MAY 2021

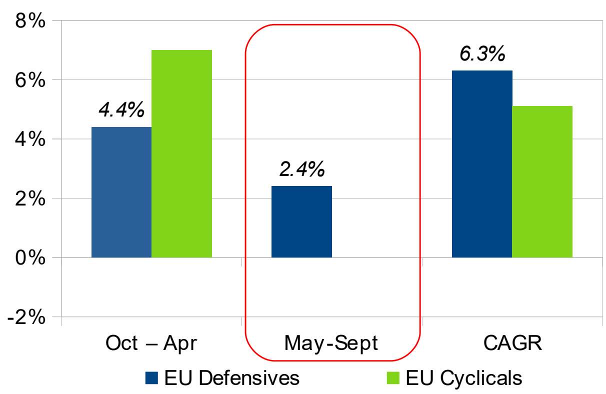
Investment Strategy Focus

Summary

1. **Seasonality urges caution:** the old stock market idiom "Sell in May and Go Away" (implying until October) has indeed been historically good advice in general. Equity markets have typically performed poorly in May-June and Aug-Sep.
2. **Low volatility investing for the summer**: low volatility and dividend growth strategies are starting to perform well. Cautious investors should consider low volatility, defensive income equity orientation over summer.
3. **More defensive sector recommendations:** Upgrade Health Care to Positive, Consumer Staples to Neutral; Downgrade Industrials, Materials down to Neutral (but remain positive on Gold miners).
4. **US residential Real Estate rallies hard:** residential property markets are performing well globally, buoyed by housing shortages and ultra-low lending rates. US-listed REITs have steadily outperformed the S&P 500 index since the start of this year. We prefer solid real estate exposure to bonds at this point in the economic and rate cycles.
5. **The inflation surge is not over yet**: beware high US inflation data prints over the next few months, on the back of higher commodity (e.g. copper, lumber) and semiconductor prices, re-opening acceleration and high capacity utilisation rates. Too early to buy US Treasury bonds, prefer TIPs.
6. **Is clean energy attractive?** The main S&P Global and Wilderhill Clean Energy indices have fallen 35-40% from February highs. But the EU carbon credit market is soaring, signalling tougher carbon emission regulations to come. It could be time to buy the dip in clean energy stocks that have positive exposure to rising EU carbon credit prices.

Contents

DEFENSIVE STOCKS OUTPERFORM OVER SUMMER



Source: BNP Paribas Wealth Management, STOXX

Edmund Shing, PhD

Global CIO

BNP Paribas Wealth Management

BNP PARIBAS WEALTH MANAGEMENT

The bank for a changing world

The Big Picture

The US leans towards income redistribution

The American Jobs Plan: President Biden is proposing a roughly USD2 trillion plan for improving the US's infrastructure (roads, bridges, airports, broadband, utilities, housing and job training) and for investment in renewable energy over the next 8 years.

The American Families Plan: in addition, the American Families Plan would strengthen child tax credit to end-2025, and would expand child care and paid holiday leave. Around USD500bn in tax credits would be dedicated to poorer households as a result, which could amount to as much as USD3,600 for each of those households.

Companies and wealthy to pay: these plans are to be funded by increases in taxation for both corporates (headline corporate tax rate to rise from 21% to 28%, plus a global minimum corporate tax rate) and the wealthiest households (capital gains tax rate to rise from 20% to 39.6% for people earning over USD1m).

Difficulty of passing these bills: given the Democrats' wafer-thin majority in the Senate, these measures are unlikely to all pass. One Democrat senator has called for "a more targeted infrastructure bill", which may require bipartisan agreement on a smaller programme.

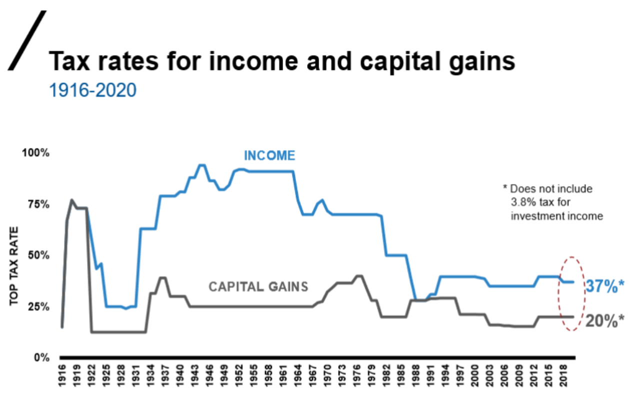
Potentially the biggest US income redistribution in decades: even if not all of these measures are passed into law, they would still constitute effectively part of the largest US income redistribution shift in decades, reversing years of falling tax burdens on the wealthiest American households and companies.

