JULY 2024

Investment Strategy Focus

Spotlight on policy uncertainty and global disinflation

Summary

1. **Election uncertainty surges**: early July French and UK legislative elections trigger increased policy uncertainty. November's US Presidential election is also increasingly in focus. Typically, political events trigger short-term volatility but have little long-term effect on financial markets.
2. **Hedging against heightened uncertainty**: to hedge against this increasingly volatile backdrop, investors can look to safe havens such as physical gold and short-dated bonds, secular growth themes such as electricity/energy infrastructure & clean water, and structured solutions with downside protection.
3. **Global disinflation to intensify,** driven by lower goods prices, stable energy costs and slower rental growth. We believe that US, European and Asian inflation rates will fall towards or below 2% in H2 2024. Supports sovereign and corporate bonds, with short-dated yields likely to fall.
4. **Global rate-cutting cycle to gather pace.** Easing inflation should permit central banks to lower benchmark rates. The Bank of England and the Fed should join the ECB, SNB, PBOC and Bank of Canada in reducing interest rates over H2. Should lend support to selected short rate-sensitive property markets like the UK and Spain.
5. **Look to add on weakness** to i) selected cheap emerging markets bonds and stocks such as South Korea, Turkey and Latin America; ii) precious and energy transition metals (gold, silver, copper, aluminium) and associated miners; iii) European bank sector bonds and stocks.

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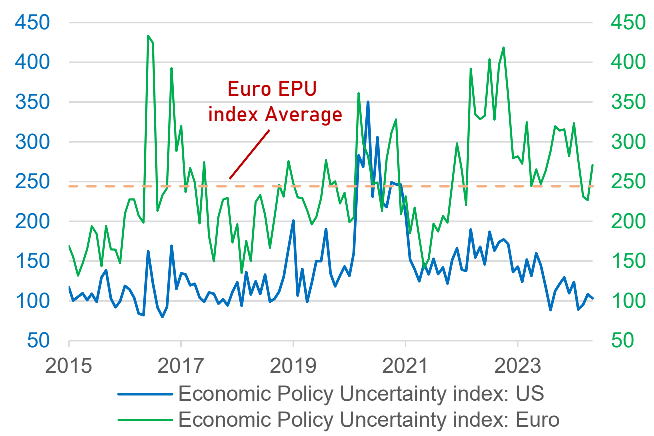
GEOPOLITICAL RISK INDICES ARE NOT EXTREME



Source: BNP Paribas, Bloomberg

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Macro, Market Views

	Macro		– Monthly inflation prints continue to decline on a bumpy path as they descend towards 2%. – We expect the Fed to cut rates once this year (25bps in September).The ECB should lead the rate-cutting cycle with 2 further rate cuts this year. – GDP growth should slow in the US over H2 but should rebound in the eurozone and China. Election-related volatility could persist to November.
	Rates	=	– Large Treasury bond issuance should prevent an imminent sharp decline in US bond yields. – We prefer intermediate maturities in EUR (<10 years) and short maturities in the US for the time being (3-5 years). – EM sovereign bonds (local currency and USD) still offer attractive 6%+ yields.
	Credit	+	– EUR spreads offer further potential to tighten more than US spreads in our view. – Prefer maturities up to 7 years in the US and up to 10 years in the eurozone. – 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. – We like EU Small Caps. Positive on Healthcare, Industrials and Mining & construction materials. We also like EU financials, tech and REITs.
	Real Estate	=	– Lagged impact from higher interest rates to fade after further falls in commercial real estate valuations in Q1 2024. We see European real estate prices slowly stabilising, with rental yields now more attractive. – Industrial/logistics exposure preferred for healthy yields, higher expected rental growth on robust underlying demand growth.
	Commod-ities	+	– We keep our USD85-95 expected price range for the Brent as OPEC+ production cuts help to balance the market in a context of high geopolitical risks, rising demand and slower non-OPEC production growth. – Gold: Positive view as EM central banks should continue strategic purchases and Asian households remain buyers. Gold could reach USD2600/oz next year.
	Alternative UCITS/ Private Assets	=	– We favour relative value equity, credit and event-driven funds for their robust risk-adjusted returns at low volatility. – Private equity buyout funds are a preferred private asset subclass, given robust long-term returns and an abundance of public market opportunities
	FX		– EUR/USD target is USD 1.12 (value of 1 euro) in 12 months, on narrowing US vs. EU interest rate gap in 2025.

