

A photograph of several hurdles on a red running track, arranged in a line that recedes into the distance. The hurdles have white tops and red bases. The track has white lane markings.

Research

#12
December
2021

CROSS ASSET Investment Strategy

CIO VIEWS

The “real” puzzle

THIS MONTH'S TOPIC

Q3 earnings season: results better than expected but doubts remain about next year

Confidence
must be earned

Amundi
ASSET MANAGEMENT

#12 - December 2021

Table of contents

Global Investment Views

CIO Views

The “real” puzzle

p. 3

Central banks are sticking to their temporary inflation narrative, even though the latest CPI readings support the “sticky” narrative. We think, investors should look for ‘real’ returns in credit offering higher yields, together with real assets. In addition, we maintain an overall neutral stance in equities, but prefer value, quality and dividend stocks that can complement investor income. However, on government bonds we remain cautious overall but recommend investors to stay flexible. There is a need to explore a wide array of assets as the real value left in the markets is not abundant.

Macro

Chinese growth to stabilise in 2022

p. 4

2021 has seen unprecedented regulatory changes amid the Common Prosperity pursuit. But policy clarity and coordination ahead should aid China’s structural transition.

Multi-asset

Look for upside potential while limiting the downside

p. 5

While remaining neutral on risk assets and diversified overall, there are selective opportunities to benefit from the mild, near term upswing in equities through options.

Fixed income

Direction of real rates in focus

p. 6

Central banks embrace a benign neglect approach to inflation and stay behind the curve. Investors should stay active and monitor the direction of real rates which will affect asset valuations.

Equity

A positive earnings season, with some clouds

p. 7

Equities still offer attractive risk-adjusted returns, but the situation is more nuanced as inflation is a major issue for companies, underscoring the importance of selection.

Thematic Global views

Will the US policy mix “build back better”?

p. 8

On 19 November, the House of Representatives (HoR) passed the Build Back Better Act (BBB). The bill will now be considered by the Senate. This is a big step forward for the Biden administration, especially since this vote comes just after President Biden signed the infrastructure plan into law.

This Month’s Topic

Q3 earnings season: results better than expected but doubts remain about next year

p. 10

Q3 21 results were generally well above expectations, which was not taken for granted given the bottlenecks and higher input costs. However, the 2022 consensus remained very cautious, with EPS forecasts at best equivalent to nominal GDP growth! Good surprises cannot therefore be ruled out.

Thematics

Fed officials’ discomfort is growing with the inflation overshoot: why it will remain cautious

p. 14

US consumer prices jumped by 6.2% in October, their highest level in 30 years! Deteriorating inflation data have pushed markets towards forecasting a faster pace of tapering and a more rapid removal of accommodation in 2022. However, we expect the Fed to remain cautious as Covid remains a major risk and as long as inflation is not due to a tight labour market. The Fed will have a step-by-step approach and a rapid turnaround in strategy is possible. To a greater extent, a high level of debt, a tight valuation of assets, and the huge investments required to move to a low-carbon economy will limit the Fed’s ability to raise rates.

ESG bond market bound to deliver another record year of growth

p. 17

Global ESG bond markets are bound to deliver another record year of new issuance volumes, led by broad-based dynamic activity in all its major segments. In the first nine months of the year, combined global issuance of green, social, sustainability and sustainability-linked bonds were already equal to 145% of global ESG bond supply in full year 2020.

Geopolitics of the vaccine: variance risks

p. 21

Covid-19 vaccines have been rolled out for a year now. Despite official commitments to provide access to effective jabs to all countries, production constraints and national priorities have resulted in uneven distribution, with some countries close to 100% vaccination rates while others are still below 5%. More than a dozen vaccines are now available, but with different efficacy levels. As expected, the geopolitics of the vaccine have come into play. COVAX’s inability to reach its targets shows that, on top of real constraints, vaccines are soft power weapons that are being used for geostrategic purposes.

Market scenarios & risks

> Central & alternative scenarios

p. 25

> Top risks

p. 26

> Cross asset dispatch:

Detecting markets turning points

p. 27

> Global research clips

p. 28

> Amundi asset class views

p. 29

CIO VIEWS



Pascal BLANQUÉ,
Group Chief Investment Officer



Vincent MORTIER,
Deputy Group Chief Investment Officer

The “real” puzzle

Halloween ‘ghosts’ of Fed tapering, the Evergrande crisis, and the earnings season did not scare the markets. The Fed telegraphed its message well: while keeping the option to adjust tapering depending on the state of the economy, it reiterated the “transitory” inflation narrative. The BoE proved more dovish than expected, actually keeping rates unchanged (‘benign neglect’) regarding inflation risk. As a result, nominal yields declined and real yields fell to near new record lows. **Although CBs are sticking to their temporary wording, our view, in contrast, is that the latest CPI readings support the “sticky” narrative.**

On equities, the earnings season has overall been strong. Another area for concern, the possible default of Evergrande in China, was averted once again and we expect policy intervention to kick in to avert a default again, if necessary. In the US, even as President Biden reappointed Powell as Fed Chair to ensure continuity in monetary policy, he confirmed Brainard as the Vice Chair. But some volatility will likely return amid Democrats’ efforts to pass the Social Infrastructure Bill through the Senate (due to be passed before 13 Dec.). The path looks uncertain, as does the final total amount of the package.

Lastly, we have entered a new Covid wave. Moving into the winter season in Europe and the US, cases will rise. However, we don’t expect this to derail the growth outlook, thanks to vaccination campaigns. On the other hand, it is difficult to see any significant upside after the recent highs in equities: Santa Claus gifts have arrived already. Range-bound equity markets and volatile bonds, with reduced liquidity across the board, is the most likely scenario through year-end.

Against this backdrop, we keep our neutral stance in equities and short duration view in core bonds, and a mildly positive view in credit and peripheral bonds. In terms of portfolio construction, targeting real returns will be the name of the game.

- **Overall asset allocation will continue to favour equity**, as no other choices are available moving to a late cycle. The equity stance will likely shift from neutral to a tactical overweight once the economy reaccelerates in Q2/Q3 2022. But the need for hedges will remain high as the risk of policy mistakes is on the rise. We also recognise that equity exposure has risen to a peak in the cycle, favouring DM and in particular the US, where valuations are now extreme. With the recovery broadening towards EM, where allocation has fallen below strategic targets and return potential is higher, we expect investors to start to reallocate towards these markets in the search for attractive valuations. Overall in equities, areas of bubbles persist. We don’t know which companies lack pricing power (swimming naked) because discrimination on this basis is yet to happen in markets. So, investors should favour quality/value, dividend names and stocks that indicate sustainable pricing power (not easy to measure).
- **Credit with higher yields and short duration** may be the best means to navigate high inflation, but selection will be key as default rates will start to bottom out as financial conditions get less supportive.
- **Real assets will be favoured, as they can help in terms of inflation protection.** There are many opportunities in this regard. On private debt, the floating rates available in this market and the liquidity premium may help with seeking income opportunities that are more resilient to possible increases in core yields in a market in which financing demand is on the rise. Infrastructure investing is also seeing strong momentum amid opportunities linked to the energy transition and this is also generally an asset class that provides inflation protection. Private equity is key to financing the recovery and to seeking higher potential returns. Real estate could also offer selective opportunities in the recovery phase.
- **Some ESG risks are becoming real.** The COP26 meeting highlighted the need for urgent action on emissions reduction. The China-US last minute deal could mark a further reacceleration of this trend, which could lead to a rising demand from investors and eventually translate into higher market prices in a positive feedback loop.

We believe investors face a meagre real returns outlook for the next three years. In our view, a 60 equity/ 40 aggregate bonds portfolio’s real annual return could be close to zero both in the US¹ and Europe². **The investment puzzle for the future is how to increase real return potential. This will require grasping opportunities where available across all asset classes, as the real value left in the market is not abundant, underscoring the need for investors to maintain a wide arsenal of instruments.**

Overall risk sentiment



Amid asymmetric risks in the markets characterised by financial repression, we remain risk-neutral but watchful of any opportunity.

Changes vs. previous month

- ▶ Tactical adjustment to duration within the cautious ambit.
- ▶ Enhanced derivative exposure to play risk assets, raised protection.
- ▶ More vigilant on credit throughout.

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

¹ 60% S&P 500 and 40% US Aggregate Bond. Assumption of 3.2% inflation.

² 60% MSCI EMU and 40% Euro Aggregate Bond. Assumption of 2.1% inflation.

CROSS ASSET
RESEARCH ANALYSIS



Monica DEFEND,
Global Head of Research



Claire HUANG,
EM Macro Strategist

2021 has seen unprecedented regulatory changes amid the Common Prosperity pursuit. But policy clarity and coordination ahead should aid China's structural transition

Chinese growth to stabilise in 2022

The Chinese economy continued to suffer from its self-imposed policy constraints at the beginning of Q4, registering a weak recovery. The top culprits behind this slowdown are as follows:

- The zero-tolerance Covid-19 policy;
- Energy emission controls for high-polluting and high-emission sectors; and
- Tightening in the housing market since Q4 2020.

Nevertheless, the broad weakness in the economy has caught policymakers' attention. **In October, the National Development and Reform Commission (NDRC) stepped up significantly to boost coal production to address power shortage issues**, while some local governments began to remove energy use controls and resumed normal production. More relaxation is likely at the turn of the year, easing the pressures on the industrial side.

As for pandemic control and prevention, there appears to be little intent to change the zero-tolerance policy before the Beijing Winter Olympics (4-20 February). But given the high vaccination rate in China, we do expect some adjustments to domestic travel policies after February. Operational adjustments on housing policies are also under way.

That said, policy fine-tuning so far has been helpful in relaxing near-term liquidity pressures for developers, but this has not been material enough to change our assessment for a housing slowdown in the medium term.

Looking ahead, we expect the overall economy to restart its engine slowly, once the above-mentioned constraints are removed one by one. However, the housing sector deleveraging is most likely to continue

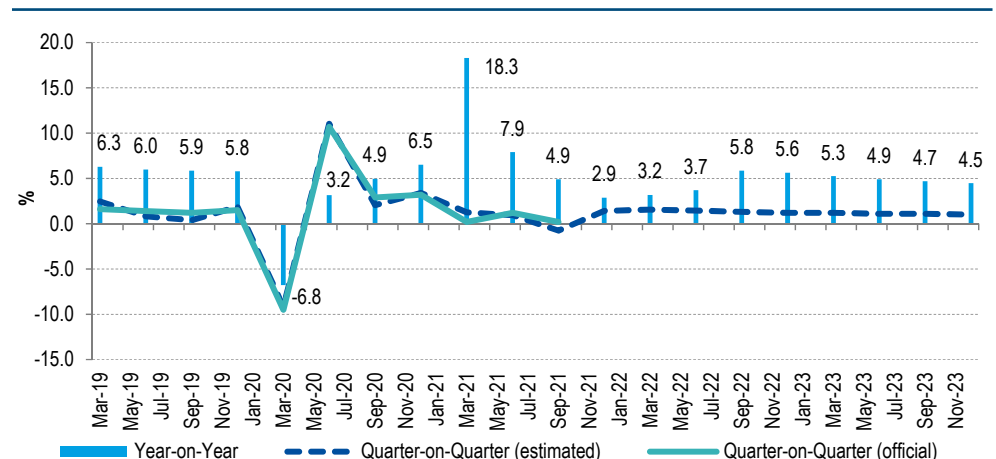
and it would be too complacent to expect another round of broad credit stimulus when the People's Bank of China's (PBoC) target is to keep a stable debt/GDP ratio. **Hence, we expect policy easing to remain targeted, and an exit from abrupt deleveraging and tightening to be sufficient to help stabilise growth.** We maintain our view that economic growth will rebound sequentially in Q4 from its dip in Q3 and then stay slightly below trend in 2022.

However, due to strong negative base effects, China's headline year-over-year growth should drop to just below 3% in Q4 and print in a range of 3-4% in H1 2022 before bouncing back to above 5%. The major downside risk to our forecast is a sharper housing slowdown without additional policy stimulus.

From an investor perspective, this calls for vigilance in the near term as the country navigates its way through regulatory changes and towards 'Common Prosperity.' Beijing's tolerance of slower growth has increased notably, but we expect increasing policy clarity and coordination to assist in this structural economic transition. **In the long term, we believe, these measures should reduce systemic risks, allowing us to explore opportunities through a selective lens.**

To conclude, Chinese assets, including the CNH, offer strong diversification benefits to global portfolios in the search for higher real income, supported by the country's expanding role in regional Asian trade and the government's desire to increase the international relevance of the currency.

China GDP growth (%)



Source: NBS, CEIC, Amundi Research, as of 16 November

MULTI-ASSET



Matteo GERMANO,
Head of Multi-Asset

While remaining neutral on risk assets and diversified overall, there are selective opportunities to benefit from the mild, near term upswing in equities through options

Look for upside potential while limiting the downside

The global growth outlook has weakened slightly amid the narrative of persisting stagflation risks, but markets seem to be ignoring this for the time being and are focusing on robust earnings and momentum. We acknowledge this strength but believe investor vigilance must be maintained in light of concerns over future margin pressures. As a result, the scope for active management is high in bonds as well as in equities because what appears cheap and attractive on the surface may not offer sustainable returns in long run. **We recommend that investors remain risk-neutral, looking for attractive entry points and exploring options to participate in any tactical upside.** In addition, amid tight valuations, hedges to protect equity and credit exposure should be considered.

High conviction ideas

While we maintain our overall neutral stance on DM and EM equities, we are monitoring the current stronger-than-expected earnings season, particularly in the US, which has highlighted that the impact of supply bottlenecks on corporate margins has been muted. In the US, we slightly revised upwards the level at which we think equities may be tactically attractive. However, we remain active on this front, looking for any sign of weakening pricing power for companies. Based on an overall neutral approach, investors should look at a wide array of instruments, including derivatives, to play potential further moderate upside in US equities, but they should stay well balanced and diversified. On EM, we keep a neutral stance and are watchful for any near-term weakness in China. **In bonds, we remain agile and identify opportunities from a tactical as well as long-term perspective across yield curves globally.** Thus, we are tactically neutral on 10Y USTs now, as yields approached our target levels. However, this doesn't represent any structural change to our cautious view on duration. In fact, we continue to see upside potential for yields in other shorter maturity segments on the Treasury curve. Secondly, UK 2Y yields also hit our target after the BoE's decision not to hike rates.

