Monthly Investment Brief

Fizz (bis)

ODDO BHF ASSET MANAGEMENT ODDO BHF FRANKFURT TRUST

February 2018

No change to our strategy of overweighting equities and keeping duration as low as possible as the year begins

After a spectacular start to the year for risky assets, equities in particular (with the MSCI World All Countries up 5.6% for the month of January), investors have been troubled by the rapid rise in yields throughout the US curve.

The problem is in how sudden and brutal the correction was. After such a shock, the market will take a little time before coming to its senses.

In equities, the rush for the exits has been driven mostly by the unwinding of short-volatility quantitative strategies, with investors forced to hedge their sales of options with sales of shares in order to maintain the same level of risk. However, we have so far not seen a significant sector rotation that might point to a change in trend.

On the credit markets (particularly in high yield), investors have remained calm and focused on corporate earnings releases. Neither in currencies have we seen a flight to quality that would point to a change in paradigm, i.e., safe haven being taken in the yen, the Swiss franc or the US dollar.

One more thing: bond yields, in which the correction began, have not accelerated upward. On the contrary, they have fallen by about 10 basis points, thus invalidating fears of a rapid run-up in inflation or an accelerated exit from accommodative monetary policies.

No change to our strategy of overweighting equities and keeping duration as low as possible as the year begins. With all this in mind, a fact-based analysis of the current situation is no different from the analysis we made as the year began, i.e., leading indicators remain especially solid on both the macroeconomic level and in projected earnings growth. In light of this, we are making no change at this stage to our asset allocations in diversified portfolios.

Still, we remain cautious. We will be paying especially close attention to how fast long bond yields rise, to signs of inflation, to risk indicators (volatility), and, above all, to investment inflows and outflows, which will guide market momentum.

Current convictions	Macroeconomic analysis	Market analysis

Our 6-month view

Central scenario: strong world growth (US, Europe, emerging markets)

80%

Europe
- Accelerated growth fueled by improving credit conditions and fall in unemployment rate
- Monetary policy set to gradually normalize even though (i) it remains highly accommodative and (ii) financial-market trends will depend more on the real economy's development than on central banks' support

US
- Economy at cruising speed with Trump's plan for tax reform set to have positive effects growth
- Monetary policy normalizing gradually, and this should continue
- Uncertainty regarding protectionism

Assets to overweight
- Equities
- Europe credit (HY over IG)

Assets to underweight
- Sovereign bonds

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

Alternative scenario: inflation returns at a higher-than-expected rate, with modest growth

15%

- Wage growth and/or oil-price growth accelerate
- Underlying growth-rates fall once again
- Sovereign yields rise rapidly

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

Assets to underweight
- Equities
- Core sovereign bonds
- High Yield credit

Alternative scenario: growth slows down and protectionism puts international trade at risk

5%

- Geopolitical risks become ever more real
- US: consumption and gross fixed capital formation decline again
- China: economic rebalancing begins to present risks
- Europe: Japanese-style growth sets in

Assets to overweight
- Money Market CHF & JPY
- Volatility
- Core sovereigns

Assets to underweight
- Equities
- High Yield credit

Our current convictions for each asset class – Central scenario

Asset class		Change from the previous month	Level of conviction
Equities	Large-Cap Equities Eurozone	↗	2
Equities	Mid-Cap Equities Eurozone	→	1
Equities	Small-Cap Equities Eurozone	→	1
Equities	UK	→	-1
Equities	US	↗	1
Equities	Emerging markets	→	0
Equities	Japan	↗	1
Convertible bonds	Europe	→	0
Convertible bonds	US	→	0
Government bonds	Core Europe	→	-1
Government bonds	Peripheral Europe	↘	-1
Government bonds	US	→	-1

Source: Oddo BHF AM SAS. Data at 31/01/2018

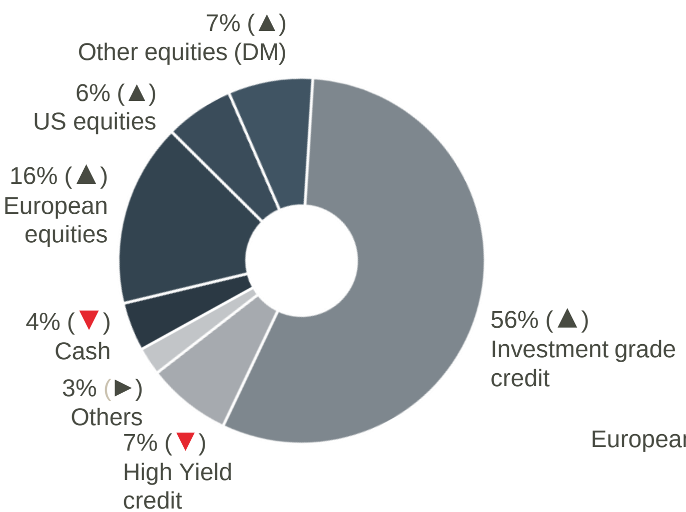
Our current convictions for each asset class – Central scenario

Asset class		Change from the previous month ↗	Level of conviction
Corporate bonds	Investment grade Europe	→	0
	Short-duration credit	↘	1
	High Yield* Europe	→	1
	High Yield* US	↗	1
	Emerging markets	↗	0
Money market	Developed markets	↘	-2
Currencies	USD / €	↗	1
	YEN / €	→	0
	GBP / €	↗	0
Commodities	Gold	→	1
	Crude oil	→	0

