View for 2020

US Assets

Economic resilience, Fed and elections to drive markets in 2020

Investment Insights | Market Stories

US assets still attractive in 2020: Three themes on the spot

KEY THEMES

RESILIENCE OF PRIVATE CONSUMPTION

Consumption is likely to remain solid and able to bear some labour market cooling, thus supporting overall US GDP growth

MONETARY POLICY TRENDS

Easy financial conditions should support risk assets, even if the Fed is likely to stay on hold this year or delivering an extra cut if the outlook deteriorates

PRESIDENTIAL ELECTION

The outcome will shape economic policies over the next four years, together with market trends and sector rotation throughout this year

Contents

01

US economy to stabilise, Presidential election under the spotlight

US economy: key themes to watch

GDP growth should stabilise around potential this year, at 1.7% from an estimated 2.3% average growth last year, driven by private consumption

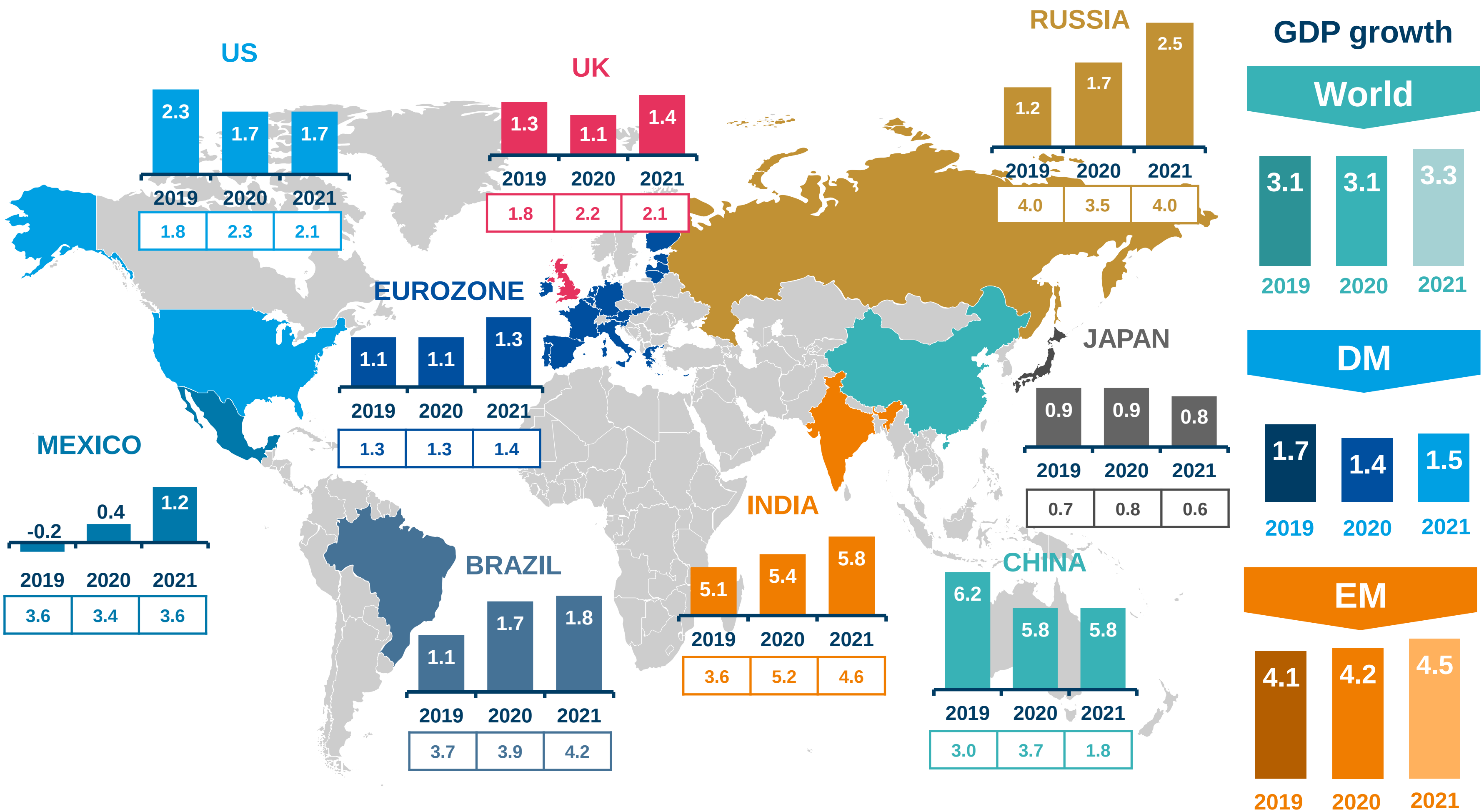
Labour market will likely prove resilient, though some signs of deceleration are emerging

Monetary policy remains accommodative. The Fed should be on hold this year; an extra cut could come in the case of disappointing economic data

Trade challenges will likely be receding this year with the signing of a phase-one trade deal between the United States and China, however a final deal is unlikely

Source: Amundi, as of 15 January 2020.

US economy to decelerate in 2020, but still leader in DM



Source: Amundi Research; Latest forecasts are as of 8 January 2020. Data in percentages. Bars represent real GDP growth (YoY%) forecasts, tables show inflation (CPI, YoY%) forecasts.

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US recession dashboard: no recession risk insight

Start of recession	Yield curve	Manufac. Sector	Inflation	Jobs	Housing Activity	Credit	Earnings
November 1973	🔴	🔴	🔴	🔴	🔴	NA	🔴
January 1980	🔴	🔴	🔴	🔴	🔴	NA	🔴
July 1981	🔴	🔴	🟢	🟢	🔴	NA	🔴
July 1990	🔴	🔴	🔴	🔴	🔴	🔴	🔴
March 2001	🔴	🔴	🔴	🔴	↔	🔴	🔴
December 2007	🔴	🔴	🔴	↔	🔴	🔴	🔴
Present	↔	🔴	🟢	🟢	🟢	🟢	↔

🔴 **Indicator pointing to recession**

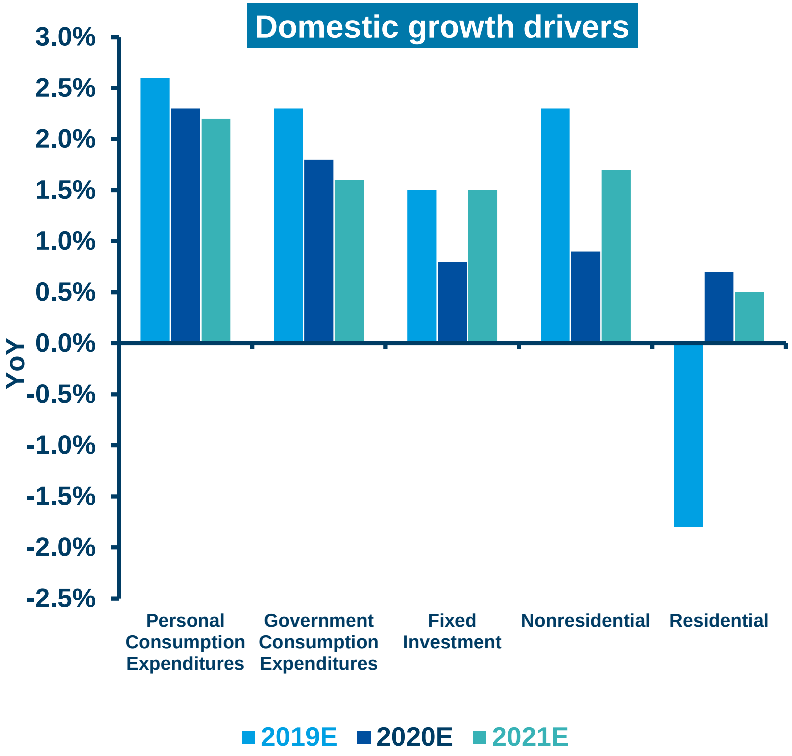
🟢 **Indicator not pointing to recession**

