INVESTMENT STRATEGY

Equity Focus
How passive investments benefit index heavyweights

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BNP PARIBAS WEALTH MANAGEMENT

The bank for a changing world

Are European Earnings finally turning the corner?

Key Points

- **Earnings Season Update**: Over 80% of S&P 500 companies and 55% of STOXX 600 companies have now reported Q4 results. EPS growth for the quarter is tracking at +7% y/y in the US, and -11% y/y in Europe. On aggregate, US companies strongly beat expectations with EPS surprises being 8%. European companies have disappointed vs consensus expectations by 2%. More importantly though, while still in negative territory, the levels of forecast Sales and Earnings revisions breadth continue to improve. This increases our confidence that European earnings revisions are likely to trough near-term (if not forming a trough already) which supports our positive stance on the region.
- **Markets start to look at the 2024 US Presidential Election.** 2024 is a super election year. Roughly 50% of the global population will head to the polls with the US presidential election being the *primus inter pares.* While the election will only take place in early November and the candidates have not been officially chosen, markets start to look for the potential impact on companies. With betting odds of Mr. Trump winning rising, (recall, there are still legal cases pending which could prevent him from running at all) so are stocks which are expected to benefit from this victory, while potential losers start to fall behind. We will provide more detailed information of which sectors may benefit / suffer from a given outcome in the month ahead.

Main recommendations

Upgraded US Mid/Small Caps to positive. We see the stars aligned for a period of outperformance of US mid/small caps as valuations, historical market patterns and economic growth point to future relative and absolute strength. We prefer the S&P 400 and 600.

We stick to our positive view on EU Tech despite the good run recently and continue to like a barbell approach of selected growth and value (e.g. financials) sectors.

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

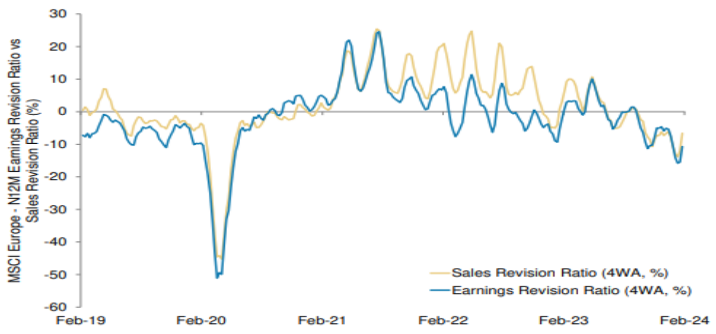
Be cautious/selective with expensive market segments, such as some large-cap US tech stocks and some Consumer Staples.

We downgrade Chemicals to negative due to ongoing earnings risk and too high valuations

We see increasing risks for battery metals, especially lithium, as the market is likely to stay in surplus due to weaker demand

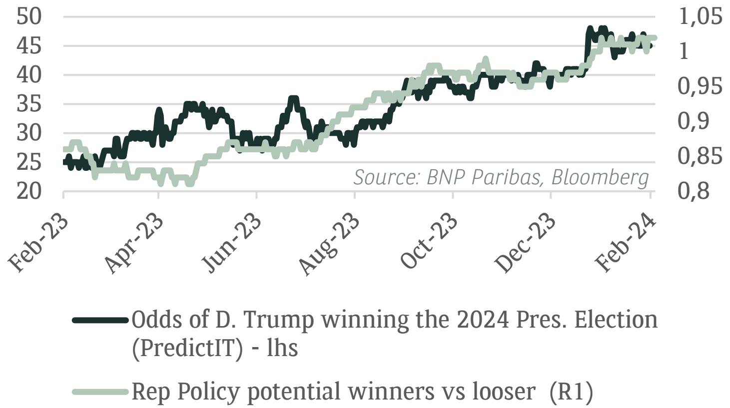
The key risks are that the US Federal Reserve or the ECB could be forced to further push out rate cuts or even shift back to a hawkish rhetoric should inflation surprisingly pick up again.

SALES AND EARNINGS REVISION BREADTH CONTINUE TO IMPROVE IN EUROPE



Source: MSCI, IBES, Morgan Stanley Research

STOCKS EXPECTED TO BENEFIT FROM A GIVEN ELECTION OUTCOME START TO OUTPERFORM



Focus on

The impact of passive investments

Index & Macro Observations

Asian Equity View

Sector Views

The impact of passive investments

ETF FLOWS ARE PRO SIZE & PRO MOMENTUM

Passive investment products now command more assets than active managed mutual funds. This evolution has several consequences for market dynamics, which investors should be aware of. Active managed funds usually deviate from their benchmark, be it due to an active decision by the portfolio manager or some diversification rules. Mutual funds that register with the Securities and Exchange Commission as "diversified" cannot put more than 25% of their assets into large holdings — with a large holding defined as a stock that represents more than 5% of the fund's portfolio at the time of investment. Those restrictions do not apply for passive funds which simply track their underlying index.

As a consequence, flows into ETFs are by nature pro momentum and pro large cap. This is becoming increasingly concerning as the weight of growth increases in major benchmarks like the S&P 500. The same is true for the growing weight of US stocks in global indices such as the MSCI World where US stocks now represent roughly 70% of the index.

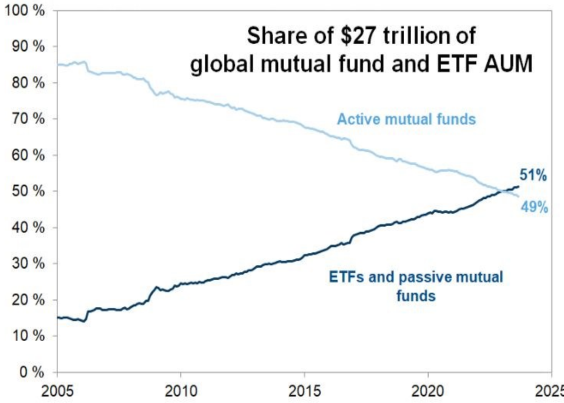
The five largest stocks represent 26% of the S&P 500 market cap, the highest concentration on record. If you allocate $1 passively to that index, 26 cents goes into the top 5 companies. The issue is even more extreme in the Nasdaq 100. Here, the largest 5 companies represent 32.6%. If you allocate $1 passively, 33 cents goes into the top 5 companies. Allocating into the MSCI does provide little more diversification effects. US equities represent 70% of MSCI World equities, the largest country weight on record. If you allocate $1 passively, 70 cents goes into US equities and 18 cents into the top 5 US stocks.

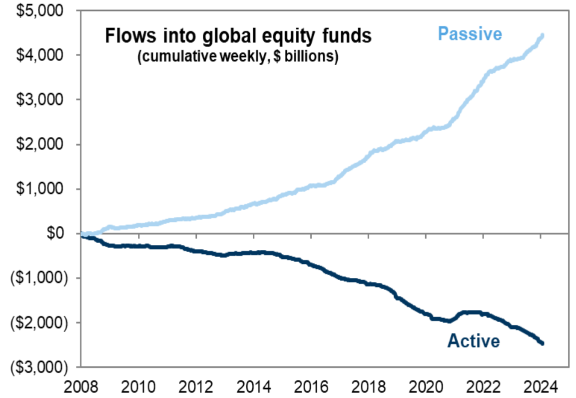
As passive funds just track their reference index, the trend in flows creates a self-feeding effect. The more money flows into ETFs, the more money goes into the index heavyweights, increasing their weight further. Thus, those indices became far less defensive than usual with almost record low weightings on utilities, consumer staples or healthcare. This provides investors with an inflated exposure to any downside in tech stocks by having both a greater weighting to that sector and smaller weighting to defensive sectors. On top of that this creates a smaller weight (~ 30%) than usual to cyclicals like energy, materials, industrials or financials. For reference: The MSCI World ex US has a weight of over 50% in traditional cyclicals.

*we added Consumer Disc & Com. Services to Tech as those sectors include many tech related US names such as Amazon, Meta or Netflix after the 2018 GICS changes. Usually, they´re considered to be cyclical.

