



INVESTMENT INSIGHTS

MONTHLY ISSUE #55

August 1st, 2019

FASHION VICTIMS

EDITORIAL VIEW

Page 2

- Increasingly frequent purchases of inexpensive garments cause severe environmental damage
- Circular business models are now gaining traction all along the fashion supply-chain
- Recycled materials, clothing repair/re-commerce/rental or virtual styling: opportunities abound

GLOBAL STRATEGY

Page 3

- Mixed macro momentum: industrial data down while services/consumption still hold up
- Central Banks are pulling their “dovish” cards back out – Fed just cut rates... but enough for Mr. Trump?
- Ongoing global trade risk & limited visibility – Keep an *all-terrain* portfolio positioning

ASSET ALLOCATION

Page 4

- Equities – Still cautiously constructive but now is a good time to hedge portfolios via options
- Fixed Income – Reducing exposure to EUR government bonds at historically low yields
- Alternatives – Favor gold in this environment of low rates and heightened geopolitical risk

Editorial View

Fashion Victims

- Increasingly frequent purchases of inexpensive garments cause severe environmental damage
- Circular business models are now gaining traction all along the fashion supply-chain
- Recycled materials, clothing repair/re-commerce/rental or virtual styling: opportunities abound

Did you ever realize that fashion ranks close to oil in the infamous listing of most polluting industries? In our world of “fast consumerism”, the traditional winter/summer clothing seasons have been replaced by 52 “micro-seasons” – with some USD 500 billion lost each year due to items being hardly worn and seldom recycled. Over the past 30 years, we have collectively developed a liking for frequent purchases of inexpensive (but also lower quality) garments, in an attempt to keep up with the latest fashion trends. Needless to say, online shopping, with the possibility of free returns, has taken this behavior to an extreme.

The problem is that increasingly-popular synthetic materials shed millions of microfibers when washed, contaminating water streams – and ultimately oceans – to the tune of over 50 billion plastic bottles. Also, large quantities of toxic chemicals are employed in both growing cotton and processing garments. Not to mention the 8% of greenhouse gas emissions and 92 million tons of solid waste that the global apparel and footwear industry is said to generate annually.

But all is not lost, far from it. Circular business models are currently being promoted by an increasing number of participants in the fashion supply chain. And, judging by current environmental awareness – particularly amongst millennials – these models stand a good chance of being embraced, making for interesting investment opportunities.

In the textile space, Italian company Aquafil has for instance developed a regenerated nylon yarn made from used fishing nets, fabric scraps and carpets intended for disposal. Prada, notably, has partnered with Aquafil, recently bringing to market a “Re-Nylon” bag collection – with a

percentage of sales revenues dedicated to a sustainability awareness project. Moreover, while already producing millions of shoes that contain recycled ocean plastic, Adidas has an even bigger dream: shoes made to be remade. Its “FUTURECRAFT.LOOP” project intends for raw materials to be forever repurposed – not just to be turned into basic goods but to actually produce another high-performance running shoe.

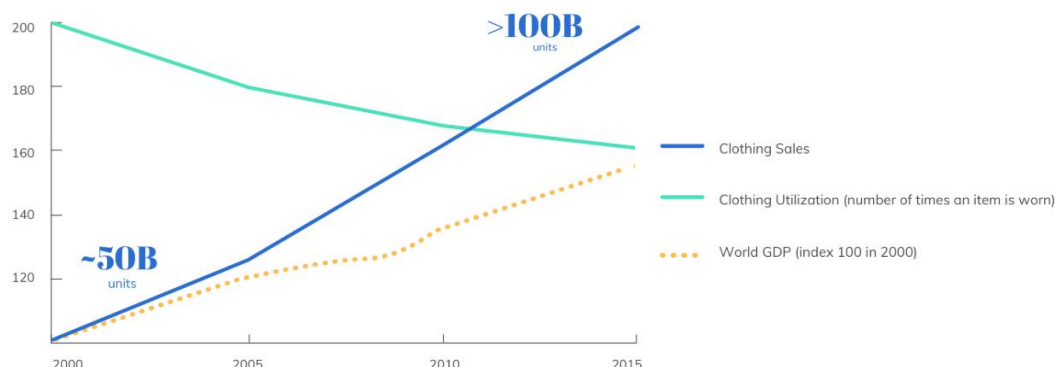
Repair is also being promoted by a number of brands as part of a circular model: Patagonia’s “Worn Wear” program literally hit the road in 2015, with trucks touring the US – and now also Europe, Japan and South America – to repair clothing (of any brand!) for free. Similarly, every pair of Nudie Jeans is sold with the promise of free repairs (55’173 in 2018).

