Monthly Investment Brief

A spike of uncertainty

March 2020

The global economic outlook has darkened considerably in recent weeks. Although the spread of the coronavirus seems to be slowing in China, business activity there has dropped even more than expected (with the PMI manufacturing index at 35.7). What's more, the virus is now spreading quickly outside of China, particularly in certain parts of Asia and Europe and particularly severely in northern Italy. The US are not spared.

Economic indicators had been showing some signs of recovery, but it was hard to get an exact reading on the situation, given the uncertain state of trade relations and a weakened manufacturing sector. Against this backdrop, supply chain disruptions will inevitably undermine growth prospects.

So, what could happen?

First of all, given the uncertain contours of this shock to the economy, there is no point in venturing any precise forecasts on its macroeconomic or market impact. The path that the public health emergency will take and the political response to it are two parameters that could alter the trajectories of risky assets. By injecting liquidity, central banks will have a major role to play in preventing bankruptcies, particularly among smaller companies.

Even if lowering rates or injecting liquidity (as the FED has just done) helps to limit the deterioration of financial conditions and restore confidence, this does not solve the supply problem we are facing. Governments have limited room for manoeuvre due to their debt levels and are unlikely to be able to compensate with strong stimulus policies. Thus, in our scenarios we must now consider a contraction in world real GDP in the first quarter. The prolongation of the combined supply and demand shock could cause the world economy to possibly stall for the year.

What indicators should we keep an eye on in the next few months?

- Credit spreads (an indicator of rising default rates)
- Company sales and profit warnings
- Macroeconomic figures
- Consumer confidence
- Announcements of central bank and government policies
- Infection rates

One more thing: here's a small indication that the markets have certainly not bottomed out. Prior to the correction, the US equity market was trading at 19 times forward earnings (based on a +9% forecast for 2020). It is now trading at 16.50 or 17. And what will happen if earnings growth is revised down to zero? That would put us right back at 18 or 19. With this in mind, we could see a repeat of last week's losses before returning to entry points that better reflect this risk.

This may indeed be what we are now seeing – a broad repricing of risk with higher volatility and, as a corollary, future investment opportunities. In the meantime, we reiterate the cautious message that we issued last month. Be patient: an exogenous shock like this cannot be reabsorbed within a few days. That being said, rising temperatures should ultimately rein in the health risk, along with the virus's global mortality rate. Let's hope so.

In the longer term, the question of relocating and centralizing value chains must be already be addressed. For what costs and benefits in the medium and long term? Just-in-time processes have also raised the issue of precautionary inventories and the impact on supply in the event of inventory shortages.

How will companies react in adjusting to this new environment? We got some initial hints during the trade war and this will lead to decisive choices in portfolios and no doubt new value creators will emerge. It is up to us to capture this new trend...

01 CURRENT CONVICTIONS

Scenarios

Our 6-month view

Central scenario: Global growth negatively impacted by coronavirus outbreak, but disruptions are only temporary

Europe

- Coronavirus outbreak causing disruptions on the supply side and the demand side and will negatively affect economic growth at least in the first quarter of 2020
- Accommodative monetary policy prolonged at least until 2021
- Fiscal policy action still being discussed, mostly aimed at demand-side shocks

US

- Economy to stagnate at least in the first quarter on the back of coronavirus outbreak
- Fed already resumed rate cut cycle with 50 bps emergency rate cut
- Fiscal policy action still being discussed, mostly aimed at demand-side shocks

65%

Assets to overweight

- Equities
- Credit

Assets to underweight

- Sovereigns

Strategy

- Flexibility
- Hedging (options, gold,…)

Alternative scenario: Interest rate risk fueled by surprise jump in the US inflation and growing US budget deficit

- Wage acceleration
- Surging oil prices fuelled by an escalation of political tensions in Middle East
- Reduction of growth potential

10%

Assets to overweight

- Inflation-hedged bonds
- Alternative strategies
- Cash

Assets to underweight

- Equities
- Core Sovereigns
- High Yield credit

Alternative scenario: Increase in protectionism and contagion from geopolitics and pandemia extension

- Global recession with a risk on financial equilibrium
- Geopolitical risks materializing
- China: risks of economic rebalancing
- Brexit: No deal risk

25%

Assets to overweight

- Money Market CHF & JPY
- Volatility
- Core government bonds

Assets to underweight

- Equities
- High Yield credit

Source: ODDO BHF AM, comments as of 03/05/2020

Our current convictions for each asset class

Equities	Large cap Eurozone			0		
	Mid cap Eurozone			0		
	Small cap Eurozone			0		
	UK			0		
	USA			0		
	Emerging markets		-1			
	Japan		-1			
Convertible bonds	Europe				1	
	USA			0		
Currencies	USD / €			0		
	YEN / €			0		
	GBP / €			0		
Commodities	Gold				1	
	Crude oil			0		

Change vs the previous month

Source: ODDO BHF AM, comments as of 03/05/2020

Our current convictions for each asset class

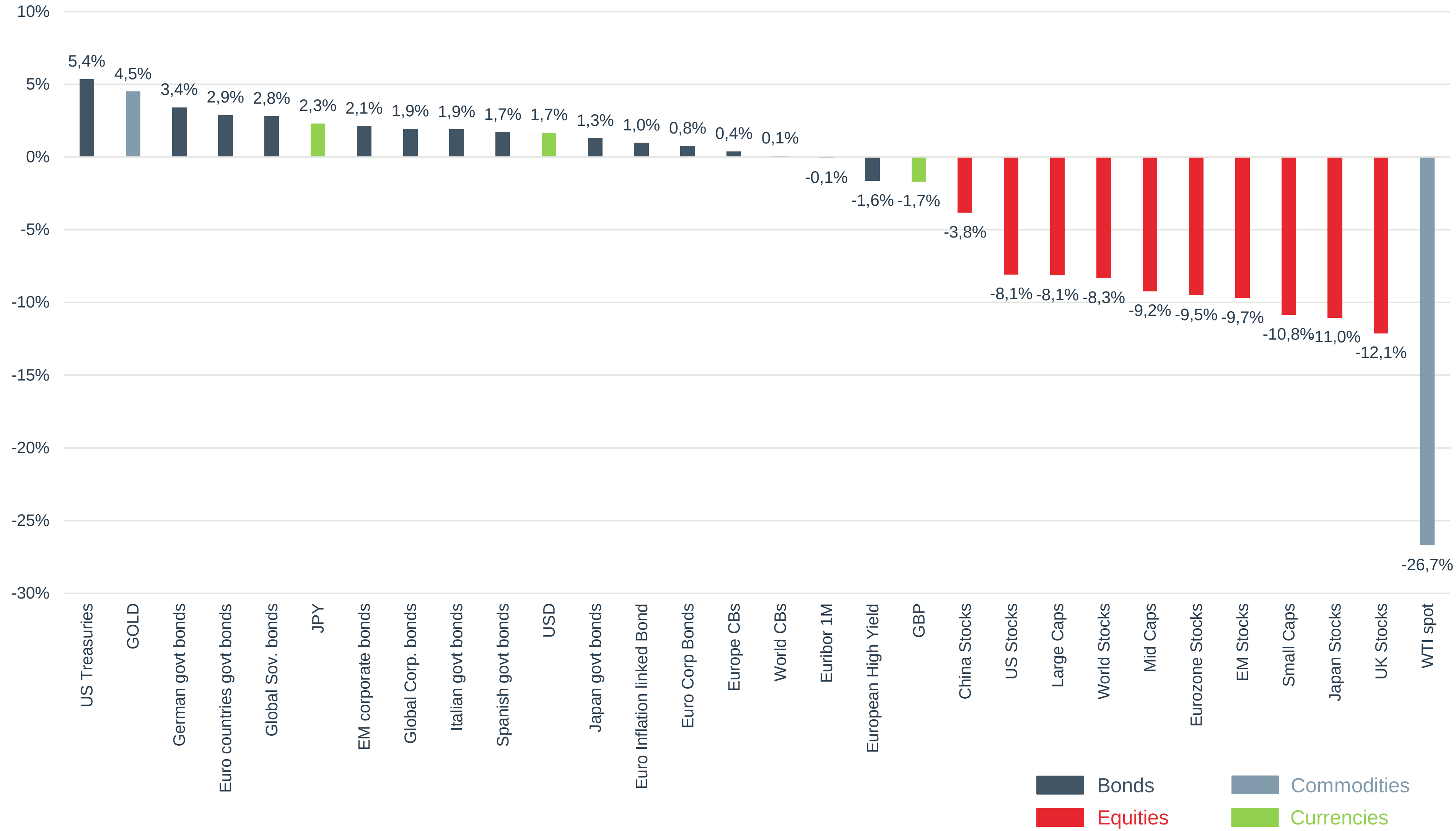
Government bonds	Core Europe	0
	Peripheral Europe	0
	USA	0
Corporate bonds	Investment grade Europe	1
	Credit short duration	0
	High Yield Europe	-1
	High Yield USA	-1
	Emerging markets	0
Money market	Developed markets	1
Alternative assets	Private Equity	1
	Private Debt	1
	Real Estate	0
	Hedge Fund	1

Change vs the previous month

Source: ODDO BHF AM, comments as of 03/05/2020

02 MACROECONOMIC AND MARKET ANALYSIS

Year-to-date performances of asset classes



Past performances are not a reliable indicator of future performances and are not constant over time.

