

For professional investors - JULY 2020

THEMATIC EQUITY INVESTMENTS FOR A POST-PANDEMIC WORLD



BNP PARIBAS
ASSET MANAGEMENT

The asset manager
for a changing
world

INTRODUCTION

Contrary to popular perception – particularly given the current circumstances – equity exposures have provided a resilient store of value to pension funds and endowments, asset allocators and retail investors alike. To be more specific: For an asset class typically positioned in the higher risk category of an asset allocator’s toolbox, as in previous periods of stress, equities have remained liquid, offering long-term investors an opportunity to share in the proceeds of both economic growth and secular change.

The careful construction and prudent management of portfolios – so called “active management” – can enhance the returns on an allocation to equities in rising and falling markets, with proprietary research enabling the active manager to identify compelling opportunities, perhaps resulting from volatility in share prices, from which concentrated portfolios can be constructed.

Believing in mean reversion – that stock prices ultimately reflect the intrinsic value of companies, and that the intrinsic value is most often determined by an assessment of a company’s current and future earnings – our fundamental research focuses on assessing the resilience of businesses and their potential for organic earnings growth.

Competitive advantage – from product, to people and through to technology – is a critical determinant of the sustainability of that growth in earnings. Our preference for companies that can generate strong free cash flows is important during periods of economic change and uncertainty, not least in also providing greater scope to invest for the future. Industry structure can help to sustain investment and the generation of shareholders’ returns.

It is already clear that the 2020 pandemic has given rise to a new cycle of low growth and high debt. In this world of predominantly low growth, financial value will be generated less through asset allocation, as during the last 30 years of continuously declining interest rates. Instead, added financial value will come from stock picking as the falling interest rate cycle ends and the discrepancy in performance between the top companies and the rest forces investors to be highly selective in their choices. The starting point in this process is the selection of the high-growth segments, where companies exercising sound capital allocation without employing financial engineering to inflate earnings will be able to offset challenging valuation multiples with earnings growth.

In this paper we present five segments within developed equity markets:

- Environmental Challenges
- Disruptive Technology
- Healthcare Innovators
- Consumer Innovators
- The Energy Transition

July, 2020



- Guy Davies -

Chief Investment Officer,
Active Equity Portfolio Management

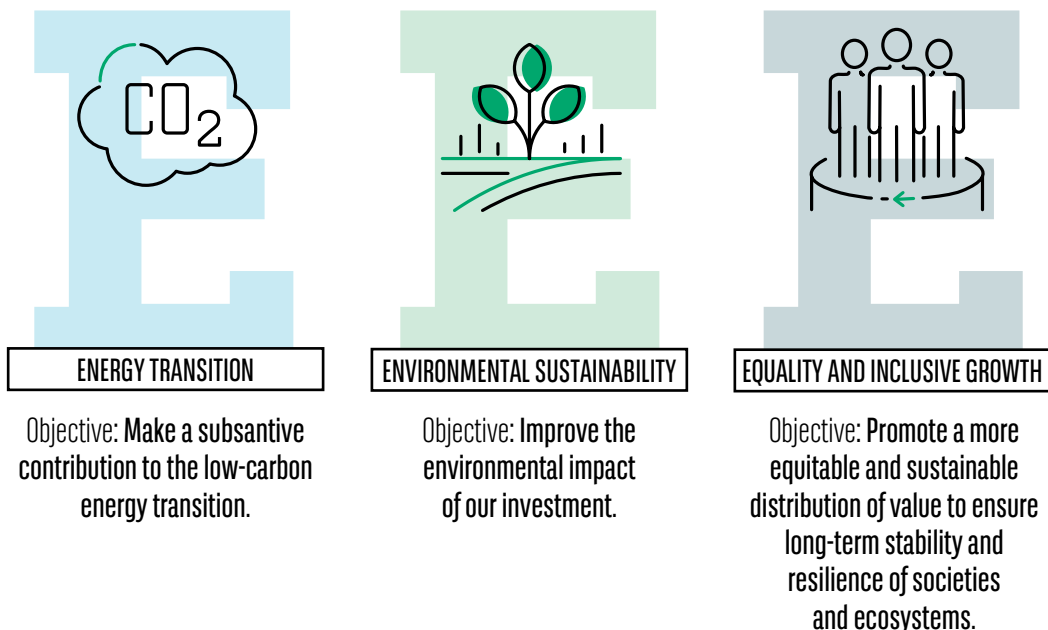
OUR CONVICTIONS

We believe our approach to investing puts us in a strong position to meet our clients' objectives. We place a premium on contrarian and independent thinkers who can challenge the conventional wisdom and the companies that are the flavour of the month, and instead identify the structural themes that will drive future socio-economic trends and the specific companies that are best placed to exploit them.

