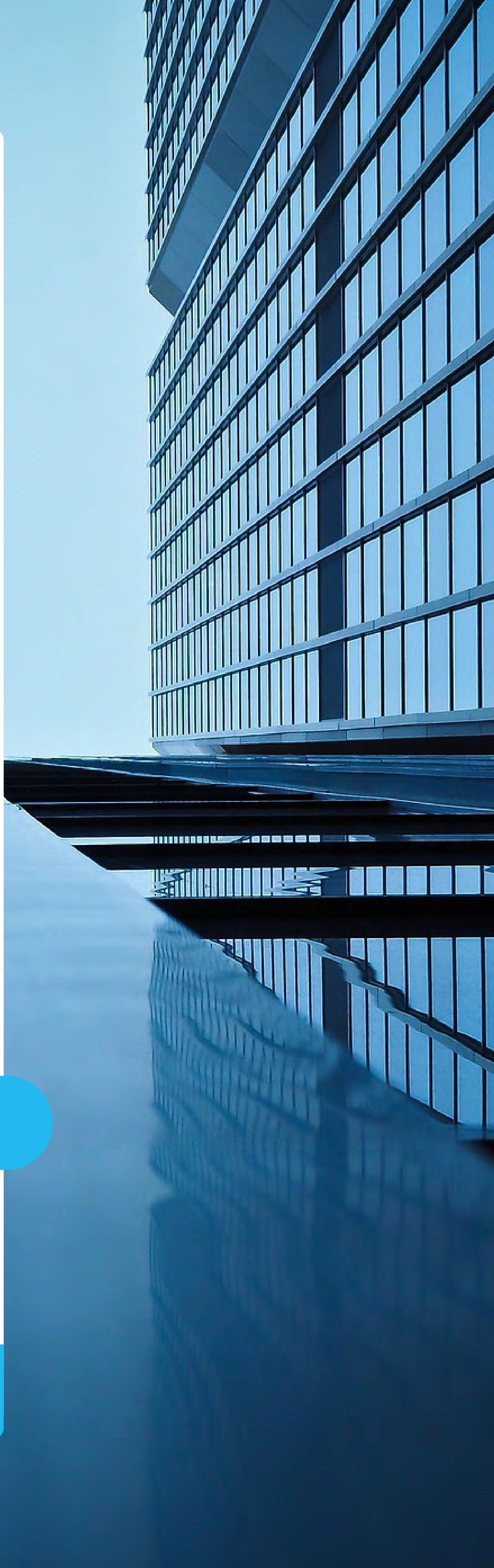
CANDRIAM
A NEW YORK LIFE INVESTMENTS COMPANY