Vintage shops (aka re-commerce) are another – increasingly trendy among young fashionistas – means to extend a garment’s life. Still, they involve owning a product, when just accessing it could be sufficient. Yes, the sharing/subscription models that we have grown used to in media, transport or lodging are now extending to fashion. Urban Outfitters is busy launching an online subscription service, enabling customers to borrow six items on a monthly basis. GlobalData research suggests that this burgeoning market could reach USD 2.5bn by 2023. Private company Rent The Runway is one of its best-known players, having built up a 9mn strong “community” since inception in 2009.

Finally, on a more futuristic note, comes the virtual styling concept. Showing off on Instagram wearing clothes designed only in the digital form could offer the ultimate solution to environmental damage caused by (too) fast fashion...

Chart of the Month

We Are Buying Twice As Much Clothing & Wearing It Half As Long





Global Strategy

Don't Fight The Fed?

- Mixed macro momentum: industrial data down while services/consumption still hold up
- Central Banks are pulling their “dovish” cards back out – Fed just cut rates... but enough for Mr. Trump?
- Ongoing global trade risk & limited visibility – Keep an *all-terrain* portfolio positioning

Don't fight the Fed! US president Trump seems well aware of this driving principle for investors as he keeps Fed Chair Powell under pressure to ease monetary policy further ahead of the 2020 election year. However, cutting rates for the first time in 11 years last month while pointing to a “mid-cycle adjustment” (rather than the start of a new easing cycle) will definitely not be enough for his liking, suggesting further action ahead...

In this “noisy” context, we stick to our cautious but constructive outlook for the remainder of the year, still not anticipating an escalation to full-blown trade war nor a global economic recession at this stage. Admittedly, headline risks have increased (again) but we maintain a balanced stance for now. On the one hand, we acknowledge the weakening global macro momentum, the downside risk on earnings and the uncertain geopolitical context. On the other hand, consumer & services trends remain supportive (vs. manufacturing) and, more importantly, “ultra-dovish” central banks stand ready to act further – as the Fed just demonstrated.

At the portfolio level, we maintain an *all-terrain* positioning, i.e. keeping a neutral allocation to equities, though ready to add back some risk opportunistically (on potential pullbacks). However, we also *recommend taking advantage of the current low volatility to hedge part of the equity allocation through options* while maintaining the upside potential intact.

In fixed income, we now move to an underweight stance. Even though economic data and dovish central banks should keep pressuring rates downward, investing in the asset class is becoming increasingly challenging as the amount of negative yielding debt reaches new highs. On top of that,

