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## EXECUTIVE SUMMARY

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## Put the Growth Bucket Back in the Spotlight



As long-term investors, Pension Funds need to find new distinct ways to invest and rethink the full potential of their growth bucket as a flexible opportunity to deal with the uncertain, regulated and challenging environment they are facing.

### Three ideas to reinvent the growth bucket investment approach

**Megatrends** represent the major disruptive evolutions to be expected in the coming decades, which incorporate an intergenerational approach and grasp structural growth engines.

Through thematic investments fully integrated in megatrends, investors have a concrete way to exploit prospective potential returns.

Within a Pension Fund asset allocation, the **Equity** space provides for a liquid and mid to long-term investment horizon. Pension Funds should seek higher returns over the long-term.

Looking beyond capital appreciation, equities are an attractive asset class from an income perspective, that is becoming more and more important.

Equities offer investors a source of reliable income, with dividend yields comfortably in excess of other available yields in fixed income markets, which are at historic lows.

**Emerging Markets** shall no longer be seen as a unified block. This will help investors move beyond traditional investing in this asset class and promote new innovative solutions across the full Emerging Markets spectrum.

As Emerging Markets become more relevant in strategic asset allocation, investors should embrace a more holistic approach with new tools to better grasp their intrinsic key characteristics and risk factors.



**Élodie LAUGEL**  
Head of Institutional Business Development Support



**Éric TAZÉ-BERNARD**  
Chief Allocation Advisor

## Growth-Driven Investment: Is Your Growth Portfolio Fit for Purpose?

### A blurred split between matching portfolio and growth bucket

The low interest-rate situation, that investors have been facing over the past 10 years, has been quite challenging for their asset allocation models. After a long period of denial during which, year after year, they have anticipated a return of interest-rate levels to their historical standards, there has finally been a widespread acceptance that low rates were here to stay.

Progressively, they have adapted their strategic investment plan, through different and complementary types of approaches:

- **Interest-rate mitigation strategies**, with a tighter duration matching between assets and liabilities, underlining investors' preference for incurring opportunity costs in case of interest-rates rise rather than funding risk in case of a continuation of their decline.
- **A massive "search for yield"** move, whereby investors have exchanged market risk against better cash-flows visibility, notably through an increased exposure to real assets, which has in some cases been further supported by a friendly regulatory evaluation of illiquidity risk.
- **The emergence of cash-flow driven solutions**, for which the "separation theorem" between the liability-matching portfolio and the growth portfolio seems now outdated as Cash Driven Investment (CDI) approach aims at combining search for yield and liability matching, while yield sources are becoming scarce.
- This focus on cash-flows has been reinforced by the observation of a growing number of Pension Funds turning cash-negative, with benefits payments starting to be higher than contributions. As a result, they are increasingly looking for **income or even coupon generation over short-term horizons**, as illustrated by the emergence of multi-asset credit or credit continuum solutions.

### The horizon puzzle

Pension Funds, but also other sovereigns, life insurers, and other institutional investors managing pooled assets, are therefore currently confronted with a combination of concerns:

- **Matching pension benefits**, a hard task in a context of extremely low rates and in some cases of negative cash-flows.
- **De-risking** the balance sheet as a result of a deterioration of the funding ratio over the past few years.
- On the opposite, **re-risking the balance sheet** as the last chance to recover from a poor financial situation.
- Continuing to diversify into higher-risk assets in order to **generate the required yield** and to **try creating a funding buffer**.
- **While preparing for the anticipated end of the cycle** by moving into more defensive strategies.

Needless to say, some of these objectives appear contradictory and illustrate the necessary arbitrage between short-term constraints and long-term goals and ambitions. Beyond any potential horizons' trade-off, it triggers the absolute necessity to define the objective by time maturity and allocate assets by horizon buckets. Allocating assets across different horizons is not something new for institutional investors. They have been used to it as far as their liability-matching portfolio is concerned, but we argue that the new environment we are facing also justifies such time horizon bucketing approach to growth portfolios.

*"They have been used to it as far as their liability-matching portfolio is concerned, but we argue that the new environment we are facing also justifies such time horizon bucketing approach to growth portfolios."*

**What are the objectives of your growth portfolio?**

The growth portfolio is traditionally designed to generate return over the long term, without consideration to liability matching. It is therefore essentially invested in higher return assets, which are typically equity-related. In order to address short-term constraints related to evolving risk bearing capacity, investors are usually adjusting the exposure to this growth portfolio or at least to the most liquid or hedge-able part of it.

Such risk budgeting approach should certainly remain the key driver in any investment plan design, but before even starting assessing it, we could take a step back and question the ultimate objective of such a performance quest. Risk budgeting is not the destination of your portfolio construction; this is the way you decide to make your journey: more or less quickly, more or less risky.

Taking the case of an open Pension Fund managing pooled assets, we can wonder what is the ultimate objective of a growth portfolio, and what is its horizon, whether single or even multiple?

1. First, it has to generate a sufficient buffer to absorb all the liability impacting developments which cannot be hedged through the matching portfolio. There are some risks embedded in pension liability that cannot be mitigated properly through financial instruments, like for instance the local salary inflation or a given population’s longevity. More generally, for all assumptions related to non-financial parameters that are used to project future pension cash-flows, there is an estimation error risk that could impact the funding. For all these unexpected liability developments, there is no true way for hedging or even getting some sort of partial return indexation. Capital growth should enable to create a sufficient buffer to absorb unexpected developments. This buffer should be built with a moderate risk budget combined with a short to medium-term return target horizon.

The second dimension is far more long-term oriented and related to the long-term dynamic of the liabilities.

2. For an open Pension Fund, the shape and value of future benefits will indeed evolve according to trends in the population of its employee members. The Pension Fund has to remain solvent not only for current pensioners and employees but also for the coming or future ones. **In that sense, Pension Funds are responsible towards future generations and have to warrant solidarity between generations and integrate a dimension of perpetuity in their objectives and ambitions.**

**To whom does the current funding belong?**

In a post-crisis context, there is a consensus on the fact that pension policies have been very much in favor of the current generation at the expense of the next generation, and that there is a need now to re-equilibrate. While subject to multiple interpretations, the concept of intergenerational equity is increasingly shared by thought leaders, governments as well as by the Pension Funds industry.

Savings or reserve institutions with perpetual maturity are gradually refocusing their attention to this responsibility towards future generations, but the current degree of intergenerational solidarity varies across Pension and Sovereign Funds.

**Targeting the intergenerational horizon**

Investors embracing Responsible Investment approaches or for instance integrating solutions to finance the green economy transition are definitely moving to that intergenerational focus. More and more conscious about their fiduciary duties, investors are also considering sustainable growth to avoid disruptive risks and economic instability that could impact future funding. Obviously, if Responsible Investment is not exclusively addressing long-term challenges, it however definitely participates to this perpetual horizon ambition.

