

MONTHLY *investment* BRIEF

AI: fad or margin effect?

A disappointing earnings season (for now)

For the first time in 10 years, European companies are reporting results below consensus. The negative surprises are limited to just -2%, suggesting there's no immediate cause for alarm. However, it would make sense to examine the sustainability of margins at this point in the cycle. In the United States, the operating margin of S&P 500 companies has risen from 13% in 2019 to over 17% expected for 2025. In the meantime, this same margin had fallen to 10% in 2020 amid the Covid crisis.

Net margins remain high

What is most surprising, though, is the trend in net margins. The rise in interest rates and the resulting increase in financing costs should have eroded this margin. Instead, the net margin rose slightly. While government support during the Covid crisis, fiscal policies backed by central banks, and positive consumer sentiment have played a role in the pick-up in net margins, the duration mismatch between assets and liabilities is one of the main reasons for this trend. Since debt has a longer maturity than assets (essentially cash or cash proxies), companies have seen the return on their assets more than offset the rise in the cost of debt. As a result, the inversion of the yield curve - i.e. where short-term rates surpass long-term rates - continues to generate positive cash flows.

What are the key parameters for margin growth?

1. Economic growth
2. Rise in the prices of goods and services
3. Unit labour costs
4. Productivity gains
5. Pricing power
6. Taxes and regulation

Are current margin levels sustainable?

Our central scenario is based on a moderate slowdown in global growth ('soft landing') and quasi-stagnation in Europe. Against this backdrop, margins are unlikely to rise overall. However, major sectoral differences need to be taken into account, as a soft-landing scenario is not necessarily synonymous with falling margins. For example, quarterly earnings expectations in the technology sector remain markedly different from those in the chemicals sector, which is still suffering from the sharp rise in energy costs.

An in-depth fundamental analysis is required to identify those companies that will benefit more from the current cycle. In terms of the cycle, we are still in a period of normalisation of inflation following the successive shocks of recent years. After peaking at almost 10%, consumer price inflation in the United States has fallen back to 3.1% year-on-year. Disinflation is a driver of margin reduction, as costs are now tending to fall less than inflation. Also in the United States, producer prices, which had been falling rapidly since the spring of 2022, now appear to have stabilised at around 0% year-on-year since the summer of 2023.

Let's try to understand the dynamics between labour costs, selling prices and margins. Using a simple regression model, a 1% rise in unit labour costs reduces the margin by 0.5%, while a 1% rise in selling prices increases the margin by 0.3%. The net effect is a 0.2% reduction in the overall margin. Therefore, if unit costs and selling prices rise at the same rate, the margin will automatically fall. But that's without taking into account any productivity gains, pricing power that exceeds the market, or lower taxes.

Regarding productivity gains, the potential offered by generative Artificial Intelligence (AI) is substantial but will take time to spread. More stringent environmental regulation and re-onshoring are negative factors (from a purely financial point of view).



- Regarding **pricing power**, after the multi-sector phenomenon of "greedflation", when all companies across all sectors were able to pass on price rises that exceeded inflation, we are seeing a harsh return to reality for sectors where barriers to entry are lower.
- Regarding **taxes**, while the share of taxes in price rises has been below its historic rate since mid-2022, the opposite trend seems to be underway since last autumn...The trajectory of budget deficits and debt/GDP ratios does not bode well in this regard.

In summary, maintaining net margins at high levels (without even considering a potential increase) appears largely subject to the rapid and continued spread of productivity gains associated with AI.

How should investors position themselves?

We favour sectors that will benefit from the exponential development of Artificial Intelligence. AI as an investment theme has accelerated sharply in 2023 thanks to generative AI, but this secular trend is only in its infancy. The theme is spreading from semiconductors to software. Data-intensive sectors such as healthcare and automotive will follow in the next few years. With this in mind, we are maintaining our preference for software over semiconductors, for AI enablers over AI adopters, for the United States over Europe and the emerging markets, and for large caps over small caps. Finally, we are starting to shift our weighting slightly back towards the healthcare sector (Life Science).

We reiterate our recommendation to invest in companies with the ability to pass on price rises regardless of the cycle. In that respect, the Luxury Goods sector makes sense, but at the top end of the market. Brands such as Burberry or Kering do not have the same barriers to entry as Richemont or LVMH. Not to mention Ferrari or Hermès, which benefit from a low volume effect leading to multi-year waiting lists. The purchase of ultra-luxury items caters to the desire for

exclusive group membership, where the notion of price becomes secondary. This is the sub-sector we are favouring.

Finally, we draw attention to the impact of regulation on margins. The recent farmers' crisis in France has made us aware of the micro-economic impact of certain government decisions. Our aim is not to judge whether a particular decision is rational, but to analyse its consequences. More regulation has never helped companies. Our advice is simple: avoid segments or sectors that are sensitive to government action. To name just a few: telecoms, utilities and even banking.

To conclude, if we had to choose 2 criteria for observing the evolution of margins, those would be productivity gains and pricing power. They have the advantage of taking you partly out of the economic cycle, and even out of geopolitical uncertainty. But above all, looking at investments from this angle is akin to adopting a resolutely optimistic stance about future growth and value creation. To those who will argue that valuations are too high or that companies are more sensitive to interest rates than envisaged in this editorial, I would say that, as long as the growth in the quarterly earnings of these companies is at least double nominal global growth, 2-digit multiples are justified. At the very least, it's a fine way to emerge from secular stagnation.



LAURENT DENIZE
Global Co-CIO, ODDO BHF



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CURRENT CONVICTIONS



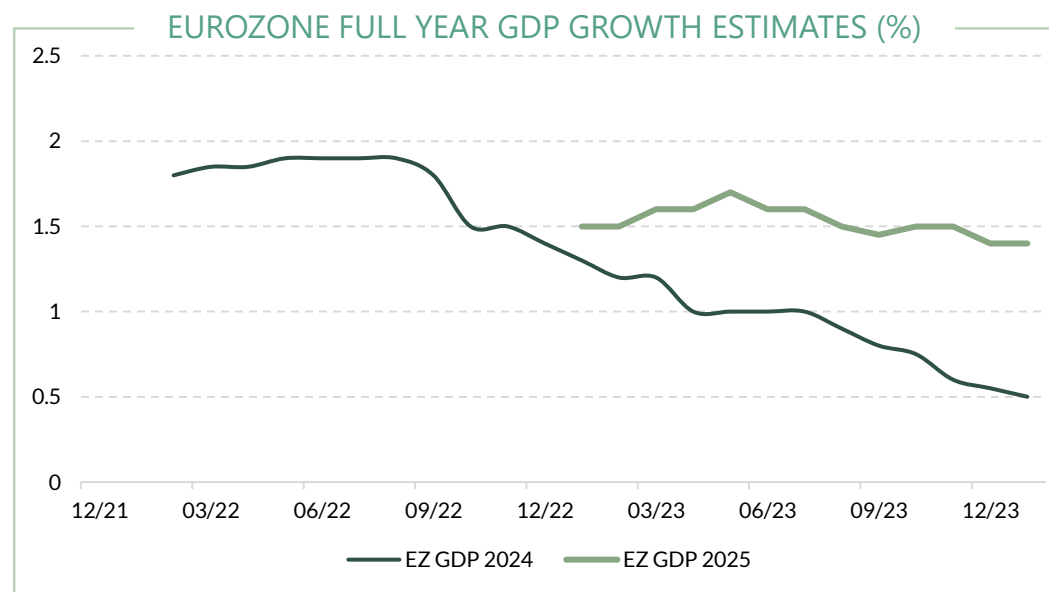
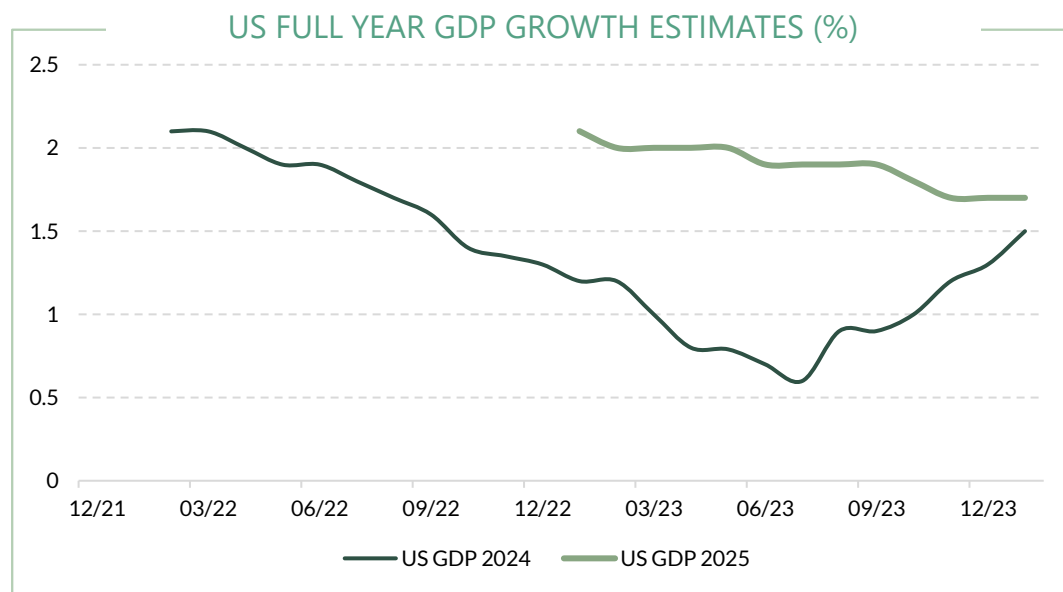


01

MACROECONOMIC *outlook*

Growth outlook

DISPERSION CONTINUES

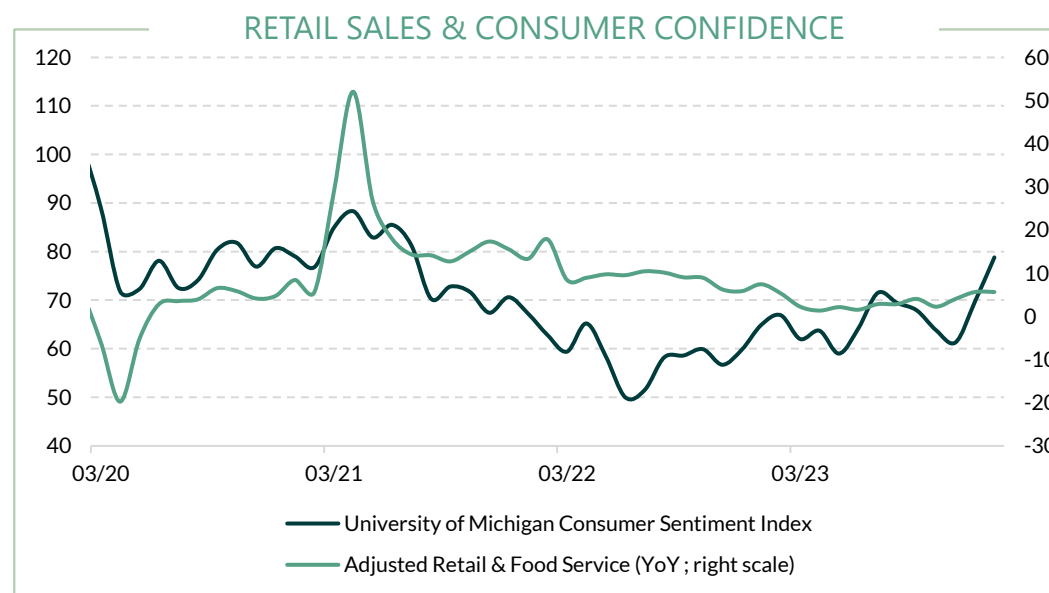
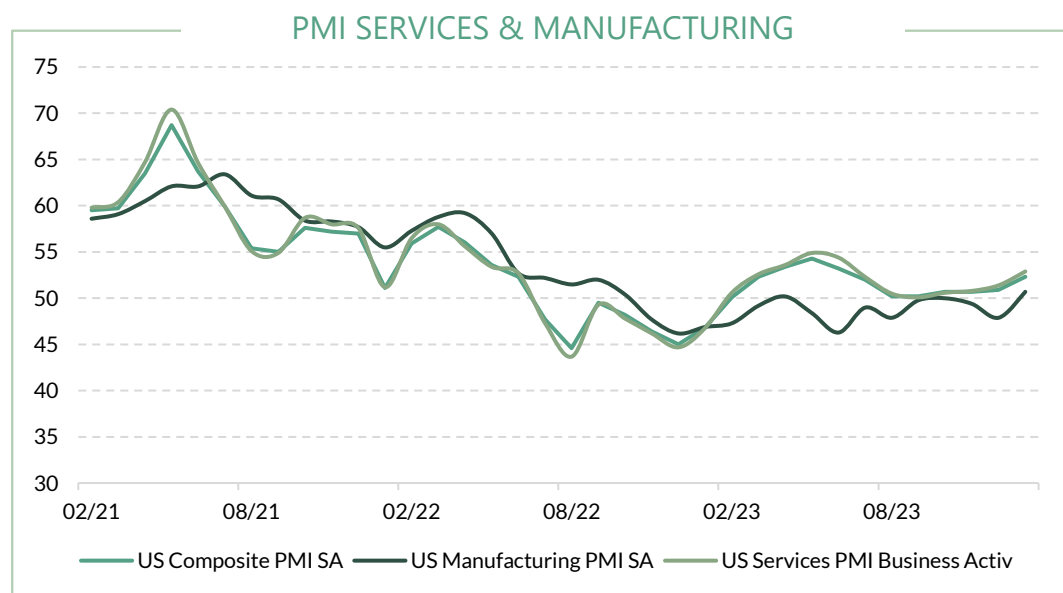


- The US growth outlook has been revised-up persistently since mid 2023 to currently 1,5% and 1,7% respectively for 2024 and 2025
- This in stark contrast to the successive downward revisions for Eurozone growth to only 0,5% this year and 1,5% in 2025 and other regions like China or UK



USA

FROM SOFT LANDING TO NO LANDING?

