ALESSIA
Société d'Investissement à Capital Variable

MACROECONOMIC OUTLOOK
For 2016

A HAPPY NEW YEAR FOR EUROPE?

ALESSIA SICAV: THE ABSOLUTE RETURN COMPANY

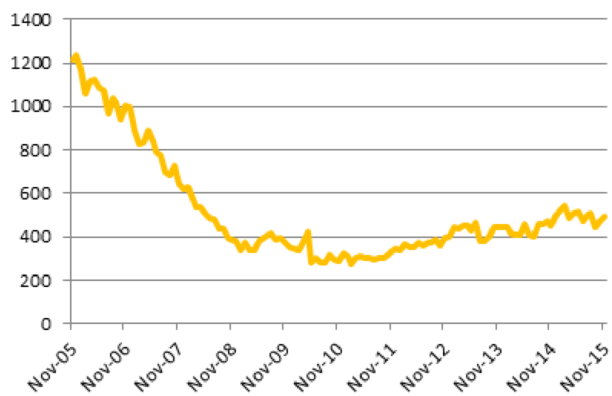
January 2016

We will focus this outlook on Europe, China and Oil. Indeed, we see Europe as the geographical area that offers the best investment opportunities in the coming year but at the same time, we cannot jeopardize the fact that China and Oil are, at present, the main "drivers" of financial market instability.

We consider 2015 as a pivot year, during which the ECB broke, with the QE, a taboo unthinkable at the time of its creation and the Fed ended a decade of easing and began the normalization of its policy. The year 2015 has disappointed those who expected an immediate and striking economic recovery, especially in Europe.

1. In the US, unemployment's rate dropped to 5% but in a context of 2% growth rate, well below the 4% expected in this kind of environment. Probable under-employment, the strengthening of the dollar and a middle class still in debt with less disposable income than in the past had a significant impact. Chart 1 show that despite the recovery that started six years ago, the construction sector is still in crisis with a level of new home sales that remains historically low at about 1/3 from the peak reached in 2005. Explanations can be found in demographics, indebtedness level and households' disposable income. Construction industry, public and private, represents 7% of the US GDP.

Chart 1. US New Home Sales



2. In Europe, the strong initial optimism created by QE has not yet fully materialized in robust growth but the area is out of the recession.

3. Oil and raw materials prices have dominated the markets. Their variations have not only an effect on the value of companies in their own sector but also on consumer prices and other industries production costs.

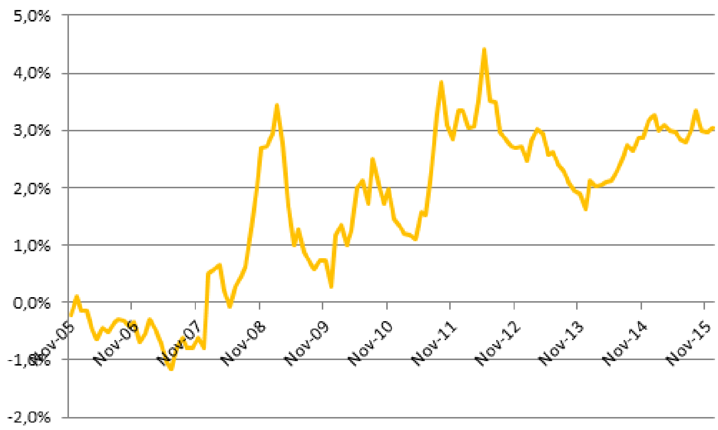
4. China confirms its necessary conversion to a growth model based less on the production of goods for export and more on services. Investors have difficulties to assess the impact of this switch and have little trust in the data provided by Chinese authorities.

2016 EXPECTATIONS

1. *Equity Investments remains attractive in terms of risk/return*

The spread between the "dividend yield" and the yield on government bonds is still very interesting. Chart 2 shows that this difference is still historically high despite the rise in equity prices last year.