Sources: Bloomberg and BoA ML as of 02/28/2020; performances expressed in local currencies

Historical performances of asset classes

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020 YTD
US equities	-37.6%	26.3%	14.8%	1.4%	15.3%	31.8%	12.7%	0.7%	10.9%	21.2%	-5.0%	30.9%	-8.1%
Eurozone equities	-44.9%	27.3%	2.4%	-14.9%	19.3%	23.4%	4.3%	9.8%	4.4%	12.5%	-12.7%	25.5%	-9.5%
WTI spot	-53.5%	77.9%	15.2%	8.2%	-7.1%	7.2%	-45.9%	-30.5%	45.0%	12.5%	-24.8%	34.5%	-26.7%
Gold	5.1%	25.5%	29.4%	10.1%	7.1%	28.1%	-1.4%	-10.6%	8.0%	13.5%	-1.6%	18.3%	4.5%
EM sovereign bonds	-10.9%	28.2%	12.0%	8.5%	18.5%	-6.6%	5.5%	1.2%	10.2%	9.3%	-4.6%	14.4%	0.9%
EM corporate bonds	-12.4%	30.9%	9.2%	5.6%	13.2%	-1.3%	3.9%	-1.0%	5.5%	7.3%	-1.4%	11.6%	2.8%
EM equities	-53.3%	78.5%	18.9%	-18.4%	18.2%	-2.6%	-2.2%	-14.9%	11.2%	37.3%	-14.6%	18.4%	-9.7%
European High Yield	-34.2%	74.9%	14.3%	-2.5%	27.2%	10.1%	5.5%	0.8%	9.1%	6.7%	-3.6%	11.3%	-1.6%
Eurozone Gvt bonds	9.1%	4.4%	1.1%	3.3%	11.2%	2.3%	13.2%	1.6%	3.3%	0.1%	1.0%	6.8%	2.9%
US Gvt bonds	14.0%	-3.7%	5.9%	9.8%	2.2%	-3.4%	6.0%	0.8%	1.1%	2.4%	0.8%	7.0%	5.4%
German Gvt bonds	12.2%	2.0%	6.2%	9.7%	4.5%	-2.3%	10.4%	0.3%	4.1%	-1.4%	2.4%	3.1%	3.4%
Euro Libor 1m	4.0%	0.7%	0.4%	0.9%	0.2%	0.1%	0.1%	-0.1%	-0.3%	-0.4%	-0.4%	-0.4%	-0.1%
Spreads (%age points)	**67.5%**	**82.2%**	**28.9%**	**28.5%**	**34.3%**	**38.4%**	**59.0%**	**40.3%**	**45.4%**	**38.7%**	**27.2%**	**34.9%**	**32.1%**

Past performances are not a reliable indicator of future performances and are not constant over time.

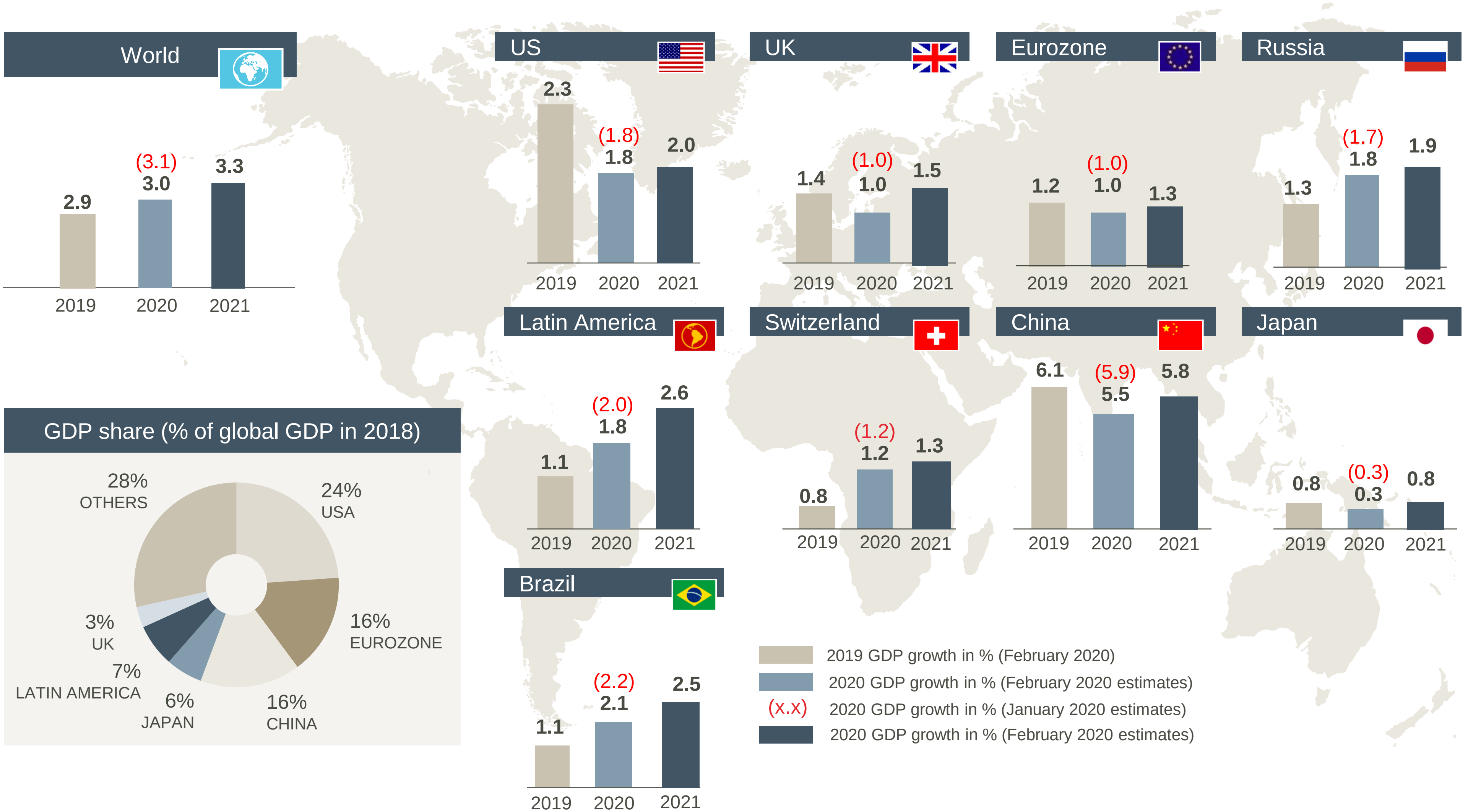
Colour scale

Best performance											Worst performance
1	2	3	4	5	6	7	8	9	10	11	12

Sources: Bloomberg and BoA ML as of 02/28/2020 ; performances expressed in local currencies

Global GDP* growth forecast

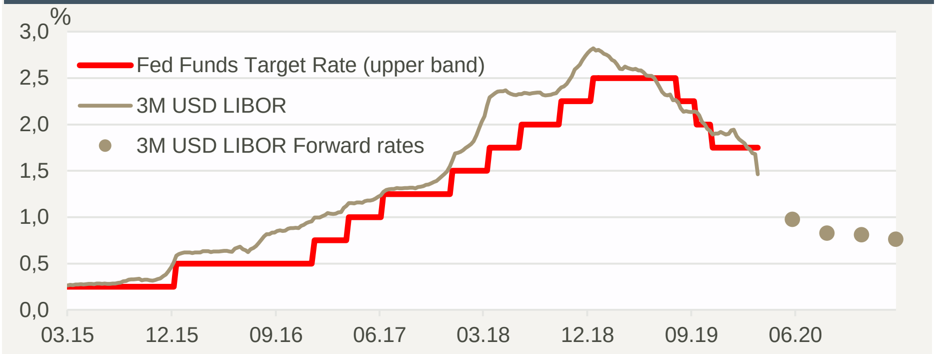
Severe down revisions are underway – global recession in H1 quite likely



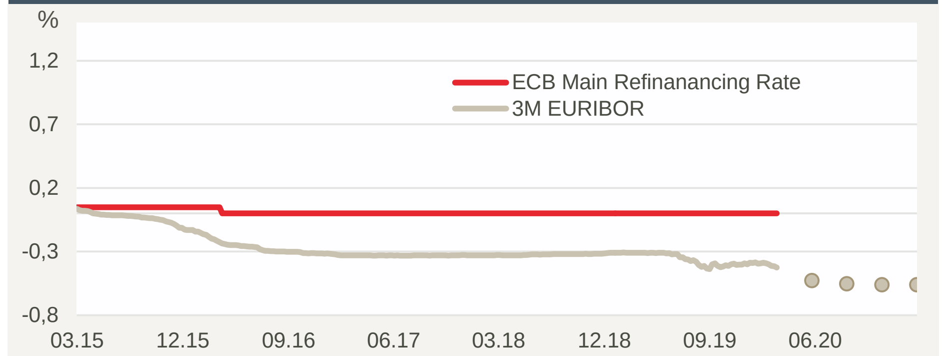
*GDP: Gross Domestic Product | Sources: ODDO BHF AM SAS, Bloomberg economist consensus forecast | Data as of 02/28/2020

Monetary policy & inflation expectations

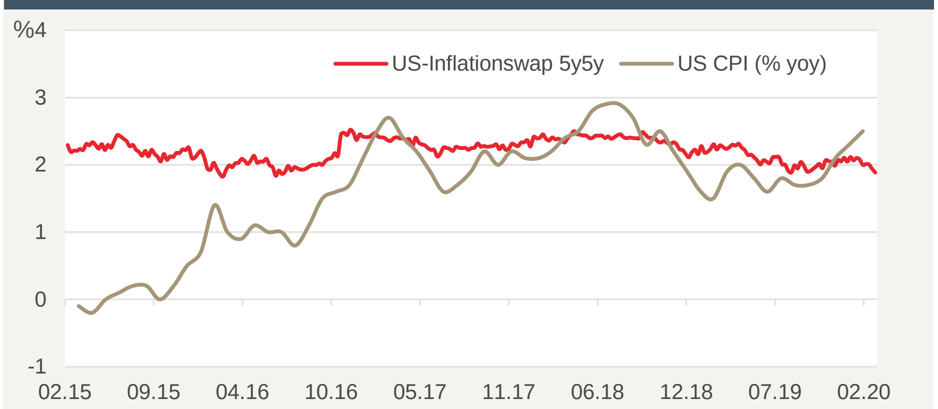
Fed Funds Target Rate, 3M USD LIBOR & 3M USD LIBOR FRAs



