MARCH 2024

Investment Strategy Focus

Don't get too carried away

Summary

1. **Beware of over-exuberance in stocks.** As stock markets in the US, Japan and Europe hit fresh all-time highs, investors are easily seduced into forgetting that economic and market risks still exist. Follow the trend for now but watch for signs of trend fatigue or change.

2. **Expect lower interest rates from mid-year.** We now expect the Fed and ECB to cut benchmark interest rates in June and beyond as inflation eases lower. Don't focus on current cash interest rates as these will fall, favour other asset classes with higher long-term returns.

3. **Short-term bonds yield more than expected cash rates:** over 2024-25, cash interest rates should thus average 4.5% in the US and 3% in the eurozone. Short-term government and investment grade corporate bonds already offer higher yields. Look to lock in higher yields for longer via short-term bond and credit exposure.

4. **For higher yield in bonds, consider financial credit, asset-backed securities, emerging market sovereign bond funds:** for a modest increase in investment risk, investors can achieve higher yields in Euro financial bond funds, asset-backed securities funds and emerging market government bond funds.

5. **Consider lower-volatility stock strategies:** global low volatility stock index funds, low volatility high dividend exposure in the European Utilities and Healthcare sectors, and higher yield or downside protected stock exposure via structured solutions.

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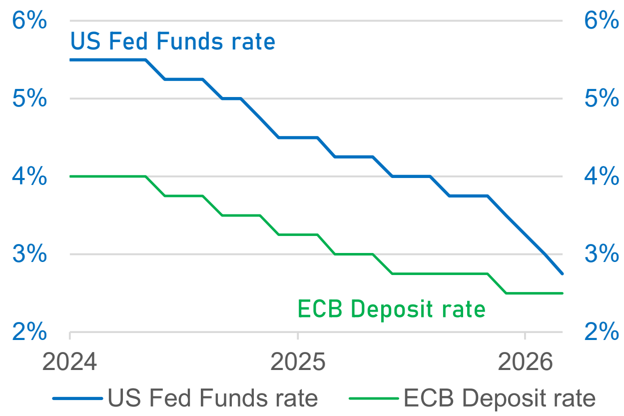
ECB TO CUT DEPOSIT RATE TO 2.5% BY END-2025, FED TO CUT TO 2.75% BY EARLY 2026



Source: BNP Paribas, Bloomberg.

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Global CIO

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Macro, Market Views

Macro		– Monthly inflation prints have declined sharply over the last 6 months. – US, EU central banks should cut interest rates starting in June. US Fed Funds rate to end 2024 at 4.5%, ECB deposit rate at 3.25%. Further benchmark interest rate cuts expected in 2025. – GDP growth is running at an annualised 2.9% in the US for Q1 2024 and is slowly improving from zero in the eurozone.
Rates	=	– After a sharp fall in 10Y bond yields, there is little further price upside to our 12-month yield targets. – Prefer short duration (2-3 year) government bonds for higher yields. – EM sovereign bonds (local currency and USD) still offer attractive 6%+ yields.
Credit	+	– EUR spreads offer more potential to tighten more than US spreads in our view. – Shorter duration preferred (<5 years duration). – For higher yield (at higher risk), consider the US fallen angels strategy and Euro subordinated financial bonds.
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 post multi-year highs. – European financials set 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. – Industrial/logistics exposure preferred for healthy yields, higher expected rental growth on robust underlying demand growth.
Commod-ities	+	– Oil (+) Brent should remain in the USD 85-95 range due to gas/oil substitution & the progressive ban on Russian oil. – Gold (+) is our preferred safe haven - weaker USD and stable long-term rates should help. 12-month expected range = USD 1950-2150.
FX		– Our EUR/USD target is USD 1.15 (value of 1 euro) in 12 months, on narrowing US v EU interest rate gap by year-end.

Attractive alternatives to staying in cash

Cash deposit rates to fall this year

At present, US dollar and euro short-term benchmark interest rates offer investors nominal rates that have not been seen since at least 2007, at 5.5% in the US and 4% in the eurozone. It is understandable that many conservative investors have chosen to retain a high proportion of their investment assets in cash, either via money market funds or term deposits.

As global inflation rates renormalise closer to the 2% explicit inflation target of central banks, we expect these benchmark interest rates to begin to fall from June this year. This rate-cutting cycle should then continue well into 2025, with benchmark interest rates bottoming out below 3% in the US and at 2.5% in Europe. As a result, these currently attractive cash interest rates will also decline over the second half of this year, and even more in 2025.

