

April 2022

The energy crisis heightens inflation fears

Strategies to protect portfolios from inflation risk

Confidence
must be earned

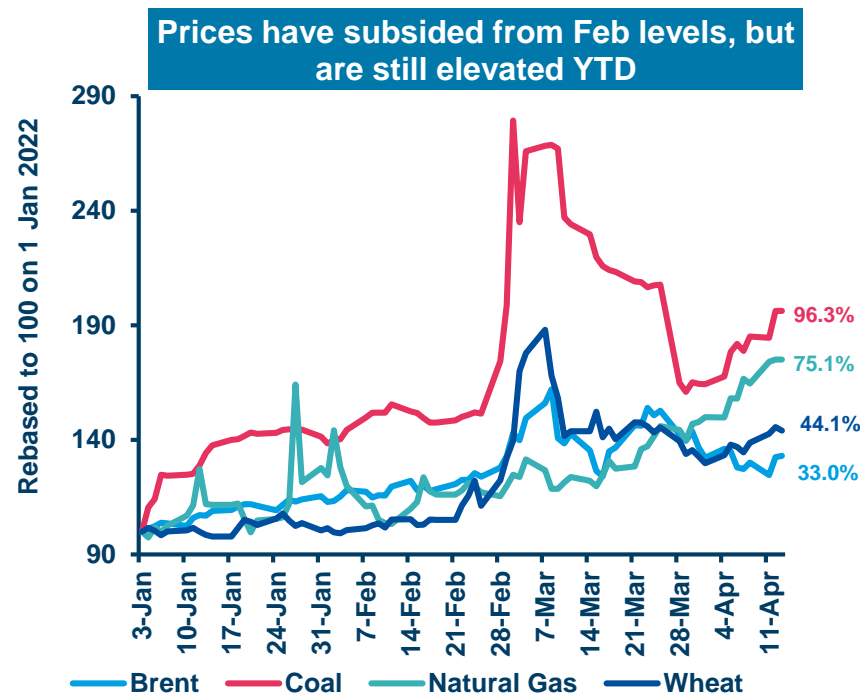
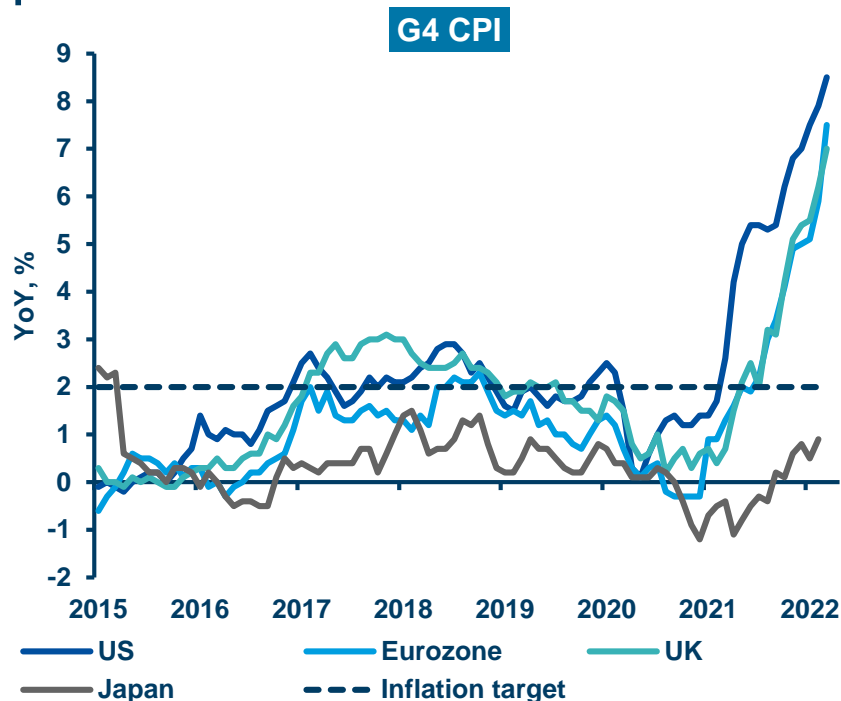
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ASSET MANAGEMENT

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Already-high inflation to be exacerbated by high commodity prices due to the Russia-Ukraine war



» Inflation was already running well above central banks' targets as we entered the year. The war has put additional pressure on prices and supply chains and this could have repercussions not just on oil, but on other commodities as well. Furthermore, given these (intermediate) commodities are used in the production of other finished products, we are likely to witness more broad-based inflation, particularly in Europe, the region closest to the crisis.

Source: Amundi Institute, Bloomberg. Data as of 13 April 2022.

Source: Amundi Institute, Bloomberg. Data as of 13 April 2022.

01

A new inflation regime is under way

Markets yet to fully price in the primary drivers of inflation

1 Geopolitics fuel inflation through commodity prices



2022

The Russia-Ukraine war is adding to the inflation pressures, contributing to sustained price trends, especially for commodities.

2 Supply chain bottlenecks and PPI-CPI pass-through



2022

Soaring shipping costs, recovering demand, reshoring policies and supply chain disruptions will keep inflation high in 2022. Additional pressures could emerge from the pass-through of higher production prices to consumers.

3 Psychological dimension is starting to kick in



2022-23

Inflation has a critical psychological dimension that is affected by forces of memory, forgetfulness and policymakers' behaviour. While consumer demand and labour markets are strong – especially in the United States – investors should be aware of the wage-inflation loop, which may become self-fulfilling.

4 Structural factors such as *greenflation*

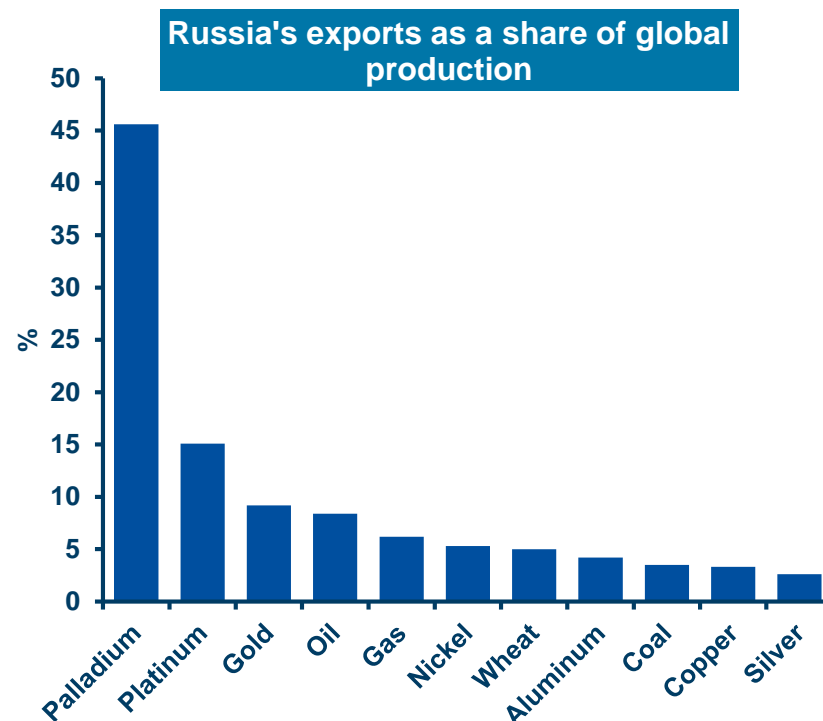
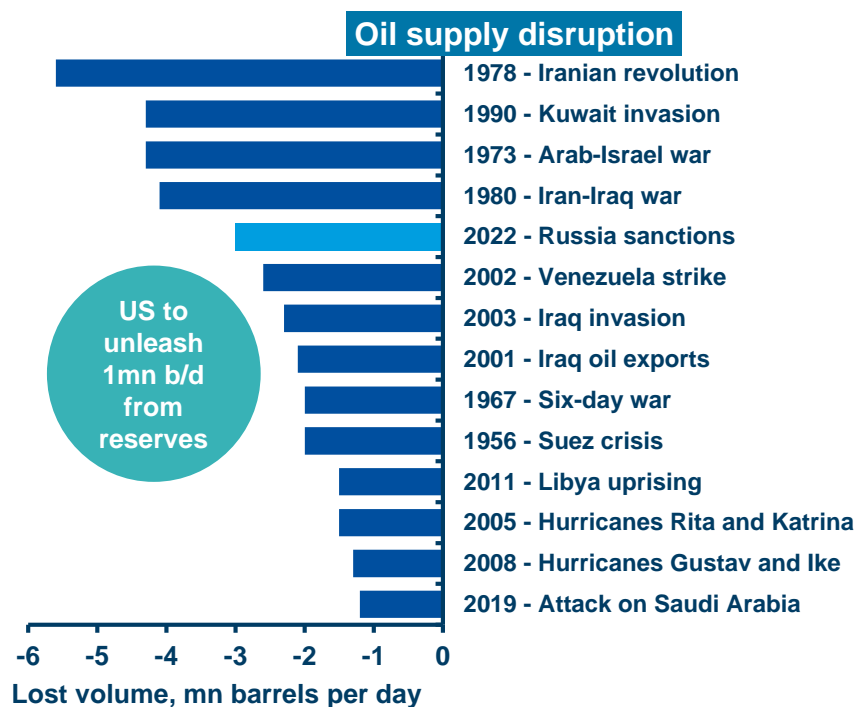


Long run

Structural factors such as the energy transition will add to inflationary trends in the medium to long run. This, coupled with the still limited production capacity of renewable energy and the high demand for commodities needed in the transition, will push up energy bills and boost the prices of commodities linked with the green transition.

Source: Amundi Institute, as of 11 April 2022.

