#19 / November 2023

PENSION FUNDS LETTER

Trust must be earned

Amundi ASSET MANAGEMENT

Building together smart solutions to face a challenging environment

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EXECUTIVE SUMMARY

The twists and turns of responsible investing across the pension landscape

Inflation pressures may well have fallen as we near the end of 2023, but at times it can seem like they're the only thing trending in the right direction. Question marks remain plentiful over the next actions for central banks and the probability of a slowdown in developed markets. Elsewhere crises and geopolitical tensions proliferate, global fragmentation is increasing and warnings over the consequences of climate inaction become ever more frequent and urgent.

It is in this context that we seek to look again at the **role of responsible investing**, in particular the contribution of one of the largest investors in ESG, pension funds. The 2023 Amundi-CREATE pension survey takes a **closer look at sustainability investing** following the series of exceptional events in 2022, triggered by the invasion of Ukraine, which hit investment strategies across the board and ultimately saw ESG strategies underperform. 2022 also saw **major progress on ESG regulation** and policy in major markets worldwide, which aim to improve consistency and transparency. The survey examines how pension fund's **perception of responsible investing** may have changed following these developments, what are their goals and how do they hope to achieve them.

Despite the higher level of complexity and uncertainty that markets face, we remain convinced that **responsible investment delivers long-term value to investors**. The results of the 2023 survey underlines how it is evolving to focus on changes in the real economy in addition to its financial returns.

We continue this ESG themed letter with a look at one of the major sources of risk for pension funds – climate risk – and more specifically, **how pension funds are addressing the net zero transformation** in their investment portfolios.

After that, we look ahead to next year more broadly and present Amundi's outlook and **investment convictions for 2024**. We also share our views on the next priorities for responsible investing as a whole and the main themes that will impact the industry with a particular focus on the energy transition.

Finally, we wrap up this final edition of 2023 with our usual look at the pension funding ratios and whether the positive momentum seen at the beginning of the year has continued.

WHAT'S NEW & COMING UP?

28.11.2023
IPE Conference & Awards Vienna
Amundi was once again a proud sponsor of the 2023 IPE Conference & Awards in Vienna. Vincent Mortier, Amundi CIO, took part in a key session looking at the global challenges for investors.

13.03.2023
Pension Fund Club
COMING SOON
Save for date for Amundi's annual virtual event exploring some of the major developments and challenges across the pension landscape.

Amin RAJAN
Chief Executive
Officer of CREATE

The next stage of responsible investment evolution for pensions

Crises tend to accelerate trends. Events of 2020, the Covid-19 pandemic, a heightened focus on racial injustice and social inequality and the ongoing threat of climate change, provided **powerful tailwinds for responsible investing and highlighted companies' vital role in tackling these issues**. But more recently there have been signs of a slowdown, as ESG returns suffered in 2022 and the Ukraine war led to an outperformance in the energy sector.

After meeting responsible investors' return expectations since the 2015 Paris agreement, last year's savage bear market hit all investment strategies, no matter their intrinsic merits. ESG was no exception.

The episode showed that ESG investments are exposed to periodic setbacks due to a larger dynamic that has little to do with ESG per se.

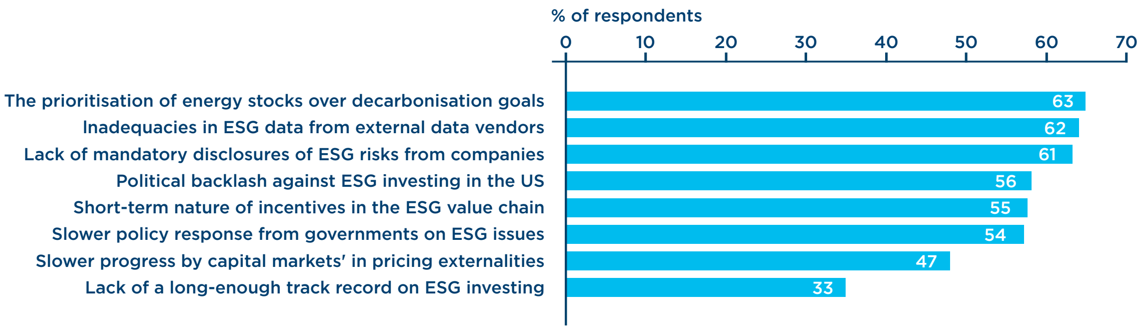
ESG-related topics have never been so central to the investment conversation. Assets are growing, almost quadrupling since 2020[1], and the integration of ESG factors into general risk management is strengthening. The financial materiality of the inherent risks is now widely accepted as gradually reshaping the ecosystem of capital markets.

Pension funds worldwide are among the biggest responsible investors. The **2023 Amundi-CREATE** survey takes a closer look at how these developments are perceived by pension investors and what this means for next stages of responsible investing.

Slow, slow, quick, quick, slow

Several factors have held back progress in responsible investing according to the survey participants (Figure 1). 63% consider energy to have gained the upper hand over decarbonisation goals, as governments prioritised short-term energy security. Data inadequacies are equally thought to have been a big drawback (62%). Progress on the mandatory disclosure of risks by listed companies is considered patchy (61%), and clearly defined standards of measurement and performance are also still lacking. Despite recent progress, global consensus on how ESG performance should be defined

Figure 1: Which factors have recently hindered progress in ESG investing?



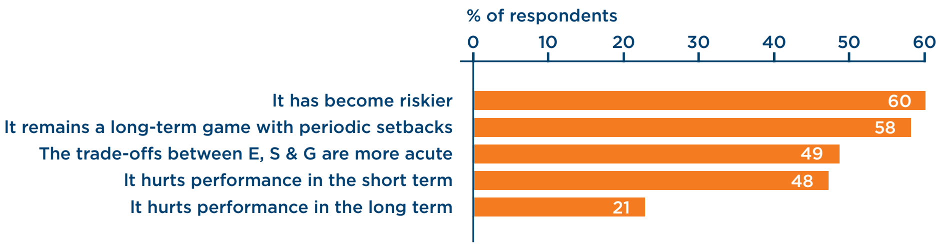
Source: Amundi / CREATE Survey 2023

1. AUM in responsible investment funds since 2020, source Broadridge as of June 2023 and measured is slow to evolve, with little consistency across markets and metrics.

