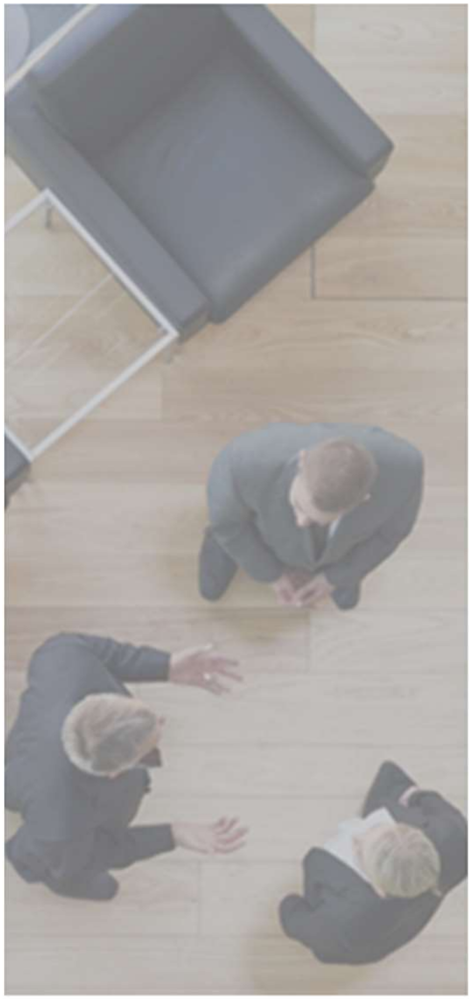
C.I.A. NETWORK

Asset Strategy in Brief

January 2024

BNP PARIBAS WEALTH MANAGEMENT

The bank
for a changing
world



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Macro Insights

Macro, Market Views

Macro		– Monthly inflation prints have declined sharply over the last 6 months. Central banks should cut interest rates starting in May – GDP growth is running at an annualised 2%+ in the US for Q4, but around zero in the eurozone
Rates	=	– After a sharp fall in 10Y bond yields, there is little further to gain to our 12-month yield targets. – Prefer short duration government bonds for their higher yields to maturity. – EM sovereign bonds (local currency and USD) still offer attractive yields, in our view.
Credit	+	– EUR spreads offer more potential to tighten than US spreads in our view. – Short duration preferred.
Equities	+	– Key drivers include falling inflation, lower long-term interest rates, improving macro liquidity, and easing energy prices. – Favour eurozone, UK, Japan, Latin American markets. – European financials look to break out to new multi-year highs
Real Estate	=	– Lagged impact from higher interest rates to fade, which should allow real estate prices to slowly stabilise
Commodities	+	– Oil (+) Brent should remain in the USD 80-95 range due to gas/oil substitution & the progressive ban on Russian oil. – Gold (+) is our preferred safe haven, weaker USD & stable LT rates should help, 12-month exp. range = USD 1900-2150.
FX		– Our EUR/USD target is USD 1.15 (value of 1 euro) in 12 months.

Key macro & market forecasts

	GDP Growth %		Inflation %		Central Bank Rates %				Key market forecasts		
	2023e	2024e	2023e	2024e		Now	Q1 24	Q4 24		Now	Q4 24
US	2.4	0.9	4.1	2.6	US Fed Funds Rate	5.5	5.5	4.0	US 10Y yield %	4.0	4.0
Eurozone	0.5	0.6	5.5	2.2	ECB Deposit Rate	4.0	4.0	3.25	Euro 10Y yield %	2.1	2.25
Japan	1.8	1.0	3.2	2.6	Bank of Japan Policy Rate	-0.1	0.1	0.25	UK 10Y Yield %	3.7	3.65
UK	0.5	0.0	7.4	3.0	Bank of England Base Rate	5.25	5.25	4.25	S&P 500	4705	n/a
China	5.2	4.5	0.4	1.5	China MLF 1Y Interest Rate	2.5	2.35	2.25	Euro STOXX 50	4455	n/a
									Oil Brent USD/bbl	78.8	80-95
									Gold USD/oz	2043	1900-2150

Source: BNP Paribas WM. As of 4 January 2024

Asset Allocation

Allocation changes this month:

- ❑ **Equity sectors:** No Changes
- ❑ **Bonds**:
  - We expect 150 bps of rates cuts in 2024 by the Fed as of May (vs. our previous estimate of 125 bps as of June), and we anticipate 75 bps of rate cuts by the ECB from June (September previously).
- ❑ **Commodities:** No changes

