CENTRAL & ALTERNATIVE SCENARIOS

Monthly update

This month, we amend the narrative of our central and downside scenario to take into account a larger than expected Covid second wave in Europe and delayed fiscal support in the US. We reduce the probability of our central scenario from 70% to 65% and increase the probability of the downside scenario from 20% to 25%,

DOWNSIDE SCENARIO 25%

Secular stagnation

Analysis

- Protracted economic downturn
- Due to uncertainty (lack of visibility), policy multipliers in place are low: financial conditions tighten, liquidity does not feed through to the real economy, the labour market deteriorates further
- Economic crisis evolves into a financial crisis forcing policymakers to move even more in uncharted territory (nationalisations? negative rates? helicopter money? etc.)
- Protectionism and deglobalisation accelerate, negatively affecting trade and global value chains.
- Global potential growth is seriously weakened and pockets of inflation emerge.

Market implications

- Favour cash and US Treasuries
- Favour gold, CHF, Yen
- Play minimum volatility strategies

CENTRAL SCENARIO 65%

Multi-year and multi-speed recovery

Analysis

- Multi-year process to get the world back to order
- 2021 may see a sequence of economic relapses/infections outbreak/selective lockdowns/ policy boosters (our working assumption is that vaccines/ treatments won't be available before H2 2021). Don't rule out a short-lived double dip (Q4)
- Low growth, low inflation, low rates: "unconventional" monetary policies to persist to cope with rising debts. Strong political commitment to mobilise fiscal policies in AEs, but execution is a material risk.
- Global trade to global GDP ratio expected to slip further.
- The Covid crisis exacerbates income and wealth inequalities (risk of increased social tensions)

Market implications

- Contained steepening of US yield curve
- Progressive rotation from credit HY into equity
- Maintain income pockets: EM bond, IG
- Equity thematic are sector and more domestic driven
- Favour gold on pervasive uncertainty, deflation and recession fears

UPSIDE SCENARIO 10%

V-shaped recovery

Analysis

- Rapid development and wide distribution of safe, effective vaccine/ treatments. New outbreaks are avoided.
- Productivity boosts on new digital /green developments or faster normalisation of recovery. With lower uncertainty, policy boosters feed through to the real economy and financial markets, closing gap between manufacturing and service sectors.
- Sustainable recovery and diminishing need for further (fiscal) policy support

Market implications

- US curves steepens (in particular on the long end) on economic recovery and inflation expectations
- Favour risky assets
- Favour linkers, gold as inflation hedge

Covid-19 update

THE DISEASE: new global hotspots emerging

- The Covid-19 death toll is accelerating again amid a remarkable resurgence of infections. At the time of this writing, India's fatalities are on the rise, while Central and South America are the current epicentre of the pandemic. Renewed global hotspots are affecting the Netherlands, Spain, France, Austria and the UK, with caseloads reaching new highs (partly explained by the ramp-up in testing activity). Several states are imposing curfews and seem reluctant to impose lockdowns. Ireland is back to a full lockdown except schools. Near-term downside risks for euro area PMIs and European equities are increasing.

THE SOLUTIONS: advances in testing and treatments continue on a bumpy road

- Medical solutions are tracked on the basis of: (1) diagnostic testing; (2) antibodies therapy and (3) vaccine.
  1. A new PCR-based saliva test (Nine) is available and available on the US market.
  2. Some progress occurred with a new cocktail based on two separate antibodies (Regeneron). Response has been strong in particular in patients given the medicine early in the disease progression.
  3. Pfizer/BioNtech expect efficacy results by the end of October. Recently, J&J paused any further dosing in its phase 3 trial, due to an unexpected illness in a study participant. The timeline still points to 2H21.

TOP RISKS

Monthly update

Risks are clustered to ease the detection of hedging strategies, but they are obviously linked. We maintain the overall narrative and probabilities on the risk outlook with the pandemic exacerbating existing fragilities and vulnerabilities.

ECONOMIC RISK 20%

— **A double-dip recession is a distinct possibility in several countries**
- Although our ability to deal with the virus has improved (treatment, health infrastructure, and social distancing), the 2nd wave and partial lockdowns may trigger a W-shaped recovery: after a technical rebound (Q3), the global economy is set to slow markedly in Q4 2020, with growth possibly falling in negative territory.
- While all policy efforts and social benefits have been/will be activated to preserve personal income, the deterioration of the labour market might still weigh on the recovery looking ahead

