Confidence must be earned

Amundi ASSET MANAGEMENT

Asset Class Return Forecasts

Quarterly Update

Medium and Long-Term Return Forecasts | Q3 - 2020 ***Finalised in August 2020***

All signs indicate we have passed the inflection point of the Covid-19 pandemic crisis, even if this signals a clearer picture moving forward, different uncertainties are emerging. Our latest forecasts, incorporating analysis of key driving factors, confirms last quarter's future sequence of macro-financial regimes[1] registering some slight fine tuning in terms of recovery forecasts coherent with the macro picture taking shape. We maintain that the subsequent recovery will not happen immediately, with spurts of relief rallies not quite reaching pre-pandemic levels accompanied by the cooling of monetary and fiscal policies, eventually landing in a late cycle or potentially an asset reflation regime if central banks remain ultra-supportive.

Recent events have shown that the authorities are persisting in their unanimous stance, both in words and deeds through the medium term horizon – most recently evidenced by the unprecedented 750 billion euro rescue plan – meaning rates and yields are set to remain lower for longer. While removing market uncertainty, these moves will also materialise into even lower capital gains and total returns as rates inevitably trend upwards after this lower-for-longer yields regime. In such environment of low rates and central bank balance sheet expansion, yield-seeking investors will continue solidifying the status of high quality corporate debts as the new risk free assets.
Since our last update of the Medium to Long-Term forecasts, the market has anticipated the prolonged effect from the dual-pronged approach of exceptional monetary and fiscal policies. Equity has continued its recovery and credit spreads across the board have tightened considerably since the March rout. The resulting asset price has led to even higher starting points, contributing to lower return estimates with respect to last quarter from a valuation standpoint for the majority of asset classes and in particular for equity and credit.

Assets in local currency	10 yr Simulated Expected Returns	10 yr Simulated Volatility	10 yr Simulated CVaR 95%	2000-2020 Historical Returns (annualised)	2000-2020 Volatility (annualised)	2000-2020 Max Drawdown
Government Bonds						
US Bond	0.7%	4.8%	9.1%	5.0%	4.7%	5.3%
UK Bond	0.0%	7.4%	14.4%	5.9%	5.9%	7.7%
Japan Bond	0.2%	3.5%	7.0%	1.9%	2.1%	4.5%
EMU Bond All Maturity	0.0%	3.9%	6.9%	4.9%	4.0%	5.8%
Credit Investment Grade						
Euro Corporate IG	0.6%	3.8%	6.7%	4.5%	3.6%	7.2%
US Corporate IG	2.1%	6.2%	10.7%	6.2%	5.6%	16.1%
Credit High Yield & EMBI						
Euro Corporate HY	2.4%	10.3%	24.3%	5.1%	11.9%	37.9%
US Corporate HY	4.1%	10.5%	23.5%	6.8%	9.4%	33.2%
EM Hard Currency Debt*	4.2%	9.7%	25.5%	8.4%	8.6%	21.8%
Equities						
US Equity	6.4%	18.2%	38.0%	5.2%	15.0%	51.1%
Euro zone Equity	6.1%	21.4%	43.0%	1.3%	17.6%	57.3%
UK Equity	6.6%	17.7%	45.8%	3.5%	13.6%	41.0%
Japan Equity	5.6%	22.2%	46.3%	1.3%	17.6%	57.4%
Pacific ex-Japan Equity	6.7%	21.2%	47.1%	6.0%	13.9%	49.6%
Emerging Markets Equity	7.2%	20.2%	41.0%	9.5%	16.8%	51.9%

Source: Amundi Asset Management CASM Model, Amundi Asset Management Institutional Advisory and Research Teams, Bloomberg. Data as of the 24th of July 2020. Local currency. CVaR 95% is the average of the returns below the 5th percentile taking into consideration the annualized simulated distribution over 10 years. Max drawdown is the max loss from peak to trough considering 20 yr horizon sample, monthly frequency.

[1] **Our scenario is a for a U-shaped crisis, with a very gradual medium-term recovery.** A global recession with sequencing drawdown and diverging recovery paths is our base case at present. We expect to see signs of global growth stabilisation around the last quarter of this year, with different timelines at the country level depending on countries' relative outbreak developments and pre-existing economic and financial weaknesses.

