

the day after

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*Climate
change
post
Covid-19:
A crisis at a
crossroad*

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“Never let a good crisis go to waste”

Sir Winston Churchill

I. Introduction

This year was supposed to be the year when policymakers, corporates and investors charged ahead in the fight against climate change. After the disappointing COP25 in Madrid, shocking wildfires in Australia at the end of 2019, an ambitious plan emerged from the European Union to tackle climate change head on with its Green Deal. Instead, 2020 has become the year of the coronavirus pandemic. COP26 has been postponed, climate strikes have been cancelled and the European Commission’s ability to push through the Green Deal has yet to be proven. However, while the global lockdowns are sure to make a dent in global emissions for 2020, it remains to be seen whether climate change will fight its way onto the agenda into the recovery period or become sacrificed yet again. This is cause for concern. As Christiana Figueres recently wrote in an article for The Financial Times: “We cannot jump out of the frying pan of the pandemic and into the fire of exacerbated climate change¹.”

In this new edition of the “Day After” series, where we explore the impact of the coronavirus on investors, we look at what the coronavirus could mean for climate change in the near and medium term.

“For investors, integrating climate change risks and opportunities into their investment guidelines is an absolute necessity in our view.”

The path that climate change is going to take, and the political and private sector reactions to this, could vary widely, with differing consequences for investors. For instance, a timid response to climate change now may trigger a brutal policy response in the

next decade, with violent consequences on portfolios².

Our approach is the following: from a high-level and stylised viewpoint, we study three potential scenarios by considering two underlying “variables”: the political and private sector responses to the coronavirus pandemic. These responses will vary based on different factors, including the length and severity of the economic crisis, debt levels and budget constraints, lower fossil fuel prices and international coordination.

The possible paths that these two variables take will determine the outcome on climate change.

“We see three possible scenarios: the good (“green momentum”), the bad (“policy meltdown”) and the status quo.”

In the “good” scenario, we anticipate recovery measures from the coronavirus to include climate change policies, with corporates significantly stepping up their efforts to transition to sustainable business models. This would lead to a global climate change path aligned with the Paris Agreement. In the “bad” scenario, we expect recovery measures to overlook climate change, with the private sector scrambling to survive without consideration for greening its activities. This would lead to significantly diminished chances of meeting the goals of the Paris Agreement and could very well lead to a large policy backlash in the near future. In the “status quo” scenario, policymakers include lukewarm climate policies in their recovery packages, with some corporates transitioning to more sustainable business models while others do not. Undoubtedly, even under the last scenario, the world is still faced with an urgency to increase its climate change mobilisation to meet the goals of the Paris Agreement. It is important to note that we expect and hope the “good” scenario

1. <https://www.ft.com/content/9e832c8a-8961-11ea-a109-483c62d17528>

2. Inevitable Policy Response, Vivid Economics & Principles for Responsible Investing

materialises. In this regard, the “bad” scenario can be taken as the worst-case counterfactual scenario, one that warns stakeholders what could happen if our economic recovery path is not based on inclusive and sustainable stimulus packages.

What would these scenarios mean for investors? As the Nobel laureate Niels Bohr once said: “Prediction is very difficult, especially about the future.” Of course, we do not claim to be scientific in our approach: each variable has been stylised. The objective of this piece, however, is to provide a framework for investors to better understand and anticipate the different possible paths that are ahead. In all cases, as a responsible asset manager we urge and assist our clients to integrate climate change into their investment policies. Nevertheless, these can take different forms, and based on which scenario unfolds, one approach may be more relevant than another.

