

FEBRUARY & MARCH 2023

European Equity Perspectives

Europe: Showing New Year Resolve

New Year, new start? Perhaps.

Dragged down by Russia's war in Ukraine, inflation and tightening monetary policy, the STOXX 600 Index ended 2022 lower by 12.8%, its worst performance since 2018.

The outlook for European stock markets in 2023 turns on a connected set of economic and geopolitical drivers, which include inflation, sanctions on Russia, central bank policy, China's reopening, oil prices and currencies.

But 2023 has at least started on a more positive footing. Firstly, Europe has benefited from an unusually mild winter, which has resulted in a sharp fall in gas prices that has lessened the risk of an energy shock. This has been a positive for both corporates and consumers alike.

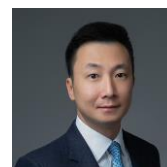
Next, China's reopening can be viewed as favourable, supporting sectors such as luxury goods, even if it does bring the risk of new inflationary pressures. German stocks have traditionally outperformed European peers when China outperforms the rest of Asia. In that context, investors have turned more positive on the region, reflected in increased fund flows into regional exchange-traded funds.

Anticipation of less aggressive European Central Bank rate hikes, thanks to lower inflation data, has also been supportive. This is despite some more hawkish Governing Council members suggesting that there is still further to go.

This early-year outperformance has seen cyclical names outperform defensive names, with investors looking beyond recession and inflation risks. Last year's winners like Energy, and traditionally defensive areas like Healthcare and Consumer Staples, are languishing at the bottom in terms of returns. Italy's FTSE MIB Index, which closed 2022 at record valuation lows, has led the way in 2023 while the UK has lagged - a sure sign that pro-cyclical value is attracting fund flows.

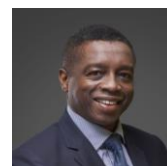
Chris ZEE

Head of Equity Advisory, Asia
BNP Paribas Wealth Management



Godfrey OYENIRAN

Senior Adviser
Equity Advisory Asia
BNP Paribas Wealth Management



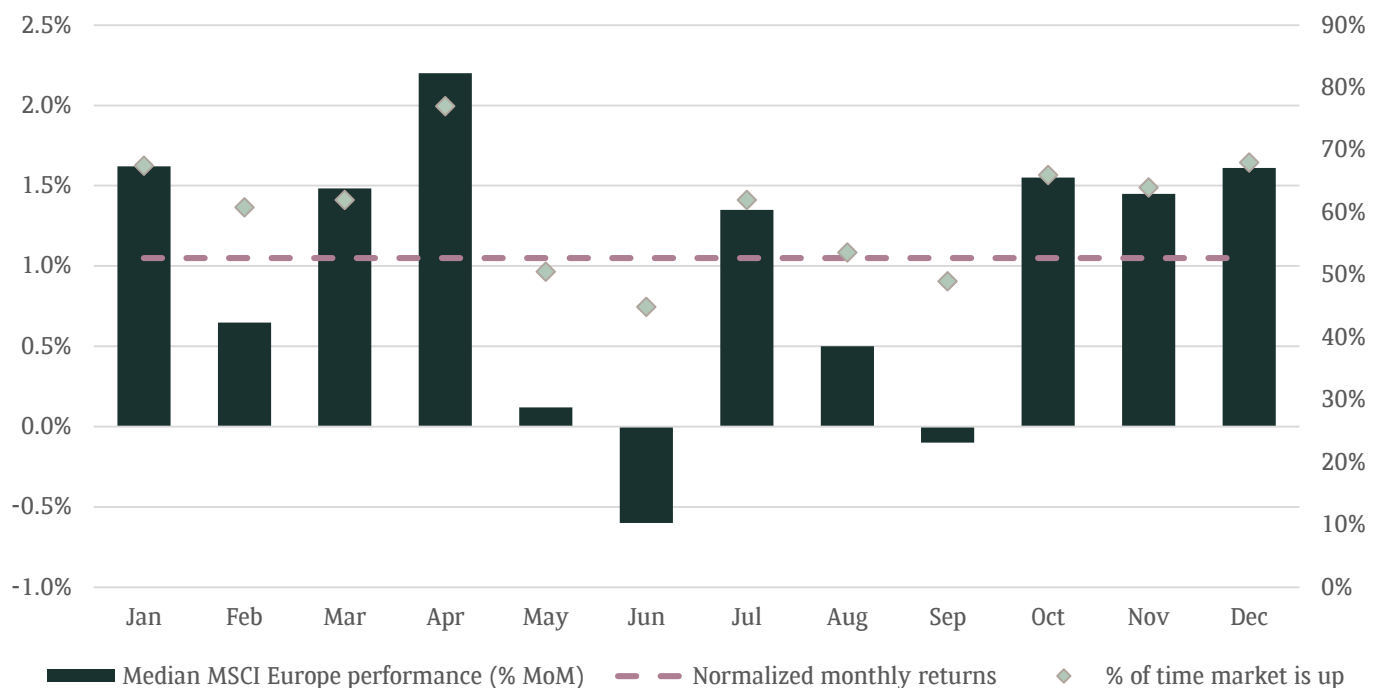
Given the confident start to the year, quarterly earnings are a big focus. Analysts had been more aggressive in revising down European earnings expectations going into the results season than was seen in the US. But that has not stopped us from seeing volatility.