Russia-Ukraine war disrupting oil supply, other commodities also at risk

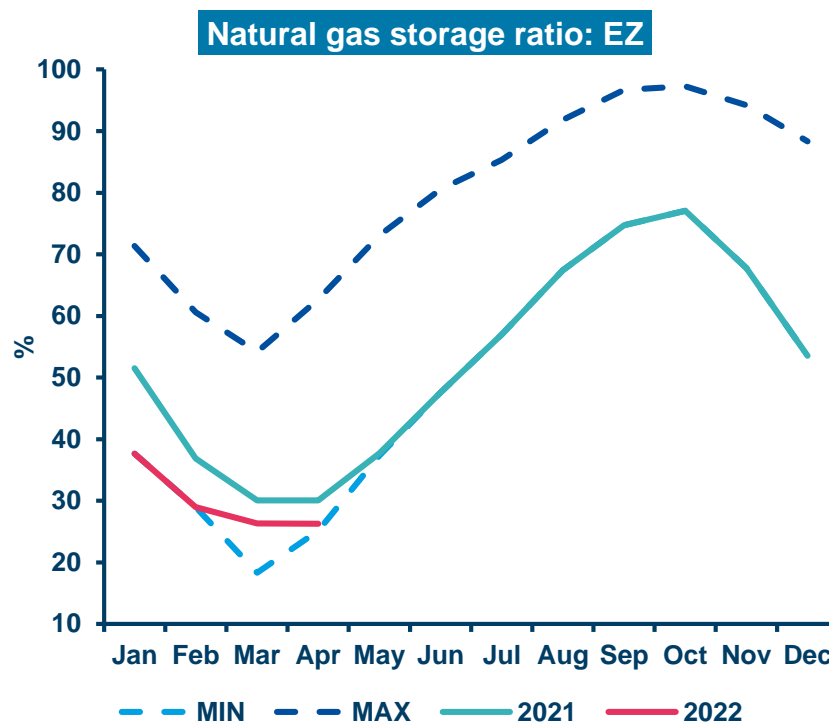
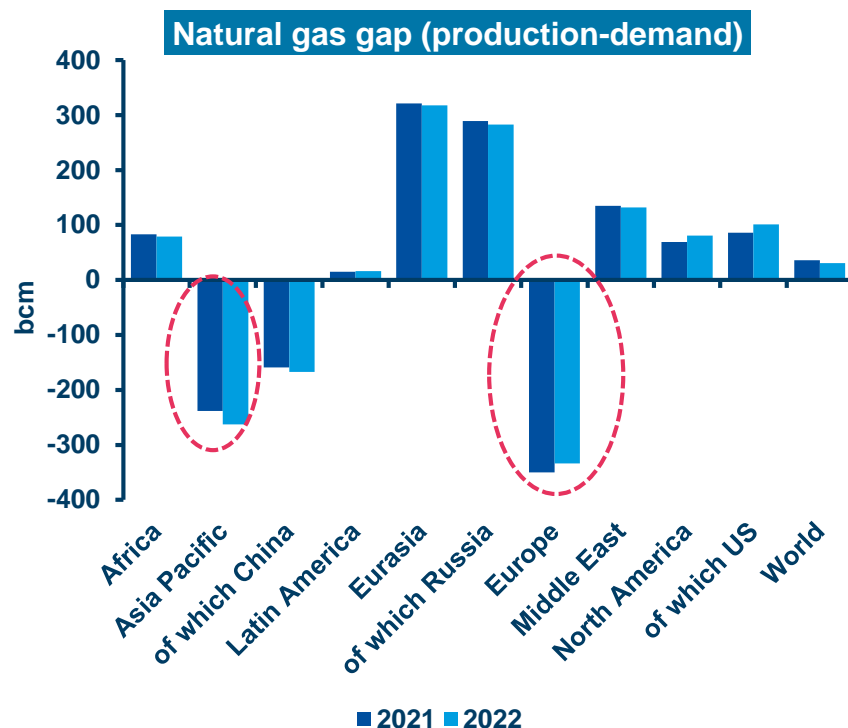


» The ostracisation of Russian oil from the markets is creating a global shortage and the recent decisions to ban Russian oil from the United States and the United Kingdom are exacerbating the picture. The lost volume is estimated to be some 3mn b/d, according to the International Energy Agency, and this loss is only partially being offset by the unleashing of 1mn b/d of US oil reserves. In addition, Russia is a key exporter of other commodities, and the country's exclusion from global supply chains may impact the prices of these.

Source: Amundi Institute on Bloomberg, International Energy Agency estimates. Data as of 22 March 2022. B/d: barrels per day.

Source: Amundi Institute, Bloomberg, JP Morgan. Data from 2020.

The crisis will also be felt in natural gas markets

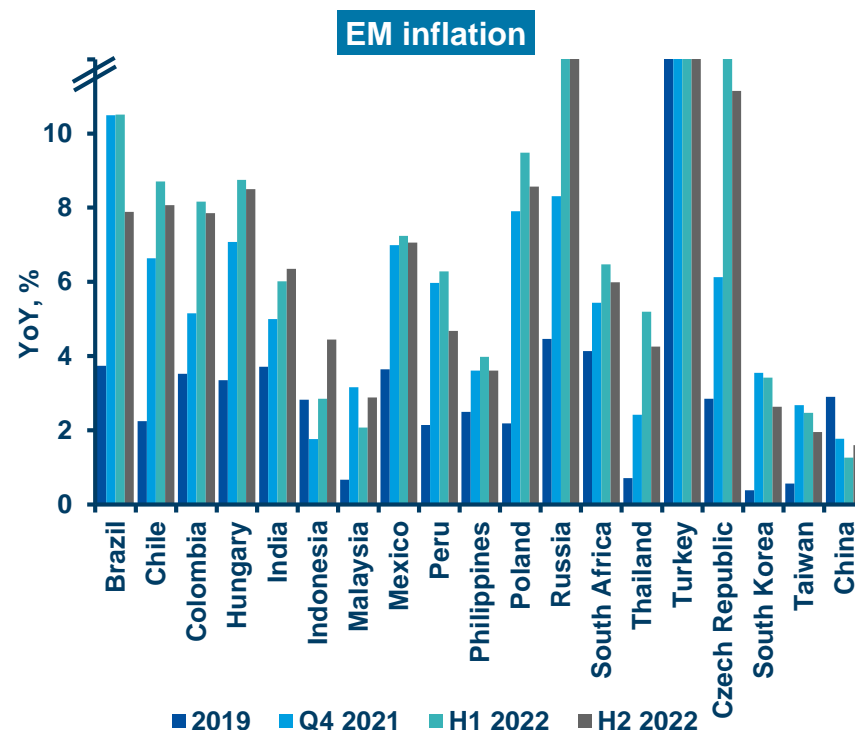
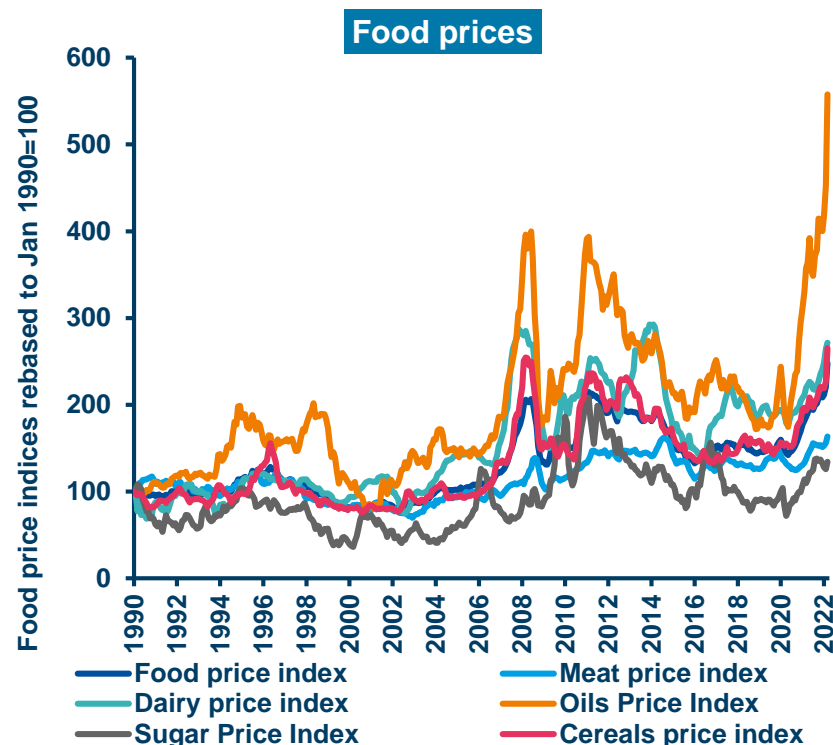


» The supply/demand mismatch in natural gas was already acute in Asia Pacific and Europe before the war. Given Russia's role in supply, the geopolitical ramifications of the war are tremendous, including higher prices and a potential threat to supply, both of which feed into the inflation narrative. Gas storage levels in Europe are only enough to cover near-term demand and a more coordinated European effort is needed to wean the region off Russian dependence in the long term.

Source: Amundi Institute, Energy intelligence. Data as of July 2021. Bcm: billion cubic metres.

Source: AGSI.GIE, Bloomberg, Amundi Institute, as of 8 April 2022. Monthly storage ratio = actual gas volume/maximum storage capacity. Minimum and maximum range from Jan 2011 to March 2022.

