BNP PARIBAS WEALTH MANAGEMENT

2021 Investment Themes

Half-Year Update

June 2021

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WEALTH MANAGEMENT

The bank
for a changing
world

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Introduction: The post-reflation outlook

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Introduction

THE POST-REFLATION OUTLOOK

Reopening in progress despite global infection wave: thanks to an impressive acceleration in COVID-19 vaccination programmes, US and European economies are joining China in exiting lockdowns and progressively reopening their domestic economies, ushering in a recovery in the services sector. Unsurprisingly, corporate earnings are also rallying ahead of consensus analyst expectations, driving optimism in equities.

A vigorous debate over the long-term inflation path: while it is clear that US inflation will increase quickly in the next few months, led by food and energy prices along with housing costs, the long-term inflation path is still hotly debated. On the one hand, buoyant commodity prices and strong end-demand point to higher general prices ahead, while on the other, the deflationary forces from high unemployment, better post-COVID productivity and accelerating technological advances may ultimately prevent inflation **from rising too far, too** fast.

Attractive summer defensive alternatives to 100% equity risk: with equities potentially entering the seasonally more challenging summer period after an impressive 27% gain in global equities since the beginning of last November, investors may wish to consider more defensive strategies. The obvious lower-risk choices of sovereign bonds or Investment Grade credit still offer negative after-inflation yields, but there are still solutions offering potential positive real returns at a reduced level of investment risk. These can be found both using some form of lower-risk equity-based exposure, using hybrid (part equity, part fixed-income) assets or via specific strategies embedded in structured products and alternative UCITS funds.

The rush to target a net zero-carbon economy: with the European Union countries, the US Biden administration and the Chinese Communist Party all prioritising a cut in carbon emissions and pollution via low or zero-carbon energy sources, we see stricter environmental regulations boosting carbon credit pricing. Since last November, European Union carbon credits have more than doubled in price to nearly EUR50/metric tonne. But rather than just targeting solar panels, wind power and hydrogen fuel cell technology, we look to energy conservation, large-scale industrial battery storage, biomass harvesting/refining and carbon capture for "clean" gas provision as more attractive investment subthemes within climate change. Nuclear power is also potentially a consideration as an official low-carbon energy source as well, with the Joint Research Council of the European Union arguing that nuclear energy deserves a "green" label.

The future of food in a sustainable world: food is essential to life, forming an important part of our cultural identity, and playing a chief role in the economy. Many people want their food to form part of a healthy lifestyle, but we should also consider the impact that producing and consuming food has on the world's resources. Food production is responsible for 26% of global carbon emissions, and thus must be an essential part of a global net zero-carbon strategy.

A sustainable food system is a type of food system that provides healthy food to people while ensuring sustainable impacts on environmental, economic and social systems linked to food. Indeed sustainable food systems start with the development of sustainable agricultural practices (e.g. more efficient use of water in agriculture), more sustainable food distribution systems (using recycled/recyclable packaging), creation of sustainable diets and reduction of food waste throughout the system in line with the United Nation's 17 Sustainable Development Goals.

Consumers ready with bulging wallets: households around the world have accumulated at least USD5.4 trillion in excess savings since the start of the Coronavirus pandemic, of which USD2+ trillion is expected to be spent as countries' economies reopen upon approaching herd immunity. Evidence from Israel, the US and the UK suggests that COVID-19 infections and hospitalisation rates collapse once vaccination rates reach 40-60% of total populations. Continental Europe should achieve this vaccination rate by end-June at the current daily rate of vaccination. This suggests accelerating consumer spending over H2 2021. In the near term, domestic travel, home entertainment (gaming and streaming services), pet care, Do-It-Yourself (home and garden) and clothes retailing should all benefit from this consumer boom.

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Economic growth and inflation

ECONOMIC GROWTH

We expect an overshoot of the pre-pandemic GDP levels with the additional plan in the US with the "Build Back Better" infrastructure plan. The outlook is very positive based on lessons learnt from the recent reopening in the UK and the US.

- In the US, vaccination progress and the two historical plans should turbo charge strong growth in 2021/22.
- We expect a gradual recovery in the eurozone from June following the lifting of lockdown restrictions and an acceleration in the second half of the year.
- COVID-19 vaccine distribution is gaining pace and death tolls should continue to fall, now that vulnerable patients have been vaccinated. Hospitals and intensive care units are also seeing improvements.
- Government expenditure programmes will be rolled out in the second half of the year and should lead to so-called "fiscal multiplier effects".

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
Source: BNP Paribas – 02/04/2021

INFLATION

Vaccination progress and short-term effects will lead to an overshoot in inflation. Indeed, inflation should thus peak around year-end in the US and early 2022 in the eurozone.

- Inflation will continue to rise in the coming months. Most effects should however be short-lived.
- In the US, a surge in inflation to above 3% is likely in Q2/Q3 but figures should gradually soften at the start of next year. In the eurozone, inflation will exceed 2% in the second half of the year and normalise below 2% in early 2022. There is still a lot of excess labour capacity and good potential for people to return to the job market. This should limit the inflation risk, especially in Europe.
- Central banks will monitor the risks of self-fulfilling prophecies as inflation expectations are influenced by latest data.
- Inflationary pressure should remain generally weak in the medium term in advanced and emerging economies.

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	0.4	2.1	1.5
France	1.3	0.5	1.4	1
Italy	0.6	-0.1	1.5	1.4
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

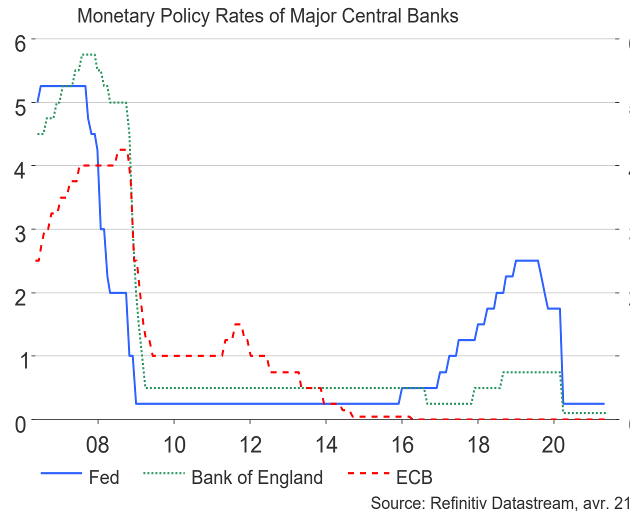
* Fiscal year
Source: BNP Paribas – 02/04/2021

Central banks and bond yields

CENTRAL BANKS

In the US, we expect a tapering announcement in September, with the start of tapering in early 2022, and the first rate hike when the effects of the pandemic have dissipated, i.e. in Q3 2023. The European Central Bank (ECB) will reduce its bond purchases very gradually from June, while underlining the flexibility of the Pandemic Emergency Purchase Programme (PEPP). No interest rate increase is on the cards.

