May 2023

Investment Navigator
Asia Edition

How to Recession Proof Your Portfolio?

Summary

- Our major asset allocation calls have worked year-to-date. Consensus expected a tough first half and better second half, while we were the opposite: overweight non-US equities since last November, overweight investment grade credit and gold, while being underweight the USD.
- The depth and timing of recession is key. How much will financial conditions need to tighten? The US regional banking crisis is getting worse. Watch for policy action. We remain vigilant and retain the moderate recession view.
- What is still attractive? Non-US equities, USD diversification, structured solutions to generate better entry points, income, hedging, and finally the continued case for quality income.

Incoming recession?

Recent growth and inflation measures are better than expected overall in Europe and the US. The Federal Reserve now faces a dilemma on the back of low unemployment and still persistent inflation. How much will monetary policy need to tighten to raise unemployment and bring inflation durably to 2%? At the same time, the regional banking crisis is worsening. What can authorities do? For example, a program such as the **TLGP or temporary liquidity guarantee program implemented** in October 2008, **could guarantee non-interest business transaction accounts such as checking accounts.** This could balance moral hazard issues and lower the risk of bank runs. **Assessing the impact on bank lending several quarters from now will also be key.** That recession call can move to later this year or even early next year. **The key now will be how much financial conditions need to tighten, generating either a moderate or deeper recession.** We are in the moderate recession camp but remain vigilant.

Our Asset Allocation Calls Worked!

The consensus was for a tough first half of 2023, and better second half. We were the opposite: **overweight non-US equities since last November, including Europe which was contrarian as most market forecasters stayed cautious on equities.**

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Year-to-date (YTD, as of end April 2023) returns are as follows: Europe - Euro Stoxx 50 equities up +16.1%, Japan - Nikkei +11.7%, and China up +2.7% after a strong end of 2022. Furthermore, we are also **overweight investment grade credit (YTD +4%) and gold (YTD +9%), while being underweight the USD. All these key asset allocation calls paid off.**

Recession Proof the Portfolio

(1) Maintain Overweight on Non-US Equities: Top up China and Japan equities

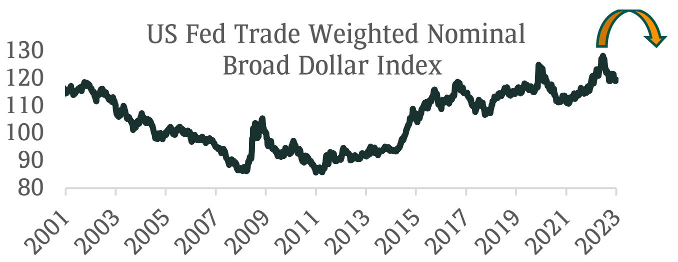
In this regard, given our recommendations on Europe and UK equities are now at all-time highs, we would also highlight the recent weakness in China equites.

- Growth: China's economy is gathering speed, with year-on-year GDP up by 4.5% in the first quarter of 2023, retail sales experiencing the highest level of growth since June 2021 and total social financing better than expected. The government is now focused on achieving a 5% GDP growth target for 2023, and hence, there is a likelihood for more policy measures to be announced, such as a stimulus targeted at the property and consumer sectors.
- Opportunity: Chinese equities pulled back further in March 2023 on geopolitical jitters, weakness in manufacturing and further profit taking after the rally at the start of the year. The domestic A-share market could be more immune to the banking turmoil in the short term. Once the dust settles, we expect outperformance of broad-based Chinese markets (onshore and offshore).

Japan Land of the Rising Return on Equity (ROE)? Japanese equities starting to outperform. Why?

