CENTRAL & ALTERNATIVE SCENARIOS (12 TO 18 MONTHS HORIZON)

Monthly update

We are maintaining the narrative and the probabilities of the scenarios. The central scenario assumes that the policy mix and improving fundamentals will support the recovery and the markets. Beyond 18 months, we expect US growth to revert to potential amidst a higher inflation regime, while stagflationary pressures rise, in particular across Europe. As valuations are stretched and economic momentum is fading, equities' expected risk-adjusted return of equities is diminishing. We now consider vaccine-resistant virus variants or vaccination-related issues as a risk to the central scenario.

DOWNSIDE SCENARIO 25%

Slumpflation

Analysis

- **Recovery undermined** by pandemic-related constraints, despite successful vaccination campaigns
- **Growth** in Advanced Economies (AEs) back at (or below) potential, despite fiscal support
- **Persistent inflationary pressures** due to prolonged supply-chain bottlenecks
- China **slowdown** and regulation crackdowns impact AEs
- **Economic and financial fragilities** exacerbated by tighter financial conditions
- **Falling** medium-term **growth expectations** and higher interest rates undermine public debt sustainability and limit fiscal support
- **Protectionism** and **de-globalisation,** affecting trade and value chains
- **Stagflationary** pressures exacerbated by deleveraging and bottlenecks

Market implications

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

CENTRAL SCENARIO 60%

Multi-speed recovery

Analysis

- **Strong but uneven multi-speed** recovery in 2022 followed by a mild slowdown in 2023
- **Supportive policy mix** allowing debt to GDP ratios to stabilise
- AEs monetary policies to normalise gradually starting with the Fed
- **Narrower growth premium gap** between EMs and AEs (US policy boosters and China's deceleration)
- US growth and inflation peaked in Q2 and normalise gradually; EZ growth and inflation to peak in H2; China negative growth in Q3, weak in Q4 and a rebound in 1Q22
- **NGEU** execution is **diluted,** despite political commitment
- **Lower solvency risk** thanks to positive corporate earnings momentum, active deleveraging and low funding costs
- **Income and wealth inequalities** increase social and political tensions

Market implications

- Lower risk-adjusted expected returns due to high valuations and decelerating growth
- Contained steepening of US Treasuries yield curve as well as EZ and EM
- Favour equity momentum and quality
- Inflation hedge via gold, linkers and equities
- Favour barbell positioning in the currencies space
- EM: Short-term caution, long-term income and growth story intact

UPSIDE SCENARIO 15%

Sustainable & inclusive recovery

Analysis

- Mass vaccinations enables a **full global recovery**
- Closing gap between manufacturing and service sectors
- **Consumption strength** driven by savings and increased disposable income
- The Fed **normalisation is very gradual** despite the US job market recovery and wage pressures
- **NGEU** implementation is a **success**
- **Virtuous circle** of growth and inflation without global overheating
- **Inclusive** and sustainable recovery
- **Higher potential growth** thanks to productivity gains driven by digital and green developments

Market implications

- US Treasuries curves bear steepen
- Favour risky assets with cyclical and value exposure
- Favour linkers as an inflation hedge

Covid-19 related topics
Growth and inflation expectations
Monetary and fiscal policy
Recovery plans or financial conditions
Solvency of private and public issuers
Economic or financial regime
Social or climate related topics

TOP RISKS

Monthly update

We make no change to the probabilities of the risks to the central scenario. We consider Covid-19- related risks, as part of the economic risks. Risks are clustered to ease the detection of hedging strategies, but they are obviously linked.

ECONOMIC RISK 20%

— **Pandemic 2.0**
- Despite mass vaccinations, a 4th Covid wave kicks in. New variants with limited vaccine efficacy undermine the economic recovery (new lockdowns or mobility restrictions)
- Supply chain bottlenecks carries on and input cost pressures lead to corporate earnings recession

— **Global tightening**
- As inflation expectations rise, the Fed and other DM central banks could tighten financing conditions too early and hurt the recovery
- Central banks' miscommunication could be sources of uncertainty

— **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

+ **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 could increase 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
- Emerging market weaknesses (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** could 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, and could lead to higher UST yields spilling over into the Eurozone bond market

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

- **Oil, risky assets, frontier markets and EMs**

(GEO)POLITICAL RISK 20%

— **US & Europe vs. China cold peace**
- US takes a hard line with China
- Sanctions, disclosures requirements and delistings of Chinese companies are signs of escalation
- European countries could follow the US, despite their economic interests
- Lost influence of the US post Afghanistan exit
- Possible accidental confrontations in the South China Sea or the Taiwan Strait

