Amundi ASSET MANAGEMENT | Research

CROSS ASSET Investment Strategy

10

October 2020

Monthly

CIO VIEWS

Markets at a crossroads, opportunities from divergences

THIS MONTH'S TOPIC

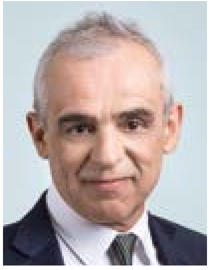
Contraction > recovery > late cycle: the cycle round trip is confirmed

Advanced Investment Phazer: top-down assessment

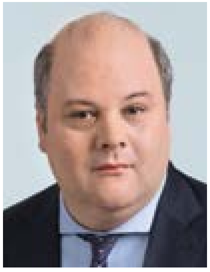
#10 - October 2020

Table of contents

CIO VIEWS



PASCAL BLANQUÉ
Group Chief Investment Officer



VINCENT MORTIER
Deputy Group Chief Investment Officer

Markets at a crossroads, opportunities in divergences

Back from holidays, investors are dealing with **rising volatility in the equity markets and initial signs of a fall in the extreme market complacency over the last few months**. After the summer overshoot, Big Tech stocks have seen a pullback and some tensions have also materialized in the US HY segment, while IG markets remained more or less flat in the last month. The relative calm in credit and US Treasuries reassures that the readjustment is mainly due to investor repositioning, and is not driven by financial-market stress.

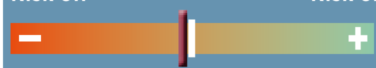
At the investment strategy level, this means that investors should follow the evolution of some key divergences that the post Covid-19 recovery phase is highlighting, in order to exploit current opportunities and monitor possible rotations on the horizon.

1. **The first and most important of these is the detachment of the market from economic reality** due to the extreme policy support, which mainly benefitted the long tech, long duration trade that became increasingly crowded over the summer. Central banks will remain accommodative but markets will ask for additional accommodation, that will come only if conditions worsen materially. Some volatility is therefore on the cards entering the autumn, when the direction of the economy and, most importantly, the pandemic will be tested. **Investors should therefore maintain a cautious (normalization of economy will not happen soon), but not risk-off stance.** It would be difficult to see any further upside in risk assets in absence of a clear catalyst. This means investors should prioritize liquidity and quality, explore relative value opportunities and remain watchful of bubbles. On duration, instead, investors should be neutral.
2. **A second divergence we see is in credit**. After a first wave of indistinctive sell-off at the beginning of the crisis, the subsequent bounce-back has triggered a divergence between quality companies that will be able to navigate the crisis and the more challenged ones. With deflationary fears abounding and CBs highly accommodative, yields are set to remain suppressed. Search for yield will continue, but at this point in the cycle, with possible rising defaults, we reiterate the importance of being highly selective and not compromising on quality and liquidity. This is because while technicals remain strong due to central bank support, fundamentals still remain weak. We see opportunities in IG, securitised credit and hybrid/subordinated debt. In HY, investors should be cautious on names and sectors at higher risk (consumer, cyclicals, financials).
3. **China (and selective Asian countries) vs. rest-of-world divergence.** With still-high uncertainty around the evolution of the cycle in Europe and in the US, China is emerging as the engine of growth. Strong recent Chinese economic data enables the recovery narrative to continue, with the pendulum shifting toward some Asian countries (Korea, Taiwan). China's strength is behind the appetite for selective EM bonds and EM equity, and also EM currencies. This pattern has translated into a strengthening Yuan and into the outperformance of those European equities which have high sales exposure to China vs. the rest of the European equities. Emerging dominance of Chinese assets or assets exposed to China's growth will likely endure. The relative weakness of the dollar also supports selective EM currencies, making exposure to EM LC bonds more appealing; some rerating has started.
4. **ESG will continue to gain prominence, particularly the 'S' factor.** Governments will have to deal with rising inequality and diverging social standards as reducing fiscal payments and unemployment support exacerbate the effects of a slow economic rebound. Overall, the growing trend toward the adoption of green standards, as well as best practices in the social space, should benefit those companies able to improve their profile in this area, and investors will likely reward them.

In conclusion, markets are pricing a lasting deflationary and low discount rate environment, and the ability of monetary and fiscal policies to continue to feed the "financial multiplier," hence keeping a positive momentum of policy support. **This support generates a certain dispersion of returns that offers opportunities for relative value play. This is the game investors should play as long as the policy mix keeps markets in a relative calm.** Yet, at some point, stronger rotations will come from either higher than expected growth or higher inflationary expectations or loss of momentum of policy support (second derivative), and this calls for a watchful approach especially to areas of extreme market complacency (high growth big tech space).

Overall risk sentiment

Risk off | Risk on



Overall cautious approach; explore market dispersions and divergence to benefit from relative value opportunities

Changes vs. previous month

- Neutral in European equities but keep portfolio protection
- Weak GBP amid no-deal Brexit risk

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

MACRO

Rotation from credit to equities in the pipeline

MONICA DEFEND
Global Head of Research

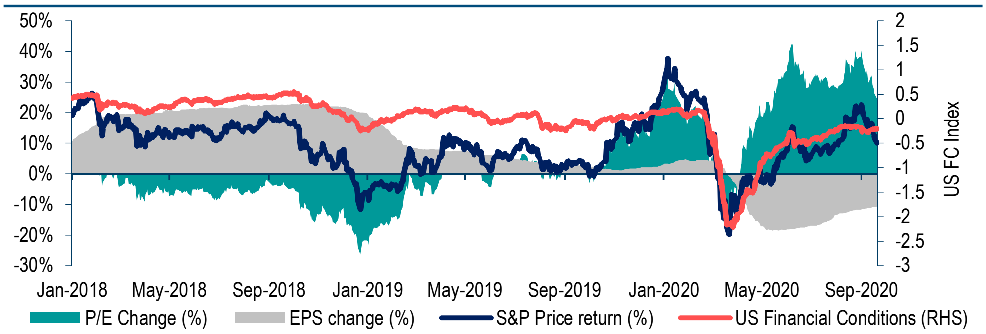
FEDERICO CESARINI
Cross Asset Strategist

Investors should consider a rotation from credit to equities, without changing the risk budget, amid expectations of double-digit earnings growth and the limited potential for financial conditions to ease further

A transition towards a new financial regime is happening, hiccups may occur but policy boosts will intervene to mitigate relapses. While the bottom has passed, **economies do not seem to be climbing out quickly enough to ensure a quick recovery**. On the other hand, **earnings will prove to be more resilient** and quick to recover, whereas the picture is more scattered within credit. **It is now time to consider a rotation from credit (starting from HY low rated issuer) into equities (deep value, quality), all the while leaving the risk budget balance unchanged.** After responding quickly to the Covid-19 economic shock, CBs confirmed their role as lenders of last resort and extended the measures to include the private non-financial sector among the main beneficiaries. Conventional and unconventional tools were enough to restore confidence in markets and offset one of the sharpest contractions of economic activity. With artificially high demand for spread products, financial conditions eased and translated into higher multiples, which in turn, drove a rebound in equities. Six months after the intervention, policy accelerators have already pushed business confidence higher and shaped the standard features of a recovery scenario for 2021. **Whilst both equities and credit are likely to perform well in this scenario, investors will start questioning whether the relative preference "Credit vs. Equities" still holds**. Earlier, with the direct support of CB, corporate bonds were perceived as safer than stocks and inflows to the asset class surged since March 2020. But the economic recovery is on track and the second quarter is expected to have marked the trough for earnings, suggesting P/E dynamic should not be the only driver of equities going forward. Given the expectations of double-digit growth in earnings and the limited potential for financial conditions to ease further, we think the case for profit growth, taking the lead over multiples (see chart) and, supporting equities over credit remains valid. Currently, spreads are tight across the board and not far from pre-pandemic levels even in the HY space, despite concerns on defaults. A clear anomaly of this exceptional situation is that investors' search for yield has offset the weak fundamentals story. Now, with less juice to squeeze in credit from current levels and the approaching recovery, **we see asymmetric profiles for the two asset classes – credit will offer better downside protection (than equities), but equities will offer higher gains in case of a potential upside**. Despite the bumpy road, with recovery extending to the early stages of 2022, we see opportunities to rotate progressively to stocks, as we see only limited carry in corporate bonds. **On the other hand, equities are attractive from an income standpoint.** ERPs remains well supported and the percentage of stocks with higher DY than corporate bonds yield has surged since CB intervention. Moreover, inflation expectations are bouncing back and could prove to be a source of volatility for FI investors. As commitment on lower rates for longer seems strong, we see limited risks for the time being. If any, early spikes in nominal rates would favour equities over credit, as stocks remain among the best "growth-based" hedges against rising inflation figures.

Considering the limited participation of international institutional investors in the March-to-August rally — apart from US retail investors and option volumes — **a repositioning in equities is likely along 2021.** Current positioning remains below historical standards, as investors preferred credit to play the first leg of the rebound. We think something is changing in the landscape and expect further confirmations on the recovery path would trigger a gradual rotation to equities in the coming months.

EPS growth expected to take the lead over multiples



Source: Amundi Research, FactSet, as at 21 September 2020. Data for S&P 500. 12 month forward P/E (price equity ratio) change y-o-y, 12 months forward EPS (Earnings per share) change y-o-y, Price return y-o-y. US Financial Conditions is an Amundi-created index – A positive number means easing conditions, whereas a negative reading means tightening conditions

DY = Dividend yield, ERP = Equity Risk Premium. CB = Central banks, FI = Fixed income.

MULTI-ASSET

Keep portfolio protection, consolidate performance

MATTEO GERMANO
Head of Multi-Asset

We stay overall neutral on risk assets, maintaining a cautious stance on US equities but converging to neutrality in Europe. Credit, especially EUR IG, remains attractive for carry reasons

We expect the economic performance to progress along a slow and a gradual upward path, fuelled by the long-lasting central bank support as confirmed by the recent shift in the Fed stance to a more (flexible) average-inflation-targeting regime. We believe this 'lower for longer' rates environment and improving economic backdrop call for preparation for some risk rotation while keeping a balanced, defensive and diversified stance. **Investors should stay neutral on risk assets (slightly cautious on equities, positive on quality credit) but remain watchful to identify opportunities, book profits where the upside seems limited and maintain appropriate hedges.**

High conviction ideas

On DM equities, we upgraded our stance on Europe to neutral. This could be done by making some changes to derivatives strategy rather than by increasing outright positions in order to maintain an overall cautious stance. Equity risk premia are high, although absolute valuations are stretched. We believe expectations of a recovery and a stronger link between fiscal and monetary policies have slightly improved the case for DM equities (and EU equities in particular), but due to the uncertainties on virus evolution and economic recovery we prefer to remain conservative. In addition, we acknowledge that key risks remain in the form of uncertainty over the US elections supporting our slightly cautious view on the US. In EMs, we prefer Asia (China and Indonesia), as we believe the region can continue to drive the EM rally in light of a more pronounced recovery and higher expected earnings in the near term. On duration, we remain neutral to long amid continued expectations of low interest rates. **We are cautious now on UST 5y vs Germany 5y, and believe investors should lock-in gains**, as markets are reluctant to price in negative rates in the US and this has led the volatility of the spreads to collapse. We are positive on US inflation amid the aforementioned Fed comments. Some pick up in prices should continue, due to cost pressures and the vanishing negative base effect of energy prices. We are constructive on Euro peripheral debt due to ECB support, favourable technicals and the EU recovery fund, but deem it prudent to hedge upside risks related to reflation, vaccine availability and stronger growth. In this context, we are no longer positive on the Italian BTP 10y; **instead we believe the BTP 5y could offer better protection** as this would suffer less if a bear steepening of curves materializes in Europe.

Credit has been the asset class used by investors to play out the rally in risky assets. We don't expect further spread tightening across the board, as the movement since March has already been sharp. Consequently, we remain positive on quality **credit for carry and 'search for yield' purposes**. We favour EUR IG on the back of the combination of attractive valuations, strong CB support and lower leverage than their US counterparts. **In EMs, we remain constructive on HC debt** and believe overall EMBI spreads are not far-off fair value. While HY spreads could still see some tightening in the next three months, in IG the levels are already in line with historical averages. Local rates are still on a declining trend, but room for further compression is more limited, the main driver being currency exposure. On FX, we believe investors should favour a diversified basket of high-yielding EM currencies amid improving growth dynamics, light positioning and rising inflows into the region. **On DM FX, we now believe that the GBP would be pressurized, vs the EUR and the USD**, by the continued uncertainty over Brexit due to the UK Internal Market Bill and over 2021 economic recovery in the UK.

Risks and hedging

Markets could be affected by insolvency risks when stimulus measures are withdrawn, as well as by another wave of defaults and geopolitical tensions. **We recommend investors to maintain all pillars of the hedging including**, in high yield credit, gold and the yen and readjust option strategies that enable savings on hedging costs.

Amundi Cross Asset Convictions

	1 month change	---	--	-	0	+	++	+++
Equities	↗			■				
Credit						■		
Duration						■		
Oil					■			
Gold						■		

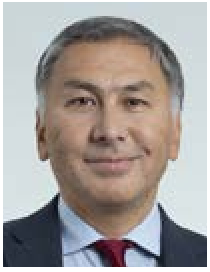
Source: Amundi. The table represents a cross-asset assessment on a three-six month horizon, based on views expressed at the most recent global investment committee. The outlook, changes in outlook and opinions on the asset class assessment reflect the expected direction (+/-) and the strength of the conviction (+/++/+++). This assessment is subject to change.

USD = US Dollar, JPY = Japanese yen, UST = US Treasury, DM = Developed markets, EM/GEM = Emerging markets, FX = Foreign exchange, FI = Fixed income, IG = Investment grade, HY = High yield, CHF = Swiss franc, NOK = Norwegian Krone, EUR = Euro, CBs = central banks, TIPS = Treasury Inflation-Protected Security, BTP = Italian government bonds, EMBI = EM Bonds Index.

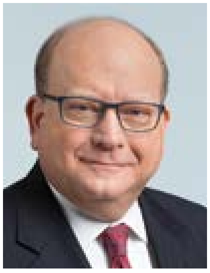
FIXED INCOME

Relative value, sector allocation is the story for now

ÉRIC BRARD
Head of Fixed Income



YERLAN SYZDYKOV
Global Head of Emerging Markets



KENNETH J. TAUBES
CIO of US Investment Management

We believe the defaults are expected to be concentrated in low-rated HY issuers in the US (CCC and below rated), particularly in sectors — energy, retail, tourism — worst affected by the crisis

The markets are operating in the context of better-than-expected economic data, large monetary/fiscal support and accommodative liquidity and financial conditions. However, huge uncertainty remains over the evolution of the pandemic and availability of a vaccine, which could be the game changer. **We believe this environment is conducive for carry and relative value opportunities, without taking any strong directional risk but with a focus on selection, quality and liquidity**.

Global and European fixed income

We keep a neutral view on duration overall, with some distinctions. The Fed Chair's recent comments on inflation have led us to reassess our positive stance on US duration (still positive) and made us more constructive on US breakevens. We are now positive on JGB. In Europe, we think it is the right time to implement a barbell strategy on the euro yield curve – a positive stance on 10y on one end, and cautious view on the longer 30y (and 5y) position, with a view of curve flattening for the time being amid low inflation in EZ. In addition, we remain constructive on peripheral bonds vs. Germany (ECB support and spread tightening). **Within credit, we maintain positive view** through **financials and subordinated debt** but believe we will see increasing fragmentation on two fronts – (1) companies that maintain high cash levels for any contingency vs. those that burn cash to sustain themselves; (2) increasing gap between sectors (tourism, energy) that experienced heavy fall in revenues vs. those (technology) that witnessed higher sales. For investors, this means idiosyncratic and default risks are not correctly priced in and spread compression will not be uniform. As a result, attention to selection and quality is paramount. Overall, we prefer EUR vs. US in HY.

