Confidence must be earned

Amundi ASSET MANAGEMENT

March 2021

Global Investment Views

Pascal BLANQUÉ
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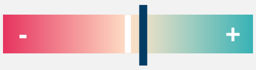
Overall risk sentiment

Risk off | Risk on



Risk-on attitude, with equity favoured to credit in a reflationary environment. 10 year US rates above 1.5% are a key risk to monitor

Changes vs. previous month

- Upgrade of selective cyclical /commodity FX
- More constructive on US breakeven, cautious on UST in global fixed income
- More cautious on EM local currencies

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

How hot is the inflation pot?

If the start of 2021 led markets to question the *no inflation forever* mantra, the debate has been hotting up in February, with the US 10Y inflation breakeven reaching its highest level since 2014, pricing in higher inflation expectations. We are also seeing pricing pressure on the food and energy side. Despite this rising trend, absolute inflation levels remain subdued. Some inflationary pressure is more than expected this year on base effects. However, the problem is not this short-term rebound of inflation, but the change in the paradigm ahead. **The hot questions today are how much inflation surprise can we envisage for 2021 and how temporary will this inflation pick-up be?** Or are we heading towards a prolonged period of higher inflation? The return of inflation narrative is gaining traction, propelled by the expected large US fiscal package and the recovery in demand that should come as the vaccination campaign progresses. The proposed package of $1.9tn has led some economists (Summers, Blanchard) to warn that inflation will be the end game of this huge fiscal push. However, others argue that there is room for this package, as the job market is still weak and it should not lead to a permanent rise in inflation as wage growth should remain limited.

Importantly, the starting point out of this recession is very different from that of 2008. First, this is a huge temporary shock that will be followed by a sharp reversal with less permanent consequences than a financial crisis. Second, the high levels of liquidity in the system, higher personal income and savings and the strong wealth effect will likely unleash pent-up demand: a cocktail that could further fuel inflation. Third, there is a risk that CBs will be trapped in their mantra of low interest rates and accommodative policies to restore economic conditions and tackle strategic social themes.

The big fiscal stimulus could make the case for a strong economic rebound which could not only drive some inflation pressure **but also further increase divergences between the US and the rest of the DM world**. This will make the case for being short the dollar quite challenging and increase the appeal of US fixed income in the desert of yield. **China (and more broadly Asia) is maintaining a solid recovery pace** and this was reflected in buoyant equity markets at the start of the year. The Asian region continues to be attractive to investors: it remained very resilient last year in terms of foreign direct investments (FDI) in an overall weak environment, and China for the first time surpassed the US in FDI flows. Signs of deceleration are emerging here as well, but if we look at the change in PMI over the last three months, China and India are among the best performers, together with the US. India's new pro-growth budget is likely to see investors return to the country. Against this backdrop, our key convictions are:

- **As the reflation trade continues, investors should still prefer equities to bonds, keeping a tilt towards more cyclical markets** (Japan and EM Asia) and start to build in some laggards/value markets (Russia). But, investors should monitor the impact of inflation on earnings through input prices, which is emerging as a topic for discussion. As there is a rising consensus on cyclical trade with the reopening of the economy, selection in equities is increasingly relevant. The focus should be on sound businesses with a preference for value vs. growth as a multi-year rebalancing trend. In the short term, any sign of deceleration in economic activity may pause the rotation, but we believe this will be temporary and further reinforced by a steepening of the yield curve and an interest rate rebound.
- **Stay risk-on in credit markets to benefit from central banks' umbrellas**, and start to increase the tilt towards SRI in bonds (green and social), as CBs may start to adjust their purchasing programmes in this direction. For example, in Europe, the ECB's Villeroy has recently proposed starting to decarbonise the ECB's balance sheet, while President Lagarde also made clear the ECB's willingness to take steps towards taking a more active role in fighting climate change. This is just the beginning of a trend that we think will continue as CBs' mandates start to adapt to the new post-Covid paradigm (huge fiscal push to fight the pandemic and move towards a more green economy and inclusive growth model).
- **Start building hedges against inflation risk with breakeven** and more generally with an investment approach that tests each investment case against a possible rise in inflation. This will affect sector allocation with a preference for sectors linked to real assets (commodities, energy, infrastructure) and single name selection with a preference for businesses with manageable debt levels, realistic valuations and pricing power.