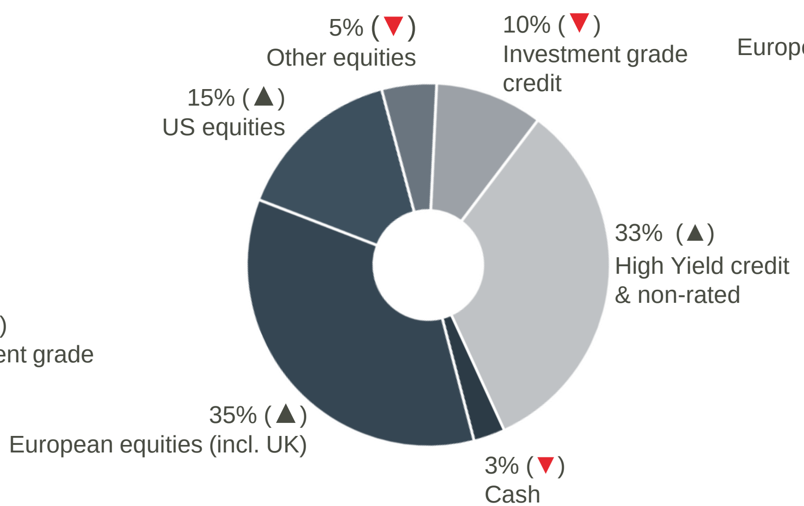
Source: Oddo BHF AM SAS | Data as of 31/01/2018