Big Tech in the Biden administration's sights: the combination of a higher corporate tax rate and a global minimum corporate tax rate is squarely aimed at raising revenue from multinational US mega-cap companies, notably in the Tech sector where effective tax rates have been extremely low ion recent years.

Income redistribution is not new in the US: while Europe has a long social democratic tradition of a relatively large welfare state, the US has also increasingly seen social transfer payments go to lower income households. According to the Congressional Budget Office, by 2017 the poorest 20% of US households by income received on average USD15,000 per year in means-tested transfer payments.

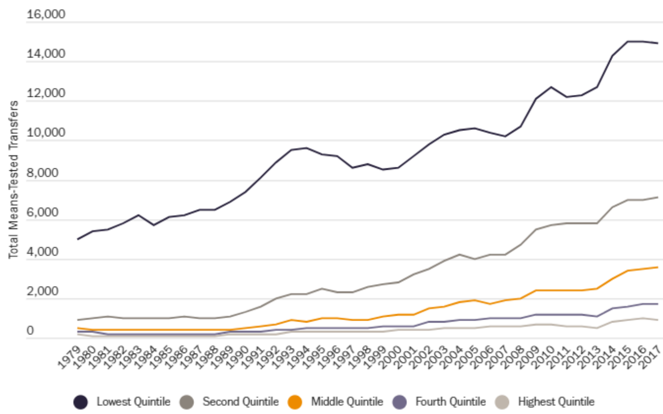
But clearly, the Biden administration's latest proposals would take this redistribution much further.

US INCOME AND CAPITAL GAINS TAX RATES HAVE FALLEN STEADILY SINCE THE 1960S



Source: www.taxpolicycenter.org/statistics

LOWEST INCOME US HOUSEHOLDS HAVE RECEIVED GREATER SOCIAL BENEFITS



Source: Congressional Budget Office

CONCLUSION

While President Biden's latest investment and tax plans are unlikely to pass Congress without major modification, nevertheless they should help poorer families, thus boosting domestic consumption. But higher taxes would represent a further headwind for low tax-paying technology companies. Note that Americans earning in excess of USD1m annually represent just 0.3% of US individual taxpayers.

Theme in Focus

Buy the Clean Energy Dip?

Renewable energy stocks now less overvalued: clean energy ETFs have corrected hard since mid-February, with a 35-40% fall to the recent low in the main S&P Global and Wilderhill Clean Energy indices. While one can agree that these solar, wind and biomass energy stocks were overvalued at peak earlier this year, this is not so obviously the case today.

Fund flows continue to flood into ESG-themed funds year-to-date, which remains a structural long-term trend showing little sign of changing. The correlation between clean energy indices and US Big Tech stocks (represented by the Nasdaq 100 index) remains very high - so it should be no surprise that as the tech sector rallies, so do clean energy stocks.

President Biden's proposed employment and infrastructure plan (funded by hikes in personal and corporate taxation) is a clear boost to the renewable energy sector in the US, even if this proposed investment is to be spaced out over the next few years.

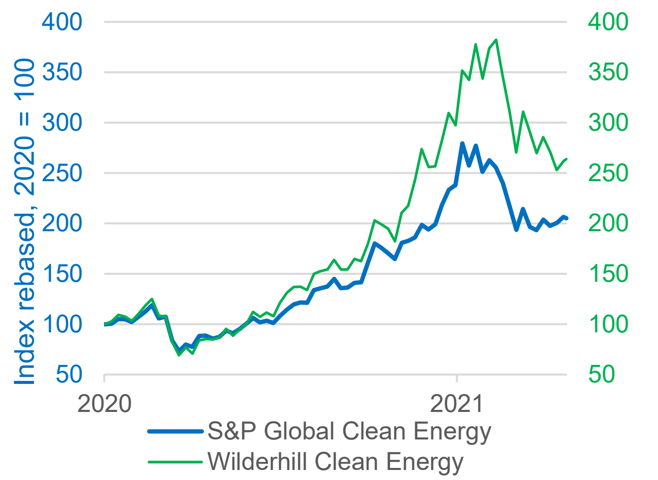
.