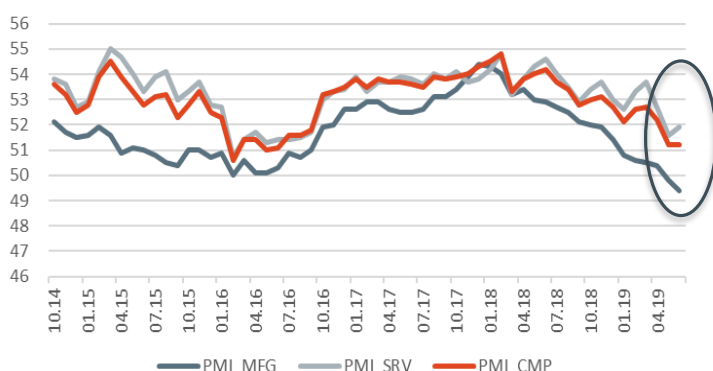
credit metrics are not improving – leaving the asset class exposed to central bank policies. While slightly reducing our exposure to defensive segments (higher quality & longer duration assets – especially EU government bonds), we keep our more aggressive carry-driven allocation to emerging markets bonds unchanged for now.

On the equity front, although 2019 “easy gains” may be behind, we still see selective upside. The ongoing earnings season is proving mixed, but expectations have already been reset, valuation multiples are far from stretched, bond yields are back to multi-year lows (attractive dividend yield), investors are still defensively positioned (high cash & low equity) and the aforementioned increasingly accommodative central bank stances offer downside protection. Though somewhat consensual, we keep our preference for quality and secular growth assets at this stage of the cycle. That said, both the recent sharp de-rating of multiples and underperformance of value stocks look extreme. While it is too soon to call for a bottom, we now recommend adding back some tactical value investments to portfolios.

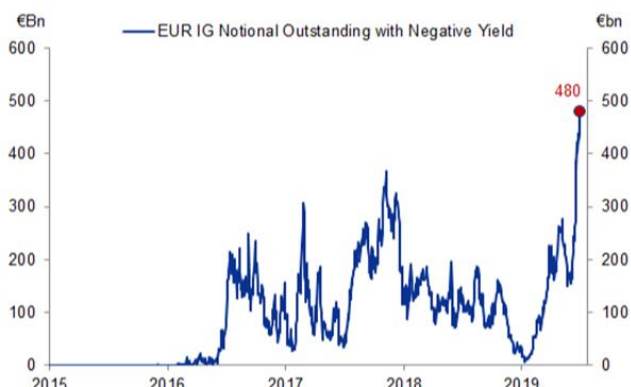
The Fed and ECB both being dovish, we maintain our positive near-term view on the USD vs. EUR owing to the rate differential, stronger domestic economic momentum and lower political risk. Valuation, fundamentals (current account, fiscal deficit, debt to GDP) and positioning should, however, still benefit the EUR medium-term.

Finally, we believe the resilience of typical “safe havens” such as gold, the Swiss franc or the Japanese yen will continue to help us navigate this year's winding roads more comfortably and thus remain an integral part of our currently (more) balanced allocation.

World PMI Indices (Manufacturing, Services, Composite)



