INVESTMENT OUTLOOK | H2 2022

Life above zero: investors' journey at a time of rising rates

Marketing communication

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TOP CONVICTIONS

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1. The H2 economic outlook will feature divergences in growth, inflation and policy mix across regions. Stagflation risk will be a common feature across Developed Markets (DM). In addition, since there will no longer be a synchronous global cycle, country risk is back.
2. The US economy is heading for a soft landing, while the Eurozone is fragile, hit by rising energy prices. China growth should rebound in H2, thanks to policy support.
3. Inflation may be close to a peak, but will stay high due to deglobalisation, supply bottlenecks, high commodity prices and upbeat US wage growth. A psychological dimension is also kicking in.
4. Central Banks will act to curb inflation at a time of slowing growth, high debt and fragmentation risk in financial markets. They will not go too far, and markets have already priced in most of their new hawkish stance.
5. Fiscal stimulus is mostly behind us, with some country-specific room available, particularly in Europe and China. In the United States, fiscal space is non-existent ahead of mid-term elections.
6. The depth of the equity sell-off has helped absorb overvaluations but it has not incorporated a deterioration in corporate fundamentals. Risks remain in the growth space. The buying signal for risky assets will depend on bond yield's capacity to stabilise. Although the global repricing is still underway, this prospect does not appear so distant.
7. We are cautious on DM equities, as the earnings outlook remains too optimistic. Tactically, we favour US over EU equity and China should benefit from an economic rebound in H2. Quality, value and dividend stocks should outperform.
8. In fixed income, some value is back in government bonds. It is time to move to a neutral duration stance and play monetary policy divergences. Chinese bonds remain good diversifiers.
9. The search for yield at all costs is over. In credit, we favour US IG credit, as Fed action should not significantly affect demand-supply dynamics.
10. Unstable cross-asset correlation dynamics will require investors to seek additional diversification in commodities, currency and alternative strategies that exhibit low correlation with equities and bonds.

Source: Amundi Institute as of 16 June 2022.

IN SEARCH OF A NEW POLICY MIX AMID RISING RISKS

Assessing the key themes for investors in H2 2022

Pascal BLANQUÉ,
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We started the year with expectations of strong growth and high inflation throughout the first part of 2022. **The Russia-Ukraine war accentuated the inflationary trend, now well above Central Bank (CB) targets, which is now set to persist longer than expected.** This triggered a sharp repricing in financial markets, starting with bonds where the amount of global negative-yielding debt plunged from over $11tn at the start of the year to below $2tn as of mid-year. The repricing has also widened to risky assets, particularly those areas of extreme valuations in the growth space. Moving into H2, it will be key to assess the growth / inflation pattern and the policy mix.

Rising recession risk amid high inflation

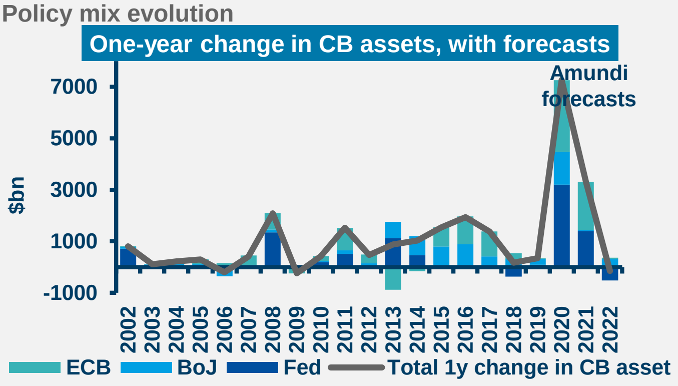
We expect economic momentum to slow in H2, as inflation acts as a regressive tax on consumers with huge divergences across regions, countries and sectors. However, **we do not foresee a global recession.** Inflation might be close to peaking in most areas, but we expect the inflationary environment to persist in 2022 and 2023.

- The **US economy is set to slow to below pre-crisis levels**, though it will avoid stagnation under our main scenario. In this respect, we need to monitor mortgage rates, corporate earnings and wage rises to get a clearer picture of economic fundamentals.
- The **Eurozone economy is facing tougher challenges**. Growth should stagnate in 2022, with huge divergences. Germany and Italy may actually experience a technical recession due to their dependence on Russian energy, while inflation should close the year at 7-8%. Two dynamics to look out for are energy prices – the main inflation driver – and food prices.
- **We are cautious on China's prospects, although the worst is likely behind us**. We expect full-year growth below the government's 4% target due to the fallout of Covid-19 curbs, with the bottom probably being hit in Q2 and a recovery in H2. Divergences have heightened **across Emerging Markets (EM)**. In this respect, we favour commodity exporters and countries with significant policy room, e.g., Brazil, South Africa and Indonesia, while countries highly exposed to the Russia-Ukraine war and commodity importers look less appealing (more on p. 7).