- Reopening: Japan is reopening this year. Recent entry restrictions have been lifted signaling a further pickup in in-bound tourism. Chinese visitors were once more than 1/3rd of total visitors. Japan is leveraged to Asia trade as well.
- Valuation: Japanese equities remain reasonable with Topix on a forward Price-to-Earnings ratio (P/E) of 12.9x.
- With a looming recession in the US, Japanese companies are healthy with **50% of corporates in Topix1000 having more cash than debt**.
- Shareholder friendly behavior with a record 9.2 trillion yen in buybacks in 2022. Also, **ROE has gradually increased from below 7% in 2012 to over 9% in 2022**.
- Positioning: Average investor portfolio is underweight Japan. Foreign investors have been sellers of 10 trillion yen in Japanese equities since 2020.
- Monetary policy: Latest comments from new Bank of Japan (BOJ) governor Ueda hinted at keeping in place Yield Curve Control (YCC) for up to a year. Longer-term, we would expect a gradual shift in policy given the impact on Yen and USD investments. Important to note: ***longer-term, the P/E of the stock market is positively correlated to bond yields including of course the financial sector.***

CONSOLIDATION OF USD LIKELY, FOLLOWED BY MEDIUM-TERM WEAKNESS



Source: Bloomberg, BNP Paribas (WM), as of 5 May 2023. Past performance is not indicative of current or future performance.

(2) Diversify Dollar Exposure

We went underweight USD after it hit 20-year highs last September. It has since dropped 11%. While the USD may need to consolidate recent gains, on a 12-month basis, we still see further weakness. Hence, utilise near term USD strength, which will gradually fade.

Why?

- Safe Haven Status Waning: The USD's safe haven status led to strong flows last year. This is less important given Europe's warmer winter and refilling of gas storage as well as China's reopening.

- Positioning: International investors are structurally overweight in US equities after its massive 10-year outperformance. **The US is more than 60% of global market cap, while it is 24% of global GDP.** While the US is a center of innovation, "US exceptionalism" may not be as strong in the next 10 years. For example, flows to European equities are improving. Portfolio asset flows to non-US equities can weaken the dollar over time.
- Peaking inflation and narrowing yield differential means that after the May 2023 Federal Reserve meeting hike, the Fed is at or near the peak rates, which should lower risk premiums and the USD over time.
- Reserve diversification is happening and the main beneficiary is gold with a target of $1950 to $2150. Central banks are buying more gold than any period since 1950 and account for 33% of monthly demand recently. We remain positive after recent gains expecting some consolidation. Gold is a safe haven, diversifier in times of recession, and benefits from a weakening dollar.

(3) Add Investment Grade Bond Exposure with Higher Yields?

While we tactically took profits on our overweight government bonds after yields dropped following SVB news in March 2023, we remain overweight investment grade bonds.

- While we expect the Federal reserve to be on hold longer than the market is currently pricing, **once again we remind investors that there is reinvestment risk in deposits. Already, deposit rates have dropped in the past months.**
- With a possible recession, investors no longer need to reach for yield and investment grade bonds will have lower default rates while being more defensive in downturns. **Investment grade bond yields are the highest in a decade.**
- The corporate investment grade yield curve is relatively flat vs. the inversion on the treasury yield curve. **Hence the Investment Grade curve is positively sloped from 3 to 20 years,** so investors are paid to take on more duration risk.

S&P VOLATILITY INDEX BOTTOMING

Source: Bloomberg, BNP Paribas (WM), as of 5 May 2023. Past performance is not indicative of current or future performance.

(4) Monetise Volatility and Hedge?

Missed our contrarian calls on the equity rally? One can monetize the volatility via structured solutions in favoured names, allowing better entry points and income. **Volatility = Opportunity**.

In addition, if one is already overweight equities, they can take advantage of low index volatility (S&P 500 volatility below 17) to hedge market risk while maintaining portfolio exposure.

CONCLUSION

Our favoured allocations include (1) Non-US vs. US equities, in particular presently China due to its recent pullback and Japan, after large outperformance in Europe (for which we are still overweight). (2) Dollar diversification while expecting some short-term consolidation or rise in the dollar. The position remains on a medium term basis and dollar strength should fade. (3) Gold remains the ideal diversifier as well to buy on pullbacks. (4) Structured solutions allow portfolio flexibility to tailor positions for better entry points and income as well as hedging. and (5) Quality income via investment grade bonds remain an attractive allocation.

