Equity Portfolios

Top Down Views from Amundi Research

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The markets do not price in the end of a cycle until a few months beforehand. As a US recession – and, hence, a global recession – is unlikely in 2018, the markets will probably continue to perform well. However risks are also increasing.

Have US equities become so expensive that they have hit a ceiling? No, but it shows that the risk-reward has deteriorated

Relative to interest rates, US equity valuations are not extreme. However, the lack of supply of bonds has pushed yields to abnormally low levels. So it is worth comparing equity valuations directly with inflation. This is where the "rule of 20" comes in. Each time that the P/E on trailing 12-month earnings moves above the "20-inflation" level, it is overvalued. That is now the case, as it was in 1987 and 1996. In our view, this measure is a good indicator of market exuberance, keeping in mind that while there was a crash in 1987, in 1996 the market continued to rally for another three years.

Is volatility gone forever? No, it should rebound sometime in 2018

Volatility is a trailing function of monetary policy. It generally rises about two years after key rates begin moving up and the Fed began to raise its key rates in December 2015. This is due to liquidity. Adding liquidity reduces volatility, and vice versa. Although central banks are proceeding cautiously, the liquidity argument, which has carried the markets since 2009, is now reversing its momentum. This trend will gather strength in 2018.

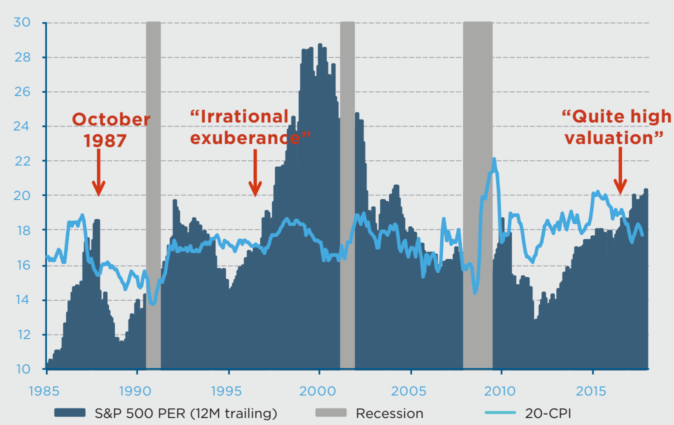
Can earnings continue to drive the markets higher? We think so

The synchronisation of global growth is a favourable factor. In the United States, assuming, conservatively, that margins remain stable, earnings growth will be close to nominal GDP growth, i.e., ca. +4%. In addition, we can look forward to the tax cut, the accretive impact of share buybacks, and the delayed impact of the weak dollar. Thus, the Ibes consensus of 11% EPS growth seems credible.
Elsewhere, margins are likely to improve. In the eurozone, they lag behind the US by 22 months this time. Higher bond yields, which help banks, are a key factor to this improvement. Nor are margins in Japan, which are at a high since the 1980s, showing any sign of weakness. And, lastly, the upturn in earnings in emerging markets is likely to extend into 2018.

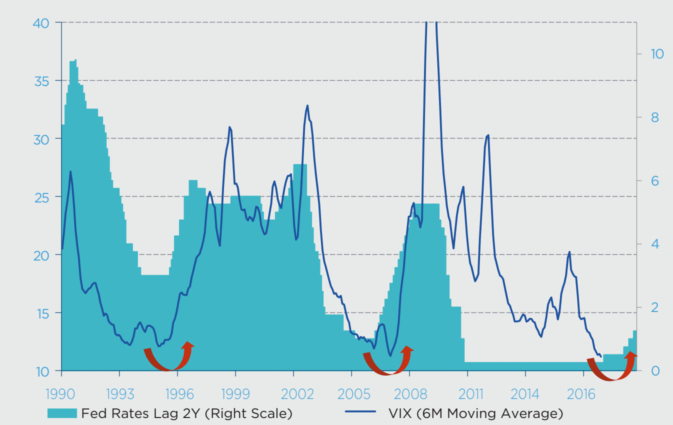
Against this backdrop, what is to be done on a regional level?

While the US market is expensive and the cycle is expected to last beyond 2018, the other markets are less expensive and now re-synchronised with the US and, as a result are more attractive. However, given these markets' high sensitivity to the behaviour of the US market and how mature the cycle is, investors should consider only moderate risk exposure or to implement hedges.

1/ **S&P500 Price Earnings Ratio (PER) and the "Rule of 20"**



2/ **Fed rates and US Equity Volatility**



Source: Datastream, Amundi Research

Amundi ASSET MANAGEMENT

- **The eurozone**: improved margins, re-steepening in the yield curve (good news for banks), renewed inflows (which, however, would mean an appreciation in the euro) are keys. Political risk (Catalonia) is less systemic in nature. Brexit, of course, is the elephant in the room but is expected to burden UK assets more than European ones.
- **Japan**: further rise in margins, ongoing improvement of governance, and inflows (BoJ and pension plans) are constructive arguments. However, the yen, which is closely correlated to equities, will remain decisive. Shinzo Abe's election success points to continuity in economic and monetary policy (weak yen). However a significant market shock, if one was to occur, would strengthen the Japanese currency and weight on equities.
- **Emerging markets** are riding the synchronisation of global growth, which is also a boost for commodities. This moderately bullish scenario can be derailed by USD appreciation, Fed rate hike (if stronger than expected), Fed balance sheet normalisation, global (and China) growth deceleration.

