The European Green Deal

Monthly Investment Strategy

AXA IM Research

June 2021

Summary: June 2021

Theme of the month: The European Green Deal

- The European Green Deal is an ambitious set of policy initiatives, investment programs and subsidies aimed at accelerating the reduction in European GHG emissions to meet a net zero goal by 2050 (and 55% of 1990 level by 2030). It is also designed to encourage bolder action elsewhere.
- The estimated cost of transitions is €3.5tn. Around one-third will come from public funding, including around one-quarter up to 2027 from EU long-term budget and Next Generation EU package. The remainder will be privately funded, including through EIB, which is estimated to contribute €1tn by 2030.
- Reform to the EU Emissions Trading System later this month will be part of the necessary internalisation of carbon pricing. This may include extending the scheme to include other sectors. In term of internationalisation, the Commission may also consider a carbon border mechanism adjustment.

Macro update: Recovery, inflation and central banks juggle similar but divergent themes

- The ebb and flow of the virus continues to affect activity. Some EMs including Asia and Latam have seen growing cases, which has weighed on activity. In Europe, receding cases has allowed for a quicker re-opening and we have lifted our growth outlook. In the UK, both case numbers and growth outlook are rising together, although we expect growth to soften into H2. US activity also appears to be chafing against re-opening frictions, rather than COVID.
- Price pressures are rising to varying degrees. PPI inflation has been fuelled by rising commodities and food prices. Broader CPI has risen sharply in the US, but barely at all in China. In Europe, inflation has risen broadly back to target but looks to overshoot on a transitory basis over the coming months.
- Central bank activity has been divergent. The Fed recently turned more hawkish, perversely lowering longer-term interest rates. The ECB continues its more elevated PEPP purchases, to offset a spillover of tighter financial conditions. Meanwhile, PBoC tightening (through slower credit growth) may have done enough and we consider a more growth supportive second half.

Investment strategy: small hawkish shift by the Fed broadly absorbed by risky assets

- FX: The Fed brought forward its own rate hike expectations and stated it would start to consider the tapering process. This has shifted policy expectations, pushing US real rates a little higher. JPY is a good candidate to short against the USD. Shorts in EUR or CHF may be even better.
- Rates: Technical factors like the drawdown of the Treasury General Account as well as the adverse carry/roll down in shorting USTs have contributed to the UST rally in Q2. Looking ahead, we believe the market has priced-in technicals, which leaves focus on fundamentals and the question of inflation.
- Credit: continues to be unperturbed by exogenous factors and taking the longer view about uncertainties in macro fundamentals and central bank policy. Ample liquidity has driven investors down the credit quality curve, causing spread compression. Fallen angel risk emphasises the value of active investing.
- Equity: After the take-off post-Covid in 2020 when global equity market gained +67.5% equities are now in cruise phase with +12%ytd. US implied volatility is gradually stabilising at a lower level, but some risks persist, notably the difficulty of reaching collective immunity. We favour Eurozone and UK.

Central scenario

Summary – Key messages

Monetary policy

Fed tone turned more hawkish. But monetary policy remains key policy support all central banks will be wary of withdrawing support too quickly.

Inflation

Energy, base effects and bottlenecks lift rates in 2021. Inflation in 2022 depends on spare capacity and unlikely outside US and some EMs.

Fiscal policy

US has passed exceptional stimulus – future in more doubt. In Europe and UK fiscal support rolled out more slowly.

Growth

Consensus for faster growth: virus fades, vaccines grow and fiscal stimulus. Virus risk remains.

Our central scenario:

2021 rebound as virus controlled, recovery needs policy support

We forecast global growth to rise by 5.6% in 2021 and 4.3% 2022.

Economic rebound on vaccine and stimulus, must overcome labour market and indebtedness headwinds. Monetary and fiscal policy to support.

Emerging Markets

EM's see virus pressures persist with less vaccine access for now. Export economies to benefit. Less policy space for most.

Rates

Rates stable as technical offset growth and inflation outlook for now. Macro still argues for higher rates.

FX

Rising real rates unwound USD weakness abruptly. Strong vaccine supports high beta currencies: GBP, CAD and NOK. GBP new variant risks

Credit

Tight spread belie yet higher corporate debt levels, implicitly locking-in central banks as an ultimate backstop.

Equities

Value/Growth rotation still at play. Corporate earnings 2021 rebound on track. Equity risk premium has compressed.

Alternative scenarios

Summary – Key messages

Persistent recession *(probability 15%)*

What could be different?

- Coronavirus mutations reduce vaccine effectiveness
- Labour market dislocation and business disruption create ongoing headwinds to demand recovery
- Fiscal policy fades amidst elevated debt and political opposition
- Geo-political tensions mount in post-Covid world

What it means

- Growth/inflation expectations weaken further, additional GDP disruption, corporates' earnings under more pressure
- Further monetary policy where space permits (including China). Government's continue with fiscal stimulus and divide between monetary financing blurs further.

Market implications

- Risk appetite deteriorates / equities sell off / credit widens
- Safe-haven rates rally resumes
- EM debt to come under pressure

Fast recovery *(probability 20%)*

What could be different?

- Vaccine rolls out more quickly than expected, spurring pent-up demand burst
- Labour market recovers, economies benefit from post-virus euphoria and faster consumption of 'excess saving'
- Virus-shock reshapes business practice, boosting productivity

What it means

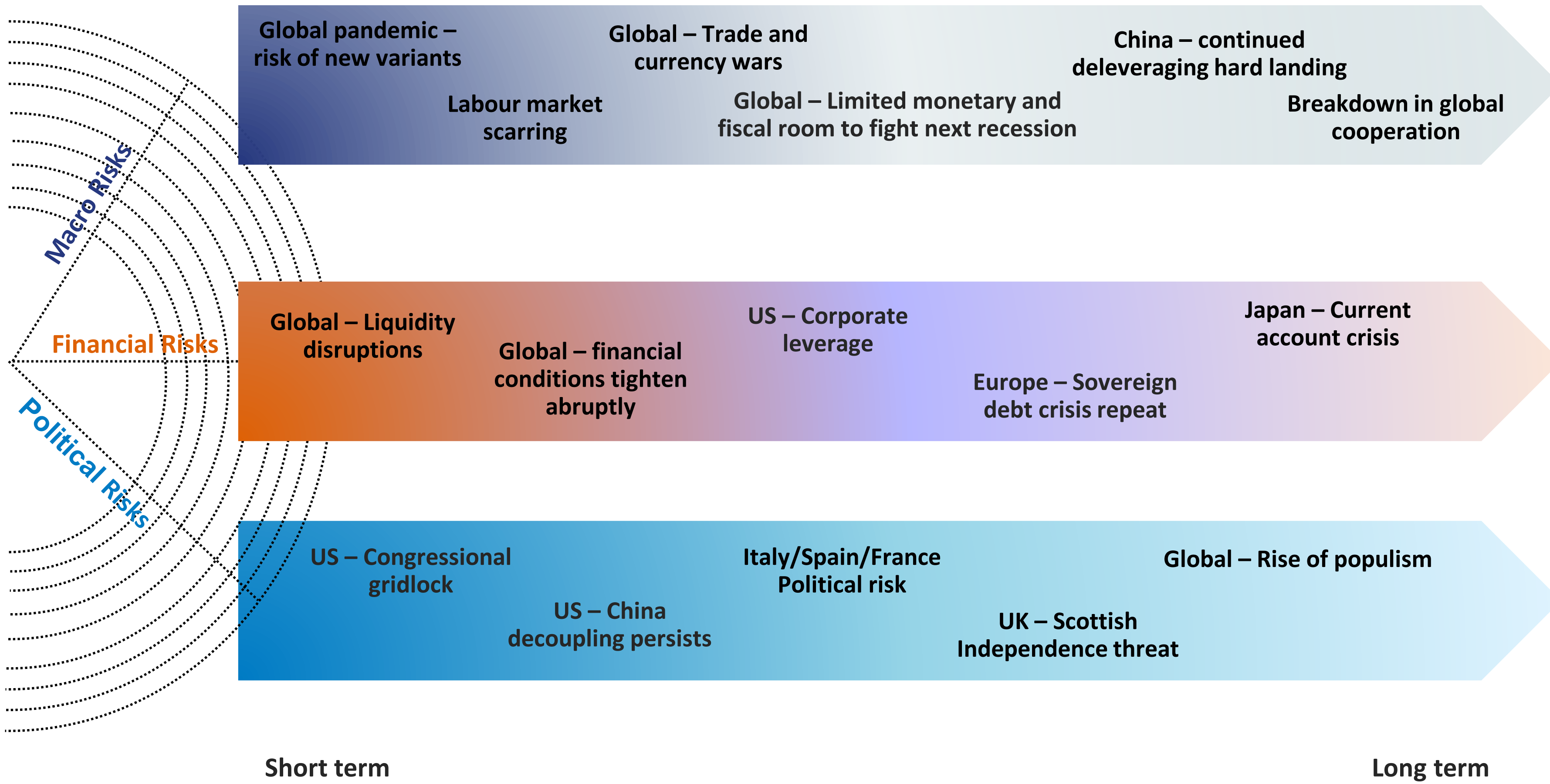
- Global/US/EMU growth surprise on the upside in a stronger and more persistent rebound from 2020
- Monetary policy fights expectations for swift tightening through forward-guidance

Market implications

- Risk-on environment with equities making further gains amidst broader rotation
- UST and EUR break-evens rise
- Spreads grind tighter

RISk Radar

Summary – Key messages



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Theme of the month

Theme of the month: The European Green Deal

Definition and objectives

An ambitious policy package to decarbonize the EU…

- The goal is to reach climate neutrality by 2050, and to turn the transition into an economic and industrial opportunity for Europe. The deal is made up of a wide array of policy measures and subsidies aimed at cutting pollution while increasing research and investment in environmentally friendly technologies.

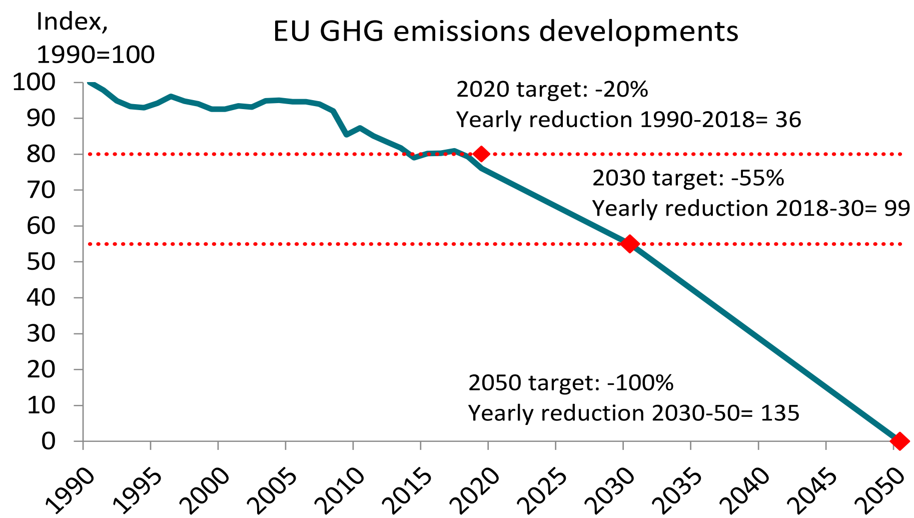
… And inspire efforts to combat climate change

- EU target reductions are ambitious: the EU will need to reduce net GHG emissions much faster than in the past to meet the 2030 target (55% GHG reduction compared to 1990 levels) and to become climate neutral in 2050.
- Yet, a transition away from carbon that would only focus on Europe would not do much to mitigate global warming, as Europe represents just c. 8% of global GHG emissions. Actually, it could even be counterproductive: simply displacing Europe's GHG to its trading partners (carbon leakage problem). So a secondary objective is to push others to take bolder actions: export EU standards or prevent carbon leakage via a carbon border adjustment mechanism for instance.

When "Multi-faceted" makes sense…

Source: European Commission and AXA IM Research, June 2021

A long and ambitious road ahead



Source: EEA, AXA IM Research, June 2021. Note: GHG emissions including international aviation, excluding land use, land use change and forestry (LULUCF). Yearly reduction in megatons of CO2 equivalents.