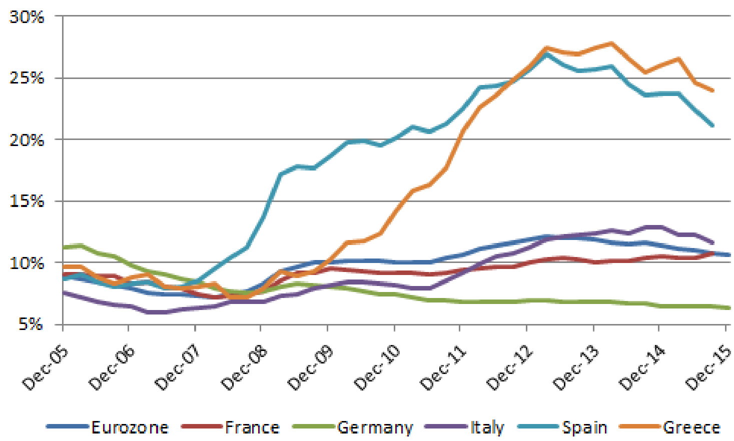
Chart 2. Spread between Eurostoxx50 dividend yield and 10Y Bund yield.



While US equities appear to have exhausted their upward trend as markets are faced with a tighter monetary policy, slow global growth and dollar appreciation. In Europe, the economy is starting to show, with a delay, clear signs of recovery.

This recovery is based on consumption growth (+ 4.2% in 2015) supported by the drop in energy costs, given that Europe is the real winner of this fall in prices. On top on that, we observe a recovery in banking loans and the strong devaluation of the Euro should offset the decline in global growth with an increase in exports.

Chart 3. Unemployment rates in various Eurozone countries



The decline of unemployment will also act positively on consumption, although it will be heterogeneous across the Eurozone. Chart 3 shows how jobless rate is declining across Europe (except France).

To continue with, PMIs (purchasing managers indices) are all on the upside and bodes well for the future despite some differences between the various euro area countries.

If the recovery is confirmed by data, we could expect an acceleration of consumer prices for the second half of the year, especially if there is a simultaneous recovery in energy prices. Furthermore, ECB will play an increasingly supporting role to financial markets. A recovery in inflation expectations that would have immediate effect especially at the long end of the curve of interest rates would also be a strong stabilizer of the EUR / USD exchange rate.

Nevertheless, differences across the Euro area remains strong and in some cases increases the growth gap among countries throwing the seed for future crises. In fact, while Spain and Ireland maintain growth rates above average, having made the necessary structural reforms, it is not the case for Italy, France, Greece or Portugal who have not resolved their problems through the structural reforms needed to enable growth. Chart 5 shows that as Greece and Italy have a GDP lower than 2000 and that the Italian growth rate never picked up.

