2021 INVESTMENT OUTLOOK

Market rotations in an uneven recovery

Confidence must be earned

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INVESTMENT OUTLOOK 2021
Market rotations in an uneven recovery

CIO letter

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The Covid-19 pandemic drove an unprecedented collapse in economic activity in H1, which was followed by a desynchronised rebound. The recovery phase has been uneven, with the virus cycle dictating the sequence of it. We believe that the damage to the global economy will last well beyond 2021. Output and personal income losses, the rise of inequality and the disruption in some sectors will be the legacies of the pandemic. Expecting that a vaccine will cause these to dissipate within a few months is too optimistic.

Expectations of additional fiscal and monetary measures will continue to mount in the coming months amid possible virus relapses. This will drive sentiment in financial markets, in line with the 'bad news for the economy, good news for the markets' narrative that saved the day for investors in the dramatic year of 2020. The performances of risk assets rebounded strongly amid the policy support. However, investors in a traditional balanced portfolio experienced a doubling of volatility compared with the previous decade, a nasty drying up of market liquidity and an increased correlation among risk assets. These features will affect portfolio construction in 2021 and beyond.

We see five investment themes to play in 2021 at portfolio level.

From a cross-asset perspective, a rotation from credit (HY) into equities. Equities will likely have a better risk-return profile than high yield in a phase of mild recovery and earnings re-acceleration in 2021. **Investors should add exposure to cyclicals stocks, quality value and post-Covid-19 ESG themes.** We believe old-fashioned geographical diversification will come back into focus, thanks to global trade no longer driving global growth, the repatriation of value chains and the desynchronisation of cycles. At the same time, sector discrimination will become even more evident, providing additional diversification opportunities.

Move from fixed income to smart income. With the amount of negative yielding debt close to historical highs and interest rates expected to remain low in the short term, investors should build an income engine by searching for opportunities across the board, including emerging market bonds, private debt, loans, real assets (infrastructure, real estate) and high-income equities. Opportunities in credit markets remain, but the big theme for 2021 is what we call **'the great discrimination'**. What is sound and expensive will become even more expensive. Some areas of the market will likely deteriorate further, as the abundant liquidity injected by central banks is hiding weakening fundamentals. Selection will be key in 2021.

Consider govies for liquidity. Investors should consider allocating a portion of their portfolio to core government bonds, regardless of their valuations, primarily for liquidity reasons in case there are phases of liquidity shortages.

Play the recovery through emerging markets assets. In a still highly uncertain virus and economic cycle, the Chinese and Asian economies are emerging as the most resilient, having been able to effectively manage their outbreaks. So far, China has been the only country to recover to its pre-crisis GDP level. The outlook of EM countries in LatAm should also improve through 2021 as the virus cycle is improving in this area. These trends should support EM regional themes and EM bonds in local currency.

Include 'true' diversifiers. In a world of high correlation among risk assets, adding uncorrelated sources of returns may help balance the allocation. **Absolute returns approaches, volatility, hedging strategies and gold** may help improve overall portfolio diversification, as well as **real assets, private markets and insurance-linked securities.** Those asset classes show a lower correlation to traditional asset classes, and some, like real estate and infrastructure, can provide an hedge against inflation.

In the medium term, the **main risk for investors will be the de-anchoring of real rates and inflation expectations** due to the massive fiscal stimulus, the monetisation of public deficits, the rebalancing of social and political support in favour of labour and the retreat of global trade. Markets are not pricing in this risk yet, but investors should start looking at strategies for a possible inflation comeback.

