Confidence must be earned

Amundi ASSET MANAGEMENT

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Global Investment Views

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DIVERGENT FORCES: BALANCE RISKS

Ongoing dovishness from Central Banks and higher geopolitical risks are the divergent forces driving financial markets at this point. Central Banks' tone remains broadly accommodative around the world, continuing to be a mildly supportive factor for risk takers. On the other side, geopolitical risks remain high. Market volatility has been relatively contained despite the escalation of geopolitical tensions coming from the North Korean nuclear tests. This can be attributed to the "safety net" created by Central Banks. However, the risk aversion has been visible in the demand of the so-called safe assets such as Gold, Japanese Yen and US Treasuries. The key question now is how long this Central Banks' support will continue, in a contest of robust and more synchronized growth and what could be the consequences on financial markets, where valuations are getting overall less compelling (especially in fixed income). Should the threats from North Korea remain only noises, as we believe they will, financial markets will refocus on fundamentals, which are still mildly positive for equities and could bring upward pressure on bond yields. The main risk we envisage at this stage is on the many consensus trades / views in the market (long inflation, short duration, long credit and long equity) that could be vulnerable to sudden changes in sentiment due to changes in Central Banks policies (effective or feared), unmet economic expectations, and unexpected geopolitical events. For this reason, we believe investors should continue to exploit market opportunities where there is still value (being selective on equity and credit and with an increasing focus on quality), but at the same time, constantly reassess the risk factors in their portfolios considering different dimensions (credit, liquidity, market risk). Being most of these risks hidden, (liquidity is good until it suddenly dries up) and correlation across asset classes quite high, we believe that an increased use of hedging strategies will remain crucial to limit potential losses.

High Conviction Ideas

- **Multi-Asset:** We believe that investors should maintain a moderate exposure to risk through equities, with an increasing focus on selection. We have recently upgraded the European equity outlook and we also believe that a rebalancing in favor of Emerging Market (EM) equities would be appropriate going forward, due to a stronger than expected macro picture, valuations and renewed momentum. We have now a more cautious view on credit and we are negative on core govies. Due to high geopolitical risks, a strong focus on hedging should remain in place.

- **Fixed Income:** The recent fall of core government bond yields is a reflection of the search for safety, downward revisions of inflation expectations, and positioning. Even though secular deflationary forces should prevent a dramatic raise of interest rates, we believe that core government bond yields will experience some upward pressure over the next few months. With Central Banks unhurried to remove their policy accommodation, credit market remains favourite in fixed income, supported by a pick-up in growth and improved corporate fundamentals. Emerging Market bonds also benefit from the current backdrop and may offer carry opportunities. Quality and selection are crucial at this stage, as well as a strong focus on liquidity.

- **Equities:** The medium-term outlook for equity is still constructive, especially for European, Japanese and Emerging Market equities. In this mature stage of the cycle, the focus is on quality stocks and value, with a selective approach.

- **Real Assets:** We currently see opportunities to play the strong European economic momentum through diversified European real estate, infrastructure and through investments financing the real economy. Tight valuations in some segments of real assets suggest that an active approach is appropriate.

MACRO

Philippe ITHURBIDE
Global Head of Research, Strategy and Analysis

In our view, Fed, ECB and North Korea crisis will not be sufficient to challenge growth prospects, which remain strong.

Autumn tests won't change growth prospects

The economic situation has been positive enough to reassure the financial markets: Brazil and Russia confirm their emergence from recession, growth is a little more solid than expected in China, the Eurozone maintains robust growth momentum, as well as Japan, whose phase of expansion is historically long and strong. There is now talk of standardizing the balance sheet policies of the ECB and the Fed. This trend proves how much Central Banks are more comfortable with the level of growth.

German elections… in the end, it is Angela Merkel who wins

German voters have chosen the deputies of the Bundestag. With 35% of the seats, the Angela Merkel's CDU/CSU party has won, but a coalition is inevitable. Several government coalition scenarios are still possible. The parties that will form a coalition (CDU/CSU, FDP and/or Greens), while sharing many essential views, do diverge significantly on a number of fiscal and European topics. The implementation of some of the campaign promises will generate a moderate fiscal stimulus in Germany, but we believe that GDP growth will be a little less strong in 2018 than in 2017 (a return to trend rather than a meaningful slowdown).

