

#03
March
2022

CROSS ASSET

Investment Strategy

CIO VIEWS

**Hot inflation and geopolitical tensions:
cool down risk**

AMUNDI INSTITUTE

Special Ukraine

Confidence
must be earned

Amundi
ASSET MANAGEMENT

#03 - March 2022

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CIO VIEWS



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Hot inflation and geopolitical tensions: cool down risk

The geopolitical escalation at month's end marks a further rise in volatility. Credit spreads (IG, HY and Euro peripherals) continued to widen while equity markets corrected further. The rotation towards value continued, but with a pause from the most cyclical segments, amid increasing economic growth risks from the Russia-Ukraine conflict. **Markets continue to reassess the hawkish turns of the Fed and the ECB as well as the risks related to the escalating crisis in eastern Ukraine. On the macro front, US job market data were well above expectations; the January inflation reading was at its highest level in four decades.** This complicates the route for central banks caught between possibly higher inflation and lower growth (stagflationary risk on the rise).

In contrast, the Chinese Year of the Tiger appears to be characterised by increasing policy accommodation, indicating the divergent policy trends versus the rest of the world on the easing side, once again pointing to a **desynchronisation in the economic cycle of China versus the US that supports the role of Chinese assets as global diversifiers.** At the current juncture, with significant price changes already being seen since the beginning of the year, there are two burning questions for investors to consider:

- 1. Could the current volatility turn into a double bear market (in bonds and equities), therefore calling for structural de-risking in asset allocation?** Volatility is certainly rising across the board (bonds, equity, commodities, currencies), and the investment landscape is looking riskier than one month ago. With growth expected to remain sound throughout 2022 amid economic reopening post the Omicron wave and the China soft landing, earnings growth should decelerate from the peak, but remain positive. The big risk relates to possible spillover from the Russia-Ukraine conflict, with significant impacts on the growth and the inflation outlook. This is the crucial point that investors need to keep track of. Equity bear markets occur during recessions (except during the 1987 crash). We don't expect to see a recession, but the risk of it in Europe is increasing amid rising inflationary pressure at a time when the ECB plans to reduce its quantitative easing. As geopolitical risks are very hard to assess (any positive changes could lead to a relief rally while further escalation could put further pressure on the market), **investors should still seek to benefit from the recovery mainly through selective equity markets, but also be prepared for the worst (adjusting hedges to address even more unfavourable developments) outcomes. All in all, the inflation theme is seeing further reinforcement,** again calling for a medium-term preference for value/quality in the equity space, although we may see some pauses short term regarding the value rotation. In credit, we have moved to a more cautious stance amid rising liquidity risks and a less appealing risk/return profile for credit compared with equity.
- 2. Is 2% a target level for UST yields or is there more to come and therefore the duration stance should stay short?** The Fed's hawkish turn and the inflation surprise temporarily pushed 10Y Treasury yields above the 2% threshold for the first time since July 2019 and contributed to a restoration of value in particular on the short end of the curve. The Russia-Ukraine conflict raises risks regarding financial systems and on inflation in primis, but also regarding the global economy. As the market is already pricing in significant Fed action, we believe that the rise in yields could pause awaiting the Fed's March meeting. **Some technical adjustments to duration are due, and therefore we recommend an active approach. For the time being, we confirm our cautious duration stance while we actively play opportunities at curve and country levels.**

Market uncertainty will remain high. We are facing a period of low visibility on geopolitical developments and economic implications. Equity volatility will stay high, as given the high liquidity profile of equities, they will be the first target in case of fast risk adjustment, which could also offer opportunities to buy the dip and re-enter some oversold areas of the market.

The timeframe of the crisis will be crucial, as a prolonged period of uncertainty with rising escalations could lead to further repricing across global risk premia. Central banks will be in the spotlight and they may at some point have to adjust their agendas to address rising stagflationary risk. For investors, all this means they should stay well-diversified, increase their hedges, and focus on areas of resilience to high inflation.

Overall risk sentiment



Decrease risks in credit and add protections to risk assets.

Changes vs. previous month

- Reduced credit risk and increased selection focus.
- Enhanced portfolio hedges in light of geopolitical tension.
- Value medium-term call intact.

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

AMUNDI INSTITUTE

Amundi Institute: a new journey begins



Pascal BLANQUÉ,
Chairman, Amundi Institute

Investors expect a deeper dialogue and sophisticated advice to build more robust portfolios owing to the many structural regime changes under way in areas such as inflation, the environment and geopolitics

Why the institute, and why now?

As the investment world evolves in the face of new trends encompassing economic, financial, geopolitical and ESG dimensions, new challenges emerge for investors. How will the energy transition impact asset classes' behaviour? What does the regime shift in course mean for strategic asset allocation? What will the future geopolitical order be, and what are the implications for investors?

These are just some of the questions that are at the front of investors' minds today. We are at a delicate juncture in the regime shift that I call **the "road back to the 70s"**. **The great return of inflation** is one key feature of this shift. **The reordering of geopolitical powers** is another, one that is further exacerbated by rising price dynamics (in particular, energy prices) and supply chain readjustments after Covid. **Liquidity risk is also an element of the puzzle**. In February, volatility rose in the treasury market to its highest level since early 2020 on the back of diminishing market liquidity. The retreat of large banks from dealing activity after the 2008 crisis means the market structure now is more fragile, at a time when the end of easy money means that liquidity-addicted markets could soon face the test of quantitative tightening, with the Fed planning to reduce its almost \$9tn balance sheet. Finally, we are also living in an era of **ESG mainstreamisation, in both the investment industry and the economy at large**. The 2020s will be critical for the energy transition, on the one hand, but there is a crucial need to engineer a more inclusive growth model, on the other, to fight the inequality legacy from past crises.

All this means that investors have to reconsider their asset allocation around the four elements – risk, return (in real terms), liquidity and ESG – to reassess their investment objectives and rethink portfolio construction around these pillars. The critical dimension to consider will be the purchasing power of a portfolio per unit of risk. This means searching for sources of lasting positive real returns and becoming exposed to what is positively correlated to inflation. In this context, equities – some of them – are a long-term positive call because they are liquid real return assets – in particular, those that have bond features (low debt, high earnings visibility).

To help investors in this delicate phase, we are launching the Amundi Institute, which I have the pleasure of supervising in my role as Chairman. The Amundi Institute's mission is to strengthen the day-to-day dialogue, both inside Amundi, in strict partnership with the investment teams, and externally, with our clients and the financial community at large. By bringing together our investment insights, macro research, market strategy, quantitative research, and asset allocation activities under one umbrella, we aim to provide a holistic view of the main challenges that investors face today to stimulate ongoing debates and client dialogues. This month, our internal debate has been centred around oil and gas price dynamics amid the impact of the Russia-Ukraine conflict.



Monica DEFEND,
Head of Amundi Institute

Commodities: impact of the crisis on oil and gas

The Russian invasion has repercussions for energy markets and supply, particularly in Europe.

- The price of natural gas has risen over the past few days. This sharp upswing **is likely to have serious effects on European growth and inflation, with expectations of downward revisions to GDP growth and upward revisions regarding inflation (stagflation)**.
- In contrast, US natural gas prices have risen relatively mildly and not as a reaction to domestic shortage but expectations of higher liquefied natural gas (LNG) demand from Europe. We believe the US does not have unlimited capacity to replace Russian gas for Europe and that could put upward pressure on US natural gas prices.
- With respect to oil, prices currently are already above our near-term target of around \$80/bbl and because Russia is a major supplier, any disruption may cause prices to move up further. Nonetheless, for now, oil increases (relatively limited compared to natural gas) have priced in market expectations of an agreement with Iran, coupled with restoration of oil production by other large producers, including Saudi Arabia and other OPEC members.

On the demand side, we should not underestimate China's role.

