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Go the extra mile, but check the exits

A tug of war between downward and upward forces is preventing clear directional trends in the markets: equities are moving in a broad trading range, below year-to-date highs, and, in general, we have entered into a regime of diminished returns. Sensitivity to news flow is, and will continue to be, very high, as markets try to adjust to new financial and economic conditions. How should investors navigate this new phase? First, **they should be aware of the mid-term scenario**, which will be increasingly challenging (ie, risk of recession, risk of policy mistakes) **while playing three major short-term themes**. First, **the economic outlook is still sound**, but with the peak of economic acceleration, we believe, now behind us. Higher oil prices and protectionist talk support this, but without major disruption, as our central case still sees the oil price remaining stable around current levels and no full-on trade war materialising. World GDP growth is expected to be around 4% in 2018, and slightly below 4% in 2019, but still above potential for major economies. On top of this, the narrative of global synchronised growth is losing momentum, with the US still leading (and likely accelerating) among developed markets, thanks to the extension of the cycle, supported by the fiscal boost. Second, **central banks (CB)** will continue to drift away from their policies of exceptional easing, even **if gradually and at a slow pace**, as inflation is not viewed to be a major threat at this point. In the Eurozone, inflation is far from being a problem, and the current deceleration of the economy, even if downplayed by the ECB and likely temporary, could further slow the pace of ECB tapering. In the US, the normalisation path seems clearer and the Fed appears keen to accept a modest overshoot of inflation above the target, waiting for full employment wage growth to finally kick in. Third, we may see phases of **appreciation of the US dollar**, but these should be transitory, as a consequence of perceived temporary divergences in CB policy normalisation and better risk sentiment while the long-term forces (higher US deficit and debt, diversification in international CB reserves) should work in favour of a weaker USD. This dollar appreciation should not be seen as a major threat **for emerging markets**. Current conditions are tougher (stronger USD, higher US rates, idiosyncratic stories), but as these adjustments are absorbed through higher spreads and weaker FX, **EM opportunities may open again**, with higher selectivity and focus on specific drivers (ie, oil, electoral cycle, external vulnerability). In this environment, investors should continue to tactically

go the extra mile, playing the current adjustments (strong growth, but peaking, low inflation, still accommodative and asynchronous CB) through relative value, bottom-up selection and diversification of strategies/ styles. **Volatility in the coming weeks could be considered an opportunity to re-examine the most impacted asset classes**. At the same time, investors should be prepared for turning (progressively) the ship around (in risk exposure), amid possible medium-term real and/or financial correction, driven by endogenous/exogenous forces. In this transition period, **liquidity** management will remain key for investors to quickly adjust and rotate portfolios, as well as **capital preservation**.

High Conviction Ideas

- **Multi-Asset:** Asset allocation is still biased towards risk assets, with opportunities to be mainly exploited using relative value trades. In equities, we look at opportunities in US energy vs the S&P500, while we believe that the risk/reward profile is no longer attractive for Japanese banks and Russia. This phase is still consistent with a cautious view on duration and a preference for IG vs high-yield credit. Hedges should remain in place as a means of protecting portfolios.
- **Fixed Income:** We continue to see an upward trend regarding rates, especially in the US, where economic data remain strong, with some (modest) inflation pressure on the radar: the short duration bias is confirmed for the moment. On credit markets, valuations are tight, with some weakening of economic momentum. This scenario requires more conservative selection and risk allocation. The outlook for EM debt is still constructive in the medium term, and if USD appreciation remains contained and US rates don't overshoot, we continue to see value in the asset class. Focus on capital preservation will be key, as conditions are more challenging.
- **Equities:** Q1 reporting season data have been strong across the board so far. The earnings outlook remains positive in the short term, despite some economic moderation, and valuations are reasonable. Rising bond yields, energy and capex growth are key themes to play in the market, as well as an increasing focus towards some more defensive/high-quality stocks.
- **Real Assets:** Real estate investment may be challenged by rising interest rates (not imminent in Europe, but to be considered in 2019) and high valuations. In this scenario, we believe that favouring high-quality core assets, while focusing on geographic and sectorial diversity, may provide investors with some protection and return potential.

