Asset Class Return Forecasts

Quarterly Update

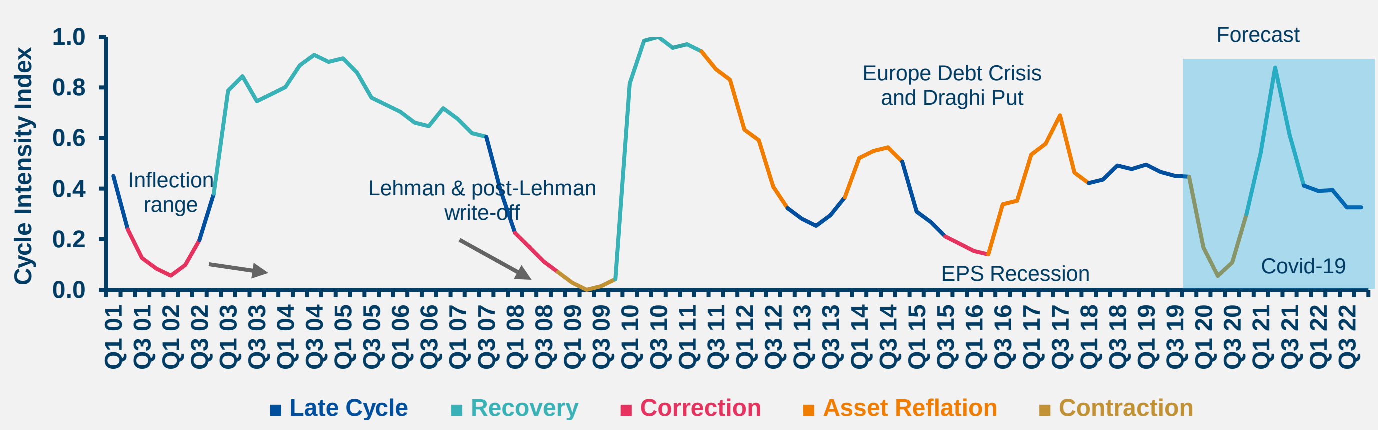
Medium and Long-Term Return Forecasts | Q2 - 2020 ***Finalised in April 2020***

In our latest analysis released at the beginning of the year, we had laid out our medium-term outlook as a correction of the business cycle, including an economic slowdown, yield curve inversion, a return to lower bound policy rates, and subdued inflation prints. The **global shocks** resulting from the eruption of the coronavirus pandemic have **significantly altered the sequence of economic and financial phases**, shortened the timeframe and expanded the scale of the ripple effect. Certainly, global trade will decline as fault-lines along the supply chain surface, and whole economies come to a standstill. Monetary authorities have acted swiftly to assuage the markets, having learned the lessons from the GFC. The insidious deflation risk has become a reality because of the freefall of oil prices. Even if the main reason has been the oil producers' price war, it is in itself having a meaningful impact in energy and financial sectors worldwide.

In that light and weighting carefully the depth of the crisis, in the short to medium term we remain along the lines of prolonged, "whatever it takes" dovish and expansive policies, and disinflationary risk. As detailed in **Amundi's Blue Paper, "Covid-19: the invisible hand pointing investors down the road to the 70s"**, we need to evaluate carefully the inflationary risk, looking at the medium to long term and also the strong challenges to current economic systems. The big questions are about **the structural impacts** of the crisis: 1) modified production function; 2) different sectors, regions, countries balances (and/or imbalances); 3) a new inflationary regime, 4) debt sustainability and so on. Further investigation and analysis are required to understand and quantify the answers to those questions, so for the time being we are relying on the long-term assumptions we refined at the beginning of the year, while we look at further guidance linked to the evolution of the crisis. Thus, the continuous recalibration of our working assumptions (i.e., starting points, short and medium term trajectories, and long-term equilibrium levels) in our estimation process reflects the still unfolding events and fallout affecting every aspect of the markets.

Our current assumption for the short term is for a **broad-base U-shaped crisis (|____/)**, marked by central bank and government support, a prolonged recession, and rising unemployment. A subsequent gradual **recovery** in late-2021 would be characterized by economic activity retracing but below 2019 levels, rising labour costs, and cooling down of monetary and government actions, eventually landing in a **late cycle** or **potentially an asset reflation regime** should central banks remain ultra-supportive. In this, all the key driving factors (economic growth, inflation, earnings, monetary and fiscal policies) are strongly interconnected, and the potential mismatch of one could affect the results on the overall. For this reason, we can depict the scenario moving forward only focusing on the assumption behind it.