MACRO & STRATEGY

Monica DEFEND
Global Head of Research

> *Improving growth prospects and a high fiscal package in the US may cause a higher inflation trend but labour market slack would prevent excessive inflation at least in 2021.*

Inflation risk amid labour market slack and "act big"

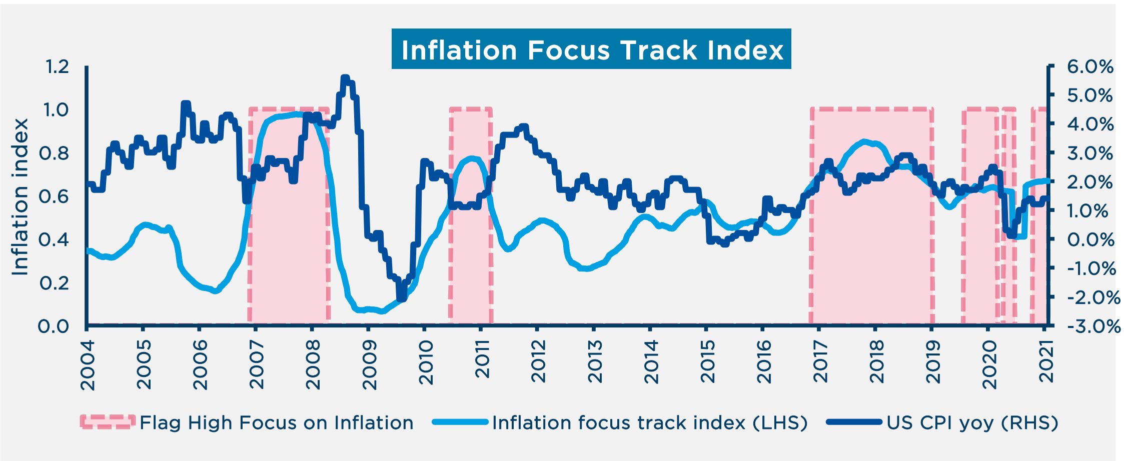
- The inflation narrative is back in focus. We reiterate our preference for value, cyclicals, EM assets and US breakevens.
- Labour markets slack would temper inflation dynamics this year, notwithstanding the size of the US fiscal package and Yellen's "act big" moment.
- A more uncertain environment for the US dollar.

We believe a more successful vaccine rollout and expectations of a sizeable US fiscal package favour US growth over Europe. Amid this background, a fascinating debate on inflation is occurring. Our Global Inflation Focus index flags this narrative of a rising inflation trend, particularly in the US.

Where do we stand on this inflation debate?

- **Labour market** – We expect the CPI to move higher, then stabilise and not accelerate further. An important factor here is the labour market, which we do not see recovering to its pre-crisis levels, not even in 2022. There are divergences, in terms of unemployment in different sectors and a skill gap, which has aggravated inequalities. A labour market recovery will be uneven and take some time, thereby damping down inflation pressures at least in 2021.
- **Output gap** – We estimate the US output gap to be worth $900bn and we put that into the context of the labour market data. **The size and in particular the destination of the fiscal package** in 2022/2023 **might trigger a structural change in the US** in terms of productivity and labour market dynamism.