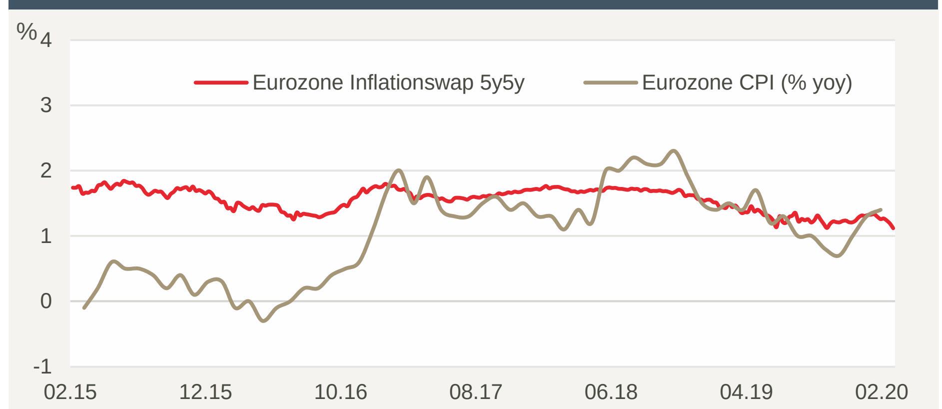
ECB Main Refinancing Rate, 3M EURIBOR & 3M EURIBOR FRAs



Market-implied inflation expectations (5y5y) & US CPI (%yoy)



Market-implied inflation expectations (5y5y) & Eurozone CPI (%yoy)



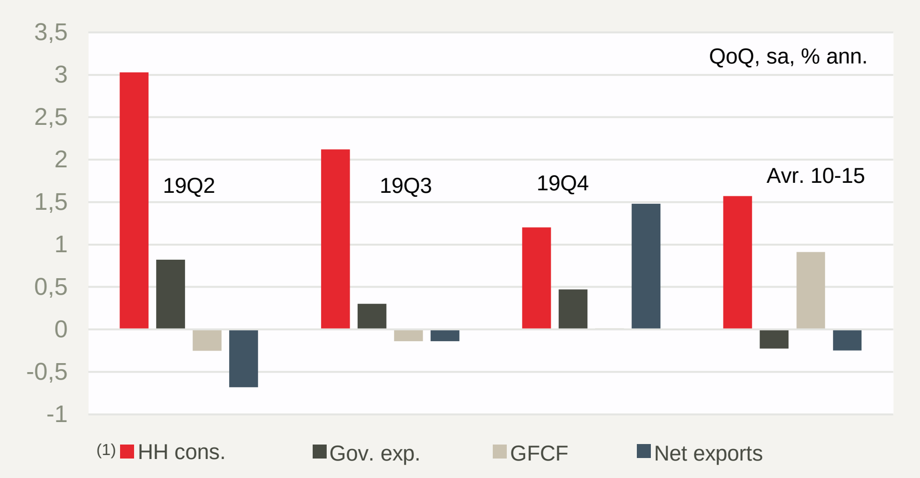
- FED delivered a 50bp emergency cut on March 3rd
- More to follow from the FED over the next months
- Other CBs and even the ECB are likely to follow in an effort to stem uncertainty and keep credit channels open
- Although monetary policy is not adequate to tackle a supply shock, it nevertheless may stabilize sentiment

Sources: Bloomberg, ODDO BHF AM GmbH, as of 02/28/2020

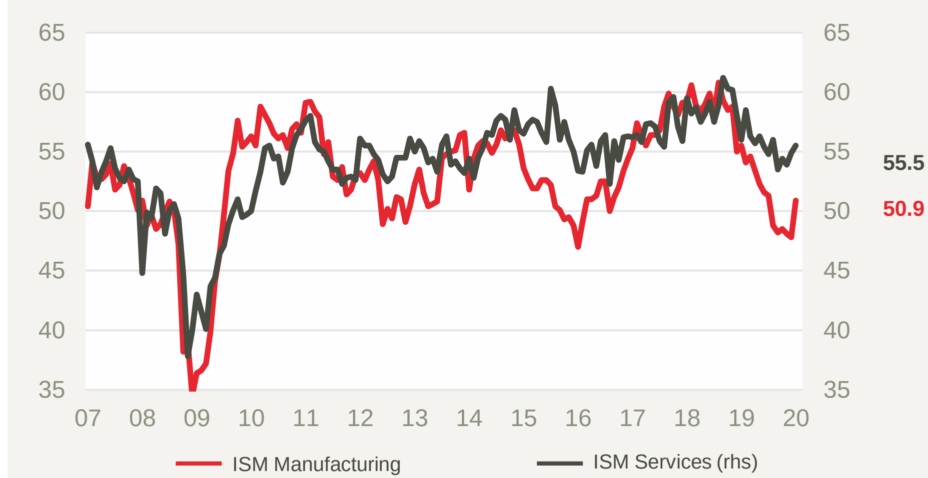
USA

Tentative signs of weakness only below the surface yet

Contributions to GDP (QoQ, seasonally adjusted, % annualised)*



Business confidence**



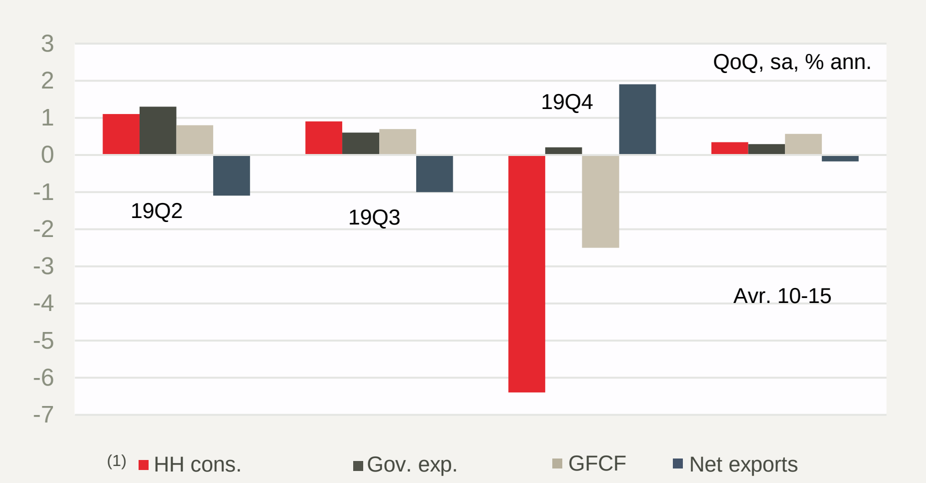
- Indications of any weakness in February reports have been scarce so far
- On the contrary, regional Fed reports, housing and employment suggest even an acceleration in early 2020
- However, supply chain disruptions and a hit to consumer sentiment will dampen growth considerably
- GDP probably reduced to 1-1.25% in 2020
- U-shaped recovery likely when impact of virus ebbs, but difficult to judge whether H2 is already on the rebound leg of the U
- More Fed easing to come

(1) HH cons.: household consumption / Gov. exp.: government expenditure / GFCF: gross fixed capital formation Net exports.
Sources: Bloomberg, Thomson Reuters, Datastream, ODDO BHF AM SAS. *Data as of 12/31/2019 | **Data as of 01/15/2020

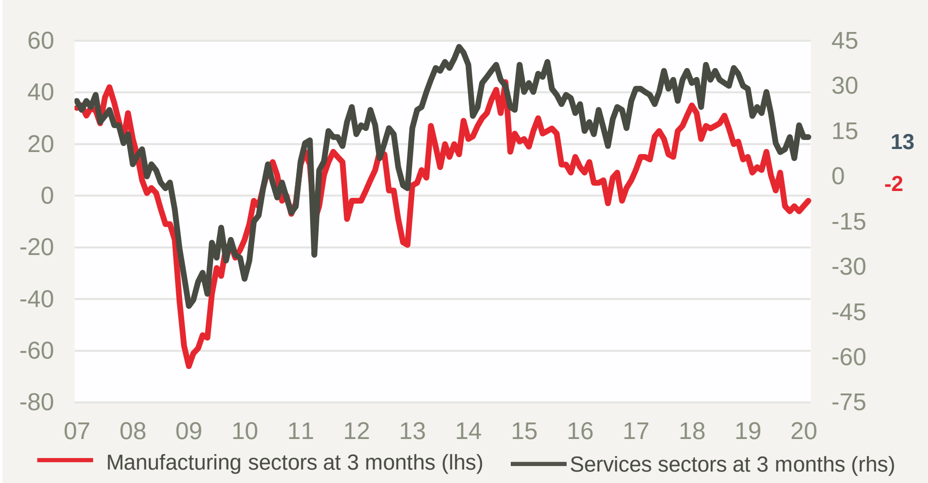
Japan

Recession ahead

Contributions to GDP (QoQ, seasonally adjusted, % annualised)*



Business confidence**



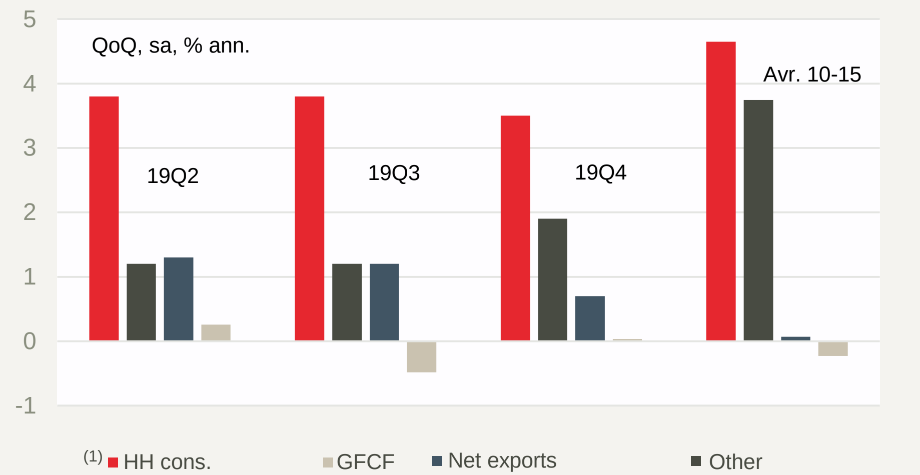
- Japan is likely to enter recession in Q1 after an already negative Q4
- GDP for the whole of 2020 is also expected to be negative as the virus shock hits and consumers are still suffering from the VAT hike in autumn
- IP rose in January for the second consecutive month, but production still remains weak
- The job-offers-to-applicant ratio fell sharply in January, sending an early signal of a weakening labor market

