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Our Investment Themes mid-year update 2024

BNP PARIBAS WEALTH MANAGEMENT

The bank for a changing world

CONTENTS

What a risk-on year so far!

Against a backdrop of conflicts and numerous elections around the world, growth concerns are looming and investors will remain glued to central banks which are set to cut policy rates further this year. To help you to navigate this complex landscape, we focus on four mid-year investment themes, driven by dominant trends offering attractive opportunities.

Despite obvious geopolitical tensions around the world, global equity returns rallied in the year to the end of May, propelled by US, eurozone and Japanese stocks on the back of abundant global liquidity and surprisingly strong earnings trends. Gold has continued to perform its traditional safe-haven role and remains an effective diversifying asset.

Inflation is coming down and central banks will lower their policy rates, with the European Central Bank already leading the way. After a period of rampant inflation in the wake of COVID-related supply chain disruptions and the energy price surge triggered by the conflict in Ukraine, inflation finally looks to be on the wane. We expect further (albeit irregular) progress in the inflation rate approaching the 2% target. In early June, the ECB got the ball rolling by cutting its policy rate by 25 basis points, and the Federal Reserve is expected to follow suit before year-end. Key to this continued progress will be a cooling in employment markets, thus reducing wage pressure on service sector prices.

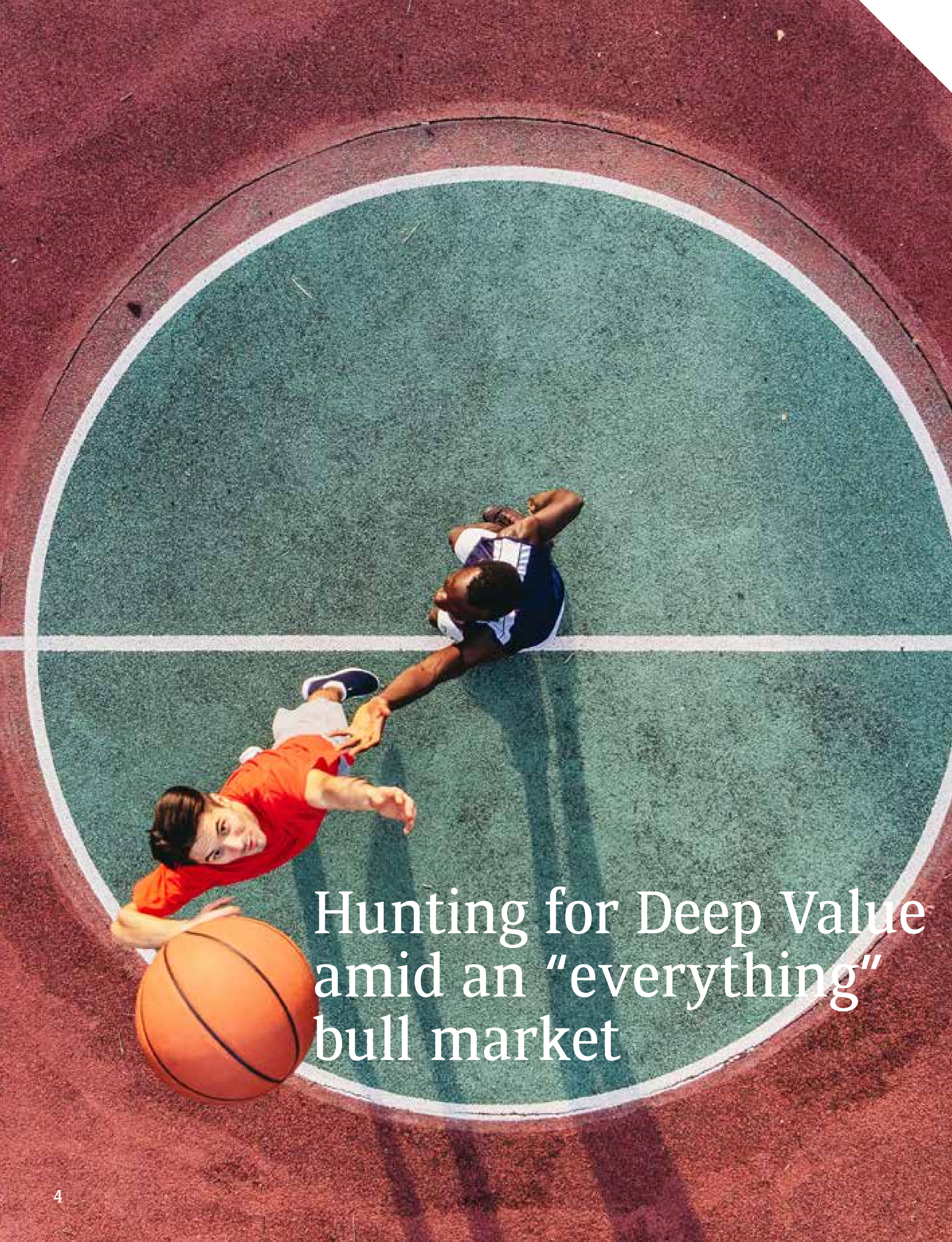
Unprecedented 7 Magnificent dominance. The stellar returns in global equity markets since late 2022 have been largely driven by a small group of technology mega-caps, dubbed the *7 Magnificent* (including Nvidia, Microsoft and Amazon). This elevated stock market concentration, last seen in 1968-73 and 1999-2000, is rare in historical terms.

