Confidence must be earned

Amundi ASSET MANAGEMENT

March 2020

Global Investment Views

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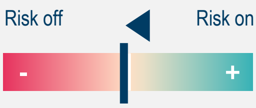
Overall risk sentiment



Tactical risk reduction, looking for entry points to recalibrate risk once the situation calms

Changes vs previous month

- Cautious on equities and EM FX, and constructive on duration, from a cross-asset perspective

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

Modest risk reduction, looking for entry points

The spread of the novel Coronavirus disease (COVID-19) outside China has rattled risk assets in the recent trading sessions. Investors triggered **some profit taking** in markets, which reached historical highs and even broke psychological thresholds in previous weeks. The atmosphere of fear has remained consistently high only in the so-called safe assets — the US Dollar (USD), US Treasuries and gold — signaling that investors have been looking for effective hedging strategies. **Our central scenario is for a temporary deterioration of the global economic picture in Q1 of this year, with some possible spill over into Q2**, given that weaker-than-expected global trade growth is ultimately affecting industrial production and manufacturing activity and there are some impacts on the internal demand. **Later on, we should see a recovery over the remainder of the year.** Overall, we have downgraded **global growth from 3.2% to 3.0%.**

Clearly, **the main risk now is the unwinding of recent market complacency** and the reaction of "animal spirits." The good run in risky assets has been driven by investors who believe (1) the COVID-19 episode will be temporary (our central scenario); (2) a worsening situation will trigger more Central Bank (CB) action; (3) they have no alternative, given the moves of safe-haven assets. Therefore, we can expect to see some profit-taking, short-term market volatility and overreaction.

A tactical move towards neutrality in risk exposure and an increase in hedging looks to be a good strategy to navigate this phase. Beyond that, COVID-19 must be seen as a way to implement our investment convictions, exploiting entry points in some areas of the markets such as the cyclical value component in European equities (already attractive, but even more so now), EM equities (help-yourself-countries or domestic-demand stories) and Emerging Market (EM) currencies. All these stories will be back in focus once the virus headlines recede. In addition, falling core yields will likely reignite **the search for yield in credit or in higher-yielding government bond space in EM and Developed Markets (DM) (e.g. Italy).** We should also not underestimate the fact that if the situation worsens, CBs and governments could start to use stimulus on a massive level, **renewing the narrative of *"bad news is good news"*. The US Federal Reserve (the Fed) recent inter-meeting emergency rate cut of 50 bps is a step in that direction.**

As main areas of risk and opportunity lie in credit, the main question for investors is: **to what extent will the coronavirus generate non-idiosyncratic disruptions?** We expect resilience in the credit market, in particular EU investment grade (IG), but we expect divergences between good quality names and bad quality names, which could come under stress. This reinforces our view of **an increased scrutiny in credit, focus on bottom-up research and a rise in attention on liquidity**.

From a long-term perspective, coronavirus reinforces some pre-existing trends:

- **De-globalisation and retreat in global trade** should support insulated investment themes, such as domestic-demand driven EM countries or a focus on more domestic real assets.
- **Low interest rates at equilibrium**. Core US bonds are providing a cushion for risky assets in reaction to setbacks, but they are also leading the rebound of risky assets. It follows that duration management must be asymmetric: it is much more risky being short duration than long duration, and there is a clear hedging-role for US Treasuries. In this scenario, the interest rate factor dominates the growth and earnings components of equity returns. Investors should be alert to the early signs of either a change in equilibrium rates or a shift pointing to more prominence for the real component of returns versus the monetary component, but we are not yet at this point.
- **Demand for real assets**. The absence of real illiquid assets is a recurring weakness as they represent an already large, but rising component of relative value plays. De-globalisation is driving demand for real estate on the basis that it provides significant international geographical diversification. The search for a better remuneration of the interest factor (infrastructure) or simply equity-like returns with bond features is also driving demand. This mismatch in supply and demand, along with trade and pandemic noise, can only accentuate this sort of safe-haven status with fast rising complacency.

MACRO & STATEGY

Monica DEFEND
Global Head of Research

Didier BOROWSKI
Head of Global Views

"The economic fallout is likely to prove transitory — albeit profound and impactful — as long as the virus spread is contained and activities can resume over a reasonable time horizon."

