Confidence must be earned

Amundi ASSET MANAGEMENT

JULY 2019

Global Investment Views

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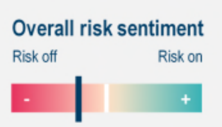

Overall a still cautious approach, with some opportunities on risk assets.

Changes vs. previous month

- More positive on Euro IG Credit and EM Bonds (tactically also in local currencies), and cautious on US corporate credit
- More constructive on EU equities

Overall risk sentiment is a qualitative view of the

Central banks fuel markets: illusion vs reality

The journey from market complacency to awareness of fragilities is in full swing, and the market correction in May is part of that, as is the recent recovery fuelled by dovish Central Banks (CB). Aware investors should recognise that the late cycle phase and mature market trends require improving fundamentals and positive political events to deliver sustainable uptrends in risk assets. But, it is difficult to see such improvements happening in the short term. Purchasing Manager Indices have been declining and what we are seeing is a deterioration in the ‘quality’ of growth. Headline figures of growth are still moderately positive, and not far off our expectations of few months ago, but the composition of growth has changed. Most components of growth are of concern to policy makers beyond the decline in trade growth. We particularly pay attention to the decline in investment growth. However, as far as domestic demand is concerned, it remains healthy, thanks to sound labour markets.

Can this equilibrium hold, given the fragilities overall have increased?

In our view, risk assets will continue to face significant hurdles, with sharp selloffs occurring due to data being below expectations, disappointments related to trade negotiations, and repricing of expectations based on changes in CB policies, which will continue to trigger volatility. In this situation, **the behaviour of CB becomes crucial again**: markets all over the world are currently pricing in rate cuts, with more than 100 bps expected in the US before the end of 2020 and lower rates also likely in Europe, Japan, Canada, Australia and New Zealand. **Promises of interest rate cuts and easier financial conditions will likely keep the Goldilocks narrative alive** and help markets to avoid persistent downturns in stock prices. However, **there are still risks of policy mistakes being made by CB**: the line between ‘pre-emptive’ or ‘reactive’ CB cuts is very thin. While a pre-emptive Fed will likely be market-friendly for equities, a Fed perceived as reactive, or as starting an aggressive easing cycle, would probably be of concern to investors, as they would start to read higher recession risks in the numbers.

Can we expect there to be any positive developments on this journey?

If our central case is confirmed, the Fed could deliver a pre-emptive cut this year, responding to risk assets’ appetite for liquidity. With lower rates in the US, China could have more space for monetary policy easing. A stabilisation of growth could be possible. Countries in Europe with fiscal space could experience a fiscal boost thus sustaining internal demand. Regarding the US, this will be more of a story post-2020 election. The markets would make a toast if a deal between China and the US is reached, which could happen in the medium term, even if tensions between the two countries continue related to a much deeper and long term geopolitical strategic game.

Setting the unpredictable aside, we focus on what is reasonably predictable – ie, **a further extension of this extra-long cycle** – and we build our investment strategies around the following convictions:

- **A positive stance on credit and spread products**. Search for yield is definitely in focus, thanks to the refreshed CB dovishness. We keep a cautious and flexible approach to avoid areas of fragility;
- **A constructive stance on EM Bonds**. EM continue to be supported by the Fed dovishness and expected USD weakening. Here the **focus on vulnerability** (investing in the less fragile countries) will be key at this point of the cycle as weaker demand from DM tends could affect some EM;
- **A moderate defensive stance on equities.** Lacking strong fundamental support, we prefer to play the Goldilocks scenario via credit. That said, the **European equity market seems to have already priced in the worst case scenario**. Valuations are attractive and positive surprises could support the asset class on a relative basis;
- **The FX market as a liquid instrument to play trade disputes** and political uncertainty.

There is not much room to make mistakes in this sort of market: potential gains and losses show an asymmetric profile. We recommend keeping a cautious risk stance. We think it is key to protect YTD gains (which are not far off our goals of the beginning of the year), as we are well aware of an overall increase in fragilities.

MACRO & STATEGY

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"The ECB and the Fed delivered the same message: they are ready to act "if necessary"."