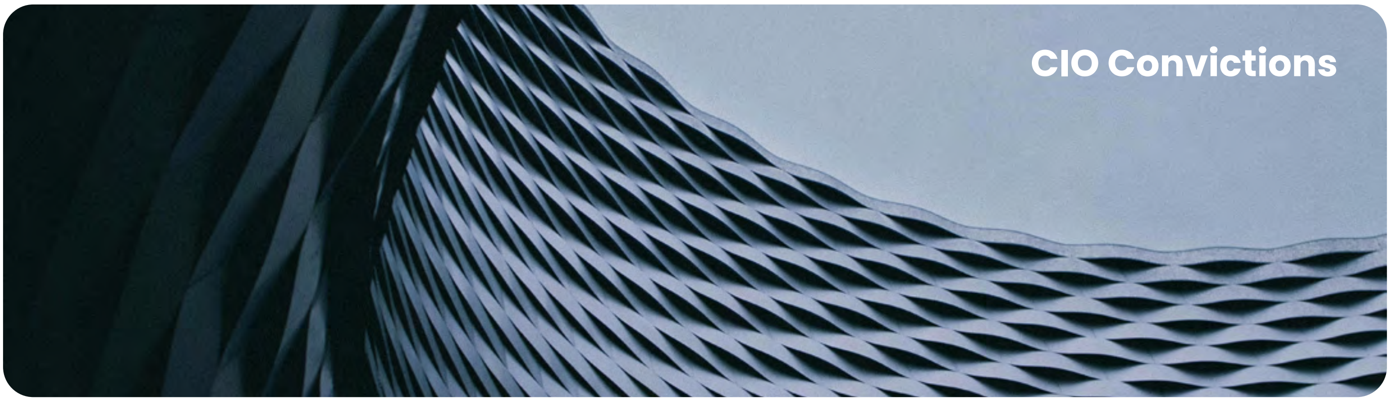
Half-yearly Investment Outlook



JULY 2024

Marketing communication

OUTLOOK



CIO Convictions

Watching the growing forest rather than the falling trees

Nicolas Forest
Chief Investment Officer

At the beginning of every January, the world eagerly awaits the *Global Risks Report* from the World Economic Forum[1] for its annual overview of risks as seen by 1,500 experts from around the world.

This year's 'risk winners include':

1) **Economic uncertainties**, exacerbated by inflation and the explosion in public debt,

2) **Climate change** and the increase in extreme weather events,

3) **Increased insecurity** and **misinformation** amplified by new technologies and AI,

4) The resurgence of **armed conflicts** while half the world's population is voting this year,

5) Worsening **inequalities** and the erosion of human rights.

Reading such a report, it's hard to remain serene, positive and constructive. So investors probably haven't read a single line: Stock market indices are at record highs, largely supported by US technology stocks. Volatility is falling. Credit spreads have tightened steadily since the beginning of the year, despite rising default rates. And interest rates, although affected by inflation, have shown no concern for budgetary slippage.

The attitude of investors -- who are of course well aware of the risks described in the report -- is therefore raising questions. Should we ignore such risks, or should we panic? Without being overly naive, shouldn't we be looking at the progress underway[2]? How about, instead of watching the trees fall, we listen to the forest grow?

> *"Although valuations appear stretched in the middle of the year, there are still opportunities for investors and signs of hope for citizens."*

How can we fail to be fascinated by the potential of artificial intelligence ? The performance of a number of US stocks illustrates not only investor appetite, but also the prospect of profound transformation in companies across all sectors -- IT, of course, but also healthcare, finance, media and industry. According to *IDC Worldwide*, the size of the AI market could double by 2026 while in the banking sector alone, spending is estimated to triple in the next few years. In this context, it is understandable that the valuation is not the most attractive. However, the technology sector remains a long-term conviction, and we don't see a valuation bubble today, as contrasted with the late 1990s .

In the face of climate change, however, it's hard not to worry. Each new year is the hottest on record, carbon emissions set a new record in 2023, and the probability of exceeding the 1.5 degree target set by the Paris Agreement is now close to 80 %. However, according to a recent NBER analysis, a global temperature rise of 1°C degree could impact world growth by almost 12% over the next 6 years, an economic impact six times greater than previously calculated. With these risks increasing and a relative investor fatigue regarding ESG, where can we find hope? Some good news worth mentioning: In 2023 we set a new record for electricity generated by renewable energies worldwide -- almost 30%[3]. The growth rate for solar-generated electricity is over 20%[4]. And according to the IEA, investment in renewable energies should triple in order to comply with the Paris Agreement. Investment should continue, and benefit from technologies that are now mature and more competitive than fossil fuels. Against this backdrop, the sharp depreciation in the value of 'climate' equities represents a long-term opportunity for investors.

The number of armed conflicts reached a record high in 2023. At a time when 50% of voters have or will have to vote in 2024, it again seems hard to find any sign of progress. However, he global trend towards a '*disimpoverishment*' of the world is clear. Extreme poverty continues to decline. At the same time, the reduction of gender inequality is making headway. According to the *Gender Equality* index, the gap between men and women continues to narrow, particularly in terms of access to education and healthcare. Life expectancy continues to rise, while the global aging of the population poses a major challenge to Western economies and a structural opportunity for investors in the healthcare sector -- a sector whose valuation is also relatively attractive.

Watching the growing forest rather than the falling trees. Despite pervasive political and geopolitical risk and structural challenges, financial markets have focused on future central bank rate cuts and the strong resilience of the economy. Although valuations appear stretched in the middle of the year, there are still opportunities for investors and signs of hope for citizens.

