Confidence must be earned

Amundi ASSET MANAGEMENT

Q2 2019

Global Asset Class Spotlights

Top Down Quarterly Assessment

Strategy Research Team

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Setting the scene

Market recovery in Q2 closed fundamentals mispricing

High Conviction Ideas

- **Growth, monetary policies and geopolitics remain the key drivers of market returns and investment decisions, with their relative influence changing over time.** The YTD revival of risk assets has translated into rosier expectations on growth. We remain cautious; we confirm the late cycle environment with extra dovish central banks and growth stabilisation ahead, as our economists are predicting. However, we also look towards the **reporting season** to confirm the solidity of corporates' fundamentals and we expect a re-rating in the face of European elections.
- We consider the **US and European reporting seasons and a Sino-American trade agreement as potential triggers for the financial markets to re-rate in Q2**.
- While it is tricky to find good top-down stories because of messy or challenging issues at regional/country level that require us to **be selective**, we think emerging markets and credit continue to screen well on a cross asset perspective

What to Watch

- EPS reporting season
- Geopolitical (tariffs, Brexit, EU elections)
- Chinese economy and policy mix challenge
- US consumers' resilience

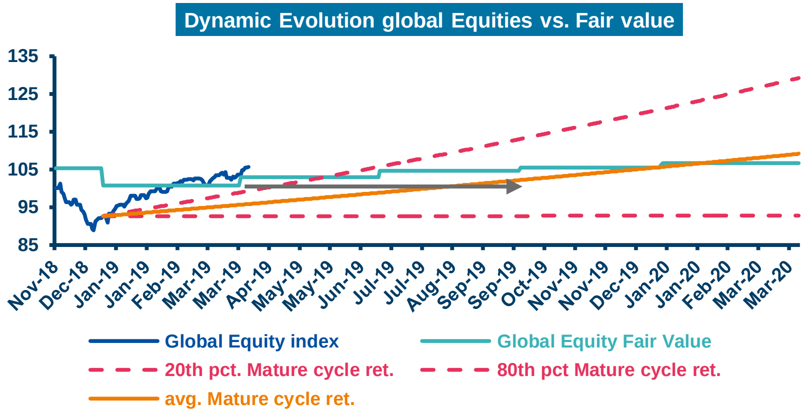
Overall Assessment

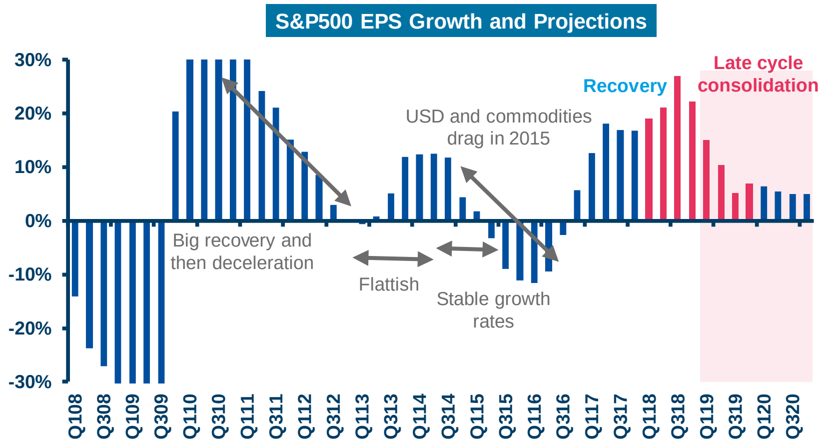
We confirm our **defensive stance, sticking to the conviction of a late cycle with newly dovish central banks. Credit and emerging markets are usually favoured under these circumstances.**

Risks to Our Assessment

- Liquidity risk
- Inflation surprises
- Monetary policy mistakes
- Debt concerns
- Escalating tensions and political risks (trade, EM, Eurozone)

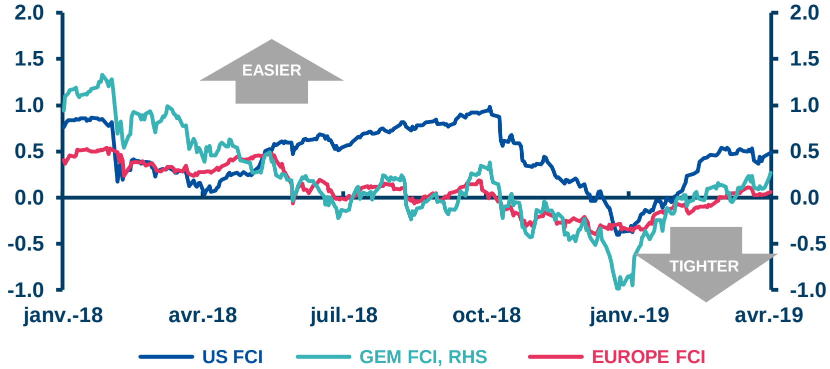
Global equities vs. fair values – dynamic evolution. Q2 expectations are priced in already, with price levels almost at the end of year target



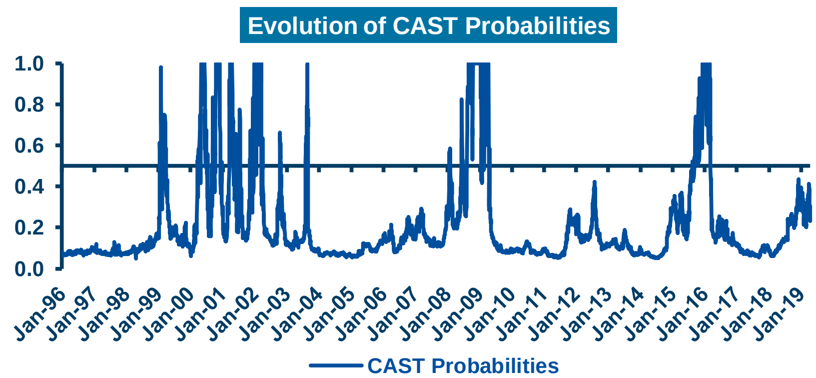


Key Charts

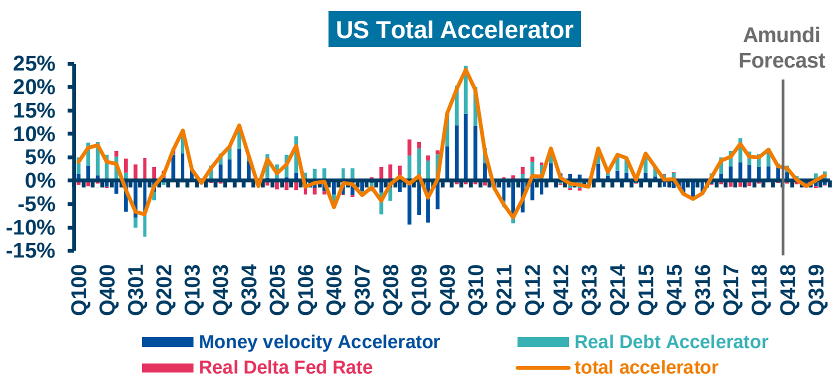
Global financial conditions rebounded strongly in Q2 2019 on the back of tighter spreads, low market volatility and less stressed money markets across the main regions.



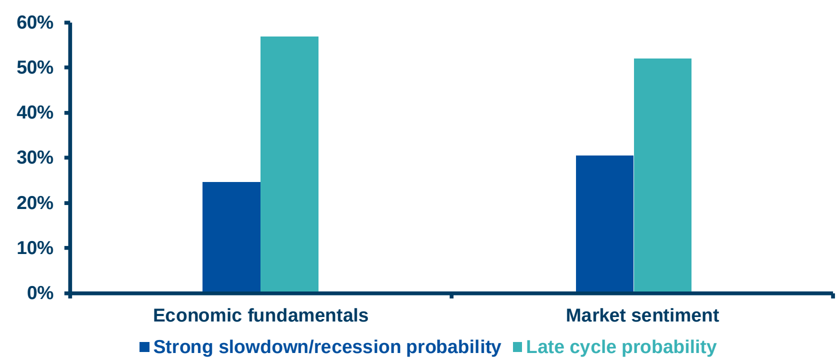
Cross Asset Sentinels Threshold (CAST). The CAST Alert probability (@ 36%) started rising again on the back of stronger USTW$. Still far from Alert threshold.



US real money accelerator expected to tighten in H2 2019 and then reaccelerate on the back of the pause in the normalisation process.



Financial markets levels are more consistent with a late cycle environment. They have been correcting end of year overshoot to the downside. Reporting season and a Sino-American trade agreement will be the triggers in Q2.



Source: Bloomberg, Amundi Research internal calculations, April 2019

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Global Asset Classes and Cross Asset Views

2Q 2019 – Strategy team assessment

CROSS ASSET	Our central case is still for **a late-cycle phase**, despite there still being a significant possibility of **a tail risk of a slowdown (probability 20%).** A late cycle is normally benign for risky assets, with a **preference for DM equities vs credit and GEM; this time, however, CBs have reversed again and extra dovish tone is shifting preference towards credit and emerging markets.** However, this kind of Goldilocks environment will be challenged by economic and profit cycles and monetary policies will be tested by a more difficult environment with more limited capacity to step back economy and markets. Considering the impressive Q1 rally (with both US and Europe up +15%), we believe **global equities could be vulnerable to some correction should momentum buying a pause**. We are **tactically short equities mainly in Europe and Japan, where fundamentals remain depressed and disconnected from the YTD rally.**
EQUITIES	The rebound of equities year to date continues, pushing P/Es back to their 200-day moving average. Earnings estimates continue to be revised down. It seems that **the current rally has gone too far too fast and that a consolidation is due** (probably in Q2). By region, we **prefer EM and underweight Japan**. If the cycle becomes prolonged, **EM should benefit most from Chinese stimulation, a weak USD and a finalisation of the US-China trade agreement**. The **underweight on Japan acts as short-term protection**, should it be more difficult to reach a trade agreement. Moreover, **earnings behaviour is also disappointing there**. On the style dimension, we prefer to use the **most diversified among the defensive styles** (quality, which starts to be expensive, high dividends and Min Vol), in a phase with the position within the cycle. We would choose some **cyclicality on a case-by-case basis on a more granular level (sectors or stock picking).**
FIXED INCOME & FX	Both the Fed and ECB have surprised significantly regarding dovish stances: the Fed announced the ending of QT in September and hinted at no more hikes for 2019, while the ECB announced a new round of TLTRO and extended forward guidance on rates. **Central bank actions thus supported a strong recovery of credit markets and contributed to the further compressing of bond yields in Q1** We maintain our preference for **US Treasuries among developed government bonds**, mainly on the back of relative value and despite that in the short term, an adjustment of the announcement effect on Treasuries could take place: on the back of the new monetary policy accommodative environment, we have **lowered our targets on government bond yields across the board**. Among credit markets, we still **prefer US IG and European HY**, the latter supported by a stronger and persisting search for yield in the short- to medium-term curve segments. The USD is likely to remain strong in the short run, but is expected to somewhat reverse its 2018 trend over the coming quarters, as the Fed has probably reached its rate target.
COMMODITIES	Oil has by far outperformed all other risky asset class since the beginning of the year, driven by supply dynamics and concerns. Oil benefited from the supply disruption in Venezuela and OPEC production cuts of 3mb/d in Q1 (the largest since the Great Financial Crisis). In the first weeks of April, the oil rally was supported by two other factors: 1) the military situation in Libya, which exacerbated the global supply disruption; and 2) the most recent boost came from Trump's decision not to renew waivers for countries that buy oil from Iran, putting further pressure on global oil production. According to our analysis, **the current levels for Brent and WTI already significantly discounted potential supply disruption in Venezuela and a dramatic cut in Iranian exports (current Iran exports are 1.3mb/d), thus we maintain our targets of $55-65/bbl for WTI and $62-2 for Brent.** On the other hand, negative economic momentum, combined with low risk appetite and a dovish Fed are once again providing **support for gold**, as reflected in the recent positive performance. **Gold should remain a reasonably efficient hedge** for all the relevant risks on which the market will be focused this year.