What are the themes for 2018?

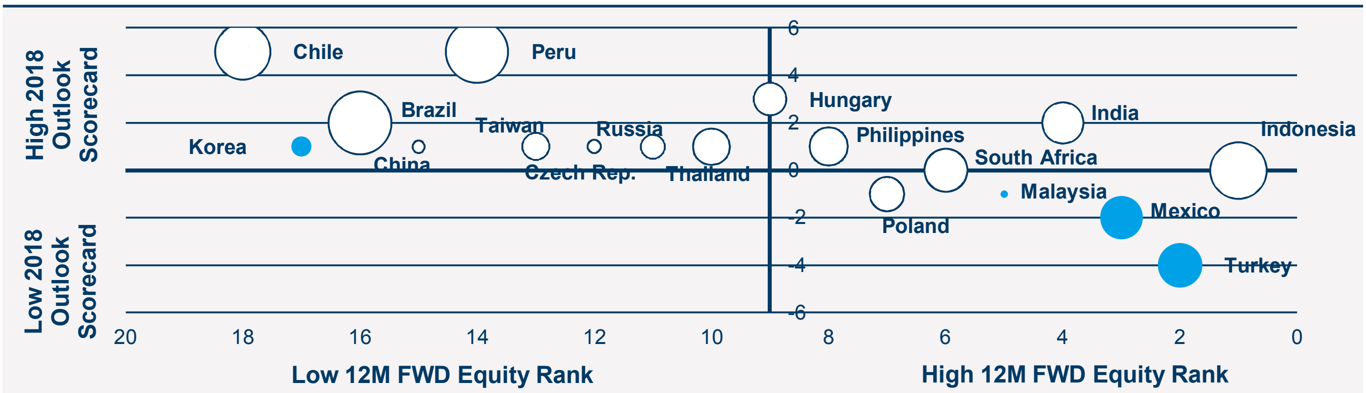
There are four key themes at this stage of the economic recovery:

- **Upturn in inflation:** overweight companies with pricing power (e.g., luxury goods companies). Financials may also benefit from the higher bond yields that are coming late in this cycle.
- **Upturn in investment?** The resynchronisation of global growth and the upturn in earnings are arguments for this theme. However the decline in potential growth is cooling things off. The idea is that investors at least should keep some cyclical exposure and not switch too early to a purely defensive strategy.
- **Look for quality:** Growth stocks are very expensive globally, a consideration that is feeding the theory of a bubble. Quality companies, which are less leveraged and less expensive, are clearly a good trade-off.
- **Watch out for liquidity:** as regards equities, this theme concerns mainly small caps. True, their earnings remain strong for the time being in Europe and Japan. And in the US, the upcoming tax reform is a true argument for these more domestically oriented stocks. However these arguments will vanish during the year as liquidity will be less supportive.

What about Emerging markets?

- **The most appealing area for 2018 is EM Asia**, mainly India, Indonesia and the Philippines. We see three reasons for this: 1) widespread quality, 2) convergence of positive macroeconomic environment (in terms of growth, inflation and liquidity), 3) low vulnerability vs other GEM and good fundamentals. After a strong rally in 2017, China looks expensive. Anyway the ongoing process of reforms can improve the market picture. FXs seem overvalued in many of the Asian countries which warrants hedging positions.
- **We also remain positive on EMEA** (mainly Turkey and South Africa). Equity fundamentals are good and growth will remain supportive. South Africa is appealing (strong earnings and decent valuation). Growth is still weak but improving, with some weakness on the fiscal side. Turkey is inexpensive with high profitability and robust earnings growth. However, a cyclical slowdown in 2018 will call for more fiscal expansion and monetary accommodation, making more difficult for inflation to move towards the CB target. FX seems attractive on a 12-month horizon.
- **In LATAM we are more cautious:** macroeconomic conditions improved during this year but the equity market rally made the area expensive, with the only exception of Mexico. The area could become attractive if some correction occurs.

3/ **EM Scorecard**



The chart shows the cross between internal 12m FWD Equity Rank and internal 2018 Outlook Scorecard. Countries in the top right section are the most attractive. The economic variable "Reforms underway in China" is not included in this analysis. Bubbles represent the attractiveness of FX: white bubble = downside at 12m horizon; blue bubble = upside at 12m horizon.
Source: Amundi Research, 2018 Outlook Scorecard based on a number of macro indicators (GDP growth, external demand, public sector, inflation, liquidity). 12m FWD Equity Rank based on 12m horizon expected upside (based on macro fair value), medium-term valuations, EPS growth expectation, profitability, positioning and FX medium-term attractiveness.

CIOs' investment strategies: Q&A

Global equities investment strategies

ROMAIN BOSCHER, Co-Head of Equities

Q1 / How do you believe investors should play the 2018 investment environment in terms of positioning and budgeting for risk?

