APRIL 2021

Investment Strategy Focus

Summary

1. **US growth upgrade:** In addition to the USD1.9 trillion America Rescue plan, we expect a "Build Back Better" Program that could provide a USD2-4trn in additional fiscal stimulus over the next 10 years. We forecast **US real GDP growth at 6.9% and 4.7% in 2021 and 2022** respectively.

2. **Expect higher US yields:** A higher-than-expected growth and inflation outlook calls for higher bond yields, especially in the US where the debate on the reduction of the bond buying programme will intensify in H2 2021. We raise our **12-month US 10-year bond yield forecast to 2%** (from 1.4%) and to 0% (from -0.25%) for its German peer. Too early to return to long-term US or euro sovereign bonds.

3. **But too early to worry about inflation:** While US CPI will undoubtedly rebound over the next few months largely due to depressed 2020 inflation, it is too early to conclude that we are facing a lasting inflation surge. In the Eurozone and Japan, there are few signs of real inflation.

4. **Ultra-easy financial conditions support equities**: US and global financial conditions remain extremely loose in spite of higher bond yields, supporting risk assets like equities.

5. **Value, not Big Tech**: We see ongoing risks to US large-cap growth stocks, underlining our relative caution on US equity exposure. Favour value exposure to Banks, Basic Materials in the US.

6. **Real Estate – the next reopening trade**: Real Estate continues to offer discounts to NAV, attractive yields. We see opportunities for long-term investors in residential REITs, & in private real estate focused on logistics and prime offices.

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US, WORLD FINANCIAL CONDITIONS STILL VERY LOOSE, HELPING GROWTH

Source: Goldman Sachs, Bloomberg

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BNP PARIBAS WEALTH MANAGEMENT

The bank for a changing world

The Big Picture

US economy reaches for the sky

Increasing US growth optimism: Economists have been hard at work upgrading their expectations of US growth this year. The Federal Reserve themselves now expect the US economy to expand by a stellar 6.5% growth rate this year. Since February, the 2021 consensus US GDP forecast has risen from 4% to 5.7%.

We have upgraded our global growth forecasts following the rapid vaccine roll-out in parts of the world and substantial fiscal stimulus, especially in the US. In addition to the USD1.9 trillion America Rescue plan, we expect a "Build Back Better" Program that could provide a USD2-4trn in additional fiscal stimulus over the next 10 years. This suggests that US real GDP growth should be at **6.9% and 4.7% in 2021 and 2022** respectively.

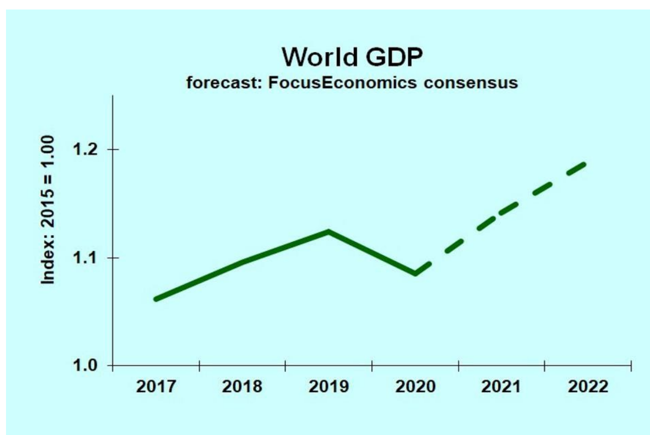
We also expect European growth to exceed market expectations (the consensus expects 4.2% growth in 2021 and 2022), closing the gap with the US. In contrast, we have turned more cautious on China. We now see potential positives outweighing negative risks.

US; China growth will spill over to the Rest of the World: While focused on the US, this boost to US government spending will also have indirect positive effects on global growth, given spillover effects on consumption and investment which will be supplied in large part by overseas companies.

The key question is: Have financial markets already priced in all of this growth optimism? We would answer NO - for the simple reason that overall financial conditions both for the US and for the world remain very loose, encouraging growth and thus boosting the earnings power of companies as a result.

