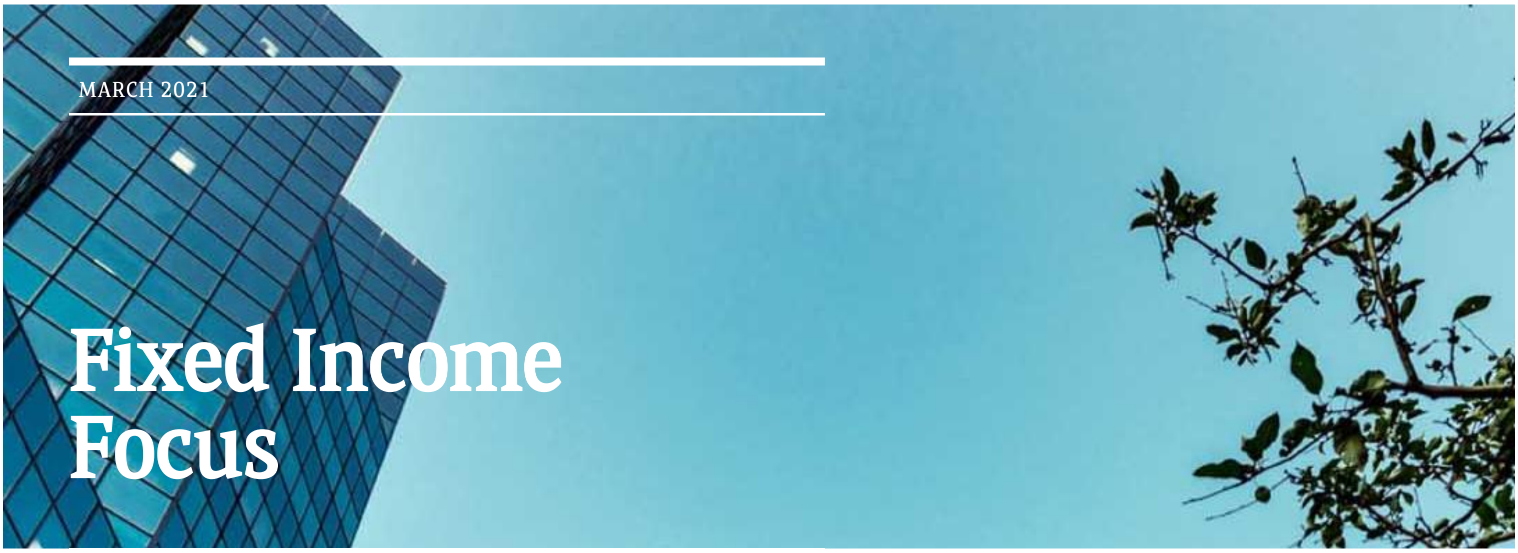


MARCH 2021

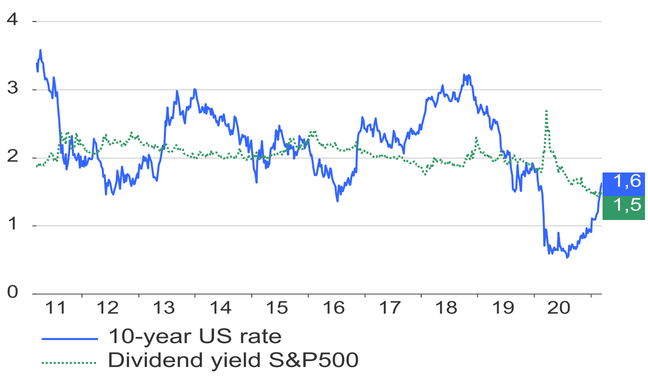
Fixed Income Focus

Summary

1. **The ECB has decided to act and will significantly increase its bond purchases.** Eurozone countries' long-term rates will be less vulnerable to movements in US rates. Expect stable or even lower long-term interest rates in the euro area.
2. **On 17 March we will finally know what the Fed thinks about rate movements and the market expectations about the first rate hike.** Our sentiment is that the Fed will appease these expectations. We don't think there will be a hike in policy rates next year.
3. **Long-term rates continue to rise in fits and starts. A deluge of new Treasury bond issues is expected in March and a pending regulatory matter (leverage ratio calculation).** Confirmation by 31 March at the latest. High volatility on rates in March due to these two uncertainties.
4. **Rising rates create a buying opportunity in corporate bonds.**
5. **Emerging market bonds are suffering from rising rates, but are likely to regain some appeal once US rates have stabilised.**
6. **TINA (There Is No Alternative to equity markets) is less and less true.** The yield on the 10-year Treasury note is now in line with S&P 500 dividends.

