Confidence must be earned

Amundi ASSET MANAGEMENT

October 2018

Global Investment Views

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Price dislocations lead to a rise in contrarian views

The hot summer in emerging markets (EM) has been a key investor theme in the third quarter of this year. While the ongoing US/China trade tensions continue to weigh on investor sentiment, the sequence of country-specific stories (Turkey, Argentina and South Africa) contributed to the almost **indiscriminate repricing of EM assets**, starting with plummeting EM currencies. The causes of the collapse seen in the currencies' values in these countries are different (need to apply for IMF aid for Argentina; balance of payment crisis in Turkey, accelerated by the perceived lack of independence of the central bank; the start of an economic recession in South Africa, with additional concerns regarding the land reform plan). However, what **all these countries had in common are some areas of vulnerability,** starting with government deficits and dependence on foreign funding, often denominated in USD, which resulted in a higher exposure to multiple headwinds that are surfacing in this late phase of the cycle. On the opposite side, strong economic momentum in the US (with 4.1% GDP growth in Q2 2018, the highest level since Q2 2014), shrinking global liquidity, higher US rates, and a strengthening US dollar are all forces driving outflows from EM and making US assets more attractive. Yet, **in a late cycle phase, a small size problem** (Turkey+Argentina+South Africa make up only around 3% of the global economy*) **can turn into a catalyst for a risk-off mode in the EM area. However, we do not expect to see a broader market capitulation or systemic risk.** The trigger for either of these issues would be a marked slowdown in China, which is not our main scenario. In fact, credit growth in China, certainly a higher risk for global economy, is showing further signs of stabilisation, with Chinese policymakers acting to keep the monetary stance on the easing side and shifting the fiscal stance to be more supportive.

Going forward, in a phase of slowing global economic momentum and a late business cycle, we expect market participants to remain vigilant in light of upcoming political events. In this new phase, directional markets leave room for less directional markets, with **more divergences in styles/factors and higher rotation** in investment themes, to extract the remaining value. In our view, recent dislocations will lead to value entry points opening up. **Opportunities may arise in some quality and value parts of equity markets**, in relative value trades across yield curves, and in currencies to play CB divergences. In this environment, **Europe**, which has not been in favour to the same extent as the US, **will become more attractive**, in our view, supported by cheap valuations (assuming that Italian headwinds dissipate -- our assumption beyond likely tensions arising first). In **EM, price dislocation has been more pronounced. Significant noise will continue to be a distraction in the short term, but we think an entry point will open up in the coming months** (after Brazilian and US mid-term elections). This will require a selective approach to countries and names with decent fundamentals, though having been disproportionally hit during the selloff. Strong portfolio construction discipline, with a focus on liquidity management and macro and bottom-up research, will represent the compass to navigate this market phase and indicate how/when to rotate into the most compelling themes. **With less beta-driven markets, expect alpha to be the name of the game in the coming months.**

High conviction ideas

- **Multi-asset:** In a context of risk asset neutrality, we favour US equity and we are becoming more constructive on European equity based on valuations. We remain very selective on EM assets in the short term, and believe investors should look for better entry points. On duration, we are still cautious and still favour gold and hedges to protect against a possible increase in geopolitical tensions.
- **Fixed income:** Factors backing the short duration stance in the US are receding and we think it is time to reduce the short duration bias there, while we keep it in Europe and Japan. We have become increasingly cautious on credit over the summer, with a strong focus on quality and liquidity. On EM bonds, short-term volatility could persist, but valuations have become attractive.
- **Equities:** Valuation as a support factor has not worked over the last 12 months, but we now expect a reversal of this trend. As a result, we are rotating towards the value theme in the US equity market. In Europe, investors should consider playing value with a strong quality focus, and balancing cyclical and defensive exposures to continue to benefit from the still-positive economic backdrop.
- **Real assets:** The current environment requires investors to be selective when looking for well-priced private equity targets with attractive long-term returns. We see opportunities in European small and mid-caps, with a focus on companies able to take advantage of disruptive trends.

