

editorial

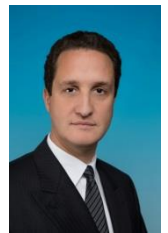
Uncertainty is also a source of opportunity

The start of this year have been characterised by a paradox. The first quarter has ended with a strong performance of risky assets, particularly emerging assets in local currencies: Equities have delivered a performance of 12% in US Dollar, closely followed by Sovereign Debt with 9%. The performance of EM Equities is nearly twice the performance of the US Equity market on a year-to-date basis. Hence the paradox: ultimately, the assets that were most at risk of being jeopardised by the rhetoric or protectionist intentions of the new US administration were the ones that performed the best.

Excessive caution by analysts regarding emerging economies is one of the explanations. Looking at the economic surprise indices, which measure the discrepancies between published figures and the expectations of analyst consensus, the net balance of surprises for emerging economies was as positive as for G10 economies. The same observation holds true for inflation. In other words, emerging economies have benefited as much from "reflationist"¹ trends as advanced economies.

The European political calendar is another reason. Another explanation lies in the busy political calendar in Europe, against a backdrop of rising Eurosceptic political movements. Even so, European equities have not been penalised: the MSCI EMU index rose 8.5% in dollar terms, or two points more than the US equity equivalent. However, an additional source of uncertainty has emerged, with the United Kingdom's official submission of its request to leave the European Union.

Has reflation been overbought? Europe isn't the only continent to face headwinds. The last-minute withdrawal of the health insurance (Obamacare) repeal-and-replace bill is feeding questions about another issue: tax reform. Without any reform on this front in 2017, there are expected to be few obstacles to stop the slowdown of the US economy, where rates are already being normalised by the Fed. This, in substance, is the current message of the decline in US long-term rates and the dollar. That said, it is still possible that the prospects of a weak dollar and more moderate inflation dynamics, if there is no severe downturn, might extend this "Indian summer". We are fairly supportive of this view. That said, as we mentioned in our first editorial of the year, investors must know how to adapt their strategies. This environment is favourable to holding liquid hedging assets that are tailored to a portfolio's risks. Volatility in equities or bonds, for example, which are close to all-time lows, remains an opportunity.



Marc-Ali Ben Abdallah
Senior Analyst, Investment Solutions

¹ An economic improvement combined with a non-excessive recovery in factors underlying inflation
Past performance is not a reliable indicator of future results or a guarantee of future returns.

convictions

Investment scenarios

- **Our central scenario**, based on a limited but stabilized global growth remains valid - around 3.3% per year in 2016-2017 – with a **70% probability of occurrence (stable)**. US growth should be slightly higher than expected for 2018 (2.2% vs 1.7%) and Developed Economies globally driven by domestic demand (Europe, US, Japan). Emerging Markets should improve benefiting from the stabilization of oil prices. This environment should favor risky assets and also QE friendly assets (Euro Corporate and Equities, Peripheral Sovereign Debt).
- **Our first alternative scenario (stable at 20% probability)** assumes an acceleration of US growth as well as US inflation expectations thanks to fiscal expansion leading markets to reprice rates higher and USD stronger, with the Fed eventually more aggressive than initially anticipated. It would create a widening gap between disappointing growth expectations and sustained inflation expectations.
- **Our second alternative scenario** sees a global growth slowdown with **10% probability of occurrence (stable)**. The trigger could be a deterioration of the US economy (Trump downside), tighter policies in China or the consequences of the Brexit vote.

