizations (EC) have been actively tackling these issues for many years, encouraging developed countries to find home-made viable waste solutions and promoting a faster transition to the circular economy. Both greater awareness and financial incentives have thus created new attractive business opportunities pushing many companies to revisit their models & activities (e.g. waste, nutrition, re-manufacturing). As such, various circular pure players, supporting the industry's transition, can already be found today, especially in the resource recovery field (Aquafil, Dowa Holdings, Waste Management). Even in more traditional sectors, Evian has announced that it will only use recycled plastic bottles by 2025 while Coca-Cola vowed to use only recycled cans by 2025. And that's just the start of the circle…

Chart of the Month



Global Strategy

Fasten Your Seatbelt – Further Turbulence But No Hard Landing

- Economic momentum decoupling accelerating - US vs. Rest of the World
- Divergent Central Banks policies – Near-term USD support & Emerging Markets headwind
- Markets rollercoaster ride not over yet – Geopolitics to stay in focus but no reason to panic

Notwithstanding revived trade war concerns, we keep our constructive global macro scenario broadly unchanged as we still expect more rhetoric than action from political leaders, hence suggesting only limited impact on world growth. Admittedly, market fundamentals have weakened from recent peak levels with economic growth now decelerating, corporate trends inflecting, major Central Banks further tightening, and geopolitical uncertainties resurfacing. However, not all is bleak and we still see grounds to retain our cautiously optimistic stance on risky assets though recent high-altitude market turbulence is likely to continue throughout the summer as clouds gather.

Therefore, whereas renewed political turmoil and growth deceleration have revived market volatility as of late, we remain selectively constructive on equities. Indeed, healthy fundamentals with both positive earnings growth and supportive investor positioning along with more affordable valuation levels still warrant a constructive near-term stance, in our view. However, aforementioned risks related to geopolitical tensions (Trade war, OPEC), negative economic surprises, slowing EPS upgrades, rising interest rates, and potential policy mistakes by Central Banks should not be ignored. Regionally, Switzerland's defensive growth remains our preferred play in this market environment followed by both resilient US and Japan. Meanwhile, we keep our cautious stance on Emerging Markets and stay very selective across Eurozone following last month's tactical downgrade. Sector-wise, we continue to favor a balanced approach with slight pro-cyclical bias.

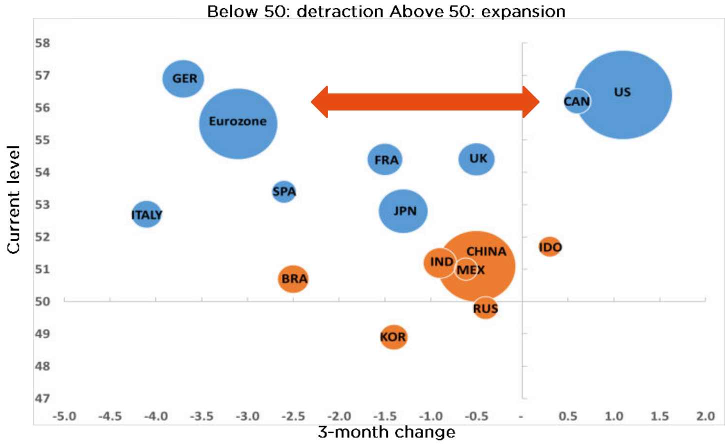
In Fixed Income, we maintain our cautious stance unchanged while downgrading the Emerging Markets (hard currency) segment by one notch as both a stronger US Dollar and higher interest rates should keep the pressure on. We nevertheless retain our US Treasury 10 years position as a hedge against geopolitical turmoil for now. Moreover, we still to prefer US duration to Europe's as we believe the latter provides greater downside risk.

We are leaving our FX allocation unchanged following last month's USD tactical upgrade (to Neutral) driven by a more attractive rate differential, better economic momentum, tighter FED policy, investor positioning, and EU political risks. As such, the US dollar may well retain its appeal in the short run but we remain more constructive on the euro over the medium-term as valuation & fundamentals (current account, fiscal deficit, debt to GDP, ECB policy shift) provide support. In commodities, gold has taken a hit from the recent rebound in USD but we recommend keeping a small position as a hedge against both rising political risks and inflation expectations. As far as oil is concerned, the latest OPEC decision to increase production only modestly is consistent with our positive stance which in turn is driven by better industry fundamentals (balanced demand/supply for 2018/19) and further tensions in the Middle East.