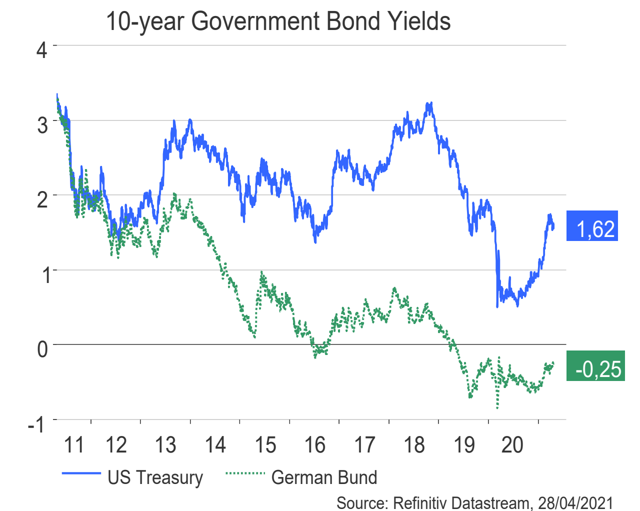
- The US Federal Reserve (Fed) maintains its central scenario: Inflation will be short-lived, growth and employment will continue to recover, but not enough to justify withdrawing monetary support yet. The Fed wants the labour market to improve for all Americans, including minorities. However, 20% of workers in the lowest wage bracket remain unemployed after 12 months. We expect a tapering announcement in September, the start of tapering in early 2022, and a first rate hike in Q3 2023.
- The ECB has adopted a reasonably optimistic tone. The vaccination campaign is accelerating and the economic recovery should be strong. The central bank should reduce its purchases very gradually from June, while underlining that the PEPP tool remains flexible. No interest rate increase is on the cards.



BOND YIELDS

After a short-term pause, long bond yields should move higher again as actual data confirm the recovery in economic activity. Our 12-month targets for 10-year rates are 2% in the US and 0% in Germany.

- The sharp rising trend in bond yields appears to be behind us (see chart). Long-term rates declined in April, particularly in the US with the 10-year Treasury note rebounding from an oversold position as investors, both foreign (Japanese etc.) and domestic (US public and corporate pension funds) turned buyers.
- After the pause, we expect long bond yields to climb higher, maybe from the summer when actual data will reflect a snap-back in demand and higher inflation. We forecast the US 10-year yield to rise to 2% in 12 months.
- The ECB has successfully capped the rise in the German 10-year yield so far. That effect should diminish as the ECB starts discussing the end of net purchases of the PEPP. Our target is 0% for the German 10-year yield in 12 months.



01

The future of food: health, productivity and water security

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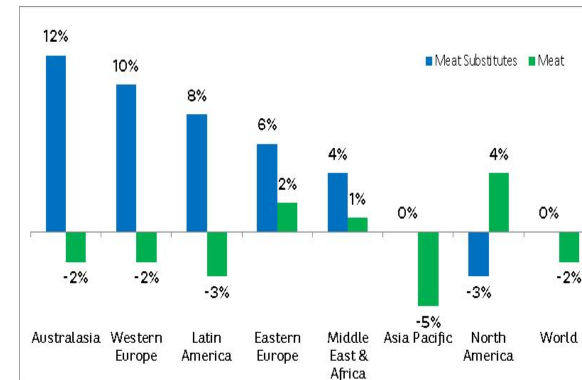
The future of food: health, productivity and water efficiency

MEDIUM-TERM, HIGH RISK

There is growing awareness of the impact of food production and the consumption chain on the environment and our carbon footprint. These themes are among the UN's Sustainable Development Goals (SDGs). Consequently we expect a strong demand for goods and services in these areas.

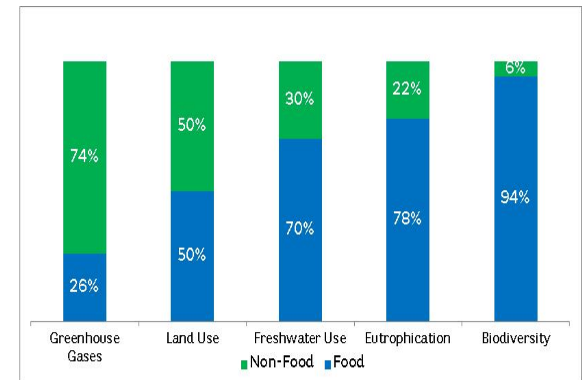
New trends in food and nutrition are today focused on healthy eating and nutraceuticals (food with health properties), vegan/vegetarian diets and products including plant-based meat substitutes. We also analyse the role of innovation in food production in improving agricultural productivity and using less water, more environmentally-friendly fertilizers and recycling. Finally, environmentally-friendly packaging and alternatives to plastics offer attractive investment opportunities.

Global meat substitutes vs. meat volume growth in 2020



Sources: Euromonitors, UBS Analytics

Global environmental impacts of agriculture and food



Source: Our World in Data – Sustainalytics

Food demand and innovations in food production

This theme relates to several of the UN's Sustainable Development Goals (SDG): "Zero hunger", "Good health and well-being", "Responsible consumption and production" and "Water". The UN estimates that the world's population will soar to 9.7 billion by 2050 from 7.7 billion today, despite a falling fertility rate. Ensuring that the world population is fed in a sustainable and environmentally-friendly way is one of the biggest challenges ever. This theme will be a top priority for consumers, governments and companies.

Demand for food is on the rise due to population growth but it is also changing in nature. Indeed, recent trends in demand suggest a shift towards non-meat or vegan food due to mounting concerns about health and carbon footprint awareness (see chart).

Indeed, food production is a major source of pollution and water consumption. This is especially true for meat production and is even responsible for CO2 emissions (see chart). The path towards more sustainable food production systems is thus crucial. Innovations in agricultural sciences, precision farming and ways to reduce waste in the value chain are contributing to this goal

Food & beverage companies are also aware of the impact on final demand for their products, and are quickly adapting product ranges to accommodate these new food trends. Furthermore, the growing appetite of both institutional and retail investors to apply ESG criteria in selecting their investments will also fuel pressure on companies to adopt the necessary changes.

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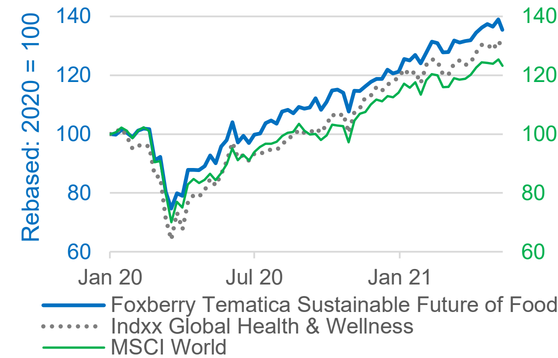
Opportunities and Risks

MAIN RISKS

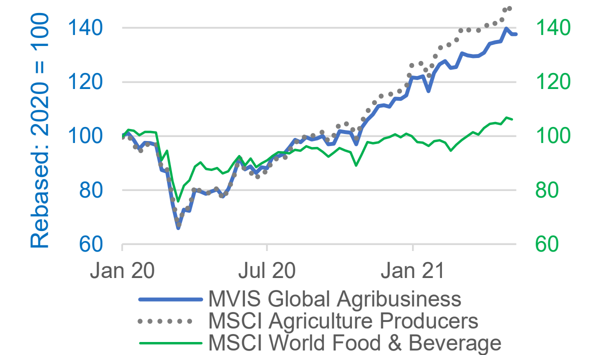
The investment solutions related to this theme mainly relate to equities. Despite the theme's relevance and attractive potential returns, investment solutions will still be subject to global equity market movements. A factor that should limit the risk relative to global equity markets could be that companies related to this theme should often benefit from a high rating for Environmental, Social and Governance (ESG) criteria.