- LNG, which is far greener than natural gas, is the energy source used by many large countries, including China, to move their economies towards cleaner fuels.
- Secondly, the country can potentially replace Europe (in oil and gas) as a major buyer for Russian exports and this could happen not necessarily at market prices. Hence, there is a possibility that energy sanctions would not be as successful as hoped for but they could still aggravate the energy situation in Europe.
- Finally, it is not completely unrealistic to view the unfortunate event of Russia pausing gas and oil exports to Europe as retaliation regarding US/EU sanctions on its financial sector.

Conclusion: the crucial risk to our central scenario on economic growth is natural gas and energy markets in the Eurozone over the short and medium terms.

MULTI-ASSET

Adapt to mounting risks, reinforce hedges



Francesco SANDRINI,
Head of Multi-Asset Strategies



John O'TOOLE,
Head of Multi-Asset Investment Solutions

As we await clarity on monetary policy and the evolution of geopolitical tensions, we think investors should become more cautious on credit - more exposed to liquidity risk - and implement robust hedges

The recent rise in market uncertainty has been driven by escalating geopolitical tensions, the hawkish pivot from CBs, and stubborn inflation. Collectively, these indications of QT and the effects of inflation on consumers' disposable incomes represent a major risk. However, financial conditions remain easy and economic growth is robust. Thus, **we don't think it is time to structurally move to a risk-off allocation. We do think investors should tactically readjust risk exposure, based on a cautious approach.** The interplay of inflation risk, the tightening stance from CBs to tame it, and the Russia-Ukraine crisis present a unique correlation framework across assets. **A well-diversified and active stance is needed. Investors should strengthen hedges and adjust FX views while monitoring CB policies and war risks.**

High conviction ideas

Our overall stance on equities is close to neutrality on DM and EM, but with a cautious tilt provided by hedges against possible market downturns. **We are monitoring the evolving geopolitical situation for more clarity on the medium-term path for equities in Europe.** The uncertain backdrop underscores the need for active stock picking. While the value style should help investors to protect portfolios from inflation, emerging risks related to Russian policy could affect the stagflationary narrative, causing a move towards quality sectors. Meanwhile, we remain marginally positive on China (should benefit from more clarity on policy from tightening to targeted easing) amid a stabilising regulatory framework.

In FI, we remain defensive overall on duration through 5Y German bonds, but suggest investors manage this exposure actively. Yields have been moving sharply after the ECB's announcements and the Russian attack, thereby confirming our agile and active view across curves. We look to benefit from any tactical market move towards safe-haven assets, including USTs. On the other hand, we believe investors should look for income outside of traditional areas, such as in Chinese government and euro peripheral debt. Regarding the latter,

we now think Italian BTPs offer attractive relative value opportunities vs German debt on the back of the country's political stability and economic growth potential as well as the ECB's aim to avoid fragmentation in the euro area despite a slight change in its overall stance. In Asia, we maintain our positive view on Chinese sovereign debt due to its diversification benefits and the PBoC's monetary easing, but we are monitoring the front-loaded measures. **In Europe, we await more clarity on CB policymaking to evaluate our long-term convictions on corporate credit.** We now believe the ECB's adjustment (due to the urgency to act on inflation) could result in spread widening in EUR IG, affecting investor sentiment, particularly regarding longer-maturity issuance. Thus, we are no longer positive and remain vigilant. However, corporate fundamentals (low default rates) and balance sheets are strong, and HY companies are continuing with their deleveraging efforts. We maintain our marginally constructive stance on EUR HY, but are monitoring it with respect to geopolitics and inflationary pressures jeopardising GDP growth.

The FX universe allows us to implement our geopolitical views and identify relative value strategies globally. We think the GBP has risen sufficiently vs the CHF and we are no longer optimistic on sterling, given that the highly aggressive sequence of hikes from the BoE is already priced in by the market. However, we keep our cautious view on the GBP/EUR. We believe the UK will remain geopolitically isolated in the post-Brexit world vs the US and EU. Finally, we think that the CNH should perform well vs the EUR. Geopolitically and from a trade perspective, China will remain the main driver for intra-Asia regional trade and this should support Chinese assets.

Risks and hedging

Investors should put in place sufficient hedges to safeguard their US HY and US and European equity exposures, bearing in mind the additional volatility from the current geopolitical context. Gold can also help as a tactical hedge in this phase of uncertainty.

Amundi Cross Asset Convictions

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

Source: Amundi. The table represents a cross-asset assessment on a three- to six-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.

CGB = Chinese government bonds, EM = emerging markets, PBoC = People's Bank of China, FX = foreign exchange, IG = investment grade, HY = high yield, CBs = central banks, BTP = Italian government bonds, EMBI = EM Bonds Index. QT = Quantitative tightening

FIXED INCOME

Liquidity in focus: uncertain rate path, geopolitics



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Kenneth J. TAUBES,
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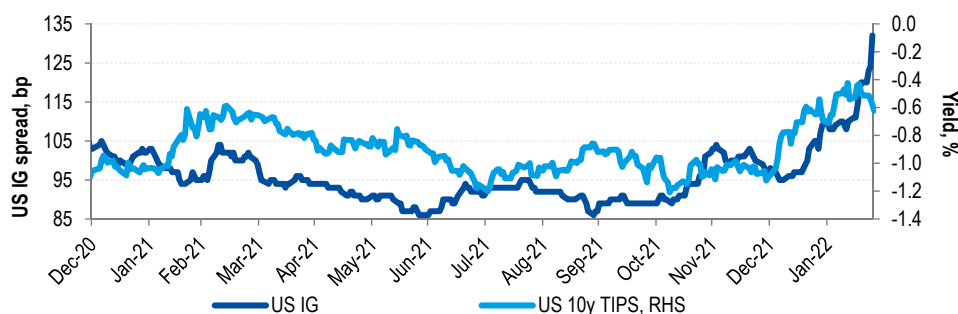
As markets assess the path of quantitative tightening by CBs, we believe volatility in credit could increase, along with discrimination between high-quality and low-quality names

Inflation in the US and Europe is prompting CBs to adopt hawkish stances, causing repricing in Euro and US rates. On the other hand, markets are waiting to see if CBs can tame inflation without hampering the economic rebound particularly in light of the geopolitical environment in Eastern Europe. Thus, policy sequencing will be key and QT could cause a weakening of sentiment in credit through a drain in liquidity/volatility, even as corporate fundamentals are strong. Robust consumer demand and accumulated savings are another positive. **Hence, we acknowledge the need for additional caution in credit, with an increased focus on selection. On duration, while our medium-term stance is defensive, investors should tactically look towards govies for protection.**

Global and European fixed income

We are cautious on duration (US, core and semi-core Europe) due to upward pressure on yields, but remain agile amid new dynamics related to inflation and policy issues. In the current geopolitical environment, sovereign bonds (US, core Europe) provide safeguards to portfolios. Regarding Euro peripherals, we are watchful but acknowledge Italy's robust growth potential and political stability, and remain constructive. We look for income opportunities in Chinese duration. However, for US breakevens, valuations are becoming less attractive. **In credit, there are concerns related to inflation/liquidity, but default rates are low and earnings strong.** To deal with inflation, we focus on names with the ability to pass on higher costs to consumers. In IG, we prefer short- and medium-term maturity credit; in HY, we see spread compression opportunities (hybrids, BB/CCC) in areas with potential to improve their credit metrics. Here, investors should prioritise diversification and liquidity. Overall, we like subordinated financials' debt, plus the energy and auto sectors.

