Confidence must be earned

Amundi ASSET MANAGEMENT

June 2022

Global Investment Views

Vincent MORTIER
Group Chief Investment Officer

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Overall risk sentiment

Risk off — Risk on

We have a slightly cautious risk stance and are increasing our cross-asset diversification. We continue to play the preference for US vs. Europe in equities.

Changes vs. previous month

- Moving towards a neutral duration stance, with only a slightly short stance.
- More constructive on US IG credit, but cautious on higher risk credit.
- Considering oil for diversification.

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

Tech sell-off and bond temptation

The second quarter of the year is becoming increasingly painful for tech stocks, recalling memories of the 2000s tech bubble bursting. The repricing of a more aggressive Fed stance has been brutal, real yields rose – the rate on 10-year TIPS has turned positive for the first time since 2020 – and on the nominal yields front, the US 10-year Treasury yield temporarily reached the 3% threshold, falling close to 2.75% on economic growth concerns. Rates are now at a level that could call for a recalibration of asset allocations.

The key themes to follow to detect future market directions are:

(1) **Stagflationary risks:** The growth inflation battle is evolving unevenly at the global level, with the main theme being the shift from rising inflation and robust growth to lower growth and persistently high inflation. To account for this, our main scenario already pencils in regional divergences (technical recession for the Eurozone vs. US growth moving below potential, but no recession in 2022).

(2) **China's economic outlook:** For 2022 we see growth at 3.5%, given the broad slowdown in economic activity since March, the extended lockdown in Shanghai and restrictions expanding into other regions. These will harm growth, particularly in Q2, while we expect a rebound in H2, thanks to more incisive policy support.

(3) **Central banks:** In their fight against inflation and, most importantly, to preserve their credibility, central banks will continue to focus on communication while de facto staying behind the curve. In this battle, the ECB is facing more significant challenges than other CBs: the impact from the Russia-Ukraine conflict and from financial conditions tightening will be uneven across countries. High debt levels and higher economic risks on the euro periphery may impact the ECB's room for manoeuvre.

(4) **Markets and earnings growth expectations:** We believe earnings expectations remain too optimistic across the board. We expect US EPS growth to be in the 5-9% range, supported by buybacks (consensus is at +9.8%) and for Europe to potentially enter a profit recession.

All of this means that it is difficult to see an imminent end to the current weak market environment and, as such, while keeping an overall neutral risk stance, we believe some adjustments are warranted.

- **From a cross-asset perspective, we believe investors should further increase diversification while not increasing risk**. To achieve this, we have **become slightly more cautious on equity** – in particular regarding Europe, and while **we are more positive on US investment grade credit**, we maintain our relative preference for US equity amid the more resilient growth expectations for the US economy and higher earnings growth potential in the US equity market. We are **also positive on oil** for diversification purposes and as a hedge against the still-high geopolitical risk.
- **In bonds, we have further reduced our short duration stance** – in Europe in particular, but also in the US, and we believe **investors should move towards neutrality**. After the recent moves, the risks on nominal yields are now more symmetric, as on one side, inflation poses upward risks, while on the other, geopolitical and economic uncertainty favour downward moves. In credit, we continue to focus on quality and we are more cautious on higher-risk segments in Europe. We maintain our positive view on EM bonds in hard currency due to their attractive valuations and exposure to commodity exporters. Regarding currencies, we continue to hold a positive view on the US dollar vs. the euro.
- **Uncertainty regarding equities remains high as markets reprice the earnings path ahead**. Regionally, **we continue to favour the US vs. Europe while we remain neutral on EM.** While maintaining our preference for value, **we continue to increase the quality tilt**. In EM, we have become more cautious on Asia due to inflationary pressures and expensive valuations, while we remain positive on Brazil, UAE and Indonesia. In China, most of the bad news is priced in: an economic rebound, coupled with more benign regulation, should pave the way for a rebound in H2.

