JUNE 2022

Investment Strategy Focus

Summary

1. **Mid-cycle economic pause or approaching recession?** Growth fears have now supplanted inflation fears. Stock and credit markets have priced in a higher risk of recession. We see a slowdown, not recession. Key employment, housing activity indicators remain robust.

2. **Little change in global energy demand:** high oil, gas and electricity prices have not triggered demand destruction. OPEC+ production lags behind quotas, while Chinese demand will recover post COVID. Energy prices should stay high, boosting producers and service providers.

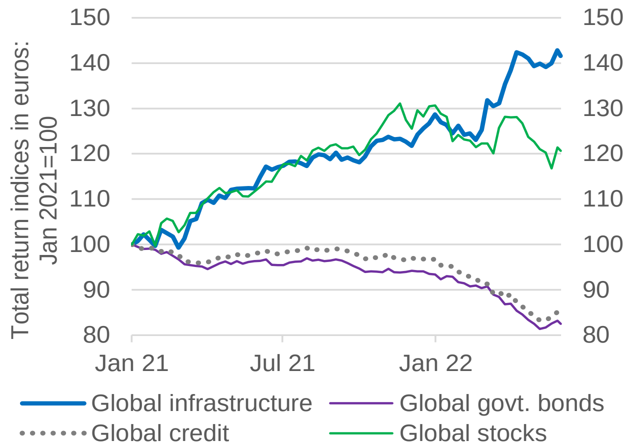
3. **Just a bear market rally, or a more lasting rebound?** Stronger signs of sustained positive growth, plus lower uncertainty surrounding Chinese policy, would trigger a more lasting rebound in stock and credit markets. We remain neutral on both stocks and credit for now, in anticipation of clearer macro signals to come.

4. **Sector, thematic leadership has changed hands:** do not simply expect what worked well over the last 10 years to work as well in future. Thematically, energy efficiency, commodity production and productivity-boosting investment should dominate this year and beyond.

5. **Four interesting investment opportunities today:** a) US investment-grade corporate bonds, b) oil & gas producers and service providers, c) infrastructure linked to renewable energy and energy efficiency, and d) producers of "industrial metals of the future" with a focus on tin, copper and aluminium.

Contents

GLOBAL LISTED INFRASTRUCTURE HAS BEEN A RARE PERFORMER IN 2022



Source: BNP Paribas, Bloomberg

Edmund Shing, PhD

Global CIO

BNP Paribas Wealth Management

Our Key Convictions: biased towards real assets

Buy:

1. **UK equities**
2. **Global energy and mining companies**
3. **Gold and precious metals**
4. **Warehouse/logistics real estate**
5. **Global macro/trend-following alternative UCITS/hedge funds**

Avoid:

1. **Euro cash**

Asset Allocation: No Changes in June

	Very underweight	Underweight	Neutral	Overweight	Very Overweight
Equities			=		
Government Bonds			=		
Corporate Credit			=		
Real Estate				+	
Alternatives				+	
Cash		-			

Note: Alternatives include Commodities, Infrastructure and Alternative UCITS/hedge funds

Focus: Now a growth scare

Painfully high inflation slows growth

Inflation uncertainty pushes growth lower: rapid increases in the cost of living have had a predictable effect of slowing down domestic consumption trends. Companies are also reacting to persistent geopolitical uncertainty and tightening financial conditions by holding back investment, thus slowing a key source of growth.

Financial markets today worry more about growth: the focus of stock, bond and FX markets has shifted from inflation worries to growth fears, with the European Central Bank about to join other central banks in raising benchmark interest rates in June and again in September.

Medium-term inflation expectations, priced into sovereign bonds, have started to decline from recent peaks as bond markets anticipate lower growth.

