NOVEMBER 2022

Investment Strategy Focus

Reasons to be hopeful, at last

Summary

1. **Are we finally seeing green shoots of recovery in financial markets?** There are tentative signs of changes in trend for the better in bond yields, financial conditions, liquidity, and near-term economic momentum. These modest improvements need to be confirmed before we further upgrade exposure to stocks + credit.

2. **A good entry point for bonds:** in US dollars, global government bonds have erased all returns over the last 12 years. With US bond market liquidity finally starting to improve, it looks a good time to buy fixed income. We favour US investment-grade credit and Treasury bonds, particularly for USD-based investors.

3. **A modest US recession ahead in Q2 2023:** inflation should peak late-2022, declining gradually thereafter. We expect modest eurozone and US recessions in 2022-23, but still see positive annual GDP growth rates in 2023 overall. A favourable fixed income environment.

4. **What to expect post the Chinese Communist Party Congress?** Chinese financial markets could remain volatile in the near term given foreign investors' concerns over a rising country risk premium. Signs of re-opening plus a bottoming in the property market would be key positive catalysts to drive improved investor sentiment.

5. **New Italian right-wing government: conclusions.** The ease and speed at which the new Meloni government has been formed, plus the continuity with the previous administration both represent reassuring signals for foreign investors. The current 4.2% Italian BTP 10-year yield should draw interest from investors.

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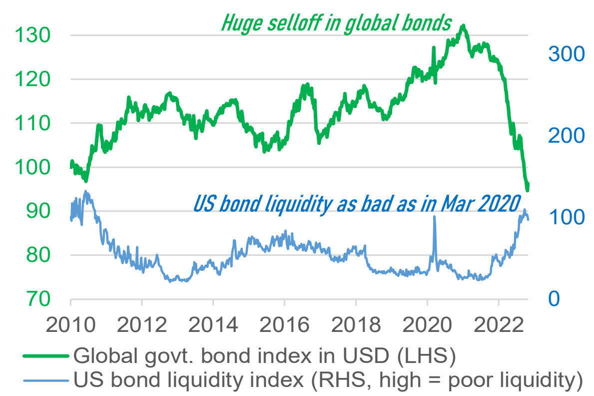
PEAKING BOND MARKET LIQUIDITY STRESS SUGGESTS TIME TO BUY SOVEREIGN BONDS



Source: BNP Paribas, Bloomberg

Edmund Shing, PhD
Global CIO
BNP Paribas Wealth Management

BNP PARIBAS WEALTH MANAGEMENT

The bank for a changing world

Our Key Convictions: Focus on US IG credit

Buy:

1. **US investment-grade corporate credit**
2. **UK and Japanese equities**
3. **Global infrastructure funds**
4. **Global energy including alternative/low-carbon**
5. **Gold and precious metals**

Avoid:

1. **Euro cash**

Asset Allocation: Modest tilt to risk assets

Outlook Summary

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

Note: Alternatives include Commodities, Infrastructure and Alternative UCITS/hedge funds

Market Outlook

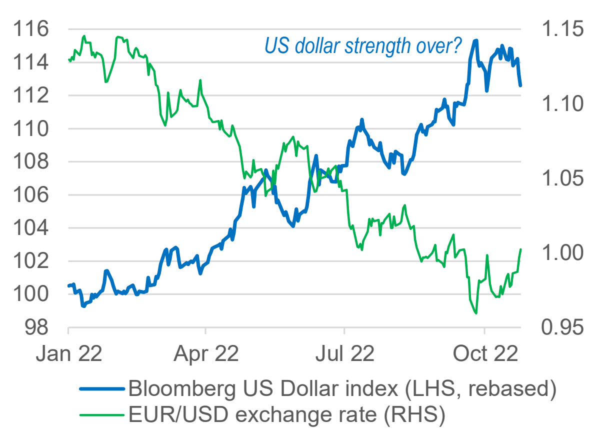
The key indicators we are watching

What are we watching for signs of improvement in the overall financial market environment?