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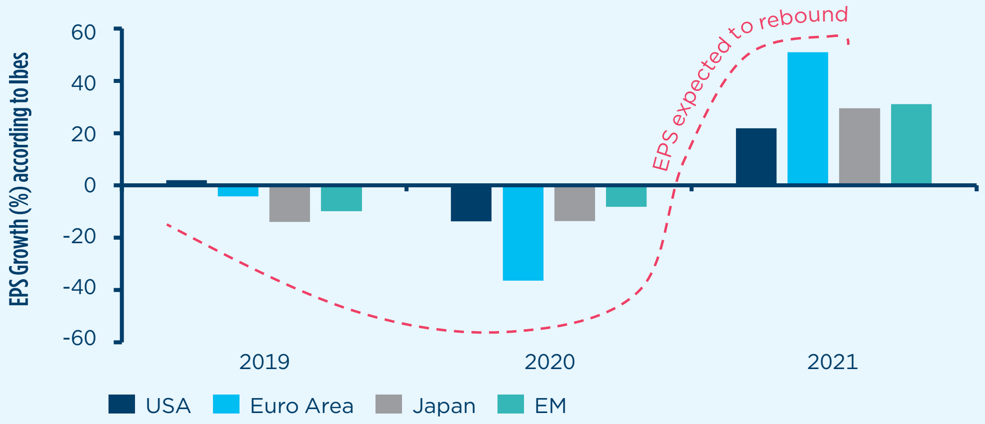
Global CIOs investment themes

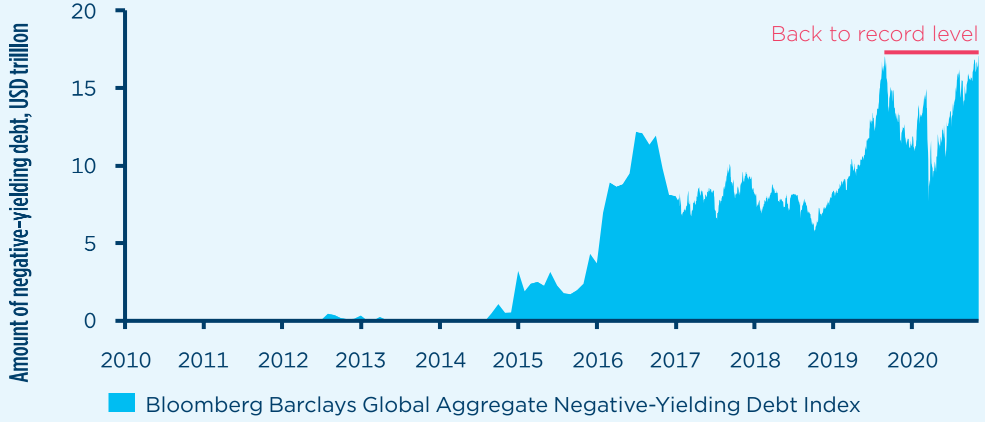
GLOBAL THEMES

Cyclical recovery...



... and high volatility and high correlation among risk assets

Low rates, with a continuous search for income

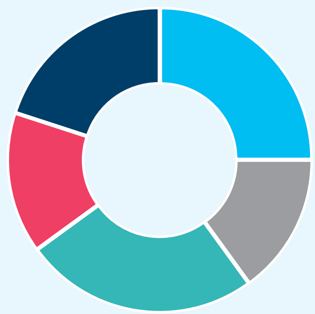


Source: Amundi Research, Bloomberg, IBES, Datastream. Data as of 28 October 2020.

2021 PORTOFLIO IDEAS

1. Consider core govies for liquidity purposes. Include core govies to maintain adequate liquidity buffers and hedge in risk-off phases

2. Rotate from credit (HY) risk into equities. Add exposure to equities with a tilt towards cyclical (some EM, sectors, commodity-driven themes), value and post-Covid-19 ESG themes



3. Move from fixed income to smart income. While searching for income, explore opportunities across the board, with strong selection: HY, EM bonds, private debt, infrastructure, real estate and high dividend equities

4. Include 'true' diversifiers. Balance risk allocation with the inclusion of a diversification bucket to search for uncorrelated sources of returns (absolute return, volatility strategies, gold, real assets)

5. Play the recovery with EM assets. China and Asia resilience will support the recovery in EM assets and in particular EM equities and EM bonds in local currency

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Setting the scene: central and alternative scenarios

CENTRAL AND ALTERNATIVE SCENARIOS

65% CENTRAL SCENARIO – *Multi-year and multi-speed recovery*

- Multi-year process to get the world back in order
- 2021 may see a sequence of economic relapses/infection outbreaks/selective lockdowns/policy boosters (our assumption is that vaccines/treatments will be available in H2 2021)
- Low growth, low inflation, low rates: ‘unconventional’ monetary policies to persist. Strong political commitment to fiscal dominance in advanced economies but execution is a material risk
- Global trade to global GDP ratio to slip further
- The Covid-19 crisis exacerbates income and wealth inequality, with rising social tensions