Although the 'great repricing' in equities and bonds may not be over yet, we are likely to see some pause and a continued rotation inside the market as it awaits more clarity on the inflation/growth outlook. In these uncertain times, investors should continue to focus on bottom-up selection as this will help in finding the most resilient names, but they should also look for opportunities that may have been excessively penalised during the repricing phase.

AMUNDI INSTITUTE

Big picture in *short*

Pascal BLANQUE
Chairman,
Amundi Institute

> *Central Banks have had to hike rates and drain liquidity in this time of looming stagflation, but will maintain a benign-neglect tilt, and allow inflation to run to preserve growth.*

The end of the 'Great Coincidence' for the policy mix

The age of the 'Great Coincidence' in the policy mix is over. Budget deficit reductions are near, and will be accompanied by diminished household savings and greater pressure on corporate profits in light of wage negotiations. **The widespread belief that fiscal spending is effectively unlimited (i.e., the fiscal 'free lunch') is going to be severely tested. On the monetary side, we're witnessing the end of ultra-cheap money**. Central banks have had to hike rates and drain liquidity in this time of looming stagflation, but will maintain a benign-neglect tilt and allow inflation to run to preserve growth. While the public debate has been focused on the monetary side, we should look at the overall policy mix to understand the novel role of monetary policy. I see three possible scenarios moving forward:

1. **Continued fiscal expansion and monetary normalisation**. This is difficult, insofar as monetary normalisation is a fiscal space 'killer', making large debt burdens unsustainable. Moreover, policymakers should consider a safety net for further manoeuvring in case of recession. The main risk here is timing: monetary authorities could turn off the taps too quickly; and fiscal authorities could intervene too late. In markets, this option implies further repricing (towards the downside) on risky assets, particularly on interest-rate sensitive stocks.
2. **Central banks remain behind the curve for some time in order to accommodate a renewed fiscal impulse**. This is the best way to optimise the growth/inflation trade-off, and to engineer a controlled economic slowdown. Here, investors should look to combat inflation through dividend equity and real assets.
3. **Fiscal expansion and complete central bank accommodation, uprooting all inflation expectations, to levels most people today have never before been confronted with**. Think of this as a '70s style regime, with high inflation, nominal growth, market-led corrections in nominal rates, adjustments in all risk premia and valuations at equilibrium. Investors will have few places to hide except in cash and real assets.

While public opinion is mostly focused on the first option, I believe the second or third are more likely. **Fiscal spending must target critical new sets of public goods (the energy transition, social and strategic autonomy) and central banks will have to accommodate these priorities**. This is particularly true in Europe, where monetary authorities have to fill the void left by the lack of credible budgetary rules. The worst-case scenario is full-blown stagflation. If nothing is done on the fiscal side, then mechanically there will be a tightening in the policy mix, reversing the trend of the past few years.

Didier BOROWSKI
Head of Global Views
– Amundi Institute

NATO expansion a watershed moment for geopolitical order

Finland and Sweden have announced their intentions to join NATO, ending decades of neutrality/non-alignment. This is a tectonic shift, with major consequences for the regional geopolitical order. Both countries immediately concluded that the Russian invasion of Ukraine could threaten their sovereignty. The Swedes and Finns are, however, careful to point out that their membership is defensive and primarily aimed at increasing their security. As evidence of this, Sweden is putting two conditions on its candidacy: no NATO base and no nuclear weapons on its territory.

Finland and Sweden are of strategic interest to NATO. Sweden's high-tech equipment enables intelligence gathering in the entire Baltic Sea region. Finland has nearly 900,000 reservists, who could provide a significant defence force for NATO. During the accession process, which could take a year, the two candidate countries are not protected by Article 5 of the NATO Treaty, which provides for mutual assistance by member states in case of aggression. That's why **the US and the UK have already stated that they would support both countries in the event of an attack in the interim.**

President Erdogan threatens to veto their membership, probably because he wants to leverage the absence of a veto for some benefit. In all likelihood, the Turkish president wants to secure the delivery of US military equipment to his country. Moreover, Erdogan is asking the two countries to abandon their support for the PKK rebels, who are hosted in their territories.

