2019

INVESTMENT THEMES
Following a context of uncertainty that weighed on 2018, we anticipate an improvement in confidence that will drive a positive momentum in stock markets.

Our 10 investment themes for 2019 will mostly focus on equity markets which will resume an upward trend amid a volatile environment.

The first two themes, however, are aimed at investors seeking performance but with a more cautious profile.

The third and fourth themes look at opportunities in Asia. One is related to the internationalisation of China’s capital markets and the other addresses the winners of new trade policies. It is anchored in the assumption of a shift in supply chains, leading to new opportunities in areas such as technology components, food and auto parts in some countries.

Themes 5 to 9 are based on specific demand-driven stories such as new developments in mobility, security, greener and smarter cities, longevity and Industry 4.0.

The last theme looks at opportunities in currencies for both euro- and dollar-based investors.
In 2018, political risk factors weighed on the performance of financial markets despite a positive environment of economic growth and corporate profits. We anticipate a gradual easing of political concerns and an improvement in confidence. This should lay the foundations for a return to positive dynamics in the stock markets. Our assumption of a gradual increase in interest rates suggests a difficult environment for bond investors. As a result, most of the 10 themes we selected for 2019 focus on equity markets. The first two, however, offer alternatives for investors with a more conservative risk profile.

Late in the cycle but not at the end of it
Economic growth slowed almost everywhere in 2018, except in the US. The cyclical desynchronisation helped the US dollar to appreciate against most currencies.

Global growth should continue to ease further in 2019 and lead to a resynchronisation. The US is in a very mature stage of its business cycle, whereas the situation in the eurozone is less advanced. That said, there are signs that the expansion is set to continue, for several reasons.

Firstly, cost pressure on companies remains moderate. Secondly, job market and wage trends are lifting consumption prospects. Thirdly, investment spending (as a share of GDP) is reasonable and the potential of a further rebound is high. Fourthly, interest rates remain fairly low, in both nominal and real terms, and credit conditions are favourable. Finally, the risks for global trade are manageable.

The outlook for Emerging Market economies is good due to their weak currencies, the limited upside for US bond yields and a resilient outlook for global growth. The recent initiatives (fiscal, monetary and regulatory) by the Chinese authorities and improving credit trends comfort our opinion that economic activity will decelerate only moderately in the coming months.
Our outlook for monetary policy is basically unchanged. Consistent with the US central bank’s growth and inflation projections, most Fed members have not yet changed their views despite another round of criticism from President Trump and growing uncertainty. Market expectations fell somewhat last November. At the time of writing, the Fed was expected to hike interest rates in December, and had guided to two more in 2019. The policy rate would therefore reach 3% by the end of 2019 and the Fed would likely stop the tightening cycle, in line with slower economic growth.

In Europe, Mario Draghi believes that Italy is facing a budget risk (which should be addressed by the Italian government and the EU Commission) and that the ECB has no role to play as this aspect is not part of its mandate. Mr Draghi justified the weak PMI figures for the eurozone by a loss in momentum as opposed to a downturn, and was confident about the inflation outlook. For the ECB, the end of the Quantitative Easing programme represents the first step in the normalisation of monetary policy. Moreover, we forecast the ECB to raise the deposit rate from -0.40% to -0.20% in September 2019, followed by a dual increase in the deposit rate to 0% and the refi rate to 0.25% in December 2019.

In terms of bond yields, our 2-year yield target in 12 months is 3% as these Fed rate hikes have been priced in, matching our Fed funds target for the end of the cycle. As for the 10-year yield, our target is 3.25% as US growth should slow down and there are no clear signs of inflation. Yet, we cannot exclude a temporary overshoot of our targets in the coming months given the dynamic labour market. We expect yields to climb higher in Germany, as the ECB will gradually adopt a more hawkish stance by phasing out its net asset purchasing programme. Indeed, further inflationary pressure could come from the labour market. Our target is 1.25% for the 10-year yield.
Beyond political risks
The political environment remains uncertain. Indeed, it has been a major drag on financial markets despite solid fundamentals. Moreover, tensions between the European Commission and the Italian government are a key source of concern. With its proposal of a 2.04% deficit target, the Italian government is seeking a compromise. At the time of writing, the Commission’s response was unknown. Negotiations continue.

With regards to Brexit, the situation has been very chaotic since the vote in Parliament (originally planned for 11 December) was postponed. The British government does not have the majority to obtain the Parliament’s approval of the compromise text negotiated with the European Union. The uncertain climate persists.

Trade tensions between the United States and China are changing rapidly: tensions faded after a truce was reached in Argentina during the G20 summit. Then new tensions arose following the arrest in Canada of a top executive at the Chinese group Huawei, and subsequently tensions eased with the willingness of both countries to enter into the crux of the negotiations. Both sides could go beyond confrontation to make a strategic deal that should increase investor visibility and confidence.

Historically it has been important for long-term investors to look beyond temporary political risks and focus on economic fundamentals. Needless to say, this is relevant in today’s environment.

A transition period ahead
Financial markets saw a major correction in 2018 especially as of October. As discussed above, we think the chief reasons for this are political. Given the expected slowdown in economic growth, earnings are now beginning to transition towards lower—albeit more sustainable—growth rates. We cannot exclude more downward pressure on equity prices in the short term, but to fear that it will lead to a trend change would imply the start of a US recession in the next 12-15 months. This is not our scenario.

A gradual fading of political concerns coupled with improving business confidence should lay the foundations for the return of a positive momentum in equity markets.

