SUMMER EDITION (JULY-AUGUST) 2023

Investment Navigator
Asia Edition

2023 Mid-Year Outlook

Summary

- At the start of the year, we viewed "known" risks of an impending recession as an opportunity given price dislocations last year. As a result, our multi-asset allocation calls have worked year-to-date. Consensus expected a tough first half and better second half for equities, while we had the opposite view: overweight global equities since last November. In addition, our overweight to investment grade credit and gold, while forecasting a weaker dollar also boosted returns.
- However, risks remain. Interest rates continue to rise as central banks globally continue their fight against inflation. Additionally, geopolitical uncertainty remains, with the ongoing Russia-Ukraine war, as well as worsening US-China tensions.
- Looking ahead, the key focus is on the depth and timing of a possible recession, as well as the central banks' actions. Will we see recession in 2023 or 2024? If so, will it be a hard landing? Crucially, how should we navigate through this uncertain period and stay invested in the second half of the year?

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Strong first half for multi-asset returns

It is the **best start to a 60/40 equity-bond portfolio since 1995.** Many declared the 60/40 equity-bond portfolio dead after the bear market in bonds and equities in 2022. We highlighted how economists by the end of 2022 had already forecasted a US recession at the highest probability since the 1980s. In that regard, always look at what is priced in. We had turned overweight global equities based off this notion and after equity markets bottomed last November. **In addition, we were also positive on investment grade credit and gold, while forecasting a weaker dollar, further boosting returns.**

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No landing, soft landing, or hard landing?

The recent unemployment rates in the US and Europe continue to remain near all-time lows. However, the June US non-farm payrolls missed for the first time in 15 months. Revisions to prior months were also lower. Will this finally be the start of a softer labour market? Central banks still face the challenge of calming core inflation, while also having to deal with this current resilient labour market.

Nonetheless, the fact is employment and inflation are lagging indicators. In fact, the timing may be appropriate, and we may start to see the effects of interest rate hikes given it typically takes 12-24 months on average to work its way into the economy. Important to note, the US Federal Reserve only started raising rates in March 2022.

This cycle is slightly different with labour hoarding and a persistently tight employment markets. However, advance indicators like job openings or temporary hires still show only moderate weakness. Overall, our base case is for a moderate recession in the US in 2024. We currently forecast one more rate hike from the Federal Reserve, two more from the ECB, and three more from the Bank of England.

Recession Proof the Portfolio:

1) Diversify cash exposure via extending duration with investment grade bonds

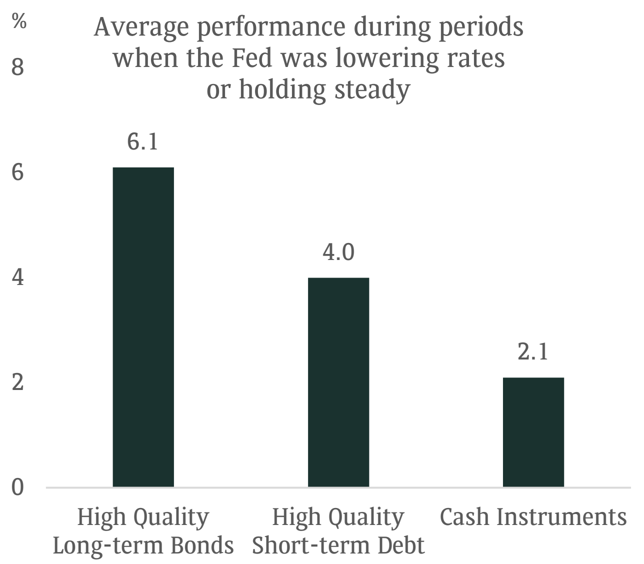
Cash is Not King!

As mentioned, our forecast is for one more rate hike in the US, with the Fed Funds ending at the terminal range of 5.25% - 5.5%. Nonetheless, the market has already started pricing this additional rate hike in. The current rate hike cycle is one of the fastest in history, and it is important to remember that monetary policy acts with a lag. We don't expect any rate cuts until after March 2024.

As investors have been observing the uncertainty on interest rates as well as the economy, many have been sitting in hefty cash positions. Some were earning reasonable yields in the form of money market funds, while others in the form of deposits, and that meant missed opportunities after the strong performance of equities and bonds. Given our outlook, holding too much cash can indeed be costly going forward.

