Investment Strategy Focus

Summary

1. **Growth slows on energy costs, cooling consumer demand**: in Europe, expensive energy costs hit consumption and growth. Lower inflation ahead, high employment levels and robust household/company finances should still support positive US, Europe growth.

2. **Inflation has (likely) peaked**: inflation remains high, but should start to decline soon. Consumer demand is already cooling off fast and energy costs are easing. The inflation scare is mutating into a growth scare. Lower consumption should help cool goods price inflation by year-end.

3. **Bonds become attractive:** the record sell-off in US Treasury bonds is providing an attractive entry point for contrarian investors. US 1-5Y investment-grade corporate bonds look appealing at a 3.5% average yield. We upgrade short-term German sovereign bonds to Neutral.

4. **Still neutral on equities**: but investor sentiment is very depressed, suggesting that a stock market recovery could be likely over the next 6-12 months. Once inflation falls and long bond yields start to stabilise/decline, the environment should be more positive for stocks.

5. **Copper, natural gas breakouts underline commodity supercycle**: we do not see increased investment to boost long-term supply of oil & gas, battery metals and foodstuffs. I remain a believer of a commodity supercycle, post long-term underinvestment in commodity production. Stay long commodity-producing companies.

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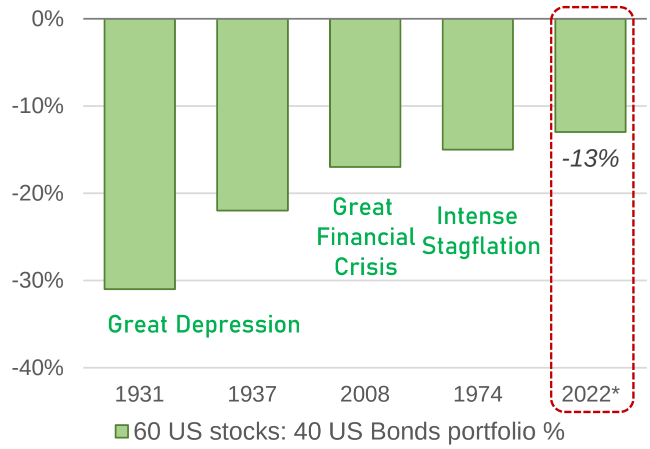

*Source: Bloomberg, BNP Paribas. *2022 performance for first 4 months*

Edmund Shing, PhD
Global CIO
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BNP PARIBAS WEALTH MANAGEMENT

The bank for a changing world

Our Key Convictions: biased towards real assets

Buy:

1. **UK equities**
2. **Global 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: Remaining Prudent

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

Focus: Inflation has (likely) peaked

Food and energy put the brakes on demand

Back to preferring experiences over stuff: the COVID-boosted demand for goods is finally fading as economies (ex-China) fully re-open. Consumers are deterred by the abnormally high prices for many products, and prefer (joyful) experiences over stuff.

Consumer goods demand peaked in April 2021: excluding the effect of higher prices, and just focusing on retail sales volumes, the peak in goods purchases occurred back in April last year in Europe and the US.

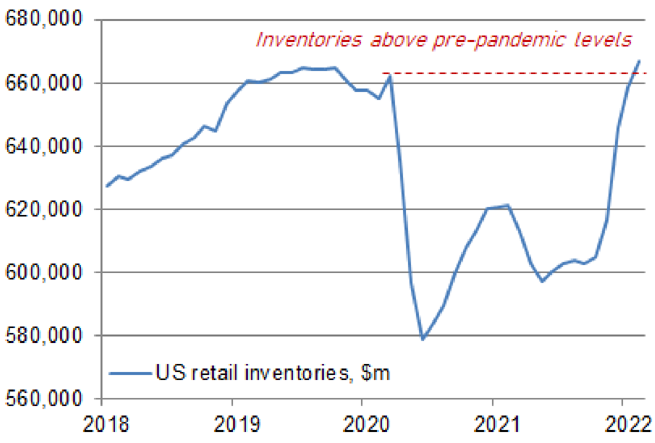
Plenty of stuff on store shelves now: there is plenty of stuff on the shelves now, with US retail inventories back above where they were pre-pandemic lockdowns. The combination of weaker demand for goods, combined with the plentiful supply of goods on shop shelves today, should eventually bring down goods price inflation. Used cars are one key category of expensive goods that are now seeing falling prices.