The ECB intends to announce in October a reduction of its asset purchases but will keep an eye on the Euro

At the beginning of September, Mario Draghi acknowledged that the economic recovery in the Eurozone has been stronger-than-expected. The ECB has upgraded its 2017 GDP growth forecast from 1.9% to 2.2%, the highest growth pace since 2007. However, Mario Draghi expressed that the 'recent volatility in the exchange rate' represented a 'source of uncertainty for the medium-term outlook for price stability' and a downside risk for the growth outlook. Mostly because of the Euro appreciation, the ECB staff has downgraded its 2019 core inflation forecasts from 1.7% to 1.5%, which is quite low. We expect the ECB to announce in October a reduction of its asset purchases for 2018, probably by €20bln per month (from €60bln to €40bln per month). The amounts being purchased will still cover the total amount of net issues in the Eurozone: Difficult in such a context to foresee a sustainable and significant rise in bond yields. Interest rate hikes will intervene after the end of net QE purchases.

The era of "monetary policy easing forever" is now over

The Fed tightening is not aggressive, the ECB and BoJ will continue to keep interest rates at low level, but the situation has changed. With the reduction of the Fed's balance sheet and the reduction of the ECB's asset purchases, the net issuance of sovereign bonds is expected to be less and less negative in 2018. The normalization of monetary policy planned by Central Banks is not completely priced in by financial markets and there may be monetary policy surprises such as the recent and unexpected hike of the Bank of Canada. In sum, the era of "monetary policy easing forever" is over. As a reminder, the G4 Central Banks, whose total balance sheet currently amounted to $19,500bln, injected together $12,500 bln since the bankruptcy of Lehman Brothers.

Political and geopolitical risks confirmed as permanent worries

A large part of the recent decline in bond yields came from geopolitical tensions between North Korea and the US / Japan, and might rebound in the short-run in case of easing of these tensions. It is very difficult to foresee anything on this subject, but it does not seem legitimate for us to rely on a political escalation that could lead to a military conflict. Political and geopolitical risks (Islamic State, terrorism, Syria, refugees, North Korea…) will now be part of our daily lives. In our view, investors should integrate different scenarios into their portfolios. As regard the US, the agreement between Donald Trump and the leaders Democrats to raise debt ceiling has only delayed the issue until December 8.

ECB: European Central Bank. Quantitative Easing (QE): it is a type of monetary policy used by Central Banks to stimulate the economy by buying financial assets from commercial banks and other financial institutions.

Multi-Asset: Squeezing risk asset juice

MULTI-ASSET

Matteo GERMANO
Head of Multi-Asset

We still have a moderate risk on stance (especially in European and EM equities), but risks are creeping up in the market. We believe a stronger focus on hedging is needed.

Overall assessment

The economic backdrop for risk assets remains mildly favourable, in particular for equities. At the same time, risks are creeping up, spreading in many asset classes, and discrepancies between the exceptional monetary stimulus and the solid growth rates are unveiling. We believe it is relevant to continue to seek value opportunities across the board, while at the same time maintaining a strong focus on managing risks.

High conviction ideas

We see the most interesting opportunities in European and in EM equities, which still offer attractive valuations. In the Eurozone, the appreciation of the Euro is impacting earnings growth, but thanks to balancing dynamics linked to the internal demand strength, we expect momentum to remain positive, especially if some steepening of the yield curve materializes. A steeper yield curve could, in fact, benefit the European financial sector, which represents a significant share of the European equity markets (around 21% of the STOXX EUROPE 600). We expect further rerating in the EM equity space. We recently extended the preference for Russian equities relative to EMs. In China, further evidence has emerged of the economy being more resilient and less risky. Our conviction in Korea Equity remains, as we do not expect serious geopolitical events in the region despite recent noises, while fundamentals remain supportive based on our macro and equity assessments, with FX risks hedged. Within EM equity we also like Russia because of macro fundamentals and valuation. Russia has been a laggard so far this year among EMs and we would expect some catch-up. In fixed income, we consider US and European Government bond yields too low on the back of the improvement of the economic backdrop and potentially less accommodative Central Banks. The positive risk sentiment towards European assets should support a reallocation out of the so-called safe haven assets. We see value on inflation-linked bonds (in the US and in the Eurozone), as the current inflation expectations do not seem consistent with the ongoing recovery. We have moved towards a more cautious view on credit, still favoured versus govies, but less attractive than equities among risk assets.

Risks and hedging

The focus on hedging is strong: we remain aware of market risk (considered as a general market sell off), as the historically low volatility in equities and bonds reveals a concerning increase in market complacency. In our view, investors should consider keeping hedging strategies in place, and trying to protect and diversify their assets through gold, US dollar, Yen and option strategies.