Flows into passive funds are decreasing diversification

Passive funds eventually outgrew active funds





Source: Goldman Sachs Investment Research Division, Cormac Conners, as of 12/15/23. Past performance is not indicative of future returns.

The S&P is mainly long tech & short cyclicals vs peers

	GICS Sector	S&P 500	MSCI Europe	Topix	MSCI Asia Ex - Japan
Tech & Tech related*	**Information Technology**	**30%**	**8%**	**14%**	**22%**
	Consumer Discretionary	11%	11%	19%	12%
	Communication Services	9%	3%	7%	8%
	total	**50%**	**22%**	**40%**	**42%**
Defensives	Utilities	2%	4%	1%	3%
	Consumer Staples	6%	11%	6%	5%
	Healthcare	13%	16%	7%	5%
	total	**21%**	**31%**	**14%**	**13%**
Cyclicals	Energy	4%	6%	1%	4%
	Materials	2%	7%	6%	7%
	Industrials	9%	16%	24%	7%
	Financials	13%	18%	12%	23%
	Real Estate	2%	1%	2%	3%
	total	30%	48%	45%	44%

Source: BNP Paribas

The impact of passive investments

ETF FLOWS ARE BENEFITTING EXPENSIVE AREAS OF THE MARKET

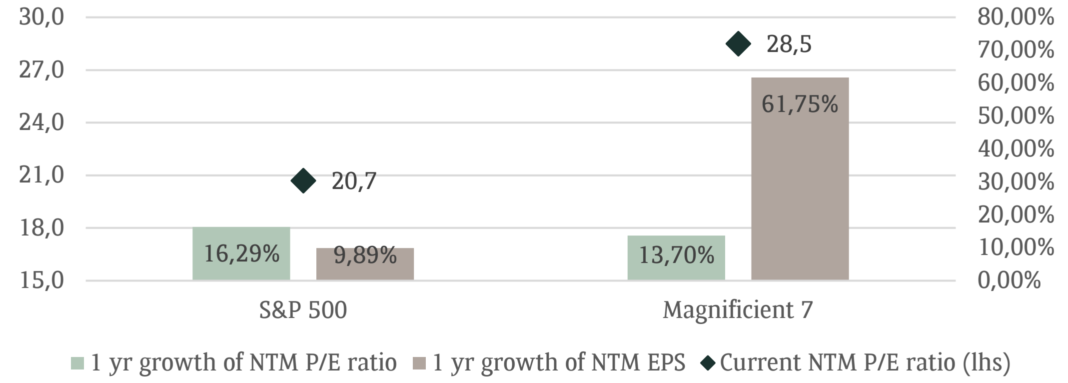
The aforementioned dynamics create another issue. Not only are those flows amplifying concentration risk, but investors are as well increasing their exposure to one of the most expensive parts of the market. The "Magnificent 7" are still trading close to record valuation premiums compared to the rest of the market. However, those names have also shown superior earnings growth over the last couple of quarters. One might thus be forgiven for thinking that the valuation premium is warranted. If, and that looks like a big "if" to us, big tech can continue to deliver at least the outstanding earnings growth which is currently priced into valuations, those valuations should be less of an issue. Bulls may take further comfort from the fact that valuations are still well below the extremes we observed during the dotcom bubble.

This being said, we are still worried by the simple fact that valuations do have an impact on returns. While there is basically no relationship between valuations and the subsequent one-year returns, the picture changes completely if we look at the subsequent five-year returns. Apparently, valuations do matter in the long run. This makes intuitively sense as high valuations require outstanding earnings growth which can be easily achieved (or expected) for a short period of time. Do keep the pace in the long run is a totally different venture which is much harder to realize.

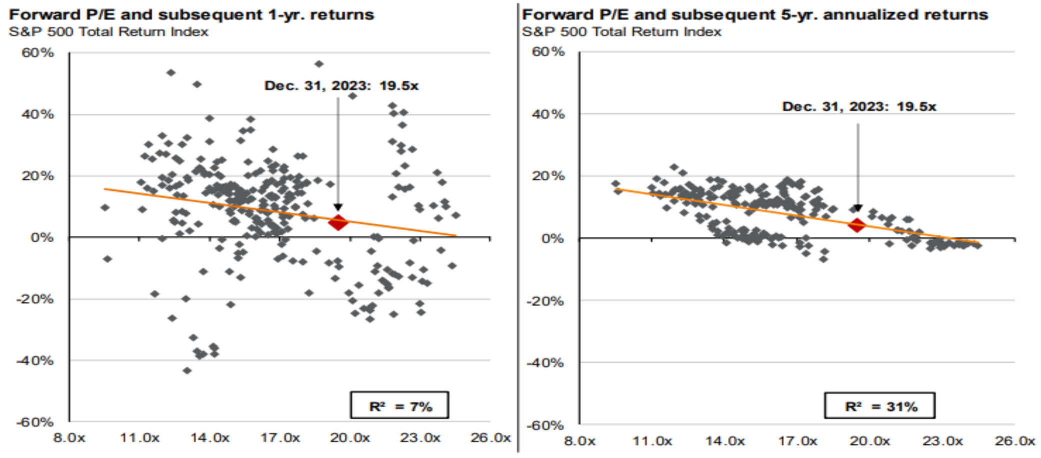
Where does this take us? Given the strength of flows into passive products, the observed trends may have some room run. Having said that we do think that investors should be aware of the concentrations risks which arise from the current weights in American und global indices. With manufacturing purchase manager indices both in Europe and the US looking to rebound, the more cyclical parts of the market could start to question big techs leadership in the near-term future. **We thus see increasing value in diversifying into areas of the market which offer better long term return prospects due to more attractive valuations. Those areas include US Mid/Small Caps as well as European and Japanese equities.**

