FEBRUARY 2023

Investment Navigator
Asia Edition

Chinese equities to bounce further in the Year of the Rabbit?

Summary

- We remain positive on Chinese equities, both onshore and offshore, and believe the "buy-on-dips" story remains intact.
- The consumption-led recovery still have room to go further, the government is still easing, corporate earnings are set to improve, positioning is far from crowded as domestic onshore and foreign investors just started to return and the still attractive valuations are key reasons for the uptrend to go further in the Year of the Rabbit.

Macro Insight of the Month	1
Overview of our CIO Asset Allocation	4
GDP & CPI Forecasts	5
Equities	6
Fixed Income	7
Forex & Commodities	8
2023 Investment Themes	9

A faster-than-expected reopening

The rapid shift in Covid policy, plus the wrap up in regulatory policy for the big internet companies, saw a sharp rebound in China equities over the past three months with the MSCI China (offshore Chinese equities) up 58% and CSI 300 (A-shares)up 20% from the end-October lows.

The fast and furious rally has been largely driven by short-covering by hedge funds (mostly on the internet companies), significant Southbound Stock Connect buying (for Hong Kong-listed China equities), and robust Northbound buying (for on-shore A-shares).

In fact, Southbound saw net inflows of USD49 billion in January 2023, while the Northbound net inflows reached a record high (since the Stock Connect began in 2014) of USD34 billion in January 2023 (vs. only USD13 billion for the whole 2022).

We turned more positive on the overall China equities (both onshore and offshore) in early December 2022 amid more certainty about the re-opening and the still depressed valuations.

Prashant BHAYANI
Chief Investment Officer
Asia
BNP Paribas
Wealth Management

Grace TAM
Chief Investment Adviser
Hong Kong
BNP Paribas
Wealth Management

Dannel LOW
Investment Specialist
Asia
BNP Paribas
Wealth Management

The rally still has legs. Why?

After such a strong run, it is reasonable to see a consolidation recently. The next question is "Do we think there is still room for more upside?"

We believe Chinese equities, both on-shore A-shares and offshore Chinese equities (H-shares, ADRs), could bounce further in the Year of the Rabbit due to the following reasons:-

(1) A consumption-led economic recovery

Massive excess savings (estimate to be around 10% of GDP) during the pandemic will unleash pent-up demand, coupled with an improvement in the labour market, should see a strong turnaround in private consumption this year.

With Covid infections already peaked (which suppressed sentiment previously), we expect to see a V-shaped recovery in consumer and real economy data in coming months.

We have just started to see evidence from the high frequency mobility data, such as domestic tourism, hotel revenues and theater box office numbers, moving back to 80-90% of the 2019 levels during the Chinese new year holidays.

(2) China is still in easing mode

Beijing vowed to prioritise economic growth this year with plans on more tax/fee cuts and financing support to relieve pressure on stressed SMEs. State Council and provincial level meetings were held in major economic hubs, such as Beijing, Shanghai and Guangdong, with signals to boost confidence of private companies. We recently revised up our 2023 China GDP growth forecast from 4.5% to 5.1%. This is in contrast to the tightening mode and recession risks for other major economies.

(3) Corporate earnings estimates are set to revise upwards

After the re-rating (valuation recovery) in Chinese equities over the past three months, the next phase of the rally will likely be driven by earnings.

Earnings estimates have just started to bottom out for the CSI 300 (onshore) and begun to stabilise for the MSCI China (offshore). Continued upward revisions in earnings estimates usually bode well for equity markets.

(4) Pre-position before onshore investors are back

The onshore A-share market is generally a domestic retail-driven market as they usually dominate over 60% of fund flows. Turnover in A-shares markets remained subdued in January 2023, implying a lack of participation by domestic retail investors. There is also no sign of pick up in retail investor account opening yet, while margin financing balance has just rebounded from multi-year lows in recent days.

