Confidence must be earned

Amundi
ASSET MANAGEMENT

June 2020

Global Investment Views

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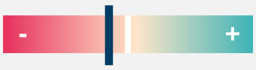
Overall risk sentiment

Risk off | Risk on



Focus on active risk management, liquidity; stay cautious

Changes vs. previous month

- Tactical adjustments in credit, exploiting value in primary markets.

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

The great market detachment from reality

The dichotomy between the false market tranquillity and the high level of uncertainty about the length of the crisis and its long-term implications is striking. In our view, we are far from being out of the woods and investors should stay alert as current market levels are still pricing in a ‘too rosy too soon’ endgame. **The race between the three cycles will continue.** On the pandemic cycle, markets have been relying on the narrative that the worst may be behind us in Europe and the US, with rising expectations of contagion curve-flattening. If these hopes are not realised, market tensions will resurface. On the economic front, the huge fiscal and monetary measures are like an insurance policy for the next six months, but should the recession prove worse than expected, markets will need more and any disappointment will trigger a correction. ‘Credit’ is becoming addicted to CB action; market conditions have improved but not normalised. On the credit default cycle, critical in a world that will see even more debt after the Covid-19 crisis recedes, markets have already priced in a first round of defaults but not a second one for traditionally laggard assets. The battle between liquidity and solvency will continue and US commercial real estate is an area to monitor. The disconnect between market hopes and economic and pandemic reality reinforces **our conviction that now is a time to remain cautious: don’t chase the bulls, but gradually and selectively play investment themes better positioned towards a slow road to recovery.** Reasons to be vigilant, on top of the uncertainties in the three cycles mentioned above, are: First, a resurgence of the US-China rivalry, amid the ‘blame for the virus’ game, was the main risk that re-escalated in May. Second, the outcome of US elections is uncertain. Third, EM are facing high idiosyncratic risks (Brazil). Finally, the long-term consequences (retreat in global trade, rebalancing of policies in favour of labour, transformation of business models, and acceleration of trends, i.e. smart working) of Covid-19 are complex and remain under scrutiny. During the unprecedented last 3 months, our focus has been**: the dual objective of protecting investment capital from any permanent loss and having room to add to emerging investment opportunities.** This attitude remains unchanged and investors should focus on the following:

- **Liquidity:** This is precious in managing transition from the deepest phase of the crisis to an uncertain recovery. The crisis has made clear that liquidity should be a key metric of portfolio construction, despite recent signs of improvement. In fact, the depth of liquidity in credit markets remains thinner and more expensive than prior to Covid-19. Investors should keep some liquidity for defensive and aggressive strategies, so they can reposition in some areas of market when opportunities arise.
- **Positive stance on IG credit:** This should benefit from CB actions and the primary market can offer opportunities. However, investors should remain very selective at the sector and company level, focusing on good balance sheets and businesses that can withstand the economic lockdown.
- **Conservative risk exposure to equities** amid further EPS growth revision: Any catalyst for improvement must come from a vaccine or a potential treatment because only these factors could trigger a permanent recovery and positive change in consumer behaviour.
- **Cautious on EM in light of rising geopolitical risks**, with opportunities to watch in credit as well as in Asian and Chinese equities, but the evolution of the China-US relationship is key (recent tensions could derail market sentiment). The credit market is discounting an aggressive rise in defaults, but investors should consider that many of the most troubled stories have already traded down to their distressed recovery levels and some are currently even restructuring. Investors should identify those companies that can successfully draw up a plan to emerge from the distressed status.
- **Covid-19 is an accelerator of growing importance of ESG:** While the E and G will remain high on the priority list, the societal focus towards higher social equality, fair treatment of employees and care for their health will underpin the growing dominance of the S component. There will be greater scrutiny of the ways companies act in the interest of all stakeholders and the community. This will translate into a greater impact on stock prices of some ESG risk factors, which will provide opportunities for active managers, in both the equity and bond space.