Real yields and IG spreads



Source: Amundi Institute, Bloomberg, 24 February 2022. US Investment Grade = ICE BoFA US Corporate Index

GFI = global fixed income, GEMS/EM FX = global emerging markets foreign exchange, HY = high yield, IG = investment grade, EUR = euro, UST = US Treasuries, RMBS = residential mortgage-backed securities, ABS = asset-backed securities, HC = hard currency, LC = local currency, MBS = mortgage-backed securities, CRE = commercial real estate

EQUITY

Navigate short-term uncertainty with an inflation tilt



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Global Head of Emerging Markets



Kenneth J. TAUBES,
CIO of US Investment Management

With higher uncertainty and increasing inflationary pressure, we explore high quality value names that can be more resilient in the current environment

Overall assessment

The hawkish pivot of CBs has caused significant repricing of duration risks and subsequent market expectations regarding rate hikes. This, coupled with the rapidly deteriorating and very serious situation around Russia/Ukraine, will pressurise valuation multiples. On the other hand, the economic recovery continues amid strong consumption, and this should support the rotation towards value in the medium term. However, not all companies are able to pass rising costs on to consumers, meaning margin compression/pricing power is not equal among companies. We look for brands, patents and differentiated products that allow **companies with strong business models to raise prices, preserve margins and pay dividends.**

European equities

We remain biased towards value, cyclical stocks and are evaluating the earning season from an inflation and margins perspective, as we see better sales than earnings for some companies. **While some businesses are unable to pass on costs and raise prices sufficiently, a small group is using the environment of the 'strong consumer' to increase margins through price hikes.** On the other hand, we are assessing consumer behaviour as inflation is becoming a political issue and there is a risk of regulatory measures. We are exploring how this could affect sectors such as utilities, where we are cautious, along with IT, though we are slightly less concerned about the latter given some structural growth stories that have been battered by the recent volatility. However, our focus is on selection and balance sheet strength amid our normalisation tilt, and we see opportunities in industrials and financials. At the other end, we are exploring attractively valued stocks in defensive segments – for example, the healthcare sector.

US equities

In an environment where inflation is now clearly a political matter, we think markets are still not pricing in the risks related to increases in the cost of capital. Thus, the move from growth to value is a medium-term trend owing to the latter's still-attractive valuations and the reasonably strong economic growth (reopening). **We explore high-quality value names that can withstand operational challenges** through the inherent strength of business models, strong pricing power and core competency. Thus, stock selection is crucial in this latest leg of value rotation. On the other hand, we remain cautious on expensive long duration and growth stocks, but acknowledge that selective tech growth names are becoming attractive after the recent volatility. Overall, growth remains overvalued, and if real rates increase, it may weaken further. At a sector level, we like cyclicals in financials (banks), materials and energy. Interestingly, selective consumer and reopening-related stocks are becoming cheaper, but we focus on names that are able to manage the challenges related to tight labour markets and supply chain disruptions.

EM equities

EM valuations, stabilising economic growth in 2022, and the PBoC's easing stance should be positive for the asset class, but the Russia-Ukraine conflict could harm market sentiment in the short term. The EM space appears increasingly fragmented amid geopolitical, idiosyncratic risks and global inflation. At a country level, we favour commodity linked-stories – India, Hungary and the UAE. Our main convictions at a sector level are discretionary, real estate and communication services, plus a preference for energy over materials. Finally, we maintain our tendency to increase value over growth.

US and Europe equity volatility



Source: Amundi Institute, Bloomberg. Data as of 25 February 2022

Special Ukraine



Pascal BLANQUÉ,
Chairman, Amundi Institute



Monica DEFEND,
Head of Amundi Institute



Didier BOROWSKI,
Head of Global Views

Foreword

The invasion of Ukraine by Russian troops has caught Europe off guard, reminding it of the darkest hours before the Second World War. NATO countries and European leaders have so far ruled out direct military confrontation because of the risk of escalation between nuclear powers.

However, the Western democracies and Russia have been engaged in an unprecedented confrontation over the past few days. This takes the form of a merciless economic and financial war, the declared aim of which is to suffocate the Russian economy. The freezing of the assets of the Russian central bank is a measure that undermines its financial sovereignty, preventing it from fighting the collapse of the rouble. The sanctions will result in a deep recession in Russia, which should prevent Putin from financing a long war.

Our baseline scenario is therefore “a short conflict”. But we keep in mind that in history, short conflicts can last for many months. Uncertainty about the outcome of the conflict is not likely to dissipate quickly.

Financial interconnectedness and the high degree of globalisation give economic weapons a power that they hardly had in past centuries. Two orders are confronting each other: the economic-financial order and the military order, which is unprecedented in modern history. The resulting shock of uncertainty will inevitably have major consequences.

In this special edition, we seek to shed some light on different possible scenarios and questions. Paradoxically, it is perhaps in the longer term that the clearest consequences of the current crisis are emerging.

Politically, NATO has emerged stronger from this crisis and Europe has been able to show its unity on issues that were the subject of disagreement (defence policy, arms supplies, nature of sanctions). But the consequences go beyond Europe and NATO. The role that China will play will give a new shape to the new international order.

Investors should bear in mind that we are not living in normal times. We are in the middle of a regime shift characterised by unprecedented inflationary forces not seen in the past five decades. The regime we are moving into (see “Russia conflict marks a further step on the road back to the ‘70s”¹) is not only inflationary in nature. It will come with a harsh readjustment of the geopolitical order (implying higher fragmentation), with the final death of globalisation and the emergence of regionalisation centred on new global powers. Among the winners will be China, whose economic cycle is gaining independence from the US and with a rising role for the Chinese renminbi as the currency of trade for the region.

In any case, the evolution of the conflict will have important (geo)political and economic consequences. And we hope this document will help investors understand the issues for asset allocation.

¹ Pascal Blanqué. “Russia conflict marks a further step in the road back to the ‘70s”. *Shift & Narratives* #14, March 2022.

Special Ukraine Anatomy of a crisis

[A]¹ Where we stand

Geopolitical impact

1. The West response to Russia's invasion of Ukraine

The West is seeking to progressively stifle the Russian economy. The goals of sanctions are to trigger a systemic financial crisis and economic recession in Russia. The West will do whatever it takes to avoid a direct military confrontation.

At the time of writing, partial sanctions are in place and important decisions have been made:

- **Individual sanctions** on the Russian oligarchs with limited impact, as they had pre-emptively insulated their business
- Exclusion of several Russian lenders from **SWIFT**. Key lenders to watch will be VTB, Sberbank and Gazprombank
- **Freeze on Central Bank of Russia reserves** abroad to limit RUB protection. This has the most serious financial implications because it increases the risk of default on Russian assets
- **EU bans its aerospace** to Russian aircraft
- **Increase in military expenses** announcements, starting with Germany, which is a paradigm shift

Key points to highlight:

- **Sanctions** need to be strong, but not so strong as to exacerbate soaring energy prices (Russia will still have access to several billion dollars' worth of hard currency export earnings) or to put Putin in a position where he has nothing left to lose
- **China in a wait-and-see attitude:** a pragmatic and opportunistic stance
 - China calls for a halt to violence; it doesn't want to turn into the financial channel for Russian assets, but nor does it want to derail its commercial partnership with Russia.
 - China is the game changer. China will want, at some point, to show that it will play a central role in the new world order
 - China probably has no interest in a long-term conflict that would exacerbate global deflationary pressures. This would reinforce the international role of the renminbi and the diversification procured by Chinese assets, unless the current situation inspires a military resolution in Taiwan
- **India** remains loyal to Russia and abstained from voting the UN Security Council resolution which condemn Putin's invasion

2. Ukraine and Russia: first diplomatic talks near the Ukraine-Belarus Border

These were not direct negotiations, but "negotiations on the formation of a package of the first round of negotiations – on where and when these negotiations can take place". Although the first round was not conclusive, both parties agreed to meet for a second round.

Russia has already stated that it will not stop the military operation even for the duration of these negotiations.

Ukraine is resisting, while Putin on Sunday ordered Russian nuclear forces to be placed on high alert, citing NATO aggressive statements.

