CENTRAL & ALTERNATIVE SCENARIOS

Monthly update

We maintain the overall pandemic narrative confirming the probabilities, assigned to the base and alternative scenarios.

DOWNSIDE SCENARIO
L shaped
20%

- **Pandemic extended up to mid-2021,** with slow medical advances and a second round of outbreaks late 2020
- **National lockdowns measure are extended** as fatalities increase
- **Deep and long global recession leads to a depression**. Demand and economic activity collapse, even beyond the direct impact of the public health emergency
- **Full debt monetisation** worldwide with ballooning public debts and rising CB balance sheets
- **Loss of potential output** on collapsing businesses
- Long period of **financial repression** (through regulation and zero-interest-rate policies)
- **Massive bankruptcies and mounting costs of collapsing businesses** undermine confidence in the banking sector and lead to financial instability
- **Secular stagnation** comes back to the fore and **de-globalisation is the new norm**

CENTRAL SCENARIO
Base shaped
50%

- Temporary but prolonged shock:
  - **the pandemic is not over end 2Q20** (falling death rate, but the disease doesn't disappear)
  - thanks to national **lockdowns limited in time** (3-months max), the epidemic is finally under control in late Q3
  - health and economic crises in vulnerable emerging markets (Africa and South Asia)
- **Global deep recession in Q1, Q2 and Q3 2020**
- **Slow recovery beginning in 4Q20** (hysteresis effects and sluggish growth), followed by a **rebound in 2021** (mostly driven by the base effect and stimulus packages)
- Governments and CBs "**Bazooka" policies** fail to calm animal spirits (fear factor) in the short run (Q2) but **preserve incomes and businesses**
- **Corporate defaults surge in 2020** with tighter financing conditions and declining profits, coupled with the oil-price fall. Deep fragmentation of credit markets and solvency issues
- The **reversal in the manufacturing sector lags the reversal in services**
- **The Chinese recovery** is curbed by weaker demand from the RoW
- Some stagflationary forces materialise **(de-globalisation)**

UPSIDE SCENARIO
U shaped
30%

- **Time-limited shock, the pandemic** is under control in 2Q20
- **Deep but short-lived recession** mainly in 1H2020
- Global central banks and fiscal **coordinated actions** support the restart of the economy which heads back to its pre-crisis level
- **Reversal** of the manufacturing sector and services
- **Limited number of corporate defaults** thanks for government supports and central bank liquidity measures
- Pent-up demand materialises
- **Above potential growth in 2021**, and possibly in some countries as early as 2H2020

Where do we stand on Covid-19

The potential easing of lockdown measures bring some light at the end of the tunnel. This is particularly the case in Europe where several countries are opening back shops, manufacturing capabilities or services. **Data show that the worse is probably over** in Italy and France for instance, but in the US, many states such as New York remain in an acute phase of the outbreak. Moreover, **emerging countries are still at the beginning of the pandemic.** Although it is too early to draw a conclusion, the low level of death toll registered so far in Africa gives hope for a more benign impact than feared. On one hand, these countries' infrastructures will make the disease more difficult to fight but on the other hand, EM demographics are more favourable. Going forward, the lack of tests make the **statistics less and less reliable.**

The total number of deaths directly linked to the virus are significantly underestimated according to recent studies. Therefore, we still ignore the magnitude of the outbreak at the global level. The situation seems to be **stable in China** where feared of a second wave remain. As constraints measures starts to unfold, many questions remain unanswered: Is the **collective immunity** sufficient to avoid a sharp pick up in cases once we reduce confinement measures? Are we going to see a second wave? If so, will it be smaller or bigger than the first? **It is reasonable to assume that Covid-19 will not disappear anytime soon,** and will remain a source of risk until a medical treatment appears.

TOP RISKS

Monthly update

Risks are clustered to ease the detection of hedging strategies but they are obviously linked. While we confirm the overall narrative on the outlook, pandemic exacerbated existing fragilities and vulnerabilities while more risks materialized in our radar: financial and geopolitical risks' probabilities are set to creep higher.