MACRO & STATEGY

Monica DEFEND
Global Head of Research

Lorenzo PORTELLI
Head of Cross Asset Research

Equities: a bear rally or a meaningful rebound?

The big question we are debating is: **should we raise the allocation to equities and chase the market rally or not?** While we maintain our strategic preference for risky assets, we are convinced it is tactically safer to stay in the IG space (supported by central bank umbrellas) given that we believe a relapse in equities is due, as explained below.

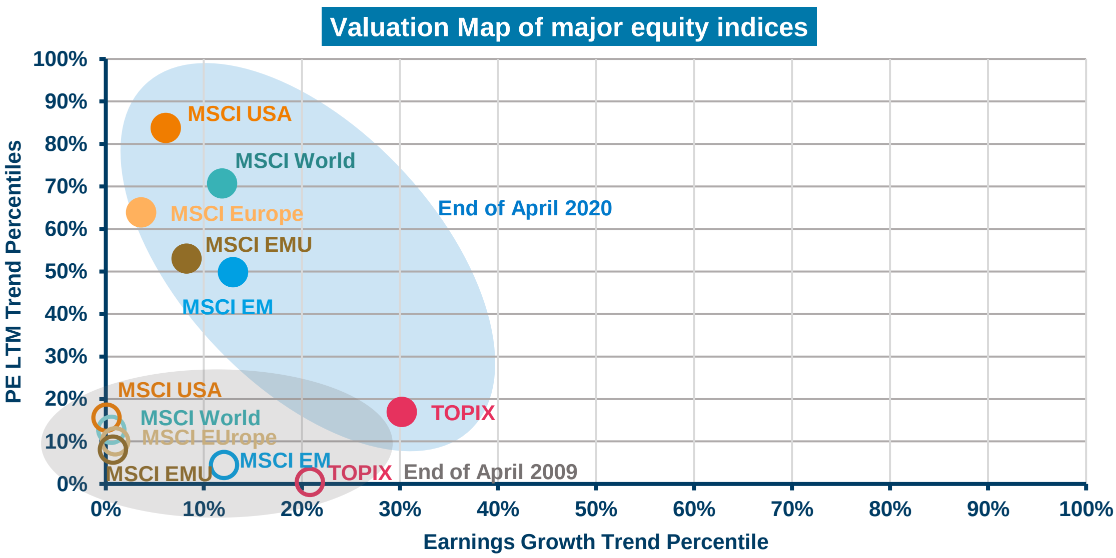
The economic backdrop has rapidly deteriorated: both hard data and economic momentum have reversed, hurting risk sentiment. We recognise that the medium-term recovery scenario that will probably play out later in 2021 provides significant potential upside. **However, equity markets are anticipating the upside scenario now, at a time when profound uncertainties persist.** These uncertainties relate to health care policies around treatments. While testing and vaccine are on a fast learning track, a lot still needs to be done. There is no clarity on a timeline for availability of a treatment or a potential vaccine.

On the fiscal side, full capacity has to be tested and maintained in the medium term: the speed of implementation is choppy, spending quality still needs to be assessed (in terms of composition and targets), and capacity (of fiscal packages) to recover from the damage has not been fully estimated.

On the other hand, central banks – after having dealt with the 2008 financial crisis – were quick to respond this time and allowed financial conditions to ease, particularly in the US. This was the most convincing factor for the markets to move higher and multiples to expand. **This is where we detect the dangerous inconsistency of falling earnings per share generation and total returns moving higher.**