US starts to slow as the eurozone picks up at last

US consumers hit the brakes

If you were simply to look at the 3% annualised GDP growth rate suggested by the Atlanta Fed's GDPnow indicator for Q2 2024, you might say that the US economy is still growing strongly. But other statistics tell a different story.

US consumers represent nearly 80% of the US economy. They are thus the key motor of US economic growth, and an important driver of global growth given the US's 25% share of global GDP.

Up to now, a strong employment market delivering high wage growth and a high level of excess savings built up in pandemic times have fuelled strong consumption growth.

But now those excess savings have been spent, and higher unemployment underlines weakening in the labour market. As a result, US retail sales (in value terms) has slowed to an annual 2.3% growth rate.

What is more, adjusted for 2.7% PCE (Personal Consumption Expenditure) inflation, real retail sales are shrinking, not growing.

This consumer slowdown is reflected in the downturn in US economic momentum, highlighted by the sharp fall in the US economic surprise index shown below.

We expect further moderation in US economic growth over the remainder of this year and into 2025. However, we still believe that the US will keep growth in positive territory next year, so long as the Federal Reserve does not delay rate cuts too long.

There is a silver lining to this moderation in consumption. Easing demand should allow prices to cool, bringing inflation down closer to the Fed's 2% official target and allowing for more timely rate cuts.

While the Euro consumer finally awakens

The domestic European economy has struggled to post any growth at all for most of last year. In contrast to the case in the US, European household spending has been heavily impacted by unusually high food, energy and services inflation.

With Euro area headline inflation below 3% for the last 8 months, consumers are finally starting to erase the memory of double-digit inflation rates. With average wage growth in the 3%-4% zone, households are finally beginning to enjoy a recovery in their purchasing power. This translates into rising consumer confidence and improving domestic economic activity.

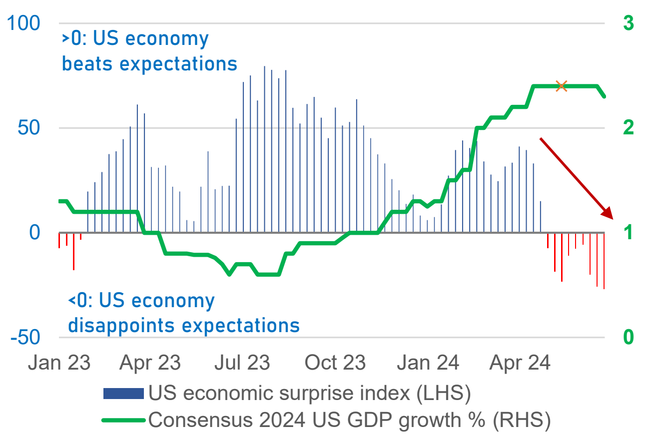
We look for this improving growth trend to persist over the remainder of 2024, aided further by lower interest rates as the European Central Bank continues its rate-cutting efforts. This will reduce the cost of borrowing for households and companies.

Global growth continues to improve

At a global level, economic momentum maintains the steady improvement in place since late 2023. Both the manufacturing and service versions of the S&P/JP Morgan Global Purchasing Manager Index (PMI) reflect economic expansion with 50.9 and 54.1 readings respectively for May (readings of above 50 signal positive growth).

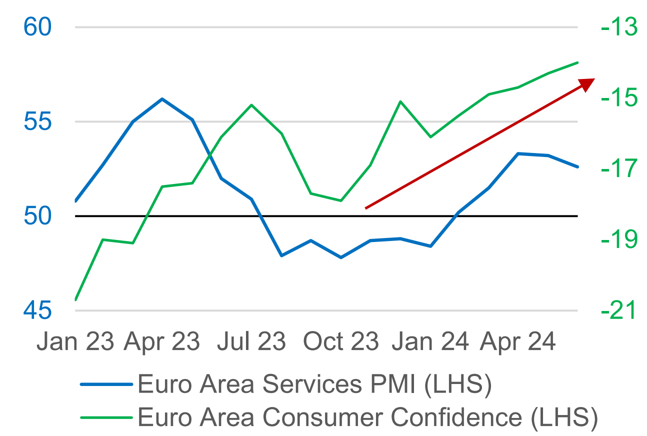
This improvement in global growth is confirmed by the 10% rise in the average energy and metals commodity price since the beginning of this year, according to the Bloomberg Energy and Metals equal-weighted index.

