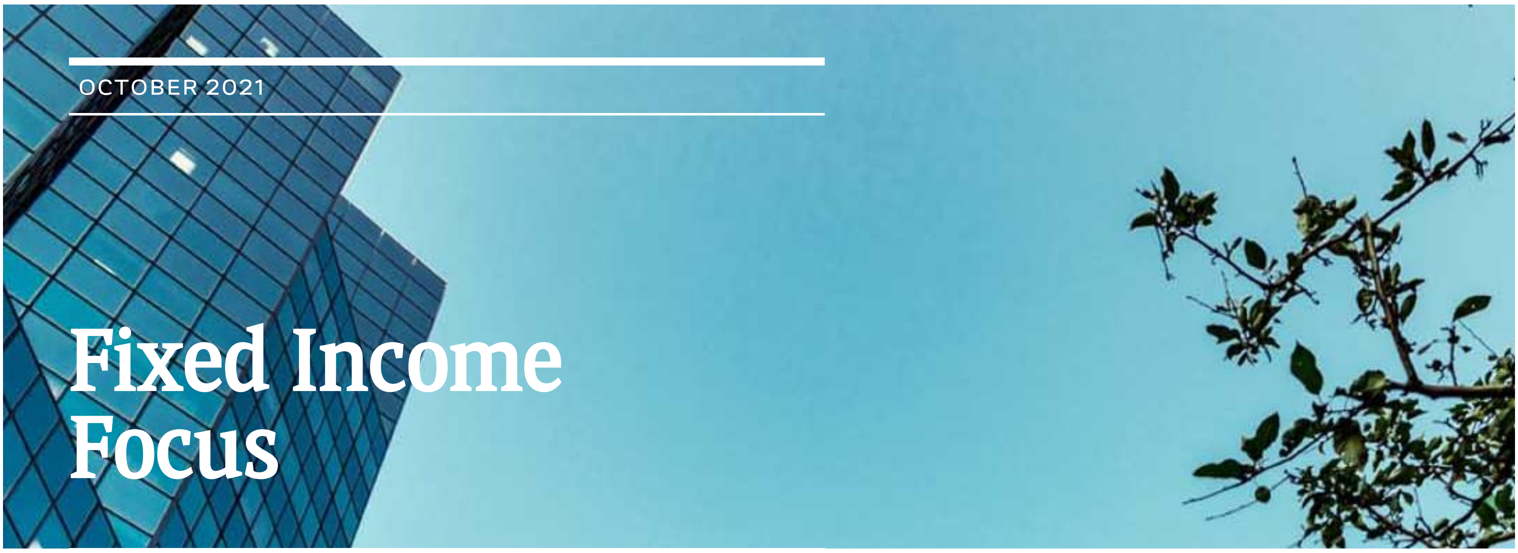


OCTOBER 2021

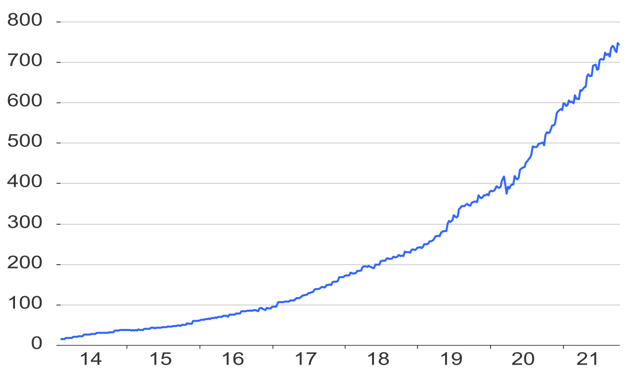
Fixed Income Focus

Summary

1. **The ECB has recalibrated its asset purchase programme. Further announcements are expected at the December monetary policy meeting. The goal is to keep financial conditions favourable over the long term.** The ECB is seeking to limit any excessively rapid rise in long-term interest rates and any spike in interest rate spreads between eurozone countries.
2. **The Fed is likely to gradually phase out its emergency support measures, which will mean starting to reduce (from the end of the year) the amount it buys on the market every month.** Long-term interest rates should continue to rise. We have a negative view on US long-term Government bonds.
3. **The rise in long-term rates is set to continue.** Our targets are 2% in the US and 0% in Germany in 12 months.
4. **EM hard currency Sovereign bonds (dollar for the vast majority) have suffered in recent weeks.** Economic recovery, the search for yield and attractive valuations relative to other asset classes should support EM hard currency bonds.