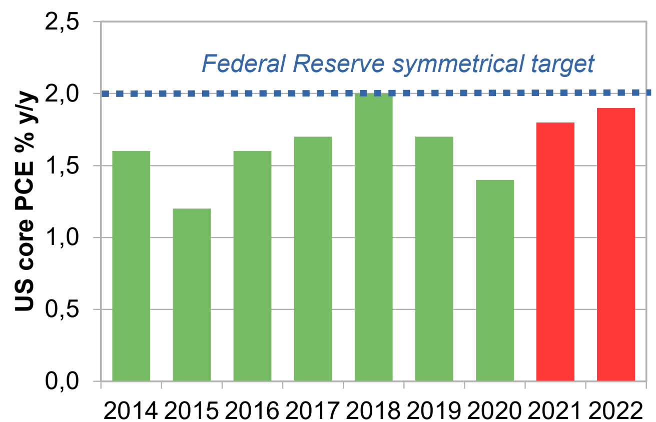
Resurgent inflation? We expect a temporary acceleration in inflation and inflation expectations. The persistent labour market slack is expected to prevent a durable acceleration in wage growth. Structural forces such as digitalization and demographics will also limit upside pressures. US inflation should move to 2.5% this year but fall back to 2.2% in 2022. In the Eurozone, we expect 1.7% and 1.4% respectively.

CONSENSUS WORLD GROWTH OF 5.2% IN 2021, 4.1% IN 2022



Source: Focus Economics

CONSENSUS FORECASTS US INFLATION BELOW FED TARGET EVEN IN 2022



Note; Red columns represent consensus forecasts. Source: Bloomberg

CONCLUSION

We have upgraded our US GDP economic growth expectations to above consensus forecasts (of 5.7% GDP growth in 2021), as we see the combination of re-opening and stimulus packages boosting first consumption, then infrastructure and corporate investment. Don't be downbeat on European prospects: the export-oriented nature of the European economy allows for piggybacking off strong US and Chinese momentum.

Bond, Credit and FX Outlook

Higher long-term US yields are coming

The bond market tests the Fed: In the aftermath of the recent Fed meeting and subsequent press conference, US treasury bonds reacted to the Fed's apparent lack of concern over inflation pressures by pushing 10-year yields up further, to 1.7% (as of March 19). At this level, yields have finally returned to the levels they sat at in February 2020, prior to the pandemic-induced stock market crash.

US 10-year breakeven inflation rates, the bond market's best guess for average long-term US inflation, has recovered sharply to 2.3% from the low of below 0.8% touched in March 2020. At this level, US inflation expectations have completely renormalised, now sitting 0.3% above its 2010-February 2020 average.

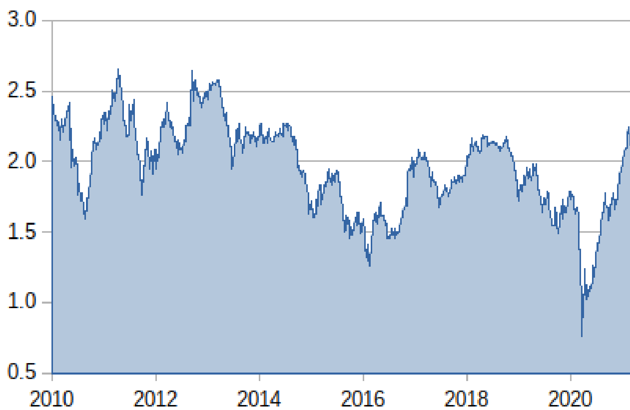
The USD64,000 question today is: "How far can long-term US bond yields rise before the Federal Reserve is forced to act to curb the rise in borrowing costs for the US government?"

Federal borrowing costs are low: At what point does the US government budget start to really suffer from the rise in interest costs? The average maturity of outstanding US Treasury debt is around 6 years. On a 12-month rolling average basis, 5-year US Treasuries sit at 0.4% - still the lowest average level seen over the last 30+ years. In addition, the US government can always reduce the interest cost of new debt by issuing more shorter-maturity debt - the 2-year Treasury yield sits at a paltry 0.15%, still incredibly cheap.

At what point do rising long-term interest rates hurt economic growth? At 3.3%, the 30-year fixed mortgage rate is only a little above its 3% December 2020 low, and far below its 5.1% average since 1999.

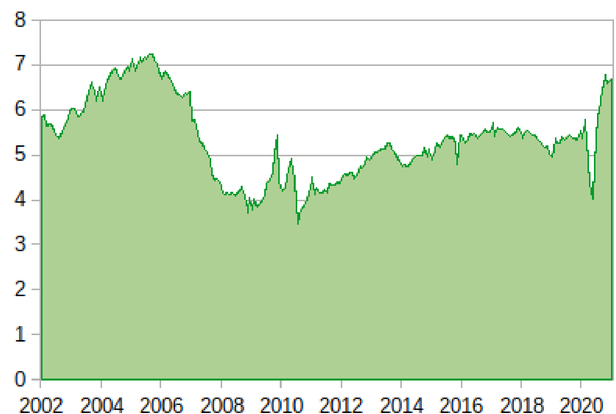
So far, the hike in rates seems to have had little impact, with existing home sales running at a 6.69 million annualised rate, the highest such rate since 2004, and good for overall economic growth.