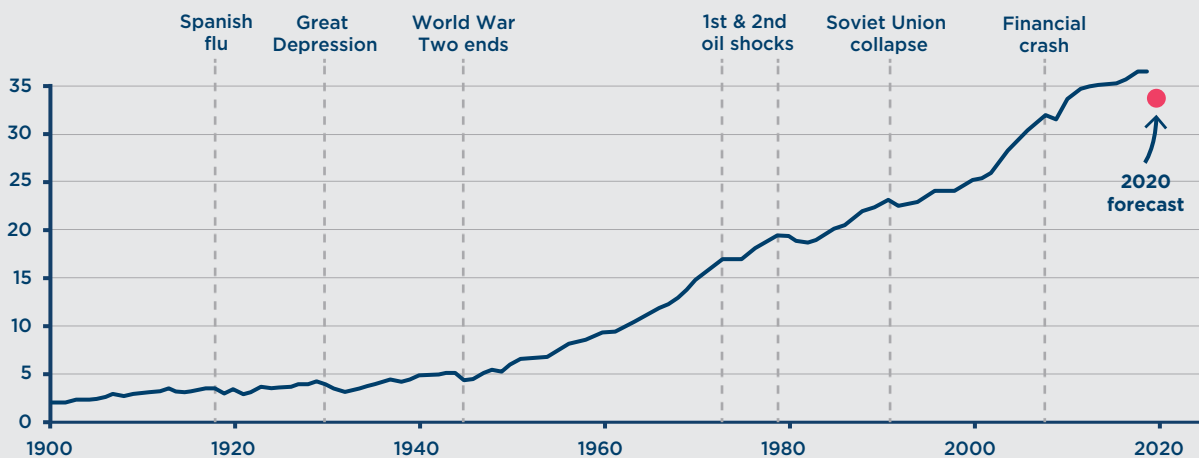
II. COVID-19 and the climate change emergency

Since the beginning of the lockdown, pollution levels have been dramatically reduced.

According to Carbon Brief³, annual warming gas emissions are anticipated to fall by 5.5% in 2020. Although this could be the largest ever annual fall in CO₂ emissions due to an economic crisis or period of war⁴, this large reduction will not be sufficient to limit warming to 1.5°C above pre-industrial temperatures, for which around an annual reduction of 7.6% of global emissions is needed⁵. Nevertheless, this large natural experiment is an unprecedented opportunity to observe what happens when humans have a restricted impact on the environment. Nature seems to have thrived in the face of human inactivity. Deer were strutting through the suburbs of Paris, distant mountains became visible in New Delhi and coyotes have even been spotted near San Francisco’s Golden Gate Bridge⁶.

This should not lead us to think that the coronavirus has solved our climate change problem. In fact, it may even hinder it if the response undermines or slows down climate policies and investments. For instance, the 2008 financial crash led to a very small one-off reduction in CO₂ emissions, but the gains made were completely erased in the following years⁷.

Figure 1: Global CO₂ emissions, 1900-present
Billion tonnes of CO₂ per year



Source: Global Carbon Project, CDIAC & IEA.

BBC

3. [https://www.carbonbrief.org/analysis-coronavirus-set-to-cause-largest-ever-annual-fall-in-co₂-emissions](https://www.carbonbrief.org/analysis-coronavirus-set-to-cause-largest-ever-annual-fall-in-co2-emissions)

4. [https://www.carbonbrief.org/analysis-coronavirus-set-to-cause-largest-ever-annual-fall-in-co₂-emissions](https://www.carbonbrief.org/analysis-coronavirus-set-to-cause-largest-ever-annual-fall-in-co2-emissions)

5. Global emissions would need to fall by some 7.6% every year this decade to keep warming less than 1.5°C above pre-industrial temperatures.

6. <https://www.latimes.com/science/story/2020-04-22/with-humans-shut-in-by-the-coronavirus-shutdown-nature-sees-an-opportunity>

7. <https://www.osti.gov/biblio/1038499>

History could repeat itself unless serious preventive measures are taken. After falling in the first quarter of the year, **CO₂ emissions in China have already started rising as economic activity resumes**, and emission drops around the world are expected to be short-lived. If this trend continues, a strong rebound in 2021 could even completely erase the temporary emission reductions in 2020. For some sectors, governments may step in to ease climate-related constraints.