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02

Assessment

Spotlight on global asset classes

Q2 2019 cross asset assessment (model-driven)

Cross Asset BOX

ASSET CLASS	ECONOMIC BACKDROP	VALUATION	RISK SENTIMENT	TECHNICAL	ASSESSMENT
Cash					−
Core government bonds	Medium	Medium	Medium	Good	+
Core credit	Good	Medium	Good	Medium	+
EM bonds (HC)	Medium / Good	Medium / Good	Poor / Medium	Medium	=
Global equities	Good / Medium	Poor / Medium	Medium	Poor / Medium	=
Commodities	Good	Medium	Medium	Medium / Good	= / +

Poor Medium Good

Source: This cross asset assessment is based on **quarterly forecasts and analytical tools** (factors) working on various frequencies. Results are then **used for strategy research cross asset portfolio allocation, used as a reference in the multi asset division.** For further information and details please refer to the cross asset strategy team at Amundi Research. All data as of April 2019. Internal calculations.

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Monetary policy views

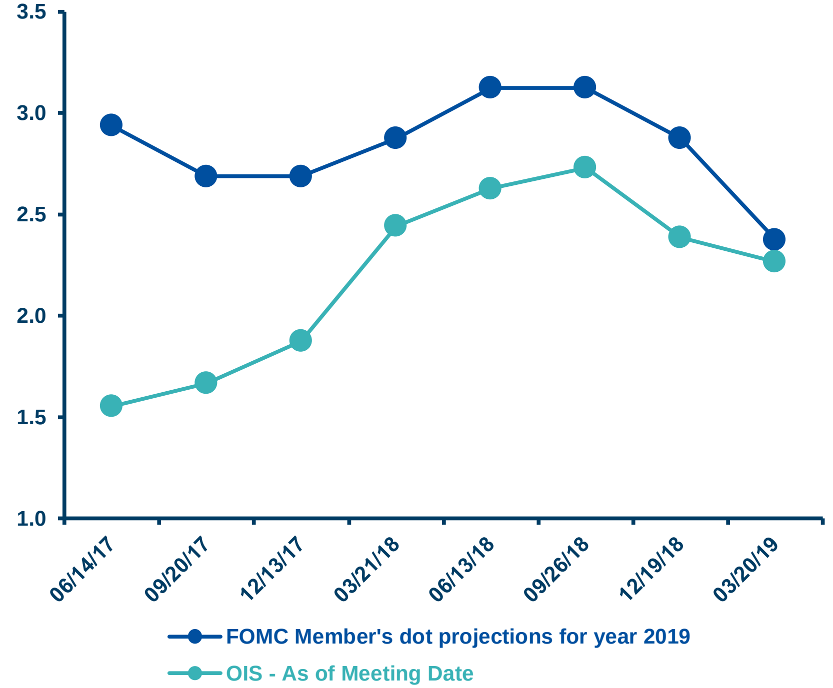
GOVIES BOX

Central bank rates forecasts

	29/03/2019	Amundi + 6m.	Consensus Q3 2019	Amundi + 12m.	Consensus Q1 2020
US	2.50	2.5	2.50	2.50	2.75
Eurozone	0.00	0.00	0.00	0	0.00
Japan	-0.10	-0.10	-0.10	-0.10	-0.10
UK	0.75	0.75	0.75	1.00	1.00

- **FED:** The Fed's monetary policy normalisation is to end in 2019 on both rates hikes and balance sheet run-off. The Fed announced the plan to end QT by September; the balance sheet reduction is likely to end at around US $3.5trn, or 17% of US GDP, still a remarkable level compared with QE levels. According to our central macro scenario, we do not expect the Fed to cut rates for the time being.
- **ECB:** The ECB surprised with its dovish stance on the timing of decisions, which were earlier than expected both on the TLTRO announcement and rates forward guidance, and also in terms of its downward revisions to its growth and inflation outlooks.
- **BOE**: BoE monetary policy perspectives depend on the outcome of Brexit scenarios. In case of a hard Brexit, the CB is likely to provide all the stimulus it can, while in the case of a deal, it could slightly normalise its policy rate, but at the same time no normalisation in BS size is expected in the near future.
- **BOJ:** The CB has "capitulated" towards a more accommodative stance, in line with the shift of the Fed and the ECB, in order to avoid unwanted excessive impact on its currency. However, no major moves are expected in the short run, and in case of need, more purchases of ETFs look to be the major channel that could be used.

Markets constantly below the Fed's projections



Source: Bloomberg, Amundi Research. Data as of April 4. 2019

Expectations are currently attaching a 60% probability of a rate cut at the December 2019 meeting.

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DM credit – the ‘desert of yield’ in the Eurozone supports spread products

High Conviction Ideas

- **Q2 saw a strong recovery in credit markets, mainly driven by the more dovish stance of central banks: the search for yield is back as a driving force of tighter spreads in a low for longer yield scenario.**
- **Technicals** turned more supportive (ECB’s TLTRO reduces future supply from financials, intensifies the yield search and on a relative basis, supports more periphery financials), while the Fed was credit friendly, too, surprising on the dovish side.
- **Diverging fundamentals.** Earnings are still credit friendly in the US, confirming strong profits and supportive EBIDTA growth. In the Eurozone, profits are less brilliant than in the US, but credit metrics show that companies’ leverage remains low. US and EUR HY distress ratios fell further in March, remaining consistent with a low default rate regime
- **Valuations moved back closer to fair value in Europe, tighter vs. fair value in the US.** At the same time, on a relative basis vs. safe havens they look more attractive in the current “desert of yields”. US HY looks tighter vs. other credit segments, US IG included.

What to Watch

- European political risk (Brexit and European elections)
- Global trade tensions
- China and emerging markets growth trends

Overall Assessment

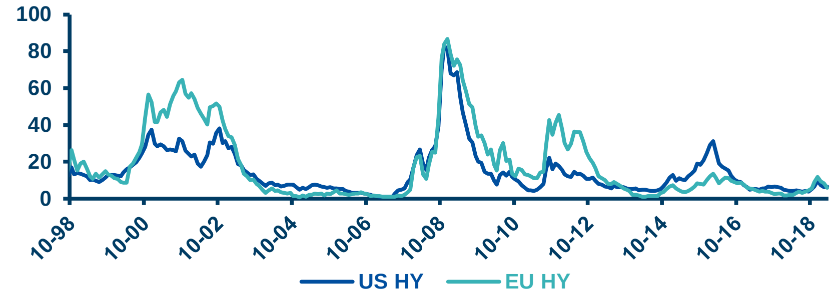
- Monetary policy improved technicals, while fundamentals look to offer some staibilisation.
- However, we need to keep a strong focus on liquidity.

Risks to Our Assessment

- Political risk (Brexit, European elections)
- Escalation in protectionism
- Further economic slowdown

HY default rates expected to remain low in the next quarters

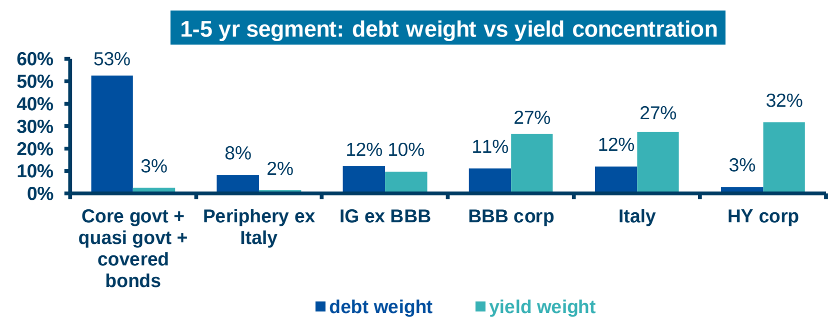
In February European HY default rates fell to 0.9%, the lowest level in 10 years: the recent fall in the distress ratio bodes well for the next quarters for both US and EUR HY.



Source: Bloomberg, Amundi Research

In the Eurozone the FI market is a “desert of yield” in the 1-5yr segment: 25% of debt offers almost all the yield left.

