CENTRAL & ALTERNATIVE SCENARIOS (12 TO 18 MONTHS HORIZON)

Monthly update

We maintain the content and probabilities of our scenarios. Note that some of the risk factors we identify may occur in our central scenario, which is probably not yet fully priced-in by markets. It would take a combination of risk factors for the downside scenario to materialise. The downside is counterbalanced by an upside scenario, that of a rapid decline in inflation due to an easing of gas prices and/or to the combined tightening of global monetary policies, the impact of which can be underestimated.

DOWNSIDE SCENARIO 15%

Deep global slump

Analysis

- Worsening/expanding **war in Ukraine**
- Energy crisis and **deep recession in Europe**
- **Covid-19 resurgence**
- **De-anchoring of inflation expectations,** disorderly adjustments by CBs
- **Recession in China**
- **Global economic downturn** with, in a second stage, renewed deflationary pressures
- **Global financial crisis/debt crisis with several EM defaults**
- **Governments fail to implement countercyclical fiscal policies.** Decisive action on financial repression
- **Climate transition measures postponed**

Market implications

- Favour cash, USD and US Treasuries
- Play minimum-volatility strategies
- Gold

CENTRAL SCENARIO 70%

A stagflationary episode, with rising divergences

Analysis

- **Stalemate in the war in Ukraine**
- **Confidence shock in EU,** due to high energy prices
- **Covid-19** is an endemic disease
- **Inflation fails** to return to CB targets by 2024
- Global **nominal GDP growth to trend higher,** mitigating the impact on earnings
- **Growth divergences:** recession in the EZ/ UK, sluggish rebound in China, sub-par growth expected in the US (well below potential in 2023)
- **CBs divergences:** Fed to continue its tightening cycle but adopting a dovish stance (end of Q4); BoE on a soft hiking cycle; ECB to raise rates, and activate the TPI; PBoC in easing bias
- **Divergent fiscal policies:** mild expansion in the EU; restrictive in the US in 2022-23
- **Climate change** disrupts the commodity cycle and adds to stagflationary trends

Market implications

- Lower risk-adjusted real returns expected.
- Contained steepening of US Treasuries yield curve as well as EZ and EM
- Inflation hedge via gold, linkers, equities, real assets and commodities
- EM: short-term caution, long-term real income and growth story intact

UPSIDE SCENARIO 15%

Inflation falls back quickly, ending the stagflationary episode

Analysis

- **Ukraine war** ends and **sanctions** are withdrawn gradually.
- **Russia maintains gas supplies,** commodity market normalises
- **Covid-19** recedes
- **Inflation falls back quickly,** supply bottlenecks ease
- **Recession fears dissipate** and inflation remains under control which eases the pressure on CBs
- **Lower uncertainty,** extra savings and renewed purchasing power can fuel consumption and investment in DM without erosion of corporate margins
- **Fiscal discipline** gradually restored
- **Climate change** policies and energy transitions become first priority

Market implications

- US Treasuries curves bear steepen
- Favour risky assets with cyclical and value exposure
- Favour linkers and equities as an inflation hedge

Geopolitic *Covid-19 related topics* *Growth and inflation expectations* *Monetary and fiscal policy* *Recovery plans or financial conditions* *Solvency of private and public issuers* *Economic or financial regime* *Social or climate related topics*

TOP RISKS

Monthly update

We keep the same probabilities for the three families of risks. We see risks growing on all fronts, closely linked to each other. Economic fundamentals are deteriorating globally (which is reflected in the central scenario). The course of the war in Ukraine and its potential implications can tip the scenario in either direction. We consider Covid-related risks (including lockdowns in China) as part of the economic risks.
Risks are clustered to ease the detection of hedging strategies, but they are obviously related.

