Confidence must be earned

Amundi ASSET MANAGEMENT

Janauray 2021

Global Investment Views

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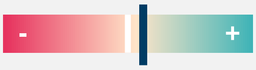
Overall risk sentiment

Risk off   Risk on



Watch out for inflation and selective rotation into equities balanced by the need for hedges and duration exposure

Changes vs. previous month

- Exploit rotation opportunities in cyclical, value segments
- UK assets upgraded (equities and GBP)
- Use TIPS for diversification and inflation protection

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

The big shock, the big hope, the big illusions

2020 has been an unprecedented year in modern history, with the Covid-19 pandemic leading to the deepest global recession post World War II that has affected the most countries simultaneously since the 1870s (World Bank). **This big shock is not going to reverse completely, and the old normal will not return as it used to be.** Hopes for a fast vaccine distribution, a further fiscal push, and for decreasing geopolitical tensions are all driving the reflation narrative. As a result, despite the recession, most markets are closing the year with positive performances. Entering 2021, the reflation phase may continue, but investors will have to assess four factors to play the rotation, avoid bubbles, and build resilient portfolios.

Factor 1. Recent market rally is based on blind faith in the success of vaccines and on the brave assumption that everything will be as before. This is the first source of risk – not only because the production, and dissemination, of vaccines on a large scale is not a trivial endeavour, but also because markets are assuming that a large majority of the population will be vaccinated. The idea of normality being just around the corner is a chimera, and this will bring up all the issues associated with this scattered restart. For investors, distribution of a vaccine should further support recovery and the case for favouring equity vs HY credit. In this rotation, Value will benefit the most while investors should stay cautious in the most crowded growth areas, where a significant bubble could be under pressure in a reflation environment.

Factor 2. Fiscal and monetary policy are keeping the economic system going, but what has been put in place so far is insufficient – especially on the fiscal side – but also not always well directed or calibrated. Any withdrawal of measures is unthinkable; on the contrary, CBs will be called upon to do more, and the risk of a policy mistake is underestimated by the market. On the other hand, some inflation pressure will eventually materialise. Closing out 2020, 10Y Treasury yields are back in the 0.9-0.95% range. Should the recovery drive some higher inflation, yields could rise further, with some possible domino effects on markets. Again, we do not expect to see high inflation tomorrow, but buoyant housing markets, supply chain relocations, and a huge amount of savings waiting to fuel pent-up demand could rapidly change the *zero inflation narrative forever*. It's likely that the Fed will intervene in case of any quick move in yields in a sort of curve-control mode. Investors should be watchful of inflation to avoid being trapped in the long-duration trade, which is increasingly risky. We recommend a balanced approach to duration and investors should consider exposure to US inflation which could be first to materialise in a weak dollar scenario.

Factor 3. The recovery path is being led by China. It is leading the way out of the crisis as the only big economy to fully recover in 2020. In 2021, China should continue on this trajectory of faster growth compared to the RoW, lifting EM Asia and with a positive feedback loop, especially with Europe, given the strong trade links with China and Asia. Investors should consider entering 2021 with an allocation to EM, and Chinese and Asian equities. In fact, despite the strong performance seen in 2020, there is room for further growth, in our view, especially in areas more linked to internal demand.

Factor 4. The key risk today in the market is the consensus itself. The skyrocketing negative-yielding debt will push the search for yield to the extreme. The temptation to go down in quality is high as well as to make all the same *low-interest-rate* forever bets. But, this is dangerous, if we consider the scarce market liquidity in the system. For investors, credit selection is paramount, but it is key to look across the board to search for yield. Including investments in private markets, for investors with the appropriate time horizon, will provide a wider and diversified spectrum of opportunities. In addition, investors should balance the appetite for yield in HY and EM bonds (including LC) and credit with exposure to government bonds as liquidity providers and diversifiers in asset allocation.

Investors will enter 2021 with a positive backdrop for equities. Lower expected returns in bonds amid low interest rates and tight credit spreads mean that investors will have to embrace higher risk (higher equity) to reach their return targets. Volatility could also return in *'stop-and-go'* phases related to vaccine distribution. This reminds us of the importance of **adding further sources of diversification with uncorrelated investment strategies and keeping some hedges in place.** The outlook is positive, but the road to recovery will likely be bumpy. Fasten your seat belt and watch out for a 2021 full of opportunities.

MACRO & STRATEGY

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"The increased stimulus is consistent with a scenario of low rates for longer and search for yield in the Eurozone."

