NOVEMBER 2021

Investment Strategy Focus

Summary

1. **Strong earnings season, favourable seasonality for equities**: a very strong Q3 earnings season for US companies drives global equities to fresh all-time highs, led by a 20% earnings beat on average for banks. Positive Q4 seasonality continues to play out, while real yields remain solidly negative. Trend-following indicators suggest a continued positive stance on equities.

2. **Is the worst past for US, UK?** Economic surprise indices have rebounded to the zero line in both cases, underlining improvement in the macro environment from the September lows. The UK government forecasts a strong 2022e 6% growth rate, led by buoyant household consumption. We continue to believe that UK equities and bonds are attractive for the long term.

3. **Central banks are the greatest risk**: with the Bank of Canada flagging a likely rate rise in April 2022, markets are pricing in a higher risk of a policy mistake by central banks such as the US Fed. Markets seem to be overpricing in rate hikes in the US and UK, but we see overhasty rate hikes as the main danger to financial markets today.

4. **Everyone hates US Treasuries**: the consensus against US and Euro sovereign bonds is almost universal, and yet long-term bonds are surprisingly resilient. Note the 25 basis point decline in 10-year US real rates since late September, supporting real assets and equities.

5. **Taking profits on Indian equities**: we downgrade our Indian equities view to neutral from positive, after impressive outperformance versus Emerging Market equities since February.

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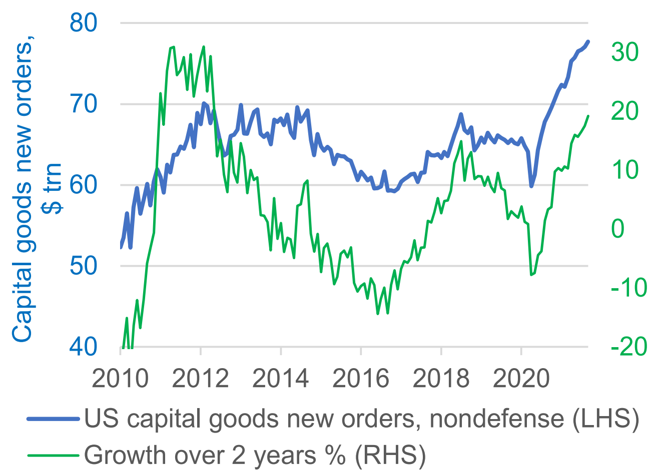
INVESTMENT ACCELERATES IN THE US



Source: Bloomberg

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BNP PARIBAS WEALTH MANAGEMENT

The bank for a changing world

The Big Picture

Supply chain disruptions to ease, UK economic projections revised up

Supply chain hit to economy is at its worst now: the combination of global supply chain disruptions from a lack of essential components, combined with logjams at US West Coast ports is likely having its peak effect on the global economy right now.

Companies in the US and Europe expect these supply chain difficulties to ease in Q4 and further in 2022, while the huge surge in energy prices is easing in Europe, also hopefully reducing the drag on the Euro economy. The ECRI US weekly leading economic indicator ticked up in October, suggesting that the worst of the short-term drag on the US economy is past us. More importantly, new orders indices remain very high, indicating no slowdown in demand.

Government and corporate investment ramps up: comparing US capital goods investment with 2 years ago (thus avoiding the lockdown disruptions), it is clear that corporate investment is accelerating as companies respond to supply chain disruptions.

