Confidence must be earned

Amundi ASSET MANAGEMENT

December 2017

Global Investment Views

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GEOPOLITICAL RISK MAY PAUSE RALLY

Confirmation of both robust global economic recovery and expectations for US tax reform contributed to keeping risk asset exuberance high and compressed equity volatility to record low levels in October. In Japan, the landslide victory of the LPD in the Lower House strengthened the case for *Abenomics* and boosted market sentiment on Japanese equities. In China, Mr Xi strongly consolidated and further defined the direction of his reformist project. But, if risks in these areas have declined, **other sources of geopolitical tensions have recently re-emerged,** which should be monitored as we move towards a more vulnerable stage of the cycle. Among the problematic issues is the renewed instability in the Middle East. The equilibrium in the area is fragile and an escalation of tensions would have implications for oil prices. The rise in oil prices seen this year to date has mainly been due to stronger global demand and the expected extensions of OPEC production cuts into 2018. But geopolitical factors are starting to come into play. An additional focus of concern is North Korea. Here, a collaboration between China and the US is emerging to contain the situation, but the extremely unpredictable international policy strategy of North Korea clearly remains a problem. In the Euro area, tail risks have been contained, but Brexit remains an issue that we believe is underestimated by financial markets. Focus is also on Germany, as the formation of a new government coalition is not straightforward. With all these elements in mind, financial markets have become slightly more cautious. We still recommend some exposure to risk assets, preferably through an asymmetric risk/return profile to protect from downside while still capturing some upside, but utilising **a more cautious approach** to the most crowded areas of the market. Further, we would look at tactical profit-taking in areas that have recently outperformed, such as Japanese equities (which remains a long term attractive story). Investors should also continue to implement hedging strategies ahead of market volatility driven by a resurgence in geopolitical risk.

High Conviction Ideas

- **Multi-Asset:** We believe that investors should recalibrate risk in their portfolios, as a temporary correction cannot be ruled out. Areas that outperformed in the past months, such as Japan, or which are not seeing imminent support from proactive fiscal policy, such as Europe, could be vulnerable. While we remain positive on these areas based on a medium-term perspective, we believe that investors should play exposure to these markets with an asymmetric approach (through options) which can help to capture potential upside but limit downside in this phase. Credit continues to be favoured in fixed income, but with increased attention to quality and liquidity.
- **Fixed Income:** With interest rate risk on the rise, we believe investors should remain underweight duration and favour inflation-linked bonds. Convertible bonds could also offer opportunities with rising interest rates. In credit, tight spreads are likely to be counterbalanced by a still-positive earnings outlook. However, areas of attention are emerging (i.e., US HY), and an increasingly selective approach is necessary. Venezuela is not expected to derail the outlook for EM bonds, which could remain in focus, thanks to the shorter-duration characteristics of the asset class.
- **Equities**: The medium-term outlook for equities is still constructive, owing to still-strong earnings growth. However, some profit-taking is expected in the short term, as investors may want to lock in positive performance approaching year-end. Quality and sustainability of a company's business model may act as a natural hedge, in our view.
- **Real Assets:** Bank disintermediation and the need for alternative sources of financing, in combination with the search for positive real yield in an era of ultra-low yields make private debt investment attractive for investors. We believe that selection within the private debt asset class may offer investors the potential to capture an illiquidity premium and exploit diversification benefits.

EM = Emerging Markets, DM = 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

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Head of Macroeconomic Research

"We expect the ongoing cyclical upswing to continue, with risks to growth are slightly tilted to the upside, while inflation should remain subdued."

A cyclical upswing that has further to go

At a global level, hard data and business surveys point to the continuation of the global expansion driven, in most countries, by domestic demand. In addition, there are increasing signs that global capex are on the rise. As a result global trade remains firm, adding momentum to global GDP growth.

