Confidence must be earned

Amundi ASSET MANAGEMENT

March 2019

Global Investment **Views**

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Licence for value hunting

If an investor had woken up today after three months and looked at the markets, he/she could reasonably say that not much had changed. The year started on strong footing and **risk assets experienced a massive rebound in the first weeks of 2019**, erasing most of the losses experienced in one of the most awful Decembers in history. As a result **some valuation gaps have been closed somewhat, though not exhausted**. Markets switched rapidly from a "fear" to a "greed" mood. Catalysts of the renewed optimism have included the dovish shift in the Federal Reserve's strategy, and increasing signs of progress in the trade negotiations between the US and China.

So, something has changed. A year ago, the narrative was about synchronised growth, inflation returning to the radar screen, and higher rates. In the second half of 2018, the scenario changed, however, featuring a synchronised slowdown and almost no signs of inflation risk. Going forward, we expect further **divergences through the year**: the US will continue to decelerate (from strong growth), EM could stabilise and rebound in H2, with differences among countries, and the Eurozone could follow, with stabilisation and rebound in H2, if significant risks don't materialise. So, **we are now in a sweet spot** (slowdown but no recession, central banks on pause mode or accommodative stance, core bond yields stable at low levels) and as long as this continues (ie as long as growth does not falter too much or alternatively the Fed is back to focusing on inflation or growth concerns), this spot is market-friendly, though we are likely to see volatility as some areas of uncertainty (geopolitics) and vulnerability (high debt) persist.

The guiding principle for navigating this late phase of the cycle is the consistent **search for sustainability from different perspectives**. Focuses include the following: **sustainability of growth –** ie, countries/areas with solid domestic sectors. It is particularly important in EM countries to avoid situations of excessively unbalanced and vulnerable growth models, preferring areas that are experiencing a rise of internal demand (Asia in particular); **sustainability of corporate earnings**, focusing on companies with solid business models; and **sustainability of debt**, avoiding the most fragile situations, which could suffer the most in phases of scarce market liquidity.

We strongly believe that focusing on fundamentals will prevent investors from **falling into the pessimism (and/or excess of optimism) trap** that a noisy news flow could trigger (trade disputes still in the radar screen and CBs communications). Following this sort of focus will also help in identifying market areas that could offer value for long-term investors. In January, we saw opportunities to increase risk exposure, starting with EM and credit (now partially exploited). We are now closely monitoring **European equities** which could now be an investor focus again. It is true that economic momentum remains weak, but further fiscal impulses could help stimulate domestic demand and a re-acceleration in EM growth could also benefit Europe. Earnings revisions reflect the pessimism associated with a slowdown, but we now see signs of deceleration in negative revisions, a signal that we are likely moving past the pessimism. Valuations are not discounted as they were at the beginning of the year, but they are not expensive either, with areas of opportunities in some cyclical sectors (i.e in industrials). Investors should not yet be in a hurry, but there could be reasons for deploying capital in European equities during the year, and we don't believe there is cause to be short now on this asset class.

In conclusion, *as we expect the market mood to continue to swing between fear and greed, we see some room for* ***rotation to quality****,* ***reduction of directional market exposure or tactical recalibration of the risk budget****. With a medium-term view, in a world of low yielding risk-free assets, the key guideline is to try to* ***hunt for value opportunities arising from cyclical fluctuations****.*

Overall risk sentiment

Risk off | Risk on

Cautious risk assessment, close to neutral, reduced vs previous month after the strong market rebound

Changes vs previous month

- Some profit taking in credit
- Overall more cautious stance after the rebound

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

MACRO & STRATEGY

Philippe ITHURBIDE
Global Head of Research

Monica DEFEND
Head of Strategy, Deputy Head of Research

Didier BOROWSKI
Head of Macroeconomic Research

> ***With recession unlikely in the near future, markets will be driven mainly by political developments and CB actions.***

What marks the end of monetary normalisation?

Global trade contracted sharply in 4Q18 (-3.6% annual rate). This contraction partly represents a return to the "more normal" levels set after the great financial crisis of 2008, while 2017 was just an abnormally high year. In fact, while the annual growth rate in global trade was around 6% in the period 1992-2007, this has moved down to around 2.6% since 2012 (while 2017 was very high at 5% annual growth). That said, the contraction in trade seen at the end of 2018 proved to be particularly extreme: indeed global trade was down by -1.4% yoy in December, a contraction unseen since 2009. In part, this could be due to the high level of uncertainty. In fact, in response to an uncertainty shock, firms potentially adjust their inventory policies by making disproportionately large cuts to their orders of foreign intermediates.

