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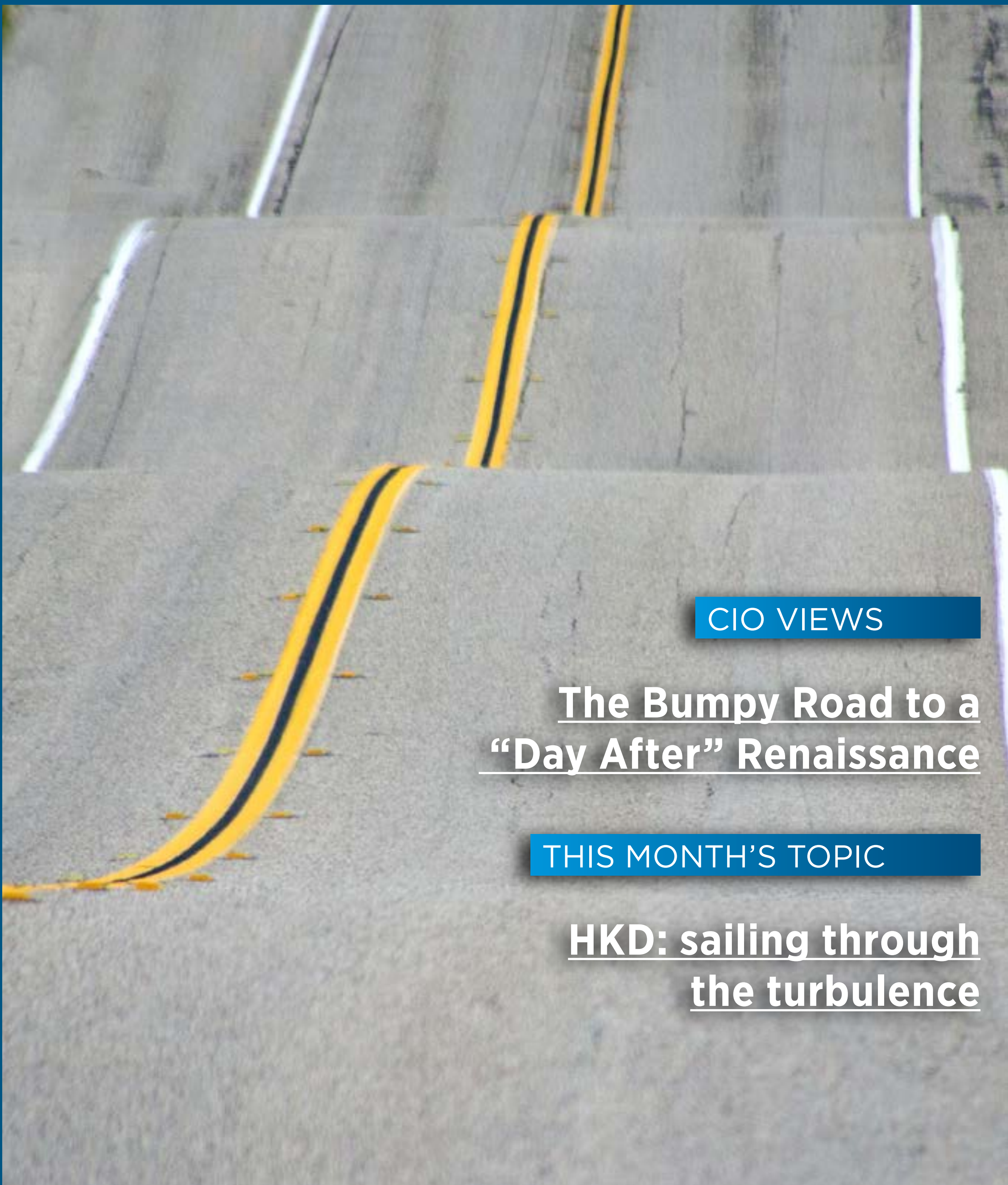
CROSS ASSET
Investment Strategy

07/08
July—August
2020

Monthly



CIO VIEWS

The Bumpy Road to a "Day After" Renaissance

THIS MONTH'S TOPIC

HKD: sailing through the turbulence

#07/08 - July—August 2020

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CIO VIEWS

The Bumpy Road to a "Day After" Renaissance

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Covid-19 has triggered a sequence of economic and financial market narratives and is giving way to a new status quo characterised by extreme fiscal and monetary measures, to which markets have responded well, though some volatility has returned in the past few days. In effect, these **policy measures are painting a new picture, that of a "day after" renaissance**. **Markets have already priced in their rosiest scenario:** the end of the worst of the virus cycle, the possibility that a second wave will be weaker than the first, and a cure and vaccine arriving fast and becoming broadly available before a new pandemic pushes the economy into a fresh wave of lockdowns. Some recent data supported this view, such as the PMI bottoming out (still weak) and the US job market surprising on the upside (though it is trending down).

Overall, the data isn't pretty, but the general idea is that the economic freeze is almost over and that it's time to look forward. This is what has pushed the equity markets to almost erase year-to-date losses in the US, with the S&P 500 (Total Return) down 2.7% YTD, after a QTD performance of +21%, as of the close on 17 June. Recently, **a strong rotation clearly showed up in favour of cyclicals, small caps, value stocks and laggards. There has been a race to follow the trend, favouring the lagging markets such as Europe, Japan and EM assets, and corporate credit is also attractive.**

In the "day after" scenario, the expectation of low bond yields and massive central bank buying also works in favour of a relative preference for equities vs. bonds as dividend yields outstrip bond yields. It's true that earnings growth expectations are still too high, but if we think the worst is over, that there's no juice in bonds and liquidity abounds, we have no choice other than to look at equities to try to grasp opportunities in areas that haven't fully recovered their pre-crisis valuations. **However, the road along the recovery phase could be bumpy**. So far, only those companies most directly affected by the lockdown measures have gone bankrupt. But the race against time between solvency and liquidity continues. There will likely be more victims, and many downgrades are still to come.

Expectations that the pandemic is over may be too optimistic, and any slip-ups could heat the markets up again. While it's true that governments and central banks have introduced extreme measures, more will be needed, particularly outside the US, where the magnitude of measures doesn't match the economic damage. Moreover, the risk of policy mistakes can't be underestimated. The money available has to be targeted efficiently, and too much haste to secure electoral consensus could result in a misallocation of capital. **Geopolitics will increasingly take centre stage the further we move toward the final phase of the US Presidential election.**

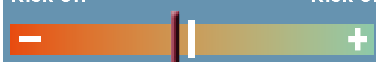
Against this backdrop, we recommend the following guidelines at the level of portfolio building:

- **Maintain a balanced risk exposure and play the rotation toward value and cyclical stocks.** The markets were too fast in pricing the end of the lockdown and the recovery ahead. Current valuations -are the result of a **liquidity-driven rally** and are being sustained in the short term only thanks to the continued aggressive monetary expansion. Markets are clearly addicted to CB liquidity at the moment, but in the second part of the year **a reality check on earnings growth has to be considered**. Therefore, we suggest combining a high level of liquidity with some exposure to cyclical assets that offer high performance potential in the event that a favourable scenario plays out.
- **Stay positive in the credit space, which is benefiting from fiscal and monetary measures, and very selective.** IG credit and the better-quality BB companies in HY will remain the sweet spot in a climate of a slow recovery, very low rates and rising defaults. Investors should seek opportunities in the IG primary market, where activity is at a record high. We expect the default rate to increase for low-rated HY issuers, and this is not fully priced in by the market, so selection is paramount in the HY space.
- **Liquidity is, has been, and will be a key variable in the new order**. Keeping liquidity buffers is particularly important in this phase, as a second leg-down in the market can't be ruled out. This will provide room to move into segments and markets that display attractive entry points.

For investors, this means we can't ignore any "day after" directions, but we must also exercise caution and selectivity. Don't move from depression to euphoria, but from uncertainty to navigating a careful path forward.

Overall risk sentiment

Risk off **Risk on**



Prioritise liquidity, and stay active and balanced, amid the lack of visibility on earnings growth and the deteriorating default outlook

Changes vs. previous month

- A slightly more positive view on credit, peripheral debt and cyclical stocks that are supported by central banks' actions.

Overall risk sentiment is a qualitative view of the overall risk assessment of the most recent global investment committee.

MACRO

Rising appetite for EUR, but too early for a bull run

MONICA DEFEND
Global Head of Research

FEDERICO CESARINI
Cross Asset Strategist

Potential opposition from the 'Frugal Four' countries to the EU Recovery Fund, relatively lower growth in the EZ and its EPS growth differential vs. the US point to a limited short-term upside for EUR/USD

Currency markets have had a clear winner in H1 2020: the USD. While the Fed's intervention in fact removed the cyclical support from the rates advantage the greenback has had since rates normalisation started, **the flight to quality and USD liquidity needs took the lead and kept pushing the currency away from fair value**. Valuation doesn't always work, especially when global growth is collapsing and visibility remains very low. This is when the safe-haven nature of the USD became paramount, therefore sentiment and investor flows were the main performance drivers. It would have been surprising to see the USD moving substantially lower when the preference for USD duration and low beta markets (i.e., the S&P 500) was so accentuated.

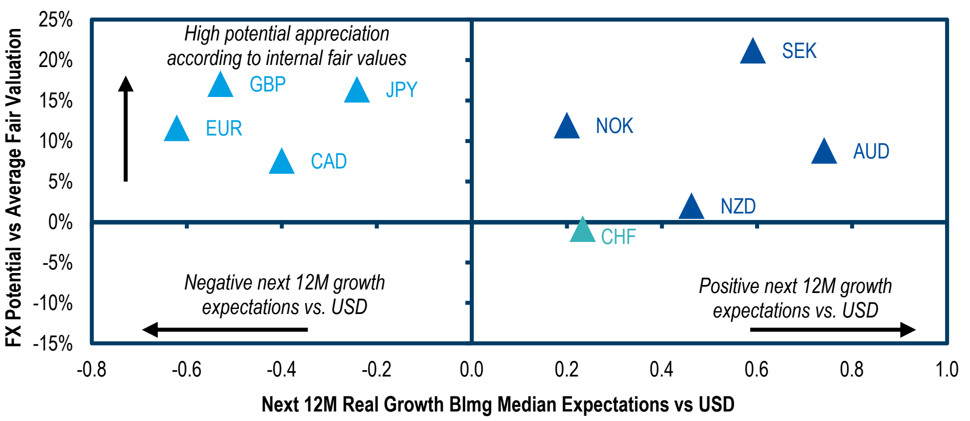
But lockdown measures are being eased globally and CBs' strong commitment, together with some ambitious policy initiatives at national level, have already started pushing growth expectations higher, thus providing a framework for valuation to perform and for the USD to finally take a step back.

Moreover, the EU Commission's proposal for the Next Generation fund (EUR 750bn, financed by mutual debt issuance and consisting of a mix of grants and loans), intended to ensure that the long-term prospects of the EU remain intact, is substantially lowering the tail risk of a Eurozone (EZ) break-up. We acknowledge that the event could prove to be a medium-term game changer for the EUR (as debt sustainability issues across member states, de facto, fade). **However, in the short term, we remain sceptical about saying that we are at the beginning of a EUR bull market,** versus the USD in particular.

The downside risks have diminished and should prevent a further collapse in the EUR, but **sentiment has so far been the only driver supporting the EUR/USD rally in early June**. Even assuming that the EU Commission's proposal does not find any material obstacles to its approval, the potential pitfalls are still in place (with the "Frugal Four" countries' potential opposition at the top of the list and many details on the allocation and sizing still pending). These issues could cause another gyration in risk sentiment. The EZ is still without short-term cyclical support (it remains among the few regions/countries expected to grow less than the US in next 12 months) and the month-to-date rally looks overdone given there are few short-term drivers. Physical commodities and the differential in its EPS expectations vs. the US suggest that things need to get worse before they get better, and would point to little short-term upside vs. USD (see chart).

In our opinion, the cleanest way to play such a shift in sentiment towards the single currency would be against the British pound. The UK seems to be experiencing the worst economic consequences in the G10 and the no-deal Brexit risk has materially increased with the EU's Commission proposal. The probability of a further extension in the transition period should be lowered substantially if we consider the increased contribution to the EU budget that all the member countries (UK included for the time being) will be asked to provide once the plan is approved. We see EUR/GBP moving higher in the short term as both positive sentiment for the EUR and the need to hedge the no-deal outcome will provide support.

Potential from fair values vs. next 12M growth expectations



Source: Amundi Research, Bloomberg, as at 18 June 2020. FX upside/downside calculated vs. the average of four internal econometric models – purchasing power parity (PPP) and three behavioural equilibrium exchange rate (BEER) models. Price dynamics, rates and productivity differential, together with terms of trades, fiscal spending and the degree of openness of a given economy, are the main variables that we consider. Models' estimations have been run with the USD being the base. Currency expansion on last page.

MULTI-ASSET

Market euphoria clouding the need for caution

MATTEO GERMANO
Head of Multi-Asset

We remain conservative as markets, especially equities, are pricing in perfection

Over the past month, we have witnessed changes on two key fronts: (1) an orderly reopening of economies; and (2) strong fiscal support in the US and important policy actions in Europe, where we believe that the EU Recovery Fund and national fiscal interventions could prove to be a short-term game changer. However, there are no signs of improvement on a third front, the sustainability of corporate earnings. **Consequently, we maintain our defensive, balanced and diversified risk stance**, and believe investors could play some tactical rotation opportunities in the value and cyclicals sectors, green themes and the US consumer area, which remains supported by fiscal plans. Liquidity buffers are paramount at this stage.

High conviction ideas

On **DM equities**, **we remain conservative and vigilant on hard data**, but see tactical opportunities in Europe (a reduction in the political risk premium) in value, utilities related to renewable energy and industrials exposed to green initiatives. In the US, value, banks, credit cards, industrials (recovery exposure) and discretionary names, including autos, look attractive. However, growth names in the software and internet, staples and utilities sectors in the US are expensive. **Our view on EMs remains neutral,** with a regional preference for China, South Korea and Taiwan, due to their sector exposure, strong stimulus and better contagion containment. Valuations in some ASEAN countries (Thailand, Indonesia and Philippines) are attractive but we are cautious on some countries due to virus concerns. Overall, it is important to hedge global equity exposure. **On duration, we adhere to our close-to-neutral view on the US** owing to the current curve control environment and the Fed's stance of not hiking policy rates until 2022. The Fed will prevent long-term yields from rising too much to avoid tightening financial conditions. **We are monitoring the US 5-30Y curve**, which we believe is quite steep considering the fundamental economic picture and the Fed's policy, but is still driven in the short term by sentiment and partly by technicals. Fed buying (especially in the short- to medium-term segments), safe-haven demand and the global search for yield, although to a lower extent, enable us to maintain a preference for US 5Y vs. German 5Y. In addition, UST yields still have room to fall if the Fed signals an openness to negative rates. **We are positive on US inflation bonds** (medium term), due to depressed valuations and long-term reflationary forces. **Euro peripheral debt** should be supported by the ECB's actions (recent PEPP expansion) and the EU Recovery Fund. The latter should reduce the risk premium on peripherals and, collectively, both are putting a ceiling on Italian yields. As a result, we now prefer an outright Italian BTP position over a relative Italy 30Y vs. Germany 30Y position. The former is also less correlated to equities. **Amid continued CB support**, **we retain our constructive stance on credit**, and prefer IG (better valuations) over HY and EUR over US (high leverage). Investors should have a well-diversified exposure across sectors (cyclical, defensive, financial senior debt) with a particular focus on high-rated debt of A, A+ and BBB+ grade. However, liquidity assessment and some protection in HY is important (default risk). **We are neutral on EM debt**. The gap between IG and HY countries is declining, with HY spreads strongly compressing but still attractive, while IG has now reached levels more in line with historical averages. **In EM FX**, we are now constructive on some high yielding currencies as they are benefiting from sentiment, flows and the focus on improving growth dynamics, but some risks factors (oil war, US-China tensions) remain.