On Italian peripheral debt – ie, the 30Y BTP vs the Bund – we remain constructive, given that Italian Q2 and Q3 GDP growth surprised to the upside, resulting in an improvement in the ratings outlook. In Asia, we continue to be positive on Chinese government bonds on account of our expectations of stable rates in the near term, diversification benefits, and weakening economic growth in the country. But on EM bonds, we stay neutral.

Credit offers returns potential, especially EUR IG and HY, as spreads remained resilient to core yields, fundamentals and technicals are improving, and CBs maintained their support by keeping short-term rates anchored. In Europe, high-beta segments, such as HY and subordinated debt, are attractive areas to exploit amid the downward trend in default rates.

At a time when valuations in many corners of the markets are full, FX offers relative value opportunities. In general, the Fed's modest policy normalisation should be marginally supportive for the USD as we approach year-end. We like the FX carry basket favouring the GBP vs the CHF. However, against the USD and the EUR, we stay cautious on the GBP due to geopolitical issues and the effect of inflation on consumer purchasing power. In EM, we are constructive on the RUB/EUR due to the former's attractive valuation and the Russian CB's hawkish stance. In Asia, our positive view on the CNH/EUR remains in place as the country will continue to be the driver of regional trade and the government's objective of making China a global superpower should also be supportive of the CNH. However, we now believe that weakening capital flows to Korea could affect the won in the near term.

Risks and hedging

Despite continuing growth, the inflationary regime presents a high risk to the markets in terms of its potential impact. We think investors should use cost-efficient hedges to protect HY credit exposure while maintaining protection for their DM equity holdings.

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- to 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.

EM = emerging markets, FX = foreign exchange, IG = investment grade, HY = high yield, CBs = central banks, BTP = Italian government bonds, EMBI = EM Bonds Index.

FIXED INCOME

Direction of real rates in focus



Amaury D'ORSAY,
Head of Fixed Income



Yerlan SYZDYKOV,
Global Head of Emerging Markets



Kenneth J. TAUBES,
CIO of US Investment Management

CBs embrace a benign neglect approach to inflation and stay behind the curve. Investors should stay active and monitor the direction of real rates which will affect asset valuations

Economic growth remains strong, but projections point to a weakening environment (growth dispersion). On the other hand, inflation remains elevated, driven by a supply-demand mismatch, commodity prices, and pressures emanating from the labour market. Overshooting inflation is testing CBs' patience to act: the Fed announced tapering plans, as expected, but the BoE kept rates unchanged (CB asynchrony). We think markets are trying to judge the tolerance threshold of CBs to inflation even though the Fed clarified that 'transitory' inflation pressures from supply bottlenecks could last until H2 2022. As real yields continue to be at unsustainably low levels, **we remain cautious on govies and instead search for income in peripheral countries, DM credit and EM bonds through a very selective, active approach.**

Global and European fixed income

On duration, we are defensive but flexible in the US and core (slightly less so now) and semi-core Europe. We also remain cautious in the UK and Canada. However, on Italian peripheral debt (strong growth), China (diversification), and Australia, our constructive stances remain in place.

In credit, a positive outlook on ratings and Q3 results indicate no widespread warnings from supply bottlenecks. But volatility in core yields, dispersion in evolution of financial ratios, and year-end liquidity issues are potential fragilities.

We explore short-dated debt (low duration risk) with high spreads through higher emphasis on credit selection. We also see an acceleration in deleveraging in HY and BBB- compared to A-rated debt and continue to explore the rising star theme. While doing all this, we carefully monitor ESG dynamics and incorporate this factor into our overall selection process.

US fixed income

The markets seem to have bought into the Fed's temporary inflation narrative, despite the recent data and the rising political echo of the inflation theme. We also believe fiscal stimulus will recede, but not as much as market expects. Thus, we stay positive on breakevens (compared to Treasuries), but recommend some fine-tuning due to valuation concerns. On USTs, we are defensive, owing to higher government spending and debt, and continuing economic growth, but are tactically managing our stance. In credit, we remain moderately constructive in IG and HY through a more selective lens. Another source for yield is the consumer, residential mortgage and securitised markets amid robust consumer savings, but we are very vigilant. We also seek selective opportunities in securitized credit (RMBS, ABS).

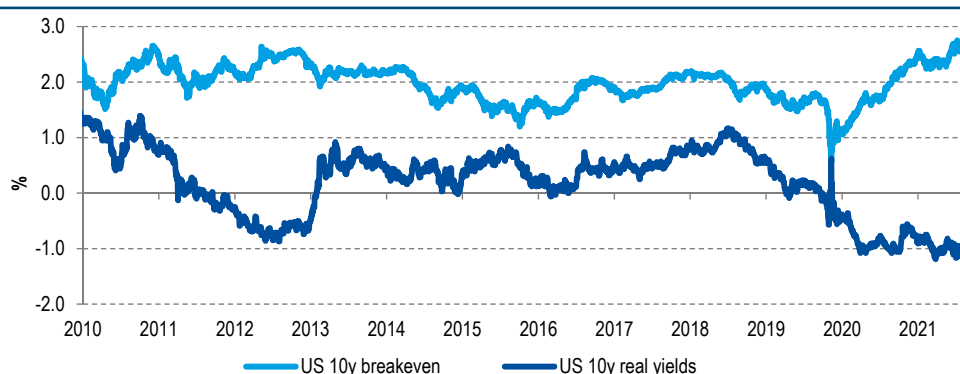
EM bonds

EM bonds are an area of interest, especially in a world of low yields and given our expectations of prudent policy normalisation by the Fed. We are positive on HC and keep our bias towards HY over IG, but are cautious on LC. Interestingly, upside inflation surprises continue to drive EM CBs to front load their tightening, notably across EEMEA and LatAm. We focus on commodity-driven countries (Russia) and sectors while we have turned vigilant on Brazil and Turkey.

FX

CBs' delays in hiking rates could affect FX and we are actively following these developments. We maintain our long view on the USD and given the BoE's recent decision, we are keeping a neutral view on the GBP. On EM FX, we are positive on the RUB, IDR and COP given their high carry and commodity exports.

The important variable is real yields, which remain low



Source: Amundi, Bloomberg, as of 16 November 2021

GFI = global fixed income, GEMs/EM FX = global emerging markets foreign exchange, HY = high yield, IG = investment grade, EUR = euro, UST = US Treasuries, RMBS = residential mortgage-backed securities, ABS = asset-backed securities, HC = hard currency, LC = local currency, CRE = commercial real estate, CEE = Central and Eastern Europe, JGBs = Japanese government bonds, EZ = Eurozone, BoP = balance of payments.

EQUITY

A positive earnings season, with some clouds



Kasper ELMGREEN,
Head of Equities



Yerlan SYZDYKOV,
Global Head of Emerging Markets



Kenneth J. TAUBES,
CIO of US Investment
Management

Equities still offer attractive risk-adjusted returns, but the situation is more nuanced as inflation is a major issue for companies, underscoring the importance of selection

Overall assessment

Markets have been buoyant in recent weeks, led by strong earnings, encouraging forward guidance and progress over economic reopening as multiples expanded. However, three factors stand out for us: inflationary pressures, relative and absolute valuations, and real rates. The last factor – ie, when rates start to rise – will challenge higher equity multiples and that could aggravate the distinction between companies that possess pricing power and those that do not. This, coupled with high valuation dispersion in the markets, underscores the importance of our disciplined bottom-up process through which we identify companies that have the ability to pass on rising costs to consumers. **Thus, it is an opportune time for selectively playing rotations favouring quality and value stocks.**

European equities

In an overall tilt towards economic reopening, we are exploring names in the value, quality and cyclical spaces, led by our selection efforts. We find such names in financials and industrials even though we are slightly less constructive. Robust earnings in this season from financials and cyclicals further convince us of our stance. At the other end of the barbell, we like names in defensive sectors (healthcare). **However, pricing power is key in a world of rising costs** and to judge this we evaluate a company's brand portfolio, intellectual property, etc. In contrast, we remain skeptical of hyper-growth tech names and discretionary sectors. ESG remains in focus amid momentum driven by policy measures such as EU green deal. Overall, we look at the E and S aspects as pools of opportunities that allow us to participate in the green transition and which could reduce inequalities without compromising returns.

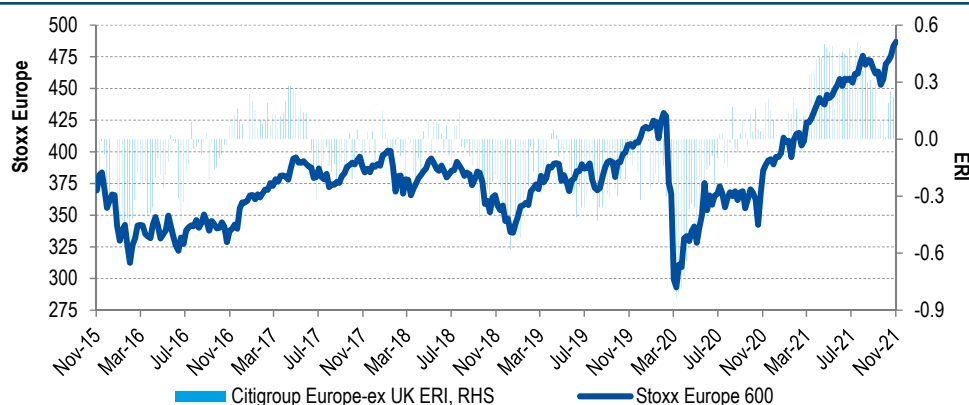
US equities

Sentiment remains strong at a time when markets touched new highs, driven by positive results for S&P500 companies, which have for the time being successfully navigated supply chain disruptions and elevated inflation. Now, as we await clarity on the labour market and wages, we are watchful of whether companies are willing to give up some margin to protect a bit of market share. **This remains a key input in our decision-making: ie, whether pricing power can be sustained.** We are constructive on high-quality cyclical value names over defensive stocks, but believe stock selection will drive returns, as each company differs in its capacity to address operational issues on the supply and labour sides. However, we are cautious about bond proxy (long duration) sectors, high momentum/growth (technology, including large-cap tech), and distressed value names. At a sector level, we continue to prefer financials and energy over industrials, particularly where we can tilt the company-decision making towards promoting green energy and reducing carbon emissions. Consumer sectors appear fully valued and are exposed to labour and supply chain issues.

EM equities

Prospects of EM-DM growth premiums widening in 2022 and cheap relative valuations should support EM equities, but we suggest defensive positioning until year-end due to low visibility on market direction. The near-term Chinese outlook is affected by uncertainty over the current slowdown, although the long-term story is intact. Elsewhere, we are optimistic on Russia (commodities, energy exporter), Hungary and India. At a sector level, we prefer energy over materials, discretionary and communication services, and we keep a preference for value/cyclicals over growth.

Earnings have been strong, but selection around pricing power is key



Source: Amundi, Bloomberg, weekly data as of 18 November 2021.
Earnings Revision Index on RHS.

THEMATIC
GLOBAL VIEWS


Didier BOROWSKI,
Head of Global Views

Ultimately, the objective is to make growth more inclusive in the medium and long term

Joe Biden wants the bill to be passed before Christmas but this is not a given

Will the US policy mix "build back better"?

On 19 November, the House of Representatives (HoR) passed the Build Back Better Act (BBB). The bill will now be considered by the Senate. This is a big step forward for the Biden administration, especially since this vote comes just after President Biden signed the infrastructure plan into law.

The BBB act, adopted by HoR, will be examined in the Senate in the coming weeks. Several questions arise. Why implement stimulus measures in the current environment? What measures are envisaged by this new program, and what are the chances that BBB will be

passed by the end of the year? Is there a risk of deadlock in the Senate? Will US fiscal policy increase the deficit and public debt in the long run? And could it increase inflationary pressures? If so, is it a game changer for the Fed? We offer some answers.

Why the big fiscal plans?

The economic situation in the US is normalising. By the end of next year, the economy should return to full employment. Inflation is at its highest level in over 30 years. Normally, this context would not be compatible with continuing an expansionary policy mix.

However, the BBB plan is not about stabilising the economy in the short term. It is primarily about putting in place a package of social spending and tax breaks for lower and middle-income

households. The objective is to make growth more inclusive in the medium and long term, in line with the Democrats' election promises.

There is thus a triple motivation for the Biden administration: economic (to increase growth potential in the medium term), societal (to have a more inclusive and less unequal growth model), and political (to retain the Senate in the mid-term elections).

Will the Senate block the "Build Back Better" plan?

Moderate Democrats are openly concerned about implementing expansionary fiscal policy in an economy that, for some, is already showing signs of overheating. Even though the economy is not at full employment, wages have already accelerated significantly, with the employment cost index (in its compensation component) up by an annualised 6% in Q3 (4.2% YoY).

In this context, moderate Democrats in the Senate will seek to roll back some of the provisions proposed by the House or even repeal them. Three spending items are in their sights: immigration spending, paid leave and adjustments to the SALT deduction (see box).

- The \$120bn increase in immigration spending likely to be trimmed
- Paid leave (an extension of about \$200bn) may have to be dropped to receive the approval of all Democrats
- The SALT deduction cap will probably have to be lowered and/or means-tested (see box)

The reconciliation procedure theoretically allows the bill to be passed by a simple majority. However, in the Senate, this procedure gives more power to the opposition, which has the means to slow down passage of the text and sow discord among Democrats. Each budget provision must be found to comply with

certain budget rules (otherwise the provisions are dropped, this is the so called "Byrd rule"¹). In addition, Republicans can filibuster, filing numerous amendments that can force votes on difficult issues (i.e., the "vote-a-rama"²).

Joe Biden wants the bill to be passed before Christmas, but there is a significant risk that it could be delayed until later in January, which would diminish its chances of being passed.

It seems to us, however, that the Republicans will not get their way. The Democrats will want to stick together. Their drop in popularity in the polls bodes for an uphill battle in the November 2022 mid-term elections. Current projections show that the Democrats will most likely lose control of the House. If they want to retain a majority in the Senate, they must avoid giving the Republican camp a victory.

With the bill currently before the Senate, this is likely to be the last budget measure that the Biden administration will be able to pass. Time is of the essence, as the election campaign will begin in January. The risk of a new epidemic wave should help cement the Democrats, as the Omicron variant threatens to further slow down aggregate demand next year (with less risk of overheating).

What impact on the deficit and growth?

The text envisages a myriad of measures. It is therefore difficult to estimate the impact precisely. The legislation is more-or-less paid

for, according to the CBO. But since spending will be concentrated in the early years (2022-25), and taxes in the later years, the impact on the

¹ A Senator opposed to the inclusion of extraneous provisions (extraneous to the purpose of implementing budget resolution policies) in reconciliation legislation may offer an amendment that strikes such provisions from the legislation.

