Confidence must be earned

Amundi ASSET MANAGEMENT

June 2019

Global Investment Views

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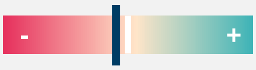
Overall risk sentiment



Cautious in the short term. Further volatility will give room to selectively increase risk exposure areas with

Changes vs. previous month

- More cautious and selective in US credit
- More defensive in EM assets

Overall risk sentiment is a qualitative view of the overall risk assessment of the most recent global investment committee.

Increased risk requires a cautious attitude

After weeks of relative stability, the threat of a trade war has returned, shaking investor confidence and awakening markets from complacency. However, while there is still a significant optimism in the market that a deal can be struck, we believe that the risk of disappointment leading to another wave of volatility remains significant.

What we have seen recently is that **the politics continue to dominate financial markets,** but mainly at the news flow level: political risk is currently perceived as a short-term nuisance, but **its impact could have much longer and more significant implications should it interfere with the economic cycle.** Even our central macro scenario – i.e., a continuation of moderate global growth, with the growth differential between Emerging and Developed Markets widening in the second part of 2019 and low inflation thanks to accommodative central banks – could be challenged in case of a material escalation of the trade war. In fact, retaliation by China could mean the extension of tariffs to all remaining Chinese exports to the US. This could have a direct impact on GDP (reduced exports) as well as indirect impacts related to business and consumer confidence, with rising inflationary pressures and input costs affecting corporate earnings.

However, we do not think a deal is just around the corner. The risks of a tough and prolonged battle remain and will not fade away in the near future, as they are the reflection of the battle of power between old and new empires in the geopolitical landscape. We are also conscious of the unforeseeable side of protectionism (reduced global trade, potential inflation pressures, etc.), and we don't see it as being priced into risk assets. **We expect the tug of war between softer and harsher tones to continue, resulting in further market volatility.**

It is also too early for the Fed to cut: markets went probably too far in pricing in a move and we don't buy this view at the moment. We think that the movement of downward revision to inflation expectations is now completed and could possibly reverse. This would mean that though the inflationary risk is marginal, volatility should show in inflation data and inflation expectations which should open up a less linear and benign phase in the bond space, especially in the US.

Market focus will soon shift to growth data (trade, earnings) and in some segments - almost priced for perfection - there is little room for disappointment at current risk premia: another challenge for the US.

On balance, regarding these considerations, we believe **it is not yet time to go completely risk off**, but that it is time to implement strategies to protect portfolios in case of a deterioration of the situation and to take some profit, where investors have achieved target returns, as the risk / return profile looks now asymmetric (higher risks / lower returns expectation).

Financial conditions are quite easy across the board, with dividend yields appealing compared with bond yields, especially in Europe. The recent market movement has brought global equity markets back closer to fair value, erasing the excess of optimism of Q1. Even if the outlook for earnings is not particularly rosy, with earnings converging across regions in a typical late cycle feature, we don't see any risk of an earnings recession and see potential for bottom-up approaches throughout the year. However, we believe that **the global sweet spot is entering a more fragile phase during which absolute risk should be scaled back** whilst relative value opportunities could be exploited in favor of some segments in Europe and Emerging Markets.

This is clearly a tactical view for the remainder of the year, as in 2020 the risks of further deceleration will resurface, but in a low yield world playing tactical opportunities is crucial to adding some oomph to an otherwise lacklustre returns picture.

MACRO & STATEGY

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Global Head of Research

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> ***In absence of inflation and given the downside risks, Central Banks will keep accommodativ e policies.***

Downside risks, but global economy is resilient

The outlook is somewhat more uncertain than last year due to the rise of protectionism, but we must not sink into an excess of pessimism. The global economy is resilient:

- **The most advanced economies remain supported by domestic demand.** The first quarter growth data are clear proof of this: they were better than expected in the United States, the Eurozone and Japan, with respectively 3.2%, 1.6% and 2.1% growth (at annual rates).
- **Emerging economies will continue to grow.** Their external markets are weakening, but they are not threatened like last year by either the rise in US interest rates or the dollar appreciation.

That said, the climate of uncertainty is not conducive. The global manufacturing sector is at half mast. The countries most heavily involved in global trade are taking the biggest hit. Against this backdrop, the world economy is slowing this year. We expect about half a point less global growth YoY in 2019, with growth of 3.3%.

In the absence of inflation and given the downside risks, central banks are implicitly committed to maintaining accommodative monetary conditions. So far we have maintained a status quo for our fed funds rate estimate in 2019/2020, in line with our own GDP growth and inflation expectations. **We have increased the probability of the downside risk scenario** (from 20% to 25%) and recognise that risks have become asymmetric (in line with markets' expectations).

