Amundi
ASSET MANAGEMENT

Cross asset investment strategy

Research,Strategy and Analysis

WEEKLY

Letter finalised at 3pm Paris time **May 1 - 5, 2017**

Highlights of the week

- **Markets:** very limited reaction in the US curve after the FOMC; “commodity” currencies were down. The credit markets continued to perform well, with the euro market outperforming; a positive week for the equity markets.
- **United States:** strong nonfarm payrolls; deceleration in industry, acceleration in services.
- **Eurozone:** increase in GDP growth at 0.5% in Q1.

Key focus

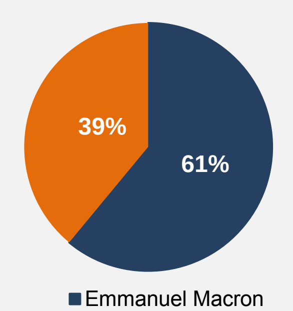
French elections: the eyes are already turning to the legislative elections

This Sunday will take place the second round of the French presidential elections. The extreme risks disappeared gradually and, **except for huge surprise, Emmanuel Macron should be the next president of the French Republic**. This is what the polls tell us: 60%-62% for E. Macron, 38%-40% for Mr. Le Pen). This is also what the surveys of the French tell us, especially those that were conducted after the last broadcast debate between the two candidates, a debate of which Macron came out large winner. Next step: the parliamentary elections (11 and 18 June).

Although we usually tend to trust the methodology of French pollsters and conclusions, the results of the surveys must be taken with caution. 5 uncertainties are at play:

- There is, first of all, **an unknown factor: the participation rate**. Will it be higher, weaker? Who will benefit from this?
- There is then **a new deal: the end of the traditional bipartition** (traditional right, traditional left), which will undoubtedly be of importance in the choice of voters;
- There is **a variant**: locally, the French certainly vote for a party, but also for the political personality, except that the desire for "new heads" clearly manifested during the presidential election;
- There is **a novelty: a crumbling of the republican front**. For the first time, a party ("Debout La France", Nicolas Dupont-Aignan) took the step and concluded an alliance with the Front National.
- **For some parties, it is simply a question of political survival**. These parties, the biggest losers in the presidential elections (the Socialist Party and the Republican Party), have to do everything they can to have a broad representation in the National Assembly, and they will probably have more difficulty to withdraw in the second round At the national front) and to make electoral "gifts" to the new president.

French presidential election second-round polls



Source: Poll's average after the first round, Amundi Research

« En Marche ! / Macron», the great winner of the general elections ?

It should be remembered that for a party to have a parliamentary group in the Assembly, which is an important condition for active participation in political life, it needs at least 15 seats

According to an *OpinionWay poll - SLPV analytics* made for the newspaper "Les Echos, **the movement of Emmanuel Macron would be the big winner, totaling between 249 to 286 deputies on the 535 positions covered by the survey**. The Republican right would obtain between 200 and 210 seats, the Front National of Marine Le Pen would obtain only 15 to 25 seats (consequences of the transfers of votes and the "vitality" of the republican front), , i.e. less than 5% of the seats. The socialist left party (between 28 and 43 seats) and the radical left of Jean-Luc Mélenchon (between 6 and 8 seats for “La France Insoumise”) would be the other great losers of these elections. **As for the Socialist Party, it would be the worst result of its history**. This would also be **the end of the left-right bipartition of the National Assembly.**

General elections: second rounds with 2, 3 or 3 contenders?

Let us remember that it is necessary to obtain at least 12.5% of the votes in the first round to be able to compete at the second. **Political fragmentation raises fears for many triangular and even quadrangular ones** (three candidates, or even four who compete in the second round).It should not be the case this time. According to this study, there would be between 90 and 116 duels opposing En Marche! and the Front National, 180 duels opposing En Marche! and the right wing party, 46 duels opposing left wing and En Marche!, 154 duels opposing right wing party and Front National, 6 to 32 duel opposing left wing and Front National. There would also be around 30 triangular elections, opposing Front National, En Marche! and La France Insoumise. By way of comparison, in 2012, there were 420 duels between the classical right and the classical left, both absent to the second round of the presidential election last Sunday.

The week at a glance

> Other events

Eurozone >

The House of Representatives has approved the repeal of Obamacare. The bill barely squeaked through (with 217 votes for (all Republicans) and 213 against. The law would repeal Barack Obama's healthcare reform. In March an initial attempt at repeal had run into opposition from both right-wing and moderate Republicans, marking a crushing defeat for Donald Trump. Among the planned changes is an opt-out for states on certain obligations that Obama had imposed on insurance companies (no higher rates for pre-existing conditions and covering certain essential costs).