Shorter-term yields are sensitive to interest rate expectations. The bond market is already in the process of pricing in another rate hike and a pause. Nevertheless, long-term investors will eventually need to shift into bonds as there could be an opportunity cost to having too much cash. Additionally, investment grade yields are the highest in a decade. Meanwhile, we remain neutral on high yield bonds given expectations of rising default rates. Importantly, trying to time the peak in yields will be difficult and could be proved costly. Given there is reinvestment risk on any longer-term deposit, investors should start to examine their cash allocation and gradually over time extend duration to high quality bond allocation.

BONDS OUTPERFORMED CASH IN FLAT AND FALLING RATE ENVIRONMENTS



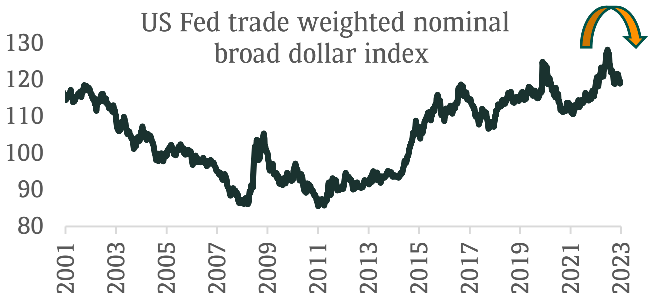
Source: Bloomberg, BNP Paribas (WM), as of 12 July 2023.
Past performance is not indicative of current or future performance.

It is crucial to highlight that historically since 1990, as the Federal Reserve approaches being on hold and/or begins to cut rates, high quality long-term and short-term debt have outperformed cash. This is the environment we believe the market could enter in the coming months. Additionally, the recent rise in yields also provides a good opportunity to moderately extending bond allocation across the curve.

2) Diversify dollar exposure

Overall we went underweight the greenback just as treasury yields peaked in the fourth quarter 2022. While the USD may need to consolidate recent weakness, we still see further moderate weakness on a 12-month basis. This view is predicted on peaking yield differentials, reserve diversification, and flows to non-US equities. However, the dollar view is not across all currency pairs. Given central banks are raising rates at different paces to deal with contrasting levels of inflation, this creates trading opportunities in different currency pairs. Hence, it is important to look at individual currency pairs rather than just the dollar overall.

CONSOLIDATION OF USD LIKELY, FOLLOWED BY MEDIUM-TERM WEAKNESS



Source: Bloomberg, BNP Paribas (WM), as of 12 July 2023. Past performance is not indicative of current or future performance.

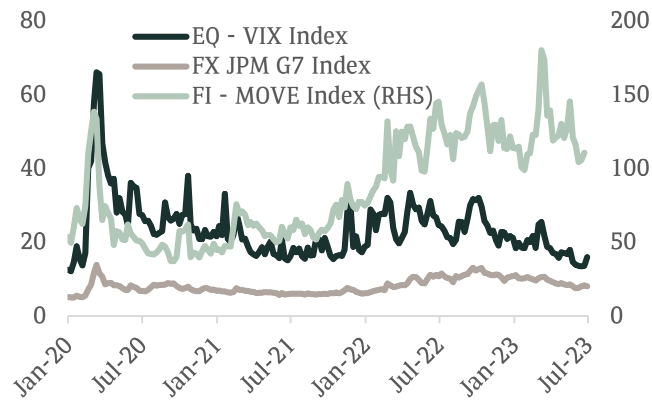
3) Monetise volatility and hedge?

The average investor this year is more likely than not to have missed our contrarian call on the equity rally. One way to ensure participation at this juncture is to monetise the volatility via structured solutions in favoured names, allowing better entry points and income. In short, **volatility creates opportunity**.

If one is already overweight equities, they can take advantage of the low index volatility (S&P 500 volatility below 15) to hedge market risk while maintaining portfolio exposure.

In addition, uncertainty about interest rate forecasts, as well as when rates will peak and for how long, creates opportunities in foreign exchange and fixed income structured solutions pricing.

VOLATILITY HAS TRENDED DOWN SIGNIFICANTLY



Source: Bloomberg, BNP Paribas (WM), as of 12 July 2023. Past performance is not indicative of current or future performance.