A protracted expansion in the DM

In the United States, the cycle is almost 9-years old but an extension in 2018 and 2019 is likely, owing to tax cuts, low inflation and still accommodative monetary and financial conditions. We forecast growth at or above 2% in 2018 and 2019. Given the uncertainty surrounding the final tax reform bill, it is difficult to evaluate its impact on our projections. While the House of Representatives passed the tax reform bill, the vote from the Senate will probably take more time. We expect a tax reform to be delivered in Q1 2018 at the latest. The resulting boost to our GDP forecast would range from +0.1% (case of low multiplier effect) to +0.5% (high multiplier) on top of our base case. Note that if, as we expect, the ongoing cycle continues after mid-2019, it would become the longest expansion on record (since 1857).

In the Eurozone, the late recovery is broadening to all countries and GDP components. The flash GDP estimate suggested growth in Eurozone at 0.6% just a tad below the upwardly revised Q2. yoy pace of 2.5% is the fastest since Q1 2011. Spanish and French data were very strong as well (0.8% qoq 3.1% yoy, and 0.5% qoq, 2.2% yoy respectively). Owing to long-lasting accommodative monetary and credit conditions, growth is expected to remain above potential for several years. Notable progress in implementing reforms has been made, and most macroeconomic imbalances have been corrected. Even though local-risks remain, political stability has improved and uncertainty regarding the whole EU architecture has diminished. Against this backdrop, we do not see the political gridlock in Germany as a major risk to the economic outlook. Recall that, recently, long periods without a government in Belgium and Spain did not lead to a slowdown. However, there is no economic emergency at the moment and current delays can probably be made up later. In addition, the fact that the SPD said it could accept forming again a "grand coalition" with the CDU/CSU is good news, as both parties are in favour of a strengthening of the Eurozone and EU. Of course, geopolitical risk in Eurozone remain an important factor to watch: Italian election, that will probably occur in March, would add to the political noise and perception of risk by markets. But minority parties will in all likelihood remain in the minority camp, and as a result, this is not sufficient to invalidate our positive view on the Eurozone for 2018-2019.

In Japan, Abenomics should support the economy in its the longest period of post-war expansion. The economy is not particularly strong by historical standards but this cycle has proved more robust than expected, driven both by domestic demand and global trade. Strong corporate profits should sustain business investment while, following the recent snap elections and the ruling coalition’s victory, fiscal policy should turn more expansionist in 2018.

A more resilient China will favour the ongoing global cyclical upswing

In China, the economy appears to be more resilient than previously expected. The slowdown (widely expected) is likely to be moderate, as growth drivers are now more broadly based and meaningful supply-side adjustments, including cuts in overcapacity and property destocking, have already materialised. The 19th Party Congress confirmed that among the top priorities were the deepening of reforms and the improvement of governance which would increase the chance that China manages a relatively soft landing.

At the end of the day, we expect the ongoing cyclical upswing to continue. We even believe that risks to growth are slightly tilted to the upside, while inflation should remain subdued. That said, a poor implementation of economic policies (in the US notably), a monetary policy mistake, and/or a sudden repricing of risks in fixed income markets could generate a marked economic slowdown. Threats to a benign scenario could also come from the heightened geopolitical tensions in the Middle East, which could temporarily push the oil price higher.

Preparing for a more selective risk exposure

MULTI-ASSET

Matteo GERMANO
Head of Multi-Asset

Overall assessment

A synchronised recovery is likely to continue in 2018, with the current benign scenario to last for longer than expected, although momentum is perhaps peaking. The most challenging risk ahead is likely to come from possible policy mistakes in a highly complacent market. The ongoing recovery is therefore more vulnerable to financial conditions, which for now remain generally supportive, rather than to specific risks for the real economy. A light preference for risk assets is still our main scenario, but with an asymmetric profile (i.e., with options) in order to protect from a possible market correction. A strong focus on hedging remains key.

High conviction ideas

While a late-cycle phase is still mildly supportive for risky assets (especially equities), the overall risk-adjusted returns profile is less benign, so investors should tactically start to reduce directional risk after the 2017 bull market. Areas of risk reduction in equities are in Europe (less favoured by imminent fiscal boost) and Japan (euphoria after Abe re-election). The global profits recovery will likely continue and consolidate around 10% on average in 2018, but the drivers for further appreciation of the equity markets, at least temporarily, are weaker. In this context, investors should exploit some exposure to equities through options: this would potentially protect portfolios from complacency risk while keeping a bias towards risk assets. In this phase, we confirm our positive view on selective EM themes (New vs Old China sectors, Russia).