² The procedures allow members of Congress to propose an unlimited number of amendments to budget-related measures, and these amendments are all voted on one after the other after the time allotted for debate expires.

THEMATIC GLOBAL VIEWS

The economic impact will ultimately depend more on private demand than on public demand

federal deficit will be higher over the next four years.

Given that the measures that will be trimmed or even cancelled by the Senate, the impact on the federal deficit should be fairly small (especially compared to the impact of the Covid crisis in 2020). However, some of the provisions that are set to expire (such as the child tax credit), if extended, would weigh on the federal deficit later. The HoR plan's impact on growth is also estimated

to be very moderate next year (no more than half a percentage point in 2022, which is already factored into our current forecast). That said, the BBB act should help anchor expectations of growth and a sustainable recovery in the labour market, and thus encourage households to mobilise the excess savings they accumulated during the crisis. The economic impact will ultimately depend more on private demand than on public demand.

Monetary policy: the return of a risk management approach?

US growth accelerated in Q4 and inflation is at a 30-year high. Although growth will slow next year, we believe it will remain slightly above potential in late 2022. Inflation will also slow but will remain above the Fed's target.

Under normal circumstances, an expansionary fiscal stance would be accompanied by a less accommodative monetary stance. But following the revision of its strategy review, the Fed has *de facto* changed its reaction function. On the one hand, the BBB program, if passed by the Senate, will strengthen the camp of those who believe that it is time to rebalance the policy mix, with less monetary support (accelerated tapering). On the

other hand, threats from the new Omicron variant are likely to weigh on growth next year.

In the past, such periods of uncertainty have generally led the Fed to opt for a risk management approach (i.e., to favour maintaining growth over fighting inflation). Ultimately, we believe the Fed will remain more cautious than the markets expect, even if the BBB plan passes the Senate. The Fed may reduce/end its asset purchases, but it is still far from hiking its key rates. The bottom line is that real interest rates are not about to move back into positive territory, despite the fiscal stance.

Finalised on 30 November 2021

The infrastructure and the Build Back Better acts in a nutshell

1. The Infrastructure Investment and Jobs Act

The plan was passed by the HoR on 5 November, with the support of 13 Republican representatives but the opposition of six progressive Democrats who had made their vote conditional on the Build Back Better Act. It had already passed the Senate in bipartisan fashion (69-30) on 10 August. It has since been signed into law by the president.

- **More than \$1,000bn** in spending on transportation and other physical infrastructure over the 2022-2031 decade, including nearly \$600bn in additional funding.
- **Strongly increasing:** spending on roads and bridges, power systems, railways, broadband, water networks and public transport (of which \$274bn in transport infrastructure and \$239bn in public utilities).
- **Objectives:** lower costs for companies, improved competitiveness and productivity, and reduction of carbon emissions.
- **One of the main arguments in favour of this plan is that it is the right time to do it:** the expected return on public infrastructure is estimated to be much higher than its financing cost (with 30-year Treasury yields below 2%).
- **Ex-post, the cost is modest.** There is no substantial impact on the deficit and debt over the next 10-year budget horizon, once the expected multiplier effects on growth over 10 years are taken into account.

2. The Build Back Better (BBB) Act, as passed by the House

This plan, which still needs to be approved by the Senate, provides:

Approximately \$2100bn in spending:

- \$2100bn in new spending and tax credits on social programs (child care, education, health care), which can be broken down into three:
 - Social programs (\$1100bn).
 - Climate and housing (\$700bn).
 - Other expenditures (\$300bn).
- Increased spending on climate and housing investments.

To finance them, several measures would generate about \$2,000bn in revenue:

- Corporate taxes (\$820bn).
 - The corporate tax rate would remain stable at 21%.
 - A new alternative minimum tax coming into effect in 2023 (\$320bn).
 - A 1% tax on share buybacks (\$120bn).
 - A tax increase on multinationals (\$280bn).
- Taxes on high-income households (\$640bn).
 - For high-income earners (over \$400,000/year): \$400bn in revenue.
 - For very-high-earners (over \$5 million/year): \$230bn.
 - However, the adopted plan raises the current \$10,000 cap on state and local tax (SALT) deductions to \$80,000. This will result in a significant tax cut for high earners beginning in 2022-25.
 - Savings from drug pricing reform (\$300bn).
 - Better enforcement of tax laws (\$200bn, according to CBO estimates). The White House is more optimistic, hoping for \$400bn in revenue.

THIS MONTH'S TOPIC



Debora DELBO',
Senior EM Macro Strategist



Ibra WANE,
Senior Equity Research Strategist

The consensus 2022 looks shy

Q3 earnings season: results better than expected but doubts remain about next year

Q3 21 results were generally well above expectations, which was not taken for granted given the bottlenecks and higher input costs. However, the 2022 consensus remained very cautious, with EPS forecasts at best equivalent to nominal GDP growth! Good surprises cannot therefore be ruled out.

Since most companies have released their third quarter results by now, it is a good time to review the situation. With publications coming out well above expectations across all regions, things are looking good. After the economic halt suffered in 2020, the comparison bases were without doubt easy. But given the congestion of freight, the surge in commodity prices, wage pressures and bottlenecks in several sectors due to the shortage of semiconductors, the increases recorded were by no means in the bag. That said, the consensus forecasts for next year's earnings remain very cautious, with EPS expected to reach +7.3% in the US and +6.5% in Europe, at best equivalent to nominal GDP growth! After a rapid catch-up in 2021, economic momentum will undoubtedly slow

down, but real growth in developed countries is likely to remain well above potential in 2022. The usual relationship therefore between GDP growth and earnings would suggest EPS growth in the region of 16% in the US and 20% in Europe. Two very different visions but the real figures probably lie somewhere in between. As the pandemic seems like it could become endemic, the bottlenecks are easing only very slowly, and inflationary pressure looks relatively entrenched, growth of around 10% in both the US and Europe seems more realistic in our view. In all cases, in an environment in which inflation is set to be more prevalent, depending on the sector or company, the key to differentiating will more than ever be pricing power.

S&P 500: a record high quarterly performance

By 19 November, nearly 95% of S&P 500 companies had already published their 2021 Q3 results. At USD53.75 in Q3, S&P 500 EPS set a **new quarterly record**. Despite the doubts that emerged in September, these results managed to **significantly beat expectations once again**. At the last check, they showed growth of **+42%**, well above what was expected at the start of the earnings season on 1 October (+29%). They are all the more impressive as they also show a sharp increase in relation to Q3 2019 (+33%), a period that was not impacted by Covid. Despite this upswing in Q3, the consensus for Q4 has remained stable overall (+22%, as on 1 October), leading therefore to just a **modest upward revision to the consensus for the full year** (+49% for 2021 vs. +46% on 1 October). What's more, this limited upward revision for 2021 is **to the detriment of 2022**, for which the consensus forecast has been revised down from +9.2% to +7.7% since 1 October.

While the consensus of sell side analysts usually tends to be overly optimistic, this time **we feel it is rather conservative**. True, the peak of the recovery is behind us and comparison bases next year will be much more difficult. Similarly, wage pressures and higher input costs will impact results. Nevertheless, companies that have pricing power should be able to neutralise a significant proportion of inflation. In particular, if US GDP growth is largely above 3% next year (Amundi's central scenario is +3.7%), EPS growth of only +7.7% would be unusual as it would be scarcely higher than average EPS growth over the long term for much higher GDP. In fact, between 2000 and 2019, S&P 500 GDP and EPS rose

by an average of +2.1% and 6.9% respectively per year. But since one additional point of GDP would lead to an additional 6% of EPS, all other things being equal, with +3.7% growth in US GDP expected next year, S&P 500 EPS would be expected to increase by +16%, which is twice the consensus estimate (+7.7%). In the end, to maintain a margin of security given the unforeseeable nature of the pandemic, the bottlenecks and the ability to pass on price increases, we feel **a midway increase in US EPS of around 10% next year** is realistic.

The growth in earnings by sector is also instructive. While all major sectors showed growth, the levels varied considerably. Over the full year, the three sectors with the highest EPS growth were **energy** (+146% in 2021e), **materials** (+89%) and **manufacturing** (+88%). Concerning energy and manufacturing, in addition to the recovery, they enjoyed an easy comparison base after a heavy fall in their results last year. For materials, however, which showed very good resilience in 2020, the sector's sharp growth this year is primarily thanks to the surge in commodity prices. **In bottom position, unsurprisingly, are defensive sectors** such as utilities (+4%) and consumer staples (+10%); the beverages and food retailer segments continue to be penalised.

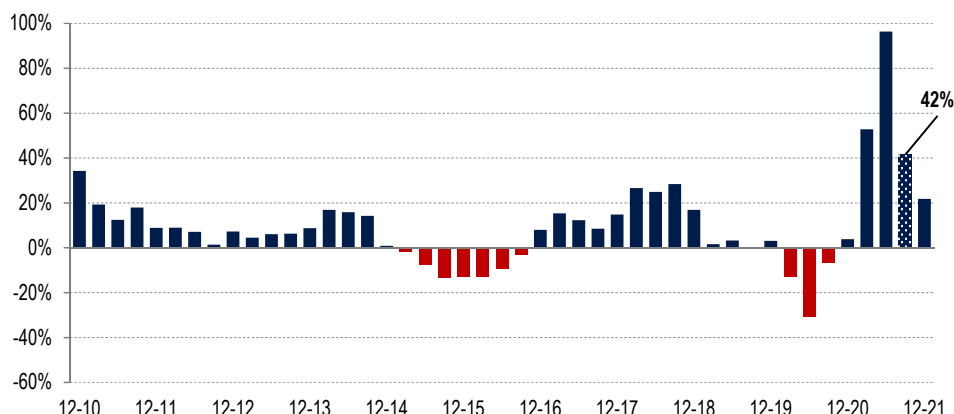
Over two years (2019-2021), then, to compare with **the situation before the pandemic**, the six sectors for which EPS growth should be higher than average (+30% for the S&P) are: materials (+78%), IT (+50%), energy (+44%), communication services (+39%), healthcare (+38%) and financials (+35%). With the

THIS MONTH'S TOPIC

Both in the US or Europe...

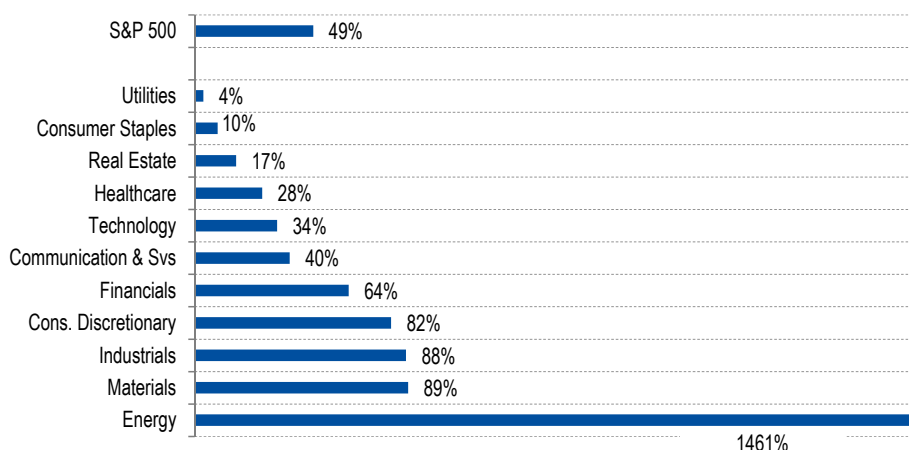
... a 10% 2022 EPS increase looks doable

1/ S&P 500: Quarterly results (YoY, %)



Source: Ibes, Refinitiv, Amundi Research, Data as of 19 November 2021

2/ S&P 500: FY 2021e earnings (% chge YoY)



Source: Ibes, Refinitiv, Amundi Research, Data as of 19 November 2021

exception of healthcare, underpinned by the health situation, these sectors are mainly cyclical, linked to commodities or to Gafam (IT & communication services) or are benefiting from the improvement in the general economic outlook, such as financials. On the other hand, **defensive sectors** such as consumer staples

(+14%) and utilities (+5%) remain well below the average. Finally, by contrast with the other cyclical sectors, manufacturing (-17%), which is being penalised by the bottlenecks and the rise in commodity prices, is still a long way from its 2019 level.

Stoxx 600: a much higher rebound in earnings than in the US

On 23 November, the Stoxx 600 **earnings publication season also came to a close** with 89% of companies having published their Q3 2021 numbers. **Even more so than the US, the European results surprised on the upside** with growth of **+59%** versus 46% expected on 1 October. Unlike the US, this very good Q3 caused a substantial upward revision for both Q4 (+52% vs. +39% on 1 October) and for full-year 2021 (+65% vs. +58%).

However, like the US, analyst expectations for 2022 seem conservative in view of the expected growth in GDP (Amundi's scenario is +4.1% in the Eurozone and +4.3% in the UK). The consensus forecasts +8.0% for EPS in the Eurozone and +2.5% in the UK (penalised by very high base effects in 2021), i.e. **+6.5% for all of Europe**.

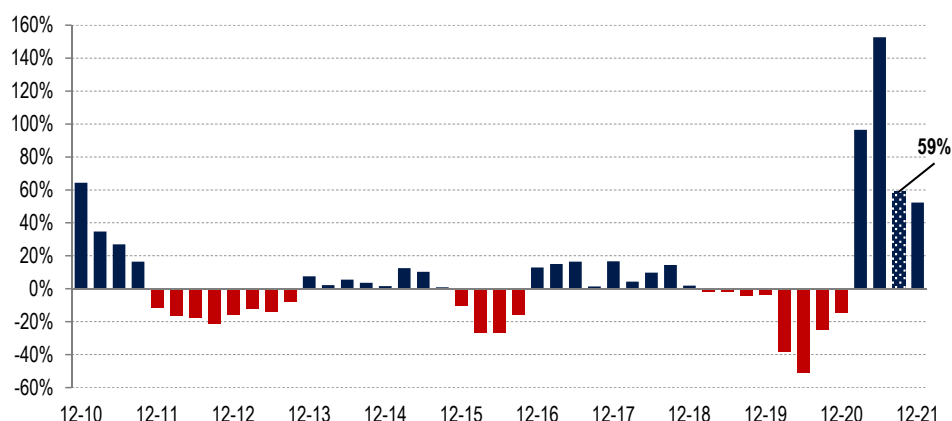
Historically, over the long term (2000-2019), EPS growth in Europe (+3.6%) is

clearly weaker than in the US (+6.9%). However, GDP growth in Europe over the period under consideration was only +1.6% while it is expected to surpass 4% next year. Consequently, given the sensitivity of EPS in Europe to GDP, **such a level of growth should, all other things being equal, give rise to an increase in EPS of +20%**. Here also, like in the US, a margin of security is needed given the various risks already mentioned. But given the economic gap between the two regions and the strength of the dollar, which should both benefit Europe, EPS growth of +10% in Europe, of which +12% in the Eurozone and +5% in the UK, seems plausible.