Coronavirus impact on economy and markets

Since the virus outbreak started, governments have implemented restrictions on travel to China and many activities have been shut down. This will affect both Chinese and global economic outlook in Q1. **We have consequently downgraded our 2020 growth forecasts for China and the main DMs**. We believe that such economic fallout will **prove transitory** — albeit profound and impactful — as long as activities resume in a reasonable time frame. Chinese authorities and many Central Banks (CBs) in EM have already loosened monetary policy and announced more fiscal stimulus to help their economies weather the virus fallout. We expect this shock to spillover to China's Asian trading partners, causing temporary disruptions to the supply chain, followed by a rebound and growth stabilisation at potential.

Global trade and GDP growth will be the main casualties of such idiosyncratic shocks, along with those economies that are more open to external trade, such as Eurozone countries -- Germany and Italy above all. For instance, Germany's exports to China as a share of GDP were 2.8% in 2018, the highest share of any Eurozone country. Conversely, **the US economy should prove more resilient** thanks to its strong domestic demand (its exports to China accounted for only 0.6% of GDP in 2018). We also expect to see a hit to confidence indicators, with lower global Purchasing Managers' Indices (PMIs) eventually hitting earnings formation**.**

In our revised base scenario, the expected rebound in the global manufacturing sector only gets delayed. Operational hurdles will affect the automotive and energy sectors and the Q1 reporting season could deliver below-expectation results. Financial markets still rely on CBs' ability to support economies under difficult circumstances. Such a scenario remains mildly supportive of risk assets. **Since uncertainty on virus-related developments is high, we stress our central scenario**, with China's economic recovery proving slower than expected and the virus fallout more persistent. Global trade would contract by 2.0%, entailing significant supply chain disruptions and causing a 2.3% contraction in US industrial production in 2020. In the Eurozone, the drop is likely to be larger — at 3.3% — with Germany and Italy heavily hit. In the longer run, Western corporations might insource activities from China. Under such circumstances, the stall in economic activity would cause a plunge in confidence indicators and tighter financial conditions.

Based on historical evidence, we modelled the fallout of a four-point (or higher) drop in the global manufacturing PMI for a quarter, followed by a rebound. Such developments would cause a 4.8% fall in US equities and around 7.4% for Japanese and European equities. If this is the case, in the last few days the market has probably overshoot on the downside (our base scenario at the moment) or it has started to price in a darker scenario, under which the downside move would continue.

Finally, we built a **downside risk-off scenario** in which the efforts of Chinese authorities to restart growth falter, China's 2020 GDP slows to 4.9% YoY — rather than 5.6% as outlined in our revised base scenario — and the global economy moves into recession. In addition, as new virus hotspots emerge in Europe, we have included an endogenous slowdown of Italy's economy in our analysis, where cities are put into quarantine and activities are shutdown to contain the spread of the virus. Italy might experience a recession this year, as affected areas account for about 40% of its GDP. Should similar occurrences be seen in other European countries, we would need to review our forecasts accordingly. In that case, the global economy would experience both a supply and demand shock to both the manufacturing and the services sectors and US GDP growth would be barely positive this year, while both Eurozone and Japan's GDP would contract. Financial risks would rise, along with a spike in default rates and distressed ratios and tightening of financial conditions. Corporates would experience contracting earnings per share (EPS) growth – our estimates are for a 6% EPS contraction in the US and an 8% contraction in the Eurozone. CBs may have to jump in with emergency liquidity injections. The US Fed would cut rates by 75 bps (50 already cut) and global CB balance sheet expansion would hit 4%. In Asia, fiscal authorities will likely support the outlook with a massive fiscal expansion aimed at restoring both production and consumption trends. However, some countries have limited room for manoeuvre and may not be able to put in place powerful countercyclical tools. In such a scenario, we would switch to a defensive asset allocation and European equities may suffer as poor Q4 2019 results would be intensified by new hurdles related to the virus outbreak.

For now, **we estimate a low probability that this scenario will materialise.**

MULTI-ASSET

Matteo GERMANO
Head of Multi-Asset

Time to reduce risk, but be prepared to re-enter

Our fundamental view on the stabilisation of global growth around potential has not changed and we believe the continued active role of monetary and fiscal policies will support this. However, the spread of COVID-19 beyond China into other areas in Asia, Europe and America could have an impact on demand and this is now reflecting in asset prices. As a result, **we have become more cautious on risk assets to accommodate these possible events**. Having said that, our strategy is to stay vigilant and monitor fresh data to better assess the effects on the global economy.