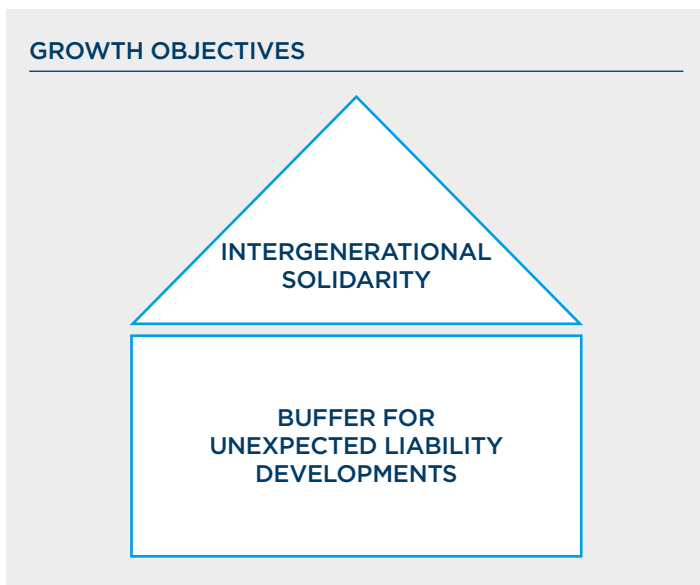
But if the intergenerational horizon is concerned, then investors have to plant the growth seeds of the next generations in their portfolio.

Alongside asset classes indexed to developed and emerging economic growth, investors should build an exposure to the megatrends shaping the economy of tomorrow.

**Megatrends: the growth’s seeds of tomorrow’s economy**

Technology revolution, demographics evolutions or social changes are examples of trends that will shape the future of the economy and therefore the growth of tomorrow. Getting strategies indexed to tomorrow’s growth engines allows investors to improve the robustness of their funding over the long-run (alongside traditional liability matching strategy and risk budgeting approach).

“Megatrend thematic equity” strategies have been defined in response to trends expected to occur in the very long-term and driven by new forces. These strategies are based on perspectives of positive growth linked to structural changes or trends such as the “silver age economy” or the “disruptive technology techniques”.



Such very long-term investment strategies bring several benefits to a performance-seeking portfolio:

1. They enable to build a more robust indexation to growth, by complementing medium and long-term economic performance with assets linked to very long-term micro-economic developments.
2. It mitigates some long-term risks that could have a detrimental impact on the liabilities' profile. In the case of a megatrend with a significant impact on liabilities, being exposed to the beneficial side of the same megatrend could partially mitigate this impact. As an example, the increasing longevity trend is significantly weighing on the liability value but at the same time supports the growth perspectives of the "silver age economy".
3. Finally, while the typical growth portfolio construction follows a central scenario, whereby equity returns estimates are based on normative macroeconomic assumptions and dominate those of other asset classes in the long-term, the introduction of megatrends provides exposure to alternative scenarios that integrate disruptions in global trends.

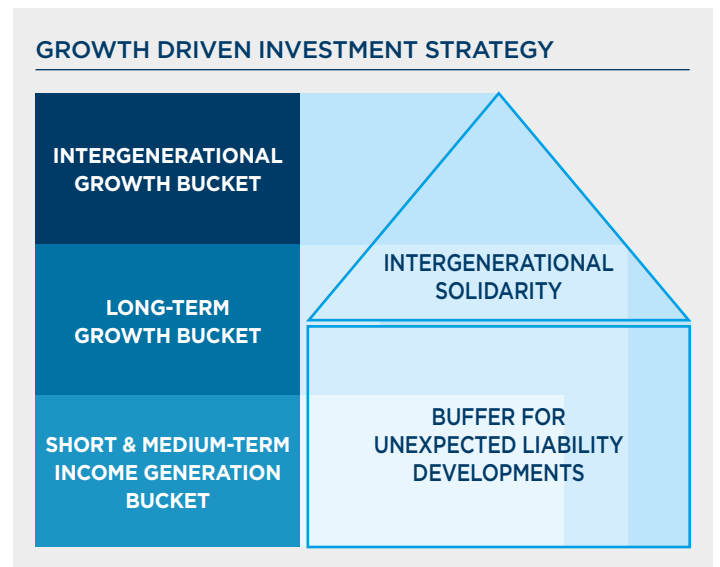
**The Growth Driven Investment (GDI) across the horizon ladder**

When building a return-seeking portfolio, we do then believe investors should select an asset universe suited to address their specific ultimate goal, i.e. to generate performance over multiple horizons:

- A short to medium-term income generation bucket
- A long-term growth bucket
- An intergenerational growth bucket

With these three pillars, the GDI aims at delivering sufficient return to create a buffer in case of unexpected negative liability developments as well as reinforcing intergenerational funding solidarity.

Moving towards this enhanced definition of a return-seeking portfolio split across horizon buckets, like Liability Driven Investment (LDI), leaves a number of questions open, notably the relevant horizon buckets' allocation to match these less explicit growth objectives. Still, we believe that segmenting such portfolio along several buckets adapted to different investment horizons, as well as using thematic strategies for the very long-term intergenerational portion of this portfolio, will improve its efficiency, and is certainly worth considering adapting the investment universe to such multiple horizons.





**Vafa AHMADI**  
Head of Thematic Equity Management,  
CPR AM

*Interviewed by Eric Tazé-Bernard*

## Thematic Investing: Our Specialists' Viewpoint

### Vafa, let us start with a clarification of concepts: themes, trends, megatrends, can you give us your own definition?

Megatrends are major disruptive evolutions expected to affect the global economy over the next decades, in terms of technological, socio-demographic and environmental changes in our societies.

**Thematic investments are investable ways to capture some of the consequences of such megatrends, which tend to play out over very long horizons and whose significance is usually underestimated by investors.** They also have broad cross-sectional effects that change over time, implying that thematic managers must be able to regularly adapt their investment universe.

We, therefore, view megatrends as a general concept, while thematic investments are a more concrete way to exploit the expected megatrend. Likewise, the megatrend is by definition structural and long-term, it is here to stay, whereas the notion of theme refers to the consequences of the megatrend, and can be subject to market cycles.

### Can you please describe the megatrends?

We consider that the four following megatrends are shaping the world:

- **Demographic and social changes**, which include ageing population, urbanisation and smart cities, changing lifestyles, with applications in terms of health food, attraction to brands...
- **Economic shifts**, which may include the rapid development of some areas of the world (such as the Silk road), the theme of de-globalization, the potential return of inflation...
- **Technological revolution**, as discussed in a recent paper<sup>1</sup>, may encompass the development of cognitive computing ("watsonisation"), the consequences of increased availability of data ("googlisation"), the exploitation of the power of platforms ("amazonisation") or of new business models permitted by the development of technologies ("uberisation"), as well as the potential offered by an increasingly connected, collaborative and transparent world ("twitterisation").