Our model portfolios

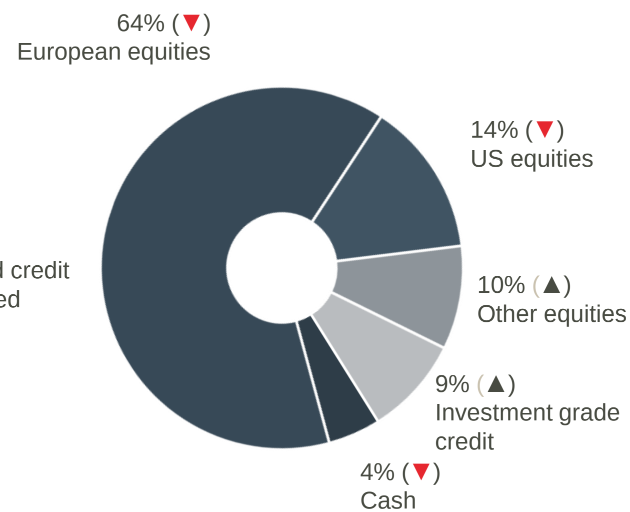
Moderate



Balanced - Dynamic



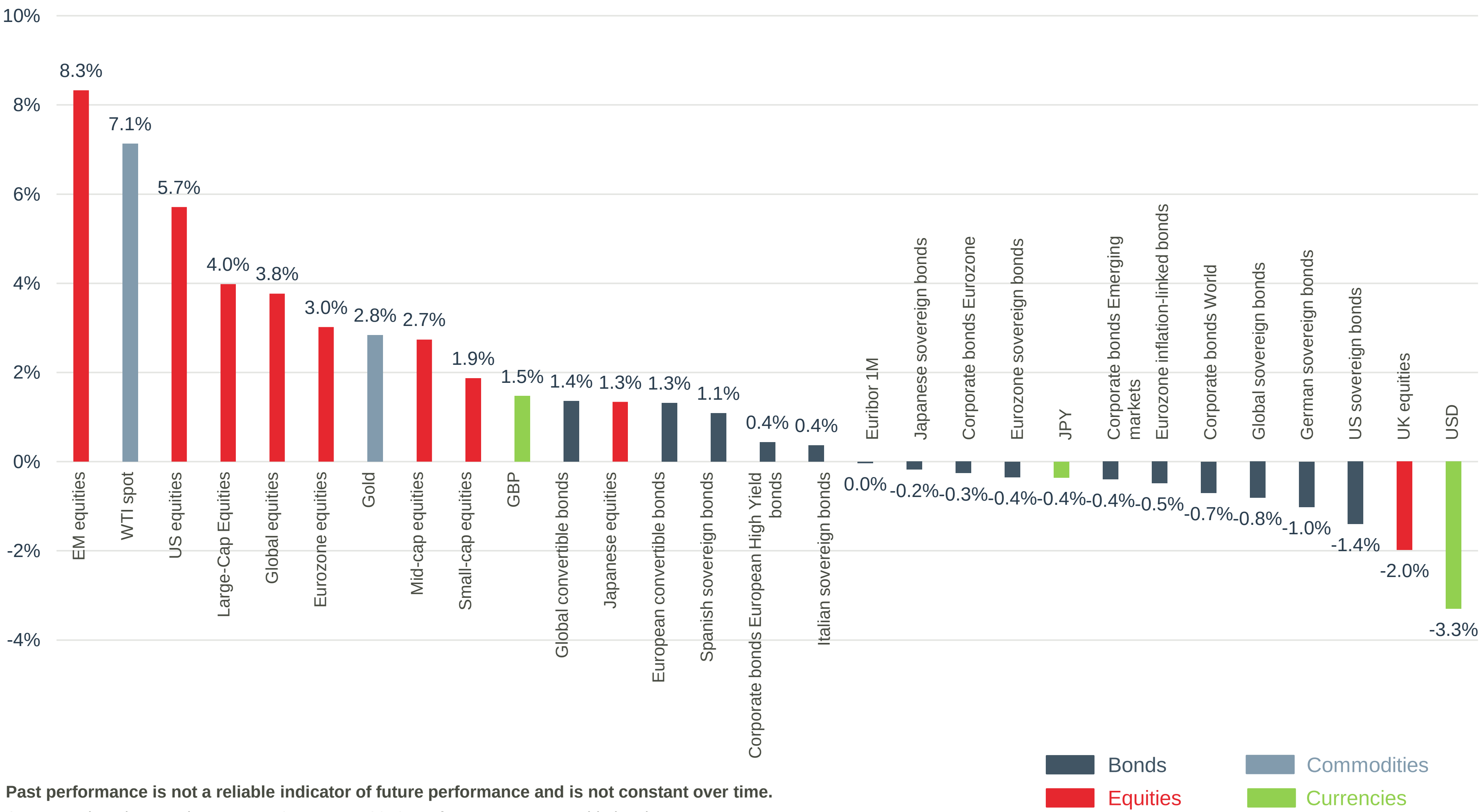
Dynamic



▶ Change from previous month

Source: Oddo BHF AM SAS | Data at 31/01/2018

Year-to-date performance of asset classes

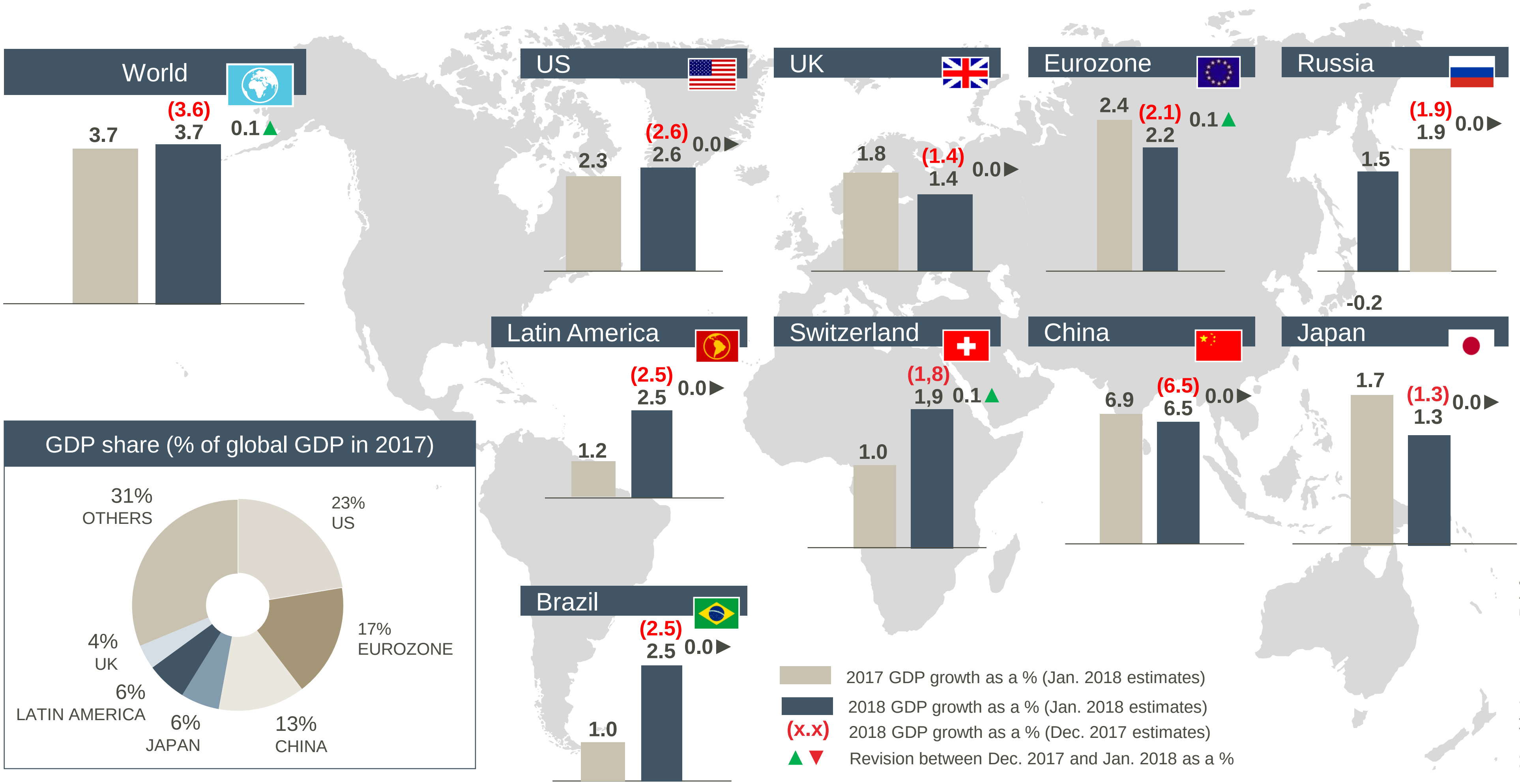


Past performance is not a reliable indicator of future performance and is not constant over time.

Sources: Bloomberg and BoA ML at 31 January 2018; performance expressed in local currency