The conflict will keep EM inflation high due to food prices



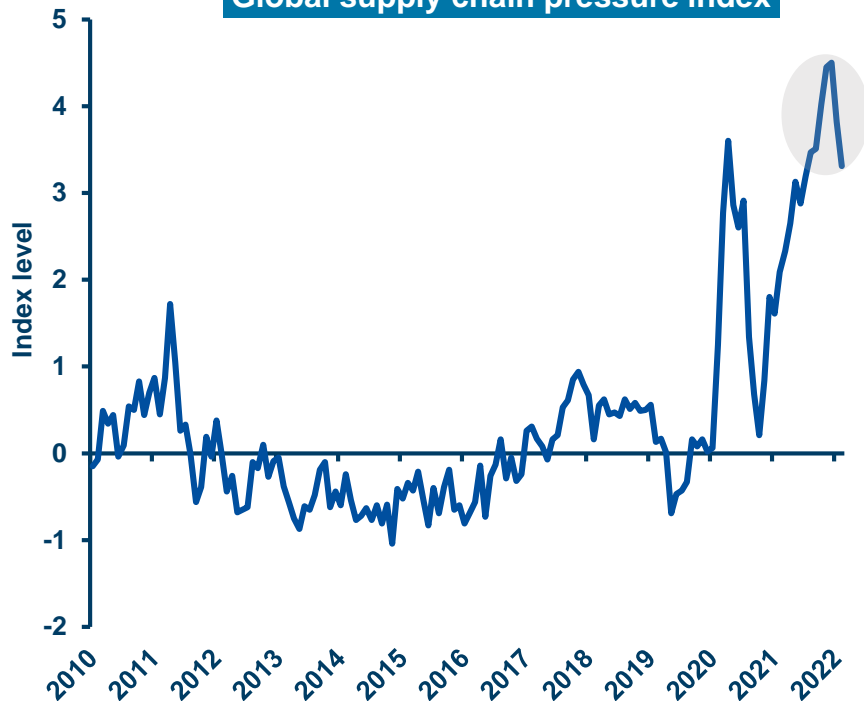
» Global inflationary pressures have been exacerbated by the Russia-Ukraine war and are proving persistent across most EM, as food prices tend to account for a large share of the inflation basket in these countries. Among the EM universe, Asia's inflation picture looks more benign, while Turkey and Russia are idiosyncratic stories.

Source: Amundi Institute analysis on Food and Agriculture Organisation of the UN data, as of 8 April 2022.

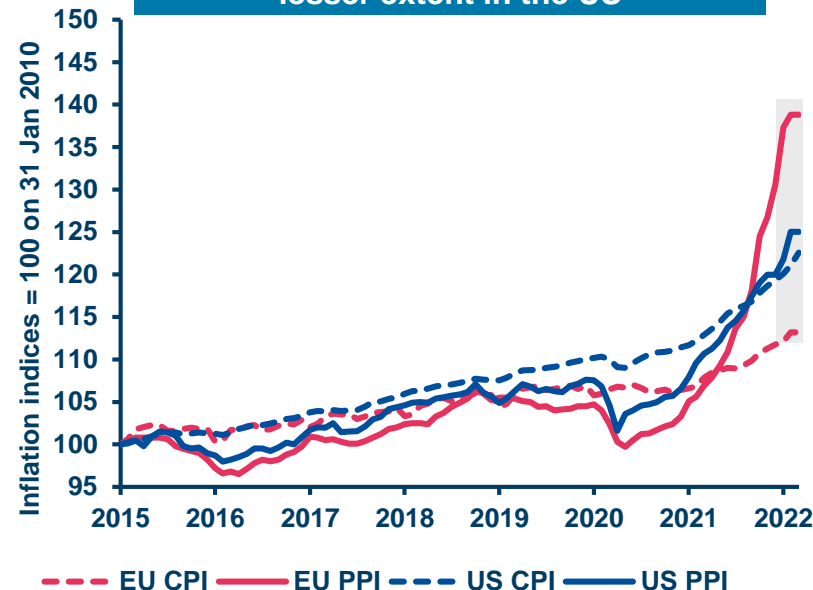
Source: Amundi Institute. Data as of 23 March 2022. Turkey's inflation was 15.46% in 2019 and 25.76% in Q4 2021. It is expected to be 56.45% in H1 2022 and 55.81% in H2 2022. Russia's inflation is expected to be 16.69% in H1 2022 and 19.29% in H2 2022. The Czech Republic's inflation is expected to be 12.14% in H1 2022. EM: emerging markets.

Supply chain bottlenecks are high, pass-through of higher production costs to consumers not yet complete

Global supply chain pressure index



PPI-CPI divergences prevail, though to a lesser extent in the US

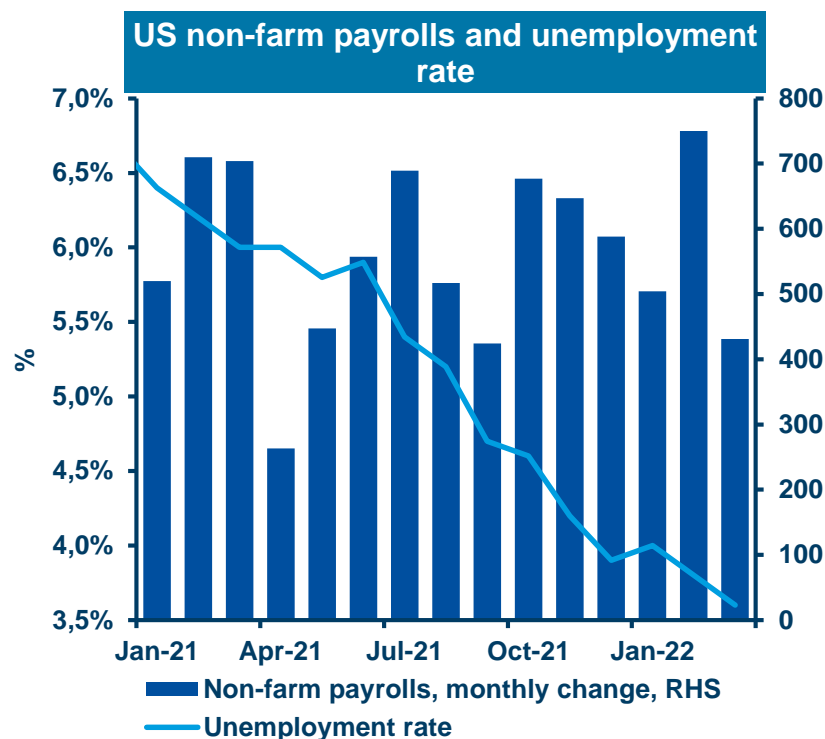


Global supply chain disruptions are at an all-time high, which is keeping shipping costs elevated. In the United States, high production costs have not yet been fully passed on to consumers. If enough firms have strong enough pricing power to pass these on fully, then US CPI might accelerate further. In Europe, the story is similar, but the CPI-PPI gap is larger, implying a potential further acceleration of inflation.

Source: Amundi Institute, Bloomberg. Data as of 29 March 2022. Zero indicates index is at average value, but a positive reading shows how many standard deviations the index is above its average. A negative reading means the opposite.

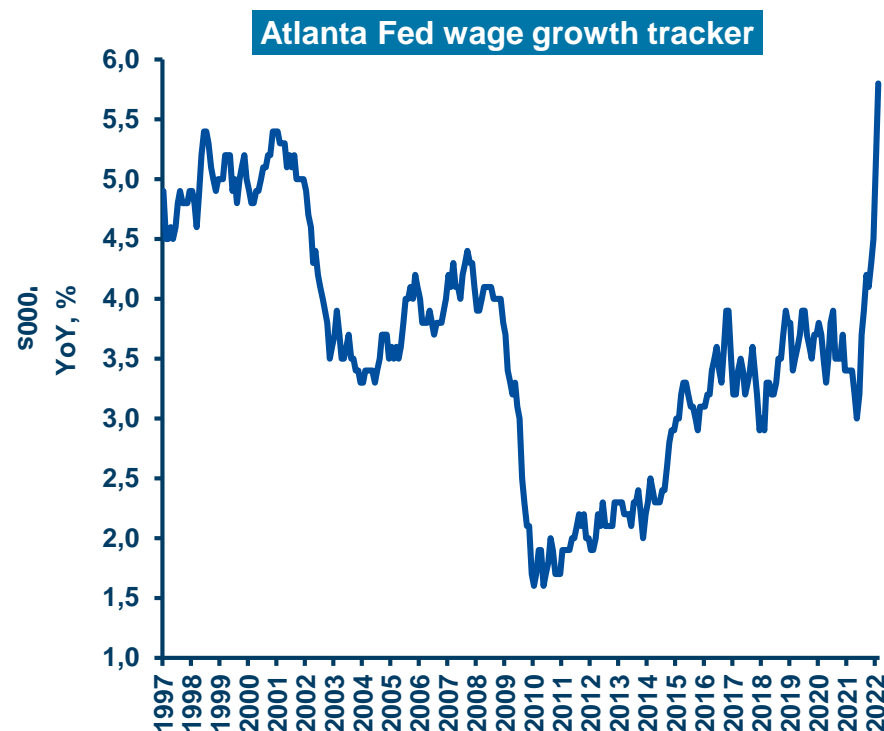
Source: Amundi Institute, Bloomberg. Data as of 7 April 2022. PPI measures inflation at the company level, whereas CPI refers to inflation faced by the end-consumer.

