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A cloudy summer

Investors have experienced generally low returns so far this year, due to the clouds currently gathering on the horizon, and the approach to risk assets is being characterised by increased caution. This attitude has led to weaker equity markets, wider corporate spreads, and some areas of stress in EM (especially in local currencies). We can identify different fronts that need to be monitored closely in the short to medium term: the evolution of the cycle and potential regime shift, geopolitical issues, and EM anxieties. First, in order to identify a potential regime shift, it is crucial to understand the evolution of the cycle. **In the current phase**, on the one side, there is an **extended cycle in the US and an upward trend in earnings**; on the other, however, we are seeing signs of a maturing cycle: global growth looks to be peaking and inflation is rising gently; **global liquidity is expected to diminish and leverage is creeping up**. In the current environment, central banks are continuing to withdraw their stimulus, with different speeds of adjustment (**further divergences emerged** between the Fed and the ECB at their most recent meetings). CBs are no longer responding to any bout of volatility and they are not providing umbrellas against political storms. **Geopolitical risks are a second sphere of uncertainty**. Disagreements within the EU are assuming harsher tones. The escalation of trade disputes are a nuisance (see US vs China but also vs Canada, Europe). Political issues are also weighing on some EM (elections in Brazil, Mexico and Colombia). Idiosyncratic risks (Turkey) add fuel to EM stress, already challenged by higher US rates and the stronger USD. China's resilience becomes essential in this context. But while these clouds continue to gather, the positive cyclical backdrop is still expected to support earnings growth across the board in 2018 and for most of 2019. In addition, the still-low level of interest rates should support higher valuations and risk appetite. To navigate this multifaceted environment, investors should rethink portfolio construction through time horizons. **In the short term, equity continues to be preferred vs bonds**. Seeking **quality and value in the equity market** should help to deal with challenging phases of lower liquidity in the future. **Duration should be slightly short overall in the short term**. As we move towards the medium term, cyclical slowdown could resurface and the support to risk assets could fade. Duration could become neutral/long again. Currency dynamics will continue to act as shock absorbers, mirroring divergences and creating opportunities from dislocations (selectively in EM,

US vs the EUR in the short term). With a long-term perspective, the underlying trends of macro variables point to low interest rates at equilibrium and mean reversion of equity returns around earnings secular trends. This situation will translate into lower return potential for a balanced portfolio in the future. Based on this perspective, in order to combine short-term positioning with long-term awareness, investors should focus on extracting the value left in the market while rethinking long-term strategies focusing on an asymmetric payoff profile to limit the downside when a correction does come, but still capturing long-term risk premia. During this transition, liquidity management and capital preservation will be key.

High Conviction Ideas

- **Multi-Asset:** We are close to neutral on risk assets. In the short term, we have adopted a more cautious approach on equities (US is the favoured market) and credit. At the same time, we have increased the focus on relative value opportunities and portfolio diversification (for example, European basic materials vs Stoxx Europe, selective EM Asian currencies vs the USD). As the risks to the scenario have risen, we believe that hedges should remain in place to try to protect portfolios and build an asymmetric risk/return profile.
- **Fixed Income:** The US fixed income market is reasonably pricing in future Fed rate hikes. We prefer to have a less negative view in duration in US govies market, while in core euro bonds, duration should remain short. On credit, fundamentals are still positive, but we now have a cautious approach, as leverage in the market has increased. CB divergences are now resulting in opportunities at the currency level: the USD looks well **supported** in the short term vs the EUR, but this trend could revert as structural forces kick in. EM debt remains under pressure, but yields are attractive and the asset class could be back in focus in 4Q18 as an income engine.
- **Equities:** The focus very much continues to be on EPS growth, and those names that can deliver over the medium term. We prefer US names on the back of stronger earnings and the fact that risks related to regulation have been identified and priced in. Valuations have improved. Capex growth and a rotation towards quality and value are themes to play, in our view, in the next market phase.
- **Real Assets:** The real estate market seems to be in the late phase of the cycle and faces stiff competition. To protect from a correction in the market, we believe that investors need to differentiate real estate strategies – for example, adopting a flexible and differentiated approach in the senior commercial real estate debt market while remaining very selective, including applying ESG criteria.

