Institute

#05
May
2022

CROSS ASSET
Investment Strategy

CIO VIEWS

Looming divergences and the great asset repricing

AMUNDI INSTITUTE

Q2 2022: A late cycle with a greater focus on inflation

Confidence must be earned

Amundi ASSET MANAGEMENT

#05 - May 2022

Table of contents

Global Investment Views

CIO VIEWS

Vincent MORTIER,
Group Chief Investment Officer

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Looming divergences and the great asset repricing

We are witnessing significant divergences in the economic outlook (we have revised down the EU and Chinese economic outlooks vs. the more resilient US economy) and in market performances. In particular:

(1) Inflation expectations – short-term peak vs. long-term rise: While short-term inflation may start to decelerate, the long-term view is increasingly showing that sticky inflation (e.g., shelter inflation) remains high (harder to reverse) in light of geopolitical risks and the supply chain stress amid Shanghai's lockdown.

(2) Recession risks: The US economy remains solid while the Eurozone is the most exposed to stagflationary risk. We will most likely see at least a short-lived recession in H2, triggered by Germany and Italy, while France and Spain might show some resilience. In China we see the official target of 5.5% growth for 2022 as being difficult to reach.

(3) Central banks on diverging paths: The Fed might join the club of CBs raising rates by 50bps in order to move to a neutral policy stance as rapidly as possible, while the ECB will be even more data dependent. The BoJ remains in its easing stance, and in China the PBoC remains ready to cut the key rate.

(4) Earnings – still strong expectations (with regional differences) vs. weak consumer sentiment. This is certainly a key earnings season to watch as any sign of strength from corporates, signaling a further inflationary push, may add pressure on the Fed to act. In Europe the earnings season will focus on guidance as a profit recession is increasingly likely on the back of the effects of the war though these are not likely to be reflected in this season's numbers.

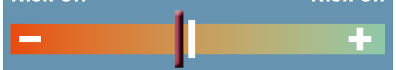
From an investment standpoint, while investors should maintain a neutral risk stance, there is room to play these divergences across the different asset classes:

- **In bonds, the market has moved fast in repricing a more aggressive stance from the Fed.** The initial moves were concentrated on the short part of the curve, but more recently the 10-year part has also started rising further, with the 10-year yield reaching the 2.9% level. **While longer term the rate trajectory remains upwards, it no longer makes sense to remain as short as we have been in the recent past, e**specially on the front end of the curve given the latest market movements, and therefore we are tactically adjusting our duration stance. There is room to play tactical relative value opportunities and curve opportunities in Australia and Canada, as well as in France, where the uncertainty over the presidential election outcome has driven spreads higher.
- **In FX, the rise in commodity prices should benefit the Brazilian real vs. the US dollar,** while the Russia-Ukraine conflict continues to benefit the Swiss franc vs. the Euro. We also favour the USD vs. the Euro.
- **Equities remain favoured vs. credit at this stage, but within equities selection is key**. The approaching earnings season appears more challenging for Europe, for which we keep a short relative bias vs. the US as the latter should prove more resilient. We continue to hold the view that a combination of value and quality (with a less cyclical bias and a tilt towards financials and more defensive value) is the best way to find opportunities in names that could have less volatile earnings and be less sensitive to rising rates. The growth repricing (down), especially on the most extremely valued names, is not finished yet, in our view.
- **In credit, we remain cautious and have moved further towards less risky names across the fixed income dedicated allocations. In our search for income, we are becoming more positive in EMBI.** After the recent yield rise, the EMBI market should be supported by the stabilising US 10-year yields, oil gradually moving down and the improving EM-DM gap. The EMBI composition, tilted towards LatAm and towards commodity exporters, is also a positive contributor.
- **Diversification remains crucial.** We believe adding real asset exposure in areas more resilient to inflation (infrastructure, loans with floating rates and real estate) and using strategies that offer low correlation compared with traditional asset classes could help navigate this unfriendly market environment.

To conclude, as the great asset repricing unfolds, investors should be ready to adjust their allocations to deal with inflation. So far, we have seen most of the repricing taking place in bonds. **We expect more to come in the longer part of the curve and in the most fragile equity markets, those where recession risks are on the rise (for example, European equities). However, the divergences in the markets will offer opportunities to tactically calibrate risk towards the most resilient areas.**

Overall risk sentiment

Risk off **Risk on**



Explore relative value across assets, favour more resilient areas, but without increasing risk as market directionality is limited.

Changes vs. previous month

- Moving towards a more neutral duration stance.
- More constructive on EM bonds.
- Tactically positive on USD vs. EUR.
- Enhanced hedges in credit and equities.

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

AMUNDI INSTITUTE

Amundi Institute column

Pascal BLANQUÉ,
Chairman, Amundi Institute

As the Fed tries to balance inflation and growth, investors should bear in mind that a repricing of rates would have consequences on bond and equity portfolios

Is the Fed behind the curve?

Judging by the current environment in the US, by any reasonable measure of inflation the Fed has fallen "*behind the curve*". Inflation is running rampant well above its 2% target, suggesting the Federal Open Market Committee (FOMC) should be hiking rates more rapidly to suppress price increases. Addressing this notion of being "behind the curve", St. Louis Fed President James Bullard offers two interpretations:

- Taylor-type monetary policy rules suggest the Fed is lagging by approximately 300 bps; and
- On the other hand, the two-year Treasury yield is at 2.47%, indicating the gap is not so wide. Nevertheless, the central bank must hike rates in order to deliver on its forward guidance.

Since the 1960s there have only been two other times when core PCE inflation was as high as it is today. The first was in 1974. Back then, the Fed downplayed the monetary factors that contributed to price rises and kept its policy rate relatively low. Consequently, it fell *behind the curve*, causing volatility in the real economy, higher inflation and multiple recessions.

In 1983, it did not wish to repeat its mistake and kept rates high in the face of declining inflation, eventually leading to the 1990-91 recession. Today we are closer to a 1974-style scenario, characterised by high, persistent and self-perpetuating inflation, a low ex-post real policy rate and nominal rates trending upwards with no way to stabilise the volatility in the real economy. It is also true that policy normalisation entails a high recessionary risk. **The Fed must decide between killing inflation at the risk of triggering a recession now, or buying more time for nominal growth to increase, with a hefty price to pay later on. It is likely that it will sway towards the latter.**

Investment convictions

In terms of investment implications, there is an ongoing global repricing of risk under way. Although it started on the short end, the final leg will occur on the long end via a steepening of the yield curve, signalling an inflection point for risky assets. The performance of equities and bonds will deteriorate or even reverse, provoking a widespread underperformance. **The repricing point in equities should see a tilt toward value and quality, which points to an outperformance in these sectors.**

Further repricing in equities and credit, signalled by a plateauing on the 10-year portion of the curve, would give a more comfortable signal that it is time to rebuild risk.

Monica DEFEND,
Head of Amundi Institute

Lorenzo PORTELLI,
Head of Cross Asset Research

Fed quanititative tightening (QT) and cross-asset pricing

1Q completely changed the Fed's course of monetary policy and forward guidance. As demand-driven data kicked in, the CB was forced to become more aggressive on hikes and balance sheet shrinkages. Going forward, consumer prices will force the Fed to act and eventually curb demand-inducing soft-landing in order to prevent structurally higher long term inflation expectations. The side effect of this new policy will be a liquidity drain in the ongoing asset reflation regime, providing a less friendly environment for financial markets.

The logical outcome will be a sort of readjustment in financial market levels to the new framework, and the process will drive a reassessment of multiples and valuation metrics to lower levels. Previously, the Fed's balance sheet expansion to $9tr slashed the long end of the curve and lifted the P/E. The $3.4tr injected during the lockdowns and the post-Covid recovery was only the final stage of a multi-year process.

Expected impact on the markets (also see table below)

- Monetary policy normalisation (Fed B/S back to the pre-Covid level) will generate a contraction in valuation multiples and lift UST 10Y rates above 3%.
- Viewed through the lens of different metrics and tools, the financial environment will take equities and fixed income into expensive territory, with sell-offs likely in both areas.
- Ultimately, the market's response will depend on how successful the Fed is in managing the slowing growth and profit cycle. In any case, the current outlook is not favourable for a re-rating of P/E multiples.

QT timeline	Annual B/S reduction ($ tn)	Cumulative B/S reduction ($ tn)	P/E contraction[1]	Fed balance sheet/total UST publ. debt	UST 10y[2]
1y forward	1.14	1.14	5.1%	25.8%	2.90%
2y forward	1.14	2.28	18.9%	22.1%	3.11%
3y forward	1.14	3.42	32.7%	18.3%	3.40%

Source: Amundi Institute, 19 April 2022. 1Price/Earnings adjusted for balance sheet expansion: distance from average considering mean reversion, 2UST 10y rates targets according to Amundi Macro Nelson-Siegel model and current debt levels.

MULTI-ASSET

Relatively play EM bonds, US vs. European equity

Francesco SANDRINI,
Head of Multi-Asset Strategies

John O'TOOLE,
Head of Multi-Asset Investment Solutions

In an environment of decelerating economic momentum, we remain risk neutral and wait for better clarity before adding directionality

Upward revisions to inflation are causing central banks to accelerate their tightening programmes. While the ECB is cautious due to the high level of uncertainty around growth, the Fed seems keen to reach to its neutral policy rate as soon as possible. Geopolitics is adding another layer of uncertainty to markets, which are already feeling the impact of stagflation, driven by upward pressure on commodities.

Such divergences in policy actions due to the nuances prevailing in these regions open the door for investors to exploit relative value opportunities in duration and FX. They also point to the importance of not increasing risk and being aware of valuations to identify attractive bets, including in EM. Finally, investors should look to strengthen their hedges in credit and equities, and maintain a well-diversified stance.

High conviction ideas

Our stance is neutral on equities but we seek relative value opportunities favouring the US over Europe on account of resilient consumer demand and solid labour markets in the former. In addition, in Europe, as the earnings season unfolds, we see risks from higher producer prices and margin pressures. As volatility has declined recently, we believe investors could exploit this relative value opportunity through options. On EM we are neutral, but we are carefully evaluating whether the Chinese government's more accommodative stance can offset the effects of the new Covid-related lockdowns.

On duration, we are cautious in USTs as we continue to believe in the upward movement of yields despite the recent increase. Our flexible and active stance allows us to explore opportunities across yield curves in other regions as well. For instance, we are now constructive on 10Y French (OAT) vs. German govt bonds (Bund) on account of attractive carry and OAT's cheap valuations when viewed from a historical perspective. Similarly, we remain optimistic on Italian BTPs over Bunds but believe the longer maturity segment now offers more scope for spread tightening. We are also positive on 10Y Australia vs. 10Y UK because Australian inflation has so far been contained compared with the UK, thereby limiting the onus on the Reserve Bank of Australia to raise policy rates. In EM bonds, we think the CNY is facing some near-term headwinds due to geopolitical tensions with the US (causing outflows) and the deterioration of the economic outlook. As a result, we are no longer positive on the local government debt. On the broader EMBI, however, we are now constructive, given its high carry, attractive valuations and tilt towards Latin America and commodity exporters. But we are monitoring the risks from default rates in HY countries.

