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## A recovery without overheating

**JUNE 2021**

The keenly awaited US employment report for May again proved a disappointment, with non-farm payrolls increasing by 559,000 in May, thus falling short of the expected 675,000. What is more, the labour force participation rate fell slightly from 61.7% to 61.6%. Hence, the 0.3 percentage point drop in the unemployment rate to 5.8% therefore makes the labour market situation look somewhat better than it is.

Yet, while this data came in below consensus, the labour market growth seen in May is consistent with the Fed's projected timeline for raising rates by the December 2022 FOMC meeting (i.e., an average monthly rise in payrolls of around 500,000). In addition, the labour force participation rate will automatically increase in late summer/early fall as schools, childcare facilities and educational institutions reopen. Similarly, with extra unemployment insurance benefits expiring in September, Americans will be more eager to re-enter the labour market, giving a boost to both the participation rate and non-farm payrolls.

U.S. Treasury yields fell following the report's release, suggesting that slower-than-expected job growth is prompting investors to reassess the Fed's policy timeline. While disappointing, the jobs report does not warrant a change in the Fed's outlook in our view, including discussions about "tapering" this summer.

### What strategy to adopt?

**In fixed income**, investors should keep duration low as inflation base effects will peak in a few months, likely leading to long rates moving up one last time before truly stabilizing. Only then (with US 10-year rates close to 2%) will it be time to reposition in US Treasuries and to buy growth stocks significantly.

**In equities**, it makes sense now to reconsider thematic equities, particularly "green" stocks, which have undergone a correction (albeit justified by extreme valuations), but whose outlook looks set to brighten up given the infrastructure stimulus plans.

We are therefore once again favouring a "barbell" positioning:

- Cyclical stocks such as automotive and banks in Europe to benefit from the anticipated acceleration in growth
- Global "green" stocks, with a strong bias towards Europe

**At a regional level**, we see a 10% upside potential for Japan after its year-to-date underperformance. The reopening of the Japanese economy, an acceleration in the rollout of vaccinations and, in the longer term, a boom in green investments are all reasons to favour the "value" style in this country. In emerging markets, corporate earnings are trending higher: the consensus earnings growth forecast for 2021 for Asian equities is 36%; estimates for 2022 should be revised upward as vaccination progresses.

**In terms of capitalization**, smaller companies are best positioned at this point in the cycle to capture this positive momentum. Relatively speaking, they are historically cheap compared to large caps and have rarely offered such encouraging earnings prospects across all geographies.

**As regards currencies**, regardless of the timing of monetary policy normalization (in particular a possible tapering), the widening of deficits will further weaken the US dollar. Any strengthening of the dollar should be taken as opportunity to sell.

### What are the risks?

In addition to risk of rate hikes already broadly covered in the media, we need to keep a close eye on the credit trend in China, a leading indicator of global growth/cycles. An overly sharp reversal could hurt global growth expectations in an environment where, let's not forget, equities are expensive and therefore likely to correct in the event of a significant change in the economic trend caused by changes in monetary or fiscal policy. We are far from it!

Stay invested in risky assets



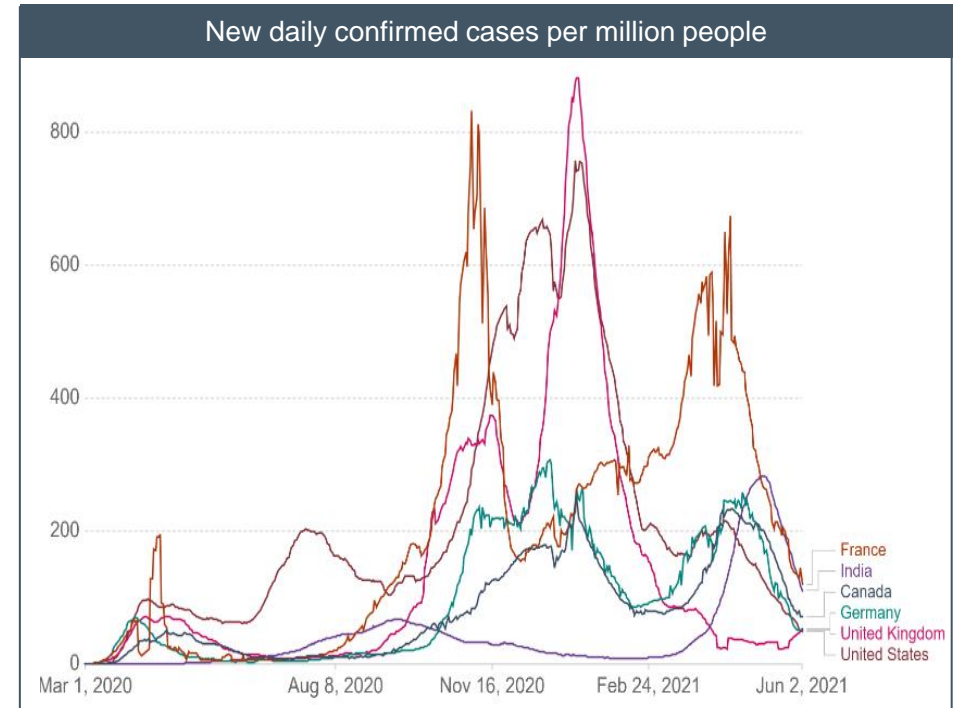
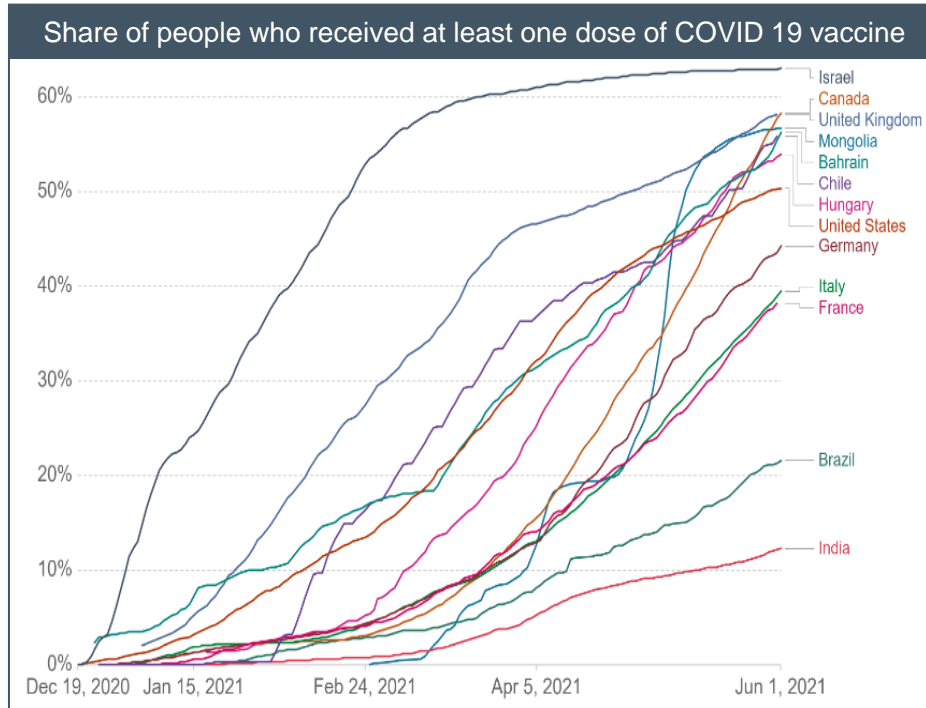
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# MACROECONOMIC OUTLOOK

# Covid19: year 2



## Eurozone vaccination process catches up with UK and US

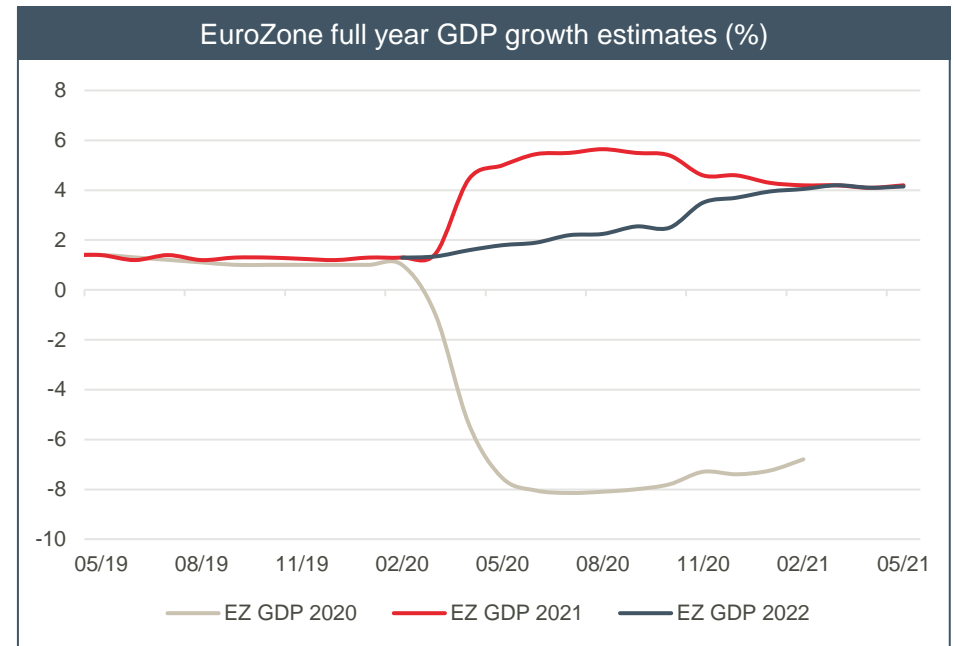
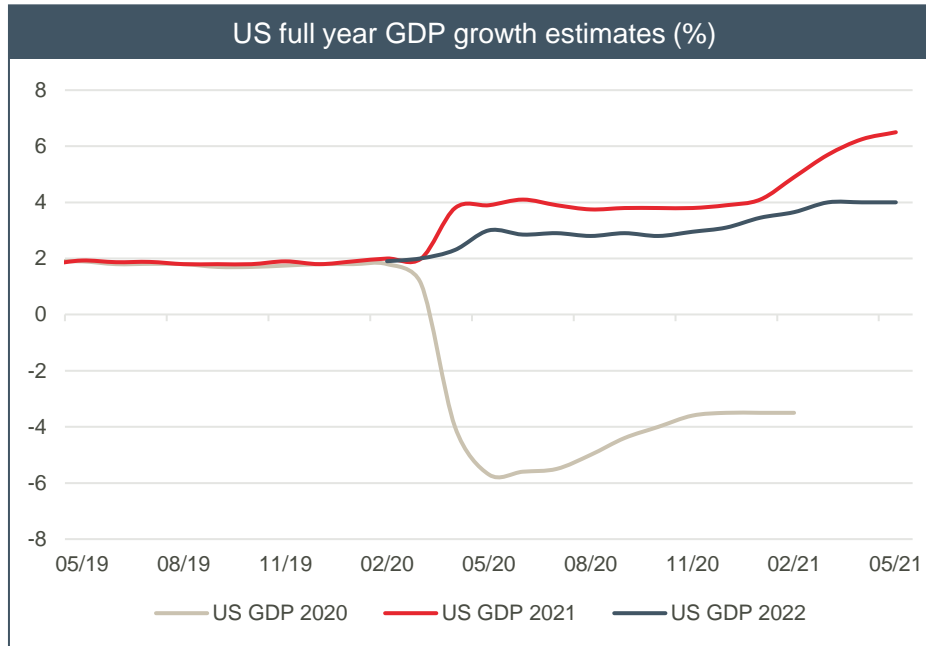


- Good progress in the Eurozone
- All eyes on the UK: Is the Indian variant threatening the final reopening?
- While the West reopens, Asia faces a third Covid wave and is partly imposing restrictions

# Growth outlook



Global recovery in full swing, but still uneven



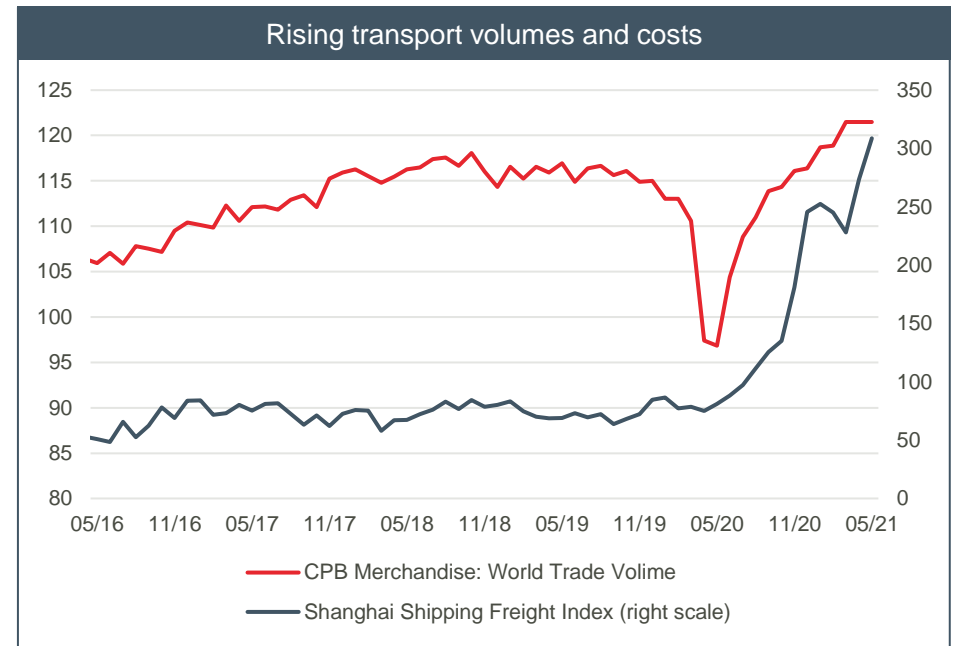
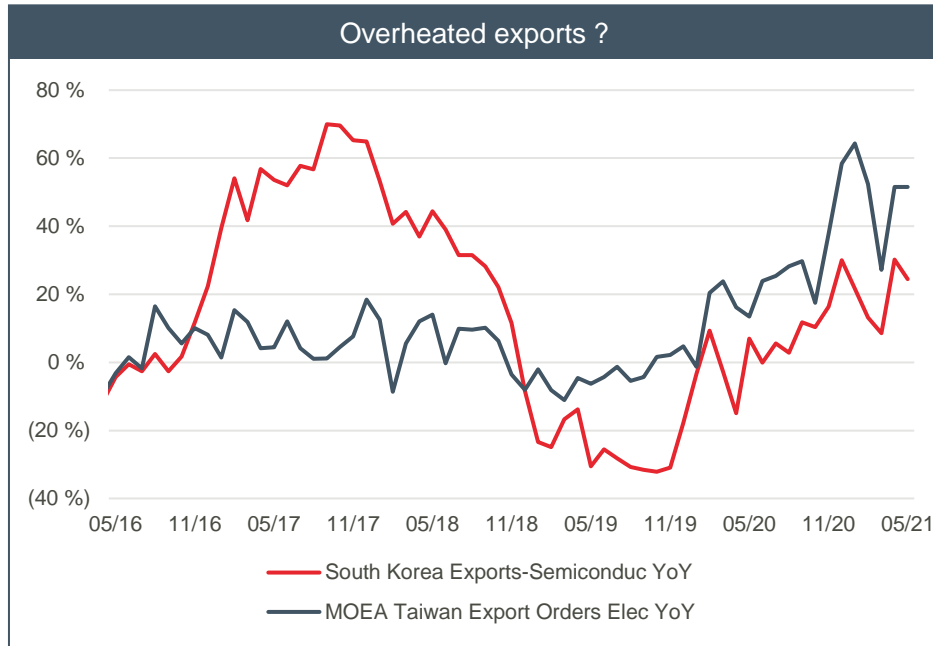
- Eurozone just started to recover at a strong clip
- The US is close to peak growth, but will grow above potential for quite some time
- China and parts of Asia are already losing momentum given the fading credit impulse and the third Covid wave in countries like Vietnam and Taiwan



