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Overall risk sentiment



Amid asymmetric risks in the markets characterised by financial repression, we remain risk-neutral but watchful of any opportunity.

Changes vs. previous month

- Tactical adjustment to duration within the cautious ambit.
- Enhanced derivative exposure to play risk assets, raised protection.
- More vigilant on credit throughout.

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

The “real” puzzle

Halloween ‘ghosts’ of Fed tapering, the Evergrande crisis, and the earnings season did not scare the markets. The Fed telegraphed its message well: while keeping the option to adjust tapering depending on the state of the economy, it reiterated the “transitory” inflation narrative. The BoE proved more dovish than expected, actually keeping rates unchanged (‘benign neglect’) regarding inflation risk. As a result, nominal yields declined and real yields fell to near new record lows. **Although CBs are sticking to their temporary wording, our view, in contrast, is that the latest CPI readings support the “sticky” narrative.**

On equities, the earnings season has overall been strong. In the US, even as President Biden reappointed Powell as Fed Chair to ensure continuity in monetary policy, he confirmed Brainard as the Vice Chair. But some volatility will likely return amid Democrats’ efforts to pass the Social Infrastructure Bill through the Senate (due to be passed before 13 Dec.). The path looks uncertain, as does the final total amount of the package.

Lastly, we have entered a new Covid wave. Moving into the winter season in Europe and the US, cases will rise. However, we don’t expect this to derail the growth outlook, thanks to vaccination campaigns. On the other hand, it is difficult to see any significant upside after the recent highs in equities: Santa Claus gifts have arrived already. Range-bound equity markets and volatile bonds, with reduced liquidity across the board, is the most likely scenario through year-end. **Against this backdrop, we keep our neutral stance in equities and short duration view in core bonds, and a mildly positive view in credit and peripheral bonds.** In terms of portfolio construction, targeting real returns will be the name of the game.

- **Overall asset allocation will continue to favour equity**, as no other choices are available moving to a late cycle. The equity stance will likely shift from neutral to a tactical overweight once the economy reaccelerates in Q2/Q3 2022. But the need for hedges will remain high as the risk of policy mistakes is on the rise. We also recognise that equity exposure has risen to a peak in the cycle, favouring DM and in particular the US, where valuations are now extreme. With the recovery broadening towards EM, where allocation has fallen below strategic targets and return potential is higher, we expect investors to start to reallocate towards these markets in the search for attractive valuations. Overall in equities, areas of bubbles persist. We don’t know which companies lack pricing power (swimming naked) because discrimination on this basis is yet to happen in markets. So, investors should favour quality/value, dividend names and stocks that indicate sustainable pricing power (not easy to measure).
- **Credit with higher yields and short duration** may be the best means to navigate high inflation, but selection will be key as default rates will start to bottom out as financial conditions get less supportive.
- **Real assets will be favoured, as they can help in terms of inflation protection.** There are many opportunities in this regard. On private debt, the floating rates available in this market and the liquidity premium may help with seeking income opportunities that are more

resilient to possible increases in core yields in a market in which financing demand is on the rise. Infrastructure investing is also seeing strong momentum amid opportunities linked to the energy transition and this is also generally an asset class that provides inflation protection. Private equity is key to financing the recovery and to seeking higher potential returns. Real estate could also offer selective opportunities in the recovery phase.

- **Some ESG risks are becoming real.** The COP26 meeting highlighted the need for urgent action on emissions reduction. The China-US last minute deal could mark a further reacceleration of this trend, which could lead to a rising demand from investors and eventually translate into higher market prices in a positive feedback loop.

We believe investors face a meagre real returns outlook for the next three years. In our view, a 60 equity/ 40 aggregate bonds portfolio's real annual return could be close to zero both in the US¹ and Europe². **The investment puzzle for the future is how to increase real return potential. This will require grasping opportunities where available across all asset classes, as the real value left in the market is not abundant, underscoring the need for investors to maintain a wide arsenal of instruments.**

¹ 60% S&P 500 and 40% US Aggregate Bond. Assumption of 3.2% inflation.

² 60% MSCI EMU and 40% Euro Aggregate Bond. Assumption of 2.1% inflation.