Risks and hedging

Hedging in the form of gold, JPY/USD (safe haven) and derivatives is important to mitigate the risks related to earnings, insolvency and geopolitics.

Amundi Cross Asset Convictions

	1 month change	---	--	-	0	+	++	+++
Equities				□				
Credit						■		
Duration						■		
Oil					■			
Gold						■		

Source: Amundi. The table represents a 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. USD = US Dollar, JPY = Japanese yen, UST = US Treasury, DM = Developed markets, EM/GEM = Emerging markets, FX = Foreign exchange, FI = Fixed income, IG = Investment grade, HY = High yield, CHF = Swiss franc, NOK = Norwegian Krone, EUR = Euro, CBs = central banks, TIPS = Treasury Inflation-Protected Security, BTP = Italian government bonds, ASEAN = Association of South East Asian Nations.

FIXED INCOME

Markets addicted to central banks: focus on quality

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Head of Fixed Income

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CIO of US Investment Management

Spreads are tightening and default rates at the moment are low — compared to previous recessions — due to unprecedented CB-infused liquidity. This calls for high selectivity in terms of sectors and names

Ultra-accommodative CBs and strong fiscal support continue to gradually normalise market conditions, leading to a rebound in risky assets and causing USD weakness. However, as markets are now addicted to CB support, there is a risk of an increase in credit defaults when this support fades. Therefore, in their search for yield, investors should ensure that they don't go too low in the credit quality spectrum because the risks are asymmetric. Instead, this is a time to remain selective and active, and maintain liquidity and headroom to manage allocations tactically. Investing in green strategies will be a key way to navigate markets.

Global and European fixed income

We refrain from making any strong calls on duration and keep our stance close to neutral, with a constructive bias on the US and France and a negative view on bunds. We see curve-steepening opportunities on the long end of the US and Euro (10-30Y) yield curves as there is room for long-term yields to increase in light of the massive issuance programmes. The continued ECB support and the prospect of the EU Recovery Plan now allow us to be **positive on the Euro periphery debt**. On inflation bonds, we maintain a slightly positive outlook owing to attractive breakeven valuations, but don't expect a substantial increase in inflation (slow economic recovery). **We are slightly more constructive on credit amid investors' search for yield in the low-rate environment**. In IG, we are positive on financials and on subordinated debt, in particular, and find selective opportunities (re-leveraging) in TMT, energy and other cyclicals. HY should remain supported by recent backstop announcements from CBs. However, investors should remain cautious and maintain high cash levels due to concerns over debt and the low visibility on earnings.

US fixed income

Markets have stabilised due to stimulus-driven liquidity, but they are underpricing the downside risks. We acknowledge the optimism, but think it's crucial to maintain cash buffers. **In credit, demand is driving spreads tighter**. We are constructive, particularly on the long-duration credit of quality companies with stable cash flows (financials, industrials, consumer sectors). Consumer and housing markets are demonstrating resilience and, accordingly, we are positive on non-agency RMBS and see value in subordinated and esoteric ABS. We are cautious on the UST 10Y owing to rich valuations and concerns over rising fiscal deficit, and believe the yield curve is likely to steepen, with longer-maturity yields rising due to a pick up in economic activity and increased issuance. TIPS offer inflation protection from a medium- to long-term perspective. Agency mortgages offer liquidity and the prospect of higher yields, but selection is critical as the securitised market may lag the recovery and subdued employment could impair consumer spending and debt repayments.

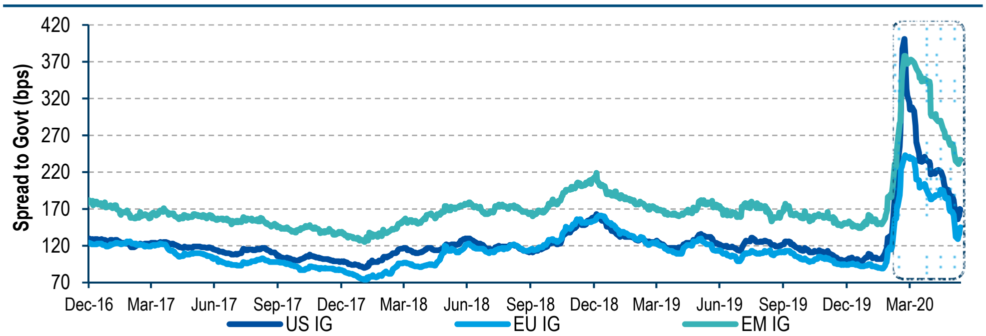
EM bonds

We favour HC debt, but valuations are starting to look less appealing. We are more positive on HY (Serbia, Ukraine) as valuations are attractive and spreads could compress further vs. IG. But **we are more cautious on rates**, given the strong performance of Russia, Mexico and Egypt. In LC, selectivity and curve positioning is required. It is also important to consider the US elections.

FX

In DM, we are cautious on USD in short term and are now positive on EUR/USD. In EMs, we are constructive on commodity and high-beta currencies amid reopening and oil rebound.

IG credit spreads



Source: Bloomberg, daily data as at 15 June 2020. Analysis based on ICE BoA indexes

GFI= Global Fixed Income, EM FX = Emerging markets foreign exchange, HY = High yield, IG = Investment grade, CHF = Swiss Franc, EUR = Euro, USD = US dollar, UST = US Treasuries, RMBS = Residential Mortgage Backed Securities, ABS = Asset Backed Securities, HC = Hard currency, LC = Local currency, TIPS = Treasury Inflation-Protected Security, GFC = Global Financial Crisis of 2008, JPY = Japanese yen.

EQUITY

Central bank support is driving sentiment

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Faith in central banks is lifting equity markets. A rotation towards cyclical themes could offer some opportunities in markets priced for perfection

Overall assessment

Markets are pricing in the narrative that the worst is behind us, leading to a strong rebound in equities and meaning implied expectations are no longer depressed. However, as uncertainty remains amid subdued economic data, US elections and geopolitical tensions, it is important for investors to remain highly selective and focus on high-quality names. At the same time, some positive signals of reopenings in the US and the Recovery Fund in Europe play in favour of a rotation towards value and the cyclical space that could benefit in the recovery phase.

European equities

Overall, we are cautious after the strong rally and believe in maintaining strong liquidity buffers and reassessing our cyclical bias, with a focus on resilient, non-disrupted business models and balance sheet strength. There are rotation opportunities in value stocks in banks (prefer banks vs. insurers), amid the progress on the EU Recovery Fund. But the focus should be on names with strong capital positions and profits. It is also important to pay attention to liquidity around small caps, where the situation is more fluid. At sector level, we recommend a barbell approach, with exposure to both defensive areas (for example, resilient yet attractive sectors such as healthcare) and cyclical areas (quality cyclical stocks in luxury and building materials), which will benefit from an economic recovery. We are cautious on technology, due to high valuations, and consumer discretionary (autos), owing to the combination of structural and cyclical challenges. In all cases, **agility is required and we continue to focus on process discipline and stock selection, as well as tightly managing market, factor and style risks**. This allows us to selectively look for dislocations after any market correction.

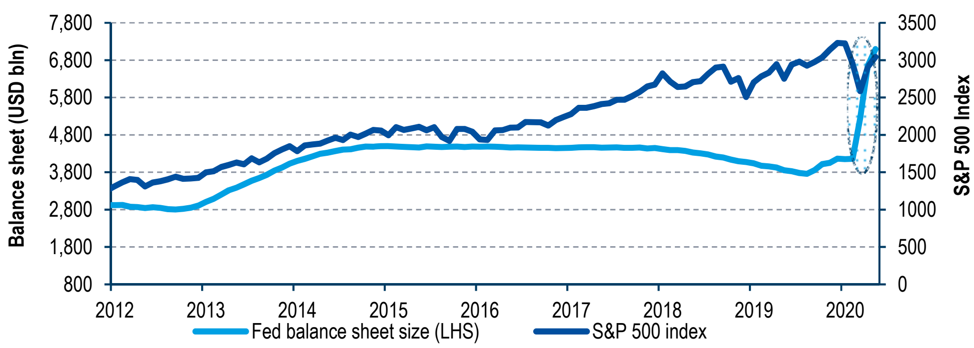
US equities

US equity has showed strong resilience during the Covid-19 crisis. Importantly, while the economy is hampered, around two-thirds of the S&P 500 is made up of companies in sectors that had a positive/neutral impact from the shutdown (technology, healthcare, communication, staples, etc.). The economy is reopening quickly and valuations are fair outside the few large concentrated stocks. We see a leadership rotation in favour of value and recovery stocks, where we like high-quality names with robust balance sheets and some secular advantage. We look for such attractively valued companies in financials (mega-cap financials), industrials, traditional consumer cyclicals (communication services) and commodity cyclicals. We believe cyclicals could display better performance in case of a recovery but require a thorough fundamental analysis. On the other hand, we are defensive towards bond proxies (staples and utilities) owing to their unsustainable valuations, and are avoiding expensive growth stocks. The valuation differentials between growth and mega-cap stocks are extreme. From a market-cap perspective, a shift down the market-cap spectrum within quality in large caps could offer selective opportunities.

EM equities

We are slightly more optimistic on EM equities but remain cautious, and believe policymakers' actions will be supportive of a global growth re-acceleration. We are cautious on the US-China relationship as potential sanctions might be detrimental (for China and the whole EM universe). EM equity valuations look more attractive vs. DMs, but the earnings outlook is still challenging. We are positive on Russia and India and search for more value and cyclicality in sector allocation (industrials, discretionary, materials).

QE-driven rally in S&P 500



Source: Bloomberg, Amundi, monthly data as at 29 May 2020.

THEMATIC

DIDIER BOROWSKI
Head of Global Views

PIERRE BLANCHET
Head of Investment Intelligence

Tackle the EU fragmentation risks

Covid-19 is a symmetric shock with asymmetric outcomes. Existing imbalances within Europe such as public debt, economic models or vision for the union, turn to cracks and the EU is facing fragmentation risks. However, the EU should be able to get over it as it did with the Global Financial Crisis.

The *Conference on the Future of Europe*, planned earlier this year, will probably open in September in a very different context than initially thought. Who will chair it and whether or not a new treaty for the union will be at the agenda is still unclear, but what is clear is the need to strengthen both the institutions and the financial architecture of Europe. Indeed the European Union (EU) is suffering from a **risk of fragmentation along several lines,** which could deeply undermine its ability to deal with the upcoming decade challenges.

Debt & growth fragmentation

More than twenty years since the inception of the euro, northern countries GDP per capita is nearly twice of the south. Monetary union proved to be conducive to economic convergence between 1999 and 2008. However, **since the GFC, economic fragmentation has increased,** particularly in the Eurozone (EZ) as a result of the sovereign debt crisis. To put it another way, Europe functioned well when «everything was going well», but has shown its shortcomings in times of crisis, especially on the EMU side. As a consequence of economic fragmentation, national debts are increasingly diverging. The decoupling between France and Germany is striking in this respect and shows that fragmentation is not confined to the North/South axis. Since the EZ crisis, the level and **management of public debt is the major source of tensions and mistrust among member states.** North vs. south public debt imbalances structures the bond market breakdown between core vs. periphery and spread movements incorporate a remainder of convertibility risk, which never fully disappeared.

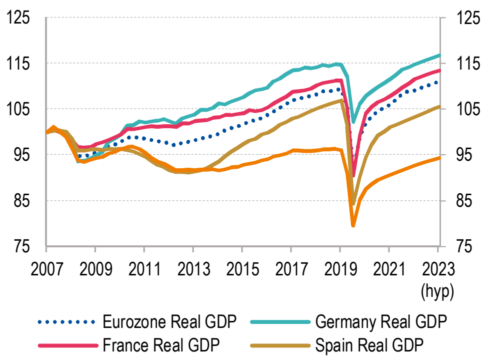
Public debt imbalances are a major source of tension in the Eurozone

The covid-19 crisis has amplified the real economic fragmentation of the EZ. By an unfortunate accident of history, it is indeed the countries with the highest debts and/or which had suffered most economically from the sovereign debt crisis that are the first victims of the current crisis (Italy and Spain). Large deficits **post Covid-19 will lead to further divergences between north & south,** and subdued real growth in the South will raise a debt sustainability question at some point in time. The ECB's asset purchase programmes play a key role in avoiding increased financial fragmentation (sovereign debt, corporate debt). Nevertheless, this can only be a temporary fix to a structural problem. Pan-European transfers and national reforms are the only way to deal with these imbalances and thus to strengthen the EZ's resilience to future shocks. This crisis (like the previous one) shows the shortcomings of EMU's financial and institutional architecture.

Economic model fragmentation

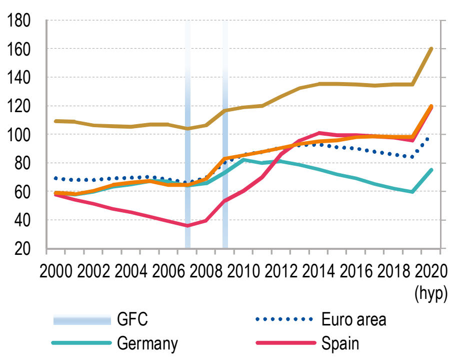
The second fragmentation risk comes from another factor, which can be summarised as internal vs external dependency and type of economic models. Some countries rely more on external demand than others do. The EZ has an external trade surplus of 7% of GDP(2019 numbers). All EZ countries are showing a surplus (except France…) but several countries have a larger surplus extra Euro-zone such as Germany (6%) or The Netherlands (+11%). This illustrates that the surplus savings of Northern European countries do not come to finance the investment needs of Southern countries. Moreover the northern countries reliance on global trade is greater (autos, industrial goods) than that

1/ Italy unlike Spain never fully recovered from the GFC



Source : Amundi Research, Data as of 22nd June 2020

2/ Spanish Debt to GDP has tripled since the GFC



Source : Amundi Research, Eurostat, Data as of 22nd June 2020

THEMATIC

of the rest of the EU27. Other countries rely more on internal demand particularly those with a stronger service sector like France or Spain[1]. The Covid-19 crisis has shown that these differences are a **source of vulnerability, since a symmetric shock brings asymmetric outcomes.** Hence, the European Commission's "Recovery Fund" proposal to address this issue.

Trade Balance 9 Countries*	2019 GDP (EUR Bn)	Intra Eurozone Balance % GDP	Extra Eurozone Balance % PIB
Germany	3 435	7%	0%
France	2 419	1%	-4%
Italy	1 788	3%	0%
Spain	1 245	-3%	0%
Netherlands	812	-12%	20%
Belgium	473	-2%	5%
Austria	399	4%	-5%
Ireland	347	12%	6%
Portugal	212	-2%	-8%

* 9 countries which represent 95% Eurozone GDP
Source: Amundi Research, Eurostat

Vision for the EU

The third fragmentation comes from the national vision for the EU, which is more complex than the traditional federalists vs nationalists dualistic debate. Whereas the EU project was considered, still a decade ago, as a positive way forward in bringing peace and wealth to Europeans, diverging aspirations have arisen among and within member states. It should be remembered that, at the origin of the euro, all EU countries were supposed to join the monetary union. Today the European project has become ambiguous. The Brexit requires a rethinking of objectives beyond the EZ's economic and financial dimension. European institutions such as the ECB and the ECJ are being challenged by the German Constitutional Court, illustrating **a deeper divide on the axis of the political legitimacy of the institutions**. In addition, national opinions are keen to maintain a degree of sovereignty over sensitive issues (such as foreign policy and migration policy), which is reflected by the rise of 'anti-establishment' parties in national elections. The debate between federalists vs nationalists has changed into *globalised elite* vs *real people*. These tensions should not be underestimated as they are at the heart of the Brexit vote.

