Monthly Investment Brief

Europe looks great again

ODDO BHF ASSET MANAGEMENT

October 2020

Let's try to move away from a short-term view focused on the US elections or the risk of a one-off lockdown. A three-month recommendation, which is necessarily tactical in nature, is subject to too many uncertainties for the most conservative investors. What are now the key parameters that should dictate your asset allocation in a long-term investment outlook? We see two of them:

1. Risk premiums

Negative real bond yields will continue to prop up equities. The yield on 30-year inflation-linked bonds has fallen by more than 90 basis points in 2020. Even assuming that global profits will not return to their pre-pandemic levels until the end of the decade, the steep drop in the risk-free component of the discount rate has nonetheless raised the present value of future cash flows by almost 20% so far this year. We commented at length on this point in our investment strategy.

These exceptionally low real bond yields are keeping equity risk premiums high. The TINA mantra ("There Is No Alternative") is spreading in the investment world. There is indeed no alternative to equities. To get an idea of how powerful "TINA" is, let's look at yields in the STOXX 600. They currently average 3.3%. That may seem low by historical standards, but they are nonetheless 3 percentage points higher than the negligible aggregate 0.10% yield on 10-year government bonds. Imagine that you have to invest your money in either equities or in a basket of 10-year European government bonds. Assuming, pessimistically, that dividends per share remain unchanged over the next 10 years, the Stoxx 600 would have to fall by 27% over the next decade to come into line with the 10-year government bond yield. If we measure this by comparing the expected earnings yield (1/ P/E = 1/17≈ 6%), the Stoxx 600 would have to plunge by almost 45%!

Some of you will (justifiably) argue that high risk premiums are not generally enough to justify overweighting equities. A catalyst is needed as well. Alongside an end to the pandemic or the discovery of a vaccine, we feel that this famous long-term catalyst is a sustained decline in the dollar. A weaker dollar could indeed help propel international equities upward over the next 12 months.

2. A weaker dollar for some time to come

The US dollar will face a number of headwinds in the coming months:

- First of all, the gap has narrowed considerably between the 2-year US and 2-year European yield. It is no longer as favourable to the dollar.
- Second, as a counter-cyclical currency, the dollar is likely to weaken as the global economy improves, which is what our baseline scenario says.
- Third, the current accounts deficit is rising again. It exploded by more than 50% in just three months, from $112 billion in the first quarter to $170 billion in the second. According to the Atlanta Fed's GDPNow model, the trade balance is likely to widen further in the third quarter.

This worsening in dollar fundamentals comes as the currency is still 11% overvalued based on purchasing power parity. Meanwhile, the drop in the dollar is helping foreign borrowers whose loans are denominated in dollars but whose revenues are denominated in local currency (there are many of these in emerging market economies). No wonder non-US equities have tended to outperform US equities when global growth strengthens and the dollar weakens.

As you may have guessed, we reiterate our overweighting of equities vs. bonds and of the euro zone vs. the US on a long-term investment horizon. The gap between European equities' projected yields of almost 6% and the 10-year Bund's negative -0.50% rate is more favourable than in the US, where the two equivalent figures are, respectively, 4.70% and 0.70%. Seen from this point of view, "Europe looks great again".

01 CURRENT CONVICTIONS

Scenarios

Our 6-month view

Central scenario: Global growth recovering from sharp recession with strong monetary and fiscal policy support

65%

Europe
- COVID-19 outbreak has resulted in most severe recession. Recovery has started in Q2 and 2020 growth figures could be better than feared. Divergence between strong business confidence and weak consumer confidence needs to be monitored.
- Unprecedented intervention from both monetary and fiscal policymakers will mitigate the coronavirus shock

US
- COVID-19 outbreak has resulted in most severe recession. Recovery has started in Q2 and 2020 growth figures could be better than feared. Divergence between strong business confidence and weak consumer confidence to be monitored.
- Unprecedented intervention from both monetary and fiscal policy will mitigate the coronavirus shock

Assets to overweight
- Equities (still neutral)
- Credit

Assets to underweight
- Sovereigns

Strategy
- Flexibility
- Hedging (options, gold,…)

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

10%

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

Assets to overweight
- Inflation-hedged bonds
- Alternative strategies
- Cash

Assets to underweight
- Equities
- Core Sovereigns
- High Yield credit

Alternative scenario: Increase in protectionism from geopolitics and pandemia extension

25%

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

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 10/13/2020

Our current convictions for each asset class

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

Change vs the previous month

Source: ODDO BHF AM, comments as of 10/13/2020

Our current convictions for each asset class

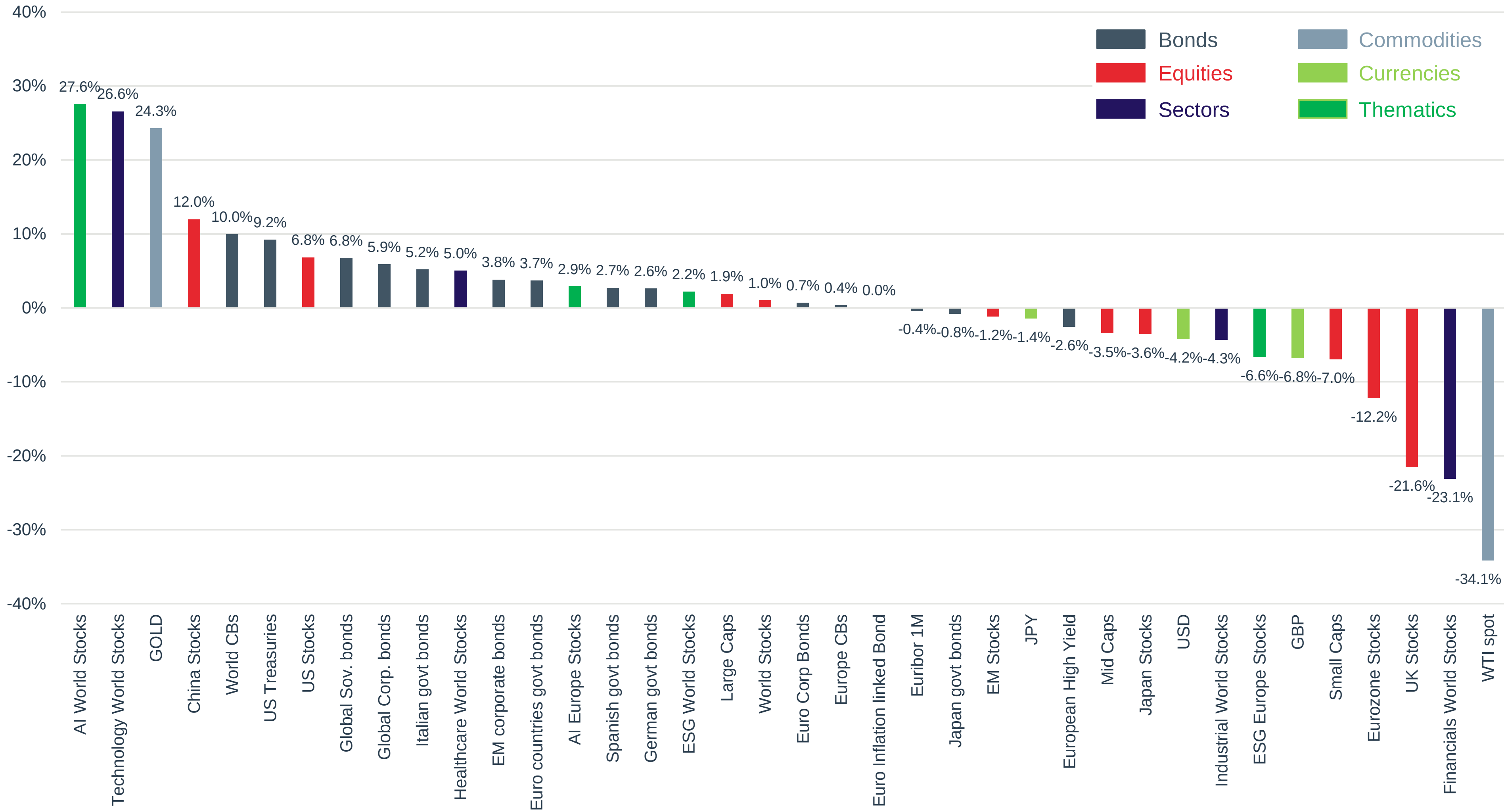
Government bonds	Core Europe	0
	Peripheral Europe	0
	USA	0
Corporate bonds	Investment grade Europe	1
	Credit short duration	1
	High Yield Europe	0
	High Yield USA	-1
	Emerging markets	0
Money market	Developed markets	1
Alternative assets	Private Equity	1
	Private Debt	1
	Real Estate	0
	Hedge Fund	0

Change vs the previous month

Source: ODDO BHF AM, comments as of 10/13/2020

02 MACROECONOMIC AND MARKET ANALYSIS

Year-to-date performances of asset classes



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

Sources: Bloomberg and BoA ML as of 09/30/2020; performances expressed in local currencies

