THE LAB NEWS

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EXECUTIVE SUMMARY

- **All stars (fundamental, mechanical, technical) are aligned for a continuation of the current market sequence, which we anticipated vocally and that is now driving the strong out-performance of our basket of single stocks,**

- The specter of deflation is dissipating and the underlying structure of the market seems to be increasingly responsive to a potential interest rate inflection,

- Latest macro-economic data confirmed that our scenario of a subdued, wavy recovery is unfolding, consistent with the disconnection, which we have long been highlighting between surface agitation (market volatility) and the relative calm underneath (stability of Market Interactions at a low level),

- We observe for the first time since September a disconnection between Market Interactions at the country and at the company level, suggesting that the great rotation from bonds to equities might finally be taking place,

- With market mechanical forces moving slightly up at the macro level, and still trending down at the micro level, our selection of single stocks is benefiting from a positive scissors effect,

- Even if its cumulated out-performance is at a historical high (+42.57% since June 2012), with a very low turnover, we take the view that there is still a long way to go,

- Against this backdrop, we stay the course and keep our positions unchanged.

FUNDAMENTAL BACKGROUND

Latest macro-economic data confirmed the reality of the economic recovery in Western countries, and surprised positively in China. This is very much consistent with the great stability - at a low level - of Market Interactions at the macro level, which we highlighted in the wake of the UK Referendum and throughout the summer. Same observation at the micro level where European Banks and cyclical companies (except for specific cases), which have long been shunned by investors, posted sound results and rebounded sharply. Our long-standing scenario of a subdued, wavy recovery is unfolding.

More importantly, the specter of deflation is (finally) dissipating, which is accelerating the sector rotation in favor of European Banks and cyclical companies. Market participants seem to be progressively accepting the idea that the worst is not certain and that interest rates will at some point have to reverse their course and head north. As shall be seen from the evolution of 5-year, 5-year forward inflation rates (see Exhibit 1A), inflation expectations bottomed out during the summer and moved steadily higher since then, both in the US (FWISUS55) and in Europe (FWISEU55). The September monetary policy meeting of the Bank of Japan clearly participated to the awareness process of market participants that they should get ready for steeper interest rate slopes. The move remains limited at this stage but the trend will likely gain momentum in the forthcoming weeks given the latent inflation embedded in commodity prices. As a matter of fact, should the oil price remain stable at around $45 by the end of December, the y-o-y price change would be as high as +50% (see Exhibit 1B); the oil price does indeed only need to remain above $30 at the end

of the year to have a positive contribution to inflation on a y-o-y basis.

In this respect it is worth pointing out that the underlying structure of the market seems to be

Exhibit 1A. Market Inflation Expectation Evolution from Jan 1st through November 9th 2016

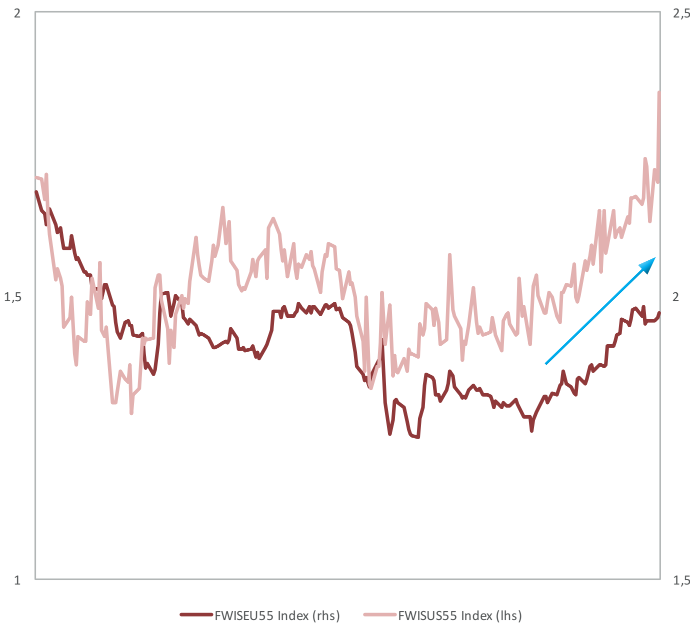
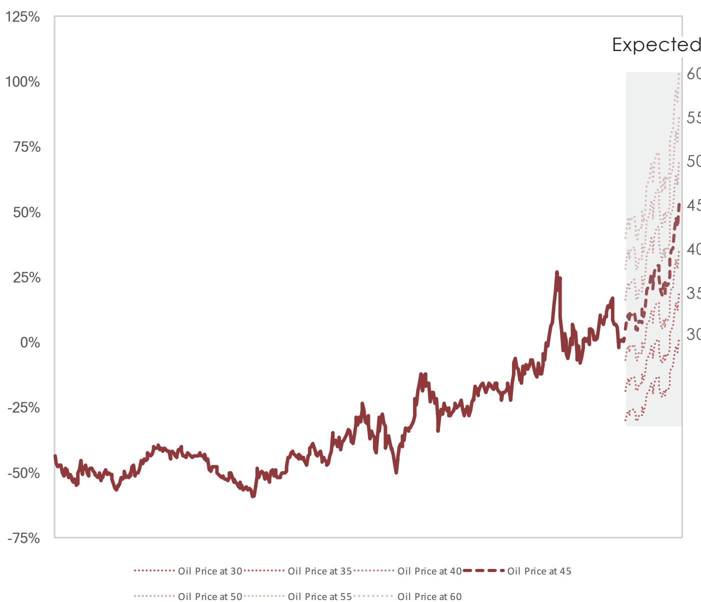