Diverging visions for the union have arisen among and within member states

That said, the difficulties encountered by the British Government with Brexit (and the economic cost associated with it) are a deterrent. It can be observed that the anti-establishment parties (in France and Italy) no longer put an exit from the euro on the agenda. **Ironically, Brexit could even open up new prospects for the EU project**. Indeed, the Eurozone's share of EU GDP rose from 72% (EU-28) to 86% (EU-27). France and Germany, taken together (which account for more than 50% of the Eurozone's GDP), are de facto becoming Europe's new centre of gravity, which could make it easier to set up a "new project".

The Covid-19 crisis has increased economic fragmentation in the EZ and illustrates once again the need to strengthen the Eurozone's financial architecture. **The debate on risk sharing goes far beyond the debate on fiscal federalism, which northern countries refuse to implement**. The crisis illustrates the need to forge "tools" that can absorb asymmetric shocks without putting taxpayers in the north in a position of having to pay off the south's debts one day. There are many proposals to share risks better. The strengthening of the capital market union, the creation of a common debt instrument, and the revision of the budgetary rules of the Growth and Stability Pact (which have proved too pro-cyclical) are all on the table. But, like any compromise, it will require concessions from the countries that will potentially benefit from transfers in crisis times. Member states will request a 'right of scrutiny' of the policies put in place.

Increased imbalances and fragmentation could become irreversible if they are not addressed. The forces in play are more complex than the classic north/south public debt imbalance, as economic models and vision for the EU are two other axis of discord. The Next Generation EU instrument partially deals with those risks but requires more political support in order to help the union moving forward.

[1] *"Countries and regions with economies dependent on client facing services, exports or a high number of small businesses, will be hit much harder than others. And while every Member State has supported its workers and companies as much as possible, not all can do this to the same extent. This creates the risk of an imbalanced recovery, an uneven playing field and widening disparities." EU Recovery Fund proposal*

THEMATIC

Brexit: don't rule out a no-deal exit

The Brexit saga, somewhat overshadowed by the Covid-19 crisis, continues and could return to the spotlight this summer. While rounds of negotiations follow one another without concrete progress, the British refusal to extend the deadline raises the risk of an exit from the Single Market without an agreement at the end of the year. The consequences for sterling and UK equities could be negative. However, it is likely that in the face of the risk of disrupting the economic recovery from the historic recession we are going through, pragmatism will prevail in the end.

TRISTAN PERRIER
Global Views Analyst

PIERRE BLANCHET
Head of Investment Intelligence

The Brexit theme has resurfaced after a few weeks during which all the attention was captured by the Covid-19 epidemic (which contaminated some of the main decision-makers on both sides of the Channel). Negotiations have resumed with new momentum under Prime Minister Boris Johnson in recent days, but with no significant progress as the timetable tightens and tensions rise between the parties.

No progress and no extension

At the time of writing, the United Kingdom refuses to ask for an extension of the transition period beyond the end of 2020 (the deadline for making this request is, in principle, 30 June), as suggested by Michel Barnier, the negotiator for the European Union. Barring an extension, and in the absence of other agreements, the UK, which left the E.U. on 31 January, would suddenly lose its access to the Single Market on 31 December.

On the other hand, the negotiation of a free trade agreement still faces significant differences of opinion. The E.U. wants a comprehensive agreement with a mechanism *guaranteeing a level-playing field*. The United Kingdom, for its part, intends to give priority to a number of sectors. Above all, the UK rejects any mechanism that would lead to a quasi-automatic adjustment of its legislation with the rules of the Single Market, and to the settlement of disputes by the European Court of Justice. Moreover, British negotiators are challenging the European interpretation of the agreement signed at the end of 2019 on the Irish border, which proved the most difficult point to resolve to allow the UK to leave the EU. Finally, on sensitive issues such as fishing rights or judicial cooperation some key issues remain unresolved.

The prospects for rapid release are low

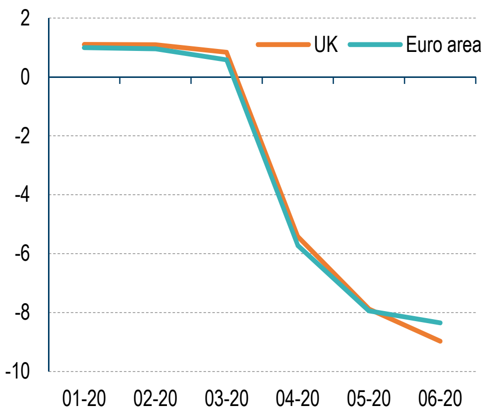
Political incentives do not, in fact, play in this direction. On the E.U. side, member states are concerned that the United Kingdom could gain "A la Carte" access to the Single Market and, ultimately, a regime more favourable outside the union than within. On the British side, Boris Johnson, although challenged for his handling of the epidemic, can count on a very strong parliamentary majority that does not force him to reach a quick agreement. Boris Johnson also does not want his mandate to focus solely on negotiating Brexit. In addition, the perception of the economic risks of a no-deal exit at the end of 2020 may have become a worry of secondary importance compared to the immediate damage caused by the epidemic.

Markets will discount the no deal exit in 2H2020

The risk of a "Brexit cliff" at the end of 2020 is therefore real, with trade between the EU and the UK governed only by WTO clauses. As this deadline approaches, markets may be concerned. Indeed, the economic cost of

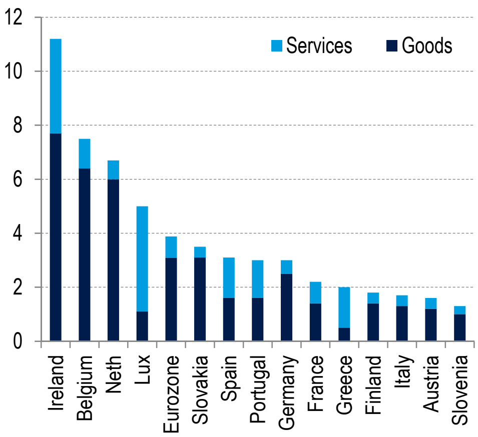
The risk of a "Brexit cliff" at the end of 2020 is real

1/ The consensus now expects the 2020 GDP fall to be worse in the UK than in the Euro area



Source: Consensus Economics, Amundi Research
Data as of June 15 2020

2/ Exports to the UK, % of GDP of each exporter country



Source: IMF, Amundi Research - Data as of 2016

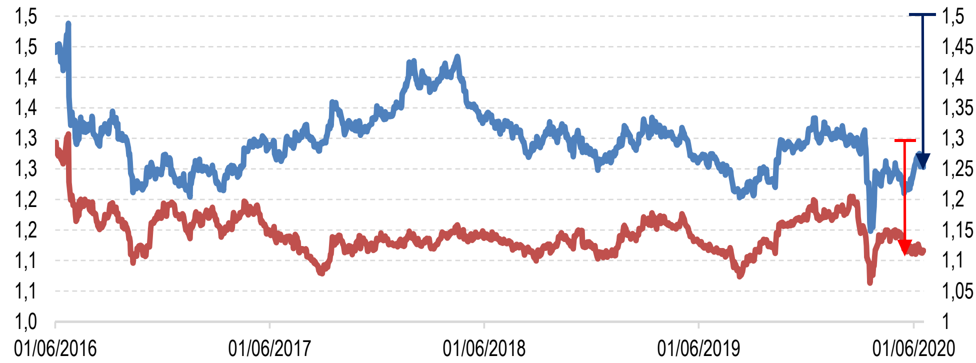
THEMATIC

Markets may discount the risk way before the year-end deadline

introducing tariffs and trade frictions (border controls, divergences in standards) could be significant. The perception of that cost could increase in a few months, when the UK economy starts its convalescence, and all the attention is no more grabbed by the immediate GDP collapse due to the pandemic. Moreover, if not fully resolved by this date, the issue of the Northern Irish border could have serious political implications both for the UK (as a physical border could threaten the 1998 peace agreement), and for the EU (as an open border could be a breach in the integrity of the Single Market).

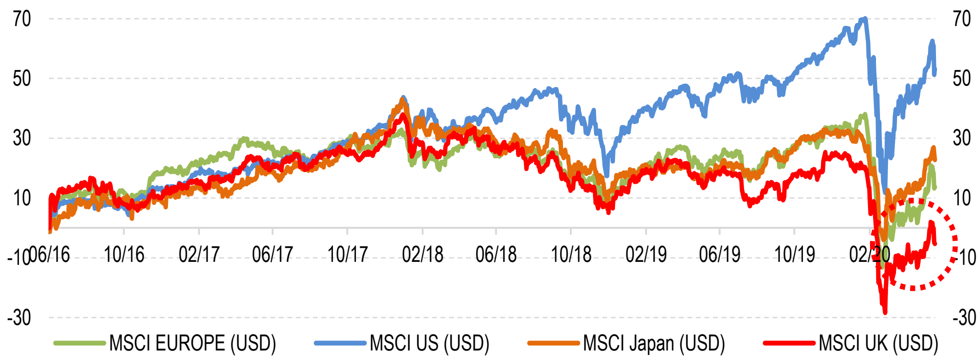
Sterling, which has lost almost 20% against the US dollar since the June 2016 referendum, could fall again (especially against the euro) if the probability of a "no-deal" increases. The market for Gilts (British Treasury Bills), which is mainly driven by domestic investors, is not expected to be impacted, especially as the Bank of England is engaged in a substantial programme of repurchasing crown debt. However, the corporate bond market could be penalised, as could some sectors of the share rating that are strongly intertwined in the Single Market (such as industry and finance). Over the past four years, UK equities have underperformed the world's major markets (-20% against Europe and -50% relative to the US in USD). As it usually happens with political catalysts, markets will probably discount the risk exists way before the year-end deadline, and then move in the opposite direction post-event. Therefore, the downside risk on UK risk assets could be concentrated a 2H2020 topic rather than a 2021.

3/ **Sterling since the EU referendum**



Source: Amundi Research, data as of 17th June 2020

4/ **Relative performances of major equity indices since the UK referendum on the EU (in USD, rebased)**



Source: Amundi Research, data as of 17th June 2020

Eventually pragmatism should prevail

It remains possible, however, that the growing perception of these risks will lead policymakers to narrow their differences and keep trade from being based solely on WTO rules. Despite all the obstacles, the conclusion of a limited free trade agreement is not entirely impossible (remember that the initial situation is that of regulatory alignment, which is not the case in negotiations with third countries). Temporary sectorial measures to mitigate the trade shock could still be concluded. The 2019 negotiations showed that Johnson may be more pragmatic at the end of the race than his tone would suggest.

In any case, it is unlikely that this new episode of the Brexit saga will end for several months. An agreement, if any, must, in theory, be secured by this autumn to leave enough time for its approval by national and European bodies. While it could still end favourably, this soap opera, whose first episode dates back to 2016, certainly has new twists in store for us.

Finalised on 18/06/2020

THEMATIC

BBB-BBs, best investment profile in credit

In an environment of low growth, low interest rates and rising default rates, investment grade and BB-rated issuers remain the ideal segment for investing. (1) The major central banks will support directly these issuers for an extended period through their asset purchase programmes. (2) Investor demand will remain strong, driven by a need for yield in a low interest rate environment. (3) The probability of default of these issuers remains very low.

VALENTINE AINOUZ, *CFA*
Deputy Head of Developed Markets Strategy Research

BELLAICHE MICKAEL,
Fixed Income Strategist

We are not even thinking about thinking raising rates (Powell, June 2020)

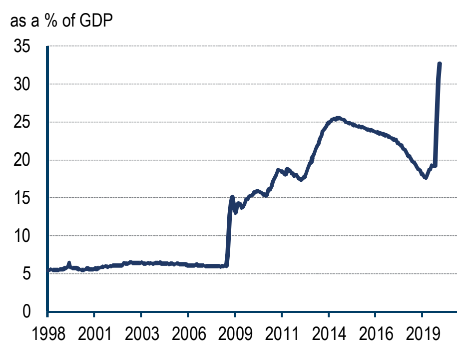
A slow recovery underpinned by unprecedented coordination between fiscal policy and monetary policy

The shock caused by the Covid-19 crisis is unprecedented in scale. The lockdown measures that helped to save lives have also led to a significant and rapid decline in global economic activity. The OECD and the World Bank recently announced there would be a decline in global GDP in 2020 of 5-6%. In parallel, the responses to the crisis by the various governments and central banks were also unprecedented in scale and rapidity. The governments that initially put in place support measures to help companies maintain their operating capacity and to prevent households from losing too much income, are now putting in place stimulus measures. The crisis has brought government deficits to historically high levels. In the US, the CBO estimates that the federal deficit will reach $3,700 billion in 2020 and $2,100 billion in 2021, representing around 18% and 10% respectively of GDP. The European Commission estimates that the public deficit in the Eurozone will reach around one trillion euros in 2020, equal to 8.5% of GDP. All of these estimates are likely to be revised upward over the coming months.

We will continue to see low interest rates over the next few quarters. In our view, this massive supply of sovereign debt is not likely to give rise to a significant increase in interest rates. The major central banks are purchasing assets at an unprecedented rate and absorbing governments' new financing needs.

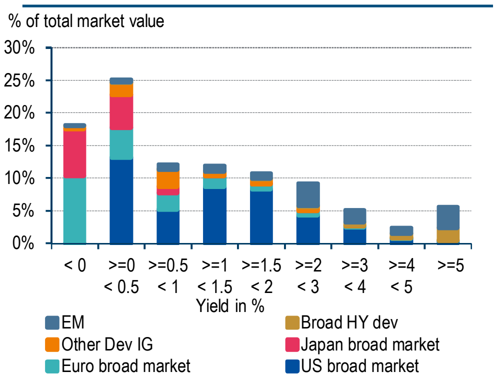
- The ECB increased the amount of its pandemic emergency purchase programme (PEPP) by €600 billion to €1,350 billion and has extended it until the end of June 2021 at least.
- At its last meeting in March, the Fed announced unlimited purchases of Treasuries and MBS. Federal Reserve Chairman Jerome Powell specified that the pace of purchases would be at least $ 120bn per month with $80bn of Treasuries and $40bn of Mortgage Backed Securities.

1/ G4 Central Bank Balance Sheet



Source: Bloomberg, Amundi Research as of 22/06/2020

2/ Fixed income market yield distribution



Source: Bloomberg, Amundi Research as of 22/06/2020

We believe that economic activity will not return to pre-crisis levels before 2022. There are clear objectives behind the coordinated central bank and government action: (1) limit the decrease in activity, (2) avoid massive company defaults, and (3) prevent a sharp increase in unemployment. A sharp increase in unemployment and company defaults would cause a depression and not just a temporary weakening of our economies. For this reason, the support measures for companies are a central element of the stimulus measures and the credit markets have become a central tool in the monetary policy of the major central banks.

