Confidence must be earned

Amundi
ASSET MANAGEMENT

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Global Investment Views

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PREPARING FOR TRANSITION

After a less than thrilling summer, since September, equity markets have been relatively immune to news flow on the geopolitical front, despite North Korea’s nuclear threats and the crisis regarding Catalonia, which remains broadly unresolved. We see two main reasons for the uptick in equity market performance: 1) the pro-European axis led by France and Germany is still strong and appears to be a **potential backstop** for further deterioration with regard to the situation in Spain, which is not, in our view, a systemic risk for the Eurozone; and 2) in the last quarter of this year, we expect to see a renewed **focus on market fundamentals**. The benign growth scenario and the positive momentum for corporate earnings should continue to be supportive for equity markets, though **we acknowledge that we are moving towards a more mature phase of the cycle.** On fixed income, this “back to fundamentals” framework is **driving a rebound in interest rates** from year-to-date lows. In this context, we continue to maintain a cautious view on duration and a constructive approach on risk assets, especially equities. However, we believe that the **extraordinarily low volatility regime** that we are currently experiencing (in the last three years, a daily reading of the VIX below 10 has occurred 4% of the time, compared to a 0.6% incidence from 1990) **will be challenged** moving into 2018 **by a number of factors**: the ongoing monetary policy normalization; the economic cycle moving towards a more mature phase (where this transition will likely not be linear); a revival of inflation expectations from extremely low levels (potentially surprising on the upside); and unforeseeable geopolitical developments which are not fully priced into the market at this time (eg, Brexit, North Korea). The expected transition will require, in our view, a risk rotation in 2018, with a cautious approach on the most complacent areas of the market (ie, credit, momentum trade). In the meantime, we believe investors should focus on quality and an efficient use of hedging strategies to help to mitigate market risks.

High Conviction Ideas

- **Multi-Asset:** We believe investors should remain constructive on risk assets, equities in particular, as the positive macroeconomic backdrop is still translating into solid earnings growth. We still selectively see value in EMs, where we favour a country-specific approach (South Korea, China, Russia), Europe and Japan. In fixed income, we believe investors should prefer credit to core govies, keeping a focus on inflation-linked securities. As we believe that 2018 will be the year of transition into a late cycle phase, we suggest that multi-asset investors should play this transition phase with hedges and an even more cautious approach on credit, while maintaining a negative stance on duration.
- **Fixed Income:** Credit markets remain our favourite area in fixed income. In a world of tight credit spreads, investors should give priority to quality of issuers and security selection to capture alpha opportunities. In core govies, a short duration approach should be considered to mitigate the risk of rising rates. EM bonds remain more and more a carry trade story. In EMs, we see pockets of value in Russia and Brazil, which are experiencing improved macro conditions.
- **Equities**: We believe that global equities continue to be supported by sound corporate earnings growth. However, the equity bull market is extended, and markets are priced for perfection. As valuations are getting rich, especially in DMs, stock picking, in our view, will become even more relevant, with a focus on companies able to translate top-line growth (sales) into profits, as well as a rebalancing between cyclicals and more defensive stories.
- **Real Assets:** As the need for a transition, from a cyclical to a more structural and inclusive recovery, will be at the forefront for policymakers in the years to come, we believe that infrastructure investing may be an interesting way to diversify risk and enhance returns. As the demand for infrastructure investing is very high, the case for selection is key with regard to uncovering investment opportunities at reasonable price.

EMs = Emerging Markets, DMs = Developed Markets. Alpha: The additional return above the expected return of the beta adjusted return of the market; a positive alpha suggests risk-adjusted value added by the money manager vs the index.

MACRO

Philippe ITHURBIDE
Global Head of Research, Strategy and Analysis

Global expansion is set to continue, with no major threat in the short term.

European renaissance in play despite Catalonia

Eurozone: macro indicators point to a continuation in strong growth and mild inflation

Soft and hard activity data for August and September continued to be strong, pointing to a GDP growth rate that has probably remained around 0.5-0.6% on a QoQ basis in Q3. The unemployment rate remained at 9.1% in August (unchanged since June); in spite of a rapid fall at the beginning of the year. Credit to non-financial corporations continued to be robust, but without a sharp acceleration, at 2.5% YoY in August. Core inflation declined slightly in September (1.1% YoY vs 1.2% in June-August), confirming that the prior increase was a result of temporary effects seen in the summer period and given that underlying inflation pressure remains very moderate.