MACRO & STRATEGY



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The risk of a global trade war may impact GDP growth before the war begins

After several months of hesitation, US President Trump finally decided to implement some of his protectionist threats, first against the EU, Canada and Mexico (with a rise in tariffs on steel and aluminum on 1 June), then, more recently, with China, with a threat to raise taxes on USD200bn of imports from China. Without delay, China has announced retaliatory measures of an equivalent magnitude. This may in turn provoke announcements of further tariff increases (from the US) on other products. Trump has also openly threatened to increase taxes on auto imports with the plan being to rebalance the US bilateral trade balance with Europe and Japan. Trade tensions between the US and most of its partners have already begun to weigh on business confidence (particularly in Germany, the most exposed European country to world trade). Uncertainty now risks weighing on business investment, even before global trade is affected by measures, some of which may never be put in place. As global value chains are highly integrated, it is common knowledge that there would be no winner to a global trade war.

Trump seeks to increase pressure on the US' partners to negotiate, on a bilateral basis, trade agreements whose terms would ultimately be more favourable to the US. And, he has some room for manoeuvre in the short run, as this does not weigh on confidence in the US, where the economy is currently stimulated by fiscal policy. Moreover, Trump is undoubtedly strengthened in his attitude by the recent rise of his approval rating, which, at 45%, is at the highest since he took office. But despite this, projections continue to indicate that the House of Representatives is likely to tip over to the Democrats as a result of the mid-term elections (6 November). Against this backdrop, the US president is encouraged to remain "offensive" on trade. We continue to believe that the impact of protectionist measures on world trade will be modest and that global economic expansion will continue in 2018 and 2019. But, the threat of serious confrontation definitely makes it necessary to take into consideration the risk scenario: in that regard, we have increased the probability from 15% to 20%.

The strategist's view: Central banks and trade tariffs in the spotlight Central banks

The Fed has signaled that inflation and growth are on track. The minutes from the most recent meeting suggest the FOMC injected the word "symmetric" into its inflation discussion (eg, tolerating even slightly overshooting on inflation prints). This implies that the Fed is unlikely to surprise in a hawkish manner in the near future. Unlike his predecessor, Chairman Powell seems less keen to consider current EM strains and trade conflicts in altering the outlook towards further tightening. **EM** with large account deficits and unable to adjust levels have suffered tightening conditions (Brazil, South Africa, Turkey, India, Indonesia). As a consequence, **CBs, mostly in Asia** (Indonesia, Turkey, Malaysia, India) turned more hawkish than we expected, forced to do so by external conditions (higher US Treasury yields, stronger USD). EM FX depreciated significantly for the same reasons and on idiosyncratic stories (Argentina, Brazil, Turkey).

ECB members' recent speeches signal more confidence on inflation across the Eurozone, despite the recent soft path in economic prints. The ECB will conclude its QE by the end of the year. The end of the purchases occurs in more challenging time than the Fed experienced in 2014 (less liquidity, the peak of growth has been surpassed while remaining above potential, rising political risks). The end of QE will be challenging for peripheral issuers and Italy in particular, as Italian banks are reliant on ECB funding, with refinancing risk significant in 2020-2021.

Trade tariffs

Trade tensions increased, allowing higher volatility and contributing to the generalised risk-off environment. This represents a challenging situation for commodity-led EM countries that depend on foreign capital and/or have large account deficits.

All in all, the US equity market is not pricing in a trade war that would undermine growth and the USD, and, as our economists expect, the proportion of global trade affected by the new tariff plans remains contained. In general, our sensitivity analysis to the USD and Treasuries shows that India, Turkey, Malaysia and Russia are the most insulated while Latam is the region that might be the most negatively affected.

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The escalation in trade tensions is increasing the probability of a risk scenario.