Contents

THE GREEN BOND MARKET IS BOOMING (USD BN)



Source: Refinitiv Datastream, 12/10/2021

Edouard Desbonnets
Investment Advisor, Fixed Income
BNP Paribas Wealth Management

BNP PARIBAS WEALTH MANAGEMENT

The bank for a changing world

Central banks

Divergence

European Central Bank (ECB)

The rise in inflation and the resolve of some ECB members to revise up their inflation forecasts for 2023 mean that the markets are now anticipating an increase in the ECB deposit rate from the end of 2022. We think this scenario is unlikely.

Next key date: 16 December. This meeting should outline the new post-pandemic monetary policy.

The ECB is expected to announce the end of the Pandemic Emergency Purchasing Programme (PEPP), launched during the health crisis, taking effect from the end of March 2022.

In a bid to avoid any market turmoil (rising bond yields, spread widening, etc.), the ECB could increase its existing traditional Asset Purchase Programme (APP).

An alternative is that the ECB could introduce a new asset purchase programme, in addition to the APP, which would not be linked to the distribution of capital key to the ECB. However, it is questionable whether this programme is legal.

US Federal Reserve (Fed)

The latest jobs report, which is widely followed by Fed members, was not amazing, but not bad enough to prevent the Fed from phasing out its emergency measures, i.e. begin reducing the amount of its monthly asset purchases (tapering).

Next key date: 3 November. The monetary policy meeting when the Fed is expected to announce the above decision, with implementation the following month.

First, tapering would end around June 2022, according to Jerome Powell. Second, the Fed would continue to reinvest maturing bonds. Its balance sheet would therefore be kept more or less at the current level.

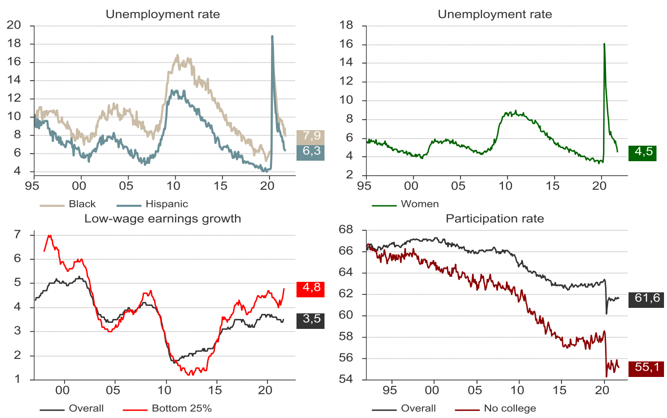
Tapering would therefore be a little faster than expected, probably because the Fed wants to have free rein to raise its key rates, in case inflation proves to last longer than expected.

We expect a first rate hike in Q4 2022.

THE MARKETS EXPECT A RISE IN THE DEPOSIT RATE FROM THE END OF 2022 (BASIS POINTS)

Source: Refinitiv Datastream, 11/10/2021

IMPROVEMENT IN MOST JOB MARKET INDICATORS FOLLOWED BY THE FED



Source: Refinitiv Datastream, sept. 21

CONCLUSION

The Fed is expected to phase out its emergency support measures, i.e. begin to reduce (at the end of the year) the amount of bonds it buys on the market every month (tapering). The ECB is expected to stop its emergency asset purchase programme in March 2022, but is considering several options to prevent any tightening of financial conditions.

Bond yields

Rising long-term rates

Long-term rates continued to rise last month, driven by inflationary pressures and central banks talking about reducing extraordinary monetary support during the pandemic. US real rates could also rise accordingly, as the Fed has particularly distorted the market price of inflation-linked bonds by intervening in this relatively illiquid market.

10-year bond yields are closer to our 12-month targets, namely 2% on the US rate (currently 1.58%) and 0% on the German rate (currently -0.10%).