(1) HH cons.: household consumption / Gov. exp.: government expenditure / GFCF: gross fixed capital formation (investment) Sources: Bloomberg, Thomson Reuters, Datastream, ODDO BHF AM SAS. *Data as of 12/31/2019 | **Data as of 02/15/2020

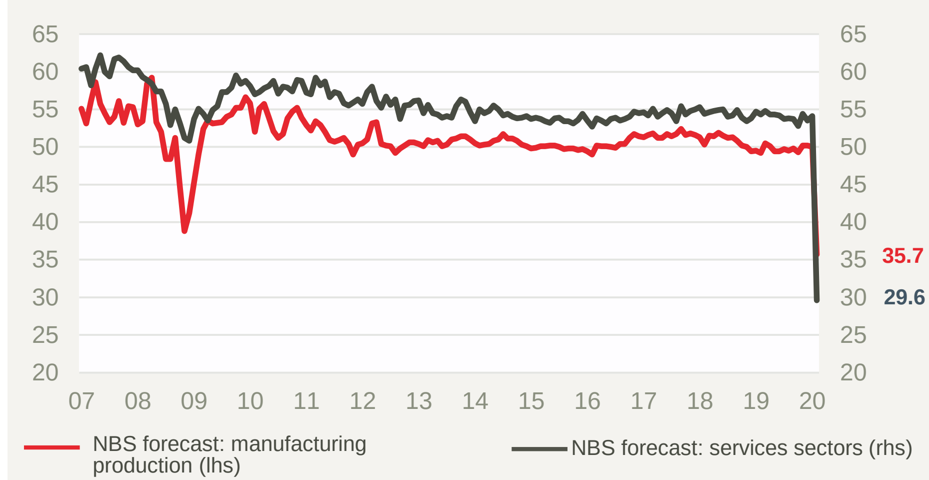
China

Production slowly picking up

Contributions to GDP (QoQ, seasonally adjusted, % annualised)*



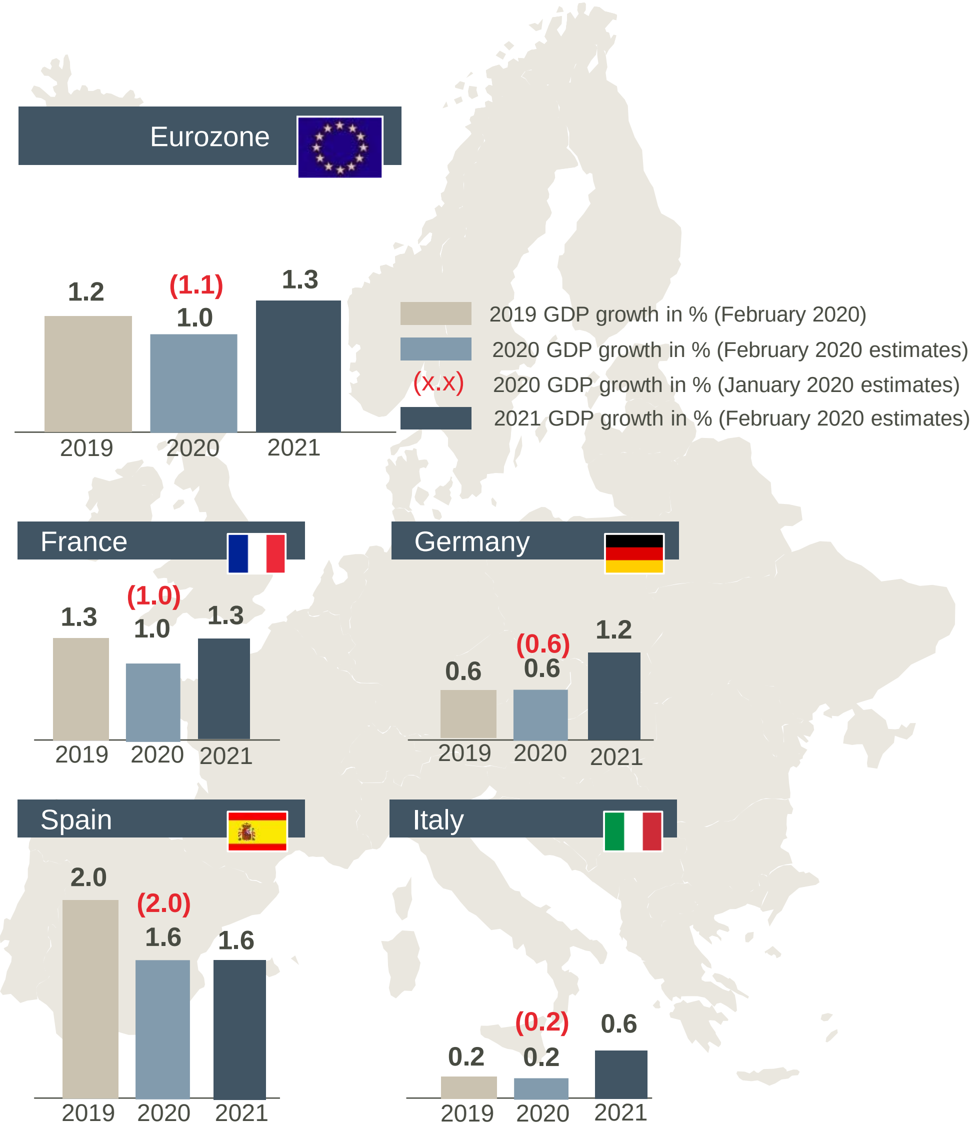
Business confidence**



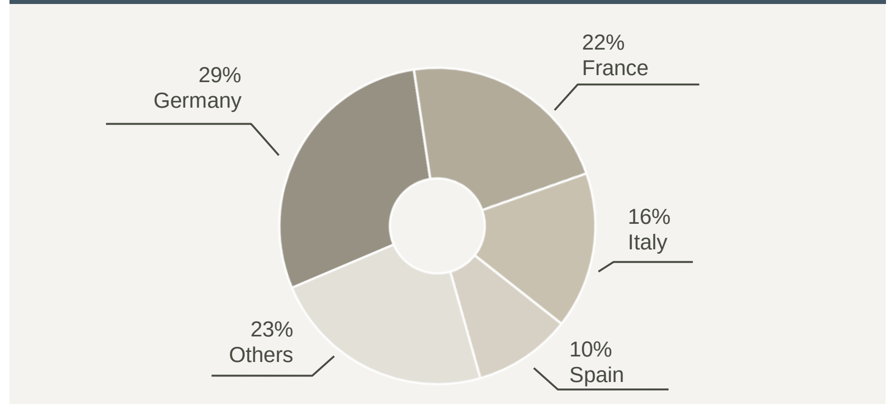
- PMI (official and Caixin) have collapsed to the lowest levels in history
- Q1 GDP to contract sharply with a high risk of a weak Q2, a significant rebound likely in H2
- But catch-up most probably insufficient to make up for loss in demand in 2020
- High-frequency indicators suggest that production is slowly picking up, albeit from depressed levels

(1) HH cons.: household consumption / Gov. exp.: government expenditure / GFCF: gross fixed capital formation (investment)
Sources: Bloomberg, Thomson Reuters, Datastream, ODDO BHF AM SAS. *Data as of 12/31/2019 | **Data as of 02/15/2020

Eurozone



GDP share (% of total Eurozone GDP)



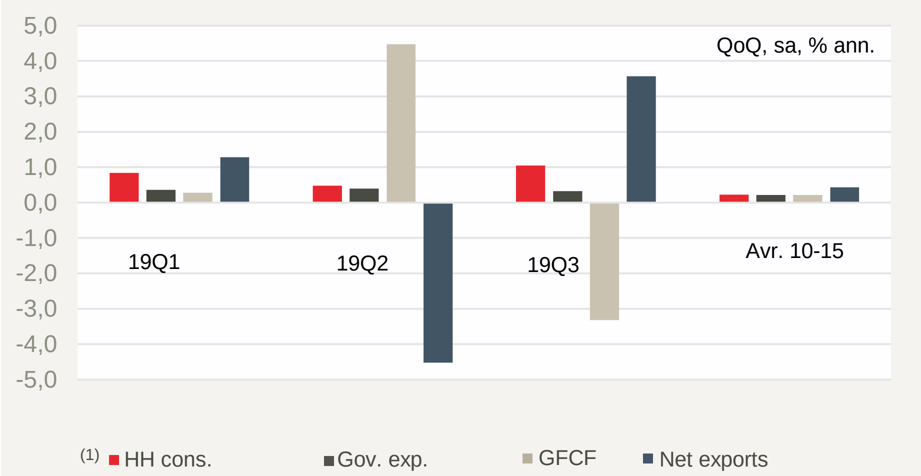
- Visibility of economic impact remains quite low
- Recession risk in H1 is quite elevated as supply shock hits and demand shock is developing for an already fragile economy
- Germany and Italy are the weakest links in the EZ, while France posted a negative GDP in Q4 but is likely to see some pick-up from the strike induced disruptions in December and January