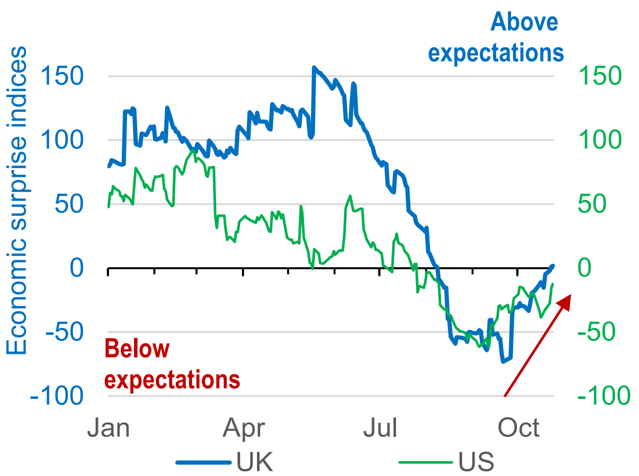
The key risk – central banks' overreaction to near-term inflation: with the Bank of Canada flagging a likely rate rise in April 2022, markets are pricing in a higher risk of a policy mistake by central banks such as the US Federal Reserve or the Bank of England.

The risk that inflation remains higher for longer is a clear and present danger, particularly in the US where even the Cleveland Fed trimmed-mean core CPI has risen to 3.5%. But, with supply chain disruptions set to improve and energy prices starting to fall, inflation may ease by early 2022.

In our view, the markets seem to be overpricing in rate hikes in the US and UK, with almost three 25bp rate hikes priced into US Fed Funds futures by the beginning of 2023. In contrast, we expect the Fed to raise rates by 25bp for the first time at end-2022, a far less aggressive pace.

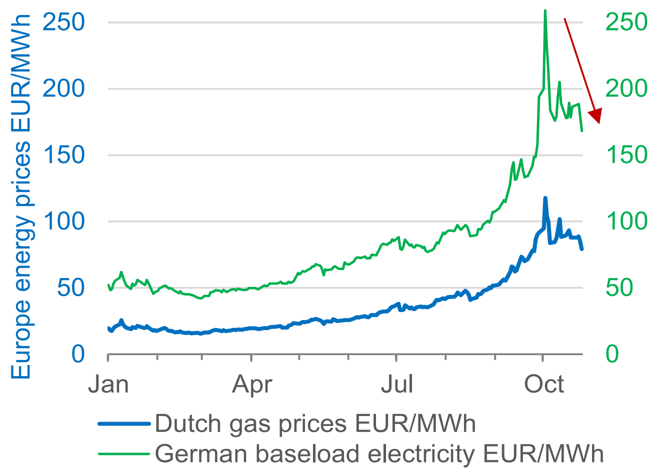
We see overhasty central bank rate hikes as the main danger to financial markets today.

US, UK MACRO ECONOMIC SURPRISE IMPROVES – PAST THE WORST



Source: Citigroup, Bloomberg

EUROPE ENERGY PRICES CONTINUE TO EASE FROM RECORD HIGHS



Source: Bloomberg

Macroeconomic momentum has waned over the last couple of months on the back of supply chain and energy price headwinds. However, final demand is holding up well, both in terms of household consumption and corporate investment. This comforts our robust 2022 growth forecasts. The main risk to our central scenario of robust nominal growth is over-aggressive central bank tightening.

Theme in Focus

Selective bubbles re-emerge

Animal spirits are alive and well: several of 2020's hot investment "memes" have rallied once again to new highs, highlighting investor euphoria in certain pockets of the financial markets. Two clear examples of this recurrent euphoria exist in the cryptocurrency and US mega-cap tech stock spaces.

Since May 2021, Tesla (in the NYSE FANG+ Index) has nearly doubled, while the Shiba Inu meme coin (SHIB) has risen more than 1,000% since the end of September.

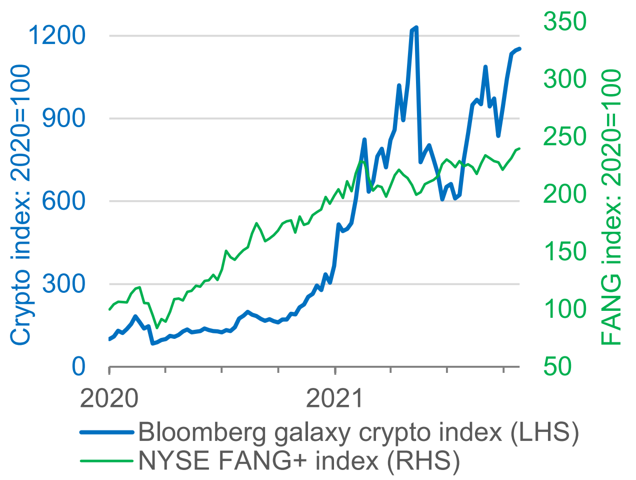
Cheap money is the driver: the underlying driver for this euphoria remains the very cheap cost of money, combined with enhanced unemployment benefits (which have now ended) and the issuance of "helicopter money" in the form of cheques mailed directly to qualifying US households.

