JULY 2020

Investment Strategy

By Florent Brones
Chief Investment Officer

. The Covid-19 pandemic is not over, the authorities are putting in place local health measures that will be effective in limiting the economic impact. In our scenario, there will be no new widespread lockdown but no vaccine will be available before the second half of 2021 at the earliest.

Our scenario, confirmed by the leading indicators, is a recovery of the global economy with a U-shaped pattern. Reflationary economic policies are widespread. A €750 billion European recovery plan was announced this summer.

. Monetary policies will remain accommodative, interest rates will remain low for a long while and long-term inflationary expectations are beginning to rise again.

We are changing our targets on the dollar to 1.16 in 3 months and to 1.22 in 12 months against the euro.

. On the equity markets we are bullish over the long term and we stick to our "buy on dips" strategy. A consolidation will provide an opportunity to strengthen positions.

The COVID-19 Pandemic

In recent weeks, the number of new infections has grown again in Europe but has declined in the United States. In most mature economies where testing is now commonplace, these new infections primarily concern young people, and the number of people admitted to hospital (and especially deaths) remains stable. The situation is serious though, and health authorities are putting in place local measures. The latter have proved effective in curbing the spread of the virus in Asia, and we believe they will also pay off in the US and Europe.

Our baseline scenario is that Covid-19 will continue to have a significant economic impact on several sectors, but the authorities will not resort to general lockdown measures, as the economic cost is too high. Two more extreme scenarios exist: a positive scenario in which a vaccine becomes widely available earlier than expected (in 6 to 12 months in our baseline scenario), and a negative scenario in which a second wave of infections in the autumn leads to widespread lockdown measures.

Thanks to reflationary policies, we stick to our U-shaped recovery scenario

The signs of a pick-up in economic activity are clear; as soon as lockdowns were eased, economic activity mechanically rebounded. All leading indicators of activity (the ISM in the United States, the PMI in Europe and Asia) confirm this point.

Central banks and governments are pursuing very active stimulus policies and the scale of plans and liquidity injections is unprecedented. The €750 billion European stimulus package was announced this summer; it will have a major long-term impact on investment in several areas. Economies are recovering, but stimulus will take time before it has a full effect. In addition, certain sectors (tourism, airlines, etc.) are still hampered by the pandemic. Hence the idea of a U-shaped profile for the economic rebound (underway), which will continue into 2021.

In the present environment, consumers remain cautious and the level of precautionary savings accumulated during the health crisis is high. In the same way, companies have put a break on their investment programmes. Economic agents will need time to return to their pre-crisis behaviour.

The trend on the equity markets remains positive; we stick to our “buy on dips” strategy

Although economic growth and corporate earnings have been sharply down this year, the global stock markets have reached a new record, driven by a handful of large technology stocks. Equity markets anticipate that fiscal and monetary stimulus policies, and a vaccine (which will arrive sooner or later depending on the scenario) will allow economies to return to their previous growth path. That said, because interest rates are very low, and negative in real terms, ‘there is no alternative’ to equities. This is the famous ‘TINA’. These positive factors for equity markets are in place, and will remain so for a long time.

Yet the outperformance of the US market over the past few quarters is due to the stellar performance of a small number of technology stocks whose companies often have a quasi-monopoly on their respective markets. The fall in the dollar, which we will discuss below, was also a supporting factor.

If this positive phase on stock markets is to continue, changes in fundamentals must confirm the anticipation of an economic recovery, a rebound in profits and continued flows into equity markets.

This confirmation will come, but it will take time, and a consolidation should ideally bring stock markets back to their 200-day moving averages, i.e. a consolidation of around 10% (it started two days ago at the time of writing). The reasons for this consolidation may be manifold: excessive optimism at the moment, little cash in institutional portfolios according to the surveys, a tense environment in the run-up to the US presidential election and US-Sino tensions.

It will also be necessary for stock market leadership to expand (our scenario). That is to say, the rise in the stock markets will not be dominated by a small number of stocks. The sectors likely to rebound are cyclicals, in particular energy (especially in Europe), materials, health care (excluding pharmaceuticals, on which we are neutral) and insurance. No change to our country recommendations; we are positive on the US, the eurozone and the emerging markets.

Awaiting the consolidation which will provide another opportunity to strengthen positions

Positive factors have dominated the markets in recent days. Observers often say that if further problems arise, monetary authorities and governments would intervene again, and ultimately, the economic recovery and the rebound in profits would support the stock markets. This market expectation incorporates a ‘perfect’ scenario. However we fear that the reality will be complicated by risks of corporate defaults, the challenge of completely eradicating the virus without a vaccine or treatment, the American elections and international tensions. Equity markets are expensive, and will be sensitive to bad news. But it is clear that liquidity is abundant and with interest rates close to zero, and negative in Europe and Japan, equities are the asset to favour in the long term. In our scenario, a U-shaped growth trend will accelerate in 2021. The markets are moving too fast today, in our view.

