CENTRAL & ALTERNATIVE SCENARIOS (12 TO 18 MONTHS HORIZON)

Monthly update

We note progress on the vaccine front despite logistics and side effects issues. In our central scenario, equities outperform on the back of abundant liquidity, improving fundamentals and accommodative monetary policy. Vaccine resistant virus variants, hawkish policy surprises and geopolitical tensions are the main sources of risks. Beyond 18 months, we expect (US) growth to revert to potential amid an higher inflation regime while stagflationary pressures will rise across Europe.

The balance of risks evolves over time. While it is premature to significantly de-risk portfolios while macro and micro fundamentals are still improving and accelerating, we believe there are narrower margins for a policy mistake or adverse events.

DOWNSIDE SCENARIO 10%

Multifaceted pressures*

Analysis

- Genetic evolution of the virus leads to cases spikes leading to growth relapses and lockdown measures until 4Q21, prolonging the crisis
- Vaccine side-effects and/or lasting shortages undermine confidence and diminish global prospects
- The highly pro-cyclical US policy ends up destabilising inflation expectations and causes a rise in interest rates, the USD and/or commodities, hurts risky assets (volatility shock) and impairs financial stability. Tighter financial conditions exacerbate economic and financial fragilities
- Euro-area fails to engineer the relaunch of the recovery with some countries falling into stagflationary spirals
- Lack of growth hurdles debt sustainability
- Chinese growth slowdown spills over to DM economies
- The rebalancing of geopolitical equilibria leads to protectionism and de-globalisation, negatively affecting trade and global value chains

Market implications

- Favour cash, USD and US Treasuries
- Play minimum volatility strategies

CENTRAL SCENARIO 70%

Multi-speed recovery

Analysis

- Vaccine rollouts surging in 1H21, though uneven across regions. Weakening in EM growth and likely in Europe, due to delays in vaccination and/or new lockdowns
- Policy boosters allow a multi-speed recovery narrowing the growth premium gap between EMs and AEs (US driven)
- Despite political commitment to mobilise fiscal policies in AEs, execution in the EU likely to be diluted
- Accommodative monetary and fiscal policies continue to support the recovery, keeping deflationary risks at bay and allowing debt/GDP ratios to stabilise for the time being
- Positive momentum, albeit at different speeds, in corporate earnings, reducing solvency risks
- The Covid crisis exacerbates income and wealth inequalities, thus increasing social and political tensions
- Macro and micro fundamentals positive momentum to pause. Stretched risk asset valuations and technical narrow the room for manoeuvre if something goes wrong

Market implications

- In a cross asset perspective, progressive rotation from Credit HY into equities. Value and cyclicals outperformance to continue. Favour barbell positioning in the equity and currencies space
- Contained steepening of US Treasuries yield curve spills over into EZ and EM.
- Maintain growth and income pockets with EM Equity and credit on rising earnings. Selective on EM HC.
- Favour linkers as an inflation hedge

UPSIDE SCENARIO 20%

Sustainable & inclusive recovery

Analysis

- Mass vaccinations resolve the public health crisis by the end of 1H21, eventually enabling a full global recovery in 2H21
- With less uncertainty, policy boosters feed through to the real economy and financial markets, closing the gap between manufacturing and service sectors
- Savings turn into consumption on increased disposable income, which allows a virtuous circle of growth/ inflation (no global overheating)
- Inclusive and sustainable growth diminishes the need for further policy support to reduce inequality gaps
- The US job market is recovering faster than expected and wage pressure arise
- Medium-term productivity gains from new digital and green developments

Market implications

- US Treasuries curves bear steepen on fast rising growth and inflation expectations
- Favour risky assets with cyclical and value exposure
- Favour linkers as an inflation hedge

* *There is no single downside scenario. Here, we take into account the many downside risk factors we have identified. These risk factors may or may not combine to give rise to a relapse in growth and/or higher inflationary pressures, and thus generate renewed volatility in the markets. Some risks are "exogenous" (pandemic dynamics, availability of vaccines), others are directly related to the crisis and/or economic policies. While the virus related risks should decrease over time thanks to the vaccination campaigns, the other risks mentioned in the Top Risks will have higher occurrence probabilities over the next 12 to 18 months.*

TOP RISKS

Monthly update

Risks are clustered to ease the detection of hedging strategies, but they are obviously linked. We have left the narrative and the risk of the central scenario unchanged this month.