Some Fed's member already argue that a simple disappointment on inflation rate / inflation expectations could justify a cut in the fed funds rate regardless of GDP growth (i.e. even if growth remains close to potential, with no risk of recession). The implicit idea is that the neutral rate (r*) may be a little weaker and that the Fed has gone too far in terms of rate hike last year. James Bullard (President of the Fed of St Louis) – while recognising that the normalisation has been successful and that the "stopping point" is appropriate – recently argued that a cut might also be appropriate if inflation disappoints. **We have maintained also a status quo for the ECB.** The ECB would not hesitate to mobilise the available tools if the need arises. All of this will help keep interest rates low for governments and corporates, and thus contain the debt burden.

For their part, governments will not remain inactive if GDP growth slows further. There is less and less opposition to the mobilisation of counter-cyclical fiscal policies in a structurally weak interest rate environment. As the center of gravity of the global economy will continue to shift from West to East, we should not focus our analysis only on short-term. The world of tomorrow will benefit from multiple sources of growth. Global value chains are re-regionalising or even re-nationalising, which means that going forward we should benefit from economic cycles that are less dependent on each other at the global level

The strategist's view – US / China trade disputes shake markets

Since Trump's first tweet threatening to add tariffs on Chinese goods from 10% to 25% on the 5th of May, markets moved into full risk-off mood: equities sold off, core rates rallied, high yielding/high beta currencies took a hit. Core rates have benefitted from their safe haven status and went lower: US 10Y touched 2.40%, and the German Bund is back to negative territory (both yields are back to the lows of March end). The US curve steepened (2Y10Y) as markets are back to increasing the odds of getting a cut on rates from Fed by 2019 end (the probability has moved from 50% as of post 1st of May FOMC to 75% as of 14th of May). In the G10 currency space, the USD was impacted negatively as, due to its current high-yielding currency status, it suffered the unwind of FX carry trades, to the benefit of reserve currencies like JPY, CHF and EUR. Further escalations of US/China disputes could exacerbate the aforementioned moves, in particular on the USD front as current positioning (both on the speculative and real money side) is rather elevated on the long side.

In EM, volatility has been quite high after the latest news on trade talks. Further escalation would affect not only China but also markets more linked to the global cycle and, among them, some relevant Asian markets such as Korea and Taiwan. Our key call is for China not to devaluate RMB to face higher tariffs and eventually not to overshoot the 7.0 level. Other EM FX are undervalued but, in case of escalation and RMB devaluation, they will be strongly impacted, in particular the Asian FX like the Korean Won and Taiwan Dollar. EM FX volatility has been quite high YTD, mainly for the high carry currencies that usually react strongly in a risk-off environment. In our view, EM FX volatility will remain high also because of some idiosyncratic stories like Turkey and Argentina that are politically related.

MULTI-ASSET

Low visibility on market = cautious approach

In a late financial environment, we are maintaining an overall cautious stance on risk assets, with a preference for credit vs equities. Those elements that, a couple of months ago, suggested some risk reduction in our positioning, are still present (Brexit, growth concerns in China and escalating trade disputes). We believe current equity levels are discounting very high expectations regarding a deal between US and China. Therefore markets remain vulnerable to a tactical pull back, given the ebb and flow of negotiations. Weaker momentum in the global expansion and world trade are expected to continue into the summer. Risks are skewed to the downside as a combination of geopolitical and idiosyncratic hazards increases the uncertainty on the policy reaction front and may further dampen growth.

High conviction ideas

We remain cautious on DM equities: while the easy financial conditions and the light positioning of institutional investors in Europe rapresent a good support for the market, many factors suggest a defensive stance. Since the beginning of the year, the undervaluations gaps have mostly closed, and global equities are priced at fair value now, profit cycle has passed the peak – although we still expect single digit growth in 2019. Moving on to economics, the global situation remains fragile and exposed to further negative surprises. We express this caution through a defensive stance regarding Europe and the US market. We have moved to neutral view on EM equities, where we prefer a country specific / relative value approach, in light of the lack of visibility on on market direction. In EM, we prefer more cyclical markets – Korea for example which could benefit from a mild rebound in the cycle in the second part of the year, and exhibits interesting valuations compared to the rest of the EM.

We continue to like China, particularly the domestic sector, which should benefit from the recent fiscal and monetary stimulus. Investors could also play EM divergences in the currency space, preferring for example currencies with positive carry (ie a basket of Indonesian Rupia, Brazil Real and Russian Rouble), vs shorting high beta currencies (South African Rand). This offers a way to keep volatility low while exploiting relative value opportunities.