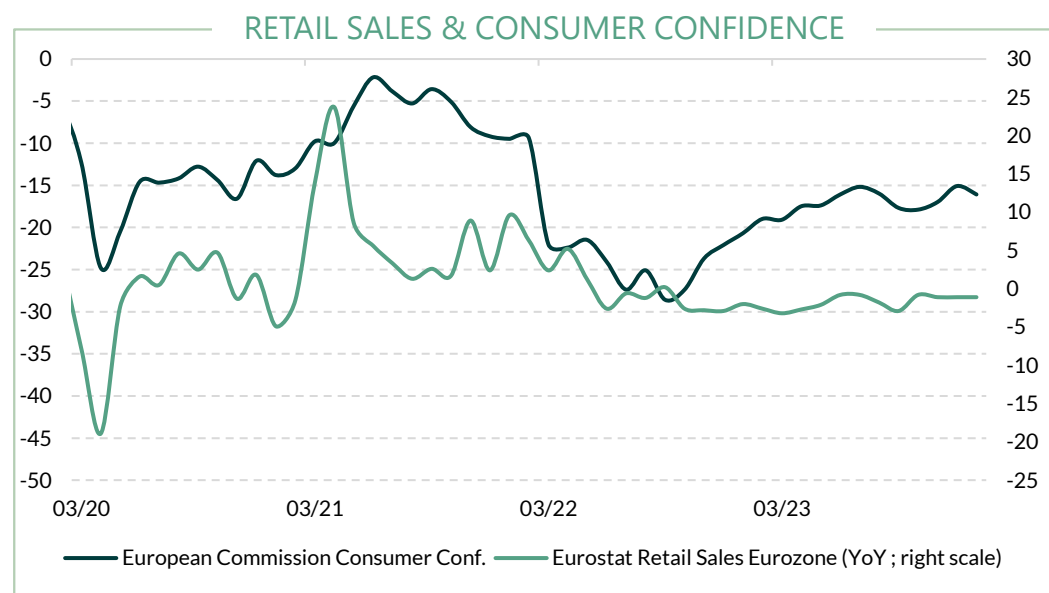
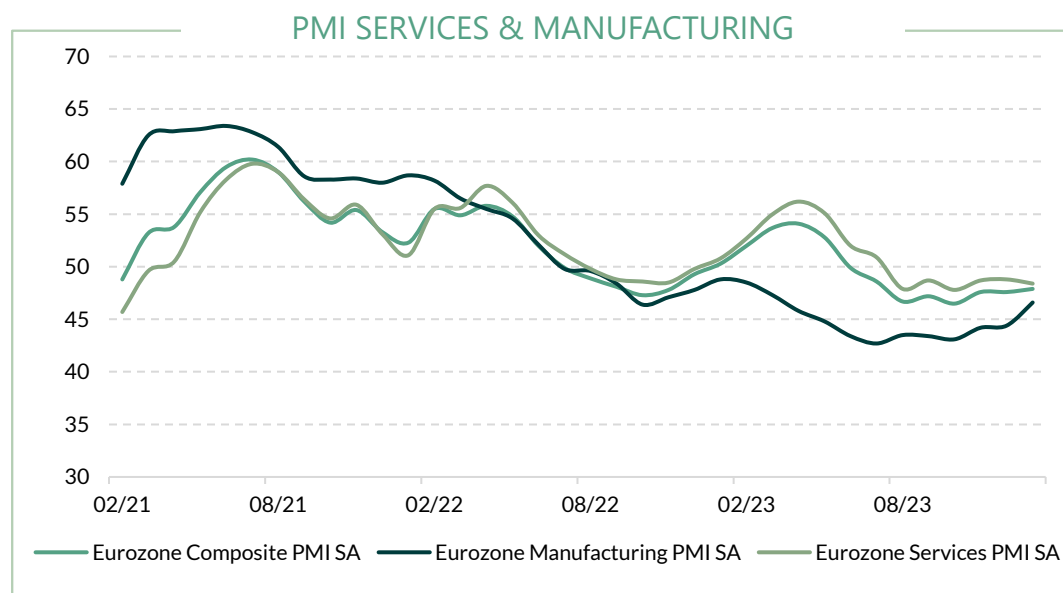


- The US economy remains pretty strong and even appears to accelerate slightly into early 2024
- ISM manufacturing improved but remained just shy of the 50-expansion mark, while the services indicator jumped back to the September 2023 level with a very strong new orders figure
- Also, the labor market showed considerable strength in January with a 317k jump in the NFP and upward revisions for the previous months
- Nevertheless, not all is golden. Regional Fed surveys remain weak, indicating a downbeat manufacturing sector. Moreover, some labor market indicators like the quits and hiring rates are suggesting that the labor market is not as solid as it looks on the surface



Europe

STAGNATION AT BEST

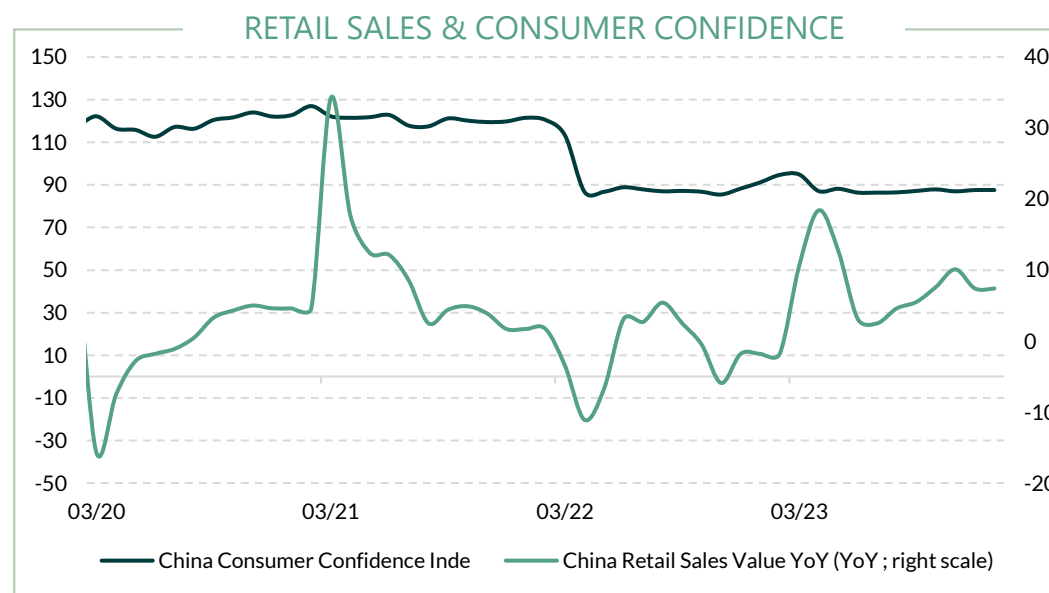
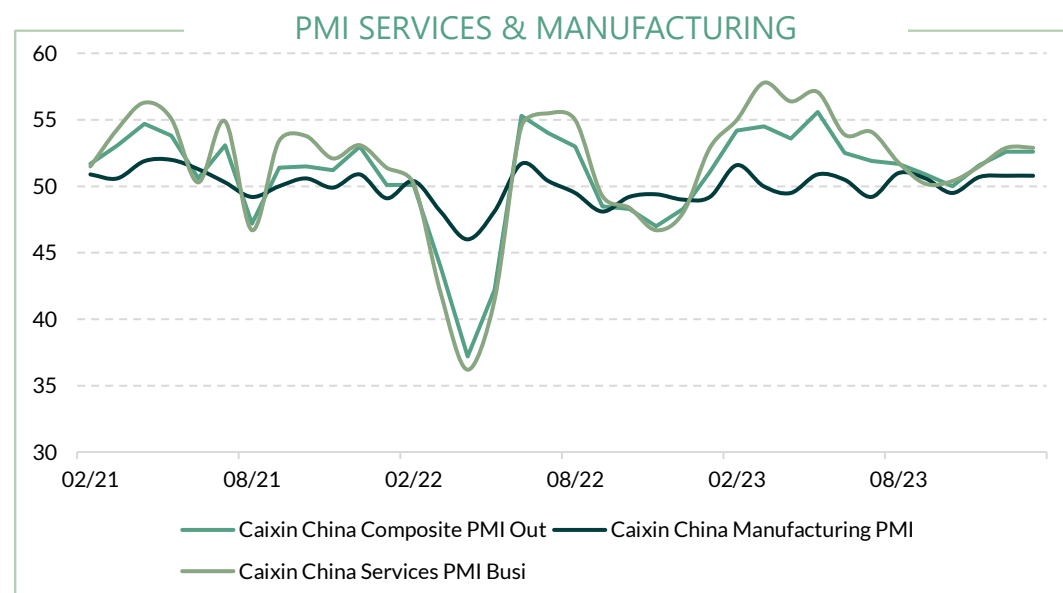


- While there are significant growth differences across countries with Germany falling back and peripherals leading, the region as a whole has been stagnating over the last quarters
- Real retail sales volumes have been falling around 5% from their highs on November 2021
- PMI have improved recently reflecting a shale rebound in manufacturing but are still deep into contraction territory
- On the positive side increasing real disposable incomes and a solid labor market are putting a floor under the economy, but may not be sufficient to spark a trend change



China

TOO LATE TOO LITTLE?

