FEBRUARY 2021

Investment Strategy Focus

Summary

1. **Stock market volatility spikes**: while financial market stress indicators remain low, stock market volatility spiked at end-January on the back of hedge fund positioning (closing shorts).
2. **Bubble worries**: mini bubbles have appeared in many areas of the markets, fuelled by surging retail investor volumes. This could be the prelude to a near-term US stock market correction. We would use any correction as a buying opportunity in stocks.
3. **Key EM, Japan, Small-cap equity preferences perform well**: while equity markets generally marked a pause last month, our positive preferences in Japan, Emerging Markets and Small-cap equities outperformed over the month.
4. **US bond yields factor in higher expected inflation**: 5-year inflation expectations have exceeded 2% for the first time since mid-2019. Avoid US & German sovereign bonds, prefer TIPs.
5. **Commodities continue to shine**: base metals and agricultural goods lead commodities indices higher, as global inventories fall. The global economic recovery is driving demand growth, pressuring prices higher. Helps mining stocks.
6. **Pause in weaker US dollar trend**: US dollar positioning is now extreme, suggesting a risk that the dollar will rebound in the short term. We still expect a weaker USD at end-2021.
7. **Cash savings await investment**: in the US, households have built up USD1.5 trillion in extra cash savings in 2020. Some will be spent, but much should be invested, potentially boosting equity and credit markets.

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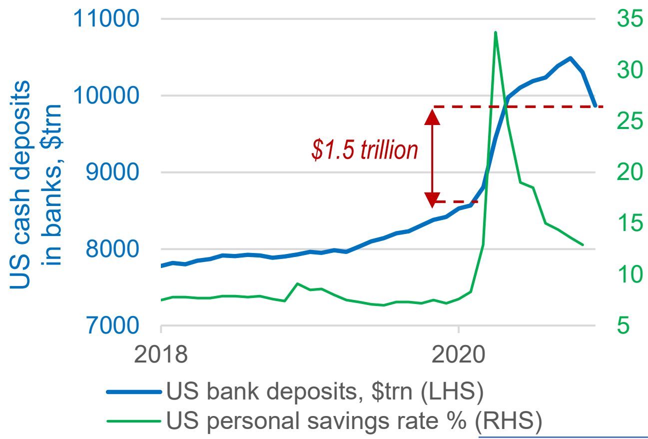
HUGE EXCESS CASH SAVINGS STILL TO BE SPENT OR INVESTED



Source: St Louis Fed

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The Big Picture

Biden hits the ground running

Focus on shifts in US Federal policy: following the inauguration of President Biden, the focus of economic recovery lies squarely on the shoulders of his administration, led by Treasury Secretary Janet Yellen.

The key immediate priorities will be controlling the spread of Coronavirus infections, and supporting the labour market to boost recovery in employment. Adjusted for the fall in the labour participation rate, the US unemployment rate has risen to around 10%, versus the early 2020 pre-pandemic level of 3.6%.

Further stimulus to focus on investment: with the US readmitted to the Paris climate accord, renewable energy infrastructure should receive a huge investment boost, focusing not only on solar and wind power, but also biomass and potentially nuclear energy.

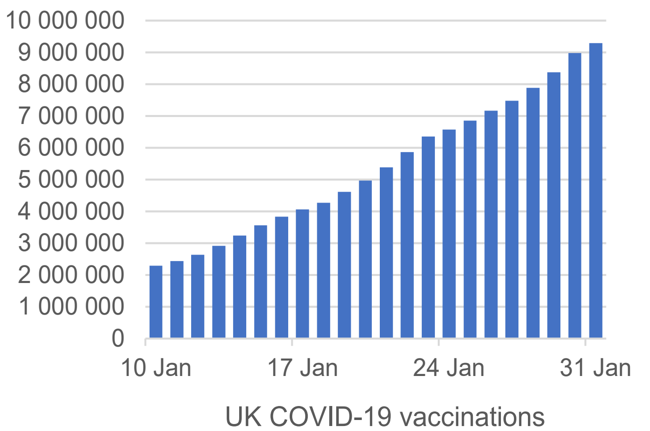
Vaccination programme acceleration: with three Covid-19 vaccines in use and more coming, vaccine deployment is accelerating worldwide, led by China, the US and the UK. In the UK, 9 million people have already received their first dose (as at 31 January).

Current inflation eases, but expectations rise: while current inflation rates have fallen in developed economies, expected future inflation rates have drifted higher, reflecting market concerns that economic recovery will also push inflation much higher in the medium term.

