FLASH: 24 MARCH 2022

Upgrade US stock exposure to Neutral

Translate the Market — Decode the latest market events

Key Messages

Fundamental drivers remain solid: four fundamental factors support US stocks, including easing financial conditions, positive earnings momentum, robust share buybacks and more reasonable valuation levels.

Potentially past peak uncertainty: oil and gas prices have fallen back significantly from February 2022's peak levels, easing inflationary pressures on the global consumer. Financial market measures of uncertainty have equally declined from recent peaks. This easing stress in the global economy and markets suggests better days ahead for stocks, real estate, corporate credit, and private equity.

Investor confidence surveys have recently hit long-term lows: surveys, such as the American Association of Individual Investors (AAII) bull-bear survey and the Investors' Intelligence Investor Sentiment index, measure the confidence of investors. These surveys highlight that investor sentiment was extremely depressed at end-February 2022.

The 8-year low in the AAII survey suggests a 12% return to stock markets over the next 6 months: the extreme -30 AAII bull-bear reading on 24 February suggests a potential +12% return to global stocks over the next 6 months, based on past performance post sentiment lows.

Upgrading US stock view to Neutral: we believe that there is room for this stock rally to run. However, given key ongoing uncertainties around a) how far the Federal Reserve will raise rates, b) how high commodity-influenced inflation will stay and c) how much the US economy will slow, we are only raising our view to Neutral at this stage.

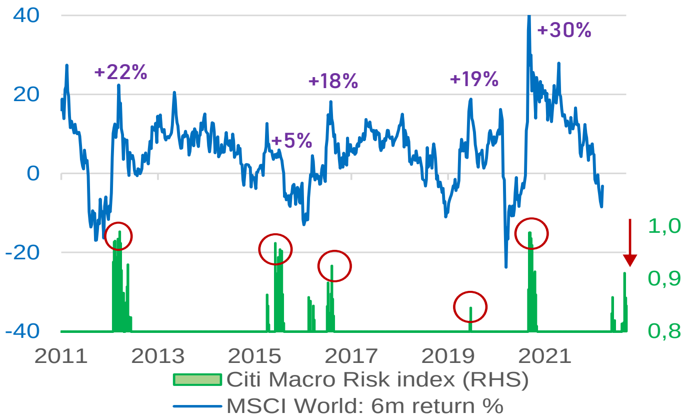
Sector views: the US economy, corporate cash flows and earnings all continue to demonstrate strong resilience. We believe that US technology and US consumer discretionary now appear less risky today than in early February. We thus **upgrade the US Technology and US Consumer Discretionary sectors to Neutral** (from negative).

Why upgrade our US stock view to Neutral?

There are four key reasons to believe this current US stock market rebound can continue:

- **Solid earnings momentum:** US stocks are forecast 9% 2022e EPS growth, plus the 12-month forward S&P 500 EPS forecast continues to rise;
- **Valuations have fallen** over 10% to a S&P 500 2022e P/E ratio of 19x, still not cheap but certainly less expensive than at the end of 2021;
- **Market-implied risk is receding**, with the VIX volatility index falling to 23, and the Citi Global Macro Risk index falling to 0.8 from a peak of 0.91;
- **Share buybacks should remain a key support** for stocks at this point, focusing on the Tech, Banks and Health care sectors in particular;

STRONG GLOBAL STOCK PERFORMANCE USUALLY FOLLOWS MACRO RISK PEAKS



Source: BNP Paribas Wealth Management, Bloomberg

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The bank for a changing world

Post peak macro uncertainty, stocks tend to perform well

At the beginning of March, macro risks hit a peak of 0.91 (on a scale of zero = no risk, to +1 = max risk), as measured by the Citi Global Macro Risk index. The chart below highlights previous peaks in this risk index (in green), together with the following 6-month returns from global stocks (in blue).

Following similar extreme peaks in macro risks hit in 2012 (eurozone sovereign debt crisis), 2015 (US Federal Reserve begins to raise interest rates), 2016 (post UK Brexit referendum), 2019 and early 2020 (COVID-related lockdowns), each time global stocks gained between +5% and +30% over the following 6 months post macro risk index peak. We believe that there is a good chance of a similar stock market rebound this time, based on this historical analysis.

