For professional investors - Marketing Communication - April 2024

ASSET ALLOCATION MONTHLY - APRIL 2024

More equity, more gold, less bonds and some steepeners

We made five shifts in our asset allocation in March and early April:

- Increased allocation to equity markets by neutralising our short position in European equity and adding to Japanese equities. Combined with our existing long in emerging Asian stocks, equities are mildly favoured in our asset allocation.
- Reduced long duration by cutting a third of our long position in US real yields after strong rallies in early March. We remain long duration by 0.5 years; long duration stood at between 1 and 2 years at the peak of our allocation in November.
- Put on European sovereign curve steepeners between the five and 30-year points on the German yield curve (duration neutral) as market expectations of a summer cut in European Central Bank (ECB) interest rates mount. Timing is key, and we believe a trade set up two months ahead of the first cut has highest efficacy.
- Unhedged our long Japanese equities position, taking long JPY exposure alongside Japanese stocks as NIRP (Negative Interest Rate Policy) ends. We have funded this in Swiss francs as a euro-proxy with an 'alpha kicker', that is, a more dovish Swiss National Bank (SNB). Following the surprise cut in rates by the SNB, we added a standalone JPY/CHF position.
- Added and formalised a long gold position as a key hedge to inflation and with supportive fundamentals. Overall risk taking has been increased, towards the neutral quintile (for flexible multi-asset funds).


Maya Bhandari
Global Head of Multi-Asset


Daniel Morris
Chief Market Strategist

BNP PARIBAS ASSET MANAGEMENT

The sustainable investor for a changing world

As noted in our last monthly, the narrative of 'immaculate goldilocks'– rising growth and falling inflation – was at risk of being challenged in the first half of 2024. The threat seemed more likely to stem from stickier inflation in the US rather than weaker growth. And so it has been. Above-trend growth in the US and the significant boost to inflation from one-offs (such as car insurance, which drove half of March's higher CPI reading), have challenged the narrative of sustained price depreciation.

There are numerous risks, however, that may threaten economic growth in the quarters ahead. If inflation stays high, high real interest rates could eventually have a bigger impact on activity than we have seen so far, particularly as excess consumer savings run out. Any more unpleasant surprises from US regional banks due to problems in the commercial real estate sector would not help. In addition, the cost of credit has soared for consumers and companies, US federal fiscal support is waning, and election risks are running high.

Outside of the US, things look more balanced. For the eurozone, the risks are for modestly better growth, excluding Germany. Recent data has surpassed slowly improving consensus expectations, labour markets have remained firm, and there appears to be an upturn in survey data. For the UK, we see a modestly positive outlook from a low starting point for growth. Recent data has been better for manufacturing and housing. Consumer and retail sales data has improved, and inflation has stopped falling. Forward earnings expectations have remained steady. And although headline Japanese macroeconomic data has been weaker, the corporate sector has found a sweet spot.

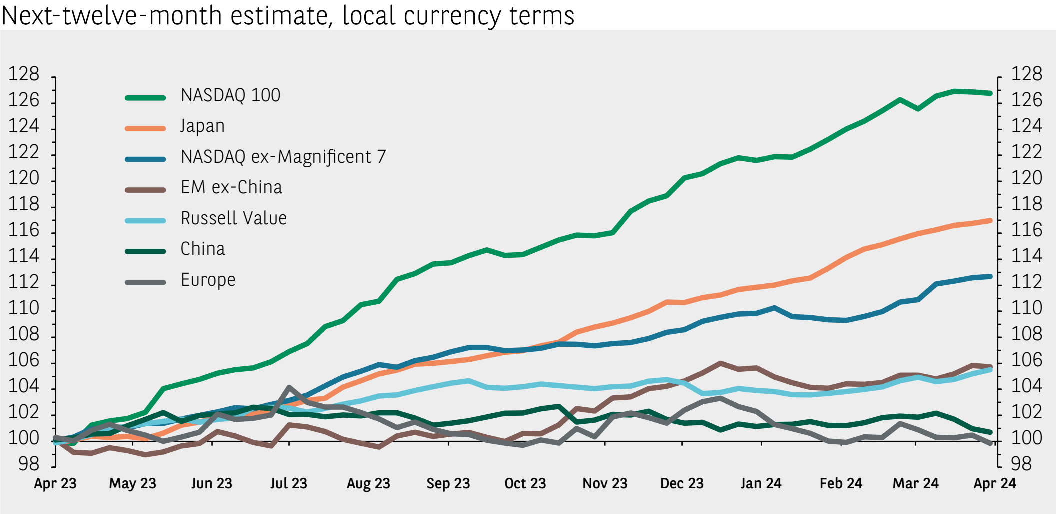
Adding to equities

Japanese stocks appear to be in a 'sweet spot', offering investors exposure to preferred sectoral and secular themes underpinned by a strong structural reform story and attractive prices. Both fundamentals and valuations look supportive, notwithstanding the strong rally in the Japanese market this year. To be sure, as earnings have continued to grow (well ahead of what might be explained by currency moves), Japanese equities have broadly preserved their valuation appeal, trading at a 15% forward price/earnings discount to global equities and a 50% discount on forward price-to-book and forward price-to-sales ratios. Since our last monthly, we have added to Japanese equities on weakness.

