INVESTMENT STRATEGY

Equity Focus
Did reduced tails break the VIX?

June 2024

Edmund Shing, PhD
Global CIO
BNP Paribas Wealth Management

Stephan Kemper
Chief Investment Strategist
BNP Paribas Wealth Management –
Private Banking Germany

BNP PARIBAS
WEALTH MANAGEMENT

The bank
for a changing
world

Rotation incoming

Key Points

- **Feelings vs reality –** it feels different, but the median Nasdaq 100 stock is up only +4% this year and the equal-weighted index gained only +4,5% YTD. This tells a more mediocre picture of Tech's performance when compared to other assets like Copper +21%, Gold +14%, SX5E +12%, Nikkei +16% or Hang Seng +11%.
- **The (less) magnificent 7 -** Q1 was the 5th quarter in a row where, if Mag-7 contribution is taken out, the remaining 493 S&P500 constituents showed outright negative yoy% EPS growth. The group however cracked apart performance-wise as only 2 names managed to beat the market on a 3-month horizon.
- **Beware the discount rate –** while a strong US economy should benefit stocks, not all are created equal. Valuations may become an increasing concern for those hoping that the discount rate in their dividend discount model might soon recede. Rate cut expectations continue to get pushed further out. We stick to our expectation of a first – and sole - 2024 cut in September.
- **Wind of change -** Over the past quarters, US earnings strongly beat the Eurozone. This is changing, with Q1 US earnings spread vs Europe beginning to narrow. Looking at median Q1 EPS growth rates, Europe improves from -7% to 0% yoy. The shift is consistent with relative bottoming in Euro Area PMI momentum vs the US and strengthens our relative preference of European vs US equities.

Main recommendations

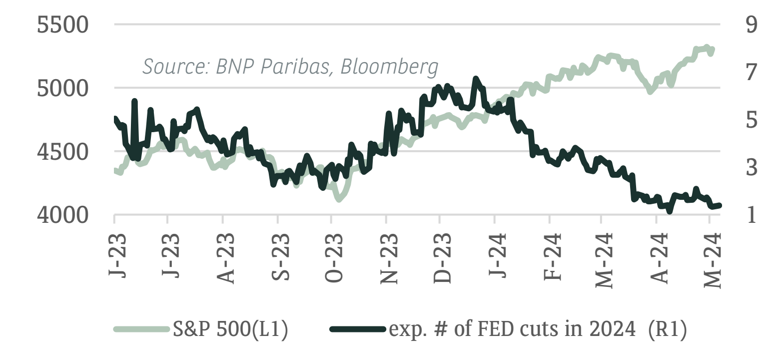
Stay long Europe: The sentiment around Europe remains poor which is reflected by a recent "The Economist" cover. Historically though, such extreme headlines have had a track-record of proving a contrarian indicator (something even they have discussed in the past, highlighting a 68% contrarian hit rate on a 1Y view). Looking at the facts, the economy is recovering, and valuations remain attractive. **Reiterate overweight**

Taking profits on Basic Resources: Hopes for a stronger demand rebound, M&A activities and ongoing strength in copper pushed prices higher. While we still like the long-term story, a 20% run in 3 months looks should limit the potential to outperform in the near term -> **downgrade to neutral**

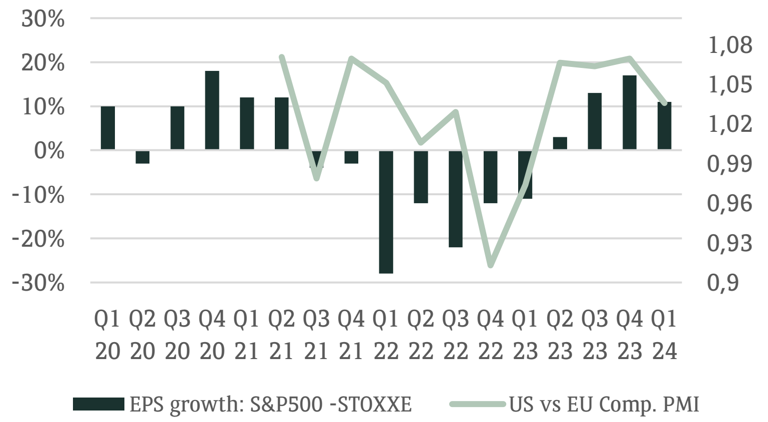
Potholes ahead- we downgrade EU Automobiles to underweight due to increasing margin pressures from Chinese BEVs and falling used car prices. The sector is also vulnerable to a deterioration in global trade, especially from tariffs.

The key risks are that the US Federal Reserve or the ECB could be forced to further push out rate cuts or even shift back to a hawkish rhetoric should inflation surprisingly pick up again

RATE-CUTS CONCERN MARKETS AGAIN



THE US-EU EPS GROWTH SPREAD NARROWS



Source: BNP Paribas, Bloomberg

Is the VIX broken?

WHAT KEEPS THE VOLATILITY MUTED THOSE DAYS?

We have a war in Europe and the Middle East with Israel involved, a high-profile Iranian leader recently dies in a helicopter crash, China continues to flex its muscles towards Taiwan, a convicted felon is most likely to run for the most powerful office in the world and leading the polls.....you can say a lot about today's world but not that it´s a boring one.

Despite plenty of reasons to keep investors on their toes, the VIX (equities) and the MOVE (rates) index, which measure the future expected volatility, are **trading at depressed levels**. Apparently, the future path of the US economy and – consequently – the response function of the US central bank seems to be the only thing really concerning markets.

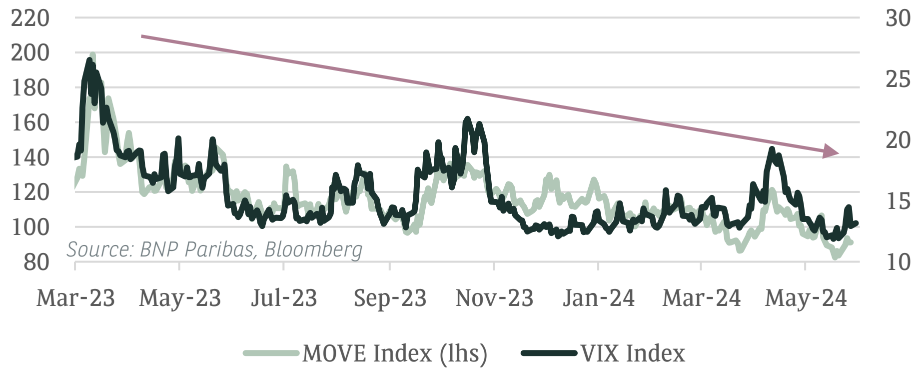
In this sense, a mix of **a steady Fed, softer US growth, and modestly better US inflation outcomes** seems to be providing exactly the sort of Kool Aid that markets are looking for. Weaker US growth has reopened a path towards rate cuts, while alongside better non-US growth, it has limited the scope for “divergence” that seemed to be opening up in April. The Fed was clear in regard to growing fears of a “hawkish pivot”, saying on one hand that it retains faith in the disinflation path with a high threshold for hiking. On the other hand, it still feels able to cut rates if the economy or the labor market weakens. Both reassurances **reduce key tail risks** for the equity market and, by lowering the chances of hikes and deep and early cuts, for the rate distribution too.

