



JUNE 2020

Investment Strategy



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Highlights Editorial Changes this month Summary of our main recommendations



Confirmation of our scenario

- The rebound in leading indicators with the end of lockdowns that has begun in Europe and the US comforts our scenario of a gradual economic recovery in the second half of the year, and amplifying in 2021.

The pandemic is fading

- The pandemic is fading overall, and its epicentre is now in emerging market countries (Latin America). Until now, the health authorities have successfully managed the risk of a second wave.

A 750 billion-reconstruction plan

- Europe is taking decisive measures with the European Commission's EUR 750 billion-reconstruction plan, which should be finalised after the likely difficult negotiations at the next summit on 19 June.
- The risk of tensions between China and the United States may suddenly re-emerge.
- We keep to our 'buy on dips' strategy by accumulating risky assets: a short-term consolidation would not surprise us. We are positive on the US, emerging markets and the eurozone in the medium term.
- We are more positive on a few cyclical sectors.
- We are buyers of gold, oil, and (since this month) base metals. Commodities are a good means of diversification, as are hedge funds.



BNP PARIBAS
WEALTH MANAGEMENT

Investment Strategy

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Confirmation of an economic recovery scenario in the shape of a U

Latest economic figures published for April and May show that mature economies are in deep recession, the worst since the end of the Second World War. There is nothing astonishing about this as whole sections of economies were stopped overnight due to lockdowns. Sectors that used to act as buffers in previous recessions, particularly services, are now worsening the phenomenon.

China started to exit lockdown in March, and the recovery in its economy has been moderate. Furthermore, the recovery is continuing despite sluggish international demand. Other Asian countries, and then Europe, then the United States slowly began to reopen their economies in May, and leading indicators started to recover very quickly. The sentiment of economic agents about the future is improving. This is particularly important for the financial markets. Our economic scenario is comforted: helped by the exceptional stimulus measures taken by governments and central banks, the recovery will start in the second half of 2020 and pick up next year. This pattern will consolidate in the coming months, as long as the number of company bankruptcies remains limited. Governments are well aware that the production tool must remain intact (as far as possible) and they are therefore doing their utmost to provide aid, loans and guarantees.

The pandemic is increasingly under control

A second prerequisite for a U-shape recovery is, of course, that the pandemic itself continues to improve. If economies are reopened, it is because confinement measures have curbed the spread of the epidemic and the number of new cases is falling in Asia, Europe and the United States. The situation remains worrying in a number of emerging countries, particularly in Latin America.

The risk of a second wave needs to be monitored. But, in China and South Korea for example, when new outbreaks of infection occur, tighter local management, through tests and dedicated health teams, is preventing this second wave. Health authorities have drawn lessons from the crisis and now have the necessary means and experience. That said, nothing will replace a vaccine or suitable drugs which are currently being developed.



The European Reconstruction Fund

In the context of the major economic recession, Europe is about to make an essential step forward in its history towards more federalism. The European Commission has just presented the creation of a European reconstruction fund aimed at shoring up the zone's economy and financing national recovery plans. New taxes, levied at the European level by the Commission, would help to finance EUR 750 billion in transfers or loans on favourable terms. This proposal is very similar to the Franco-German agreement announced in May; but it has yet to lead to negotiations with four countries (the Netherlands, Austria, Denmark and Sweden) that are calling for adjustments. The European Council meeting on 19 June will be key.

China/US tensions

In December 2019, the financial markets were relieved that China and the US had signed a 'Phase 1' agreement, after months of tensions and tariff increases on both sides. The Covid-19 pandemic, the global recession, fast-approaching US presidential elections and contraction in international trade are fuelling tension between the world's two leading powers. At another time, the two superpowers would have cooperated.

Trade is not the most serious dispute. The two countries are strategic competitors on technology, 'soft power' and global leadership issues. Several scenarios are possible, from the worst scenario (unilateral tensions by the US ending the Phase 1 agreement for domestic policy reasons) to a status quo with an extended agreement after new negotiations. This moderate scenario seems most likely in the long run, in our view.

In early June, the financial markets reacted well to the announcement that the Trump administration had adopted a moderate tone and hinted at a continuation of the Phase 1 deal. We fear, however, that this will only be transitory. Tensions between the US and China are a significant risk in the short term, in our view.

We stick to our strategy of accumulating on dips

The rebound in stock markets was driven by better leading indicators related to lockdowns, good news regarding the pandemic in Europe and the US, as well as the proposal of a European reconstruction fund. This rally was stronger than expected and somewhat overdone, in our view. Admittedly, interest rates are low and indeed will remain durably low, partly because of the central banks' programmes of purchasing financial assets. The sharp increase in share prices and the massive downgrades to earnings forecasts are rapidly deteriorating valuations.