These Mag 7 stocks have posted impressive earnings growth over the past few quarters but have also benefited from a substantial valuation attracting huge inflows. Today, they make up for 31% of the S&P 500 and 19% of the MSCI All Country World index. This concentration represents the opposite of the diversification that investors typically seek.

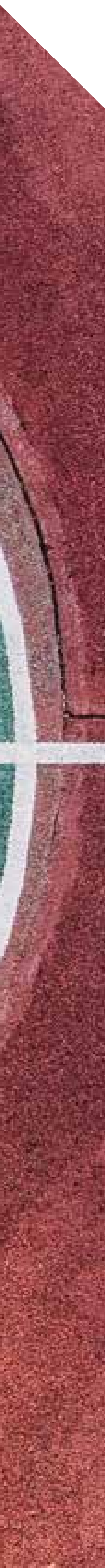
Commodities bite back with a vengeance. The change in macroeconomic and geopolitical environments since 2022 has triggered a huge shift in the attractiveness of exposure to the commodity asset class, in our view. Thanks in part to a long period of under-investment in new production, the world is confronted with growing imbalances between constrained supply and increasing demand for a broad range of raw materials. These include copper, cocoa, silver, tin and even uranium. However, crude oil and oil products far outweigh all other commodity markets combined. Even here, we see the prospect of a tightening of the global supply-demand balance, as US onshore oil production plateaus after a long period of robust production growth. OPEC members may finally re-establish their traditional role as the swing producer of crude oil to the world.

Anti-obesity medications boost longevity potential. The explosive arrival of GLP-1 inhibitor treatments for type 2 diabetes and obesity from Novo Nordisk and Eli Lilly have given new hope that we can improve the healthy lifespans of a huge swathe of the world's population, given that 890 million people were obese in 2022 and 2.5 billion people overweight.

We invite you to go further by reading the publication on our four mid-year investment themes.



Hunting for Deep Value amid an “everything” bull market



Despite strong gains in equity and other asset markets both in 2023 and this year to date, we are extremely excited about selected value investing opportunities from an asset allocation perspective.

Today, in the context of short- and long-term interest rates that are likely to fall over the next 12-24 months, the backdrop for several out-of-favour, cheap asset classes and regions offers extremely attractive opportunities for the patient investor.

We identify four long-term deep value investment opportunities: emerging markets, such as Brazil or Mexico, which offer good potential thanks to raw materials production and reshoring, the United Kingdom against a backdrop of catalyst linked to mergers and acquisitions activity, commodities which suffer from imbalances between supply and demand, and finally clean energies which remain a major focus after suffering from a rapid increase in long-term financing costs.

OUR RECOMMENDATIONS

- **UK and emerging market stocks:** favour UK FTSE 100 and MSCI UK stock and ETF exposure. Within emerging markets, look to the attractive income offered by emerging market sovereign bonds, Latin American stocks and ETFs/funds, and broad emerging market stock exposure.
- **Focus on key transition metals, clean energy:** copper, aluminium and tin have surged to their highest levels since January 2023, driven largely by supply issues. Long-term mining under-investment supports a bullish medium-term view on copper. Clean energy is a contrarian value & growth theme where the underlying need has only intensified.
- **We also like hedge funds** with long/short strategies.