ECONOMIC RISK 30%

- **Global recession** driven by an oil/gas shock, a tightening of monetary conditions, and a loss of purchasing power.
- **The *weaponisation* of gas supply** by Russians could cause a s**evere energy crisis in Europe,** leading to a **deep recession** (confidence shock).
- **Economic crisis in Eastern Europe** following a collapse of the Russian economy, elevated energy prices, uncontrolled inflation, and a migrant crisis.
- **Disordered adjustments by CB,** which underestimate supply-driven inflation and lose control.
- **Global profit recession t**riggered by the global slowdown, coupled with persistent input-cost pressures (margin compression).
- **Recession in China.** Zero Covid-19 policy combined with a housing crisis spiraling out of control.
- **End of the great coincidence:** with the persistence of stagflationary pressure, CB and governments' objectives are no longer fully aligned: the room for countercyclical fiscal policies is reduced.
- **Pandemic:**
  - Risk of a more dangerous and vaccine-resistant variant.
  - New lockdowns or mobility restrictions.
- **Climate change-related natural events** hurt growth visibility and social balance.

+ **Cash, linkers, JPY, Gold, USD, Quality vs. Growth, Defensive vs Cyclicals.**

- **Risky assets, AUD CAD and NZD, EM local CCY.**

FINANCIAL RISK 30%

- **Sovereign debt crisis:**
  - An extended war in Ukraine would hurt DM vulnerable public finances with public debt ratios already at historic highs.
  - De-anchoring inflation expectations could lead to harsher monetary tightening and to a bond market dislocation.
  - Most countries are vulnerable to rating downgrades and rising interest rates.
  - Weak EM could face a balance-of-payment crisis and increased default risks.
- **Corporate solvency risk increases,** amid deteriorating fundamentals, rising uncertainty, and corporate margins under pressure (high input cost, double orders lead to profit warnings).
- **Widespread greenwashing and ESG investment bubble undermine the energy transition funding.**
- **USD overshooting** leads to unstable currency markets.
- **Currency wars:** currency appreciation is a way for CB to fight inflationary pressures.

+ **CHF, JPY, Gold, CDS, optionality, Min Vol.**

- **Oil, risky assets, frontier markets and EMs.**

(GEO)POLITICAL RISK 30%

- **Ukraine war:**
  - Prolonged military struggle leading to high-intensity conflict and potentially to a Western military confrontation.
  - The Russians are losing ground militarily, which increases the risk of Russia using tactical nuclear weapons.
  - High risk of accident at the nuclear facilities in Ukraine.
  - [That said, it is also possible that in the coming months the situation will calm down, paving the way for a resolution/ceasefire].
- **EU political fragmentation** or populist vote bring disagreement on how to manage the relationship with Russia.
- **The United States takes a hard line with China** in order to block any attempt to occupy Taiwan. Risk of accidental confrontations in the South China Sea or the Taiwan Strait.
- **EM political instability driven** by higher food and energy prices, leading to a wave of social unrest.
- Iran or Korea nuclear programmes renewed concerns and sanctions.
- **On a global scale, increasing risks of setting back the energy transition once again. Global warming** leads to increased risk of conflicts, driven by water shortages and migration movements.
- **Cyber-attack or data compromise,** disrupting IT systems in security, energy, and health services.

+ **DM Govies, Cash, Gold, USD, Volatility, Defensive, Oil.**

- **Credit and equity, EMBI.**

CROSS ASSET DISPATCH: detecting markets turning points

The turning point has occurred | Approaching the turning point | Not reached yet too early to call it

ECONOMIC BACKDROP

- Economic momentum is slowing amid persistently high inflationary pressures and weakening domestic demand. While we still expect a soft landing for the US economy, recession risks remain for mid-2023, as a policy mistake remains a key risk. On the European front, we expect a cost-of-living and inflation-driven recession during winter, which we now expect to be deeper than previously expected and followed by a shallow recovery.
- Direction of revisions on the inflation and growth outlook diverge amid stagflationary momentum.
- The prolonged stress on the geopolitical front and the tug of war between fiscal and monetary policy makes the final economic outcome uncertain, exacerbating data volatility.