Historical performances of asset classes

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020 YTD
Gold	5.1%	25.5%	29.4%	10.1%	7.1%	28.1%	-1.4%	-10.6%	8.0%	13.5%	-1.6%	18.3%	24.6%
US Gvt bonds	14.0%	-3.7%	5.9%	9.8%	2.2%	-3.4%	6.0%	0.8%	1.1%	2.4%	0.8%	7.0%	9.2%
US equities	-37.6%	26.3%	14.8%	1.4%	15.3%	31.8%	12.7%	0.7%	10.9%	21.2%	-5.0%	30.9%	6.8%
EM corporate bonds	-12.4%	30.9%	9.2%	5.6%	13.2%	-1.3%	3.9%	-1.0%	5.5%	7.3%	-1.4%	11.6%	4.5%
Eurozone Gvt bonds	9.1%	4.4%	1.1%	3.3%	11.2%	2.3%	13.2%	1.6%	3.3%	0.1%	1.0%	6.8%	3.7%
German Gvt bonds	12.2%	2.0%	6.2%	9.7%	4.5%	-2.3%	10.4%	0.3%	4.1%	-1.4%	2.4%	3.1%	2.6%
EM sovereign bonds	-10.9%	28.2%	12.0%	8.5%	18.5%	-6.6%	5.5%	1.2%	10.2%	9.3%	-4.6%	14.4%	0.4%
Euro Libor 1m	4.0%	0.7%	0.4%	0.9%	0.2%	0.1%	0.1%	-0.1%	-0.3%	-0.4%	-0.4%	-0.4%	-0.1%
EM equities	-53.3%	78.5%	18.9%	-18.4%	18.2%	-2.6%	-2.2%	-14.9%	11.2%	37.3%	-14.6%	18.4%	-1.2%
European High Yield	-34.2%	74.9%	14.3%	-2.5%	27.2%	10.1%	5.5%	0.8%	9.1%	6.7%	-3.6%	11.3%	-2.6%
Eurozone equities	-44.9%	27.3%	2.4%	-14.9%	19.3%	23.4%	4.3%	9.8%	4.4%	12.5%	-12.7%	25.5%	-12.2%
WTI spot	-53.5%	77.9%	15.2%	8.2%	-7.1%	7.2%	-45.9%	-30.5%	45.0%	12.5%	-24.8%	34.5%	-34.1%
Spreads (%age points)	**67.5%**	**82.2%**	**28.9%**	**28.5%**	**34.3%**	**38.4%**	**59.0%**	**40.3%**	**45.4%**	**38.7%**	**27.2%**	**34.9%**	**58.8%**

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

Colour scale

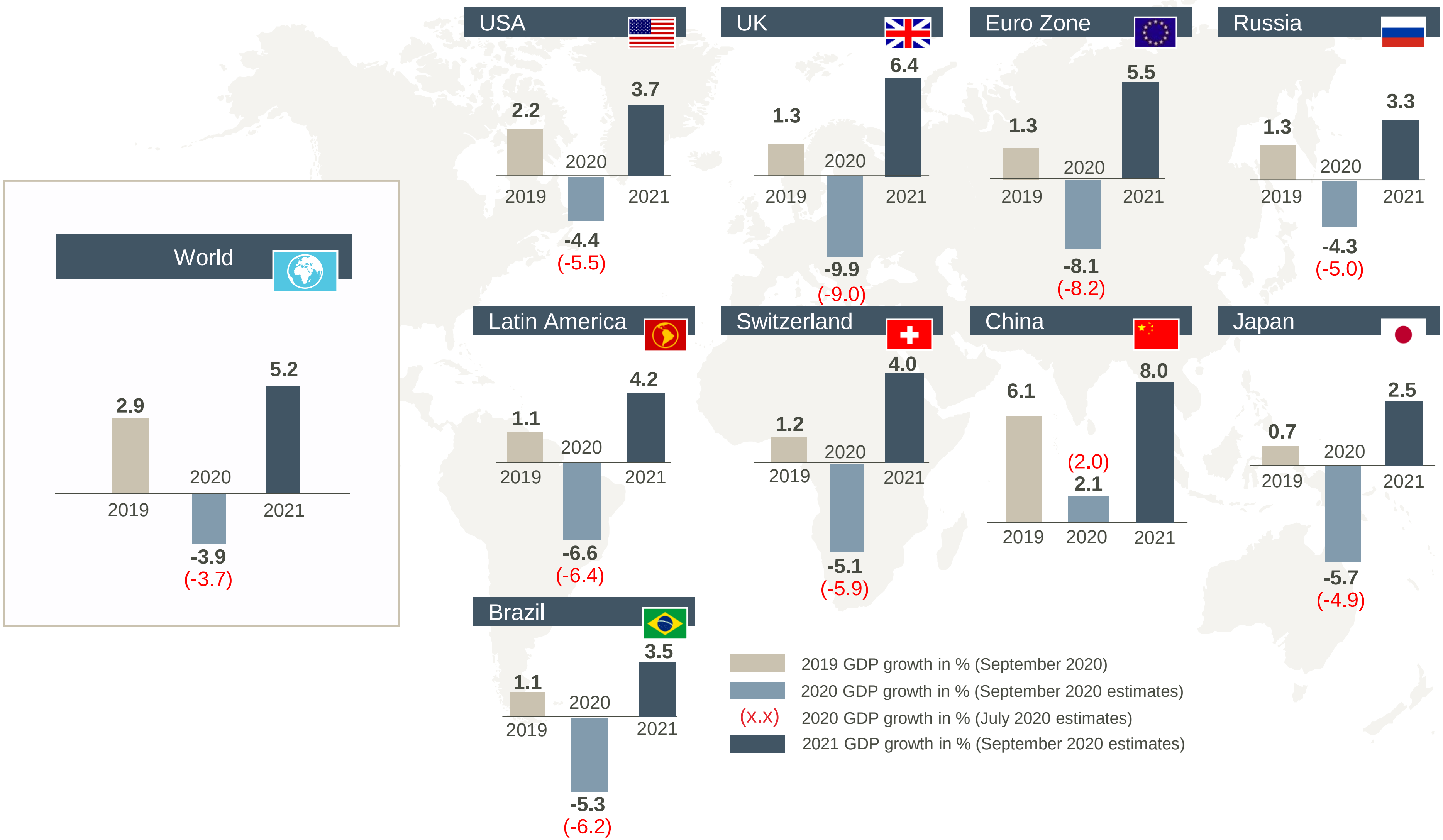
Best performance — Worst performance

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

Sources: Bloomberg and BoA ML as of 09/30/2020 ; performances expressed in local currencies

Global GDP* growth forecast

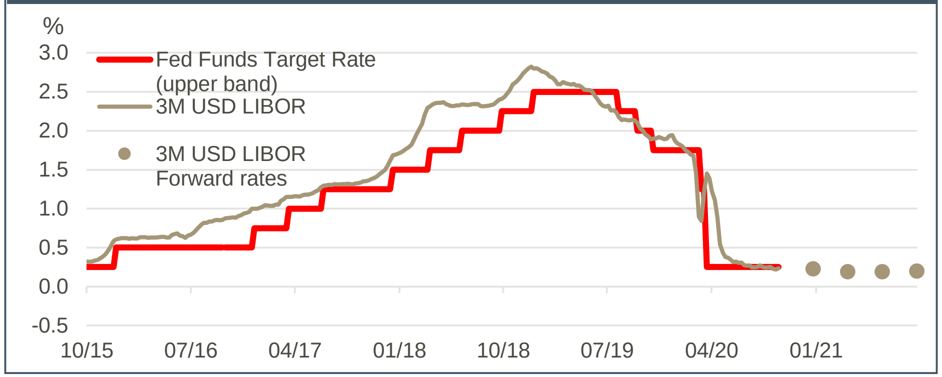
Consensus growth forecasts are in an upgrade process



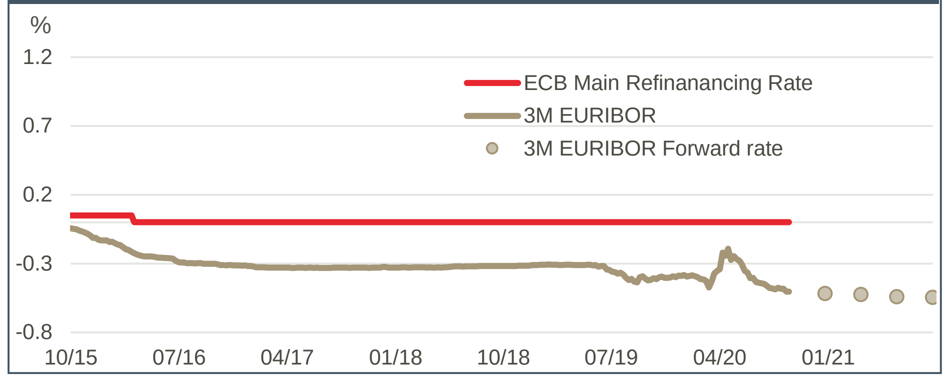
*GDP: Gross Domestic Product | Sources: ODDO BHF AM SAS, Bloomberg economist consensus forecast | Data as of 09/30/2020

Monetary policy & inflation expectations

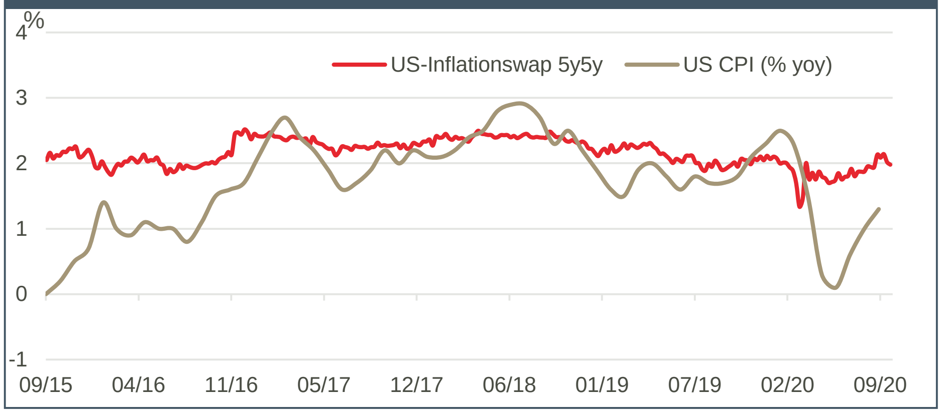
Fed Funds Target Rate, 3M USD LIBOR & 3M USD LIBOR FRAs



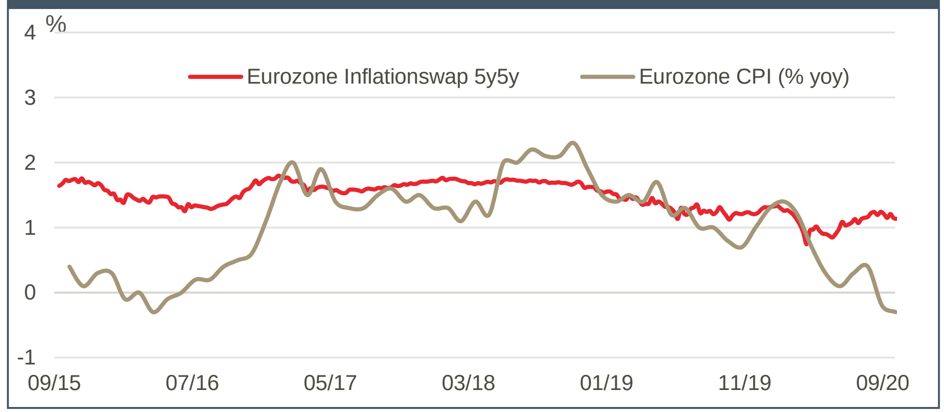
ECB Main Refinancing Rate, 3M EURIBOR & 3M EURIBOR FRAs



