

BNP PARIBAS WEALTH MANAGEMENT

2020

INVESTMENT THEMES



BNP PARIBAS
WEALTH MANAGEMENT

The bank
for a changing
world



What are our 2020 investment themes and why are they relevant to investors?

INSIGHT

Easing political risks and improving economic indicators will support the upward trend in risky assets in 2020. Like last year, our 10 investment themes for 2020 will mainly focus on the equity markets using tactical and structural themes.

The first three themes are aimed at investors with a more conservative profile and offer solutions in lower volatility assets. The fourth and fifth themes address opportunities in global trends such as deglobalisation and fiscal stimulus policies.

Themes 6 and 7 relate to a transition towards a more socially-responsible world, with a focus on environmental issues and human capital. The last three themes focus on structural trends such as 'disruption' innovation, the digitalisation of consumption and technological innovations in the health care sector.

At the end of autumn 2019, political risk factors faded gradually and leading economic indicators improved. Monetary policies will support a very low interest-rate environment in the year ahead. This is maintaining a positive momentum in stock markets. Our assumption of very low interest rates over the long term implies a challenging environment for bond investors going forward. As a result, most of the 10 themes we selected for 2020 are oriented to the equity markets. The first three, however, offer alternatives for investors with a more conservative risk profile.

Political risks fade

The US and China are likely to sign a partial agreement, paving the way for a more permanent ceasefire. Not all strategic issues will be resolved, but a truce should be decreed (at least) for the period until the US elections in November 2020.

Turning to Brexit, the general election on 12 December was a key milestone. The main achievement for the financial markets is that the risk of a hard Brexit (no agreement between the European Union and the UK) has diminished considerably since the different votes in parliament and the new agreement with the EU.

Leading economic indicators stabilise

Leading economic indicators have stabilised, and in some cases, improved. The financial markets are looking for any signs of improvement with a view to anticipating a change in trend. A slower deterioration is already an important signal.

This is precisely what we have observed since the beginning of the autumn. We expect another improvement in the economy in early 2020, driven by household consumption, which in turn will be supported by low unemployment in most economies. We are therefore confident in our scenario of moderate economic growth in mature economies that excludes a recession in 2020. At this stage, we believe that the contribution of government stimulus programmes will be moderate, but we might have some nice surprises.

The environment of very low interest rates is set to persist

Accommodative monetary policies are maintaining a very low interest-rate environment. The Federal Reserve cut its key interest rate in October. It is expected to make two more rate cuts in 2020. The ECB continues to use all the tools at its disposal to fight the very low level of inflation: negative official rates, particularly favourable financial conditions known as TLTRO (Targeted Longer-Term Refinancing Operations), a tiering system to bolster banks but, above all, the resumption of bond purchases to a tune of €20 billion per month.

Furthermore, we expect several central banks in emerging economies to cut their interest rates, amplifying the accommodative measures implemented recently. Bond yields depend on the expected series of central bank interest rate hikes. We do not expect interest rates to rise in major countries in 2020. Inflation expectations remain low despite an improvement in the labour market in the G10 economies. In addition, demand for Investment Grade bonds is likely to remain very high in view of the central banks' bond purchasing programmes and the strong liquidity in the financial markets. We therefore forecast a lateral movement in bond yields, with a target of 1.75% for the 10-year US Treasury bond and -0.50% for the 10-year German bund.

The equity market valuation remains attractive particularly versus bonds

With the exception of the US markets, most equity markets in industrialised countries remain attractive by historical standards based on the price-to-earnings ratio. In addition, we expect a moderate increase in earnings in 2020. Another criterion that should whet investor appetite for equities is the dividend yield. Indeed, in European markets, this yield is above 3%, which compares with an average maturity yield of below 1% on Corporate bonds. In other markets, this difference is less apparent but remains close to historical records. This should provide additional support for equity markets in the coming months as we do not foresee a substantial increase in bond yields over the next 12 months or beyond this horizon.



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2020 Investment Themes



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THERE IS NO
ALTERNATIVE (TINA)

THE SHIFT FROM BONDS
TO EQUITIES

○ LONG-TERM ■ MODERATE RISK



THERE IS NO ALTERNATIVE (TINA): THE SHIFT FROM BONDS TO EQUITIES



Bond yields are set to remain extremely low for a long time. The hunt for yield will continue to whet investor appetite for high, safe and growing dividend stocks, which are known as 'dividend aristocrats'. In the long run, this universe offers a better risk/return ratio than the equity market as a whole. However, investors must pay the price of higher volatility compared with bonds and be willing to invest over the long term.

OUR RECOMMENDATIONS

This theme mainly concerns investments in developed markets. In this space, the problem of squeezed bond yields is widespread.

In euros, this issue is particularly acute with negative yields on the lion's share of Government bonds and on around 40% of Corporate bonds. The dividend yield is very attractive, i.e. above 3%.

For bonds in dollar terms (if we exclude 2009), the yield differential has never been so favourable.

This theme is proving an attractive alternative for investors looking for steady income, as long as they invest over the long term and accept higher volatility than that in the bond market.

MAIN RISKS

The main risk relates to the economic climate. If a recession were to occur, there would be a risk of capital loss. Only the end to that recession would reduce the loss. Hence, it is important to have a long-term investment horizon to mitigate any disruption to the business cycle. Structural advantages may thus emerge.

A related risk is if protectionist trends and trade tensions escalate further.

A minor risk is an underperformance versus the equity asset class. This would occur in the event of a significant rise in the stock markets. As the primary motivation for an investment in the 'aristocrats' is the search for regular income, this is a minor risk.



Steady income: an increasingly scarce commodity

Never have official rates and bond yields been as ridiculously low as they are today. Indeed one third of developed market Government bonds offer a negative yield, and one-half offer a yield of less than 1%. This dearth of steady income is set to persist in the environment of sluggish growth and low inflation. This is a crucial issue for the vast majority of investors (private and institutional), as generating regular income is at the top of their investment objectives. This problem can only get worse with the ageing population, exacerbated by longer retirements and hence a longer period to pay pensions.