Such outlook for reduced tails attracts a lot of interest from volatility sellers who – overly simplified – bet on the market to stay rather range bound with muted moves only. Those Volatility sell programs currently provide record oversupply to banks derivatives trading desks. With risks being perceived so low, there are only a few buyers out there looking to hedge. This is creating a dealer long gamma dynamic. Goldman Sachs estimates that index dealers are currently long $8.1B worth of gamma per every 1% move in spot. This means, that index desks will sell $8.1B worth of equities if the market gains one percent and will buy the same amount if it falls. This feature will help to mute a larger potential drawdown and is subduing volatility at the same time, nudging model-based strategies to re-lever further.

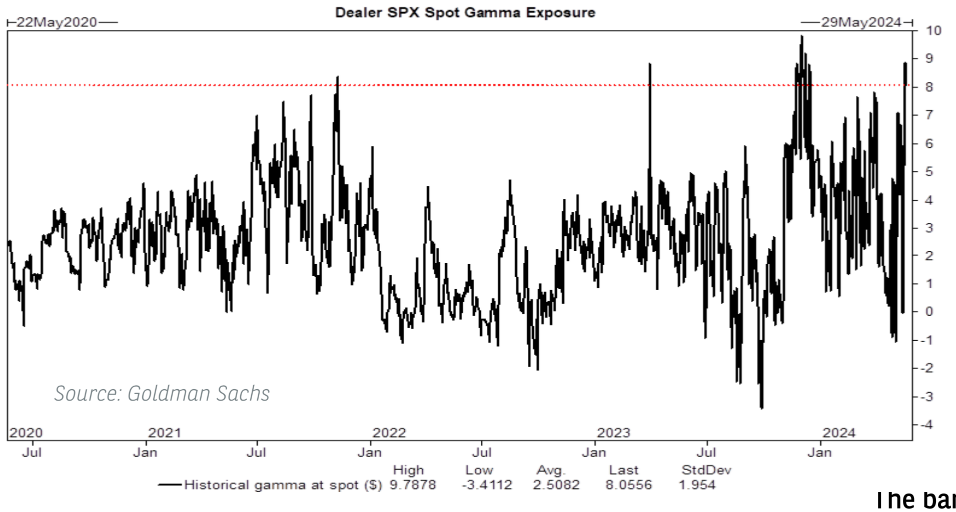
While its hard to predict when those dynamics turn, they always do and often in a violent manner, its safe to say that **investors can benefit from it by buying volatility** via structured products which include the purchase of optionality, be it for upside participation or downside protection.

Take advantage of low volatility levels via structured products

Volatility declines as.....



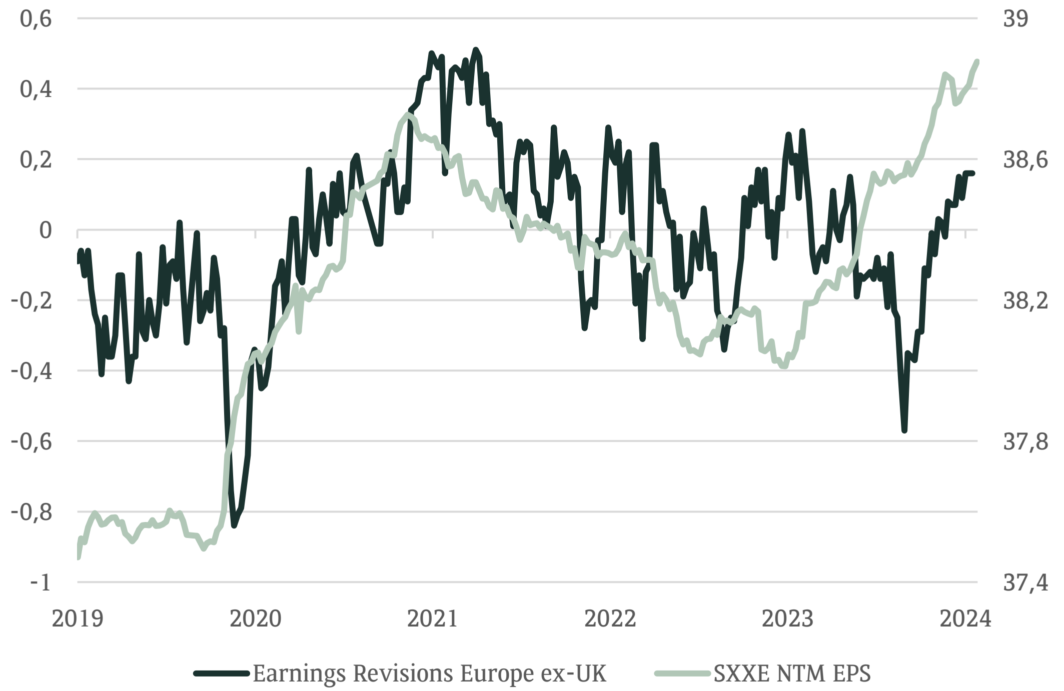
... banks become increasingly long gamma



Europe

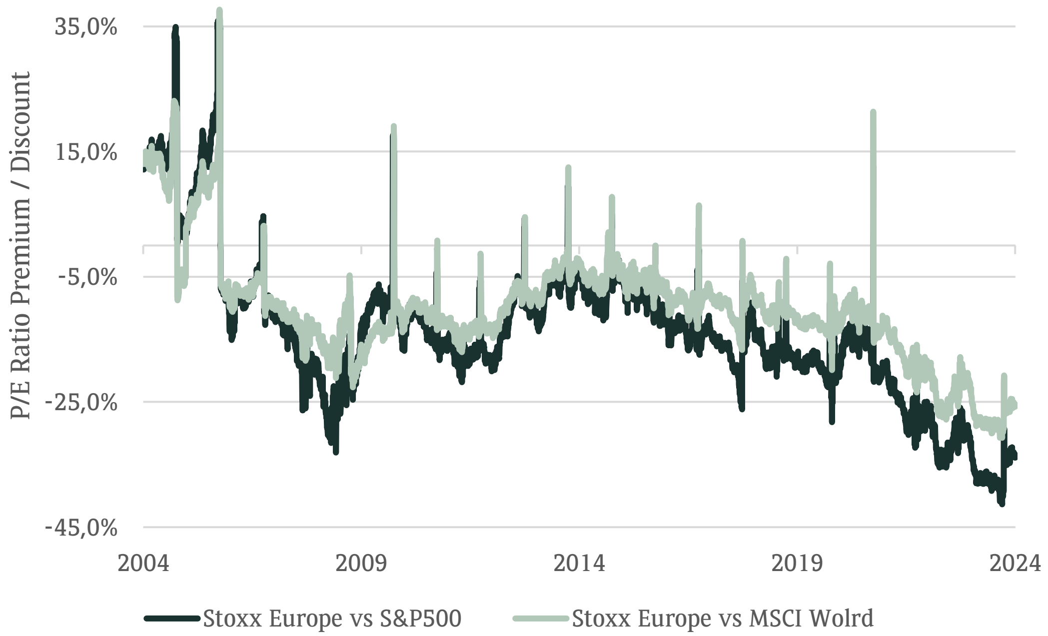
EARNINGS REVISIONS ARE RECOVERING, SO ARE EPS EXPECTATIONS