We continue to like markets with attractive valuations, such as the eurozone, Japan and selected Emerging Market equities. We stick to our positive view on pro-cyclical sectors (Materials, Industrials and “Value” themes, e.g. Financials). We also favour more defensive sectors, such as Energy and Health Care as a way of diversifying portfolios because volatility could be higher than usual.
OUR 2019 INVESTMENT THEMES

AT A GLANCE

THEMES:

1. Volatility: adopting cautious strategies via defensive investments and real assets

2. Nearly the end of the stock market cycle: favouring solid companies

3. China’s markets: riding the internationalisation of the financial markets

4. International trade tensions: anticipating the redistribution of roles in Asia

5. Responsible and innovative mobility: transforming the way we get around

6. Tomorrow’s security: modernising protection & cyber security and using the blockchain

7. Urban transformation: promoting a more efficient water and waste management

8. Health and well-being: focusing on the business of longevity

9. Industry 4.0: betting on the winners of the current revolution

10. Currencies: finding diversification opportunities
Volatility: adopting cautious strategies via defensive investments and real assets

The year 2019 will be marked by the normalisation of monetary policies and the impact on liquidity. Thus, volatility may cause trouble on the financial markets. Certain assets considered as defensive and other unlisted assets will be more suitable for investors with a more cautious risk profile.

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For all investors, regardless of their reference currency

- **Alternative strategies (Newcits funds)**
  Global-Macro fund managers are in the best position to benefit from a normalisation of monetary policies and rising interest rates. Among other, they should benefit from the lag in economic cycles between the US and Europe, the latter being still vulnerable to several political risks (e.g. Brexit, Italy, etc.). “Macro” strategies largely seek to benefit from changes in stock market indices, interest rate movements in addition to volatility in commodity prices or currencies. These may be positive or negative trends, because such strategies require a certain stability in these trends to allow fund managers to create value.

  After a long bull market in some equity sectors, supported by extreme monetary policies, the withdrawal of liquidity and rising interest rates will likely reveal an overvaluation of some over-indebted and low-quality companies.

**OUR RECOMMENDATIONS**

This theme is aimed at investors with a more cautious risk profile.

For all investors, regardless of their reference currency. It covers investments in:

- alternative strategies (Newcits funds)
- structured products
- rural land

For investors whose reference currency is the dollar, we recommend US short-dated bonds.

For investors whose reference currency is the euro, we recommend real estate assets.
"Long-Short" fund managers can benefit from these situations by simultaneously taking "long" and "short" positions (a strategy consisting of betting on the fall of a share price and on the rise in the price of another share or group of shares). This helps to limit the portfolio's sensitivity to a general fall in equity markets or to a rise in interest rates. Certain Newcits funds are managed with a level of risk in line with bond funds. However, the expected returns for Newcits funds are higher in the present context than for bond funds.

- **Structured products**

Structured products typically involve the use of sophisticated instruments (futures, options or credit default swaps) to which individual investors usually have limited access.

These instruments can be used to optimise the return or limit losses while reducing the sensitivity to a rise in interest rates. We recommend investing in short-dated defensive products (typically between 1 and 3 years). In other words, it is better to focus on investment products offering full or partial protection of the invested capital.

The underlying assets may consist of various types (oil, gold, equity indices, interest rates etc.).

- **Rural land**

Rural land offers an attractive alternative to investors seeking to diversify their portfolio. These assets are not correlated to the financial markets and provide revenue which is usually indexed, while potentially offering long-term capital appreciation.

Agrifrance, a department of BNP Paribas Wealth Management, specialised in rural real estate transactions in France, advises clients (on both the buying and selling side) as well as executes and facilitates transactions involving farms, vineyards, forests and country estates. It also assists buyers in their search for real estate management solutions.
For investors whose reference currency is the dollar, we recommend

- **Short-dated US bonds**
  They have become attractive for dollar-based investors thanks to the rise in bond yields. This is not the case for investors whose reference currency is different from that of the dollar because the cost of currency hedging is high. US bonds with a short maturity (1-3 years) offered in late 2018 an annual yield of 2.8% (sovereign bonds) and a yield of between 3.0% for AAA-rated corporate bonds (the safest) and 3.5% for A-rated bonds. The default rate or debt restructuring risk is very low given their quality.
  We believe the market has already priced in most of the rate hikes planned by the US Federal Reserve in 2019. The risk of a sudden and extended rise in short rates is therefore low, limiting the risk of these bonds losing value.

For investors whose reference currency is the euro, we recommend

- **Real estate assets**
  An important factor for direct (commercial and residential) investors is that real interest rates do not increase substantially, which is not necessarily the case for nominal rates. If interest rates rise in sync with economic growth, and as a result, underlying inflation goes up, this may be a positive factor for real estate. In the event of higher inflation, homeowners in many parts of the world would be entitled to raise rents (indexing/rental adjustment). Higher rents would eventually push up values, taking into account the usual lag of 6-18 months.
Volatility: adopting cautious strategies via defensive investments and real assets

**MAIN RISKS**

Liquidity risk. Unlisted assets (real estate and rural land) are by nature long-term investments, which may be illiquid.

Interest rate risk. If rates rise, bond prices go down in value. Short-dated bonds are, however, less exposed to this risk. Unlisted assets are penalised by a rise in real rates.

Default/restructuring risk, if the issuer is unable to redeem its debt. This is why we recommend focusing on quality issuers.

![10-year Government Bond Yield](Source: Thomson Reuters Datastream, 03/12/2018)
Nearly the end of the stock market cycle: favouring solid companies

The approach of the end of the cycle in the United States and the overall tightening of monetary policies favour an outperformance of quality securities (high profitability, little indebtedness and low variability of profits).

In the eurozone, companies that generate high and sustainable dividends also offer a good opportunity for quality investments.

In addition, we recommend US and Asian corporate bonds with high credit ratings and short durations.

What is a quality security?

MSCI defines a good quality security as follows: its profitability must be high, its indebtedness limited and the variability of profits must be low. We pay particular attention to the return on equity (ROE), capital debt and the low correlation to the economic cycle. Thus, objective ratios are used to assess a quality company.

A winning style in late stages of the cycle

Sir John Templeton said: "Bull markets are born on pessimism, grown on scepticism, mature on optimism and die on euphoria." This statement infers that current conditions differ from those of the early stages and do not correspond to those of the late stage. However, two factors support the view that we are in a late stage of the cycle when describing the current situation: the gradual upward shift in bond yields and the rise in stock market volatility. These two factors combined create a favourable environment for an outperformance of so-called "quality" stocks. Another factor that favours high investor appetite is the global political context, between protectionism and populism.