# Global trade

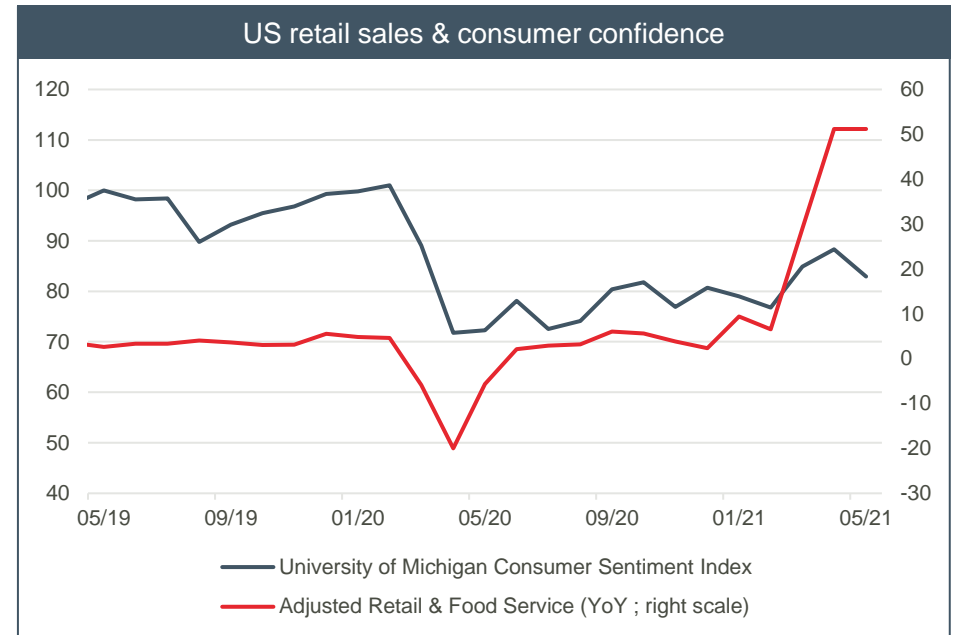
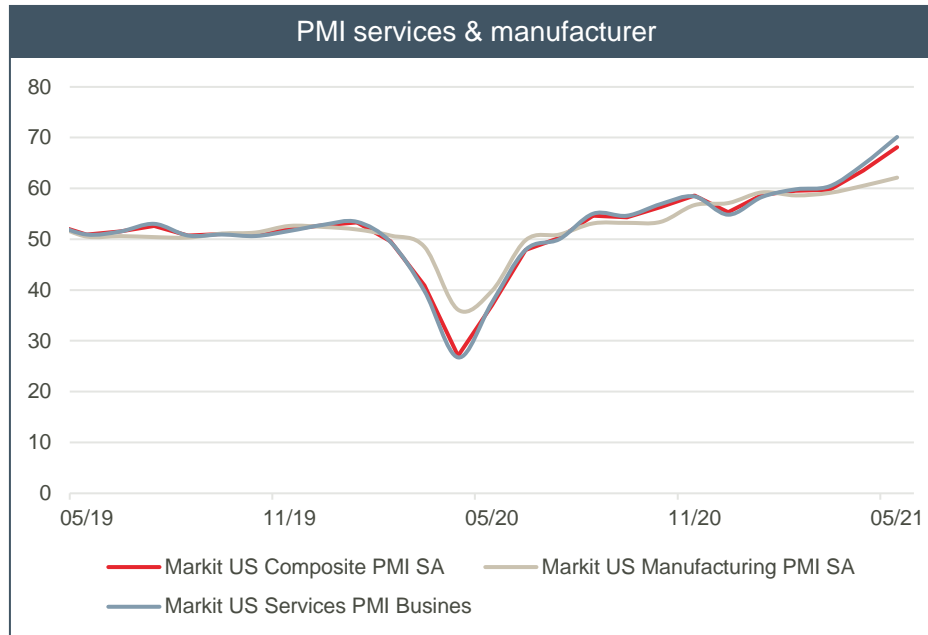


Still very strong trade, but supply chain disruptions denting further growth



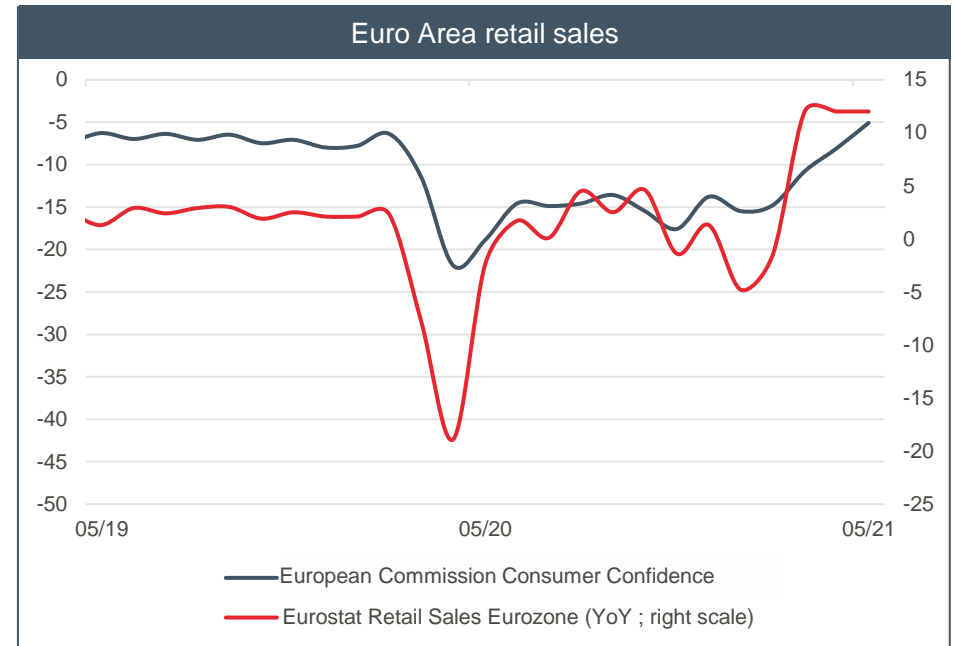
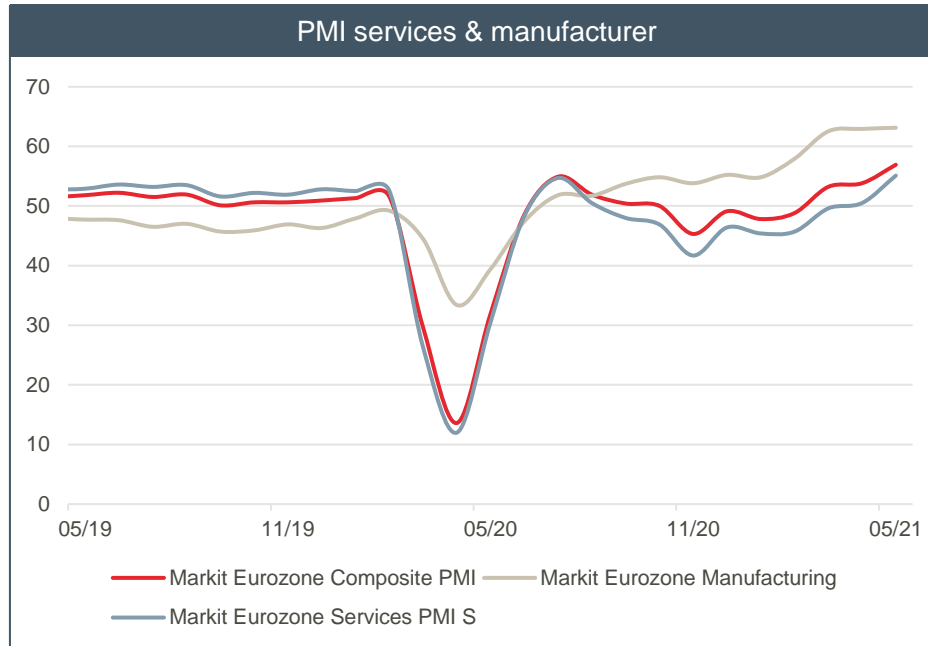
- Supply chain disruptions and exploding energy costs are putting a lid on trade for the time being
- Those factors should fade over time, but horizon is crucial

## Growth engine is firing on all cylinders



- Unprecedented fiscal stimulus and reopening have propelled the economy higher, but growth momentum is about to peak
- Growth gap to the 2019 level should have been closed by now, output gap should turn positive at the end of this year
- Despite notable improvements still more than 8 million jobs have been lost. However, the labour market should be on the mend over the next months
- Some early signs of wage pressure as job openings are hard to fill

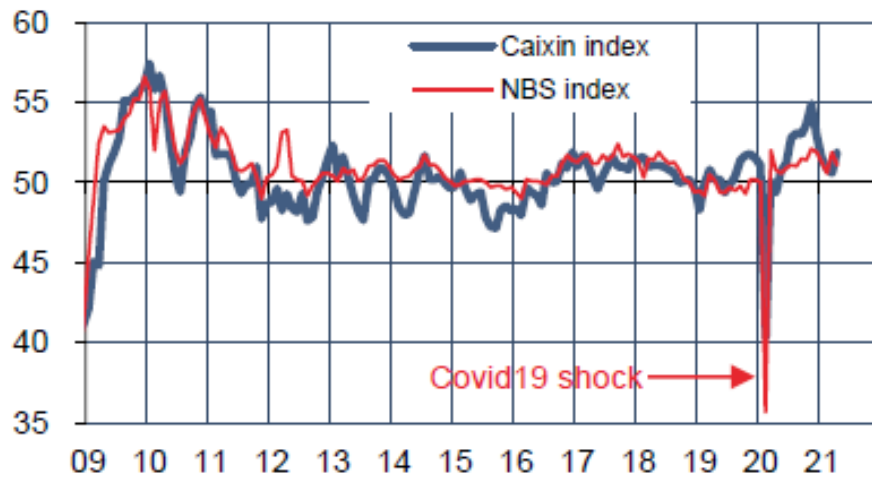
Let the recovery begin



- Manufacturing PMI have partly reached all-time highs and are likely at their cycle tops
- Service sector is now closing the gap to manufacturing fast with re-openings underway
- Price pressures and supply disruptions are increasingly showing up in the data
- Overall the catch-up potential of the Eurozone recovery still seems to be underestimated

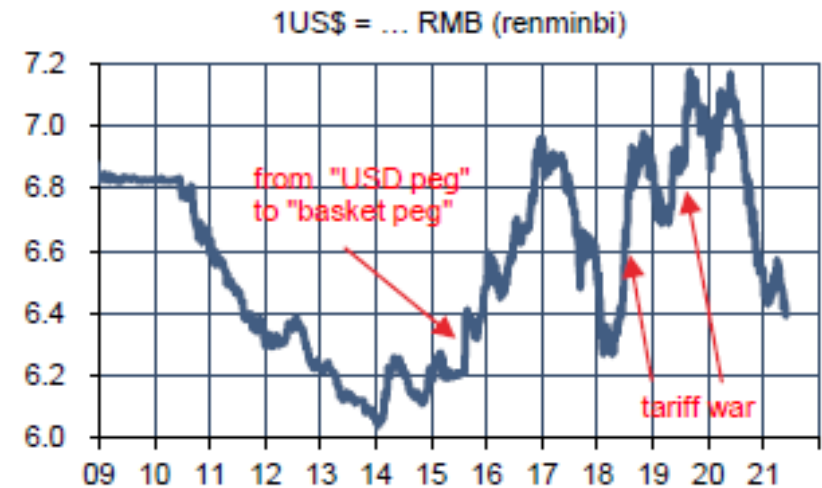
## A fading credit impulse

Business surveys - PMI index manufacturer (points)



- May PMI have been stronger but manufacturing appears to level off
- Economic momentum should be past the peak
- Restrictive measures are slowly taking effect

Dollar vs RMB

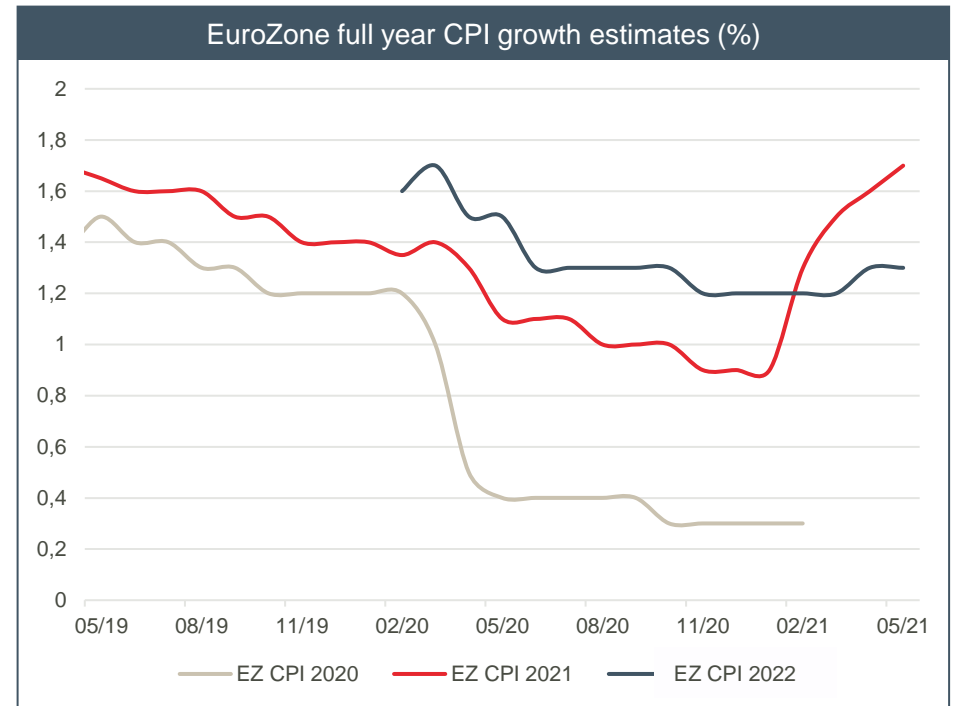
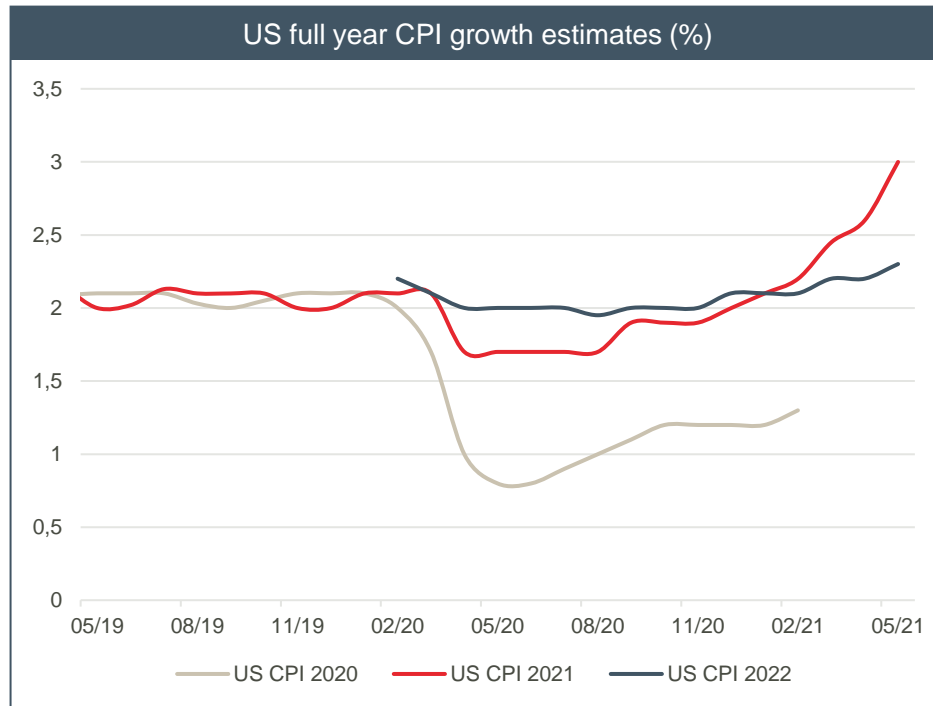




