Amundi ASSET MANAGEMENT | Smart Beta

Viewpoint

The Time is Now to Act – Conservatively

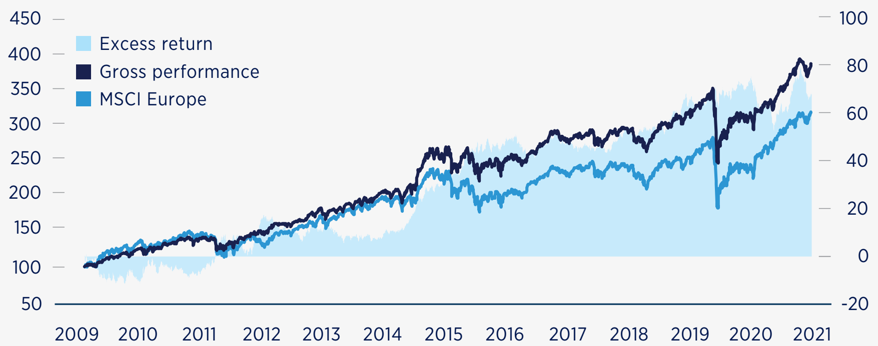
The path to economic recovery in 2021 has been somewhat volatile. Although we are witnessing the most robust post-recession recovery for 80 years[1], the expected 5.6% global economic growth is reflective of specific rebounds in major economies[2]. While equities remain attractive, this has tempered to a neutral outlook in the fourth quarter, paving the way for investors seeking defensive equity exposure to consider conservative strategies.

Why conservative now?

Until early September 2021, there had been seven consecutive months of gains in the equities market[3] reflecting the early signals of growth in the US economy. This was supported by the US Federal Reserve boosting economic activity. The ECB and Bank of England took similar action, mobilising European economies. Then came concerns of rising global inflation, social and economic inequality worsened in some geographies following the Covid-19 crisis, and emerging market growth slowed. In the second half of 2021, the sell-off of Chinese stocks raised fears of possible systemic risk in the global financial system. The S&P 500 dropped after a record high at the beginning of September[4].

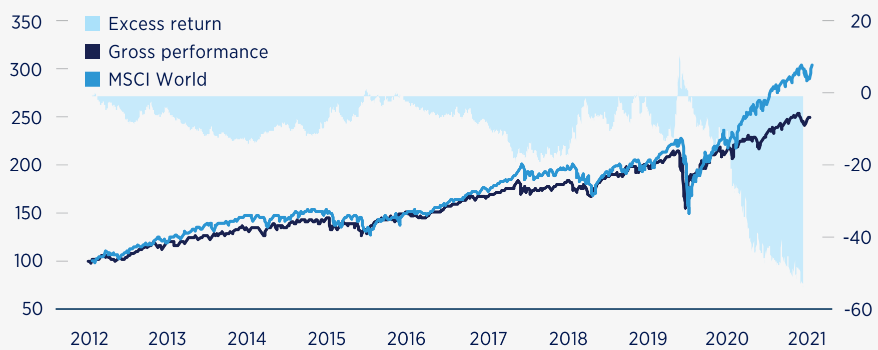
In the context of this much-winding path towards recovery, low risk, low volatility conservative equities have performed well as illustrated in the following charts. Moreover, they look set to continue in this way, presenting opportunities for institutional investors – such as pension funds, and insurers – seeking portfolio diversification, long-term performance, and capital preservation, with low risk.

Amundi Funds European Equity Conservative



Source: Amundi AM. Gross performance as of 30/09/2021. IE share class. (Chart rebased to 100)

Amundi Funds Global Equity Conservative



Source: Amundi AM. Gross performance as of 30/09/2021. IE share class. (Chart rebased to 100)

Past performance is not a reliable indicator of future results or a guarantee of future returns.

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Investing in a conservative equities strategy provides pure equity exposure in a defensive strategy, with minimum variance (low volatility stocks of high quality) and good diversification.