— **Disinflation in the short run / upward inflationary pressure in the medium term**
- QE programmes (which will likely be extended) may become problematic during a recovery when inflation enters the equation. The risk is very low in the short run but upward pressure are expected to build over time, as the epidemic fades away.
- The Fed is moving to average inflation target and the ECB is considering moving in the same direction (among other options)
- Inflation dynamics and the CB reaction function could be sources of uncertainty. In particular, EM inflation is at an inflection point but the trend ahead remains comfortable due to depressed demand (watch Turkey, India and Mexico)

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

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

FINANCIAL RISK 20%

— **Mounting corporate vulnerability**
- Prior to the Covid-19 crisis, corporate leverage reached levels above pre-GFC highs
- The magnitude of the recession will increase solvency risks regardless of central banks' actions and government guarantee schemes
- Default rates could rise to 15% or even 20% with spillover into the credit market and stress on banks' balance sheets

— **Sovereign debt crisis**
- Public debt will rise as a share of GDP across most countries in the coming years, starting from already high levels in Europe, Japan and the United States. This could lead to rating downgrades and rising interest rates over the long term
- Emerging market fragilities (single commodity exporters, tourism), could also face a balance of payment crisis and increase default risks
- Risks incurred in implementing the European Recovery Fund should not be underestimated. Dissensions among EU members could bring back EZ periphery bond risk

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

- Oil, risky assets, frontier markets and EM

(GEO)POLITICAL RISK 20%

— **Contested US elections**
- The post voting process is already under scrutiny and the outcome won't be clear on Election Day.
- A legal dispute over the results could drag on for weeks
- Although it's unlikely there won't be a President for Inauguration Day, the political uncertainty could climax end November early December

— **US / China tensions**
- The equally hawkish tone from Democratic Party brings new policy uncertainties to the bilateral relationship in a Biden-win scenario.
- Possible accidental confrontations in the South China Sea or the Taiwan Strait

— **Hard Brexit**
- A no-deal Brexit in the context of partial lockdowns could push the UK in a deep recession with spillover effects on the EU.
- With or without deal, the UK will be outside the EU in 2021, and a phase of adjustment to the new framework will begin. As the UK will try to get trade deals outside the Single Market with potentially better terms, it could create tensions between EU members with similar economic priorities

— **Instability within and among EM countries**

+ 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

- The recovery in economic activity continued in October, despite slowing down significantly as affected by the new surge of Covid-19 cases across the globe.
- The softening momentum is further highlighted by the Citi Economic Surprise Index, which continues its downward reversion both in the EZ and in the US.
- Soft and hard data confirm the softening trend and sector divergence, with manufacturing sector holding up better than services.
- Yet, increasingly stricter mobility restrictions increase the risk of a contraction in activity the fourth quarter.

FUNDAMENTALS & VALUATION

- **Risky assets look less expensive as EPS start to gradually recover.**
- Equities' absolute PEs are still higher than their historical average even considering high 2021 EPS expectations. The equity risk premium and PE adjusted for CB liquidity injections favour equities in terms of relative value.
- So far, CBs have prevented any significant market correction since April, providing strong support to risky assets.

DEFENSIVE ASSET ALLOCATION

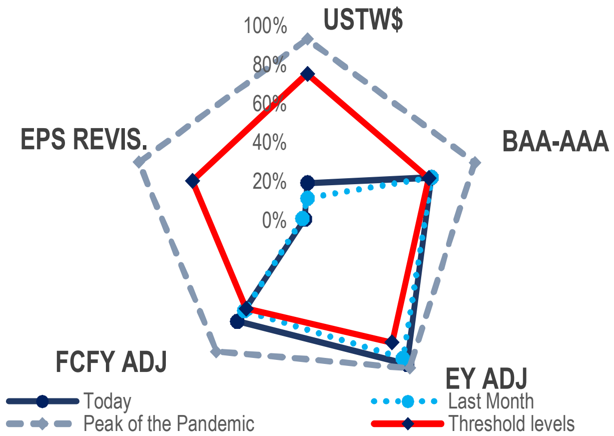
TECHNICALS

- Technical signals have strongly supported the first leg of the rebound in risky assets since March.
- Momentum, the strongest market mover since the summer, turned out less supportive this month. Seasonality, US election risk and a potential second round of restrictions have weighed on risky assets since the beginning of September.
- From a contrarian standpoint, markets are not overstretched any more though, as the recent sell-off has normalised the picture.
- Technicals remain thus overall neutral, as trend following signals and contrarian indicators compensate each other

SENTIMENT

- CAST remains the strongest contributor. EPS revisions have rebounded, and the USD depreciation has added support. The credit risk premium (Moody's BAA-AAA) remains around the alert threshold, but it's not enough to offset the call.
- Financial conditions eased further over the summer, as central banks pushed appetite for spreads products higher.
- Cross asset flows (based on State Street data) confirm the mild pro-risk stance. Although appetite for high beta and cyclical segments moved lower in September, the overall flows scorecard remain in neutral+ territory.