MARKET IMPACT

- Limited steepening of the US yield curve
- Rotation from credit HY into equity
- Maintain income pockets: EM bond, IG
- Equity themes are sector-specific and more domestically driven
- Favour gold on pervasive uncertainty, deflation and recession fears

25% DOWNSIDE SCENARIO – *Secular stagnation*

- Protracted economic downturn
- Due to uncertainty, the policy multipliers in place are low. As financial conditions tighten, liquidity does not feed through to the real economy and the labour market deteriorates further
- Economic crisis evolves into a financial crisis, forcing policymakers to move even further into uncharted territory (nationalisations, negative rates, helicopter money, etc.)
- Protectionism and deglobalisation accelerate, negatively affecting trade and value chains. Global potential growth is hit and pockets of inflation emerge

MARKET IMPACT

- Favour cash and US Treasuries
- Favour gold, CHF and JPY
- Play minimum volatility strategies

10% UPSIDE SCENARIO – *V-shaped recovery*

- Rapid development and wide distribution of safe, effective vaccines/treatments. New outbreaks are avoided
- Productivity boosts on new digital/green developments or faster recovery normalisation. With lower uncertainty, policy boosts feed through to the real economy and financial markets, closing the gap between the manufacturing and service sectors
- Sustainable recovery and diminishing need for further (fiscal) policy support

MARKET IMPACT

- US curve steepens on economic recovery and some inflation returns
- Favour risky assets
- Favour linkers and gold as inflation hedges

Source: Amundi Research, as of 10 November 2020.

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Global macroeconomic themes

GLOBAL THEMES

1 A more balanced globalisation will offer new investment opportunities

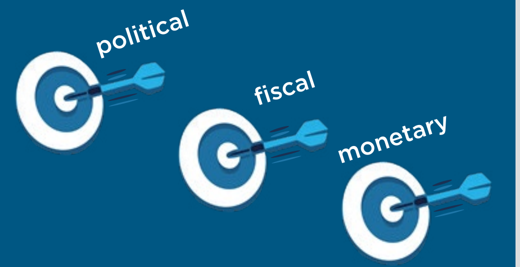
The unbridled growth of trade will tend to fade away as a relatively larger share of the economic cycle should come from domestic demand. **We expect global trade to remain weak** and uneven: the regions and countries more dependent on highly impacted sectors (i.e., tourism, leisure, travel) are particularly vulnerable. **We expect more decorrelated business cycles** across countries and areas than in the past and this implies there will be **more opportunities for diversification** amid increased fragmentations and divergences at country and sector level.

2 The big divergences in growth engines with on-off periods dictated by outbreaks

The timing and extension of the pandemic, outbreaks and targeted lockdowns will set the economic paths and further increase divergences. Asia has been leading the *first in, first out* timeline with successful policy boosters and virus containment measures, and as such we expect **Asian countries to dominate the macro-financial scene.** Therefore:

- Inflation expectations will likely grind higher in EM than DM; EM FX should rebound vs. the USD; and
- the growth/value dislocation should eventually move to a tipping point.

3 Political, fiscal and monetary trilogy seek the *'triplete'*



The bar to prevent further amplification of the Covid-19 shock is set very high: execution from political to fiscal dominance is the challenge for 2021 and beyond. We expect central banks to continue fine-tuning their accommodation, providing credit provisions to a wide range of borrowers and simultaneously supporting sentiment. **This multi-year global effort will end with larger debt levels.** Debt composition, quantity and repayment will open up an arduous debate on taxation to avoid financial repression, hyperinflation and defaults. It is unlikely debt will constitute the highest vulnerability for 2021, but we believe we have to consider it.

Source: Amundi Research, as of 10 November 2020.