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MULTI-ASSET

Risk reduction in the short term

The outlook continues to be positive for growth, with some deterioration in economic momentum, apart from the US. A reduction in global liquidity, combined with an increase in short-term geopolitical risks (trade wars, migration disputes, etc), taken in context of vulnerable investor confidence makes us more vigilant. This prompts us to take another step towards a neutral view on risky assets in the short term, with a more cautious and less directional view on equities and credit. At the same time, investors should try to increase the low expected returns through relative value trades and portfolio diversification.

High conviction ideas

While European equities still enjoy fundamental and valuation support, political situations are creating headwinds for the market. We prefer to maintain a more cautious approach for the moment on European stocks with an ongoing positive view on US equities. However, we suggest exploiting some relative value opportunities in Europe: we prefer European basic materials vs the Stoxx Europe on the back of good fundamentals for the sector, reasonable valuations and a still-favourable economic environment for commodities. We think being long UK equities vs Eurozone equities could perform well due to slowing macro momentum in Europe, coupled with relatively cheap valuations and light positioning in the UK market. In the EM space, we continue to prefer the HSCEI vs EM, and we maintain a small preference for the Chinese renminbi vs the USD and EUR. This view is supported by positive fundamentals on the macroeconomic side, positive carry and technical factors, such as the possibility of significant capital inflows on the back of benchmark inclusion of Chinese onshore bonds.

We also see opportunities in Asian currencies with current account surpluses vs the USD, given that these currencies should be more resilient during monetary policy normalisation. On DM credit, we now have a neutral view on the Itraxx Europe, following increased Italian political risk, which may resurface at a later stage. On the government bond side, we prefer to have a neutral from negative bias on the 10Y Bund (as a protection strategy) while we are still cautious on the short part of the curve (2Y Schatz), as we still fundamentally expect higher German rates in 2018. We also look for higher 10Y break-even rates (in Europe, the US, Japan), as our macro forecasts call for a gradual pickup in inflation throughout this year. We tend to favour a steepening of the US curve (US 2-10Y segment). We think the curve is currently too flat, as we believe that more inflation risk premia should be discounted. On the US inflation swap curve, we don't expect commodities to rally much further from current levels, reducing pressure on the front end which might correct lower. The faster pace of growth we expect in the US could increase the inflation risk premium, so we see potential for the US 2-10Y inflation swap curve to steepen.

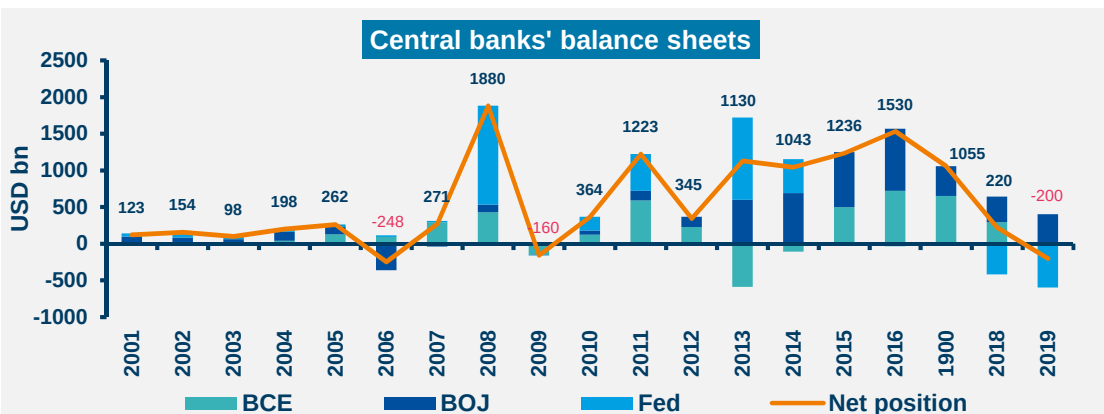
Risks and hedging

During the Italian political turmoil, the possibility of higher geopolitical risk returned to the spotlight, and this will remain a concern until the situation in the Eurozone becomes clearer. Trade war concerns remain in focus, as does the impact of US trade policies on business confidence and investments. We continue to suggest keeping positions in gold as a shelter asset, and in the JPY vs the USD and the JPY vs the AUD via FX options.