Chart 4. PMI indices in various Eurozone countries

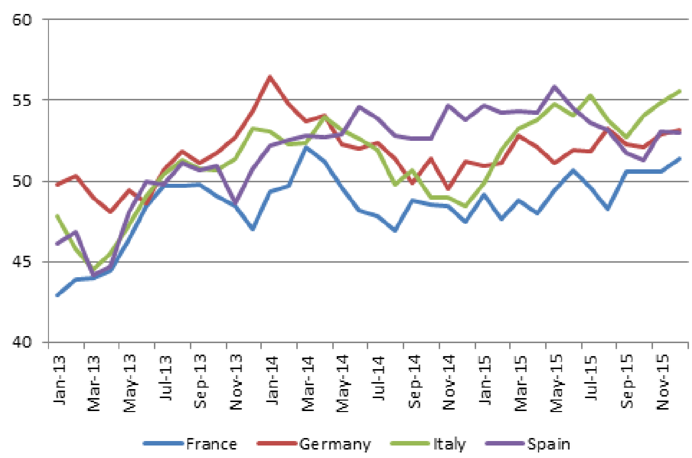
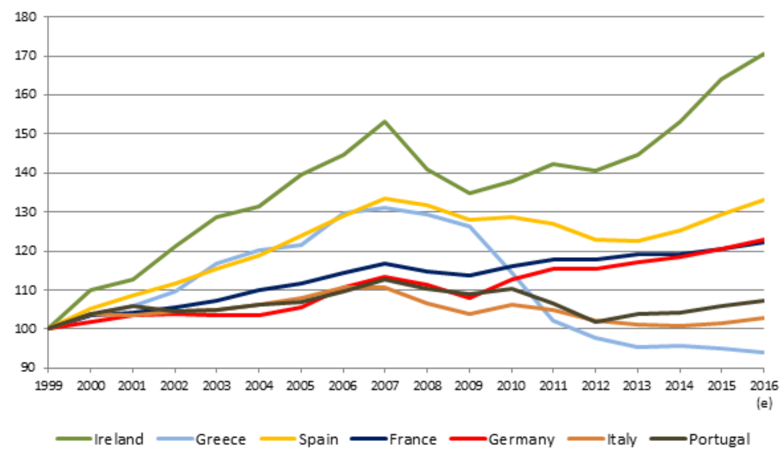


Chart 5. GDP evolution for the main Eurozone countries



2. Expecting strong volatility

We believe that the main factors of this instability are the following elements:

a. The very low level of interest rates and the huge amount of liquidity available in the financial markets multiply in an exaggerated manner any expected change in real economic variables.

b. The sharp decline associated with volatility in oil prices after years of relative stability.

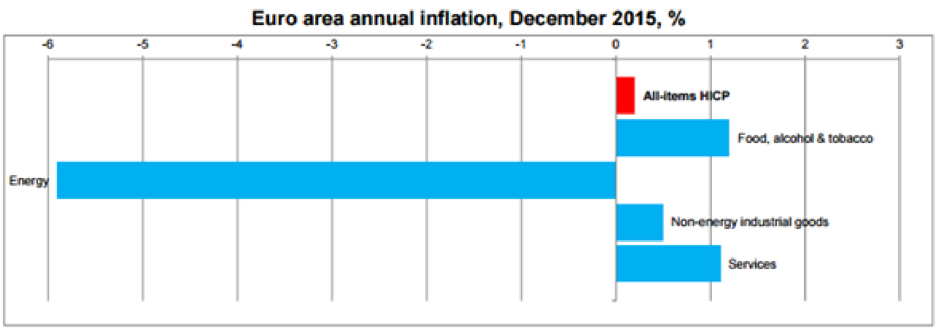
c. Market's interpretation of the Chinese macroeconomic data.

3. Fixed income risk/return isn't attractive anymore.

Interest rates so low especially at the long end of the curve make investment in fixed income asymmetric, i.e. the likelihood and magnitude of the gains are reduced in comparison with strong and fast losses associated with a rise in interest rates.

In addition to a swing on prices that could arise from a recovery in consumption, on the supply side the oil could finally be at the end of its decline and any subsequent upside would add to consumer price increase.

Chart 6



4. Oil price is low, we expect stabilization before a recovery.

In 2016, the trend in oil prices will be important as it was in 2015.

The sharp drop in oil prices was due to several factors including the nuclear deal with Iran, the decision of Saudi Arabia to attack the US "shale gas" industry and the global slowdown (especially in China).

For next future we see many factors that could contribute to a rise in oil prices:

a) An (least partial) abandonment by Saudi Arabia's of its market share defence policy in order to avoid breaking its currency peg with the US dollar and exacerbate the crisis that exists between the various factions in the Arab countries.

b) Lower investments in new exploration projects.

c) Increasing number oil fields shutting down due to low oil prices making them non-viable.