Future of Food index beats global equities



Source: Bloomberg

Agriculture producers outperform Food & Beverage sector overall



Source: Bloomberg

Water and Packaging

Water has been defined as a specific SDG by the UN. Only around 3% of the earth's water is fresh. Of this amount, approximately 7.5% is usable. Governments worldwide are ever-conscious of the importance of useable water especially in food production. Optimising the use of water and technologies to reuse and recycle water will be central to the path towards a circular economy in this area.

Growing awareness from consumers on the environmental consequences of packaging (above all plastics) will be another key driver of change. This is particularly true as this topic is attracting greater media coverage. Governments too understand the need to act quickly. The Directive (EU) 2019/904 "New Directive for Single Use Plastics", adopted in the European Union in June 2019, was a key milestone, and other countries, such as the US, are following suit.

Key beneficiaries of the mega trend shaping the food industry

We focus on three sections of the food value chain and look at companies which actively contribute to sustainable food production and the transition towards a circular economy:

(1) Demand for new kinds of food, such as alternatives to meat as well as vegan food;

(2) Innovations in agricultural science including biological pesticides and fertilizers, precision farming (increasing the crop yield for any given amount of inputs needed) as well as waste reduction technologies, and

(3) Sustainable packaging thanks to technologies which reduce and reuse packaging, and alternatives to plastics etc.

We will focus on stocks of companies that operate in these areas, or via actively-managed funds or ETFs.

02

Cash in on carbon credits

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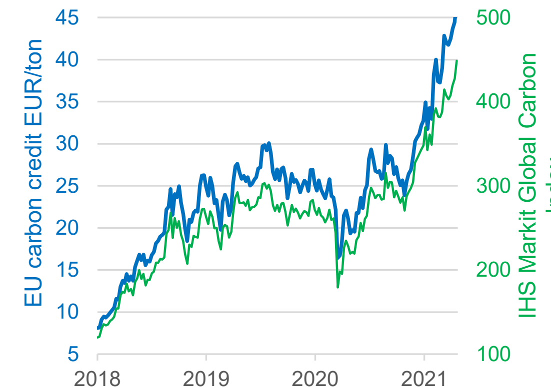
Cash in on carbon credits

MEDIUM-TERM, HIGH RISK

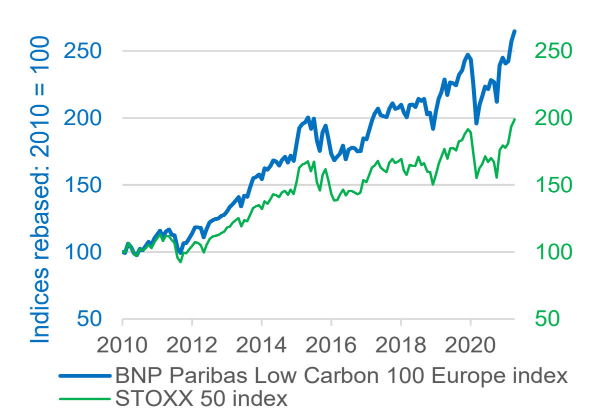
- Global carbon pricing is in vogue. The EU carbon credit market is growing in importance, with prices having doubled to EUR45/tonne since last November. Tighter regulations will boost this carbon pricing in order to make net zero-carbon targets achievable.
- Europe, the US and China are ramping up investments to lessen their energy reliance on fossil fuels, via a combination of solar, wind, biomass and nuclear power generation.
- An increasingly electrified world will require greater large-scale industrial battery storage capacity to supply electricity when the weather does not allow solar and wind power to be generated.

EU Carbon credit pricing has doubled since November 2020



Source: Bloomberg

Low carbon equities have outperformed consistently



Source: Bloomberg

The race to meet net zero-carbon targets hots up

Europe and the US prepare to invest even more to achieve zero carbon: post the US rejoining the Paris Climate Accord, President Biden's Jobs Plan is targeted at green infrastructure improvement, i.e. cutting US greenhouse gas emissions by 50% from 2005 levels by 2030, and 100% by 2050. Funded by hikes in personal and corporate taxation, this plan should be a clear boost to the renewable energy sector in the US over the next eight years.

Similarly, the EUR750bn European Union Recovery Fund also targets a green transition (EUR225bn over three years) in the European economy, boosting investment in solar, wind and biomass energy production as the world is increasingly electrified.

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 admittedly these solar, wind and biomass energy stocks were overvalued at peak earlier this year, this is much less the case today.

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

Carbon credits take off: a market which has quietly enjoyed a vibrant bull market since last November is the EU carbon credit market, driven in part by prospective EU plans to put in place another, tougher emissions trading system to cut carbon output. Since November last year, the December-2021 EU carbon credit price has doubled to EUR45/tonne.

Putting a price-tag on carbon emissions is not just a European project – carbon credit schemes exist in California, the US North East and Quebec. In addition, China has launched its own carbon allowance market this year, which is expected to be the largest in the world and involves c. 3.3 billion tonnes of CO_2. This will put additional pressure on economies to move to low-carbon sources of energy, and to promote carbon capture systems and carbon offset plans.

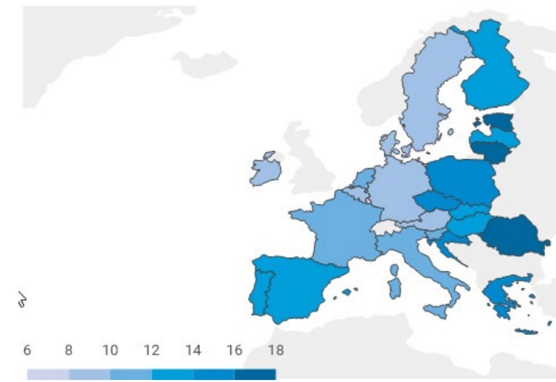
25 May a key date: European Union leaders gathered in Brussels for a special session to discuss how to achieve the EU bloc's collective 2030 target of cutting greenhouse emissions by at least 55% compared with 1990 levels. They have considered creating an additional system of pollution-cutting incentives for buildings and road transport, boosting EU carbon credit demand.

Watch German Greens in September: a Green party victory in the upcoming 26 September German legislative elections (in which the former could become a key ruling coalition partner) could hasten the country's move to phase out Internal Combustion Engine or ICE vehicles (thus cutting oil demand) and boost support for higher CO_2 pricing.