US 10-YEAR BREAKEVEN INFLATION BACK TO HIGHEST SINCE 2014



Source: Bloomberg

US EXISTING HOME SALES RUNNING AT HIGHEST SINCE 2004



Source: Bloomberg

CONCLUSION

Investors should accept rising US bond yields as a natural consequence of a US nominal growth rate that could hit from 7% to 10% this year. We now forecast the 10-year US Treasury yield to rise to 2% on a one-year horizon, implying a negative annual return from US bonds. We continue to avoid German and US long-term sovereign bonds

Risk Radar

Caveat Tech Emptor

Nasdaq at risk of under-performing: Watch out on the Nasdaq! We all know that Big Tech had a phenomenal run over 2020 post COVID crash, but the Nasdaq Composite chart does not look "healthy" right now.

Note in the chart below how the Nasdaq has not only broken down below its rising trend line, but notably has so far failed to recapture its recent highs, in contrast to the equal-weight S&P 500 or US small-caps.

Fundamental reasons for concern include the risk of increased regulation on these Big Tech companies in both Europe and the US, plus the risk of a higher corporat tax burden, potentially in part via a new global digital sales tax.

For those investors looking to invest in technology-driven growth, we would rather favour semiconductor, cybersecurity or Asian technology exposure rather than the US FANMAG names.

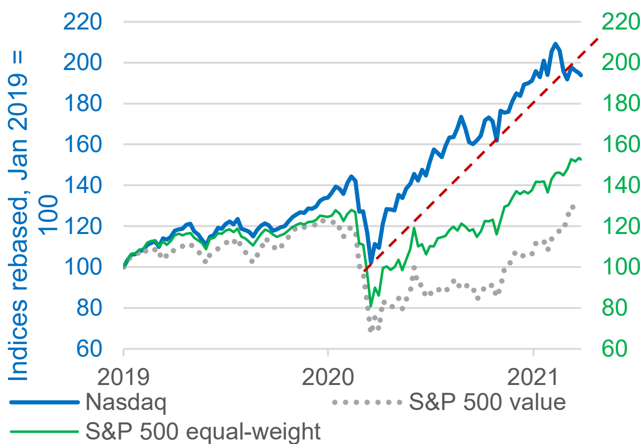
Should we expect lower volatility?: The VIX volatility index, often called the 'fear' index, has returned to test the 20 level, the bottom of its trading band since the COVID-inspired sell-off of February-March 2020.

The BNP risk premium index remains at modest levels atnd the St Louis Fed financial stress index sits near lows, not indicating any elevated level of financial market risk.

At the same time, liquidity remains plentiful, financial conditions remain very loose and global economic growth is being revised up, suggesting a healthier economic outlook.

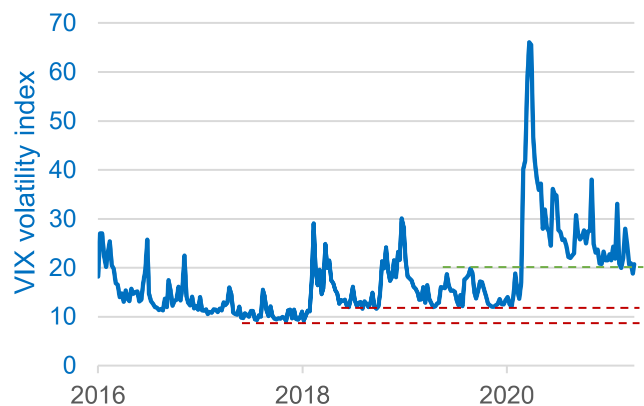
Should the VIX index manage to break below, and stay below the 20 threshold level, we could enter a new lower volatility regime for stocks; which would be a positive driver for global stock markets over the next few months.

NASDAQ AT RISK OF CONTINUED ROTATION FROM GROWTH TO VALUE



Source: Bloomberg

VIX VOLATILITY INDEX THREATENS TO DROP BELOW 20, COULD HEAD BACK TO 10?