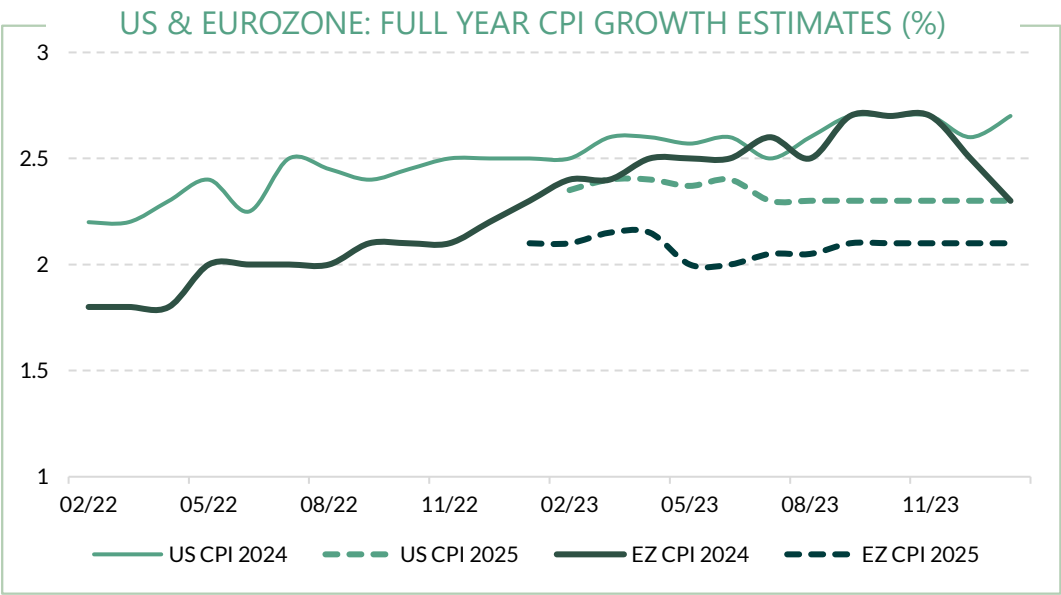


- Authorities are increasingly trying to stem the structural headwinds from the deflating property bubble
- Monetary policy, however, has a limited impact as the economy faces a liquidity trap
- Recent measures focus more on direct support of the equity market and improving conditions for property companies
- It is very questionable that the government can even come close to the growth targets of 5% over the next years



Inflation expectations

STILL ANCHORED



		YOY CPI ESTIMATES				
		2/2/2024				
		CPI YoY	Jan-24	Dec-23	1Y trend	5Y average
Canada	CACPIYOY Index					
U.S.	CPI YOY Index			3.4		3.5
				3.4		2.0
						2.8
Brazil	BZPIIPCY Index			4.6		2.9
Mexico	MXCPYOY Index			4.7		2.5
Chile	CNPINSYO Index			3.9		2.9
						8.0
						6.2
Eurozone	ECCPEMUY Index		2.8	2.9		1.8
Germany	GRCP20YY Index		2.9	3.7		1.8
France	FRCPIYOY Index		3.1	3.7		1.4
Italy	ITCPNICY Index		0.8	0.6		1.6
						2.6
Poland	POCPIYOY Index			6.2		3.6
Sweden	SWCPYOY Index			4.4		2.2
Switzerland	SZCPIYOY Index			1.7		0.5
U.K.	UKRPCJYR Index			4.0		2.1
						3.1
India	INFUTOTY Index			5.7		2.9
Indonesia	IDCPIY Index		2.6	2.6		1.4
Malaysia	MACPIYOY Index			1.5		0.8
Japan	JNCPIYOY Index			2.6		0.7
South Korea	KOCPIYOY Index		2.8	3.2		1.3
China	CNCPYOY Index			-0.3		0.8
Hong Kong	HKCPIY Index			2.4		0.9
						7.6
						7.3
						0.4
						3.1
						2.5
						1.8

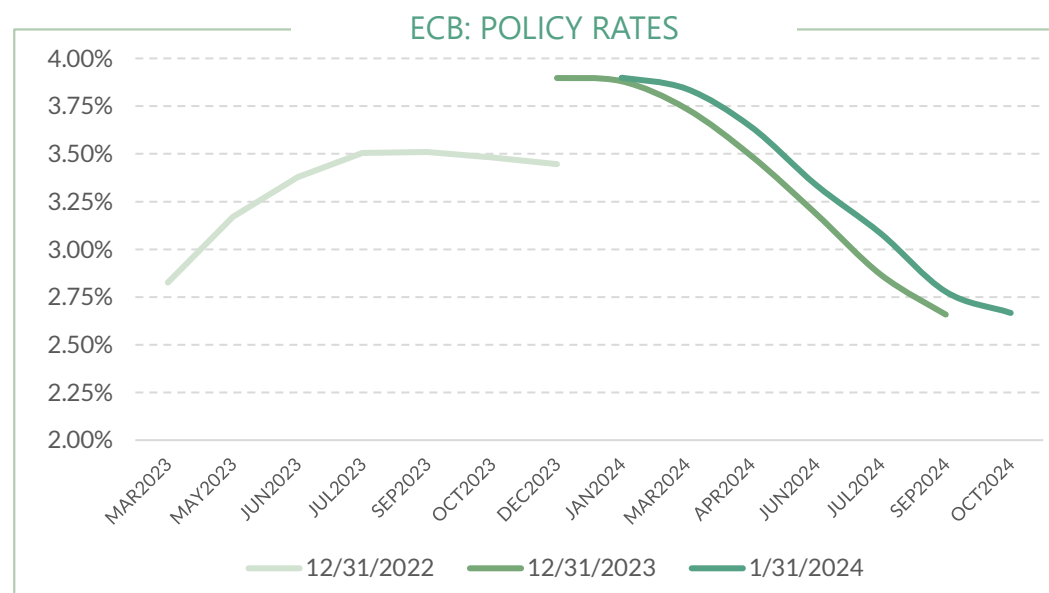
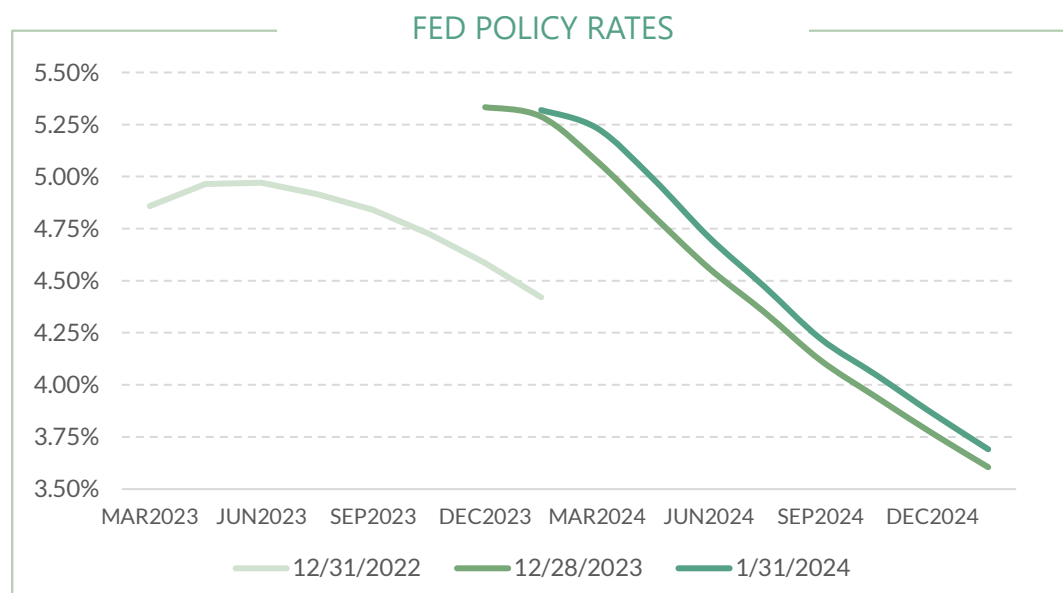
- Surveys in the US and the Eurozone do not reflect heightened inflation expectations longer-term
- Market based break-even rates have even declined markedly over the last year in response to the strong disinflation

Sources: ODDO BHF AM SAS, Bloomberg | Data as of 02/02/2024



FED & ECB policies

BACK TO “HIGH FOR LONG” AGAIN?



- While easing expectations remain alive and kicking, probabilities for the first FED cut and the total amount of cuts for 2024 have been on a constant rollercoaster ride. Currently, a FED cut in March has almost completely been priced out given the blockbuster jobs report and remarks by Jerome Powell. Instead, the market now sees June as the starting point with a total of 4-5 cuts this year
- Interestingly, expectations for the terminal rate have remained almost unchanged (approx. 220bp lower), showing that the market assumes that a later starting point would mean stronger central bank action afterwards
- For the ECB the consensus converges around June for pulling the rate trigger and pricing a total of 120bp cuts in 2024, about the same as in the US. This looks fairly mispriced given the current significant growth gap