US fixed income

We are witnessing a US recovery amid slowing employment gains and positive consumption and small business sentiment. On the other hand, after Congress failed to pass a stimulus bill, we believe the demise of fiscal support may stress consumer credit and stymie job growth. It now appears the Fed is left to do most of the heavy lifting as evident in its recent forward guidance (average inflation, full employment/tight labour market). **This allows us to stay constructive on TIPS but cautious on USTs** given a negative real rates environment, fiscal deterioration and increased UST issuance. The last two also underpin our continued stance on a steepening yield curve. **On corporate credit**, we maintain our positive view, but believe investors should pare back duration risk and safeguard against any further fall in rates. We also believe exposure to HY cash bonds should be trimmed in order to deal with default risks in line with a slow recovery. **Housing and consumer markets remain strong**, as demonstrated by a resilient consumer and a low loan-to-value ratio in residential housing debt market. We now prefer agency MBS to RMBS, given the added protection of the former coupled with their liquidity and yield advantages.

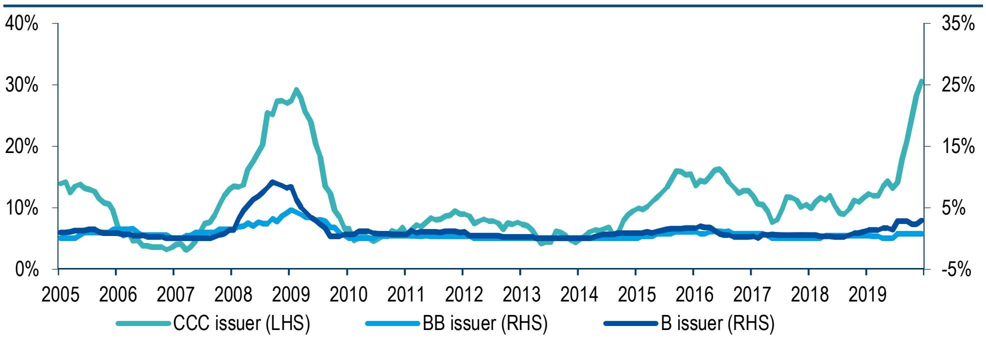
EM bonds

We prefer HC debt, in particular in HY, as IG spreads have already tightened to pre-Covid 19 levels and prospect of new supply lingers. HY spreads are still wide compared to history and may offer opportunities. We remain selectively positive on rates.

FX

We are cautious on the USD and GBP. In EMs, we like relative value trades, Asian names and are now positive on CEE FX.

US HY default by rating, %



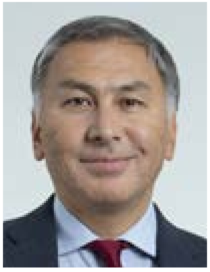
Source: Amundi, Moody's, as at 31 August 2020

GFI= Global Fixed Income, GEMs/EM FX = Global emerging markets foreign exchange, HY = High yield, IG = Investment grade, EUR = Euro, USD = US dollar, UST = US Treasuries, RMBS = Residential mortgage-backed securities, ABS = Asset-backed securities, HC = Hard currency, LC = Local currency, TIPS = Treasury Inflation Protected Security, CRE = Commercial real estate, JPY = Japanese yen, CEE = Central and Eastern Europe, JBGs = Japanese government bonds, EZ = Eurozone.

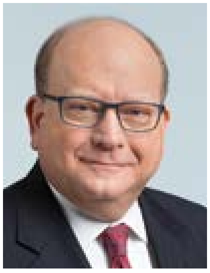
EQUITY

Aim for portfolio balance, avoid expensive areas

KASPER ELMGREEN
Head of Equities



YERLAN SYZDYKOV
Global Head of Emerging Markets



KENNETH J. TAUBES
CIO of US Investment Management

Overall assessment

The immediate demand recovery witnessed after the lockdown, coupled with a better-than-expected Q2 earnings season, has supported markets. Now, the pace of recovery will become the focus going forward. However, the recovery is still uneven, and markets are exhibiting high valuation dispersion. **For investors, this dispersion presents an opportunity for bottom-up stock selection. We urge an overall balanced stance given the high uncertainty, and a focus on balance sheet strength.**

European equities

We selectively look for opportunities but are cautious to avoid expensive areas and value traps. For instance, in **technology**, we are now less negative, but disagree with the view that the sector is "anti-fragile," and, believe valuation gravity is a powerful force that could make the sector vulnerable, though timing is uncertain. We maintain a balanced view through attractive names in defensive health care stocks on one hand, and quality cyclical names in **building materials** on the other. While we are marginally less constructive on the latter, we think the sector is increasingly recognised as an "infrastructure/green deal winner," with good structural growth and is an attractive way to play the rotation towards quality cyclicals. On **financials (banks)**, the bull case is that Covid-19 will become a trigger for a push towards greater digitization, branch/cost reduction, and, eventually consolidation. However, we keep a neutral view as we evaluate Covid-19 related loan losses and signs of higher rates for any material rerating to happen, although it is unlikely. We remain defensive on **energy** amid concerns over weak short-term demand outlook and high medium term risk over "decarbonisation."

US equities

Although equity risk premiums are still supportive of broader markets, relative valuations and momentum for the big-five tech stocks will start to seem egregious, as it has happened since early September. **This calls for a very balanced approach across sectors now due to the high intra-sector correlations and a wide range of outcomes** driven by the upcoming Presidential elections. In addition, we believe, now is the time for a more sustained leadership rotation in favour of high-quality value and 'growth at reasonable price' stocks, which have strong balance sheets, and display secular advantages and a potential for high returns. On the other hand, we are cautious on deep value names and high-growth areas, particularly the big five mega-caps and high momentum stocks due to the diversification principle and their expensive valuations.

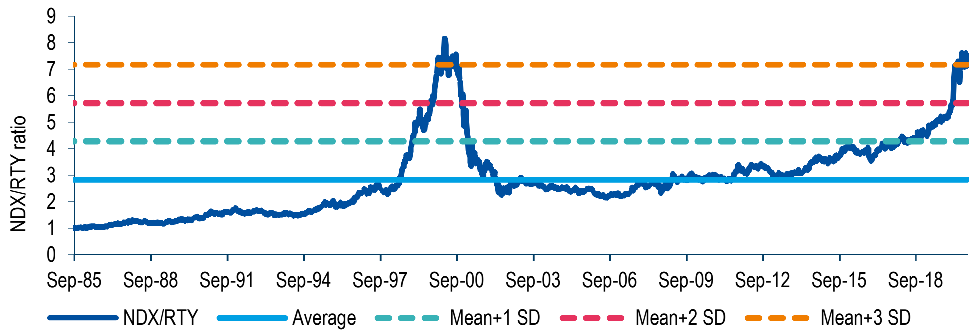
Within cyclicals, we prefer industrials to financials and energy, as quality names are easy to find among industrials and are not subject to the challenges of 'lower rates for longer.' Among defensives, we favour consumer staples and utilities — attractive valuations — over real estate because the latter may be affected by a weak economic recovery.

EM equities

In the heterogeneous EM universe, we believe **select Asian countries (China, South Korea) have better managed the pandemic** (first-in, first-out). We are also assessing how the improving commodities outlook could affect prospects for Latin America. At a sector level, we see selective opportunities in value and cyclicals within industrials, discretionary and materials, and are exploring internet and tech names. However, risks such as US/China rivalry and the latter's more assertive foreign policy must be monitored.

While the crisis affected all companies, preparedness made all the difference. The ones with strong balance sheets outperformed and will be better able to manage this slow recovery

US Tech and small caps ratio close to dotcom bubble levels



Source: Amundi, Bloomberg. Weekly data as at 18 September 2020. NDX = Nasdaq 100, RTY = Russell 2000

THEMATIC

DIDIER BOROWSKI
Head of Global Views

PIERRE BLANCHET
Head of Investment Intelligence

TRISTAN PERRIER
Global Views Analyst

EU and UK would probably agree on temporary shock mitigation measures

You asked, we answer

Our Global Views team attempts to answer some of the questions often asked by our clients

Brexit : what will happen if there is no deal between UK and Europe?

What happens after the end of the transition period (31 Dec 2020) is a major political uncertainty. As we write, a number of EU-UK divergences must still be cleared before a trade deal can be secured. Moreover, tensions have recently flared up over the UK's Internal Market Bill.

While we acknowledge that the "no-deal" risk has risen and can rise further in the coming weeks, our base **case remains a suboptimal trade deal** (an FTA for goods and some provisions for services) before year-end. With no customs union, this deal would not prevent trade frictions.

Should they fail to reach a trade deal, the EU and UK would probably agree on temporary shock mitigation measures, so that all trades are not conducted under a "raw" WTO regime in all sectors as soon as 1 Jan 2021. However, there would still be a major hit to trade and growth, and probably more severe for the UK than for the EU. As such, we see no-deal Brexit as a negative for the GBP.

US elections: what scenario after Joe Biden or Donald Trump ?

While national and "swing-states" polls show Biden leading, the confidence margin is thin, especially judging from the experience of 2016. Regarding Congress, the House of Representative is likely to retain its Democrat majority, but the Senate race is too close to call.

Short term, **markets may worry first and foremost about the risk of a disputed election.** There may be no clear winner on 3 November. We expect a record turnout, with the highest number on record voting by mail which the incumbent President considers unreliable. There is no fully predictable legal process to sort the issue; given the backdrop of extreme polarisation, political uncertainty may remain very high in the weeks after the election.

There are three main themes in **Trump's campaign: law and order, China, and Biden's fitness for office. Biden is campaigning on economic policy** (Build Back Better), **healthcare, racial justice and morality.** Biden is planning another fiscal stimulus package to address economic issues tied to the pandemic. Also, he has plans for a major infrastructure investment and supports Green New Deal. Biden plans to boost Obamacare and prescription drug reform. Both candidates will have to deal with the long-term issue of rising inequality.

For markets, Trump supports tax cuts while Biden backs higher spending and tax hikes. As such, there is a near consensus among investors that a Trump victory would be beneficial for equity markets in the short run, while a Biden presidency would cause a market correction. But this may well be a short-sighted view. Their proposals will only be able to pass through Congress if the House of Representatives and Senate are of the same colour, which seems rather unlikely. On the other hand, the macro-financial context is very different from what it was four years ago.

In addition, the US elections will have geopolitics implications. In particular, the relationship with the European Union could evolve in case Joe Biden is elected. (For more details see: *US election: how it will impact the economy and financial markets*)

Europe: is there a risk of another European debt crisis?

This is very unlikely in the short term. A consequence of the crisis is that both public and private debt levels are rising (corporations account for most of the rise in private debt). But **public debt is for the most part absorbed by central banks'** purchase programs, meaning no additional net supply of bonds in the short term.

This **additional public debt held by central banks doesn't lead to short term sustainability issues** either: interests (when positive) remain in the public sector i.e. they contribute to central banks capital, in general a property of the Treasury, and the central bank has the option to rollover the securities at maturity. So that there is neither reimbursement constraint for the government nor a need for market net incremental refinancing.

However in the long term, Europe needs a combination of higher nominal growth, balanced budgets and debt mutualisation for the debt risk to dissipate. High debt ratios are not a short-term risk, but diverging debt trajectories among European countries could lead to renewed tensions within the EU, especially when all countries return to pre-crisis GDP and unemployment levels. A (new?) **framework for the fiscal rules** that each country commits itself to respect will then have to be established at some point. It is therefore essential that the additional debt be used to finance not only investment projects but also reforms that improve productivity growth in the medium term.

As far as the incremental **private debt** is concerned, it is mostly backed by state guarantee schemes for at least two years.

THEMATIC

Additional public debt doesn't lead to short-term sustainability issues

It is the long-term equilibrium rate that has fallen

Therefore, if the economy rebounds, corporate leverage should shrink. Many corporations have also built important cash buffers during the crisis. For those who do not have access to capital markets, banks interest rates are very low and state support of viable corporations reduce solvency risks. Nonetheless, we expect rising defaults from companies that were fragile before the crisis and whose business models will continue to struggle in the coming months.

Are Central Banks out of ammunition? How does the ECB policies compare with the Fed's?

We believe that **Central banks are far from being out of ammunition** (For more details see: New frontiers for central banks) but they are trapped in their QE policies. CBs have de facto entered in fiscal dominance where, in the absence of inflation, they need to maintain low bond yields to ensure that both public and private debts remain sustainable.

The **relationship between the money supply and inflation levels** (on goods and services) **has been broken** for more than 25 years. Monetary expansion causes inflation on financial and real assets. Asset price bubbles are therefore perhaps more to be feared than a real return of inflation in the current environment (For more details see: Inflation persistent headwinds but a possible inflationary cocktail).

As a result of its strategic review, the **Fed changed its 'reaction function'.** Now, the FOMC will seek to stabilize inflation around 2% on average over an entire economic cycle, most likely over a 4 to 8-year period. In practice, this will allow the Fed to avoid rate hikes at the first signs of accelerating inflation. Rate hikes will require that the recovery is firmly anchored and that inflation remains above 2%. These two conditions will not be met before 2024 according to most FOMC members (only 4 out of 17 members anticipate a first rate hike in 2023, despite having recently upgraded both their growth and inflation forecasts). In doing so, the Fed will anchor the short end of the yield curve and support the economic recovery. In a very uncertain environment, it is essential to reassure investors that monetary conditions will remain very accommodative during the recovery phase. Also, this strategy will help contain interest costs and postpone the debate on rising federal debt.

As for the ECB, it is far from having completed its strategic review. In the meantime, its communication is clear: contrary to the Fed, **all the tools are still on the table** i.e. including a rate cut if necessary; the ECB is firmly committed to maintaining very accommodative monetary conditions in the recovery phase. Given the shortfall in global demand, the risk of a further slowdown in inflation in the Eurozone is undoubtedly perceived as greater at this stage than that of a sudden and self-sustaining acceleration of inflation.

What are the implications of low long-term interest rates?

First let's recall that **the fall in real interest rates is not only related to monetary policies. There is a broad consensus that it is the long-term equilibrium rate that has fallen. As a result the equilibrium valuation of risky assets has increased. All other things being equal, this factor should encourage savers to switch to equities from bonds.** That being said, rising costs related to value-chain disruptions, deglobalisation, re-onshoring, and the aspirations of a growing share of the population for wage rises are likely to push up inflation expectations at some point. Moreover, real interest rates have fallen into negative territory and are now below their equilibrium level. In the short term, if inflation expectations rise, real rates may fall even more sharply, temporarily supporting growth stocks.

However, it should be remembered that the Fed is not committed to maintaining long-term yields at their current level. In particular, **if growth and inflation pick up simultaneously and more sharply than expected, the Fed may want to let market forces play their role, leading to a rise in long-term Treasury yields and to a steepening of the yield curve.** This is a potential source of volatility and correction in the stock market that will need to be monitored very closely.

What policy mix should we expect in case of a new downturn?

This is a difficult question to answer given the lack of visibility. We're in uncharted territory. Moreover, we still don't have enough information of the impact of announced fiscal and recovery plans.

Yet one could assume that **in case of new downturn, monetary support will be increased** (CBs balance sheet expansion, negative interest rates, helicopter money), and **government will step in again** to protect the economy. Policymakers are far from having exhausted their room for manoeuvre. But the bar is probably high to experiment new policies (the policy mix would be more reactive than proactive). However, it's clear that if those stimulus/ stabilisation plans are launched during phases of uncertainty and low confidence (like a 2nd wave), **the multiplier effects will be much lower** than in a "normal recovery cycle". Therefore the policy mix could be different on the fiscal side and we could even see nationalisation of struggling but strategic corporates at least partially or temporarily.

Finalised on 30/09/2020

THEMATIC

Fixed income dynamics in the current monetary and fiscal landscape

The global economy rebounded quickly during the summer from the coronavirus pandemic. In this phase of recovery, central banks played a key role in the massive supply of credit to governments and companies. To tackle the health crisis, almost all governments implemented large-scale fiscal stimulus and support measures, including corporate loan guarantees. At the same time, major central banks increased their purchases of sovereign debt to levels never seen before, played a backstop role in the corporate debt market and provided cheap liquidity to banks (in the case of the ECB). In a second phase, we expect government to implement stimulus measures. What will be the impact for the fixed income market?

VALENTINE AINOUZ, *CFA*
Deputy Head of Developed Market Strategy Research

DELPHINE GEORGES
Fixed Income Strategist

The coronavirus crisis has been characterised by counter-cyclical credit conditions

The global economy rebounded quickly during the summer from the coronavirus pandemic. Economic data surprised on the upside, especially in the US. However, the risk of reduced government support, permanent layoffs and business bankruptcies need to be monitored until a vaccine arrives. Economic activity is unlikely to return to pre-Covid levels until 2022.

