

## Market Watch

Our market views

When the multiplier “green zone” fuels global growth

**The strength of fiscal and trade multipliers should not mask the fact that they are short-lived by their very nature. The global recovery that is underway is thus more fragile than many think. Subsequently, investors must, more than ever, remain vigilant.**

In spite of the recent financial turmoil, most business surveys carried out indicate that growth is getting stronger, including in the Eurozone. The positive newsflow accumulating on a global scale is the result of several factors.

Firstly, the economic policies implemented in 2009 are still having a positive impact on economic activity. This is particularly the case in the United States, where household consumption has been stimulated by transfer income associated with a temporarily generous tax policy. This is also the case in China, where previous stimulus measures are still driving activity; so much so that the authorities are now obliged to tighten monetary policy in order to curb soaring lending.

Secondly, global trade – which plunged even more sharply following the collapse of Lehman Brothers than it did after the crash of 1929 – is rising from the ashes once again. The recovery is striking in major emerging markets and the combined normalisation of trade flows is having another multiplier effect, which is underpinning global GDP growth. Thanks to the geographical structure of its exports, Germany is one of the main European winners. The knock-on effect of this is also benefiting other countries.

Finally, the inventory cycle is being driven by the general positive trend. Inventory build-up in most countries is stimulating industrial production. In the United States, it is responsible for half of the GDP growth recorded in the first quarter alone.

These three factors are clearly not independent from each other. There would not be a rebound in global trade without a recovery of domestic demand in most countries. And companies would not reconstitute their inventories if they did not have full order books once again. Once they are set off, the current trends provide mutual strength to each other – we are at the core of the multiplier “green zone”.



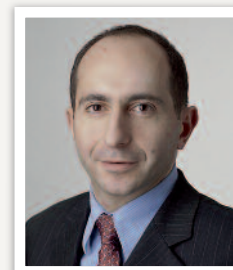
*Multipliers are threatening to fade by the end of the year*



However, despite the strength with which these factors are driving global growth, and even though they have been underestimated by most economists, we cannot deny their temporary nature. Multipliers are threatening to fade by the end of the year. Indeed, in major developed economies, unemployment is still high, household confidence is low, and lending conditions remain tight despite highly accommodative monetary policies. Even stronger than expected, the global recovery remains fragile. In terms of asset allocation, the “green zone” appears, for now at least, to naturally favour risky assets. However, insofar as multipliers lose their intensity, investors will have to be increasingly vigilant.

• *Didier BOROWSKI*

Strategy and economic research  
May 2010



Amundi Strategist

### 3-Month Outlook

(at 3 May 2010)

#### > Fixed Income

**Wave of downgrades in Europe hits Greek, Portuguese and Spanish debt**

- Eurozone
- United States
- Japan

#### > Equities

**Risk aversion rides again**

- ↗ Energy
- ↗ Consumer staples
- ↘ Utilities
- ↘ Telecom Services

#### > Commodities

**Reserves of value are still out there**

- ↗ Gold
- Copper
- ↗ Oil

#### > Currencies

**The ups and down of the euro**

- EUR/USD
- ↘ EUR/GBP
- ↗ USD/JPY

#### Opinion Scale

- ↗ Positive
- ↘ Negative
- Neutral
- ↗↗ Very Positive
- ↘↘ Very Negative

# Fixed Income

Wave of downgrades in Europe hits Greek, Portuguese and Spanish debt

The Greek tragedy and sovereign risks have captured the attention of global markets; the flight to quality is holding down yields.

According to the "advance" estimate released by the Bureau of Economic Analysis, the US economy accelerated at an annualized rate of 3.2% in the first quarter of 2010. The report shows the economy expanding at a moderate pace in line with the outlook described by the Fed in the last FOMC statement.

The increase of real growth primarily reflects the significant contribution from private consumption. For the first time since 2008 Q1 the level of inventories increased and contributed positively to GDP for the second quarter in a row. Inventories decreased in Q4 but at a slower pace, and what is relevant for inventory investment is not the level but the change.

The last FOMC meeting held the fed funds target at 0-0.25% and reiterated that current economic conditions were "likely to warrant exceptionally low levels of the federal funds rate for an extended period", so we are maintaining our forecast that the first rate hike is likely to come towards the end of 2010. Furthermore, the last financing support measure – the Term Asset-Backed Securities Loan Facility (TALF) – is scheduled to close at the end of June.

In Europe, sovereign risk is dominating the scene. The biggest "domestic" crisis to hit the European Union since its inception is the first that has really impacted overseas markets. Greece has

to redeem €8.5 billion of its debt on 19 May, and this impending deadline fueled risk aversion and speculation on a default. The yield on the Greek 2-year note climbed to 15.9%, the 10 year yield to almost 10% in April.

With the rescue plan put together by the EMU states and the IMF, Greece was able to breathe a sigh of relief given that there are no major redemptions for the rest of the year. But the problems are not confined to Greece, where austerity will worsen the economic situation.