Italy accounts for almost the entire yield remaining among periphery govies (periphery other than Italy accounts for just 2% of yield left vs. 8% debt weight). Together with BBB among corporates, BTPs represent the only providers left of yield in the IG world. HY bonds are the segment with the highest yield concentration



Source: Bloomberg, Amundi Research

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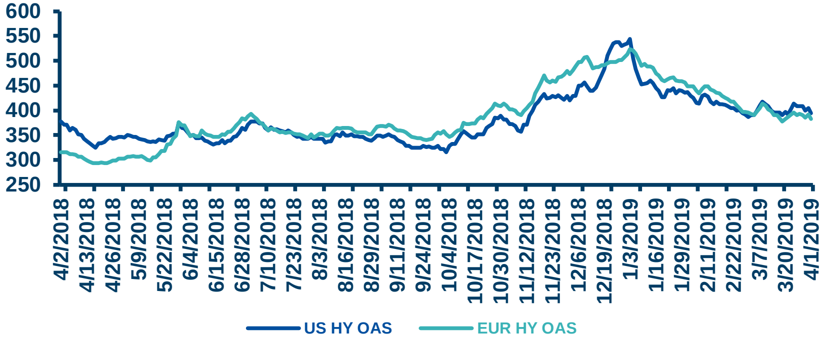
Credit markets supported by central banks and yield search

CREDIT BOX

Credit spreads finally more stable in March, following Jan-Feb rally

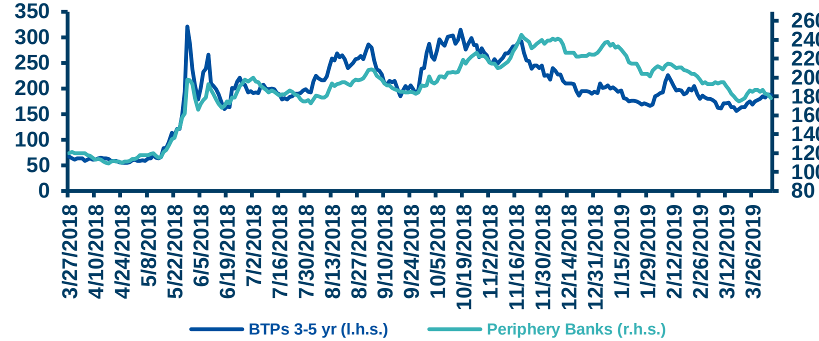
HY spreads finally stabilised close to 400bp after record tightening at the start of the year



Source: Bloomberg, Amundi Research

Peripheral financials supported by TLTRO announcement

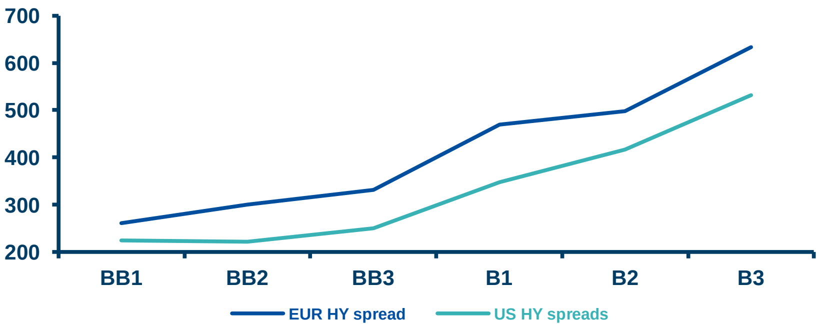
Peripheral financials finally closed the gap with Italian government bonds with similar duration



Source: Bloomberg, Amundi Research

Valuations

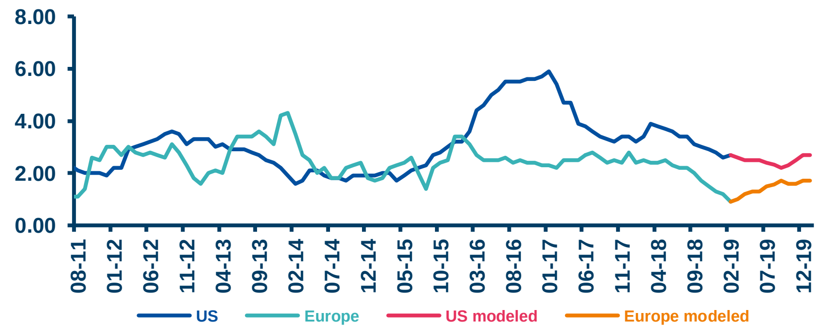
EUR HY spreads are more attractive than US HY; comparison by notch shows a broad premium paid by European names for the same credit risk



Source: Bloomberg, Amundi Research

Fundamentals

Europe looks in a better position than the US in terms of prospective default rates: both areas should record only a small rise in default rates in the next year



Source: Moody's, Amundi Research

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DM FX: Finally time to sell king USD?

High Conviction Ideas

- **USD:** a few dollar negative factors are supporting our bearish DXY view: i) lower rate differentials on the back of the dovish FED; ii) the convergence of the RoW's economic growth/margins generation; and iii) expectations for recession risks to remain very low. In the short term, the USD might show resilience as markets question global growth prospects and political uncertainty weighs on risk sentiment. We see a 4% depreciation for the DXY on a 12M horizon.
- **EUR/USD:** the single currency is still trading in a tight range as signs of Chinese and Eurozone activity bottoming out are offset by concerns on the political front. Our base scenario of a soft Brexit and stabilising global growth implies a stronger EUR, assuming concerns of a US recession don't materialise. We expect the currency to sit around 1.17 at the end of 2019 (last quarter @ 1.18-1.20).
- **USD/JPY:** financial conditions and US assets' risk-adjusted returns remain the main drivers of the FX. Any volatility spike is set to exert upward pressure on the JPY as a consequence of capital repatriation from Japanese investors. We see the currency moving higher from current levels, with a 12M target for USDJPY of 107 (from the 105 we have had since last month).
- **GBP/USD:** Sterling is still struggling to find a direction amid ongoing uncertainty related to Brexit. In a deal scenario, our base case, we see the GBPUSD appreciating towards the 1.36 – 1.38 range in Q2 2020, as the currency is strongly undervalued while its fundamentals are still holding up well, particularly the labour market.

What to Watch

- Evidence of Eurozone activity bottoming out
- Economic conditions of Eurozone countries
- US-China trade negotiations and Brexit developments

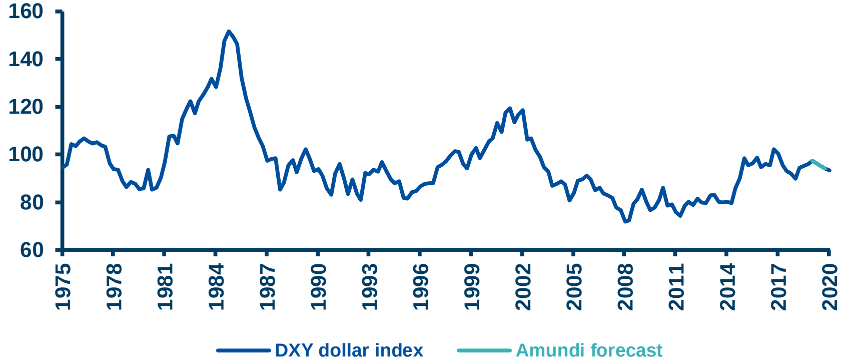
Overall Assessment

- RoW's growth bottoming out vs. US decelerating from 2018's peak and dovish Fed the main headwinds to USD in 2019.
- Dissipation of political risks following a positive outcome from Brexit and European elections main catalysts to a stronger EUR and GBP vs. USD. JPY remains set for appreciation, especially if a volatility spike was to deteriorate financial conditions materially.

Risks to Our Assessment

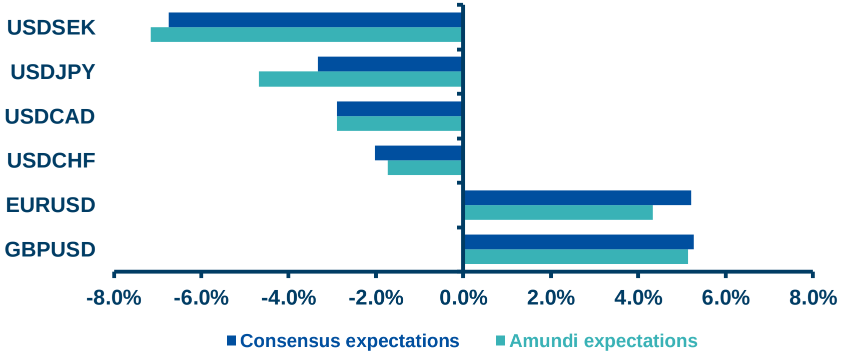
- Global economic recession pushing the USD higher
- Material slowdown in Eurozone economic growth
- Strong US inflation dynamics and Fed turning hawkish again
- No deal Brexit

DXY Index expected to correct lower in 2019



Source: Bloomberg, Amundi Research. Data as of March 29, 2019.

Dollar (DXY) CCY 12M expectations – Amundi vs. consensus

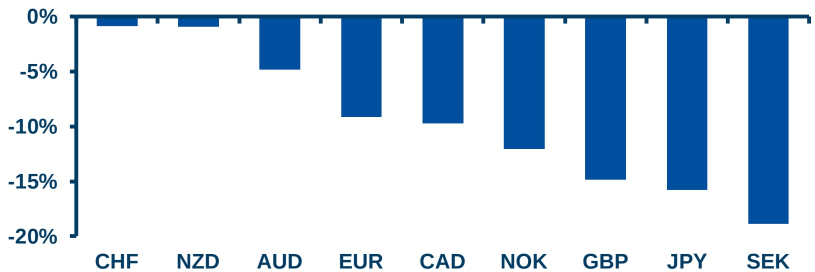


Source: Bloomberg, Amundi Research. Data as of April 05, 2019

U$ to peak; € to gain momentum in H2; ¥ exposed to upside pressures

The strong USD appreciation in 2018 didn't reflect fundamentals. The USD is overvalued against the entire G10 universe. SEK, NOK, GBP and JPY are the most undervalued currencies.

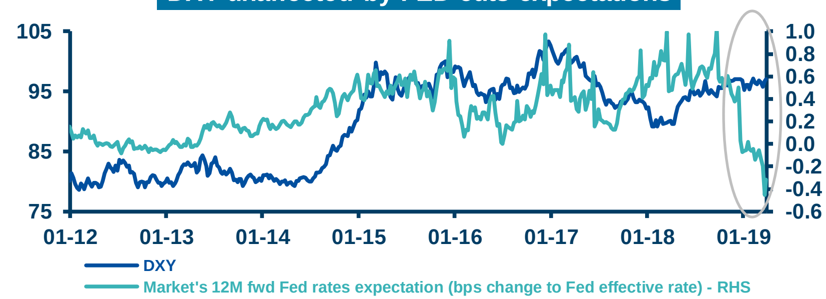
G10 FX O/U Valuation vs USD



Source: Amundi Research, Bloomberg. Data as of April 5, 2019

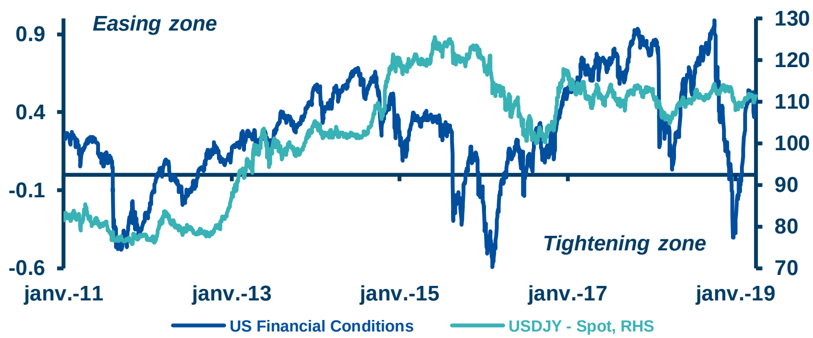
USD is overall unchanged vs. the G10 despite the Fed's lower dots plot as markets question whether the CBs dovish shift might signal an imminent recession (USD acts as safe haven) and amid political risks, mainly from Brexit.