MACRO & STRATEGY



Philippe ITHURBIDE
Global Head of Research



Monica DEFEND
Head of Strategy,
Deputy Head of
Research



Didier BOROWSKI
Head of
Macroeconomic
Research

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Vulnerabilities are building up in the system and need to be considered and idiosyncratically hedged.

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Global economic expansion with some clouds

The global outlook continues to point to broad-based momentum, though the prospect of trade restrictions and counter restrictions threatens to undermine confidence and therefore capex plans, sobering medium-term prospects. While several clouds are accumulating, we stick to our scenario of continued global economic expansion. Global financial conditions have generally remained loose, despite the smooth normalisation of monetary policy. The global output gap is progressively closing. As a result, global inflation is expected to pick up: this is particularly true for the US, where we expect the economy to reaccelerate; risks to inflation remain tilted to the upside. Risks to world trade increased, particularly regarding the China-US and US-Eurozone relationships. We do not expect to see serious escalations, but relationships could become tense at some stage. Tighter financial conditions represent a risk to our outlook should they move abruptly and become persistent. The oil price is back on the radar screen: we think the recent rise reflects risks related to sanctions and disruptions in Iran, Venezuela and Libya. We expect the oil price to drop to the USD60-70/bbl range in the next 12 months (Brent). In contrast, we would note that US oil production has reached an all-time high, driven by the shale oil component. This will likely offset the OPEC oil production cut in the long run. Geopolitical risks remain elevated, in particular based on rising tensions between the US and Iran.

In Italy, the potential of seeing the 5-Star Movement (M5S) and the League (two parties often defined as “populist” and euro-skeptic) forming a government has increased significantly, but the situation is still evolving and the outcome is uncertain. Despite of claims that this would be a political government with full rights and powers, question marks remain over the role that the Prime Minister will have: his powers and autonomy should be granted by the Constitution but, in reality, these would be limited by the “contract” – i.e. the future Government’s agenda agreed and signed by the two parties’ leaders that gave birth to this government. There are a number of points in the “contract” that appear potentially at odds with the Stability Pact on the trajectory of deficit and debt and that, therefore, would be difficult to implement within this framework and also within the framework of a balanced budget (art 81 of the Constitution, introduced in May 2012). Even from an international perspective, looking at the new “contract”, the amount of topics that could put Italy in contrast with its partners is still far from negligible: As a first stage, we would expect the EU partners to be carefully monitoring the developments. Key to the perception of the Italian stance will be the nomination of the Foreign Affairs Minister, which should be a person able to quickly catch-up with open international dossiers in order to reassure partners.

What is behind the US dollar rebound?

- **Technical factors.** The Dollar Index has gained c.4% since April highs, appreciating mostly vs the SEK, CHF and JPY. The EUR/USD rate has moved quite significantly lower, from 1.24 to 1.17 over the past four weeks, mostly driven by technical factors and risk sentiment. Given the extreme short positioning of investors on the USD, it takes only a mild catalyst (eg, recent disappointments on Eurozone macro data) to give the USD price momentum. For the current trend on the EUR/USD (and DXY1) to invert, we would need to see better data on the Eurozone (and the other major economies) and ECB rhetoric (and that from other major CB) becoming more hawkish again.
- **Better risk sentiment.** The USD is currently supported by better sentiment related some geopolitical risks, which are abating a bit: threats from North Korea appear to be decreasing and there has not been further escalation of trade tariffs rhetoric. All in, this is clearly helping market sentiment and easing downward pressure on rates.
- **CB rhetoric.** In the short term, the USD is mostly backed by CB rhetoric. The Fed seems to be the only one maintaining a hawkish stance. The recent tones of the ECB, Riksbank, RBA, BOE and BOJ are still quite dovish, meaning market expectations regarding rate hikes have been postponed.
- **Medium-term assessment.** Structural factors (current account deterioration and expansionary fiscal policy) and the unpredictable policy of the US will still be a drag on the USD in the absence of a global economic slowdown (our year-end target for the EUR/USD rate is 1.25).
- **Cross asset implications.** We expect continued EM FX selloff over the coming weeks on a USD rebound, a rise in US rates at the next FOMC meeting, and lower appetite for risk assets.

