

Quarterly Asset Class Return Forecasts

Finalised on January 2018

Global Equities Favoured

Our growth outlook for global GDP remains positive. Global equities look a bit expensive relative to fair value but are less expensive than bonds. Investors are still being compensated more for taking equity risk.

GOVERNMENT BONDS

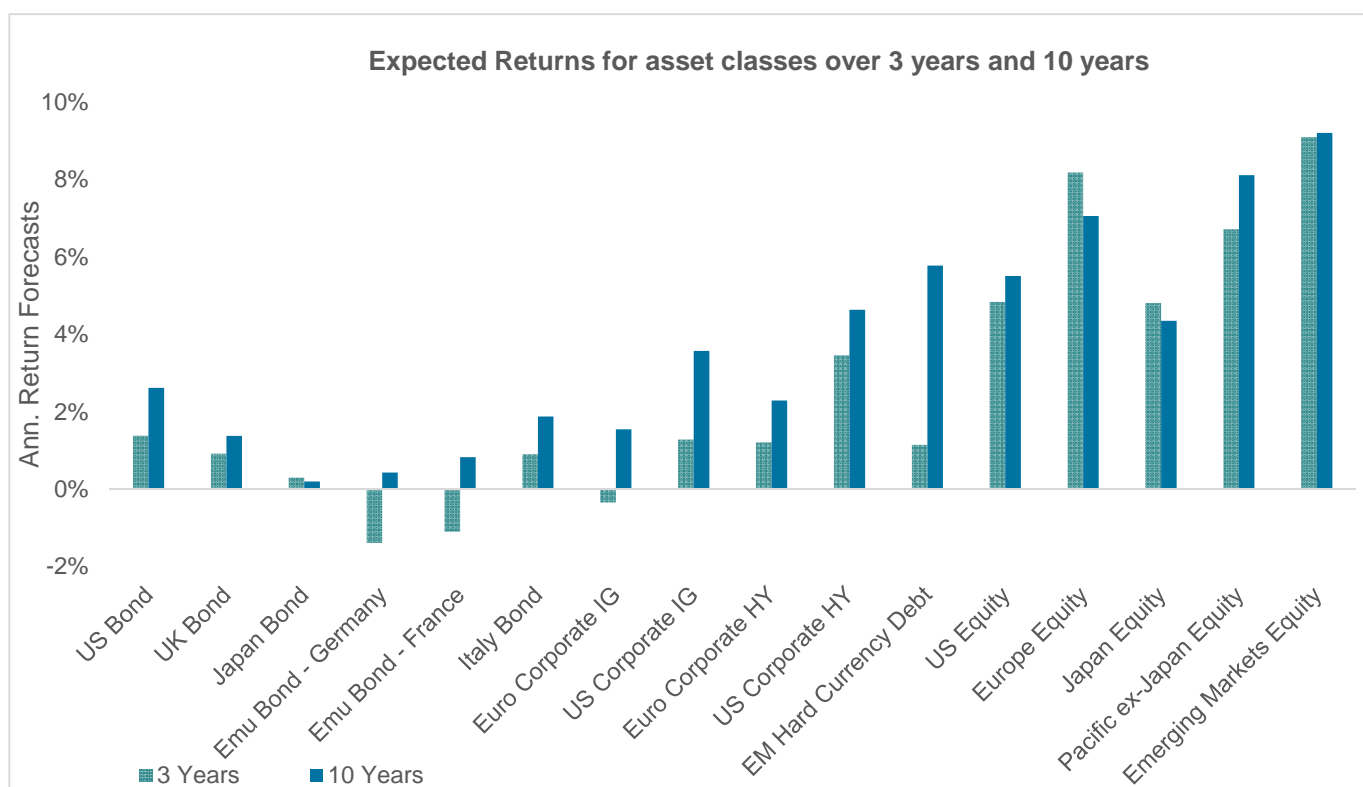
Our strategic view on government bonds is for rising yields and we see confirmation of this trend on both short and medium-term horizons. The normalisation of global interest rates wipes out duration premium and moves total returns on longer-dated bonds down to the level of cash returns over the long term.