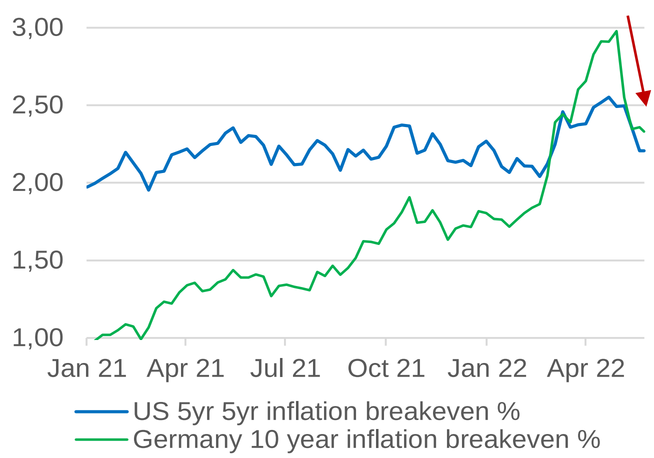
There are other signs of weaker growth being anticipated by financial markets. Investment-grade and high yield corporate bond spreads have widened substantially of late, reflecting fears of higher defaults.

Lead economic indicators decline: these US and Euro indices have been declining for some time, highlighting the slowing trajectory of growth globally. But classic indicators of impending recession, such as the US yield curve, continue to suggest only a modest risk of recession within the next 12 months. In Europe, recession risk is intimately linked to energy prices, as higher energy costs drag economic growth down.

Just a mid-cycle pause, then? Financial markets are unsure whether we are experiencing merely a mid-cycle growth pause, or the early stages of a full-blown economic recession, with central bank rate hikes and inflation acting as twin brakes on economic activity.

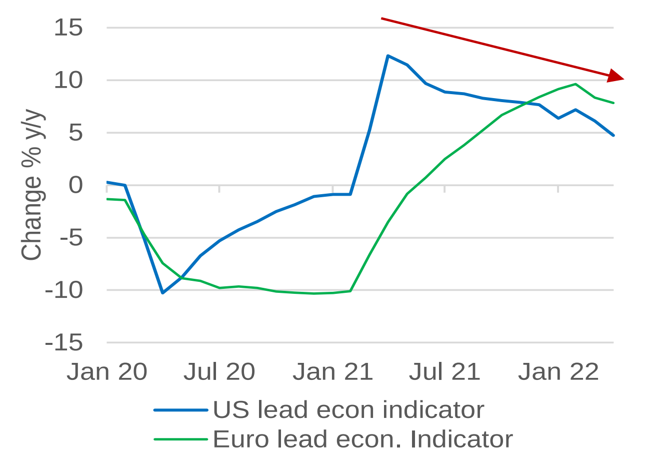
Probabilities favour slowdown, not recession: we maintain that slower growth, but not a recession is the most likely out-turn from here. But a recession cannot yet be ruled out, at a time when the US Federal Reserve remains determined to raise interest rates quickly to bring down demand and inflation. In Europe, energy costs remain the key variable to watch.

INFLATION EXPECTATIONS FALL BACK EVEN WITH HIGH ENERGY COSTS



Source: BNP Paribas, Bloomberg

US, EURO LEADING ECONOMIC INDICATORS CONTINUE TO FALL



Source: BNP Paribas, Bloomberg

INVESTMENT CONCLUSION

The Federal Reserve is set to raise its Fed Funds rate in 0.5% steps in their next meetings in order to slow demand sufficiently, to then bring down US inflation. The risk of a policy error is evident at a time when the global economy is already slowing sharply on the back of the surge in energy and food costs. We await concrete signs that inflation rates have peaked and are declining before upgrading our views on risk assets like stocks and high yield credit. For now, remain watchful and patient.

Bear market rally, or real rebound?

Remember, even during the long bear markets of 2007-09, 2000-03 and the Japanese bear market in the early 1990s, there were several moments when stock markets rebounded by over 10%. This was before markets subsequently began to fall once again to new lows.

With this in mind, we have to ask ourselves: is the 7% rise in the US S&P 500 and Nasdaq indices and the 8% rise in the Euro STOXX 50 from their mid-May lows the beginning of a sustainable stock market recovery, or just one of those bear market rallies that could soon run out of steam?

There is no doubt that global economic growth is slowing quickly, with the US, Europe and China all struggling in different ways as the 2020-21 post-COVID lockdown stimulus measures fade from view.

The cost of financing for companies and households is also going up, as both short-term and long-term interest rates return to positive territory.

Liquidity is also being gradually restricted, as the US Federal Reserve is about to embark on a programme to reduce its balance sheet as Treasury bonds mature over time.