Leading economic indicators surge: the ECRI's weekly US leading indicator highlights a continued acceleration in economic growth, in spite of the obvious Coronavirus headwind. Note too the strength of the Chinese economy, with a better-than-expected 6.5% growth rate recorded for Q4 2020. This strong momentum remains a key support for risk assets, including equities, credit and commodities.

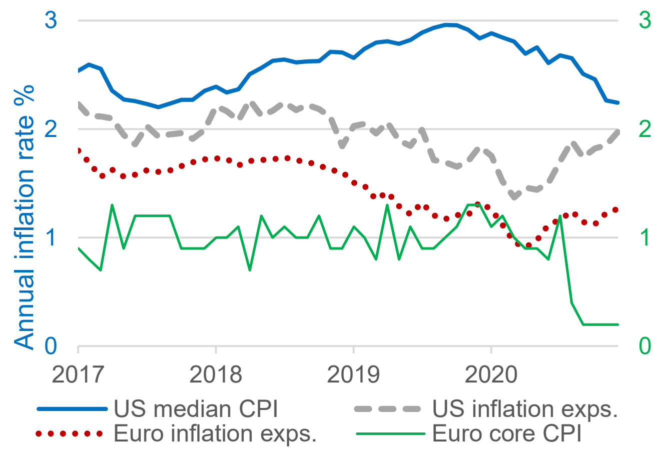
Volatility falls for now, but risks remain: as always, financial markets climb the wall of worry. Key concerns remain the emergence of new Covid-19 variants that current vaccines may not protect against, and the risk of more stringent lockdowns in Europe that could put a brake on economic recovery.

UK VACCINATIONS ADVANCE QUICKLY



Source: UK Office for National Statistics

INFLATION EXPECTATIONS RISE, EVEN AS CURRENT INFLATION FALLS



Source: St Louis Fed FRED database

CONCLUSION

For now, the markets are focusing on the acceleration in Covid vaccination programmes in the US and UK, and the falling UK and US infection rate following the festive season. Economic data remain robust and signal an ongoing global economic recovery. However, risks of an economic setback in Europe persist given the threat of more stringent lockdown measures.

Risk Radar

Mini bubbles all over the financial markets

Bubble worries: while we are generally optimistic, there are a number of indicators in the financial markets that are starting to concern us. Notably, the emergence of several mini bubbles in several different areas of the financial markets such as:

- Bitcoin and Ethereum
- Hydrogen stocks
- Loss-making technology stocks
- Special Purpose Acquisition Companies (SPACs)
- Recent US IPOs

The FANG stocks gained over 100% in 2020, providing much of the return of the entire S&P 500 index. In our view, this leadership is unlikely to be repeated in 2021. Rather, we see cyclical recovery stocks leading the way as the economy recovers sharply.

Since 2015, the outperformance of the US stock market has come almost exclusively from the top 10 by size, dominated by household name mega-cap internet and technology stocks.

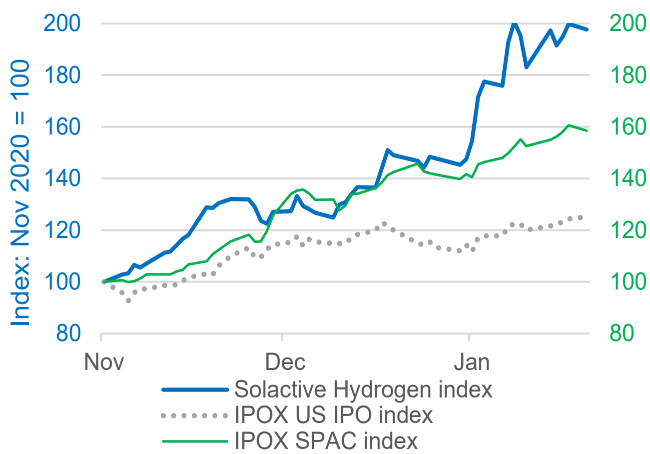
Sentiment verges on euphoric: sentiment indices such as The CNN Money Fear & Greed index are showing Greed currently.

Stock option volumes have been huge recently in the US, underlining the exuberant bullish sentiment of retail investors.

This over-exuberance could be the prelude to a stock market correction, should the upwards momentum seen over the last few months be interrupted by unforeseen events. A dramatic worsening of the global coronavirus infection rate could be one such catalyst.