Matteo GERMANO
Head of Multi-Asset

“New and unpredictable political dynamics are emerging in a mature cycle: it is not the time for directional calls but for diversification and relative value.”



Source: Amundi Research, Datastream. Data as of 18 June 2018.

FIXED INCOME



Eric BRARD
Head of Fixed Income



Yerlan SYZDYKOV
Head of Emerging Markets



Kenneth J. TAUBES
CIO of US Investment Management

“
We are more cautious on EM debt, but yields are becoming attractive again and, as USD and US rates stabilise, the asset class will be back in focus.
”

Opportunities from divergences

Overall assessment

The latest FOMC release was hawkish, confirming the Fed's current stance and its confidence in the strength of US growth. The Fed's projection regarding future interest rates – also referred to as the “dots” – pulled forward its hikes by 25 bps, increasing from three rate hikes to four in 2018, maintaining three hikes in 2019, and moving from two to one hike in 2020. At the same time, the ECB's press conference was dovish compared to market expectations. The ECB introduced a commitment to leaving rates unchanged until summer 2019, thereby anchoring the expectations of low rates for an extended period of time. Nevertheless, the ECB decided to reduce its bond purchases, which should limit the appetite for euro govies in the bond market. We will continue to play the CB divergences through their reflections in yield curve dynamics and currencies. We see short-term forces supporting the USD vs the EUR, with a rebalancing towards the EUR through year-end.

DM government bonds

The ECB has reinforced the anchoring of the short maturities and the directionality of the curve. Upside surprises on growth and/or inflation could impact the longer maturities and translate into a steeper curve. We continue to favour a short duration view in core bonds due to expensive valuations and the end of QE approaching. In the US, upside pressure on US T bonds could continue, barring an escalation of the China-US trade dispute. By the end of 2018, the 10Y Treasury might return to between 3% and 3.5%, assuming a 2.4% Fed funds target rate. The short duration view is confirmed, but is less pronounced than at the start of the year. Given the significant flattening in the yield curve, we believe investors may favour a more balanced underweight across the yield curve.

DM corporate bonds

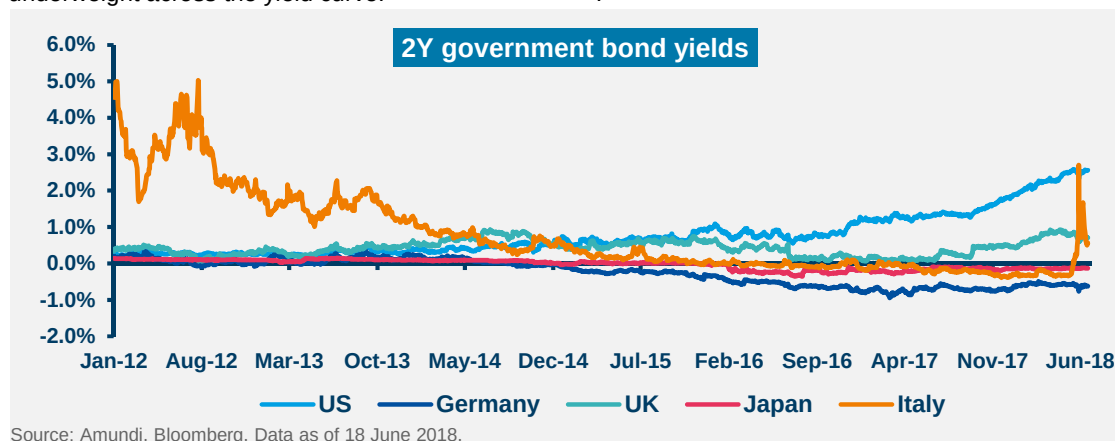
Caution continues to be key given current market conditions and risks. On the other hand, in the Eurozone, ECB corporate purchases will continue to support the market even after the end of QE. Fundamentals also remain strong (solid balance sheets). Investors should prefer high-beta short-dated bonds, in our view, which may provide a large carry and are less sensitive to rising interest rates. We are, we would note, more cautious on the highly subordinated and long-dated banking sector bonds. Selective opportunities should come from the primary market which now offers larger new issue premia.