Thus the real question is the following: is this a growth pause or is a full-blown economic recession ahead of us?

Are we really facing a global recession?

All of the last severe bear markets for stocks occurred in the face of global recession (2020, 2007-09, 2000-03), each time driving stock markets 35%-50% lower from peak.

Are we facing a global recession today? Pessimists can point to any number of worrying statistics:

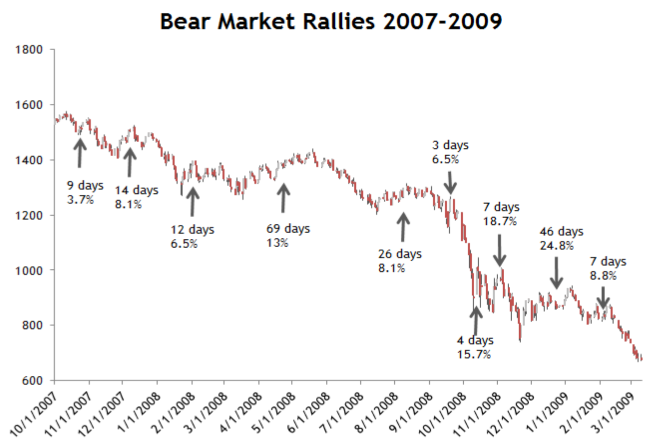
- US and European central banks are raising interest rates from zero, in an effort to curb runaway inflation rates;
- Energy and food prices are hurting consumer wallets, cutting consumer spending on all other items;
- Global economic growth is evidently already slowing quickly, after a huge surge in growth since mid-2020.

I could go on… but the most concerning statistic for me in the US (the world's largest economy for now) is the sharp tightening in US financial conditions.

This means that financing has become more difficult and more expensive for both companies and households, which then slows both corporate investment and household spending, thus slowing overall economic growth.

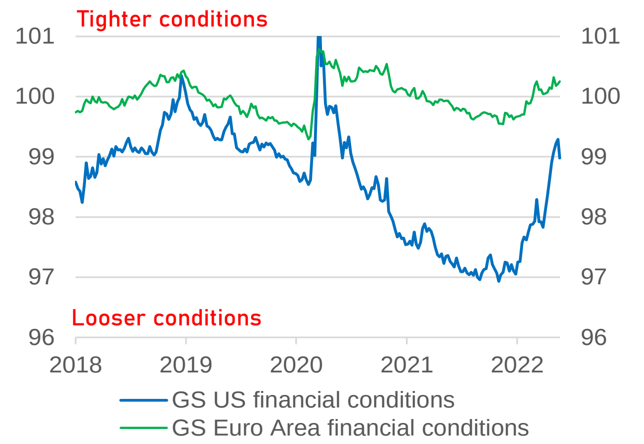
Slowing global growth is thus inevitable at this point. But does this mean that a recession (i.e. a substantial drop in economic activity) is also inevitable?

FOUR DOUBLE-DIGIT BEAR MARKET RALLIES 2007-09 AS US STOCKS FELL 50%



Source: investing.com

US FINANCIAL CONDITIONS HAVE TIGHTENED, SLOWER GROWTH AHEAD



Source: BNP Paribas, Bloomberg

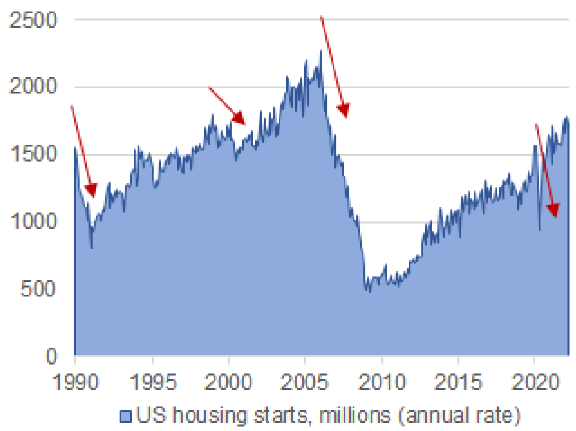
Several recession indicators NOT flashing red

There are a number of macro economic indicators that typically foreshadow a recession, but are not sending a recession signal at the moment.