- **Environmental challenges**, regarding global warming, which will be an obvious game-changer for our economies and everyday life in the decades to come. Thematic strategies related to this megatrend may range from broad global environment strategies to more focused ones, for instance dedicated to smart energy, expected scarcity of water resources, waste management and recycling.

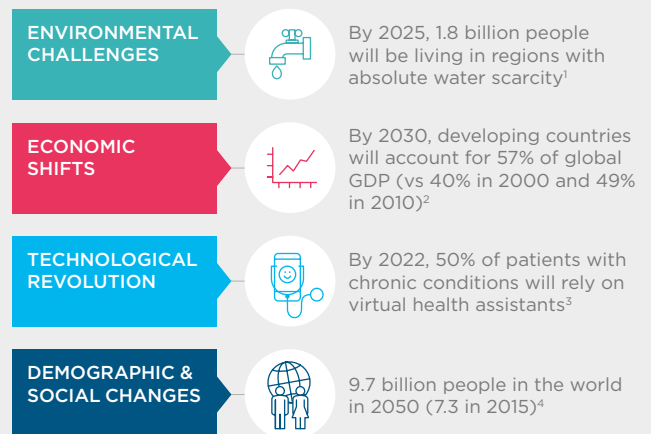
Our analysis of these major changes underway has led us to create a number of different thematic strategies, related to at least one of these megatrends, and we see potential for additional ones in the months to come.

### Megatrends to prepare the future now

*"The world is being redrawn by the shifting tectonic plates of demographic, economic, technological, and environmental changes."*

#### INVEST IN FOUR MEGATRENDS

The key drivers to benefit from long-term growth opportunities



Sources: 1. FAO; 2. OECD, Perspectives on Global Development 2010: Shifting Wealth, 2010; 3. Gartner, Maverick Research: Endangered! How technology will cause extinction of the Primary Care Tier of Medicine; 4. United Nations, World Population Prospects, 2017 revisions.

1. For a more detailed description of these, please refer to Amundi's Discussion paper DP-28-2017, "Megatrends and disruptions: Consequences for Asset Management" by Philippe Ithurbide.

## How do you decide to launch a new thematic strategy?

The typical process consists in:

- Identifying a theme and assessing its growth and sustainability potential through time. This is an extremely research-intensive phase with multiple sources of inputs;
- Constructing a dedicated universe based on screenings specific to the investment strategy, such as the share of companies' revenues generated by the theme;
- Conducting analyses on the universe to check whether its characteristics are in line with our return expectations;
- Then applying a quantamental process - i.e. mixing quantitative and fundamental approaches - in order to take into consideration market dynamics and thorough due-diligence in order to build the most robust portfolio in terms of risk and return...
- ... Bearing in mind that a demanding ESG process is henceforth totally embedded in all our strategies.

Let us take the example of the Education theme. Education is one of the key challenges of the current century, as it favors economic growth, well-being and reduction in inequalities, contributing to several of the UN Sustainable Development Objectives, and has a positive impact on society. It is therefore related to:

- Demographic and social megatrends,
- Technological revolution, due in particular to the expected impact of automation on labor markets and on the need for educational technology,
- The expected rebalancing of growth to developing markets, and the expected growth of the population, especially the middle-class, in emerging countries.

Once the justification for this theme was clear, we needed to check whether it was implementable. In order to construct our investment universe, we have defined 7 sub-sectors related to the theme: educational technology (Ed Tech), online education and training, post-secondary, content, career development, supply and services, including student housing and financing of education.

***“We still believe that thematic strategies help investors to achieve the intergenerational goal as they benefit from the structural growth attached to the identified themes.”***

The initial universe included about 140 stocks, which we considered sufficient to launch the strategy. Due to a strong dynamic in terms of IPOs, this universe is expanding fast and has now reached about 150 stocks. In order to be included in the universe, a stock must derive at least 15% of its revenues from education, and this percentage threshold is set at 60% at the level of the total portfolio. Then, a sustainability screening could be applied, excluding companies in controversial sectors (e.g. training in the weapons industry) or with an unfavorable ESG rating based on external data providers. At this stage, we conduct a study to check the behavior of the universe during different market environments and launched the strategy in October 2018.

## What does subsequently thematic investing bring to investors?

Thematic investing is a rather new territory for academic research and remains dominated by beliefs - as well as anticipatory fundamental research and efficient portfolio construction expertise. One reason is that it is not defined in a homogeneous and widely accepted way. Moreover, as the development of thematic investing is rather recent, the universe of thematic funds with a long enough track-record on which to conduct quantitative analysis remains rather limited. Much more research has been conducted on sector strategies, which are admittedly sometimes considered as responding to a thematic approach. However, we concur with the majority of investors that thematic investing is broader than sector investing, as its objective is precisely to look beyond standard sector categories to identify the beneficiaries of a given investment theme.

We still believe that thematic strategies help investors to achieve the intergenerational goal as they benefit from the structural growth attached to the identified themes. Moreover, as thematic managers are highly focused and conduct research in a different angle from that adopted by most market participants, they have a clear ability to generate performance through their stock selection process.

As Pension Funds need to align their growth bucket with their long-term horizon, thematic equities may be part of the solution by providing diversification and exposure to long-term growth.

## What are the usual traps to avoid in thematic investing?

I would mention issues related to the investor's objectives, the definition of the theme and the construction of the investor's portfolio.

Starting with the investor's objective, the major risk is a mismatch between the investment horizon of the theme and the investor's patience and risk appetite. If you have identified a theme for the long-term, you should evaluate its performance over the long-term. You should also be clear that the thematic strategy you invest in does not respond to a market fad and is in line with your investment philosophy and objectives. I would mention the example of the Education strategy again, which has been selected by institutions in the education field, due to its fit with their mission.

Regarding the theme definition, we recommend investors to avoid excessively narrow themes, in particular those that would be essentially dependent on one macro factor or indicator, for instance the global market cycle. The available stock universe should also be broad enough to limit the degree of idiosyncratic risk in the strategy. This implies that thematic strategies should be diversified enough over different sectors. The Silver Age strategy is a good example of this as it encompasses healthcare, leisure, financial services companies etc.

Finally, investors should be well aware of the implicit factor biases in the thematic strategies they have selected and that these strategies have a positive contribution to the construction of their portfolio. In particular, aggregating a number of thematic strategies that would all be carrying similar factor biases would not be efficient in terms of portfolio construction.



**Philippe ITHURBIDE**  
Global Head of Research, Analysis and Strategy



**Yerlan SYZDYKOV**  
Global Head of Emerging Markets

## Emerging Markets: Be Aware of Vulnerabilities and Play Multiple Opportunities

The Emerging Markets (EM) universe has experienced significant changes over the last decade with the further addition of investable countries (e.g. China A shares in 2018), the surge in size of EM bond markets and the further development of local currency bond markets.