However, this inflation slowdown will take time, as the high cost of energy used in the manufacture and transportation of goods is still being passed through to the final consumer.

More spending on essentials means less on everything else: with the cost of food and energy rocketing higher ("flexible inflation" +20% year-on-year in the US), households are obliged to spend less on everything else. For now, consumer spending is being supported by the high employment rate and the savings cushion that many built up over the 2020/2021 lockdowns. But this will not last forever...

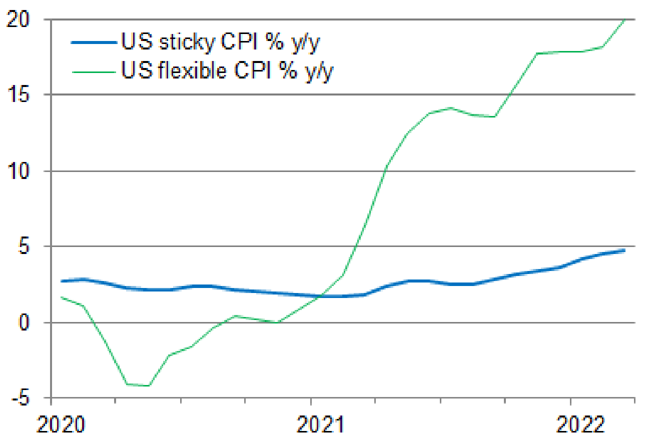
With flexible CPI moving from negative or zero levels in 2020 to 20% today, we can expect so-called "base effects" (i.e. the starting price a year ago being a lot higher month by month) to bring down the inflation rate over the second half of 2022 and into 2023. I think this will also be true for "sticky" prices, although the decline will be less dramatic than in flexible prices.

US RETAIL INVENTORIES BACK ABOVE 2020 PRE-PANDEMIC LEVELS



Source: BNP Paribas, Bloomberg

US FLEXIBLE PRICE INFLATION (DOMINATED BY FOOD AND ENERGY) +20% ON A YEAR AGO



Source: BNP Paribas, Bloomberg

INVESTMENT CONCLUSION

We believe that inflation will slowly return to a more moderate level over the next couple of years, as these short-term disruptions work their way out of the system. This is also what bond markets are pricing in, with US inflation over the medium term expected to average 2.4% over the next five years (lower than the expected inflation level prior to 2014), compared with today's headline inflation figure of 8.5%.

The Big Picture: Economic Outlook

Is a global recession imminent?

The twin pressures of very high energy prices and a sharply rising cost of short-term and long-term financing suggest that the risk of a global recession has risen substantially.

Surveys of business in the US and Europe both indicate that companies are increasingly pessimistic about the future business landscape. The business expectations component of the German IFO survey has declined alarmingly this year, following the events in Ukraine.

Equally, US consumers seem very depressed about their prospects, with the University of Michigan consumer sentiment survey registering new lows not seen since the Great Financial Crisis and the early 1990s recession.

At times like these, it is easy to become really quite downbeat about economic prospects outside of oil- and gas-producing countries such as the OPEC+ nations.

However, we should also balance the prevailing mood of pessimism with a few key facts.

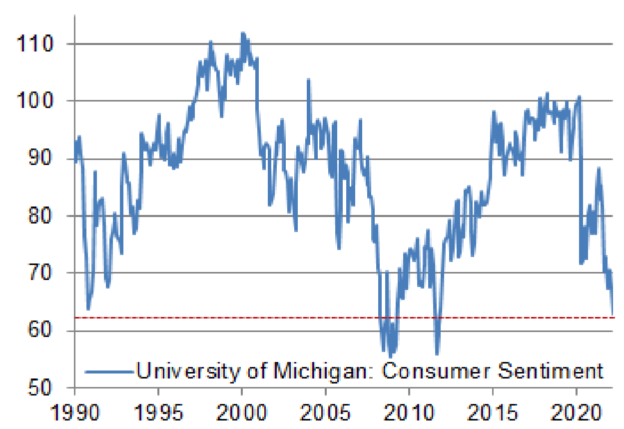
US and European employment levels at all-time highs. Eurozone employment numbers are impressive. 161.9 million workers are employed today, more than at start-2020 and 7 million more than at peak at the end of 2007. The labour force participation rate is a record high of 74.5%, and the unemployment rate has fallen to 6.8% today from a 12% high in 2013.