We can argue that housing IS the economy, given its huge weight and importance. Note that in the US, housing starts are still rising - a positive sign. Prior to and during previous recessions, the housing market suffered and housing starts slowed sharply.

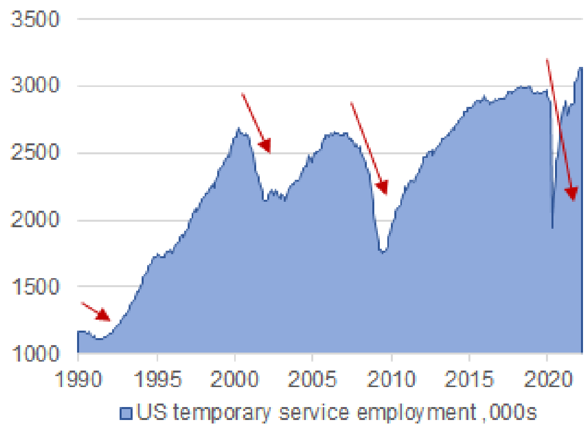
Secondly, temporary service sector employment in the US is still rising. Prior to previous recessions, companies cut back on service sector employment, starting with the easiest category of workers to let go, temporary workers. This time around, temporary service sector employment continues to increase, recently hitting a new high.

US HOUSING STARTS STILL RISING, UNLIKE PRIOR TO PREVIOUS RECESSIONS



Source: BNP Paribas, Bloomberg

US TEMPORARY SERVICE EMPLOYMENT STILL RISING, HITS NEW HIGHS



Source: BNP Paribas, Bloomberg

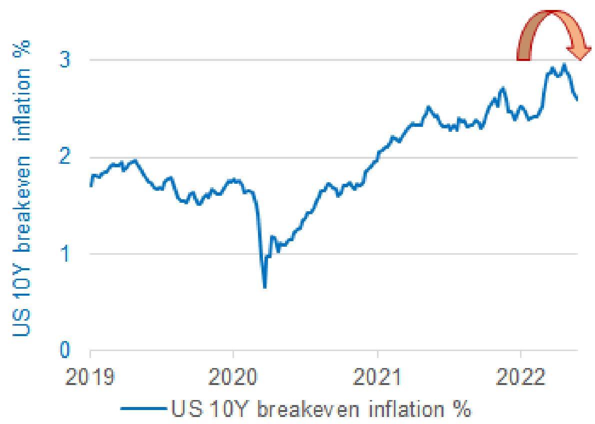
Inflation expectations, monthly inflation finally calming down

One of the key drivers of recession concerns are rapidly rising interest rates, triggered by the need to curb high inflation rates.

Well, another piece of good news is that inflation expectations in the US bond market are now falling, as are some early inflation indicators. This suggests that US inflation may well already have peaked, and is due to fall in the months ahead. This in turn would reduce the Federal Reserve's need to raise interest rates quickly to curb demand, and thus inflation. In turn, this would then reduce the risk of a recession.

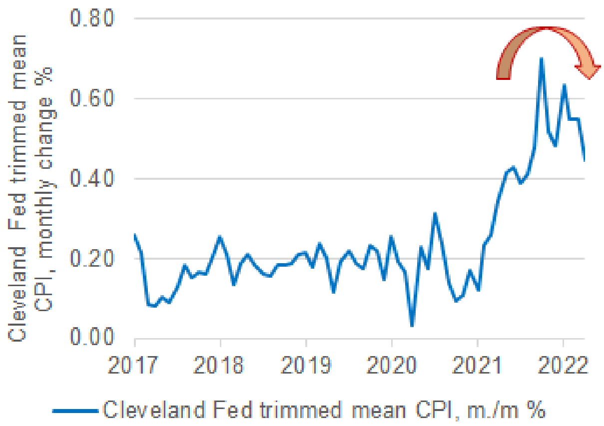
The Cleveland Fed trimmed-mean CPI monthly inflation rate, which looks at inflation by cutting out outlying components that may skew the classic CPI calculation of inflation, is also falling sharply.