1. **(Lower) Real bond yields**: 10-year bond yields have edged down of late in the US and Germany, but need to decline more (e.g. US 10-year yield to under 4%) to underline a change in trend to lower real yields. Such a shift in trend would support equities and corporate credit markets.
2. **(Looser) Financial conditions (credit spreads, volatility, interest rate spreads):** there has been a marked improvement in the form of lower US and European investment-grade credit spreads (looking at CDS indices), in lower stock market volatility (VIX index) and in tighter US interest rate spreads (the TED spread). However, financial conditions need to improve further in the US and Europe to confirm this support for financial markets.
3. **(Weaker) US dollar index:** USD strength has been an issue in Europe, Japan and China of late. However, with the EUR/USD exchange rate returning to parity and GBP/USD back above USD1.15, we might finally see the dollar peak.
4. **(Deeper) Liquidity in financial markets:** broad money supply has slowed sharply as policy interest rates increase around the world. In addition, central bank balance sheets have been reduced (via selling of bonds). These factors have triggered worsening financial market liquidity since late 2021. But recently we have seen a turn for the better. US government bond market liquidity has started to recover since late September. If this more positive trend continues, we could see the benefit both in bonds and credit but also in stocks.
5. **(Rebound in) Economic momentum**: while we now expect modest economic recessions in the US and Europe over the next few quarters, near-term economic momentum is actually improving in both regions. Further improvement could highlight that these periods of economic contraction could be shallow and relatively short-lived, allowing investors to "look through" the bad news to better times ahead.

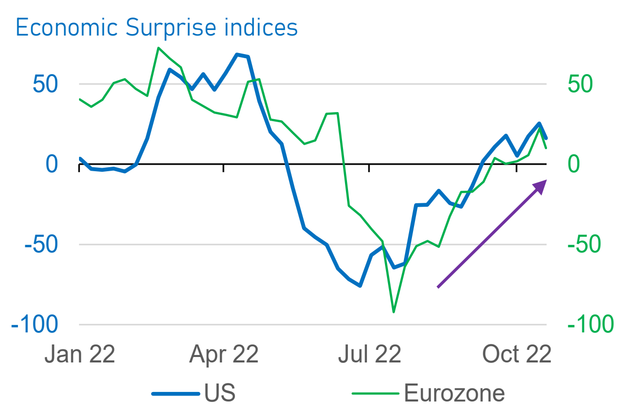
Institutional and retail investor sentiment remains depressed; this is still a good contrarian indicator.

EURO REBOUNDS TO PARITY AGAINST THE US DOLLAR



Source: BNP Paribas, Bloomberg

NEAR-TERM ECONOMIC MOMENTUM HAS IMPROVED



Source: BNP Paribas, Citigroup, Bloomberg

INVESTMENT CONCLUSION

It is still too early to confirm a definitive change for the better in global financial markets. But there are several tentative signs of improvement in the key markets and macro indicators that we monitor. If these trend changes are confirmed in the coming days and weeks, we will look to increase our exposure to stocks and credit markets.

The Macro Picture

Modest recessions in US and Europe

Guy Ertz

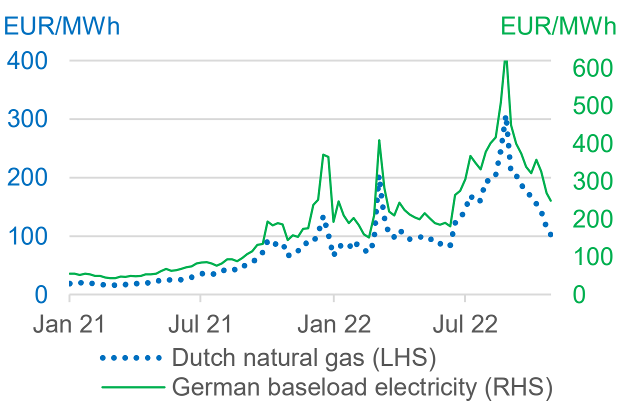
The current economic slowdown is mainly the consequence of high energy prices, elevated inflation and tightening financial conditions linked to significant increases in interest rates decided by most major central banks. The US is almost self-sufficient for its energy, and its unemployment rate remains low, which supports wage growth. The Inflation Reduction Act (IRA) passed in 2022 has been key, with the implementation of important social and environmental measures.

Growth will continue to slow, and we expect a recession in 2023 as the negative effects of interest rate hikes materialise. The eurozone is probably already in a recession. The unprecedented combination of shocks (geopolitical, energy, inflation, monetary) has hampered economic activity, underlined by recent PMI and IFO business surveys. The probable recession in the eurozone should remain limited in scope and amplitude thanks to the support of fiscal measures and the resilience in the labour market. In the short term, other main risks relate to the energy supply this winter. Sticky high inflation could also prompt central banks to hike more than expected with a more negative impact, especially via housing.

