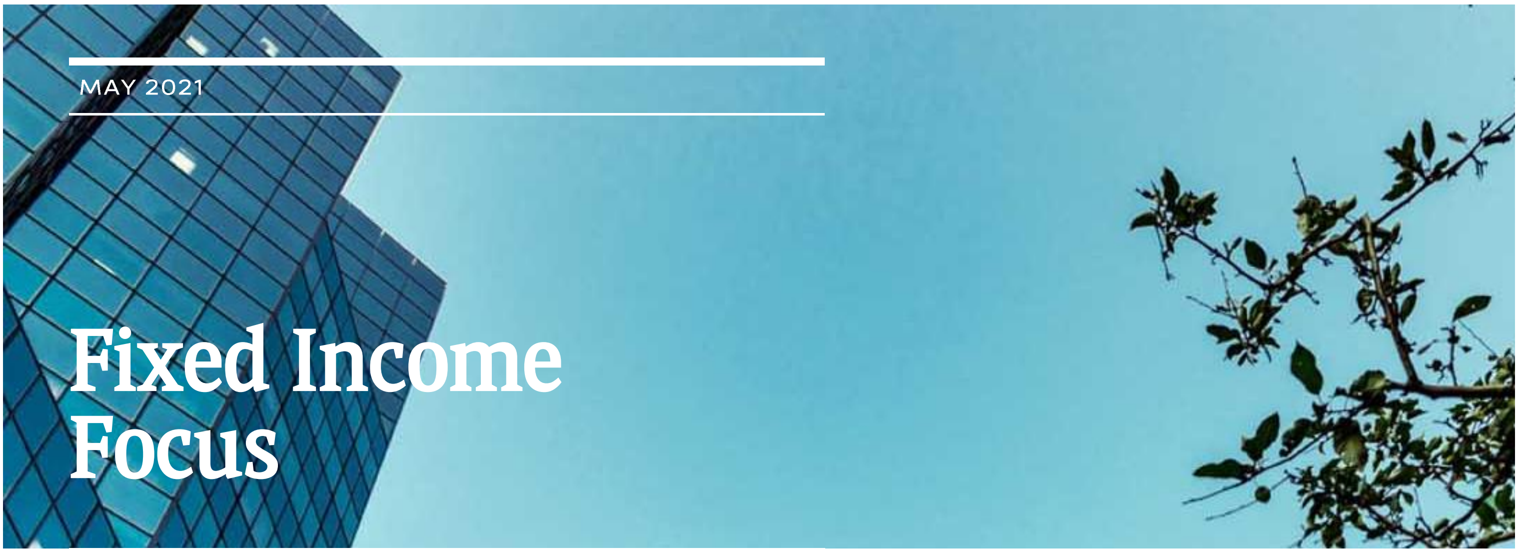


MAY 2021

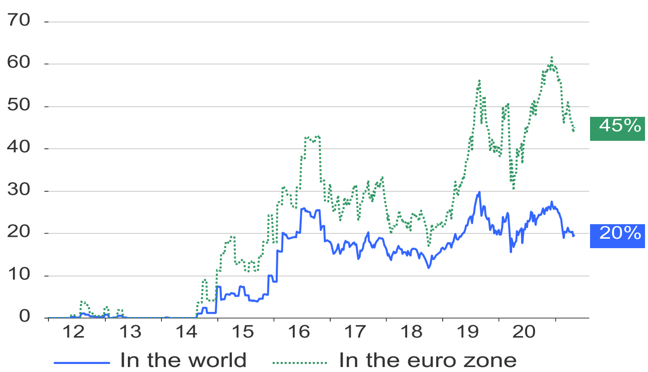
Fixed Income Focus

Summary

1. **After the central banks of England and Canada, the ECB and the Fed are next in line to reduce the emergency measures.** The reduction/end of net bond purchases does not mean that these central banks are tightening monetary policy because they will continue to reinvest matured bonds for several years. Given the accumulated stock of bonds, the amounts to be reinvested will be substantial.
2. **Long term rates are expected to return to the upward path from June onwards.** We remain negative on US and German long term bonds.
3. **More opportunities on US short-term bonds for USD investors** as we believe the Fed will be more patient in normalising its monetary policy than the market expects.
4. **More inflation in the United States in the coming months,** but inflation-linked bonds seem fairly valued. The upside potential is limited.
5. **In credit, default rates are falling thanks to the improvement in fundamentals.** Spreads are at historically low levels. The performance of corporate bonds will come from carry.