# Inflation expectations



## Base effects still to peak

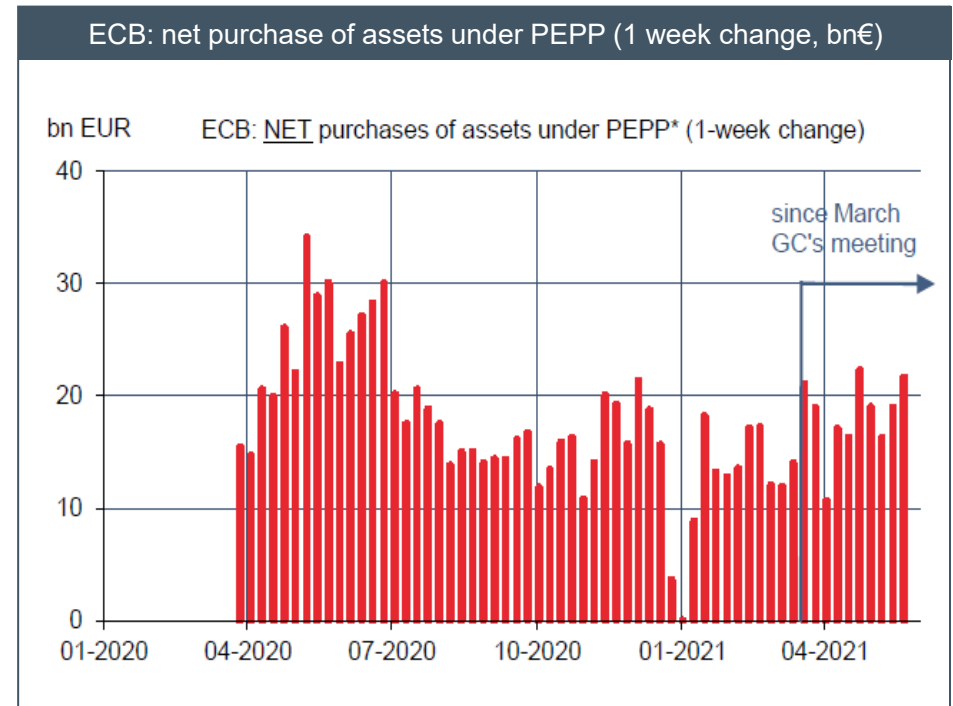
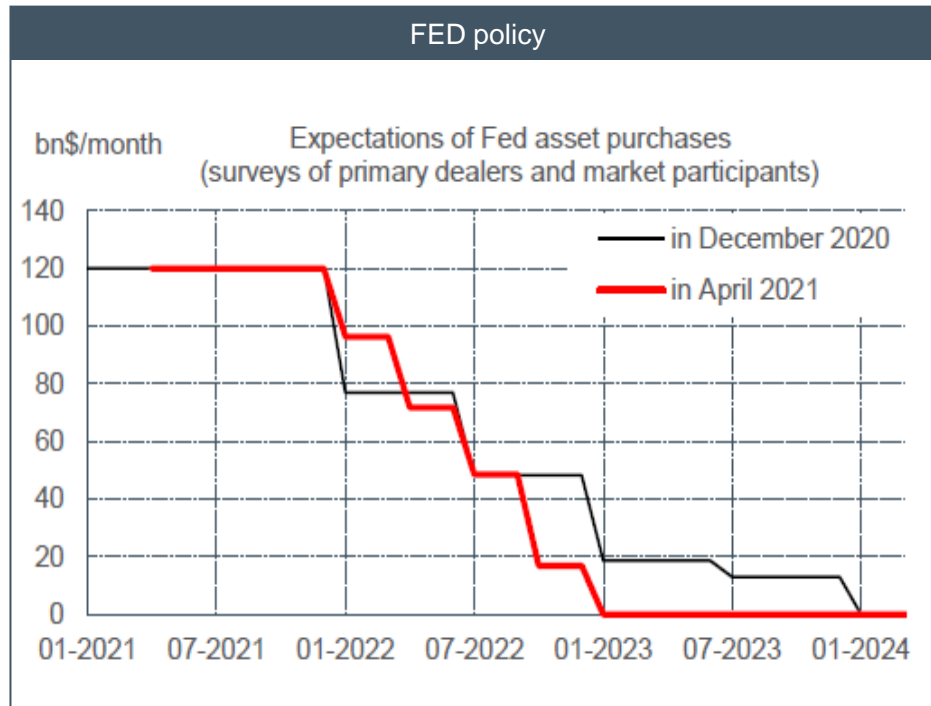


- In the US, 10-year break-evens have rallied to around 2,5% which is not exceptionally high against the medium-term history
- For now, markets embrace the FED narrative of mostly transient inflation contributors
- However, even for the FED `s optimistic scenario, real yields at -0,8% are much too low for the cycle phase
- Eurozone 10-year break-evens have partly normalized at 1,4%, but should have a bit more leeway as inflation will be under upside pressure for at least another six months

# FED & ECB policies



The mantra has worked – for now

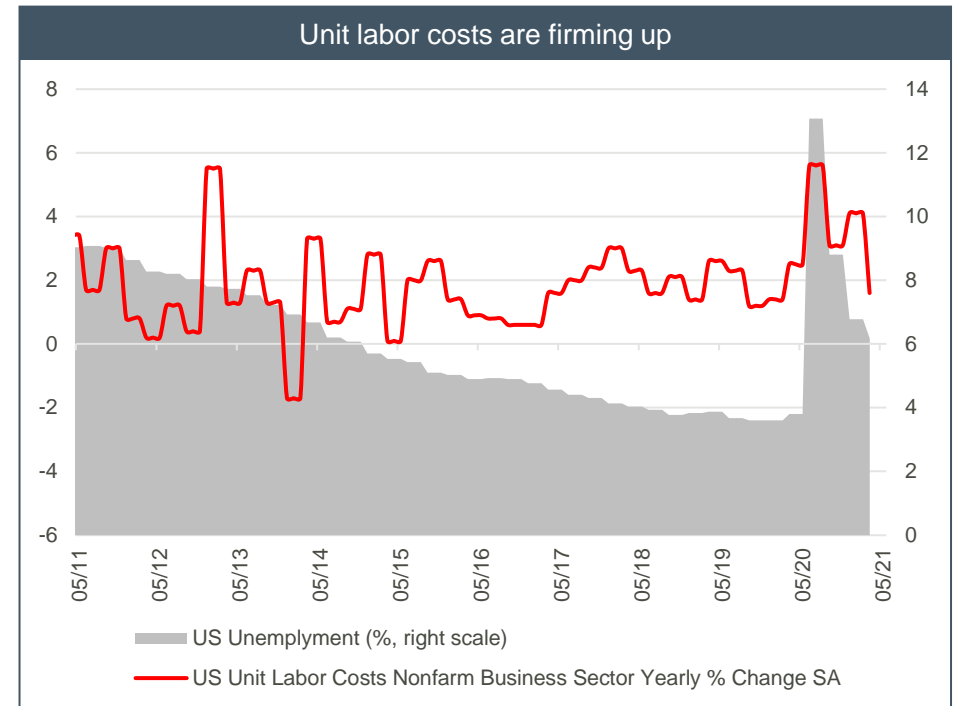
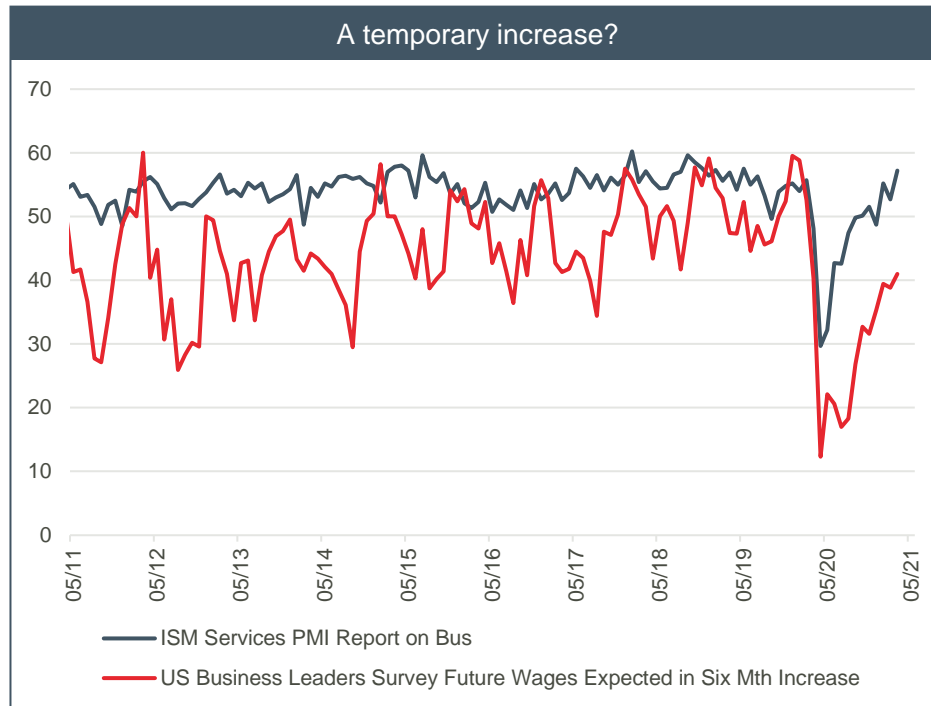


- The FED has convinced investors to embrace the view that inflation is mostly transitory and the central bank can completely look through
- However, there is the risk that this benign view could be challenged and force the FED into an earlier tapering at year's end
- The ECB's communication policy remains fuzzy, but the bank has been very vocal on a continuation of its accommodative stance recently
- Thus, the PEPP is likely to run into autumn at the same pace

# US job market



## Recovery still incomplete



- Despite notable improvements the labour shortfall is still significant
- Direct paychecks and incomplete re-openings have so far hampered willingness and ability to take jobs
- Hard-to-fill jobs at record levels and jobless claims hint to improvements and early evidence of higher wage growth

# US job market

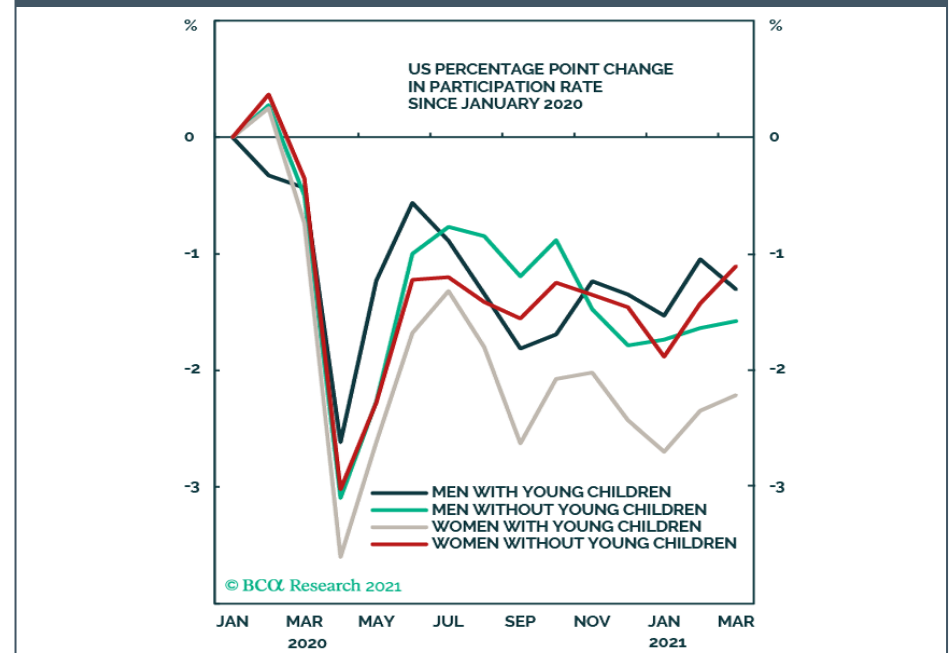


The labor force participation will be the indicator to watch

NFIB Jobs hard to fill & JOLTS Quits rate



Mothers with children had to leave the labor force

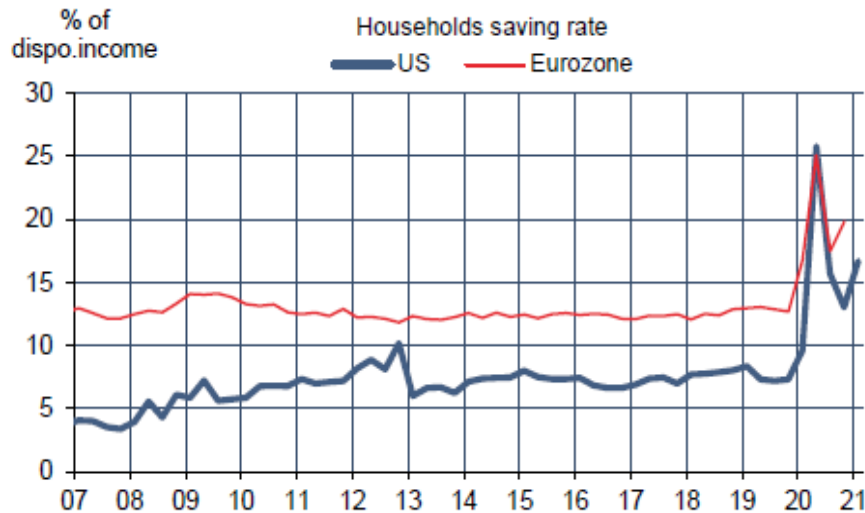


# Savings

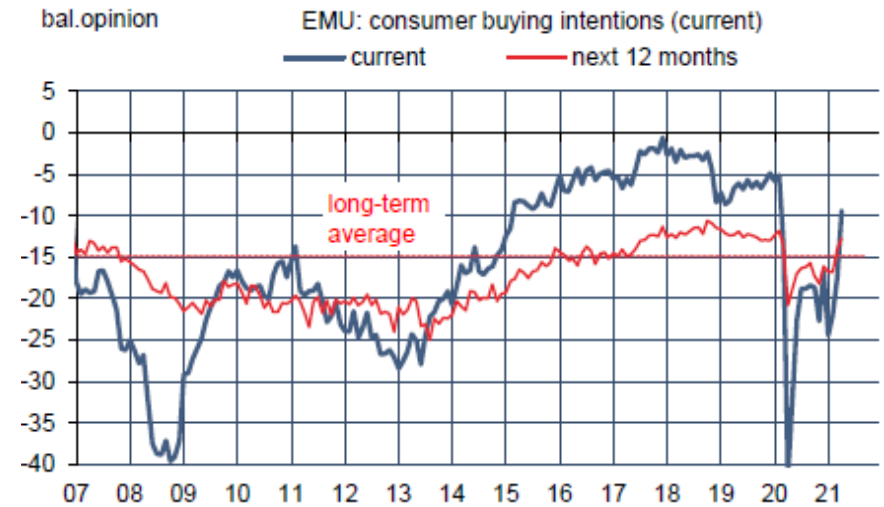


Shop till you drop

Households saving rates



EMU: consumer buying intentions

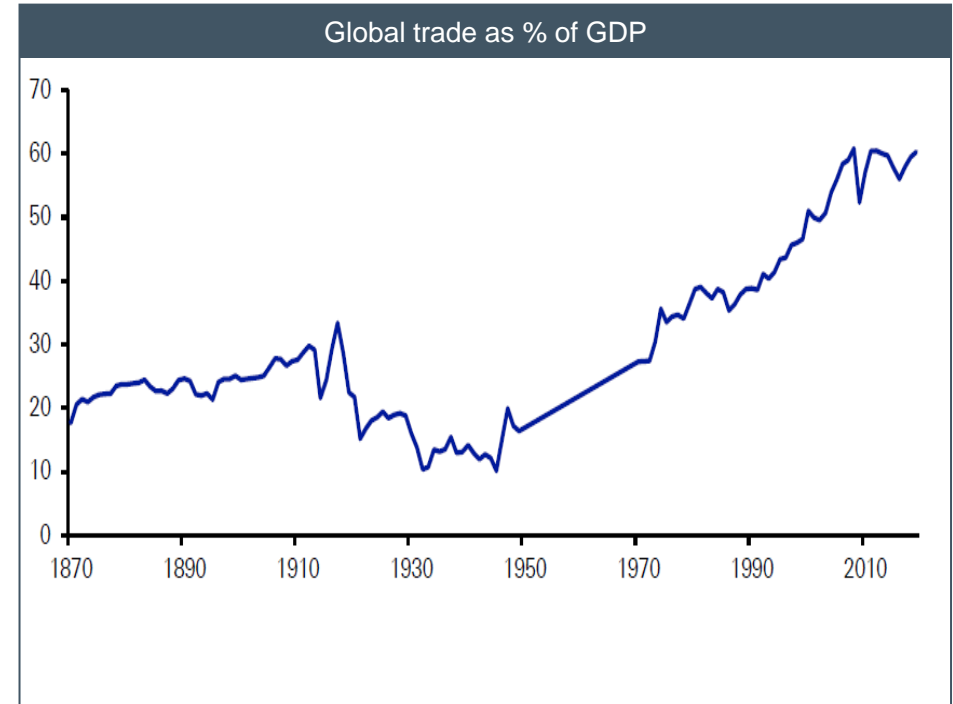
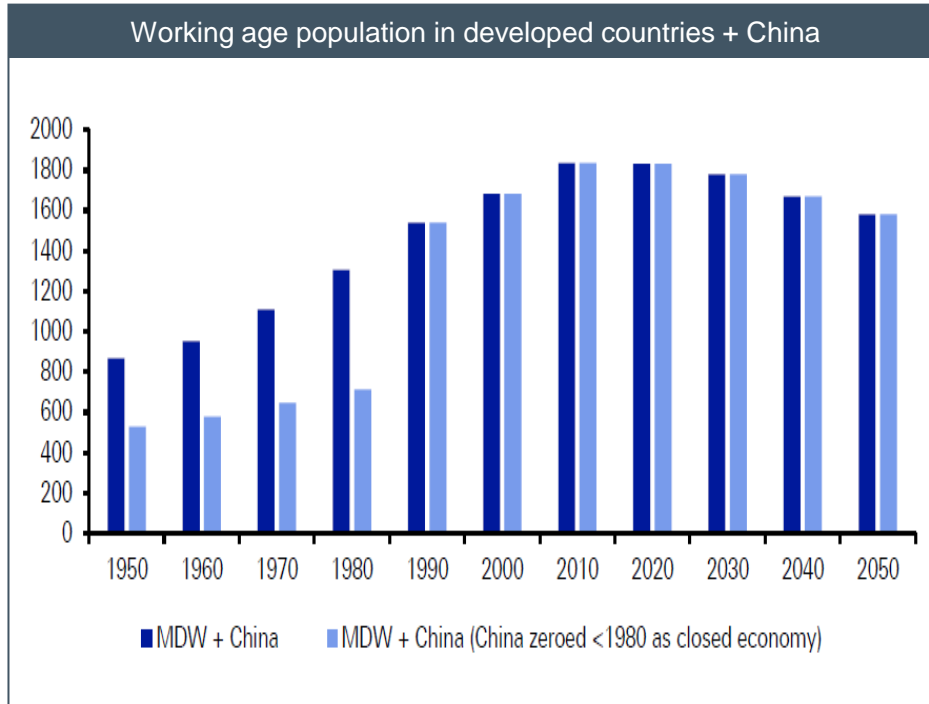