Theme of the month: The European Green Deal

Priority: Reshaping the energy system

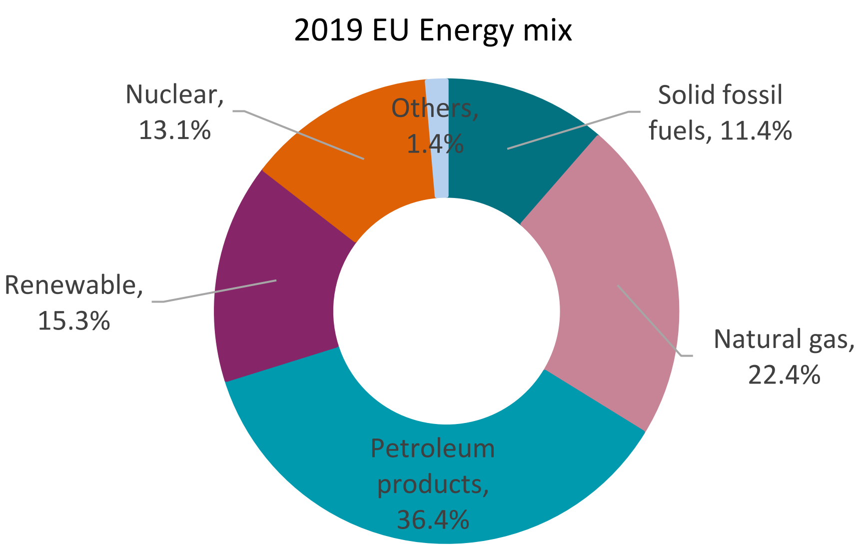
A complete revamp of the energy system…

- The production and use of energy across the economy accounts for more than 75% of the EU'S GHG emissions. Oil dominates the energy mix, followed by natural gas, but the renewable energy share has almost doubled since 2008, at 15.3%.
- In July 2020, the EC presented a *Strategy on Energy system Integration*. It relies on 3 pillars: large-scale electrification, more closed-cycle energy use (eg waste heat management) and the development of green gases/fuels (such as hydrogen)

… Focusing on 5 sectors

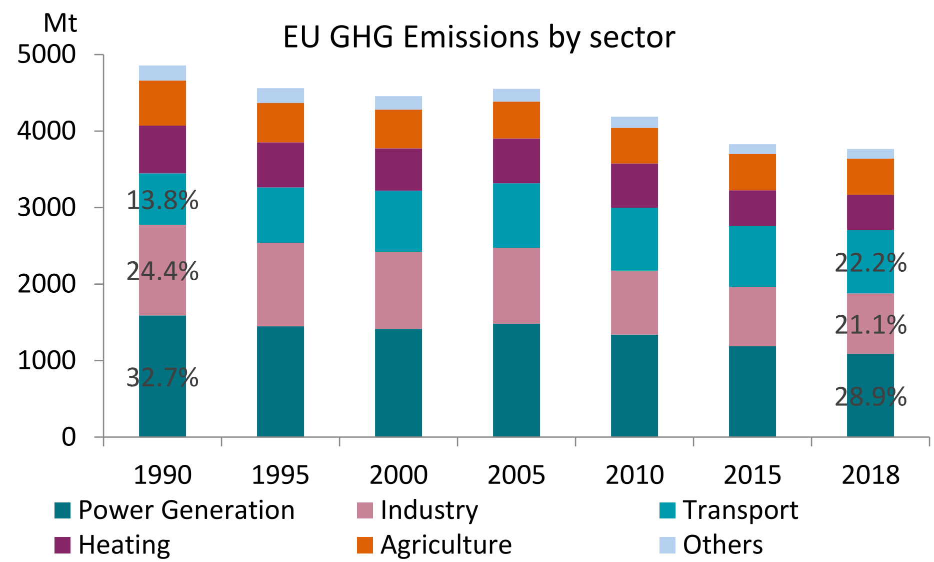
- Power generation (29%), transport (22%), industry (21%), heating (12%) and agriculture (12%) gather the bulk of EU's GHG emissions. Since 1990, GHG emissions have declined across all sectors, except transport.

Reshaping the way energy is produced and consumed…



Source: Eurostat, AXA IM Research, June 2021. Note: Gross available energy.

…And focussing on 5 sectors



Source: EEA, AXA IM Research, June 2021

Theme of the month: The European Green Deal

The costs of transition

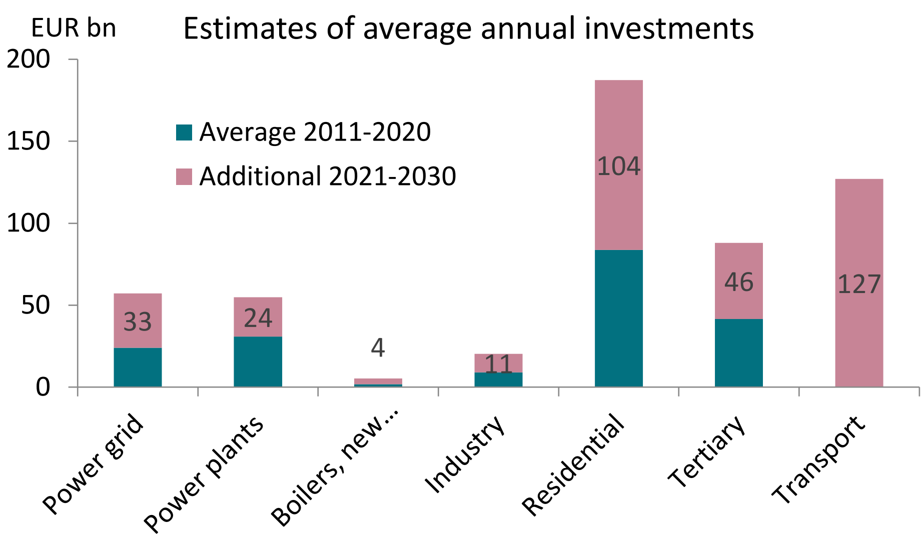
At least €3.5trn needed in the coming decade…

- The EC estimates that to reach the 55% GHG target in 2030, annual investment in the energy system will need to be around €350 billion higher in each year of the coming decade (2021-2030) than in the 2011-2020 period. As a share of GDP, this is an increase equivalent to 1.7% of GDP in the period 2021-2030 compared to 2011-2020. To put things into perspective GFCF averaged 21.5% of GDP in 2000-2019.

…Masking divergence between and within countries

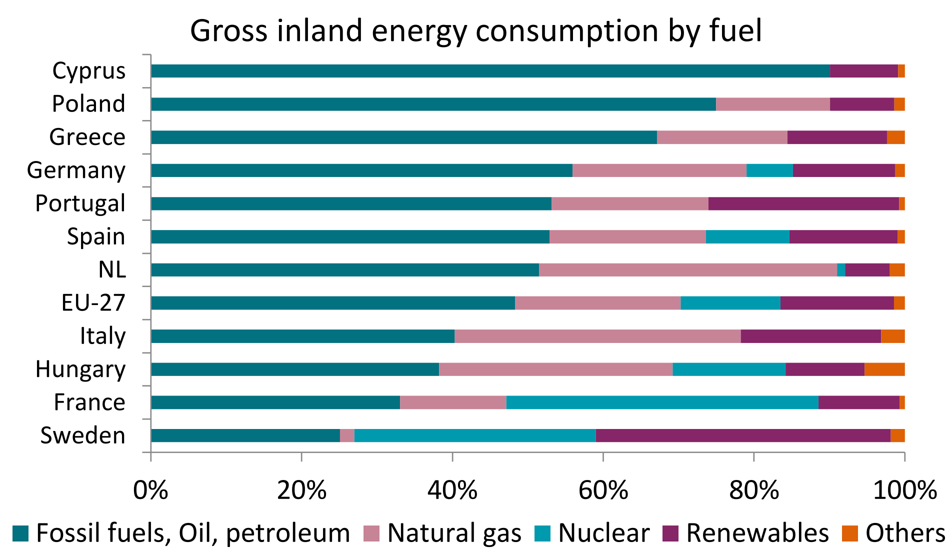
- Costs also need to take into account that the impacts of policy decisions on reallocation across and within countries: need complementary policies to ensure public acceptability.

€350bn Investment needs to achieve the 2030 targets…



Source: European Commission, AXA IM Research, June 2021. Note: Transport only shows additional investment. Historical average for 2011-2020 was EUR 492.2 bn.

… but some will need more than others



Source: Eurostat, AXA IM Research, June 2021

Theme of the month: The European Green Deal

Mobilising public funds and crowding in private funding

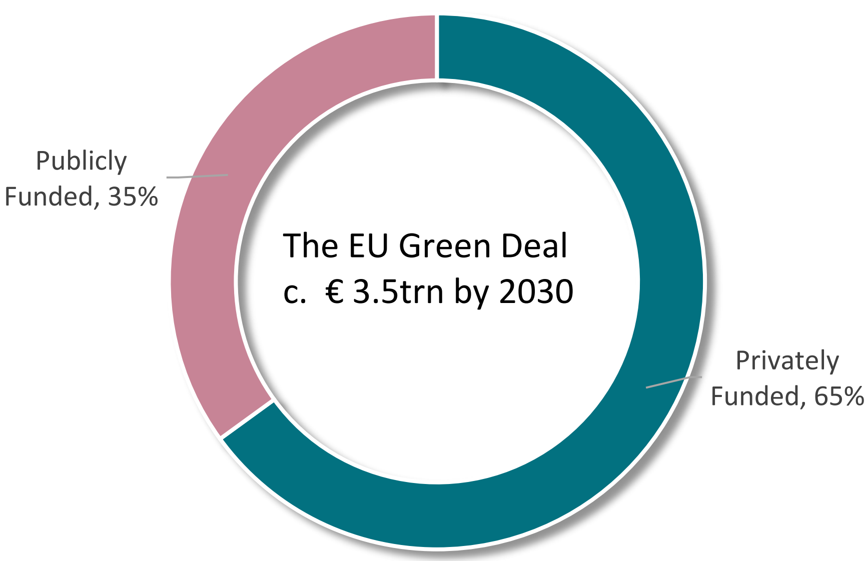
Greening public investments by setting higher climate spending targets

- At least 30 % of the €1074.3bn agreed under the EU long-term budget for 2021–2027 and at least 37% of the €750bn NextGenerationEU should be spent on climate-related policies and programmes. So between 2021 and 2027 c. €600 billion of fresh EU resources will be made available for the green transition, c. 25% of the investments needs. It could get higher if countries seize the opportunity of the revamp of the fiscal framework, for example considering a "green golden rule"?

Crowding in private funding: the role of the European Investment Bank

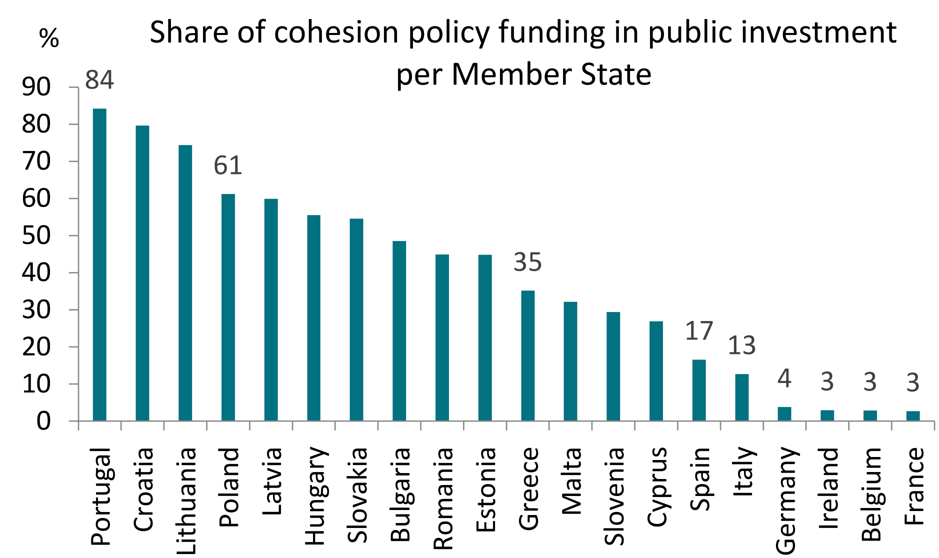
- New climate strategy announced in 2019: dedicating at least 50% of its lending to climate by 2025 (from 37% in 2020) and supporting €1 trillion of investments by 2030. But more could be done as new lending has declined since 2015.

EU Green deal estimate investment split



Source: European Commission, AXA IM Research, June 2021.

Not enough public funds… still a potential catalyst role in some countries



Source: European Commission, AXA IM Research, June 2021. Note: share of cohesion policy funding in public investment during the 2015-2017 period.