Seek value in divergences

Solid growth and contained inflation path, justify our mildly positive view on risky assets, equities in particular. We are more cautious on a short-term perspective, considering the slowdown in macro momentum in some regions, the increased tensions on the trade side and looming geopolitical risks. Overall, the case for equity remains in place as long as the global cycle remains intact. Heterogeneity may play out as a source of returns: the global economies are differently positioned in the global cycle as reflected in the different stages of the EPS cycle, capex recovery and eventually the ability of risky asset to absorb higher rates. This heterogeneity opens to relative value opportunities across sectors and regions, amid low directionality.

High conviction ideas

Given the aging financial cycle, we recommend defensive and well diversified regional equity allocation within the US and Europe. In the US, we are positive on energy vs the S&P500, as the sector should benefit from strength in the oil price. Opportunities may open up in European materials vs the MSCI Europe; strong fundamentals and momentum support this view if risk related to China growth and potential for a trade war remain contained. We are now more cautious on Japanese banks, due to the deterioration of a number of drivers (earnings, a stronger yen, and resurgence of political instability). On EM equities, we have now a neutral view, from positive, on Russia, amid the significant rise in political risk and deterioration in the risk/reward profile. On DM credit, we still like the Itraxx Europe, as the ECB firmly dismissed expectations of a premature tapering in the corporate bonds programme. On the government bonds side, higher 10Y break-evens (in Europe, the

US and Japan) remain our central case, as our macro forecasts call for gradual increases in inflation rates to continue throughout this year.

Weak data released in the past month led us to lower our growth projections for the UK; this framework, combined with nominal rates vulnerability to a sharp sell-off, is still supportive for higher UK real rates. A weak GBP (vs both the EUR and USD) can be a natural hedge regarding the elevated headline risk on the Brexit process. On curves, we expect the US 2-10Y spot curve to steepen, as higher inflation risk premia should be discounted. We see potential for the Swedish curve to flatten on the back of increasing prospects of a gradual monetary tightening. On EM FX, we still like the renminbi (RMB) vs the USD and the EUR. The RMB looks resilient despite a recent rebound of the dollar, supported by a resilient economy. We also point to improvements in sentiment, particularly on the local level. Risks are skewed more towards a moderately stronger RMB longer term, although impacts of the bond inclusion could take some time to play out.

Risks and hedging

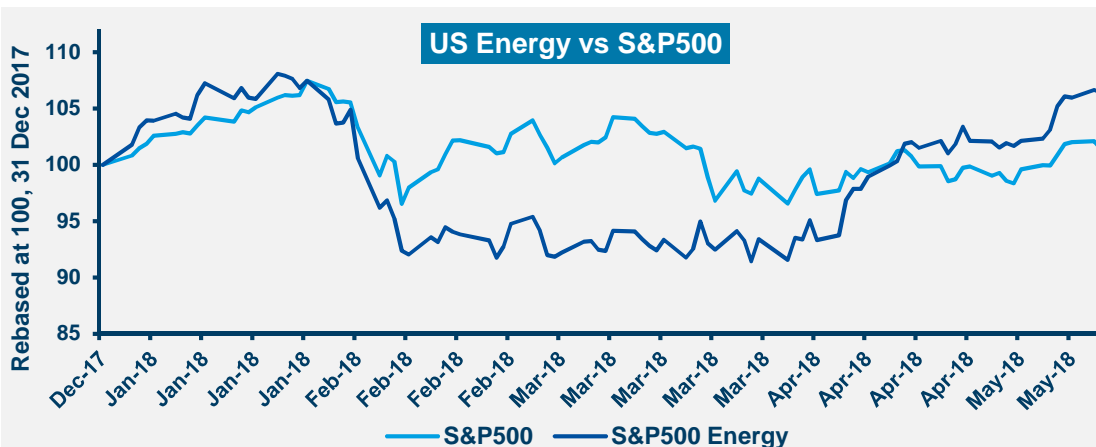
We continue to recommend a dynamic hedging process in order to mitigate risks. SPX put options and long JPY vs the A\$ are a natural hedge in case of risk off. Gold exposure may help to protect against geopolitical risks. These hedges should also work in case of a rapid and unexpected deterioration of the macro outlook. On credit, we are conscious that the asset class has very elevated valuations and further spikes in volatility and nominal rates could negatively affect the market. So, protection via options could help investors to benefit from the asset class return potential as well as limiting downside.