- Unprecedented involuntary savings will boost consumption
- As European consumers tend to take into account debt repayment and job insecurity slightly more than their US counterparts, the normalization of savings should be more rapid in the States
- As supply structures in the service sector are also distorted, the surge in consumption is likely to generate temporary inflation spikes in this sector as well

# What about the longer trends for inflation?



Demographics and waning globalization are structural inflationary forces





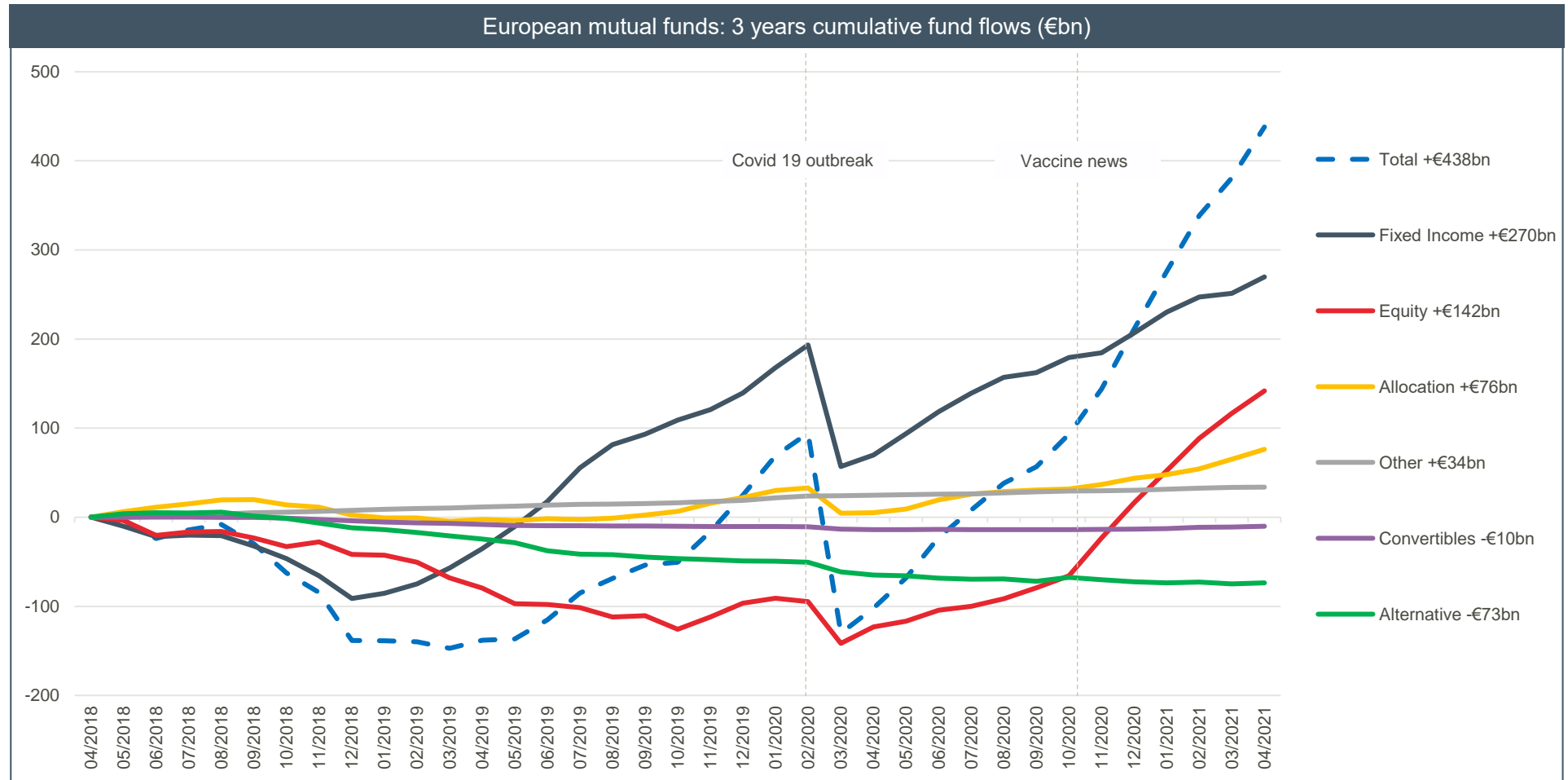


## 02 MARKET ANALYSIS

# European mutual fund flows – 3 years trend



## Equity gaining market shares

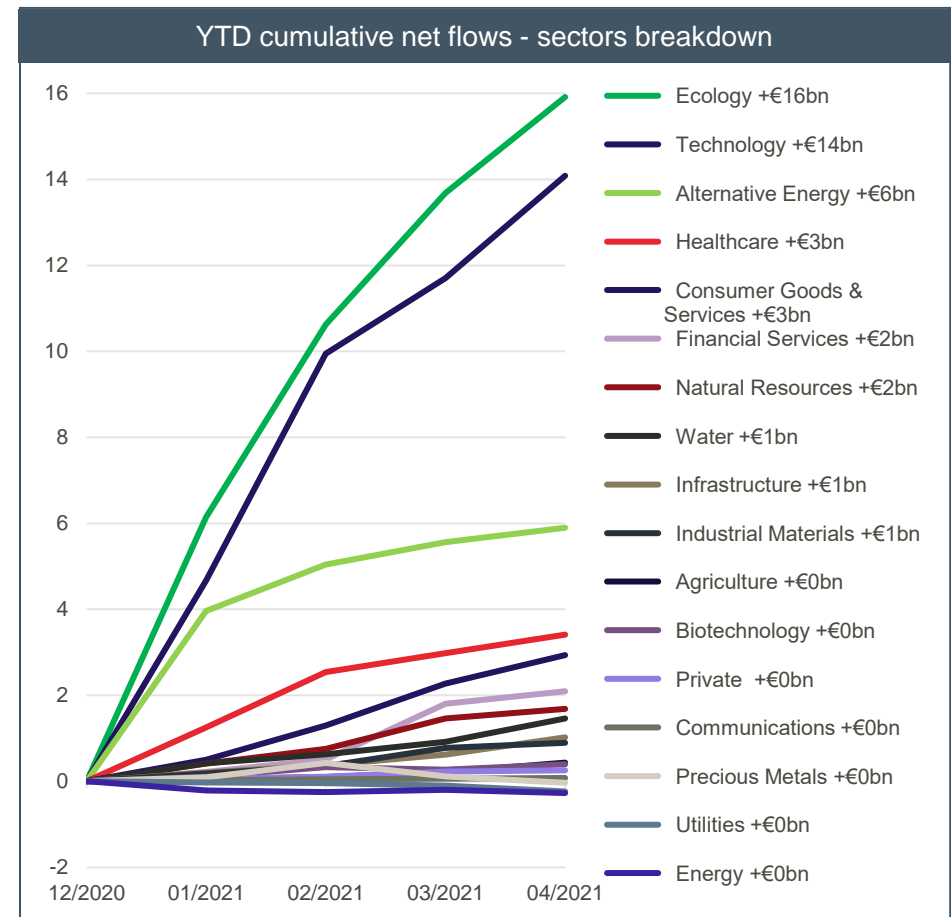
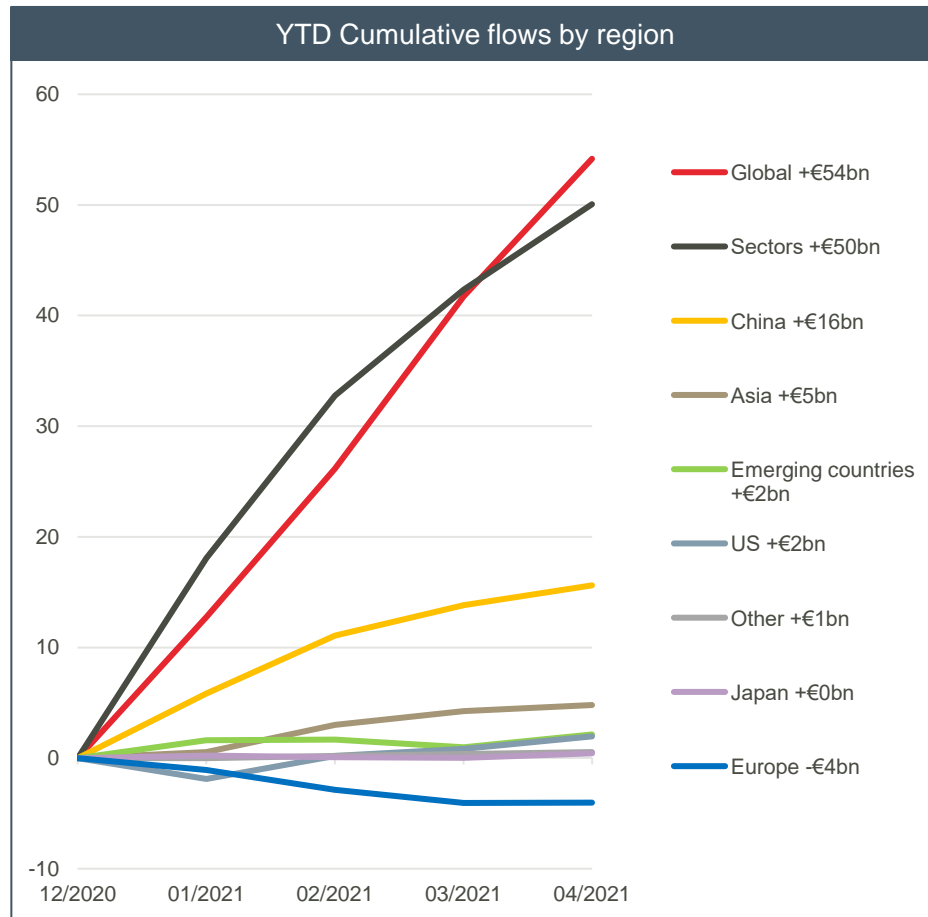


Source : Morningstar. Data as of 30.04.2021 (Europe OE ex ETF ex MM ex FoF ex Feeder (domiciled, most compr.))

# European mutual fund flows – year-to-date equity flows



Flows driven by global and sector strategies

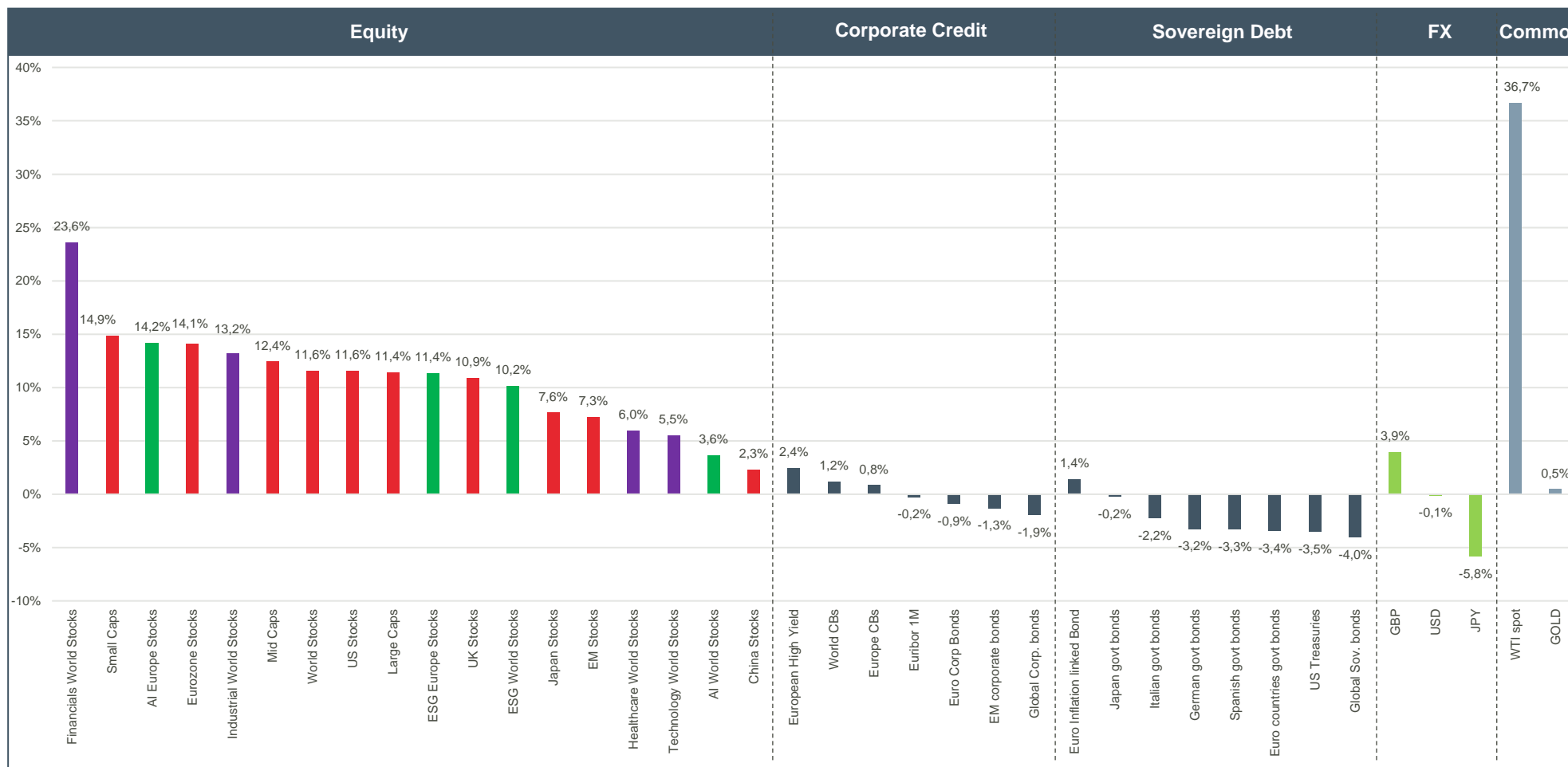


Source : Morningstar. Data as of 30.04.2021 (Europe OE ex ETF ex MM ex FoF ex Feeder (domiciled, most compr.))

