Confidence must be earned

Amundi ASSET MANAGEMENT

Global Investment Views

NOVEMBER 2021

MARKETS IN QUICKSAND: INFLATIONARY RISKS PERSIST

The alignment of planets regarding inflation[1] is likely to persist in the medium term. While this has been our view for some time, markets and central banks are realising only now that not all components of inflation will be temporary. Consequently, investors should stay risk-neutral, vigilant and active with regards to economic data and asset valuations.

INVESTMENT IMPLICATIONS

RISING INFLATION EXACERBATING INEQUALITIES

Supply chain bottlenecks and reviving consumer demand are causing higher inflation, which is aggravated by rising energy and food prices. The last ones affect the vulnerable sections the most. Investors should stay vigilant of opportunities that can contribute towards addressing these challenges (green transition, reducing inequalities) without compromising on returns.

STAY CAUTIOUS ON GOVERNMENT BONDS

We expect nominal rates[2] to drift higher but the key variables to watch are real rates[3] and the speed of increase in both. Thus investors should remain defensive on duration[4], with a very flexible approach across yield curves.

EARNINGS GROWTH IS CRUCIAL

While waiting for better entry points, we focus on Value[5], Quality companies with a potential to deliver sustainable earnings growth in the face of rising input costs. Businesses that possess strong pricing power are key here.

USE THE CREDIT LEVER TO GENERATE INFLATION-ADJUSTED RETURNS

As corporate fundamentals improve, euro investment grade[6], high yield[7] and subordinated bonds[8] along with emerging markets fixed income, offer attractive prospects for real returns. However, selection is crucial to identify gems and avoid over-leveraged areas.

OPPORTUNITIES ON THE HORIZON FOR WATCHFUL INVESTORS

Rising inflation and slowing growth momentum, investors should place greater emphasis on selection. Opportunities exist for balanced investors who explore - with the appropriate time horizon - the entire fixed income spectrum including in high quality credit, subordinated bonds, emerging markets debt. Secondly, ESG[9] themes, across equities and fixed income, are another area where investors should focus on amid the push for green transition and fight to reduce inequalities.

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1. Inflation: increase of the general level of prices for goods and services, decreasing purchasing power as a result.
2. Nominal rates: refer to the interest rate of a debt instrument before taking inflation into account.
3. Real rates: refer to the interest rate of a debt instrument that takes inflation into account.
4. Duration: expressed in number of years, the duration is the present calculation, of the average lifetime, of all the interest and capital flows relating to a bond or a bond portfolio. Others things being equal, the higher the duration is, the higher the risk is. In order to know the level of risk of a portfolio composed of bonds, it is useful to know the duration of each bond to determine the average duration of the portfolio.
5. Value: stocks considered underpriced given the performance of the underlying company.
6. Investment grade: refers to securities issued by an issuer of negotiable debt securities (Treasury bonds...) or bonds for which the Standard & Poors rating is greater than or equal to BBB-. 'Investment grade' bonds are considered by the various rating agencies as having a low risk of non-repayment.
7. High yield: bonds with a lower credit rating but which therefore offer a higher return.
8. Subordinated bonds: bonds that are paid after all other corporate debts and loans are repaid, in the case of borrower default.
9. ESG: criteria used to evaluate a company's consideration of environmental standards, social criteria (workers/union rights and ethical behavior towards clients and suppliers) and governance standards (management corruption). The consideration of these criteria, beyond the traditional financial criteria, distinguishes socially responsible investments (SRI) from traditional management.