EARNINGS REVISIONS PICKED UP MATERIALLY AFTER A STRONG EARNINGS SEASON IN EUROPE. EPS EXPECTATIONS RECOVERED STRONGLY, TOO



Source: BNP Paribas, Bloomberg

AND YET, THE VALUATION DISCOUNT VS GLOBAL / US PEERS REMAINS CLOSE TO RECORD HIGHS

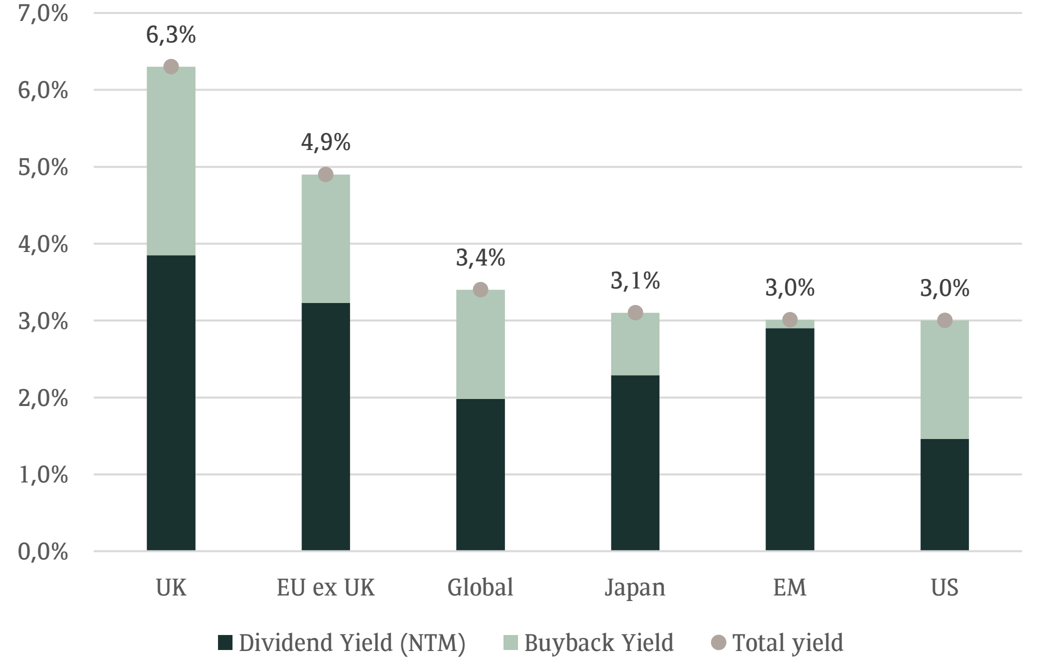


Source: BNP Paribas, Bloomberg

Europe

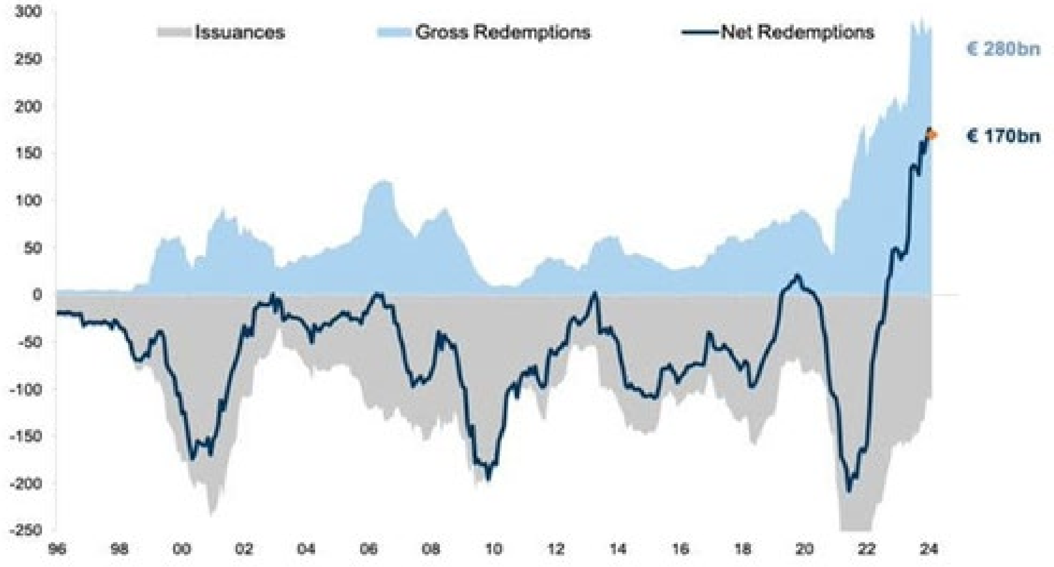
SHAREHOLDER YIELDS & A RECOVERY IN M&A ACTIVITY SHOULD INCREASE ATTENTION AMONG GLOBAL INVESTORS

EUROPEAN EQUITIES ARE OFFERING THE HIGHEST SHAREHOLDER YIELDS GLOBALLY. THE SPREAD VS THE US EVEN REACHED RECORD LEVELS



Source: BNP Paribas, Bloomberg

EZ + UK NET REDEMPTIONS ARE AT RECORD LEVELS, SUPPORTING OUR PREFERENCE FOR SECTORS WITH HIGH BUYBACKS, E.G. BANKS & TECH