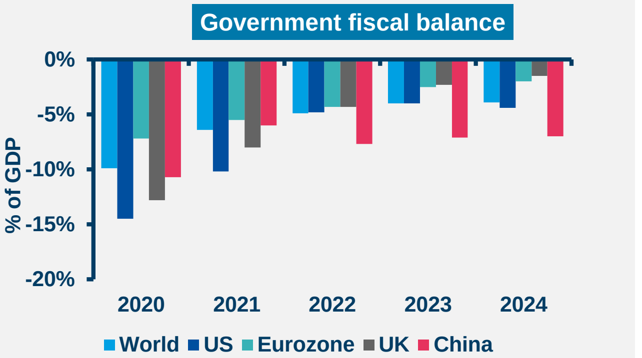
New policy mix and policy mistakes

The policy mix will hold the key to the cycle. CBs' task will be challenged by a combination of slowing growth and high inflation. They will need to coordinate their efforts with fiscal authorities, as the Covid-19 era budget '*bonanza*' is likely to be over, but wide divergences are likely across regions. On one side, **China has ample room to be accommodative, while Western CBs are tightening aggressively** to tackle high inflation. We foresee further Fed rate hikes for 175 bp overall, on top of what has been done in H1. The ECB will start its hiking cycle aggressively in July, while putting in place an anti-fragmentation tool to prevent excessive peripheral spread widening. EM countries are split on the policy front: a few are in control of inflation, while others are not. The latter include Eastern European countries, stuck with high rates of inflation. We believe the most likely option is some fiscal expansion such as the Next Generation EU plan in Europe and a little extra stimulus in the United States amid the upcoming mid-term election, coupled with some CB tightening, though it will remain 'behind the curve'. The outcome would be still high inflation accompanied by a controlled economic slowdown, yet with increasing risks on the economic front. Such a combination would lead to a difficult market environment, which demands the inclusion of inflation-sensitive stocks and some geographical rotation. **A policy mistake – no fiscal expansion, coupled with full monetary normalisation – is one of the main risks to watch out for, as this would end the cycle.**

Policy mix evolution



Source: Amundi Institute, Datastream. Data is as of 19 May 2022. CB: central banks.



Source: Amundi Institute, IMF Fiscal Monitor, April 2022. Forecasts are by the IMF.

Building *stagflation*-proof portfolios

In a fragmented world featuring high inflation, a growth slowdown and falling global liquidity, investors need to look for sources of positive real return and gain exposure to assets that can protect against high inflation and low growth. Investors should look for opportunities that may arise from a de-synchronised cycle and different paths in fiscal and monetary policy. At the same time, they should increase portfolio diversification, including strategies on currency markets and strategies targeting absolute real returns, while carefully monitoring liquidity conditions.

Following the **great asset repricing of H1**, the strong relative appeal of equities versus bonds has eroded and **bond investing is becoming more attractive. For H2, we think investors should opt for a balanced / cautious allocation to risk assets, while focusing on increasing the diversification axis.**

In **fixed income it is time to move tactically to a neutral duration stance and play divergences in monetary policy.** However, we believe it is not yet time to go overweight duration. We may reach such a position if growth disappoints and CBs become more accommodative. On peripheral bonds, we maintain a neutral stance and remain watchful on the ECB's action. Inflation-linked securities and floating rates are part of the toolbox for building portfolios that are resilient to inflation.

The search for yield at all cost is over. In **credit**, investors should **focus on quality** and low-leverage companies, and areas resilient to a slowdown, such as US IG. Investors can find **opportunities in selective EM bonds** with the potential to deliver positive real returns. Our preference is for hard-currency debt and selective HY. The low appetite for local debt could selectively turn more constructive for those countries at the end of their tightening cycle. **Chinese bonds are another appealing area in the search for diversification**, as the People's Bank of China (PBoC) has not embarked on unorthodox policies and is currently easing, in contrast with the West**.**

Equity repricing has helped clean up some excess valuations. Moving into a late cycle with inflation pressures, investors should focus on resilient businesses within those sectors more correlated to inflation dynamics. At a regional level**, US equities appear more resilient than EU ones,** as we foresee a profit recession in the EU. Yet, the US equity market is not cheap, despite the large correction.