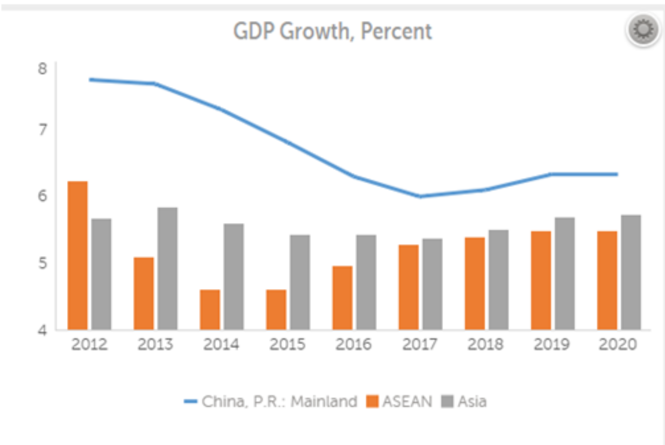
d) Increase in demand, not only due to economic recovery but also because low prices make it a viable alternative to other forms of energy or other types of consumption.

5. China.

China can be a source of volatility, but it is expected to decrease in the future on the basis of the following considerations:

a. China is in a phase of normalization with a lower growth than in the past but in line with other Asian countries. The shift from an economy based on the production of goods for export, which has an objective limit on foreign demand for such goods, towards a development of services and on domestic

Chart 7. Chinese Normalisation



demand is crucial to continue economic development . A country of this size cannot go to tow the rest of the world but must have a balanced economy. Table 1 shows how the services have already become the drivers of the economy.

b. The Bull Run in Chinese Equity from mid-2014 to mid-2015 was related primarily to increasing equity investments by retail investors, helped by the change of the regulatory framework. Despite the sharp drop in the indices from mid-2015, and downward revisions of Chinese and global growth indices are still positive if we consider the period starting in July 2014 (+ 67% for the CSI composite index).

c. The devaluation of the currency, after an appreciation mainly due to the huge trade surplus, goes hand in hand with the transition from manufacturing and export-oriented growth to one based on domestic consumption and services.

Table 1: Chinese GDP composition

	Yuan (Bn)	%
GDP Cumulated Q3 2015	48 777	100,0%
Primary Sector	3 919	8,0%
Industrial Sector	19 779	40,0%
Service Sector	25 077	51,4%

Source: National Bureau of Statistics of China

6. Other Emerging Markets.

In other emerging markets, the picture remains negative and is aggravated by the lack of structural reforms. Currency devaluation is not enough in the absence of reforms. We are witnessing major political changes toward this direction in South America. The shift in Argentina may also occur in Brazil who experienced a strong development in the past thanks to rising commodity prices but suffers from a lack of strong state and competitive manufacturing industries. Currency devaluation, liberal reforms and a recovery in commodity prices are the prerequisite for a recovery of these economies. Turkey for geopolitical reasons didn't benefit from the opportunity resulting from the drop in oil is still in a spiral of inflation and currency devaluation that is continuously worsening.

Conclusion

Our Asset Allocation is the following:

Equities. We remain positive on European equity indices that will likely, in our view, outperform their global peers. Value can also be extracted through an opportunistic management / tactical positions over long-term strategic allocations.

Credit. A very vulnerable and risky asset class so we keep close attention to the duration of the investments (that will stay short) and to realize a well-diversified and selected selection across sectors and issuers.

Fixed Income. We have a negative outlook on the asset class hence the duration of the portfolio will be very low and tending to be negative especially if we see signs of inflation in Europe.

Emerging Markets. We remain unexposed until we see clear signs of reversal that could arise from a recovery in commodity prices or political and economic policy changes.

Alessia SICAV's Investment Team

Chart 1&2 source: Internal realization using Bloomberg Data
Chart 3 source: Eurostat
Chart 4 source : Markit, Bloomberg
Chart 5 source: Internal realization using Bloomberg Data
Chart 6 source: Eurostat
Chart 7 source: IMF

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