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



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



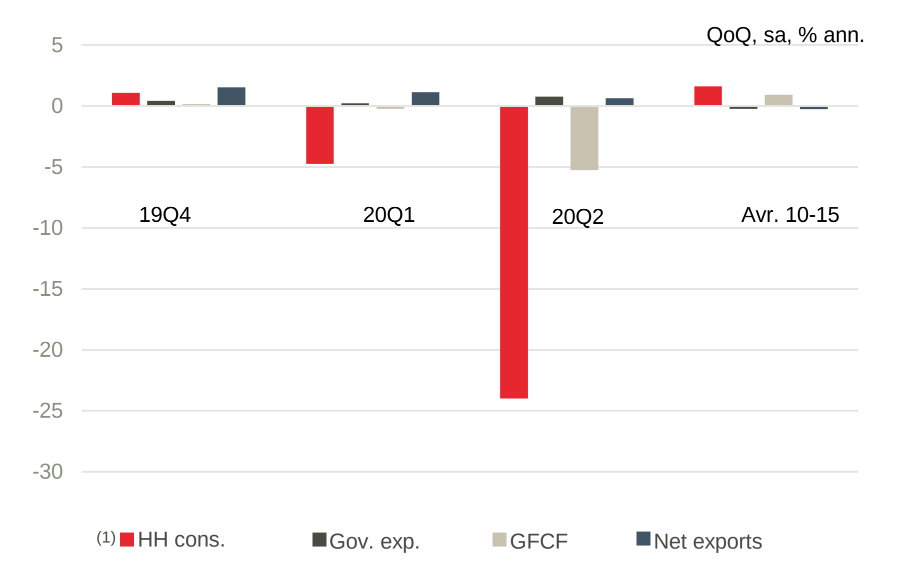
- Central Banks have signaled unlimited support for a very extended time frame
- FED especially supportive via new policy strategy with a strong focus on maximum employment
- In the short-term no additional stimulus expected

Sources: Bloomberg, ODDO BHF AM GmbH, as of 09/30/2020

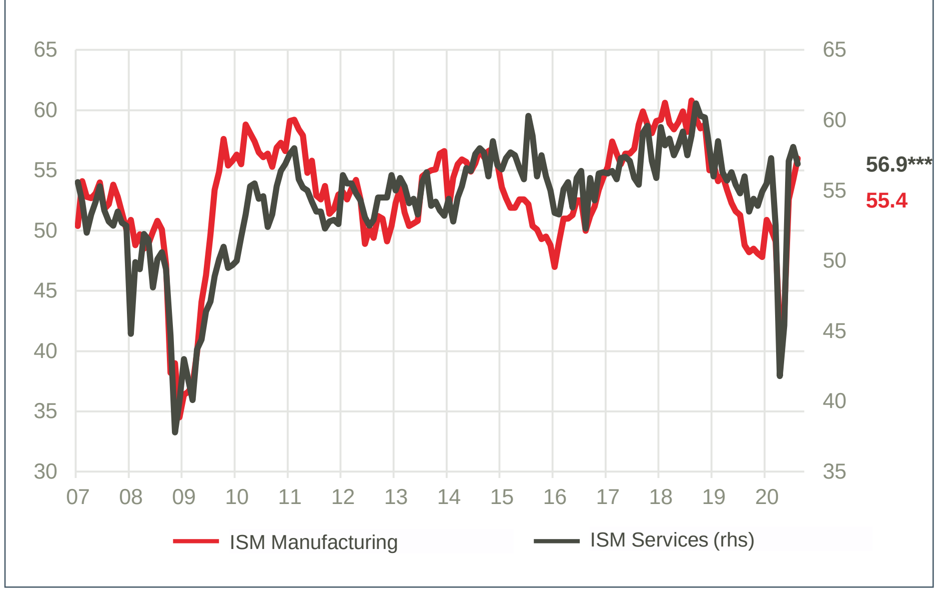
USA

Fiscal cliff dampens Q4 perspectives

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



Business confidence**

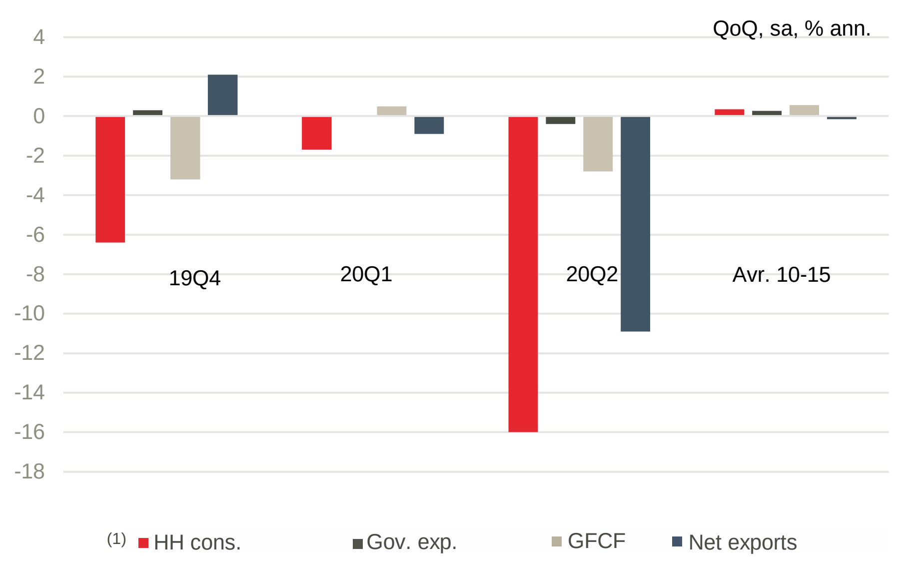


- V-shaped recovery through August. Q3 is expected at 32% QoQ ann.
- In September some growth momentum loss
- Goods sector is doing quite well, while service-related sectors remain depressed
- Stalling jobless claims point to setbacks in job growth
- Q4 forecast starts to being trimmed as implementation of fiscal stimulus measure is quite uncertain
- High savings rate (approx. 12%) may buffer part of that blow

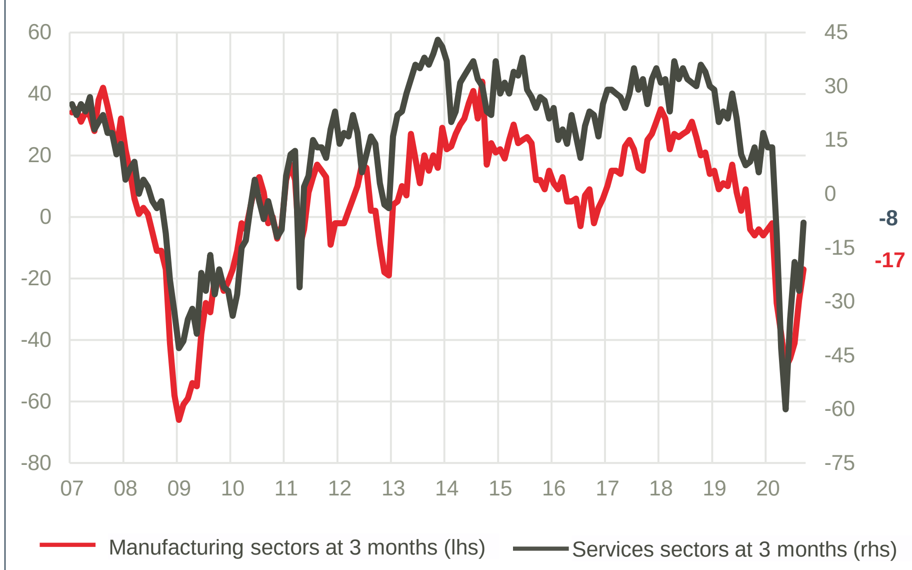
(1) HH cons.: household consumption / Gov. exp.: government expenditure / GFCF: gross fixed capital formation Net exports.
Sources: Bloomberg, Thomson Reuters, Datastream, ODDO BHF AM SAS. *data as of 09/30/2020 |** Data as of 09/15/2020 | ***Data as of 08/15/2020

Softness in the summer

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



Business confidence

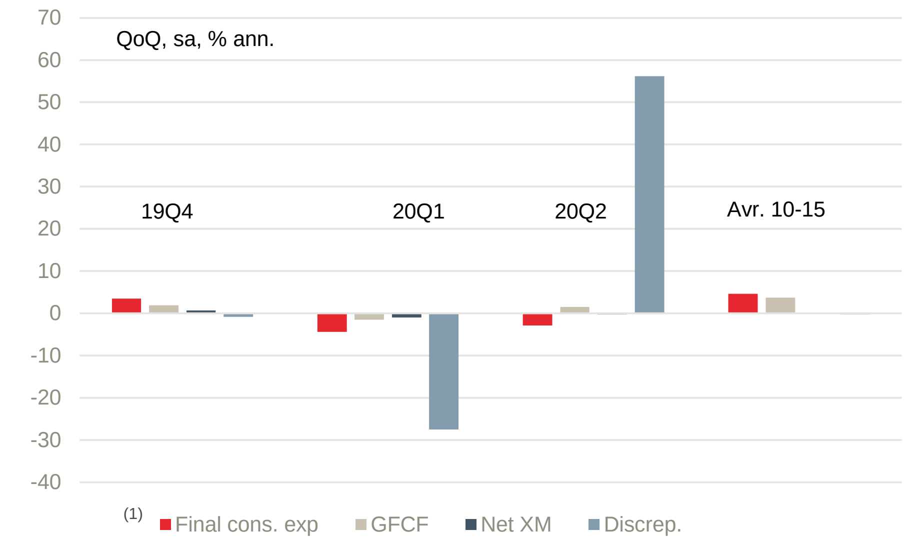


- September PMI showed that Japan's economic recovery flattened out
- Especially consumption was hit hard
- Q3 Tankan improved but fell short of expectation
- Subsidy measures should improve the situation

