Amundi
ASSET MANAGEMENT

Market Watch

Our market views

Strategy and economic research
February 2010

Shifting gears

Following a tumultuous 2009, where the worst was avoided due to concerted government efforts, 2010 is likely to be complicated, with a change of pace and a reshuffle of possible scenarios.

Markets fell in January, with the MSCI World losing 3.8%, even though most economic statistics were reassuring. Indeed, in view of the leading indicators and data on fundamentals, the IMF raised its 2010 growth forecast to 3.9% from 3.1%. Furthermore, factors supporting growth early in the year, while temporary, reinforce the baseline scenario of recovery.

Even so, the **risks we identified** in late 2009 have materialised sooner than expected:

- Negative surprises in the financial sector, such as earnings reports and regulatory proposals from President Obama and Paul Volcker,
- Uncoordinated fiscal policies,
- Vulnerability to specific sovereign risk, notably for some European countries,
- Commodity price speculation,
- Management of monetary tightening and negative market perception of China's tightening move.

As a result, market volatility surged and investors began to seek safe havens such as gold and government bonds. The **multi-scenario approach** is therefore breathing new life into alternative scenarios and affecting all stakeholders in the "exit strategy". These include:

Governments, whom we still think will avoid economic policy "missteps", despite the forthcoming challenges to monetary credibility and fiscal sustainability.

Then, the still-convalescent real economy, where the impact of planned deleveraging and the eventual shift in the risk burden from public sector to private must be taken into account.

Finally, investors who are still displaying an appetite for "risky" assets but are paying closer attention to portfolio building rules rather than simple "directional" views on the various asset classes. Accordingly, a **more selective approach** to stockpicking will allow investors to comb through the many opportunities in search of those less dependent on market trends.

> *"Looking for trading opportunities less dependent on market trends"*

In sum, the recent market correction does not undermine the fundamentals of the growth/inflation tradeoff, a relationship that is anything but linear. Instead, it is increasing the rotation of investment themes and encouraging portfolio managers to be more flexible, selective proactive than they were last year.

• Patrick de FRAGUIER

Head of Strategy at Amundi

3-Month Outlook
1st February 2010)

> Fixed Income

Be a little more patient to see higher yields

- Euro zone
- United States
- Japan

> Equities

Broad decline in equities in January

- Energy
- Consumer staples
- Utilities
- Retail

> Commodities

Awaiting entrenchment of the rebound in advanced economies

- Energy
- Gold
- Basic metals
- Cereals

> Currencies

Towards a firmer dollar versus the yen than the euro

- EUR/USD
- EUR/GBP
- USD/JPY

Opinion Scale

Positive
Negative
Neutral
Very Positive
Very Negative

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Fixed Income

Be a little more patient to see higher yields

In 2010 we expect a more pronounced increase of short term rates rather than long term rates, both in Europe and in the USA.

The increase in US 10-year nominal yields during 2009 was chiefly related to market inflation expectations, which gradually returned to pre-crisis levels. The main correction occurred in the first half of 2009 (see 1st graph), after which long-term yields fluctuated without direction. Moreover market inflation expectations have been increasing while professional and consumer surveys are still indicating very low inflation expectations.

What can we expect for 2010?
Our fundamental model does not signal any huge mis-pricing for long-term rates. And for the moment economic conditions point neither to a lasting improvement of real growth expectations nor to a further rise of inflation expectations. In the long run, high levels of public deficit and debt will have more impact on bond prices, but for the moment these factors have not affected these prices and the Fed will try to manage the yield curve in order to keep the level of yields reasonably low.

Turning to monetary policy, our central scenario indicates that the Fed is likely to hike rates in the autumn. We therefore envisage a rise in short-term yields and, consequently, a flattening of the yield curve. During past tightening cycles the flattening movement began on average nine months before the first Fed hike, but the start of each flattening movement differs from one cycle to another. The trigger could be a major change in Fed communication, but for this we shall probably have to wait until spring.

Similar considerations apply to long-term rates in the core European countries (i.e. France and Germany). For this reason we do not foresee huge performance discrepancies between US and European long-term sovereign securities in 2010. We recall that 2009 saw the largest difference in performances for the last 20 years; a generic 10-yr US T-Note lost 9.4% and the Bund gained 0.46%.