Outlook Summary

	Very underweight	Underweight	Neutral	Overweight	Very Overweight
Equities				+	
Government Bonds			=		
Corporate Credit				+	
Real Estate			=		
Alternatives				+	
Cash		-			

02

Fixed Income

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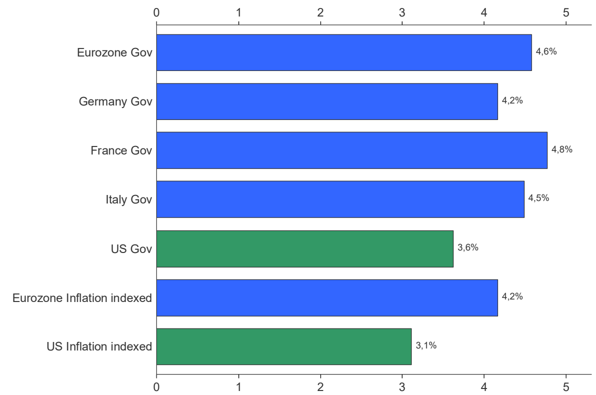
Fixed Income

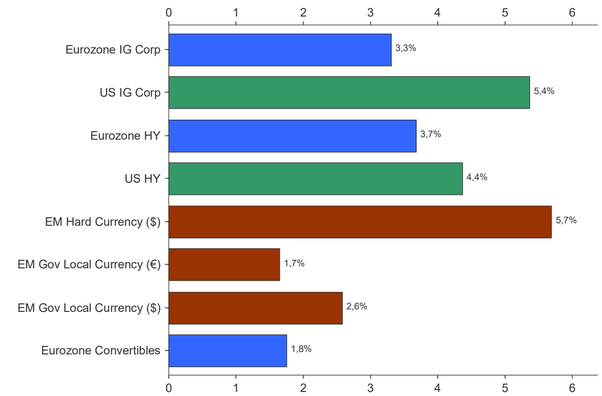
The Fed surprised the markets with its dovish stance at the December meeting, triggering a rally. Bond yields dropped sharply, and credit spreads tightened. While asset classes are now expensive over a 1-year history, they remain in line with average valuations over the past decade. Hence, it's not too late to build a portfolio that will generate decent returns over the next few years. We favour US Treasuries, UK Gilts, US TIPS, EM bonds, and IG corporate bonds in the US and eurozone.

Returns over one month



Source: LSEG Datastream, 19/12/2023 Source: Bloomberg Barclays indices exept Convertibles (Exane)

Returns over one month



Source: LSEG Datastream, 19/12/2023 Source: Bloomberg Barclays indices exept EM local debt (JPM) and Convertibles (Refinitiv)

Central Banks

We expect 150 bps of rates cuts in 2024 by the Fed as of May and we anticipate 75 bps of rate cuts by the ECB from June.

Government Bonds

Our 12-month targets are at 4% for the US 10-year yield and 2.25% for the German 10-year yield. We stay Positive on US government bonds (prefer 3-5 years maturity) and US TIPS with maturities up to 10 years. Neutral on German government bonds.

Peripheral bonds

Spreads have tightened significantly since the ECB decision to be very cautious to taper the PEPP programme. Spreads are low in our view and do not offer further potential to tighten. We stay Neutral on peripheral bonds.

Corporate Investment Grade (IG) Bonds

We stay Positive on IG corporate bonds. EUR spreads offer more tightening potential than US spreads in our view. We prefer short maturities in the eurozone, and short to intermediate maturities in the US.

Corporate High Yield (HY) Bonds

Credit spreads are low and discount a rapid rate cut cycle that central banks will not deliver in our view. The maturity wall is a headwind. Spreads should widen moderately in 2024.

Emerging Market (EM) Bonds

EM should benefit from the current environment of decent growth, central banks cutting rates and dollar weakening. We stay Positive on both hard and local bonds.