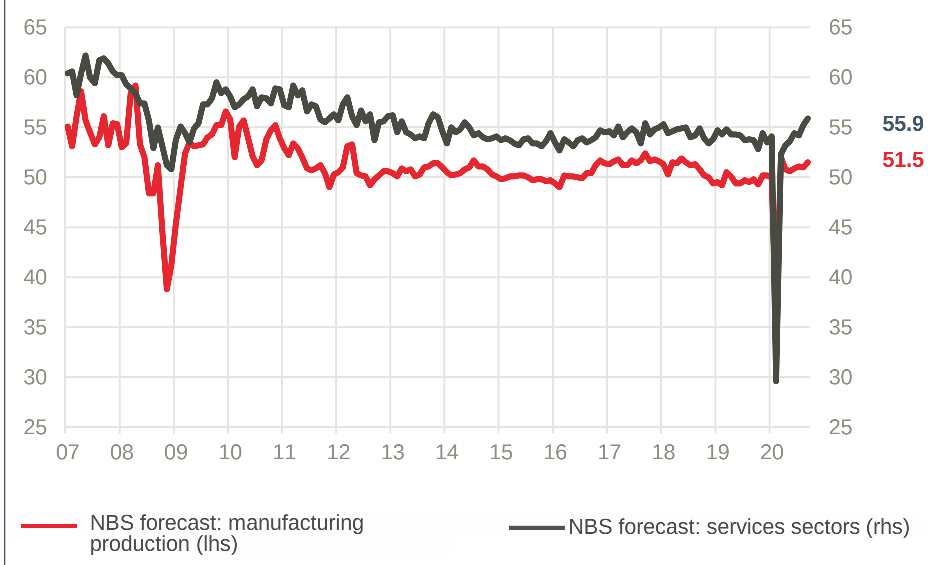
(1) HH cons.: household consumption / Gov. exp.: government expenditure / GFCF: gross fixed capital formation (investment) Sources: Bloomberg, Thomson Reuters, Datastream, ODDO BHF AM SAS. *Data as of 09/30/2020 | **Data as of 09/15/2020

Signs of ongoing improvement

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



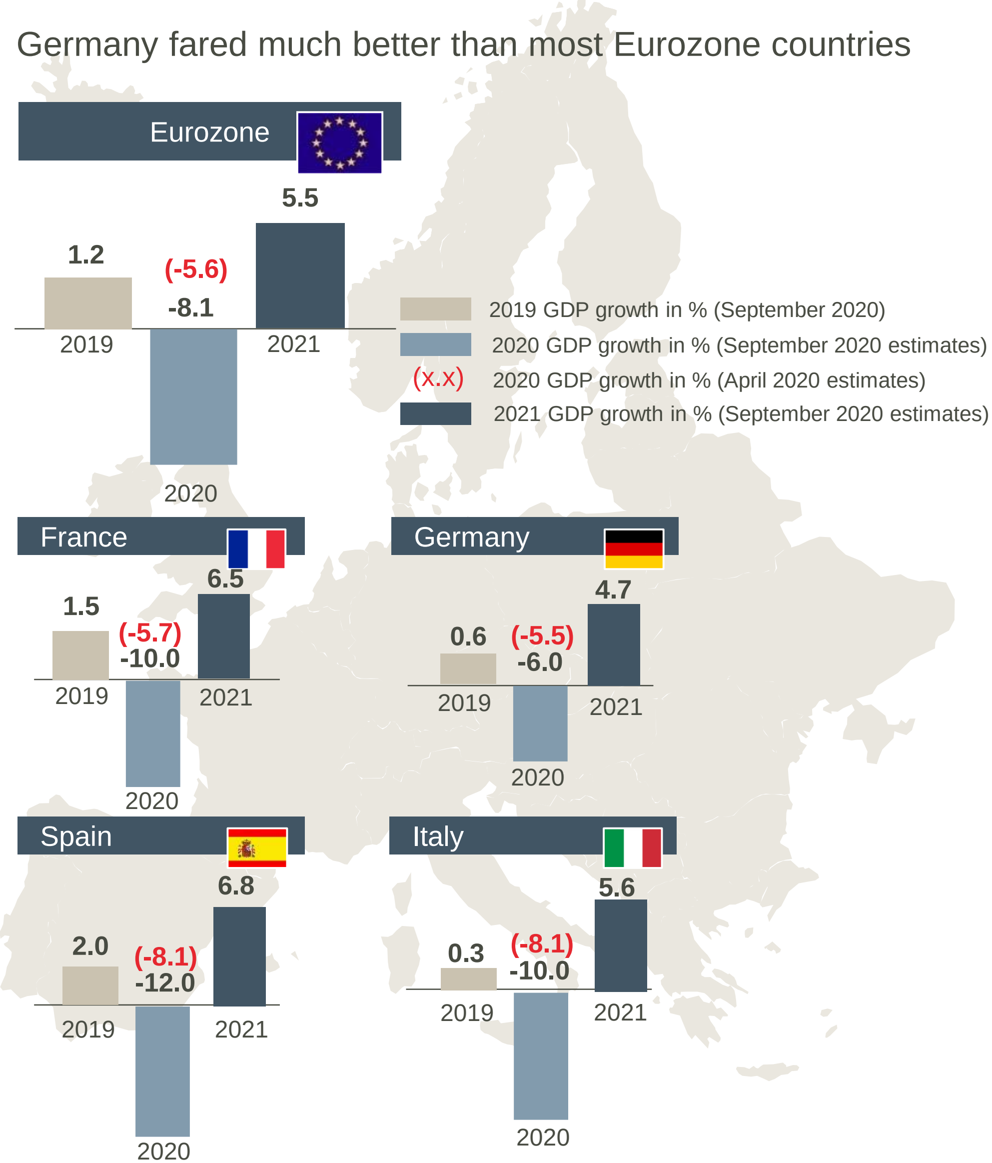
Business confidence**



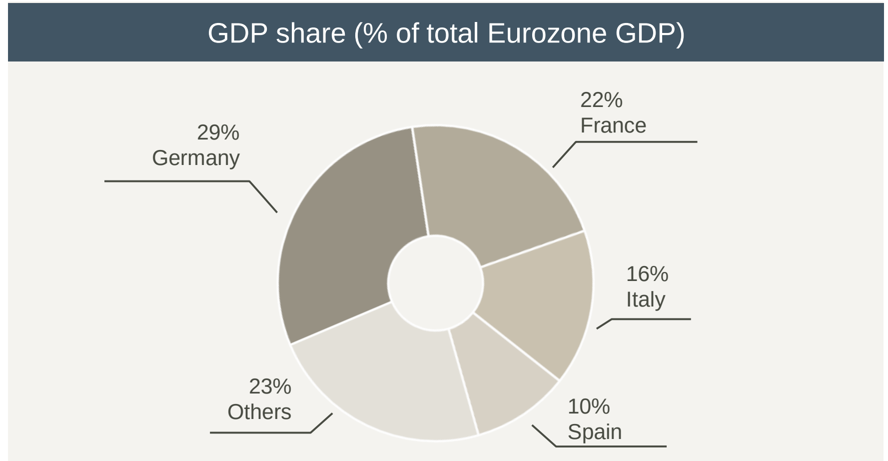
- September composite PMI improved further to 55,1 lifted by manufacturing and non-manufacturing sectors
- Improvements in Industrial production and exports signaling an ongoing recovery in global demand
- Retail sales showed also an improvement but remains depressed so far

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

Germany fared much better than most Eurozone countries



Sources: ODDO BHF AM SAS; Bloomberg Economist Forecast. Data as of 09/2020

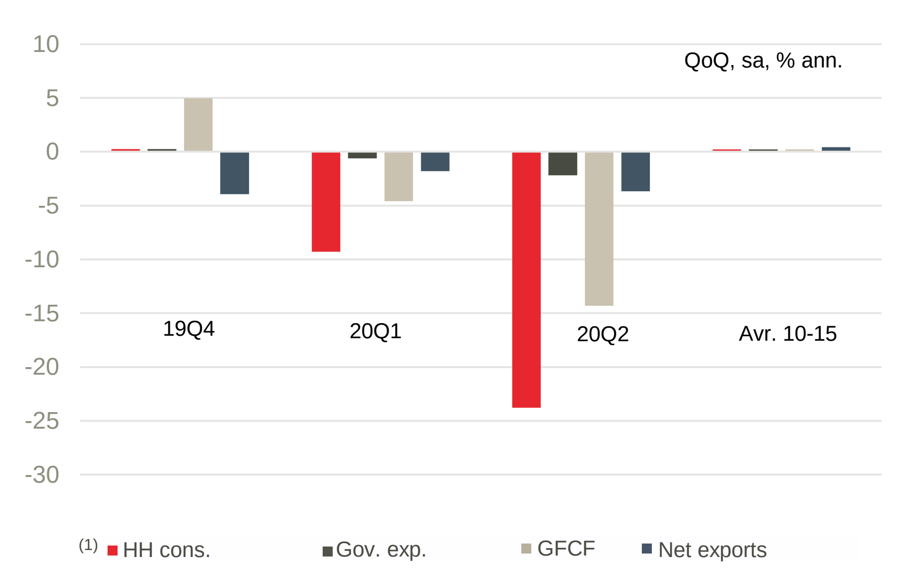


- Recovery story is still intact
- But growth momentum has slowed somewhat during Q3
- Significant divergences between EZ countries
- France and Spain on the weak side of the spectrum