According to the IMF, c. 40% of the US price increases compared with the pre-COVID trend can be attributed to production disruptions and rising commodity prices. In the eurozone, the figure was higher (60%+). The rest is largely attributable to economic stimulus and changes in consumption patterns from services to goods. These drivers have partially reversed but the ongoing energy crisis and dollar strength have fuelled pressure especially in countries outside the US. Inflation has remained high in the US, mainly due to wage increases and high capacity utilisation. There are several reasons to believe that inflation has peaked or is close to a peak, looking at house prices, rents, used cars, gasoline and other key inflation components.

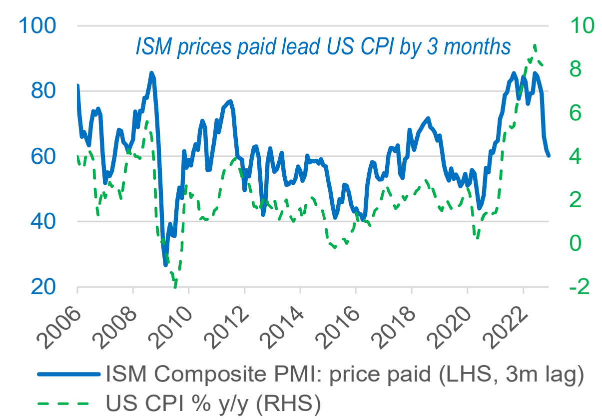
High frequency data suggest that supply chain constraints have decreased and should normalise. Goods demand is also slowing in favour of services. Wage growth could become an issue in the US, but most wage increases are concentrated in a low wage bracket. In the eurozone, recent pay deals have been quite moderate and unemployment rates are much higher. Long-term inflation expectations remain relatively stable, suggesting that central bank credibility is intact.

THE LONGER ENERGY COSTS FALL, THE SOFTER THE HIT TO EUROPEAN GROWTH



Source: Bloomberg

ISM PRICES PAID COMPONENTS POINT TO SHARPLY LOWER US INFLATION AHEAD



Source: BNP Paribas, Bloomberg

INVESTMENT CONCLUSION

Inflation should peak in late 2022 and the decline will be gradual. Central banks are close to the end of their rate hike cycle – we expect a terminal rate of 5% by January 2023 for the Fed and 2.75% in Q1 2023 for the ECB. Modest recessions are expected both in the eurozone and the US, although we still see positive annual GDP growth rates in 2023 overall. An economic slowdown but not slump, together with the prospect of falling US inflation, looks an attractive cocktail for fixed income.

Bond and Credit

Peaking bond volatility is good for credit

Government bond yields have retreated from October highs: Italian 10-year BTP yields have eased back 0.6% from mid-October highs to 4.2% at present, while 10-year UK gilt yields have retreated almost 1% from post mini-budget extremes, to 3.5% at present. German 10-year bund yields have seen a more modest reset, down 0.2% to 2.2% now.

Bond volatility has been extreme: the combination of high uncertainty around US Federal Reserve interest rate policy and poor liquidity conditions has forced long-term Treasury bond volatility to extreme levels, judging by historical standards. In fact, 20-year US Treasury bond volatility has even exceeded the volatility on US stocks of late, almost unheard of.

CDS spreads for investment-grade credit have also declined: in addition to this decline in long-term bond yields over the last few weeks, credit risk (measured by CDS spreads) has also decreased, with the cost of insuring European investment-grade credit against a default over the next 5 years falling from nearly 1.4% at peak at end-September, to 1.17% now.

