Investment Themes 2024

BNP PARIBAS
WEALTH MANAGEMENT

The bank
for a changing
world

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A year of extremes and exaggeration

Absorbing regime changes from the 2020-22 period

2023 was a year when we finally saw inflation rates fall from historic highs. Stock markets managed to advance on the back of a surprisingly resilient global economy, in the face of short- and long-term interest rates rising to multi-decade highs.

The highest interest rates in 15 years continue to have huge lagged knock-on effects across the global economy – on real estate prices and on corporate investment. But there are also some beneficiaries of higher interest rates of course, notably savers who can now take advantage of attractive risk-free rates of return not seen since the 2008 Financial Crisis.

Key trends in focus for 2024

We believe that there are a select few trends that investors should keep front of mind when looking to the new year:

- **The impact of far higher interest rates** have not yet been fully reflected in (lower) economic growth and inflation rates, above all in the US. Moreover, central banks continue to repeat their mantra of "higher for longer", suggesting that they will not reduce interest rates until they are convinced that inflation will not flare up anew.

- **The shift away from globalisation** and towards national interests will continue, potentially triggering shortages of raw materials and goods. This shift is also powering near-shoring and re-shoring of manufacturing production in order to reinforce supply chains, especially of key strategic industries, such as semiconductors.

- **Energy transition momentum** continues to accelerate, propelled by a 2023 summer that was the hottest on Earth since records began in 1880. Insufficient progress on climate goals up to now, and an increased emphasis on energy security are obliging global governments to commit huge financial resources to reduce our reliance on fossil fuels.

- **Lifestyles have changed probably permanently** following the 2020 pandemic: more and more, people are putting working at home or free time on an equal footing with financial compensation. This is having a profound impact on patterns of consumption, as well as on the ongoing demand for office space in big cities.

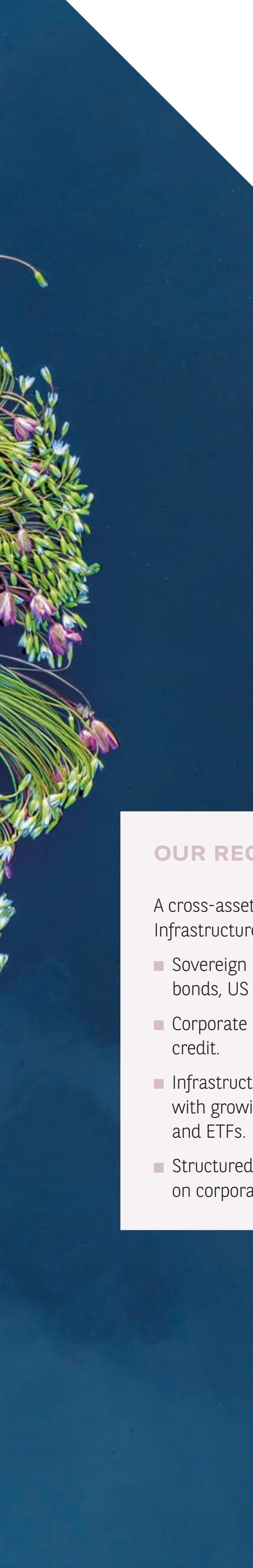
- **New obesity treatments:** the arrival of effective medicines from Novo Nordisk and Eli Lilly to treat obesity promises potentially the biggest improvement in average longevity since global campaigns to persuade smokers to quit were promoted in the 1970s and thereafter.

- **Global stock market leadership has become extremely focused** on a very narrow set of mega-cap technology stocks - representing a growing concentration risk in supposedly diversified investment portfolios. The warning signs from the 1970s Nifty Fifty and the 2000 technology bubble seem to be echoed in today's Artificial Intelligence mania, centred around just 7 US tech stocks.

These key trends are the driving forces for the 6 investment themes we outline in this report. Our **Reaping real returns** theme underlines the income opportunities in fixed income markets; **Winners in a multipolar world** explores the shift towards national interests; and **Decarbonisation and Electrification** addresses an accelerating energy transition.

Democratising AI is our plea for investors to look beyond the Magnificent Seven tech stocks to benefit from the generative AI trend; **Diversifying beyond the 60:40 portfolio** highlights the need for investors to include more than just stocks and bonds for true diversification; and **Democratics: the wellness revolution** focuses on opportunities resulting from new weight-loss drugs.