OUR RECOMMENDATIONS

In today's context of a gradual rise in yields and in volatility, companies offering high profitability, healthy balance sheets and little exposure to the economic cycle are well positioned to deliver above-average returns.

This ability to outperform should be a global trend. In the eurozone, securities yielding high and sustainable dividends are also covered in this theme.

This is a core investment for anyone seeking to invest in the equity markets for at least a year. Even when the next recession looms on the horizon, the theme's attractiveness should remain intact or even increase.

For the bond component of this theme, US and Asian corporate bonds with high credit ratings and short durations are attractive.

Quality stocks have begun a new period of outperformance.
Nearly the end of the stock market cycle: favouring solid companies

A late stage of the cycle, really?
The statement of Sir John Templeton aside, fundamentals and valuation levels show that the global economy and stock markets have definitely reached a late stage of the cycle. The best examples are probably the sharp decline in unemployment rates since 2009, the high level of consumer and business confidence, the high level of corporate debt and the gap between actual and potential output. Moreover, valuations are high in the US but in line with long-term averages in the rest of the world.

A global theme
We note that economic and stock market cycles in the various regions of the world are not very different. In our view, this is therefore a global theme.

Add in the eurozone’s securities with high and sustainable dividends
As interest rates and bond yields continue to remain durably low in the eurozone, the niche of high and durable dividend securities may be included in this quality theme. If a company pays a high dividend and can afford to maintain it at the same level, then it has the capacity to generate a decent level of profit, irrespective of the economic climate.

In addition, in the eurozone, pay-out ratios are below the long-term average and balance sheets are generally strong. Such stocks can be included in the quality theme.

Valuations are already high, but for good reason
Quality securities had already outperformed before 2016 at the global level, owing to the context of anaemic growth. Now that the growth peak has been exceeded, a new period of outperformance is beginning, even though valuations have not returned to attractive levels judging from the ratios since the beginning of the millennium. Prior to 1999, however, valuations were often in line with today’s levels. We believe that they can easily hold up in the environment we foresee in the coming quarters.
An attractive bond pocket

US bonds have become attractive for dollar-based investors in today’s context of rising bond yields. This is not the case for investors whose reference currency is not the dollar because the cost of currency hedging is high. We like quality corporate bonds rated between AAA and A and with a short-dated maturity (1-3 years) in order to curb interest rate risk because we believe long bond yields will continue to rise. We forecast 3.25% in 12 months for the 10-year US Treasury bond yield. We are more cautious on the BBB and High Yield segments. The BBB segment has more than doubled in 10 years and now represents half of the Investment Grade (IG) Index. These companies are more likely to be downgraded to the High Yield segment by rating agencies when the US economy starts to slow down. The yield spread for bonds in the BBB category (1.05% for short maturities) remains below its medium- to long-term average, despite the correction in 2018, and therefore does not offset this risk, in our view.

MAIN RISKS

Three circumstances could jeopardise this recommendation.

The first would be another acceleration in the world economy. Investors would move away from quality securities, favouring those offering the best exposure to the economic uptrend.

The second would be a decline in volatility or, at least, a sustained and moderate level of volatility. This would imply that investor confidence remains well supported. Therefore, they would have a greater appetite for higher-beta stocks than for quality stocks.

The third circumstance is linked to interest rate risk (if rates were to rise) and the risk of default. The latter is low for Investment Grade bonds.

Quality stocks initiated this year a new period of outperformance

Source: Thomson Reuters Datastream, 06/12/2018
China’s journey of liberalisation has continued to accelerate with its stock, bond and currency markets opening up further. In 2018 there were more government announcements to ease restrictions on foreign access to the domestic financial market. The increasing inclusion of both onshore equities and bonds in the major international indices is a milestone for the internationalisation of China’s capital markets, which will take a hundred billion (or even a trillion) dollars of inflows to the domestic market in the medium to long term.

Inclusion in major international indices are driving long-term flows
Last year, more index companies made announcements of the initial or increasing inclusion of China’s onshore equities and bonds in their major indices, thanks to the robustness of Stock Connect and Bond Connect, an improvement in market accessibility (such as quadrupling the daily limit in Stock Connect and a visible decline in trading suspensions), as well as reform measures by the Beijing government.

1. Increasing MSCI inclusion of China A-shares:
Following a successful 5% China A-share inclusion in 2018, MSCI recommended increasing the inclusion factor of China A-share large caps to 20% in 2019 and broadening eligible A-shares to ChiNext and midcap stocks within this two-year period. Upon the 20% inclusion by 2020, the weighting of China A-shares in the MSCI China Index will increase from 2.3% currently to 10.8%; from 0.7% to 3.4% in the MSCI EM Index; from 0.9% to 4.0% in the MSCI Asia ex-Japan Index; and from 0.1% to 0.4% in the MSCI AC World Index.

OUR RECOMMENDATIONS
The A-share market, onshore bond market and currency market (RMB) are the three financial channels that China has been focusing on to achieve internationalisation. Recommended investment ideas include the following:

- Since the sharp sell-off in 2018, there have been plenty of China A-share stocks offering good earnings visibility, albeit at depressed valuations. Individual A-share stocks may be acquired through Stock Connect. Investors may also invest in a portfolio of A-shares through ETFs and mutual funds.
- Investors may invest in the onshore bond market through mutual funds.
- Beneficiaries of increasing cross-border RMB settlements are banks with regional and/or broader EM networks that provide currency settlement services and trade finance. Stock exchanges could also benefit from the secondary listing of China’s financial products denominated in RMB.

This is a multi-year investment theme. The recommended investment horizon is more than 1 year.
2. **Initial FTSE inclusion of China A-shares:**
The FTSE (Financial Times Stock Exchange) announced that it would on-board China A-shares with a 25% inclusion factor within these two years. After completion by 2020, China A-shares will represent about 5.9% of the FTSE All Cap EM Index and 0.6% of the FTSE All World All Cap Index.

Market expectations of the combined MSCI and FTSE inclusion-related flows from both passive and active funds are estimated to reach approximately USD 100 billion by the end of 2020. The MSCI inclusion has increased foreign investors’ focus on the domestic equity market, while the upcoming onshore bond inclusion should have a much bigger impact.