Regulatory progress on mandatory disclosures of data, as well as clearly defined standards of measurement and performance have been patchy: not robust enough to be decision-useful for investors. The resulting confusion provided further ammunition for the political backlash against responsible investing in the US (56%), unnerving investors and their asset managers alike.

These factors have meant that **investors have become more demanding of their responsible investments** in the past two years, prompting a re-examination of its scope and goals. 60% of respondents believe these investments have become riskier (Figure 2). But responsible investment has never been about short-term results – 58% believe it remains a long-term game that will suffer from periodic set-backs and despite recent poor performance, **79% do not believe ESG will harm performance over the long term.**

Figure 2: After its adverse performance in 2022, how do you now view ESG investing?



Source: Amundi / CREATE Survey 2023

In Europe, the backtracking around the European Union's Sustainable Finance Disclosure Regulation (SFDR) has caused confusion, with 30% of survey respondents invested in SFDR funds revealing that it's leading them to change their responsible investment policy. But another 23% believe the recent issues to be teething problems and that the regulation will prove robust over the longer term. **Legislation such as SFDR is likely to be the beginning of a long journey, not a finish line.**

Where does responsible investing stand today?

Despite these perceived difficulties, **responsible investing has clearly taken root in the pension landscape**. 38% of our survey respondents have more than 20% invested in ESG in their active portfolios. For passive portfolios this figure is 34%. At the other extreme, 19% of respondents have zero allocations in either portfolio.

Nearly four in every five survey participant (Figure 3) already have either a mature ESG portfolio (26%) or are in the implementation phase (55%). The rest are either close to decision making (16%) or at the awareness-raising stage (3%). In terms of net zero goals, **around 60% of our survey participants have already adopted the goal as part of a major reset inspired by the Glasgow COP26 in 2021**, while the rest are still in the awareness-raising and decision-making phases.

Figure 3. In which stage is your pension plan currently with respect to ESG investing and your net zero climate goal?

Source: Amundi / CREATE Survey 2023

Impact strategies have gained prominence since the pandemic, averaging around 5% of holdings in pension portfolios today. The inherent features of impact investing have meant take up has been slower compared to other approaches. Alternative investments in private markets are the most popular approach (52%) according to survey respondents, followed by green, social, sustainability and sustainability-linked bonds (47%) and blended finance vehicles (38%).

The majority of participants expect to increase the share of responsible investments in their portfolios over the next three years: 53% in active portfolios and 49% in passive ones.

The responsible investing evolution - Refining and defining

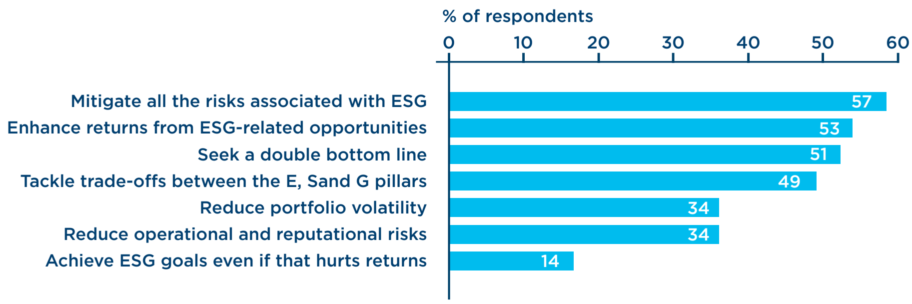
There is little debate that an **evolution is occurring on the ESG landscape**. What is appearing is a dual emphasis on achieving attractive returns whilst also making a difference for wider society. This is done via a transparent investment approach that assesses the positive and negative impacts of corporate actions affecting businesses, people and the planet.

This evolution has been accelerated by a host of new pension regulations in key markets. However, as yet there is **no robust system** to assess the value created or destroyed by the use or misuse of ESG capital. Language and ways of thinking are evolving, as is regulation and the indicators that guide investment processes. What has emerged is the wider recognition that **responsible investing complements traditional modern portfolio theory by reinforcing the role of fundamental concepts like risk and return**.

Respondents cite a number of goals for ESG integration in their portfolios (Figure 4), 57% aim to minimise all ESG factor risks, 53% to enhance returns from corresponding opportunities, whilst 51% seek double bottom line benefits via societal as well as financial returns.

In pursuing these goals, pension funds are **demanding more transparency** across the entire ESG value chain. They are also demanding robust independently audited outcome and impact metrics. More than ever, they want to see **evidence that their responsible investments make a difference**.

Figure 4. Which goals are being targeted by ESG integration in your portfolio, currently and over the next three years?



Source: Amundi / CREATE Survey 2023

One size doesn't fit all - A more differentiated approach

The early phase of ESG investing mostly bundled the three pillars of E, S & G together. However, recent growth has seen greater granularity between and within the pillars. Currently, "environment" is considered the most important component, followed by "social" and then "governance". But the story is far more nuanced.

First, the ranking varies across three key pension regions. In Asia-Pacific, the predominant emphasis is on governance, in Europe on environment and in North America on social. Differences in regulation are a major factor here.

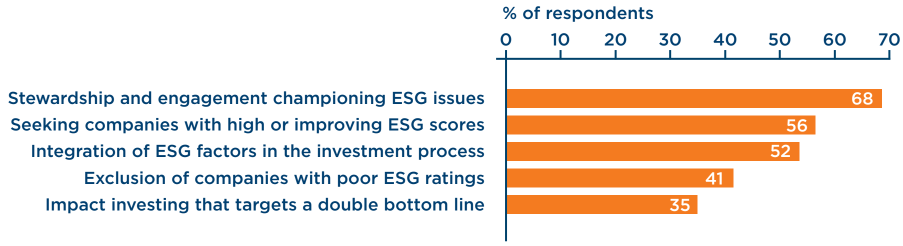
Second, within individual pillars, there are clear differences in emphasis. In the environmental pillar, decarbonisation and biodiversity top the list. In the social pillar, it is employee engagement and diversity & inclusion. In the governance pillar, it is executive compensation and corporate board composition.