Corporate credit, both US and EUR, will likely be affected by higher core rates and potential impact on earnings. Overall, we remain neutral for now, with a slightly positive outlook on IG vs HY, on account of valuations concerns in the latter, particularly in US HY.

Our FX views are reflective of our economic projection and its subsequent impact on the respective currencies. We are now cautious on the EUR vs. the USD and the JPY. The US/EUR interest rate differential and inflation pressures in Europe could weigh on the euro. Secondly, we are positive on USD vs. the CAD and the NZD, given that a potential increase in US real yields would support the greenback. Finally, we maintain our view on CHF/EUR on account of the franc's safe-haven status, and remain cautious on GBP/EUR. In EM, we are now positive on BRL/USD as the former should be supported by the strength in commodity prices.

Risks and hedging

Economic headwinds and geopolitical risks mean investors should enhance their hedges. We think investors should keep their protection on US HY and add safeguards on European credit. Even in equities, there is scope to protect European and US exposures, particularly amid the risks from the Fed's hawkish overtures.

Amundi Cross Asset Convictions

	1 month change	---	--	-	0	+	++	+++
Equities					■			
Credit & EM bonds	↗					■		
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.

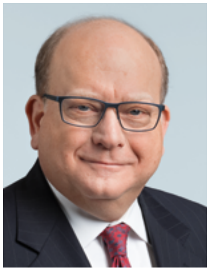
CGB = Chinese government bonds, EM = emerging markets, PBoC = People's Bank of China, FX = foreign exchange, IG = investment grade, HY = high yield, CBs = central banks, BTP = Italian government bonds, EMBI = EM Bonds Index. QT = Quantitative tightening.

FIXED INCOME

Expect tighter financial conditions: vigilant in credit

Amaury D'ORSAY,
Head of Fixed Income

Yerlan SYZDYKOV,
Global Head of Emerging Markets



Kenneth J. TAUBES,
CIO of US Investment Management

Financial conditions have not tightened for now, but the tricky part for risk assets will come when an increase in real yields is accompanied by pressure on corporate earnings

The current high inflation is a result of multiple factors, including years of underinvestment in physical capital (infrastructure, production capacity etc.), global reshoring and financial repression in the developed world. CBs are responding to inflation pressures but both the Fed and the ECB appear to be 'behind the curve', despite their hawkish views. Financial conditions have not tightened significantly so far, but they might if CBs are aggressive enough to curb inflation. Thus, **a watchful, bottom-up stance on credit is required to prepare for future discrimination. On government bonds, investors should remain agile as they provide support in times of stress, although the long-term direction of rates is up.**

Global and European fixed income

We have moved to a less cautious stance on duration in core Europe and the US as the uncertain economic environment is creating a move towards safe-haven assets. In addition, **we look for tactical opportunities across the curve and geographies,** enabling us to be positive now on Belgium, neutral on peripheral debt and defensive on UK duration. Taking a long-term view, we believe in diversifying duration exposure through China despite some near-term clouds.

In credit, spreads have retraced from the levels seen in early March and corporate fundamentals remain solid, but sentiment is fragile owing to high inflation, the recession risk (in Europe) and the less accommodative ECB.

We expect some decompression of spreads between IG and HY, wherein markets will distinguish high-quality credit from lower-quality credit. At a sector level, we are selectively constructive on banking, auto (slightly less than before) and energy, but cautious on consumer, utilities, transportation and chemicals.

US fixed income

While US growth is likely to gradually decelerate closer to trend by year-end, we do not see any indication of a recession this year. Demand remains strong on the back of solid wages and savings, with some weakness in mortgage applications. **We believe rates will increase in the long term, but it is vital to keep an active approach regarding duration amid the strong movements in the US yield curve.** In securitised assets, we look for value in agency MBS, which have underperformed corporate bonds so far as investors price in QT in the former. But MBS are increasingly becoming attractive. We also look for selective opportunities in non-residential and CRE. Corporate credit valuations are within their long-term averages but we prefer idiosyncratic risks and believe there is no need to be overly pessimistic because issuer fundamentals are still robust. However, we maintain hedges and are watchful of liquidity risks.

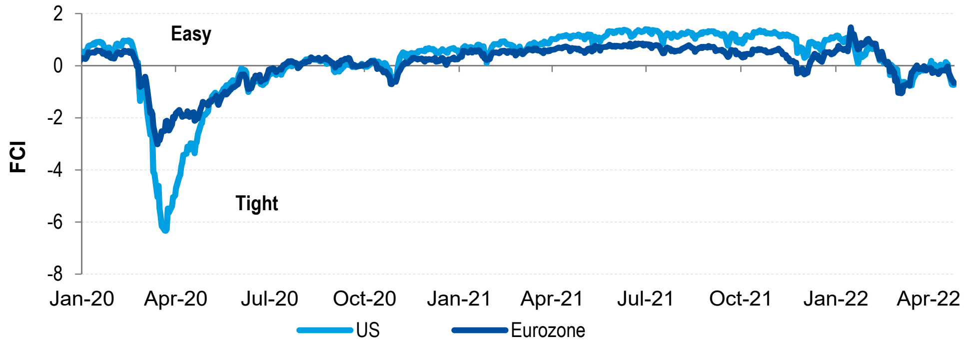
EM bonds

Elevated inflation increases the probability of further policy tightening across EM, with the high dispersion across countries underpinning the need for selection. We remain defensive on duration but are slightly less cautious. In HC, we foresee some spread tightening now, mainly in HY. In LC, we favour commodity exporters, both corporates and sovereigns, in LatAm and South Africa that could benefit from the current trend of strong commodity prices, but we are selective.

FX

The market's flight to quality is leading us to be positive on USD, but cautious on EUR. The current market expectations of two or three rate hikes this year priced in the EUR appear excessive. In EM, we are constructive on selective FX in LatAm (MXN, CLP) and Asia (THB), but cautious on the HUF.

Financial conditions indices



Source: Amundi Institute, Bloomberg, 22 April 2022. Positive value indicates accommodative financial conditions

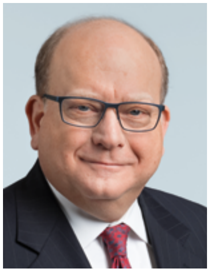
GFI = global fixed income, GEMs/EM FX = global emerging markets foreign exchange, HY = high yield, IG = investment grade, EUR = euro, UST = US Treasuries, RMBS = residential mortgage-backed securities, ABS = asset-backed securities, HC = hard currency, LC = local currency, MBS = mortgage-backed securities, CRE = commercial real estate

EQUITY

Diverging fortunes amid earnings reassessment

Kasper ELMGREEN,
Head of Equities

Yerlan SYZDYKOV,
Global Head of Emerging Markets



Kenneth J. TAUBES,
CIO of US Investment Management

Overall assessment

Rising inflation and slowing economic growth (Russia's invasion, supply disruptions in China) are likely to weigh on corporate earnings. Hence, in the current reporting season, **we will pay special attention to forward guidance on demand trends and pricing power in particular**. Pricing power, resilience of business model and strength of balance sheet is key for us at this point. Pricing power can arise from brands, intellectual property and other forms of product differentiation. The risk remains around valuations and, in this respect, a relative value approach is key. **Overall, value (less-cyclical) vs growth, and at a regional level, US vs Europe are preferred given a benign impact on former's earnings.**

European equities

Current valuation dispersion is high, encouraging us to be selective and yet balanced given the risk outlook. **Certain areas such as value remain attractive, even though we are now focussing more on the less-cyclical, defensive aspects because of the clear economic deceleration**. One exception is the banking sector, which is cyclical but which we continue to like at this point. We also like attractive defensive stocks in the health care and consumer staples sectors. In general, investors should consider moving away from low-quality defensive areas to high-quality segments. Information technology remains overall less attractive, given strong valuation headwinds, especially given the rising interest rate outlook. In addition, we fear that some fundamental risks such as regulatory headwinds and very high profit margins are not sufficiently appreciated by the market. Overall, we stay very selective and rely on our bottom-up approach to identify names that can generate sustainable, long-term returns.

US equities

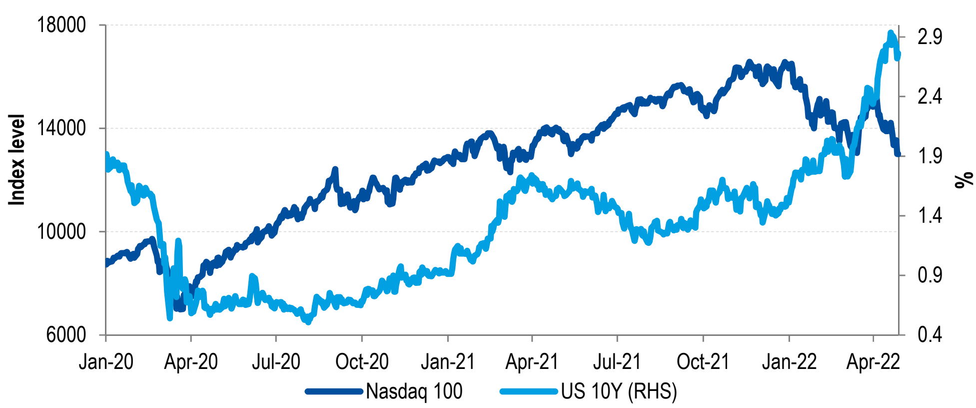
The US recovery should be driven by a strong labour market and solid consumer balance sheets, but inflation may affect disposable incomes. Interestingly, earnings are likely to increase due to inflation but, when rates rise, these earnings would be discounted by a higher cost of capital. So, some pressure on valuation multiples is expected. Thus, **amid an overall quality, value bias, we are exploring companies with strong operational efficiencies** and business models resilient to geopolitical risks, and those with a tendency to reward shareholders by returning excess cash (dividends, buybacks). But investors should avoid names with weak balance sheets. From a sector perspective, we are constructive on energy, materials, banks and healthcare. US banks are demonstrating high, stable returns on equity, and are investing in technology that should enable them to gain market share in the long run, although markets are not valuing this aspect appropriately, in our view. In addition, we are witnessing solid innovation in select healthcare companies and as such, some pockets of the sector look attractive. However, a careful selection process that helps uncover strong names remains a priority for us.

EM equities

Although current visibility is low, EM valuations allow us to see upside over the next 12 months, but divergences across countries are strong and we are selective. We believe commodity exporters (Brazil, UAE) and domestic consumption stories (India) could benefit. In China, as we watch authorities' stronger stimulus, we maintain a more cautious stance from a near-term perspective, given that recent lockdowns are likely to impact economic activity. But the long-term growth story remains intact. At a sector level, we favour discretionary, real estate and value.