CROSS ASSET
RESEARCH ANALYSIS

**Monica
DEFEND**
Global Head of
Research



**Claire
HUANG**
EM Macro Strategist

“2021 has seen unprecedented regulatory changes amid the Common Prosperity pursuit. But policy clarity and coordination ahead should aid China’s structural transition.”

Chinese growth to stabilise in 2022

The Chinese economy continued to suffer from its self-imposed policy constraints at the beginning of Q4, registering a weak recovery. The top culprits behind this slowdown are as follows:

- The zero-tolerance Covid-19 policy;
- Energy emission controls for high-polluting and high-emission sectors; and
- Tightening in the housing market since Q4 2020.

Nevertheless, the broad weakness in the economy has caught policymakers’ attention. In October, the National Development and Reform Commission (NDRC) stepped up significantly to boost coal production to address power shortage issues, while some local governments began to remove energy use controls and resumed normal production. More relaxation is likely at the turn of the year, easing the pressures on the industrial side.

As for pandemic control and prevention, there appears to be little intent to change the zero-tolerance policy before the Beijing Winter Olympics (4-20 February). But given the high vaccination rate in China, we do expect some adjustments to domestic travel policies after February. Operational adjustments on housing policies are also under way.

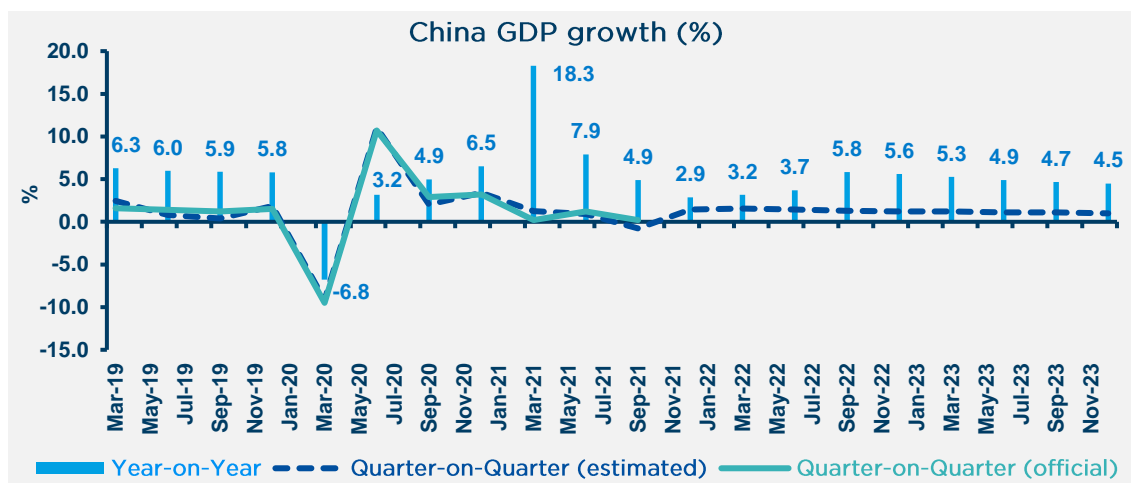
That said, policy fine-tuning so far has been helpful in relaxing near-term liquidity pressures for developers, but this has not been material enough to change our assessment for a housing slowdown in the medium term.

Looking ahead, we expect the overall economy to restart its engine slowly, once the above-mentioned constraints are removed one by one. However, the housing sector deleveraging is most likely to continue and it would be too complacent to expect the People’s Bank of China’s (PBoC) target is to keep a stable debt/GDP ratio. Hence, we expect policy easing to remain targeted, and an exit from abrupt deleveraging and tightening to be sufficient to help stabilise growth. We maintain our view that economic growth will rebound sequentially in Q4 from its dip in Q3 and then stay slightly below trend in 2022.

However, due to strong negative base effects, China’s headline year-over-year growth should drop to just below 3% in Q4 and print in a range of 3-4% in H1 2022 before bouncing back to above 5%. The major downside risk to our forecast is a sharper housing slowdown without additional policy stimulus.