ECONOMIC RISK 15%

- **Pandemic 2.0 with vaccine rollout issues**
  - Unexpected logistic issues or side-effects of the vaccine could have a very negative impact on investor and business sentiment
  - One or several virus variants that would make existing vaccines ineffective would undermine the economic recovery
- **A protracted recovery with multiple relapses** might hit business and consumer confidence, looping in sectors that have not yet been directly hit by the pandemic, such as financials
- **Underestimated hysteresis effects in the labour market,** with rising unemployment could generate social tensions
- **A rebirth of inflation and a second "taper tantrum"**
  - Upward inflation pressures could build up, as the epidemic fades away
  - QE programmes may become problematic as inflation expectations rise
  - Inflation dynamics and central banks' reaction function could be sources of uncertainty, in particular in EM, where inflation is close to most CBs' target
  - An early exit or miscommunication by the Federal Reserve could lead to a second taper tantrum similar to 2013

\+ **Cash, linkers, JPY, Gold, USD, Defensives vs. Cyclicals**

\- **Oil, risky assets, AUD CAD or NZD, EM local CCY exporters**

FINANCIAL RISK 20%

- **De-anchoring inflation expectations** leading to a bond market dislocation as an outcome of policy mistakes (such as pre-emptive monetary policy tightening or outsized fiscal plans)
- **Corporate solvency risk:** Despite improving fundamentals, the magnitude of the recession increased solvency risks once central bank liquidity and government guarantee schemes are withdrawn
- **Sovereign debt crisis**
  - With public debt as a share of GDP reaching historically high levels in peacetime, most countries are vulnerable to rating downgrades and rising interest rates, in the event of policy errors
  - Emerging market fragilities (single-commodity exporters, tourism) could also face a balance of payments crisis and increased default risks
- **USD instability, which could impact in both directions:**
  - **(1) depreciation c**ould push the Fed to stop its APP and negatively impact the Treasuries market, bring deflation into the EZ and Japan, and undermine the EM recovery; **(2) appreciation** could hurt EM countries, with higher UST yields spilling over into the Eurozone bond market

\+ **CHF, JPY, Gold, CDS, optionality, Min Vol**

\- **Oil, risky assets, frontier markets and EM**

(GEO)POLITICAL RISK 15%

- **US/China cold war**
  - Democrats take a hard line with China
  - Several sanctions and delisting of Chinese companies are signs of escalation
  - Possible accidental confrontations in the South China Sea or the Taiwan Strait, where Chinese aircraft are regularly making incursions
- **Instability within, and among, EM countries** on the back of chaotic virus crisis management and rising food prices
- **Post-Brexit risk of undermined European cohesion**
  - 2020 ended with an exit deal but implementation proves to be a lot more disruptive than expected
  - Tensions arise in Northern Ireland on new boarder rules
  - The City might lose market share faster than expected
  - The UK has to decide where to stand between the US and the EU, as well as China

\+ **DM Govies, cash, gold, linkers, USD, volatility, quality**

\- **Oil, risky assets, EMBI**

CROSS ASSET DISPATCH: Detecting markets turning points

How to the read turning point assessment

Not reached yet too early to call it | Approaching to the turnaround | Turnaround happened

ECONOMIC BACKDROP

- Economic activity in the Eurozone remains heavily impacted by the Covid-19 restrictions, as confirmed by both soft and high-frequency data. Divergences at both national and sector level remain evident, with the manufacturing sector outperforming services. Growth should progressively gain momentum from Q2 onwards as economies gradually reopen.
- Economic activity in the US is gradually gaining momentum with both high-frequency and soft data showing a sustained increase in private-sector business activity in the manufacturing and service sectors. The new fiscal stimulus will further support growth.
- A gradual reversal in economic surprises will likely continue as further upside surprises become increasingly difficult to materialise, as the consensus remains very high.