MULTI-ASSET



Matteo GERMANO
Head of Multi-Asset

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Relative value trades are key to be exposed to specific stories (i.e. US energy), with low directional risk, amid high market uncertainty.
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Source: Amundi, Bloomberg. Data as of 14 May 2018.

FIXED INCOME



Eric BRARD
Head of Fixed Income



Yerlan SYZDYKOV
Head of Emerging Markets



Kenneth J. TAUBES
CIO of US Investment Management

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The focus on capital preservation will be key as conditions become tougher for fixed income investors.
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The Fed and the others

Overall assessment

CB divergences are regaining centre stage and amplifying interest rates dynamics: The respective 2Y and 10Y US and German yield spreads reached all-time highs, pricing in different CB rhetoric. In recent weeks, the ECB's tone has been more dovish than expected amid signs of moderation in economic growth and weak inflation figures in the Eurozone (core inflation fell to 0.7% YoY in April, close to its lowest level since the creation of the euro). The BOE postponed the hike expected in May and further decreased market expectations for June, based on a weak economic performance and Brexit uncertainty. The BOJ did not provide any imminent sign of changes to the current accommodative stance, as inflation is still well below target. Among the main DM CB, the Fed is the only one on track with the a normalisation policy, with at least two further interest rate hikes likely this year and the risk of inflation surprises. Amid this short-term uncertain trajectory in global rates and CB tones, we believe investors should be very flexible in duration management and playing opportunities that multiple a-synchronicities can trigger in intra- and cross-country yield curve movements or currencies dynamics.

DM government bonds

While recent CB dovishness prevented government bond yields from rising in the Eurozone, the outlook remains more challenging for the rest of the year. The economic outlook is still strong, despite some recent moderation, and inflation is expected to accelerate mildly through the year. At this stage of the cycle, rates are too low, so a short duration bias is still favourable in core markets (especially in Europe relative to the US, where the rate trajectory is clearer). Also, some inflation protection should still to be considered, as we expect stronger

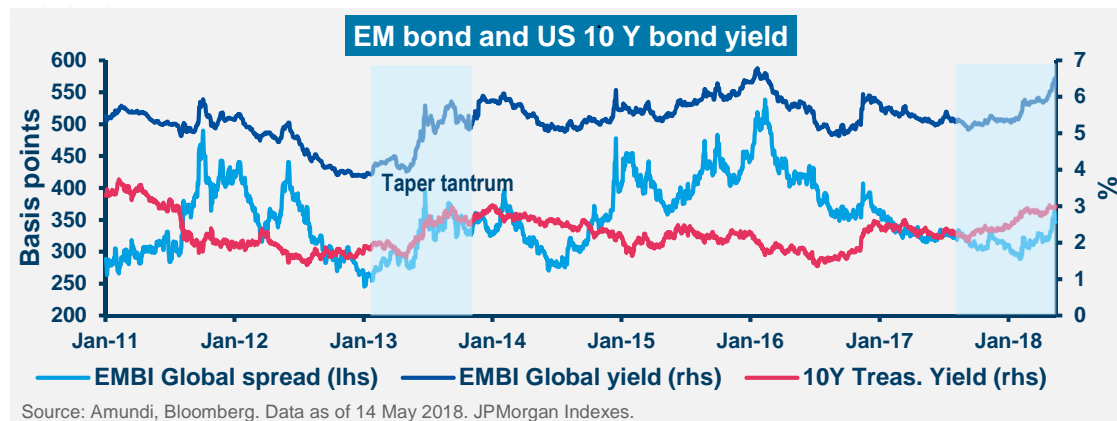
inflation figures over the year across the board.