Global GDP* growth forecast

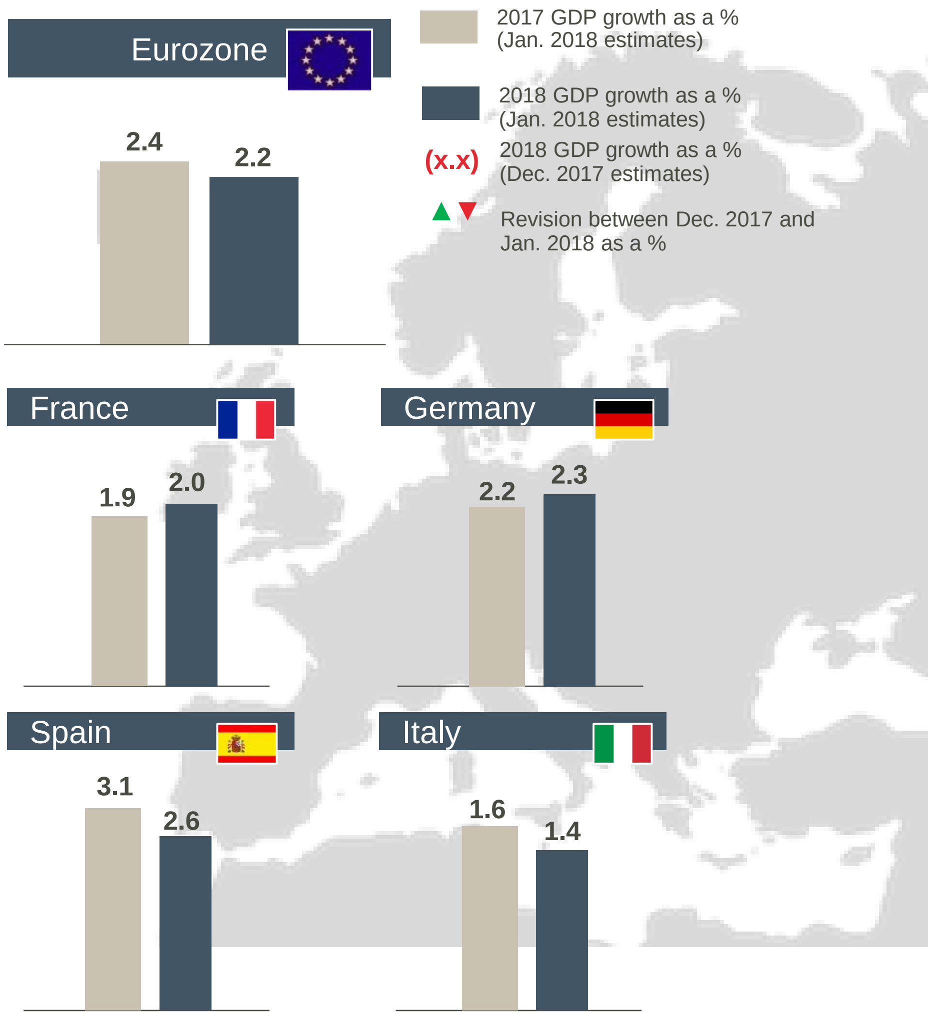
Strong growth dynamic



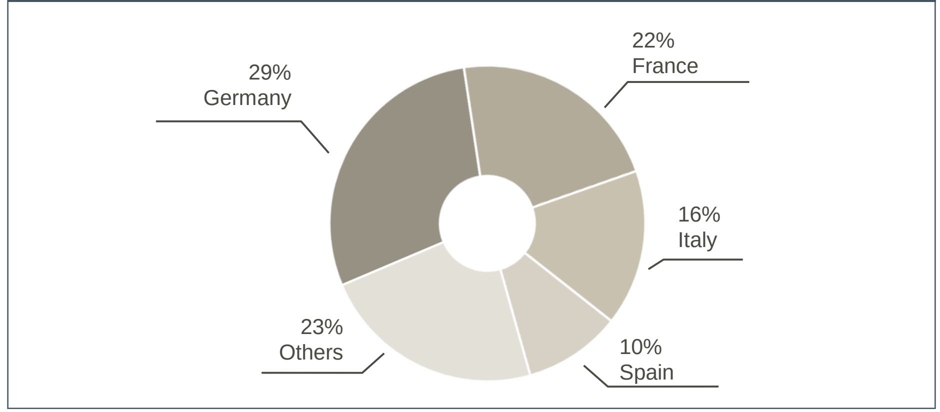
*GDP: Gross Domestic Product | Sources: Oddo BHF AM SAS, Bloomberg economist consensus forecast | Data at 31/01/2018

Eurozone

All indicators remain positive



GDP share (% of total Eurozone GDP in 2017)



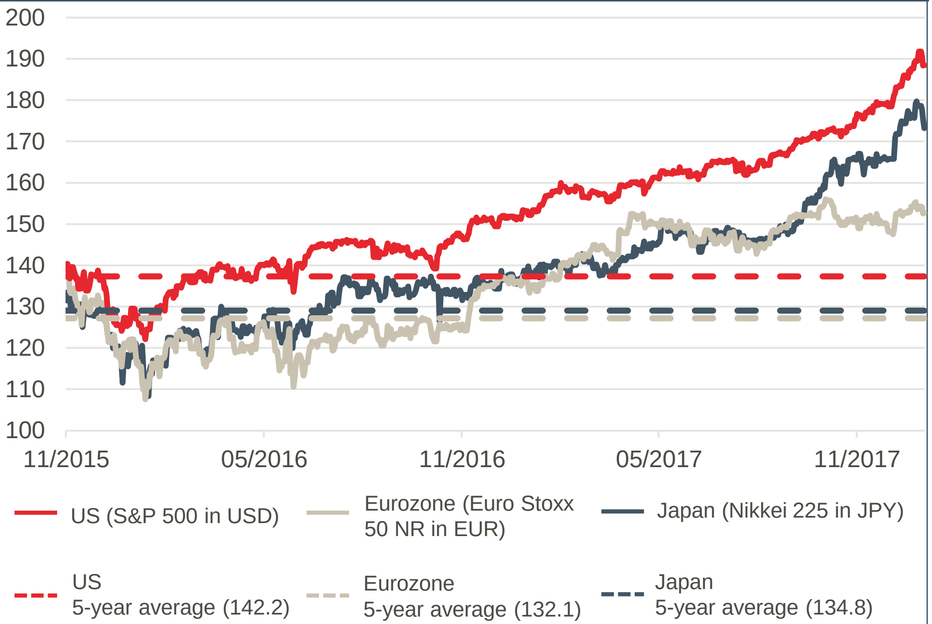
- The first estimate of eurozone growth for 17Q4 is 2.7%. Although surveys of economic players have revealed a slight downturn in January, the fundamentals of this growth remain robust, as can be seen in bank credit and the falling unemployment rate.
- The synchronisation among countries continues, which has been observed for several quarters already, with considerable improvement in public finances and sovereign debt, bar some exceptions.
- More acceleration could come from the political realm and structural reform, both nationally and at the level of Europe.
- The Italian election results should be followed closely, as should Spain's Catalonian issue.