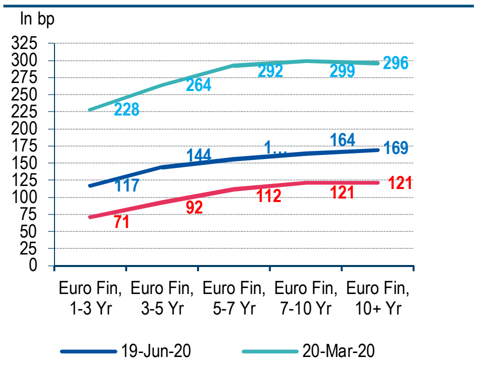
The central banks have taken substantial measures to improve financing conditions

The impact of the Covid-19 crisis on the credit markets has been remarkable. Spreads have widened, especially on the US market. Spread curves have flattened

THEMATIC

Strong central bank support will benefit BBB-BBs

3/ OAS curve : Euro IG Fin



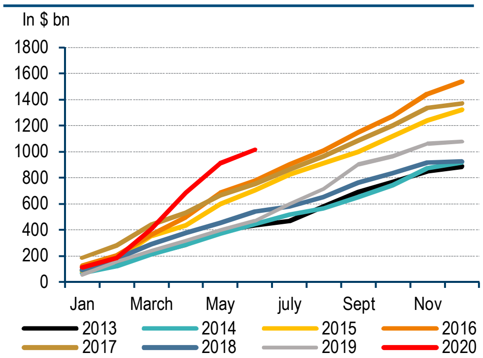
Source: Bloomberg, Amundi Research

significantly or even inverted. Activity on the primary market has slowed considerably. This hardening of financing conditions and the lack of liquidity would have had second-round effects on economic activity without CBs.

The central banks took substantial measures to improve financing conditions on the credit markets. Progress were rapid.

- Spreads tightened, particularly on shorter maturities.
- The markets benefited again from inflows as investor demand was underpinned by the central banks' engagement.

5/ US IG primary market (cumulative flows)



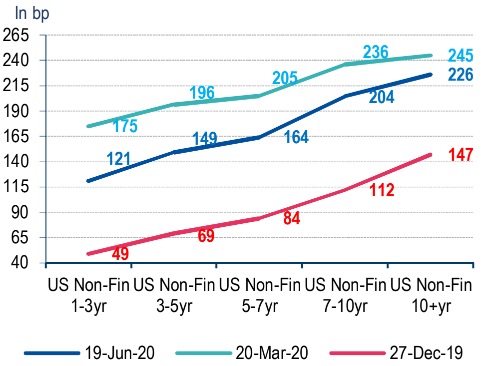
Source: Bloomberg, Amundi Research as of 20/06/2020

Default rates are expected to increase over the next few quarters

It is difficult at this point to assess the impact of the crisis on the solvency of companies. There continues to be easy access to liquidity for most issuers: state-guaranteed loans, use of existing credit lines or deferral of maturities. This is a sharp contrast with the great financial crisis when banks withheld credit to protect their balance sheets exacerbating the downturn. Banks are better capitalized and benefit from the strong support of central banks than during the great financial crisis. Otherwise, the ECB long-term refinancing operation was a success: banks borrowed a record of 1.31 trillion euros from the ECB. Banks will use about €760bn of ultra-cheap loans to repay earlier ECB loans and will use the €549bn remaining to lend to corporates and to buy bonds issued by their own governments.

It is important that we make a distinction between companies in difficulty whose situation will normalize and those whose situation will continue to deteriorate. When the state-guaranteed measures run out, companies with very high debt and low capacity to generate profit will be in trouble. It should be noted that many companies already had high debt before the Covid-19 crisis, and companies that borrow to maintain their production capacity are simply increasing their debt.

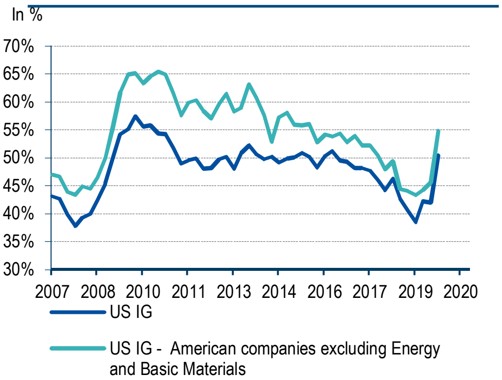
4/ OAS curve: US IG Non-Fin



Source: Bloomberg, Amundi Research

- Activity on the primary market for investment grade issues reached record levels in the US and Europe. Volumes on the US IG primary market have already reached one trillion dollars in 2020, equivalent to the total full-year issuance seen in 2019.
- Activity on the high yield market resumed in the US following the Fed's decision to expand its support to investment grade securities that dropped into high yield (fallen angels) due to the crisis.
- Companies used the funds raised to strengthen their balance sheets and raised their cash holdings

6/ US IG - Cash ratio



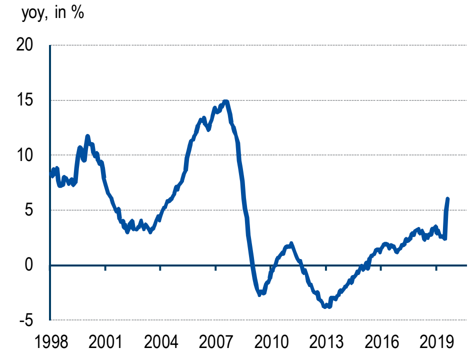
Source: Bloomberg, Amundi Research as of 1Q 2020

THEMATIC

Default rates are on the rise

Moreover, an increase in non-performing loans could cause banks to tighten their financial conditions. In this scenario, companies would not benefit from increased bank liquidity which would give rise to an increase in surplus reserves.

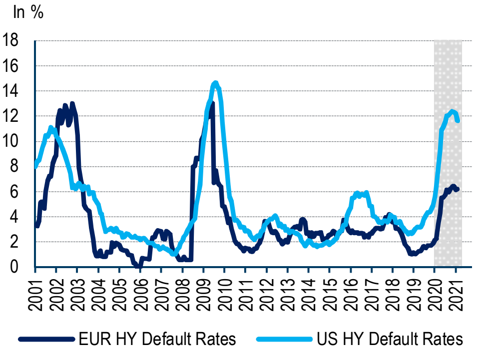
7/ Euro Area Loan to Non-Financial Corp



Source: ECB, Bloomberg, Amundi Research as of 30/04/2020

We anticipate an increase in defaults over the next few quarters. The company default profile could spread out over time and differ from the peak seen in 2008. This would see companies not going into default due to a lack of liquidity but rather due to a lack of profitability in relation to high debt levels.

8/ 12M forward default rate



Source: Moody's, Amundi Research as of 29/05/2020

In this context, investment grade and BB-rated issuers remain the ideal strategy in an environment of low growth, low interest rates and rising default rates.

1. The major central banks will support these issuers for an extended period through their asset purchase programmes. These companies will be favoured to bolster the recovery and limit an increase in unemployment.
2. Investor demand will continue to be driven by a need for returns in an environment of low interest rates. The coordination of fiscal and monetary policies should help to avoid an increase in bond yields.
3. The probability of default of these issuers remains very low. Companies have used the funds raised to shore up their balance sheets.

Finalised on 22/06/2020

THEMATIC

U.S. Housing Outlook
Why We Don't Expect a Collapse in Home Prices

NOAH FUNDERBURK,
Vice President,
Portfolio Manager
Amundi Pioneer

Many investors are using the Global Financial Crisis as a stress test for what may come in the years ahead

With median incomes expected to decline, we expect modest declines in home prices in 2020. The base case scenario for home prices has deteriorated. Of greater importance, in our view, is that the stress scenario of substantial home price declines remains remote. A retrospective analysis of the 2008 Global Financial Crisis suggests that home prices are unlikely to decline substantially, because the conditions that led to the crisis were unique and in most cases the opposite of the current environment.

In a few short weeks, the public policy response to COVID-19 has drastically changed the economic outlook. Faced with the prospect of double-digit unemployment, many investors are using the Global Financial Crisis (GFC) as a stress test for what may come in the years ahead. While this is an instructive exercise, the applicability of the GFC's headline numbers to today's housing market is limited by the drastic differences between today's housing market and the one that led to the GFC. Rather, by dissecting the drivers of home prices, one can form more realistic expectations and sensitivities around those expectations. We currently forecast modest single-digit home price declines in the coming years, and we maintain our focus on median income as the most important driver of home prices going forward.

What causes home price changes?

Though they are intertwined, it is helpful to separate the drivers of changes in home prices into four categories:

1. Affordability Correction
2. Supply Surplus
3. Distressed Selling
4. Declining Income

Affordability correction

Affordability is destiny for home prices. Historically, homeowners have been willing to spend roughly one-third of their monthly after-tax income on housing. This is captured in the chart below, where we compare the "market value" (median home sale price) with an estimate of "fair value". We estimate fair value by calculating the home price that is affordable to the median income household spending 30% of its after-tax income on a home using traditional financing (a 20% down payment and conforming mortgage rates). In the years immediately before the GFC, the chart shows that the long term relationship between market value and fair value broke down, with market prices skyrocketing amidst a debt-fuelled speculative bubble. When the bubble popped, prices overcorrected to the downside. In the roughly eight years since home prices bottomed out, we have seen home prices recover, but not enough to reach fair value. Because the housing market entered into the current recession with broadly affordable home prices, we do not expect a correction as we witnessed during the GFC.

Supply surplus

Every year, new homes are built in order to satisfy the incremental demand from the new households that are being formed. In the near term, home prices fluctuate to balance housing supply and housing demand. In the years immediately before the GFC, spurred by an errant price signal, home builders rushed to add supply, only to see housing demand plummet at the onset of the crisis. The subsequent surplus exacerbated price declines. Since then, single-family housing starts (new construction) have yet to recover to a rate that matches long-term household formation rates. As a result, the housing market entered the current crisis with the lowest inventory levels in decades. In our view, there are two implications for home prices going forward. First,

Drivers of Home Price Declines

	2008 Financial Crisis	Current Crisis
Affordability Correction	↓ Home prices corrected from unaffordable pre-crisis levels.	↑ We enter the current recession with broadly affordable home prices.
Supply Surplus	↓ Home builders had overbuilt during the boom years prior to the Global Financial Crisis, resulting in a surplus.	↑ Underbuilding over the past ten years has left the housing market in a shortage, not a surplus.
Distressed Selling	↓ Millions of homeowners were pushed into foreclosure during the global financial crisis, with distressed sales eventually comprising more than 40% of all home sales.	↑ Fundamental shifts in mortgage finance policies have mandated proper loan underwriting along with improved loss mitigation strategies that prioritize modifications over liquidations.
Declining Income	↓ Median household incomes declined roughly 8% during the financial crisis.	↓ We expect incomes to decline, bringing home prices modestly lower on the margin.

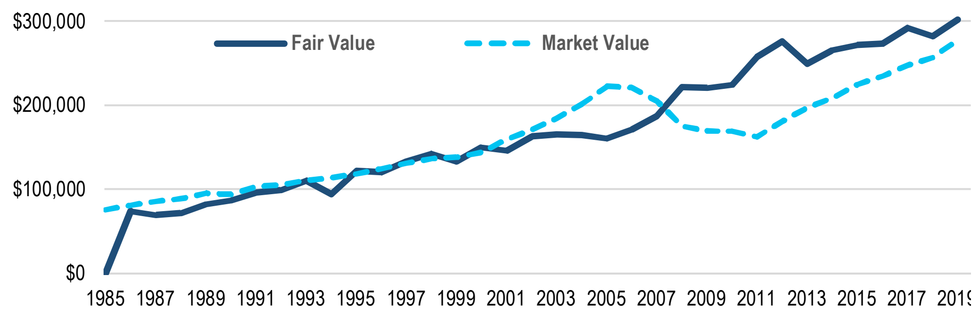
Source: Amundi Pioneer. May 2020.

THEMATIC

While housing demand decreases as unemployment and uncertainty spike, a new equilibrium could largely be met through quantity rather than price

Housing is a real asset whose price has tended to fluctuate with incomes

1/ **Housing: Market Value vs. Fair Value**



As of December 31, 2019, data is updated semi-annually. Source: Amundi Pioneer, National Association of Realtors and Federal Housing Finance Agency (FHFA).

entering the current crisis from a position of shortage rather than surplus could insulate the housing market from drastic home price declines. Second, while housing demand decreases as unemployment and uncertainty spike, a new equilibrium could largely be met through quantity rather than price, as new home construction will decline far more than prices.

Distressed selling

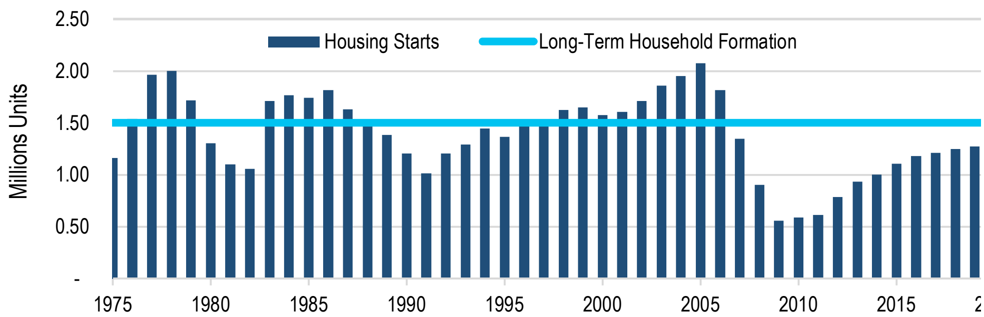
During the GFC, distressed housing supply skyrocketed, creating a feedback loop that furthered home price declines. Millions of newly unemployed homeowners elected to quit making payments when overly optimistic pre-crisis appraisals left them with no equity to defend in their homes. Millions more experienced financial distress despite stable employment when the short-term "teaser rates" expired on their mortgages, causing their monthly payments to become unaffordable. Before foreclosure moratoriums were announced in 2010, distressed sales had climbed from 6-8% to above 40% of all home sales. (Source: Attom Data Solutions, 1/31/2017)

Distressed sales tend to trade at a discount to non-distressed sales, because the buyer has pricing power. The transactions are often cash-only, and in many cases prospective buyers have been unable to conduct an internal inspection. Historically, distressed home sales have tended to drag all prices lower, due to the 'substitution effect'. Though distressed sales are expected to rise in the current crisis, we do not forecast anything near the magnitude seen during the GFC, because of the lessons learned during that crisis. We expect the impact of distressed sales on aggregate home prices to be limited because the supply will be limited as a result of better underwriting, appraisals, mortgage products and loss mitigation procedures that prioritize modifications over foreclosures. Additionally, for the minority of mortgage delinquencies that are ultimately resolved via liquidation, the foreclosure process will take even longer subsequent to the forbearance programs that have been announced. By the time distressed housing supply arrives, we expect aggregate incomes will already be in recovery mode.

Declining income

Housing is a real asset whose price has tended to fluctuate with incomes. With incomes expected to decline, home prices should be expected to decline as well. This is the one factor affecting home prices that overlaps with the experience of the GFC. In fact, we believe unemployment could climb more rapidly during the current recession compared to prior recessions. That said, we believe the focus for home prices belongs on income, due to the long-term and intuitive relationship between home prices and income, and because unemployment

2/**Housing Starts vs. Household Formation**



As of December 31, 2019, data is updated semi-annually. Source: Amundi Pioneer, National Association of Realtors and Federal Housing Finance Agency (FHFA).

THEMATIC

We assign low probabilities to scenarios that mirror the home price experience witnessed during the GFC

Any improvement to the macroeconomic environment should translate into marginally higher home prices through marginally higher incomes and a return to a market characterized by a housing shortage

has historically been an imperfect proxy for income. Unemployment statistics are distorted by underemployed and discouraged workers, and there is a mismatch between the employment trends across the broad labour market versus the subset of the labour market that comprises current and potential homeowners. Finally, in the current recession, we note that the unprecedented income stabilization programs from the federal government should alter the historic relationship between unemployment and income.