Sources: ODDO BHF AM SA; Bloomberg Economist Forecast. Data as of 02/2020

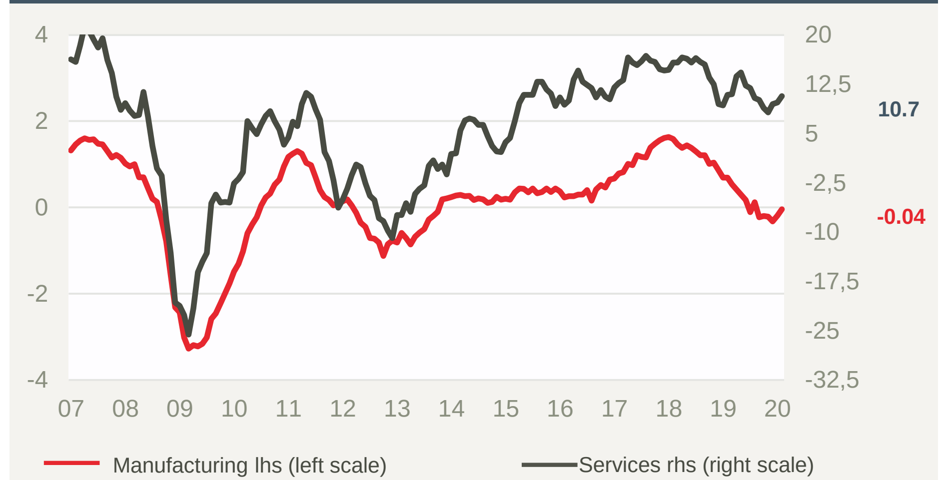
Eurozone

Do not mention the R-word

Contributions to GDP (QoQ, seasonally adjusted, % annualised)*



Business confidence**



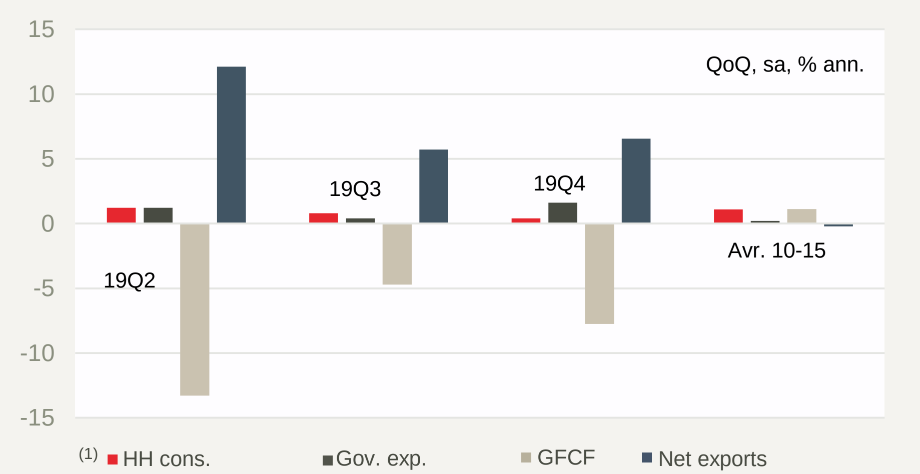
- Pre-corona data had suggested a reacceleration of growth
- But hit to growth could be quite substantially
- Risk for a technical recession has risen substantially for Italy and Germany as growth had been negative or flat in Q4 already
- ECB is likely to join the global monetary bazooka in an effort to stem the outbreak impact
- Fiscal leeway will also be used, even in Germany

(1) HH cons.: household consumption / Gov. exp.: government expenditure / GFCF: gross fixed capital formation (investment)
Sources: Bloomberg, Thomson Reuters, Datastream, ODDO BHF AM SAS. *Data as of 09/30/2019 | **Data as of 02/15/2020

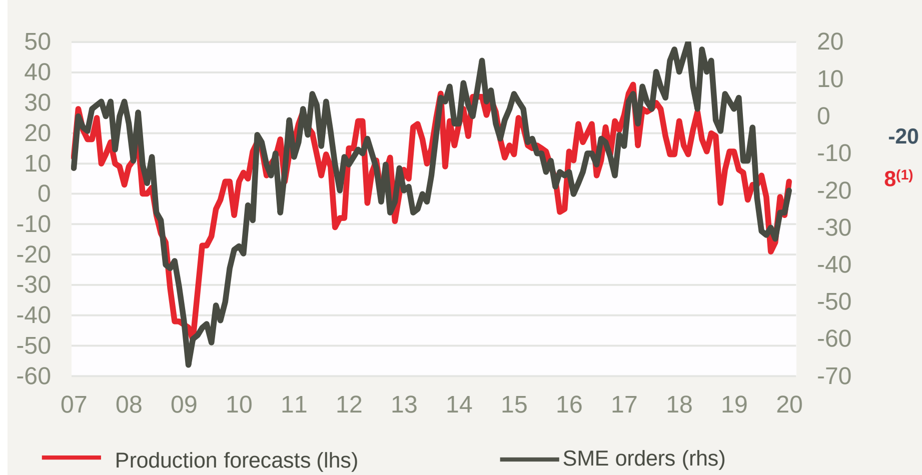
United Kingdom

Brexit negotiations are getting serious

Contributions to GDP (QoQ, seasonally adjusted, % annualised)*



Business confidence**



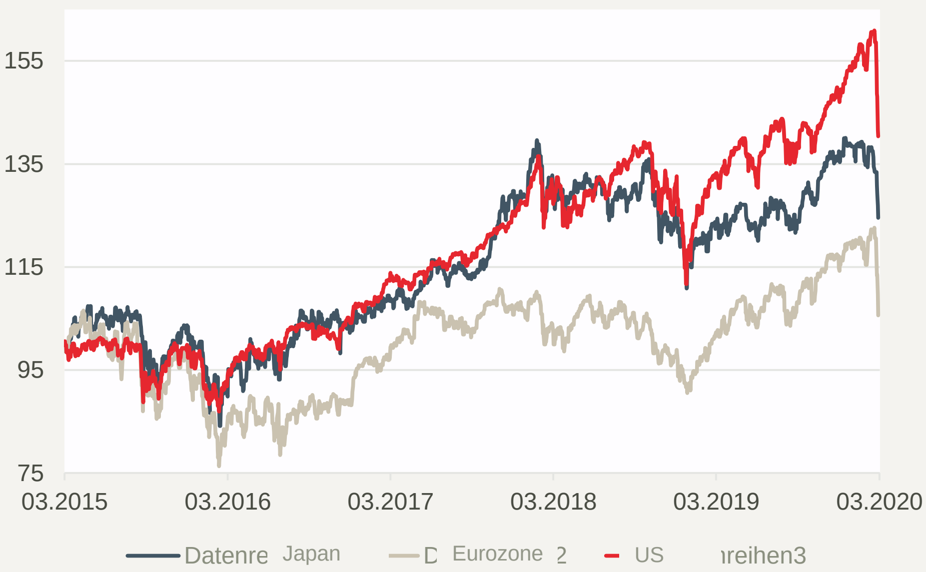
- UK not shielded from virus disruption
- Policy response at this stage becomes likely
- Brexit negotiating guidelines published with talks to start next week

Monthly Investment Brief

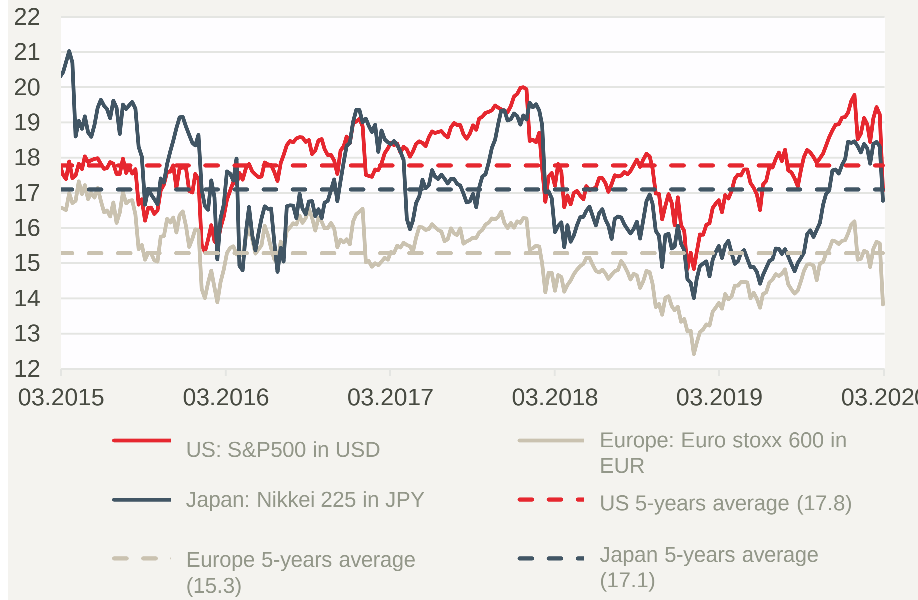
(1) HH cons.: household consumption / Gov. exp.: government expenditure / GFCF: gross fixed capital formation (investment)
Sources: Bloomberg, Thomson Reuters, Datastream, ODDO BHF AM SAS. *Data as of 12/31/2019 | **Data as of 01/15/2020 | (1) data as of 02/15/2020

A sudden reversal

5-year equity market performance



5-year price/earning ratio



- February appeared like a caricature repeat of January. Developed markets initially reached new highs (driven by decreasing yields from sovereign bonds), ignorant of not so rosy data figures and ever mounting Covid cases in Asia.
- The last week was a sudden reversal, taking index performances in negative YtD territories. S&P500 lost -12% in 5 days, a weekly loss not seen since 2008. With this acknowledgment of the global threat of Covid, volatility (VIX) tripled to 40%.
- On the full month, S&P500 lost -8.4%, EuroStoxx -7.9% and the Topix -10.3%. Emerging market (in USD) fell only -5.3% and MSCI China eventually gained +1.3!

- With indexes taking the plunge much faster than expected earnings, immediate valuations ratios appear much lower.
- Taking into account the decreasing yields of risk-off assets, risk premia still appear quite rich.
- Due to the surge in volatility, perceived uncertainty and systemic risks, those higher risk premia may take time to diminish.

