



Inflation blows on markets, and investors need to act

# INVESTMENT OUTLOOK | H2 2021

PART 2

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Confidence  
must be earned

**Amundi**  
ASSET MANAGEMENT

## HOT MACRO QUESTIONS

What will be left after the peak?



China has passed its peak economic acceleration. The United States is likely to peak in Q2, while Europe will lag by a quarter. Services and consumption are likely to compensate for a cool down for manufacturing. Beyond the peak, we could see some deceleration and no structural shift towards higher growth.

Inflation: base effects or structural shift?



Inflationary pressures are grounded in the United States and in some EM. Inflation trends will be supported by the cyclical recovery and pent-up demand, as well as by the US fiscal package. Over the longer run, market narratives are expressing a preference for inflation as a way out of the crisis. This will have key implications in three-to-five years' time.

Central banks: will the music stop?



DM central banks will stay accommodative as long as possible, neglecting any inflation risk, while in EM some tightening is underway. Markets will start pricing some possible tapering and volatility may rise. A key risk is that the yield curve goes out of control and expectations become de-anchored.

EM: improving momentum ahead?



EM are likely to see improving economic and health conditions in Q3/Q4. Currently, the virus cycle, the slow vaccination campaign and geopolitical issues are a drag, but all these conditions are expected to improve. China, and part of Asia, will remain the most resilient, while momentum in CEMEA and Latam will improve later in the year.

## MAIN INVESTMENT THEMES

1. **Tactically adjust risk stance, start neutral and seek entry points.**
2. **Equities: seek a “barbell” approach, favouring cyclical quality value on one side and defensives on the other.**
3. **Bonds: stick to short, active duration and moderately long credit.**
4. **Emerging markets: Short-term caution, long-term income and growth story intact – China and Asia the winners.**
5. **Commodities: Short and long-term positives. Short-term living imbalances exacerbated by the pandemic, long-term shortages (i.e. base materials) in the pipeline.**
6. **FX: In the short term long USD vs. short JPY & EUR, long commodity bloc, selective on EM FX. Medium term, the dollar will likely weaken.**

## TACTICALLY ADJUST THE RISK STANCE

### Start neutral and balance risk in a world of changing correlations

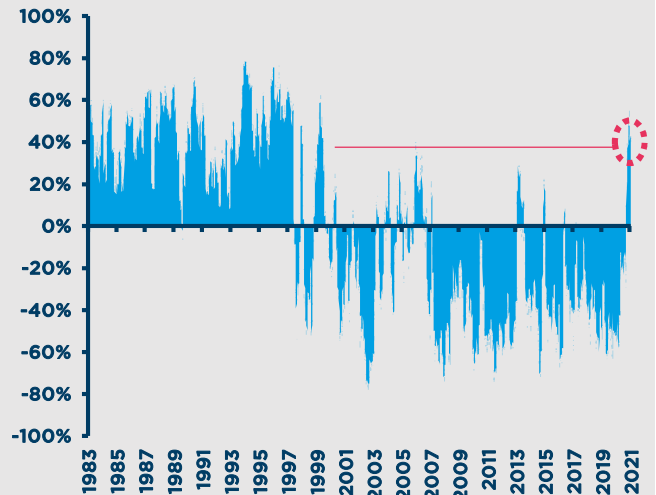
We expect equity markets to remain side-lined in the short term as markets assess the inflation path. Moving into the summer the inflation test will arrive once base effects fade and markets focus on central banks' communication.

Entering this more uncertain phase at a time of high market valuations, it is wise to stay neutral in equities. A more cautious stance is also recommended amid possible higher volatility and changing correlation dynamics. In fact, with bond/equity correlation turning positive in phases of higher inflation expectations, US Treasuries are no longer effective as an equity hedge should yields start to rise further.

This is a short-term view while with a strategic view, as we said previously, exposure to equities is warranted amid higher inflation with protection against the bursting of the tech bubble. Hence, investors should see market setbacks as opportunities to add risk back.

- **Market trigger:** Growth rebalancing
- **To watch:** PPI dynamics and Fed reaction function
- **Risks:** Monetary policy mistakes, virus variants resistant to vaccines

60-day correlation between S&P500 Index and US Treasury yield futures at the highest since 1999



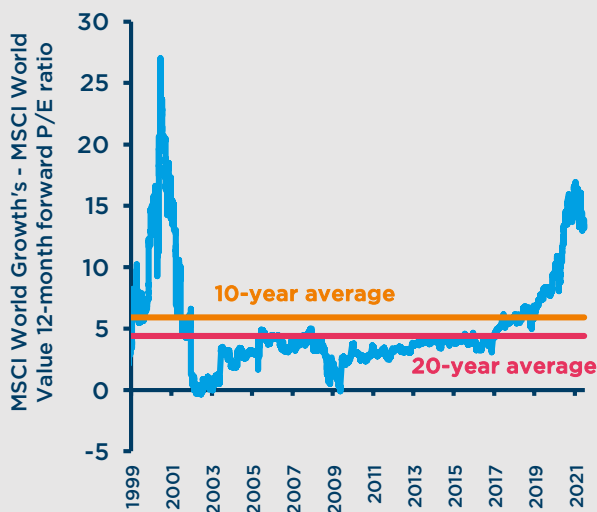
Source: Amundi on Bloomberg. Data as of 10 June 2021.