This changing world remains highly heterogeneous as the differences between EM countries exceed their similarities. Extensive research is therefore key for identifying the variables that are the main drivers of each economy at any given point in time, the investment factors that can be most rewarding and the portfolio allocation that can deliver the best risk/return payoff.

Emerging markets still account for a marginal part of institutional investors' portfolios. Looking ahead, the ongoing development of domestic markets, becoming more open to international investors and increasingly diversified, should be a major catalyst. In a world of diminished return potential, the ability to tackle market opportunities and the search for sustainable

alpha will be even more relevant. This is especially key in the EM world, where **discrimination based on the vulnerability factor can be rewarding, especially in times of crisis.**

In order to capture the next wave of returns, investors will have to embrace an EM-MOVES (Multi-Opportunity Vulnerability-Enhanced Selective) approach, based on an assessment of the vulnerability of each economy and an analysis of the five key drivers of EM opportunities (Debt, Dynamism, Diplomacy, Dependency and Domestic demand).

How to differentiate among emerging countries?  
What is the appropriate classification?  
How to think about alpha while minimising risks?

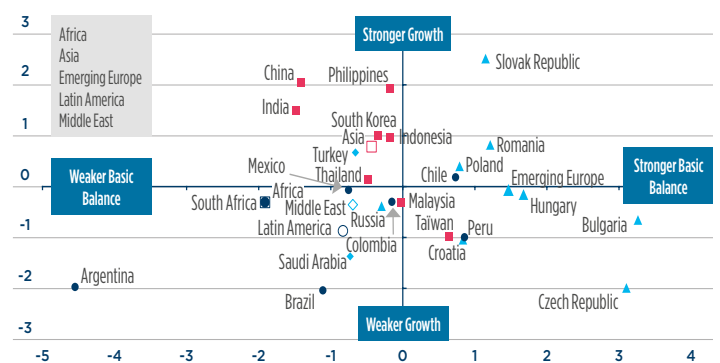
### Reviewing the traditional bloc classification of emerging markets

None of the developed markets, the dollar-denominated countries, the Eurozone, and therefore the emerging countries should be considered as a bloc, neither from an economic point of view nor from an investment perspective. Economic divergences, structural characteristics and vulnerabilities, particularly in capital flows, can vary widely across countries. Differences from one country to another can be extraordinarily significant, based on various factors: economic growth, inflation rate, external trade, energy dependence, commodities dependence, debt level, leeway in terms of monetary, fiscal and tax policies, external vulnerability (external debt, dependence on foreign capital flows, among others), or political stability.

The following graph highlights the heterogeneity of emerging markets. The X-axis segments countries according to the strength of their basis balance, the Y-axis classifies countries according to their level of growth. Emerging Europe is mainly - but not only - in the Eastern quadrant, while Asia is mostly - but not only - in the North-Western quadrant; Latam and the Middle East countries are mainly in the South-Western quadrant. However, even if an economic proximity is obvious

and it is possible to differentiate regions, the differences go far beyond regional realities.

### Emerging bloc: A first visualisation of economic heterogeneity



Source: Datastream, Amundi Research. Data as at May 2019.

To overcome the traditional bloc concept, several methodologies can be developed that provide an alternative typology to traditional approaches and that can help direct investment strategies. To go beyond the traditional ‘bloc’ concept, several methodologies can be developed that provide an alternative to conventional approaches and that can help guide investment strategies.

**The first approach is dynamic**, and uses the structural and cyclical characteristics of emerging countries to define groups. **It identifies each country with the factor that best characterizes it.** For example, Brazil is a producer of commodities, but what makes it even more distinctive is that it is an economy with twin deficits, two weaknesses in the current environment.

This way of grouping shows how close countries are economically and financially, regardless of the region they belong to, which gives a clear idea of the risks of contagion at any given point in time. It offers the possibility of avoiding at least part of the contagion effects prevalent in financial markets by moving as far away as possible from the factors that caused the contagion. It is particularly attractive in large market movements, as it allows portfolios to focus on tailwinds. The major disadvantage of the dynamic approach is that sub-groups vary significantly from one period to another, as various cyclical criteria supplement the structural criteria of each country.

**The second approach is a static one. The vulnerability criterion is selected as the discriminatory factor:** both as a financial and an economic indicator, it is a telling signal about the strengths and weaknesses of a country.

A proprietary ‘vulnerability index’ can then be developed, which is built on three components: (i) balance of payments, (ii) ‘liquidity’ and external vulnerability indicators, and (iii) sub groups of the 22 EM countries that are more stable over time, when compared to the dynamic approach. In particular, we can consider the two sub groups of countries that are identified either as solid or fragile countries, looking then at the relative performance of FX, equity and debt markets for these two groups (equal weighted long/short portfolios).

*“The ability to look at the full capital structure and bring together varied expertise (loans, debt, equity, distressed situations) will help move beyond traditional investing in EM and foster new innovative solutions across the full EM spectrum.”*

The results tend to demonstrate that vulnerability is a real criterion of discrimination. **The performance of ‘solid countries’ (hereafter the Solid6, or S6) is significantly better than the performance of ‘vulnerable countries’ (the Vulnerable6, or V6) and the vulnerability criterion is particularly rewarding in times of crisis.**

**Performance: Solid6 vs Vulnerable6**

2018	Equity markets perf.	FX (vs. USD) perf.	EMBI markets perf.
<b>All countries*</b>	<b>-5.2%</b>	<b>-9.8%</b>	<b>-3.1%</b>
V6 Group	-13.7%	-18.8%	-6.5%
S6 Group	+2.5%	-8.2%	-0.5%
S6 - V6	+16.1%	+10.6%	+6.0%
2001-2018	Equity markets perf.	FX (vs. USD) perf.	EMBI markets perf.
<b>All countries*</b>	<b>+13.6%</b>	<b>-1.6%</b>	<b>+7.8%</b>
V6 Group	+13.4%	-4.6%	+7.2%
S6 Group	+15.6%	-0.9%	+9.5%
S6 - V6	+2.1%	+3.7%	+2.3%

Source: Amundi Research. \*All countries included in our sample. Note: for fixed income markets, due to some missing data, the study covers 5 vulnerable countries and 4 solid countries.

**A unique approach to EM: MOVES (Multi-Opportunity Vulnerability-Enhanced Selective)**

While vulnerability is a key factor to consider from an investment perspective, a unique EM investment approach can be developed called EM-MOVES (Multi-Opportunity Vulnerability-Enhanced Selective).

– **Multi-Opportunity** means enlarging the opportunity set by widening the investment universe to off-benchmark countries/companies/instruments to enhance the non-vulnerable choices. A comprehensive approach that combines top-down macro assessment with bottom-up equity and credit analysis can help to build a deeper understanding of this complex investment universe.