Exhibit 1B. Oil 250-day Rolling Price Change from Jan 1st through December 31st 2016



increasingly responsive to a potential interest rate inflection. The investment vehicles undergoing siginficant market pressures turn out to benefit from significant tail winds whenever the probability associated with the deflationary scenario decreases. And, the stronger the market mechanical forces, i.e., the greater the discrepancy between perceived and proven risks is, the more violent the market moves. Hence the swift sector rotation(s) that we have experienced lately and in turn the strong outperformance of our selection of single stocks over the last few weeks (see Exhibit 7).

We are only at a very early stage of the normalization process, and it will certainly not be smooth sailing. The US election is another example of the long list of exogenous shocks that have (remember Greece, Ukraine, China, UK, etc.) and will hit the financial system along this long and winding road. These shocks will certainly give rise to epidermal reactions, and foster short-term volatility. But as we shall see later on, the great resilience currently shown by the system is suggesting that this risk will - everything else equal - be (potentially) richly rewarded for stock pickers.

As emphasized many times in our previous monthly Dash Boards, our basket of single stocks was built with the idea that the risk of deflation was largely overstated, and that its short-term volatility was implicitly the premium to pay to be able to take advantage of the process that is now kicking into gear. The outcome is a rebound of +25% since the UK Referendum, with very little portfolio turnover.

ANALYSIS OF MARKET INTERACTIONS

We observe one more time a clear disconnection between surface agitation, which is generated by the on-going uncertainty, and the relative calm underneath. Most Western European countries do indeed remain well-anchored at the lower-hand of our risk scale (see Exhibit 2). And, Portugal joined Italy and the UK in the [1-2[range of our risk scale toward the end of October.

This being said, it is important to note that while no critical threshold has been reached, the increase in the level of interest rates has been accompanied (except for Portugal) by a slight pick-up in the level of Market Interactions, essentially via the government bond market. As previously mentioned, this might be the harbinger of a tidal wave. To be followed…

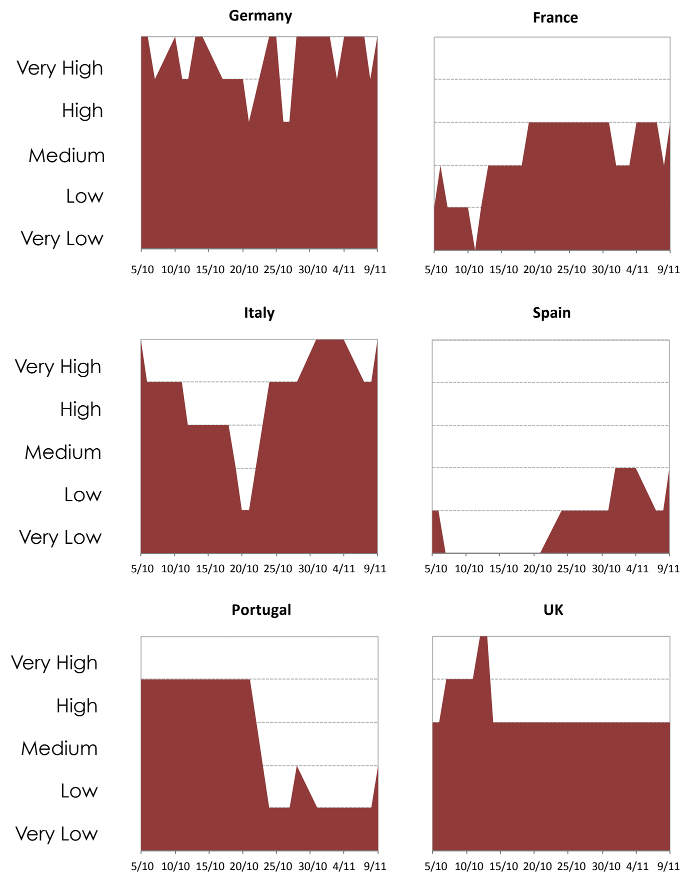
Exhibit 2. Market Interactions at the Country Level (as of November 9th)