Going green in stages

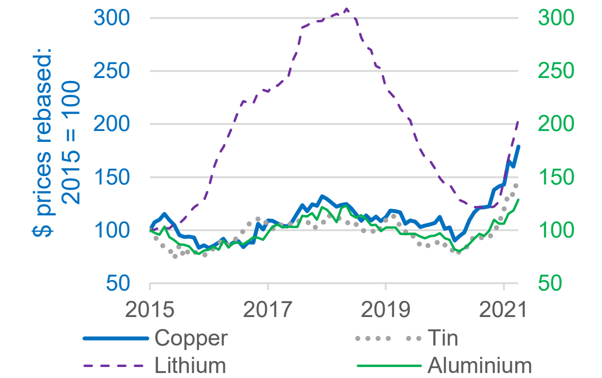
- Do not assume that all fossil fuels will be abandoned in the near term. With the average age of European cars being 11.5 years, we will not all be driving electric or hybrid cars before many years to come.
- Biofuels, such as biodiesel and bioethanol, remain a greener medium-term solution for existing Internal Combustion Engine (ICE) vehicles.
- Invest in: low carbon companies, Energy Efficiency, companies positively exposed to carbon credits, biofuel refiners, carbon offset programmes including blue carbon, carbon capture technologies and battery/"electrifying" metals focused on electricity storage.

Average age of EU cars is 11.5 years!



Source: ACEA

Battery metals rising fast on strong demand



Source: Bloomberg

Electrifying the global economy will take years

We will not all be driving Teslas overnight: aside from the fact that Teslas are still relatively expensive and relatively unreliable (according to JD Power's 2021 survey), recall that we do not all drive new cars. The average age of cars on the road today is 11.5 years in Europe, and 12 years in the US. If anything, the average age of cars is likely to grow this year, given the shortage of semiconductors slowing new car production around the world.

Biofuels remain an important pre-electric step: used cars and heavy vehicles can still go greener by using more biofuels, in the form of bioethanol or biodiesel made from wood pulp, wheat or corn. Biofuel refiners within the Oil & Gas sector are thus "green" oil-related companies, crucial in making existing cars and lorries more environmentally-friendly.

Platinum group metals to cut pollution: stricter vehicle emission regulations in Europe and China are accelerating demand for the key precious metals used in car catalytic converters used in ICE cars in order to reduce pollution in cities - platinum, palladium and rhodium.

Battery metals in demand for electric vehicles, green infrastructure: the prices of key "electrifying" base metal commodities, such as copper, nickel, aluminium, lithium and tin, have all gained at least 50% since April 2020, thanks to electric car and renewable energy needs.

According to the World Bank, increases in demand of up to 500% are estimated for some of these metals, particularly those used in energy storage technologies, such as lithium, graphite and cobalt. By 2050, annual demand for nickel solely from energy technologies could equal the global total nickel production in 2018. The incremental demand for the base and precious metals used in energy production and storage (e.g. silver) will be huge.

Carbon Capture & Storage (CCS) and Carbon Offset, e.g. Blue Carbon: investing in carbon capture and carbon offset projects are two practical solutions for reducing carbon footprints today. Carbon capture refers to a chain of different technologies that can prevent the CO2 produced by major factories and power plants from being released into the atmosphere and contributing to global warming. The first step is to fit factory chimneys with solvent filters, which trap carbon emissions before they escape. The gas can then be piped to locations where it can be used or stored. Most carbon dioxide will be injected deep underground (e.g. into disused mines or oil wells).

Carbon projects are a way to offset carbon emissions by investing in natural habitats offsets including Blue Carbon that can absorb CO2, for instance by financing in the planting of new forests, or in the creation and maintenance of coastal blue carbon ecosystems, such as mangrove swamps, tidal marshes and seagrasses.

03

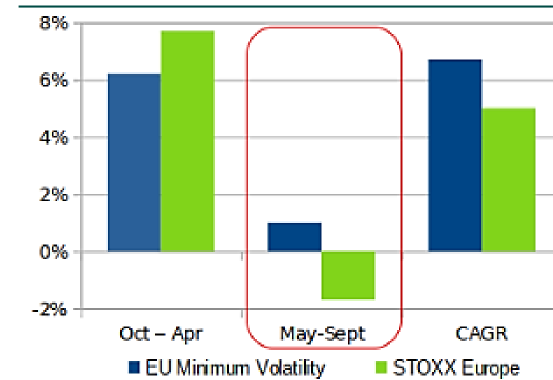
Achieve real returns without 100% equity risk

Real returns without 100% equity risk

MEDIUM-TERM, MEDIUM RISK

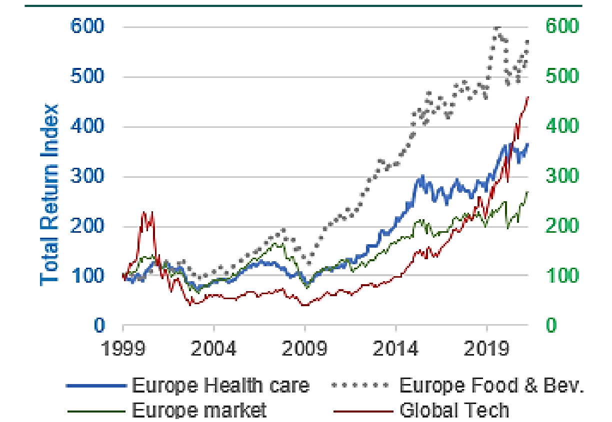
- We believe the medium-term equity market outlook remains positive, so we do not advise investors to sell their stock market exposure despite accumulating outsized gains since early 2020.
- However, over the summer months, some rotation of equity exposure out of riskier cyclical sectors and stocks into more defensive factors and sectors, such as Low Volatility and Health Care, has historically achieved superior results. Low volatility and quality income dividend strategies are an attractive option for income-oriented investors who are seeking positive real returns, not available in cash, sovereign bonds or IG credit.

Low volatility factor wins over the summer



Note: Average returns over 1997-2020
Source: BNP Paribas, Bloomberg

Health Care, Food & Bev., Global Tech have all beaten the European benchmark over time



Source: Bloomberg

Nervous investors seek to dial down their equity risk

"Sell in May and Go Away" (until the end of September). This year there are a host of reasons for even calm and rational investors to heed to this old stock market adage:

Strong stock market returns: the global stock market has risen 84% in USD terms since the March 2020 market low, and 27% since the beginning of November. Stock market valuations are on the high side, particularly in the US (end-2022 P/E of 22.3x for the S&P 500 index). We know that high valuations today generally lead to lower future long-term returns.

Negative seasonality: equity returns have historically been far worse over the summer (May-September inclusive) than over October-April, suggesting that investors should take a more defensive approach at this point in time.