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Given the greater uncertainty prevailing in the current macro and financial environment, we will be presenting an additional asset class risk/return trade-off measure. Together with the two classical dimensions (returns and volatility), we analyse the Conditional Value at Risk 95% (corresponding to the average return of the left tail below the 5th percentile of the distribution) to represent the drawdown risk implied in our simulations.

At page 1 we represented the 10 yr expected return for the main asset classes (i.e. the average annualized return of the CASM simulated path up to the 10 year horizon) together with the simulated volatility and CVaR 95% over the same horizon. These simulated figures are compared with similar historical figures calculated on last 20 year horizon (sample used to represent the long term). The historical shortfall figure is the max drawdown over last 20 years (including both the current and the great financial crisis).

Implications for asset class returns

GOVERNMENT BONDS	UK and US rates continued to slide, inching closer to zero in response to the greater flexibility enjoyed by the Fed and BoE. EU-area yield curves have all flattened in anticipation of the upcoming assessment of the damage wreaked by the shutdown. Going forward, we expect these policies to remain in place for at least the medium term with persistently low interest rates. We expect EU periphery to consolidate the current support, with BTP and Bonos vs. Bund spreads set to hold relatively steady over the investment horizon, assuming that flexible policies act as a ceiling to their yields and a backstop to credit downgrades. This steadiness will help shore up their outperformance, as their carry is high enough to counter the inevitable medium-term rate hikes. However, we will be keeping a close eye on debt sustainability. Our projection for UK government bonds reflects the challenges the country is facing on multiple fronts: the ongoing twin challenges of Brexit and pandemic, coupled with a reluctance to wade further into negative rate territory. The UK's expected performance over the medium to long-term horizon is subpar within our sovereign universe, exhibiting higher volatility and downside risk associated with the specific structure of the bond universe, which is tilted at the long end of the curve. Although the US market presents its own set of daunting challenges in the short term – namely the lag and magnitude of the pandemic cycle and political risks – its time-proven resources remain in its dynamic economy and Fed's maneuverability in the policy space. Accordingly, we expect the US bonds to continue generating slightly positive returns over the investment horizon. In the EM space, risk premium over the developed market sovereigns has compressed notwithstanding enduring Covid hotspots. Barring a significant surge in new cases, we expect the EM spread to benefit from a gradual normalization of global trade in the medium term, balanced by the inevitable rise in interest rates.
CREDIT	Compression of corporate spreads in recent months across all sectors and regions has confirmed our previous medium term assessment – the prevailing of the buoyant effect caused by the CB balance sheet expansion over default and quality deterioration concerns. Going forward, all signs point to the continuation of the current policy stance, at least through the medium term, when a clearer picture of the damage wreaked by the crisis emerges. Notwithstanding the asynchronicity of the pandemic evolution in EU and US, our central scenario in corporate debt is that spreads spanning all regions and qualities will continue to tighten in tandem. Under this scenario, the more advanced stage of the pandemic cycle in the EU is offset by the interaction between the Fed's greater flexibility and the dynamic US corporate sector. In comparison with last quarter, lower yields and tighter spreads indicate a higher starting valuation, leading to lower overall expected returns for all corporate debt. Despite the higher default risk, we expect US IG to outperform its EU counterpart due to a higher duration and underlying yields. On the HY, expected performance on the medium term horizon remains on par, while the greater default risk for energy-industry issuers in US HY segment reduces the benefits of its relatively higher carry return. As with last quarter, we expect default trends to have a greater effect on the US corporates with the HY sector in particular. Our estimates indicate the default rates to peak in the short term due to the ripple effects of the lockdown, normalizing thereafter in the medium term.