Europe in focus: Yield curve steepening could support the equity market

Source: Amundi analysis on Bloomberg. Data as of September 18, 2017.

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FIXED INCOME

Eric
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Head of Fixed Income

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CIO of US Investment Management

> ***The big three Central Banks are increasingly offside in the continuation of their extreme monetary accommodation.***

Fixed Income: Try to mitigate increasing risks

Overall assessment

In our view, the amount of leverage in the system (with public debt still rising) and the anomalies introduced by Central Banks (flat yield curves, tight investment grade and high yield corporate spreads) leave fixed income investors exposed to an asymmetric risk profile (limited expected returns and high potential losses, also in case of limited rise in interest rates). Therefore, we think it will be key to mitigate risks in fixed income. Overall, we are constructive on credit, but with an increasing focus on quality and liquidity, while, on a structural basis, we increasingly believe that EMs offer better opportunities, as DMs are distorted by the still unconventional monetary policies.

DM government bonds

In our view, DM government bonds are at the epicenter of the overvaluation in fixed income. With global growth picking up, the big three Central Banks (ECB, Fed, BoJ) are becoming increasingly offside in the continuation of their extreme monetary accommodation. In our view, short duration strategies on core govies (Bund and US Treasuries) should help in protecting from upside yield pressure when tapering talks will be back in the market as well as a stronger focus on economic fundamentals. We maintain a cautious view also on Japanese and UK government bonds, due to valuation reasons. In Europe, we favour Spain and Italy. The growth outlook here is supportive and we believe that political risks are manageable.

DM corporate bonds

We maintain our constructive view on credit versus govies, as Central Banks tightening looks limited for now, and economic growth is improving globally. In the US, we see a deterioration in credit metrics and also valuations are getting rich. Therefore, we are increasingly taking a more cautious approach on US corporate, especially in High Yield, with a preference for loans versus HY.

EM bonds

Improved balance-sheet quality and better financial/stability conditions are supportive conditions for EM bonds. The asset class is still favoured by investors' flows, but spreads are becoming tight with widening risk when tapering talks will resurface. To deal with this risk, investors could pursue two main strategies:

- stepping up in credit quality (better average credit rating but with a barbell approach)
- keeping a relatively short duration.

Currencies

We maintain a positive view on Euro vs USD and GBP. EM local currencies remain an interesting asset class for 2018.

10-Year German and US government bond yields

Source: Amundi analysis on Bloomberg. Data as of September 18, 2017.

EMs = Emerging Markets, DMs = Developed Markets

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Cycle: Late but not over

EQUITY

Overall assessment

Earnings per share growth in global equities should remain sustained by strong and synchronized growth (around 10% EPS growth in 2017). We acknowledge that we are approaching the late stage of the market cycle, but it's still too early, in our view, to review the cyclical spin. We remain focused on quality stocks, paying attention to the areas of overvaluations which are emerging.

Europe

We base our constructive view on European equities on stronger economic growth, improved corporate fundamentals (earnings growth) and supportive market conditions (valuations but also M&A outlook). In terms of corporate profit margins, we see convergence across sectors (including banks) around the market average, which indicates a return to more normal conditions. Europe is also closing the profit gap with the US and valuations have become more attractive due to the recent underperformance. Overall, we still like the cyclical sectors, with a focus on quality stocks.