We believe that investor autonomy coupled with robust peer review and risk management are the principal pillars of a strong investment culture. Our investment teams have the intellectual freedom to develop their own investment theses, which are then subject to rigorous challenge and debate. We habitually ask ourselves the same set of questions about every company in investment meetings:

- Is the competitive advantage that this company currently enjoys likely to last over the coming years?
- Does the company possess a strong intellectual capital and brand? Is the management prepared to invest to innovate?
- Is there a demonstrable record of success and – particularly important for our approach – integrity?
- How does the company's management frame the challenges and opportunities associated with the energy transition and environmental sustainability, as well as equality and inclusive growth?

The "3Es" of our approach to sustainable investing – specifically the energy transition, the environment and equality – are embedded in the way we assess companies. We share a common philosophical approach; we look for companies with strong business models, significant pricing power, solid brand loyalty and resilient balance sheets.



Our preference is for unconstrained portfolio management. This means we can offer clients distinctive portfolios based on our high conviction views, rather than the conventional approach which offers a diffuse exposure to a large number of stocks, often driven by an arbitrary weighting scheme that has ultimately proved to be a consistent drag on investment performance. But managing money is not just about delivering excess returns; it is about being prepared to meet our clients' demand for cash, which requires prudent management. This is the essence of our philosophy and approach, but we are acutely aware that we need to constantly enhance what we do and how we do it to retain the confidence and capital of our clients.



WE FOCUS ON PRINCIPLES:

**Thematic investing in corporate
emerging trends and forward-looking perspectives**



**Investors ensure their capital is deployed
to reflect their convictions**



Themes cut across regions and industries



Provide investors a dynamic way to express their views



**Combination of top-down views
and bottom-up insights**

We like to think that a constant focus on improving performance by reviewing all aspects of our approach – from honing our investment process, to enhancing our research output and managing our talent more efficiently – has paid dividends and will continue to do so.