3. **Initial Bloomberg Barclays Index inclusion of onshore bonds:**
Bloomberg announced in March 2018 the inclusion of China onshore government and policy bank bonds in their Bloomberg Barclays Global Aggregate Index, which will be phased in over 20 months starting from April 2019. By November 2020, the index is expected to include 386 local currency China bonds, accounting for a 5.5% slice of the USD 54 trillion index. This is a big step towards the global recognition of China’s USD 12 trillion bond market.

If two other major global bond benchmarks—namely the JP Morgan Government Bond Index -Emerging Markets and the Citi World Government Bond Index—follow suit, this would be a game changer for the Chinese bond market, not to mention the untapped potential of China’s domestic corporate bond market.

**Internationalisation of the RMB**
Since the inclusion of the RMB as a reserve currency in the new Special Drawing Right (SDR) valuation basket (launched by the IMF in 2016), cross-border RMB settlements have been few and far between but the trend is picking up. China’s Belt and Road Initiative will be a powerful force in propelling the RMB to the global stage amid a rise in cross-border trades and investments in RMB.
Key beneficiaries of this trend are financial institutions involved in the settlement process, such as banks with regional and/or broad EM networks. In addition, certain other stock exchanges are bound to reap the benefits of the secondary listing of an increasing number of China’s financial products, denominated in RMB.

Conclusion
Foreign investors’ participation in the onshore financial market will keep growing from a still low base. With Beijing continuing to improve market access, foster greater transparency and reform its regulatory and legal framework, all this will drive an increasing inclusion in major global indices, and gradually bring massive inflows onto the third-largest equity market (Shanghai and Shenzhen exchanges combined) and the third-largest bond market in the world in the long run.

The weighting of China A-shares in the MSCI EM Index is likely to increase from 0.7% to 3.4% by 2020

Source: Thomson Reuters Datastream, 12/2018

The key risks of investing in this theme are the following:

1. China’s growth slows much more than expected (“hard landing” scenario) which hurts sentiment in any China-related investment.
3. RMB shows a disorderly depreciation.
4. China’s authorities show signs of a pause or reverse the direction of capital market liberalisation.
5. No further inclusion of onshore bonds and equities in major global indices as numerous foreign restrictions are still in place.
International trade tensions: anticipating the redistribution of roles in Asia

Even before US-China trade tensions emerged, manufacturers were moving their supply chains from China to low-cost regions such as Southeast Asia, India, Eastern Europe and Mexico. The trade dispute is a wake-up call for companies to grasp the importance of diversifying their production bases. We believe that trade tensions will accelerate this trend. In the context of this theme we identify the sectors that will benefit from the shift and upgrade in supply chains and we look at their knock-on effects on local consumption markets in the medium to long term.

Trade tensions - a potential catalyst for upgrading supply chains

In the 1980s, the sharp appreciation of the dollar caused difficulties in US industries, leading to the signing of the 1985 Plaza Accord (to devalue the dollar against the yen and the deutsche mark). Subsequently, both Japan and Germany faced a significant deterioration in their terms of trade. However, this somehow facilitated their respective industries to move up the value-added ladder in the 1990s in a bid to win back market share. Indeed, this could happen to the Red Dragon.

For the past decade or so, many manufacturers have been moving parts of their supply chains to other Emerging Markets to take advantage of lower wage costs and affordable land prices but also to move up the value-added ladder. Trade tensions have forced companies to think up ways to hedge risks and cut costs, which will likely accelerate the process of shifting and upgrading their supply chains to reduce their length, shorten sourcing times and/or regionalise supply chains to ramp up efficiency.

OUR RECOMMENDATIONS

This theme focuses on specific EM sector/stock beneficiaries of the shift/upgrade of supply chains and the potential intra-regional trade corridor due to ongoing trade tensions.

We recommend investing in the following sectors:

- Automation and robotics in the context of upgrading manufacturing facilities
- Logistics and transportation (airlines, shipping companies, ports) with intra-regional capacities
- Banks with regional networks to offer cross-border currency settlements and trade finance services
- E-commerce transitioning from B2B to B2C
- Consumer Discretionary with rising brand awareness and absolute costSCALE advantages

This is a multi-year investment theme. The recommended investment horizon is 1 year or longer.
Potential winners of new trade policies

1. **Trade substitution**
   Recent trade data highlight that some European and Emerging Markets have already gained market share from China.

   Looking deeper, when the US imposed an additional 25% tariff on USD 34 billion worth of Chinese goods, with effect from July 2018, figures showed that Germany, Canada, France, Mexico and Thailand were the top 5 “winners” of market share in machinery and electrical equipment exports to the US.

2. **Automation and robotics**
   The relocation and upgrade of manufacturing facilities result in higher Capex and an acceleration in automation.

   The latter is likely to play a major role along the whole supply chain, providing additional value-added services to customers, such as a greater emphasis on “green production”, design and in-time delivery (shorter order cycle). This would require smart warehouses (run by robots), increased automation for high-speed assembly and packaging as well as enhanced automation in logistics companies.
3. **Existing production hubs**

Certain EM countries, which already have the relevant infrastructure and production networks in place, are set to benefit when more companies move their production capabilities. For instance, India has existing production networks in software, Thailand and Indonesia have the same in autos and components, and Malaysia in solar panels.

Meanwhile, Vietnam is on track to become an important low-tech manufacturing production hub.

4. **New trade corridor**

Favourable demographics and the fast growth of the middle classes in Southeast Asia may strengthen the North-South (Asia) trade corridor, thus reducing reliance on the existing East-West (China-US/Europe) corridor. This process is being facilitated by the free trade agreement between China and ASEAN. Shipping companies, ports, e-commerce players, banks and logistics companies with intra-regional capacities are potential beneficiaries of intra-regional trade growth.

5. **Knock-on effects**

Shifts in production imply employment and income growth in local markets that will have a positive impact on consumption, such as household appliances, consumer electronics and local consumer goods (wholesalers and retailers).
Conclusion

China’s enormous scale implies that it is difficult to ignore the country’s essential role in the global supply chain. Nevertheless, shifts in manufacturing already existed before the Sino-US trade tensions as companies were seeking cheaper pastures outside of China. Threats of supply chain disruptions due to ongoing trade disputes are likely to prompt more companies to diversify their production bases.