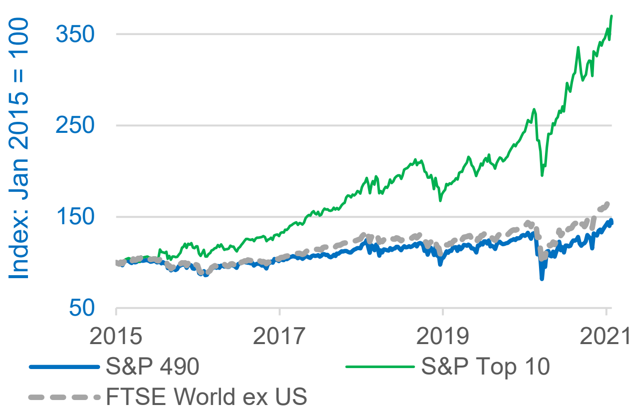
Any market correction is an opportunity to add: that said, we should remember that macro and earnings fundamentals remain strong for the economy and for the stock market, on the back of strong economic momentum and continued support from governments and central banks. We would thus use any stock market correction in the near term as an opportunity to add to positions, particularly in our favoured areas such as mid-/small-caps and cyclical sectors.

HYDROGEN, US IPO AND US SPAC STOCKS ALL GAIN 20-100% IN 3 MONTHS



Source: Solactive, IPOX

S&P 500 INDEX OUTPERFORMANCE DRIVEN ALMOST COMPLETELY BY TOP 10 (TECH)



Source: BNP Paribas, FTSE

CONCLUSION

There is clear evidence of a number of mini bubbles in a number of markets. However, this risk should be balanced against the positive backdrop of stimulus support for economic recovery, fuelling a strong corporate earnings recovery. We would advocate adding to equity exposure on any near-term market correction.

Theme in Focus

Time to rotate out of Big Tech?

Can 2021 possibly repeat 2020? US mega-cap technology stocks, personified by the FAANG group of stocks (including Apple, Amazon and Google), rose over 100% in 2020, leading the global stock market. One of the most frequently-asked questions we receive is: "*Surely this has gone too far already, so does this mean it must correct?*"

Lessons of the 1990s: the 1990s were a strong decade for stock market investors. As early as 1995, notable investors, such as Ray Dalio of Bridgewater and Peter Lynch of Fidelity, were warning of the risks of a significant stock market correction, following a 38% gain for the S&P500 in that year.

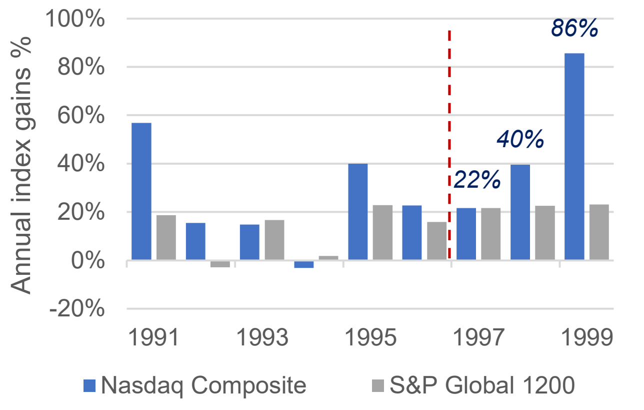
"Irrational Exuberance": this was then followed in late 1996 (after a further 23% gain for the S&P 500) by a similar warning of "irrational exuberance" in financial markets from the then US Federal Reserve chairman, Alan Greenspan

1997-2000, the Nasdaq soared even more! In the five years from 1994 to 1999, the Nasdaq Composite index gained about 40% per year, rising 86% in 1999 alone, plus a further 15% in the first few months of 2000. We would conclude from this that timing the top in any parabolic market is difficult, with potential risks of missing out on huge further gains.

Where should the focus be in Tech today? There are two particular areas of technology that we believe can continue to perform particularly well, potentially outperforming the mega-cap FAANG stocks in 2021. These are the **semiconductor sector** and **video games & eSports stocks**.

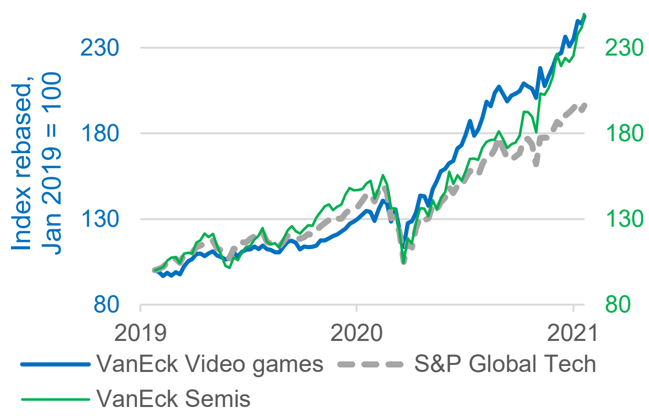
The semiconductor sector is set to enjoy structural demand growth for processors, memory and storage chips on the back of the investment boom in 5G mobile phone and Artificial Intelligence infrastructure. This, in turn, will enable the Internet of Things, which will drive demand for much more semiconductor content.