Conversely, bond yields and oil prices remain depressed, and the rebound has not benefitted cyclical areas that much. Earnings revisions are pointing sharply down to historical lows, **pushing P/E ratios back towards their peaks**. The chart below explains our rationale for current caution. In 2009, we saw a profit recession and central bank efforts paved the way for a full asset reflation regime to play out. Today, valuations (P/E percentiles for 2020 earnings) are completely different, with all the major equity indices already at peak. In fact, an MSCI US valued in the 84th percentile (in the blue bubble) may not offer the best possible case for upside. This is the major difference between the situation now and in 2009. In the latter case, P/Es were already in their low percentiles (grey bubble) and the unconventional monetary policies of central banks allowed upward movement in equities. The only exception to this is the TOPIX, which is in a lower percentile now and shows more reasonable valuations. One could argue that this is because Japan is already in a recession, but compared to other advanced economies, a later but smaller shock is likely, with Covid-19 outbreak being largely contained. The unprecedented lockdowns and monetary and fiscal policy responses help us maintain our 'strategic' preference for risky assets, but high valuations don't provide the best possible upside. To close, we would say that unconventional monetary policies have once again reflated asset prices. However, when compared with 2009, **current earnings per share are depressed and P/E levels are so extreme that a bull market driven by multiples expansion is unlikely.**

> ***While CBs engaged in unconventional policies on both occasions – now and in 2009 – this time the valuations are so extreme that a bull market driven by multiples expansion seems unlikely.***



Source: Amundi Research, as at 20 May 2020. All indices in local currency. PE LTM refers to Price earnings ratio on Last Twelve Month earnings. Names of indices in the grey circle above are same as the ones in the blue circle.

Amundi
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MULTI-ASSET

Matteo GERMANO
Head of Multi-Asset

> ***We maintain our defensive stance on equities; positive view on credit and on peripheral bonds as supported by Central Banks action.***

Manage risk dynamically; avoid following the bulls

The economic backdrop is characterised by global recession and sequential slowdown, followed by de-synchronised recovery paths across countries. The length of the weakness, the extent of permanent output loss, and of demand destruction will depend on the duration of lockdowns and the effectiveness of the fiscal/monetary push. We confirm the scenario of growth stabilisation around Q4 2020. Throughout the crisis, we have focussed on active management of risk exposure – protecting credit positions, keeping hedges in place, and prioritising quality of holdings and credit selection.

High conviction ideas

We remain defensive on European and US equities because of tight valuations and ambiguity regarding the impact of Covid-19 on global growth. The consensus for 2020 earnings growth has corrected, but it still remains too optimistic for 2021, in our view, despite low visibility. In an environment in which risk remains clearly tilted towards the downside, we wait for markets to provide better entry points (the 2650-2700 level is the trigger for the S&P 500) to act and change our current stance. **We maintain a neutral view on EM** as market volatility remains high, but continue to prefer China, South Korea and Taiwan due to strong stimulus and relatively better containment of the virus.

We have a neutral stance on duration, as we believe central banks will aim to keep the cost of public debt low to support governments' fiscal needs, leading range-bound movement in for yields. A Treasury yield of around 60 bps is consistent with the Fed's stance and a sharp worsening of the macro picture. **We remain constructive on US 5Y vs Germany 5Y**, as USTs should benefit from safe-haven flows (although to a lower extent than in the past) and Fed purchases, especially in short- to medium-term segments. Regarding US inflation, we are now positive on a medium-term perspective and believe inflation swaps and TIPS breakevens are trading well below their historical averages.

As we exit the pandemic, reflationary forces, such as deglobalisation and debt monetisation, should support higher inflation risk premiums and demand for inflation protection.

The search for yield continues on the Italian curve, as it offers relatively attractive yields. We maintain our constructive stance on Italy 30Y vs Germany 30Y and are now positive even on Italy 10Y BTPs, as ECB actions are helping to put a ceiling on yields and spread volatility. The German court ruling represents a downside risk; however, the ECB is unlikely to change course. We maintain our stance, as it could provide balance to investors' portfolios.

With a focus on liquidity, **we are still constructive on credit**, supported by CB umbrellas in the US and the Euro area, but we prefer IG to HY. EUR HY could suffer from high default rates and slowing top-line growth. Accordingly, we are very defensive.

