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Amundi ASSET MANAGEMENT

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INVESTMENT TALKS

A lot of bad news already priced in US assets: a gradual approach to exploit market dislocations

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- ***US in the pandemic crisis:*** *The US economy has entered a recession, induced by the social distancing and quarantining measures introduced to tackle the pandemic crisis. To monitor how deep the recession will be, we use both traditional macroeconomic data (eg, weekly retail sales, jobless claims) and big data (e.g., dining out, travel and box office sales, travel numbers and google searches for 'recession' and unemployment statistics). Both sets of variables suggest an unprecedented collapse in domestic demand.*
- ***US fixed income****: Regarding the Treasury market, as long as the COVID-19 pandemic continues but with signs that the curve is flattening in Europe and getting closer to doing that in the United States, US Treasury yields may have bottomed. In the long term, the fundamentals for Treasuries look challenged, with rising budget deficits and surging Treasury issuance.* ***As to credit markets, following the sharp March sell-off, we are looking for some stabilisation.*** *There is some evidence of liquidity returning to US fixed income markets. The liquidity premium is being wrung out of the market and the credit premium is resuming its prominence in valuation. The new Fed facility to buy corporate bonds will support stability and liquidity in the credit markets. However, this has not been fully discounted along the term structure by the market. Driven by the Fed corporate buying programme, short-maturity corporate bonds are scarcely offered, though there is high demand. HY markets are beginning to recover, though the depth and breadth of trading both remain spotty. Limited but newly re-energised new issuance 'rescue' has resumed successfully. We might be at attractive entry points, as, on average, there is a history of attractive positive HY returns vs government bonds two years after spreads ascend through 800 bps. Regarding securitised credit, we remain constructive on the residential housing market and maintain a high-quality bias in Commercial mortgage-backed securities, where there is risk of modifications and forbearance. Given continued economic uncertainty and the market focus of recently enacted policy measures,* ***we favour high-quality assets within each fixed income sector****.*
- ***US equity outlook****: After having peaked at an all-time high on 19 February, US equities had plunged by more than 33% by 23 March. Since then they have recovered somewhat. In our view, a rebound was warranted after such a quick sell-off.* ***Going forward, market trends remain clouded by high uncertainty*** *over the extent of the virus' economic fallout; this will reflect in the performance of corporate earnings. We keep a cautious stance and wait for evidence related to the potential performance of US earnings, together with corporate guidance for the quarters ahead. On a long-term perspective, US stocks have outperformed most markets for structural reasons (e.g., stronger economy, high share of growth stocks). When an external shock hits, the companies that exit the crisis in better shape tend to be those that can seize the opportunities likely to emerge in the next phase. At the sector level,* ***investors should avoid those that have been most hard hit****, as the segments that fall significantly during a bear market never end up driving the following bull market. Given current circumstances, it is very difficult to call a market bottom.* ***However, huge market dislocations may offer opportunities to long-term investors to enter the market gradually.***

United States enters a recession

There is little doubt the United States has entered a recession. But, this is not the typical recession we have seen in modern history. It was not caused by surging oil prices or an overheating economy or -- the cause of the last three recessions -- dislocations in asset prices. The COVID-19 pandemic crisis, the first since the Spanish flu of 1918-19, triggered this recession. The social distancing and quarantining measures to tackle the pandemic spread are effectively shutting down the economy. According to the Bloomberg weighted consensus, the

"The US economy is on target to suffer its worst recession since the Great Depression".

US economy is forecast to contract by an annualised -4.4% in Q1, then plunge -20.4% in Q2, before bouncing back in the second half of the year. Suffice it to say**, the economy is on target to suffer its worst recession since the Great Depression**. In order to determine the breadth and severity of this recession, we look at traditional macroeconomic variables and non-traditional 'big data' -- that is, a large set of data-sets that can be analysed to reveal patterns and trends.

Traditional measures confirm deep recession

Based on the traditional macroeconomic factors, we are monitoring data as per our recession dashboard:

US recession dashboard

Weekly data	Trend
Johnson Redbook retail sales	Expanding
Bloomberg consumer comfort index	Falling
Entertainment (dining out, travel, box office, etc)	Collapsed
Jobless claims	Increasing
Local business activity	Declining
Rail traffic	Declining
Total gas production supplied	Declining
Coal output	Declining
Price statistics	Declining
Monthly data	
ISM manufacturing	Contracting
ISM non-manufacturing	Expanding

Source: Amundi-Pioneer, Bloomberg. Data as of 6 April 2020.