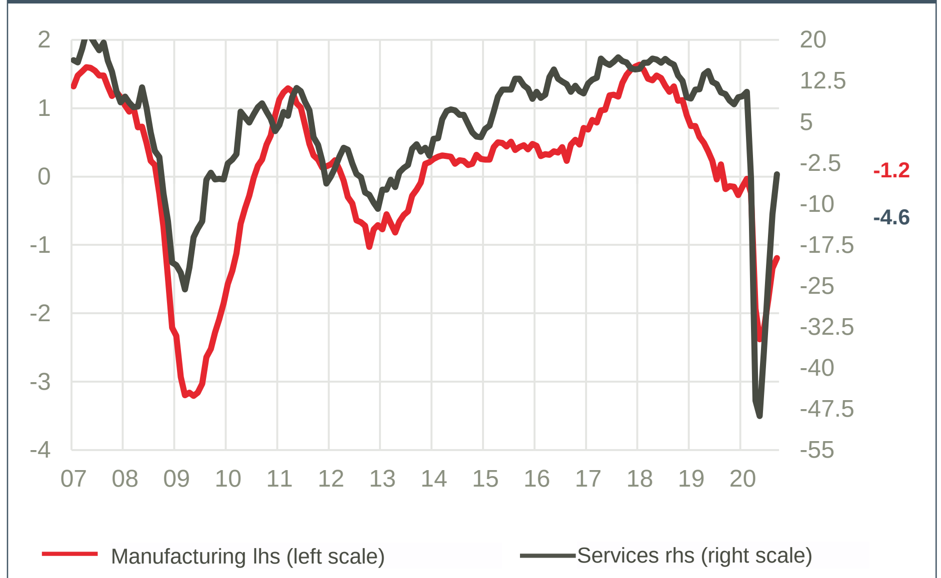
Eurozone

Growth recovery still intact, but momentum fades

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



Business confidence**



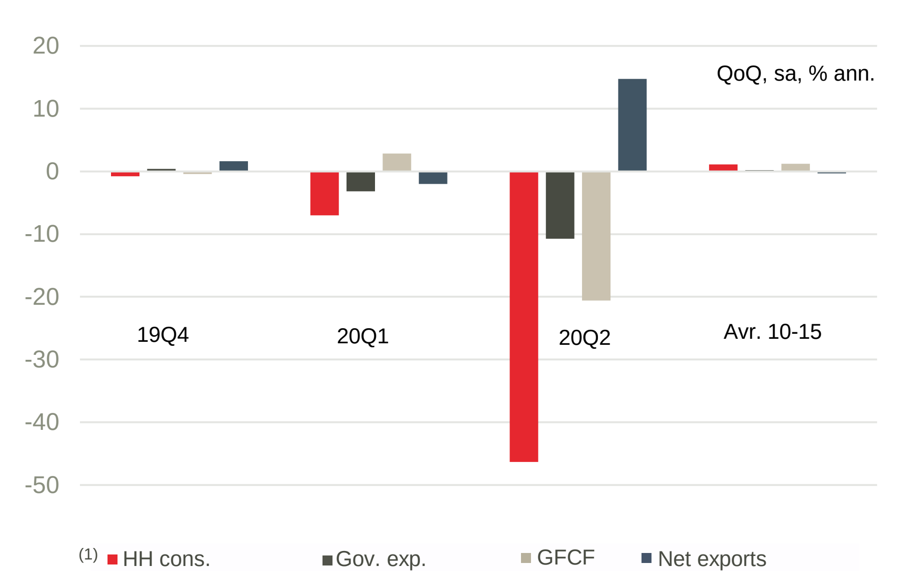
- September data reflective of a mixed picture on growth at the end of 3Q20
- A fall in composite PMI for September pointed to some loss of momentum
- Weakness in services especially pronounced, but a strong showing in German manufacturing
- German IFO and French INSEE rose, sending more positive signals
- Headline CPI flash estimate fell to -0,2% in part due to effects from the VAT cut in Germany

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

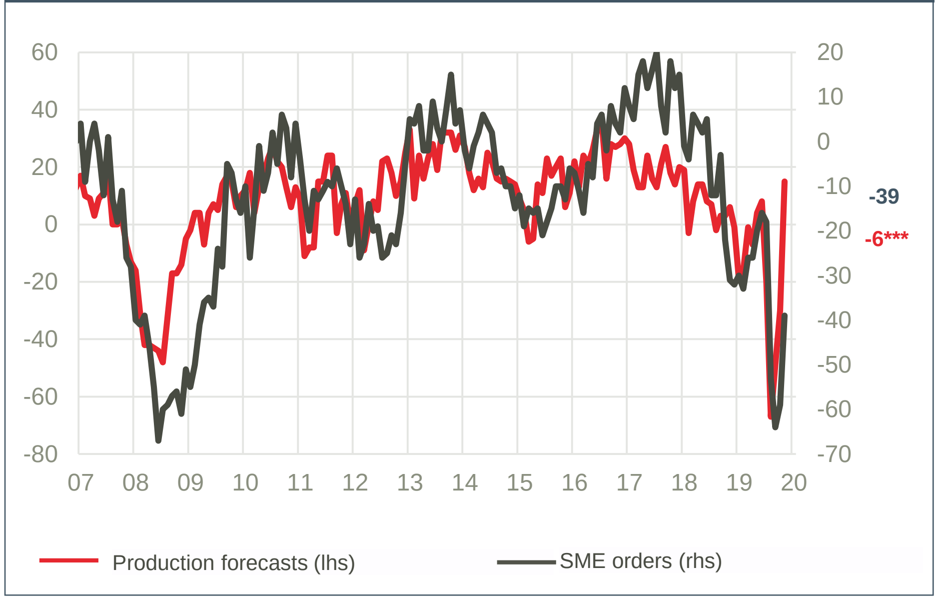
United Kingdom

Virus restrictions dampens growth outlook

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



Business confidence**

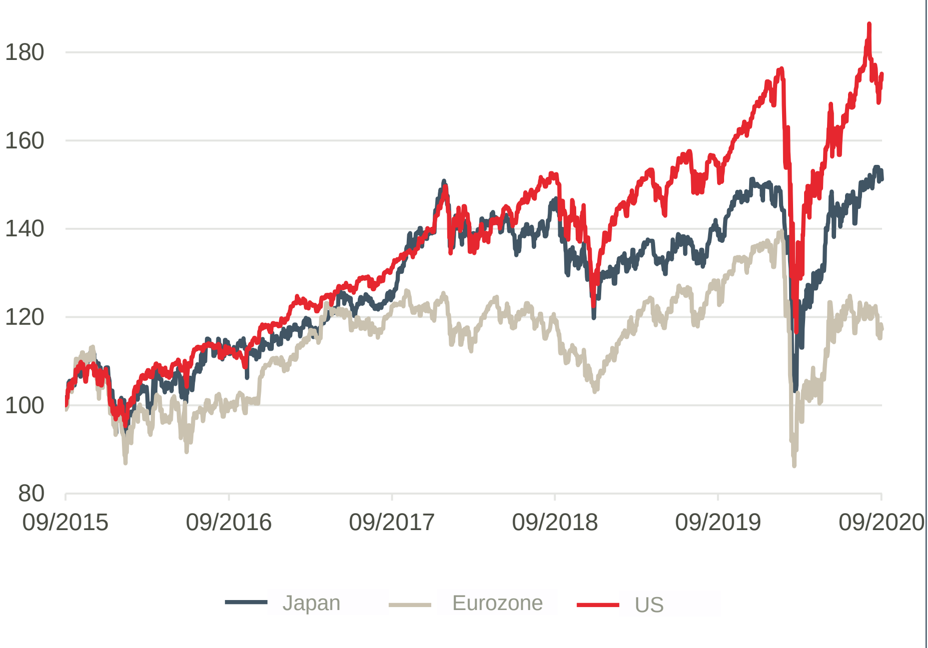


- New virus restrictions start to weigh on consumer sentiment
- Falling service sector PMI underlines that risk
- Risks to the growth outlook are to the downside

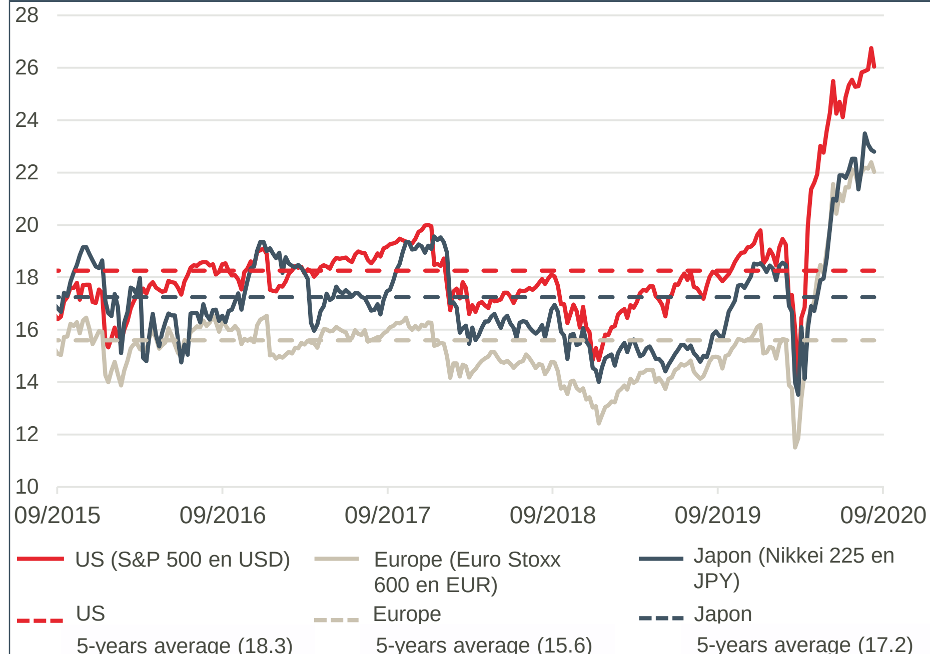
(1) HH cons.: household consumption / Gov. exp.: government expenditure / GFCF: gross fixed capital formation (investment)
Sources: Bloomberg, Thomson Reuters, Datastream, ODDO BHF AM SAS. *Data as of 09/30/2020 | **Data as of 07/15/2020 | ***Data as of 09/15/2020