Source: Haver Analytics, Goldman Sachs Global Investment Research

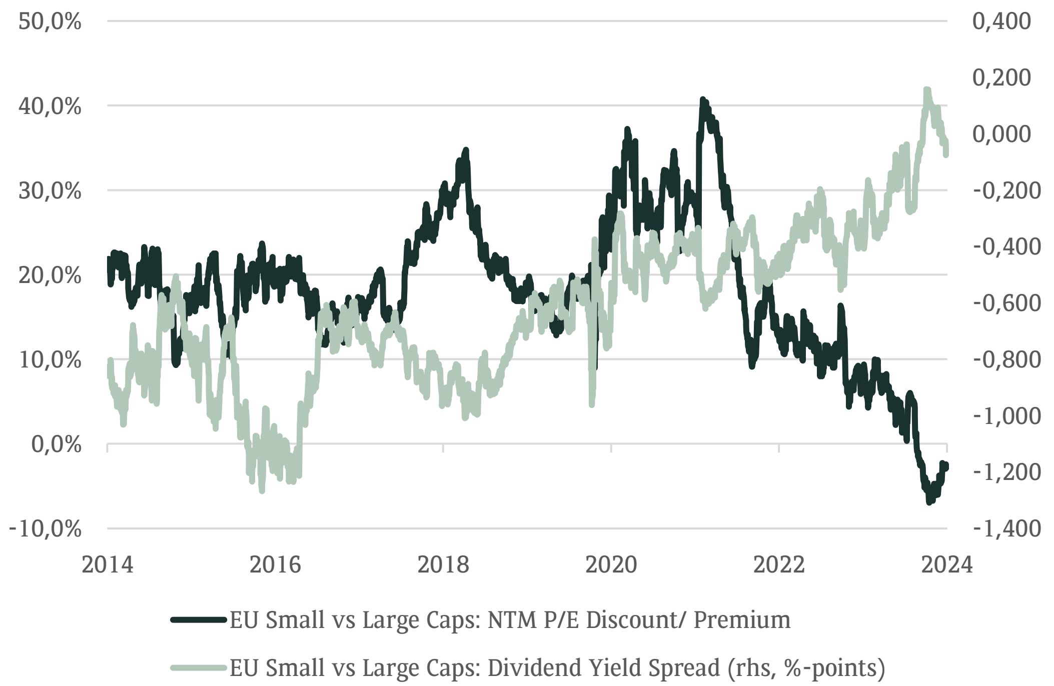
Europe – Small pockets of outperformance

THE RECENT OUTPERFORMANCE OF SMALL CAPS SHOULD CONTINUE AS WE PASSED PEAK RATES

EUROPEAN SMALL CAPS STARTED TO OUTPERFORM LAST MONTH. FALLING RATES SHOULD PROVIDE FURTHER TAILWINDS

Source: BNP Paribas, Bloomberg

EUROPEAN SMALL CAPS ARE CLOSE TO DECADE EXTREMES IN TERMS OF RELATIVE VALUATIONS VS SMALL CAPS



Source: BNP Paribas, Bloomberg

Back to the 90s?

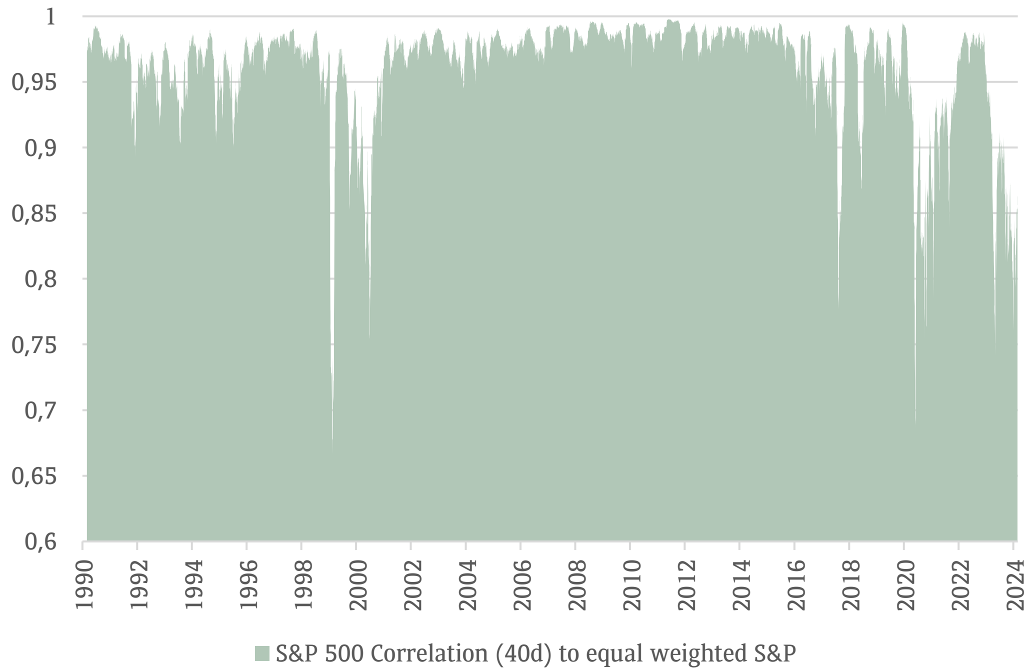
THE DOMINANCE OF BIG TECH LOOKS STRETCHED, OFFERING OPPORTUNITIES FOR A REVERSAL IN TRADITIONAL CYCLICALS

WHILE THE PERFORMANCE OF CYCLICALS VS DEFENSIVES LOOKS STRETCHED, THE RATIO OF LOOKS FAR LESS EXTREME EX TECH

Source: BNP Paribas, Bloomberg

** = IT, Industrials, Commodities, Consumer Discretionary, Financials*
*** = Consumer Staples, Healthcare, Utilities, Communication (aka Telcos)*
**** = Financials, Industrials, Energy, Commodities*