US ECONOMIC MOMENTUM SLOWS DOWN AT LAST



Source: BNP Paribas, Bloomberg.

EUROZONE CONSUMER CONFIDENCE BOOSTED BY LOWER INFLATION



Source: BNP Paribas, Bloomberg.

Could we see surprisingly low inflation, near term?

The global rate-cutting cycle may accelerate

While the spectre of double-digit inflation rates may still be relatively fresh in the memories of most in the developed world, the reality is that this pandemic - and conflict-fuelled inflationary phase should now be firmly behind us.

For at least the remainder of this year and into 2025, we can look forward to a period of relatively stable prices not unlike the pre-2020 era.

Drivers of more modest inflation include:

- lower goods prices as China and other Asian countries export cheaper products to the rest of the world (helped by weaker FX) to support growth;
- stable energy costs, particularly in Europe where both natural gas and baseload electricity prices have settled down after an enormous price spike over 2021-22;
- Lower food inflation, with the FAO world food price index now 25% lower than its March 2022 peak and food producers no longer able to pass through inflationary price hikes to the final consumer; and
- slower house price and rental growth, as the effects of higher financing costs impact house prices with a long lag.

A spreading wave of global disinflation should permit central banks around the world to gradually reduce benchmark interest rates from their current elevated levels from now into 2025 and potentially beyond.

But we should not ignore inflation in future. In the longer term, we will likely find that inflation can spend periods well above 2% once again.

Long-term inflation expectations are modest

Whether we look to long-term inflation expectations priced into US or eurozone bonds, we see the same result. In both cases, these inflation expectations have returned to long-term average, underlining the bond market's relaxed inflation outlook. As an example, 10-year US Treasury bonds price 10-year expected average inflation at 2.3% currently, while German 10-year bunds price a 2% average inflation rate.

Energy prices are key to long-term inflation trends

In the long run, energy prices are a key determinant of global inflation. On this front, the good news is that the prices of crude oil, oil products and natural gas have returned to below pre-2022 levels. This suggests little inflation pressure from energy prices.

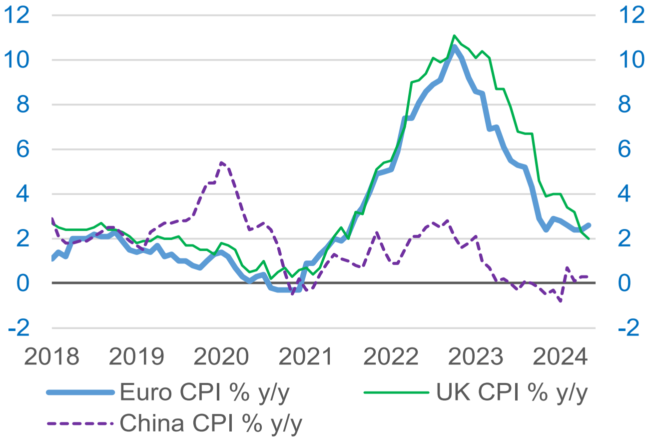
Stable inflation outlook is good for bonds

This more stable inflation outlook after a period of extreme inflation volatility should benefit both sovereign and corporate bonds. Declining central bank reference interest rates add further support to bond markets, particularly to shorter-dated bonds.

Corporate bonds begin to perform

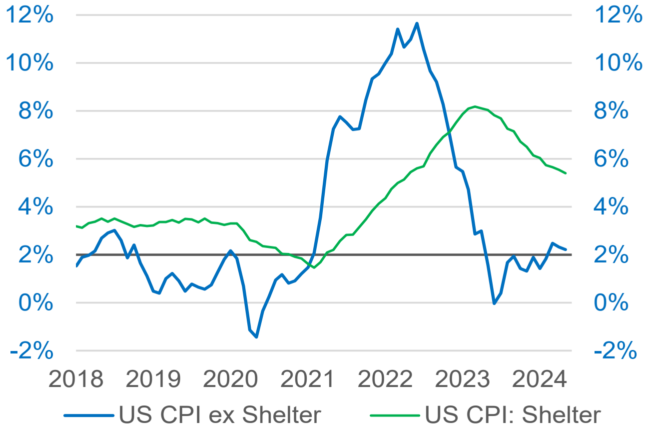
Global corporate bonds have returned +2% in euro terms since the beginning of 2024. Certain riskier corporate bond subsectors have done even better: i) European high-yield corporate bonds have delivered +3.2% so far this year; ii) European AT1 bank contingent convertible bonds have returned over 5%; and iii) The Janus Henderson US AAA-rated collateralised loan obligation ETF has returned nearly 4% so far this year.