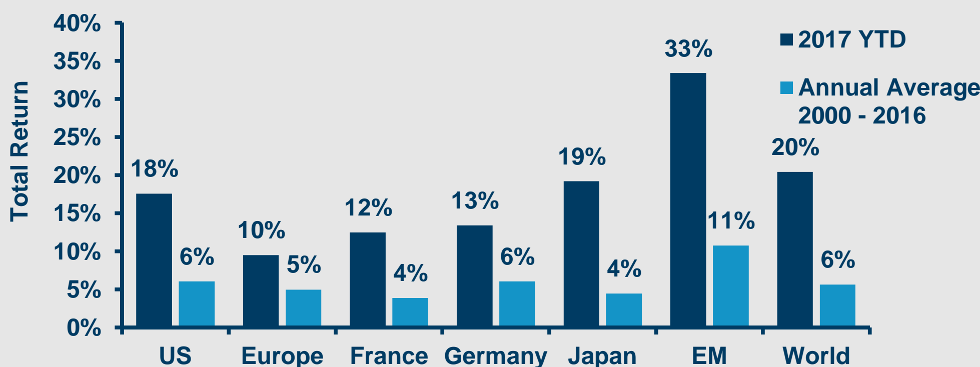
In fixed income, we continue to prefer credit. We view German rates as still fundamentally too low, as the improvement of economic conditions and the ECB's still-accommodative stance support positive risk sentiment towards reallocation out of safe-haven assets. In the short term, we have a neutral view on US rates because we don't see triggers for further rises, mainly on the back of the Fed's December hike repricing and a revamp in market expectations on tax reform. We see opportunities in the FX market, in particular in the Norwegian krona vs the euro. Its historical correlation with oil has failed to materialise since September, so we expect the krona to play catch-up. We also like the New Zealand dollar (NZD) vs the Australian dollar, due to diverging macro newsflow, excessive NZD depreciation post elections, and a supportive relative valuation.

Risks and hedging

Given the tight valuations across the board, we strongly believe that a risk-taking approach requires more selectivity, relative trades and asymmetric payoff strategies. We maintain a positive view on gold and the USD for hedging a resurgence in geopolitical risk.

> ***"Moving into 2018, investors should position their portfolios for an asymmetric risk/return profile and prepare for a more selective risk exposure."***

A pause may be due after equity markets' extraordinary performance this year



Source: Amundi analysis on Bloomberg. Data as of 15 November 2017. US = S&P500, Europe = Stoxx Europe 600, France = CAC40, Germany = DAX, Japan = NIKKEI 225, EM = MSCI EM. Total return performance in local currency.

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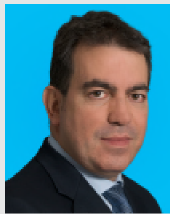
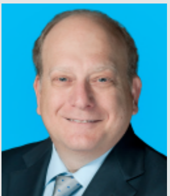
FIXED INCOME

Eric BRARD
Head of Fixed Income



Mauro RATTO
Head of Emerging Markets



Kenneth J. TAUBES
CIO of US Investment Management

Prudent duration exposure to mitigate interest rate risk and selective credit overweight are the strategies do deal with fixed income challenges in 2018.

Be aware of duration risk

Overall assessment

The bond market is still too complacent in assessing central bank (CB) policies and underestimates the strength of the global economy and the risk of an inflation pick-up, mainly in the US, where the labour market is now very tight and the approval of tax reform could further boost GDP in 2018. The risk of a market correction, driven by a possible policy mistake or CB behind the curve is very real and could be exacerbated by the duration of indices at all-time highs (see chart). Thus, we believe investors should remain prudent on duration and mildly constructive on the credit market. Here, fundamentals are still strong, but we believe it is worth reducing risk allocation towards companies that have started to aggressively re-leverage (especially in US HY) and focus on areas that could benefit from higher rates/steeper yield curve (i.e., Euro financials). On the recent German political stalemate, we don't expect a major impact on the bund, but possibly on the euro, so we monitor any development there.