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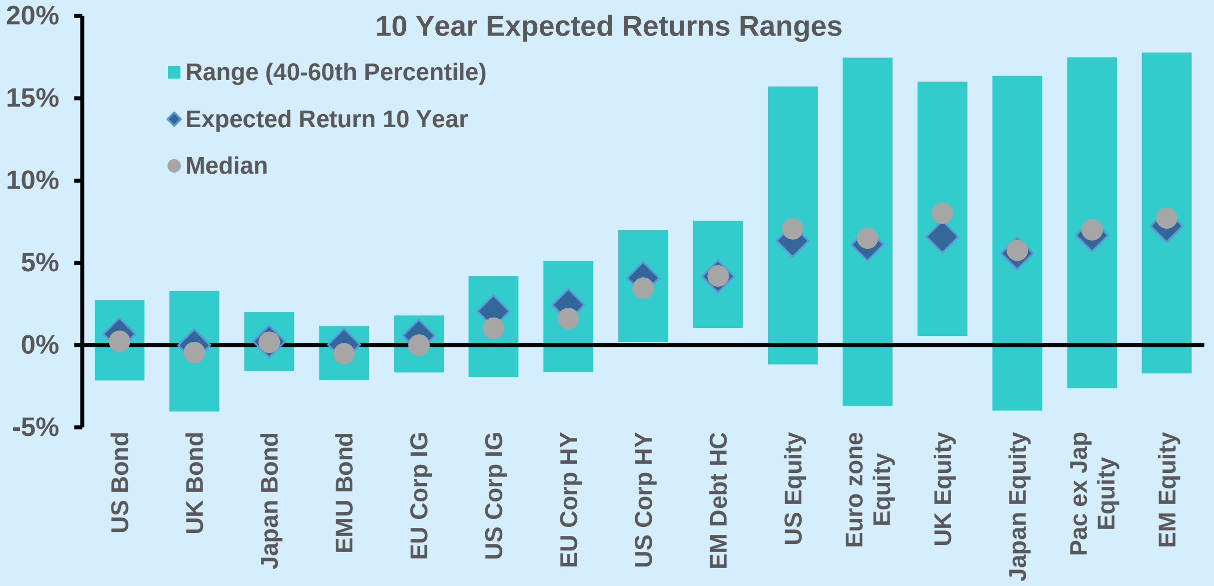
EQUITY

Equity markets rebounded last quarter, in some ways anticipating the recovery we expect to see in the future and incorporating positive news flow in terms of fiscal and monetary support across the globe. As this higher starting point represents a mismatch between equity prices and fundamentals, we expect this divergence to be gradually reflected in prices, with current expected return estimates lower than last quarter across the different horizons. This mismatch is further represented by a higher volatility and downside in our simulations when compared with past estimated returns

Aided by the still ongoing recovery of the equity market, ex-ante returns for equity overall are set to peak in the medium term, losing steam thereafter. Subsequent returns in the 10-year may be lower, as the predominant factor is the interaction between starting-point valuations, short to medium term earnings growth trends and the respective equilibrium levels.

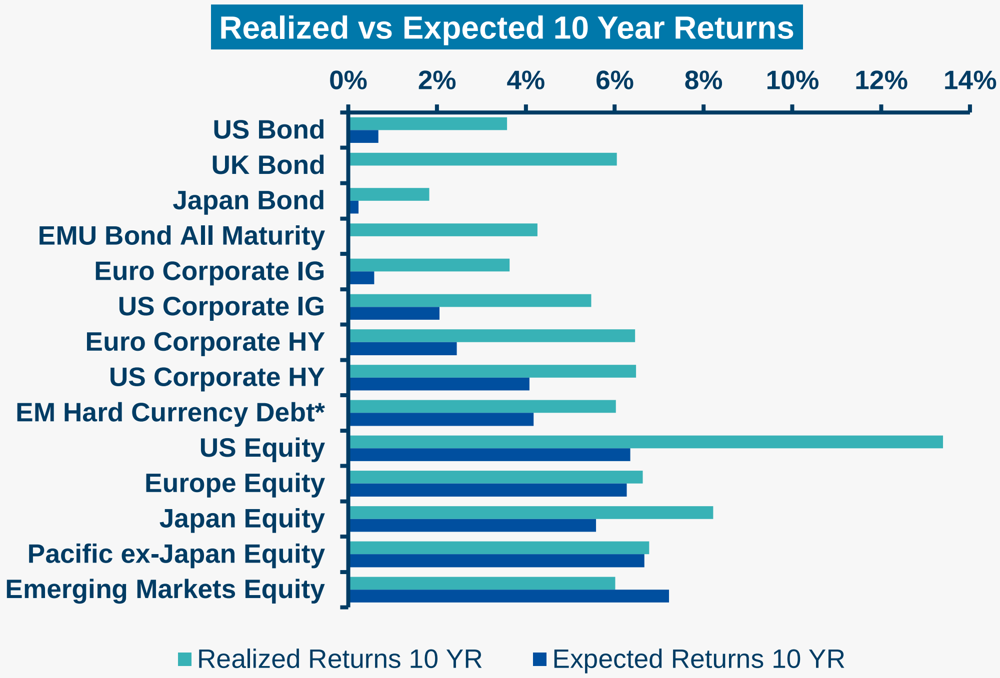
Looking at relative preference, higher-beta regions (such as EM, Pacific ex Japan and Europe) could perform better in the short to medium term, while moving beyond medium term horizon, the US may recover its position being ranked among developed markets. Meanwhile, we expect EM to deliver stronger returns due to the gradual pick-up in global trade from its crisis nadir.