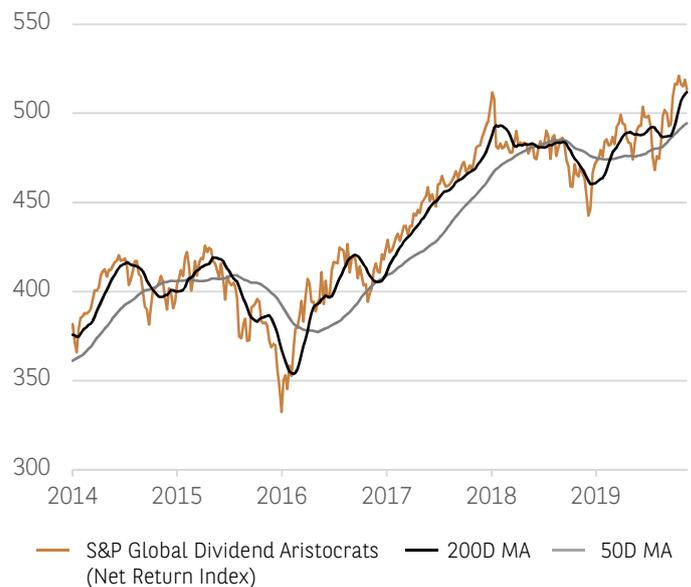
Dividend aristocrats: the most promising alternative

The regular yield differential between bonds and equities has rarely been so much in favour of the latter, especially in euros. Investors seeking regular income can thus seriously consider shares, especially those with high dividends. Investment choices must, however, be well targeted. A study by Fama & French (covering the period from 1928 to 2013) shows that selecting the quintile with stocks offering the highest dividend yields is not the best strategy because the investor could be exposed to a 'value trap', or to companies that could reduce their dividends.

An ideal strategy is to select companies with high, secure and growing dividends. These are known as 'dividend aristocrats'. To be part of this exclusive club, dividends need to have risen every year for the past 25 years! In terms of characteristics, this universe contains many more Investment Grade companies than the underlying index, and is more balanced between the value and growth styles. Another positive characteristic is that over the long term, the 'aristocrats' outperform the equity market as a whole while exposing the investor to lower volatility. In other words, the 'aristocrats' offer a better Sharpe ratio.

The price paid for investing in this universe is the acceptance of a much higher volatility than in the bond markets and a long-term investment horizon. For example, with an investment horizon of 10 years, an investor can afford to lose more than 20% on his dividend 'aristocrats' and enjoy a performance that continues to outperform fixed-income investments. The performance advantage would grow significantly if we consider that dividends tend to rise while bond yields are fixed. It also means that 'dividend aristocrats' would offer a better protection against inflation if the latter were to rise.

S&P GLOBAL DIVIDEND ARISTOCRATS



Source: Refinitive, Datastream, 03/12/2019

There are good reasons why valuations are (and will remain) relatively high

The hunt for steady income in recent years has clearly driven up equity valuations. As the bond yield squeeze is set to persist for a long time, the demand for 'dividend aristocrats' will remain strong and valuations will remain above their long-term averages.

Another supporting factor for the 'dividend aristocrats' is the moderate upside potential in equity markets. This stems from already high-profit margins and valuations, which reflect widely positive expectations. Dividends will thus play a major role in the next few years in the total return of stock market investments.

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QUALITY NEVER GOES OUT
OF FASHION

INVESTING IN
HIGH-QUALITY COMPANIES

○ LONG-TERM ■ MODERATE RISK



QUALITY NEVER GOES OUT OF FASHION: INVESTING IN HIGH-QUALITY COMPANIES



Economic growth will remain weak and vulnerable to shocks. Companies' profit margins are high and reflect a late positioning in the cycle. This is an ideal environment for quality stocks. A stock is deemed high quality when it meets three criteria: high profitability, a low gearing and low profit variability. These strengths warrant a high valuation.

Companies investing heavily in research and development (R&D) are part of this defensive universe.

OUR RECOMMENDATIONS

This theme allows investors to take a prudent approach to equity markets. This is reflected in price volatility, which is below the market average. It is therefore an ideal core holding for most investors who usually have a high loss aversion. This is especially true as nowadays the fixed-income universe plays a more minor role of regular income generator and portfolio stabiliser than in the past.

This theme is global because growth in the world economy and profit trends are synchronised and both have reached high maturity levels.

The investment horizon is by definition long term due to the theme's defensive nature. Periods of relatively lacklustre performance are generally not too badly perceived by cautious investors because priority is given to earnings visibility in today's highly uncertain world.

MAIN RISKS

As for any investment in equity markets, a bear market generates capital losses. And these losses could be substantial. Compared with other investment styles, however, these losses are likely to be smaller.

Quality stocks have become expensive following a very good run in 2019. Accordingly, they have less upward potential.

A marked recovery in leading indicators would reduce investor appetite for defensive investments, leading to an underperformance.

A clearly bullish market trend would be detrimental in relative terms due to below-average growth.

A flagship style in 2019

Quality stocks delivered a much higher-than-average performance overall in 2019. Indeed, at the end of November, they were up 31% versus +24% for global equities. A company is deemed 'quality' if it meets three criteria: high profitability, limited gearing and low profit variability. These stocks have benefited from persistent uncertainties linked to geopolitics, cycles and earnings growth.

Still a choice investment in 2020

The longevity of the current economic and stock market cycle is remarkable! It is very likely that the current decade will be the first one to escape a recession since records began. In any case, quality stocks tend to stand out in late stages of the cycle and outperform other market segments during recessions. They are core holdings in a portfolio.

During the first few months of 2020, it is very likely that quality stocks will not perform as well as in 2019, for two reasons: a return of confidence in the economic climate and a high valuation. Admittedly, when leading indicators begin a new uptrend, the pro-cyclical equity market segments are the main winners. However, we expect the cyclical momentum to remain soft. This will maintain investor interest in investments with above-average visibility at a high level. For this reason, valuations will remain stretched.

In addition, stock market volatility has remained low of late. In the course of 2020, it is expected to begin an upswing. Historically, this factor benefits quality stocks.

The majority of investors have a conservative investment profile. This is reflected in a smaller focus on the relative performance of quality stocks and a greater focus on volatility and downside risks. If we combine these characteristics with our low earnings growth forecasts for 2020, quality stocks are a prime investment. A potential widening of credit spreads would increase the attractiveness of quality stocks.

MSCI WORLD QUALITY INDEX



Source: Refinitive, Datastream, 03/12/2019

A segment not to be overlooked: companies with high R&D costs

Beyond the official definition of a quality stock, companies investing heavily in R&D are also a quality investment. The logic is the following: investing in knowledge leads to an above-average return on equity. Furthermore, investing in knowledge creates value added and barriers to entry. As a result, the capacity to raise sale prices improves and the generation of significant cash flows increases. At the end of the chain, dividends are not only better protected but are also easier to increase.

This type of company is found mainly in the health care and technology sectors.

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DEFENSIVE DIVERSIFIERS

SEEKING LOW RISK YIELDS

○ SHORT / LONG-TERM  LOW / MODERATE RISK



DEFENSIVE DIVERSIFIERS: SEEKING LOW RISK YIELDS



As we approach the end of the economic cycle, some investors are increasingly looking for a defensive positioning in their portfolios. Investment opportunities have shrunk since central banks adopted negative rates in the eurozone and Japan. Slightly more than 20% of global bonds have a negative yield-to-maturity. However, there are still solutions that offer positive expected returns for a relatively low level of risk.