ECONOMIC RISK

10%
Probability

Depression

- **The pandemic continues with a second outbreak and rising fatalities**
- **A deep, long global recession:** demand and economic activity collapse and national lockdowns remain for more than six months
- **Loss of potential output** as businesses collapse
- **Debt burden** exacerbated by emergency fiscal policies and liquidity injection to overcome the coronavirus drawdown
- **Rising default risk** on small countries single commodity exporters (i.e. oil) and strongly dependent on touristic flows

+ Cash, linkers, USD, Defensives vs. Cyclicals

- Oil, risky assets, FX commodity, EM local CCY exporters

FINANCIAL RISK

15%
Probability

Financial instability

- **Mounting corporate vulnerability,** solvency issues, and increase of default risks (>15 or even 20%)
- **Spill over into the banking sector** and financial risk exacerbation with a large number of defaults due to global recession and financial instability
- **Credit illiquidity** and risk misallocation
- **USD liquidity** drought
- **Central bank policies inefficacy**: UST long-term bond yields to rise despite the Fed QE with low pick-up in the primary markets (the same may occur in Europe)
- **Rating downgrades, Balance of Payment crisis and at the worst credit default** as a result of excessive policy easing on existing fiscal and external vulnerabilities

+ CHF/AUD, YEN (AUD, NZD, CAD), CDS, optionality, Min Vol

- Oil, risky assets, frontier markets and capital outflows

(GEO)POLITICAL RISK

15%
Probability

Covid-19 exacerbates political tensions

- **US elections:** Trump poorly handling the pandemic national emergency might revert the course of presidential election while no electoral campaign will take place
- **Economic and national security interests** (and objectives) arising from a revival in the coronavirus, lead to a new wave of trade conflicts
- Failure of **Eurogroup's deal,** anti-establishment parties take the lead (mainly a European risk)
- The UK is moving to **hard Brexit**
- **US-China fissures** are opening up in many areas of crisis response, from debt relief plans to WHO funding
- Open **oil war**
- **North Korea and KJU health risk:** unintended escalation on bumpy power transition

+ DM Govies, cash, gold, linkers, USD, volatility, quality

- Oil, risky assets, EMBI

Methodology

- **Scenarios**

The probabilities reflect the likelihood of financial regimes (central, downside and upside scenario) which are conditioned and defined by our macro-financial forecasts. We use the k-means clustering algorithm to our enlarged macroeconomic dataset, splitting the observations into the K cluster, where K represents most of the variability in the dataset. Observations belong to one cluster or another based on their similarities. The grouping of the observations into the k clusters is obtained by minimizing the sum of squared Euclidean distances between observations and clusters centroids i.e. the reference values for each cluster. The greater the distance, the lower the probability to belong to a given regime. The GIC qualitative overlay is finally applied.

- **Risks**

The probabilities of risks are the outcome of an internal survey. Risks to monitor are clustered in three categories: Economic, Financial and (Geo)politics. While the three categories are interconnected, they have specific epicentres related to their three drivers. The weights (percentages) are the composition of highest impact scenarios derived by the quarterly survey run on the investment floor.

CROSS ASSET DISPATCH: Detecting markets turning points

How to the read turning point assessment

Not reached yet too early to call it | Approaching to the turnaround | Turnaround happened

ECONOMIC BACKDROP

- **Global growth contraction** in Q1-Q3 2020 followed by a bounce-back sequence in 2021.
- **Economic momentum** based on soft-data indicators pencil in the same "Weakening" flash with some differencies: US/EZ/China nit distance from the bottom, Row in transition phase.
- **Covid-19 outbreak has stretched global financial conditions.** Despite central banks' efforts, **investors' "perceived" liquidity is under stress but far higher than the lows seen during the Global Financial Crisis.**

FUNDAMENTALS & VALUATION

- We expect **earnings to drop in Q2, Q3 this year and to bounce back in 2021.**
- **Despite recurrent downward revisions,** we believe consensus EPS expectations remain far too high.
- **Valuation:** PEs are far from flagging potential entry points (S&P500's PE @ 15 and Euro Stoxx 600 PE @ 13 2020).