Contents

THE PERCENTAGE OF INVESTMENT GRADE BONDS WITH A NEGATIVE YIELD TO MATURITY FELL TO 45% IN THE EUROZONE AND TO 20% WORLDWIDE



Source: Refinitiv Datastream, 07/05/2021

Edouard Desbonnets

Investment Advisor, Fixed Income
BNP Paribas Wealth Management

Central banks

Reducing emergency measures soon

European Central Bank (ECB)

Reasonably optimistic tone on the ECB's side: While the challenges against Covid are still there, the vaccination campaign is accelerating and the economic recovery is expected to be strong.

New economic projections to come in June. They will probably be better than those of March.

As a result, ECB hawks -members advocating tighter monetary policy- will certainly renew their calls for the ECB to reduce the amounts it buys in bond markets each week through its Pandemic Emergency Programme (PEPP).

We believe that they will be listened to and that **the ECB will reduce its purchases very gradually from June**, while insisting on the flexibility of the PEPP tool and therefore the possibility of increasing purchases if necessary.

We expect the ECB to exhaust the 1850 billion euros PEPP envelope and not to extend the programme beyond March 2022.

US Federal Reserve (Fed)

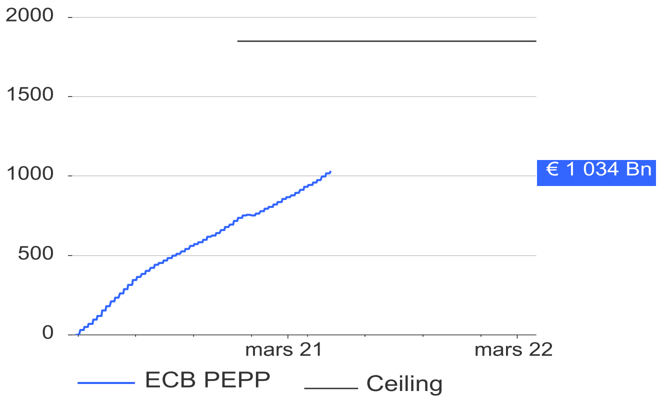
The Fed remains on its line of thought: Inflation will be temporary, the economy is improving, employment too, but not enough to justify the start of a withdrawal of monetary support. The Fed wants the labour market to improve for all Americans. However, 20% of workers in the lowest wage bracket are still unemployed after a year since last February. The latest job report was not as good as expected, so the Fed is comforted in its idea to be patient.

Therefore, the Fed will continue to buy $120 billion per month of securities in the market. Tapering is not the order of the day.

Tapering: The debate is likely to be launched in June, after several strong employment reports and 70% of the adult population vaccinated against Covid.

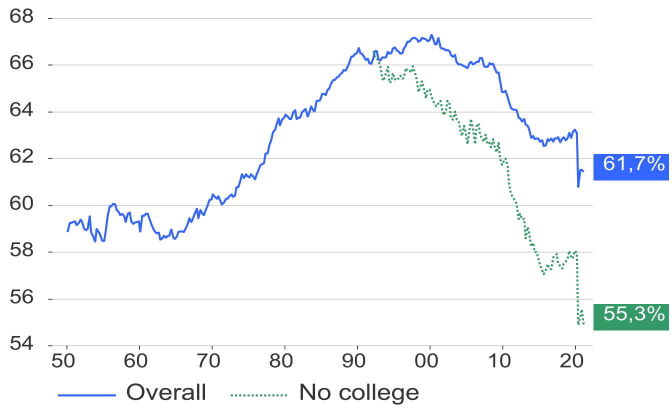
We expect a tapering announcement in September, with implementation in early 2022, and a first rate hike when the effects of the pandemic have dissipated, in Q3 2023.