FUNDAMENTALS & VALUATION

- Current market levels already discount a significant part of the expected recovery in profits.
- Absolute PE levels are above historical trends despite growth remaining a solid argument for a temporary divergence from the historical average.
- After the recent spike in rates, the relative value metrics offer less support for markets to move significantly higher.

NEUTRAL + ASSET ALLOCATION

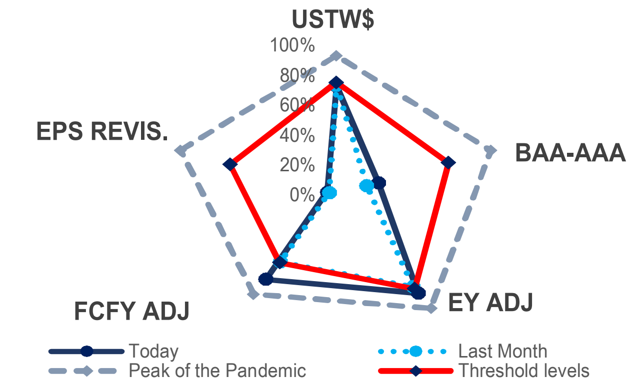
TECHNICALS

- Technicals remain mixed and challenging for the entire risky assets spectrum.
- While equities and HY still show decent momentum scores (signalling that investor appetite is still anchored to those assets), contrarian signals are flashing orange (i.e. neutral exposure), as most of those assets seem getting closer and closer to overbought territory.
- Our RSI-based signal looks less stretched now that markets are in a consolidation phase, yet we remain far from a green light.
- With rising interest rates weighing on multiples (which remain stretched and linked to the huge liquidity injected into the system) and no clear-cut directionality in many risky markets, we see no clear-cut signals from a technical perspective.

SENTIMENT

- Risk sentiment remains strong despite the turbulence associated with the quarterly rebalancing (Q1 2021).
- The overall RISK OFF probability remains low and continues to suggest an overweight in risky assets at the expenses of defensive.
- The following two points are to be closely monitored in our view. i) The sharp bounce back in the USD (so far contained) did not translate into lower EPS revisions and higher Credit risk premium. Should that happen, we expect our CAST indicator to deteriorate from current levels. ii) Financial conditions didn't deteriorate globally in response of the sharp nominal/real interest rates repricing we had in Q1 and seem currently stretched from historical standards (signalling complacency in the market).

Cross Asset Sentinels Thresholds (CAST) still supportive



Source: Amundi Research, Data as of 19 April 2021

CAST flags extremely low risk perception.

Sentinels remain in pro-risk territory due to a general improvement in all its components (except ERP adjusted for credit risk).

<u>Methodology</u> We consider five inputs which we call "Sentinels": USTW$, Moody's Baa-Aaa, EPS revisions, Earning Yield risk adjusted and Cash Flow yield risk adjusted. These sentinels are used to reposition our tactical asset allocation. Once sound thresholds are detected, the five variables are aggregated as an indicator that anticipates the market's stress conditions, with a certain level of conviction. The pentagon visualizes the five sentinels where the red line represents the alert threshold. The greater the distance above the red line, the higher the risk perception, and eventually the need to move closer to a defensive asset allocation.

GLOBAL RESEARCH CLIPS

1 A tactical pause in global economic momentum

- We are observing a tactical pause in the very strong rerating of global economic momentum that began in April last year.
- EPS revisions and economic surprises seem to have peaked from very elevated levels, signaling that expectations may have already been priced in and a pause in the recent optimism build-up may be due.

Investment consequences:

- In cross asset, the current "risk-on" stance is confirmed, although cautiousness is required on valuations both in absolute and relative value terms
- The recent upward trend in the USD could affect the pro-risk stance if it spills over into credit and triggers EPS revisions

2 US inflation to normalise, differing trends within the EA, Brazilian inflation to watch

- In the most advanced economies, inflation is set to move close to the CB target by the end of 2021.
- US inflation is rising faster than Euro Area inflation. Germany should see the highest peak in headline inflation, while Spain and Italy should be the laggards.
- EM inflation is visible on the cost side, magnified by currency weaknesses
- Looking at the historical evolution of US inflation indices, we envisage a high probability of a normal (CPI between 2-3%) to inflationary regime (CPI 3-6%) up to 2023.