If this is true, the soaring uncertainty induced by the fear of an escalation in the trade war between the US and China (uncertainty indices peaked in December) may explain the sharp fall in trade in the same month. Political uncertainty dropped in January, probably because of the perceived potential for an agreement between the US and China. **It is likely that uncertainty will fall further in February, which, *ceteris paribus*, could help world trade to stabilise.**

However, other elements of uncertainty persist, especially in the short term in Europe. On the one hand, the risks around Brexit remains high, while on the other hand, Donald Trump may want to increase pressure on Europe by "demanding" measures to rebalance bilateral trade between the US and the Eurozone (with the automotive sector in focus). These issues could prove to be problematic, given the recent weakness in the Eurozone.

It is in this context that central banks have changed their communications:

- With respect to the **ECB**, the extent of the deterioration of the economic situation in the Eurozone has surprised the ECB, which no longer thinks that this is solely due to temporary factors. The ECB's growth forecasts will clearly be lowered. **In such conditions, the door for new TLTROs* is wide open** as the ECB wants to avert any further deceleration by supporting the bank lending activity;
- With respect to the **Fed**, several FOMC members openly stated doubts about the need to raise rates again. **"Wait and see" have become the watchwords.** In addition, the minutes confirm that the Fed intends to maintain a larger balance sheet than expected just few months ago. The resurgence of domestic (shutdown) and external (China, Eurozone, Brexit, trade tensions) risks is put forward to explain this turnaround. There are too many unknowns to continue monetary normalisation, especially as inflation remains contained and unit labour costs are declining.

Ultimately, support from central banks tends to reinforce our scenario: the shock should prove temporary, with domestic demand expected to remain solid (especially consumption) on both sides of the Atlantic.

The Strategist's View – Credit and peripheral bonds in demand

Peripheral bonds: January saw quite strong and successful new issuance activity on the part of the Italian Treasury, as Italy accounted for roughly 16% of overall gross issuance and 78% net issuance for the whole year: other peripheral countries were successful too in placing new debt. February started with another successful, oversubscribed, 30Y deal, but weighting in the secondary market, while the macro picture remains challenging.

Credit: January also saw one of the best monthly performance of the last years for both US and EUR HY, with most of the ground lost in Q4 being recovered. Technicals turned more supportive for EU spread products as: 1) the ECB turned dovish and is likely to deliver a new round of long term operations; 2) the fall in safe haven bond yields increased the relative attractiveness of spread products; 3) the search for yield should persist, especially in the 1-5Y, where 75% of debt has negative or flat yield to maturity; 4) positioning was quite light at the start of the year and inflows were back. The other side of the coin is that valuations now look to be more in line with fair values (though still attractive vs quite low equity implied volatility) while the macro slowdown intensified in the Eurozone.

A consolidation phase and a more carry-like return by spread products may now be expected on the back of recent strong tightening, less compelling valuations, and persisting economic slowdown. Short-term drivers are likely represented by developments on the political side together with the next steps in monetary policy to be taken by the ECB and the Fed.

* The targeted longer-term refinancing operations (TLTROs) are Eurosystem operations that provide financing to credit institutions for a predefined period of time. They offer long-term funding at attractive conditions to banks in order to further ease private sector credit conditions and stimulate bank lending to the real economy.
DM= Developed Markets, EM = Emerging Markets, CB= Central Bank, ECB= European Central Bank, Fed= Federal Reserve.

Don't chase the bull

The strong bounce experienced by risk assets which followed the December meltdown has reduced many valuations gaps and stretched oversold conditions. We wonder if the rally is sustainable. **We believe this is not the time for chasing the bulls but rather for being selective and vigilant**, taking profit where the rebound has already materialised and getting ready to re-enter in areas where the repricing has not fully occurred yet. Our central case is for a decent but decelerating global economic growth, with slowing profit growth. Plus, there is a combination of high geopolitical risks and a number of idiosyncratic risks, which increase the uncertainty on the policy reaction front. These factors are today tamed by the more dovish attitudes of CBs, which will help to further extend the late cycle, and will allow the persistence of **favourable conditions for selected risk assets (credit, selected EM stories).** Given the fragile balance at play, we would stress the need to be vigilant, in a framework of cautious optimism.

