Confidence must be earned

Amundi ASSET MANAGEMENT

INVESTMENT TALKS

December 2021

Private markets: focus on ESG and transformation

Dominique CARREL-BILLIARD
Global Head of Real Assets

"The role of private capital will be crucial in Europe's recovery from Covid-19 and the transition to carbon neutrality, as well as the development of a more inclusive growth model."

- ***A challenging year ahead****:* According to our 2022 Investment Outlook, *next year will feature growth deceleration, persistent inflation pressure and asynchronised central bank action. 2022 will also be a pivotal year for the transition to carbon neutrality and the development of a more inclusive growth model. In this environment, real assets and private markets have an important role to play in investors' portfolios: they can help enhance diversification with a focus on inflation protection, they offer some of the best risk/return prospects for the next decade*[1] *and, finally, they provide a direct lever for allocating capital to projects and companies that fulfil a broader social and environmental agenda.*
- ***Private debt:*** *The financing earmarked for the recovery will create opportunities in the private debt space, but selectivity will be paramount. Indeed, there is a divergence between the best credits, where competition is fiercer than ever, and more complex situations in sectors where visibility remains poor. We are observing a flight to quality, as investors wish to protect themselves from the situation potentially deteriorating as government support winds down. This is driving a search for conservative investments with limited risk. Private debt has been an important contributor to economic growth, thanks to the support it provides to the real economy as a complement to banking intermediation. This trend should accelerate, creating appealing investment opportunities for long-term investors.*
- ***Infrastructure:*** *With governments relying on infrastructure investment to stimulate economies, the asset class has been a bright spot throughout the Covid-19 crisis. Private capital is needed to complement public funding and is giving infrastructure investments strong momentum. The pandemic has not only brought the need for health and communications infrastructure to light, but also stressed the urgency of the energy transition. A significant share of the EU 2021-27 multi-year budget and of the Next Generation EU plan has been committed to the green transition and digital infrastructure. In 2021, we have seen a sharp acceleration in the number of transactions, especially for energy transition assets that are likely to attract significant private capital flows.*
- ***Private equity****: Record numbers continue to be hit thanks to strong post-pandemic growth on the back of a steeper-than-expected recovery. Post-crisis periods are historically the best times to invest in private equity, as demand for capital from unlisted companies increases significantly. With many companies weakened by the crisis, sector consolidation has been accelerating, creating plentiful investment opportunities for private equity funds. The adoption of existing technological or environmental trends has been accelerated by the pandemic and investors are willing to bid up the valuations of companies on the right side of these changes. The Covid-19 crisis has shone a light on several market disruptions in technology, the environment, demographics and relocation.*
- ***Real estate:*** *The steeper-than-expected recovery could boost the leasing market and 2022 could be a solid year for real estate. The keys for success will be to focus on quality and the repositioning of properties to match tenants' post-pandemic needs in terms of technology and make environmental, social, and governance (ESG) a key operational component of investment and management procedures.* ***Offices*** *will remain an important part of investors' real estate portfolios, mainly due to the depth of this market. However, the adjustment cycle for offices will be long. Demand for office space is likely to be concentrated on modern buildings in major cities and inter-city centres that are close to transport links.* ***Logistics*** *has been among the big winners of the crisis. The sector is still experiencing strong demand on the back of booming e-commerce and more fragmented supply chains and this should continue in 2022.* ***Residential:*** *demographic changes have accelerated, impacting the residential market, with many provincial towns (with a good level of transportation connectivity to the main cities) experiencing a resurgence. There is still a demand-supply mismatch for second-tier urban areas, which is creating some tension in a competitive market.*

[1] Source: Amundi CASM model, Amundi Quant Solutions and Research teams, Bloomberg. Data is as of 20 April 2021, macro figures are as per latest release. Expected returns are not necessarily indicative of future performance, which may differ significantly. **Past performance is not indicative of future results**. Returns on credit asset include default losses. Forecasts for annualised returns are based on estimates and reflect subjective judgments and assumptions. These results were achieved by means of a mathematical formula and do not reflect the effects of unforeseen economic or market factors on decision-making.