Furthermore, there are rumours that onshore institutional investors have largely missed the rally in the past three months. The onshore mutual funds' cash holdings were at a 3-year high of 12% in 4Q 2022.

ONSHORE MUTUAL FUNDS STILL HAVE A LOT OF ROOM TO DEPLOY CASH

Source: Wind, Morgan Stanley, BNP Paribas (WM), as of 31 Jan 2023. Past performance is not indicative of current or future performance.

(5) Foreign investors have just returned very recently

We believe we are still early in the cycle as net buying from foreign investors in Hong Kong-listed Chinese equities has just returned in recent weeks after six months of continued weekly net outflows in 2H 2022.

On positioning, long-only global funds are nearly universally underweight China (reduced their underweight recently but still underweight). On average, Asian and Global Emerging Markets (GEM) funds are modestly engaged in recent months, while global funds stayed relatively cautious. Given the current low exposure, there are plenty of room for foreign investors to increase weighting in China in their global portfolios especially after they had missed the initial sharp rally and have to chase back performance.

(6) Valuations remain attractive

Despite the sharp rebound, the MSCI China and CSI 300 are trading at 11.2x and 12.4x forward PE respectively, still lower than their respective historical 5-year average of 12.3x and 13.4x.

Both onshore and offshore China markets are also trading at a discount to MSCI Asia ex-Japan's 13.2x and MSCI EM's 12.4x, as well as a huge discount to S&P 500's 18.4x forward PE.

Moreover, we are overweight Emerging Markets (EM) as a whole, thanks to the peaked dollar and peaking monetary tightening cycle in most of the major EM countries.

Key risks

Geopolitical tensions would be a key factor to watch. One of the key risks is a potential US broad ban on investment in China's technology-related sectors. There were signs of stabilisation in the bilateral US-China relationship early this year with Vice Premier Liu He's meeting with US Treasury Secretary Janet Yellen at Davos in mid-January. However, US Secretary Blinken postponed his visit to Beijing in early February due to the suspected "spy" balloon fuels tensions again.

Premature tightening soon after the rebound in economic activity, continued weaknesses in the property markets and a deeper-than-expected recession in the US are other key risks to our bullish view on China equities.

Conclusion

The Fed's peak hawkishness is already behind us, which is also an indication that the dollar has peaked. A medium-term declining trend in the greenback (expect to see some consolidation in near term after consecutive few months of weaknesses) is a tailwind for EM and Asia assets, including China.

We continue to stay positive on Chinese equities, both onshore and offshore, and expect the performance decoupling between China and US equities to continue. Therefore, any corrections are buying opportunities.

Overview of our CIO Asset Allocation for February 2023

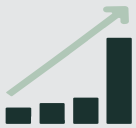
	Views Current	Views Prior	Constituents	We like	We avoid	Comments
EQUITIES	+	+	Markets	Europe, UK, Japan, Latin America, China, South Korea, Singapore and Indonesia		■ **We maintain our positive view on non-US equities. Europe and China up double digit in January.** Key drivers include falling US inflation, lower long term interest rates, improving macro liquidity, and easing energy prices.
			Sectors	Oil & Gas, Financials, Healthcare, Materials, Semiconductors, Precious/"battery" Metals		■ Momentum, earnings and valuations are still very supportive to Energy, some Metals & Mining, Health Care and Financials. **We downgrade Consumer Staples sector to Negative.**
			Styles/ Themes	Megatrend themes		■ **Security, circular economy, and income growth themes**
BONDS	=	=	Govies	US Treasuries		■ **We expect 10-year yields to reach 3.5% in the US** ■ **We are positive** on US government bonds
	+	+	Segments	Investment Grade, Emerging Markets Bonds (USD + local currency)		■ **We are positive on US IG corporate bonds, and EM bonds in hard and local currency.** ■ **We turn positive on Euro IG corporate bonds.**
CASH	-	-				
COMMO-DITIES	+	+		Gold & Oil		■ **Gold - positive**: Gold to trade in the $1850-2000 range. ■ **Oil - positive**: Brent to climb back to $90-105 range. ■ **Base metals –upgrade to positive: demand should be supported by the Chinese post-Covid recovery and decreasing recession risks in Europe.**
FOREX			USDCNY			■ **CNY see upside targets at 6.75 for a 3-month horizon and 6.50 for a 12-month horizon.**
ALTER-NATIVE	+	+		Real Estate (warehouses, healthcare, UK commercial); Global Macro, Relative Value & trend-following Hedge Funds		■ **We prefer Global Macro and upgrade Relative Value strategies to positive, as well as trend-following CTAs** given the strong trends this year. ■ **We are neutral on Event Driven, and Long/Short Equity.**