In this phase of recovery, central banks played a key role in the massive supply of credit to governments and companies. The coronavirus crisis has been characterised by counter-cyclical credit conditions, thanks to unprecedented strong coordination between governments and monetary policy makers. To tackle the health crisis, almost all governments implemented large-scale fiscal stimulus and support measures, including corporate loan guarantees. At the same time, major central banks increased their purchases of sovereign debt to levels never seen before, played a backstop role in the corporate debt market and provided cheap liquidity to banks (in the case of the ECB). We observed:

- **On the sovereign debt market, a big wave of new issuance.** The crisis has pushed government deficits to historically high levels. However, huge supply did not push up yields, as central bank purchases absorbed most of additional government issuance. In recent months, sovereign long-term yields fell sharply and peripheral spreads in the Eurozone tightened.
- **On the corporate bond market, a record level of issuance**. The corporate debt market was boosted by the support of central banks. Credit spreads have narrowed even though they have not yet fully returned to their pre-crisis levels on average. Indeed, companies took advantage of historically low yields and strong investors' appetite to boost their balance sheets and increase their cash holdings. This liquidity cushion has largely contributed to limiting the number of defaults.

Once the coronavirus crisis phase is over, central banks' actions will aim to support economic recovery. The governments that initially put in place support measures to help companies to maintain their operating capacity and to prevent households from losing too much income, will, in a second phase, implement stimulus measures. Most of the 2021 deficit estimates for developed economies are likely to be revised upward over the coming months. We expect major central banks to continue to absorb a lot of governments' extra issuance and to play a backstop role on corporate credit markets.

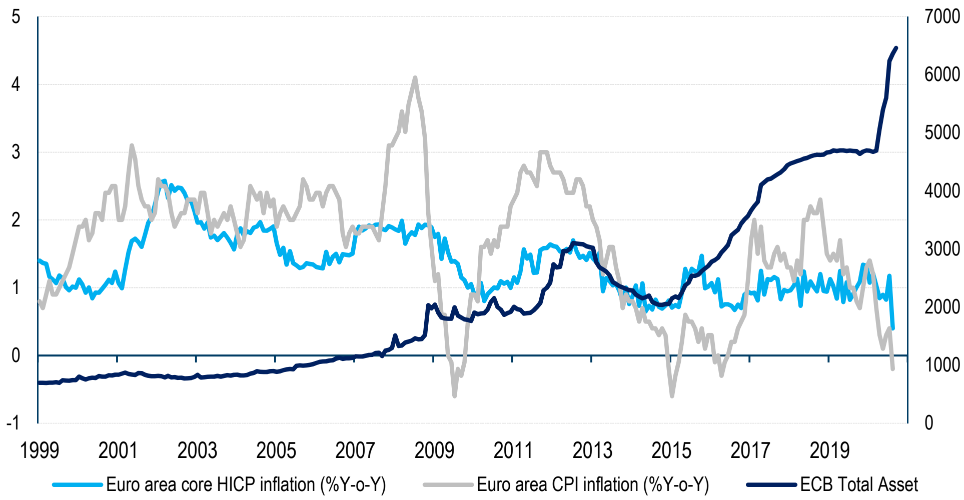
- **The Fed undertook a historic shift in its mandate: its priority is now maximum employment**. Fed Chair Jerome Powell said in his Jackson Hole speech that the central bank is adopting a "flexible form of average inflation targeting", i.e., targeting inflation that "averages 2 percent over time". The Fed also adopted a new forward-guidance: The benchmark interest rate would remain near zero "until labor market conditions have reached levels consistent with the committee's assessments of maximum employment and inflation has risen to 2% and is on track to moderately exceed 2% for some time." This means that the Fed will wait until a tight job market has begun pushing inflation higher before thinking about rising rates. Otherwise, the Fed also intends to continue its bond purchase program at its current pace ($80bn in Treasuries and $40bn in Mortgage Backed Securities). The message is clear: rates will remain low for at least the next three year to support economic activity. What to expect next? A transition to a traditional asset purchase program buying more longer-maturity securities
- **The ECB adopted a "wait and see" mode at its last meeting despite recent disappointing inflation data and the appreciation of the euro**. The ECB increased in June the envelope for the pandemic emergency purchase programme (PEPP) by €600bn to a

THEMATIC

total of €1,350bn and extended the programme to at least the end of June 2021. At the end of August, the ECB had already bought more than €500bn under the PEPP. Otherwise, the ECB's new economic projections suggest that the monetary stance of its policy will have to remain extremely accommodative. Core inflation is expected to increase only by 1.1% in 2022. We expect the ECB to extend its asset purchase programs (via the APP or the PEPP) to maintain financial stability and ensure a smooth transmission of monetary policy.

We expect major central banks to continue to absorb a lot of governments' extra issuance and to play a backstop role on corporate credit markets

1/ **Inflation Vs ECB Asset (in %)**



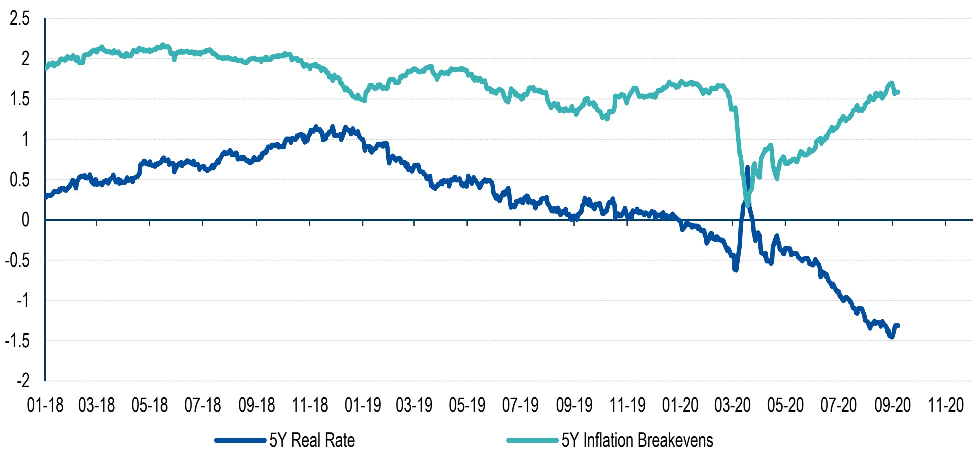
Source: Datastream, Amundi Research, Data as of 09/11/2020

What are the implications on the fixed-income market?

Since the Fed successfully addressed liquidity tensions in the Treasury markets through unlimited Treasury purchases, the main trends on the bond markets have been:

1. **A strong decline in US real yields**, driven by: (a) a dovish Fed supporting the recovery (b) the move to an Average Inflation Targeting framework, which means that the Fed will hike later in the cycle than it would have under its previous monetary policy framework. The decline in yields was stronger in the 5Y segment, as expectations of a rate hike were pushed forward to 2024. Since the beginning of May, 5y, 10y and 30y real yields have declined by 95bp, 53bp, and 17bp, respectively.
2. **Limited nominal yield changes** because the fall in real yields was offset by a rise in inflation break-evens.
3. **A steepening of the yield curve as the difference between the yields on five-year and thirty-year Treasuries widened by 25bp.**

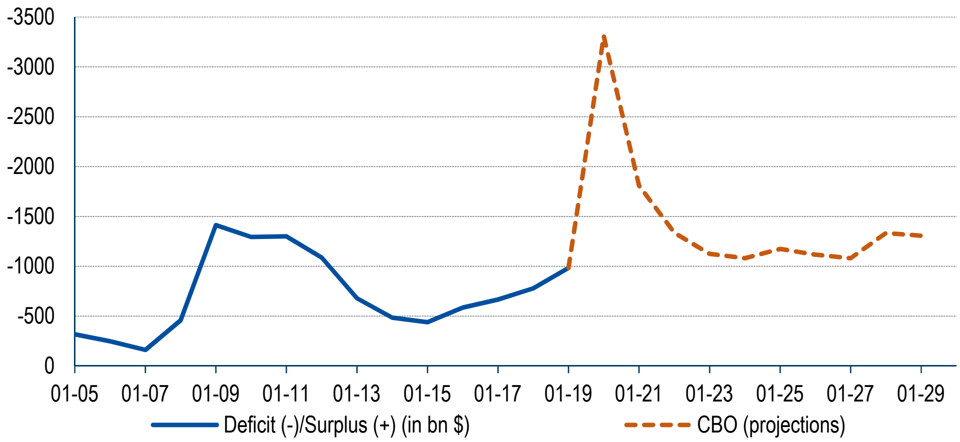
2/ **Strong decline in US 5Y real yields (in %)**



Source: Bloomberg, Amundi Research - Data as of 07/09/2020

THEMATIC

3/ CBO's Baseline Budget Projections Deficit (-) or Surplus (+) (in $bn)



Source: Bloomberg, Amundi Research - Data as of Q3 /2020

Will the prolonged period of combined fiscal and monetary stimulus change the landscape for inflation and growth?

In the future, we expect the sovereign yield curve to steepen slightly mainly at the very long end.

- **A slightly steeper yield curve would be consistent with the economic recovery scenario**. As the recovery progresses, the medium-term trend will be for the curve to continue to gradually steepen as 10y and 30y yields will likely increase from current levels over the next year.
- **The timing of the steepening will be contingent on evolution of the virus and on the fiscal stimulus put in place**
- **However, the Fed would adjust its QE by extending the average duration of Treasury purchases, if long-term bond yields rise too far, too fast.** We expect central banks to continue to absorb a lot of governments' extra issuance, limiting the risk of a steepening induced by excess supply. Since March 16th, when the Fed started its QE, total Treasury holdings have risen $1.9 trn..

The big question now is whether the prolonged period of combined fiscal and monetary stimulus will succeed in changing the inflation landscape. Over the last decade, central banks have failed to bring inflation back to the 2% target. Falling interest rates and billions in asset purchases have not succeeded in boosting investment, productivity and wage growth. The pandemic has mainly exacerbated already existing vulnerabilities.

Finalised on 23/09/2020

4/ Fed balance sheet US Treasuries Securities (in $ trillion)

Source: Bloomberg, Amundi Research - Data as of 16/09/2020

THEMATIC

Is France still on track to reduce its competitiveness gap vs. Germany?

TRISTAN PERRIER
Global Views Analyst

Germany clearly outperformed France on most macroeconomic metrics in the last two decades. Yet France has implemented many supply-side reforms since 2014. Despite the larger damage taken by France from the current Covid crisis, the lagged effect of these reforms can still help reduce the competitiveness gap with Germany after a few years. However, a key driver of medium-term relative performance will also be how both economies adapt to major "disruption"-related sectoral challenges.

Blatant French underperformance since 1999 and even more so since 2009.

France has underperformed Germany on most growth (at least in GDP per capita), labour market, external trade and public and private finance metrics since 1999 (the year the euro was introduced) with most of this relative movement occurring in the last decade (*see table*).

This underperformance coincided with a dramatic shrinkage of the weighting of the French manufacturing sector in GVA and total employment, as opposed to a much milder decline in Germany, where its weighting remains much larger than in most advanced economies.

A number of key French metrics had also fallen behind not only Germany's, but also the Eurozone's average by 2019, at least when it comes to the public deficit, current account and private debt, even though it could be argued that: 1/the current and public French deficits were not very large in absolute terms; and 2/ the large private debt level owed a lot to corporate debt numbers partly explained by internal lending within multinational corporations, and partly offset by large corporate cash balances[1].

This relative French-German trend is generally attributed to:

1. **differences in economic structure** that preceded the euro, with Germany having strong position in manufacturing sectors that were heavily exposed to global demand trends during the period, notably against the backdrop of China's rapid expansion;
2. **economic policies**, notably major competitiveness-enhancing German reforms in the mid-2000s; and
3. **the interaction of the single currency with economic policies**, at least through two channels:
   a/France could not offset through external devaluation the competitiveness gains Germany achieved through internal devaluation thanks to its reforms[2].
   b/The perceived implicit German guarantee of French public debt through

[1] *See, notably, "Is the Increase in French firms' indebtedness a cause for concern?", M. Khder and C. Rousset, Insee, Dec 2017*

[2] *The euro conversion rates with the former German and French national currencies, and Germany's access to a pool of relatively low-wage workers thanks to its reunification are also often mentioned.*

France has clearly underperformed since the creation of the euro

	Germany	France	Euro area
Manufacturing, % of GVA, 1999	22.18	16.17	19.29
Manufacturing, % of GVA, 2019	21.11	11.04	16.37
Exports of goods, % of GDP, 1999	23.2	19.9	-
Exports of goods, % of GDP, 2019	37.3	21.4	-
Real GDP growth, 1999-2019 average	1.4	1.4	1.4
Real GDP growth, 2009-2019 average	2.0	1.3	1.4
Nominal GDP/person growth, 1999-2019 average	2.5	2.2	-
Unempl. rate, %, 1999	*8.6*	*10.4*	*9.8*
Unempl. rate, %, 2019	3.1	8.5	7.6
Public debt, GDP %, 1999	*60.1*	*60.5*	*71.9*
Public debt, GDP %, 2019	59.8	98.1	87
Structural budget balance, GDP %, 1999	*-1.7*	*-1.6*	*-1.5*
Structural budget balance, GDP %, 2019	1.4	-3.0	-0.7
Current account, GDP %, 1999	*-1.4*	*4.4*	*-0.5*
Current account, GDP %, 2019	7.1	-0.8	2.7
Nonfin corporate debt, GDP %, 1999	*53.0*	*96.6*	-
Nonfin corporate debt, GDP %, 2019	58.7	151.6	-

Sources: IMF, Eurostat, Bank of International Settlements

THEMATIC

the euro architecture resulted in low French yields (notably in comparison with southern European countries) that acted as a disincentive to adjustment and allowed the persistence of a public, private and (to a lesser extent) external debt-fuelled growth model.

Nonetheless, years since 2014 have seen significant supply-side reforms by French authorities, while similar efforts have been largely paused in Germany.

In the past decade, Germany clearly exercised leadership in Eurozone politics, playing a very visible (and successful) role in keeping the currency area together. Conversely, Germany made few domestic supply-side reforms, with some observers even concluding that a number of measures, notably on pensions and the minimum wages, went in the opposite direction.

French supply-side reforms have been very positively assessed by international organizations

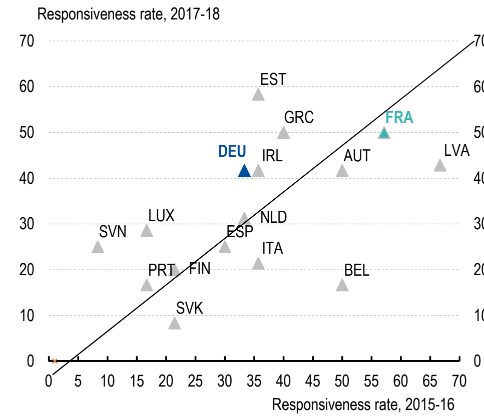
It was France that took the lead in terms of supply-side policies from 2014 on. This orientation was chosen, first under the Hollande presidency, yet without clear communication (as it represented a shift from Hollande's electoral pledges), then much more openly, from 2017 on, under the Macron presidency (in line with election promises).

Beyond their details, the French reforms generally pursued two goals:

- **Shift part of the burden of taxation from corporations to households, at least until 2018** (and, within households, from employees to reasonably well-off pensioners);
- **Pursue a Nordic-style "flexi-security" model** by: 1/easing the protection enjoyed by incumbents and increasing competition on the labour, product and services markets; and 2/streamlining the welfare system to make it easier to steer and more suited to the mobility of professional careers.