	RISK LEVEL	TREND*				
		5-Day	21-Day	65-Day	260-Day	780-Day
Germany	green flag	→	→	→	→	→
Austria	green flag	→	→	→	→	→
Belgium	green flag	→	→	→	→	→
Spain	green flag	→	→	→	→	→
France	green flag	→	→	→	→	→
Ireland	green flag	→	→	→	→	→
Iceland	green flag	→	→	→	→	→
Italy	yellow flag	→	→	→	→	↘
Denmark	green flag	→	→	→	→	→
Norway	green flag	→	→	→	→	→
Netherlands	green flag	→	→	→	→	→
Portugal	yellow flag	→	→	↗	↑	↘
Sweden	green flag	→	→	→	→	→
Switzerland	green flag	→	→	→	→	→
UK	yellow flag	→	→	→	↗	→

*The trend is derived from a standardized X-day exponential moving average. N.B.: a green(respectively red) flag is raised whenever the level of risk reaches the level of 0 (respectively 5).

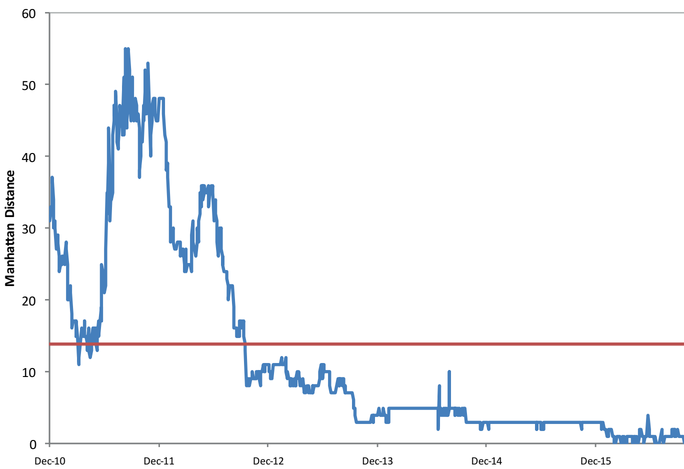
For now, we observe a bit more tensions over the short-term, which is not surprising when we put in perspective the very low level of Market Interactions with the on-going uncertainty; but no structural change (see Exhibit 3).

Exhibit 3. Short-term Velocity of Market Interactions from October 5th through as of November 9th



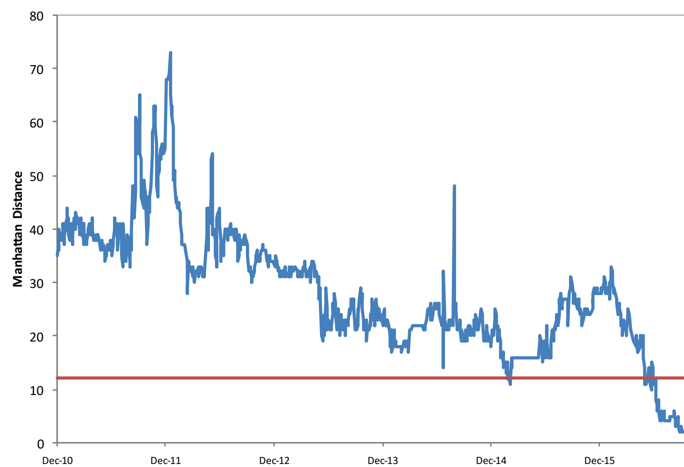
The Interaction Distance Model therefore keeps on showing a flat encephalogram for Western European countries (see Exhibit 4).

Exhibit 4. Interaction Distance Model on Western European Markets (as of November 9th)



No significant change in Emerging countries too (see Exhibit 5), where the median level of risk remains particularly low, at around 1.0, and the hotbeds of tension stay the same (e.g., Brazil, Venezuela).