Central Banks: seeking to extend the cycle

The ECB and the Fed delivered the same message: they are ready to act "if necessary". Their tones contrast with the current economic conditions. Domestic demand on both sides of the Atlantic remains resilient, particularly household consumption, which still benefits from good labour market performances. True, the manufacturing sector and global trade are both at half-mast and business investment is expected to slow in the US. And we've been observing for a few years that the correlation between industry and services tends to diminish. That said, more pressure on the manufacturing sector implies higher risk that weakness will spread to the economy as a whole. This is CB's fear today, in addition to inflation, which is too low at this stage of the cycle.

The ECB has revised its economic forecasts, but at the margin. The stronger-than-expected growth in Q1 gave the bank the opportunity to raise its figures for the Eurozone in 2019 (from 1.1% to 1.2%); on the other hand, it revised its forecast for 2020 down (from 1.6% to 1.4%). The ECB is concerned about the weakening of inflation expectations. Companies do not have enough pricing power to pass on wage increases in selling prices. **The combination of subdued growth, falling inflation expectations and increased downside risks explains the ECB's tone.** Opening the door to a rate cut is intended to prevent the euro from appreciating "by default" (if the Fed were to lower its key rates sooner than expected). Opening the door to a new securities purchase program is intended to maintain very accommodative credit conditions. Finally, the generous terms of the TLTRO-IIIs are intended to guarantee the banks cheap funding for an extended period of time.

On the Fed side, the bias has clearly become accommodative with the disappearance of the term "patience" in the bank's statement of 19 June. The economic outlook – even if business investment is expected to slow further – does not fully justify the rate cuts that are priced in by markets. And, Chairman Powell was very careful not to feed such expectations. **But a possible increase in protectionist tensions between the US and China is being taken very seriously by both the Fed and the ECB.** The Eurozone is about twice as sensitive to world trade as the US. A fall in global demand can therefore be accompanied by unwelcome disinflationary pressures if the euro appreciates at the same time. The ECB is now expected to clarify its intentions and forward guidance at its next Monetary Policy Committee meeting (25 July). The next FOMC (31 July) could also be an opportunity to give some more clues regarding Fed's policy. Finally, while trade-related risks are explicitly mentioned by the ECB and the Fed, **both CBs fail to highlight what growth owes to the increase in public and private debt.** To ensure the solvency of indebted agents, there is nothing like keeping interest rates artificially low (i.e. well below nominal GDP growth) – in addition to the fact that by containing the debt burden, monetary policy opens up opportunities for a complementary fiscal stabilisation, if needed.

The strategist's view – The markets conundrum

Fixed income market: Trump trade unwound

The fixed income market has now priced out all the reflating effect previously attached to the Trump fiscal reform In the US: inflation expectations are now back to pre-Trump levels. The US 30Y yield is also at levels similar to those prior the US Presidential elections while the US 10Y yield is still slightly higher. What is very different vs 2016 is the shape of the US curve, which is now much flatter (and negatively inverted in the short end), with the Fed having normalised interest rates. As growth uncertainty and tariff disputes increased in the past months, markets aggressively priced in the beginning of a tightening cycle, causing the forward curve to bull steepen.

Is the weakness in PMIs priced in by the markets?

The May equity market correction, which followed, among other factors, the deterioration of PMIs, was deep, and shifted the equity risk premium down to levels below trend, creating room for a short-term rebound. Is the rebound sustainable, considering the current decline of PMIs? Looking at PMI levels, we see limited room for further upside of the stock market. To assess the impact of PMIs on financial markets, we identified different regimes of PMIs. The current regime (US manufacturing PMI in the range 50-53) is historically associated with EPS growth of around 3%, much lower than analysts' expectations of roughly 10% discounted in today's equity prices. A narrower discrepancy from what is discounted and what is "PMI-consistent" emerges in the interest rates market: the current PMI regime would call for rate cuts not far from what short rates are discounting.

DM= Developed Markets, EM = Emerging Markets, CB= Central Bank, ECB= European Central Bank, Fed= Federal Reserve. ERP= Equity risk premium is the excess of return of equity investing vs. risk free rate. TLTRO: The targeted longer-term refinancing operations (TLTROs) are Euro system operations that provide financing to credit institutions for a predefined period of time.

MULTI-ASSET

Time to play central banks and politics

We still call for a late cycle environment with extra dovish central banks. Growth concerns and trade disputes continue to be the key risks which darken the outlook. On trade in particular, although we still expect a deal between US and China will be eventually reached later in the year, we do not expect any near-term solution. Uncertainty may remain high with regards to geopolitical risks.