NASDAQ, GLOBAL STOCKS POSTED STRONG GAINS EVEN AFTER 1995-1996 WARNINGS



Source: BNP Paribas, Yahoo Finance

SEMICONDUCTORS AND VIDEO GAMES CONTINUE TO LEAD GLOBAL TECH



Source: BNP Paribas, VanEck, S&P

CONCLUSION

US mega-cap technology companies are unlikely to outperform in 2021 as they did in 2020, given today's far higher starting valuation levels and risks from further US and EU regulation and taxation. The technology subsectors we prefer include semiconductors, video games and cybersecurity.

Equity and Commodities Outlook

Renewable Energy under the spotlight

EU and US stimulus focused on clean energy: the combination of the EU Recovery Fund and further US fiscal stimulus from the new Democrat administration underpins the strong momentum in clean energy stocks, even after a stellar 2020 for the sector.

All clean energy indices are not created equally: interestingly, the choice of global clean energy stock index to follow has had a huge impact on investor returns over the past two years. The Wilderhill Clean Energy index has more than doubled the return of the S&P Global Clean Energy index since start-2019.

This reflects huge sector weighting differences: the Wilderhill index emphasises hydrogen power, fuel-cell and battery technology companies in its methodology, while the S&P index has more than 50% of its weighting in Utilities.

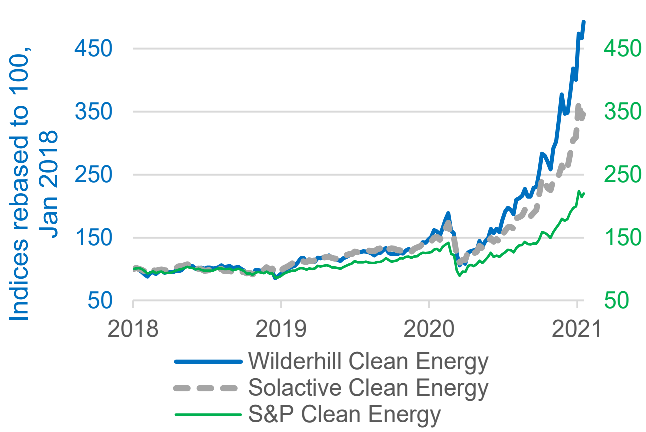
Clean Energy has started 2021 strongly: the Wilderhill Clean Energy index has already risen over 20% just in the month of January.

Commodities definitely exit bear market: the second half of 2020 definitively marked the end of the 2007-2020 commodities bear market, led by a strong ongoing recovery in base and precious metals. Latterly both oil and soft commodities have also started to rally, driving a strong rebound in the CRB equal-weight commodities index since the beginning of November 2020.

A new multi-year bull market in prospect? Driven by a combination of long-term underinvestment in new commodities production capacity (on the back of ever-falling prices) and strong projected global economic recovery, investors could be facing the potential for a multi-year commodities bull market.

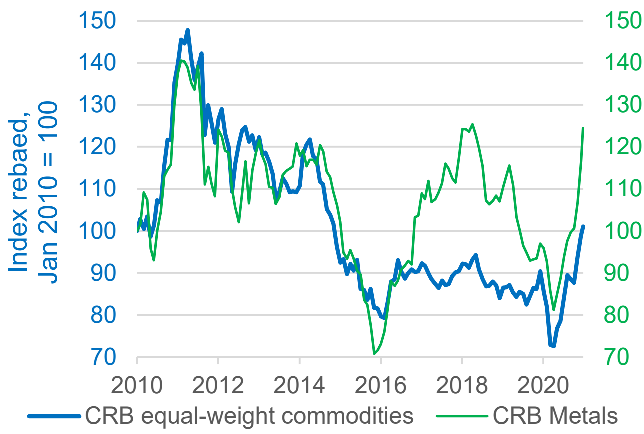
Our favoured segments – base and precious metals: rising demand for electric vehicles and renewable energy sources are key for demand growth in copper, nickel, tin, silver and aluminium. This would also argue for strength in certain commodity currencies including the Australian and Canadian dollars.