These two examples raise the spectre of euphoric investment bubbles emerging once again – a sign in our view that investors should exercise some caution in risky assets.

But not all recent investment memes are working: though this euphoria seems to be very selective. The Renaissance IPO Index has traded sideways over 2021.

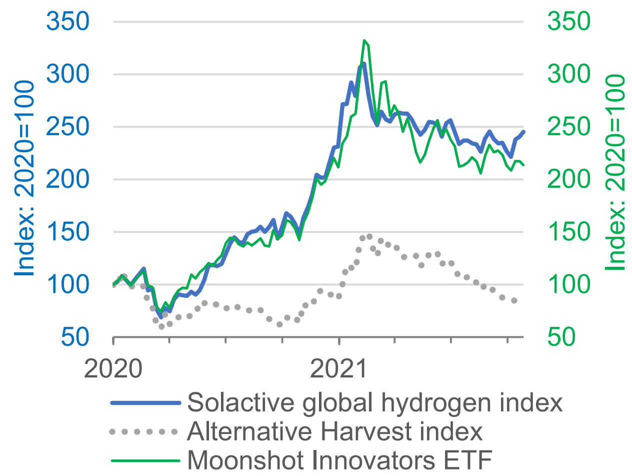
Social sentiment, alternative harvest, hydrogen themes have not reignited: equally well, other investment themes that enjoyed a sharp rise in early 2021 such as the social sentiment (an ETF that buys stocks mentioned often on social media), alternative harvest (cannabis stocks) and hydrogen indices have not rallied back. Rather, all three indices remain some way off their February 2021 highs. This is similarly true for hyper-growth ETFs, such as the ARK Innovation ETF and the Direxion Moonshot Innovators ETF.

CRYPTOCURRENCIES AND FANG STOCKS BACK TO THE HIGHS...



Source: BNP Paribas, Bloomberg

...BUT NOT ALL LATE 2020 INVESTMENT MEMES ARE WORKING TODAY



Source: BNP Paribas, Bloomberg

Selective reflation of potential investment bubbles in FANG+ stocks and cryptocurrencies do not point to widespread euphoric over-optimism across financial markets in general. Many other former investment memes from late 2020 have not recovered, and overall retail investor sentiment remains far from levels seen in 2000.

Equity and Commodities Outlook

The trend remains your friend

Equity markets progressed over October: a 3% gain in the US over the last month and modest gains in Europe, combined with a surprising 6% bounce in the Hong Kong Hang Seng Index fit with typical bullish Q4 seasonality.

Strong earnings momentum on the back of a bullish Q3 result season, allied with rising buybacks, negative real yields and boosted M&A activity are key drivers for stocks. The huge levels of cash savings still on the side-lines highlight the potential firepower that could still flow into stock markets in Q4 2021. The major risk to stock markets remains a shift in macro liquidity conditions on a tightening in global monetary policy.