In Europe, the growth in earnings by sector is also instructive. Generally speaking, in 2021 there **will be an even bigger contrast than in the US between defensive sectors**

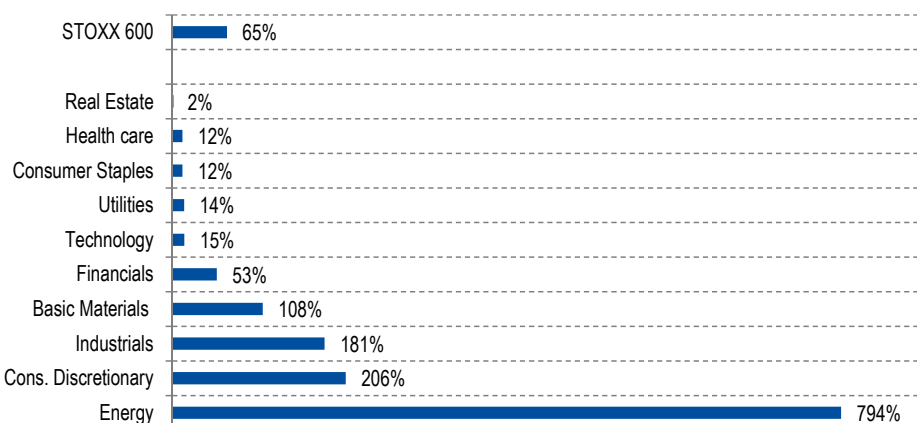
THIS MONTH'S TOPIC

3/ Stoxx 600: Quarterly results (YoY, %)



Source: Ibes, Refinitiv, Amundi Research, Data as of 23 November 2021

4/ Stoxx 600: FY 2021e earnings (% chge YoY)



Source: Ibes, Refinitiv, Amundi Research, Data as of 23 November 2021

on the one hand (healthcare +12%, consumer staples +12%, utilities +14%) **and cyclical sectors** on the other (IT +15%, financials +53%, commodities +108%, manufacturing +181%, consumer cyclicals +206%). However, **specific features** will impact sectors depending on the region. For instance, energy in Europe is less integrated upstream, hence a smaller decline in 2020, but also a smaller rebound in 2021. Similarly, IT and healthcare in Europe are weak

in relation to the US, while the reverse is the case for industrials.

Finally, despite the economic lag in Europe versus the US, EPS in Europe has also broadly surpassed pre-crisis levels. EPS in 2021 is set to be 14% higher than in 2019, a feat due largely to the sharp rebound in commodities (basic materials +86%, energy +69%); while the other sectors are expected to increase by no more than 4% on average versus 2019.

Emerging markets: Good results overall in 2021 despite China; will China take the lead in 2022?

The earnings season for emerging countries is also nearing an end, with 82% of companies having released their figures by 22 November. **Here also there was a significant rebound in Q3 2021** with MSCI EM EPS up **+32%** in USD, or +55% in local currency, i.e. +20% above initial forecasts. China bucked the general trend, with EPS growth of just +2%. However, due to the semiconductor and commodities effect, EPS growth (in local currency) was stronger in Taiwan (+60%), South Korea (+70%), Saudi Arabia (+130%), Brazil (+162%) and Chile (+237%).

Naturally, in sequential terms, growth was slightly less than at the start of the year,

reflecting a certain slowdown in growth in those countries that experienced a particularly strong recovery in the recent period. This is notably the case for LATAM (Mexico, Brazil and Colombia in particular), several ASEAN countries (Philippines, Thailand and Malaysia) and China. China saw both a slowdown and a rebalancing of its domestic economy.

While the **surprises** were mainly on the upside for the twenty countries in our sample (+20% in local currency), this was not the case for China (-1%), Thailand (-2%) or the Philippines (-3%). Similarly, the percentage of companies that surpassed expectations fell (50%) and is

After a lacklustre year for GEM in 2021...

THIS MONTH'S TOPIC

...will China recover in 2022?

now lower than that of Europe (64%) and, it goes without saying, the US (81%).

By sector, **the MSCI EM results were**, like in Europe, **particularly positive for cyclical sectors** (consumer discretionary > 1000%, manufacturing +272%) **and commodities** (energy +285%, basic materials > 1000%).

The IBES consensus forecasts a **+6% increase**

To conclude

By region, the results for Q3 21 and more broadly for the full year were very good, but they have not completely dispelled doubts about next year. This is because the easy comparison base will automatically disappear, stimulus is likely to be moderated, input costs will increase and uncertainties around the health situation will be ongoing. That said, while analysts' earnings forecasts

in MSCI EM EPS in 2022, of which **-6% for LATAM**, which is set to suffer the payback of its high results this year (+204%), but **+8% for Emerging Asia**, which is set to benefit from the recovery in China (+16%) after a lacklustre year in 2021 following a negative performance in consumer discretionary and real estate.

are usually broadly optimistic, we believe that this time they hold the potential for an upward revision. Less advanced than the other regions in its recovery cycle and capable of taking advantage of a strong dollar, Europe, and the Eurozone in particular, will probably play a good hand next year.

Finalised on 25 November 2021

THEMATIC



Valentine AINOZ,
Deputy Head of Developed
Markets Research



Delphine GEORGES,
Senior Fixed Income Research
Strategist

"The inflation that we're seeing is really not due to a tight labour market, it's due to bottlenecks and it's due to shortages and it's due to very strong demand meeting those"
(Jerome Powell)

Fed officials' discomfort is growing with the inflation overshoot: why it will remain cautious

US consumer prices jumped by 6.2% in October, their highest level in 30 years! Deteriorating inflation data have pushed markets towards forecasting a faster pace of tapering and a more rapid removal of accommodation in 2022. We expect the Fed to act gradually as Covid remains a major risk and as the Fed would like to see a higher participation rate. The Fed will have a step-by-step approach and a rapid turnaround in strategy is possible. To a greater extent, a high level of debt, a tight valuation of assets, and the huge investments required to move to a low-carbon economy will limit the Fed's ability to raise rates.

The current high level of inflation is due to very strong demand meeting bottlenecks and shortages. The Covid-19 crisis has been characterised on the one hand by impressive lockdowns and supply-chain disruptions and on the other hand by unprecedented support from governments and central banks. These support measures have aimed to preserve demand and limit long-term damage to our economies. For central bankers and fixed-income investors, the challenge in 2022 will be to predict: (1) the persistence of supply constraints and

lockdowns, (2) the sustainability of demand, and (3) their joint effects on inflation and growth. Indeed, it is crucial to determine what conditions will be like on the labour market and what the drivers of inflation will be: costs and/or strong demand. These points will be decisive in the Fed's reaction to this more inflationary environment. Rising rates cannot resolve supply-side shocks. In addition, for the Fed, it is appropriate to be "patient" to determine the true state of the economy and to assess potential structural changes.

US inflation pressure should ease in early 2022, if the pandemic remains under control

We expect inflationary pressures to remain above 5% through the end of the year and into the first quarter of 2022 and begin to ease in the second quarter as supply-chain bottlenecks ease and demand normalises. Nevertheless, core PCE inflation should stay above the FOMC's 2% target all next year. We forecast 2.4% YoY core PCE at the end of 2022, with risks still tilting towards the upside.

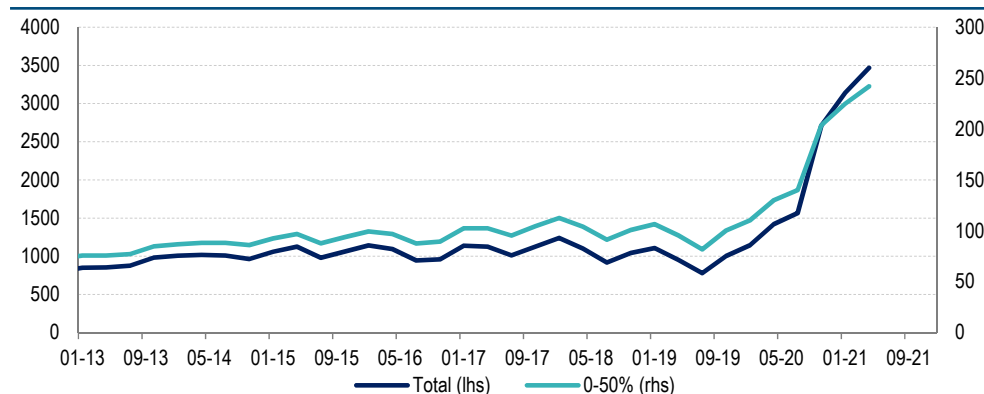
— Barring a worldwide resurgence of Covid cases, supply bottlenecks should ease in early 2022 as:

- Asian mobility has improved constantly as the pace of vaccination accelerates.
- President Biden has made resilient supply chains a top priority. One flagship measure: the Port of Los Angeles is now operating 24 hours a day.
- There is a seasonal drop in US port activity in February and March. August through early November is usually the peak season as retailers prepare for the holidays. This seasonal decline in the level of activity can help normalise inventories.
- Shipping prices have begun to fall. The Baltic Exchange's Dry Bulk sea freight index reached a low since early June thanks to the weaker demand for the larger Capesize and Panamax vessels.

— Demand for goods is expected to normalise in early 2022 as official Covid-19 support measures fade:

- The strong support to consumption provided by the liquidity buffer accumulated during the pandemic should fade. US households' "excess savings" dropped by the end of September

1/ Checkable deposits and currency holdings by income group (in \$Bn)



Source: Bloomberg. Amundi Research - Data as of 1st April 2021

THEMATIC

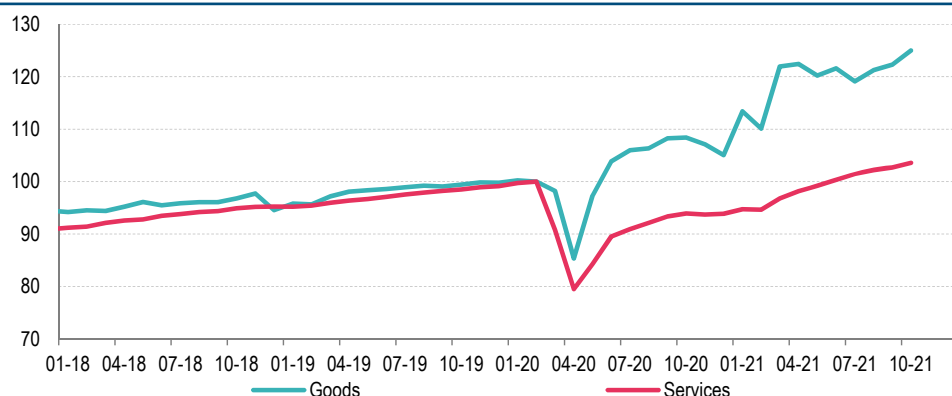
"It is very difficult to predict the persistence of supply constraints or their effects on inflation. Global supply chains are complex"
(Jerome Powell)

"Our tools cannot ease supply constraints"
(Jerome Powell)

to \$1.3 trillion or 7.3% of disposable income on annual basis, only slightly above their pre-pandemic level. Overall, we could assume that \$2.4tr in excess savings have been accumulated during the pandemic. However, we estimate that only 20% or 0.5tr is held by the bottom two quintile combined.

- Overconsumption of goods compared to services should decline with the reopening of economies. US consumers have gone on a "spending binge," fuelled partially by stimulus checks and have been buying goods rather than spending money on services. Indeed in 2021, US residents will have spent 20% more on durable and non-durable goods than in 2019.

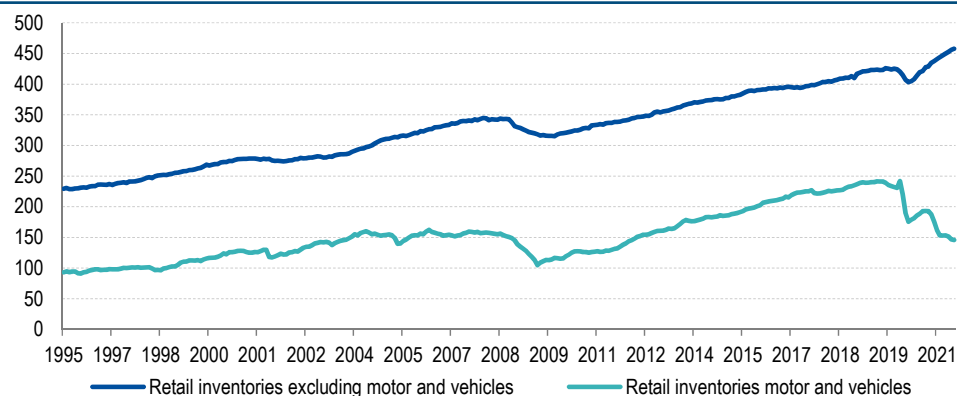
2/ US consumer spending (100=dec 2019)



Source: Bloomberg, Amundi Research - Data as of 31 October 2021

- Inventory should soon reach appropriate levels. Business inventories (excluding motor and vehicles) increased solidly in recent months (+0.7% MoM on average in 2021 vs. +0.2% on average in 2017-2019). US inventories have already risen above pre-Covid levels as retailers expect a strong holiday season. However, motor vehicle retailers continued to struggle to restock amid an ongoing global semiconductor shortage, which has undercut production.

3/ Retail inventories (in \$Bn)



Source: Bloomberg, Amundi Research - Data as of 31 October 2021

- At the global level, the slowdown of the Chinese economy is playing a key role and should be monitored. A shortfall in global demand would ease inflationary pressures.
- **Wages keep accelerating depends largely on the duration of the labour shortages.** The US labour market is now running hot: job openings are at a historic high, the quit rate is at an all-time-high. Wages are rising sharply but low-wage sectors. The recent build-up in savings has given Americans some time to wait and some power to negotiate better employment terms. However, in the coming months, this liquidity buffer will wane especially for low-household income. These trends should normalise with the shrinking in savings.

We expect prices to remain higher than what prevailed between 2014 and 2020

— Business costs are on the rise.