Source: Bloomberg

CONCLUSION

Any short-term rebound in US technology stocks (eg the Nasdaq 100 index) should be used as an opportunity to reduce weightings, in favour of mid/small-cap and cyclical sector exposure. With the surge in US bond yields seemingly calming down below 1.7%, risk assets such as equities, commodities and real estate look well positioned for the next few months.

Equity and Commodities Outlook

Kiss Goodbye to TINA?

Equities good value relative to bonds, credit: The longstanding argument for buying stocks, that "There Is No Alternative" (TINA), is no longer really true, in my view, now that US bond yields have rallied substantially. For foreign investors willing to accept unhedged US dollar risk, these yields could once again be at least acceptable.

But we remain positive on equity markets, as we expect stronger US and global growth to boost earnings growth for companies worldwide, while earnings risk premia for the US, UK and Eurozone stock markets remain generous, at 5-9%. Thus, stocks remain good value relative to real bond yields, even after strong performance since November last year.

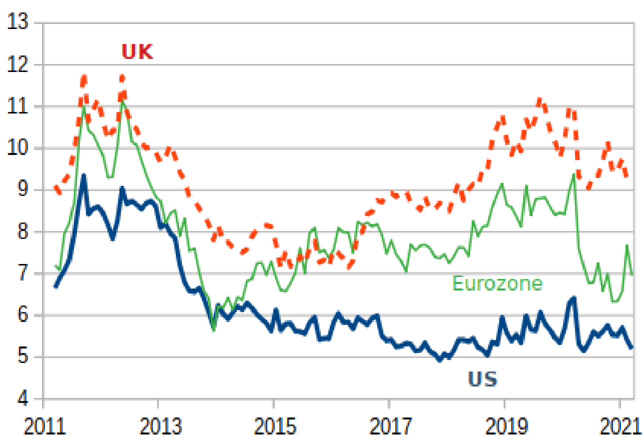
Remember that stock markets are liquidity-driven, and thus continue to profit from a tailwind of very loose financial conditions, boosted latterly by Biden's fiscal stimulus package and also to be helped by increased ECB bond buying. We maintain our bias to cyclical sectors and markets and mid/small-caps.

No stopping the commodities train: There can be no doubt that the commodities markets have embarked on a new bull market: the CRB Raw Industrials index is 37% higher and the CRB Industrial Metals index 70% higher than in the May 2020 cycle trough.

Is this commodities cycle overhyped already? While commodities have staged an impressive recovery, we should remember that this comes after a 10+ year bear market. The Bloomberg commodity index is still only 3% above its January 2020 high. Indeed, priced in euros or Chinese renminbi, it is actually 4% below its January 202 hgih. So I would argue not at all.

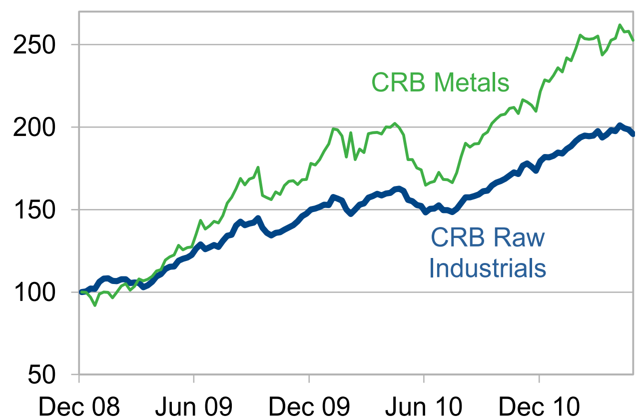
The Financial Crisis playbook: from December 2008 (the Lehman Brothers bankruptcy), the CRB Metals index rallied by 150% to April 2011 as the global economy recovered on the back of a wave of monetary stimulus. Today we have bigger waves of both monetary and fiscal stimulus, but so far a much smaller gain for commodities in aggregate.

EQUITY RISK PREMIA REMAIN STABLE BY HISTORICAL STANDARDS



Source: BNP Paribas

POST THE 2008 FINANCIAL CRISIS, CRB RAW INDUSTRIALS, METALS GAINED 100%-150%



Source: BNP Paribas, Bloomberg

CONCLUSION

In equity markets, our preferences remain towards cyclical recovery exposure in the UK, Japan and Eurozone, while we remain neutral on the US.

In commodity markets, we favour industrial metals such as copper, nickel and tin, plus precious metals with strong industrial demand such as silver, platinum and palladium. We are neutral on crude oil, following the run-up in Brent to the $70 level recently.