US 10-YEAR BREAKEVEN INFLATION RATE FALLS FROM 3% TO 2.6%



Source: BNP Paribas, Bloomberg

CLEVELAND FED TRIMMED-MEAN CPI FALLS ON A MONTHLY BASIS



Source: BNP Paribas, Bloomberg

The need for investment should (eventually) support growth

Companies and sovereign governments both have an urgent need to invest for the near term.

Governments need to invest now and to spur investment in order to deal with a number of pressing issues, including the lack of sufficient housing stock, the need to accelerate the energy transition in order to reduce reliance on Russian energy exports, and the need to invest to boost physical and electronic defences.

Companies must invest in order to boost productivity and reduce reliance on employees, as these are now becoming more difficult to find in sufficient numbers as employment continues to recover and unemployment falls to new lows. Companies also need to invest to reduce costs, such as energy costs, and also to reinforce the robustness of their supply chains by producing more closer to home ("near-shoring").

The good news is that companies in general have strong balance sheets and high levels of profitability and cash flow generation, underlining that they have the financial resources to be able to invest now for the longer term. I would particularly expect new investment in the production of agricultural, industrial metals and energy given record commodity prices.

These investment needs should provide the platform for reasonable economic growth in the years ahead, once inflation falls back and as long as financing rates do not rise too much.

Credit spreads begin to fall

On the debt financing side, the fact that credit spreads (a component of the cost of debt financing for companies) are falling, after surging since the start of the year, is welcome news.

It also supports the notion that there could be further recovery in stock markets, as risk appetite is also clearly returning to the credit markets at the same time.

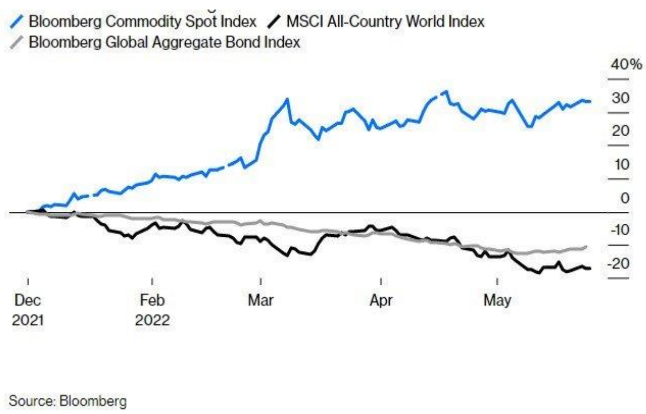
Awaiting Chinese catalysts

Activity in both China's manufacturing and services sector 'rebounded' in May, but recovery remains 'tepid'. The official manufacturing PMI rose to 49.6, from 47.4 in April, while the non-manufacturing PMI rose to 47.8 in May from 41.9 in April.

The Chinese stock market remains volatile given ongoing policy uncertainties and the long-standing zero-COVID policy. More decisive stimulus measures and evidence are required to follow through on previous policy pledges in attempting to achieve the Government's stated 5.5% growth target. Nonetheless, signs of slowing coronavirus infections are helping to reverse negative sentiment, while easing monetary policy is also positive.

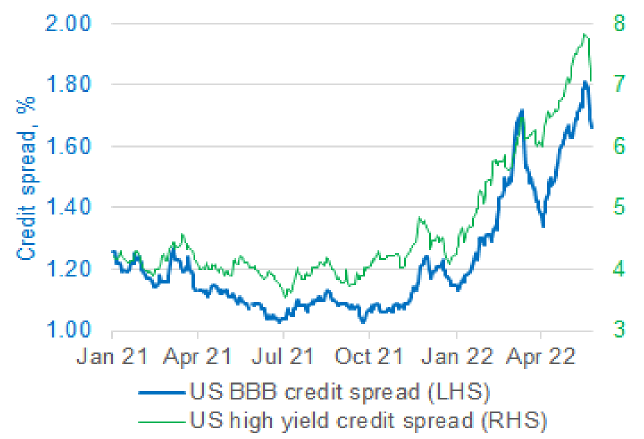
We look for a) further lowering of interest rates, b) specific measures to support the key residential property market, and c) easing of the regulatory crackdown on technology companies to upgrade our current Neutral stance on Chinese equities.