High conviction ideas

Given this volatile environment, we believe it is appropriate to tactically take profits and trim the directional risk exposure. Derivatives are a good tool to reduce the exposure to European and US equity. Overall, we have moved to a negative stance on these markets. **These actions are tactical in nature,** and driven by risk management considerations in order to try to protect investors' portfolios from short-term volatility. In EMs, we have removed our positive view on China and the relative preference for Korea vs. global EM as these are among the most directly (and indirectly) affected areas by the spreading of the virus. Nonetheless, we remain ready to reconsider our stance on the EM equity asset class once the situation calms down.

In fixed income, **we are more constructive on duration in Europe and the US** as this is also an hedge in case of further volatility in the market.

We maintain our relative preference for 5Y US Treasury vs. Germany 5Y, owing to stronger safe-haven demand for the former and given that the Fed has more scope to cut interest rates than the European Central Bank (ECB), as reflected in the recent comments by Christine Lagarde. The **Italian Government securities (BTPs) remain a search for yield strategy**, where we see some short-term pressure if the markets start discounting an economic recession and also if investors start to book profits from their long market positions. However, we prefer a wait-and-see approach amid favourable technicals, relative value and lower political risks. BTPs continue to offer attractive yields (compared with similar-rated sovereign and corporate bonds). We maintain our relative preference for Italy 30Y vs. Germany 30Y.

Credit is attractive, particularly in Europe, supported by technical factors, inflows and the ECB's quantitative easing programme. **However, we believe it is prudent to protect credit exposure through derivatives** in case there is a sell-off as witnessed in equities recently. We prefer Euro (EUR) over US in both IG (lower leverage in EUR) and high yield (HY) (better quality in EUR and lower exposure to the energy sector). **In EMs**, attractive carry, subdued inflation and dovish EM central banks are supportive of EM debt, where we prefer hard currency (HC) over low currency (LC). However, we suggest partially hedging the duration and currency risk.

On FX, while we believe the effect on Chinese growth should be transitory, the virus outbreak could have negative consequences for EM currencies. Accordingly, **we are more cautious now and have temporarily removed our positive stance on EM FX**. In DM, EUR/USD moved lower, given that the US economy appears to be less exposed to external risks. This **extreme movement has already started to reverse.** However, the strength of the USD could last for some time as growth concerns in Europe are expected to continue and interest rate differentials are also in favour of US Treasuries. Therefore, **we prefer to move to a neutral view on EUR/USD** and monitor market conditions to reassess this view.

"In search for protection from continued market volatility, we believe it is appropriate to tactically trim the directional risk exposure and look for more favourable entry points when visibility will improve."

Risks and hedging

The virus impact, high market expectations regarding central banks policies, and the evolution of the Brexit transition process are all risks that could cause volatility. **We recommend hedges such as gold, US Treasuries and the Japanese yen (JPY)** to safeguard investor portfolios.

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.

FIXED INCOME

Eric BRARD
Head of Fixed Income

Yerlan SYZDYKOV
Global Head of Emerging Markets

Kenneth J. TAUBES
CIO of US Investment Management

"In a world of falling yields, investors should look at credit and peripheral bonds as a source of yield, but also leave some space for further addition in areas where price dislocation could arise."

High selectivity in credit, but there are opportunities

With elevated uncertainties on the macro side and investors' continued search for safety, **we expect the core government bond yields to remain very low**, with limited upside pressure. Negative yielding debt is back to US$14 trillion in value and this continues to push investors towards the 'oasis of yield' in credit, securitized assets and peripheral debt.

Here, a close look at the evolution of the macro economic situation is crucial. While abundant macro-liquidity supports financing of corporations, **a deterioration of the economic environment could affect the most leveraged areas of the market**.

DM bonds

In global fixed income, we maintain a slightly positive bias on duration, with a preference for the long end of the curve and flattening. We continue to prefer US, despite some profit-taking, as safe-haven demand is likely to support US Treasuries. Elsewhere, we have a short to neutral stance on core Euro duration (negative on Germany) and a short one on Japan and the UK as fiscal stimulus is likely to push rates higher and the Bank of England is likely to keep rates on hold. EU peripheral countries continue to offer attractive yields and we are constructive on Italy. Investors can also play curve flattening opportunities in Euro peripheral areas and steepening in the UK**. Credit remains an area of opportunity for us but selection is crucial.** EUR IG has been resilient and we continue to prefer it vs. US IG as the former should benefit from the ECB programme, in particular in the subordinated debt financial sector. In HY, EUR remains our favoured pick over US. Overall, we suggest investors to partially reduce the credit exposure to **make room for additions in the future**.