We expect breakevens to move higher on the back of fiscal impulses and improving growth. **Separately, the 5/30Ys real rate curves may steepen further.** The 5Ys should drift lower on the Fed's stance of keeping rates low and tolerate higher inflation while the long end will price in the additional fiscal stimulus and a faster recovery.
While we think there's an upper limit to the long end of the curve (10Y Treasury yield at 1.50% remains pivotal to us), some more inflation may be tolerated by the Fed as the debt will eventually become more serviceable (and counter-balance a moderate and smooth rates increase).
For this reason, we believe investors should remain cautious on US duration and constructive on US breakevens.
On the other hand, **slightly higher inflation-tolerance by the Fed, which is not expected to be pre-emptive in hiking rates, is likely to cheer equity markets.** We are comfortable with cyclical, value and EM (full spectrum). Obviously, the management of the Covid-19 crisis and avoiding the emergence of any new virus strain will be important, given that the market is not considering any further healthcare-related issue (this is a key risk).
In addition, the **hedging characteristics of equities during regime shifts support this asset class.** According to our analysis, equities should offer a good hedge against an inflation regime shift based on higher growth, improving corporate fundamentals, and higher unit labour cost, which can be passed on to consumers.
The one caveat. As per our analysis on monthly returns since 2000, rising breakeven and falling real rates have historically triggered a USD sell-off. For the time being, we see the USD remaining weak vs. commodity FX and strong against low yielders (namely the CHF, the yen).
However, in H2, this trend may pause, with the environment becoming more mixed for the USD. When breakevens reach the tipping point and fall (and real rates rise), we might see the USD get stronger.
We are not there yet, but we believe this would be a key risk to monitor.



Source: Amundi Cross Asset Research, as on 7 February 2021. Methodology: Inflation Focus Track Index is Amundi's Cross-Asset Research proprietary tool based on big data analysis from the web (Google Trends). The relevant text/word combinations for the inflation theme are identified and dynamically tracked according to the popularity of web searches. We detected two relevant regimes (high focus and low focus) to articulate the most appropriate cross-asset investment implications.

MULTI-ASSET

Benefit from reflation and relative value strategies

An improving economic backdrop in both DM and EM on the back of a stimulative economic policy mix is reflected in business confidence, the market's inflation expectations, and UST yields. While manufacturing continues to display resilience, services are showing signs of divergence amid Covid-19 restrictions and variants. Divergences are also emerging at regional levels (ie, the US and the EU). This environment confirms the dependence of economies on successful vaccination and where absolute and relative valuations are showing a dichotomy. **Investors should keep an active stance in search of opportunities across and within asset classes,** but acknowledge some noise and volatility in rates and inflation trends. Accordingly, adjustments are required to dynamically adopt the overall stance.

High conviction ideas

A rebound in manufacturing, earnings revisions and easing financial conditions allow us to **maintain our positive view on equities, even as we acknowledge that some pockets are stretched, underpinning our selective and relative value approach.** We remain neutral on Europe and the US, and constructive on Japan and Australia as the last two should find support in their pro-cyclical tilts. On EM, **we maintain our optimistic view on Asia** through Chinese 'old economy' stocks and consumer discretionary names. Investors can play the laggards/value story through South Korea, Latin America and Russia.

On duration, we keep a neutral view on the US (UST10Y) for diversification purposes and we favour breakevens. In the UK, we believe investors should now consider curve steepening strategies, particularly along the 2-10Y side. The Bank of England's (BoE) dovish stance and the rising gilt supply towards the long end of the curve may put upward pressure on long-term yields. In addition, the country's success on the vaccination front and rising consumer prices support higher inflation expectations. In Europe, even though the current valuations of peripheral debt offer lower potential for further tightening, we remain constructive. This is particularly true for a relative value strategy of 30Y Italy vs Germany on the back of the ECB's firepower, demand from foreign investors for Italian debt, and the new government lead by former ECB president Draghi.

Credit continues to be supported by quantitative easing. We expect very limited spread tightening, but the asset class still provides some yield. We favour EUR IG given its lower leverage vs US IG.

On EM FI, we remain positive, but now recommend investors fully hedge US rates (USD and duration) exposure to smoothe the risks of higher growth/inflation dynamics, which are being supported by stronger fiscal stimulus in US. We also believe there is higher potential for spread tightening in HY compared with IG. Even regarding local rates, where the main driver remains FX exposure, room for further compression is limited.