Theme of the month: The European Green Deal

« Market pull » strategy: Carbon price at the core

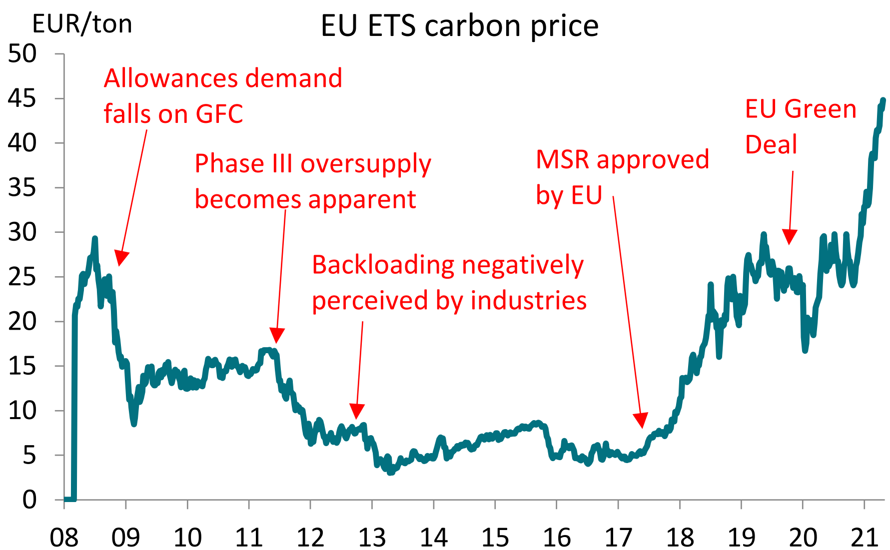
The Emissions Trading System reform: from an enforcement mechanism to the core of climate policy?

- Today ETS covers 40% of EU GHG emissions. Thanks to EC credible commitment to net-zero, the carbon price has soared (was too low for too long!).
- By mid-July 21, EC to propose revision/possible extension of EU ETS to transport and heating sectors. Should be done via separate ETS first (transitional period) and with complementary (redistribution) measures.

Carbon border mechanism adjustment: just a threat to push for a climate club?

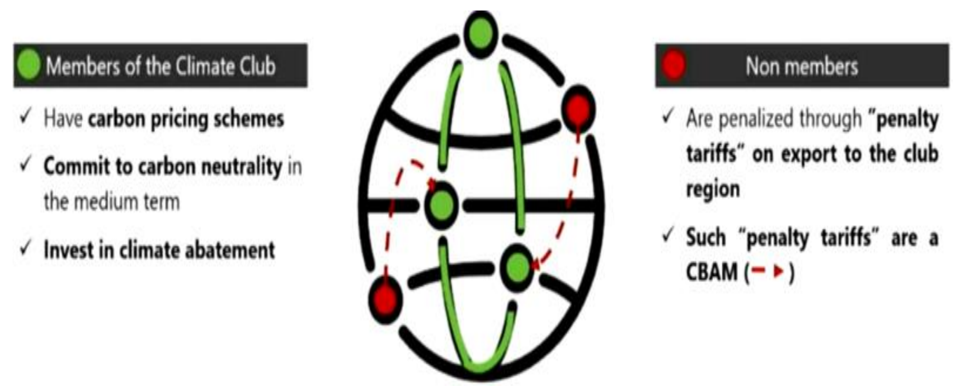
- Proposal by mid-July 21. Aims at i) preventing carbon leakage ii) incentivising other countries across the world to also decarbonise. The tax or tariff would be based on the emissions embedded in imported products. But this includes several technical, legal, geopolitical issues.

When carbon prices start to get relevant…



Source: Datastream, AXA IM Research, June 2021.

A carbon border mechanism to push towards a climate club?



Source: Bruegel, AXA IM Research, June2021

Theme of the month: The European Green Deal

The Recovery and Resilience plans under scrutiny: walking the talk

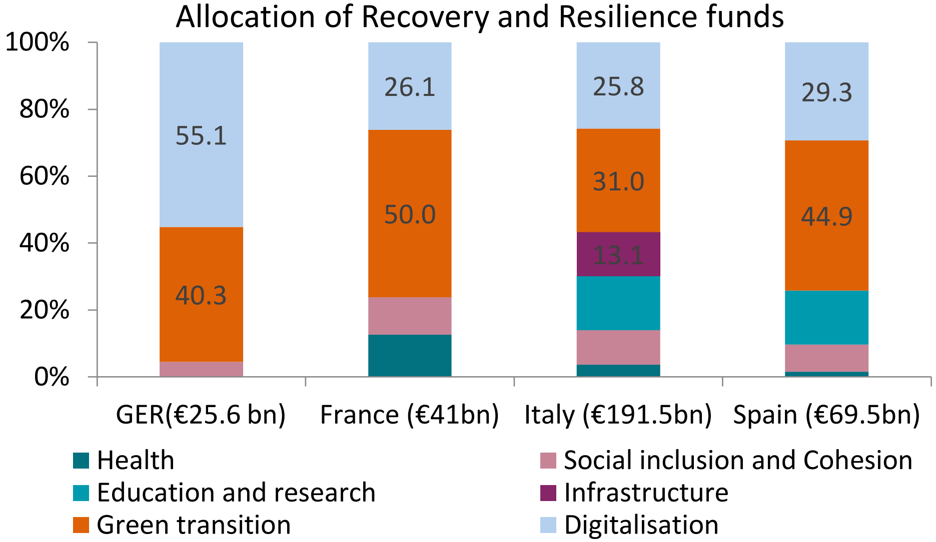
Officially matching the EC climate targets

- Drafts of national Recovery and Resilience plans show that spending on green transition is above 40% on average, while digitalisation accounts for at least 25% of the expenditure, meeting the EC target of 37% of spending on green and 20% on digital.

Details highlight different priorities for different countries

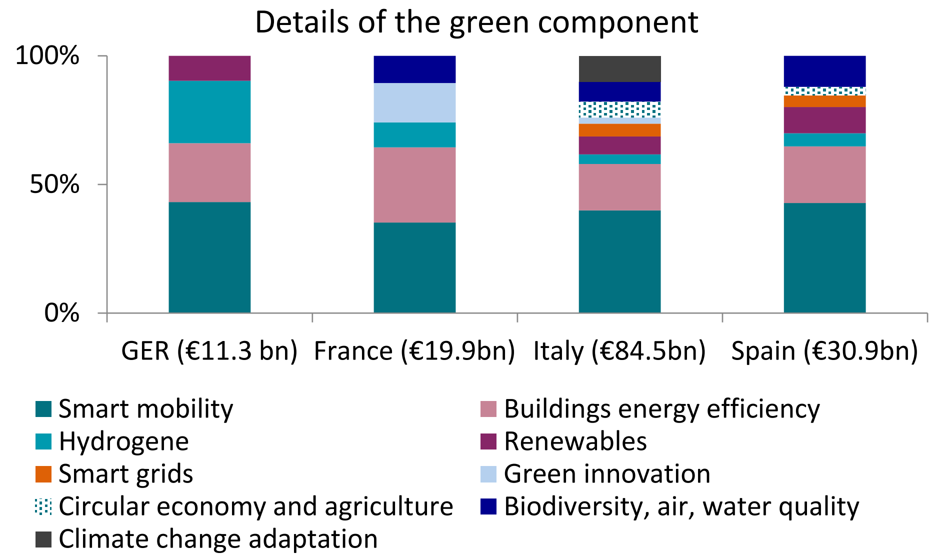
- In all the big 4, spending on smart mobility and buildings energy efficiency is leading. But details highlight different focus across countries: Germany on hydrogen, France putting strong emphasis on buildings renovation and Spain and Italy being more diversified.

Spending the Recovery and Resilience Facility resources…



Source: National RRP drafts, AXA IM Research, June 2021.

Smart mobility and buildings renovation lead in all countries



Source: National RRP drafts, AXA IM Research, June 2021

Macro outlook

Frictions

US

A transitory price shock

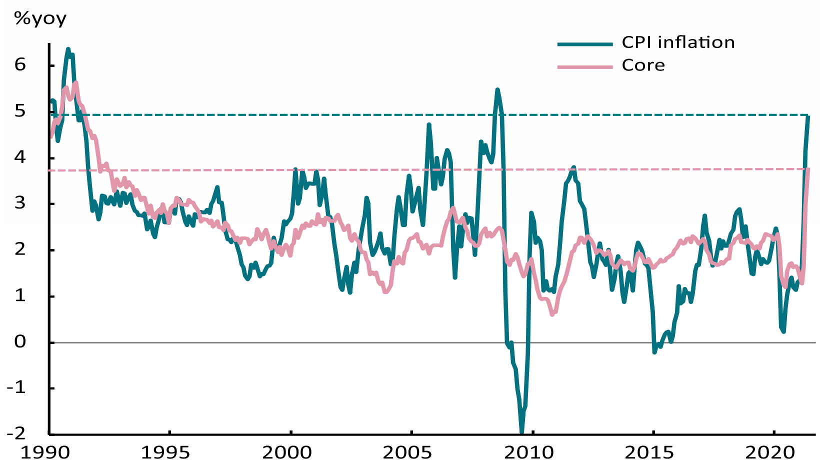
- CPI inflation reached 5.0% in May and core 3.8%, a 1992 high. Base effects, energy prices and bottlenecks appear to be driving this sharper than expected jump in prices, but should prove transitory. Already there are some signs of commodity price declines. Other factors will be more persistent, including the semiconductor shortage, which looks set into next year. Labour market tensions will be most closely watched, but we expect these tensions to ease over H2 2021.

Biden's spending aims

- The White House is struggling to make progress advancing proposed spending bills. Republicans don't want much of Biden's spending and reject most of his financing proposals – the Democrats are now working with a smaller moderate Republican group, but the chances of a bipartisan deal look slim. Reconciliation allows Democrats to secure easier passage of legislation, but internal squabbles are delaying this. In all tortuous negotiations look set to delay any agreement and scale-back its size.

CPI reaches likely peak in May but at multi-year high

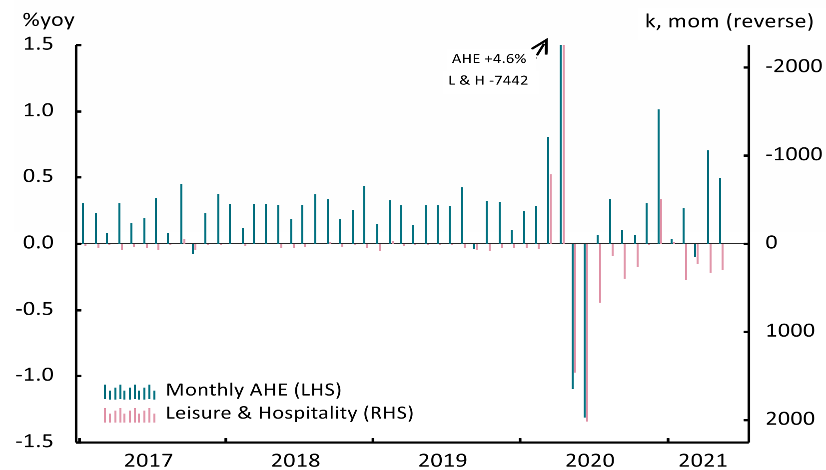
CPI inflation and core



Source: US BEA, AXA IM Research, May 2021

Earnings rise despite composition – illustrates labour market frictions

Composition effect in earnings



Source: BLS, AXA IM Research, May 2021

Fed tone turns more hawkish

US

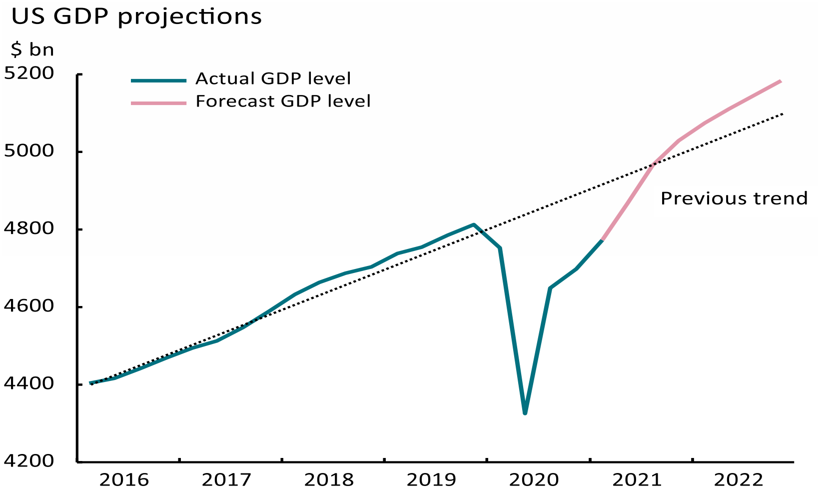
Growth set to fully recover

- The US growth outlook remains robust. We forecast annualized growth of around 8% in Q2 and Q3. We also forecast growth of 6.6% for 2021 as a whole and 4.5% for next year (consensus 6.5% and 4.1%). While less than UK growth for example, the US only posted a relatively modest 3.5% drop last year. Our growth outlook envisages the US closing its output gap this year and operating in 'excess demand' next. This is likely to underpin a more medium-term and persistent lift to prices.

