Long-term ‘transitory’ inflation

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Laurent Denize

Global CIO
ODDO BHF AM

> In such an environment driven by robust growth, it’s better to overweight asset classes able to limit the erosion in capital caused by inflation, including listed stocks and private equity.

In the letters that Santa Clause is now receiving, one of the most popular gift requests is no doubt this one: the answer to the question “How will central banks react to inflation next year?”.

Let’s take a brief look at the parameters that have driven inflation to new highs.

Bottlenecks caused by supply-side shocks, combined with demand-side shocks caused by accumulated disposable income have triggered a spike in prices of durable goods and commodities.

And yet, successive lockdowns should normally have resulted in lower prices for services. That didn’t happen.

Indeed, much of the insufficient demand for services is due to shifts in behaviour that cannot be remedied by lowering prices. If someone doesn’t go to the movies or doesn’t take a flight out of fear of catching Covid, lowering prices will not get him back in a cinema or on a plane. Households could even interpret lower prices as a signal of heightened risk, making them even more risk-averse. In technical terms, the elasticity of demand for some services has reversed itself.

This is a big problem for central banks, as price-elasticity of demand has changed, whereas the increase in total inflation is no longer a reliable indicator of stronger aggregate demand. This is why, investors may be fearing a monetary policy error by the central banks – either by tightening too quickly, thus disrupting growth, or by waiting too long and “getting behind the curve”, which would engender second-round effects (e.g., higher wages, higher inflation expectations from households and investors, etc.) and a shift to a more inflationary paradigm.

Investors are still locked in on the assumption of transitory inflation or, rather, the return to secular stagnation. 30-year US bond yields at 1.70% with annual inflation of 6.2% and 5.5% GDP growth in 2021 is a perfect illustration of the financial repression being orchestrated by central banks, as well as of growth that is returning to a potential that is ultimately limited. If this is true, it’s best to continue favouring quality and growth stocks.

Let’s look more closely at the best-case scenario, in which Covid moves from pandemic to endemic in 2022, clearing the path to a normalisation of monetary policies. Central banks would nonetheless have to be flexible in tapering their asset purchases and in timing their rate hikes. For, a too sudden hike would mean a heavier debt burden for governments, which would widen fiscal deficits even further.

If we were to rank all asset classes in descending order of risk, US bond yields would rank first. Here’s our reasoning: in the event that 30-year US Treasury yields rise to 2.50% (from 1.70% currently), i.e., their March 2021 level, and assuming a duration of 22.8, they would return -18% (0.8%*22.8), all other factors being equal.

In such an environment driven by robust growth, it’s better to favour asset classes able to limit the erosion in capital caused by inflation, including listed stocks and private equity.

Meanwhile, the US dollar’s trajectory will flag the future performances of regional assets. If the dollar falls, it’s better to favour Europe and emerging markets. If it continues to rise, the US will once again certainly outperform other markets.

Let me take this opportunity to wish you safe and happy holidays. I look forward to seeing you at the presentation of our investment strategy at the “ODDO BHF Live 2022” event, on 10 January 2022 at 12:45 pm.

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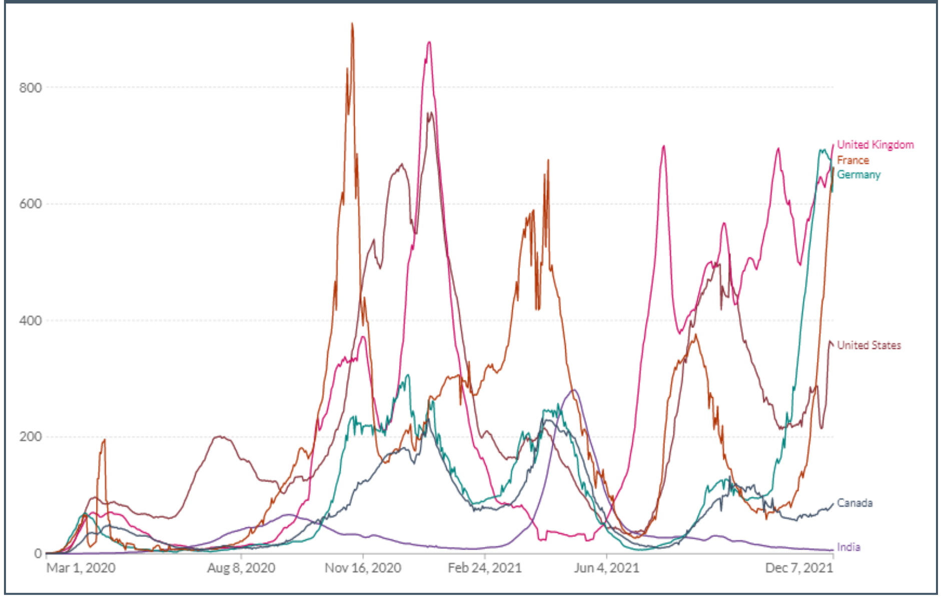
01 MACROECONOMIC OUTLOOK

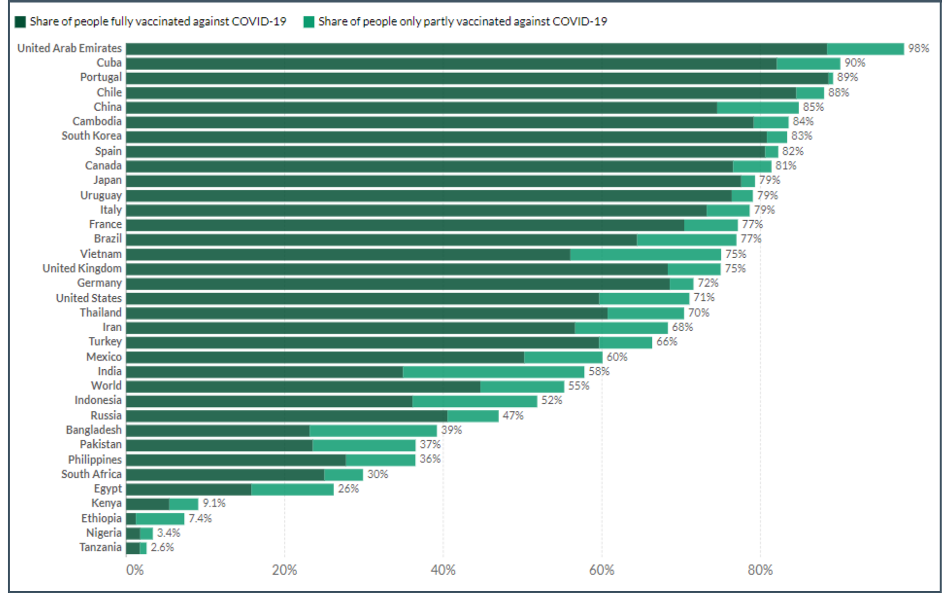
Covid status

New covid wave and Omicron threat weighing on mobility in Europe

Daily new confirmed covid-19 cases per million people



Share of people vaccinated against Covid-19

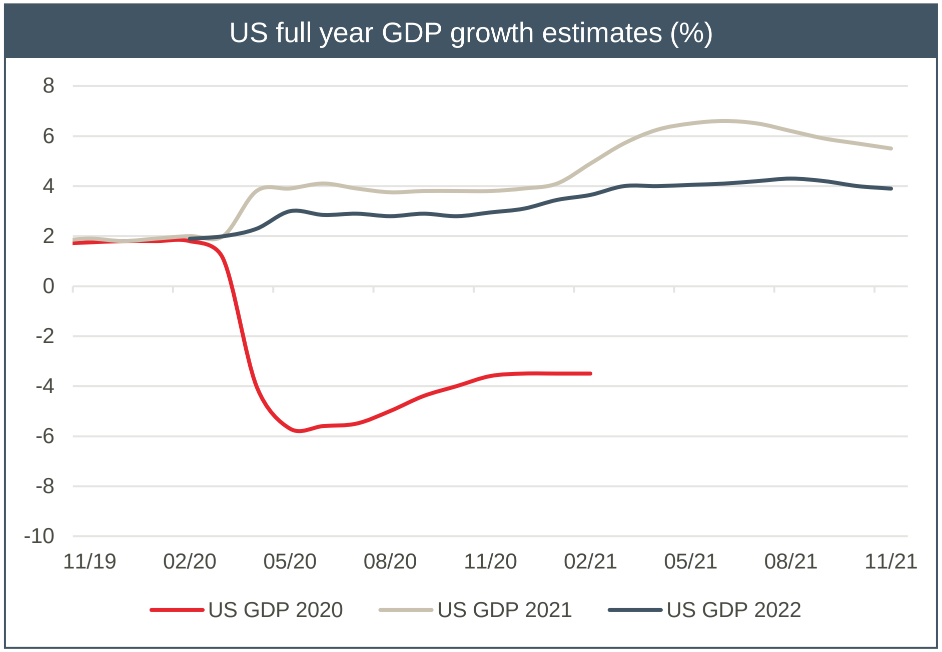


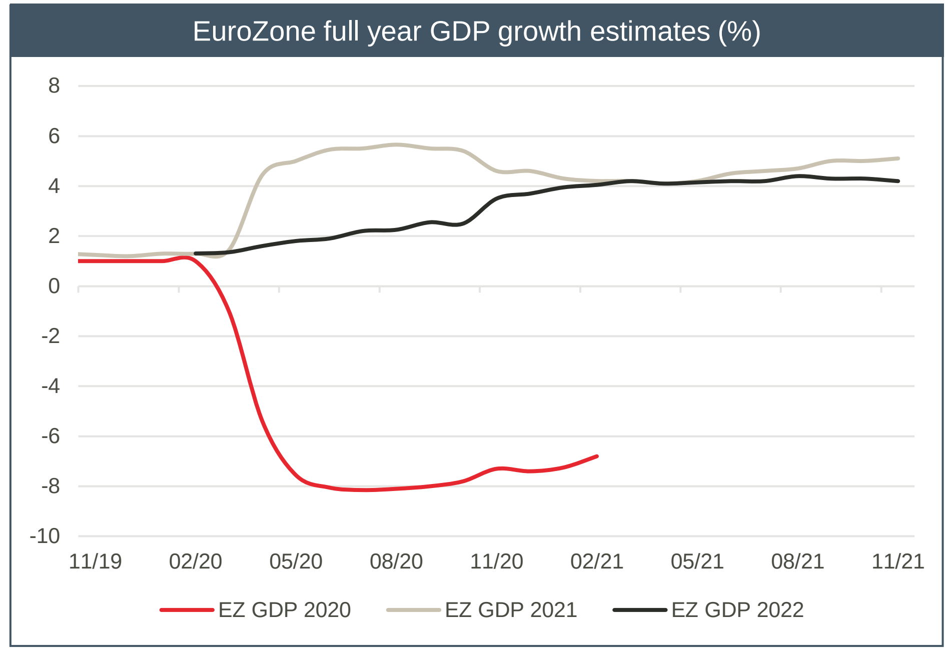
- Impact should however be less than last year
- Restrictions and lockdowns are more modest and rather local
- Countries with high vaccination rates are faring much better
- Decoupling of infection and hospitalization rates
- New Omicron strain is a wildcard for now, but first indications suggest booster vaccinations could work

Sources: ODDO BHF AM SAS | our world in data, John Hopkins University

Growth outlook

Almost unchanged





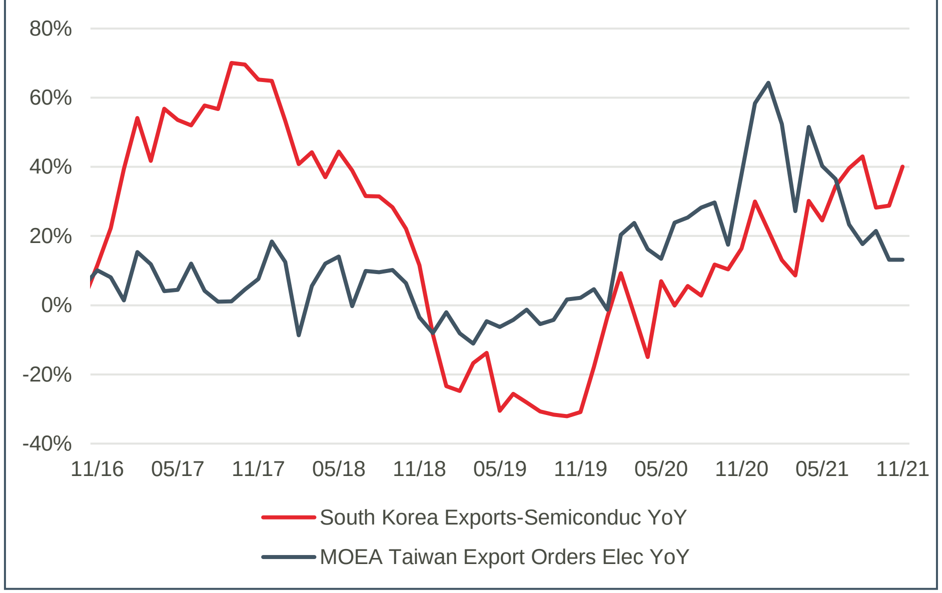
- Consensus estimates have been marginally downgraded for the Eurozone and China in 2022
- Given the covid restrictions there is probably a bit more to come for the Eurozone