Equities – overview

5-year equity market performance



5-year price/earning ratio



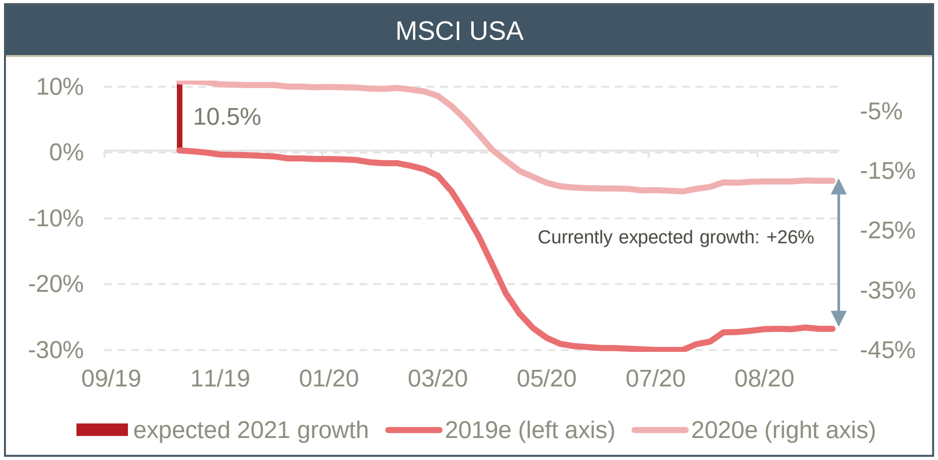
- September was the first risk-off month (both for credit and equities) since March. Among developed markets, Japan was the sole positive monthly return.
- After some initial euphoria (driven by retail flows and enthusiasm with the FED redefining its objectives for monetary policy) in late August and the first days of September, US indexes reached new all-time highs. But this rally, mainly driven by some new-tech companies, was accompanied by a rise in volatility
- Between the 3rd and 8th of September, the Nasdaq encountered a severe (-11%) correction, but contagion to other markets was limited.
- During the second half of the month, equity markets were supported with regularly increasing expected earnings (while macro expectations for 2020 were also revised higher by central banks and investors).
- Nevertheless, policy newsflow (Trump, Supreme Court, Covid in Europe, Brexit…) still generates significant volatility.

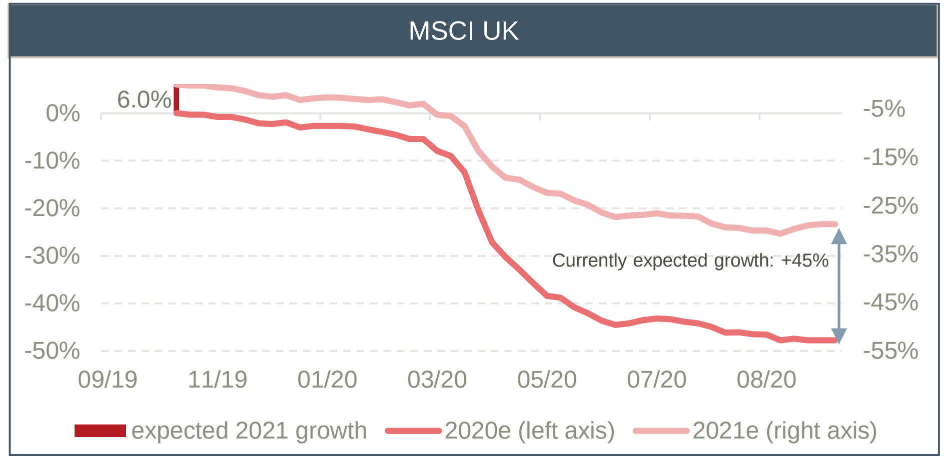
Past performances are not a reliable indicator of future performances and are not constant over time.

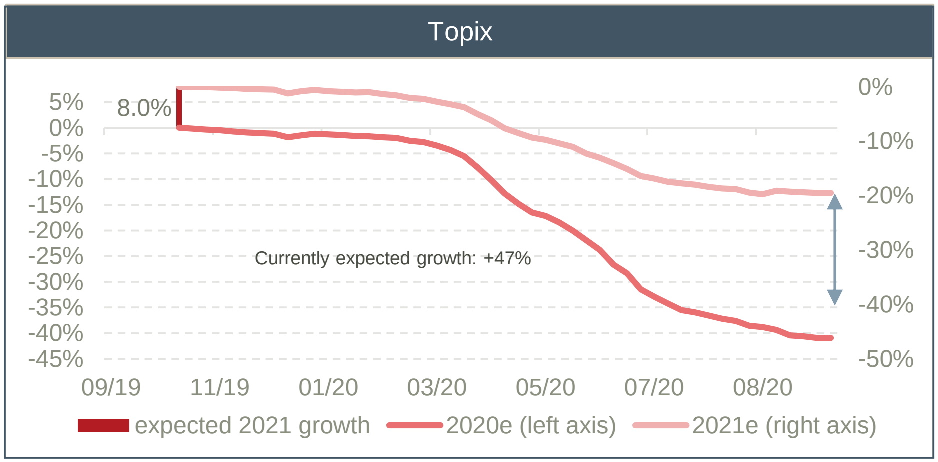
*See Glossary, page 27 | Source: Bloomberg, ODDO BHF AM SAS | Figures as of 09/30/2020

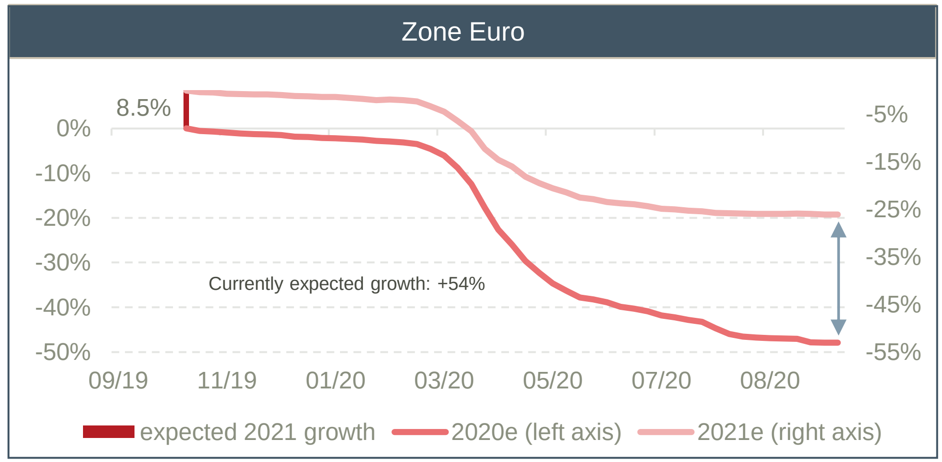
Equities – EPS trends*

*estimated earnings revisions & changes in expected growth









- Estimates for 2020 full-year estimates have globally stabilized. In the US, estimates have even slightly rebounded from July lows.
- The picture is similar or slightly better for 2021 estimates.
- 2021 vs 2020 estimated growth rates are impressive: between 26% (US) and 54% (Eurozone)….
- …but that still means that estimates for 2021 are -15% to -25% lower than they were before the pandemic struck!

Sources: ODDO BHF AM SAS, Deutsche Bank AG/London. |Thomson Reuters | Figures as of 09/30/2020

European equities

Earnings momentum continue to improve with growth stocks outperforming

	12-month forward P/E, Oct. 2020	2018 EPS growth	2019 EPS growth	2020 EPS growth	2021 EPS growth	Dividend yield	YTD Perf.	1 month perf.
STOXX Europe 600	17.4 x	5%	3%	-33%	39%	3.2%	-12.8%	-2.3%
Commodities								
Basic resources	12.2 x	-2%	-24%	-11%	32%	4.7%	-11.0%	-2.4%
Oil & Gas	19.2x	40%	-16%	-83%	277%	6.6%	-42.8%	-4.8%
Cyclicals								
Automotive and spare parts	71.0 x	-10%	-17%	-97%	2825%	2.8%	-16.3%	1.1%
Chemicals	23.8 x	4%	-13%	-17%	24%	2.5%	1.1%	-1.8%
Construction and materials	17.9 x	7%	17%	-28%	39%	2.9%	-9.7%	-1.2%
Industrial goods and services	23.3 x	5%	6%	-40%	58%	2.2%	-8.3%	-0.9%
Media	17.3 x	10%	0%	-33%	30%	2.9%	-19.0%	0.7%
Technologies	26.7 x	8%	7%	-8%	30%	1.1%	11.2%	-4.2%
Travel & leisure	32.8 x	-4%	-5%	-282%	119%	1.1%	-35.2%	-3.2%
Financials								
Banks	10.0 x	13%	2%	-60%	64%	5.3%	-41.1%	-7.9%
Insurance	9.2 x	9%	7%	-21%	33%	6.3%	-26.7%	-6.6%
Financial services	14.6 x	-42%	140%	-33%	1%	3.1%	-8.0%	-2.9%
Real estate	16.8 x	19%	0%	-5%	9%	3.9%	-20.7%	-2.0%
Defensives								
Food & beverages	20.5x	4%	7%	-11%	9%	3.1%	-9.3%	-1.2%
Healthcare	18.2 x	4%	6%	0%	13%	2.6%	-1.6%	-0.6%
Household & personal care	23.2x	7%	2%	-6%	6%	2.3%	-4.7%	0.6%
Retailing	26.9 x	6%	0%	-47%	73%	2.1%	-0.2%	2.7%
Telecommunications	13.3 x	-9%	-5%	-2%	13%	5.0%	-21.0%	-4.6%
Utilities	16.4 x	-12%	24%	-8%	12%	4.4%	0.0%	-0.1%