Company profitability and balance sheets in good shape. Companies are in far better shape today than prior to the 2000 and 2008 recessions. The banking sector is not overextended today as it was during the US subprime loan debacle in 2007, due in large part to reinforced banking regulations on required capital.

Household wealth at record highs. The combination of the boost in housing and financial markets and above-average cash savings has put households in a very strong financial position.

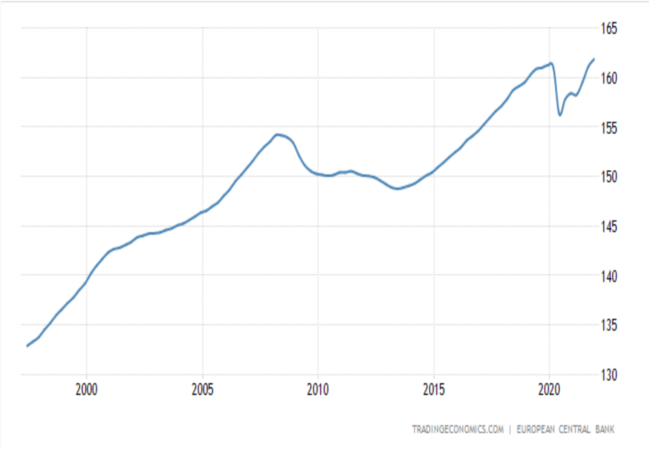
Robust housing sector activity. Housing sector construction activity remains robust thus far, which is important for economic growth given the substantial weight of the construction sector in the economy.

US CONSUMER SENTIMENT AT DEPRESSED, RECESSIONARY LOWS



Source: BNP Paribas, Bloomberg

EUROZONE EMPLOYMENT BEYOND PRE-PANDEMIC HIGHS



Source: BNP Paribas, Bloomberg

Investment Conclusion

Recessions are always a question of when, not if - as inevitably, economic growth will decline below the zero line when the current economic cycle ends. But the current economic indicators we look at do not (yet) suggest an overwhelming probability of recession in 2022 or 2023. In Europe, energy prices are the key threat to growth, while in the US it is central bank interest rate hikes that threaten the post-COVID recovery.

Fixed Income Outlook

US 10Y Treasury yields become attractive

A brutal bond sell-off since Dec-21: US long-term Treasury bonds have suffered their worst performance since the early 1980s, losing 21% since the beginning of December last year.

Bond markets have gone from pricing in a relatively modest 3 Fed Funds interest rate increases over 2022 (for a total of +0.75% on short-term interest rates to just over 1% by end-year) in December last year, to 10 rate increases today (which would take the Fed Funds rate to nearly 2.8% by the end of this year).

The main culprit behind this radical change in the expected Federal Reserve interest rate policy is of course the sharp jump in US inflation from 1.4% at the end of 2020, to 8.5% in March 2022.

When to buy into US Treasuries again? In the past 40 years, when US 2-year bond yields have peaked, long-term (20-year+) US government bonds have subsequently performed well as inflation pressures have eased. With the 10-year US Treasury bond yield close to 3% today, have we reached such a buying point?