Strong wage growth in a tight labour market



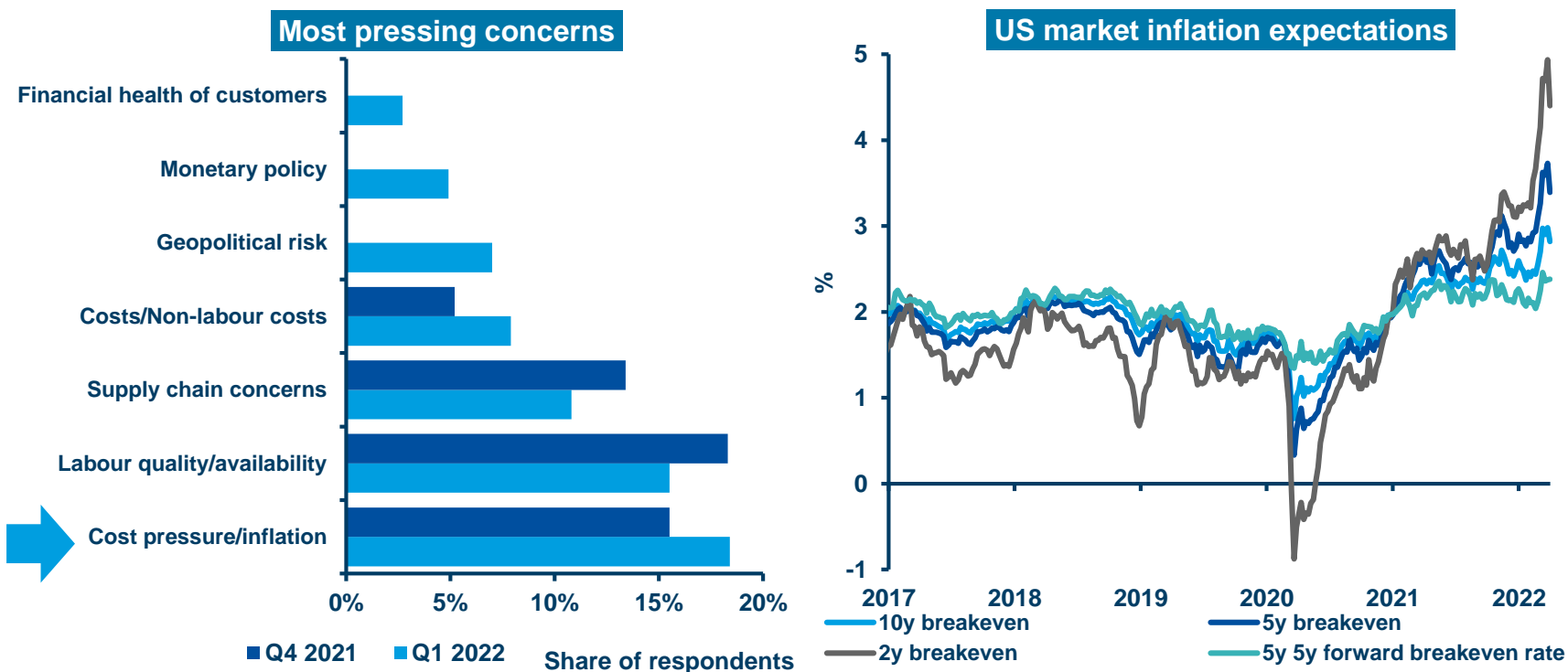
» The US labour market has been recovering quickly post the pandemic and wage growth has picked up. This demand for higher wages could further feed inflation as companies pass on rising wage costs to consumers, creating a sort of a wage-inflation loop. Interestingly, narratives play a role in inflation spreading exponentially, like a virus, turning it into a mass phenomenon with feedback loops and self-fulfilling prophecies.

Source: Amundi Institute, Bloomberg. Data as of 1 April 2022.



Source: Amundi Institute, Bloomberg. Data as of 29 March 2022. The Atlanta Fed's wage growth tracker is a measure of the nominal wage growth of individuals. It is constructed using microdata from the Current Population Survey and is the median percentage change in the hourly wage of individuals observed 12 months apart.

Medium-term consumer expectations: inflation is the main concern



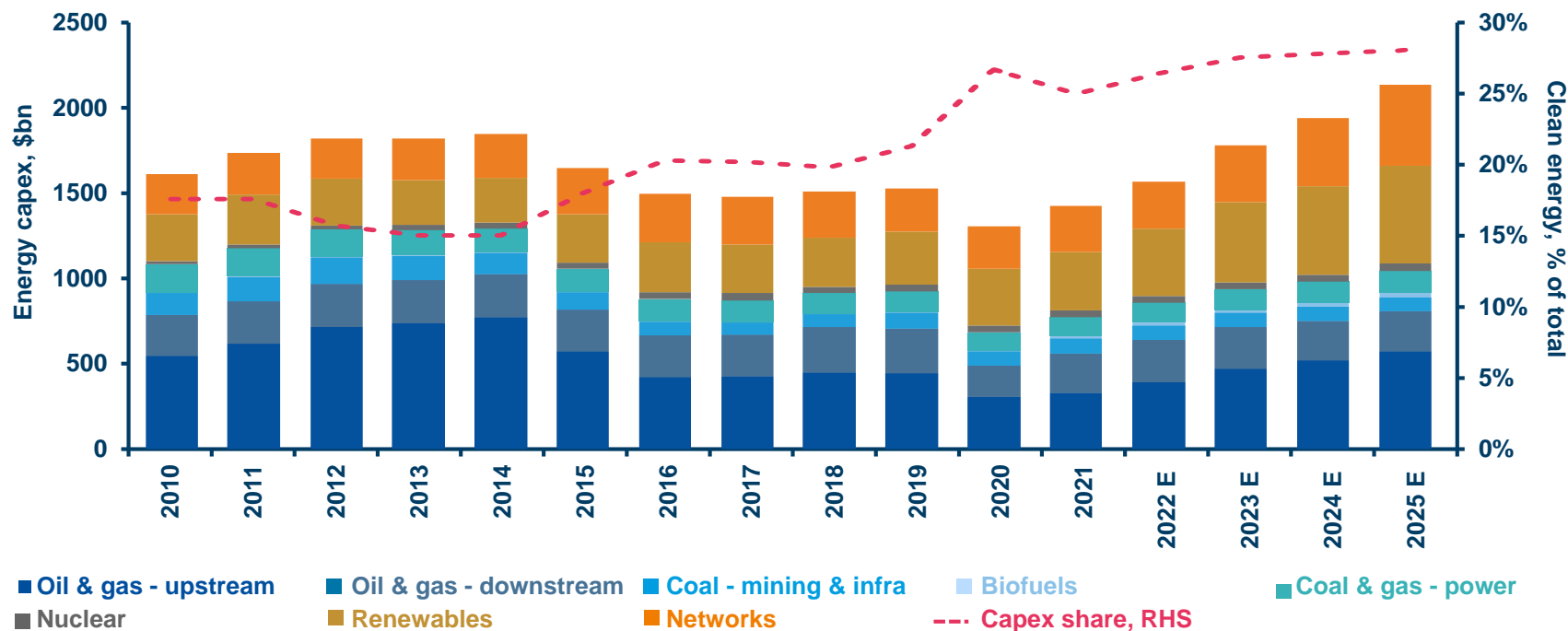
» High inflation and wage costs are taking a toll on finance chiefs' outlook for the US economy, as their optimism about the economy fell in the first quarter to the lowest level since the Covid-19 crisis began. Market inflation expectations are on the rise as well; this trend could revive long-term memory patterns and activate the inflationary process.

Source: Amundi Institute, Bloomberg, CFO survey. Data as of 30 March 2022.

Source: Amundi Institute, Bloomberg. Latest weekly data as of 7 April 2022.

Russia-Ukraine war may facilitate the energy transition and boost investment

Energy supply capex and clean energy

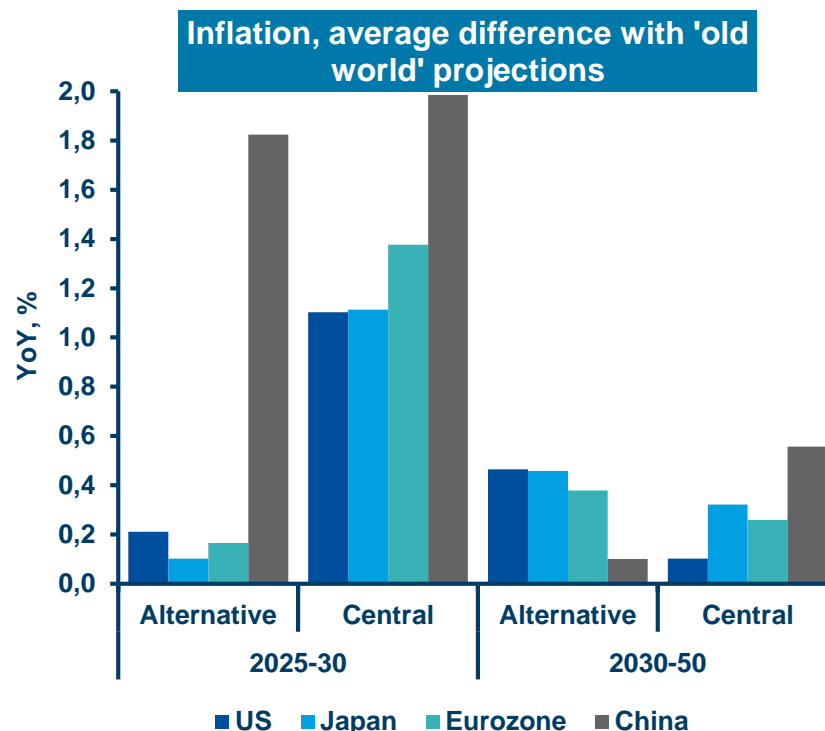


➤ The energy industry has been underinvesting since 2014, with investments in oil and gas falling the most. The overall growth in investment in renewable energy was not enough to offset the sharp drop in the traditional energy space. The recent focus on energy security should drive a new era of energy investment, which should return to growth and exceed the historical peak of \$2tn per year by 2024.

Source: Goldman Sachs Global Investment Research. Data as of 17 March 2022.

Green transition to play a role in keeping up inflation trends

Amundi scenarios: assumptions	
Old world	No specific climate policies; 'business as usual' along the considered time horizon.
Central	Slow introduction of climate policies starting from 2026, but proceeding in a muddling fashion. The 1.5° Celsius goal is not reached; it is more likely to reach the 2.0° Celsius target. Net Zero CO2 emissions are not met by 2050.
Alternative	Divergent schemes introduced, leading to a more efficient and faster phasing out of oil, but at a higher cost. Lack of global coordination among institutions; insufficient policies to meet the 2.0° Celsius target.



» Under the central scenario, the green transition comes at the cost of higher inflation, especially in the early phases of policy implementation. Under the alternative scenario, uncoordinated and delayed policy implementation translates into a more subdued inflation profile, especially for DM countries and in the near term.