From an investor perspective, this calls for vigilance in the near term as the country navigates its way through regulatory changes and towards ‘Common Prosperity.’ Beijing’s tolerance of slower growth has increased notably, but we expect increasing policy clarity and coordination to assist in this structural economic transition. In the long term, we believe, these measures should reduce systemic risks, allowing us to explore opportunities through a selective lens.

To conclude, Chinese assets, including the CNH, offer strong diversification benefits to global portfolios in the search for higher real income, supported by the country’s expanding role in regional Asian trade and the government’s desire to increase the international relevance of the currency.



Source: National Bureau of Statistics of China, CEIC, Amundi Research, as of 16 November 2021. Quarter-on-quarter growth numbers are seasonally adjusted.

MULTI-ASSET

Look for upside potential while limiting the downside

The global growth outlook has weakened slightly amid the narrative of persisting stagflation risks, but markets seem to be ignoring this for the time being and are focusing on robust earnings and momentum. We acknowledge this strength but believe investor vigilance must be maintained in light of concerns over future margin pressures. As a result, the scope for active management is high in bonds as well as in equities because what appears cheap and attractive on the surface may not offer sustainable returns in long run. **We recommend that investors remain risk-neutral, looking for attractive entry points and exploring options to participate in any tactical upside.** In addition, amid tight valuations, hedges to protect equity and credit exposure should be considered.

High conviction ideas

While we maintain our overall neutral stance on DM and EM equities, we are monitoring the current stronger-than-expected earnings season, particularly in the US, which has highlighted that the impact of supply bottlenecks on corporate margins has been muted. In the US, we slightly revised upwards the level at which we think equities may be tactically attractive. However, we remain active on this front, looking for any sign of weakening pricing power for companies. Based on an overall neutral approach, investors should look at a wide array of instruments, including derivatives, to play potential further moderate upside in US equities, but they should stay well balanced and diversified. On EM, we keep a neutral stance and are watchful for any near-term weakness in China. **In bonds, we remain agile and identify opportunities from a tactical as well as long-term perspective across yield curves globally.** Thus, we are tactically neutral on 10Y USTs now, as yields approached our target levels. However, this doesn't represent any structural change to our cautious view on duration. In fact, we continue to see upside potential for yields in other shorter maturity segments on the Treasury curve. Secondly, UK 2Y yields also hit our target after the BoE's decision not to hike rates.

On Italian peripheral debt – ie, the 30Y BTP vs the Bund – we remain constructive, given that Italian Q2 and Q3 GDP growth surprised to the upside, resulting in an improvement in the ratings outlook. In Asia, we continue to be positive on Chinese government bonds on account of our expectations of stable rates in the near term, diversification benefits, and weakening economic growth in the country. But on EM bonds, we stay neutral.

Credit offers returns potential, especially EUR IG and HY, as spreads remained resilient to core yields, fundamentals and technicals are improving, and CBs maintained their support by keeping short-term rates anchored. In Europe, high-beta segments, such as HY and subordinated debt, are attractive areas to exploit amid the downward trend in default rates.

At a time when valuations in many corners of the markets are full, FX offers relative value opportunities. In general, the Fed's modest policy normalisation should be marginally supportive for the USD as we approach year-end. We like the FX carry basket favouring the GBP vs the CHF. However, against the USD and the EUR, we stay cautious on the GBP due to geopolitical issues and the effect of inflation on consumer purchasing power. In EM, we are constructive on the RUB/EUR due to the former's attractive valuation and the Russian CB's hawkish stance. In Asia, our positive view on the CNH/EUR remains in place as the country will continue to be the driver of regional trade and the government's objective of making China a global superpower should also be supportive of the CNH. However, we now believe that weakening capital flows to Korea could affect the won in the near term.

Risks and hedging

Despite continuing growth, the inflationary regime presents a high risk to the markets in terms of its potential impact. We think investors should use cost-efficient hedges to protect HY credit exposure while maintaining protection for their DM equity holdings.

Amundi Cross-Asset Convictions

	1 month change	---	--	-	0	+	++	+++
Equities					■			
Credit						■		
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. BoE = Bank of England, 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

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While remaining neutral on risk assets and diversified overall, there are selective opportunities to benefit from the mild, near term upswing in equities through options.”