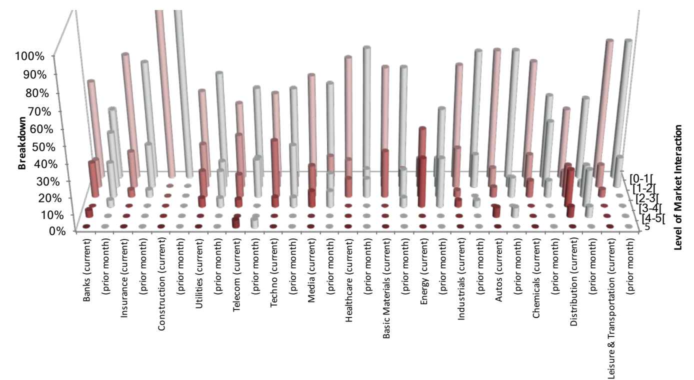
Exhibit 5. Interaction Distance Model on Emerging Markets (as of November 9th)



For the first time since September, we are seeing a disconnection between Market Interactions at the country level, which are moving slightly up across the board, and Market Interactions at the company level, which are still trending down on average. Again, this might be the harbinger of that the great rotation from bonds to equities. To be followed…

Of note, while the repricing of risk remains largely sector driven, hence the sector rotations that we have experienced, we are seeing a bit more cross-sectional dispersions in the sectors enjoying greater visibility.

Exhibit 6. Breakdown of European Corporates by Level of Risk (as of November 9th)



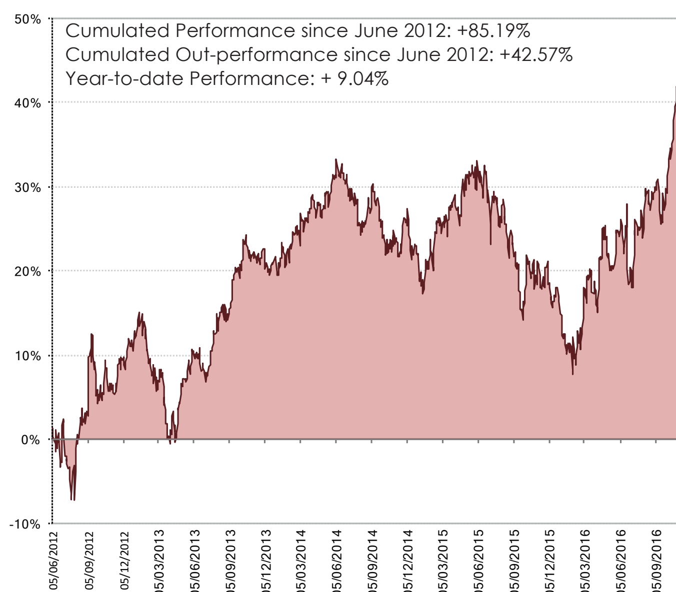
INVESTMENT STRATEGY

With market mechanical forces strengthening at the macro level, and weakening at the micro level, our selection of single stocks is benefiting from a positive scissors effect. And as can be seen with the out-performance of the basket, the moves can be swift and violent (see Exhibit 7).

Even if the cumulated out-performance of our selection of single stocks is already at a historical high (+42.57% since June 2012), in spite of a very low portfolio turnover, we believe that there is still a long way to go. The reason is twofold: 1/ the normalization process on the interest rate side is only at the very beginning, and we have seen the impact that a very limited steepening of the interest rate curve has already had on stocks such as European banks, and 2/ investors are significantly underweighted on European stocks (we shall not forget that we have just had over 35 weeks of consecutive outflows from European equities), and in their European equity bucket, they are underweighted on Banks and cyclical companies.

All stars (fundamental, mechanical, technical) are therefore aligned for a continuation of the sequence initiated during the summer. Against this backdrop we stay the course and keep our positions unchanged.

Exhibit 7. Cumulated Out-Performance of GINJER Single Stocks vs. Stoxx Europe 600 Index (as of November 9th)



CONCLUSION

We maintain our constructive view on European cyclicals, for which the risks priced in by the markets remain overestimated.

We pursue the rotation towards the stocks showing the greatest discrepancy between perceived and proven risks (e.g., Banks, Energy companies).

About Ginjer

Ginjer AM is an independent, entrepreneurial asset management company founded in July 2011. Ginjer AM has been approved by the French Regulator (AMF) on September 2011. The raison d'être of Ginjer AM is to provide investment solutions that are at the cutting-edge of financial theory and industry practices. The French ministry of research granted Ginjer AM the innovative start-up venture status (JEI) in October 2013.

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