Note: + Positve / = Neutral / - Negative

GDP & CPI Forecasts

		GDP (YoY%)			CPI (YoY%)		
		2022f	2023f	2024f	2022f	2023f	2024f
Developed	US	2.1	0.3	-0.2	8.1	4.2	2.4
	Japan	1.2	0.9	0.3	2.5	2.2	1.2
	Eurozone	3.4	0.2	1.3	8.4	5.0	2.4
	UK	4.4	-0.9	0.8	9.0	6.8	2.1
North Asia	China	2.6	5.1	5.3	2.0	2.7	2.5
	Hong Kong*	-0.8	3.9	3.0	1.9	2.4	2.5
	South Korea	2.6	1.4	1.9	5.1	3.5	1.9
	Taiwan*	3.3	2.8	2.1	3.1	2.2	1.4
South Asia	India	8.3	6.2	6.5	7.9	5.9	5.5
	Indonesia*	5.3	5.0	5.4	4.6	5.5	3.2
	Malaysia*	5.4	4.4	4.9	3.2	2.8	2.4
	Philippines*	6.5	5.0	6.0	5.3	4.3	3.1
	Singapore*	3.0	2.3	2.6	5.5	3.0	2.0
	Thailand*	2.8	3.7	3.6	6.3	2.8	1.5

Source: BNP Paribas Group Economic Research, BNP Paribas Global Markets forecasts as of 31 January 2023
** IMF data and forecasts as of 31 January 2023*



GROWTH

- The macroeconomic outlook has improved on a global scale in the past month. We have revised up the outlook for the US and the Euro-zone GDP. The IMF also announced an upcoming upward revision. The end of the downward revisions would be a potential catalyst for markets.
- The Euro-zone GDP for 2023 is revised up to +0.2% narrowly missing a recession. The US GDP growth is revised from -0.1% to +0.3% for 2023, however, we believe a mild recession has been pushed to 2024 with -0.2%.

INFLATION

- Recent inflation data has supported our view of peaking inflation. The sharp fall in the energy prices have contributed to a decrease in inflation in the US and especially in the Eurozone. However, the two regions are not currently experiencing the same trend in core inflation. The core inflation pace slowed down in the US while the fall in the Euro-zone is still to come.
- The US annual inflation peaked in June 2022 at a rate of 9.1%. Inflation has dropped 2.6 points to 6.5%. On a month-on-month basis CPI decreased -0.1% for third month in a row. We revised down our US inflation for 2023 from 4.4% to 4.2%.

Equities

POSITIVE NEUTRAL NEGATIVE

OVERALL GLOBAL: POSITIVE			OVERALL ASIA: POSITIVE		
COUNTRY			COUNTRY		
UK Japan Emerging Mkt Eurozone	US	-	China Singapore South Korea Indonesia	Taiwan India, Thailand Malaysia Philippines	-
SECTOR			SECTOR		
Energy Healthcare Financials Materials	Comms. Industrials Utilities Real Estate Technology Consu. Discre.	▼ Consu. Sta.	Comms. Consu. Discre. Consu. Sta. Healthcare Technology	Energy Materials Real Estate Financials ▼ Industrial	Utilities

