Three Investment Themes for the New Globalisation Age

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Itinerari Previdenziali end year Congress

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Theme #1: Unravelling ChinAmerica

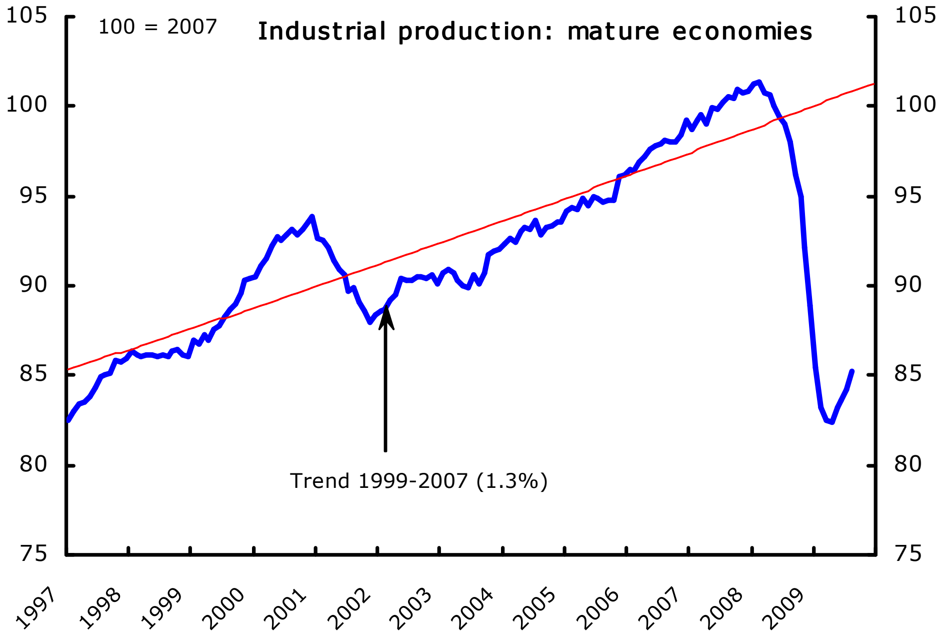
Theme #2: War time debts in peace time

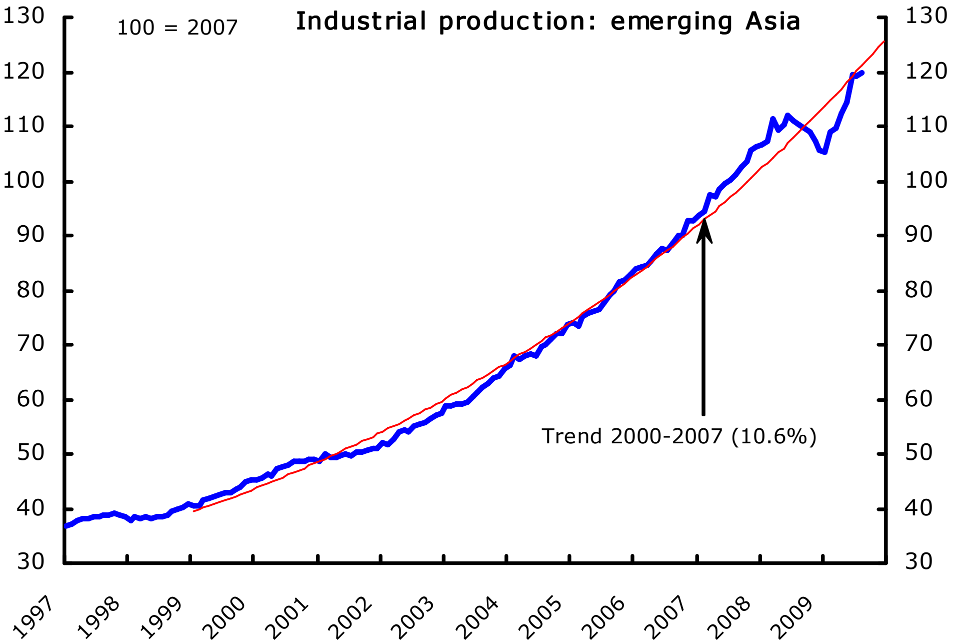
Theme #3: Play the carbon war

The second age of globalisation is beginning

- The liquidity crisis ended in March. The 'real' recovery started in April-May
- There are two different tales in this recovery

Global Industrial Production





Tip for investors:

There is already a winner in this crisis: China

The 'Great Recession' will leave deep scars in Europe, the US and Japan

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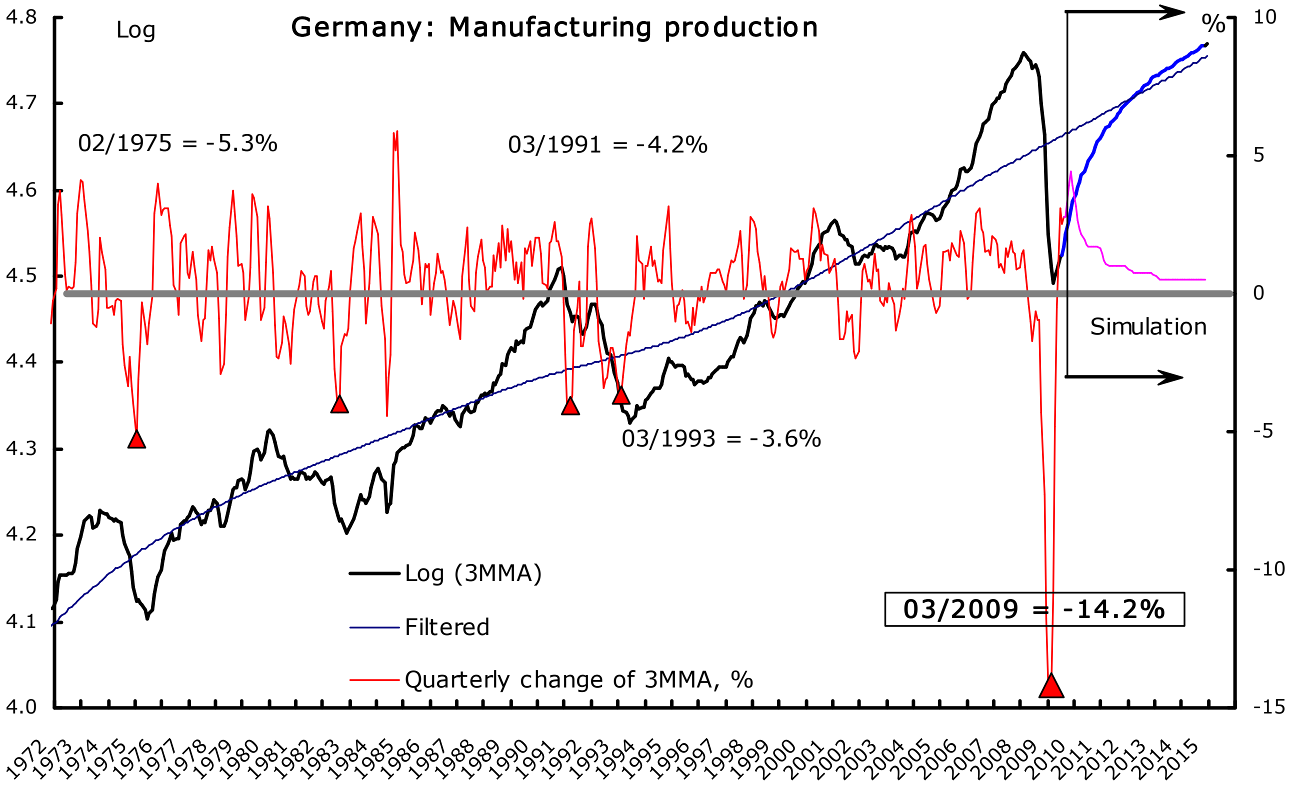
Even with a V-shaped recovery, it may take up to 5Y to catch up with 2008 production levels



German manufacturing production simulation:

- Catch-up with 2008 peak not before 2015
- Catch-up with trend not before 2012

Tip for equity investors:

Favor companies able to cut costs / innovate in the long term

Long term theme #1: Unravelling ChinAmerica

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- Previous globalized cycle: US consumers ‘consumer of last resort’; Chinese export-based strategy very successful; but *ChinAmerica* was funded by excessive credit leverage, which caused global overheating.

- Next cycle will be different:

- ► US personal savings rate to rise to 10% or more
  ► Higher government spending on healthcare/ infrastructures/ energy
  ► Weak dollar, come back of US manufacturers in export markets
  ► Chinese government to spend 20% of GDP on social safety net
  ► Share of consumption and services in Chinese GDP to rise
  ► Smaller global imbalances; slower global growth (3.5%, not 4.5%)
  ► Renminbi floated before 2020

Long term theme #2:
A new risky asset class: sovereign bonds

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- Previous cycle: with few exceptions, sovereign credit risks were concentrated in imbalanced and poorly managed emerging economies

- Next cycle will be different:

- ► OECD countries government debt to rise above 100% of GDP
  ► Largest rises in US & UK: debt transfer from households to gov't
  ► In €-area, German constitution substituted to Stability Pact
  ► Sustained fiscal divergences within €-area won't be sustainable
  ► Wider spreads here to stay; markets much less permissive
  ► IG corporate and sovereign credit: frontier blurred
  ► Fear of inflation as a solution makes inflation proof bonds attractive
  ► Risk of moderate (3%) to high (5%) inflation in the US and $ zone
  ► Risk of inflation in €-area very remote; risk of debt deflation instead