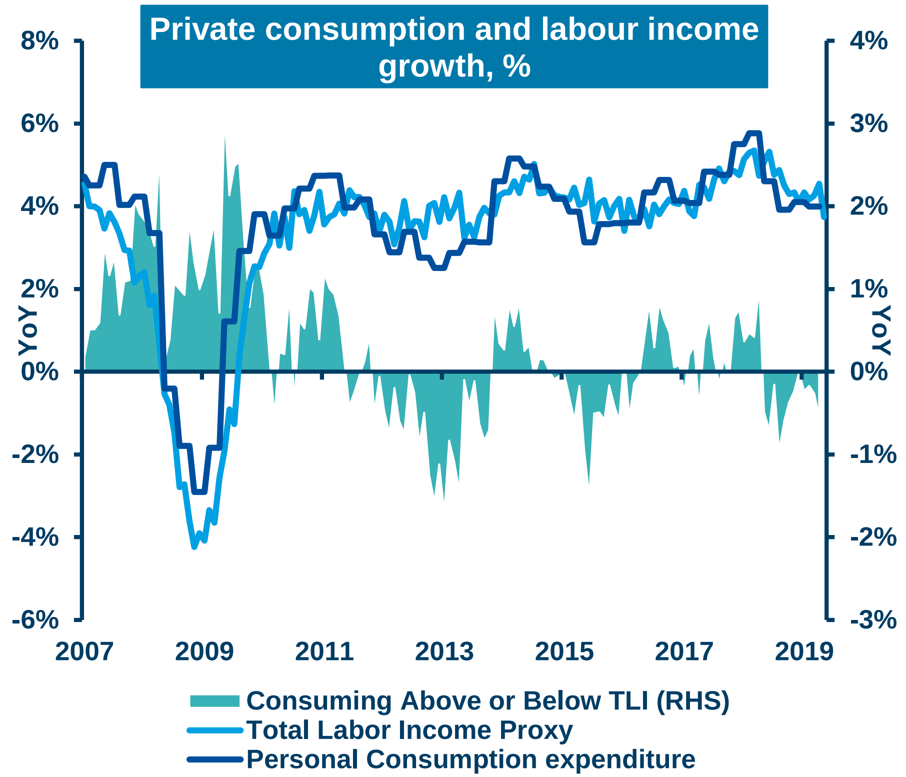
↔ **No clear indication on recession risk**

» Historically, an economic recession has been anticipated by some “sentinels”. At the moment, only the manufacturing sector is flagging red.

Source: Amundi, as of 15 January 2020.

Labour market still supportive to consumption



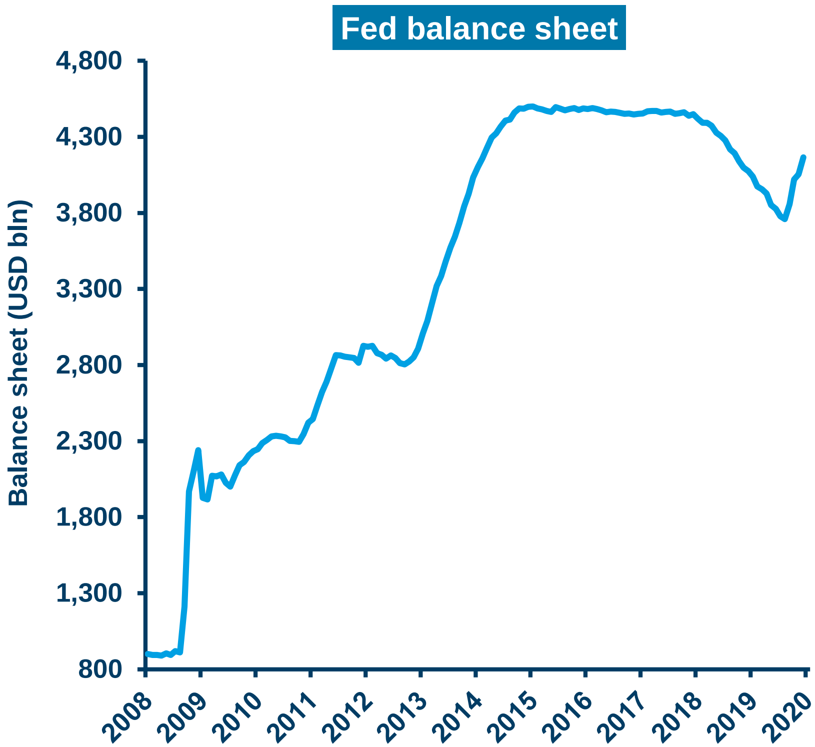


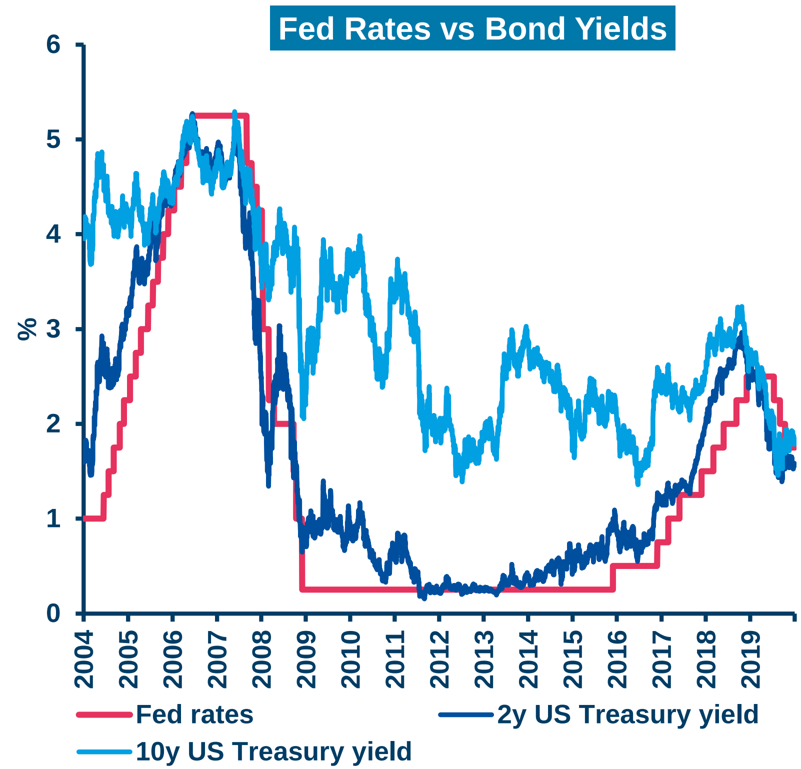
» The labour market appears resilient, with low unemployment, strong hours worked and moderate wage growth. However, signs of deceleration are appearing, as hires, quits and separations have plateaued at cycle highs, while job openings are declining. The duration of unemployment is increasing, flagging the risk that the jobs market could be losing momentum, albeit still cyclically strong.

Source: Amundi elaboration on National Bureau of Statistics data, as of 31 December 2019.

Source: Amundi Research, Amundi Research, Datastream. Data as of 7 January 2020

Fed most likely on hold, but overall accommodative





» The Fed should remain broadly accommodative, avoiding any tightening of financial conditions, that could have a negative impact on the economy. Federal Reserve should not deliver an extra rate cut unless economic data disappoint, especially on the labour market front.

Source: Amundi, Bloomberg, as of 13 January 2020.

Source: Amundi, Bloomberg, as of 13 January 2020.

Possible election outcomes and investment implications

Trump re-election

45%

Trump has been supportive of energy output, rolling back regulations and passing the 2017 Tax Cuts and Job Acts. Further action can be expected on taxes in a second term. There is no plan to reduce the size of the budget deficit and there may be a further rise on infrastructure spending. Trump has called for a **weaker USD** and free and fair trade. **He could implement more protectionist policies if re-elected**.

Another Republican nominee

5%

Healthy growth, making the tax cuts permanent, capital gains indexing and reduced trade tensions will **support equity prices.** A neutral Fed policy is likely to keep interest rates consolidated in a wide range. While stable interest rate differentials mean a stable USD, the latter is more likely to be influenced by developments overseas. A recovery in global growth will help send the **USD into a bear market**.