In fact, **the coronavirus has set the stage for massive government interventions**. In Spain, private hospitals have been nationalised, with the United Kingdom and France possibly following with their own nationalisation plans⁸. Some have argued that with greater public tolerance for government intervention comes greater acceptance of stringent public policies to avert climate change⁹. Undoubtedly, **the private sector will also play a determining role**. How it fares during this crisis, and whether companies are willing or able to make the best of this crisis by transitioning to more sustainable business models will be a decisive factor in determining the climate change path.

Of course, it is impossible to predict the impact that the pandemic will have on climate change. Nevertheless, it is possible to build a high-level roadmap for the different scenarios that could play out.

To do so, one needs to look at the potential political and private sector responses to the outbreak and the climate change paths that arise from these responses. Hence, this study aims to shed light on the impact of the coronavirus outbreak on climate change, with an emphasis on the implications for investors. The two variables used in the scenarios are:

i) **The political response to COVID-19**, both in terms of international negotiations and the implementation of national (or regional) policies: will they include climate change concerns?

ii) **The private sector response to COVID-19**. To what extent will companies be willing or able to undergo shifts to more sustainable business models at a time when their very existences may be threatened?

The responses will result from several “risk factors”, which include (but of course are not limited to):

- The length and severity of the economic crisis: this could lead policymakers to favour the “S” in environmental, social and governance (ESG) over the “E”, while maintaining short-term pressure on corporates;
- Debt levels and budget constraints, both for public policymakers as well as corporates, will determine to what extent capital is allocated to green activities;
- Lower fossil fuel prices may challenge the relative competitiveness of low-carbon alternative solutions; and
- International coordination, or a lack thereof, may increase the perceived risk of global supply chains and hinder a coordinated response to climate change.

Taking into account the political and private sector responses, what path will climate change take in the coming years? Will we see a stabilisation of emissions, a timely and transparent implementation of climate regulation and limits to chronic and acute climate-related weather patterns? Or will 2008 unfold again, with the one-off gains quickly erased by rebounding economies? These stylised variables enable us to draw **three main scenarios: the “good” (or green momentum), the “bad” (policy meltdown) and the “status quo”**. In this context, what are the implications for investors in each of the scenarios? The investor implications are framed in the context of the level of threat of transition risk and physical risk, which stands as the best practice approach to defining the financial risks of climate change for investors¹⁰. Under all of the scenarios, even the good

8. <https://theconversation.com/what-will-the-world-be-like-after-coronavirus-four-possible-futures-134085>

9. <https://www.ft.com/content/052923d2-78c2-11ea-af44-daa3def9ae03>

10. It is important to note that the actual COVID-19 crisis should not have any direct impact on physical risks per se, but the response to the crisis, from policymakers and corporates, will certainly have an impact down the line.

Table 1: Possible scenarios for climate change and investment implications

	The Good	The Bad	The Status Quo
Political response to COVID-19	Strong political response to COVID-19 includes forward-looking climate policies that foster sustainable growth.	Lack of international cooperation and the rise of nationalism and protectionism undermine a sustainable recovery.	International negotiations struggle, while policymakers introduce lukewarm climate policies in recovery packages.
Private sector response to COVID-19	Corporates transition to more sustainable business models.	Immediate concerns for corporates demote climate change in the order of priorities.	Some corporates focus on surviving the current pandemic, while others are able to charge forward in decarbonising.
Actual climate change path	Climate change emissions do not rebound and economies shift to the Paris-aligned paths.	Emission levels keep rising exponentially, triggering a political response backlash in the coming years.	Emissions continue rising, albeit at a slower pace, triggering needs for transition down the line.
Investment implications	Climate change risks are more manageable due to a timely and clear low-carbon transition, along with a stable global climate and climate-resilient economies.	Climate change risks become near to unmanageable as economies implement abrupt policy decisions and the global crisis destabilises beyond the point of repair.	Depending on the region, the countries and the sector, climate policy gaps and progress will diverge and exacerbate the impact of an unstable global climate.