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Equities

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Equities: I love it when a plan comes together

Key Points

- **The S&P 500 is now up over 15% since 27 October.** The expected Santa rally continued even after he dropped his presents around the world weeks ago. A combination of strong consumer spending in stores, a rapid deceleration of inflation and a dovish tilt from the Fed have all contributed to an extremely market-friendly backdrop for stocks, especially as US growth remains resilient, reflected in strong November labour market data.
- **The markets have increasingly priced in the likelihood of the economy making a soft landing,** while also contemplating the prospect of a higher-for-longer rate environment. After the dovish tilt from the Fed, that outlook changed quickly. While inflation has decelerated at an accelerated pace, growth has remained firm (albeit not too firm), real yields have receded.
- **This better-than-expected macro environment**, further supported by easing financial conditions, drove a rerating of the rest of the market vs. the Magnificent Seven. The S&P 600 Small Cap index have beaten the “Mag 7” by more than 5 percentage points during the last 4 weeks. Meanwhile, the equal-weighted S&P has outperformed its capital-weighted counterpart by 1.2 percentage points.

Main recommendations

+ **EU Tech upgraded to Positive.** The sector is well positioned to capture the growth potential of B2B application growth while valuations are low.

European Utilities showed some relative strength last earnings season, leading to substantial positive earnings revisions. Valuations are low and positioning is light. We see room for further upside, especially if rates continue to fall.

Stay diversified, including in some cheap and solid cyclical stocks (Energy, European Financials).

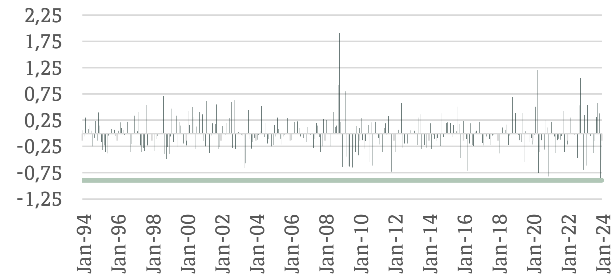
+ **Country-wise, we maintain our Positive stance on the eurozone, UK, Japan and Latin America**

- Be cautious/selective with expensive market segments, such as Consumer Staples, some large-cap US tech stocks and some Consumer Cyclicals: pricing power is weakening and operating profits are under pressure from rising costs. Some very high P/E ratios are difficult to justify.

The key risks are of a deep economic recession, which would heavily impact corporate earnings. Liquidity is likely to fall in the coming months, especially in the US.

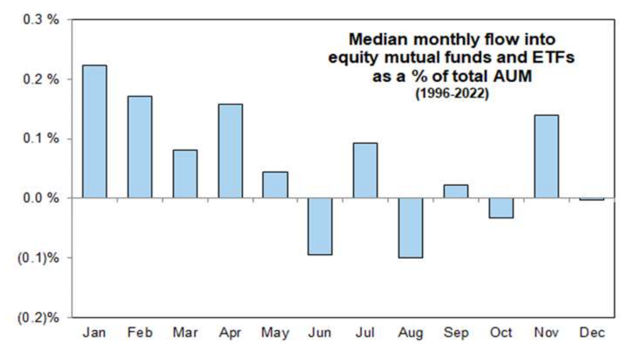
Our position this month
Change in our position since last month