Buy amidst investor pessimism

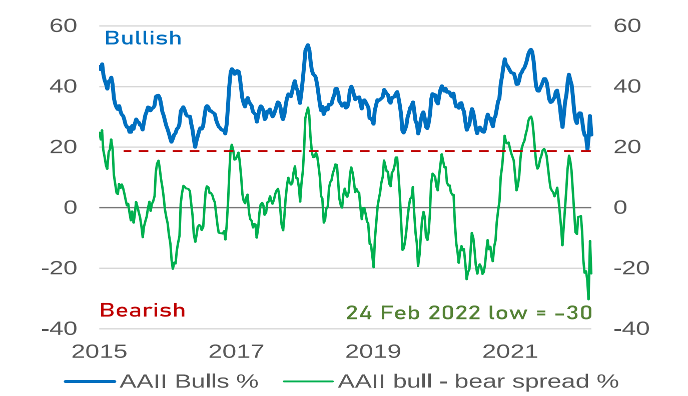
Experienced investors know that a good time to buy stocks is when everyone around them is at their most pessimistic.

One measure of retail investor sentiment in the US is the weekly AAII (American Association of Individual Investors) sentiment survey, also known as the bull-bear survey. This simply asks investors if they are bullish (positive) or bearish (negative) on stock markets for the future.

The green line in the first chart simply measures the difference between the number of bulls (optimistic investors) and bears (pessimistic investors) taking part in this survey: euphoric peaks in sentiment appear when the green line peaks, as in April 2021 and then again in November 2021.

The AAII survey showed a pessimistic extreme reading on 24 February 2022, when this bull-bear balance measured -30, the most negative reading in over 8 years.

AMERICAN RETAIL INVESTORS: MOST PESSMISTIC SINCE 2013 ON 24 FEBRUARY 2022



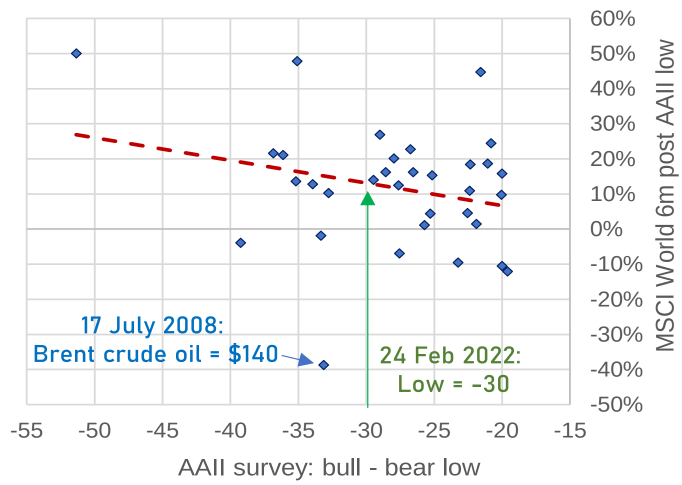
Source: BNP Paribas Wealth Management, Bloomberg

Contrarian investing: buy when everyone around you is seeing black

The second chart shows the performance of the MSCI World index in the 6 months after the AAII sentiment survey hits a pessimistic low (taking data from the start of 2000 to now) of at least -20.

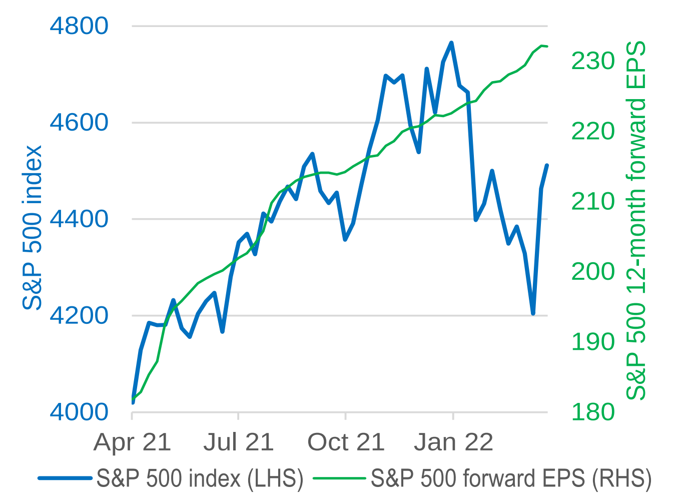
We can observe that stocks have typically rebounded strongly following these moments of peak pessimism, on average gaining 11% in the following 6 months. The key exception to this rule of thumb was July 2008, when the world was in the midst of a deep recession triggered by the Global Financial Crisis, and when the Brent crude oil price peaked at over USD 140/barrel.