Taper talk and rate hikes sooner

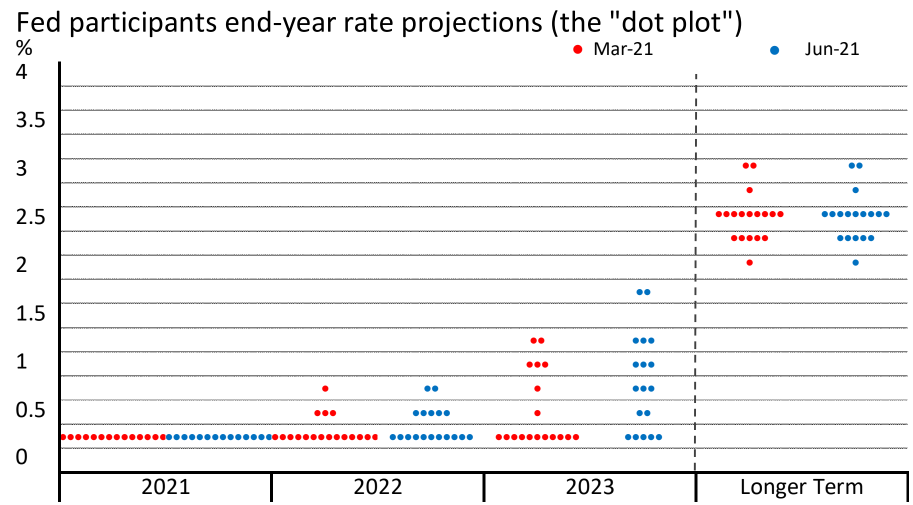
- June's FOMC marked a more hawkish tone. Fed Chair Powell stated the Committee had started "talking about talking about tapering" and suggested each meeting would now check progress towards the Fed's hurdle of "substantial further progress" before announcing a taper. We continue to expect this in December. FOMC participants also considered rate hikes likely sooner, the median view now for two hikes in 2023 (from none), but 7 members expected 2 hikes in 2022.

GDP on track to exceed former trend



Source: The White House, AXA IM Research, May 2021

June's FOMC meeting strikes a more hawkish note



Source: ISM,BEA, AXA IM Research, May 2021

Summer boost

Euro area

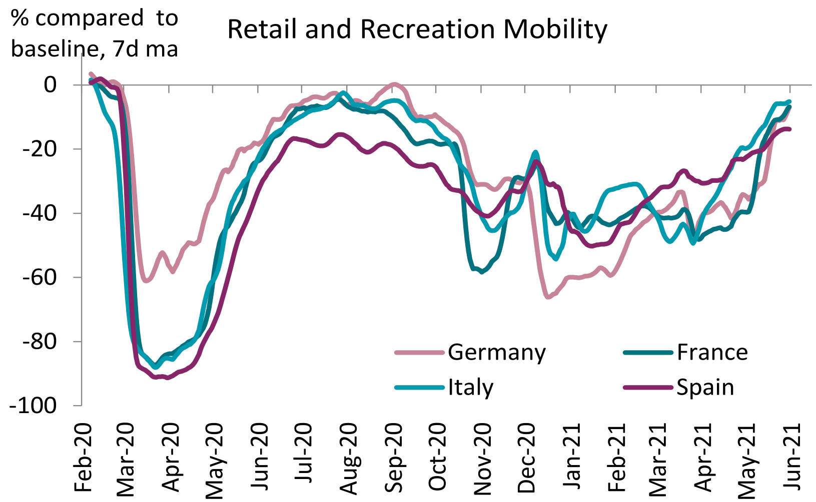
Upgrading our growth forecasts…

- The improving Covid-19 situation and accelerating pace of vaccinations have prompted a faster than expected reopening. Positive momentum can be seen through sharply recovering mobility, narrowing gaps to pre-covid levels as signalled by the OECD weekly trackers, and buoyant business and consumers confidence. This has led us to upgrade our 2021 euro area growth forecast to 4.4% yoy (from 3.8% yoy).

…But no sustained underlying pressure on the horizon

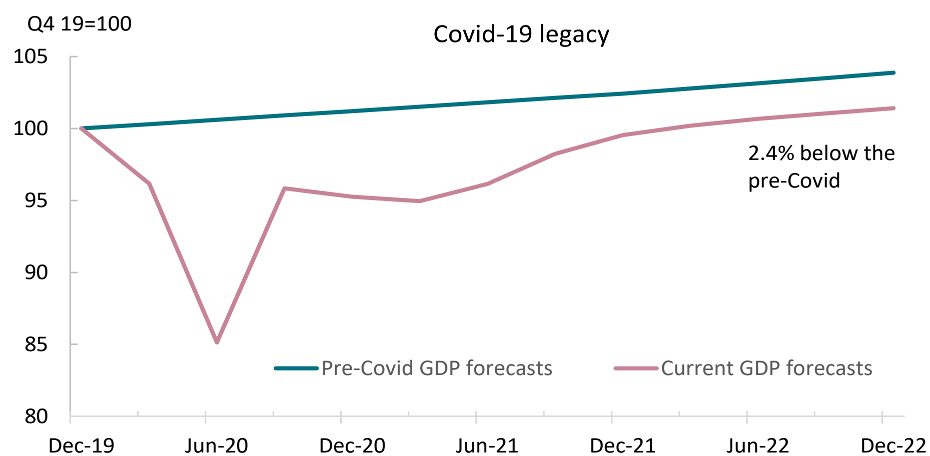
- EA headline inflation reached 2%yoy in May, we expect it to move above the ECB target in Q4 on German VAT cut base effect and seasonality distortions. But ingredients for sustained inflationary pressures are lacking: long-term inflation expectations remain well below the ECB target and wages negotiations point to lacklustre growth ahead. Two things might be worth watching though: minimum wage policies and potential changes to carbon prices with ETS revision and Carbon Border Mechanism Adjustment proposal.

Mobility – and spending- is back!



Source: Google Mobility, AXA IM Research, as of 20 June 2021.

Better growth but still a pre-pandemic gap



Source: Eurostat, AXA IM Research, as of 11 May 2021.

Autumn challenges

Euro area

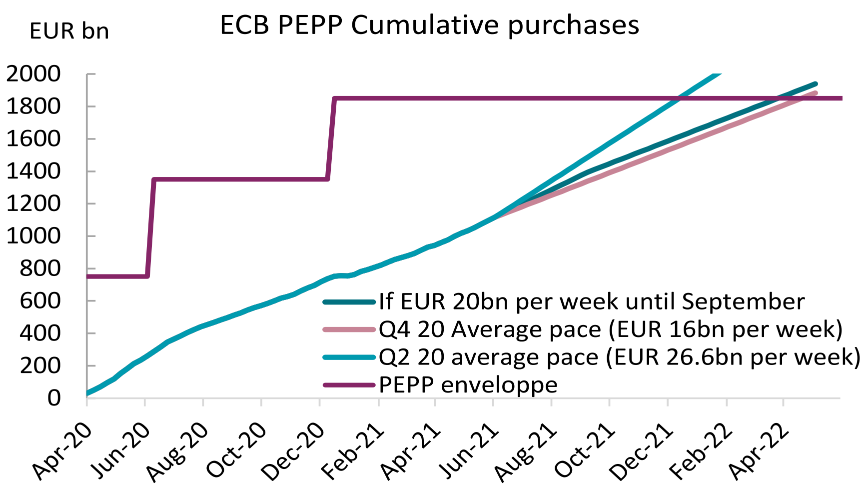
A patient ECB…

- At its June meeting, the ECB refrained from signalling a deceleration in the pace of PEPP purchases. From a risk management perspective it makes sense to wait and see before potentially altering the current course as it allows to a) watch the Fed developments, b) gauge the strength of the consumer rebound, c) check developments of the pandemic front (vaccination/ variants race still ongoing).

…Getting ready for Autumn challenges

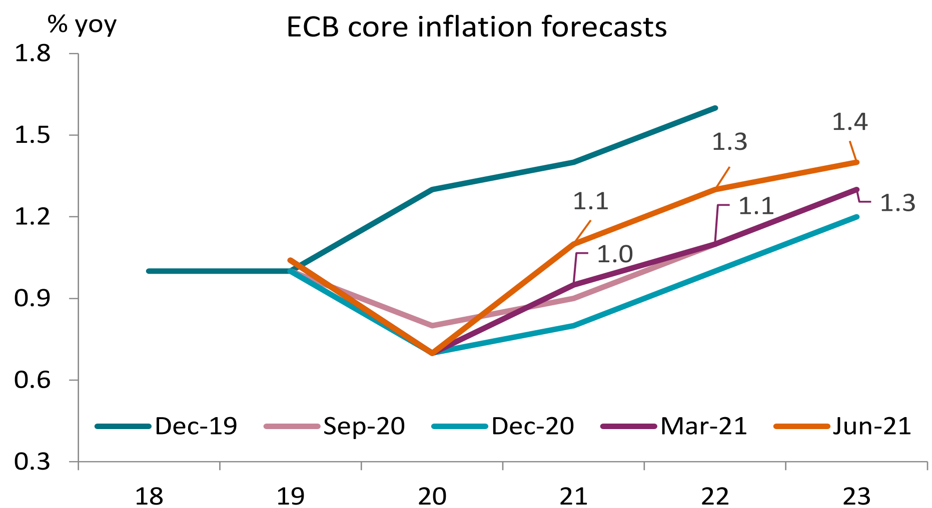
- Growth was upgraded by 0.6pp to 4.6/4.7% yoy in 21/22 but crucially 2023 core inflation was only lifted by 0.1pp to 1.4% yoy. Unless by the end of PEPP – probably in March 2022 – the ECB's inflation forecasts are back to where they were in December 2019, purchases under the APP would normally have to rise further, even when ignoring the additional "price level gap" accumulated since the beginning of the pandemic. Still discussions on the strategy review are unlikely to be easy, we expect the hawks to be noisy as economies rebound.

No need for a significant taper from here…



Source: ECB, AXA IM Research, as of 20 June 2021

… Still a lot of work ahead for the ECB



Source: ECB, AXA IM Research, as of 20 June 2021

AXA Investment Managers

Robust growth, but heightened uncertainty

UK

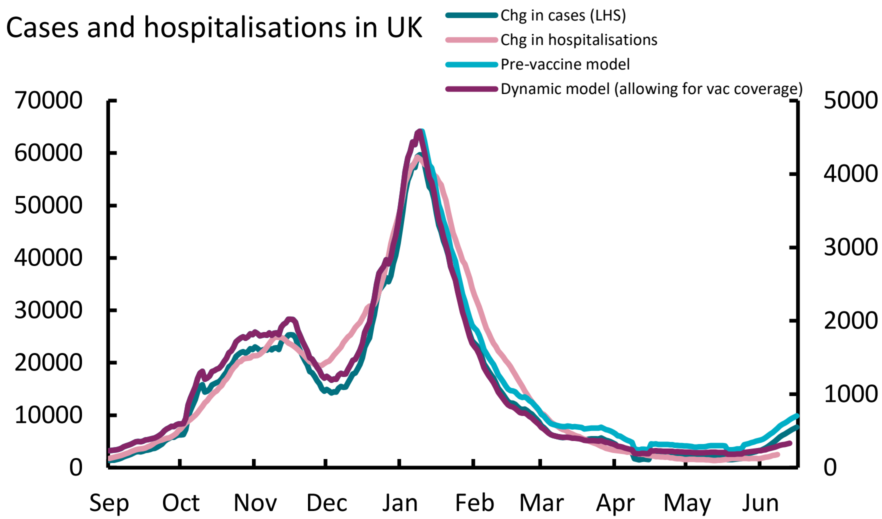
A high-vaccine, high-virus economy

- Virus numbers are rising in the UK again with the delta variant accounting for 96% of new cases. Yet, with the UK's high level of vaccinations, hospitalizations have not risen by as much. So far the government has only postponed the final lifting of restrictions until 19 July, suggesting virus cases will continue to rise. Without a marked rise in hospitalizations, lockdowns are likely to be avoided, but high cases could still dampen economic activity through requests to self-isolate and precautionary behaviour.