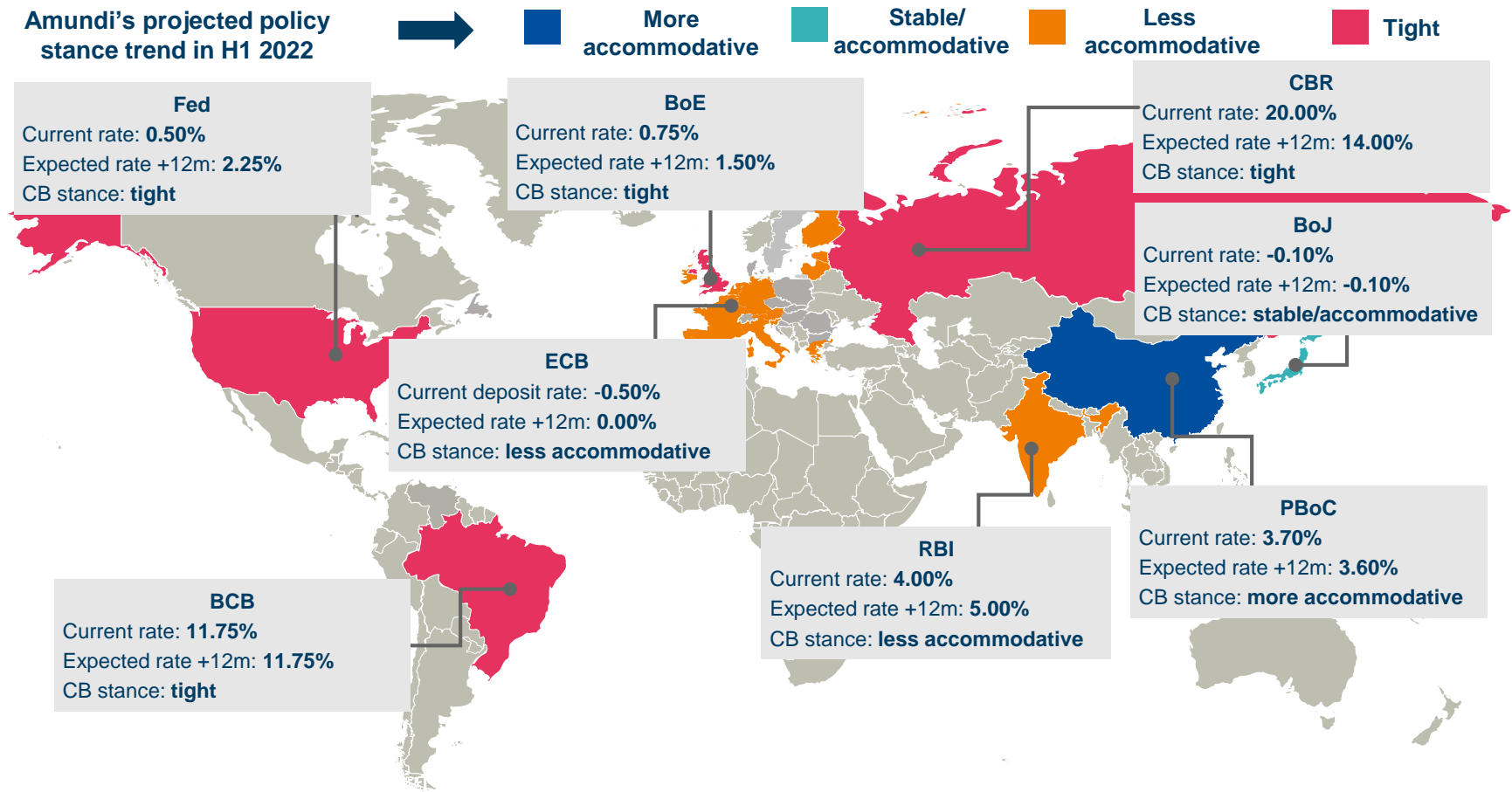
Source: Amundi Institute, Network of Central Banks and Supervisors for Greening the Financial System (NGFS). Data as of 25 March 2022. DM: developed markets.

Source: Amundi Institute on [NGFS scenarios](#), MESSAGEix-GLOBIOM (IIASA), NiGEM, Shared Socioeconomic Pathways. Data as of 25 March 2022.

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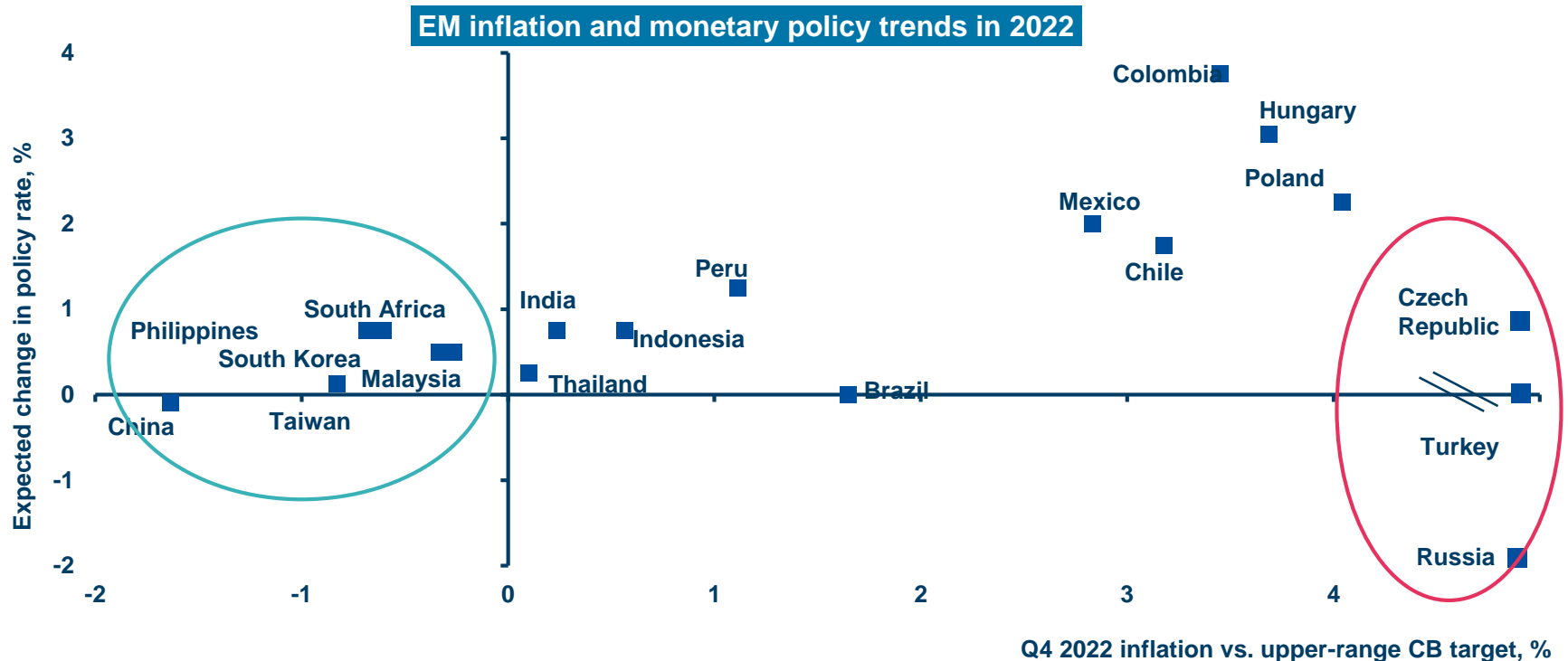
Central banks on a hawkish pivot: markets are reacting

CBs to stay on the hawkish side despite the war



Source: Amundi Institute, as of 30 March 2022. Illustrative map for monetary policies. Central bank stance refers to expected changes on QE or unconventional tools throughout mid-2022. CBs: central banks. Fed: Federal Reserve, ECB: European Central Bank, BoE: Bank of England, BoJ: Bank of Japan, PBoC: People's Bank of China, BCB: Central Bank of Brazil, CBR: Central Bank of Russia, RBI: Reserve Bank of India. For the Federal Reserve, current rate refers to the upper bound of the target range.

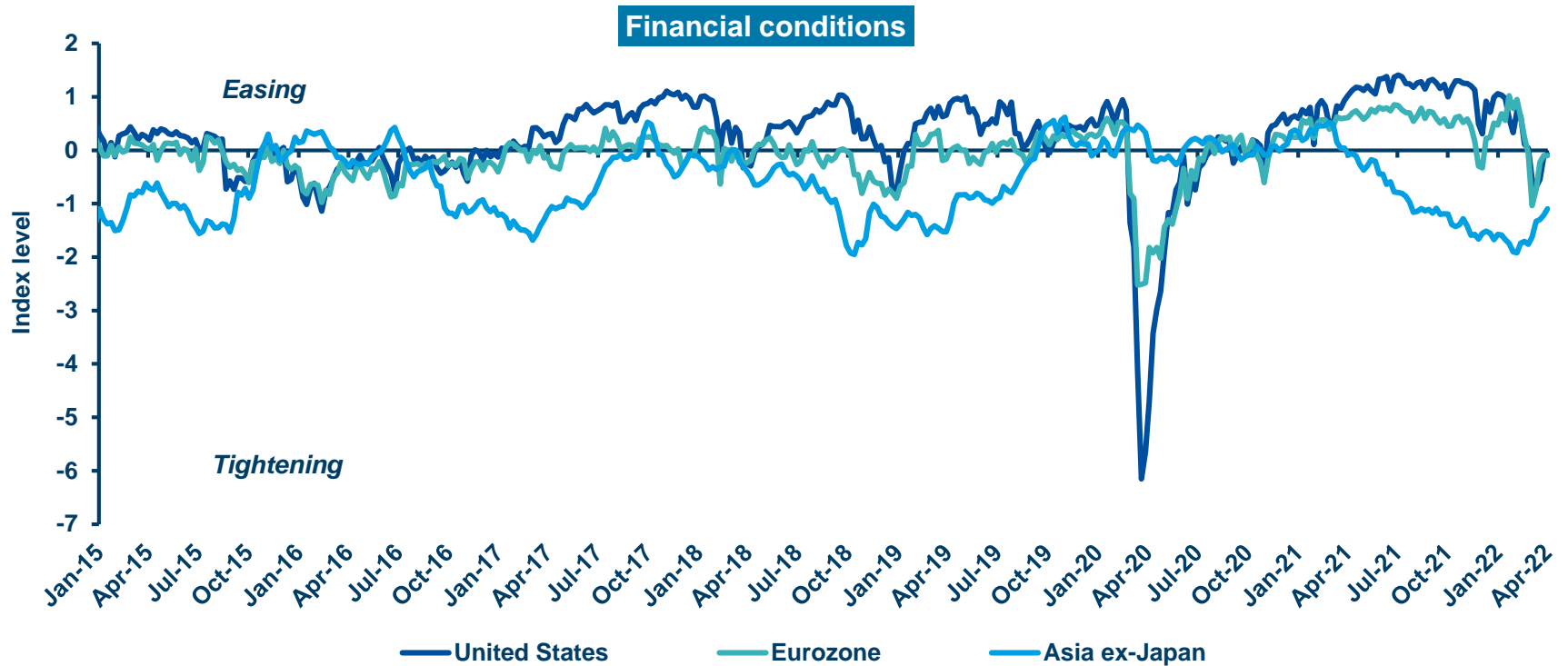
Asia better positioned in the fight against inflation



» Asian countries show subdued inflation trends that are allowing their CBs to stay on hold, though in China some easing is expected. Investors should focus on countries in the green circle that are fighting inflation successfully, while the red circle highlights those countries exposed to tightening and rising inflation, including Russia and Turkey, which are idiosyncratic stories (for different reasons).

