Amundi
ASSET MANAGEMENT

Cross asset investment strategy

Research,Strategy and Analysis

WEEKLY

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April 18 - 22, 2016

Highlights of the week

- **US :** Mixed real estate figures. Initial jobless claims reach a new multi-decade low.
- **Eurozone :** Public debt presented its first annual decline as a share of GDP since the crisis.
- **Japan :** Improvement in the trade balance figures in March.
- **Emerging Markets :** Weak inflation data in India. Politics continues heating up in Brazil.
- **Markets :** Oil prices recovery contributed to the pressure on government bonds; the US dollar weakened against almost all major currencies over the week; credit spreads tightened further in both the IG and HY sectors; equity markets up once again.

Key focus

Equities: the main US market is back to its historical high!

- **The fears of the start of the year have been erased**

After the concerns that prevailed at the start of the year (slump in the RMB, concerns over China), the equities markets regained their bull trend just before mid-February. Some of them were able to erase January's poor performance, specifically the US market. The markets benefited from two growth drivers: the turnaround in oil prices (Brent has risen from $27 to $43 per barrel since the end of January) and the weakening of the dollar, in particular following March's FOMC meeting when the Fed showed that it was determined to remain accommodating over a longer timeframe. The US ISM Manufacturing Index moved back above 50 and, recently, Chinese statistics (GDP, industrial output, external trade, money supply) have reassured the markets over China's capacity to "manage" the soft landing of its economic growth.

- **The US market mitigated the fall and then rebounded strongly**

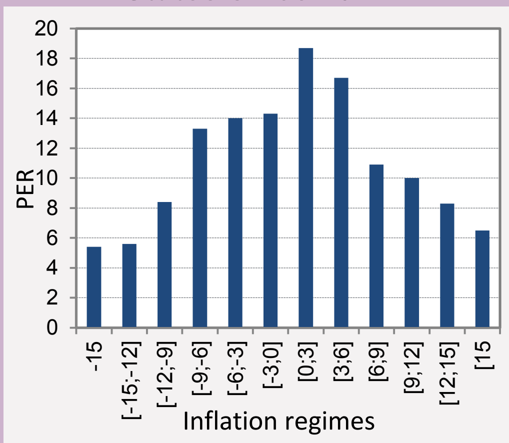
The market PER fell from its 18x 12-month trailing earnings to less than 16x, before returning to its starting point. As such, there is a perennial relationship through time between inflation and PER levels (see chart). The markets earn the most when inflation is slightly positive (between 0% and 3%). If inflation increases or falls into negative territory from these levels, the PER level falls. This is exactly what happened at the beginning of the year. The 18x level is perfectly in line with the historic average for a perfect inflation regime (between 0% and 3%). Deflationary risks then drove the PER downwards. Finally, when these risks dissipated, we returned to square one.

- **What does this mean for the future?**

Exceeding the 18x 12-month trailing earnings level would mean being back in upside exaggeration territory in terms of valuation. Unless of course profits were to rise thanks to an improvement in nominal GDP growth. During the oil counter-shock of 1987, margins that were declining managed to rebound. However, we remain cautious about this possibility as wages are beginning to recover. Whatever the case, the US market valuation currently seems very high compared to other markets. A combination of the S&P500's PER and PBV relative to the MSCI World comes out to more than one standard deviation above the average for the last ten years, which leaves room for a catch-up (in relative terms) in the other markets, in particular the emerging markets and the Eurozone.

In 2016, the markets have become decidedly more tactical than directional.

PER and inflation in the United States since 1914



Source: Datastream, Amundi Research

The bars represent the median PER for the US market by inflation tranche. They are calculated on the base of historic earnings since 1914.