This is only the first step. Now the law must be approved, with amendments, by the Senate, where the Republicans' majority is very slim (52 seats out of 100). A failure would cause trouble for Trump, as he also has his work cut out for him in the coming months in negotiating tax cuts with Congress.

> Economic indicators

Eurozone >

0.5% growth in GDP in Q1. Eurozone GDP increased by +0.5% in Q1 (a figure in line with expectations, following +0.4% in Q4). Compared to Q1 2016, the gain is 1.7%. **The eurozone's PMI Composite index accelerates again.** It was 56.8 in April (vs. 56.7 according to its preliminary estimate, and after 56.4 in March). Country by country, the **PMI Composite** was 56.7 in Germany, 56.6 in France, 56.8 in Italy, and 57.3 in Spain. **Stable unemployment in March at 9.5%.** In Eurostat-normalised data, it was 3.9% in Germany, 10.1% in France, 11.7% in Italy and 18.2% in Spain.

The eurozone continues to be a positive surprise, and the recovery still has significant potential. What the region needs most right now is improvement in Italy, which is the major weak link (Italy's GDP growth in Q1 is not yet known), but the economic indicators, such as PMI indices, look good for the country.

United States >

ISM indicators: deceleration in industry, acceleration in services. The ISM Manufacturing index fell to 54.8 in April (compared with 56.5 expected and after 57.2 in March). Its new-orders component also dropped noticeably (but stayed high) to 57.5 (after 64.5 in March). The ISM Non-Manufacturing index rose to 57.5 (compared with 55.8 expected and after 55.2 in March).

Strong nonfarm payrolls. The US economy generated 211K new jobs in April (vs. 185K expected and 79K in March). The unemployment rate continued its decline at 4.4% (4.5% in March). Average workweek hours increased slightly at 34.4 while average hourly earnings decelerated at +2.5% YoY (vs 2.6% YoY). The participation rate declined slightly to 62.9% (63% in March).

The job market continues to improve, at a pace stronger than we thought a few months ago. The trend for wage growth is positive, but only very moderately, a situation that is compatible with a very gradual increase in the Fed's policy rates. Despite their monthly volatility, ISM indices are still high, sending a reassuring message about the pace of the recovery (despite the weak growth in GDP in Q1, probably attributable to seasonal statistical factors).

China >

China's April official manufacturing PMI came in weaker than expected at 51.2- (vs. consensus 51.7 and prior at 51.8), -remaining in expansion territory for the ninth consecutive month. Also, China's Caixin manufacturing PMI came in weaker than expected as well at 50.3 (vs. consensus 51.3 and prior 51.2).

We have been calling a continuous manufacturing PMI stabilisation within expansion territory, but the-weaker-than expected official and Caixin manufacturing PMIs raise doubts for the markets on whether Chinese economic stabilisation is peaking out. We don't think so and we believe the current weakness amounts to temporary corrections given surplus inventories during the restocking period in the past year. The April official manufacturing PMI remained relatively high, where output (53.8 in April vs. 54.2 in March), new orders (52.3 in April vs. 53.3 in March), and new export orders (50.6 in April vs. 51.0 in March) showed slight weakness but remained in expansion territory. However, the purchasing price index declined to 51.8 in April from 59.3 in March, perhaps suggesting that the PPI (Producer price index) continues to correct before rebounding later. A very positive sign is that small enterprise business expectations continue to improve to 50.0 in April vs. 48.6 in March, entering into expansion territory. Longer-than-expected Chinese economic stabilisation from 2016 to 2018, is helping shape an upturn in the global cycle, which clearly benefits global cyclical sectors, commodities and also emerging markets, in our view.

EMEs ex-Asia>

While industrial output was weaker in March (+1.1% YoY) than forecast by consensus (2.1%), **all PMI surveys in Brazil were up in April**, including the composite (50.4 vs. 48.7 in March), manufacturing (50.1 vs. 49.6), and services (50.3 vs. 47.7). **In Mexico and Turkey, manufacturing PMIs rose in April** to, respectively, 50.7 vs. 51.5 in March and 51.7 vs. 52.3. **The global emerging manufacturing PMI was slightly down** in April (50.8) compared to March (51.6).

