

Investment Strategy Focus

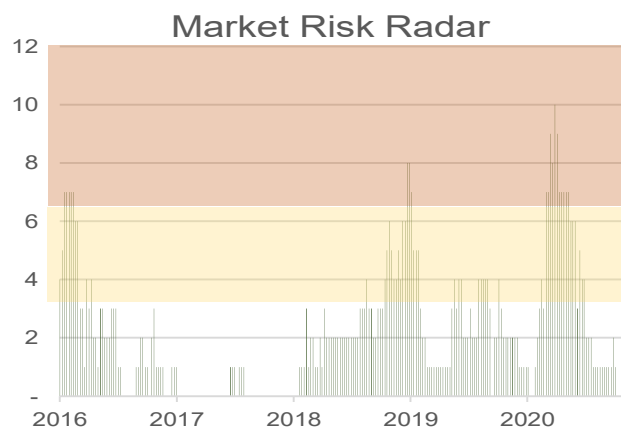
Summary

- Risk-on backdrop:** the BNP Paribas WM Risk Radar scorecard for December is at 0 out of 12, suggesting a favourable backdrop for risk assets overall. Favour equities and commodities.
- Positive Global Macro momentum:** European and Chinese economies surprise to the upside, in line with bullish corporate earnings revisions. Cyclical sector exposure preferred.
- Expecting higher US Treasury yields in 2021:** we raise our end-2021 forecast for US 10-year Treasury yields to 1.4% (1.25% previously), suggesting a negative 12m return on Treasuries.
- Desperation for yield benefits fallen angels, hard currency EM sovereign bonds:** US High Yield spreads have contracted to 4.2%, the tightest level since March this year. We like higher-yielding EM bonds and credit.
- US dollar continues to hit new lows:** We forecast a higher EUR/USD at \$1.25 at end-2021 (\$1.22 previously), with Chinese renminbi and euro among the key winners.
- Gold and silver pause despite weaker USD:** Gold and silver are pausing for breath after a very strong 2020 to date for both. Precious metals and miners are one of our key convictions into 2021.
- Small- and mid-caps continue to shine:** Both in the US and Europe, smaller companies lead the way. Prefer SMID exposure in European equities.
- Is a Brexit deal near?** 11th-hour talks between the EU and the UK could well result in a “skinny” deal, avoiding a disruptive no-deal cliff edge. UK assets could be finally attractive.

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RISK RADAR AT 0: UNDERLINES RISK-ON BACKDROP



Source: BNP Paribas Wealth Management
 Note: Risk Radar composed of 12 separate components for risk and volatility, covering equities, bonds, FX and economic series

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 BNP Paribas Wealth Management



The Big Picture

Optimism for 2021, but beware politics

Vaccine announcements trigger optimism: even as the world's Covid-19 infection rate continues to rise, global equity markets have posted a 10% rise since the end of October, boosted by positive Phase III Covid vaccine trial news from Pfizer/BioNTech and Moderna.

Economic momentum strong globally: surprisingly, despite the economic drag from a second round of lockdowns in several major European countries, economic surprise indices remain solidly in positive territory, highlighting that current economic data are consistently coming out above the expectations of economists.

Near-term economic risks remain: but not all is rosy in the global economic garden. In Europe, both Hungary and Poland are threatening to block EUR 1.8 trillion of EU jointly-funded Recovery Fund spending unless a clause linking budget transfers to the Rule of Law is changed. This could delay an expected increase in EU spending on infrastructure, notably in the renewable energy space.

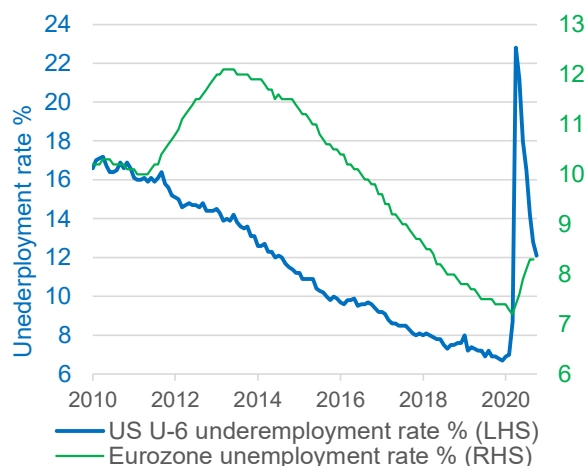
US aid programmes expire before end-2020: in the US, economic risks remain in the form of aid programmes that are due to expire in late December, which if not extended by President Trump, could result in much lower economic momentum in Q1 2021.