Contents

THE YIELD ON THE 10-YEAR TREASURY NOTE IS NOW IN LINE WITH S&P 500 DIVIDENDS



Source: Refinitiv Datastream, 12/03/2021

Edouard Desbonnets

Investment Advisor, Fixed Income

BNP Paribas Wealth Management

BNP PARIBAS WEALTH MANAGEMENT

The bank for a changing world

Central banks

Under pressure

European Central Bank (ECB)

The March monetary policy meeting enabled ECB members to reach a consensus in the light of new economic projections. Thus, they will put their money where their mouth is and significantly increase bond purchases via the emergency programme (PEPP) to put pressure on long-term rates.

This decision therefore reinforces the credibility of the institution, since it said that it was worried about rising rates but had not increased its bond purchases in the past two weeks.

The ECB is primarily seeking to maintain accommodative financial conditions rather than to set long-term rates at lower levels, such as those seen in December 2020.

Inflation could accelerate this year, albeit temporarily. So no change in monetary policy is expected.

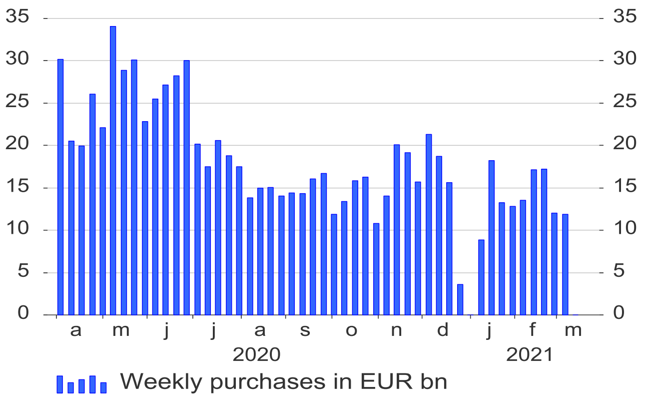
US Federal Reserve (Fed)

All eyes will be on the Fed on 17 March when it holds its monetary policy meeting. The markets are waiting for answers, or even actions, following the rise in long-term rates and new expectations for the date of the first hike in policy rates.

Whereas in December 2020, the first rate hike was only anticipated in 2024, it is now expected in December 2022. Will the projections of each Fed member confirm what the markets think? We doubt this and **expect a first rate hike in 2023.**

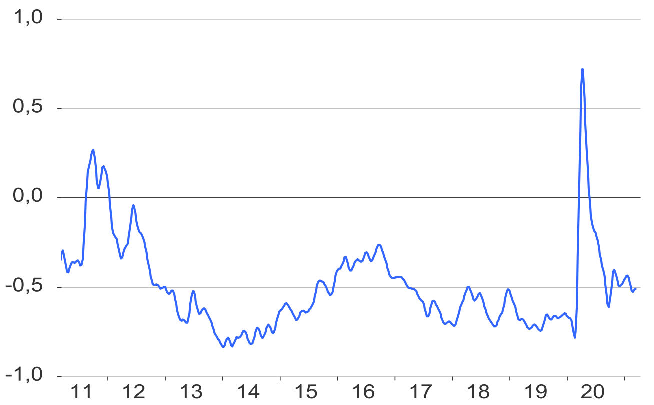
For now, the Fed has not sought to rein in the rise in long-term rates, probably because the deterioration in financial conditions has been only modest (they remain accommodative) and there has been no dysfunction/correction in the markets.

BOND PURCHASES VIA THE PANDEMIC EMERGENCY EMERGENCY PURCHASE PROGRAMME-PEPP



Source: Refinitiv Datastream, 05/03/2021

FINANCIAL CONDITIONS CHICAGO FED



Source: Refinitiv Datastream, 05/03/2021

CONCLUSION

Central banks will remain accommodative and will ensure that financial conditions are not restrictive. The ECB appears to be tackling rising long-term rates more than the Federal Reserve, as growth prospects are still low in the eurozone, unlike in the US, where the pace of vaccination is rapid (synonymous with a reopening of the economy) and fiscal policy is extremely ambitious.