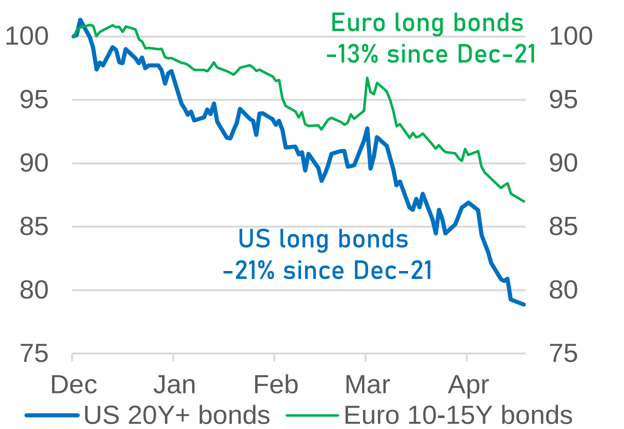
Look at short-/medium-term corporate bonds

Investors have been selling bond funds: according to the Investment Company Institute, US investors have been big sellers of bond funds this year, with net bond fund sales of USD 84 billion over Q1 2022. This is a huge reversal from 2020 and 2021's huge bond fund inflows - in 2021, US investors bought a net USD 592 billion in bond funds over the year.

Look at US investment-grade corporate bonds: according to Bloomberg bond indices, investment-grade US corporate bonds in the 1-5 year maturity range today offer an average 3.5% yield, up from less than 1% as recently as in September 2021. We see the near-term default risk as very low for this range of corporate bond maturities, given strong company balance sheets and cash flow profiles.

Upgrading short-term German sovereign bonds to Neutral: the move higher in German 2-year bond yields has been considerable this year, from -0.73% at the end of February to +0.27% by the end of April, i.e. +1% in just two months. While these yields are still not particularly attractive in absolute terms, we have returned to yield levels not seen since mid-2013. We thus upgrade our German short-term government bond recommendation to Neutral (from Negative).

LONG-TERM GOVT. BONDS HAVE SUFFERED A DEEP SELL-OFF SINCE DEC-2021



Source: Bloomberg, BNP Paribas

ONCE 2-YEAR BOND YIELDS PEAK, LONG BONDS PERFORM WELL OVER 6 MONTHS

				US long bond perf. %		
Start	End	US 2Y yield rise	US Long Bond Selloff	+1m	+3m	+6m
Jul 20	Apr 22	2,36	-27,3%			
Jun 16	Oct 18	1,49	-0,4%	6,9%	26,9%	45,2%
Jun 03	Jun 06	1,55	5,1%	7,2%	8,8%	22,3%
Oct 98	Jan 00	2,32	-6,9%	5,3%	20,8%	21,5%
Aug 93	Dec 94	3,84	-8,8%	8,3%	30,7%	28,7%
Aug 86	Mar 89	1,93	7,1%	15,1%	10,0%	29,1%
Feb 83	Jun 84	3,84	-6,9%	20,4%	38,4%	101,9%
AVERAGE	6	2,49	-1,8%	10,5%	22,6%	41,5%

Source: Bloomberg, BNP Paribas

Investment Conclusion

We remain Neutral overall on sovereign bonds for now, and prefer 1-5Y maturity US Treasury bonds as well as US investment-grade corporate bonds (short + long-term). We are however approaching a point where long-term inflation expectations are overshooting (at 3% for 10-year breakeven inflation expectations), which could soon represent an attractive entry point for long-term US bonds. With German 2-year bond yields up 1% in 2 months, we upgrade German short-term sovereign bonds to Neutral.

Equity and Commodities Outlook

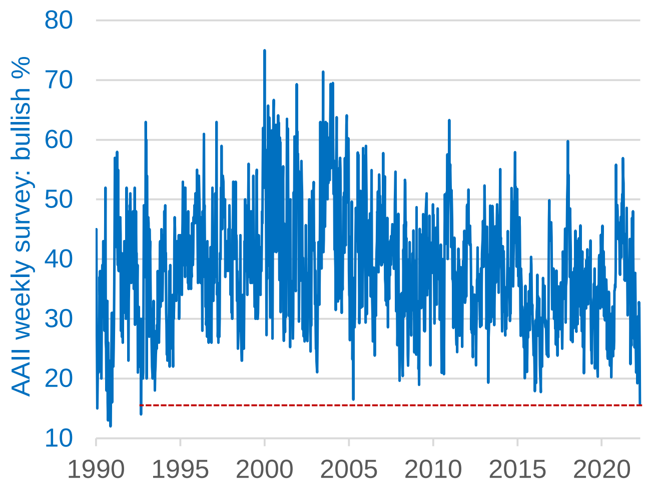
Very few stock market bulls in evidence

Stock market sentiment surveys are not optimistic: investor surveys of stock market sentiment are depressed following the stock market falls seen this year. In April, the American Association of Individual Investors (AAII) weekly survey saw the lowest level of bullish replies in 28 years, since 1992!