Sources: ODDO BHF AM SAS, Bloomberg | Data as of 11/30/2021

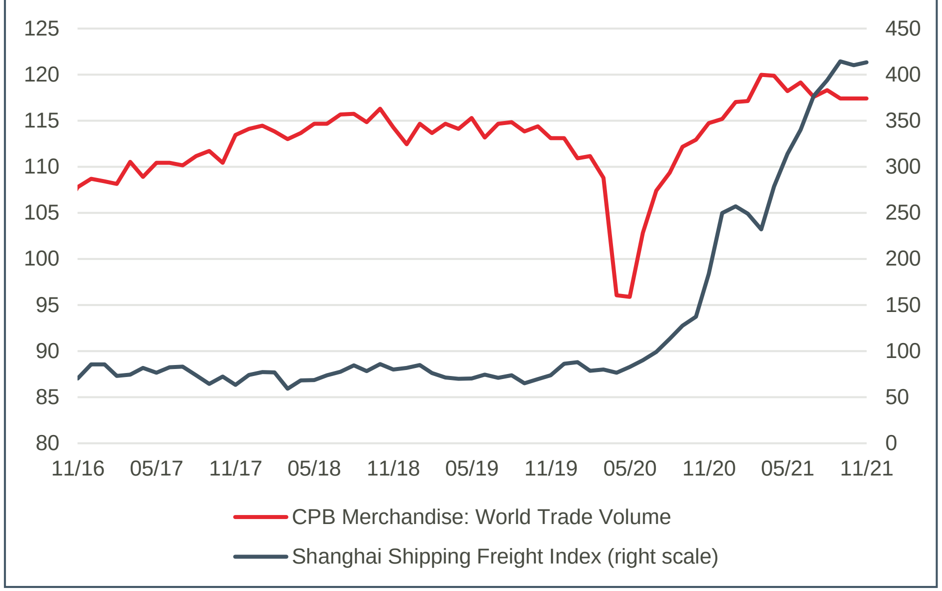
Global trade

Trade could be hit by volume and value effects

Exports volumes



Transport volumes and costs

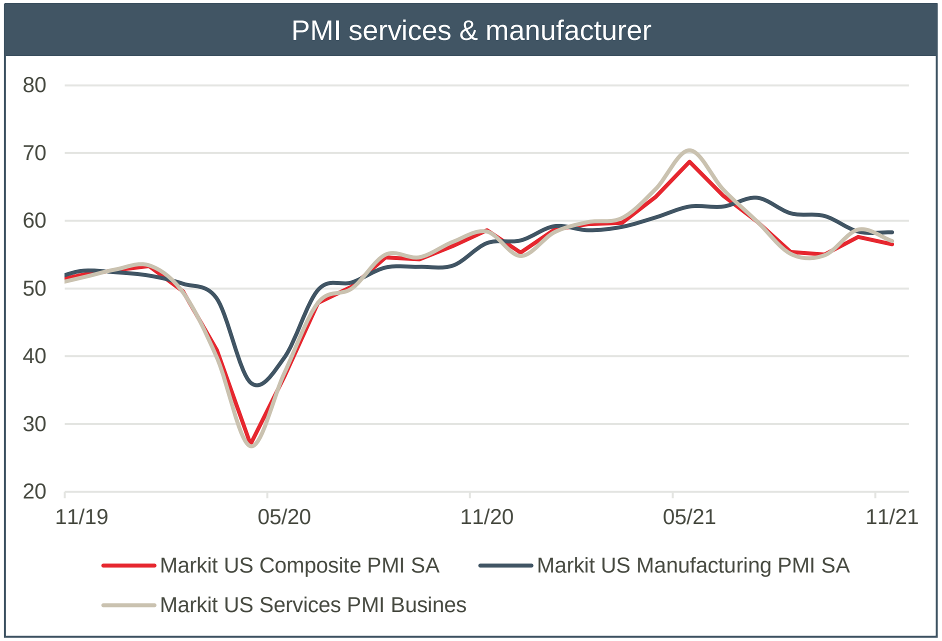


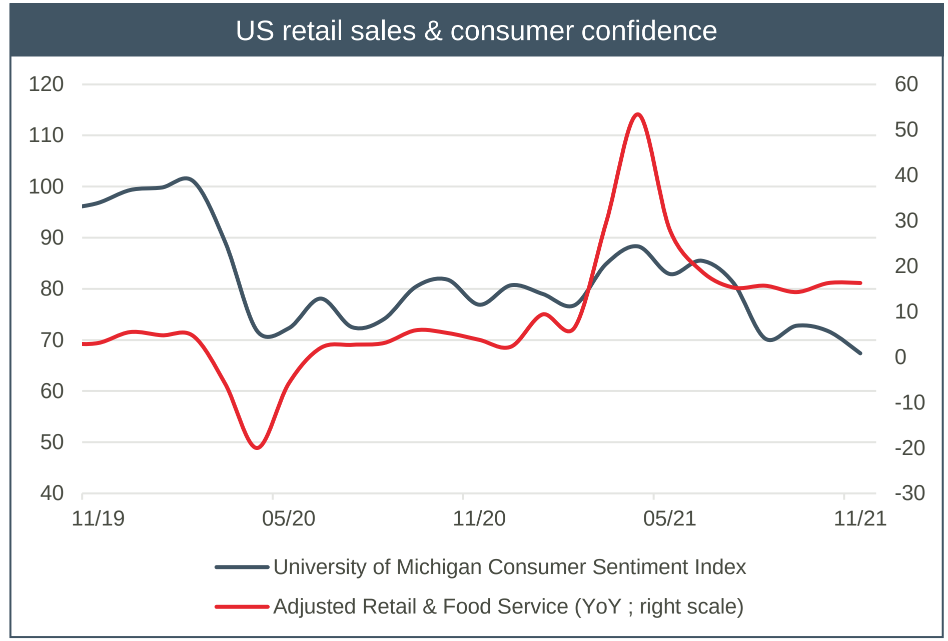
- German industrial orders flag downside risk for trade into 2022
- A bit of easing in container costs is a silver lining

Sources: ODDO BHF AM, Bloomberg, 11/30/2021

USA

Momentum is currently accelerating



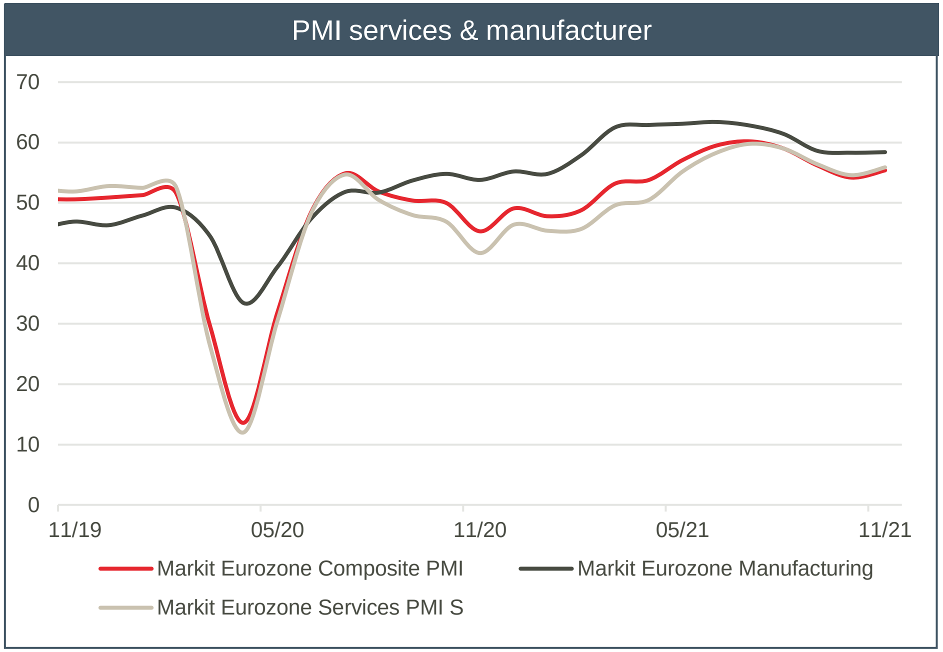


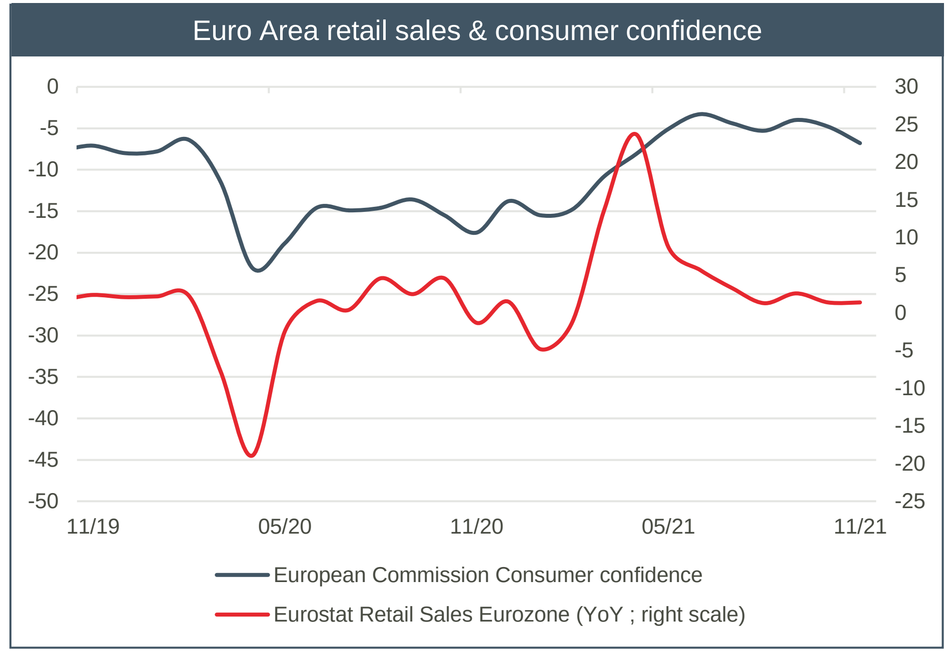
- Thanks to complete reopening and improved mobility, consumer demand is quite strong
- Moreover, consumers are tapping their ample reserves
- PMI are likely to decelerate from the current very high readings
- Easing PMI components like supplier delivery times offer a glimmer of hope that bottlenecks and supply restrictions are slowly receding

Sources: ODDO BHF AM, Bloomberg, 11/30/2021

Europe

Short-term air pocket



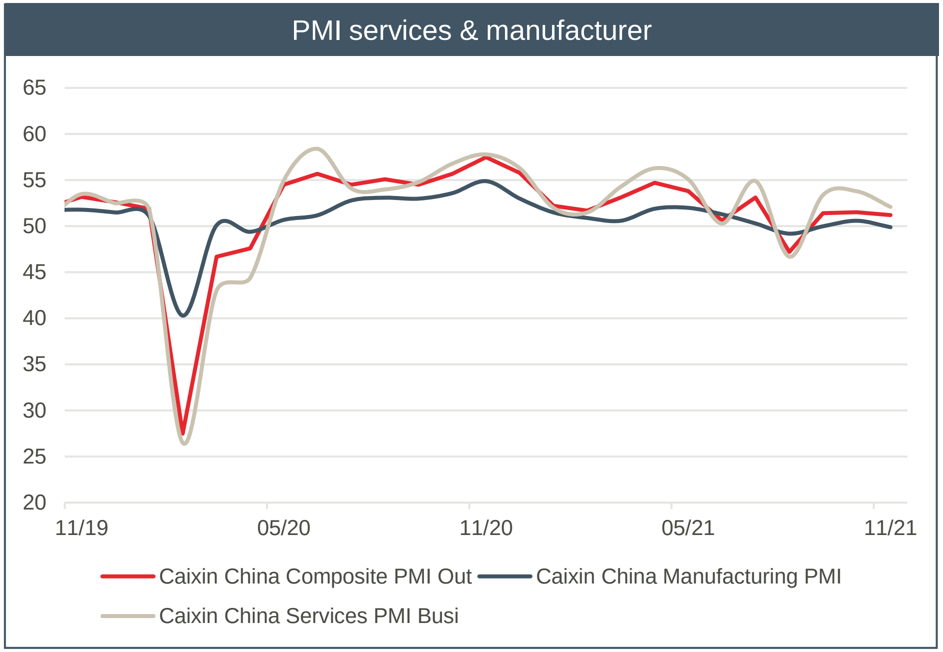


- Supply dislocations, covid impact and Chinese deleveraging add to near-term downside growth risks esp. for Germany
- Q4 GDP forecasts are still mostly too elevated
- However, any shortfall in growth should be mostly made-up for next year as the demand overhang is unlikely to crumble
- GDP level from Q4 2019 has still not been reached