DM corporate bonds

Our view on credit markets is more cautious. In Europe, due to the future ECB exit from QE, weak primary market performance and tight valuations, we believe it is worth maintaining a more conservative bottom-up selection towards lower-beta names with a strong focus on liquidity. In IG, we favour shorter-term maturities and subordinated financials. In US credit, recent spread widening has provided some opportunities in IG corporate. Amid a more conservative risk allocation, some value can be found at the bottom-up level in idiosyncratic stories, such as health care convertibles.

EM bonds

Geopolitical risks, some slowdown in global growth momentum, and USD strength, combined with country-specific issues (Russia, Turkey, Argentina) are weighing on the short-term outlook. Technical supply is now more favourable, with some larger issuance already in the market in May (ie, Middle East, Latam). If USD appreciation and the rise of US bond yields remain contained, investors' search for income should reward the asset class. Argentina is an idiosyncratic story. A high current account deficit and lack of clarity in monetary policy, coupled with a stronger USD contributed to peso depreciation. Pressures are expected to continue, as investor positioning was heavy, but the near-term default risk should be avoided, as the country has completed funding needs this year. Further, if the IMF line is triggered, Argentina may not need to issue much next year either. If default risk, as we believe, is averted, current volatility could represent an opportunity to generate value in the long term.



Beta measures an investment's sensitivity (volatility) to market movements in relation to an index. A beta of 1 indicates that the security's price has moved with the market. A beta of less than 1 means that the security has been less volatile than the market. A beta of greater than 1 indicates that the security's price has been more volatile than the market.

Taper tantrum refers to the sharp increase in US Treasury bond rates which occurred in 2013 as a consequence of investor reaction to news of Fed tapering of its liquidity injection into the system. Basis point (bps) refers to a common unit of measure for interest rates. One basis point is equal to 1/100th of 1%, or 0.01%.

Oil, FX, capex: three key market themes

Overall assessment

Some signs of economic growth moderation and modest pressures on costs should not prevent corporate earnings from growing over 2018 and the first part of 2019, creating a still-benign backdrop for markets, but with higher volatility amid tightening financial conditions. We believe investors should exploit opportunities related to different stages of the earnings cycle. While Japan has probably seen the peak, in the US, the earnings cycle has further to go, as a consequence of fiscal expansion and capex acceleration, and in Europe, corporate profitability is still strong. Also, market valuations are reasonable. In a fundamentally good environment for equity, periods of correction and volatility could represent opportunities for long-term investors.

Europe

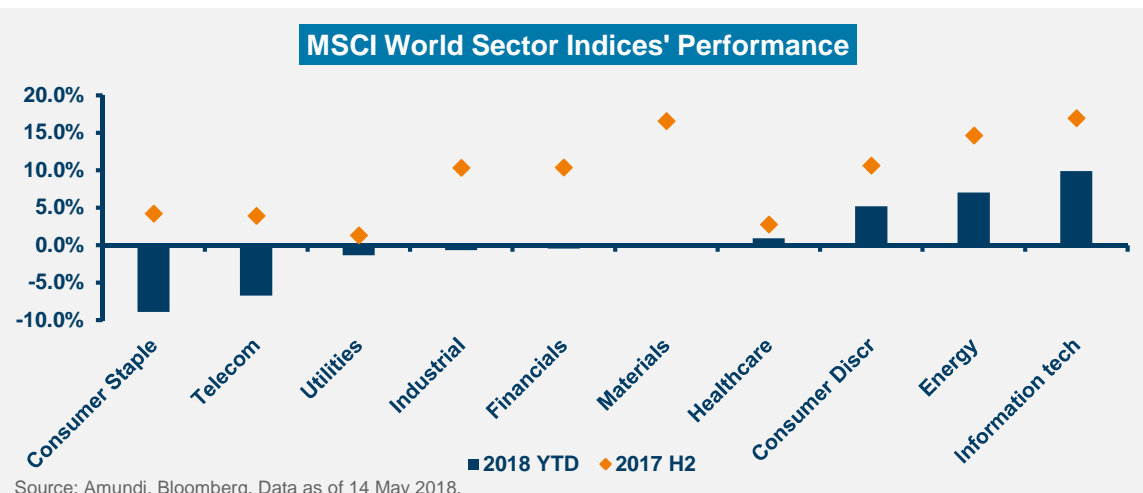
The solid Q1 reporting season reflects sound corporate fundamentals, and the capability of European corporations to absorb the negative impact of euro appreciation. We believe that most of the currency headwinds are behind us. Recent growth moderation does not compromise the sound earnings outlook: our view continues to be constructive for European earnings per share through 2018, with stabilisation of EPS in 2019 close to a cyclical peak. Main themes are the rebound in the oil price and interest rate trends. The former is benefitting the energy sector (strongest YTD performance among MSCI Europe), but could weigh on industrials, should the WTI oil price should move towards USD80/bbl (not our base scenario). We expect that a gradual rise in interest rates will become more evident with the European CB's gradual exit from ultra-accommodative monetary policy. This should also support value themes in Europe, to be exploited via stock selection.