FIXED INCOME



**AMAURY
D'ORSAY**

Head of Fixed Income



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**Kenneth J.
TAUBES**

CIO of US Investment
Management

Direction of real rates in focus

Economic growth remains strong, but projections point to a weakening environment (growth dispersion). On the other hand, inflation remains elevated, driven by a supply-demand mismatch, commodity prices, and pressures emanating from the labour market. Overshooting inflation is testing CBs' patience to act: the Fed announced tapering plans, as expected, but the BoE kept rates unchanged (CB asynchrony). We think markets are trying to judge the tolerance threshold of CBs to inflation even though the Fed clarified that 'transitory' inflation pressures from supply bottlenecks could last until H2 2022. As real yields continue to be at unsustainably low levels, **we remain cautious on govies and instead search for income in peripheral countries, DM credit and EM bonds through a very selective, active approach.**

Global and European fixed income

On duration, we are defensive but flexible in the US and core (slightly less so now) and semi-core Europe. We also remain cautious in the UK and Canada. However, on Italian peripheral debt (strong growth), China (diversification), and Australia, our constructive stances remain in place.

In credit, a positive outlook on ratings and Q3 results indicate no widespread warnings from supply bottlenecks. But volatility in core yields, dispersion in evolution of financial ratios, and year-end liquidity issues are potential fragilities.

We explore short-dated debt (low duration risk) with high spreads through higher emphasis on credit selection. We also see an acceleration in deleveraging in HY and BBB- compared to A-rated debt and continue to explore the rising star theme. While doing all this, we carefully monitor ESG dynamics and incorporate this factor into our overall selection process.

US fixed income

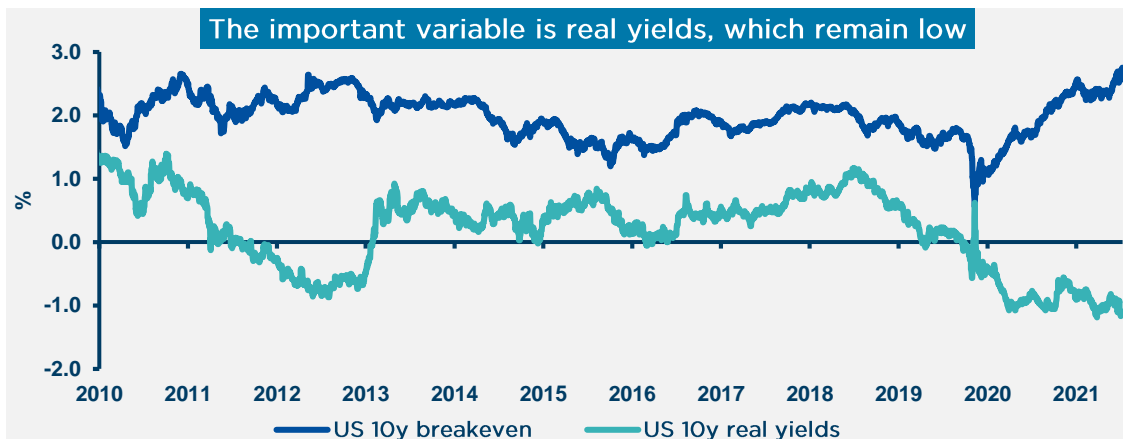
The markets seem to have bought into the Fed's temporary inflation narrative, despite the recent data and the rising political echo of the inflation theme. We also believe fiscal stimulus will recede, but not as much as market expects. Thus, we stay positive on breakevens (compared to Treasuries), but recommend some fine-tuning due to valuation concerns. On USTs, we are defensive, owing to higher government spending and debt, and continuing economic growth, but are tactically managing our stance. In credit, we remain moderately constructive in IG and HY through a more selective lens. Another source for yield is the consumer, residential mortgage and securitised markets amid robust consumer savings, but we are very vigilant. We also seek selective opportunities in securitized credit (RMBS, ABS).