In fixed income, we reccomend continuing to exploit carry from credit, where we still prefer Euro IG over US IG, given the better fundamentals. We also find a better risk/reward profile in IG vs HY securities. While we have revised down our rate projections, **we believe investors should keep low duration risk.** We don't expect core European bond yields to fall below current levels, especially in short-term maturities, as the ECB is not expected to cut rates further unless the Eurozone economy deteriorates sharply, which is not our base case scenario. Accordingly, we find more value in 5Y US Treasuries vs 5Y German Bunds. We are defensive on UK 10Y real rates, based on a weaker outlook regarding UK growth, combined with nominal rates being vulnerable to sharp sell-off.

Risks and hedging

The main risks to monitor emanate from the political arena, especially the tensions over trade disputes (US-China, US-Eurozone). The lack of visibility on Brexit, and the imminent European elections are also in focus. Investors should keep hedging strategies in place (to protect equity and high yield bond exposure) and a preference for the Yen vs USD, which should outperform in case of a further escalation in geopolitical risk**.**

Amundi Cross Asset Convictions

	1 month change	---	--	-	0	+	++	+++
Equities	↘		■					
Credit							■	
Duration					■			
Oil					■			
Gold					■			
Euro cash				■				
USD cash						■		

The table above represents cross asset assessment on a 3-6 month horizon, based on views expressed at the most recent global investment committee. The outlook, changes in outlook and opinions on the asset class assessment reflect the expected direction (+/-) and the strength of the conviction (+/++/+++). This assessment is subject to change.

Matteo GERMANO
Head of Multi-Asset

> *We remain defensive, as the elements that previously called for de-risking in our approach are still present.*

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FIXED INCOME

Eric BRARD
Head of Fixed Income

Yerlan SYZDYKOV
Head of Emerging Markets

Kenneth J. TAUBES
CIO of US Investment Management

"We believe it is appropriate to adopt a "careful carry" approach, moving up in quality."

Price for safety is, and will likely remain high

The scenario of moderate growth and dovish central banks remains supportive for fixed income, and in particular for bonds which provide investors with an income - ie corporates and EM bonds. However, as these markets are no longer cheap, it is important to "optimise" the carry opportunities across the board (EM debt hard currency, EU investment grade, US corporates less exposed to trade disputes). We expect US Treasuries to continue to protect portfolios in case of an escalation of trade tensions and other geopolitical risks (resurfacing frictions around the Iran nuclear deal could impact the oil outlook). The price for safety is high, with the 10 Y US treasury yield at 2.4% (10 Y Bund yield in negative territory), but it will likely remain so, as there is strong demand for safe assets and scarce supply. As we expect the US dollar to stay around current levels in the short term, non US-investors could consider gaining exposure to this source of protection and liquidity without a full currency hedging.

DM bonds

Current market conditions don't justify in our view aggressive duration stances. US treasuries may benefit from uncertainty, due to their "safe haven" status, but the market is quite expensive and it is difficult to see rates going far below the current levels: a 25bps cut for next year is already priced in; we do not expect a cut this year. Inflation expectations are low now and we could see a mild repricing in inflation expectations (due to oil, input prices and wages rising) which could cause a return of volatility to fixed income. In relative terms, we see more value in US Treasuries vs German Bunds. We remain positive on EU peripherals bonds, keeping a flexible approach as the political situation appears quite fragile.

Credit

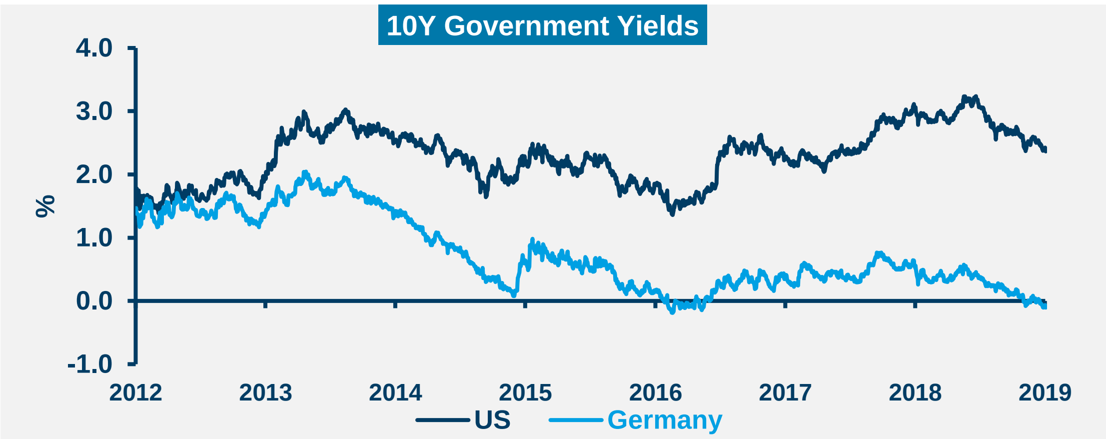
Considering the current economic conditions, carry rapresents the primary source of return for fixed income investors; investors should maintain a preference for European credit, due to good fundamentals, even if the room for spread tightening is limited considering the strong performance of the asset class since the start of the year. We believe it is appropriate to adopt a "careful carry" position, that involves selectively reducing spread duration and moving up in quality. We see also selective opportunities in the high yield market, especially after the repricing which followed the recent tariff disputes, as the outlook for default rates remains benign.