BIG DISPARITY IN CLEAN ENERGY INDICES, BUT ALL HAVE DONE WELL RECENTLY



Source: Yahoo! Finance

COMMODITY INDEX ENTERS NEW BULL MARKET PHASE, LED BY METALS, SOFTS



Source: Tradingview

CONCLUSION

Clean energy indices continue to post an impressive performance in 2021 to date, fuelled latterly by hydrogen and biomass stocks in particular. Investors continue to direct substantial flows into this space, following the lead of US and EU governments. Commodities have entered a new bull market phase, driven not only by base and precious metals, which we favour, but also now by soft commodities and also crude oil.

Bond, Credit and FX Outlook

Rising US Yields reflect risk

US Treasury yields have been rising for 6 months: since bottoming out in August 2020, US 10-year Treasury yields have risen by 0.6% to 1.1% as at 21 January, 2021. We continue to project a target of 1.4% at end-2021, implying a further rise of 0.3%.

However, in our view, US bond yields have not yet risen sufficiently to tempt foreign investors to buy; 12 months ago, US 10-year yields stood at nearly 2%, far above today's levels. We continue to prefer inflation-protected US TIPs to nominal Treasury bonds, to hedge against the risk of further increases in inflation expectations.

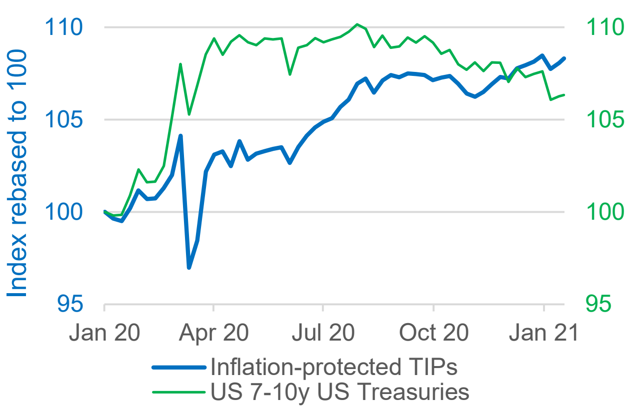
Fallen Angels outperform in January: in the credit space, our preference for Fallen Angels High Yield credit continues to bear fruit, with the US Fallen Angels credit index up 10% since the start of November 2020, outperforming other US credit classes in January.

US dollar weakness already largely priced: the FX story of 2020 was the persistent weakness of the US dollar, against the euro, Japanese yen and Chinese renminbi. We expect modest further weakening of the greenback against the euro over 2021 (targeting USD1.25 per 1 euro at end-2021, versus USD1.21 as at 21 January). But note that investors are already largely positioned bullishly on the euro and bearishly on the US dollar, judging by CFTC FX futures contracts.

Beware of the rising risk of a short-term countertrend rally in the US dollar; this could be a better entry point for investors looking to benefit from a weaker dollar.

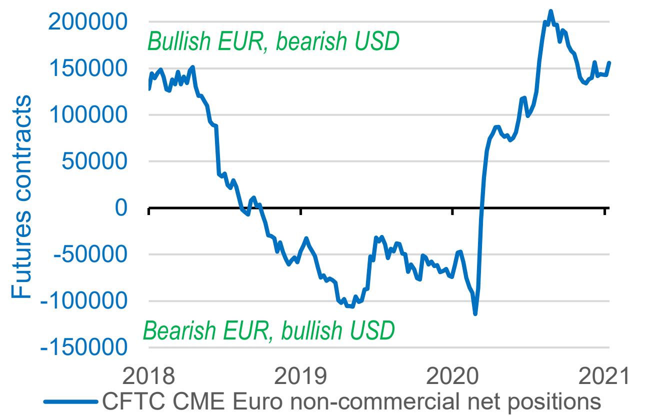
Sterling strength could accelerate: following the conclusion of a Brexit accord with the EU, sterling has strengthened significantly against the euro and the US dollar. We look for further sterling strength on reduced uncertainties, targeting £0.86 per 1 euro at end-2021.

US INFLATION-PROTECTED BONDS OUTPERFORM NOMINAL US TREASURIES



Source: Yahoo Finance

POSITIONING REMAINS BULLISH EURO, BEARISH US DOLLAR



Source: CFTC

CONCLUSION

US Treasuries continue to underperform on the back of rising inflation expectations, now a consensus view in bond markets. This underlines our continued avoidance of this segment of the bond market, with inflation-protected TIPs remaining our preference.