NAVIGATING THE GREAT GLOBAL PANDEMIC OF 2020

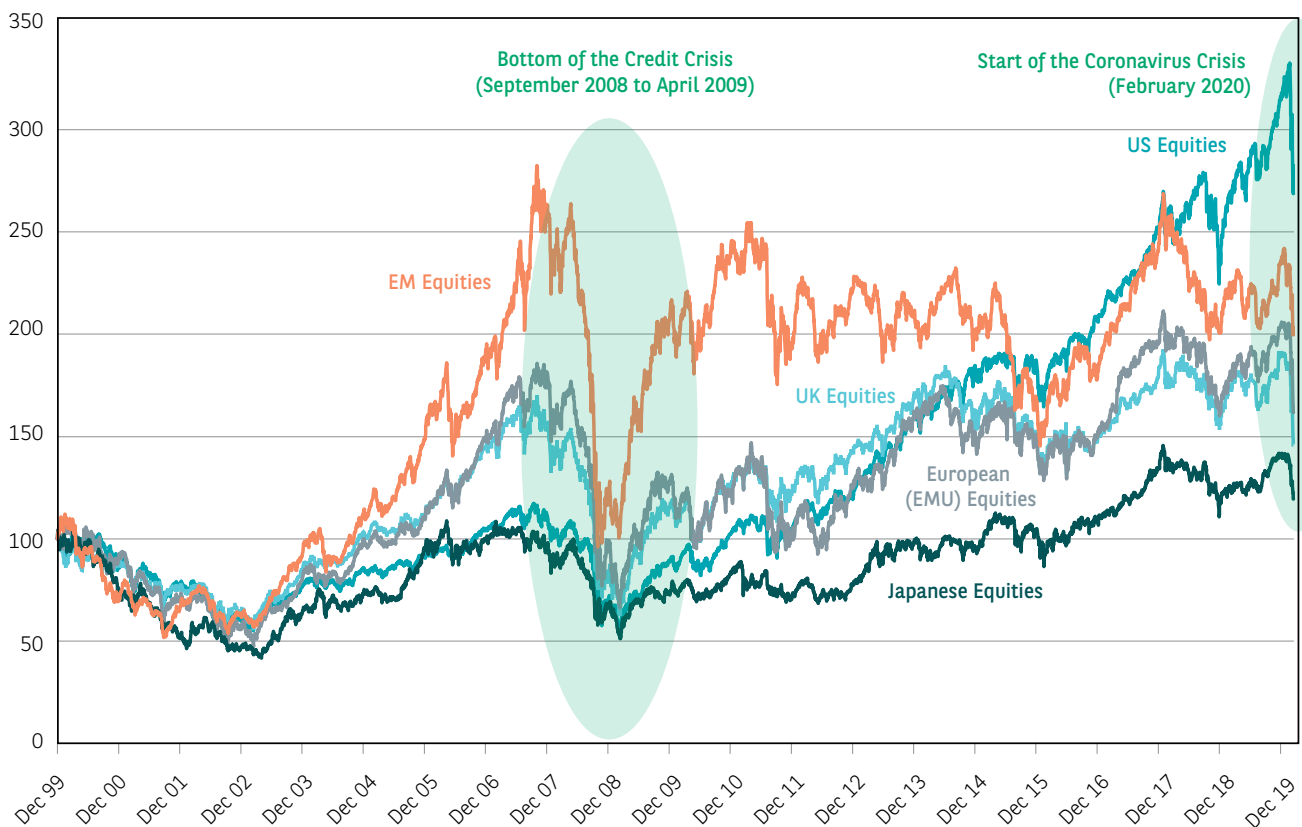
Movements in equity markets during the first half of 2020 have only served to strengthen our conviction in the case for a structural allocation to equities and the added value that an active manager can provide. Of course, valuations took a severe hit in the sell-off between mid-February and late March as investors priced in the implications of locking-down the global economy. But, unlike the markets for other risk assets, equity markets did not seize up during this extreme risk-off phase.

We were proactive in managing our portfolios throughout. We focused on improving quality and return potential. This helped us avoid finding ourselves in the position of being a forced seller of a stock, which can prove ruinous for performance, especially with concentrated portfolios.

And while experience and the ability to remain calm are important character traits, resilience is also necessary – not only from an operational perspective but also mentally. Many of our investors have worked through the various crises way back to Black Monday in 1987, and we recognise that each event is different – both in cause and response. We are thus conscious that personal perceptions will also differ based on roles and experience at the time.

Remaining true to our philosophy and approach - and remaining close to our people and clients - has proven an effective defence against the inevitable tendency towards knee-jerk reactions to headlines and chasing the latest market moves.

Long-run performance of equities by region



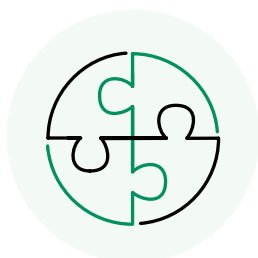
Source: Bloomberg, March 2020

LOOKING TO THE FUTURE

The COVID-19 pandemic is the first interconnected global crisis since World War II and, to a large degree, it is unique both in its cause and in the global response. With the lack of an effective blueprint for dealing with such a crisis, combined with the scale of human suffering and economic destruction, we believe that the pandemic will ultimately prove to be a defining shock to society.

It is the shifts in behaviour that this experience will trigger that demand our attention as investors. COVID-19 will have – and has had – profound implications for industries and consumer behaviour. Technologies that enable remote working and communication are one area we expect to benefit, whereas business travel could be severely disrupted. The pandemic is also likely to trigger lasting changes in our collective patterns of consumption, how we allocate our time between work and leisure, and the way companies organise their affairs. Of course, the pandemic is not the only transformative event in living memory, but what perhaps sets it apart is the ferocity of the disruption that it will likely bring about. Whereas technological innovations, commercial trends or political movements gradually shift the tectonic plates of society and the economy across multiple decades, the pandemic has the potential to trigger a more sudden realignment. Changes in behaviour that might otherwise have taken decades to play out may now occur on a much more compressed timetable.

