For professional investors - December 2021

INVESTMENT SYMPOSIUM 2021

THE AGE OF TRANSFORMATION

Our annual Investment Symposium took place virtually on 16-18 November 2021.

This year's edition focused on the key investment themes of tomorrow and their application in our portfolios today.

Among the factors shaping the age of transformation are global net-zero plans, social inequities, inflation risk, technological change and developments in China. Discussions centred on how they may change economies and transform the investment landscape.

The current crisis is a reminder that we as investors must align investing with the realisation of sustainable long-term growth. Investing for the long run will be crucial, because the typical three to five-year investment cycle does not always match the lifespan of financing the shift to the net-zero economy, nor the innovation required to achieve widespread e-mobility, restore natural capital and build green infrastructure.

As investors, we need to watch closely and understand the signposts driving significant economic and societal change. There are opportunities to put capital to work profitably in dynamic and high-growth areas.

- We must pay close attention to the policies being implemented to enable to transition towards net zero, with 90% of global GDP now covered by such a commitment post-COP26*.

* As of 15 November, 135 countries, 111 regions, 230 cities and 640 enterprises were covered by carbon neutrality commitments. This represents 90% of GDP and 85% of the world's population. Source: Net Zero Tracker.

BNP PARIBAS ASSET MANAGEMENT

The sustainable investor for a changing world

- Significant transitions include the growth in electric vehicles globally to full EV domination; improving the heating technology mix for buildings; expanding the use of heat pumps; continuing the propagation of onshore and offshore wind, solar and hydrogen; promoting the production and consumption of alternative meats.
- We see encouraging growth in the number of private investors looking to purchase high-quality offsets such as carbon credits amid the increased use of nature-based solutions – reforestation, afforestation, etc.

EXECUTIVE SUMMARY

China – Addressing structural economic imbalances now the priority
After the withdrawal of policy support, China's economy was always likely to slow in the second half of 2021. However, the actual slowdown has been sharper than most had anticipated. A key drag on economic growth is the property sector, where tight regulatory controls have suppressed activity.

Despite the economic weakness, China's policymakers have been reluctant to ease policy significantly to boost activity. The lack of a policy response, coming on the heels of the wave of regulatory tightening in 2021, suggests that policymakers' 'pain threshold' has moved higher.

We believe China's authorities have agreed on the key imbalances in the economy and the need to address them. Their challenge remains juggling the need to maintain growth in the short term and addressing medium-term structural goals such as greater shared prosperity.

We think Chinese officials will not leave a sharp slowdown in growth without response, particularly ahead of a major leadership reshuffle in 2022. As a result, we anticipate moderate policy easing in the coming months.

In our view, a loosening of property market controls is not the preferred option for shoring up growth, given how much emphasis policymakers have put on containing risks in the sector. However, should growth slow sharply, controls could be relaxed to ensure stability.

We expect boosting household consumption and investment in non-property sectors – technology/high-tech manufacturing, green energy, and infrastructure – to be the preferred choice. Growth should rebound as we go into 2022, but the pace of growth in 2022/2023 is likely to be slow as policymakers focus on tackling the structural imbalances.

In emerging markets such as China and India, investors should look at opportunities in, for example, zero emission vehicles and decarbonising industry and agriculture.

China's promise of carbon neutrality by 2060 will mean the creation of a new, green, low-carbon, circular economy. It will need to improve energy efficiency and lift the share of non-fossil fuel energy to roughly 80% by about 2050. China is set to be a major player in restoring biodiversity.

Climate action: Giving investors the tools to navigate to net zero
We are a strategic partner to the Inevitable Policy Response (IPR) Forecast and Required Policy Response projects to produce scenarios that help asset managers and owners understand the impacts of the net-zero transition – which sectors, which regions and over what timelines – so that we can navigate it in the best way. A huge part of the challenge lies in agriculture and land use, focus points that other climate scenarios lack.