Being mindful of valuations, investors should be long on 'short duration' areas (value, banks) that can reward shareholders through dividends, but short on 'long duration' sectors such as IT

Rising yields impact IT valuations



Source: Amundi Institute, Bloomberg, as of 26 April 2022

THEMATIC GLOBAL VIEWS

French presidential election: Macron's victory provides continuity but lacks political support

Pierre BLANCHET,
Head of Investment Intelligence

The incumbent president's re-election avoids an unpredictable political phase for France. Although Emmanuel Macron provides stability from an economic and a geopolitical standpoint, his narrower electoral base might be an issue in implementing his reform agenda.

Emmanuel Macron has won French presidential elections against far-right leader Marine Le Pen by 58.5% to 41.5%, confirming his leadership after five years in power. He has become the first incumbent president to be re-elected since the president and parliament terms were aligned on five-year terms. However, the outcome of the second-round race was much narrower than in 2017, and voter turnout was the lowest since 1969. **The French political landscape is increasingly fragmented,** with more than half of the votes going to populist candidates in the first round. **However, the strength of the institutions of the Fifth Republic are often underestimated,** and they have shown their ability to ensure a stable government in many challenging circumstances in the past.

During the second part of the campaign, Macron had to make several concessions to his left wing, including on the retirement system reform, and to endorse social measures to support household purchasing power. Moreover, several opposition leaders from each side of the political spectrum gave their support Macron but clearly in order to oppose Marine Le Pen without subscribing to his platform. This and the low voter turnout means that **his electoral base is not as large as the second round results suggest,** and his freedom of action will be limited particularly on the most difficult reforms. In this context, there is a risk that a social movement similar to the Yellow Vest one will appear as new reforms are initiated.

The debate between Macron and Le Pen made it clear that this election was a referendum on Europe. The French presidential election outcome is therefore a success for Europe and a guarantee of stability for the Eurozone. Macron's pro-European manifesto clearly showed support for more European integration and enhanced European autonomy in an evolving geopolitical context. Political continuity will also reassure NATO countries on France's foreign policy. Macron wants to "ensure the power of Europe" with a focus on energy, technology and defence. This includes accelerating decarbonisation and deploying clean energy to reduce dependence on imported coal, gas and oil. Europe's technological autonomy was often mentioned during his campaign. Macron calls for more investments to support European champions and more protection in the most strategic areas. He will also support a strengthening of European armies' capabilities and their coordination. At the EU level, Macron highlighted several reforms as priorities, including new fiscal rules, a renewed common energy market, and a new governance set-up for the EU.

Macron's next challenge is to secure a majority in the lower house (Assemblée Nationale) in two-round parliamentary elections, on 12 and 19 June. Left and right populists parties want to benefit from the momentum of the presidential election and secure a large number of seats. **However, the voting system makes it difficult for these candidates to succeed in the second round.** Moreover, the electoral premium given by the presidential election has always been sufficient to ensure a large number of seats for the president's party. It is likely that Macron's majority will be made up of a coalition that includes centre-left and centre-right MPs, as was the case in the previous parliament. Yet there is a risk this majority will be more difficult to achieve, since the traditional political parties have lost their voting shares and are deeply undermined by their poor results in the first round of the presidential election (below 5% for the Socialist Party and Les Républicains). Although a hung parliament looks unlikely, **strong populist opposition could block any significant reforms and in particular constitutional reforms,** which require a three-fifths' majority of both the lower and the upper house (Senate).

Despite a narrower electoral base and probably a weaker majority in parliament, **Macron should still be able to pursue part of his plans to transform the French economy and improve EU governance.**

The French presidential election outcome is a success for Europe and a guarantee of stability for the Eurozone

Finalised on 26 April 2022

THIS MONTH'S TOPIC

Lorenzo PORTELLI,
Head of Cross Asset Research

Silvia DI SILVIO,
Cross Asset Research Macro Strategist

Annalisa USARDI,
Cross Asset Research Senior Macro Strategist

Q2 2022: A late cycle with a greater focus on inflation

- **The shift to an inflationary late cycle has been confirmed with greater conviction and a focus on higher inflation (and rates). Economic momentum is still decelerating at a global level but with tentative signs of stabilisation.**
- **This translates into a cautious equity stance with a significant tilt to asset classes that are resilient to inflationary regimes with decent growth. Due to short-term uncertainties on the European economy arising from the war in Ukraine, equities are tilted more towards global value, quality factors and inflation-resilient sectors, with linkers offering a hedge. Base metals are the favourite commodities.**

Inflation Phazer Update

The inflation picture worsened over the course of Q1 2022. Before the start of the Ukrainian conflict, price pressures were seen peaking by the end of the first quarter, with oil (WTI) normalising within a range of $65-75/bbl. by yearend and prices of goods easing as pressures from supply bottlenecks would have partially subsided in H2 2022.

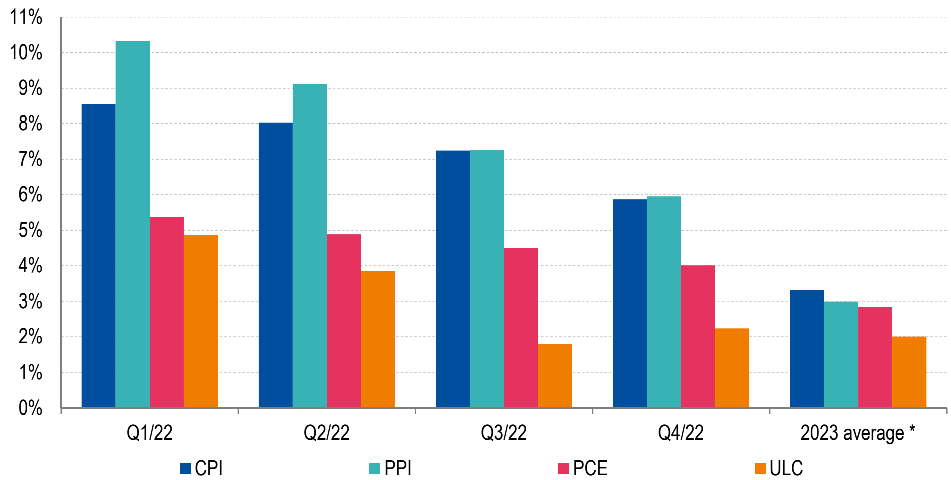
Instead, a few factors during the quarter added additional stress to prices, exacerbating the still ongoing pandemic-related supply constraints and bottlenecks, and spurring reported inflation figures and expectations to new record highs. The main event was definitely the start of the conflict in Ukraine, which renewed supply shortages, particularly in the food sector (Ukraine is one of the world's biggest exporters of wheat and vegetable oil), triggering also a sharp rally in the prices of oil and natural gas, due to heightened geopolitical risk and sanctions on Russia. Additionally, the rise in the number of Covid infections and renewed restrictions in China threaten to make matters worse, suggesting that previous signs of improvement tentatively materialising on shortages indicators are unlikely to be sustained.

Looking at the next 12 to 18 months, developments in commodity prices will be a key factor in assessing the inflation path ahead. We foresee oil (WTI) around the current level ($110/bbl.) for the remainder of Q2 2022 and subsequently fading to gradually reach $75/bbl. in Q1 2023. Overall, energy prices are likely to remain sustained, at least until the Ukrainian conflict ends. In the US, broad inflationary pressures are expected to peak in early Q2 2022 and to gradually ease over the subsequent quarters, due to a moderate correction in commodity prices, a negative contribution from base effects and weaker economic activity (the Fed's normalisation of monetary policy will play a crucial role in this respect). The average landing levels of inflation indices will, however, be higher than both what was previously expected and their pre-pandemic norm. More specifically, the still-high inflation projections are a by-product of the persistently strong PPI dynamics which are expected to be smoothly passed into CPI.

Amundi's forecasts on US inflation for 2022:

- **Headline CPI** to continue averaging around 8% in Q2, following, however, a descending pattern from the peak;
- **Producer Price Index (PPI):** pipeline pressures are expected to remain elevated in the near term and to progressively begin to abate in H2 2022;

1/ **Amundi US Inflation forecasts YoY Quarterly**



* 2023 is the average of YoY quarterly projections.
Source: Amundi Institute. Data as of April 2022.

THIS MONTH'S TOPIC

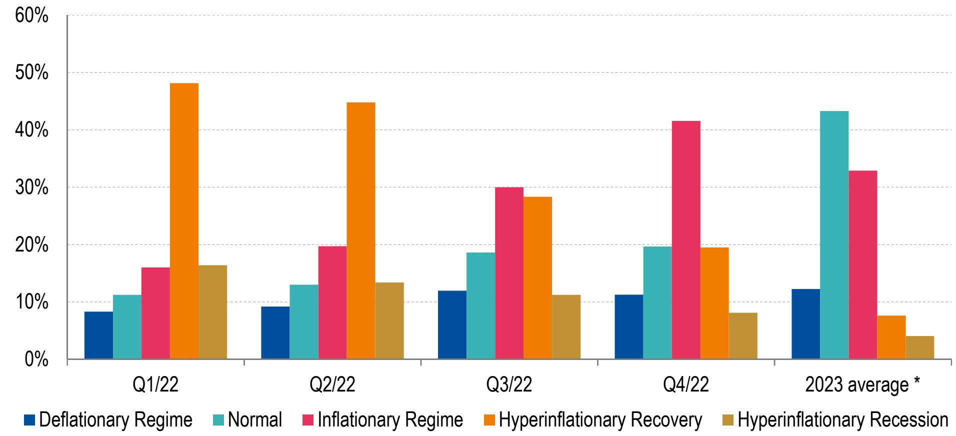
Current hyperinflationary regime extending to Q2 2022

- **Core inflation (Core PCE):** we're going to see a transition from the current 5.4% to 4% by yearend;
- The trend for **unit labour cost (ULC)** is projected to stabilise around pre-crisis levels (around 2%) but to average slightly higher during the year.

In 2023, the aforementioned measures of US prices should stabilise in the 2-3% range (based on YoY quarterly average), with the exception of CPI, which on average will decrease to a level slightly above the 3% mark.

Based on the projected pattern of inflation for the main US price indices (see chart above), **Amundi's Inflation Phazer** provides a probability distribution to each of the five relevant inflation regimes over the forecasting horizon.