*Source: IMF, GDP based on PPP, share of world (Percent of World), 2018.
Alpha – Alpha measures risk-adjusted performance, representing excess return relative to the return of the benchmark. A positive alpha suggests risk-adjusted value added by the manager versus the index. Beta – 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.

MACRO & STATEGY

More risks of trade war and synchronised slowdown

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On 17 September, US President Trump announced that the US will place (as of 24 September) a 10% tariff on an additional c.$200bn of imports from China. Furthermore, as of 1 January 2019, those tariffs will rise to 25%. In retaliation, China has announced new tariffs of 5-10% on $60bn of goods imported from the US. The White House said that it would further raise tariffs on approximately $267bn of additional imports in case of further retaliation from China. For now, this threat from the US side seems to be avoided given the Chinese moderation. We estimate that the measures taken could remove 0.1-0.2% from US growth in 2019. If the US increases its tariffs to 25%, it could cut 0.6% from Chinese growth. Regarding the Chinese side, however, one should not underestimate the capacity of the authorities to stimulate growth: they have recently relaxed both fiscal and monetary policies and this should offset at least 0.3% of the negative impact mentioned above (ie, all of the negative impact coming from the rise in tariffs to 10% on $200bn). Moreover, China has room for manoeuvre to do more if necessary. The US authorities, on the other hand, have less leeway: fiscal policy is already very expansionary and the Fed intends to continue to raise key rates.

In the US, the outlook is still good and financial conditions remain accommodative, but they are likely to tighten with the rise in interest rates and the appreciation of the USD. Thus, the probability of a recession in the next 12 months tends to increase, based on our estimates: at between 10% and 20%. While low, it is now much higher than the historical average. If the Fed continues, as we expect, to raise its key rates by 25bp/quarter, by mid-2019, this would lead to an increase in interest charges for companies that have significantly re-leveraged during this cycle. The impact on investment would potentially be significant, as the expansionary effects of fiscal stimulus will recede next year.

The weakening of world trade (zero growth qoq in Q2) shows that the protectionist rhetoric is a shock of uncertainty that has begun to spread to real economic activity (confidence shock, slowdown in business investment, disruption of chains of production). Even if the US and China decide to negotiate after the US mid-term elections, uncertainty about global trade is increasing.

In Europe, growth has already slowed and confidence has weakened due to this uncertainty and to the rise in the oil price. Furthermore, there is the political risk related to the potential for a hard Brexit or a marked fiscal slippage in Italy.

Finally, the outlook for EM (taken as a whole) has deteriorated, with the dollar rallying and the monetary conditions tightening in many countries simultaneously. Ultimately, the potential for a synchronised slowdown in the global economy is now gaining ground fast.

The Strategist’s View – Risk-off mode for now

Generalised market disturbance: Financial volatility mainly related to the difficult state of global politics has shaken investors, but has not yet destabilised economic and macro fundamentals. Based on this perspective, however, a remarkable diverging trend has emerged, with the US (almost at the peak of the cycle) outpacing the rest of the world. Fundamentals have proved resilient to the uncertainty so far. However, we think that tighter financial conditions, including exchange and interest rates, could trigger significant market strains at current valuation levels.

Long-term rates under pressure: The US yield curve remains -- and will remain, in our view -- flat, due to the difficulty of pricing in a decent inflation premium in the US and given weaker fundamentals elsewhere. In Italy, BTPs move primarily on political developments. Since the end-August auction (which was exceptionally strong), BTP flows have been centred around bank buying, which has compensated for a big chunk of international investor outflows, and strong short covering on better-than-expected news on the fiscal front. From here, additional spread tightening might occur, should the political picture and rating agencies remain constructive, and budget deficit be confirmed below 2%, with credible measures included in the government’s plan.

EM still the key focus: The biggest risk relates to GEM FX spillover effects on GEM bonds and equities. Turkey looks to be the most vulnerable to this dynamic, but is followed by the more fragile countries with large funding needs (eg, South Africa, Chile). While the environment is very tough and we keep a short-term negative view on the asset class, our base scenario is for these risks to remain idiosyncratic.