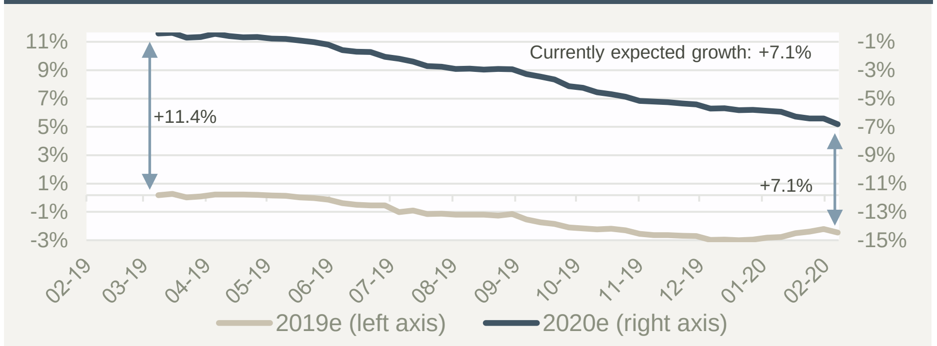
Past performances are not a reliable indicator of future performances and are not constant over time.

*See Glossary, page 27 | Source: Bloomberg, ODDO BHF AM SAS | Figures as of 03/02/2020

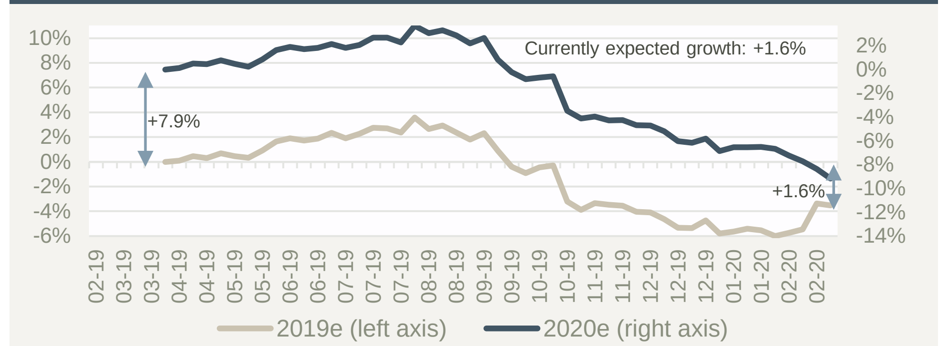
Equities – EPS trends*

2019 full year earnings were revised slightly upwards in the USA and UK, thanks to better than expected Q4 results…

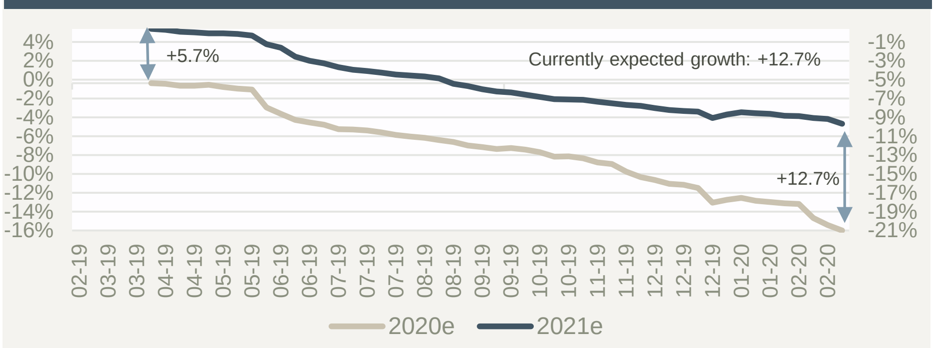
MSCI USA



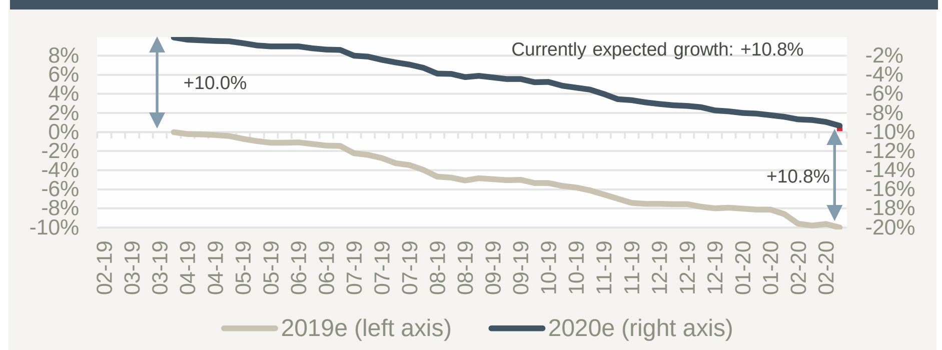
FTSE 100



Topix



Zone Euro



- …but revisions for current year are still trending downwards globally.
- In Europe and Japan, analyst’s expectations for 2020 results are broadly in line with what was already expected for 2019 one year ago and failed to be delivered by companies.

*revisions to estimated revenues and changes in expected growth

Sources: ODDO BHF AM SAS, Deutsche Bank AG/London. |Thomson Reuters | Figures as of 28/02/2020

European equities

Markets in the grip of corona: Earnings growth to be sharply revised downwards in the coming weeks

	12-month forward P/E, Mar. 2020	2017 EPS growth	2018 EPS growth	2019 EPS growth	2020 EPS growth	Dividend yield	YTD performance
STOXX Europe 600	13.6 x	21%	5%	2%	6%	4.0%	-9.7%
Commodities							
Basic resources	10.1 x	111%	-2%	-24%	11%	5.8%	-17.9%
Oil & Gas	9.6 x	83%	40%	-16%	12%	7.4%	-21.2%
Cyclicals							
Automotive and spare parts	6.7 x	34%	-10%	-18%	19%	4.5%	-17.3%
Chemicals	18.1 x	24%	4%	-11%	9%	3.0%	-11.8%
Construction and materials	14.3 x	13%	8%	17%	9%	3.4%	-9.0%
Industrial goods and services	16.0 x	14%	5%	7%	10%	2.9%	-10.6%
Media	14.2 x	10%	10%	0%	4%	3.8%	-11.9%
Technologies	20.1 x	11%	8%	7%	18%	1.5%	-6.2%
Travel & leisure	12.0 x	14%	-4%	-5%	13%	3.1%	-17.5%
Financials							
Banks	8.2 x	49%	13%	1%	2%	6.5%	-12.8%
Insurance	9.7 x	-9%	10%	7%	8%	5.8%	-11.7%
Financial services	15.4 x	16%	-42%	140%	-34%	3.3%	-7.1%
Real estate	17.4 x	12%	19%	1%	6%	4.1%	-5.9%
Defensives							
Food & beverages	19.0 x	10%	4%	7%	7%	2.8%	-9.1%
Healthcare	17.0 x	4%	4%	6%	7%	2.8%	-5.2%
Household & personal care	15.8 x	19%	7%	2%	6%	3.6%	-8.5%
Retailing	17.2 x	3%	6%	0%	8%	3.3%	-11.1%
Telecommunications	13.4 x	19%	-9%	-3%	9%	5.1%	-7.1%
Utilities	15.9 x	5%	-12%	24%	4%	4.6%	4.4%

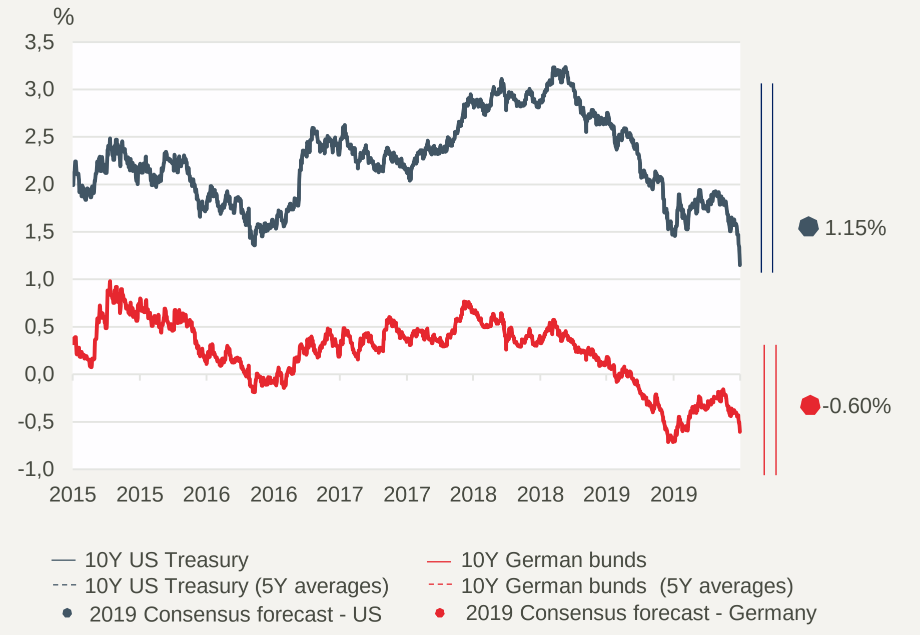
- After having reached new historical records, markets suffered towards month end a sharp correction not seen in 2008 as Coronavirus cases multiplied worldwide.
- In the face of this threat that prompted fears of a new global recession among the most pessimistic, the publication of good annual results took a back seat in investors' minds.
- No sector has been spared, with cyclicals logically being hit the hardest. With the return of credit stress and contamination in Europe, indebted securities and those linked to domestic consumption are undergoing heavy corrections.
- Only utilities remain resilient, posting by far the best performance in 2020. They are benefiting from sharply falling sovereign yields, but their relative valuations have been pushed to tight levels.
- We note a more resilient behaviour in relative terms for stocks with significant exposure to China, where the epidemic seems to be showing signs of stabilizing.
- The technology sector is showing some resilience despite supply chain concerns.
- With their underperformance over the last 6 months, the Food & Beverage and Staples sectors are returning to more attractive valuation levels, thereby improving the risk profile.