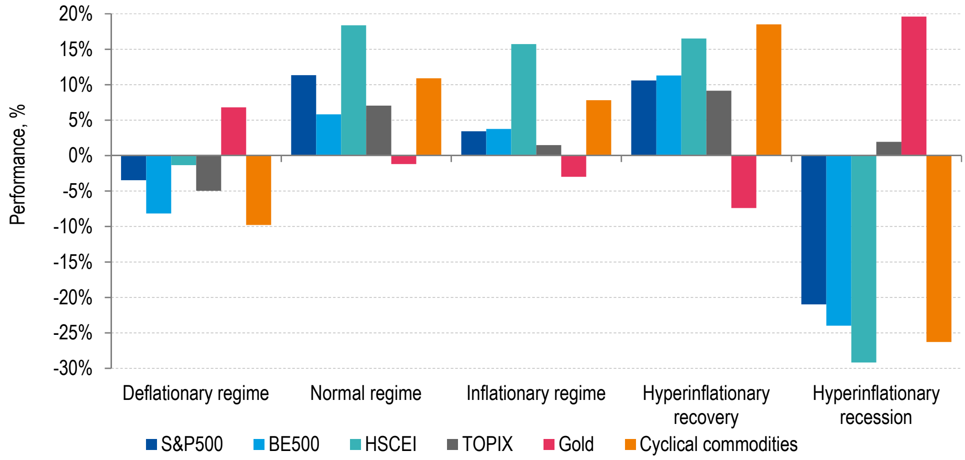
2/ Inflation Phazer Quarterly probabilities 2022-2023



* Probabilities for 2023 are based on average YoY quarterly forecasts.
Source: Amundi Institute. Data as of April 2022.
Inflation Phazer is Amundi's proprietary tool aiming to provide a compass for identifying the inflation regime most likely to materialise over both the short and medium terms, as well as the impact that can be expected on major asset classes. Five inflation regimes are identified using the following price indices as discriminating factors: the US Consumer Price Index (CPI), US Producer Price Index (PPI), US Core PCE (personal consumption expenditure) and US unit labour costs (ULC). Historical data are YoY monthly since 1959.
https://research-center.amundi.com/article/resilient-multi-asset-portfolios-inflationary-regime

According to the tool, the ***hyperinflation*** phase of Q1 (and actually ongoing since H2 2021) will extend into Q2, where we currently see inflation data peaking. Indeed, such a regime is characterised by inflation levels between 6% to 10%, where our forecasts for CPI and PPI currently land in Q2. Past the peak in inflation data, the regime will transition to ***inflationary,*** as YoY levels of prices move closer to the 3-6% range through year end. However, it must be noted that in Q3 ***hyperinflation*** risks will still be elevated (hyperinflationary only 3% less likely than inflationary regime). For 2023, the stabilisation of inflation indices in the 2-3% band (with the exception of CPI) will support the case for a further shift towards a more moderate inflation regime, called ***normal.*** Notwithstanding this expectation of inflation getting back to more balanced and sustainable levels, in 2023 the inflationary regime still has

3/ Amundi US Inflation forecasts YoY Quarterly



Source: Amundi Institute. Data as of April 2022. Equity performance is in price-index and local-currency terms. For the HSCEI index, returns under the Hyperinflationary recovery and the Hyperinflationary recession scenarios are based on simulations run by Amundi Research on the broader EM equity index.

THIS MONTH'S TOPIC

In H2 2022 the economic cycle will transition from recovery to late cycle

a very elevated probability of materialising (33%, vs 43% normal) and must therefore be taken into account when taking asset allocation decisions.

In terms of investment consequences, the reiterated sequence of positive inflation surprises since H2 2021 and the renewed threats to global supply chains due to the Ukrainian conflict, potentially resulting in a new geopolitical order, are strengthening the case for an allocation focussed towards assets that tend to benefit during regimes of elevated price pressures, in a still-decent economic growth context (as in the hyperinflation recovery regime).

In the equity space, investors may consider increasing their exposure to sectors that benefit from higher commodities prices and that possess good pricing power, such as energy, materials and financials, and playing their relative value against those sectors that are more vulnerable to interest-rate increases (e.g., technology and 'growth' sectors in general). Regionally, European equities is the area that historically bodes well in such an environment although Ukraine conflict uncertainties call for cautious here.

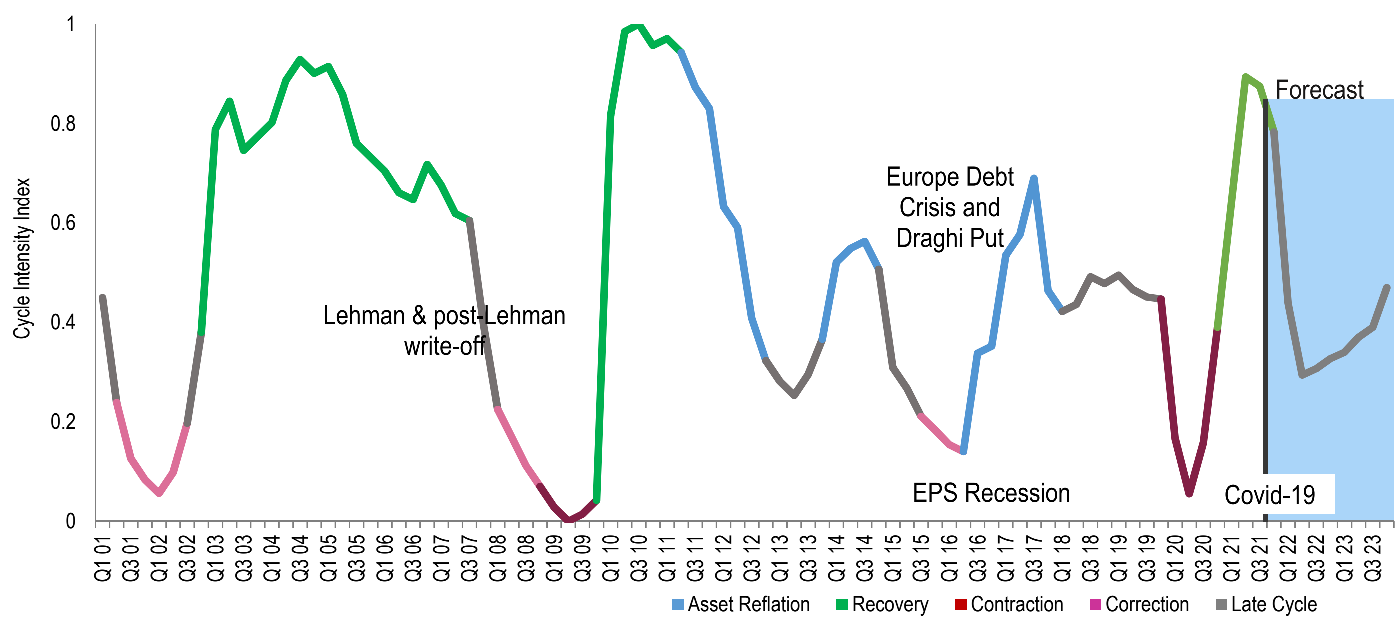
In such a context of pronounced demand/supply imbalances, the positive case for cyclical commodities holds, particularly for base metals, which we are expecting to retain some appreciation potential, given the low level of inventories and the elevated future demand driven by the green transition. Finally, we believe that inflation-linked bonds still provide a valid hedge to protect portfolios against a scenario of elevated inflation.

Medium-term business cycle update

The geopolitical events that drive commodity prices and inflation expectations are also contributing to the **deterioration of the global and regional growth outlook.** Amundi has revised down its forecasts for average world GDP (3.2% in 2022 and 2023, vs 4% and 3.4%, respectively), with global inflation higher (6.9% in 2022 and 4% in 2023, vs 5.3% and 3.4%, respectively). Such an additional acceleration in prices has further fuelled expectations that **monetary policy will get much tighter** over the next 12-18 months, in an effort to restore price stability and prevent long-term inflation expectations from de-anchoring. A **tightening in financial conditions** will be the main transmission channel of central banks' restrictive stance, with an overall softening in the current pace of economic activity. The expected deterioration of the macro-financial outlook is visible in the shift of the probability distribution among the regimes of **Amundi's Advanced Investment Phazer.** The second quarter of 2022 will now see the **late cycle** phase taking over the **recovery** phase, which has been in place since Q4 2020, and extending through 2023. In such an environment, EPS growth has little scope to deliver and is expected to fall into the positive single-digit area. Asset allocation-wise, the rotation from recovery to late cycle calls for a reallocation from high-beta markets to more defensive/higher quality assets.

Looking at next year, as the business cycle matures further and as economic activity re-approaches trend or stabilises even below, **correction** becomes the second most likely regime, suggesting an even more cautious asset allocation, with an increasing focus on defensive assets (govies and gold).

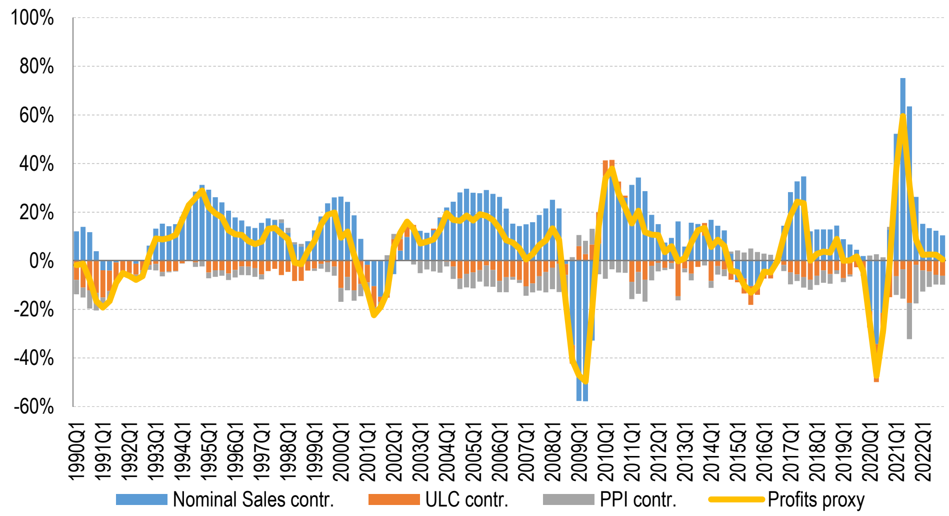
4/ **Advanced Investment Phazer Regimes occurrences since 2001**



Source: Amundi Institute. Data as of February 2022.