THE CORRELATION BETWEEN THE MARKET AND THE EQUAL WEIGHTED S&P HITS A LOW LAST SEEN DURING THE DOTCOM BUBBLE

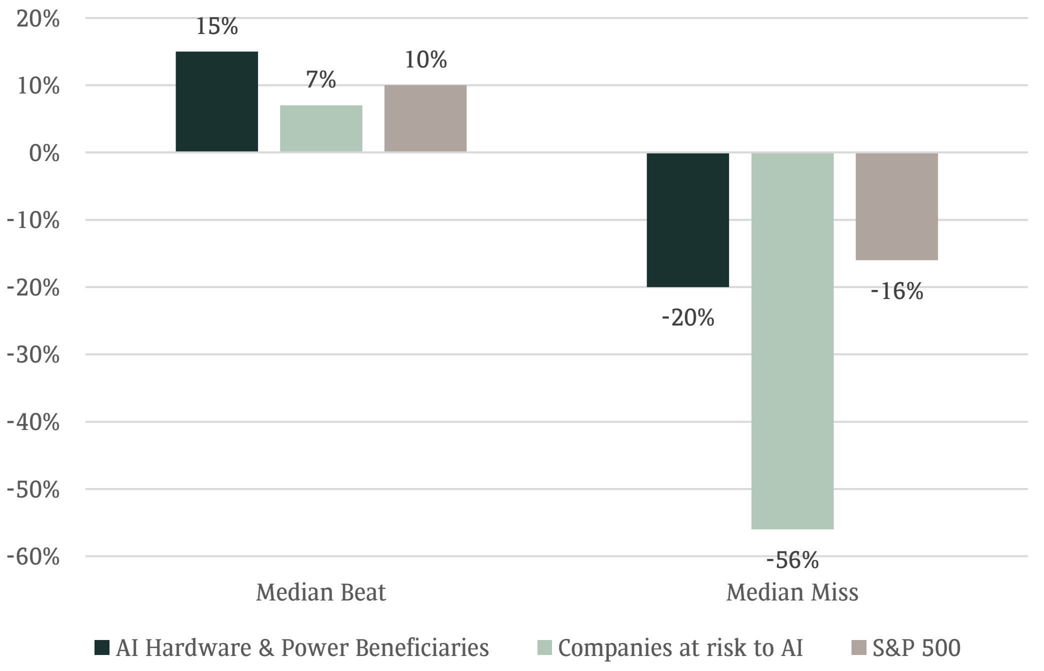


Source: BNP Paribas, Bloomberg

AI – a divided world

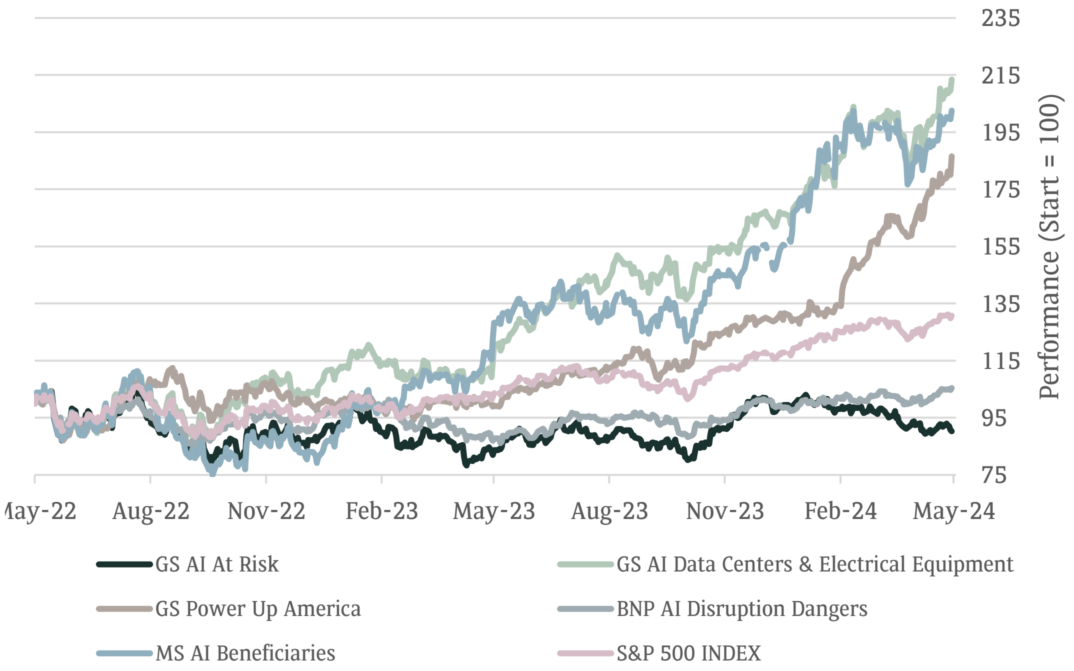
SEPERATING THE WHEAT FROM THE CHAFF AS A RECORD NUMBER OF COMPANIES EXAMINE THE TOPIC

THE "PICK & SHOVELS" PROVIDERS TO AI SHOWED SUPERIOR EARNINGS CHARACTERISTICS VS THE MARKET AND COMPANIES AT RISK TO AI



Source: BNP Paribas, Goldman Sachs

COMPANIES AT RISK TO AI ARE SUBSTANTIALLY LAGGING THE MARKET AND THE BENEFICIARIES OF AI

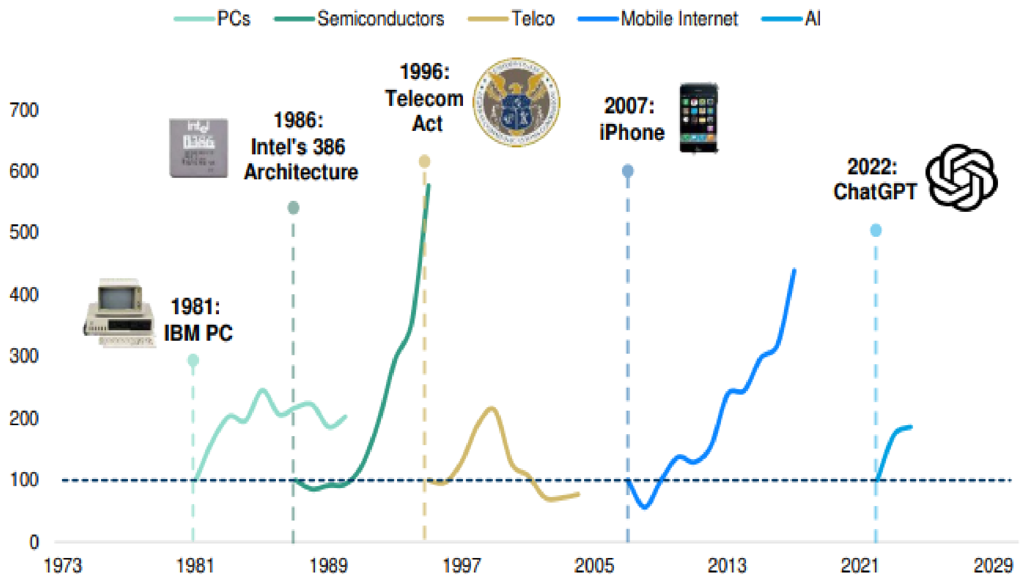


Source: BNP Paribas, Bloomberg

Too much AI? Looking at the threats from oversupply

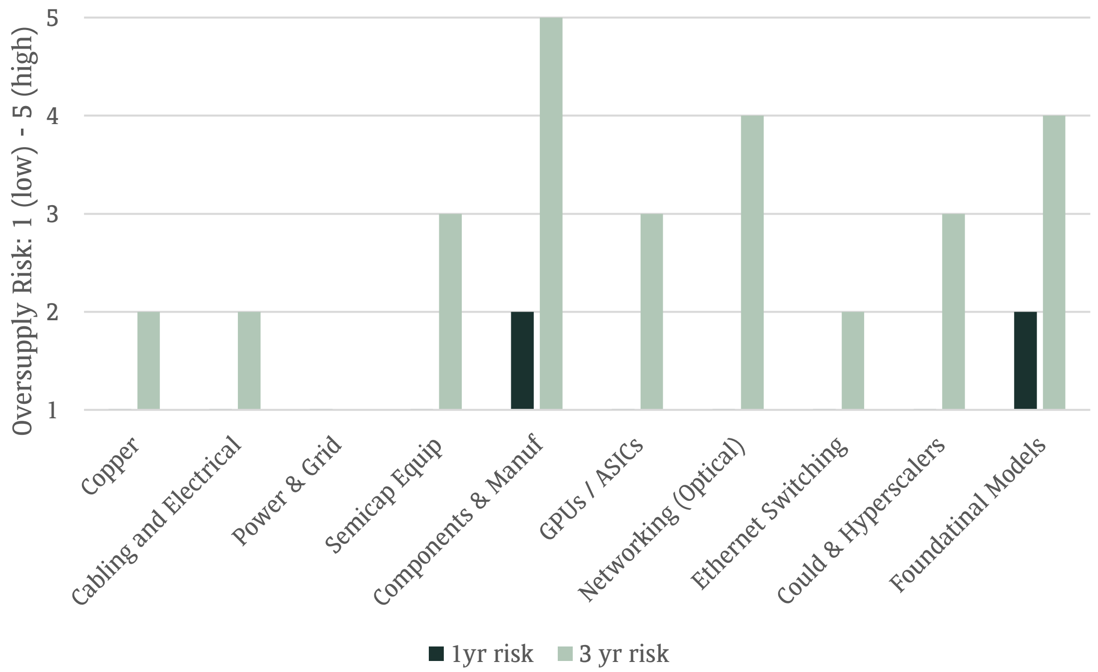
NOT ALL KEY TECHNOLOGY SHIFTS CREATED SUPERIOR LONG TERM RETURNS, STAY SELECTIVE