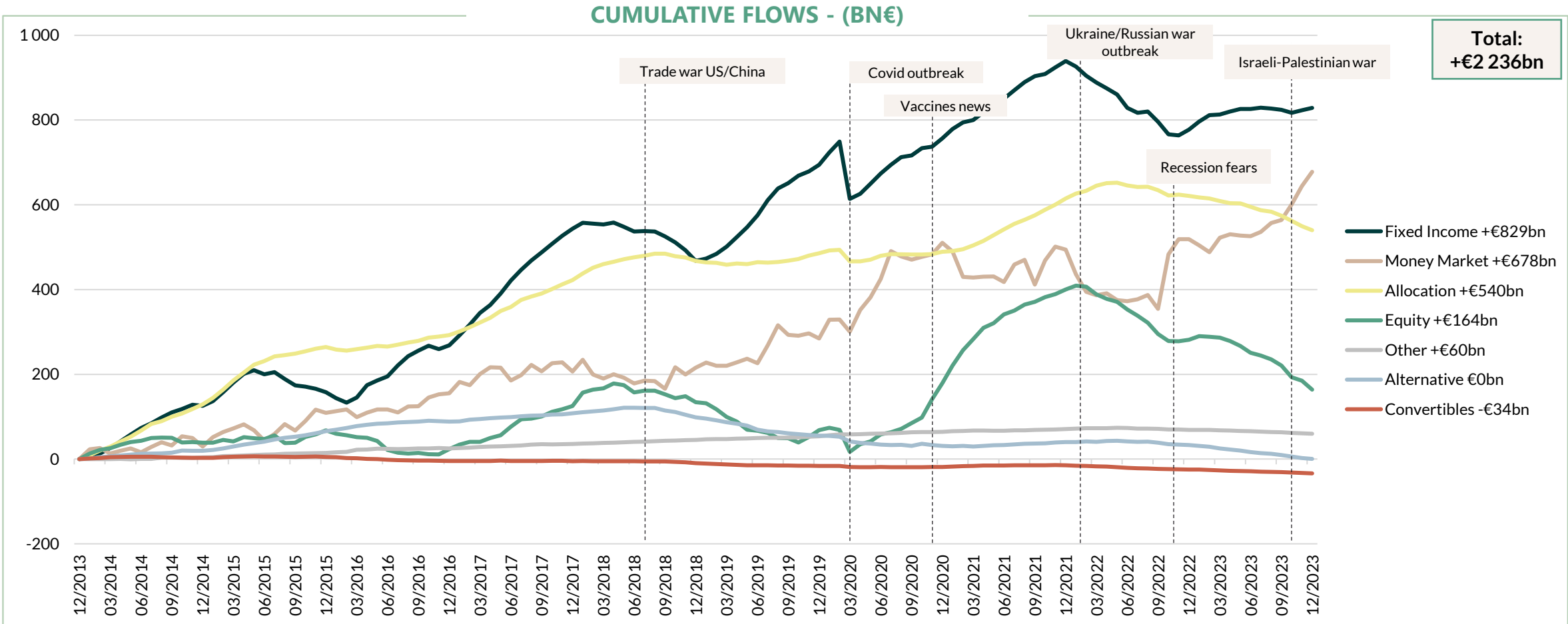
02

MARKET *analysis*



Cumulative mutual fund flows (€bn) since 2014

INVESTORS SITTING ON PILES OF CASH

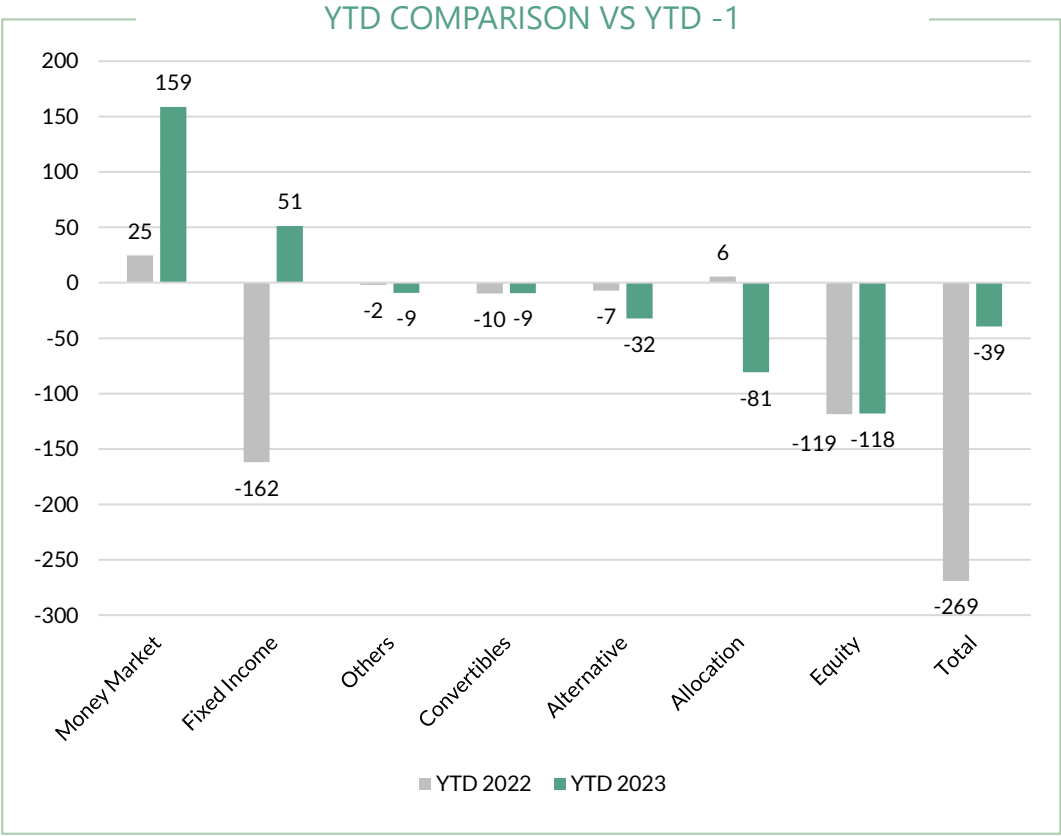
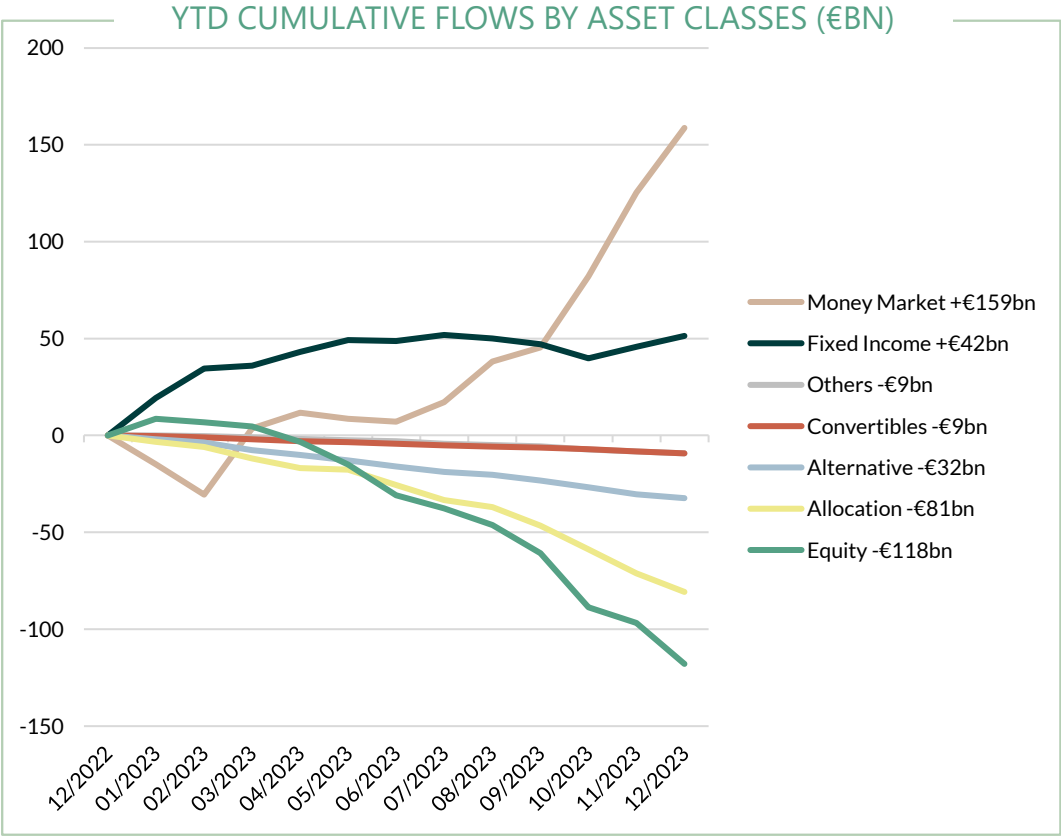


Source: Morningstar. Data as of 31/12/2023 (Europe OE ex ETF ex MM ex FoF ex Feeder (domiciled, most compr)



2023 European mutual fund flows

CONTINUED DISINVESTMENT FROM RISKY ASSETS (EXCEPT BONDS)

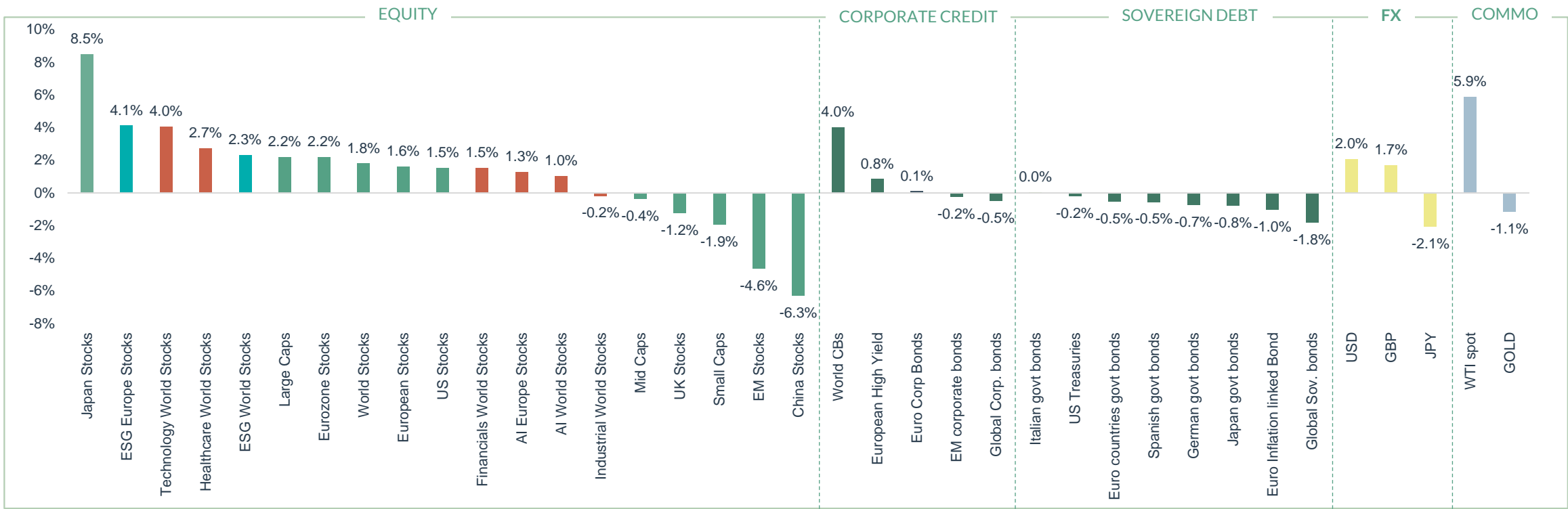


Source : Morningstar. Data as of 31/12/2023 (Europe OE ex ETF ex MM ex FoF ex Feeder (domiciled, most compr))



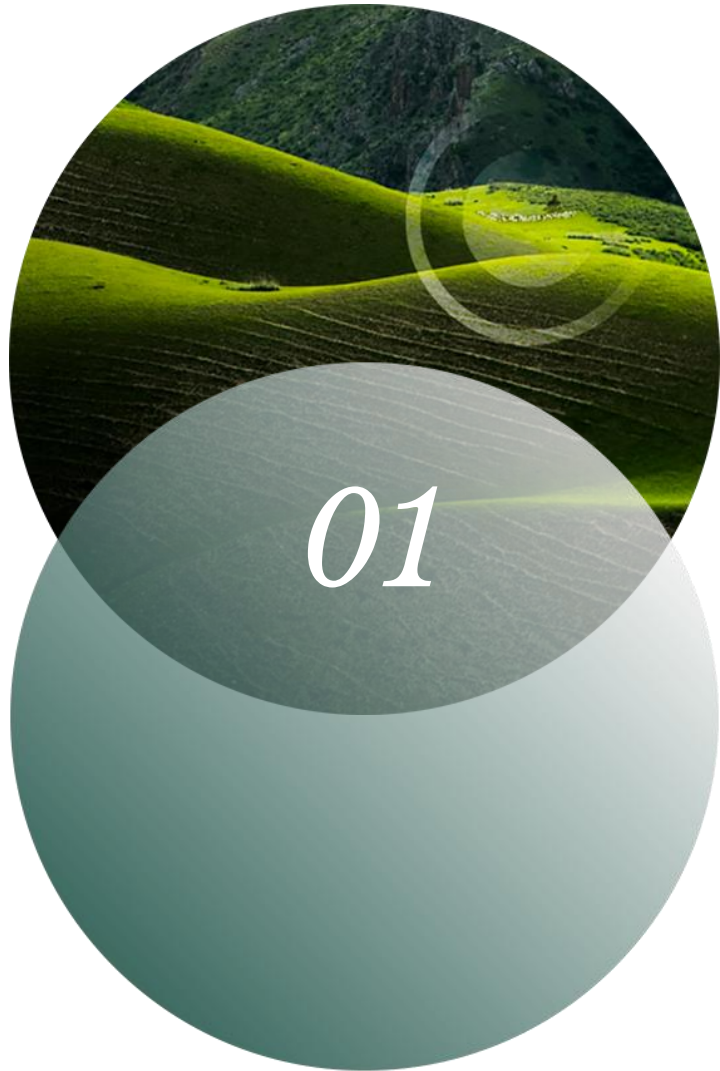
Year-to-date performances of asset classes

LAST YEAR'S TRENDS CONTINUE ALMOST UNCHANGED



■ Sectors/thematics ■ ESG indices ■ Equities ■ Bonds ■ Currencies ■ Commodities

Past performances are not a reliable indicator of future performances and are not constant over time.
Sources: Bloomberg and BoA ML as of 31/01/2024; performances expressed in local currencies

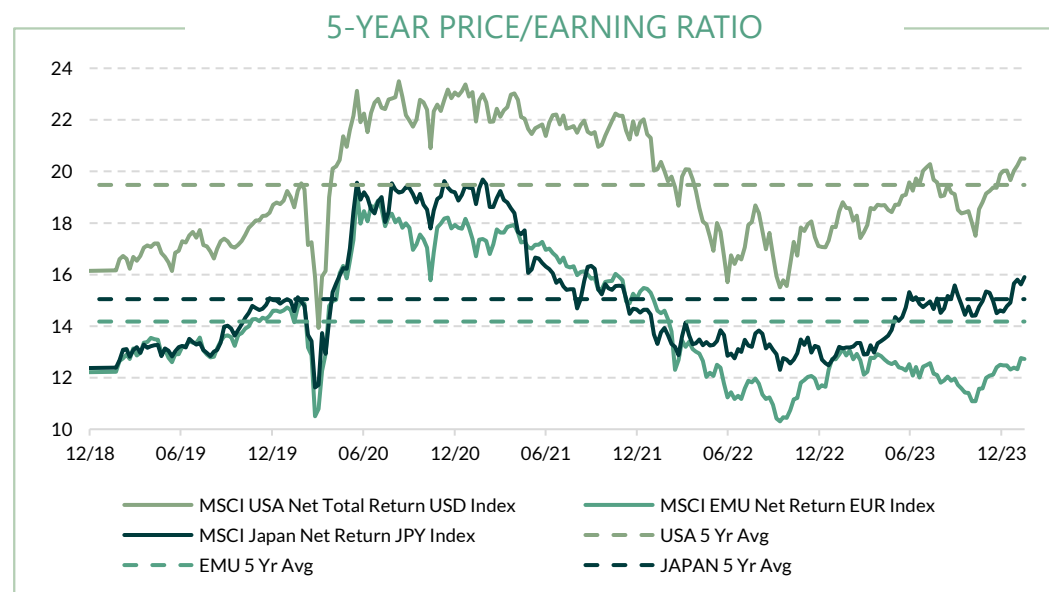
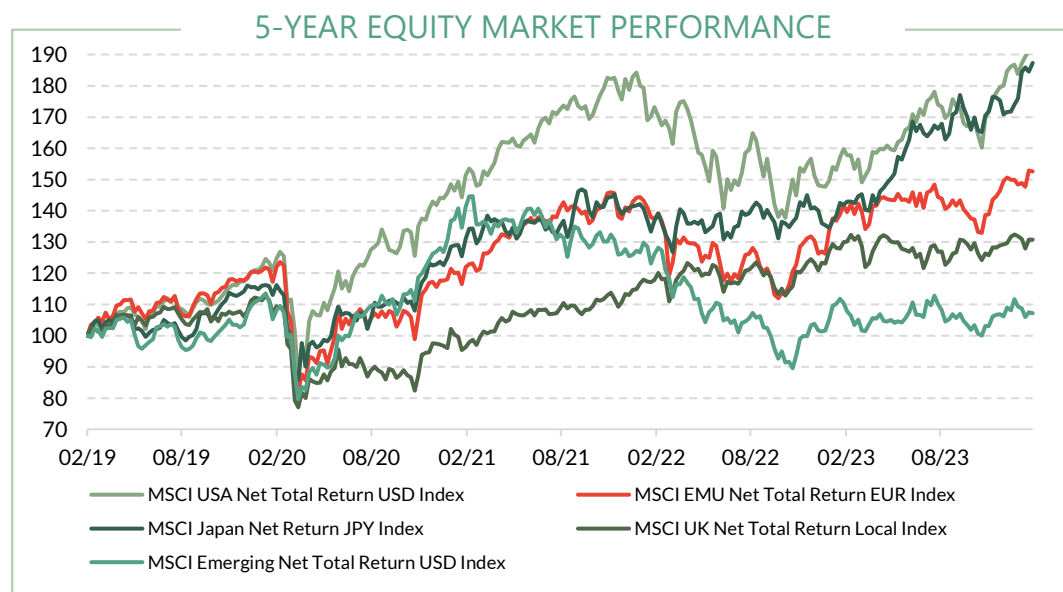


EQUITIES



Equities

DESPITE TEPID EARNINGS, THE GLOBAL EQUITY RALLY GOES ON



- Earnings expectations were barely changed over the last months.
- The recent increase in equity prices leaves investors with valuations multiples above historical-average for most equity indexes, Chinese and European indices being the exceptions.