THIS MONTH'S TOPIC

5/ Profits margins are vulnerable to rising production costs and supply disruptions this time
Top & Bottom Line: YoY Contributions



Source: Amundi Institute, data as of April 2022

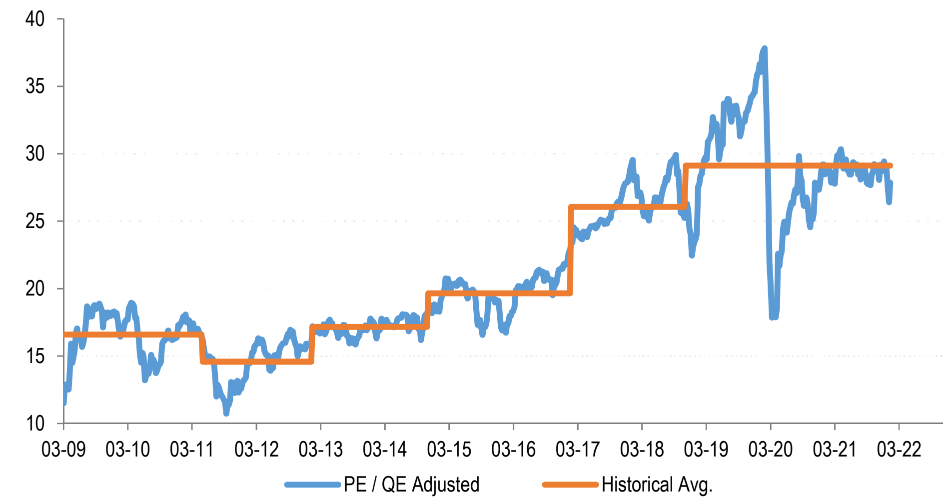
Quantitative tightening (QT) and a deceleration in profits not in favour of an expansion in multiples

Profits to come under pressure due to increasing costs

The Fed's monetary policy and unconventional tools have been pumping an extraordinary amount of liquidity into the markets, providing formidable support to the 2021 equity rally, besides the strong rebound in profits and economic growth. Liquidity-adjusted valuation metrics have been in cheap territory, with few exceptions so far. Although the Fed is expected to remaining dovish, supporting the economy through monetary base increases, the QT process should reduce liquidity propellant to the markets, while the deceleration in EPSs should mitigate investors' complacency. As a result, the shift from unconventional monetary policy to a more traditional one will be less market-friendly and more capex-oriented, limiting the expansion in multiples going forward. Profits will come under pressure in term of squeezed margins, due to increasing labour (wages), capital (rates) and real (raw materials) costs.

Finalised on 22 April 2022

6/ Unlikely to see higher multiples from current levels going forward, even on a liquidity-adjusted base
S&P 500 PE Adjusted for Fed balance sheet expansion



Source: Bloomberg, Amundi Insitutute calculation. Data as of April 2022.
Methodological note: the S&P 500 P/E is the time-weighted average of current and next year P/Es. These PEs are then adjusted (ratio) for a liquidity multiplier: the Fed Total Asset Balance Sheet (rebased to 1 at the beginning of QE in March 2009).
The historical average is dynamic and considers historical breaks in reflecting monetary and economic regimes changes.

THEMATIC

Upward pressures on inflation are the major market driver

Valentine AINOUZ,
Deputy Head of Developed Markets Research

Sergio BERTONCINI,
Senior Fixed Income Research Strategist

We expect central banks to remain on the hawkish side as long as inflation expectations remain on the upside, as central banks are afraid of losing their credibility. However, the Fed and the ECB are in different positions. The Fed wants to tighten financing conditions to slow demand, as the US economy is running hot. However, the ECB is stuck in an impossible situation: Eurozone inflation is primarily driven by higher energy costs, and a central bank has few "tools" to fight cost-driven inflation without hurting growth.

Core inflation could place pressure on central banks in the months to come

Inflation is skyrocketing. We expect that inflation is now close to peaking and will start to decline in the second half of the year, but core inflation could remain elevated and surprise on the upside. In March headline inflation reached 8.5% in the US and 7.4% in the Eurozone. Indeed, inflation first accelerated because of energy prices, commodity prices and supply bottlenecks. The war in Ukraine and ongoing lockdown measures in China have amplified these inflationary pressures. Supply bottlenecks are persisting much longer than expected. Henceforth, core inflation will be at the centre of attention. The risk is that inflation will be increasingly driven by second-round effects. On the one hand, more and more companies should continue to raise their prices to compensate for the jump in the cost of production. On the other hand, demand could be supported by a strong labour market (US) and targeted government support (Eurozone). "*The longer inflation numbers are at the high level where they are, the more likely it is that wages negotiations, entry-level salaries, and renegotiations of existing agreements will actually take place.*" (Christine Lagarde)

We expect central banks to remain on the hawkish side as long as inflation expectations remain on the upside

The Fed wants to slow demand

We expect the Fed to remain firmly committed to fighting inflation. The Fed wants get to a neutral policy stance as rapidly as possible, in order to move to more restrictive levels if that is what is required to restore price stability. Chair Powell was clear on the Fed's determination to do whatever it takes to bring inflation down when he said the FOMC would like to slow demand so that it is better aligned with supply, and that it is aiming for less accommodative financial conditions. The US economy is running hot:

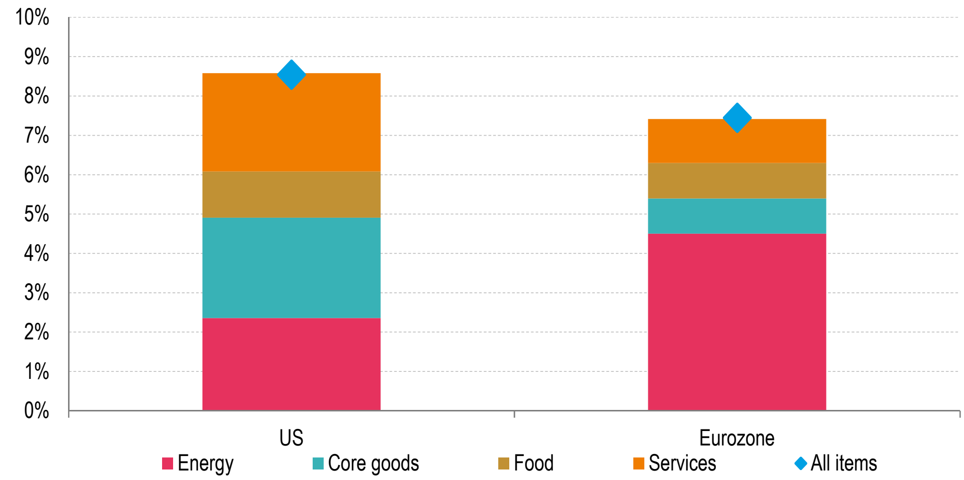
- Inflation pressures remain high and continue to broaden. The pace of growth in core consumer prices slowed in March, but this was largely due to a steep drop in auto prices, and other prices continued to show increases.
- The US labour market is extremely tight and is pushing wages to grow at the fastest pace in decades. Demand for workers is "too hot -- you know, it is unsustainably hot." (Powell).

We expect the Fed to hike rates at each meeting this year. Two to three 50bps rate hikes this year are on the table. Powell's comments were on the hawkish side, endorsing the market's pricing of a 50bp hike at the May, June and July meetings.

We do not believe in a recession soon in the US. We think the US economy is well-positioned to absorb the next rate hikes:

The US economy is running hot

1/ **Inflation: fundamental differences between the US and the Eurozone**



Source: Datastream, Amundi Institute, data as of 27 April 2022

THEMATIC

- For the corporate sector: higher cash holdings, higher debt duration and lower effective cost of debt than before the Covid crisis.
- For households: healthy balance sheets, large stacks of accumulated savings, and a constructive wealth effect, as housing prices and shares rose sharply from pre-pandemic levels.
- Increased borrowing costs could weaken demand for homes, but with the inventory of homes for sale at a record lows, it could take time before that shift affects home prices.

ECB to stick to rates normalisation despite the downside risk to growth

The ECB remained much more focused on the risk of inflation expectations' becoming unanchored than on downside risks' weighing on growth

After the hawkish surprises of previous meetings, in April the ECB refrained from announcing a further acceleration of stimulus withdrawal, fully confirming both its previous guidance on QE, which is set to end in Q3, and the policy sequence, with interest rates to rise possibly, but not necessarily, after QE ends. At the same time, flexibility has been emphasised as a valuable means to preserve the transmission of monetary policy and avoid fragmentation, but mostly to be used in case of need and not in a proactive way. In June – when the new set of macroeconomic projections will be available – the ECB is likely to announce the exact month when QE will end. Under this respect, the latest statements delivered after the meeting from some ECB members, like Vice-President De Guindos, hinted at July as a possible timing to end QE.

The ECB has few "tools" to fight cost-driven inflation without hurting growth

Although we perceived a more cautious stance at its last meeting, we keep our view that the Governing Council still seems more sensitive to the risk of record inflation than to a growth slowdown. Inflation is the ECB's top priority, and the central bank will carefully monitor any possible signs of de-anchoring of inflation expectations. According to our current baseline scenario, we expect rate normalisation to lift rates out of negative territory over the next few months, with two hikes before year-end, followed by another in Q1 2023. Then we expect the ECB to pause, given a combination of growth slowdown and inflation likely to turn lower from peaks. When compared to market expectations' currently implying five full hikes of 25bps over the next 12 months, we stay in the cautious camp, as our macroeconomic projections attach a higher probability to a technical recession, at least in countries such as Germany and Italy, which are more dependent on energy supply and prices.

Conclusions for fixed income markets

The short end of the US curve has intensively repriced over the last months. The US market is pricing more than 50bps for May and June and a mid-2023 peak in the OIS forward curve around 3.2%. Despite significant hike pricing and higher real yields, traded inflation has continued to drift higher across the forward curve. The 10-year break-even point exceeded 3% for the first time since the introduction of TIPS. In this context, we expect the Fed to remain on the hawkish side and we continue to see a compelling case for real yield shorts.

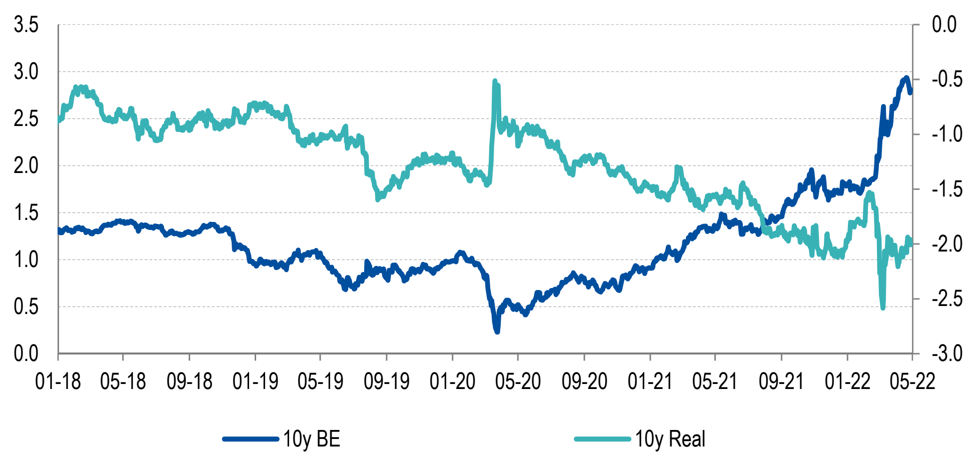
In the Eurozone, we think that too much is priced in the short end of the curve but we do not expect a shift in the ECB communication soon. We remain cautious on peripheral debt as high inflation limits the ECB's room to act and risks to growth are on the downside. Financing conditions will remain on the ECB's radar screen, not only in terms of spreads but also in terms of overall bond yields. Finally, a cautious stance remains on credit markets, where US corporates look more resilient in terms of macro perspectives and technicals.