EM bonds

EM bonds are an area of interest, especially in a world of low yields and given our expectations of prudent policy normalisation by the Fed. We are positive on HC and keep our bias towards HY over IG, but are cautious on LC. Interestingly, upside inflation surprises continue to drive EM CBs to front load their tightening, notably across EEMEA and LatAm. We focus on commodity-driven countries (Russia) and sectors while we have turned vigilant on Brazil and Turkey.

FX

CBs' delays in hiking rates could affect FX and we are actively following these developments. We maintain our long view on the USD and given the BoE's recent decision, we are keeping a neutral view on the GBP. On EM FX, we are positive on the RUB, IDR and COP given their high carry and commodity exports.



Source: Amundi, Bloomberg, as of 16 November 2021

“
CBs embrace a benign neglect approach to inflation and stay behind the curve. Investors should stay active and monitor the direction of real rates which will affect asset valuations.
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EQUITY

A positive earnings season, with some clouds

Overall assessment

Markets have been buoyant in recent weeks, led by strong earnings, encouraging forward guidance and progress over economic reopening as multiples expanded. However, three factors stand out for us: inflationary pressures, relative and absolute valuations, and real rates. The last factor – ie, when rates start to rise – will challenge higher equity multiples and that could aggravate the distinction between companies that possess pricing power and those that do not. This, coupled with high valuation dispersion in the markets, underscores the importance of our disciplined bottom-up process through which we identify companies that have the ability to pass on rising costs to consumers. **Thus, it is an opportune time for selectively playing rotations favouring quality and value stocks.**

European equities

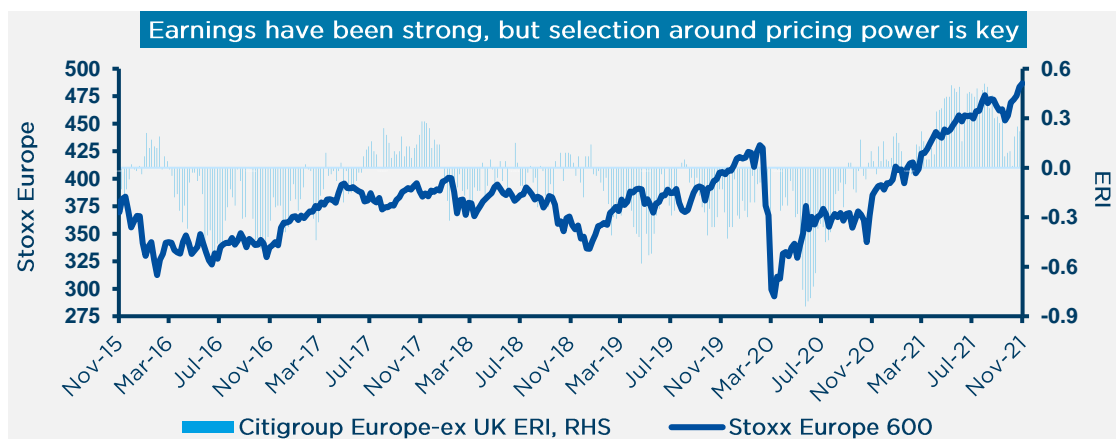
In an overall tilt towards economic reopening, we are exploring names in the value, quality and cyclical spaces, led by our selection efforts. We find such names in financials and industrials even though we are slightly less constructive. Robust earnings in this season from financials and cyclicals further convince us of our stance. At the other end of the barbell, we like names in defensive sectors (healthcare). **However, pricing power is key in a world of rising costs** and to judge this we evaluate a company's brand portfolio, intellectual property, etc. In contrast, we remain skeptical of hyper-growth tech names and discretionary sectors. ESG remains in focus amid momentum driven by policy measures such as EU green deal. Overall, we look at the E and S aspects as pools of opportunities that allow us to participate in the green transition and which could reduce inequalities without compromising returns.