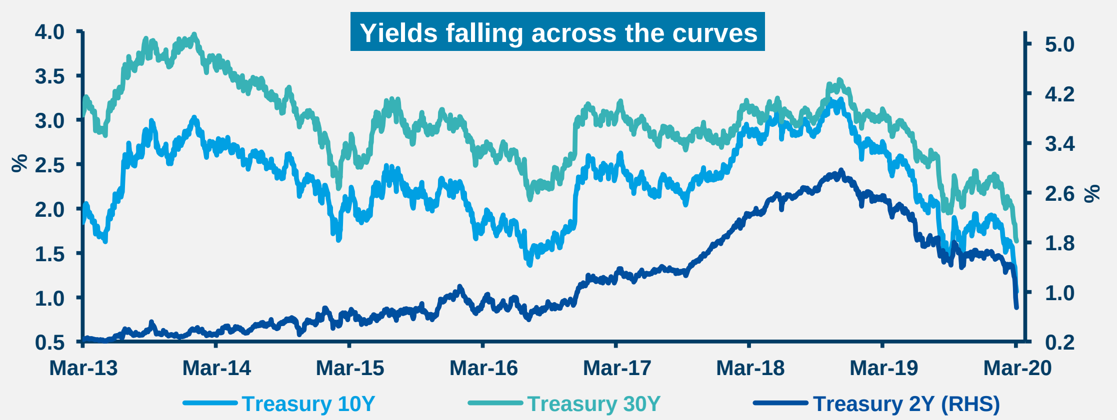
In the US, solid economic data and corporate earnings have helped propel credit spreads to near all time tight levels before coronavirus risk erupted. Tail risks to economic growth remain, potentially weighing on credit fundamentals. As a result, **we are cautious and selective overall**. **In US credit**, while we realise that prospective returns from securitized credit would be lower after last month's strong performance, we continue to favour securitized over unsecured due to the former's better risk/return profile**. Structured securities, including non-agency residential mortgage-backed securities (RMBS) and consumer debt, remain attractive vs. most other IG sectors**. Given that employment, wealth and confidence are strong, and as fundamentals in the housing market remain positive, low mortgage rates should boost home sales, prices and affordability. Spreads in the agency mortgage-backed securities (MBS) are attractive, but their potential for further tightening is limited owing to the net supply impact of the Fed's dwindling MBS holdings.

EM bonds

We remain constructive on HC bonds, notwithstanding the risks from the coronavirus and the US election cycle, as the technical backdrop remains favourable and monetary policy easing along with fiscal stimulus should be supportive. We **prefer select high-yielding names such as Indonesia, Ukraine and South Africa**. In LC, we think valuations have become less attractive and there will be some negative impact from currency weakening. Nevertheless, we continue to see pockets of value, especially in frontier markets.

FX

We maintain our cautious view in aggregate on EM FX, particularly regarding currencies more exposed to a further slowdown in Chinese growth and currencies of commodity exporting countries such as Thailand and Chile.



Source: Amundi, Bloomberg, as of 2 March 2020.

EQUITY

Volatility will reinforce bottom-up selection

Overall assessment

There is an elevated uncertainty regarding the short-term outlook for global equities. The coronavirus outbreak will weigh on economic growth this quarter and next. There is some political risk — underestimated in case of US election — and the expected earnings rebound will likely be postponed. Despite this short-term challenge, we expect the economy to rebound once the most acute phase is over. Moreover, the dovish stance of central banks and fiscal stimulus should support a manufacturing stabilisation and improvement in the outlook for equities. It is important to note that US markets, in general, are more defensive in a weak environment for equities. But **as soon as the situation stabilises, investors who are cautious in this phase, should exploit opportunities in the most dislocated areas of the market** (EU and EM equities). **Bottom up selection is extremely important,** to navigate the markets in this phase.