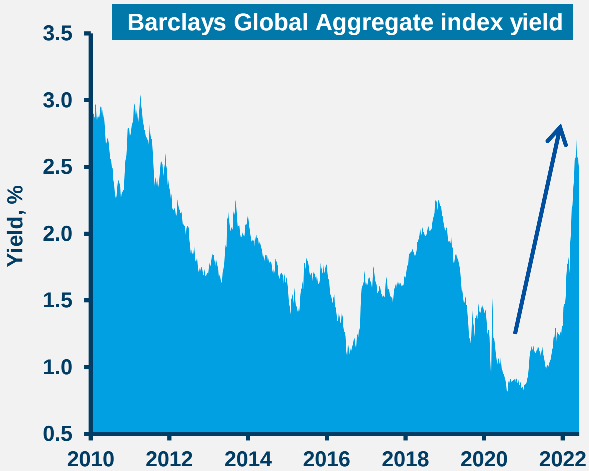
In terms of styles, value, quality and dividends are a good mix. Value should benefit from rising real rates, peaking inflation and eventually wider HY spreads. Finally, dividends usually follow inflation and represent a key component of returns when inflation is high. While staying neutral overall in EM equities, **we are becoming positive on Chinese equity**. This should benefit from the reopening of the economy, which should recover in H2, and A-shares are insulated from the developed world. On a medium- to long-term perspective, equities remain the engine of returns. They will normalise and be more aligned with fundamentals in a range of 5-7% growth at best.

As the negative correlation between bond yields and risky assets – with bond yields leading - logically reasserts itself in a more inflationary regime, **the buying signal for risky assets will depend a lot on the capacity for bond yields to stabiliz**e at least. **This may prove not such a distant prospect though the global repricing still does not seem at completion.**

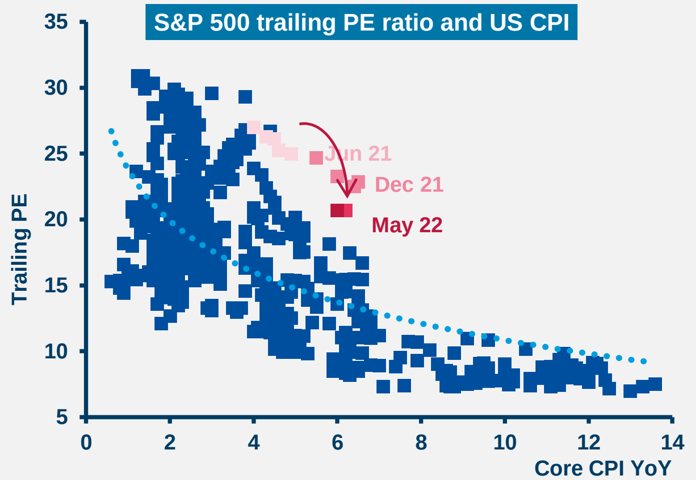
Regarding **real assets**, we favour real estate and infrastructure as an inflation hedge and private debt with floating rates, while we are more cautious on private equity markets, amid some areas of excess valuations. Given currently high geopolitical tensions, **commodities** – especially oil and gold – could be a good short-term hedge against geopolitical risk.

On **currencies**, we believe the dollar should stay strong and hit parity against the euro based on both a fundamental and technical basis. Meanwhile, we expect the renminbi to stop weakening and improve in the medium term. More generally, we are constructive on EM currencies.

Bonds and equity repricing



Source: Amundi Institute. Analysis on latest weekly data from Bloomberg. Data is as of 14 June 2022.



Source: Amundi Institute, Bloomberg, latest monthly data is as of 13 June 2022. Data starts from January 1970.

H2 2022 THEMES FOR THE GLOBAL ECONOMY

Stagflation risk rising amid divergences

Global economy is slowing, due to the fallout from the Russia-Ukraine war, supply bottlenecks and China's zero-tolerance Covid-19 policy. CBs will tighten financial conditions to tame persistent inflation. A global recession is not our main scenario, but there are areas of strong vulnerability such as Europe, areas for attention such as the US consumer, and potential sweet spots such as China in H2.