United States

The Q1 reporting season has shown very strong results: growth mainly came from margin growth more than fiscal expansion. The effects of fiscal reform have further to go, in our view. Consumers saw their pay cheques adjusted for the recent tax cut in mid-February, so the benefits to consumer stocks are at early stages. Another key theme is capex recovery. Forward-looking soft data (the ISM semi-annual capital expenditure survey) point to an acceleration in capital expenditures. In the December 2017 forecasts, ISM panelists indicated capital expenditures would increase 3.8% y/y in non-manufacturing and 2.7% y/y in manufacturing in 2018. In the May 2018 report, these figures were revised up to 6.8% y/y for non-manufacturing and 10.1% y/y for manufacturing. Our main convictions remain US consumer (job and wages growth), mega cap banks (regulation, raising rates) and tech (at reasonable prices), while we are still cautious in this phase on defensive value.

Emerging Markets

It is still early in Q1 reporting season, but results are solid on average so far. Risks are mainly linked to USD appreciation. Latam (mainly Brazil), China, Thailand and Poland are the areas/countries more affected by a stronger USD. If, as we believe, dollar appreciation remains contained, EM equity should prove resilient. Russia, hit by sanctions, recovered most losses in April. We maintain a positive view on the country, and the outlook on oil is a supportive factor. Market valuations are still attractive vs main DM, but volatility will likely increase, as many countries are dealing with their electoral seasons (Mexico, Brazil, Colombia, Turkey).



EQUITY

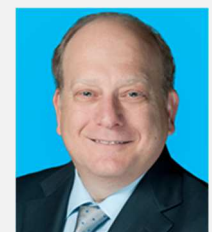
“
Earnings growth is not at a risk despite recent moderation in economic figures.
”



Diego FRANZIN
Head of Equities



Yerlan SYZDYKOV
Head of Emerging Markets



Kenneth J. TAUBES
CIO of US Investment Management

REAL ASSETS



**Pedro-Antonio
ARIAS**
Global Head of Real &
Alternative Assets

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In the evolving real estate landscape, the investment strategy should focus on selecting high-quality core assets.

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Real Estate: Winds of change blow on Europe

Real estate investment is at a crossroads

We expect 2018 to be another solid year for real estate, supported by positive market and economic fundamentals. In our opinion, however, real estate investors should prepare for challenging times over the coming years, as headwinds such as pricing and competition are intensifying and the macroeconomic environment looks likely to change. The era of historically low rates, which has benefitted real estate investment up to now, may be coming to the end, with the main consequence being a downward adjustment of real estate values. In addition, rates of return have been converging downwards in the main European real estate markets (see figure below), which is causing concern among investors seeking at least consistent levels of performance. This can be especially observed in EU's main countries, i.e. Germany, France and the UK. Rates of returns are also converging between cities in the same country, especially between the capital and the other main municipalities.