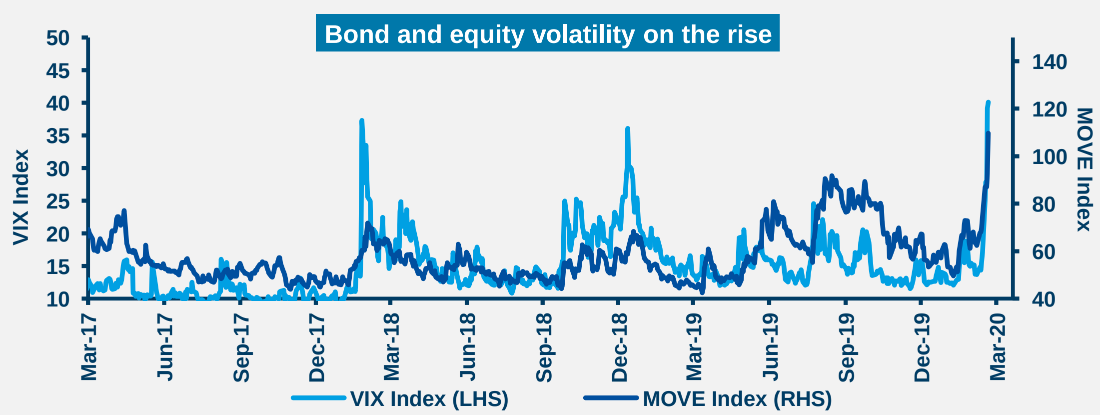
DM equities

In European equities, we did not change our main conviction that **price dislocations in the cyclical value space are an opportunity for bottom up investors.** For the overall market, due to the deterioration of the economic outlook, earnings growth is critical for future performance. The situation in China has created new headwinds and a completely accurate assessment of its potential impact is not easy. We have used market volatility to favour companies where we are convinced about strong balance sheets and resilient business models. At a sector level, we have become more positive on banks and industrials among cyclicals, and health care among defensives, and we are less positive on energy. We believe markets are expecting too much from the IT and Consumer Staples sectors, making us cautious in these areas.

In the US, **we think markets are too optimistic** about the macro-economic situation and underestimate the political risk. Although an earnings rebound will likely be delayed, earnings should eventually improve later in 2020 on the back of lagged effects of lower interest rates and input costs (lower energy prices). This would benefit the consumer-dominated US market. Higher earnings are likely to support our conviction of cyclical value outperforming growth, **but this should happen only when the manufacturing recovery materialises.** We are cautious overall on the market at the moment**.** At a sector level, we favour relatively conservative (less cyclical) cyclical names in Financials and Industrials. In Healthcare, we realise that the meaningful discount that existed in the sector when candidate Elizabeth Warren's chances peaked last summer has now corrected and value is no longer obvious, especially with drug pricing legislation likely to come up soon in US Congress. We are cautious on IT (expensive valuations), Consumer Staples and Utilities sectors.

EM equities

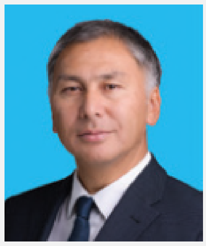
We are selectively positive on EM equity with a medium term perspective. **We focus on companies related to domestic consumption** that are relatively insulated from the coronavirus story and those that can potentially benefit from strong domestic demand or the continuing shift in the value chain (Russia, Indonesia, Vietnam). On the other hand, we have become very cautious on Chinese tourism-related sectors such as hospitality, aviation and consumer discretionary. In this regard, we are defensive on companies listed in countries such as Thailand, Korea and the Philippines that are beneficiaries of demand from Chinese tourists.



Source: Amundi, Bloomberg, as 2 March 2020.

"Our core convictions have not materially changed in Europe, but we have modified our stance to take into account US election risks and the global virus threat."