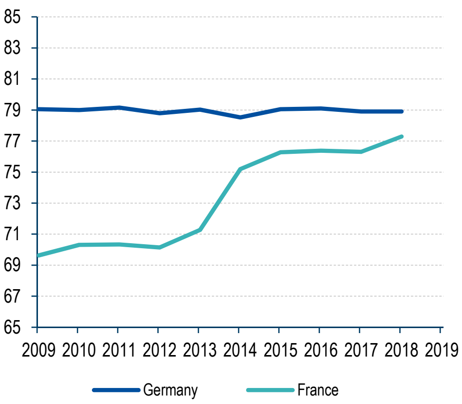
The prudent approach to fiscal consolidation (vs. other high-deficit euro countries) during that period was partly a political corollary of this supply-side momentum, reflecting the intention of not endangering the social acceptability of reforms by accompanying them with austerity measures. This was particularly

1/ Responsiveness to Going for Growth recommendations



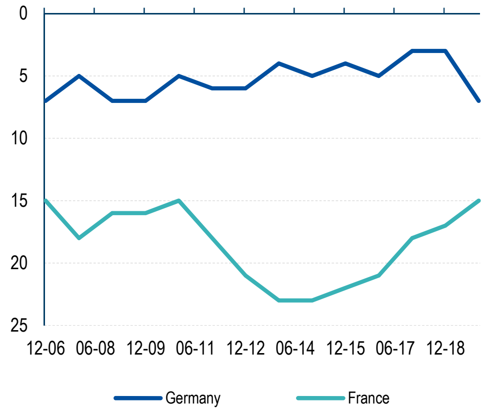
Source: Amundi Research - Data as of 2019

2/ World Bank's Ease of Doing Business Index distance to frontier



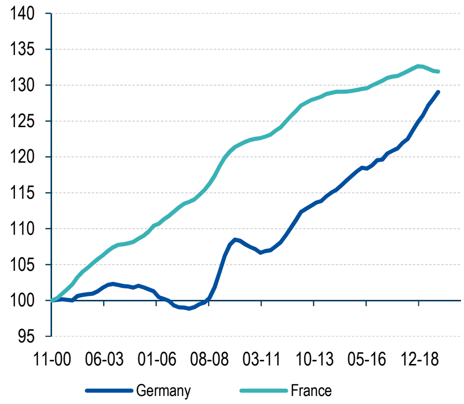
Source: World Bank, Amundi Research - Data as of 2019

3/ Global Competitiveness Index ranking



Source: World Economic Forum, Amundi Research - Data as of 2019

4/ Unit labour costs (base: 100 in 2000)



Source: Eurostat, Amundi Research - Data as of 2019

THEMATIC

France has been hit harder than Germany by the Covid crisis

blatant when, faced with the *Gilets Jaunes* social tensions in late 2018 and early 2019, the government yielded a number of demand-supportive measures, yet was capable of pursuing further supply-side reforms until the Covid crisis.

Supply-side reforms often take years to yield their effects. Whether results were already visible in 2019 is debatable. Nonetheless, market-friendly organizations identified the French efforts as promising.

A number of French metrics improved in absolute or relative (vs. Germany) terms in 2017 and 2018, yet this was first and foremost the effect of: 1/trade and manufacturing disruptions (US-China tensions, Brexit, and specific issues in the auto sector) that hit Germany much harder, due to the structure of its economy; and 2/a "normal" improvement of lagged economic variables (notably the unemployment rate) after several years of general Eurozone recovery.

International organizations, for their part, did assess French reforms very positively:

- **The *OECD's Going for Growth* ranking**, notably, identified France as the most reform-responsive large Eurozone economy in 2017-18 (on par with Greece, and only exceeded by Estonia) after it had already been one of the very top performers in 2015-16 (surpassed only by Latvia), while Germany's performance was only average (graph 1). **In quantitative terms,** the OECD estimated in its 2019 "*Report on France*" that the 2017-2018 changes alone could yield a positive effect of 3.2pp of GDP after 10 years.
- **Other well-known competitiveness indicators**, such as the World Economic Forum's *Global Competitiveness Index* of the World Bank's *Ease of Doing Business* index, also showed significant relative French progress, even though France remained below Germany in absolute terms (graphs 2 and 3).
- **A number of surveys showed that France was becoming a more attractive destination for international investment**. For instance, Ernst&Young's *Europe Attractiveness* Survey of May 2020 noted in that France had become Europe's top destination for FDI in 2019.

Relative French vs. Germany dynamics were also, to some extent, visible in classic unit labour costs metrics, which in 2019 showed a near complete reversal of the relative compression achieved by Germany in the 2000s (graph 4), even though the most recent narrowing had to do with 2018-19 short-term growth developments.

French supply-side momentum may even have some (residual) life left before the mid-2022 election, even though the Covid crisis has shifted priorities, as in all countries, to the stabilization and stimulation of demand,

- **The recently announced French fiscal stimulus (see next article) can be described as slightly more "supply-side" than its German counterpart.** Both plans amount to about 4% of GDP, yet the French version is more oriented towards corporations (incl. with permanent production tax cuts) and does not include untargeted support to consumption similar to the German VAT cut.
- **The French government has also stated its intention to pursue its planned corporate profit tax cuts, and even to conclude its major pension reform,** whose parliamentary approval process was interrupted by the Covid crisis. While not changing much over the short term (workers born before 1975 will remain in the current system), this latter reform sends out a powerful signal of adaptation of the economy to professional mobility across sectors, generally considered a positive for long-term growth.

The Covid crisis may delay the positive effect of French reforms, yet the ongoing general reassessment of public debt-related vulnerabilities and German "disruption"-related sectoral challenges must also be watched.

So far, the Covid crisis has hit France's economy harder than Germany's (i.e., a larger hit to GDP in H1 of -11.5% vs. 18.9%), due to a combination of luck (the location of early European clusters), health policies and sectoral exposures (although different statistical measurement choices may also have played a role in short-term GDP prints).

As France entered the crisis with much worse deficit and debt metrics than Germany, it is easy to see it as less capable of bringing further fiscal support to its economy without jeopardizing the stability in its public finances. While France may gradually reap the rewards of its recent reforms when the economy normalizes, part of these gains could thus be offset, in relative terms, by more intense public investment in Germany.

Yet the rapidly changing perception of the economic cost and vulnerabilities of "monetized" public debt may lead to some reassessment of available "fiscal space". As all Covid-related debt of Euro countries will be (indirectly) purchased by the ECB, "fiscal dominance" is likely to keep interest rates ultra-low for a prolonged period of time. Moreover, the Modern Monetary Theory paradigm is gradually gaining ground and raising doubts, among market participants, over the true fiscal cost of public debt. It is therefore a possibility (although far from a certainty), that a relatively high pre-crisis debt situation

THEMATIC

Germany must cope with major "disruption" challenges in some of its key industrial sectors

becomes no obstacle to borrowing more if really needed. Future stimulus plans could thus be much more constrained by operational bottlenecks (choice of projects, red tape, and "obstructive stakeholder" opposition, obstacles of which there are many in Germany) than by financing capacity. Moreover, with its recently decided "Next Generation EU" recovery fund, the Eurozone has just taken a new step in terms of debt mutualisation (even though modest, "one-off" in principle, and with France as a net contributor).

Finally, much of Germany's ability to maintain its outperformance may depend first and foremost on how it copes with "disruptive trends" at the sectoral level:

- **Germany, like France, has strong positions in sectors that are heavily exposed to global current trends** (both countries, for instance, are strong in the provision of large urban and transport infrastructure, which are essential to accompanying the development of "global cities" around the world).
- **Conversely, Europe in general is also described as losing its edge to the US and China when it comes to big tech and big data**.
- **However, while the services-oriented French economy faces innovation challenges that are broadly similar to those of other mid-sized advanced countries, Germany may face unusually large sectoral issues.** Indeed, the country stands out in its much larger share of its GDP and employment in manufacturing sub-sectors (notably autos and chemicals, which account for 6.4% of German GVA vs. only 1.7% in France, according to 2017 Eurostat data) where it is a world leader, yet that are heavily disrupted and, being capital-intensive, require well-planned strategic investment choices. A number of studies have pointed out, in particular, the large number of jobs that could be at risk in the car industry[3]. Whether Germany makes the right investment choices to adapt these sectors to new environmental, technological and trade challenges so that they remain world leaders will play a significant part in determining to what extent it can remain the unchallenged economic powerhouse of Europe.

Conclusion

Underperforming France has made significant efforts to regain potential during the 2014-20 period. Despite the Covid crisis and its large costs on GDP and public finance, and assuming that the typical delays before seeing the positive effects of supply-side reforms still stand, the French economy, now slightly more flexible and competitive (at least in relative terms), is likely to reap some rewards during the rest of the 2020s. Germany, for its part, has made fewer supply-side reforms recently, yet remains ahead on most competitiveness indicators and with very deep pockets to invest for the future. Its main challenge, however, may be the strategic choices that its large manufacturing and export-oriented sectors will need to make to retain their edge against a backdrop of rapidly changing global demand trends.

Finalised on 30/09/2020

[3] *In January 2020, a study by the National Platform Future of Mobility, a research agency funded by the German government, estimated that as much as 400,000 auto jobs could be gone in the country by 2030 out of a 2019 total of 830,000)*

THEMATIC

France just announced a €100bn stimulus plan

VALÉRIE LETORT, *Fixed Income Strategist*

Main features of the plan:

The two-year, €100bn "Relaunch France" plan is in line with Emmanuel Macron's presidential program: it aims to restore the competitiveness of French companies, to facilitate the creation of companies and hiring through flexibility in the labour market, in order to lower unemployment and generate growth.

The plan is not accompanied by a policy of direct stimulus of demand as in the United States or Germany (check or lower VAT). However, the massive short-time work mechanism, also called the "anti-unemployment shield", should last until the end of the year, at least for sectors in the greatest difficulty, such as events, culture, restaurant and accommodation.

€30bn has already been allocated to this "anti-unemployment shield" under previous programs, and €7bn will again be allocated to it as part of the recovery plan.

In total, direct liquidity injections linked to Covid-19 have already reached €60bn (€8bn for the self-employed, €8bn for healthcare, and €10bn in various aid in addition to the aforementioned €30bn), not counting the sums allocated under form of business loans (€120bn at this stage). So, this plan comes in addition, but must above all make it possible "to invest in the future... to transform the France of tomorrow", according to Emmanuel Macron.

The plan would be 40% funded by Europe. Together with the other support measures, It would increase the country's debt from 100% to 120% of GDP.

It is based on three pillars of €30bn to €35bn each:

1/ €30bn is earmarked for the environmental transition, but in fact is being steered mainly towards green infrastructures (expanding freight traffic and bike paths and promoting thermal insulation of buildings) and green vehicles, such as green cars and green aircraft. This will be in the form of state-sponsored projects or buyer bonuses. The spending targets look relatively within reach, even though they will be spread out over time. Job market support will come mainly from the construction sector, which is one of France's biggest employers.

2/ €15bn will be spent on innovation and reshoring, targeting mainly the pharmaceutical and digital sectors, as well as the shortening of production chains. Although it will probably be easier to launch the work of digitising the state and targeting large companies, local and regional governments will be called upon to help leverage the impact on small and mid-sized companies, which collectively are France's biggest employers and those most interwoven into the social fabric. In fact, in 2019, these small and medium-sized enterprises accounted for 9% of GDP, and employed 49% of France's 14 million workers. They are mainly in the construction, restaurant and accommodation sectors. It should be remembered that France was the European champion in business creation in 2018 (+691,000). €20bn more will fund production and property tax cuts, with three quarters targeted at small and mid-sized companies (a key reason for the government to claim that its plan is also "supply-side").

3/ The remaining €30bn will be spent on social welfare, including €15bn for employment and training with the issue of retraining, almost €7bn on apprenticeships, more than €7bn for the short-time work mechanism, and €6bn for the health sector.

So, the stimulus plan's three pillars are consistent and intertwined and meant to unleash a virtuous economic circle through increased hiring and start-up creation[1], and the restoration of confidence that will allow French households to spend their savings, thus complementing government projects with physical or digital infrastructure.

Indeed, French households' precautionary savings reached a record amount of €100bn, the same amount as the stimulus plan.

The French government therefore wishes to encourage French households to spend. It pledged not to increase their taxes. While the purchase bonuses in the plan will help defray a little, restoring confidence as layoffs announcements from large French companies multiply and health conditions deteriorate is a difficult task that should require some time.

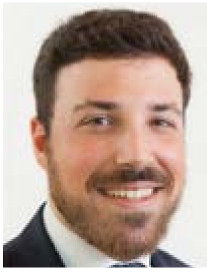
Though the timetable of the plan is ambitious, with €30bn earmarked for 2021 (allocated on a monthly basis by Prime Minister Jean Castex's Ministerial Committee). The plan could extend as far as into 2024.

[1] *160,000 jobs expected in 2021, thanks to this plan, +200,000 thanks to the resumption of activity after the lifting of the lockdown.*

THEMATIC

Japan: Policy continuity expected under Suganomics

CLAIRE HUANG
Macro-Strategist, EM



FEDERICO CESARINI
Cross Asset Strategist

ERIC MIJOT
Head of Developed Markets Strategy Research

Striving to consolidate power with a snap election, Mr. Suga vows continuity of Abenomics and hints at additional fiscal stimulus. Domestic politics aside, we expect global factors and positioning to play a key role for Japanese equities and currency.

Following Shinzo Abe's resignation over health issues, Yoshihide Suga was elected as the President of Liberal Democratic Party (LDP) and the 99th Prime Minister of Japan in mid-September. By design, Mr. Suga will serve out the remainder of Abe's term as LDP leader, which officially ends in Sep 2021. A month later, Japan's Lower House election is due to take place.

Political incentives for a snap election are strong. Polls indicate Mr. Suga started his term on a high note. His approval rating right after inauguration was higher than Abe's in 2012 and the third highest since 2000. If history is any guide, his approval rate will start to fall and the waiting strategy won't play out well. Instead, the new administration could utilize this honeymoon period, and consolidate power whilst it can. In addition, a snap election will leave the newly-merged opposition party CDP little time to bring the fractious opposition forces together.

End-2020 or early 2021 is more likely than a delay into summer. A snap election is likely to take place months before the Tokyo assembly elections in July and the Tokyo Olympics from 23 July to 8 August. As a prelude, we expect to see Suga administration introduce a third supplementary budget in October. The administration has also hinted at an expansive fiscal stance for FY2021. That said, remarks from the ruling coalition party Komeito and Mr. Suga have ruled out an election in October. They stated the government's top priority now is to bring Covid-19 under control.

Political stability is likely and will be supportive for markets. With a boost from the latest leadership reshuffle, the ruling LDP will likely hold onto power. Meanwhile, support for opposition parties has been fragmented. If LDP wins the general election, Mr. Suga will enjoy a greater chance to be re-elected in the LDP leadership contest next year and remain in office until September 2024. This provides a period of stability and policy continuity for Japanese markets in the medium term.

Essentially, *Suganomics* promises a continuation of *Abenomics*. But Mr. Suga is also believed to be capable to drive forward reforms, thanks to his extensive experience and network. He has panned out a reform agenda with a near-term focus on digitalisation. Other ambitious goals include restructuring regional banks, rejuvenating SMEs, and reshoring of Japanese production chains.

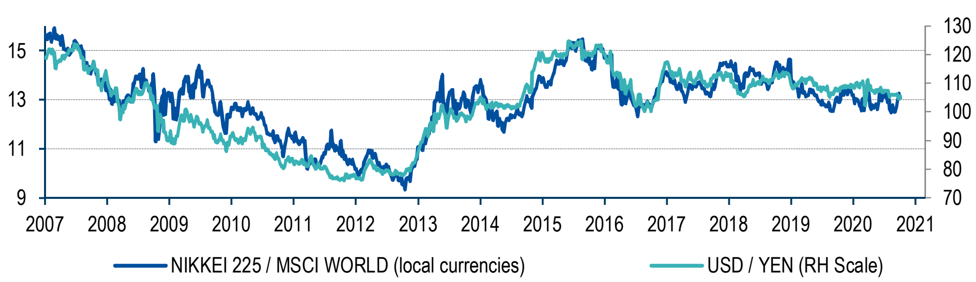
Market implications

With Mr Suga's election as President of the LDP, the initial response of the JPY was to strengthen, as investors started pricing in a possible end of *Abenomics*. Although the programme failed to achieve its targets, a significant shift in domestic policies seems unlikely at this stage. Odds remain in fact in favour of policy continuity in the short term and, as a result, we believe the JPY would be mainly driven by external risk factors. With expectations of a global recovery in 2021, sentiment normalization should offset any potential upside coming from the increased focus on domestic reforms, Suganomics should bring going forward.

As far as the equity market is concerned, Japan is one of the most cyclical markets globally. Industrials, which should be among the winners of the coming cycle, account for 20% of the market vs. 9.6% for the MSCI World. Japan is therefore a natural candidate to increase the cyclicality of a Global Equity portfolio, especially as the BoJ program to buy ETFs is helping to reduce market volatility; the new political situation should not be a game changer in this respect.