ECB: strong support to Euro fixed income in 2021

Very much in line with consensus and market expectations, **the package delivered by the ECB at its December meeting combined additional measures of quantitative easing (QE) with further support to the financial system**. The pandemic programme (PEPP) was extended in time and increased by EUR 500bn while the APP (Asset Purchasing Programme) was confirmed to proceed at the current path of EUR 20bn in purchases per month, **meaning additional firepower of EUR 300bn over 15 months**. Measures in support of the financial system came through the TLTRO tool, extended, enlarged in its scope and confirmed in terms of very favourable conditions attached to ECB lending operations. A nine-month extension of the PEPP into 1Q22 is longer than the six-month (end 2021) extension generally expected by consensus, but the decision appears to be consistent with recent messages from many ECB members on the **importance of both the size and duration of the stimulus.** The extension of the reinvestments horizon of maturing bonds is very much in the same direction as well.

The ECB's emphasis has turned mostly on providing and keeping favourable funding conditions for as long as needed to support economic growth in recovering from the pandemic crisis. In the Q&A following the meeting, President Lagarde underlined that the strategy of the ECB aims at *"preserving favourable financing conditions over the pandemic period"*, defining them "*in a very holistic way*", namely "*for all sectors of the economy.*" Therefore, the ECB made it clear that lending rates to households and corporates, and at sovereign levels are all within the scope of the support, together with credit flows to the economy. In order to reach this target, the ECB calibrated a very strong increase in its QE, securing a "*significant constant market presence*" which will provide the central bank with the necessary flexibility for managing its QE. In this respect, the ECB president also underlined the symmetry of the eventual pace of adjustment as on one side, the envelope represents a ceiling and "*does not have to be spent in a pre-defined way, or even in full*", but "*equally, the envelope can be increased if it is necessary.*"

We assess that the increased stimulus looks consistent with the objective of **keeping up support for technicals regarding fixed income markets into 2021** and thus supporting the current low rates for longer scenario as well as the yield search.

Between the now larger PEPP and APP, **the ECB will in fact have more than €1.4tn of remaining net purchasing capacity by end-March 2022**.

ECB QE also looks more than sufficient to cover eventual additional Euro government bond net funding that may be needed to finance new support measures to counteract negative impacts from current restrictions and to increase its presence in supranational segment as well in sight stronger EU issuance. On the TLTRO side as well, our guess is that the **new measures will be effective in keeping a high level of liquidity available in the financial system, indirectly supporting bond technicals.**

Ultra-cheap credit for banks, even with strong conditionality, will not be enough to avoid a tightening in banks' lending conditions for companies. This crisis has been characterised by contra-cyclical credit conditions, thanks to the coordinated actions of CBs and governments.

In recent months, banks' credit conditions have remained accommodative, thanks to (1) strong liquidity injections via TLTROs and (2) government loan guarantees. The massive supply of credit for all businesses has limited corporate defaults and the long-term economic damage from this crisis. **We remain concerned about a significant tightening in bank lending conditions once government guaranteed loans expire.** Banks had already curtailed access to corporate credit in Q3 and expected to tighten further in the coming three months. "*Banks referred to the deterioration of the general economic outlook, increased credit risk of borrowers and a lower risk tolerance as relevant factors for the tightening of their credit standards for loans to firms and households*".

The duration of the monetary support is as key as the degree of accommodation. A lot of monetary and fiscal support is currently justified by the pandemic. However, very accommodative monetary policy will still be needed after March 2022. In the coming years, (1) inflation is expected to remain well below the 2% target and (2) economic fragmentation among Eurozone countries will continue to be a challenge.

In 2021, questions and concerns will arise about what kind of monetary support is required once the coronavirus crisis ends. It is likely that the more hawkish members of the ECB will be more opinionated on this issue.

TLTRO= targeted longer-term refinancing operations.