FOLLOWING LOWS IN INVESTOR SENTIMENT, STOCKS USUALLY REBOUND



Source: BNP Paribas Wealth Management, Bloomberg

S&P 500 CORRECTS, BUT EPS FORECASTS RISE



Source: BNP Paribas Wealth Management, Bloomberg

US sector views

As long as the full consequences of the conflict in Ukraine are still unknown, investors should remain prudent and well diversified.

Our favourite defensive sector remains healthcare (+) as we are comfortable with valuations and we really appreciate in uncertain times the pricing power of most of these companies as well as the huge cash flows they generate, financing their growth and innovation, as well as healthy dividends and significant share buybacks.

Retain exposure to sectors that traditionally hedge/ profit from high inflation rates. Typically, commodities, real estate, energy and financials are good hedges in this regard. However, a worsening conflict could have dire consequences on the global financial system. The geopolitical situation continue to weigh for now on the (cheap) banking sector. We thus feel more comfortable with insurers (+) and diversified financials (+) within Financials, which can even profit from a high market volatility environment. You should be more selective with traditional banks stocks, due to their high volatility. **Therefore, we retain a neutral rating on banks.**

Most other sectors look fairly priced now in the US. The uncertain environment and consequences of the conflict limit our strong convictions. **We remind investors that in uncertain times, you should favour quality companies with good visibility, generating solid cash flows and paying good dividends.**

Mid-February, we considered that some risks were not sufficiently priced in. In case of worsening economic or geopolitical risks, equities would be vulnerable, particularly those expensive sectors which had performed very well since early 2020. This motivated our downgrade mid-February of the expensive US technology and US Consumer Discretionary sectors to negative.

We have evidence that companies are still spending heavily for their IT systems and, as a consequence of the war, they might have to spend even more. Cybersecurity is an obvious candidate for extra spending.

Most 'Mega Tech' companies have become less cyclical (increasing recurring revenues), are cash-rich, demonstrate good pricing power and are able to buy back shares. Big Tech now even pays more and more dividends.

Order books are full, and many traditional companies still have to upgrade their IT systems, connectivity, cybersecurity, cloud systems, etc. Long-term growth also looks assured with secular themes such as the Metaverse, Artificial Intelligence, 5G, e-payments, Electrification (requiring lots of semiconductors), Reshoring, etc.

Despite the higher energy prices and despite the gloom brought by the conflict in Ukraine, there has been NO significant slowdown in consumption in the US so far. Latest figures from some major companies including Mastercard and Visa confirm this. Other surveys show that many Americans still plan to buy big ticket items.

In the meantime, investors have dramatically reduced their exposure to technology and consumer discretionary (in favour of commodities, energy, staples and healthcare).

As US technology and US consumer discretionary are much less overweight today in many portfolios, they have room to recover. **Today, we upgrade the US Technology and the US Consumer discretionary sectors back to neutral.**

Reco	Sector (Level 1)	Industry (Level 2) +	Industry (Level 2) =	Industry (Level 2) -
+	Health care	Pharmaceuticals + Biotech Health Care equip. + services		
+	Financials	Diversified Fin. Insurance	Banks	
=	Materials	Metals & Mining	(other) Materials	
=	Real estate	EU real estate	US real estate	
=	Energy		Energy	
=	Consumer Staples		Food & Beverages Food Retail Household & Personal Care Products	
=	Communication Services		Telecoms Media	
=	Utilities		Utilities	
=	Industrials		Commercial Services Infrastructure Capital Goods Transportation	
From - to =	Technology		Technology (preference for 'Metaverse', Semis & Cybersecurity)	
From - to =	Consumer Discretionary		Luxury Goods Consumer Services Retail Automobiles Travel & Leisure	

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