COMMODITIES HEAD TO NEW HIGHS, POINTS TO NEED TO INVEST IN NEW SUPPLY



Source: Bloomberg

BBB INVESTMENT GRADE, HIGH YIELD CREDIT SPREADS FINALLY START TO FALL



Source: BNP Paribas, Bloomberg

What opportunities are emerging?

Suggestions for long-term investments

2022 has been a difficult year so far for investors in stocks and bonds. Amid this fall in financial markets, investment opportunities are emerging in a number of areas.

But equally, I believe that there are a number of investment traps that investors could fall into. What do I mean by this?

Trap 1: stocks that have fallen far from their 2021 highs will return to those levels once again. But why should that be the case? History tells us that following previous financial market bubbles such as in 2000 or 2008, stocks that had been flying high before the bubbles burst did not, in general, return to their highs for many, many years, if at all. So do not assume that this will be the case, that previous market leaders pre-market selloff will be the leaders in any market recovery. Generally, there is rotation in market leadership when the economic conditions change dramatically, as is the case today.

Trap 2: **assuming that investment returns will average the same in the future as in the recent past**. Recognise that the period post the March 2020 lockdown-triggered crash produced exceptional stock market returns, predominantly in growth stocks.

But since economic conditions have changed markedly since the beginning of this year via higher inflation, higher interest rates and slower growth, we should accept that investment returns in future will likely be far lower than over the exceptional 2020-21 vintage.

Trap 3: There Is No Alternative (TINA) to stocks. Clearly, with the sharp increase in short-term and long-term interest rates over the last few months, the bond and credit markets **do** now give investors an interest-bearing alternative to stocks.

Opportunity 1: US investment-grade corporate bonds. US Treasury bond yields have risen sharply to 2.6% for 2-year bonds, and 2.9% for 10-year Treasuries. Credit spreads on investment-grade corporate bonds have also widened, so now one can receive a 3.5%+ yield for investing in US 5-10 year maturity corporate bonds.

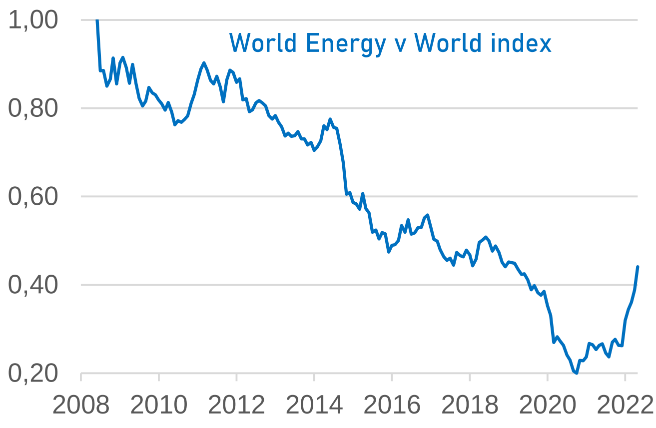
Opportunity 2: oil & gas producing companies. Despite a slowing global economy, there seems to be little reaction in global oil demand, which remains robust. At the same time, production capacity in the OPEC+ group of oil-producing countries struggles to increase to match current production quotas. Put simply, OPEC+ countries do not have much (if any) spare capacity to bring on line to benefit from today's USD115/barrel crude oil prices.

Refining margins (the profit from turning crude oil into oil products such as petrol, diesel, heating oil and jet fuel) have surged in the last few months, as European countries struggle to replace Russian diesel exports, particularly as we approach the summer holiday travel season. The combination of high crude oil prices and record refining margins are an excellent fundamental backdrop for oil-producing companies. Yes, these shares have already performed well, but only after very poor performance since 2015.

POST 1999-2000 TECH BUBBLE, THE NASDAQ TOOK 18 YEARS TO RETURN TO ITS HIGHS

Source: macrotrends.com

OIL & GAS STOCKS STILL HAVE A LONG, LONG WAY TO CATCH UP TO MSCI WORLD INDEX



Source: BNP Paribas, Bloomberg

Long-term investment opportunities

Ideas for the patient investor

Opportunity 3: Clean energy/Energy efficiency. In conjunction with other growth-oriented investment themes, clean energy and energy efficiency ETFs/funds have underperformed global stock markets since December 2021. But in our view, this offers patient investors an excellent entry point for a long-term investment in this theme.