Exhibit 1

Earnings expectations rising sharply for Japan

Next-twelve-month estimate, local currency terms



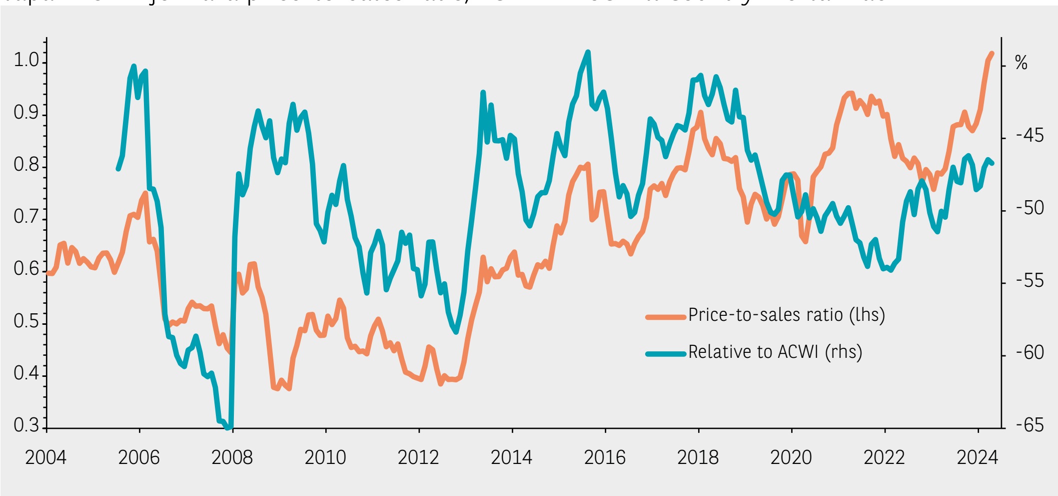
Data as at 11 April March 2024. Sources: FactSet, BNP Paribas Asset Management.

By contrast, although Chinese earnings expectations have yet to rise, green shoots in global manufacturing should benefit manufacturing-heavy, operationally levered and attractively valued areas such as emerging Asia, with an additional boost from domestic Chinese policy support.

Exhibit 2

Japanese equity market valuations are appealing

Japan TOPIX forward price-to-sales ratio; ACWI = MSCI All Country World Index



Data as at 12 April 2024. Sources: LSEG, BNP Paribas Asset Management.

The widening gap – Shorting the Swiss franc against the yen

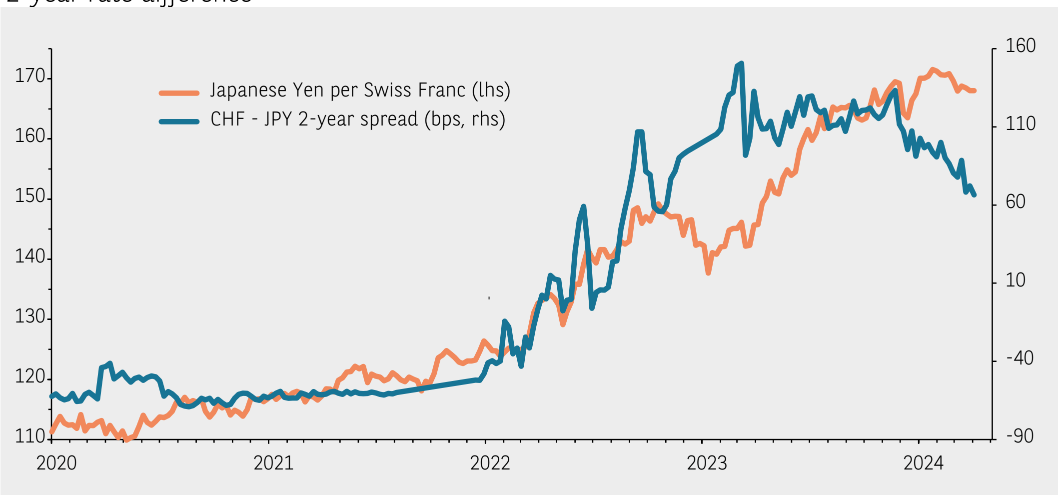
We switched our long exposure to the Japanese yen versus the euro, which had been costly in carry terms, to a long versus the Swiss franc (CHF), considered an 'alpha proxy' for the EUR. JPY/CHF valuations sit at multi-decade extremes across a host of metrics, and the Swiss central bank has begun cutting rates in line with our economists' expectations, and against the consensus.