- **Our upgrade to non-US Equities was non-consensus** in December 2022. In January, the rally continued with EuroStoxx 50 index +11.4% in USD.
- In addition, the **upgrade to the global materials** also performed very well with a gain of +10.4%.
- Considering that the global economic environment is looking better after a warmer European winter and China reopening, **we downgraded consumer staples (expensive defensive) to negative.** We believe their pricing power will fade in 2023.
- **Our upgrade to China equities has also performed strongly in 2023.** In January, the Hang Seng index up more than 10% and the CSI 300 up more than 9.7% in USD terms. **China's Covid pivot led to positive sentiment and strong inflows to China equities.** January inflows from foreign investors were 50% higher than the previous record.
- **We downgraded Asia industrial to neutral.** Although China domestic demand is expected to pick up in 2023, sluggish demand elsewhere remains a risk.

		1-month (%)	YTD (%)	2021 (%)	Forward PE (x)	Trailing PB (x)	Dividend Yield (%) 2022f	EPS Growth (%) 2022f	EPS Growth (%) 2023f	ROE (%) 2022f
Developed	US	6.5	6.5	-20.8	18.1	4.0	2.1	2.2	11.0	21.5
	Japan	4.7	4.7	-6.6	12.7	1.3	2.5	10.9	1.5	8.8
	Eurozone	9.5	9.6	-14.6	12.5	1.7	3.2	0.7	8.5	12.5
	UK	4.0	4.0	3.0	10.3	1.7	3.8	-2.7	2.5	13.1
	Asia Ex-Japan	8.2	8.2	-21.6	13.4	1.6	3.0	4.0	17.6	11.3
North Asia	China	11.7	11.8	-22.4	11.5	1.5	3.1	14.7	14.0	10.9
	China A-shares	7.4	7.4	-21.6	14.1	2.6	2.0	16.5	13.8	11.0
	Hong Kong	4.2	4.2	-7.8	14.6	1.2	3.3	29.1	12.1	8.9
	South Korea	9.5	9.5	-26.4	12.8	1.0	2.5	-20.3	40.6	5.8
	Taiwan	10.1	10.1	-24.7	13.6	2.2	4.4	-16.0	18.0	18.5
South Asia	India	-4.0	-4.0	1.6	21.2	3.9	1.4	21.0	14.3	13.7
	Indonesia	-0.9	-0.9	10.4	13.1	2.7	2.4	3.7	6.4	18.1
	Malaysia	-0.4	-0.4	-4.3	13.5	1.5	3.6	11.7	6.3	11.1
	Philippines	3.3	3.4	-7.3	15.6	2.1	1.5	16.3	11.7	10.0
	Singapore	0.8	0.8	4.4	13.2	1.4	4.1	22.3	10.1	9.8
	Thailand	-1.2	-1.2	6.3	18.0	2.3	2.4	15.2	11.1	9.6

Source: MSCI indices in local currency terms, Bloomberg, Datastream, BNP Paribas (WM), as of 31 January 2023

Fixed Income

POSITIVE NEUTRAL NEGATIVE

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

OVERALL ASIA (USD): NEUTRAL		
▲ Hong Kong ▲ Indonesia	India, China Philippines Singapore	-

		Total Return (%)			Yield-to-Worst (%)
		1-Month	YTD	2022	
Asia	Asia USD Bond	2.9	2.9	-11.7	5.7
	Asia Local Currency Bond	6.0	6.0	-8.6	4.2
	China	3.0	3.0	-10.9	6.0
	Hong Kong	3.2	3.2	-10.5	5.2
	India	1.9	1.9	-9.7	7.1
	Indonesia	2.9	2.9	-12.9	5.2
	Singapore	2.4	2.4	-11.0	5.1
	South Korea	1.7	1.7	-8.6	5.0
	Philippines	2.8	2.8	-14.2	5.3
Other Regions	US 10-year Treasuries	2.4	-10.0	-12.1	3.4
	US Investment Grades (IG)	3.1	-10.3	-13.0	4.3
	US High Yield (HY)	3.8	-7.8	-11.2	8.1
	Emerging Market USD Bond	3.2	-9.3	-12.1	6.5