Investment Phazer Dynamic - Smoothed



Source: Amundi Research as of May 2020. Advanced Investment Phazer.
Medium term view: a contraction followed by a recovery supported by massive policies coordination and eventually a late cycle, or potentially asset reflation should central banks continue to expand its B/S.

The question we posed earlier about the interaction between monetary and fiscal policies has become even more crucial than at the beginning of the year. We expect yields to stay low for a long time, and it now seems certain that interest rates will now struggle for an even longer period to reach their long-term equilibrium levels. In fact, while in the short to medium term yields will be anchored by the monetary policies in place across countries and the term structure could eventually adjust the shape marginally, moving from medium to long term we can expect some more dynamism in yields.

We expect corporate defaults to surge in 2020 with tighter financing conditions and declining profits, coupled with a fall in oil prices. This can only be mitigated if central banks continue to expand their balance sheets into the credit side. Our main concerns remains the deep fragmentation of credit markets and solvency issues. The exacerbation of the economic crisis has already had the impact of widening credit spreads across the spectrum partially mitigated by the CB expansion, and will go on increasing the default rates. Moving to the medium term, we can anticipate corporate spreads to tighten, after the short-term spikes and we can expect a normalization in default rates: this could be beneficial mostly for the high-yield sector as a reversal of the current crisis.

On the equity side, we expect a profits' recession in the range -30%/-20% in the short term, where the duration of lockdowns is key in estimating the extent, followed by a rebound of the same size in the following 12 months and a normalization towards a late cycle in 2022. EPS resilience and markets are in favor of equities making new highs in the medium term without stretching valuations and with healthy expected PE. Equity markets can converge to a more neutral stance in the medium to long term.

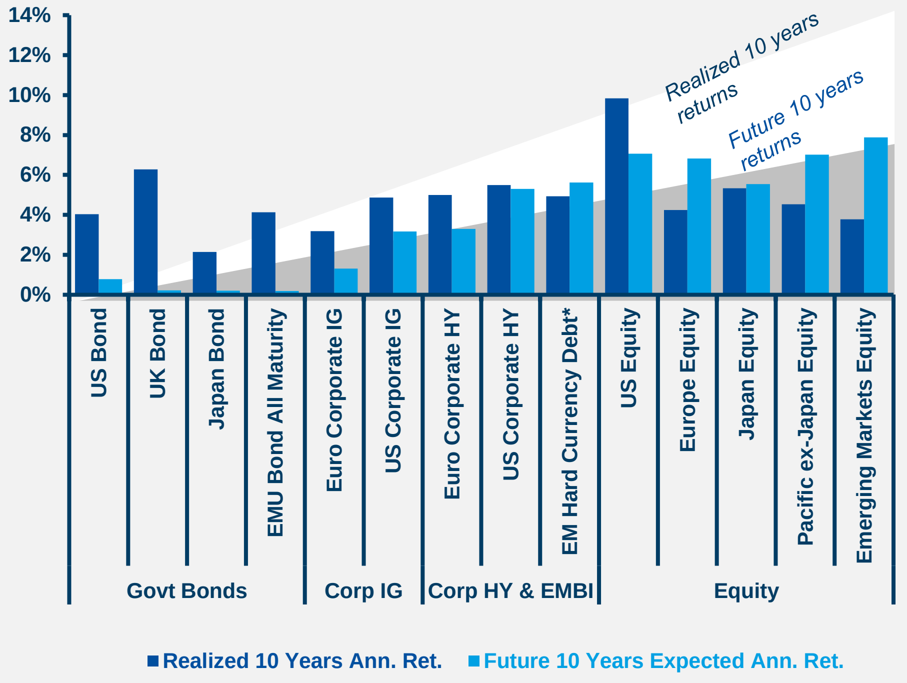
The economic impact of the Covid crisis on EM is recessionary, and no country will be spared. The economic performance in EM will be weak for a long time, resulting in a U-shape, even if we are less pessimistic in the short term. The effect will be exacerbated by a strong USD (or weaker local currencies) and very low oil prices. In addition, the policy stimulus put in place to reverse the recessionary trend will emphasize countries' vulnerabilities and add further risk. By virtue of being in the late-stage coronavirus cycle or with stronger fundamentals, some countries look to recover faster. While other commodity-dependent markets or more vulnerable economies could see the overall situation trigger downgrades or currency/balance of payments crises (and defaults in the worst cases). Given this short to medium term outlook and considering the higher potential for EM countries, we can expect EM assets to deliver decent returns with respect to developed markets, even if this will come at a cost of higher volatility that could be prolonged and will evidence some more heterogeneity.