Positioning under our central scenario

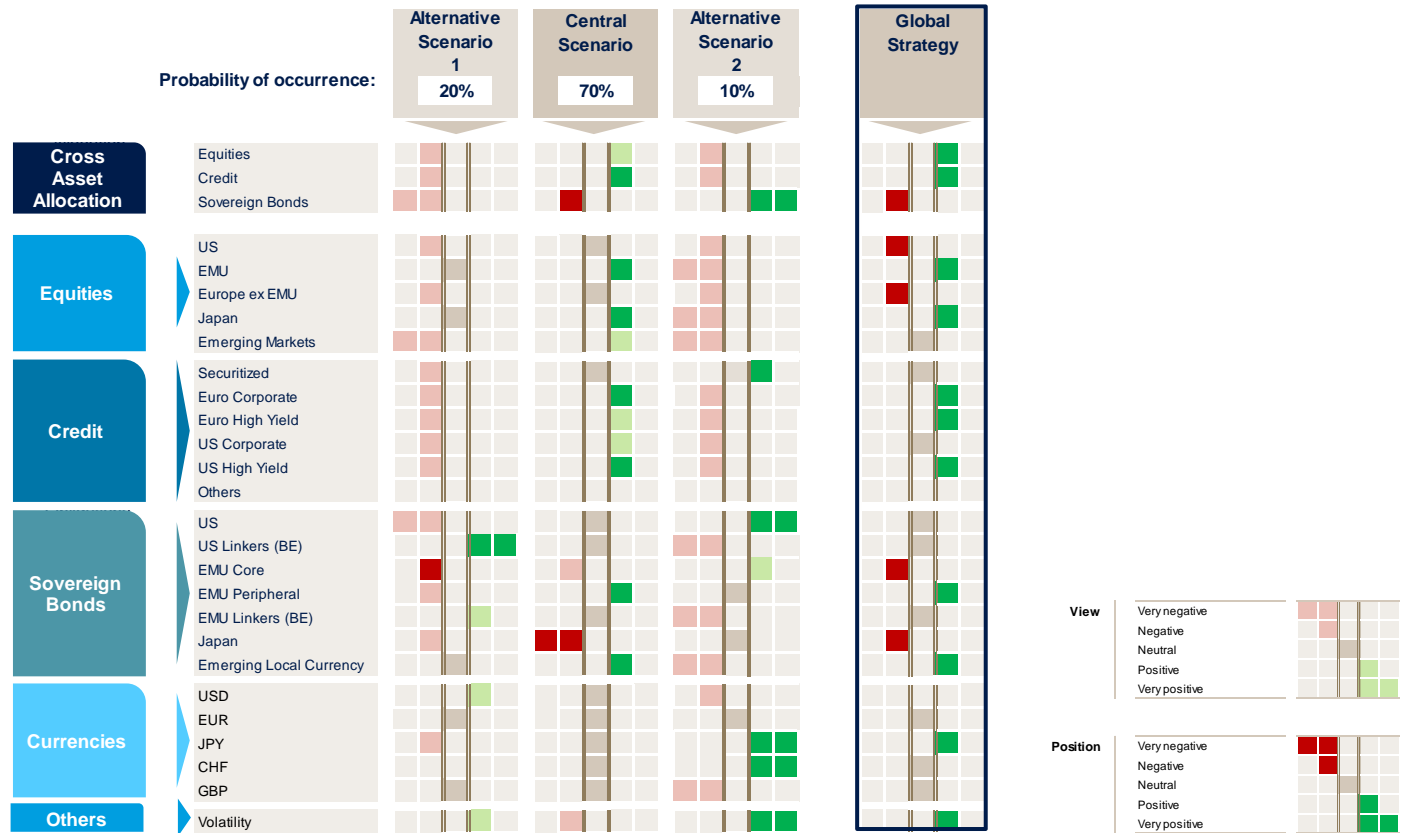
The intermediate risk budget has been increased from 5 to 6 out of 10.

- **On equity markets**, we are moderately long versus the benchmark.
 - **Geographically**, we maintain our long exposure to Eurozone as the region is supported by both earnings upwards revisions and relatively attractive valuations. We also keep an overweight Japan as valuation is attractive and earnings momentum very strong. We decrease our exposure to US from Neutral to Underweight as valuations are at all-time highs and earnings momentum losing steam. On Emerging Markets, we keep a Neutral stance as there are still question marks related to USD level, US interest rates hike and risk on US tariff policy. However EM equities are cheap and earnings recovery underway. We keep the underweight on Europe ex-EMU as valuations are extremely expensive especially in Switzerland and UK.
 - **Sectors/factors**: we still favor the Value bias in Eurozone and rebalanced our exposure between “Quality” and “Value” in the US by decreasing our positions on “Quality” stocks.
- **In the fixed income space**, we keep an underweight exposure in nominal duration and a long exposure to higher yielding FI assets
 - **Rates**: we maintain a short duration exposure to Core Eurozone and a moderate long exposure to Peripherals. We decrease our exposure to US duration by taking partial profits on US 2Y (fairly priced). We keep reducing the exposure to Euro and US Breakeven (seasonality not favorable).
 - **Credit**: we are still globally positive on the asset class. The overweight exposure is still balanced between Industrials and Financials and we wait post-election to potentially arbitrage our long position on US Investment Grade (heavy primary market and lower quality) in favor of Peripherals (better expected return going forward). Although we still have long positions on Euro and US High Yield, we could potentially arbitrage to favor EM debt in local currency.
- **Currencies**: we maintain a long position on JPY but we do not implement other significant exposure on Forex.
- **Macro Hedging**: we maintain equity volatility as the main macro hedging position in a context where there is currently a lack of appealing hedging options. Indeed US nominal bonds and the Yen look less appealing after the recent rally.