- **Vulnerability-Enhanced:** with vulnerability being the most important discriminatory factor, it is vital to assess if markets are correctly pricing in different country vulnerabilities. An overweight to most solid countries, and even more importantly, an underweight to the most vulnerable ones, is logical.
- **Selective:** focusing on a bottom-up selection for each investment case with integration of ESG criteria and combined with a top-down assessment. The fragility in EM can then be analysed based on the five key drivers, the 5Ds (Debt, Dynamism, Diplomacy, Dependency and Domestic demand) to uncover the most compelling investment ideas.

► [Read the full publication on our online portal Amundi Research Center](#)



**FIVE KEY DRIVERS IN EMERGING MARKETS: THE 5Ds**

Debt dynamics	Dynamism	Diplomatic attitude	Dependency on foreign capital	Domestic Demand
Understanding the debt sustainability path is paramount when investing in sovereign bonds, where rising expenses on public debt can harm the growth potential of the country	The ability of countries and companies to adapt dynamically to a changing market environment will be crucial to their success. Infrastructure, business reforms, market openness are key	In a still-globalised financial world, but with a more polarised geopolitical order featuring trade disputes, sanctions and counter-sanctions, diplomacy will be even more crucial than in the past	Very much related to vulnerability, high dependence on external debt in hard currency represents a weakness in case of crisis	By 2030, based on current population projections, two-third of the global middle-class is expected to be in Asia. This expansion will drive consumption and growth in the future

To conclude, a cross asset capability in Emerging Markets can offer added value. Understanding government bond markets helps better comprehend growth, inflation and systemic risk. Credit and equity markets are symbiotic, but not always efficient. Apprehending the full cost of capital and bringing together varied expertises can constitute a distinctive competitive advantage in capturing the next wave of returns in emerging markets.

**Confidence must be earned**  
**Amundi**  
ASSET MANAGEMENT

## The Insurance & Pension Fund Investment Club

Versailles, September 26<sup>th</sup> & 27<sup>th</sup>, 2019

“ This exclusive event will stand as an opportunity to share ideas and knowledge about Insurers’ and Pension Funds’ long-term capital management philosophy. ”



**Dominique Carrel-Billiard, Jean-Jacques Barbéris**  
and **Thierry Ancona**

are pleased to host this second edition at the Trianon Palace in Versailles.

**EXPERT KEYNOTES SPEAKERS & INTERACTIVE ROUNDTABLES**

**How do demographic changes impact investment policy?**

**Pablo Antolin**

Principal Economist and Head of Private Pension unit - OECD

**Strategic and tactical asset allocations over a long-term horizon**

**Marie Brière**

Head of Investor Research Center - Amundi  
Affiliate Professor, Paris Dauphine University

**How to implement a responsible investment policy into an existing asset allocation?**

**Laurent Babikian**

Director Investor Engagement Europe - CDP



**Kasper ELMGREEN**  
Head of Equities in Amundi

## European Equity in the Growth Bucket

### After an extended cycle with equity markets reaching new highs, what are the medium-term opportunities that you see in equities?

We are certainly entering a more volatile environment in our view. Markets are hostages of news flow. Trade-related anxiety and central bank policy have recently been driving the swings (pessimism of a broken deal between China and US led to a correction in May while the renewed hope of a partial deal brought equity markets back to yearly highs in June). Such volatility can open up opportunities for alpha generation. Looking at the markets today, few dislocations appear. Valuation dispersion is at record levels and value is at an all-time discount to growth in Europe as another. These market anomalies can provide an attractive market environment for stock pickers.

With a medium-term perspective, the recent ultra-dovish tone of major Central Banks added to the optimism. However, risks remain amid a deceleration of global growth and a mixed earnings outlook. Against this backdrop of uncertainty, global equities are expected to remain in a trading range until more visibility on trade, Brexit and growth appears. This points to the need for investors to focus on relative value opportunities across regions and names to extract value rather than betting on strong directional calls. On a regional basis, we see some interesting opportunities are emerging in Europe. European equities is a significantly under owned asset class, sentiments towards European equities is poor and flows are very negative with over 70 billion USD outflows year to date. While there have been some reason for this pessimism, it has gone too far. Ultimately, company fundamentals are robust and economic indicators are showing signs of stabilization. Hence, we see room for European equities to be among the relative outperformers in the global equity space and provide fertile ground for investors in search of opportunities.

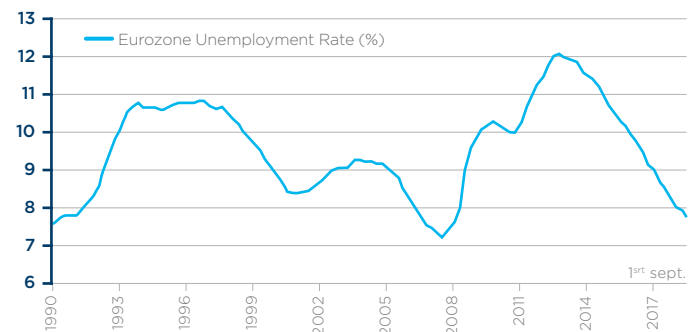
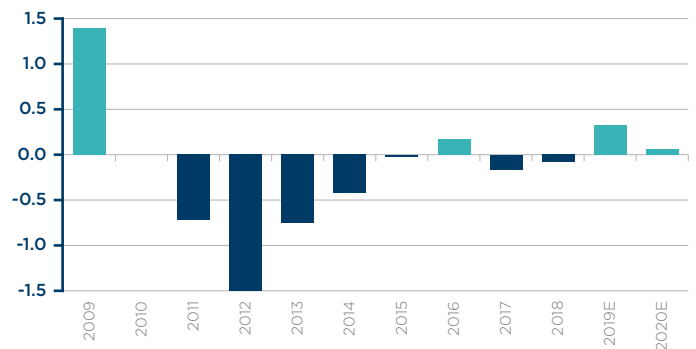
### Why selecting European equities in particular?

Europe is as an area of opportunity for equity investors. The European equity market has fallen out of favour in recent years, as investors have flocked to the more compelling growth stories in areas like the US. In addition, concerns for Europe have centered on political risks, slowing global growth recently made worse due to trade tensions (European companies generate more than half of their revenues from outside of Europe), and of course the continuing Brexit saga. That said, taking a step back from the external macro environment, internal demand dynamics in Europe are strong and improving with robust employment, rising wages and the thoughtest fiscal stimulus in

over 10 years on the way. Finally, company fundamentals that underpin the asset class are quite strong. European companies enjoy low levels of leverage relative to other geographies as well as strong cash flow generation – which helps to underpin the attractive dividend yield of 4% (for the MSCI Europe).