# Year-to-date performances of asset classes



Strong confidence in the recovery



Equities Sectors Thematics

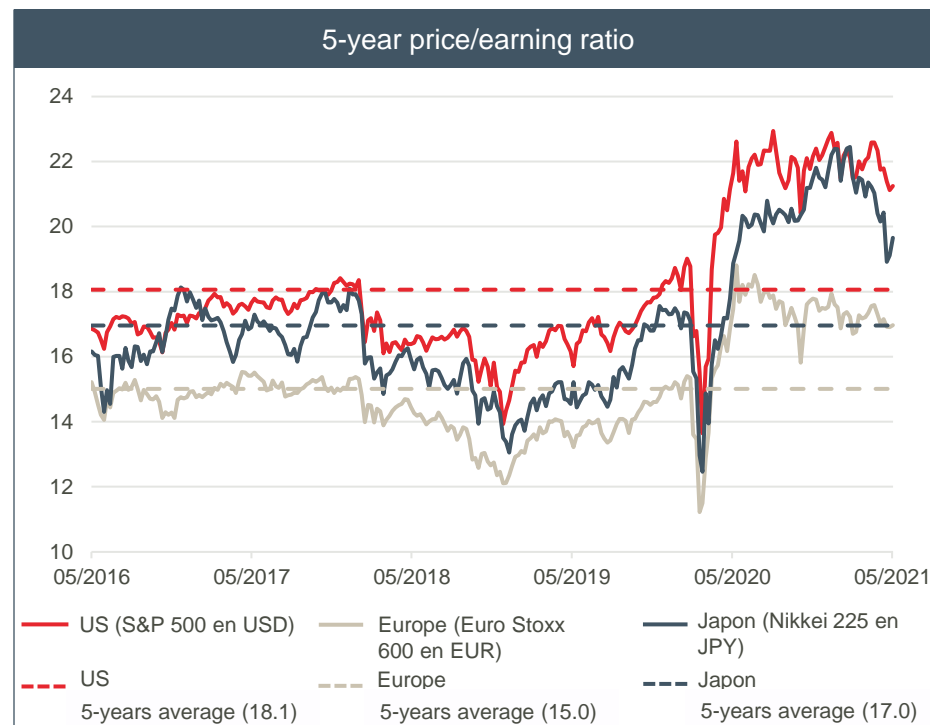
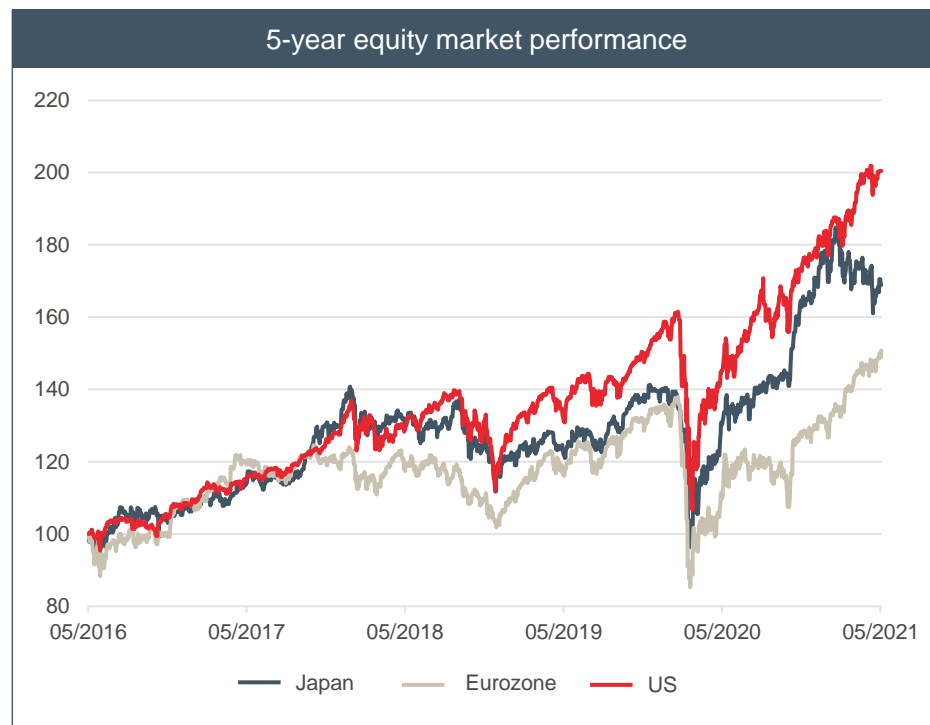
Past performances are not a reliable indicator of future performances and are not constant over time.

Sources: Bloomberg and BoA ML as of 05/31/2021; performances expressed in local currencies



# EQUITIES

The only way is up?



- After a bout of volatility early on in the month, global equities eventually kept on rallying in May.
- Value kept outperforming growth themes. In Europe and the US, banking indexes gained 5%. Materials, Autos and Energy also led the rally.
- Many emerging indexes beat developed peers. LatAm was supported by the value/reflation theme, but Asian indexes also posted strong performances after having strongly lagged in the previous months (Shanghai, Manilla +4%, Bombay +6%...). Nevertheless, estimated EPS in these economies are revised much more slowly than in developed markets.

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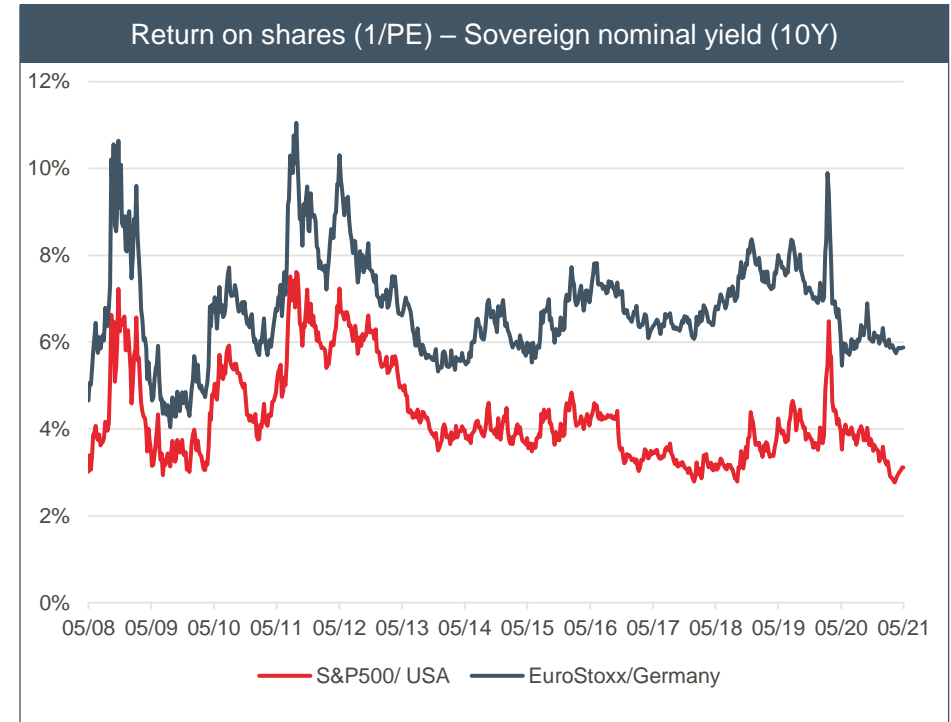
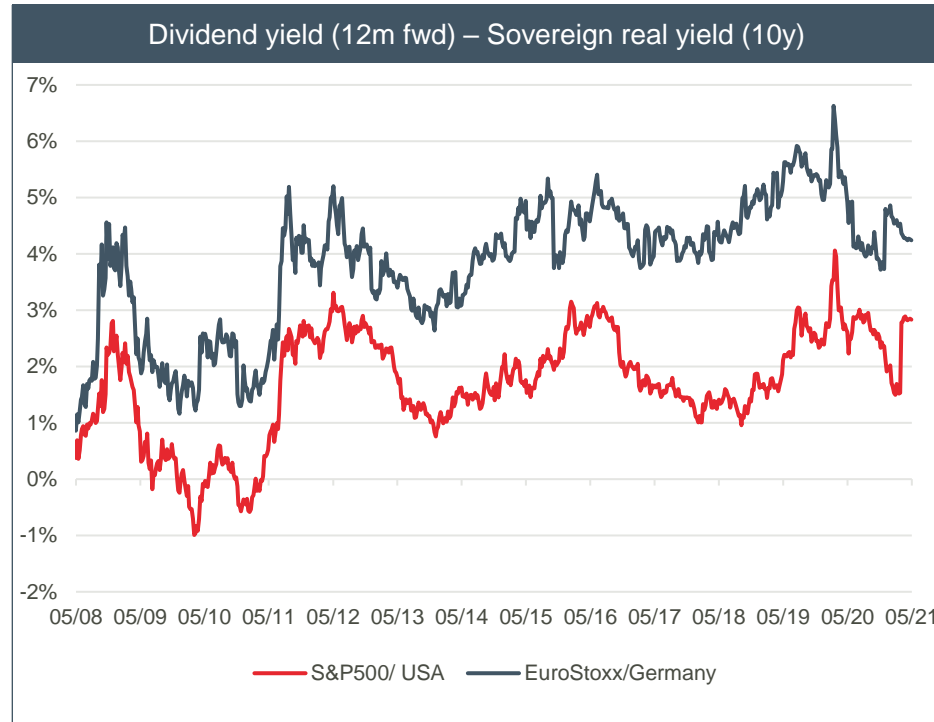
Source: Bloomberg, ODDO BHF AM SAS | Datas as of 05/31/2021 | Datas as of 05/28/2021



# Risk premiums



## Dwindling risk premia



- With higher expected inflation and flattish yields, real yields have moved further into negative territory
- Equity dividend yield thus still compare favorably
- When comparing earning yields with nominal yields, US equities still never seemed so expensive since 2007!

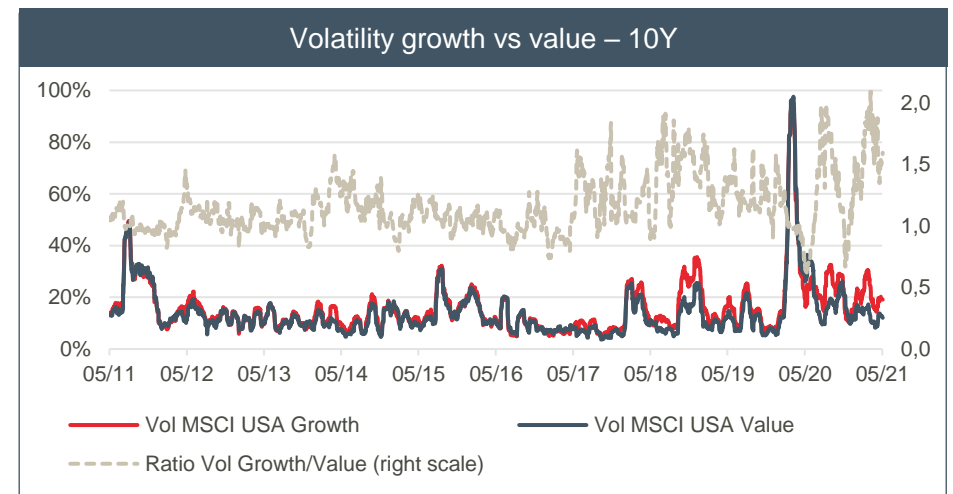
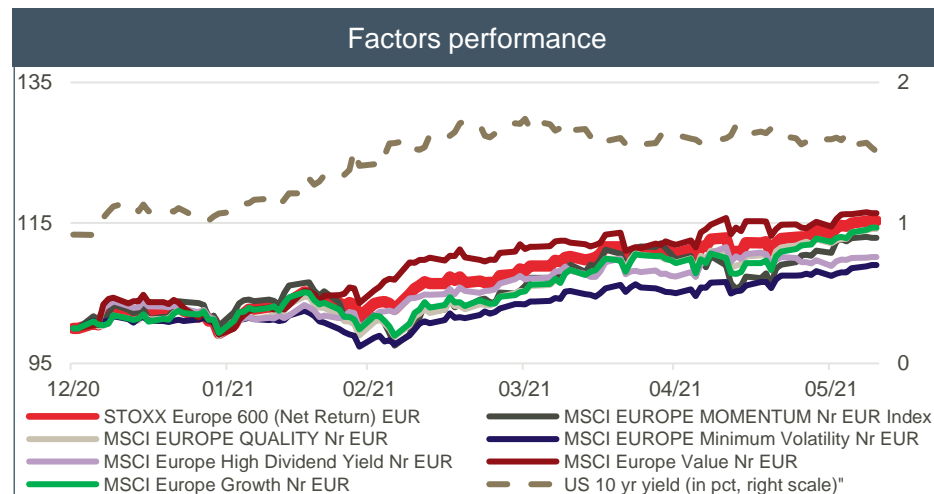
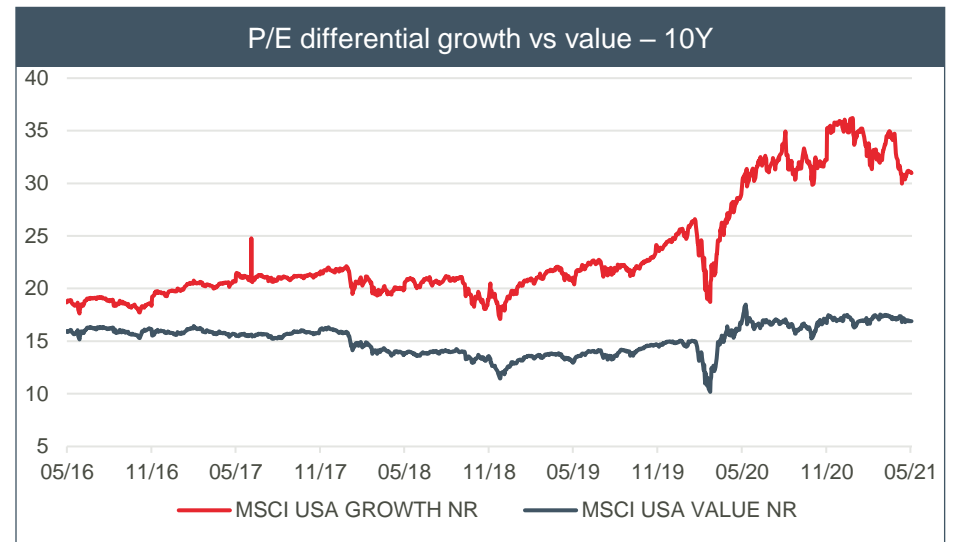
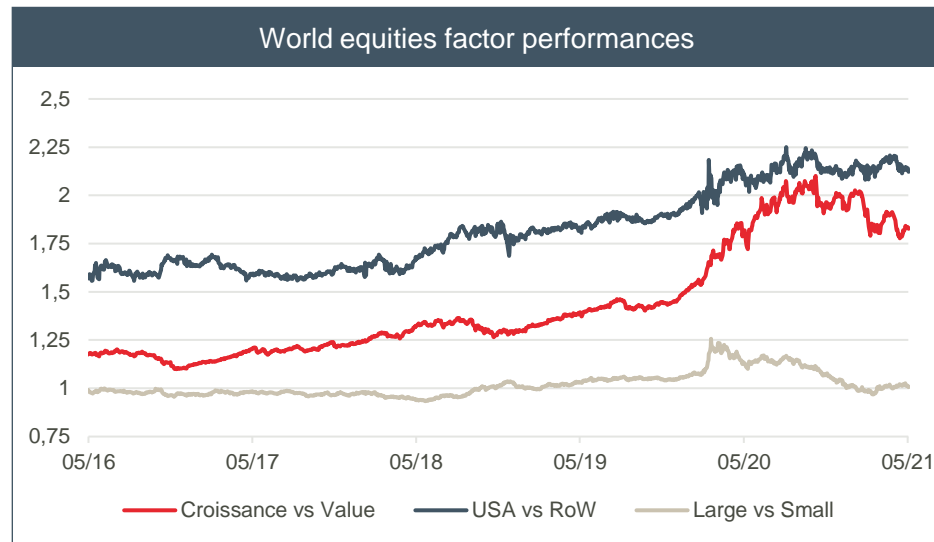
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Source: Bloomberg, ODDO BHF AM SAS | Figures as of 05/31/2021