Cross Asset Sentinels Thresholds (CAST) still supportive



Amundi Research, Data as of 26 October 2020

CAST flags extremely low risk perception.

Sentinels remain in pro risk territory due to a general improvement in all the 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 Adjusting our central scenario to the impact of the 2nd wave

- The Covid-19 2nd wave is much stronger than expected in many European countries while the situation has also recently deteriorated in the US. Latin America has become the epicentre of the pandemic.
- Authorities have to choose between public health i.e. lockdowns and economic wealth. In Europe, the priority is clearly to maintain public health.
- Despite medical advances and treatments, we are still in the grip of Covid-19 a year after it appeared in China and a vaccine is still not available.
- This changes the balance of risk in our scenario analysis. We increase the probability of the downside scenario from 20 to 25% (deep recession/ secular stagnation) and reduce the central scenario probability to 65%.

2 Q4 GDP growth may return in negative territory

- After the technical rebound, the global recovery is confirmed smoother. We expect weaker growth both in the US and in Europe. We do not rule out a mild double dip in our central scenario.
- High frequency indicators in aggregate show a flattening curve.
- The service sector continues to suffer with increasing divergences with manufacturing. Tourism, leisure and consumer-facing activities remain highly disrupted. The situation will mechanically deteriorate further in economies subject to new restrictions.

3 Emergency measures are back, with the blessing of CBs

- Emergency measures are back. The second wave will once again increase the pressure on policymakers to act. The major central banks (notably the Fed and ECB) are calling on governments to do more. This means that CBs will (when possible) continue to support their efforts, by increasing their asset purchase programmes.
- This postpones until a little later the need to implement stimulus plans (infrastructures in the US, Recovery fund in Europe).
- Execution of structural/medium term oriented /fiscal measures remain however key. In Europe, the EU recovery plan is in the national approbation phase which might be longer than expected. 4 years after the referendum, the uncertainty on the Brexit outcome remains.
- Bad news is no longer good news. The policy mix, however proactive it may be, is not able to offset all the effects of the Covid crisis.

4 The ECB inflation challenge

- What if the risk of deflation intensifies and the euro appreciates further? This could be a dangerous cocktail for the ECB.
- A rate cut is the only effective tool that the ECB has at its disposal to combat deflationary pressure exacerbated by the euro appreciation but it would have negative side effects hosted my some members in the Council.
- Negative deposit rate and yields could weaken the euro and alleviate the burden of sovereign debt. But are a tax on the banking system despite rates tiering and may not stimulate economy with positive `reversal rate while it could endanger financial stability and remain difficult to exit. ‘
- The bar is high to cut rates (outright deflationary pressure coupled with a strong appreciation of the euro). We expect the ECB to extend its QE, in time and in volume.

The impact of the Covid-19 crisis on global social and economic inequalities

The extraordinary economic growth and social progress seen since WW2 have been underpinned by increasing wealth and income divergence across the globe, in particular in emerging economies and the United States. The steep Covid-19-driven economic recession is likely to further widen inequalities due to the combined effects of several factors. The business sectors most severely affected by the lockdown measures are those employing the highest percentage of low-income, low-education and low-saving workers, who are clearly the most exposed to sudden income changes. Similarly, the impact on young people and women is particularly severe, increasing gender and social inequalities. Despite already evident signs, the magnitude of the economic and social impact of the pandemic is extremely dependent on its length and the efforts made by governments and international authorities to counterbalance it. The extensive reliance on debt financing to fund social, welfare and labour protection schemes is driving countries’ debt burdens to historical highs, raising questions as to their sustainability, and potentially forcing governments to progressively revert to a more disciplined fiscal approach going forward. Similarly, potential pandemic-driven structural changes such as the shortening of supply chains across the globe could further accelerate inequalities in emerging economies, and also lead to significant disruptions across the developed markets. If there is uneven access to a new Covid-19 vaccine, this could be a key catalyst causing wider inequalities and leading to a multi-stage global economic recovery.