Bond Yields

Volatility in March

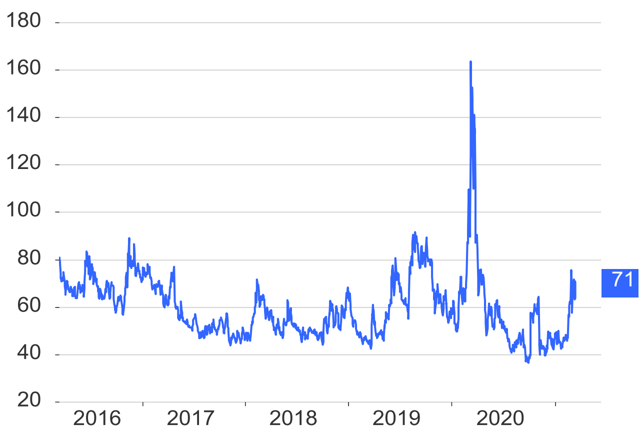
The rise in long-term rates has been a global phenomenon. It's the speed of the movement (rather than amplitude) that has been surprising.

There are two major risks to US rates in March. The first is that the US Treasury will issue about $400 billion of new bonds in March. Investors snubbed the last auction of a 7-year issue in February, which had pushed up yields sharply. Lately, the 3-year, 10-year and 30-year issues have been quite successful. The second risk is regulatory. The Fed may decide not to extend the easing measures on the calculation of the supplementary leverage ratio (SLR). If this is the case, large banks could limit their purchases of Treasuries, causing upward pressure on rates. Confirmation by 31 March at the latest. Interest rate volatility risk.

Unlike the Fed, the ECB wants to tackle the rise in long-term rates.

We are in the process of reassessing our rate targets in the light of certain criteria, detailed in the article "Taper(less) Tantrum" of 5 March.

VOLATILITY ON US RATES
MOVE INDEX



Source: Refinitiv Datastream, 15/03/2021

	Maturity (in years)	11/03/2021	12-month targets
United States	2	0.14	0.25
	5	0.79	0.50*
	10	1.54	1.40*
	30	2.29	1.90*
Germany	2	-0.69	-0.50
	5	-0.63	-0.40
	10	-0.33	-0.25
	30	0.18	0.30
United Kingdom	2	0.10	0.25
	5	0.33	0.25*
	10	0.74	0.60*
	30	1.26	1.20*

Source: Refinitiv Datastream, BNP Paribas WM
* Under review

CONCLUSION

The rise in long-term rates has been rapid and global. Volatility remains high, particularly in US rates. Unlike the Federal Reserve, the ECB will intervene to stop the upward movement in rates.

Theme in Focus

Emerging market bonds

Emerging market assets are generally dependent on global risk appetite. Hard currency bonds (USD and EUR) underperform during a period of reflation when rates rise and the performance of local currency bonds is very sensitive to exchange rate changes.

Emerging market countries have not been spared from the rise in long-term rates in the United States and their 10-year rates in local currency are under pressure.

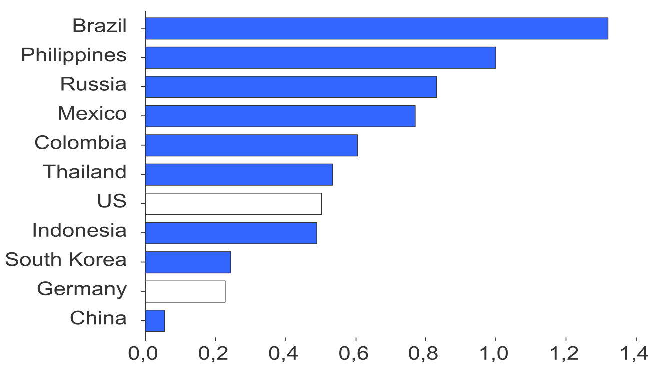
One exception is China, where long-term rates have remained relatively stable since 1 January as the country entered the COVID crisis earlier and emerged earlier as well. Its 10-year rate has already experienced reflation, and tightened by around 0.8% from May to November 2020.

At the same time as rising rates, spreads (between emerging markets and US Treasuries) have fallen since 1 January, suggesting a fall in credit risk and liquidity risk. The economic recovery should allow spreads to remain low and limit default rates.

Accommodative financial conditions, inflation under control, as well as rising commodity prices should also benefit emerging bonds.

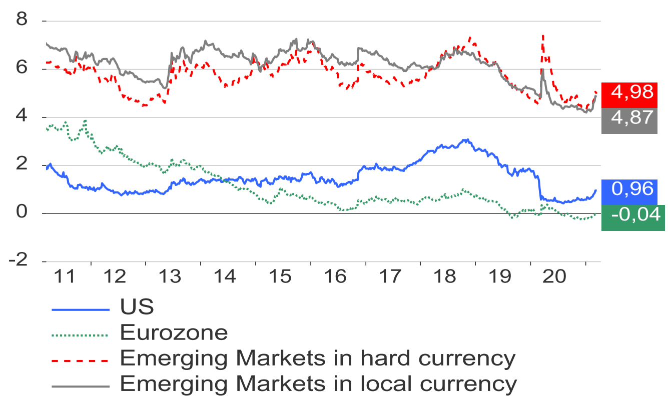
The rise in risk-free rates has not been powerful enough to really change things in the low interest rate environment: there are still a quarter of bonds around the world that have negative rates at maturity and 55% of global bonds offer rates below 1%. So the "search for yield" phenomenon is not going to stop.