OUR RECOMMENDATIONS

Diversification reduces the overall risk of a portfolio. We diversify assets in a number of low-risk products and others with a calculated risk.

Defensive investors are likely to favour high quality issuers in their base currency. There is also value in short-term US Government bonds and Emerging Market bonds for those who accept currency risk. Other solutions such as structured products, leveraged loans in Europe and Newcits funds may also be considered.

Equities solutions are a bit more risky. Defensive funds such as buy-write funds offer partial market exposure to limit risk.

MAIN RISKS

The risks of the 'defensive diversifiers' theme are mainly opportunity costs in the event of risky assets continuing their upward trend.

The risks inherent in the product offered are risks related to a sudden rise in interest rates, the default of an issuer, reduced liquidity in the event of market tensions, or exchange rate fluctuations. We will seek to limit these risks with short-term bonds and by favouring high quality issuers.

Investors with a low risk profile used to buy bonds that were deemed safe, such as those issued by governments or large companies with high credit ratings. Those bonds are now expensive, or even have a negative yield-to-maturity, which means in concrete terms that the buyer is certain to lose money if he holds them until maturity. Actually, 20% of bonds worldwide have negative yields. In the eurozone, this percentage rises to 40%! Against this backdrop, we are exploring several solutions that should offer positive returns for investors with low and moderate risk profiles.

Bonds

In an environment of low interest rates and slow economic growth in the eurozone, investors can find returns in **subordinated debt**. However, this is more risky than senior debt, since it only comes second in the order of repayment priority in the event of the issuer's bankruptcy. But the positive side is that it offers a more attractive yield. We favour **Investment Grade issuers** in order to limit the risk of restructuring/default.

For dollar-based investors, or those invested in euros who accept currency risk, **short-term US Government bonds are attractive**. The Federal Reserve should cut rates twice in 2020, in our view, while the market is discounting only one rate cut, suggesting that short-term rates are likely to drop. **Green bonds issued by US companies** deserve attention. There is a good supply and yields are attractive. They behave like conventional bonds, the difference being that they finance projects primarily designed to mitigate climate change.

Finally, **Emerging Market bonds** remain attractive: both Corporate bonds in hard currency and Government bonds in local currency. This asset class is supported by the search for yield as developed countries offer only low or even negative yields. The indices are now highly-diversified, which means that the risk is not as high as in the past. Emerging Market currencies are undervalued according to us, so the currency risk is small.

In an environment of low interest rates, **leveraged loans in Europe** offer an attractive risk/return and a natural protection against the risk of rising interest rates since the income generated is based on variable interest rates. Traditionally, the asset class has low volatility, but is not immune to the potential volatility of other asset classes. Senior loans are the safest part of the capital structure, so defaults should be scarcer in this part. Liquidity can be low, so it is recommended to invest over a long period.

Equities

Buy-write funds are intended for defensive investors. They offer exposure to the equity markets with the objective of reducing risk through the use of options (sale of call options). These funds participate less in rising indices in bull markets but mitigate declines in bear markets. Their return is generally less volatile than traditional funds.

PERCENTAGE OF NEGATIVE-YIELDING IG BONDS

Government and Corporate bonds



Source: Refinitive, Datastream, Bloomberg Barclays index, 05/12/2019

Newcits funds

Newcits funds offer the asset manager the opportunity to benefit from the increase (or decrease) in asset prices depending on the strategy. We favour macro strategies because trade tensions and populism are challenging some sectors, which should generate volatility and therefore opportunities. In addition, the dispersion between Emerging Markets helps to foster investment ideas. Long-short equity strategies are also attractive because they can exploit structural factors such as low yields and disruptive innovations.

Structured Products

These products use sophisticated instruments, such as futures, options and credit default swaps (CDS) to which individual investors typically have limited access. Structured products can be built with a 100% capital protection for very defensive investors or with a risk on part of the capital. Investors can benefit from the difference between short-term and long-term interest rates or generate returns by focusing on movements in implied volatility. Structured products in euros are less attractive than those in dollars due to low interest rates in the eurozone.

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DEGLOBALISATION

BENEFICIARIES OF THE REVERSAL IN GLOBAL TRADE

○ MEDIUM / LONG-TERM  ADVANCED RISK

DEGLOBALISATION: BENEFICIARIES OF THE REVERSAL IN GLOBAL TRADE



Globalisation is likely to have peaked amid the rise of populism and protectionism as well as social and environmental challenges. The shifting trend from globalisation to regionalisation/localisation is creating opportunities in regional/local markets including mid- and small-caps. At the same time, deglobalisation also entails more political/geopolitical uncertainty, which could lead to market volatility. Investors are recommended to hedge their portfolios with safe-haven assets.

OUR RECOMMENDATIONS

Regionalisation/localisation

- New trade dynamics/new production hubs (Taiwan and South Korea for upstream manufacturing products and Southern Asia for low-end consumer goods)
- Brexit (domestic British stocks, UK REITs, GBP)
- US election (almost all presidential candidates have plans that will benefit US consumers)
- Mid- and small-caps

Political/geopolitical uncertainty

Hedge with safe-haven assets (such as gold, JPY, tactical long USD opportunities)

MAIN RISKS

The trend of globalisation escalates again as:

- a comprehensive US-China trade deal is agreed;
- global trade tensions ease significantly;
- disruptive innovations in digital technologies substantially increase cross-border trade flows

Brexit does not materialise in the near future as:

- a Brexit stalemate results from a hung parliament

Intensified trade tensions lead to a global recession in 2020. Investors then become 'risk-off' which hurts equity performance, while safe-haven assets perform nicely.

How can investors benefit in the regionalisation/localisation?

New trade dynamics/production hubs

Bilateral trade conflicts (e.g. US-China, Japan-South Korea etc.) have been replacing multilateral trade agreement frameworks (e.g. NAFTA, TPP). There are more signs that companies are moving some parts of their supply chains or planning relocations of their supply chains regionally/locally, which should have profound implications for the regional and local economies in the medium- to long-term.

In an attempt to benefit from US-China trade tensions, some EM Asian countries are offering tax incentives to attract companies looking to shift their supply chains out of China. For instance, India imposes new manufacturing companies a corporate tax of only 15%, effective since 1 October 2019 (vs. 22% for other companies). Thailand has also announced a 50% tax cut for businesses moving from China. Furthermore, Taiwan's 'homecoming' policy, which entails a provision of industrial land and tax breaks, announced in November 2018, has so far been successful in facilitating the return of 142 companies with approved investment projects valued at TWD 611 billion (USD 20 billion). We expect the redistribution of supply chains to benefit Southern Asian countries for low-end consumer products, and Taiwan and South Korea for sophisticated upstream manufacturing products.