FOUR FORMER CYCLES OF MAJOR TECH SHIFTS HAVE PROVIDED DIVERGING LONG TERM RETURNS



Source: Datastream, FactSet, Morgan Stanley Research. Note: Indices represent S&P Composite 1500 sector indices for US computer hardware, US semiconductors, US Telecom Services, US Mobile Internet and AI Enablers with 'Significant' or higher AI Materiality from MS 2023 AI Mapping survey.

NOT ALL AREAS OF AI ARE CREATED EQUAL: WHILE THERE IS LITTLE SHORT TERM OVERSUPPLY RISK IN GENERAL, SOME AREAS FACE SEVERE MID TERM RISKS FROM COMMODITIZATION OR CYCLICAL IMPACTS



Source: BNP Paribas, Morgan Stanley

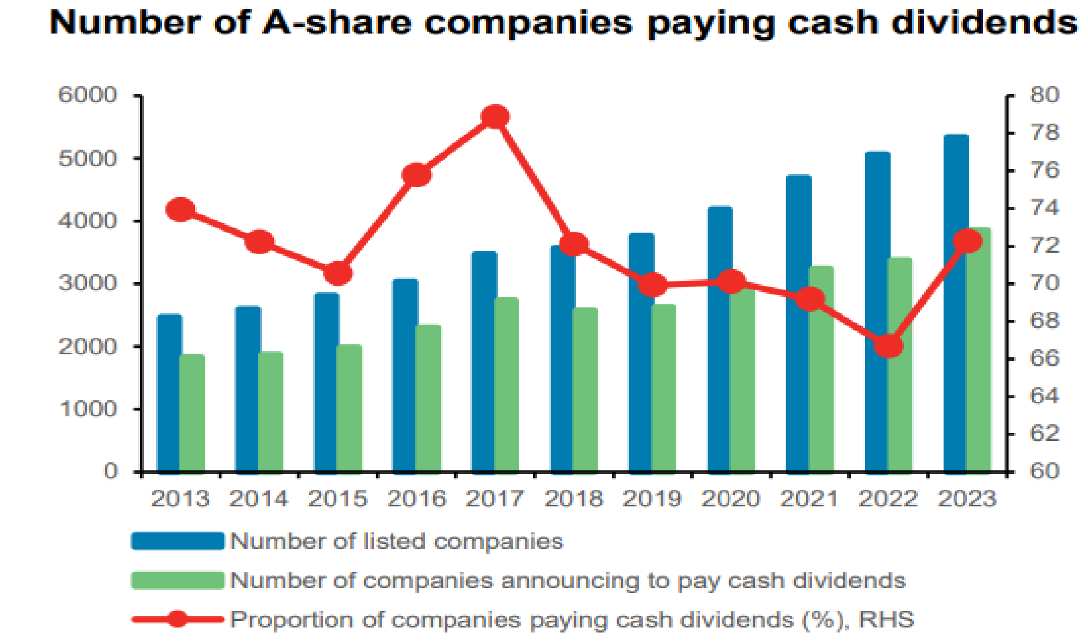
China – climbing the Great Wall (of Worry)?

WHILE THE JURY IS STILL OUT, SOME SIGNS OF HOPE ARISE

SHORT INTEREST IN ONE OF THE BIGGEST CHINA FUNDS HAS REACHED EXTREME LEVELS WHICH WAS ASSOCIATED WITH MAJOR RALLIES IN THE PAST

Source: BNP Paribas, Bloomberg

COMPANIES ARE RESPONDING TO REGULATORY PRESSURES TO ON "HIGH QUALITY DEVELOPMENT THE CAPITAL MARKET" AS THEY INCREASE PAY OUTS



Sources: Wind, BNP Paribas

Sector Allocations – Overview

European Sector View	
Overweight	**Underweight**
STOXX Europe 600 Technology (SX8P Index)	STOXX Europe 600 Chemicals (SX4P Index)
STOXX Europe 600 Insurance (SXIP Index)	STOXX Europe 600 Personal Care (S600PDP Index)
STOXX Europe 600 Health Care (SXDP Index)	STOXX Europe 600 Food, Bev. & Tobacco (S600FOP Index)
STOXX Europe 600 Banks (SX7P Index)	STOXX Europe 600 Consumer Products (S600CPP Index)
STOXX Europe 600 Financial Services (SXFP Index)	STOXX Europe 600 Telecommunications (SXKP Index)
STOXX Europe 600 Real Estate (SX86P Index)	STOXX Europe 600 Automobiles & Parts (SXAP Index)
STOXX Europe 600 Industrial Goods & Services (SXNP Index)	
STOXX Europe 600 Construction & Materials (SXOP Index)	
Neutral	
STOXX Europe 600 Basic Resources (SXPP Index)	STOXX Europe 600 Travel & Leisure (SXTP Index)
STOXX Europe 600 Retail (SXRP Index)	STOXX Europe 600 Media (SXMP Index)
STOXX Europe 600 Energy (S600ENP Index)	STOXX Europe 600 Financial Services (SXFP Index)
STOXX Europe 600 Utilities (SX6P Index)	