For this reason, the International Monetary Fund continues to warn that "the [global economic] recovery may be losing momentum", and as a result, "uncertainty and risks are exceptionally high".

Central bank support is key: the lack of inflation and the rising waves of Coronavirus infections continue to give the US Federal Reserve and the ECB good reasons for continuing to support the economy via continued unconventional monetary policy, with M2 money supply at record highs as a result.

December's ECB meeting should see further help being extended to the eurozone economy in the form of further Targeted Longer-Term Refinancing Operations (TLTROs) and an expanded Pandemic Emergency Purchase Programme (PEPP).

US UNDEREMPLOYMENT FALLS, BUT STILL HIGH



Source: Refinitiv Datastream

MONEY SUPPLY GROWTH HAS ACCELERATED IN 2020



Source: Refinitiv Datastream

CONCLUSION

We maintain an optimistic outlook for strong global economic growth in 2021, supported by pent-up consumption, strong housing demand and substantial monetary and fiscal stimulus.

But we keep a watchful eye on potential risks to the recovery from political discord in the US and Europe.



Theme in Focus

After a record November for stocks, what might come next?

The facts: at a 12.8% gain, November 2020 saw the biggest rise for the MSCI World index (in USD) since 1980.

The context: against the backdrop of a sustained recovery in stock markets from the Coronavirus-inspired bear market, the news of 3 Coronavirus vaccines posting high efficacy rates in Phase III trials, plus the expected start of mass vaccination in Europe and the US before the end of this year, has fuelled a surge of optimism in financial markets.

Economic growth forecasts remain high: global GDP growth of over 5% is expected for 2021 according to consensus forecasts, resulting from a sharp expected recovery in investment and consumer spending post-lockdowns.

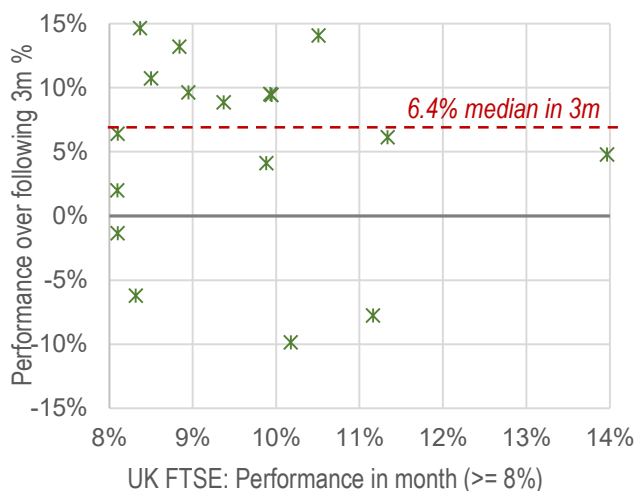
The concern: after such an amazing surge in stock markets in November, and a 44% rise in the MSCI World index (in USD) to date since end-March 2020,

should investors sell equity exposure to take profits?

A historical guide: after a calendar month gain of 8% or more (on 19 occasions over 1980-2020), the MSCI World index has gained an additional 6.5% on average over the following 3 months, and 12.6% on average over the following 6 months, rising 15 out of 19 times over these subsequent time periods.

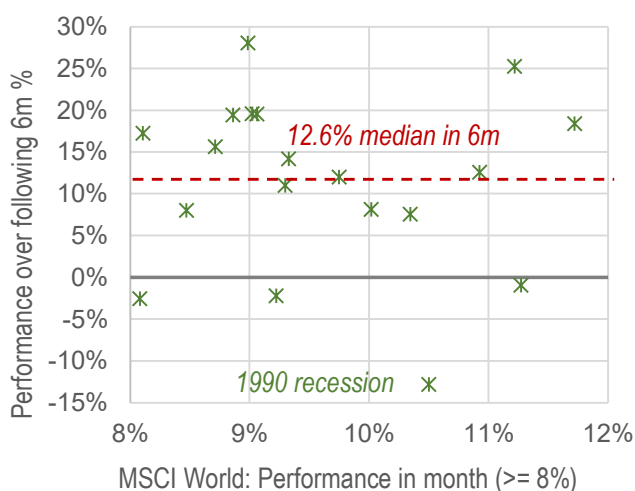
Where has been the strongest?: the countries/regions that have historically posted the best subsequent 3- and 6-month performance following such strong calendar months include the MSCI Emerging Markets, the French CAC-40 and the UK FTSE 100. Our regional preferences in equities are Emerging Markets (with a focus on Asia), Japan and the eurozone.