In detail:

"The surge in jobless claims over the last two weeks tentatively suggests the United States already has an unemployment rate of 10.4%".

- **Jobless claims** will be one of the key measures for determining the severity of the recession. They rose by an all-time record of 6.65 million on 28 March, topping the previous record of 3.3 million recorded the previous week. **The surge in jobless claims over the last two weeks tentatively suggests the United States already has an unemployment rate of 10.4%**. If we see jobless claims data of 5 million — as per current consensus estimate — on 9 April, the unemployment rate could reach 13.4%. This compares with the February unemployment rate of 3.5%. The labour market is set to deteriorate sharply in Q2 to the highest unemployment level since World War II;
- **Johnson Redbook chain store sales** measure the health of the consumer. This weekly series includes over 80% of the official retail sales collected by the US Department of Commerce. There has been a sharp divergence in sales, with department store sales plummeting 10% YoY while discount store sales had surged 13.8% YoY on 28 March. Overall, the chain store sales growth rate has remained healthy, at 6.3% YoY, but there are signs of slowing. So far, initial strength in sales is benefitting from the stockpiling that has been taking place. As the stockpiling abates, retail sales should slow dramatically in the coming weeks;
- **Bloomberg weekly consumer comfort index** measures the state of the US consumer. This index includes three components: the state of the national economy, the state of personal finance, and good/bad time to buy. It has fallen from a near-record-high of 67.3 on 26 January to 56.3 on 29 March. The index is now on a sharp downward trend. In addition, the other benchmark consumer confidence indicators (University of Michigan sentiment and Conference Board consumer confidence) are both off their peaks and have confirmed this trend;

- **ISM manufacturing and non-manufacturing**: The former is probably the strongest coincident indicator of the manufacturing sector, where a sustained number below 48 is an indication of a recession. During the Great Financial Crisis (GFC), ISM manufacturing collapsed to 34.5. But it did not remain at that depressed level for an extended period. This indicator is now contracting, at 49.1, as per March data. The more important ISM non-manufacturing index has fallen from 57.3 in February to 52.5 in March. Given the shutdown, the service sector will fall sharply in April, most likely to below the 2008 low of 37.8.

"Monitoring high-frequency and big data may be helpful in identifying early inflection points, but for now most indicators are pointing south".

Big data indicate severe contraction

We add big data or alternative data to our dashboard:

- Many parts of the service sector have effectively been shut down due to social distancing and the lockdown measures that have been implemented in most parts of the country. We are monitoring **dining out, travel and box office sales**. Restaurant reservations are down 100% YoY, according to data from Open Table. Box office sales are down 100% during the last two years compared to the same period a year ago. These sectors are effectively closed. The **travel industry** has been crushed as well, with security checkpoint travel numbers collapsing from approximately 2.5 million a year ago to just 135,000 during the last week of March. These declines are unprecedented, so it is difficult to compare them with prior cycles as there previously has been no period during which an entire sector has been shut down. We will be monitoring the speed and breadth of recoveries in these sectors once the pandemic crisis is contained;
- **Local business activity** has collapsed in an unprecedented manner. Businesses open, hours worked and employees working had declined some 50-60% YoY during the last week of March;
- We are monitoring **internet google searches for recession and unemployment**. Searches on the internet are well above 2008 levels, most notably for unemployment. Online searches for recession and unemployment hit a peak of 100 during the last week in March, a level not attained during the GFC. A decline back to 20 could signal that the economy is starting to make a positive turn;
- **Rail traffic** was down over 10% YoY during the last week in March. That level is higher than the recent trough in 2009 when rail traffic declined over 20% YoY;
- **Commodities** such as coal production and total gas production supplied. Coal output has fallen by 16.9% in the last four weeks. Significantly, total gas production supplied plummeted 27.1% YoY on 28 March, the largest drop recorded since the inception of the series in 2004;
- **Price statistics:** we are monitoring internet prices collected by State Street as another way to gauge demand. The early indication is that internet prices -- a good proxy for CPI -- has rolled over as demand has fallen from a high of nearly 2.5% YoY in Q4 2019 to approximately 1.0% in the last week of March.