Many of the additional required reductions for net zero will need to be achieved in the emerging markets, so it is up to the developed economies to play a more active role in facilitating that transfer, by investing both in climate mitigation and, importantly, in adaptation.

We also need to think about risk management and to continue to help our clients understand and do more work around bringing these climate scenarios into their asset allocation. Our work enables us to understand clients' sector exposures in different regions and how these decarbonisation pathways will play out.

And finally, we engage with companies. We are very active in initiatives like Climate Action 100+. But one of the biggest opportunities over the next 24 months will be collective investor engagement with policymakers, to really push them to implement changes clearly and consistently so that companies and investors can allocate capital appropriately.

Food – Restoring ecosystems
Boosting our efforts – and investments – to restore Earth's biodiverse natural capital and shift towards a healthy, sustainable food future is critical to achieving 1.5°C and keeping further climatic tipping points at bay. The global food system needs to evolve away from being the single largest net source of emissions. That means adopting smart agriculture – in one generation – and a greater focus on preserving intact ecosystems and restoring others.

Within the food system, it is time to cut greenhouse gases, stop biodiversity loss and land system expansion, streamline freshwater use and end the overloading of nutrients. Moving towards the healthiest diets and sustainable food systems is a win-win: health for people and health for the planet. Transforming the food system is absolutely key to bringing our use of natural capital back within planetary boundaries.

Disruptive technology, big tech
Big Tech faces mounting pressure from government and stakeholders for increased oversight to ensure their activities respect individual rights. While on the one hand Big Tech represents great promise on issues such as access to basic services (e.g. health, education), marginalized populations' empowerment (e.g. black lives matter, me too) inclusivity and customer reach, it has also been tainted from an ESG perspective with rhetoric of its role in curtailing civil rights (e.g. autocratic regime surveillance), deteriorating health, and curbing social cohesion (e.g. social media echo chambers).

(Greater) transparency will help investors evaluate responsible ('do no harm') corporate behaviour and assess the impact of Big Tech on a broad range of stakeholders. Overall, society still lacks the tools to ensure that Big Tech operates in a way that is consistent with the public interest. Efforts in this area, including related potential regulations, will significantly affect the investment environment and outlook for tech companies. In assessing them, investors will need to determine to what extent tech's contribution to inclusive growth issues are material to investment decision-making and weigh trade-offs between pressure for privacy and protecting public health – issues traditionally in the domain of governments. It is critical they have and start using a framework for understanding the intersection of tech and ESG in order to make the right investment choices.

US inflation – A major policy error at the US Federal Reserve?
Guest speaker Professor Olivier Blanchard argued that the US Federal Reserve is misreading US inflationary pressures as 'transitory'. In his view, an inflation shock is imminent. He argues the Fed is overly fixated on the risks of Japanese-style deflation and does not put enough weight on the possibility of a rise in inflation.

Such an event is now underway, in his view. The economy is experiencing an explosive post-lockdown rebound in demand, fuelled by what he sees as excessive fiscal stimulus.

In this scenario, Professor Blanchard believes a rapid normalisation of monetary policy to be necessary. This would primarily mean significant increases in the federal funds rate. In inflation-adjusted terms, he sees the current level as being (at -6%) completely inappropriate.

We are not expecting as significant an increase in US policy rates as Professor Blanchard. In our view, the Fed will raise policy rates several times in 2022, but we expect only a short cycle of increases. Capped inflation expectations and the size of the Fed's balance sheet should help contain the upside of longer-term US Treasury bond yields.

PUTTING THE THEMES INTO ACTION AND CONCLUSIONS

- China is set to occupy a central role in the age of tranformation, leading the world on a range of issues. We have a constructive assessment with regard to valuations of Chinese risk assets. Policy stimulus may be approaching, although regulatory risk is a key headwind. Across Asia, the prospect of stronger growth and developing capital markets is likely to provide good investment opportunities notwithstanding slower growth in China. We will seek to bolster our ESG engagement efforts in China with the emission gap a focus point.