RISE IN 10-YEAR RATES SINCE 1 JANUARY (%)



Source: Refinitiv Datastream, 12/03/2021

GOVERNMENT BOND YIELDS



Source: Refinitiv Datastream, 15/03/2021

CONCLUSION

Emerging assets are dependent on global risk appetite and are vulnerable to rising US rates. We believe that emerging market bonds remain attractive on the assumption that the potential for further US long-term rate rises is diminishing.

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	=	• Positive on short-term debt for dollar-based investors. • Negative on long-term debt.
Corporate bonds Investment Grade	Eurozone and United States	+	• We prefer corporate bonds to sovereign bonds. • We favour EUR and US bonds with a similar duration to the benchmark (5 and 9 years respectively). • Positive on convertible bonds in the eurozone.
Corporate bonds High Yield	Eurozone and United States	=	• Neutral on HY bonds. • Positive on *fallen angel* bonds.
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	1.53	- - -	
Germany	-0.33	- - -	
France	-0.10	24	+1
Italy	0.61	94	+2
Spain	0.31	64	+6
Portugal	0.19	52	-1
Greece	0.78	112	-10

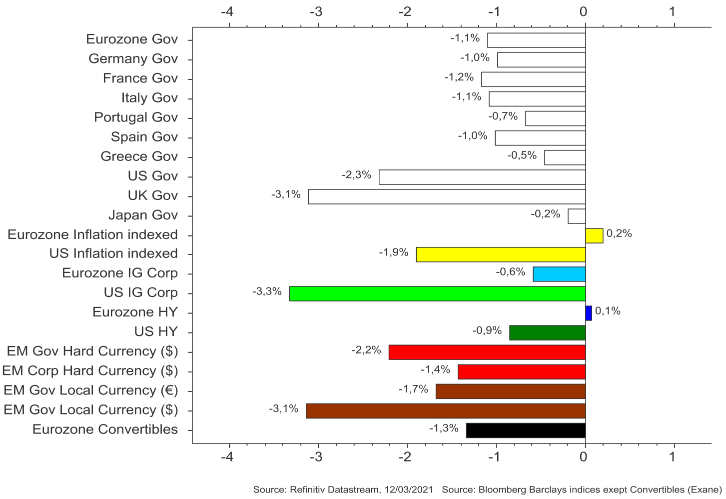
11/03/2021
Source: Refinitiv Datastream

	Yield (%)	Spread (bps)	Spread change 1 month (bps)
Global	1.10	33	0
Corporate bonds IG EUR	0.34	90	+2
Corporate bonds IG USD	2.22	98	+6
Corporate bonds HY EUR	3.01	307	+6
Corporate bonds HY USD	4.32	326	0
Emerging government bonds in hard currency	4.86	326	+15
Emerging corporate bonds in hard currency	4.86	325	+14
Emerging government bonds in local currency	4.82	404	+21

11/03/2021
Source: Refinitiv Datastream, Bloomberg Barclays and JPM indices

Returns

OVER ONE MONTH



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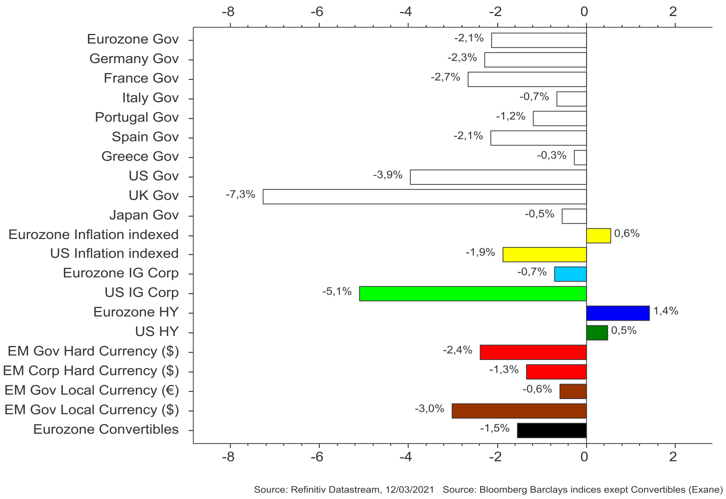

EM = Emerging Markets

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