# Equities performances – styles differential



Value rerating, still some room to go

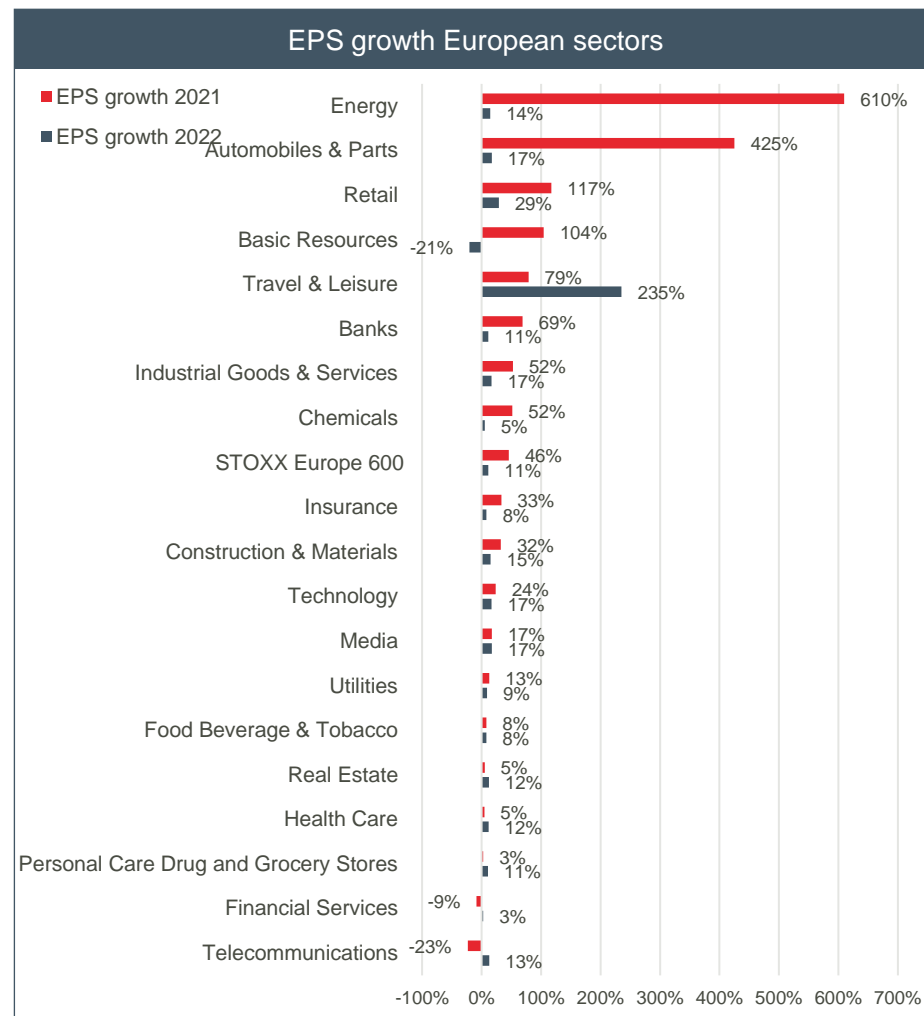
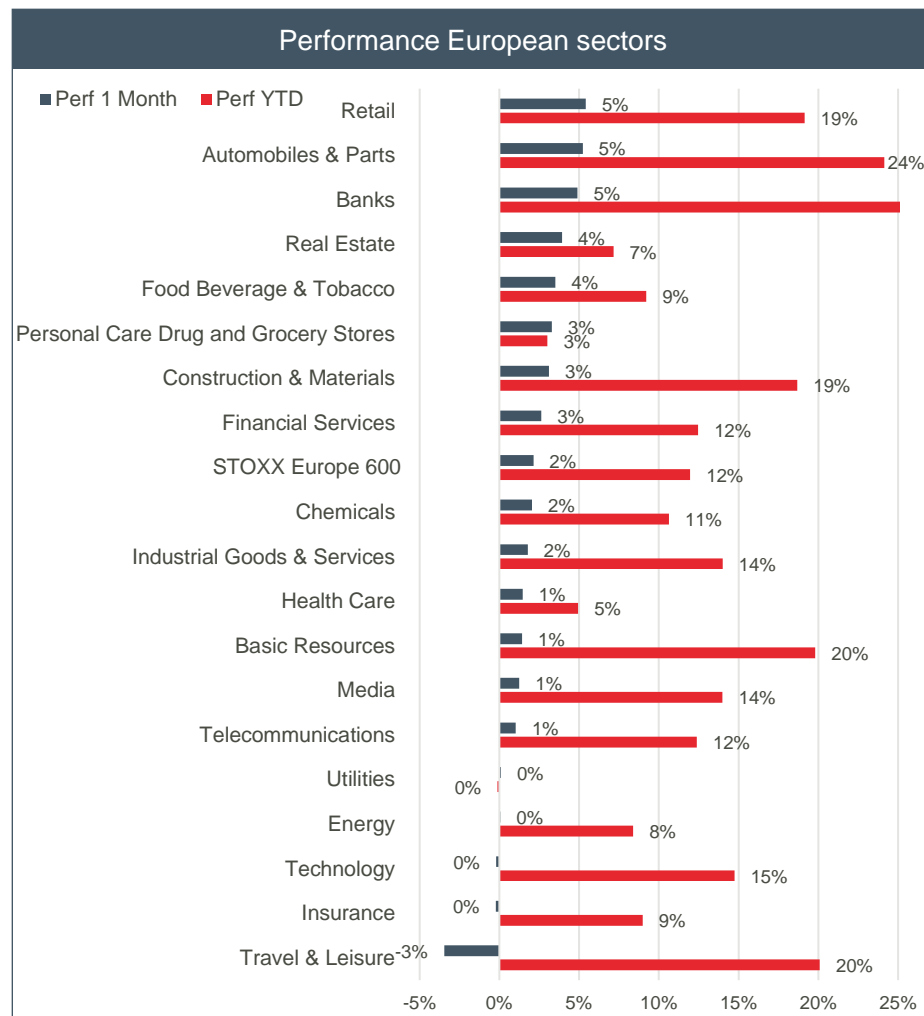


Sources: ODDO BHF AM SAS, Bloomberg | Figures as of 05/31/2021

# European equities - sectors



With an extraordinary rebound in cyclicals, investors are buying them back

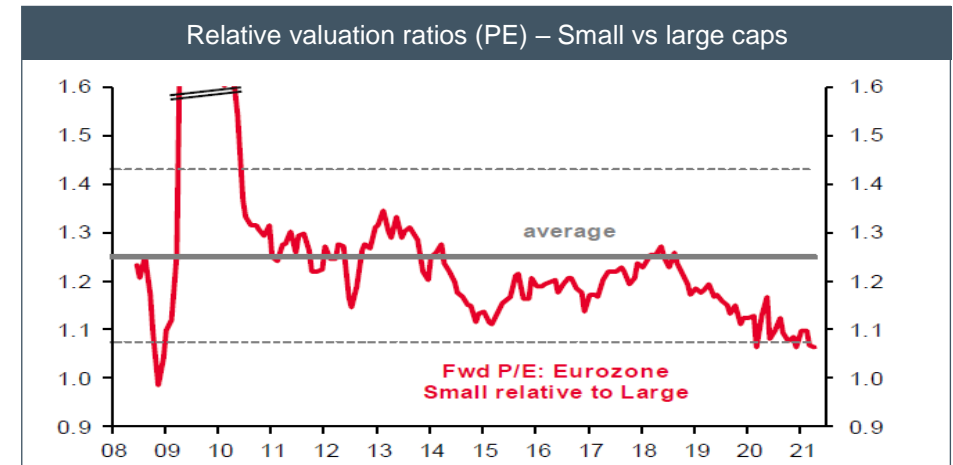
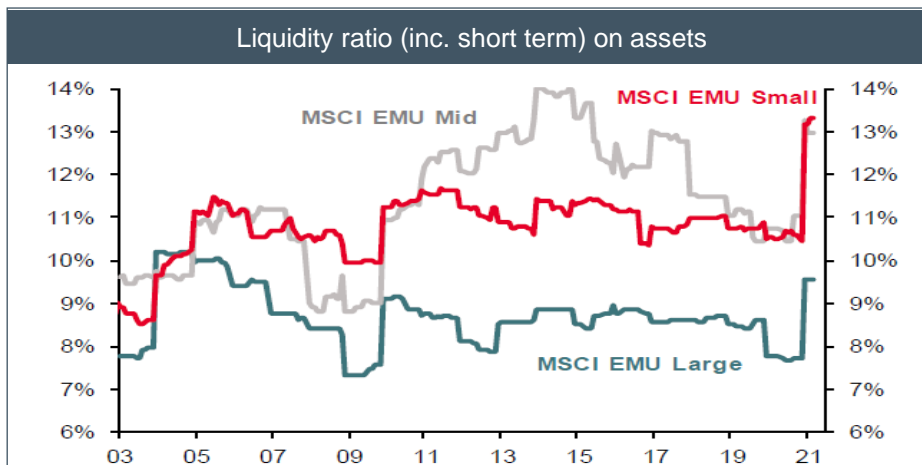
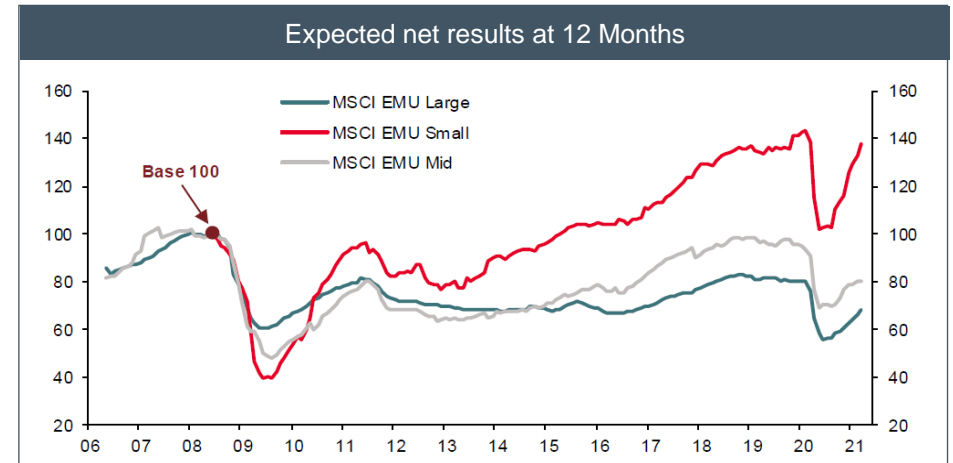
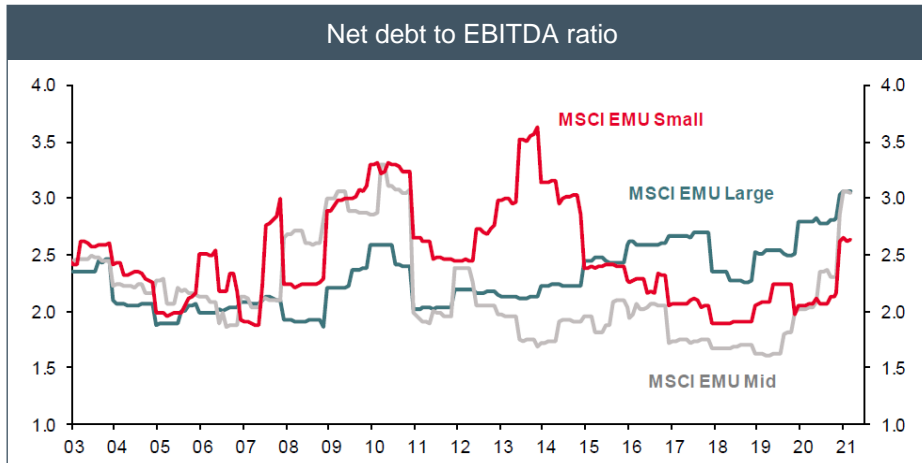


Source: ODDO BHF AM SAS, Factset, data as of 05/31/2021

# European equities – size



Small & mid cap still relatively attractive



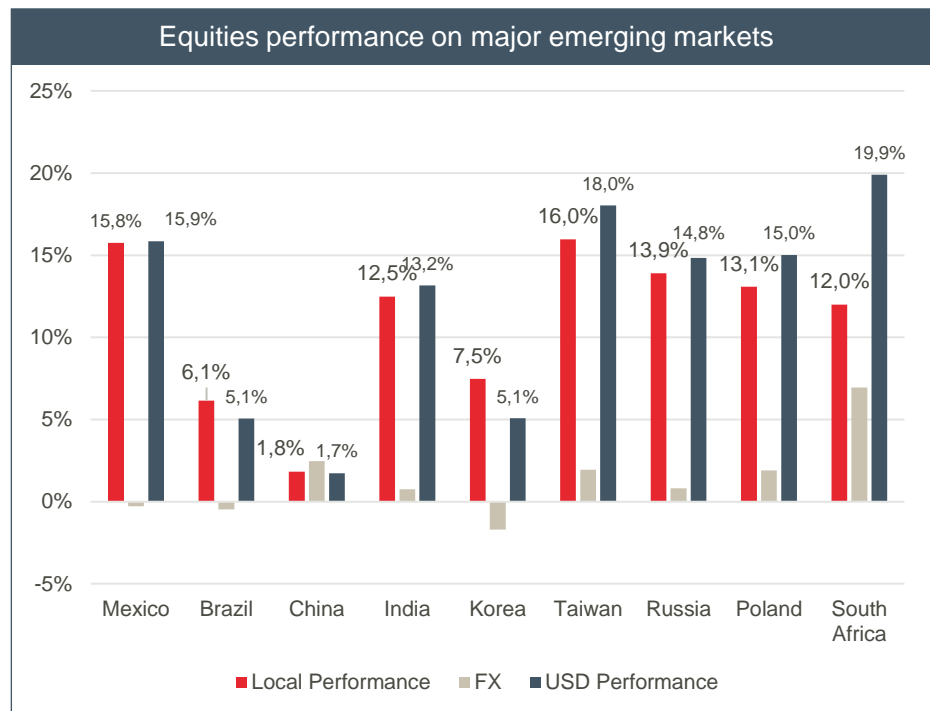
- Measured debt and strong liquidity
- Strong dynamic of results: relatively attractive valuations

Source: ODDO BHF AM SAS, Société Générale

# Emerging markets



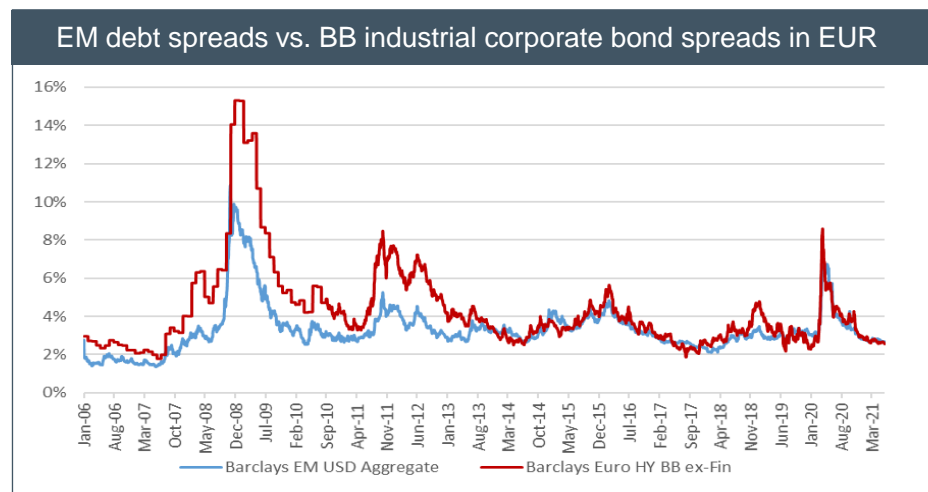
Very much reliant on US rates



- Emerging markets have caught up nicely in May as US rates and the USD were broadly flat
- At these levels, vulnerabilities against another US rate upleg have grown
- Moreover, the infant vaccination process and the less accommodative Chinese policy speak against a lasting outperformance of EM sectors

EPS (including losses) growth and PE (local currency)

Indices	PE 12m fwd	2020 EPS growth	2021 EPS growth	2022 EPS growth	Dividend yield
MSCI EM	14.9	-17%	59%	10%	2.4%
MSCI CHINA	17.1	-9%	19%	17%	1.5%
MSCI KOREA	12.2	6%	95%	9%	1.7%
MSCI INDIA	22.2	-27%	93%	14%	1.3%
MSCI INDONESIA	17.5	-30%	27%	20%	2.7%
MSCI PHILIPPINES	20.2	-52%	60%	26%	1.7%
MSCI MALAYSIA	13.0	-26%	79%	-8%	4.4%
MSCI RUSSIA	8.0	-58%	90%	4%	7.0%
WSE WIG INDEX	12.9	-33%	110%	3%	2.8%
MSCI TURKEY	5.7	6%	63%	20%	7.1%
MSCI SOUTH AFRICA	11.3	-10%	73%	15%	3.5%
MSCI BRAZIL	9.4	-38%	203%	-6%	4.2%
MSCI COLOMBIA	11.2	-77%	209%	36%	3.1%
MSCI MEXICO	15.4	-50%	130%	8%	2.9%