High conviction ideas

Given this backdrop, we maintain a **defensive stance on equities,** as the risks of negative EPS revisions remain high and we prefer to seek value by playing key themes, such as: divergences in growth and central banks policies, and politics-related topics.

In fixed income, the Goldilocks scenario induced by accommodative CBs remains our central case, and we do not expect recessions in the coming months. Therefore, we believe that the “hunt for yield” theme remains front and centre. Hence, **we increase our preference for corporate bonds – in particular in the investment grade space** – which is backed by strong technical factors and the low rates environment. Here, we **prefer Euro corporates to US,** due to better fundamentals and favourable technical trends against expensive USD hedging costs.

On rates, we revised our forecasts down, and keep our preference for 5Y US vs 5Y Germany; we also remain negative on the German short end (2Y), where we don’t see any value left. In the UK, the weaker outlook for growth, combined with nominal rate vulnerabilities to sharp sell-off, supports our defensive stance on UK real rates (10Y). In Norway, a strong domestic economy is still supporting the central bank’s hawkish stance, compared to a more dovish stance from the ECB, which is still facing downside economic risks. Thus, we continue to prefer the NOK vs the EUR. In playing **relative value opportunities,** we prefer the Italy-Germany 10Y spread versus the 2Y spread, as we believe it offers more interesting carry and has more potential for tightening.

A political theme we are currently playing is the possibility that Trump could withdraw from NAFTA by presidential notice. This could increase pressure on the Democrats on one side and on Mexico on the other. We express this trade risk theme via currencies with a positive view for USD vs CAD. We do not expect the ratification process to be completely derailed, but we would like to be protected if the negative scenario materialises.

EM markets in general continue to remain an area of interest, especially as the threat from US rates and a stronger dollar dissipates. In GEM equities, we have a neutral stance overall, but we maintain regional preferences, such as Korea and China, which could benefit if visibility around trade negotiations improves or as a domestic demand story. On EM Bonds, with an income focus, we continue to **seek selective opportunities, favouring hard currency to local currency**. On the GEM currency space, we have a preference for IDR, BRL, RUB vs ZAR.

Risks and hedging

The market continues to be focused on the risks of a trade war (US vs China, but also vs the Eurozone, Mexico, Canada) and other geopolitical issues (tense situation in the Gulf of Oman) and their impact on the growth outlook. **We suggest maintaining some hedges through a preference for the Yen vs USD, which should outperform in case of a further escalation in geopolitical risks.**

Amundi Cross-Asset Convictions

	1 month change	---	--	-	0	+	++	+++
Equities			■					
Credit	↗							■
Duration					■			
Oil					■			
Gold					■			
Euro cash				■				
USD cash						■		

The table represents cross-asset assessment on a 3-6 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.

Matteo GERMANO
Head of Multi-Asset

> *ECB dovishness make Euro IG credit even more appealing.*

GEM = Global Emerging Markets.
BRL= Brazil Real, CAD= Canadian Dollar, EUR= Euro, IDR= Indonesian Rupiah, NOK = Norwegian Krone, RUB = Russian Ruble, USD= US Dollar, ZAR = South African Rand

FIXED INCOME

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Management

Expect rates swings on monetary policy uncertainty

We see two key themes driving fixed income markets: **1. The potential impacts of a trade war on growth prospects and 2. The Fed's and the ECB future dovish policy stances**. The two themes are strictly interconnected as they drive market expectations on CB policy moves, with CB on their side watching out for growth evolution and financial conditions to reassess their policy mixes.

The implications appear to be a strong push on yields towards record-low levels, with markets in our view too complacent on future FED cuts and a continuation of a more volatile regime on bond markets. It is paramount to be ready to tactically **adjust duration views**, **play curve opportunities and seek carry** with a selective approach to avoid areas of complacency and poor fundamentals or unrewarded liquidity risks.

DM bonds

We expect US Treasury rates to stay supported, due to the increased downside risks to growth and the low visibility on trade issues which, in our view, encourage a prudent approach. **We see some value in TIPS.** Despite the recent weakness in inflation data, an escalation of tariffs will tend to boost near-term inflation, a concept that is currently completely off investors' radars: market measures of inflations expectations (eg, inflation breakeven) are at extreme lows.

In Europe, from a relative value perspective, **we maintain a positive view on the main peripheral European countries**, preferring Spain to Italy based on higher political risk and potential warnings on the budget deficit (though 30Y Italy could be an interesting area to monitor). We see opportunities on the Euro curve (e.g., playing a flattening move on 5-30Y segment).