Valuations matter in the long run

The current valuations seem to be well backed by earnings



The impact of valuations rises with the holding period

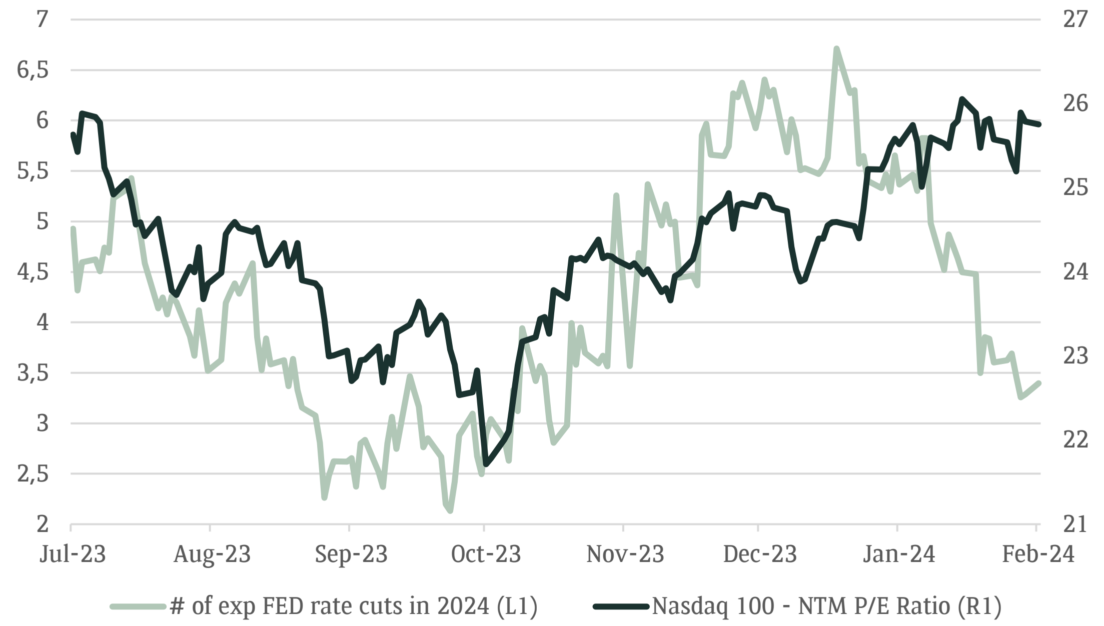


Source: JP Morgan Asset Management

US Tech stock valuations seem to be priced for perfection

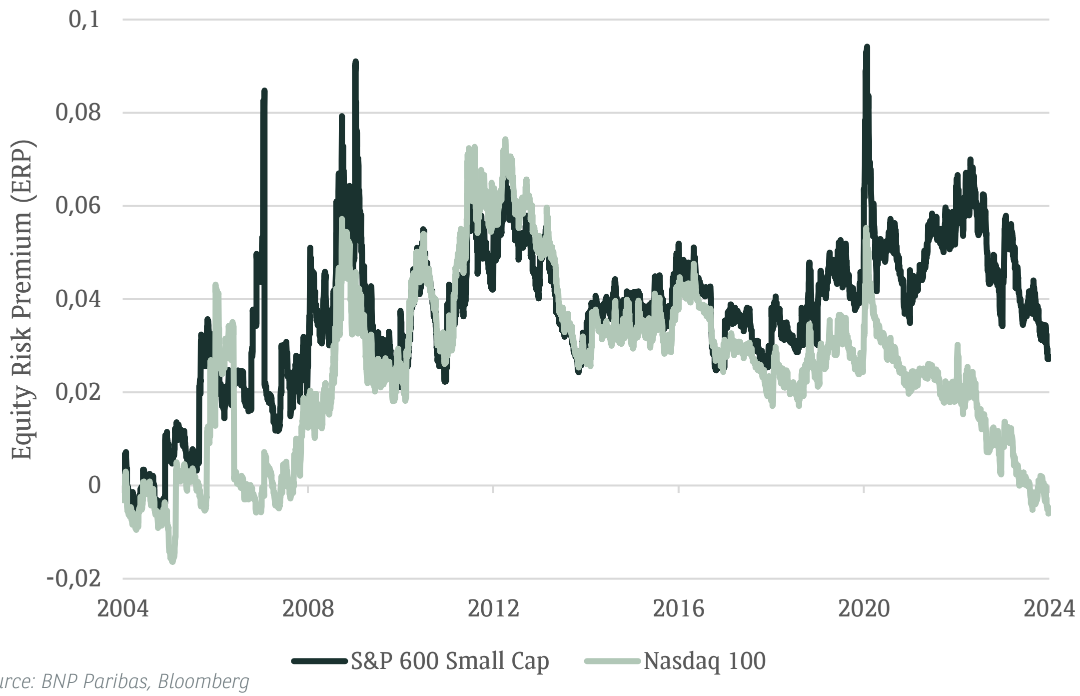
WHILE US SMALL CAPS ARE LOOKING MUCH MORE REASONABLE PRICED

VALUATIONS HAVE SO FAR COMPLETELY IGNORED THE CHANGED RATE OUTLOOK



Source: BNP Paribas, Bloomberg

WHILE THE ERP OF TECH STOCKS IS CLOSE TO A 20-YEAR LOW, SMALL CAP STOCKS LOOK MUCH MORE REASONABLY PRICED

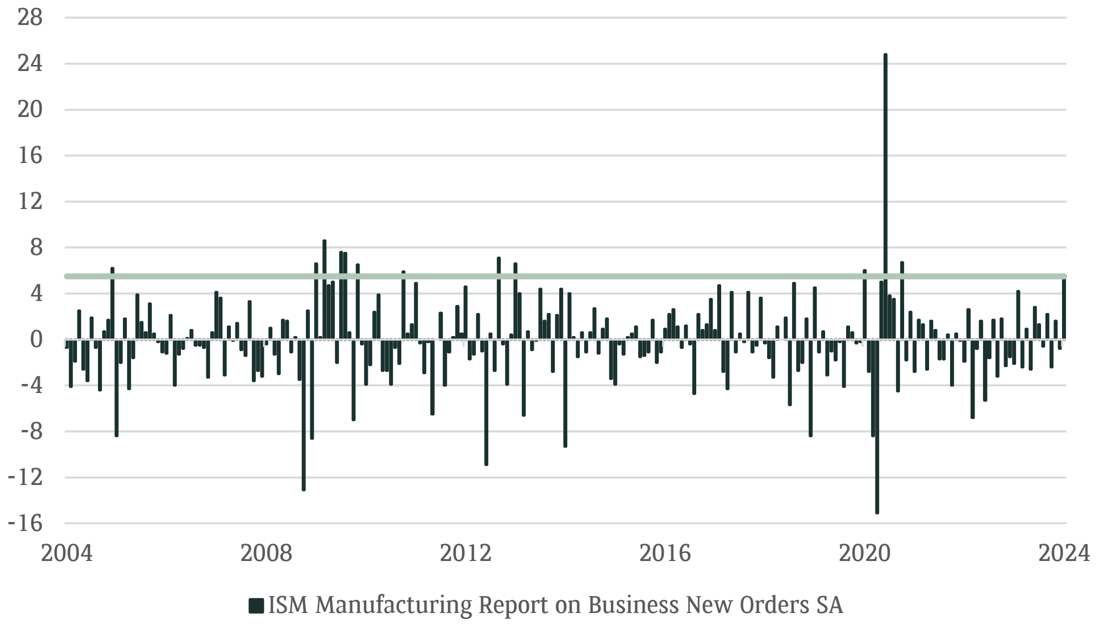


Source: BNP Paribas, Bloomberg

Will a manufacturing rebound squeeze Small Cap shorts?

THE NEW ORDERS COMPONENT OF THE US MANUFACTURING PMI ROSE STRONGLY, INDICATING AN ECONOMIC REBOUND

THE NEW ORDERS COMPONENT OF THE US MANUFACTURING PMI ROSE BACK TO EXPANSION TERRITORY (>50) IN A MOVE OF A MAGNITUDE ONLY EXCEEDED 11 TIMES IN 20 YEARS



Source: BNP Paribas, Bloomberg

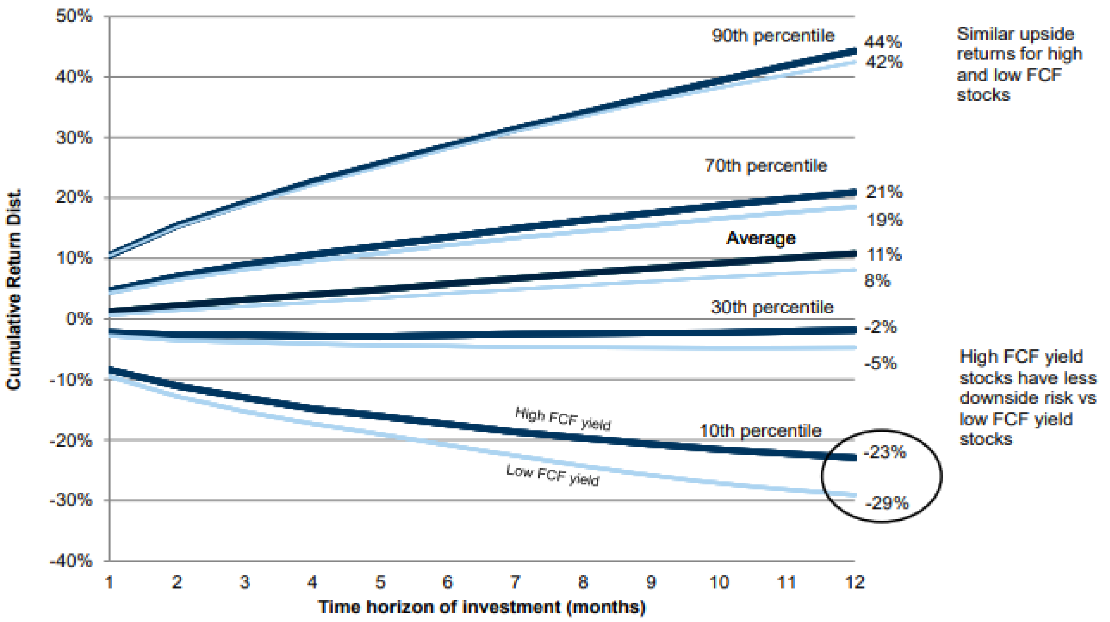
THE AGGREGATE LONG/SHORT RATIO IN RUSSELL 2000 CONSTITUENTS REMAINS WELL BELOW HISTORICAL AVERAGE LEVELS (29TH PERCENTILE ON A 5-YEAR LOOKBACK)