Overview of our CIO Asset Allocation for May 2023

	Views Current	Views Prior	Constituents	We like	We avoid	Comments
EQUITIES	+	+	Markets	Europe, UK, Japan, Latin America, China, South Korea, Singapore and Indonesia		■ **We maintain our positive view on non-US equities.** Key drivers include falling US inflation, lower long-term interest rates, and improving macro liquidity
			Sectors	Energy, Healthcare, Mining		■ We favour Quality names across sectors. Be aware that volatility could persist. **Focus on the strongest players.** We also like sectors exposed to the Chinese economic recovery (Energy, Materials).
			Styles/ Themes	Megatrend themes		■ **Security, circular economy, and income growth themes**
BONDS	=	=	Govies	-		■ **We expect 10-year yields to reach 3.5% in the US** ■ **We stay neutral on US government bonds**
	+	+	Segments	Investment Grade, Emerging Markets Bonds (USD + local currency)		■ **We are positive on US and Euro Investment Grade (IG) corporate bonds, as well as EM bonds in hard and local currency.**
CASH	-	-				
COMMO-DITIES	+	+		Gold Oil Battery metals		■ **Gold - positive**: target range $1950-2150 ■ **Oil - positive**: Brent to climb back to $90. ■ **Base metals – positive**
FOREX			EURUSD			■ **New EURUSD 3- and 12-month targets at 1.08 and 1.15 respectively**
ALTER-NATIVE	+	+		Real Estate (healthcare, UK commercial); Hedge Funds (Long-Short equities, Relative Value); Infrastructure (energy, transportation, water)		■ We upgrade Long-Short equities and downgrade Macro. Positive opinion on Long-Short equities and Relative Value. Neutral on Event Driven, and Macro

Note: + Positve / = Neutral / - Negative

GDP & CPI Forecasts

		GDP (YoY%)			CPI (YoY%)		
		2022	2023f	2024f	2022	2023f	2024f
Developed	US	2.1	1.4	-0.1	8.0	4.4	2.6
	Japan	1.0	1.2	0.8	2.5	2.7	1.5
	Eurozone	3.5	0.8	0.5	8.4	5.5	2.7
	UK	4.0	-0.4	1.0	9.1	6.6	2.0
North Asia	China	3.0	5.6	5.3	2.0	2.7	2.5
	Hong Kong*	-3.5	3.5	3.1	1.9	2.3	2.4
	South Korea	2.6	1.4	2.0	5.1	3.7	2.3
	Taiwan*	2.5	2.1	2.6	2.9	1.9	1.7
South Asia	India	7.0	5.7	6.0	6.7	5.4	4.5
	Indonesia	5.3	4.8	5.0	4.2	3.9	3.0
	Malaysia	8.7	4.0	4.4	3.4	3.0	2.3
	Philippines*	7.6	6.0	5.8	5.8	6.3	3.2
	Singapore*	3.6	1.5	2.1	6.1	5.8	3.5
	Thailand	2.6	3.7	3.8	6.1	3.0	2.1

Source: BNP Paribas Group Economic Research, BNP Paribas Global Markets forecasts as of 30 April 2023
** IMF data and forecasts as of 30 April 2023*

GROWTH

- We revised our 2023 GDP growth forecast marginally higher for the Eurozone and slightly lower for the US. For 2024, US growth forecast figures were revised slightly lower.
- Our base case is that the Eurozone avoids a full fledged recession, especially as energy prices wane. Meanwhile, we expect a US recession to start in the third quarter of 2023, with a probability of delaying till 2024 as the lagged effect of interest rate hikes work its way into the economy.

INFLATION

- We revised our inflation forecast slightly higher for the Eurozone and the UK.
- Core inflation continues to remain sticky, and proves to be challenging for central bankers to manoeuvre. We expect services to overtake energy and core goods as the main drivers of global price inflation in 2023.

Equities

POSITIVE NEUTRAL NEGATIVE

OVERALL GLOBAL: POSITIVE		
Positive	Neutral	Negative
COUNTRY		
UK Japan Emerging Mkt Eurozone	US	-
SECTOR		
Energy Healthcare Materials	Comms. Industrials Utilities Real Estate Technology Consu. Discre. Financials	Consu. Sta.