High reinvestment risk

Both money market funds and term deposits are thus vulnerable to reinvestment risk – lower returns in future are very likely given our expectations of substantially lower central bank benchmark interest rates over the next 1-2 years.

Today, over USD6 trillion is currently invested in US money market funds at around 5.3%, while EUR2.75 trillion is kept in cash deposits at banks by German households, a new record. According to the ECB, eurozone time deposits of maturity of up to 1 year have an average 3.3% interest rate. These US dollar and euro cash interest rates should fall in future months as central banks cut rates.

Consider conservative income investments

We can identify a good number of relatively attractive income-producing investments across bond, stock and alternative asset classes. These relatively conservative investments provide an attractive income-generating alternative to cash deposits, in our view.

What cash rate do we look to beat? According to our central bank rate forecasts, the Fed Funds rate should average 5% for the remainder of this year and just 4% in 2025. The ECB deposit rate should average 3.7% over March-December 2024, and 2.9% in 2025.

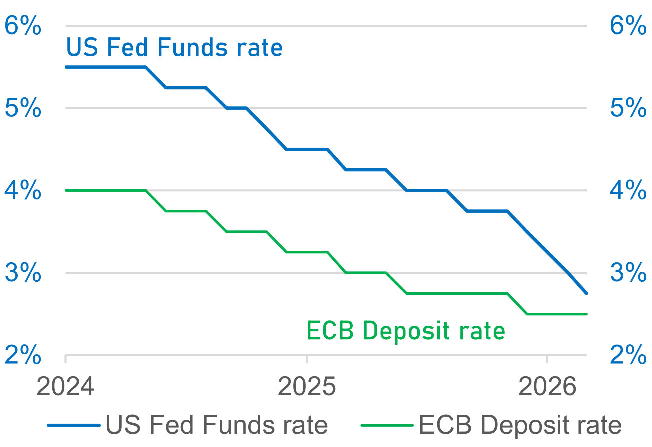
Given the current spreads of US money market funds to the Fed Funds rate, and euro term bank deposit rates to the ECB deposit rate, we could thus expect US money market funds to yield 4.8% on average in 2024 and 3.8% in 2025. Euro term deposit rates are likely to yield closer to 3% over 2024 and well under 3% in 2025, on average.

Thus, we believe that a reasonable income benchmark to beat is 4.5% per year over the next 2 years in the US, and 3% over this same period in the eurozone.

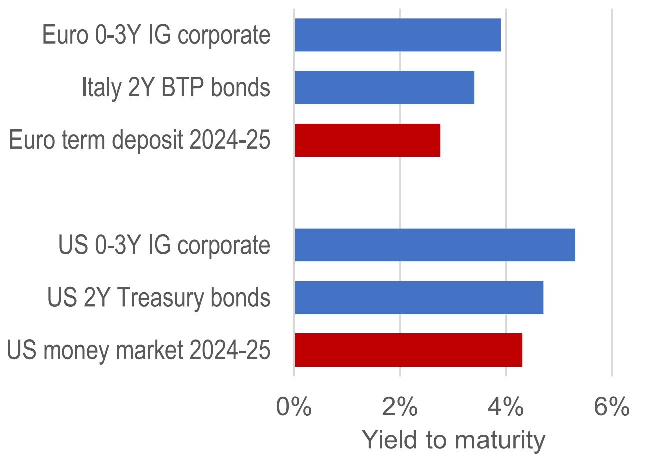
Today, 2-year US Treasury yields offer 4.7%, while Italian 2-year BTP bonds yield 3.4% at present. Both thus already beat these 2-year US and euro interest rate benchmarks.

Short-dated investment grade corporate bonds offer even more, at very limited additional risk: US 0-3 year maturity corporate bonds offer a 5.3% yield, while the equivalent Euro 0-3 year corporate bonds carry a 3.9% yield.

ECB TO CUT DEPOSIT RATE TO 2.5% BY END-2025, FED TO CUT TO 2.75% BY EARLY 2026



SHORT-TERM GOVIES AND CORPORATE BONDS SHOULD BEAT FUTURE CASH RATES



Source: BNP Paribas, Bloomberg.

Conservative income investments in bonds and stocks

In bonds, consider financial corporate bonds, asset-backed securities and emerging market sovereigns

European financial corporate bonds: for higher yields in Europe within the bond universe, one can consider funds that hold financial corporate bonds, i.e. bonds of banks, insurance companies and other financials. At present, these financial corporate bonds offer slightly higher yields and credit spreads than equivalent non-financial corporate bonds of similar credit quality.

