CENTRAL & ALTERNATIVE SCENARIOS

Monthly update

This month, we maintain the probabilities and narrative of our central and alternative scenarios. We confirm our constructive medium-term view on the “financial recovery regime”, with more caution in the short-term on financial markets, given the virus-dependent news flow and inflation concerns..

DOWNSIDE SCENARIO 15%

Secular stagnation

Analysis

- Genetic evolution of the virus drives the pandemic out of control and leads to another negative growth shock, extending the length of the crisis
- Policy mistakes and execution risks of fiscal plans undermine the recovery
- Pause or rollback of accommodative monetary policies, due to internal (asset bubble) or external (FX) constraints
- Protracted economic downturn, due to uncertainty and lack of visibility, affecting business and consumer confidence
- Economic crisis evolves into a financial crisis
- Protectionism and de-globalisation accelerate, negatively affecting trade and global value chains

Market implications

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

CENTRAL SCENARIO 75%

Multi-year and multi-speed recovery

Analysis

- Multi-year process to get the world economy back on track, with a bumpy road to recovery
- Relapses in economic growth, due to virus outbreaks and lockdown measures until 4Q21
- Massive vaccine rollouts in 1H21 though uneven across regions
- Strong political commitment to mobilise fiscal policies in AEs, but timely execution is a risk
- Accommodative monetary policies continue to support the recovery, cope with deflationary risks and rising public debt
- Positive momentum in corporate earnings and diminishing solvency risks
- Ratio of global trade to global GDP slips further but lower geopolitical tensions after the US elections
- The Covid crisis to exacerbate income and wealth inequalities (risk of increased social tensions)

Market implications

- Contained steepening of US Treasuries yield curve
- Progressive rotation from Credit HY into equities
- Equity thematics are cyclical sectors and are more domestically driven
- Maintain income pockets with EM bond, and credit IG
- Favour gold on pervasive uncertainty, deflation and recession fears

UPSIDE SCENARIO 10%

V-shaped recovery

Analysis

- Health crisis resolved by the end of 1H21, thanks to mass vaccination and efficient lockdown measures
- Sustained “vaccine- enabled” recovery
- Productivity boosts on new digital and green developments
- Faster normalisation of economic activities
- With lower uncertainty, policy boosters feed through to the real economy and financial markets, closing the gap between manufacturing and service sectors
- Sustainable growth and diminishing need for further (fiscal) policy support

Market implications

- US Treasuries curves bear steepening on fast rising growth and inflation expectations
- Favour risky assets with cyclical exposure but can undermine growth stocks
- Favour linkers and gold as an inflation hedge

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 change the probabilities of risks in light of the recent developments.

ECONOMIC RISK 20%

- **Covid-19 vaccine rollout issues**
  - Unexpected logistic or side effects issues of the vaccine could have a very negative impact on investors and business sentiment, which has improved significantly since November 2020
  - One or several virus variants that would make existing vaccine ineffective would undermine the expectations of an end soon to the pandemic
- **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 and uneven impact, could undermine the recovery and generate social tensions
- **A rebirth of inflation and a second "taper tantrum"**
  - The risk is very low in the short run, but upward inflation pressures could build up over time, as the epidemic fades away
  - QE programmes may become problematic when inflation enters the equation
  - Inflation dynamics and central banks reaction function could be sources of uncertainty, in particular in EM, where inflation is close to CBs target
  - Federal Reserve early exit or miscommunication 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 15%

- **Corporate solvency risk**
  - Prior to the Covid-19 crisis, corporate leverage reached levels above pre-GFC highs
  - The magnitude of the recession has increased solvency risks, regardless of central banks' actions and government guarantee schemes
- **De-anchoring inflation expectations** leading to the bond market dislocation
- **USD significant weakness** could push the Fed to stop its APP and negatively impact the UST market, bring deflation into the EZ and Japan, and undermine the EM recovery
- **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 increase default risks