DM government bonds

In the short term, geopolitical flare-ups could lead to a flight to quality in US Treasuries. Moving into 2018, and a scenario of rising rates, we believe investors should remain cautious on US and Euro core government bonds. Peripherals still offer decent value: the growth outlook is supportive and political risk seems manageable. Spain could suffer relative to Italy, due to the Catalan issue. We maintain a negative view on the UK market, viewing it as expensive and affected by turmoil (political and macro). We have a positive view on inflation-linked securities in the US and the Eurozone.

DM corporate bonds

Credit market is still favoured in fixed income. In Europe, the focus should still be on 5-10Y maturities and on financials, subordinated debt and industrials (even though these have become more expensive due to the ECB's purchasing programme). We are still constructive in high yield, but with additional cautiousness and focus on liquidity. In the US, the IG market seems fairly priced, with sector opportunities in banks, financials and energy. Recent spread widening in the HY market could represent a tactical opportunity, but with a focus on selection. Convertible bonds could offer value with rising rates.

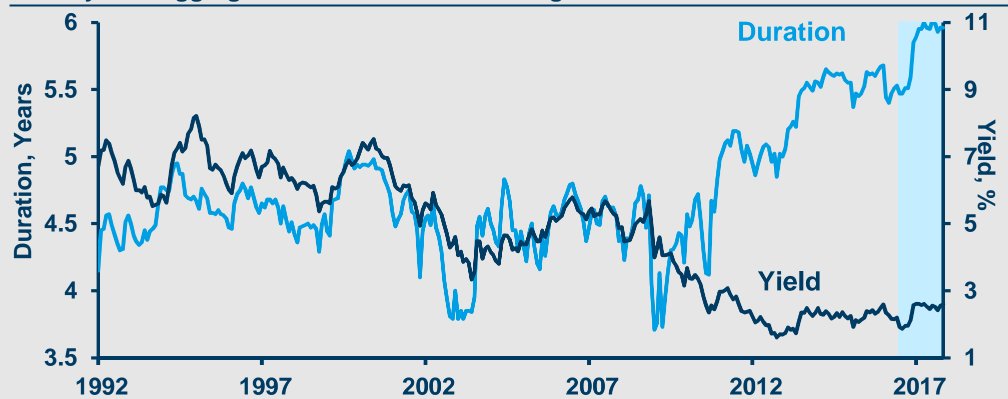
EM bonds

The situation in Venezuela is putting pressure on EM bond spreads, but we believe that the contagion should continue to be mitigated by low investor exposure to the country and improving fundamentals in EM (i.e., current account surpluses). The outlook for EM bonds still looks positive moving into 2018. A key risk to manage is rising rates in the US and a stronger US dollar, impacting sentiment. Corporate bonds remain favoured vs sovereign paper for carry reasons. At the country level, we see opportunities in Brazil and Russia, based on a re-rated economic outlook.

Currencies

In the short term, the USD should continue to be supported and in the medium term, the euro should regain momentum. We are negative on sterling.

Barclays US Aggregate duration at historical highs



Source: Amundi analysis on Bloomberg. Data as of 15 November 2017.

EM = Emerging Markets, DM = 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. Duration is a measure of the sensitivity of the price (the value of principal) of a fixed income investment to a change in interest rates, expressed as a number of years.

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Constructive, with short-term fatigue

EQUITY

Overall assessment

The overall economic backdrop should lead to higher earnings per share and capital expenditures. Nevertheless, after such a strong year, we look for a technical pause through to year-end as investors lock in gains. This can be viewed as an opportunity to further focus on idiosyncratic stories at the single company level that can mitigate a possible rise in volatility, which could occur next year (see chart). Based on a more structural view, we think that EM still have room to play catch-up with DM.