Earnings have been far from stellar. As of 10 February 2023, only 58% of the STOXX 600 have beaten earnings expectations and 35% have missed. Banks have been the standout, with Consumer Discretionary particularly heavily hit. The worst of a profit recession may have been avoided but negative share price reactions have been significant on disappointing results. Some companies posted double-digit declines on earnings misses. Forward guidance has been key, and stock prices tended to hold up when companies signalled the outlook had not deteriorated dramatically.

One issue that gets highlighted by analysts is that fixed income in Europe is finally starting to offer a viable alternative for multi-asset fund managers, particularly as the equity risk premium in Europe has fallen to cycle lows. Nonetheless, European equities still look attractive from an earnings growth, shareholder returns and valuation perspective. Given that payout ratios remain low, there is also room to raise dividends across the region. This is important because over the longer term, dividend income in Europe typically provides two-thirds of total equity returns through the cycle.

With valuation multiples still looking attractive relative to the US, and the market in a seasonably favourable period (see chart 1), we believe the market can start to look beyond looming earnings risk. Our view on Continental Europe has been raised to positive.

CHART 1: SEASONALITY OF MSCI EUROPE PERFORMANCE – MEDIAN SINCE 1970



Source: Organisation for Economic Co-operation and Development, Bloomberg, as of 28 November 2022
 Past performance is not indicative of current or future performance.

UK: A Winter of Discontent

The UK's FTSE 100 index eked out a gain for 2022 and outperformed major equity markets for the first time in a decade, aided by the record decline in the pound and buoyant commodity prices.

The benchmark finished 2022 up 0.9% at a time when the more domestic-focused FTSE 250 lost 19.5%, its biggest annual loss since 2008. In US dollar terms, the FTSE 100 lost 10%, still beating the MSCI All-Country World Index by nine percentage points – the most since 1996.

Differentiating stocks exposed to the domestic growth story with those with high overseas exposure is important when it comes to the UK, given that the domestic economy is facing one of the most challenging macroeconomic backdrops amongst advanced economies.

On the surface, the UK still faces many challenges. A range of strikes has disrupted daily life, from public transport to health services, in the biggest wave of industrial unrest since the 1980s. Inflation is still running at 10.5%. The British Chambers of Commerce suggests the economy has entered a five-quarter recession, with growth returning gradually in late-2024. The International Monetary Fund expects the UK to be the only G7 economy in recession in 2023. In relation to the energy crisis, help only started for households in October 2022 and will be scaled back in April 2023, meaning higher bills to come. Concerns remain that the situation will not improve by next winter.

The Bank of England also delivered its 10th consecutive interest-rate increase, raising rates by 50 basis points to 4%, alongside forecasts

underscoring the risk that inflation becomes more persistent in the UK economy. A major retailer's cautious profit outlook highlighted the challenges within the UK market.

Yet, expectations were already low going into 2023, and so far the worst-case scenarios have not played out. The consumer demand is holding up post-Christmas. Inflation may be peaking. European gas prices have fallen more than 20%. Mortgage rates have already come down from their November 2022 high. Such has been the recent turnaround in the outlook, a 2023 recession is no longer guaranteed – or at least the very least could be shallower than expected.