KEY RISKS

- The current dominance of mega-cap technology stocks continues, with investors further ignoring deep value opportunities and influencing the valuations of these markets.

Bonds are back (again): the last chance to lock in high rates

In Europe and the US, inflation rates are coming down, closer to central bank targets. Growth is showing signs of weakness in the US. In the eurozone, while the services sector is accelerating, the manufacturing sector has been contracting for almost two years.

Our interest rate scenario predicts that the ECB will cut rates three times this year. The first rate cut occurred at the beginning of June. We think the Fed will follow suit by cutting its key benchmark rate later in the year.

There is a strong correlation between policy rates and bond yields, and between bond yields and bond returns. When central banks cut benchmark rates, bond yields fall, and bonds tend to perform well.

Given the upcoming drop in deposit rates and the risk of reinvesting cash in this context, it is therefore necessary to move from savings to investment and to consider products with longer maturities. Investors will thus be able to lock in the current high rates for a few years in order to take advantage of high coupons and potentially benefit from capital appreciation.

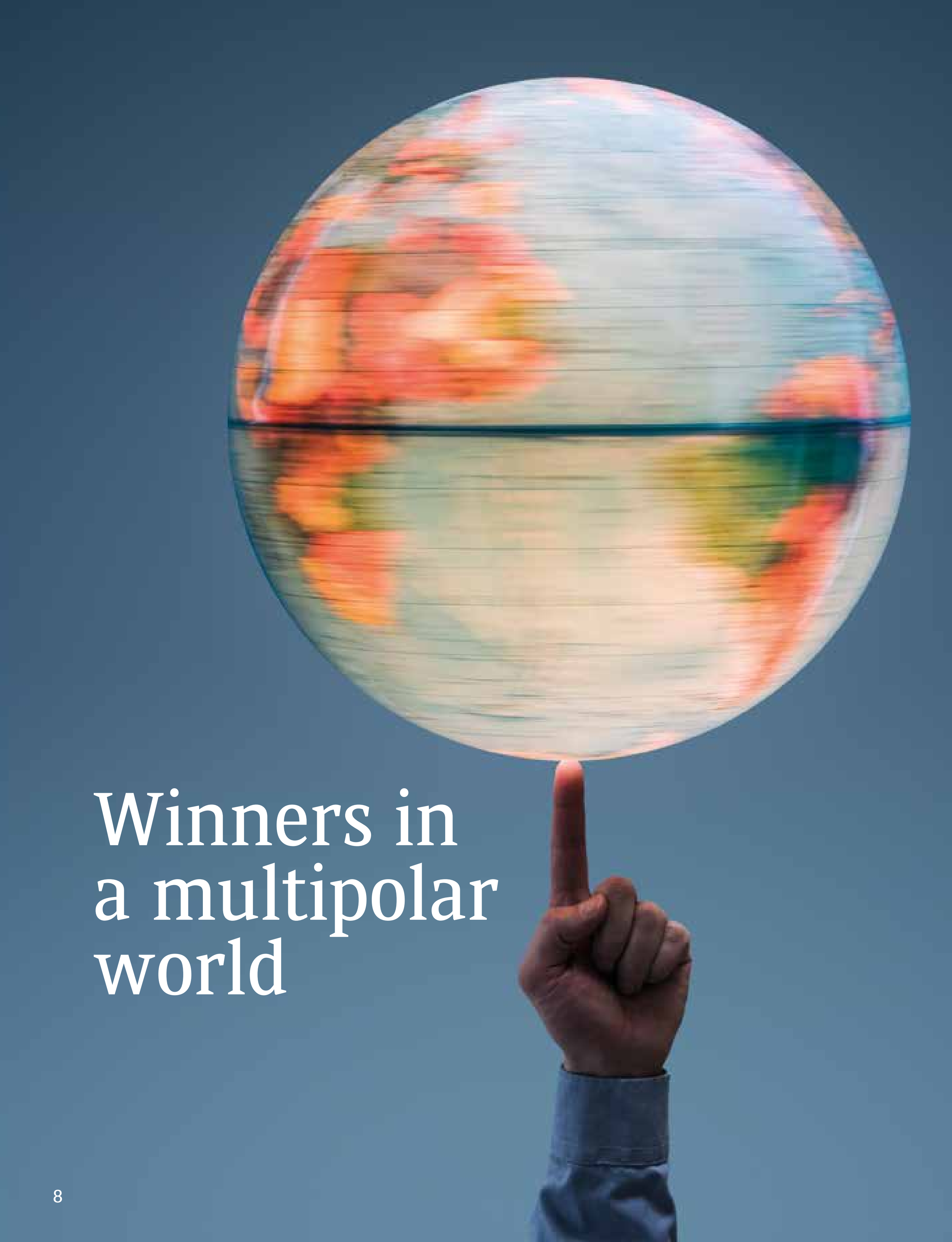
OUR RECOMMENDATIONS

A theme that mainly focuses on bonds:

- **Sovereign bonds:** we are Positive on US Treasuries, US inflation-linked bonds, US Agency Mortgage-Backed Securities and UK gilts.
- **Corporate credit:** European and US investment grade corporate bonds.
- **Emerging markets:** we are also Positive on emerging market bonds in hard and local currency. For some of these markets, valuations are sometimes stretched, but fundamentals are strong/improving. Carry is attractive.