Carbon credits resemble bitcoin: a market which has quietly enjoyed a vibrant bull market since last November is the European carbon credit market, driven by prospective EU plans to put in place a tougher emissions trading system to cut carbon output faster.

25 May is the key date: European Union leaders will gather in Brussels for a special session on 25 May to discuss how to achieve the EU bloc's collective 2030 target of cutting greenhouse emissions by at least 55% vs. 1990 levels. They are considering creating an additional system of pollution-cutting incentives for buildings and road transport, which could drive further demand for EU carbon credits in future years.

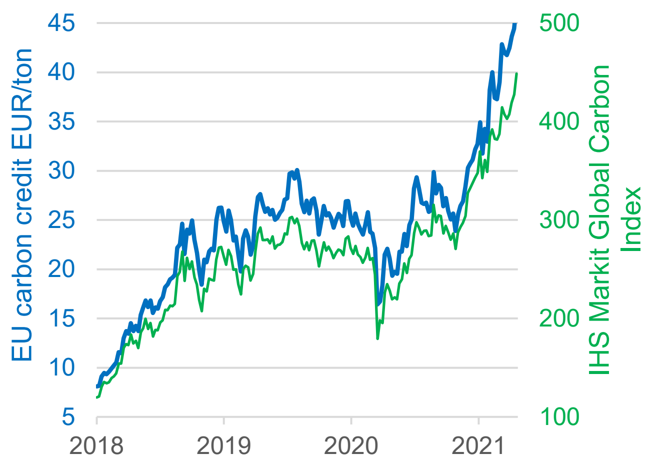
Watch German Greens: a Green party victory in the upcoming 26 Sep German legislative elections (in which it could become a key ruling coalition partner) could hasten the country's move to phase out Internal Combustion Engine (ICE) vehicles, thus cutting oil demand, and boost support for higher CO2 pricing.

35-40% CORRECTION IN CLEAN ENERGY INDICES



Source: BNP Paribas, Bloomberg

EU CARBON CREDIT PRICING HAS DOUBLED SINCE NOVEMBER 2020



Source: BNP Paribas, Bloomberg

CONCLUSION

While EU carbon credits have already more than doubled in the last few months, further tightening of EU and global regulation in the quest to move to a zero carbon future could drive the price of these credits far higher still: a consensus of analyst forecasts, recently aggregated by Vivid Economics, point to a EUR56-EUR89/tonne EU carbon allowance forecast by 2030 under their base-case scenarios, vs. EUR45/tonne today.

Equity and Commodities Outlook

Summer seasonality favours Low Volatility, Defensive equity investing

Beware summer doldrums: the old stock market idiom "Sell in May and Go Away" (until October) has been historically good advice in general, particularly when applied to investing in European stock markets.

Low Vol Factor is best in summer: but there are some strategies that still deliver positive returns on average during the summer months. These are Low Volatility and Defensive equity strategies in Europe. Low and minimum volatility factor indices (which can be bought via ETFs) have generated small albeit positive returns (1.0%) on average over the May-September period, at a time when the benchmark STOXX Europe index has typically declined by 1.7% on average.

Defensive sectors too: Defensive stocks (including sectors such as Health Care, Utilities and Food & Beverages) demonstrate a similar pattern. Since 2005, European defensive stocks have gained 2.4% over the summer months, while cyclical stocks have delivered only a flat return on average over the same period.

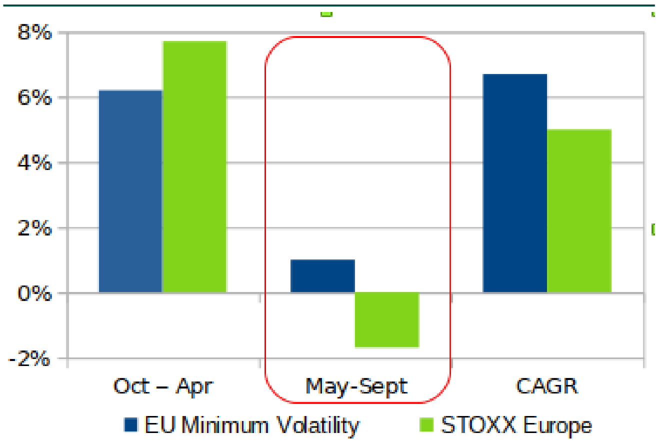
Low volatility, quality dividend strategies make a comeback: low volatility and quality dividend strategies are starting to perform well once again, after a long period of under-performance for equity dividend strategies. Dividends are, at last, making a comeback in Europe, with banks now able to pay 2021 dividends (most passed on their 2020 dividends).