POST 8%+ MONTHLY RISE, UK FTSE HAS GAINED AN AVERAGE 6% MORE OVER 3M



Source: BNP Paribas, Refinitiv Datastream

POST 8%+ MONTHLY RISE, MSCI WORLD HAS GAINED AN AVERAGE 13% MORE OVER 6M



Source: BNP Paribas, Refinitiv Datastream

CONCLUSION

As we expect continued volatility in stocks over the year-end holiday period, be selective in cyclical sector exposure (we prefer the Mining, Construction and Industrial sectors over Travel & Leisure and Banks).

History suggests that investors reducing equity exposure now may miss out on further gains over the next six to twelve months.



Equity and Commodities

Finally, retail investors buy the equity story

Equity flows turn positive at last: the 3 weeks ending 24 November saw over USD 22bn of net inflows into US-based equity funds and ETFs, representing the biggest such 3-week inflow in 2020, according to the Investment Company Institute.

But remember that year-to-date (to end-Nov), investors have been selling into the equity bull market, to the tune of nearly USD 400bn in cumulative outflows from US-based equity funds/ETFs. There is thus plenty of scope to see equity fund buying catch up with the current extremely bullish sentiment readings.

Focus on Japan as a cyclical value market: there has been an enormous rotation out of growth and into value across the world stock markets in November. We upgrade Japanese equities to overweight, as one of the best expressions of “forgotten value”. Investors are still paying little attention to this market even as it breaks out to a new multi-decade high.

JAPAN IS AN EXCELLENT CYCLICAL VALUE INDEX



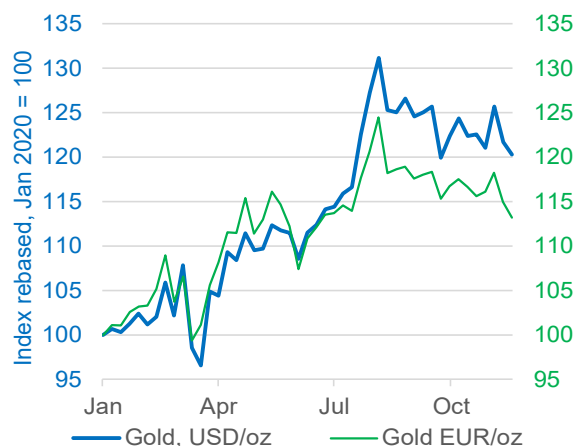
Source: Refinitiv Datastream

No let-up in the Clean Energy revolution: the ESG space continues to draw heavy investor inflows, with a focus on renewable energy given government infrastructure initiatives in this space. The S&P Global Clean Energy index, encompassing leaders in solar, wind, and hydrogen electricity production as well as investments in industrial battery storage has now gained over 150% since the start of 2019, far outstripping the MSCI World index.

Precious metals pause for breath, for now: one asset that has been a direct beneficiary of the weakening US dollar is gold, which even after the recent pullback, has posted returns over 2020 to date of 20% in US dollars and 13% in euros.

We view gold as an essential diversifying asset in a balanced portfolio, helping to diversify away from dominant equity risk at a time when traditional sovereign bonds are becoming less effective in this diversification role.

GOLD MARKS A PAUSE POST BIG 2020 RALLY



Source: Refinitiv Datastream

CONCLUSION

We remain bullish on equities, with a focus on cyclical value via Japan, and on ESG via clean energy and the strong corporate governance theme. Sector-wise, we retain our preference for cyclical sectors (mining, construction, industrials) and add a preference for Real Estate (REITs), which have not rallied as much as other value sectors of late.

Within commodities, we see a positive outlook for both base and precious metals in the months ahead, particularly for copper as well as gold, with the current pullback in gold prices a buying opportunity.