There are some strategies that still deliver positive returns on average over the summer months. These are **Low Volatility and Defensive equity strategies in Europe**. Low and minimum volatility factors 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%. Looking at defensive stocks (companies that are not economically sensitive in general, including Health Care, Utilities and Food & Beverages), we see a similar pattern emerging. Since 2005, European defensive stocks have gained 2.4% over the summer, while cyclical stocks have delivered only a flat return on average over the same period.

Low volatility, quality dividend strategies make a come-back: low volatility and quality dividend strategies are starting to perform well once again, after a long period of underperformance for equity dividend strategies in general. Dividends are at last making a comeback in Europe, with banks now able to pay 2021 dividends (after generally being banned by financial regulators from paying dividends in 2020). While there is still very little yield on offer from cash, sovereign or even Investment Grade corporate bonds, the Euro STOXX Select Dividend 30 index offers a 5%+ dividend yield on end-2021 estimates.

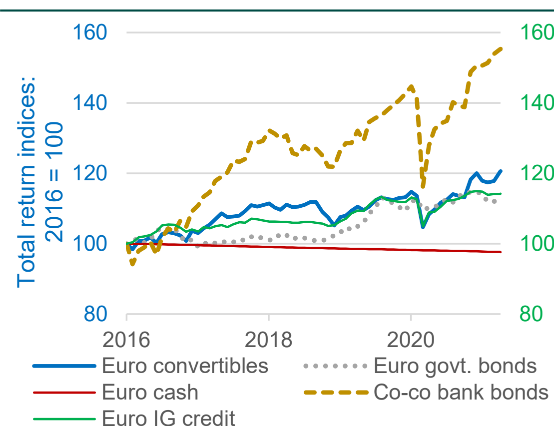
We prefer not to have an exposure to a pure high dividend index like the Select 30, but rather to a dividend growth or quality dividend strategy that may have a slightly lower (but still appealing) dividend yield, combined with a reasonable payout ratio, strong profitability and future dividend growth potential. This gives a far better chance both of maintaining and/or growing the dividend over time, and also generally gives a better total return to the patient investor.

Note too that academic research has highlighted the risk-adjusted outperformance over time of a low-volatility, high dividend equity portfolio strategy, which correlates well with the quality and dividend growth approaches to equity income investing. In Europe, since 2016 Low Volatility and Quality Dividend stock indices have returned between 6% and 13% on average annually, at a lower level of risk than for the STOXX Europe benchmark index.

Hybrid income, real return solutions

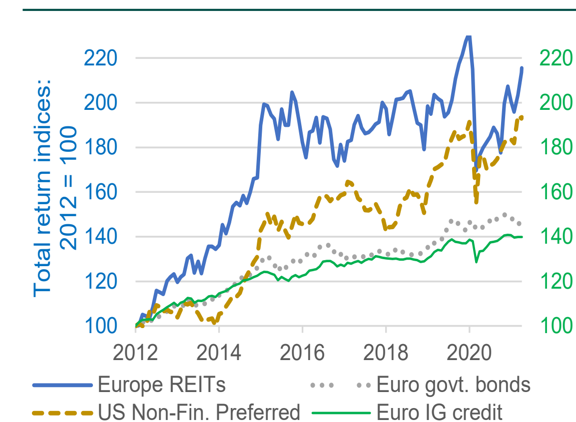
- Hybrid asset classes sit in between risky stocks and ultra-low yield bonds, with a potential positive real return on offer but at lower-than-stock market risk.
- We favour hybrid asset exposure for income and real returns: convertible bonds, contingent convertible (co-co) bonds, and preferred shares.
- Listed and private real estate funds continue to offer attractive valuations, solid yields and the potential for both capital and rental growth over time. The reopening of European economies should be a catalyst to spur recovery in office and retail sectors.
- Lower-volatility forms of investment in equities can also be achieved via structured products and alternative UCITS funds.

Co-Co bonds, convertibles beat bonds, credit



Source: BNP Paribas, Bloomberg

Real Estate, Preferreds outperform bonds + credit



Source: Bloomberg

Seeking less risky solutions than equities, but yielding more than bonds

Looking for positive after-inflation returns, but not from stocks? Without accepting the negative after-inflation returns from government bonds or cash, there are several hybrid asset classes which have historically been less risky than stocks, but have beaten bonds and credit returns. **Convertible bonds**: these are hybrid fixed-income corporate bonds that yield interest payments, but can also be converted into a predetermined number of equity shares. The conversion from the bond to stock can be done at certain times during the bond's life and is usually at the discretion of the bondholder. Since 2016, Euro convertibles have returned 3.6% on average per year, beating Euro Investment Grade credit and government bonds by over 1%. **Contingent convertible (AT1) bonds**: these are corporate bonds issued by European banks. They offer a higher yield than traditional bonds given the higher risk involved. Also known as “CoCo bonds”, they are perpetual bonds with callable dates and bear a risk of loss absorption. They are converted into shares (at current price i.e. depreciated) once the issuer's equity ratio falls below a predefined level. The issuer can cancel the interest payment. **Preferred shares**: these are shares of a company’s stock with dividends that are paid before common stock dividends are issued, and rank above common shares in the event of insolvency. Most preferred (or “preference”) shares have a fixed dividend, and have returned on average 7+% since 2021.