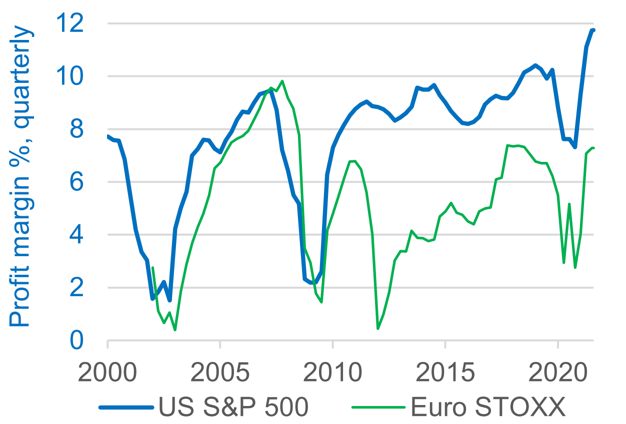
COP26 a catalyst for renewable energy: the COP24 and COP25 global climate conferences acted as a positive catalyst for clean energy stocks in 2018 and 2019. We expect COP26 to similarly refocus attention on clean energy stocks, after a cooling in renewable energy enthusiasm since February of this year.

Taking profits on Indian equities

We have decided to take profits on India largely due to the extremely strong price action, moving from Positive to Neutral. The Sensex has appreciated 52% over the last 12 months, and is the best-performing major equity market in the world in 2021. It trades at a record 60% premium to Asian stocks. The Sensex 30 Index trades at a 26x current year earnings and 22x next year earnings. Furthermore, higher energy prices and higher inflation will lead to RBI rate hikes as we are seeing globally.

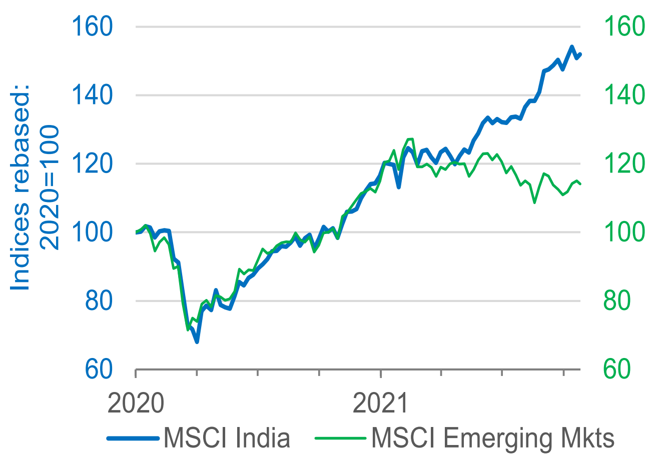
India's long-term fundamentals remain strong: i) improving business landscape under PM Modi; ii) young population – demographics key to growth in an ageing world; iii) lower levels of debt compared with other major countries; iv) large and growing domestic market, and v) strong culture of high return on equity with company returns. We would revisit the case on a market pullback. India also provides diversification potential from China with lower correlation.

US, EUROPE PROFIT MARGINS RISE IN Q3 2021 DESPITE COST PRESSURES



Source: BNP Paribas, Bloomberg

INDIAN EQUITIES HAVE FAR OUTSTRIPPED OTHER EMERGING MARKETS



Source: Bloomberg

Size works in Europe, EM and rallying back in US: smaller companies continue to outperform in Europe over the year-to-date (+23%), benefiting from stronger earnings outlooks and ongoing cyclical recovery. The MSCI EM Small Cap Index (mid-cap in reality) benefits from its bias to Taiwan and South Korea. We downgrade Indian equities to neutral from positive post an impressive outperformance.

Bond, Credit and FX Outlook

The consensus bets heavily against US Treasury bonds

US 2-year bond yields rally on Fed hike expectations: with the Bank of Canada flagging a likely rate rise in April 2022, markets are pricing in a higher risk of a policy mistake by major central banks.

Nearly three Fed rate hikes by end-2022 now priced by Fed funds futures: the implied US Fed Funds rate priced by the Fed Funds futures market now stands at 0.7% by the end of 2022, far above our expectation of just a single 25bp rate hike in Q4 2022. This is reflected in a US 2-year Treasury bond yield now above 0.5%, up nearly 40bp since mid-June.