AAII survey a good contrarian indicator: just to remind the reader – when this AAII survey has been pessimistic in the past, the stock market has usually performed strongly in the months following such a low reading. When the number of bullish US investors has been similarly low in the past (< 22%), the S&P 500 index has typically delivered a double-digit return over the following 6 and 12 months.

	1m later %	3m later %	6m later %	1 year later %
Average returns	1.1%	5.6%	12.2%	19.7%
Win Rate %	61%	94%	97%	94%

AAII SURVEY: BULLISH INVESTORS AT LOWEST LEVEL SINCE 1992



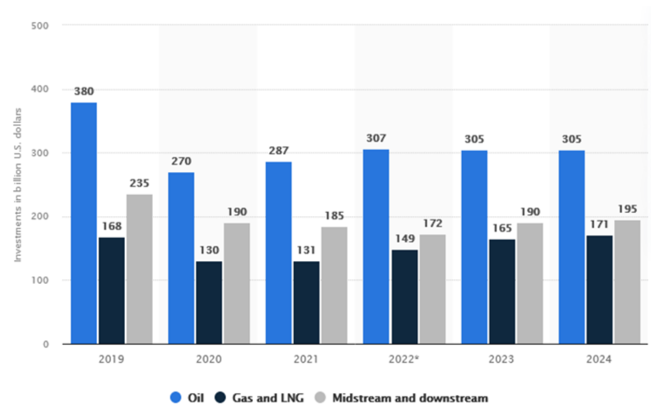
Source: BNP Paribas, Bloomberg

Energy investment needs to grow faster

Despite high oil & gas prices, energy companies are cautious: it is commonly said that in commodity markets, the cure for high prices is... high prices. Whenever commodity prices have risen sharply in the past as they have done since early 2021, commodity-producing companies have responded to these high prices and high profitability by investing heavily. This heavy investment eventually results in greater supply of commodities such as oil and gas, which then forces the price of these commodities back down.

However, there is little sign of this corporate investing behaviour thus far. For now, it seems that companies prefer to use the high profits and cash flows that they are generating to pay dividends and buy back shares, rather than to pour money into new investment projects. According to Rystad Energy, global oil & gas industry investment will remain lower in 2023 than in 2019, with only modest growth over 2020 or 2021 levels expected. The result? Commodity prices may stay higher for longer...

FORECAST 2023 GLOBAL OIL & GAS INVESTMENT REMAINS BELOW 2019 LEVELS



Source: Statista, Rystad Energy

INVESTMENT CONCLUSION

In the absence of a global recession, I would expect commodity prices to continue to remain high and potentially move even higher, as we have not yet seen any significant response in terms of increased investment to boost long-term supply of oil & gas, key battery metals and foodstuffs. I thus remain a believer of a commodity supercycle, post the underinvestment in commodity production of all types over the last 10+ years.

Alternative UCITS Outlook

Global macro, Trend-following funds shine

Q1 2022 tough for stocks and bonds, but strong for selected hedge fund strategies: the combination of high financial market volatility and strong trends in stocks, bonds, currencies and commodities have provided a fertile backdrop for both global macro and trend-following alternative UCITS/hedge fund strategies. According to hedge fund tracking service BarclayHedge, global macro hedge funds have gained 5.8% in US dollar terms (8.7% in euros) over Q1 2022, while trend-following funds up 5.3% over Q1 2022 in US dollars (+8.2% in euros).