The week at a glance

Other events

Brazil >

Politics continues heating up in Brazil. After months of discussions on a possible impeachment of President Dilma Rousseff, the lower house of Congress finally voted and decided on Sunday (18 April) to support the impeachment of the president who faces charges of breaking budget laws. For now the president is going to still rule the country. However, if the Senate decides by a simple majority to put Rousseff on trial, she will immediately be suspended for up to six months while the Senate takes a final decision. In this case, the Vice President Michel Temer, who was a former ally, will take office as acting president until 2018 - Rousseff's end term.

Uncertainty in the Brazil political side may persist for a while as no one knows how long the impeachment process is going to take. While markets reacted positively to the news as Mr. Temer is perceived as been more “market friendly” than Mrs. Rousseffs, it is important to note that life is going to be hard for Mr Temer if he assumes as president as: 1) he has little popular support as he and also dozens of political leaders, including his close associates, are under investigation for corruption; 2) It is not sure that he is going to have the majority in the Congress; 3) moreover, he would face a daunting task restoring confidence in the economy and taking the country out of recession.

Economic indicators

Eurozone >

Eurozone public debt came out to 90.7% of GDP in 2015, compared to 92% in 2014. This is the first annual decline since the crisis. The **public deficit** continued to shrink, to 2.1% of GDP (vs. 2.6% in 2014). For the major countries in the zone, the public debt to GDP ratio declined sharply in Germany (71.2% in 2015 compared to 74.7% in 2014) and to a lesser extent in Spain (99.2% vs. 99.3%), but rose in France (95.8% vs. 95.4%) and Italy (132.7% vs. 132.5%). In 2015, Germany posted a **public surplus** of 0.7% of GDP, while France, Spain and Italy posted **public deficits** of 3.5%, 5.1% and 2.6%, respectively. In addition to Spain and France, the Eurozone countries that maintained a deficit of 3% of GDP or higher were Greece (7.2% of GDP), Portugal (4.4%) and Slovakia (3%).

Most of the Eurozone’s debt-to-GDP reduction is due to Germany. In Spain's case in particular, the persistence of a large deficit means that debt stabilisation has not yet been achieved. The Eurozone will need support from the ECB for a long time to come, as it enables its member states to fund themselves at very low rates.

United States >

Mixed real estate figures, while weekly jobless claims hit a new low. In the real estate sector, **housing starts** disappointed in March (1,089,000 vs. 1,166,000 forecast and 1,194,000 in February), as did **building permits** (1,086,000 vs. 1,200,000 forecast and 1,177,000 in February). **The NAHB index** (which tracks real estate developer confidence) is stable in April at 58 (vs. 59 expected). In contrast, **resale home sales** were slightly stronger than expected (5.33m in March vs. 5.28m expected and 5.07m in February). Finally, **weekly unemployment benefit applications** hit their lowest level since 1973, at 247,000 (vs. 265,000 forecast).

The lower than expected housing start figures confirm that the initial first-quarter GDP growth estimate is likely to be very low (probably well below 1% annualised). That said, these figures alone are not sufficient to call into question the continued rebound in the construction sector, which is expected to remain a key driver of the recovery. The labour market continues to show increasing signs of strength, although a slowdown is likely during the second half of the year.

Japan >

In March, the trade balance rose 2.4% from the previous year with imports falling by 14.9%, much faster than the 6.8% decline in exports.

Terms of trade continued to improve and were impacted by lower oil prices until the beginning of the year. Although it accounts for only a small share of total exports (1.0%), we emphasise the rise in pharmaceutical products to an all-time high (+48% YoY) with solid demand from both China and the US. Automotive exports to China recovered for the second month in a row (+56% YoY), but electric machinery exports remain sluggish (-8% YoY). Exports to the US fell in general machinery (-14% YoY) but rose for automotive (+11% YoY) and equipment for transmission (+6% YoY). For the first quarter of the year, exports decelerated (+7.09% YoY) from the previous quarter (+22.22% YoY) mainly owing to the slowdown in China and Asian NIEs, while it stayed relatively strong in the Americas and Europe. Volume has been decreasing for years on the back of a sluggish global economy, although prices have been managed in such a way as to support the value of exports. However prices started falling on the back of the appreciation of the yen and therefore, the trade balance is likely to return to deficit.