1 - https://www.weforum.org/publications/global-risks-report-2024/
2 - The return of war to Europe sounded the death knell for Francis Fukuyama's 1992 End of History. As influential as it was controversial, this theory established that the end of history would culminate in the triumph of the Western democracy model. With the return of empires and the coalition of the global South, Fukuyama's prediction seems lost, making it difficult to see any meaning or progress in recent contemporary history. Yet Fukuyama, a disciple of Hegel, asked the right question about the dialectics of history. For Hegel, history is a history of the whole, in which Reason is on the move. The dialectic allows for an overcoming - *Aufhebung* - that moves history towards its end. And even violence and struggle can be necessary steps towards the realization of the whole.
3 - Source: EMBER
4 - Source: IEA

Macro Outlook

Central banks remain cautious

Florence Pisani, PhD
Global Head of
Economic Research

Emile Gagna
Economist

At the start of summer 2024, growth continues, but its pace remains uneven across countries and regions. China is still facing deflationary pressures, the eurozone is making slow progress, while growth in the United States, still close to 2%[5], seems to be slowing a little. Wherever inflationary pressures have been felt, they have continued to abate over the months, paving the way for a cautious easing of monetary policy.

China : growth stalls...

Among the major economies, China is the only one where value-added prices are falling: beginning of 2024, while real GDP was growing by just over 5% year-on-year, nominal growth was barely above 4%, well below the 9% average observed over the second half of the 2010 decade[6]! The country is no longer able to absorb the enormous mass of savings it generates every year. This "savings glut" had, for a time at least, found its counterpart in a vast infrastructure investment program, largely financed by local authorities. The decline in their revenues, linked in particular to the fall in land sales, is now limiting their ability to finance an ever-increasing number of infrastructure projects. The government is now trying to "channel" excess savings into financing industries of the future (solar panels, batteries, electric vehicles, etc.). The limits of this strategy are likely to become apparent very quickly: as with the photovoltaic industry, and in the absence of sufficient domestic demand, China will be faced with overcapacity and will have to look abroad for an outlet for its production. However, it is likely to encounter strong resistance from its American and European partners. Europe's decision to increase taxes on electric vehicles if no agreement is reached echoes the increase in customs duties decided a few weeks earlier by the United States! Against this backdrop of trade tensions, it is futile to hope that monetary policy will come to the rescue. The current easing of mortgage rates has had little traction on household borrowing: despite mortgage rates having fallen by almost 200 basis points since mid-2022[7], real estate lending is still not responding. As long as households continue to have a high saving rate, and as long as the authorities do not rebalance growth in favor of consumption, and in particular do not make an effort to strengthen the social safety net, growth is likely to remain disappointing.

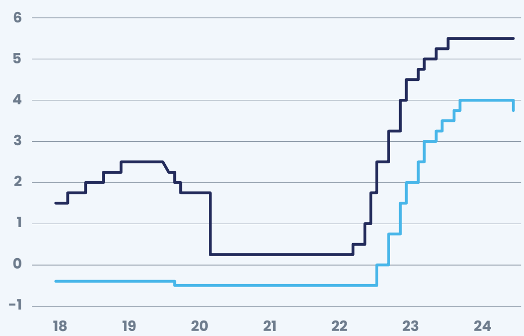
United States: Fed remains cautious...

In the United States, growth continued at the start of the year, underpinned by still solid consumption. The dynamism of job creation is no stranger to this situation: far from slowing down, job creation has risen, in monthly terms and smoothed over three months, from less than 200,000 in November 2023 to almost 250,000 in May 2024[8]. However, the arrival on the job market of an ever-increasing number of migrant workers has prevented the labor market from tightening up: for several months now, the unemployment rate has been gradually rising. The past tightening of financial conditions should now contribute to slowing growth. Interest rates on consumer credit are high, and credit card defaults have just risen significantly. Still elevated mortgage rates and rising house prices should also weigh on residential investment. As for the support provided by public spending and the implementation of the *Inflation Reduction Act*, this is gradually fading. Against this backdrop, growth is expected to slow from an average of 2.5 % in 2024 to 1.7 % in 2025[9].