Source: Barclays indices, Bloomberg, BNP Paribas (WM) as of 31 January 2023

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

- As widely expected, the latest FOMC raised interest rates by 25bps to 4.75% and signalled further rate hikes are appropriate. **We maintain our 5.0% forecast for terminal Fed funds rate, which implies just one more 25bps rate hike in March 2023.**
- The ECB hiked 50bps in February 2023 as expected. **We expect another 50 bps in March and a final 25 bps rate hike in May.** We thus see the terminal rate for the deposit rate at 3.25% and 3.75% for the main refinancing rate and then pause for the rest of 2023.
- **We upgraded Hong Kong credit to positive.** Arguably we believe the worst is over for Hong Kong property as confidence is resuming and rate hiking cycle is coming to an end. We expect HK GDP and HK issuers' business profile gradually recover as China economic activities pick up and border reopening resumes.
- **We upgraded Indonesia credit to positive.** As China opens up, we expect commodity demand to be strong which will be supportive for the IDR. Onshore liquidity is ample, with financing cost lower compared to offshore. We expect lower supply of corporate bonds in the USD market, resulting in many of the bonds to trade at tight levels.

Forex & Commodities

POSITIVE NEUTRAL NEGATIVE

12-MONTH FOREX VIEW

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

COMMODITIES

Gold Oil ▲ Base metal		-

DXY: The resilience of the US economy appears to arrive at an end. Weakening growth expectations for this year have weighed on the dollar. The DXY index has lost over 2.8% over the month.

CNY: The yuan appreciated in January 2023 on the back of peaking Covid cases and positive investor sentiment as inflows were strong into China equities boosting the currency as well.. We revise our 3-month target on CNY to 6.75 and 12-month target at 6.50.

JPY: The Yen continued to rally in January, and we expect this trend to carry on. The BOJ announced an adjustment of its yield curve control in December widening the band to +/- 50 bps instead of 25 bps. While there was no further revision in January their will be a new BOJ governor coming in a few months and the market will be sensitive to any new policy before and after this event..

GOLD: The precious metal surged more than a $100/ounce to $1928/ounce during the month. The weakening dollar, lower bond yields, and increased investor positioning boosted the metal. **It remains as our preferred hedge against tail risks. 12m target range: $1850-$2000.**

OIL: Brent prices were relatively unchanged closed marginally down for the month at $84.50 given warmer weather. **We maintain a positive bias on oil as China reopening and longer-term supply issues remain elevated. We expect Brent prices to trade between $90-105 in the coming months.**

BASE METALS: We upgraded our stance from neutral to positive as demand should be supported by the China post-Covid recovery demand and decreasing recession risks in Europe. Medium-term outlook remains bullish given the huge needs of the energy transition.

Forex Forecasts

		Spot	3-month		12-month	
		As of 31 Jan 2023	View	Target	View	Target
Developed	USD Index*	102.10	+	105.9	=	101.9
	Japan	130.0	=	130	=	128
	Eurozone	1.086	-	1,03	=	1.08
	UK	1.231	-	1.17	=	1.23
	Australia	0.705	=	0.70	=	0.70
	New Zealand	0.647	=	0.65	=	0.65
	Canada	1.334	+	1.30	+	1.30
Asia Ex-Japan	China	6.757	=	6.75	+	6.50
	Hong Kong*	7.839	=	7.85	=	7.85
	South Korea*	1,232	-	1,380	=	1,250
	Taiwan*	30.03	-	32.3	=	30.7
	India	81.93	=	82.0	=	82.0
	Indonesia*	14,990	-	16,000	=	15,600
	Malaysia*	4.266	-	4.75	=	4.40
	Philippines*	54.63	-	58.5	-	58.6
	Singapore*	1.314	-	1.38	=	1.33
	Thailand*	33.01	-	35.50	=	33.50

Note: + Positve / = Neutral / - Negative

What are your investment concerns / needs?