- **Infrastructure:** diversified infrastructure funds with growing yields, energy infrastructure funds and ETFs.
- **Structured products:** high-income solutions indexed to inflation.

KEY RISKS

- Inflation erodes the purchasing power of the fixed interest payments that bonds offer, which can make them less attractive relative to other assets. Persistent inflation leading to further rate hikes by central banks (very low risk in the eurozone and low risk in the US).
- A deluge of bond issuance and weak demand would push bond prices lower.



Winners in a multipolar world

Following a 30-year post-Cold War period when the United States was the only global superpower, we are today confronted with an emerging multipolar world. Replacing relative global peace and stability is a period of greater geopolitical instability and conflict. In addition, 2024 is a year of heightened geopolitical tensions and pivotal legislative elections, most notably the November US Presidential Election. Tariff war risk involving the US, Europe and China also looms large.

We see three key reasons for this shift towards a multipolar world: disruptions in supply chains following the pandemic, the Ukrainian conflict, and intensifying tensions between Western countries and China.

Several sources of opportunities emerge from this context. A first one will be the security of strategic resources such as raw materials, energy and food. A second dimension is related to re-shoring and new partnerships to secure supply chains. The latter will necessitate automation and robotisation given the scarcity of qualified workers and costs related to local production in industrialised economies. The use of artificial intelligence will also play a key role.