Core inflation
% year on year

Source: LSEG Datastream

Policy rates
%



Source: LSEG Datastream

Nevertheless, the Federal Reserve has every reason to remain cautious: inflation in services, even though it eased in May, is still too high in relation to its target. If the easing in the labor market continues, the Federal Reserve should still be able to cut interest rates twice this year, with the first cut in September. Migration policy - J. Biden has just signed an executive order which, if implemented, would reduce the number of adults entering the U.S. illegally by 85,000 per month - and, more generally, the economic policy to be followed after the November 5 elections could, however, significantly alter the trajectories of growth and inflation in 2025 and, with them, that of monetary policy.

Eurozone: towards a sustainable rebound in activity?

After two years of high inflation and stagnant activity, the euro area economy is showing signs of improvement. GDP grew at an annual rate of 1.3% in the first quarter[10] and PMI surveys point to an ongoing recovery. The increase in household purchasing power should ultimately support consumption and thus the upturn in activity: after 0.6 % in 2023, growth should gradually accelerate to 0.8% in 2024 and slightly above 1% in 2025[11].

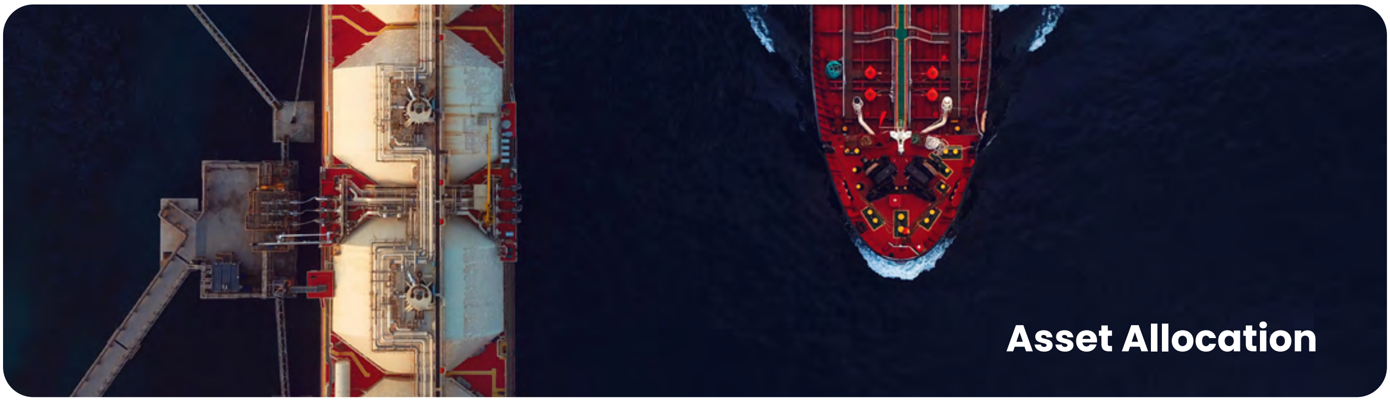
Composite PMI and GDP growth

Sources: Bloomberg, LSEG Datastream

"Wherever inflationary pressures have been felt, they have continued to abate over the months, paving the way for a cautious easing of monetary policy."

Above all, inflation fell sharply to 2.6% year-on-year in May[12]. With this improvement, the European Central Bank decided in early June to cut rates for the first time since... 2019! Indeed, the decrease in inflation is not due solely to the fall in energy prices. Core inflation (excluding energy and food) also fell significantly. This is particularly true of goods whose prices had risen sharply as a result of the severe disruption to supply chains in the wake of the pandemic. Their return to a more normal functioning put an end to this rise. Within services, progress has been more tentative. Certainly for those with a low labor content, inflation has returned to a pace almost in line with the ECB's expectations. But this is still not the case in services where labor represent a high proportion of production costs. For the disinflation process to continue as the central bank hopes, a slowdown in wages is now necessary... but not sufficient. Productivity gains, at a standstill since 2017, also need to recover. Over the next few quarters, the acceleration in activity should help, especially as companies have been hoarding labor since the pandemic. Beyond that, however, without a revival in productivity gains, the central bank may find it difficult to continue cutting rates. Like the Federal Reserve, the European Central Bank has every reason to remain cautious !