There remains much debate on the type of recovery we might see once the pandemic crisis is under control. There are three possible scenarios: V-shaped, hockey stick- or U-shaped. Our base case scenario is a **long U-shaped recovery**. Given the total collapse in demand, it will take time for the economy to recover from this dramatic shock. Scientific advancement in the form of antiviral treatments and a vaccine will be essential to an ultimate recovery of global economic activity and consumption patterns. The dynamics of this recession point to more of a demand shock than a supply one, which does not favour a V-shaped recovery. Supply-chain disruptions can cause a short-term hit to output, but once the disruption is reversed, pent-up demand will lead to a quick bounce back in activity. However, demand destruction in the dining, accommodation and travel sectors will not lead to a bounce back, as that lost demand cannot be made up. Our assessment of our dashboard of economic variables indicates a **U-shaped recovery with no signs of a recovery yet.** However, these are still early days in the pandemic crisis**. In the service sector, both the traditional and big data variables suggest unprecedented collapse in domestic demand,** with restaurant and movie sales at zero. Travel is virtually shut down. While the manufacturing sector has slowed sharply, the size of the current hit does not appear unprecedented.

US fixed income outlook

Treasury market

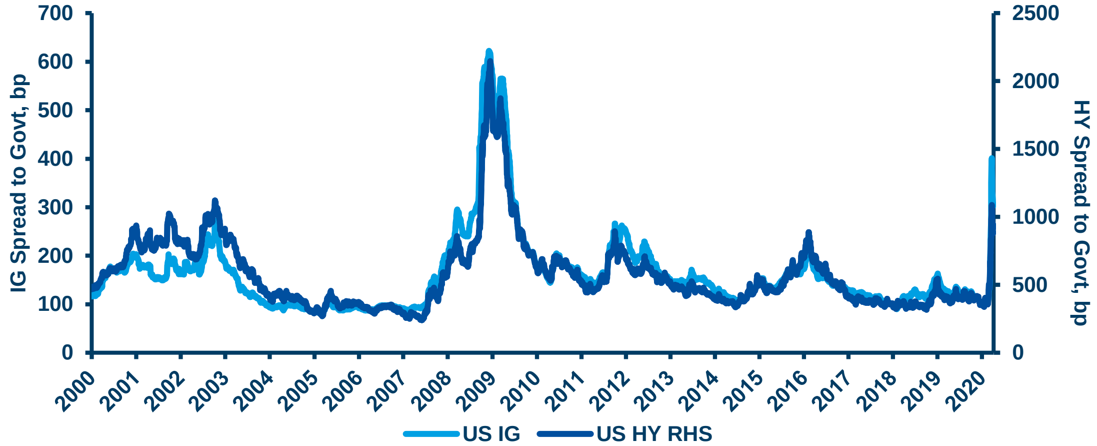
As long as the COVID-19 pandemic continues on the current trajectory, with signs that the curve is flattening in Europe and getting closer in the United States, **US Treasury yields may have bottomed.** In any case, the US Treasury market will see safe haven flows during heightened periods of uncertainty over the pandemic from time to time, but then will see yields rise as this uncertainty wanes. In the long term, the fundamentals for Treasuries look challenged given rising budget deficits in excess of 10% of GDP and surging Treasury issuance for the foreseeable future. A wildcard is the slope and breadth of the recovery: a sluggish one will support Treasuries while a more robust one will help send yields higher.

Credit markets

"As the Fed buys shorter-term investment IG bonds, it will help underpin stability in the breadth of the market and better reflect fundamentals".