This year's survey demonstrates that pension investors approach their responsible investment strategies in two distinct manners.

1. **Financial risk**, which identifies external ESG risks that can impact an investee company's own business performance,
2. **Double materiality**, which looks beyond the impact of ESG risks on the investees to assess how the companies' own activities affect broader social, economic and environmental systems.

At least one in every two survey respondents, use one or more of these methods.

Figure 5: What are the dominant approaches that your pension plan currently uses in its ESG investing?



Source: Amundi / CREATE Survey 2023

Three responsible investment approaches target ESG financial risks (Figure 5). Investors in the early phase of their ESG journey rely on the exclusion of so-called sin stocks: shares in companies linked with activities deemed unethical such as controversial weapons, tobacco, fossil fuels and poor labour standards (41%). While not ignoring negative screening, others now also rely on overt integration of ESG factors in their investment process (52%). A third group rely on a variant of this approach: they invest in best-in-class companies with high or improving ESG scores (56%). These last two believe that negative screening is less effective: it merely reshuffles asset ownership. Far better to **engage with such companies** and **improve their ESG credentials** than ditch them altogether.

Two approaches target double materiality. First, impact investing that aims for both financial and non-financial benefits (35%). They target themes that are part of long-term secular growth trends. These strategies seek to generate a positive measurable social or environmental impact alongside financial returns.

Last but not least, the most **popular approach is stewardship and engagement** that overtly aim to drive progress on ESG themes (68%). Stewardship recognises that there needs to be clear alignment between corporate strategy and existential multifaceted ESG and climate risks.

All of these approaches address the fact that ultimately ESG can be considered as a financial metric that aims to minimise the financial harm that negative externalities can cause to a company, as well as how its own operations can minimise their negative impact on our planet and its people.

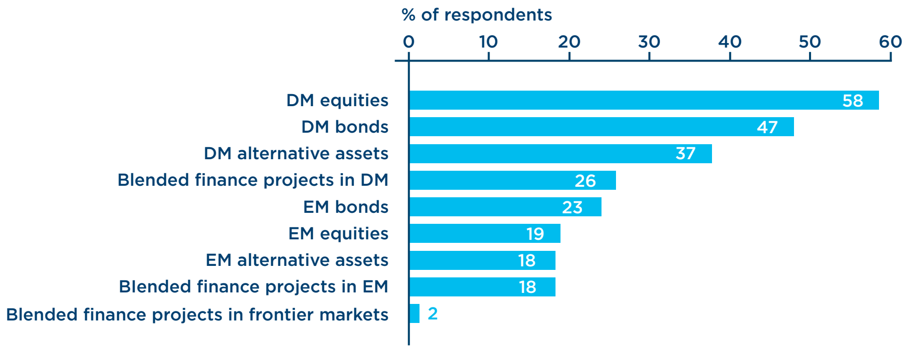
Levelling the playing field

Climate change has no regard for national borders or geographies. Yet, responses to it have varied across regions and reflect the uneven pace of economic development. However, given their rising share of carbon emissions, **the battle against climate change will be won or lost in emerging markets**.

Developed markets had a head start in responsible investing due to regulatory and societal pressures, while emerging markets have been focused on raising the basic living standards of their citizens, with a policy focus on economic growth, rather than sustainable development. The impact has been exacerbated by decades of offshoring from developed economies, outsourcing some of their most heavily polluting manufacturing activities to emerging markets.

This imbalance between markets is duly reflected in the asset allocation of our survey participants (Figure 6). In every asset class, developed markets rank highly, followed by emerging markets and then frontier markets, duly raising the hurdle rate of return for latecomers. As things currently stand, participants' total allocation to the latter two markets are around 8% on asset-weighted basis. ESG assets account for just under half of it, focused principally on green bonds.

Figure 6: Which asset classes are deployed in your ESG investments currently and/or are likely to be deployed over the next three years?



Source: Amundi / CREATE Survey 2023

The gap is however expected to narrow over time due to:

- EM companies coming under pressure from their trading partners in the West to improve their ESG credentials following new policy measures, while in parallel EM regulators start to roll-out disclosure and compliance rules;
- Blended finance projects coming under the 'loss and damage' mechanism agreed at COP27 in 2022.

Adapting asset allocation approaches

As responsible investing becomes more sophisticated, **investors are refining their asset allocation approaches**.

Currently, ESG investing mostly relies on bottom-up security selection with 63% of our survey participants reporting this method of allocation to ESG factors. But for 21%, ESG pillars now also feature in top-down strategic asset allocation, as they gradually become compensated risk factors, similar to other long-established ones like inflation, GDP and interest rates. According to our post-survey interviews, ESG is reported as a compensated risk factor in Europe, but less so in America and Asia.

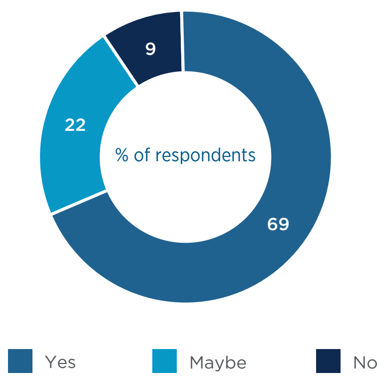
Becoming part of Strategic Asset Allocation with its own policy benchmark will mean that **ESG investing is no longer constrained by traditional benchmarking frameworks**.

Stewardship: when passive becomes active

Stewardship and proxy voting have become a vital issue in manager selection. This applies not only to active, but also to passive funds.

In the past, passive funds have been stereotyped as disinterested owners of companies neglecting to exercise their considerable influence. The result is ownerless companies. This is in marked contrast to current thinking among our survey respondents (Figure 7).

Figure 7: Are stewardship and proxy voting just as relevant in passive funds as they are in active funds?



Source: Amundi / CREATE Survey 2023

They believe that since passive funds cannot divest their positions in poorly performing companies, they are forced to be long-term investors. They have every incentive to exercise their stewardship role to boost the quality of beta via the sheer weight of their holdings.