Our Disruptive Technology Strategy: Creating Value for Investors



PORTFOLIO CHALLENGE

Digital transformation is changing society and the global economy. The challenge is to identify the most impactful themes and the best positioned companies, while avoiding those that fail to adapt.



PORTFOLIO OPPORTUNITY

There is an opportunity to outperform over the long term by investing in the secular growth themes of Cloud Computing, Artificial Intelligence, Automation/Robotics, and the Internet of Things.



PORTFOLIO VALUE

We build a concentrated portfolio of compelling stocks across a broad range of the global economy, by combining a top-down perspective with bottom-up fundamental stock research. We invest in sustainable companies with resilient business models, that do no harm or have improving ESG* profiles.

Source: BNP Paribas Asset Management 31 March 2020.

Past performance is not indicative of future performance.

*ESG stands for Environmental, Social and Governance

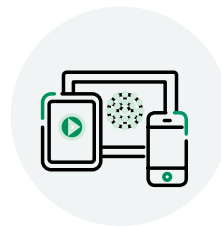
CHANGE IS ON THE WAY...

We believe that this combination – rapid and radical societal change – will inevitably lead to major shifts in economic activity, corporate earnings and ultimately valuations. This can represent fertile territory for long-term investors who believe in high conviction trades based on forensic research of fundamental themes. Our task as investment professionals is to understand the rapid nature of that disruptive change and identify the most efficient way to position for it. A keen understanding of the macroeconomic back-drop is invaluable here: The state of the business cycle, the level of market interest rates, the ebb and flow of trade and regulatory policy, and so on. But we invest in companies, not economies, and our focus is therefore on how these deeper socio-economic themes impact global corporations.

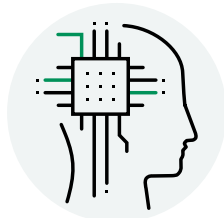
The Investment Themes within Disruptive Technology



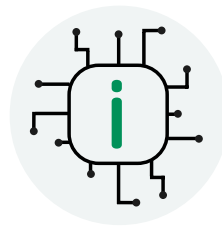
CLOUD COMPUTING



INTERNET OF THINGS



ARTIFICIAL INTELLIGENCE /
DATA ANALYTICS



FOUNDATIONAL &
EMERGING THEMES



AUTOMATION / ROBOTICS

...WITH A NEW SOCIAL CONTRACT?

One natural consequence of a crisis on the scale of the pandemic would be the emergence of a new social contract, perhaps similar to the period following the World War II, where universal healthcare and education was prioritised alongside economic redevelopment. With the importance of dealing with income and wealth inequality already creeping up the political agenda, the pandemic could prove to be a further catalyst for radical change. The economic impact of the lockdowns on income and net worth has been asymmetric; some individuals have seen their savings eviscerated, while others have been largely unaffected. With a repeat of the austerity measures that followed the Global Financial Crisis of 2008 being less likely, the relatively well-off will have to assume a greater role – and not least through higher taxes, as we move from “I” to “we” and from self-interest to caring for the greater good. The public health response has reminded large swathes of the population of the critical services performed by (often poorly paid) individuals in key jobs: The so-called ‘essential workers’.



Forecasting the shape of such a new social contract is not straightforward. Progressively, it may take the form of a wider offer on sustainability. For example, it may prove more effective to build consensus behind a policy designed to deliver significant improvements in air quality in the aftermath of a disease that will have killed hundreds of thousands of people through severe respiratory illness. Alternatively, the rapid global spread of COVID-19 combined with the recognition of the fragility of global connectivity may reinforce the rejection of globalisation already embraced by large swathes of blue-collar workers who have felt left behind.

As investors, we must be alive to the possibility of radical shifts in the regulatory and anti-trust framework within which companies operate. This would clearly have an impact on valuations, alongside the more obvious changes in the tax and benefit system for individuals. And in a purer reflection of the preferences of wider society, consumer behavioural change may outpace the actions of politicians; sustainability is an obvious example of this. Demand for goods and services that are perceived to be incompatible with the transition to a net zero carbon economy may fall faster than any intervention by politicians.