Attractive yields on offer: the Euro STOXX Select Dividend 30 index today offers a 5%+ dividend yield on a prospective end-2021 basis.

We prefer exposure not to a pure high dividend index like the Select 30, but rather to a dividend growth or low volatility dividend strategy that may have a lower current dividend yield, combined with strong profitability and future dividend growth potential. This gives a far better chance of maintaining and/or growing the dividend over time, lowering volatility and delivering a better total return to the investor.

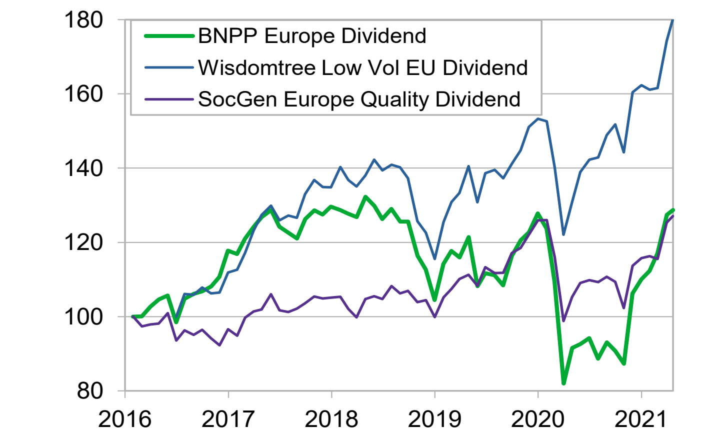
In Europe, such dividend strategies have delivered between 6% and 13% per year on average since 2016.

LOW/MINIMUM VOLATILITY WINS IN SUMMER



Source: BNP Paribas, STOXX. Note: Period = 2001-2021

LOW VOLATILITY, DIVIDEND GROWTH STRATEGIES HAVE RECOVERED OF LATE



Source: BNP Paribas, Wisdomtree, Société Générale

CONCLUSION

Equity markets continue to trend higher at present, comforting us in our positive stance on this asset class. We continue to prefer Japan and the UK along with the eurozone, and remain cautious on US technology exposure.

In terms of sector allocation, we upgrade Health Care to Positive and Food & Beverage to Neutral, while we downgrade Industrials and Materials to Neutral, to reflect a slightly more prudent portfolio approach.

Bond, Credit and FX Outlook

Rising US inflation casts a long shadow

The inflation surge is not over yet: beware high US inflation data prints over the next few months, on the back of higher commodity (e.g. copper, lumber) and semiconductor prices, re-opening acceleration and high capacity utilisation rates.

Sovereign bonds continue to lose ground: more dramatically in the US, where the 20+ year US Treasury index has lost virtually all of its 2020 pandemic-related gains. European sovereign bonds have delivered a similar level of under-performance, despite spread tightening in peripheral (Italy, Greece) Euro bonds versus the German bund.

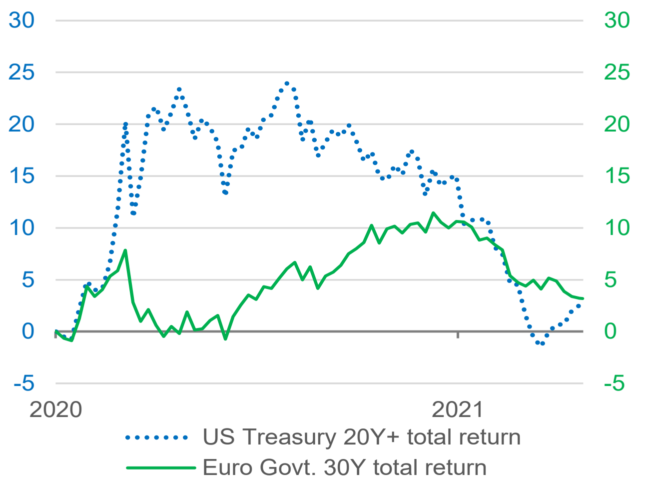
Little better in investment-grade corporate bonds: with BBB corporate bond spreads at their lowest level (1.1%) since 1999 in the US, and around their lowest level in Europe (1.0%) since 2007, corporate bonds have performed in line with sovereigns, US corporate bonds registering a -4% total return since start-2021.