CREDIT

Expected returns on corporate bonds remain low both in the Eurozone and the United States as they are being dragged down by an environment of low rates and tight spreads. As a result, the credit premium will also be moderate going forward.

EQUITIES

The overall picture for global equities is still positive, even though equity market valuations have become more expensive. Earnings growth is positively synchronised in all major equity markets.



Source: Amundi Asset Management CASM Model, Amundi Asset Management Institutional Advisory and Strategy and Economic Research Teams, Bloomberg. Data as of the 19 January 2018. Macro figures as of last release. Interest rates and spread levels updated as of the 5 January. Equity returns updated as of the 5 January based on MSCI indices. One year forward views and fair values provided by Strategy team (macro, yields, spread and equity). Please see page 6 of this document for methodology of CASM Model. Forecasts for annualised returns are based upon estimates and reflect subjective judgments and assumptions. These results were achieved by means of a mathematical formula and do not reflect the effect of unforeseen economic and market factors on decision making. **The forecast returns are not necessarily indicative of future performance, which could differ substantially.**

Asset Class Expected Returns

In the following table, we present our return forecasts across different asset classes, calculated as the average of simulated returns, on different forward looking horizons (from 3 Years to 10 Years). In order to give a coherent representation of risk, we also include a reference to long-term volatility (historical volatility on 15-year monthly sample).

Assets in local currency	Reference Index	Duration	Volatility	Average Asset Forecasts at Horizon		
				3 Years	5 Years	10 Years
Cash						
Euro Cash	JPCAEU3M index	0.3	0.5%	-0.4%	-0.1%	0.5%
US Cash	JPCAUS3M index	0.2	0.5%	2.3%	2.6%	2.7%
Government Bonds						
US Bond	JPMTUS Index	6.4	4.5%	1.4%	2.1%	2.6%
UK Bond	Customized Index	9.0	6.2%	0.9%	0.8%	1.4%
Japan Bond	Customized Index	8.8	3.2%	0.3%	0.3%	0.2%
Emu Bond - Core	JPMTWG index	7.4	4.1%	-1.4%	-0.3%	0.4%
Emu Bond - Semi Core - France	Customized Index	8.7	5.9%	-1.1%	-0.4%	0.8%
Italy Bond	JPMTIT index	6.7	5.6%	0.9%	1.0%	1.9%
Spain Bond	Customized Index	9.1	7.7%	0.3%	0.8%	1.5%
EMU Bond All Maturity	JPMGEMUI Index	7.1	4.0%	-0.4%	0.3%	1.1%
Barclays Global Treasury	BTSYTRUU Index	7.9	6.7%	0.6%	0.9%	1.3%
Credit Investment Grade						
Euro Corporate IG	ER00 index	5.3	3.4%	-0.3%	0.7%	1.5%
US Corporate IG	C0A0 index	7.2	5.5%	1.3%	2.6%	3.6%
Barclays Euro Aggregate	LBEATREU Index	6.7	3.4%	-0.4%	0.3%	1.1%
Barclays US Aggregate	LBUSTRUU Index	6.3	3.4%	1.6%	2.3%	3.1%
Barclays Global Aggregate	LEGATRUU Index	7.1	5.7%	0.8%	1.3%	1.9%
Credit High Yield						
Euro Corporate HY	HE00 index	3.9	10.5%	1.2%	2.2%	2.3%
US Corporate HY	H0A0 index	3.9	9.1%	3.5%	4.6%	4.6%
Emerging Market Debt						
EM Hard Currency Debt	JPEGCOMP Index	7.1	8.2%	2.2%	4.3%	5.5%
Equities						
US Equity	NDDLUS Index		13.3%	4.8%	5.2%	5.5%
Europe Equity	NDDLE15 index		13.7%	8.2%	7.5%	7.1%
Euro zone Equity	NDDLEMU Index		16.2%	7.7%	7.0%	6.6%
UK Equity	NDDLUK Index		12.8%	9.0%	8.1%	7.5%
Japan Equity	NDDLJN Index		17.9%	4.8%	4.6%	4.4%
Pacific ex-Japan Equity	NDDLXPJ Index		13.2%	6.7%	7.5%	8.1%
Emerging Markets Equity	NDLEEGF index		16.3%	9.1%	9.2%	9.2%
World Equity	NDDLWI index		12.8%	5.7%	5.8%	5.9%
AC World Equity	NDLEACWF Index		12.8%	6.2%	6.3%	6.3%