Source: Amundi Institute, Bloomberg. Data as of 29 March 2022. Inflation and policy rate expectations are by Amundi Institute. EM: emerging markets. CBs: central banks. Turkey's policy rate is expected to be on hold in 2022, while Q4 2022 inflation is expected at 45.44% against an upper CB target range of 7.0%. Russia's policy rate is expected to be cut by 2% in 2022, while Q4 2022 inflation is expected at 11.50% against an upper CB target range of 5.2%. The policy rate in Czech Republic is expected to rise by 1% in 2022, while Q4 2022 inflation is expected at 7.28% against an upper CB target range of 3.0%.

Financial conditions are tightening as yields rise



» Over one month into the Russia-Ukraine war, financial conditions are getting tighter, mainly due to bond yields rising, while equities have rebounded.

Source: Amundi Institute, Bloomberg. Latest weekly data as of 7 April 2022.

03

Strategies to protect portfolios from inflation

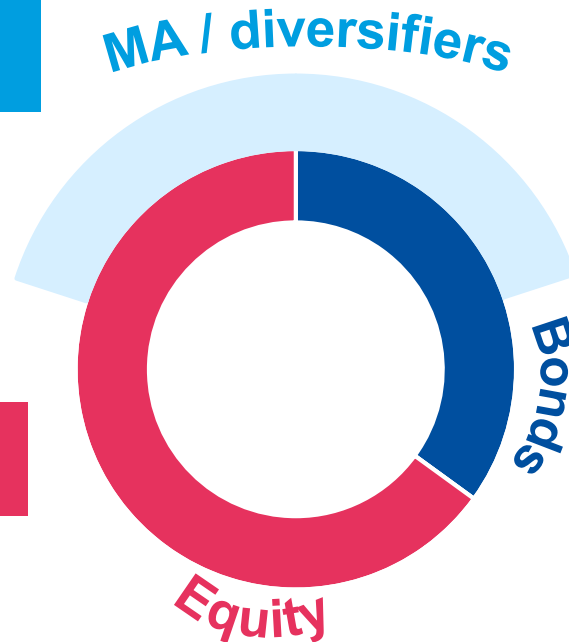
Investors may rethink portfolios due to inflation

Real income assets and enhanced diversification

- MA real return solutions;
- Real assets;
- Liquid alternative strategies;
- Commodity-linked solutions (gold, green transition).

Value, dividend and stock selection resilient to inflation

- EU, US, global quality, value themes;
- High dividend.



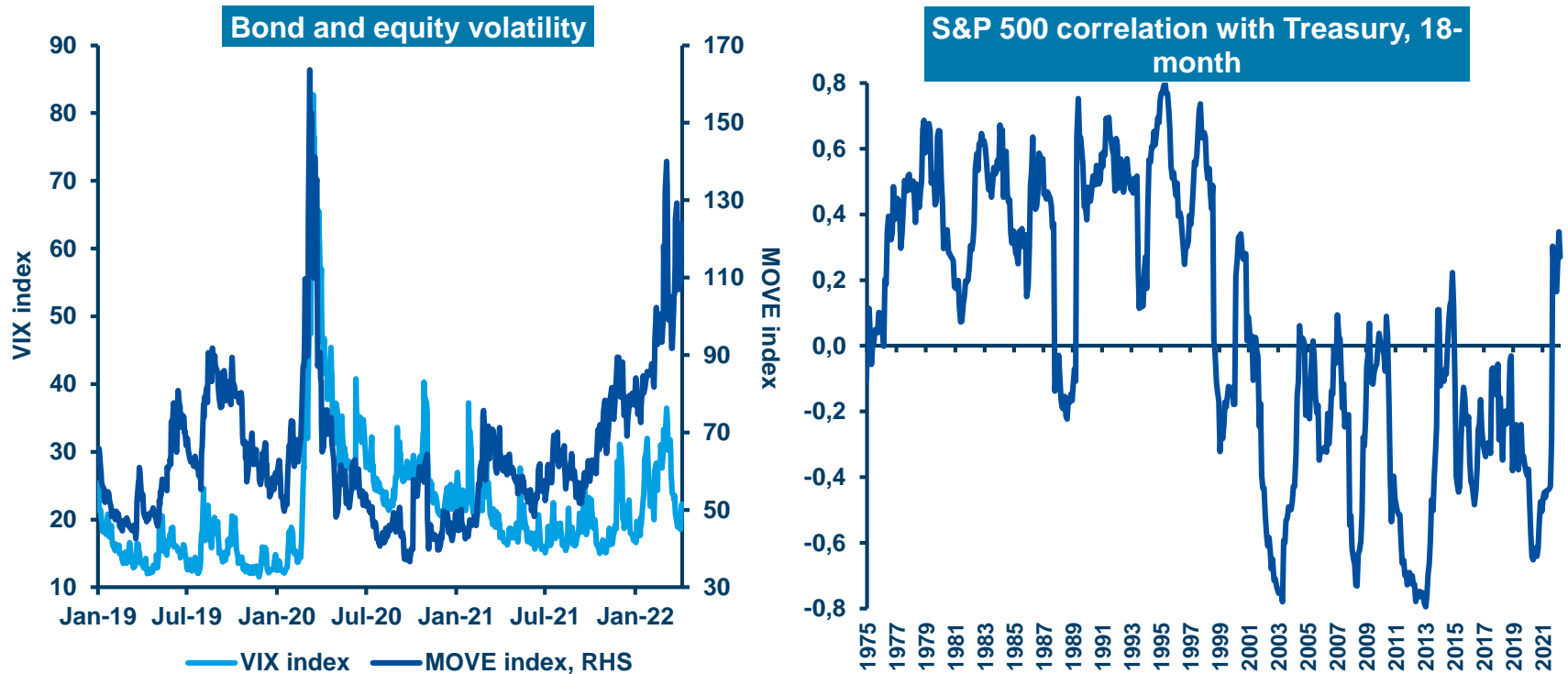
Fixed income strategies to cope with higher rates

- Inflation-linked bonds;
- Floating-rate notes;
- Loans;
- USD short-term bonds;
- EM short-term bonds.

Source: Amundi Institute, as of 15 April 2022. EM: emerging markets. **For illustrative purposes only.**



Evolving correlation dynamics and rising volatility



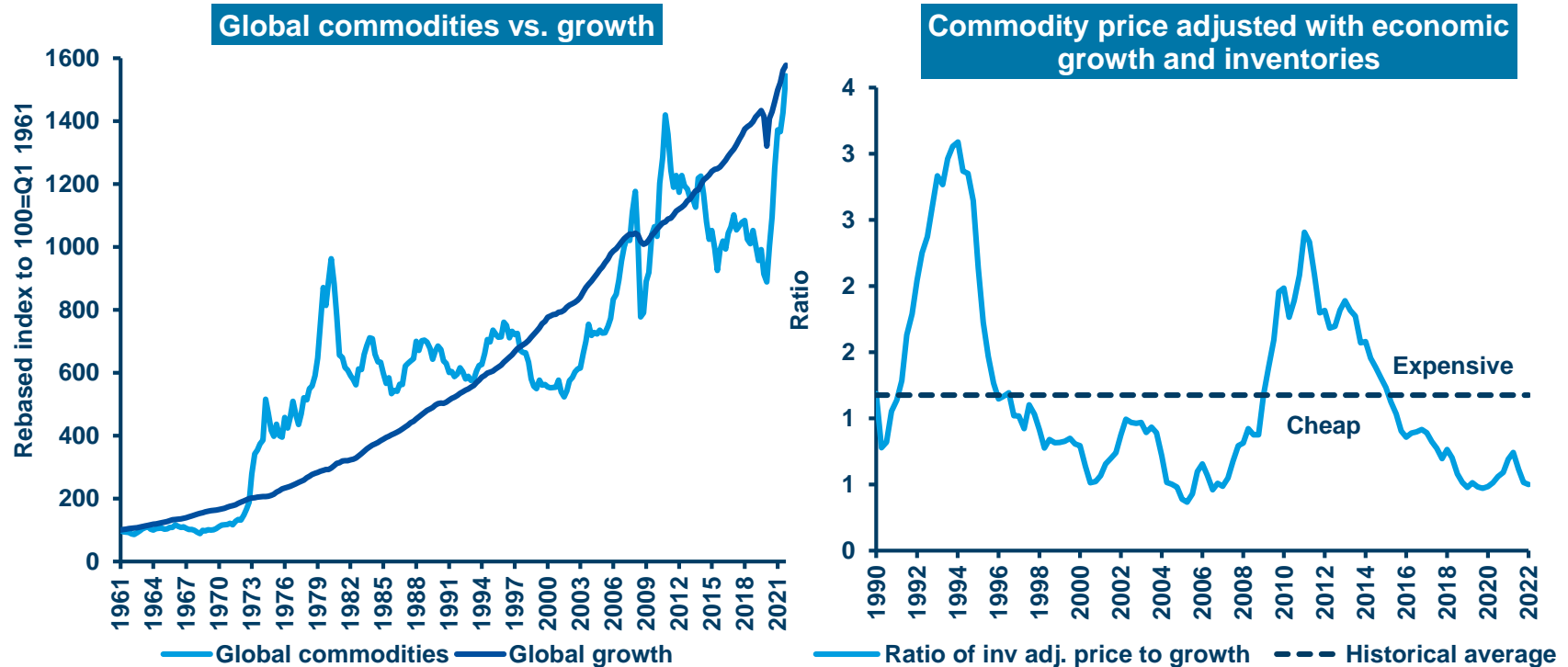
» The Fed's indication that it will take the "necessary steps" to ensure price stability has been pushing core yields up, both in the United States and in Europe. This is also increasing market volatility. As correlation dynamics evolve, the traditional bond-equity diversification does not work. Investors should seek investment strategies that exhibit low correlation.