Real Estate Outlook

Reopening value

Reopening value? Several real estate sectors such as Retail remain challenged by ongoing lockdowns and the growth of e-commerce; however, this same trend should benefit the logistics (warehouses) sector. Equally well, I do not believe the prevailing conventional wisdom that all office workers will want to continue working from home, once COVID-related restrictions are eased.

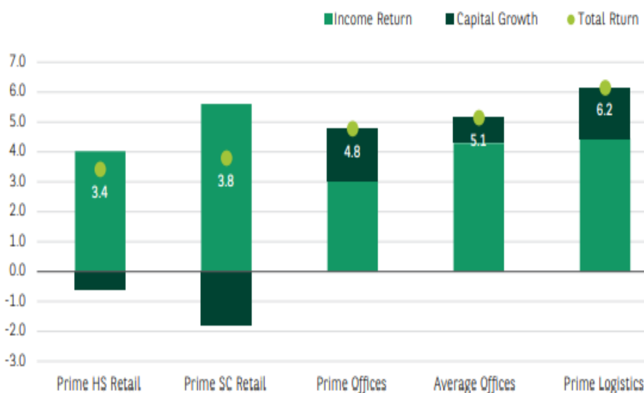
I believe rather that we have a deep psychological need to (a) have a change of environment to separate our work and home lives, and (b) to meet and discuss with our colleagues in a physical environment, where serendipitous conversations can result in better productivity and better creative and collaborative thinking, than when all meetings are held over Zoom. Progressive reopening of Western economies should prove an important driver for the real estate sector over the next year or so.

Focus on logistics; prime office: BNP Paribas Real Estate prefers logistics and prime office sector exposure in European real estate over the next few years, expecting yield compression (boosting capital values) in each segment. This should drive overall returns from logistics and offices into the 5%-6% region.

The residential property segment remains attractive across Europe, with Madrid, Barcelona and Dublin offering value in terms of the price/rent ratio, while rented accommodation in these cities remains in short supply. In Germany, we see value opportunities in the 3 large listed residential REITs, with steady rental growth, discounts to net asset values ranging from 12% to 29% and dividend yields well over 3%.

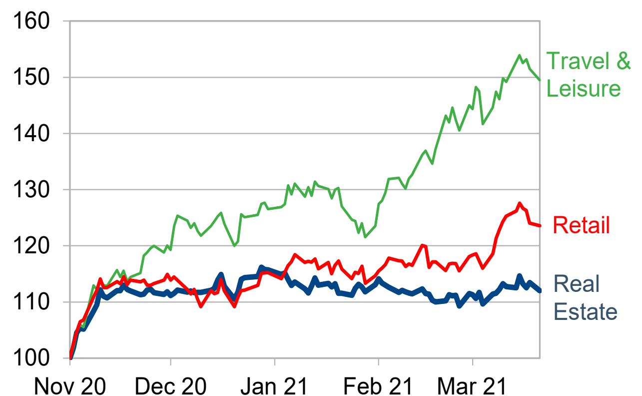
This robust rental demand, combined with mortgage rates at historic lows (under 2% in the UK, and c.1% in France for example) remain strong supports for the residential property markets in Europe.

BNPP RE: ESTIMATED 3%-6% RETURNS FROM EUROPEAN PROPERTY OVER 2021-25



Source: BNP Paribas Real Estate

EUROPE LISTED REAL ESTATE HAS LAGGED OTHER REOPENING EQUITY SECTORS



Note: STOXX Europe sectors. Source: Bloomberg

CONCLUSION

While the European and US listed real estate sectors have lagged other “reopening” equity sectors over the year to date, we see value opportunities in a number of areas, most notably in the residential sector. In private real estate, we remain attracted to the long-term attractions of the logistics and prime office sectors in Europe, but would remain more cautious over exposure to retail, except for specific exposure to supermarket-based shopping centres and leases – we look for exposure to omnichannel food retailers, combining physical supermarket shopping with online retail fulfilment.