¹ Letters refer to the scenario location within the event tree

Special Ukraine Anatomy of a crisis

Economic impact

3. Slower growth and higher inflation in Europe

The Ukrainian war is happening in the context of decelerating global growth and high inflation. The longer the conflict continues, the more consumer and business confidence will deteriorate, and the more likely inflation will remain high and economic activity will slow. It is difficult to anticipate economic spillovers related to the conflict, given the high level of uncertainty. This is a cold shower for investors, as, in addition to inflation, there will be an impact on growth, especially in Europe.

Europe has already been hit by the increase of energy prices, which is eroding consumers' purchasing power and corporate profits, and diluting NGEU firepower via higher costs. Therefore, we expect slower growth and higher inflation: the risk of stagflation by the end of 2022/23 is increasing. The Eurozone is going to pay the highest economic price, even if the crisis is short-lived.

4. Monetary policy, a more challenging context for the ECB than for the Fed

The ECB and the Fed will err on the side of caution in the short term. Both will probably be keen to signal their willingness to normalise monetary policy this year in order to anchor inflation expectations, which will may exert further downward pressure on domestic demand.

However, the question of monetary policy will not be posed in the same terms for the Fed and the ECB. The Fed can more easily justify rate hikes and shrink its balance sheet than the ECB. The risk of a marked economic slowdown is much more pronounced in Europe than in the US.

5. The strategic autonomy of Europe becomes a first priority and changes fiscal policy

Because of its geographical proximity and energy dependence, the EU will need large fiscal support and will have to decide what has to get the priority: diversifying energy suppliers or defence.

a) Diversifying energy supply:

The ultimate goal is to speed up the green transition and to diversify energy suppliers to limit external dependencies, but the evolution will take several years. Therefore, mitigation solutions will have to be implemented in the meantime:

- German is rapidly building two LNG terminals to overcome its energy dependence on Russia.
- The EU has announced extraordinary bond issuance in March to allow loans to member-states and mitigate gas prices fluctuations (≈SURE like instruments)

b) U turn in military budgets:

The EU has approved a 450 million euros in military aid for Ukraine. Germany has announced a EUR 100 billion "special fund" for its military in its 2022 budget which is a regime shift as far as military budget is concerned.

We can expect other European countries to follow suit as a major U-turns the European doctrine towards major spending in the military sector.

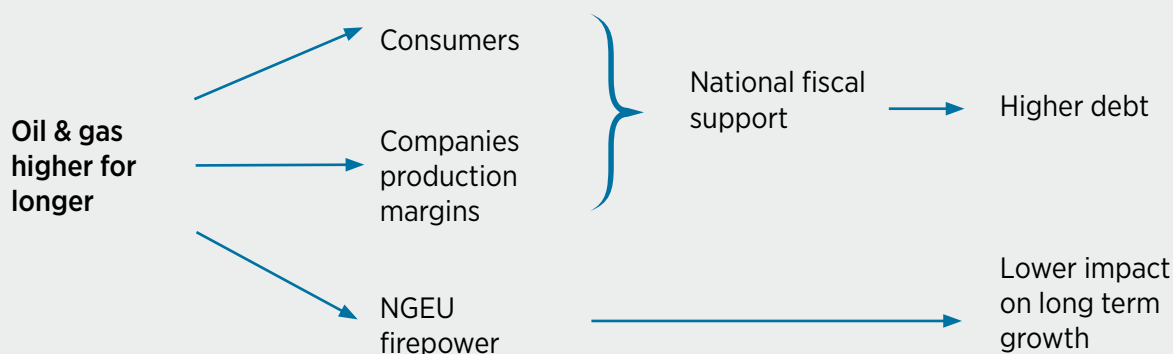
Key point to highlight:

- If the Europeans want to finance the green transition, diversify energy suppliers and increase defence spending at the same time, they will have to revise their fiscal policy doctrine considerably. But there has probably never been so much convergence of interest in Europe on this point.

Special Ukraine Anatomy of a crisis

Commodity impact

Energy prices to remain high: Europe will remain hostage to Russia until supply diversification and /or transition progresses.

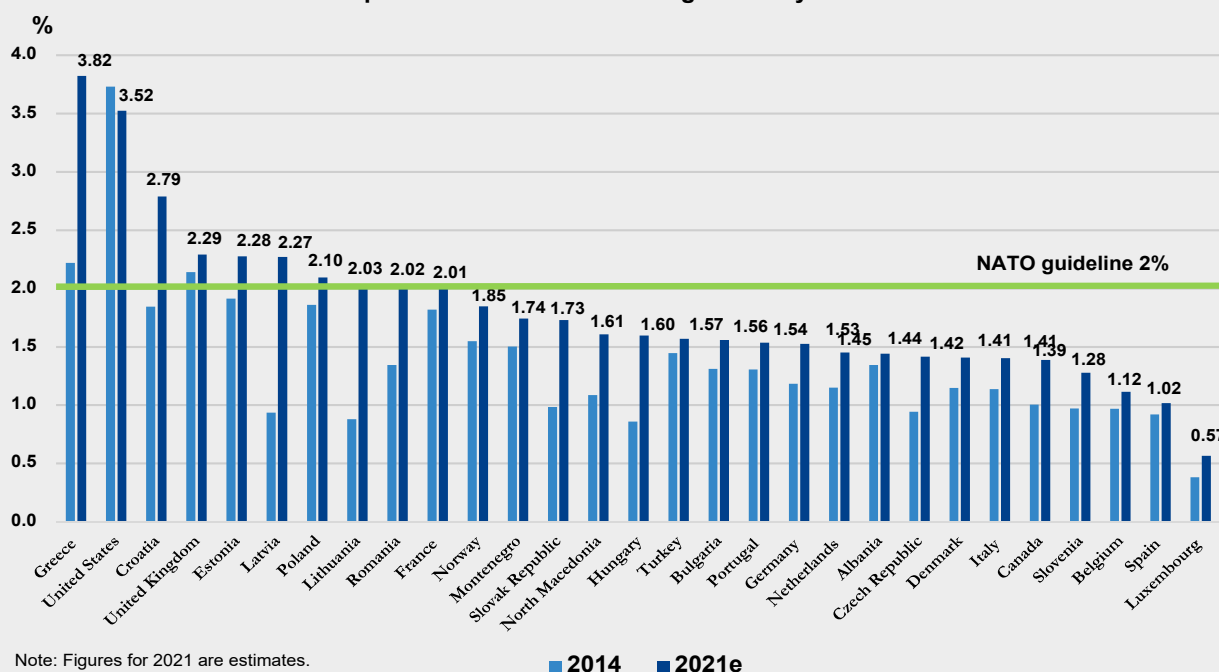


Prices of food and chemical gas (for semiconductors production) have been lifted higher but might normalise if the conflict is short-lived

Financial markets

Last week's reaction was limited: long-term yields and FX almost unchanged, global equity up (HSCEI being the only exception). We expect this subdued market reaction to be short lived unless de-escalation materialises. We believe market action and asset prices do not reflect further military escalation and do not reflect the further evolution in the regime shift (towards more stagflation, at least in Europe). A market correction to reset risk premia looks likely in our view.