Sources: ODDO BHF AM, Bloomberg, 11/30/2021

China

Deflating

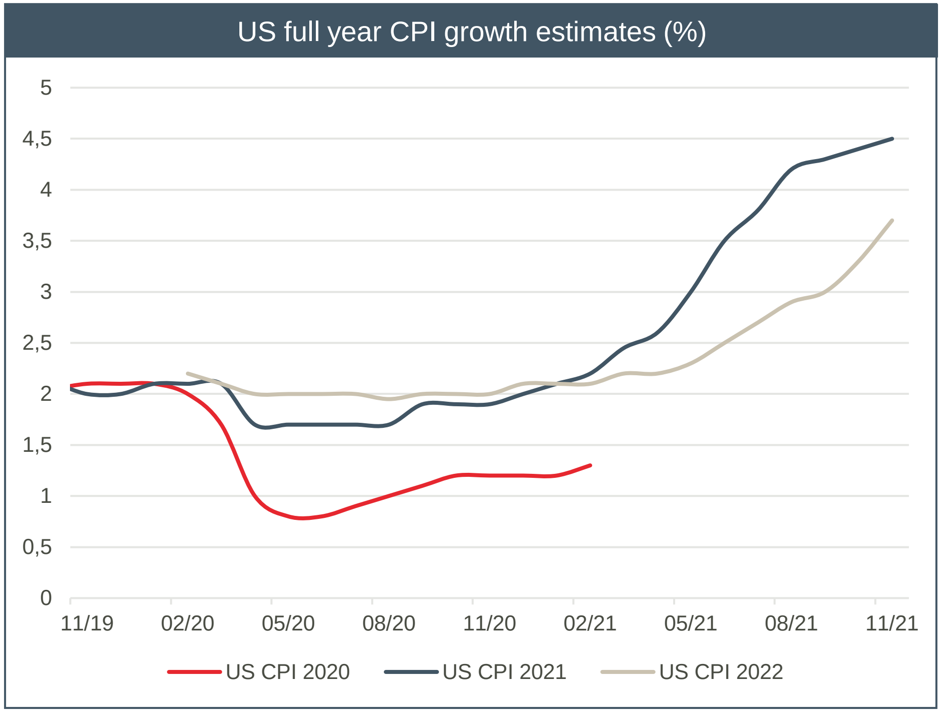


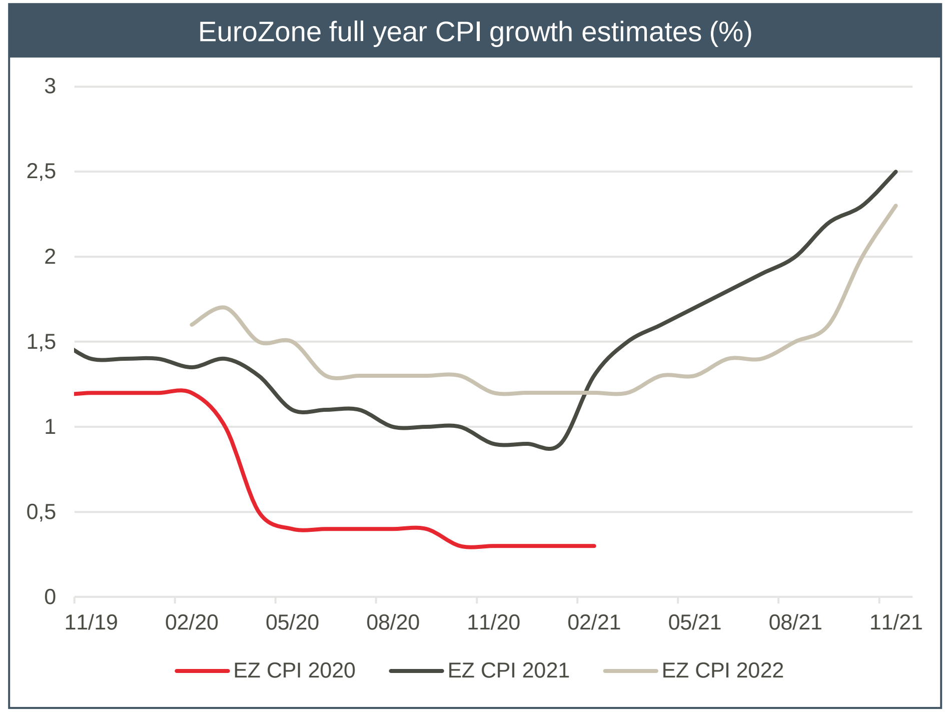
- Slightly diverging signals from October Chinese PMI.
- While the official composite figure rebounded to 52,2, the Caixin number edged marginally down to 51,2.
- Deflating the real estate bubble, while keeping growth dynamics intact will remain to be a delicate balancing act.
- Some property developers are close to restructuring
- Given the downside risks to growth, China started to relax policy measures
- However, this will only buffer the dynamics but not prevent them
- Credit impulse has not turned the corner

Sources: ODDO BHF AM SAS; Bloomberg Economist Forecast. Data as of 11/30/2021

Inflation expectations

Still anchored?





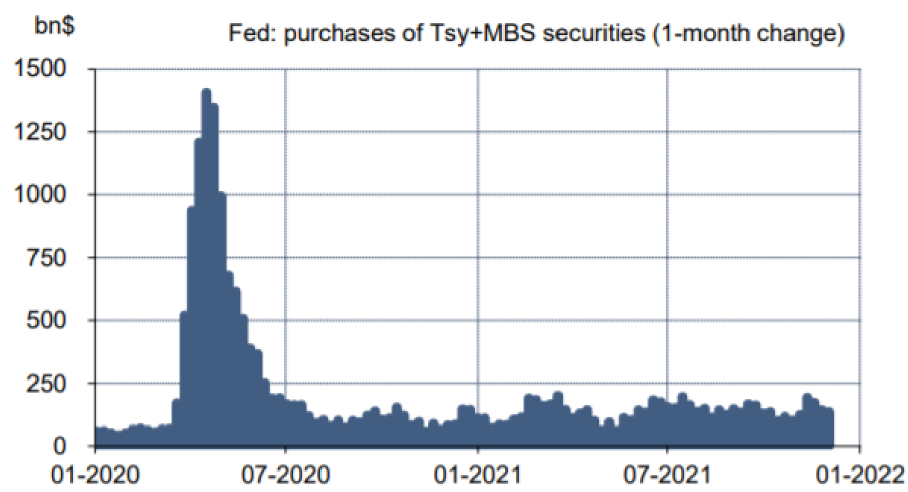
- Depending on the gauges to measure inflation expectations, there are tentative signs that some of them in the US are becoming unhinged
- With a 7% handle on US CPI to be very likely, inflation in the US is becoming a top political issue

Sources: ODDO BHF AM, Bloomberg, as of 11/30/2021

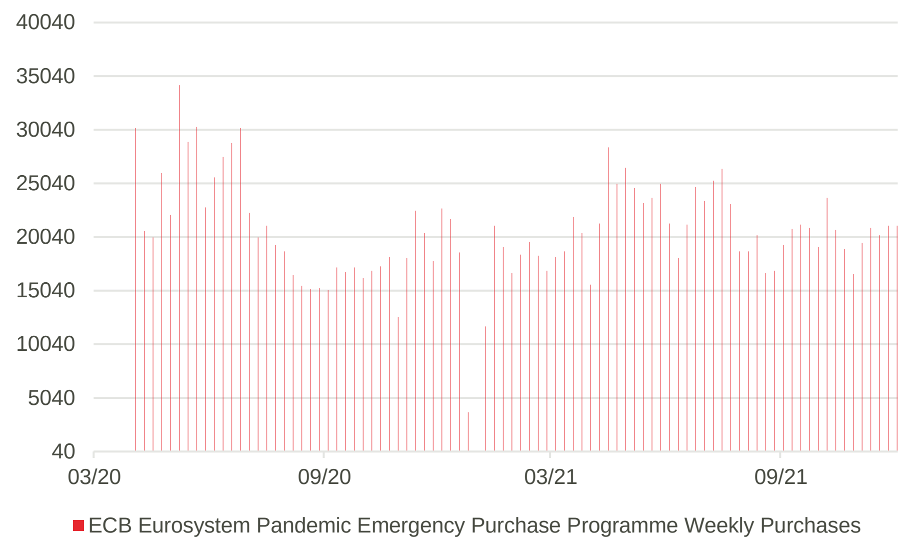
FED & ECB policies

When doves cry

FED monetary policy



ECB: net purchase of assets under PEPP (1 week change, bn€)

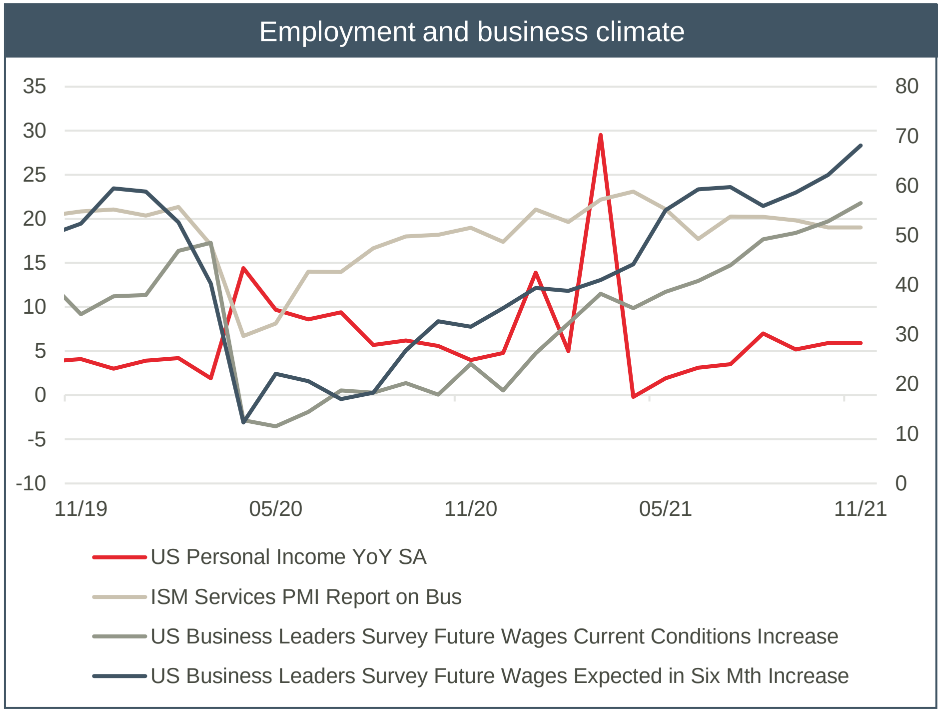


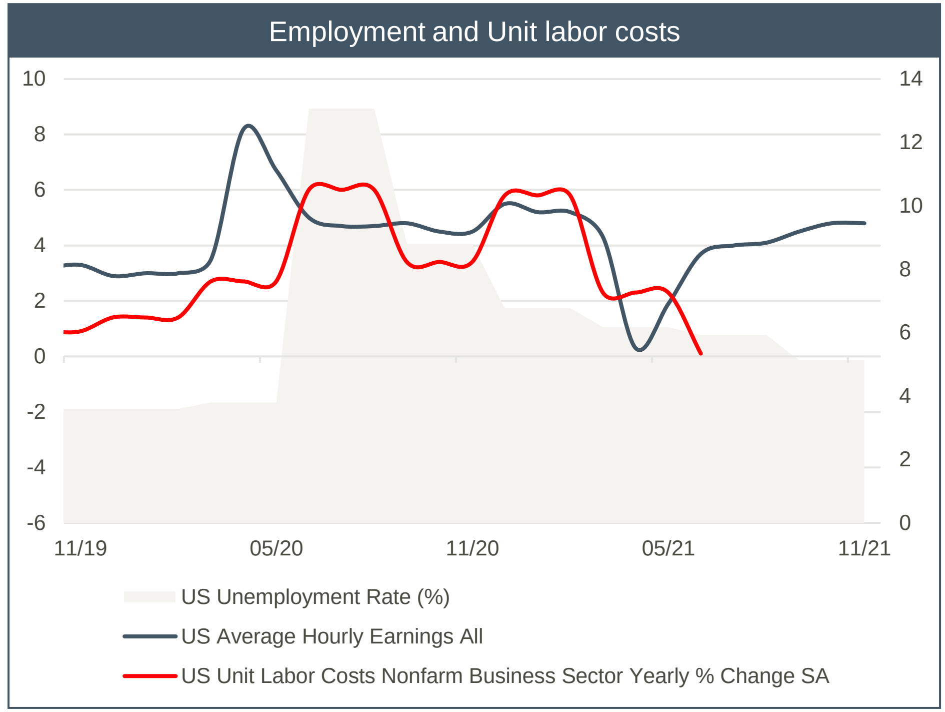
- Fed Mantra of transitory inflation sources has been laid to rest
- Market expects 2,5 hikes in 2022, but only a terminal rate of around 1,5-1,75%
- This is fairly complacent and below the Fed`s own dot plots
- ECB`s unofficial comments have been a bit inconclusive of late, as to when details will be given about the future path of QE
- We expect PEPP to fade out at the end of March and the APP program to be doubled to 40bn Euro
- Inflation forecasts (then including 2024) will be lifted somewhat but still stick to transitory inflation script

Sources: ODDO BHF AM, ODDO BHF Securities, Thomson Reuters, Bloomberg, data as of November 2021

US job market

The path to normalization





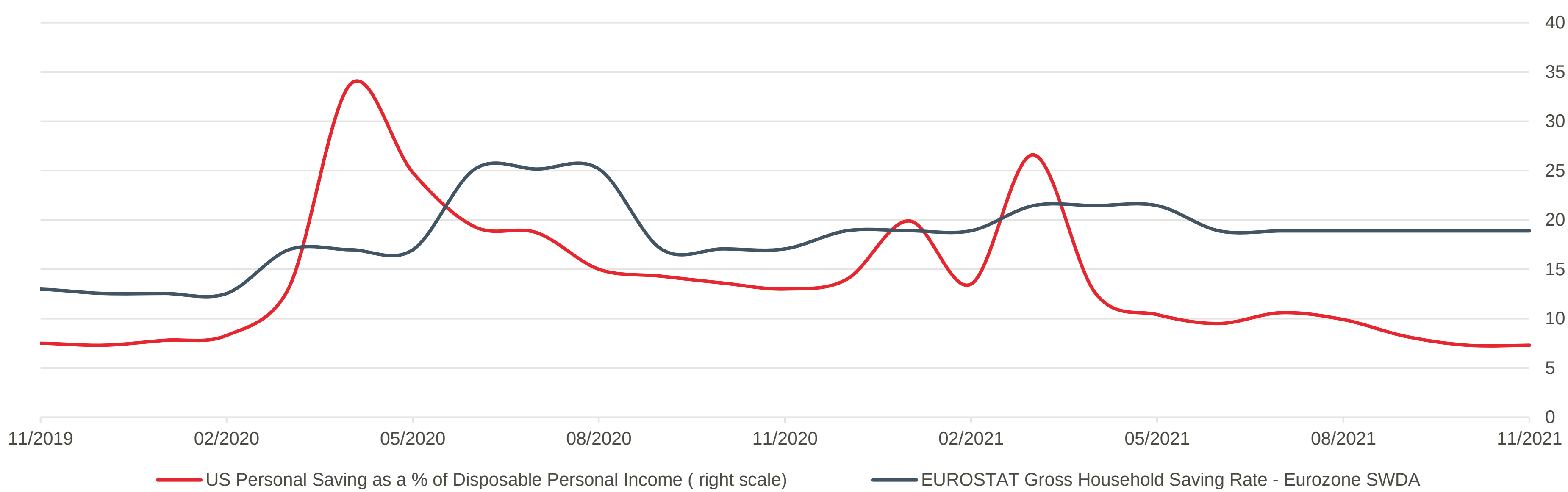
- Contradicting signals from the November establishment report and the household survey
- While the 250k increase in nonfarm-payrolls fell massively short of expectations, the unemployment rate decreased to 4,2% which is not far from historical lows
- Moreover, the participation rate increased slightly, but is unlikely to rebound to pre-covid levels, because of structural issues
- The labor supply shortage increases inflation risk and puts more pressure on the Fed