Investment consequences:

- Risky assets perform best when inflation is at a "normal" level.
- In an inflationary environment, while equities continue to make positive returns (single digit), credit spreads tend to widen as central banks resume a tightening policy. Unsurprisingly Linkers offer a hedge in such a regime.

3 The cyclical rotation will continue

- The first indications from the Q1 earnings season sound promising, with consensus expectations moving significantly upward over the last two weeks. For the S&P 500, IBES foresees +31% vs. +24% on April 1. Idem for the Stoxx 600 with +56% vs. +47% respectively.
- In both regions, sectors that were the first to be hit last year, such as financials and cyclical consumer, are now leading the rebound. Even if these preliminary numbers are poised to fluctuate, this pro-cyclical pattern looks here to stay.

Investment consequences:

- The pro-cyclical rotation continues, is mature, but has further to go. Value may also be supported by stronger EPS growth going forward as well as some momentum.
- We are keeping a pro-cyclical positioning also on regions with an overweighting in EM, EMU, Japan and Pacific excl. Japan, neutral on the US and the UK, and an underweighting of defensive markets such as Switzerland in Europe.

4 China's growth recovery to continue at a strong pace; reflation without high-flation

- We expect economic recovery to re-accelerate in sequential terms after the Q1 slowdown, driven by the services sector.
- Growth will be less of a concern for policymakers, leading to cautious fiscal/credit policy tapering plus targeted tightening in the housing market.
- Inflation should not be an issue for the PBoC in 2021. We expect PPI inflation to peak in Q2 amid moderating fiscal and credit impetus. CPI inflation should strengthen at a gradual pace in 2021/22, with core inflation staying below 3%.

Investment consequences:

- The transitory spike in inflation, re-acceleration of sequential growth and increased bond supply should cause upward pressure on government bond yields in Q2. We prefer to buy into yield pick-ups, if any, as yields are likely to hold stable 12m from now.
- As the liquidity tide begins to ebb, we remain selectively constructive on China's equity market, favouring dividend stocks over growth stocks. Small caps also have higher upsides in the near term, benefiting from a broadening economic recovery.
- Lingering SOE and LGFV default risks continue to weigh on the credit market and prolong risk aversion.

5 Japan's two-track recovery to continue, well-positioned in the global capex upcycle

- The vast contrast between domestic and overseas machinery orders in early 2021 suggests external capex demand remains the main driver of Japan's recovery.
- Japanese corporate profits tend to move in tandem with the global manufacturing cycle. In light of the global manufacturing recovery, Japan's profit growth should continue to bounce back.

Investment consequences:

- Japan remains a cyclical play, which should be favoured in a global recovery, while the Yen should weaken along with the potential increase in appetite for carry trades.
- We are keeping a slightly positive bias only as the risk is that the global recovery, once Japan and Europe join the US and China, could also be coupled with less upward pressure on the USD.