Bond, Credit, FX and Alternatives

Hunt down the vanishing yield

Pity the poor income-seeking investor: traditional sources of low-risk income from liquid sovereign bond markets is becoming increasingly hard to find, as financial repression by central banks continues. In peripheral European sovereigns, one has to look at maturities of 6 years or longer to achieve a positive yield today in Italian BTPs, while Greek sovereign yields only break above zero at 5 years maturity.

Higher 2021 10Y US Treasury yields forecast: we increase our end-2021 10Y US Treasury yield forecast to 1.4% (from 1.25%) on the back of higher inflation expectations, as the economy posts stronger growth.

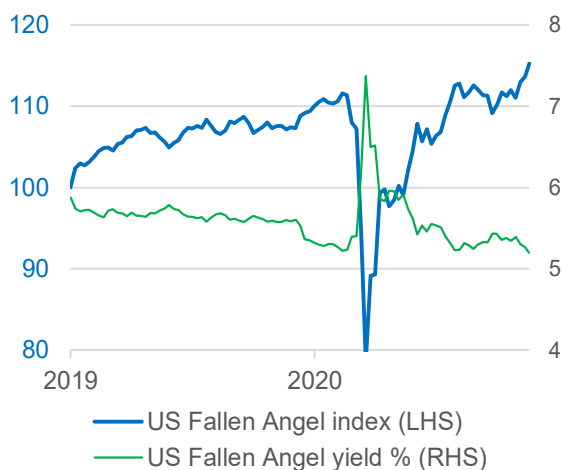
In contrast, we lower our end-2021 forecast for 10-year German bund yields to -0.25% (previously 0%), as we expect the ECB to buy more euro sovereign debt in 2021 than countries will issue, suppressing any rise in yields in its efforts to support economic recovery.

Fallen angels a sweet spot in US credit: with investors ever more desperate to find positive yields at limited risk, we like US High Yield Fallen Angels, as they offer a similar income as classic US (around 5%), but with a lower risk profile.

US dollar continues to decline: the US dollar continues its decline against major trading partners, with the broad trade-weighted US dollar index hitting its lowest level since early 2018. We now forecast the EUR/USD exchange rate to move up to USD 1.25 at end-2021, on a lower 2-year US-euro yield differential.

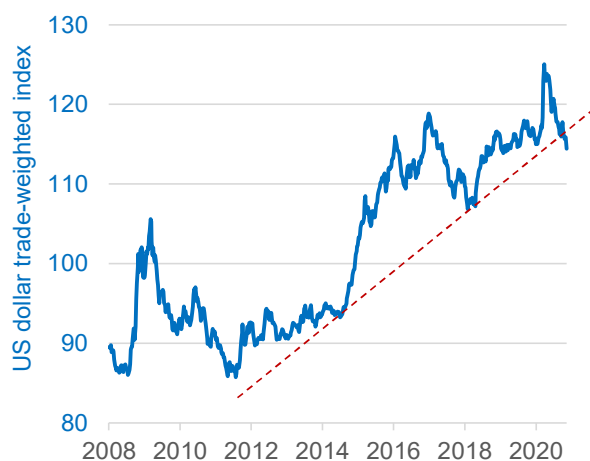
Investment flows weighing on USD: one of the major negative influences on the US dollar remains the low level of US Treasury yields available to foreign investors – at 0.9%, nearly 1% lower than the yield available this time last year to investors.

US FALLEN ANGELS HIGH YIELD CREDIT SOARS



Source: Refinitiv Datastream

US DOLLAR INDEX AT NEW TWO-YEAR LOWS



Source: Refinitiv Datastream

CONCLUSION

Investors are being inexorably forced higher up the risk and maturity curves in the hunt for income. We like fallen angels US credit, US preferred shares and EM hard-currency sovereign bonds for positive yields, while US and euro sovereign bonds seem unappealing.

Absolute return bonds funds are a lower-risk alternative to low-yielding US and European sovereigns, in our view. Within Alternative UCITS funds, we take a positive view on event-driven funds, given the positive outlook for merger & acquisition activity in 2021.