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Macroeconomic outlook

Global growth accelerated in 2017 and will remain robust in 2018. The advanced economies (with the notable exception of the United Kingdom) will continue to experience above potential growth. The major emerging economies will also continue to grow at a sustained pace. The ongoing rebalancing in China is progressing quietly – such that the slowdown appears to be under control. The recovery in most economies is being driven by domestic demand, and we note a recovery in investment in many regions (United States, Europe, Japan, Asia). The resynchronisation of the global cycle generates “multiplier effects” – via trade – that sustain the recovery on a global scale and make it more robust.

In the US, the recent approval of the Tax Cut and Job Act will provide further boost to Personal Consumption and Investments, making the US economy grow above potential again in 2018 and likely in 2019. Low inflation, the ongoing accommodative monetary and financial conditions and the tax reform significantly reduce the risk of a recession in 2018-19.

In the Eurozone, the recovery in investment, solid consumption figures and the drop in unemployment are generating a virtuous circle. Growth should remain

significantly above potential in 2018 and 2019 as credit conditions remain highly accommodative.

Growth is more robust than expected in China. The reduction in overcapacity has reduced the downside risks. The economy’s growth drivers are now more diversified. Debt remains essentially domestic and manageable. We expect the gradual deceleration of growth to continue and a slow rebalancing (less growth, less debt). The transition looks to be under control. However, vigilance should still be exercised.

Core inflation, which is excessively low at this stage in the cycle (especially in advanced economies), is expected to recover gradually in 2018. That said, the slowdown in inflation over recent years is primarily structural (tied to supply factors), while the cyclical component of inflation has weakened (flattening of the Phillips curve). While the pick-up in core inflation promises to be modest, the likelihood of an “inflation surprise” is nonetheless increasing as surplus capacities disappear around the world.

Central banks and interest rate assumptions

We make the assumption that the Fed will continue its rate tightening cycle by raising the Fed funds rate three times in 2018. This view has been reinforced by the recent adoption of the tax reform in the US, that will extend the economic cycle. In the longer-run, we assume the Fed funds rate will roughly converge to the levels indicated by FOMC members in their projections. This implies that the neutral real Fed funds rate will gradually climb to 1% (nominal Fed funds rate around 3%).

As far as the US fixed-income market is concerned, we presume that long-term rates will finally rise more convincingly. One very important element to take into consideration for longer horizons is the unwinding of the unconventional monetary policies. The Fed has also started to shrink its balance sheet and will continue to do so for years. According to the Fed staff’s calculations, the Fed’s large balance sheet is currently depressing the 10-year term premium by 85 bps. In the longer-run, we see the 10-year yield approaching 3.50% as the 10-year term premium gradually normalises.

In the Eurozone, we project that the ECB will stop its net asset purchases in 2018, which would diminish the monetary policy support to the fixed-income

market. However, contrary to the Fed, the ECB will continue to reinvest the maturing assets it holds for years: the upward pressure on long-term yields caused by the shrinking of the balance sheet will take more time to materialise.

The ECB will probably start hiking its key rates in 2019 but we anticipate a considerably low terminal rate as the neutral rate is lower than in the US. We make the assumption that the neutral real rate is currently negative and that it will gradually turn less negative in the coming years.

The German 10-year yield could reach 1% in 2018. It will take more time than in the US to witness the normalisation of the term premium. In the longer-run, the 10-year yield is expected to approach 2.40%.

