Press release

Stagflation looming and the new market regime: investing in the great transformation

Takeaways from Amundi's annual investment outlook

Paris, 17 November 2021 – Amundi, the largest European asset manager, today publishes its investment outlook for 2022.

Key takeaways from Amundi's 2022 investment outlook include:

- **The 'road back to the 1970s' narrative gaining traction***.* Secular stagnation is a thing of the past and the "roaring 20s" – a chimera. Global growth will return to potential after the peak, as cyclical stimulus fades. Inflation will prove to be permanent and uncertain, fuelled by supply shortages and scarcity all around. De-synchronisation within growth and inflation trends are back with a vengeance, and globalisation will take a hit.
- **Central Banks will accept falling behind the curve, given their benign neglect of the inflation narrative**. After an initial tiptoe into tapering, expect more, not less, monetary accommodation amid decelerating growth and the rising fiscal needs required to finance the green and just transition.
- **The concept of Emerging Markets as a homogenous block is definitely over.** The great divide will be across three worlds: 1) countries with inflation and Central Banks acting to control it; 2) countries with Central Banks remaining inactive (out of control); and 3) China. Investors should favour 1 and 3, where currencies should also appreciate versus the US dollar, bearing the burden of hyper-Keynesian policies.

Amundi's main convictions for 2022

In terms of portfolio construction, **next year will bring more challenges compared to 2021**. The key elements to consider in portfolio construction will be: return, liquidity risk and exposure to growth and inflation risk. Against this backdrop, investors should:

Start light in terms of risk exposure and re-calibrate risk throughout the year, with a focus on portfolio resilience to rising yields.

- **Investors should start the year with a cautious, neutral allocation** (also considering stretched market valuations) and try exploiting relative value opportunities across regions and segments. In a sequence of slowing growth followed by more stimulus, investors will likely have a window to increase risk allocation again and exploit the opportunities brought by an extended cycle.
- **Beware of the nominal illusion by targeting real returns.** The 60/40 portfolio model will be challenged. Positive equity-bond correlation calls for more dynamic allocation. Relative value plays and additional sources of diversification that can potentially mitigate inflation risk, such as real assets, will be key.

Use unconstrained approaches in the search for real income, by enlarging the asset class spectrum in an environment of structurally higher inflation.

- **Investors should resist the temptation to go long duration after the first leg of rising nominal yields**. Curve movements, currencies and cross-regional opportunities will flourish in a world of divergent monetary policies. Unconstrained fixed income will remain the name of the game.
- **To seek higher income investors should explore areas beyond the traditional bond space** and consider equity dividends, real assets, EM bonds with a focus on short duration, and more generally areas offering higher yields with relatively low duration risk, such as subordinated credit and loans.

Credit with longer duration and/or where spreads are too tight, will be challenged.

- **We will likely see some cracks relating to leverage issues emerge.** This will trigger the first round of the great discrimination between unsound and expensive credit, at risk during a time of tighter liquidity conditions and default rates bottoming out, versus sound and expensive credit.

Play equity with a focus on the least stretched areas (value, EM, Europe) that are less sensitive to higher rates.

- **Real rates will determine the fate of excessive equity valuations**. They will eventually pick up, challenging the expensive areas in the growth space. Selection should focus on earnings and pricing power, quality and value, amid higher costs and rising rates. We expect an environment characterised by a high dispersion of returns among stocks, providing an attractive backdrop for stock picking.
- **Europe should also be favoured thanks to its Next Generation EU Fund, with a focus on the green transition.**
- **EM equities should be back in focus.** Equity exposure has increased to a peak in the cycle, favouring DM equities. The next increase should favour EM, where allocations are far below the strategic target and valuations look relatively attractive.

Add thematic exposure to ESG factors that will likely have a material impact on risk/returns.

- **Environmental, Social and Governance (ESG) themes should be seen as complementary to classical portfolio metrics of risk and return**, particularly for areas that could have a material impact on asset prices. Changes to regulations and rising demand from institutions and investors mean some factors are becoming increasingly relevant in this respect.
- **The net zero emissions initiative will have a significant market impact**, in our view. Tackling inequalities will likely be the next prominent theme, as this is a significant focus of governments during the current recovery phase. Some blended themes combining environmental and social aspects could emerge, such as the Just Transition drive to tackle climate change in an equitable way, a particular focus of concern for emerging economies.

Pascal Blanqué, Chief Investment Officer at Amundi, said: *"A new financial regime has started, characterised by 1970s-style stagflationary features. The end of the ultra-easy monetary era, as well as the growing momentum for policies targeting the green and just transformation, will define new mandates for central banks. Their reaction function appears uncertain and inflation expectations may become unanchored. Expect some reordering of risk premia, when real and nominal yields start rising, and ESG factors having an increasing impact on market prices."*

Vincent Mortier, Deputy CIO at Amundi, added: *"In 2022, the cycle will extend further, but frenzied markets are no longer in sight. In the sequence of tapering and deceleration, followed by more stimulus and re-acceleration, investors should be cautious first and search for entry points to complement their strategic positioning in equities, commodities and EM, in typical late cycle play. "*

The full publication is available here.

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About Amundi

Amundi, the leading European asset manager, ranking among the top 10 global players[1], offers its 100 million clients - retail, institutional and corporate - a complete range of savings and investment solutions in active and passive management, in traditional or real assets.

With its six international investment hubs[2], financial and extra-financial research capabilities and long-standing commitment to responsible investment, Amundi is a key player in the asset management landscape.

Amundi clients benefit from the expertise and advice of 4,800 employees in more than 35 countries. A subsidiary of the Crédit

[1] Source: IPE "Top 500 Asset Managers" published in June 2021, based on assets under management as at 31/12/2020
[2] Boston, Dublin, London, Milan, Paris and Tokyo

Agricole group and listed on the stock exchange, Amundi currently manages more than €1.8 trillion of assets[3].

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[3] Amundi data as of 30/09/2021