Overall valuation levels and the length of this bull market dictate that risks regarding equities will likely be higher in 2018 than in previous years. However, earnings growth continues to accelerate, Central Bank tightening is modest, and there are compelling funds flow arguments for equities. Earnings are consequently in the driver's seat and flows could inflate valuations further. On the negative side, Central Banks' behaviour could be a trigger for a more adverse scenario if interest rates move significantly higher. In other words, the outlook that could emerge is a kind of 'Goldilocks' case or a move away from it, depending on the speed/ intensity of monetary policy normalisation.

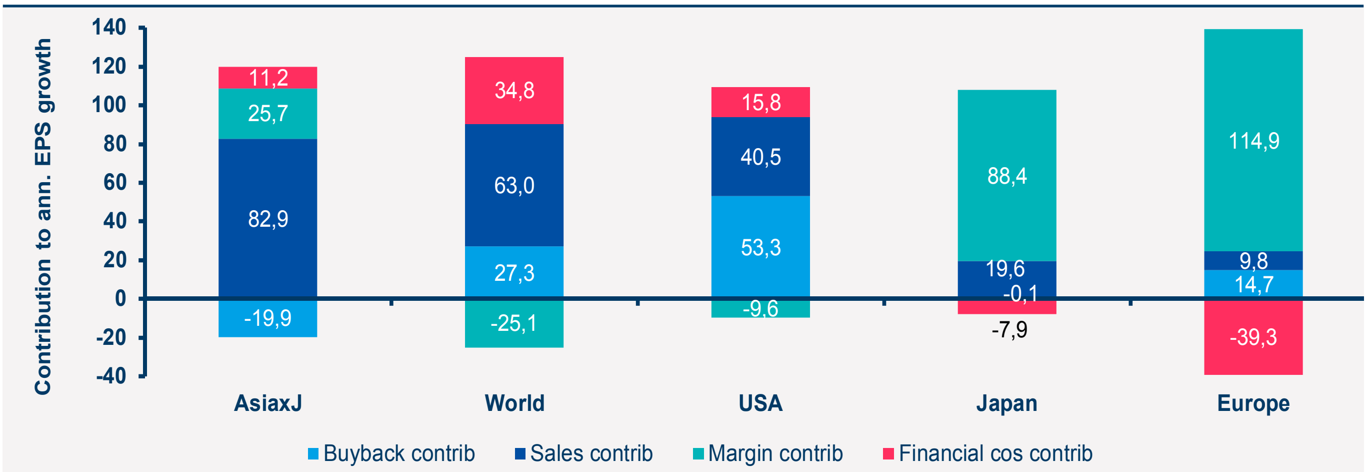
Regarding the importance of earnings at this stage, we are paying attention to earnings growth, but also to sustainability of growth. On the former issue, we prefer Europe and EMs, which combine higher and better earnings per share growth prospects, fuelled more by higher margins than by share buybacks, as highlighted in the chart below. But when it's about quality and sustainability of earnings, Japan is offering a convincing profile. From a sector point of view, we are paying attention to those stocks that have seen extreme benefits from an every-day-lower-rates environment.

These bond proxies could suffer, at least in relative terms, which would explain why, for instance, we believe investors should prefer consumer discretionary to consumer staples stocks. It could also be worth underweighting domestic UK and US industrial stocks.

Q2 / What are the major changes in your investment outlook for 2018 compared to 2017, and how have these come about?

We think that it's too late to be a trend-follower. In other words, we believe investors should avoid momentum, preferring value and quality. Some high-dividend names, after significant though not massive underperformance, could potentially do better in a bumpier market.

1/ **MSCI regions: EPS growth breakdown (last five years**



Source: MSCI, Amundi Research. Data as of November 20, 2017

Q3 / What are the main issues/events to watch during the year, and why?

US inflation rates, central bank policy (in the US, Japan and Europe), and US 10-year bond yields will, in our view, be by far the most important factors to monitor in 2018. An increase in short and long rates plus modest curve steepening could signal normalisation of the cycle 11 years after the Global Financial Crisis and could lead to some important rotation in equity markets.

A more rapid normalisation of inflation, particularly in the US, would raise the possibility of policy mistakes by central banks which would likely end this market cycle. This is not our central expectation, but is a risk to be aware of.

Q4 / In your view, what are the biggest opportunities and risks not priced into the markets for the new year?

We could still benefit from synchronised global growth in 2018, combined with modestly rising inflation. The uplift in nominal growth could have a material impact on earnings in 2018, particularly when combined with modest fiscal expansion. This backdrop would favour financials and economically sensitive stocks as well as smaller capitalisation stocks at the expense of mega cap growth stocks. It would facilitate the closure of the last valuation gaps available in the market.

Q5 / What could be the most appropriate strategy to mitigate risk?

In our view, playing geographic opportunities, with a rigorous and disciplined focus on valuations, avoiding excessive financial leverage and poor governance frameworks, plus the retention of some high-quality names, even after a strong rally, would be the most sensible ways to mitigate risk in the scenario outlined above.

European equities investment strategies

DIEGO FRANZIN, Co-Head of Equities

Q1 / How do you believe investors should play the 2018 investment environment in terms of positioning and risk budgeting?