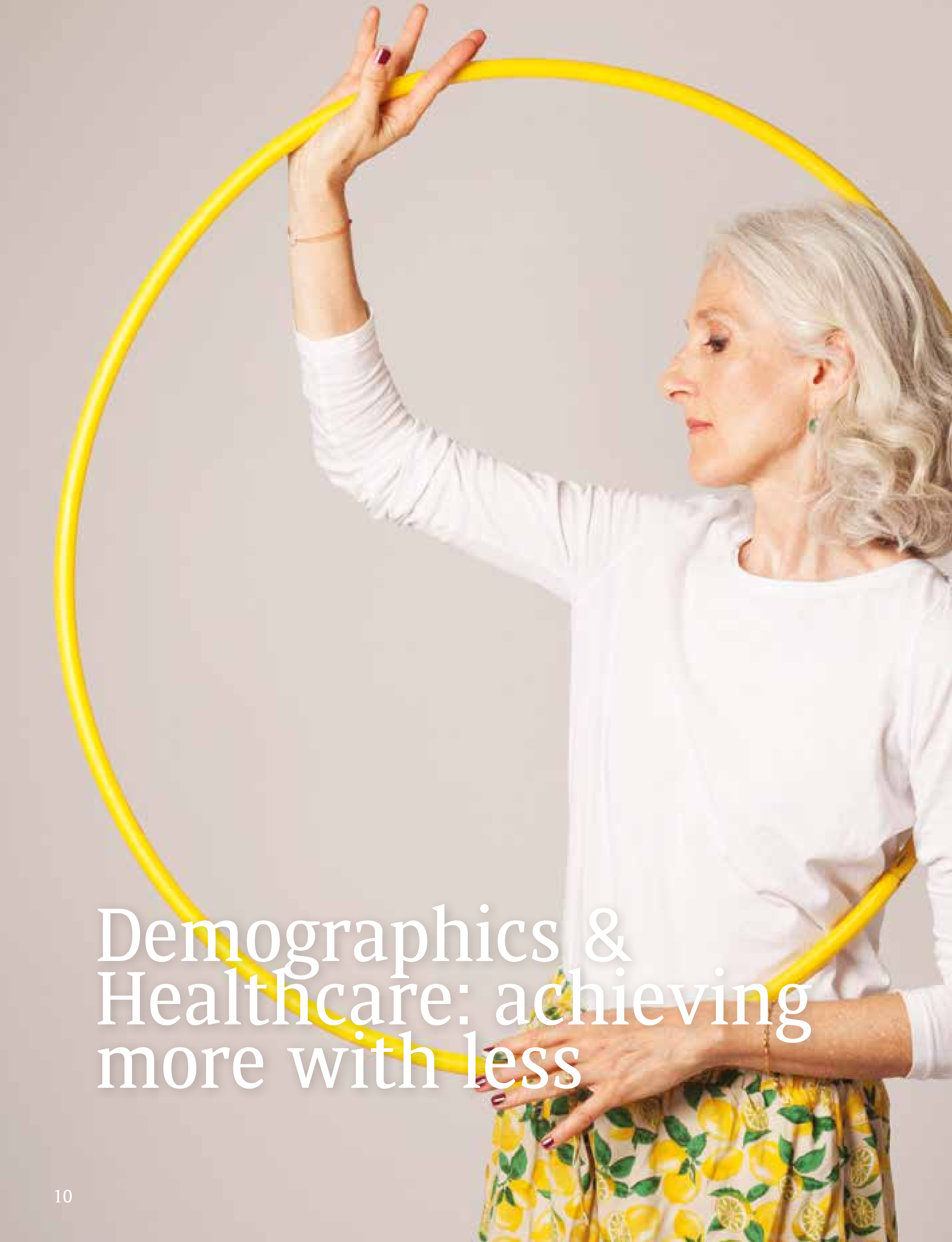
OUR RECOMMENDATIONS

A cross-asset theme focusing on equities, bonds and commodities.

- **Commodity exposure** e.g. gold, precious metals.
- **Structured solutions** based on stock and credit markets to minimise downside risk.
- **Security-related investments:** cybersecurity and semiconductor supply, and the supply of essential transition metals such as copper.
- **Low-volatility hedge funds** focusing on equity and credit long/short strategies and merger arbitrage strategies.

KEY RISKS

- An unexpected rise in inflation, leading central banks to review their monetary policy outlook.
- The evolution of energy and raw material prices which vary considerably depending on economic growth, but also geopolitical events that are often unpredictable and uncontrollable.



Demographics & Healthcare: achieving more with less

The share of the population over 60 will double to 2.1 billion by 2050. Added to this, obesity has tripled in the world since the mid-1970s. COVID, aging, and rising incomes have raised awareness of wellness and a renewed focus on increasing people's lifespans and more importantly, the number of healthy living years.

Poor health conditions weigh heavily on potential GDP growth because they impact economic activity in several ways. Goldman Sachs estimates that GDP could be more than 10% higher if poor health outcomes do not limit labour supply in the US.

The emergence of weight-loss medications, AI-powered drug discovery, genomic and regenerative medicine techniques, such as gene and cell therapy, and advances in diagnostics for detection of diseases such as Alzheimer's all imply a remarkable pace of healthcare innovation. This implies a sustained pace of innovation and investment which could have a positive impact on the entire economy.

OUR RECOMMENDATIONS

A theme focused mainly on equities:

- Selected Pharmaceutical stocks
- Selected Biotechnology & Medical Technology stocks and diversified funds
- Health and Wellness:
  - Healthcare Technology
  - Health & Sustainable Food
  - Selected Nutraceuticals
  - Consumer and Service Companies that are well exposed to Silver surfers.

KEY RISKS

- Cuts to healthcare budgets from governments.
- Greater-than-expected numbers of drugs that fail to receive regulatory approval.
- Changes in healthcare regulation by major governments especially after the upcoming US elections (5 November 2024).
- Major recession that impacts spending on the health and wellness sector.

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