Brexit

With the Conservative Party winning a majority in the election, we expect Britain to leave the EU by the end of January and some moderate fiscal stimulus in 2020 to bolster the economy. As a result, we expect to see a re-rating in UK equities and UK REITs, as well as a rebound in Sterling.

US election

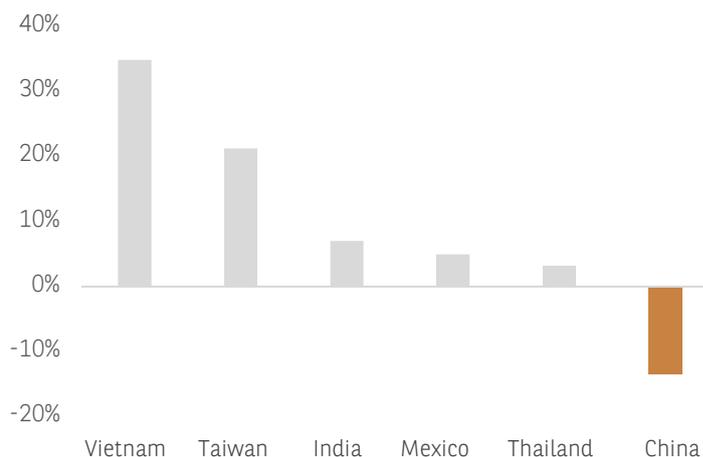
US equities generally perform well in an election year with the S&P 500 index gaining an average of 9% in the 12 months prior to the election (based on figures since 1964). So far, almost all presidential candidates have plans to benefit US households. Investor expectations of more favourable policies to boost the domestic economy in the medium term should be positive to US equities.

Mid- and small-caps

Small and medium-sized enterprises tend to be more domestic-oriented. With domestic and fiscal easing measures to support local economies, SMID caps should benefit from the cyclical recovery. Some SMIDs may also benefit from the shift of supply chains.

EXPORT GROWTH TO U.S.

Year-to-date



Source: Datastream, 28/11/2019

Dealing with political uncertainty

The trend of deglobalisation could also create persistent political/geopolitical uncertainty. We recommend investors to hedge their portfolios with some safe-haven assets such as gold, the Japanese yen and/or some tactical long USD positions when opportunities arise.

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FROM MONETARY TO FISCAL POLICIES

OPPORTUNITIES IN INFRASTRUCTURE SPENDING

○ MEDIUM / LONG-TERM  ADVANCED RISK

FROM MONETARY TO FISCAL POLICIES: OPPORTUNITIES IN INFRASTRUCTURE SPENDING



In 2019 many central banks eased monetary policies to cushion the global synchronised slowdown. Interest rates now stand at very depressed levels compared with previous late cycles. Some developed countries are close to their limits for further monetary easing. Fiscal policy is believed to be a more effective counter-cyclical tool (than monetary policy) for stimulating growth and raising inflation expectations. Expansionary fiscal policy via cutting taxes and building affordable housing should help to combat rising populism. Moreover, some governments are stepping up spending to address environmental goals.

OUR RECOMMENDATIONS

Fiscal stimulus has been underway in many countries, and more is expected in 2020. Investors may benefit from an increase in fiscal spending through:

- Building/construction material stocks
- Renewable energy and clean transportation stocks
- Thematic funds: infrastructure-related mutual funds or private equity funds, green/SRI-related funds
- A re-rating in UK equities
- China policy beneficiaries (multi-assets) e.g. cement, consumer discretionary, staple stocks and selective Corporate bonds

MAIN RISKS

- Governments do not deliver fiscal policies in line with market expectations
- Significant delays in the implementation of fiscal policies
- Intensified trade tensions lead to a global recession in 2020. Investors then become 'risk-off' which, in turn, hurts equity performance

Developed markets

More fiscal spending earmarked to sustainability

Most developed markets have struggled to meet their inflation targets in this business cycle, even though central banks continue to ease monetary policy. We have already witnessed some form of fiscal stimulus as countries strive to improve growth and achieve inflation targets. For developed nations, more fiscal spending is likely to come in the form of green energy spending.

United States

Fiscal stimulus is already underway given the massive tax cut in 2018. In early August 2019, a budget deal was passed to eliminate spending caps, suspend the debt ceiling until July 2021 and increase spending allocations over the next two fiscal years. Post-election, there may be an increase in 'green' infrastructure, given that most presidential candidates are in favour of clean energy spending.

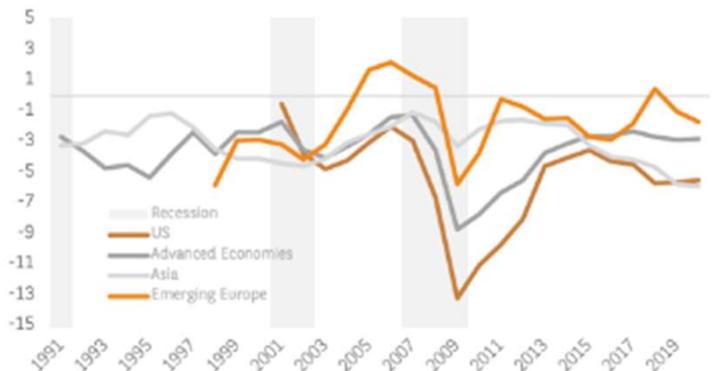
Europe

There are growing expectations of fiscal stimulus in the eurozone, particularly given the extended ultra-easy monetary environment with negative interest rates that has seemingly reduced the effectiveness of monetary policy. Both Germany and Netherlands are well positioned to implement fiscal stimulus given their fiscal surpluses. Fiscal spending, if any, should likely come in the sustainability space. In fact, the German parliament recently approved a EUR 54 billion package for the next four years to speed up the country's transition to renewable energy, and reduce carbon emissions. The Netherlands is also preparing a national investment fund aimed at supporting the economy sustainably over the next 30 years. Modernising transport infrastructure may be another important way of boosting government spending. The German government recently unveiled a EUR 86 billion plan to modernise the Deutsche Bahn rail network.

United Kingdom

With the Conservative Party winning a majority in the election, our base-case scenario is that Britain will leave the European Union by the end of January 2020. However, uncertainty will remain over the future relationship with the EU. We expect some moderate expansionary fiscal policy to cushion the growth slowdown in 2020.

FISCAL EXPANSION TENDS TO OCCUR DURING LATE CYCLES



X Axis: Budget Balance (% GDP)

Source: IPCC, NASA

Asia

Ambitious infrastructure plans and tax cuts to lift weakening growth

A growing number of central banks in Asia have cut rates to combat slowing growth in 2019. Some countries are turning to ambitious fiscal plans, including infrastructure-spending increases and tax reductions.