Over the last five years, European financial credit bond funds have generated an average return of close to 6% per year.

Asset-backed bonds: asset-backed bond funds invest in short-term corporate bonds (maturities averaging around just 2 years) with specific asset backing, such as asset-backed securities (ABS), residential mortgage-backed securities (RMBS), and collateralised loan obligations (CLOs). This subclass of corporate bonds are deemed to carry lower risk than unsecured corporate bonds of similar credit quality, given their link to a specific asset and to specific cash flows.

European asset-backed bond funds currently offer yields of over 4.5% and have returned over 4% per year on average since 2019.

Emerging market sovereign bonds: emerging market sovereign bond funds invest primarily in investment grade debt of countries such as China, Mexico, Indonesia, Brazil and Malaysia, with a small portion also invested in bonds with the highest BB credit rating within high yield. These EM sovereign bond funds offer a yield of well over 5% at present and have performed well over 2023.

Look to conservative opportunities in rising stock markets

Conservative income-seeking investors may not initially consider any investment in stock markets, given the higher investment risk inherent in stocks versus bonds or cash.

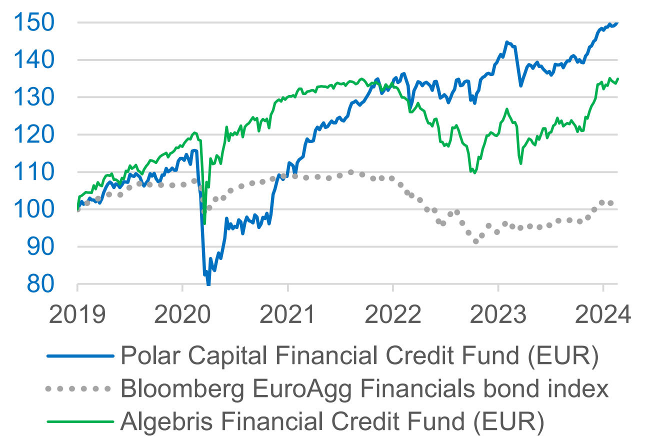
But we feel that there are several ways to invest in stocks while reducing the level of investment risk.

The first and simplest way is to invest in ETFs and funds that set out to invest only in stocks with the lowest volatility (risk), as represented by the **MSCI World Minimum Volatility index**. This index has returned 8.7% per year on average over the last 5 years in euros, or over 50% cumulatively. Compare this to a mere 3.1% from cash deposits in euros and 0.2% from a global bond index over this same 5 years.

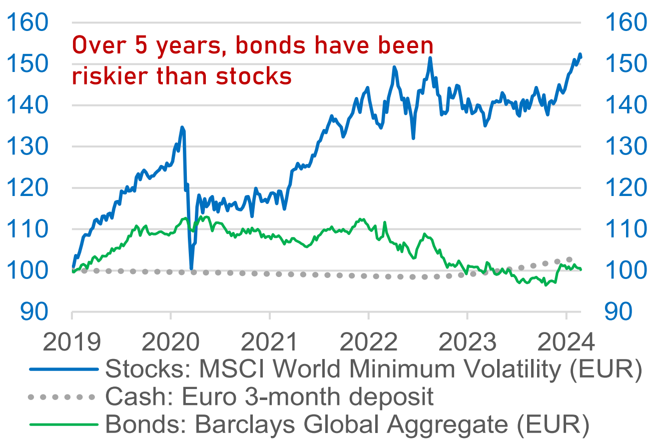
Secondly, one may consider investment in lower volatility, higher dividend sectors such as the **European Healthcare** and **Utilities sectors**. Over time, low volatility, high dividend strategies have been shown to outperform broad stock market indices. Since the start of 2019, the European Utilities sector has returned 8% on average per year, while European healthcare stocks have returned an average 11% per year over the last 5 years.

Finally, investors may choose to use **structured products** to either generate a potentially high yield from stocks (e.g. via reverse convertible products) or exposure to the upside in stocks but with very limited or no downside (via capital guaranteed solutions).

OVER 5Y, FINANCIAL CREDIT FUNDS HAVE BEATEN THE UNDERLYING BOND INDEX



SINCE 2019, STOCKS HAVE BEEN THE KEY REAL SOURCE OF INVESTMENT RETURNS



Source: BNP Paribas, Bloomberg.