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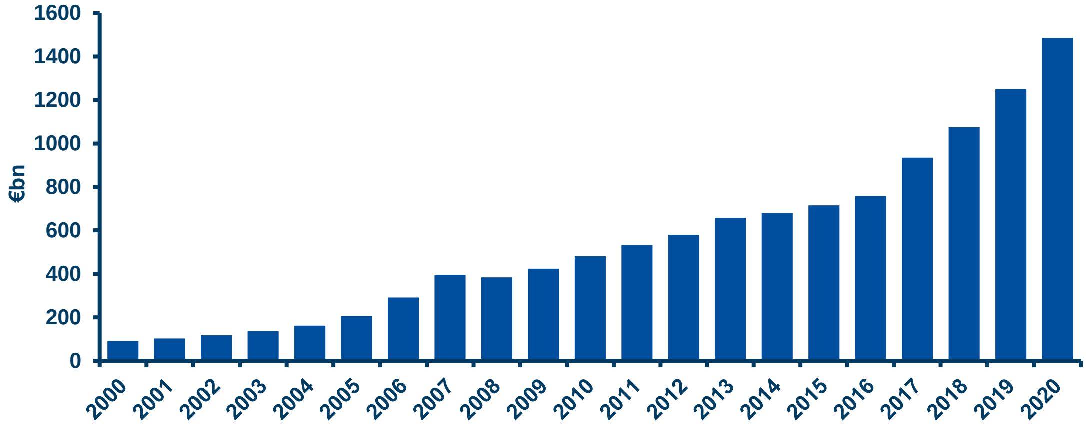
Guy LODEWYCKX
Head of Private Markets Multimanagement

Aided by unprecedented levels of government support, the economy is experiencing a steep recovery that hides divergences and fragmentation at a sector level, as well as a period of intense disruption in the economic system, as shown in statistics on energy prices, automobile production and sea freight. After decades of disinflationary forces, we see a resurgence of inflation on the back of shortages and hyper-consumption. While the market debates if this will be temporary or structural in nature, the ruptures in supply chains and the consequences of these on the rate of inflation could endure and complicate the task of central banks in the coming months.

In this context, real assets and private markets can be seen as a haven of stability for investors, which is reflected in market figures. According to Preqin, AUM of real and private asset funds in Europe grew by almost 19% in 2020 to reach €1.486 billion (excluding hedge funds)[2], and fundraising in H12021 reached 59% of the 2020 total – which represents the second highest level on record. Europe now represents 24% of global alternative AUM[3].

Europe-based alternatives assets under management (AuM), 2010-2020



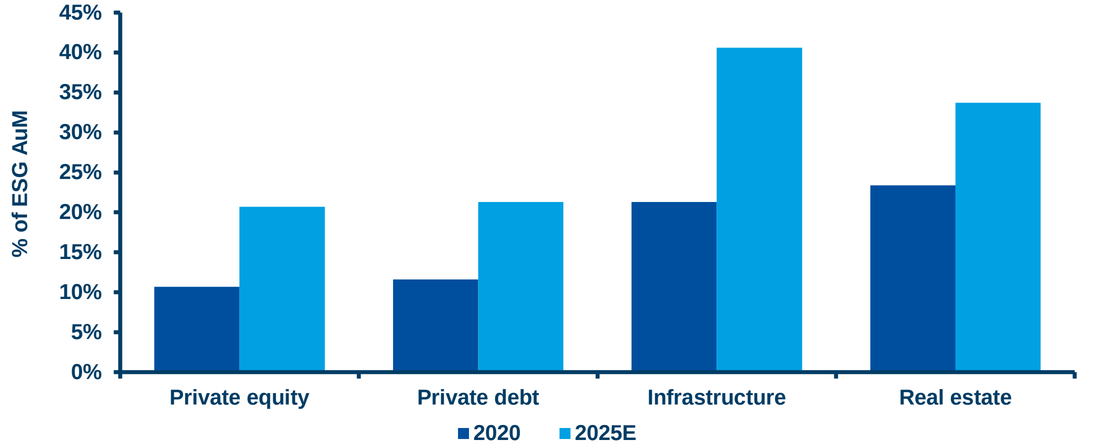
Source: Amundi based on Preqin Pro data as of July 2021. Fund of funds, hedge funds and secondaries are excluded to avoid double counting. Natural resources includes natural resources and timberland fund types only to avoid double counting.

However, in this uncertain and disrupted environment, where dispersion of performance is high, investing successfully in real assets involves a long-term horizon, powerful deal sourcing, stringent asset selectivity, robust operational infrastructure and financial robustness. This framework is more critical than ever for selecting assets with the best risk-return profiles, capturing the different expected return premiums and building resilient portfolios.

We believe that investors should consider 'core' strategies which have historically proved to be less volatile and shown more stable income generation, including during times of crisis: 'core' and 'core plus' assets in real estate and infrastructure, senior secured instruments in private debt, primary buyouts and growth capital in private equity.

[2] Preqin's 2021 Alternative Assets in Europe Report.
[3] Preqin's 2021 Alternative Assets in Europe Report.

ESG will gain traction in European private markets



Source: Amundi on PWC: *EU Private Markets: ESG Reboots*, October 2022.

Thierry VALLIERE
Global Head of Private Debt

Private debt supported by rising demand for company financing after the crisis

In the aftermath of the Covid-19 crisis, financing earmarked for the recovery and the needs of corporations will create significant opportunities in the private debt space for 2022 and beyond. We see strong demand from companies, either to aid post-crisis rebounds or to address areas of underinvestment highlighted by the pandemic, e.g., in digital infrastructure and supply chains. The need to reduce debt is also driving interesting asset disposal opportunities. In contrast, bank-financing remains constrained, as banks focus on managing their own portfolios, which will open up some interesting opportunities for private debt managers.