Defence expenses below 2% NATO target – many countries well below



Special Ukraine Anatomy of a crisis

[A]

Ukraine is holding out, while Putin on Sunday ordered Russian nuclear forces to be placed on high alert

[B]

short-term resolution
+ no military confrontation with the West, nor nuclear escalation

[C]

Prolonged military struggle and global military escalation

B1] Acceptable way out for Putin
diplomatic talks / sanctions deterrent



- Partitioning and demilitarising Ukraine and /or Ukraine moving to "neutral" status
- CBs back to normalisation mantra
- Market relief: limited repricing of global relative risk premia, limited global spillover but profit recession a tangible risk
- Energy prices remain high as long as a supply diversification materialises (e.g., Saudi or Iran) and the search to diversify suppliers makes further progress

B2] Russia creates a "subdued" government in Ukraine, contained casualties, no Kiev siege



- Energy prices to remain high
- Market instability starting to price in Russia crossing new red lines
- Profit recession a tangible risk (Europe)
- Seek safe havens, sell off of liquid assets (equities and credit the primary candidate for repricing)
- Euro weakens

B3] Civil war siege in Kiev, high number of casualties (Chechnya-style resolution)



- Selective military escalation with large markets capitulation and panic-selling
- Russia economic and financial crisis reflected in domestic prices with spillover into EE

B4] Unrest in Putin's regime (military putsch)



- Russia economic and financial crisis reflected in domestic prices with spillover into EE
- US, LATAM, China favoured asset class, selective Europe value + quality
- Energy prices to remain high
- CBs back to normalisation mantra, yield curves flatten
- High risk of profits recession (Europe)
- Euro weakens, RUB collapse, FX turmoil

B5] Nuclear de-escalation supported by China



- Chinese assets are the real diversifier providing real returns + RMB > USD; euro weakens
- CBs back to inflation control; yield curves flatten
- Repricing of global risk premia but risk of global profits recession

C1] Low intensity conflict with limited supply chain disruptions (evolution of B2)



- Global stagflation fight: debatable movement of yields in the curve's long end
- Negative real rates, after correction back to equity, credit, and search sources for real return in EMs
- Search for safe liquid assets (cash, treasury, high quality + value equity)

C2] High intensity conflict (evolution of B3)



- The worst can be expected including West and Russia military confrontation

Special Ukraine Anatomy of a crisis

What to expect?

Below we describe two possible outcome [B] and [C] with the subset of potential evolution (1, 2, 3 ...) and their economic and financial markets impacts

[B] Resolution in a few weeks or months

[B1] Acceptable way out for Putin (recalling Cuba in 1962?) – Successful Ukraine /Russia diplomatic talks and / or sanctions deterrence

Economic impact (B1)

- Central banks back to their normalisation rhetoric, but European growth slows down and risks falling into recession (on the existing scars and the ECB's policy mistakes in raising rates and tapering)
- US, LATAM commodity exporters and China are the favoured asset classes

Financial markets (B1)

- Defence and cyber defence stocks to be favoured
- IT stocks may ultimately also benefit from this crisis
- Energy prices remain high until a structural diversification of suppliers is settled (it will take years)

[B2] Russia wins: ends Zelensky regime, replaces it with a government and gets ready to cross new red lines

Economic impact (B2)

- Ukraine conflict opens the door to Russia to continue rolling out in Europe, pointing to the Baltics and Poland
- Civil war in Russia/Ukraine with great human losses
- Russia tests NATO with cyber-attacks or NATO retaliates, Russia to cross new red lines in the future
- China will want to show its role in the new international order
 - > Other military conflicts might flare up

Financial markets (B2)

- Energy prices to remain high
- Market instability (markets starting to price in that Russia may cross new red lines)
- Profit recession a tangible risk (Europe)
- Seek safe havens, sell off of liquid assets (equity, credit)
- Euro weakens

[B3] Civil war, siege in Kiev, high number of casualties (Chechnya-style resolution)

Economic impact (B3)

- Massacre in Kiev and other cities: the number of casualties is unacceptably high for the Russian people
- This will likely entail some form of direct military confrontation with the West (but not nuclear escalation)

Financial markets (B3)

- Markets capitulation and panic-selling

Special Ukraine Anatomy of a crisis

B4] Russia loses: significant opposition jeopardies Putin's regime

- Domestic authoritarian repression gets harsher, leading to social unrest and/or civil war in Russia

Economic impact (B4)

- Russia runs into an economic recession and financial crisis with limited global spillovers if the new Russian set up is perceived as a "Western satellite"

Financial markets (B4)

- Markets sell off and then a fragmented puzzle type of world might favour US and Asian assets and possibly Europe if a deep recession is avoided

B5] Nuclear de-escalation endorsed by China: War rapid manoeuvres

- EU/US implement new sanctions, overwhelming power in a civilised form.
- China joins the West in condemning violence
 - > Russia stops its military operations. The economy is frozen but the political regime survives.

Economic impact (B5)

- Commodity supply chains delays (including crude oil, natural gas, coal, nickel aluminium, palladium, titanium, iron ore), disrupts or holds back trade
- Drag on global economic growth
- Russia runs into a systemic financial crisis and economic recession (the depth of which depends on the war length)
- Fiscal and monetary efforts to get bolder. ECB steps back from normalisation
- Migrant crisis hitting Europe
- Europe moves into the new military doctrine

Financial markets (B5)

- Sustained pressure on energy markets
- Financial markets in uncharted waters (due to systemic risk on Russian markets)
- Flight to quality (classical safe havens)
- The cutting-off of some Russian Banks from SWIFT incentivises the use of alternative channels, including crypto-assets (e.g., Ethereum)

[C] Resolution of the conflict taking longer

Military deadlock, with Ukraine resisting and the Russian offensive continuing for months

C1] Prolonged military struggle but low-intensity conflict

Economic impact (C1)

- Civilian and military casualties
- Limited global supply chain disruption
- Growing public discontent and anger in Russia
- Escalation into sanctions inflicted on Russia
- NATO enlargement, with Nordics likely joining but no direct military confrontation
- Stagflation in Europe
- The ECB de facto loses its independence. It will have to reconsider asset purchases (to support defence and energy transition spending) directly or indirectly.

Special Ukraine Anatomy of a crisis

Financial markets (C1)

- Fight against global stagflation: Central banks back to the forefront with a debatable move on the long end of the yield curve and global financial conditions
- Real rates to stay in negative territory: after a correction, investors would reposition themselves in equity, credit, searching for sources for real return in EMs
- Search for safe liquid assets (cash, treasury, high quality + value equity)

C2] Prolonged military struggle & high-impact: expect the worst

- Possible use of nuclear weapons
- Global systemic risk, global stagflation, financial markets crash and remain highly volatile

A period of war can justify a strong financial repression. Real interest rates will remain in deep negative territory.

Finalised on 1st March 2022

Special Ukraine Q&A

You asked, we answered

Our answers to some of the key questions asked concerning the Ukraine crisis

1] Will the global economy enter stagflation or not?



Pierre BLANCHET,
Head of Investment
Intelligence

The longer the conflict continues, the more consumer and business confidence will deteriorate

The Ukrainian war is happening in the context of decelerating global growth and high inflation. The post Covid-19 recovery is now behind us and economies were expected to head towards their potential as the freeing up of bottleneck and supply-chain constraints relieved inflation pressures. However, the Russian invasion has brought energy prices to record levels and reduced short-term visibility.

In Europe in particular, we expect weaker domestic demand dynamics – which are being adversely affected by **higher inflation (rising energy and commodity prices), higher production prices impacting corporate profit margins, higher interest rates affecting investments and NGEU firepower –to be diluted by higher costs.** This is a shock of uncertainty that may affect the dynamics of business investment and household consumption in the short term. Sanctions on Russia could limit exports of important raw materials and grains, on top of oil and gas. Supply shortages could eventually have a negative impact on industrial production, and consumers could be hit by higher food prices.

The longer the conflict continues, the more consumer and business confidence will deteriorate, and the more likely that inflation will remain high and economic activity will slow. Because of its geographical proximity and energy dependence, the confidence shock would be stronger in continental Europe than in the US. This is all the truer as the current crisis could be coupled with a migratory crisis (there are already almost 400,000 refugees in Ukraine's neighbouring countries).