Credit

Credit is well remunerated on the basis of current outlook, but we recommend a selective approach, with a preference for the short end of the credit curve and **favouring Euro IG**. **In the US,** given the increased risks, we continue **to recommend a 'careful carry'** posture that involves reducing overall risk and moving up in quality. Within government-quality sectors, we view **Agency MBS** as especially attractive relative to nominal Treasuries. We continue to play the strong fundamentals of the consumer sector within the **structured securities'** space.

EM bonds

Despite recent trade tensions, performances for both EM local and external debt were positive, benefitting from a tightening in spreads. Potential FED cuts this year and the lower-for-longer yields in DM should favour EM assets. **We like EM local duration** (Brazil, Indonesia, Russia and South Africa) **as we think that EM rates can perform well in different macro scenarios** due to anchored inflation expectations**.** We are **still cautious within EM LC,** especially in low-yielding, China-sensitive economies in Asia, but **our outlook has tactically improved**, given a stable US dollar.

FX

The **USD** remains one of the highest yielding among the main DM currencies and could offer some protection against trade escalation. We **stay cautious on the Euro**. On EM, we favour some Eastern European and LATAM currencies (BRL and RBL), while staying cautious on Asian ones (KRW, TWD, SGD) more vulnerable to protectionism.

> *"Markets have gone too far in pricing in aggressive Fed cuts. This increases the risk of disappointment."*

Source: Amundi analysis on Bloomberg data. Data as of 20 June 2019.

TIPS = Treasury Inflation Protected Securities
BRL= Brazil Real, KRW= South Korean Won, RUB = Russian Ruble, SGD= Singapore Dollar, TWD= Taiwan Dollar.

Play quality cyclicals, stay away from "bond-proxies"

Overall assessment

The equity rally was capped early in May on renewed concerns about US tariffs, but after the pullback, the equity market quickly recovered, staying close to all-time highs. What is peculiar regarding this market is that flows have not accompanied the rally of the first months of 2019, and this is especially true for DM equities. In an environment of low rates and a prolonged long cycle, with deteriorated but stabilising macro fundamentals, we believe that equities could continue to be supported, based on interesting valuations (in some segments), low investor positioning, and potentially supportive factors further extending the cycle (dovish monetary policy and areas of supportive fiscal stance in Europe). Nevertheless, with uncertainty still high, the market will continue to be vulnerable. Volatility and valuation dispersion could offer opportunities for active stock picking.

DM equities

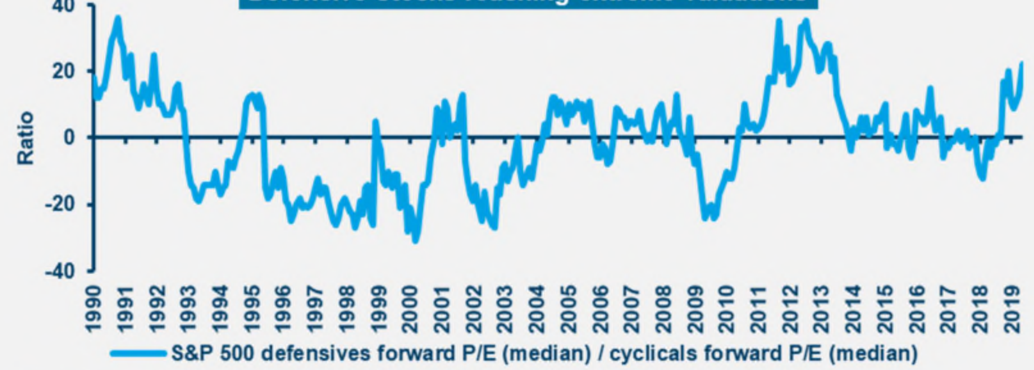
European markets look more attractive vs the US based on valuations: the Brexit saga, Italian political situation, exposure to trade issues, and low growth have contributed to Europe being unloved. This perception could change with a Brexit deal and with some improvement on the US-China trade front. We don't foresee earnings growth driving European equities from here into the next year. Earnings growth is probably set to continue to be revised downward, although not equally across sectors and names. This environment plays well for selecting opportunities among and within sectors. Overall, **we prefer cyclicals vs more defensive segments**, which, in our view, have become too expensive. **We like high-quality industrials with strong balance sheets**, some of which discount very negative outlooks, and we see opportunities in healthcare as well. We find tactical opportunities selectively within European banks which on the whole are trading at extremely depressed valuations. The negative story on European banks is well known, but implied expectations are too low in some of the higher-quality core European banks.