Source: Goldman Sachs

A high Free Cash Flow yield provides a cushion in downturns

A LOW / NEGATIVE FCF YIELD RESULTS IN RISING LEVERAGE RATIOS WHICH PROVIDES A HEADWIND DURING A SELLOFF

LOW FCF YIELD STOCKS HAVE LESS DOWNSIDE SUPPORT THAN THEIR HIGH FCF YIELD PEERS



Source: Goldman Sachs

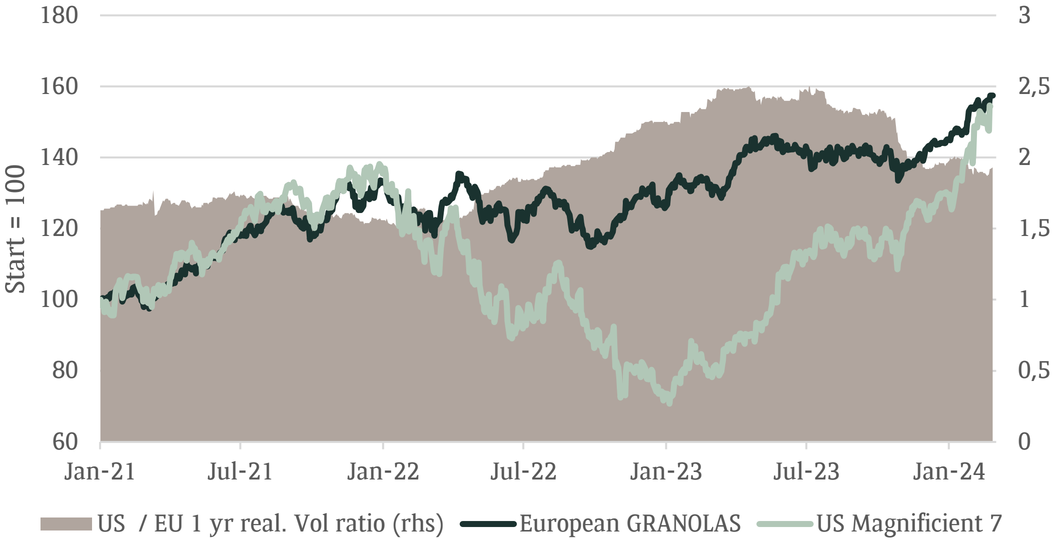
HIGH FCF YIELD SUPPORTS STRONG ROE & HEALTHY DIVIDEND GROWTH, HELPING QUALITY DIVIDEND INDICES TO OUTPERFORM

Source: BNP Paribas, Bloomberg

Europe has its own magnificient crowd

THE LEADING EU STOCKS HAVE MANY MAG 7-LIKE FEATURES BUT ARE TRADING ON LOWER MULTIPLES

EU GRANOLAS MANAGED TO KEEP TRACK WITH THE MAG 7 PERFORMANCE WITH ONLY HALF THE VOLATILITY



Source: BNP Paribas, Bloomberg

EU GRANOLAS SHOW A SIMILAR MARKET AND MARGINS THAN THE MAG 7 BUT ARE CHEAPER AND OFFER HIGHER DIVIDEND YIELDS

	EU GRANOLAS*	US Magnificient 7
%weight of regional benchmark	25%	29%
2023 %chg	60%	63%
5Y outperformance to reg benchmark	50%	73%
NTM P/E Ratio	19%	27%
Net Profit Margin (LTM)	20%	20%
Div Yield (NTM)	2,50%	0,25%
European Revenues (%)	19%	14%
US Revenues (%)	37%	47%

Source: BNP Paribas, Goldman Sachs, Bloomberg

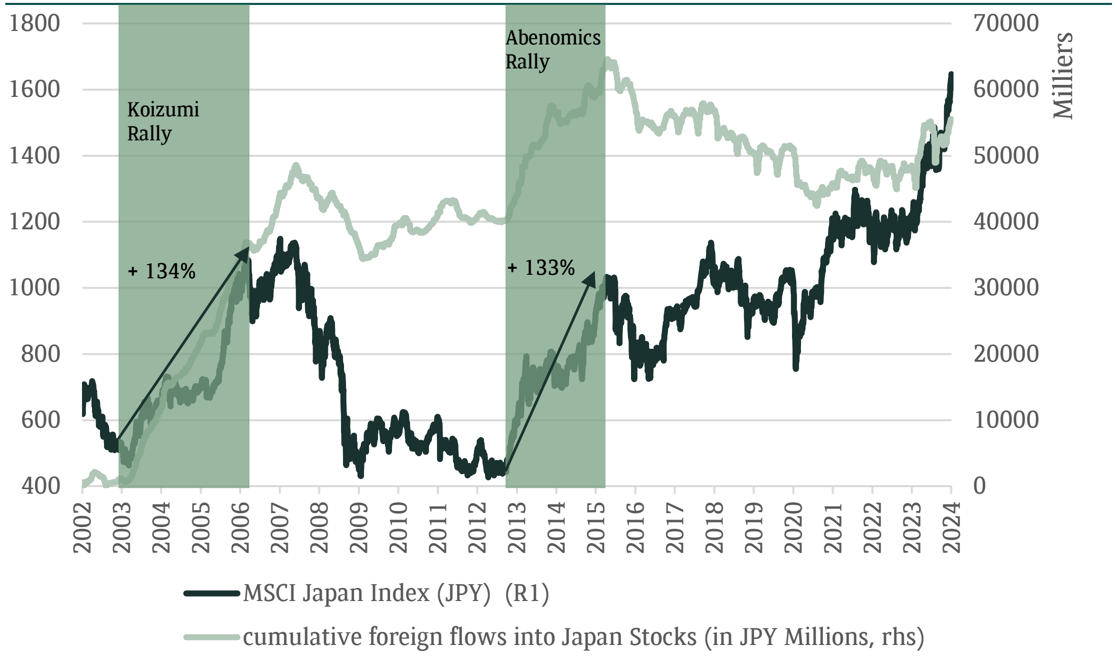
** The terms is derived from the names of the companies in this group which constitutes of the 11 biggest European listed companies*

Like the US, Europe's equity market is dominated by a small group of internationally exposed quality growth companies. They benefit from strong earnings growth, low volatility, high & stable margins and strong balance sheets. While trading with a justifiable (but not cheap) 60% P/E premium to the European market, the GRANOLAS offer a 30% discount vs the Mag 7. This comes despite certain similar characteristics, a superior sharp ratio and a more diversified sector allocation.