Politics: some new negatives but no systemic risk to the Eurozone

The German election yielded a disappointing victory for Chancellor Merkel's centre-right CDU/CSU party, and an even more disappointing result for her former coalition partner, the centre-left SPD. In any case, Mrs Merkel secured a fourth term as German chancellor, and has started talks to build a three-way 'Jamaica' coalition with the pro-market FDP and the Greens.

The Catalonia independence referendum, considered illegal by the Spanish central government, has resulted in a standoff between the pro-independence regional government and the central government. Catalan independence (which would set a dramatic precedent in Western Europe) remains highly unlikely, as the regional authorities do not have the practical means to impose it and polls show that the majority of the Spanish population does not support it (there was a broad victory for the ‘yes’ at the referendum, but with a very low turnout). While tensions will probably remain high for a few weeks, we expect the situation to be defused through negotiations. Brexit negotiations appeared to make some progress in September, with British government acceptance of the principle of a payment to settle the accounts, and hints that the Eurozone could choose to negotiate a transition period before negotiations on the separation issues are concluded. However, no further progress has been made so far in October on these issues. Difficulties appeared to worsen, especially due to the weak position of British PM May (in Parliament and within her own party) and news that the British government was making plans for a ‘hard’ Brexit. It is very likely that the EU will formally declare ‘insufficient progress’ in the coming weeks.

A more confident ECB gets ready to remove excessive accommodation

We expect the ECB to maintain a cautious stance. Core inflation has shown no sign of convincing acceleration and the job market is still far from full employment. We expect Mr Draghi to re-confirm the sequential approach at the meeting on 26 October (no rate hike before the end of the asset purchase programme). As a result, we do not expect the first ECB rate hike before 2019.

United States: fiscal measures are the major issues

US economic indicators continue to confirm that economic activity remains solid. The job market recovery continues. Wages remain contained even if the bulk of US firms plan to increase wages in the future. ISM surveys continue to point to GDP growth above 2%. In sum, barring a substantial shock (financial or external), a recession does not look likely in 2H17 or in 2018. Note that fiscal policy is likely to extend further the current cycle and to encourage the Fed to raise interest rates. Given the uncertainty still surrounding the final definition of the tax reform bill, it is difficult to evaluate the impact of tax reform on our projections, both in terms of a short-term boost to GDP and/or a long-term lift to potential growth. By applying the CBO framework to our current estimates for GDP growth in 2018, and assuming that in 1Q18 reform is delivered, we obtain estimates of a boost to our 2018 estimates ranging from +0.1% (case of low multiplier effect) to +0.45% (case of high multiplier) on top of our base-case expectations.

Emerging economies: 2Q performance was better than expected

Chinese growth in 2Q was +6.9% year-on-year. Moreover, despite the appreciation of the Renminbi, economic indicators remained very reasonable. Even though the growth rates recorded by Russia and Brazil are low, these countries appear to have exited recession. The decline in inflation in these two countries should allow central banks to continue their monetary easing and provide economic agents with favorable financial conditions.

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: high market complacency

MULTI-ASSET

Matteo GERMANO
Head of Multi-Asset

> ***"The extremely low volatility and the tight valuations require hedges and diversification towards the less expensive areas of the market."***

Overall assessment

Economic conditions are benign and still mildly supportive for risk assets. We expect growth rates to stabilise around current levels. Under present conditions, we might have already seen the best of momentum, but the global synchronisation feature might result in cyclical upside risk without material chances of a rise in inflation.

We remain aware of a possible return of geopolitical risks and of late cycle conditions (less accommodative monetary policies, potentially even tighter than market expectations). Volatility is extremely low and tight valuations across the board expose investors to downside risk.

Therefore, we will carefully monitor areas where market complacency is particularly high (segments of the credit markets), and we believe investors should maintain a strong focus on hedging.

High conviction ideas

We continue to favour equity markets, in line with our base-case scenario of asset reflation persisting over the next quarter and a gradual move towards a late cycle scenario in 2018. We prefer European equities, as these are supported by strong economic recovery in the Euro Area and positive earnings momentum. We are also positive on Japan.

As fundamentals look to be holding up relatively well in most EMs, we are constructive on EM equities, in particular China, where the economy continues to show resilience, while the recent targeted Reserve Requirement Ratio cut (and the potential for further cuts) is positive for banks as they reduce their reliance on interbank borrowing and shadow banking. We also see opportunities in South Korea and Russia (relative to EMs).

In fixed income, the transition to a late cycle scenario could bring higher rates (in the US and the Eurozone), as we expect inflation to rise slowly and central banks to gradually reduce stimulus.