DEFENSIVE ASSET ALLOCATION

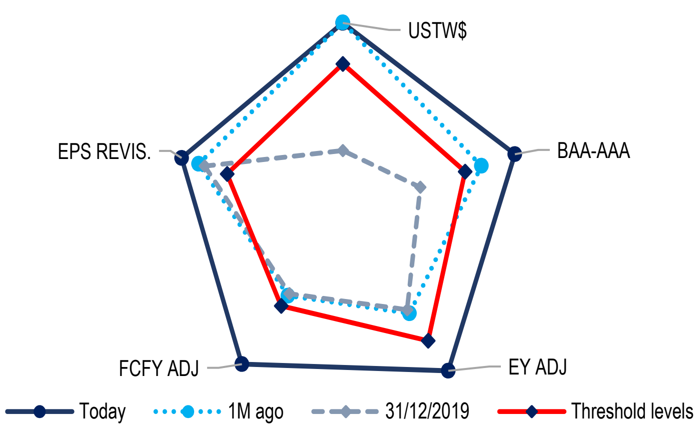
TECHNICALS

- **Price Momentum signals turned mildly constructive** on building back some risk exposure during the first week of April. However, this has **not been followed by a broader Risky Assets improvement on a more medium-term perspective.**
- **Dislocation strategies remain profitable** (since end of March). However, there are some selected pockets of dislocation that continue to underperform (oil in particular).

SENTIMENT

- **Despite markets retracing, our overall assessment on risk sentiment remains negative. Financial conditions** improved only at the margin with unclear direction**.** **The credit risk premium** remains high despite the spread tightening in response to the Fed's umbrella on Fallen Angels. **EPS revisions are negative and the USD strength vis a vis the broader FX spectrum acts as a headwind.**
- **Flow-based sentiment metrics,** tracking institutional investors' risk appetite, show **some attempts to reposition in search for a potential bottom in the defensive spectrum,** "barbelling" risk in a relative positioning.

Cross Asset Sentinels Thresholds (CAST) touching the top



Source: Amundi Research - Data as of 24/04/20

CAST flags extremely high risk perception.

Sentinels wave above the top on persistent stress in the low-quality credit names as flashed by the Moody's spread (AAA↓↓, Baa↓). EPS revisions continue to run downwards touching all-time lows.

Methodology We consider five inputs which we call "Sentinels": USTW$, Moody's Baa-Aaa, EPS revisions, Earning Yield risk adjusted and Cash Flow yield risk adjusted. These sentinels are used to reposition our tactical asset allocation. Once sound thresholds are detected, the five variables are aggregated as an indicator that anticipates the market's stress conditions, with a certain level of conviction. The pentagon visualises the five sentinels where the red line represents the alert threshold. The greater the distance above the red line, the higher the risk perception, and eventually the need to move closer to a defensive asset allocation.

GLOBAL RESEARCH CLIPS

1. **The big picture: The pandemic outbreak has altered the financial regime cycle we had in mind** at the end of 2019. We now expect a **contraction** (*central bank and government support, a recession, and rising unemployment*), followed by a **recovery** later in 2021 (*economic activity retracing back but below 2019 levels, rising labour costs, and cooling down of monetary and government actions*), which would eventually land in a **late cycle** in 2022 (or potentially an asset reflation regime, should central banks remain ultra-supportive). The first phase is characterized by a preference for cash, govies, IG under the CB umbrellas, and gold. The following step will be to move to EM equity (*first-in, first-out*), base metals and HY as soon as the profit cycle bounces back while the last stage will be a broad repositioning in DM equities and the full credit spectrum.