“The prospect of a synchronized slowdown in the global economy is now gaining ground fast.”

BTP= Buoni Poliennali del Tesoro, Italian government bonds.GEM FX = Global Emerging Markets currencies

MULTI-ASSET

Stay neutral, seek value

Matteo GERMANO
Head of Multi-Asset

> *It's time to be positioned for a late cycle, favouring selective equity themes (US, value) and being prudent on credit.*

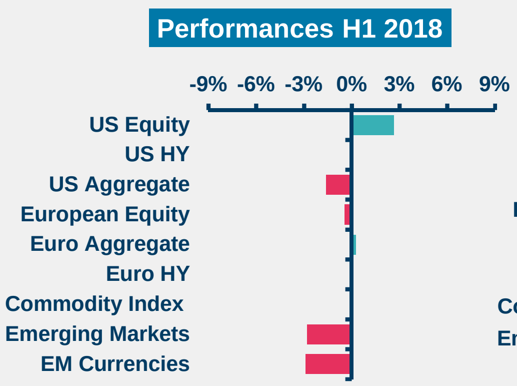
Global economic expansion continues, but momentum is weakening. We are seeing some deceleration in certain emerging markets while political and geopolitical noise remains elevated (trade disputes, elections). As a result, the fragility of investor confidence can suddenly translate into a risk-off mode in some asset classes, as we have seen over the summer in the EM space. Yet, that concern did not cause a "flight-to-quality" and subsequent outperformance of DM assets. Instead, the US ended up as the clear winner, thanks to a combination of hope (earnings, productivity and capex growth), fear (safe-haven status, repatriation of funds) and momentum. Returns so far in the third quarter clearly support this pattern, as the US equity market continues to post new highs while most other markets are either flat (European and EM equities, aggregate bond indexes). Against this backdrop, we remain cautious on risk asset exposure and focus on themes that are backed by either strong economic momentum or compelling valuations.

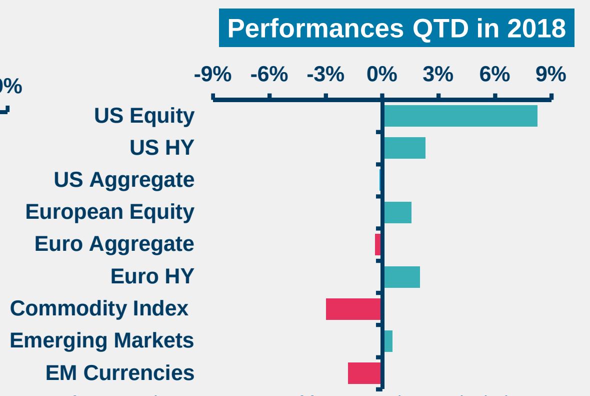
High conviction ideas

In terms of risk assets, we maintain a positive stance on the US equity market, supported by positive growth momentum and earnings growth trends. In European equities, we favour value themes in the search for defensive exposure and we are gradually becoming more constructive overall. In fact, while the Italian budget and Bavarian elections may keep uncertainty high in the short term, we believe we are approaching a phase where European equities will become more attractive, as valuations are increasingly appealing. We also have a positive view on the UK equity market, where we see a combination of valuations, flows and earnings revisions supporting this call, which also benefits from the defensive nature of this market in a late cycle environment. However, we will continue to carefully assess the evolution of Brexit negotiations to confirm this view going forward. At a sector level, European basic materials remains our top call, based on good fundamentals, reasonable valuations, and an ongoing favourable economic environment for commodities. In bonds, we suggest a limited duration exposure while investors seek opportunities by actively playing curve positioning and relative value between US and German bonds which should benefit from diverging CB stances. Currencies also offer fertile ground to play these divergences, with geopolitical themes also offering some attractive opportunities. In this regard, we are negative on the GBP amid uncertainty related to Brexit negotiations. On inflation, our central case continues to expect a gradual increase in price dynamics, but we think that the case for inflation-linked bonds in the US has receded, as we see limited further upside/overshoot risk in US inflation in the future. We maintain a cautious stance on credit markets and also on EM assets. Here, we confirm our preference for China within the EM equity universe on the basis of attractive valuations and the more constructive medium-term outlook for China, following the recent change in policy towards a more supportive stance.