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Risks to watch

RISKS & PROBABILITIES

Risk	Analysis	Market impact
20% Financial instability due to multi-wave pandemic	Multiple waves of Covid-19 may trigger a sharp market correction and hit financial stability. Although the economic outlook remains uncertain, market participants remain confident that policy actions will be bold in the event of an economic relapse. The longer the crisis lasts, the greater the doubts will be on the marginal effectiveness of new measures and the capacity of authorities to implement them. Financial conditions would tighten. The magnitude of the recession would increase solvency risks regardless of CBs' actions and government guarantee schemes, and despite banks' stronger capital bases.	▪ Positive US Treasury/Bund and gold ▪ Negative oil, basic materials, currencies of commodity-exporting countries, EM bonds
20% Increase in corporate defaults	Liquidity shortfalls, rising defaults and downgrades degenerate into bankruptcies and financial sector impairment. The magnitude of the recession increases solvency risks regardless of CBs' actions and government guarantee schemes. Banks' capital bases are stronger but corporate defaults and NPLs spike as state support fades and "grace" periods end (i.e., retail and commercial real estate). A financial crisis with widespread distress and deleveraging is a risk in countries that entered the crisis in a weak position.	▪ Negative for risky assets ▪ US IG BBB downgrade, EURO and US HY B-CCC default increase ▪ Positive for USD, DM sovereign bonds and gold
20% Hard Brexit	A no-deal Brexit in the context of partial lockdowns could push the UK into a deep recession, with spillover effects on the EU. With or without a deal, the UK will be outside the EU in 2021, and a phase of adjustment to the new framework will begin. As the UK will try to get trade deals outside the single market, with potentially better terms, it could create tensions between EU members with similar economic priorities.	▪ US equities underperform, raising risk asset volatility
10% Post US elections, frictions to redesign the political board	The outcome of the US elections is unlikely to change the US stance against China. 5G, foreign holdings, the situation in HK, potential US sanctions on Chinese banks and a Phase 2 of the trade deal are all topics that will make a strong comeback in 2021. This "cold war" might also extend to Europe. The EU received the green light from the WTO to hit the US with US$4bn in tariffs on the back of Airbus Boeing and France has initiated a tax on Big Techs.	▪ Risk on the HK peg ▪ Negative for Chinese equities and CNY ▪ Positive for USD, JPY, UST and gold ▪ The harsher the escalation, the more detrimental it is for risky assets
10% Inflation surprise	QE programmes may become problematic during the recovery phase when inflation enters the equation. In EM, inflation is at an inflection point. DM governments' responses to rising inequality and social instability could change the inflation dynamics. The unknown reaction function of CBs confronted with a positive shock on inflation (or on inflation expectations) could be a source of uncertainty. This risk is very low in the coming year, but is expected to increase over time.	▪ Positive TIPS, gold ▪ Positive equities, rotation from growth into selected value and sectors with pricing power that are investment driven ▪ Negative long-term UST and Bunds
10% EM financial crisis	The health and economic crisis is potentially conducive to geopolitical stress and national instability within EM. At this point, there is no identified 'systemic' crisis with market impact, but a number of events must be monitored such as Libya, Greece/Turkey, Lebanon, Belarus, the protests in Eastern Russia and the India and China frontier dispute. For Turkey, which is already on very thin ice with domestic imbalances flashing warning lights, the economic headwinds carry additional risks.	▪ Negative EM equities and LC debt ▪ Positive UST ▪ Positive gold, USD and CHF