We expect both the ECB and the Fed to err on the side of caution in the short term. Both will probably be keen to signal their willingness to normalise monetary policy this year in order to anchor inflation expectations, which will may add further downward pressure on demand. However, the question of monetary policy will not be in the same terms for the Fed and the ECB. The Fed can more easily justify a rate hike and stop its asset purchases than the ECB. The risk of a marked economic slowdown is much more pronounced in Europe than in the US. Several European economies could enter stagflation by the end of 2022 or in 2023.

At the end of the day, we can say that **staglatory forces are already at play, due to slowing growth and high inflation. But stagflation in the true sense (a sharp slowdown or even recession with persistent inflationary pressures) will only happen if the conflict in Ukraine stalls and several layers of sanctions are implemented.**

Finalised on 27 February 2022

Special Ukraine Q&A

2] Central banks policies: tapering or not tapering?



Valentine AINOUEZ,
*Deputy Head of Developed
Markets Research*

*Russian-Ukrainian
conflict is going
to push inflation higher*

The Ukraine crisis might delay, but not derail, the normalisation of Eurozone monetary policy and should have a very limited impact on the Fed's decisions.

In February, market participants went through a radical repricing of inflation expectations and monetary policy actions. We think that, despite the dramatic military escalation, central banks will act and remove the accommodation.

Inflation in the US and in the Eurozone remains in record territory and the Russian-Ukrainian conflict is going to hit inflation prints, especially in Europe via energy prices (namely for natural gas). It will take time before second-round effects dent into growth via lower disposable income while, at the same time, the latest economic data confirm the strong recovery in developed economies.

The US labour market is booming with very strong wage growth. The labour market recovery is also impressive in all Eurozone countries, although wage growth has so far remained subdued.

In the Eurozone, new economic projections in March could open the door to a rate hike in 2022 and, implicitly, an end of the asset purchase program in Q3. However, **we expect the ECB to be more cautious.** Governing Council member Francois Villeroy de Galhau said the ECB is "obviously monitoring closely the geopolitical developments and their possible economic and financial implications. "Optionality – about the right monetary stance – and flexibility – to guarantee the right monetary transmission – are the two names of the game for our policy."

The Fed will hike rates in March (by 25bps) and enter a "light" quantitative tightening in Q2 to avoid abating equity markets' potential. **We see an inconsistency between the Fed's terminal rate, which should reprice higher, if the Fed want to get the inflation "genie" back to the 2% bottle.**

Finalised on 27 February 2022

Special Ukraine Q&A

3] How to play the equity value rotation in Europe in this new context?



Éric MIJOT,
Head of Developed Markets
Strategy Research

The Value style has the potential to withstand the turmoil

Since the autumn of 2020, the Value factor, as measured by the MSCI Europe index, has begun a rebound phase compared to the Growth style. The historical valuation gap between these two factors and the rebound in long rates and inflation expectations have strongly contributed to this turnaround. The MSCI Europe Value outperformed the MSCI Europe Growth by 15% from the end of October 2021 to 10 February 2022, when the US warned of a full-scale invasion of Ukraine. From then on, the MSCI Europe dropped (-7% to 24 February), a movement amplified by the banking sector (-14%), often associated with the Value style, but the MSCI Europe Value itself fell only slightly more than the market (-8%).

Indeed, the other overweighted sectors in the Value index have offset the banks' underperformance. The index is exposed to three categories of sectors: 1) Financials (overweighted by 10%, including 6% for banks); 2) Energy and Materials (overweighted by 7%); and 3) Defensive sectors, such as Utilities and Communication Services, while traditional cyclical sectors (Industrials, Consumer Discretionary and IT) are underweighted by 16%.

On the economic front, **the Russian-Ukrainian crisis could ultimately lead to less growth and more inflation in Europe, driven in particular by energy prices. Moreover, with the increase in risks, the cost of risk could also rise at the banking level.** If the geopolitical situation becomes more complicated, the MSCI Value Europe index could then suffer further in the first group of sectors (financials), **but exposure to commodities and defensive stocks should still allow it to absorb the shock in relative terms**, as has happened in recent weeks. Finally, let's not forget that the yield offered by Value (around 3.5%, compared to around 1.5% for Growth stocks) is an additional argument.

In conclusion, **the Value style has the potential to withstand the turmoil. Combining it with the Quality style, which favours non-leveraged companies**, also makes sense. Finally, let us not forget that crises arising from geopolitics are often temporary and generate opportunities that could well benefit the Value style in the medium term, especially as inflation levels are likely to be permanently higher in the coming years.

Finalised on 27 February 2022

Special Ukraine Q&A

4] What could be the impact of Ukrainian war on emerging markets?



Alessia BERARDI,
Head of Emerging Macro
and Strategy Research

*Most of the negative
impact will be
concentrated in areas
near the conflict zone*

As far as Emerging Markets are concerned, **most of the negative impact will be concentrated in areas near the conflict zone and on net oil/gas Importers.**

Eastern Europe will suffer through its direct trade exposure to Russia as well as indirectly through the weakness that the current crisis is inflicting on core European countries such as Germany, one of the region's most important trade partners.

A prolonged conflict, could generate **refugee movements, which would weigh on fiscal positions not yet restored after the pandemic.** In this regard, the most vulnerable countries in terms of thin fiscal buffers are Hungary and Romania. For **Poland**, which is already struggling to comply with the rules of access to the European Fund, the refugee flows could divert resources from more productive items. While **Oil & Gas Net Importers** will suffer an external and fiscal deterioration (high imports bill and high energy subsidies cost), in particular the ones with twin deficit like India, **Commodity Exporters** will benefit relatively from the recent events. Indeed, **Latin America**, not only is physically distant and the least commercially linked to the conflict zone, but even the most positively correlated to the Commodity cycle, either via Oil or Metals (only Mexico is less so). In the meantime, China shift of position to more strategically neutral is an important element to consider for more effective peace talks in the near future. On the Equity side, while the stance remains cautious and selectivity is the name of the game, trends in place before the crisis should continue stronger: the **Brazilian Equity Index**, which is already being impacted by the rotation towards Value, has proven quite resilient at the front of the recent events. In the Fixed-Income space, the preference goes to the **Hard Currency Debt amid high Oil Prices** and a more uncertain outlook for growth and inflation penalising **Local Debt**. Local currency bonds could end up being relatively less appealing at front of the crisis, as sliding towards stagflation means more persistently high inflation, as well as the possibility that delayed MP easing will reduce the appetite for long duration and as well as for EMFX.

Finalised on 2 March 2022

CENTRAL & ALTERNATIVE SCENARIOS (12 TO 18 MONTHS HORIZON)

Monthly update

We amend the narrative of our scenario to take into account the consequences of the war in Ukraine. We increase the probability of our downside scenario to 30% (from 15%) to reflect the rising risk of stagflation. The probability of our central scenario is moving down to 60% (from 70%) while the probability of the upside scenario is reduced to 10% (from 15%). We expect a repricing of risk premia across the asset classes in this new geopolitical and economic context.

DOWNSIDE SCENARIO
30%
Renewed slump toward stagflation
Analysis

- 🌐 Long lasting **war in Ukraine** is hurting confidence and activity, and pushes commodities and energy price higher for longer, and disrupting supply.
- 🌸 **Covid-19** Omicron resurgence leads to renewed mobility restrictions and bottlenecks.
- 🌟 Both triggers lead to an **economic downturn** while **inflation** remains elevated and uncontrolled.
- 🕒 **Renewed monetary and fiscal accommodation**, possibly a further step in financial repression.
- 🕒 Inflation amid slower growth, forces some **Central Banks** and the ECB in particular, to **deviate** from their guidance and potentially lose credibility.
- 🌿 Policies and investments designed to fight **climate change** are postponed and/or countries policies are disorderly implemented.