It is our view that in 2018, we will probably see the late phase of one of the longest cycles of the last 100 years. In general, these phases of consolidation are associated with economic deceleration, as inflationary pressures and rising rates have an impact on wage growth, capital investments and, ultimately, profitability. It is our opinion that this late-cycle phase will be atypical and will be characterised by: (i) a subdued level of inflation, which is on the rise across Europe but is nowhere near a point that would prompt the European Central Bank to take strong action; (ii) a recovery in capex to meet rising customer demand both domestically and outside of Europe; and, more importantly, (iii) a continuation of the earnings recovery which made 2017 such a remarkable year. European earnings should continue to experience support from the operational leverage that has improved in the aftermath of the Global Financial Crisis and the Sovereign crisis, allowing them to be ready to reap the benefits from a recovery in top-line growth.

Lastly, valuations in the European market appear full in absolute terms, but are quite interesting from a relative perspective, which should offer further support for the asset class in the coming months.

Q2 / What are the major changes in your investment outlook for 2018 compared to 2017 and why?

We expect 2018 to be a market environment in which European equities will remain in the spotlight. We believe that earnings growth will be the main fundamental factor driving performance, but we also see external factors (macroeconomic events, political elections, monetary policy changes) that could potentially cause an increase in volatility, and thus possible rotation within the market. Now more than ever, we believe that it is very important to maintain a balanced approach to portfolio construction, avoiding major style biases and focusing as much as possible on idiosyncratic investment cases that have the potential to deliver consistent and reliable earnings growth over the medium-term, independent of the phase of the market. If anything, we believe investors should start thinking about portfolio construction with "a hedge", which can take a different format depending on the investment strategies. Quality and sustainability of the business model will, in our view, act as a natural hedge for stock picking approaches and should be favoured in this phase of the cycle. For other strategies, some optionality could be appropriate. So, our keywords for 2018 are "balanced with a hedge", focusing all the attention on individual companies' investment cases.

Q3 / What are the main issues/events to watch during the year and why?

As we mentioned previously, our view remains that the continued delivery of earnings growth will be the main catalyst for the market to move higher, therefore we will be paying very close attention to the upcoming reporting seasons. From a more macro perspective, we see any action from central banks globally, regarding their intentions to withdraw monetary stimulus, as a potential driver of sentiment. From a political standpoint, any progress from the US administration on tax reform (which could impact the earnings outlook for US corporates) may have an impact, not only on European equity markets but around the globe. In addition, 2017 has proved to be a pivotal year for the European political landscape as concerns about a populist revolt did not come to pass, given the positive outcome of the French presidential election and, more recently, the German elections. That said, in 2018, Italy will go to the polls and this could be a source of short-term volatility, while the ongoing situation in Spain regarding the independence of Catalonia could spark bouts of volatility. Finally, a strengthening euro could also be a headwind for European equities; however, we expect this to weigh more on sentiment than on actual earnings power.

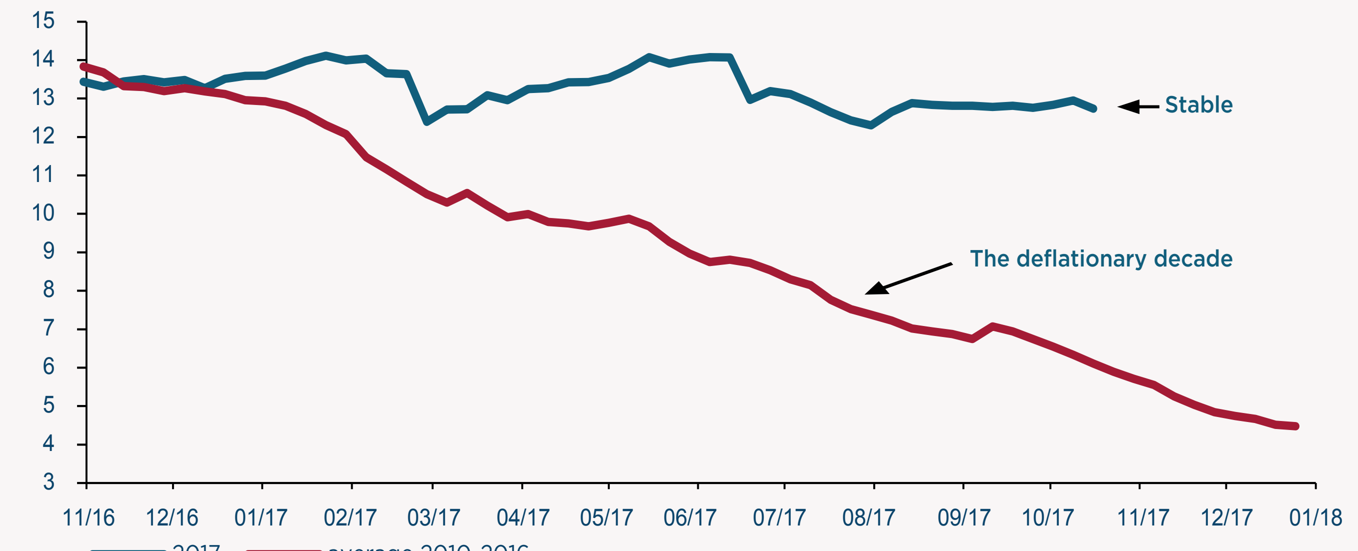
Q4 / In your view, what are the biggest opportunities and risks not priced into the market for the new year?