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

Sources: Bloomberg, ODDO BHF AM SAS | Data at 05/31/2021



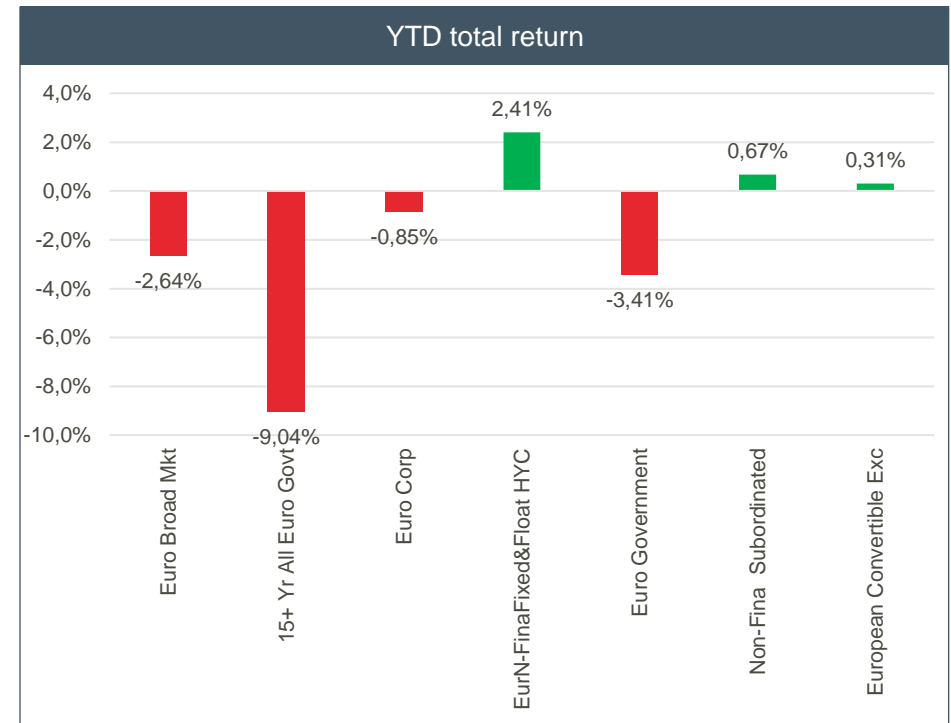
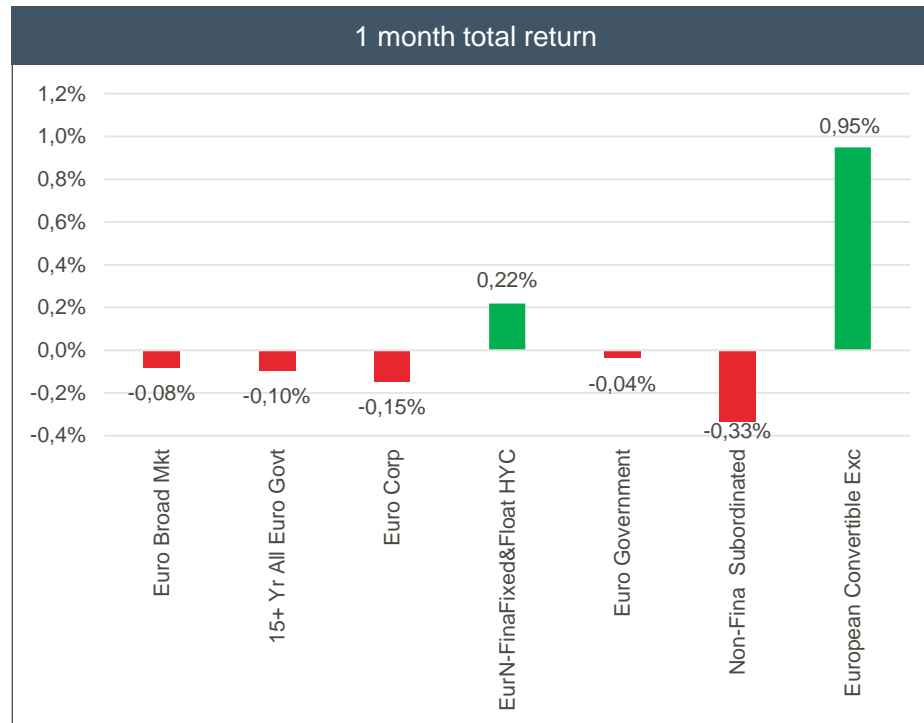
# FIXED INCOME



# Performance fixed income segment

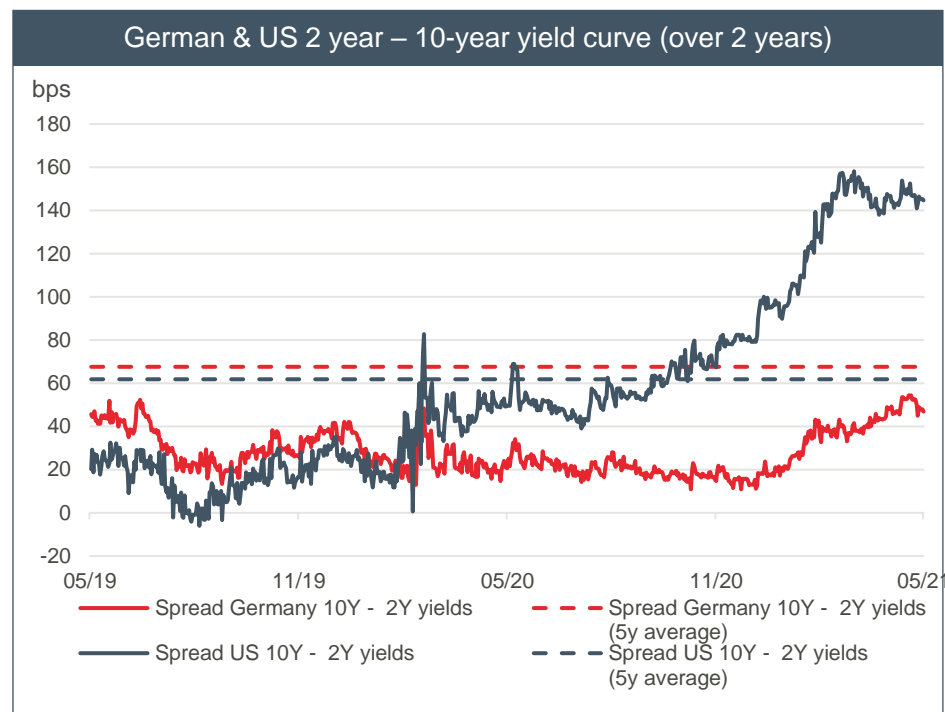
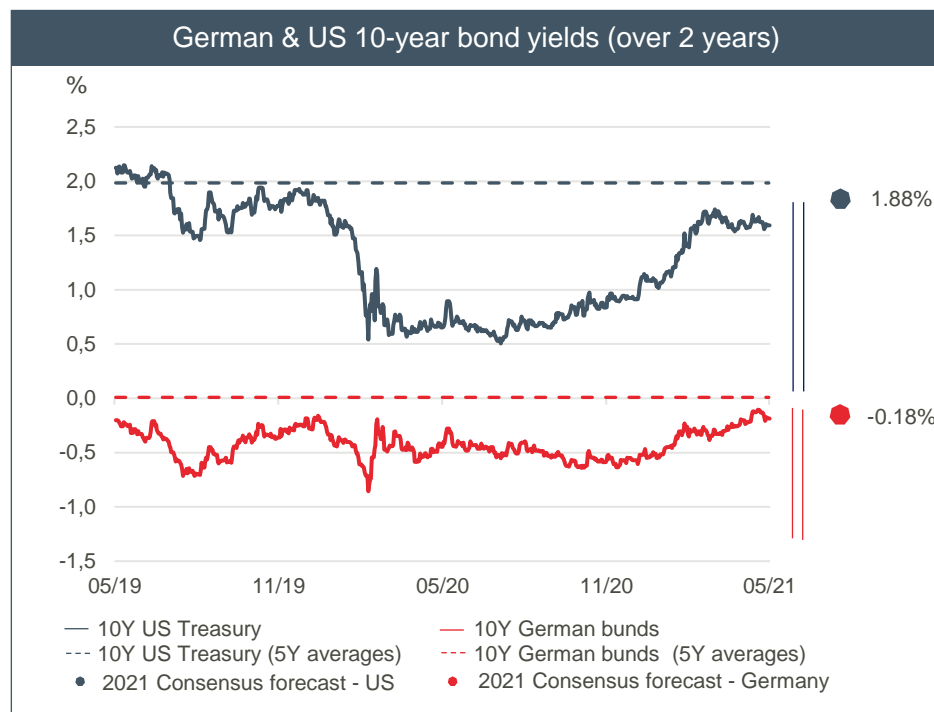


10-year Bund yields bounced from 2-year highs



Source: ODDO BHF AM, Bloomberg, data as of 05/31/2021

## Defying gravity



- Despite a drumbeat of inflation readings at multi-year (in some cases even multi-decade) highs, US Treasury yields retraced almost 20bp from their late March highs
- Besides earlier crowded short positioning, investors appear to be willing to embrace the FED narrative of a pure temporary inflation spike and so try to look through the recent inflation moves
- This benign investor view may be challenged when US core inflation remains above 3% over the next couple of months
- Bunds should be able to outperform in the next upleg for US treasuries so that the 10-year spread is likely to surpass the 2% level again

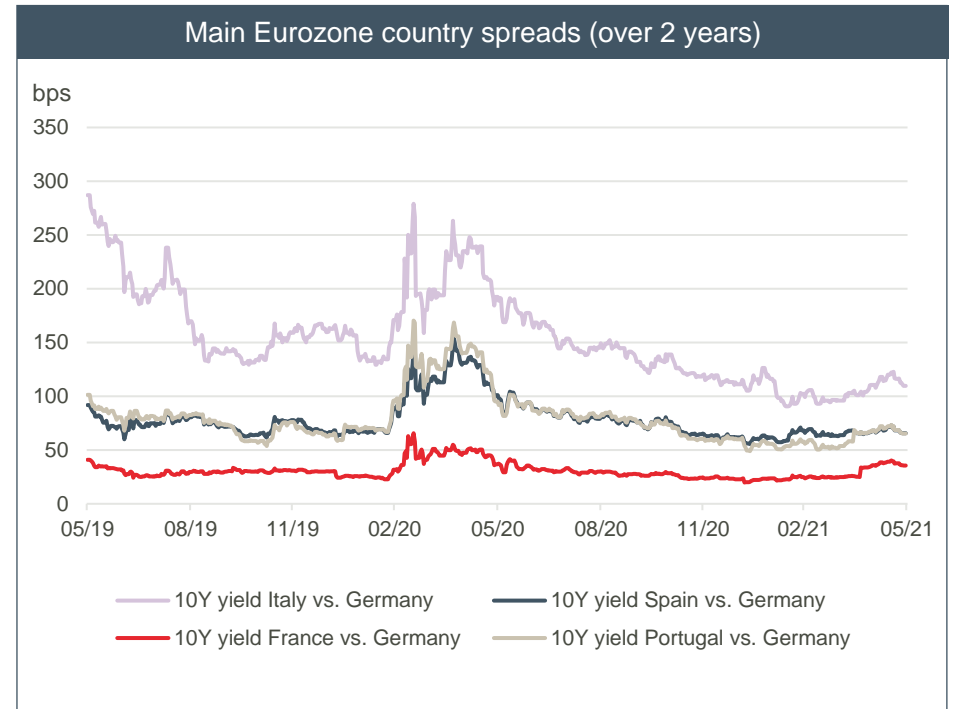
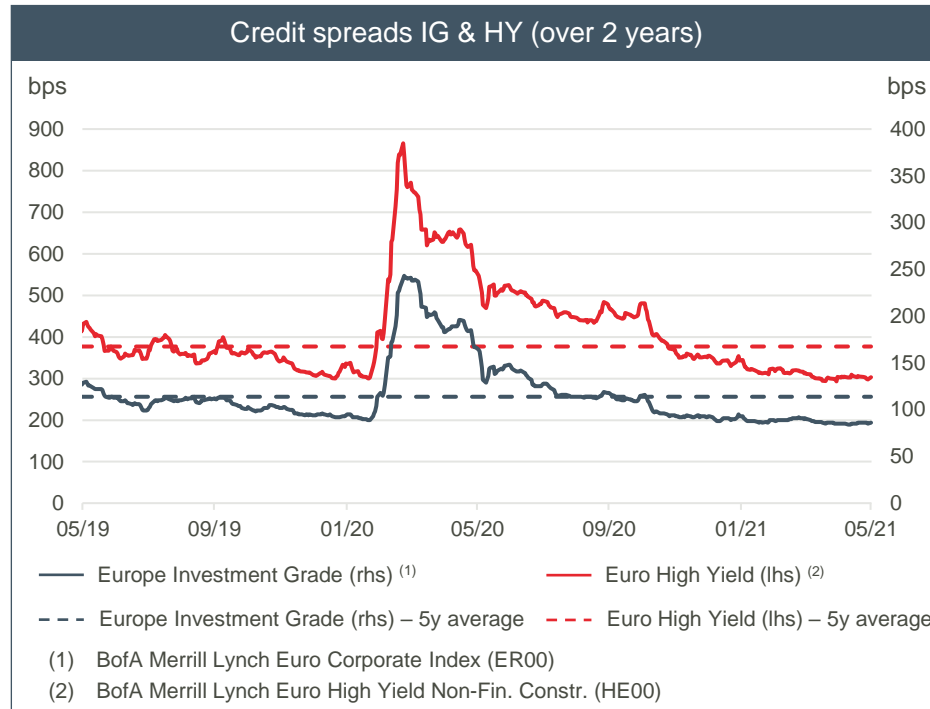
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(1) Bloomberg Economic Forecast | Sources: ODDO BHF AM SAS, Bloomberg | LHS: Data as of 05/31/2021; RHS: Data as of 05/31/2021

# Credit Spreads



Boredom is good for carry



- Corporate spreads probably have little compression potential left, but are supported by ample liquidity and CB demand
- Peripheral spread widening has reversed as various ECB members cooled expectations for a PEPP rundown announcement as early as at the June meeting

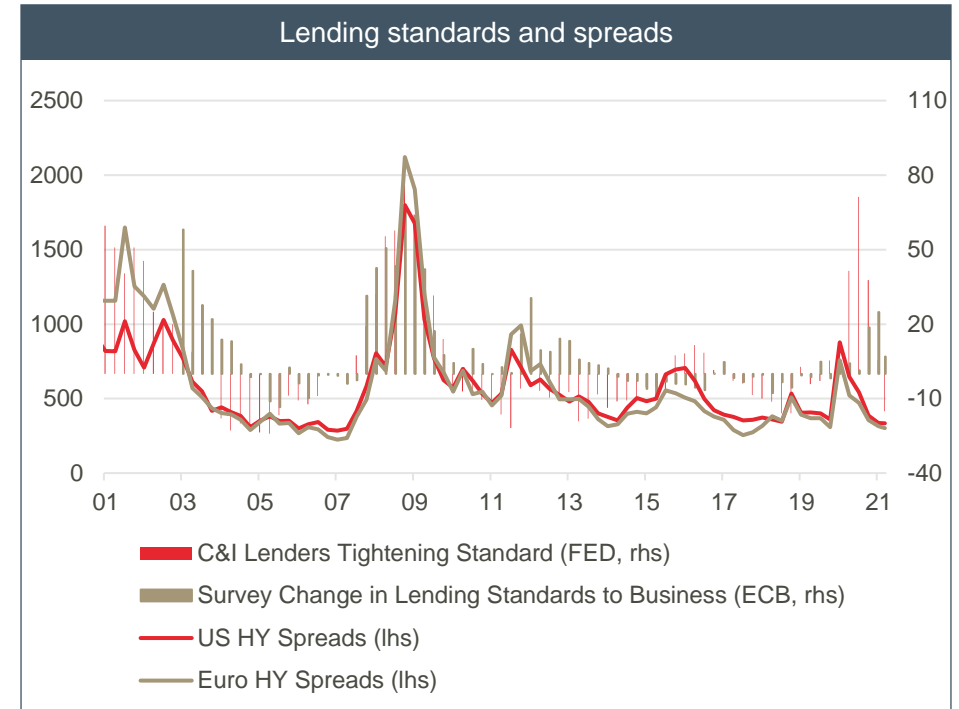
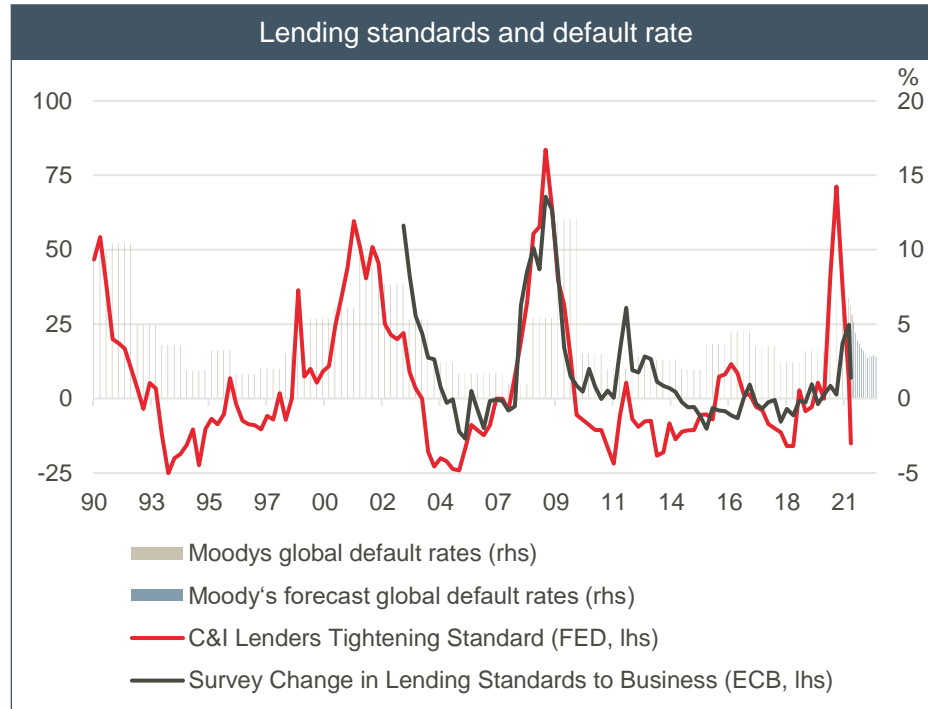
**Past performance is not a reliable indicator of future performance and is not constant over time.**