MULTI-ASSET

Reinforce cyclicality with relative value and hedges

We continue to see support for risky assets as we move into 2021, backed by the shift from a contraction phase to a recovery. Importantly, a potentially split US congress represents a challenge to the reflation trade narrative, but doesn't alter, in our view, **the positive backdrop for cyclical segments.** In this environment, **equity remains more attractive than bonds** and we see some upside over a one- year horizon. We are mindful that this recovery is different from those in the past in the sense that equity valuations are already high as we enter this phase and it is dependent on an effective, large-scale rollout of vaccines. As a result, **we recommend that investors be very selective and valuation-conscious across the asset spectrum.**

High conviction ideas

Overall constructive on DM equities due to positive momentum on PMIs and strong fundamentals, **we have upgraded our view on the UK** amid the current 'Brexit discount' and improving earnings revisions, but stay vigilant. On the other hand, we continue to believe that **Japanese and Pacific-ex-Japan (Australia) equities** should benefit from an economic rebound. Their high operating leverage means profit margins could grow in proportion to the higher sales we expect in 2021. On EM, we remain optimistic overall, with a positive view on **Asia.** In particular, with an eye for relative value, we now believe the Chinese A-share market (largely financials, conventional consumption) should do well vs MSCI China (ie, internet, e-commerce and telecoms) while financials should benefit from the improving economic momentum supporting the factor-rotation towards Value and Laggards; internet-related segments may be weighed on by a regulatory overhang. Financials will also benefit from favourable technicals, sentiment (potential inclusion in MSCI indices) and earnings.
On duration, we remain positive on the 10Y UST from a tactical perspective as tail risks for 2021 are tilted to the upside, linked with US political developments and the effects of a reflationary environment, especially if the Fed is perceived to be behind the curve. We also stay positive on US inflation. **On Euro peripheral debt**, our view remains constructive, especially on the 5Y BTP, which now offers lower potential for spread tightening, but is still supported by strong technicals. **We are positive on credit** as demand for carry and QE should support it, but we favour EUR IG over US due to attractive valuations, the ECB's recent extension of its purchasing programmes and lower leverage in EUR IG.
Investors' search for yield would support a 'smart income' strategy in EM HC where we stay constructive, but believe potential for spread tightening is higher in HY compared to IG. On FX, maintain our positive view on the Russian ruble, Mexican peso and Indonesia rupiah.
In DM FX, we are positive on CAD vs USD as we believe an economic recovery could weigh on the greenback, which already looks overvalued. On the other hand, growth in Canada is proving to be stronger than expected and the CAD has lagged the rest of commodity FX in 2H20. Another factor supporting the CAD is that carry is the highest in Canada among the G10. Secondly, **we upgraded our stance on the GBP** to neutral vs the USD and EUR due to a potential positive surprise from Brexit news flow, but are monitoring the situation closely.

Risks and hedging

Additional waves of coronavirus infections and accompanying lockdowns, a premature withdrawal of stimulus and geopolitical tensions represent credible risks to an economic recovery. As a result, investors should maintain robust hedging structures in the form of derivatives, JPY, USD and USTs to safeguard credit and equities exposure. We also believe gold continues to act as a strong hedge in the current environment.

Amundi Cross-Asset Convictions

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

Source: Amundi. The table represents a cross-asset assessment on a 3- to 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. UST = US Treasury, DM = Developed markets, EM/GEM = Emerging markets, FX = Foreign exchange, FI = Fixed income, IG = Investment grade, HY = High yield, CBs = central banks, BTP = Italian government bonds, EMBI = EM Bonds Index.

Matteo GERMANO
Head of Multi-Asset

We maintain a pro-cyclical tilt and believe the reflation trade can continue, but investors must protect their equity and credit exposure through robust hedges.

Amundi
ASSET MANAGEMENT

FIXED INCOME

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Economic reopening could raise inflation expectations in the US, affecting real yields. Investors should use credit research as a means to strike a balance between higher yields and high quality.

"Great discrimination" in credit

The Q3 rebound in GDP numbers was stronger than expected, but renewed lockdowns due to the second wave of Covid-19 infections could affect economic activity in 4Q20 and 1Q21. On the vaccine front, a large-scale rollout and accommodative policies, as put in place by the ECB at its latest policy review meeting, should drive a recovery in global GDP in 2H21, providing a supportive environment for risky assets. However, in credit, there is a wide gap between valuations and fundamentals. So, we recommend investors balance their search for yield with quality credit through strong research and selection.

Global and European fixed income

With an overall cautious view on duration, we marginally downgraded our US stance to move close to neutral and maintain our defensive position on core Europe. We remain constructive on peripheral debt mainly through Italy (ECB support, strong EU policy response) even though the likelihood of spread tightening going forward is now lower. On the US curve, we stay vigilant on the 2Y, 10Y and 30Y segments. Finally, we upgraded our US break-even view, favouring 5Y over 10Y, and believe valuations are attractive in the EZ. The upside potential in break-even is not currently priced-in by the markets. **We remain constructive on credit**, particularly cyclicals, and see the recent rally as an opportunity to lock in some gains without altering our stance. Ihe scope for further spread compression is higher in HY vs IG, in BBB vs A-rated, and in subordinated vs senior debt. However, markets are not far from a situation where spreads do not appropriately reward for the risk. Hence, we stay very active. At a sector level, we are positive on financials and telecommunications, but cautious on basic utilities, healthcare and transportation.