Rising USD loan cost

Stable income

Inflation

Recession-proofing

"Safe haven" investments

Market volatility

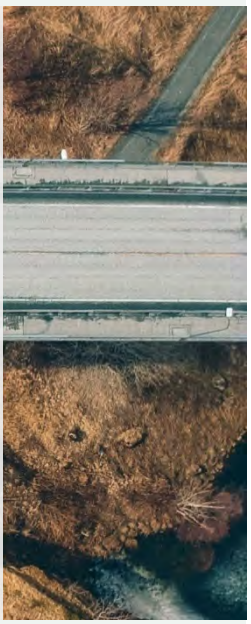
Recession risk

Diversifying from long-only exposure

Adding equity exposure given valuations

Underwater positions

Switching ideas



Our 2023 Investment Themes

Looking through the inflation and rates peak

Seizing new income opportunities: from TINA to TARA

Embracing market volatility

Investing in a new era

Accelerating energy efficiency

Click here for more details on our website!

THEME 1

Click to find out more!

2022 has been a year of surprises for investors, ranging from the aftermath of Covid-related disruptions in global supply chains to the conflict in Ukraine and an associated European energy crisis. In addition, the global economy has also seen an unprecedented swing from massive government and central bank boosts to the global economy in 2021, to a sharp reversal towards higher policy interest rates from global central banks in 2022 as inflation rates spiked to decade highs.

The resulting slowdown in economic demand, easing of supply chain pressures and cooling of commodity prices should calm inflation pressures. This in turn should lead to lower long-term bond yields. We believe that long-term investors should look beyond the peak in inflation and policy rates to the investment opportunities that lower inflation and long-term rates can offer.

LOOKING THROUGH THE INFLATION AND RATES PEAK

In anticipation of lower inflation and long-term rates in 2023

OUR RECOMMENDATIONS

Our recommendations for this theme revolve around Equities and Fixed Income, particularly:

- **Investment grade credit**: as its spreads and yields have reached multi-year highs and now offer attractive opportunities.
  - **Quality stocks with strong cash flow and solid balance sheets:** as they can increase margins by taking advantage of easing input costs.
  - **High-end luxury names with strong pricing power:** as high net worth individuals (HNWIs) are less affected by rising living costs, in that they can comfortably spend on luxury goods.
- **Stocks with exposure to automation, digitalisation, and cybersecurity:** as companies increase Capex to adapt to a new, scarce and expensive labour market. Businesses are forced to ramp up Capex in digitalisation and automation in a bid to remain competitive. Security investments are also needed to mitigate risks from cybercrime.
- **Emerging Market equities, which tend to benefit from a weaker dollar:** we expect the greenback to weaken in 2023

KEY RISKS

- If inflation remains at high levels for longer, central banks would be forced to keep hiking rates beyond expectations, thus pushing bond yields higher. This would probably have a negative impact on equity and bond prices.
- Further disruption in supply chains could hurt input prices and squeeze profit margins, in turn having a negative effect on equity prices.
- Several investment solutions in this theme relate to equities. Despite the theme's relevance and attractive potential returns, investment solutions will be subject to movements in global equity markets.

THEME 2

Click to find out more!

After years of loose monetary and fiscal policies when both volatility and risk were gradually suppressed, bond yields fell to nearly or even below 0%. Investors had no choice but to invest in equities to find reasonable returns. That was the era of TINA: There Is No Alternative (to equities).

Those days are now past.

The transition to TARA (There Are Reasonable Alternatives) has been painful for bondholders, but necessary. The recent dramatic surge in bond yields and the widening of credit spreads have finally created some opportunities in the fixed income space for investors with a lower appetite for risk.