Given the high uncertainty and divergence of fundamentals and valuations, **we have a neutral view on EM debt** and see a gap between IG and HY countries. In external debt, the IG sector should remain more resilient in the coming months. HY, however, presents a binary risk/tradeoff between default risk for distressed countries and a catch-up from very depressed valuations. On local rates, the main driver for debt is the currency exposure and we believe room for further compression is limited.

On DM FX, we are no longer constructive on the EUR/CHF, owing to safe-haven status of the franc, high money supply growth in the Euro area, and the German court ruling which could pressurise the EUR. We maintain the NOK/EUR position, as the Krone has already corrected significantly and is a way to benefit from a more optimistic scenario.

Risks and hedging

Hedging instruments in the form of the JPY, derivatives and gold remain key to protect portfolio returns in this phase of high uncertainty.

Amundi Cross-Asset Convictions

	1 month change	---	--	-	0	+	++	+++
Equities				■				
Credit						■		
Duration						■		
Oil					■			
Gold						■		

Source: Amundi. The table 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. USD = US Dollar, JPY = Japanese yen, UST = US Treasury, DM = Developed markets, EM/GEM = Emerging markets, FX = Foreign exchange, FI = Fixed Income, IG = Investment grade, HY = High yield, CHF = Swiss franc, NOK = Norwegian Krone, EUR = Euro, CBs = Central Banks, TIPS = Treasury Inflation-Protected Security. BTP = Italian government bonds.

Amundi ASSET MANAGEMENT

FIXED INCOME

Eric BRARD
Head of Fixed Income

Yerlan SYZDYKOV
Global Head of Emerging Markets

Kenneth J. TAUBES
CIO of US Investment Management

> ***We look for market dislocations and also strive to stay away from names that won't withstand this crisis. This is even more important as the BBB market share has increased substantially.***

Credit quality is key

Over the past month, we have seen a gradual improvement in market conditions after massive price and liquidity dislocation in March, but we are still not back to normal. Investors should remain cautious, continue to maintain sufficient liquidity, and be mindful of potential rating migration which could cause volatility in credit markets. On the other hand, they should try to make tactical adjustments in order to benefit from market events – for instance, if there are attractive issues in the primary market – without changing strategic convictions.

Global and European fixed income

We have an overall neutral stance on duration, with a constructive view on the US and cautious ones on Japan and Germany. Investors can take advantage of yield curve movements (curve flattening in US, Europe, UK; steepening in Japan). **While we remain positive on Euro peripheral debt**, we are more cautious but still constructive on Italy (strong investor appetite as €22 billion raised recently through BTPs). Concerns on German court ruling and increased debt burden are balanced by Franco-German proposal for a sort of 'recovery fund'. On credit, **US IG (we recently became more positive on this segment) and EUR IG remain well supported by CB actions, but credit selection and quality are important to distinguish issuers who will make it through the crisis vs those that will become insolvent.** We like subordinated financials, telecoms, pharmaceuticals and insurance, but are cautious on US energy. Bond issuance in the US has been concentrated in IG borrowers and on BB-rated corporates (Fed's decision to include fallen angels and HY ETFs in its programme). We have confidence in BB sector, but search for quality is key here. Activity in US HY has resumed (demand exceeded supply) but activity is muted in Europe. **However, investors should exercise caution.**