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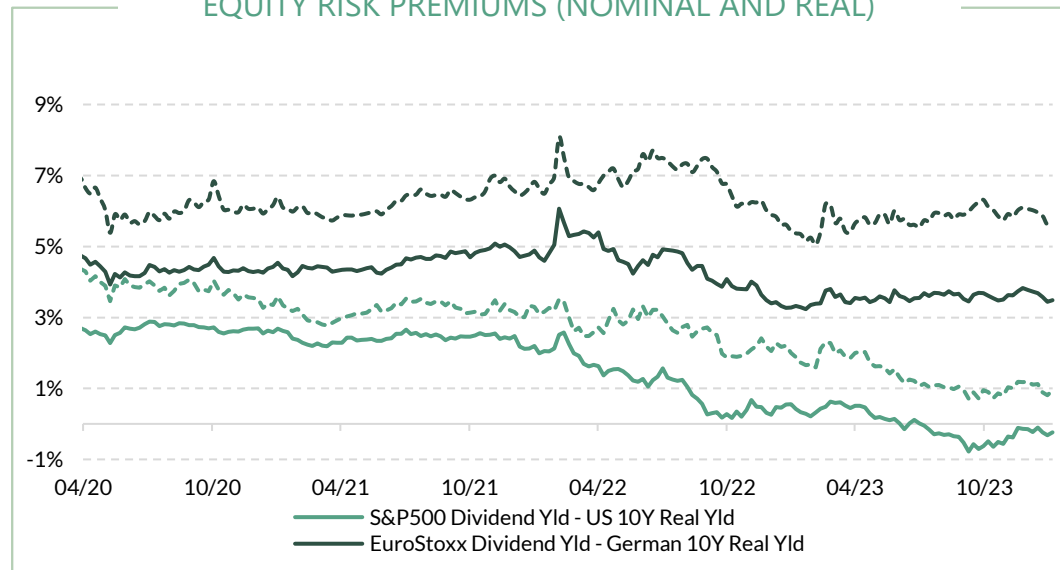
Sources: ODDO BHF AM SAS, Bloomberg | Data as of 02/02/2024



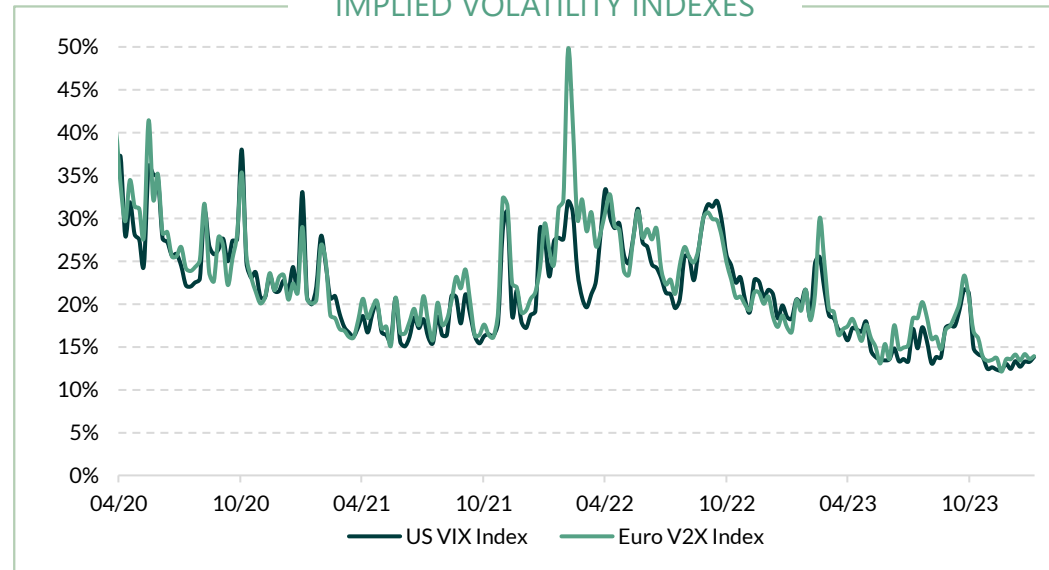
Risk premiums & volatility

STABLE AT LOW LEVELS

EQUITY RISK PREMIUMS (NOMINAL AND REAL)



IMPLIED VOLATILITY INDEXES



- With S&P500 exhibiting a dividend yield below the risk-free inflation-adjusted yield offered by the US TIPS market, the risk premium of US equities appear very tight.
- Very benign level of indexes' volatility (vs history but also vs other asset classes) probably explain most of this apparent complacency.
- The recent driver of these very depressed level of volatility of equity indexes lies mainly with record dispersion within equity markets.
- Any sudden re-correlation among individual stocks could be a catalyst for a significant correction of the developed equity markets.

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

Sources: ODDO BHF AM SAS, Bloomberg | Data as of 02/02/2024



European equities – sectors overview

NO CHANGE FROM Q4 2023 TRENDS: GROWTH KEEPS PERFORMING

EUROPEAN SECTOR	WEIGHT	PRICE PERFORMANCE		EPS GROWTH		P/E 12m	Div Yield	Valuation FCF Yield	EV/EBITDA	Price/Book
		1m %	YTD %	2023	2024					
STOXX Europe 600		1%	1%	0%	5%	12.9 x	3.6%	5.7%	8.8 x	1.8 x
Commodities										
Energy	4.6%	-3%	-3%	-34%	-2%	8.0 x	5.1%	10.8%	3.7 x	1.1 x
Basic Resources	2.7%	-7%	-7%	-51%	8%	10.5 x	4.4%	6.5%	5.3 x	1.1 x
Cyclicals										
Automobiles & Parts	2.7%	1%	2%	2%	-5%	5.9 x	5.4%	10.1%	5.3 x	0.7 x
Chemicals	2.7%	-4%	-4%	-46%	20%	19.0 x	3.2%	3.9%	9.7 x	1.9 x
Construction & Materials	4.1%	-1%	-1%	-2%	9%	14.2 x	3.1%	7.0%	8.3 x	1.9 x
Industrial Goods & Services	14.1%	2%	1%	-6%	8%	17.1 x	2.6%	5.4%	10.0 x	2.8 x
Media	1.9%	7%	6%	6%	8%	18.1 x	2.6%	5.6%	11.6 x	3.3 x
Technology	8.1%	11%	9%	43%	4%	26.4 x	1.1%	2.8%	17.8 x	4.3 x
Travel & Leisure	1.4%	7%	6%	110%	15%	13.9 x	2.0%	6.4%	7.3 x	2.6 x
Consumer Products and Services	6.2%	3%	2%	2%	11%	23.4 x	2.0%	4.2%	13.1 x	3.9 x
Financials										
Banks	8.9%	-1%	0%	32%	1%	6.4 x	7.8%	-		0.7 x
Insurance	5.3%	1%	2%	30%	13%	9.7 x	5.7%	6.6%	28.9 x	1.5 x
Financial Services	4.2%	0%	-1%	79%	9%	12.9 x	3.1%	6.2%	7.9 x	1.3 x
Real Estate	1.9%	-4%	-5%	-12%	2%	15.0 x	4.2%	5.2%	22.0 x	0.9 x
Defensives										
Health Care	15.2%	2%	2%	2%	8%	17.2 x	2.6%	5.1%	12.3 x	3.3 x
Food Beverage and Tobacco	5.8%	2%	1%	0%	5%	14.8 x	3.7%	6.2%	10.9 x	2.5 x
Personal Care Drug and Grocery Stores	2.1%	0%	0%	2%	8%	14.7 x	3.6%	6.2%	8.3 x	2.5 x
Retail	1.2%	-4%	-5%	6%	16%	15.4 x	3.7%	6.3%	7.6 x	2.6 x
Telecommunications	2.7%	0%	1%	-20%	35%	12.7 x	5.2%	11.4%	6.1 x	1.1 x
Utilities	4.1%	-5%	-6%	2%	-2%	11.8 x	5.1%	-0.6%	7.5 x	1.5 x

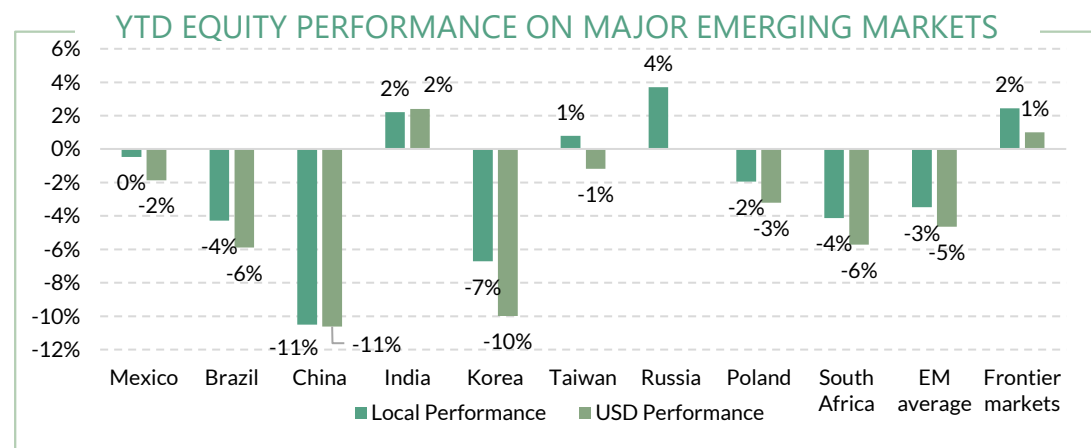
Past performances are not a reliable indicator of future performances and are not constant over time