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

- Oil, risky assets, frontier markets and EM

(GEO)POLITICAL RISK 10%

- **US/China cold war**
  - Post US elections the hawkish tone from Democrats maintains uncertainties regarding the relationship with China
  - The delisting of Chinese companies might trigger similar retaliation
  - Possible accidental confrontations in the South China Sea or the Taiwan Strait
- **Instability within, and among, EM countries** on the back of chaotic virus crisis management
- **The pandemic evolution is still one of the most important risk for EM growth,** as vaccine rollouts are quit slow
- **Global financial conditions getting tighter mainly through US yields,** could revamp the case of EM external fragility when the domestic MP stance are still extremely dovish
- **Post-Brexit**
  - 2020 ended with an exit deal but implementation of it might prove to be a lot more disruptive than anticipated
  - The City might lose market share faster than expected
  - More friction on the boarder of Ireland and tensions within the Union (election in Scotland)
  - UK exploiting the divergence and looking for competitive behaviour across the EU which would potentially undermine the EU cohesion

+ 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 levels remain evident, with Spain holding up better than Italy, France and Germany, thanks to less strict restrictions. Similarly, the manufacturing sector continues to outperform services. The consensus progressively revert downward, while economic surprises are stabilising after upticks on better-than-expected Q4 GDP data.
- In the US, after a deceleration in Q4 2020, economic activity is progressively gaining back momentum, supported by the new fiscal stimulus. Both high-frequency and soft data highlight sound private-sector business activity, with manufacturers and service providers reporting expanding business activity. The consensus keeps moderating progressively, with the economic surprise indexes trending alike.

FUNDAMENTALS & VALUATION

- After a strong YtD performance risky assets are discounting solid growth expectations and profits recovery.
- Equities' absolute PEs are still above their historical averages, though they are expected to revert going forward as profits rebound.
- The equity risk premium and PE adjusted for CB liquidity injections are less in favour of equities in relative value terms, as interest rates have moved higher and reached important technical levels.

DEFENSIVE ASSET ALLOCATION

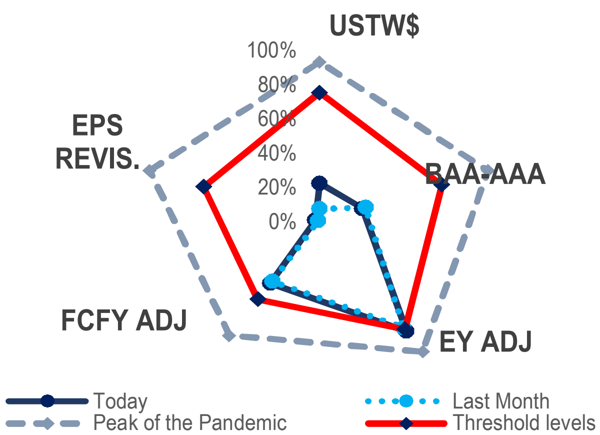
TECHNICALS

- The "risk on" tone which started with the US fiscal stimulus expected and then confirmed by the Biden Administration,should continue in 2021 .
- Signals of overbought risky markets, which materialised weeks ago, have faded a bit as RSI indicators look less stretched now and markets are in a consolidation phase

SENTIMENT

- Financial conditions remain benign despite some tentative signs of CB normalisation due to the economic recovery and vaccine roll-out.
- The USD downward trend and improved perceptions of credit conditions are the key supports for our CAST indicator, which shows a limited probability of a sell-off (CAST OFF probability < 10%).
- Additional supports come from our flow-based risk indicator, suggesting that investor appetite remains high at cross-asset levels (equities and commodities are the segments with a higher risk stance).

Cross Asset Sentinels Thresholds (CAST) still supportive



Source: Amundi Research, Data as of 24 February 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).

__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 Economy: assessing the stimulus package impact on growth and inflation

- The introduction of a new fiscal package in the $1-1.2t range would likely move the growth outlook above 6% Y in the US, with implications for higher average inflation but not for dynamics, which would be tamed by persisting high labour market slack.
- While the output gap would close by the end of 2021, the labour market slack would be absorbed more slowly, which would limit core domestic inflationary pressures. The core PCE overshoot would only be temporary.
- A bigger $1.9t package would bring upside risks to real growth and would lift the Core PCE more steadily in line with the Fed target.