Source: ODDO BHF AM SAS, FactSet. Figures as of 03/02/2020

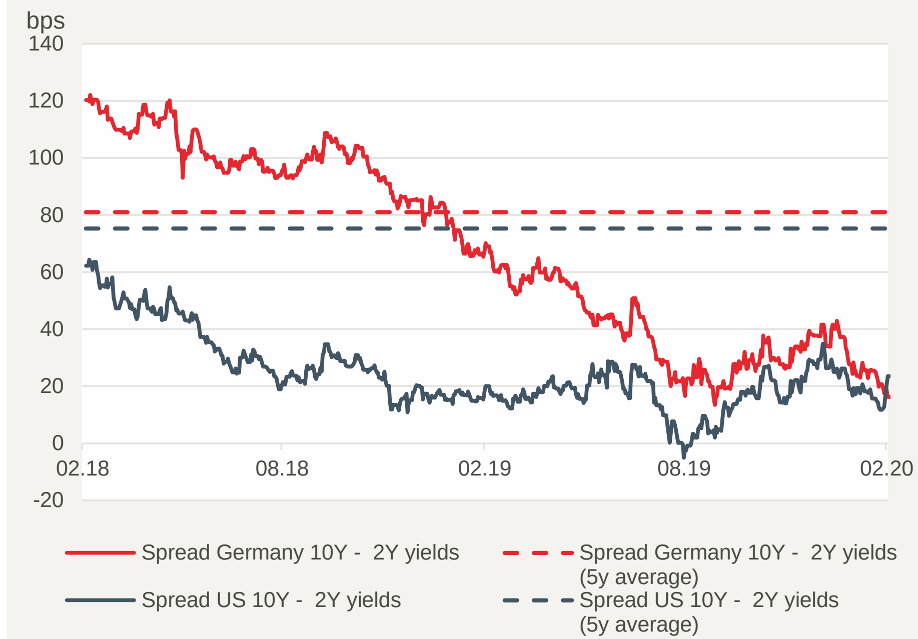
Fixed income – Rates

Will US-treasuries be the next negative rate regime?

German & US 10 - year bond yields (over 5 years)



German & US 2yr - 10yr yield curve (over 5 years)



- Rates have collapsed on mounting fears of the economic impact of the corona virus
- Treasuries have taken the lead as the FED is in cutting mode again
- With "economics of fear" at work and a high likelihood of further CB cuts, rates are likely to stay extremely low
- However, extreme positions and recessionary levels can produce quite significant rate spikes

- Steepening in the US continues as more FED cuts to 0,5% within the next months are priced in
- Bunds have bull-flattened as the front end has limited leeway to fall further

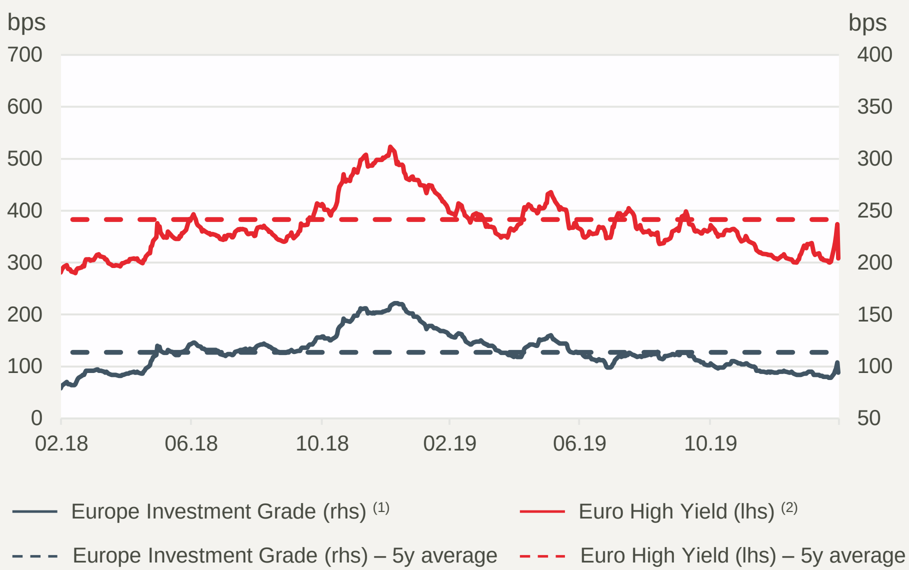
Past performance is not a reliable indicator of future performance and is not constant over time.

(1) Bloomberg Economic Forecast │Sources: ODDO BHF AM SAS, Bloomberg│LHS: Data as of 02/28/2020; RHS: Data as of 02/28/2020

Fixed income – Credit Spreads

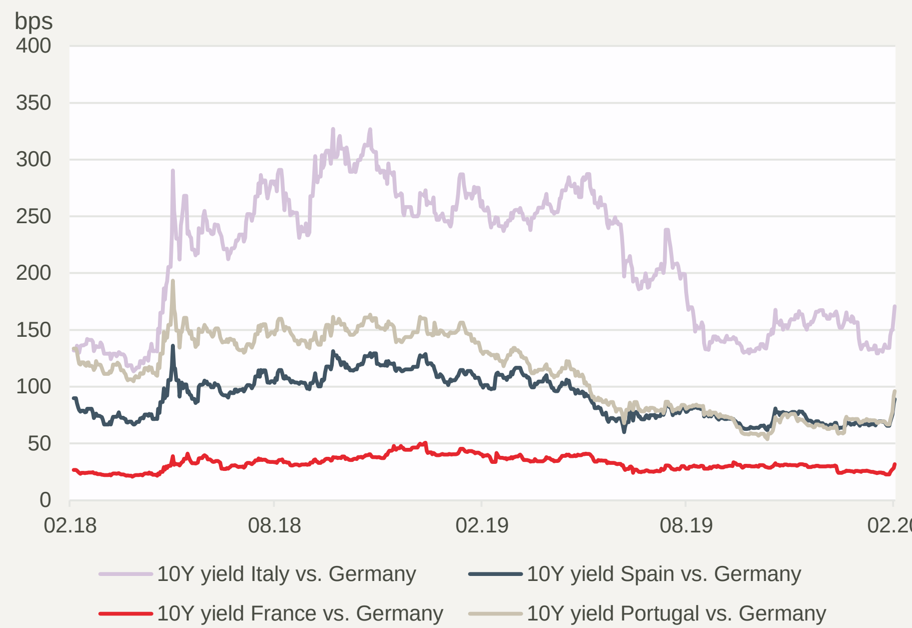
Wider spreads might lure first investors back

Credit spreads* IG & HY (over 2 year)



(1) BofA Merrill Lynch Euro Corporate Index (ER00)
(2) BofA Merrill Lynch European Currency High Yield Index (HP00)

Main Eurozone country spreads (over 2 years)



- Spreads have widened considerably over the recent weeks in anticipation of worsening economic conditions and liquidity concerns
- At the current level spreads reflect some cushion for a temporary negative shock but not for a deeper recession

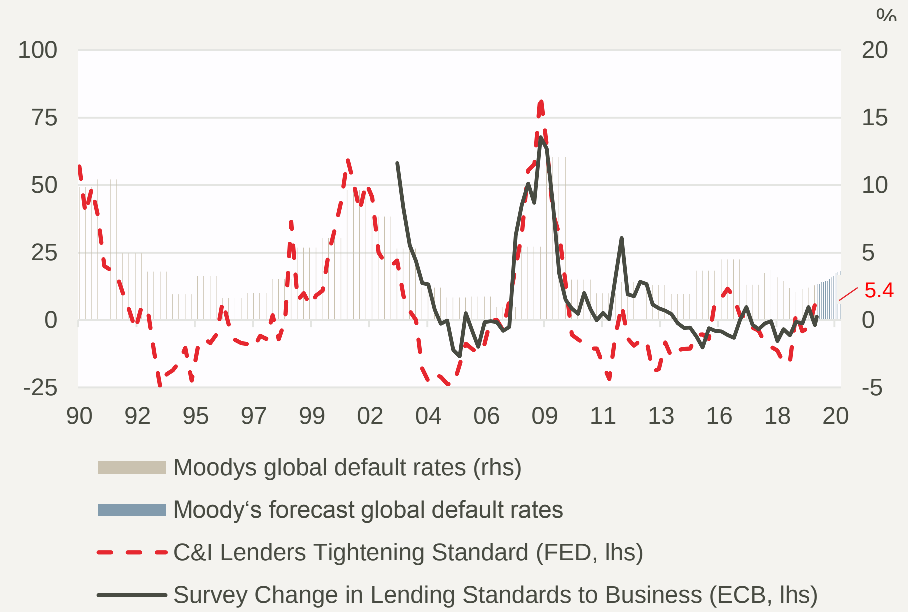
- Eurozone peripherals started to behave like credit again
- Especially, Italy was hard hit on recession and debt sustainability concerns
- Spreads look attractive again and we recommend to fade a further widening

Past performance is not a reliable indicator of future performance and is not constant over time.

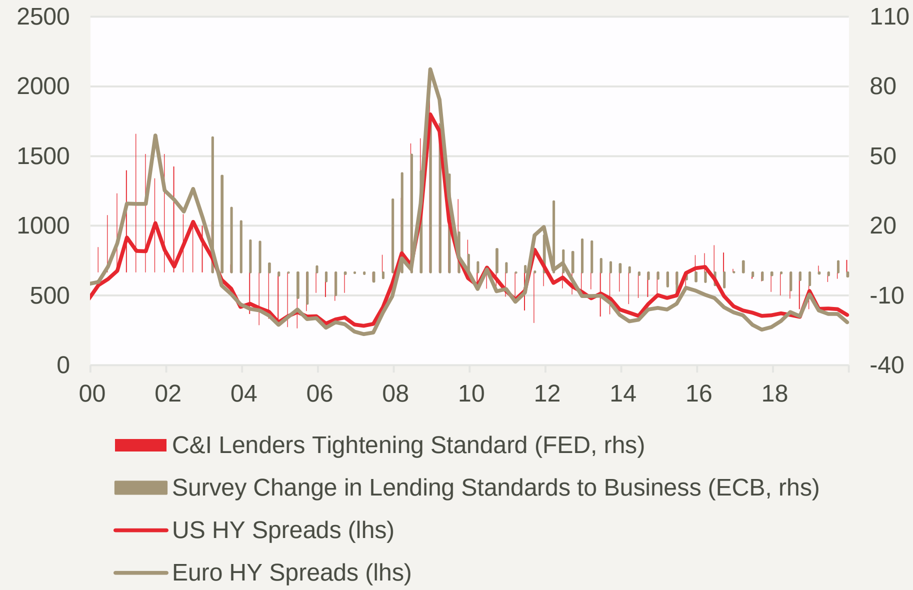
Sources: ODDO BHF AM SAS, Bloomberg | Data as of 02/28/2020