RATIONAL OPTIMISM

We believe that science and innovation, supported by the capital markets, will deliver scalable solutions to a range of global challenges. It is our role as investors to identify the companies best placed to recognise, facilitate and benefit from the associated shifts in economic and consumer behaviour. One obvious example is healthcare. The pandemic has clearly exposed the risks associated with healthcare systems that either permanently operate close to full capacity or offer limited coverage to a significant fraction of the population. We expect spending on healthcare to rise so as to gradually address these deficiencies. We also foresee considerable concurrent expenditure in the biotech and pharmaceutical sectors to fight the pandemic with tests, antivirals and ultimately a vaccine. Beyond that, we believe that the underlying theme of technological change facilitating improvements in the quality of healthcare services – and ultimately the earnings of companies driving those trends – remains intact. This is likely to be the case whether it be using technology to enable contact over large distances between patient and clinician, or exploiting the advances in genetic sequencing to develop new treatments.

Key Innovative Trends in Healthcare



**UNLOCKING & EMPOWERING
THE POWER OF THE GENOME**



**UTILISING MINIATURISATION AND AUTOMATION
IN MEDICAL DEVICE DEVELOPMENT**



**NOVEL MODES OF
DELIVERING THERAPIES**



**HARNESSING BIG DATA TO SOLVE
HEALTHCARE PROBLEMS**



**DRIVING SYSTEMATIC CHANGES IN THE DELIVERY
SYSTEM TO INTEGRATE CARE & CONTROL COST**

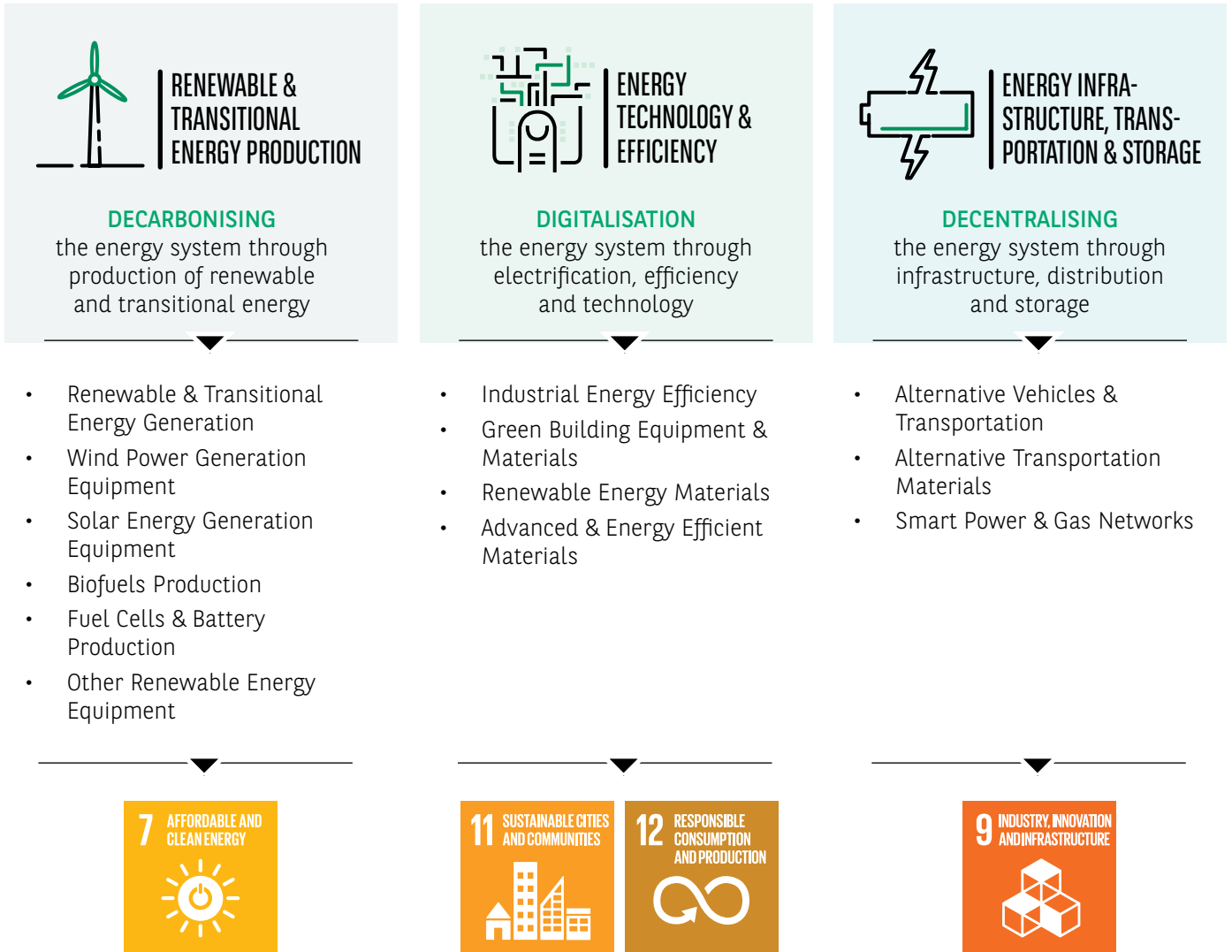
A NEW WAY OF WORKING