SEIZING

NEW INCOME OPPORTUNITIES FROM TINA TO TARA

OUR RECOMMENDATIONS

A cross-asset theme: Bonds and Equities:

- **US government bonds for USD-based investors and long-term UK government bonds** as yields are at decade highs.
- **Investment Grade corporate bonds in the US** for USD-based investors following the rise in both bond yields and credit spreads.
- **Investment Grade corporate bonds in the eurozone,** with a preference for short-term bonds issued by companies with solid balance sheets. Opportunities also exist in corporate hybrids, Tier 2 bank bonds, and Contingent Convertible (CoCo) bonds.
- **Unconstrained bond funds.**
- **Equities, with a focus on solid companies** that deliver growing dividends.
- **Income-focused structured products.**

KEY RISKS

- **Interest rate risk.** Inflation has proved difficult to predict. A slower-than-expected decline in inflation will force the Federal Reserve and the European Central Bank to keep hiking rates, pushing bond yields higher and bond prices lower. This is the so-called interest rate risk i.e., the potentially negative impact of the change in market interest rates on the bond price.
- **Liquidity risk**, which is the risk that an investor will be unable to sell a bond before maturity, or will only sell it at a much lower price than expected.
- **Credit risk.** Aggressive central banks may push economies into recession. Long-term bond yields would drop but corporate credit spreads would widen materially, and corporate bankruptcies would increase. The credit risk is the capacity of an issuer to honour its commitments: downgrades of an issue or an issuer's rating may lead to a drop in the value of associated bonds.
- **Currency risk**, which is the risk of making a loss due to the fluctuation of the currency used for the bond issue, in comparison with the investor's reference currency.

THEME 3

Click to find out more!

The year 2022 will rank as one of the highest years in decades for volatility in global bond and foreign exchange (FX) markets given the uncertainty around interest rates and the question of when inflation will peak. The era of zero rates and the global central bank "put" are now history. Global central banks are pursing different paths for controlling inflation. In addition, global equities entered a bear market and are experiencing higher volatility amidst mounting fears about the extent of a recession.

This environment is creating enhanced opportunities to utilise structured solutions across asset classes in bonds, FX, equities and commodities. In addition, it provides unique opportunities in global macro and trend-following strategies, gold, as well as higher quality companies with secure and growing dividends.

EMBRACING MARKET VOLATILITY

OUR RECOMMENDATIONS

A cross-asset theme: Foreign Exchange, Bonds, Equities, Commodities and Hedge Funds.

- **Cross-asset structured solutions:** with elevated volatility, it is an advantageous time to create customised structured solutions for investors for better entry points, capturing buffered upside and capital protection.
- **Global Macro/CTA hedge strategies:** for years, negative and zero rates suppressed interest rate volatility. Now, there are clear directions in FX, interest rates, and equities which can be exploited via trend-fol-lowing strategies.
- **Secure/growing dividends:** in periods of rising or above-average inflation, we focus on a defensive equity strategy including high-quality companies with pricing power as well as those that can raise dividends and benefit from high nominal GDP growth.
- **Gold:** the precious metal is an underperformer during periods of a stronger dollar, higher interest rates and rising real yields as it does not offer a yield or carry. As inflation peaks, the properties of a gold hedge could shine again, driven by the increase in global government debt, recession, and geopolitical uncertainty.

KEY RISKS

- Depending on the structured solutions chosen, an increase, **a decrease, or a change in asset prices** could lead to capital loss.
- There is no guarantee that global macro or trend-following strategies will benefit from the current trends in asset markets. Furthermore, any sudden suppression of **interest rates back to zero** could reduce opportunities.
- A deeper recession could lead to cuts in dividends for higher quality companies. Furthermore, the current acute inflationary environment with geopolitical uncertainty means that not all companies will be immune to profit warnings or dividend cuts.
- If inflation takes longer to peak and remains higher for longer, gold can struggle and still have negative returns given its lack of carry and inverse correlation with higher real yields.

THEME 4

Click to find out more!

INVESTING IN A NEW ERA

The last twenty years were marked by several dominant global trends: disinflation, ultra-cheap/free money for borrowers, and the global production of raw materials and goods & services that suppressed prices.