DXY unaffected by FED cuts expectations



Source: Bloomberg, Amundi Research. Data as of April 3, 2019

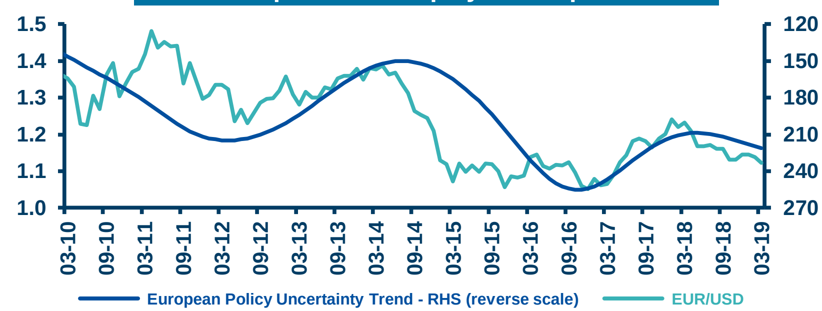
The huge corporate spreads compression, together with the extremely low volatility environment, put downward pressures on the JPY. We believe this is more a short-term story and should it revert, would point to capital repatriation.



Source: Amundi Research, Bloomberg. Data as of April 2, 2019

Despite narrowing interest rate differentials with the USD and signs of stabilisation in the Eurozone's economic activity, the single currency is dragged by political risks that have started to increase since Italy's political elections in March 2018.

EUR/USD: political risk plays an important role



Source: Bloomberg, Amundi Research. Data as of March 29, 2019

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Global equity – Cyclical climax confirmed!

High Conviction Ideas

The YTD rebound of equities has pushed equities back above the level of December, when they were collapsing

- **The strong rebound pushed the 12M trailing PER of the MSCI World back to its declining 200-day moving average.** To break out would need strong arguments. The pause of the Fed may not be sufficient.
- **The perspective of an earnings revival will be crucial.** So far, our indicators are flagging weak earnings growth (0-5% this year). This means that the Chinese stimulation has to outpace the US slowdown. The USD is then a key indicator to watch; a weaker USD would be an encouraging sign and vice versa.
- **The cycle is effectively mature, but not dead. Look for a mixed bag.**

  We have a preference for EM vs. Japan on a regional basis, keep defensive styles (quality, high dividends and MinVol) according to the late cycle stage, and pick some cyclicality on the more granular sector and stock picking level.

What to Watch

- Sino-American tariff negotiations
- Brexit and 2019 European elections
- USD and industrial commodities
- EPS net up: 1Q may be the worst of the year

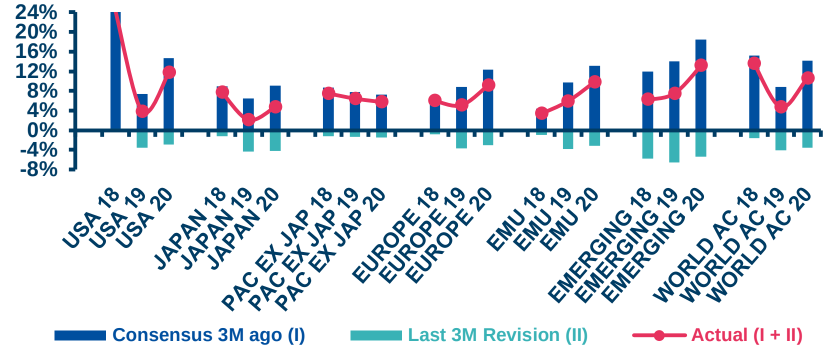
Overall Assessment

No directional bets. Little regional plays. Keep a preference for EM (vs. Japan), while staying on quality, high div and MinVol in terms of styles; pick some cyclicality at sectors and stocks level.

Risks to Our Assessment

- Tariff negotiations failing
- A stronger than expected slowdown in the US
- A less strong revival of China than expected

MSCI indices IBES consensus EPS growth by region



Source: IBES consensus, as of April 2, 2019, Amundi Research

Multiples have moderated in all regions

Fundamental metrics (data as of April 3, 2019)

12M FW PE	13.1	16.9	13.1	14.0	12.5	11.0	11.7	17.1	12.8
PBV	1.8	3.4	1.3	1.6	1.6	1.2	1.3	2.8	1.7
PSALES	1.2	2.1	0.9	1.1	0.9	0.6	1.2	2.5	1.1
PCF	9.0	12.5	7.7	8.9	8.2	5.8	5.5	11.9	8.7
DY	3.6	2.0	2.4	3.2	3.2	3.9	4.3	3.0	4.5
PEBITDA	6.8	10.1	7.0	6.9	5.9	3.4	5.5	12.5	5.7

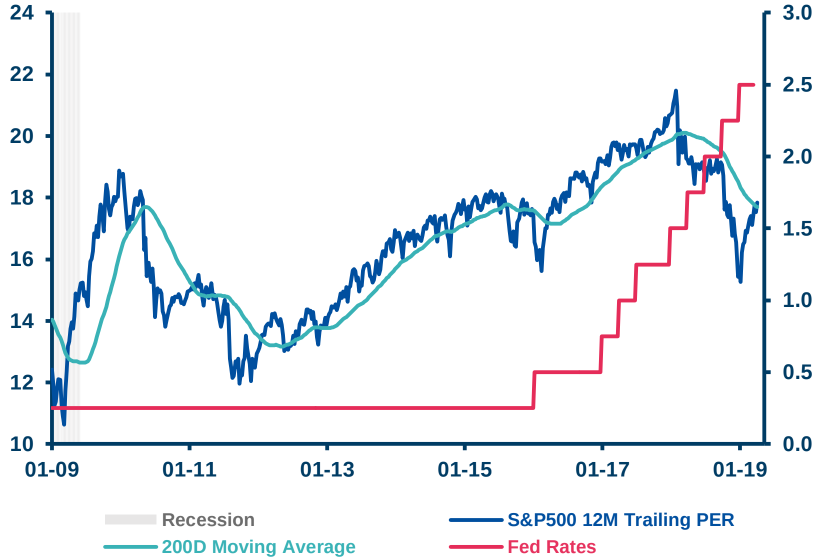
Very cheap | Cheap | Neutral | Expensive | Very expensive

Source: Analysis by Amundi Research. Colour stands for each market relative to its own history over a 10-year period. Ratios are classified by percent rank from 0 (very cheap) to 100 (very expensive) with an incremental step of 20. The 12-month forward price/earnings (12M FW PE) is the ratio of a company's market share price compared to its 12M FW earnings. The price/book value (PBV) is the ratio of the share price over its book value of equity. The price to sales (PS) is the ratio of the share price to its revenue per share for the trailing 12 months. The price to cash flow (PCF) compares the share price to its level of annual cash flow. Dividend yield (DY) is the annual dividends per share divided by the share price. The price to EBITDA (PEBITDA) compares the share price to earnings before interest, taxes, depreciation and amortization. List of indices: S&P 500 for the USA, MSCI for other countries and Europe

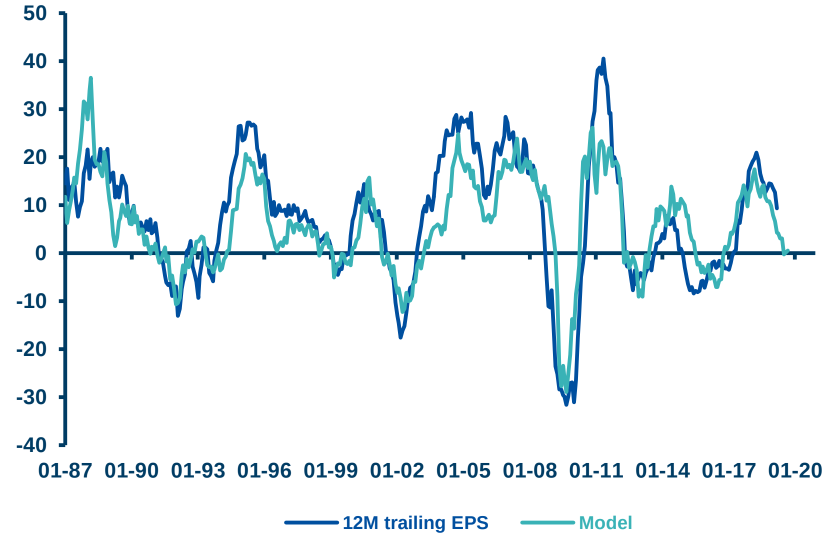
Equity markets needs further arguments to go ahead

DM Equity BOX

The PER moved back up



Earnings prospects are still poor



After its strong reset last year, the MSCI PER has moved back to its declining 200-day moving average.

Usually PER declines when the Fed raises rates, with rare exceptions such as 1987 and last year. In these cases a strong reset is due. This is what happened in December 2018. A pause of Fed rates may not be a sufficient argument by itself to reverse the trend on the PER.

Source: Datastream, Amundi Research; April 1, 2019

A simple model, based on CRB industrials, USD, equity/bonds and ISM manufacturing is still flagging for lower earnings going forward.

The positive reading is that it will remain in positive territory. Otherwise, we may also expect 1Q 2019 to be the weakest quarter of the year.

Source: Datastream, Amundi Research; April 1, 2019

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US equity – Leading the equity market rebound, but for how long?

High Conviction Ideas

- **Valuation**
  The rebound of the US market has been stronger than the rest of the world, pushing the relative PER back more than one standard deviation above its long-term average.
- **Fundamentals**
  The fading of US fiscal reform and the slowdown of the economy has led earnings to be sharply revised down over the last six months (by 5.5% on the 2019 figure). IBES now expects +6.4% over the next 12 months, which is much more reasonable. Net earnings are also stabilising and the worst may be over on this front.
- **Technicals**
  The S&P 500 has come back to its long-term resistance, near the previous tops and it could be building a triple top.
- **Style/size/factors**
  We diversify among the defensive styles, favouring quality (beware valuations), high dividends and minimum volatility. Value is still cheap in relative terms.