Sources: ODDO BHF AM SAS; Bloomberg Data as of 11/30/2021

Savings

A lot to spend

Households saving rates – US vs Europe



- US households have accumulated 2.2 tr since the start of the pandemic thanks to fiscal transfers and are starting to tap their reserves
- In the Eurozone the savings rate hovers around a stunning 18%
- Those healthy household balances should support demand for quite some time

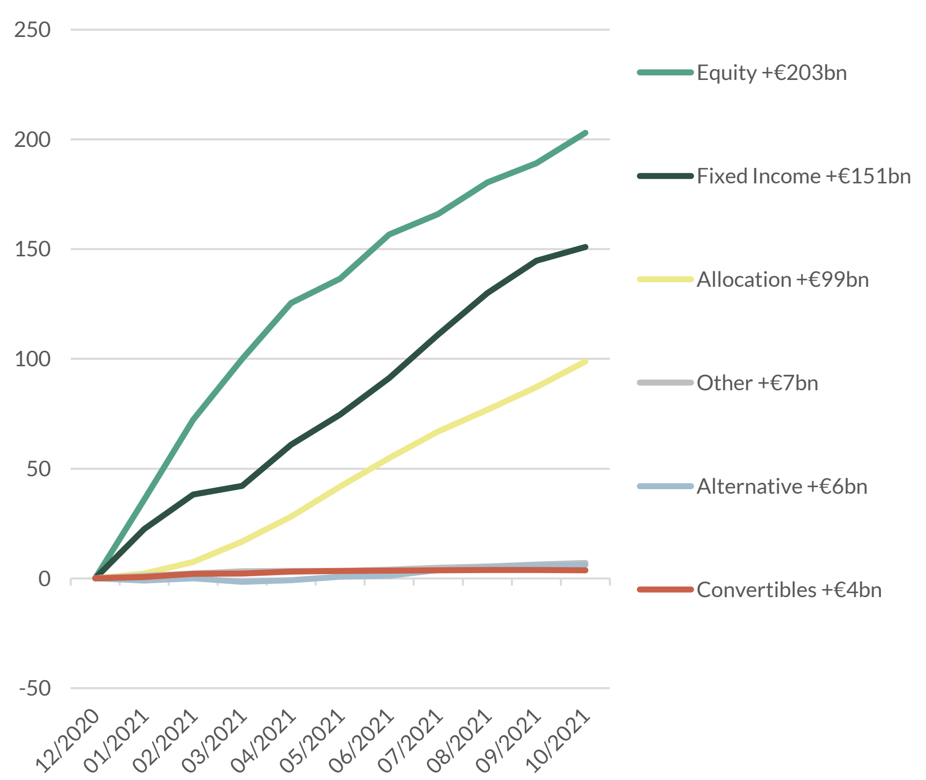
Sources: ODDO BHF AM, Bloomberg, datas as of 11/30/2021

02 MARKET ANALYSIS

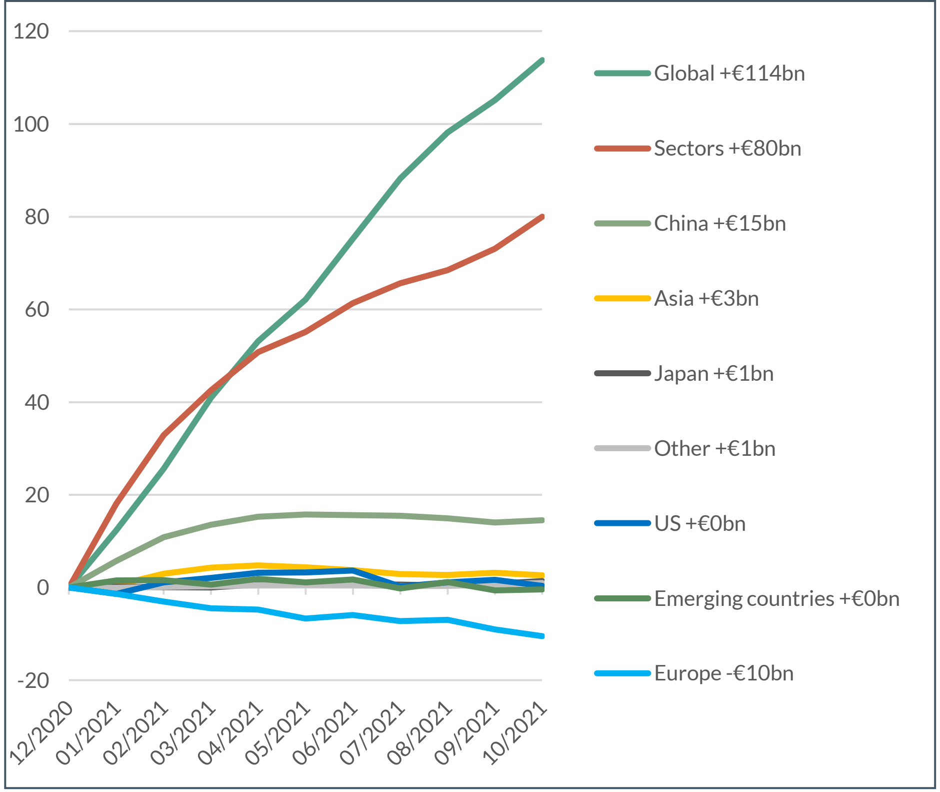
European mutual fund flows – year-to-date

Where is Europe's catch-up?

European mutual funds: YTD cumulative fund flows (€bn)



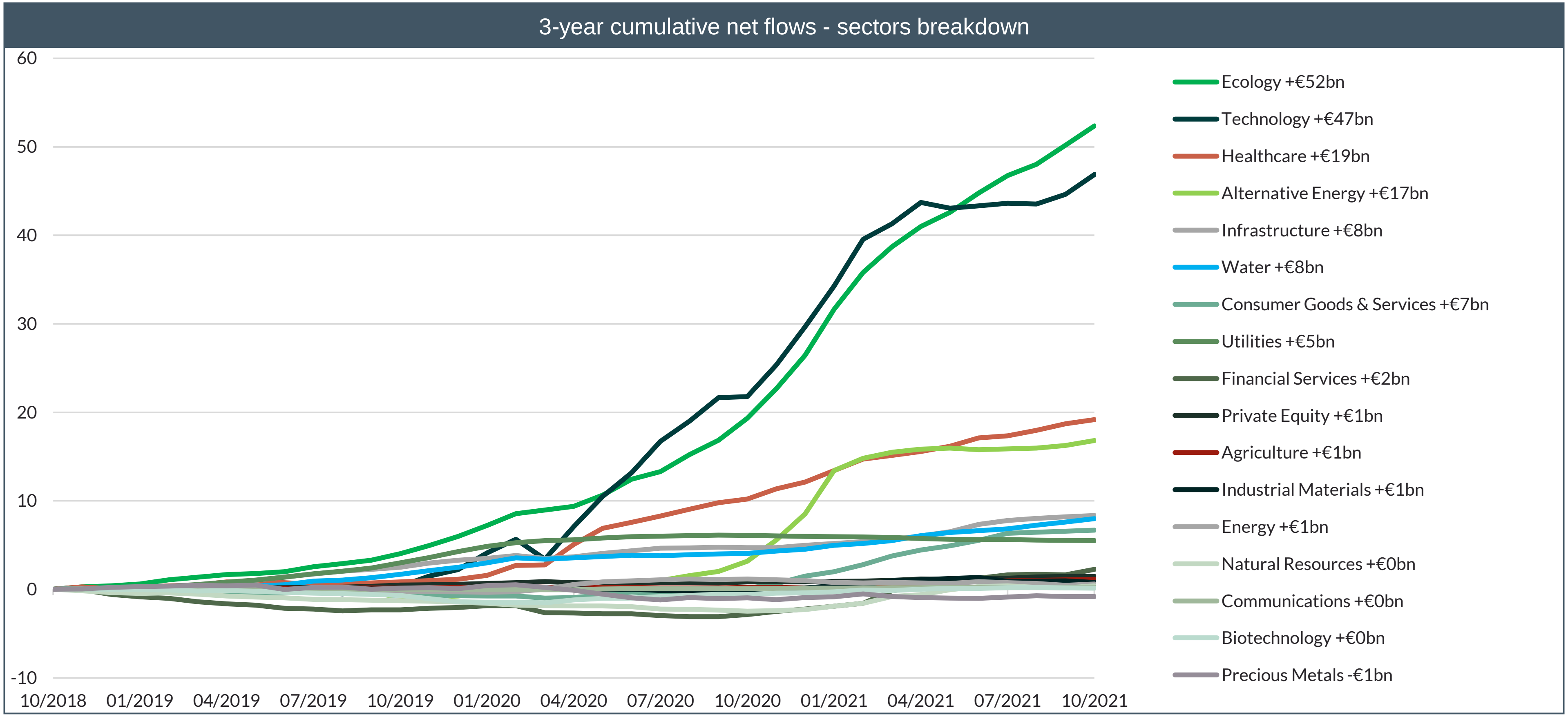
European mutual funds: equity cumulative fund flows (€bn)



Source : Morningstar. Data as of 31.10.2021 (Europe OE ex ETF ex MM ex FoF ex Feeder (domiciled, most compr.)

European mutual fund flows – equity flows

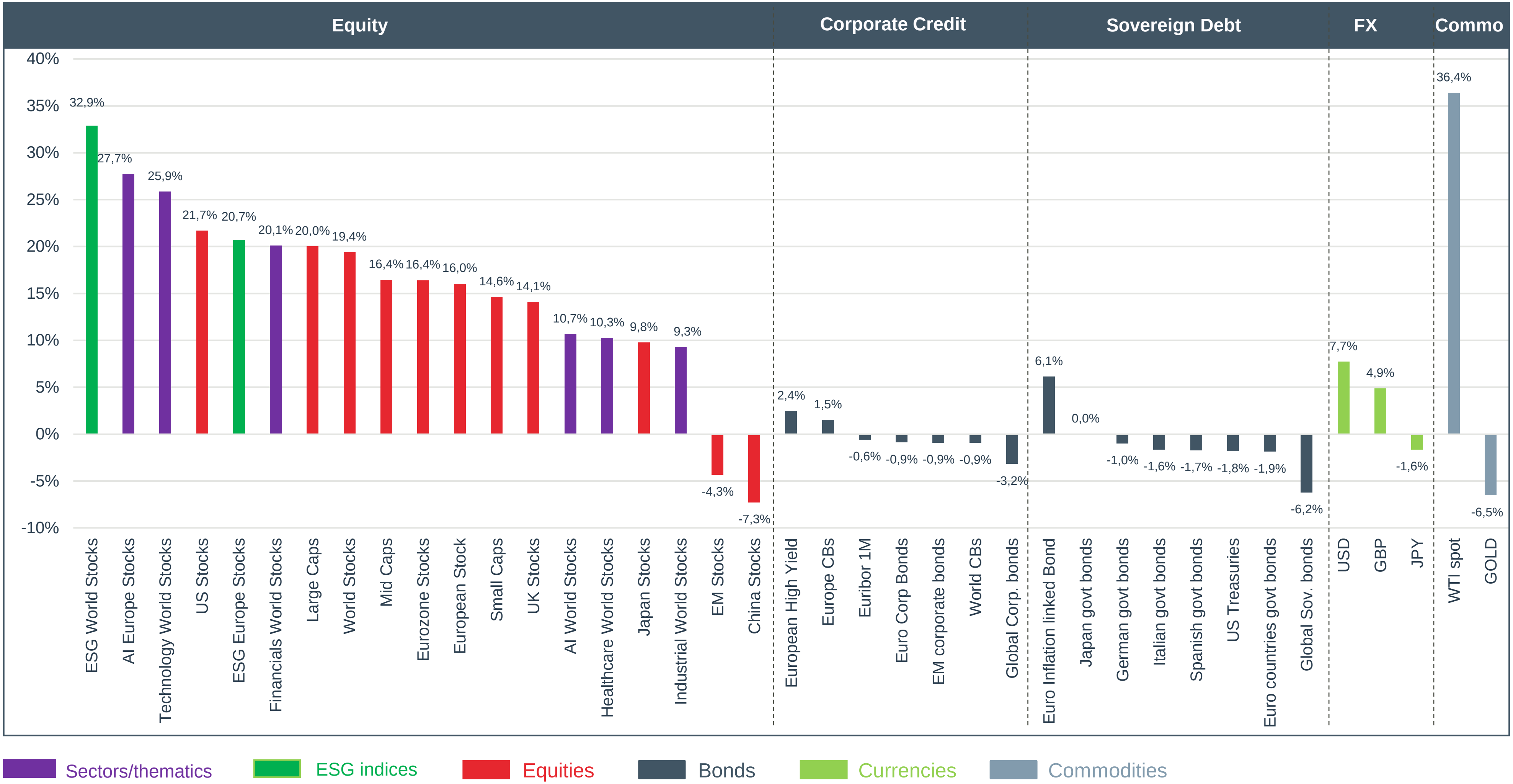
The trends remains the same



Source : Morningstar. Data as of 31.10.2021 (Europe OE ex ETF ex MM ex FoF ex Feeder (domiciled, most compr.)