High conviction ideas

Global profit cycle has passed the peak although we still expect single digit growth in 2019. Revenues will be a key factor regarding global equity returns performance. We prefer to keep an overall defensive bias, with a focus on diversification among regional equities, and on the value factor. We **favour Japan equity**, as the market still offers attractive valuations after the December correction, and light investor positioning, and it is a bit more sheltered from geopolitical tensions (trade disputes in particular).
On EM equity, valuations are not as appealing as at the beginning of the year, but the sentiment is **still moderately in favour of EM**. We are particurlarly **positive on China**, where there is a better policy space (monetary and fiscal) that in many other EM, plus it is more domestically oriented and valuations are still moderately attractive.
In **credit**, the recent spread compression across the board has been material and valuations have become less attractive compared to the beginning of the year. We prefer to **lighten part of the credit position for tactical profit taking** but the outlook remains positive: the envivornment of low growth (but limited recession risks) and low rates is favourable for carry trades and investors' appetite is high. We favour EU credit vs US credit, due to better technical and fundamental features.
Our overall **view on duration is neutral**, waiting for better entry points to become more aggressive on the Treasury market. The picture remains very fluid for taking strong views on the yield curve, but we expect some slight flattening pressure to persist.
We maintain **a preference for US versus German bonds** (on the 5 year) and we plan to increase it with a medium term investment perspective as better entry levels materialize.
On currencies, we believe the USD will continue to be supported in the short term – weak growth in Europe and EU political risks at the forefront – but we expect to see some weakening trends later in the year as the Fed moves close to its target. We remain constructive on the NOK, and cautious on the GBP (against both the EUR and USD), due to the still uncertain Brexit outcome, and we are positive on the JPY.

Risks and hedging

We continue to suggest **gold and yen exposure as hedges**. Gold could also benefit from a more dovish Fed stance.

Amundi Cross Asset Convictions

	1 month change	---	--	-	0	+	++	+++
Equities vs bonds					■			
Credit	↘					■		
Duration					■			
Oil					■			
Gold						■		
Euro cash				■				
USD cash						■		

The table above 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.
NOK = Norwegian krona , GBP = British Pound, EUR = Euro, USD = US dollar, JPY = Japanese yen.

MULTI-ASSET

Matteo GERMANO
Head of Multi-Asset

> ***Given the fragile balance at play, it is time to stay vigilant, take profit in areas that have already outperformed and look for further entry points.***

FIXED INCOME

Eric BRARD
Head of Fixed Income

Yerlan SYZDYKOV
Head of Emerging Markets

Kenneth J. TAUBES
CIO of US Investment Management

"The U-turns in CB tones have pushed investors back towards the search for yield. It is time to focus on carry and fundamentals, after the strong spread compression."

Carry is your friend

The U-turn in central bank policies will likely prevent any material increase in long-term rates. Markets priced out previously expected Fed hikes and are now focusing on the changing stances of all main DM and EM central banks which are becoming more accommodative across the board. The new CB mood should support sentiment for risk assets (credit and EM), keeping the search for yield alive among investors, though the focus should now be on appealing carry opportunities, after the strong spread compression.

DM bonds

On US bonds, we have an overall **neutral view on duration**, given the Fed's greater policy flexibility and the potential for an early end to the balance sheet taper. On a global perspective, we are **more positive on the US, neutral on the UK, and less negative on the Eurozone**, as we don't expect to see further downside in yields from current levels. We confirm our negative bias on Japan. We also continue to be positive on inflation linked bonds, in particular in the US. In Euro fixed income markets**,** we are **more constructive on peripheral countries** with some opportunities in Italy and we continue to exploit curve opportunities (i.e. playing the 2-30 year differential in Germany).