In currencies, a pro-reflationary environment, coupled with the relative value opportunities in this space, enables us to **upgrade our view on the GBP and CAD** vs the CHF owing to attractive valuations. We maintain our views on the CAD/USD and NOK/EUR. In EM, while we maintain our positive stance towards an EM FX basket, we upgraded the RUB. Separately, we also improved our views on the CNY and KRW vs the EUR, driven by expectations of inflows into CNY assets and by the possibility of participating in the global transition towards the green electrical energy world, which relies on conductive metals, such as semiconductors.

Risks and hedging

Any material increase in rates and inflation dynamics and UST yields could affect the appeal of equities vs bonds, as the cost of funding would increase. As a result, we stay vigilant and recommend investors protect equities, credit and duration exposures through multiple hedging strategies. Gold could also provide support amid abundant liquidity 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.

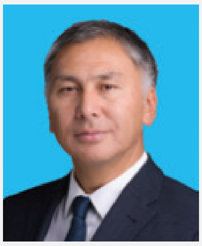
Matteo GERMANO
Head of Multi-Asset

"In an overall supportive environment for risk assets, with some indicators softening, we see selective opportunities in the FX markets to play long-term green themes and a pro-cyclical tilt."

Amundi ASSET MANAGEMENT

FIXED INCOME

Eric
BRARD
Head of Fixed Income



Yerlan
SYZDYKOV
Global Head of
Emerging Markets

Kenneth J.
TAUBES
CIO of US Investment
Management

"In an environment of state support for markets, investors should explore sectors and names where there is visibility and transparency on future cash flows."

Progressive discrimination in a risk-on environment

We believe the development of herd immunity and expectations of continued fiscal stimulus will drive an economic rebound. However, questions such as those related to the pace of this recovery, inflation, extension of the pandemic, and credit quality remain unanswered. We may now see already expensive assets increasing in value as CB-infused liquidity and investors' search for yield boost prices for some pockets in the credit market. On the other hand, cheaper and low-quality assets may fall even more. As a result, **investors should complement their risk-on stance with a prudent, selective and research-driven approach in credit.**

Global and European fixed income

We downgraded our view to become cautious on US duration amid huge fiscal support and inflation, while staying defensive overall, including in Europe. We believe the US curve is likely to steepen and, as a result, investors should maintain a barbell exposure along the 2-10Y and 30-10Y curves. **On breakevens, we upgraded our view on US 10Y and 30Y** (the Fed's tolerance for higher inflation, structural changes, base effects) and moved to a neutral/positive stance on Europe.
Regarding Europe, we remain positive on peripheral debt, particularly on Italy, but see growth concerns. The new government has reduced political risks for now, but we remain vigilant.
We remain positive on credit, as rising inflation expectations affect real yields, but **prefer shorter-dated debt in general**.
Some spread tightening is more likely in HY, particularly in lower-rated and hybrid instruments, which could offer opportunities too. Euro financial subordinated debt is another area we like, provided they become eligible for ECB bond buying.