Sources: Oddo BHF AM SA; Bloomberg Economist Forecast. Data at 31/01/2018

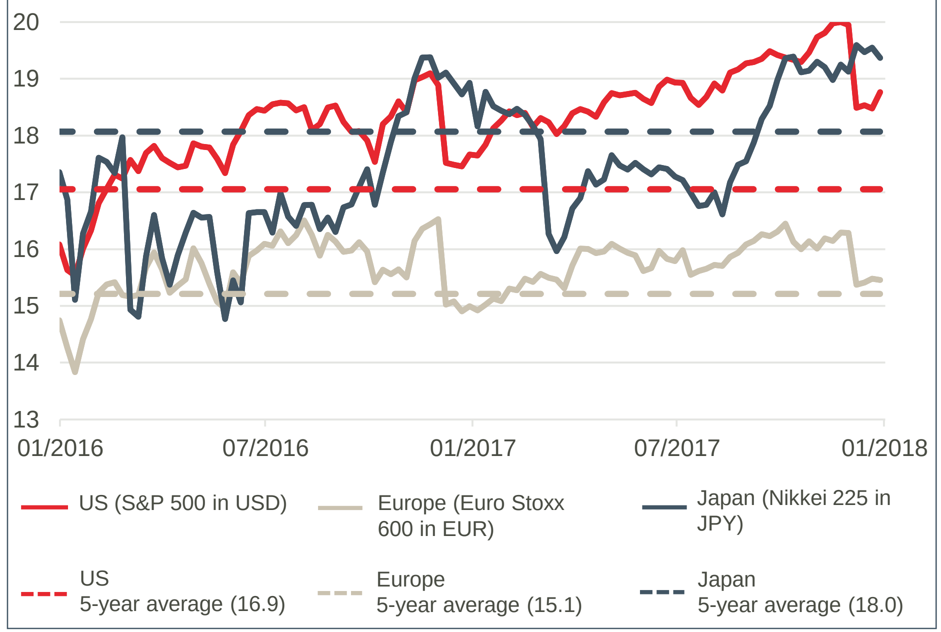
Equities – overall view

An impressive January (perhaps too impressive)

Equity market performance over two years (base 100 at 31/01/2013)



Change in PER over two years



- The start of the year has been exhilarating for the US equities market, which posted an upswing of nearly 6%.
- Yet the euro's appreciation has curbed the European market, where growth was limited to 3% with strong sector rotation benefiting the 'valuation' sector.
- The Japanese market (up 1%) was disappointing, similarly penalised by the yen's appreciation against the dollar (up 3%).

- Multiples were down in the US and Europe, mainly due to the change in reference year ...
- ... but they remain above the five-year averages, especially in the US market
- The Japanese market reached a high point in terms of valuation (forecasts for March 2018)

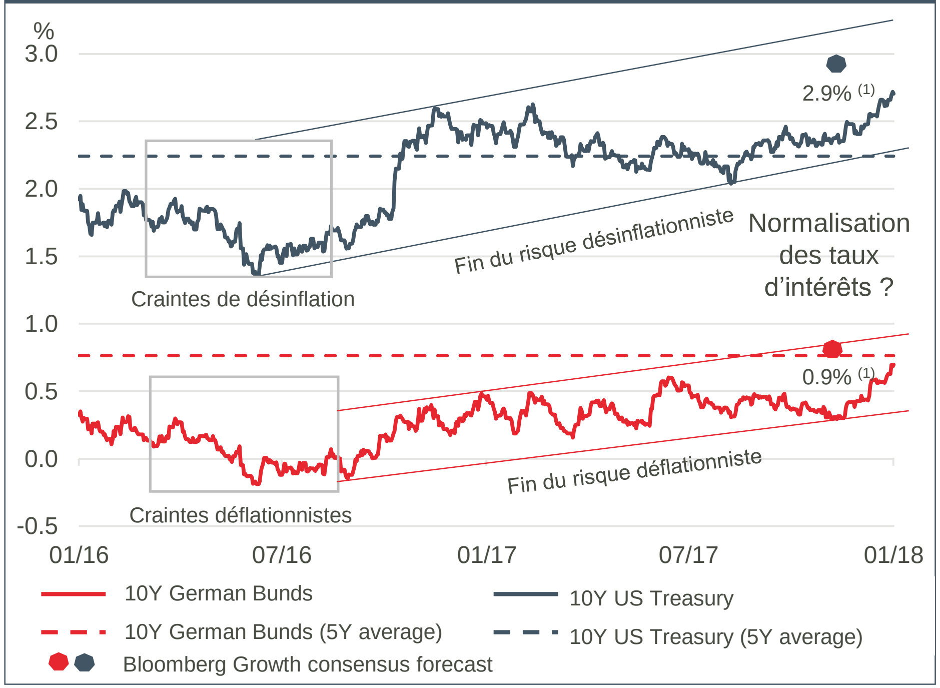
Past performance is not a reliable indicator of future performance and is not constant over time.