EXPECTED RETURNS RANGES



Source: Amundi Asset Management CASM Model, Amundi Asset Management Institutional Advisory and Research Teams, Bloomberg. Data as of the 24th of July 2020. Local currency. Expected returns ranges are calculated taking into consideration the 40th and 60th percentile of the distribution of the annualized simulated returns over 10 yr horizon.

Asset Class Return Forecasts

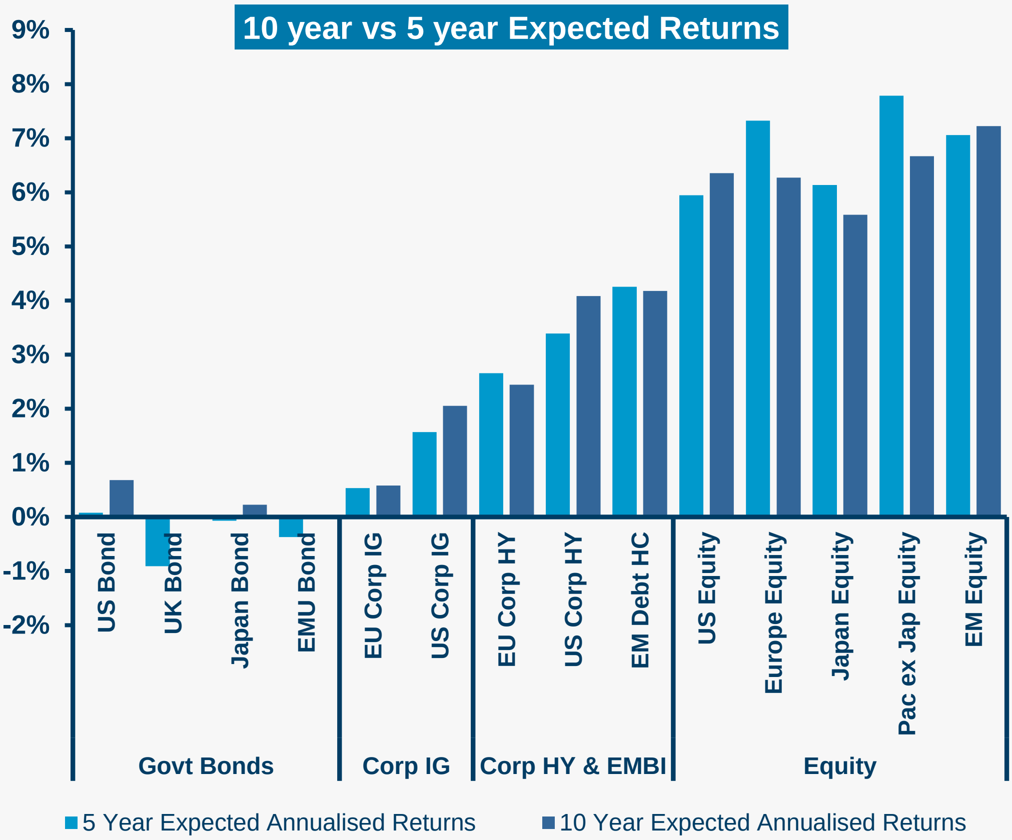


Expected 10-year returns are **compressed** due to **less favourable valuations** versus last quarter.