Growth to peak in Q2

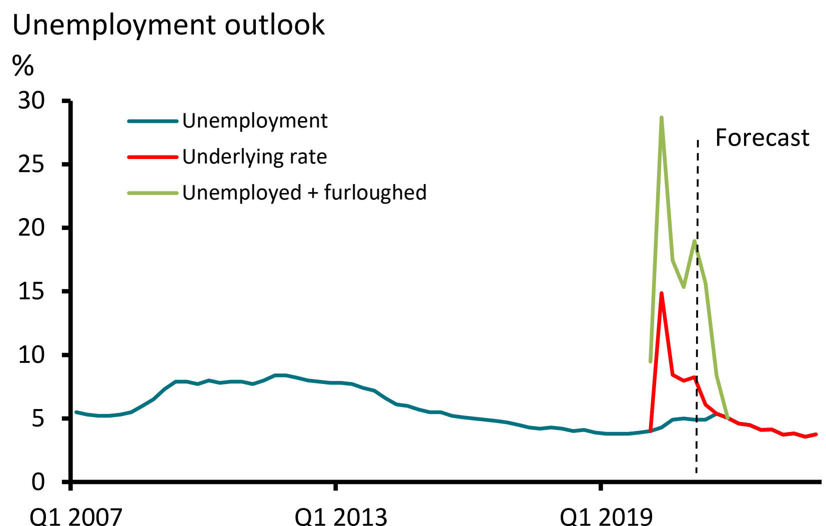
- A better-than-feared Q1 has given way to a strong re-opening bounce in March and April. We forecast 5% qoq in Q2. In H2 we expect growth to slow (although remain robust) at 2% and 1.5% in Q3 and Q4. Beyond virus concerns, we see some risks as the furlough scheme unwinds. However, a faster unwind of excess savings and strong growth in the housing market provide upside risks. We forecast GDP rising by 6.8% in 2021 and 5.8% in 2022 (consensus 6.4% and 5.5%)

Vaccines break link between virus cases and hospitalizations



Source: PHE, AXA IM Research, Jun 2021

Furlough scheme has masked labour market weakness, ends Q3



Source: National Statistics, AXA IM Research, Jun 2021

Inflation to fall below target next year, delaying tighter policy

UK

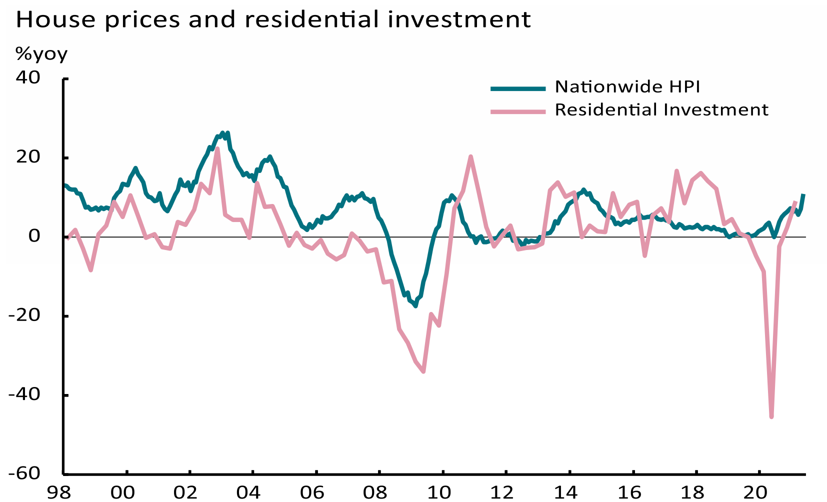
Transitory inflation to give way to below target inflation

- Inflation rose to 2.1% in May a 22-month high. As in other economies, base effects, energy prices and supply bottlenecks have lifted prices and, given the pattern of UK support, look set to push inflation to a peak in Q4 of close to 3%. Yet we forecast inflation to soften thereafter and close 2022 close to 1.5%, averaging 2.0% in 2020 and 2.1% in 2021 (consensus 1.6% and 2.0%). Price pressure thereafter will depend on spare capacity, in turn a function of supply-side damage done by the pandemic and Brexit.

Attention shifts to rate policy

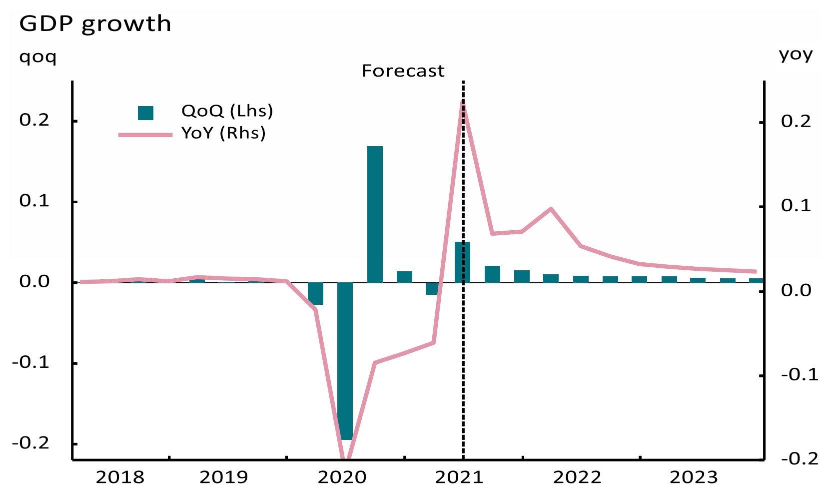
- The pace of BoE asset purchases was reduced in May, consistent with QE coming to an end this year – ahead of both the Fed and ECB. Market focus will thus turn to Bank Rate ,with expectations currently focused on a Q1 2023 hike. We forecast Bank Rate rising in Q3 2023, a little later than markets, in part reflecting a tightening in broader financial conditions (including international yields and sterling). However, if upside risks to GDP materialize, we would indeed consider rate hikes emerging sooner.

A strong housing market to support the economy



Source: Nationwide, National Statistics, AXA IM Research, Jun 2021

Growth surge expected in Q2, to normalise thereafter



Source: National Statistics, AXA IM Research, Jun 2021

Recovery loses some steam, but growth structure improves

China

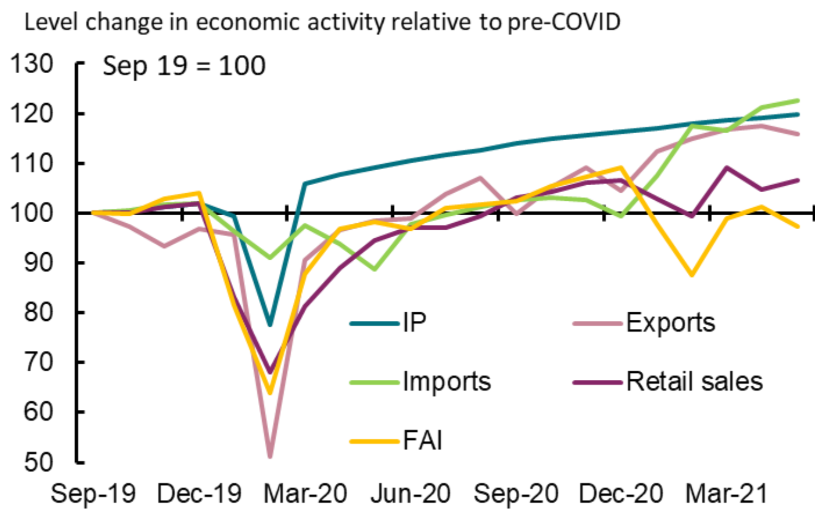
Industrial growth slows, driven in part by temporary factors

- Our calculation, after adjusted for base effects, shows that industrial production growth eased slightly to 6.6% in May. The softer headline print was consistent with moderating export demand and some supply disruptions in China's manufacturing center, Guangdong, which suffered a combination of power shortages and COVID-related restrictions. In addition, supply bottlenecks in semiconductors and production restrictions – related to decarbonization – led to lower auto and steel output growth last month, although high-end manufacturing production continued to power ahead, growing over 13%

A rotation of growth drivers with laggards catching up

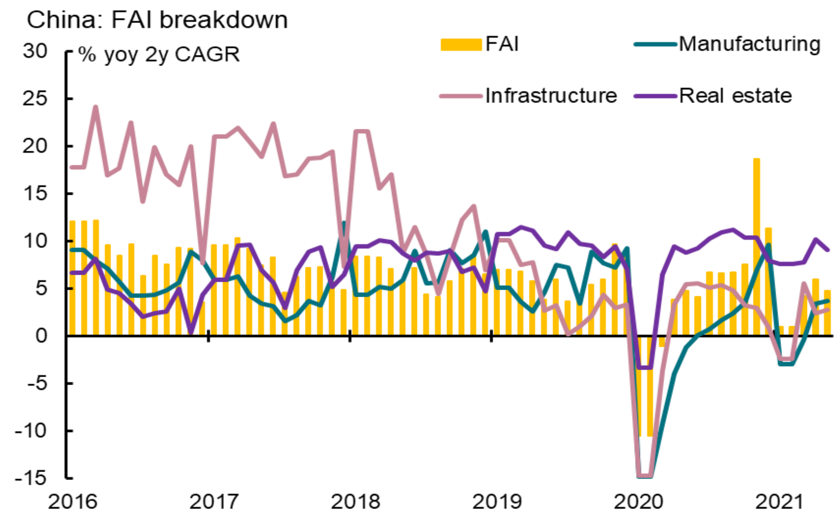
- Making up for the slower headline growth was an improved economic structure. Retail sales growth accelerated to 4.5%, with broad-based improvement across sub-components. On the investment side, headline growth ticked down in May, driven primarily by weak real estate activity. Manufacturing capex growth, in contrast, accelerated for the third month, as stretched production capacity encouraged firms to put their improved profits to use

Recovery continues but remains uneven



Source: CEIC, AXA IM Research, June 21

Investment growth moderates



Source: NBS, AXA IM Research, June 21

Fading growth impulse leads to policy rethinking

China

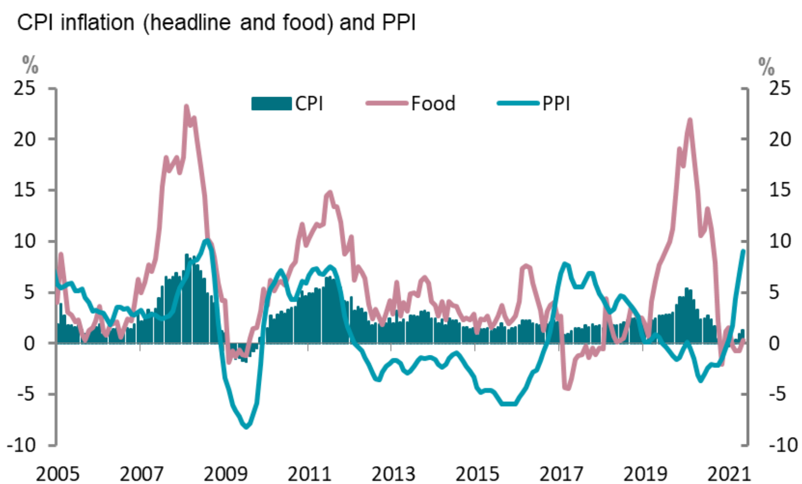
Growth momentum close to peaking

- Sequential growth is approaching a peak in the current quarter and should start to slow in the second half of the year. This, in part, reflects our view of weakening external demand for Chinese exports, as the global recovery shifts from trade of goods to services activity. Also contributing to this view is Beijing's policy normalisation, which has manifested in falling credit growth and tighter controls for the property market. The deteriorating credit impulse will likely weigh on the economy from Q3 onwards

Beijing to recalibrate policy operation

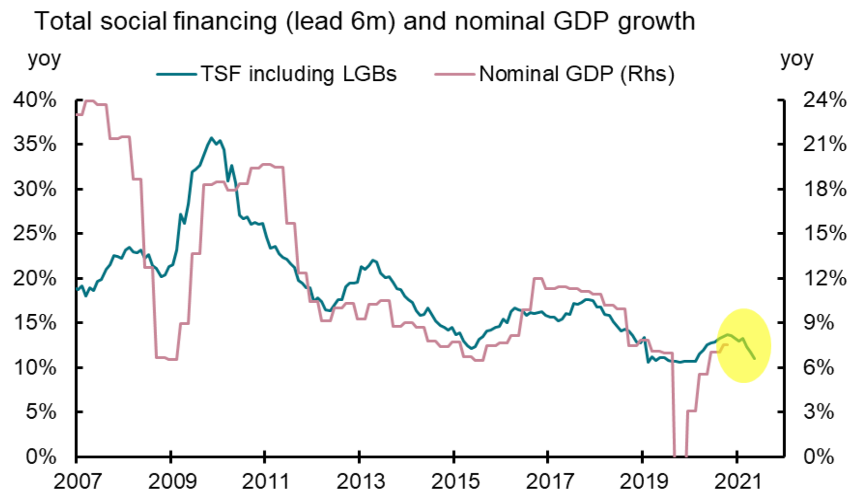
- The collective policy actions so far have helped to drive convergence between credit growth and nominal GDP growth. However, any additional tightening from here could be constituted as a "sharp turn" for policy in an economy that still operates on uneven ground. Unless inflation rises more sharply, which we see as unlikely, Beijing could start to feel uneasy by the speed of the credit growth slowdown. We wouldn't be surprised to see a recalibration of the current policy package, with some emphasis shifting back to preserving growth from risk management

Inflation is no hurdle for policy recalibration



Source: CEIC, AXA IM Research, June 21

Deteriorating credit impulse to weigh on growth in H2



Source: CEIC, AXA IM Research, June 21

AXA Investment Managers

The worse is probably behind us

Japan

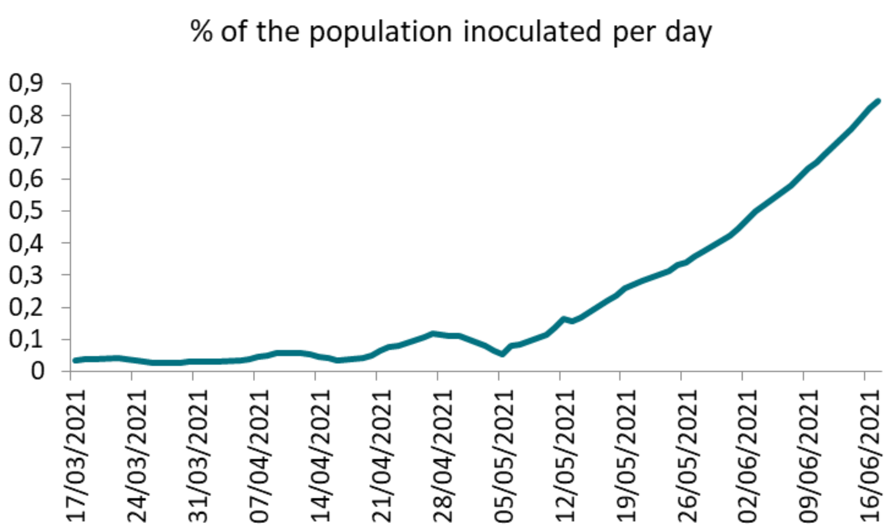
The government is likely to lift the last restrictions

- The state of emergency has been effective in reducing the number of new coronavirus cases and has provided some time to ramp up vaccinations. The former has accelerated substantially and currently stands at 800k inoculations per day.
- All over-64s should be vaccinated by the end of August and 70% of the population with two doses by the end of this year.