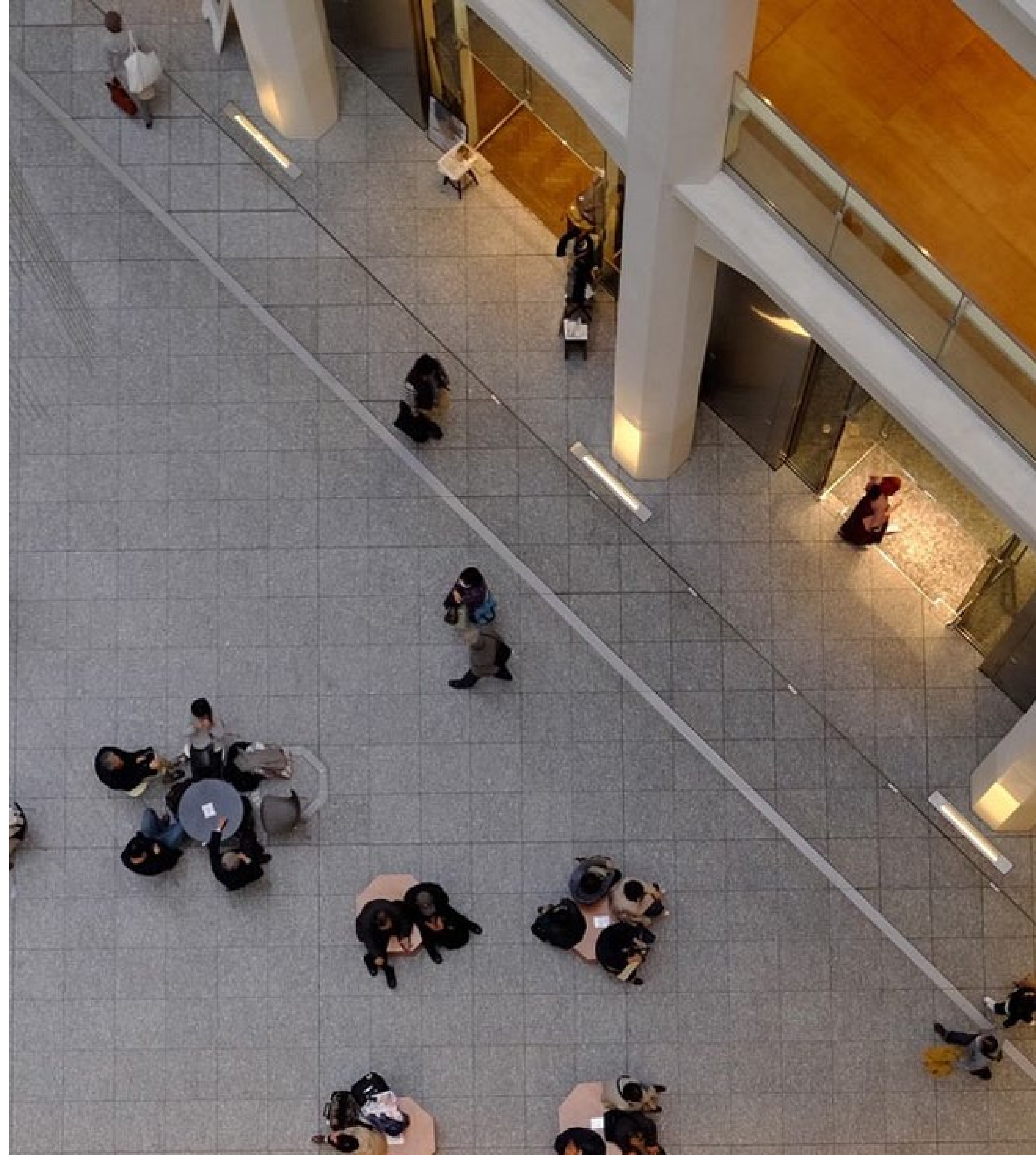
Real Estate Investment Trusts (REITs) and funds: Listed European real estate companies (REITs) performed strongly up until February last year, and are now staging a strong recovery in values as European economies move towards reopening post-pandemic, led by shopping centre and warehouse real estate assets.

Structured products typically involve the use of sophisticated instruments (futures, options and credit default swaps) to which individual investors usually have limited access. These instruments serve to optimise returns or limit losses while reducing sensitivity to a rise in interest rates or a fall in underlying shares. We focus on equity-based structured products of two types: a) those offering a partial or full capital guarantee plus exposure to any rise in European stock markets; and b) those combining a long exposure to European or global stock markets together with a long volatility or long put option that can act as a hedge against falling stocks.

Alternative UCITS (hedge) funds: these funds can take both a long and short exposure to asset classes like equities, allowing them to reduce the net exposure of a fund to the stock market and thereby reducing the volatility of a fund’s returns over the long term. We focus on three strategies here: Long/Short equity (8.0% average annual return since 2012), Global Macro (4.6%) and Event-Driven (6.7%), all of which have far outpaced credit and government bond returns (albeit at lower volatility) than for equity markets.

04

Prepare for the consumption *tsunami*

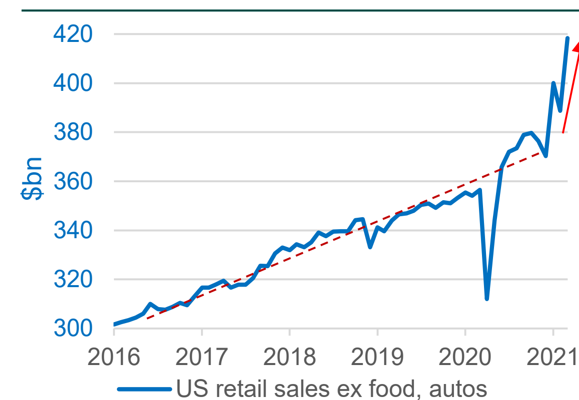


The savings *tsunami* is about to hit

MEDIUM-TERM, HIGH RISK

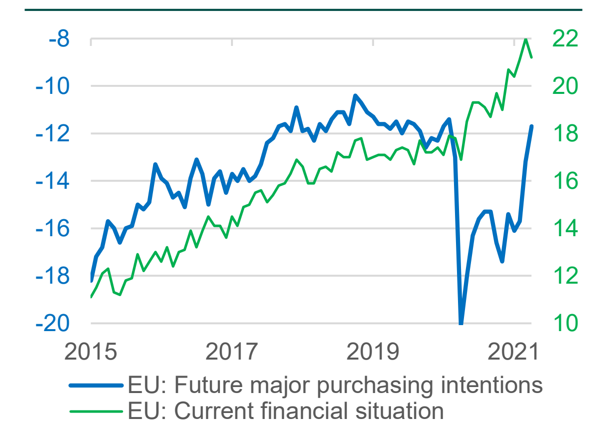
- **"Revenge" consumption:** travel and travel-related consumption, housing-related demand (construction, DIY, furniture). Banks and Real Estate should profit from strong consumption growth.
- **Structural consumption growth trends**: pet care, personal health & fitness (health nutrition, home exercise equipment/sportswear, fitness trackers) and 5G smartphones.
- **Growth of click-and-collect hybrid model**: consumers like to browse products online, but are ready to visit physical stores to check out products, ask for advice and then purchase or collect what they have ordered online, which in turn speeds up fulfilment times.

US retail sales explode in 2021



Source: Bloomberg

EU household finances are strong and ready to spend



Source: Bloomberg

Households strike back

The savings *tsunami* will be released: households around the world have accumulated at least USD5.4 trillion in excess savings since the start of the Coronavirus pandemic with USD2+ trillion of this amount expected to be spent as countries reopen, approaching herd immunity.

Vaccination programmes allow reopening: evidence from Israel, the US and UK suggests that COVID-19 infections and hospitalisation rates collapse once vaccination rates reach 40-60% of total populations. Continental Europe should achieve this vaccination rate by end-June at the current daily rate of vaccination, pointing to an acceleration in consumer spending over the second half of this year. But with new COVID-19 infection rates falling rapidly in most Western countries, on the back of beneficial effects of accelerating COVID-19 vaccination programmes, these physical restrictions should be gradually eased over Q2 2021.

Households are desperate to spend: we would expect these two trends to result in a boom in household consumption over the remainder of 2021, fuelling a strong earnings recovery in a number of service sectors, such as finance, retail, travel & leisure, media and autos.

We focus on consumption categories which have already exhibited robust growth over the past few months, including DIY and home improvement, gardening, pet care as well as sporting goods and "athleisure" clothing.

Once travel restrictions and national lockdowns are lifted, we can expect lockdown-weary consumers to rush to travel once again. The World Tourism Organisation expects domestic tourism to return faster than international tourism, boosting demand for petrol/diesel via increased car journeys and also for hotels for short stays and weekend breaks.