China

Fiscal spending has played a leading role in the latest round of policy easing, including the announcement of RMB 2 trillion (USD 298 billion) in tax cuts and fee cuts (in pension and social security contributions) in 2018. In addition, the Chinese government has called for an acceleration in the issuance of special local Government bonds to boost infrastructure, such as transport, energy, agriculture, forestry and medical care in 2020.

Other Asian regions

India has announced a surprise headline corporate tax cut from 30% to 22%, equivalent to INR 1.45 trillion (USD 20 billion), representing 0.7% of the country's GDP. Meanwhile, South Korea has put forward a record-breaking budget plan of KRW 514 trillion (USD 424 billion) for 2020, representing an 8% increase from last year's expenditure when a supplementary budget is taken into account. Meanwhile, Taiwan's 'homecoming' policy with the provision of industrial land and tax breaks, announced in November 2018, has been successful in facilitating the return of 142 companies with approved investment projects valued at TWD 611 billion (USD 20 billion).

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THE ENVIRONMENT & THE FUTURE OF OUR PLANET

FOCUSING ON WATER AND WASTE MANAGEMENT

○ MEDIUM / LONG-TERM  ADVANCED RISK



THE ENVIRONMENT AND THE FUTURE OF OUR PLANET: FOCUSING ON WATER AND WASTE MANAGEMENT



There is a growing awareness that human society and the global economy are closely related to the ecosystem, in particular water and energy sources. This has led to government-related actions linked to the Paris agreement COP21 and the UN's Sustainable Development Goals (SDGs), etc. We expect a growing demand for goods and services, in particular related to water availability, waste management as well as clean and renewable energies. The awareness related to ESG criteria should also incite investors to focus on such sectors.

OUR RECOMMENDATIONS

We focus our attention on 2 sub-themes

1.a. Water

- provide access to water
- guarantee the quality
- optimise its use

1.b. Waste management

We have identified opportunities for investors interested in collection methods, recycling, waste-to-energy solutions and any innovations that a company may offer in these fields.

2. Clean and renewable energy

Promising industries are those related to technological innovation and equipment in solar, wind, geothermal energy and hydroelectricity. Other chief areas include batteries and related chemicals as well as power and grid equipment-makers.

We will focus our attention on equities of companies that are leading players in these areas but also via actively-managed funds or ETFs (Exchange Traded Funds).

MAIN RISKS

The investment solutions related to this theme are mainly linked to equities. Despite the relevance and high potential of this theme, investment solutions will be subject to fluctuations in the global equity markets. However, some activities (for example Utilities) are less sensitive to those markets. Another factor that should limit the risk relative to global equity markets is that companies related to this theme should benefit from a high Environmental, Social and Governance (ESG) rating.

A global recession could severely limit the ability of governments to support the necessary transitions. A sharp drop in oil prices could represent a major constraint for renewable energies.



Opportunities in water and waste management

Water

According to the UN, "Water is a precondition for human existence and for the sustainability of the planet". They also argue that "water is at the heart of adaptation to climate change, serving as the crucial link between the climate system, human society and environment". Governments and companies will likely be compelled to invest heavily in **water management** over the coming years. We expect three main goals to drive demand: i) provide access to water, ii) guarantee quality and iii) optimise use. Technological innovation is very strong in the areas of water treatment, sanitation, desalination, the design of pumps/filters, automation and new optimisation techniques, making networks more efficient (smart meters, sensor networks, leak detectors).

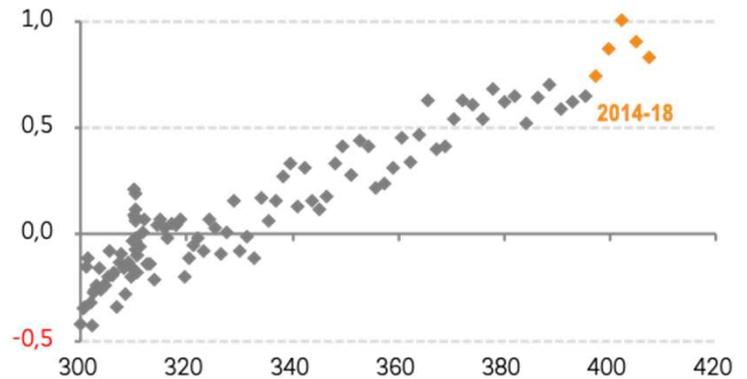
Waste management

This activity should lead to a circular economy model focused not only on waste management, but also on the reduction at the outset. Public authorities generally encourage rubbish-sorting, investments in recycling and the reduction of overcapacity in infrastructure for waste treatment based on incineration. In this changing environment, we have identified opportunities for investors interested in collection methods, waste-to-energy solutions and any innovation that a company may offer in the field.

Plastic waste

Plastic waste has been increasingly in the spotlight in recent months. Media reports and documentaries have increased the sense of emergency to tackle this huge challenge. By 2030, all plastic packaging used on the EU market will be reusable or recyclable in a cost-effective way. The plastic recycling market will therefore grow in the coming decades.

THE GREENHOUSE EFFECT (1880-2018)



X Axis: Atmospheric CO2 level (parts per million)

Y Axis: Global mean surface temperature relative to 1850-1900 (°C)

Source: IPCC, NASA, BNP Paribas

Opportunities in clean and renewable energies

We expect the 'energy transition' to gain traction over the coming years. By energy transition, we mean structural shifts from traditional, centralised, fossil-based production that do not have to pay for negative externalities towards a clean/renewable energy and a decentralised model where technological innovation and the pricing of externalities will be the key drivers. The speed of the transition will be linked to technological innovations, government policies (carbon tax and/or subsidies for clean energies), and changing consumer and investor preferences: ESG/SRI, or Socially Responsible Investment). This trend is supported by media reports on climate change, 'Fridays for future' demos and the introduction of investment themes such as Environmental, Social and Governance.

The demand for renewable energy sources is also likely to be fuelled by the fall in prices in production and energy storage (electricity, hydrogen etc.). Promising industries are those related to technological innovation and equipment in solar, wind, geothermal energy and hydroelectricity. Other key areas will be batteries and related chemicals as well as power and grid equipment makers.

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INVESTING IN HUMAN CAPITAL

'BEST EMPLOYERS', EDUCATION AND HEALTHY LIVING

○ LONG-TERM  ADVANCED RISK



INVESTING IN HUMAN CAPITAL: 'BEST EMPLOYERS', EDUCATION AND HEALTHY LIVING



There is a growing awareness that companies which value their staff (the 'human capital') and others which contribute to education, health and entrepreneurship (microfinance) are contributing to a more sustainable and responsible world. These themes are among the UN's Sustainable Development Goals (SDGs). We expect a growing demand for goods and services related to these areas. Companies which obtain high ratings in the areas of 'best employers' or 'gender equality' have shown a strong performance in terms of the risk-return trade-off.