FUNDAMENTALS & VALUATION

- Current wild sell-off cleaned up the overvaluation built up after the summer rally. Still difficult to see entry levels in the near term.
- Stock multiples looks more in line with the current inflationary environment and tight monetary policy, but are not discounting recession yet, as EPS expectations remain optimistic.
- Fundamentals are worsening compared to September, as stagflation should sound an alert for corporate profitability.

NEUTRAL + ASSET ALLOCATION

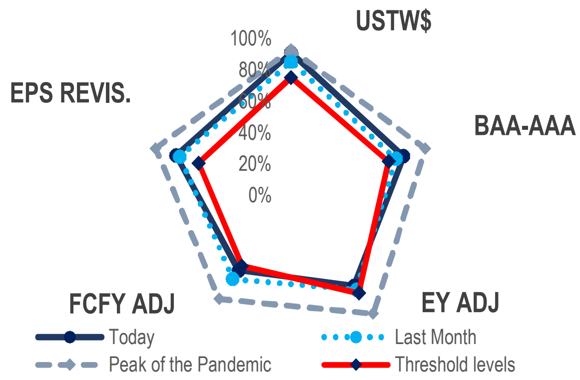
TECHNICALS

- Technicals highlight a fragile picture across the multi-asset universe. Asset trends are highly fragmented, failing to open for continued breaths in the market. Equities, government bonds, and credit remain unattractive from a trend-following perspective, yet contrarian metrics prevent aggressive de-risking and, from time to time, are triggers for sharp short-squeezes.

SENTIMENT

- Risk sentiment deteriorated strongly in September, with all our three models in deep risk-off. Financial conditions tightened everywhere following the worse-than-expected September US CPI, while the USD and risk-concentration metrics keep fuelling into higher risk-off probability in our CAST and MoMo models, respectively. All in all, the risk-sentiment pillar keeps suggesting that a defensive asset allocation may be required in the short-term.

Cross Asset Sentinels Thresholds (CAST) still supportive



Source: Amundi Institute. Data as of 30 September 2022.

The CAST risk perception failed to show a structural increase in Q1, but has turned less favourable since Q2. EPS revisions have turned negative in response to recession fears and the USD calls loudly for risk-off. Credit risk premium remains high and above alert, calling for a defensive stance across risky assets.

Methodology: we consider five input variables, called 'sentinels': US trade-weighted dollar, Moody's Baa-Aaa spread, EPS revisions, adjusted earning yield risk, and adjusted cash flow yield risk. 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 any market 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 greater the risk perception, and eventually the need to move closer to a defensive asset allocation.

GLOBAL RESEARCH CLIPS

1 US inflation proved strong, but has probably peaked; Fed to stay hawkish

- US August CPI data surprised on the upside. It may have peaked, and we expect US headline inflation to slow from its 9% high to the 7.5-7.0% range in Q4 2022, but momentum will stay strong in the near term.
- Should the next couple of readings show stronger resilience of core inflation than we expect, then the Fed may adopt an even tighter approach to avoid an inflation resurgence later on, thus increasing the risk of overtightening.
- Against such a backdrop, the Fed will keep its hawkish stance to cool down inflation. We expect it to keep hiking rates aggressively, with a terminal Fed Funds rate seen at 5.0% in March 2023.
- We have raised our US two-year Treasury yield forecast to 4.3-4.5% over a 12-month horizon and our 10-year yield forecast to 3.9-4.1%.

Investment consequences

- Stay cautious on equities.
- Underweight US 10-year inflation-linked bonds and Eurozone nominal bonds.
- Neutral on US breakevens.
- Favour IG over HY credit.