They want their **voice heard on pivotal issues like strategy, governance and ESG**. The active risk associated with ESG indexes has also been rising as the indexes target specific themes that require a higher tracking error. As a result, **the term 'passive' applies less and less to responsible investing**.

More generally, pension funds are **demanding more from their ESG asset managers**. The list of selection criteria has expanded to show a clear distinction between qualifiers, the basics an asset manager needs to get right, and differentiators, the elements that provide a competitive advantage. Value-for-money (58%) and embedded core responsible investment values (56%) lead amongst the qualifiers, while a good track record on delivering ESG goals (67%) and on stewardship and voting (65%), as well as a deep and broad talent pool (63%) top the list of differentiators.

Amundi-CREATE 2023 survey: Highlights

(% of pension plan respondents)

Current state of play

26% Have already implemented ESG strategies and a further 55% are in the process of doing so

18% Have already implemented a net zero strategy and a further 43% are in the process of doing so

57% Seek to mitigate all ESG-related risks

53% Aim to enhance risk-adjusted returns from ESG-related opportunities

Blockers hindering progress recently and drivers fueling future growth

63% Suffered ill-timed sector bets during the 2022 bear market, harming performance of ESG investments

56% Think the political backlash against ESG in the US is unnerving pension investors

61% Think new regulatory progress on data disclosures will weaken barriers to growth in ESG assets

59% Believe recent policy initiatives in America, China and Europe will speed up the pricing in of ESG risks

Evolution over the next three years

53% Expect the share of ESG investing in their active portfolio to rise

49% Expect the share of ESG investing in their passive portfolio to rise

63% Favour climate change as their main environmental theme

64% Favour diversity & inclusion as their main social theme

Manager selection criteria

67% Require their external asset managers to have a good track record on delivering their clients' ESG goals

65% Require their external asset managers to have a good track record on stewardship and proxy voting

58% Require a value-for-money fee structure

56% Require core ESG values to be embedded in their managers' corporate culture

About the survey: each year, Amundi and CREATE interview pension plans to highlight insightful convictions for the year to come. Pension plans worldwide have been amongst the biggest ESG investors. It is time for a stocktake on how they now see the future. The 2023 edition pursues four broad questions:

- What is the current state of play in light of 2022 events?
- What are the recent blockers and future drivers of ESG investing?
- How will ESG investing evolve over the three next years?
- Why is external manager selection set to change radically?

The survey is based on 158 respondents in Asia-Pacific, Europe and North America, collectively managing €1.91 trillion of assets.

Click here to Read the full Amundi-CREATE report

Sofia SANTASIERO
Head of Institutional Business Solutions & Innovation

Tom DENEKE
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How Pension Funds are approaching the shift to Net Zero

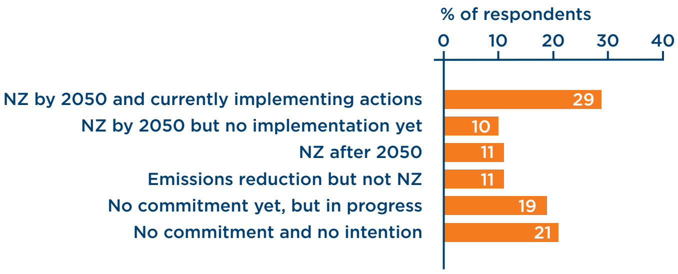
As ESG integration into portfolios has become relatively widespread amongst pension funds, the environmental pillar has for now been the real winner in terms of flows[1]. However, pension funds are still divided on the impact that climate change risks and opportunities can have on their portfolios and how to integrate decarbonization targets.

After inflation, **climate change is the second most important medium- to long-term concern** for public pension funds[2]. Most funds report climate change to be in their top three concerns, making it a more worrying factor than geopolitical tensions, demographic trends and low equilibrium rates. In the context of the widespread consensus that climate change is a key challenge, it is worth considering how investors are tackling the issue.

Globally, 29% of institutional investors have set net-zero targets and are actively implementing actions to reach this objective, while 50% have set net-zero targets, but have not yet started the implementation phase[3].

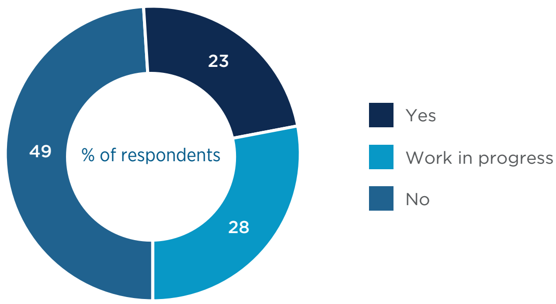
Among the pension funds surveyed in the 2023 Amundi-CREATE survey, a similar level of commitment can be observed: 23% of respondents have a comprehensive strategy for achieving net-zero portfolio emissions, with another 28% working on a strategy to achieve net-zero portfolio targets. Climate change is a top-of-mind concern for many investors, and while target setting has not been universal, the Net Zero journey has already started for many pension funds.

Figure 1: Global institutional investors: status of net-zero commitments



Source: Schroders Institutional Investor Survey 2023

Figure 2: Amundi/CREATE: Does your pension plan have an overt strategy for achieving the net zero climate goal by 2050?



Source: Amundi / Create survey 2023

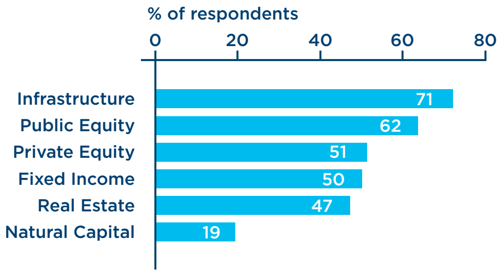
1. Amundi/Create Survey, 2023
2. OMFIF, Global Public Pensions, January 2023
3. Schroders, Institutional Investor Study, 2023

Net zero integration across asset classes

While net zero target-setting behaviour of pension funds can be considered relatively similar to the broader institutional community, more significant differences arise when it comes to which asset classes are prioritized in the net-zero integration process. Institutional investors in aggregate tend to prioritize alternative assets, while **pension funds tend to focus more on equities**. For now both pension funds and institutional investors in general focus more on equities to reach their net-zero goals rather than fixed income.