US fixed income

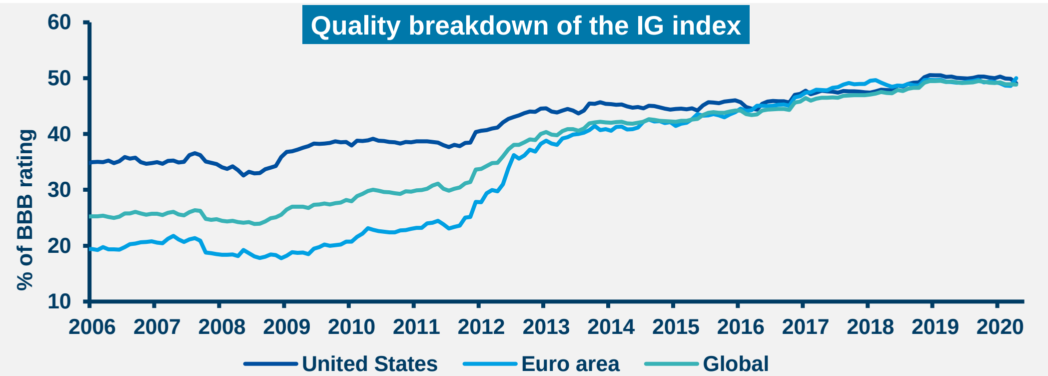
Securities and sectors with limited prospects for price appreciation, such as insurance-linked securities (which have delivered 2% returns YTD) and AAA consumer and commercial real estate securitisations, have been resilient and may provide opportunities to serve as funding sources for long-duration IG corporates and some HY credit at deep discounts. We remain positive on RMBS outside of the AAA-rated tranches, as their spreads grind tighter but are overly discounted. **Being careful to maintain adequate liquidity, investors should hold positions in UST, TIPS and US government agency mortgage bonds, and cash.** In addition, this is a time to consciously pare back idiosyncratic risk when liquidity and pricing afford opportunities. Spread tightening in leveraged loans may enable investors to exit BB names at prices near par, and improve liquidity and quality while extending credit duration.

EM bonds

We are mindful that the Covid-19 crisis is weighing on global growth and corporate earnings, with negative effects on EM outlook, pushing many countries into recession. **We have been cautious on names dependent on exports, commodities and tourism. Portfolio hedges and liquidity remain important.** On HC, we are positive, particularly on HY (Ukraine). There are opportunities in primary market to gain exposure to IG names at discounted levels (Mexico). We are cautiously constructive on local rates in Mexico and South Africa, and positive on Russia.

FX

We remain positive on USD/EUR because of the extraordinary slowdown caused by the pandemic, making US assets attractive in such a crisis. In EM, we remain bearish, especially on growth-sensitive currencies such as China and South Korea.



Source: Bloomberg, monthly data 30 April 2020. Analysis based on ICE BoA indexes.

GFI= Global Fixed Income, EM FX = Emerging markets foreign exchange, HY = High yield, IG = Investment grade, CHF = Swiss Franc, EUR = Euro, USD = US dollar, UST = US Treasuries, RMBS = Residential Mortgage Backed Securities, ABS = Asset Backed Securities, HC = Hard currency, LC = Local currency, TIPS = Treasury Inflation-Protected Security, GFC = Global Financial Crisis of 2008, JPY = Japanese yen.

EQUITY

Low earnings visibility calls for caution

Overall assessment

As governments ease lockdown measures and the world gradually moves out of the Covid-19 crisis, we are likely to see ballooning government debt, low interest rates and economic growth, a rise in the importance of ESG (especially the S factor), growing inequality, political fragmentation and increased geopolitical tensions (US-China, EU unity). We observe a stark contrast between ‘market sentiment’ and ‘economic fundamentals’. While it is important to note that policymakers can provide short-term liquidity, the demand recovery also depends on fear and confidence. This in turn could still impact earnings and long-term corporate solvency. **Investors are forced to navigate this situation with exceptionally low forward visibility in an environment with potentially a wide range of outcomes.**