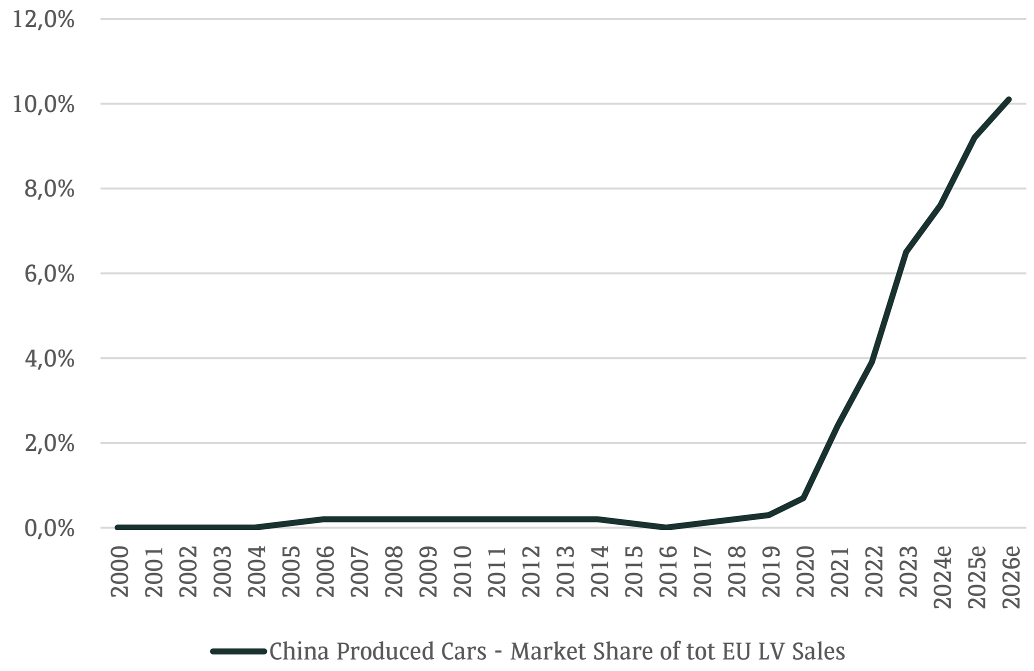
US Sector View	
Overweight	**Underweight**
S&P 500 Health Care Sector GICS Level 1 Index	S&P 500 Consumer Staples Sector GICS Level 1 Index
S&P 500 Industrials Sector GICS Level 1 Index	S&P 500 Consumer Discretionary Sector GICS Level 1 Index
S&P 500 Materials Sector GICS Level 1 Index	
Neutral	
S&P 500 Financials Sector GICS Level 1 Index	S&P 500 Communication Services Sector GICS Level 1 Index
S&P 500 Utilities Sector GICS Level 1 Index	S&P 500 Information Technology Sector GICS Level 1 Index
S&P 500 Energy Sector GICS Level 1 Index	S&P 500 Real Estate Sector GICS Level 1 Index

We have changed our Sector approach as we switch to Stoxx Sector indices in Europe while focussing on GICS Level 1 Sectors in the US. As those sectors offers the most popular and liquid product suites, the new methodology makes it easier to follow our sector views and transforming them in actual positions.

EU Automobiles: downgrade to underweight

THE SECTOR IS FACING MULTIPLE HEADWINDS WHICH SHOULD CONTINUE TO WEIGHT ON PERFORMANCE

CHINA IS GROWING ITS MARKET SHARE RAPIDLY THANKS TO PRICE ADVANTAGES



Source: BNP Paribas, S&P Global

OEMs seem to be increasingly located between a rock and a hard place. Demand trends are worsening as low affordability and the decline in used-car prices have opened a price gap with new cars, pushing consumer buying intentions (new vs used car) to historically low levels in the US. Extrapolating this to other markets, including Europe, seems to be a fair assumption to us, especially as we hear the same story from China. Upper class / entry level luxury car dealerships demand higher discounts to improve their margins while reducing high levels of inventory.

Data from ACEA, the European Automobile Manufacturers' Association, shows that, the average age of the European fleet has been aging to record levels (12 years+). Stretched affordability seems to be the most likely explanation. Thus, introducing more of lower-priced cars as a necessary precondition to ignite a notable replacement cycle in Europe. This is putting pressure on margins from one side.

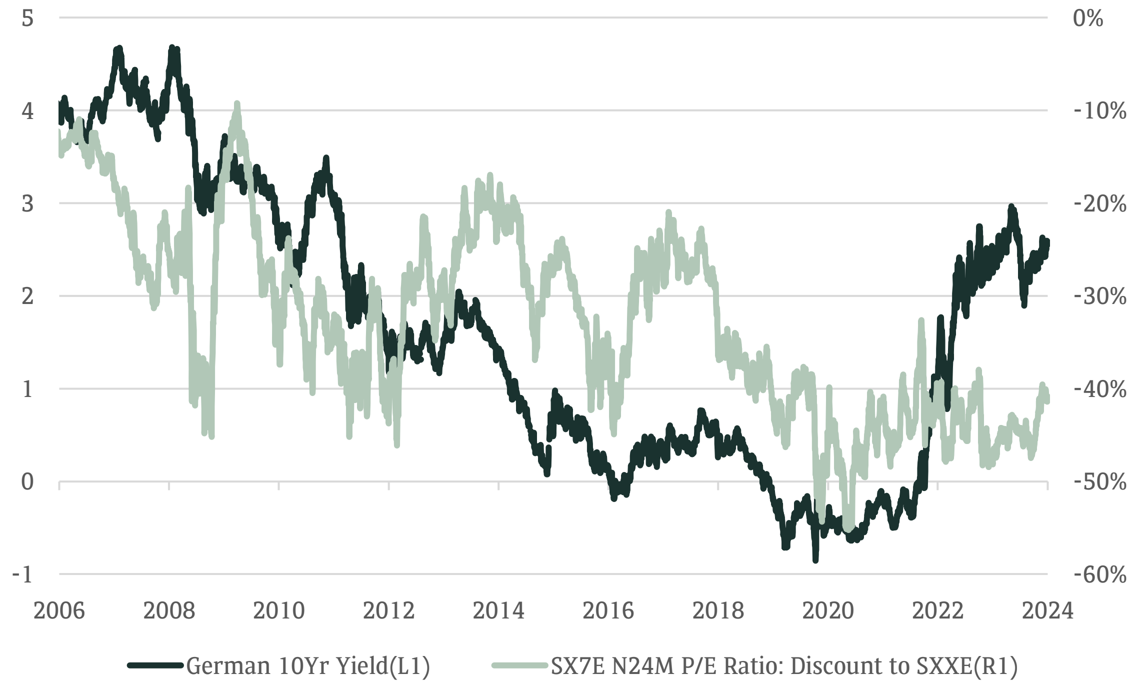
At the same time the industry is confronted with large overcapacities following the EV capex rush. This was especially pronounced in China which keeps exporting price deflation globally to improve capacity utilisation. As a result, the European Commission's launched an anti-subsidy investigation into Chinese BEVs, adding to trade policy debates ahead of the upcoming US/EC elections. Whatever the outcome, European OEMs, are looking extremely vulnerable to any deterioration in global trade.