OUR RECOMMENDATIONS

We focus our attention on 3 sub-themes:

Best Employers* and gender equality

The approach for selecting companies is based on rankings such as 'Best companies to work for' (e.g. Fortune). Regarding gender equality, there are similar rankings (e.g. Equileap).

Microfinance and education

Microfinance is a key driver to support sustainable growth and fight poverty. In education, we have identified opportunities in new technologies in the areas of digital education, education management as well as services and supplies.

Healthy food and food security

We see opportunities in areas such as alternative food, environmentally-friendly food production, food safety as well as healthy and natural food.

*employee satisfaction

We will focus our attention on equities of companies that are key players in these areas or via actively-managed funds or ETFs.

MAIN RISKS

Most investment solutions in this theme are mainly linked to equities. Despite the relevance and high potential of this theme, investment solutions will be subject to fluctuations in the global equity markets.

However, some activities related to this theme should benefit from a high Environmental, Social and Governance (ESG) rating, which may lead to lower volatility. Microfinance funds have a higher level of risk.





Best Employers and gender equality

These sub-themes are part of the UN's Sustainable Development Goals in the areas of 'Decent work and economic growth', 'Gender equality' and 'Reduced inequalities'. Furthermore they contribute to a more sustainable and responsible world. There are also economic and financial reasons to invest in companies operating in such areas. Indeed, in a ground-breaking survey conducted by Alex Edmans in 2012¹, the author showed a link between job satisfaction and the firm's value. In other words, he showed that the benefits of generating a high employee satisfaction outweigh the costs. Indeed, by using 28 years of data, he found that "firms with high employee satisfaction outperform their peers by 2.3 - 3.8% per year...". Findings also suggested that "it's employee satisfaction that causes good performance, rather than good performance allowing a firm to invest in employee satisfaction". The underlying factors being that high employee satisfaction allows companies to attract and keep talented workers and drives employee productivity. There are also empirical studies that show international evidence of this positive relationship: see Edmans, Li and Zhang (2014)² and Faleye and Fahan (2011)³ for example. There are numerous best employer rankings including Fortune ('Best companies to work for') and Glassdoor ('Best places to work'). Regarding gender equality, there are similar arguments to explain the link to company performance, i.e. attracting and keeping talented workers and improving employee productivity. Moreover, gender equality can also generate more innovative management and thinking (S. Turban, D. Wu and L. Zhang 2019)⁴.

Microfinance and education

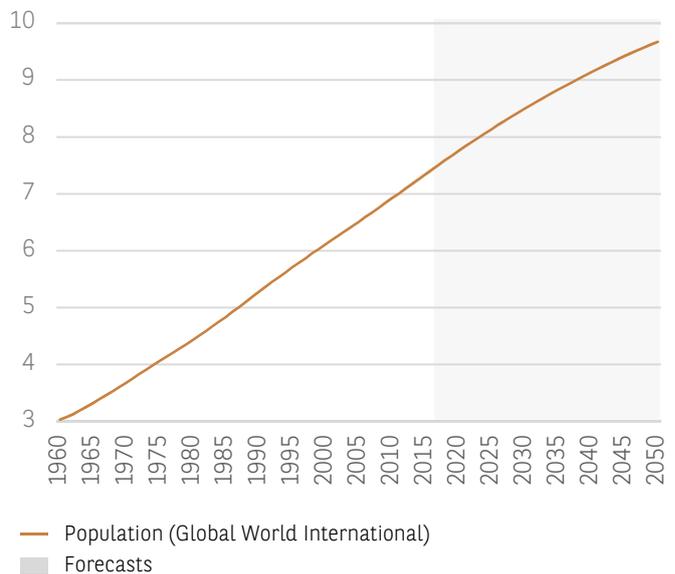
These sub-themes are key for the Sustainable Development Goals 'Quality education' and 'Reduced inequalities'.

Microfinance is a banking service that offers microloans to people with no access to financial services. The amounts are small (often a few thousand dollars or less depending on the country) and the idea is that borrowers have access to financial expertise at every stage of their project. This is a driver to support sustainable growth and gender equality and reduce inequalities.

Education

We expect spending on education to rise sharply over the coming years due to the rise of the middle classes in emerging economies and the need for lifelong learning in a world in which Artificial Intelligence offers opportunities for workers but also creates the need for them to adapt. Innovations in educational technologies have brought new opportunities and made education more accessible to millions of people. We see opportunities in new technologies in the areas of digital education, education management at every level as well as education services and supplies.

WORLD POPULATION (IN BILLIONS)



Source: Refinitiv Datastream, World Bank

Healthy food and food security

This theme relates to the Sustainable Development Goals 'Zero hunger', 'Good health and well-being' but also 'Responsible consumption and production'. The UN estimates that the world's population will rise to 9.7 billion people by 2050 (about 2 billion more than today) despite a falling fertility rate. Making sure that the world population is fed in a sustainable and environmentally-friendly way will be one of the biggest challenges ever. This will need massive investments in alternative food and food production, technological innovation and education. Many food production chains (especially meat) today use huge resources and are harming not only the environment but also people's health. Particularly harmful are artificial fertilizers, pesticides, hormones, deforestation, excessive water use but also negative externalities related to food transport over long distances. Methane emissions related to animal farms are a major contributor to human-induced emissions of CO₂. These challenges suggest that there will be huge investments in these areas. We see opportunities in areas such as alternative food (plant-based), environmentally-friendly food production, food safety and healthy and natural food. The focus will also be on companies contributing to the reduction of food waste and CO₂ emissions.

1. For more details see A. Edmans (2016) "28 Years of Stock Market Data shows a Link between Employee Satisfaction and Long-term Value", Harvard Business Review, March 2016.

2. Edmans, Li and Zhang (2014), "Employee Satisfaction, Labor Market Flexibility, and Stock Returns around the World", NBER Working Paper N° 20300, July 2014.

3. Faleye and Trahan (2011) "Labor Friendly Corporate Policies: Is What is Good for Employees Good for Shareholders?", Journal of Business Ethics, 101, 1-27.

4. S. Turban, D. Wu and L. Zhang (2019), "When Gender Diversity Makes Firms More Productive", Harvard Business Review.

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BENEFITING FROM DISRUPTION

5G AND ARTIFICIAL INTELLIGENCE INNOVATIONS

○ MEDIUM / LONG-TERM  ADVANCED RISK

BENEFITING FROM DISRUPTION: 5G AND ARTIFICIAL INTELLIGENCE INNOVATIONS



Innovation is accelerating and taking so many different forms that it is ushering in a huge disruptive trend for businesses. Among the most disruptive technologies are 5G and Artificial Intelligence. 5G is a huge leap forward and a powerful catalyst for digital transformation. As for Artificial Intelligence, it is present in virtually every value-added stage of a company.