In our view, unforeseen political and macroeconomic events at a global level are the risks that could derail an otherwise positive market for European equities. The strength and the geographical breadth of the global recovery might indeed offer some additional surprises to equity investors, particularly those disciplined enough to concentrate their allocation in sectors that will benefit from an expansionary market environment. Here, value may offer some attractive opportunities.

Q5 / And what could be the strategy to mitigate risk?

The key risks to bear in mind are connected with a rise in volatility and in a breakdown in correlations – both within sectors and in the market in general. Our central scenario is that of a late-cycle positive performance for the equity markets; however, given the risk of sudden disruptive rotations, we believe investors should focus on idiosyncratic investment cases or consider hedging to mitigate systemic risk.

1/ **Revisions to the Consensus Estimate of Average Current Year EPS Growth (Europe)**



Source: Amundi Research, Datastream, Kepler Cheuvreux

Japanese equities investment strategies

ROMAIN BOSCHER, Co-Head of Equities

Q1 / How do you believe investors should play the 2018 investment environment in terms of positioning and budgeting for risk?

The macroeconomic conditions are not likely to change much next year for Japan. In our view, the Bank of Japan has little room to reverse its accommodative monetary policy. Japanese firms should experience earnings growth, but the consensus outlook points to rates slowing significantly from 16% yoy in FY17 to 7% yoy in FY18 (our estimates are in line with the consensus) after having benefited from the global economic recovery. At the sector level, despite rich valuations, we have a positive outlook on electronics, semiconductors, and industrial machinery on the back of advances in the "Internet of Things" and an imminent necessity for labour substitution. ADAS (Advanced Driver-Assistance Systems) are a growing opportunity for these sectors, along with other drivers, such as smartphones and games. The trend towards electric vehicles will eventually cause a transition of leaders in the market, from automotive to electronics companies. Moreover, many companies have started investing in automation to bolster productivity – e.g., assembly line automation and self-checkout systems at retailers – as a natural development in response to demographic shifts in Japan.

Q2 / What are the major changes in your investment outlook for 2018 compared to 2017, and on what factors are these based?

The investment style may gradually shift to value given decelerating earnings growth in 2018. Overseas flows could favour large caps as more global asset allocators rebuild their exposures to Japan after confirming the political stability of the Abe administration.

Q3 / What are the main issues/events to watch during the year and why?

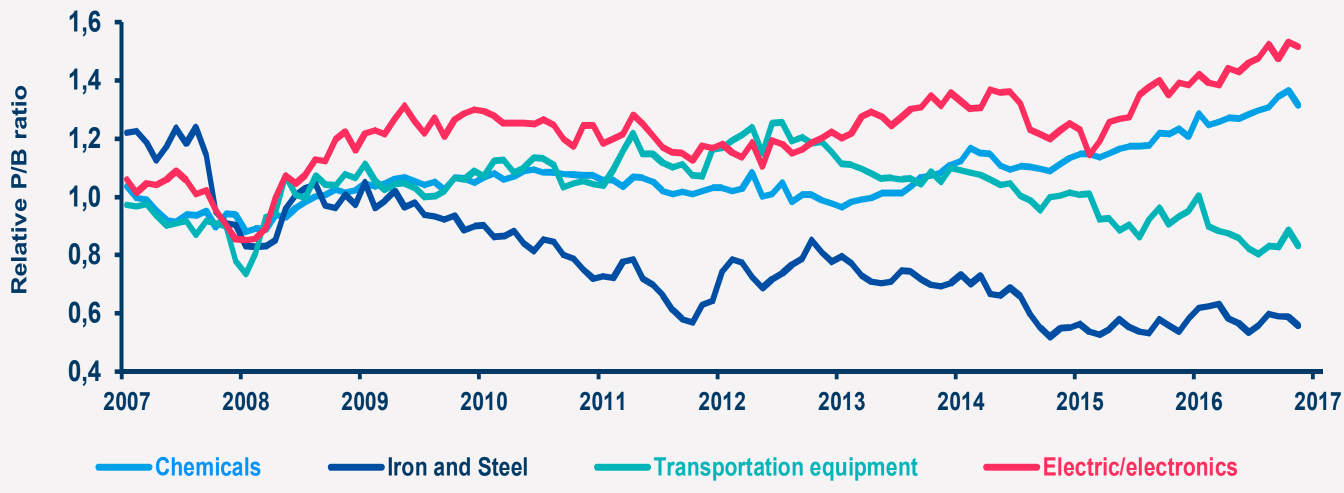
We see four major issues to watch next year that could drive the market:

1. The BoJ could potentially recalibrate its policy trajectory. As the Fed and the ECB begin balance sheet reduction and tapering, respectively, the BoJ could face political pressure if the yen were to depreciate significantly as it maintains its current policies of "QQE + YCC" (quantitative and qualitative easing and yield curve control, respectively). We see three options being available to the BoJ: pegging the yield officially targeted by the BoJ of a shorter maturity; revising up the BoJ target for the JGB 10-year yield; steadily reducing asset purchases. The main implications for the market of a policy recalibration along the lines noted above could provide support to banks.
2. Revision of labour laws to address current labour shortages as part of the "work style" reform. A conversion to permanent employment could drive a reduction of precautionary savings, with potential positive implications for consumption/domestic demand-related stocks.
3. Arguments regarding another consumption tax increase (from 8% to 10%) could be made. Despite PM Abe's statement prior to the snap election, a rate hike could result in a prolonged negative impact on consumption and business activity, likely negatively affecting consumption stocks.
4. Growing awareness of ESG (environmental, social, governance) could have an impact on policy decisions. This is a global trend. The market would begin to price in ESG factors as more managers try to incorporate non-financial information into company processes while addressing a need for better disclosure. This situation has the potential to generate asymmetries in company returns, increasing the scope for selection and active management.

Q4 / In your view, what are the biggest opportunities and risks not priced into the market for the new year?

A positive factor for the market, which is not fully priced in, could be the debate over taxing retained earnings, a point raised during the electoral campaign. This could well push for a demand for capex and earnings distribution to shareholders and/or employees. On the downside, the main risk is a margin squeeze due to surging energy costs on the back of rising geopolitical risks. This scenario could materialise if oil were to move towards USD 70/bbl. In order to mitigate the risk, during the year, it will be important to apply rigorous fundamental analysis to financial and non-financial aspects, and to constantly review the state of invested companies based on economic and earnings contexts, and in relation to how alternative scenarios (positive and negative) could potentially unfold.

1/ Leadership migration: sector Price to Book ratios vs. Topix



Source: Bloomberg, Amundi Research. Data as of November 10, 2017

US equities investment strategies

MARCO PIRONDINI, Head of Equities, US

Q1 / What are the most attractive investment opportunities for 2018?

We believe US large value stocks offer the best risk-reward for three reasons:

- Large value stocks have greater exposure to cyclical growth than growth stocks. We believe the US and global economies are still reflating, which should benefit value stocks over growth stocks
- Tax reform, if passed, will likely cause economic growth to accelerate, benefiting value
- Value has underperformed growth by over 16% in 2017 as investors have favoured high growth stocks such as Netflix and Tesla over value stocks. We think this extreme outperformance of growth over value is unlikely to continue, especially given a positive backdrop for most value sectors and stocks.

Within the value universe, we believe financials will perform particularly well as they should benefit from a higher interest rate environment and low levels of credit defaults. In addition, we believe reasonably valued technology stocks are attractive given their exposure to both a strengthening economy and underlying secular growth trends, such as the shift to mobile computing. Conversely, we are less optimistic about interest rate sensitive sectors such as consumer staples, REITs, and utilities.

While the enactment of tax reform is far from certain, it would likely provide an additional boost to GDP growth. Lower taxes at both the corporate and individual level will almost certainly result in higher investment and consumer spending, which should benefit stocks that are tied to the economic cycle.

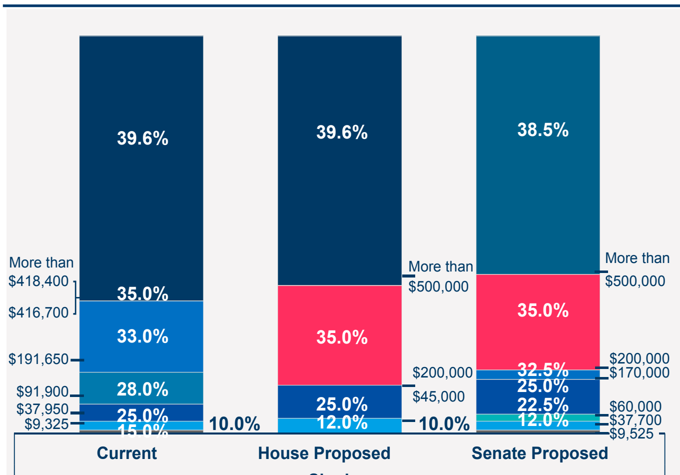
Though the environment is positive for investing in US equities in 2018, there are risks to this outlook including the potential for the Fed to become more aggressive in raising interest rates if inflation picks up, uncertainty with respect to public policy, and geopolitics.

For this reason, we believe it is a particularly good time to invest in equities with an active management approach which seeks to balance risk and return.

Q2 / What are the major changes in your investment outlook for 2018 compared to 2017 and why?

The major difference in investment approach entering 2018 versus 2017 is the focus on owning stocks that should benefit from a reflation of the US economy. While economic growth in 2017 has been solid, it has not been as high as some thought it would have been after the presidential election in 2016. However, the economy has strengthened as the year has progressed: consumer confidence is high, business investment is rising, and productivity has increased. As a result, we believe GDP growth has the potential to surprise to the upside in 2018 even without tax reform and could be the highest level in years if tax reform passes.

1/ Current vs proposed US income tax structure



Source: Amundi

2/ Possible surprises to watch for in 2018

Positive Surprise	Negative Surprise
• Tax reform on US economy • Rebound of US consumer • Rebound in depressed consumer discretionary stocks	• No tax reform • Inflation spike • Central Banks ineffective • Global / political events

Q3 / What are the main risks to the equity market in 2018 and why?