EM bonds

Increased trade and political risk still suggest a cautious stance on the EM debt sphere. The EM macro story is still intact and we keep our positive view on the asset class over the medium-long term. The recent volatility, while suggesting us the need for a more defensive and selective approach for the time being, likewise may create attractive entry points in countries and sectors. We thus look for tactical opportunities in hard currency debt, which continues to be an appealing source of carry and may continue to perform well at this stage. We also view exporting countries favourably: they could potentially benefit from a global shift in the supply chain; conversely, we keep a defensive stance on currencies more exposed to China growth.

FX

We have our positive view on the USD in the short term and cautious stance on the EUR due to downside risks on growth.



Source: Bloomberg, Amundi. Data as of 21 May 2019.

EQUITY

Deep dive in search for value

Overall assessment

The intensification of the trade disputes between the US and China alted the equity bull run. However the correction was limited, the US and the European markets partly recovered from the post-tariffs lows, supported by financial conditions which continue to remain loose, dovish CBs, generally easier fiscal policies and relief from the low expectations on Q1 reporting season. Supporting factors for the market are still in place, but a cautious and selective approach is preferable due to the wide spectrum of geopolitical risks and the less appealing risk/return profile compared to the beginning of the year.

DM Equities

US equity valuations remain attractive relative to fixed income. There are opportunities in quality and growth, but these are very stock- or vertical (i.e., within a sector)-specific. We see value in companies linked to infrastructure/cloud/data centre spending (these stocks sit in three sectors), selective financials such as insurance brokers, and auto & home insurance. In addition to valuations, many of these services stocks have lower foreign input costs that might be subject to tariffs and are also less exposed to potential trade retaliation given they have less non-US sales exposure than goods companies. Services stocks have faster sales and earnings growth, more stable gross margins, and stronger balance sheets. We are now cautious on capital goods, tech hardware, and semiconductors, industries which had been among our preferences in the past few years. Bond proxies, such as consumer staples and utilities, plus staple-like companies with no structural threats in many other sectors, are expensive on a relative-value basis.

European equities could offer interesting entry points after the EU elections, should the economic outlook improve in H2 and domestic demand remain resilient, as we expect. The current features of the market (increasing valuations dispersion, lower sectoral correlation) fit a stock picking approach. We continue to see selective opportunities in the cyclical part of the market (but with less conviction than one month ago), while the defensive part is expensive. Industrial and energy are the high conviction ideas, while on banks we believe a cyclical rebound has to be confirmed to see a convincing repricing opportunity. In the defensive space, health care sector is our favourite choice.
Japanese equities show compelling valuations but a possible strengthening of the yen backed by increased uncertainty rapresents an headwind for the equity market.

EM Equities

We see a mixed picture for EM equities: relative performance will now largely depend on the development of US-China trade story. A satisfactory deal would be beneficial for EM stocks, as it is not fully priced in at the moment. Given ongoing uncertainty, downside risk are still lurking in the background, suggesting near-term defensive positioning. Global investors are underweight EM, providing a potential technical support to the asset class. Dividend theme is attractive as the dividend per share growth is accelerating in main countries. We maintain our preference for China given the supportive measures related to credit growth rebound and tax cuts. Also some domestic demand growth stories in Asia, more insulated in case of a trade escalation, are attractive as defensive plays.

Economic surprise index and EU equity relative performance

Source: Bloomberg, Amundi. Data as of 21 May 2019.
CitiEconomic surprise index EU vs G10 and MSCI Europe vs World.

We see a more favourable stock - picking market ahead, due to rising valuation dispersion and decreasing sectorial correlation.