What to Watch

- The current earnings season. Will Q2 be the worst of the year?
- Monetary policy, flattening/inversion of the yield curve and credit spreads
- The development around IT (still leading the rebound)

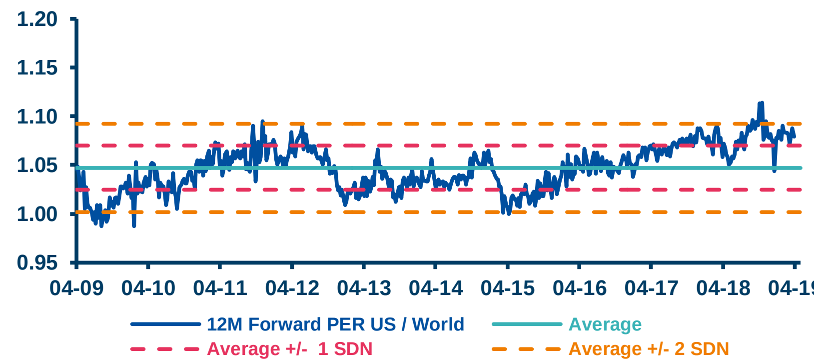
Overall Assessment

The US still deserves a slightly positive rating vs. other DM markets, as it has stronger earnings growth than the rest of the world.

Risks to Our Assessment

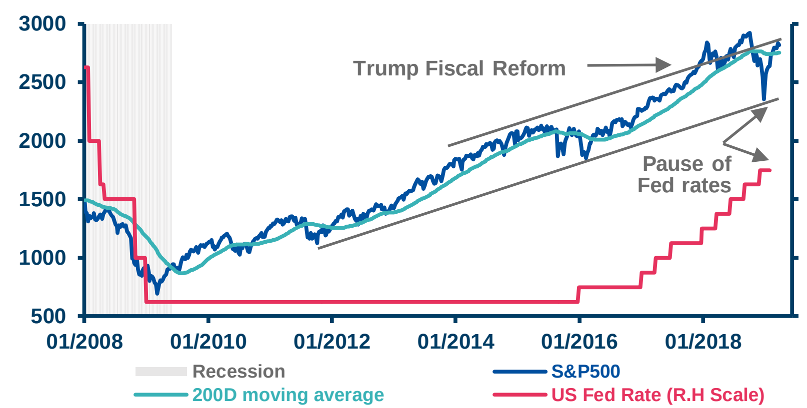
- If IT was to strongly underperform

S&P 500/MSCI World Forward PER



Source: Datastream, Amundi Research; April 1, 2019

S&P 500 and Fed rates



Source: Datastream, Amundi Research; April 1, 2019

EMU – Still under threat of political risk

High Conviction Ideas

- **Valuation**
  The relative PER is still below average, but the political risk (Italian budget, Brexit, EU elections) requires a risk premium.
- **Fundamentals**
  EPS growth was eventually one of the weakest in the world in 2018 (+3%). The 2019 figure has been revised down by 7% in the last six months. IBES still foresees +7% over the next 12 months – a bit optimistic – but should global growth stay above 3% (our expectation), earnings growth should remain in positive territory over the next 12 months.
- **Technicals**
  MSCI EMU has moved back above its 200-day moving average in absolute term but remains in relative terms below MSCI World.
- **Style/size/factors**
  Quality, high divi and MinVol outperform and remain the place to be. Cyclicality must be found on granularity through sectors and stock picking.

What to Watch

- The earnings season
- A too strong rebound of the euro would be a headwind
- Political developments (Brexit, EU elections)
- EMU is vulnerable to external shocks (oil, China, US cycle and a trade war)

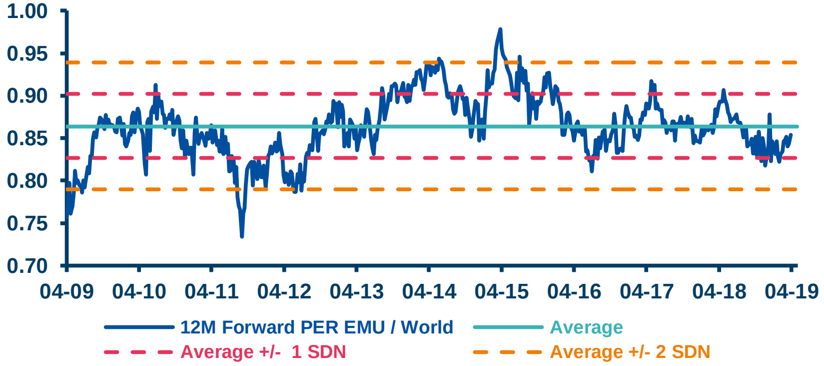
Overall Assessment

We are Neutral on EMU. Valuation is a positive argument but the political situation is still weighing.

Risks to Our Assessment

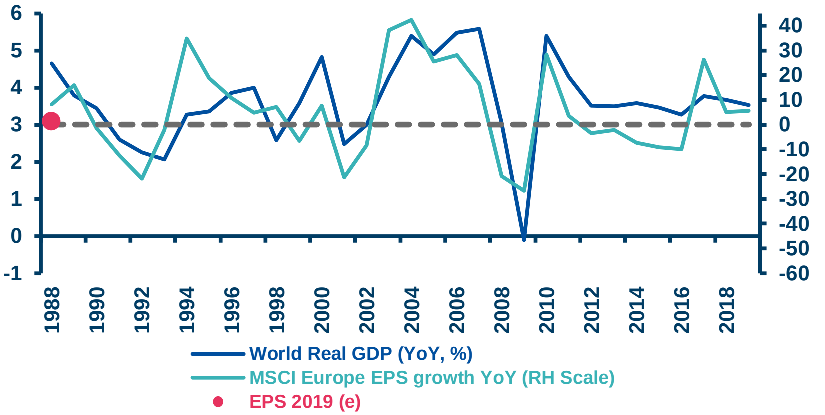
- A strong revival of China and global growth
- An external shock or a wrong endgame on Brexit

MSCI EMU/World Forward PER



Source: Datastream, Amundi Research; April 1, 2019

Global GDP growth and European EPS growth



Source: Datastream, Amundi Research; April 1, 2019

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UK – A late cycle play but Brexit is still disturbing

High Conviction Ideas

- **Valuation**
  With a relative P/E one standard deviation below its average, valuation looks attractive but the political situation (Brexit) warrants a risk premium.
- **Fundamentals**
  EPS growth should be one of the weakest of the world in 2019 (+2%). The typical late cycle play – proxy of energy/industrials and high DY (5.3%) – would suffer if the cheap GBP was to rebound (i.e., in case of no deal).
- **Technicals**
  As for EMU, the FTSE 100 has broken out of its 200-day moving average in absolute terms, but not in relative terms.
- **Style/size/factors**
  Small caps have rebounded only in the first two months of the year. They benefit in relative terms when sterling is strong.

What to Watch

- The earnings season
- Bond yields (key given UK's high div. yield) and GBP (key for EPS)
- MSCI Europe Energy/Industrials
- Brexit negotiations

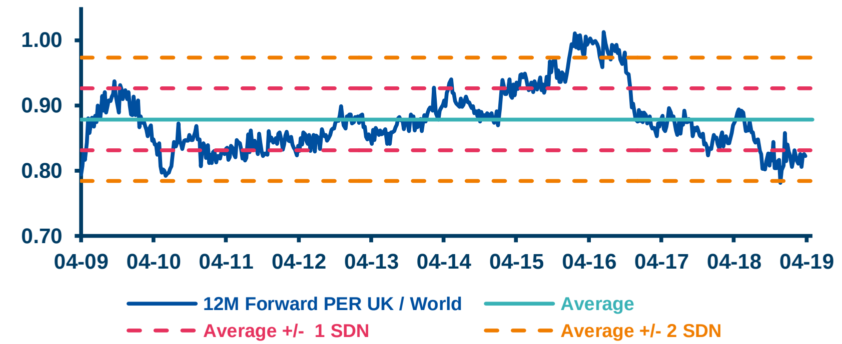
Overall Assessment

We are neutral on the UK as the Brexit issue is still unknown, but consider this market as a natural late cycle play.

Risks to Our Assessment

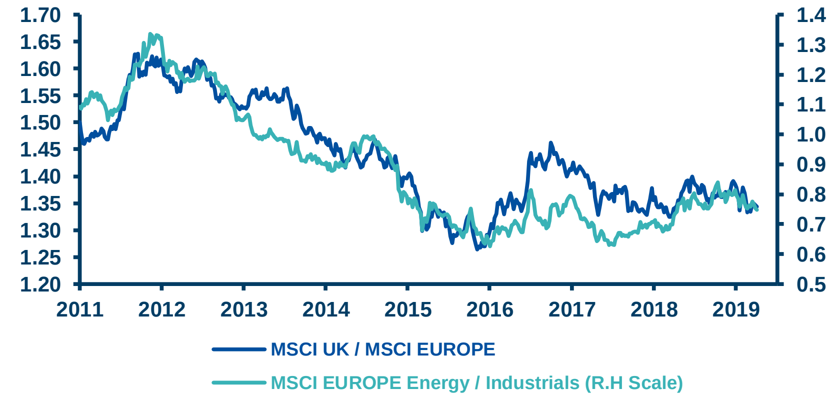
- A sharp move of the GBP, one way or the other
- A strong rise of bond yields

FTSE 100/MSCI World Forward PER



Source: Datastream, Amundi Research; April 1, 2019

MSCI UK/EUROPE and MSCI EUROPE Energy/Industrials



Source: Datastream, Amundi Research; April 1, 2019

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Japan – Confirmation that the profit cycle has peaked

High Conviction Ideas

- **Valuation**
  The Japanese market is very cheap. The PER and the P/BV are below average compared with the MSCI World, while the political situation is clearer than in Europe and corporate governance has improved.
- **Fundamentals**
  EPS growth should fade to c. 2% in 2019, according to IBES, and be one of the weakest compared with the rest of the world. The VAT hike expected in October should support economic growth before but weight after.
- **Technicals**
  Japan is trending down in relative terms. Its relative performance very much depends on the Yen, which is cheap and could rebound on external shocks more than it could weaken on good international news (asymmetry).
- **Style/size/factors**
  MinVol is the only factor really outperforming.