New all time high for the Nikkei -> we remain bullish

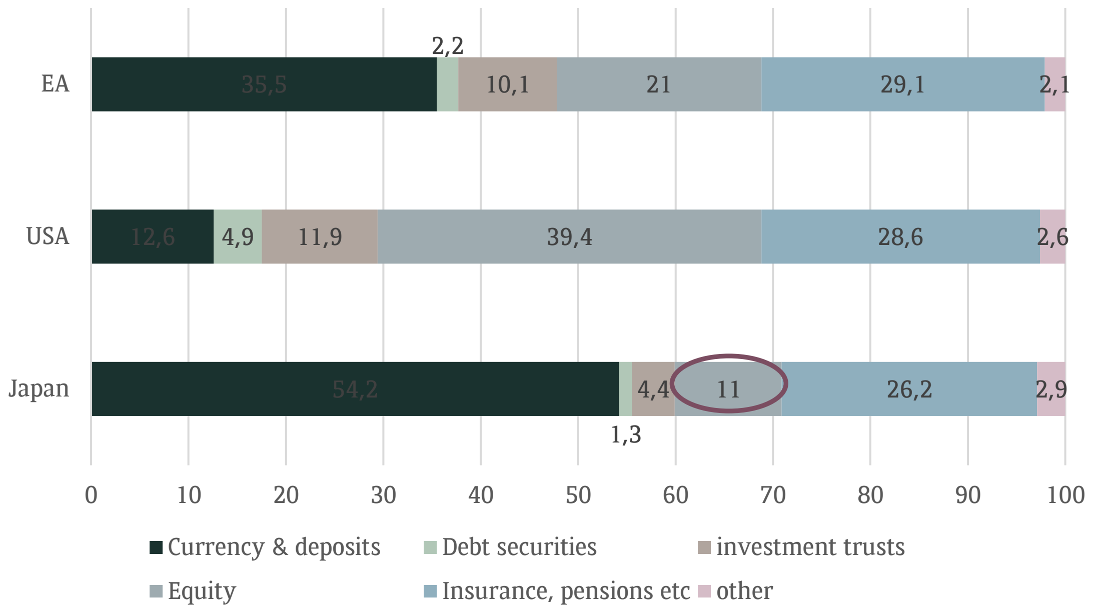
THE AGE OF REFORMS: TSE, PENSION PLAN AND THE NISA REFORMS ARE ALL SUPPORTING FLOWS INTO JAPANESE EQUITIES

ROOM TO RUN: THE LAST REFORM EPISODES ATTRACTED JPY 25-30TRN INFLOWS INTO JAPANESE EQUITIES WHICH FUELED 100%+ RALLIES. LAST YEAR SAW JUST 5 TRN



Source: BNP Paribas, Bloomberg

THE LAUNCH OF NEW NIPPON INDIVIDUAL SAVINGS ACCOUNTS (NISA) ARE SUPPOSED TO DRIVE UP EQUITY INVESTMENTS. A 1% SHIFT IN JAPANESE HOUSEHOLD ASSETS IS THE EQUIVALENT OF $150BN BUYING



Source: BNP Paribas, Bloomberg

Sector Allocations – Overview

Reco	Sector	Industry (Level 2) / Industry Group (Level 3)		
	(Level 1)	+	=	-
	Materials	Metals & Mining Construction Materials		Chemicals
	Utilities	Utilities		
	Health Care	Pharma + Biotech HC equip. & services		
	Financials	EU Banks EU Insurance EU Div. Financials	US Banks US Insurance US Div. Financials	
	Energy	US MLPs (Energy Infrastructure		
	Real Estate	EU Real Estate	US Real Estate	
	Communication Services		Telecoms Media & Social Networks	
	Industrials		Commercial Services Capital Goods Transportation	
	Technology	EU Technology	Technology	
	Consumer Discretionary		Luxury Goods Consumer Services Retail Automobiles Leisure	
-	**Consumer Staples**		EU Food & Beverages EU Food Retail	US Food & Beverages US Food Retail Household & Personal Care Products

No changes for the month

Please refer to the„Thoughts and Convictions“ section on the next page for brief comments on ***selected*** sectors

Sector Allocations – Thoughts and Convictions

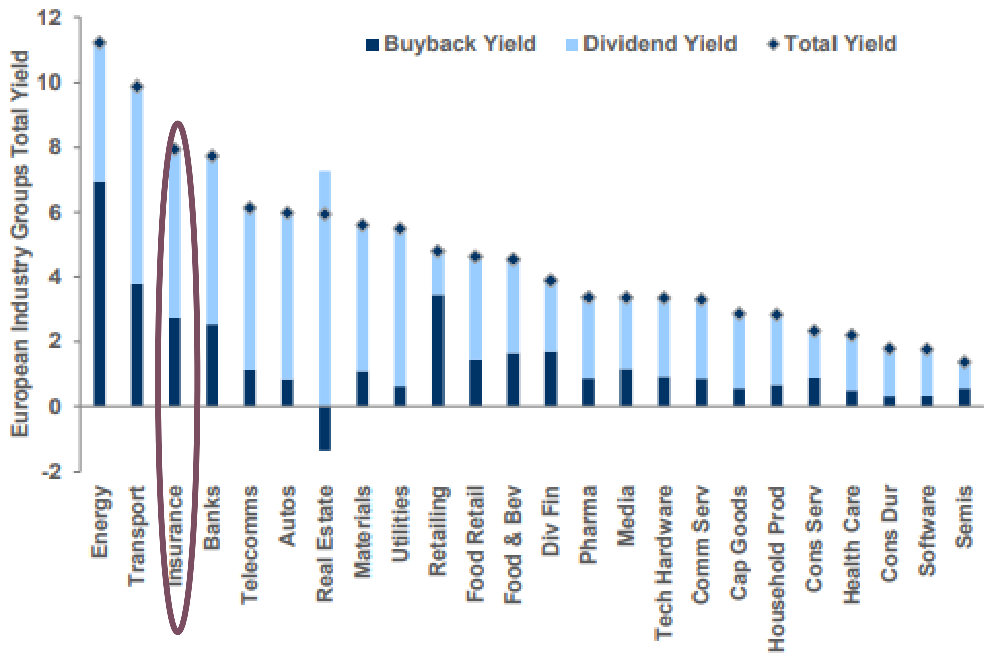
WE PROVIDE SOME BRIEF THOUGHTS ON SELECTED SECTORS. FOR A FULL OVERVIEW KINDLY REFER TO THE PREVIOUS PAGE

Overall view on Equities	Region	Sector / Style in Focus	View	Comments
POSITIVE	Global	Utilities	+	Utilities had the worst relative start of the year since at least 1986. Having been resilient to declining power prices in H2 2023, and helped by the drop in yields, correl to the negative trajectory for EU forward power prices is accelerating (40% correlated 96th percentile). Gas prices could be close to a bottom though as the risk of "tank tops" next summer decreased while European Gas prices need to stay competitive in order to attract sufficient flows to refill storage capacities. Recall that China´s LNG demand is also firming up.
		Automobiles	=	BEV prices continue to decline for new and used models as low-cost Chinese electric vehicles are seen as a "colossal strategic threat" hitting western shores. EV manufacturers are now offering buyback guarantees to leasing companies to keep selling new battery cars. While this helps shift risk into the future, carmakers remain on the hook to find used-car buyers at a decent price, or risk write-downs. Tarif risks remain as well, especially for highly US & China exposed names. Remain selective
		Travel & Leisure	=	Some encouraging comments from sector heavyweights regarding global leisure travel demand, indicating strong growth on the books for travel that's scheduled to take place in 2024, which gives early indications of potentially another record summer travel season. Consequently, guidances for RevPAR estimates are going up. At the same time, we see some pressure on margins accross the value chain (Premium, Midscale & budget) due to rising costs. Globally, the sector trades with a ~20% premium to pre-covid levels and is
		Retail	=	With tight labour markets across Europe we expect wages to remain stickier and higher than inflation this year, providing households with benefits from positive real income growth and falling interest rates. European households are clinging to their savings with excess saving as a share of GDP having fallen since the pandemic in the US, but growing in Euro area and the UK. This may outweigh positive income effects.
		Chemicals	-	Utilisation rates are likely to remain low as supply is expected to further outgrowth demand while the structural concerns on competitiveness for Europe (i.e. energy costs) will persist. On the other hand, we have a lack of permanent shutdowns globally, and a likely muted outlook for global GDP including a new lower norm in China. We thus expect further downgrades and reduce the sector to underperform. Within the sector, industrial gases should be the best sub-segment.
	US (=)	Technology	=	The Sector is still heavily dominated by too expensive maega cap names. We prefer to look at subsectors which structural growth trends such as Cyber Security and Seminconductors.
	Europe (+)	Technology	+	The majority of European Software companies are active in the application layer of the AI value chain. We expect a growing demand as AI enables users to overcome traditional software limitations when it came down to process automation. This potential does not seem to be not fully appreciated by the market yet.
		Banks	+	European Banks continue to outperform the market on the back of improved earnings estimates. We see further re-rating potential driven by the high number of expected rate cuts from the ECB. Lower rate cuts should support banks net interest income. At the same time, the recent retreat in rates should help reviving loan growth will bringing relief to borrowers which should translate in lower future losses in the loan books.
		Real Estate	+	Despite the recent rally, EU Real Estate is still trading > 40% below both ist pre- and post covid highs. Valuations are still looking cheap and we see room for recent asset price write downs to reverse. Keep in mind that the sector was trading at a price/book ratio of ~ 1 the decade pre covid while today it is only at 0.66. Due to structural trends (anemic new building activity, demographics etc) we´re especially constructive on residential RE. Beyond, we like Logistics and Data Centers while being a bit more cautious on Office and Shopping RE.
		Industrials	=	EU Manufacturing PMIs seem to have found a bottom and are slowly recovering. Inventories are bottoming while orders are picking up and the impact of higher rates starting to fade does in sum suggest a continued modest improvement from here. Historically, Industrials have always outperformed during an improving manufacturing cycle. The sector is not cheap though