We would argue that painfully high oil, natural gas and electricity prices in the US and Europe reinforce the need to invest even more rapidly in renewable energy, energy efficiency and energy infrastructure and storage solutions.

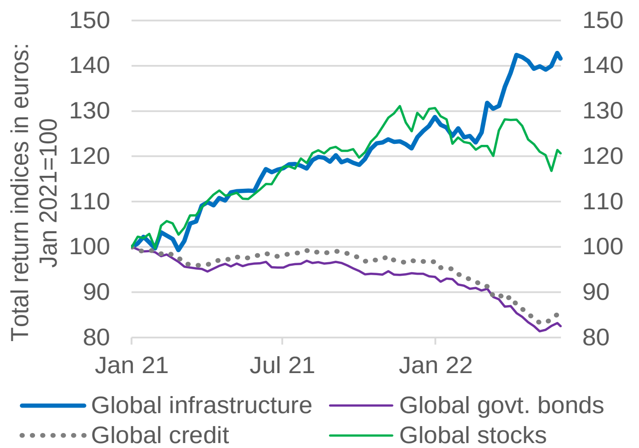
We particularly like infrastructure funds that devote a substantial part of their investments towards renewable energy, energy infrastructure and energy storage projects in Europe and the US, both listed and private. We also favour companies that supply energy efficiency solutions like insulation; double-glazing windows and heat pumps, as one can generate a higher return on investment from energy efficiency projects than by increasing energy generation.

Opportunity 4: Key industrial metals producers. We still see excellent long-term potential in a number of key industrial metals such as copper, tin and aluminium. These metals are all essential key raw materials used in electric transportation solutions and renewable energy power generation in particular, be it in solar panels, high-capacity batteries or other emerging technologies.

Global copper and tin production has been relatively stable over the last five years, while demand has been growing principally from electronics and renewable energy uses. The demand from these sources is set to accelerate over the next 5-10 years, while global supply growth will be limited. This increase in aggregate demand has depleted stockpiles of these three metals, driving their prices to multi-year highs.

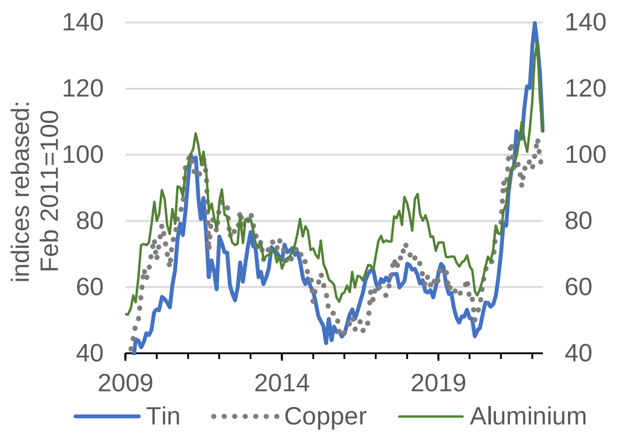
We favour investment in global miners concentrated in copper, aluminium and tin production as we expect prices for these three metals to stay elevated, generating excellent profitability for miners of these commodities.

GLOBAL INFRASTRUCTURE HAS OUTPACED STOCKS, BONDS AND CREDIT



Source: BNP Paribas, Bloomberg

INDUSTRIAL METALS TIN, COPPER AND ALUMINIUM RECENTLY HIT NEW HIGHS



Source: BNP Paribas, Bloomberg

Investment Conclusion

After a difficult 2022 so far for stocks, bonds and credit, we now see attractive investment opportunities. These include: a) US investment-grade corporate bonds, b) oil & gas producers and service providers, c) infrastructure linked to renewable energy, energy storage/transportation and energy efficiency, and d) producers of "industrial metals of the future" with a focus on tin, copper and aluminium.