Implications for asset class returns

GOVERNMENT BONDS	The global fiscal and monetary reactions to the onset of coronavirus has been swift and coordinated. In response, interest rates in the UK and US have shifted downwards over the past quarter. On the other hand, the yield curve in the euro area and Japan have been relatively stable, reflecting aspects of the different policy implementations. Going forward, we expect these policies to persist as economic fallout from ongoing events become clearer, leading to stable and low interest rates worldwide. For UK and US fixed-income instruments, the downward yield shift and increased interest-rate risk translates to lower expected returns with respect to last quarter but still outperforming EU and Japanese bonds over the medium- and long-term horizon. For the EU periphery, we expect improved performance in the medium term under the assumption that flexible policies act as a ceiling to their yields and a backstop to credit downgrades. We remain vigilant though on debt sustainability (periphery). Expected returns on government bonds will be lower in the 10-year horizon as a result of the starting point and the slow normalization path. In EM debt, whereas the fundamentals points to tighter yields (and spreads) over the medium term and result in higher ex-ante returns, we expect higher volatility and possible deterioration, owing to oil price instability and country vulnerability. Thus, the final assessment is more balanced on the basis of risk-adjusted figures.
CREDIT	Over the medium term, we expect the credit market in both the US and EU to be dominated by opposing forces, due to the coronavirus pandemic: on the positive side the ever-expanding asset purchase program and on the opposite end increasing default and credit downgrades particularly among the energy industry. Our expectation is the willingness of both ECB and Fed to expand the balance sheets will override the liquidity concerns and give support to expected returns in the medium term albeit with a higher volatility. As the starting points of the credit markets are significantly higher than a quarter ago with a slow normalization process, we estimate higher carry and overall returns for EU credit. While on the US side, the picture is less sanguine, due to the prominence of the energy industry with improved returns distributed along a long time horizon. We expect default trends to be consistent with our updated macro and financial scenario, strongly penalizing performance in high yield during the crisis, with the US being the most affected. Then default probabilities could normalize, moving to the medium term with a benefit for the expected returns.
EQUITIES	Short-term equity returns imply a contraction in earning growth. In the medium term equities could recover, delivering returns above their long-term averages, but this overshoot will disappear in the long term with the normalization of all the factors involved. Looking at relative preference, higher-beta regions (such as EM and the Eurozone) could perform better in the short to medium term. Over a 10-year horizon, the US can recover its position being ranked among developed markets. We expect higher returns than last quarter, owing to lower starting points and better entry point from a valuation point of view as a result of the equity turmoil due to the coronavirus crisis. Equity markets will inherit high volatility from the current environment, leading to higher downside risks in our models.

Asset Class Return Forecasts

Realized 10 years vs future 10 years returns



Source: Amundi Asset Management CASM Model, Amundi Asset Management Institutional Advisory and Research Teams, Bloomberg. Data as of the 20th of April 2020. Local currency. Historical performance from 31/03/10 to 31/03/20.

The strong impact of the global shock on financial crisis has eroded the past performance of risky assets by around 2-3% on annualized basis, while government bonds have further strengthened their performance.

On the **10 yr horizon** returns on **risky assets can be a bit higher** than before by starting from more favourable valuations. The opposite is true for returns of developed country governments.

Our long-term scenario assumes lower growth rates (related to decreasing population growth and stagnant productivity), lower short-term interest rates, less steep curves than historically, lower inflation rates (close but below the range of central bank targets),and lower long-term earnings growth.

10 years vs 5 years Expected Returns

Source: Amundi Asset Management CASM Model, Amundi Asset Management Institutional Advisory and Research Teams, Bloomberg. Data as of the 20th of April 2020. Local currency.