Clothing, luxury goods catch up: in addition, when social gatherings (in some form) are permitted once again, we expect people to spend on cosmetics, perfumes and celebration clothes as they will be able to dress up and socialise in safe conditions again. This could be good news for luxury goods companies, which have suffered from the drop in duty-free retail sales and restrictions on social events.

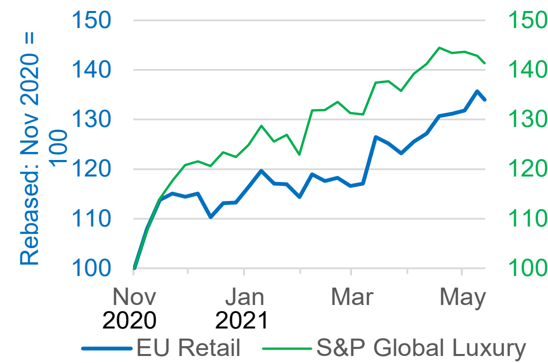
Daily life revolves around smartphones/5G: just how central are mobile phones to our daily lives? Well, consider the following facts: smartphone users worldwide will reach 3.8 billion this year; 47% of US smartphone users say they couldn't live without their device; 62% of smartphone users have made a purchase with the device; in-app advertising will rise to USD 201 billion by 2021; 99% of all internet users in China used their mobile devices to go online in 2020.

Conclusion: super-fast 5G mobile internet is triggering the next huge global wave of smartphone upgrades, aided by excess savings burning a hole in consumers' pockets. This will inevitably boost 5G infrastructure providers, handset makers and semiconductor manufacturers.

E-entertainment, Financials and Real Estate to benefit

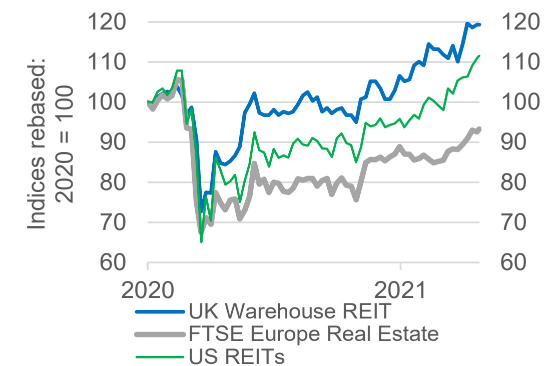
- **E-consumption habits**: e-gaming, 5G-related mobile internet phones + infrastructure, audio & video streaming, semiconductors, AI/Big Data-assisted personal shopping recommendations, e-transportation (electric cars, scooters, hydrogen vehicles).
- **Consumer environment to benefit Banks and Real Estate:** with more households able to pay back their loans and/or take out new loans to buy a car or to move out of city centres to further afield.
- **Online and omnichannel retail:** logistics real estate, logistics operators, ecological packaging, online retail fulfilment, online retailers, cybersecurity (for consumer trust).

Retail and Luxury get a vaccine boost



Source: Bloomberg

Certain UK and US Listed Real Estate have exceeded pre-COVID-19 levels



Source: Bloomberg

E-entertainment and some Materials are still doing well

E-consumption continues to develop, though obviously there will be a slowdown in growth in 2021 as consumers leave their homes more. Key beneficiaries will be restaurants, hotels, amusement parks, shopping malls and other entertainment venues.

Nonetheless, after more than a year of lockdowns in various forms, a large chunk of the population that was previously uncomfortable with computers and online surfing cannot do without the internet today. Online purchases have accelerated and market shares will keep growing. **E-commerce, streaming, video gaming, and e-sports** are capturing a widening audience and the latest corporate results confirm the rising popularity of these new pastimes. Increasingly powerful equipment and telecom infrastructure are needed to support this growth. The resulting severe component shortages remain an unresolved issue.

The earnings of companies designing and producing new **high-end semiconductors, telecom components and equipment** are booming as super-fast 5G mobile internet becomes a reality.

Real Estate companies providing data centres and other tech facilities are also doing well.

Demand for more ecological products, such as hybrid or electric cars, is driving structural demand growth for “battery” metals (copper is reaching new highs) **and rare-earth components that are increasingly scarce.**

Financial institutions and Real Estate are now also profiting

When whole swathes of economies were closed down in early 2020, fears emerged that the financial systems would suffer considerably. However, thanks to the prompt intervention of monetary and political authorities, the massive support plans put in place helped to avoid the collapse that some commentators had predicted.

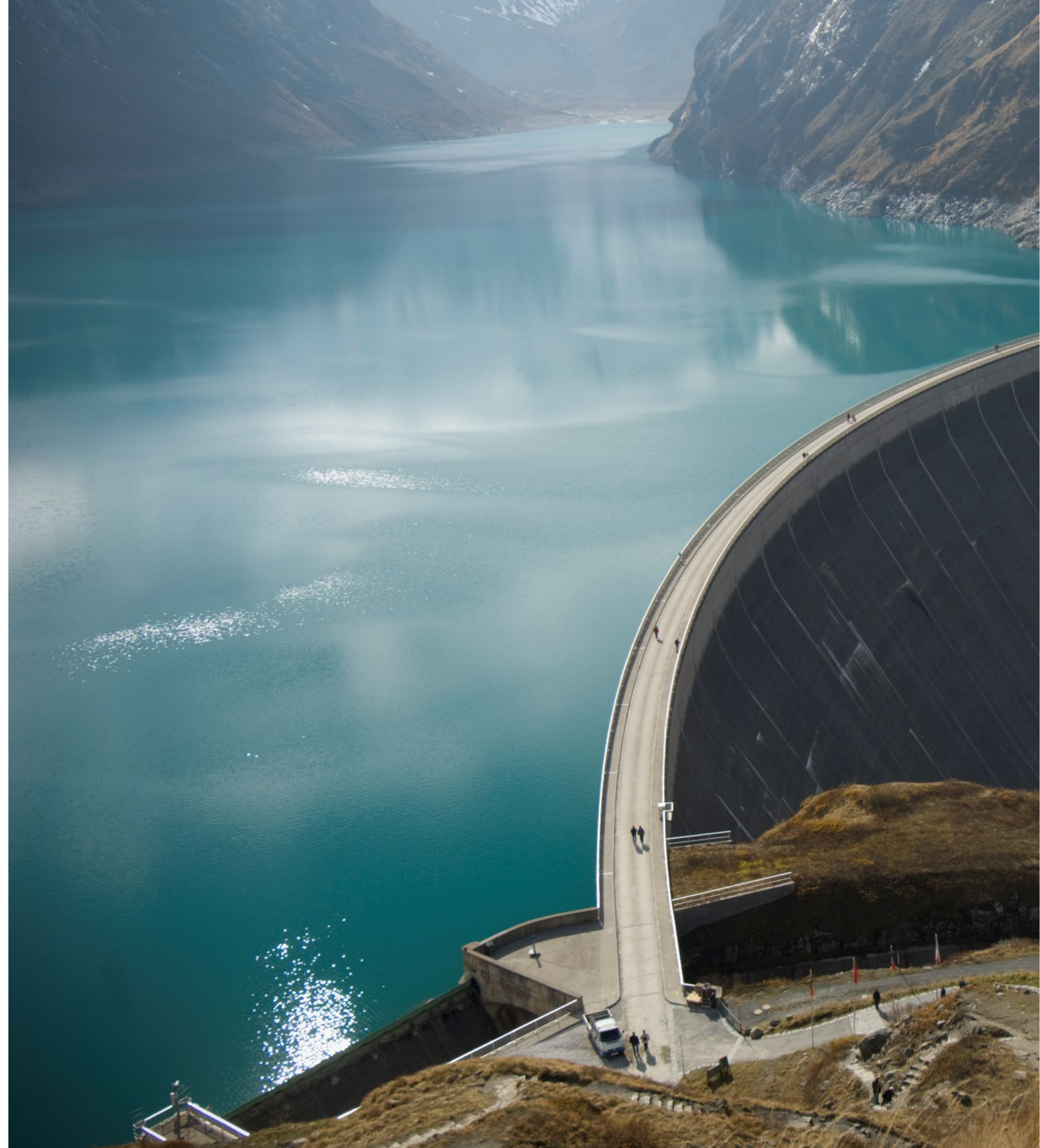
Banks had previously provisioned large amounts for expected bad loans, and are now in a position to significantly take back these provisions. **Banks reported stellar QI 2021 earnings, much better than expected.** Balance sheets are robust (some banks continue to grow via mergers and acquisitions). With the resumption of dividend payouts this year, the Banking sector is attractive again, even cheap, and has lagged the wider stock market recovery up to now. **Robust balance sheets, excess cash and the consumption recovery will underpin lending growth.** A strong online presence has become an absolute necessity. Financial institutions providing easy, reliable and attractive online services will be the winners.