5 - Source: BEA
6 - Source: NBS
7 - Source: Bloomberg
8 - BLS, Candriam calculation
9 - Candriam estimates
10 - Source: Eurostat
11 - Candriam estimates
12 - Source: Eurostat



Asset Allocation

Winds of change

Nadège Dufossé
Global Head of Multi-Asset

The " soft landing " scenario is confirmed...

Our allocation strategy for the second half of the year is based on an economic environment that remains favorable for equities, and is improving for bonds.

We anticipate a slowdown in US activity, in line with a "soft landing" scenario (activity decelerating below 2 % annualized from the second half of 2024), a very gradual economic recovery in Europe, and still robust growth in Asia. Global economic growth is expected to be around 3.5%[13] annualized. At the same time, disinflation should continue, with core CPI around 3% at the end of the year in the United States[14]. This context is positive overall for equities and bonds.

... and is one of the best possible backdrops for action.

While investors' expectations of earnings growth over the next 12 months seem credible for the USA (around 10%), Europe (5%) and Japan (6%)[15], there is greater uncertainty for emerging countries : earnings per share growth is currently expected at 16%, after downward revisions in 2022 and 2023.

Following the strong performance of equities in the first half of the year, valuations remain reasonable overall : P/E for the next 12 months is below 14[16] in Europe, around 12 in emerging countries, and 15.5 in Japan, in line with 20-year historical averages. Only the United States has a P/E above its long-term average, above 20 - a high level linked to the growing weight of the technology sector and the " Megacaps[17]" . The free cash flow/sales ratio, which takes into account the substantial cash flow generated by these companies, nevertheless indicates valuations in line with the historical average of the last 30 years, and below the level of the TMT bubble of the early 2000[18] .

Equity valuations should also benefit from the start of the central bank rate-cutting cycle. Historically, the Fed's first rate cut is followed in 80% of cases by a positive performance by US markets[19].

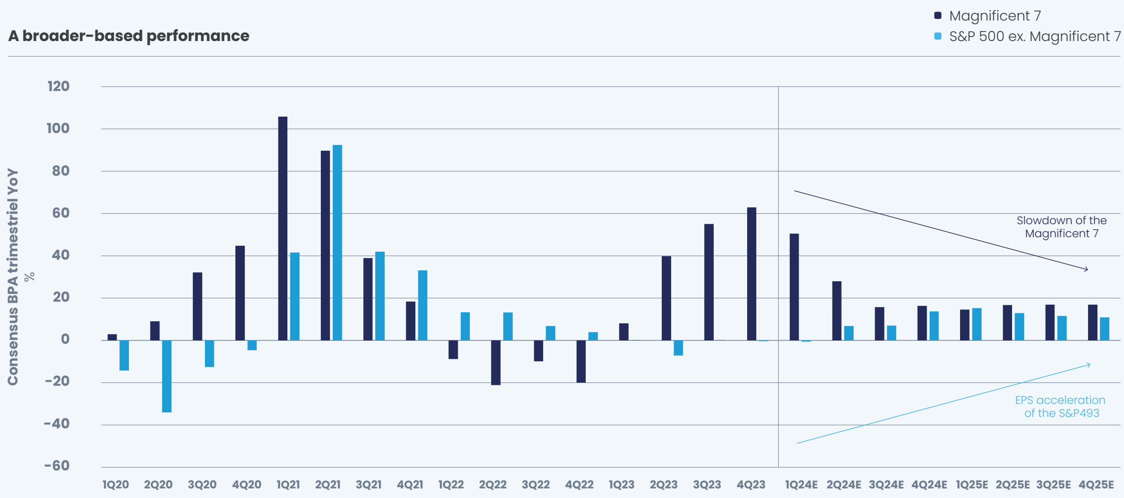
In addition, the start of the rate-cutting cycle by the major central banks should redirect investors' allocations towards longer-term assets. After eighteen months of inflows, money market funds are set to lose ground to longer-duration bonds and equities. Investors seem to be rebuilding a stronger exposure to equities after the shock of 2022.