1/ Reaping real returns



Since the end of 2021, the interest rate world has undergone a seismic shift with central banks abandoning zero interest rate policies, and government bonds suffering their biggest jump in yields and falls in price since the late 1970s.

Investors today are faced with an expanding choice of seemingly attractive income opportunities, both in the fixed income asset class and elsewhere. However, what was judged safe up until 2022 may not be so secure in future, given rising debt costs, and thus concerns over long-term debt sustainability.

Positioning to profit from real bond yields (excluding inflation) that are the highest since at least 2011 is also an attractive choice for conservative investors, in order to lock in a generous inflation-protected level of income for the next few years.

OUR RECOMMENDATIONS

A cross-asset theme: Sovereign and Corporate Bonds, Infrastructure, Equities, Structured Products.

- Sovereign bonds: US Treasury Inflation-Protected bonds, US sovereign bond funds and ETFs.
- Corporate bonds: US and euro investment-grade credit.
- Infrastructure: diversified infrastructure funds with growing yields, energy infrastructure funds and ETFs.
- Structured products: high income solutions based on corporate credit.

KEY RISKS

- An unexpected inflation increase, leading central banks to reconsider the outlook for monetary policy.
- A resilient American consumer who defies any odds of economic slowdown.
- Interest rate risk: when interest rates rise, bonds go down in value.
- Liquidity risk: some long-term investments can be fairly illiquid.

2/ Winners in a multipolar world

The world exited a 30-year post Cold War period when the United States was the only clear global superpower in a largely unipolar world. Today, we are confronted instead with an emerging multipolar world, where a number of countries vie for global political and strategic leadership.

Replacing relative global stability is a period of greater geopolitical instability and uncertainty. The pendulum has swung towards nationalist and near-shoring trends, away from free markets and globalisation. Security of strategic resources is the new imperative. Pockets of raw material and worker scarcity have emerged from a prior environment of abundance of manpower, raw materials and energy. We look to identify emerging trends, sectors and countries that stand to benefit in this new multipolar world.