Shifting manufacturing bases and upgrading supply chains are hugely complex and lengthy exercises. Obviously changes do not happen overnight. The positive impacts on the company/sector winners may only be visible in the medium to long term.

MAIN RISKS

The key risk of investing in this theme is if the extreme scenarios of US-China trade tensions pan out:

1. An extreme positive scenario: US and China reach a trade agreement with much stronger strategic cooperation than ever in all aspects.

2. An extreme negative scenario: a full-blown trade war becomes out of control and leads to a global economic recession.

The change in political dynamics would impact companies’ business decisions on the supply chain significantly.

Trade tensions may accelerate the shift in supply chains to low-cost regions.

Source: Thomson Reuters Datastream 28/11/2018
In cities that are often saturated and polluted, economic players are grappling with the challenge of mobility and are endeavouring to come up with new transport solutions.

The challenge of more efficient mobility offers investment opportunities across the whole value chain. This theme addresses all responsible mobility solutions (urban, logistics, individual and shared transport).

The growing challenges of travelling call for new reflections on mobility. The fight against pollution and the increasing traffic congestion in city centres have prompted economic, private and public players to reinvent new means of transport. Solutions now lie in technological innovations.

**Innovations in mobility**

Driven by growing ecological demands, the automotive industry is undergoing a major transformation. Electric cars are booming, representing a larger slice of manufacturers' revenues. Electric power is becoming an important challenge for them, especially as newcomers are emerging on this segment. The penetration rate of electric vehicles will account for more than 15% of the European market by 2025 (Exane, September 2018).

Meanwhile, cheaper individual means of transportation are riding the wave of this new sales momentum thanks to electrification (e.g. bicycles, scooters).

**OUR RECOMMENDATIONS**

Geographical region: worldwide. Both Emerging Market and developed economies are concerned.

Asset class: an investment in the stock markets via funds and individual securities. Many sectors of the economy are involved: Materials, Industrials, Technology and Consumer Staples.

Risk profile: investing in the innovative mobility theme means accepting an above-average risk. Most sectors in which this theme invests are cyclical.

Investment horizon: long term
Another challenge for the near future will be the development of self-drive vehicles. Many technology companies are already investing in this strategic business by rolling out sensors, cameras, software and electronic components that are part of the production chain. Finally, in the business world, electric trucks and delivery drones are fine examples of innovation.

Plans to build "smart cities"
Cities are expected to become increasingly sprawling, polluted and congested. Investing in better quality urban services has become an absolute necessity. Public authorities have the task of creating cleaner and less noisy public transport (trams, underground trains, high-speed trains), but also "smart" transport (traffic management) which should make transport more efficient.

In addition, they must provide infrastructure to facilitate the use of electric vehicles by individuals. Moreover, with or without the support of public authorities, private companies are innovating by rolling out new mobility solutions (e.g. carpooling services).

How to invest in mobility
We recommend investing in the mobility theme through individual stocks and investment funds. Our solutions are positioned across the whole value chain. Upstream, demand for specific materials for manufacturing new vehicles (lithium, nickel and cobalt for electrical batteries), suppliers of electricity and recharging infrastructure, suppliers of electrical equipment, electronic components and software are concerned. Finally, at the other end of the value chain, manufacturers of innovative vehicles, but also end services offered to consumers (e.g. carpooling) will onboard new trends in transport.

In terms of geography, mobility is a worldwide issue. Both developed countries and Emerging Markets face pollution and congestion challenges in cities.
Conclusion
In conclusion, despite cyclical downturns, in our view, the mobility theme is a long-term trend in the financial markets. Investors will benefit from opportunities in a wide range of sectors that are often cyclical (Automobile, Semiconductors, Software, Hardware, Manufacturing), but also defensive (e.g. electricity producers). When stock markets consolidated in October 2018, this theme became more attractive thanks to its valuation. The price/earnings ratio of the Kensho Transportation Index (US stock market index linked to innovative mobility) fell to 14, versus 16 in September 2018.

MAIN RISKS
Industries in this theme are cyclical. A sharp economic downturn could change the theme’s potential though.

Some components of this theme may depend on public initiatives (e.g. tax incentives), which are in turn dependent on the budgetary capacity of public authorities.

Extremely low oil prices could reverse demand for innovative means of transportation.

One part of the value chain that is not immune to ecological scandals is the extraction of raw materials used in batteries.

Source: Thomson Reuters Datastream, 04/12/2018
Tomorrow’s security: modernising protection & cyber security and using the blockchain

Security has become a major preoccupation for individuals, businesses and governments.

This fast-growing market offers attractive prospects for companies operating in the protection of goods and people, quality control and cybersecurity.

### A growing market

In an increasingly complex and interconnected world, security is becoming a major preoccupation for all economic players (individuals, businesses and governments). Companies that offer their clients better security have a high potential for revenue growth.

There are three main types of security needs:

- **Secure spaces**: the aim is to protect against specific risks by securing certain spaces. For example, surveillance systems for homes and businesses, airbags in vehicles, infrastructure to make roads safer or protect airports.

- **Quality control**: legislation is becoming increasingly stringent and sometimes imposes tight controls in some sectors of the economy. These tests are particularly essential in the food, pharmaceutical and environmental industries.

### OUR RECOMMENDATIONS

Geographical region: worldwide. Emerging Market and developed economies are concerned.

Asset class: this theme invests in stock markets through funds and individual stocks.

Risk profile: this theme is extremely sensitive to market movements owing to its exposure to technological and industrial activities.

Investment horizon: long term. This investment theme is driven by a long-term structural trend.
Tomorrow’s security: modernising protection & cyber security and using the blockchain

- **Improvement of IT security**: in view of the growing use of the Internet and networks, protecting information technology is becoming a priority. Hacking is on the rise across the globe, representing a mammoth cost for companies. The Facebook scandal and the hacked Yahoo! accounts helped to draw economic players’ attention. The International Data Corporation estimates that between now and 2020, companies will be required to spend a total of $100 billion on security software and ancillary services to combat cyberattack threats.