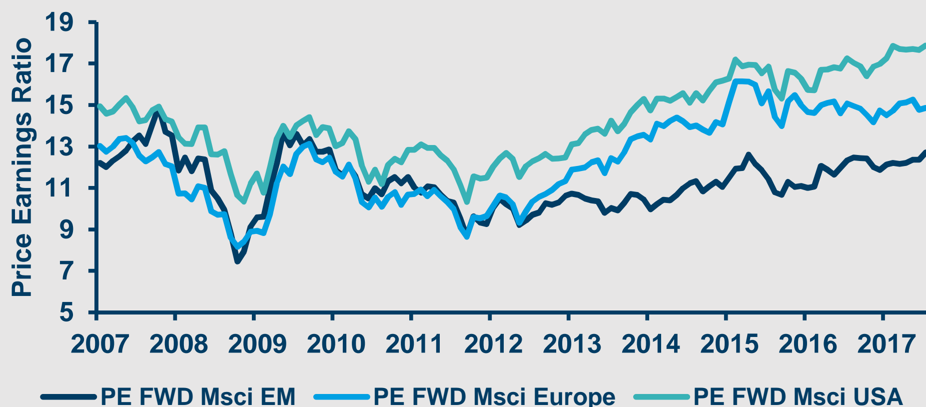
United States

Market sentiment is balanced for US equity. On the positive side, corporate fundamentals are still solid: revenue growth has accelerated in recent quarters and this enabled invested capital to be scaled for the first time since 2013. We see an acceleration of profit growth in 2018 which could put less pressure on market valuations. These are high in absolute terms but attractive versus bonds. However, some areas of attention are emerging. Though there is no immediate risk of recession, we are entering the late stage of the economic cycle and this deserves a very selective approach to the market, as many momentum / high growth stocks are reaching stretched valuations. Going forward, we believe an active and selective approach is recommended. In our selection, we continue to focus on value and quality stocks and structural mega cap winners which are widening their competitive advantage versus traditional players.

Emerging Markets

EM are favored by the global trade rebound and a more synchronized global cycle. The main theme for the next potential market rally, in our view, will not be related to superior GDP growth but to company profitability. Among EM equities, China is our high conviction idea for the foreseeable future both on macro and micro fundamentals. Investors could play the positive EM equity outlook either with a high conviction approach to the market on structural stories or, on a more defensive side, with a strong focus on dividend.

Equity Markets: Price Earnings Comparison



Source: IBES, MSCI, Datastream, Amundi, data as of September 15, 2017

> *We are still constructive on equities with a cyclical bias, but with a strong focus on quality.*

Romain BOSCHER
Co-Head of Equities

Diego FRANZIN
Co-Head of Equities

Mauro RATTO
Head of Emerging Markets

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Price earnings ratio: the ratio between market value and earnings.

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REAL ASSETS

Pedro-Antonio ARIAS
Global Head of Real & Alternative Assets

"In our view, active strategies in real estate are crucial to deal with high valuations and risk of raising rates."

European real estate markets remain attractive

Will the expected Bond yield evolution affect the relative attractiveness of the sector?

The speed of the rise in bond yields is the key factor to assess the attractiveness of the real estate sector. Our central economic forecast is for short- and medium-term bond yields to rise slightly in the coming months. At the moment, the spread between prime office yields and long-term interest rates is still wide (for instance 234 bps risk premium in Paris and 275 bps in Munich for best offices in June 2017) compared with the historical average risk premiums (respectively 151 bps and 169 bps on average between 2000 and 2016). If bond yields rise gently, this spread is likely to compress but to remain attractive. We expect most of yield compression being over, even if a slight decrease is still likely in some markets like in the German offices in H2 2017. Prime rent increases are forecast to continue in major European cities which are attractive to corporates and where individuals like living. We continue to favour core-plus assets with a focus on a long term investment horizon.

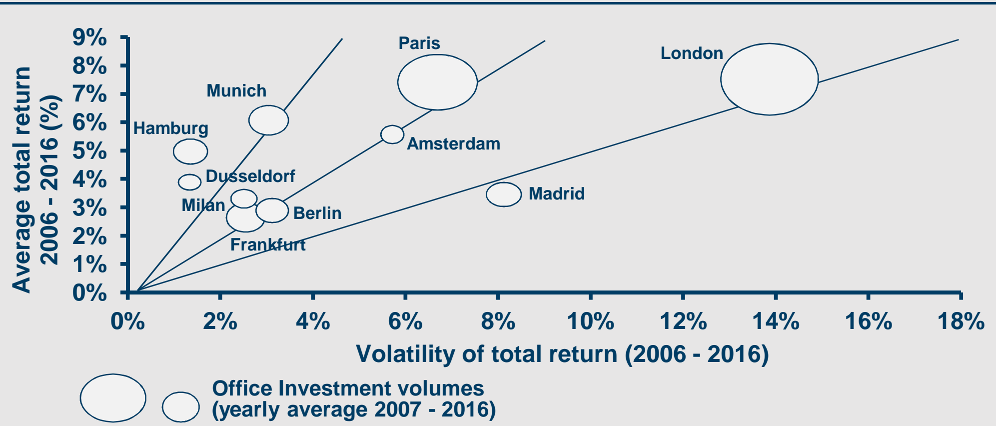
Adding value to existing assets is always a good strategy and probably even more today

A higher interest-rate environment would have a negative impact on all real estate assets, particularly for the highest quality assets acquired at low yields and financed using high-levels of leverage. If so, restructuring assets give the investor the opportunity to upgrade the building and capture future rent increases, which would compensate for the higher capitalization rate. While we remain confident in our central scenario of slow rate increases, we believe investors should increase the proportion of portfolios invested in value-added assets but still located in attractive areas, to hedge against the risk of a more rapid increase in interest rates in Europe.