India > **India's wholesale prices index (WPI) extended its yoy contraction trend** to 17 months in March, coming in slightly worse than expected at -0.85% (vs. consensus -0.70%, and prior -0.91%). **India's March CPI came in slightly weaker than expected** at 4.83% yoy (vs. consensus at 5.00%, and prior of 5.18%). The decline in CPI was mainly driven by softer energy prices, while food prices remain stable.

Indian wholesale prices have been in contraction for 17 months, which is the longest stretch of WPI deflation that India has experienced since 1975. However, the WPI bottomed out in August 2015 and has since shown an improving deceleration trend. We believe there is a chance that, in the next few months, the WPI will finally come back into positive territory. We think the marginal weakness in CPI is exactly in line with our overall view that the RBI's inflation outlook has been lagging, with inflation much weaker than the RBI expected. One important factor coming into sight is that a normal monsoon might happen this year in India, which would provide a very favourable inflation outlook. We believe the RBI has to remain accommodative longer than the market is expecting, and ease more than the market is expecting.

Monetary policy

Sweden > **The Riksbank decided to keep the interest rate unchanged at -0.5% as expected, but they extended their program of government-bond purchases for a further SEK 45 bn in Q2 2016.** A priori, this program is scheduled to end in June. Moreover, as stated in previous meetings, the Riksbank reiterated they are prepared to make monetary policy even more expansionary if this is needed to protect the inflation target of 2%. However, at this time, they added that they think further actions may not be necessary. It is also important to note that the decision was not unanimous: Ms Cecilia Skingsley introduced a reservation against the decision of purchasing further bonds given the current economic situation in Sweden.

The decision to extend the asset purchase program is controversial in the context of strong economic growth and better inflation outlook of the Sweden economy. Both indicators were, by the way, revised up in the new forecasts released by the Bank (GDP: from 3.7% to 4.1% in 2015 and from 3.5% to 3.7% for 2016; CPI: from 0,7% to 1% in 2016). The trigger behind this decision was clearly the currency: as stated by the Riksbank, in the context of a very expansionary monetary policy abroad, monetary policy in Sweden "needs to continue to be expansionary" in order to prevent the Krona from strengthening at a faster pace than in the central banks' forecast. For Sweden, the euro is by far the most important currency and the central bank does all it can to prevent too strong an appreciation of the SEK vs the EUR. However, we do not believe the new round of QE will be able to prevent further Krona appreciation due to the fact that 1) the amount of the QE itself is not impressive and 2) an important growth differential between Sweden and other G10 economies is making Sweden by far much more attractive for investments. Moreover, it is important to note that the Riksbank' hands are pretty much tied: strong growth will impact inflation at some point completely closing the room for any additional monetary policy expansion, an opposite direction from other major central banks.

Financial markets

Fixed-income

Despite a disappointing meeting in Doha, oil prices recovered further as we are writing, and this trend contributed to the pressure on government bonds: therefore both European and US yields to maturity tended to trend higher over the week, together with TIPS break-evens. This trend was also consistent with a further tightening in credit spreads, on both sides of the Atlantic, and with generally lower levels of financial stress and equity implied volatility.

We believe that a partial recovery of energy-driven components of inflation, together with the effect of improving wages and other components will provide some arguments for the Fed to move on with a further rate hike of 25 b.p., probably by mid-year. The recovery in financial conditions together with easing fears about a hard landing in China are coherent with this possibility. However, Janet Yellen was quite determined in her dovish message on the limited normalisation needed this year, and the dots have shown a growing consensus for just two 25 b.p. hikes in 2016. We are therefore maintaining our view of a slight flattening of the US Treasuries' curve, with only a limited increase in long-term yields.