- Commodity and energy prices should remain high.
- The longer the supply-chain crisis continues, the more inclined companies will be to secure their production chains and move away from highly globalised and 'just in time' supply chains. In particular, companies may start to over-order and carry heavier inventories as they shift from a just-in-time to a just-in-case model.
- The transition to a low-carbon economy also means higher costs and investment for companies.

THEMATIC

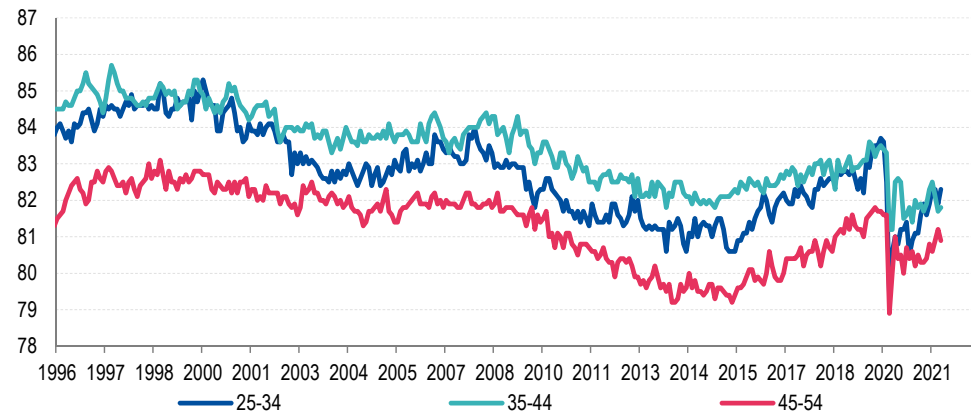
The Fed expects inflation to recede by Q2 or Q3 of next year

According to the Fed, “maximum employment” could be achieved by H2 of 2022. The Fed is calling for patience for a better assessment of the post-Covid macro picture, including the participation rate

— The strength of demand is more questionable.

- More social policies could play a key role in raising low wages.
- We also remain attentive about a possible structural decline in the participation rate in developed economies and in China. In the US, we observed a record level of retirements since the start of the pandemic. A more favourable family social policy (like an extension of child tax credit payments) could contribute to a more persistent decline in the participation rate of married people living with spouses. A persistent decline in the participation rate could contribute to higher structural wage growth. In any case, increases in wages are a concern only if they are rising persistently and materially above inflation and productivity gains.

4/ Labour force participation rate (in %)



Source: Bloomberg, Amundi Research - Data as of 31 October 2021

The Fed should normalise its monetary policy but not as aggressively as the market is pricing in. However, a rapid turnaround in strategy is possible

The Fed will start tapering bond purchases in November, as expected by the markets, and is ready to adjust the pace of purchases if needed. The focus is now on taper “speed” and when the rate normalisation process starts. We expect the first rate hike in June 2022.

— The Fed should normalise its monetary policy.

- The recovery is already well underway. US GDP was 1.4% higher than its pre-pandemic level in Q3 2021.
- Above-target inflation should persist. We forecast 2.4% YoY core PCE at the end of 2022, with risks still tilting towards the upside.
- Real yields are too low and are increasing risks to financial stability, including a surge in asset valuations, a record level of M&A, record share buybacks, increased issuance for LBO purposes.

— We expect the Fed to remain cautious as Covid remains a major risk and as long as inflation is not due to a tight labour market. The Fed will have step-by-step approach and a rapid turnaround in strategy is possible.

- The Fed expects inflation to move down by Q2 or Q3 of next year. “The inflation that we’re seeing is really not due to a tight labour market.”
- Our tools cannot ease supply constraints.
- According to the Fed, “maximum employment” could be achieved by H2 of 2022.
- There is a debate around the participation rate. For the Fed it is appropriate to be “patient” to decide what the true state of the economy is.

— A persistent cost-push inflation would put central banks in a difficult position. A premature tightening will do more harm than good and would represent an unwarranted headwind for the recovery.

- Rising rates can’t solve supply-side shocks. Real long-term interest rates will have to remain low so that the necessary investment could be made.
- The low-carbon transition will also bring a considerable need for investment. Real long-term interest rates will have to remain low, as these investments offer low profitability and some will only replace destroyed capital.
- The strategy of keeping real rates low implies an increased need for redistribution in favour of low-income households. Financial markets could start to integrate quickly climate transition risks.

Finalised on 30 November 2021

THEMATIC

ESG bond market bound to deliver another record year of growth

Global ESG bond markets are bound to deliver another record year of new issuance volumes, led by broad-based dynamic activity in all its major segments. In the first nine months of the year, combined global issuance of green, social, sustainability and sustainability-linked bonds were already equal to 145% of global ESG bond supply in full year 2020.



Sergio BERTONCINI,
Senior Fixed Income Research
Strategist



Mickael BELLAÏCHE,
Fixed Income and Credit
Research Strategist

Even with green bonds still representing the main component, social bonds and sustainability bonds have also gained ground in the ESG market

The tremendous acceleration in the path of issuance activity in the very last few years was led first by **green bond** issuance, which grew from just USD 11bn in 2013 to USD 285bn in 2020 and to roughly USD 400bn as of September this year. Growth by segment is even greater than the mere numbers would indicate. Even with green bonds still representing the main component of the ESG market, a look at the first chart shows that **social bonds and sustainability bonds** have also gained ground in importance, especially in 2020, and their contribution has surged further to almost half of overall ESG issuance on the year to date. Finally, issuance of sustainability-linked bonds (SLBs), although still low compared to other segments, accelerated rapidly from just USD 11bn last year to USD 72bn as of September.

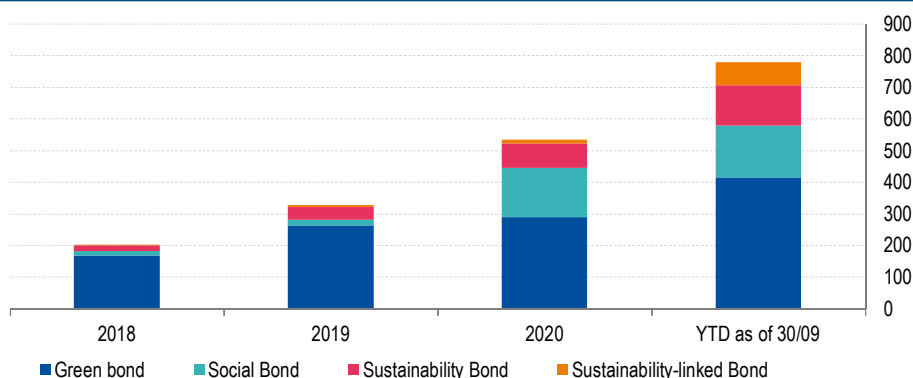
The **Covid-19 pandemic crisis** has produced relevant impacts on issuance dynamics over the last two years. Leading to a sharp decline in primary bond market activity in some of the first months of 2020 (like March, for example) it indirectly contributed to a subsequent acceleration of issuance volumes in following quarters. Furthermore, issuance of **social bonds** to finance and refinance funds utilised to respond to the pandemic has accounted for a large share of global ESG-bond issuance in the past two years, with EU the largest issuer of social bonds, as it sought to refinance loans provided to EU member-states under the

SURE program exclusively by issuing social bonds. Another remarkable impact of policy response to the pandemic crisis will take place in the **green bond** segment, as, according to EU announcements, this segment should represent roughly 30% of overall **NGEU funding**.

One of the main takes from the analysis of supply figures of the last two years is the increased role of the **public and supranational sector**, especially in the green and social bond segments, but also in sustainability bonds. New sovereign presence and supranational activity in primary markets drove most of the surge in outstanding debt, helping to improve **liquidity** through larger deals and to extend **average duration** through longer-dated bonds.

The **euro is the number-one currency** in which ESG bonds are issued, representing almost 50 per cent of overall supply, as EUR-denominated bonds accounted for 45% of the green-bond sector and an overwhelming 72% of the social-bond segment in first three quarters of 2021. This share is even expanding, whereas the share of EUR-denominated bonds in the sustainability-bond sector was only 32% in 9M21. In the following section, we will provide more colour on the dynamics and major drivers of each of the four major segments of ESG bond markets.

1/ Growth in ESG supply, by market segment



Source: Bloomberg, Amundi Research, Data as of end October 2021

Green bond highlights

As shown by Chart 1, green bond issuance still accounts for the largest share of new ESG bond supply this year. As of September, global green bond issuance amounted to more than USD 400bn, up by 43% vs full year 2020. Both private and public sectors were quite active.

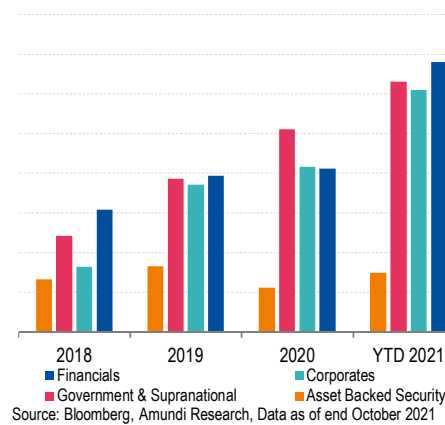
Chart 2 shows that corporates and financials kept playing an important role, as in previous years, but public and supra sector volumes also accelerated remarkably, thanks to several European sovereign issuers, which issued large amounts of liquid green bonds, while EU just

THEMATIC

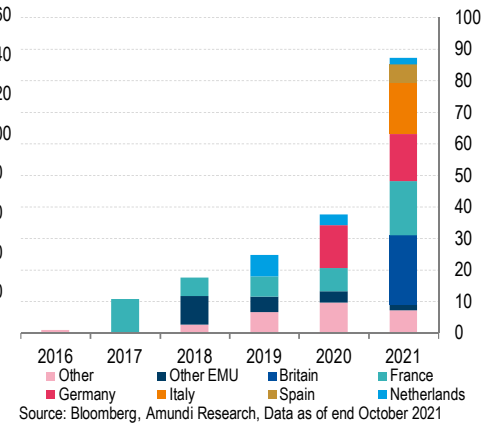
began its activity in this segment in Q3. The largest issuers on the year to date were the UK (close to USD 22bn), France (with USD 17.0bn) and Germany (close to USD 15.0bn). Periphery countries were active, too, for the first time with inaugural deals, as Italy and Spain issued

green bonds in the regions of USD 16bn and USD 6bn, respectively. European sovereign issuers totalled almost USD 90bn in supply, while issuance by supranationals will be further pushed in Q4 by the inaugural green EU bond, which was placed in mid-October.

2/ Green Bond supply, by issuer sector



3/ Sovereign Green Bond issuance



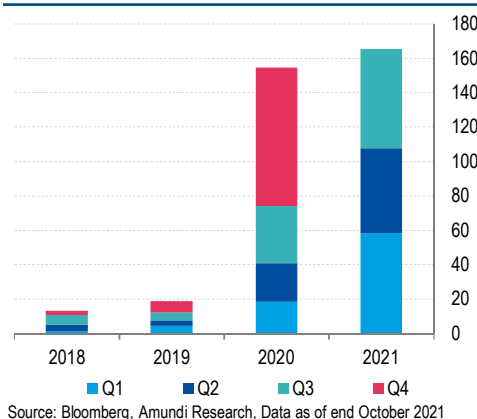
Social and sustainability bonds highlights

Social-bond issuance reached almost USD 170bn in 9M21 and therefore already exceeded full year 2020 issuance (USD 155bn). In both years, supranationals and agencies contributed the lion's share of the record amount, while the private sector continued to play a more limited role. EU SURE bonds related to the Covid-19 pandemic, in the first place, cumulated more than EUR 100bn between Q4 2020 and H1 this year, while CADES, the second-largest issuer of social bonds, added USD 31.7bn of bonds to total social-bond supply in 1H21 and USD 5.9bn in 3Q21. The frontloading of large parts of bond supply in 1H21 did not come as a surprise, as the EU wanted to focus on NGEU funding in 2H21. Besides supranationals and agencies, financial issuers were also quite active in this segment, issuing roughly USD 25bn worth (15% of global social bonds issued in 9M21), whereas non-financial corporate issuance of social bonds amounted to a smaller amount of USD 8bn, or just 5%. However, corporates were quite active in sustainability bonds

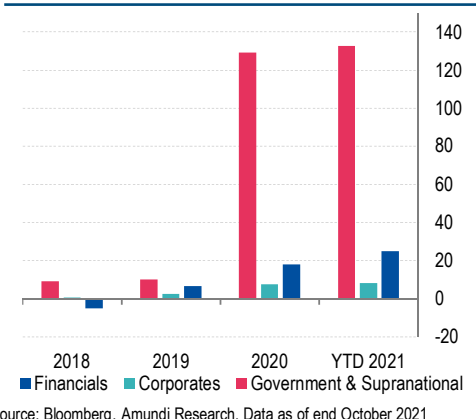
(which combine green and social projects), with a market share of 18%, which, coupled with financials' 27%, drove the private sector contribution to a remarkable 45%, amounting to USD 58bn in 9M21, almost double the amount issued in full year 2020 (USD 31bn). We may expect an increasing number of corporates and financials to combine social and green expenditures in a sustainability-bond format, as social topics are becoming more relevant and as social expenditure can also be used to fill in the gaps when a sufficient amount of eligible green assets is not available to tap the green bond market.

Supranationals took the lead in this segment and issued USD 36.7bn (27.8%) of sustainability bonds, which is why the three largest issuers are from this segment. The International Bank for Reconstruction & Development was the largest issuer, with USD 20.6bn, followed by the Asian Infrastructure Investment Bank, at close to USD 6.0bn, and the International Development Association, with USD 4.3bn.