Notably, the Bank of Japan started a hiking cycle (after decades of loose monetary policy) in the same week that the SNB began easing. Rate differentials could widen further since both central banks are on record as indicating that currency market intervention is possible: the SNB is keeping the option open to sell CHF and Japan's Ministry of Finance is threatening purchases of JPY.

Exhibit 3

There is a large gap between Swiss-Japanese exchange rate and bond yields

2-year rate difference



Data as at 12 April 2024. Sources: FactSet, BNP Paribas Asset Management.

It is all gold that glimmers

Gold has rallied significantly since mid-February, but we have held our ground as market sentiment does not appear extreme, seasonality and historical analogues are positive, gold volatility is still low, and market positioning appears to be underwhelming.

Being overweight gold seeks to capture four positive factors: it is a hedge against a return of inflation; it is a diversification asset for portfolios; real rates are falling; and it is a haven in an increasingly multi-polar world. On the latter, central banks have purchased an average of 330 tonnes of gold per quarter since Russia invaded Ukraine more than two years ago. This is more than 2.5 times the quarterly average purchases of the preceding decade.

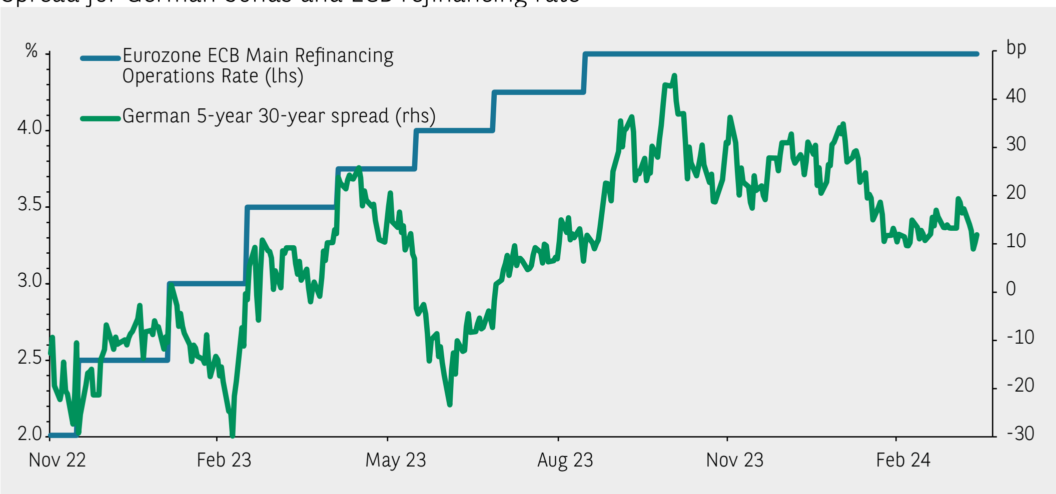
Steepening yield curve in Germany

Weak German growth, combined with improving inflation data in the eurozone, suggests the ECB will lead the US Federal Reserve in cutting interest rates, lowering near-term bond yields. Timing is key, and trading two months ahead of the first policy move has been ideal historically. In addition, the spread between 5-year and 30-year bonds captures similar initial moves in the spread between 2-year and 10-year bonds, but at a far less demanding cost of carry and roll. We have initiated a German 5-year/30-year steepener trade, expecting a bull steepening.

Exhibit 4

Two-months ahead of a central bank cut is an ideal time to position for a steepening curve

Spread for German bunds and ECB refinancing rate



Data as at 12 April 2024. Sources: Bloomberg, BNP Paribas Asset Management.

Our asset class views

	Strongly dislike	Dislike	Neutral	Favour	Strongly favour
PRR/risk appetite		X			
Asset allocation			Real Estate Commodities Cash	**Equities** Government bonds Credit	
Equity regions			**Europe ex-UK** US UK EM ex-Asia	Japan EM Asia	
Equity style/size	Consumer staples	Utilities	Energy Materials Communication Srvcs Real Estate EU large cap EU small cap US large cap US small cap	Industrial Health Care Financials Tech	
Sovereign bonds		Japan	Australia Europe UK	US linkers US MBS EMD (local)	
Credit			EMD US IG US HY EUR HY	EU IG	
Commodities			Energy Base metals	Precious metals	
FX		CHF	EUR, USD, AUD, GBP, JPY	EM FX JPY	

Twelve-month, risk-adjusted view. The above view(s) represent our judgement as at the date of this presentation and may be subject to change without notice.
Data as at March 2024. Sources: BNP Paribas Asset Management.

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VIEWPOINT

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