Foreign exchange

The US dollar weakened against almost all the major currencies over the week, with few exceptions such as the yen, which depreciated 2.3%. Commodity currencies in particular had a very strong performance, especially the oil related ones. The Colombian peso (as at last week) was the currency that appreciate the most (almost 2%) while the Norwegian krone and the Canadian dollar, gained more than 0.5%. It is also important to note the strong performance of the GBP/USD which gained 1.4%, reaching back the 1.44 level, not seeing since 18 March. The EUR/USD was relatively stable at the 1.12 level over the week.

Improving economic indicators in China and renewed expectations of an oil production freeze agreement by the main oil exporters in the short run has contributed to reduce risk aversion and to support commodity currencies recently. However, if the hawkish tone adopted by some Fed members recently regarding monetary policy for the US is confirmed next week by the FOMC , the US dollar may gain some upside momentum.

Credit

Credit spreads tightened further in both the IG and HY sectors. Among speculative grade issuers, USD denominated bonds outperformed Eurozone HY bonds and both generated positive excess return over corresponding government bonds. Among EUR high grade names, financials recovered only a small part of the gap accumulated vs. non-financials in the weeks following the ECB's latest announcements, and, relatively speaking, valuations are still more attractive for the former than the latter.

Non-financials have outperformed financials since the ECB's latest announcement, and the gap in valuations now looks to be more in favour of financials. Despite not being included in the purchase programme (as IG non-financials are) or not being indirectly supported by QE (as IG financials with TLTROs are), EUR HY strongly outperformed both IG financials and non-financials. In the 1-5 year segment, BBBs and BBs still represent most of the remaining yield (55%) in the Eurozone, compared to just 11% of outstanding debt: therefore, they are likely to be more supported by the search for yield in perspective. Furthermore, ECB measures will further reduce default risks in the Eurozone from an already stable outlook.

Equity

Equity markets up once again. Some markets have now been in positive territory since the beginning of the year. These include the S&P500 (+3%) and the emerging markets (+7%). The Eurozone is a little further back at less than 3% (MSCI EMU) and Japan is lagging at -8%. Markets remain fairly closely correlated to oil prices, which held up against the failed negotiations in Doha and the end of strike action in Kuwait. The beginning of the earnings publication season in the United States has also been encouraging, with 85% upside surprises from 83 releases.

With the US market PER having virtually returned to 18x 12-month trailing earnings, room for growth is more limited. Unless valuations move into excessive territory or earnings improve of course. In any case, the relative valuation of the US market is already excessive compared to other markets, which leaves room for the other markets to close the gap, relatively speaking at least.

Key upcoming events

Economic indicators

US: Markets expect consumer sentiment to improve in April **Germany :** Inflation is expected to be in negative territory in April

Date	Country	Upcoming macroeconomic data	Consensus	Prior
25 April	Germany	IFO business climate index, April	107.1	106.7
26 April	US	CB Consumer confidence, April	95.6	96.2
	US	PMI services, April	52.5	51.3
27 April	UK	GDP, QoQ, Q1	0.4%	0.6%
	Germany	CB Consumer confidence, May	9.4	9.4
28 April	US	GDP, QoQ, Q1	0.7%	1.4%
	Japan	Core CPI, YoY, March	0.5%	0.6%
	Japan	Unemployment rate, March	3.3%	3.3%
	Japan	Retail sales, MoM, March	0.5%	-2.3%
	Japan	Industrial production, MoM, March	2.8%	-5.2%
	Germany	Unemployment rate, April	6.2%	6.2%
	Germany	CPI, MoM, April	-0.2%	0.8%
29 April	Eurozone	GDP, QoQ, Q1	0.4%	0.3%
	Eurozone	Unemployment rate, March	10.3%	10.3%
	US	Michigan consumer sentiment, April	90.2	89.7
	UK	GFK Consumer confidence, avril	-1	0