AMUNDI ASSET CLASS VIEWS

	Asset Class	View	1M change	Rationale
EQUITY PLATFORM	US	=		Massive fiscal support, easy financial conditions coupled with pent-up consumer demand and huge savings, provide a positive backdrop for US equities. However, investors should avoid over exuberant areas where valuations are not justified by fundamentals. Instead investors should focus on leadership rotation in favour of value, cyclical and quality stocks with a strong selection bias and on ESG themes. Corporate taxation is another area that deserves attention.
	US value	+		Improving earnings prospects and a steepening yield curve should support cyclical value stocks (in sectors such as financials) that would benefit from normalisation of the economy. Over the long term, US value offers a combination of structural growth, quality, stability and ESG improvers.
	US growth	-		Rising rates and an improving economy could negatively affect valuations of long duration growth stocks, some of which already look very expensive. A cautious approach is suggested in these areas.
	Europe	=/+	▲	Reacceleration of the vaccine campaign in H2 and improving economy and EPS forecasts support a positive stance towards European equities, which appear attractively valued from a relative perspective. However, the region may witness some divergence across sectors as some areas benefit from reopening. Accordingly, investors should stay selective, focus on fundamentals, and play rotation opportunities in value and cyclical segments. Some opportunities are also opening up in defensive sectors, with extremely cheap valuations.
	Japan	+		We maintain our constructive view on Japan in light of its cyclical and industrials tilt that should benefit from an improving global economy and a weakening yen, which makes exports competitive.
	Emerging markets	+	▼	We stay positive on EM equities as the potential for growth, especially in EM Asia, is intact, but acknowledge the near- term headwinds in the form of a strengthening USD and the Covid situation. This necessitates a more selective approach in a heterogeneous EM world, where domestic consumption and value/cyclicality remain important themes. Finally, the rebalancing of China towards a more sustainable growth path should be positive for EM overall.
FIXED INCOME PLATFORM	US govies	-/=		We stay cautious on US duration amid higher inflation expectations, higher US debt and an improving economy. However, we believe yields have already risen sharply and therefore investors should stay flexible to add duration if market volatility increases. On the other hand, the case for US inflation and Treasury Inflation Protected Securities remains strong. In our US portfolios, we are cautious on USTs.
	US IG corporate	=		Investors should monitor interest rate risks in their portfolios and therefore limit long duration IG. While we remain overall positive, we are witnessing high valuations in some segments where risks may be reduced. Securitised credit is attractive in light of strong consumer earnings and savings, but selectivity is crucial.
	US HY corporate	=		Fundamentals in the HY market and the default rate situation appear to be improving as the economy recovers and as the cost of funding remains low. However, a strong focus on security selection is essential.
	European govies	-/=		We remain cautious on core Euro bonds, but realise that the ECB would not allow yields to rise too much in order to maintain accommodative financial conditions. However, we stay constructive on peripheral debt, especially Italy as the recent PEPP actions affirm ECB support to prevent any fragmentation in European markets.
	Euro IG corporate	=/+		We are positive on IG in light of improving fundamentals and the search for yield, with a focus on shorter dated debt and the BBB-rated segment. However, credit selection remains important as we believe divergences are likely to emerge between sectors most affected by the crisis and ones that have recovered. ECB support remains important for the market.
	Euro HY corporate	=/+	▲	We prefer to play spread compression opportunities in selective lower-rated names and explore relative value opportunities in the financial sector (positive on subordinated debt and cautious on senior financials). However, we believe it is important to strike a balance between quality and yield, and to distinguish high-quality credit from low quality.
	EM bonds HC	=/+		While in the long run HC debt supports investors' search for income, in the near term investors should watch out for rising US rates. Higher profit growth is supportive of corporate bonds, but room for further spread compression in HY remains limited outside of idiosyncratic stories. We look for selective opportunities in frontier markets.
	EM bonds LC	=		Given the risks associated with a strengthening USD, we believe LC debt is more vulnerable and expensive. Accordingly, selection remains crucial.
OTHER	Commodities			Commodities, including base metals, should benefit from strong economic recovery expectations for 2021 and from reflationary trades' investment implications. This would also be positive for oil prices, which should stay at current levels over the coming months. Among precious metals, gold found some support in the recent dovish statement from the Fed.
	Currencies			The recent USD appreciation did not affect financial conditions, but the dollar seems to have reached an alert threshold levels per our internal models. Despite that, we believe, some factors allowing a temporary USD bull run are re-aligning.

LEGEND

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Negative			Neutral	Positive			Downgrade vs previous month	Upgraded vs previous month

Source: Amundi 22 March 2021, views relative to a EUR-based investor. 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.
IG = Investment grade corporate bonds. HY = High yield corporate; EM bonds HC/LC = EM bonds hard currency/local currency. WTI = West Texas Intermediate. QE = Quantitative easing.

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ASSET MANAGEMENT

CROSS ASSET
INVESTMENT STRATEGY

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