US equities

Sentiment remains strong at a time when markets touched new highs, driven by positive results for S&P500 companies, which have for the time being successfully navigated supply chain disruptions and elevated inflation. Now, as we await clarity on the labour market and wages, we are watchful of whether companies are willing to give up some margin to protect a bit of market share. **This remains a key input in our decision-making: ie, whether pricing power can be sustained.** We are constructive on high-quality cyclical value names over defensive stocks, but believe stock selection will drive returns, as each company differs in its capacity to address operational issues on the supply and labour sides. However, we are cautious about bond proxy (long duration) sectors, high momentum/growth (technology, including large-cap tech), and distressed value names. At a sector level, we continue to prefer financials and energy over industrials, particularly where we can tilt the company-decision making towards promoting green energy and reducing carbon emissions. Consumer sectors appear fully valued and are exposed to labour and supply chain issues.

EM equities

Prospects of EM-DM growth premiums widening in 2022 and cheap relative valuations should support EM equities, but we suggest defensive positioning until year-end due to low visibility on market direction. The near-term Chinese outlook is affected by uncertainty over the current slowdown, although the long-term story is intact. Elsewhere, we are optimistic on Russia (commodities, energy exporter), Hungary and India. At a sector level, we prefer energy over materials, discretionary and communication services, and we keep a preference for value/cyclicals over growth.



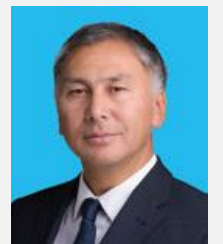
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Equities still offer attractive risk-adjusted returns, but the situation is more nuanced as inflation is a major issue for companies, underscoring the importance of selection.

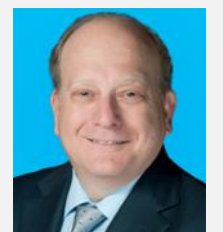
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Amundi asset class views

Asset class	View	1M change	Rationale
EQUITY PLATFORM	US	=	The ongoing earnings season highlighted that companies have been able to navigate margin pressures and supply chain bottlenecks for now. However, with inflation and supply-demand mismatches staying persistent amid high valuations and slowing growth momentum, we remain very selective and continue to focus on fundamentals. In this respect, we are monitoring the progress on the Social Infrastructure Bill that aims to boost long-term growth.
	US value	+	As the economy progresses along a slower recovery curve, we look for names that will benefit from reopening but also possess the pricing power to pass on rising costs to consumers (sustainable earnings growth), have a sticky client base and display a tendency to improve their ESG performances. Strong selection is crucial in identifying these names.
	US growth	-	In an environment of rising inflation, and potentially higher US rates, long duration stocks whose valuations are dependent more on long-term future cash flows could be negatively affected. This, coupled with the fact that valuations are already expensive in some corners of the market, makes us cautious in this area.
	Europe	=	Markets have been driven by strong earnings and progress on economic recovery (uneven), but we believe absolute valuations are stretched in some segments and therefore the scope for stock picking is high. We are positive on companies that can preserve margins and those that operate in the value, quality and cyclical spaces. Our focus is on fundamentals and ESG, as this will unearth names that can deliver returns beyond the short-term earnings season.
	Japan	=	Japan would benefit from political stability (stimulus) under the new leadership, expectations of improving earnings growth and attractive relative valuations. As Covid cases decline, the country's recovery should catch up with rest of the DM.
	Emerging markets	=	EM prospects look attractive from a long-term perspective as the region emerges from the crisis. However, we remain very selective across geographies and see the regulatory actions in China as a source of near-term weakness, even though the country presents opportunities in the long run. In addition, relative valuations in EM look attractive, as does economic growth in the medium term. With a tilt towards value and cyclicals, we like countries such as Russia and India.
FIXED INCOME PLATFORM	US govies	-	Inflation pressures persist, testing the Fed's tolerance threshold, even as the CB announced its taper plans and moves towards normalisation. The medium-term path for nominal and real rates must be monitored and we believe that the massive debt and fiscal deficit will put upwards pressure on core yields. Given that this move will not be linear, we remain cautious on duration but flexible across the curves. On TIPS, we remain constructive but are watchful of valuations.
	US IG Corporate	=	We look for quality credit but prefer company-specific risk over beta exposure in IG. On the other hand, we avoid debt where increases in core yields could have negative impacts. Consumer and residential mortgage markets remain strong as delinquencies remain moderate, but we think investors should be watchful of duration extension due to increase in rates.
	US HY Corporate	=	In line with our aim to balance yield and quality, we remain selective on HY and rely less on directionality even as credit fundamentals are improving. We avoid areas of excessive leverage.
	European Govies	-/=	We stay defensive on core and semi-core European government debt amid inflation pressures but acknowledge that the ECB will maintain a supportive stance to maintain accommodative financial conditions despite slowing its asset buying. On the debt of peripheral countries such as Italy, however, we are positive due to the nation's strong economic growth prospects and potential benefits from Next Gen EU funds.
	Euro IG Corporate	=/+	Credit fundamentals are improving and companies look to be able to withstand supply bottlenecks for now, as evidenced by recent results. However, we are monitoring volatility from core yields, dispersion of credit metrics across companies and liquidity. Thus, through a selective approach, we prefer short-dated assets, with limited directional risk, and are exploring names that display potential to improve metrics before the premium sets in (rising stars, BBBs).
	Euro HY Corporate	=	We remain active in HY and believe subordinated debt offers attractive yield as we are seeing improving distress ratios and accommodative financing conditions. However, there is a need to remain selective. Investors should balance quality, yield and stay mindful of liquidity across markets in light of the approaching year-end.
	EM Bonds HC	=/+	In an overall defensive stance on duration, we continue to favour HC debt and maintain a bias towards HY over IG as it offers attractive yields. However, we are very selective in light of the Fed's policy normalisation and lower vaccination rates in EM compared to DM.
OTHER	EM Bonds LC	=	We see some challenges for LC debt stemming from a stronger dollar but there are opportunities from a bottom-up perspective. Countries such as Russia continue to be supported by strong commodity prices but we are monitoring idiosyncratic risks and the situation in China's real estate sector.
	Commodities		Commodities are still consolidating at current levels, digesting news on growth and potential shortages. Supply issues and bottlenecks will last for a while, supporting base metals and energy prices. However, central banks and real rates are still the key variables for gold. Finally, oil, for the time being, is being driven by OPEC decisions to increase production.
	Currencies		Stronger-than-expected US inflation, labour market and retail sales data are affecting investor expectations, indicating an earlier rate lift-off from the Fed, but we are monitoring this closely. In the short term, we maintain our preference for the USD, especially vs low-yielding currencies.

