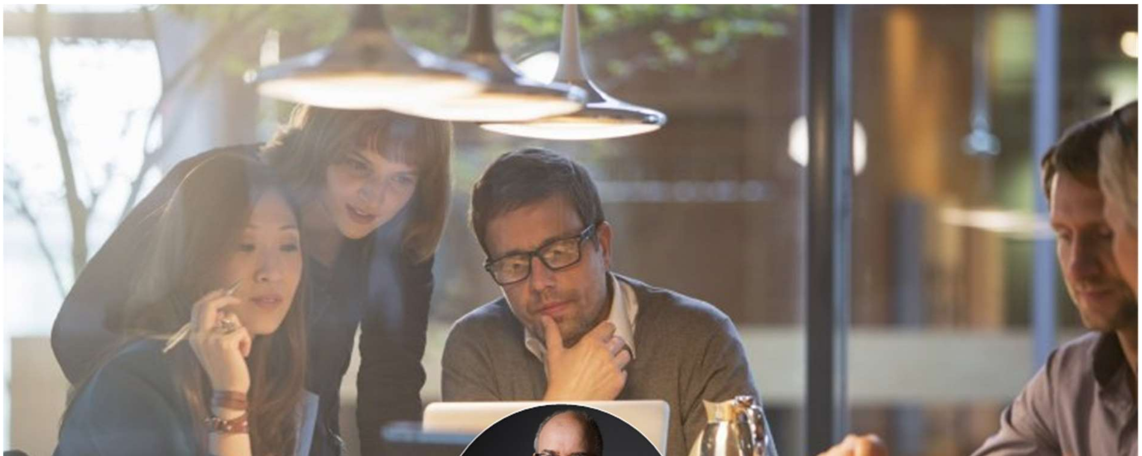
INVESTMENT STRATEGY LETTER

January 2020



Florent BRONES
Chief Investment Officer

SUMMARY

1. **Our base-case scenario is that tensions between Iran and the US should not escalate. Our convictions for 2020 are unchanged:**

   a) economic growth will remain moderate and with no inflation, so we exclude the risk of a recession. A truce agreement is expected to be signed in mid-January between the US and China;
   b) bond yields will remain low;
   c) stock markets will deliver positive returns thanks to rising profits and dividends. Flows into equities will continue and
   d) we need to diversify our bets as volatility will return from time to time during the year.

2. We increased our exposure to the stock markets in the last quarter of 2019, and have made no changes to our recommendations this month except in the Energy sector. We remain bullish on the US, eurozone, UK and Emerging Markets. In terms of sectors, we are buyers of European technology, US Financials, Insurance in both Europe and the United States and European Building Materials. **We are now buyers of the whole Energy sector.** Style-wise we prefer Value to Growth, and small and mid caps to large caps. We recommend buying European convertible bonds.

3. Taking into account the reduced global risks and the new tone of the Fed's rhetoric, we no longer expect US official rates to be cut in 2020 (vs. our previous expectation of two more cuts).

4. We adjust our bond yield targets by 25 basis points; in 12 months we now expect 2% (instead of 1.75%) on the US 10-year and -0.25% (instead of -0.50%) on the Bund. Our forecast for the dollar is unchanged: 1.12 per €1 in 3 months, i.e. stability from the current level. Then, later, we expect the dollar to fall to 1.14 in 1 year. We are becoming cautious on Scandinavian currencies (SEK and NOK).

5. We reiterate our positive view on gold for its diversification role (range revised up by $50 to $1450-1650). Our neutral views are maintained on industrial raw materials and oil (unchanged range of $60-70 for the Brent despite tensions between Iran and the United States).

6. In Alternative Investments, our preferences for Global Macro and Long/Short Equity strategies are unchanged. We are neutral on REITs in Europe.

Our convictions for 2020

2019 was a very good year for the financial markets with the global stock market index gaining 25%. Admittedly, it offset a difficult year in 2018; indeed, in two years the global stock market (MSCI World index) rose by only 12.1%. But bear in mind that the profits of listed companies did not increase in 2019! Here are our convictions (unchanged this month) for the future.

Moderate economic growth, low inflation

For more than a year, global industry has been in a recession, and leading economic indicators predict that this trend is not about to reverse. The recession in the industrial sector is linked to two factors. Firstly, trade tensions between China and the United States. This factor will diminish with the signing of the Phase One agreement expected on 15 January, but it will not disappear completely as the difficult Phase Two negotiations are likely to last at least until the US presidential election. Secondly, the contraction in the Automotive sector, which is linked to cyclical factors (uncertainty, production costs, etc.) and structural factors, particularly the major technological change in the sector towards electric cars.