NOVEMBER SAW THE BIGGEST EASING OF US FINANCIAL CONDITIONS IN 30YR+



Source: BNP Paribas, Bloomberg

THE “JANUARY” EFFECT



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Forex

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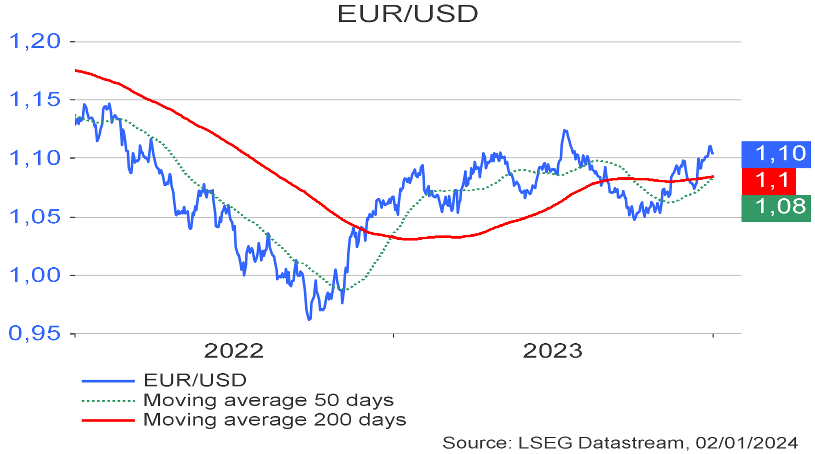
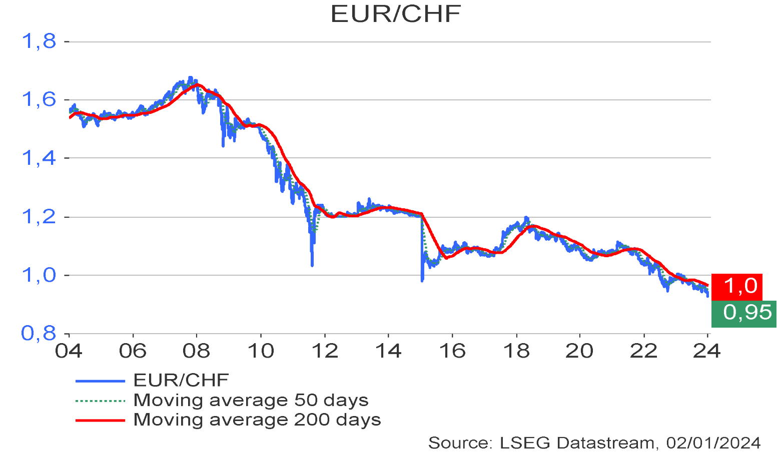
Forex

Recent weakening of the US dollar



The Swiss franc has strengthened further



- We believe that both the Fed and the ECB have reached their terminal rates of 5.5% and 4% respectively. For 2024, we project a dovish shift in monetary policy. We expect the Fed to start a new rate-cutting cycle, cutting rates by 150 bps starting in May. Similarly, we expect the ECB to follow suit with a cut of 75 bps starting in June. The interest rate differential should favour the euro in the coming months. **We maintain our EUR/USD 3-month target at 1.06 and our 12-month target at 1.15.**

- The EUR/CHF is nearing historical lows, reflecting the Swiss franc's role as a stable global inflation hedge and safe haven. Despite some expected normalisation we believe the franc will remain strong. **We decrease our 3-month target from 0.98 to 0.95 and maintain our 12-month target at 0.98 (value of one euro).**

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Commodities

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Commodities

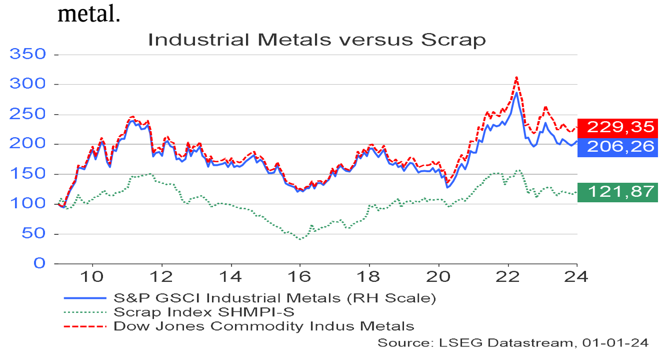
Oil prices recovered their early losses in December as insecurity increased in the Red Sea, hampering traffic of oil tankers. The Brent ended the month at USD 77 (Brent).

Base Metals **rebounded slightly in December.** From the start of 2023, copper and tin rose 2%, aluminum 1% while lead has lost -10%, zinc -11% and Nickel -45% (as of 30/12).

Gold ended 2023 at USD 2063 helped by lower real yields and a weaker dollar.

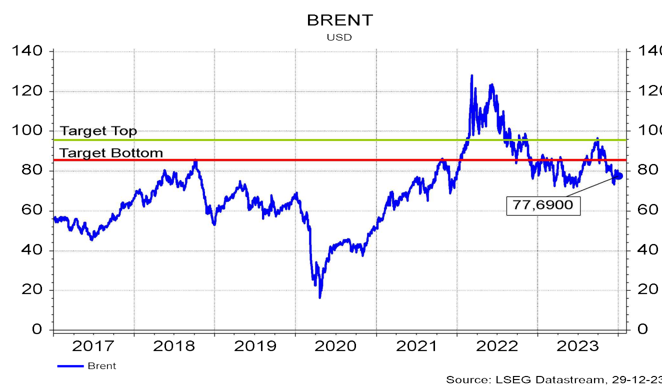
BASE METALS

The ST outlook should remain bleak as long as manufacturing PMI do not rebound. The necessary restock should amplify the recovery. We keep our MT positive stance because of the huge needs of the energy transition. Copper is our favourite base metal.