European equities

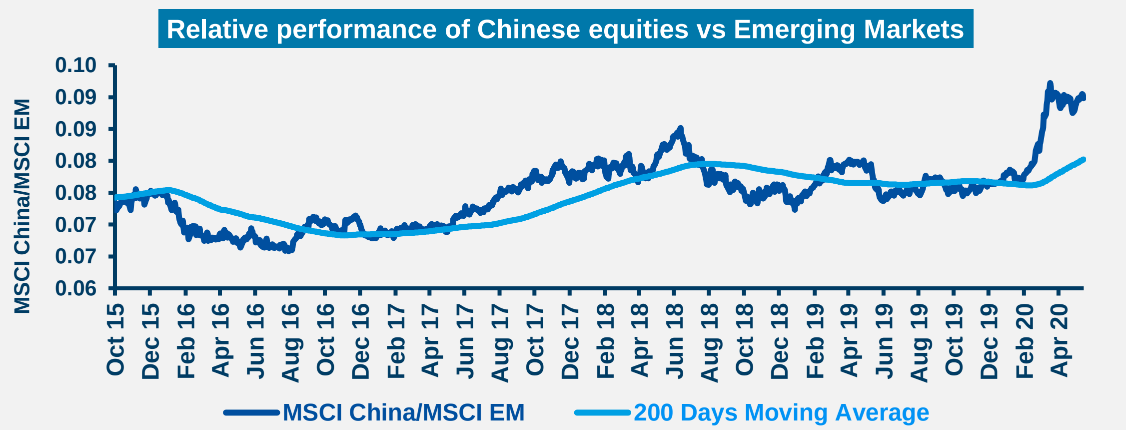
Overall we urge caution, given the heightened level of uncertainty and deteriorating fundamentals. **It is crucial to maintain process discipline, focus on stock selection, and ensure appropriate liquidity levels.** We continue to favour balance sheet strength and believe investors should balance near-term risks with medium-term opportunities through extensive use of scenario analysis. Opportunities exist and we suggest investors to apply barbell strategy with exposure to attractive stocks in the defensive sectors (utilities, health care, consumer staples) on the one end and non-disrupted and discounted cyclical sectors (luxury, construction) on the other. In addition, identifying some structural winners in some accelerating trends, such as e-commerce, will be key in generating long-term returns. From a style perspective, there are selective opportunities within value in non-disrupted cyclical areas.

US equities

US equities remain one of the best long-term asset classes in the world, and the outperformance continues to build in these conditions. We expect the market consolidation that started in mid-April to continue. In terms of convictions, we believe the winners will continue to win. Investors should avoid the sector/stocks that are under extreme short-term pressure, including airlines, challenged retailers, cruise lines, high fixed-cost and low-margin businesses, and commercial real estate. **Instead, we think investors should focus on sector leaders with sustainable businesses in an ESG integrated approach.** This approach proved to be right during the correction and we recommend investors continue to follow this path. Sustainable companies with market-leading positions win when market conditions are tough. **Now is also a time for investors to marginally start adding cyclicality to their portfolios**, as low volatility is overpriced. At a sector level, we prefer financials, communications services and industrials while we are cautious on consumer staples, utilities and materials.

EM equities

We are focusing on countries at a later stage of the coronavirus cycle (China, Taiwan, Korea) and less vulnerable names within stories of resilient domestic growth and progress in structural reforms (EMEA, India). While there could be headwinds as global uncertainties remain, **skillful bottom-up selection, a careful top-down assessment, and liquidity management can help investors weather the current storm.** In conclusion, although we prefer to maintain an overall cautious stance for the time being, our outlook is constructive for EM assets in the medium term – as long as the risk of a second wave of infection does not materialise.



Source: Bloomberg, Amundi as at 20 May 2020. MSCI China and MSCI Emerging Markets Price Index in US dollar.

Dividends are now likely to be pro-cyclical because they will reflect the environment in which companies operate, as the latter will be accountable not only to shareholders but also to society.