Towards wider participation in the growth of profits ?

In the US market, we remain positive on the technology sector, which should continue to enjoy strong earnings and cash flow growth. After 4 quarters of dominance by the magnificent 7 (over 40% increase in earnings, largely driven by Nvidia[20]), the other 493 S&P500 companies are forecast to deliver positive earnings growth and close the gap with the Megacaps. In this hypothesis, the rise in financial markets would be healthier, as it would be driven by the positive performance of a greater number of stocks.

In Europe, we are increasing our exposure to small- and mid-cap companies in order to benefit from the gradual upturn in business. Indeed, these companies in Europe have underperformed the

A broader-based performance



Source: Candriam, LSEG Datastream

Past performance is not a reliable indicator of future performances. Markets could develop very differently in the future.

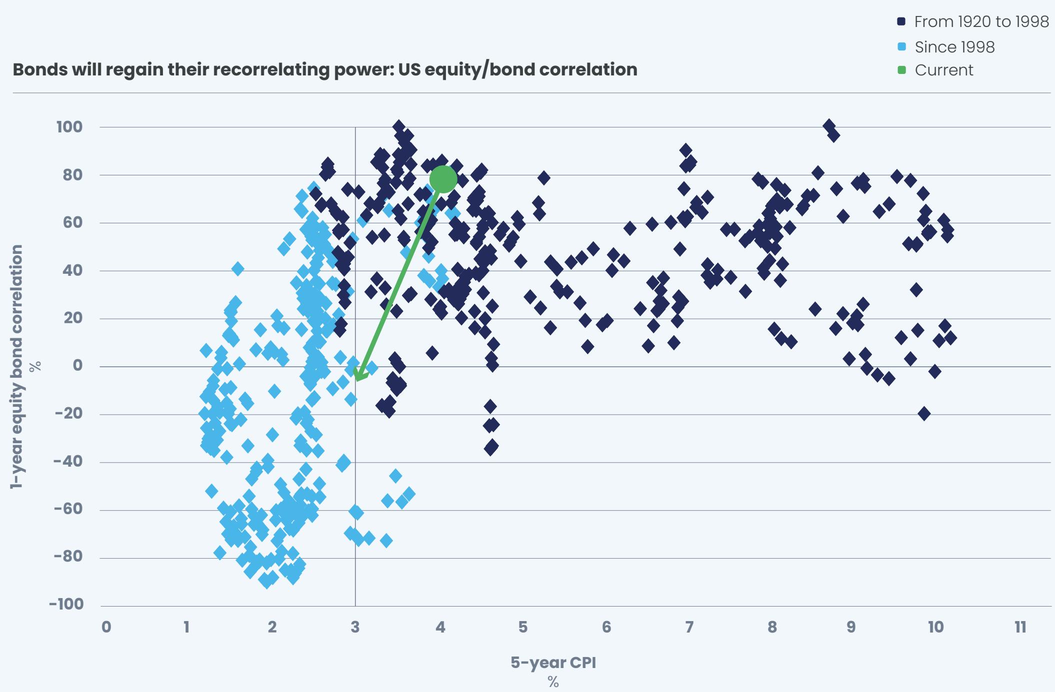
largest caps by 25% since 2022[21], and by almost 5% since the beginning of the year. The performance of small and mid-caps is strongly linked to the progress of leading economic indicators such as PMIs, and should be supported by an improvement in macroeconomic factors over the coming months, as well as by the first rate cuts by the European Central Bank. Over the past 40 years, small and mid-caps have outperformed by 8% in the 12 months following the first rate cut.

The best possible diversification between asset classes...

The positive correlation between equities and bonds in recent years has complicated the management of diversified portfolios, with the prices of both major asset classes moving in the same direction. Rate hikes led to declines in equity markets and bond prices, while any easing in long-term rates enabled equity and bond markets to post positive performances. Our quantitative analysis shows that this is historically the case when inflation exceeds 3%, which has been the case since the end of the Covid. Below this threshold of 3 %, the correlation between equities and bonds can drop and become negative again, allowing effective diversification between equities and bonds. In our economic forecasts, we expect to fall below this 3% level in the United States by 2025.