Credit

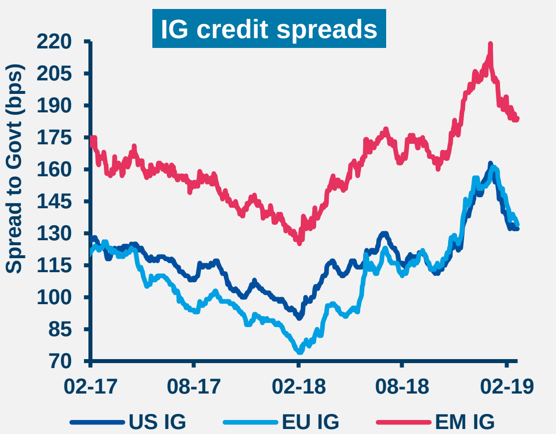
Credit has been a big beneficiary of the rally and the valuation reset was very fast in January. Therefore, we have **become more cautious in the short term,** though we believe that credit remains a key yield engine for bond investors. **In Euro credit,** we keep our preference for subordinated debt financial. **In US credit,** after becoming more positive at the end of 2018 when credit spreads widened, we are now maintaining our stance. We focus on investment ideas in bonds that may not have fully participated in the rally, and at the same time we are taking profits in the areas that now appear to be fully valued. We remain wary of bonds from issuers with higher leverage than is appropriate for their credit rating. We continue to believe that structured credit sectors – specifically non-agency MBS, CMBS and ABS – may offer relative value to investors backed by a strong US consumer, and by the superior credit protections they offer relative to their quality ratings.

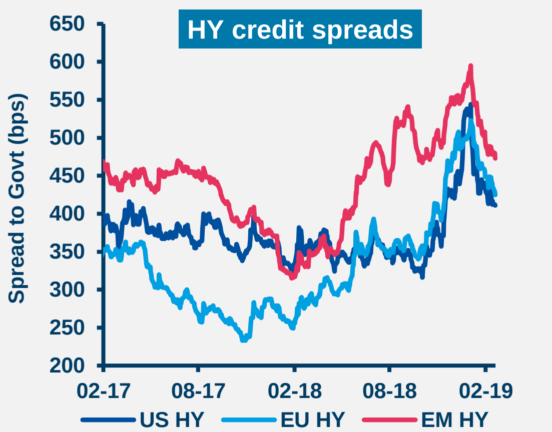
EM bonds

The start of the year saw an improvement in sentiment regarding EM debt. We expect that a more dovish tone by the Fed (and by other CB), a benign inflation outlook in most EM countries, and a stabilisation of economic **conditions will continue to favour the asset class** in 2019. On EM hard currency debt, we expect returns in line with the carry, while **EM bonds in local currency may offer higher return potential**, with many EM currencies still undervalued, albeit at higher volatility. We think investors should improve the quality of their portfolios, as risks persist (slowdown and trade).

FX

On **USD**, we have a neutral view due to the more dovish Fed. We are turning more **cautious on the Euro** amid a weak economic momentum (prefer SEK & NOK) and **neutral on the GBP** given Brexit uncertainty. We are positive on **JPY** (safe heaven in case of turmoil) and we favour **EM FX** with room for further appreciation.





Source: Amundi, Bloomberg. Data refers to ICE BofAML Bond Indices, as at 20 February 2019. EU IG: Euro Corporate Index; US IG: US Corporate Master Index; EM IG: IG EM Corp Plus Index, US HY: US High Yield Master II Index, EM HY= High Yield EM Corporate Plus.

Take a breath

Overall assessment

The equity rebound has come on fast and we can reasonably now expect the markets to take a breath. Going forward, the focus will be on earnings growth. This has been revised down materially across the board, **and the market is overall more vulnerable, being in a late cycle**. However, in a central scenario of no recession, earnings growth should remain positive globally, with opportunities opening at regional/ sector and stock levels. Investors should be aware of potential vulnerabilities (slowdown, geopolitical risks), but at the same time exploit the opportunies that some price dislocation can open, as it happened in Q4.

DM Equities

In the US, there are really no meaningful warning signs or excesses in the market that usually precede a recession or bear market. In Q4 earnings season, companies have generally announced earnings that are stronger than low investor expectations, but the number of companies revising down expectations is the highest since 2016, and the deterioration in earnings revisions should be a focus. We still like the more cash-generative tech companies with solid competitive positions. We also like value and cyclicals with the lowest valuations. We are cautious on traditionally defensive sectors both in value (utilities) and growth (staples). **European equities** were neglected last year, but bounced back in 2019, but there is still likely an excessive pessimism regarding this asset class. In our view, there is not a strong case to remain too short: political uncertainty is high, but may well fall after a Brexit resolution and EU elections.

Earnings revisions reflect the pessimism of the slowdown, but we now see signs of deceleration in negative revisions, a sign that the worst may now be behind us. Valuations are not as discounted as they were at the start of the year, but they are still attractive. Within an overall balanced approach, we continue to favour cyclicals over defensives, with some pockets of cyclicals pricing in a recession, which is not our base case. For banks, a catalyst is needed (relief of the political uncertainty or new accommodative measures from the ECB) for the sector to be back in favour.