Portugal, whose debt was downgraded two notches by Standard & Poor's (from A+ to A-), may have to bolster measures to cut its deficit, since it is the "next most likely" nation after Greece that will struggle to meet its budget goals. The wave of April downgrades continued with Spanish debt, now rated AA (from AA+) by S&P. The real "winners" in this case, have been German bonds, boosted by a flight to quality.

• *Ombretta SIGNORI*

Central bank forecasts (%)

	3 May 2010	3-mth	6-mth	1-yr
United States	0 - 0.25	0 - 0.25	0 - 0.25	1.25
Eurozone	1.00	1.00	1.00	1.50

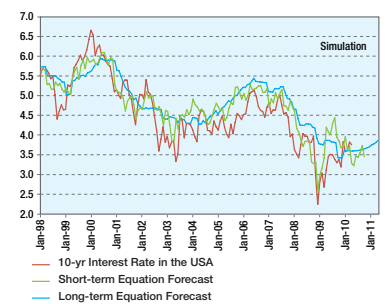
Source: Amundi Strategy

Interest rates (in %)

	At 3 May 2010	Change in	
		1 month	1 year
<b>Eurozone</b>			
Eonia	0.34	0.01	-0.25
3-mth Euribor	0.67	0.03	-0.70
10-yr OAT	3.32	-0.08	-0.28
<b>United States</b>			
3-mth	0.35	0.06	-0.66
10-yr	3.69	-0.19	0.51
<b>United Kingdom</b>			
3 mth	0.75	0.13	-0.68
10-yr	3.87	-0.05	0.33

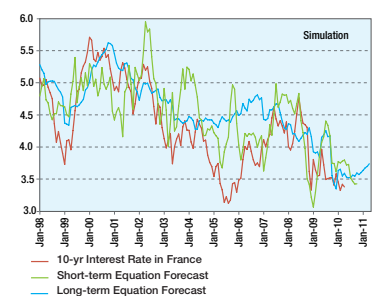
Source: Datastream, Amundi Strategy

10-yr Interest Rate in the USA  
Forecast Model



Source: Datastream, Amundi Strategy

10-yr Interest Rate in France  
Forecast Model



Source: Datastream, Amundi Strategy

“  
The US economy accelerated at an annualized rate of 3.2% in the quarter of 2010  
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# Equities

Risk aversion rides again

**Markets reached fresh highs in mid-April before concerns over Greece and the new Goldman Sachs affair turned the mood to doubt. This tense environment momentarily overshadowed positive first-quarter earnings.**

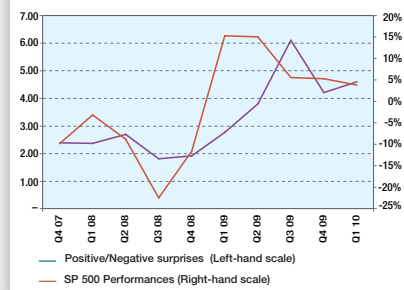
The MSCI World index reached a year-to-date high in mid-April. It was driven by positive statistics, including the US, German and Chinese PMI indices and the US employment report, and by the Fed's decision to stand pat. But then the Goldman Sachs affair and procrastination on assisting Greece triggered profit taking, which the market absorbed readily until 26 April. On 27 April, S&P downgraded its ratings for Greece, Portugal and Spain simultaneously, giving substance to investors' fears of a domino effect and accelerating the downturn. The US market, which had been more resilient till then, finally caved in when first-quarter GDP growth came out slightly below expectations (3.2% compared with 3.4%) and fresh accusations targeted Goldman. Still, for the month as a whole, the MSCI World remained neutral, with Japan and the USA slightly positive. Meanwhile both the UK and the eurozone came under heavier selling pressure, the former because of election uncertainties, the latter because of the Greek crisis.

Although it is hard to predict what will happen next with the eurozone and Goldman Sachs, we believe the earnings season will remain an anchor point for the market. Pending a clearer view of the situation in Europe, the sales recovery at S&P 500 companies, which first appeared in fourth quarter 2009, was confirmed in the first quarter by an 8% rise. Similarly, earnings rebounded 47% overall and 26% excluding financials. After nine down quarters, this shows

that the rebound began in the fourth quarter and has extended beyond just the financial world (4% in Q4 excluding financials). Moreover, the percentage of positive surprises remained very high, at 53% for sales and 80% for earnings. Investors tend to respond more to the good news on the top line than on the bottom line, where it was concentrated chiefly in technology (sales up 21%, 76% positive surprises) and consumer discretionary (13% and 75%). In contrast, earnings were well below average in traditionally defensive sectors such as energy, consumer staples, telecoms and utilities.