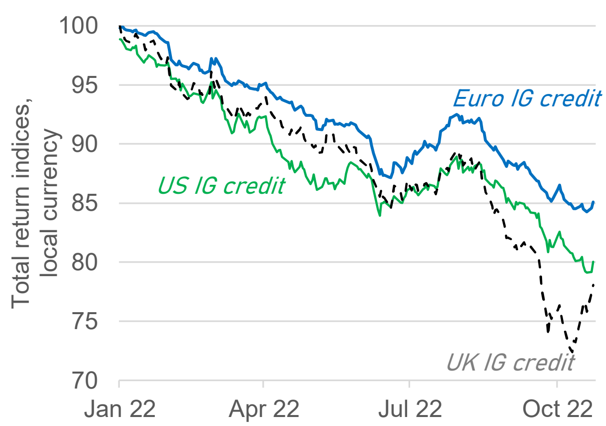
Extreme US Treasury bond volatility has preceded a risk rally: the last three times that long-term US bond volatility has exceeded 25 (as today), both investment-grade credit and stocks have delivered strong returns over the following 12 months. While clearly not a large enough sample to draw firm statistical conclusions, this does at least suggest now is a good potential entry point into investment-grade credit.

LONG-TERM US TREASURY VOLATILITY >25 PRECEDED STRONG CREDIT, STOCK RETURNS

Date	Peak in UST 20Y bond volatiltiy %	Subsequent 12m Return % US IG Credit	Subsequent 12m Return % US Stocks
Dec 2008	37	21%	27%
Sep 2011	26	9%	31%
Mar 2020	37	16%	73%
Oct 2022	27	?	?

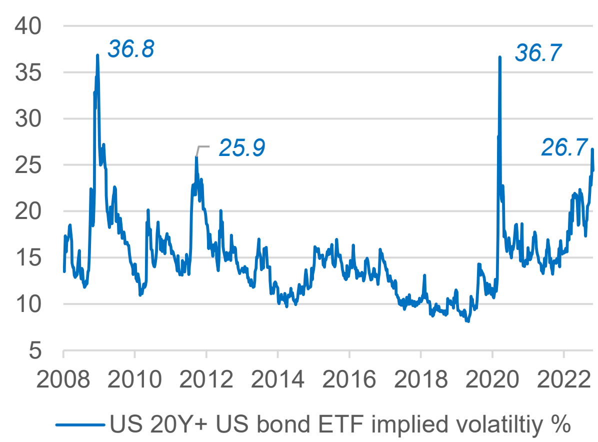
Source: BNP Paribas, Bloomberg

INVESTMENT-GRADE CREDIT HINTS AT A RECOVERY POST HISTORIC SELL-OFF



Source: BNP Paribas, Bloomberg

PEAKING US TREASURY BOND VOLATILITY A POSITIVE SIGNAL FOR US CREDIT, STOCKS



Source: BNP Paribas, Bloomberg

INVESTMENT CONCLUSION

We upgraded investment-grade credit to a positive recommendation in October. The peak in US Treasury bond volatility reinforces our conviction in IG credit (offering around 6% in the US, and nearly 4.5% in Europe). This view is also comforted by the decline in investment-grade credit risk (measured by CDS spreads) and the relatively solid balance sheets and cash flow generation of companies in the IG credit universe.

Equities Outlook

Tilt towards value sectors, US small-cap

Within our Neutral stance on global stocks, there are a number of clear trends and preferences that we would highlight for investors looking to gradually deploy cash back into stocks after a tough 2022 to date.

Stay the course with Energy: we believe that energy prices have an asymmetrical outlook – a much higher probability that they rise than fall over time, remaining far above long-term averages. We favour the global Oil & Gas and Renewable Energy sectors.

Cash flow-rich value sectors still favoured: we like portfolios based on the value style, containing a heavy bias to strong cash flows and balance sheets, given the inherent Energy, Financials and Materials sector bias.

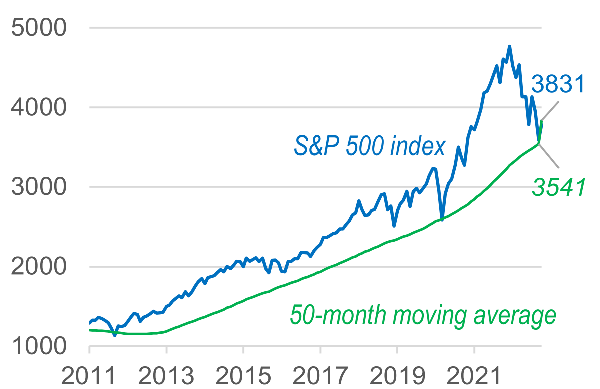
Prefer US small-caps over large-caps: US small-caps are much more domestically-focused than large-caps, which is a definite advantage at the moment given the strong US dollar (and the impact on overseas earnings of US large-caps), while US domestic consumption remains robust. US smaller companies still boast robust balance sheets and trade currently at a historically wide 25% P/E discount to the S&P 500 index.