In the US, the value segment is at the cheapest levels since the tech bubble and the financial crisis. In order to have a strong performance of the value sector, we need reflationary conditions which are not visible in the current phase of the cycle. But the heavy short positioning and the extreme valuations suggest a **preference for at least some segments of the value space**, in particular: **quality cyclicals** with long-term growth characteristics, but priced for a recession; **retailers** relatively insulated from pressure from online sellers; **mega cap banks** that have been regulated into stability and that have the scale and technology to win. Among our strongest convictions, we believe that **"bond proxies" stocks are extremely overvalued** (e.g. some consumer staples and utilities stocks).

EM equities

At this juncture, we think the US-China trade issue remains the main trigger that could either boost or negatively affect the asset class. Despite a still-constructive outlook for EM equity supported by our expectation for a deal to be finally reached (at least partially) and earnings stabilisation, we expect short-term volatility. Therefore, we have turned slightly more defensive on China for the time being. We focus on markets where valuations look set to remain supportive and where idiosyncratic risk is less pronounced, and avoid sectors most exposed to possible tariffs.

Defensive stocks reaching extreme valuations



Source: Amundi, Bloomberg. Data as of 18 June 2019.

EQUITY

"In the search for yield, some bond proxy stocks have become too expensive on both sides of the ocean. Despite cheap valuations, value sectors are not a buy per se, but a selective play"

Kasper ELMGREEN
Head of Equities

Yerlan SYZDYKOV
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Amundi asset class views

	Asset class	View	1M change	Rationale
EQUITY PLATFORM	US	-/=		The extension of the bull market counts more and more on the Fed initiating an easing cycle. Earnings downgrades have no reason to stop in-between times, in line with some global growth moderation. So the outlook for the market is broadly unchanged. Opportunities are at the sector/ stock levels as risks are still broadly asymmetric.
	Europe	=/+	▲	Some arguments for a more positive relative call on European equities are related to a stabilisation in the economic outlook and reduced political risks, converging earnings growth with the rest of the world and attractive valuations on a relative basis. Investors could continue to benefit from strong sector rotation and high valuations dispersion.
	Japan	-/=		Broadly unchanged outlook. The earnings per share momentum is weak, although valuations are very attractive. Increased volatility due to geopolitical factors, could lead to a stronger Yen, which could potentially be a drag for the market. Opportunities could be found at the stock picking level, but we are cautious on the overall market.
	Emerging markets	=/+		We have a slightly positive view on EM equities on the back of a stabilising earnings outlook. We prefer domestic demand stories, which look more resilient in case of a continuation of trade disputes.
FIXED INCOME PLATFORM	US govies	=		Markets have gone too far, in our view, in discounting aggressive Fed cuts and the risk of disappointment and volatility have increased, due to current economic and financial conditions. We have a neutral view on duration.
	US IG Corporate	-/=	▼	We have a cautious view on credit markets, as there are segments, such as the BBB, that could be affected by some downgrades. Investors should continue to favour a "careful carry" posture that involves selectively reducing credit risk and moving up in quality. We prefer securitised credit to the corporate sector, as the US consumer sector is strong.
	US HY Corporate	=		Our outlook for the asset class is broadly unchanged. We see valuable carry, but limited space for spread compression The still sound economic picture is benign for the default outlook. Default rates are expected to remain very low in 2019.
	European govies	-/=		The new dovish ECB stance will prevent any rise in core yields. The market is expensive and it will remain quite expensive as the search for safety will continue to be at the forefront of investors' minds. Opportunities can be found playing yield curve flattening and Euro peripheral bonds – for example, in the very long end of the curve where 30Y maturities could bring significant carry in the government space.
	Euro IG Corporate	++	▲	We have recently upgraded our view on the asset class. The dovish tone of the ECB and the recent spread widening amid stable fundamentals are supportive factors for the asset class, which could enjoy mild spread compression and investors' appetite in the search for income.
	Euro HY Corporate	+		The high yield segment, as well as the IG, could enjoy the dovish ECB tone and benefit for a mild spread tightening. Leverage is still low and default rates are likely to stay low in the next 12 months. In a scenario of stabilising growth in the Eurozone, the asset class could provide selective carry opportunities.
	EM Bonds HC	=/+		Our view is still constructive on HC debt. Financial environment is supportive for EM duration (attractive carry, pretty low and stable US rates, stable US Dollar, dovish Fed and dovish EM Central Banks, and subdued inflation).
	EM Bonds LC	=/+	▲	The accommodative monetary policy stance, we believe, will be able to offset the hurdles to global growth from protectionism. Therefore, we have tactically improved our outlook on the asset class.
OTHER	Commodities			Oil price rebounded on tensions between Iran and the US, after having plummeted in May as trade war escalation added concerns to economic growth. Recent US inventories figures, which were higher than consensus, added pressure, despite the overall central case still being supportive for commodities. For WTI, we keep the US$55-65 range as OPEC will remain vigilant and committed to stabilising prices. Base metals will be affected by China and global economic slowdown.
	Currencies			EUR/USD: the single currency is still trading in a tight range as both the Fed and the ECB turned more dovish. We expect the EUR/USD to trade around 1.17 on a 12M horizon while remaining supported in the short term, due to political and growth concerns in Europe. We expect the USD/JPY at 107 on a 12M horizon. EM FX are expected to appreciate from current levels (+1.2%), according to models. Being selective remains key.