Risks and hedging

Markets remain vulnerable and we think it is sound policy to keep hedges in place and consider some exposure to gold in an effort to hedge against rising geopolitical tensions and to take advantage of a potentially softer stance from the Fed. Exposure to the JPY (vs the USD and AUD) could also benefit from the safe haven status of the JPY.





Source: Amundi, Bloomberg. Data as of 21 September 2018. Past performance is no guarantee of future results. Equity indexes are from MSCI, bond indexes are from JP Morgan and BofA Merrill Lynch. All indexes are total return in local currency.

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FIXED INCOME

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Head of Fixed Income

Yerlan SYZDYKOV
Head of Emerging Markets

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CIO of US Investment Management

We think it is time to reduce the short bias on US duration and continue to focus on quality and liquidity in credit markets.

Reassessing duration views

Overall assessment

While global economic fundamentals remain sound, with some signs of deceleration, uncertainty will continue to dominate based on upcoming elections, CB actions and trade discussions. Core government yields (US, Germany) will likely remain range-bound, as demand for "safe" assets should counterbalance the upward rate pressure driven by the economic backdrop. We think it is key that investors focus on quality and liquidity across the board while seeking opportunities that may emerge after a period of noise -- for example, in selective EM bonds.

DM government bonds

At current yield levels and given market expectations (Fed hikes well priced into the market), we think the case for a short duration bias on US Treasuries is receding while we keep a short duration view on Europe and Japan. Within Europe, we continue to expect the yield differential between 5Y and 30Y bonds to decrease (flattening), as the curve appears too steep at current levels. At the country level, we see tactical opportunities in selective peripheral countries (eg, Spain and Portugal).

DM corporate bonds

While the near-term growth outlook appears supportive, future Fed policy considerations and market valuations support cautious positioning on credit, with a focus on liquidity. Opportunities should be played across and within sectors. In the US investment-grade space, we like banking, insurance and energy names, given their valuations and credit cycle positioning. We are more cautious in basic materials and tech on valuations and on pharma due to concerns about the business model. Loans also continue to offer opportunities against a backdrop of strong fundamentals, rising profits and low defaults. In Europe, we also keep a defensive stance with a focus on short-term issuance, and we continue to seek selective opportunities in financial subordinated bonds.