Hyper inflation? Leave it to scare mongers

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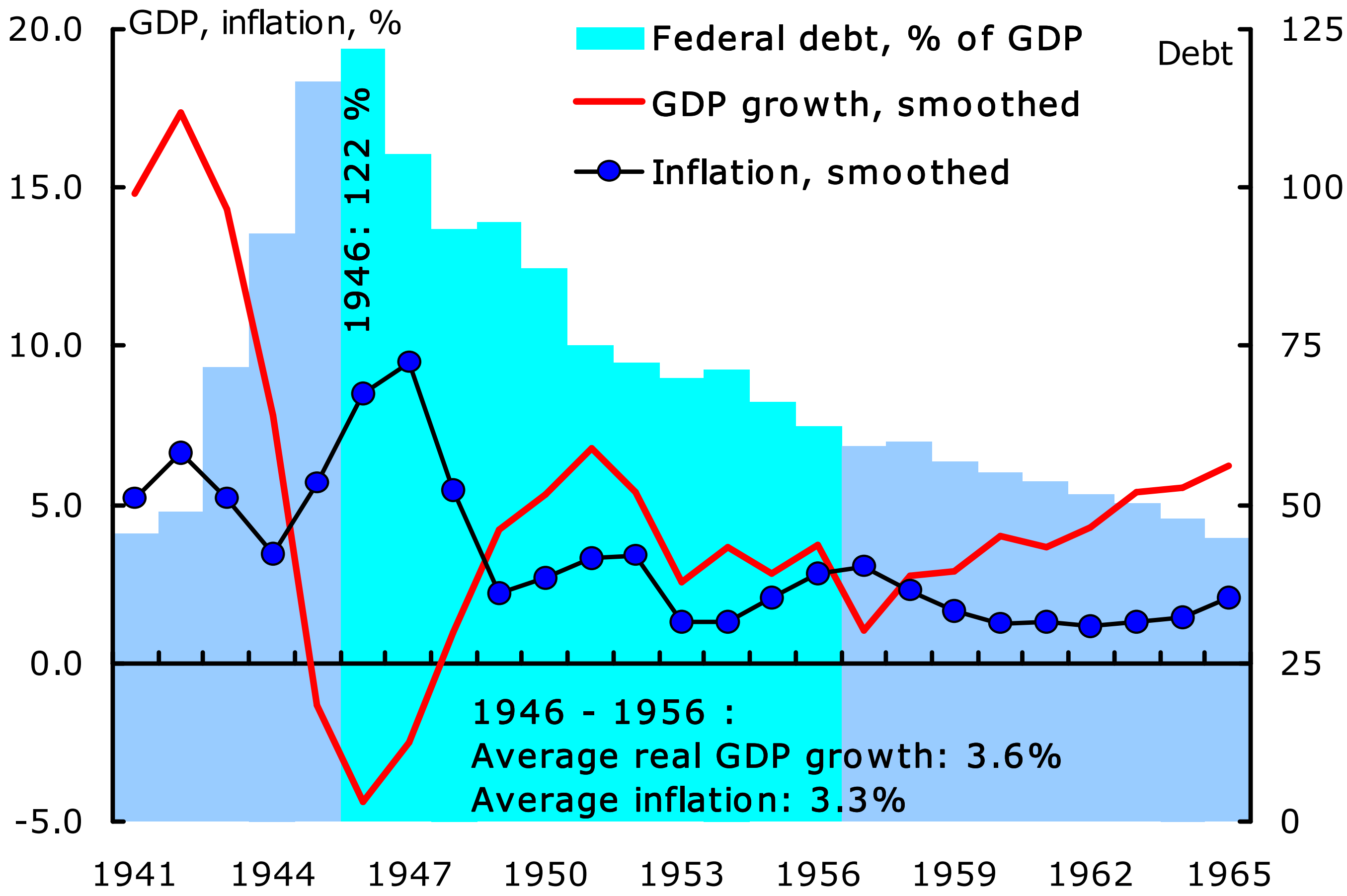
Case study: US government debt, post WWII



Source: BEA, OMB, AXA IM Research – Inflation is measured by the GDP deflator

1946-1956

Debt/GDP reduction: -60 pts

Contribution of real growth: -18 pts

Contribution of inflation: -17 pts

Contribution of primary budget balance: -13 pts

Source: AXA IM estimates, based on the first order approximation of the dynamic equation of the debt.

Long term theme #3: Play the carbon war

- Previous cycle: reducing GHG emissions (CO_2, CH_4, N_2O) was debated, but with limited impact on policy and investment decisions

- Next cycle will be different:

- ► More carbon markets in the world (yet not a *single* market)
  ► Carbon derivatives (hedging, arbitrage) markets to flourish
  ► Competition between US, Europe and Japan to supply de-carbonized energy supply, smart infrastructures, carbon sequestration technologies
  ► Possible final outcome: acceleration of productivity (innovation)
  ► Biggest potential markets (buyers): US, China and India
  ► Climate change leaders (investment side): big sovereign wealth funds
  ► Responsible investment to become progressively mainstream

Conclusion

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IT’S TIME TO TAKE RISKS

Thank you!