• Ombretta SIGNORI

Central bank forecasts (%)

	1st Feb. 2010	3-mth	6-mth	1-yr
United States	0 - 0.25	0 - 0.25	0 - 0.25	1.00
Eurozone	1.00	1.00	1.00	1.25

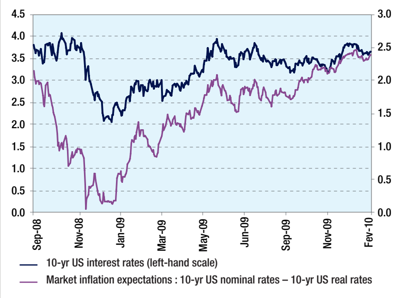
Source: Amundi Strategy

Interest rates (in %)

	At 1st Feb. 2010	Change in 1 month	Change in 1 year
Eurozone			
Eonia	0.32	-0.09	-0.95
3-mth Euribor	0.67	-0.03	-1.42
10-yr OAT	3.44	-0.15	-0.37
United States			
3-mth	0.25	0.00	-0.94
10-yr	3.65	-0.18	0.81
United Kingdom			
3 mth	0.63	-0.03	-1.54
10-yr	3.99	-0.12	0.09

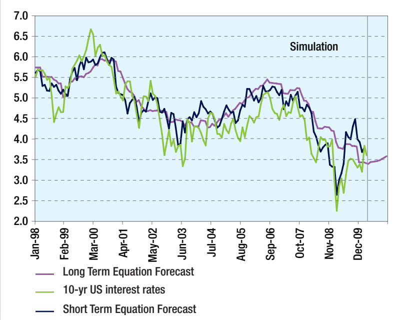
Source: Datastream, Amundi Strategy

10-year US interest rates vs. market inflation expectations



Source: Datastream, Amundi Strategy

10-year US interest rates Forecast Model



Source: Datastream, Amundi Strategy

“Our fundamental model does not signal any huge mis-pricing for long-term rates”

Equities

Broad decline in equities in January

Compounding earlier concerns over the recovery and the exit strategies of the Fed and ECB, markets are now faced with euro zone debt problems, monetary tightening in emerging markets and growing tensions in Washington.

Markets slumped in January

Equities began 2010 on the wrong foot, with the MSCI World losing 3.8% in January. Only Russia and, to a lesser extent, Japan managed a better performance. Europe and the USA were neck and neck, down 3.6%. And unusually, Brazil (-4.4%) and China (-8.5%) brought up the rear.

New areas of concern…

A whole set of new issues are compounding earlier concerns regarding:

- The reality and sustainability of the recovery and,
- The exit strategies of the Fed and ECB.

Three factors are worth noting:

- Increasing concern over sovereign debt risks, centred on the weakest links in the euro zone,
- The beginning of monetary tightening in a growing number of emerging countries,
- The growing tensions in Washington against a backdrop of speculation regarding the Fed and, the Treasury, and the announcement of far-reaching banking sector reform, which is adding to the uncertainties.

…but substantial improvement in macroeconomic and corporate results

However, these new concerns will not overshadow the very real progress being made. Q4 GDP growth was over 10% in China and beat expectations in the USA, at 5.7% vs. 4.6%. Leading indicators held firm in January, suggesting that H1 results will confirm the recovery.

Despite stronger-than-expected GDP growth, the Fed decided to leave its rates unchanged "for an extended period".

As for corporate earnings, US companies posted growth in the fourth quarter for the first time in nine quarters, with earnings up 76%, or 4% excluding financials. This performance was much better than what analysts had been predicting just three months ago, i.e. 67% growth, or a 7% drop excluding financials. Furthermore, unlike the five previous quarters, in which cost cutting played a vital role, revenues also perked up, rising 9%. We note however that there were a greater number of "upside surprises" among revenues (56%, up 11% compared with Q3) than among earnings (78%, down 4%). In addition, the upside surprises on earnings were concentrated in only two major sectors, consumer discretionary (96%, up 26%) and technology (98%, up 12%), whereas they were stagnant or declined in numerous other sectors, such as utilities, consumer staples, materials, energy and finance.

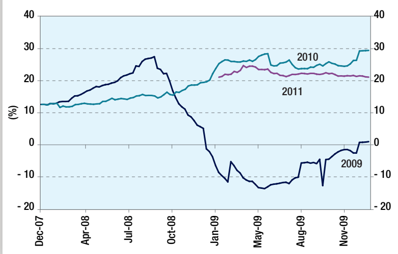
• Delphine GEORGES, Ibra WANE

Equity market indices

	At 1st Feb. 2010	Performance in euro (in %) 1 month	1 year
Europe			
DJ Euro Stoxx	264	-4.06	27.29
Cac 40	3 762	-4.43	26.50
FTSE 100	5 247	-1.43	28,63
United States			
Dow Jones	10 186	0.85	17.40
S&P 500	1 089	0.85	21.62
Nasdaq	2 171	-1.21	35.61
Asia			
Nikkei	10 205	2.46	16.47
MSCI Asia Pac. (ex Japan)	399	-3.87	56.66
MSCI World	810	-0.22	24.15