Economic data have been mixed but the outlook is brighter

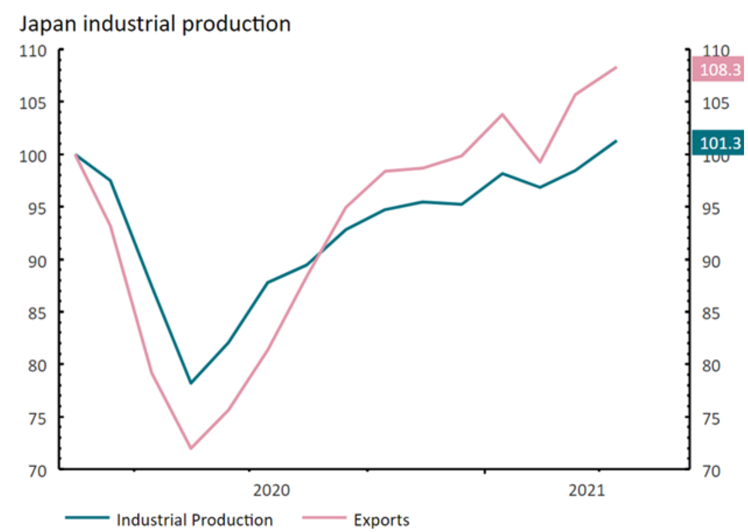
- Despite strong semiconductor shortages that impacted auto production, April's industrial production rose by 2.5% mom and returned to its pre-crisis level. May real exports confirmed a large decline for auto exports but remains well oriented as global demand is robust.
- Domestic demand has been less resilient. April retail sales fell (-4.5% mom) and the May Services PMI remained in contraction territory at 46.5, down from 49.5.
- But we expect a strong recovery in the coming months with GDP growth bouncing by approximately 2% qoq for both Q2 and Q3.

The pace of inoculation has drastically accelerated



Source: Our world in data, AXA IM Research, as of May 2nd

Industrial production came back to its pre crisis level



Source: Refinitiv Datastream and AXA IM Research Apr 21

Japan does not have the same kind of inflation debate

Japan

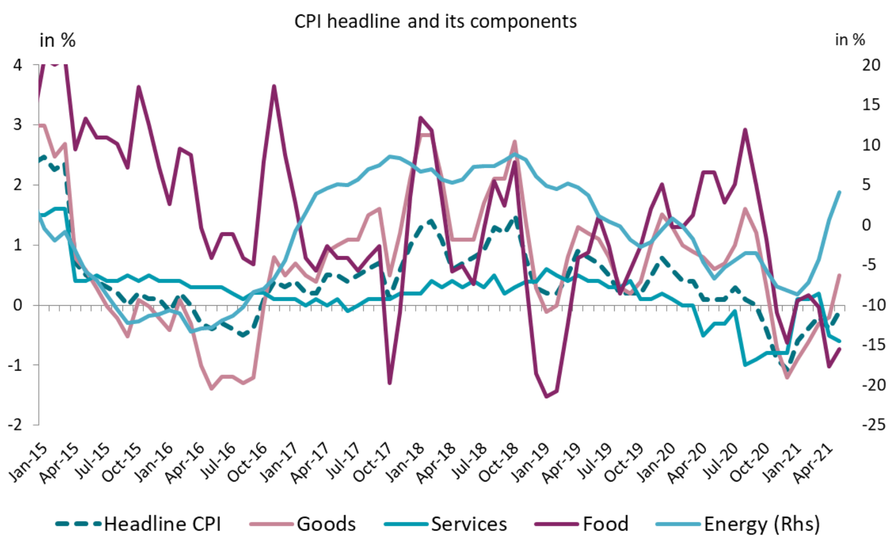
May headline CPI reached -0.1% yoy (up by 0.3pt)

- In detail, this was mostly due to a strong rise in energy prices (+4.1% yoy) as food prices fell (-0.9% yoy). Goods prices have been robust (+0.5% yoy) but services prices declined (-0.6% yoy) reflecting mobile phone charges.
- Those special factors (including the move to free education, the Go To Travel campaign) have recently complicated the reading of the underlying trend. We continue to forecast headline CPI to reach 0% on average in 2021 and gradually increase to 0.5% in 2022.

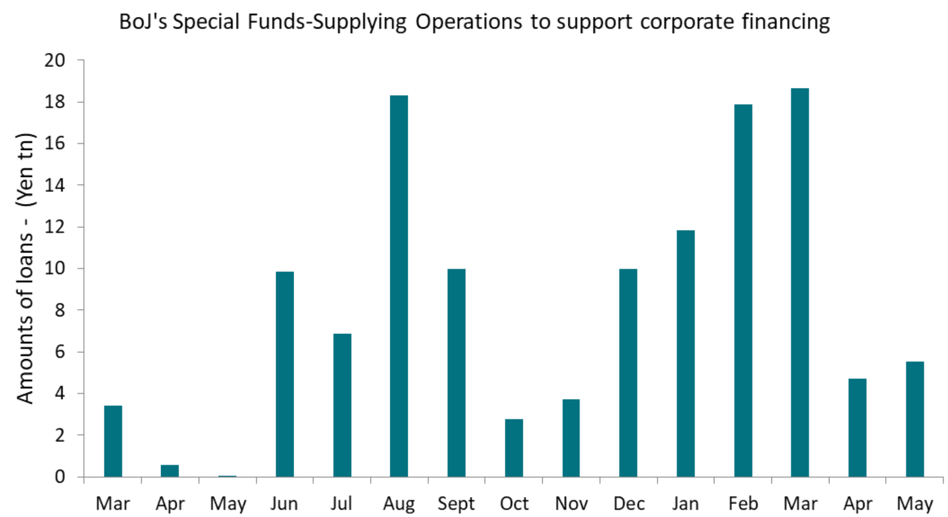
The Bank of Japan left its main monetary policy tools unchanged in June but …

- The Bank has extended the special program to support financing in response to COVID-19 by 6-months until the end of Mar 2022.
- More surprisingly, the BoJ has also announced a new financial support program to promote lending by private financial institutions to address climate change issues. The BoJ intends to release a draft of this new programme at the July meeting, but it is highly likely it will create a mechanism with cheaper funds for banks who participate actively in the climate transition.

Pressure on core prices remains muted



Last restrictions increased the take up in the Special Fund Supplying



Source: Bank of Japan, AXA IM Research, as of May

Economic recovery continues to take place, albeit gradually

Emerging Markets

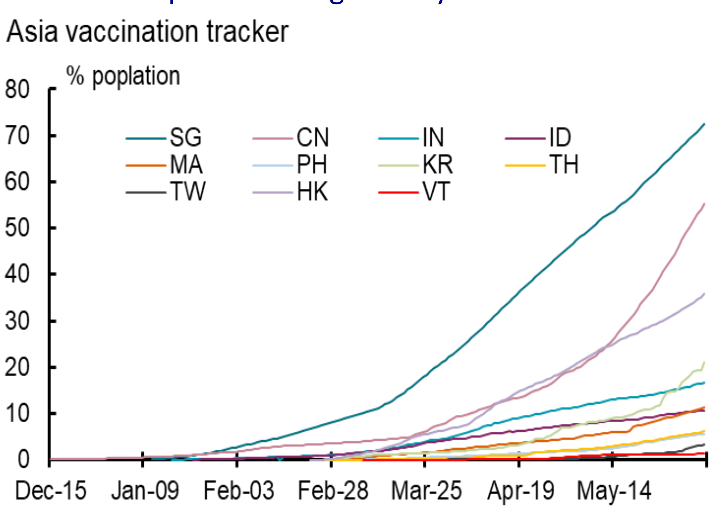
EM Asia suffers from virus revival

- Indonesia's daily count has spiked again. Thailand, Malaysia and Taiwan continue to struggle as well. While India's daily case counts have significantly dropped compared to the peak in May, the level still remains elevated. In addition to the struggle to contain the virus, some of the most populous countries in the region (e.g. India, Indonesia, and the Philippines) are also facing difficulties in speeding up vaccination. Within Asia, only Singapore, China, HK are expected to achieve collective immunity by end-2021. For the rest of the region, lack of both vaccine supply and forceful government actions suggest that challenges remain acute.

Despite the slow progress in fighting the virus, economic recovery has continued

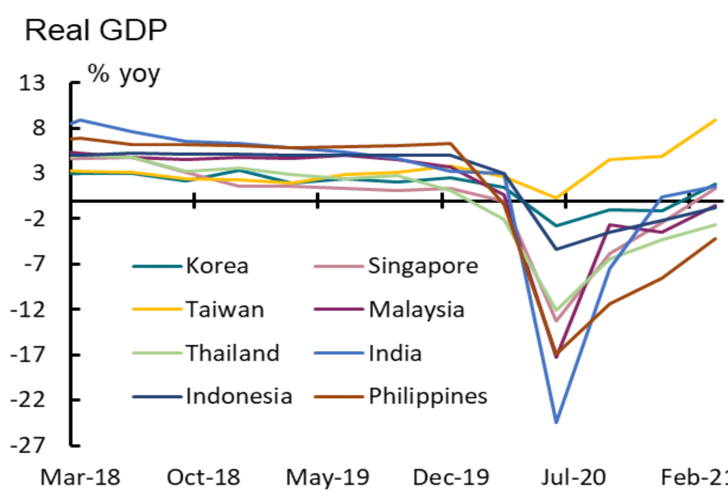
- First quarter growth figures in general improved for the region. Korea, Taiwan, Singapore and Hong Kong, Q1 growth accelerated on the back of strong exports. While the recovery in Indonesia, the Philippines and Thailand were less impressive due to lacklustre consumption growth. As for India, Q1 GDP came in stronger than consensus. The recovery was broad-based in manufacturing and construction as firms rushed to complete projects following last year's nationwide lockdown, and before the end of the fiscal year.

Vaccination pace moves gradually in EM Asia



Source: CEIC, AXA IM Research, June 2021

Economic growth recovery is taking place



Source: CEIC, AXA IM Research, June 2021

Despite the upward surprises in headline CPIs, central banks will remain on hold for now

Emerging Markets

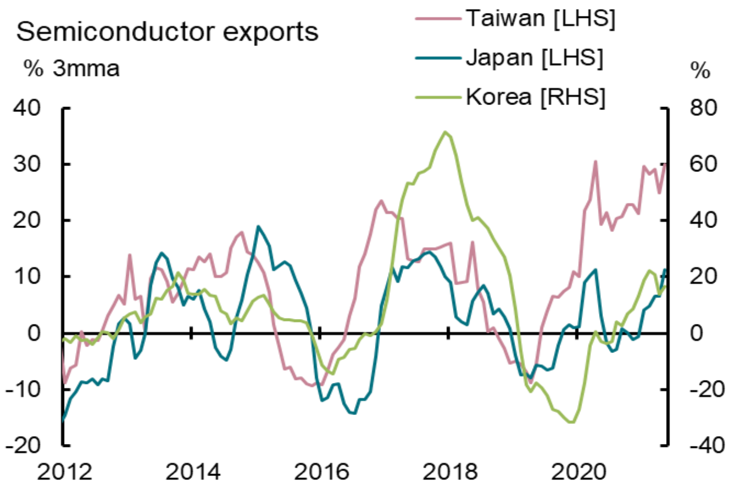
Still resilient exports momentum on solid tech-related exports

- Export model continues to show improvement in export performance of the region. In particular, Korea's May full month's export growth printed another strong reading. Apart from the solid tech exports, non-tech export growth also accelerated. By region, exports to China, US, EU, JP and ASEAN all gained momentum. We expect the positive trend in Asia export growth to continue, benefiting from the ongoing reopening of developed economies.