Japan is still worth a look

Japanese equities offer increasing quality & value: over the year to date, hedged exposure to Japanese stocks via exposure to the Wisdomtree Japan hedged equity index would have generated a +2/+3% return in euros or US dollars. Post a 23% slide in the trade-weighted Japanese yen index since the start of 2021, Japanese exporters today have a huge competitive advantage to exploit. Japanese stocks look cheap on a (12x) P/E, (2.9%) dividend yield and (1.2x) price/book basis. This suggests the potential for higher long-term returns from Japanese stocks.

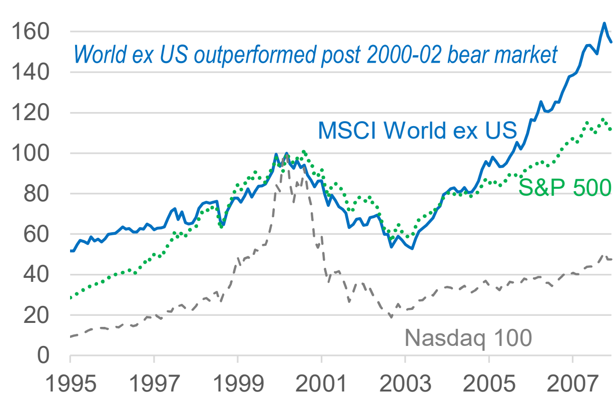
Peak US dollar to drive World ex-US comeback? A stronger US dollar and a technology stock mania in the late 1990s were the twin motors of US stock outperformance up until 2000. Today, we have seen the same tech mania and US dollar strength trends, notably since 2020. But a peak in the greenback plus unwinding of tech stock outperformance could drive World ex US outperformance, as seen in the 2003-07 period. The starting point is a record gap in valuations between US stocks and the World ex US stock universe.

BULL MARKET TREND: S&P 500 REBOUNDS ABOVE ITS 50-MONTH MOVING AVERAGE



Source: BNP Paribas, Bloomberg

2003-07: PEAK DOLLAR COINCIDED WITH WORLD EX US OUTPERFORMANCE



Source: BNP Paribas, Bloomberg

INVESTMENT CONCLUSION

There are tentative signs of changes in trend (for the better) in bond yields, financial conditions, liquidity, and near-term economic momentum. These modest improvements need to be confirmed before we upgrade exposure to stocks from Neutral. We retain a bias towards the Value investment style, towards energy sectors, Japanese stocks and to US small-cap exposure. More conservative investors can focus on low volatility, high dividend strategies given the generous pay-outs available today, especially ex US.

Focus: China post Party Congress

Grace Tam

What are the economic & market implications of the Party Congress?

- **A more unified top leadership** – this could mean more consistent policy directions and stronger policy execution.
- **Monetary & fiscal easing policies –** we expect to see continued fiscal expansion, credit support and liquidity flush to help the economic recovery in order to pursue the objective of a medium-developed country by 2035. We will see more clarity of economic policy direction at the annual Central Economic Work Conference in December.
- **Geopolitical tensions –** the key events to gauge any change in US-China tensions:

i. The US recently announced export curbs on advanced semiconductor and chip-making equipment to China. Response from China whether to de-escalate or to retaliate is a key factor to monitor.

ii. President Xi is attending the G20 meeting in November and will have a meeting with US President Biden. Will there be any upside surprise given that the market has no expectations?

iii. Preliminary findings on China ADR auditing will likely be announced by early December.

Focus on policy beneficiaries

The Chinese asset market could remain very volatile in the near term given foreign investors' concerns over a rising political risk premium. That said, for investors who have investment exposure in China, this is not the time to sell. We believe much bad news is already priced in, and further significant downside may be limited, as capitulation looks to have occurred and valuations are already very depressed.

Potential catalysts: signs of re-opening (even a gradual re-opening path) as well as a bottoming in the property market would be the key positive catalysts to drive a turnaround in investor sentiment and a sharp rebound in equity markets.