Like many investors, we have leaned upon the lessons from the GFC to inform our expectations for the current crisis. Given the aforementioned differences between the GFC and today's crisis, we assign low probabilities to scenarios that mirror the home price experience witnessed during the GFC. We note that in the three recessions since the 1980s, the only one in which housing declined in the aggregate was the recession that housing itself caused.

Where Do We Go From Here?

We expect home prices to follow the broader economy lower, with modest single-digit declines in the coming year, followed by a recovery in home prices alongside an expected recovery in income and employment. In terms of supply and demand for housing, equilibrium should be reached largely through quantity rather than price. We expect extensive mortgage forbearance and modification programs to take place prior to lenders resorting to foreclosures and short-sales. With Fannie Mae and Freddie Mac having already announced up to twelve months of forbearance for borrowers experiencing hardship, and with typical liquidation timelines in the range of 12 to 24 months for borrowers who are unable to recover, we expect several years to pass before distressed supply meaningfully arrives, at which point incomes will have already begun to recover.

What Could Go Wrong?

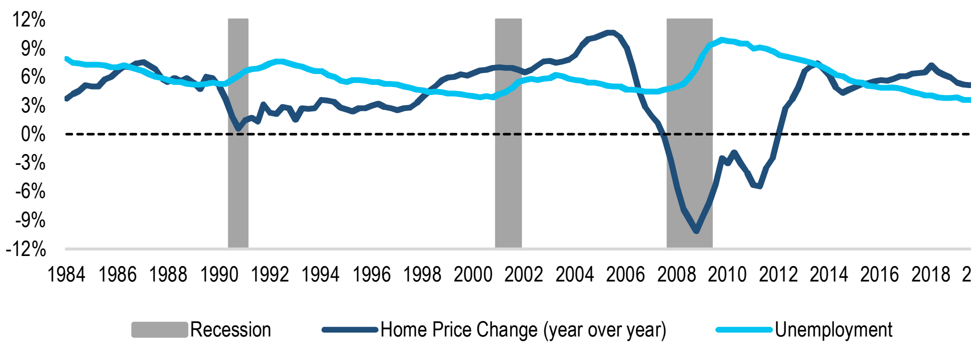
The rate of unemployment has spiked following the lockdowns on economic activity and could reach 20%, but we believe it should begin to decline after social distancing measures are relaxed and the economy begins to reopen. It could take several years for income and employment to fully recover, and the exact timing and path remains highly uncertain. A prolonged second or third wave of infection could set back the recovery, as could delays in the arrival of longer-term treatments against the virus. Additionally, the economic recovery is partially predicated on the effectiveness of fiscal and monetary policy. Should these prove to be insufficient or ineffective, median home prices will follow median incomes lower. Finally, we note that real estate is local. Home prices in the aggregate should not determine the outcome for all geographies and all price points.

What Could Go Right?

We entered into this crisis with the expectation that home price gains would modestly outpace inflation, but with risk to the upside due to the tight housing supply situation. We believe any improvement to the macroeconomic environment should translate into marginally higher home prices through marginally higher incomes and a return to a market characterized by a housing shortage. In addition, interest rates provide an upside scenario, even in less benign environments. Mortgage rates are currently near all-time lows, and yet mortgage rates are at their widest levels versus Treasury yields since the 1980s (with the notable exception of the three months immediately after the failure of Lehman Brothers in 2008). Today's record-low mortgage rates already provide a tailwind for home prices, but to the extent that the spread between mortgage rates and Treasury yields normalizes to historically normal levels, we believe this tailwind will only grow stronger.

Finalised on 17/06/2020

3/Home Prices Have Been Resilient to Recessions Except the Recession Caused by Home Prices



Source: Bloomberg As of June 17,2020

THIS MONTH'S TOPIC

HKD: sailing through the turbulence

Caught in the struggle between Beijing and Washington, can Hong Kong pull through the hardship without special trade status? Is Trump's announcement symbolic or destructive for the territory? Will the Hong Kong dollar peg fall apart? We review these questions one by one in this analysis.

CLAIRE HUANG
Macro-Strategist, EM

JOEVIN TEO
Head of Asian Fixed Income

Hong Kong to hold its shape without special trade status

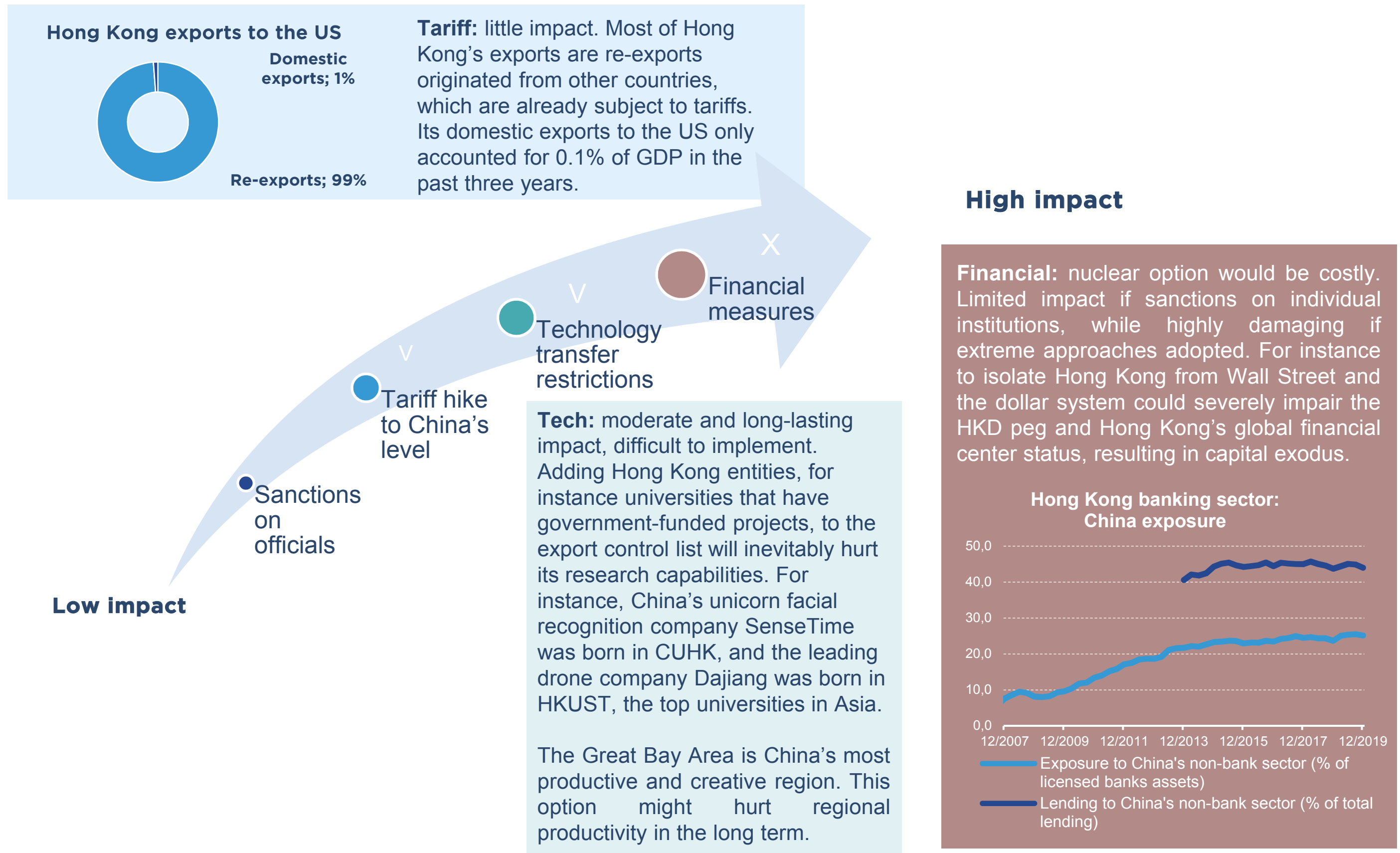
As a major global financial hub, and one of the most open economies in the world, Hong Kong is consistently ranked top in terms of economic competitiveness and institutional soundness.

However, the territory is not immune to the struggle between Beijing and Washington. In response to the introduction of National Security Law in Hong Kong at the end of May, the Trump administration announced plans to eliminate US policy exemptions for Hong Kong. After examining the options one by one, we found that the revocation of special status will leave Hong Kong in a similar position as before, unless the US opts for the "nuclear option" – isolating Hong Kong from the Wall Street.

Removing Hong Kong's trade preferential policy will result in a tariff hike that has little economic consequence, since Hong Kong's domestic exports to the US only account for 0.1% of GDP. The remaining majority are re-exports, which are subject to tariffs for countries of origins. Separately, given Hong Kong's small manufacturing base (1% of GDP) and the absence of participation in the regional production chain, adding Hong Kong to the US export control list will mostly affect R&D in the region but leaves the supply chain intact. Although the shock in the near term appears minimal, these new barriers could be costly for Hong Kong in the longer run in terms of its own technological advancement.

Markets are relieved for now, absent indications from the US to deprive Hong Kong of its financial access to the western world. To the US, this option could bring more harm than good. Today, Hong Kong not only contributes the most to the US trade surplus ($26bn in 2019), but also maintains net external claims with the US ($94bn at end-2019, or 0.5% of US GDP). In 2019, US firms had 278 regional headquarters and over 1000 regional/local offices in Hong Kong.

1/Hong Kong: caught in the US-China struggle



Source: Amundi Research, CEIC

THIS MONTH'S TOPIC

The free flow of capital, and free convertibility of the HKD will continue to be safeguarded by the Basic Law

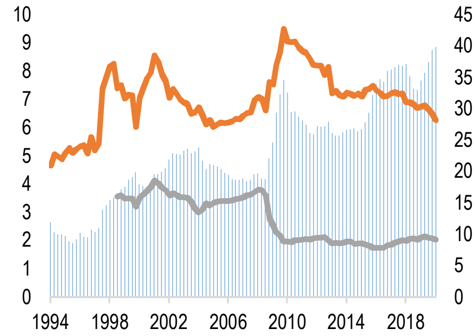
USD/HKD peg is here to stay

In light of elevated uncertainties, it is fair to ask whether Hong Kong can maintain its Linked Exchange Rate System (LERS) and continue to keep the USD/HKD in the targeted range (7.75-7.85). We believe both Hong Kong and mainland China authorities are willing and able to defend the LERS. It is also worth noting that Hong Kong has the autonomy to design its monetary regime, including exchange rate policy.

The latest policy remarks are indeed reassuring. HKSAR Government and HKMA have responded with strong messages reaffirming the free flow of capital, and free convertibility of the HKD will continue to be safeguarded by Article 112 of the Basic Law. Furthermore, PBoC stressed on 4th June it will unswervingly support the development of Hong Kong's financial markets, and maintain its economic and financial stability and prosperity. On 8th June, Beijing said it would enhance its supports to Hong Kong after the introduction of National Security Law. It will solidify Hong Kong's international financial center status, and continues to position it as a super-agent between mainland China and the rest of the world.

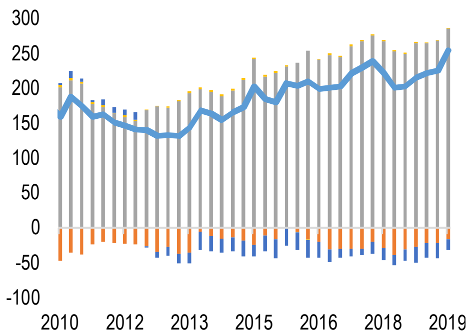
Meanwhile, the HKMA, which acquired a long record of capable financial management, has ample ammunition to defend the currency. It holds $440billion in foreign currency reserves – double the size of the entire monetary base – and covers 30-40 days of retained merchandise imports. Hong Kong's strong external positions should help as well. The territory maintains a gigantic net portfolio investment position to the rest of the world. During the turbulent times, repatriations of external investment assets could help mitigate outflow pressures from non-resident portfolio investments, even before the central bank needs to dig into its reserve savings.

2/ **Hong Kong: foreign reserves adequacy**



Source: Amundi Research,CEIC, HKMA, Data as of 5 June 2020

3/ **Net private international investment positions (% of foreign reserves)**



Source: Amundi Research,CEIC, HKMA, Data as of 5 June 2020

HKD's strength supported by equity inflows

HKD demand surged on equity inflows, driving HIBOR-LIBOR spread to the widest in 20 years

While there was a sharp movement in the spot USD/HKD after the NPC announcement, the USD/HKD has since traded near the strong end of the band. The abundant pipeline of IPOs has driven up demand for HKD, leading to a widening of the HIBOR-LIBOR spread to its widest in 20 years amid Fed's rate cuts. The wide interest rate differential in turn has been supporting HKD strength.

A couple of factors will continue to support the HKD's strength. With Hong Kong relaxing its dual-listing rules, more Chinese companies listed in the US will choose to dual-list at HKEX, which was the case for JD.com and NetEase. The dividend calendar of Chinese companies and strong southbound flows will bring extra inflows in the near term.

Alternative capital flow barometers, including housing prices and deposit growth, point to subdued outflow pressures so far. Despite the economic downturn in 2019-20, Hong Kong's deposit managed to eke out positive growth, led by foreign currency deposit expansion. Housing prices were slightly higher than a year ago, which was surprisingly resilient given the long-lasting social unrest.

A matter of confidence

We cannot rule out the risk that a significant escalation in US-China tensions will result in further retaliatory measures imposed by both sides. Although it is very unlikely for the US to pursue financial measures on Hong Kong, it is not completely impossible. The options range from excluding Hong Kong's banking sector from SWIFT to the withdrawal from bilateral regulatory

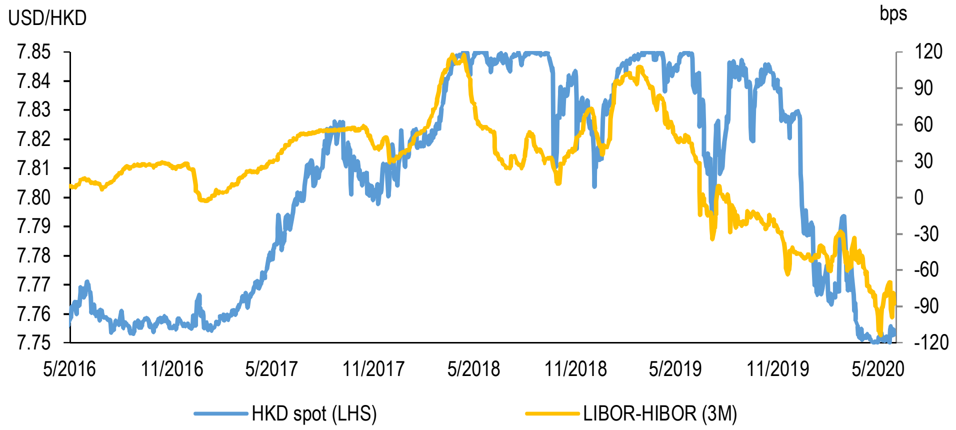
Hong Kong's competitiveness will be supported by high regional growth, and its position as a gateway to mainland China

agreements. For instance, the enforcement agreements between HK SFC and US SEC, and HKMA's position in the oversight committee in Fed-regulated CLS to name a few. In this risk scenario, capital exodus and a higher USDHKD may be inevitable. That said, HKMA may have just enough bullets to cover a sharp one-way sell-off, given the city's gross portfolio investment liabilities stood at 1.3x of its FX reserves. This is not a base case scenario, but any future expectations of Fed rate hikes could result in a narrower US-HK short end spread, potentially leading to HKD weakness. In such a situation, the HKMA would be able to drain liquidity in order to raise HKD interest rates; the structural viability of the peg would not be in question.