Year-to-date performances of asset classes

A breather for equities in November



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

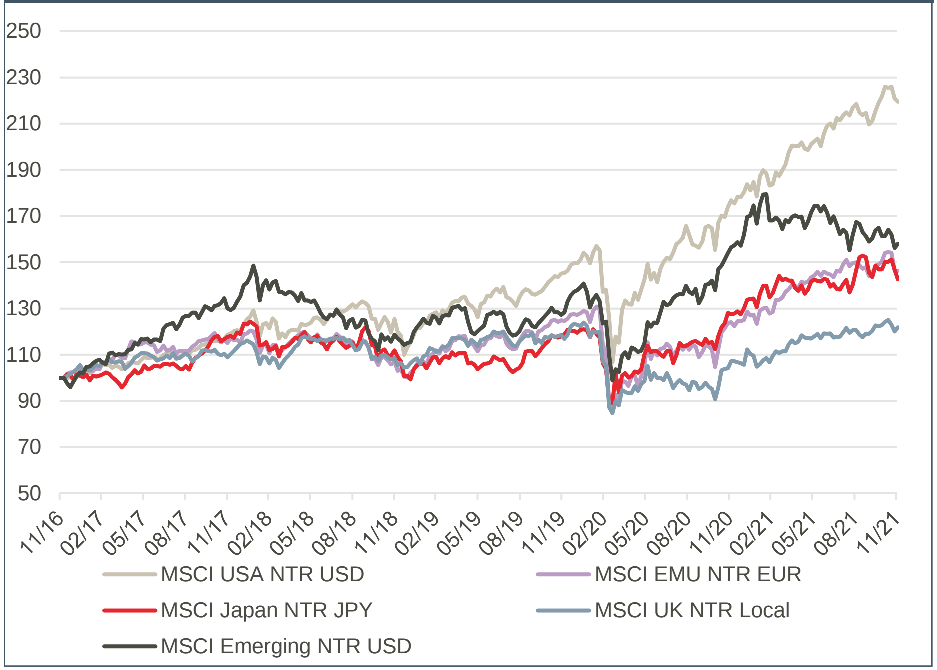
Sources: Bloomberg and BoA ML as of 11/30/2021; performances expressed in local currencies

EQUITIES

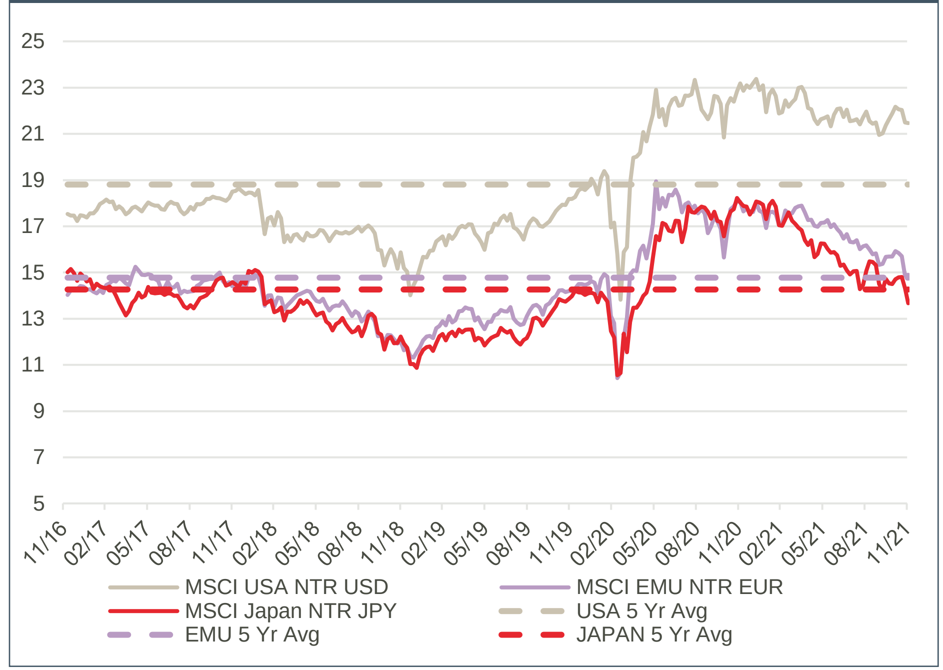
Equities

Equity gets volatile!

5-year equity market performance



5-year price/earning ratio



- After early gains, global markets crashed during the last days of November and the “fear index” VIX reached its highest since February.
- Over the month, the S&P 500 lose only -1% (Nasdaq even gaining 2%), while EuroStoxx, Topix and Msci Emerging indexes lost -4%.
- Among worst performers, Spanish Ibex lost -8% (now a small +3% YTD), the Hang Seng -8%, and Russia RTS fell -11%.

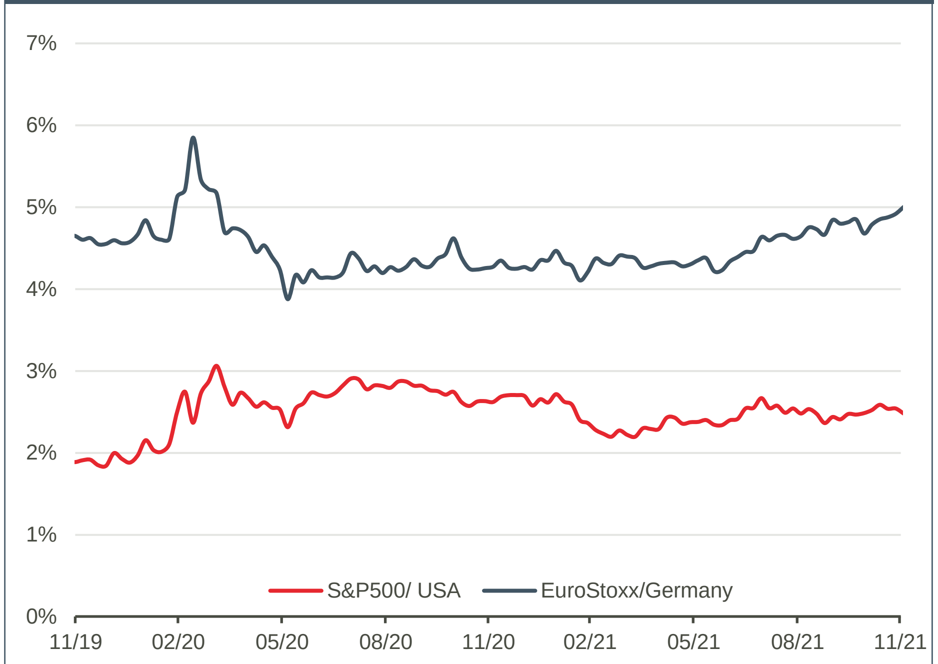
Past performances are not a reliable indicator of future performances and are not constant over time.

Source: Bloomberg, ODDO BHF AM SAS | Data as of 11/30/2021

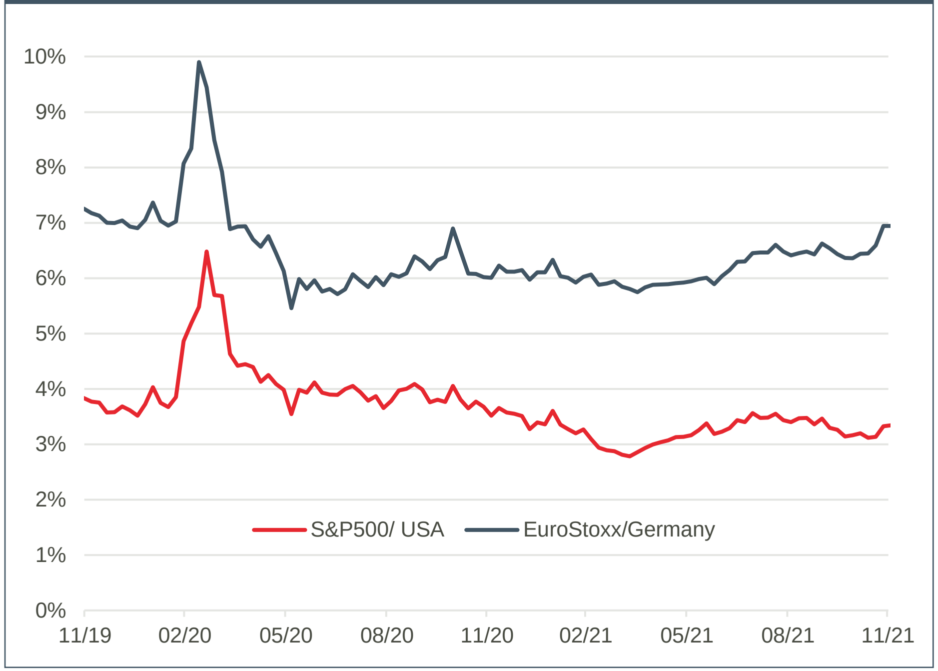
Risk premiums

Increasing divergences

Dividend yield (12m fwd) – Sovereign real yield (10y)



Return on shares (1/PE) – Sovereign nominal yield (10Y)



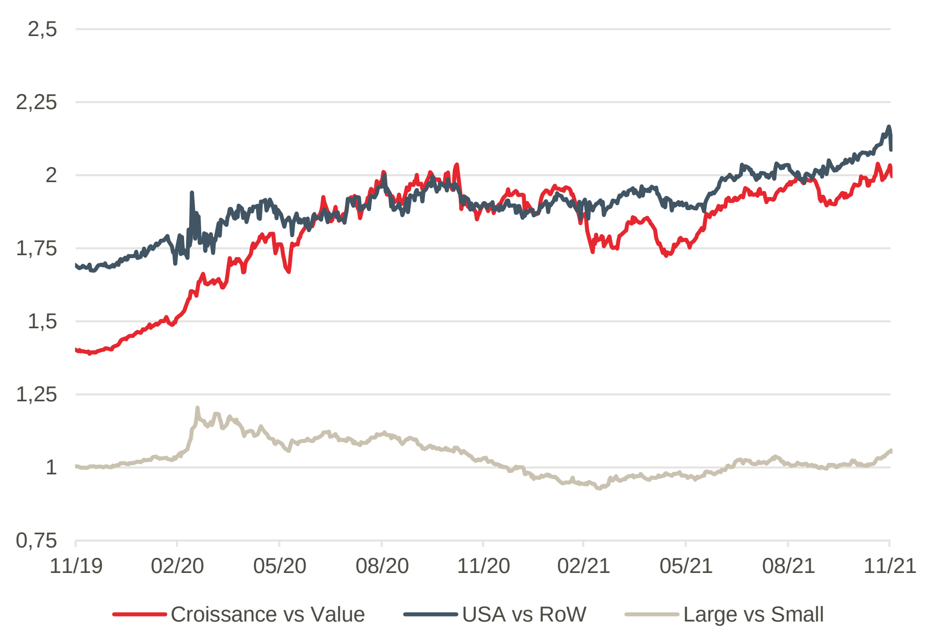
- With lower government bond yields and falling equity prices, while estimated earnings were rather stable, risk premia are a little bit larger for most markets.
- The discrepancy between US equities and the rest of world kept on increasing.

Past performances are not a reliable indicator of future performances and are not constant over time.
Source: Bloomberg, ODDO BHF AM SAS | Figures as of 11/30/2021

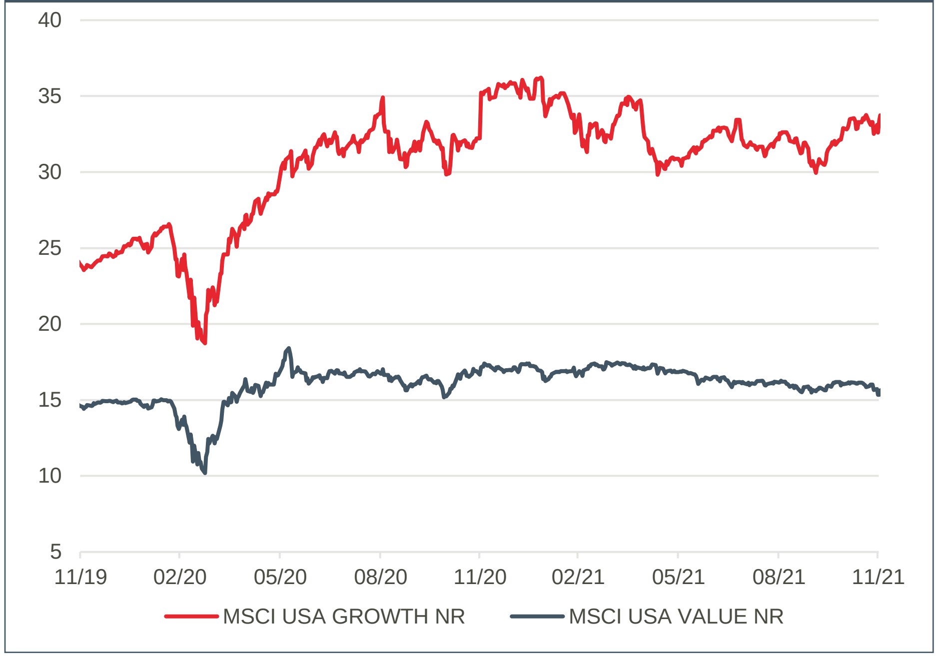
Equities performances – styles differential

Growth style's comeback is confirmed

World equities factor performances



P/E differential growth vs value



- With yields falling and oil getting hit by Omicron variant fears, value and cyclical mostly underperformed during November's second half.
- MSCI World "Value" index PE is back at its lowest level since April 2020

Sources: ODDO BHF AM SAS, Bloomberg | Figures as of 11/30/2021

European equities - sectors

A market split in two. Energy, materials and automotive face massive earnings growth and falling multiples