EASING EURO, UK, CHINA INFLATION PERMIT CENTRAL BANKS TO CUT RATES



Source: BNP Paribas, Bloomberg.

US INFLATION EX SHELTER BACK TO 2% TARGET; SHELTER INFLATION TO FALL



Source: BNP Paribas, Bloomberg.

Election-related uncertainty surges

July legislative elections in France, UK

In Europe, the political focus has moved to France and the UK, where surprise legislative elections were announced by the French President and UK Prime Minister (and held in June/early July).

This follows European parliamentary elections held in early June, where a pronounced increase in the number of seats held by far-right parties was registered. According to Chatham House, a think-tank, far right parties in the:

- European Conservatives & Reformists Group (ECR, led by Italy's Giorgia Meloni), the
- Identity and Democracy Group (ID, including the National Rally) blocs, plus
- Germany's Alternative for Germany (AfD) and Hungary's Fidesz

now together number 156 MEPs (Members of the European Parliament), nearly 22% of the total of 720 sitting MEPs.

The centre-right European People's Party (EPP), the centre-left Socialists and Democrats (SD) and the liberal Renew Europe Group remain the three largest groupings in the European Parliament. But far-right parties have clearly gained in importance.

This higher representation of far-right parties the European Parliament mirrors the trend across Europe, with far-right parties today forming part of coalition governments in Italy, the Netherlands and Sweden.

Financial market risk rises, but still limited so far

Since President Macron's 9 June election announcement, European policy uncertainty has increased. This is evident in the subsequent fall in French stock and bond prices, and modest weakness in the euro.

It is far less evident in UK asset prices, with sterling stable again the US dollar and euro, and UK bond yields falling (and prices rising) since Prime Minister Sunak's 22 May election date announcement.

French and UK legislative elections plus the approaching November US Presidential election have not yet resulted in a significant rise in global financial market risk, according to the Citi Macro Risk Index.

Typically, election-related uncertainty and financial market risk peaks at the time of the election, as was the case in the 2016 US Presidential election, the 2017 French Presidential election, and the 2022 Italian parliamentary election. But following the final election result, financial market risk then tends to recede relatively quickly.

Hedging against heightened uncertainty

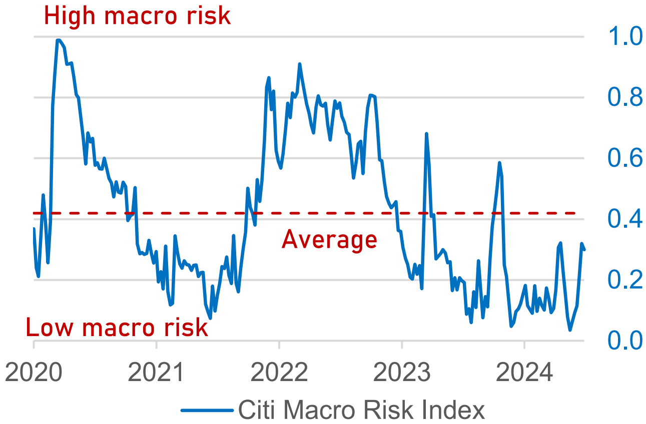
To hedge against this increasingly volatile backdrop, investors can look to:

a) safe havens such as physical gold and short-dated bonds,

b) secular growth themes such as electricity/energy infrastructure and clean water, and

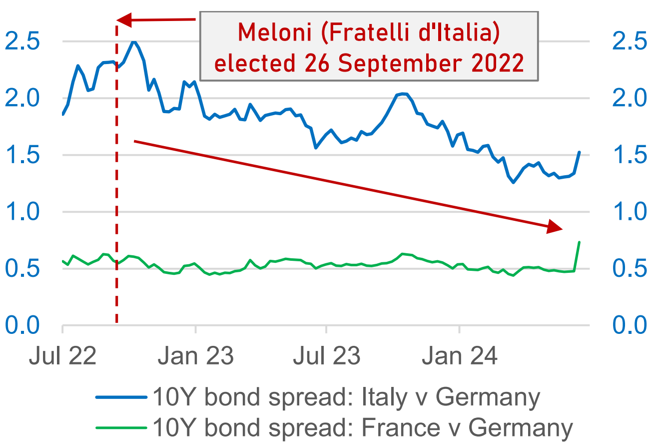
c) structured solutions with downside protection.