Source: Amundi, as of 12 June 2020.

scenario, investors must integrate climate change considerations into their investment decision-making processes. Indeed, climate change's materialization is not in question, but rather the global capacity to reduce it and to become resilient.

It is important to note that we hope the "good" scenario materialises.

III. Where do we go from here? Three scenarios: the good, the bad and the status quo

1) The "good" scenario: green momentum

In the "good" scenario, climate change would be fully integrated into COVID-19 recovery plans by public policymakers, both at national and regional levels, and also into international climate negotiations. With pressure and assistance from public policy, corporates

from various sectors would embark on a large-scale revamp of their business models to align themselves more closely with the objectives of the Paris Agreement. As such, the drop in emissions and pollution due to the pandemic would be rooted.

In such a scenario, although climate change risks become more "manageable", they certainly do not disappear. For instance, it would be important for investors to be particularly careful of areas where transition risks have yet to materialise. Moreover, as the "environment" becomes "mainstream" for investors, and as markets increasingly prices in such risks, new areas of opportunity will open up: biodiversity, social issues and so on.

Reinforced climate commitments from the public and private sector

In this scenario, policymakers pay heed to the rising consensus from economists on

the necessity to integrate climate change in COVID-19 responses¹¹. Subsidies are given to entities investing in clean physical infrastructure, green products (such as electric vehicles), building efficiency retrofits, education and training, natural capital and clean R&D (new sources of energy such as hydrogen) as they constitute high potential on both economic multiplier and climate impact metrics.

On the international stage, lessons from the pandemic on the lack of coordination and the potential impact of climate change and biodiversity are fully integrated. Therefore, climate negotiations resume and lead to significant progress and action plans. The European Union and China lead the way, while the United States reacts to international pressure by realigning itself with Paris Agreement commitments. The COP26 ups the ante by raising climate commitments and unlocking significant financing pledges from both the public and private sectors.

At national or regional levels, policies are successful in fostering sustainable growth, creating clean jobs and ensuring social cohesion around recovery plans from COVID-19. Political consensus over sustainable debt levels evolves towards less fiscal orthodoxy, and countries agree on fiscal packages for a green recovery.

At the European level, the European Commission pushes the Green Deal through, with its Just Transition mechanism ensuring that no regions or sectors are left behind. The taxonomy is finalised and paves the way for investors and corporates to green their activities¹². The European Central Bank includes sustainability criteria in its asset purchase programmes. Finally, the EU Emissions Trading System (ETS) is expanded.

Investment implications of the good scenario

Investors would still need to continue taking steps to integrate climate change into their investment processes. Indeed, the integration of sustainability into fiduciary duty would continue given the ongoing rise in sustainable finance regulation, such as France's Article 173. As end-savers increasingly demand climate-aligned investments from their asset managers, reporting on such metrics will become a more crucial component. Along with the greater availability of data, stringency of regulations and climate commitments would make Paris-aligned strategies a must.

Investments based on climate change considerations would become easier. Clear and timely climate policy and regulation roadmaps would provide transparency and oversight to investors on when and how the low-carbon transition would occur. Thus, the materialisation of transition risk would be foreseeable and steady. Economies and companies would have integrated climate resilience, thus reducing the threat of asset impairments.

In such an environment, the sustainable investment trend is likely to be strengthened. Markets would further price in a green premium, as strong policy support would strengthen the long-term growth and quality profile of green assets. Since investors integrate climate change with a social lens, the "E" and "S" pillars of ESG would gain importance and materiality in terms of portfolio performances¹³.