In the **medium term**, government **bond returns** are expected to be **weak**. In fact, we expect prolonged low yields and the normalization path to be even slower than before the crisis.

We expect corporate spreads to tighten, after spikes in the short term and we expect a normalization in default rates. This can be **beneficial mostly for the high-yield** sector as a reversal of the current crisis.

Equity returns can recover, as well delivering results above their long-term average in the medium term and then converging to more neutral stance.

Source: Amundi Asset Management CASM Model, Amundi Asset Management Institutional Advisory and Research Teams, Bloomberg. **Data as of the 20th of April 2020**. Macro figures as of last release. Interest rates as of the 31st of March 2020. Equity, spread and FX updated as of the 15th of April 2020. Equity returns based on MSCI indices. Reference duration are average figures. Local Currency. Returns on credit asset are comprehensive of default losses. **Forecast and fair values up to a three-year horizon provided by the 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,**

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Asset Class Return Forecasts

In the following table, we present our annualised return forecasts across different asset classes, calculated as the average of simulated returns, on different forward-looking horizons (from three to 10 years).

			Average Annualised Expected Returns			1999-2019 Historical Returns (annualized)	1999-2019 Volatility (annualized)
Assets in local currency	Reference Index	Duration	3 year Expected Returns	5 year Expected Returns	10 year Expected Returns		
Cash							
Euro Cash	JPCAEU3M index	0.3	**-0.5%**	**-0.4%**	**-0.1%**	1.9%	0.5%
US Cash	JPCAUS3M index	0.2	**0.3%**	**0.6%**	**1.3%**	2.3%	0.6%
Government Bonds							
US Bond	JPMTUS Index	6.3	**0.0%**	**0.0%**	**0.8%**	5.0%	4.7%
UK Bond	JPMTUK Index	11.2	**-1.6%**	**-0.5%**	**0.2%**	5.8%	5.9%
Japan Bond	JPMTJP index	9.7	**-0.8%**	**-0.3%**	**0.2%**	2.0%	2.1%
Emu Bond - Core	JPMTWG index	7.4	**-1.3%**	**-0.9%**	**-0.7%**	4.5%	4.0%
Emu Bond - Semi Core (France)	JPMTFR index	7.8	**-0.8%**	**-0.5%**	**-0.3%**	4.8%	4.2%
Italy Bond	JPMTIT index	6.7	**1.2%**	**0.8%**	**1.3%**	5.2%	5.7%
Spain Bond	JPMTSP index	6.9	**0.2%**	**0.1%**	**1.0%**	5.2%	5.2%
EMU Bond All Maturity	JPMGEMUI Index	7.3	**-0.3%**	**-0.2%**	**0.2%**	4.8%	4.0%
Barclays Global Treasury	BTSYTRUU Index	7.7	**0.2%**	**0.3%**	**0.7%**	4.3%	6.6%
Credit Investment Grade							
Euro Corporate IG	ER00 index	5.1	**1.3%**	**1.4%**	**1.3%**	4.2%	3.6%
US Corporate IG	C0A0 index	7.0	**3.0%**	**2.8%**	**3.2%**	5.8%	5.5%
Barclays Euro Aggregate	LBEATREU Index	6.5	**0.1%**	**0.2%**	**0.4%**	4.5%	3.4%
Barclays US Aggregate	LBUSTRUU Index	5.7	**1.1%**	**1.1%**	**1.7%**	5.1%	3.4%
Barclays Global Aggregate	LEGATRUU Index	6.7	**1.1%**	**1.0%**	**1.5%**	4.4%	5.5%
Credit High Yield							
Euro Corporate HY	HE00 index	3.5	**4.9%**	**4.2%**	**3.3%**	4.4%	11.9%
US Corporate HY	H0A0 index	4.1	**5.7%**	**5.2%**	**5.3%**	6.3%	9.4%
Emerging Market Debt							
EM Hard Currency Debt*	JPGCCOMP Index	6.9	**8.6%**	**6.6%**	**5.6%**	7.8%	8.6%
EM-Global Diversified**	JGENVUUG Index	5.2	**5.0%**	**3.5%**	**4.7%**	0.0%	12.0%
Convertible Bond							
Europe Index (Eur Hedged)	UCBIFX20 Index		**6.3%**	**3.9%**	**2.3%**	3.2%	8.9%
Equities							
US Equity	NDDLUS Index		**11.8%**	**7.8%**	**7.1%**	4.0%	14.9%
Europe Equity	NDDLE15 index		**15.1%**	**10.0%**	**6.8%**	1.9%	14.9%
Euro zone Equity	NDDLEMU Index		**14.5%**	**9.6%**	**6.7%**	0.4%	17.5%
UK Equity	NDDLUK Index		**16.5%**	**10.8%**	**7.1%**	3.0%	13.6%
Japan Equity	NDDLJN Index		**11.9%**	**7.3%**	**5.5%**	0.6%	17.6%
Pacific ex-Japan Equity	NDDLPXJ Index		**14.6%**	**10.0%**	**7.0%**	5.2%	13.9%
Emerging Markets Equity***	NDLEEGF index		**13.5%**	**8.7%**	**7.9%**	8.8%	17.1%
World Equity	NDDLWI index		**12.4%**	**8.2%**	**6.9%**	3.0%	14.0%
AC World Equity	NDLEACWF Index		**12.5%**	**8.2%**	**7.0%**	3.2%	14.0%