*The macro environment favours risk assets, but stretched valuations and possible inflation surprises call for a more neutral stance on equities.*

## EQUITIES: SEEK A “BARBELL” APPROACH

### Favour cyclical quality value and balance with some defensives

Growth vs. value excess valuations still have room for further correction



Source: Amundi on Bloomberg. Data as of 26 May 2021.

Despite a possible pause in the market, the overall environment remains slightly pro-cyclical, favouring markets such as Europe, Japan, Emerging Markets and small caps.

Against a backdrop of higher inflation expectations and earnings growth, investors should favour value/cyclical names and balance this exposure with some defensive stocks with strong balance sheets. In fact we believe that the rotation from growth to value has further to go. The excess overvaluation of growth vs. value has not been reabsorbed yet and the improving earnings outlook further supports some value names, as well as the dividend income theme. Company discrimination will be key: pricing power, exposure to higher input costs, ESG risks and higher corporate taxes will drive the equity selection. Moreover, we recommend being mindful of areas of potential bubbles in the hyper-growth space, while looking in the global technology at stocks exposed to compelling secular trends.

- **Market triggers:** European recovery to gain momentum on vaccine rollout and investment cycle deployment on Next Generation EU
- **To watch:** Real rates dynamics
- **Risks:** Policy mistake driving volatility in the market

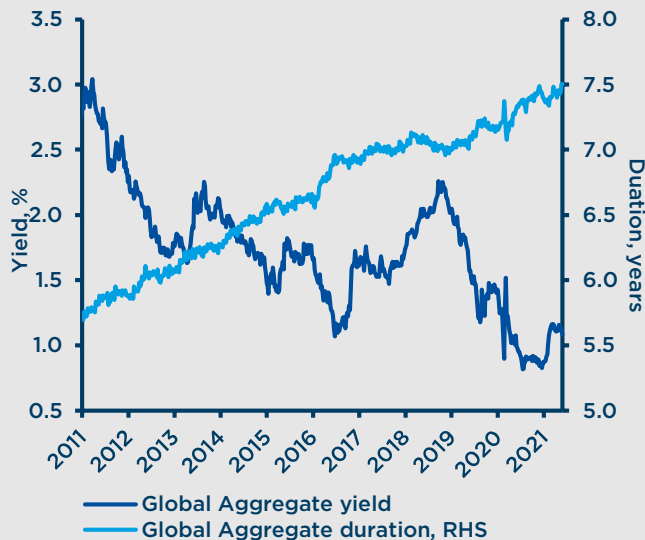
*Earnings trajectory is key to checking companies' ability to navigate the higher inflation framework. Exposure to real economy and dividend themes will be key in H2.*



## BONDS: SHORT DURATION AND LONG CREDIT

Duration risk management is the name of the game

**The duration problem of traditional benchmarks (Bloomberg Barclays Global Aggregate Index)**



We recommend staying short duration, particularly in the US, and waiting for better entry points to move towards neutrality. Treasury yields are capped by supply-demand imbalances, but the inflation risk is real, in our view. When yields reach 1.8%-2% investors should resist the temptation to go long duration, and look at opportunities at curve levels and among short duration, higher yielding assets.

This means being positive credit markets where fundamentals are improving amid the economic recovery, Central Banks remain supportive and yields could offer a higher cushion against rising rates, with overall lower duration compared to traditional aggregate benchmarks. High Yield credit, subordinated bonds and Emerging Markets bonds with a short duration bias can offer investors a good yield / duration / risk profile in this phase.

In Europe, investors can also benefit from peripheral bonds' higher yields, while in the US robust consumer earnings and savings support a positive view on the consumer, residential mortgages and securitised credit markets.