Furthermore, China remains committed to its "Green Agenda" with favourable policies to support reduction in carbon emissions. Related sectors such as electric vehicle supply chains, energy transition and green construction materials are the potential policy beneficiaries that long-term investors can consider.

HONG KONG-LISTED CHINESE STOCKS HAVE SUFFERED SINCE FEB 2021

Source: Bloomberg

EMERGING ASIA HAS PERFORMED FAR BETTER THAN CHINA

Source: BNP Paribas, Bloomberg

INVESTMENT CONCLUSION

- The Chinese asset market could remain very volatile in the near term given foreign investors' concerns over a rising political risk premium.
- Signals of re-opening as well as a bottoming in the property market would be the key positive catalysts to drive a turnaround in investor sentiment.

Focus: A new Italian government

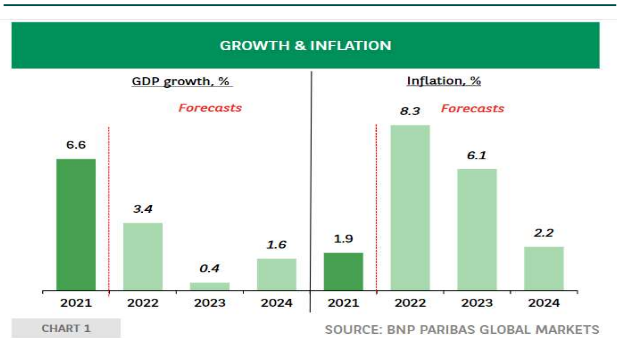
Luca Iandimarino

Formation of a new Italian government: on 23 October at the Chigi Palace, the outgoing premier Mario Draghi welcomed the new Prime Minister Giorgia Meloni, who had led the Brothers of Italy (FdI) to a convincing win for her right-wing coalition in the recent general election. The new government, largely made up of politicians but very few technicians, started to work on 23 October.

A demanding agenda: the new government must handle Italy's geopolitical and economic situation within a tight timeframe. The first priority is to tackle the rising inflation and cost of energy. The new government must rapidly approve the *Aiuti ter* decree and possibly extend measures by introducing a new decree in a bid to support citizens and businesses (perhaps through the *Aiuti quarter* decree). Meanwhile the next Budget Law (2023) must be approved by 31 December to avoid a potential government shutdown.

Other urgent matters include the race to obtain funds from the National Resilience Recovery Plan (NRRP) and the military aid package to support Ukraine in the war. Furthermore, 2023 will see the likely renewal of directors' contracts on the boards of directors at many state participated companies including Poste, Ferrovie dello Stato, Eni and Enel. Renewals must be made during the first half of 2023 and will be crucial for the responses Europe is seeking for the NRRP.

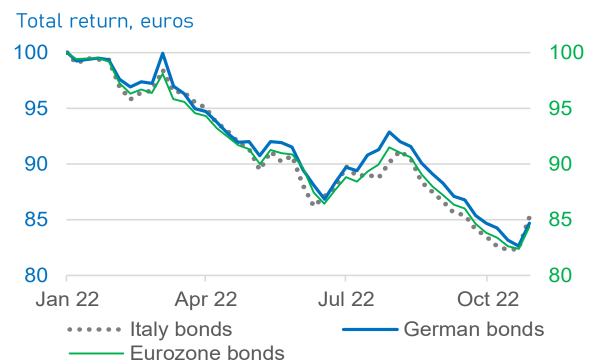
ITALIAN GDP GROWTH AND INFLATION



How did the markets react? Bond markets applauded the formation of the new government. The 10-year BTP yield hovered at around 4.6%, down slightly from the previous close (21 Oct). The spread with the Bund fell to 225 bps (on 24 Oct). Also the rating agency S&P has affirmed Italy's rating at "BBB" with a stable outlook.

In addition to the timing of the reforms, investors will continue to watch Italy's debt sustainability considering that the Italian debt/GDP ratio stands at 150% and interest rates are rising. We stress, however, that although the average cost of new BTP issues has increased by around 120 bps year-to-date, the absolute levels of rates are still much lower than in 2011-12 (at the time of the sovereign debt crisis). Furthermore, in this inflationary context, nominal GDP growth could benefit and the debt/GDP ratio may improve in the short term.