US fixed income

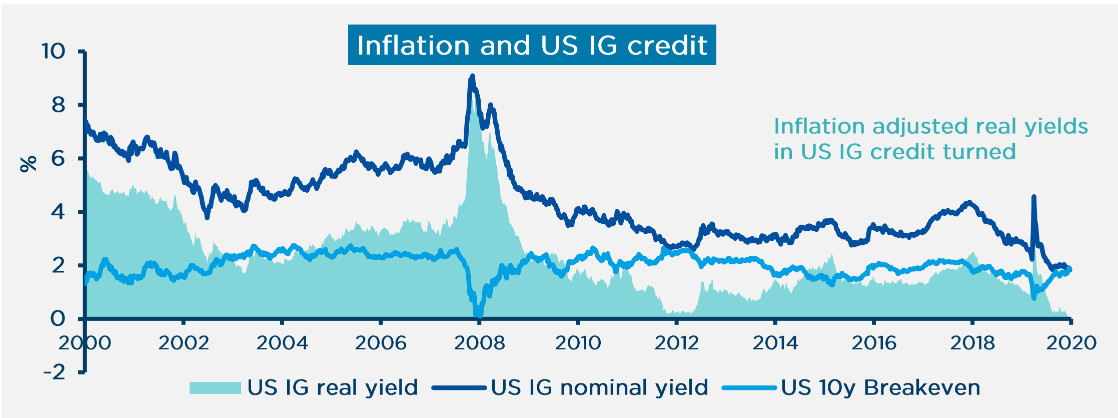
As we move out of the pandemic and see large-scale vaccine distribution, we believe, the pent-up demand for goods and services from US consumers (supported by savings), coupled with the Fed's lower-for-longer stance, should push up inflation. Accordingly, we believe TIPS are a good way to diversify portfolios and protect from inflation. On the other hand, deficit spending and increased UST issuance may put upward pressure on yields, leading to some steepening. Hence, we remain defensive, but believe UST futures offer strong liquidity. On credit, active selection and research are crucial in allowing investors to de-risk portfolios. We think investors should avoid sectors that have completely normalised. In fact, current conditions are ripe for idiosyncratic aspects rather than a complete market beta exposure. In particular, consumer (esoteric ABS) and residential mortgage markets (agency mortgages) remain attractive in light of strong aggregate consumer earnings, savings and debt repayments.

EM bonds

Overall positive on EM FI, we believe there is still room for spread compression in HY. Local FX is supported by low yields globally, benign inflation, stable US policy, and an early-cycle growth environment. Asian growth could outperform other regions in 1H21, offering selective opportunities. In Turkey, we acknowledge risks related to the BoP and lira, but believe there are opportunities amid credible normalisation of economic policies and cheap valuations.

FX

We are cautious on USD/JPY and USD/CNY given improving environment for cyclical FX. Our constructive view on NOK/EUR is also maintained.



Source: Amundi, Bloomberg at 14 December 2020. Yield to worst for Bloomberg Barclays US Total Return Index.

GFI= Global Fixed Income, GEMs/EM FX = Global emerging markets foreign exchange, HY = High yield, IG = Investment grade, EUR = Euro, UST = US Treasuries, RMBS = Residential mortgage-backed securities, ABS = Asset-backed securities, HC = Hard currency, LC = Local currency, CRE = Commercial real estate, CEE = Central and Eastern Europe, JBGs = Japanese government bonds, EZ = Eurozone. BoP = Balance of Payments.

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ASSET MANAGEMENT

EQUITY

Still room for Value to catch up

Overall assessment

The progress on vaccines globally and the approval of one in the UK and two in the US seem to have put a time limit on the pandemic, which is encouraging markets to look into the future. On the corporate front, earnings growth is expected to be significant in 2021, driven by continued stimulus and an economic recovery. However, stretched valuations in some segments, risks of multiple Covid-19 waves, and worries over corporate solvency require a selective approach. We believe that a fundamental, bottom-up analysis of businesses with quality balance sheets will be crucial for sustainable returns.