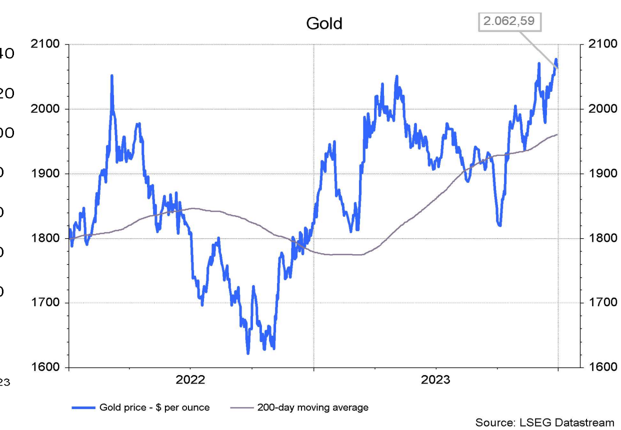
OIL

Assuming a continuation of the OPEC+ supply management policy, we expect Brent price to trade back in the USD 85-95 range. MT outlook remain bullish as needs seem underestimated.



GOLD

We expect gold to trade in the USD 1950-2150 range as lower real bond yields, a weakening USD, continuing EM central bank purchases, geopolitical and stagflation risks hedging underpin the market.



Our position for this month

Evolution of our position from last month

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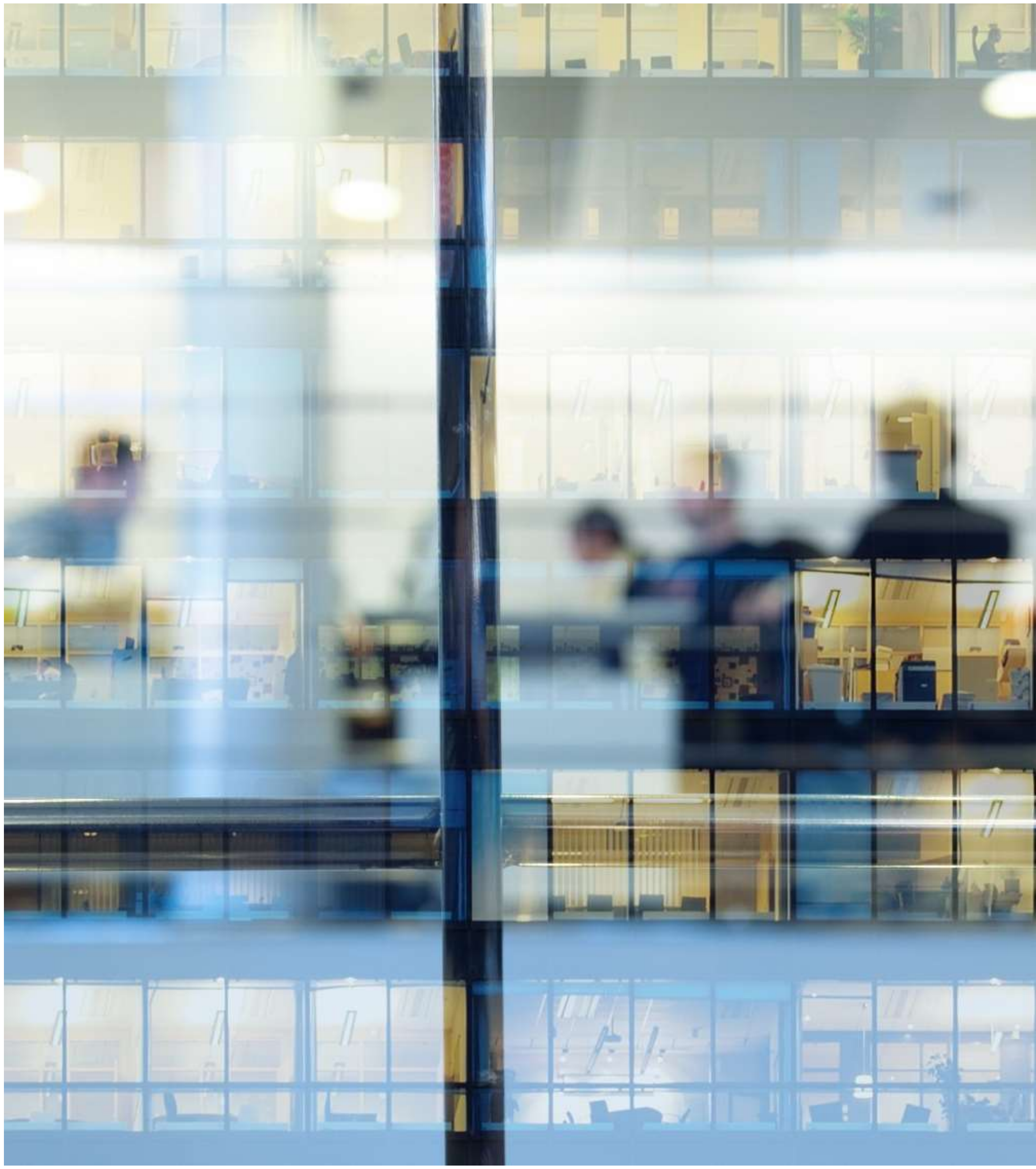
Alternative Investments