What to Watch

- China-US trade negotiations
- Chinese economic support
- The earnings season
- If the BoJ was to remove monetary accommodation (impact/Yen)

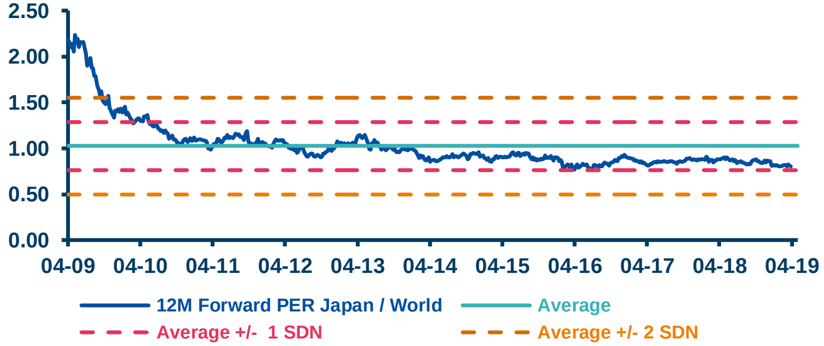
Overall Assessment

We underweight Japan given the negative relative trend in earnings and the asymmetry of reaction of the Yen, which could gain more than it could lose.

Risks to Our Assessment

- A sharp decline of the Yen

TOPIX/MSCI WORLD 12M forward PER



Source: Datastream, Amundi Research; April 1, 2019

TOPIX/MSCI WORLD and USD/YEN

Source: Datastream, Amundi Research; January 15, 2019

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Pacific ex-Japan equity – Narrower valuation gap

High Conviction Ideas

- **Valuation**
  Pacific ex-Japan's PER is neutral in relative terms vs. the MSCI World as this region has resisted well recently.
- **Fundamentals**
  The EPS trend is clearly negative vs. the MSCI World and has underperformed the rest of the world since 2011. As global earnings growth is converging and as the region could benefit from the potential improvement in China, it is worth watching. But it is too early to really become overweight on just yet.
- **Technicals**
  The MSCI Pacific ex-Japan has been in a relative downtrend since October 2009. However, there are signs this trend may be reversed as was the case in early 2016 for six months and in 2012 for one year.

What to Watch

- The earnings season
- China/commodity complex/USD
- The outcome of the Sino-American agreement on tariffs

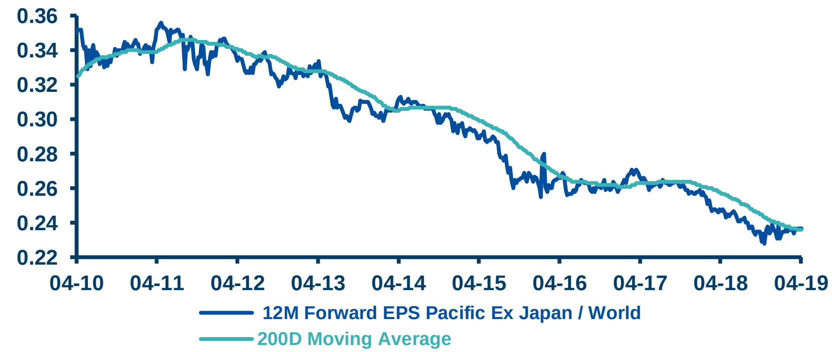
Overall Assessment

Neutral on Pacific ex-Japan. We have it on positive watch, should Chinese economic support become stronger.

Risks to Our Assessment

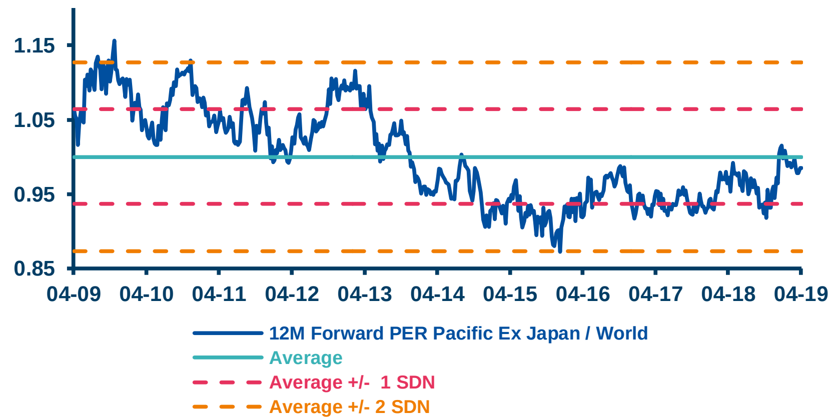
- A strong move in commodity prices, one way or the other

MSCI Pacific ex Japan/MSCI WORLD EPS (in USD)



Source: Datastream, Amundi Research; April 1, 2019

MSCI Pacific ex Japan/MSCI WORLD PER



Source: Datastream, Amundi Research; April 1, 2019

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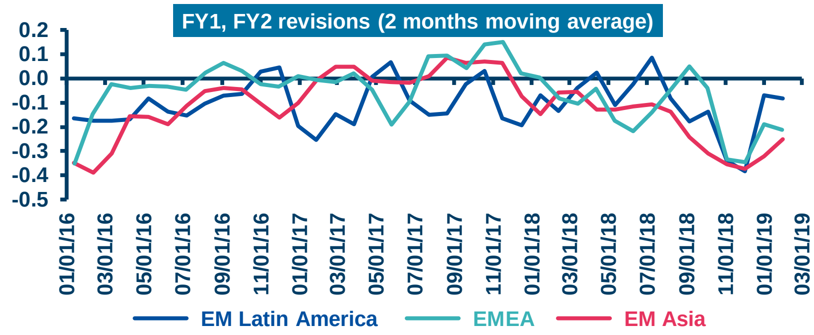
Emerging market equity – selectivity is key

High Conviction Ideas

- **Valuations.** The internal scenario in terms of macroeconomic and financial conditions (mainly stabilisation in commodity prices and falling momentum in EPS growth) suggests that there is no further upside in the 12M horizon at aggregate level.
- **Fundamentals.** EPS growth consensus expectations are decelerating. Earnings revisions have been very negative since September 2018 but are bottoming out. In March we see a further improvement in Asia and a stabilisation in EMEA and LatAm. Q4 2018 reporting season closed quite flat in local currency but close to -10% in USD.
- **We prefer to be selective.** Some themes to play: 1)DPS growth increased strongly in GEM and is expected to further improve. DY can be a good factor to play in a late cycle scenario; 2) China and domestic stories in Asia. Asian markets have been particularly neglected during 2018 due to trade war worries and now they have more potential upside if uncertainties fade away (that is our base case). Moreover, China is going to accelerate fiscal and monetary stimulus and this could be particularly positive for the whole area. Other than China, our preference in Asia is concentrated on some domestic stories (such as the Philippines, Indonesia and India) that could also be a good hedge in case of a further revival of protectionism tendencies.

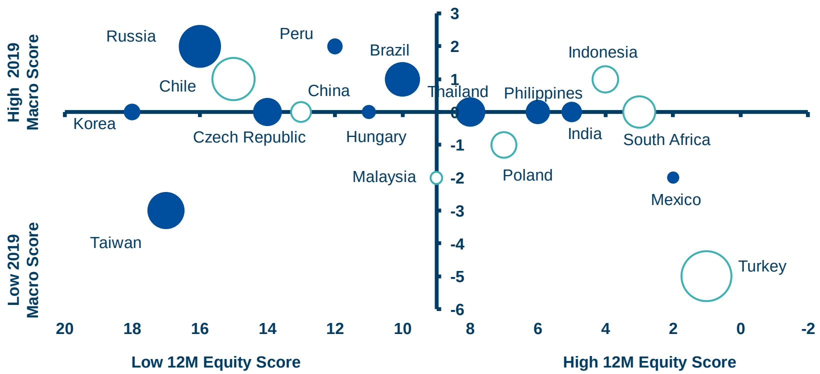
GEM earnings revisions are bottoming out



Source: Analysis by Amundi Research, January 2019. Internal forecasts.

Country selection paramount in EM equity

Equity score based on fundamentals and valuations meets macro momentum



The chart shows the cross between internal 6M equity score and 2018 macro score. Countries in the top right section are the most attractive,
*Reforms processes are not taken into consideration explicitly in any country, although the economic outcomes everywhere somehow consider them.
**Bubbles represent the 12M FWD FX upside (internal tool): white bubble = high vulnerability, blue bubble = low vulnerability

What to Watch

- **Protectionism and politics:** Geopolitics, reforms and elections, for example, in Brazil, along with trade war tensions, all need to be monitored, along with any deceleration in global growth
- **Commodity prices:** a strong rally could hurt Asia but a further deceleration coming from a global slowdown is negative for all areas of the asset class
- **Fed** rate hike and USD appreciation

Overall Assessment

Our overall view on EM equity is mainly neutral at current levels. Selectivity is key.

Risks to Our Assessment

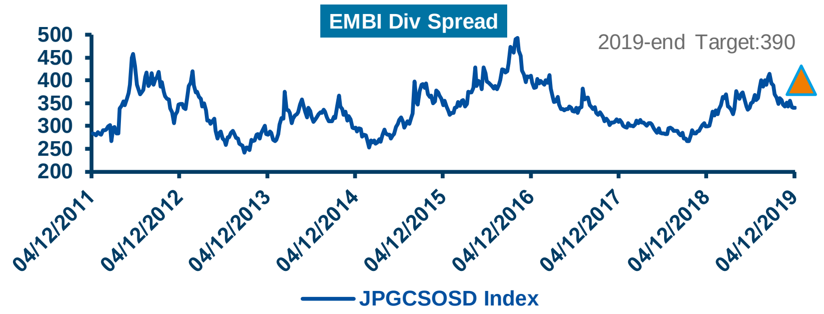
- Protectionism/Trump policies
- Commodity prices
- Slowdown in the global recovery
- Fed policies (strong USD, higher real rates) and GEM hawkishness
- Geopolitics (trade war debate)

Emerging market bonds (hard currency) – not cheap anymore

High Conviction Ideas

- **Valuations:** In terms of the EMBI spread, our target for the end of 2019 is close to 390. Currently the index is close to 340 and, on the basis of our calculation, it has run too far too quickly. Expectations of widening are justified by the weakening scenario in terms of global growth (even if some improvements in the growth differential still favour EM vs. DM in H2 2019), EM government debt increasing and average volatility being sustained in line with 2018. GCC inclusion, on the other hand, will push things in the opposite direction, reducing the path of the widening.
- **We prefer to be selective,** favouring countries with strong fundamentals (low vulnerability), credible reform agendas, attractive valuations and risk-adjusted carry.
- **Sentiment:** Outflows from HC EM bonds have been limited during 2018 but the environment is not supportive and many headwinds will remain.