*Please refer to glossary on page 37 | Source: Bloomberg, Oddo BHF AM SAS | Data at 31/01/2018

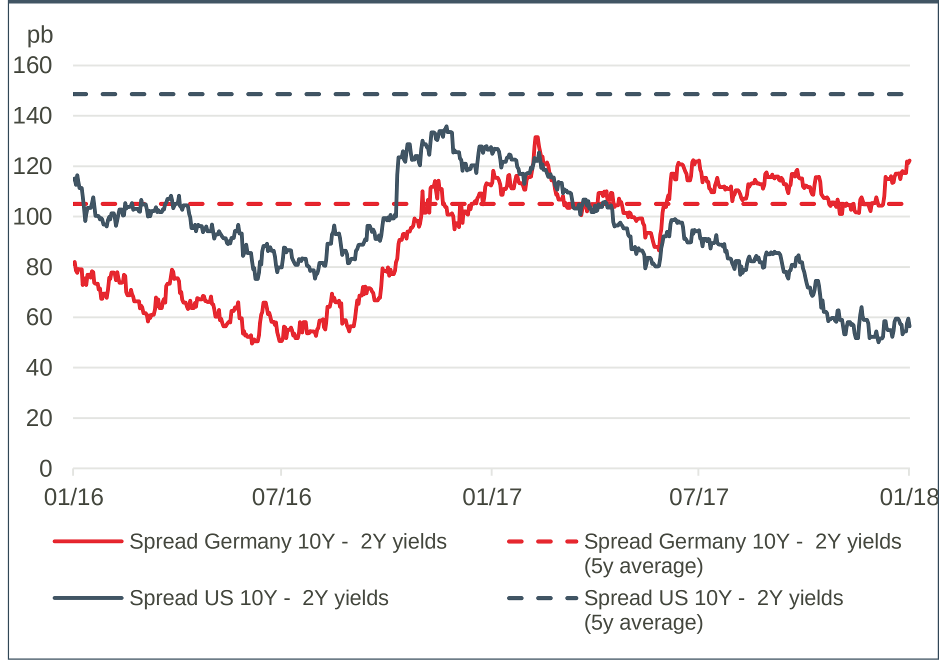
Fixed income – Rates

Another false dawn for bond vigilantes?

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



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



- 10-year Bund and US-Treasury levels have recently increased sharply as a reaction to signs of inflation and more aggressive central bank action
- Despite the recent increase, the US-Treasuries and German Bunds remain still vulnerable to any positive inflation surprises and changes in the reaction function of central banks

- Flattening of the US and EUR curves has been pronounced given policy recalibration, while the market still do not buy the reflation theme
- That may change and result in a temporary steepening phase for both curves
- US curve to reflatten at a later stage when the economy is about to roll over

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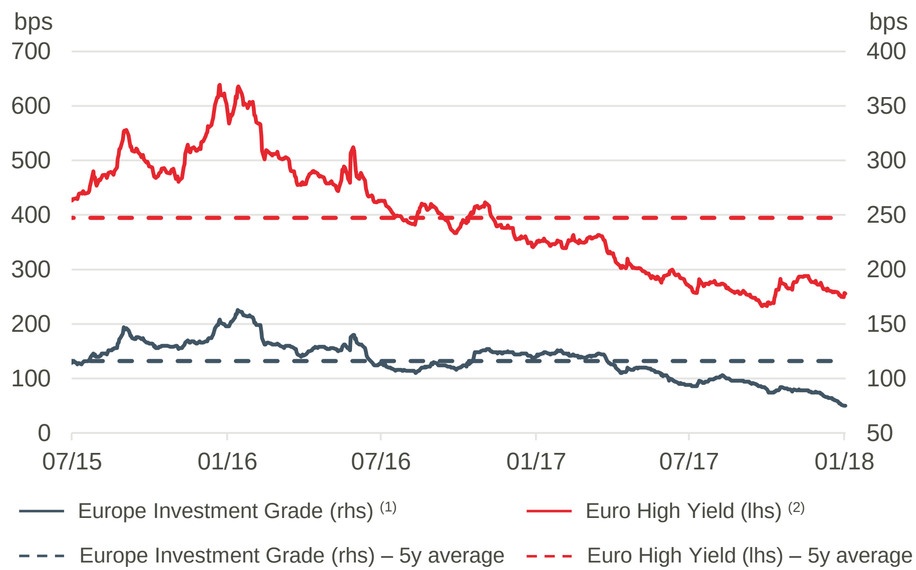
(1) Bloomberg Economic Forecast Sources: ODDO BHF AM SAS | LHS: Data as of 31/01/2018; RHS: Data as of 31/01/2018

Fixed income – Credit Spreads

Compression is mature but spreads can still grind lower

Credit spreads* IG & HY (over 2 year)

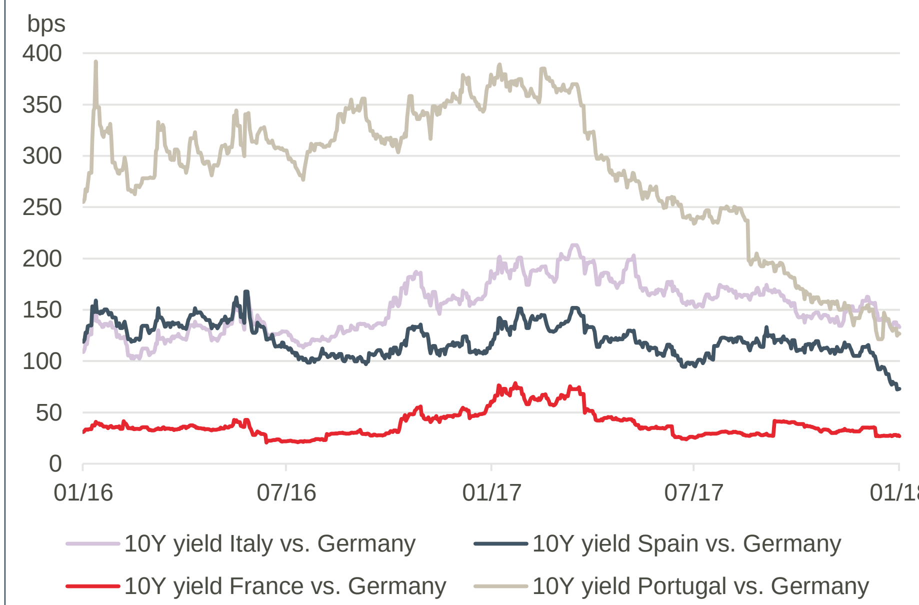


(1) BofA Merrill Lynch Euro Corporate Index (ER00)