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Amundi convictions for 2021

	Asset class	2021 view	2021 outlook rationale
EQUITIES	US	=	The US economy is due to return to 2019 levels around mid-2022, after China but before Europe. A steepening of the yield curve and a weaker USD should help the more cyclical/value markets to rebound first, but the US, which is rich in disruptive stocks, is a winner due to its low rates, which will be the other part of the equation in 2021.
EQUITIES	Europe	=/+	In 2020, the EU recovery fund made Europe investable again. In 2021, the strong relationship between EMU and MSCI World in bond yields should eventually help the region to benefit tactically from a steepening of the yield curve. The more defensive UK, also a proxy for energy (ESG unfriendly) vs. industrials (among the winners of the next cycle) will likely still lag.
EQUITIES	Japan	+	Japan is one of the most cyclical markets, with the biggest weighting in industrials (20%), a winner of the coming cycle, and consumer discretionary (18%) the second biggest. As such, Japan is a candidate to benefit from the recovery. The biggest headwind would be a strong rebound of the JPY, which we do not expect if global risks eventually fade next year.
EQUITIES	Emerging markets	+	EM are an interesting combination of secular technology-related sector plays (IT, consumer discretionary and communication services), mostly in North Asia, and more traditional cyclicals (financials and materials), especially in LatAm and EMEA. Asia has been strong in 2020. A USD breakdown would be a catalyst for a broader EM outperformance.
FIXED INCOME	US govies	=	As the recovery progresses, the medium-term trend will be for the curve to continue to gradually steepen on the very long part. The extent of the steepening will be contingent on the evolution of the virus and on the fiscal stimulus put in place after the elections. The inflation premium at the long end of the US curve should continue to rise moderately.
FIXED INCOME	US IG corporate	=	We maintain a constructive view on US IG on the back of: (1) central bank support; and (2) the search for yield. The curve steepened with Fed buying and the sweet spot is in 7-10y.
FIXED INCOME	US HY corporate	=	We expect to see increasing fragmentation in US HY on two fronts: (1) companies that maintain high cash levels for any contingency vs. those that burn cash to sustain themselves; (2) the increasing gap between sectors (tourism, energy) that experienced heavy falls in revenues vs. those that witnessed higher sales (technology). For investors, this means idiosyncratic and default risks are not correctly priced in and spread compression will not be uniform. As a result, attention to selection and quality is paramount.
FIXED INCOME	European govies	-/=	On the back of unattractive valuations and with an expected stable outlook for yields, we maintain a cautious view on core government bonds. However, on peripheral debt, we remain positive amid strong ECB support, to be strengthened further in 2021 through additional purchases and coming EU support, starting with the SURE programme.
FIXED INCOME	Euro IG corporate	=/+	Despite most of the spread tightening having been delivered, IG and especially BBB-rated corporates are still targeted by yield searchers and look resilient thanks to ongoing ECB QE. We continue to prefer EUR over US, due to the lower leverage in the latter, and play this through financial and subordinated debt that offers the potential for extra yield.
FIXED INCOME	Euro HY corporate	=	Among European HY we recommend the higher quality segment (BBs in particular), in order to combine the need to reduce volatility and to profit from remaining carry. EUR HY continues to be more resilient to default risk than US HY, thanks to its higher credit quality and sectoral exposure. However, the need for selection and cash buffers remains high.
FIXED INCOME	EM bonds HC	=/+	While the spread tightening potential in EM bonds is limited for 2021 given what has already occurred in 2020, we believe the asset class could still benefit from inflows from investors in search of carry in a world of low rates. Among EM asset classes, HC debt would be the most resilient in case of a deterioration of the outlook.
FIXED INCOME	EM bonds LC	+	In a scenario of economic recovery, the low yields in DM and the weak dollar are supportive for EM debt in local currencies and the FX component should benefit in 2021. However, selection will be relevant as some countries are still vulnerable in the current uncertain environment.
OTHER	Commodities		In 2021 commodities will be supported by the recovery in the economic cycle and by the still favourable financial conditions. WTI oil should stay in the $40-50 range in H1 2021, while base metals should also recover. Gold will also benefit from easing central banks and is favoured in the case of continuing uncertainty.
OTHER	Currencies		A shift from a contraction phase to a recovery will likely put the USD under pressure. A broad USD move lower is expected, but considering the higher policy flexibility and the direct link to China, we believe commodities-related currencies will be the relative winners in G10. On EM FX, volatility will remain throughout 2021, but some appreciation is on the cards.

--- -- - Negative View | = Neutral | + ++ +++ Positive View

Source: Amundi, as of 12 November 2020. 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.

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Important information

Document issued by Amundi, "société par actions simplifiée"- SAS with a capital of €1,086,262,605 - Portfolio manager regulated by the AMF under number GP04000036 – Head office: 90 boulevard Pasteur – 75015 Paris – France – 437 574 452 RCS Paris – www.amundi.com

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