Market implications

- Favour cash, USD and US Treasuries
- Play minimum-volatility strategies
- Gold
- Commodities and energy

CENTRAL SCENARIO
60%
Bumpy road, regional divergences
Analysis

- 🌐 The **war in Ukraine** is hitting confidence and pushes commodities and energy price temporarily higher.
- 🌸 **Covid-19** becomes an endemic disease, with random contagion waves.
- 🌸 **Global activity** to hold better than previous waves, but supply chain bottlenecks will remain until end-2022.
- 🌟 **Growth** progressively abate to trend in 2022. Opening 2023's to downside risk. Soft patch in H1 2022 due to China's slowdown, negative impact of Omicron and accelerating inflation.
- 🌟 Persistent **inflation** pressures throughout 2022 due to high energy and commodity prices, supply-side bottlenecks, rising wage pressures; and abating in 2023. Inflation is a psychological and political issue.
- 🕒 **Monetary policy asynchrony**: Fed in fast move from tapering to a light QT and initiating a hiking cycle; BoE in a soft hiking cycle, ECB recalibrate QE and potentially hiking rates; and PBoC on an easing bias. Rates to move higher but to stay low for longer.
- 🕒 **Fiscal policy**: withdrawal of some support, but public funding and subsidies are used to smooth the impact of the energy transition on households in the short term.
- 🌿 **Climate change** bites into growth and pushes commodity and energy prices higher, adding to stagflationary trends.

Market implications

- Lower risk-adjusted expected returns real
- Contained steepening of US Treasuries yield curve as well as EZ and EM
- Inflation hedge via gold, linkers and equities
- EM: Short-term caution, long-term real income and growth story intact

UPSIDE SCENARIO
10%
Inclusive and sustainable growth
Analysis

- 🌐 The **war in Ukraine** ends quickly with limited disruption of the energy and commodities market.
- 🌸 **Endemic recedes** more quickly than anticipated, despite variants.
- 🕒 Extra savings and wage rises fuel **consumption** with low erosion of corporate margins.
- 🕒 **Productivity gains** thanks to digital and energy transition and structural reforms.
- 🌟 **Inflation** remains under control.
- 🕒 **Higher interest rates**, due to stronger investment and less savings.
- 🕒 **Central banks'** policy normalisation is well received by financial markets.
- 🌟 **Debt is sustainable** thanks to strong growth and a gradual shift towards fiscal discipline.
- 🌿 **Inclusive growth** and effective fight against inequality.
- **Possible triggers** include structural reforms, effective drugs and vaccine campaigns, and inclusive decentralised finance.

Market implications

- US Treasuries curves bear steepen
- Favour risky assets with cyclical and value exposure
- Favour linkers as an inflation hedge

TOP RISKS

Monthly update

We increase the probability of economic and geopolitical risks to 30% from 20% to take into account the war in Ukraine and its potential implications on the economic and financial risks. We consider Covid-19-related risks to be part of the economic risks.

Risks are clustered to ease the detection of hedging strategies, but they are obviously linked.

ECONOMIC RISK 30%

- **Global recession** driven by an oil and gas shock and a deteriorating sentiment as the war in Ukraine stalls
- **Economic crisis in Eastern Europe** following a collapse of the Russian economy, elevated energy prices, uncontrolled inflation and a migrant crisis
- **Pandemic 3.0**
 - After Omicron (2.0) a more dangerous and vaccine resistant variant starts a new wave
 - New lockdowns or mobility restrictions could further undermine the global recovery
- **Supply chain disruptions** carry on, and input cost pressures lead to corporate earnings recession
- **China property market collapses**, leading to lower growth prospects
- **Monetary policy mistake**
 - Central banks' miscommunication in the context of a high geopolitical uncertainty.
 - Central banks underestimate the strength of supply driven inflation and lose control
- **Climate change-related natural events** hurt growth visibility and social balance

FINANCIAL RISK 20%

- **Sovereign debt crisis**
 - The extended war would hurt DM vulnerable public finance with public debt as a share of GDP already at historically high levels
 - Most countries are vulnerable to rating downgrades and rising interest rates.
 - De-anchoring inflation expectations could lead to a bond market dislocation and harsher monetary tightening
 - EM weaknesses could also face a balance-of-payments crisis and increased default risks
- **Corporate solvency risk increases**, despite improving fundamentals as uncertainty rises and corporate margins are under pressure (high input cost, double orders lead to profit warnings)
- **Widespread greenwashing and ESG investment bubble** undermine the energy transition funding
- **USD instability** and gradual loss of its reserve currency status lead to unstable currency markets

(GEO)POLITICAL RISK 30%

- **War in Ukraine***
 - Short term resolution following Russia military success: markets instability remain as investors are starting to price in Putin crossing new red lines
 - Prolonged military struggle leading to a high intensity conflict leading to western military confrontation and potential market capitulation
- **EU political fragmentation** and populist vote bring a disagreement on how to manage the relationship with Russia
- **The US takes a hard line with China** in order to block any tentative to invade Taiwan. Accidental confrontations in the South China Sea or the Taiwan Strait
- **EM political instability driven by:**
 - Chaotic virus crisis management
 - Higher food and energy prices, leading to a wave of unrest similar to the Arab Spring
- **US & China lose credibility** on the energy transition and undermine the Paris agreement
- **Global warming** leads to an increased risk of conflicts, driven by water shortages and migratory movements
- **Cyber-attack or data compromise**, disrupting IT systems in security, energy and health services