Another fundamental change that the pandemic is likely to trigger is around the way we work. Over recent decades, globalisation and automation have been gradually transforming the world of work by changing where certain activities take place or determining whether those activities are performed by humans or machines. The decision to lockdown society to curtail the spread of the virus triggered a seismic shift in the world of work in a matter of days. While it was technically possible for many people to work from home before the pandemic, it was also difficult for many to imagine a time when offices were not central to our lives and our cities.

The pandemic has broken that convention and demonstrated that some teleworking is a viable option for most companies. Companies are likely to conclude that they can save considerable sums of money on renting floorspace, and employees are likely to conclude that working from home provides more flexibility and avoids the time and expense of commuting. We believe this shift to agile working is here to stay and that it will have major consequences on a number of fronts. It implies an increased demand for the technological and logistical services that will facilitate efficient and secure teleworking, but less demand for the transport services and real estate that the old model of work relied upon.

Finally, the COVID-19 pandemic has shown the positive knock-on effects on communities and countries across the globe of less public transportation, energy consumption and air travel. It has also highlighted the catastrophic effects that our global carbon-intensive energy system is having on our planet – how urban transportation systems are polluting both the air we breathe and related ecosystems. It has once again reminded us of the incredible importance of our natural capital, with oceans and river systems, land use and farming forming the base of economic activity and prosperity.

The Energy Transition Strategy covers three core themes covering some 1 000 companies globally evolving around decarbonising, digitalising and decentralising the global energy system