Summary of our main recommendations

| | Opinion New | Opinion Prior | Constituents | We like | We avoid | Comments |
|----------------------|----------------|------------------|-------------------|---|--|--|
| EQUITIES | + | + | Markets | EU, Japan (NEW), EM: China, Taiwan, India, Sth Korea. | | Japan upgrade driven by pro-cyclicality, rising profitability levels and attractive valuations. The US downgrade to neutral is due to high valuations. |
| | | | Sectors | Real Estate (NEW), Industrials, Materials, Insurance, Healthcare, EU Tech | Consumer staples | Upgrading the Real Estate sector to play the end of 'stay at home'. |
| | | | Styles/ Themes | Megatrend themes | | Good potential remains for secular themes. |
| BONDS | - | - | Govies | EM bonds (USD + local currency) | US long-term Treasuries and German Bunds | We revised our 12-month targets to 1.40% from 1.25% for the 10-year Treasury yield and to -0.25% from 0% for the bund yield. We upgrade EM hard currency bonds to positive. |
| | | | Segments | Peripheral euro and eurozone convertibles. IG credit and Fallen Angels (NEW). | | We upgrade fallen angels to positive as they enter the HY space with larger spreads than existing BBs. |
| | | | Maturities | At benchmark | | |
| CASH | = | = | | | | |
| COMMO- DITIES | + | + | | | | Gold - positive: Negative real rates and inflation should drive gold back above \$2000/oz Oil - positive: Brent prices should be in the \$45-55 range. Base metals - positive: prices are underpinned by the Chinese rebound and by pro-cyclical policies in Europe and US. |
| FOREX | | | EURUSD | | | We revised up our 3 and 12-month targets respectively to 1.18 and 1.25. |
| ALTERNATIVE UCITS | | | | Macro, Long-short equity, relative value and event- driven | | We upgraded event-driven due to the improved outlook for M&A and special events. |

Economic, FX forecast tables

| | BNP Paribas Forecasts | | | Forecast Revisions (%) | |
|-----------------|-----------------------|-------------|------------|------------------------|------------|
| GDP Growth % | 2019 | 2020 | 2021 | 2020 | 2021 |
| United States | 2.2 | -3,6 | 3,7 | 0,6 | -0,5 |
| Japan | 0,7 | -5,4 | 1,5 | 0,0 | 0,3 |
| United Kingdom | 1,5 | -11,5 | 6,4 | -1,8 | -0,5 |
| Eurozone | 1,3 | -7,5 | 5,6 | 0,5 | 0,4 |
| Germany | 0,6 | -5,9 | 4,2 | -0,3 | -0,5 |
| France | 1,5 | -9,5 | 6,3 | 0,3 | -0,5 |
| Italy | 0,3 | -9,1 | 6,0 | 0,9 | 0,7 |
| Emerging | | | | | |
| China | 6,1 | 2,0 | 8,6 | -0,5 | 1,1 |
| India* | 4,2 | -11,4 | 11,6 | 0,0 | 2,0 |
| Brazil | 1,1 | -4,5 | 3,0 | 0,5 | 0,0 |
| Russia | 1,3 | -4,5 | 3,8 | 0,5 | 0,7 |

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

| | Country | Spot | | Target three months | | Target twelve months | |
|----------------|-------------|------------|-------|---------------------|-------|----------------------|-------|
| | | 09/12/2020 | | Trend | Mid | Trend | Mid |
| Against euro | US | EUR / USD | 1,21 | Positive | 1,18 | Negative | 1,25 |
| | UK | EUR / GBP | 0,90 | Neutral | 0,90 | Positive | 0,88 |
| | Switzerland | EUR / CHF | 1,08 | Neutral | 1,08 | Negative | 1,11 |
| | Japan | EUR / JPY | 126 | Positive | 123 | Neutral | 128 |
| | Norway | EUR / NOK | 10,57 | Neutral | 10,70 | Positive | 10,10 |
| Against dollar | Japan | USD / JPY | 104 | Neutral | 104 | Positive | 102 |
| | Canada | USD / CAD | 1,28 | Negative | 1,31 | Neutral | 1,29 |
| | Australia | AUD / USD | 0,75 | Negative | 0,73 | Negative | 0,73 |
| | New Zealand | NZD / USD | 0,71 | Negative | 0,69 | Neutral | 0,71 |
| | Brazil | USD / BRL | 5,12 | Negative | 5,30 | Positive | 4,50 |
| | Russia | USD / RUB | 73,6 | Negative | 76,0 | Positive | 68,0 |
| | India | USD / INR | 73,7 | Neutral | 75,0 | Neutral | 75,0 |
| | China | USD / CNY | 6,54 | Neutral | 6,60 | Neutral | 6,50 |

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