Establishment Democrat

30%

The stock market will rebound as growth improves. The **tech, pharmaceutical** and **healthcare sectors** will underperform, while **renewable energy and transportation** will outperform. **Interest rates** will stay range-bound as stable growth and soft inflation keep the Fed on hold. The global convergence in growth and monetary policy will drive the **USD lower**.

Populist Democrat

20%

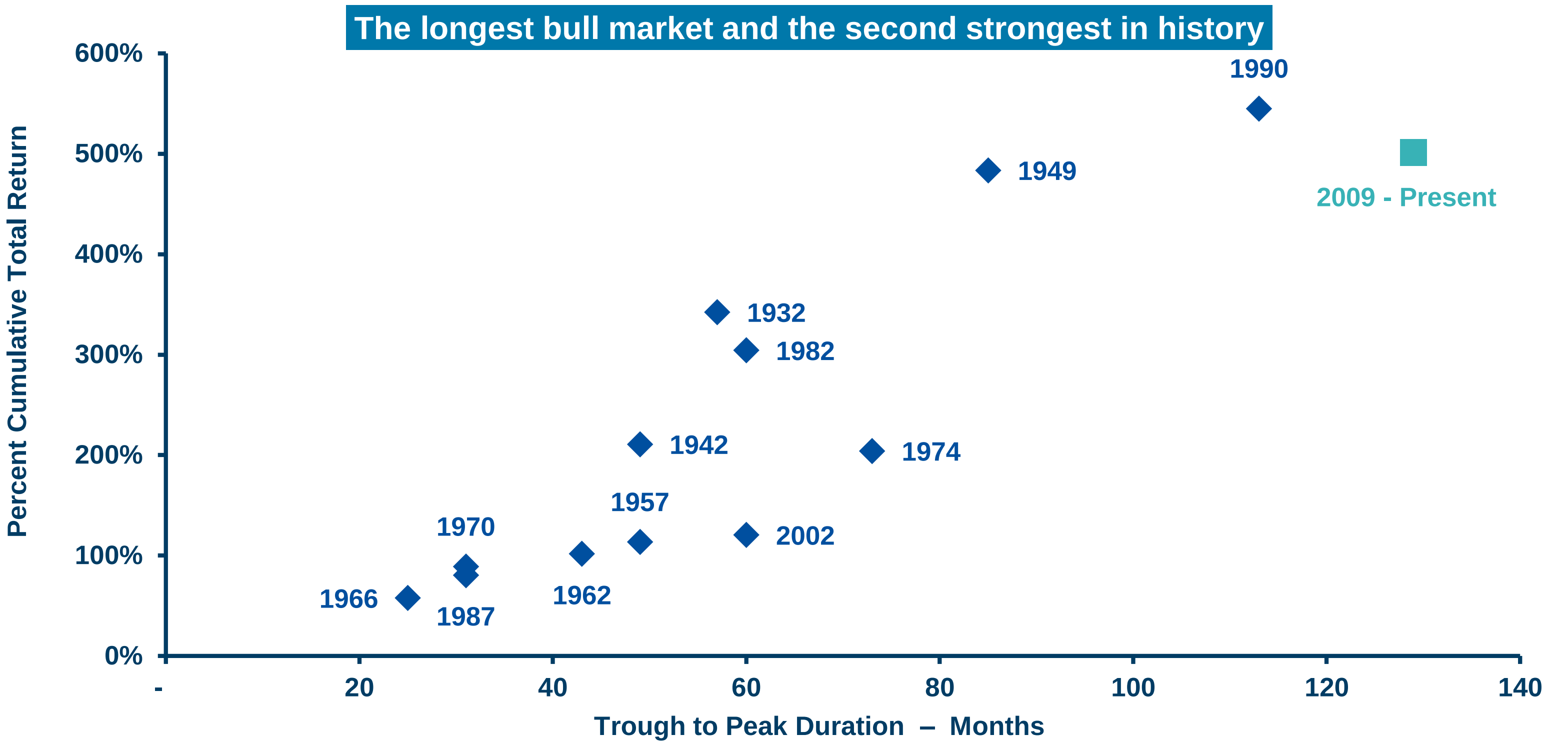
Below-trend growth and a populist agenda will lead to a **negative environment for equities**. **Tech, pharmaceutical, energy, defence, and healthcare sectors** will underperform while the **construction, transportation and resource stocks** will outperform. Interest rates rally **as Fed eases** policy but as concerns about stagflation emerge, the curve steepens. The negative outlook on US asset prices and narrowing interest rate differentials lead to a USD depreciation.

Source: Amundi, as of 13 January 2020.

02

Equities: bull market could continue, but soften

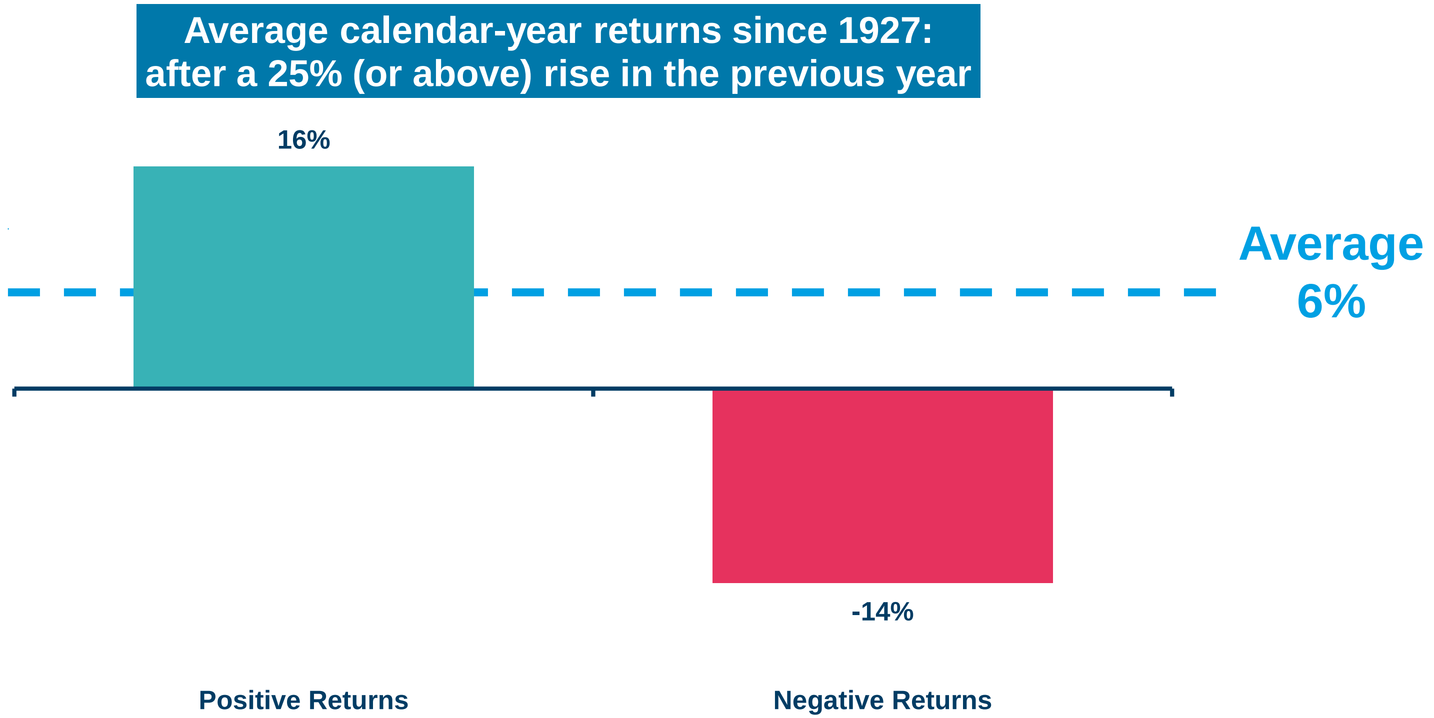
US equity: the longest bull market in history



» In terms of cumulative total return, the current bull market ranks second only to the expansionary cycle that started in 1990.