Fixed-income returns are weaker, which is even more evident looking at the last 10 years, characterized by yields descending trend. Moving from government to credit, asset returns can benefit from higher carry.

Equities can deliver **normalized returns** in the range of long-term averages.

As highlighted in the previous publication, we need to evaluate carefully the structural impact of the crisis and the inflationary risk in the medium to long term. For this purpose, further investigation and analysis are required on long-term assessment. For the time being, we confirm the our long-term scenario assumes lower growth rates (related to decreasing population growth and stagnant productivity), lower short-term interest rates, less steep curves than historically, inflation rates close to the range of central bank targets and lower long-term earnings growth.



In some ways, **the markets have anticipated the recovery** driven by exceptional central bank intervention amplified by strong fiscal policies. This quarter's starting prices incorporate credit tightening and some equity rebound, so the overall picture is less benign than last quarter from a valuation standpoint.

Central bank announcements and actions unanimously point to **lower-for-longer rates**, aimed at providing some certainty on the current situation. When **interest rates start increasing** (even if only slowly), they will generate **negative capital gains** that will partially offset the increase in yields.

We expect **corporate spreads to tighten further**, even if most of the adjustment has been already incorporated.

Equity can deliver **returns higher in the medium term** because of the recovery, afterwards moving to a more neutral stance.

Source: Amundi Asset Management CASM Model, Amundi Asset Management Institutional Advisory and Research Teams, Bloomberg. Data as of the 24th of July 2020. Macro figures as of last release. Interest rates as of the 30th of June 2020. Equity, spread and FX updated as of the 15th of July 2020. Equity returns based on MSCI indices. Reference duration are average figures. Local Currency. Returns on credit asset are comprehensive of default losses. **Forecast and fair values up to a three-year horizon provided by the Research team (macro, yields, spread and equity)**. 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 Return Forecasts

In the following table, we present our annualised return forecasts across different asset classes, calculated as the average of simulated returns, on different forward-looking horizons (from 3 to 10 years).