Finally, within the current volatile market environment, we continue to favor Alternative Investments with both uncorrelated strategies in Hedge Funds (e.g. market neutral, arbitrage) and Private Equity still our preferred plays.

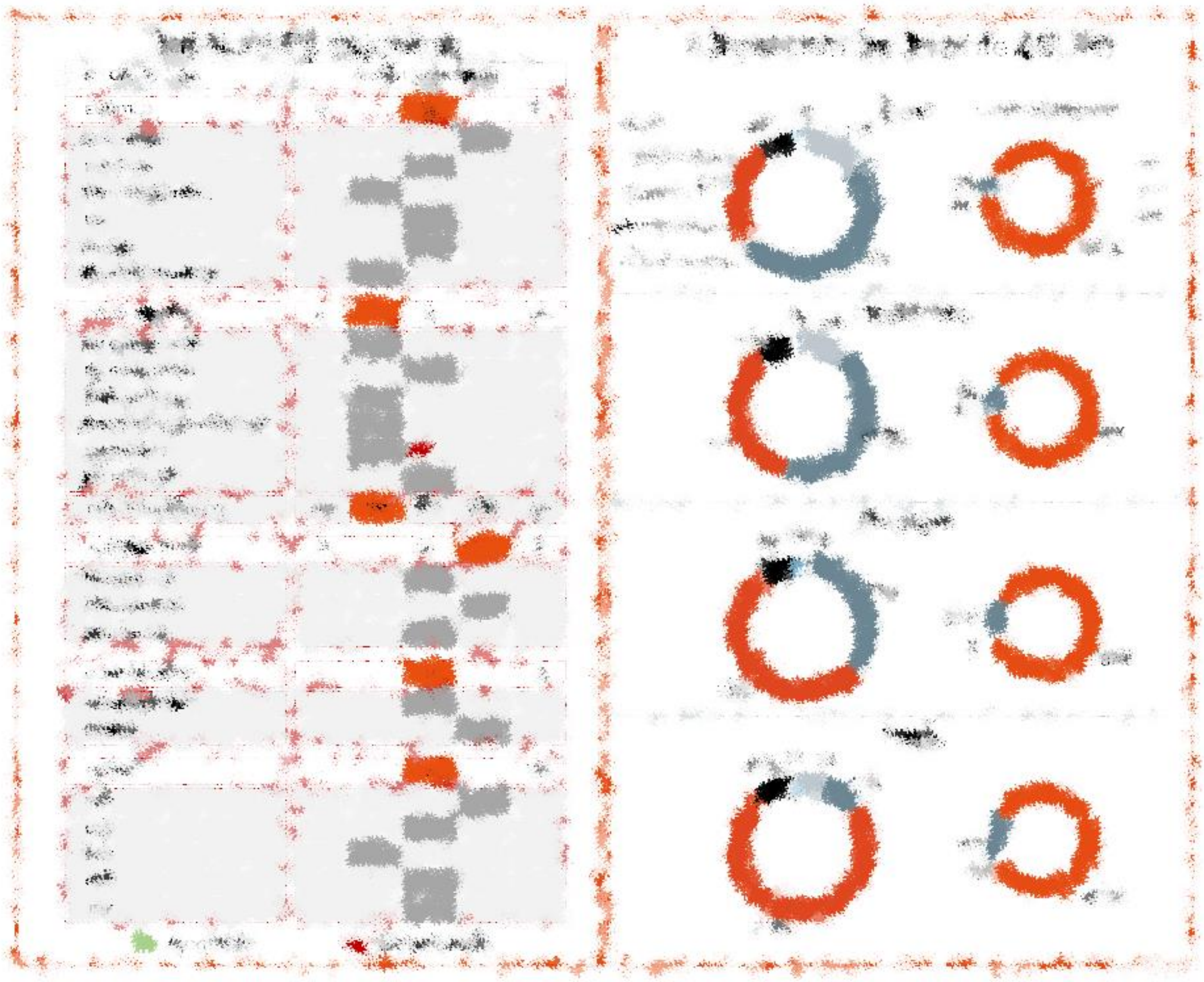
PMI Manufacturing

Below 50: detraction Above 50: expansion



Emerging Markets 5Y CDS

Asset Allocation



- Equities – Expect further short-term volatility but stay invested & beware of sector rotation
- Fixed Income – Downgrade Emerging Bonds (hard currency) by one notch – Stay cautious
- Alternatives – Still favor uncorrelated strategies & Private Equity in the current environment

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External sources include: Bloomberg, Thomson Reuters DataStream, Suez Environment, EEA, Ellen MacArthur foundation, Accenture

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