OUR RECOMMENDATIONS

This theme concerns the equity markets. It is present in every region of the world. Companies that play a key role in this theme are located in the US, Europe and Asia. Innovation is developing at such a fast pace that the idiosyncratic risks are very high. Significant diversification is required to reduce these risks.

By definition, a high level of risk is accompanied by above-average volatility. In other words, an investor participating in this theme needs to accept a high risk of loss on the capital invested. This is an aggressive investment. Innovation has become a permanent feature in our society; hence a long-term investment horizon is necessary.

MAIN RISKS

The main risk is the pace of investments in disruptive technologies. Investments usually have a strong correlation with the level of generated profits that have become very high overall following 10 years of uninterrupted economic growth.

With the advent of new innovations, companies will not deliver on their promises for some services and applications. The sale price of smartphones will be a determining factor in the choice of consumers. The same is true of the functionalities and the network coverage.

Investing in the most disruptive trends

Technological advances are opening up a multitude of new prospects and new markets. Some innovations are particularly disruptive, for example 5G and Artificial Intelligence, which feature in this investment theme. According to a very talented hedge fund manager, Stan Druckenmiller, we are in the most economically-disruptive period since the 1880s.

5G: a gateway to new universes

5G represents the fifth generation of wireless technology. 1G brought phone calls. 2G offered the opportunity to send and receive text messages. 3G brought Internet and video connections on mobile phones. 4G gave users access to an abundance of data, among other to watch films and listen to music streaming. 5G is not just another step. It is a huge leap forward, towards new dimensions such as remote surgery, virtual reality and autonomous vehicles. It multiplies the possibilities of Artificial Intelligence, the Internet of Things, Industry 4.0 and Cloud Computing. It represents a powerful new catalyst for digital transformation. Moreover, it achieves this by being much faster and by providing much higher throughput and minimal latency times. The cherry on the cake is that this technology consumes far less energy.

Massive opportunities

The 5G technology market will really take off in 2020. It includes (but is not limited to) mobile network equipment and operators, manufacturers of semiconductors, antennas, towers and software providers. By 2021, the number of connections could reach between 50 and 100 million. Accenture, an international consulting and technology company, estimates that American telecom operators will invest around USD 500 billion in infrastructure over the next few years, creating up to 3 million new jobs. According to Qualcomm, a wireless communications equipment manufacturer, 5G will make it possible to achieve an economic output of around USD 12.3 trillion by 2035, equivalent to total US consumer spending in 2016.

The 5G promises are only starting to impact stock prices



Artificial Intelligence

Could it be a major disruptive trend like the invention of printing or the industrial revolution?

According to Wikipedia, "Artificial intelligence (AI) is the ability of a computer programme or a machine to think and learn". It is seen as technology that can be embedded in almost every stage of a company's value creation process and can impact almost every area. It is closely associated with Industry 4.0 and is characterised by the combination of Big Data and computing power. A survey conducted by MIT Sloan (a management school) and Boston Consulting (an international strategy consultancy) among 3,000 companies in 17 countries found that 60% of them expect Artificial Intelligence to have a far-reaching impact on their processes and products. The most impacted industries should be technology, media, telecom operators, consumer staples, financial services and health care. The least-concerned is the public sector. The main consequences of Artificial Intelligence are improved productivity, cost reductions and the human-machine collaboration. According to PricewaterhouseCoopers (a consulting and audit firm), Artificial Intelligence will contribute up to USD 15.7 trillion to the global economy over the next 15 years.

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CONSUMERS BECOME HYPER-CONNECTED

NEW TRENDS IN DIGITAL CONSUMPTION

○ LONG-TERM **▮** MODERATE / ADVANCED RISK

CONSUMERS BECOME HYPER-CONNECTED: NEW TRENDS IN DIGITAL CONSUMPTION



On the back of technological progress, especially in telecoms (4G, 5G, smartphones), chips and ever-more powerful components, consumers now have access to a whole new range of products and services. They spend more and more time surfing the Web and want new experiences and leisure activities. The e-commerce market is estimated to expand from USD 1.8 trillion in 2018 to USD 2.7 trillion in 2023. Online providers and services are growing as well in streaming, gaming, sport, augmented reality, etc. So who will be tomorrow's winners?

OUR RECOMMENDATIONS

This technology theme is aimed at dynamic investors, who are interested in innovation, the progress in the Internet and new means of communication.

There are many (large) companies listed on the US equity markets to play this theme. In addition, many funds, trackers, structured products and private equity make it possible to invest in this theme.

Other major regions of the world (Europe and Asia) are enjoying a boom in this area. North-East Asia has even overtaken the West, in a whole new range of consumer applications.

Given the intrinsic volatility of this type of investment, a long-term horizon is recommended.

MAIN RISKS

After the resounding success of giants such as Amazon, many entrepreneurs dream of becoming the next 'Jeff Bezos'. Consequently, there is a huge number of start-ups, and **competition** in the sector is **fierce**.

The enthusiasm around some fabulous success stories and the search for growth in a world where it is slowing down substantially have led to **valuations that have sometimes become very rich**.

Some companies that are not very mature or profitable have tried their luck on the stock market with **sometimes consequential setbacks**. For example, Uber and WeWork's IPOs (initial public offerings) went pear-shaped!

So investors must be **selective**, especially in view of the rally in technology stocks in 2019.

This is a 'Business to Consumer' ('B2C') theme, which means that it relates to the sale of products and services by a business to an end customer. That said, the theme may also be played by investing in key companies in the 'Business to Business' ('B2B') segment (e.g. digital financial services, targeted advertising, cyber security).

Context

Disruptions and new technologies are creating new products, services and consumer habits. For example, digital transformation enables consumers to order products online and gain access to a new range of services on the Web. Moreover, they enjoy greater quality, faster connection speeds, customisation and reliability.

Consumers are more and more connected via their smartphone or laptop, which are gateways to an exponentially-growing digital universe. They are looking for new digital experiences and leisure activities and are more demanding. The economy of this new virtual world is growing. Indeed, it is striking to see the value acquired by some web-based companies, such as Uber even though it has no vehicles, Facebook which does not create content, and Airbnb which owns no property!

What do consumers spend more and more time doing on the Web and what are they buying?

E-commerce: everything is done so that customers no longer have to go into a physical store if they have no time or just don't want to. The improved quality of photos, 3D images, and online financial services has allowed customers to make purchases sitting comfortably in their armchair.