Finalised on 27 April 2022

We're still in a situation where we're supportive in terms of monetary policy. Real rates are today very, very negative. So the beginning of the normalisation process should be relatively independent of the real economy

(Pierre Wunsch)

2/ **European nominal rates remained unchanged through the recent sell-off**



Source: Bloomberg, Amundi Institute, Data as of 27 April 2022

THEMATIC

Claire HUANG,
Senior EM Macro Strategist

Hold tight for the Chinese demand shock: faith over fear

The extended lockdown in Shanghai and other cities have shattered market confidence, sending Chinese equity market down again over the month. Taking into account the damage of the zero-Covid policy to the Chinese economy, we expect a recession in Q2 and full-year growth to undershoot the government target by a wide margin (Amundi forecast 3.5% versus the 5.5% official target).

Nevertheless, a simple extrapolation of Shanghai's case would be wrong. Despite the fact that one fourth to one third of the economy is under various levels of restrictions, activities outside of Shanghai have started to recover since early April, heralding an adjustment of policy execution and a gradual reopening in May/June.

More importantly, hesitation on broad policy easing has decreased. The Central Financial and Economic Committee on 26 April called for comprehensive infrastructure construction, laying the ground for a rebound in sentiment. Three days later, the Politburo reassured markets by reiterating its annual economic targets and calling for an end to regulatory crackdowns on the platform economy.

The Growth puzzle – how much should we discount on the downside?

GDP growth came in firmer than we expected at 4.8% YoY in Q1, defying strong negative base effects. A closer look at the numbers reveals an increased statistical discrepancy between official and alternative data, especially on industrial and housing sides. In our view, the upbeat print is likely to overstate actual economic growth.

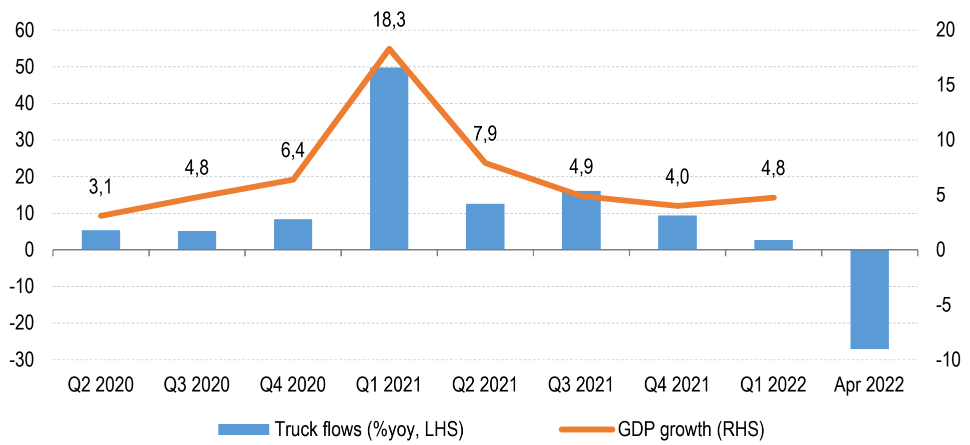
The upbeat Q1 GDP growth print is likely to overstate actual economic growth

In Q2, the extended lockdown in Shanghai and expanded restrictions into other regions will send China into a transitory recession. The evidence is telling. National freight traffic – an indicator that tracks China's growth closely – was down by 27% YoY in April (Chart 1). Shanghai and Jilin have shown that the economic cost of zero-Covid policy is high and will only get higher with more transmissible variants, as a city needs to bring mobility down more for an Omicron outbreak than for a non-Omicron outbreak.

Using truck flow data, academic economists Chen et al., 2022 have estimated that a one-month full-scale lockdown in Shanghai, Beijing and Shenzhen will reduce national GDP by 4%, 3.6% and 2.8%, respectively. Now, Shanghai's full-scale lockdown has stretched over a month into early May, and the Ministry of Transport predicts a 60% YoY decline of national travel during the Labour Day Golden Week. Even though the lockdown economy (e.g., medical equipment production and online shopping) may thrive again, a recession is inevitable in Q2 in our view, assuming a cautious reopening in May and June (see Chart 2 for forecast details).

Nonetheless, we cannot rule out upside surprises to our forecasts. For one, the statistical smoothing will lead us to catch up with the official numbers in the coming quarter. Just in the last week of April, a PBoC official called for securing growth above 5% in Q2, signifying the importance of achieving the full-year growth target. Another meaningful source of upside surprise is infrastructure investment, which could go beyond our forecast range and land above 10% for the full year.

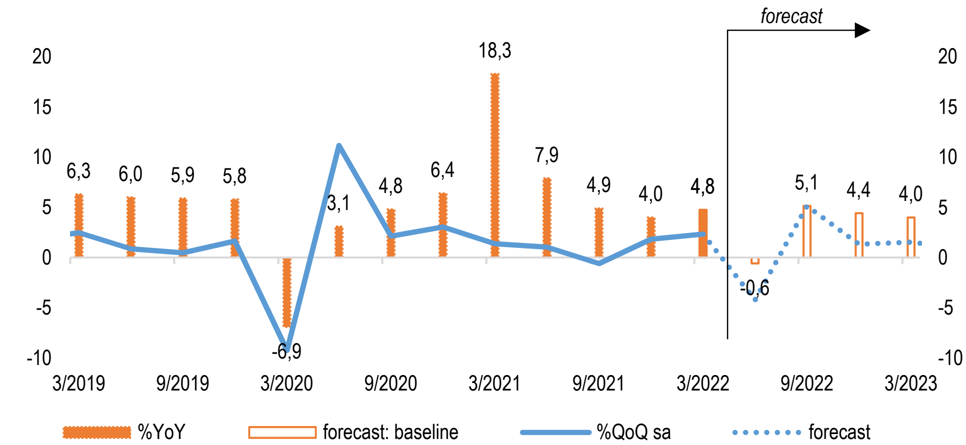
1/**China's truck flows and GDP growth**



Source: Wind, Amundi Institute, data as of 29 April 2022

THEMATIC

2/China GDP growth forecasts



Source: CEIC, Amundi Institute, data as of 29 April 2022

The Covid puzzle – how long will the zero-Covid policy last?

The zero-Covid policy remains the major catalyst to our growth outlook, and poor execution could thwart other stimulus efforts. The April Politburo meeting stated clearly its intention of sticking to a dynamic zero-Covid approach. With a busy political schedule ahead, including local leadership reshuffles in 17 provinces in Q2 and the Politburo/Central Committee elections in November, we expect officials to adhere to the zero-Covid policy throughout the year.

However, it would be wrong to simply extrapolate Shanghai's hit to other cities. At the execution level, adjustment is underway to accommodate logistics demand, for instance a streamlined application process for truck drivers to get their health passes. As a result, we have observed a steady recovery of activities outside of Shanghai and at the national level, paving the way for an economic recovery in May/June and Q3.

We expect the credit impulse to turn positive in April and to continue to climb higher throughout September

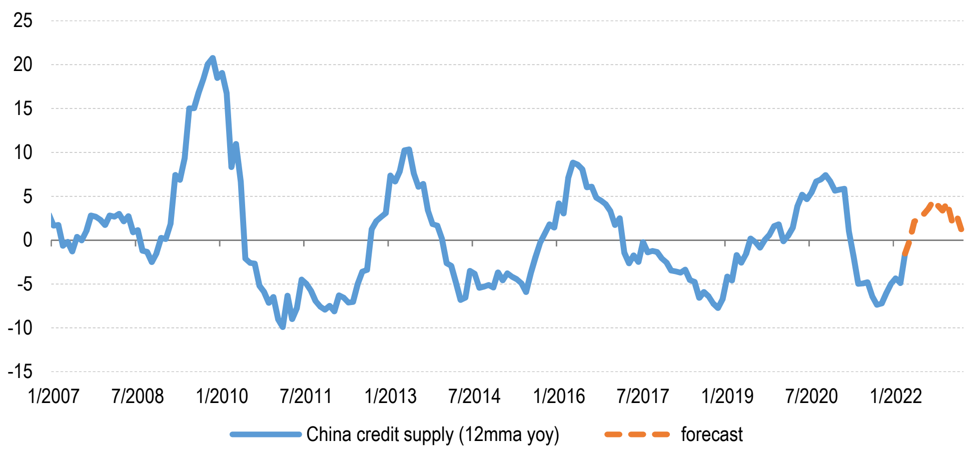
The policy puzzle – will policymakers under-deliver?

Markets have been disappointed by the follow-through of policy promises, in particular monetary easing. In fact, the PBoC disappointed again in April in keeping its policy rates unchanged for the fourth straight month and cutting the RRR less than expected. That said, interbank liquidity conditions have loosened further, with front-end rates plunging. Meanwhile, the PBoC has turned its focus to transmission, guiding banks to extend loans and relax their lending requirements. With mounting downward pressures on growth, we do see the need for additional rate cuts and expect another 10bp rate cut in coming months.

Although the PBoC is behind the curve in the traditional monetary easing space, its window guidance appears to be working. Credit growth has regained its lost ground, picking up again in March. We expect the credit impulse to turn positive in April and to continue to climb higher throughout September (Chart 3).

On the other hand, fiscal stimulus has come more in the form of tax and fee cuts, which probably explains the expectation gap between markets and policymakers. In addition, as public debt growth has accelerated, infrastructure spending is

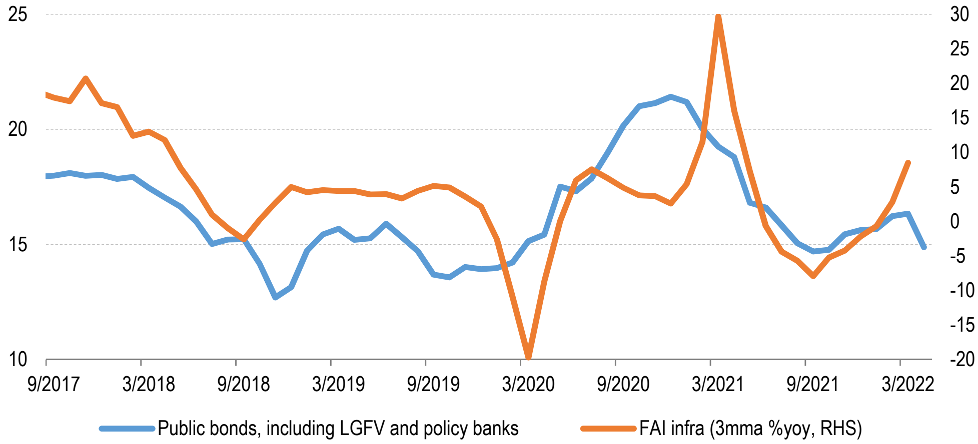
3/China's credit impulse



Source: CEIC, Amundi Institute, data as of 29 April 2022

THEMATIC

4/ Public debt growth and infrastructure investments



Source: CEIC, Amundi Institute, data as of 29 April 2022

Following the April Politburo meeting, we are likely to see a quicker follow-through of policy supports

also likely to strengthen. Infrastructure investment growth is now heading to a higher range of 5-10% in 2022, compared with our previous forecast of 0-5%. This will be supported by the relaxation of infrastructure project quality requirements and public bond issuance. Cash handouts or subsidies to consumers, if any, would be positive surprises to our forecasts.