Follow stock momentum for now, but watch for signs of exhaustion

Stocks: the trend remains your friend

Reviewing the performance of financial markets over the first two months of 2024, it seems clear that abundant global liquidity and positive US economic momentum are the principal factors behind the positive performance of stocks, bonds and even cryptocurrencies.

Stock markets around the world continue to motor higher, led by US large-cap technology, but also with broad participation through multi-year or even all-time highs in the Japanese Nikkei 225, Euro STOXX 50 and French CAC 40 indices. Note too the strong performance year to date of the MSCI Emerging Markets ex China index, led higher principally by India, Taiwan and South Korea.

While everyone still seems to be obsessed with Artificial Intelligence and Nvidia, note that the tech rally has broadened out to the extent that the European and Japanese technology sectors (both +29%) have outperformed the US Magnificent 7 (+24%) and the Nasdaq 100 index (+19%) since November.

Corporate credit: high yield in the lead

Investment grade credit has lost a little ground in February as global bond yields have moved higher on the back of robust US economic growth, employment growth and higher-than-expected January US inflation readings driven by resilient services prices.

In contrast, US and European high yield credit indices have followed stock markets higher on the back of compression in credit spreads, reflecting buoyant global risk appetite.

No bull trend lasts forever; watch for exhaustion

Signs of euphoria are emerging in sentiment readings of retail investors – as an example, the CNN Fear & Greed index has reached an "extreme greed" level of 75 out of 100, while retail investors continue to pour money into US technology ETFs, almost to exclusion of everything else in the stock market.

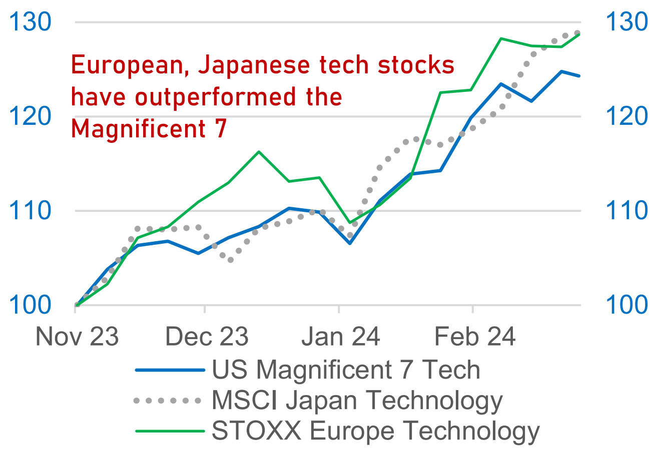
While investors should enjoy the strong run-up in global stock markets for now while the trend remains solidly positive, we should not get carried away. Remember that risk management is key to robust positive investment returns over the long haul.

Key indicators I am keeping a close eye on

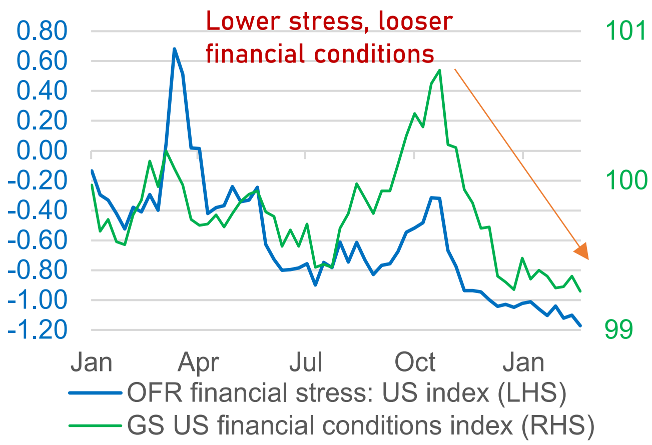
These are some of the key indicators that I am monitoring closely for signs of a potential trend change in global stocks:

- **Global liquidity**: very important but rather difficult to measure accurately – but we can proxy this with global M2 money supply growth, which has continued to increase since October, a positive sign.
- **US financial stress, financial conditions indices**: the OFR US financial stress and Goldman Sachs US financial conditions indices both continue to support higher stocks, for now.
- **US bond market volatility**: a key measure of risk that is particularly important for stock markets is the level of volatility in the US bond market, as measured by the MOVE index. This remains close to its lowest levels since mid-2022, so no warning signs are evident here yet.

EUROPEAN, JAPANESE TECH STOCKS HAVE BEATEN THE MAG 7 SINCE NOVEMBER



FOR NOW, STOCKS SUPPORTED BY LOWER FINANCIAL STRESS



Source: BNP Paribas, Bloomberg.