11. <https://www.smithschool.ox.ac.uk/publications/wpapers/workingpaper20-02.pdf>

12. The indicative timetable can be accessed via <https://ec.europa.eu/info/sites/info/files/european-green-deal-communication-annex-roadmap-en.pdf>

13. Bennani, L., Le Guenedal, T., Lepetit, F., Ly, L., Mortier, V., and Sekine, T. (2018a), The Alpha and Beta of ESG Investing, Amundi Working Paper, 76, <http://research-center.amundi.com>. Drei, A., Le Guenedal, T., Lepetit, F., Mortier, V., Roncalli, T. and Sekine, T. (2019), ESG Investing in Recent Years: New Insights from Old Challenges, Amundi Discussion Paper, 42, www.research-center.amundi.com. Ben Slimane, M., Le Guenedal, T., Roncalli, T. and Sekine, T. (2019), ESG Investing in Corporate Bonds: Mind the Gap, Amundi Working Paper, 93, <http://research-center.amundi.com>.

Across the world, large investments in clean energy and biodiversity are included in stimulus plans. Similar to the bailout of the US automobile industry in 2008, which came with higher emission standards, public support is conditioned on tangible actions towards sustainability. Clean R&D spending, clean energy infrastructure and connectivity infrastructure investments are augmented, whereas subsidies to “harmful” sectors are phased out. Carbon taxes are introduced or deepened, entailing “smart” transfers to ensure that they are socially acceptable.

In this “good” scenario, the private sector plays its role by transitioning to more sustainable business models. As strong policy support provides visibility, companies maintain their capital allocation plans for green energies and consider further opportunities as new technologies receive strong public support. Firms integrate ESG practices to mitigate climate change-related risks and ensure long-term resiliency. At sector level, lower-for-longer oil prices encourage energy producers to diversify into renewable energy, while electric vehicle production ramps up. ESG reporting is standardised, ensuring that investors and end-savers have better access to financial information.

As a result of supportive public policies and important shifts from the private sector, the “climate” gains from the coronavirus pandemic are maintained, even after lockdowns are over and economic activity recovers. In such a scenario, climate change-related risks remain very prevalent but potentially manageable.

2) The “bad” scenario: policy meltdown

Before we delve into the worst-case scenario, it is important to note that Amundi believes this to be the least likely. In the “bad” scenario, climate change is sidelined in the economic recovery plans from the current crisis. As global coordination continues to unwind, the Paris Agreement becomes increasingly moot and emissions and pollution quickly rebound.

In such a scenario, it would be important for investors to consider a potentially brutal

policy backlash down the line, as well as integrate extremely high physical risks. As such, it would be important for investors to identify “safe” green assets. Engagement with investees would be key to making sure that corporates include sustainability in their business models.

Timid climate plans from the public and private sector

Under this scenario, with less international cooperation and more protectionism, COVID-19 significantly slows down policy-makers’ efforts towards achieving climate change goals. The “tragedy of the horizon”, as described by Mark Carney in a hallmark speech in 2015, unfolds: climate change actions are delayed so that the risks end up materialising in an unmanageable way.

Regarding the international community, a resurgence of nationalism and protectionism undermines international cooperation on global climate change issues. As physical risks from climate change materialise (e.g., potential impacts on mass migrations), this feeds into more nationalism and protectionism. The COP26 makes the Paris Agreement officially moot, with leaders unable to renew, let alone strengthen, their climate commitments.

At national and regional levels, policies focus on more short-term goals such as the economic recovery from the pandemic, and fail to include meaningful climate policies. Across the world, higher debt-to-GDP ratios restrict governments’ willingness and ability to allocate budgets for tackling climate change. Industries successfully push back on emission regulations. Governments subsidise and bail out industries severely impacted by COVID-19 (e.g., airlines and energy) without any conditions about improving the sustainability of the sectors.

At the European level, under heavy pressure the European Commission abandons the Green Deal or fails to implement it with any consequential effects. At the member level, German coal exit plans or the new Dutch climate

plan are postponed¹⁴. European carmakers manage to postpone the application of the CO₂ emission limits for new vehicles¹⁵.