Russia called their membership applications to NATO a "serious mistake" with "far-reaching consequences". Russia has cut gas supplies to Finland, but has neither the means nor the desire to confront NATO. Retaliatory measures could, however, take many other forms (cyber-attacks, intimidation measures such as airspace violations, etc.).

Our view: The invasion of Ukraine has affected the medium-term growth prospects of Sweden and Finland (uncertainty shock). Their accession will help restore the confidence of local economic actors and could encourage foreign investment. Furthermore, the application process should accelerate a reflection on the need to strengthen European defence.

MULTI-ASSET

Rotate risk allocation from equity to IG credit

Mounting inflation concerns, along with geopolitical tensions, quantitative tightening (QT) and Covid restrictions in China are creating two main risks. One is related to the liquidity drain from QT and another to corporate margin compression, implying we should not ignore the risks of a profit recession, which is currently not priced in by the markets. On a positive note, consumption remains strong, labour markets tight and corporate balance sheets healthy, particularly in the US.

As a result, **investors should consider playing the relative resilience of the US, in particular adding into US IG credit, while becoming more cautious in cyclical equities, especially in Europe.** For diversification purposes, we continue to be positive on commodities and **we are now positive on oil**, where the tight supply will continue to support the bull market, despite the deceleration of demand due to the slowing economy.

High conviction ideas

We have a defensive stance in DM equities, where we are cautious on Europe and play the relative preference for US equities against Europe. This reflects a desire to be less cyclically exposed in this phase of slowdown and avoid the areas most exposed to the effects of the Russia-Ukraine war. We are neutral in EM equities, but we acknowledge the impact of Covid restrictions on Chinese growth, and remain vigilant there.

On duration, we maintain a slightly cautious stance in the US, while globally we continue to explore opportunities at cross-country and curve levels. In Europe, we maintain our relative preference for Italy vs. Germany in the 10-year maturity, while we have closed our positive stance on France vs. Germany as the political risk premium faded after the elections. We believe in the steepening of the UK 2-10-year curve, as the BoE has displayed slightly dovish tendencies in light of the deteriorating outlook. 2Y yields currently price in aggressive tightening, but could move lower. The 10y yield should rise on the back of QT.

We have removed our positive bias for the Australia 10Y vs. the UK, as the surprising rate hike by the Reserve Bank of Australia due to inflation pressures suggests a more hawkish stance vs. the BoE's dovish tone.

After becoming constructive on EMBI last month, **we are further increasing our preference for credit and EM bonds by adding a positive stance on US IG**. This is based on the US' solid macroeconomic background, positive corporate fundamentals (solid balance sheets with high liquidity levels and coverage ratios), low risk of refinancing debt in the near term and stable leverage. Valuations also seem more attractive following the recent spread widening. Sentiment remains cautious on risky assets, but in the case of widening, US IG would be the most resilient, in our view.

We continue to seek opportunities in the currency space as the divergences in economic and inflation patterns and monetary actions offer attractive themes to play. In particular, we continue to be cautious on the EUR vs. the JPY and the USD. EUR valuations are less appealing vs. the greenback considering the current inflationary pressures. We maintain our positive view on CHF/EUR and our bias for the USD vs. CAD as the latter is a cyclical currency that can be damaged in a decelerating growth environment. We are no longer constructive on the USD vs. NZD, as after the NZD depreciation there is space for a technical rebound. In the EM FX space, we see potential for the BRL to outperform.

Risks and hedging

Increasing stagflationary risks and still-present geopolitical tensions suggest investors should maintain or even increase hedges. Hence, we think investors should keep their protection on credit while readjusting hedges on the US equity markets in search of cost-efficient options that can enhance their overall protection.