In the longer term, Hong Kong's competitiveness will be supported by high regional growth, and its position as a gateway to mainland China. These factors should ease some concerns of political uncertainties stemming from US-China relations.

Finalised on 11/06/2020

4/**HKD vs. interest rate differential**



Source: Amundi Research, Bloomberg, Data as of 5 June 2020

CENTRAL & ALTERNATIVE SCENARIOS

Monthly update

We marginally amend the narrative of our central and alternative scenario on the back of recent developments. We also increase the probability of our central scenario from 50 to 60% while reducing the likelihood of the upside scenario from 30 to 20%.

DOWNSIDE SCENARIO 20%

- **Second wave of outbreaks kicks in late 2020**
  - Pandemic expand with slow medical advances
  - National lockdowns measures are restored
- **Economic relapse in 4Q2020 and 1Q2021**
  - Surge of corporate defaults lead to a solvency crisis
  - Persistent high unemployment and rising social tensions
- **Deep and long global recession leads to a depression and a financial crisis.**
- **Monetary and Fiscal policies aren't sufficient enough**
  - Central Banks' constraints by size and liquidity
  - Fiscal responses in Europe happen too late
- **Secular stagnation** comes back to the fore, **debt monetisation** and **de-globalisation are the new paradigm**

CENTRAL SCENARIO 60%

- **Short-term rebound (3Q 2020) from deep short-lived recession 1H 2020)** and convergence to pre-crisis levels with divergences on timing and gaps (2Q 2021 in EMs, by end 2022 in AEs)
  - Pandemic is contained to manageable levels
  - Credit fragmentation and default surge
  - Unemployment slowly correct on the downside
  - Rising fragilities in S-Asia/S. Africa and LATAM)
- **Full debt (new issuance) monetization worldwide with ballooning central banks' balance sheets**
  - Urgency of stimulus fades entering 2021
  - Persistent headwinds (hysteresis effects uncertainty, corporate weakness, precautionary savings).
- **Manufacturing recovers faster than services**, consumption recovery is slow
- **Global trade recovers** but remains sluggish by historical standards. The global cycle is increasingly based on domestic engines
- **Slow recovery**

UPSIDE SCENARIO 20%

- **Economic activity recovers to pre-crisis levels by mid-2021 (US, EZ) with growth moving above its potential in 2H2020 – 1H2021**
  - Pandemic is almost suppressed (treatments, vaccine or natural disappearance)
  - Prompt and pre-emptive stimulus (Europe/ US) / high fiscal multipliers
- **Monetary and fiscal Policy fusion continues** with fast spill-overs to the real economy and financial markets
  - Pent up demand materializes (full mobilization of households forced savings , business investment restarts)
  - Policy aims at productivity increase
- **V shaped economic recovery leading to a strong risk asset momentum**

Assessing the recovery path post Covid-19

The pandemic has altered the picture we had at the end of 2019. Covid-19 has sent us into deep, global economic contraction bottoming out in the end of 2Q2020. A rebound will take place in 3Q2020. Thanks to policy boosters, we will progress into a sequencing recovery with divergences across and within regions. We expect EMs to converge to pre-crisis GDP levels in 2Q2021 while for AEs we have to wait the end of 2022.

In this environment, growth, rates, inflation, monetary and fiscal policies are strongly interconnected. **The potential mismatch of one could affect the overall results**. We expect ultra-accommodative monetary policies to persist, leading to stable and low interest rates worldwide. Strong demand from central banks will cap yields, while the recalibration versus the short end of the curves will ease tensions in the long end. In fact, governments are financing the emergency with short-dated issuance. Central banks' purchasing programs and state guarantees are supporting spreads, in an attempt to safeguard default rates, at least in the short term.

Carry amid low yields is boosting the appeal for credit. Monetary policies are lifting equity markets, but the decoupling from fundamentals is increasing downside risks. We are more cautious than the consensus and we expect EPS to drop and then to bounce back in 2021. The collapse of interest rates differentials and the secular US deficit are building the case for **a bearish USD in the medium term. Be cautious.**

TOP RISKS

Monthly update

Risks are clustered to ease the detection of hedging strategies but they are obviously linked. While we confirm the overall narrative on the outlook, pandemic exacerbated existing fragilities and vulnerabilities while more risks materialized in our radar: financial and geopolitical risks' probabilities are set to creep higher.

ECONOMIC RISK 10%

Depression

- **A Covid-19 second wave** with rising fatalities and restored lockdown measures would weigh on sentiment, increase national and international political tensions and trigger a "W shaped" the economic recovery.
- **A deep and long global recession** where demand remains weak regardless of stimulus packages, and unemployment stays high could undermine mid-term economic prospects. When the sanitary crisis is over, a coordinated response will be more difficult to achieve, leading the global economy to a prolonged stagnation
- **Widespread distress and default rate spikes** will force deleveraging and a pullback on investment and employment, turning the recession into a depression.

+ **Cash, linkers, JPY, Gold, USD, Defensives vs. Cyclicals**

- **Oil, risky assets, AUD CAD or NZD, EM local CCY exporters**

FINANCIAL RISK 15%

Financial instability

- **Mounting corporate vulnerability**
  - Prior to the Covid-19 crisis, corporate leverage reached levels above the pre-GFC highs.
  - The magnitude of the recession will increase solvency risks regardless of central banks' actions and government guarantee schemes.
  - Default rates could rise to 15% or even 20% with spill-over on the credit market and stress on banks' balance sheets.
  - Spill over into the banking sector and financial risk exacerbation
- **Sovereign debt crisis**
  - Public debt will rise as a share of GDP across most countries over the coming years, starting from already high levels in Europe, Japan and the United States. This could lead to rating downgrade and rising interest rates over the long term.
  - Emerging markets fragilities (single commodity exporters, tourism), could also face a balance of payment crisis and increase default risks.

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

- **Oil, risky assets, frontier markets and EM**

(GEO)POLITICAL RISK 15%

Covid-19 exacerbates political tensions

- **US-China fissures** are opening up in many areas from covid19 response to trade and technology. The US elections campaign and the hard rhetoric from President Trump could exacerbate tensions negative spill-over effects. Phase 2 deal might be more challenging with a deteriorated economic backdrop.
- **European fragmentation**
  - E.U. member states fail to agree and/or implement the Recovery Plan, eventually undermining the political integration
  - **Or** the Recovery Fund comes too late and its implementation lacks of momentum. This undermines the ECB's position as economic divergences are exacerbated and the EMU becomes unsustainable.
  - Diverging vision about the future of the EU could lead to exit.
  - No-deal Brexit
- **A wave of new trade conflicts** on the back of the Covid-19 crisis and national security interests.

+ **DM Govies, cash, gold, linkers, USD, volatility, quality**

- **Oil, risky assets, EMBI**

Methodology

- **Scenarios**

The probabilities reflect the likelihood of financial regimes (central, downside and upside scenario) which are conditioned and defined by our macro-financial forecasts. We use the k-means clustering algorithm to our enlarged macroeconomic dataset, splitting the observations into the K cluster, where K represents most of the variability in the dataset. Observations belong to one cluster or another based on their similarities. The grouping of the observations into the k clusters is obtained by minimizing the sum of squared Euclidean distances between observations and clusters centroids i.e. the reference values for each cluster. The greater the distance, the lower the probability to belong to a given regime. The GIC qualitative overlay is finally applied.

- **Risks**

The probabilities of risks are the outcome of an internal survey. Risks to monitor are clustered in three categories: Economic, Financial and (Geo)politics. While the three categories are interconnected, they have specific epicentres related to their three drivers. The weights (percentages) are the composition of highest impact scenarios derived by the quarterly survey run on the investment floor.

CROSS ASSET DISPATCH: Detecting markets turning points

How to the read turning point assessment

Not reached yet too early to call it | Approaching to the turnaround | Turnaround happened

ECONOMIC BACKDROP

– Global consensus keeps falling but although it may fall further as Q2 data related to the lockdown period become available, economic surprises should mean revert (i.e. start becoming less and less negative) as consensus already corrected significantly. In the US, Economic Surprise Index (Citi) has reached historical highs on the back of positive surprises both on soft and hard data.

FUNDAMENTALS & VALUATION

– **We expect earnings to drop in Q2 and Q3 this year and to bounce back in 2021.**
  - In general, potential upside in the central case is not big enough to counterbalance further potential drawdown of the downside risk scenario.
  - Valuation: PEs are far from flagging potential entry points in H2 (S&P500's PE @ 17 and Euro Stoxx 600 PE @ 15 2020).

DEFENSIVE ASSET ALLOCATION

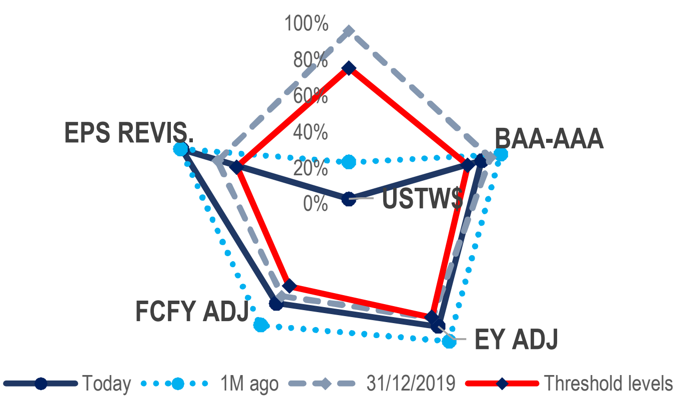
TECHNICALS

– When dealing with tactical signals (ie. Technical factors in addition to pure sentiment indicators) **the picture remains fragile but signs of improvement are visible versus last month.** Technicals proved to move the market since the end of March (Trend following signals kept on suggesting there space for risky assets), but sentiment indicators, which stayed negative since the Covid-19 outbreak, starting to improve less negative at the beginning of June.

SENTIMENT

– Financial conditions eased further on the back of Central Banks' intervention i) Banking System's Health proxies - TED, Libor/OIS, Comm. Papers - back to normal levels and, ii) Corporate Spreads tightened massively. However, **the main change in sentiment relates to our CAST Call, which turn risk supportive on the back of USD** (QoQ) dynamic. From a flows perspective (State Street data) the mood, after being "neutral+" in April and May, moved strongly in RISK ON territory on the back of renewed appetite for high yielders (both corporate and sovereign) and equities lately (Asset Allocation change to equities surged since the beginning of the month).

Cross Asset Sentinels Thresholds (CAST) touching the top



Amundi Research, Data as of 15 June 2020

CAST flags extremely high risk perception.

Sentinels receded from alert levels due to dollar weakening and some relies in financial conditions.

Methodology We consider five inputs which we call "Sentinels": USTW$, Moody's Baa-Aaa, EPS revisions, Earning Yield risk adjusted and Cash Flow yield risk adjusted. These sentinels are used to reposition our tactical asset allocation. Once sound thresholds are detected, the five variables are aggregated as an indicator that anticipates the market's stress conditions, with a certain level of conviction. The pentagon visualises the five sentinels where the red line represents the alert threshold. The greater the distance above the red line, the higher the risk perception, and eventually the need to move closer to a defensive asset allocation.

GLOBAL RESEARCH CLIPS

1 EUR

The appetite for EUR/USD has been rising too fast and too far. We confirm our 1.07/1.10 short-term target and our 1.14 medium-term target.

- Support for a stronger EUR since May has been driven by: (1) lower political risk perception (EU Commission's proposal of a Recovery Fund; lack of strong response by the US towards the China New Security Law in HK, and a commitment on both sides to keep the Phase One Deal alive); and (2) the rebalancing the growth premium towards the Rest of the World thanks to revamping fiscal expansion.
- Although we acknowledge EUR tail risk has fallen substantially, we remain of the view that **the current movement has overshot some short-term drivers.** Moreover, the **differential in EPS 12M growth expectation has continued favouring the US, and physical commodities (our preferred proxy for growth) haven't bounced back consistently**. We prefer EUR vs. GBP (while hedging Brexit risk) and expect a correction vs the USD.
- Financial conditions have eased but they remain fragile. We are struggling to see banks, which have been provided with ample USD liquidity (TED, LIBOR-OIS Spreads are back to normal levels) circulating it to the system. FX will continue to be the asset class pricing in this risk and supporting USD.

2 inflation

We expect short-term *low-inflation*, if not disinflation, risk. Then higher mid- to long-term inflation is likely, but hyperinflation isn't.

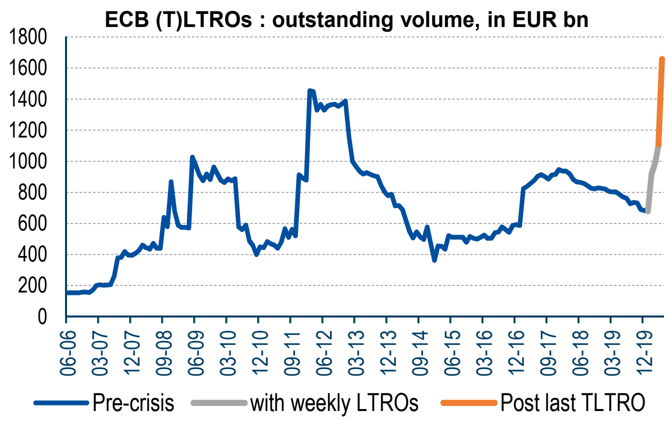
- A negative output gap and slack in the labour markets will overcome short-lived price spikes on selected items or the oil basis effect. ECB has a 0.9% target for 2022
- Debt overhangs amid prosecution of monetary and fiscal monetary fusion might lead to higher inflation rates in the medium to long terms.
- Central banks will be managing price dynamics systematically to avoid secular stagnation, in case real rates do not decline sufficiently to balance private sector savings and investment. CBs might possibly revise their mandates and allow temporary overshoots to avoid premature tightening.

3 Potential market catalysts

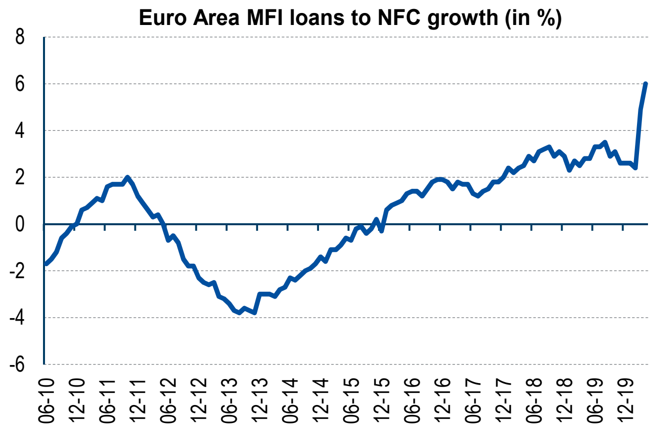
(+) A positive combination of falling virus cases, rising PMIs, and continuous policy support leading to rising growth expectations
(+) Consolidation of commitment and political capital in the Eurozone, with the European Council approving the EU Recovery Plan
(+) US labour market improvement
(+/-) US elections in November, year-end Brexit deadline
(-) Widening gap between China and EM
(-) German Constitutional Court's early-August deadline for the ECB's PSPP proportionality assessment

TLTRO: positive for spreads and supporting real economy

The ECB's TLTRO successfully added net €550bn of liquidity, on top of the €400bn already injected since March through weekly LTROs. Since the outbreak of the covid-19 crisis, almost a €1t of additional liquidity has been injected thanks to long-term financing. The high take- up represents a positive test for the effectiveness of monetary and fiscal policy in supporting SMEs and easing financial conditions.