Following the April Politburo meeting, we are likely to see a quicker follow-through of policy supports. These supports, albeit addressing major market concerns directly, will not be enough to cancel out the damage from Covid restrictions. But since the downside of Chinese growth becomes visible to us, we believe policies will only be looser instead of tighter, underpinning a recovery in sentiment.

Finalised on 29 April 2022

CENTRAL & ALTERNATIVE SCENARIOS (12 TO 18 MONTHS HORIZON)

Monthly update

We keep the narratives and the probabilities of our central and alternative scenario unchanged versus last month. However, the war in Ukraine could evolve in several ways (see Ukraine crisis tree) with significant implications on economic and financial markets. The new wave of Covid-19 in China is another source of uncertainty over the short-term.

DOWNSIDE SCENARIO 30%

Renewed slump toward stagflation

Analysis

- Long lasting **war in Ukraine** is hurting confidence and activity, and pushes commodities and energy prices higher for longer, and disrupting supply.
- **Covid-19** Omicron (or another variant) resurgence leads to renewed mobility restrictions and bottlenecks across the globe.
- Both triggers lead to an **economic downturn** while **inflation** remains elevated and uncontrolled.
- **Renewed monetary and fiscal accommodation** to support the economy, possibly a further step in financial repression.
- Inflation amid slower growth, forces some **Central Banks** and the ECB in particular, to **deviate** from their guidance and potentially lose credibility.
- Policies and investments designed to fight **climate change** are postponed and/or countries policies are disorderly implemented.

Market implications

- Favour cash, USD and US Treasuries
- Play minimum-volatility strategies
- Gold
- Commodities and energy

CENTRAL SCENARIO 60%

Bumpy road, regional divergences

Analysis

- The **war in Ukraine** is hitting confidence and pushes commodities and energy prices higher but only temporarily.
- **Covid-19** becomes an endemic disease, with random contagion waves.
- **Global activity** to hold better against waves, but supply chain bottlenecks will remain until end-2022.
- **Global growth** progressively abate to trend in 2022. Opening 2023's to downside risk. Soft patch in H1 2022 due to China's GDP contraction in Q2 (lockdowns) and weaker Euro-area growth (Ukraine).
- Persistent **inflation** pressures throughout 2022 due to high energy and commodity prices, supply-side bottlenecks, rising wage pressures; and abating in 2023. Inflation is a psychological and political issue.
- **Monetary policy asynchrony:** Fed in fast move from tapering to QT and a steep hiking cycle; BoE in a soft hiking cycle, ECB recalibrating QE and probably hiking rates in 2022; PBoC on an easing bias. Rates to move higher but to stay low for longer.
- **Fiscal policy:** withdrawal of some support, but public funding and subsidies are needed to smooth the impact of the energy transition on households.
- **Climate change** bites into growth and pushes commodity and energy prices higher, adding to stagflationary trends.

Market implications

- Lower risk-adjusted real returns expected
- 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 real income and growth story intact

UPSIDE SCENARIO 10%

Inclusive and sustainable growth

Analysis

- The **war in Ukraine** ends quickly with limited disruption of the energy and commodities market.
- **Endemic recedes** faster than anticipated, despite variants.
- Extra savings and wage rises fuel **consumption** with low erosion of corporate margins.
- **Productivity gains** thanks to digital and energy transitions and structural reforms.
- **Inflation** remains under control.
- **Higher interest rates,** due to stronger investment and less savings.
- **Central banks'** policy normalisation is well received by financial markets.
- **Debt is sustainable** thanks to strong growth and a gradual shift towards fiscal discipline.
- **Inclusive growth** and effective fight against inequality.
- **Possible triggers** include end of the war in Ukraine, structural reforms, effective drugs and vaccine campaigns, and inclusive de-centralised finance.

Market implications

- US Treasuries curves bear steepen
- Favour risky assets with cyclical and value exposure
- Favour linkers and equities as an inflation hedge

Geopolitic · *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 keep the probability of economic and geopolitical risks to 30% to take into account the war in Ukraine and its potential implications on the economic and financial risks. We consider Covid-19-related risks (including lockdowns in China) to be part of the economic risks.
Risks are clustered to ease the detection of hedging strategies, but they are obviously linked.

ECONOMIC RISK 30%

— **Global recession** driven by an oil and gas shock and a deteriorating sentiment as the war in Ukraine stalls

— **Economic crisis in Eastern Europe** following a collapse of the Russian economy, elevated energy prices, uncontrolled inflation and a migrant crisis

— **Pandemic 3.0**
- After Omicron (2.0) a more dangerous and vaccine resistant variant starts a new wave
- New lockdowns or mobility restrictions could further undermine the global recovery

— **Supply chain disruptions** carry on (China new lockdowns), and input cost pressures lead to corporate earnings recession

— **China zero Covid policy combined with regulatory crackdown and property market collapses,** leading to lower growth prospects

— **Monetary policy mistake**
- Central banks' miscommunication in the context of a high geopolitical uncertainty.
- Central banks underestimate the strength of supply driven inflation and lose control

— **Climate change-related natural events** hurt growth visibility and social balance.

+ **Cash, linkers, JPY, Gold, USD, Quality vs. Growth, Defensive vs Cyclicals, Oil**

- **Risky assets, AUD CAD or NZD, EM local CCY**

FINANCIAL RISK 20%

— **Sovereign debt crisis**
- An extended war in Ukraine would hurt DM vulnerable public finance with public debt as a share of GDP already at historically high levels
- De-anchoring inflation expectations could lead to a bond market dislocation and harsher monetary tightening
- Most countries are vulnerable to rating downgrades and rising interest rates.
- EM weaknesses could also face a balance of-payments crisis and increased default risks.

— **Corporate solvency risk increases,** despite strong fundamentals as uncertainty rises and corporate margins are under pressure (high input cost, double orders lead to profit warnings)

— **Widespread greenwashing and ESG investment bubble** undermine the energy transition funding

— **USD instability** and gradual loss of its reserve currency status lead to unstable currency markets

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

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

(GEO)POLITICAL RISK 30%

— **War in Ukraine** *
- Short term resolution following Russia military success: markets instability remain as investors are starting to price in Putin crossing new red lines
- Prolonged military struggle leading to a high intensity conflict and potentially western military confrontation

— **EU political fragmentation** or populist vote bring a disagreement on how to manage the relationship with Russia

— **The US takes a hard line with China** in order to block any tentative to invade Taiwan. Risk of accidental confrontations in the South China Sea or the Taiwan Strait

— **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

— Iran or Korea **nuclear programs** renewed concerns and sanctions

— **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

* *For more detailed on potential outcomes see "Ukraine crisis tree" P. 20*

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

- **Credit & equity, EMBI**

Ukraine Crisis Tree

[A] Russia has partially invaded Ukraine, but is facing resistance and unprecedented economic sanctions. Russia has moved his action to the Donbass region. High level talks have started but no resolution - Russia nuclear forces are placed on high alert

[B] Short-term resolution with limited military escalation				[C] Prolonged military conflict and global military escalation	
B1] Sanctions deterrent effects and diplomatic talks end the conflict with an acceptable way out for V. Putin	**B2] Russia controls Donbass and land north of Crimea. End of the conflict**	**B3] Russian army controls East and South Ukraine and the conflict extends to Moldova**	**B4] Unrest or military putsch ends Putin's regime**	**C1] Low intensity conflict with limited supply chain disruptions (evolution of B2)**	**C2] High intensity conflict (evolution of B3]**
Partitioning and/or demilitarisation of Ukraine moving to "neutral" status i.e not joining NATO		Full sanctions against Russia which enters an economic and financial crisis	Russia economic and financial crisis	Global stagflation	Worst case scenario, we can be expected including West and Russia military confrontation and Ukraine becomes a battlefield
Markets relief: limited repricing of global relative risk premia, limited global spillover but profit recession in EU still a tangible risk	Worse growth than our central scenario with EU GDP contractions and growth [0%-2%], Inflation towards 8%-10%	Spillover into Eastern Europe		GDP and inflation close to our central scenario	Global GDP contraction comparable with GFC or Covid-19
Better growth prospects than our central scenario and CBs back to normalisation	Energy prices to remain high as sanctions remain and rationing of energy coming from Russia and limited substitution capabilities		High uncertainty on Russian political new situation	Oil decelerating towards 75-80 by Q1 23 or even 60-65 in case of partial diversification (horizon 12-18months)	EU GDP down -4.5% to -2% with rationing of energy supply and economies to support the war efforts
Energy prices remain temporarily high before supply diversification materializes (e.g., Saudi or Iran) and the search to diversify suppliers makes further progress	Market instability starting to price in Russia crossing new red lines in Europe	Worse growth than our central scenario with EU GDP contractions and growth [0%-2%], Inflation towards 8%-10%	Energy prices to remain high and unstable	GDP for EA at 2.2%-2.4% (annual average growth), inflation in the 5.5%/6% (average)	Inflation skyrockets to double digit on severe shortages of commodities, even higher energy prices, food emergency
	Profit recession in Europe				
			GDP contractions and growth [0%- 2%], Inflation towards 8%-10%		
			CBs back to normalisation		
• Positive: European and Chinese equities, EM credit • Negative: Gov Bonds, commodities, energy and gold	• Positive : safe havens (USD), Oil prices stay close to 100-120 • Negative : liquid assets, and EUR	• Equity markets capitulation with US outperf. • Bond yields collapse • Oil prices high and volatile • Stronger USD and gold	• Yield curves flatten • Euro weakens, EM FX turmoil • Oil prices high and volatile • Equities high dividends and quality • Within EM favour Latam and China	• Negative real rates favour real assets, gold, commodities and EM debt • Equity value, quality and defensive • Short duration	• Markets capitulation • Favour UST and secured real assets • Bond yields collapse • Stronger USD, weaker EUR and strong gold • Negative EM

Source Amundi Institute

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

- Macroeconomic uncertainty on the growth and inflation front has been progressively increasing as the Ukraine war extends, new sanctions are elaborated, renewed supply chain disruptions materialise, and China implements new lockdowns under its zero-Covid policy.
- Directions of revisions diverge on inflation and growth, as inflation is set to grind higher still for a few months on higher energy, food and commodity prices, while growth is impacted negatively on both the demand and supply sides. Stagflationary momentum is evident in the Eurozone in particular.
- While hard data do not show the impact of the war yet, confidence data have started to deteriorate, highlighting material downside risks to the growth outlook.