US fixed income

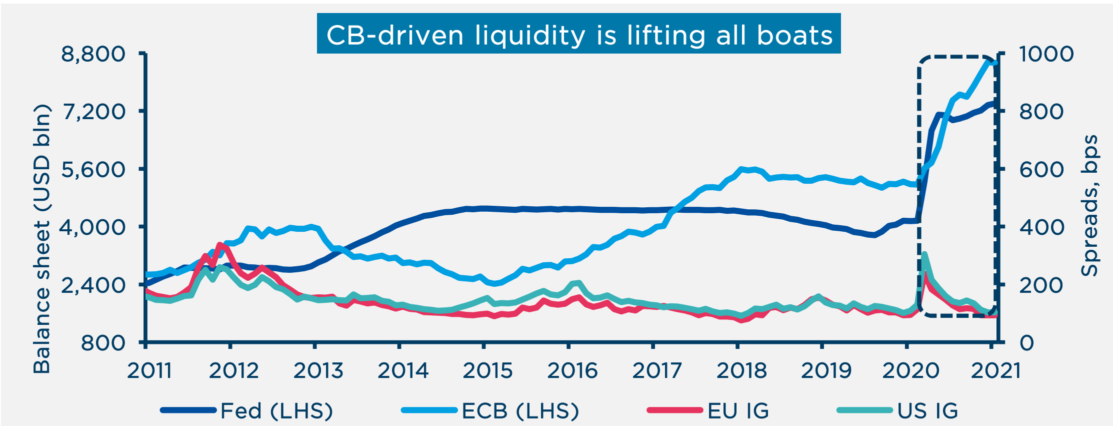
Fiscal profligacy, and additional spending by the private sector, coupled with a supportive Fed (which is keeping rates low and financial conditions easy), point to an economic recovery. Add to this the difficulty in finding skilled labour and excess household savings and you get rising inflation expectations and a steeper yield curve. **This explains our negative stance on USTs and positive view on TIPS**. But, twin deficits and fiscal deterioration are not a good recipe for a strong USD in the medium term (although investors should watch out for rising rates).
Risky assets — corporate credit, securitised credit and housing markets — are a key component for generating returns. **However, a high level of selectivity is crucial across the board, with a strong focus on corporate fundamentals.**
Securitised credit, especially related to the housing market, is displaying robust fundamentals and technicals. Finally, the mortgage market remains supported by consumer earnings and savings.

EM bonds

Developments around Covid-19 are pressurising growth expectations, but the EM/DM growth differential is still expected to increase. We maintain our positive stance on HC, especially in HY. **On LC and FX, we are more cautious now** in light of the upward pressure on US rates and the USD's direction, but believe certain EM currencies will continue to perform. At a country level, Russia and Brazil are two of our main convictions.

FX

We are now neutral on the USD vs JPY and CNY amid better US growth prospects and upward movement in US rates. We are also positive on commodity FX vs the EUR and the CHF.



Source: Amundi, Bloomberg. Latest monthly data as at 17 February 2021.

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.

EQUITY

Play reflation through value, cyclical and small caps

Overall assessment

Markets are looking beyond the near-term headwinds of Covid-19 and a sluggish vaccine rollout across Europe. Sentiment appears to be driven by hopes of continued policy support combined with an increasingly clear path to reopening. However, the actual situation is more nuanced, as this positive sentiment has turned **into exuberance in some segments**, leading to the possibility of high volatility, especially in interest- rate-sensitive sectors. We believe in imposing some cautious optimism onto this exuberance. **Investors should rely on fundamental analysis and process discipline** to unearth businesses with sustainable income streams/balance sheets.

European equities

We continue to believe in the story of cyclicals vs defensives and value vs growth, but it is important to acknowledge that some segments have already discounted a very rosy opening, which underpins the need for a selective approach.