Economic risks: US consumer slowdown ahead?

US economic momentum continues to surprise

The story of US January economic data releases has been one of consistently stronger activity than expected, and employment growth that has equally been stronger than expected looking at nonfarm payrolls.

This is reflected in continued strong readings from the Atlanta Fed GDPnow indicator for Q1 2024, which remains well above trend growth at a 2.9% annual rate. There should be no surprise then that the US economic surprise index has risen further into positive territory in the first two months of this year, reflecting this strong run of economic data.

What is perhaps less obvious is that economic momentum has continued to improve too in the eurozone, although from admittedly very weak levels late last year. Consumer confidence is beginning to recover as the impact of very high inflation rates gradually recedes, and as the positive impact of higher wages finally feeds through to improved household spending,.

But higher interest rates to bite; excess savings effect exhausted

But we should sound a note of caution with respect to the US economy. The full impact of previous short- and long-term interest rate hikes has probably not yet been felt in consumer and manufacturing activity, and COVID-era excess household savings are likely exhausted by now. Consequently, we expect slower US consumer spending by H2 2024.

Europe getting a boost from lower energy costs

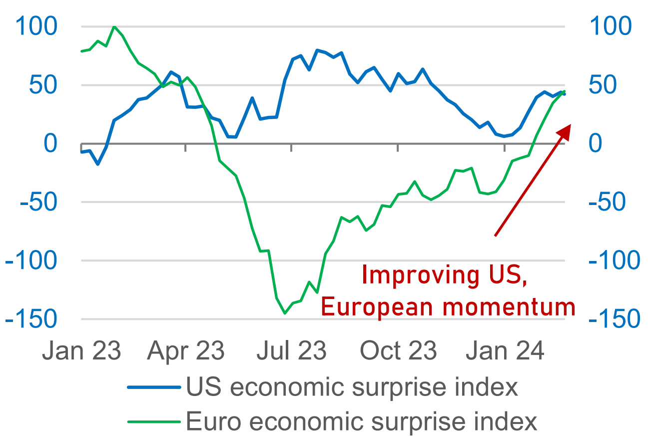
One very good item of news flow for the European economy has been the consistent fall in wholesale natural gas and electricity prices in the wake of the 2022 post-Ukraine invasion energy crisis.

Current Dutch natural gas and German baseload electricity benchmark prices ~~we~~ have now returned to price levels not seen since early 2021, i.e. well before the outbreak of the Ukraine conflict. This is already being reflected in lower costs for industry, with eurozone PPI falling at a 27.5% annual rate as of December. These lower wholesale energy costs have yet to be fully reflected in lower consumer prices, with the January energy component of the eurozone CPI at -6% on a yearly basis.

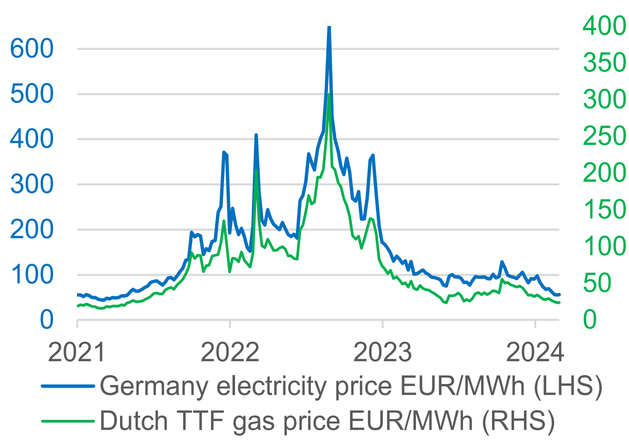
These energy costs should remain low or even fall even further as we move into springtime, and thus see falling heating demand. In addition, we risk seeing a glut in Liquefied Natural Gas (LNG) cargoes being shipped from the US and Qatar. European natural gas storage is still at a seasonal high of 66% full, which combined with falling seasonal demand, could result in even lower natural gas and electricity prices in the months to come.

This could provide a further drop in European headline inflation rates over the coming months, boosting household spending power and boosting corporate profit margins through lower operating costs. This is a good reason not to be too pessimistic over the economic prospects in Europe this year.

EUROPEAN AND US ECONOMIC MOMENTUM NOW BEATING FORECASTS



EUROPEAN GAS AND ELECTRICITY PRICES HAVE RETURNED TO EARLY 2021 LOWS



Source: BNP Paribas, Bloomberg, Citigroup.