€ 1 TRILLION ALREADY PURCHASED THROUGH THE PANDEMIC EMERGENCY PLAN (55% OF ITS TOTAL CAPACITY)



Source: Refinitiv Datastream, 07/05/2021

LABOUR MARKET PARTICIPATION RATES ARE FAR FROM PRE-PANDEMIC LEVELS



Source: Refinitiv Datastream, avr. 21

CONCLUSION

The Fed and the ECB are expected to gradually reduce their emergency measures in the coming months. Monetary policies, however, will remain very accommodative. Even if net buying flows stop, reinvestment of matured bonds will continue for years. The huge stock of bonds held by central banks guarantees substantial reinvestment.

Bond Yields

Short-term pause in a bear market

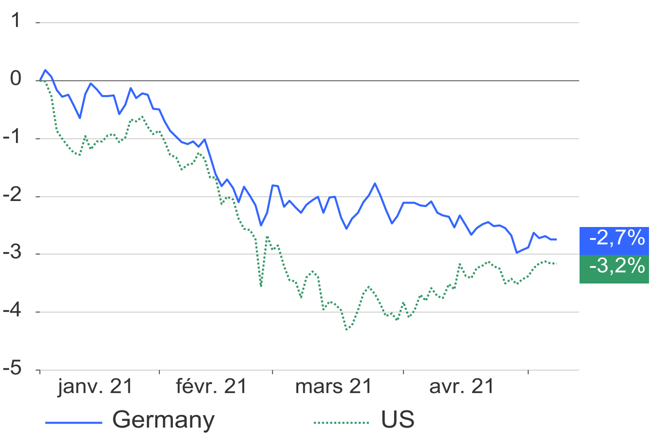
The Fed's cautious and concerted messages have borne fruit: The US 10-year yield fell close to 1.55% after hitting a high of 1.74% at the end of March. **Conversely, long term German yields rose slightly** following a series of better than expected economic figures. The German 10-year yield returned to its pre-pandemic level (-0.20%). The average 10-year yield of the eurozone countries (weighted by their GDP) returned to positive territory (0.12%).

In any case, long rates in the United States and Europe remain very low in view of the very strong economic growth to come. **We expect long term rates to resume their upward path in June**, as central banks gradually change their rhetoric.

Negative view on long-dated, US and German sovereign bonds.

Positive view on short-dated US sovereign bonds. The market is pricing in an overly aggressive policy rate hike sequence in our view.

YEAR-TO-DATE PERFORMANCE OF GOVERNMENT BONDS



Source: Refinitiv Datastream, 10/05/2021

	Maturity (in years)	07/05/2021	12-month targets
United States	2	0,15	0,40
	5	0,77	1
	10	1,58	2
	30	2,28	2,60
Germany	2	-0,69	-0,50
	5	-0,59	-0,30
	10	-0,22	0
	30	0,35	0,50
United Kingdom	2	0,03	0,30
	5	0,32	0,60
	10	0,78	1,20
	30	1,32	1,50

Source: Refinitiv Datastream, BNP Paribas WM

CONCLUSION

The divergence between recent developments in US and German long-term yields is not the beginning of a trend. Long term rates are expected to rise again from June onwards.

Theme in Focus

Treasury Inflation Protected Securities (TIPS)

The pandemic has caused major breakthroughs in global supply chains. Now that the economic recovery is beginning in most developed countries, commodity prices are soaring. Oil and metals have gained between 3 and 30% since the beginning of the year (except for gold, which lost 3%). The same applies to the prices of agricultural products, with increases of 10-20% and even up to 60% for corn.