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Amundi asset views

	Asset class	View	1M change	Rationale
EQUITIES	US	-/=		Q1 earnings season has been positive, with revenue and earnings increasing. While the top line was sustained, the bottom line was less bouyant, and marked a clear deceleration vs 2018. We remain cautious on the market after the strong YTD rally, with sector/stock selection being the main stategy to approach the market, in which there are very expensive stocks (ie, in bond proxies) as well as more appealing situations (eg, in the service sector).
EQUITIES	Europe	=		Q1 reporting season has been solid. Green shoots could come from easier fiscal policy and stabilization/improvement of growth in H2. Geopolitical factor could ease somewhat, with the EU election behind us. Valuations are attractive. Potential market entry points could materialize in the coming weeks in the market.
EQUITIES	Japan	-/=		The earnings per share momentum is weak, although valuations are attractive. Increased volatility due to geopolitical factors, could lead to a stronger Yen, which could potentially be a drag for the market. Opportunities could be found at the stock picking level, but we are cautious on the overall market.
EQUITIES	Emerging markets	=/+	▼	EM equity valuations are less compelling than few weeks ago. The 1Q19 reporting season showed marginal signals of bottoming out in Asia. We still think that China and domestic stories in Asia are attractive. Dividend is an attractive theme to play, as dividend per share growth increased strongly and is expected to further improve.
FIXED INCOME	US govies	=		We believe that the market has overestimated the probability of a rate cut by the Fed. The market could be vulnerable in case of readjustment of inflation expectations. A cautious duration position is warranted given current 10Y Treasury yields
FIXED INCOME	US IG Corporate	=		The current environment should be supportive for spread assets. We note, however, that recent market performance has reduced the prospects for returns relative to risk in many credit sensitive asset classes and reduced the scope for material near-term spread tightening.
FIXED INCOME	US HY Corporate	=		Our outlook for the asset class is broadly unchanged. We see valuable carry, but limited space for spread compression at the current level. The still sound economic picture is benign for the default outlook. Default rates are expected to remain very low in 2019.
FIXED INCOME	European govies	-/=		At the current Bund yield levels, we see little value in core govies. For fixed income investors, opportunities could be found playing yield curve flattening and Euro peripheral bonds.
FIXED INCOME	Euro IG Corporate	+		Valuations have become less compelling after the aggressive spread tightening but the asset class is still attractive for carry reasons and fundamentals remain solid. Central Banks actions could support financials. Subordinated debt is an area of interest too.
FIXED INCOME	Euro HY Corporate	+		Leverage is still low and default rates are likely to stay low in the next 12 months. In a scenario of stabilising growth in the Eurozone, the asset class could provide selective carry opportunities.
FIXED INCOME	EM Bonds HC	=/+		Our view is still constructive on HC debt in the medium term, due to a benign economic outlook for EM, dovish Central Banks and loose financial conditions. In the short terms, spreads are quite tight and some volatility could return in the market in light of the increased tensions between China and the US.
FIXED INCOME	EM Bonds LC	=	▼	We have a neutral view on the asset class, as currency volatility has increased and geopolitical risks are elevated.
OTHER	Commodities			For WTI, we keep the 55-65 range (USD/Barrel) despite the recent strong rebound driven mainly by OPEC cut and economic stabilization. However geopolitical tensions in middle East, Iran sanctions and Venezuela political situation will likely inflate volatility and upward pressure in the short term and will exacerbate supply disruption concerns. Base metals are vulnerable to China and global economic slowdown. All in all, the picture remains still supportive for delivering decent returns as the inventories cycle remain reasonably supportive.
OTHER	Currencies			EUR/USD: the single currency is still trading in a tight range as signs of Chinese and Eurozone's activity bottoming out are offset by concerns on the political front. We expect the EUR/USD to trade around 1.17 at the end of 2019, while remaining supported in the short term. We expect USD/JPY at 107 on a 12M horizon. For the next 12 months we expect also a mild upside for EM FX (on average +1.5%, with differences from country to country). To be selective remains key.

LEGEND

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Negative Neutral Positive

▼ Downgraded vs previous month ▲ Upgraded vs previous month

Source: Amundi, as of 21 May 2019, views relative to a Eur-based investor. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This information should not be relied upon by the reader as research, investment advice or a recommendation regarding any fund or any security in particular. This information is strictly for illustrative and educational purposes and is subject to change. This information does not represent the actual current, past or future asset allocation or portfolio of any Amundi product.

IG = Investment grade corporate bonds, HY = High Yield Corporate;

EM Bonds HC / LC =EM bonds hard currency / local currency. WTI= West Texas Intermediate.

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AMUNDI Investment Insights Unit

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