Commercial and industrial lending standards

Lending standards and default rate



Lending standards and spreads

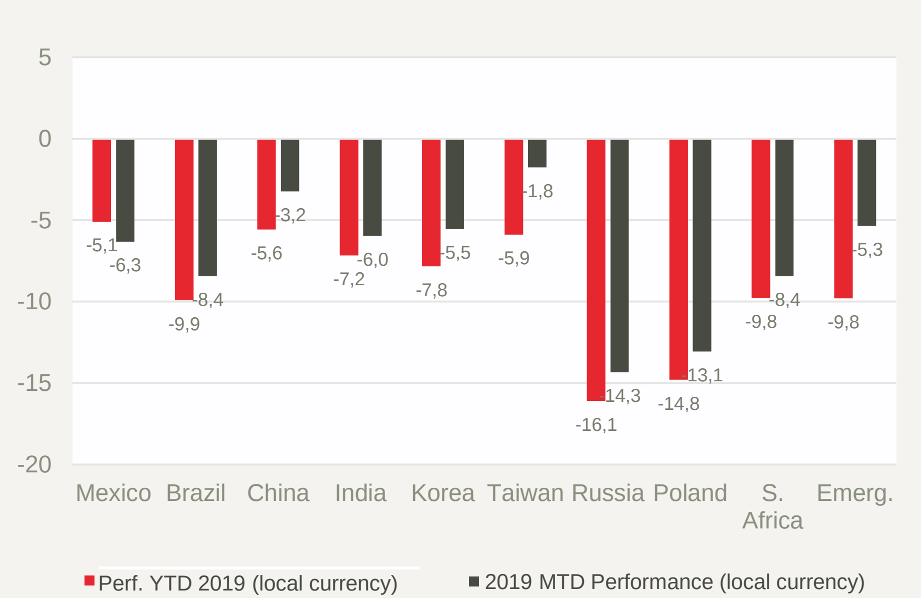


Source: Moody's as of 28/02/2020, Fed, ECB, Bloomberg | Data as of 02/28/2020

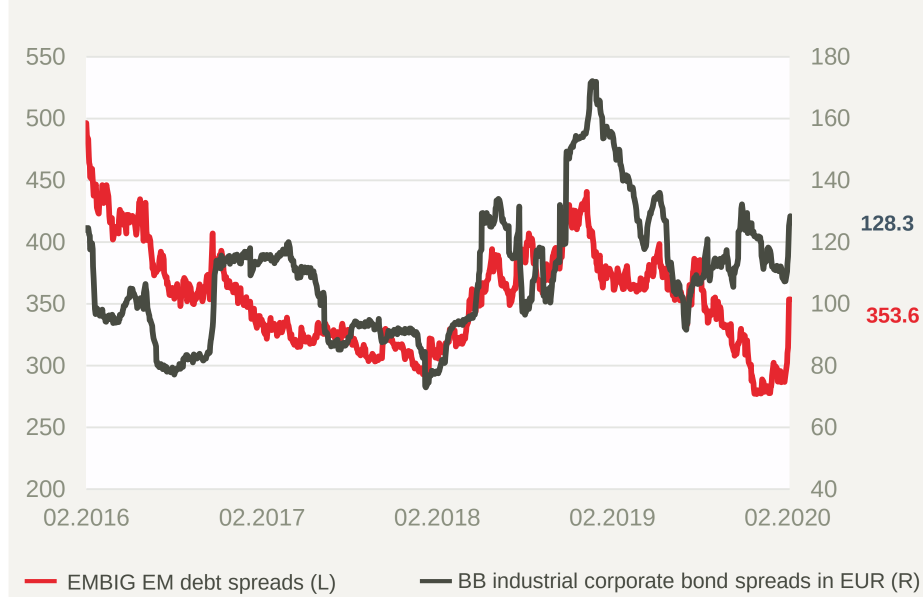
Emerging markets

Relative resilience

Equities performance on major emerging markets



EM debt spreads vs. BB industrial corporate bond spreads in EUR



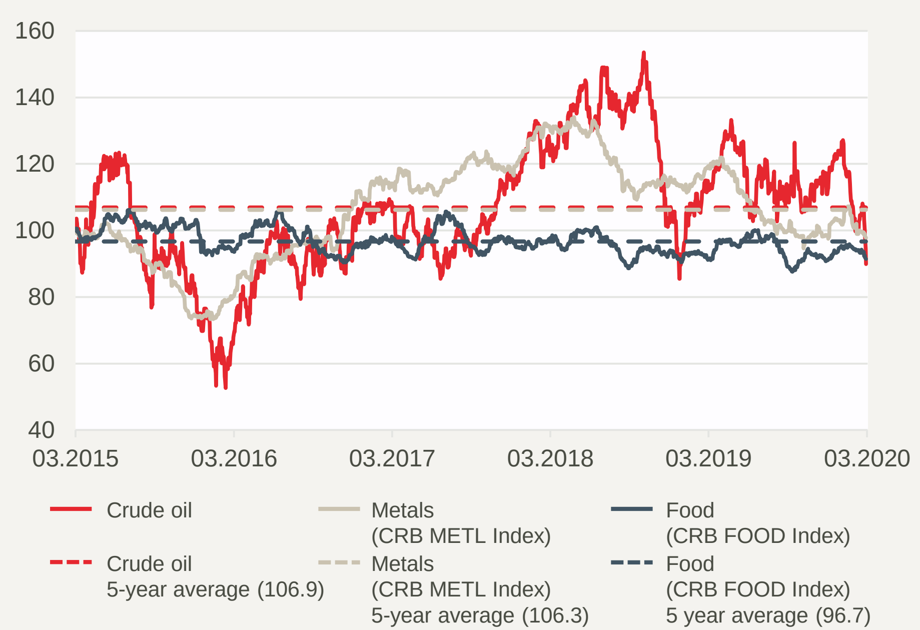
- GEM equities have been hit hard, but have slightly outperformed developed markets
- Lower currencies partly help to buffer the economic shock
- USD bonds have seen a bit more of volatility recently as fears towards USD debt sustainability have emerged
- This is currently a lower probability risk, so any weakness presents attractive entry levels

Past performances are not a reliable indicator of future performance and are not constant over time.

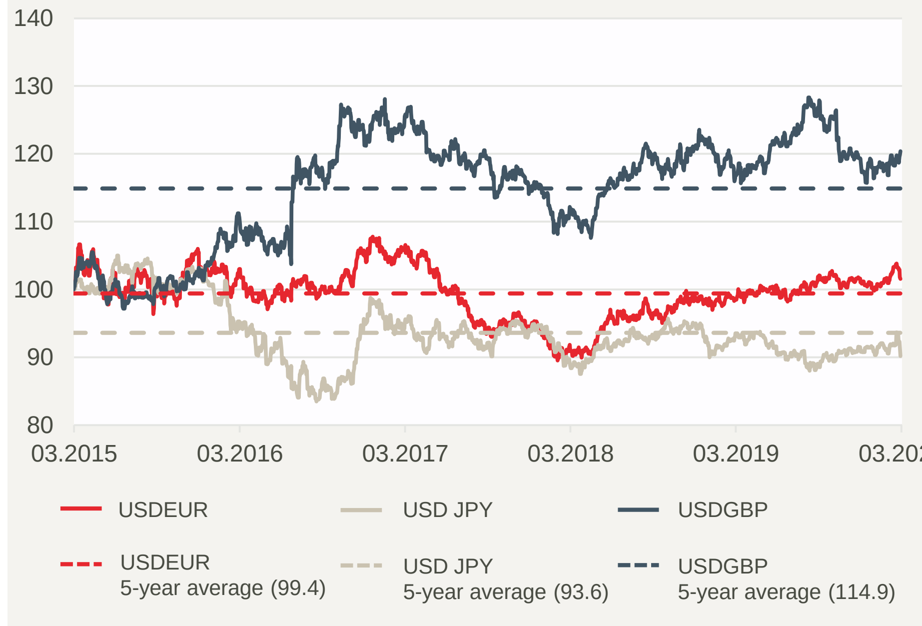
Sources: Bloomberg, ODDO BHF AM SAS | Data at 03/02/2020

Currencies and commodities

Commodities - Change over 5 years



Currencies - Change over 5 years



- Most commodities are in a downtrend as demand has slowed considerably, while gold has profited from its safe haven status
- Short-term gold seems over owned and might be vulnerable to position adjustments
- USD has whipsawed and been battered recently as FED rate expectations explodes. Given the high probability of further cuts and risks of a weakening US economy further USD weakness is likely

Past performances are not a reliable indicator of future performance and are not constant over time.

Sources: Bloomberg, ODDO BHF AM SAS | Data at 03/02/2020

Discover our guide
*« **Basics of sustainable investing** »*

Glossary

How performances are calculated	Cumulative fund performance is calculated based on dividends reinvested. Annualised performance is determined on an annual, 365-day actuarial basis. A fund's performance relative to its benchmark index is expressed as arithmetic difference. Static indicators are generally calculated on a weekly tick that is taken on Fridays, or failing that, on the day prior to valuation.
Volatility	Volatility is a risk indicator measuring the level of fluctuations observed in a portfolio (or index) over a defined period. It is calculated as annualised standard deviation of absolute returns within a defined period of time.
Credit spreads (credit premiums)	The credit spread is the risk premium or the difference between the yields of corporate bonds and that of sovereign bonds with the same characteristics.
Investment grade	Investment-grade bonds are bonds issued by issuers rated between AAA to BBB- by Standard & Poor's of the equivalent.
High yield	High-yield bonds are speculative bonds rated lower than BBB- (Standard & Poor's) or the equivalent.
PE (price-earnings ratio)	A stock's price-earnings ratio is equal to the stock's price divided by the issuing company's earnings per share. It is also called the "earnings multiple". It depends mainly on three factors: the company's forecast earnings growth, the risk associated with these forecasts, and the level of interest rates.

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Notes