2 US Treasury long-term yields have further upside potential

- The pro-cyclical fiscal policy, with additional fiscal stimulus in sight, and an accommodative monetary policy will support reflation trade, allowing real rates (at the long end) and breakeven inflation rates to move higher.
- The latest CBO projections released in September 2020 foresee a deficit of around 8% of GDP for 2021. When adding the $900bn agreed package and a potential additional $1tn, the 2021 deficit could go up to 17%.
- US 2s10s and 5s30s are expected to steepen further, driven by the real curve and higher debt issuance.
- Amundi UST 10y range for 2021 is 1,5 to 1,8%.
- Long-end breakevens have more upside potential in the medium term due to the size and speed of the economic recovery and the Fed's move to a Flexible Average Inflation Targeting (FAIT).
- We remain confident the long end will move higher. As such we don't rule out the possibility of the Fed implementing a YCC.

3 Risk assets expected to remain positive on a 12-month fwd basis

- We expect single-digit returns given our assumptions on the economic cycle and valuations.
- The current recovery phase of the economic cycle is pro-risk although with fatter tail risks than in the past due to uncertainties related to the pandemic.
- Valuations are higher as in previous recovery cycles due to central banks' ongoing monetary policy support, which leaves less room for rerating.
- Based on macro financial cycle projections (Advanced Investment Phazer) and top down valuation (fair value models), we expect single digit upside for most risky assets.

4 Super Mario in the driving seat to relaunch Italian economic growth

- Mario Draghi's appointment and the technocrats assigned to the strategic roles (ministry of digital economy, infrastructure, environment…) have been welcome by the market. This will secure the NGEU implementation process.
- BTP-Bund spread at the lowest, which renews equity investors appetite.
- Key challenges: having the "all in " government at play and maintaining cohesion across a multi-facets government.
- Italy will lead the next G20. Draghi will play a big global role in leading the meeting: multilateralism, environment and inequalities will be top priorities in the agenda.

Covid-19 situation update

by Pierre BLANCHET, *Head of Investment Intelligence*

The outbreak continues to expand across the globe with at least three active variants, more than 110m confirmed cases and 2.5m deaths according to the WHO. The Americas have overtaken Europe in number of cases and the US death toll has passed 500k. However, the trend has been reversing for several weeks, giving some hope to the Biden administration, despite the risks of another wave.

The vaccine roll-out continues. Israel is leading the race with more than half of its population having received at least one dose, follow by the UK (25% according to OWD[1]). Vaccination programmes are taking place at different speeds across the globe, and Europe is still suffering from production delays and logistics issues.

More than 15 vaccines are now available. Johnson & Johnson should get US FDA approval of its single dose refrigerated (easy logistics) product soon, which could be produced at a pace of 1bn+ doses this year. Studies show that the Pfizer and Moderna vaccines are less effective against the new coronavirus variants although at a level that would give some immune protection.

To shed light on the geopolitics of the vaccination, we compiled a sample of the countries that have reserved enough vaccines to cover more than half their population (above 15 years old). DM countries fully rely on North Am. & European providers. More than half of doses delivered in EM countries come from North Am. & European companies, followed by China (32%) and Russia (14%). Globally, North Am. & European firms contribute to 88% of the sample demand while China and Russia combined account for less than 12%[2].

[1] *Oxford's Our World in Data*

[2] *Source : Duke Global Health Innovation Center, data as of 15th February 2021*