EMBI spread is expected to widen but GCC inclusion will push things in the opposite direction



Source: Bloomberg, Analysis by Amundi Research. Data as of April 2019. EMBI = JP Morgan EM Bond Index. Fair value model calculated based on EM growth expectation in 2018, projected growth differentials (EM–DM), govt. debt projections in EM, VIX and projected short-term and long-term US rates.

What to Watch

- Fed policy, US Dollar and EM central bank tightening
- GCC inclusion
- China macro and monetary policy
- Commodity prices (i.e., sentiment)
- Geo-political risk events: trade war risks, contagion of idiosyncratic stories

Source: Bloomberg, analysis by Amundi Research. Data as of April 2019. We consider the median rating on external debt published by Moody's, S&P and Fitch. The blue line is the non-linear trend line of EM 5yr CDS. Countries above the blue line are attractive (cheaper) relative to its average rating, while countries below are expensive.

Overall Assessment

=

Selection is key for EM bonds in our view. The asset class is still attractive from an income perspective, but exposed to limited upside.

Risks to Our Assessment

- Aggressive Fed, EM CBs tightening
- Protectionist measures/trade war
- Chinese hard landing
- Commodity price slowdown
- Geopolitical risks, idiosyncratic contagion

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Weakening flows

EM HC BOX

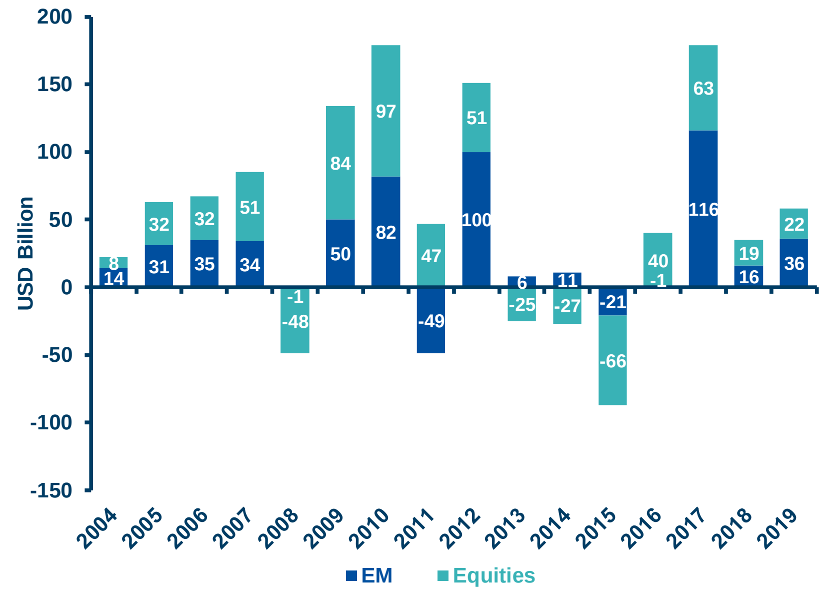
USD Billion

Exhibit 1: Weekly Cross-Asset Flows

Fund Flows

Asset	8w flows (8w ago → current)	This wk	YTD
EM Bonds and Equities		0.1	57.6
EM Bonds		1.1	35.8
Hard Ccy		1.3	28.7
Local Ccy		-0.2	7.1
EM Equities		-1.0	21.8
US HG		3.8	41.0
US HY		1.8	14.8
Global Equities		-0.7	-6.4
EM Bond and Equity ETFs		-0.1	28.7
EM Bond ETFs		0.4	8.9
EM Equity ETFs		-0.5	19.8
Non-resident EM flows*		1.7	24.8
EM Local Bonds		0.1	7.7
EM Equities		1.6	17.2

Exhibit 2: Annual EM Bond and equity fund flows



*Using high frequency non-resident EM portfolio flow data where available.

Source – All charts and data in this report: J.P. Morgan, EPFR Global, Bloomberg

Flows from JPM

Hard currency fund inflows slowed after the end of March surge, while local currency funds had outflows for the first time this year.

Source: EM Fund Flows Report, JP Morgan, data as of April 2019. The report analyses fund flow trends pertaining to EM as an asset class, focusing on high-frequency dedicated-EM fund flows using a combination of EPFR and JP Morgan data.

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Emerging market bonds (local currency) – attractive, mainly in H2 2019

High Conviction Ideas

- **Valuation-wise we recommend remaining long**
  We remain more positive on EM bonds in local currency than in hard currency. Our internal view of a still positive upside for EM FX (close to 1.5% on average on all EM FX) improves the support for EM bonds in local currency.
- Real yields are expected to remain stable in the 12M horizon (GBI diversified weighted) and remain higher than DM (EM 2.4% higher than US 5yr real yield).
- The EM – DM growth differential will still move in favour of EM in the second half of 2019. Moreover, GBI Div weighted EM FX upside vs. USD for 2019 is still expected to be positive (+1.6%). However, volatility will remain high and it will be very important to be selective.
- **Technicals:** flows remained sticky during 2018 but have been showing some weakening signals in the latest weeks (see previous slide). On the other hand, the very positive sentiment on EM FX seen at the beginning of the year is stabilising. All in all, the expected upside for EM FX in 2019 is still positive, but with differences from country to country.
- **We continue to prefer a relative value approach. External vulnerability has to be strictly monitored.**

What to Watch

- Fed policy and US Dollar
- Progress with Chinese inclusion in bond index
- Commodity prices (i.e., key for LatAm)
- Geo-political risk events: trade war tensions, idiosyncratic stories

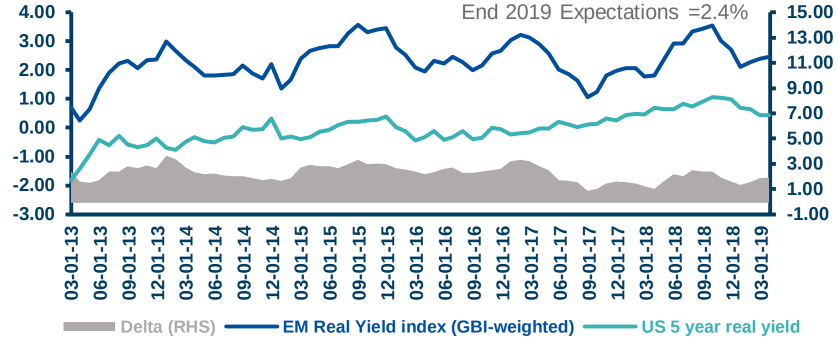
Overall Assessment

The asset class is attractive from an income perspective thanks to positive investor sentiment.

Risks to Our Assessment

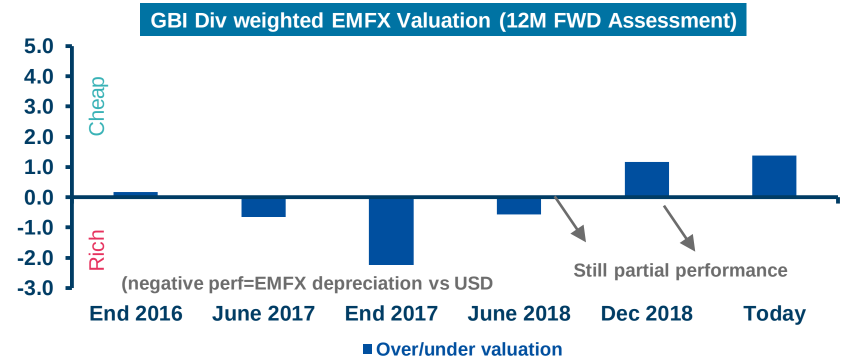
- Aggressive Fed
- Protectionist measures/trade war
- China hard landing
- Commodity price slowdown
- Geo-political risks: Russia-US sanctions, US-China trade war
- Idiosyncratic stories

EM ex-ante real yield (GBI-weighted) vs. US5yr real yield: still attractive



Source: CEIC, Bloomberg, analysis by Amundi Research. Data as of April 2019. We calculate real rates based on our expected monetary policy outlook and expected inflation, and weightings with GBI Weights

EMFX valuation (GBI-weighted): undervalued, positive for LC bonds



Source: Bloomberg, analysis by Amundi Research. We calculate over/undervaluation of the EMFX based on the Engle and Granger co-integration model with a diversified basket of assets, and weightings with GBI Weights. Data as of April 2019

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EM currencies – undervalued but selectivity is key

High Conviction Ideas

- **Valuations remains attractive on a one-year horizon:** Our internal scenario for the next year of the USD depreciating vs. EUR to 1.17, mainly in H2 2019, of WTI oil at 61 and US10Y at 2.4% is aligned with further appreciation of EM FX vs. USD (close to 1.5% on average on all EM FX). In terms of USD broad vs. EM FX we see only a marginal appreciation of EM FX vs. USD (+0.5%), mainly due to our view of CNY and MXN (which have the largest weights in the index) being close to fair value at the 12-month horizon.
- Global conditions are only partially supportive for EM FX in the short term because: a) EM FX momentum, after the dramatic improvement seen YTD, is showing some weakening signals; and 2) the commodity momentum moved negative recently and this is historically negative for all EM FX, with the exception of India and Turkey.
- Selectivity remains key: BRL, PEN and PHP are attractive. The RUB valuation is less attractive but has good carry and low vulnerability. There are supportive signals for MYR, RON and PLN, but they are slightly more vulnerable.
- EM FX's strategic risk is higher than its tactical risk. RUB, PEN, PHP and BRL are among the safest EM FX.

What to Watch

- US foreign policy: China, Russia, Mexico
- Commodity prices
- USD and US real rates
- China macro developments.