Companies in the security theme mainly operate in the areas of technology (IT Services) and industry (Commercial Services & Supplies and Capital Goods).

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**The potential of blockchain technology**

Within the security theme, the blockchain is a new technology for the storage and secure transmission of data. This technology allows for digital security, benefiting not only transactions but also valuable documents. It also helps to monitor supply chains and is used for "smart contracts", which are based on a conditional execution without the need for intermediaries (Bernard Marr, "Blockchain is changing our world: Here are the best practical examples of how it is used in 2018", Forbes, January 2018.). Thanks to this technology, contracts are secure.

Blockchain technology goes well beyond the controversial methods of payment such as crypto-currencies, e.g. Bitcoin (given their opaque and speculative nature, we do not recommend buying crypto-currencies.). It is a good way of making secure electronic payments and facilitating international trade finance.

In addition, companies wishing to go further in securing their production processes can track and trace their products across the supply chain, thanks to this new technology, for example in the Agrifood (e.g. tracking meat) and Diamond industries and in Maritime Transport.
Another aspect of blockchain technology is to create safe property registers in areas such as luxury goods, land ownership and real estate, and help governments to manage census data. Finally, it may be used to ramp up efficiency and curb fraud in the Insurance sector.

Therefore, the large number of usages suggests that in today's increasingly digital world, this kind of technology could expand considerably in the coming decades.

In conclusion, everyone wants to live in a safer and more secure world. There is a growing number of needs and the list is already long. We recommend investing in this theme through individual stocks and investment funds. All markets—Emerging and developed—are concerned.

**MAIN RISKS**

This theme's stockpicking concentrates on companies that are dependent on the economic climate and sensitive to market sentiment. Although it is driven by a long-term trend, this theme may be penalised by a marked economic slowdown.

Blockchain technology is based on algorithms that require significant computing power. Excessive energy consumption poses a problem for the environment. Moreover, the complexity of blockchain technology and associated questions could hamper its development.
With the fast growth of cities, it has become an absolute necessity to have a better water and waste management. To meet this challenge, public authorities are fixing themselves more ambitious targets for recycling waste, including plastic.

This theme identifies investment opportunities in companies offering innovative solutions for water management and a more efficient waste treatment.

The "smart city" concept
Cities have grown rapidly over the past few decades. According to the United Nations' forecasts, urbanisation combined with total world population growth imply an additional 2.5 billion people living in urban areas by 2050. As a result, 70% of the population will live in cities by 2050. The largest urban areas will therefore face mounting problems of congestion, pollution and resource management. A design of the so-called "smart" city may offer solutions.

The concept of "smart city" covers all innovations used to manage effectively the assets and resources of a city. "Smart" cities offer solutions for greater efficiency in the areas of mobility, energy, housing, and water and waste management. Our investment theme focuses on the latter.

Geographical region: this theme is global. Emerging Market and developed economies are concerned.

Asset class: this is an investment in stock markets through funds and individual stocks.

Risk profile: sectors involved in the theme—Industry, Chemicals, Technology—are dependent on the economic cycle and therefore rather volatile in stock markets. However, some activities (e.g. Utilities) are less sensitive to the financial markets (a beta below 1), which balances the theme, to some extent.

Investment horizon: long term
Opportunities in water and waste management, among other

For a city, while water and waste management is not a major environmental challenge, it also ensures a good quality of life for its inhabitants. Building, modernising and enhancing the efficiency of utilities has become an absolute necessity.

With regards to water management, three goals are targeted: i) provide access to water, ii) guarantee the quality and iii) optimise its use. Many innovative solutions are being developed in the areas of water treatment, the design of pumps/filters, automation and new optimisation techniques (smart metres, sensor networks, leak detectors), making networks more efficient and therefore generating cost savings. This results in offering a better service to local communities (municipalities) and a higher return on investment at companies, which are large consumers of water in certain sectors.

Waste treatment is also changing. The traditional model (management from bin to rubbish tip) is leading to a circular economy model focused not only on waste management, but also on the reduction at the outset. Public authorities (e.g. the European Union) encourage rubbish-sorting, investments in recycling and the reduction of overcapacity in infrastructure for waste treatment based on incineration. In this changing environment, we have identified opportunities for investors interested in collection methods, waste-to-energy solutions and any innovation that a company may offer in the field.
A new environmental challenge: plastic

Today, plastic is used in a myriad of industries, including Construction, Transport, Electronics and Packaging. The world production of plastic has increased by 190 since 1950, reaching 380 million tonnes in 2015 (Science Advance). For all their sustainability and usefulness characteristics, single-use disposable plastics (e.g. plastic bottles) pose serious problems for the environment.

Plastic is manufactured from fossil fuels and is not biodegradable by nature. Almost 26 million tonnes of plastic waste are produced every year in Europe. The potential for recycling plastic waste is often largely untapped. The reuse and recycling of end-of-life plastics is very low (9% of production), compared with other materials such as paper, glass or metals. The bulk of plastic production is made from natural sources. In the face of this scourge, the European Commission confirmed in 2018 its goals for the production and use of plastic. By 2030, all plastic packaging used on the EU market will be reusable or recyclable in a cost effective way. The plastic recycling market will therefore grow in the coming decades.
In conclusion, many companies contribute to the development of new, more effective and cleaner mechanisms for water and waste treatment. Given the high potential growth in this activity, they represent an attractive investment opportunity in the long term. This theme covers sectors such as Utilities, Industry and Technology. The Chemicals industry also works closely with plastic recyclers to improve the value chain.

This theme is global as all mature and Emerging Market regions are concerned by the challenge of water and waste management. Mature countries will need to upgrade their infrastructure, while Emerging Market economies will build new networks.

**MAIN RISKS**

This theme could come under pressure in the event of a sharp macroeconomic slowdown. Activities covered in this theme are often very sensitive to industry indicators (e.g. industrial production).

The main constraint weighing on projects is financing. We believe that financing conditions will remain attractive in 2019 only in the context of a gradual rise in rates. However, many governments and municipalities are suffering from a large debt burden, which is curbing new investments.