Regarding Brazil, these figures show that the recovery is underway, but, as we have pointed out on several occasions, it could be slower than expected by the consensus. The Mexican and Turkish economies have clearly borne the brunt of the political environment – Mexico because of Trump and Turkey due to domestic factors (the referendum on changing the constitution). However, the US administration is unlikely to put through protectionist measures as stringent as announced, which should ease the pressure on Mexican assets and growth. Likewise, the Turkish vote appears to have been interpreted by the markets as ensuring greater political stability. In the short term the situation is expected to stabilise and Turkish assets could be the main beneficiaries.

Financial markets

Fixed-income

The largely unchanged wording of the FOMC statement, as expected, led to very limited reaction from the US curve, with the 10-yr Treasury yield to maturity moving quite in a limited range during the week, though finally trending higher. Despite the recovery following the first round of French presidential elections, the 10-yr US treasury yield is still in the low area of the trading range in place since November last year, namely between 2.30% and 2.60%. In Europe, polls following the TV debate between the two candidates in the second round of French presidential elections, showing an increased gap between the two, supported the tightening of sovereign spreads vs. bunds in sight of Sunday's elections. Positive macro data and higher than expected inflation figures previously published, together with lower perceived political risk, led bund yields to higher levels.

More than on the statement, markets will focus on the future release of the latest FOMC minutes as, together with forthcoming speeches from Fed members, they are likely to shine more light on the discussion on future balance sheet management. For the moment, expectations still point to two further rate hikes in 2017, therefore supporting our view on UST yields. On the other side of the Atlantic, the first month of the ECB's reduced EUR 60bn QE, down from the previous level of EUR 80 bn,failed to show remarkable changes in the split between the various asset classes compared to previous months. The second round of the French presidential elections is likely to drive peripheral spreads next week, despite the large gap in opinion polls between the two candidates, which may reduce market reaction in assuming the polls are right, taking into account last days' market moves as well.

Foreign exchange

"Commodity" currencies were down. The main driver for this movement was the fall of commodities prices in the week - in particular, oil prices reached their lowest level since December. In this regard, there is an increasing consensus that OPEC and non-OPEC members might extend their oil production cuts agreement beyond June in order to cut a supply glut. Among the worst-performing ones were the Russian ruble(-2.6%), Colombian Peso (-1.3%) and the Australian dollar (-1.2%). The EUR/USD gained 0.7% in the week, supported by the perception that Emmanuel Macron had a better performance in the presidential debate and reached the highest level since November. The USD/JPY is back to the 113 level, not observed since mid-March.

The (highly possible) elimination of the French political risks can give some extra support for the euro. This fact combined with improving economic growth perspectives for the region makes the case for an even stronger currency at the year end.

Credit

The credit markets continued to perform well, with the euro market outperforming. The euro and dollar credit markets offer different performance profiles. On the euro market, the riskiest securities are outperforming. On the dollar market, IG securities are outperforming HY.

On the euro market, we are favouring high beta issuers – especially financials. Investors were pleasantly surprised by 1) the stronger than expected recovery in the eurozone, 2) the easing of political risk in France, and 3) highly positive first-quarter corporate earnings. Furthermore, the markets were not overly concerned by the recent reduction in CSPP asset purchases by the ECB It is too early at this stage to draw any conclusions.

On the dollar market, we are favouring IG issuers and remain cautious on the lowest-rate high yield issuers. US corporate fundamentals are improving – companies' debt leverage has stabilised over recent quarters and we are expecting the default rate to drop during 2017. Interest coverage ratios are still in a critical zone for many issuers.

Equity

A positive week overall. The equity markets made gains the week leading up to the second round of French elections, buoyed by good corporate earnings. 62% of companies published their first-quarter earnings in the United States, 49% in Europe, and 30% in Japan. In the US, 80% of those were higher than expected (+13% year-on-year, 6% better than expected). In Europe, 69% did better than expected (+25%, 10% better than expected). And in Japan, 58% came in above expectations, a +28% increase from last year.

The earnings recovery is, above all, the consequence of the oil counter-shock, resulting in an increase in interest rates, which was good for financials. Note, too, that the basis for comparison is good, and will remain so until the end of the third quarter of this year. In addition, US long-term rates are still far from 3%, which could become a problem. So the equity markets can still go further. Yet this will not prevent fluctuations or temporary profit-taking.

Key upcoming events

Economic indicators

US : Retail sales are expected to rise in April. **Eurozone:** Industrial production should have increased in March.