Finalised on 24/09/2020

1/ **Japan: Equity Market and FX**

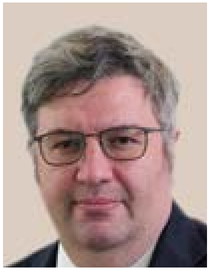


Source: Amundi Research, Datasteam, as of 29 September 2020

THIS MONTH'S TOPIC

Contraction > recovery > late cycle: the cycle round trip is confirmed Advanced Investment Phazer: top-down assessment

MONICA DEFEND
Global Head of Research



LORENZO PORTELLI
Head of Cross Asset Research

- **Economic and corporate-profit recoveries continue along a gradual, upward-sloping catch-up process, where growth speed and composition will be key to landing in a "recovery financial regime" towards year's end.**
- **Transition to the new financial regime will continue amid a sequel of relapses in the real economy, where policy boosters will prove critical, moving the needle between base and risk scenario.**
- **Over the next three to six months, while keeping the risk budget unchanged, progressively rotate risk from US HY into deep value/cyclical equities. Global IG remains supported by central banks' purchasing programs and offer palatable yields. Lastly, expansive monetary policies and safe haven nature will support gold.**

End of quarter assessment: what surprised us and what to expect next

The global recovery continues at different speeds and compositions at the regional level. Policies are pivotal in shaping the recovery trajectories, influencing market participants' narratives and rebuilding confidence.

In order to shed some light amid this global uncertainty, we believe it is helpful to have a look at what has been surprising us during the quarter:

1. **In the US, the Q3 technical rebound is exceeding our expectations on GDP, unemployment and housing market prints vs Q2, although still falling short of recovering lost output.**

   Some deceleration in high-frequency data late in the summer won't compromise the Q3 rebound, but is worth monitoring, as the speed at which economies will enter Q4 will be crucial to stretching the recovery into 2021. Global growth will be driven strongly next year by extraordinary base effects compensating the unprecedented 2020 Q2 losses.
2. In the US, fiscal policy is more diluted than expected with little visibility on the Phase 4 bipartisan deal in particular.
3. The speed at which new rules and new framework have been set up in the EZ on the budget, including a larger EU integrated budget, including the rescue package, temporary relapse of budgetary constraints at the national level to engage expansive policies, and the acceleration of the unconventional monetary policy mandate.

   All in all, the recovery path will progress along a **gradual, upward-sloping catch-up process**. **Relapses in the real economy will occur, and we expect policy intervention to take place hopefully at any juncture to allow a further step forward**.

Q3 set a strong technical rebound from the Q2 collapse in activity and confidence, although still falling short of recovering lost output

In our central scenario, this translates into pre-Covid 19 levels' not being reached for several more quarters on average (with the exception of China). A vaccine, which we expect to be available by mid-2021, would keep temporary damages from morphing into longer-lasting damage and thus would revive the recovery via greater confidence in both households and businesses. When compared to last quarter, we now have greater conviction in our base scenario (70% probability to deploy), while we emphasise the asymmetry of alternative scenarios (downside at 20% , upside at 10%).

During the quarter, inflation had been another relevant matter (but not a market mover), with the Fed delivering its new AIT (average inflation targeting) at a time when EU inflation readings were near historical lows (i.e., -0.2 % YoY in August). Attempts to anchor inflation expectations at higher levels look premature to us.

Inflation volatile in the short-term, trending higher and possibly episodically spiking next year.

In developed markets, inflation may experience unusual volatility in the months to come, due to lockdown-induced distortions. As long as the output gap remains open, global and local deflationary forces may put a lid on inflation, whilst the fading negative drag from the oil base effect will help inflation grind higher over next 12 months. For **DMs**, we expect inflation to remain subdued in the near term but to move higher into next year, due to the combination of: a) disappearing negative energy base effects; b) increasing input prices and cost-push pressures; and c) vanishing base effects of VAT cuts where implemented. In **EMs** as well, inflation started to pick up in July, driven mainly by supply shocks. Goods, and food in particular, are still playing an important

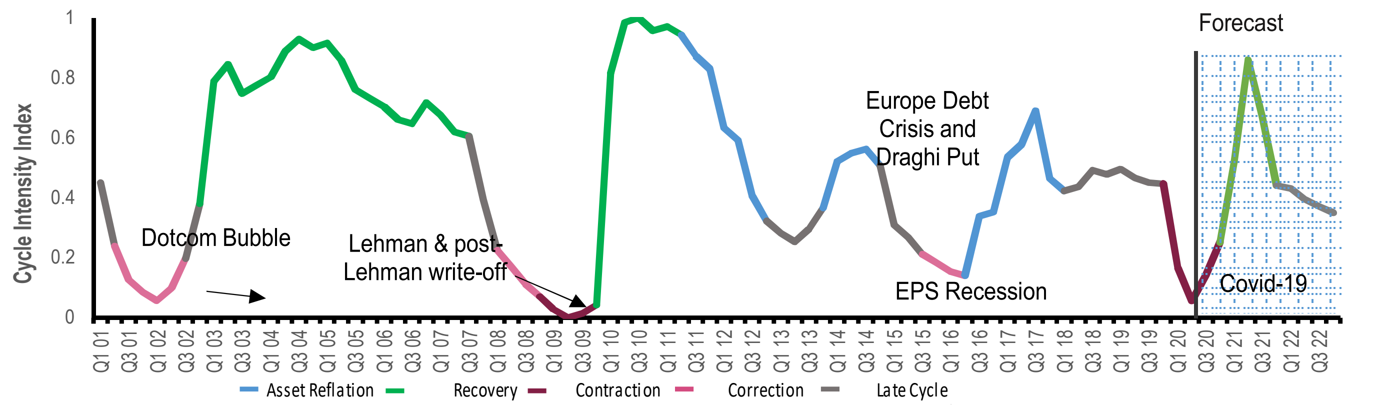
THIS MONTH'S TOPIC

Monetary policy is expected to remain accommodative

role in CPI baskets. **The overall picture is expected to remain benign, bringing headline inflation within CBs' targets;** however, prices dynamics are worth monitoring, given the huge dovish effort put in place by most CBs.

Monetary policy is expected to remain accommodative, with major central banks' playing a key role via almost unlimited QE, providing coverage of huge fiscal needs and acting to ensure liquidity to markets and the financial system. On the DM side, as expected, major central banks are revisiting their longer-term policy guidelines after constantly missing their inflation targets and thus allowing for extended periods of policy easing, even in case of modest upward moves in inflation. In the EM space, in contrast, monetary authorities have to balance their policies more carefully in light of very different inflation dynamics. While in the near term we see still very expansionary monetary policy with marginal easing in the laggards (e.g. Colombia, Mexico and Malaysia), we do expect a more stable MP on the back of a gradual recovery later on.

1/ Investment Phazer Dynamic - Smoothed



Source: Amundi Research - Data as of 18/09/2020

Financial regime mapping according to the investment phazer

Financial regimes	Macroeconomic parameters behaviour				Investment implications	
	Growth	**Inflation**	**Monetary Policy**	**Financial Conditions**	**Cross Asset Evidence**	**Cross Asset Preference**
Slowdown	• Growth below trend level • Below trend EPS growth	• CPI, PPI below trend • Falling ULC YoY growth	• Easy conventional MP • CBs balance sheet growth at trend levels	• Financial conditions start to be tighter	• Global equity suffer • IG preferred to HY in credit • Gold good hedge • Volatility increases	• Govies • Gold • Investment Grade
Contraction	• Growth far below trend level • Falling EPS	• Inflation far below trend	• CBs very accommodative • Excessive CBs balance sheet growth	• Tight financial conditions	• Credit and global Equity unattractive • Safe to quality • Lack of trust • High volatility	• Cash • Gold • Govies
Asset Reflation	• Growth at trend level • Above trend EPS growth	• Inflation below trend	• CBs very accommodative • Excessive CBs balance sheet growth	• Easy financial conditions	• Global Equity rises • Bond yields fall • Most assets do well • Volatility stays low	• Global Equity • High Yield • Commodities
Recovery	• Growth expanding far above trend level • Strong EPS growth	• CPI, PPI above trend levels • Above trend ULC YoY growth	• Tight conventional MP • CBs balance sheet growth below trend level	• Easy financial conditions	• Risky assets the most attractive • Commodities and EM Equity rally • High volatility	• High yield • Base Metals • EM Equity
Late Cycle	• Growth expanding slightly above trend level • EPS consolidation	• Inflation rises towards targets	• CBs correction (less easing)	• Easy financial conditions	• Bond yields rise • Global equity consolidates • HY rotation into Equity • Volatility Increases	• DM Equity • Investment Grade • High Yield

THIS MONTH'S TOPIC

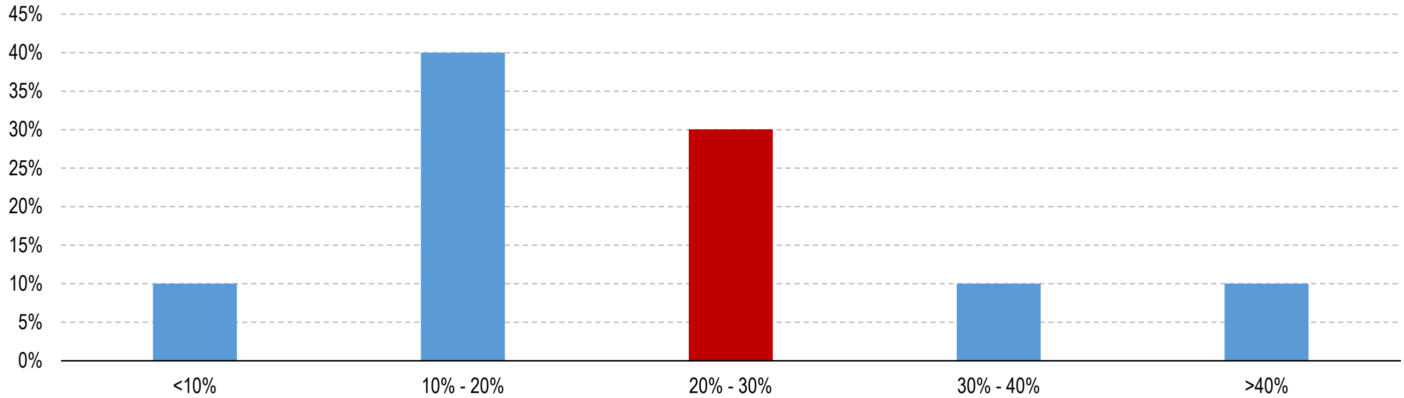
The time is coming to rotate risk

The fiscal response to contain the economic pain has been sizable in most advanced economies, and many emerging markets have also begun announcing significant fiscal support for the hardest-hit sectors. **Measures implemented will move debt-to-GDP ratios up by almost 20% in advanced G20 countries** over 2020, due to the combination of higher deficits vs. GDP (in the double-digit region) and an unprecedented GDP contraction. **A key role is being played by the ECB and Fed in absorbing the huge new debt issuance, managing QE's size and the duration of asset purchases**.

Advanced Investment Phazer (AI) medium-term implications

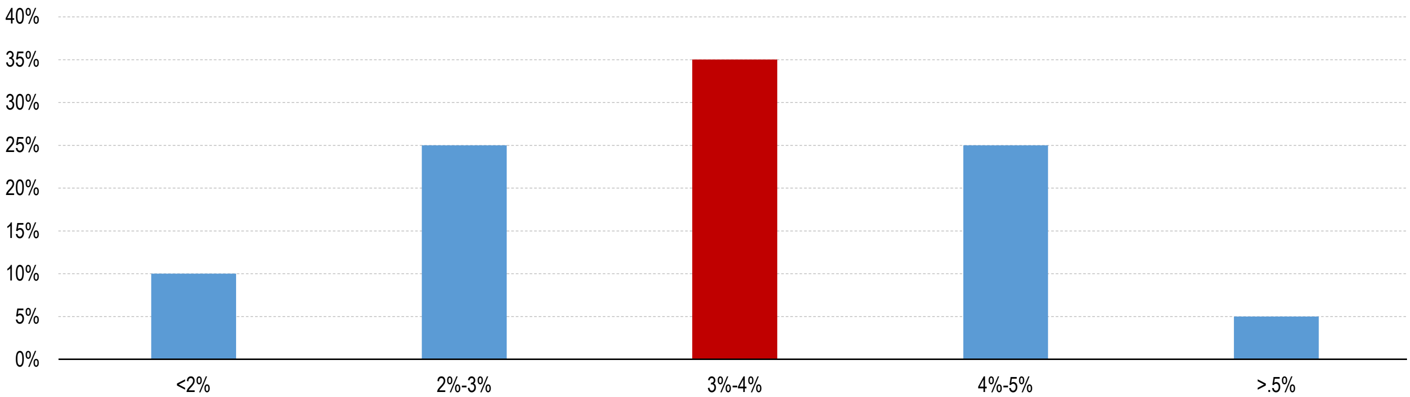
We described all the ingredients to our cycle indicator, the Advanced Investment Phazer, which underpins our medium-term investment views. As "recovery" is our central case, growth and macro determinants remain paramount. On our radar, the "contraction" regime remains confined to H120; the Q320 technical rebound will be short-lived; and the convergence of economic growth to pre-crisis levels will be slow and bumpy. EPS will be more resilient and faster in recovering to pre-crisis levels (in the US we expect to drift even higher to December

3/ **S&P 500 2021 Expected EPS Probability distribution (Red bar central case)**



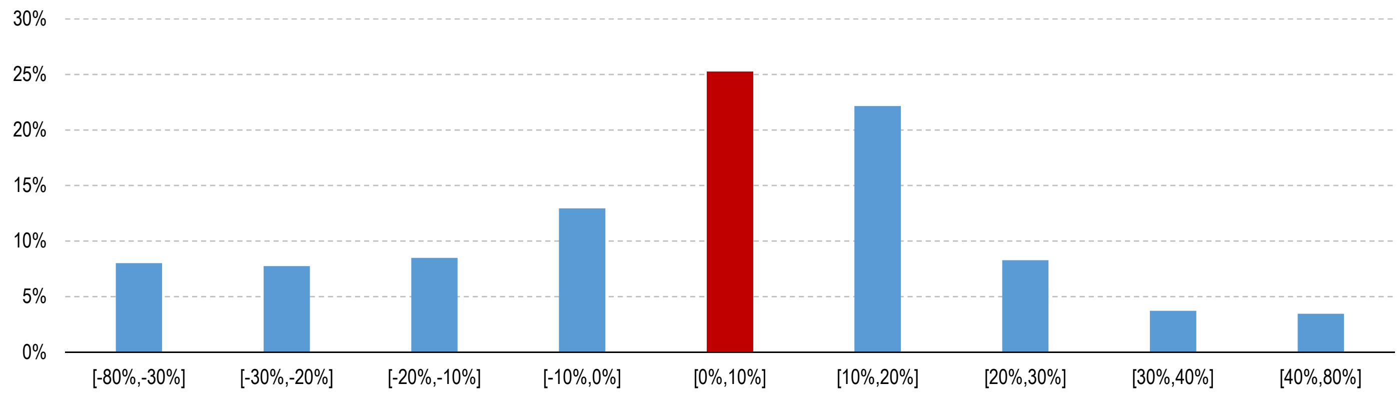
Source: Standard&Poor Website, Amundi Research - Data as of 18/09/2020

4/ **US Real GDP 2021 Expected YOY Growth Probability distribution (Red bar central case)**



Source: Bloomberg, Amundi Research - Data as of 18/09/2020

5/ **S&P 500 2021 Expected Returns Probability distribution (Red bar central case)**



Source: Bloomberg, Amundi Research - Data as of 18/09/2020

THIS MONTH'S TOPIC

2019 levels in 2021). Price dynamics will evolve from disinflation to below CBs' targets, with a potential spike down the road on components' base effect (oil). Policies accelerators are supporting risk assets, but the decoupling from their fundamentals increases downside risks.

While the central scenario remains that of a recovery in 2021, risks remain more skewed on the downside, given the uncertainty on the pandemic and the implementation of tax plans, mainly in developed countries. Until now, central banks have been able to buy time and let governments prepare the appropriate fiscal policy. Implementation will be decisive in returning to growth on more solid paths. The strength of the recovery will also depend on Covid developments and potential new lockdowns, should infections increase this autumn.