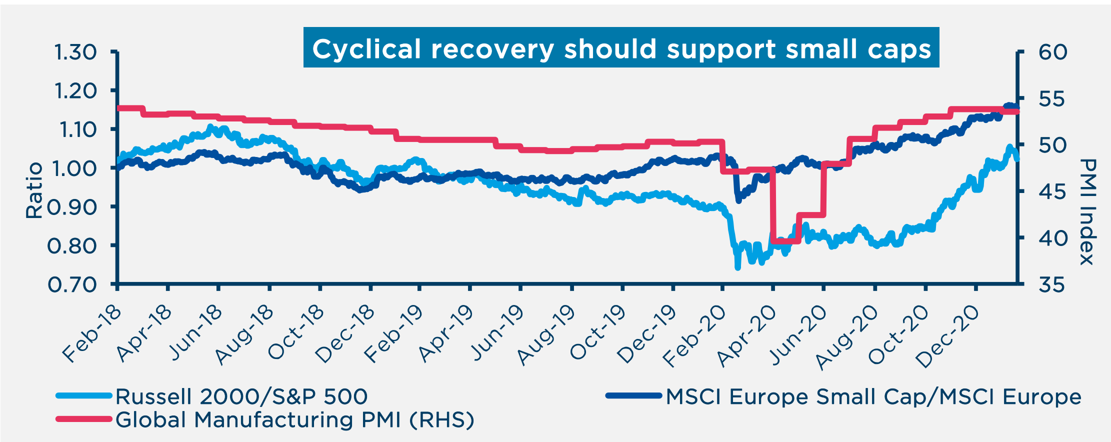
In particular, we like banks, as this is an area where reopening is not yet discounted; we also maintain our bias towards materials and healthcare. On the other end, we downgraded interest-rate-sensitive sectors such as real estate and are cautious on capital goods, as the sector has been very fast in pricing in a recovery. We are negative on segments such as technology which display prices that are way above fundamentals. However, we see inflation and market consensus on recovery as key risks. Thus, we maintain positions in some defensive components of the economy such as telecommunications, which we have upgraded. Finally, we like small caps as they are reasonably priced and are linked with the cyclical domestic recovery theme. All in all, we remain valuation-conscious.

US equities

Substantial fiscal stimulus, progress on the vaccination front, and strong corporate earnings make economic rebound, profit recovery and reflation the main themes in the near term. This thinking supports our expectation of a sustained leadership rotation out of high growth/momentum and high duration stocks, which are more dependent on discount rates for their high stock prices. Low rates have driven their cost of capital lower and valuation multiples higher, which is a key risk. But now, with steeper yield curves and inflation expectations, their prices may be affected. **Instead, value (high-quality value) and cyclical stocks should gain due to their attractive valuations and improving cyclical earnings later in 2021**. We are also constructive on cyclical sectors as they gradually price in the economic recovery. From a sector perspective, a steeper yield curve should support financials and energy over industrials (high earnings multiples) and this marks a switch from 2020, when yields were very low. Importantly, investors should explore sectors where recovery is not yet priced-in by the market. Overall, we remain very selective and believe there are opportunities in Covid-impaired sectors, but new virus strains could present some risks.

EM equities

Difficulties in vaccine production and spread of Covid-19 variants affected some EM but this doesn't alter our long-term constructive view on the region, where selectivity is important. We maintain our positive stance on discretionary, IT and real estate. While we remain cautious on staples, we upgraded the sector marginally through bottom-up ideas in China. However, we are concerned on some Chinese financial names due to high valuations as we continue to look for value stocks with cyclical, growth and quality characteristics.



Source: Amundi, Bloomberg, latest data as on 18 February 2021.

"Higher rates and market exuberance in some sectors are conditions that make us even more focus on valuations and fundamentals."