- Digitalisation and automation offer scope for better economic outcomes through productivity gains. Potentially they also bring great promise on issues such as access to basic services (e.g., health and education) and empowering marginalised populations. However, the dark side of new technologies requires us as asset managers to concert with our peers in ensuring concerns about privacy and public health are respected.

- Will the age of transformation bring a regime change via an inflation shock and wage spiral while the US Federal Reserve misguidedly persists in combatting low inflation? We tend to think not, but central banks face a delicate balancing act with little room for error as they seek to normalise policy. We anticipate ongoing central bank support and scope for countercyclical fiscal policy in the event of downturns. With good economic growth and negative/low real bond yields, we remain constructive on equities.

- The risk of regime change requires us to seek to maximize the opportunity in traditional fixed income strategies with flexible mandates aimed at taking advantage of and providing diversification through a broad global opportunity set. We will engage with investors to ensure benchmarks are appropriate in today's environment of low real and nominal yields. In corporate debt markets, the energy transition, rapid adoption of new technologies, and post-pandemic evolution of supply chains and consumer behaviour will only reinforce the importance of active management.

- In today's investment environment, it makes sense to look for alternatives beyond traditional asset classes. For example, private debt and real assets, which we believe provide attractive income-generating potential. We are continuing to develop extensively our capabilities in private credit. When it is consistent with client objectives and expectations, we will look to take advantage of the illiquidity premium in real estate and real assets. Infrastructure investment will be critical in the next decade. We see our focus on identifying beneficial ESG criteria in infrastructure projects as a significant competitive advantage.

- Our 2021 Investment Symposium focused on macroeconomic and sustainability considerations. Today the world remains far from meeting the goal of limiting warming to 1.5 degrees Celsius versus pre-industrial levels. Pledges and targets for decarbonisation have risen but the actions to achieve them remain insufficient. The energy transition represents a capital allocation event of unprecedented proportions. Evaluating both the risks and opportunities for the transition directly, and assessing indirect implications across asset classes, will be increasingly critical for investors. We are committed to ongoing engagement with policymakers and international organisations to develop the best frameworks, tools, and solutions to enable investors to analyse the risks and opportunities arising from the transition to Net Zero – and encouraging the necessary steps to achieve it.

Participants in this session:

Sandro Pierri - CEO, BNP Paribas Asset Management
Rob Gambi - Global Head of Investments
Jane Ambachtsheer - Global Head of Sustainability
Maya Bhandari - Global Head of Multi-Asset
David Bouchoucha - CIO, Private Debt and Real Assets
Guy Davies - CIO, Equities and Convertibles
Olivier de la Rouzière - CIO, Global Fixed Income

KEYNOTE SPEAKERS

Olivier Blanchard is a Senior Fellow at the Peterson Institute for International Economics and Professor of Economics emeritus at the Massachusetts Institute of Technology. From 2008 until 2015, he led the research department at the International Monetary Fund. He has worked on issues including monetary and fiscal policy, and the Global Financial Crisis.

Professor **Christine Loh** is Chief Development Strategist at Hong Kong University of Science and Technology. She advises the World Health Organization and International Energy Agency on air pollution and public health.

Professor **Johan Rockström** is joint director of the Potsdam Institute for Climate Impact Research. He chairs the Earth Commission and is a sustainable development advisor to the World Economic Forum, the UN Sustainable Development Solutions Network (SDSN) and the UN Framework Convention on Climate Change Conferences (UNFCCC).

David Kaye is Professor of Law at the University of California, Irvine, director of its International Justice Clinic, and co-director of the Center on Fair Elections and Free Speech. He is also a former (2014-2020) UN Special Rapporteur on the right to freedom of opinion and expression and an independent chair of the Board of the Global Network Initiative, in which BNP Paribas Asset Management actively participates.

For BNP Paribas Asset Management, speakers from these teams took part:

- Macro Research
- Sustainability Centre
- Global Fixed Income investment centre
- US, European and Asian Equities investment centres
- Multi-asset and quantitative solutions investment centre
- Environmental Strategies Group

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