Source: Bloomberg (data on S&P 500 index) and Amundi. Data as of 7 January 2020. Trough to peak duration: the stage of the market cycle from its cyclical bottom (trough) to a period of growth (peak).

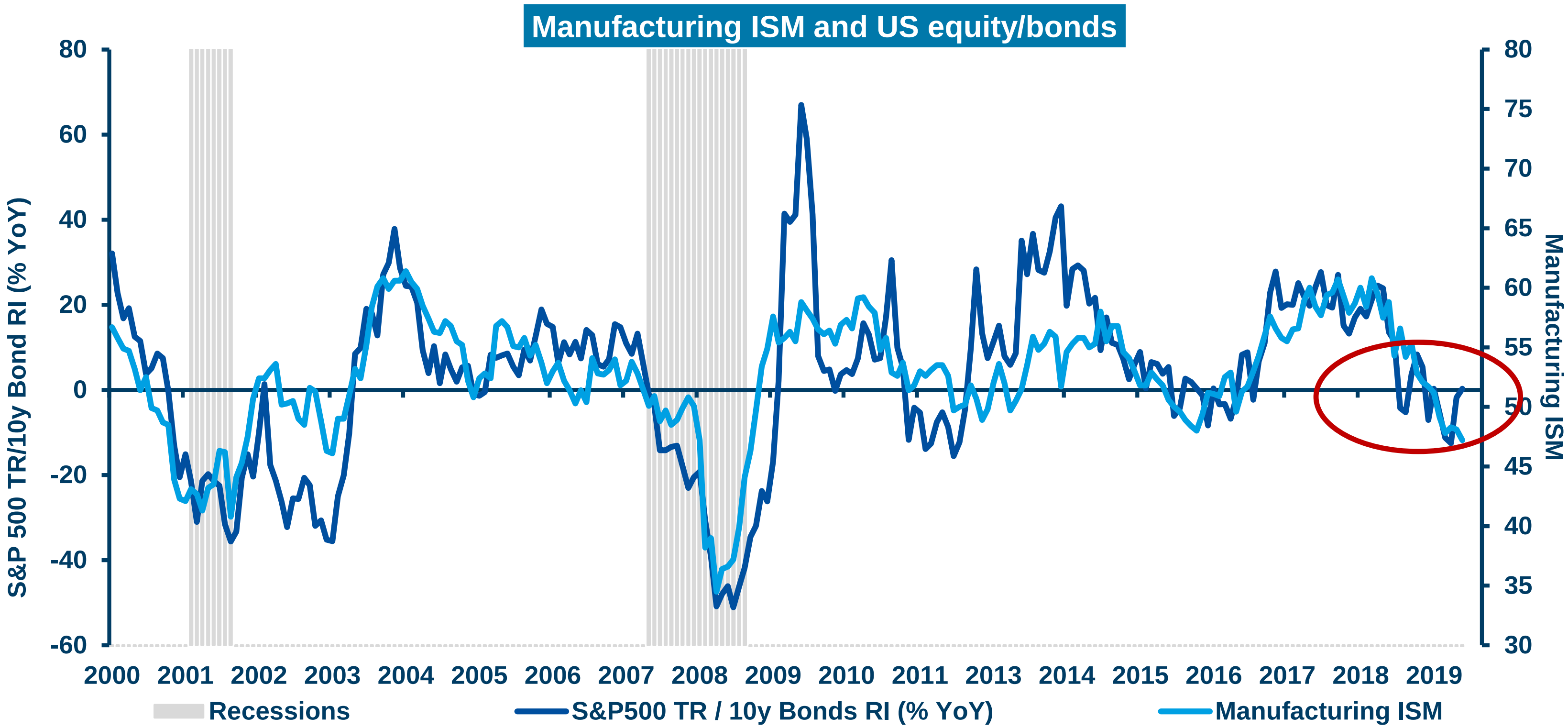
Historical evidence points to still positive returns in 2020, but with binary possible outcomes



» Following a calendar-year rise of at least 25% -- we compute 18 such occurrences since 1927 -- the S&P500 index returned positive results during the following year in 12 instances (or 67% of times), while returns were negative in 6 instances (or 33% of times). The overall average return in the following year is 6%.

Source: Amundi Research, analysis on Bloomberg data as of 16 January 2020.

Fundamental reasons for a continuation of the bull market



» The Manufacturing ISM index could bottom out, allowing the US bull market to continue throughout 2020; the favourable geopolitical landscape should provide a window of opportunity, at least until the electoral campaign for the upcoming presidential election officially gets underway.

Source: Amundi Research, analysis on Bloomberg data as of 7 January 2020. S&P 500 index is in total return terms. For 10y bonds, coupons are reinvested.

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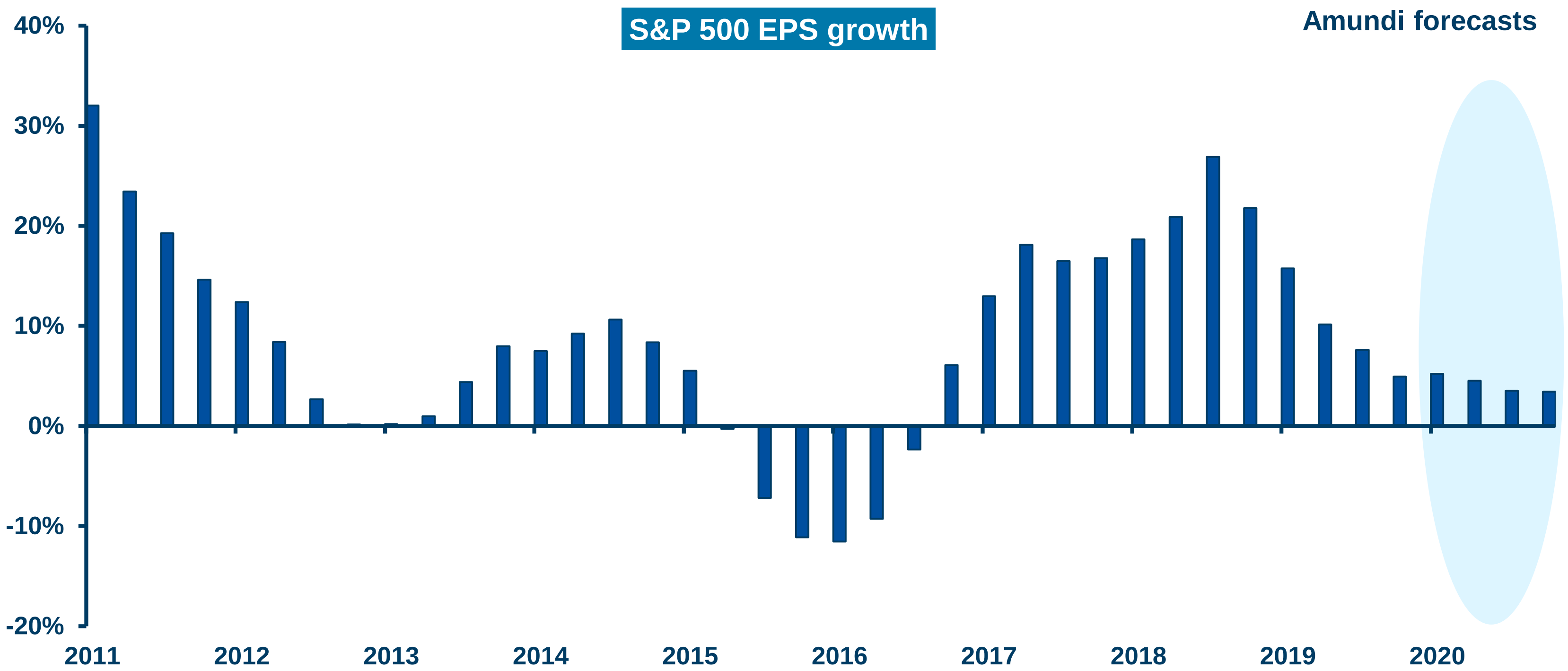
S&P 500 EPS growth in mid-to-high single digit in 2020



We expect US earnings growth to be mid- to high-single digit, aided by a recovery in manufacturing activity. Earnings growth will also be helped by easy comparisons in some cyclical sectors, such as energy and materials, where earnings were depressed in 2019.