Summary of our main recommendations

	Current Recom	Prior Recom	Constituents	We like	We avoid	Comments
EQUITIES	+	+	Markets	EU, UK, Japan, EM: China, Taiwan, India, S. Korea.		The combination of historically low long-term real rates and accommodative financial conditions are giving a powerful boost to global stocks. . Attracted to the pro-cyclical profile of Euro Area, Japanese and UK stocks. Positive on Emerging Markets, based on a superior earnings growth profile and room for further re-valuation.
			Sectors	Banks, Real Estate, Industrials, Materials, Insurance, EU Energy	Consumer staples, Utilities	Positive on these pro-cyclical sectors: Materials, Industrials, Construction, Real Estate and Banks. In Europe: positive on Energy.
			Styles/ Themes	Megatrend themes		Good potential remains for secular themes such as 5G, connected consumers, health tech, water, waste and infrastructure.
BONDS	-	-	Govies	EM bonds (USD + local currency)	US long-term Treasuries and German Bunds	We are negative on German govies, and on long-term US govies.
			Segments	Peripheral euro and eurozone convertibles . IG credit and Fallen Angels.		We prefer corporate bonds over government bonds. We like EUR and US IG bonds with a duration at benchmark (5 and 9 years, respectively).We are positive on eurozone convertible bonds. We are neutral on both US and eurozone HY. We prefer Fallen Angels. We are positive on EM bonds, in both hard and local currency.
			Maturities	At benchmark		
CASH	-	=				
COMMO-DITIES	+	+				Gold - positive: The sharp corrections after the vaccine news seems excessive. Negative real rates and inflation worries should drive gold back above USD2000/oz. Oil - neutral: OPEC+ restrictions, lower US production and recovering demand thanks to vaccines should keep Brent prices in the USD55-65 range. Base metals - positive: prices are underpinned by the Chinese rebound and by pro-cyclical policies in Europe and US.
FOREX	=	=	GBPUSD			▪ Positive view on sterling, helped by progressive re-opening and reduction in Brexit-related uncertainty.
ALTERNATIVE UCITS				Long-short equity, relative-value and event-driven		

Economic, FX forecast tables

BNP Paribas Forecasts

GDP Growth %	2019	2020	2021	2022
United States	2.2	-3,6	4,2	4,1
Japan	0,3	-5,3	1,1	3
United Kingdom	1,5	-11,1	4	8,6
Eurozone	**1.3**	**-7,3**	**3,8**	**5,5**
Germany	0,6	-5,6	2,7	5,1
France	1,5	-9	5,5	4,7
Italy	0.3	-9	4,5	4,4
Emerging				
China	6,1	2,3	9,5	5,3
India*	4,2	-11,4	11,6	5
Brazil	1,1	-4,5	3	3
Russia	1,3	-4,5	3,8	3

* Fiscal year
Source: BNP Paribas - 15/01/2020

BNP Paribas Forecasts

CPI Inflation %	2019	2020	2021	2022
United States	1,8	1,3	1,9	1,9
Japan	0,5	0,0	-0,4	-0,3
United Kingdom	1,8	0,9	1,5	2,1
Eurozone	**1,2**	**0,2**	**0,8**	**1,3**
Germany	1,4	0,4	1,3	1,2
France	1,3	0,5	0,6	1,2
Italy	0,6	-0,2	0,5	1,3
Emerging				
China	2.9	2,6	2,3	2,8
India*	4,8	5,8	4,3	3,8
Brazil	3,7	3,1	4	4
Russia	4,3	3,4	3,5	3,5

* Fiscal year
Source: BNP Paribas - 15/01/2020

	Country		Spot 28/01/2021	Trend	Target 3 months	Trend	Target 12 months
	United States	EUR / USD	1.21	Neutral	1.20	Negative	1.25
	United Kingdom	EUR / GBP	0.89	Neutral	0.88	Positive	0.86
	Japan	EUR / JPY	126	Neutral	125	Neutral	128
	Switzerland	EUR / CHF	1.08	Neutral	1.08	Negative	1.11
	Australia	EUR / AUD	1.59	Neutral	1.58	Neutral	1.56
	New Zealand	EUR / NZD	1.70	Positive	1.67	Positive	1.67
	Canada	EUR / CAD	1.56	Positive	1.52	Neutral	1.56
	Sweden	EUR / SEK	10.13	Neutral	10.20	Neutral	10.20
	Norway	EUR / NOK	10.53	Positive	10.20	Positive	9.90
Asia	China	EUR / CNY	7.84	Neutral	7.80	Negative	8.00
	India	EUR / INR	88.5	Neutral	90.0	Negative	93.75
Latam	Brazil	EUR / BRL	6.55	Positive	6.36	Positive	5.63
EMEA	Russia	EUR / RUB	92.4	Neutral	91.2	Positive	85

Source: BNP Paribas, Refinitiv Datastream

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