CONCLUSION

Our favoured allocations include: (1) Quality income via investment grade bonds which remain an attractive allocation to gradually extend duration. (2) Dollar diversification while expecting some short-term consolidation. However, we are not bearish on the dollar versus every currency pairs, as different central banks are moving at a different pace. (3) Gold remains the ideal diversifier; accumulate on pullbacks. (4) Structured solutions allow for more portfolio flexibility and to tailor positions for better entry points, income as well as hedging. (5) We remain overweight global equities, preferring non-US equities such as Japan, Europe and China. For sectors, we prefer healthcare, financial, materials, and continue to overweight semi-conductors based off long-term AI growth narrative.

2023 Investment Themes:
Snapshot of July Update(1/2)

Our 2023 Investment Themes have been updated. Please click HERE for the full version

THEME 1: WHEN CONSISTENT LOSERS BECOME WINNERS

- Persistent underperformance over 2-3 consecutive years in country stock markets or asset classes can rebound to impressive double-digit returns during the following year.
- Three laggard assets in 2021-22 were: i) Chinese equities; ii) Emerging Market sovereign bonds and iii) Silver.
- In each case, we see strong fundamental drivers to underpin a strong rebound this year.

THEME 2: RIDE THE CLEANTECH INVESTMENT WAVE

- Huge US, EU spending programmes support heavy renewable energy investment. Today, solar power is the cheapest source of new renewable electricity, due to more efficient solar panel designs.
- The need for energy security remains a key driver behind European clean energy and energy conservation investment. The circular economy is an important tool in decreasing indirect energy consumption in the production/provision of goods and services.

THEME 3: SCARCITY AND SECURITY ARE THE NEW WATCHWORDS

- **Scarcity & Security**: in today's world of heightened geopolitical tensions, and increasing shortages of energy and other commodities, new trends of energy & raw materials security and technological security have emerged.
- The increasing prevalence of floods and droughts highlights once again the focus on food and water security. The current Artificial Intelligence excitement provides a new boost to cybersecurity solutions.

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2023 Investment Themes:
Snapshot of July Update (2/2)

Our 2023 Investment Themes have been updated.
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THEME 4:

NEW INCOME OPPORTUNITIES: FROM TINA TO TARA

- 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.
- We are now moving from an era of TINA (There Is No Alternative) to TARA (There Are Reasonable Alternatives).

THEME 5:

LOOKING THROUGH THE INFLATION AND RATES PEAK

- The current slowdown in demand, easing of supply chain pressures and cooling of commodity prices are calming inflation pressures.
- These, in turn, should lead to **lower long-term bond yields** later this year. Investors should look beyond the peak in inflation and policy rates to the investment opportunities that lower inflation and long-term rates offer.

THEME 6:

VOLATILITY CREATES OPPORTUNITY

- A combination of i) uncertainty around risk interest rates; ii) high inflation; iii) recession fears, and iv) the 2022 global equities bear market unleashed an environment of high volatility.
- This environment is creating enhanced opportunities to **utilise structured solutions across asset classes in bonds, FX, equities and commodities.**

Overview of our CIO Asset Allocation for July-August 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, Materials		■ We also like some utilities (preference for Europe and for the electrification & clean energy themes), as well as some tech (semiconductors). In Europe, we also like financials and real estate.
			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 (EM) 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 creep back to \$80-90. ■ **Base metals – positive.**
FOREX			USDJPY			■ **USDJPY 3- and 12-month targets at 138 and 128 respectively.**
ALTER-NATIVE	+	+		Real estate (healthcare, UK commercial); hedge funds (long-short equities, relative value); infrastructure (energy, transportation, water)		■ We are positive 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	1.5	-0.1	8.0	4.2	2.4
	Japan	1.0	1.5	1.0	2.5	3.1	1.8
	Eurozone	3.5	0.4	0.6	8.4	5.4	2.9
	UK	4.1	0.4	0.0	9.1	7.5	2.9
North Asia	China	3.0	5.6	4.5	2.0	1.1	2.5
	Hong Kong*	-3.5	3.5	3.1	1.9	2.3	2.4
	South Korea	2.6	1.4	2.1	5.1	3.6	2.3
	Taiwan*	2.5	2.1	2.6	2.9	1.9	1.7
South Asia	India	7.2	6.1	6.5	6.7	5.5	4.5
	Indonesia	5.3	4.8	5.0	4.2	3.6	2.4
	Malaysia	8.7	4.5	4.5	3.4	2.8	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	2.7	2.1