Some arbitrage operations may be carried out, depending on the level of commodity prices. Profitability of recycling projects may dwindle in the event of very low prices of certain raw materials.

This theme depends on the willingness of public authorities to support ambitious long-term goals in the treatment of water and waste.
One of the major demographic trends is life extension. By 2050, life expectancy worldwide is set to increase by seven years.

One consequence is that people will have more free time and will seek to lead a healthier lifestyle, especially as seniors have never been in such a strong financial position. This phenomenon is creating good investment opportunities in the Health, Nutrition and Leisure sectors.

Our Recommendations

This investment theme is based on a strong, secular and global trend with very good visibility. The best way to benefit is through the equity markets.

Companies covered by this theme operate in the Health sector but also in Consumer Discretionary and Technology. Such companies may have large or small market capitalisations, especially those specialised in medical technology. In this field, the risk may be very high, hence the importance of high diversification.

The ideal investment period is multi-annual given the structural nature of life extension and the desire to lead a healthier lifestyle. If exposure to this theme is taken via highly-diversified investments, then it should be considered as a core holding.
A good prognosis for the Health sector
The Health sector is expanding at 5% per annum. The longevity business has a higher potential. A longer life expectancy has a downside to it: chronic and degenerative diseases are on the rise. In order to rein in costs, innovation is playing a key role. Beyond the development of new drugs and increasingly personalised treatments, demand for medical technology is on the up. Artificial Intelligence, "Big Data" and the Internet of Things should help people to make better decisions in the field. New and very promising opportunities are emerging thanks to remote medicine and mobile devices, used for informing, alerting, registering purposes, and so on. A still nascent activity is gene therapy, which enjoys huge potential for treating and preventing disease. The approach is based on the use of genes rather than medication or surgical operations.

Healthy living implies a healthy diet
In recent years, there has been an explosion of consumer interest in nutrition, mainly stemming from the problem of obesity. This interest in food is accelerating with the boom in longevity and the desire for healthy living among seniors.

Companies focusing on organic food markets, fresh goods, products with higher nutritional value and the improved productivity of agricultural practices are the first to cash in on this phenomenon.

Old Age Dependency Ratio

Source: Thomson Reuters Datastream, 30/06/2017
Ratio of people over 64 to the working age population (between 15 and 64)
More committed to leisure!

Never before have seniors enjoyed such financial health! Adding to their physical health, money helps them to keep up many activities. According to McKinsey & Company, a consultancy, seniors living in urban areas in developed countries will contribute to half of the consumption growth between 2015 and 2030. Top spending priorities are personal care, the home, leisure (especially travel) and exercise. According to McKinsey, the time dedicated to leisure and exercise in the US among people aged 65 years or over should grow by 195 million hours, a massive chunk of the projected total increase of 210 million hours. This is good news for employment, accounting for the equivalent of 24 million full-time jobs.

A choice investment

Life extension is an investment in a strong trend, which boasts good visibility. This makes an ideal core holding.

MAIN RISKS

The main risk is stock-picking, particularly for investments in medical technology companies. This is an absolute risk. Technological risks may result in very steep price declines.

A relative risk exists. If investors were to be enthused by pro-cyclical investments, the interest in themes considered as core holdings and for the long term would be eroded, and an underperformance would ensue.
The business world is undergoing another industrial revolution, the fourth to date. This one is characterised by a major transformation of the value chain. Optimising costs, time and resources is becoming a priority. Indeed this priority ushered in the fourth industrial revolution. Industry 4.0 spans a very wide universe including robotics, connected objects, Artificial Intelligence, cloud technology, Big Data, 3D printing, etc. Companies are showing a huge willingness to invest.

Industry 4.0: a new industrial revolution

Industrial revolutions are a Schumpeterian force, i.e. a force of destructive creativity. They partially replace human capital, thereby releasing it for new more value-added tasks. By the end of the 18th century, the first industrial revolution emerged in the form of mechanisation via the use of water and steam. The second one took place at the turn of the 20th century, with the advent of mass production, facilitated by electrification. And the third industrial revolution occurred at the beginning of the 1970s, introducing computers and production automation. Today, another major transformation of the value chain is underway, starting a revolution based on so-called cyber-physical production systems.

Industry 4.0 is an equities theme. There are no geographical barriers. Companies covered by this theme mainly operate in the Industrial and Technology sectors. Their market capitalisations range from small to large.

Valuations are no longer cheap but justified by good long-term prospects. These stocks will not escape the various disruptions often occurring during the late stages of the cycle. This is not a defensive investment.

We chose Industry 4.0 as a theme for 2019 but clearly an investment in this area could remain in a portfolio for several years in view of the structural nature of this revolution.
Industry 4.0: betting on the winners of the current revolution

Indeed, factories are becoming "smart" or connected thanks to a combination of computer and physical elements. We note a convergence of industrial production on the one hand and information and communication technologies on the other. This huge field covers robotics, the Internet of Things, Artificial Intelligence, cloud technology, Big Data, 3D printing, to cite just a few examples.

This revolution is increasing competitiveness

In a world in which end demand is growing slowly and competition is fierce, companies must constantly endeavour to stay on top. Optimisation of resources in addition to cost and time savings inevitably usher in another industrial revolution, the fourth to date. Other goals may be pursued, such as tailoring ranges of products and services or shortening supply chains, the latter being a growing need in the context of a strong return of protectionism. As a result, flexibility and agility are important attributes that companies need to onboard.

A world with dimensions only limited by the imagination

Automation is making huge strides thanks to the development of sensors for visual, measuring and interaction purposes, etc. Indeed, automation makes it possible to undergo non-invasive or precision surgery, or drive an autonomous vehicle. With the advent of cloud computing, the creation of various services (e.g. software over the Internet) is on the rise. The Internet of Things is all about objects communicating between themselves and creating "smart" cities (e.g. home automation, energy efficiency, connected vehicles, cybersecurity).