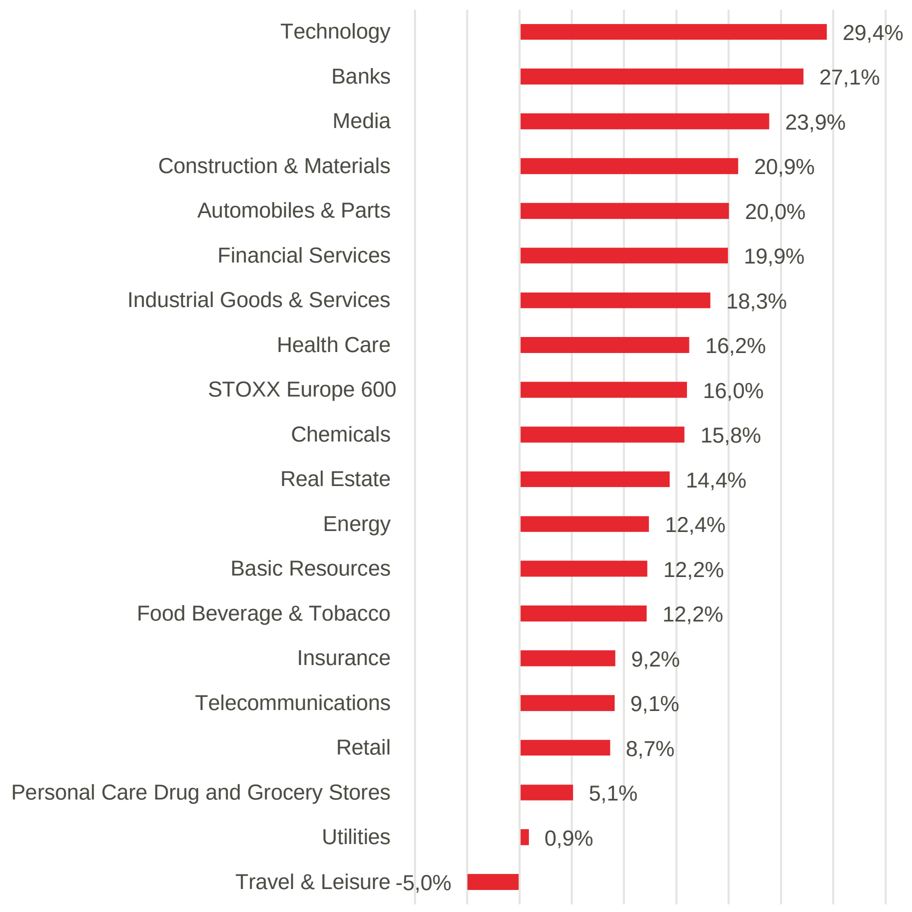
EUROPE / EURO LARGE / SMID SECTORS	P/E Next 12 months as of 11/21	Rerating P/E	EPS growth 2021	EPS growth 2022	Rev 3m EPS21	Rev 3m EPS22	Div Yield	Perf 1 Month	Perf YTD
STOXX Europe 600	15,6 x	**13%**	69%	4%	5,9%	4,6%	3,1%	-2,6%	16,0%
Commodities									
Basic Resources	7,4 x	**-43%**	162%	-20%	2,2%	6,0%	6,6%	-1,2%	12,2%
Energy	8,7 x	**-16%**	992%	11%	17,5%	21,2%	5,0%	-8,0%	12,4%
Cyclicals									
Automobiles & Parts	7,1 x	**-30%**	548%	9%	1,5%	3,3%	4,5%	-5,7%	20,0%
Chemicals	19,2 x	**23%**	78%	1%	11,0%	5,3%	2,4%	-1,5%	15,8%
Construction & Materials	16,7 x	**7%**	45%	14%	0,3%	0,3%	2,7%	-1,9%	20,9%
Industrial Goods & Services	19,0 x	**22%**	78%	16%	7,1%	8,1%	2,3%	-2,3%	18,3%
Media	18,9 x	**14%**	17%	16%	-6,1%	-6,6%	2,4%	-0,3%	23,9%
Technology	29,5 x	**54%**	32%	14%	16,6%	6,5%	0,9%	-2,5%	29,4%
Travel & Leisure	22,3 x	**36%**	64%	167%	-2,7%	-7,0%	1,4%	-19,6%	-5,0%
Financials									
Banks	8,5 x	**-27%**	118%	-4%	11,8%	4,5%	5,5%	-7,6%	27,1%
Insurance	10,0 x	**-6%**	33%	8%	-10,4%	2,0%	5,5%	-4,9%	9,2%
Financial Services	14,1 x	**-12%**	31%	-24%	16,6%	4,8%	2,6%	-2,3%	19,9%
Real Estate	21,1 x	**17%**	9%	11%	23,9%	4,1%	3,1%	0,7%	14,4%
Defensives									
Food Beverage & Tobacco	18,5 x	**4%**	8%	8%	2,0%	1,6%	3,0%	-1,9%	12,2%
Health Care	19,1 x	**23%**	11%	10%	4,2%	1,9%	2,3%	-2,3%	16,2%
Personal Care Drug and Grocery Stores	19,4 x	**22%**	2%	8%	1,7%	0,5%	2,9%	1,0%	5,1%
Retail	20,3 x	**31%**	172%	19%	5,0%	1,4%	2,4%	-2,5%	8,7%
Telecommunications	13,9 x	**-8%**	11%	-20%	-7,4%	0,2%	4,4%	0,6%	9,1%
Utilities	15,5 x	**20%**	19%	7%	1,6%	2,6%	4,4%	-1,1%	0,9%

Source: ODDO BHF AM SAS, Factset, data as of 11/30/2021

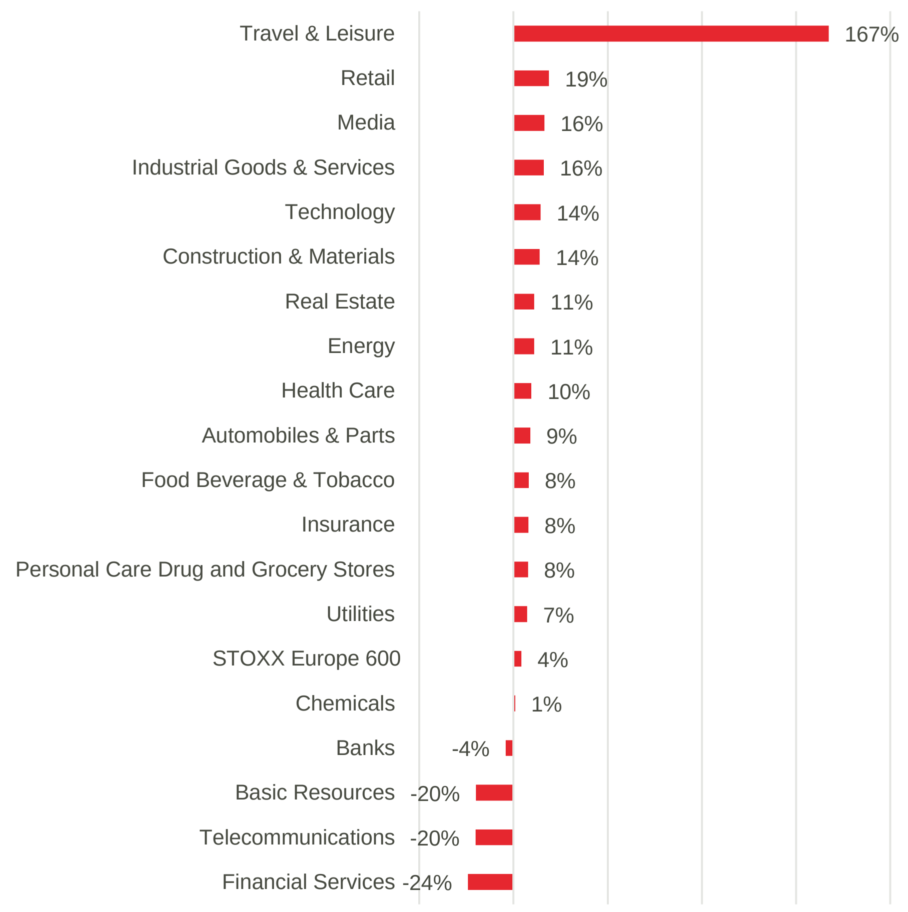
European equities - sectors

Late in the normalisation cycle, the tourism sector faces high expectations for 2022

YTD Performance European sectors



EPS growth 2022 European sectors

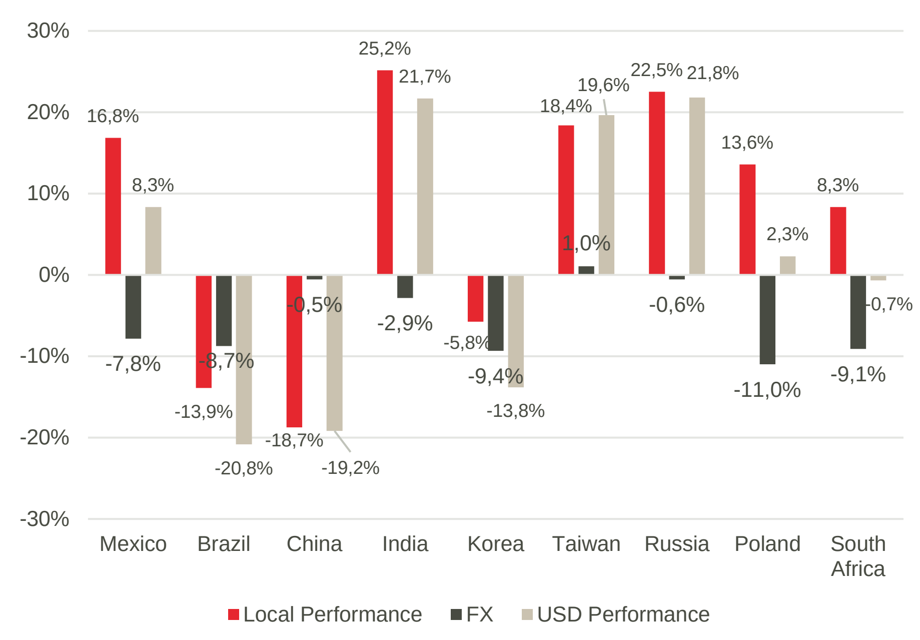


Source: ODDO BHF AM SAS, Factset, data as of 11/30/2021

Emerging markets

Divergences

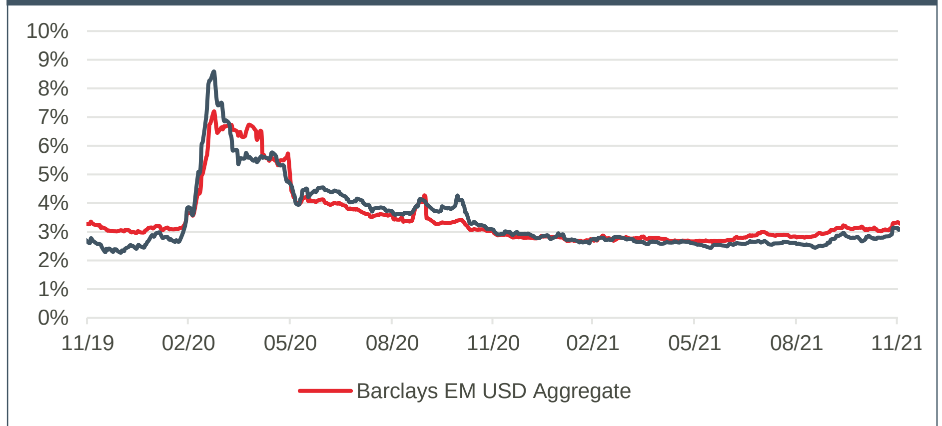
Equities performance on major emerging markets



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	13,2	-17%	60%	7%	2,8%
MSCI CHINA	14,4	-9%	11%	15%	1,9%
MSCI KOREA	10,0	6%	116%	-5%	1,9%
MSCI INDIA	25,7	-27%	89%	18%	1,2%
MSCI INDONESIA	18,1	-30%	28%	20%	2,7%
MSCI PHILIPPINES	22,3	-52%	52%	27%	1,6%
MSCI MALAYSIA	15,9	-26%	35%	7%	3,9%
MSCI RUSSIA	6,4	-60%	161%	4%	8,6%
WSE WIG INDEX	10,6	-33%	162%	-6%	2,9%
MSCI TURKEY	6,5	5%	94%	13%	6,1%
MSCI SOUTH AFRICA	10,1	-9%	82%	12%	4,6%
MSCI BRAZIL	6,4	-40%	222%	-12%	8,7%
MSCI COLOMBIA	9,8	-77%	272%	14%	2,9%
MSCI MEXICO	14,3	-50%	135%	8%	3,0%

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



- Russian (sensitive to oil) and Polish (banking bias) indexes lost around -10% over the month but are still up +19% YTD.
- Hong-Kong lost -7%, with YTD performance now at -14%. Other Asian markets fared much better (with Jakarta and Manilla indexes both up +6%).
- In a world fearing the new Omicron Covid strain, Johannesburg 40 posts one of the best performance with a +5% monthly return.
- While USD gained vs most peers, CNY keeps increasing, and BRL eventually stabilizes.

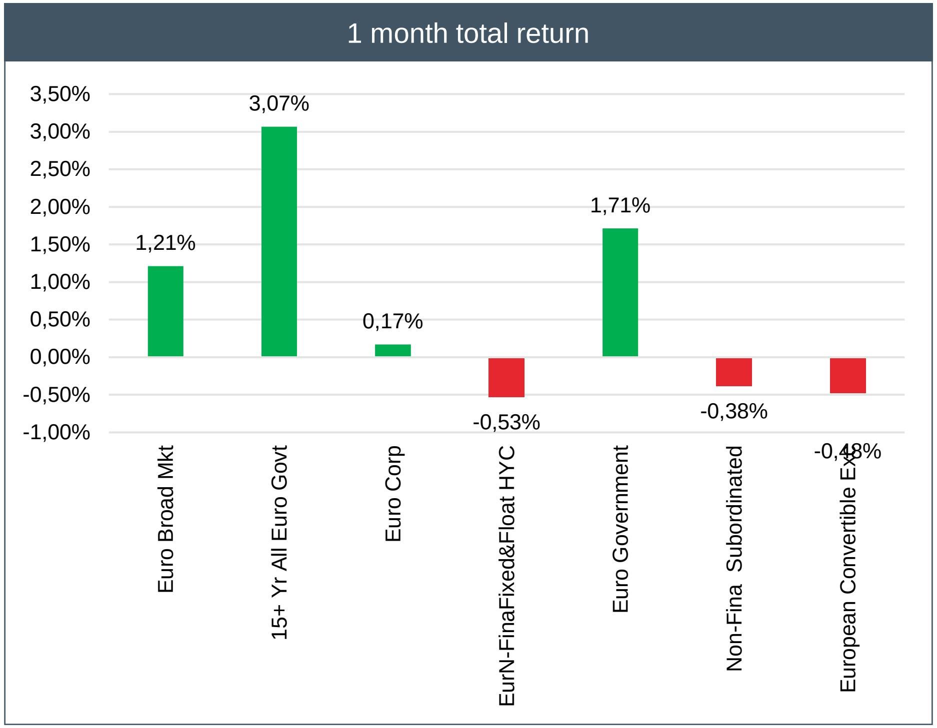
Past performances are not a reliable indicator of future performance and are not constant over time.