Summary of our main recommendations, by asset class

	Current Recom	Prior Recom	Constituents	We like	We avoid	Comments
Equities	+	+	Markets	UK, Japan, eurozone, Latin America, China, S. Korea Singapore and Indonesia		Buoyant global liquidity continues to support stock markets. Key drivers include falling US inflation, lower long-term interest rates, improving macro liquidity, and easing energy prices. Build stock exposure gradually on market consolidations.
			Sectors	Global Health Care, European Utilities, Materials, EU Financials & Technology		**Materials** to benefit from rebounding Chinese activity, low base metals inventories. **European banks** should benefit from surprisingly resilient consumption, rising Net Interest Margins & rising ECB deposit rate.
			Styles/ Themes	Quality, Megatrend themes		Circular Economy, Electrification, Security, Income Growth themes
Bonds	=	=	Govies	Favour US short duration. Prefer inflation-indexed bonds		Our 10-year bond yield targets are 4% in the US and 2.5% in Germany in one year. Favour US and UK inflation-linked bonds.
	+	+	Credit	US, Euro IG credit		We favour investment grade Credit, focusing on US and EU credit on the back of decade-high yields and strong balance sheets.
	+	+	EM bonds	USD and local currency		
Cash	-	-				
Commo-dities	+	+		Gold Oil Industrial metals		Oil (+) Brent should remain in the USD 85-95 range due to gas/oil substitution & the progressive ban on Russian oil. Base metals (+) boosted by China's reopening in the short term, and energy transition demand in the longer term. Gold (+) is our preferred safe haven, and a weaker USD & stable LT rates should help, 12-month exp. range = USD 1950-2150.
Forex			EUR/USD			Our EUR/USD target is USD 1.15 (value of 1 euro) in 12 months. Target change for Chinese CNY with less potential for rebound.
Real Estate	=	=		Health Care, logistics/ warehouses		Unlisted real estate faces enduring headwinds from slowing economies and much higher financing rates. Prefer listed real estate.
Alternative UCITS				Long/Short Equity and Relative Value, Trend-following		
Infra structure	+	+		Energy, transportation, water		Excellent long-term returns expected from private and listed infrastructure given long-term underinvestment.

Economic, FX forecast tables

BNP Paribas Forecasts			
GDP Growth %	2023	2024	2025
United States	2,5	2,0	1,4
Japan	1,9	0,4*	0,9
United Kingdom	0,1	-0,1	1,1
Eurozone	**0,5**	**0,7**	**1,6**
Germany	-0,1	0,2	1,3
France	0,9	0,6	1,4
Italy	0,7	0,9	1,5
Emerging			
China	5,2	4,5	4,3
India**	7,5	7,0	6,5
Brazil	3,1	1,8	1,8

Source: BNP Paribas - 16/02/2024

*Japan GDP Growth has been revised (prior 0,8)

BNP Paribas Forecasts			
CPI Inflation %	2023	2024	2025
United States	4,1	2,7	2,4
Japan	3,2	2,1	1,9
United Kingdom	7,4	2,0	2,4
Eurozone	**5.4**	**2,0**	**2,0**
Germany	6,1	2,2	2,0
France	5,7	2,2	1,6
Italy	6,0	1,5	2,5
Emerging			
China	0,4	1,5	1,7
India*	5,8	5,7	4,5
Brazil	4,6	3,6	3,9

Source: BNP Paribas - 16/02/2024

* Fiscal year

	Country	Spot 03/03/2024		Target 3 months	Target 12 months
Against euro	United States	EUR / USD	1,09	1,06	1,15
	United Kingdom	EUR / GBP	0,86	0,86	0,86
	Switzerland	EUR / CHF	0,96	0,95	0,98
	Japan	EUR / JPY	163,58	154	154
	Sweden	EUR / SEK	11,17	11,00	11,00
	Norway	EUR / NOK	11,41	11,30	10,80
Against dollar	Japan	USD / JPY	150,75	145	134
	Canada	USD / CAD	1,35	1,32	1,30
	Australia	AUD / USD	0,65	0,68	0,70
	New Zealand	NZD / USD	0,62	0,60	0,63
	Brazil	USD / BRL	4,98	5,00	5,00
	India	USD / INR	82,90	82,0	82,0
	China	USD / CNY	7,20	7,20	7,20

Source: BNP Paribas, Refinitiv Datastream. As a 3 March 2024

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