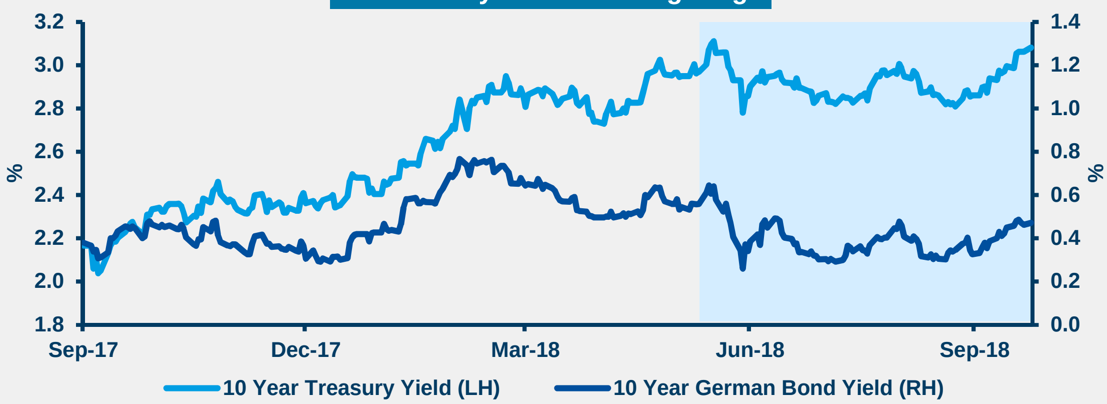
EM bonds

We expect volatility to remain high as we move towards US mid-term elections, which could drive some hostile talks on the trades/tariffs/ sanctions front. The weakening in the risk sentiment at a time of tightening liquidity has resulted in some EM being caught in the selloff and as a consequence now offering very interesting valuations. An example is Mexico, where we think the local sovereign debt shows compelling value, with an almost 8% yield on the 10Y bond in LC for an investment-grade country (as of 18 /9/18). We think Mexico is likely to enjoy a period of calm before year-end, when the president-elect will take over, while NAFTA headlines are softening. In contrast, we are cautious on Turkey local debt. Recent lira weakness has been impacting inflation expectations, and although the CB finally delivered a rate hike, the focus will be on upcoming budget, with the expectation of meaningful fiscal policy tightening.

FX

Ongoing and rising concerns on trade disputes continue to support the USD in the short term and to add volatility for EM currencies, where local politics are also contributing to uncertainty. We are positive on the USD, as global growth and rising inflation are supportive. On EM, we remain cautious on EM Asia currencies, which are more vulnerable to trade wars, and on Brazil, due to approaching elections

Core bond yields in trading range



Source: Amundi, Bloomberg. Data as of 21 September 2018.

EQUITY

Quality and value stocks in focus

Overall assessment

In the medium term, the US market outlook remains positive, but with trade disputes and mid-term elections ahead, some volatility may emerge in the coming weeks. As European equities is the most unloved asset class following €40bn of outflows this year, any good news on known unknowns like Italy/Brexit/trade war would see a rally in the asset class. We believe that risks are now symmetrical, as the markets have already adjusted to these risks. Globally, the growth vs value ratio appears excessive, having reached end-1990s levels. Thus, the risk of correction is increasing. In our view, the best way to navigate this phase is to focus on quality stocks that seek to deliver sustainable earnings growth in the future and that are currently trading at reasonable prices.

Europe

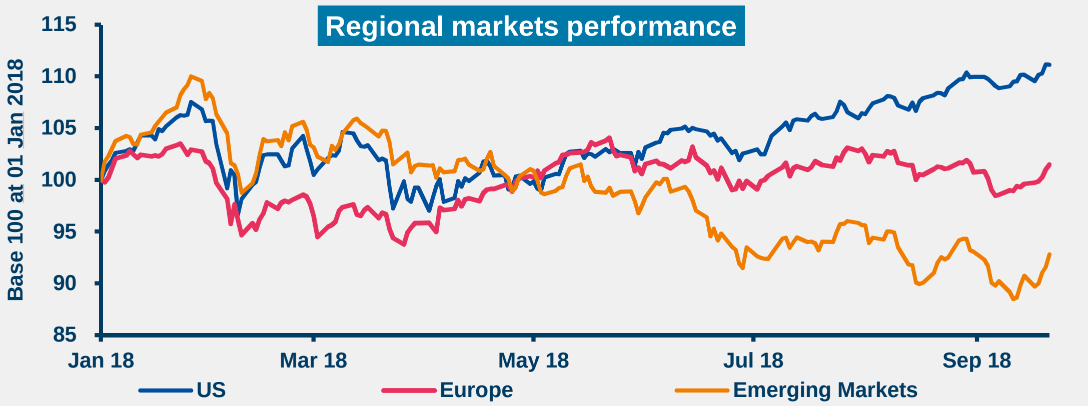
Q2 earnings growth stabilised around 9%. The more favourable FX environment was balanced by higher input costs and weaker economic momentum. Earnings-wise, energy and real estate improved the most while consumer discretionary, telco and healthcare lagged. In Europe, we would play value with a strong quality focus, and balance cyclical and defensive exposures to continue to benefit from the still-positive economic backdrop. We would seek out sustainable business models that can continue to deliver solid earnings growth. Industrials, for example, offer some interesting late-cycle opportunities, particularly in capital goods with a focus on attractive valuation opportunities.