Recent factors driving inflationary pressure likely to be only transitory

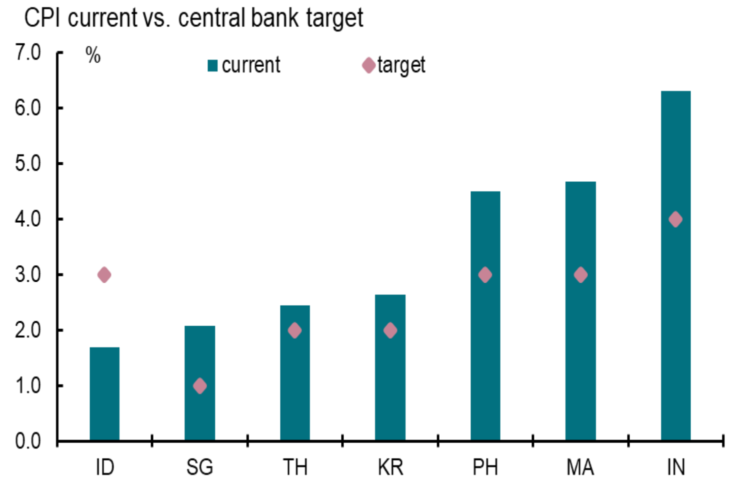
- Inflationary pressure has been rising in recent months. Korea's consumer inflation accelerated to a 9-year high and India's also rose sharply to 6.3% on the back of price increases in food and fuel. While base effects partially explained the rise, supply-side bottlenecks and higher prices in food and energy were also at play. The near-term trend is expected to remain in the upper range of the central banks' targets – limiting scope for additional stimulus. However, we believe these factors driving recent price upturns are likely to be transitory and should not pose too much of a concern for Asia.

Semiconductor exports remain resilient



Source: CEIC, AXA IM Research, June 2021

Upside risks in headline inflation figures



Source: CEI, AXA IM Research, June 2021

Investment Managers

AXA Investment Managers

Investment Strategy

Multi-Asset Investment views

Our key messages and convictions

Positive on equites

#1

Economic and earnings rebound remain on track whilst the liquidity backdrop remains supportive

Neutral on Investment Grade Credit

#2

Despite support from monetary and fiscal initiatives, valuations are no longer attractive due to tight spreads

Negative Sovereign Bonds

#3

Bond markets starting to price a policy shift by the Fed as fiscal stimulus takes hold although monetary arsenal remains supportive

Long Volatility

#4

Concerns over COVID-19 variants and Fed monetary policy transition generate higher volatility

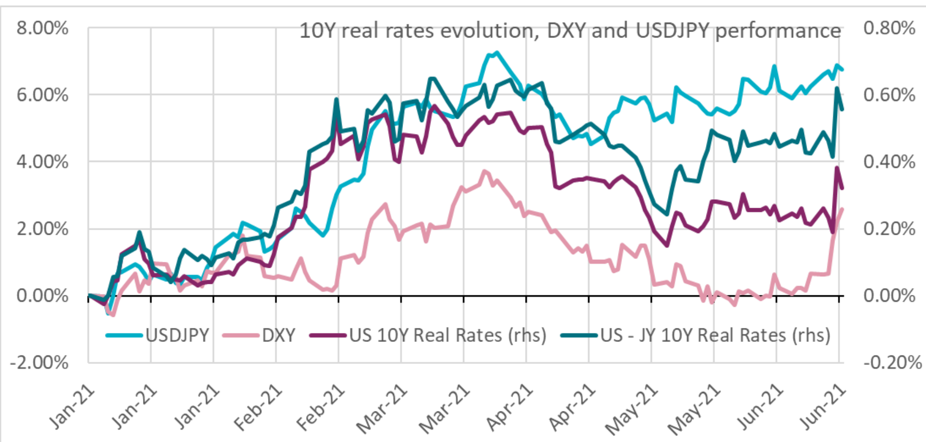
Source: AXA IM as at 23/06/2021

FX Strategy

The Fed comes out of dovish hibernation – other may follow

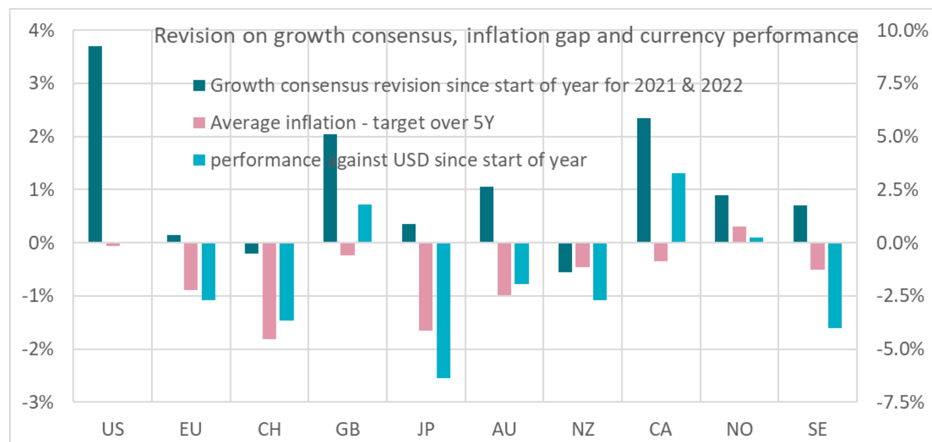
- The US Federal Reserve brought forward its own rate hike expectations and announced that it would start considering progress towards tapering. This has shifted policy expectations, pushing US real rates a little higher.
- JPY is a good candidate to short against the USD in this context although JPY valuation is already very low. Shorts in EUR or CHF may be even better as both ECB and SNB face large 'inflation gaps', which should keep them from turning more hawkish, even if the Fed has begun to do so. EUR and CHF are also less undervalued than other currencies.
- GBP and CAD have benefited from better growth prospects since the start of the year, while inflation has been in line with targets, which makes a hawkish shift by BoC and BoE plausible. AUD and SEK have lagged this year despite moderate inflation gaps and supportive growth forecasts.

JPY was already low prior to the recent rebound in US real rates



Source: Refinitiv and AXA IM Research, June 2021

RBA and Riksbank could follow BoC and BoE hawkish turn



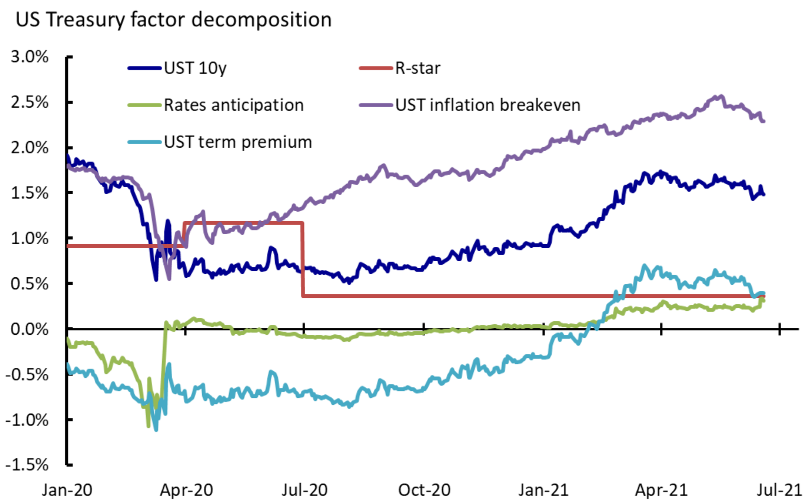
Source: Bloomberg and AXA IM Research, June 2021

Rates Strategy

US Treasury yield outlook remains the key call for global markets in 2021

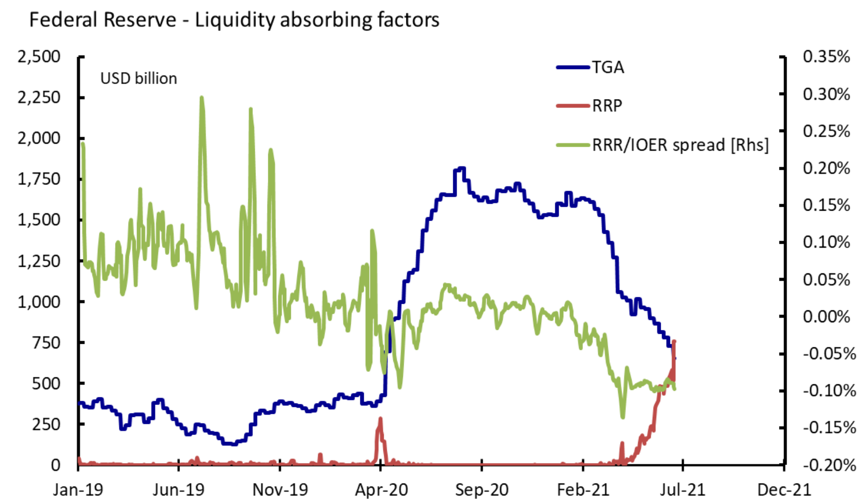
- After a challenging Q1 (-4.2%) the US Treasury market is on track to stage a better performance in Q2 (+1.3%). While some market participants and officials may have started a discussion about the near-term stance of US monetary policy, the FOMC remains reluctant to add to this debate and continues to "*monitor the implications of incoming information for the economic outlook*".
- Technical factors like the liquidity stemming from the drawdown of the Treasury General Account as well as the adverse carry and roll down in shorting UST yields, have contributed to the UST rally in Q2.
- Looking ahead, we believe the market is now fully internalizing technical factors into current valuations, which circles back to fundamentals and the key question of temporary inflation. Commodity markets are up notably year to date, while the Fed's narrative hasn't really drifted away from "*transitory*". Labour markets are also likely to contribute to the discussion about inflation risks.

US Treasury factors have stabilised in Q2



Source: Bloomberg and AXA IM Research, June 2021

Technical drivers behind the US Treasury rally



Source: Bloomberg and AXA IM Research, June 2021

Credit Strategy

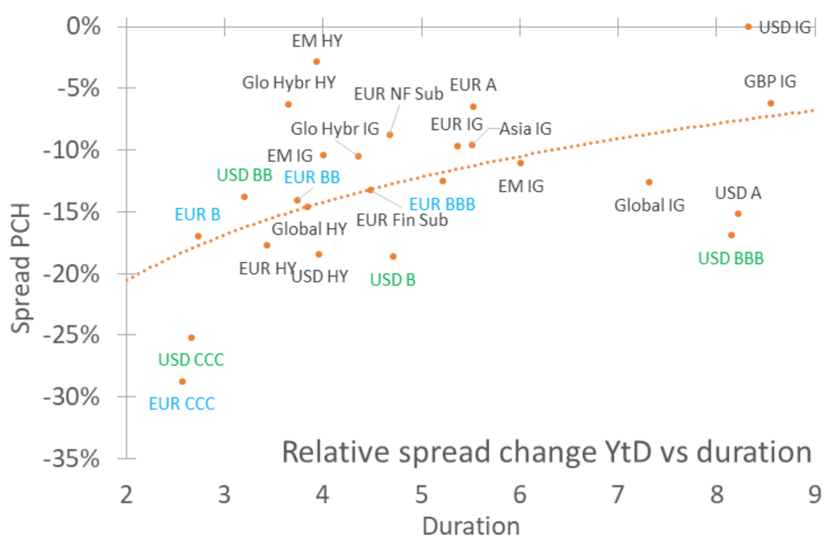
Credit markets have been as cool as a cucumber year to date and spread compression has been strong

- Credit markets continue to be unperturbed by exogenous factors, the most recent of which was the 16 June US Federal Reserve policy meeting. The immediate aftermath of the Fed saw US Treasury bond yields rise by 10bp and equity markets correct. By contrast, credit default swap indices in the US widened by less than 1bp in investment grade (CDX IG) and by less than 5bp in high yield (CDX HY).

- Credit seems to be taking the longer view about uncertainties in macro fundamentals and central bank policy. The ample liquidity that has suppressed interest rates has also driven investors down the credit quality curve, causing spread compression, i.e. higher beta outperforming lower beta spreads. This reflects investor caution regarding duration risk, as interest rates have rebounded from their Covid crisis lows.