Source: Amundi Research, analysis on Bloomberg data as of 31 October 2019.

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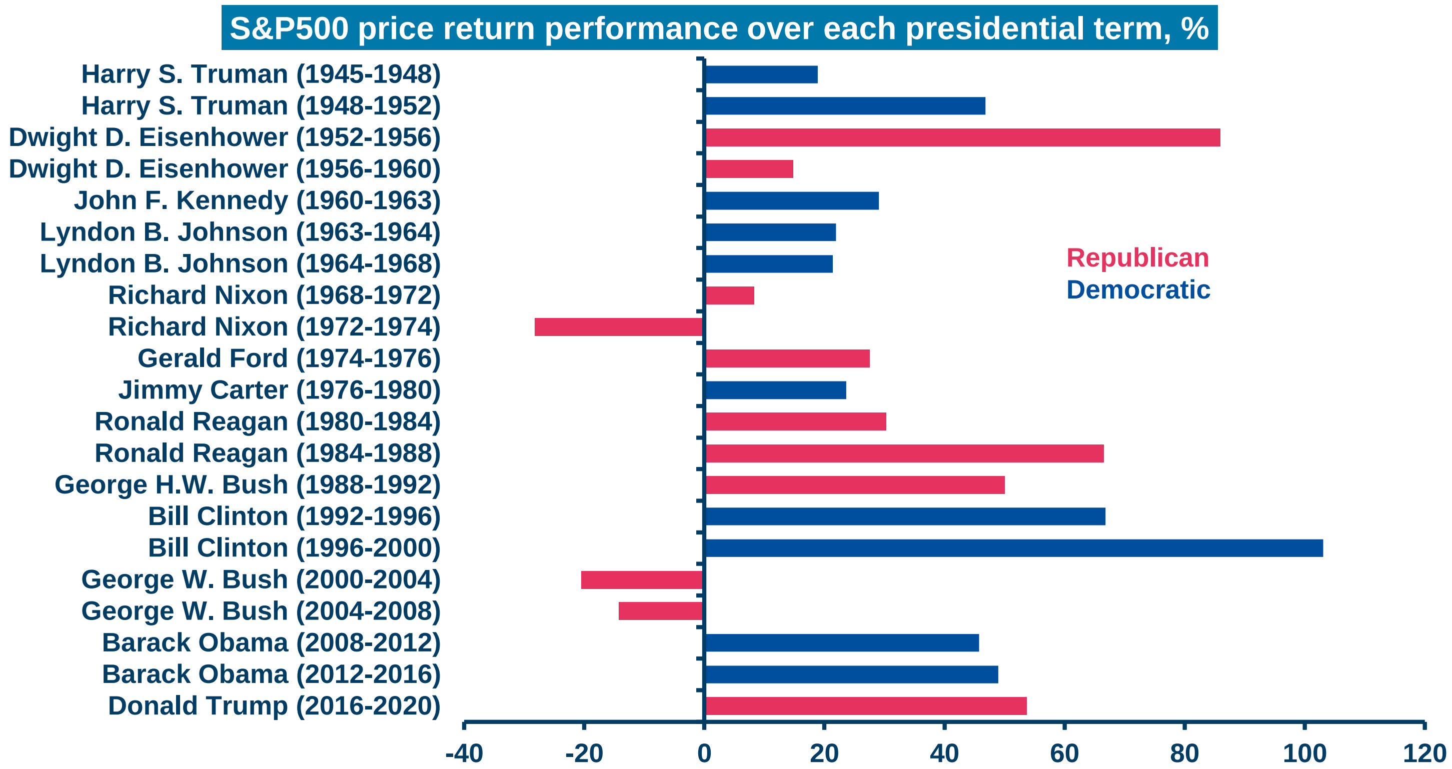
Presidential election will be a key factor this year



» Since World War II the US equity market performance has been shaped primarily by the business cycle momentum and secondly by economic policies pursued under different presidents, as different policies may cause sector/single stock rotation.

Source: Bloomberg data on S&P 500 index and Amundi, as of 7 January 2020. President Roosevelt died in office on 12 April 1945 and Harry S. Truman took office on the same day. President Kennedy died in office on 23 November 1963 and Lyndon Johnson took office on the same day. President Nixon resigned from office on 9 August 1974 and Gerald Ford took office on the same day.

Key bottom-up themes in US equity market for 2020

Industry/Theme	Rationale
Cyclical versus defensive stocks	Valuations are more attractive in cyclical sectors than in defensive sectors. A resolution of the trade issues with China, coupled with a recovery in manufacturing activity, could cause growth to reaccelerate and cyclicals to outperform in 2020, with defensive sectors lagging.
Financials to benefit from cyclical upswing	Financials should be among the biggest beneficiaries if economic growth reaccelerates. The yield curve has steepened in anticipation of stronger growth, boding well for banks as they lend at long-term rates and borrow at short-term rates.
Specific consumer/retail	The US consumer segment is healthy, thanks to job and wage growth. We favour companies that prosper even in an e-commerce-dominated retail landscape. A critical success factor for these companies is the ability to manage margins.
Structural winners in tech, with decent valuations	There are still opportunities in the sector, specifically those companies with strong secular tailwinds such as the adoption of cloud infrastructure. A recovery in economic growth would benefit segments of technology that are economically sensitive. The semiconductor industry has consolidated, making the downturns less severe and recoveries more sustainable.
Healthcare volatility is likely	The sector will be volatile as the presidential election season gets under way. Progressive Democrat candidates favour healthcare reform, which could weigh on health insurers. Medical technology stocks are a safer haven, given the low likelihood that healthcare reform would impact their businesses.
Utilities appear overvalued	In a low-interest rate environment, regulators may opt to lower the allowed rate of return for utilities. The sector is also vulnerable to the shift to alternative energy.

Source: Amundi, as of 10 January 2020.

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Risks to watch, currently with low probability

Geopolitical developments could prove more fragile than anticipated and the long-term relationship between China and the United States could deteriorate

Other international geopolitical risks could flare up (e.g., Turkey, Middle East tensions)

Domestic political developments could be adverse and include Trump's possible, but unlikely, removal from office or the emergence of a populist Democratic candidate

Deteriorating US domestic economic growth, with weak manufacturing and services sector performance

Source: Amundi, as of 10 January 2020.