Streaming: consumers can now choose what film or series they want to watch, and when. They also have a wide choice of live and retransmitted sporting events via the Internet. The quality of the onscreen image and Internet connection speeds are much better these days thanks to next generation telecom networks. The leader Netflix is threatened by newcomers, such as Walt Disney, AT&T, Comcast, Amazon and Apple.

e-Gaming & e-Sport: older game consoles (Play Station, Nintendo, Xbox, etc.) now face strong competition from online gaming. E-sport tournaments are now played in venues filled with thousands of spectators, who attend such events as though they were going to a concert.

'BLACK FRIDAY' US ON-LINE PURCHASES HAVE BEEN A BIG SUCCESS WHEREAS RECEDED IN TRADITIONAL SHOPS



Source: Bank of America Merrill Lynch, Adobe Analytics

Augmented reality: nowadays you can walk around whilst using your smartphone, and for example hunt for a Pokemon hidden in your favourite park. In the comfort of your own home, you can play tennis or dance in a virtual setting, which may seem more real than reality! Google has developed eyeglasses that take wearers into a virtual world from wherever they are.

The sharing economy: it is no longer necessary to own a car or a holiday home. Through Uber, Airbnb and Booking, people have access to gigantic databases of cars with drivers, resorts and luxury hotels. So what's changed? As a user, it is easy to impose very strict criteria, keep tabs on one's choices and, above all, check out the experience of previous users, or even share one's own experience with others!

What key B2B services are being developed to support online consumption?

Online payments: because all purchases must be paid for, there is a need for powerful, reliable and efficient online payment facilitators.

Online advertising: in our capitalist world, consumers are encouraged to spend increasingly more. Nowadays it is conducted in a very efficient way: certain companies indeed specialise in targeted sales and marketing.

Cyber security: consumers need to be sure that their data are well protected, and nobody other than the online product and service provider can take their money.

01 02 03 04 05 06 07 08 09 **10**

INNOVATIONS IN HEALTH CARE

TECHNOLOGY MULTIPLIES DISCOVERIES AND NEW APPLICATIONS

○ LONG-TERM **▮** MODERATE / ADVANCED RISK



INNOVATIONS IN HEALTH CARE: TECHNOLOGY MULTIPLIES DISCOVERIES AND NEW APPLICATIONS



The health care sector is outpacing the rest of the economy. On the back of growth of the Internet, means of communication, Big Data, data storage, and Artificial Intelligence, health care is progressing considerably at every level.

There are new powerful methods of research and development, new (types of) treatments, tools and services. Therapies and health care centres are being managed more efficiently thanks to large amounts of quality data available and a better exploitation of the latter.

OUR RECOMMENDATIONS

This theme is aimed at dynamic investors who are willing to take some risk, because innovation does not always produce the expected benefits.

The most dynamic companies in this area or the fastest-growing ones—are often small- and medium-sized enterprises (SMEs). However, the risk is often higher because these companies are less mature, less diversified and have fewer resources than large companies operating in this innovative industry.

Therefore, parallel to investing in stocks of a handful of leading companies, in riskier sub-segments, we like investing in diversified funds, which are managed by highly-specialised professionals.

A long-term investment horizon is recommended for this relatively risky industry.

MAIN RISKS

Although the health care sector is structurally one of the most profitable, it also carries risks:

News flow around the forthcoming US election is causing volatility. Left-wing candidates, for example, want to make public certain privately-run services. Their aim is to make drastic cost savings for the patient. This should squeeze sales and profits of industry players.

In the meantime, the American President and Congress are working on lowering health care costs. Established companies are more at risk given their product portfolio (which is older on average) and the will of regulators to foster innovation.

Costs and failure rates are high in the initial stages of research. Despite some great success stories, many start-ups are forced to close down rapidly.



On the back of growth of the Internet, means of communication, Big Data, data storage and Artificial Intelligence, the whole health care industry is changing considerably at every level.

Research and Development

Genome-sequencing costs have fallen sharply in recent years thanks to more powerful computers and chips. This phenomenon has led to the development of new research and treatments through genome analysis. Moreover, significant progress has been made in designing and developing:

- Medical equipment/devices and ancillary activities, such as the huge field of medical imaging
- Laboratories (which have some automation)
- Diagnoses
- Treatments

Medical treatments and equipment

A revolution is taking place in treatment methods. Surgeons are being **assisted by robots** providing improved images and visibility, a higher resolution and focus, more stability during operations (for instance, reduced hand trembling), more flexibility and convenience for operating (e.g. remotely). The patient should receive better treatment and recuperate more quickly, with fewer complications during and after the operation. Furthermore, progress is being made in:

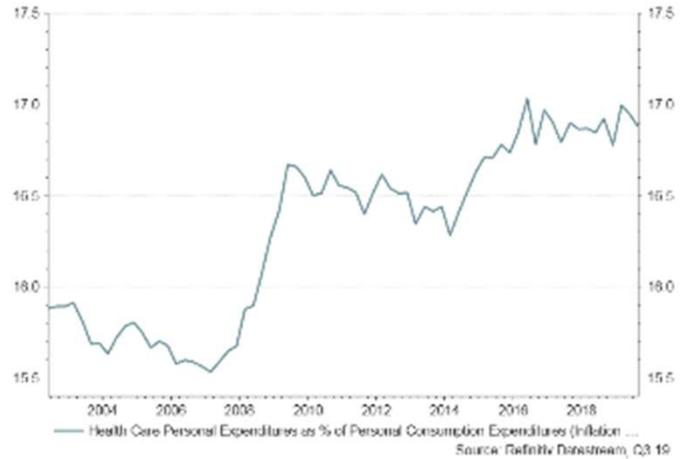
Biotechnology: Sector players are maturing and some are very profitable. For example, new therapies related to genome analysis are booming. Promising research is CAR-T (Chimeric Antigen Receptor) therapy, which consists of repairing or replacing damaged cells and stimulating the implanted healthy cells (via immunotherapy). There are a host of outlets in oncology or in the treatment of rare diseases.

Personalised treatment: thanks to a large amount of data on a patient.

In addition to robots, there is an emergence of new generations of implants, (more sophisticated) bionic products manufactured, with advanced materials, which the human body can cope with much better.

Other increasingly sophisticated devices help to detect pathologies (heart disease, diabetes) more rapidly.

HEALTH CARE PERSONAL EXPENDITURES IN THE US
AS % TOTAL PERSONAL CONSUMPTION EXPENDITURES



More efficient health care centres

The explosion of data, the Internet of Things, the Cloud and new means of communication have led to **greater efficiency and better exchanges**.

At hospitals and clinics, digital data are less likely to get lost (X-rays and other heavy files can be sent easily). Nowadays thousands of data on a patient can be stored electronically.

More accurate and detailed data analysis.

Some diagnoses can be made remotely via video or online. Doctors and businesses specialise in this sub-sector.

It is really important that data on patients are protected and their privacy respected. Again there are specialised companies in this area.



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