In the US, we believe investors should be selective, investing in IG, where we have witnessed most of the excesses of this credit cycle. Here, we prefer the more highly regulated financial sector (lower event risk, like M&A or share buybacks). We also favour the energy sector, particularly mid-stream companies (benefiting from strong US GDP and higher oil prices).

EM bonds

Yields for EM debt have become more attractive and we expect investors to come back to the asset class in the last part of the year (with USD and US rates stabilising). In the short term, conditions are tough and we are cautious, especially for local currencies, as liquidity is fading.

Geopolitics continue to be the dominant theme in EM, with the escalating protectionist rhetoric between the US and China, and elections in Latam (Mexico, Brazil, Colombia among the main ones). In Turkey, the re-election of President Erdogan reduces political uncertainty but economic risks remain. Idiosyncratic stories (mainly due to weak current accounts) continue to weigh on the market.



Hold on amid risks

Overall assessment

The positive cyclical backdrop is expected to support earnings growth over the rest of the year. Revenue growth has reaccelerated in recent quarters; economic profit is growing incrementally again. In our view, equities could still post the highest returns among asset classes.

The risks to this outlook, however, are elevated, and include the mature stage of the economic and financial cycle, and increased trade tensions. We would also consider the risk of more aggressive tightening of monetary policy if inflation picks up. Overall, we could see higher volatility compared to the last five years and with the need to play different themes in the transition towards a more mature phase of the cycle.

The capex story is still confirmed and is strong across the board. A sectoral rotation towards a value theme could also be considered for the next phase, looking at the exaggerated expansion of growth (mainly driven by technology) vs value.

Europe

European equities were negatively affected by the Italian political crisis and tensions surrounding trade disputes. Earnings remain supportive and valuations are overall attractive. A weak EUR is a potential tailwind in terms of EPS growth for the coming quarters. Given the increased risks, we are trimming our cyclical preference to a more balanced one (eg, preferring food retail and utilities to materials).

Quality is now outperforming even in Europe, and the trend is now encouraging. We continue to prefer energy, luxury and IT in terms of sector allocation. Bank and insurance are still favoured, despite the recent rout.

United States

Fundamentals are solid across the US market; earnings revisions are strong. The US consumer is quite healthy, taxes are lower, regulations are easing in many sectors, and capex/R&D is increasing. Adjusted for still very low interest rates, US equities are not overvalued. Critical issues are wage inflation, raw materials price increases, competitive pressures, and trade policy as an offset to the tax reform and regulatory windfall. It is key to identify companies with pricing power, to understand logistics pressures as business models evolve, and to assess trade policy (NAFTA, China, tariffs). On this perspective, a bottom-up investment process can help to maintain higher quality and lower profit volatility in a portfolio. Sector-wise, consumer discretionary, information technology, and financials remain our favourite picks.

Emerging markets

Despite short-term volatility, EM equities should be able to weather the more challenging external conditions. Earnings dynamics remain favourable. On the other hand, rising US protectionism is a headwind to GEM EPS. Domestic factors and reforms can reduce the spillovers (eg, India could be more sheltered against trade war risk).

Among our country preferences, we like Russia on improved macro management (both fiscal and monetary), external account surplus, very attractive valuation and a stronger oil price. In China, despite the mild slowdown, we expect financial deleveraging and reforms to continue. We are thematically positive on companies supported by good cash flows and dividend yields. We are constructive on the tech, insurance and energy sectors.

EQUITY

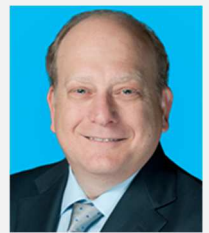
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Investors could consider capex growth and rotation towards value as themes to play in the market.