Source: Bloomberg, Amundi Research. Data as of June 2020



Source: Bloomberg, Amundi Research. Data as of April 2020

AMUNDI ASSET CLASS VIEWS

	Asset Class	View	1M change	Rationale
EQUITY PLATFORM	US	-/=		The US market was a core holding in the 2009-2019 cycle. There is room for more cyclical markets to catch up, but US elections could bring uncertainty in the form of a potential victory for the Democrats (in both houses). That could potentially lead to changes in regulations and taxation policy. However, the huge liquidity being fueled into markets is here to stay, as are low interest rates, which may again support quality stocks, which make up a large portion of the US market. The US market is concentrated in a few large stocks and valuations tend to be better outside this concentration.
EQUITY PLATFORM	Europe	-/=		Europe has suffered during the past cycle. Two factors have revived international interest: the Recovery Fund plan, should it be confirmed, and the cyclical/value catch up. This revival has further to go. The risk is that if Europe is a value play, financials and energy – which are value sectors – are also disrupted sectors, which might limit their outperformance.
EQUITY PLATFORM	Japan	=		Japan experienced ups and downs in the previous cycle. Being one of the most cyclical markets in the world, it is benefiting from the current cyclical catch-up. Should it be confirmed, it could benefit for the remainder of the year.
EQUITY PLATFORM	Emerging markets	=		Globally, EMs have underperformed since 2011, except for the 2016-18 period. They could catch up, should the USD confirm a breakdown. Asia is potentially safer, given, among other factors, its exposure to technology, but US-China tensions and geopolitical risks (North Korea) could be a drag.
FIXED INCOME PLATFORM	US govies	=/+		From a global portfolio perspective, we maintain our preference for US Treasuries duration vs. other DMs, on better absolute and relative valuations and the Fed having more leeway available through unlimited QE. We expect the Fed to absorb most net additional issuance of US Treasuries over the next months. In US portfolios, we are cautious on USTs amid the rising fiscal deficit and the unprecedented fiscal support plans.
FIXED INCOME PLATFORM	US IG Corporate	=/+		Despite recent tightening, US IG spreads still offer attractive absolute and relative valuations. Primary market activity is high, benefiting from the search for yield and investment flows, while the Fed will keep supporting the demand for this asset class thanks to its QE programme. Selectivity is increasingly relevant in a weak macro and microeconomic environment.
FIXED INCOME PLATFORM	US HY Corporate	-/=	▲	HY should remain supported by recent backstop announcements from CBs. The valuations of US HY spreads look tighter than those in other credit markets. For this reason, together with liquidity issues, we favour high-quality versus low-rated names, as the latter discount only partially the rising default risk. Sector and issuer selection remains key.
FIXED INCOME PLATFORM	European govies	-/=		We are cautious on core European government bonds but slightly constructive on the peripheral countries after the ECB's recent expansion and extension of its PEPP, and the encouraging steps on the EU fiscal front. Core curves should remain stable, close to current yield levels. However, we still need concrete implementation details of the Recovery Fund.
FIXED INCOME PLATFORM	Euro IG Corporate	++		We are positive on Euro IG, particularly on BBB-rated debt and financials. The ECB will support the technicals of this asset class directly through CSPP and PEPP and indirectly as they push investors to hunt for yield. Among different credit markets, valuations look attractive, while fundamentals tend to show a lower financial leverage than in the US. However, selection remains key.
FIXED INCOME PLATFORM	Euro HY Corporate	=	▲	In EU HY default rates should rise less than in the US, thanks to the higher average credit quality and the lower exposure to the distressed energy sector. We prefer high-quality and more liquid BB-rated debt on the back of an attractive risk-return profile. A focus on selection, idiosyncratic risks and liquidity is extremely important.
FIXED INCOME PLATFORM	EM Bonds HC	=/+		We are cautious on EM debt but favour HC over LC. In the former, we see room for further spread compression between HY and IG and believe valuations are attractive in HY. The support from the USD strength should remain in the short term. However, the risk of sovereign default has to be monitored carefully.
FIXED INCOME PLATFORM	EM Bonds LC	=		We are neutral on LC and believe there is more scope for selectivity in this asset class. We are still prudent — but slightly more constructive — on the EM FX side. It is important to consider the US election risk.
OTHER	Commodities			The outlook is moderately positive for commodities, assuming a global recovery. WTI oil should move in the $/b 30-40 range, while dovish CBs and low real rates will support gold. Geopolitical tensions related to the US-China dispute should inflate some volatility within base metals as we approach the US elections.
OTHER	Currencies			As most countries ease lockdown measures and with the prompt policy intervention, USD will lose ground as we move into 2021. The reduction of the rates advantage and the expectations of a global growth rebound will reduce the appeal of US assets. The path will not be linear, as the short-term picture remains gloomy and liquidity does not necessarily translate into higher solvency.

LEGEND

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Negative | Neutral | Positive | Downgrade vs previous month | Upgraded vs previous month

Source: Amundi, as of 18 June 2020, views relative to a EUR-based investor. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This information should not be relied upon by the reader as research, investment advice or a recommendation regarding any fund or any security in particular. This information is strictly for illustrative and educational purposes and is subject to change. This information does not represent the actual current, past or future asset allocation or portfolio of any Amundi product.
IG = Investment grade corporate bonds, HY = High Yield Corporate; EM Bonds HC / LC = EM bonds hard currency / local currency. WTI= West Texas Intermediate. QE=quantitative easing.

DEVELOPED COUNTRIES

Macroeconomic outlook

Data as of 18/06/2020

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2019	2020 range	2021	2019	2020	2021
World	**3.1**	**-4.3/-2.9**	**4.0/5.1**	**3.0**	**2.4**	**2.5**
Developed countries	**1.7**	**-7.5/-5.9**	**3.6/4.8**	**1.5**	**0.7**	**1.1**
US	**2.3**	**-6.5/-4.5**	**3.0/4.0**	**1.8**	**1.0**	**1.2**
Japan	**1.2**	**-4.7/-4.1**	**2.0/2.6**	**0.7**	**0.1**	**0.5**
UK	**1.4**	**-9/-7**	**3.0/5.0**	**1.8**	**1.2**	**1.4**
Eurozone	**1.2**	**-10/-8**	**4.5/6.5**	**1.2**	**0.6**	**1.1**
Germany	0.6	-7.5/-5.5	2.5/3.5	1.5	0.7	1.2
France	1.2	-11.0/-9.0	6.4/8.4	1.3	0.6	1.1
Italy	0.3	-12.5/-10.0	3.8/5.8	0.7	0.1	1.0
Spain	2.0	-13.5/-11.5	6.5/8.5	0.7	0.3	1.0

Source: Amundi Research

- **United States:** while hard data help size the lockdown-induced impact on Q2 activity and production, soft and high-frequency data are showing a gradual pickup. As pent-up demand comes through, activity will rebound in Q3, followed by further improvement in Q4. We expect GDP to drop by 4.5%-6.5% y/y in 2020, followed by a rebound of 3.0- 4.0% y/y in 2021, and to return to its pre-Covid-19 level by mid-2022. Lockdowns have also impacted inflation, which is driven by shifts in demand and has exhibited short-term weaknesses in 2020, with reflating forecast in 2021 on base effects and a pickup in demand.
- **Eurozone:** after the trough in Q2 (GDP -13% q/q), we expect economic activity to rebound in Q3 & Q4, leading EZ growth to contract by 8-10% y/y in 2020, followed by a pickup of 4.5-6.5% in 2021. 2019 GDP levels are unlikely to be reached until late 2022. High-frequency indicators show the recovery is on track, although gradual, while confidence is not reaccelerating fast. Disinflationary pressures in 2020 are induced by shifts in demand or production shortages, although underlying components of the basket show diverging trends. In 2021, inflation is expected to normalise while remaining subdued vis-à-vis the ECB target.
- **Japan:** following a relatively short lockdown, Japan's domestic economic activities are gradually recovering. Mobility has picked up in workplace, retail and recreation areas. By mid-June, these activities were down by only 10% to 20% from March. In contrast, external demand indicators continued to weaken, with Q2 exports in their steepest fall since Q1 2009. We believe Japan is less impacted than other DM, with a better control over the Covid-19 outbreak, and forecast GDP to drop by 4.1% to 4.7% for the full year. Inflation will stay soft, as deflationary pressures persist in the services sector.
- **United Kingdom:** After a long lockdown, the UK will experience a deep and forced 2Q contraction, followed by a partial bounce-back as activity resumes in Q3. We expect a moderate subsequent recovery with a gradual pickup in domestic demand; we see a return to pre-crisis levels in 1H2023, although Brexit may further delay it. With demand restrained and high unemployment, we see deflationary pressures in the near term. Going into 2021, headline inflation will come back on base effects (oil prices), while core inflation will stay below target, while core inflation will stay below target.

Nota Bene: The uncertainty around our macroeconomic forecasts is very high, and it triggers frequent reassessments any time fresh high frequency data are available. Our forecasts at this point include a higher qualitative component, reducing the statistical accuracy and increasing the uncertainty through wider ranges around them.

Key interest rate outlook

	19-06 2020	Amundi + 6m.	Consensus Q4 2020	Amundi + 12m.	Consensus Q2 2021
US	**0.13**	**0/0.25**	**0.08**	**0/0.25**	**0.05**
Eurozone	**-0.50**	**-0.55**	**-0.56**	**-0.58**	**-0.58**
Japan	**-0.05**	**-0.2**	**-0.09**	**-0.2**	**-0.09**
UK	**0.10**	**0.00**	**0.06**	**0.00**	**0.03**

Source: Amundi Research

- **Fed:** The FOMC made just one policy change, by committing to maintain at least the current pace of asset purchases over coming months at $80bn in US Treasuries and $40bn in MBS per month. But it gave investors greater certainty that policy will remain on hold for a long time (through the economic projections, the dots and the reaction function). The Fed will wait to have more clarity on the path of the recovery before fine-tuning other monetary policy tools (strengthening in forward guidance, calibration of asset purchases with more clarity regarding its goal, and possibly introducing a front-end yield curve control). The median of members' projections sees near-zero federal funds rate at least through the end of 2022.
- **ECB:** The ECB has delivered a stronger than expected combination of measures:
  - PEPP increased in size: the envelope will be increased by €600 billion to a total of €1,350 billion;
  - Extended horizon of net purchases: the horizon for net purchases under the PEPP will be extended to at least the end of June 2021;
  - Long horizon fixed for reinvestments: the maturing principal payments from securities purchased under the PEPP will be reinvested until at least the end of 2022.
- **BoJ:** Following up on the government's plan to expand the no-interest/unsecured lending program, the BoJ increased its special lending program from ¥75tn to ¥110tn in mid-Jun, in addition to JGB purchases and ETF purchases at ¥12tn per year. The June meeting statement downplayed the inflation target, reducing the likelihood of further easing. Governor Kuroda also hinted the central bank will not raise interest rates in FY2021-22 before the Fed. He reiterated that the stability of the yield curve at low levels is important.
- **BoE:** At its last meeting, the BoE left rates unchanged and expanded its asset purchases by £100bn, broadly in line with the consensus of expectations. In signalling that, thanks to the latest extension, QE would see purchases run until year-end, the BoE is pointing to a slower pace of weekly asset purchases relative to the current one. Negative rates were not part of the discussion, confirming that for the time being QE remains the privileged tool of monetary policy

Monetary policy agenda

Central banks	Next meeting
Federal Reserve FOMC	**July 27**
ECB Governing Council	**July 16**
Bank of Japan MPM	**July 15**
Bank of England MPC	**August 6**

Source: Amundi Research

EMERGING COUNTRIES

Macroeconomic outlook

Data as of 18/06/2020

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2019	2020 range	2021	2019	2020	2021
World	3.1	-4.3/-2.9	4.0/5.1	3.0	2.4	2.5
Emerging countries	4.1	-2.1/-0.9	4.3/5.2	4.0	3.5	3.4
Brazil	1.1	-6.4/-5.0	-0.4/0.6	3.7	2.7	3.6
Mexico	-0.1	-8.1/-7.1	-1.0/0	3.6	3.0	3.5
Russia	1.3	-6/-4	2.5/4.5	4.5	3.2	3.9
India	5.3	-2.7/-1.3	2.3/3.6	3.7	5.8	4.9
Indonesia	5.0	-1.1/-0.1	3.5/4.5	2.8	2.5	3.1
China	6.2	1.4/2.4	7.6/8.2	2.9	2.4	1.9
South Africa	0.2	-6.4/-5.4	4.0/5.0	4.6	4.0	5.0
Turkey	0.8	-6.9/-5.9	4.2/5.2	16.2	10.5	9.8

Source: Amundi Research

- **China:** Economy continued to grow above trend sequentially in May, led by public investments and a steady pick-up of consumption. Q2 growth is tracking at 2-3%yoy, with seasonally-adjusted sequential growth close to 10%qoq, reversing the fall of 9.8% in Q1. We expect sequential growth to normalize down in H2. Year-over-year growth will print at 5-6% during the same period. Inflation has dropped faster than expected, driven by declining pork prices. We expect CPI to drop to 0%yoy in 4Q with subdued inflationary pressures and high base last year.
- **India:** the economy has shown further signs of weakness with May data, although the deceleration looks like milder than in April, as a consequence of a partial easing of lockdown since the beginning of the month. Freight Traffic and Electricity Generation declined by 21.3% YoY and 17.8% from 35.3% and 25.8% previously reported. Despite the lack of communication on the complete set of figures, Inflation seemed moderating in May. The fiscal outlook remains very gloomy and Fitch has revised the sovereign ratings outlook to "negative", while maintaining the rating at BBB-.
- **Central Europe:** The European Commission proposed a simulation of key allocations according to which CEEs will win except Czechia that could be one of the losers, paying net 0.6€bn (0.3% of GDP). In % of GDP, the biggest winners would be Croatia and Bulgaria. Compared to the initial Budget planned for 2021-2027, Czechia, Poland, Hungary and Estonia will gain less. The disbursements of the recovery fund will likely start only early next year so as the positive growth impact from the recovery fund to CEEs countries is to be expected only from 2021.
- **Mexico:** overall growth remain very weak with consumptions (durable and services) and investments (particularly public) trending down. Daily data available for the end of May are showing an extremely slow recovery. Inflation in comfortably within the target range and a low level of pass through from the currency weakness is visible. Banxico still enjoys a decent easing room moving forward, relatively higher than other CBs in the EM universe. Despite Mexico remains committed to some fiscal prudence, its Government Debt on GDP is expected to increase due to the weak growth and the use of assets to deal with the Covid crisis.

Nota Bene: The uncertainty around our macroeconomic forecasts is very high, and it triggers frequent reassessments any time fresh high frequency data are available. Our forecasts at this point include a higher qualitative component, reducing the statistical accuracy and increasing the uncertainty through wider ranges around them.