ITALIAN BTPS HAVE MOVED IN LINE WITH GERMAN, EUROZONE SOVEREIGN BONDS



Source: Bloomberg

Investment Conclusion

Italy has a new government headed by Giorgia Meloni. Even if currently high volatility persists given the difficult macro backdrop, Italy's risk premium should remain stable unlike in the 2011-2012 euro sovereign crisis. With Italian 10-year bond yields at 4.2%, investors could start considering BTPs again, even if longer durations depend on rates stabilising in Europe. The speed at which the new Meloni government was formed and the continuity from the previous government have sent reassuring signals to foreign markets and investors.

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		We await looser financial conditions, lower long-term real interest rates and improving liquidity conditions before adopting a more positive outlook on the stock market.
			Sectors	Energy,Financials, Health Care Precious/'battery' metals Semiconductors		We continue to recommend a more defensive sector stance, biased towards quality dividend/dividend growth and buyback strategies.
			Styles/ Themes	Megatrend themes		Circular Economy, Security, Income Growth themes
BONDS	=	=	Govies	US Treasuries		Our 10-year bond yield targets are 3.5% in the US and 2.5% in Germany in one year.
			Segments	US IG credit. EM bonds in HC & LC.		We favour investment-grade credit, focusing on US credit on the back of decade-high yields and strong balance sheets.
			Maturities	Lower than benchmark		
CASH	-	-				
COMMO-DITIES	+/=	+/=		Gold Oil		Oil (+) Brent should climb back into the USD 105-115 range due to gas/oil substitution & the progressive ban on Russian oil. Base metals (=) due to the delay in the Chinese recovery, recession threat in Europe but MT outlook still+. Gold (+) preferred safe haven, weaker USD & stable LT rates should help, 12-m exp. range = USD 1750-1900.
FOREX			EUR/USD			Our EUR/USD target is USD1.08 (value of one euro) in 12 months.
REAL ESTATE	=	+		REITs warehouses Health Care, UK commercial		Private Real Estate faces enduring headwinds from slowing economies and much higher financing rates. Prefer listed Real Estate.
ALTERNATIVE UCITS				Global macro and trend-following		

Economic, FX forecast tables

BNP Paribas Forecasts			
GDP Growth%	2022	2023	2024
United States	1,9	-0,1	-0,2
Japan	1,5	0,9	0,6
United Kingdom	3,4	-0,1	1,4
Eurozone	**2,8**	**0,3**	**1,5**
Germany	1,4	0,4	1,7
France	2,3	0,5	1,5
Italy	3,4	0,4	1,6
Emerging			
China	3,0	5,3	5,0
India*	8,3	6,2	6,5
Brazil	1,5	0,0	1,2
Russia	-7	0,8	0,3

* Fiscal year

Source: BNP Paribas - 31/10/2022

BNP Paribas Forecasts			
CPI Inflation %	2022	2023	2024
United States	8,1	4,4	2,4
Japan	2,3	2,3	0,6
United Kingdom	9	6,5	3,0
Eurozone	**8,3**	**5,9**	**2,5**
Germany	8,6	5,8	2,4
France	5,7	4,8	2,0
Italy	8,4	6,4	2,2
Emerging			
China	2,3	3,1	2,5
India*	7,9	5,9	5,5
Brazil	11,0	7,1	4,3
Russia	14,0	10,5	7,6

* Fiscal year

Source: BNP Paribas - 31/10/2022

	Country	Spot 06/11/2022		Target 3 months	Target 12 months
Against euro	United States	EUR / USD	0,99	1,00	1,08
	United Kingdom	EUR / GBP	0,88	0,88	0,86
	Switzerland	EUR / CHF	0,99	0,96	0,98
	Japan	EUR / JPY	145,71	145	151
	Sweden	EUR / SEK	10,85	11,00	11,00
	Norway	EUR / NOK	10,18	10,20	9,80
Against dollar	Japan	USD / JPY	147,25	145	140
	Canada	USD / CAD	1,35	1,35	1,30
	Australia	AUD / USD	0,64	0,66	0,70
	New Zealand	NZD / USD	0,59	0,58	0,62
	Brazil	USD / BRL	5,04	5,40	5,00
	Russia	USD / RUB	62,05	100,0	90,0
	India	USD / INR	82,44	82,0	80,0
	China	USD / CNY	7,27	7,30	7,00

Source : BNP Paribas, Refinitiv Datastream. As at 6 november 2022

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