Real Estate is another sector to benefit from the reopening of economies (and has also lagged the stock market recovery). Needless to say, warehousing and logistics did well during the pandemic and will continue to do so. Going forward, shopping malls and residential real estate should also benefit from consumers shopping more and looking for more living space following extended lockdowns. Companies are now encouraging staff to come back to the office. **US real estate has performed very well upon reopening, and we expect Europe to follow suit.**

A

Appendix: Our Original 10 Investment Themes for 2021

BNP PARIBAS
WEALTH MANAGEMENT



Our Original 10 Investment Themes for 2021

OUR INVESTMENT THEMES FOR 2021

THEME 1

Vaccines, recovery, and reflation
P. 05

THEME 2

Low volatility absolute return: facing the challenge of a negative-yield world
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THEME 3

Sniffing out yield truffles
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THEME 4

Constructing a new diversified portfolio for a changing world
P. 14

THEME 5

Enter the dragon: China's opening of capital markets and economic reform
P. 17

THEME 6

New consumption habits in a post-lockdown world
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THEME 7

Shifting generational influences: how demographic trends are improving the quality of life
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THEME 8

Enablers of smart technologies
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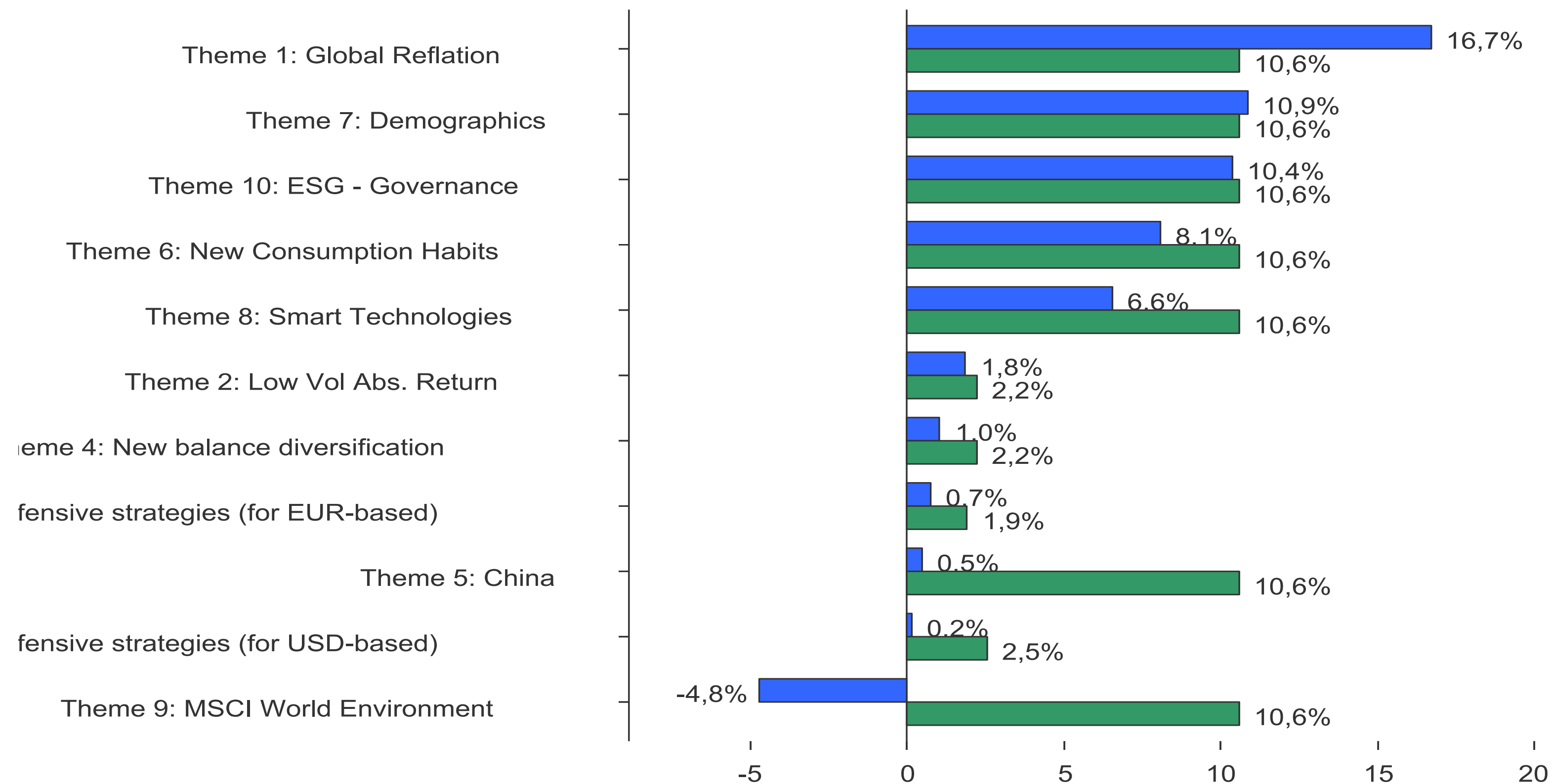
THEME 9

The energy transition and the 'green deal': long-term opportunities
P. 29

THEME 10

Strong governance as an aid to low-risk outperformance: investing in trust and profitability
P. 32

Investment Themes 2021: Returns since 1 January 2021 vs benchmark



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