2 Eurozone to enter a recession in late 2022 amid a hawkish ECB

- Our baseline scenario for natural gas prices poses downside risks to the contraction expected in Q3 2022-Q1 2023 and to the recovery foreseen beginning in Q2 2023, making it shallower. We have cut our 2023 real GDP growth forecast to -0.5%.
- The impact of measures put in place by national governments to offset the energy crisis will be limited by tight monetary policy. Fiscal support is unlikely to offset the shock fully.
- With no regulation changes, Eurozone inflation should pick up during the fall-winter season, with the peak still to be reached.
- Consequently, the ECB has turned very hawkish. We expect further rate hikes, with the terminal deposit rate at 2.75% by May 2023 amid discussions of quantitative tightening.
- Sovereign core bond yields should rise further. We have raised our two-year Bund yield target to 1.8-2.0% over a 12-month horizon and our 10-year yield target to 2.3-2.5%.

Investment consequences

- Stay cautious on Eurozone assets; on equities and credit, we prefer the United States to the Eurozone.
- We are cautious on sovereign core bonds.
- On the forex market, we believe the USD could appreciate further against the EUR, possibly to 0.94 in the short term.

3 Italy election outcome is mildly positive for markets

- The centre-right coalition won with some 44% of votes. It will have enough seats to form a stable government but not enough to vote for constitutional amendments, which require a two-thirds majority.
- Italy's new prime minister should be Brothers of Italy's leader Giorgia Meloni. Mario Draghi's caretaker government will address some of the work on the budget law.
- The new government may make adjustments to public finance figures and try to negotiate a revision to the NRRP. It is likely to stick to EU fiscal targets and avoid clashes with EU institutions on economic policy.
- The recent widening in spreads looks to be driven by external factors, such as the strong repricing of ECB terminal rates and the rise in core yields. Technicals have improved and could help offset the hawkish ECB stance.
- On equities, we expect some short-term relief. To see a structural rally, we need more clarity on government appointments, on the approval of the 2023 budget law, and on possible changes to the NGEU plan.

Investment consequences

- Stay cautious on Italian debt, as volatility may stay high.
- In Italian equities, focus on companies that have visibility on future growth, along with some protection from strong inflation, and keep a balanced exposure to sectors.

4 FX market: risk of technical short squeeze rally and high volatility

- The USD is a long position that both speculative and institutional investors have held since mid-2021.
- USD longs are widespread, while EUR, GBP, and JPY are at their lowest levels in two to five years, yet we are still far from historic lows.
- Despite the stretched positioning on G4 FX, we should not factor in yet a shift in the strategic view.

Investment consequences

- Exploit any rebound of short-positioning currencies to add to USD long positions, especially against EUR, GBP, CAD, SEK, and NZD.
- JPY is the only currency that we would not short and where we see upside risks by end-2022.
- CNY could depreciate further, as moderating China export growth, negative interest rate differentials against the United States, and Taiwan tensions could outweigh positive factors, including expected positive growth differentials and stabilising portfolio flows.