LIMITED FINANCIAL MARKET RISK IS PRICED TODAY



Source: BNP Paribas, Bloomberg.

ITALIAN BOND RISK PREMIUM DECLINED POST 2022 ELECTION



Source: BNP Paribas, Bloomberg.

Asset Allocation: Stay focused on the long term

Liquidity and financial conditions still supportive

While investors fret at present over the outcome of elections, we remain focused on the longer term when determining our asset allocation.

The key factors we concentrate on include:

- **Liquidity (supportive)**: global macro liquidity continues to grow, boosted by major central banks and growing broad money supply.
- **Financial conditions (supportive)**: loose financial conditions helped by improving bank lending volumes, lower long-term bond yields and tight credit spreads.
- **Modest growth and easing inflation trends (supportive)**: a macroeconomic environment that is not too hot and not too cold is generally a positive backdrop for stocks and corporate credit.
- **Low risk level** on our composite risk radar: our proprietary mix of economic, volatility- and market-based risk indicators scores only 2 out of a possible 9, and so does not point to an elevated risk to financial markets.

Given that the underlying trends for these four factors have not changed significantly of late and continue to support risk assets, we do not see any reason to change our main asset allocation recommendations.

What would change this view?

A rising risk of global economic recession is the obvious risk, most likely triggered by a sharp deterioration in the US employment market. We continue to watch US initial jobless claims and the under-employment rate for signs of increased risk.

Why gold is an excellent "each-way" investment

We believe that exposure to physical gold is a highly desirable diversifying asset in investor portfolios. We maintain our 12-month USD2600/ounce gold price target, representing 10%+ upside to the current price. We see gold propelled higher by the following factors:

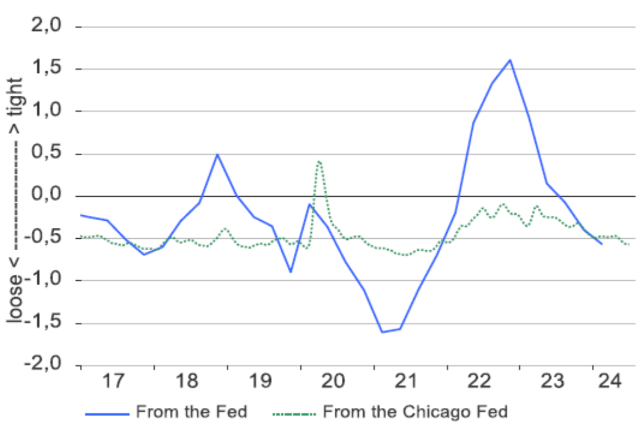
- Central bank demand;
- Asian investor demand (China, India);
- Long-term store of value at times of inflation and FX volatility;
- Form of money with very limited supply 1.0%-1.5%/year growth;
- Performs well when central banks such as the US Federal Reserve cut benchmark interest rates.

Since January 2000, gold has gained 581% in US dollars, an annual average growth rate of 8.1%. This has far outperformed global stocks (+271%), global bonds (+114%), other commodities (+70%) and US dollar cash (+58%).

Since the end of 2021, gold has once again established a superior record of returns, far ahead of these other asset classes over the last 2½ years.

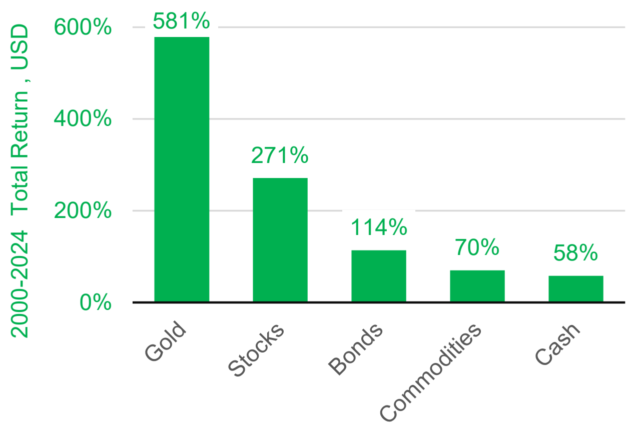
> **Positive on precious metals:** exposure to gold is an excellent diversifying asset, given its tendency to rise during times of crisis, when other asset classes tend to fall. We continue to recommend exposure to this subclass of commodities as underlying global demand drivers remain in place.