Sources: ODDO BHF AM SAS, Goldman Sachs, 06/02/2024



Emerging markets

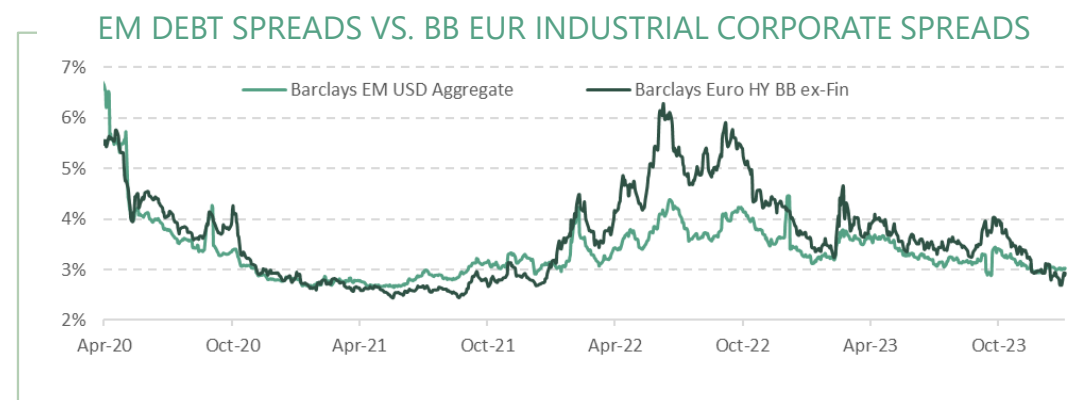
GENERALIZED UNDERPERFORMANCES



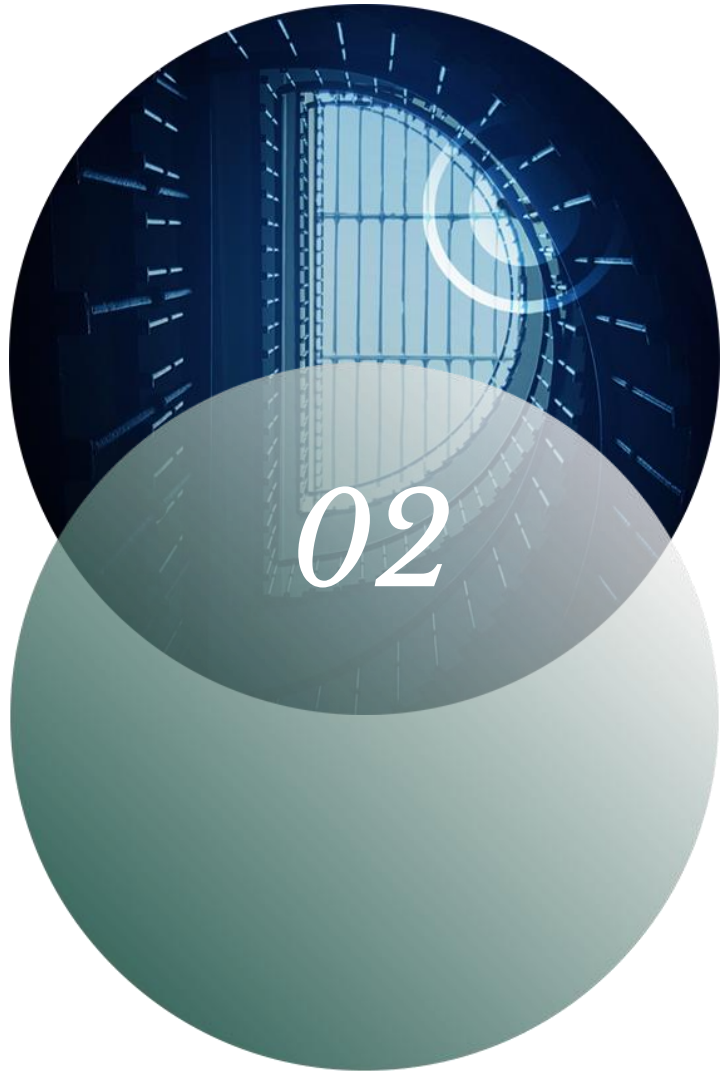
12 MTH FWD ESTIMATED VALUATIONS

Emerging	Price to Book 12mth fwd	PE 12mth fwd	Dividend Yield (trailing 12m)
MSCI EM	1.5	13.2	2.7%
MSCI CHINA	1.0	9.5	3.0%
MSCI KOREA	1.0	18.1	1.6%
MSCI INDIA	3.4	22.7	1.1%
MSCI INDONESIA	2.2	15.1	3.9%
MSCI PHILIPPINES	1.7	13.2	2.4%
MSCI MALAYSIA	1.4	15.9	4.2%
MOEX Russia Index	0.5	3.0	5.9%
WSE WIG INDEX	1.2	8.4	3.1%
MSCI TURKEY	1.6	5.7	2.5%
MSCI SOUTH AFRICA	1.5	13.5	4.1%
MSCI BRAZIL	1.5	7.9	5.1%
MSCI COLOMBIA	0.8	5.5	10.8%
MSCI MEXICO	2.2	13.9	3.2%

- EM debt average spread remained stable over the month, despite a global tightening of credit spreads globally.
- Most equity indexes posted negative performances, with the exception of the Indian market, where hopes for growth prospects keeps more than counterbalancing the fear stemming from very rich valuations.
- Despite increasing measures from Chinese finance ministry and financial watchdogs, both A-Shares and H-Shares markets took severe plunges; moves that were probably amplified by forced selling linked to structured products.



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Sources: Bloomberg, ODDO BHF AM SAS | Data at 31/01/2024

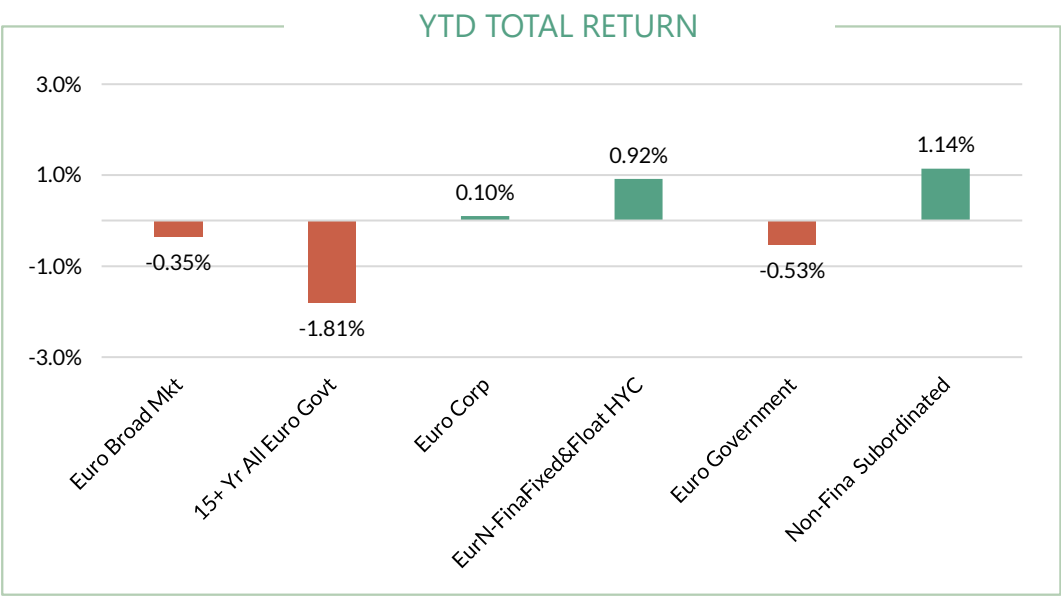
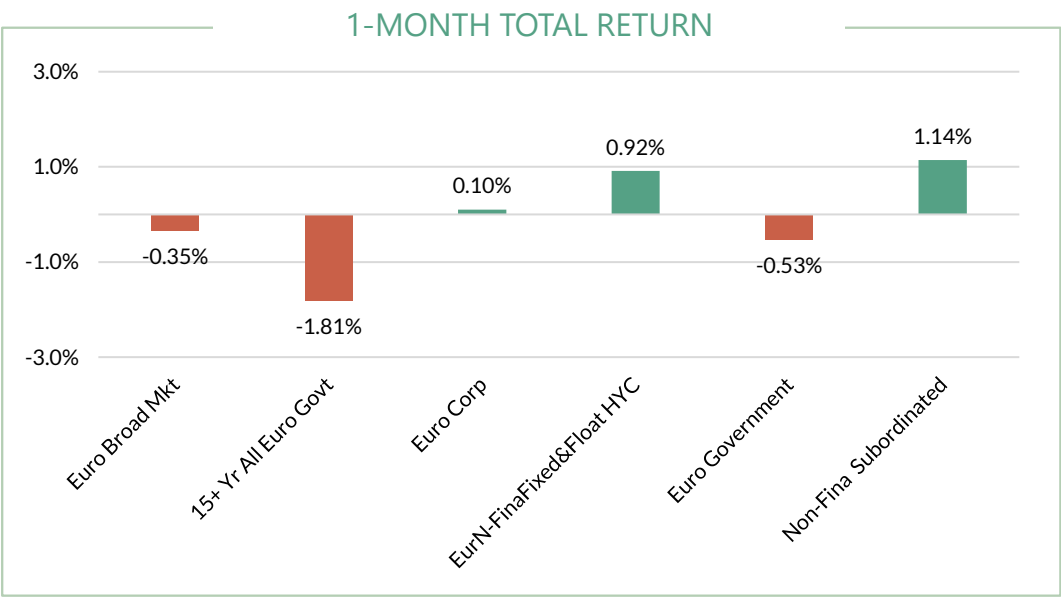


FIXED INCOME



Performance fixed income segment

RISK AND CARRY PREVAIL

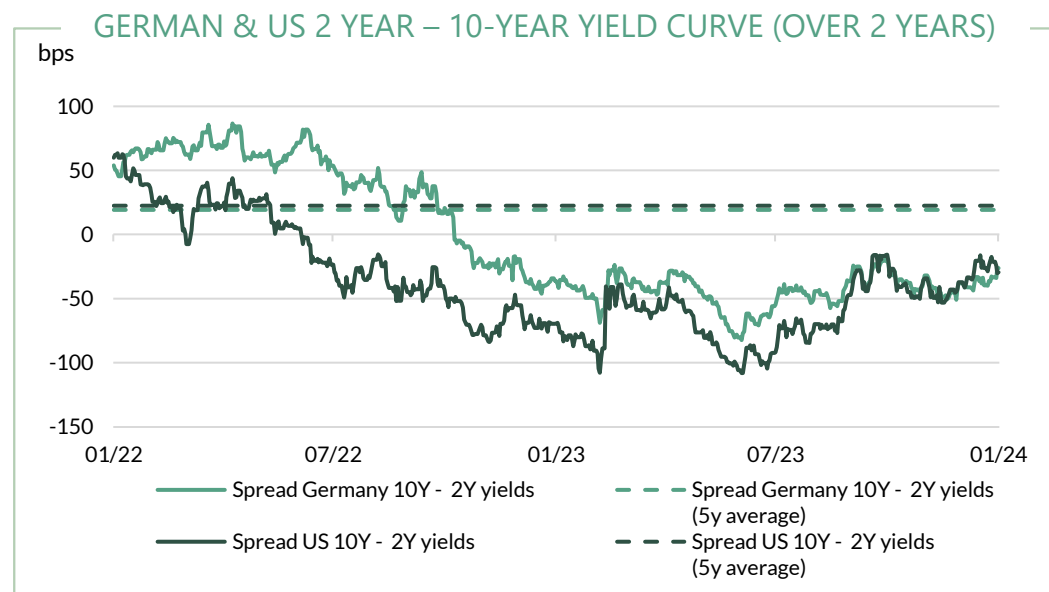
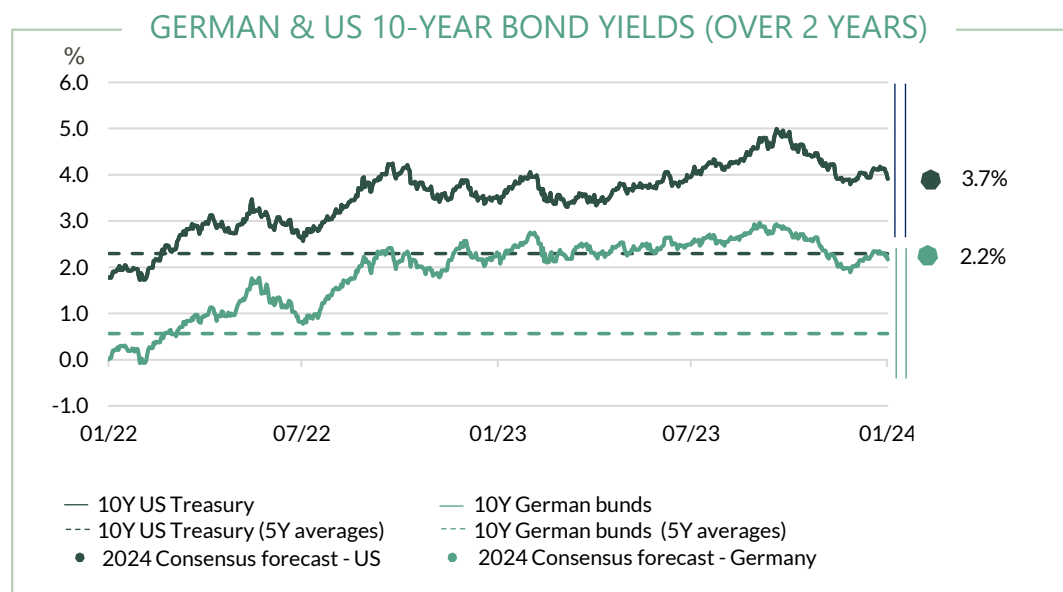


Past performances are not a reliable indicator of future performances and are not constant over time
Source: ODDO BHF AM, Bloomberg, data as of 31/01/2024



Rates

A BREATHHER FOR THE RALLY NOT ITS END



- Upbeat US economic data and a pushback to March rate cuts by Mr Powell sent yields higher after the December rally
- Although there is a risk that the narrative moves back to the “high for long” mantra from mid 2023, we still see a continuation of the rally as likely
- Disinflation has further to run albeit with some distortions along the path allowing the FED to embark on an easing cycle in May or June
- Data in the US is still strong but set to cool over the next months as the hiking cycle works with a lag and special boosters are fading
- The Eurozone is vulnerable to a deterioration in underlying economic momentum