Policy mix: in search of a new balance

The policy mix will need to find a new balance as most DM CB have embarked on rate hiking cycles or will start soon, removing the Covid-19-era policy accommodation. Fiscal deficits will fall but should remain above pre-pandemic levels. **Cooperation between monetary and fiscal policy will also be required to address the issue of debt sustainability**.

Geopolitical shock waves and political noise

The war in Ukraine will have **long-lasting consequences on the global geopolitical landscape and international alliances.** A **likely political gridlock in the United States** following the US mid-term election would challenge US geopolitical power and lower the potential to deliver on the fiscal front. Short term, this could put some less market friendly reforms on hold, which would be positive for markets.

EM and China: fragmentation has increased further

The Russia-Ukraine war will exacerbate divergences further. Accordingly, the CB response will vary worldwide. **Commodity exporters and countries with policy room** are favoured. **China's economy is close to a turning point** due to its policy accommodation, but is still impacting some Asian countries.

> ***"In H2 higher stagflationary risks will call for caution, but diverging economic and inflationary paths will offer opportunities."***

Source: Amundi Institute as of 17 June 2022. DM: developed markets. EM: emerging markets. CB: central banks. PBoC: People's Bank of China.

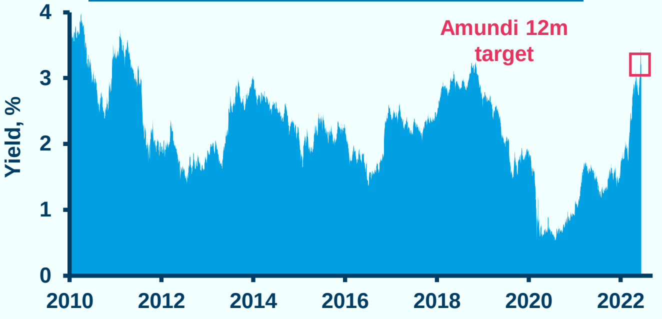
Amundi ASSET MANAGEMENT

INVESTMENT THEMES FOR H2 2022

Bonds: rebuild core bond allocation after the great repricing

- It is time to go back to neutrality in duration, government bonds, credit IG, and some EM bonds.
- Include Chinese bonds for diversification purposes and green bonds in the core allocation.
- Prefer quality credit and stay selective on high-yield credit and watchful of liquidity risks.

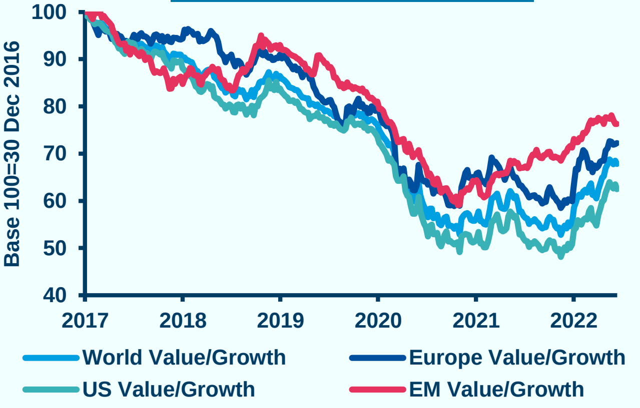
US ten-year nominal yields already at 12M target



Equity: play value and quality, US earnings resilience, and China's reopening

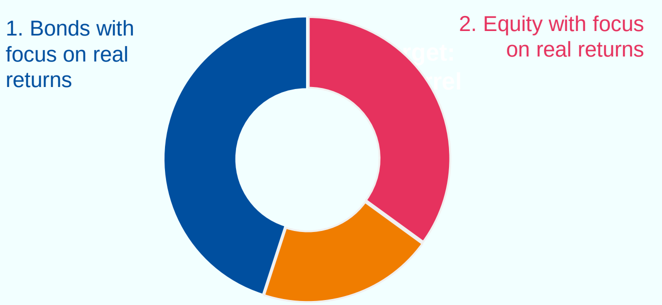
- Focus on value stocks with a quality tilt and appealing dividends.
- In the short term, the Unites States is favoured over Europe thanks to stronger fundamentals.
- China may be back in H2, alongside its economic recovery.