Looking ahead, our base case remains an optimistic one. In the case of both the Brexit situation and the ongoing “trade tensions”, logic will ultimately prevail and a pragmatic solution will be found. Without disregarding these risks, our base case continues to be a constructive solution on both sides. Assuming that we are correct, we believe that the positive trajectory of the equity market can continue over the medium-term as company fundamentals are sound, valuations are not stretched, and monetary policy should remain supportive – especially in light of the recent news that Christine Lagarde will assume the lead role at the ECB. With bouts of volatility continued market rotations in the near term and macro forces driving short term direction, this is an attractive stock picking environment. Volatility can create the opportunity to take advantage of misperceptions amongst investors.

### Eurozone Fiscal Stimulus as % of GDP



Source: Amundi, Bloomberg Data as of June 2019.

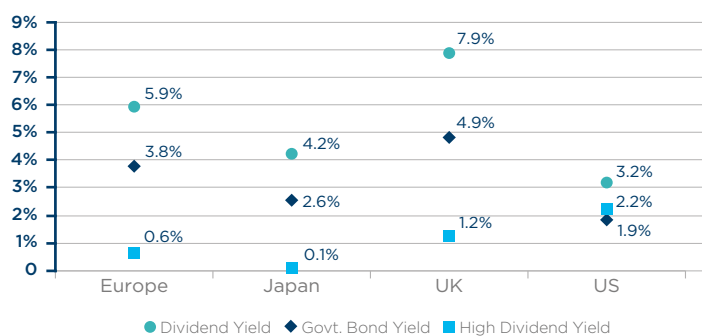
From a stock picking viewpoint, we do not foresee earnings growth driving European equities from here into the next year. While downward revisions appear to be stabilising, we see limited room for an aggressive rebound. Overall, we prefer cyclical relative to the more defensive segments, which have become too expensive. We like high-quality industrials with strong balance sheets, some of which discount a negative outlook. Healthcare is our preferred defensive sector as we see more idiosyncratic stories here. We find tactical opportunities selectively within European banks, which overall are trading at extremely depressed valuations. The negative story on European banks is well known, but implied expectations are too low in some of the higher-quality core European banks. We believe that sector rotation will continue, as we have seen during market correction, and this could open up opportunities for active selection. Value sectors remain very cheap.

**As a long-term investor, how a Pension Fund could embrace Equity asset class into a portfolio?**

We believe that an allocation to equities is increasingly required given current alternatives. In an era of low (negative in some regions), interest rates and lower expected returns across asset classes going forward, many investors are being forced further out the risk curve to achieve their return objectives. In terms of an allocation to the growth bucket, equities are a liquid place where a Pension Fund should look in search for higher returns over the long-term. While the equity asset class is potentially more volatile, an active approach is an attractive one, as stock pickers can take advantage of bouts of shorter-term volatility and drawdown by buying good companies at a discount. This is an approach that we believe will deliver not only strong absolute performance, but also alpha to clients over the longer term.

Looking beyond capital appreciation, equities are an attractive asset class from an income perspective. With the yields across other asset classes at historic lows, equities offer investors a source of reliable income – with dividend yields comfortably in excess of the yields available in fixed income markets. Again, Europe can be a very attractive play for investors with a demand for income. As noted earlier, European corporates enjoy good cash flow generation (with growth expected) and strong balance sheets – both key supports for the sustainability of dividend generation. If income is the core requirement, we believe that it is important to look beyond just the optical yield on offer. Instead, investors should focus on the potential for a company to deliver dividend growth, which will allow for income sustainability over the medium to longer term.

**Bond yields vs equity dividends**



Source: Amundi, Bloomberg as of 24 June 2019. MSCI indices for Equities

Finally, we see ESG investing as a dominant secular theme going forward. For investors with a desire to improve their ESG footprint, equity can be seen as an area that can make the difference. Firstly, from an engagement perspective, an active approach allows for a proactive dialogue with companies with the aim of improving the ESG dynamics of the business. This active approach, focused on company interaction can help identify red flags earlier and help avoid ESG related risks which can ultimately lead to capital losses. In terms of alpha generation over the longer term, ESG is becoming increasingly important. From a risk perspective, companies which are strong ESG stewards generally have more robust business models. Furthermore, companies with improving ESG trends should benefit from increasing investor demand fuelling share price appreciation. In order to benefit from these trends, it is critical to have a good understanding of the ESG trajectory of the business and to invest in names which are showing signs of continuous improvement. ESG momentum can be a source of alpha generation.

*“In terms of an allocation to the growth bucket, equities are a liquid place where a Pension Fund should look in search for higher returns over the long-term.”*

**On ESG investing, in particular in Europe, which approach do you think will benefit the most equity investors in the long run?**

Identifying companies with a strong ESG standing (called ESG leaders), or companies with a commitment to improve their ESG trajectory (ESG Improvers) can offer investors a real source of alpha potential.

Within a global context, European companies are already embracing ESG factors more so than their global peers and they enjoy a higher ESG rating versus companies in other regions. There is however still a long way to go for European companies in terms of mitigating relevant ESG risks and embracing ESG opportunities. Importantly, reducing relevant ESG risk is not just about doing good, as we believe the lower cost of capital from the risk mitigation will also lead to improved share price.

ESG investing in Europe is developing fast and we see this tide as structural. As the data set has improved significantly over the last few years and as Europe has experienced some rather significant ESG risks unfold for European companies - investors are increasingly embracing the ESG data in making their investment decisions.

The ESG investing framework is very much evolving from negative screening to ESG integration and engagement. It is also clear that investors are increasingly demanding more ESG solutions and that regulators are embracing and seeking to further its development.

*“Identifying companies with a strong ESG standing or companies with a commitment to improve their ESG trajectory can offer investors a real source of alpha potential.”*



**Florent GAUTHIER**

Head of Legal  
International  
Pension Solutions

**Caroline HERRGOTT**

Senior Legal  
Counsel - International  
Pension Solutions

## IORP II – Implementation into National Law: Where Are We?

Six months after the deadline for implementation of the IORP II Directive<sup>1</sup> into national law set on 13 January 2019, where do the 28 European countries stand with respect to their implementation process?

In April 2019, the European Commission’s Directorate-General for Financial Stability and Capital Markets (DG FISMA) has launched an infringement procedure against 17 EU member States for incorrect implementation of the IORP II Directive, either due to lack or delay of the notification, incomplete communication or non-communication of national transposition measures.

Hence, the following classification of the EU member States may established:



Where some countries have not communicate any transposition measures, some other countries, such as Luxembourg or Ireland, are currently working on draft legislation but need more time to fulfil their implementation process. It should be noted that some of the local transpositions are made within the framework of pension reform incorporating many other measures: the United Kingdom (Master-Trust regulation), Ireland (Pension Roadmap/ Auto-enrolment), the Netherlands (Pension reform/to withdraw 10% in a lump sum), France (PACTE Law)...

### Key points from IORP II Directive

The IORP II Directive both aims at **strengthening the standards** established by the first IORP Directive, in particular with respect to governance and to facilitation of development of cross-border pension activities and at **establishing news rules** by introducing more transparency in terms of information and by enhancing supervision powers of national authorities.