- **Market triggers:** Change in Central Bank stance
- **To watch:** US labour market and the implementation of fiscal policy
- **Risks:** De-anchoring of inflation expectations

*Duration management is key in this phase of uncertainty for the inflation path and Central Banks' actions, while credit benefits from improving fundamentals in the recovery.*

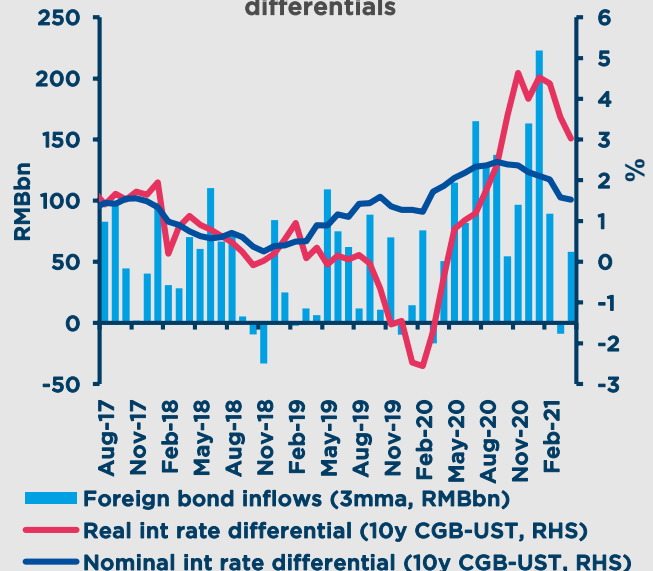
## EMERGING MARKETS: CHINA AND ASIA THE WINNERS

Short-term caution, long-term income and growth story intact

Inflation is a theme to watch also in EM. Many EM countries are facing price pressures that come from commodity markets. Some EM policymakers have already started to reverse their policy easing stance in order to limit new inflation forces. This trend coupled with the possible further rise in US Treasury yields could pressure EM bonds in the short term. In the mid term, a weaker dollar should be supportive for EM FX, hence benefitting EM equities and EM local currency bonds. Yet, the EM world is scattered with areas of vulnerability. China and some Asian countries will likely be the winners, the currencies will be the critical channel to adjusting relative prices in the new regime and will become core assets for investors. With low real rates, Chinese bonds are appealing for global investors. China is one of the few countries that has not embraced unconventional monetary policy and is targeting an ordered slowdown of credit growth. The Renminbi could become a reference currency for Asia and its internationalisation could go ahead further supporting the appeal of Chinese assets.

- **Market triggers:** vaccination campaign September 2021
- **To watch:** Rising US rates and appreciating USD
- **Risks:** Spreading of variants, Fed policy mistake

**China's bond inflows vs. nominal interest rate differentials**



*Short-term possible rise in US Treasuries is a headwind for EM, but they still offer higher risk-adjusted return potential in the medium term. Chinese bonds appeal in a world of low real rates.*

## COMMODITIES: SHORT AND LONG-TERM POSITIVES

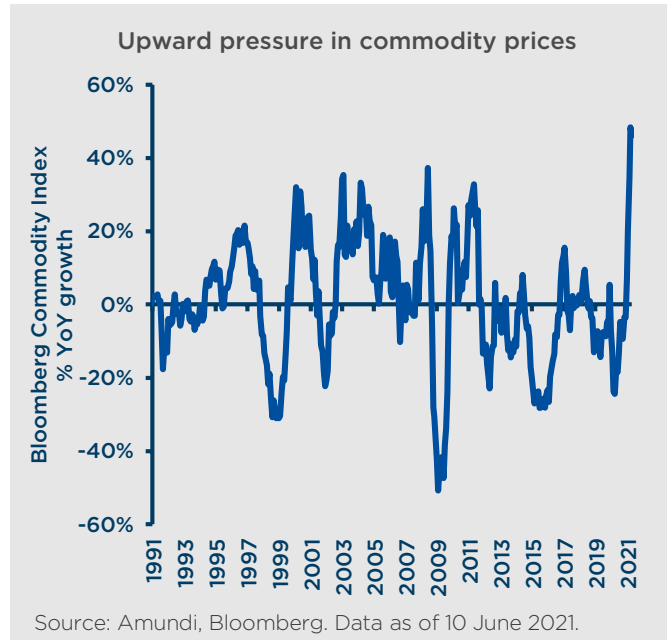
### Imbalances due to the pandemic and long-term shortages

The global economic rebound is supporting commodity prices. Base metals in particular witnessed a jump in prices due to rising demand and concerns over supply shortages. This is the case of copper, for which the potential demand boost from strong fiscal stimulus and the transition towards greener economies, together with the still concentrated production (mainly in Chile, Peru, Republic of Congo and Zambia) should support copper prices in the long term.

This brings opportunities for investors, as exposure to base metals could help to inflation-proof portfolios.