US dollar weakens in April: the Bloomberg US dollar index fell 2.3% over April, reversing much of the Greenback's strength since the start of this year, largely at the hands of the euro and Japanese yen.

Euro re-opening momentum to support the euro: gradual re-opening of European domestic economies over the next couple of months should allow, for instance, the French economy to operate at about 98% of its typical capacity by June.

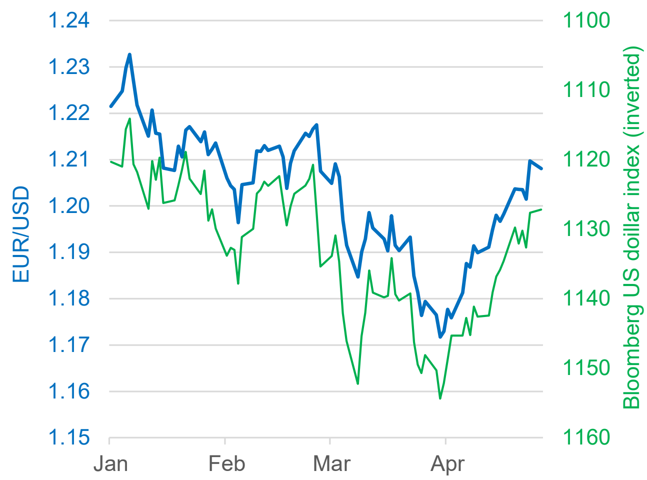
This is one reason for the continued strength of not only manufacturing activity, but more surprisingly services sector activity – with the Markit eurozone services PMI just over the 50 level in April, signalling a very slight expansion in the services sector overall in spite of ongoing restrictions. This, in turn, supports the euro against its major trading partners. Also true of the Japanese economy, with its Economic Surprise index surging to a robust +99 reading by late April.

LONG BONDS HAVE LOST VIRTUALLY ALL THEIR EARLY 2020 PERFORMANCE



Source: Bloomberg

EURO REGAINS THE UPPER HAND OVER USD



Source: Bloomberg

CONCLUSION

The risk of higher US inflation in the short term, combined with the continued rise in medium-term US inflation expectations, suggest that it is too early to buy the correction in US Treasuries. We continue to prefer US inflation-protected bonds (TIPs), and investment-grade corporates (relative to sovereign bonds).

April's US dollar weakness reinforces our conviction in our year-end target of USD1.25 per 1 euro, implying modest further US dollar weakness.

Real Estate Outlook

Residential housing boom gathers pace

Historically low lending rates boost prices: the positive side of central bank bond buying and zero interest rate policies has been the decline of residential mortgage rates to new all-time lows. In the Netherlands, for example, the average mortgage rate for lending of over 5 years has fallen progressively from 4.8% in 2011 to just 2.6% today. US 30-year fixed rate mortgages are now offered on average at just under 3%, versus 5% in late 2018.

Shortage of housing, rental supply: in addition, the construction of new apartments and houses has lagged the rate of new household formation in the developed world since 2008, post the shock of the Great Financial Crisis on bank balance sheets and housing values.

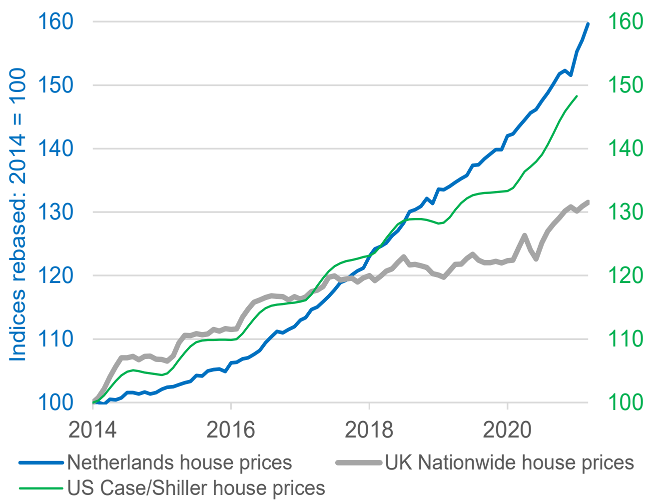
According to new data from US mortgage lender Freddie Mac, the US housing market does not have enough homes to meet current demand - and is short by 3.8 million, mostly impacting first-time buyers.