So, while we don't see value in nominal bonds, we think that inflation-protected securities continue to be interesting in this context (US, EU and Japanese inflation-linked bonds). We still believe in the European credit markets which continue to benefit from the low rate environment, even if we don't see much scope for spread tightening.

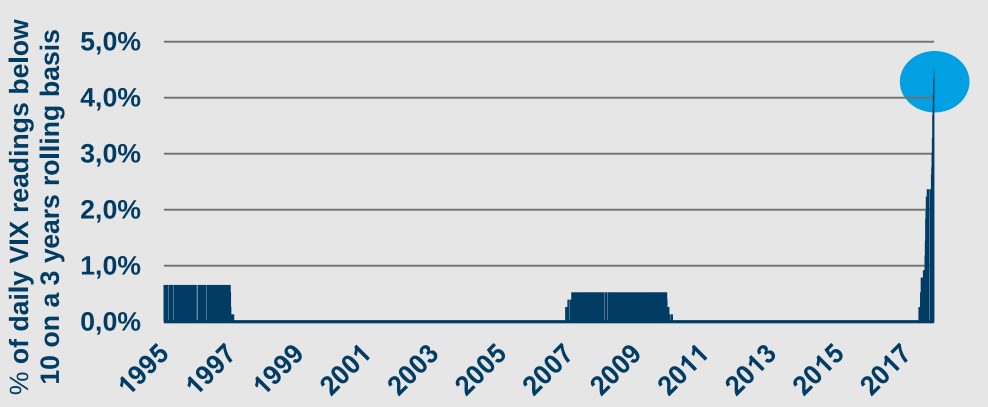
Risks and hedging

We are not complacent about political and geopolitical risks: one of our top concerns is a politically ineffectual president in the US which would jeopardise a smooth transition towards a late cycle.

The escalation of tensions in North Korea and the Middle East are also risks to take into account. We consider crucial for investors to adopt efficient hedging strategies.

Therefore, we retain our positive views regarding gold or specific currency strategies, which tend to perform well in risk-off phases, as well as equity option strategies to try to smooth the risk of market sell-off.

VIX: market complacency at unprecedented levels



Source: Amundi analysis on Bloomberg. Data as of 13 October, 2017.

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FIXED INCOME

Fixed Income: inflation conundrum

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> ***Fixed income investors should consider strategies to rotate risk and increase diversification, if market complacency on Central Banks wanes.***

Overall assessment

The debate on inflation is now at centre stage. Central Banks are busy assessing the new set of economic relationships between growth, inflation, unemployment and wages. Current low inflation figures are driving market expectations for a slow removal of accommodative monetary policies. This is a key element to watch regarding fixed income as we move towards 2018. If inflation were to move higher, with economic acceleration (thanks, in addition, to a renewed focus on fiscal stimulus) and tighter labour market conditions (especially in the US) finally passing through to wages, we might see a more aggressive Central Bank response, which is currently not fully priced into the markets. Investors should consider strategies to reduce risk and increase diversification (ie, short duration, high quality and liquid names in credit, floating rates, convertibles or event-linked securities).

DM government bonds

The risk that the Fed will be more aggressive in 2018 is mounting and therefore we believe investors should keep a short duration stance on core government bonds.

In Europe, we are still mildly positive on peripheral bonds, where supportive growth and low interest rates are helping structural adjustments. However, we have become a bit more cautious, as volatility is back, due to the current situation in Spain and the Italian elections next year. We are also slightly positive on inflation-linked bonds.

DM corporate bonds

Market fundamentals remain relatively stable both in the US and Europe. In the US IG space we believe investors should remain constructive, but we see limited scope for spread compression. Higher corporate leverage is counterbalanced by solid growth and supportive investor demand. Favourite sectors in the credit cycle are banks, financials and energy. In Europe we also view credit positively, but increasingly with a more cautious focus. We prefer industrials and financials, which appear to be favoured by a steeper yield curve.