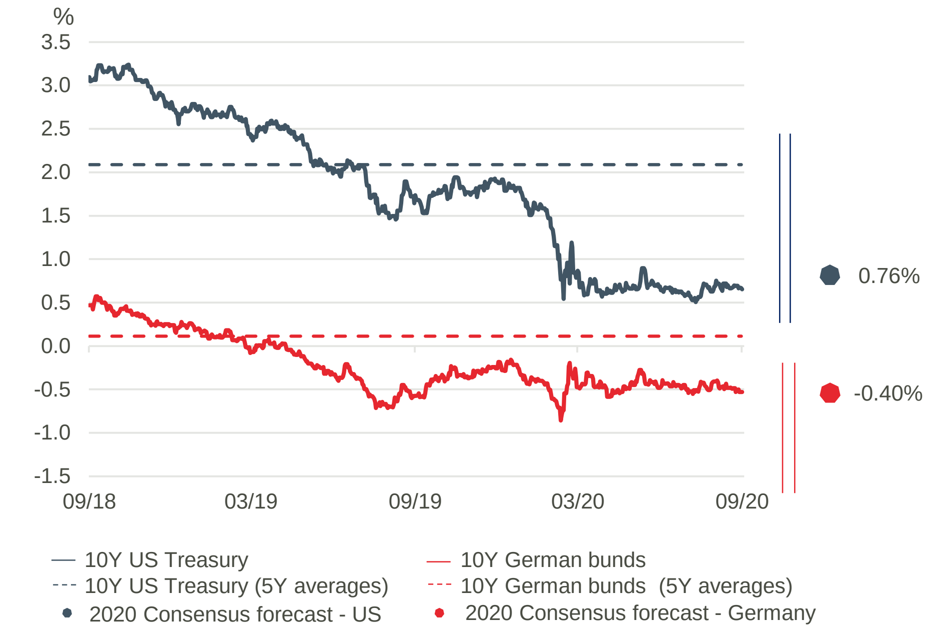
Source: ODDO BHF AM SAS, FactSet. Figures as of 10/05/2020

- The threat of a new wave of infections in Europe and political uncertainties (US election, tensions with China) weigh on risky assets.
- While European equities have overall moved sideways since June, performance varied widely between sectors and themes, with growth/technology stocks clearly outperforming value/banking/energy stocks, justified by the growth differential.
- Earnings revision momentum has been improving for several months and the Q3 reporting season should confirm this trend, judging from pre-release information given by companies.
- Equity valuation multiples remain at a high level in absolute terms (17x) but are still undeniably attractive compared to bonds.
- A paradigm shift in market themes would require the announcement of an effective vaccine and the effective implementation of recovery plans allowing for hopes of normalization in certain areas of activity.
- In this context, the healthcare and technology sectors remain attractive investment opportunities.
- In the short term, the automotive sector seems to benefit from operational trends turning out much better than anticipated.

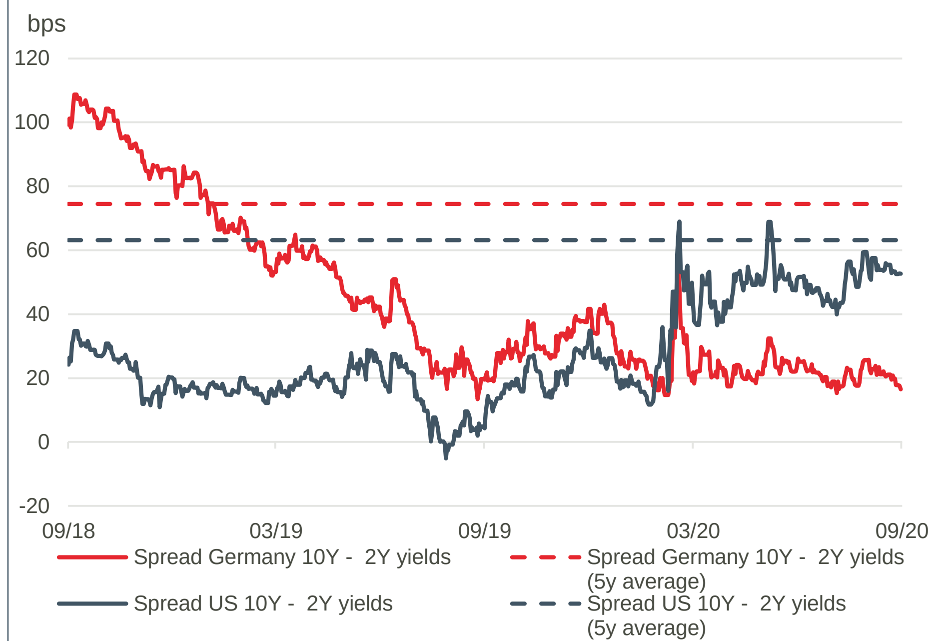
Fixed income – Rates

Bond vigilantes have been bored to tears

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



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



- Central banks are desperate to absorb the supply shock and keep rates stable
- Volatility is at extreme lows given central bank QE
- Expect rates to range trade further for the time being, but risk for curve steepening increases
- Bunds and US Treasuries are of little value as a hedging tool as evidenced by the equity correction in September

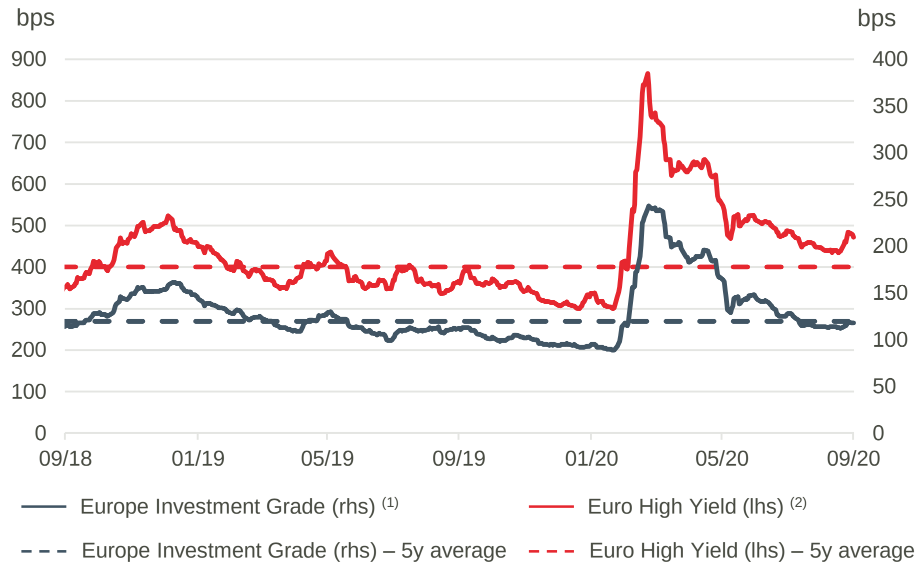
Past performance is not a reliable indicator of future performance and is not constant over time.

(1) Bloomberg Economic Forecast │Sources: ODDO BHF AM SAS, Bloomberg│LHS: Data as of 09/30/2020; RHS: Data as of 09/30/2020

Fixed income – Credit Spreads

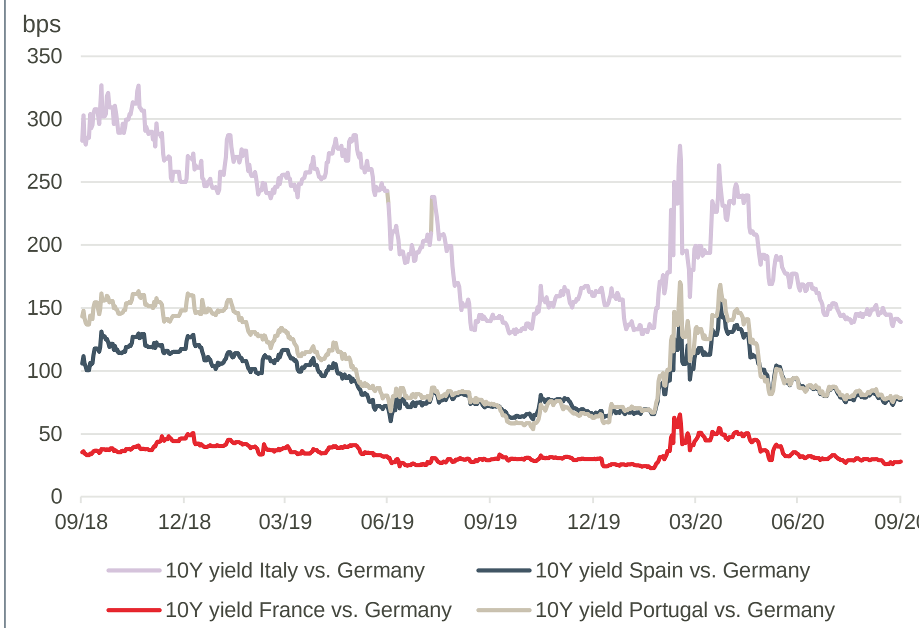
Investment Grade bonds have morphed into a policy tool

Credit spreads IG & HY (over 2 year)



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

Main Eurozone country spreads (over 2 years)



- Credit beta to the equity correction in September has been extremely muted
- That reflects quite squeezy market conditions with little supply but still healthy demand
- ECB alone absorbs around 10bn eligible supply per month
- Italian spreads have taken comfort in the recent local election outcomes
- Current 10-year BTP levels are close to this years' low, so that significant tightening may be difficult to achieve

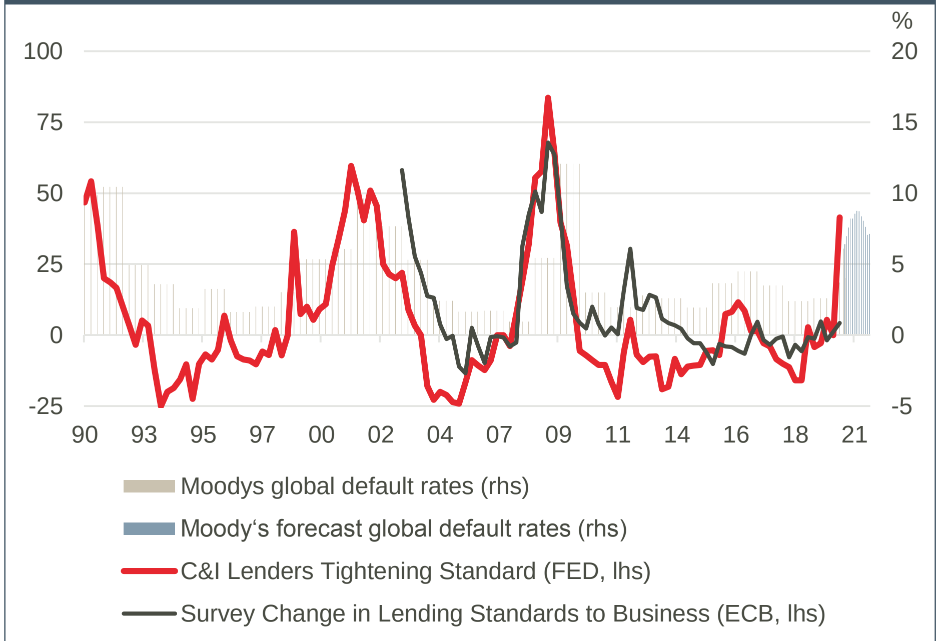
Past performance is not a reliable indicator of future performance and is not constant over time.