Active Asset Management is crucial in a highly valued market

We believe that neither passive investments nor 'buy, finance and hold' strategies will produce adequate returns in the current environment. A focus on technical improvements of buildings as well as securing better occupants or filling vacant space will be crucial going forward. A growing number of occupants want more flexible office spaces as well as a higher number of services located in the building. More companies are interested in a building with a creative working environment. Both investors and occupants increasingly demand buildings offering high standards of environmental performance. Investors like environmentally efficient buildings because these assets maintain their value better and remain more liquid over the long-term. All these changes offer opportunities for refurbishing existing buildings, making them more attractive to tenants.

Office yield and volatility (annual data)



Source: Amundi RE, MSCI, as of September 18, 2017.

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Amundi high convictions

Asset allocation: multi-class outlook								
	1 month change	---	--	-	0	+	++	+++
Equities vs govies	→						■	
Equities vs credit	→					■		
Credit vs govies	→					■		
Duration	→			■				
Oil	→					■		
Gold	→					■		
Euro cash	→				■			
USD cash	→					■		

The table above represents cross asset assessment of 3 to 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 (+/++/+++).

	3-6 month research view	Relative outlook and convictions by major asset class				
		Asset Class	1 month change	Underweight	Neutral	Overweight
GOVIES	--	US	→	●●		
	--	Euro core	→	●		
	+	Euro peripherals	→			●
	-	UK	→	●		
	-	Japan	→	●		
CREDIT	+/=	US IG	→			●
	+/=	Euro IG	→			●
	-/=	US HY	→	●		
	+/=	Euro HY	→			●
	+	GEM debt hard cur.	→			●
	+	GEM debt loc. cur.	→			●
EQUITIES	+	US	→		●	
	++	Eurozone	→			●●
	=	UK	→		●	
	+	Japan	→			●
	+	Pac. ex Jap.	→			●
	+	Global EM	↗			●

CURRENCY AND REAL ASSETS

FOREX	+	EUR vs USD	↗
	=	EUR vs GBP	↘
	=	EUR vs JPY	→
	=	USD vs JPY	→
REAL ASSETS	+	Real estate	→
	++	Global Infrastructure	→
	+	Private Debt	→

LEGEND

- – Negative
- = Unchanged
- + Positive

- ● Underweight
- ● Neutral
- ● Overweight

Source: Amundi, as of September 20, 2017. The 3-6 month return outlook refers to research views based on expected returns by asset class. 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.**

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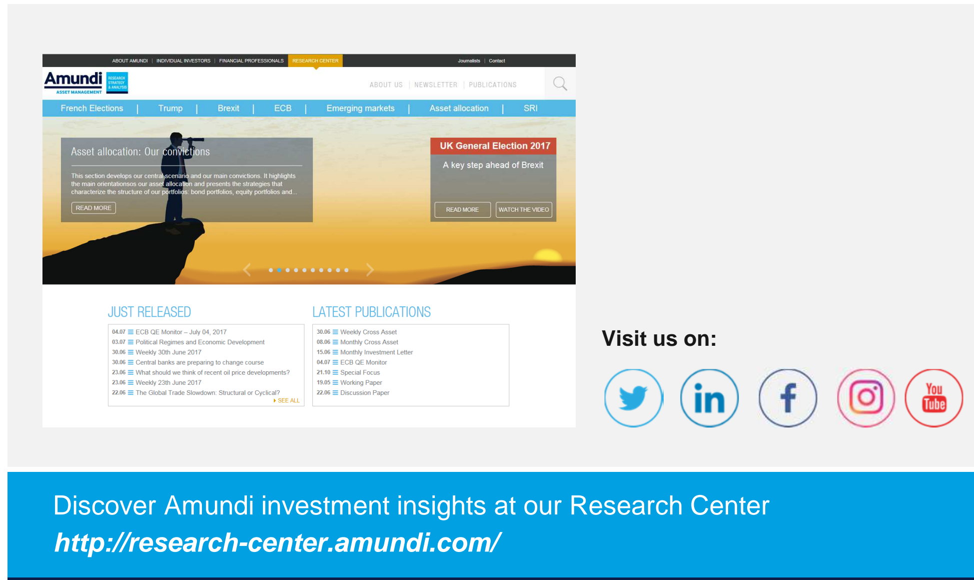
In a world where investors are exposed to information from multiple sources we aim to become the partner of choice for the provision of regular, clear, timely, engaging and relevant insights that can help our clients make informed investment decisions.



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