European equities

Given that reopening of the economy is very much dependent on a large-scale vaccine rollout, **we maintain a balanced stance, with a bias towards normalisation and recovery**. This supports our barbell stance regarding defensive sectors such as healthcare and telecommunication services, on the one hand, and quality cyclical stocks in the industrials and material sectors, on the other. While we are optimistic on the last two, we became marginally positive on financials, which should benefit from a shift towards Value. Interestingly, the last month saw **Value investing coming back in favour vs Growth**. However, on a longer historical perspective, **the Growth vs Value premium is still high.** We believe the potential for Value to outperform is still significant, but depends on the aforementioned vaccine rollout, economic recovery, improving PMIs, and direction of rates. Therefore, we prioritise process discipline and stock selection, all the while managing market and style risks. In contrast, we are more cautious on consumer discretionary, but have maintained our negative view on tech. In all cases, though, we focus on resilient businesses.

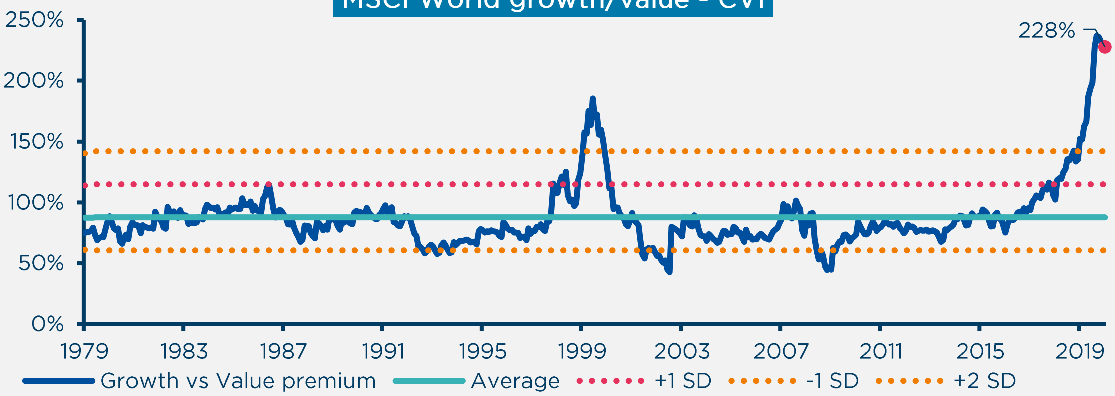
US equities

We believe equities are more attractive than credit from an income perspective, but, however, this doesn't eliminate the need to stay active. In fact, selection is even more important today because there are pockets of extreme valuations in the market. However, digging deeper, investors should avoid hyper-growth stocks and see if continuous fiscal stimulus, a recovery in 2021, and improvement in corporate earnings drive a **rotation from the mega-cap growth stocks towards more cyclical growth and cyclical value stocks**. The last should benefit from lower interest rate sensitivity. Growth names are more rate-sensitive because they have a higher dependency on future earnings and would be more negatively affected by rising discount rates. Conversely, financials, heavily represented in the Value universe, would benefit from a steeper yield curve. As a result, investors should: (1) consider shifting away from hyper-growth and high momentum stocks and move to reasonably priced, stable growth names (ie, medical devices); (2) aim to benefit from a rotation favouring high-quality Value stocks (ie, industrial automation, parcel delivery); and (3) explore opportunities in the ESG space.

EM equities

While geopolitical risks remain on our radar for EM assets, we continue to be constructive about exploring names in countries where economic activity has rebounded. At a sector level, we are selectively positive on tech and internet, consumer discretionary and industrials, but are mindful of extreme valuations in these areas. We don't like sectors where profitability may be restrained by government action. Stylistically speaking, our tendency is to look for value with sufficient cyclical growth and quality characteristics

MSCI World growth/value - CVI



Source: Amundi Research, DataStream on 15 December 2020.

> *Despite the recent outperformance of Value vs Growth, the catch-up potential for Value is significant and depends on earnings growth and economic normalisation.*