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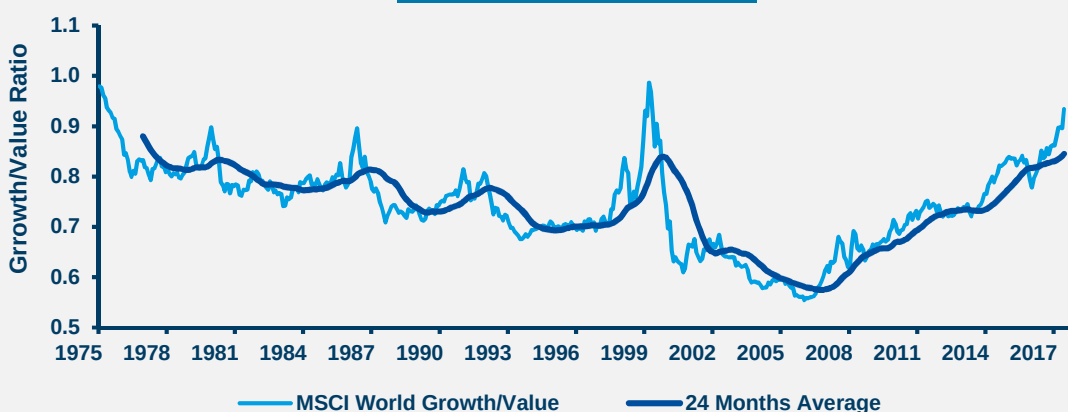


Yerlan SYZDYKOV
Head of Emerging Markets



Kenneth J. TAUBES
CIO of US Investment Management

MSCI World Growth / Value



Source: Amundi Research, Bloomberg. Data as of 18 June 2018.

REAL ASSETS



Pedro-Antonio ARIAS
Global Head of Real & Alternative Assets

“
The European real estate debt is an increasingly appealing strategy given its potential for providing stable return with low volatility.
”

Real estate debt: Reliable return with low volatility

A rising traction in investor portfolios

Global investor appetite for real estate debt has grown significantly over recent years along with the disintermediation of banks due to tighter regulation, such as Basel III and Solvency II, and the ongoing hunt for return in a lasting low-yield environment. According to London-based research firm Preqin, 2017 was a particularly strong year for the private real estate debt industry, with 56 real estate debt funds reaching a final close and raising USD29bn in capital in aggregate, a 10-year record high. This could be a sign of investors rebalancing their portfolios to add more diversification given the current and expected market conditions. The economic growth in the Eurozone in general has strongly supported the overall underlying European real estate market, which is characterised by its size and diversity, thus involving significant volume of issuances: approximately EUR100bn a year across Europe, 10% of which is in France (CBRE data, October 2017).

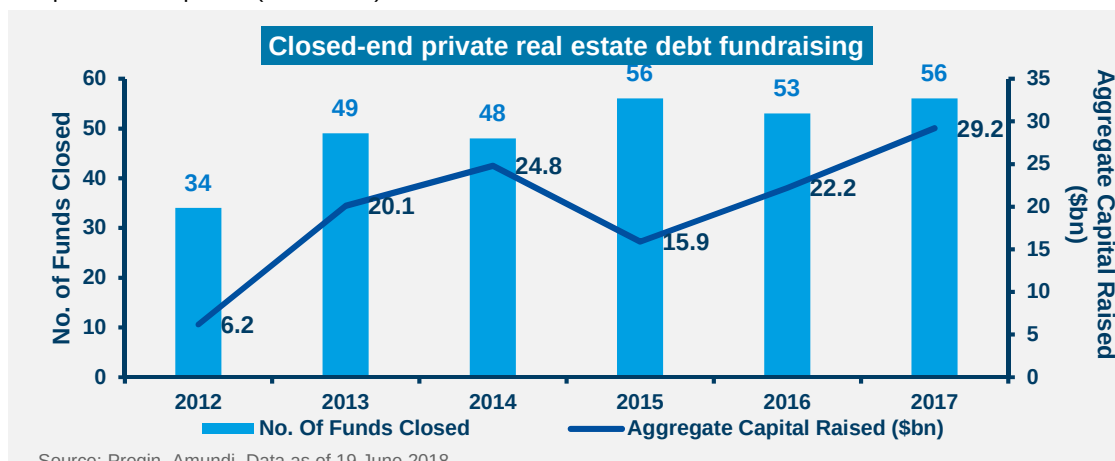
Key benefits for institutional investors