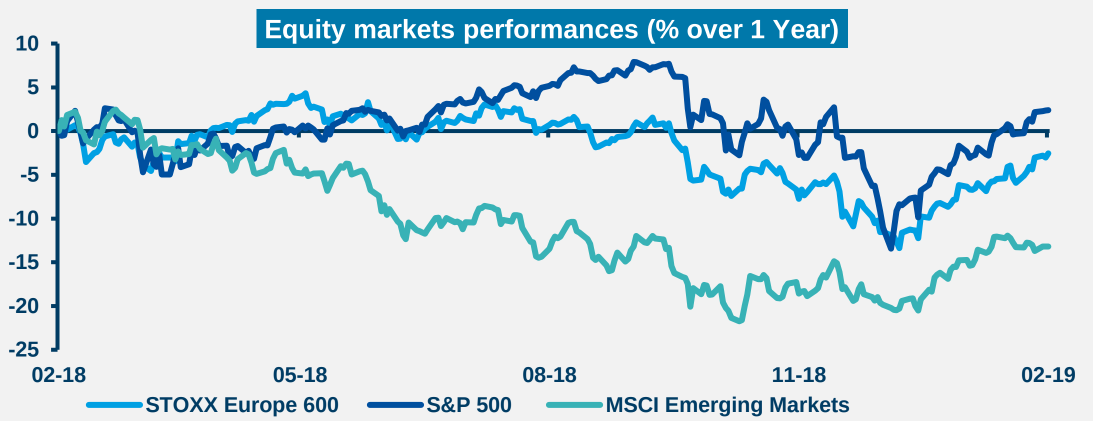
Valuations and fundamentals are attractive for **Japanese equities**, but with some risks (dollar strength and vulnerability to exports).

EM Equities

We remain constructive on EM equities although in the short term there could be a pause after the rebound.

Positives for the asset class include the widening expected growth differential, attractive valuations vs DM, improving capital expenditure discipline, no major macroeconomic imbalances, and decent earnings growth (with country/sector differences). We like countries with resilient macroeconomic fundamentals and domestic growth drivers, strong reform agendas and attractive valuations. We also like countries with favourable monetary and fiscal room and low external vulnerabilities. Our most preferred markets are China, India and Indonesia in Asia; we favour Russia in CEEMEA (as sanctions have been partially discounted) and Argentina in Latam.

We are cautious on countries with expensive valuations and high political risk.



Source: Amundi, Bloomberg. Data from 20/2/2018 to 20/2/2019. EM index in USD.

EQUITY

"We still see positive earnings growth this year, but after the rebound, valuations are less attractive. Focus on sustainability of earnings is key in a late cycle."