Short-term and long-term interest rate forecasts

	1-year forecast	Long-term equilibrium level
Short Rates		
US	2.20%	2.80%
Euro	-0.30%	1.70%
Government Bond Yields		
US 10y	2.80%	3.50%
UK 10y	1.20%	2.80%
Japan 10y	0.10%	1.50%
German 10y	1.00%	2.40%
Spreads vs German Bond Yields		
France 10y	30	50
Italy 10y	130	130
Spain 10y	100	80

Return forecasts

Cash

The expected returns from rolling an investment in cash over the different holding periods are derived from our projected trajectory of policy rates over the medium to longer-term. The monetary policy trajectory is defined by the estimation of an equilibrium real policy rate (defined as the real rate consistent with full employment and stable inflation in the medium-term) and by the projection of a normalisation path toward the equilibrium real rate.

In the Eurozone, the nominal expected return on cash over the next 10 years is low at 0.5% as it is very much influenced by the difficulty in normalising inflation and by a cautious view on the long term growth prospects. We consider a neutral real rate at -1% since 2009 (approximately equal to ECB estimates) versus 1% before 2009 and we make the assumption of 0% in the longer-run.

One of the most relevant point of discussion is the timing of the normalisation of short-term interest rates towards the neutral policy rate. Our assumption is based on the Taylor rule model that would point to a first rate hike in early 2019 based on the ECB's economic projections and on our equilibrium rate estimate.

After defining the real policy rate trajectory, our model incorporates our inflation forecast to obtain a nominal expected return on cash. Our projections are for core Eurozone inflation at 1.7% over 10 years and 2% for US inflation.

Government Bonds

The normalisation of global interest rates wipes out the duration premium and moves total returns on longer-dated bonds down to the level of cash returns over the long term. Over the next 5 years, government bonds offer the unappealing prospect of negative returns in excess of cash in all regions.

Our framework projects 10-year US treasuries to return 2.6% over the next decade while Eurozone government bonds should return 1.2% per annum, a low nominal return given extended valuations and depressed starting yields.

Those assumptions are based on a scenario of a moderate rise in bond yields. Building on our expected path of the short-term real rates over the medium to longer term we derive our bond yield forecasts adding the expected inflation over the holding period and a nominal term premium which we assume will remain low leading to moderate rises in bond yields in our scenario. The term premium corresponds to the additional return that investors demand to hold a long-term bond as opposed to rolling over a short-term bond. It can be broken down into the inflation premium and the real term premium, both of which will remain fairly moderate because of our projected outlook of low real rates and inflation.

Emerging Market Bonds

The biggest risk underlying the EM fixed income investments is the upcoming changes to central bank balance sheets among the major players – namely, the Fed, ECB, BoJ and BoE. The EM spreads are expected to widen over the next year: together with normalisation of US interest rates, this will lead to moderate returns over the next 3 years. But over the longer term, the outlook for emerging markets has strengthened. While the investors base keeps broadening for EM assets, these economies continue to present attractive opportunities as they exhibit greater growth potential in comparison with developed world, with more balanced fundamentals.

Credit

Corporate fixed income continues to exhibit historically tight spreads. In 2018, we expect credit spreads for IG US and IG EU to stabilise and we anticipate a widening for high yield corporate bond spreads. We are approaching the point in the business cycle where in the past, credit spreads have started to widen.

Expected returns remain low both in the Eurozone and the United States for IG corporate bonds as they are dragged down by the environment of low rates and tight spreads. The credit premium for Euro IG should be close to zero over the next 3 years and be moderate by historical standards over the next 5 to 10 years at 0.4% vs Eurozone government bonds and 1% versus German Bonds. The US IG market is likely to exhibit similar returns to US bond in the medium term. In particular the spread premium could be not so significant on the 3 to 5- year horizon as a result of

the higher duration and adjustments at spread level, before gradually moving to an excess return of around 100bp over the longer- term.

For high yield corporate bonds, the normalisation of interest rates and spreads is expected to have a negative effect on the total return but the carry effect is deemed to be sufficiently high to offset rising interest rates and widening spreads. The interest rate increases should have less of an impact (compared to IG) in the expected total returns, due to its lower duration and higher carry term. In relative terms, US HY spread are closer to long-run spread levels than EU HY which, together with the higher carry on government debt in US will lead to higher total returns. Regarding default rates, we expect some resilience in the short-term and an increase to the historical average in the medium-term.