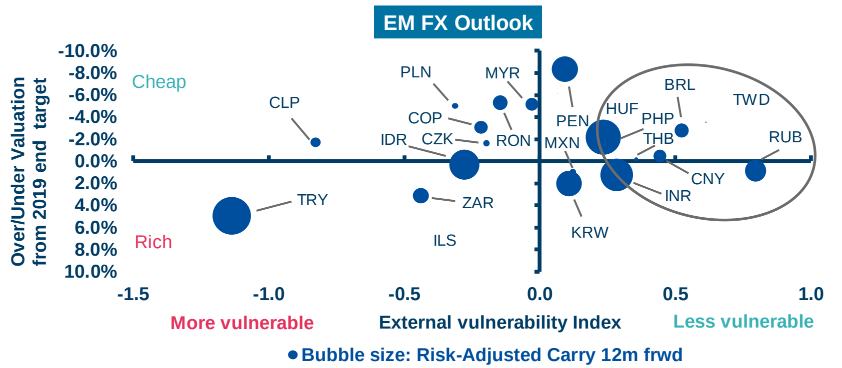
Overall Assessment

The asset class is still undervalued. Different economic conditions and sensitivity to commodities, an EU recovery and Trump's economic programmes could provide relative opportunities within EM currencies.

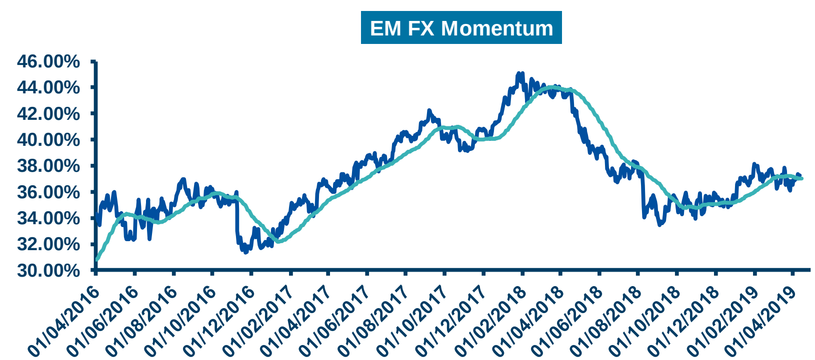
Risks to Our Assessment

- Idiosyncratic political risks
- Chinese hard landing
- Commodity price decline
- Aggressive Fed
- US-Russia sanctions and other geopolitical developments in the region

EM FX outlook: preference for high carry with low volatility, less externally vulnerable and under/fairly valued currencies



Source: CEIC, Bloomberg, analysis by Amundi Research. Data as of April 2019.
We calculate over/undervaluation of EM FX based on the Engle and Granger co-integration model with a diversified basket of assets, internal EM external vulnerability index and risk-adjusted carry calculated for 12M forward yields adjusted with 12M forward volatility



Source: CEIC, Bloomberg, analysis by Amundi Research. Data as of April 2019
EM FX momentum measures the positive/negative momentum across EM FX

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Commodities – economic deceleration weighs on cyclical commodities

High Conviction Ideas

- Rollercoaster continued in Q2 for oil as WTI posted one of the best ever quarters (+30%) after OPEC cut production by 3 MLN b/d, the most significant cut since the GFC. All in all oil is still driven by supply considerations. On the one hand, OPEC and supply disruption concerns in Venezuela, Iran and lately Libya support oil prices in the short run, on the other US shale oil production increases in the pipeline will put pressure on the downside.
- For the reasons above we are sticking to our range target of $55-65 and $60-70 for WTI and Brent, respectively.
- Decelerating demand will affect prices more in H219 and 2020 unless credit easing in China drives the global economy faster than expected.
- The Fed's U-turn provides support to gold again by adjusting the nominal rate to weaker inflation figures and projections. US Dollar and general financial conditions remain the key variables for gold going forward.
- Tentative signs of stabilisation in our global economic momentum indicator are providing some ground for a base metals rebound. Also, in terms of the inventories cycle, the picture is reasonably healthy.

What to Watch

- OPEC and US oil production, Libya, Venezuela and Iran political issues
- Growth in EM (i.e., China), world trade (base metals)
- Central banks' monetary policy normalisation and global real rates (gold)

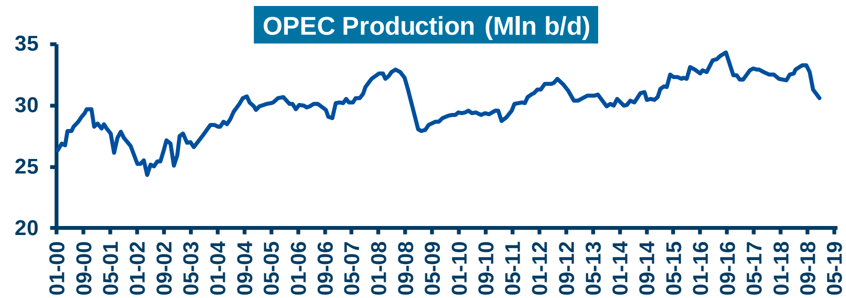
Overall Assessment

Our overall view on commodities remains moderately constructive.

Risks to Our Assessment

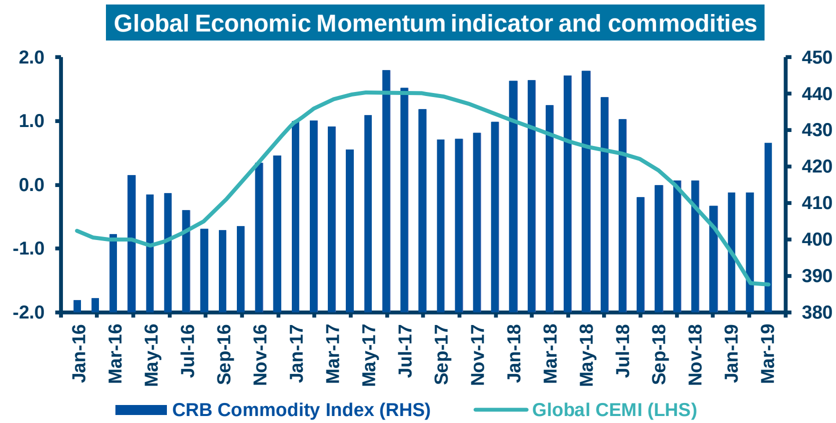
- Protectionism/Trump's policies
- Slowdown in the global recovery
- A Fed policy mistake (strong USD, higher real rates)

OPEC commitment to cut production has translated to 3M b/d less in Q2, the most significant cut since Q408



Source: Bloomberg, Amundi Research, April 2019

Global economic momentum indicator is indicating tentative stabilisation



Source: Analysis by Amundi Research. Internal calculation, January 2019. Internal indicator based on three regional (US, Eurozone, Japan) baskets of the following variables: earnings revisions, 10 int. rates, Lei, CPI yoy, PMI surveys, economic surprise index and inflation surprise index

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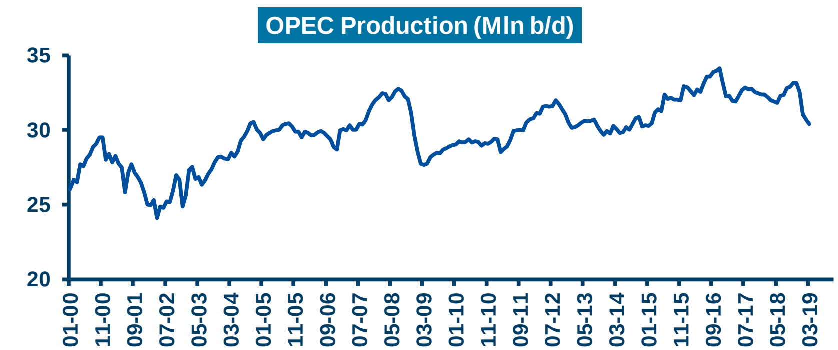
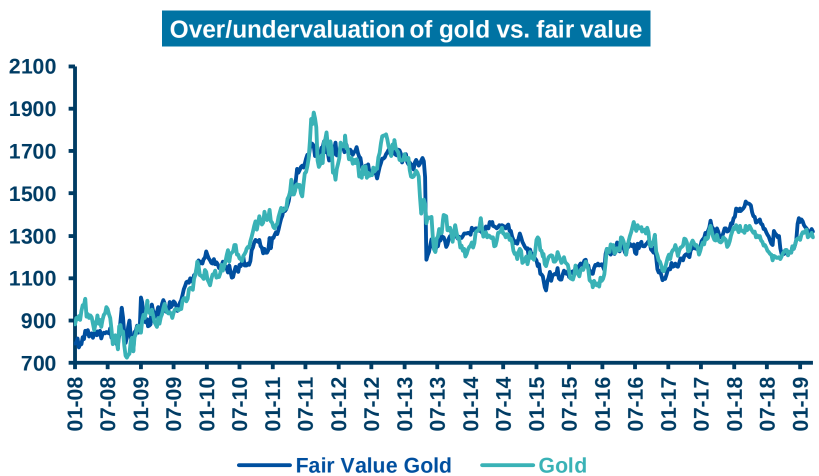
Commodities relatively cheap despite less favourable economic conditions

Commodity BOX

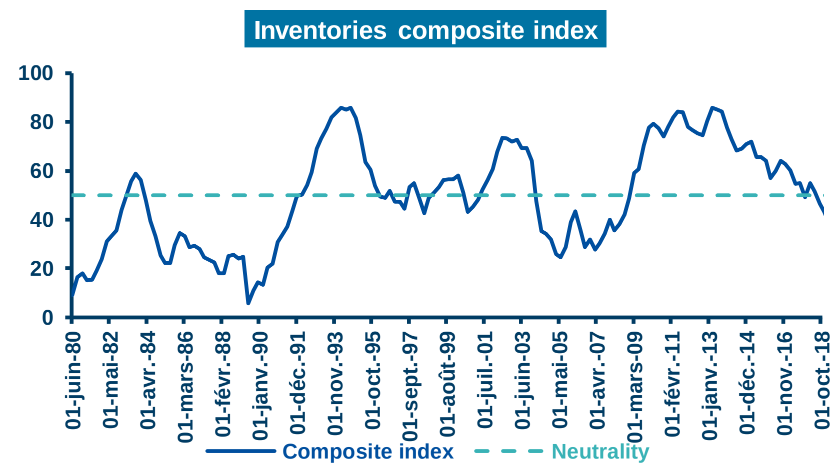
- **OPEC production cut has been significant in Q2 and confirms commitment** to stabilising markets above $60 for the WTI. Overall, the picture remains supportive for oil in the short run even if the undervaluation gap has been closed.
- **Gold still a cheap macro hedge** as fair value remains above actual levels on the weak dollar and the Fed's extra dovish tone. The target is still $1,340 at the end of 2019.
- **Base metals** remain relatively cheap considering inventories cycle.



Source: Bloomberg, Research Amundi; April 4, 2019



Source: Bloomberg, Strategy Research Amundi



Source: Analysis by Amundi Research. Internal calculation, January 2019

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