Berlin rent caps judged illegal: a recent German constitutional court ruling banned the Berlin state government's rent cap imposed in 2019 (which had frozen rents for 5 years), boosting German listed residential REITs.

Strong outlook for suburban housing: the COVID lockdown-inspired trend of households relocating from city centre flats to suburban houses shows no signs of abating, boosting house prices in suburbs around mega-cities like New York, London and Paris.

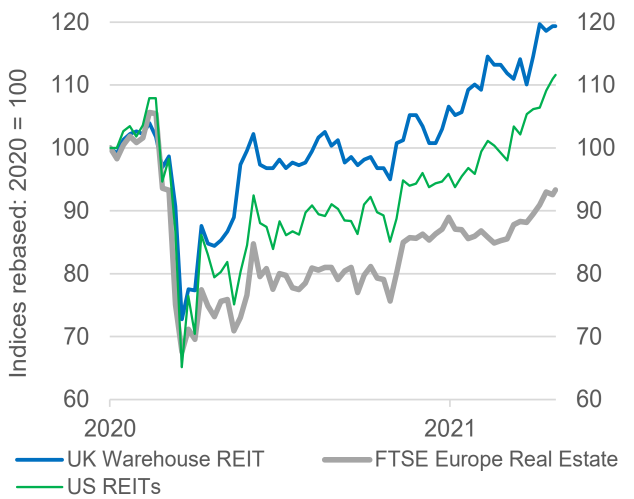
This is also creating opportunities in commercial real estate in the form of satellite offices that are being established in these suburbs by many companies, in a hub-and-spoke configuration that suits these employees. At the same time this is helping companies attract and retain staff but also reduce costs over time (as this office space is cheaper than in key city centres).

NETHERLANDS HOUSE PRICES +11% Y/Y ON RECORD-LOW MORTGAGE RATES



Source: Bloomberg

CERTAIN UK AND US LISTED REAL ESTATE HAS EXCEEDED PRE-COVID LEVELS



Source: Bloomberg

CONCLUSION

Listed REITs have performed strongly since November 2020 as global economic prospects have improved, and should continue to perform well as domestic economies re-open on the back of vaccination programmes, boosting retail and office traffic and helping the services sector to recover. We prefer exposure to industrial (warehouses and logistics) and residential, and expect the European REIT sector performance to replicate that of the US REIT sector, which has outperformed the S&P 500 since the start of the year.

Summary of our main recommendations

	Current Recom	Prior Recom	Constituents	We like	We avoid	Comments
EQUITIES	+	+	Markets	EU, UK, Japan, EM: China, Taiwan, India, S. Korea.		The combination of historically low long-term real rates and accommodative financial conditions are giving a powerful boost to global stocks. . Attracted to the pro-cyclical profile of Euro Area, Japanese and UK stocks. Positive on Emerging Markets, based on a superior earnings growth profile and room for further re-valuation.
			Sectors	Real Estate, Financials, Health Care, Semiconductors, Goldminers, EU Energy	Utilities, Household Products	Becoming more defensive. Industrials and Materials downgraded from + to = after sharp rally. Health Care is upgraded from = to + and Cons staples from – to = (except HPC still -)
			Styles/ Themes	Megatrend themes		Good potential remains for secular themes such as 5G, connected consumers, health tech, water, waste and infrastructure.
BONDS	-	-	Govies	EM bonds (USD + local currency)	US long-term Treasuries and German Bunds	We are negative on German govies, and on long-term US govies.
			Segments	Peripheral euro and eurozone convertibles. IG credit and Fallen Angels.		We prefer corporate bonds over government bonds. We like EUR and US IG bonds with a duration at benchmark (5 and 9 years, respectively).We are positive on eurozone convertible bonds. We are neutral on both US and eurozone HY. We prefer Fallen Angels. We are positive on EM bonds, in both hard and local currency.
			Maturities	At benchmark		
CASH	-	=				
COMMO-DITIES	+	+				Gold - positive: The sharp corrections after the vaccine news seems excessive. Negative real rates and inflation worries should drive gold back above USD2000/oz. Oil - neutral: OPEC+ restrictions, lower US production and recovering demand thanks to vaccines should keep Brent prices in the USD55-65 range. Base metals - positive: prices are underpinned by the Chinese rebound and by pro-cyclical policies in Europe and US.
FOREX	=	=	GBPUSD			▪ Positive view on Sterling, helped by progressive re-opening and reduction in Brexit-related uncertainty.
ALTERNATIVE				Real Estate (Industrial, Residential, Specialist). Long-short equity, relative-value and event-driven hedge funds		