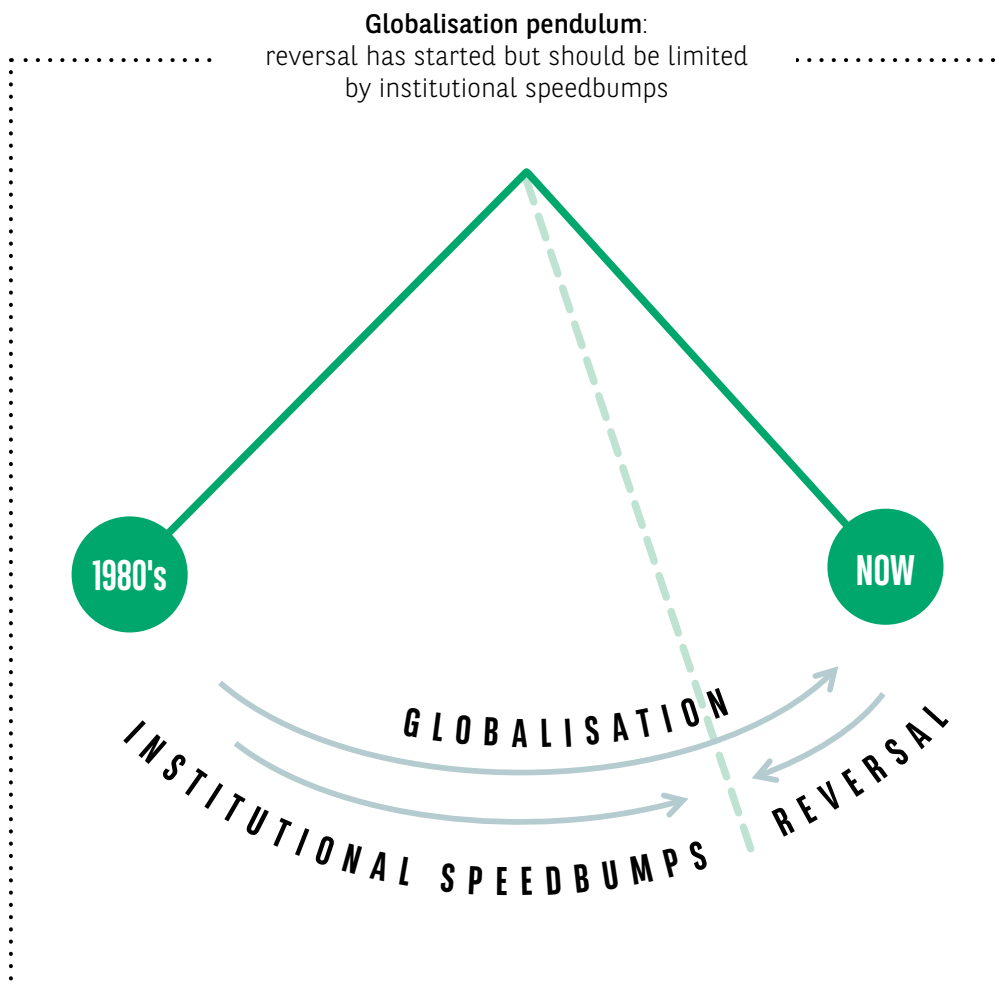


Source: BNPP AM, March 2020

REMAKING THE CORPORATE LANDSCAPE

The economic carnage the pandemic has created may trigger a coordinated shift in corporate behaviour that could at least partially unravel the corporate landscape that evolved during the era of globalisation. Just-in-time inventory management at each stage of a production process that snakes across borders many times before it reaches the consumer may be the most effective way to minimise costs, but it does so at the cost of making production more fragile. The same goes for contracting out core services to external providers. Companies may come to attach greater importance to the resilience of their business model, which might imply a phase of on-shoring production, and companies with established, efficient local supply chains stand to benefit. This resilience agenda would also encompass increased expenditure to protect against the threat from cyber warfare as production becomes ever more dependent on technology. Politicians may encourage or even force this process of reverse globalisation at least in certain sectors – either on grounds of national security (for example, the need to be able to manufacture certain medical equipment domestically) or as part of a broader protectionist agenda.

A partial reversal of globalisation?



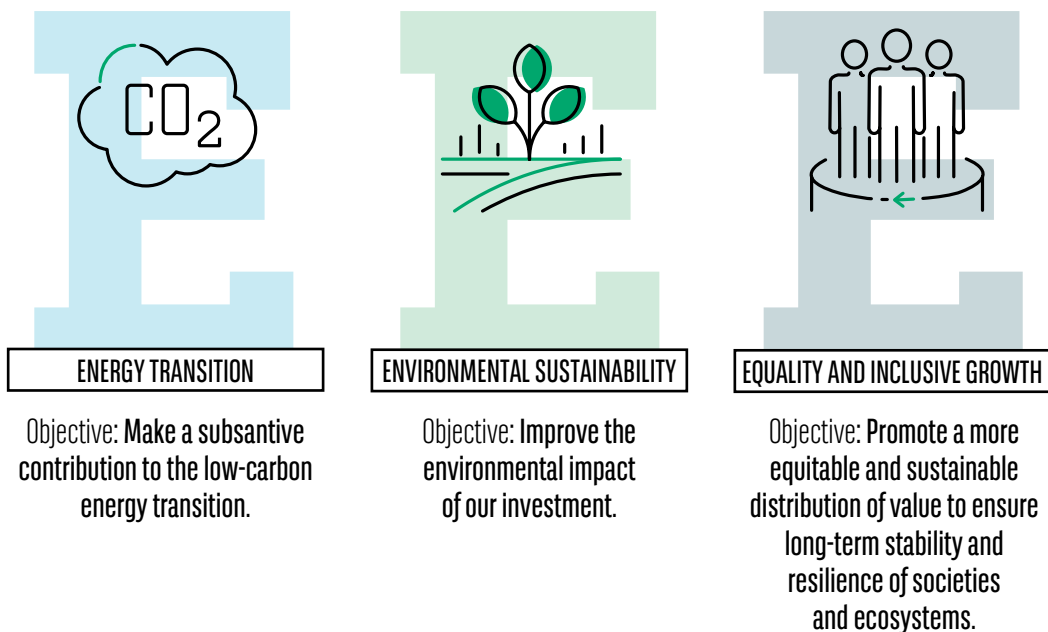
TOWARDS TOMORROW - AMID SHIFTS IN THE WORLD ORDER