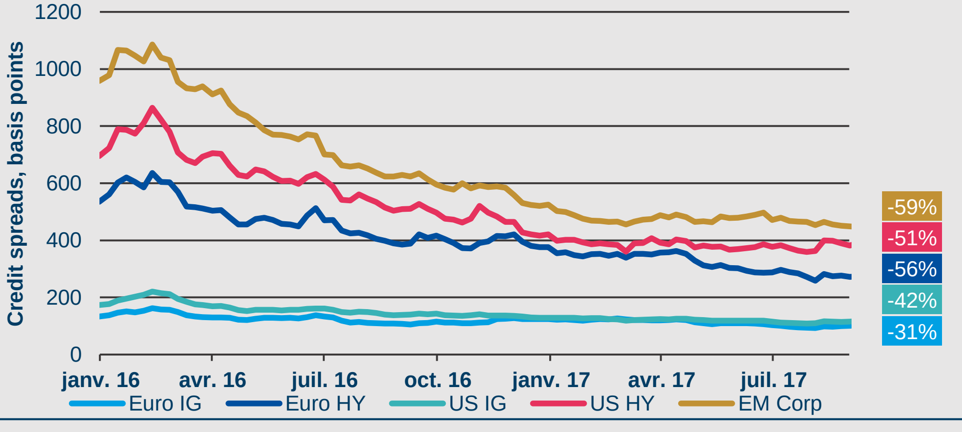
EM bonds

EM debt (EMD) should be considered more and more as a “carry trade” and diversification story, as we see little room for spread compression going forward. Relative to other areas of fixed income (ie, Euro HY), EMD spreads are still attractive, in our view, with a preference for credit markets. We maintain a cautious stance on sovereign debt which could be exposed to the risk of raising rates in the US. A stronger USD could also drive a temporary pause in local currencies. In EMD at country-specific levels, we prefer countries with improved fundamentals not fully priced in by the market (Brazil, Russia) or with higher risk priced in (Argentina).

Currencies

Improved conditions for the USD (Fed-ECB policy divergences, Trump fiscal plan). Negative on GBP, on Brexit risks, and Yen.

Credit spread compression, since January 2016



Source: Amundi analysis on Bloomberg. Data as of 12 October 2017.

EMs = Emerging Markets, DMs = Developed Markets. Carry trade: A trading strategy that involves borrowing at a low interest rate and investing in an asset that provides a higher rate of return.

Equity: priced for perfection

EQUITY

Momentum is still strong, but moving towards a more mature phase of the cycle. More focus on selection is needed.

Overall assessment

The positive economic momentum is still supporting earnings growth globally. The focus is now on the extension of the global cycle, which could further lift equity markets in the next few months, until we enter a more mature phase, which we expect to occur in 2018. With this transition in mind, we believe investors should start introducing a balance between cyclical and defensive themes, with an focus on quality stocks.

Europe

The market is pricing in a very benign scenario: strong economic growth translating into earnings growth, low inflation, no major surprises from central banks. While we remain constructive on EU equity markets for the coming quarters (with the earnings cycle still at an earlier stage than in the US), we believe investors should start to seek more balance between the cyclicals (industrial and consumer discretionary) and defensives (e.g., health care). Rising interest rates should continue to support the financial sector recovery and value themes. Some profit taking could be possible in areas which recently performed particularly well (ie, Italian small caps).

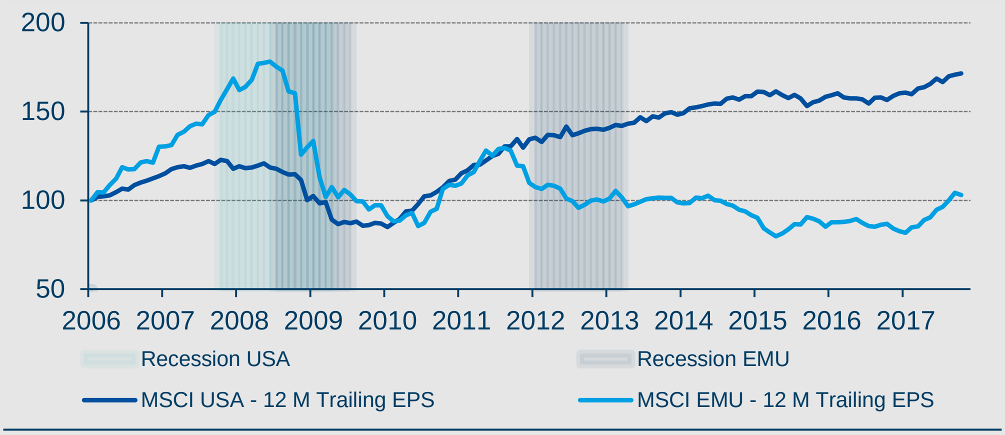
United States

The expectation of the long-waited tax reform in the US has been a trigger for a continuation in the reflation trade. This could drive a temporary outperformance by US vs European equities, despite less attractive valuations, even though the market, we believe, has gotten a bit ahead of itself in the short-term. A reasonable deal on tax reform, in the first part of 2018 (now priced in for half of its potential), could positively play in two directions: first, to lower tax for corporations, which could increase earnings in the coming years and have a positive impact on market valuations; second, to foster the repatriation of foreign earnings. This could reduce capital inefficiency for many multinationals that have piled up cash, fostering investments, buybacks or dividends. Higher inflation could be supportive for banks.