Value vs. Growth performance



Add inflation-sensitive diversifiers amid break-up of correlation dynamics

- More unstable cross-asset correlation dynamic will require investors to seek additional diversification and focus on real returns.
- Include commodities, currencies, and alternative strategies with low correlation to equities and bonds.
- Real assets are favoured in a higher inflationary backdrop, with a focus on infrastructure, real estate and floating private debt.



3. Inflation-sensitive diversifiers:
- Commodities
- Currencies and absolute return strategies
- Real assets

Source: Amundi Institute, Bloomberg. Data is as of 16 June 2022. Value and Growth indices are from MSCI. **For illustrative purposes only..**

AMUNDI ASSET CLASS VIEWS

	Asset class	Current positioning	Expected positioning H2 2022
EQUITY PLATFORM	United States	=/+	=/+
	US value	+	+
	US growth	-	-
	Europe	-	=
	Japan	=	=
	China	=/+	=/+
	Emerging markets ex-China	-/=	=
FIXED INCOME PLATFORM	US govies	=	=
	US IG corporate	=/+	=/+
	US HY corporate	=	=
	European govies (core)	=	=
	European govies (peripherals)	=	=
	Euro IG corporate	=	=
	Euro HY corporate	=	=
	China govies	=/+	=/+
	EM bonds HC	=/+	+
	EM bonds LC	=	=
OTHER	Commodities	+	+
	Currencies (USD vs. G10)	+	+

-- - = + ++

Negative Neutral Positive

Source: Amundi Institute as of 23 June 2022.

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Definitions and abbreviations

Alpha: The additional return above the expected return of the beta-adjusted market return; a positive alpha suggests risk-adjusted value is added by the money manager compared with the index.
Beta: Beta is a risk measure related to market volatility, with 1 being equal to market volatility and less than 1 being less volatile than the market.
Correlation: The degree of association between two or more variables; in finance, it is the degree to which assets or asset class prices have moved in relation to each other. Correlation is expressed by a correlation coefficient that ranges from -1 (always move in opposite direction) through 0 (absolutely independent) to 1 (always move in the same direction).
Credit spread: The differential between the yield on a credit bond and the Treasury yield. The option-adjusted spread is a measure of the spread adjusted to take into consideration the possible embedded options.
Currency abbreviations: USD: US dollar, JPY: Japanese yen, GBP: British pound, EUR: euro, CAD: Canadian dollar, SEK: Swedish krona, NOK: Norwegian krone, CHF: Swiss Franc, NZD: New Zealand dollar, AUD: Australian dollar, CNY: Chinese renminbi.
Cyclical vs. defensive sectors: Cyclical companies are companies whose profit and stock prices are highly correlated with economic fluctuations. Defensive stocks, on the contrary, are less correlated to economic cycles. MSCI GICS cyclical sectors are: consumer discretionary, financial, real estate, industrials, information technology and materials. Defensive sectors are: consumer staples, energy, healthcare, telecommunications services and utilities.
Duration: A measure of the sensitivity of the price (the value of principal) of a fixed income investment to a change in interest rates, expressed as a number of years.
FX: FX markets refer to the foreign exchange markets, where participants can buy and sell currencies.
High growth stocks: A high growth stock is anticipated to grow at a rate significantly above the average growth for the market.
Liquidity: The capacity to buy or sell assets quickly enough to prevent or minimise a loss.
PE ratio: The price-to-earnings ratio (PE ratio) is the ratio for valuing a company that measures its current share price relative to its per-share earnings (EPS).
Quality investing: This means to capture the performance of quality growth stocks by identifying stocks with: 1) A high return on equity (ROE); 2) Stable year-over-year earnings growth; and 3) Low financial leverage.
Quantitative easing (QE): QE is a monetary policy instrument used by central banks to stimulate the economy by buying financial assets from commercial banks and other financial institutions.
Quantitative tightening (QT): QT is a contractionary monetary policy aimed to decrease the liquidity in the economy. It means that a CB reduces the pace of reinvestment of proceeds from maturing government bonds. It also means that the CB may increase interest rates as a tool to curb money supply.
Value style: This refers to purchasing stocks at relatively low prices, as indicated by low price-to-earnings, price-to-book and price-to-sales ratios, and high dividend yields. Sectors with a dominance of value style: energy, financials, telecom, utilities, real estate.
Volatility: A statistical measure of the dispersion of returns for a given security or market index. Usually, the higher the volatility, the riskier the security/market.
Yield curve flattening: An environment in which the difference (spreads) between yields/rates of short-term and long-term bonds of the same credit quality reduces.

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