2. **Economic backdrop: a global recession with sequencing drawdown and diverging recovery path**. The length of the weakness and the extent of permanent output loss and demand destruction will depend on how long the lockdowns last, only partially compensated by central bank and government actions. The recovery will lead to de-synchronized paths in three blocks: China/South Asia, US/Europe and developing countries, each producing specific investment opportunities.
   - **Labour** markets will be key to assessing the final shock to domestic demand. Unemployment is expected to rise to levels not seen in the past 50 years, if policies and schemes to support reduced hours workers fail to produce their intended effects. Most vulnerable are Italy and Spain, whose labour markets are more exposed to temp workers, sectors at risk (tourism-related), and those that still have not fully recovered from 2012 crisis. Among EMs, the larger the informal sector, the more pronounced the shock.
   - **China first-in-first-out**. Policy has tilted towards further easing to cope with downside (exacerbated by weakening global demand).
   - Covid-19 is exacerbating **EM fragilities** on rising debt, increasing external vulnerability and oil dependency. Fiscal and reserves buffers are favouring Russia, South Korea, the Philippines and Peru.

3. **Global liquidity** started to increase in Q2 2019, with the Fed back on a rate-cut course and eventually entered cross-border banking circuits. However, **liquidity as perceived by market participants remains tepid**. In fact, global financial conditions, while far from GFC levels, have bottomed out in 2020 and corrected only marginally, notwithstanding the massive monetary policy efforts.

4. **Italy:** Covid-19 and lockdowns will be a drag on GDP that we expect to revert back to pre-crisis levels in 2022 in our base case. The debt/GDP path will depend on growth, the average cost of debt and the primary balance. **PEPP** (flexibility on capital key and no issuer limit) will **support short-term financing needs**. The ECB has around €100-120bn of firepower for buying BTPs and will absorb the €55bn of new net issuance for 2020 very easily (including €25bn of new fiscal measures). In the **medium term, Italy will take more than 10 years to revert back** to its 2019 debt/GDP level. Rating agency actions will depend on the policy response.

Stimulus packages - Update

The **large fiscal packages** announced by governments to counter the virus crisis aim, so far, at stabilizing more than stimulate economies. In addition to **funding emergency response** to the virus situation itself, these packages intend to prevent a worsening of the crisis through the financial and household income channels. Only part of the amounts recently announced by governments are budget easing measures under a strict definition. On these, there is a larger push in the US and Japan than in Europe so far. Other amounts are advances meant to be reimbursed, or (for the largest amounts) government guarantees to corporate debt.

Regarding **guarantees**, the European push is, at this stage, much larger than the US one. Within the specific architecture of the Euro area, **European institutions have also played a major part,** by lifting restrictions so that member states can deploy their national program. A European-level mutualized response is also under way, with a number of programs already decided and larger ones currently being negotiated.

The combined effect of the recession and the whole array of above-mentioned measures on deficits and debt could be, very roughly for large advanced economies given the many unknowns, a **7% to 15% of GDP deficit increase and a 15% to 25% of GDP public debt increase in 2020**. However, the public debt sustainability of large advanced economies may not be that damaged by the crisis, due to the large QE programs announced by central banks that will monetize the additional debt. Yet, the recently announced stabilization-aiming fiscal measures are not the end of the fiscal easing chapter opened by the crisis. Indeed, they will probably give way to further measures, this time stimulus-oriented, once the confinement measures are gradually lifted. It is also very probable that some of the crisis-fighting fiscal measures, currently presented as temporary will become more or less permanent due to demands of a stronger government role in the economy, and stronger social safety nets. If not matched by offsetting revenue-raising measures, they **may lead to permanently higher structural primary deficits.**