Credit markets have been hit very hard by the perspective of a deep recession and an increase of default risk. **Following the sharp March sell-off, we are looking for market stabilisation.** Regarding this, we focus on five points after the unprecedented policy intervention: a flattening in the number of new cases; central bank support; fiscal support; narrowing of economic outcomes; and better clarity on the availability of a vaccine and therapeutics. **Credit curves** are normalising and quality differentials are being reflected in market pricing. Such discernment is evidence of liquidity returning to US fixed income markets. The liquidity premium is being wrung out of the market and the credit premium is resuming its prominence in valuation. **Especially in energy, there are significant risks of permanent impairment**. In all US credit, there is evidence of opportunistic buying in the United States and on an overnight basis from Asia. We believe that the new Fed facility to buy corporate bonds, called the **Secondary Market Corporate Credit Facility (SMCCF**), is one of several significant developments, as it will support stability and liquidity in the credit markets. However, we believe that this has not been fully discounted along the term structure by the market. As the Fed begins to buy shorter-term investment grade (IG) corporate bonds on a sustained basis, it will **help underpin stability in the breadth of the market and better reflect fundamentals**. Fed action has helped foster risk appetite among investors from a place where cash seemed to be the only option. **Driven by the Fed's corporate buying programme, there is very low offer of short maturity corporate bonds which are in high demand.** A record level of new issuance has concentrated at the long end of the curve, though there is evidence of nascent interest in intermediate-maturity IG corporate bonds in both the new issue and secondary markets. IG corporate spreads have contracted by about 100bps since the heights of the liquidity crisis. That said, **credit differentiation is critical** and **rating downgrades are expected for certain corporate bond issuers. The amount of fallen angels is likely to exceed that of the 2008-09 financial crisis.**

US IG and HY spreads over Treasuries, bps



Source: Amundi, Bloomberg, ICE indices. Data as of 7 April 2020.

"We believe that corporate credit offers attractive investment opportunities, but a focus on credit selection is needed as conditions are challenging".

High yield (HY) markets are beginning to show signs of recovery, though the depth and breadth of trading remain spotty. Limited but newly re-energised new issuance 'rescue' has resumed successfully. Following the sharp widening in HY spreads to over 1,000bps in March, **there appear to be signs of normalisation, as new issuance has resumed on higher-quality HY** corporate bonds and been well received.

Liquidity was challenging in March, especially in the bank loan market compared to the HY bond market. The bid-ask spread narrowed but remains large. We **might be at attractive entry points,** as, on average, there is a history of attractive positive HY returns vs government bonds two years after spreads ascend through 800bps.

Long-duration high-quality US corporate bonds look cheap, but credit discernment is **critical. To sum up, we believe that corporate credit offers attractive investment opportunities.** At the margin, there may be opportunities in long-duration higher-quality corporates, primarily in issues regarding which we hold high conviction, and using non-agency RMBS as a funding source.

Securitised credit

Given the post-GFC reforms, underlying collateral and credit enhancement is strong in this market. Especially in the higher levels of securitisation, the bids are strong and liquidity is available. Subordinated securities are receiving some attention, but they remain thinly bid. The collateralised loan obligation (CLO) new issue market has recently opened with two deals placed successfully. **We remain constructive on the residential housing market** and maintain a high-quality bias in CMBS, where there is risk of modifications and forbearance.

Lessons from the past and investment opportunities

The unintended consequences of the GFC reforms that solidified the banking system also limited its capacity to absorb liquidity demands of the magnitude and at the velocity we saw in mid-March. With this pandemic crisis, we are in unchartered territory, and there are no precedents to follow that perfectly match the current situation. **We believe the Fed facilities represent a major backstop that will help restore liquidity in markets in due course.**

Despite the increase in credit risk, the sharp repricing in spreads has created notable investment opportunities. For most non-government sectors of the **US bond market, yield premiums over Treasuries net of expected losses are at very attractive levels**. This is the case across all rating categories. Given continued economic uncertainty and the market focus of recently enacted policy measures, we **have a high-quality bias within each fixed income asset class**. In contrast to the 2008 financial crisis, the financial system is on stronger footing and credit availability should not be materially impaired once economic activity resumes.

US equity outlook

"Market trends remain clouded by high uncertainty over the extent of the economic fallout of the virus".

After having peaked at an all-time high on 19 February, US equities had plunged by more than 33% by 23 March. Since then, they have recovered somewhat. In our view, a rebound was warranted after such a quick sell-off and some entry opportunities may have opened.

Going forward, **market trends remain clouded by high uncertainty over the extent of the virus' economic fallout**: this will reflect in corporate earnings. Some clarification may come with the upcoming Q1 reporting season (late April to mid-May). Until then, markets are likely to stay volatile.