EU Insurance

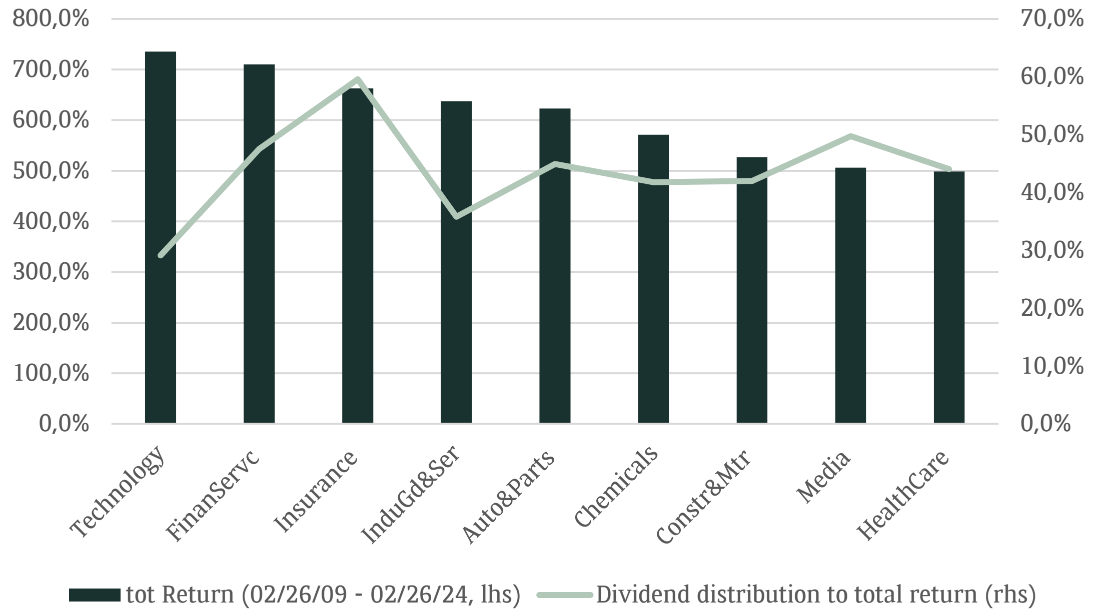
ATTRACTIVE SHAREHOLDER YIELDS BOOST LONG TERM RETURNS

EUROPEAN INSURANCES OFFER ONE OF THE HIGHEST SHAREHOLDER YIELDS IN EUROPE



Source: Factset and Morgan Stanley Research

AMONG THE SECTORS BEATING THE STOXX EUROPE 600 SINCE 2009, DIVIDENDS HAD THE BIGGEST IMPACT ON THE TOTAL RETURN OF INSURANCE

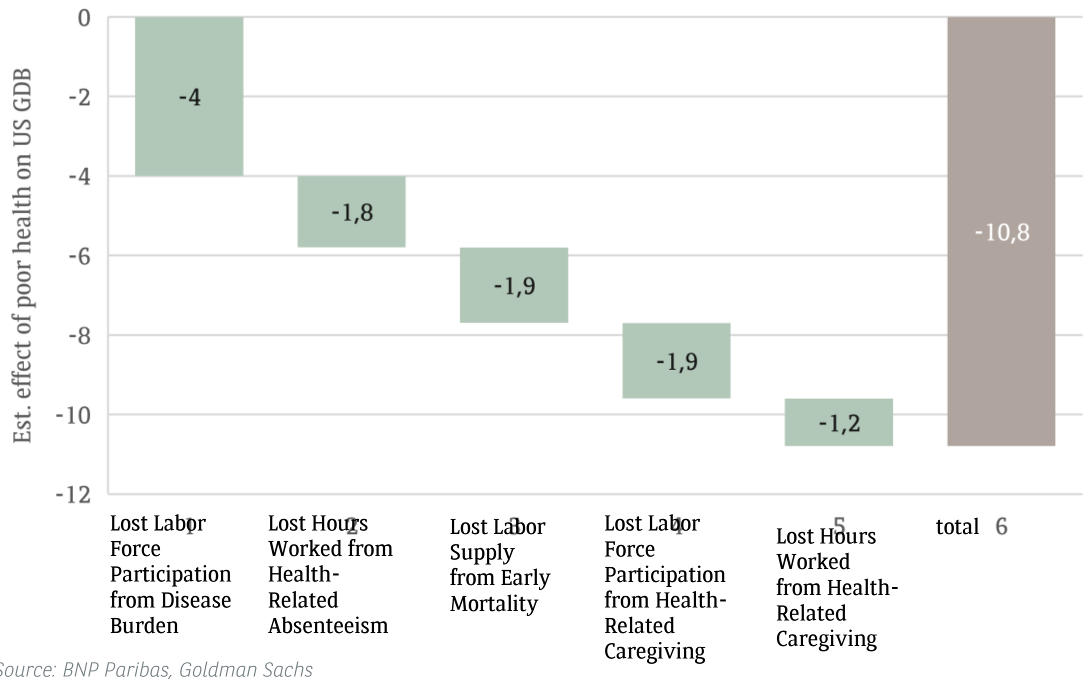


Source: BNP Paribas, Bloomberg

Healthcare & Biotech

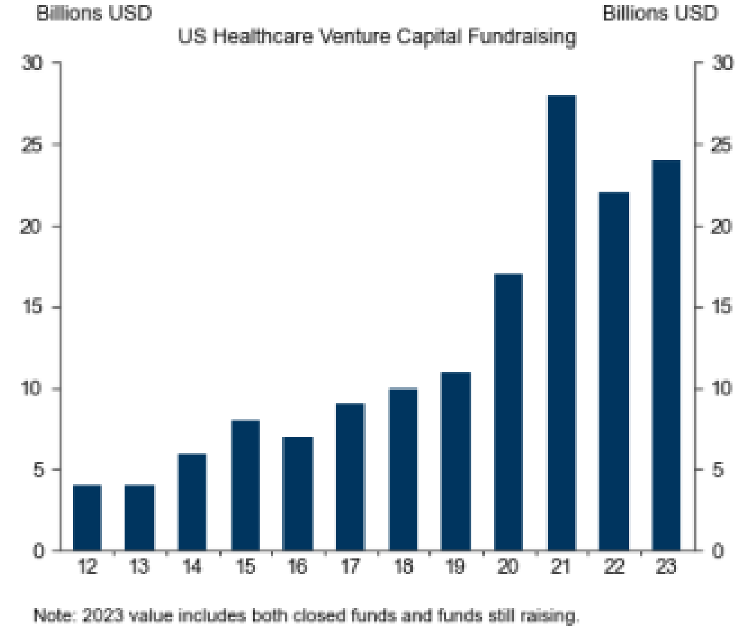
BATTLING THE NEGATIVE IMPACT ON GLOBAL GDP