Source: Amundi Institute, Bloomberg, as of 7 April 2022.

Source: Amundi Institute, Bloomberg, as of 25 March 2022.



A commodity supercycle has begun

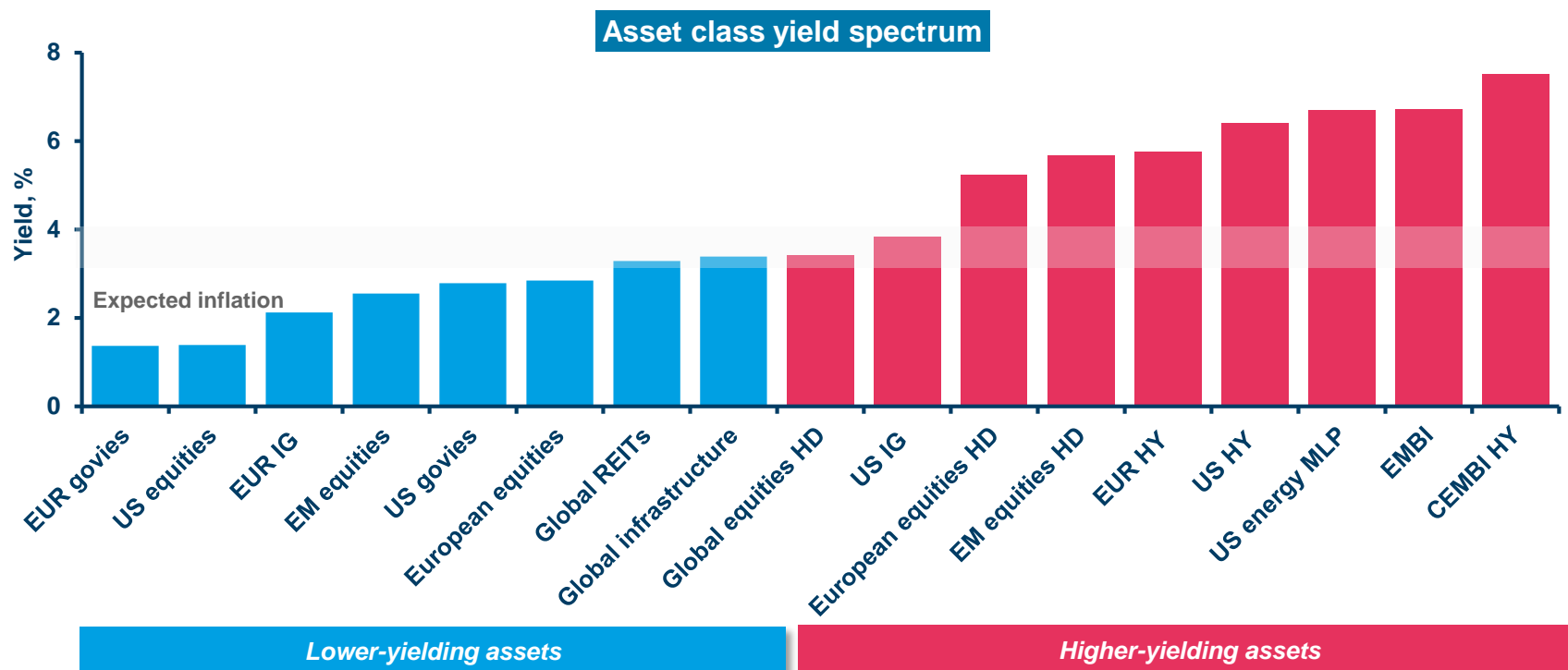


» The recent rally has allowed commodities to close their undervaluation gap with economic growth. However, the asset class still looks attractive when adjusted for inventories, and also when considering the favourable structural forces and geopolitical reordering. This should have implications for inflation and, accordingly, for investors looking for real returns and opportunities to play long-term themes, although they should be aware of the high volatility.

Source: Amundi Institute elaborations on Bloomberg data, as of 31 March 2022. Global growth time series calculated from US nominal GDP and global OECD Leading Indicator. Commodities is the Global Commodities Price index. Both are rebased to 100.

Source: Amundi Institute elaborations on Bloomberg data, as of 31 March 2022.

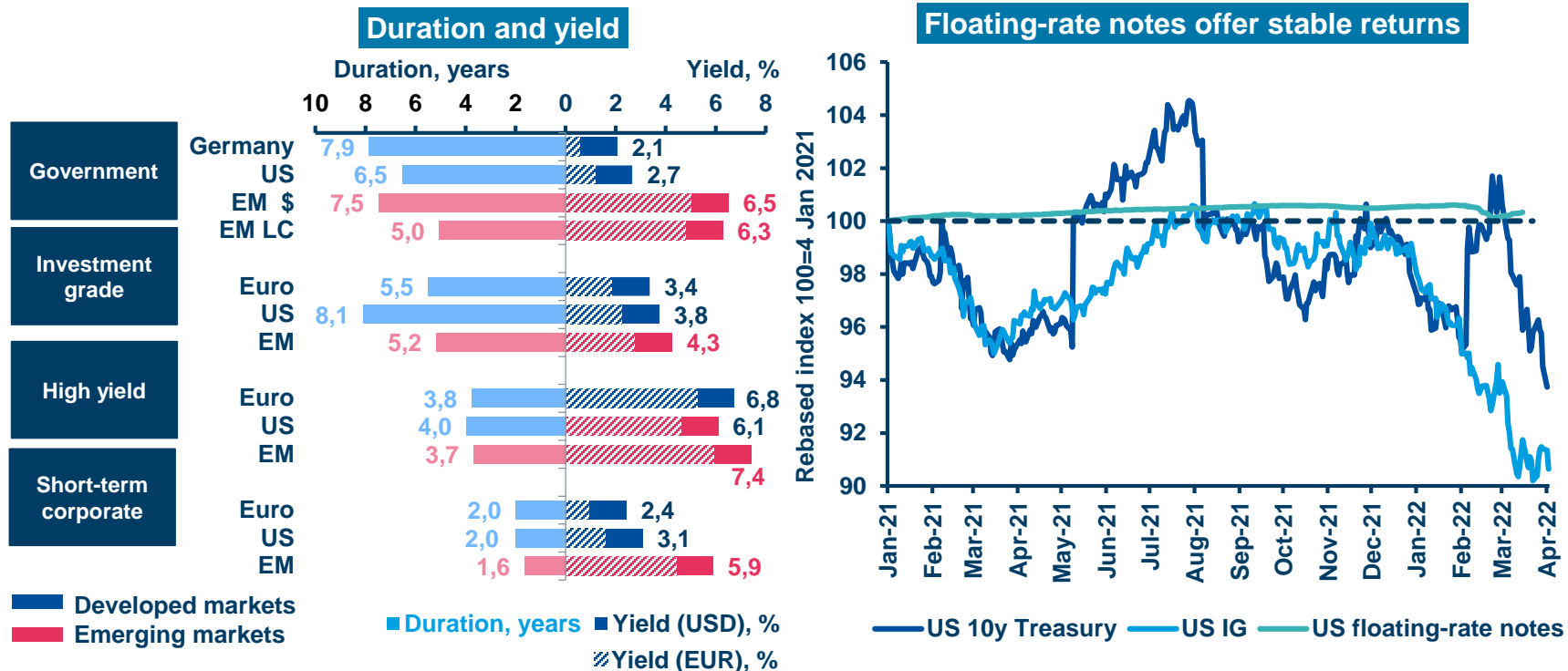
Target real income through a wide range of assets



» Higher-yielding asset classes can provide above-inflation returns. These can be found across alternative asset classes, so a broad-based investment approach – beyond the traditional benchmark approach – will be paramount.

Source: Amundi Institute, Bloomberg. Data as of 11 April 2022. Dividend yield refers to the past 12 months, yield for bonds indices refers to yield to worst.