In China, employment becomes the new priority. Irrespective of their environmental impacts, authorities approve projects as long as they contribute to employment aims. In fact, the number of coal-fired power plants approved in the first three weeks of March was already more than the number approved during the whole of 2019¹⁶. In 2021, China's 14th five-year plan fails to reverse this course.

“Under the “bad” scenario, the private sector aims to compensate for the financial impact of COVID-19 by focusing on short-term survival needs rather than the long-term resilience and sustainability of business plans.”

Distressed companies sell their quality green assets to safeguard balance sheets and dividends (in 2016, Repsol sold its offshore wind business). For example, in the energy sector, low oil prices discourage the necessary R&D investments in renewable energy production, storage and transmission, delaying the global transition to sustainable energy resources. As they struggle, corporates seek to water down environmental regulations.

In the long term, as physical risks materialise, especially in the most vulnerable parts of the world (i.e., India, Bangladesh and Ghana¹⁷), a brutal policy backlash becomes a real possibility. The impacts of such an untimely and aggressive regulatory push are hard to predict, but they could be massive. What would the impact on carmakers be should regulators ban all non-electric vehicles by 2030? What would the social consequences of a brutal and disorderly phasing out on coal in regions where coal production provides most of the employment be?

Investment implications of the bad scenario

Policymakers and regulators have failed to implement adequate climate policies and sustainable finance regulations. With that in mind, investors would have to take it upon themselves to avoid the serious losses to investment portfolios that could be caused by the extremities of climate change transition and physical risk. Green value is at risk, and green investing must be picky. Most mature green technologies that are close to fossil fuel in competitiveness, such as wind and solar, fare better and can still develop without subsidies.

As the catastrophic physical impacts of climate change continue to unfold, policymakers have no choice but to implement emergency regulation, causing U-turns in global economies. Indeed, the current financial impacts of managing COVID-19 provide some level of foreshadowing. Under such a scenario, investors should search for “safe” green assets.

To this effect, investor engagement with companies will be key to ensure that even without more stringent climate regulations, corporates include sustainability into their business models. Notably, such practices will need to follow science-based decisions, along with a holistic approach covering all three objectives of the Paris Agreement.

3) The status quo scenario

In the “status quo” scenario, the risks induced by climate change are not fully integrated into recovery plans and are internalised by the private sector. International climate negotiations struggle, while policymakers

14. <https://www.cleanenergywire.org/news/german-government-postpones-hydrogen-strategy-coal-exit-hearing>

15. <https://www.theguardian.com/business/2020/mar/27/carmakers-accused-of-using-covid-19-weaken-environmental-laws>

16. <https://www.ft.com/content/052923d2-78c2-11ea-af44-daa3def9ae03>

17. <https://www.iisd.org/faq/adapting-to-climate-change/>

introduce lukewarm climate policies in their recovery packages. As a response to COVID-19, some corporates focus on short-term survival, while others accelerate their sustainable transition plans.

In such a scenario, it would be important for investors to accelerate the integration of physical and transition risks in their portfolios, and to monitor the growing dispersion of these risks across geographies and sectors, as some countries charge ahead while others focus solely on putting out the COVID-19 “fire”. Again, engagement should be a key lever used by investors to ensure investees do integrate sustainability into their business models.

Moderate climate actions from the public and private sector

In the “status quo” scenario, we expect international cooperation to restart after a brutal 2020, although the international community will continue to struggle to deliver tangible advancements. The European Union powers ahead on the international scene, while the United States remains aloof. At the COP26, no consensus is reached on burden-sharing between developed countries and emerging economies, meaning that multilateral talks give way to more bilateral or regional talks (e.g., EU-India, EU-China).