Equities

The overall picture for global equities is positive, as for the first time since 2010, earnings growth is synchronised across all major equity markets.

Moving forward we expect earnings growth to make up the brunt of future returns. In the shorter-term we anticipate a positive contribution from operational leverage in Europe, while tax cuts, buybacks and the weak USD should be key determining factors in the US.

Global equities look a bit expensive relative to their fair value but are less expensive than bonds. Risk premia across non-US equities still look attractive compared to those in fixed income. Investors are still being compensated for taking equity risk.

In the Eurozone, we project a rewarding risk premium (ie excess return versus bonds) despite higher uncertainty regarding the macro outlook as investors question whether current environment is cyclical or structural in nature. In our view, the valuation of Eurozone equities is still attractive versus government bonds, and over the next 3 to 5 years, we anticipate an outperformance by Eurozone equities as they should be supported by an improvement in corporate profitability.

On the other hand, US equity reached record highs and seem expensive versus other markets on a stand-alone basis. US equity valuation is the most stretched relative to its fair value, so we see a risk of correction in the short term. For this reason US equity should deliver a total return below historical average in the medium term and its premium return versus bonds is

less attractive than the rest of global equities as US rates have pulled higher and US equities have outperformed.

For Japanese equities, we expect a total return in line with the US market over the next 3 years. On the positive side, the macroeconomic momentum has been improving, thanks to the continued progress on economic and corporate reforms and on earnings growth. In the longer-term, total return is ranking well versus other markets for the following reasons: low GDP growth potential, low dividend yield and low inflation (below 5% overall total return).

We remain moderately constructive on EMs in the short term. Fundamentals hold up relatively well and world trade volume continues to surprise to the upside signalling stronger than expected global demand and further improvements in corporate margins. We don't see many risks from financial conditions (USD and US real rate). On the other side valuations are a bit stretched and our internal view of a gradual transition towards a late cycle stage calls for some risk recalibration in the medium term. Asia (mainly India and Indonesia) and EMEA remain attractive in the short term both on the macroeconomic and equity side. In LATAM, mainly Brazil, fundamentals are improving but local dynamics (political instability, in particular) make the asset class more vulnerable.

In the long term EM equity could converge to 9% returns thanks to stronger growth in comparison to the developed countries.

Cascade Asset Simulation Model (CASM)

This long-term return forecast report intends to provide some guidance for investor expectations. The time horizon under consideration is 10 years, a period deemed to be an appropriate timeframe, during which long-term trend factors and issues can reasonably be expected to play out, and thus, market returns should accurately reflect this information. We use a Monte-Carlo methodology in order to generate the possible evolutions of different risk-factors for the time horizon considered, representing the future states of these factors under objective measures. The resulting model is then used to price the instruments in line with these factor scenarios.

In order to determine possible interest rate scenarios, we analyse the evolution of three major economic DM regions: the EU core (represented by Germany), the EU periphery (represented by Italy) and the US. For this, we used a cascade-style modelling technique using risk factors such as the GDP cycle, inflation, real rates and slope for each of the economic regions in question.

Moving into spread-related assets (EM bonds and corporate bonds), we focus on implied volatility, quality, default and recovery rates, together with economic cycles, to estimate a forward looking path for EM bonds (hard currency), EU