Sources: ODDO BHF AM SAS, Bloomberg | Data as of 05/31/2021

# Financial conditions



## Ample liquidity



Source: Fed, ECB, Bloomberg | Moody's as of 04/30/2021, Lending Standard & Survey Change as of 04/2021, Spreads as of 05/31/2021

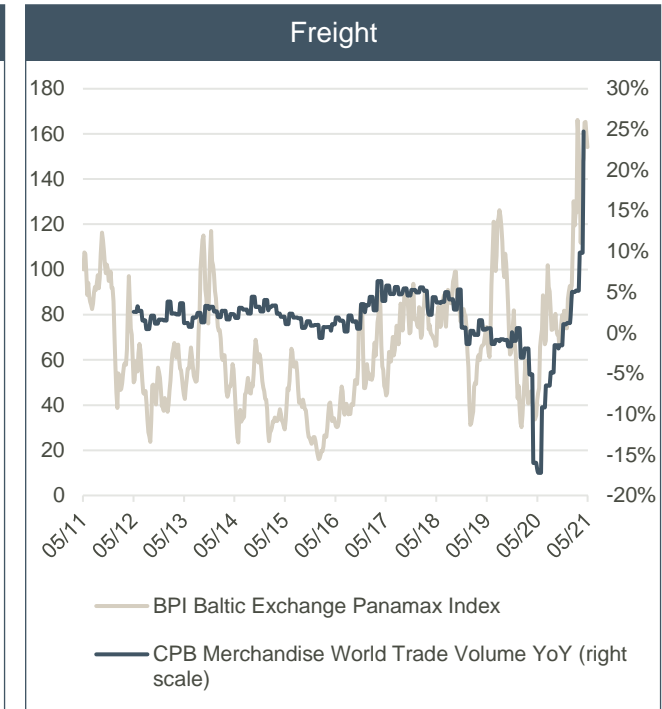
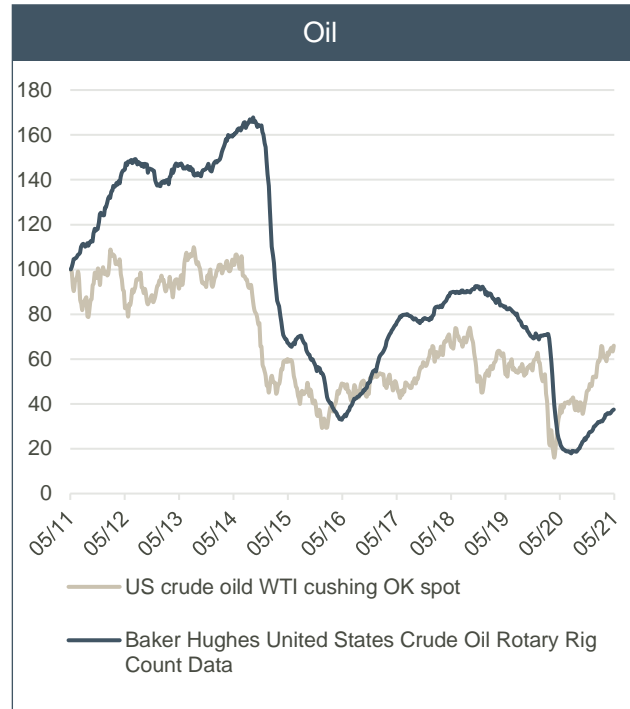
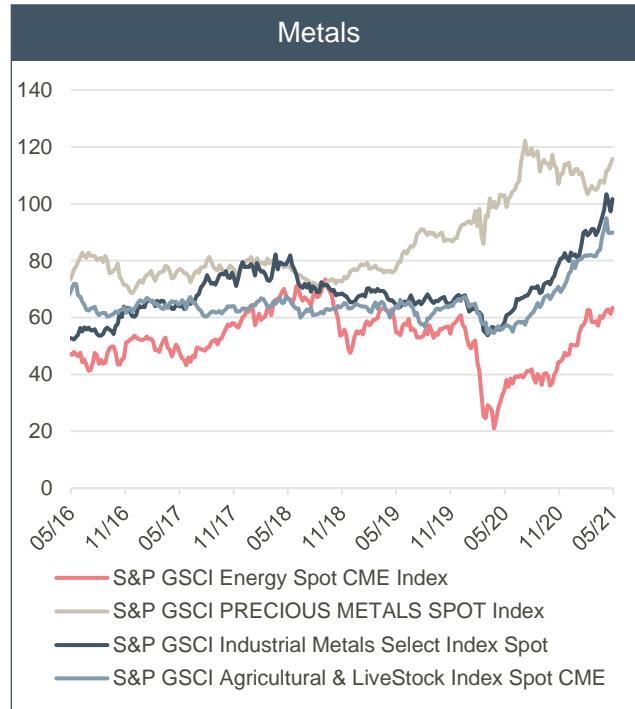


# COMMODITIES & CURRENCIES

# Commodities



## Soaring costs



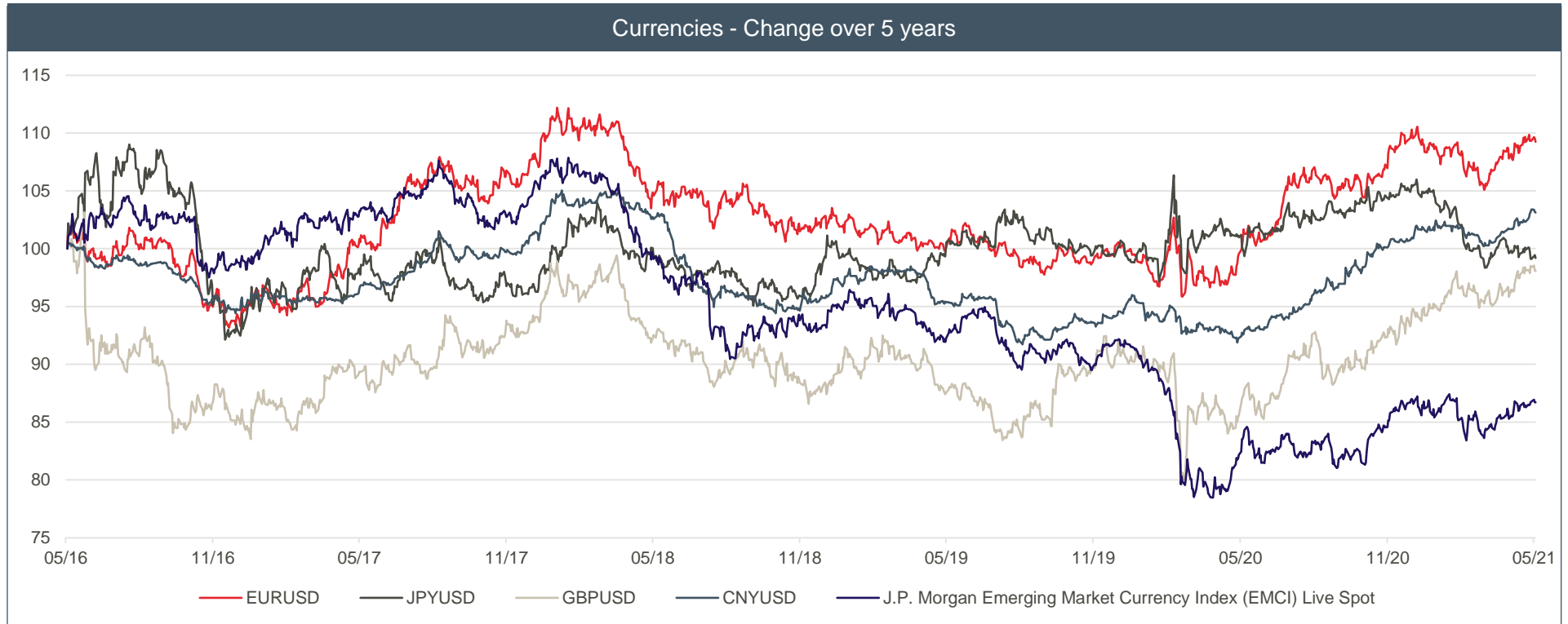
- Most commodity indexes moved higher this month, including gold (+8% in USD).
- Many freight rates reached new highs (Shanghai SCFI +15% in May, ~3.5x higher than pre-Covid level)

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

Sources: Bloomberg, ODDO BHF AM SAS | Data at 05/31/2021



## Depreciating USD



- With US yields moving slightly down (and inflation expectations slightly up!), CNY and EUR kept appreciating vs USD.
- “Cyclical” and “high beta” currencies rose significantly (BRL +4%, RUB +3%, S.A. Rand +5%)

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Sources: Bloomberg, ODDO BHF AM SAS | Data at 05/31/2021



## 03 CURRENT CONVICTIONS

# Structural challenges



## Long-term trends and potential risks

Horizon	Structural trend	Potential financial risks	Risks at 12 months		Recent changes
Short term <1 year	Monetary expansion	Excess of debt	Increasing		Increase in bankrupts in H2 2021
	US earnings supercycle	Decline in margins	Increasing		Rising input prices
	European identity crisis	Hard Brexit, Ital-Exit	Decreasing		OECD Reform 2.0 will support tax harmonisation in the Eurozone!
Mid term 1-5 years	China's economic transition	Economic and political crisis	Decreasing		New five-year strategy for the Chinese government
	The globalisation of inequalities	Political instability	Increasing		New US fiscal plan expected
Long term > 5 years	Ageing of the world population	Secular stagnation and decline	On going		China is getting concerned
	Global warming	Natural disasters and over-regulation	Non foreseeable		Greening of public expenditure

Source: ODDO BHF

## Our 6-month view

### Central scenario:

**Growth recovery in Europe, normalizing growth trend in the US & China, still strong earnings momentum**

70%

#### Europe

- Growth acceleration with vaccination campaigns progressing finally
- Recovery lagging vs the United States, China
- Positive earning momentum will continue after the last strongest year of the decade

#### US

- With economic sentiment, GDP growth and also inflation close to their expected peak levels, the management of growth normalization will be in the focus
- Corporates fundamentals strong
- While fiscal support remains unprecedented, current monetary support might fade as tapering discussions are expected to start relatively soon

#### Assets to overweight



- Equities (focus on high quality cyclicals)
- Credit

#### Assets to underweight



- Sovereigns

#### Strategy



- Flexibility
- Hedging (options, gold,...)

### Alternative scenario: Interest rate risk fueled by more persistent increase in US inflation and intensifying tapering discussion

25%

- Wage growth and continuation of supply-demand imbalance resulting in broad based inflation increase
- Central banks' view of just „transitory“ inflation increase is tested by the market
- Reduction of growth potential & pressure on equity valuations

#### Assets to overweight



- Inflation-hedged bonds
- Alternative strategies
- Cash

#### Assets to underweight



- Equities
- Core Sovereigns

### Alternative scenario: Increase in protectionism from geopolitics and pandemic extension

5%

- Global recession with a risk on financial equilibrium
- Geopolitical risks materializing
- Covid-19 variants with much higher negative effect than expected resulting in new lockdowns in autumn/winter

#### Assets to overweight



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

#### Assets to underweight



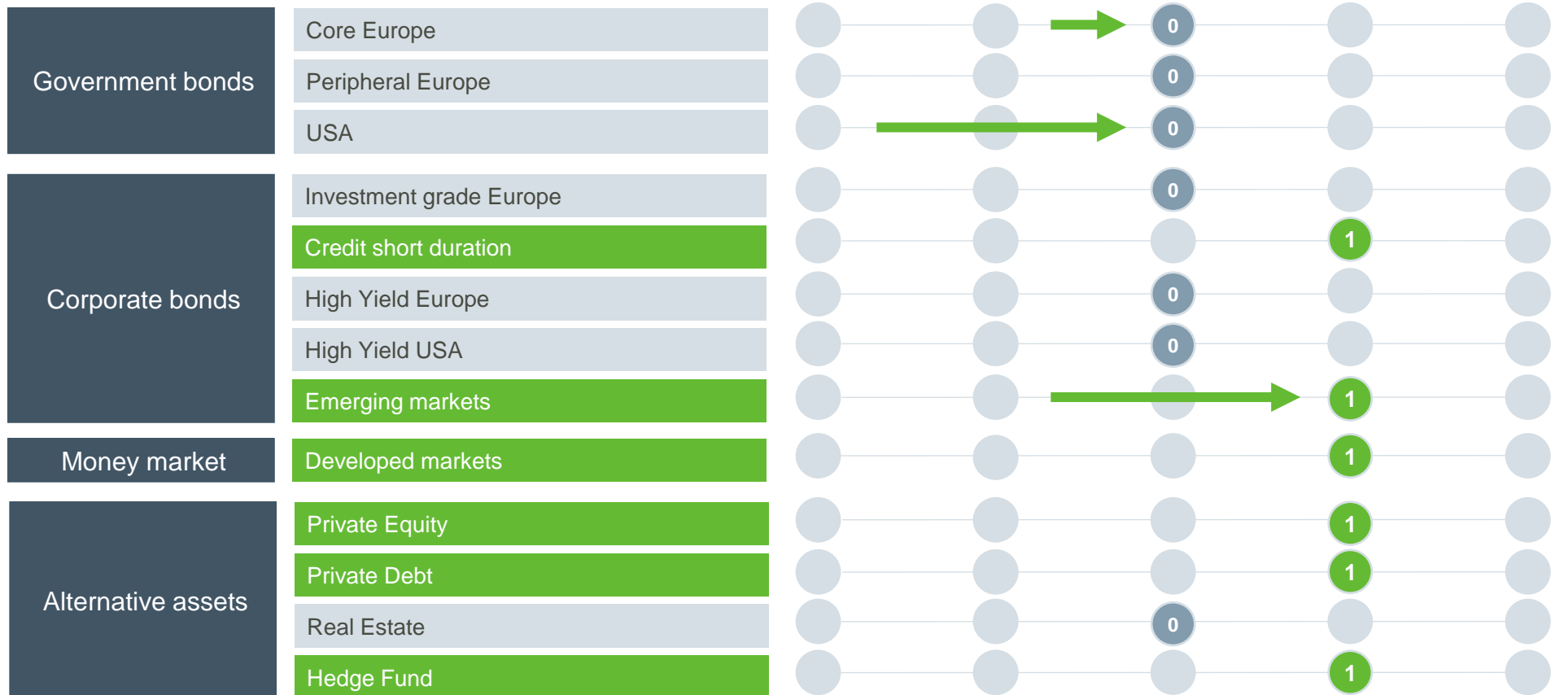
- Equities
- High Yield credit



# Our current convictions for each asset class



Source: ODDO BHF AM, comments as of 06/08/2021

# Our current convictions for each asset class





 Change vs the previous month



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 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.

# Our latest publications



## MONTHLY INVESTMENT BRIEF

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[May 2021 – « Welcome to France! »](#)

[April 2021 – « Twist again »](#)

[March 2021 – The XXL Biden effect](#)

[February 2021 – Destination rather than journey](#)

## MARKET VIEWS

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[May 17th 2021 - When the chips are down](#)

[May 3rd - SPACs: Opportunities and risks for investors in Europe](#)

[April 8<sup>th</sup> 2021 - Covid 19 crisis: impacts on listed real estate](#)

[March 22nd 2021 – Sugar Rush](#)

[March 9th 2021 - How should investors react to the rise of long-term rates?](#)

[February 9th 2021 – Will inflation pick up in 2021 in Europe and the United States?](#)

## INVESTMENT STRATEGIES

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[January 2021 – Re-opening](#)

## SUSTAINABLE INVESTING

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[Sustainable investing - ODDO BHF AM's approach](#)

[Basics of Sustainable Investing](#)

[White paper – The ecological transition: a sustainable investment opportunity](#)

[White paper – Human Capital – a factor of resilience and differentiation](#)



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