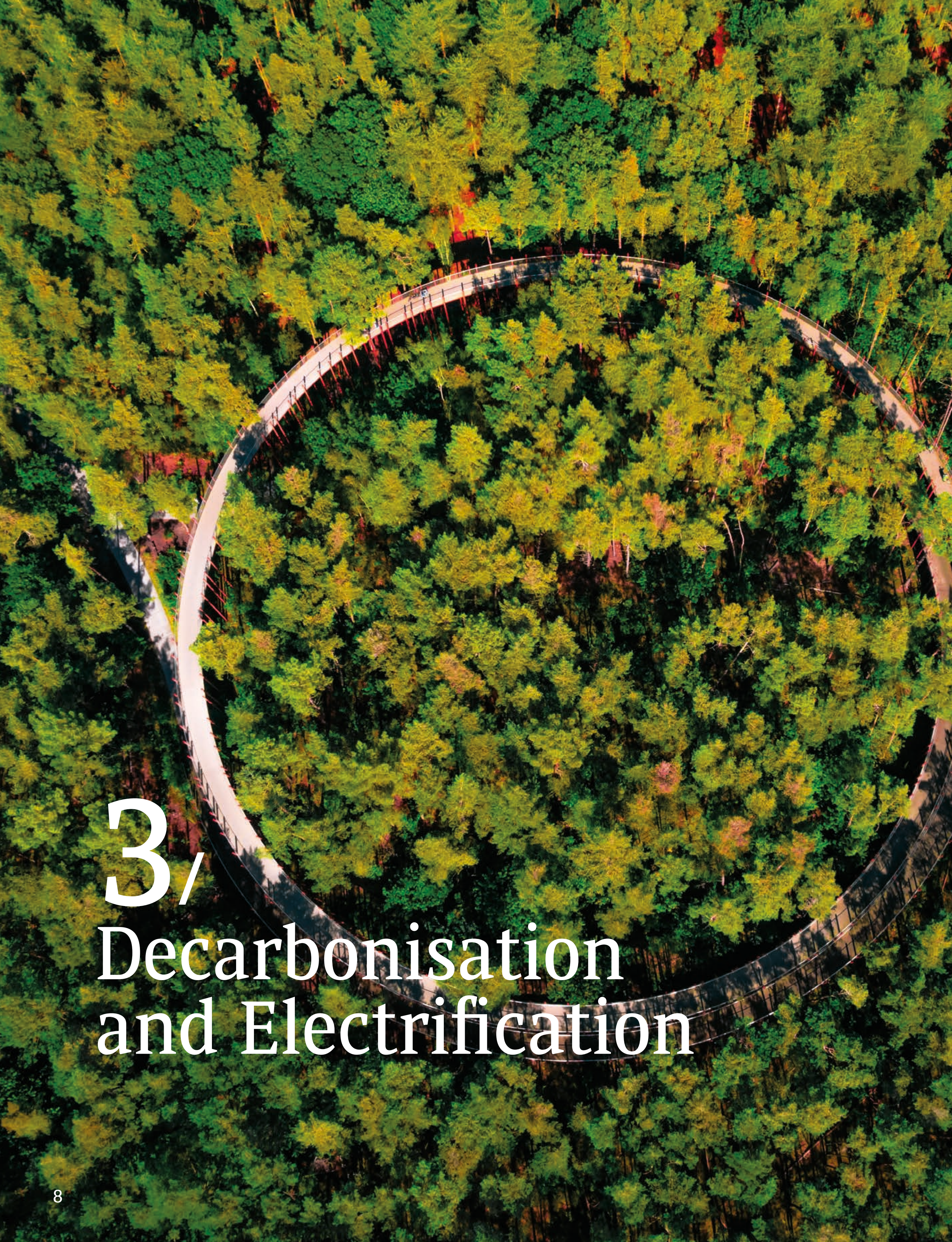
OUR RECOMMENDATIONS

A cross-asset theme focusing on Equities, Bonds and Commodities.

- Productivity-improving products and services as companies seek to offset increasing wage pressures through the greater use of technology to replace human effort.
- Near-shoring: investment in robotics and automation in new production facilities.
- Growing importance of "middle power" countries: India as a key multipolar beneficiary; the growing importance of key producers of strategic commodities including Brazil, Mexico, Indonesia and Australia.
- Technology security: cybersecurity, semiconductors, satellite technology and networks.
- Food & water security: more effective water irrigation and clean water production, fertilisers & technologies to boost crop yields, companies which combat food waste.
- Critical battery metals: metals and associated miners necessary for electric vehicles and for large-scale industrial electricity storage.

KEY RISKS

- Production costs and thus the price of the energy transition are rising sharply. Without strong government support, the transition could slow down, given that many countries are heavily indebted and the cost of debt rocketed in 2022. Very tricky fiscal and societal choices must be made.
- Today it is still difficult to source essential materials and components. This is particularly the case for areas (e.g. lithium) in which demand is growing rapidly because supply is struggling to keep up with the pace of demand. This could hamper the transition.
- Generally speaking, energy is a cyclical sector. Energy prices fluctuate considerably in tandem with economic growth, but also with geopolitical events that are often unpredictable and uncontrollable. Return on investments can therefore be highly volatile and sometimes lower than expected.



3/ Decarbonisation and Electrification

Since the record temperatures reached over the summer of 2023, the pressing need to decarbonise the global economy has gathered pace. The key to energy transition is electrification – allowing us to gradually move away from a dependence on fossil fuels. Attractive economics, rising social acceptance and growing policy support should help incentivise the heavy necessary upfront investment in electric infrastructure including power generation, transmission and storage.

The continued trend towards electric vehicles for logistics and personal transportation requires heavy initial energy investment first to produce the necessary raw materials, and then to transform them into finished products such as cars, cables and solar panels. Energy efficiency is also a key focus in this transition effort, as it remains far cheaper to economise energy than to produce it.