Emerging Markets

In the last three months, we have seen an improvement in corporate fundamentals, with China, Brazil and Turkey showing double-digit upside revisions for corporate net income in the next 12 months. Globally synchronised growth, as well as benign financial conditions, remain supportive for EM equity. In our view, selection, at country, sector and company levels, will become more and more relevant going forward as we enter a phase of less accommodative monetary policy in DMs. We maintain our pro-cyclical bias in all three EM regions. Our preference goes to Asia over EMEA (here, we are positive on banks) and LatAm. Key risks to monitor are the unwinding of monetary policies next year and the situation regarding North Korea.

Earnings per share (EPS) recovery in the US and Eurozone



Source: MSCI, Amundi, data as of 12 October 2017

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REAL ASSETS

Pedro-Antonio ARIAS
Global Head of Real & Alternative Assets

> *"As demand for infrastructure investing hits new highs, we believe it is time to be more selective to find sustainable investment cases at reasonable prices."*

Infrastructure to enhance diversification

Infrastructure investments on the rise

The popularity of infrastructure has increased rapidly in recent years, as the low-yield environment has created strong incentives for investors to give up liquidity in order to enhance long-term returns. Investor demand for infrastructure has increased over time, based on its potential to diversify portfolio risk, and provide a hedge against inflation. Infrastructure investments have become very attractive due to government backing as well (as many projects involve government), which has made them historically less exposed to default risk.

As a result, investment in global infrastructure assets hit a record high of US$413bn in 2016 (+14% vs 2015), according to data from Prequin.

The strong demand has pushed infrastructure investing beyond traditional assets—such as roads, power plants or airports—into new areas previously not viewed as infrastructure—such as retirement homes. As more investors have entered the market, competition for appropriate investments has reached unprecedented levels, pushing valuations up and making it harder to find well-priced assets with the right investment characteristics. This makes the case for being very selective when approaching infrastructure investing in order to find sustainable investment cases at reasonable prices.

Filling the infrastructure financing gap

Infrastructure investments may play a key role in driving economic growth, raising firms' productivity and creating new jobs.

For example, it has been estimated that US President Trump's proposal to spend up to US$1tn over the next 10 years on US infrastructure could create more than 11 million jobs[1]. Despite these benefits, there is still an increasing divergence between supply and demand for infrastructure across the world. The OECD estimated global infrastructure spending requirements reaches US$6.3tn per year over the 2016-30 period to support growth and development[2].

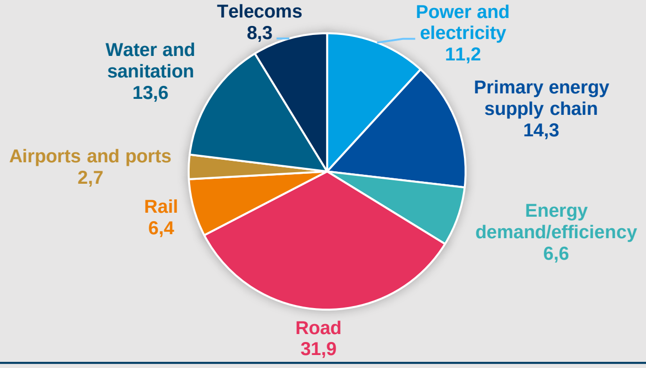
Since fiscal constraints have limited the ability of public sectors to fund new infrastructure spending, further enhancing private capital would help to close the infrastructure financing gap.

Next steps for infrastructure investing

Even if the demand for infrastructure investment has never been stronger, this asset class is not always perceived to be as reliable and accessible as more traditional assets. We believe it is crucial to create the right incentives to build confidence in the sector (eg, greater transparency, good corporate governance) as well as to provide financial instruments to easily access the infrastructure asset class.

Lastly, the implementation of structural reforms may represent the missing link to significantly boost infrastructure investment and, in turn, to revive the economies.

Estimate of global infrastructure investment needs in the 2016-30 period (US$tn)



Cumulative	US$95tn
Annual average	US$6.3tn

Source: Amundi, OECD. Data as of 31 July, 2017.

(1) Georgetown University Center, 2017. (2) OECD, 2017.

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 (+/++/+++).

Relative outlook and convictions by major asset class

	3-6 month research view	Asset Class	1 month change on view	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 Japan	→			●
	+	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 18 October 2017. The 3- to 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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