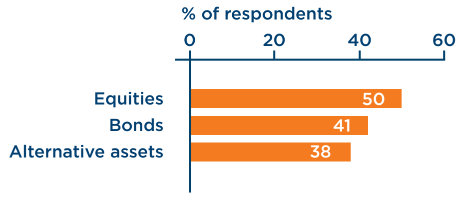
It could be argued that this difference in prioritization is partly a function of the differences in asset allocation, but is unlikely to be the full explanation since exposures to alternatives in the overall asset allocation are similar: global pension funds have allocated an average of 23% of their portfolios to alternative investments[4], while the global institutional community in general allocates 24% to private markets[5]. Differences in asset allocations are unlikely to be the main explanation for the differing priorities, therefore there are likely other factors at play.

Figure 3 Institutional investors: prioritized asset classes for climate risk mitigation



Nuveen, Global Institutional Investor Survey, 2023

Figure 4: Pension Funds: asset classes used to reach net zero commitment



Source: Amundi/Create Survey 2023

In the discussions with pension funds for the Amundi-CREATE survey, several common explanations were given for this emphasis on equities: they permit **strong stewardship and engagement**; they offer ready liquidity and they can readily target 'pure play' green business models like renewable energy companies, as well as hard-to-abate sectors. Fixed income also plays a significant role in realizing net-zero objectives: as more pension plans advance into their run-off phase due to ageing plan members, labelled ESG bonds have become attractive.

However, the inherent complexity of bond markets – given their size, variety of instruments, maturities and issuing entities – makes it harder to integrate ESG issues into credit assessments, especially interest rate and liquidity risks. Lastly, alternative assets are also key when transitioning portfolios to net-zero. Similarly to institutional investors in general, green infrastructure, real estate, private equity and private debt are prioritized in order of importance.

By decarbonizing their portfolios, pension funds have an opportunity to both **manage climate change risks and support the decarbonization of the real economy**. It is important to note that **net zero objectives are also guided by return considerations**: only 14% of pension funds surveyed by Amundi are prepared to achieve ESG goals at the expense of returns[6]. In the short-term, tracking error may also increase, but **as the real economy decarbonizes, the tracking error gap will likely shrink**[7]. For most investors, ESG is not equated to philanthropy: evidence that net-zero investing is a viable investment strategy is needed to ensure sufficient uptake.

One way pension funds can decarbonize their portfolios is by converting existing mandates into net-zero strategies. Going one step further, beyond portfolio alignment, investors can also actively finance the energy transition by investing in assets which offer direct support to climate-related activities or projects, such as green bonds.

In order to mobilize pension capital at scale, it is **crucial that the net-zero product offering is expanded** across the globe and that investors have a broad range of strategies through which net-zero allocations can take shape.

4. Willis Towers Watson, Global Pension Asset Study, 2023
5. Blackrock, Global Private Markets Survey, 2023
6. Amundi / Create Survey, 2023
7. Amundi, Net Zero investing and its impact on 60-40 allocation, 2023

Monica DEFEND
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Elodie LAUGEL
Chief Responsible
Investment Officer

Outlook 2024 - Turning tides in growth, inflation and monetary policy

2024 will see the tide turn for the economic and monetary policy outlooks, while fiscal policy may experience constrained consolidation **with the focus remaining on the energy transition.**

A fragmented outlook, with low tide on growth

We expect a gradual weakening of global growth, while inflation is expected to temper but stay above Central Bank (CB) targets. We call this **a fragmented outlook, marked by divergent economic trajectories**.

The **United States (US) is expected to face a recession in H1** as stringent financial conditions begin to impact consumers and businesses. In H2, we expect growth to stabilise below its potential and inflation to move closer to its target. In the **Eurozone, growth should remain low** with heterogeneous dynamics across countries, as fiscal policy becomes progressively more restrictive on top of already tight monetary policy. In **China, we observe an ongoing structural shift towards lower growth** (just above 3% by 2025), with some additional fiscal stimulus at play, without changing the big picture. In this fragmented outlook, India is emerging as a new power.

The investment sequence

	Start 2024	*End 2024*
Dynamic asset allocation when tides are turning	Start with a conservative allocation including hedges, and play diversification across alternative assets and strategies (gold, volatility)	Gradually add to equities and rotate from govies to credit
Bonds' appeal amid peaking rates	Gradually add duration and focus on quality credit, EM focus on HC debt and Euro HY short-term	Add high yield and EM local currencies after the Fed starts cutting rates and USD weakens
Seek resilience in equities	Stay defensive entering 2024 with focus on dividends, quality and add low volatility. Favour Global to play regional divergencies and Japan, US equal-weighted (concentration risk)	Turn towards more cyclical markets when Fed starts cutting rates. Rotate into Europe, EM and small caps.
EM winners in a fragmented world	Look at long-term winners (India), nearshoring stories across EM, winners in the energy transition (commodities) and technological advances (China)	
Energy transition and structural themes	Despite delays and a more disorderly trajectory towards net zero, energy transition remains in focus with: sustainable infrastructure, water, sustainable building and green bonds. Other relevant long-term themes are: ageing population and artificial intelligence	

Amundi Investment Institute, end of October 2023. EM: Emerging Markets. HC: Hard Currency. HY: High Yield. AI: Artificial Intelligence.

Inflation is cooling down, but Central Banks need to remain vigilant

US inflation will influence the Federal Reserve's (Fed) response and, consequently, determine whether **we witness a gentle recession or a hard one. Our outlook assumes that energy prices will remain contained and that recent geopolitical risks will be confined to specific regions**. A surge in energy prices would significantly impact headline inflation, although less than in previous periods amid a lower dependency on oil. The risk would be significant if higher headline inflation spreads to services and core inflation. Monetary policy is currently sufficiently restrictive and expected to remain so with ongoing balance sheet normalisation, which should prevent a price-wage spiral. In the Eurozone, weak domestic conditions would help reduce demand-related inflationary pressures and core inflation dynamics will progressively moderate.