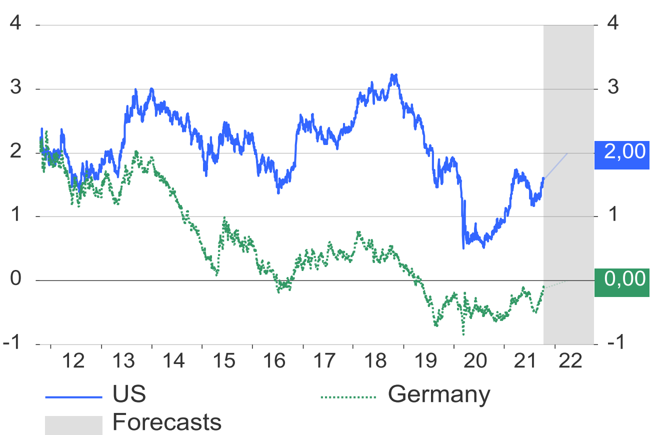
Steady growth, the persistent inflationary risk and the Fed's monetary policy should push up yields in the US, but also in the eurozone (albeit to a lesser extent) as the ECB remains very active in the bond market.

Progress may not be plain sailing. At 1.6%, the US 10-year Treasury yield is attractive to international investors, even taking into account the cost of currency hedging.

	Maturity (in years)	12/10/2021	12-month targets
United States	2	0.35	0.60
	5	1.07	1.25
	10	1.58	2
	30	2.11	2.60
Germany	2	-0.67	-0.50
	5	-0.48	-0.30
	10	-0.10	0
	30	0.40	0.50
United Kingdom	2	0.56	0.60
	5	0.78	0.80
	10	1.15	1.20
	30	1.45	1.50

Source: Refinitiv Datastream, BNP Paribas WM

10-YEAR RATES



Source: Refinitiv Datastream, 13/10/2021

CONCLUSION

Steady growth, the persistent inflationary risk and the Fed's monetary policy should push up yields in the US, but also (to a lesser extent) in the eurozone.

Theme in Focus

EM hard currency bonds

EM hard currency Sovereign bonds (dollar for the vast majority) have plunged over the last four weeks, from a YTD performance (since 1 January) of +0.3% in mid-September to -2.9% in mid-October.

They significantly underperformed US High Yield corporate bonds (+3.8% YTD) and barely outperformed developed markets: US (-2.9%), Eurozone countries (-3.3%).

The rapid rise in US yields and the dollar, leading to a higher cost of debt for Emerging Market countries, has hurt Emerging Market bonds.

EM hard currency Corporate bonds also suffered. The YTD performance moved into negative territory this month (-2.2% according to the Bloomberg Barclays index - NB the equivalent JPM index remained positive at +0.4% YTD).

Risk appetite has diminished recently due to the defaults by two major Chinese property developers.

In fact, China posted the worst performance in the Corporate bond index (-10% YTD), while it was among the best in the Sovereign index (+1% YTD).

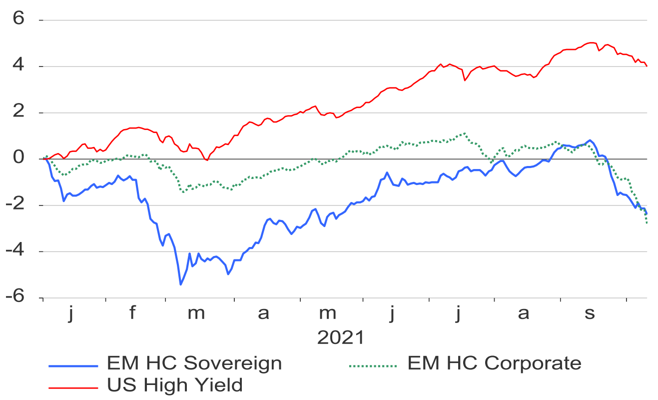
We believe that the recent weakness in EM hard currency bonds is a buying opportunity. Valuations are relatively attractive relative to other asset classes. Emerging Market bonds have not yet fully benefited from the economic recovery, unlike other asset classes. We expect spreads to tighten as economic activity picks up. This should help absorb some of the impact of rising US rates.

Soaring commodity prices are, on average, a positive factor for Emerging Market assets.

While 19% of global bonds are carrying negative yields, Emerging Market bonds have a positive yield to maturity of close to 5%.

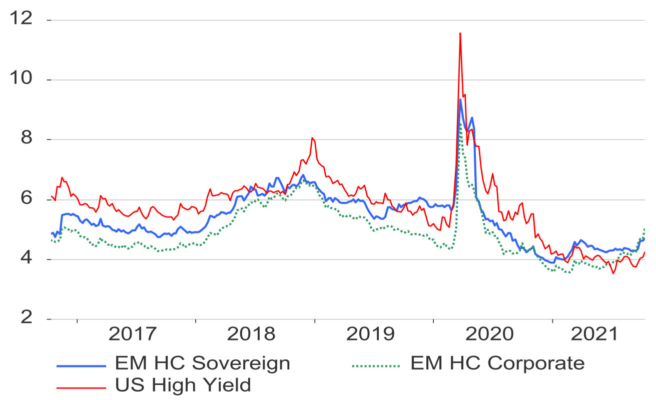
The ability of Emerging Market countries to roll out the COVID vaccine will be key.