Since 2021, there has been a 180-degree turn. The Covid-19 pandemic, the ensuing economic stimulus and escalating geopolitical tensions have ushered in a new environment of high inflation, largely on the back of a shortage of cheap energy and other commodities, sharply rising interest rates, and a reversal of globalisation in favour of nearshoring. These shifts are not temporary but structural in nature. The new economic era requires a completely different investing mind-set. We see investment opportunities in energy production & infrastructure, food & water security, cybersecurity, reuse/recycling, and in industrial automation.

OUR RECOMMENDATIONS

Investable sub-themes of this new era mega theme include:

- **Reuse and recycling of goods & services** via investment in circular economy leaders, plus focus on local production of food & energy, goods & services.
- **Energy security:** energy transportation and storage infrastructure, renewable/biomass energy generation, battery metals & energy storage, the hydrogen economy, oil & gas exploration and production, nuclear power.
- **Food security and alternative food sources:** solutions to combat malnutrition, via more effective water irrigation, fertilisers & technologies to boost crop yields, plus companies which combat food waste. Technologies for water efficiency, recycling and desalinisation.
- **Technology security:** cybersecurity, semiconductors, satellite technology and networks.
- **Nearshoring winners** (e.g. Mexico and Brazil), industrial automation and product lifecycle management software.

KEY RISKS

- **A major global recession** would likely drive severe demand destruction for energy and raw materials, pushing down commodity prices and thus hurting the profits of commodity-producing companies. It is, however, unlikely to jeopardise long-term trends.
- **Investment solutions** for this theme mainly relate to equities. Despite the theme's relevance and attractive expected returns, such solutions are subject to movements in global equity markets.

THEME 5

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ACCELERATING ENERGY EFFICIENCY

Global warming is a scientifically proven fact. The world's largest nations are implementing an array of solutions in a bid to reduce pollution (especially CO_2) in our atmosphere. Europe has set some ambitious targets with its 'Fit for 55' package to reduce greenhouse gas emissions by at least 55% by 2030.

While the energy transition is progressing, tensions with Russia and soaring fossil fuel prices have shown that the world is still too dependent on oil & gas while some suppliers are no longer trustworthy. The race to find and implement solutions has accelerated.

In order to curb energy spending and reduce pollution, demand must decrease: greater energy efficiency is needed. The most energy-intensive players are encouraged to move in this direction, in particular industrial companies and transport-related sectors.

OUR RECOMMENDATIONS

We prefer equity solutions for this theme: direct lines, funds and trackers. Other attractive solutions include private equity funds investing in energy infrastructure. This theme has several sub-themes:

- **Insulation, efficient lighting** thanks to increasingly efficient materials.
- **Smart control systems and software** for lighting and signaling, etc.
- **Production and storage of renewable energies** (wind, solar, hydroelectric, etc.), including nuclear, hydrogen and raw materials needed for storage batteries (essentially lithium, cobalt, nickel, various 'rare earth' metals).
- **Technologies** that capture or recycle carbon dioxide.
- **Some countries are well exposed** to this investment theme because they have a large market share in certain renewable energies (e.g. China and solar panels) and in batteries and electric cars (China, South Korea).

KEY RISKS

- **Production costs** and thus the price of the energy transition are rising sharply. Without strong government support, the transition could slow down. However, many countries are heavily indebted and the cost of debt has rocketed in 2022. Very tricky fiscal and societal choices must be made.
- **Today it is difficult to source essential materials and components.** This is particularly the case for areas in which demand is growing sharply (e.g. lithium), because supply is struggling to keep up with the pace of demand. This could hamper the transition.
- Generally speaking, energy is a cyclical sector. Energy prices fluctuate considerably in tandem with economic growth, but also with geopolitical events that are often unpredictable and uncontrollable. Return on investments can therefore be highly volatile and sometimes lower than expected.

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