Economic, FX forecast tables

BNP Paribas Forecasts

GDP Growth %	2019	2020	2021	2022
United States	2.2	-3.5	6.9	4.7
Japan	0.3	-4.8	3	2.3
United Kingdom	1.5	-10.2	6.1	6
Eurozone	**1.3**	**-6.8**	**4.2**	**5**
Germany**	0.6	-5.3	3	4.8
France**	1.5	-8.2	6.1	4.4
Italy**	0.3	-8.9	5	3.9
Emerging				
China	6.1	2.3	9.2	5.3
India*	4.2	-7.2	12.5	4.1
Brazil	1.1	-4.1	2.5	3
Russia	1.3	-4.5	4	3

* Fiscal year / ** Under review
Source: BNP Paribas – 29/04/2021

BNP Paribas Forecasts

CPI Inflation %	2019	2020	2021	2022
United States	1.8	1.2	2.5	2.2
Japan	0.5	0.0	-0.3	0.0
United Kingdom	1.8	0.9	1.4	2.1
Eurozone	**1.2**	**0.3**	**1.7**	**1.4**
Germany**	1.4	0.5	1.3	1.2
France**	1.3	0.5	0.6	1.2
Italy**	0.6	-0.2	0.5	1.3
Emerging				
China	2.9	2.5	1.8	2.8
India*	4.8	6.2	4.9	4.6
Brazil	3.7	3.2	6.5	4
Russia	4.3	3.4	5.1	4

* Fiscal year / ** Under review
Source: BNP Paribas – 29/04/2021

	Country		Spot 29/04/2021	Trend	Target 3 months	Trend	Target 12 months
	United States	EUR / USD	1.21	Neutral	1.20	Negative	1.25
	United Kingdom	EUR / GBP	0.87	Neutral	0.85	Positive	0.84
	Japan	EUR / JPY	132	Neutral	133	Neutral	139
	Switzerland	EUR / CHF	1.10	Neutral	1.11	Negative	1.14
	Australia	EUR / AUD	1.56	Neutral	1.54	Neutral	1.56
	New Zealand	EUR / NZD	1.67	Positive	1.67	Positive	1.67
	Canada	EUR / CAD	1.49	Positive	1.49	Neutral	1.53
	Sweden	EUR / SEK	10.12	Neutral	10.20	Neutral	10.20
	Norway	EUR / NOK	9.94	Positive	10.00	Positive	10.00
Asia	China	EUR / CNY	7.84	Neutral	7.92	Negative	8.13
	India	EUR / INR	89.7	Neutral	90.0	Negative	93.75
LatAm	Brazil	EUR / BRL	6.48	Positive	6.36	Positive	5.63
EMEA	Russia	EUR / RUB	89.9	Neutral	88.8	Positive	85

Source: BNP Paribas, Refinitiv Datastream

THE INVESTMENT STRATEGY TEAM

FRANCE

Edmund SHING
Global Chief Investment Officer

ASIA

Prashant BHAYANI
Chief Investment Officer, Asia

Grace TAM
Chief Investment Advisor, Asia

BELGIUM

Philippe GIJSELS
Chief Investment Advisor

Alain GERARD
Senior Investment Advisor, Equities

Xavier TIMMERMANS
Senior Investment Strategist, PRB

LUXEMBOURG

Guy ERTZ
Chief Investment Advisor

Edouard DESBONNETS
Investment Advisor, Fixed Income

CONNECT WITH US

wealthmanagement.bnpparibas

DISCLAIMER

BNP PARIBAS
WEALTH MANAGEMENT

The bank
for a changing
world