Amundi Cross-Asset Convictions

	1 month change	---	--	-	0	+	++	+++
Equities	↘			■				
Credit & EM bonds	↗						■	
Duration				■				
Oil	↗					■		
Gold					■			

Source: Amundi. The table represents a cross-asset assessment on a three- to six-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. CGB = Chinese government bonds, EM = emerging markets, PBoC = People's Bank of China, FX = foreign exchange, IG = investment grade, HY = high yield, CBs = central banks, BTP = Italian government bonds, EMBI = EM Bonds Index, QT = quantitative tightening.

Francesco SANDRINI
Head of Multi-Asset Strategies

John O'TOOLE
Head of Multi-Asset Investment Solutions

> *Mounting concerns on the economic outlook call for a reallocation of risk from equity to quality credit, which looks more appealing after the recent repricing.*

Amundi ASSET MANAGEMENT

FIXED INCOME

AMAURY D'ORSAY
Head of Fixed Income

Yerlan SYZDYKOV
Global Head of Emerging Markets

Kenneth J. TAUBES
CIO of US Investment Management

> *The clouds on the economic horizon call for a move towards neutrality in duration and higher selectivity in credit, amid the diminishing liquidity.*

Fixed income now selectively more attractive

Inflation and the economic growth outlook continue to be the key themes for bond investors. Central banks have started to act to tame inflation, with the Fed committed to delivering, but still data-dependent to prevent a hard landing of the economy. For the ECB, the task is slightly more difficult as the region is directly impacted by the continuing war in the form of higher energy prices and the risk of additional sanctions, which could exacerbate inflation even further. **After the great repricing in government bonds, we have been increasing our duration stance in a move towards neutrality and we remain cautious on the higher risk credit space.**

Global and European fixed income

We continue to adjust the duration stance in a move towards neutrality, but we retain different regional views. In particular, we believe that the ECB may deliver less tightening than the Fed due to the higher risk of a recession in Europe. As a result, **we are less cautious than before on UK and Euro duration,** where we have a slightly short to neutral stance, while we maintain a short duration stance in the US. For diversification purposes we also maintain a **positive view on China duration and selective EM bonds.** We also continue to play curve opportunities globally, in particular in the Euro, Canadian and Australian curves.

The main debate in corporate credit is whether the risks related to earnings, higher rates and inflation are appropriately reflected in prices. We think not all segments are pricing in these factors. Consequently, we are reducing our credit risk stance, becoming more cautious on the higher risk space of the credit market, such as corporate hybrids, and we prefer higher grade credit with short to medium-term maturities. **Geographically, we are more constructive on US vs. Euro IG credit**, amid the better fundamentals in the US.

US fixed income

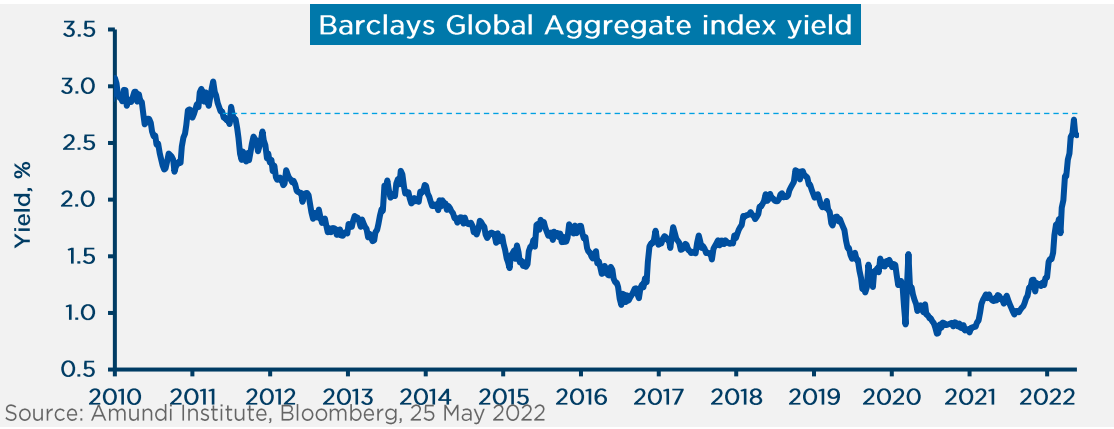
Given the amount of tightening priced in by the markets, particularly in the front end of the curve, and the high geopolitical and economic uncertainty, we think **it's wise to move back towards neutrality on duration**, while keeping a tactical approach as market volatility is still high. **Credit offers opportunities** as corporate fundamentals are strong. Here we are selective, **with a preference for financials over industrials**. We are also actively tracking new issues, as they offer substantial concessions, but here too we look for idiosyncratic, bottom-up opportunities. We believe to tactically adjust their credit allocation stance, investors could use hedges through more liquid derivatives, as credit market liquidity is lower in a more volatile environment. **We continue to seek value in securitised assets**, as the 'consumer' remains strong in light of solid earnings and savings. **We look for value in agency MBS** as they could perform better than other areas of credit given some concerns around economic growth.