On gold different forces are at play, driving volatility. On one front, being a safe haven, a positive economic environment is not supportive. Yet, negative real interest rates with higher inflation have helped gold prices recover initial losses in the year and could further prolong this trend. Hence we recommend keeping a neutral stance on gold at this stage.

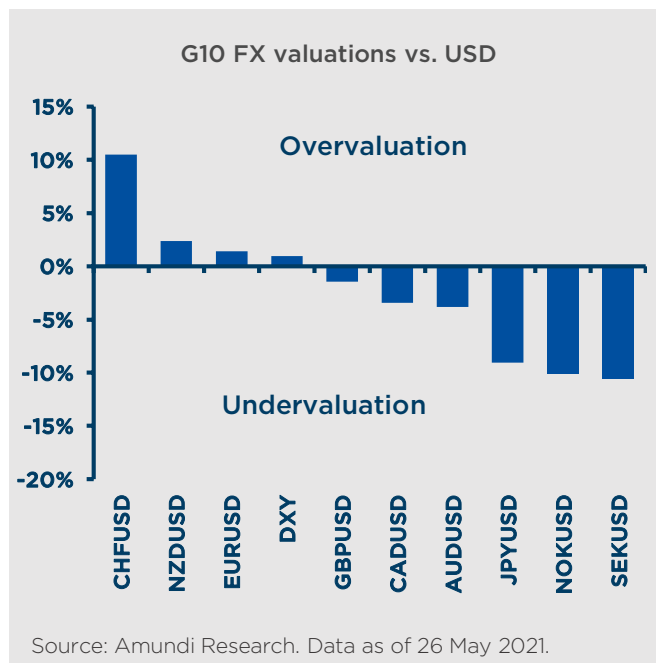
- **Market triggers:** Green economy transition
- **To watch:** Base materials dynamics
- **Risks:** Geopolitical risk



*Exposure to base metals (or equities linked to them) could benefit investors amid higher inflation dynamics.*

## FX: SHORT-TERM POSITIVE USD AND SELECT EM FX

### Playing the USD growth premium and commodities cycle



In the medium term, the huge liquidity injections and deteriorating US fiscal position remain strong headwinds for the dollar, pointing to some depreciation and possibly even a sell-off, based on eroded investor confidence. Large-scale capital outflows might take place at that stage, especially should the rest of the world proceed in the recovery.

In the short term, the fiscal boost is building a US growth premium versus the rest of the world, suggesting that international capital inflows should stay anchored to dollar-denominated assets. This should keep the dollar in the 1.16-1.18 range at end-2021. Such a trend could be bumpy though, as any consolidation in US rates could cause the dollar to weaken somewhat.

In addition, growth proving strong and rising commodity prices support commodity-related currencies (namely CAD, NOK, AUD and NZD) that should continue to outperform.

On EM FX, we see some potential for a recovery in the second half of the year, as currencies are also generally undervalued vs. the USD.

- **Market triggers:** Time varying growth premium
- **To watch:** Real rates
- **Risks:** Monetary policy mistake

*USD will benefit from the growth premium in the short term, but the medium-term outlook is more uncertain. USD will likely pay the bill of ultra-Keynesian policies.*

## AMUNDI ASSET CLASS VIEWS

	Asset Class	Current positioning	Future Direction H2 2021
EQUITY	US	=	=
	US value	+	▲
	US growth	-	▼
	Europe	=	▲
	Japan	=	=
	Emerging markets	=/+	▲
FIXED INCOME	US govies	-	▼
	US IG corporate	=	=
	US HY corporate	=	▲
	European govies	-/=	▼
	Euro IG corporate	=/+	=
	Euro HY corporate	=	▲
	EM bonds HC	=/+	▲
	EM bonds LC	=	▲
OTHER	Commodities	=/+	▲
	Currencies (USD)	=	▲

--   -   =   +   ++  
 Negative   Neutral   Positive

▼ Deteriorating future perspective   ▲ Improving future perspective

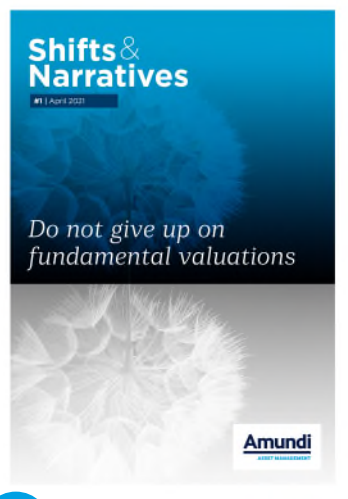
Source: Amundi, as of 15 June 2021.

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In a world in which investors are exposed to information from multiple sources we aim to provide regular, clear, timely, engaging and relevant insights that we believe can help our clients make informed investment decisions.

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