The process of disinflation is ongoing in emerging markets. Several countries, particularly in Eastern Europe and to some extent in Latin America (especially Colombia), still have room for further disinflation. In Asia, barring a few exceptions, inflation is less of a concern. In the other two regions, inflation is likely to land around the upper bounds set by Central Banks. **This leaves EM Central Banks with some space for easing, but little room for error**. Reaching the inflation target is one thing, structurally re-anchoring inflation is another. A surge in energy and food prices can halt, if not reverse, the benign process in place, limiting Central Banks' easing in an already challenging global financial environment.

RESPONSIBLE INVESTMENT VIEWS FOR 2024

To reach the carbon neutrality objective by 2050, **global clean energy spending has to increase to $4.5 trillion per year by 2030**, with nearly half of this being dedicated to emerging markets. To support investments in clean energy infrastructure and technologies, the Inflation Reduction Act in the US and the Green Deal Industrial Plan in the EU aim to mobilise $400 billion in incentives and €300 billion in tax credits, respectively.

Sustainability issues will impact the economy, and our economic activities impact sustainability matters. Investors therefore need to address the investment context in a holistic manner to keep achieving performance in the long run. While financial markets bear a higher level of complexity and uncertainty due to both the recent geopolitical and repeated extreme weather events, at Amundi we stand firm in our conviction that **responsible investment delivers long-term value to our end-savers**.

At the same time, the successful, **long-term decarbonisation of the economy will bring significant social challenges. Social, climate and biodiversity issues cannot be considered in isolation**. For example, around 78 million jobs are estimated to disappear due to the transition to a low-carbon economy, replaced by 103 million jobs that workers must be trained for. Companies will increasingly be asked to prove their commitment to a just energy transition for all stakeholders: workers, suppliers, communities and consumers.

It is also important to advance our understanding of the **interconnected risks between climate change and biodiversity**. "Planetary boundaries" is a concept that delineates the environmental limits within which humanity can safely operate and provides a compelling framework to assess issuers' exposure to these interconnected risks.

Three main themes for the responsible investment industry in 2024

1. The first Global Stocktake shows that global emissions have exceeded interim targets for meeting the 2050 objective of the Paris Agreement. To achieve the global objective of net zero, **governments must issue and maintain more ambitious climate-related policies**. Climate strategy has become an essential component of investors' long-term risk management toolbox: an **integrated net zero framework**, embracing alignment and contribution dimensions, should be favoured by responsible investors. Tail risks stemming from both physical and transition risks should not be underestimated by investors.
2. The success of the transition at a global scale **depends on its success in emerging markets**, as they are the regions most affected by climate change. Following China's Belt and Road Initiative, the US and EU have also launched their own infrastructure programmes focusing on low- and middle-income countries. However, **public capital alone will not be sufficient. Blended finance** appears to be an efficient solution to leverage public capital to de-risk private investments and channel private money where it is most needed.
3. Responsible investing is quickly moving from a niche to a standardised and regulated environment. To face the environmental and social challenges of today's economy, it is key to **increase transparency** related to investors' commitments and **bring greater clarity** to our value proposition.

To conclude, successfully decarbonising the economy **requires urgent and coordinated action from all players, including from the financial industry**. The coming years are crucial if we want to avoid huge financial, environmental and social costs in case of a delayed or not successful transition, and make the most of the massive financial, environmental and social opportunities a steady and orderly transition can gift us with. **All investors should stay the course.**

TEN CIO CONVICTIONS FOR 2024

by Vincent Mortier
Group Chief
Investment Officer

and Matteo Germano
Deputy Group Chief
Investment Officer

1 **Turning tides in global growth, with US recession in sight for H1 2024**
Assuming that the Middle East crisis remains contained, we expect a weaker global economic outlook, mainly driven by the slowdown in Developed Markets (DM). The US will tiptoe into a recession in H1, while Eurozone growth remains mildly positive.

2 **Emerging Markets (EM) resilient but with higher fragmentation. Asia winner in investment flows**
A great reallocation, friend/near-shoring, supply chain de-risking, as well as the net zero or technological transition/ transformation should continue to direct investments towards Asia.

3 **Inflation continues to moderate, but Central Banks remain vigilant**
Weaker demand should help inflation converge towards Central Banks' targets by the end of next year, barring a major energy shock. DM Central Banks remain on a hawkish pause for H1, until inflation appears further under control, while EM Central Banks have some room to cut rates.

4 **Financing the green transition is the main target for fiscal policies**
Investments targeting the energy transition continue to be deployed in a constrained fiscal space, with governments trying to regain discipline. In the Eurozone, we see an acceleration in the release of NextGenerationEU (NGEU) funds. In the US, more investment will stem from incentives (IRA and CHIPS acts), but not enough to offset the consumption slowdown.

5 **Geopolitical realignment at play in 2024**
We expect 2024 to be a year of transition, higher tension and growing protectionism, which will benefit countries at the centre of new supply chain routes in Asia but also countries rich in natural resources, for example, Latin America.

6 **Diversification in 60/40 portfolios restored in a low growth/ falling inflation scenario, but watch out for volatility increase**
The high disparity in valuations and the drying up of excess liquidity will lead to higher equity volatility. Lower growth/ diminishing inflation may favour a return to negative bond-equity correlation, benefitting cross asset strategies.

7 **Fixed income is king amid peaking rates**
High debt levels and the normalisation of central bank balance sheets will mean that markets will have to absorb a higher supply of bonds. Yields, at their highest levels in multiple years, may attract long-term investors willing to reload the income engine of their portfolios.