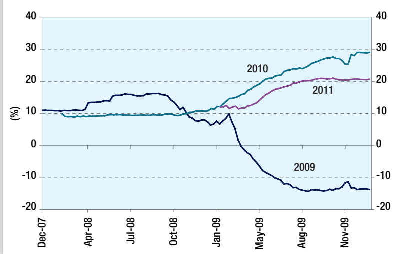
Source: Datastream, Amundi Strategy

EPS Growth Forecasts (IBES Consensus) S&P 500



Source: Datastream, Amundi Strategy

EPS Growth Forecasts (IBES Consensus) MSCI Europe ex UK



Source: Datastream, Amundi Strategy

Equity Sector Performances * at 1st February 2010

	At 1 month	At 1 year
Energy	-0.61	13.29
Materials	-4.29	47.91
Industrial	2.06	27.56
Consumer Discretionary	0.97	35.43
Consumer Staples	1.89	16.58
Health Care	2.73	10.88
Financials	-0.62	38.12
Technology	-2.12	37.04
Telecom Services	-3.47	5.29
Utilities	-1.43	-4.19
MSCI World Index	-0.22	24.15

* Performance in euro
Source: Datastream, Amundi Strategy

"These new concerns will not overshadow the very real progress being made"

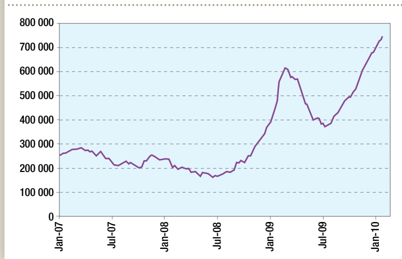
Commodities

Awaiting entrenchment of the rebound in advanced economies

Commodity prices have witnessed an impressive rise (+51% yoy in late January for the S&P GSCI Index). It is worth noting that, for an ETF investor, total returns were more modest (+19% for the S&P GSCI Index). However, this rebound is certainly far from the norm. Traditionally, it takes several years for an economic recovery to reach commodity prices. As in previous recessions, physical demand from OECD countries remained weak and inventories high in 2009. However, two things have changed compared to the past. Firstly, the influential position held by investors in these markets, coupled with the fear of resurging inflation, and secondly, China's insatiable appetite for metals and oil. Since China's announcement of initial measures to curb its economic growth, commodity prices have started to ease. In the short term, we are expecting this correction to continue, particularly for metals. We should probably wait for industrial output to return to pre-crisis levels in advanced economies, before reinvesting in commodities.

• Michel MARTINEZ

Copper Warehouse Stocks
(LME, Shangai, Comex in tonnes)



Source: Bloomberg,
Amundi Strategy and economic research

Currencies

Towards a firmer dollar versus the yen than the euro

The US dollar is expected to strengthen against both the yen and the euro in 2010. First, the economic recovery appears to be stronger in the US than in Europe or Japan. Second, the Fed is likely to be the first of the "major" central banks to tighten its monetary policy. By adopting a slightly more optimistic tone, the FOMC's January 27 press release paved the way for a rate hike in the autumn.

However, the US dollar will probably rise most sharply against the yen. Yen Libor interest rates remain higher than those in dollars on the 3 to 8-month horizons. But the Bank of Japan is not prepared to abandon its quantitative monetary policy in this timeframe and, moreover, the yen is currently overvalued. The euro situation is less clear. The euro is clearly even more overvalued against the US dollar, but its recent decline appears to be less driven by fundamentals than by increasing sovereign risk in Greece. We should remember that even if the ECB hikes its rates after the Fed, it intends to gradually bring the overnight rate (0.35% in late January) towards the repo rate (1.0%).

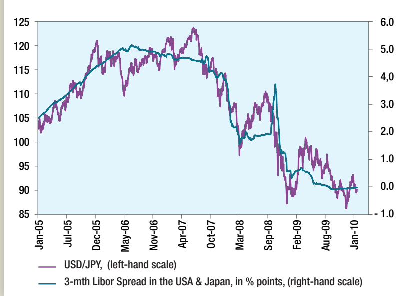
• Didier BOROWSKI

Exchange rates

Exchange Rate Parities	1st Feb.	% Change 1 month	1 year
EUR/USD	1.39	-3.4	9.0
EUR/GBP	0.87	-1.5	-3.2
USD/JPY	90	-2,3	1,0

Source: Datastream,
Amundi Strategy and economic research

USD/JPY vs. 3-month
Libor Spread



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