Even though the FTSE 100 recently reached an all-time high, the UK has lagged most of its pro-cyclical peers this year. 2022's stable performance was supported by a convergence of drivers that played to the FTSE 100's unique composition. Elevated interest rates have supported banks' profitability, while rising metals prices have driven returns in commodity names. And with more than 70% of revenue coming from outside of the UK, pound weakness has been supportive. But some of these underlying fundamental supports evident last year are now faltering or running out of steam.

Nonetheless, the market still offers yield and valuation attractions – important elements in a rockier macro environment. The FTSE 100 has a dividend yield of 3.6%, higher than the 10-year gilt yield of 3.4%. Our current preference is for UK names with international exposure, the exception being domestic-focused banks that benefit from the rising rate cycle.



DISCLAIMER

This document/communication/information ("document") is provided in Singapore by BNP Paribas, acting through its Singapore branch, and in Hong Kong by BNP Paribas, acting through its Hong Kong branch. BNP Paribas is a public limited company (société anonyme) incorporated in France with liability of its members limited. BNP Paribas, acting through its Hong Kong branch is a licensed bank regulated by the Hong Kong Monetary Authority, a Registered Institution under the Securities and Futures Ordinance of Hong Kong (Cap. 571), and registered with the Securities and Futures Commission (SFC) to carry on Types 1, 4, 6 and 9 regulated activities in Hong Kong (SFC CE Reference: AAF564). BNP Paribas, acting through its Singapore branch (UEN/Registration No: S71FC2142G), is a licensed bank regulated by the Monetary Authority of Singapore. BNP Paribas Wealth Management is the business line name for the Wealth Management activity conducted by BNP Paribas. "BNP Paribas Wealth Management" (UEN/Registration No 53347235X) is a business name registered in Singapore under the Business Names Registration Act 2014.

This document is produced for general information only and should not be used as sole reference for entering into any specific transaction, and the information and opinions contained herein should not be relied upon as authoritative or taken in substitution for the exercise of judgment by any recipient or the seeking of independent professional advice (such as financial, legal, accounting, tax or other advice) by any recipient. This document is not intended to be an offer or a solicitation to buy or to sell or to enter into any transaction. In addition, this document and its contents is not intended to be an advertisement, inducement or representation of any kind or form whatsoever. BNP Paribas reserves the right (but is not obliged) to vary the information in this document at any time without notice and, save to the extent provided otherwise in Clause 6.5 of BNP Paribas Wealth Management's Terms and Conditions ("T&Cs") applicable to your account, BNP Paribas shall not be responsible for any consequences arising from such variation.

The terms set forth herein are intended for discussion purposes only and are subject to the final expression of the terms of the transaction, if the investor decides to proceed with the transaction. It does not represent (a) the actual terms on which a transaction would be entered into, (b) the actual terms on which any existing transactions could be unwound, (c) the calculation or estimate of an amount that would be payable following an early termination of the transactions, or (d) the actual valuations given to the transactions by BNP Paribas in its books of account for financial reporting. The final terms of the transaction will be set forth in the final term sheet, any applicable agreement and/or confirmation. Please also refer to the disclaimer statements contained in the relevant documents, and disclosure and other important

information concerning our fees, charges and/or commissions as set out in the Fee Schedule.

If this document is a post-trade/transaction confirmation, please examine the information as set out in this document carefully and contact us immediately if you notice any discrepancy. The content of this document is subject to the final transaction(s) details / information in our official bank statements and/or advices (if any) which may follow by mail. This document contains confidential information intended only for the use of the addressee(s) named above. If you are not the addressee(s), you must not disseminate, copy or take any action in reliance on it. If you have received this document by error, please notify BNP Paribas and delete/destroy this document immediately.

Although the information and opinions provided herein may have been obtained or derived from published or unpublished sources considered to be reliable and while all reasonable care has been taken in the preparation of this document, BNP Paribas does not make any representation or warranty, express or implied, as to its accuracy or completeness and, save to the extent provided otherwise in Clause 6.5 of the T&Cs applicable to your account, BNP Paribas shall not be responsible for any inaccuracy, error or omission. All analysis, estimates and opinions contained in this document constitute BNP Paribas' own judgments as of the date of this document, and such expressions of opinion are subject to change without notice. Information provided herein may contain forward-looking statements. The words "believe", "expect", "anticipate", "project", "estimate", "predict", "is confident", "has confidence" and similar expressions are also intended to identify forward-looking statements. These forward-looking statements are not historical facts but based on the current beliefs, assumptions, expectations, estimates, and projections of BNP Paribas in light of the information presently available, and involve both known and unknown risks and uncertainties. These forward-looking statements are not guarantees of future performance and are subject to risks, uncertainties and other factors, some of which are beyond control and are difficult to predict. Consequently, actual results could differ materially from those expressed, implied or forecasted in these forward looking statements. Investors should form their own independent judgment on any forward-looking statements and seek their own advice from professional advisers to understand such forward-looking statements. BNP Paribas does not undertake to update these forward looking statements. Where investors take into account any theoretical historical information regarding the performance of the product/investment, investors should bear in mind that any reference to past performance should not be taken as an indication of future performance. BNP Paribas is not