United States

Some noise in the short term is expected, as trade tensions intensify and US elections spur uncertainty. The medium-term outlook is still constructive and is supported by some healthy rotation in sectors and themes that occurred over the summer. The dominance of FAANG stocks in the first half of the year (+30.4% NYSE FANG+ Index in H1 2018 vs +1.6% for the S&P500) is now reversing (-4.3% NYSE FANG Index QTD vs +7.8% for the S&P500). Another possible rotation to come could be towards value. Valuation has not emerged as a positive factor for the past 12 months and its poor performance is on par with other notable inflection points in the market since 1990: tech bubble, housing bubble, Euro/Greek debt crisis, and the peak of the Trump trade situation. In each of these cases, there was a reversal of the performance of the valuation factor. We find the most value in capital goods, housing repair and remodel-levered stocks, banks, and telecom, and are cautious on tech/FANG. Areas of concerns are related to possible retaliation in trade disputes and the strength of the US dollar, which could impact the capital goods and transportation sectors. The flattening of the yield curve is also an area to watch: should it persist, it could negatively impact banks and trigger a review of the sector.

Emerging markets

EM equity has been hit over the summer, with few significant exceptions, such as India, which has posted strong returns quarter to date. EM earnings per share revisions are deteriorating amid some challenges (trade disputes, FX spill overs) and country-specific stories in a context of expected moderate global economic slowdown. However, the selloff has been stronger than the deterioration in the earnings trend. This could pave the way for a tactical rebound in an overall scenario that requires cautious positioning. In terms of themes, we remain constructive on oil, due to politics-related supply disruptions (Iran, Venezuela) and US shale logistics bottlenecks.



Source: Amundi, Bloomberg. Data as of 21 September 2018. US = S&P500. Europe = MSCI Europe, Emerging Markets = MSCI Emerging Markets. Total return indexes in local currency. It is not possible to invest in an index.

FAANG= acronym for Facebook, Amazon, Apple, Netflix, Google.

European equity could rebound in the short term, as most of the bad news flow seem priced in.

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Amundi
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REAL ASSETS

Pedro-Antonio ARIAS
Global Head of Real & Alternative Assets

"Small and medium enterprises may offer opportunities to capture structural disruptive trends."

Look for selective opportunities in private equity

Private equity investing in challenging times

The private equity market is now navigating challenging times. On the market side, the landscape has become increasingly competitive, with the number of private equity funds in the market continuing to grow (52% rise in the number of funds raising capital at the start of Q3 2018 compared to the beginning of Q3 2017, according to the most recent Preqin figures).

This has led to an expected slowdown in fundraising activity as the overall activity seen in recent years was too abundant to be sustainable in the longer term. On the macro side, the current environment is characterised by low yield, economic growth that is still sound but decelerating, and political and geopolitical risks, which require investors to be even more selective when looking for well-priced target with attractive long term returns.

Despite heavy competition and a challenging market landscape, investor sentiment towards the private equity asset class still seems positive, thanks to its search to address investor needs, such as diversification, risk-adjusted returns, and inflation hedging. When it comes to performance, private equity has recorded steady returns, consistently outperforming the S&P500 Index over the last 10 years. So, the real challenge is to implement the right strategy to attract new investors looking for high absolute potential returns and portfolio diversification.

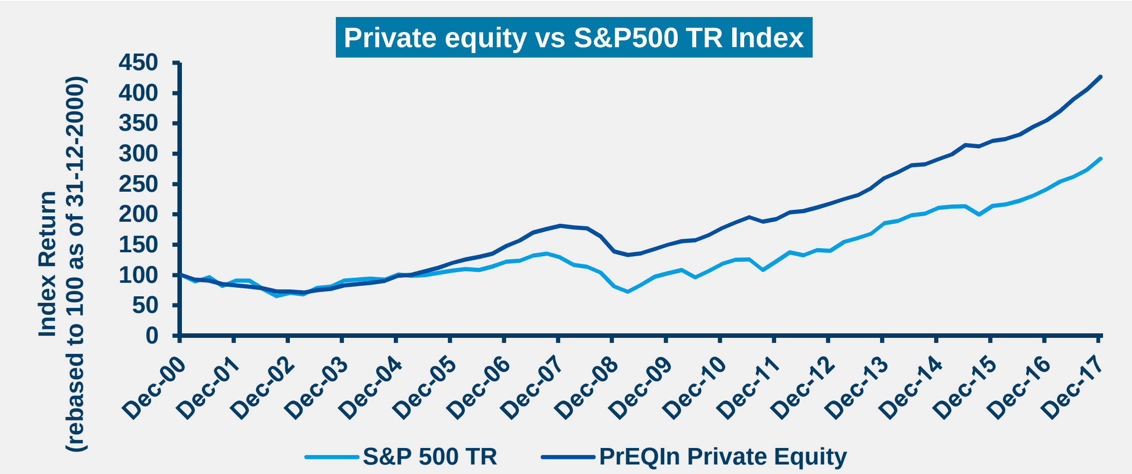
Where are the most attractive opportunities?