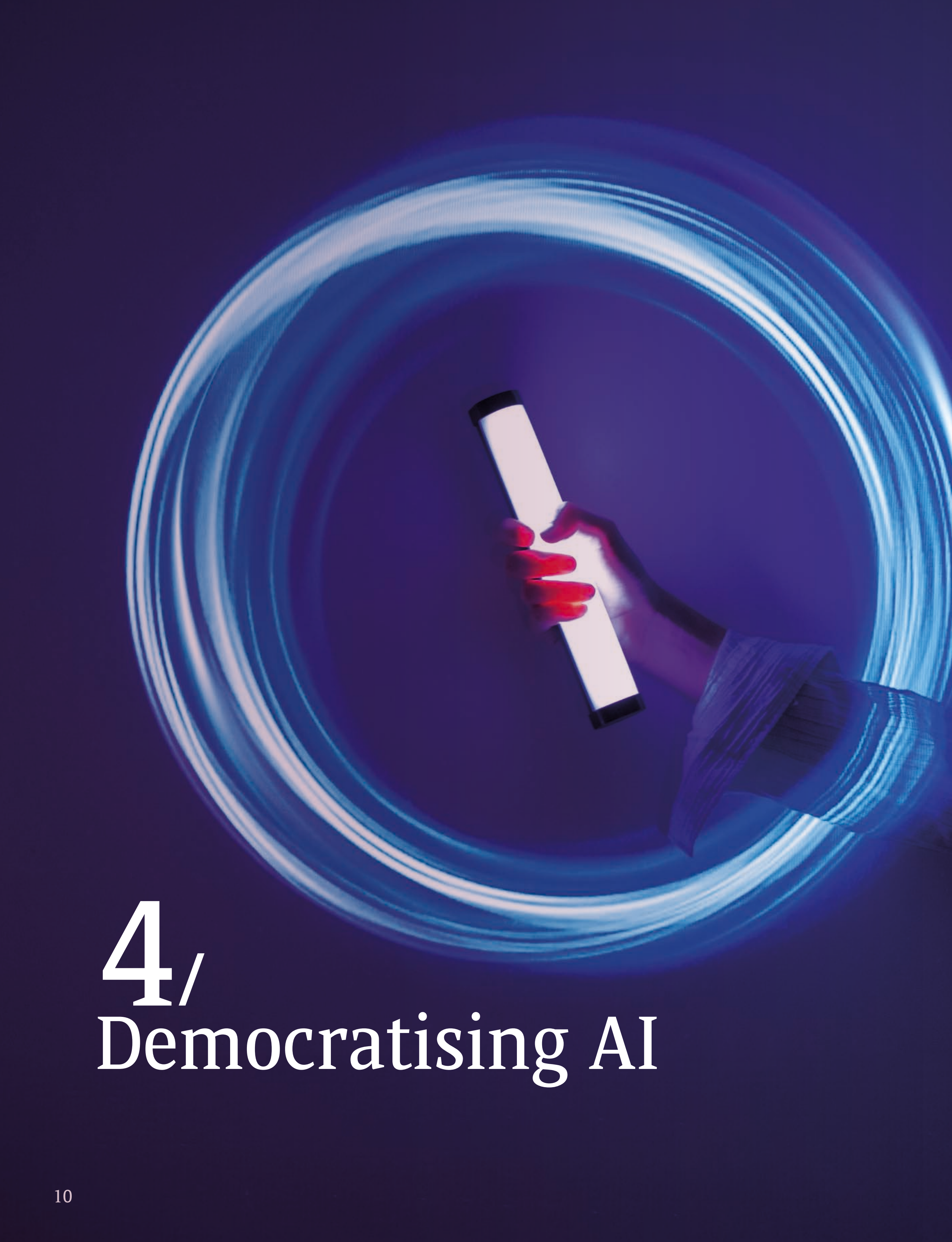
OUR RECOMMENDATIONS

A cross-asset theme: Equities, Bonds, Infrastructure and Commodities.

- High-voltage electrical equipment manufacturers
- Energy: investment in critical energy infrastructure, smart grids.
- Insulation, efficient LED lighting thanks to increasingly efficient materials.
- Smart control systems and software for lighting and signalling, smart glass.
- Production and storage of renewable energies (wind, solar, hydroelectric, etc.), including nuclear, hydrogen.
- Technologies that capture or recycle carbon dioxide.
- Critical battery metals: metals and associated miners necessary for electric vehicles and for large-scale industrial electricity storage.

KEY RISKS

- Higher for longer rates could continue to pressure valuations.
- Increased supply from Chinese manufacturers of equipment including solar panels and batteries could result in ongoing margin pressure on Western companies.
- Any roll-back of political and financial support, especially in the US, could lead to a significant loss of incentives for investments in renewable energy solutions.



4/ Democratising AI

The dramatic outperformance of seven US mega-cap technology leaders, namely Amazon, Apple, Google, Meta, Microsoft, Nvidia and Tesla, since 2020 and again in 2023 has resulted in a level of concentration of global investment portfolios in these names that has not been seen since the Year 2000 Technology bubble and the 1970s Nifty Fifty phenomenon. In both cases, the groups of "glamour" stocks that had been bid up to extreme valuations came back down to earth over the following years, resulting in big drags on investors' portfolios.

We prefer to increase diversification of investor portfolios which are potentially overexposed to these seven US technology giants. In place of these seven, supposedly the leaders in the generative Artificial Intelligence revolution, we look to identify sectors and industries that can reap huge benefits from AI applications.