Changes this month:

We are revising our targets on the dollar to 1.16 in 3 months and to 1.22 in 12 months against the euro. Interest rate spreads narrowed significantly during the Covid-19 crisis with a massive drop in Fed rates to 0. Yet the dollar did not fall during this phase as it played a safe haven role. Moreover, international demand for the dollar has been strong, with the Fed supporting it by increasing swap agreements with non-American central banks. Since June, the health situation and economic situation have stabilised, and fundamentals have regained the upper hand, pushing the dollar sharply up from 1.08 to 1.20 against the euro. We are revising our targets, to 1.16 in 3 months (a consolidation will be logical after such a move) and to 1.22 in 12 months. We maintain our scenario of a moderate decline in the greenback against the euro, bringing it back towards its Purchasing Power Parity (PPP): the fundamental equilibrium value of the dollar against the euro is at 1.36 according to the OECD.

We expect a $1900/2100 range for an ounce of gold in 12 months. In the context of the rise in gold, we revised up our targets in August (see flash of 7 August) as the factors pushing up the yellow metal are unchanged: low real rates, long-term anticipations of a rise in inflation, and a search for a risk absorber to decorrelate from the stock markets.

In Asia, we extend our positive recommendations to Indonesia

Equities

Global	●	• **A period of vulnerability lies ahead.** We have now entered a phase when fundamentals will have to validate high expectations. • **Take advantage of market movements down towards the 200-day moving average to buy**. Downside risks are deemed to be limited: the global economy is on healing path, the worst is behind concerning earnings hits and vaccine news should become increasingly promising.
Markets	●	• **No end in sight for US outperformance.** The relative uptrend remains fully intact. • **Invest in Euro Area stocks:** good potential for a reduction in the risk premium. • **Staying medium-term neutral on UK stocks.** • **Confirming our buy rating on Emerging Markets.** The superior earnings outlook and potential for a narrowing of the valuation discount are the main reasons. We add the Indonesia to the list of markets that we favour. It includes China, Taiwan, South Korea, India and Singapore.
Sectors	●	• **Positive on Materials and Insurance.** • We are positive on Healthcare except on Pharmaceuticals. • **In Europe: positive on Technology and Energy.**

Bonds

Govies	●	• We are **negative on German govies**, whatever the maturity, and on long-term US govies. • We are **positive on the front-end of the US yield curve for USD-based investors** as short-term yields have limited upside. • We **are positive on periphery debt** (Portugal, Italy, Spain, Greece) **on a buy on weakness strategy**.
Investment Grades	●	• We **prefer corporate bonds** over government bonds. • We **like EUR and US IG bonds with a duration at benchmark** (5 and 8 years, respectively). • We are **positive on eurozone convertible bonds.**
High Yield	●	• **We are neutral on both US and eurozone HY.**
Emerging	●	• **We are positive on EM local currency bonds,** for both USD and EUR based investors, and **neutral on EM hard currency bonds (sovereigns and corporates).**

Forex

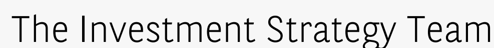
EURUSD	●	• **We revised our 3 and 12-month targets respectively to 1.16 and 1.22 as we see further US dollar weakness medium-term.**
USDJPY	●	• **We revised our 12-month target to 102 (from 106) reflecting our bearish view on the USD. Following the strong rally, we do not see further appreciation medium-term.**
G10 Com Scandanivian Currencies	●	• **We keep our bullish view on the NOK versus EUR (10.10), however, we see the SEK falling back to 10.50 medium-term (for one euro).**

Commos

Oil	●	• Reduced investments in the shale oil industry but also in classical oil fields will weight progressively on the production. With the OPEC+ production cuts and the demand recovery, Brent prices should move in the upper part of the $45-55 expected trading range for H2 2020 and should rise above in 2021.
Gold	●	• Real interest rates should remain extremely low for an extended period. Gold is seen as a refuge from 'unfettered currency printing". We revise upwards our expected trading range to $1900/2100/oz for the coming 12 months.
Base Metals	●	• Demand is slowly recovering with the reopening of the economies lead by China, the leading buyer, thanks to infrastructure spending and other stimuli. Copper and Nickel are the more promising metals.