EM bonds

Within the EM bonds investment universe we keep an overall cautious stance. **We maintain a short duration bias,** but we are slightly less defensive than before. **We favour HC bonds** and believe valuations are more attractive in HY vs. IG, but with a selective approach. Higher commodity prices are supportive for exporting countries, and in this respect, LatAm has been proving more resilient as it is economically and geographically distant from the ongoing war in Ukraine.

FX

We maintain our **positive view on the USD** and are cautious on EUR, JPY and CNY. In EM, we are **constructive on selective FX in LatAm** (MXN, CLP), but cautious on the Eastern European currencies such as the HUF.



Source: Amundi Institute, Bloomberg, 25 May 2022

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, MBS = mortgage-backed securities, CRE = commercial real estate, QT = quantitative tightening

Amundi ASSET MANAGEMENT

EQUITY

Be mindful of excessive valuations and cyclical risks

Overall assessment

High inflation, the ongoing conflict in Ukraine, slowing economic momentum and the Covid lockdowns in China are causing volatility in the markets. This is happening at a time when forward earnings multiples have contracted from the levels seen last year, amid higher inflation and rates expectations.

Overall, the focus on valuations remain key, as the expensive areas of the market will remain under pressure. Less cyclical value and quality are the places to look for resilience. Our overall approach remains that of selection, with a focus on earnings sustainability beyond the near term. Regionally, the US remains favoured within the developed world.

European equities

Challenges for the European markets continue. Higher inflation and slowing growth put pressure on company earnings, while rising rates put pressure on earnings multiples. We think current valuations do not price in a full recession, which is a risk for the Euro area.

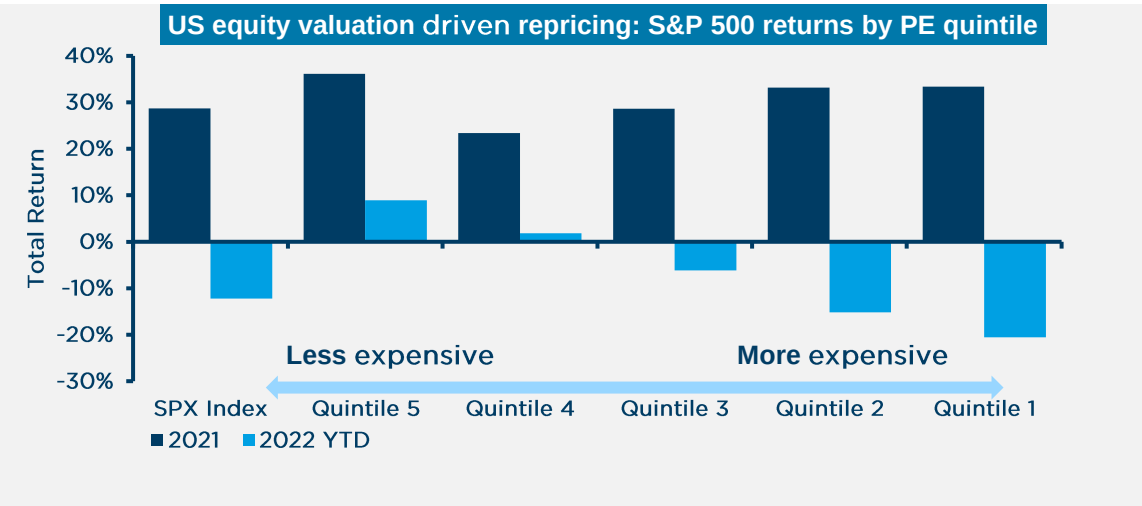
In this environment, when the range of possible economic outcomes is wide and valuation dispersion is high, we think high-quality, less-cyclical value and defensive names are good options. As a result, we maintain a barbell approach. On the one hand, **we favour defensive names in the healthcare and consumer staples** (increased our bias) sectors. On **the other hand, we are selectively exploring quality cyclical stocks in the materials and industrial sectors**. In doing so, we are mindful of the economic headwinds and keep our focus on non-disrupted business models. We also remain cautious in the information technology and utilities sectors.