Selectivity will be paramount on both a geographical and sector basis in a challenging market where we see pockets of strength and weakness in the asset class. **There is a divergence taking place between the best credits, where competition is fiercer than ever** – driving pre-emptive offers and shorter due-diligence periods – **and more complex situations** in areas such as tourism, events or other sectors where visibility remains poor in the short term. Hence, we are observing a flight to quality as investors wish to protect themselves from the situation potentially deteriorating as government support winds down, which could see a rise in default rates.

This is driving a search for conservative investments with limited risk, such as senior secured debt strategies, which historically show stable income streams and consistent premium returns over liquid and traditional debt, with modest drawdowns over the long term. Since it emerged as an asset class ten years ago, private debt has been an important contributor to economic growth, thanks to the support it provides to the real economy as a complement to banking intermediation and we strongly believe that this trend will accelerate in the post-pandemic world, creating appealing investment opportunities for long-term investors. In addition, the asset class is experiencing a strong development of sustainable-linked financing. Consequently, **we are confident that in the next five-ten years, ESG will be embedded fully within the financial risks facing companies so that markets will value private credit accordingly.**

Matthieu POISSON
CIO – Infrastructure

Infrastructure: focus on the energy transition

With governments increasingly relying on infrastructure investment to stimulate economies and deliver climate-focused policies, the asset class has been a bright spot throughout the Covid-19 crisis. **Private capital is much needed here to complement public funding, which will give infrastructure investment strong momentum in the year ahead and beyond.** In addition, the asset class has proven its ability to thrive during a challenging period, with unlisted infrastructure funds delivering a 13.4% one-year internal rate of return to Q1 2021. Few investors were exposed to infrastructure during the 2008-09 Great Financial Crisis. The Covid-19 crisis has been a real-time test for the asset class and, in the aftermath of the crisis, investors are praising its now proven ability to resist market turbulence. Such stability confirms a core feature of infrastructure: its long-term time horizon. Prices may be more attractive in some sectors today, but it will not make a big difference in terms of returns in the long run. **Buy-and-hold strategies are gaining more traction in this environment.**

In terms of sectors, the pandemic has not only brought the need for health and communications infrastructure to light, but also **stressed the urgency of the energy transition**. A significant share of the EU 2021-27 multi-year budget and of the Next Generation EU plan has been committed to the green transition and to digital infrastructure. In 2021, we have seen a sharp acceleration in the number of transactions, especially for energy transition assets, that are likely to attract significant private capital flows.

Stanislas CUNY
Head of Direct Private Equity

Private equity will be key to finance the post-crisis recovery

Private equity continues to hit records numbers as it experiences strong post-pandemic growth on the back of a steeper-than-expected economic recovery. According to Preqin's 2021 Alternative Assets in Europe report, in Q3 2021 buyout deals doubled to 1,042 compared to Q1 2021 and a record 5,284 private equity funds were in the market at the start of Q3, targeting $899 billion in total[4]. 2022 is looking bright for private equity firms. **Post-crisis periods are historically the best times to invest in private equity**, as the demand for capital from unlisted companies increases significantly. During the Covid-19 crisis, privately owned companies massively used debt and capital expenditure to finance the downturn and sometimes the shutdown in activity, notably with recourse to state-guaranteed loans as well as deferrals of all kinds.

With many companies weakened by the crisis, sector consolidation has been accelerating, creating plentiful investment opportunities for private equity funds. In addition, strong equity markets since Q2 2020 have translated into a buoyant exit market, not just for IPOs, but also for trade sales and refinancing.

Finally, **the adoption of existing technological or environmental trends has been accelerated by the pandemic and investors are willing to bid up the valuations of companies on the right side of these changes.** The Covid-19 crisis has shone a light on several market disruptions in technology, the environment, demographics, societal changes and globalisation or relocation. Some companies are well positioned to benefit from such trends that existed before the crisis but have been strengthened over the past two years. The environment megatrend is at the heart of all post-pandemic stimulus packages in developed countries and particularly in Europe.

[4] Preqin's 2021 Alternative Assets in Europe Report.