— **European populist vote,** in France or Italy on the back of the Covid crisis and underestimated hysteresis effects in the labour market could lead to a further fragmentation of the EU

— **EM political instability driven by:**
- Chaotic virus crisis management and public debt level
- Higher food prices leading to a wave of unrest in EM similar to the Arab Spring

— **Cyber-attack or data compromise,** disrupting IT systems (security, energy and health services)

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

- **Oil, risky assets, EMBI**

Covid-19 situation update

Pierre BLANCHET, *Head of Investment Intelligence*

The feared, post-summer fourth wave in the Northern hemisphere doesn't seem to have spread, despite the Delta variant's high transmission rate. According to the latest WHO data, the weekly number of cases is actually diminishing. Europe and the US have seen a pick-up from late August through September but nothing close to previous waves. The mortality rate is also falling (to a global average of close to 1.6%, according to the WHO). The number of Covid-19 deaths in persons who had received both vaccine doses and had a first positive PCR test at least 14 days after the second vaccination dose, is very low across the regions. Although we cannot exclude the risk of a new, dangerous variant, the main concerns are now the low level of vaccinations in many emerging market countries and the lack of progress in some advanced economies, such as the US, where only 56% of the population is fully vaccinated. Logistics and trade deal issues explain the delay in lower-income countries. Lack of trust in science and the health system explains the slow motion in the US. Consequently, herd immunity is unlikely to be reached soon, and the pandemic will still be with us for several more quarters.

CROSS ASSET DISPATCH: Detecting markets turning points

Monthly update: The traffic light on economic backdrop has turned from green to orange

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

ECONOMIC BACKDROP

- Economic activity expanded at a solid pace over the third quarter in the Eurozone, benefiting from the easing of Covid-19 restrictions during the summer. Growth is expected to remain strong, although high frequency and soft data are pointing to a progressive flattening. The consensus continues to adjust downward, while economic surprises remain negative.
- Economic activity in the US continues to grow at a sustained rate, although growth rates are expected to progressively moderate as confirmed by the ongoing flattening of high frequency indicators and soft data. The CESI Index remains in negative territory, as both soft and hard data failed to deliver positive surprises. The consensus continues to moderate, remaining, however, in positive territory.

FUNDAMENTALS & VALUATION

- Most equities stabilised at all-time highs, as the recovery in profits began to consolidate, as valuations looked expensive, and as earnings are vulnerable to downward revisions.
- CB liquidity injection is still the only argument for the markets' high levels, although the start of tapering should erode investors' complacency.
- Absolute PE levels are above historical trends.

NEUTRAL + ASSET ALLOCATION

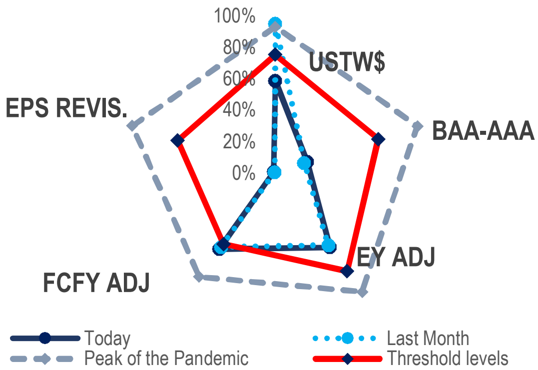
TECHNICALS

- There were some shifts in contributions with respect to the last month from our technical toolbox.
- RSIs were in overbought territory but moved into less stretched territory after their recent pullback.
- Technicals remain mixed, with a lack of directional bias at the time of writing.

SENTIMENT

- With the Fed set to tighten its monetary policy, with concerns over Evergrande's defaulting on its interest payments, and with growth momentum decelerating, volatility in risky assets rose in September, and risk appetite moderated with respect to last month.
- Most risk sentiment metrics we track, though, are still far from pure risk-off levels and keep showing moderately constructive risk sentiment in the market. Financial conditions remain loose in most regions, whilst EPS revisions are more than compensating for both the USD and the drop in economic surprises (which are clearly showing early signals of risk-gyration).
- Institutional investors decreased their risk exposure ahead of Jackson Hole last month and are neutral to longish on risk as we speak.