Source: Bloomberg, Amundi Strategy

Auctions

Date	Country	Auctions of European sovereign debt [maturity, amount (if available)]
25 April	Germany	Short-term, € 1.5 Bn
	France	Short-term, € 6.5 Bn
26 April	Italy	8 years, € 750 M
27 April	Germany	30 years, € 1 Bn
	Italy	Short-term, € 6 Bn
	Italy	Long-term, amounts not available on Friday
28 April	Italy	Long-term, amounts not available on Friday

Source: Bloomberg, Amundi Strategy

Key events

Date	Upcoming monetary policy committee meetings
27 April	Federal Reserve (Fed)
	Bank of Japan (BoJ)
12 May	Bank of England (BoE)
15 June	Federal Reserve (Fed)
2 June	European Central Bank (ECB)

Date	Upcoming political events
17 April	Oil producers meeting (OPEC and non-OPEC members), Doha
22 April	Eurogroupe Meeting
May 2016	G8 Shima (Japan) summit
June 2016	The United Kingdom European Union membership referendum
November 2016	Presidential elections in the United States

Source: Amundi Strategy

Market snapshot

Equity markets	22/04/2016	Over 1 week	Over 1 month	Ytd
S&P 500	2091	0,5%	2,0%	2,3%
Eurostoxx 50	3139	2,8%	2,9%	-3,9%
CAC 40	4565	1,6%	3,0%	-1,6%
Dax 30	10370	3,2%	3,8%	-3,5%
Nikkei 225	17572	4,3%	3,1%	-7,7%
MSCI Emerging Markets (close -1D)	854	0,8%	2,8%	7,5%
Commodities - Volatility	**22/04/2016**	**Over 1 week**	**Over 1 month**	**Ytd**
Crude Oil (Brent, $/barrel)	45	4,7%	7,9%	21,0%
Gold ($/ounce)	1242	0,6%	-0,5%	17,0%
VIX	14	0,2	-0,3	-4,4
FX markets	**22/04/2016**	**Over 1 week**	**Over 1 month**	**Ytd**
EUR/USD	1,13	-0,3%	0,3%	3,6%
USD/JPY	111	2,3%	-1,0%	-7,7%
EUR/GBP	0,78	-1,7%	-1,1%	5,9%
EUR/CHF	1,10	0,6%	0,7%	1,1%
Fixed Income markets	**22/04/2016**	**Over 1 week**	**Over 1 month**	**Ytd**
EONIA	-0,34	--	-	-22 bp
Euribor 3M	-0,25	-	-1 bp	-12 bp
Libor USD 3M	0,64	-	+1 bp	+2 bp
2Y yield (Germany)	-0,50	+1 bp	-2 bp	-15 bp
10Y yield (Germany)	0,23	+11 bp	+2 bp	-40 bp
2Y yield (US)	0,82	+8 bp	-7 bp	-23 bp
10Y yield (US)	1,87	+12 bp	-7 bp	-40 bp
Eurozone Sovereigns 10Y spreads vs Germany	**22/04/2016**	**Over 1 week**	**Over 1 month**	**Ytd**
France	+33 bp	-1 bp	-1 bp	-3 bp
Austria	+19 bp	-2 bp	-2 bp	-8 bp
Netherlands	+21 bp	-1 bp	+12 bp	+4 bp
Finland	+29 bp	-2 bp	-3 bp	--
Belgium	+38 bp	-2 bp	-2 bp	+4 bp
Ireland	+69 bp	-1 bp	+5 bp	+16 bp
Portugal	+305 bp	+1 bp	+34 bp	+116 bp
Spain	+135 bp	-2 bp	+13 bp	+21 bp
Italy	+123 bp	+2 bp	+19 bp	+26 bp
Credit markets	**22/04/2016**	**Over 1 week**	**Over 1 month**	**Ytd**
Itraxx Main	+68 bp	-5 bp	-4 bp	-9 bp
Itraxx Crossover	+290 bp	-26 bp	-10 bp	-24 bp
Itraxx Financials Senior	+81 bp	-9 bp	-7 bp	+4 bp

Source: Bloomberg, Amundi Strategy *3:00 pm Paris time*