It is now getting more difficult to find attractive opportunities, especially in developed markets, as valuations are higher than a few months ago and this may lead to lower returns in the years to come. So, it is paramount to select the right geographic area and the appropriate companies.

We think Europe still offers a positive economic backdrop and we expect private equity to remain in demand in this geographic area. In this respect, we believe Western European countries may offer good investment opportunities, but we think it is key to have an excellent deal flow, solid local knowledge, insights and networks. Looking at the market, investors should consider focusing on private European small and medium-sized enterprises (SMEs) that have demonstrated their strength over a meaningful time horizon.

However, within the SMEs market, there are a multitude of compelling business stories requiring managers to adopt a highly tailored strategy. In order to unlock the most value out of private equity investing, investors should consider combining top-down and bottom-up approaches for stock selection and playing the five key global megatrends that, in our view, are reshaping the investment landscape (demographics, environment, technology, social changes and globalisation).

Then, in each sector, it is key to identify factors that make a company well equipped to create value for investors over the long term. These are: the quality of the management team and its involvement in the capital structure; having solid fundamentals and a history of profitability; the ability to gain competitive advantage by having consistent organic growth and a strong desire to seek external growth though internationalisation; a flexible approach and the agility to adapt rapidly to changing environment conditions. Finally, investors may look at those adopting the principles of ESG (environmental, social and governance), which is a core element in value-creation.



Source: Preqin, Amundi. As of 31 December 2017. Past performance is no guarantee of future results.

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 (+/++/+++). This assessment is subject to change.

Relative outlook and convictions 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

↘ Downgrade
→ Unchanged
↗ Upgrade

● Underweight
● Neutral
● Overweight

Source: Amundi, as of 21 September 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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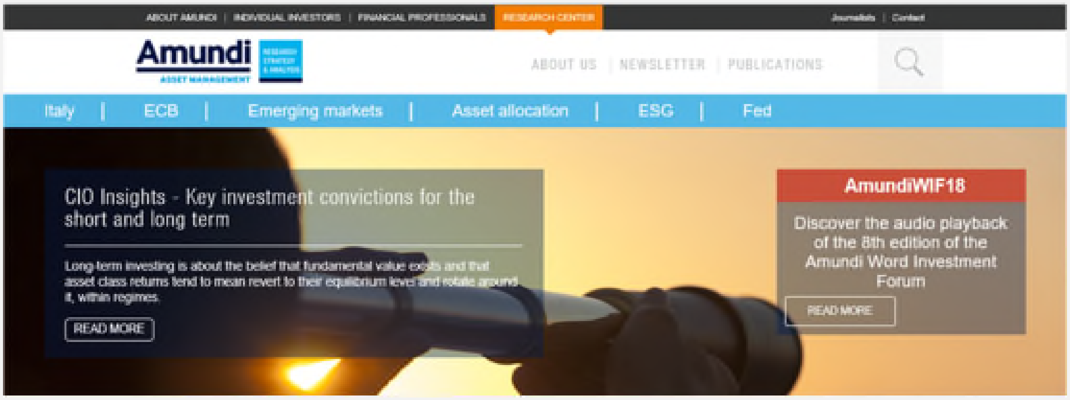
AMUNDI Investment Insights Unit

The Amundi Investment Insights Unit (AIIU) 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.



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