We thus **downgrade our sector view to underperform** and would either prefer high end luxury names (which have more time to shift on BEV and software, less competition, higher margins and strong pricing power) or names with low China exposure and an attractive price / volume mix

European Banks – a comeback story

PROFITABILTY IMPROVED SUSTAINABLY AND THE SECTOR STILL OFFERS A 10% SHAREHOLDER YIELD

THE SECTOR STILL TRADES CHEAP VS THE BROADER MARKET. THE VALUATION HAS NOT YET REFLECTED THE REBOUND IN YIELDS



Source: BNP Paribas, Bloomberg

THERE IS STILL A NOTABLE GAP BETWEEN BANKS´ RETURN ON EQUITY AND THEIR PRICE / BOOK RATIO

Source: BNP Paribas, Bloomberg

Index Valuations

			Forward															Composite	
Index	Level	1yr Range	EPS	5yr Z-Score	EPS change 4 weeks (%)	PE Ratio	5yr Z-Score	PB Ratio	5yr Z-Score	Div Yield	5yr Z-Score	ROE	5yr Z-Score	Earnings Yield	5yr Z-Score	Equity Risk Premium	5yr Z-Score	vs. ACWI	5yr Z-Score
MSCI ACWI	792		43,87		0,91	18,06		2,85		2,07		14,86		5,54		0,93		n.a.	n.a.
MSCI World	3465		182,43		0,78	18,99		3,11		1,97		15,34		5,27		0,66		1,06	
MSCI Emerging Markets	1088		86,37		1,56	12,60		1,63		2,98		12,68		7,94		3,33		0,68	
S&P 500	5271		252,09		0,72	21,05		4,31		1,46		19,02		4,78		0,17		1,21	
S&P 500 Equal Weighted	6671		390,62		0,01	17,08		2,73		2,10		14,92		5,86		1,25		0,95	
Russell 2000	2040		81,37		-0,25	25,40		1,59		2,36		5,09		3,99		-0,62		1,29	
NASDAQ 100	18774		688,67		1,32	27,40		6,99		0,85		21,67		3,67		-0,94		1,64	
MSCI USA Growth	23074		415,58		1,46	29,54		9,68		0,46		30,15		1,80		-2,81		1,87	
MSCI USA Value	13228		222,45		0,26	16,19		2,68		2,52		15,30		1,68		-2,93		0,90	
STOXX Europe 600	513		35,80		0,13	14,41		1,96		3,51		12,89		6,97		4,29		0,78	
STOXX Europe Mid 200	541		39,02		0,15	13,94		1,58		3,67		10,52		7,21		4,52		0,74	
STOXX Europe Small 200	343		24,79		0,56	13,92		1,46		3,23		9,97		7,22		4,54		0,74	
DAX	18476		1374,98		1,93	13,50		1,54		3,23		11,11		7,44		4,76		0,72	
FTSE 100	8183		680,64		-0,81	12,08		1,83		3,85		14,16		8,32		3,93		0,66	
CAC 40	7939		564,41		-0,61	14,15		1,88		3,19		12,92		7,11		4,43		0,77	
FTSE MIB	34157		3815,71		0,51	9,00		1,28		5,51		14,30		11,17		8,49		0,49	
Nikkei 225	38557		1822,41		-0,82	21,16		2,03		1,76		9,53		4,73		3,65		1,11	
Hang Seng	18477		2004,28		0,26	9,22		1,02		4,14		10,47		10,85		8,55		0,49	

Source: BNP Paribas, Bloomberg

DISCLAIMER

BNP PARIBAS WEALTH MANAGEMENT
CHIEF INVESTMENT ADVISOR (CIA) NETWORK

Edmund SHING
Global Chief Investment Officer

ASIA

Prashant BHAYANI
Chief Investment Officer

Grace TAM
Chief Investment Advisor

BELGIUM

Philippe GIJSELS
Chief Investment Advisor

Alain GERARD
Senior Investment Advisor, Equities

Xavier TIMMERMANS
Strategist Senior Investment, PRB

LUXEMBOURG

Guy ERTZ
Chief Investment Advisor

Edouard DESBONNETS
Investment Advisor, Fixed Income

FRANCE

Jean-Roland DESSARD
Chief Investment Advisor

Isabelle ENOS
Senior Investment Advisor

ITALY

Luca IANDIMARINO
Chief Investment Advisor

GERMANY

Stephan KEMPER
Chief Investment Strategist

This marketing document is provided by the Wealth Management business of BNP Paribas, a French public limited company with a capital of € 2,499,597,122, registered office 16 bd des Italiens 75009 Paris - France, registered at RCS Paris under number 662,042,449, authorised in France, under the number 662,042,449, approved in France by the Autorité des Marchés Financiers (AMF). As a marketing document, it has not been produced in accordance with regulatory constraints to ensure the independence of investment research and is not subject to the prior transaction ban. It hs not been submitted to the AMF or other market authority. This document is confidential and intended solely for use by BNP Paribas SA, BNP Paribas Wealth Management SA and companies of their Group (‘BNP Paribas’) and the persons to whom this document is issued. It may not be distributed, published, reproduced or revealed by recipients to other persons or reference to another document without the prior consent of BNP Paribas.

This document is for informational purposes only and does not constitute an offer or solicitation in any State or jurisdiction in which such offer or solicitation is not authorised, or with persons in respect of whom such offer, solicitation or sale is unlawful. It is not, and should under no circumstances be considered as a prospectus. The information provided has been obtained from public or non-public sources that can be considered to be reliable, and although all reasonable precautions have been taken to prepare this document, and, in the event of any reasonable precautions, the accuracy or omission of the document shall not be recognised. BNP Paribas does not certify and guarantees any planned or expected success, profit, return, performance, effect, effect or profit (whether from a legal, regulatory, tax, financial, accounting or other point of view) or the product or investment. Investors should not give excessive confidence in theoretical historical information relating to theoretical historical performance. This document may refer to historical performance; Past performance is not a guide to future performance.

The information contained in this document has been drafted without taking into account your personal situation, including your financial situation, risk profile and investment objectives. Before investing in a product, the investor must fully understand the risks, including any market risk associated with the issuer, the financial merits and the suitability of such products and consult its own legal, tax, financial and accounting advisers before making an investment decision. Any investor must fully understand the characteristics of the transaction and, if not otherwise provided, be financially able to bear the loss of his investment and want to accept such risk. The investor should remember that the value of an investment as well as the income from them may fall as well as rise and that past performance is not a guide to future performance. Any investment in a product described is subject to prior reading and to an understanding of the product documentation, in particular that which describes in detail the rights and duties of the investors and the risks inherent in an investment in that product. In the absence of any written provision, BNP Paribas does not act as an investor's financial adviser for its transactions.

The information, opinions or estimates contained in this document reflect the author's judgement on the day of his drafting; they must not be considered as authority or be substituted by anyone in the exercise of his or her own judgement and subject to change without notice. Neither BNP Paribas nor any BNP Paribas Group entity will be liable for any consequences that may arise from the use of the information, opinions or estimates contained in this document.

As a distributor of the products presented in this document, BNP Paribas may receive distribution fees on which you can obtain further information on specific request. BNP Paribas, its employees or Directors may hold positions in or relationship with their issuers.

By receiving this document you agree to be bound by the above limitations.

The bank for a changing world