US equities

Despite the recent weak economic growth data, a recession is not our base case because labour markets and consumer balance sheets remain strong. Yet, in a rising rates environment, the pressure on valuation multiples will remain. Hence, we maintain **our quality and non-cyclical value tilt and we remain cautious on the high momentum/growth side of the market.** We remain cautious on the mega-caps and are very selective and biased towards companies with high operational efficiencies, those that return cash to shareholders through buybacks and dividends, and can maintain earnings growth. We look for opportunities in energy and materials and we also like banks that display high returns on equity and selective consumer names. We believe the reopening would drive consumer spending, but we are monitoring labour availability and rising costs for companies and how that could affect margins and production. Interestingly, after the recent correction, selective technology names have become attractive, but we remain bottom-up in our approach and evaluate each name with respect to the quality of earnings. On the other hand, we are underweight mega caps and avoid unprofitable growth and distressed value names.

EM equities

Despite the high market uncertainty, EM valuations have certainly become more attractive, showing potential for appealing returns, but with strong divergences. Thus, we remain selective, favouring commodity exporters (Brazil, UAE) and domestic consumption stories (Indonesia). In Asia, we are becoming more cautious due to expensive valuations and renewed inflation pressures.



Source: Amundi Institute, Bloomberg, as of 25 May 2022.

We believe it is key to remain cautious in unprofitable growth and expensive areas, while maintaining a core quality tilt.