AMUNDI ASSET CLASS VIEWS

	Asset Class	View	1M change	Rationale
EQUITY PLATFORM	**US**	=		A successful vaccination programme so far, expectations of stimulus, and the ability of companies to pass on rising input prices to consumers bode well for a profit recovery this year, which has also been hinted at by the ongoing earnings season. All this supports the rotation towards value and cyclicals. However, excessive valuations in some segments, the possibility of higher taxes, and new virus strains are crucial factors to consider. Overall, investors should remain selective.
EQUITY PLATFORM	**Europe**	=		We continue to believe this should be a year of recovery, but the need for selection is even higher now as markets are fully pricing-in a recovery, despite some ground to cover on the vaccination front. As a result, while positioning for a recovery, investors should also have exposure to quality defensive stocks, all the while focusing on fundamental analysis. Value and cyclical stocks continue to offer opportunities, along with small caps closely linked with the recovery.
EQUITY PLATFORM	**Japan**	+		We remain positive on Japan in light of an improving global economic situation, given the market's cyclicals and industrials tilt. The country's improving shareholder focus and growing return on equity is not yet appreciated by the market.
EQUITY PLATFORM	**Emerging markets**	++		EM, despite some concerns over Covid-19, offer attractive bottom-up opportunities (particularly EM Asia) as the region's growth prospects remain intact. However, the evolution of US-China relation is an important factor. We stay active in the heterogeneous EM world, focusing on stock selection and valuations, and looking for catalysts for sustained dividend yields and robust businesses. At a geographical level, our favoured countries are India, Russia and Greece.
FIXED INCOME PLATFORM	**US govies**	-/=	▼	We are now cautious USTs in global fixed income, due to discussions of massive fiscal stimulus and rising inflation expectations, even as we believe the Fed would not allow yields to rise too much. Therefore, an active stance is required. We are even more positive on TIPS now. From a US perspective, we believe curve steepening will continue amid an improving economy.
FIXED INCOME PLATFORM	**US IG Corporate**	=		We remain neutral/positive on IG but favour specific stories over a full market exposure, indicating our preference for an active, selective style. In securitised credit, the housing mortgage market remains very strong due to demand and robust consumer earnings and savings.
FIXED INCOME PLATFORM	**US HY Corporate**	=		HY continues to offer attractive carry in a yield-starved world. However, this excess income must be defended through a robust sector and security selection process. US HY defaults should finally move lower from Q1 peaks in Q2 but are still expected to remain above long-term historical averages.
FIXED INCOME PLATFORM	**European govies**	-/=		We remain cautious on core Euro bonds, and constructive on peripherals as the latter still provides modest but positive yield. On peripheral debt, we remain moderately positive on Italy given that the Draghi effect should stabilise the political situation, although spread compression has been very strong and attractiveness has declined vs the previous month.
FIXED INCOME PLATFORM	**Euro IG Corporate**	=/+		Amid ECB support for the markets, rates are expected to remain lower for longer and this warrants a continuous search for carry in EUR IG, particularly in the BBB-rated category. However, investors can benefit from slight adjustments favouring short-dated instruments and those supported by the ECB.
FIXED INCOME PLATFORM	**Euro HY Corporate**	=		We aim to strike a balance between high yield and high quality through a research-driven process as we believe markets will differentiate low quality credit from high quality even more in the future. As a result, selection is important.
FIXED INCOME PLATFORM	**EM Bonds HC**	=/+		EM HC continues to offer attractive yields, but we see better risk-reward in HY, and while spreads are tighter, there is still room for compression. HY is in a better position to cushion the widening effect of UST yields, but selection is important.
FIXED INCOME PLATFORM	**EM Bonds LC**	=/+	▼	While staying overall positive on LC, we acknowledge the strengthening USD and rising rates, and are slightly more selective. We believe we are at the end of the rate cut cycle in EM and see some CBs becoming more hawkish. On local rates, we remain selective due to inflationary pressures.
OTHER	**Commodities**			Cyclical commodities and base metals should gain in light of the positive economic momentum, despite some vulnerabilities related to the pandemic. In particular, oil is expected to stay around current levels in coming months, but an overshooting in the near term is possible. Among precious metals, gold is likely to continue to be supported by dovish central banks, even though there are some concerns on monetary policy normalisation and higher real rates.
OTHER	**Currencies**			Different forces are at play in the FX market. While reflationary forces suggest the USD downward trend has some room to go, the USD exceptionalism already seems to be back in play. We are positive on the CAD (vs the USD and CHF) and NOK (against the EUR), due to expectations of a global economic rebound and interest rate advantages. Low-yielding FX, such as the CHF, could struggle the most in the current environment while the UK's successful vaccine rollout so far is a positive for the GBP. As a result, we have a constructive view on the GBP/CHF.

LEGEND

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	Negative		Neutral		Positive		Downgrade vs previous month	Upgraded vs previous month

Source: Amundi 20 February 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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Document issued by Amundi Asset Management, "société par actions simplifiée"- SAS with a capital of €1,086,262,605 - Portfolio manager regulated by the AMF under number GP04000036 – Head office: 90 boulevard Pasteur – 75015 Paris – France – 437 574 452 RCS Paris – www.amundi.com
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