Within this framework, the search for yield remains valid but requires more diversification. Favoured by a weak USD, global emerging market bonds seem like a good opportunity. Moreover, central banks in emerging market economies are artificially keeping spreads low. We reiterate our preference for inflation linkers vs. govies, as inflation expectations are extremely low but should move higher going forward.

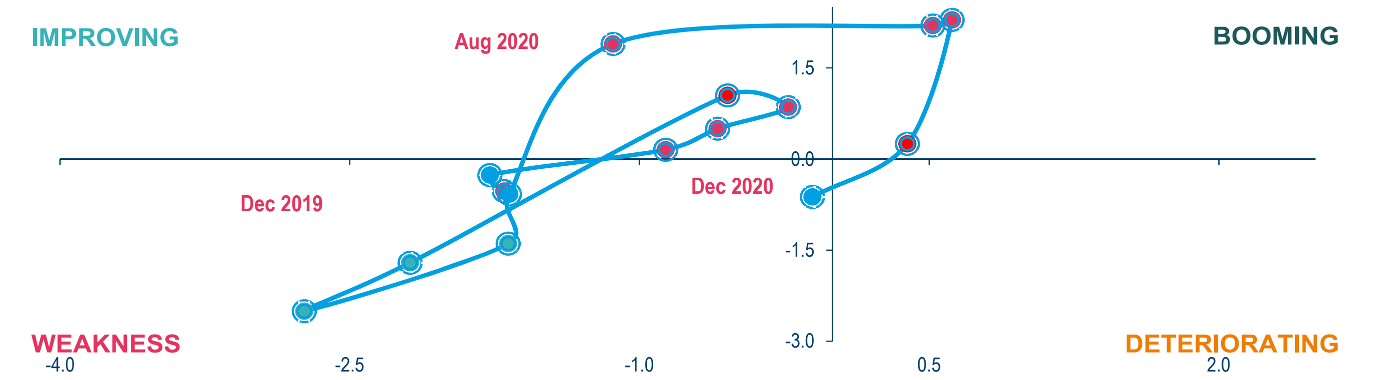
The resilience of earnings and market sentiment could help equities hit new highs in 2021-22 without stretching valuations. We expect P/Es to move to the median of historical realised P/E. As a consequence, equity markets will be appealing in relative value terms, as interest rates should remain low, helping credit to deliver acceptable risk-adjusted returns.

Advancing in Q4, state guarantees and financial support to the corporate sector will progressively fade, allowing fears of US and European corporate bankruptcies to build up. A sudden increase in default rates could hurt the high yield segment, whose spreads are tempered by central banks. Should this be the unfortunate case, we would expect central banks to prevent snowballing effects throughout the credit spectrum.

In light of these considerations, we think the time is coming to rotate risks amid risky assets, progressively shifting from high yield (namely low rated issuers) to equity (deep value, cyclicals).

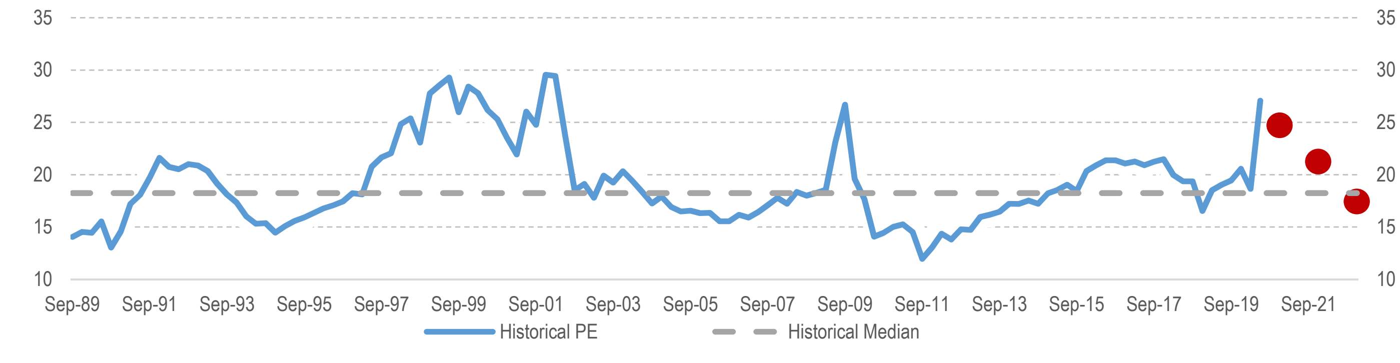
In this environment, growth, rates, inflation, monetary and fiscal policies are strongly interconnected. The potential mismatch of one could affect the results overall. If financial conditions remain as easy as they are now, the Fed will be unlikely to provide any further easing. As such, markets will be left with economic data, US fiscal stimulus , the US elections, Brexit and, obviously, Covid-19-related news.

6/ Global composite economic momentum set to rebound in Q3 20, supporting risk assets in H2



Source: Bloomberg, Datastream, Amundi Research - Data as of 02/09/2020

7/ Operating SP 500 PE (Actual)



Source: Standard&Poor Website, Bloomberg, Amundi Research - Data as of 22/09/2020

CENTRAL & ALTERNATIVE SCENARIOS

Monthly update

This month, we do not amend the narrative of our central and alternative scenario. Economic data confirm a slower recovery path in line with our central scenario and Central Banks maintain their accommodative stace. We maintain the probability of our central scenario at 70%, 20% for the downside scenario and 10% for the upside.

DOWNSIDE SCENARIO 20%

Secular stagnation

Analysis

- Economic relapse (Q4 2020/Q1 2021).
- Policy accelerators in place but with diminishing impact: liquidity does not feed through to the real economy and the labour market suffers fading employment benefits.
- Economic crisis evolves into a financial crisis.
- Protectionism and deglobalisation accelerate, negatively affecting trade and global value chains.
- Vaccine efficacy is limited and/ or people's compliance is poor

Market implications

- Favour cash and US Treasuries.
- Favour gold, CHF, Yen, NZD.
- Use minimum volatility strategies.

CENTRAL SCENARIO 70%

Slow U-shaped recovery

Analysis

- Short-term rebound (Q3), flatter and gradual convergence to pre-crisis levels, with significant divergences on timing. Economic backdrop still in the grip of the pandemic as a vaccine won't be available before H2 2021.
- Credit fragmentation and rising default rates.
- Debt monetisation and ballooning CB balance sheets.
- Global trade recovers on economies re-opening, driving the global cycle as well as domestic engines.
- Widening social gaps and inequalities

Market implications

- Sideways dynamics prevent directional positioning.
- In fixed income, be active in duration management (favour US, EU peripherals), prefer carry to beta.
- Long BBB/BB, very selective on low high yield rated issuers, cautious on EM FX. USD to be monitored.
- In equities, for the rally to continue a widening of the market's breadth beyond the FAANGs is required. Prefer long-term winners, maintain the tilt to cyclicals.
- Favour gold on pervasive uncertainty.

UPSIDE SCENARIO 10%

V-shaped recovery

Analysis

- Economic activity recovers to pre-crisis levels by mid-2021 (US, Eurozone), with above-potential growth in H2 2020 and H1 2021.
- Pandemic almost eradicated with medical treatments for cure and prevention. A vaccine is available H1 2021.
- Monetary and fiscal stimuli feed through to the real economy and financial markets.

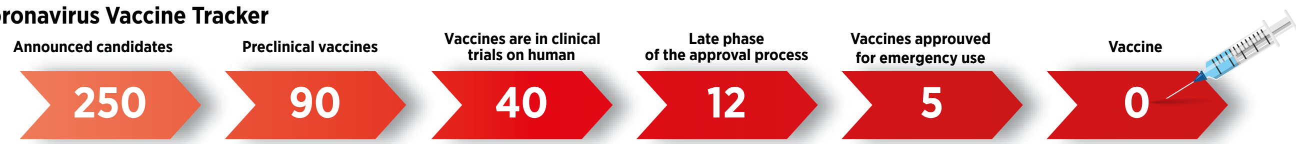
Market implications

- Favour risky assets with a rotation from credit to equity and commodities (oil).
- Favour linkers.
- Negative USD driven by negative interest rates and widening interest rate differential with the RoW.

Covid-19 update: the race for a vaccine

As the northern atmosphere begins to get colder and a second wave hits Europe, scientists around the world have high hopes of finding a vaccine to stop the SARS-CoV-2 coronavirus. At the time of this writing, 40 vaccines are in clinical trials on humans with more than a dozen in the late phase of the approval process, and around 90 preclinical vaccines are under active investigation in animals out of 250 announced candidates. Most specialists expect a vaccine with scalable production capabilities to be available early 2021 or mid-year at the latest. The key factors behind this unprecedented medical search and the likelihood of success are the slow mutation of the virus, the large number of technology platforms being used, and access to almost unlimited funding. The race for a vaccine is in its last laps. Then will come the tough decision of who gets it first.

Coronavirus Vaccine Tracker



TOP RISKS

Monthly update

Risks are clustered to ease the detection of hedging strategies, but they are obviously linked. We maintain the overall narrative and probabilities on the risk outlook with the pandemic exacerbating existing fragilities and vulnerabilities.

ECONOMIC RISK 10%

- **New lockdowns to tackle new waves**
  - Although our ability to deal with the virus has improved significantly (e.g., treatment, health infrastructure, and social distancing), the fallout in sentiment, consumer spending and the economic recovery could be negative, and trigger a W-shaped recovery.
- **No V shape recovery but a dismal labour market**
  - After a fast recovery the economy might slow down or even decelerate
  - While all policy efforts and social benefits have been activated to preserve personal income, the deterioration of the labour market might still derail the recovery
- **Inflation surprises**
  - QE programs may become problematic during a recovery when inflation enters the equation.
  - As the Fed mover to AIT then undermine
  - Inflation dynamics and the CB reaction function could be sources of uncertainty. In particular, EM inflation is at an inflection point but the trend ahead remains comfortable due to depressed demand (watch Turkey, India and Mexico)

+ **Cash, linkers, JPY, Gold, USD, Defensives vs. Cyclicals**

- **Oil, risky assets, AUD CAD or NZD, EM local CCY exporters**

FINANCIAL RISK 15%

- **Mounting corporate vulnerability**
  - Prior to the Covid-19 crisis, corporate leverage reached levels above pre-GFC highs
  - The magnitude of the recession will increase solvency risks regardless of central banks' actions and government guarantee schemes
  - Default rates could rise to 15% or even 20% with spillover into the credit market and stress on banks' balance sheets
- **Sovereign debt crisis**
  - Public debt will rise as a share of GDP across most countries in the coming years, starting from already high levels in Europe, Japan and the United States. This could lead to rating downgrades and rising interest rates over the long term
  - Emerging market fragilities (single commodity exporters, tourism), could also face a balance of payment crisis and increase default risks
  - Risks incurred in implementing the European Recovery Fund should not be underestimated. Dissensions among EU members could bring back EZ periphery bond risk

+ **CHF, JPY, Gold, CDS, optionality, Min Vol**

- **Oil, risky assets, frontier markets and EM**

(GEO)POLITICAL RISK 15%

- **Contested US elections**
  - President Trump campaign is gaining momentum and the race with Joe Biden should be very close
  - The post voting process is already under scrutiny and the outcome won't be clear on Election Day.
  - A legal dispute over the results could drag on for weeks
  - Although it's unlikely there won't be a President for Inauguration Day, the political uncertainty could climax end November early December
- **US / China tensions**
  - The US elections campaign exacerbates tensions with China
  - The equally hawkish tone from Democratic Party brings new policy uncertainties to the bilateral relationship in a Biden-win scenario
  - Possible accidental confrontations in the South China Sea or the Taiwan Strait
- **No-deal Brexit**
  - The latest developments show that the probability of a no-deal exit on 31st Dec has risen dramatically
  - The new UK legislation which over-rules key parts of the Withdrawal Agreement on the highly sensitive Northern Ireland protocol further increased tensions with the EU
  - With only 3 months left and several hot topics still unsettled, the chances of an economic shock in Europe are high
- **Instability within and among EM countries**

+ **DM Govies, cash, gold, linkers, USD, volatility, quality**

- **Oil, risky assets, EMBI**

CROSS ASSET DISPATCH: Detecting markets turning points

How to the read turning point assessment

Not reached yet too early to call it | Approaching to the turnaround | Turnaround happened

ECONOMIC BACKDROP

- The recovery in private sector business activity continues despite moderating significantly due to increasing uncertainty surrounding the pandemic.
- The manufacturing sector leads the recovery, as firms report strengthening demand and improving operating conditions.
- The service sector remains severely disrupted by the pandemic. The restrictive measures implemented to tackle the spread of the virus, are intensifying divergences across business sectors.
- The recovery remains mostly domestically driven, with, however, evident signs of improving export flows globally.

FUNDAMENTALS & VALUATION

- **Risky assets look less expensive after the recent pullback.**
- Equities' absolute PEs are still higher than their historical average even considering high 2021 EPS expectations. The equity risk premium and PE adjusted for CB liquidity injections favour equities in terms of relative value.
- So far, CBs have prevented any significant market correction since April, providing strong support to risky assets.

DEFENSIVE ASSET ALLOCATION

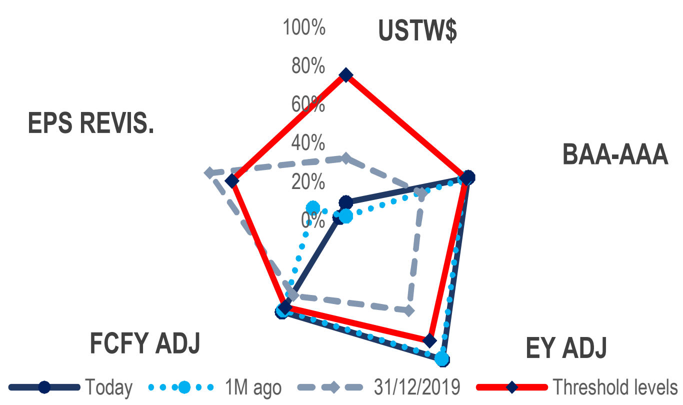
TECHNICALS

- Technical signals have strongly supported the first leg of the rebound in risky assets since March.
- Momentum, the strongest market mover since the summer, turned out less supportive this month. Seasonality, US election risk and a potential second round of restrictions have weighed on risky assets since the beginning of September.
- From a contrarian standpoint, markets are not overstretched any more though, as the recent sell-off has normalised the picture.
- Technicals remain thus overall neutral, as trend following signals and contrarian indicators compensate each other

SENTIMENT

- CAST remains the strongest contributor. EPS revisions have rebounded, and the USD depreciation has added support. The credit risk premium (Moody's BAA-AAA) remains around the alert threshold, but it's not enough to offset the call.
- Financial conditions eased further over the summer, as central banks pushed appetite for spreads products higher.
- Cross asset flows (based on State Street data) confirm the mild pro-risk stance. Although appetite for high beta and cyclical segments moved lower in September, the overall flows scorecard remain in neutral+ territory.

Cross Asset Sentinels Thresholds (CAST) still supportive



Amundi Research, Data as of 23 September 2020

CAST flags extremely low risk perception.

Sentinels remain in pro risk territory due to a general improvement in all the components (except ERP adjusted for credit risk).

<u>Methodology</u> We consider five inputs which we call "Sentinels": USTW$, Moody's Baa-Aaa, EPS revisions, Earning Yield risk adjusted and Cash Flow yield risk adjusted. These sentinels are used to reposition our tactical asset allocation. Once sound thresholds are detected, the five variables are aggregated as an indicator that anticipates the market's stress conditions, with a certain level of conviction. The pentagon visualizes the five sentinels where the red line represents the alert threshold. The greater the distance above the red line, the higher the risk perception, and eventually the need to move closer to a defensive asset allocation.

GLOBAL RESEARCH CLIPS

1 Assessing the recovery

- With the peak of the pandemic now behind us in most of the major global economies (although secondary waves need to be watched), attention now turns to the speed and composition of the recovery.
- High-frequency data suggests a technical recovery, with Europe leading, whilst the US and UK are lagging behind.
- New evidence confirms our take that this is not the V-shaped rebound priced in by the markets.
- We maintain our view that we are facing a long U-shaped recovery, and that it will be late 2021 / early 2022 before global GDP recovers to pre-Covid-19 levels. Even in this scenario, emerging economies recover more quickly (basically a China story) than advanced economies (H2 22).