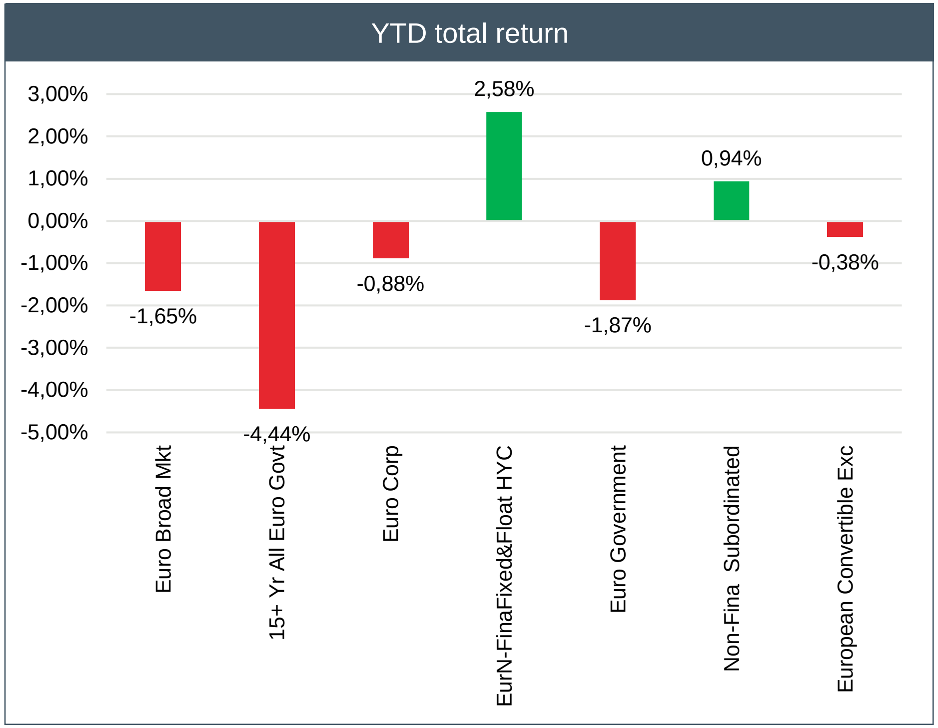
Sources: Bloomberg, ODDO BHF AM SAS | Data at 03/12/2021

FIXED INCOME

Performance fixed income segment

What a difference a month makes





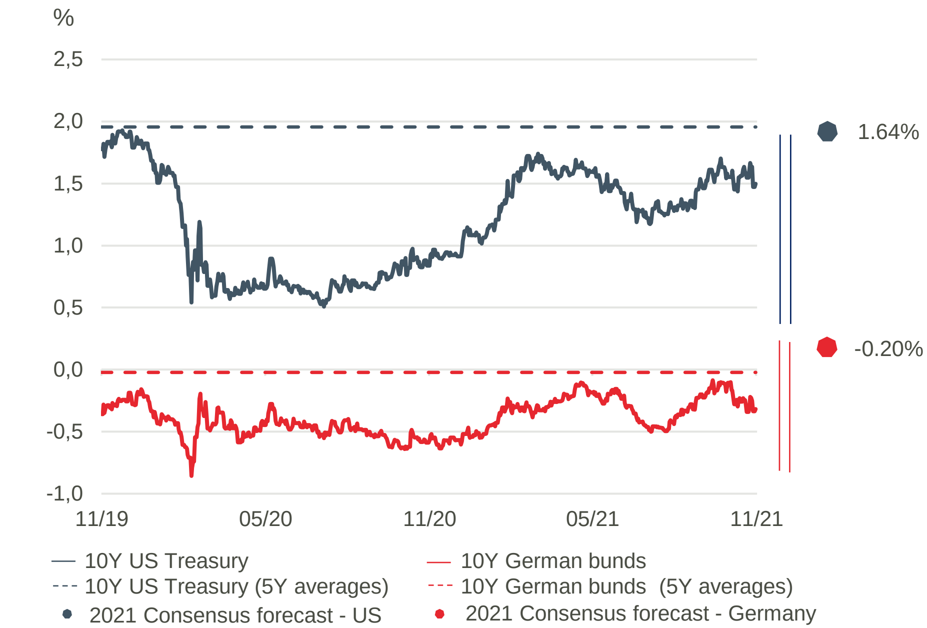
- Strong rebound for government bonds, but some spread widening

Source: ODDO BHF AM, Bloomberg, data as of 11/30/2021

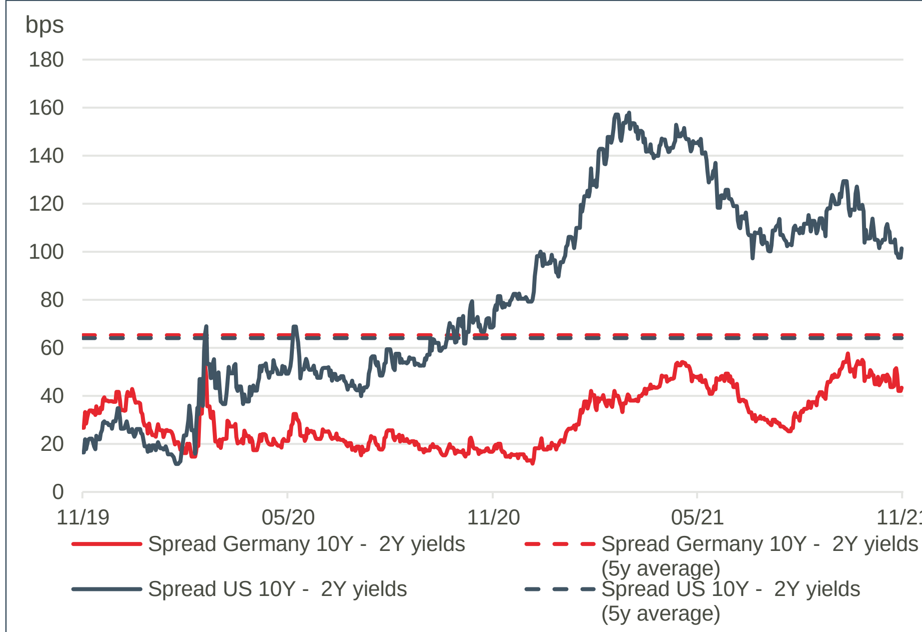
Rates

Risk aversion props up government bonds - again

German & US 10-year bond yields (over 2 years)



German & US 2 year – 10-year yield curve (over 2 years)



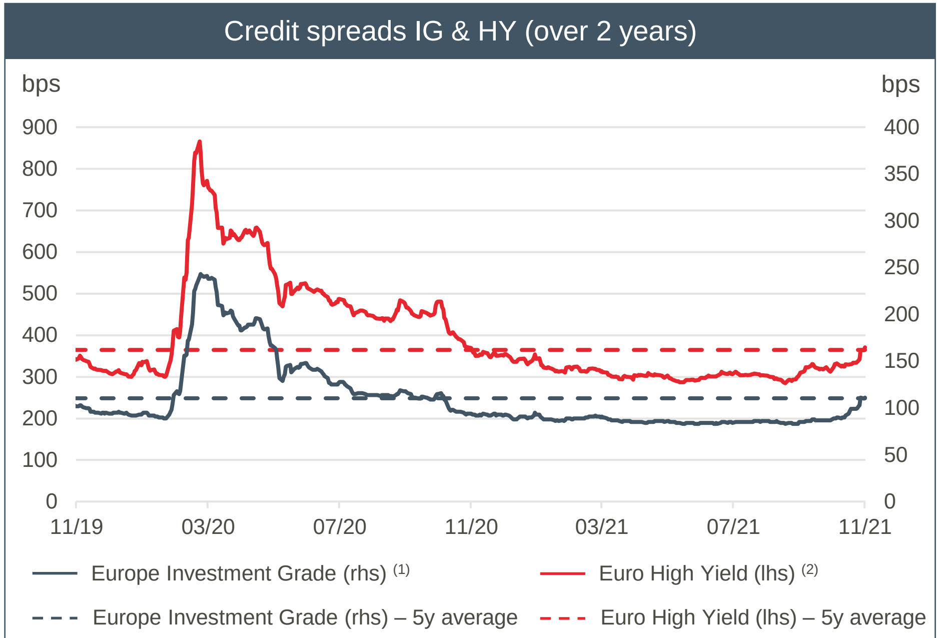
- With short-term risks around the Eurozone growth outlook building amid the threat of the 4th covid wave and the Omicron strain, bonds have rebounded strongly
- Moreover, solid technical factors and crowded short positions speak for a robust market into year-end
- We remain cautious though in 2022 on duration, as real yields still have to reflect a higher inflation regime and an ongoing recovery after the winter growth dent

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

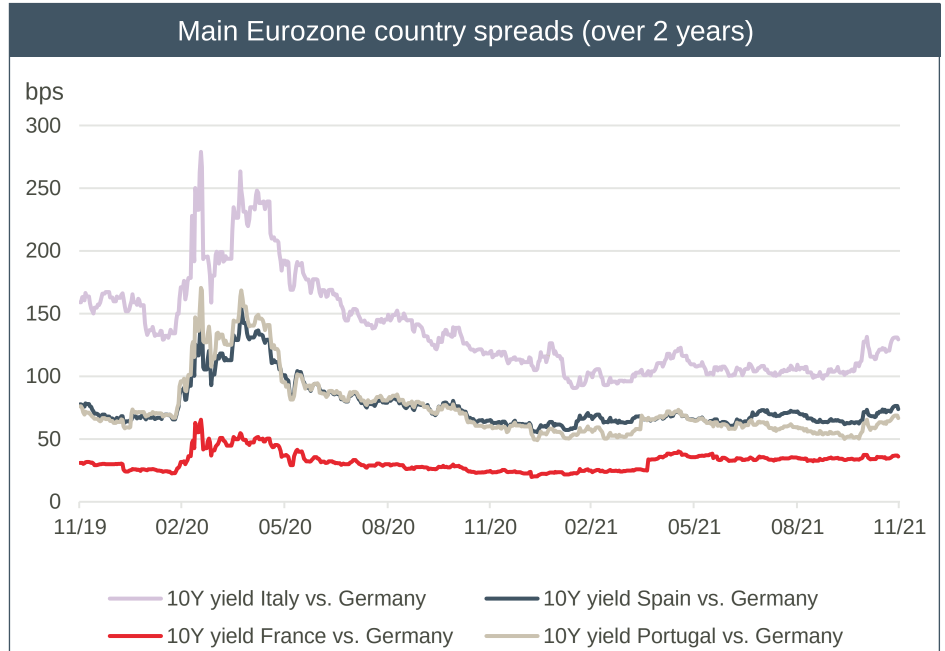
(1) Bloomberg Economic Forecast | Sources: ODDO BHF AM SAS, Bloomberg | LHS: Data as of 11/30/2021; RHS: Data as of 11/30/2021

Credit Spreads

The song remains the same



(1) BofA Merrill Lynch Euro Corporate Index (ER00)
(2) BofA Merrill Lynch Euro High Yield Non-Fin. Constr. (HE00)



- Potential for spread tightening appears to be limited, but stronger widening also unlikely.
- APP increase with focus on corporate bonds should support spreads further.
- Strong investor demand with limited supply pressure and sound corporate balance sheets also quite positive.

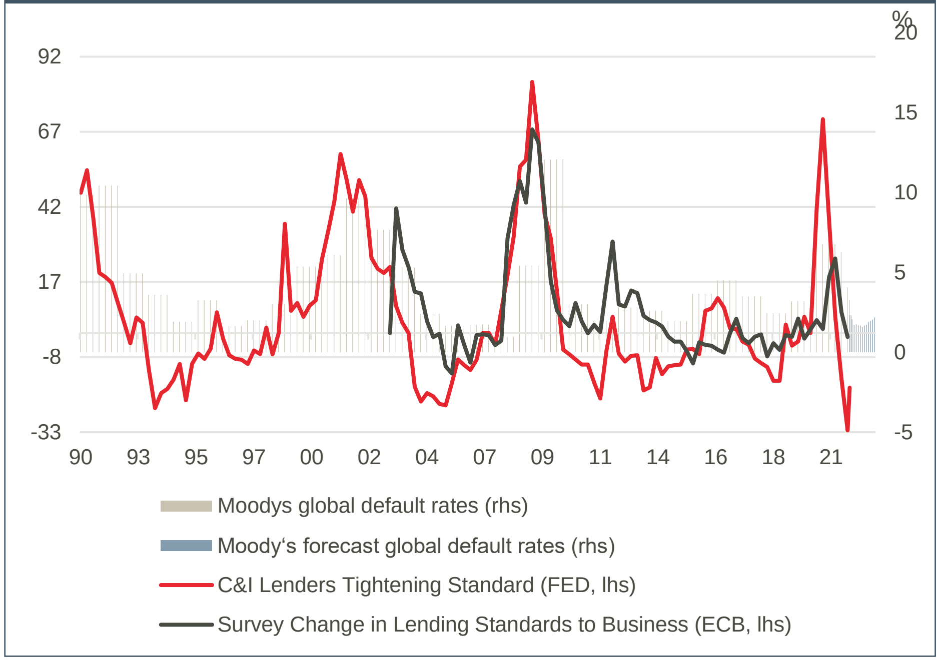
Past performance is not a reliable indicator of future performance and is not constant over time.