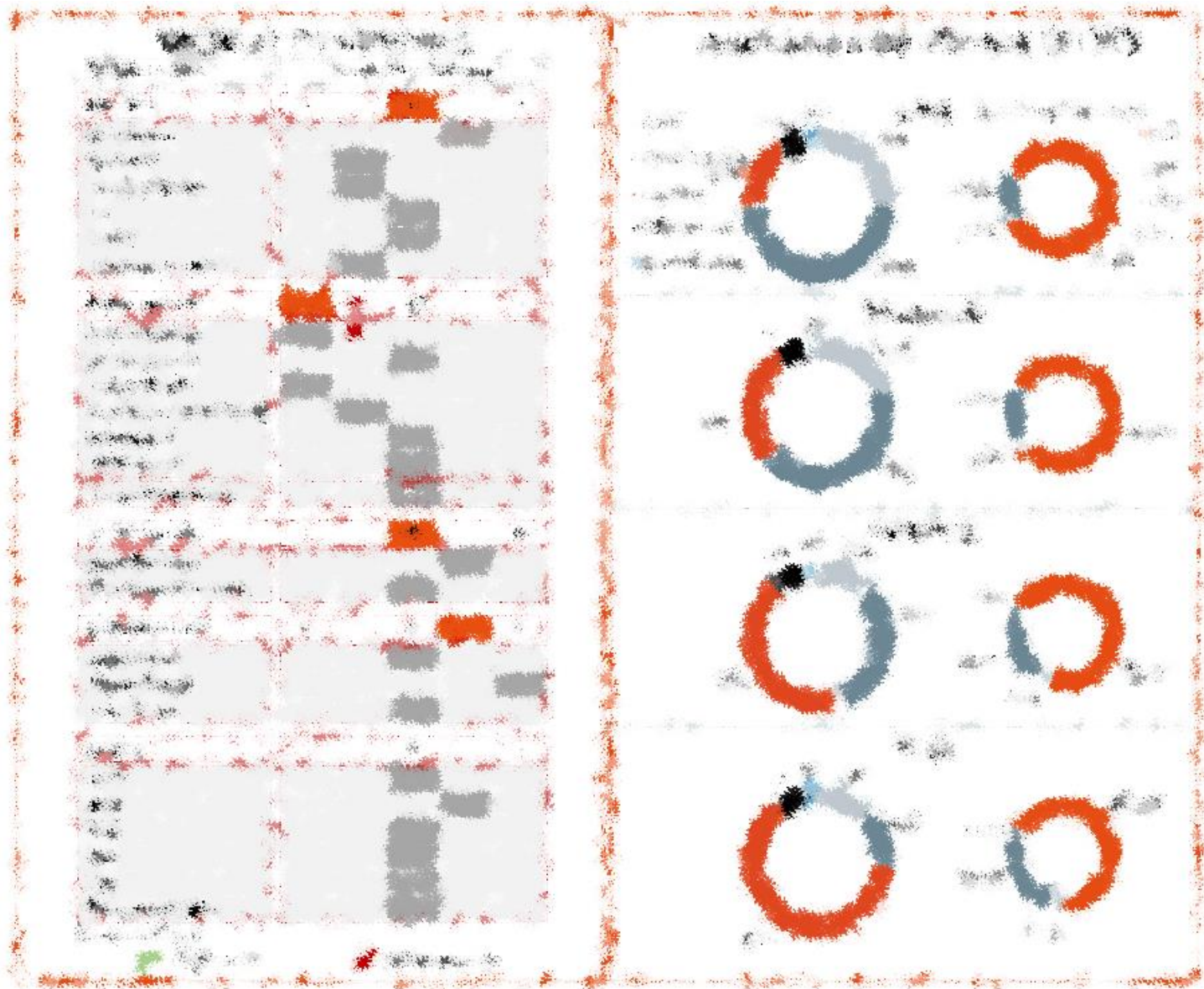
Amount of EUR bonds with negative yields (€Bn)



Please see appendix at the end of this document for information on sources, important disclosures



Asset Allocation



- Equities – Still cautiously constructive but now is a good time to hedge portfolios via options
- Fixed Income – Reducing exposure to EUR government bonds at historically low yields
- Alternatives – Favor gold in this environment of low rates and heightened geopolitical risk

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

Copyright © 2019 by Decalia Asset Management SA. All rights reserved. This report may not be displayed, reproduced, distributed, transmitted, or used to create derivative works in any form, in whole or in part, by any means, without written permission from Decalia Asset Management SA. This material is intended for informational purposes only and should not be construed as an offer or solicitation for the purchase or sale of any financial instrument, or as a contractual document. The information provided herein is not intended to constitute legal, tax, or accounting advice and may not be suitable for all investors. The market valuations, terms, and calculations contained herein are estimates only and are subject to change without notice. The information provided is believed to be reliable; however Decalia Asset Management SA does not guarantee its completeness or accuracy. Past performance is not an indication of future results. External sources include: Bloomberg, Goldman Sachs, Solar Impulse Foundation, Ellen MacArthur Foundation, CNN, BBC, Forbes, World Economic Forum, ThredUp
Finished drafting on July 31st, 2019