Artificial Intelligence concerns the development of conversational agents (chatbots), automatic language processing, machine learning and virtual assistants. For example, Big Data leads to predictive and preventive maintenance, better inventory management and a revolution in the agricultural world. 3D printing operates by adding layers, which help to cut the consumption of materials. 4D printing is certainly around the corner: with the passage of time, an object transforms itself into another structure or self-assembles; this technology is used for repairing pipes, but also has its raison-d’être in the medical or textile world.
A priority

All the reports on the Industrial Revolution 4.0 come to the same conclusion: the digital transformation is accelerating. According to a recent ECB poll conducted in Europe, the three priorities today are Big Data, cloud technology and e-commerce. The recovery in investments since the Great Financial Crisis of 2008 took a long time to materialise. Now that unemployment has fallen significantly, capacity utilisation rates have reached high levels and profitability is soaring, companies are showing a huge willingness to invest in the fourth industrial revolution.

MAIN RISKS

The main risk relates to the trend in companies’ profitability. When profits rise (as today), companies ramp up their investment spending. However, when the next recession looms on the horizon, this theme will be vulnerable to profit-taking.

Technology and Industrial stocks are more volatile than the market average.

Idiosyncratic risks are of course high, hence the importance of adopting a much-diversified approach.
Currencies: finding diversification opportunities

In an environment of low yields offered in euro terms coupled with upside potential, a positioning in the Norwegian krone (NOK) or Swedish krona (SEK) represents an opportunity for additional returns for euro-based investors.

Emerging Market currencies have already borne the brunt of the anticipated depreciation and appear attractive for dollar-based investors.

### The Norwegian krone and Swedish krona for euro-based investors

Owing to geopolitical tensions and the reluctance of central banks to raise their interest rates before summer 2018, the Nordic currencies have delivered a relatively dismal performance over the past 12 months.

However, the central banks of Norway and Sweden plan to raise their key rates in 2019. Interest rate hikes are expected to start in Sweden in early 2019, while the Norwegian central bank began its monetary policy tightening in September 2018. Less accommodative monetary policies should underpin the Norwegian krone (NOK) as well as the Swedish krona (SEK) via more attractive rate differentials. Moreover, these rate hikes, occurring well before those of the European Central Bank, have the potential to see the NOK and SEK appreciate by about 5-6% during this year.

### OUR RECOMMENDATIONS

For euro-based investors with a balanced profile, Nordic currencies should offer attractive returns given the implied volatility of the Norwegian krone (NOK) and Swedish krona (SEK).

Emerging Market currencies offer an attractive investment for more dynamic dollar-based investors willing to make a strong bet and able to bear the volatility of these currencies.

**Asset Class**

Depending on the risk profile, an investment in the NOK or SEK should be made through bonds or shares. As for Emerging Market currencies, investments should be made via bond funds to ensure good diversification.

**Investment horizon**

One year
Furthermore, the appreciation of the SEK and NOK should be supported by the health of the Swedish and Norwegian economies. Both should continue to grow at a decent rate, while inflation will remain close to central bank targets.

In addition, the expected rise in oil prices will offer significant support for the NOK (our forecast for the Brent crude oil is between $65 and $75). The NOK, which has been de-correlated temporarily, is likely to benefit from higher oil prices via the impact of oil exports on the current account.

Finally, both NOK and SEK appear to be broadly undervalued relative to their countries’ economic fundamentals. Thus, our valuation of the Norwegian krone is about 8.90 and 9.70 (value of one euro) for the Swedish krona, a deviation expected to decrease in the coming quarters.

Emerging Market currencies for US dollar-based investors

The US dollar appreciated in 2018, driven by intensifying trade pressures while President Trump's economic reforms allowed the American economy to extend its economic cycle. The Federal Reserve's monetary policy also bolstered the greenback while the euro suffered from political uncertainties in the eurozone.

However, the US dollar should change direction and depreciate in 2019. Indeed, the US is close to the peak of the economic cycle, while tax reforms should start to have a softer impact on the economy. Moreover, public finances suffered from these measures, with the public deficit and government debt expected to widen as a result. On the other hand, many developed and Emerging Markets still have room for manoeuvre before reaching a peak in economic growth. Finally, although two rate hikes are expected in the US in 2019, the markets appear to have priced in these two events. Thus, a more restrictive monetary policy at the end of 2019 should not have a major impact on US sovereign bond yields or reduce their attractiveness.
Conversely, the start of the rate hike cycle in other developed countries should have a significant impact on bond yields and their potential to redirect global capital flows away from the dollar. The prospect of a weakening dollar is particularly likely against Emerging Market currencies.

The resurgence of Sino-American tensions in the middle of the year, followed by fears of contagion of the situation in Turkey and Argentina to other Emerging Markets in August, hurt all Emerging Market currencies (see chart). In addition, the deceleration in the Chinese economy raised fears of a rapid and substantial impact on economic momentum across Emerging Markets. Political uncertainty ahead of the elections in Brazil and Mexico temporarily weighed on Emerging Market currencies. In this context, principally the currencies of countries with a double deficit (fiscal deficit and current account deficit) suffered the most.

A convergence of economic growth between developed and Emerging Market countries, along with trade tensions and higher interest rates in the US, are sources of caution. However, these fears are probably priced in by the markets and well anticipated by investors. Pressure from the rate hike cycle in the US is expected to be lower in 2019 than in 2018 and judging from economic fundamentals, Emerging Market currencies seem to have borne the brunt of the depreciation. Finally, the risk of a contagion of the situation in Turkey and Argentina declined sharply, with their respective economies embarking on a stabilisation path. Emerging Market currencies look undervalued against the dollar. The speed of normalisation is a major unknown.

**MAIN RISKS**

**For euro-based investors:** Norwegian and Swedish fixed-income assets offer a low yield. The bulk of the expected performance is based on the appreciation of the underlying currencies. Investments in equities are not suitable for all risk profiles.

**For dollar-based investors:** from a global perspective, a faster-than-expected deceleration in global trade and an intensification of trade tensions could negatively affect our forecasts. From an individual perspective, uncertainties remain in some Emerging Market countries and specific risks could emerge.

![Emerging Market Currency index](image_url)

*Source: Thomson Reuters Datastream, 04/12/2018*
We would like to thank all the contributors

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