The overall risk budget moves from 5 to 6 (out of 10) as i) we increase the exposure to US value stocks which are characterized by high beta and ii) as we reduce the exposure to expensive US nominal bond yields which tend to behave as an hedge when volatility raises.

Cross asset views and portfolio positioning

RISK LEVEL: 6/10



focus

Understanding the drivers of Macro-Hedging strategies

One of distinguishing factors of the Multi-Asset team's process is its multi-scenario approach. Using a top down approach, we build a central investment scenario, meaning the most likely scenario over the next 6 to 12 months period, and a set of alternative scenarios. These alternative scenarios are short to medium scenarios, which the team believes would be the most detrimental to the absolute or relative performance of our portfolios.

We assign to each scenario a probability of occurrence and assess their potential market impact. The team has developed a systematic process of analysing the "what could go wrong? When? And why?" (catalysts) from a macro view (top down) and per asset class (digging into market pricing is very important).

While we invest for the central scenario, we aim to increase its convexity by seeking assets that would benefit in the alternative scenarios while not being too expensive to carry in the central one. These "macro-hedges" allow us to search resiliency in our portfolio construction.

1. Macro hedging risk budgeting

The sizing of the hedges results from a judgmental and an analytical approach.

Using as a gauge our confidence in macro environments and valuations, the team assesses an overall risk appetite that ranges between 1 and 10 and sits today at 6. This helps portfolio managers decide on their use of absolute risk budget for absolute return strategies and on their use of tracking error budget for benchmark relative strategies.

Within that risk budget, portfolio managers will use macro-hedging strategies to adjust the level of risk taking in the portfolio. A highly effective macro-hedge will allow the PM to take more risk for a given risk budget. So as to assess the effectiveness of a hedge, the portfolio manager will leverage models developed by the team that assess fair values in central and alternative scenarios, using different sets of macro assumptions for each scenario. This will give them a sense of performance impact on the portfolio.