(2) BofA Merrill Lynch European Currency High Yield Index (HP00)

- Credit will still be supported by an asymmetric tapering of ECB buying and a huge stock effect via balance sheet reinvestments
- Spread compression will be substituted by carry as the main performance contributor

Main Eurozone country spreads (over 2 years)



- Peripheral spread compression now clearly more dispersed
- Italy underperforming, while Portugal and Spain holding in well on likely positive rating actions
- Prospects are for slightly tighter spreads with a likely German grand coalition supporting Macron´s Eurozone friendly measures and the Italian election likely to have a limited impact
- Italy still our preferred candidate, especially after the recent widening

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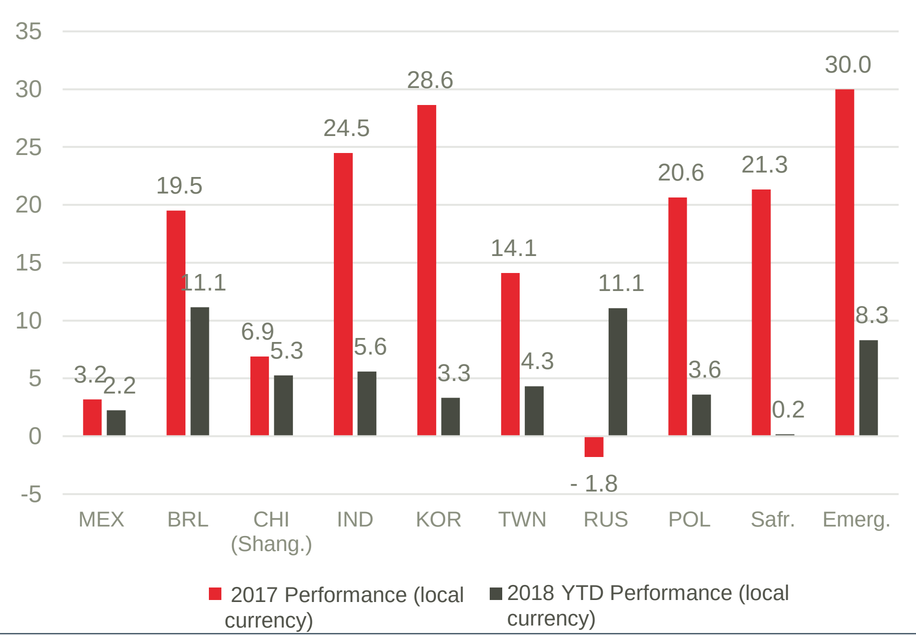
Sources: ODDO BHF AM SAS | Data as of 31/01/2018

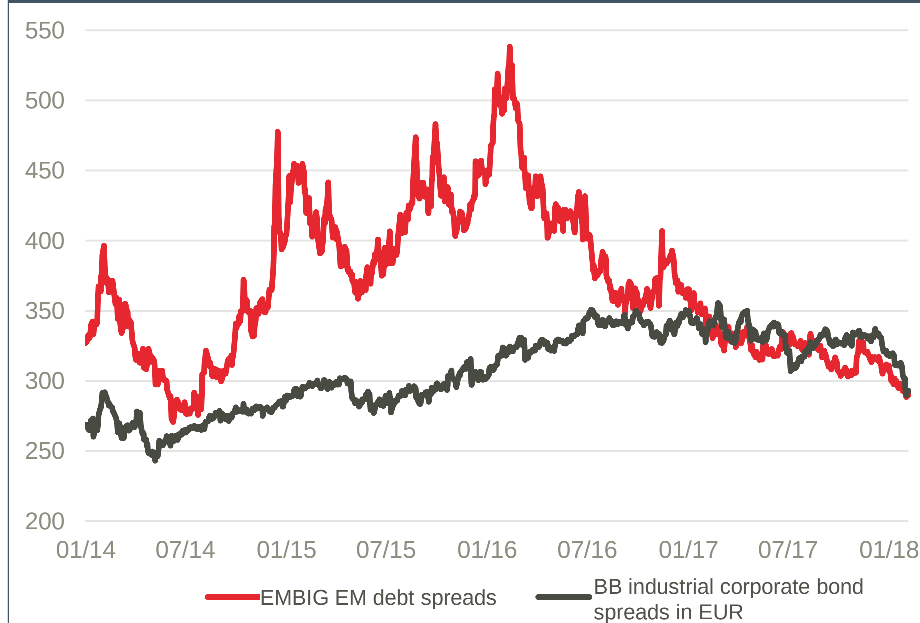
Emerging markets

A spectacular start to the year

Equities performance in main emerging markets



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



- Following 2017, the EM equity markets posted an especially high performance in January. Inflows reached almost $4.5bn per week.
- Yield spreads between sovereigns in emerging markets and developed countries tightened a little more in January, with the US dollar depreciating.
- Overall, the macro-economy remains healthy, and is even quickening its pace in some countries, while monetary policies are still accommodative. This year, the consensus expects an improvement in firms' financial results of around 15% (versus 21% last year).