The main risk to the equity markets is the inability of the US Congress to pass tax reform. If unsuccessful, our outlook for equities in 2018 would change. In addition, we are concerned that interest rates may rise more than excepted due to higher than anticipated inflation. With unemployment at 4.1% in October, the US economy appears to be at or close to full employment, so further growth may cause inflation to accelerate. This could cause the equity markets to decline in anticipation of a potential decline in economic growth in 2019. Other risks include geopolitics and political gridlock in Washington, DC.

Q4 / And what could be the strategy to mitigate risk?

There are two ways to mitigate risk. The first is by focusing on quality. Investors should focus on companies that have high returns on capital, sustainable competitive advantages, and low debt levels compared with peers. The other, is through portfolio construction, sizing positions at the security, industry, and sector level to maximise return while limiting risk. As the main risk we see is in acceleration in interest rate, a way to mitigate risk is by keeping a very cautious view on interest rate sensitive sectors.

Emerging markets equities investment strategies

MAURO RATTO, Head of Emerging Markets

Q1 / How do you think investors should approach the 2018 investment environment in terms of positioning and risk budgeting?

Although we expect a slowdown in the current strong macroeconomic momentum, we maintain a generally positive outlook for EM. Fiscal and financial conditions, with few exceptions, are quite stable across all regions on the back of the reforms implemented over the last three to four years, facilitated in some cases by the overall improvement in the global environment. The Brazilian recovery story is a case in point, still offering attractive opportunities in its cyclically exposed sectors (i.e., energy, consumer and industrial).

On a selective basis, Russia is also an interesting opportunity; we welcomed the improvement in governance practices that recently resulted in the country's biggest bank raising its dividend payout ratios. This might benefit the whole market in terms of equity risk premium. Potential surprises could come from South Africa, specifically regarding the potential for new leadership replacing President Zuma; this could lead to a reform-driven recovery similar to that seen in Brazil. The same analysis could also apply to Mexico, where the political situation is very fluid.

China appears comfortable with its new GDP growth model, based on a mix of increasing domestic growth led by consumption and the new economy sector becoming a material contributor to overall growth. An improved state-owned enterprise (SOE) model has tentatively been achieved by managing the supply/demand imbalances in key areas such as the commodity sector. This new model seems to be able to coexist with a positive producer price index (PPI) figure for 2018, a key enabler for the transition. Indeed, a positive PPI is critical for both the profitability of Chinese corporations and to avoid exporting further deflationary pressures. Tightening measures to prevent a bubble in the property sector are very likely and must be carefully watched, as this sector is pivotal for the economy and for sentiment. Nevertheless, the existing stock of unsold properties is declining to reasonable levels: the diminished inventories in tier 2 and tier 3 cities will mitigate the effects of the expected tightening measures. Property valuation metrics are indeed stretched, and investor euphoria is of equal concern.

For the very first time since 2010, EMs are experiencing earnings upgrades across the board, with EPS growing by mid-double digits vs. 10% expected at the beginning of the year. This performance has been driven by a recovery in the material/energy sectors (i.e., improvement in commodity prices led by supply/demand); the increasing relevance of IT consumer-facing stocks, which are still experiencing fast growth (i.e., 40-50%); and a reacceleration in the industrial sector, led by the synchronised global recovery. This scenario is expected to continue in 2018, as no major changes are forecast in the macro outlook and we do not foresee any political shifts.

As far as valuations, EMs still look attractive especially vs. DMs on the back of above-average valuations at about 12-14x earnings, with value/traditional economy sectors offering the best upside (i.e. financials, industrials) in countries such as China, Brazil and Nigeria. Stripping out IT/consumer stocks, valuations are even more compelling at or below 10x EPS, with high-single-digit or low-double-digit growth expected in 2018. Flows have clearly improved since mid-last year, but continue to be dominated by ETFs. The ETF dominance partly explains the outperformance of the growth style and, to an extent, the limiting of the scope for a rerating of value-driven strategies (market cap bias is a big factor in explaining returns in 2017).

We see opportunities in Nigeria, as the economy has started to grow again, driven by oil production/price improvement, reforms and FX regime improvement, making the country investable again. We favour tier 1 banks, which are very cheap compared to their sector (0.6 P/B for a 15-20% return on equity). We like materials (i.e. cement/steel) in China on supply reform-induced benefits and robust demand driven by infrastructure projects and a solid real estate sector.

Q2 / What are the main issues/events to watch during the year and why?

As far as investing in EMs goes, the external factors that are worth monitoring include potential tax reform in the US and the normalisation of unconventional monetary policies in the US and Europe.

Keeping US tax reform expectations alive is indeed relevant to supporting the global synchronised recovery concept. In a growth environment, monetary policy normalisation will cause an increase in rates and a steepening in yield curves, but we don't foresee a major credit spread widening. Indeed, better growth means better balance sheets, preventing or postponing an increase in default rates. If this prediction turns out to be incorrect, we will likely see a meaningful correction in both equity and fixed income markets.

The bulk of EM equity performance has been explained over the last 20 years by faster GDP growth in EM economies compared to developed economies. We do expect emerging equity markets to benefit more and more from the improvement in micro-economic conditions.