Our allocation is rounded out by exposure to gold, which has outperformed our expectations since the beginning of the year, thanks to strong demand from certain central banks (notably China). We believe that over the next few months, the macroeconomic context should become more favourable once again (possible fall in US real interest rates), while central bank demand for gold should remain strong over the medium term.

Bonds will regain their recorrelating power: US equity/bond correlation



Source: Bloomberg, Candriam

The presented scenarios are an estimate based on past and/or current market conditions and are not an accurate indicator.

...should make the gradual increase in duration more efficient

In addition to a long exposure to equities, we are therefore adding a progressively longer duration exposure to bonds. Our economic forecasts show that, with a " soft landing " in the United States and relatively weak economic growth in Europe, an easing of long rates is possible. In this way, we benefit from both an attractive carry and a cushioning effect in the event of a downturn in equities.

We will be more selective in both government bonds and credit. After the sharp tightening of spreads in the first half of the year[22], the risk/return profile of certain bonds seems less attractive to us. At current spread levels, US high yield bonds implicitly assume a default rate close to 0.

The risks identified for the second half of the year are primarily political in nature.

The French parliamentary elections are an unexpected first step that could lead to further political instability in France. Their triggering had a direct impact on the spread of French debt, which, at a level close to 80 bp (compared with German rates), quickly incorporated part of this risk. French and European equities were also penalized, especially certain companies and sectors such as French banks and utilities. The challenge for our overall asset allocation will be to understand, after the elections, to what extent this instability may accentuate the rise in risk premiums (on French debt, on certain equities) and possibly alter our fundamental vision. Pending the results, we have partially reduced our allocation to European equities and cut our exposure to French debt. Nevertheless, we believe that the risks of contagion to other European countries are limited, and that the ECB has the means to limit these effects if necessary.

In the United States, the presidential election will also be a key milestone for the financial markets. Historically, equity markets move sideways in the three months preceding the presidential election, with increased volatility. One of the most unfavorable outcomes of the election would be the 100% implementation of Donald Trump's inflationary and growth-destroying program. In this scenario, with the risk of " stagflation ", exposure to the US dollar and certain commodities such as gold could limit the portfolio's downside risk. In the event of a more nuanced and reasonable outcome, financial markets should return to fundamentals, which we consider to be rather good for equities and bonds.

In any case, and despite this generally positive environment, the second half of 2024 is likely to continue to be fraught with uncertainty for investors, a source of volatility often favorable to dynamic, active portfolio management.

13 - Source: Candriam estimate
14 - Source: Candriam
15 - Source: Ibes Datastream, MSCI indices, June 2024
16 - Source: Ibes Datastream, MSCI indices, June 2024
17 - The weight of technology stocks and " megacaps " has risen from 20% of the index in 2004 to 42% today (S&P500).
18 - The S&P500 as a whole has seen its Free Cash Flow/Sales ratio double from 6% to 12% between 2004 and today (source: UBS). In the early 2000s, the P/FCF was between 30 and 40, whereas it is now 25.
19 - Source: Candriam
20 - Source: Candriam, LSEG Datastream
21 - Source: Bloomberg
22 - Source: Bloomberg – ICE Bof1 – Spread reduction YTD: -46 bps Euro/HY / -18 bps Euro IG, 27/06/2024

€145 B

AUM at end December 2023*

+600

Experienced and committed professionals

+ 25 years

Leading the way in sustainable investing

*As of 31/12/2022, Candriam changed the Assets Under Management (AUM) calculation methodology, and AUM now includes certain assets, such as non-discretionary AUM, external fund selection, overlay services, including ESG screening services, [advisory consulting] services, white labeling services, and model portfolio delivery services that do not qualify as Regulatory Assets Under Management, as defined in the SEC's Form ADV. AUM is reported in USD. AUM not denominated in USD is converted at the spot rate as of 31/12/2023.