FUNDAMENTALS & VALUATION

- The QT announcement is likely to impact valuations and multiples, with possible repricing should the economy falter more than expected.
- Inflation is another headwind to the expansion in multiples expansion, while expectations are still very optimistic, at least in Europe, considering the potential shortages in raw materials.
- All in all, valuations and current levels are vulnerable to potential negative surprises on fundamentals or higher-than-expected rates. So far, reporting season is going well in the US, providing some ground to markets.

NEUTRAL + ASSET ALLOCATION

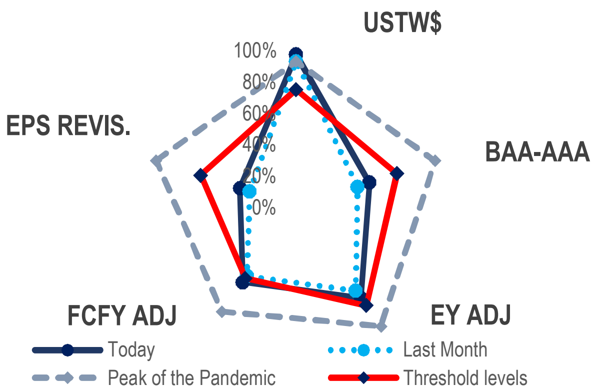
TECHNICALS

- No changes in technical signals for risky assets compared to last month.
- Despite expectations of a global downturn, trend-following signals are still lacking to call for a clear-cut short on risk. The problem we have today is that contrarian signals are still far from oversold levels (most equity indices are not at full discount vs start of year levels) – something which prevents confidence in sustainable rebounds.
- The current market environment keeps absorbing dislocation opportunities quickly, leaving no strong space for technical signals to drive risk-budgeting decisions.

SENTIMENT

- sentiment perspective. Whilst most survey-based indicators are flashing excessive pessimism on the global picture, sentiment metrics have failed to drive a substantial cut in risk exposure.
- Our risk sentiment indicators are close to neutral as we speak, yet flirting with alerts during most trading sessions. Financial conditions are showing greater resiliency than expected in April, despite the rising rates that we have experienced globally.
- CAST keeps signalling how resiliency in fundamentals would be key when deciding whether to fade or buy the recent rebound in the risk spectrum. The strong bounce in the USD and the drop in EPS revisions are still balanced by the resilient credit risk premium (the Moody's Baa-Aaa spread is still below our estimated alert).

Cross Asset Sentinels Thresholds (CAST) still supportive



Source: Amundi Institute, Data as of 19 April 2022

The CAST risk perception has failed to show a structural increase, despite the recent data show risk-off probability above 20%. The deterioration in EPS revisions remains limited and credit risk premiums (we proxy, using Moody's' Baa-Aaa spread) failed to jump above our alert threshold (i.e. 100 bps). Yet, the USD is the dimension calling loudly for risk-off, and its spillover into residual dimensions would complicate the picture, in our view.

<u>Methodology:</u> 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 Global growth revised lower – inflation revised higher

- Tighter monetary policy ahead to fight inflation: Fed funds rate @ 2.50% by yearend; ECB to exit from negative deposit rates in 2022, amid serious risks of recession in Germany and Italy over the next few quarters
- Higher commodity prices (in energy, industrial metals, and food) for a more protracted period, further exacerbated by the war in Ukraine have severe implications on global inflation and growth: 1) negative impact on consumption (through lower real disposable income), and 2) higher input costs' putting a cap on production.
- 12M yield targets revised higher: US 10Y @ 2.90/3.10% (from 2.50/2.70%) and Germany 10Y @ 0.80/1% (from 0.40/0.60%).

Investment consequences

- Reduced risk exposure, slight UW on equities.
- Recalibration in fixed-income from credit to govies and cash.
- Maintain focus on inflation via linkers and commodities.

2 More downside on the euro

- EUR/USD revised six-month target to 1.02 (from 1.09)
- Eurozone's economic backdrop for 2022 has turned gloomier, due to the commodity shock induced by the Ukrainian war and the related struggles for energy independence from Russia, with Germany and Italy challenged the most.
- Valuation of the FX deteriorates dramatically when correcting its purchasing power parity by the loss in productivity caused by the all-time high gap between PPI and CPI.

Investment consequences

- Short EUR/USD over the next 6M, as we see consensus expectations on EA economy and ECB hawkishness in 2022 as too optimistic.

3 Commodities, holding on to our constructive view

- All historical drivers of commodity prices are currently supportive:
  - **Cyclical and fundamental:** undervaluation gap with global growth is now closed thanks to the economic recovery being driven by fundamentals (increasing economic activity, infrastructure, cyclical demand)
  - **Geopolitical:** the most critical factor due to the Ukrainian war, which generated undersupply issues on natural gas and a generalised shortage in a wide spectrum of commodities, from grain to steel (Russia and Ukraine account for 30% of global wheat exports).
  - **Structural:** the green transition and a potential long-lasting demand-supply mismatch in crucial base metals are the bulk of our constructive view. As inventories are still at historical lows, commodities valuations are being adjusted by growth, and inventories look cheap in absolute and relative term.
- The rally seen over the past 24 months (CRB index up 83% since the end of April 20) closed the gap with growth. Nevertheless, valuations are not expensive when adjusted by the level of inventories.

Investment consequences

- Commodities are a key portfolio diversifier and offer opportunities in all phases of the economic cycle when managed proactively.
- Will remain structurally supported as demand in "green" commodities is going to increase due to the electrification transition.

AMUNDI ASSET CLASS VIEWS

	Asset Class	View	1M change	Rationale
EQUITY PLATFORM	US	=/+		Strong consumer spending and labour markets will support overall demand, allowing us to believe that a recession is unlikely, though we may see some pressures on economic growth. Given that real yields are close to positive and nominal yields are rising, we are watching how these affect equities. We remain selective, with a focus on companies (for instance, in banking) that reward shareholders through buybacks and those that can maintain high operational efficiencies.
	US value	+		The uncertainty around rising costs requires a focus on high-quality value companies that are less cyclical and can deliver sustainable earnings growth. While the rotation favouring value may suffer near-term setbacks, the move towards these names is likely to continue in the long term. The key point here is prioritising selection over market directionality.
	US growth	-		Despite the recent underperformance of growth vs. value, the long-term valuation of growth as a sector remains high. We also acknowledge some segments becoming attractive but believe rising rates could pressurise valuations.
	Europe	-/=		Slowing economic growth and persistent cost pressures are likely to affect consumer spending and, accordingly, corporate earnings. We are looking for signs of companies being able to pass on rising costs to consumers and how that may affect overall inflation. Thus we stay balanced and maintain our quality, value and dividend bias backed by our strong selection.
	Japan	=		A mild deterioration in economic momentum leads us to remain vigilant on earnings. Strong corporate governance, stimulus support and productivity gains should be supportive for the markets.
	China	=		The zero Covid policy is likely to weigh on economic growth (and supply chains) and we think the 5.5% target will be difficult to achieve, leading us to be a bit more cautious in the near term. However, selective, long-term opportunities remain amid policy support (monetary and fiscal) as the country transitions to a more balanced economic growth model.
	Emerging markets	=		The war in Ukraine doesn't bode well for global growth and inflation, and, accordingly, EM will be affected. However, divergences across EM are high, and as such selection is important. We are positive on commodity exporters such as Brazil and UAE, and on domestic-demand stories including India, but cautious on countries (Hungary) closer to the crisis.
FIXED INCOME PLATFORM	US govies	-/=	▲	Given that the Fed is continuing its hawkish pivot and inflation remains stubborn (particularly the sticky part of inflation), we are cautious on duration but are managing exposure tactically given the current flight to quality and the recent market movements. Our exposure to TIPS is minimal.
	US IG corporate	=		In light of the still-strong corporate fundamentals, we keep a stable risk stance in IG but prefer idiosyncratic risks and maintain broad hedges. We are also evaluating how the sector responds to the Fed's quantitative tightening and rising core yields. In this respect, we see relative value opportunities in securitised assets such as agency mortgage-backed securities.
	US HY corporate	=		We remain neutral and selective in HY. On the one hand, the sector is supported by high energy prices, but on the other hand, valuations must be monitored, particularly as waning liquidity as a result of QT could tighten financial conditions.
	European govies	-/=		While the long-term move towards higher core rates holds true, the geopolitical tensions and market stress are putting downward pressure on yields. This, coupled with the ECB's data-dependent approach wherein interest rates rise "some time" after the end of QE, underscores why investors should stay agile on duration. We are slightly less defensive on duration in core Europe and actively look for opportunities across the curve and geographies, such as in Belgium.
	Euro IG corporate	=		We are tracking the effects of the end of the ECB's asset purchase programme and the recession risks on IG spreads even as corporate balance sheets are strong, despite high producer prices (and therefore margin pressures). We think investors should consider moving from high-beta to low-beta segments/securities through a fundamental analysis-driven approach.
	Euro HY corporate	=		Concerns around Europe's economic growth and inflation could weigh on corporate earnings, although spreads are lower than the levels seen in early March, indicating strong corporate fundamentals. Looking ahead, markets will distinguish credit on the basis of quality and liquidity risks, causing us to be very selective across the market.
	China govies	=/+		Valuations in Chinese local government debt, Covid-19 lockdowns and geopolitical tensions with the US (pressures on FX) are near-term concerns. From a medium-term perspective, the asset class offers strong diversification benefits.
	EM bonds HC	+	▲	We are slightly constructive on HC, particularly on high-beta idiosyncratic stories that explain our strong bottom-up bias. Within this, we favour HY over IG on expectations of spread tightening in the former.
	EM bonds LC	=		We remain constructive on EM duration in LC and believe there is scope for a reallocation towards commodity-exporting FX, even though we are a bit cautious on EM FX as a group. The high fragmentation in EM allows us to be very selective.
OTHER	Commodities			The continued Ukraine war (undersupply issues, particularly in natural gas), the green transition and structural demand supply mismatches in crucial base metals allow us to be constructive on commodities.
	Currencies			The slowing economic backdrop in Europe is likely to weigh on the EUR/USD and we think consensus expectations are too optimistic; we have downgraded our six-month target to 1.02. We stay positive on CHF owing to its safe-haven status.

LEGEND

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	Negative		Neutral		Positive		Downgrade vs previous month	Upgraded vs previous month

Source: Amundi, as of 26 April 2022, 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.

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CROSS ASSET INVESTMENT STRATEGY

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