In particular, there has been a visible improvement in the quality of earnings in Asia. It is notable that market performance in Asia has been driven by earnings growth, not by multiple expansion. Earnings growth is backed by strong free cash flow (FCF) generation, and for the first time in a decade, the FCF yield is higher in Asia than in the US. We expect EPS growth and the improvement in its quality (FCFY) to be key return drivers in absolute and relative terms.

The improvement seen in South Korea in terms of governance, if extended to other countries/regions, can become the most significant factor and a cornerstone of the next sustainable EM rally.

Q3 / In your view, what are the biggest opportunities and risks not priced into the market for the new year?

Beyond the geopolitical risks we see, the Fed's policies and their implications for the US dollar are the main risks, in our view. As far as geopolitical risks are concerned, North Korea remains an underestimated risk, we fear, while the situation in the Middle East is definitely a more immediate concern. The most recent events in Lebanon pose a serious threat to the precarious equilibrium in the area. The risk of a war in the region and the economic consequences and reverberations of the oil price on the US dollar could rock the foundations of the prevailing benign scenario. In terms of developments from already planned events, we are closely monitoring the outcome of the upcoming elections in Brazil and Mexico. Our central case scenario still sees a market-friendly candidate as the most likely outcome in both countries. We are also monitoring closely the political situation in South Africa, as developments there are pivotal for the outlook for the country and its corporations.

Q4 / And what could be the strategy to mitigate risk?

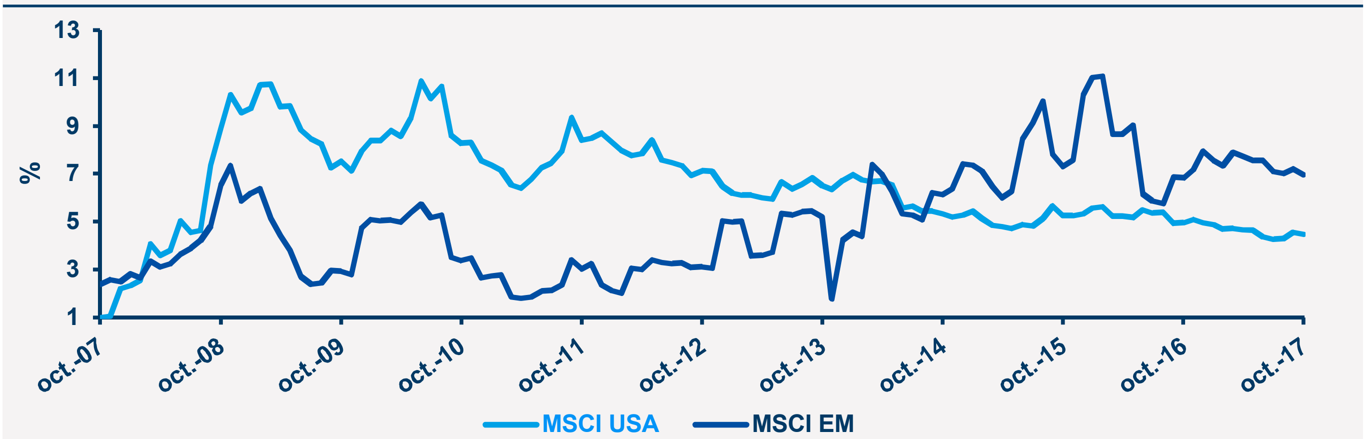
The ideal portfolio that factors in the high conviction ideas and risks highlighted above should be, in our view, a mix of quality and ad hoc stocks in which insofar as possible, any investment case incurs idiosyncratic risk[1]. This portfolio construction effort should reflect a macro framework that considers all the topics discussed so far. In that sense, we believe investors should favour countries with strong fundamentals that are less exposed to a strengthening US dollar or to a spike in oil prices. A stable oil price at, or around, current levels (USD50-60/bbl) is still our central case.

Q5 / What are the major changes in your investment outlook for 2018 compared to 2017 and why?

A late cycle mindset should drive portfolio construction in 2018, in our view. The themes to be played should be less sensitive to operating and financial leverage. Consistent with what we have discussed, the focus should be on some

[1] *Idiosyncratic risk is the risk associated with a particular investment due to the unique characteristics of that investment. Idiosyncratic risk can be managed through diversification in an investment portfolio.*

1/ Free cash flow yield US vs EM



Source: Bloomberg, Amundi Research. Data as of November 14,2017 of the themes that add quality, with good growth potential. The "G" component of an ESG approach (Environmental, Social and Governance) could add meaningful value, especially at this juncture in the cycle. In other words, we believe investors should rely less on pure "growth" stories than in the recent past, and focus more on quality and hidden opportunities. In addition, there is still space for "restructuring" stories that can offer interesting value. Overall, we believe that in the market environment we envisage for 2018 (less directional, and where relative value opportunities should be exploited to add value), it will be particularly important to take an integrated investment approach which combines macro- and micro-economic bottom-up views. Understanding this should help investors to navigate the macro themes (global, regional, and country specific) and sector-/stock-specific drivers in order to capture upside potential in the market and limit downside risk.

Disclaimer

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