2 Preference for equities in our tactical and strategic allocation

- Q3 technical rebound doesn't move economies back to pre-Covid levels. Economic performance will progress along a slow upward sloping catch-up process. We expect the inflation trend to be up and to stabilise around targets in the forecast horizon. US companies' resilience underpin the ongoing profit recovery in US.
- We therefore confirm the recovery phase as the most likely macro-financial regime in the next 12 months. Still, we maintain a 20% probability for the downside scenario. Near-term risks are tilted to the downside, but in our medium-term radar we see a rotation from credit (HY) to equity.
- Tactical (1 month): Neutral+ exposure to equity and constructive for IG EU (contributing to a long duration). Long gold.
- Strategic View (3 to 6 months): rotation from credit HY into equity. Long gold.

3 Euro's "risk-on" status

- Market participants pushed the EUR higher and the single currency has confirmed its status as a 'risk-on' currency.
- If this trend continues it will become an issue for the ECB, which "carefully monitors developments in the exchange rate, with regard to its implications for the medium-term inflation outlook".
- Looking ahead, we expect an expansion of the ECB's asset purchases via PEPP/APP, rather than further rate cuts, which still seem highly controversial.
- The EUR/USD should therefore be range-bound or maintain its mild upward slope.

4 Politics will be the main market driver till year-end

- Policies are shaping the recovery trajectory and influencing market participants' narratives.
- If financial conditions remain as easy as they are, the Fed is unlikely to provide any further easing; nor will other key central banks. As such, markets will be left with economic data and politics, US fiscal stimulus, US elections, Brexit, and, obviously, Covid-19-related news.
- US fiscal policy is still in politically awkward damage containment mode. Unilateral Trump decisions (jobless benefits and eviction moratoriums) have temporarily forestalled the fiscal cliff. But we have little visibility on the Phase 4 bipartisan deal, and the recovery / reconstruction plan will be decided after the election.
- US elections are too close to call in the White House and Senate, though the HoR will probably remain Democratic. The markets' preference between Trump and Biden remains unclear.

US elections: a very close race*

Joe Biden is enjoying a 7pt lead in the national polls. However, the race will be very close, and the outcome remains uncertain for various reasons: (1) while Biden's lead in the national polls is significant, his lead in the swing states is only 3.9% and within the margin of error in many states; (2) we expect a record turnout, with the highest number on record voting by mail; and (3) the public has a net negative approval rating for Trump, but he enjoys a positive net approval rating on his handling of the economy, which could help if the economy gains momentum.

There are three main themes in Trump's campaign: law and order, China, and Biden's fitness for office. Biden is campaigning on economic policy ("Build Back Better"), healthcare, racial justice and morality. Biden is planning another fiscal stimulus package to address economic issues tied to the pandemic. Also, he has plans for a major infrastructure investment and backing (Green New Deal). Biden plans to boost Obamacare and prescription drug reform. Both candidates would have to deal with the long-term issue of rising inequality.

Investment implications: The dollar should stay weak in the medium term, due to the re-emergence of twin deficits and an escalating debt/GDP ratio, together with the Fed's long-term commitment to near-zero rates. The greatest risk to short-term market dynamics is an undecided race. Big tech, defence, financials and carbon energy sectors would be likely to perform better under Trump, while renewable energy and infrastructure-related sectors would be winners under Biden.

* Please read more: ***US presidential election: how it will impact US economy and financial markets***

AMUNDI ASSET CLASS VIEWS

	Asset Class	View	1M change	Rationale
EQUITY PLATFORM	US	-/=		US equity risky premiums vs bonds are still supportive of equity prices, although valuations divergence in some pockets of the markets such as between big 5 mega caps and rest of the markets is extreme. This calls for a balanced positioning across sectors as the recent correction reminded investors about the US elections risks and the still prevailing risks of a virus resurgence. Investors could focus on the leadership rotation towards cyclical and high quality stocks.
	Europe	=		The economic data improved but the second wave of virus in the France, Spain, the UK and other countries has increased the risks as governments balance the need to impose strict lockdowns with boosting consumption. However, Q2 earnings were better-than-expected, and we believe, valuation dispersion is still high. This presents an environment where investors should be active, focus on resilient businesses and remain cautious overall.
	Japan	=		Better global growth prospects should favour cyclical and export oriented markets such as Japan. While the new PM is likely to continue the economic support provided by the previous administration, investors should stay watchful.
	Emerging markets	=		Emerging markets such as China, Korea have been better able to handle the crisis and this is reflected in economic data coming out of EM Asia, which confirms our first-in, first-out story. However, geopolitical risks related to China's more assertive foreign policy must be monitored. At a sector level, we are selectively exploring names in industrials, consumer discretionary and materials, and focusing on lower valuation name in technology.
FIXED INCOME PLATFORM	US govies	=/+		In global fixed income, we keep a positive view on US duration, although we believe this has to be carefully monitored in light of the recent Fed comments on inflation. In US fixed income, we prefer TIPS to UST.
	US IG Corporate	=/+		IG markets should remain supported by central bank support, however, investors should not compromise on sector and name selectivity. Investors should also look to pare back some duration risk and maintain appropriate liquidity buffers.
	US HY Corporate	-/=		We are cautious/neutral on HY as we believe the markets will remain supported by CB actions, but investors should be careful of defaults particularly in sectors such as tourism, energy which are most exposed to the crisis. In addition, a slow recovery could cause weak companies to struggle amid low business activity. The case for selectivity remains high.
	European govies	-/=		We find opportunities in this space in curve flattening amid low inflation in the Eurozone. On peripheral debt, we stay positive in light of continued ECB support and reducing risks of fragmentation with the rest of the European markets.
	Euro IG Corporate	++		We stay constructive on EUR IG as continued ECB support and lower leverage vs the US counterparts is positive for the asset class. Financials and subordinated debt remain our top pick, but selection is also important.
	Euro HY Corporate	=		We prefer the high-rated BB segment in HY because we believe investors should not go too low in the credit quality spectrum for that extra yield. There could be increasing fragmentation between companies with sufficient cash buffers vs those that struggle to meet day-to-day requirements due to lack of business activity. Therefore, selectivity is crucial.
	EM Bonds HC	=/+		We maintain our preference for Hard Currency debt, particularly in HY as IG spreads have already tightened to pre-covid levels, and the prospect of new supply lingers. However, risks of sovereign defaults should be monitored.
	EM Bonds LC	=		We remain cautious in EM rates overall. On FX, we see selective opportunities in currencies that we believe have underperformed and where there is room for a catch-up.
OTHER	Commodities			Commodities should benefit from expectations of economic recovery and availability of a vaccine. Going forward, oil demand may recover from the current subdued levels but we expect WTI price to stay between $40 and $50 per barrel over the coming few months. In precious metals, the recent sell-off in gold and silver was due to concerns over high real rates, worries about "risk-on" and a pause in asset buying by the Fed. Importantly, CB policies have been driving-up the gold prices and, as long as this accommodative stance is maintained, any painful sell-off is unlikely. However, if CBs unexpectedly change their stance, gold may be vulnerable to a serious de-rating, given that its fair value, based on traditional metrics (rates and FX), is much lower from current levels.
	Currencies			Structural and cyclical support for the USD is fading and this suggests that the greenback can continue to trend lower in 2021. Unlike the past when the USD kept on deviating from its fair value, now the USD has lost two of the main cyclical supports – the rate advantage and the US growth premium collapsed in H1 2020. However, we believe there are still short-term risks that will prevent a linear movement. In fact, correlation with risky assets stays high and some currencies (GBP, EUR above all) are still attached to the risk of disappointment in growth expectations.

LEGEND

---	--	-	=	+	++	+++	▼	▲
	Negative		Neutral		Positive		Downgrade vs previous month	Upgraded vs previous month

Source: Amundi, as of 30 September 2020, 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.

DEVELOPED COUNTRIES

Macroeconomic outlook

Data as of 21/09/2020

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2019	2020 range	2021	2019	2020	2021
World	**3.1**	**-4.8/-3.8**	**4.8/5.9**	**3.0**	**2.6**	**2.8**
Developed countries	**1.7**	**-7.2/-5.8**	**3.7/5.0**	**1.4**	**0.8**	**1.5**
US	**2.3**	**-5.6/-4.2**	**3.0/4.0**	**1.8**	**1.3**	**1.8**
Japan	**1.2**	**-5.1/-4.5**	**2.1/2.7**	**0.7**	**0.1**	**0.3**
UK	**1.4**	**-11.5/-10.5**	**7.0/9.0**	**1.8**	**0.8**	**1.5**
Eurozone	**1.2**	**-9.4/-7.4**	**4.2/6.2**	**1.2**	**0.4**	**1.4**
Germany	0.6	-7.6/-5.6	2.6/4.6	1.5	0.7	1.5
France	1.2	-11.2/-9.2	6.0/8.0	1.3	0.5	1.2
Italy	0.3	-11.7/-9.7	4.1/6.1	0.7	0.1	1.1
Spain	2.0	-12.5/-11.5	7.5/8.5	0.7	0.1	1.2

Source: Amundi Research

- **United States:** Q3 economic rebound exceeds our expectations on GDP, prompting an upside revision to our August forecasts. Yet, the deceleration in late Q3 of several indicators is keeping us from extrapolating Q3 momentum into Q4. After some softening in 2020 H2, headline inflation will move along a gradual upward trend, stabilising around 2% from mid-2021 with possible temporary overshooting. As November 3 approaches, policymakers' focus is shifting, with an increased risk that 2020 fiscal policy will become more diluted than expected, and with little visibility on the Phase 4 deal in particular.
- **Eurozone:** After staging a strong rebound in early Q3, the recovery curve for Eurozone economies has flattened while the virus resurgence from September in several countries poses concerns on economic momentum moving into Q4. We therefore expect a gradual pickup in both domestic and external demand, supported by extraordinary easy monetary policy and counter-cyclical fiscal policies. Inflation will remain subdued in the near term, moving gradually higher into 2021, yet remaining quite below target. Temporary extensions of furlough schemes may prevent severe distress in the labour market.
- **Japan:** The second Covid-19 wave left its mark on the economic recovery, with household spending turning sluggish moving into Q3 and mobility remaining flat. Business sentiment was mixed in September: while the manufacturing outlook improved on autos, non-manufacturing was dragged down by the retail sector. We maintain our view of a soft recovery ahead and do not expect the economy to return to pre-Covid levels in 2021. The slow closing of the output gap will depress inflation.
- **United Kingdom:** The economy continued in summer to bounce back from its Q2 dip, albeit at a slower pace in September amid a Covid-19 resurgence and new restrictions that will likely impact Q4 economic momentum. The labour market remains under pressure, with a possible unemployment surge should furlough schemes (ending in October) not be extended. This outcome would make a new round of fiscal support more likely, together with some easing on the monetary front later in the year as additional Brexit downside risk looms.

Key interest rate outlook

	29-09 2020	Amundi + 6m.	Consensus Q1 2021	Amundi + 12m.	Consensus Q3 2021
US	**0.13**	**0/0.25**	**0.08**	**0/0.25**	**0.07**
Eurozone	**-0.50**	**-0.50**	**-0.54**	**-0.50**	**-0.60**
Japan	**-0.05**	**-0.1**	**-0.06**	**-0.1**	**-0.09**
UK	**0.10**	**0.00**	**0.04**	**0.00**	**-0.04**

Source: Amundi Research

Monetary policy agenda

Central banks	Next meeting
Federal Reserve FOMC	**November 4**
ECB Governing Council	**October 29**
Bank of Japan MPM	**October 29**
Bank of England MPC	**November 5**

Source: Amundi Research

- **Fed:** The Fed revealed the new forward guidance associated with the recent changes to its Longer-Run Goals and Monetary Policy Strategy. The current rate will be maintained "until labour market conditions have reached levels consistent with the Committee's assessments of maximum employment and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time". The new economic projections show that rates will stay at zero at least through the end of 2023. For the moment, the Fed thinks that the policy setting is appropriate. It made no changes to the asset purchase program and showed no urgency in transitioning to a more traditional QE that tilts purchases toward longer maturities. The QE will remain at the current pace "over the coming months".
- **ECB:** The ECB appeared comfortable with its current monetary policy stance, but stands ready to adjust all of its instruments. It will carefully assess incoming information, including developments in the exchange rate, with regard to its implications for the medium-term inflation outlook. Christine Lagarde emphasised the positive result of the last round of stimulus. TLTRO, which aims to stimulate lending to the economy, has been successful. Indeed, the annual growth rate of loans to non-financial companies stood at 7% in July. PEPP still has around €850bn of unused firepower
- **BoJ:** The BoJ left its monetary policy unchanged on 17 September, one day after the launch of Suga cabinet. Governor Kuroda stressed that the central bank would maintain coordination with the government under PM Suga. This was reaffirmed at a meeting between the two on 23 September. Indicating he would serve out his term until April 2023, Kuroda reiterated that there is no change in the central bank's target to achieve the inflation target (2%), amid the latest yen strengthening.
- **BoE:** As broadly expected, the Bank of England voted to keep its policy settings unchanged. The BoE also recognised the risks to future economic growth posed by recent pandemic trends and by the Brexit outcome. The BoE is still expected to move to an extension of QE before year-end, when current programme is projected to end. In the short-term, the policy package of QE and forward guidance is likely to remain the preferred one vs other tools, despite the recent decision to explore the negative rates option in the future.

EMERGING COUNTRIES

Macroeconomic outlook

Data as of 21/09/2020

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2019	2020 range	2021	2019	2020	2021
World	3.1	-4.8/-3.8	4.8/5.9	3.0	2.6	2.8
Emerging countries	4.0	-3.2/-2.4	5.5/6.4	4.1	3.7	3.6
Brazil	1.1	-5.9/-4.9	3.7/4.7	3.7	2.7	3.0
Mexico	-0.3	-10.5/-9.5	3.6/4.6	3.6	3.5	3.8
Russia	1.3	-4.0/-3.7	2.5/4.5	4.5	3.2	3.8
India	4.9	-9.5/-8.1	7.6/8.9	3.7	6.4	5.9
Indonesia	5.0	-3.4/-2.4	2.9/3.9	2.8	2.1	2.8
China	6.2	1.8/2.4	7.6/8.2	2.9	2.7	2.0
South Africa	0.2	-9.1/-8.1	2.8/3.8	4.1	3.4	4.4
Turkey	0.8	-5.2/-4.2	3.3/4.3	15.5	11.3	11.0

Source: Amundi Research

- **China**: We expect China's sequential growth to normalise down towards trend in H2 2020, while headline YoY growth will continue to firm up to around 6%. The latest data shows a more balanced recovery, with private capex and services consumption picking up at a quicker pace. Meanwhile, we expect food inflation to ease and CPI to drop further in Q4, as sow stock recovers. Services and core inflation began to stabilise in August, thanks to improving demand and a steady rebound in the services sector.
- **Argentina:** Economic activity is picking up from a highly depressed level and in line with rising mobility, due to falling compliance with lockdown measures. GDP is still to contract by low double digits this year. The highly challenging macro story also has to digest a more unorthodox policy stance now, as authorities have tightened capital controls to prevent depletion of (net liquid) FX reserves at the expense of growth and credibility. A positive catalyst in the form of a debt restructuring agreement with the IMF still possible, however, thanks to the IMF's more realistic view of Argentina's struggles.
- **Indonesia:** The Jakarta governor announced and enforced a stricter lockdown for the metropolitan area. The lockdown started on the 14th of September and has to be renewed every two weeks. We expect it to be renewed for the coming weeks, due to hospital capacity and Jakarta's weight in Indonesia's GDP (about 20%), which is increasing the downside risks to growth. BI stayed on hold in September, confirming its commitment towards the debt monetization process. The monetary policy stance was confirmed dovish, and pressure for easing has increased due to the new risks to growth.
- **Turkey:** the central bank raised its rates by 200bp, with a one-week repo rate at 10.25%. This decision was driven by a "rapid recovery achieved in the economy with strong credit momentum", "developments in the financial markets" (the ongoing slide in the lira), and the fact that "inflation followed a higher course than expected". The lira inched up only slightly on this announcement. While this is welcome, it is not enough to restore credibility to the policy mix, as the market is hoping for a return to positive real rates.