Though developing recently, the real estate debt asset class belongs to the credit continuum and can be considered a core part of a traditional fixed income allocation. However, this young asset class is quite heterogeneous, displaying various risk profiles, depending on both the quality of the underlying real estate asset (core/core+, added-value, opportunistic) and the credit quality of issuers. In this regard, we consider that the senior commercial real estate debt market is the most appealing strategy given its potential in delivering stable and predictable returns, together with low volatility. With a target return of 2-2.5%, it allows investors to capture an illiquidity premium of more than 100 bps over listed bond instruments with a comparable risk profile (BBB-rated).

In addition, deals in this segment are structured around senior mortgage loans, which have strong protection, including delegation of rents to the lender. Also, the strong quality of the collateral against the loans means that insurers can benefit from a favourable Solvency Capital Ratio (SCR) under Solvency II: the senior commercial real estate loans strategy compares very favourably with their risk-equivalent of BBB-rated corporate bonds. Furthermore, those senior mortgage loans are typically structured with floating rates, providing investors with a hedge against potential hikes in interest rates while benefiting from downside protection, with Euribor (or Libor) being generally floored at zero.

Finally, diversification is another major benefit, as the capital is typically allocated across a large pool of loans and issuers, and also because real estate debt strategies offer a modest correlation with traditional asset classes.

Looking forward, we expect the investor appetite for this new and growing asset class to remain strong. However, the real estate market is in the late phase of its cycle, with some adjustments ahead in rates, rents, valuations, and intensified competition for the best assets. Rapid deployment of investors' capital, while remaining very selective in the investment process, including ESG criteria being applied, is more than ever under the spotlight. Combining longstanding expertise regarding real estate, fixed income and credit analysis, as well as a deep network of partners, is therefore a key strength when sourcing and underwriting operations in real estate debt. Only this combination eventually provides key information, such as the intrinsic performance of a building and, accordingly, the true potential of fair value embedded in a loan investment.



Amundi high conviction positions

Asset Allocation: Multi-Class Outlook								
	1 month change	---	--	-	0	+	++	+++
Equities vs govies	→					■		
Equities vs credit	→					■		
Credit vs govies	→					■		
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 (+/++/+++).

	3-6 month research view	Relative Outlook and Conviction by Major Asset Class				
		Asset Class	1 month change on view	Underweight	Neutral	Overweight
GOVIES	--/=	US	↗	●		
	-	Euro core	→	●		
	=/+	Euro peripherals	→			●
	-	UK	→	●		
	-	Japan	→	●		
CREDIT	=	US IG	→		●	
	+/=	Euro IG	↘			●
	=	US HY	→	●		
	=/+	Euro HY	→			●
	=/+	GEM debt hard curr	↘			●
	=/+	GEM debt loc curr	↘			●
EQUITIES	+	US	→			●
	=/+	Eurozone	→		●	
	=	UK	→		●	
	=	Japan	↘		●	
	=	Pac ex Japan	↘		●	
	=/+	Global EM	→			●
	+	Convertibles	→			●

CURRENCY AND REAL ASSETS

FOREX	=/-	EUR vs USD	↘
	+	EUR vs GBP	→
	=	EUR vs JPY	↘
	+	USD vs JPY	→
REAL ASSETS	+	Real estate	→
	++	Global Infrastructure	→
	+	Private Debt	→

LEGEND

-	Negative
=	Unchanged
+	Positive
●	Underweight
●	Neutral
●	Overweight

Source: Amundi, as of 20 June 2018. The 3-6 month return outlook refers to research views based on expected returns by asset class. 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.**

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Italy | ECB | Emerging markets | Asset allocation | ESG | Fed

MSCI China A-share inclusion along the way of China's transition to quality growth

The inclusion of Chinese A-share in MSCI's indexes will help to pave the way for foreign capital inflows into China's financial markets

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