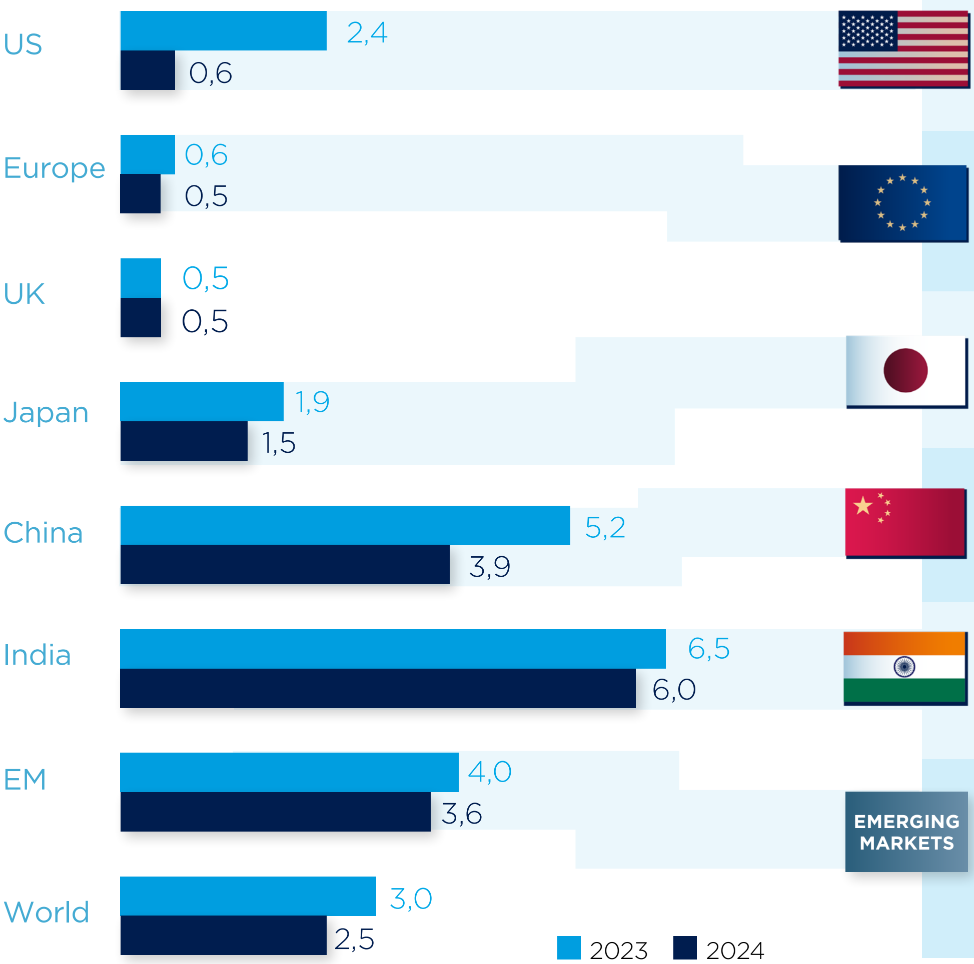
8 **In equities, defensiveness and quality value first, then cyclical markets/sectors when the easing cycle starts**
Concentration risk is high as US equity market upside has been driven by just a few names. Entering 2024, favour value in the US and Japan, and sustainable dividends globally. Later, move towards more cyclical markets and sectors, such as Europe.

9 **EM bonds lifted by peaking rates and inflation. In equities, Asia in focus**
A pause, followed by cuts from the Fed and a possible US dollar depreciation, bode well for EM assets. Fixed income hard currency debt is favoured at the start of the year. An earning's rebound should support equities, particularly in Asia.

10 **ESG investing should focus on net zero and explore themes that are gaining traction**
The energy transition remains the top focus when it comes to ESG. We expect investments into EM to accelerate with the private sector playing a key role.

Infographic - Macroeconomic Outlook for 2024

SLOWING AND FRAGMENTED GROWTH



US in an election year
Mild recession in H1 2024
Inflation to stay above 3%
⚠ **Higher inflation**

Europe in a global slowdown
Sluggish growth
Inflation slowing to target
⚠ **Low growth & lack of fiscal levers**

Japan: the return of inflation
Above-trend growth
Moderate underlying inflation
⚠ **Inflation higher for longer**

China: a lower growth paradigm
Deleveraging to outweigh easing
Low inflation
⚠ **Real estate fails to stabilise**

India still above potential.
Softening economic cycle & sound policy mix with national elections
⚠ **Higher oil prices**

EM in a fragmented world
EM cyclical downturn leaving space for a moderate rebound
Inflation just good enough
⚠ **Supply-side disruption**

Source: Amundi Investment Institute Projections at 31 October 2023 (Real GDP growth, annual percent change)

CENTRAL BANKS: ASSESSING THE TIME FOR A DOVISH TURN

FED

Recent bond market-driven tightening adding to monetary policy-lagged effects.

Fed cycle likely to turn mid-next year (first cut in May/June), with inflation moving towards target and shallow recession in H1.

We expect 150bp of overall cuts in 2024 and the Fed's Quantitative Tightening to keep going.

Inflation has fallen markedly but most of the effect of monetary policy still to come.

ECB cycle likely to turn mid-next year (first cut in June) on current and expected macro deterioration and lower inflation.

We expect 125bp of overall cuts in 2024 and ECB to continue its balance sheet reduction.

ECB

INFOGRAPHIC - Energy transition

ENERGY TRANSITION IN FOCUS

	Themes	Convictions
US	**Positive momentum amid incentives from IRA (Inflation Reduction Act)** **Key themes:** the evolution of traditional hydrocarbon firms; the increased share of new and lower-cost tech; the energy grids' ability to handle more intermittent power; and the adoption of new technologies.	**Favour the traditional hydrocarbon firms as well as the capital goods technology providers** (e.g. building controls, electrification components) **and commodity firms. Favour those exposed to CCUS** (carbon, capture, usage and storage) **and hydrogen** with competitive advantages in those areas.
EU	**A notable theme for the EU, but with some challenges** The European Green Deal should support the transition, but there are challenges related to delays, planning permission in some countries and regulation.	**Favour exposure to renewables** that can finance their transition through internal cash flows, EV trucks, solar panels, sustainable aviation fuels and the structural growth in automation, as well as reshoring activities. Conviction also in some of the cable and building insulation companies.
EM	**Greater private financing needed to support EM critical players** EM play a vital role in global supply chains and the energy transition, but these countries will need about $2 trillion annually by 2030 to reach net zero emissions by 2050*. The private sector will have to support around 80-90% of the investment needed.	**Favour countries where commitment to fighting climate change is increasing.** China is among the favoured countries in the long-term. In the EM, Sustainable Development Goals are gaining traction. In particular, these regions play a key role in the EV and renewable energy space.