We see four key drivers for allocating to conservative strategies:

- High market concentration combined with over-exuberance in growth stocks
- High corporate debt levels
- Anticipated outperformance of quality, value and high-dividend equities, with European stocks looking particularly attractive
- High level of valuation in global equities.

Global conservative equities have underperformed the benchmark recently – although it must be noted that with low volatility and low risk as important indicators, underperformance versus the benchmark does not mean bad news. With these four key drivers, we have a good feel for forthcoming market conditions, anticipating that they will exhibit and bring the benefits of 'mean reversion' properties. This typical pattern of outperforming asset prices and historical returns that revert to the long-run mean, signal good timing for a move to a conservative strategy, particularly where there is a style factor at play. ■

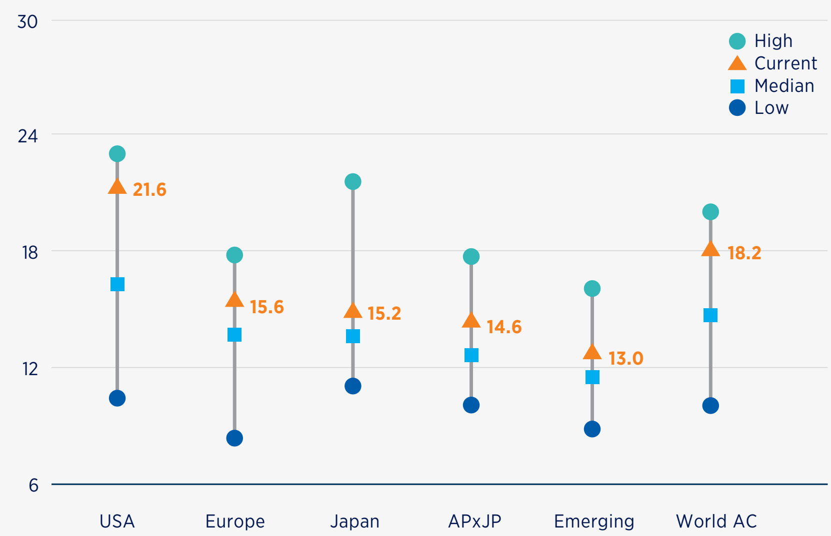
Growth stocks give way to defensive

Markets have been exuberant this year. Despite a recent decrease in the price-to-earnings ratio, equity valuations remain elevated as illustrated in the following PER chart, particularly in the US.

As mentioned September brought a shift in the stock market, from soaring to struggling[5]. And as early as 4 October it seemed that the potential rotation from growth to value and quality stocks may have already started. Facebook shares suffered their worst single day decline in nearly a year on that date at 4.9% (15% over the month) resulting from an internal technical issue affecting access for up to 3.5 billion users of Facebook, Messenger, Instagram and WhatsApp for more than 5 hours[6]. The S&P 500 had already opened down 1.3% on 4 October before sliding further to close down 2.2%, while the NASDAQ dropped 2%[7].

The FAANG[8] quintet of stocks make up 22% of the valuation of the S&P 500[9]. As high volatility, highly leveraged and consequently high-risk investments they exemplify the type of growth stocks that may not play so well for some long-term investors' strategies in the current macroeconomic environment. This may now be the turning point when those investors look to quality companies and well-discounted value stocks.

12M Forward PER (since 2009): MSCI Indices



Source: Datastream, Amundi Research, Factset, MSCI, as of 30 September 2021.

Meanwhile, Eurozone countries are returning to normal, post-Covid. European equities have been trading close to a record high discount relative to US stocks and the region is well positioned for growth with post-pandemic expectations still to peak. Europe is also leading the way in the rotation towards environmental, social and governance (ESG) investing with rising asset volumes, thanks to the more advanced regulatory framework set out by the European Commission.