Inflation is noticeable in the aggregate data, especially in the United States, where the Consumer Price Index was 2.6% in March (1.3% in the euro area).

Market participants expect higher inflation in the coming years than today, while expecting temporary overheating (see chart). They forecast annualised inflation of 2.68% over the next five years in the US, the highest level since the 2008 financial crisis. Expectations are more moderate in the eurozone: 1.28% in Germany, 1.37% in France and 1.34% in Italy.

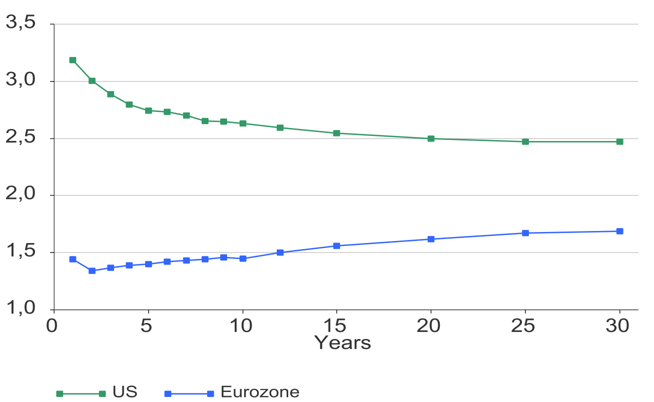
As a result, US inflation linked bonds (TIPS) have experienced significant buying flows since the beginning of the year. They offer coupons adjusted for inflation and capital at maturity also adjusted for inflation (or initial capital in the event of deflation).

Today, TIPS seem to us to be fairly valued after the sharp rise in inflation expectations.

The indicator to be followed is the evolution of real rates. The 2013 tapering (reduction in the Fed's asset purchases) pushed real rates higher, causing the TIPS valuation to fall by around 8% in a few months (see graph). History should not, however, repeat itself with the same magnitude, given the Fed's great caution. We expect tapering to be announced in September.

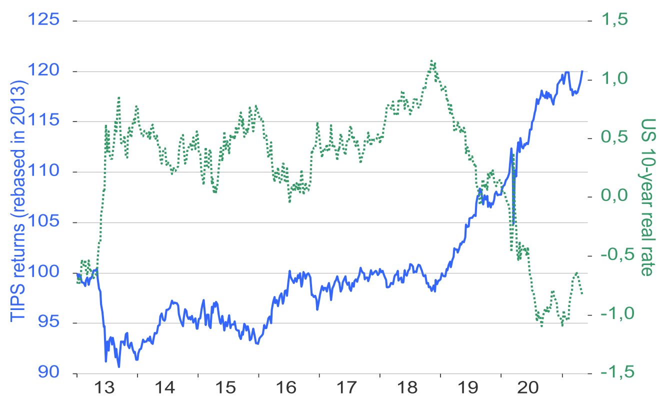
Until then, we are neutral on TIPS due to valuations. In relative terms, we believe they will outperform nominal bonds.

INFLATION-LINKED SWAP CURVES. TEMPORARY OVERHEATING IN THE US



Source: Refinitiv Datastream, 07/05/2021

PERFORMANCE OF TIPS AND REAL RATES



Source: Refinitiv Datastream, 10/05/2021

CONCLUSION

The upside potential of US inflation linked bonds (TIPS) is limited in our view. Inflation could continue to rise in the coming months, but real rates are likely to rise. We prefer to remain neutral on TIPS. In relative terms, they should outperform nominal bonds.

Our Investment Recommendations

Asset classes	Zone	Our opinion	
Government bonds	Germany	-	Negative on German sovereign bonds, irrespective of their maturity.
	Peripheral countries	=	Neutral on peripheral debt (Portugal, Italy, Spain, Greece) with a "buy on dips" strategy.
	United States	=	• Positive on short-term debt for dollar-based investors. • Negative on long-term debt.
Corporate bonds Investment Grade	Eurozone and United States	+	• We prefer corporate bonds to sovereign bonds. • We favour EUR and US bonds with a similar duration to the benchmark (5 and 9 years respectively). • Positive on convertible bonds in the eurozone.
Corporate bonds High Yield	Eurozone and United States	=	• Neutral on HY bonds. • Positive on *fallen angel* and *rising stars* bonds.
Emerging bonds	In hard currency	+	Positive on EM hard currency bonds (sovereign and corporate).
	In local currency	+	Positive on local currency government bonds.