AMUNDI ASSET CLASS VIEWS

	Asset Class	View	1M change	Rationale
EQUITY PLATFORM	US	=/+		The main themes remain how far the Fed is willing hike rates and how earnings would be affected by slowing growth. We think strong consumer demand, tight labour markets, and improving consumer surveys indicate support for corporate earnings. We stay selective and look for businesses that reward shareholders through dividends, share buybacks, etc.
	US value	+		The upcoming growth deceleration underscores the need to complement value with less-cyclical names that display quality characteristics and sustainable margins. On the other hand, investors should avoid segments where valuations do not justify the earnings potential, such as those in expensive growth sectors.
	US growth	-		In an environment of rising rates and the effects on cost of capital, stocks whose valuations depend more on cash flows way into the future would be more affected. In addition, current valuations in some segments are not justified by fundamentals. Thus, we stay cautious but are observing areas such as quality growth where prices look reasonable.
	Europe	--		Recession uncertainty and geopolitics lead us to stay cautious on Europe amid a rising cost of living. Given that Europe is a cyclical market, a global downturn is negative for European earnings. However, when the slowdown ends, the region should be among the first ones to benefit. We remain focused on long term-earnings resilience and balance sheet strength.
	Japan	=		We are neutral on Japan in light of slowing global growth (and thus potential impacts on exports) and relatively attractive valuations of the Japanese markets.
	China	=	▼	While monetary and fiscal policies are accommodative, problems in the housing sector and the sporadic Covid lockdowns are affecting household incomes and spending. Long-term drivers in the form of balanced, high-quality growth are in place.
	Emerging markets-ex China	=		The EM investment space is affected by a combination of domestic, idiosyncratic stories, coupled with global headwinds and geopolitical tensions. Thus, on the one hand, we like commodity exporters, such as UAE, Brazil, but on the other, we are cautious on countries such as Thailand, Taiwan and Tukey. We keep a selective stance overall.
FIXED INCOME PLATFORM	US govies	=		The Fed downgraded its economic growth outlook recently but reiterated its intent to tame inflation by hiking rates. This, coupled with attractive yield levels, leads us to believe bonds can offer protection. We stay neutral on duration, with a positive bias and an agile stance. Given the recent surge in real yields, we are also monitoring TIPS for entry points,
	US IG corporate	=/+		Robust corporate and consumer balance sheets, attractive carry and valuations encourage us to prefer US IG over other weaker credit. But we identify selective names that can withstand the risks of a 'hard landing' and show earnings resilience.
	US HY corporate	-	▼	The default picture looks contained for now but we are watchful of spreads, given the Fed's willingness to raise rates to tame inflation that could eventually affect the liquidity situation for companies with weak cash flow generation. Thus, we stay cautious and aim to balance yield with liquidity and fundamentals.
	European govies	=		Despite the ECB's commitment to bringing prices under control, economic pressures in Europe may limit how far the bank can go with its rate hikes. We stay neutral on core Europe for now while maintaining a flexible view and looking for opportunities across geographies and curves. On peripheral debt, we are mindful of fragmentation and political risks.
	Euro IG corporate	=		Recent spread widening seems to be an indication of a hawkish ECB, coupled with high inflation and growth concerns, although corporate fundamentals remain robust. We avoid over-leveraged areas and are instead looking for quality assets in an overall neutral approach in European credit.
	Euro HY corporate	-	▼	We notice a mild deterioration in financial conditions which could eventually lead to higher financing costs, especially for lower-rated issuers. Thus, we are monitoring liquidity, the cash flow situation & default outlook in an overall cautious stance.
	China govies	=/+		China is one of the few countries where policy is turning accommodative. This, coupled with the diversification benefit of Chinese debt for global investors, and a potential relaxation of lockdown policy in future, allow us to stay slightly positive.
	EM bonds HC	=/+		Tightening policy rates in DM are putting pressures on EM debt, but the region shows huge divergences. We see value in HY over IG, as the former may provide a cushion from Fed rate hikes. We like commodity exporters in Latin America (Mexico, Brazil) and in the MENA region (Bahrain), but are very active in adjusting this stance.
	EM bonds LC	=		While the situation is improving, it still calls for a slightly cautious/neutral stance. We are selective, with a preference for high carry countries (South African, Brazil). EM FX will remain under pressure short term owing to a strengthening USD.
OTHER	Commodities			Decelerating global growth and its resulting impact on demand, including in China, is not supportive for cyclical commodities and oil. We downgraded our 3M target for WTI to $90/bbl, but long-term supply-side issues remain. Rising real rates due to a hawkish Fed increase the opportunity cost of holding gold, putting pressures on its prices in the near term.
	Currencies			Sticky US core inflation means it is still early for the Fed to tilt towards a dovish pivot and for the USD to be dethroned. We expect the dollar to touch new highs within the next six months.

LEGEND

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	Negative		Neutral		Positive		Downgrade vs previous month	Upgraded vs previous month

Source: Amundi, as of 3 October 2022, views relative to a EUR-based investor. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This information should not be relied upon by the reader as research, investment advice or a recommendation regarding any fund or any security in particular. This information is strictly for illustrative and educational purposes and is subject to change. This information does not represent the actual current, past or future asset allocation or portfolio of any Amundi product.
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.

CROSS ASSET
INVESTMENT STRATEGY

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