4/ Social bond quarterly issuance



5/ Social Bond issuance mostly driven by supranationals



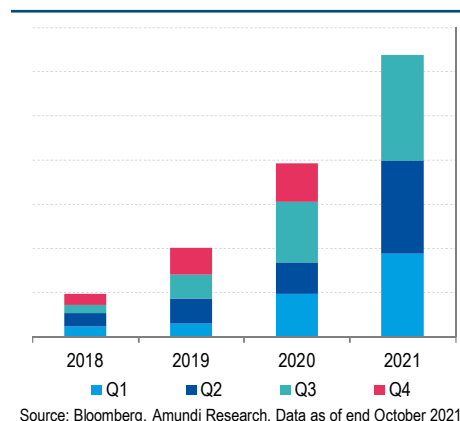
The euro is the number-one currency in which ESG bonds are issued

THEMATIC

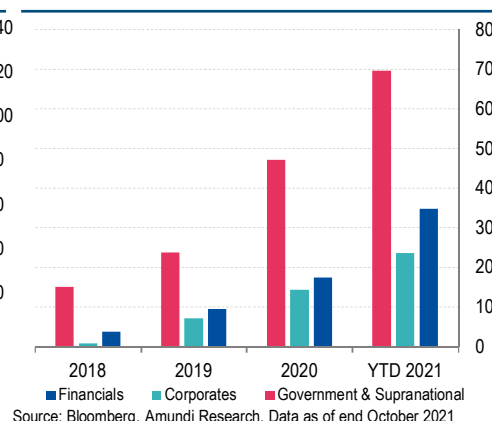
2022 is likely to be another year of strong growth for the ESG bond market

Corporates are expected to remain quite active in all segments, probably to accelerate their Sustainability-linked bonds volumes

6/ Sustainability bond supply, by quarter



7/ Sustainability bond supply, by issuer sector

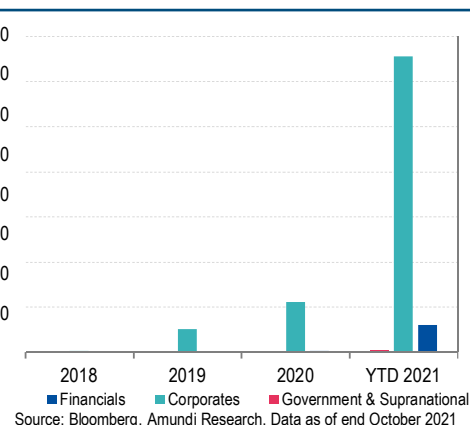
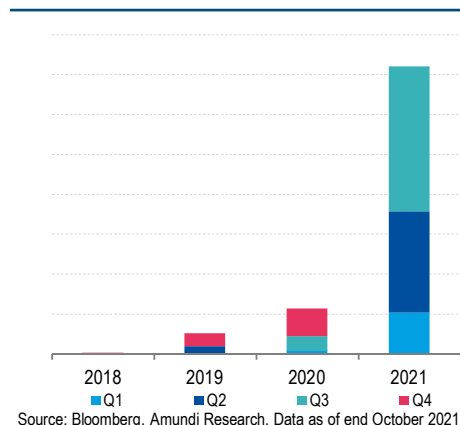


SLB highlights

SLBs represent an increasingly important part of the effort to finance a global transition towards climate neutrality, and the rapid uptake of this instrument type is the result of a broadening range of entities (in particular corporates), seeking access to sustainable finance that is not immediately tied to a specific pool of eligible projects. As a result, issuance activity in the SLB market picked up significantly in 2021, amounting to roughly USD 70bn in 9M21, seven times the volume recorded in FY20. A look at the quarterly trend shows a sort of exponential

progress, with Q3 equalling H1 volumes, while the following chart shows the dominant role of corporates in driving this segment's growth. The strong dynamic in this segment has been supported by continuing issuer diversification, with 25 inaugural issuers in Q1, more than 50 newcomers in Q2 and further 23 in Q3. Sector diversification has improved too, as, despite the dominant initial role of utility companies, an increasing number of issuers from other sectors have been issuing inaugural SLBs.

8 & 9/ SLB bond supply by quarter and by issuer sector



What about 2022 trends?

2022 is likely to be another year of strong growth for the ESG bond market, combining the role played from corporates, supra & agencies issuers, as has been the case for a number of years, with significant supply also from sovereigns in both DM and EM regions.

We may expect corporates to remain quite active in all segments, but as this year has shown, probably to accelerate their SLB volumes incrementally. Supra and agencies will keep contributing to market growth but probably at a slower pace than in the past two years, which was driven by the strong, prompt policy response to the pandemic crisis. After the remarkable role played by SURE bonds in the social segment in just a few quarters, we

may expect the highest percentage of bonds to come with a green label, thanks to the arrival of the EU's NGEU green bonds. Supra will likely be the driving force behind ESG issuance, but agencies should also be strong issuers. Finally, both DM and EM sovereigns are likely to focus on ESG issuance (and in particular green bonds) in 2022, as the green transition grows in political importance. We may expect both inaugural green benchmarks by new sovereigns already reportedly considering to tap the ESG market, and a growing presence from sovereigns already involved, the latter mainly European issuers. The same combination of new entrants and additional supply from active issuers may be expected from EM sovereigns, too.

Finalised on 22 November 2021

THEMATIC

Major ESG bond market segments

This box provides the reader with definitions of different types of ESG bonds mentioned in the piece

Green bonds: sometimes called “environmental bonds”. This is a (non-bank) bond loan issued on the financial markets by a company or a public entity (community, international agency, etc.) to finance projects contributing to the ecological transition. The difference, compared to traditional bonds, lies in the commitments made by the issuer on the one hand, on the precise use of the funds collected, which must relate to projects having a favorable impact on the environment, and, on the other hand, on the publication, each year, of a report giving investors an account of the life of these projects.

Social bonds: bonds that raise funds for projects with positive social aims in the areas of affordable basic infrastructure, access to essential services, affordable housing, employment generation, food security and socioeconomic advancement and empowerment.

Sustainability bonds: the segment combines green and social assets. The proceeds of these bonds finance a combination of both green and social projects, activities or expenditures.

Sustainability-linked bonds (SLB): SLBs are linked to the issuer’s overall sustainability strategy and its progress in this area. In this respect, they are forward-looking, performance-based instruments. Typically, this results in a structure in which the bond coupon can vary depending on whether or not the issuer achieves predefined sustainability or ESG objectives.

THEMATIC



Pierre BLANCHET,
Head of Investment Intelligence



Aurelien STRENTA,
Emerging Markets Analyst (V.I.E)

Covid could become endemic and remain a source of economic uncertainty over the medium term

Geopolitics of the vaccine: variance risks

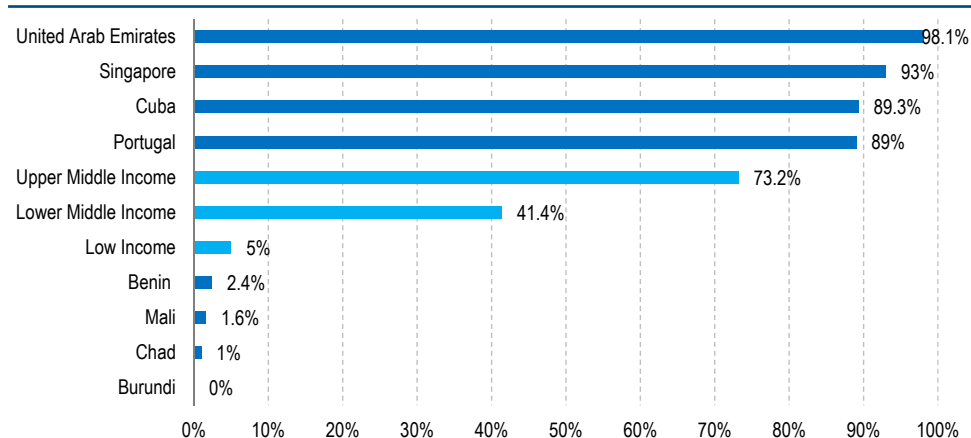
Covid-19 vaccines have been rolled out for a year now. Despite official commitments to provide access to effective jabs to all countries, production constraints and national priorities have resulted in uneven distribution, with some countries close to 100% vaccination rates while others are still below 5%. More than a dozen vaccines are now available, but with different efficacy levels and the variant Omicron will probably reduce the efficacy of existing jabs. As expected, the geopolitics of the vaccine have come into play. COVAX's inability to reach its targets shows that, on top of real constraints, vaccines are soft power weapons that are being used for geostrategic purposes.

Vaccines are unequally distributed

A year after the first Covid-19 vaccine approval, the global vaccination campaign is still underway. More than half of the world population has received at least one of the 7.5 billion doses of vaccine administered globally. Another 1 billion doses should be given by the end of the year at the current rate of 30 million doses a day. This could be considered as a success on this sole measure. Yet, **vaccination rates are very heterogeneous among countries and even social groups**, and are mainly explained by wealth disparities. In the most advanced countries, vaccination rates have already reached high levels (74% in the

UK, 70% in the EU and 67% in the US) with a direct positive impact on hospitalisation and fatality rates. In low-income countries (mainly Sub Saharan Africa), fewer than 5% of people have received at least one dose. The situation is uneven within developing countries as well, with some reaching high levels of vaccination (Figure 1) while others are still lagging behind. Vaccine shortage are not the only reason for the low vaccination rates, which also have internal causes such as lack of political will and fears over vaccines. The first consequence of this situation is that **global immunity is still far away.**

1/ Share of people that received at least one dose of Covid-19 vaccine



Source: ourworldindata.org, Amundi Research - Data as of 19 November 2021

As the wealthiest nations roll out boosters for at-risk population groups in order to fight the Delta variant, they produce or purchase more for themselves than expected and deliver less to the poorest nations. **COVAX's¹** initial goal was to donate 2 billion doses by the end of 2021. At the time of writing, only 500 million doses have actually been shipped and delivered. The US committed to 800 million doses but delivered only 108 million, and the EU only delivered 40 million out of the 350 million announced. More than 50 countries around the world have vaccinated less than a quarter of their population. For dozens of them, the 70% vaccination rate threshold will not be reached until the end of 2022 or maybe 2023. This is leading to subscale and

suboptimal allocation of vaccines. Therefore, the objective of global herd immunity looks less and less achievable. Moreover the Omicron variant includes a significant number of mutations and is spreading quickly which means that new vaccines will have to be used. Covid will probably become an endemic disease in low-income countries; in a worst case scenario virus mutations could maintain the pandemic for many more years (see Amundi Central and Alternative Scenario). As existing vaccines become less effective against new variants and/or as immunity fades after six months on average, multiple vaccines and boosters will be needed in wealthy countries, while middle-to-low-income nations will face a rising number of casualties.

¹ Covid-19 Vaccines Global Access, abbreviated as COVAX, is a worldwide initiative aimed at equitable access to Covid-19 vaccines directed by Gavi, the Vaccine Alliance, the Coalition for Epidemic Preparedness Innovations, and the World Health Organization

THEMATIC

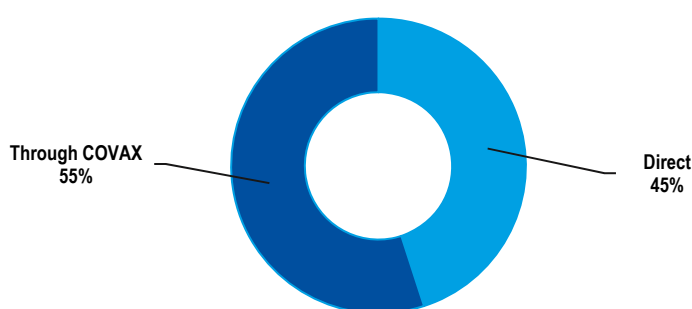
Geopolitical issues explain the uneven vaccination roll-out

There are several reasons behind COVAX's underperformance. The first is that pharma companies have failed to supply jabs in line with their commitments. Or when they did, these vaccines have not been shipped to the targeted recipients Pfizer, J&J, Moderna, Sinovac, Novavax, for instance, have delivered few or no vaccines to the program². The second is that India, which is producing a significant volume of AstraZeneca's vaccine, banned exports over the summer in order to meet its own vaccination targets. A third

reason is that **many countries would rather donate vaccines directly, in order to enhance bilateral relationships** or as diplomatic soft power rather than via COVAX, which is pooling donations. Australia, for instance, has built a partnership with Vietnam and delivered 1.7 million dose this year. 45% of US vaccine donations are made directly and 50% of all US donations are to five Asian countries – Pakistan, the Philippines, Bangladesh, Vietnam and Indonesia, which, incidentally, are important to Washington policy in the region.

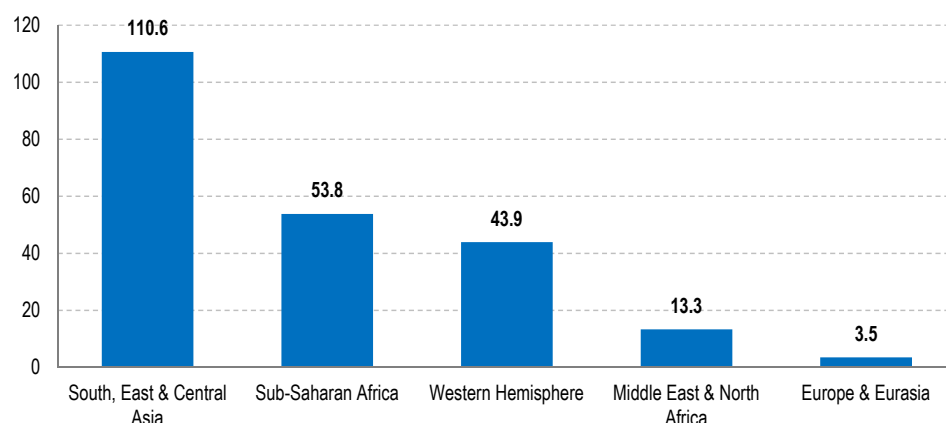
² See Moderna Chief Executive interview by the Financial Times 30th Nov 2021

2/ U.S. Covid-19 Vaccine Donation Doses Delivered by Delivery Mechanism



Source: U.S. State Department, COVAX, KFF - Amundi Research - Data as of 19 November 2021

3/ U.S. Covid-19 Vaccine Donation Deliveries by Region (in million doses)



Source: U.S. State Department, COVAX, KFF - Amundi Research - Data as of 19 November 2021

Therefore, as we were expecting in May (*Geopolitics of the vaccine*), the geopolitics of the vaccine have indeed come into play. Vaccines are not being distributed in accordance with population size or healthcare systems' relative weaknesses, but other criteria, i.e. national and geopolitical

interest. Indeed, governments focus first on their own populations and national constraints rather than on global policies, despite their commitments. Vaccines are soft power weapons being used for geostrategic purposes.