DISCLAIMER

giving any warranties, guarantee or representation as to the expected or projected success, profitability, return, performance, result, effect, consequence or benefit of any investment/ transaction. Save to the extent provided otherwise in Clause 6.5 of the T&Cs applicable to your account, no BNP Paribas group company or entity therefore accepts any liability whatsoever for any loss arising, whether direct or indirect, from the use of or reliance on this document or any part of the information provided.

Structured transactions are complex and may involve a high risk of loss including possible loss of the principal invested. If any product mentioned in this document is a structured product which involves derivatives, do not invest in it unless you fully understand and are willing to assume the risks associated with it. If you are in any doubt about the risks involved in any product/transaction, you should seek independent professional advice.

Prior to entering into any transaction, each investor/subscriber should fully understand the terms, conditions and features of the product/investment as well as the risks, the merits and the suitability of entering into any transaction/investment including any market risk associated with the issuer, and consult with their own independent legal, regulatory, tax, financial and accounting advisors before making the investment. Investors/subscribers should fully understand the features of the investment, be financially able to bear a loss of their investment and

be willing to accept all risks involved. Save as otherwise expressly agreed in writing, (a) where BNP Paribas does not solicit the sale of or recommend any financial product to the investor/subscriber, BNP Paribas is not acting as financial adviser of the investor/subscriber in any transaction, and (b) in all cases, BNP Paribas is not acting as fiduciary of the investor/subscriber with respect to any transaction.

BNP Paribas and/or persons associated or connected with it may effect or have effected a transaction for their own account in a product/an investment described in this document or any related product before or after this document is published. On the date of this document, BNP Paribas and/or persons associated or connected with it and their respective directors and/or representatives and/or employees may take proprietary positions and may have a long or short position or other interests or make a market in a product mentioned in this document, or in derivative instruments based thereon, and may purchase and/or sell the investment(s) at any time in the open market or otherwise, whether as principal or as agent or as market maker. Additionally, BNP Paribas and/or persons associated or connected with it may have within the previous twelve months acted as an

investment banker or may have provided significant advice or investment services to the companies or in relation to a product mentioned in this document.

This document is confidential and intended solely for the use of BNP Paribas and its affiliates, their respective directors, officers and/or employees and the persons to whom this document has been delivered. It may not be distributed, published, reproduced or disclosed by any recipient to any other person, nor may it be quoted or referred to in any document, without the prior written consent of BNP Paribas.

Hong Kong: This document is distributed in Hong Kong by BNP Paribas, acting through its Hong Kong branch only to Professional Investors within the meaning of Part I of Schedule 1 to the Securities and Futures Ordinance of Hong Kong (Cap. 571). The products or transactions described in this document may not be authorised in Hong Kong and may not be available to Hong Kong investors.

Singapore: This document is distributed in Singapore by BNP Paribas, acting through its Singapore branch only to Accredited Investors within the meaning of the Securities and Futures Act 2001 only and is not intended for investors in Singapore who are not such Accredited Investors and should not be passed on to any such persons. Some products or transactions described in this document may not be authorised in Singapore and may not be available to Singapore investors.

Where this document is distributed by BNP Paribas to a person in Singapore who is not an Accredited Investor, Expert Investor or an Institutional Investor, BNP Paribas, acting through its Singapore branch accepts legal responsibility for the contents of this document to such person only to the extent required by applicable law.

Save to the extent provided otherwise in Clause 6.5 of the T&Cs applicable to your account, information in this document is for general circulation to the intended recipients only and is not intended to be a recommendation or investment advice to recipients hereof. A recipient of this document should seek advice from its/his/her own professional adviser regarding the suitability of the products or transactions (taking into account the recipient's specific investment objectives, financial situation and particular needs) as well as the risks involved in such products or transactions before a commitment to purchase or enter into any product or transaction is made.