We believe that this industrial recession will not spread to the rest of the economy, because services and job creation remain strong enough (particularly in the United States and Germany) for the overall growth of the economies to be positive, albeit slowing. Wage growth is underpinning consumption without causing an acceleration in core inflation.

In other words, the longest economic growth cycle in history in the United States will continue without a recession in 2020 and 2021. Leading indicators are starting to stabilise. If this is confirmed over the coming months, a rebound in activity will start in the second half of the year, and the duration of the growth cycle will be extended to 2021. Growth is expected to accelerate once again in mature economies in 2021, while remaining subdued.

One crucial condition must be met: political risks have been fading since the autumn, and this easing needs to be amplified, particularly with the signing of a partial agreement between the United States and China. Similarly, a negotiated Brexit must be finalised since the general election on 12 December that gave the Conservative government a comfortable majority.

Tensions between Iran and the United States fall into the category of traditional risks, which are common in this part of the world. It is not possible to predict what will happen on the political side, and an escalation of tensions is of course possible. Yet this is not our base-case scenario as Iran has so much to lose, as it is already in a very difficult economic situation. Moreover, due to the fast-approaching elections in the US, the Trump administration has little manoeuvre to act. Oil prices have not risen too much, and we think they will remain within our forecast range ($60-70 for the Brent). If they were to rise further, the producer countries would increase their production, because there is capacity, as seen in the extended OPEC agreement in December.

Interest rates and bond yields will remain low for a long time

This is a new paradigm, based on a widespread idea. Interest rates are low, across all curves, and will remain so for a long time. Central banks are dovish and are communicating on a continuation of this policy in the near future. The ECB continues to use all the tools at its disposal, with negative official rates, very favourable TLTROs, a tiering system to help banks but, above all, a new phase of Quantitative Easing, with monthly purchases of €20 billion worth of bonds on the markets. Mrs Lagarde has begun a strategic review of the ECB, which will take time before deciding any changes.

The Fed put itself on hold after cutting rates three times in 2019; and its communication suggests it will make no moves in 2020. As the risk of tensions between China and the United States have faded, we are abandoning our previous scenario of two rate cuts in 2020. Many other central banks are maintaining a dovish bias, particularly in EM economies, and especially China's central bank.

Bond rates are also very low; they have slightly bounced back from their lows seen over the past few weeks. We have revised up our forecasts by 25bp to 2% in 12 months for the US 10-year, to -0.25% for the Bund (vs. 1.75% and -0.50% respectively): bond yields are likely to remain close to current levels as structural factors remain (low inflation, moderate growth, further monetary accommodation, surplus in savings, etc.).

There is one scenario in which bond yields could rise more than expected: namely, if aggressive fiscal stimulus policies are adopted to take over from monetary policies at the end of the cycle. This is what central banks want, particularly the ECB, on condition that states invest. For now, however, reflation measures remain very moderate, particularly in countries such as Germany and China, which have room for manoeuvre but not the political will. In the event that reflation measures become stronger than expected, we may revise up our forecasts for bond rates.

If interest rates remain low and negative for nearly half of European bonds, we must expect disappointing returns in 2020 in the fixed-income universe, close to 0 in euros and a little more in dollars, which will not cover inflation, except in the riskier segments we recommend. It will be possible to achieve satisfactory returns by accepting a portion of risk with European convertible bonds and EM bonds in local currencies.

Equity markets: we remain optimistic!

If growth in the global economy continues, even at a moderate pace, and yields in the bond universe are close to 0, capital flows into equities will continue in 2020. It is the famous "TINA" (There Is No Alternative) often cited in the press. Many of our positive recommendations for 2020 are in equity markets.

But let's not dream of stellar return expectations, because they will obviously not be as good as in 2019! Stock markets rose by 25% in 2019, while corporate profits remained stable. So, markets are automatically more expensive today. In our view, the stock markets will appreciate in line with earnings plus dividends. I.e. a total of +5% for mature markets and +7% for Emerging Markets. These are moderate targets in absolute terms, but very acceptable in view of interest rates which are close to 0. Long-term dividend growth is a key supporting factor for stock markets that start their 11th year of gains in the United States, making it the longest bull market in history.