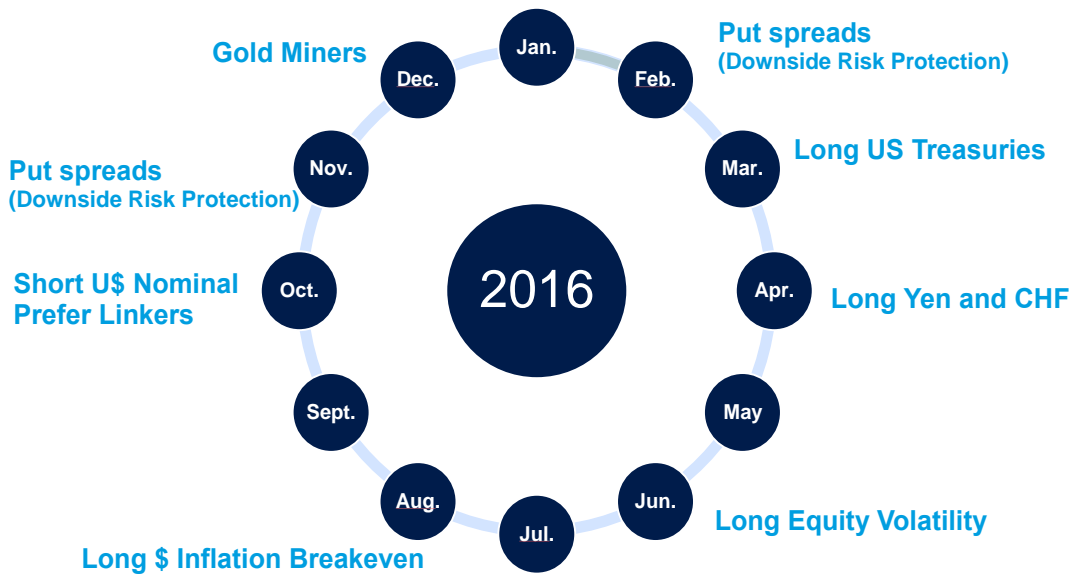
2. Macro hedging examples

Over the last 12 months, we have considered 2 major alternative scenarios. The details have changed over the year (for example the level of GDP growth or oil price) but their main characteristics have remained broadly the same:

- The alternative scenario 1 is initiated by an acceleration of U.S. growth and/or U.S. salaries triggering higher than anticipated Fed hikes, which in turn result in higher interest rates, inflation and overall fear in risky assets;
- The alternative scenario 2 is a scenario of global recession that may be started by hard landing in China or by the end of the economic cycle in the U.S.

It is for these scenarios that we considered various macro-hedging strategies. Each ought to have an asymmetric payoff (i.e. not too expensive in the central scenario but providing returns in the alternative scenarios), relative cheapness, and high liquidity. We always use a number of them to diversify our exposure. Strategies considered include for example US Treasury bonds, volatility (option strategies), USD, JPY and gold.

Main macro-hedging strategies initiated in the Institutional Mutli-Asset team over 2016



Gold miners in December 2016 exhibited for example the 3 qualities required for a good macro hedge:

- **Asymmetric payoff:** the gold miners have demonstrated:
 - A close to 0 correlation with U.S. equity markets over the last 2 years;
 - A good sensitivity to inflation shocks that drive the alternative scenario 1;
 - Negative correlation with USD and US real rates (also protective in growth fears scenarios).
- **High liquidity** as the investment vehicle is stocks.
- **Value:** we estimated in December that gold miners were attractively valued.

That being said, by March, Gold miners equity had appreciated significantly and we considered that their return profile was no longer asymmetric, therefore offering reduced opportunity for hedges.

Put spread strategies (buy downside risk): put options offer protection in periods of crisis. The issue is to manage their cost in the central scenarios. Lower than historical volatility levels suggest cheapness especially when considering the higher level of volatility in other markets (see FX volatility in the chart below). These strategies have cost us in the recent months but we believe their asymmetric profile makes them good hedges and that they should eventually pay off.



Source: Bloomberg

Specific risk hedge : political risk. Recent referendums or elections have been especially challenging to maneuver this year. We have used a similar approach, investing for the mainstream scenario but having positions that can offer good protection in case we are wrong. For example, at the time of the BREXIT referendum, we decided to favor CHF exposure as it would offer a reasonable cost of carry while providing good protection in case the Euro zone was under pressure. A GBP or a EUR exposure would have proven too symmetric, with a very positive gain in case of a favorable outcome but also a very large pain if the vote went the other way.

We believe our multi-scenario approach to be a key strength of our investment process: having the central scenario right is crucial, but limiting the drawdown in adverse circumstances will generally make the difference.



Karin Franceries, CFA
Senior Investment Manager, Multi-Asset Solutions

performance

Gross performances of our strategies (March 31, 2017)

Amundi, data as at end of March 2017. Gross performance of "Balanced Institutional Absolute Return Low volatility", Multimanager Multi-Asset Fund of Funds (Bonds)* GIPS composites in euro. Their respective benchmarks are: Eonia capitalized and a composite benchmark: 50% JPM EMU Government Bond Index, 30% JPM Government Bond, 20% Exane ECI – Europe Convertible. Past performance is not a reliable indicator of future results or a guarantee of future returns.