Date	Country	Upcoming macroeconomic data	Consensus	Prior
May 8	China	Trade balance. April	$35.2 Bn	$23.92Bn
May 9	Australia	Retail sales. MoM. March	0.3%	-0.1%
	China	CPI. YoY. April	1.1%	0.9%
May 10	Brazil	CPI. YoY. April	4.11%	4.57%
	France	Industrial production. MoM. March	1.1%	-1.6%
May 11	UK	Industrial production. MoM. March	-0.4%	-0.7%
	UK	Trade balance. March	-$3000	-£3663
	Brazil	Retail sales. MoM. March	-0.1%	-0.2%
May 12	Germany	CPI. YoY. April	2.0%	2.0%
	Germany	GDP. QoQ. Q1	0.7%	0.4%
	Spain	CPI. YoY. April	2.6%	2.6%
	Eurozone	Industrial production. MoM. March	0.4%	-0.3%
	US	CPI. YoY. April	2.3%	2.4%
	US	Retail sales. MoM. April	0.6%	-0.2%
	US	Michigan consumer confidence. May	97.0	97.0

Source: Amundi Strategy

Auctions

Date	Country	Auctions of European sovereign debt [maturity, amount (if available)]
May 8	Germany	Short-term, € 2 Bn
May 9	France	Short-term, € 6.4 Bn
	Spain	Short-term, amounts not available on Friday
	Germany	Long-term, € 0.5 Bn
May 10	Germany	5 years, € 3 Bn
	Italy	Short-term, amounts not available on Friday
May 11	Italy	Long-term, amounts not available on Friday

Source: Bloomberg, Amundi Strategy

Key events

Date	Upcoming monetary policy committee meetings
May 11, 2017	Bank of England (BoE)
June 8, 2017	European Central Bank (ECB)
June 16, 2017	Bank of Japan (BoJ)

Date	Upcoming important events
May 7, 2017	France - Second round Presidential election
June 8, 2017	United Kingdom - Parliamentary Elections
June 11, 2017	France - First round of Legislative Elections
June 18, 2017	France - Second round of Legislative Elections
24 September 2017	Germany - General Election

Source: Amundi Strategy

Market snapshot

Equity markets	05/05/2017	Over 1 week	Over 1 month	Ytd
S&P 500	2390	0.2%	1.6%	6.7%
Eurostoxx 50	3638	2.2%	4.7%	10.5%
CAC 40	5397	2.5%	6.0%	11.0%
Dax 30	12651	1.7%	3.5%	10.2%
Nikkei 225	19446	1.3%	3.1%	1.7%
MSCI Emerging Markets (close -1D)	980	0.2%	1.1%	13.7%
Commodities - Volatility	**05/05/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
Crude Oil (Brent, $/barrel)	48	-6.5%	-11.1%	-14.9%
Gold ($/ounce)	1230	-3.0%	-2.0%	6.8%
VIX	10	-0.6	-2.7	-3.8
FX markets	**05/05/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
EUR/USD	1.10	0.7%	2.9%	4.4%
USD/JPY	113	1.0%	1.7%	-3.8%
EUR/GBP	0.85	0.8%	-0.7%	-0.7%
EUR/CHF	1.09	0.1%	1.3%	1.2%
Fixed Income markets	**05/05/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
EONIA	-0.36	-1 bp	--	-3 bp
Euribor 3M	-0.33	-	-	-1 bp
Libor USD 3M	1.17	--	+2 bp	+17 bp
2Y yield (Germany)	-0.70	+4 bp	+10 bp	+7 bp
10Y yield (Germany)	0.40	+9 bp	+14 bp	+19 bp
2Y yield (US)	1.32	+6 bp	+8 bp	+13 bp
10Y yield (US)	2.35	+7 bp	+2 bp	-9 bp
Eurozone Sovereigns 10Y spreads vs Germany	**05/05/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
France	+43 bp	-9 bp	-23 bp	-5 bp
Austria	+27 bp	-2 bp	+8 bp	+5 bp
Netherlands	+21 bp	-2 bp	-3 bp	+6 bp
Finland	+6 bp	-3 bp	-5 bp	-8 bp
Belgium	+39 bp	-7 bp	-13 bp	+7 bp
Ireland	+46 bp	-8 bp	-25 bp	-8 bp
Portugal	+302 bp	-21 bp	-68 bp	-54 bp
Spain	+116 bp	-17 bp	-20 bp	-1 bp
Italy	+178 bp	-18 bp	-23 bp	+17 bp
Credit markets	**05/05/2017**	**Over 1 week**	**Over 1 month**	**Ytd**
Itraxx Main	+64 bp	-3 bp	-11 bp	-8 bp
Itraxx Crossover	+257 bp	-9 bp	-33 bp	-32 bp
Itraxx Financials Senior	+69 bp	-5 bp	-21 bp	-24 bp

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