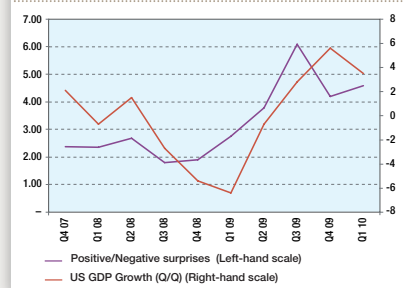
• Ibra WANE

Surprises: quarterly earnings and SP 500 variations



Source: Bloomberg, Amundi Strategy

Surprises: quarterly earnings and US GDP variations



Source: Bloomberg, Amundi Strategy

Equity Sector Performances\* at 3 May 2010

	At 1 month	At 1 year
Energy	3.17	25.19
Materials	-2.09	44.06
Industrial	4.12	44.15
Consumer Discretionary	5.99	41.11
Consumer Staples	0.00	32.91
Health Care	-1.55	28.46
Financials	1.04	41.86
Technology	4.93	41.06
Telecom Services	-0.65	14.29
Utilities	0.77	12.88
MSCI World Index	1.87	34.95

\* Performance in euro  
Source: Datastream, Amundi Strategy

Equity market indices

	At 3 May 2010	Performance in euro (in %)	
		1 month	1 year
<b>Europe</b>			
DJ Euro Stoxx	270	-4.11	22.45
Cac 40	3 828	-5.10	21.16
FTSE 100	5 553	-1.03	34.94
<b>United States</b>			
Dow Jones	11 152	4.87	36.60
S&P 500	1 202	4.86	37.82
Nasdaq	2 499	6.87	46.20
<b>Asia</b>			
Nikkei	11 057	0.09	30.22
MSCI Asia Pac. (ex Japan)	422	1.08	51.03
MSCI World	873	1.87	34.95

Source: Datastream, Amundi Strategy

“ Amid general uncertainty, the earnings season should help to anchor the market ”

# Commodities

Reserves of value are still out there

The recent intensification of Europe's debt woes is a stark reminder that fewer and fewer low-risk assets exist in the post-crisis world. What makes the present environment even more unsettled is that the problem is probably a global one. Non-conventional policy measures are winding down and economies with large trade surpluses are tightening money. Both these factors are ultimately dampening demand for bonds, whereas governments' financing needs are clearly in evidence. Current dithering over deepening government deficits could fuel a lasting rise in bond volatility, which has been trending upwards since 2006.

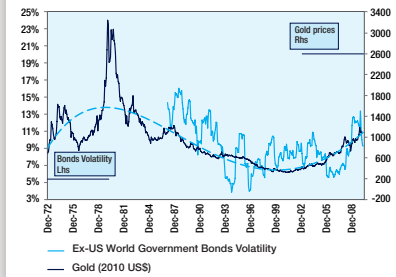
In this market configuration, we recommend seeking liquid and low beta-oriented strategies. Best candidates include

precious metals, particularly gold, which should benefit from worries over sovereign debt. These assets are highly attractive as stores of value that are also liquid. Moreover the price of gold in US dollars is up 12.5% since February and is on course to breach the \$1,200/oz. threshold, while silver and platinum are up 8.7%. Various strategies can provide exposure to rising prices, ranging from buying physical gold (ingots) to mining stocks, and including futures contracts, which are available through ETFs. We favour ETFs even though they have higher valuation multiples than other types of equity. We estimate their long-term excess return (\*) at more than 4%, sufficient to cushion short-term volatility fluctuations.

• Marc-Ali BEN ABDALLAH

(\*) Returns in excess of the rate on long-term US Treasury bonds.

Gold prices in 2010 US\$ vs ex-US World Government Bonds Volatility (LTM)



Source : Datastream, JP Morgan, Amundi Strategy

# Currencies

The ups and down of the euro

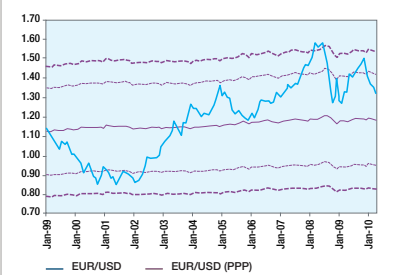
It was easy to fear the worst for the euro after the Greek government issued a call for help and credit ratings for several eurozone countries – not just Greece but also Spain and Portugal – were downgraded. The lower average quality of government debt could have put very severe pressure on the European single currency. Certainly, the euro depreciated against all other currencies, but it is far from having come apart and a purchasing power parity model still shows the euro overvalued by around 10% against the US dollar. Late-April declarations by various

governments attest to awareness of the need for solidarity among European governments.

In the months ahead, we expect the euro to stage a recovery against the yen. However, things will very likely be different versus the US dollar. Even though the resolution of the Greek crisis reassured investors, considerable uncertainty still surrounds other vulnerable eurozone members. In addition, monetary policy movements should favour the dollar, since the Federal Reserve will probably raise interest rates sooner than the ECB.

• Bastien DRUT

EUR/USD: Spot rate vs PPP rate



Source: Datastream, Amundi Strategy

Exchange rates

Exchange Rate Parities	3 May	% Change	
		1 month	1 year
EUR/USD	1.32	-2.7	-0.6
EUR/GBP	0.86	-2.3	-3.0
USD/JPY	94.5	0.6	-4.9

Source: BCE, closing prices Datastream

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Chief editor: Pascal Blanqué - Editors: Patrick de Fraguier, Michel Martinez.

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