* *For more detailed on potential outcomes see Special Ukraine table P. 12*

+ Cash, linkers, JPY, Gold, USD, Quality vs. Growth, Defensive vs Cyclical, Oil

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

+ DM Govies, Cash, Gold, USD, Volatility, Defensive, Oil

- Risky assets, AUD CAD or NZD, EM local CCY

- Oil, risky assets, frontier markets and EMs

- Credit & equity, EMBI

AMUNDI ASSET CLASS VIEWS

	Asset Class	View	1M change	Rationale
EQUITY PLATFORM	US	=		Recent weeks have been characterised by higher market volatility, led by the more hawkish tone from the Fed and rising geopolitical risks. In a rising real yield environment with inflation risks, equity is a place to look at, but selection is key.
	US value	+	▼	The rotation favouring value is a medium-term trend supported by rising real rates, and we believe this will continue as economic growth remains solid and the valuation discount of value is still attractive. We explore high-quality value names.
	US growth	-	▲	Overall, growth remains overvalued, and if real rates increase, it may weaken further. Yet, we acknowledge that selective tech growth names are becoming attractive after the recent volatility.
	Europe	=	▼	Visibility on European equities is decreasing amid the escalating Russia-Ukraine conflict and increasing energy prices. While the economic reopening still bodes well for the area, we take a neutral stance in order to reassess the evolution of the conflict and its economic implications for the area.
	Japan	=		Accommodative monetary and fiscal policies, along with improving earnings momentum, should be supportive for the country's markets. We are watching the evolution of the pandemic and the resultant pressures, if any.
	China	=/+		Better policy visibility emerging from a clear easing stance, coupled with a more balanced growth approach that should help clear out systemic risks, is supportive of Chinese equities. However, there are near-term uncertainties in the form of zero tolerance of Covid-19. All this requires a watchful and a selective approach in navigating the country's equities.
	Emerging markets	=		EM present a fragmented universe where investors should focus on important factors to avoid using a uniform approach – commodity exports, strong internal demand ('the help yourself' countries), countries with a value tilt, and those with limited external vulnerability. Overall, country-specific factors and bottom-up selection remain important.
FIXED INCOME PLATFORM	US govies	-		While we believe the Fed will raise rates multiple times this year (four), we stay cautious and agile on duration and believe the Fed will not tighten financial conditions so much that it stalls the economic recovery. Flexibility in FI is the name of the game when policy uncertainty and geopolitical risks are high. TIPS show signs of high valuations.
	US IG corporate	=		Credit markets have been affected by the tightening stance shown by the Fed even as financial conditions remain accommodative. We believe current valuations reflect the positive fundamentals, but there is uncertainty with respect to future CB policy. Thus, we aim to minimise our duration exposure and look for income in securitised markets.
	US HY corporate	=		While HY spreads have widened amid the Fed's tightening stance, we think this is more due to liquidity risks and less due to fundamental concerns over credit quality. Nonetheless, we are monitoring the effects of future monetary policy on this asset class, and are staying clear of names that could destroy value through increasing leverage.
	European govies	-/=		A relatively hawkish ECB supports our cautious stance on duration amid our belief in upward yield trajectory, but we are flexible across geographies and curves to benefit from tactical movements driven by risk sentiment. The policy path for the ECB will not be straightforward and becomes increasingly uncertain amid rising risks from the Russia-Ukraine crisis.
	Euro IG corporate	=	▼	Recent ECB communications indicate near-term volatility for the asset class due to receding support from the regulator's purchase programme, increases in core yields, and higher liquidity premiums. However, corporate fundamentals (balance sheet strength, earnings) are strong. We look for relative value opportunities in IG and favour shorter-maturity assets.
	Euro HY corporate	=		HY provides carry at reasonable risk, but we remain vigilant in light of liquidity concerns and pressures from upward movements in core yields. While default rates remain low and we prefer spread compression opportunities in BB (rising stars), we aim to balance the potential for extra yield with liquidity and quality through our bottom-up selection approach.
	China govies	=/+		We see relatively stable appetite for Chinese debt amid clear monetary easing, attractive carry, and expectations of foreign inflows. We remain neutral/positive and are closely monitoring the policy environment.
	EM bonds HC	=/+		HC bonds provide attractive yields, but inflation and policy tightening in DM are important considerations for us. We believe EM spreads may tighten in absolute and relative terms vs DM over the medium term, but we maintain a bias towards HY vs IG. We are defensive on duration, but slightly less so now due to uncertainty due to Russia's actions.
	EM bonds LC	=		We prefer countries where monetary tightening cycles are maturing or are close to peak, and where real rates are back in positive territory, i.e., China (monetary easing mode compared to 2021). However, we are cautious on EM FX. Country-wise, we are getting defensive on Russian bonds and FX near term, and are closely monitoring the situation.
OTHER	Commodities			Inflationary regime and still-robust macro backdrop allow us to be constructive on base metals. Geopolitical risks may provide near-term support to gold.
	Currencies			We keep our 12M EUR/USD target unchanged at 1.14 as the upside potential in the single bloc currency is capped by a relatively dovish ECB (vs the Fed). Higher interest rate expectations in Europe already seem to be priced into the EUR.

LEGEND

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Negative Neutral Positive Downgrade vs previous month Upgraded vs previous month

Source: Amundi, as of 24 February 2022, 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.

Special Ukraine Macro and market forecasts

Macroeconomic forecasts

(28 February 2022)

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2021	2022	2023	2021	2022	2023
US	5.8	3.2/3.4	2.1/2.3	4.7	6.0/5.7	2.9/2.4
Japan	1.7	2.1/2.4	0.6/0.9	-0.2	1.3/0.7	0.1/0.6
Eurozone	5.5	2.0/3.2	1.8/2.3	2.6	5.8/4.5	2.6/2.0
UK	7.5	3.5/4.2	1.9/2.2	2.6	6.7/5.9	2.8/2.2
Russia	4.7	-5.6/-3.6	-0.5/-1.5	6.7	13.0/9.0	7.5/5.4
China	8.1	4.2/4.5	4.5/4.9	0.9	2.0/1.4	1.6/1.6
Developed countries	5.1	2.8/3.2	1.9/2.2	3.1	5.0/4.3	2.3/1.9
Emerging countries	6.7	3.6/4.1	3.8/4.3	4.4	7.4/6.1	4.7/4.3
World	6.0	3.3/3.7	3.0/3.4	3.8	6.1/5.4	3.6/3.2

The Russia/Ukraine crisis is pushing the regime shift one step further with more severe economic implications for some regions, in this case Europe because of its energy dependence and geographic proximity. While it is still difficult to anticipate how macro fundamentals will be impacted through this crisis because of the uncertainty of its evolution and final income, we expect inflation in Eurozone to remain stubbornly high during the year on energy and food, negatively affecting both demand and production. This context could be indeed consistent with a temporary recessionary outcome in the lower end of our projections.

Due to the uncertainty related to the Russia/Ukraine conflict and its impact on global economic trend, we started with insulating the Oil/Commodity channel (incorporating a more acute geopolitical risk on top of our FV analysis on the next 6M horizon) to assess the impact on the main areas macro forecasts. Overall, Global growth revised down by 0.5% in 2022. The main drivers countries more dependent on external sourcing of Oil/Gas across DM and EM. Global Inflation revised higher across EM & DM (around 0.5% over 2022), based on the different weight of Energy component in the CPI baskets. In Eurozone, Inflation will remain more stubbornly high during the year, negatively affecting both demand and production. The lowest growth band in EU (2.0% in 2022) is consistent with a stagflationary or temporary recessionary outcome, where GDP YoY growth could slow to levels in a range of 0- 0.5% YoY over the year.

Key interest rate outlook

Developed countries

	25/02/2022	Amundi +6M	Consensus +6M	Amundi +12 M	Consensus +12 M
US	0.13	1/1.25	1.21	1.5/1.7	1.85
Eurozone	-0.5	-0.5	-0.4	0.00	-0.01
Japan	-0.02	-0.1	-0.02	-0.1	+0.01
UK	0.50	1.00	1.55	1.25	1.93

Emerging countries

	28/02/2022	Amundi +6M	Consensus +6M	Amundi +12 M	Consensus +12 M
China	3.70	3.60	3.60	3.60	3.60
India	4.00	4.50	4.35	5.00	4.75
Brazil	10.75	12.25	11.8	10.75	10.90
Russia	20.00	16.00	na	12.00	na

Long rate outlook

2Y. Bond yield

	25/02/2022	Amundi +6M	Forward +6M	Amundi +12 M	Forward +12 M
US	1.57	1.6/1.8	1.94	1.8/2	2.11
Germany	-0.42	-0.2/0	-0.21	-0.1/0.1	-0.05
Japan	-0.02	-0.10/0	0.00	-0.10/0	0.03
UK	1.21	1.0/1.20	1.38	1.20/1.40	1.39

10Y. Bond yield

	25/02/2022	Amundi +6M	Forward +6M	Amundi +12 M	Forward +12 M
US	1.95	2/2.2	2.06	2.1/2.3	2.13
Germany	0.18	0.1/0.3	0.25	0.1/0.3	0.32
Japan	0.21	0.1/0.3	0.27	0.1/0.3	0.33
UK	1.43	1.3/1.5	1.54	1.4/1.6	1.58

Currency outlook

	25/02/2022	Amundi Q2 2022	Consensus Q2 2022	Amundi Q4 2022	Consensus Q4 2022		25/02/2022	Amundi Q2 2022	Consensus Q2 2022	Amundi Q4 2022	Consensus Q4 2022
EUR/USD	1.12	1.09	1.13	1.14	1.16	EUR/SEK	10.47	10.61	10.33	10.25	10.11
USD/JPY	115	114	116	118	116	USD/CAD	1.27	1.31	1.26	1.23	1.24
EUR/GBP	0.83	0.84	0.83	0.82	0.84	AUD/USD	0.71	0.70	0.73	0.76	0.75
EUR/CHF	1.04	1.03	1.06	1.10	1.08	NZD/USD	0.67	0.65	0.69	0.68	0.71
EUR/NOK	10.05	10.16	9.86	9.55	9.75	USD/CNY	6.32	6.45	6.40	6.30	6.50

Source: Amundi Institute

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.

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.

— 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.

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INVESTMENT OUTLOOK



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