OUR RECOMMENDATIONS

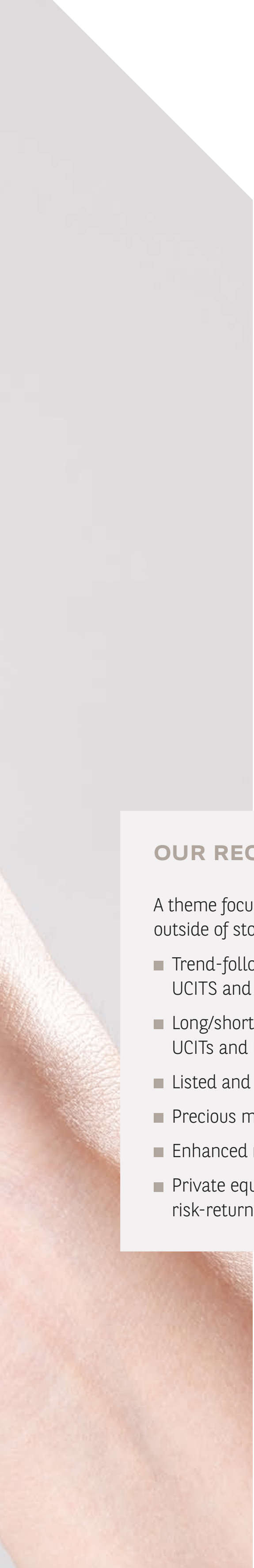
A cross-asset theme: Equities, Bonds and Infrastructure.

- World ex-US stocks including eurozone, UK, Japan, emerging markets (including or excluding China).
- Artificial Intelligence "picks and shovels" plays including semiconductors, cybersecurity, cloud computing infrastructure plays, datacentre infrastructure and real estate.
- Sectors that can see huge benefits from AI including Healthcare, Professional Services and Industrial Automation.

KEY RISKS

- Investment bubbles are notoriously difficult to time, and can go on for far longer than any investor thinks possible. The "Magnificent Seven" stocks could conceivably continue to dominate for far longer than expected.

5/ Diversifying beyond the 60:40 portfolio



The changing environment requires us to review how we construct and diversify our portfolio. Long-term inflation levels and volatility could remain high or increase more than the last 20 years. Furthermore, we can no longer assume that the correlation between long-term sovereign bonds and stocks (i.e. their reciprocal behaviour) will remain negative. Inflation is eroding investment returns, and hedging inflation volatility has become a new priority.

If the diversification benefits of bonds are lower in the future than over the past two decades (especially when equities fall), investors will need to consider which asset classes can really provide additional diversification to broaden and optimise their portfolio. In an ever-changing world, we like trend-following strategies, commodities and market-neutral strategies which generate returns, reduce risks and provide a hedge against inflation.

OUR RECOMMENDATIONS

A theme focused on alternative assets and solutions outside of stocks, bonds and real estate.

- Trend-following and global macro alternative UCITS and hedge funds.
- Long/short credit, equity, cross-asset alternative UCITs and hedge funds.
- Listed and unlisted Infrastructure funds, ETFs.
- Precious metals: gold, silver, platinum.
- Enhanced roll commodity funds, ETFs.
- Private equity based on an attractive long-term risk-return trade-off.

KEY RISKS

- Depending on the structured solutions chosen, an increase, a decrease, or a change in asset prices could lead to a capital loss.
- There is no guarantee that global macro or trend-following strategies will benefit from the current trends in asset markets. Furthermore, any sudden suppression of interest rates back to zero could reduce opportunities.
- If inflation takes longer to peak and remains higher for longer, gold may struggle and still have negative returns given its lack of carry and inverse correlation with higher real yields.

6/ Demographics: the wellness revolution

The Healthcare sector underperformed in 2023 as attention shifted to AI and the Magnificent Seven stocks. Today, as the economy slows, the sector's growth possibilities and defensive characteristics may become more attractive.

"Demographics are destiny". In fact, the share of the population over 60 will double to 2.1 billion by 2050. In the context of this ageing population, obesity has tripled in the world since the mid-1970s. Moreover, COVID, ageing, and rising incomes have raised awareness of wellness and how to increase people's lifespans and even more importantly, the number of healthy living years.

AI can reduce the cost of drug development and boost innovation in the sector. Eating sustainably and healthily, wellness technology, medical technology and innovation in pharmaceuticals including weight loss drugs will create volatility, disruption and opportunity.

OUR RECOMMENDATIONS

Equities

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