US FINANCIAL CONDITIONS REMAIN LOOSE HELPING RISK ASSETS



Source: : BNP Paribas, Bloomberg.

SINCE 2000, GOLD HAS DELIVERED THE BEST ASSET CLASS RETURNS



Source: BNP Paribas, Bloomberg. Stocks = MSCI ACWI; Bonds = Bloomberg global aggregate index; Commodities = Bloomberg commodity index; Cash = Bloomberg 1-3m US Treasury bill index

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, Industrials, Materials, EU Financials & Technology	Telecoms, Consumer Discretionary, Consumer Staples	**Materials** to benefit from rebounding Chinese activity and low base metals inventories. **European banks** should benefit from surprisingly resilient consumption, rising Net Interest Margins & high levels of ECB deposit rate.
			Styles/ Themes	Quality, Megatrend themes		Circular Economy, Electrification, Security, Deep Value themes
BONDS	=	=	Govies	Favour US 5-7 year duration. Prefer inflation-indexed bonds		Our 10-year bond yield targets are 4.25% in the US and 2.25% in Germany in one year. Favour US inflation-linked bonds.
	+	+	Credit	US, Euro IG credit		We favour investment grade Credit, focusing on EU credit (especially financials) on the back of decade-high yields and strong balance sheets.
	+	+	EM bonds	USD and local currency		Attracted by high yields versus US high yield, solid economic prospects
CASH	-	-				
COMMO-DITIES	+	+		Gold Oil Industrial metals		<u>Oil (+)</u> Prolonged OPEC+ production cuts, growing geopolitical risks and the prospects of a rate cut induced cyclical upswing should keep Brent prices in the USD85-95 range. <u>Base metals (+)</u> The outlook for the manufacturing sector is improving. Cyclical demand will meet structural while supply remains constrained. <u>Gold (+)</u> we remain positive on the medium-term for geopolitical reasons, 12-month range = USD2600.
FOREX			EUR/USD			Our EUR/USD target is USD 1.12 (value of 1 euro) in 12 months.
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, Credit and Relative Value, Trend-following		Relative value alternative UCITS funds have beaten bond/credit indices since the start of 2023, offering lower risk returns, at low volatility.
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			
CPI Inflation %	**2023**	**2024**	**2025**
United States	4,1	3,4	2,3
Japan	3,2	2,7	2,4
Eurozone	**5,4**	**2,3**	**2,0**
Germany	6,1	2,6	2,1
France	5,7	2,5	2,0
Italy	6,0	1,0	1,8
Emerging			
China	0,2	-0,1	1,5
India*	5,4	4,7	4,5
Brazil	4,6	4,1	3,5

* Fiscal year

Source : BNP Paribas, Bloomberg - 25/06/2024

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

* Fiscal year

Source : BNP Paribas, Bloomberg - 25/06/2024

	Country	Spot 03/07/2024		Target 3 months	Target 12 months
Against euro	United States	EUR / USD	1,07	1,06	1,12
	United Kingdom	EUR / GBP	0,84	0,86	0,86
	Switzerland	EUR / CHF	0,96	0,98	0,98
	Japan	EUR / JPY	170,90	159	157
	Sweden	EUR / SEK	11,25	11,00	11,00
	Norway	EUR / NOK	11,34	11,30	10,80
Against dollar	Japan	USD / JPY	159,71	150	140
	Canada	USD / CAD	1,37	1,32	1,30
	Australia	AUD / USD	0,66	0,68	0,70
	New Zealand	NZD / USD	0,61	0,60	0,63
	Brazil	USD / BRL	5,43	5,00	5,00
	India	USD / INR	83,44	82,0	82,0
	China	USD / CNY	7,26	7,20	7,20

Source: : BNP Paribas, Refinitiv Datastream. As at 25 june 2024

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