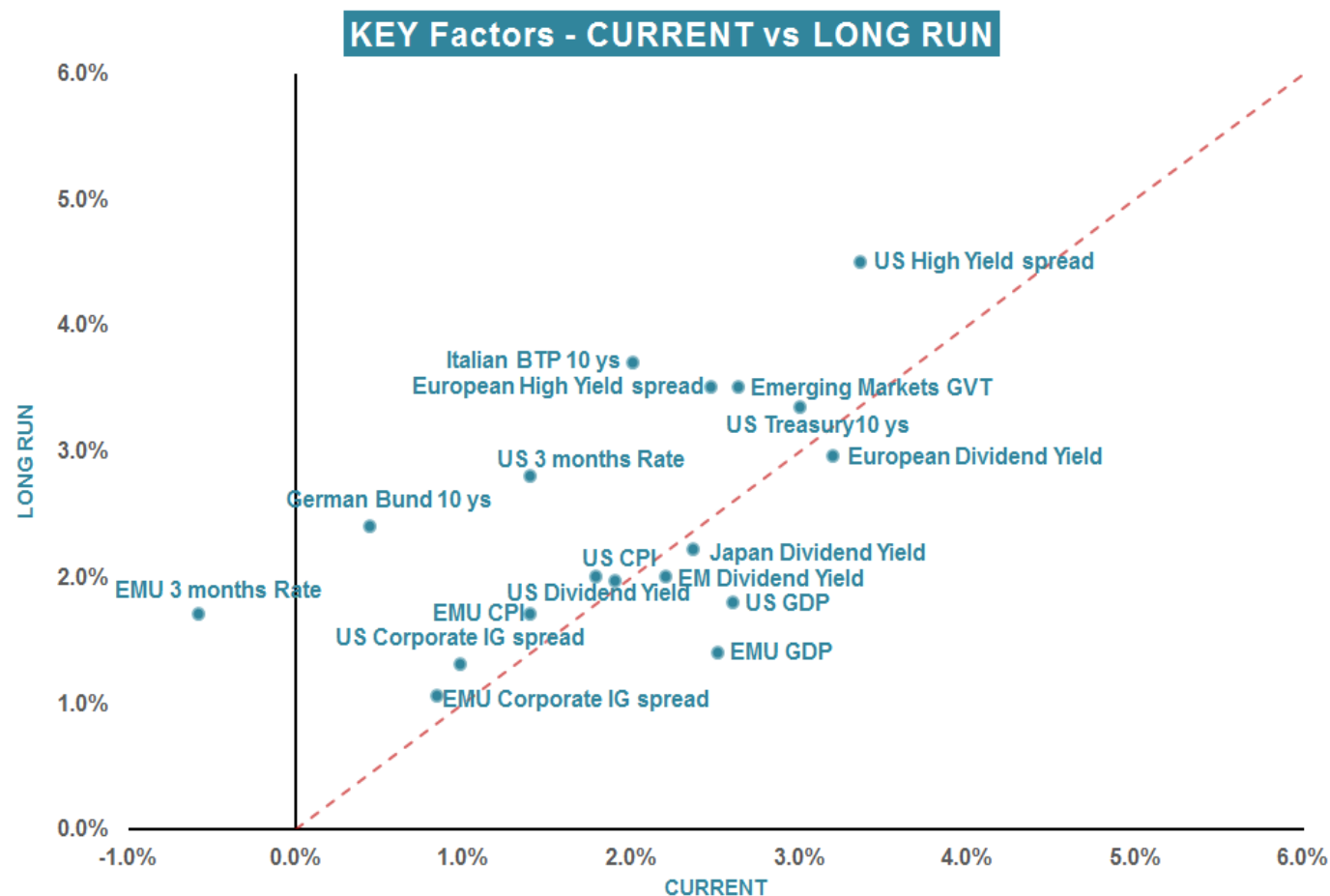
corporate (IG and HY) and US corporate (IG and HY).

Our framework on equity focuses on earnings growth and price earnings, as a determinant of capital gains and dividend yields, to represent the income effect; these variables are analysed with the macroeconomic pillars of the model (the economic and inflation cycle).

Our medium/long-term model, known as CASM, is updated on a quarterly basis to incorporate new starting points, our short-term outlook along with long-term trends, the significance of which is verified on an annual basis.

Our CASM model focuses on key factors, which drive this evolution over the medium to long-term; the resulting forecasts look at the comparison between current and long-term readings for the key factors included in the model.

Note that these are **simulated figures only** and may not represent actual asset class returns. Actual returns are based on many factors, and may vary substantially from modeled ones.



Source: Amundi Asset Management CASM Model, Amundi Asset Management Institutional Advisory and Strategy and Economic Research Teams, Bloomberg.
Data as of the 19th of January 2018

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