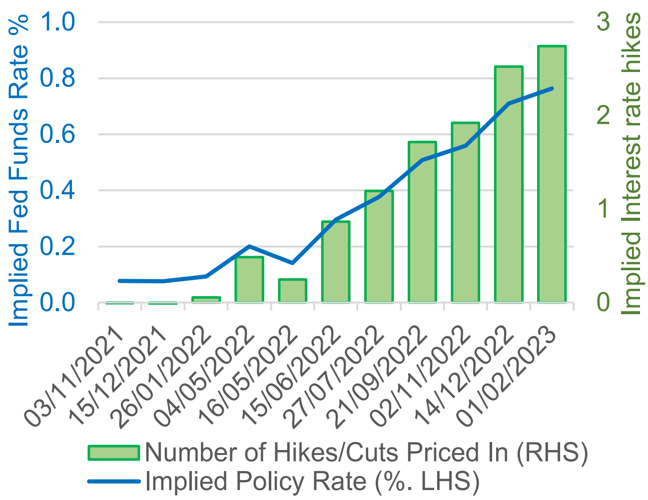
The bond market is clearly concerned that a 10-year inflation breakeven rate of nearly 2.7% and a core CPI inflation rate of around 4% could prompt the Fed to abandon its "transitory inflation" narrative and both taper bond purchases and hike rates faster than expected.

Credit recovery continues, reflected in tight spreads: Barclays US and European BBB credit spread indices remain around historic lows at 1%, reflecting the improving fundamentals among corporate borrowers.

Rising stars outpace fallen angels: according to S&P Global Market Intelligence, year-to-date the number of rising stars — companies upgraded from non-IG credit ratings to IG — has outpaced the number of fallen angels by seven to two. With the COVID-19 Delta variant on the wane in the US and most of Europe, this corporate balance sheet and cash flow improvement should continue over the months to come.

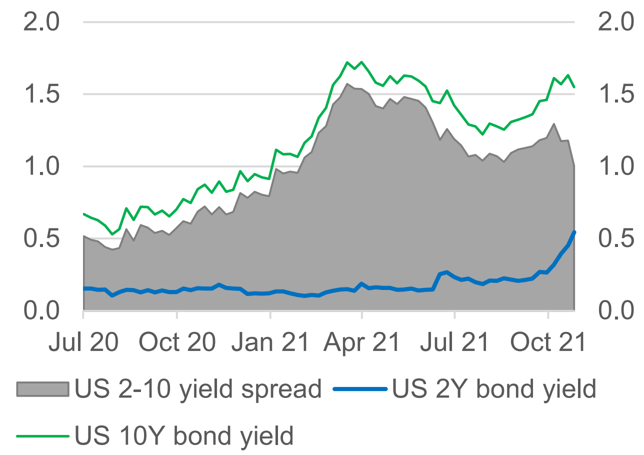
However one factor that should favour equity holders over corporate bond holders going forwards is the increased corporate emphasis on shareholder returns via dividends and share buybacks, plus greater merger & acquisition activity as companies seek growth.

US INTEREST RATE FUTURES PRICE NEARLY 3 RATE HIKES BY END-2022



Source: Bloomberg

US YIELD CURVE FLATTENS AS 2-YEAR BONDS PRICE IN EXPECTED RATE HIKES



Source: Bloomberg

While the bulk of the underperformance of developed market sovereign bonds may be behind us, it is still too early to change our negative stance on the asset class, in our view. Short-duration sovereign bonds now look far more attractive following the recent backing up of yields, but we await the latest inflation and employment data before reassessing our stance on this segment of the sovereign bond universe.