Marc BERTRAND
CEO, Amundi Real Estate

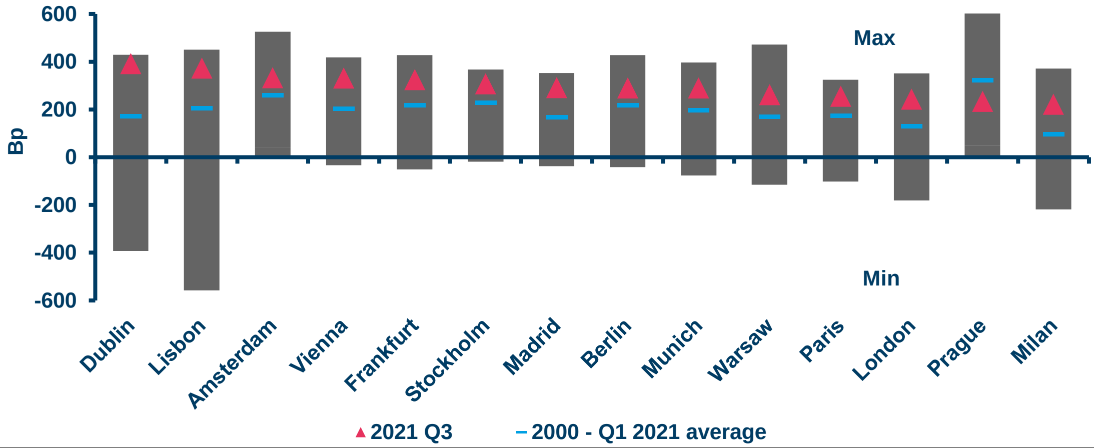
Real estate: divergences and ESG in focus

The steeper-than-expected economic recovery could boost the leasing market and 2022 could be a solid year for real estate activity. There are a record 1,284 private real estate funds worth an aggregate target of $365 billion, according to Preqin's 2021 Alternative Assets in Europe report. **Work on quality and the repositioning of properties to match tenants' post-pandemic needs in terms of technology make ESG a key operational component of investment and management procedures:** these are our strong convictions in the post-crisis environment. We have a positive view for new and recent prime buildings in major urban centres where it is easier and cheaper to implement technological or high ESG standards:

- **Offices: we believe that offices will remain an important part of investors' real estate portfolios**, mainly due to the depth of this market. However, the adjustment cycle for office real estate will be a long one, where we expect to see an increase in collaborative installations and services, as well as greater geographic polarisation. **Demand for office space is likely to be concentrated on modern buildings in major cities and inter-city centres** that are close to both regional transport links and mainline hubs. The best quality assets in the office sector have remained relatively unscathed, proving that offices still drive corporate culture, brand and team building.
- **Logistics has definitely been among the big winners of the crisis.** The sector is still experiencing strong demand, even in peripheral urban zones, on the back of booming ecommerce and more fragmented supply chains. Strong rental demand in a context of limited supply in the most sought-after locations is pushing rents higher.
- **Residential:** demographic changes have accelerated during and post-Covid-19, which has had a direct impact on the residential market, with many provincial towns (with a good level of transportation connectivity to the main cities) experiencing a resurgence. However, there is still a mismatch between the supply and rising demand for these second-tier urban areas, which is creating some tension and ongoing adjustments in a very competitive residential market.

"Work on quality and the repositioning of properties to match tenants' post-pandemic needs in terms of technology make ESG a key operational component of investment and management procedures."

Spread between office prime yields and domestic ten-year government bond yields since 2000, end of period



Source: Amundi Immobilier on CBRE Research (Q3 2021), ECB, and BoE data. Data is as of 9 December 2021.

AMUNDI INVESTMENT INSIGHTS UNIT

The Amundi Investment Insights Unit (AIIU) aims to transform our CIO expertise, and Amundi's overall investment knowledge, into actionable insights and tools tailored around investor needs. In a world where investors are exposed to information from multiple sources we aim to become the partner of choice for the provision of regular, clear, timely, engaging and relevant insights that can help our clients make informed investment decisions.

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Definitions

- **Basis points**: One basis point is a unit of measure equal to one one-hundredth of one percentage point (0.01%).
- **Core plus real estate investment strategy:** 'Core plus' is synonymous with 'growth and income' in the stock market and is associated with a low to moderate risk profile. Core plus property owners typically have the ability to increase cash flows through light property improvements, management efficiencies or by increasing the quality of the tenants. Similar to core properties, these properties tend to be of high quality and well occupied.
- **Core real estate investment strategy:** 'Core' is synonymous with 'income' in the stock market. Core property investors are conservative investors looking to generate stable income with very low risk. Core properties require very little handholding by their owners and are typically acquired and held as an alternative to bonds.
- **Default rate:** The share of issuers that failed to make interest or principal payments in the prior 12 months. Default rate based on BofA indices. Universe consists of issuers in the corresponding index twelve months prior to the date of default. Indices considered for corporate market are ICE BofA.
- **Diversification:** Diversification is a strategy that mixes a variety of investments within a portfolio, in an attempt at limiting exposure to any single asset or risk.
- **IPO: initial public offering.** It is a public offering in which shares of a company are sold to investors.
- Office vacancy rate: Share of unoccupied office space immediately available relative to all existing office space.

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