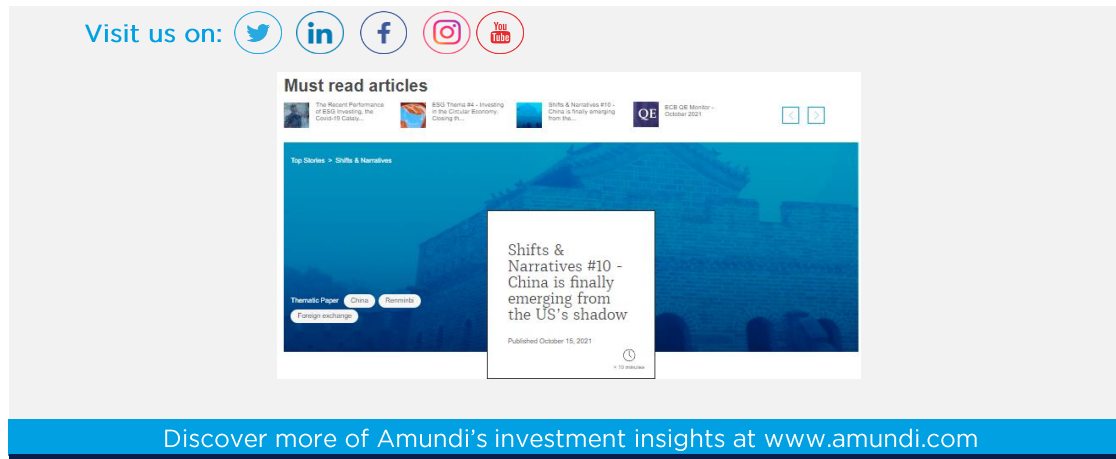
LEGEND



Source: Amundi, as of 26 November 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.

AMUNDI Investment Insights Unit

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