With this in mind, we favour the eurozone, the United States, the United Kingdom and the Emerging Markets. There is a window of opportunity for the Value segment (value with a discount) versus Growth, and for small and mid caps. In terms of sectors, we highlight Health Care and Financials globally, Technology and Building Materials in Europe in particular. We turn positive on the Energy sector this month.

Tactically, at the beginning of 2020, the stock markets were in a slightly overbought situation, at 8% above their 200-day moving average. Amid Iran/US tensions, a small consolidation has begun. A return to 200-day moving averages would provide a nice opportunity to strengthen positions.

We diversify our bets

We are fully aware that our recommendations for 2020 carry risks. However, volatility is low today, but it will not always remain so. Therefore, it is important to diversify bets as much as possible. On the stock markets, this means diversifying across countries, currencies, but also sectors, themes and styles.

In addition, it is advisable to have some investments that are as decorrelated as possible from the stock markets. That's why we like gold. We are revising up our forecast range to $1450-1650, i.e. an increase of $50. The long bullish trend of gold is set to continue. We also like Alternative funds, including Global Macro and Long/Short equity. Real Estate is also a good diversification tool.

The hardest task will be to benefit from periods of rising volatility to reinforce positions in risky assets. Experience shows that it is easier to say/write than to do.

No change this month (regions and styles). We turn positive on Energy

Amongst our latest country changes**, in November we became buyers of the UK equity market and the Emerging Markets.** Indeed the UK market has underperformed over the past three years, due to tensions over Brexit and the risk of an exit without an agreement, which could precipitate a recession. This risk has faded since the elections when the Conservatives obtained a clear parliamentary majority. The discount to UK shares has started to fall, especially domestic shares (FTSE 250), but the movement is not over in our view. On the large caps index, the large weighting of financials, oil and building materials stocks (sectors we are positive on) and the dividend yield of 5% provide a significant cushion.

In Emerging Markets, the underperformance of recent quarters is likely to reverse as the overall risk diminishes. The growth environment is becoming favourable for Emerging Markets, whose economic growth has traditionally accelerated faster than that of mature economies. In addition, central banks remain accommodative thanks to the slowdown in inflation, US rates will remain low (including the long end of the curve) and the dollar is likely to remain at around current levels. Our favourite three countries in Asia remain India (rapid economic growth, slowing inflation, but above all, structural reforms implemented by the Modi government), South Korea (weight of the Technology sector, accommodative monetary policy) and Singapore (high and solid dividends).

We remain positive on the US stock markets and the eurozone, with no change to our arguments.

In terms of sectors, we have made several adjustments in recent months to take on more risk: We are neutral on Building Materials and positive on European technology, US Banks and Insurance in both Europe and the United States. The same applies to Building Materials in Europe (positive instead of neutral). Finally, we remain neutral on listed real estate as the performance of this defensive sector has been excellent in recent years. It should be noted that we no longer differentiate between the European and UK sector. **We have turned positive on the overall Energy sector,** which underperformed last year and is cheap. Cash flow visibility is good, especially as oil prices are at the upper end of our forecast range. Dividends, and even share buybacks, could rise more than expected.

Style-wise, we prefer Value to Growth, and small- and mid-caps to large caps.

Bonds and credit: no change in recommendations

We adjust our long-term interest rate targets to 2.00% for the US 10- year, and -0.25% for the Bund (+25bp).

Despite the recent steepening of the entire US yield curve (there are now 25bp between the 2-year and 10-year, while this curve was briefly inverted during the summer), we continue to highlight short maturities in dollars, which still offer an attractive risk/return ratio, only for the dollar holder. The current level of the 2-year rate means that the carry is quite attractive for short maturities.

We still see some opportunities in Investment Grade Corporate bonds. In November, we adjusted our duration recommendation on European and US credit to neutral against the benchmark, instead of a shorter duration beforehand, as bond yields are not far from our targets (at unchanged spreads). Furthermore, with the ECB resuming its purchasing of European Corporate bonds, we have extended the positive recommendation to BBB-rated bonds.

We remain positive on European convertible bonds in line with our overall optimism on equities, as the equity component is the main driver of the current performance of convertibles, with interest rates being so low. With a few large issues in 2019, the European convertible bond market has gained some liquidity.