US GDP COULD BE UP TO 10% IF HEALTH RELATED NEGATIVE EFFECTS COULD BE ELIMINATED



Source: BNP Paribas, Goldman Sachs

FUNDING FOR US HEALTHCARE REMAINS ELEVATED, UNDERSCORING THE INTERESTING PROSPECTS OF THE SECTOR

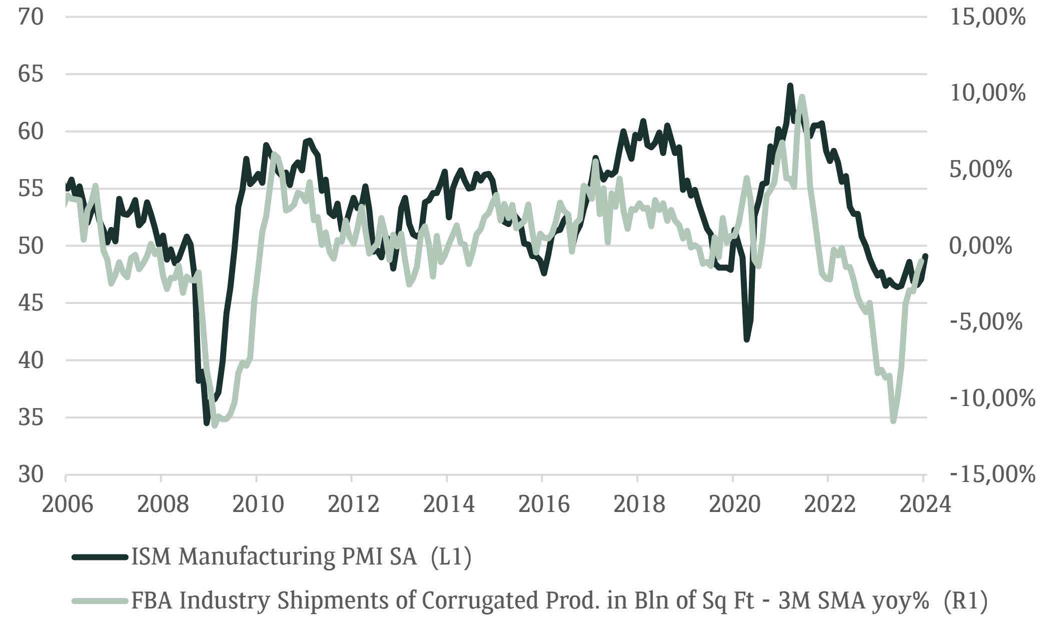


Source: GS Data Works, SVB, Goldman Sachs Global Investment Research

Materials - Containers and Packaging

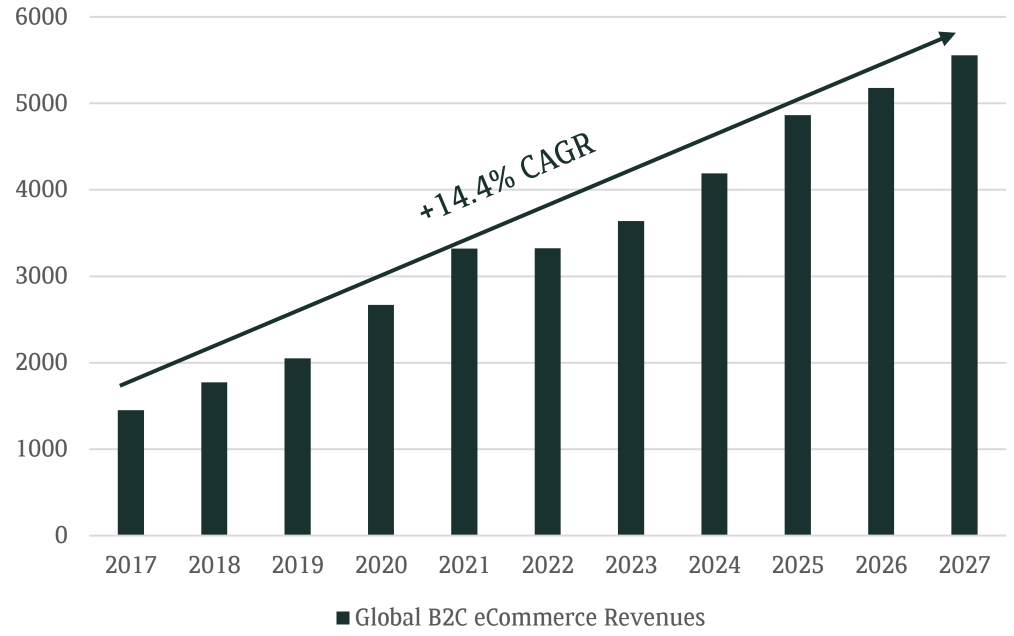
BENEFITTING FROM AN UPLIFT IN ECONOMIC ACTIVITY