03

Fixed income: attractive yields in range-bound markets

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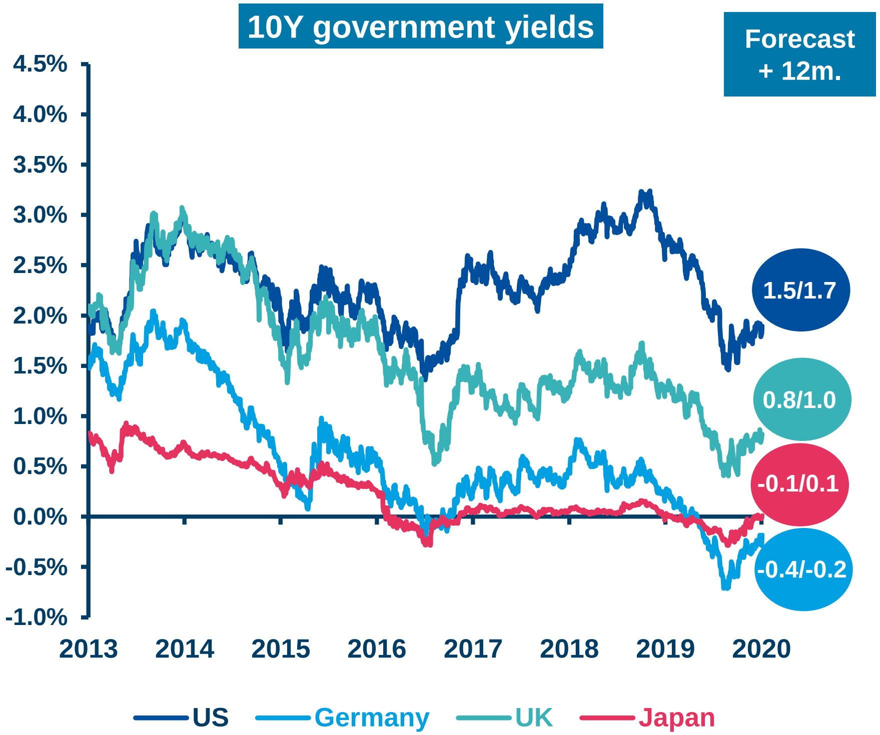
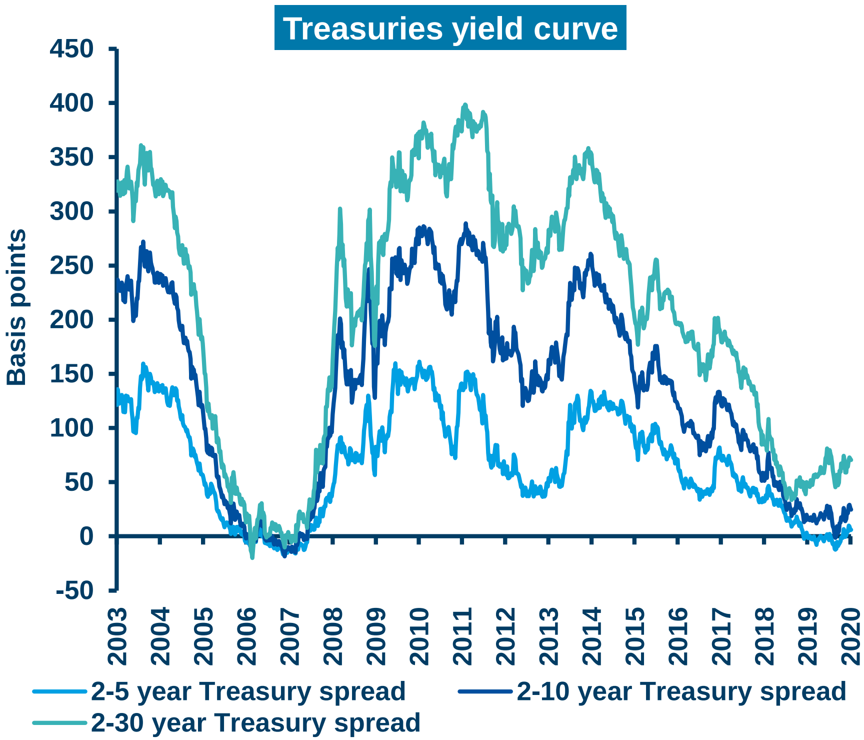
10-year bond yields in trading range, opportunities from steepening



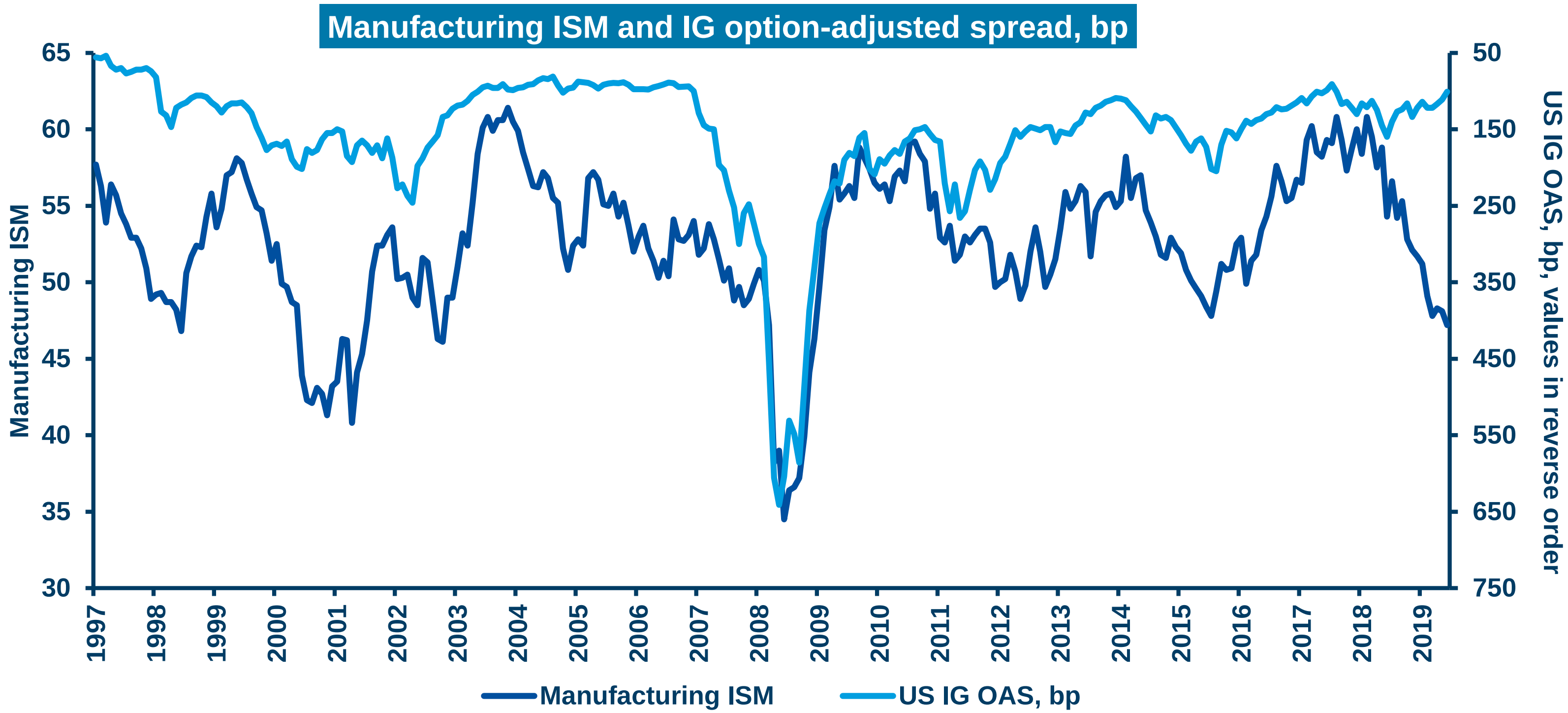


US Treasury yields will be dependent on macroeconomic and political risks. We foresee limited upside on US yields, with potential opportunities in a trading range and neutral duration positioning and a focus on steepening.

Source: Bloomberg, forecasts by Amundi Research as of 10 January 2020

Source: Bloomberg, Amundi. Data as of 14 January 2020

Benign fundamentals and technicals to support credit markets



» The recent stabilisation of the Manufacturing ISM index, together with the positive developments on global trade, bodes well for a reduction of the valuation gap between spreads and leverage. Such a reduction will be driven by the bottoming out of leading indicators rather than by a widening in credit spreads,