Sources: ODDO BHF AM SAS, Bloomberg │Data as of 09/30/2020

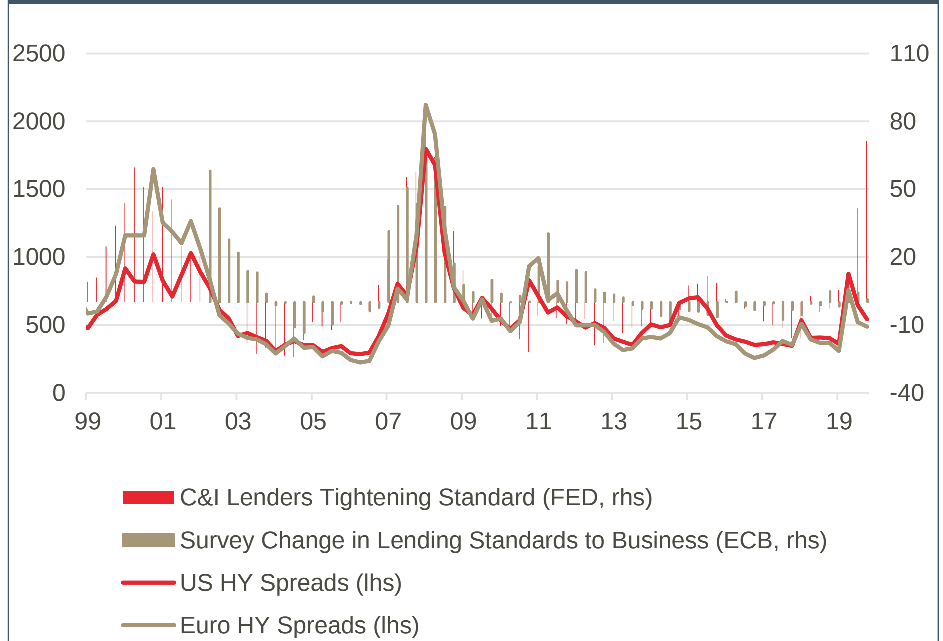
Commercial and industrial lending standards

Default rates to rise substantially, but this should be reflected in prices

Lending standards and default rate



Lending standards and spreads



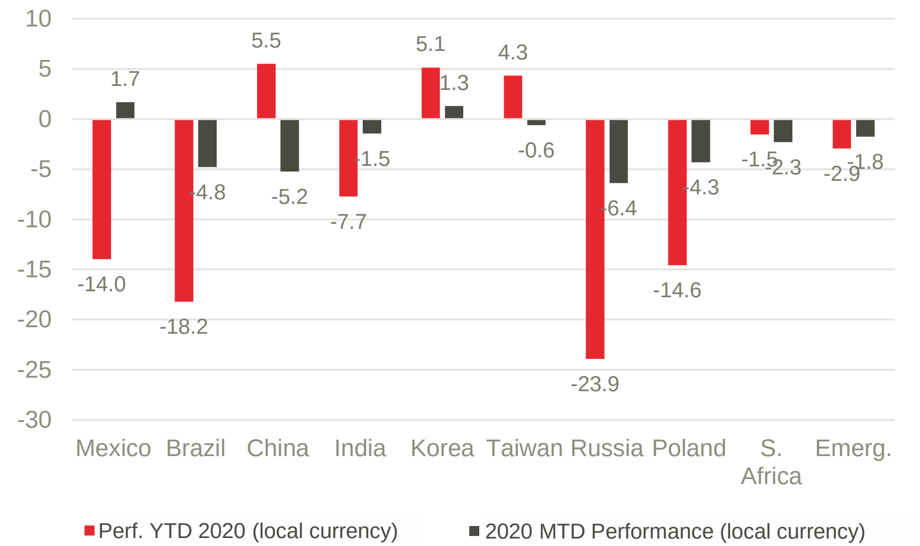
- European high yield market is better shielded than its US counterpart
- Rating structure in Europe is superior and oil impact is insignificant

Source: Moody’s as of 08/31/2020, Fed, ECB, Bloomberg | Data as of 09/30/2020

Emerging markets

USD debt appears to be attractive again

Equities performance on major emerging markets



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

- USD bonds pared gains in September with spreads widening almost 40bps from the lows
- At these levels carry looks attractive again
- Local currency bonds have fared slightly better recently on catch-up from relative weakness

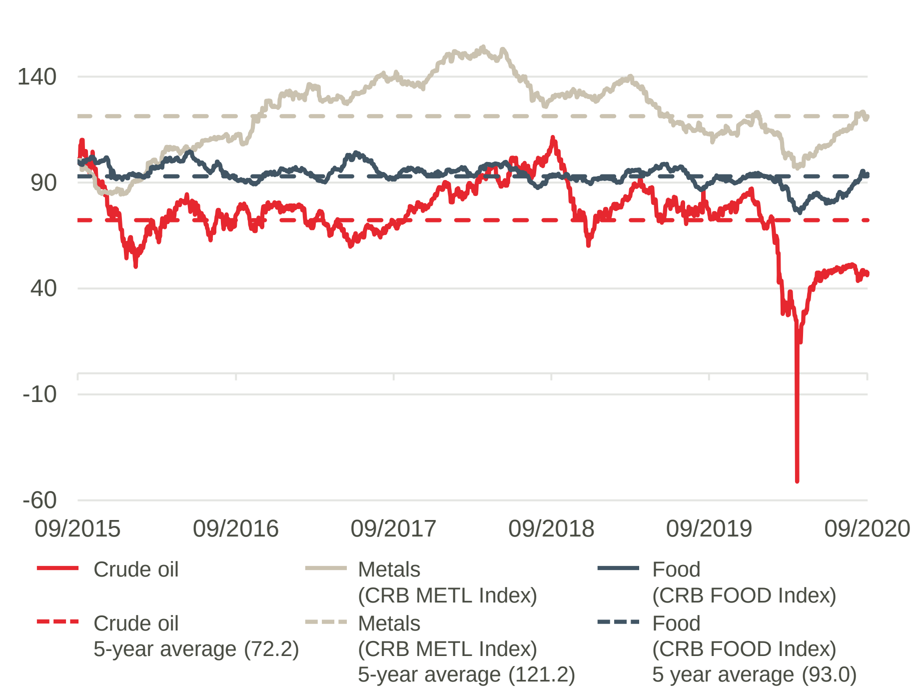
Past performances are not a reliable indicator of future performance and are not constant over time.

Sources: Bloomberg, ODDO BHF AM SAS | Data at 09/30/2020

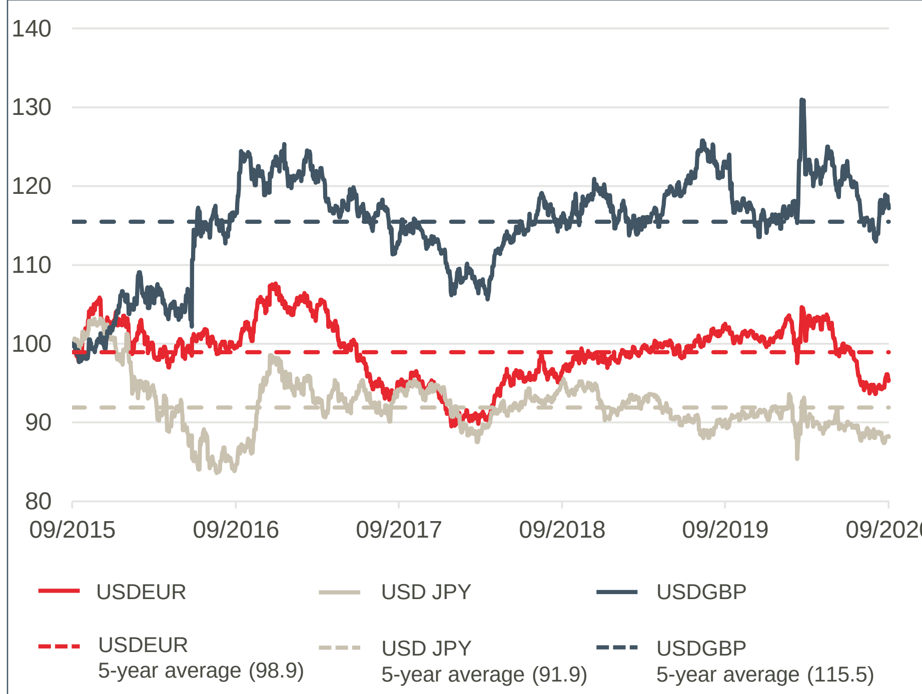
Currencies and commodities

An untimely rise of the Euro

Commodities - Change over 5 years



Currencies - Change over 5 years



- USD weakness has probably gone a bit too far in the short-term
- Current rebound for EUR/USD is expected to deepen a bit further into the 1,14 - 1,16 range
- Oil has stabilized thanks to a mix of improved storage capacity, supply limitation and the ongoing growth recovery
- However, a sustained price recovery would need much more progress on the virus front and hence economic normalization

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

Sources: Bloomberg, ODDO BHF AM SAS | Data at 09/30/2020

Our publications on sustainable finance

Sustainable finance: ODDO BHF AM's approach	Go to site
Sustainable finance, basics	Go to site
Integration of ESG criteria at ODDO BHF AM	Go to site
ESG flash - Resilience	Go to site

Glossary

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

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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 €9,500,000. Entered into the Paris Register of Trade and Companies under number 340 902 857.

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Notes