EM sovereign index are EMBI Global Diversified and EM-GBI Global diversified:* Hard Currency USD, ** USD Unhedged, including the USD currency expectation towards EM currencies. EM Local starting date is 31/12/2002. *** EM equity starting date is 29/12/2000.

Source: Amundi Asset Management CASM Model, Amundi Asset Management Institutional Advisory and Research Teams, Bloomberg. **Data as of the 20th of April 2020**. Macro figures as of last release. Interest rates as of the 31st of March 2020. Equity,spread and FX updated as of the 15th of April 2020. Equity returns based on MSCI indices. Reference duration are average figures. Local Currency. Returns on credit asset are comprehensive of default losses.

Forecast and fair values up to 3 years horizon 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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Cascade Asset Simulation Model (CASM)

This medium- and long-term return forecast report is intended to provide some guidance for investor expectations. The time horizon under consideration is 10 years, a timeframe deemed to be appropriate and during which long-term trend factors and issues can reasonably be expected to play out, and therefore, market returns should accurately reflect this information. We use a Monte Carlo methodology in order to generate possible changes in different risk factors for the time horizon considered, representing the future states of these factors under objective measures. The resulting model is then used to price the instruments in line with these factor scenarios.
In order to determine possible interest rate scenarios, we analysed the changes in the major economic DM regions and EM aggregate. We used a cascade-style modelling technique to simulate the different term structures, using risk factors such as the GDP cycle, inflation, real rates and slope for each of the economic regions in question.
Moving into spread-related assets (EM bonds and corporate bonds), we focused on implied volatility, quality, default and recovery rates, together with economic cycles, to estimate a forward-looking path for EM bonds (hard currency), EU corporate (IG and HY) and US corporate (IG and HY).
Our framework on equity focuses on earnings growth and price earnings, as a determinant of capital gains and dividend yields, to represent the income effect; these variables are analysed with the macroeconomic pillars of the model (the economic and inflation cycle).
Our medium/long-term model, known as CASM, is updated on a quarterly basis to incorporate new starting points, our short-term outlook along with long-term trends, the significance of which is verified on an annual basis.
Our CASM model focuses on key factors, which drive this change over the medium to long-term; the resulting forecasts look at the comparison between current and long-term readings for the key factors included in the model.
Note that these are simulated figures only and may not represent actual asset class returns. Actual returns are based on many factors, and may vary substantially from modelled ones.

The Advanced Investment Phazer (AIP)

The Advanced Investment Phazer (AIP) is our analytical tool that deploys cluster-based algorithms to provide probability-backed assessments of short-term global economic trends (24M) and eventually derive investment recommendations. The AIP wraps macroeconomic and financial regimes together by partitioning the dataset using global factors and local determinants (DM and EM data are considered). Therefore, monetary policy – both conventional and unconventional – and private leverage are considered, together with economic activity indicators. The model allows the calculation of regimes' "likelihood" to be conditioned and defined by internal macroeconomic forecasts. We therefore assign the expected probability for each of the regimes (we identified five regimes: contraction, slowdown, recovery, late cycle and asset reflation). Probabilities are inversely proportional to the Euclidean distance between macroeconomic forecasts and the reference values for each regime: the smaller the distance, the more likely the regime.

Important information

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