			Average Annualised Expected Returns			2000-2020 Historical Returns (annualised)	2000-2020 Volatility (annualised)
Assets in local currency	Reference Index	Duration	3 year Expected Returns	5 year Expected Returns	10 year Expected Returns		
Cash							
Euro Cash	JPCAEU3M index	**0.3**	**-0.5%**	**-0.4%**	**-0.1%**	1.8%	0.5%
US Cash	JPCAUS3M index	**0.2**	**0.2%**	**0.4%**	**1.0%**	2.2%	0.6%
Government Bonds							
US Bond	JPMTUS Index	**6.3**	**0.1%**	**0.1%**	**0.7%**	5.0%	4.7%
UK Bond	JPMTUK Index	**11.4**	**-1.7%**	**-0.9%**	**0.0%**	5.9%	5.9%
Japan Bond	JPMTJP index	**9.7**	**-0.4%**	**-0.1%**	**0.2%**	1.9%	2.1%
Emu Bond - Core	JPMTWG index	**7.5**	**-0.8%**	**-0.9%**	**-0.8%**	4.5%	4.0%
Emu Bond - Semi Core (France)	JPMTFR index	**7.9**	**-0.9%**	**-0.8%**	**-0.4%**	4.9%	4.2%
Italy Bond	JPMTIT index	**6.8**	**0.6%**	**0.6%**	**1.1%**	5.3%	5.7%
Spain Bond	JPMTSP index	**7.0**	**-0.1%**	**-0.1%**	**0.6%**	5.3%	5.2%
EMU Bond All Maturity	JPMGEMUI Index	**7.4**	**-0.4%**	**-0.4%**	**0.0%**	4.9%	4.0%
Barclays Global Treasury	BTSYTRUU Index	**7.8**	**0.0%**	**0.0%**	**0.4%**	4.4%	6.5%
Credit Investment Grade							
Euro Corporate IG	ER00 index	**5.1**	**0.7%**	**0.5%**	**0.6%**	4.5%	3.6%
US Corporate IG	C0A0 index	**7.1**	**1.8%**	**1.6%**	**2.1%**	6.2%	5.6%
Barclays Euro Aggregate	LBEATREU Index	**6.5**	**-0.2%**	**-0.2%**	**0.2%**	4.6%	3.4%
Barclays US Aggregate	LBUSTRUU Index	**5.7**	**0.8%**	**0.7%**	**1.3%**	5.1%	3.4%
Barclays Global Aggregate	LEGATRUU Index	**6.8**	**0.7%**	**0.6%**	**1.0%**	4.6%	5.5%
Credit High Yield							
Euro Corporate HY	HE00 index	**3.5**	**2.7%**	**2.7%**	**2.4%**	5.1%	11.9%
US Corporate HY	H0A0 index	**4.1**	**2.8%**	**3.4%**	**4.1%**	6.8%	9.4%
Emerging Market Debt							
EM Hard Currency Debt*	JPGCCOMP Index	**6.9**	**5.5%**	**4.3%**	**4.2%**	8.4%	8.6%
EM-Global Diversified**	JGENVUUG Index	**5.3**	**3.4%**	**2.9%**	**3.7%**	6.3%	11.9%
Convertible Bond							
Europe Index (Eur Hedged)	UCBIFX20 Index		**4.9%**	**4.0%**	**3.5%**	3.7%	8.9%
Equities							
US Equity	NDDLUS Index		**7.7%**	**5.9%**	**6.4%**	5.2%	15.0%
Europe Equity	NDDLE15 index		**9.4%**	**7.3%**	**6.3%**	2.6%	14.9%
Euro zone Equity	NDDLEMU Index		**9.4%**	**7.3%**	**6.1%**	1.3%	17.6%
UK Equity	NDDLUK Index		**9.3%**	**7.4%**	**6.6%**	3.5%	13.6%
Japan Equity	NDDLJN Index		**7.6%**	**6.1%**	**5.6%**	1.3%	17.6%
Pacific ex-Japan Equity	NDDLPXJ Index		**11.1%**	**7.8%**	**6.7%**	6.0%	13.9%
Emerging Markets Equity***	NDLEEGF index		**9.5%**	**7.1%**	**7.2%**	9.5%	16.8%
World Equity	NDDLWI index		**8.1%**	**6.2%**	**6.3%**	4.1%	14.2%
AC World Equity	NDLEACWF Index		**8.2%**	**6.3%**	**6.4%**	4.2%	14.2%

EM sovereign index are EMBI Global Diversified and EM-GBI Global diversified:* Hard Currency USD, ** USD Unhedged, including the USD currency expectation towards EM currencies. EM Local starting date is 31/12/2002. *** EM equity starting date is 29/12/2000.

Source: Amundi Asset Management CASM Model, Amundi Asset Management Institutional Advisory and Research Teams, Bloomberg. **Data as of the 24th of July 2020**. Macro figures as of last release. Interest rates as of the 30th of June 2020. Equity, spread and FX updated as of the 15th of July 2020. Equity returns based on MSCI indices. Reference duration are average figures. Local Currency. Returns on credit asset are comprehensive of default losses.

Forecast and fair values up to 3 year horizon provided by Research team (macro, yields, spread and equity). 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.

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Cascade Asset Simulation Model (CASM)

This medium- and long-term return forecast report is intended to provide some guidance for investor expectations. The time horizon under consideration is 10 years, a timeframe deemed to be appropriate and during which long-term trend factors and issues can reasonably be expected to play out, and therefore, market returns should accurately reflect this information. We use a Monte Carlo methodology in order to generate possible changes in 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 analysed the changes in the major economic DM regions and EM aggregate. We used a cascade-style modelling technique to simulate the different term structures, 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 focused 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 change 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 modelled ones.

Important information

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