Summary of our main recommendations

	Current Recom	Prior Recom	Constituents	We like	We avoid	Comments
EQUITIES	+	+	Markets	EU, UK, Japan, EM: China, Taiwan, India, S. Korea.		The combination of historically low long-term real rates and accommodative financial conditions are giving a powerful boost to global stocks. . Attracted to the pro-cyclical profile of Euro Area stocks. Positive on Emerging Markets, based on a superior earnings growth profile and room for further re-valuation. Preference the more cyclical Japanese exposure.
			Sectors	Real Estate, Industrials, Materials, Insurance, Healthcare, EU Tech,EU Energy	Consumer staples	Positive on these pro-cyclical sectors: Materials, Industrials and Insurance. Positive on this defensive sector: Healthcare. (pharma and biotech) In Europe: positive on Technology and Energy.
			Styles/ Themes	Megatrend themes		Good potential remains for secular themes such as 5G, connected consumers, health tech, water, waste, infrastructure.
BONDS	-	-	Govies	EM bonds (USD + loca currency)	US long-term Treasuries and German Bunds	We are negative on German govies, and on long-term US govies. We are positive on periphery debt (Portugal, Italy, Spain, Greece) on a buy on weakness strategy.
			Segments	Peripheral euro and eurozone convertibles. IG credit and Fallen Angels.		We prefer corporate bonds over government bonds. We like EUR and US IG bonds with a duration at benchmark (5 and 9 years, respectively).We are positive on eurozone convertible bonds. We are neutral on both US and eurozone HY. We prefer fallen angels. We are positive on EM bonds, in both hard and local currency.
			Maturities	At benchmark		
CASH	-	=				
COMMODITIES	+	+				Gold - positive: The sharp corrections after the vaccine news seems excessive. Negative real rates and inflation worries should drive gold back above USD2000/oz. Oil - positive: OPEC+ restrictions, lower US production and recovering demand thanks to vaccines should keep Brent prices in the USD45-55 range. Base metals- positive: prices are underpinned by the Chinese rebound and by pro-cyclical policies in Europe and US.
FOREX			USDCNY			▪ We expect authorities to limit further appreciation but still see upside for the CNY. We revise our 12-month target to 6.4 (from 6.5).
ALTERNATIVE UCITS				Long-short equity, relative-value and event-driven		

Economic, FX forecast tables

BNP Paribas Forecasts				
GDP Growth %	2019	2020	2021	2022
United States	2.2	-3,6	4,2	4,1
Japan	0,3	-5,3	1,1	3
United Kingdom	1,5	-11,1	4	8,6
Eurozone	**1.3**	**-7,3**	**3,8**	**5,5**
Germany	0,6	-5,6	2,7	5,1
France	1,5	-9	5,5	4,7
Italy	0.3	-9	4,5	4,4
Emerging				
China	6,1	2,3	9,5	5,3
India*	4,2	-11,4	11,6	5
Brazil	1,1	-4,5	3	3
Russia	1,3	-4,5	3,8	3

* Fiscal year
Source: BNP Paribas 15/01/2020

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

* Fiscal year
Source: BNP Paribas 15/01/2020

	Country		Spot 28/01/2021	Trend	Target 3 months	Trend	Target 12 months
	United States	EUR / USD	1.21	Neutral	1.20	Negative	1.25
	United Kingdom	EUR / GBP	0.89	Neutral	0.88	Positive	0.86
	Japan	EUR / JPY	126	Neutral	125	Neutral	128
	Switzerland	EUR / CHF	1.08	Neutral	1.08	Negative	1.11
	Australia	EUR / AUD	1.59	Neutral	1.58	Neutral	1.56
	New Zealand	EUR / NZD	1.70	Positive	1.67	Positive	1.67
	Canada	EUR / CAD	1.56	Positive	1.52	Neutral	1.56
	Sweden	EUR / SEK	10.13	Neutral	10.20	Neutral	10.20
	Norway	EUR / NOK	10.53	Positive	10.20	Positive	9.90
Asia	China	EUR / CNY	7.84	Neutral	7.80	Negative	8.00
	India	EUR / INR	88.5	Neutral	90.0	Negative	93.75
Latam	Brazil	EUR / BRL	6.55	Positive	6.36	Positive	5.63
EMEA	Russia	EUR / RUB	92.4	Neutral	91.2	Positive	85

Source: BNP Paribas, Refinitiv Datastream

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