How to cope with this new deal environment

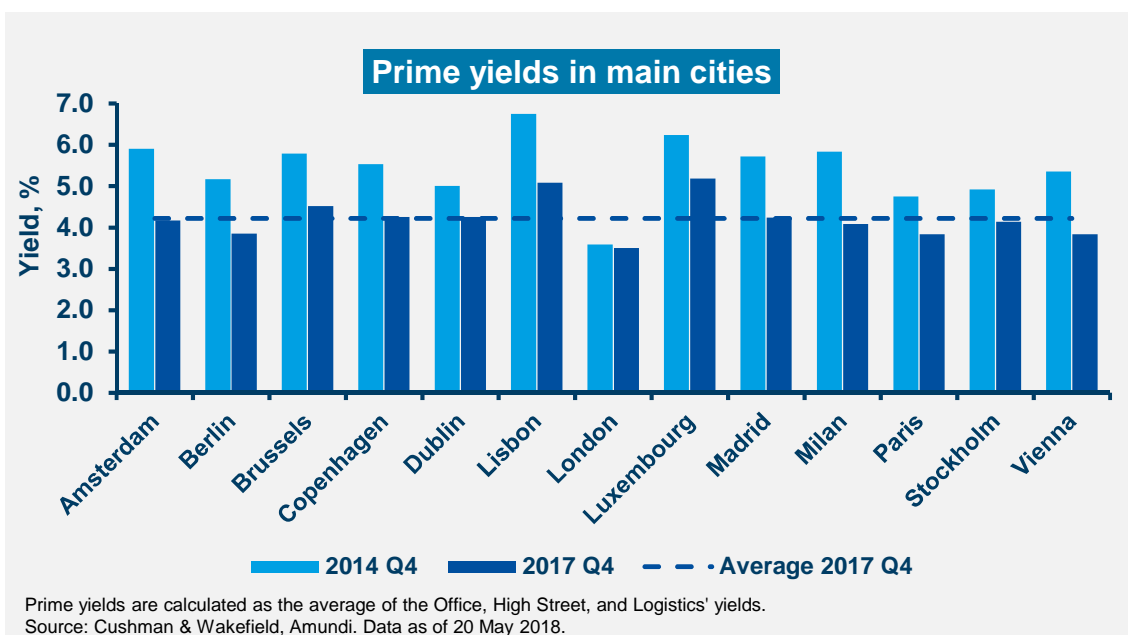
Despite this evolving environment, strong investor appetite for real estate investment continues, driven by the need for diversification, reliable income streams and attractive adjusted returns. We are convinced that any real estate strategy should more than ever focus on selecting high-quality core

assets that can preserve portfolio value, should interest rates rise.

In particular, in response to new market conditions, it is necessary to pay attention to the fundamentals of real estate investments, by focusing on the size of the market, its level of liquidity, the quality of the asset that will ensure sustainable performance, and finally, the diversity and depth of the rental market, which can provide consistent returns.

Also, we believe at Amundi that the most efficient strategy reflects diversification in Europe strengthened via partnerships with the best local players. This ensures a quick and effective market penetration, which enables investors to exploit the local opportunities. Finally, in the current uncertain environment, some countries may offer more interesting opportunities than others. For example, countries such as the Netherlands, Belgium, Luxembourg, Italy and Ireland have economies that are growing nicely and real estate returns that still exceed those of major European markets, such as Germany or France. These 'middle' countries have markets that are deep enough to provide decent liquidity, and provide opportunities to capture additional returns due to the potential in rent and values growth.

However, here again, we insist on the importance of focusing on high-quality core assets and real estate fundamentals.



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	→				■			
US\$ 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 21 May 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.**

AMUNDI Investment Insight1s Unit

The Amundi Investment Insights Unit (AIU) aims to transform our CIO expertise, and Amundi's overall investment knowledge, into actionable insights and tools tailored around investor needs.

In a world in which investors are exposed to information from multiple sources, we aim to become the partner of choice for the provision of regular, clear, timely, engaging and relevant insights that can help our clients make informed investment decisions.

INSIGHTS UNIT



Claudia BERTINO
Head of Amundi
Investment Insights
Unit



Laura FIOROT
Deputy Head of
Amundi Investment
Insights Unit

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