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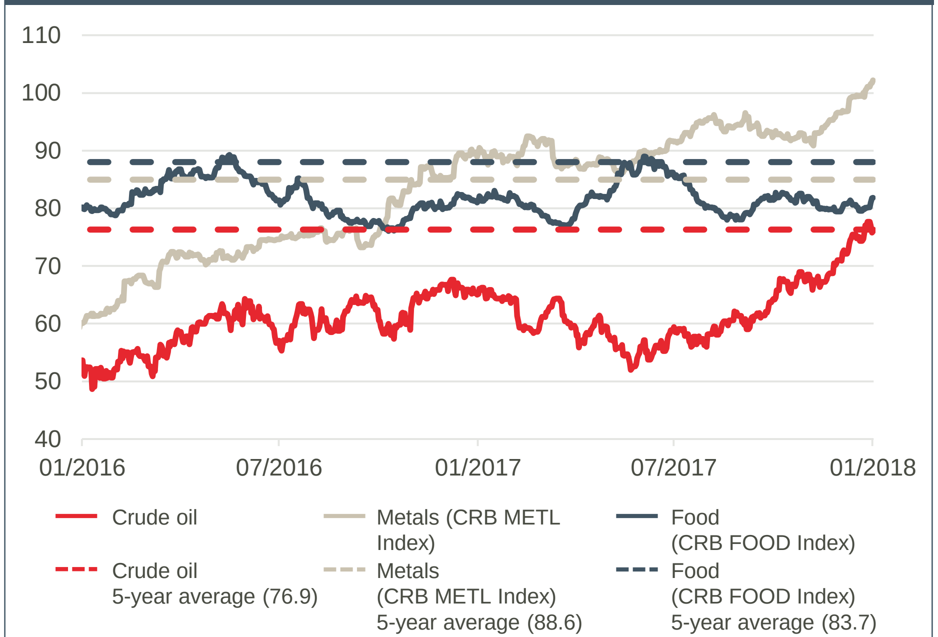
Sources: Bloomberg, Oddo BHF AM SAS | Data at 31/01/2018

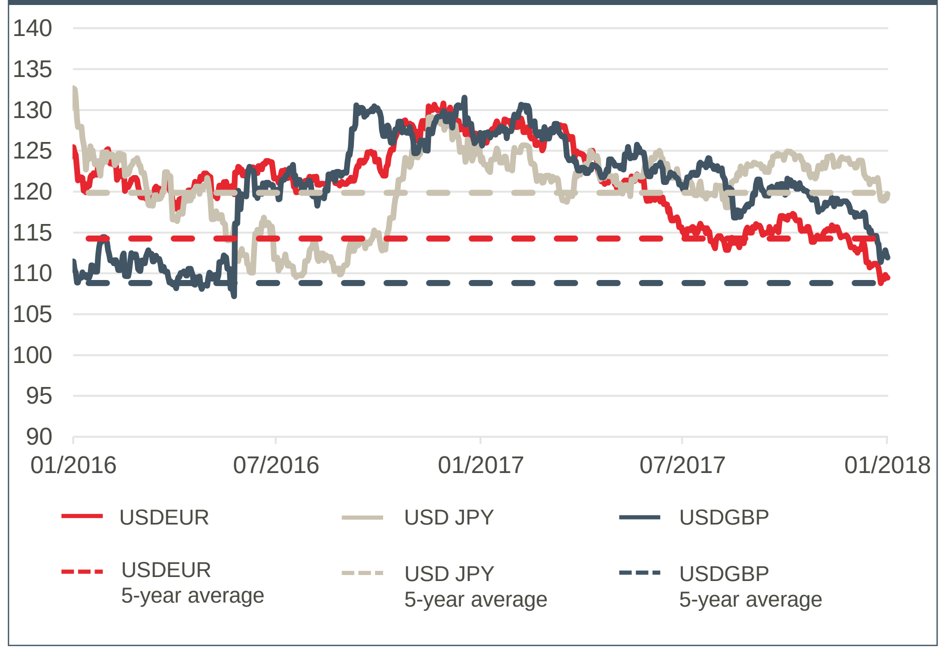
Currencies and commodities

Commodities rise while US dollar falls

Commodities - Change over 2 years (base 100 at 30/11/2012)



Currencies - Change over 2 years (base 100 at 31/01/2016)



- Metals and oil again rose respectably in January, by almost 6% (in USD) for metals and by 3% for oil.
- These upward trends remain underpinned mainly by imbalances (forecasted or real) in terms of supply and demand, with an impact on inflation that is gradually spreading.
- On the other hand, the prices of agricultural commodities, to which inflation in emerging markets is highly sensitive, again hardly varied in January.

- In January, the US dollar's depreciation quickened again. Against the euro it lost almost 3.5%; against sterling more than 5%; against the yen 3%; and also nearly 3.5% in effective terms.
- Against the euro, beyond the growth differential or external balances, the dynamic has been fuelled by declarations against a 'strong dollar' from US Treasury Secretary Steven Mnuchin and ECB minutes that were more restrictive than expected.
- Furthermore, EM currencies in general and the yuan in particular have also driven this trend, with Chinese authorities currently seeing good reasons to let their currency appreciate.

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Sources: Bloomberg, Oddo BHF AM SAS | Data at 31/01/2018

Glossary

Performance calculation	Cumulative fund performance is calculated based on dividends reinvested. Annualised performance is determined on an annual, 365-day basis. A fund's performance in relation to its benchmark index is expressed as an arithmetic difference. Static indicators are generally calculated on a weekly basis and 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	The credit spread is the risk premium, or the difference between the yields of corporate bonds and those 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.
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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