#### - Strengthened governance

IORP II Directive’s purpose in terms of governance is to insure

an “effective system of governance providing sound and prudent management” of IORP vehicles, in particular through an adequate and transparent organizational structure.

Hence, new governance requirements applying to IORP vehicles will notably imply the setting up of key functions (risk management, actuarial and internal audit, which must be independent from other functions). In addition, to avoid any conflict of interests, a person carrying out a key function will not be able to perform a similar role for any sponsoring

employer. As part of a regular review to be implemented, IORP II Directive also establishes new rules on IORPs' own risk assessment (ORA), which will have to be performed at least every three years. Investment policies of IORP vehicles will also have to be reviewed with the same frequency. IORP vehicles will now have to use a depositary for the safe-keeping of assets in case members fully bear the investment risk, which was not previously the case in all the EU member States.

The "prudent person rule" is still underpinning the design of IORP vehicles investment policies and will be reinforced by integrating environmental, social and governance criteria.

**- Simplification of cross-border process**

The IORP II Directive aims at simplifying and harmonizing cross-border procedures in order to promote an emerging market of cross-border pension activities, especially regarding the transfer of pension schemes between different EU member States.

**- New information obligation**

Another major change induced by IORP II Directive is the implementation of a broader information duty. IORP vehicles will have to reinforce their communication, not only to the members and beneficiaries, but also to prospective members, at different stages: pre-membership, membership, pre-retirement phase and pay-out phases. The pension benefit statement will be a key communication tool to be published annually by IORP vehicles. Members will benefit from deeper insights on investment options, accumulation, past performances of their underlying investment options, costs, pension benefit projections but also decumulation.

In the context of the implementation of the IORP II Directive, the European Insurance and Occupational Pensions Authority

(EIOPA) published on March 23, 2019 a second "Report on Other Information to be provided to Prospective and Current Members: Guidance and Principles based on Current Practices".

**- Enhanced supervision**

Lastly, national authorities in charge of supervising IORP vehicles will benefit from enhanced power to monitor compliance of various stakeholders with these new requirements. Prudential supervision principles will now rely on a risk-based and forward-looking approach. National authorities will have to set up control mechanisms, allowing potential sanctions.

Other actors, such as entities controlling the IORP vehicles' accounts (auditors and actuaries) and European authorities (EIOPA, European Parliament) will also be involved in the supervision process.

**- The New PEPP regulation, an opportunity for the IORP vehicles?**

On 4 April 2019, the European Parliament has voted to approve the Pan European Personal Pension Product (PEPP) regulation with standard features across the EU. In this context, IORPs which, pursuant to respective national laws, are supervised and authorized to provide also personal pension products (as in France), will be allowed to offer PEPP. In that case, all assets and liabilities corresponding to PEPP provision business shall be ring-fenced, without any possibility to transfer them to the other retirement provision business of the institution. This could open opportunities to IORPs.

These new measures set out the challenges that all EU member States will have to face to create a real competitive IORP market in Europe that will protect and benefit the European members and beneficiaries.



(Re)experience the event at:  
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& #AmundiWIF19

*"The New Frontiers are here, whether we seek them or not."*

**Time to change the compass or the direction?**



*"Solution to climate change is energy policy"*  
**John KERRY**  
68th Secretary of State of the United States



*"Young generations are extremely demanding, they behave more and more as activists."*  
**Isabelle KOCHER**  
Engie CIO



*"It's time to recognize the threat and give answers"*  
**William NORDHAUS**  
2018 Nobel in Economics

As the current economic cycle is ageing, a new geopolitical order emerges. Financial systems need to navigate through a thick fog of uncertainties. New frontiers are ahead of us: geopolitical shifts, global challenges such as climate change, raising inequalities shattering western middle classes.

Every year, the **Amundi World Investment Forum** gathers our client partners and eminent speakers across the globe to share insights on the evolving geopolitical, macroeconomic and financial regimes. As a leading European asset manager<sup>1</sup>, Amundi has a role to play in shaping tomorrow's investment world.

1. Read legal p.16

# Multi-Asset Forecast



## OUR HIGH CONVICTIONS IDEAS ON MULTI-ASSET (SHORT TERM VIEWS)

### Time to play central banks and politics

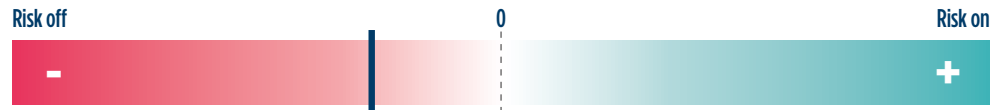
**We still call for a late cycle environment with extra dovish central banks.** Growth concerns and trade disputes continue to be the key risks which darken the outlook. On trade in particular, although we still expect a deal between US and China will be eventually reached later in the year, we do not expect any near-term solution. Uncertainty may remain high with regards to geopolitical risks.



### Overall risk sentiment

Overall a still cautious approach, with some opportunities on risk assets.

*“ECB dovishness make Euro IG credit even more appealing.”*



Overall risk sentiment is a qualitative view of the overall risk assessment of the most recent global investment committee.

### Amundi Cross-Asset Convictions

	1 month change	---	--	-	0	+	++	+++
Equities			■					
Credit	↗							■
Duration					■			
Oil					■			
Gold					■			
Euro cash				■				
USD cash						■		

The table above represents cross-asset assessment on a 3-6 month horizon, based on views expressed at the most recent global investment committee. The outlook, changes in outlook and opinions on the asset class assessment reflect the expected direction (+/-) and the strength of the conviction (+/+/+++). This assessment is subject to change. July 2019.

**GLOBAL INVESTMENT VIEWS**  
JULY 2019

Read the full publication on our online portal **Amundi Research Center**

▶ [View article online](#)




# Multi-Asset Forecast



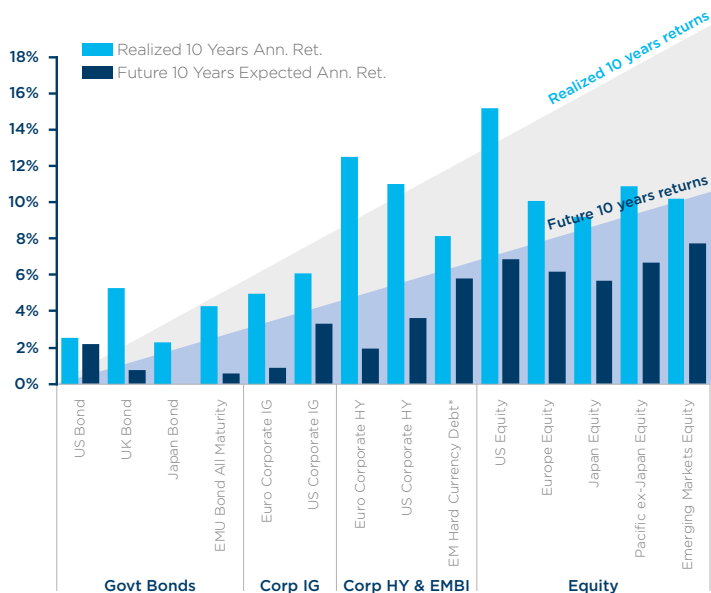
## OUR ASSET CLASS RETURN FORECASTS (MEDIUM & LONG-TERM VIEWS)

Our medium-term baseline scenario is that of a late business cycle slowdown followed by a probable mild economic recession. According to our calculations, the probability of drifting into a recession in the next three to five years is over 50%. Europe may enter a mild recession before the US, based on the rationale that the ECB has less room for maneuver: countries have little fiscal space and political impasses continue, along with delays in fiscal plans, with perverse effects on growth.