India becomes an alternative vaccine provider

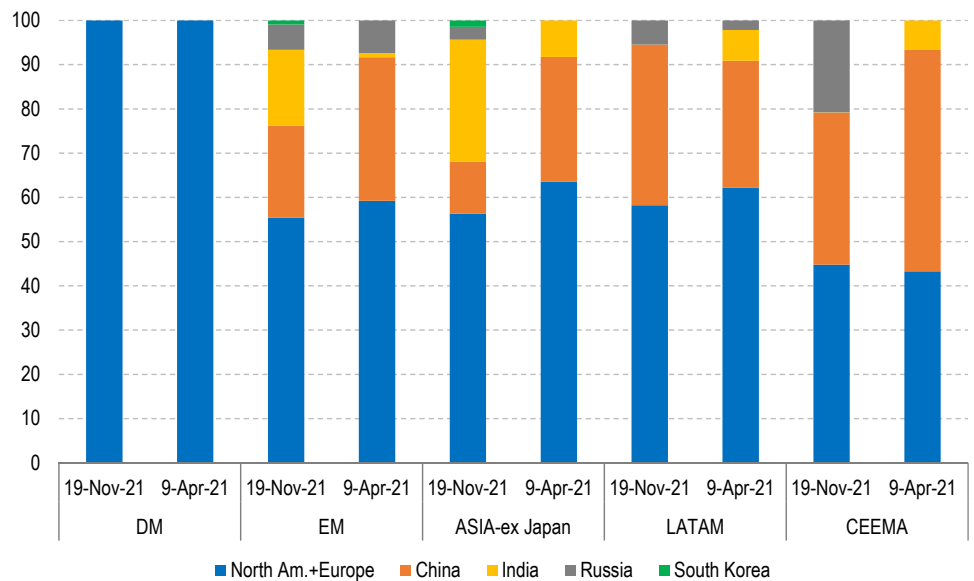
Since our latest publication (on 5 May 2021), advanced economies have remained self-sufficient and now answer to more than half of emerging economies' vaccine demand. The demand for US vaccines in particular is still very strong. However, a new player has fortified its contribution: India (see Figure 4). Among the emerging countries that have ordered vaccines to cover more than half of

their population (>15 years old), 21% are from China, 17% from India, and 5% from Russia. Moreover, India's presence in Asia-ex Japan captures almost 30% of vaccine demand, exceeding China (12%). This breakthrough is due mainly to two factors: India provides itself 47% of its orders (see Figure 5) and accounts for 37% of EM vaccine demand.

Many countries would rather donate vaccines directly rather than via COVAX

THEMATIC

4/ Vaccine providers' country by region (%)



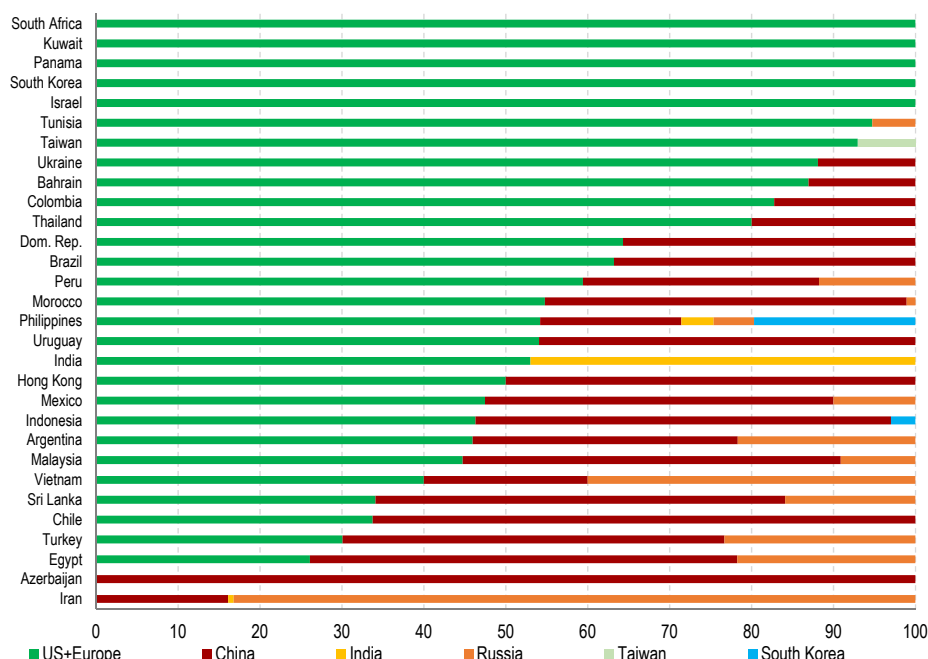
Source: Duke Global Health Innovation Center, Amundi Research - Data as of 19 November 2021

Vaccines' efficacy												
Company	Pfizer-BioNTech	Moderna	AstraZeneca	J&J	Novavax	Sinopharm	Sinopharm-Wuhan	Sinovac	CanSino	Vector Institute	Bharat Biotech	Gamaleya
Country	US & Germany	US	UK & Sweden	US & Belgium	US	China	China	China	China	Russia	India	Russia
Efficacy rate	91%	>90%	74%	US: 72%, BRL: 68%, SAF: 64%	89.7%	<ul style="list-style-type: none"> 78.1% 50.4% (Peruvian study among healthcare workers) and disappointing results in a Hungarian study	72.80%	BRL: 50.65%, TKY: 83.5%, CHL: 67%	63.7% but efficacy drops to 57.5% after 28 days according to a CanSino representative	Unknown no details published of Phase 3 trial and highly contested results of Phase 1/2	77.80%	91.6%, 88.1% (Argentine study)
Variant efficacy	Dominant variants	less effective but strong protection still	strong protection									
	Delta	88% (British study) Booster: 95.6% (Israel study)		67% (British study) 87% against hospitalization and death (Canadian study)	Mixed results	effective (early studies)	<ul style="list-style-type: none"> 70% (Chinese study during the Guangdong outbreak but not yet peer-reviewed); same antibody responses (Sri Lanka study)	70% (Chinese study during the Guangdong outbreak but not yet peer-reviewed)			65.2% Still effective for Delta plus variant	neutralised variant but less effective
	Beta			52% (South-Africa)	51%	slightly less effective but no publication in a medical journal						

Source: NY Times, Reuters, Bloomberg, Amundi Research

THEMATIC

5/ Distribution of vaccines reserved per providers' country as of total (%)



Source: Duke Global Health Innovation Center, Amundi Research - Data as of 19 November 2021

Among emerging markets, Europe and the US remain the main source of vaccines. However, China, and now India are alternative, or even the main, providers in certain countries. Burundi received from China its first shipment of vaccine in October. Yet China's vaccines'

lower efficacy (see table 1) and supply chain constraints limit its ability to distribute Chinese jabs. Although few in number, we notice that a few countries have reserved vaccines from South Korea and Taiwan.

Investment consequences

We are now assuming in our central scenario that Covid will become an endemic disease with multiple waves adding to economic uncertainty. The Omicron variant fast propagation and threats confirms this approach is relevant. In our downside scenario, virus mutations could precipitate an economic downturn. As existing vaccines become less effective and/or as immunity disappears after an average of six months, multiple vaccines and boosters will probably be needed in wealthy countries. This will lead to public support and private investment in this space, which will underpin healthcare sector valuations. Lastly middle- to low-income nations and some emerging markets will face a rising number of casualties and diverging growth paths versus highly vaccinated nations.

Despite mass vaccination and newly approved drugs³, and unless it miraculously disappears, Covid-19 is here to stay but will eventually turn endemic. The fact that AstraZeneca is moving away from the non-profit model used so far confirms it. The world could then be split into three: high-income countries with efficient vaccines and treatments; middle-income countries with mildly efficient vaccines and fatality rates based on the weaknesses of their healthcare systems; and low-income countries with limited access to vaccines, suffering from uncontrolled variants and an endemic disease similar to malaria⁴. Like climate change, Covid is bringing us back again to the debate on our collective responsibilities.

Finalised on 30 November 2021

³ Pfizer antiviral Paxlovid and Merck Lagevrio

⁴ According to the WHO report for 2019, 229 million cases of malaria worldwide resulted in an estimated 409,000 deaths. Approximately 94% of the cases and deaths occurred in Sub-Saharan Africa

CENTRAL & ALTERNATIVE SCENARIOS (12 TO 18 MONTHS HORIZON)

Monthly update

We change the narrative and the probabilities of the scenarios in line with our 2022 Outlook. The central scenario assumes that Covid becomes endemic with multiple waves albeit manageable, fiscal levers remain significant and tied to monetary policy and growth comes back to potential in 2023.

DOWNSIDE SCENARIO 15% Renewed slump toward stagflation	CENTRAL SCENARIO 70% Bumpy road, regional divergences	UPSIDE SCENARIO 15% Inclusive and sustainable growth
Analysis	Analysis	Analysis
<ul style="list-style-type: none"> Several risks precipitate an economic downturn, whose depth depends on the nature and intensity of the shock. Upward price pressures fade, as global demand falls and labour markets deteriorate. Renewed monetary and fiscal accommodation, possibly a further step in financial repression. Inflation to resurface later, forcing CB to deviate from their guidance and lose credibility. Possible triggers include China's hard landing, Covid-19 resurgence, financial shocks, de-anchoring inflation expectations, climate-change-related natural disasters and policy mistakes. 	<ul style="list-style-type: none"> Covid-19 becomes an endemic disease, with random contagion waves Growth catch-up in 2021-22 converges to trend in 2022-23. Soft patch in H1 2022 due to China's slowdown and accelerating inflation Persistent inflation pressures due to supply-side bottlenecks and to rising wage pressures. Monetary policy asynchrony: Fed to taper, BoE could hike rates, ECB on recalibration mode, and PBoC on an easing bias. Rates to stay low for longer. Fiscal policy: withdrawal of some accommodation, but support will be needed for the energy transition. Climate change bites into growth and inflation by disrupting the commodity cycle and adding to stagflationary trends. 	<ul style="list-style-type: none"> Pandemic recedes more quickly than anticipated. Extra savings and wage rises fuel consumption with no erosion on corporate margins. Productivity gains thanks to tech changes and structural reforms. Inclusive growth thanks to the fight against inequality. Inflation remains under control. Higher interest rates due to stronger investment and less savings. Central Banks on the way to normalisation, well received by financial markets. Debt is sustainable thanks to strong growth and a gradual shift towards fiscal discipline. Possible triggers include good policies (e.g., structural reforms, effective vaccine campaigns, and inclusive finance thanks to decentralisation).
Market implications	Market implications	Market implications
<ul style="list-style-type: none"> Favour cash, USD and US Treasuries Play minimum-volatility strategies Gold 	<ul style="list-style-type: none"> Lower risk-adjusted expected returns due to high valuations and decelerating growth Contained steepening of US Treasuries yield curve as well as EZ and EM Inflation hedge via gold, linkers and equities EM: Short-term caution, long-term income and growth story intact 	<ul style="list-style-type: none"> US Treasuries curves bear steepen Favour risky assets with cyclical and value exposure Favour linkers as an inflation hedge

Covid-19 related topics

Growth and inflation expectations

Monetary and fiscal policy

Recovery plans or financial conditions

Solvency of private and public issuers

Economic or financial regime

Social or climate related topics

TOP RISKS

Monthly update

We have amended the risks to take into account our 2022 central scenario, with no change to the probabilities.

We consider Covid-19-related risks to be part of the economic risks. Risks are clustered to ease the detection of hedging strategies, but they are obviously linked.

ECONOMIC RISK

20%

- **Pandemic 2.0**
 - Despite mass vaccinations, a new Covid wave kicks off in the Northern Hemisphere.
 - Variants with limited vaccine efficacy undermine the economic recovery (new lockdowns or mobility restrictions).
- **Supply chain disruptions** carry on, and input cost pressures lead to corporate earnings recession.
- **China property market collapses**, leading to lower growth prospects
- **Oil & Gas shock** driven by surging demand and capex cuts
- **Monetary policy mistake**
 - As inflation expectations rise, the Fed and large DM central banks tighten financing conditions too early, hurting the recovery while inflation eventually falls back
 - Central banks' miscommunication leads to greater uncertainty.
- **Climate change-related natural events** hurt growth visibility.

FINANCIAL RISK

20%

- **De-anchoring inflation expectations** lead to a bond market dislocation and harsher monetary tightening.
- **Corporate solvency risk increases**, despite improving fundamentals once central bank liquidity and government supports are withdrawn.
- **Sovereign debt crisis**
 - With public debt as a share of GDP reaching historically high levels in peacetime, most countries are vulnerable to rating downgrades and rising interest rates.
 - Emerging market weaknesses could also face a balance- of-payments crisis and increased default risks.
- **Widespread greenwashing and ESG investment bubble**
- **USD instability** and gradual loss of its reserve currency status

(GEO)POLITICAL RISK

20%

- **Accidental confrontations** in the South China Sea or the Taiwan Strait
- **US & Europe vs. China cold peace**
 - Escalation as the US takes a hard line with China;
 - Lost influence of the US post-Afghanistan exit and mistrust from NATO allies;
 - The EU could follow the US, despite their economic interests.
- **European populist vote**, in France or Italy on the back of the Covid crisis and rising energy prices. Increased EU fragmentation
- **EM political instability driven by:**
 - Chaotic virus crisis management
 - Higher food and energy prices, leading to a wave of unrest similar to the Arab Spring
- **US & China lose credibility** on the energy transition and undermine the Paris agreement.
- **Global warming** leads to an increased risk of conflicts, driven by water shortages and migratory movements.
- **Cyber-attack or data compromise**, disrupting IT systems in security, energy and health services

+ Cash, linkers, JPY, Gold, USD, Quality vs. Growth, Defensive vs Cyclical

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

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

- Oil, risky assets, frontier markets and EMs

+ DM Govies, Cash, Gold, USD, Volatility, Defensive

- Oil, credit & equity, EMBI

Covid-19 situation update

Pierre BLANCHET, Head of Investment Intelligence

The new variant Omicron, which was discovered in South Africa mid-November, has 50 mutations, which, presumably, makes it more transmissible and potentially more severe. The WHO highlighted an increasing risk of reinfection, as well, compared to other variants. The low vaccination rate in South Africa, where less than 24% of the population is fully vaccinated, or Botswana (20%) partially explains how we got to this point. Since the Delta variant appeared in December 2020 in India and swept quickly to Europe, starting with the UK, and then reached the US, it has become the most prominent version of SARS CoV-2. A similar scenario is likely in the case of Omicron and therefore, the main questions are the effectiveness of vaccines, tests and current treatments.

At the time of this writing, none of these questions have a definite answer and probably will not have one until mid-December. Hence, the volatility in financial markets over the past weeks. mRNA vaccine producers have confirmed they can produce a new vaccine in a few months, but the billions of doses needed to cover the world won't be ready until the summer. Moreover, protection against the Delta variant is still the first priority. As temporary precautionary measures, travel restrictions are already being implemented, along with new mobility restrictions and social distancing across regions.