Summary of our main recommendations

	Current Recom	Prior Recom	Constituents	We like	We avoid	Comments
EQUITIES	=	=	Markets	UK, Japan, Latin America,. S. Korea, Singapore and Indonesia.		Historically low long-term real rates and accommodative financial conditions support the upward trend in global stocks, long term. We continue to recommend a more defensive sector stance.
			Sectors	We like Financials, Health Care, EU Real Estate, Precious/'battery' metals, Construction Materials, Semiconductors.		We have become more defensive in our sector allocation. We continue to recommend a more defensive sector stance, biased towards quality dividend/dividend growth and buyback strategies.
			Styles/ Themes	Megatrend themes		Inflation hedging, Circular Economy themes
BONDS	=	=	Govies	US short-term Treasuries		We increase our 10-year yield 12-month target to 2.75% in the US and 1.00% in Germany. We turn Neutral after the strong rise in bond yields on US and German long-term government bonds, and German short-term bonds.
			Segments	EM bonds in HC & LC and eurozone convertible bonds. Rising stars and fallen angels in corporates		
			Maturities	Lower than benchmark		
CASH	=	=				
COMMO-DITIES	+	+		Gold, Base metals		Gold: Investors looking to hedge stagflation risks and CB purchases should keep gold in the $1900-2100 range in the next 12 months. Industrial metals: The super cycle for base metals is reinforced by the need to accelerate the energy transition and to reduce dependence on Russia. Oil should stabilise in the $105-115 range at the end of 2022.
FOREX			EUR/USD			We keep our EUR/USD target of USD1.12 (value of one euro) for the next 12 months.
REAL ESTATE	+	+		REITs, warehouses, health care, UK		BNP Paribas REIM favours healthcare property exposure given strong demographic drivers and a lack of good quality assets. UK to outperform Continental Europe.
ALTERNATIVE UCITS				Macro, trend-following and event-driven		

Economic, FX forecast tables

BNP Paribas Forecasts

GDP Growth %	2021	2022	2023
US	5.7	3.7	2.5
Japan	1.7	1.6	2.0
United Kingdom	7.5	3.6	1.7
Eurozone	**5.3**	**2.8**	**2.7**
Germany	2.9	2.1	3.4
France	7.0	3.2	2.5
Italy	6.6	2.8	2.2
Spain	5.0	4.8	2.7
Emerging			
China	7.7	4.5	5.5
India*	8.1	9.5	7.3
Brazil	5.0	-0.5	0.0
Russia	4.5	-8.5	3.1

BNP Paribas Forecasts

CPI Inflation %	2021	2022	2023
US	4.7	6.7	2.7
Japan	-0.2	1.5	1.1
United Kingdom	2.5	7.0	3.2
Eurozone	**2.6**	**6.8**	**3.4**
Germany	3.2	6.6	3.6
France	2.1	5.3	2.5
Italy	2.0	6.4	2.6
Spain	3.0	8.1	3.5
Emerging			
China	0.9	2.4	2.7
India*	5.1	6.3	5.2
Brazil	8.3	9.0	5.7
Russia	7.0	18.2	5.0

	Country	Spot 02/05/2022		Target three months		Target twelve months	
				Trend	Mid	Trend	Mid
Against euro	United States	EUR / USD	1,05	Negative	1,08	Negative	1,12
	United Kingdom	EUR / GBP	0,84	Neutral	0,84	Positive	0,82
	Switzerland	EUR / CHF	1,03	Neutral	1,03	Negative	1,08
	Japan	EUR / JPY	137,05	Positive	134	Neutral	134
	Sweden	EUR / SEK	10,42	Neutral	10,4	Negative	10,7
	Norway	EUR / NOK	9,97	Positive	9,60	Positive	9,60
Against dollar	Japan	USD / JPY	130,24	Positive	124	Positive	120
	Canada	USD / CAD	1,29	Positive	1,25	Positive	1,25
	Australia	AUD / USD	0,70	Positive	0,73	Positive	0,76
	New Zealand	NZD / USD	0,64	Positive	0,68	Positive	0,70
	Brazil	USD / BRL	5,03	Neutral	5,00	Neutral	5,00
	Russia	USD / RUB	71,00	Negative	100,0	Negative	90,0
	India	USD / INR	76,51	Neutral	76,0	Neutral	78,0
	China	USD / CNY	6,59	Neutral	6,60	Neutral	6,50

Source: BNP Paribas, Refinitiv Datastream. As of 2 May 2022

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