Please note that this document may relate to a product or products where BNP Paribas is issuer, and in such instance this document or certain information contained therein may have been prepared by BNP Paribas in its capacity as product issuer ("Issuer Document").





DISCLAIMER

Where an Issuer Document is provided to you by BNP Paribas, acting through its Hong Kong branch or BNP Paribas, acting through its Singapore branch in its capacity as distributor, it shall also be subject to Clause 6.5 of the T&Cs. To the extent that there are any inconsistency between the terms of an Issuer Document and Clause 6.5 of the T&Cs, the latter shall prevail.

Generally, please take note that various potential and actual conflicts of interest may arise from the overall investment activities or the roles of the parties involved in any investment product or transaction, their investment professionals and/or their affiliates. In particular, the counterparty / issuer / provider or its related entities or affiliates can offer or manage other investments which interests may be different to the interest of your investments in that investment product or transaction; or for cases where the product counterparty or issuer is BNP Paribas or its related entity or affiliate, BNP Paribas may also act as distributor, guarantor, calculation agent and/or arranger of the same product. BNP Paribas and its affiliates and persons associated or connected with it (collectively "BNP Paribas Group") may make a market in, or may, as principal or agent, buy or sell securities mentioned in this document or derivatives thereon. BNP Paribas Group may have a financial interest in the issuers mentioned in this document, including a long or short position in their securities, and/or options, futures or other derivative instruments based thereon. BNP Paribas Group, including its officers and employees may serve or have served as an officer, director or in an advisory capacity for any issuer mentioned in this document. BNP Paribas Group may, from time to time, solicit, perform or have performed investment banking, underwriting or other services (including acting as adviser, manager, underwriter or lender) within the last 12 months for any issuer referred to in this document. BNP Paribas Group may, to the extent permitted by law, have acted upon or used the information contained herein, or the research or analysis on which it was based, before its publication. Members of the BNP Paribas Group may face possible conflicts of interest in connection with certain duties under structured products. For example, it and its affiliates may trade an underlying for their own account or for the account of others. It or its affiliates may receive a portion of the management or other fees charged with any of the underlyings. BNP Paribas may offer other services to entities associated with an underlying, for which they may be remunerated. All of these activities

may result in conflicts of interest with respect to certain financial interests of BNP Paribas.

Where this document includes a reference to real estate, please note that real estate service offered in Hong Kong by BNP Paribas, acting through its Hong Kong branch exclusively relates to real estate properties outside Hong Kong. Specifically, BNP Paribas, acting through its Hong Kong branch is not licensed to deal with any real estate property situated in Hong Kong. BNP Paribas, acting through its Singapore branch is not licensed to and does not offer real estate service, and nothing herein should be construed as such.

BNPP clients and counterparties are responsible for ensuring that they comply with applicable provisions of Executive Order (EO) 13959, as amended (and any subsequent official guidance). For the full details of the EO, you may want to consult the following websites: For the EO itself, <https://home.treasury.gov/system/files/126/13959.pdf>, and for the latest guidance on this EO provided by the OFAC, <https://home.treasury.gov/policy-issues/financial-sanctions/recent-actions>.

By accepting this document, you agree to be bound by the foregoing limitations. In case there is a Chinese version and there is any ambiguity or difference of meaning between the English version and the Chinese versions, the English version shall prevail. In respect of any transactions or arrangement with BNP Paribas, acting through its Singapore branch, the English version is the only operative version and the Chinese version shall be disregarded.

You may contact BNP Paribas, acting through its Singapore branch at 10 Collyer Quay, #35-01 Ocean Financial Centre, Singapore 049315; Tel: (65) 6210 3888; Fax: (65) 6210 3861 in respect of any matters arising from, or in connection with, this document. This paragraph does not apply to you if you are (a) not resident in Singapore and you are (b) served by a Relationship Manager in Hong Kong. If you satisfy (a) and (b), you may contact BNP Paribas, acting through its Hong Kong branch at 63/F Two International Finance Centre, 8 Finance Street, Central, Hong Kong; Tel: (852) 2909 8888, in respect of any matters arising from, or in connection with, this document.

Photo credit @Getty images

© BNP Paribas (2023). All rights reserved.