CROSS ASSET DISPATCH: Detecting markets turning points

- The turning point has occurred
- Approaching the turning point
- Not reached yet too early to call it

●●● ECONOMIC BACKDROP

- After the strong expansion of the third quarter, economic growth rates in the Eurozone are expected to remain strong, albeit progressively moderating. High-frequency data stabilised while heading toward the pre-pandemic levels, while surveys and soft data provided evidence of an increasing impact of supply chain disruptions on manufacturing activity, and activity growth in services is softening after the strong reopening-driven rebound. The consensus continues to adjust downward in the Eurozone, while apart from Italy, economic surprises remain negative, despite some very moderate signs of a potential upward reversion.
- Economic activity in the US is accelerating in Q4 after decelerating in the second half of the Q3, in line with ongoing gradual improvements in high-frequency and soft data. The CESI Index returned to positive territory, underlain by a strong upward trend in both soft and hard data surprises. The consensus continues to trend downward, settling just below parity.

●●● FUNDAMENTALS & VALUATION

- Multiples and several metrics flagged alerts, due to very expensive levels, even considering low rates. Liquidity has been the strongest driver of risky assets, but with CBs' smooth normalisation this support should fade somehow.
- Relative value provides some ground, although our central case is for higher rates that will provide less tailwind for risk sentiment.

●●● TECHNICALS

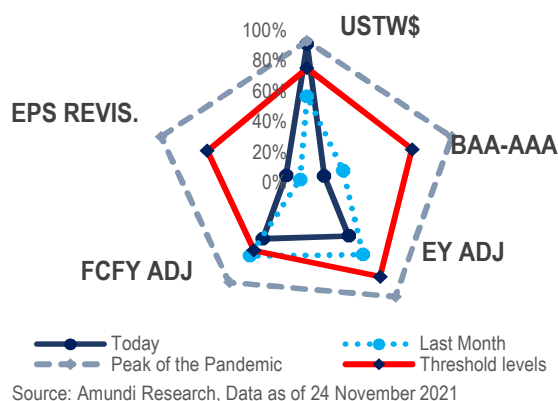
- We are still seeing the same mixed environment in technicals. Despite a solid medium-term trend in risky assets, we are lacking short-term momentum in most of those assets.
- Contrarian metrics showed that a few markets were approaching overbought levels (based on RSIs) in November, but the recent consolidation has resolved some of those dislocations.
- Technicals remain mixed, with a lack of directional bias at the time of this writing.
- This is something we find consistent with the deteriorating economic backdrop and the quite rich valuation positioning. All are pointing to higher market volatility.

●●● SENTIMENT

- Inflation is running higher across the globe, and investors have begun anticipating a more aggressive tightening in monetary conditions despite a deceleration of global growth. Yet we find no evidence of structural deterioration in risk sentiment in the market.
- Despite the mounting wall of worries, financial conditions remain loose in most regions (GEMs are still showing early signs of tightening) and both our CAST (where the USD is the only relevant metrics running above alert) and Mood-ON Mood-OFF are struggling to turn risk-off.
- Institutional investors' behaviour seems consistent with this finding: they continue to show a marginal pro-risk attitude, especially in commodities, bonds and equities.

NEUTRAL +
ASSET
ALLOCATION

Cross Asset Sentinels Thresholds (CAST) still supportive



The CAST risk perception has failed to show a structural increase. EPS revisions have stopped deteriorating with the better-than-expected Q3 reporting season and credit risk premiums remain low and a function of still-loose financial conditions. Yet the USD is the dimension calling loudly for risk-off, and its spill-over into the residual dimensions needs to be closely monitored.

Methodology: We consider five inputs, which we call "sentinels": USTW\$, Moody's Baa-Aaa, EPS revisions, Adjusted Earnings Yield Risk and Adjusted Cash Flow Yield Risk. 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 visualises 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 Reassessing DM central banks policies

- The Federal Reserve has mastered its communication, guiding markets through the start of its tapering process in the smoothest way possible with no significant market volatility.
- The ECB pushed back the recent pick-up (and anticipation) in the pattern of policy rate hikes, but had to reinforce the message several times to get a meaningful effect on pricing.
- The Bank of England misguided market participants by not raising rates as expected and not giving clear guidance on the months to come, effectively triggering a material correction not only on the UK curve but on the rest of DM short term yields, as well.
- December monetary policy decisions will take into account the impact of the new Omicron variant and its consequences on the growth and inflation outlook.

Investment consequences:

- Markets are reassessing to less aggressive pricing for a lift-off in interest rates and getting closer to Amundi's view. We now expect two Fed hikes in 2022.
- Curves could flatten as growth decelerates, but we reiterate the short duration call.

2 Italy: economic backdrop, valuation and technical are all supportive

- New positive macro surprises with higher-than-expected Q3 GDP (after a very strong Q2), improved rating outlooks (S&P, DBRS), supportive technicals and attractive relative valuations support a renewed wave of optimism towards Italian debt.
- Italian equities offer a good opportunity as well, thanks to attractive valuations (PE 2022 at 11.5x, vs 14.5 for Europe), historical high consumer and business confidence, and the potential to enjoy good relative EPS growth next year and positive earnings revisions.

Investment consequences:

- Investment case reinforced for long BTPs and long BTP-Bund spreads and positive view on FTSE/MIB.

3 DM equity markets: still all about momentum and risk appetite

- A strong earnings season outweighs the fear of margin pressures, thanks to strong demand and some pricing power.
- The strength of equity markets has managed to overcome a challenging economic backdrop (stagflation, deceleration of the economic momentum and worsening economic surprises) and high valuations, thanks mainly to benign financial conditions and elevated risk appetite.

Investment consequences:

- Regional allocation driven by profitability and debt rather than valuation: we like Japan and the US over GEMs, Asia Pac ex Japan and Europe.

4 EM macro momentum: Asia mildly picking up versus Latam and CEEMEA

- While EM macro momentum is still negative, for the first time in a while we see a shift across the regions, favouring Asia vs Latam and CEE/MEA.
- Overall, softening domestic and mainly external demand will result in lower growth projections.
- We expect China's GDP growth to stay close to, but below, 5% over the next two years. EM growth should be above 6% in 2022 and 4.3% in 2023, while inflation should be above 4% on average.

5 Reiterate our positive call on the USD

- The recent USD strength has been triggered by positive macro data and historically high inflation, leading to expectations of a faster tapering process and rate hikes in 2022.
- The bearish dollar view – which assumed that too much was priced in and that the Fed is likely to disappoint – has been proven wrong in 2021 and could once again be proven wrong in 2022. We believe the greenback has not deviated from its long-term valuation level.
- While expected growth/carry are pointing to lower upside, we remain positive on the USD on a 12 month horizon.
- Our EUR/USD 2Q 2022 target is now 1.10 versus a market consensus of 1.15. Our 12-month target remains 1.14 (consensus at 1.17).

AMUNDI ASSET CLASS VIEWS

	Asset Class	View	1M change	Rationale
EQUITY PLATFORM	US	=		The ongoing earnings season highlighted that companies have been able to navigate margin pressures and supply chain bottlenecks for now. However, with inflation and supply-demand mismatches staying persistent amid high valuations and slowing growth momentum, we remain very selective and continue to focus on fundamentals. In this respect, we are monitoring the progress on the Social Infrastructure Bill that aims to boost long-term growth.
	US value	+		As the economy progresses along a slower recovery curve, we look for names that will benefit from reopening but also possess the pricing power to pass on rising costs to consumers (sustainable earnings growth), have a sticky client base and display a tendency to improve their ESG performances. Strong selection is crucial in identifying these names.
	US growth	-		In an environment of rising inflation, and potentially higher US rates, long duration stocks whose valuations are dependent more on long-term future cash flows could be negatively affected. This, coupled with the fact that valuations are already expensive in some corners of the market, makes us cautious in this area.
	Europe	=		Markets have been driven by strong earnings and progress on economic recovery (uneven), but we believe absolute valuations are stretched in some segments and therefore the scope for stock picking is high. We are positive on companies that can preserve margins and those that operate in the value, quality and cyclical spaces. Our focus is on fundamentals and ESG, as this will unearth names that can deliver returns beyond the short-term earnings season.
	Japan	=		Japan would benefit from political stability (stimulus) under the new leadership, expectations of improving earnings growth and attractive relative valuations. As Covid cases decline, the country's recovery should catch up with rest of the DM.
	Emerging markets	=		EM prospects look attractive from a long-term perspective as the region emerges from the crisis. However, we remain very selective across geographies and see the regulatory actions in China as a source of near-term weakness, even though the country presents opportunities in the long run. In addition, relative valuations in EM look attractive, as does economic growth in the medium term. With a tilt towards value and cyclicals, we like countries such as Russia and India.
FIXED INCOME PLATFORM	US govies	-		Inflation pressures persist, testing the Fed's tolerance threshold, even as the CB announced its taper plans and moves towards normalisation. The medium-term path for nominal and real rates must be monitored and we believe that the massive debt and fiscal deficit will put upwards pressure on core yields. Given that this move will not be linear, we remain cautious on duration but flexible across the curves. On TIPS, we remain constructive but are watchful of valuations.
	US IG corporate	=		We look for quality credit but prefer company-specific risk over beta exposure in IG. On the other hand, we avoid debt where increases in core yields could have negative impacts. Consumer and residential mortgage markets remain strong as delinquencies remain moderate, but we think investors should be watchful of duration extension due to increase in rates.
	US HY corporate	=		In line with our aim to balance yield and quality, we remain selective on HY and rely less on directionality even as credit fundamentals are improving. We avoid areas of excessive leverage.
	European govies	-/=		We stay defensive on core and semi-core European government debt amid inflation pressures but acknowledge that the ECB will maintain a supportive stance to maintain accommodative financial conditions despite slowing its asset buying. On the debt of peripheral countries such as Italy, however, we are positive due to the nation's strong economic growth prospects and potential benefits from Next Gen EU funds.
	Euro IG corporate	=/+		Credit fundamentals are improving and companies look to be able to withstand supply bottlenecks for now, as evidenced by recent results. However, we are monitoring volatility from core yields, dispersion of credit metrics across companies and liquidity. Thus, through a selective approach, we prefer short-dated assets, with limited directional risk, and are exploring names that display potential to improve metrics before the premium sets in (rising stars, BBBs).
	Euro HY corporate	=		We remain active in HY and believe subordinated debt offers attractive yield as we are seeing improving distress ratios and accommodative financing conditions. However, there is a need to remain selective. Investors should balance quality, yield and stay mindful of liquidity across markets in light of the approaching year-end.
	EM bonds HC	=/+		In an overall defensive stance on duration, we continue to favour HC debt and maintain a bias towards HY over IG as it offers attractive yields. However, we are very selective in light of the Fed's policy normalisation and lower vaccination rates in EM compared to DM.
	EM bonds LC	=		We see some challenges for LC debt stemming from a stronger dollar but there are opportunities from a bottom-up perspective. Countries such as Russia continue to be supported by strong commodity prices but we are monitoring idiosyncratic risks and the situation in China's real estate sector.
OTHER	Commodities			Commodities are still consolidating at current levels, digesting news on growth and potential shortages. Supply issues and bottlenecks will last for a while, supporting base metals and energy prices. However, central banks and real rates are still the key variables for gold. Finally, oil, for the time being, is being driven by OPEC decisions to increase production.
	Currencies			Stronger-than-expected US inflation, labour market and retail sales data are affecting investor expectations, indicating an earlier rate lift-off from the Fed, but we are monitoring this closely. In the short term, we maintain our preference for the USD, especially vs low-yielding currencies.

LEGEND

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

Source: Amundi, as of 26 November 2021, 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.

DISCLAIMER

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or a component of any financial instruments or products or indices. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each other person involved in or related to compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties (including, without limitation, any warranties of originality, accuracy, completeness, timeliness, noninfringement, merchantability and fitness for a particular purpose) with respect to this information. Without limiting any of the foregoing, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including, without limitation, lost profits) or any other damages. (www.mscibarra.com).

Indices are unmanaged and their returns assume reinvestment of dividends, and unlike Fund returns, do not reflect any fees or expenses. It is not possible to invest directly in an index.

Unless otherwise stated, all information contained in this document is from Amundi Asset Management US (Amundi US) and is as of November 30, 2021.

Diversification does not guarantee a profit or protect against a loss. The views expressed regarding market and economic trends are those of the author and not necessarily Amundi US and are subject to change at any time based on market and other conditions, and there can be no assurance that countries, markets or sectors will perform as expected. These views should not be relied upon as investment advice, a security recommendation, or as an indication of trading for any Amundi product. This material does not constitute an offer or solicitation to buy or sell any security, fund units or services. Investment involves risks, including market, political, liquidity and currency risks. Past performance is not a guarantee or indicative of future results.

Amundi Asset Management US is the US business of the Amundi Asset Management group of companies.

Date of first use: 10 December 2021.

Document issued by Amundi Asset Management, "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 - DenysKuvaiev

Chief editor

BLANQUÉ Pascal, *Group Chief Investment Officer*

Editor

DEFEND Monica, *Global Head of Research*

Global Research contributors

AINOUZ Valentine, *Deputy Head of Developed Markets Strategy Research, CFA*
BELLAÏCHE Mickael, *Fixed Income and Credit Research Strategist*
BERARDI Alessia, *Head of Emerging Macro and Strategy Research*
BERTONCINI Sergio, *Senior Fixed Income Research Strategist*
BLANCHET Pierre, *Head of Investment Intelligence*
BOROWSKI Didier, *Head of Global Views*
CESARINI Federico, *Head of DM FX, Cross Asset Research Strategist*
DROZDZIK Patryk, *Senior EM Macro Strategist*

Deputy-Editors

BLANCHET Pierre, *Head of Investment Intelligence*
BOROWSKI Didier, *Head of Global Views*

GEORGES Delphine, *Senior Fixed Income Research Strategist*
HUANG Claire, *Senior EM Macro Strategist*
PORTELLI Lorenzo, *Head of Cross Asset Research*
STRENTA Aurelien, *EM Research Analyst (V.I.E)*
USARDI Annalisa, *Cross Asset Research Senior Macro Strategist*
VANIN Gregorio, *Cross Asset Research Analyst*
VARTANESYAN Sosi, *Senior Sovereign Analyst*

With the Amundi Insights Unit contribution

BERTINO Claudia, *Head of Amundi Investment Insights Unit*
CARULLA POL, *Amundi Investment Insights Unit*
FIOROT Laura, *Deputy Head of Amundi Investment Insights Unit*

DHINGRA Ujjwal, *Amundi Investment Insights Unit*
PANELLI Francesca, *Amundi Investment Insights Unit*

Conception & production

BERGER Pia, *Research*
PONCET Benoit, *Research*