LEGEND

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Negative Neutral Positive

▼ Downgraded vs. previous month ▲ Upgraded vs. previous month

Source: Amundi, as of 24 June 2019, 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.

Amundi ASSET MANAGEMENT

AMUNDI Investment Insights Unit

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

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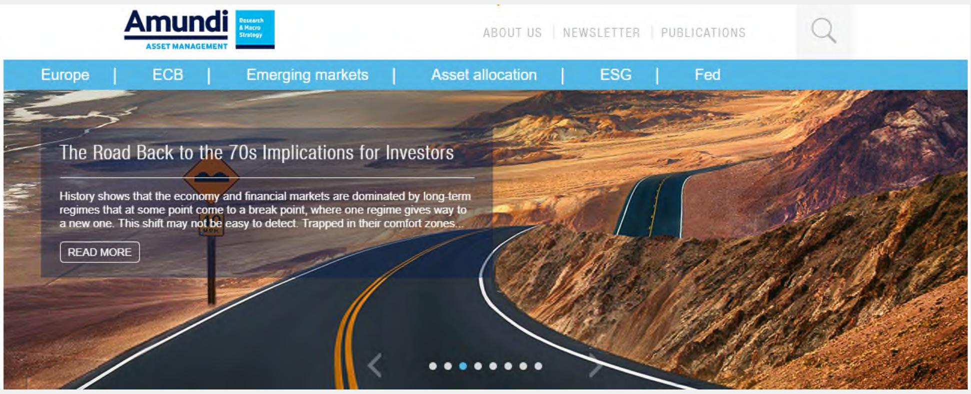

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INSIGHTS UNIT

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Definitions

- **Correlation** The degree of association between two or more variables; in finance, it is the degree to which assets or asset class prices have moved in relation to each other. Correlation is expressed by a correlation coefficient that ranges from -1 (always move in opposite direction) through 0 (absolutely independent) to 1 (always move in the same direction).
- **Credit spread:** differential between the yield on a credit bond and the Treasury yield. The option-adjusted spread is a measure of the spread adjusted to take into consideration possible embedded options.
- **Yield curve bull steepening:** A bull steepening is a yield-rate environment in which short-term rates are decreasing at a rate faster than short-term rates. This causes the yield curve to steepen.
- **Cyclical vs. defensive sectors:** cyclical companies are companies whose profit and stock prices are highly correlated with economic fluctuations. Defensive stocks, on the contrary, are less correlated to economic cycles. MSCI GICS cyclicals sectors are: consumer discretionary, financial, real estate, industrials, information technology and materials, while defensive sectors are consumer staples, energy, healthcare, telecommunications services and utilities.
- **Duration**: a measure of the sensitivity of the price (the value of principal) of a fixed income investment to a change in interest rates, expressed as a number of years.
- **FX:** FX markets refer to the foreign exchange markets where participants are able to buy and sell currencies.
- **Volatility:** a statistical measure of the dispersion of returns for a given security or market index. Usually, the higher the volatility, the riskier the security/market.

Important Information

Amundi
ASSET MANAGEMENT