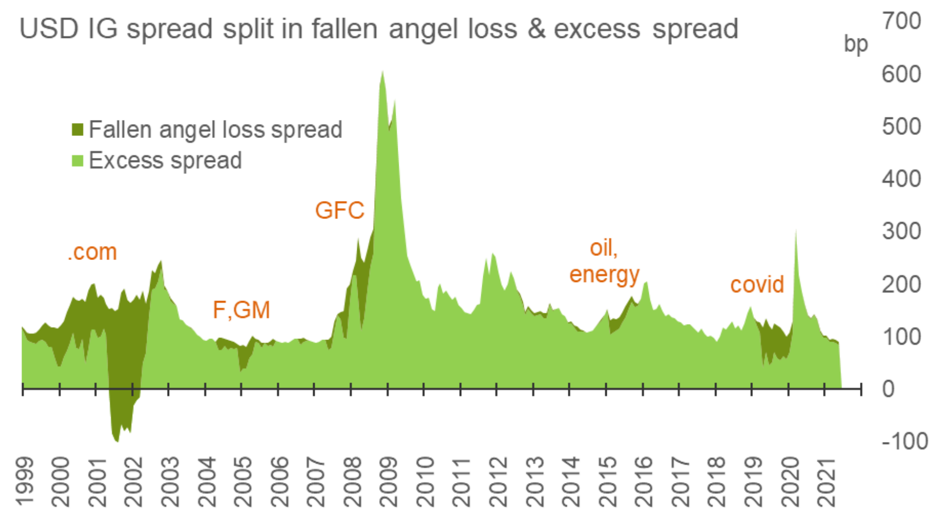
- The fallen angel cycle has indeed been the worst since the GFC and of material impact on IG portfolio performance. Passive investors who may had bought USD IG in the 12 months preceding the Mar 2020 Covid shock would have lost as much as 60% of the spread due to fallen angels. This emphasises the value of active investing with more defensive positioning on higher risk IG credits, e.g. higher levered BBB- rated credits.

Relative spread change this year has correlated inversely with duration



Source: ICE, Bloomberg and AXA IM Research, June 2021

Significant spread erosion due to fallen angel risk during Covid



Source: ICE, Bloomberg and AXA IM Research, June 2021

Equity strategy

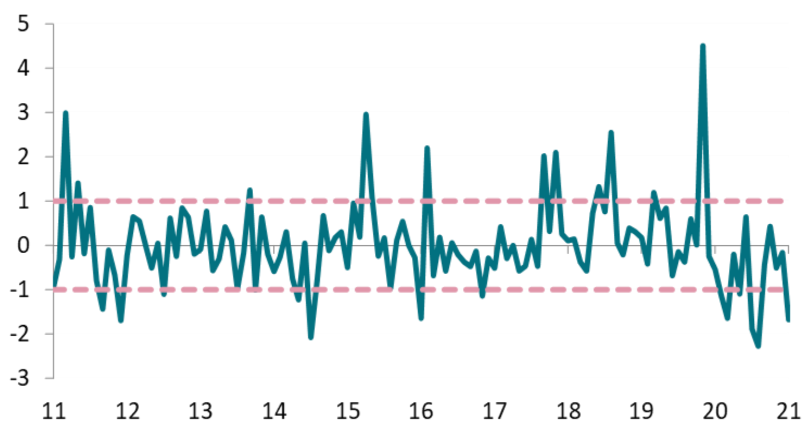
Stocks in the cruise phase after the post Covid take-off phase in 2020

- After the take-off post-Covid in 2020 when global equity market gained +67.5% equities are now in cruise phase with +12% ytd. In regions, EM Europe (+8.4%) and Switzerland (+8.0%) have recently outperformed on a regional basis. In sectors, energy continues to deliver stellar performance (+32.9% ytd) while materials show signs of weakness (-2.0% over a month). Declining inflation breakevens are turning rotation towards Growth (+5.0%) from Value (+0.5%).
- Even though US implied volatility is gradually stabilising at a lower level, averaging 17.3 in June, some risks persist, notably the difficulty of achieving herd immunity. This is resulting in a historically low realised volatility compared to implied volatility and a high term premium between 1-month and 3-month volatility contracts.
- We have investigated the levels of correlation as a function of breakeven and real rates regimes. Correlation tends to become less negative as both components rise. In the current regime (breakeven in 5th quintile and real rates in the 2nd quintile) the current level of equity-rates correlation (+24.6%) is high in historic terms.

The spread between realized and implied volatility is at historical low

US realized volatility versus implied volatility

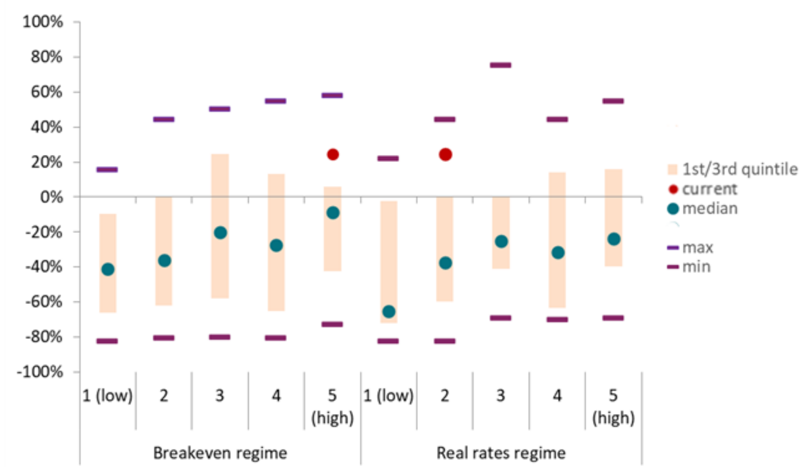
(z score)



Source: Bloomberg and AXA IM Research, June 2021

Upper real rates could drive equity/bonds correlation higher

Equity/Bonds correlation wrt B/E and real rates regimes



Source: Bloomberg, MSCI and AXA IM Research, June 2021, MSCI World/ US Treasury Bond index monthly return 12 months correlation

AXA Investment Managers

Asset allocation stance

Positioning across and within asset classes

Asset Allocation

Key asset classes

Equities			Positive
Bonds	Negative		
Commodities		Neutral	
Cash		Neutral	

Equities

Developed

Euro area			Positive
UK			Positive
Switzerland		Neutral	
US			Positive
Japan		Neutral	

Emerging & Equity Sectors

Emerging Markets		Neutral	
Europe Cyclical/Value			Positive
Euro Opening basket			Positive
Euro Financials			Positive
US Cyclical/Value		Neutral	
US Financials			Positive
Global semiconductors		Neutral	

Fixed Income

Govies

Euro core		Neutral	
Euro peripheral		Neutral	
UK		Neutral	
US	Negative		

Inflation Break-even

US		Neutral	
Euro		Neutral	

Credit

Euro IG		Neutral	
US IG		Neutral	
Euro HY		Neutral	
US HY		Neutral	

EM Debt

EM Bonds HC		Neutral	

Legend Negative | Neutral | Positive

Change ▲ Upgrade | ▼ Downgrade

Source: AXA IM as at 23/06/2021

Investment Managers

Forecasts & Calendar

Macro forecast summary

Forecasts

Real GDP growth (%)	2020	2021*		2022*	
		AXA IM	*Consensus*	AXA IM	*Consensus*
World	**-3.6**	**5.8**		**4.3**	
Advanced economies	**-5.3**	**5.4**		**4.2**	
US	**-3.4**	**6.6**	5.7	**4.5**	4.0
Euro area	**-6.8**	**4.4**	4.3	**3.7**	4.2
Germany	**-5.3**	**2.7**	3.4	**3.4**	3.8
France	**-8.3**	**5.9**	5.5	**3.1**	3.7
Italy	**-8.9**	**4.8**	4.2	**4.1**	4.0
Spain	**-11.0**	**5.2**	5.7	**5.0**	5.7
Japan	**-4.9**	**3.0**	2.8	**3.3**	2.3
UK	**-10.0**	**6.8**	4.6	**5.8**	5.8
Switzerland	**-3.0**	**3.6**	3.2	**3.3**	2.9
Emerging economies	**-2.5**	**6.0**		**4.4**	
Asia	**-1.1**	**7.4**		**5.1**	
China	**2.3**	**8.5**	8.4	**5.5**	5.4
South Korea	**-0.8**	**4.0**	3.5	**3.0**	3.1
Rest of EM Asia	**-5.3**	**6.5**		**4.7**	
LatAm	**-7.3**	**5.0**		**2.7**	
Brazil	**-4.1**	**4.7**	3.3	**2.5**	2.4
Mexico	**-8.5**	**5.4**	4.4	**2.3**	3.0
EM Europe	**-2.3**	**4.2**		**3.6**	
Russia	**-2.8**	**3.0**	2.9	**2.5**	2.6
Poland	**-2.7**	**4.1**	4.1	**4.6**	4.7
Turkey	**1.6**	**6.1**	5.1	**4.6**	3.9
Other EMs	**-3.7**	**3.3**		**4.1**	

Source: Datastream, IMF and AXA IM Macro Research – As of 23 June 2021

* Forecast

Expectations on inflation and central banks

Forecasts

Inflation Forecasts

CPI Inflation (%)	2020	2021*		2022*	
		AXA IM	*Consensus*	AXA IM	*Consensus*
Advanced economies	**0.8**	**2.3**		**1.7**	
US	**1.2**	**3.5**	2.4	**2.6**	2.2
Euro area	**0.3**	**1.7**	1.5	**1.5**	1.3
Japan	**0.0**	**0.0**	-0.1	**0.5**	0.5
UK	**0.9**	**2.0**	1.6	**2.1**	2.0
Switzerland	**-0.7**	**0.4**	0.3	**0.5**	0.5

Source: Datastream, IMF and AXA IM Macro Research – As of 23 June 2021

* Forecast

Central banks' policy: meeting dates and expected changes

Central bank policy
Meeting dates and expected changes (Rates in bp / QE in bn)

		Current	Q2-21	Q3-21	Q4-21	Q1-22
United States - Fed	Dates	0-0.25	27-28 Apr 15-16 Jun	27-28 Jul 21-22 Sep	2-3 Nov 14-15 Dec	25-26 Jan 15-16 Mar
	Rates		unch (0-0.25)	unch (0-0.25)	unch (0-0.25)	unch (0-0.25)
Euro area - ECB	Dates	-0.50	22 Apr 10 Jun	22 Jul 9 Sep	28 Oct 16 Dec	20 Jan 10 Mar
	Rates		unch (-0.50)	unch (-0.50)	unch (-0.50)	unch (-0.50)
Japan - BoJ	Dates	-0.10	26-27 Apr 17-18 Jun	15-16 Jul 21-22 Sep	27-28 Nov 16-17 Dec	TBC TBC
	Rates		unch (-0.10)	unch (-0.10)	unch (-0.10)	unch (-0.10)
UK - BoE	Dates	0.10	6 May 24 June	5 Aug 23 Sep	4 Nov 16 Dec	3 Feb 7 Mar
	Rates		unch (0.10)	unch (0.10)	unch (0.10)	unch (0.10)

Source: AXA IM Macro Research - As of 23 June 2021

Calendar of 2021 events

2021	Date	Event	Comments
June	24 Jun	BoE Meeting	Unchanged (0.1)
July	23 Jul	ECB Meeting	Unchanged (-0.5)
	27-28 Jul	FOMC Meeting	Unchanged (0-0.25)
August	23-28 Aug	Japan	Tokyo Olympics
September	9 Sep	ECB Meeting	Unchanged (-0.5)
	21 Sep	Germany	Federal Elections
	21-22 Sep	BoJ Meeting	Unchanged (-0.1)
	21-22 Sep	FOMC Meeting	Unchanged (0-0.25)
	23 Sep	BoE Meeting	Unchanged (0.1)
	30 Sep	Japan	End of term as LDP leader for PM Suga
October	21 Oct	Japan	House of Representatives term ends
	28 Oct	ECB Meeting	Unchanged (-0.5)
November	2-3 Nov	FOMC Meeting	Unchanged (0-0.25)
	4 Nov	BoE Meeting	Unchanged (0.1)
	1-12 Nov	UK/UN	Climate Conference
	27-28 Nov	BoJ Meeting	Unchanged (-0.1)
December	14-15 Dec	FOMC Meeting	Unchanged (0-0.25)
	16 Dec	ECB Meeting	Unchanged (-0.5)
	16 Dec	BoE Meeting	Unchanged (0.1)
	16-17 Dec	BoJ Meeting	Unchanged (-0.1)
January 2022	20 Jan	ECB Meeting	Unchanged (-0.5)
	25-26 Jan	FOMC Meting	Unchanged (0-0.25)
February 2022	3 Feb	BoE Meeting	Unchanged (0.1)
March 2022	7 Mar	BoE Meeting	Unchanged (0.1)
	10 Mar	ECB Meeting	Unchanged (-0.5)
	15-16 Mar	FOMC Meeting	Unchanged (0-0.25)
November 2022	8 Nov	US	Mid Term Elections

Latest publications

[Tourism: How Asia and other emerging markets could bounce back]

10 June 2021

[Central bank digital currencies, reserve currencies and geopolitics]

09 June 2021

[May Global Macro Monthly – The limitation of vaccinations]

21 May 2021

[Escaping COVID-19: Will vaccines be sufficient?]

19 May 2021

[Europe's path to net zero]

12 May 2021

[China: Financing the Green transformation]

29 April 2021

[The inflation outlook: What's changed?]

28 April 2021

[April Global Macro Monthly – Inflation to rise, but how fast and for how long?]

21 April 2021

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