Kasper ELMGREEN
Head of Equities



Yerlan SYZDYKOV
Global Head of Emerging Markets

Kenneth J. TAUBES
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Amundi asset class views

	Asset class	View	1M change	Rationale
EQUITY PLATFORM	US	=		Markets are not pricing in any meaningful election risks, which could come to haunt asset prices in the future and seems too optimistic on the macroeconomic front. US equities should be more resilient in a downturn, but we are overall cautious, and we favour conservative cyclicals in the financial and industrial sectors.
EQUITY PLATFORM	Europe	-/=	▼	The virus outbreak will delay the expected cyclical recovery and leads to a more cautious approach. Future earnings outlook remains crucial to identifying potential areas of value. We continue to favour cyclical value stocks over expensive growth names, but remain selective. Opportunities to add to good quality names at discounted prices.
EQUITY PLATFORM	Japan	=		Japanese corporates have lower debt and their profits are also growing. However, most Japanese companies are exporters and could be vulnerable to a rising yen, given its safe haven status, amid the spreading risks of the coronavirus and if geopolitical risks emerge. As a result, we remain neutral.
EQUITY PLATFORM	Emerging markets	=	▼	Attractive valuations relative to the developed markets and expectations of earnings growth should support EM equities, but short term volatility is likely to persist. Here we focus on stories linked to domestic consumption or shifts in value chain (Russia, Indonesia). We are watchful of sectors directly impacted by China tourism and trade.
FIXED INCOME PLATFORM	US govies	=/+	▲	From global fixed income perspective, we keep a relative preference for US duration as safe haven demand remain high and CBs stay ready to act in case of deterioration of the scenario. The Fed has already done a step in this direction.
FIXED INCOME PLATFORM	US IG Corporate	=/+		We remain cautious in light of elevated tail risks to growth that could affect credit fundamentals; we continue to favor securitized credit over unsecured. Structured securities, including non-agency Residential Mortgage Backed Securities (RMBS), consumer debt and auto loans, are attractive relative to most other IG sectors. In agency MBS, although spreads are increasingly attractive, the 'net supply' impact from Fed's dwindling agency MBS holdings will likely hamper the potential for near-term spread tightening.
FIXED INCOME PLATFORM	US HY Corporate	=		We are cautious in HY amid leverage risks and higher risks linked to the coronavirus outbreak. Liquidity could also deteriorate in case of further market risk off. Selection is key to avoid areas potentially at stress.
FIXED INCOME PLATFORM	European govies	-/=		We don't see value in EU core govies. We have a constructive view on peripherals, especially on Italy, although we are mindful of the potential volatility due to the spread of the coronavirus in the country. Further spread widening is in our view an opportunity to add Italian debt in European fixed income portfolios.
FIXED INCOME PLATFORM	Euro IG Corporate	++		EUR IG remains attractive relative to the US, and would also benefit from ECB's quantitative easing program. In this regard, the subordinated debt financial sector remains our top pick. Short-term volatility provides opportunity to add to this asset class, with a selective approach.
FIXED INCOME PLATFORM	Euro HY Corporate	+		We remain constructive on EUR HY. However, idiosyncratic risks are increasing and we are selective.
FIXED INCOME PLATFORM	EM Bonds HC	+		We are positive on EM debt as favourable technicals, monetary policy easing and fiscal stimulus should outweigh the coronavirus impact and volatility from US elections. We prefer countries such as Indonesia, Ukraine and S. Africa.
FIXED INCOME PLATFORM	EM Bonds LC	=		Valuations in LC debt are less attractive and we could also see some negative impact from currency weakening. This is particularly true for commodity-exporting countries and those which are more exposed to a Chinese slowdown. However, there are some pockets of value, especially in frontier markets.
OTHER	Commodities			Commodities remain relatively cheap, due to easing financial conditions and decent economic growth despite recent concerns related to the coronavirus. We remain constructive on gold in 2020, as we think these drivers will underpin demand for precious metals. Gold also looks the most efficient hedge to several risks. However, base metals are likely to suffer from the global economic slowdown. For WTI, we recently revised down our target range to \$50-\$60/bbl and for Brent to \$55-\$65, due to recent cuts in oil demand as China contribution is expected to decrease dramatically in the short run. However, OPEC should remain vigilant and very active on output cuts, mitigating external shocks if required.
OTHER	Currencies			Our 12M target for EUR/USD remains around 1.14 and we believe there are asymmetric risks in favour of the EUR. However, for the time being, the virus threat in Europe, and weak Italian production and investor sentiment could weigh on the EUR. At the same time, the USD is expected to remain resilient as concerns on global growth are not expected to dissipate soon. We keep our USD/JPY target at 104 and believe JPY is cheap relative to its medium-term fundamentals and so is GBP. We maintain our cautious view in aggregate on EM FX.

LEGEND

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Negative Neutral Positive

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

Source: Amundi, as of 3 March 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.

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