OVERALL ASIA: POSITIVE		
Positive	Neutral	Negative
COUNTRY		
China Singapore South Korea Indonesia	Taiwan India, Thailand Malaysia Philippines	-
SECTOR		
Comms. Consu. Discre. Consu. Sta. Healthcare Technology	Energy Materials Real Estate Financials Industrials	Utilities

- The MOVE bond volatility index and the St Louis Fed Financial Stress index have both eased, highlighting that the **panic caused by the recent banking crisis has abated considerably**, bringing about relief for the equities market.
- We retain our positive asset class view on Equities, but continue **to prefer non-US equities.** We like Europe, China, emerging markets in general while Japan remain our favourite regional market.
- We still favour Quality stocks and avoid being overexposed to risky / overleveraged names. Globally, we like the Health Care sector along with some Utilities (preference for Europe and for the electrification & clean energy themes), as well as some Tech (Semiconductors). As many quality names are now expensive, stay diversified with cheap cyclicals (Energy, Materials, European Financials).

		1-month (%)	YTD (%)	2022 (%)	Forward PE (x)	Trailing PB (x)	Dividend Yield (%) 2023f	EPS Growth (%) 2023f	EPS Growth (%) 2024f	ROE (%) 2023f
Developed	US	1.2	8.5	-20.8	18.3	3.8	2.1	0.1	12.0	17.8
	Japan	2.7	8.9	-6.6	13.3	1.4	2.5	5.1	5.1	8.9
	Eurozone	0.9	13.0	-14.5	12.6	1.7	3.2	1.6	8.8	13.0
	UK	3.3	5.4	3.0	10.7	1.7	3.9	-8.0	3.2	14.7
	Asia Ex-Japan	-2.2	1.8	-21.5	12.8	1.4	3.2	2.7	20.1	10.1
North Asia	China	-5.1	-0.3	-22.4	10.2	1.2	3.3	18.5	14.5	10.9
	China A-shares	-0.5	4.1	-21.6	12.8	1.8	2.4	19.5	13.6	12.9
	Hong Kong	0.4	-1.9	-7.8	13.8	1.1	3.6	13.8	11.5	7.1
	South Korea	1.9	14.6	-26.4	14.3	0.9	2.3	-37.0	69.3	5.8
	Taiwan	-3.4	9.6	-24.7	14.2	2.2	4.3	-15.8	19.8	13.3
South Asia	India	3.7	-3.8	1.6	19.8	3.4	1.5	25.0	14.8	14.6
	Indonesia	3.8	3.9	10.4	13.2	2.6	4.3	6.4	7.1	17.5
	Malaysia	-0.4	-5.3	-4.3	12.9	1.4	4.0	15.9	7.2	9.6
	Philippines	2.9	2.1	-7.3	13.8	1.9	1.7	22.8	11.0	12.3
	Singapore	1.3	0.9	4.4	12.3	1.4	4.4	34.6	5.8	9.8
	Thailand	-3.9	-7.5	6.3	15.5	1.8	3.1	-3.8	10.7	10.1

Source: MSCI indices in local currency terms, Bloomberg, Datastream, BNP Paribas (WM), as of 30 Apr 2023

Fixed Income

POSITIVE NEUTRAL NEGATIVE

OVERALL GLOBAL: NEUTRAL		
POSITIVE	NEUTRAL	NEGATIVE
EMD (LC) EMD (HC) IG	High Yield UST	-

OVERALL ASIA (USD): NEUTRAL		
POSITIVE	NEUTRAL	NEGATIVE
Hong Kong Indonesia	India China Philippines Singapore	-

		Total Return (%)			Yield-to-Worst (%)
		1-Month	YTD	2022	
Asia	Asia USD Bond	0.7	3.6	-11.7	5.8
	Asia Local Currency Bond	0.2	4.2	-8.6	4.2
	China	0.3	3.0	-10.9	6.4
	Hong Kong	0.8	4.4	-10.5	5.2
	India	1.8	3.2	-9.7	7.3
	Indonesia	1.3	4.2	-12.9	5.2
	Singapore	0.5	3.5	-11.0	5.4
	South Korea	0.6	3.3	-8.6	4.9
	Philippines	1.4	4.0	-14.2	5.2
Other Regions	US 10-year Treasuries	0.6	-8.8	-12.1	3.4
	US Investment Grades (IG)	0.6	-9.9	-13.0	4.4
	US High Yield (HY)	1.0	-7.1	-11.2	8.5
	Emerging Market USD Bond	0.6	-9.0	-12.1	6.7

Source: Barclays indices, Bloomberg, BNP Paribas (WM) as of 30 Apr 2023

US Treasury 12-month Yield Targets (%)	2Y	5Y	10Y	30Y
	4.00	3.75	3.50	3.75

- The US Federal Reserve hiked interest rates by another 25bps, as expected, at the May 2023 Federal Open Market Committee (FOMC) meeting. The upper limit of the Fed funds target range is now at 5.25% (our terminal rate forecast). We expect rates to pause with no cuts likely for the rest of 2023. Fed Chair Jerome Powell signalled that any pause will still likely remain data dependent given the strength in the labour market, which continues to feed into the stickier than expected core inflation.