Since the beginning of 2020 (prior to the COVID-19 pandemic outbreak), these alternative UCITS strategies have performed well, +26% in USD to the end of Q1 2022 for Global Macro funds and +16% for Trend-following funds. This compares favourably to +16% in USD for a 50:50 combination of global stocks and global bonds over the same period.

Trend-following strategies have performed well historically in high inflation environments: according to statistics from Man Group (a fund management company), both commodities as an asset class and trend-following strategies have both historically performed strongly during periods of high inflation, as in the 1970s-early 1980s.

We would urge investors to consider adding some measure of exposure to global macro and trend-following funds in their diversified portfolios.

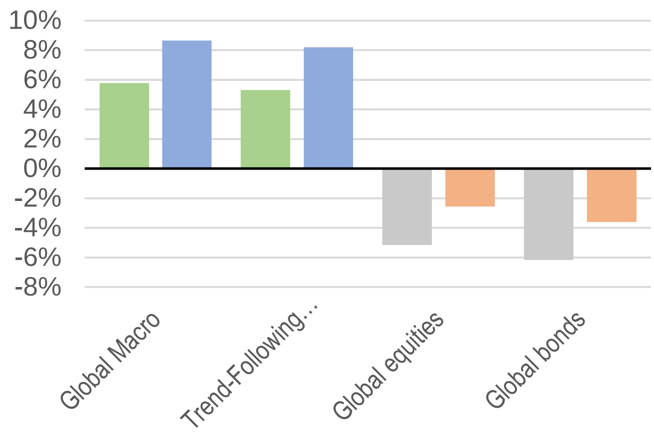
What are global macro and trend-following investing strategies?

Global macro funds profit from broad market swings: these actively-managed funds attempt to profit from market swings in stock, bond, currency and commodity markets caused by political or economic events. They can typically take long (expecting prices to go up) or short (expecting prices to fall) positions based on the market outcomes they anticipate on the back of these events. This ability to take both long and short positions allows them to reduce volatility by hedging out unwanted exposure e.g. to the overall stock or bond market, a tool not readily available to traditional UCITS funds.

Trend-following funds implement strategies that take advantage of long-, medium- or short-term trends in various financial markets. They do not aim to predict market trends in advance, but rather to exploit them as they occur, expecting them to continue in the future. After lacklustre performance from this general investment strategy between 2015 and 2019, the period from late 2020 to end-April 2022 has seen impressive performance at +34% in USD.

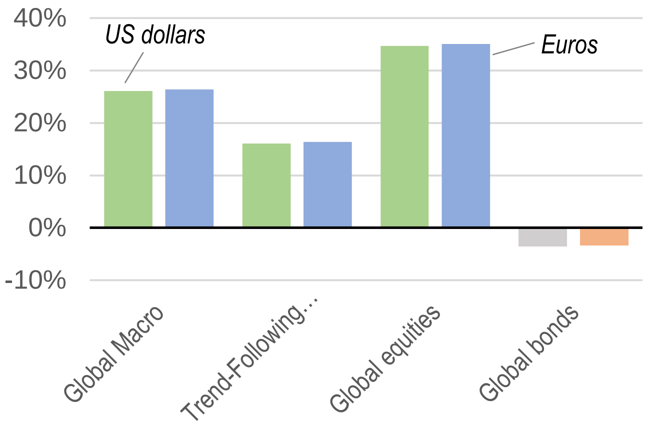
Diversification portfolio benefits: most importantly for investors seeking broad diversification in their investment portfolios, the inclusion of both global macro and trend-following alternative UCITS/hedge funds can reduce portfolio volatility, performing well when stocks and bonds do not. This has been evident over Q1 2022, and previously also during previous stock bear markets in 2001-03 and 2007-09.

GLOBAL MACRO AND TREND-FOLLOWING STRATEGIES OUTPACE STOCKS, BONDS IN Q1



Source: BNP Paribas, BarclayHedge, Bloomberg

AND HAVE DELIVERED SOLID RETURNS WITH REDUCED VOLATILITY SINCE START-2020



Source: BNP Paribas, BarclayHedge, Bloomberg

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 2.50% in the US and 0.75% 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 $95-105 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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