Cross Asset Sentinels Thresholds (CAST) still supportive



Source: Amundi Research, Data as of 23 September 2021

CAST risk perception is increasing, but we are far from structural risk off signal. Central banks are keeping credit risk premia low and earnings revisions are balancing the risk off signal coming from the USD. Visibility on the next steps though is deteriorating.

Methodology 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 US debt ceiling and the Democrats political agenda

- The US debt ceiling and Biden's infrastructure plans are sources of tensions in Congress that are undermining short-term visibility for investors.
- Progressive Dems want to link the infrastructure bill with social spending, which conservative Dems are opposing.
- The Dems' fiscal agenda is a function of their chances of success in the mid-term elections next year. At this stage, the Reps are likely to regain control of the Senate.
- Therefore the Dems could try to pass as much fiscal reform and infrastructure spending as they can to show their impact ahead of the polls.

2 ECB recalibrating, not tapering

- ECB expected to keep its stimulus persisting into 2022, in order to support NGEU efforts on the fiscal side and ensure the economy returns to a pre-Covid path.
- We expect strong monetary support as long as economic fragmentation persists.
- Inflation forecast remain well below target. Short-term rates to remain anchored to the current lows for longer on the back of ECB forward guidance.
- The ECB flagged December as the date for decisions on PEPP and TLTROs.
- We have moved our 10-year German Bund yield target to -0.40/-0.20% (from -0.10/+0.10%).

Investment consequences:

- Slight short duration on core Euro-area sovereign
- Slight steepening of the curve.

3 Energy price increases and inflation outlook for the Eurozone

- The increase in energy costs due to the surge in post-pandemic demand faces a constrained supply. The increasing costs of CO2 emissions for companies, which are already in play for some countries in Europe, should move inflation higher in the quarters to come.
- The final impact on consumer prices and households energy bills will depend on how governments limit pass-through effects on regulated prices. Currently for the Eurozone we estimate the impact at approx. + 0.3% on the average inflation rate, concentrated more in 2022. Barring further shocks, inflation is still expected to peak in Q4 and move lower into 2022, yet the peak will be higher (significantly above 3%) and pressures slightly more persistent.

4 Equity styles rotation: introducing Momentum and Quality

- Lower bond yields and a strong earnings season have allowed US and EMU equities to hit new highs.
- Below the surface, peaking growth, negative economic surprises, Covid uncertainty, and potentially lower economic support are raising question marks and pushing towards Cyclicals/Defensives and Value/Growth consolidation.
- Part of the rotation is also due to a maturing cycle in the US.

Investment consequences:

- In both US and European equities we are introducing Momentum and Quality, the usual winners in stage two of the business cycle and a way to play relative value.
- After their rebalancing in May, Momentum indices have become cyclical/defensive proxies.

5 Cross Asset China: positive on equity and credit

- Sentiment appears to be stabilising from regulatory tightening shocks. Credit outlook is being supported by fiscal loosening.
- Flow-wise, credit impulse (i.e. new credit) is stabilising and bottoming out.
- Liquidity outlook to improve further: after growth downgrade, we expect one more 50bp universal RRR cut in Q4, and are removing 10bp hikes in early 2022.
- No rate cut is expected, given that the credit slowdown was driven mainly by supply factors, i.e. regulatory tightening on housing and local government debt sectors.

Investment consequences:

- Remain positive on equities. Prefer H-shares over A-shares. Add more to HSCEI, less to HSI and MSCI China.
- Maintain Credit exposure, preference for long duration IG (5-10yr).
- Neutral on rates.

6 Commodity super cycle update: medium term upside potential

- Post-pandemic, prices have caught up with global growth. The still-depressed inventories cycle is thought maybe to perhaps be the driver of a prolonged uptrend in the medium term.

Investment consequences:

- Long on commodities in the medium term.