Key interest rate outlook

	19-06 2020	Amundi + 6m.	Consensus Q4 2020	Amundi + 12m.	Consensus Q2 2021
China	3.85	3.65	3.65	3.65	3.65
India	4	3.75	3.6	3.75	3.6
Brazil	2.75	2.25	2.25	2.25	2.5
Russia	4.5	3.75	4.25	3.75	4.25

Source: Amundi Research

- **PBoC (China):** As top financial regulators gather in Lujiazui Forum in Shanghai, their remarks on monetary policy has tilted towards the hawkish side. Easing will be selective going forward, the central bank will continue to guide borrowing costs lower but there is little tolerance for financial arbitrages. The banking sector is advised to share RMB1.5tn profits with the corporate sector, although 2/3 of it has been implemented through the easing in H1. This implies further room for lending rate cuts in H2. The State Council also vowed for more RRR cut(s) in the near term.
- **RBI (India):** for the second time in a row, in late May, the RBI reduced the policy repo rate by 40bps to 4.0% from 4.40%; the rate decision didn't surprise us in the size but maybe in the timing, ten days earlier than the regular meeting. Additional measures have been announced to improve the functioning of the markets, to provide relief on debt servicing and capital market access and to support imports and exports. Monetary Policy accommodation is going ahead together with a mild fiscal expansion.
- **BCB (Brazil):** Not done just yet? The BCB cut by another 75bps to 2.25% and indicated "remaining space (being) small" which is rather obvious in light of the long and aggressive easing cycle. Although in data dependent mode and with policy at levels compatible with the economic damage caused by the outbreak, the BCB did not shut the door to further adjustment. The CB's inflation projections running below target across the forecast horizon suggests to us there is some more easing left in the BCB's pipeline.
- **CBR (Russia):** Following the 50bps cut in April, the Central Bank of Russia cut the policy rate by 100bps on June 19th to 4,5% as disinflationary impact of factors related to Covid restrictions had been more profound than expected. The CBR said that short-term pro-inflationary risks had abated,including from weaker ruble, and that instead there was the risk that in particular in 2021 inflation may be below the 4% target. Given the drop in domestic and external demand, and inflation running at around 3% yoy, the CBR remains open to further rate cuts in order to maintain inflation close to 4%.

Monetary policy agenda

Central banks	Next communication
PBoC	July 20
RBI	August 6
BCB Brazil	August 4
CBR	July 24

Source: Amundi Research

MACRO AND MARKET FORECASTS

Macroeconomic forecasts
(18 June 2020)

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2019	2020 range	2021	2019	2020	2021
US	**2.3**	**-6.5/-4.5**	**3.0/4.0**	**1.8**	**1.0**	**1.2**
Japan	**1.2**	**-4.7/-4.1**	**2.0/2.6**	**0.7**	**0.1**	**0.5**
Eurozone	**1.2**	**-10/-8**	**4.5/6.5**	**1.2**	**0.6**	**1.1**
Germany	0.6	-7.5/-5.5	2.5/3.5	1.5	0.7	1.2
France	1.2	-11.0/-9.0	6.4/8.4	1.3	0.6	1.1
Italy	0.3	-12.5/-10.0	3.8/5.8	0.7	0.1	1.0
Spain	2.0	-13.5/ -11.5	6.5/8.5	0.7	0.3	1.0
UK	**1.4**	**-9/-7**	**3.0/5.0**	**1.8**	**1.2**	**1.4**
Brazil	**1.1**	**-6.4/-5.0**	**-0.4/0.6**	**3.7**	**2.7**	**3.6**
Mexico	**-0.1**	**-8.1 /-7.1**	**-1.0/0**	**3.6**	**3.0**	**3.5**
Russia	**1.3**	**-6/-4**	**2.5/4.5**	**4.5**	**3.2**	**3.9**
India	**5.3**	**-2.7/-1.3**	**2.3/3.6**	**3.7**	**5.8**	**4.9**
Indonesia	**5.0**	**-1.1 / -0.1**	**3.5 /4.5**	**2.8**	**2.5**	**3.1**
China	**6.2**	**1.4 /2.4**	**7.6 / 8.2**	**2.9**	**2.4**	**1.9**
South Africa	**0.2**	**-6.4/-5.4**	**4.0/5.0**	**4.6**	**4.0**	**5.0**
Turkey	**0.8**	**-6.9/-5.9**	**4.2/5.2**	**16.2**	**10.5**	**9.8**
Developed countries	**1.7**	**-7.5/-5.9**	**3.6/4.8**	**1.5**	**0.7**	**1.1**
Emerging countries	**4.1**	**-2.1/-0.9**	**4.3/5.2**	**4.0**	**3.5**	**3.4**
World	**3.1**	**-4.3/-2.9**	**4.0/5.1**	**3.0**	**2.4**	**2.5**

Key interest rate outlook

Developed countries

	19/06/2020	Amundi + 6m.	Consensus Q4 2020	Amundi + 12m.	Consensus Q2 2021
US	**0.13**	**0/0.25**	**0.08**	**0/0.25**	**0.05**
Eurozone	**-0.50**	**-0.55**	**-0.56**	**-0.58**	**-0.58**
Japan	**-0.05**	**-0.2**	**-0.09**	**-0.2**	**-0.09**
UK	**0.10**	**0.00**	**0.06**	**0.00**	**0.03**

Emerging countries

	19/06/2020	Amundi + 6m.	Consensus Q4 2020	Amundi + 12m.	Consensus Q2 2021
China	**3.85**	**3.65**	**3.65**	**3.65**	**3.65**
India	**4**	**3.75**	**3.6**	**3.75**	**3.6**
Brazil	**2.75**	**2.25**	**2.25**	**2.25**	**2.5**
Russia	**4.5**	**3.75**	**4.25**	**3.75**	**4.25**

Long rate outlook

2Y. Bond yield

	19/06/2020	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	0.19	0.25/0.5	0.22	0.25/0.5	0.25
Germany	-0.673	-0.70/-0.50	-0.72	-0.70/-0.50	-0.73
Japan	-0.142	-0.30/-0.20	-0.14	-0.30/-0.20	-0.15
UK	-0.044	0/0.25	-0.04	0/0.25	-0.02

10Y. Bond yield

	19/06/2020	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	0.71	0.7/0.9	0.81	0.8/1	0.89
Germany	-0.41	-0.60/-0.40	-0.39	-0.50/-0.30	-0.35
Japan	0.02	-0.10/0.10	0.07	0/0.2	0.11
UK	0.24	0.20/0.4	0.29	0.3/0.5	0.36

Currency outlook

	19/06/2020	Amundi + 6m.	Consensus Q4 2020	Amundi + 12m.	Consensus Q2 2021
EUR/USD	1.12	1.11	1.12	1.14	1.15
USD/JPY	107	106	107	106	108
EUR/GBP	0.91	0.90	0.89	0.88	0.89
EUR/CHF	1.06	1.08	1.08	1.10	1.10
EUR/NOK	10.78	10.30	10.70	10.00	10.55

	19/06/2020	Amundi + 6m.	Consensus Q4 2020	Amundi + 12m.	Consensus Q2 2021
EUR/SEK	10.59	10.32	10.50	10.10	10.42
USD/CAD	1.36	1.36	1.35	1.33	1.34
AUD/USD	0.68	0.69	0.68	0.72	0.70
NZD/USD	0.64	0.62	0.64	0.63	0.65
USD/CNY	7.07	7.00	7.05	6.90	7.05

Source: Amundi Research

DISCLAIMER TO OUR FORECASTS

The uncertainty around the macro forecasts is very high, and it triggers frequent reassessments any time fresh high frequency data are available. Our macroeconomic forecasts at this point include a higher qualitative component, reducing the statistical accuracy and increasing the uncertainty through wider ranges around them.

A global recession is our base case today

1. How deep?

- The deepness depends on the virus longevity in the countries affected and the consequent gradual to complete lockdown in most of them. Downturn is evident in domestic demand (across its components at different degree) and in trade dynamics. We assume the largest downturn in the lockdown quarter and a milder downturn to follow. We monitor outbreak developments and lockdown/resumption of the economic activity.

2. How long?

- The timeline depends on the deepness of the economic disruption together with the credit conditions and the rise of corporate default, magnifying the financial markets turbulence and therefore the impact on the economy.
- The timeline of the shock has extended, and overall a peak is expected by May to June 2020. The global economy was showing signs of growth stabilization during the 4Q2020.
- The timeline is also a function of the specific developments of the outbreak together with pre-existent fragilities.

3. The fiscal impact

- The impacts of micro and macro fiscal measures are not included in our forecasts but it’s fair to assume a normalization in the financial and liquidity conditions driven by Monetary Policy authorities

Financial targets

- Financial targets are reviewed on the same line and include policy actions implemented on a daily basis.

PUBLICATIONS HIGHLIGHTS

THE DAY AFTER

The day after #7

Climate change post Covid-19: A crisis at a crossroad (16-06-2020)

DE BAZIN Alice, Head of Institutional Offering & Solutions, HESSENBERGER Tobias, Business Solutions and Innovation, POUGET-ABADIE Théophile, Business Solutions and Innovation

- We look at what the coronavirus could mean for climate change in the near and medium term.
- We explore three scenario and their investment implications
- In the “good” scenario, climate change would be fully integrated into COVID-19 recovery plans by public policymakers with large investments in clean energy and biodiversity.
- The “bad” scenario would be a policy meltdown and a timid climate plans from the public and private sector. In the long term, as physical risks materialise, a brutal policy backlash becomes a real possibility
- In the “status quo” scenario, the risks induced by climate change are not fully integrated into recovery plans and are internalised by the private sector. Corporates focus on surviving the current pandemic and push back on more stringent climate regulations

The day after #6

Inflation: persistent headwinds but a possible inflationary cocktail (09-06-2020)

BALDESCHI Laetitia, Head of Strategy at CPR AM, BERTINO Claudia, Head of Amundi Investment Insights Unit, COHEN Juliette, Senior strategist at CPR AM, DRUT Bastien, Senior Strategist at CPR AM, FIOROT Laura, Deputy Head of Amundi Investment Insights Unit, PERRIER Tristan, Global Views Analyst

- We outline our views on inflation in both the short and long term, and we argue that we may be at the cusp of a complete regime shift.
- In the short term, the coronavirus pandemic is clearly likely to mean volatility in inflation figures, given factors pulling in opposite directions.
- In the longer term, and after four decades of low inflation across most economies, we may enter into a new high-inflation regime.
- In light of this, investors will need to reassess their strategic asset allocation to include investments that could help mitigate inflation risk (ie, real assets, commodities, gold, infrastructure, inflation-linked bonds), but also be ready to tactically readjust their investment decisions based on the inflation outlook.

The day after #5

New frontiers for central banks (02-06-2020)

BOROWSKI Didier, Head of Global Views

- Post Covid-19 crisis fiscal and monetary policies have become intertwined, and this is probably not reversible.
- While governments have become the buyers of last resort, CBs are playing their role as lenders of last resort.
- We argue here that CBs are still far from being out of ammunition. Financial repression and fiscal dominance are here to stay.
- CBs will continue to provide liquidity as much as needed and to combat financial fragmentation.
- We believe that global reflation is at hand with the right policy mix. However, should the crisis deepen and deflationary pressure intensify, CBs would probably not hesitate to explore new avenues, of which all may have unwelcome side effects.

The day after #4

Inequality in the context of the Covid-19 crisis (26-05-2020)

BARBERIS Jean-Jacques, Head of Institutional and Corporate Clients Coverage, DRUT Bastien, Senior Strategist - CPR AM, POUGET-ABADIE Théophile, Business Solutions and Innovation

- The social theme, and in particular the issue of social inequality, has become a major issue for global economies and for investors, both institutional and retail.
- We expect the Covid-19 crisis to accelerate this phenomenon in the months and years to come, and present action levers for investors. Indeed the pandemic is likely to push inequalities higher, in a context where inequalities were already becoming a major issue for societies, economies and consequently investors.
- Public policy makers’ responses will undoubtedly reshape the economic landscape, in terms of fiscal policies and redistribution, wage policies, regulation and consumer habits.
- In this environment, investors will need to include the “inequality” dimension in their analysis of companies, and their engagement policies.

PUBLICATIONS HIGHLIGHTS

INSIGHTS PAPER

Covid-19: short-term pain, long-term opportunities for European commercial real estate (17-06-2020)
ARIAS Pedro Antonio, Global Head of Real & Alternative Assets

- Real estate is likely to share in the economic pain in the short run, but could prove resilient in the longer term given its defensive features (low volatility & diversification)
- European real estate markets have proved healthy and valuations have benefited from a lack of supply
- The high visibility on rental cash flows, especially for properties on long-term leases, is appealing to institutional investors
- The crisis will strengthen some pre-existing changes in the way people work, with an overwhelming rise of smart working and wellness in offices. The same could be the case for retail and logistics, with the rise of e-commerce, together with the importance of supply chains and locations.
- ESG investing is a long-term trend that is much valued by investors.

Multi Asset: a solid total portfolio approach for a complex world (02-06-2020)
TAZE-BERNARD Eric, Chief Allocation Advisor, GERMANO Matteo, Head of Multi-Asset

- As result of ballooning budget policies, which are likely to lead to some form of debt monetisation later on, we are probably entering a new regime characterised by a higher probability of inflationary scenarios and increased asset volatility.
- This means investors need to question long-accepted risk and correlation patterns and calls for agility on their part.
- Moving to a Total Portfolio Approach (TPA) essentially goal-based, total return-oriented and flexible approach is one way to adapt the institutional portfolio construction framework to this new environment.

EXPERT TALK

The Coronavirus and ESG Investing, the emergence of the Social pillar (03-06-2020)
SEKINE Takaya, Quantitative Research, LEPETIT Fréderic, Quantitative Research

- Our research over the past two years has showed that ESG is becoming financially material, meaning that it is a source of outperformance, in equity and in bond markets. We have also shown that there is a growing transatlantic divide, between Europe and North America. Finally, while the E and G pillars had been outperforming from 2014, we have shown that the S pillar has caught up from 2016 onwards.
- The recent period and market turmoil confirms our recent research findings that show the financial materiality of integrating ESG criteria in investment decisions.
- The transatlantic divide has continued during the crisis, but not in the way we expected it to. Indeed, the Social pillar, which had initially been lagging behind other pillars in terms of contribution to performance, has caught up spectacularly, but only in North America and not Europe.
- By studying these trends and the VIX, we have shown that the outperformance of the S in North America is tied to increased investor aversion to risk during this pandemic period

WORKING PAPERS

Trajectory monitoring in portfolio management and issuer intentionality scoring (05-2020)
LE GUENEDAL Theo — Quantitative Research, GIRAULT Julien — ESG Analysis, JOUANNEAU Mathieu — ESG Analysis, LEPETIT Fréderic — Quantitative Research, SEKINE Takaya — Quantitative Research

Did Globalization Kill Contagion? (05-2020)
ACCOMINOTTI Olivier — London School of Economics & CEPR, BRIÈRE Marie — AMUNDI & Paris-Dauphine University, BURIETZ Aurore — IESEG School of Management & LEM-CNRS 9221, OOSTERLINCK Kim — Université Libre de Bruxelles (ULB) & CEPR, SZAFARZ Ariane — ULB & New York University (NYU)

Credit Risk Sensitivity to Carbon Price ? (04-2020)
BOUCHET Vincent, Caisse des Dépôts, Paris —LE GUENEDAL Theo, Quantitative Research

THEMATIC PAPERS

Asset Class Return Forecasts – Q2 2020 (18 05 2020)
DEFEND Monica, Global Head of Research, GISIMUNDO Viviana, Deputy Head of Institutional Advisory, KIM MOON Jung Hun, Quantitative Analyst –Institutional Advisory, PORTELLI Lorenzo, Head of Cross Asset Research

- The global shocks resulting from the eruption of the coronavirus pandemic have significantly altered the sequence of economic and financial phases, shortened the timeframe and expanded the scale of the ripple effect.
- Global trade will decline as fault-lines along the supply chain surface, and whole economies come to a standstill. Monetary authorities have acted swiftly to assuage the markets, and deflation risk has become a reality because of the freefall of oil prices.
- Our current assumption for the short term is for a broad-base U-shaped crisis (|____/), marked by central bank and government support, a prolonged recession, and rising unemployment and a gradual recovery in late-2021.

Amundi ASSET MANAGEMENT | Research & Macro strategy

CROSS ASSET
INVESTMENT STRATEGY

July—August 2020 #07/08

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