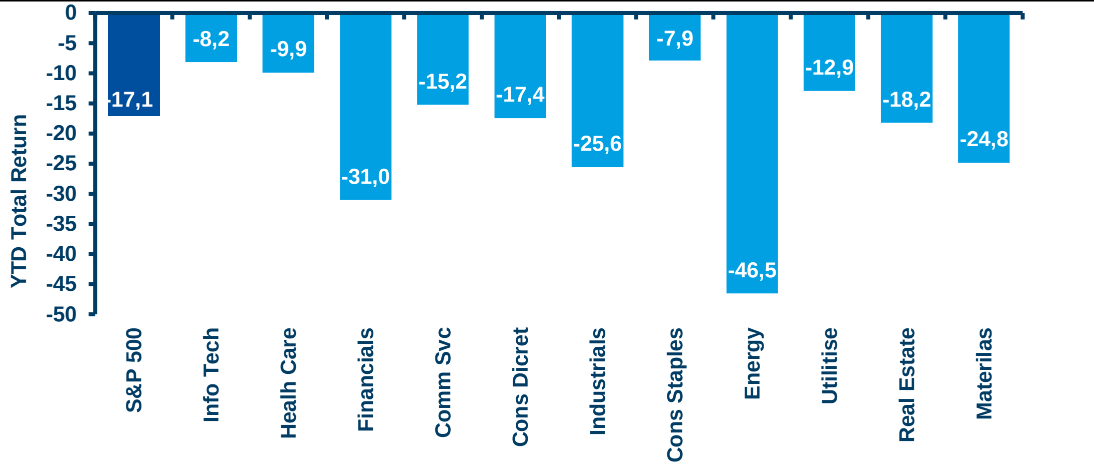
Given the extent of the rebound already recorded from 23 March though and the uncertainty surrounding current forecasts, we believe that much in the way of additional rebound is unlikely in the short term. So, **we keep a cautious stance** and wait for evidence regarding US earnings, together with corporate guidance for the quarters ahead. In our view, if US earnings drop by at least 20% in 2020, the S&P500 index may fall again rather than rebound further.

"When an external shock hits, those companies that exit the crisis in better shape are the ones that can seize the opportunities offered by the next phase".

On a long-term perspective, US stocks have outperformed most markets for structural reasons (e.g., stronger economy, high share of growth stocks). When an external shock hits**, those that exit the crisis in better shape are the ones that can seize the opportunities offered by the next phase.** We believe that US stocks may continue to be global leaders following this crisis, thanks to high innovation and a robust corporate sector.

At the **sector level**, investors should avoid the most hit sectors, as segments that fall hard during a bear market never end up driving the following bull market. This time, the most affected sectors could be **airlines, cruise lines, brick-and-mortar retailers, commercial real estate** and **shale oil. On the other hand, healthcare, technology, communication** and **financials should weather the crisis better**.

US sector performance, total return, YTD



Source: Amundi, Bloomberg. Data as of 7 April 2020.

Given current circumstances, it is very difficult to call a market bottom. However, huge market dislocations may offer opportunities to long-term investors to enter the market gradually.

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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%).
- **Bid-ask spread:** The difference between the highest price that a buyer is willing to pay for an asset and the lowest price that a seller is willing to accept.
- **Credit spread:** Differential between the yield on a credit bond and the Treasury yield. The option-adjusted spread is a measure of the spread adjusted to take into consideration possible embedded options.
- **Default rate:** The percentage of issuers that failed to make interest or principal payments in the prior 12 months. Default rate based on BofA-ML indices. Universe consists of issuers in the corresponding index 12 months prior to the date of default. Indices considered for corporate market are ICE BofA Merrill Lynch.
- **MBS, CMBS, ABS:** Mortgage-backed security (MBS), commercial mortgage-backed security (CMBS), asset-backed security (ABS).
- **Quantitative easing (QE):** QE is a monetary policy instrument used by central banks to stimulate the economy by buying financial assets from commercial banks and other financial institutions.
- **Volatility:** A statistical measure of the dispersion of returns for a given security or market index. Usually, the higher the volatility, the riskier the security/market.

Important Information

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