At the EU level, the pandemic seriously slows down the European Green Deal and its implementation, although it survives. The current proposal, whereby 25% of the EU budget would be dedicated to climate action through the Green Deal, is maintained. However, carbon taxation plans face difficulties. In fact, the carbon price in the EU ETS has already decreased by more than 41% in the first quarter of 2020, although new mechanisms in place, namely the Market Stability Reserve, have played their role efficiently. This calls the feasibility of the IMF’s suggestion of a \$75 per ton global tax by 2030 into question¹⁸.

Globally, and at national or regional levels, public policies vary widely in their integration of climate change concerns. In economies under heavy stress, most climate policies give way to the more short-term goals of stimulating employment and economic growth, while in

Investment implications of the status quo scenario

In this scenario, climate policy has stayed very top-down, without any forceful bottom-up regulation. Thus, the world has failed to implement adequate climate policy and sustainable finance regulation.

Like the “bad” scenario, the world would be struggling to come to grips with the rapid destabilisation of the global climate. Even today we see the materialisation of physical risks. For example, the IMF has already reported that climatic disasters cause significant economic damage. The past decade saw economic damage from climate change disasters amount to an estimated US\$1.3 trillion (approx. 0.2% of world GDP) per year¹⁹. Thus, the status of transitioning economies to low-carbon and climate-resilient states would become heterogeneous across geographies and sectors. Policymakers are forced to employ structural shifts similar to the ones that emerged from the coronavirus outbreak. As such, investors with a global outlook would need to carefully monitor the dispersion of physical and transition risks, which would widen quite extensively.

As in the “bad” scenario, engagement should be a key tool used by investors or their asset managers to push for and monitor the implementation of sustainable business policies at the investee level, making their models more resilient in the long run.

18. <https://blogs.imf.org/2019/10/10/fiscal-policies-to-curb-climate-change/>

19. https://blogs.imf.org/2020/05/29/equity-investors-must-pay-more-attention-to-climate-change-physical-risk/?utm_medium=email&utm_source=govdelivery

more resilient economies, public policymakers do manage to integrate sustainability features. In the former, this merely pushes necessary reforms further down the line, increasing transition risks. Economic stimulus packages tolerating higher emissions as a necessary evil would only increase the relative costs of decarbonisation, placing companies that pursue it at a competitive disadvantage and making nations more vulnerable to climate crises down the road. This phenomenon also plays out at the sectoral level, where some industries are bailed out under no conditions, while others receive aid conditional on additional sustainable criteria.

Under this “status quo” scenario, corporates focus on surviving the current pandemic and push back on more stringent climate regulations. Some structural economic shifts do benefit lower emissions, such as changes in consumer habits and localised supply chains relying on more carbon-efficient technologies in developed economies.

IV) Concluding remarks

In conclusion, the COVID-19 outbreak holds the potential to accelerate, severely undermine or have no significant impact on the fight against climate change. On the one hand, a timid response from various stakeholders, both public and private,

could threaten our ability to meet the Paris Agreement, and merely retard the problem, or make it worse. On the other hand, the pandemic could be a golden opportunity to foster decarbonisation processes and transitions to more sustainable business models and policies.

Amundi has been working hard to support the materialisation of the “good” green momentum scenario. We have signed up to the Institutional Investors Group on Climate Change (IIGCC) letter to EU heads of state supporting a green recovery in the EU. We are engaging corporates on the inclusion of energy transition KPIs in remuneration scorecards, making sure the topic remains at the top of their agendas, and we are also monitoring closely the lobbying positions of corporates.

In all scenarios, investors will still need to integrate climate change into their decision-making processes, as climate change-related risks and opportunities will not disappear, even in the “good” scenario where strong sustainable policies are implemented. In this regard, **engaging with investees will be key to ensure that such sustainable policies are integrated.** However, should we fail to use this “crisis” to embark on a more sustainable path, then investors will need to brace for the materialisation of physical risks and potential policy backlashes.



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