AMUNDI ASSET CLASS VIEWS

	Asset Class	View	1M change	Rationale
EQUITY PLATFORM	US	=		We think the supply chain shortages and pressures on labour markets should ease later in 2021 and next year. But valuations are extreme in certain segments and hence there is an increasing need to be selective and focus on relative value. Investors should also keep in mind the potential tax hikes and stay away from names that could be hurt due to regulations brought in to deal with tax avoidance.
	US value	+		We maintain our value call supported by a mild increase in core yields, vaccinations and an ongoing recovery, even though the rebound is stabilising from peak growth levels. Thus, the need for selection is high and investors should avoid cyclical value and focus more on quality value names.
	US growth	-		We believe the recent weakening of growth momentum have led growth stocks to outperform, but their valuations are above long-term averages. As rates rise and as vaccination levels improve, this gap should come down, making the case for a cautious approach in this segment.
	Europe	=		Europe continues to emerge from the crisis with expectations of growth peaking later this year. But inflation (energy and food) seems to be getting strong amid the transition towards clean energy. In this environment, we reiterate the rotation towards value, but recommend investors broaden this to include names displaying strong quality, ESG (ESG winners of tomorrow) and dividend characteristics. Overall, the focus should be on selection and pricing power.
	Japan	=		Japanese markets witnessed uncertainty due to renewed Covid concerns but are trading at attractive relative valuations. We think the country should catch up eventually, benefitting from a weaker yen and from value and dividend themes.
	Emerging markets	=		Valuations are attractive and earnings recovery momentum remains strong in EM amid ongoing vaccination programmes and reopening. We are positive on countries such as India and Russia with strong domestic consumption potential. In terms of sectors, we like consumer discretionary, real estate and communication services, maintaining our tendency to increase value/cyclicals over growth.
FIXED INCOME PLATFORM	US govies	-		UST yields remain low when compared with economic growth dynamics and actual inflation numbers, indicating that markets have accepted the temporary narrative. However, while we lowered our 10Y yield target, we believe the path for core yields is upwards as the Fed normalises its policy and as pent-up savings and consumption come into play. We remain cautious but maintain a flexible stance. TIPS offer decent real yields, but we are watchful of valuations.
	US IG corporate	=		We prefer short-maturity debt and idiosyncratic stories (rather than market exposure) due to risks from rising core yields. Accordingly, we remain selective and vigilant as economic recovery continues with some signs of peaking from high-growth levels. We are positive on agency mortgages, but think investors should be watchful for any signs of weakness as taper discussions at the Fed continue.
	US HY corporate	=		Amid strong supply this year and improving liquidity, valuations in this segment remain high as borrowing costs for HY companies are still low. Investors should aim to limit portfolio beta and instead use credit selection to identify companies whose credit metrics are improving, thereby striking a balance between extra income and quality.
	European govies	-/=		Given the ongoing recovery in the region, inflation numbers and indications of tapering by the ECB in the near future, we maintain a cautious stance on core and semi-core European government bonds. We acknowledge the key political events in the region and remain flexible and watchful. On the other hand, we are constructive on debt of peripheral countries, particularly Italy, due to optimistic growth outlooks and the still accommodative stance maintained by the ECB.
	Euro IG corporate	=/+		We are seeing signs of a general improvement in the overall credit environment as the ratings outlook remains stable and net debt to EBITDA is declining. We believe BBBs and financial subordinated debt are in a sweet spot and offer better risk/reward profiles vs the higher-rated ones. However, we remain selective and prefer shorter maturity instruments and sectors linked to the cyclical recovery.
	Euro HY corporate	=		The HY segment presents selective opportunities as we explore names with a potential for spread compression and robust ESG profiles. We also look for rising stars, subordinated debt that may witness rating upgrades and improvement in fundamentals. However, we avoid asymmetric risk profiles where changes in core yields could affect prices.
	EM bonds HC	=/+		We prefer HC credit risk and remain constructive in the medium term with a bias to HY vs IG. Within corporates, although spreads do not look cheap on an outright basis, they appear attractive compared to alternative options.
	EM bonds LC	=		We remain watchful of headwinds from potential tightening in developed markets. In China, we think the PBoC and the government would aim to avoid any contagion and liquidity crunch. Overall, we are selective and are exploring countries where EM tightening cycles are closer to the end, such as Russia, but we remain bearish on global duration.
OTHER	Commodities			A build-up in global inventory and possible supply shortages should be positive for commodities (such as base metals) over the medium term. Precious metals such as gold could witness some volatility as the Fed normalises policy, leading to an increase in real rates. However, if growth momentum decelerates next year, we could see some upside for the yellow metal.
	Currencies			Slowing global growth and Fed's policy normalisation are likely to support the USD, especially against the low yielders (EUR, JPY, CHF). However, we remain constructive in the short term on certain cyclical currencies (NOK, GBP, CAD) whose CBs are expected to move ahead of the Fed, whose valuations are supportive, and growth path seems strong.

LEGEND

--- -- - Negative | = Neutral | + ++ +++ Positive | ▼ Downgrade vs previous month | ▲ Upgraded vs previous month

Source: Amundi, as of 26 September 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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