The principal concern on the trade war front is the relationship between the two global superpowers, China and the United States. This is particularly so in the area of technology, where there is a realistic prospect of a bifurcation of the global market into two distinct poles. Once again, this is an example of the pandemic reinforcing an existing theme. Much has been written about the merits of strategic allocations “towards China”, but we think the investment case is more nuanced than that. We are firm believers in the “in China, for China” thesis; that is, investments in companies that are well positioned to serve the Chinese consumer. The case for investments in companies that sit in value chains that move through China before reaching consumers in the advanced economies – and the United States in particular – is far less clear.

Carmen Reinhart, the new chief economist of the World Bank, has gone so far as to describe the pandemic as the last nail in the coffin of globalisation. We think this is a touch premature; while corporate fads and geopolitical tensions may ebb and flow, there are plenty of great Asian, European and US companies with solid balance sheets, great business models and happy customers around the globe, that will continue to deliver healthy returns to shareholders (the author belongs to one such example).

That said, change is the one constant: Society will not go back to the way it was, and change remains the source of our investment debate. We will remain true to our philosophy and approach – and remain close to our people and clients. Stressful periods require cool heads, well thought-through capital allocations and careful portfolio construction built on conviction. These are the important ingredients in creating wealth worth having.

Our Priorities: The Energy Transition, Environmental Sustainability, Equality and Inclusive Growth



The risks associated with investments in shares (and similar instruments) include significant fluctuations in prices, negative information about the issuer or market and the subordination of a company's shares to its bonds.

The value of investments and the income they generate may go down as well as up and it is possible that investors will not recover their initial outlay.

Strategies investing in growth stocks may be more volatile than the market in general and may react differently to economic, political and market developments and to specific information about the issuer.

BNP PARIBAS ASSET MANAGEMENT UK Limited, "the investment company", is authorised and regulated by the Financial Conduct Authority. Registered in England No: 02474627, registered office: 5 Aldermanbury Square, London, England, EC2V 7BP, United Kingdom.

This material is issued and has been prepared by the investment company. This material is produced for information purposes only and does not constitute: 1. an offer to buy nor a solicitation to sell, nor shall it form the basis of or be relied upon in connection with any contract or commitment whatsoever or 2. investment advice.

Opinions included in this material constitute the judgment of the investment company at the time specified and may be subject to change without notice. The investment company is not obliged to update or alter the information or opinions contained within this material. Investors should consult their own legal and tax advisors in respect of legal, accounting, domicile and tax advice prior to investing in the financial instrument(s) in order to make an independent determination of the suitability and consequences of an investment therein, if permitted. Please note that different types of investments, if contained within this material, involve varying degrees of risk and there can be no assurance that any specific investment may either be suitable, appropriate or profitable for an investor's investment portfolio.

Given the economic and market risks, there can be no assurance that the financial instrument(s) will achieve its/their investment objectives. Returns may be affected by, amongst other things, investment strategies or objectives of the financial instrument(s) and material market and economic conditions, including interest rates, market terms and general market conditions. The different strategies applied to the financial instruments may have a significant effect on the results portrayed in this material.

This document is directed only at person(s) who have professional experience in matters relating to investments ("relevant persons"). Any investment or investment activity to which this document relates is available only to and will be engaged in only with Professional Clients as defined in the rules of the Financial Conduct Authority. Any person who is not a relevant person should not act or rely on this document or any of its contents.

All information referred to in the present document is available on www.bnpparibas-am.com

The value of investments and the income they generate may go down as well as up and it is possible that investors will not recover their initial outlay.

Investing in emerging markets, or specialised or restricted sectors is likely to be subject to a higher than average volatility due to a high degree of concentration, greater uncertainty because less information is available, there is less liquidity, or due to greater sensitivity to changes in market conditions (social, political and economic conditions).

Some emerging markets offer less security than the majority of international developed markets. For this reason, services for portfolio transactions, liquidation and conservation on behalf of funds invested in emerging markets may carry greater risk.



BNP PARIBAS
ASSET MANAGEMENT

**The asset manager
for a changing
world**