Source: Bloomberg, BofA-ML, Amundi Research. Data as of 7 January 2020

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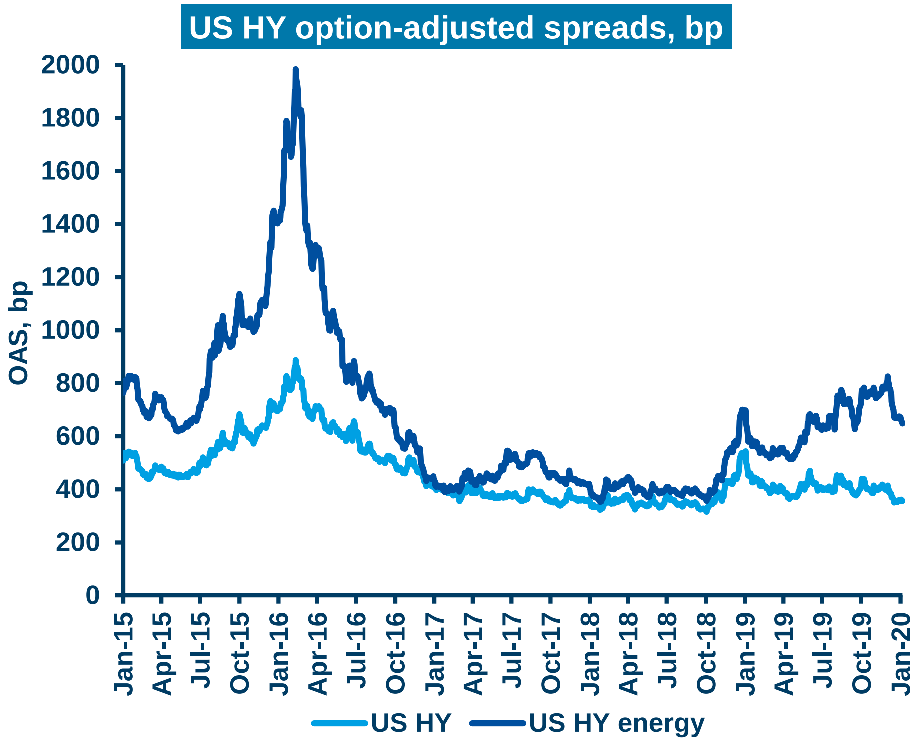
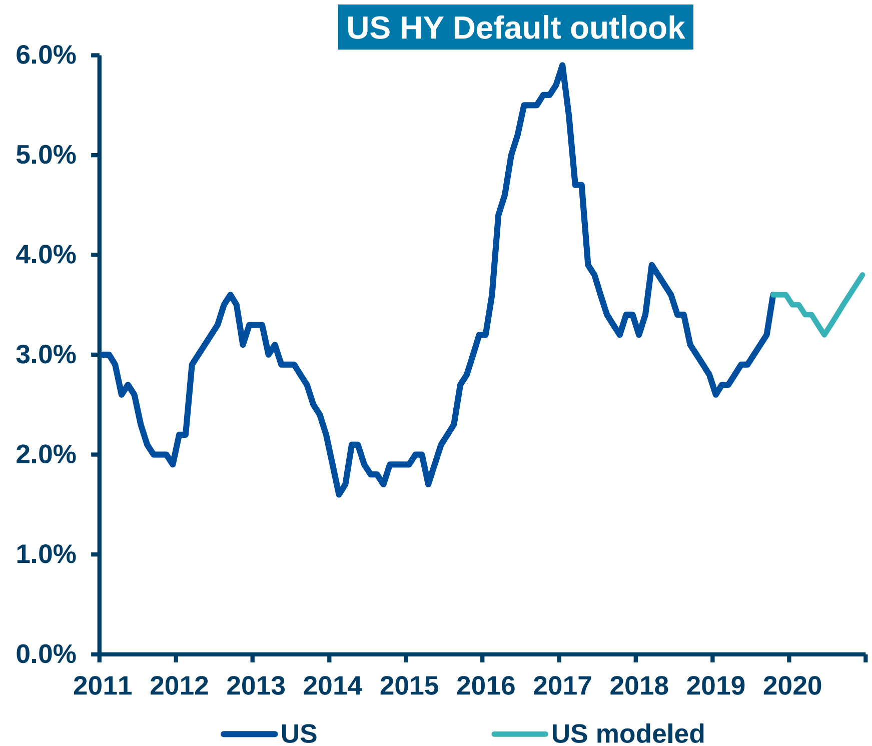
High-yield default outlook benign but selectivity is key



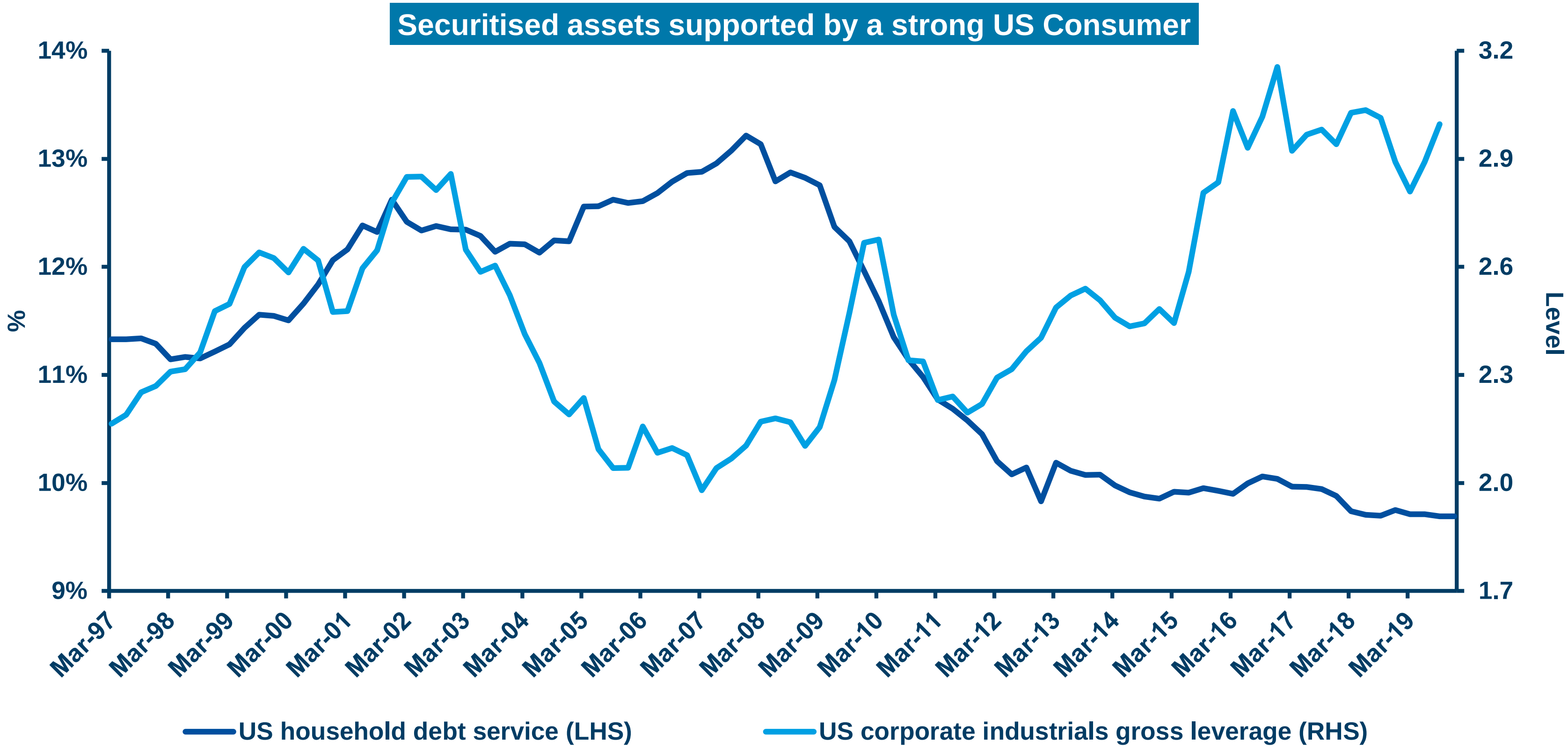


» US corporations have elevated levels of leverage which are affordable with low interest rates. Watch for stress in the event of higher rates; spreads are grinding towards multi-year tights. High yield is attractive on an idiosyncratic basis and selection is key.

Source: Bloomberg, BofA-ML, Amundi Research. Data as of 7 January 2020.

Source: Moody's, Amundi Research. Data as of 10 January 2020.

Targeting consumer credit over corporate credit



» We favour securitised assets leveraging on the consumer sector rather than the corporate sector, thanks to stronger consumer balance sheets and the market reforms that have taken place since the crisis, while US corporate leverage has been increasing again since 2015.

Source: Bloomberg, Amundi Research. Data as of 16 January 2020.