** Source: IMF and International Energy Agency.*

Source: Amundi Investment Institute, IMF and IEA on Climate Policy Initiative with staff calculations. The estimation share of private climate finance to achieve net-zero emissions by 2050 is based on public climate financing share in total public investment that increases by a factor of 1.5 until 2030. Bloomberg. Data is as of 30 October 2023. EMDEs: Emerging Markets and Developing Economies.

Click here to read the full paper

Jean-Xavier BOURRE
Head of OCIO Investment Strategy Advisory

Pension funding ratios: Back on a high

The positive momentum in funding ratios seen in the first half of 2023 continued, powered by the upward trend in rising liability discount rates.

	31/12/2018	31/12/2019	31/12/2020	31/12/2021	31/12/2022	31/03/2023	30/04/2023	31/05/2023	30/06/2023	31/07/2023	31/08/2023	30/09/2023	31/10/2023
Netherlands	103.60%	104.30%	100.20%	114.30%	115.79%	116.40%	117.30%	117.80%	117.80%	120.80%	120.30%	123.20%	
UK	95.70%	99.20%	95.50%	107.70%	136.47%	133.25%	136.14%	145.20%	145.80%	146.40%	146.20%	147.50%	147.50%
US	86.10%	86.80%	87.90%	95.50%	98.20%	98.50%	98.30%	99.00%	100.50%	101.60%	101.80%	102.30%	103.10%

Sources: - UK data: Purple Book, PPF S179 funded status. - Netherlands data: Dnb - US data: Aon Pension Risk Tracker.- German CTA data: FactSet, based on average pension exposure of German corporates of EUROSTOXX 600 for 31/12/18 until 30/12/20. Amundi estimate from 30/12/21.

2023 Market Context

Financial markets have experienced another period of extremely volatile conditions, fueled by Central Banks communications centred on how they would pivot their policies in an economic environment featuring extremely contrasting performance among and across regions, and continued rising geopolitical tensions.

Early in the summer, strong economic data coupled with decelerating inflation saw **global equity markets record their 5th consecutive month of positive returns, while credit spreads tightened in both investment grade and high yield**. Further rate hikes in both the US and Europe put bond markets under pressure.

However, as the summer advanced market sentiment shifted drastically. A mood which lasted well into October. Equity markets were pushed lower, credit spread wider and yields reached multi-year highs due to a combination of five effects:

1. Market realisation that following still strong economic data, rate cuts are not going to happen anytime soon
2. An accelerating sell-off in bonds
3. Higher oil prices stoking inflation
4. Concerns about Chinese growth
5. Increased geopolitical tensions following the surprise Hamas attack on Israel.

Impact on pension funds

In this environment, despite asset portfolios stabilising at their lowest level since Covid era's peaks, **solvency of pension funds continued improved across all jurisdictions**, driven by continuously rising liability discount rates. It is worth noting that the funding ratio in the US breached the 100% bar. In the UK, PPF7800 Index liabilities have been divided in two since 2020, while the funding ratio is stable at 147.5% in October vs September 2023 and surplus is at a historical high. In the Netherlands, despite several factors significantly impacting pension funds' liabilities (UFR discount curve methodology reform[8], re-indexation of pensions to inflation[9]), the Dutch pension funding ratio reached 123.2%, close to 2022 highs. Only 2% of Dutch pension funds have a funding ratio below 105%. In Germany, historically CTA[10] have had a lower hedge ratio compared to other jurisdictions. The recent movement in rates have also been supportive for the solvency of the different trusts, despite weak performance of both risky and fixed income assets.

8. See https://research-center.amundi.com/files/nuxeo/dl/f6a8e3c0-a1d4-4f45-8c0e-ab070f41b953 for detailed analysis of the UFR methodology
9. See https://research-center.amundi.com/article/amundi-pension-funds-letter-ndeg18 for detailed explanation of the Dutch pension system
10. See https://research-center.amundi.com/article/amundi-pension-funds-letter-ndeg11 for a snapshot on German corporate pension landscape

CROSS ASSET Investment Strategy

AMUNDI ASSET CLASS VIEWS

	Asset Class	Stance as of Oct. 2023	Direction of views for H1 2024	
EQUITY PLATFORM	US	-/=	=	Improving
	US value	+	+	Stable
	US growth	--	-	Improving
	Europe	-/=	=	Improving
	Japan	=	=/+	Improving
	China	=	=	Stable
	Emerging markets ex China	=/+	+	Improving
FIXED INCOME PLATFORM	US govies	=/+	+	Improving
	US IG corporate	=/+	=/+	Stable
	US HY corporate	-	-	Stable
	European govies (core)	=	=/+	Improving
	European govies (peripherals)	=	=	Stable
	Euro IG corporate	=/+	=/+	Stable
	Euro HY corporate	-	=	Improving
	China govies	=	=	Stable
	EM bonds HC	=/+	+	Improving
	EM bonds LC	=/+	=/+	Stable
OTHER	Commodities	=/+	=/+	Stable
	Currencies (USD vs. G10)	-	-	Stable

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Negative view Neutral Positive view

▼ Downgrade vs. previous month

▲ Upgraded vs. previous month

Source: Amundi as of 7 November 2023.
Direction of views for H1 2024 refers to the possible evolution of stance on each asset class during the period.
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.
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To go further: The Amundi Research Center

Amundi Investment Institute

In an increasing complex and changing world, investors need to better understand their environment and the evolution of investment practices in order to define their asset allocation and help construct their portfolios. This environment spans across economic, financial, geopolitical, societal and environmental dimensions. To help meet this need, Amundi has created the Amundi Investment Institute. This independent research platform brings together Amundi's research, market strategy, investment themes and asset allocation advisory activities under one umbrella; **the Amundi Investment Institute**. Its aim is to produce and disseminate research and Thought Leadership publications which anticipate and innovate for the benefit of investment teams and clients alike.

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ESG and Net zero

2024 Outlook

Thematic Papers