PERFORMANCE YEAR TO DATE (%)



Source: Refinitiv Datastream, 12/10/2021

YIELD TO MATURITY (%)



Source: Refinitiv Datastream, 12/10/2021

CONCLUSION

EM hard currency Sovereign bonds (dollar for the vast majority) have suffered in recent weeks. Economic recovery, the search for yield and attractive valuations relative to other asset classes should support EM hard currency bonds.

Our Investment Recommendations

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

Market data

	10-year rate (%)	Spread (bps)	Spread change 1 month (bps)
United States	1.58	---	
Germany	-0.10	---	
France	0.24	33	0
Italy	0.92	101	-2
Spain	0.53	63	-5
Portugal	0.41	51	-6
Greece	0.94	103	-8

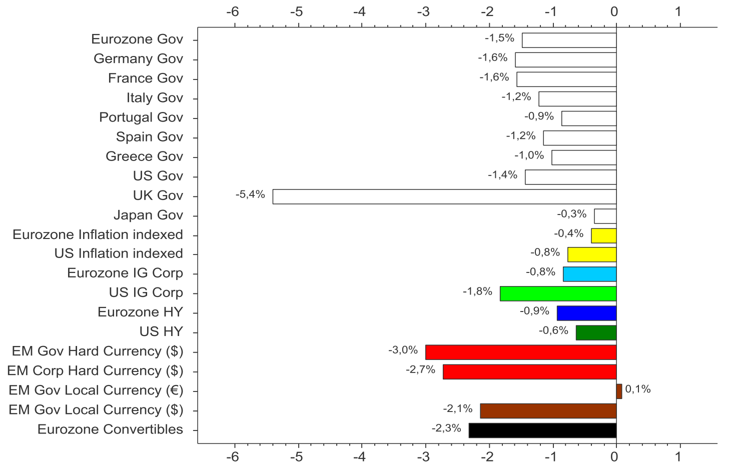
12/10/2021
Source: Refinitiv Datastream

	Yield (%)	Spread (bps)	Spread change 1 month (bps)
Global	1.24	33	-1
Corporate bonds IG EUR	0.44	87	+3
Corporate bonds IG USD	2.20	87	+1
Corporate bonds HY EUR	3.38	326	+44
Corporate bonds HY USD	4.27	300	+21
Emerging government bonds in hard currency	4.70	324	+20
Emerging corporate bonds in hard currency	5.07	406	+61
Emerging government bonds in local currency	3.80	273	-8

12/10/2021
Source: Refinitiv Datastream, Bloomberg Barclays

Returns

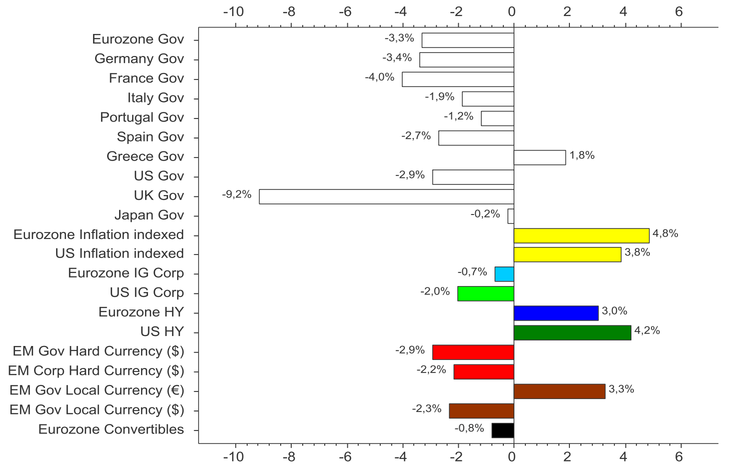
OVER ONE MONTH



Source: Refinitiv Datastream, 11/10/2021 Source: Bloomberg Barclays indices exept Convertibles (Exane)

EM = Emerging Markets

SINCE 01/01/2021



Source: Refinitiv Datastream, 11/10/2021 Source: Bloomberg Barclays indices exept Convertibles (Exane)

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