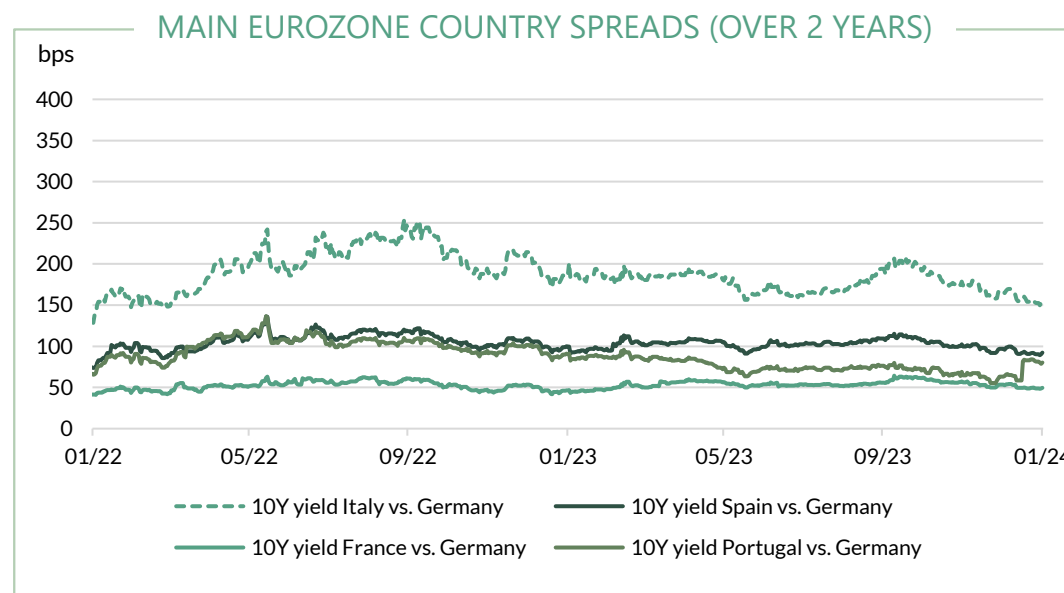
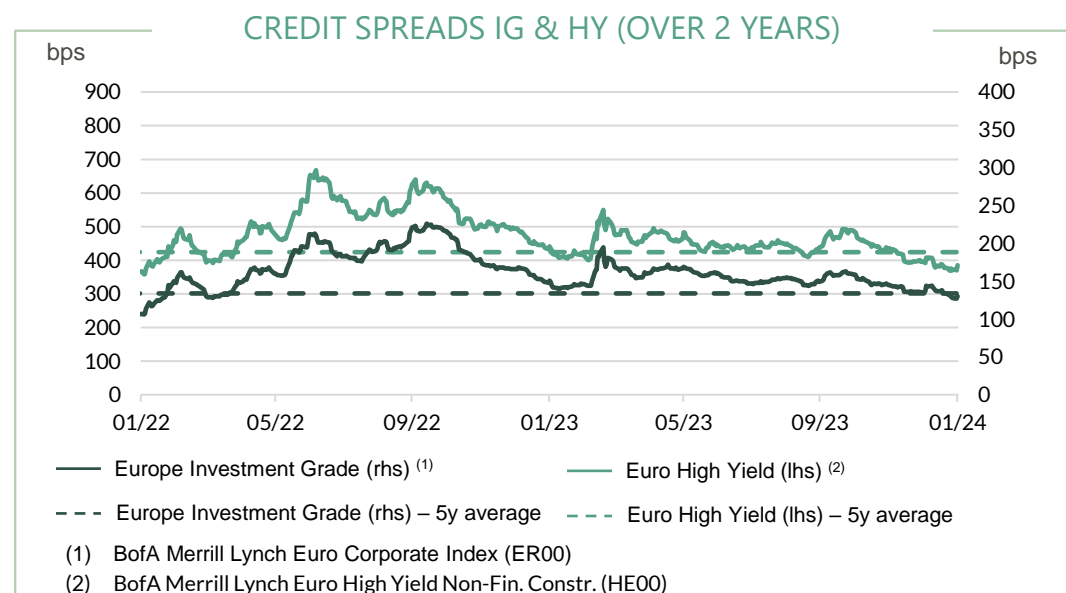
Past performance is not a reliable indicator of future performance and is not constant over time.

Bloomberg Economic Forecast | Sources: ODDO BHF AM SAS, Bloomberg | LHS: Data as of 01/31/2024; RHS: Data as of 01/31/2024



Credit Spreads

THE CARRY GAME



- Credit spreads have continued to tighten in a grab for carry
- As the “soft landing” story is supported for the time being spreads still offer attractive carry features, while further tightening is more difficult to achieve
- Peripheral and sub-sovereign spreads should also continue to benefit from the current risk-on environment

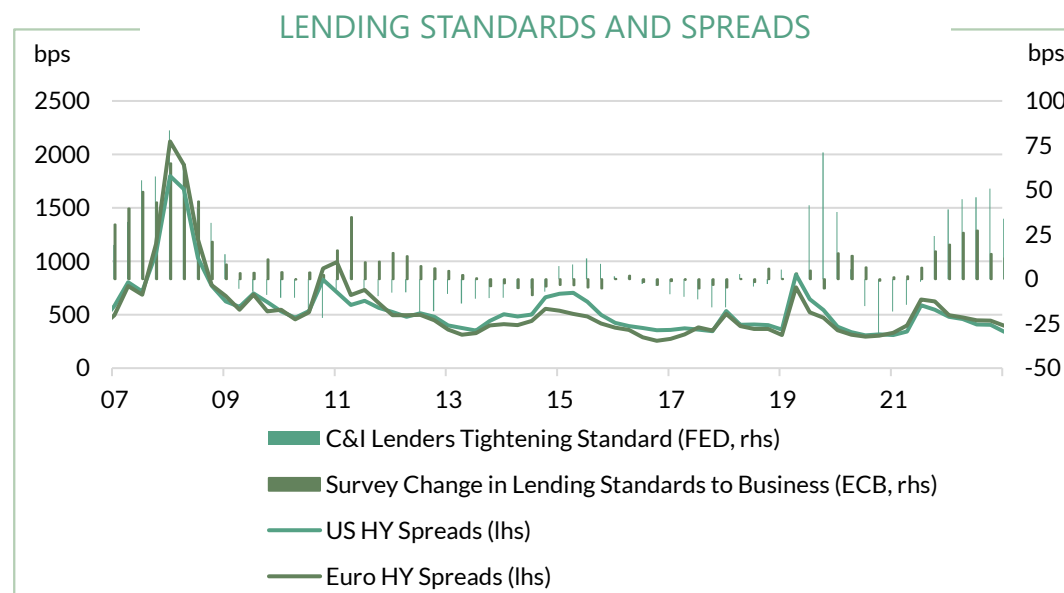
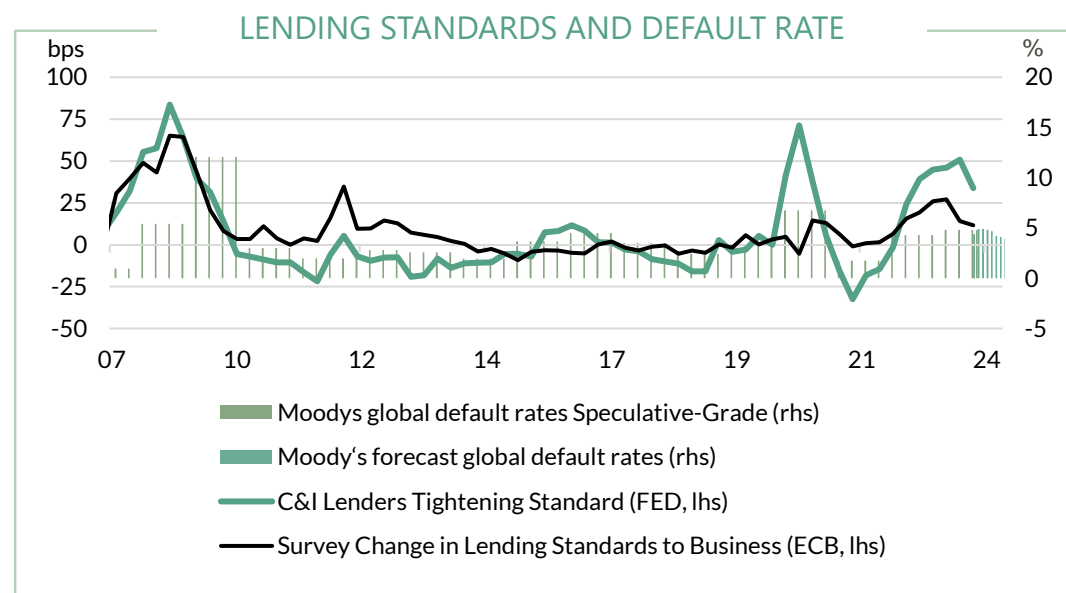
Past performance is not a reliable indicator of future performance and is not constant over time.

Sources: ODDO BHF AM SAS, Bloomberg | Data as of 01/31/2024



Financial conditions

A BIT EASIER



- Market driven financial conditions have clearly improved since October last year in the US and the Eurozone
- Recent surveys by the FED and ECB on lending availability and credit demand still reflect a restrictive stance with some improvement from the last quarter

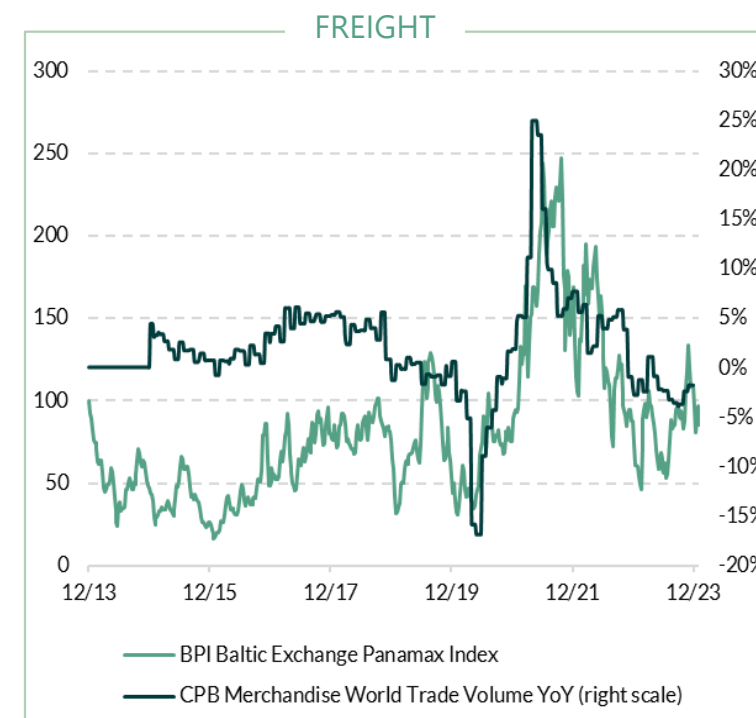
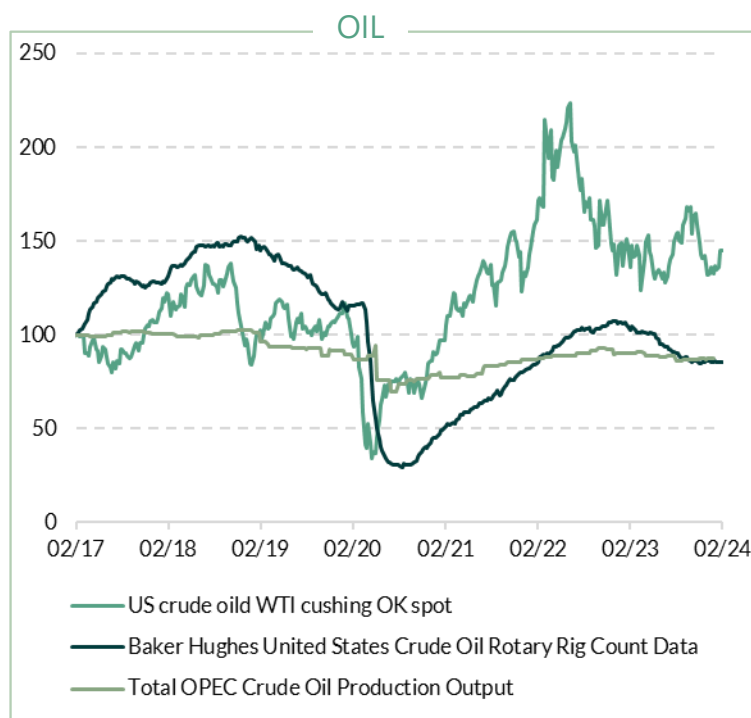
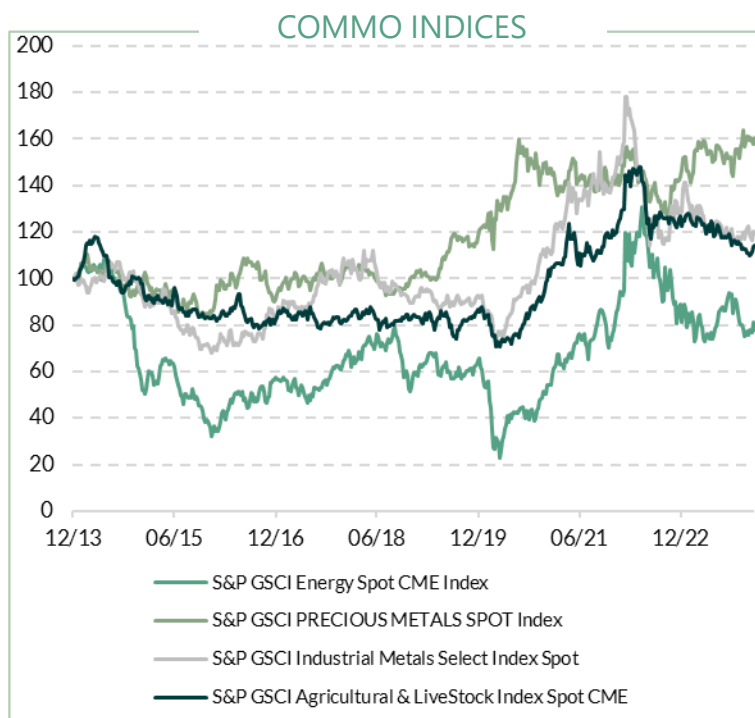