THE SHIPPED VOLUME RECOVERED IN LINE WITH THE RECOVERY IN MANUFACTURING ACTIVITY



Source: BNP Paribas, Bloomberg

STRONG B2C ECOMMERCE PROSPECTS SHOULD TRANSLATE INTO A GROWING DEMAND FOR PACKAGING PRODUCTS



Source: BNP Paribas, US Dep. Of Commerce

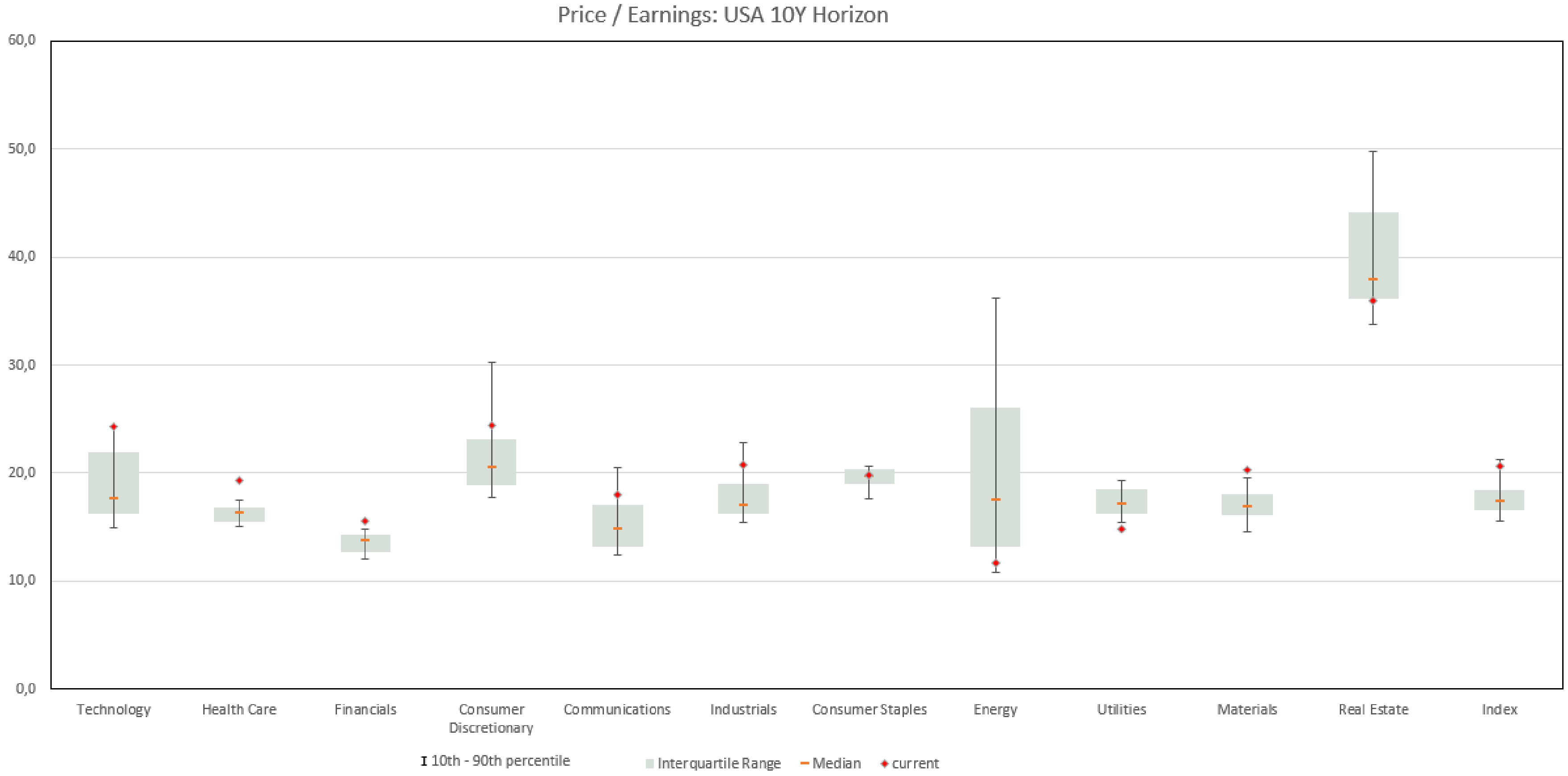
Index Valuations

			Forward															Composite	
Index	Level	1yr Range	EPS	5yr Z-Score	EPS change 4 weeks (%)	PE Ratio	5yr Z-Score	PB Ratio	5yr Z-Score	Div Yield	5yr Z-Score	ROE	5yr Z-Score	Earnings Yield	5yr Z-Score	Equity Risk Premium	5yr Z-Score	vs. ACWI	5yr Z-Score
MSCI ACWI	759		42,61		0,34	17,86		2,74		2,09		14,47		5,61		1,33		n.a.	n.a.
MSCI World	3334		177,26		0,55	18,81		3,01		1,99		14,99		5,32		1,04		1,06	
MSCI Emerging Markets	1028		78,87		-0,99	13,04		1,60		3,07		11,97		7,67		3,39		0,71	
S&P 500	5070		241,09		1,61	21,09		4,20		1,46		18,58		4,76		0,48		1,23	
S&P 500 Equal Weighted	6561		378,64		-0,58	17,31		2,71		2,08		14,63		5,77		1,49		0,97	
Russell 2000	2029		67,06		-0,99	30,26		1,64		n.a.		3,89		3,31		-0,97		1,55	
NASDAQ 100	17933		646,30		2,71	27,83		7,41		0,85		23,89		3,60		-0,68		1,71	
MSCI USA Growth	21667		371,63		5,64	31,12		11,11		0,43		33,22		1,72		-2,56		2,05	
MSCI USA Value	12852		219,13		-0,48	16,10		2,65		2,53		15,27		1,70		-2,57		0,91	
STOXX Europe 600	495		34,61		-1,06	14,31		1,97		3,89		11,86		6,99		4,55		0,79	
STOXX Europe Mid 200	514		38,12		-0,57	13,49		1,52		3,99		10,08		7,41		4,97		0,73	
STOXX Europe Small 200	326		23,73		-1,19	13,75		1,47		3,85		9,42		7,27		4,83		0,74	
DAX	17423		1329,75		-0,77	13,10		1,52		3,30		10,39		7,63		5,19		0,71	
FTSE 100	7684		642,44		-1,42	11,96		1,75		4,12		10,62		8,36		4,20		0,67	
CAC 40	7930		577,90		-0,64	13,72		1,84		3,16		12,94		7,29		4,85		0,76	
FTSE MIB	32558		3901,46		3,05	8,35		1,33		5,83		15,29		11,98		9,54		0,47	
Nikkei 225	39234		1735,58		-0,09	22,61		2,15		1,66		9,42		4,42		3,74		1,20	
Hang Seng	16635		1904,49		-1,40	8,73		0,93		4,41		10,44		11,45		9,07		0,47	

Source: BNP Paribas, Bloomberg

Sector Valuations - US

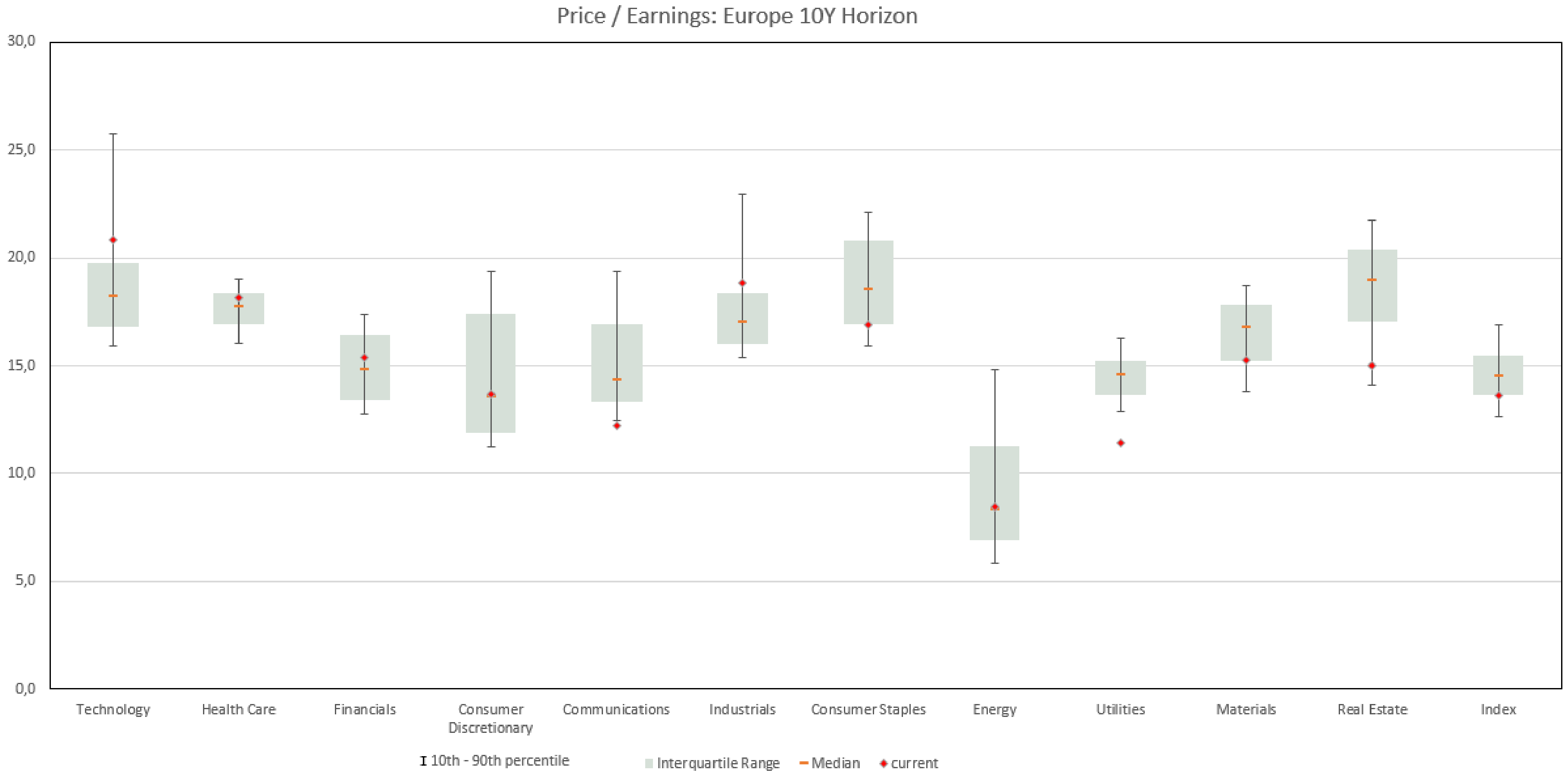
MOST OF THE SECTORS IN THE US ARE AT THE TOP OR EVEN ABOVE THEIR 90TH PERCENTILE



Source: BNP Paribas, Bloomberg

Valuations - EU

EUROPEAN SECTORS CONTINUE TO SCREEN CHEAP VS HISTORY ACROSS THE BOARD



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