AMUNDI ASSET CLASS VIEWS

	Asset Class	View	1M change	Rationale
EQUITY PLATFORM	US	-/=		Equity risk premia are attractive relative to bonds, but this doesn't mean there cannot be volatility, particularly with respect to the election outcomes. However, expectations of continued recovery, improving earnings forecasts, and a low possibility of an all-encompassing national lockdown should support prices, particularly for the cyclical and quality components of the market. Overall, investors should play market divergences with a balanced stance.
EQUITY PLATFORM	Europe	=		The economy is improving, but resurgence of virus cases and subsequent lockdowns in the region may make the recovery bumpy. The result is extreme market dispersions, which are creating opportunities for a rotation towards cyclicals and value names for active stock pickers. We look for names with strong balance sheets and resilient business models.
EQUITY PLATFORM	Japan	=		Pro-cyclical markets such as Japan should be supported by global growth prospects and attractive valuations. However, investors should stay watchful and balanced till when there is more visibility on the growth path.
EQUITY PLATFORM	Emerging markets	=		Improving economic prospects should support EM assets, but geopolitical risks, such as the recent sanctions on Russia and US elections, coupled with the US-China rivalry for global dominance, are key variables. Nonetheless, the crisis has reinforced China's role as the global growth engine, and Asian and other economies exposed to this will benefit. With an overall neutral stance, we like the semiconductor sector and attractively valued growth names.
FIXED INCOME PLATFORM	US govies	=	▼	We stay neutral/slightly positive on US duration in our global portfolios in light of UST characteristics to provide a safeguard against an uncertain economic environment. In US portfolios, we see long-term inflation prospects and prefer TIPS to UST.
FIXED INCOME PLATFORM	US IG Corporate	=/+		The IG segment will continue to find support in monetary stimulus from the Fed, though political uncertainty may cause volatility. Investors should stay active and pare back spread duration where risks are asymmetric. We selectively like consumer and residential mortgages, given the strong consumer and housing markets.
FIXED INCOME PLATFORM	US HY Corporate	-/=		We remain cautious on HY, particularly where downside potential is higher than the potential for gains. While the market will be supported by CB action, the case for selectivity is high, given that some businesses will be unable to withstand a slow recovery.
FIXED INCOME PLATFORM	European govies	-/=		We are cautious on this space as rates are already at low levels, but remain active, with a focus on relative value trades. However, on peripheral debt, we stay positive amid continued ECB support and reducing fragmentation and political risks (particularly in Italy).
FIXED INCOME PLATFORM	Euro IG Corporate	+	▼	We believe IG spreads have tightened and there is little juice left to squeeze in this asset class, although ECB QE should provide support. We continue to prefer EUR over US, due to lower leverage in the latter, and play this through financial and subordinated debt that offer the potential of that extra yield. Overall, we maintain high focus on selection and liquidity.
FIXED INCOME PLATFORM	Euro HY Corporate	=		We recommend investors balance the need for high income with the requirement of buying quality credit at attractive prices. It is important to note that the current abundant liquidity is inflating the price of credit even for companies which will witness a deterioration of performance. So, the need for selection and cash buffers is very high.
FIXED INCOME PLATFORM	EM Bonds HC	=/+		We stay positive on HC debt, but believe there is a need for caution over the outcome of US elections and the inability of central banks in some EM to finance the governments' fiscal deficits. Investors should selectively lock in gains in IG, but, we think, there is some value left in HY names where spreads are still wide.
FIXED INCOME PLATFORM	EM Bonds LC	=		We are cautious and realise that prospects of higher rates in the US (whenever that happens) could be slightly negative for EM rates. Consequently, we stay vigilant, maintain a dynamic stance to capture any dislocations, and believe investors should book profits where upside is limited.
OTHER	Commodities			The Saudi-led supply cuts have helped clear the oversupply imbalance in the oil market. On metals, the recent sell-off in gold (and silver) is related to the concerns of higher real rates, "normal" risk-on, and a pause in asset buying by the Fed. CBs' monetary policies have been the strongest driver of gold prices and as long as they maintain this extra dovish stance any painful sell-off seems unlikely going forward. In contrast, should CBs unexpectedly change their policies, gold may be vulnerable to a serious derating, as the metal's fair value, based on traditional metrics (rates and FX), is far lower than current levels. All in all, commodities are benefiting from liquidity injections by CBs, USD and a strong CNY.
OTHER	Currencies			Given that the US has lost its economic growth and rates advantage vs the rest of the G10 countries, the USD could see a correction vis-à-vis G10 FX, provided growth revisions do not occur. If, however, UK and EZ growth disappoint, then the movement will be less pronounced. Interestingly, FX correlation with risk sentiment is elevated, as evident in September when the USD proved resilient. Therefore, there is a possibility that with the political uncertainty in the US and rising volatility, the mean reversion of the USD to its fair value may be limited. On the other hand, GBP movements will be closely linked to news flow around Brexit.

LEGEND

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	Negative		Neutral		Positive		Downgrade vs previous month	Upgraded vs previous month

Source: Amundi 26 October 2020, 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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CROSS ASSET
INVESTMENT STRATEGY

November 2020 #11

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