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Amundi asset class views

Platform	Asset class	View	1M change	Rationale
EQUITY PLATFORM	US	=		A potentially divided Congress would remove the pressure on equities in the form of excessive regulations and higher taxes. In addition, equities are attractive vs fixed income as earnings yields exceed corporate IG yields and the gap between dividend yields and the 10Y Treasury yield is huge. Looking ahead, economic recovery in 2021 and earnings improvement should be supportive. However, investors should be mindful of excessive valuations and should explore rotation towards quality Value and cyclical stocks as well as ESG themes.
	Europe	=/+		We stay mildly optimistic as a vaccine rollout should support normalisation of the economy, but we believe a sustainable rotation favouring Value and cyclical depends on economic recovery, continuous fiscal push, and the direction of interest rates. However, investors should remain focused on businesses with potential for long-term earnings growth and resilient business models.
	Japan	+		Pro-cyclical markets, such as Japan, with a large share of industrials and consumer discretionary sector, should benefit from an economic rebound as well as from close trade linkages with China. In general, the high operating leverage of businesses in Japan should be positive for profit margins as a result of higher sales in 2021.
	Emerging markets	+		We remain constructive in light of a potential large-scale vaccine availability and as investors put more money to work away from low remunerating assets. Asia is our favourite area, but the improvement in economic conditions should support Latam and Cemea next year as well.
FIXED INCOME PLATFORM	US govies	=		In global portfolios, we are close to neutral on USTs, but are actively monitoring the direction of rates and curve movements in light of fiscal stimulus discussions and expectations of curve steepening. Instead, we prefer TIPS. With a US fixed income perspective, USTs offer good liquidity, but could come under pressure as the growth outlook improves. So, we are cautious.
	US IG Corporate	=		We remain neutral/marginally positive amid Fed support for the markets, but acknowledge that IG spreads have tightened. In securitised credit, consumer and housing markets present selective opportunities as US consumer and savings remains strong and loan/value ratios are low.
	US HY Corporate	=		HY offers that extra income in a low rate world supported by Fed action, but we are very selective in view of default risks and a slow recovery. Going forward, investors should differentiate between companies that have the capacity to repay their obligations vs those that are being helped by artificially low borrowing rates.
	European Govies	-/=		We stay cautious on core Euro government bonds due to overvaluation and see limited risk of yields dropping further, although the ECB will maintain its supportive policies, as highlighted in its latest round of stimulus. However, we are positive on peripheral debt, mainly through Italy, amid a strong EU policy response, even though we think prospects of spread compression in this space are now limited.
	Euro IG Corporate	=/+		Euro IG offers opportunities in the 'search for yield', particularly in the BBB segment. The scope for further spread compression is limited, and investors should lock in gains where the potential for further tightening is limited. A focus on quality and liquidity must be maintained.
	Euro HY Corporate	=		Spread tightening will not be uniform across the board. Instead, the case for selectivity is as key as ever and investors should use research as a means of balancing yield with quality and should steer clear of very-low-quality names.
	EM Bonds HC	=/+		We keep our benign outlook for EM debt, but continue to see better risk/reward in HY, and while spreads are tighter, there is still room for compression. We stay mindful of the potential risk on the duration side in IG, if there is further pressure on USTs.
	EM Bonds LC	+		We are positive on LC bonds because of expectations of USD weakness. On FX, a global low-yield environment, benign inflation, stable US policy, and an early-cycle growth environment all support EM local currencies.
OTHER	Commodities			Oil prices moved up over the past month, reinforcing our conviction about a global economic recovery and an ongoing rotation. Nonetheless, we confirm our 2021 price target range of US$40-50/bbl for WTI. We also reiterate our constructive view on gold, despite the recent correction. Gold will benefit from a prolonged dovish stance of central banks.
	Currencies			Despite most of the G10 FX undervaluation gap (vs the USD) has been absorbed, a shift from 'Contraction to Recovery' suggests that the greenback has more room to correct lower, at least in 1H21. In addition, our central scenarioof a global recovery sees commodities performing in line with nominal GDP, a mild steepening of the yield curve, and Value outperforming Growth. All of these factors are likely to weigh on the dollar, which is still about 3% above its average fair valuation. In this environment, the NOK, AUD, SEK and CAD show the highest risk/reward profiles.

LEGEND

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Negative Neutral Positive

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

Source: Amundi 21 December 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. IG = Investment grade corporate bonds, HY = High yield corporate; EM bonds HC/LC = EM bonds hard currency/local currency. WTI = West Texas Intermediate. QE = Quantitative easing.

AMUNDI Investment Insights Unit

The Amundi Investment Insights Unit (AIIU) aims to transform our CIO expertise, and Amundi's overall investment knowledge, into actionable insights and tools tailored around investors' needs. In a world in which investors are exposed to information from multiple sources, we aim to become the partner of choice for the provision of regular, clear, timely, engaging and relevant insights that can help our clients make informed investment decisions.

Discover more of Amundi's investment insights at www.amundi.com

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