Kasper ELMGREEN
Head of Equities

Yerlan SYZDYKOV
Global Head of Emerging Markets

Kenneth J. TAUBES
CIO of US Investment Management

Amundi ASSET MANAGEMENT

Amundi asset class views

	Asset class	View	1M change	Rationale
EQUITY PLATFORM	US	=		A successful vaccination programme so far, expectations of stimulus, and the ability of companies to pass on rising input prices to consumers bode well for a profit recovery this year, which has also been hinted at by the ongoing earnings season. All this supports the rotation towards value and cyclicals. However, excessive valuations in some segments, the possibility of higher taxes, and new virus strains are crucial factors to consider. Overall, investors should remain selective.
EQUITY PLATFORM	Europe	=		We continue to believe this should be a year of recovery, but the need for selection is even higher now as markets are fully pricing-in a recovery, despite some ground to cover on the vaccination front. As a result, while positioning for a recovery, investors should also have exposure to quality defensive stocks, all the while focusing on fundamental analysis. Value and cyclical stocks continue to offer opportunities, along with small caps closely linked with the recovery.
EQUITY PLATFORM	Japan	+		We remain positive on Japan in light of an improving global economic situation, given the market's cyclicals and industrials tilt. The country's improving shareholder focus and growing return on equity is not yet appreciated by the market.
EQUITY PLATFORM	Emerging markets	++		EM, despite some concerns over Covid-19, offer attractive bottom-up opportunities (particularly EM Asia) as the region's growth prospects remain intact. However, the evolution of US-China relation is an important factor. We stay active in the heterogeneous EM world, focusing on stock selection and valuations, and looking for catalysts for sustained dividend yields and robust businesses. At a geographical level, our favoured countries are India, Russia and Greece.
FIXED INCOME PLATFORM	US govies	-/=	▼	We are now cautious USTs in global fixed income, due to discussions of massive fiscal stimulus and rising inflation expectations, even as we believe the Fed would not allow yields to rise too much. Therefore, an active stance is required. We are even more positive on TIPS now. From a US perspective, we believe curve steepening will continue amid an improving economy.
FIXED INCOME PLATFORM	US IG Corporate	=		We remain neutral/positive on IG but favour specific stories over a full market exposure, indicating our preference for an active, selective style. In securitised credit, the housing mortgage market remains very strong due to demand and robust consumer earnings and savings.
FIXED INCOME PLATFORM	US HY Corporate	=		HY continues to offer attractive carry in a yield-starved world. However, this excess income must be defended through a robust sector and security selection process. US HY defaults should finally move lower from Q1 peaks in Q2 but are still expected to remain above long-term historical averages.
FIXED INCOME PLATFORM	European Govies	-/=		We remain cautious on core Euro bonds, and constructive on peripherals as the latter still provides modest but positive yield. On peripheral debt, we remain moderately positive on Italy given that the Draghi effect should stabilise the political situation, although spread compression has been very strong and attractiveness has declined vs the previous month.
FIXED INCOME PLATFORM	Euro IG Corporate	=/+		Amid ECB support for the markets, rates are expected to remain lower for longer and this warrants a continuous search for carry in EUR IG, particularly in the BBB-rated category. However, investors can benefit from slight adjustments favouring short-dated instruments and those supported by the ECB.
FIXED INCOME PLATFORM	Euro HY Corporate	=		We aim to strike a balance between high yield and high quality through a research-driven process as we believe markets will differentiate low quality credit from high quality even more in the future. As a result, selection is important.
FIXED INCOME PLATFORM	EM Bonds HC	=/+		EM HC continues to offer attractive yields, but we see better risk-reward in HY, and while spreads are tighter, there is still room for compression. HY is in a better position to cushion the widening effect of UST yields, but selection is important.
FIXED INCOME PLATFORM	EM Bonds LC	=/+	▼	While staying overall positive on LC, we acknowledge the strengthening USD and rising rates, and are slightly more selective. We believe we are at the end of the rate cut cycle in EM and see some CBs becoming more hawkish. On local rates, we remain selective due to inflationary pressures.
OTHER	Commodities			Cyclical commodities and base metals should gain in light of the positive economic momentum, despite some vulnerabilities related to the pandemic. In particular, oil is expected to stay around current levels in coming months, but an overshooting in the near term is possible. Among precious metals, gold is likely to continue to be supported by dovish central banks, even though there are some concerns on monetary policy normalisation and higher real rates.
OTHER	Currencies			Different forces are at play in the FX market. While reflationary forces suggest the USD downward trend has some room to go, the USD exceptionalism already seems to be back in play. We are positive on the CAD (vs the USD and CHF) and NOK (against the EUR), due to expectations of a global economic rebound and interest rate advantages. Low-yielding FX, such as the CHF, could struggle the most in the current environment while the UK's successful vaccine rollout so far is a positive for the GBP. As a result, we have a constructive view on the GBP/CHF.

LEGEND

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Negative **Neutral** **Positive**

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

Source: Amundi 20 February 2021, 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.

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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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