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Head of Equities

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Global Head of Emerging Markets

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Amundi asset class views

	Asset class	View	1M change	Rationale
EQUITY PLATFORM	US	-/=		The correlation between economic data (weak) and market performance (positive) has never been so low and markets are pricing in a quick recovery which is too optimistic, in our view. We believe earnings estimates will continue to come down and we stay defensive. However, this cautious view should not be confused with a long term positive stance as US equities are reasonably valued relative to their cost of capital. In addition, the dividend yield of US equities is higher than 10y UST and that is rare.
	Europe	-/=		The unprecedented economic ‘sudden stop’ has already impacted demand and supply in an environment where forward visibility is low with a wide range of outcomes. Therefore, caution is warranted and we recommend investors balance near-term risks with medium-term opportunities by maintaining process discipline, focusing on stock selection and ensuring appropriate liquidity.
	Japan	=		Corporate valuations remain below their long-term averages and balance sheets are under-leveraged; but, the current recession and weak global demand will affect earnings. We remain neutral.
	Emerging markets	=		We are cautious overall and are exploring names in countries at a later stage of the coronavirus cycle (China, Taiwan, Korea) and in countries with resilient domestic growth and progress in structural reforms (EMEA, India). However, as global uncertainties remain and further trade tensions are looming, there could be headwinds.
FIXED INCOME PLATFORM	US govies	=/+		UST demand remains strong, supported by the QE programme and foreign inflows. While at the latest FOMC the policy rate remained unchanged, the US Congress approved additional fiscal measures leading to a total fiscal stimulus of nearly $3tn. Issuance programme, including long dated bonds, will bring more duration to be absorbed by the market.
	US IG Corporate	=/+		IG spreads have tightened and markets have absorbed record issuance of corporate bonds, supported by continued QE. Given this spread-tightening and elevated uncertainty (social, economic and market), selectivity is increasingly important. However, attractive valuations offer compelling return prospects over the next one to two years.
	US HY Corporate	-		The Fed’s move to unexpectedly expand the scope of its corporate security purchase programmes in early April to include crisis-related ‘fallen angels’ as well as HY ETFs supported activity and spread tightening. Despite all that, we remain very cautious and focus on quality, as any economic recovery is likely to be slow.
	European Govies	-/=		We stay cautious and wait to see how the recent agreement between France and Germany to push for a recovery fund is received by other EU member states. We are still mildly constructive on peripheral bonds.
	Euro IG Corporate	++		EUR IG should benefit from the current normalisation environment and the ECB’s large liquidity backstop. We remain positive on EUR IG, particularly on the subordinated debt financial sector,
	Euro HY Corporate	-/=		We remain selective on industrials sectors such as auto, as well as on pharmaceuticals and media. Overall, we think, liquidity is stabilising, but is still tight in the current market environment.
	EM Bonds HC	=/+		Covid-19 and oil dynamics are shaping the economic environment for EM and in general we have been cautious. We remain positive on HC debt, where we have a constructive stance on selective HY names, and also believe that some IG primary market offerings are attractive.
	EM Bonds LC	=		We like local rates and believe selectivity is important in countries such as Mexico and South Africa. Russia continues to offer attractive value. Note that we remain cautious on FX.
OTHER	Commodities			Cyclical commodities are not supported by the economic backdrop, due to the global lockdown, and oil is suffering the same fate. While oil prices will benefit from a restoration of economic activities, markets are still discounting a huge structural oversupply and a no-recovery scenario. Gold remains the great winner in this framework, as it benefits simultaneously from economic uncertainty, increasing government deficits and central bank QE purchase programmes.
	Currencies			While CB and government interventions have helped contain credit risk and ease financial conditions, the USD stayed resilient, with depreciation visible against only a few currencies. In addition, when we look at fundamentals, the US Dollar Index (DXY) trades at a premium to its fair value. However, valuations don’t work properly in uncertain times and during capitulating growth expectations. The EUR has been an underperformer as EZ growth is collapsing (more than US) and the outcome of the German court ruling had an impact. But Franco-German agreement on a recovery fund could be positive. Our 12M target for the EUR/USD is 1.14.

LEGEND

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Negative Neutral Positive

▼ Downgraded vs. previous month ▲ Upgraded vs. previous month

Source: Amundi, as of 25 May 2020, 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.

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AMUNDI Investment Insights Unit

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