Summary of our main recommendations

	Current Recom	Prior Recom	Constituents	We like	We avoid	Comments
EQUITIES	+	+	Markets	EU, UK, Japan, EM: China, Taiwan, S.Korea, Brazil, Russia.		Historically low long-term real rates and accommodative financial conditions are supporting the upward trend in global stocks. We continue to recommend a more defensive sector stance for now.
			Sectors	Financials, Real Estate, Healthcare, Semicond, Construction Gold mines, EU Energy	Utilities, HPC	We have become more defensive in our sector allocation. We continue to recommend a more defensive sector stance for now, biased towards quality dividend/dividend growth strategies.
			Styles/ Themes	Megatrend themes		
BONDS	-	-	Govies	EM bonds (USD + local currency)	US long-term Treasuries and German Bunds	
			Segments	Peripheral euro and eurozone convertible. Fallen Angels.		
			Maturities	At benchmark		
CASH	=	=				
COMMO-DITIES	+	+		Gold		Gold faces headwinds (higher real rates, strong USD) but supply/demand dynamics remain favourable and it remains our preferred hedge asset. Industrial metals - We are Neutral as we expect lower demand from China in Q4 but MT prospects remain positive.
FOREX			EUR/USD			We adjust our EUR/USD target to USD1.18 (value of one euro) for the next 12 months.
ALTERNATIVE UCITS				Macro, relative-value and event-driven		

Economic, FX forecast tables

GDP Growth %	BNP Paribas Forecasts 2019	2020	2021	2022
United States	2.2	-3,5	6,9	4,7
Japan	0,3	-4,7	2,2	3,3
United Kingdom	1,5	-9,8	7,8	5,6
Eurozone	**1.3**	**-6,7**	**4,8**	**5,2**
Germany	0,6	-5,1	3,7	5,5
France	1,5	-8	6	4,6
Italy	0.3	-8,9	5,2	4,5
Emerging		**-4,7**	**5,6**	**5,2**
China	6,1	2,3	8,7	5,3
India*	4,2	-7,2	8,4	9,4
Brazil	1,1	-4,1	5,5	3
Russia	1,3	-4,5	4,5	3

* Fiscal year

Source: Refinitiv - BNP Paribas - CIB 22/06/2021

CPI Inflation %	BNP Paribas Forecasts 2019	2020	2021	2022
United States	1,8	1,2	3,9	2,7
Japan	0,5	0,0	0,0	0,2
United Kingdom	1,8	0,9	1,8	2,5
Eurozone	**1,2**	**0,3**	**2,1**	**1,8**
Germany	1,4	0,4	2,7	1,8
France	1,3	0,5	1,8	1,3
Italy	0,6	-0,1	1,5	1,9
Emerging		**3,9**	**4,9**	**4,3**
China	2.9	2,5	1,7	2,8
India*	4,8	6,1	5	5
Brazil	3,7	3,2	7,2	4,8
Russia	4,3	3,4	5,8	4,3

* Fiscal year

Source: Refinitiv - BNP Paribas - CIB 22/06/2021

	Country		Spot 07/11/2021	Trend	Target 3 months (vs. EUR)	Trend	Target 12 months (vs. EUR)
	United States	EUR / USD	1,158	Neutral	1,16	Neutral	1,18
	United Kingdom	EUR / GBP	0,850	Neutral	0,85	Neutral	0,84
	Japan	EUR / JPY	131,8	Positive	129	Neutral	131
	Switzerland	EUR / CHF	1,059	Negative	1,10	Negative	1,12
	Australia	EUR / AUD	1,559	Neutral	1,59	Neutral	1,55
	New-Zealand	EUR / NZD	1,630	Neutral	1,66	Neutral	1,62
	Canada	EUR / CAD	1,438	Neutral	1,45	Neutral	1,46
	Sweden	EUR / SEK	9,93	Neutral	10,00	Neutral	10,00
	Norway	EUR / NOK	9,86	Neutral	9,75	Positive	9,60
Asia	China	EUR / CNY	7,410	Neutral	7,54	Negative	7,67
Asia	India	EUR / INR	86,49	Neutral	88,16	Negative	92,04
Latam	Brazil	EUR / BRL	6,582	Positive	6,38	Positive	6,20
EMEA	Russia	EUR / RUB	82,99	Positive	78,88	Positive	80,24

Source: BNP Paribas, Refinitiv Datastream

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