Alternatives

Real Estate	●	• Positive for a 'value-added' commercial investment strategy, executed by first-class asset managers. Neutral on REITs with 'long-only' strategies, irrespective of geography.
Alt. UCITS	●	• **We upgrade Relative value to positive and downgrade Event-Driven to neutral.** Positive on relative-value, Macro and Long-Short equity.



The Investment Strategy Team

France

Florent BRONES
Chief Investment Officer

Asia

Prashant BHAYANI
Chief Investment Officer, Asia
Grace TAM
Chief Investment Advisor Asia

Belgium

Philippe GIJSELS
Chief Investment Advisor
Xavier TIMMERMANS
Senior Investment Strategy, PRB
Alain GERARD
Senior Investment Advisor, Equities
Pol Tansens
Head of Real Estate Strategy

Luxembourg

Guy ERTZ
Chief Investment Advisor
Edouard DESBONNETS
Investment Advisor, Fixed Income

Switzerland

Roger Keller
Chief Investment Officer

Follow-us

@BNPP_Wealth

bnp-paribas-wealth-management

Elite Entrepreneurs

wealthmanagement.bnpparibas/fr

Voice of Wealth

Disclaimer

This marketing document is communicated by the Wealth Management Métier of BNP Paribas, a French Société Anonyme, Head Office 16 boulevard des Italiens, 75009 Paris, France, registered under number 662 042 449 RCS Paris, registered in France as a bank with the French Autorité de Contrôle Prudentiel et de résolution (ACPR) and regulated by the French Autorité des Marchés Financiers (AMF). As marketing material, it has not been prepared in accordance with legal and regulatory requirements aimed at ensuring the independence of investment research and is not subject to any prohibition on dealing ahead of its dissemination. It has not been submitted to the AMF or any other market authority.

This document is confidential and intended solely for the use of BNP Paribas SA, BNP Paribas Wealth Management SA or their affiliates ("BNP Paribas") and the persons to whom this document has been delivered. It may not be distributed, published, reproduced or disclosed by any recipient to any other person, nor may it be quoted or referred to in any document, without the prior consent of BNP Paribas.

This document is provided solely for information and shall not constitute an offer or solicitation in any state or jurisdiction in which such an offer or solicitation is not authorized, or to any person to whom it is unlawful to make such offer, solicitation or sale. It is not, and under no circumstances is it to be construed as, a prospectus.

Although the information provided herein may have been obtained from published or unpublished sources considered to be reliable and while all reasonable care has been taken in the preparation of this document, BNP Paribas does not make any representation or warranty, express or implied, as to its accuracy or completeness and does not accept responsibility for any inaccuracy, error or omission. BNP Paribas gives no warranty, guarantee or representation as to the expected or projected success, profitability, return, performance, result, effect, consequence or benefit (either legal, regulatory, tax, financial, accounting or otherwise) of any product or transaction. Investors should not place undue reliance on any theoretical historical information regarding such theoretical historical performance. This document may contain or refer to past performance; past performance is no guarantee for future performance.

The information contained in this document has been drafted without prior knowledge of your personal circumstances, including your financial position, risk profile and investment objectives.Prior to entering into a transaction each investor should fully understand the financial risks, including any market risk associated with the issuer, the merits and the suitability of investing in any product and consult with his or her own legal, tax, financial and accounting advisors before making his or her investment. Investors should be in a position to fully understand the features of the transaction and, in the absence of any provision to the contrary, be financially able to bear a loss of their investment and willing to accept such risk. Investors should always keep in mind that the value of investments and any income from them may go down as well as up and that past performance should not be seen as an indication of future performance. Any investment in a product described herein is subject to the prior reading and understanding of the legal documentation concerning the product, and in particular the one which describes in details the rights and obligations of investors as well as the risks inherent to an investment in the product. Save as otherwise expressly agreed in writing, BNP Paribas is not acting as financial adviser or fiduciary of the investor in any transaction. The information, opinions and projections expressed herein reflect the opinion of their author at the time of writing; they are not to be relied upon as authoritative or taken in substitution for the exercise of judgment by anyone, and are subject to change without notice. Neither BNP Paribas nor any BNP Paribas Group entity accepts any liability whatsoever for any consequences that may arise from the use of information, opinions or projections contained herein.

As distributor of the products described herein, BNP Paribas may receive distribution fees on which you can obtain more information upon specific request. BNP Paribas, their employees or administrators may hold positions in these products or have dealings with their issuers.

By accepting this document, you agree to be bound by the foregoing limitations.

© BNP Paribas (2018). Tous droits réservés.

Picture From Getty Images