	Currency	Performance				Relative performance			
		1 month	YTD	1 year	3 years*	1 month	YTD	1 year	3 years*
Multi-Asset Institutional Absolute Return Low volatility	EUR	0,78%	1,82%	4,86%	3,98%	0,81%	1,91%	5,21%	4,13%
Multimanagement Multi-Asset Fund of Funds (Bonds)	EUR	-0,21%	0,06%	2,67%	5,89%	0,18%	0,55%	1,63%	0,65%
Global Multi-Asset Institutional Defensive*	EUR	-0,49%	-0,49%	4,15%	4,83%	-0,11%	-0,11%	1,39%	1,23%
Global Multi-Asset Institutional 50/50	EUR	1,08%	0,51%	5,19%	4,72%	0,16%	0,03%	1,76%	1,08%

Sources : Amundi - GIPS Composite
* Data as at February 28, 2017

(*) Annualized data



- Laurent Tignard**
Global Head of Multi-Asset, Institutional Clients
- Frédéric Pascal**
Deputy Head of Multi-Asset, Institutional Clients
- Eric Tazé-Bernard**
Chief Allocation Advisor
- Marc-Ali Ben Abdallah**
Senior Analyst, Investment Solutions
- Florian Neto**
Client Portfolio Manager
- Dan Lévy**
Head of Investment Specialists
- Bénédicte Guillemot**
Investment Specialist
- Leslie Debout**
Investment Specialist

Consideration should be given to whether the risks attached to each issuer are suitable for prospective investors who should ensure that they fully understand the contents of this document. A professional advisor should be consulted to determine whether an investment is suitable. The value of, and any income from, an investment can decrease as well as increase. Further, past performance is not a guarantee or a reliable indicator for current or future performance and returns. This document does not constitute an offer to buy nor a solicitation to sell in any country where it might be considered as unlawful, nor does it constitute public advertising or investment advice.

This document has not been drafted in compliance with the regulatory requirements aiming at promoting the independence of financial analysis or investment research. Amundi is therefore not bound by the prohibition to conclude transactions of the financial instruments mentioned in this document. Any projections, valuations and statistical analyses herein are provided to assist the recipient in the evaluation of the matters described herein. Such projections, valuations and analyses may be based on subjective assessments and assumptions and may use one among alternative methodologies that produce different results. Accordingly, such projections, valuations and statistical analyses should not be viewed as facts and should not be relied upon as an accurate prediction of future events.

The information contained in this document is deemed accurate as at 31/03/2017. Data, opinions and estimates may be changed without notice.

This material is solely for the attention of institutional, professional, qualified or sophisticated investors and distributors. It is not to be distributed to the general public, private customers or retail investors in any jurisdiction whatsoever nor to "US Persons".

Moreover, any such investor should be, in the European Union, a "Professional" investor as defined in Directive 2004/39/EC dated 21 April 2004 on markets in financial instruments ("MIFID") or as the case may be in each local regulations and, as far as the offering in Switzerland is concerned, a "Qualified Investor" within the meaning of the provisions of the Swiss Collective Investment Schemes Act of 23 June 2006 (CISA), the Swiss Collective Investment Schemes Ordinance of 22 November 2006 (CISO) and the FINMA's Circular 2013 on distribution of collective investment schemes. In no event may this material be distributed in the European Union to non "Professional" investors as defined in the MIFID or in each local regulation, or in Switzerland to investors who do not comply with the definition of "qualified investors" as defined in the applicable legislation and regulation.

In compliance with French applicable laws, Amundi Asset Management's contacts have the right to receive, rectify or ask for deletion of the personal data Amundi holds on them. To enforce this right, they can contact Amundi Asset Management at: info@amundi.com

Amundi has prepared and presented these performances in compliance with the Global Investment Performance Standards (GIPS®).

Amundi has prepared and presented the performance in compliance with the Global Investment Performance Standards (GIPS®). Amundi's claim of compliance with GIPS® for the period from January 1st, 1994 through December 31, 2015 has been verified by independent auditors. According to the GIPS® standards, the total firm assets include the assets of all portfolios falling within the definition of the Firm, i.e. EUR 605 billion as of 31/12/2015.

Document issued by Amundi Asset Management, French joint stock company ("Société Anonyme") with a registered capital of € 746 262 615 and approved by the French Securities Regulator (Autorité des Marchés Financiers-AMF) under number GP 04000036 as a portfolio management company, 90 boulevard Pasteur -75015 Paris-France – 437 574 452 RCS Paris.