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Amundi ASSET MANAGEMENT

Amundi asset class views

	Asset class	View	1M change	Rationale
EQUITY PLATFORM	US	=/+		Strong consumer spending and labour markets will support overall demand, allowing us to believe that a recession is unlikely, while the economy should slow down towards potential growth. Our preference is for quality and non-cyclical value, while we are extremely cautious on non-profitable and expensive growth and the mega caps.
	US value	+		The uncertainty around rising costs requires a focus on high-quality value companies that are less cyclical and that can deliver sustainable earnings growth. While the rotation favouring value may suffer near-term setbacks, the move towards these names is likely to continue in the long term. The key point here is prioritising selection over market directionality.
	US growth	-		The long-term valuation of growth as a sector remains high, with wide dispersions. Repricing may in the technology sector may offer selective opportunities and we remain focused on long term earnings growth potential.
	Europe	-/=		Higher stagflationary risks for Europe put pressure on earnings growth and may lead to further market repricing. Hence, we favour defensive name on one side, and high-quality cyclicals in industrials and materials on the other.
	Japan	=		A mild deterioration in economic momentum leads us to remain vigilant on earnings. On the other hand, the JPY devaluation acts as a support for the market. Therefore, overall we maintain a neutral bias.
	China	=		The zero Covid policy continues to weigh on the economic outlook for China, despite the additional recent stimulus. We see room for improvement in H2, along with the expected economic rebound.
	Emerging markets	=		After the recent price actions, the EM equity space is becoming more attractive, but divergences are significant. We are positive on commodity exporters such as Brazil and UAE, and on domestic demand stories, but cautious on more expensive Asian countries.
FIXED INCOME PLATFORM	US govies	=	▲	Risks on nominal yields are both downward and upward as the higher inflationary environment comes with rising uncertainty on economic growth. Therefore our bias is towards neutrality now, with still some slight negative duration. Our exposure to TIPS is minimal.
	US IG Corporate	=/+	▲	After the recent spread widening, we are becoming more constructive on US IG on the basis of the solid macroeconomic backdrop in the US, positive corporate fundamentals (solid balance sheets with high liquidity levels and coverage ratios), the low risk of refinancing debt in the near term and the stable leverage.
	US HY Corporate	=		We remain neutral and selective in HY. On the one hand, the sector is supported by high energy prices, but on the other hand, valuations must be monitored, particularly as waning liquidity as a result of QT could tighten financial conditions.
	European Govies	=	▲	While the long-term move towards higher core rates continues, geopolitical tensions and market stress are putting downward pressure on yields. This, coupled with the ECB's data-dependent approach wherein interest rates rise "some time" after the end of QE, underscores why investors should stay agile on duration. We are slightly less defensive (than before) on duration in core Europe less than before, as we are moving towards neutrality.
	Euro IG Corporate	=		In credit we prefer the high-grade space and short to medium maturities. We remain selective (corporate balance sheets are strong) due to high producer prices and potential pressures on margins. We think investors should consider moving from high-beta to low-beta segments/securities through a fundamental analysis-driven approach.
	Euro HY Corporate	=		Concerns around Europe's economic growth and inflation could weigh on corporate earnings, although spreads are lower than the levels seen in early March, indicating strong corporate fundamentals. Looking ahead, markets will distinguish credit on the basis of quality and liquidity risks, causing us to be very selective across the market.
	China govies	=/+		We maintain a slightly positive view on China government bonds as from a medium-term perspective, the asset class offers strong diversification benefits.
	EM Bonds HC	+		We are slightly constructive on EM bonds in HC, particularly on idiosyncratic stories that fit our strong bottom-up bias. Within this, we favour HY over IG on expectations of spread tightening in the former.
	EM Bonds LC	=		We remain constructive on EM duration in LC and believe there is scope for a reallocation towards commodity-exporting FX, even though we are slightly cautious on EM FX as a group. The high fragmentation in EM allows us to be very selective.
OTHER	Commodities			Commodities continue to be key assets for diversification and inflation protection. We are constructive on oil, owing to the tight supply (low capex over recent years) and inventories despite the continuing fall in demand.
	Currencies			The hawkish shift in communications from the ECB helped the EURUSD move away from the recent 20Y lows. While acknowledging that the end of negative rates may support the EUR in the medium term, we see the relative backdrop (growth and short-term rates) still favouring USD in the short term.

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

LEGEND

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Negative Neutral Positive

Source: Amundi, as of 26 May 2022, 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

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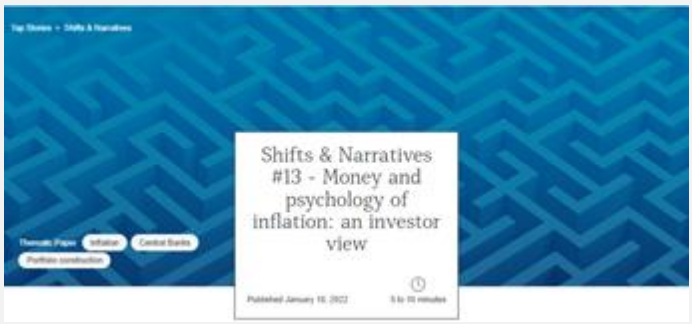

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