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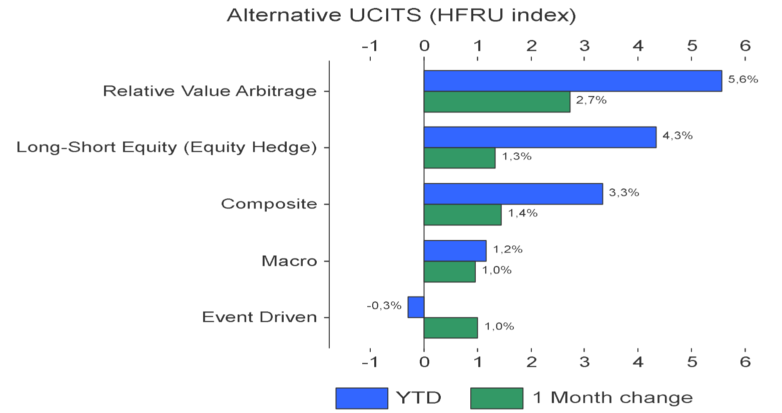
Alternative Investments

Performance in most alternative strategies was quite strong last month. Relative Value and Long-Short equity outperformed again the other strategies. This remains true for the performances year-to-date.

Positive opinion on Macro, Long-Short equities and Relative Value. Neutral on Event Driven.



Source: LSEG Datastream, 28-12-23

Global Macro

Positive: Global economies have shifted from a transition phase where they seemed unaffected by Quantitative Tightening to bearing the consequences of "Rates higher for longer" with concrete and often adverse effects, and clearer trends to come.

Event Driven

- **Neutral**: Deal flow has started to rebound somewhat from the subdued levels of H1 2023 but remains on the low side despite a few new mega-deals of H1 2023, noted by the return of mega-deal announcements. Valuations have adjusted in the new rate environment, compensating for increased financing costs.

Long / Short Equity

- **Positive:** After a macro driven year, dispersion has increased lately amongst equity, paving the way for better long and short stock picking opportunities. If equity markets move sideways or down slightly, long/short should provide strong absolute returns with low correlation to equity markets.

Relative Value

- Positive: The high-rate environment provides significant carry, but the rising default rate poses a risk to a long-only strategy. A long/short strategy can earn consistently strong returns by identifying both winners and losers, while also hedging against macroeconomic shocks. Economic resilience from the lagged effect of rising rates and the need to refinance ("maturity wall") starting in 2025 have so far limited dispersion between strong and weak issuers.

BNP PARIBAS WEALTH MANAGEMENT CHIEF INVESTMENT ADVISOR (CIA) NETWORK

Edmund SHING
Global Chief Investment Officer

ASIA

Prashant BHAYANI
Chief Investment Officer

Grace TAM
Chief Investment Advisor

BELGIUM

Philippe GIJSELS
Chief Investment Advisor

Alain GERARD
Senior Investment Advisor, Equities

Xavier TIMMERMANS
Strategist Senior Investment, PRB

ITALY

Luca IANDIMARINO
Chief Investment Advisor

LUXEMBOURG

Guy ERTZ
Chief Investment Advisor

Edouard DESBONNETS
Investment Advisor, Fixed Income

GERMANY

Stephan KEMPER
Chief Investment Strategist

Stefan MALY

FRANCE

Jean-Roland DESSARD
Chief Investment Advisor

Isabelle ENOS
Senior Investment Advisor

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