Key interest rate outlook

	01-10 2020	Amundi + 6m.	Consensus Q1 2021	Amundi + 12m.	Consensus Q3 2021
China	3.85	3.85	3.75	3.85	3.75
India	4	4	3.65	4	3.6
Brazil	2	2	2	2	2.5
Russia	4.25	4.00	4.15	4.25	4.35

Source: Amundi Research

Monetary policy agenda

Central banks	Next communication
PBoC	October 20
RBI	December 4
BCB Brazil	October 28
CBR	October 23

Source: Amundi Research

- **PBoC (China):** The PBoC left one-year LPR unchanged at 3.85% for the fifth consecutive month on 20 September. In the interbank market, we believe policy neutralisation is mostly completed. Key market rate DR007 has reached 2.2%, the rate PBoC charged on its own liquidity injection tool with the same seven-day tenor. Looking ahead, we expect the central bank to guide DR007 to hover around 2.2% by nimbly adjusting the liquidity injection amount. We expect credit growth to stabilise at current levels and do not expect credit tightening to go beyond the targeted property sector.
- **RBI (India):** After pausing in its MP easing in early August (with the Repo Rate kept at 4.0%), the RBI is expected to pause at its October meeting, as well, due to persistent high inflation (6.7% YoY for August). As inflation is struggling to take a convincing disinflationary path, we see very little room to ease further ahead. Q4 inflation figures could offer more space for easing. In the meantime, the RBI is conducting Special Open Market Operations (OMOs) of government bonds to ensure the orderly functioning of financial markets; this was last announced on the 24th of September.
- **BCB (Brazil):** The central bank kept interest rates on hold in September at 2%, in line with our expectations, and is determined to keep rates at highly accommodative levels until inflation expectations converge sufficiently close to the target. Future actions will, however, depend on fiscal developments and continued fiscal prudence. In its 3Q Inflation Report, the CB revised growth higher and confirmed its benign outlook for inflation going forward. All in all, we expect lower-for-longer to stay in place for at least a year, as long as the authorities keep fiscal risks in check.
- **CBR (Russia)**: Following the 25bps cut in July, the Central Bank of Russia (CBR) left its policy rate unchanged at 4.25% at its September 18th meeting. The reasons for the pause were slightly higher than expected inflation, due to the revival of consumer demand, weaker rouble and a more volatile external environment. The CBR has reached almost the end of its cutting cycle. It is likely to remain cautious and watch both geopolitical developments, and inflation expectations and dynamics before preceding to the last 25bps cut before year-end.

MACRO AND MARKET FORECASTS

Macroeconomic forecasts (21 September 2020)

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2019	2020 range	2021	2019	2020	2021
US	2.3	-5.6/-4.2	3.0/4.0	1.8	1.3	1.8
Japan	1.2	-5.1/-4.5	2.1/2.7	0.7	0.1	0.3
Eurozone	1.2	-9.4/-7.4	4.2/6.2	1.2	0.4	1.4
Germany	0.6	-7.6/-5.6	2.6/4.6	1.5	0.7	1.5
France	1.2	-11.2/-9.2	6.0/8.0	1.3	0.5	1.2
Italy	0.3	-11.7/-9.7	4.1/6.1	0.7	0.1	1.1
Spain	2.0	-12.5/-11.5	7.5/8.5	0.7	0.1	1.2
UK	1.4	-11.5/-10.5	7.0/9.0	1.8	0.8	1.5
Brazil	1.1	-5.9/-4.9	3.7/4.7	3.7	2.7	3.0
Mexico	-0.3	-10.5/-9.5	3.6/4.6	3.6	3.5	3.8
Russia	1.3	-4.0/-3.7	2.5/4.5	4.5	3.2	3.8
India	4.9	-9.5/-8.1	7.6/8.9	3.7	6.4	5.9
Indonesia	5.0	-3.4/-2.4	2.9/3.9	2.8	2.1	2.8
China	6.2	1.8/2.4	7.6/8.2	2.9	2.7	2.0
South Africa	0.2	-9.1/-8.1	2.8/3.8	4.1	3.4	4.4
Turkey	0.8	-5.2/-4.2	3.3/4.3	15.5	11.3	11.0
Developed countries	1.7	-7.2/-5.8	3.7/5.0	1.4	0.8	1.5
Emerging countries	4.0	-3.2/-2.4	5.5/6.4	4.1	3.7	3.6
World	3.1	-4.8/-3.8	4.8/5.9	3.0	2.6	2.8

Key interest rate outlook

Developed countries

	29/09/2020	Amundi + 6m.	Consensus Q1 2021	Amundi + 12m.	Consensus Q3 2021
US	0.13	0/0.25	0.08	0/0.25	0.07
Eurozone	-0.50	-0.50	-0.54	-0.50	-0.60
Japan	-0.05	-0.1	-0.06	-0.1	-0.09
UK	0.10	0.00	0.04	0.00	-0.04

Emerging countries

	01/10/2020	Amundi + 6m.	Consensus Q1 2021	Amundi + 12m.	Consensus Q3 2021
China	3.85	3.85	3.75	3.85	3.75
India	4	4	3.65	4	3.6
Brazil	2	2	2	2	2.5
Russia	4.25	4.00	4.15	4.25	4.35

Long rate outlook

2Y. Bond yield

	29/09/2020	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	0.13	0.10/0.3	0.15	0.1/0.3	0.18
Germany	-0.696	-0.70/-0.50	-0.75	-0.70/-0.50	-0.81
Japan	-0.136	-0.20/-0.10	-0.13	-0.20/-0.10	-0.13
UK	-0.06	0/0.25	-0.12	0/0.25	-0.14

10Y. Bond yield

	29/09/2020	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	0.66	0.7/0.9	0.77	0.8/1	0.85
Germany	-0.51	-0.60/-0.40	-0.47	-0.50/-0.30	-0.43
Japan	0.02	-0.10/0.10	0.08	0/0.2	0.13
UK	0.21	0.20/0.4	0.30	0.3/0.5	0.36

Currency outlook

	24/09/2020	Amundi Q1 2021	Consensus Q1 2021	Amundi Q3 2021	Consensus Q3 2021
EUR/USD	1.16	1.16	1.20	1.19	1.22
USD/JPY	105	105	105	106	105
EUR/GBP	0.92	0.93	0.90	0.90	0.91
EUR/CHF	1.08	1.07	1.09	1.11	1.10
EUR/NOK	11.08	10.40	10.45	10.21	10.18

	24/09/2020	Amundi Q1 2021	Consensus Q1 2021	Amundi Q3 2021	Consensus Q3 2021
EUR/SEK	10.62	10.25	10.30	10.20	10.18
USD/CAD	1.34	1.33	1.31	1.32	1.30
AUD/USD	0.70	0.75	0.73	0.75	0.75
NZD/USD	0.65	0.66	0.67	0.67	0.69
USD/CNY	6.83	6.70	6.80	6.60	6.73

Source: Amundi Research

DISCLAIMER TO OUR FORECASTS

The uncertainty around the macro forecasts is very high, and it triggers frequent reassessments any time fresh high frequency data are available. Our macroeconomic forecasts at this point include a higher qualitative component, reducing the statistical accuracy and increasing the uncertainty through wider ranges around them.

A global recession is our base case today

1. How deep?

- The deepness depends on the virus longevity in the countries affected and the consequent gradual to complete lockdown in most of them. Downturn is evident in domestic demand (across its components at different degree) and in trade dynamics. We assume the largest downturn in the lockdown quarter and a milder downturn to follow. We monitor outbreak developments and lockdown/resumption of the economic activity.

2. How long?

- The timeline depends on the deepness of the economic disruption together with the credit conditions and the rise of corporate default, magnifying the financial markets turbulence and therefore the impact on the economy.
- The timeline of the shock has extended, and overall a peak is expected by May to June 2020. The global economy was showing signs of growth stabilisation during the 4Q2020.
- The timeline is also a function of the specific developments of the outbreak together with pre-existent fragilities.

3. The fiscal impact

- The impacts of micro and macro fiscal measures are not included in our forecasts but it’s fair to assume a normalisation in the financial and liquidity conditions driven by Monetary Policy authorities

Financial targets

- Financial targets are reviewed on the same line and include policy actions implemented on a daily basis.

METHODOLOGY

- **Scenarios**

  The probabilities reflect the likelihood of financial regimes (central, downside and upside scenario) which are conditioned and defined by our macro-financial forecasts. We use the k-means clustering algorithm to our enlarged macroeconomic dataset, splitting the observations into the K cluster, where K represents most of the variability in the dataset. Observations belong to one cluster or another based on their similarities. The grouping of the observations into the k clusters is obtained by minimizing the sum of squared Euclidean distances between observations and clusters centroids i.e. the reference values for each cluster. The greater the distance, the lower the probability to belong to a given regime. The GIC qualitative overlay is finally applied.

- **Risks**

  The probabilities of risks are the outcome of an internal survey. Risks to monitor are clustered in three categories: Economic, Financial and (Geo)politics. While the three categories are interconnected, they have specific epicentres related to their three drivers. The weights (percentages) are the composition of highest impact scenarios derived by the quarterly survey run on the investment floor.

PUBLICATIONS HIGHLIGHTS

THE DAY AFTER

The day after #11
Post-crisis narratives that will drive financial markets (23-09-2020)
BLANQUE Pascal, Group Chief Investment Officer

- The Covid-19 crisis has thrown up a sequence of images from the past (pandemics, wars, the Great Financial Crisis) that have pushed central banks (CB) and governments to act in unprecedented ways. This has defined the current 'day after' narrative.
- Financial markets have adapted to this new narrative, pricing in the rosiest scenario of a 'day-after renaissance'.
- But more will be needed in terms of fiscal and monetary support to sustain the recovery moving forward. The Covid-19 fallout on the real economy and society is deep and pervasive: the overall debt level in the system is skyrocketing and some sectors are very unlikely to recover to pre-crisis levels. Rising social and inter-generation inequalities are the enemy to fight to avoid social upheaval.
- Politics is the link between public narratives (reinforced in the media and on social media) and institutional narratives. The narratives that will emerge amid hot political events — the US presidential election and the debate around the allocation of resources from the EU Recovery Fund being the most relevant — will set the direction for financial markets.
- Strong narratives can drive market consensus and lead to crowded trades around major themes. The stimulus narrative continues, coupled with zero interest rates and inflation permanently forgotten in the Covid-19 era. But investors should be aware that narratives could change quickly and be prepared for it. These shifts are arguably the only sequence via which investors can systematically extract value. It will be critical to maintain a strong level of flexibility and liquidity to exploit those opportunities arising from inefficiencies and dislocations.

The day after #10
Rethinking the macro and cross-asset research: what we have learned from the Covid-19 crisis (20-07-2020)
DEFEND Monica, Global Head of Research

INSIGHTS PAPERS

Risk budgeting and trade sizing: why they matter to multi-asset portfolio construction (21-09-2020)
GERMANO Matteo, Head of Multi-Asset — MCDONALD Shane, Head of Multi Asset Portfolio Construction and Financial Engineering — ORTISI Matteo, Portfolio Construction and Financial Engineering_Senior Analyst — TAZÉ-BERNARD Eric, Chief Allocation Advisor

With the contribution of BERTINO Claudia, Head of Amundi Investment Insights Unit, MATRAIA Massimiliano, Mutli-Asset Investment Specialist, TRIO Nuria, Head of Multi Asset Business Development and Investment Specialists

- In the current environment of heightened uncertainty, managing a multi-asset portfolio has rarely looked as complex as it does today, especially for those investors looking for an appropriate governance model on which to take investment decisions.
- The issue is not only to make accurate market forecasts and formulate appropriate investment views, but also to construct an efficient portfolio based on these views within a given risk budget.
- Mean-variance optimization has long been recognized as a standard practice, but, in our view, it can lead to highly concentrated, unstable portfolios and regular rebalancing.
- 'Effective diversification' is at the core of our approach to portfolio construction. An active multi-asset investment framework should allocate risk across four pillars: macro strategy, macro hedging, satellite strategies and selection strategies, with the goal of achieving the portfolio's target return or objective.

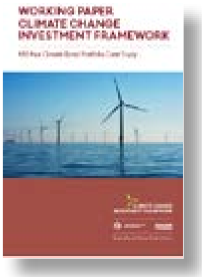
Looking for hidden ESG gems: a new frontier for responsible investing with "improvers" (01-09-2020)
ELMGREEN Kasper, Head of Equities — IACCARINO Piergaetano, Head of Equity Solutions

- The ongoing Covid-19 crisis and the resulting market turmoil have confirmed the increasing relevance of integrating ESG criteria and sustainability into the investment decision.
- ESG equities have proved resilient throughout the crisis, both in terms of flows and performance.
- We believe that Europe will play a crucial role in the trend towards ESG investing, as it is home to most global ESG leaders and has the most advanced ESG framework globally

The case for US equities in global portfolios (27-07-2020)
STERLING Craig, Director of Core Equity & Head of Equity Research, US — PIRONDINI Marco, Head of Equities US

PUBLICATIONS HIGHLIGHTS

WORKING PAPERS



Climate change investment framework (09-09-2020)
AIIB, Asian Infrastructure Investment Bank — Amundi Research

- This paper showcases a first implementation case study in the context of the AIIB Asia Climate Bond Portfolio, which is executed in partnership with Amundi Asset Management and focuses on emerging market corporate bonds. The Climate Change Investment Framework and its analytical tools can be applied across a global range of issuer types and asset classes.
- This aims to provide investors with a benchmark tool for assessing an investment, at the issuer-level, in relation to climate change-related financial risks and opportunities.
- The approach translates the three objectives of the Paris Agreement into fundamental metrics that investors can use to assess an investment's level of progress towards achieving climate change mitigation, adaptation, and low-carbon transition objectives.

Measuring and managing carbon risk in investment portfolios (2020-08)
RONCALLI Theo , LE GUENEDAL Theo, LEPETIT Fréderic, SEKINE Takaya, Quantitative Research — RONCALLI Thierry, Head of Quantitative Research

INVESTMENT TALKS

US presidential election: how it will impact us economy and financial markets
BOROWSKI Didier, Head of Global Views — PIRONDINI Marco, Head of Equities, US Portfolio Manager — TODD Christine, Head of US Fixed Income — UPADHYAYA Paresh, Director of Currency Strategy, US Portfolio Manager, US

See also on this subject, box ***US elections: a very close race*** *page 26 in this edition.*

Investing in the first in, first out theme: opportunities in Asia (07-08-2020)
MORTIER Vincent, Deputy CIO, Asia ex Japan Supervisor — BERARDI Alessia, Head of Emerging Markets Macro & Strategy Research — McCONWAY Nicholas, Head of Asia ex-Japan Equity — LAW Esther, Portfolio Manager Emerging Market Debt — with the contribution of HUANG Claire, EM Macro Strategist and LAHBABI Hicham, Deputy Head of Asia ex-Japan Equity

Challenges and opportunities in US Commercial Real Estate (29-07-2020)
SCHIAPPA Andrew, Credit Analyst — TODD Christine, Head of Fixed Income, US — UPADHYAYA Paresh, Director of currency strategy, US portfolio manager

EU agreement: a powerful answer that can lift further EU assets and ESG investing (22-07-2020)
BOROWSKI Didier, Head of Global Views — BRARD Eric, Head of Fixed Income — ELMGREEN Kasper, Head of Equities — With the contribution of de FAY Alban, SRI Corporate Bonds Portfolio Manager - Head of FI SRI Processes — VIC-PHILIPPE Isabelle, Head of Euro Govies and Inflation

NOTES

NOTES

Amundi Research Center

Find out more about Amundi publications research-center.amundi.com

Emerging Private Equity Money Markets Find Monetary Policies Foreign Top-down Bottom-up Exchange Corporate Equities Sovereign Bonds Forecasts High Yield Fixed Income Real Estate ESG Quant Investment Strategies Asset Allocation

Document issued by Amundi, "société par actions simplifiée"- SAS with a capital of €1,086,262,605 - Portfolio manager regulated by the AMF under number GP04000036 – Head office: 90 boulevard Pasteur – 75015 Paris – France – 437 574 452 RCS Paris – www.amundi.com
Photo credit: ©MDelporte - iStock/Getty Images Plus - Suriyapong Thongsawang