► For further details, please refer to [Asset Class Return Forecasts \(Q2-2019\)](#)

<b>GOVERNMENT BONDS</b>  	<p>With the probability of a recession rising over the next three to five years, government bonds should outperform cash and deliver decent returns. Over a 10-year horizon, we anticipate a widespread increase in interest rates, and as a result, total returns should be lower, as incremental accruals will be offset by price losses.</p> <p>US Treasuries should deliver the highest returns amongst developed countries in the medium and long-terms. In the Eurozone, government bond momentum is less clear. As we expect economic deterioration to spread in the region, we expect the yield curve to flatten and periphery spreads to widen. Moving to the long-term, as German rates normalise, we assume that the peripherals spreads will tighten towards long-term equilibrium levels.</p> <p>The outlook on EM debt is moderately positive in the medium- to long-term, because of high carry and resilient EM fundamentals.</p>
<b>CREDIT</b>  	<p>In the medium term, in our base-case scenario, we expect Investment Grade and High Yield spreads to widen and default rates to increase, negatively affecting returns while falling interest rates, mainly in US, should be supportive for credit returns. Beyond a five-year horizon, credit spreads will converge to their long-term levels.</p> <p>Default and recovery rates should evolve into a late-cycle regime, which incorporates heightened risk and uncertainty (because of the weaker macroeconomic environment). In the longer term, they are expected to converge back to the equilibrium level.</p>
<b>EQUITIES</b>  	<p>As developed markets will be at the origin of the macroeconomic slowdown, returns on emerging markets equities could be a bit more resilient, due also to their higher return potential.</p> <p>Returns over a 10-year horizon are expected to be lower than previous forecasts and in particular than their equilibrium levels.</p> <p>Over the longer run, the US market should grow at a trend rate of 7.7% p.a. in nominal terms, the highest amongst developed countries. EM equity returns in the long run are estimated at 9.4%.</p>

### Annualised Return Forecasts - Realised 10 years vs future 10 years returns



Our 10-year forecasts are lower than those delivered during the asset reflation period (the past 10 years), as we entered a late cycle phase in 2018, with central banks' attempts to recalibrate monetary policy and as economic growth surpassed its peak.

Source: Amundi Asset Management CASM Model, Amundi Asset Management Institutional Advisory and Research Teams, Bloomberg. Data as of the 22nd of April 2019. Macro figures as of last release. Interest rates, Equity, spread and FX updated as of the 29th of March 2019. Equity returns based on MSCI indices. **One year forward views and fair values provided by Research team** (macro, yields, spread and equity). Forecasts for annualised returns are based upon estimates and reflect subjective judgments and assumptions. These results were achieved by means of a mathematical formula and do not reflect the effect of unforeseen economic and market factors on decision making. **The forecast returns are not necessarily indicative of future performance, which could differ substantially.**

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**Asset Class Return Forecasts**  
Quarterly Update

Medium and Long-Term Return Forecasts | Q2 - 2019

Our medium-term baseline scenario is that of a late business cycle slowdown followed by a probable mild economic recession in the next three to five years. According to our calculations, the probability of drifting into a recession in the next three to five years is over 50%. Europe may enter a mild recession before the US, based on the rationale that the ECB has less room for maneuver: countries have little fiscal space and political impasses continue, along with delays in fiscal plans, with pervasive effects on growth. For further details, please refer to Asset Class Return Forecasts (Q1 2019) available at [www.amundi.com/asset-class-return-forecasts](http://www.amundi.com/asset-class-return-forecasts) or to our Asset Class Return Forecasts (Q1 2019) available at [www.amundi.com/asset-class-return-forecasts](http://www.amundi.com/asset-class-return-forecasts).

In our baseline scenario, rates initially decline, yield curves flatten, and central banks start cutting rates again (Fed) and/or attempt to move back to unconventional policies (ECB), spreads widen, and default rates rise from current levels, while remaining well below their 2008 levels. In the medium term, we are also incorporating a period of falling profits, leading to modest equity returns.

Recent market developments have resulted in some flattening and downward shifts in the yield curves, coupled with spread tightening in the European bond markets. This should lead to lower expected returns over the medium and long-term. In equities, because of last quarter's strong equity market, expected returns are lower with respect to last quarter's update.

With the probability of a recession rising over the next three to five years, government bonds should outperform cash and deliver modest returns. Over a 10-year horizon, we anticipate a substantial increase in interest rates, and as a result, total returns should be lower, as incremental accounts will be offset by price losses.

US Treasuries should deliver the highest returns amongst developed countries in the medium and long terms. In the Eurozone, government bond momentum is less clear. As we expect economic deterioration to spread in the region, we expect the yield curve to flatten and proprietary spreads to widen. Moving to the long term, as German rates normalize, we assume that the peripheral spreads will tighten towards long-term equilibrium levels.

The outlook on EM debt is moderately positive in the medium- to long-term, because of high carry and resilient EM fundamentals.

In the medium term, in our base-case scenario, we expect IG and HY spreads to widen and default rates to increase, negatively affecting returns while falling interest rates, mainly in US, should be supportive for credit returns. Beyond a five-year horizon, credit spreads will converge to their long-term levels.

Default and recovery rates should evolve into a late-cycle regime, which incorporates heightened risk and uncertainty (because of the weaker macroeconomic environment). In the longer term, they are expected to converge back to the equilibrium level.

As developed markets will be at the origin of the macroeconomic slowdown, returns on emerging markets equities could be a bit more resilient, due also to their higher return potential.

Returns over a 10-year horizon are expected to be lower than our previous forecasts and in particular than their equilibrium levels.

Over the longer run, we estimate that the US market should grow at a trend rate of 7.7% p.a. in nominal terms, the highest amongst developed countries. EM equity returns in the long run are estimated at 8.4%.

**Asset Class Return Forecasts**  
by Delphine Georges, Viviana Gisimundo, Jung Hun Kim Moon



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