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

GROWTH

- **The US economy continues to remain resilient**, as the labour market proves stronger than expected. **The most anticipated US recession should likely be delayed to 2024**, despite the tight financial conditions, which typically takes some time to work its way into the economy.
- **We still see the Eurozone avoiding a full fledged recession**, although economic surprise in Europe as well as PMIs disappointed recently. **The uneven Chinese growth post-Covid is also of concern now. The focus will be on the level of fiscal stimulus that will be put in place in the upcoming Politburo and Plenum meetings.**

INFLATION

- **Inflation is on a clear downtrend globally**, albeit still some distance away from most central bank's target. Core inflation remains sticky in the US, with the labour market still seeing wage growth and overall tight at 3.6% unemployment rate.
- **Deflation risk in China is becoming a larger concern**, as consumer inflation rate in China was flat in June while factory gate prices fell further. **The weakness highlights the need for further stimulus and policy easing for China to avoid a deflationary spiral.**

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	Consumer Staples

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

- **The robustness of consumption has been a surprise and has strongly supported US equities.** At the same time, the hype around AI has further inflated tech stock valuations. **We prefer other means of gaining exposure to AI, through semiconductors and/or sectors that should benefit from AI, such as healthcare, select industrials and some financials.**
- **We remain positive on global equities, on the back of more resilient economies and improving earnings momentum**, with European companies enjoying the strongest upwards earnings revisions.
- **Sentiment on Chinese equities remain weak, due to weaker than expected data and the ongoing geopolitical uncertainty. There is an urgency for Beijing to deliver concrete support** to restore consumer, business and investor confidence, and also address pressing socio-economical issues of unprecedented high youth unemployment as well as high levels of household savings. **Authorities should likely continue to ease policy, however that has to be balanced against weakness in the Chinese Yuan.**

		1-month (%)	YTD (%)	2022 (%)	Forward PE (x)	Trailing PB (x)	Dividend Yield (%) 2023f	EPS Growth (%) 2023f	EPS Growth (%) 2024f	ROE (%) 2023f
Developed	US	6.5	16.2	-20.8	19.4	4.2	2.0	1.0	11.2	17.8
	Japan	7.6	22.4	-6.6	14.6	1.4	3.0	3.2	6.4	8.8
	Eurozone	3.6	13.1	-14.5	12.1	1.7	3.2	2.7	7.8	13.5
	UK	1.0	0.4	3.0	10.2	1.6	4.1	-9.0	3.6	15.3
	Asia Ex-Japan	2.2	1.8	-21.5	13.1	1.5	3.0	3.2	20.9	10.0
North Asia	China	3.7	-5.4	-22.4	10.2	1.3	3.5	21.9	14.4	10.8
	China A-shares	1.2	-0.8	-21.6	12.2	1.7	3.0	18.0	13.7	12.7
	Hong Kong	3.1	-8.8	-7.8	13.0	1.1	3.8	13.3	11.6	7.2
	South Korea	-0.4	18.6	-26.4	13.9	1.0	2.2	-37.2	70.8	5.8
	Taiwan	1.9	19.8	-24.7	15.8	2.4	3.6	-18.8	22.4	12.9
South Asia	India	3.6	3.6	1.6	21.0	3.7	1.4	22.5	14.5	14.8
	Indonesia	-0.6	1.3	10.4	14.4	2.4	4.9	31.5	10.7	14.7
	Malaysia	-1.0	-8.2	-4.3	13.1	1.3	4.2	9.3	9.0	9.2
	Philippines	0.1	-1.1	-7.3	12.8	1.8	1.9	19.8	10.7	11.9
	Singapore	-0.4	-1.9	4.4	11.6	1.3	4.8	40.9	5.3	9.8
	Thailand	-0.2	-9.0	6.3	16.3	1.8	3.0	-6.4	11.8	9.5

Source: MSCI indices in local currency terms, Bloomberg, Datastream, BNP Paribas (WM), as of 30 June 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	India China Philippines Singapore ▼ Indonesia	-