Kasper ELMGREEN
Head of Equities

Yerlan SYZDYKOV
Head of Emerging Markets

Kenneth J. TAUBES
CIO of US Investment Management

Amundi asset class views

	Asset class	View	1M change	Rationale
EQUITIES	US	+		Earnings decelerated in Q4 and expectations for 2019 have been revised down. On the positive side, valuations are not expensive and could still support the asset class with a medium-term perspective. In the short term, after the sharp rebound, some consolidation is expected.
	Europe	=		Market positioning still does not favour this asset class given a weak economic scenario, downward earnings revision and political uncertainty. However, much bad news already looks to be priced in, except a no deal Brexit and an aggressive trade policy from the US administration. We have a neutral view and we could see some opportunities ahead.
	Japan	+		The market is still cheap after the December rebound. However, export-led companies exposed to global growth could be negatively affected by the weak global growth momentum. It is important to look at the currency: excessive JPY strengthening is a negative for the market and has to be carefully monitored.
	Asia-Pacific ex Japan	=		The market is highly sensitive to the commodity cycle. We are neutral at this stage, as more visibility on China spending on infrastructure is needed to take a more positive view.
	Emerging markets	+	▼	We remain slightly positive in the short term, but we could see some consolidation after the rebound. For the remainder of the year, we would focus on earnings growth and the evolution of the economic cycle. China among favourite picks.
FIXED INCOME	US govies	+		We have a constructive view on US govies benefitting from the CB's dovish stance and decelerating economic figures (from strong data). US bonds look attractive as hedging strategies and for liquidity features.
	US IG Corporate	=		A dovish Fed (rate normalisation target closer) and a still-supportive macro picture could continue to sustain the segment, but after the sharp rebound, we see less support from valuations.
	US HY Corporate	=		With spreads having recovered from the end-of-year sell-off, we see a more carry-like return for the asset class. Some opportunities may be found in bonds that may not have fully participated in the credit rally, while we are more cautious on names that rallied and appear fully valued. Focus on sustainability of debt.
	European govies	=	▲	Limited upside for core government bond yields and unattractive valuations. Pockets of value can be found playing yield curve movements. Slighly more positive on Euro Peripheral Bonds (vs 1 month ago) and neutral in UK govies.
	Euro IG Corporate	+	▼	The outlook is still constructive, but we are more cautious now after the rebound. Valuations are less attractive than just one month ago and closer to fair values and we expect technical conditions to be less supportive. We see still some upside potential linked to ECB March meeting.
	Euro HY Corporate	+		Valuations are less compelling than just one month and closer to fair values, consistent with current leading macro indicators. Leverage is still low and default rates are likely to stay low in the next 12 months. We suggest playing the asset class as a carry story, while spread compression is expected to be limited.
	EM Bonds HC	+	▼	More accommodative Central Banks are supportive for the asset class. Recent rebounds make valuations less appealing. Short-term volatility could re-open opportunities to gradually add to the asset class. Attractive carry.
	EM Bonds LC	++		We remain constructive on the asset class, due to the positive support that should come from EM FX, still undervalued and supported by the expected depreciation in the USD. Moreover, the real rates differential is still in favour of EM vs DM.
OTHER	Commodities			We revised down our oil targets to USD 55-65 and USD 60-70 for WTI and Brent, respectively. Negative economic momentum and a dovish Fed are again providing support for gold, which could remain a reasonably efficient hedge this year.
	Currencies			The USD is likely to continue to be supported in the short run, but it should weaken in the coming quarters, as the Fed is close to its rate target. The strong USD appreciation in 2018 doesn't reflect fundamentals, with the result that the currency is overvalued vs the G-10 universe. We are neutral on the GBP, amid Brexit uncertainty, and positive on the JPY, on expected repatriation of flows.

LEGEND

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Negative Neutral Positive

▼ Downgraded vs previous month ▲ Upgraded vs previous month

Source: Amundi, as of 19 February 2019. 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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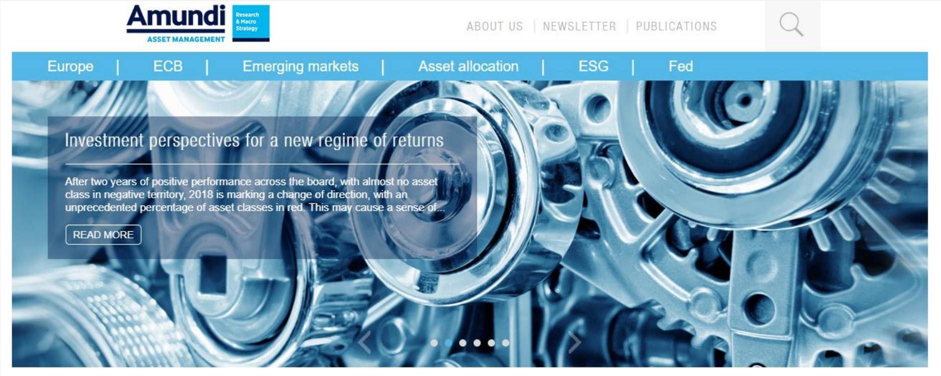

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INSIGHTS UNIT

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Definitions

- **Basis points:** one basis point is a unit of measure equal to one one-hundredth of one percentage epoint (0.01%).
- **Correlation:** The degree of association between two 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 (perfectly negative correlated) through 0 (absolutely independent) to 1 (perfectly positive correlated).
- **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.
- **Cyclical vs Defensive sectors:** Cyclical companies are companies whose profit and stock prices are higly correlated with the economic fluctuations. Defensive socks, on the contrary, are less correlated to the economic cycles. MSCI GICS cyclicals sectors are: Consumer Discretionary, Financial, Real Estate, Industrials, Information Technology and Materials, while Devensive Sectors are Consumer Stables, 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.
- **MBS, CMBS, ABS:** mortgage-backed security (MBS), commercial mortgage-backed security (CMBS), asset-backed security (ABS)
- **Volatility** is 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.

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