** See forthcoming Thematic Paper by Tristan Perrier*

AMUNDI ASSET CLASS VIEWS

	Asset Class	View	1M change	Rationale
EQUITY PLATFORM	US	-/=		The current rebound was warranted after the quick sell-off between Feb and 23 March. But there are concerns as we enter the earnings season because companies are not giving guidance for the rest of the year as visibility on the extent of the economic lockdown impact of the virus is extremely low. We maintain a cautious stance as we expect earnings to come down further.
EQUITY PLATFORM	Europe	-/=		Earnings visibility is low and the range of outcomes is wide. As a result, we do not feel confident of the recent recovery. The crisis offers attractive stock selection prospects but is producing higher than usual uncertainty and volatility, leading to dislocations in some parts of the market. We prefer companies with strong balance sheets.
EQUITY PLATFORM	Japan	=		Japanese balance sheets remain underleveraged and valuations are also attractive. But companies' earnings are likely to be affected by the global economic slowdown. As a result, we stay neutral.
EQUITY PLATFORM	Emerging markets	=		We maintain our relatively defensive stance but we are observing positive signs in countries that are in the later stage of the coronavirus cycle. In particular, we like countries with strong fiscal buffers, domestic bases and lower external vulnerabilities. However, we avoid names dependent on export, commodities and tourism.
FIXED INCOME PLATFORM	US govies	=/+		Demand for safe haven assets is supportive for US govies. The ultra-loose monetary policies of central banks are likely to keep core bond yields range-bound. UST yields appear close to fair value and the Fed's monetary response eased liquidity constraints in the second half of March.
FIXED INCOME PLATFORM	US IG Corporate	=/+		The IG market has been a beneficiary of the Fed's stimulus and we have seen high level of new issues. Importantly, the Covid 19-induced market dislocation has presented long term opportunities across all rating categories, in particular in long maturity IG corporate bonds, which initially underperformed their own equity returns. We remain selective.
FIXED INCOME PLATFORM	US HY Corporate	-		High leverage, falling oil prices and economic lockdowns due to Covid-19 increase the risk of default in the HY markets, and as a result, we are very cautious. Certain segments of HY corporates offer unique value but require a strong focus on selection.
FIXED INCOME PLATFORM	European govies	-/=		We are slightly more positive than before on core EU but remain cautious overall. Euro peripheral countries offer attractive yields, although we are now more cautious, in particular on Italy.
FIXED INCOME PLATFORM	Euro IG Corporate	++		We maintain our constructive view on EUR IG, as it will benefit from the ECB's liquidity backstop and fiscal package, which will reduce migration and default risk. The sector remains relatively less leveraged than US peers. We believe investors should continue to adjust sector allocations to reduce risk from sectors more exposed to a recession.
FIXED INCOME PLATFORM	Euro HY Corporate	-/=		We favour EUR HY to US where we believe the default rate risk is high. However, we are still very selective overall and looking at industrials sectors such as telecom, media and non-cyclical consumer. Liquidity conditions are stabilising but remain poor in the current market environment.
FIXED INCOME PLATFORM	EM Bonds HC	=/+		We remain cautious but believe sentiment is improving in terms of asset prices, as well as fund flows. There is some value in HC, particularly in high yield, where spreads have already widened to GFC levels, and there is ample value in Bahrain and Indonesia. Quasi-sovereign debt in Latin America offers attractive risk/reward in Brazil, Mexico and Peru.
FIXED INCOME PLATFORM	EM Bonds LC	=		Our preference is for EM rates, where we see value in Russian assets in both FX and rates. In Mexico and South Africa, we see value in rates, but not in FX. Overall, countries with strong fiscal buffers will be better able to weather this downturn.
OTHER	Commodities			Cyclical commodities such as oil are not finding any support from the economic backdrop, due to the current global lockdown. While oil prices may benefit from a restoration in economic acitivities, markets at the moment are discounting a huge structural oversupply and a no recovery scenario. Gold remains the great winner in this framework as it benefits simultaneously from economic uncertainty, increasing government deficits and CB QE purchase programmes.
OTHER	Currencies			Despite ongoing concerns on the economic impact that lock/down measures have so far created, CB and government interventions have helped to contain credit risk, and marginally ease financial conditions thus stabilising stock market sentiment. Despite the fact the Fed's strong intervention (conventional and unconventional) should suggest a weaker USD, the greenback remained resilient/strong in the month, with cyclical commodities-related currencies losing the most. As growth differential remains in favour of the US and uncertainty is expected to stay high in the short-term, we think it's worth maintaining USD long for the time being and maybe try to play some reflation trades (anticipating then 2021 outcomes) where dislocations are huge.

LEGEND

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Negative			Neutral	Positive			Downgrade vs previous month	Upgraded vs previous month

IG = Investment grade corporate bonds, HY = High Yield Corporate; EM Bonds HC / LC = EM bonds hard currency / local currency. WTI= West Texas Intermediate. QE=quantitative easing.

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