		Total Return (%)			Yield-to-Worst (%)
		1-Month	YTD	2022	
Asia	Asia USD Bond	0.1	3.0	-11.7	6.2
	Asia Local Currency Bond	-0.4	2.6	-8.6	4.3
	China	0.1	2.2	-10.9	6.9
	Hong Kong	-0.1	3.8	-10.5	5.6
	India	0.4	4.1	-9.7	7.4
	Indonesia	0.4	4.0	-12.9	5.4
	Singapore	-0.4	3.0	-11.0	5.8
	South Korea	-0.5	2.5	-8.6	5.5
	Philippines	0.4	3.3	-14.2	5.5
Other Regions	US 10-year Treasuries	-1.5	1.3	-12.1	4.0
	US Investment Grades (IG)	-0.4	2.1	-13.0	4.8
	US High Yield (HY)	1.7	5.4	-11.2	8.5
	Emerging Market USD Bond	0.3	3.1	-12.1	7.0

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

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

- Following hawkish policy meetings, resilient economies and higher than expected projections, we think the Fed and the ECB are not done yet. **We expect a final 25bp rate hike in July in the US and a terminal rate of 5.5%. We think the ECB will hike rates in July and September, 25bp each time, to reach a terminal rate of 4% for the deposit rate.**
- We are near peak rates as financial conditions are sufficiently tight given interest rate hikes usually have a lagged impact on the economy. **We expect a long pause from there on as central banks** continue to combat stickier components of inflation. **We do not see any rate cuts until Q2 of 2024, which is in line with our US recession call.**
- While we remain positive on Indonesia's growth and the relatively benign inflation outlook which paves the way for BI to be able to cut rates earlier, we expect BI to act cautiously to maintain IDR stability. **Overall, we expect the macro picture in Indonesia to remain resilient. That said, Indonesian credit has been on the expensive side in terms of valuation as corporates turn to domestic funding given the lower interest cost and ample liquidity.** We have seen corporates using domestic bond issuances to refinance offshore debt as well as using bank loans to buy back offshore bonds. **Given the unfavorable technical, where supply is low and demand is still strong, we downgrade our view to neutral in the Indonesian credit space.**

Forex & Commodities

POSITIVE NEUTRAL NEGATIVE

12-MONTH FOREX VIEW

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

COMMODITIES

Positive	Neutral	Negative
Gold Oil Base metal		-

JPY: **We increase our 3 month target for JPY from 130 to 138 and maintain our 12 month target at 128, as the yield differential moved more in favour of the US dollar.** This is the result of a dovish BoJ and the expectations for further rate hikes in the US. **The trend should reverse later this year as we expect a more hawkish BoJ while the US interest rate pauses.**

CNY: **CNY continues to depreciate on weaker than expected post-Covid recovery, and on interest rate differential after easing rates in June.** The Yuan moved past 7.28, a level last seen eight months ago, while the PBoC has intervened since to manage the slide. **Our better 2H outlook for China along with more expected stimulus should help see CNY strengthen near term to 6.9, and to 6.5 in 12 months.**

GOLD: **We remain positive on gold** as we expect some recession tail hedging, as geopolitical risks persist, and as EM central banks continue to diversify away from the USD. **We expect gold to trade in the $1950-2150 range next year helped by the end of the tightening cycle and an expected weaker USD.**

OIL: The deficit forecasted for year end might be less acute than feared thanks to the abundant supply of Russia and Iran. **We expect Brent prices to creep slightly into the range of $80-90 by year end.**

BASE METALS: A bottoming of the manufacturing PMI and/or new Chinese stimuli are needed to see the confirmation that base metals have well troughed. **We keep our medium-term positive stance as the huge needs of the energy transition will have to face the supply inelasticity.**

Forex Forecasts

		Spot	3-month		12-month	
		As of 30 Jun 2023	View	Target	View	Target
Developed	USD Index*	102.91	=	102.3	-	97.1
	Japan	144.5	+	138	+	128
	Eurozone	1.091	=	1.08	+	1.15
	UK	1.271	=	1.26	+	1.34
	Australia	0.666	+	0.70	+	0.73
	New Zealand	0.608	+	0.65	+	0.65
	Canada	1.323	=	1.32	=	1.30
Asia Ex-Japan	China	7.264	+	6.90	+	6.50
	South Korea*	1,318	=	1,320	+	1,232
	Taiwan*	31.14	=	30.9	+	29.9
	India	82.04	=	82.0	=	82.0
	Indonesia*	14,993	=	14,700	+	14,350
	Malaysia*	4.668	=	4.57	+	4.42
	Philippines*	55.20	=	55.6	+	53.0
	Singapore*	1.353	=	1.33	+	1.27
	Thailand*	35.46	=	34.10	+	31.80

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

Note: + Positve / = Neutral / - Negative

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