Role of US fixed income in a global portfolio

Rationale | Opportunities

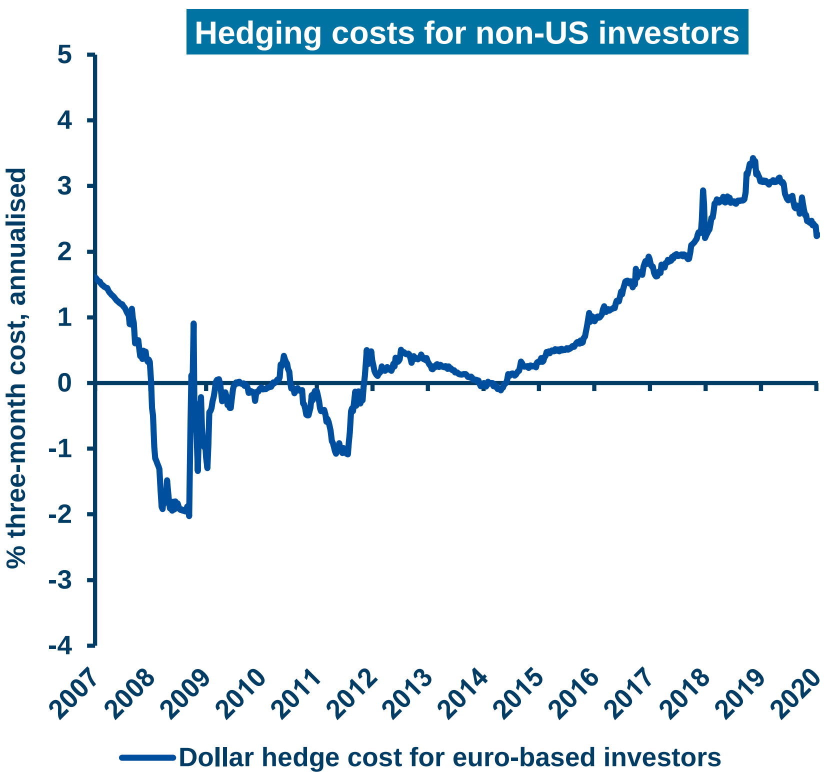
Total return opportunities

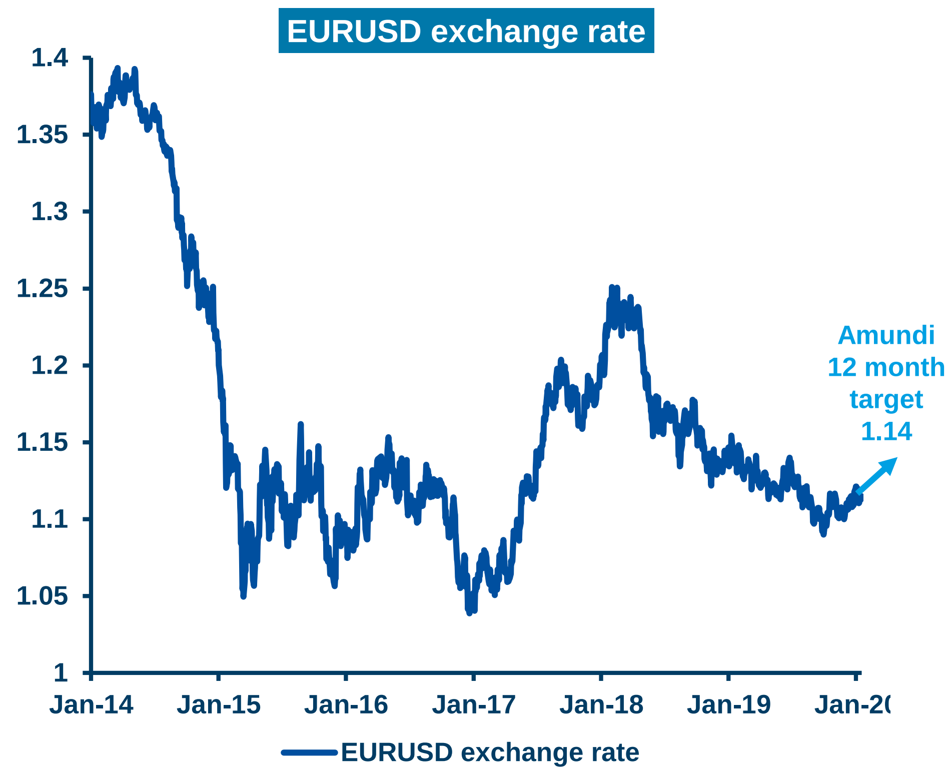
US fixed income offers **attractive return opportunities**, as Treasuries enjoy **appealing yield differentials compared with other bonds**. It is a mature and diversified market that offers opportunities in a **broad range of asset classes**, including **securitised assets**. Such returns remain **attractive despite the hedging costs** for euro-based investors, currently at 2.4%.

Liquidity and diversification

As the largest government bond market globally, US fixed income offers **diversification opportunities vs equities**, while warranting **high liquidity levels**.

Hedging cost is falling, the USD should remain close to current levels





» Hedging costs for non-US investors have dropped thanks to the Fed rate cuts. This makes the US asset appealing for non US-dollar investors. We expect the EUR/USD at 1.14 on a 12M basis.

Source: Bloomberg, BofA-ML, Amundi Research. Data as of 7 January 2020.

TO sum up: Key convictions on US assets for 2020

Bonds

We favour a **neutral/short duration** stance and expect a **steepening** of the yield curve. Stabilising growth and the dovish Fed stance will support **credit markets**. We favour **high-quality carry** with an increasing **focus on liquidity**. **Securitised assets** offer carry opportunities.

Equities

The bull market could continue, and the electoral outcome will affect sector rotation and drive some volatility. An acceleration in EPS growth in the first half of 2020 should sustain the momentum. One area that needs attention is the high market concentration.

USD

Limited countercyclical fiscal policies outside the United States and the still high US rates differential vs the entire G10 spectrum **should prevent any material dollar weakening.**

Cross Assets

Equities are likely to offer **higher return potential** than fixed income.

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Definitions

- **ABS:** Asset-backed securities. These are financial securities such as bonds, which are collateralised by a pool of assets, possibly including loans, leases, credit card debt, royalties or receivables.
- **Basis points**: One basis point is a unit of measure equal to one one-hundredth of one percentage point (0.01%).
- **Bond ratings**: Source: Moody's and S&P. If the ratings provided by Moody's and S&P for a security differ, the higher of the two ratings is used. Bond ratings are ordered highest to lowest in portfolio. Based on S&P measures: AAA (highest possible rating) through BBB are considered investment grade; BB or lower ratings are considered non-investment grade. Cash equivalents and some bonds may not be rated.
- **Cyclical vs. defensive sectors**: Cyclical companies are companies whose profit and stock prices are highly correlated with economic fluctuations. Defensive stocks, on the contrary, are less correlated to economic cycles. MSCI GICS cyclicals sectors are: consumer discretionary, financial, real estate, industrials, information technology and materials, while defensive sectors are consumer staples, energy, healthcare, telecommunications services and utilities.
- **Curve steepening**: A steepening yield curve may be a result of long-term interest rates rising more than short-term interest rates or short-term rates dropping more than long-term rates.
- **Default rate:** % issuers that failed to make interest or principal payments in the prior 12 months. Default rate based on BofAML indexes. Universe consists of issuers in the corresponding index 12 months prior to the date of default. Indexes considered for corporate market are ICE BofA Merrill Lynch.
- **Duration:** 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.
- **Growth investment style** aims at investing in the growth potential of a company. It is defined by five variables: 1. long-term forward EPS growth rate; 2. short-term forward EPS growth rate; 3. current internal growth rate; 4. long-term historical EPS growth trend; and 5. long-term historical sales per share growth trend. Sectors with a dominance of growth style: consumer staples, healthcare, IT.
- **MBS, CMBS, ABS**: mortgage-backed security (MBS), commercial mortgage-backed security (CMBS), asset-backed security (ABS).
- **Spread:** The difference between two prices or interest rates.
- **Value style** means purchasing stocks at relatively low prices, as indicated by low price-to- earnings, price-to-book, and price-to-sales ratios, and high dividend yields. Sectors with dominance of value style: energy, financials, telecom, utilities, real estate.
- **Yield curve steepening**: If the yield curve steepens, this means that the spread between long- and short-term interest rates widens. In other words, the yields on long-term bonds are rising faster than yields on short-term bonds, or short-term bond yields are falling as long-term bond yields are rising.

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Duration: 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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Date of First Use: 16 January 2020.