Europe

Buoyant economic conditions and still supportive relative valuations should continue to support European equities. Q3 earnings growth, while affected by the stronger euro and commodity prices, was still in line with expectations. We could see some further consolidation in the market given the strong rally year to date. We believe it is time to maintain a neutral beta exposure to the market and look more to stories at the single stock level with a focus on profitability, quality, cash generation, and growth potential.

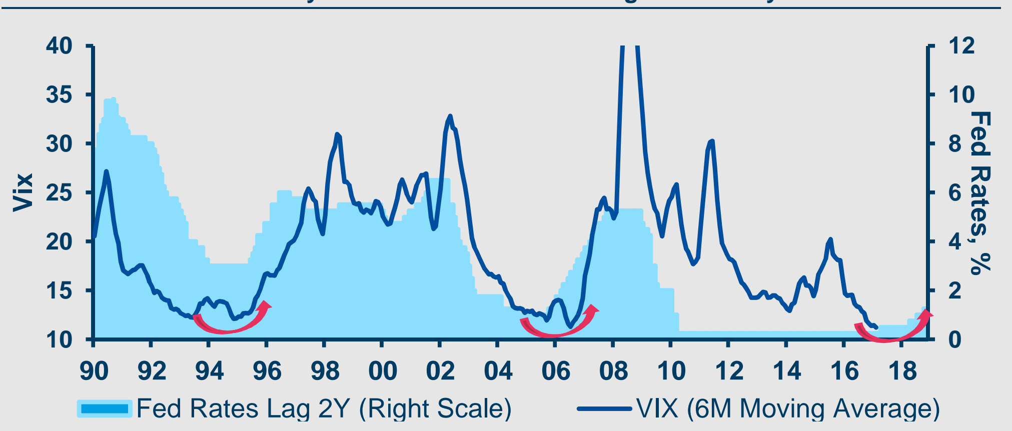
United States

If the US tax reform materializes, we expect a continuation of the trend of outperformance we have seen since mid-year. While the market is near record highs, the equity risk premium is in line with historical averages and is not showing signs of bubbles, such as during the tech or housing crises. Much market discussion has focused on peak operating margin levels and the pressures on these. Our view is that we have seen revenue growth reaccelerate in aggregate over the past year and this trend could persist in 2018. In the contrary scenario of a failure of the tax reform, we would expect a market correction. In general, we remain cautious on some areas of the market that have reached extreme valuation levels, as in some perceived defensive stocks, mainly in consumer staples, where business models face unprecedented challenges to their stability. We are constructive on some selective opportunities in the technology, energy, consumer & retail and distribution sectors. We also seek value in banks, which could benefit from a likely higher rate environment.

Emerging Markets

For the first time since 2010, EM are experiencing earnings upgrades across the board and valuations are also attractive in relative terms. At a sector level, cyclicals (i.e., financials) continue to offer the best opportunities in this phase of growth. On a regional perspective, Russia remains discounted and also supported by the recent pickup in oil price.
We also maintain a positive stance on China, where the New Economy sector is becoming a material contributor to overall growth.

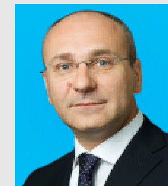
The trend of the VIX usually follows Fed rates with a lag of about 2 years



Source: MSCI, Amundi, data as of 15 November 2017.

> ***We could expect some profit taking in Equity markets, but the earnings outlook should support the continuation of a positive trend in 2018.***

Romain BOSCHER
Co-Head of Equities



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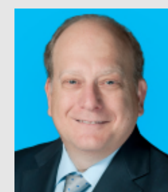

Kenneth J. TAUBES
CIO of US Investment Management

Beta measures an investment's sensitivity (volatility) to market movements in relation to an index. A beta of 1 indicates that the security's price has moved with the market. A beta lower than 1 means that the security has been less volatile than the market. A beta greater than 1 indicates that the security's price has been more volatile than the market.

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REAL ASSETS

Pedro-Antonio ARIAS
Global Head of Real & Alternative Assets

"Private debt represents an alternative way to exploit the illiquidity premium in the search for yield."