Paradoxically, stock markets are more expensive today than at the start of 2020, as profits have fallen more than prices. The markets are anticipating the rebound in 2021 and we fear that they are moving slightly too fast on this. Volatility is likely to remain high and further opportunities to add to positions are likely to arise.



Changes this month

- We are giving a stronger cyclical focus to our sector recommendations in anticipation of next year's growth rebound. To this end, we are now positive on the basic materials sector (instead of neutral) and neutral on industrials (instead of negative). On the other hand, we are taking some profits on the pharmaceuticals sector (neutral instead of positive) but remain positive on the health care sector as a whole. We downgrade the retailing sector to negative (from neutral).
- To play the rebound in the economy, one way of diversifying is to invest in the base metals segment on which we have turned positive. We are therefore buyers of oil, gold and base metals. These minerals are highly diversified, so we like copper and nickel, but remain cautious on aluminium.
- Turning to hedge funds, we have been highlighting two particular strategies for several quarters: Long/Short Equity and Global Macro. We add to these two positive recommendations the Relative Value segment, which mainly concerns 'Long/Short Credit.' On the other hand, we are becoming more cautious on Event-Driven strategies.
- In currencies, we change our 3-month target on the EUR/USD to 1.12 (instead of 1.14) but keep our 12-month target at 1.16. The euro is likely to strengthen as uncertainties about the medium term diminish, the same uncertainties that have favoured the greenback since the beginning of the year. This effect should also play out for the Swiss franc. The scale of the movement will probably be less than initially expected and we revise our 12-month target to 1.09 (instead of 1.12) against the euro.





Equities

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| Global | ● | <ul style="list-style-type: none"> • A strategy of accumulation. About 2/3 of the bear market has been erased thanks to better news on the coronavirus front and unprecedented monetary and fiscal mobilisation. The absence of positive macro and earnings releases in the coming months, coupled with technical considerations imply rising volatility. Investors should take advantage of it to accumulate. |
| Markets | ● | <ul style="list-style-type: none"> • US stocks remain a favourite, well positioned to continue its 11-year old outperformance. • Euro Area stocks: better days lie ahead with an expected global recovery in the second half. • Recovery potential for the UK market, provided by extreme discount valuations. • Emerging Markets have been cheaper only 3% of the time according to the Shiller PE. China, Taiwan, South Korea, India and Singapore are our favourite markets. |
| Sectors | ● | <ul style="list-style-type: none"> • This month, we become positive on Materials in general and we upgrade Industrials to neutral. • We remain positive on Insurance and on Healthcare but we downgrade Pharma to neutral. • We downgrade Consumer Staples to negative. • In Europe: we are also positive on Technology and Energy. |

Bonds

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| Govies | ● | <ul style="list-style-type: none"> • 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 | ● | <ul style="list-style-type: none"> • 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 | ● | <ul style="list-style-type: none"> • We are neutral on both US and eurozone HY. |
| Emerging | ● | <ul style="list-style-type: none"> • 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

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| EUR/USD | ● | <ul style="list-style-type: none"> • We keep our positive view for the euro but we see less upside potential short-term. We revised down our 3-month target to 1.12 and keep our 12-month target unchanged (1.16). |
| EUR/CHF | ● | <ul style="list-style-type: none"> • While we see the CHF remaining steady over the next 3 months around 1.06, we see less upside for the euro near term. We lowered our 12-month target to 1.09. |

Commos

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| Oil | ● | <ul style="list-style-type: none"> • The number of shale oil active rigs is declining rapidly and investments are slashed. As a consequence the US production should continue to decline in the coming months. Brent prices should recover around \$45-55 in H2 2020 thanks to the rebounding demand and lower supply both from OPEC+ and US |
| Gold | ● | <ul style="list-style-type: none"> • Real interest rates should remain negative or extremely low for an extended period. Gold is seen as a refuge from 'unfettered currency printing'. We expect gold to trade in the range \$1600/1800/oz. |
| Base Metals | ● | <ul style="list-style-type: none"> • We move from neutral to positive as demand is slowly recovering with the reopening of the economies lead by China, the leading buyer, thanks to infrastructure spending and other stimuli. |

Alternatives

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| Real Estate | ● | <ul style="list-style-type: none"> • 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 | ● | <ul style="list-style-type: none"> • We upgrade Relative value to positive and downgrade Event-Driven to neutral. Positive on relative-value, Macro and Long-Short equity. |





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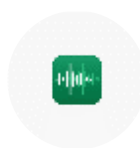
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Voice of Wealth

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