From the perspective of investors seeking a defensive strategy with European stocks, the region's more cyclical equities market could be advantageous. Variability over time depending upon business cycles and economic trends is the hallmark of European equities. A conservative strategy can therefore complement investment in value stocks, bringing diversification for investors at different points in time. ■

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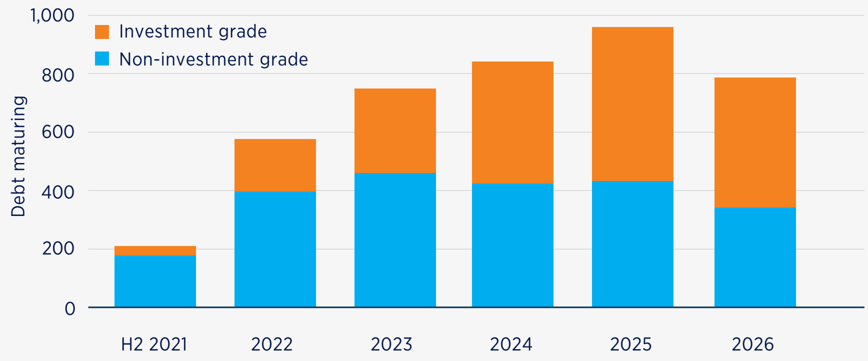
Doubts over debt

The economic environment of 2020 saw corporate leverage rise dramatically to a volume, which, in combination with a slowing economy could trigger corporate instability when bonds mature. The US Federal Reserve cites a $1 trillion increase in corporate leverage during the course of the pandemic, totalling more than 55% of US GDP in 2020[10], actually exceeding pre-pandemic levels.

The possibility of a fall in growth combined with the sustained presence of inflation presents some uncertainty for institutional investors seeking capital preservation and low risk alongside performance. ■

US nonfinancial corporate debt due to mature each year ($B)



Source: S&P Global, Weakening US economy threatens swelling corporate debt mountain, 23 September 2021

Making a conservative move

Mixed global data has had an impact on global equity markets for good reason, and has brought us to a current neutral stance on 'traditional' equities. Since September we have already seen renewed volatility in markets combined with expectations of further volatility.

The Amundi Conservative Equities funds offer investors exposure to fundamentally sound stocks in a defensive strategy, a high level of diversification and with the key strength of our strong philosophy that risk management leads to better performance. Furthermore, the ESG and carbon footprint of the Amundi conservative portfolios is superior compared to their respective benchmarks.

At this point in the fourth quarter, as we enter a transitional phase shaped by economic recovery patterns and a degree of uncertainty, conservative equities strategies – European and global - present an interesting proposition.

To find out more about Smart Beta and Factor Investing at Amundi, visit our website:

https://www.amundi.com/int/Strategies/ETF-Indexing-Smart-Beta. ■

Benefits of a conservative equities strategy in a diversified portfolio:

- Pure equity exposure
- Defensive strategy
- Risk-efficient
- Complementary to other strategies

About Amundi ETF, Indexing & Smart Beta

The Amundi ETF, Indexing and Smart Beta business line provides investors - whether institutional or distributors - with robust, innovative, and cost-efficient solutions, leveraging Amundi Group's scale and large resources. The platform also offers investors fully customized solutions (ESG, Low Carbon, specific exclusions, risk constraints, etc.).

With over 30 years of benchmark construction and replication expertise, Amundi is a trusted name in ETF & Index management among the world's largest institutions. The team is also recognized for its ability to develop Smart Beta & Factor Investing solutions, with a track record of more than 10 years.

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1 & 2 Source: The World Bank, Global Economic Prospects, June 2021
3 & 4 Source: Reuters, The S&P 500 down more than 2% as growth worries rise, 20 September 2021
5 Source: Fortune, Is this the sound of a stock market bubble popping? 6 October 2021
6 Source: The New York Times, Gone in Minutes, Out for Hours: Outage Shakes Facebook, 4 October 2021
7 Source: The Wall Street Journal, Stocks Close Lower, Driven by Facebook, Alphabet and Other Tech Shares, 4 October, 2021
8 FAANG - Facebook, Amazon, Apple, Netflix and Google (owned by Alphabet)
9 Source: Bloomberg, Faang' Dominance Too Hard to Overcome as 10% Correction Looms, 4 October 2021
10 Source: S&P Global, Weakening US economy threatens swelling corporate debt mountain, 23 September 2021

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