Private debt: an 'alternative' source of income

Need for alternative sources of financing

Since the Global Financial Crisis, banks have no longer been the sole suppliers of finance to companies, as asset managers have increasingly helped firms to fund business growth. In Europe in particular, despite the introduction of the ECB's Long Term Refinancing Operation (LTRO) — aimed at encouraging financial institutions to lend to corporates — banks have not always been able to provide appropriate types of lending for better management of a company's finances. For example, medium-term bullet loans (loans whose principal amount is due at maturity) could represent the right structure for agribusiness, for which a standard loan would jeopardise the business. Banks typically offer only short-term bullet loans or do not offer bullet loans at all. Bullet loans, instead, are particularly attractive for smaller companies to finance business growth or acquisitions and this allows management to focus on business development. As such, many small and mid-sized companies have embraced new alternative sources of financing.

The rise of the private debt market

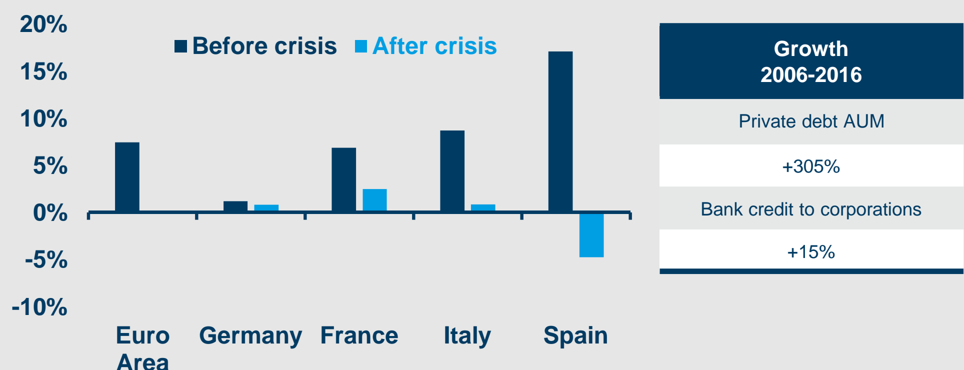
Enabling companies to access alternative sources of finance is, however, only one side of the equation, with attracting investors being the other. The ultra-low yield environment has created significant interest from investors with regard to new asset classes in search for higher returns.

In this respect, private debt has filled the gap between the need for funding by small to mid-sized companies and the search for positive real yield by investors. In fact, investing in private debt helps companies that have found it difficult to access banking finance to fund their growth, and allows investors access to small, but solid companies that they could not otherwise find in the public bond market, and also to capture an illiquidity premium.

The increased investor appetite for private debt investments (+305% in private debt funds' AUM over the past decade, according to the latest Preqin data) goes beyond its potential to deliver higher risk-adjusted returns or complement traditional income-oriented investments. Investors tend to prefer loans to other types of bonds (such as high-yield), as loans are usually more senior in a company's debt structure, so may offer investors better security. In addition, private debt investment may also provide diversification benefits, given the different risk profiles compared to traditional assets and other alternative investments.

While the US remains the main private debt market, interest in the sector is also growing in Europe since the financial crisis. Italy, for example, experienced an acute lack of bank financing due to the country's banking crisis, which has provided the private debt market with a unique opportunity to grow.

Bank Credit to private non-financial sector (average annual growth rate)



Growth 2006-2016
Private debt AUM
+305%
Bank credit to corporations
+15%

Source: Analysis by Amundi, BIS, Preqin. Before crisis: from 31 March 2000 to 31 December 2008; After crisis: from 31 March 2009 to 30 March 2017. Data as of 31 October 2017.

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Amundi high conviction positions

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 on a 3-6 month horizon, based on views expressed at the most recent global investment committee. The outlook, changes in outlook and opinions on the asset class assessment reflect the expected direction (+/-) and the strength of the conviction (+/++/+++).

Relative outlook and conviction 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 curr	→			●
	+	GEM debt loc curr	→			●
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 21 November 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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AMUNDI INVESTMENT INSIGHTS UNIT

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

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Date of First Use: 28 November 2017.

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