Sources: ODDO BHF AM SAS, Bloomberg | Data as of 11/30/2021

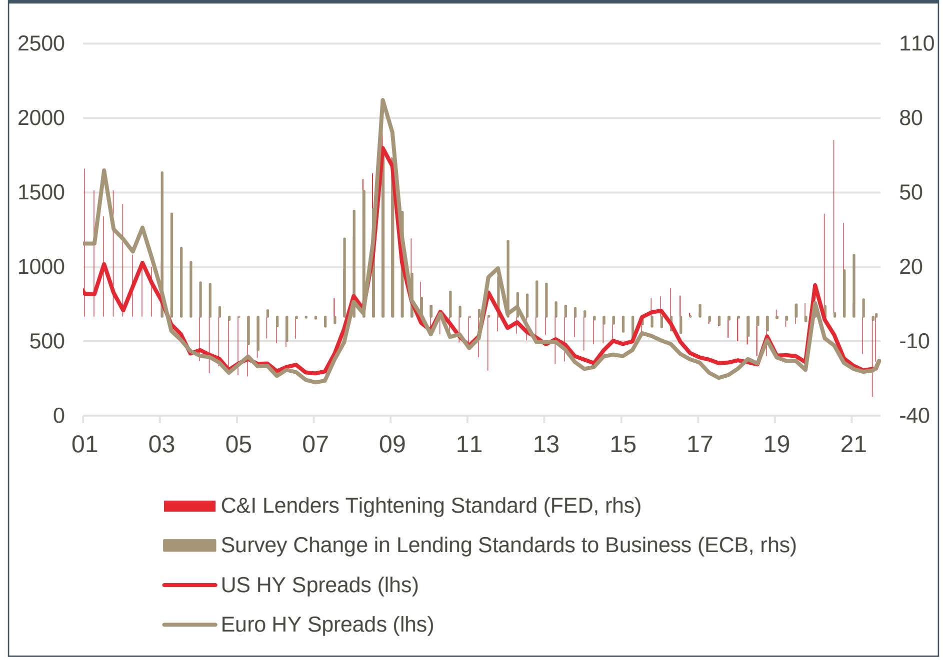
Financial conditions

Still very ample

Lending standards and default rate



Lending standards and spreads

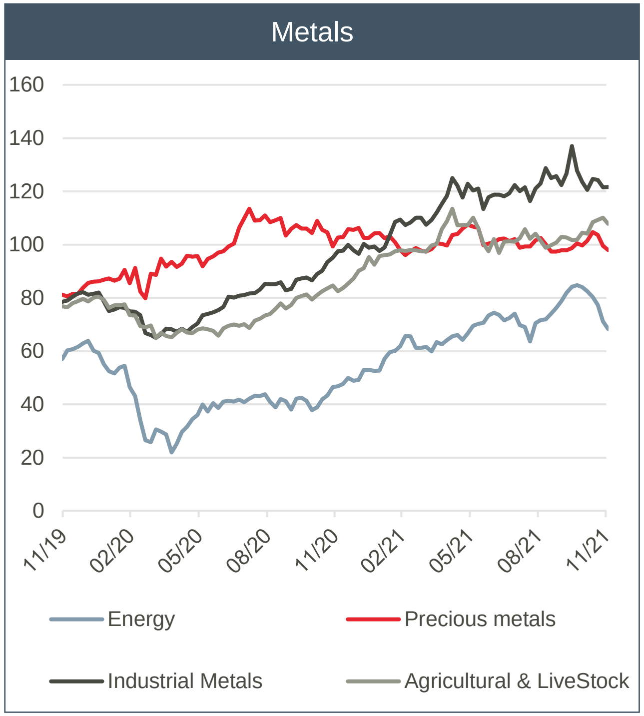


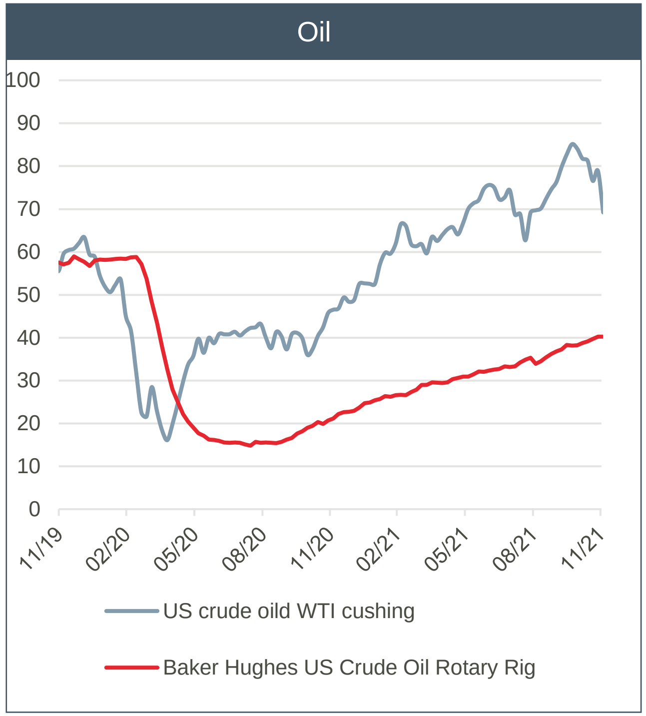
Source: Fed, ECB, Bloomberg | Moody's as of 10/31/2021, Lending Standard & Survey Change as of 10/2021, Spreads as of 11/30/2021

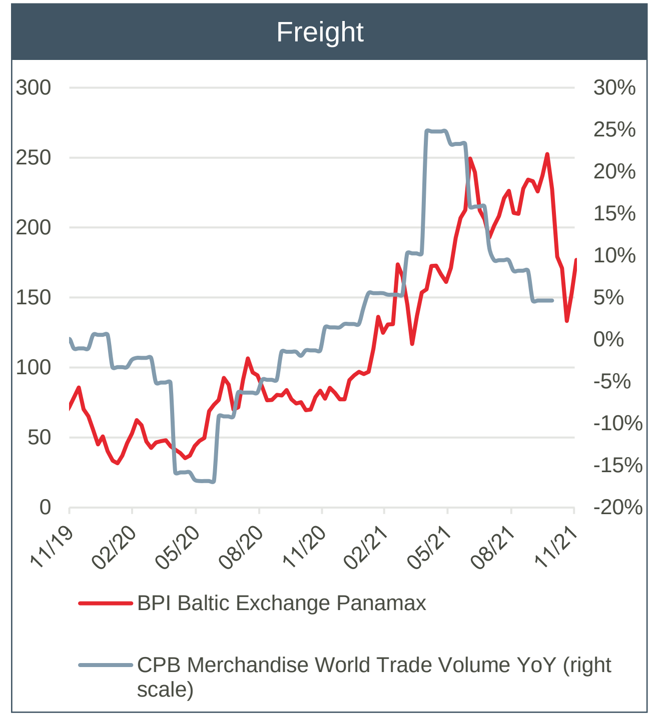
COMMODITIES & CURRENCIES

Commodities

Some stabilization on average, in a volatile environment







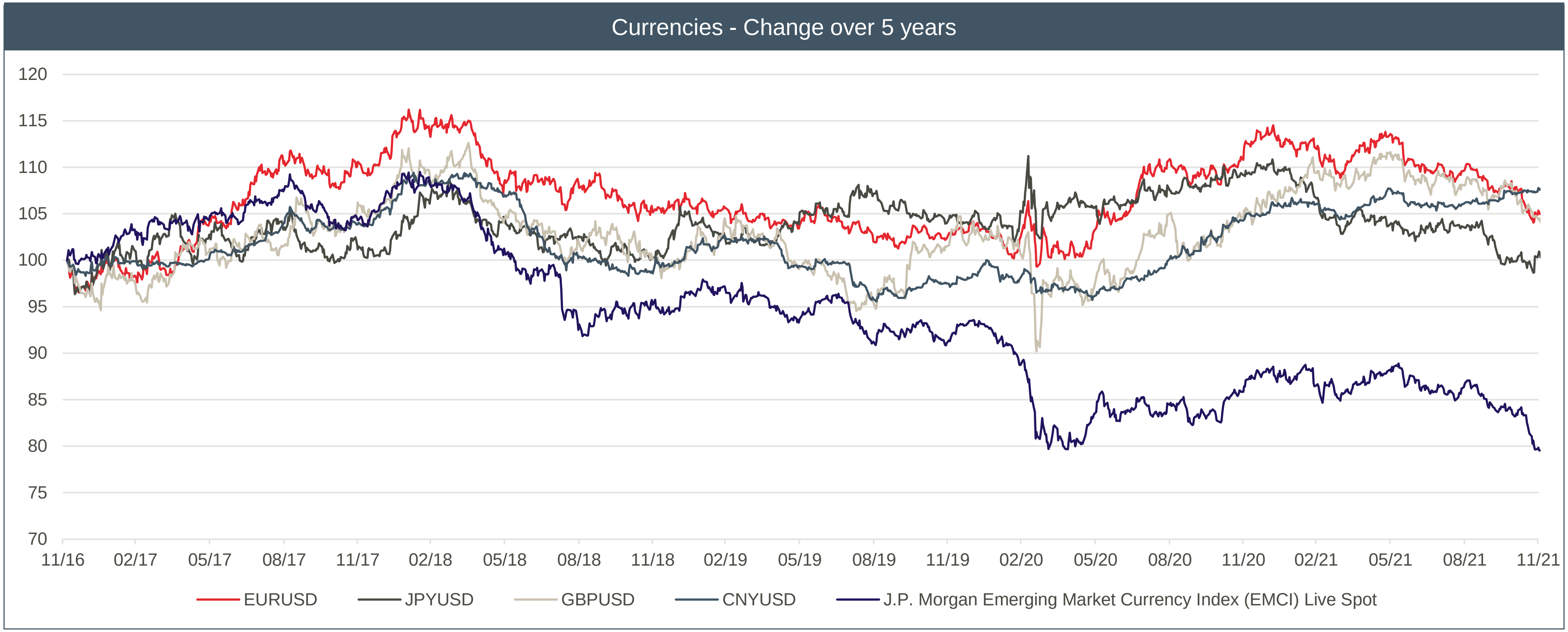
- Oil and industrial metals fell by the end of the month.
- OPEC may consider cancelling planned output hike, should Omicron result in lower demand
- But freight index is starting to move up once again.

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

Sources: Bloomberg, ODDO BHF AM SAS | Data at 11/30/2021

Currencies

USD kept on strengthening



- EUR and GBP lost some ground vs the greenback. JPY performed well in a risk-off environment.
- Cyclical currencies fell sharply (CAD -3%, AUD -5%, MXN -4%)
- With the Selic rate at 8% and its recent massive underperformance, BRL may eventually stabilize

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

Sources: Bloomberg, ODDO BHF AM SAS | Data at 11/30/2021

03 CURRENT CONVICTIONS

Scenarios

Our 6-month view

Central scenario:
Growth acceleration in Europe, peaking growth in the US while China slows down, still positive earnings momentum

70%

Europe
- Growth acceleration with vaccination rates outperforming the US
- Overall recovery lagging vs the United States, China, but GDP growth momentum is picking up in Europe while getting less in the US/China
- Positive corporate earnings momentum continues
- Fiscal and monetary policy will continue to support financial markets

US
- With economic sentiment, GDP growth and also inflation peaking, the management of growth normalization will be in the focus
- Corporate fundamentals strong with EPS upward revisions
- Fiscal support remains overall high, while lower household support should accelerate job creation in the next months
- Current monetary support might get less as tapering discussions started, but future rate hikes are decoupled from tapering

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 rate hike 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 pandemia extension in EM

5%

- Geopolitical risks materializing
- China politics and corporate debt issues with increased negative effects on global financial markets
- Covid-19 surge in EM disrupting global supply chains and cooling down global economy

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 01/12/2021

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			0		
	Japan			0		
Convertible bonds	Europe			0		
	USA			0		
Currencies	USD / €		-1			
	YEN / €			0		
	GBP / €			0		
Commodities	Gold			0		
	Crude oil			0		

Change vs the previous month

Source: ODDO BHF AM, as of 01/12/2021

Our current convictions for each asset class

Asset class	Segment	Conviction
Government bonds	Core Europe	-1
	Peripheral Europe	-1
	USA	-2
Corporate bonds	Investment grade Europe	0
	Credit short duration	1
	High Yield Europe	-1
	High Yield USA	-1
	Emerging markets	0
Money market	Developed markets	0
Alternative assets	Private Equity	1
	Private Debt	1
	Real Estate	-1
	Hedge Fund	0

Change vs the previous month

Source: ODDO BHF AM, as of 01/12/2021

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See the teaser

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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 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

October 2021 – Navigating a market in transition

July 2021 – Reflation in ambush!

June 2021 – A recovery whithout overheating

May 2021 – « Welcome to France! »

April 2021 – « Twist again »

March 2021 – The XXL Biden effect

Febrary 2021 – Destination rather than journey

MARKET VIEWS

August 23rd 2021: Bretton Woods, 50 years on: Gold, inflation and diversification

July 5th 2021 – China: stop or again?

June 21st 2021 – Bitcoin: technological innovation or pure hype?

May 17th 2021 - When the chips are down

May 3rd - SPACs: Opportunities and risks for investors in Europe

April 8th 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

September 2021 – « Breathless? »

January 2021 – Re-opening

SUSTAINABLE INVESTING

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 or resilience and differentiation

ESG: the key to unlocking opportunities in Small Caps

VIDEOS

#Moments - ODDO BHF Polaris Range - ODDO BHF AM

#Moments - ODDO BHF Green Planet: the ecological transition, a sustainable investment opportunity

Contributors to this Monthly Investment Brief

Nicolas Chaput
Global CEO
ODDO BHF AM

Emmanuel Chapuis, CFA
Co-head of fundamental equities
ODDO BHF AM

Matthieu Barriere, CFA
Multi asset portfolio manager
ODDO BHF AM SAS

Matthias Lackmann
Asset Manager Corporate Credit IG
ODDO BHF AM GmbH

Laurent Denize
Global CIO
ODDO BHF AM

Maxime Dupuis, CFA
Global Head of Marketing & Products
ODDO BHF AM

Bjoern Bender, CFA
Head of fixed income products
ODDO BHF AM GmbH

Romain Gaugry
Fund manager – asset allocation
ODDO BHF AM SAS

Gunther Westen
Global Head of Asset Allocation
ODDO BHF AM

Eugénie Leclerc
Marketing & Strategy
ODDO BHF AM SAS

Jérémy Tribaudeau, CFA
Head of Equity Products
ODDO BHF AM SAS

Rémi Gravier
Product manager asset allocation
ODDO BHF AM SAS

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