COMMODITIES & CURRENCIES



Commodities

RESILIENT PRICES OVERALL



- WTI oil prices kept hovering around the 75 USD level
- Growing uncertainties regarding safety of Red Sea maritime passage caused a threefold increase in freight price on the China to Europe routes (but just a shy one third of the peak prices of Q42021...).
- With US yields moving up slightly over the month, precious metals stopped rallying in January (Gold losing -1.1% vs USD).

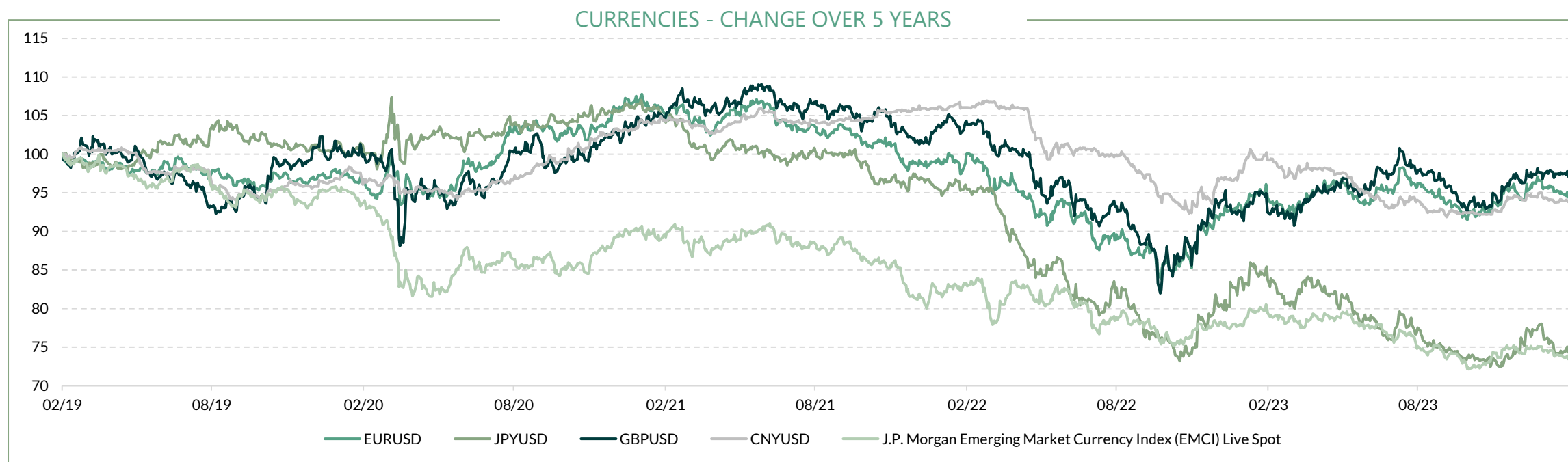
Past performances are not a reliable indicator of future performance and are not constant over time.

Sources: Bloomberg, ODDO BHF AM SAS | Data at 02/02/2024



Currencies

REBOUNDED TREASURY YIELDS SUPPORTING USD



- The US Dollar appreciated vs almost all peers.
- The Euro lost 2% while Japanese Yen and Australian Dollar plunged 4%.
- With higher inflation figures and growing doubts regarding BoE ability to cut rates soon, GBP was able to remain stable vs the dollar.
- Just as Indian stock indices were one of the few emerging markets to post positive performances, the Indian rupee was also able to appreciate slightly against the dollar in January.

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

Sources: Bloomberg, ODDO BHF AM SAS | Data at 2/2/2024



03

CURRENT *Convictions*





Scenarios

OUR 6-MONTH VIEW

01 Central scenario

Global GDP growth shows resilience so far but might slow down slightly as PMIs are weakening, especially in the Eurozone. China's GDP growth remains lackluster but might fuel disinflation further. The US economy still holds up very well. Central banks are approaching interest rate cuts while the full impact of the previous rate increases still has to be seen. Corporate earnings are solid so far with exceptions in the Chemical and Real Estate sector.

EUROPE

- Growth expectations deteriorate with weakening PMIs, especially for manufacturing
- Disinflation has accelerated and will continue also for core inflation
- ECB becomes more balanced given the progress on disinflation
- Supply chains are less disrupted

US

- So far, corporate fundamentals and the labor market remain resilient, but economic sentiment is deteriorating
- While disinflation has accelerated, the FED emphasizes its dual mandate of price stability and maximum employment.
- Massive issuance volumes of the US Treasury could absorb liquidity of bond markets.

STRATEGY

- Neutral on equities
- Benefit from attractive carry of short-term High Yield Bonds and longer duration from Investment Grade

OVERWEIGHT

- Short Duration Euro High Yield
- Government Bonds and Investment Grade

UNDERWEIGHT

- US High Yield

70%

02 Alternative scenario #1

Upside scenario

- Less disrupted supply chains and higher real income support global growth, a recession is avoided
- Central banks start to cut rates as there is substantial relief from inflation figures
- Sustainable resolution of the stress in the financial system and no repercussions to the real economy

OVERWEIGHT

- Equities, incl. Emerging Markets
- High Yield
- Sovereigns

UNDERWEIGHT

- Alternative Strategies
- Cash

20%

03 Alternative scenario #2

Leverage crisis, sticky inflation

- A more restrictive credit supply puts pressure on highly levered companies and the overindebted Real Estate sector which could have negative spill overs to the Banking sector, especially in the US.
- Inflation does not fall to the expected extent, stays sticky despite a weaker economic outlook
- Risk of overtightening by central banks
- Market volatility increases

OVERWEIGHT

- Alternative strategies
- Cash

UNDERWEIGHT

- Equities
- Credit

10%



Our current convictions FOR EACH ASSET CLASS

Change from the last
GIC meeting

➡
➡

Equities	OVERALL EQUITIES RECOMMENDATION			0		
	Large cap Eurozone			0		
	Mid cap Eurozone			0		
	Small cap Eurozone			0		
	UK			0		
	USA			0		
	Emerging markets			0		
	Japan			0		
	China			0		
Currencies	USD/€ (Direction of the USD)			0		
	YEN/€ (Direction of the YEN)				1	
	GBP/€ (Direction of the GBP)			0		
	CHF/€ (Direction of the CHF)			0		
Commodities	Gold		-1			
	Crude oil			0		

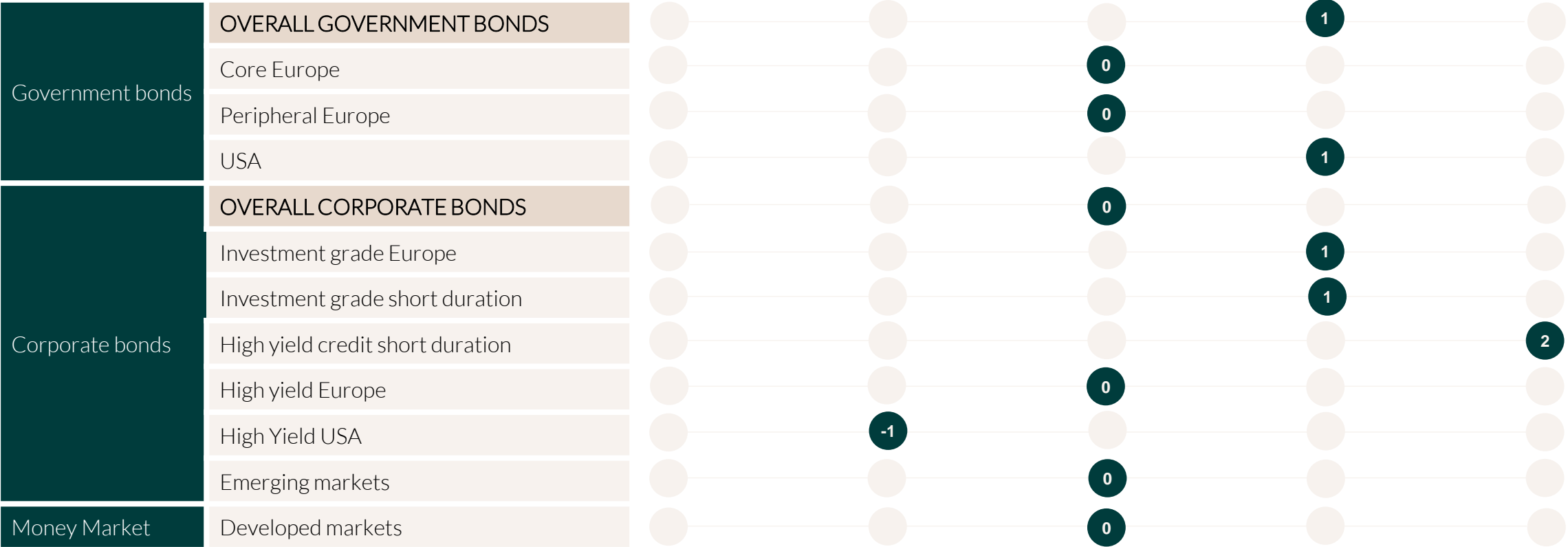
Source: ODDO BHF AM, as of February 7th 2024



Our current convictions FOR EACH ASSET CLASS

Change from the last
GIC meeting

➔
➔





HOW PERFORMANCE IS 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 SPREAD (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 or 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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NICOLAS CHAPUT

Global CEO
ODDO BHF AM

EMMANUEL CHAPUIS, CFA

Co-Head of Fundamental Equities
ODDO BHF AM

BJOERN BENDER, CFA

Head of Fixed Income Products
ODDO BHF AM GmbH

REMI GRAVIER

Product Manager Asset Allocation
ODDO BHF AM

LAURENT DENIZE

Co CIO
ODDO BHF

MAXIME DUPUIS, CFA

Global Head of Marketing & Products
ODDO BHF AM

ALEXANDER MEN

Head of Asset Allocation Products
ODDO BHF AM GmbH

GUNTHER WESTEN

Head of Asset Allocation & Fund Management
ODDO BHF AM GmbH

MATTHIEU BARRIERE, CFA

Deputy Head of Asset Allocation
ODDO BHF AM SAS

MATTHIAS LACKMANN

Asset Manager Corporate Credit IG
ODDO BHF AM GmbH

ODDO BHF Asset Management SAS (France)

A portfolio management firm certified by the French Financial Markets Authority (AMF) under n°GP 99011.

Established in the form of a simplified joint-stock company with authorised capital of €21,500,000.

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12. boulevard de la Madeleine - 75440 Paris Cedex 09, France - Tel. : 33 (0)1 44 51 85 00

www.am.oddo-bhf.com



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