- For the European Central Bank (ECB), likewise, they hiked rates by an expected 25bps. We still expect another 25bps rate hike in June, to bring us to a terminal rate of 3.5% (deposit rate). Similarly, we do not expect rate cuts this year from both the ECB and the Fed.

- **We favour Hong Kong credit.** Arguably, we believe the worst is over for Hong Kong property as confidence resumes and the rate hiking cycle approaches its end. We expect HK GDP and HK issuers' business profile to gradually recover as China's economic activities pick up following its reopening.

- **We also favour Indonesian credit.** As China opens up, we expect commodity demand to be strong, which will be supportive for the Indonesian Rupiah (IDR). Onshore liquidity is ample, with financing cost lower compared to offshore. We also expect lower corporate bond supply in the USD market, resulting in many of the bonds to trade at tight levels.

Forex & Commodities

POSITIVE NEUTRAL NEGATIVE

12-MONTH FOREX VIEW

Positive	Neutral	Negative
JPY EUR GBP AUD NZD CAD CNY KRW TWD MYR PHP SGD THB	HKD IDR INR	USD

EUR: The Euro (EUR) has continued to strengthen against the US dollar as the 2-year yield differential continues to push in favor of the EUR. We expect the ECB to do one more 25bps hike, while the Fed hiked by 25bps to reach our forecasted terminal rate of 5.25%. The Fed is expected to cut rates in early 2024, while the ECB only later and by less.

In addition, the economic momentum moved in favor of the EUR, and the EU terms of trade improved as energy prices decreased. Therefore, we increase our EUR 3-month target from 1.06 to 1.08 and our 12-month target from 1.08 to 1.15.

COMMODITIES

Positive	Neutral	Negative
Gold Oil Base metal		-

GOLD: We remain positive on gold for the medium term, with a target range of $1950-2150. Gold should resume its uptrend after the current consolidation phase at around $2000/oz, helped by higher-than-usual central bank buying, the crisis of confidence in banking and a weakening USD.

OIL: The OPEC+ quotas reduction, normalization of Chinese demand, seasonal effects and insufficient replacement of existing oil field depletions should push Brent prices above $90 by the end of 2023's second half. Target: $90-105.

BASE METALS: We remain positive on base metals. The expected recession will delay the impact of the huge demand increase linked to energy transition. Importantly, Chinese demand remains the most crucial driver in the short run.

Forex Forecasts

		Spot	3-month		12-month	
		As of 30 Apr 2023	View	Target	View	Target
Developed	USD Index*	101.66	=	102.3	-	97.1
	Japan	136.2	+	130	+	128
	Eurozone	1.104	-	1.08	+	1.15
	UK	1.257	-	1.23	+	1.31
	Australia	0.661	+	0.70	+	0.73
	New Zealand	0.616	+	0.65	+	0.65
	Canada	1.356	+	1.32	+	1.30
Asia Ex-Japan	China	6.928	+	6.75	+	6.50
	Hong Kong*	7.850	=	7.85	=	7.85
	South Korea*	1,338	+	1,260	+	1,175
	Taiwan*	30.74	=	30.2	+	29.3
	India	81.84	=	82.0	=	82.0
	Indonesia*	14,670	-	15,400	=	14,700
	Malaysia*	4.461	+	4.28	+	4.07
	Philippines*	55.39	=	53.8	+	51.9
	Singapore*	1.334	=	1.30	+	1.22
	Thailand*	34.15	=	33.20	+	30.50

Source: BNP Paribas (WM) as of 30 April 2023
**BNP Paribas Global Markets forecast as of 30 April 2023*

Note: + Positve / = Neutral / - Negative

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