Market data

	10-year rate (%)	Spread (bps)	Spread change 1 month (bps)
United States	1.58	- - -	
Germany	-0.22	- - -	
France	0.17	39	+13
Italy	0.92	114	+12
Spain	0.49	71	+4
Portugal	0.51	73	+16
Greece	1.01	123	+5

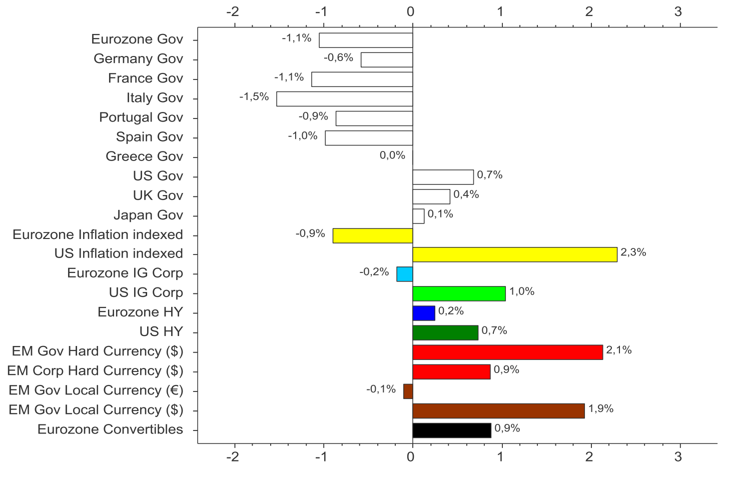
7/05/2021
Source: Refinitiv Datastream

	Yield (%)	Spread (bps)	Spread change 1 month (bps)
Global	1.11	32	0
Corporate bonds IG EUR	0.34	84	-3
Corporate bonds IG USD	2.13	87	-2
Corporate bonds HY EUR	2.90	292	-7
Corporate bonds HY USD	3.91	289	-1
Emerging government bonds in hard currency	4.34	292	-15
Emerging corporate bonds in hard currency	3.74	294	-5
Emerging government bonds in local currency	4.89	412	+7

7/05/2021
Source: Refinitiv Datastream, Bloomberg Barclays

Returns

OVER ONE MONTH



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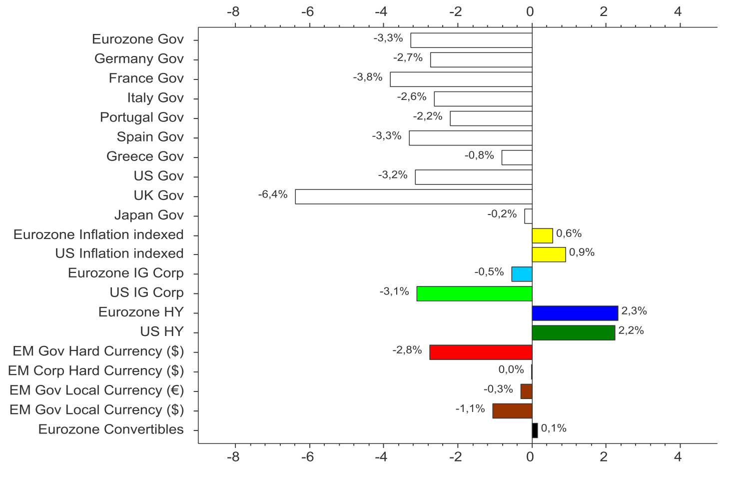

EM = Emerging Markets

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