We remain neutral on High Yield Corporate bonds in euros and dollars. No changes. In the High Yield (HY) segment, yield spreads remain low in the United States. It seems too early for us to change our recommendation on euro HY as nominal rates and risk premiums remain low, not compensating enough for the risk taken with these investments, in our view.

We remain neutral on EM Sovereign hard currency bonds (sensitive to the dollar and US rates, significant weight in the indices of Turkey, Argentina and Venezuela, three countries we are not comfortable with). We are positive on EM Corporate bonds in hard currencies; in local currencies, we are positive on both Sovereign and Corporate, which have a cushion thanks to the yield (close to 5%) they offer. Several central banks are likely to continue to cut their official rates, which will be supportive for these Emerging Market bonds in local currencies. EM currencies offer upside potential, but are still very volatile. The performance in 2019 was excellent, offsetting the bad year of 2018. The move is not over as the Fed remains dovish.

Currency markets: no change

Since the interest-rate environment remains calm, with no significant movements going forward, volatility in exchange rates is also likely to remain low.

We are still convinced that the dollar is likely to weaken against the euro in the long term due to the twin deficits (fiscal and trade) in the US, and the fact that the dollar is already overvalued against its purchasing power parity, at 1.31 for €1 (source: OECD).

Nevertheless, we expect a weak movement to 1.12 in 3 months and to 1.14 in 12 months.

We adjust our 3-month target on the pound to 0.85, i.e. the current level and maintain a 12-month target on the pound at 0.88 for €1. We can see, without any convincing explanation, that fluctuations in the pound's exchange rates are actually quite small despite the very complex political situation until the elections, and then very clear now. The unknown element in the negotiations with the European Union continues to weigh.

We became more cautious in November on the Scandinavian currencies, SEK and NOK; their declines were contrary to changes in growth fundamentals, inflation and the interest rate outlook. The market movement has since reversed, in particular thanks to the rate hike by the Swedish central bank (to 0%, it is the first central bank to exit negative rates). We believe the potential is exhausted and we turn negative on the NOK and the SEK.

After the Phase One agreement and easing tensions, we revise our 12-month target to 7.00 from 7.15 (value of 1 dollar). The Chinese currency will remain at around the current level.

Commodities: we are positive on gold and remain neutral on oil. No change

Fundamentally, **gold remains attractive, in our view**. The virtues of diversification in portfolios are topical. An important supporting factor will come from the risks of rising inflation, especially in the US. Our forecast range is revised up by $50 to $1450-1650 per ounce over the next 12 months.

We moved to neutral on oil in May. We maintain our core idea and therefore our neutral recommendation; the oil market will rebalance with a management of production production by the extended OPEC, and with US shale oil production generally unprofitable when the price is too low. Slowing demand growth in the emerging world is limiting potential price rises. So we think oil will stay in our $60-70 range. This is exactly what happened in September/October after the destruction of a significant part of Saudi production capacity: just after the attack, prices rose sharply, then they returned to our forecast range with a gradual recovery in production. A similar movement could take place admid current tensions between Iran and the United States. So far, the rise in prices has not been dramatic. But in the event of further tensions, a further rise in prices would lead to an increase in production. Capacity exists in particular in Russia, Saudi Arabia and the United States with shale oil.

Real Estate: we are now neutral on REITs in Europe including in the UK. Valuations have risen with the excellent stock market performance of recent quarters. This sector pays dividends in the region of 4%, with income (at worst) stable, so that it can maintain its dividends without a problem. That said, REITs will struggle to outperform the market in a more buoyant global environment.

Alternative Investments (unchanged)

New opportunities in the Global Macro and Long/Short Equity segments will emerge thanks to the expected return of inflation, structural changes in technology and the ongoing rebound in volatility. We remain positive on the Long/Short Equity and Global Macro segments.

THE INVESTMENT STRATEGY TEAM

France

Florent BRONES
Chief Investment Officer

Asia

Prashant BHAYANI
Chief Investment Officer, Asia

Grace TAM
Chief Investment Advisor, Asia

Belgium

Philippe GIJSELS
Chief Investment Advisor

Xavier TIMMERMANS
Senior Investment Strategy, PRB

Alain GERARD
Senior Investment Advisor, Equities

Pol TANSENS
Head of Real Estate Strategy

Luxembourg

Guy ERTZ
Chief Investment Advisor

Edouard DESBONNETS
Investment Advisor, Fixed Income

Switzerland

Roger KELLER
Chief Investment Officer

DISCLAIMER