Flexibility is the name of the game in fixed income

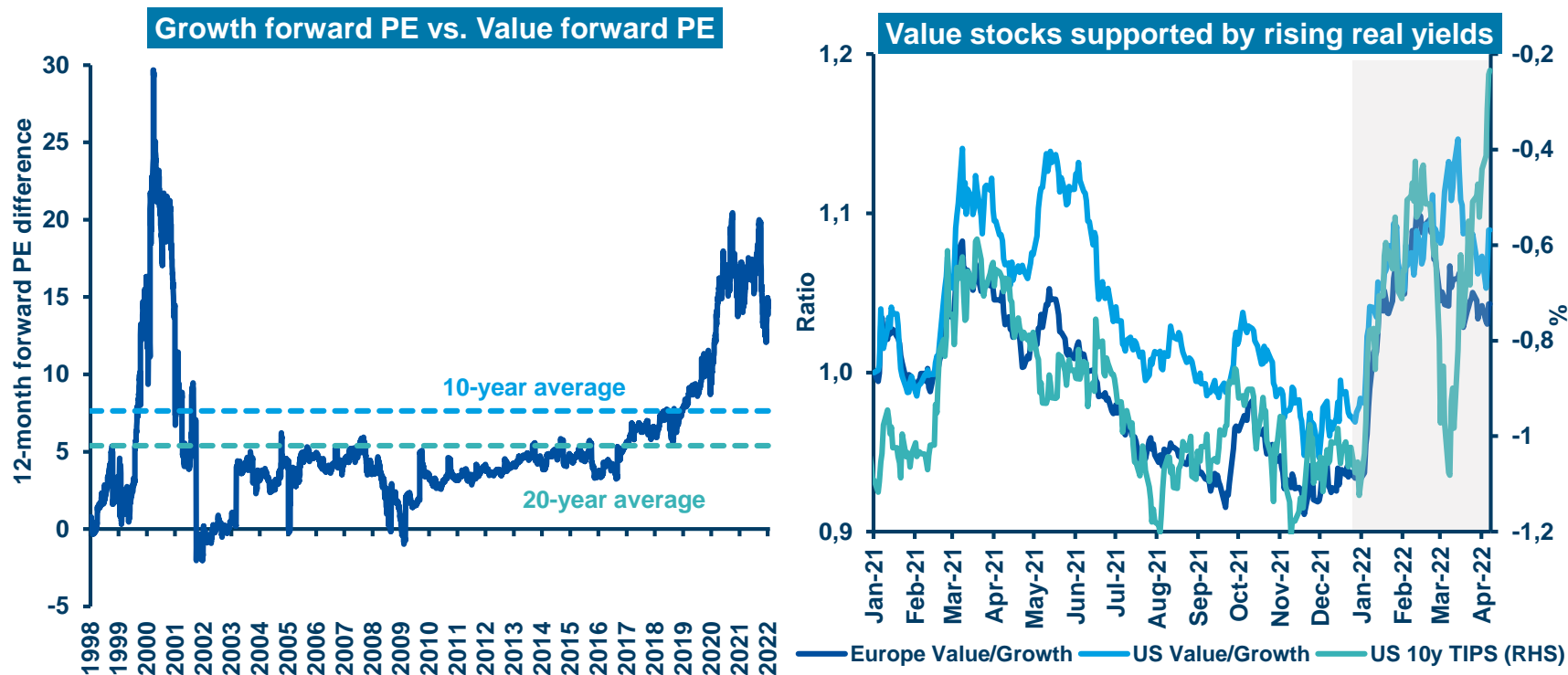


» At a time when high inflation and hawkish CB stances (upward pressure on yields) are combining with a flight to quality among investors (downward pressure on yields), bond prices and credit spreads can move fast. Investors should maintain agile and real return mindsets and adapt their strategies to enhance portfolio income by considering EM bonds and US credit selectively. Floating rate notes offer stability amid a fast-evolving environment.

Source: Amundi Institute analysis on Bloomberg data. Data as of 6 April 2022. CB: central bank. EM: emerging markets.

Source: Amundi Institute analysis on Bloomberg data, as of 6 April 2022.

Play the value call with a quality and selection tilt

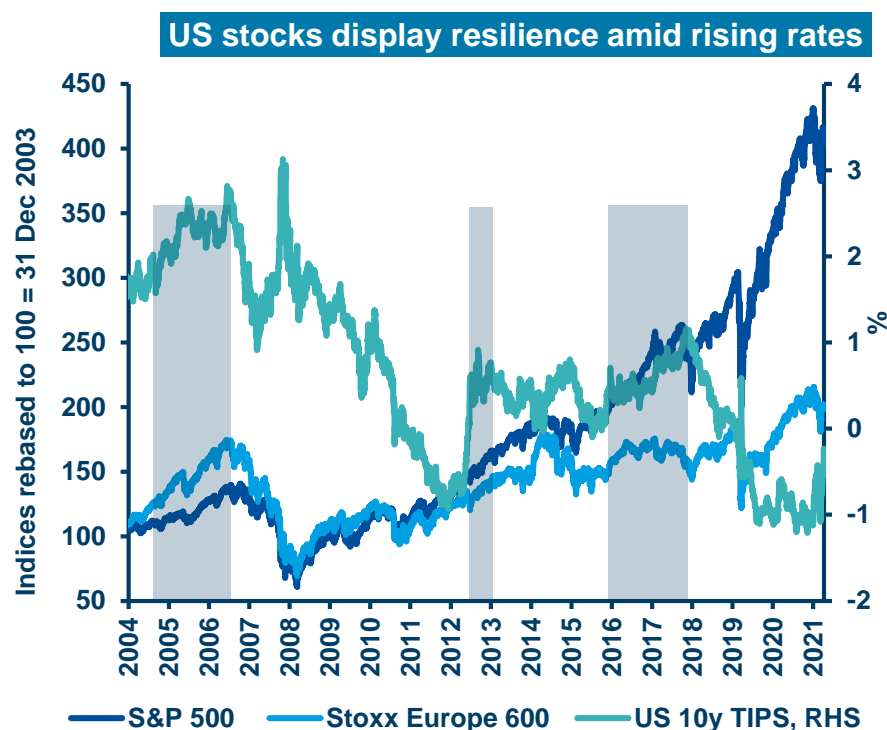
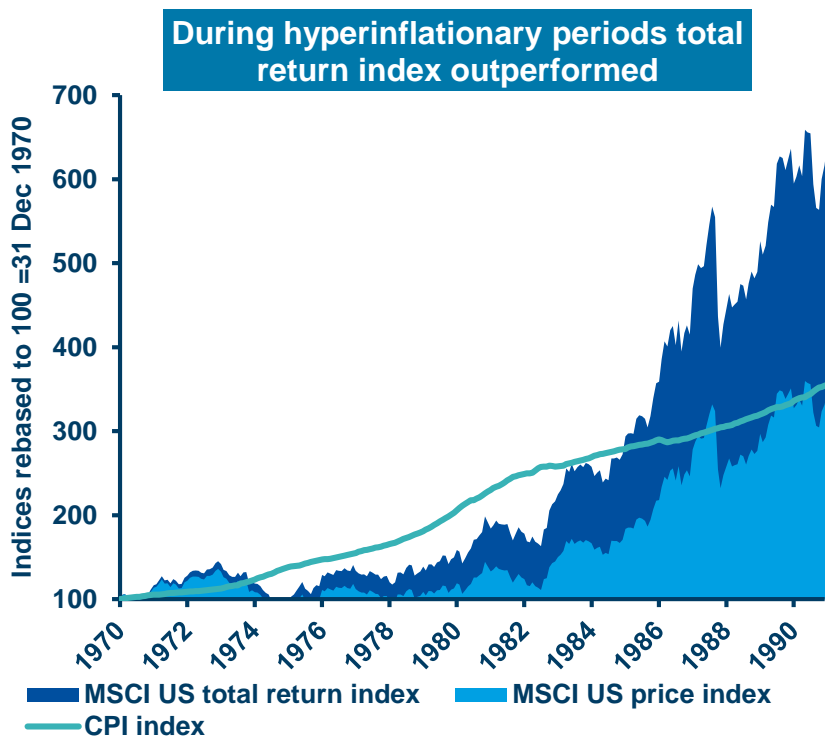


▶ We believe that the move towards value remains a medium-term trend, but it will not be in a straight line. Investors should look for businesses with a value and high-quality tilt, relying more on selection rather than on market directionality. While uncertainty related to the Russia-Ukraine war has weighed on sentiment, the US and European value sectors have outperformed growth this year so far*.

Source: Amundi Institute, Bloomberg. Data as of 7 April 2022. Data refers to best PE ratio. MSCI World Growth and MSCI World Value indices. PE: price-to-earnings ratio.

Source: Amundi, Bloomberg, as of 7 April 2022. Russell 3000 Value Index/Russell 3000 Growth Index and MSCI Europe Value/MSCI Europe Growth Index on left-hand scale. * Year-to-date 7 April 2022.

Explore resilient themes: dividends, relative US strength



» In times of high inflation, investors should complement their search for income with dividends and other sources of returns to offset the declining purchasing power. There is room to favour US equities over Europe's, given the limited impact of the crisis on US earnings and the higher ability of US companies to pass on rising input costs to consumers and preserve margins.

Source: Amundi Institute, Bloomberg. Monthly data as of 31 March 2022. **Dividends are not guaranteed and past performance is not a guarantee of future results.** Source: Amundi Institute, Bloomberg, as of 7 April 2022.

“The Russia-Ukraine conflict adds an additional element to the puzzle of higher inflation that will characterise the regime shift that we call the ‘Road back to the ‘70s’. In particular, investors should note that the inflation factor is being further reinforced by this unfortunate geopolitical event and the earnings trajectory is even more crucially dependent on the ability to pass on inflationary pressures. For investors, it is of paramount importance to look at portfolio construction through the inflation (and real rates) lens in the search for areas of resilience.”

Pascal BLANQUÉ

Chairman, Amundi Institute

Indices references and definitions

Yield and duration indices

German Govt Bonds = JP Morgan GBI Germany Index; US Govt Bonds = JPMorgan GBI US Index; Euro IG Bonds = Bloomberg Barclays Pan European Aggregate Corporate; US IG Bonds = Bloomberg Barclays US Aggregate Credit; Euro HY bonds = Bloomberg Barclays Pan-European High Yield ISMA; US HY Bonds = Bloomberg Barclays US Corporate High Yield; EMBI Div = JPMorgan EMBI Global Diversified Blended; CEMBI BD = JPMorgan CEMBI Div Broad Composite Blended; CEMBI BD HY = JPMorgan CEMBI Broad Div High Yield; Euro Corp Short Term = Bloomberg Barclays Euro Corporate 1-3Yr; US Corp Short Term = Bloomberg Barclays US Corporate 1-3Yr; EMBI Corp Short Term = J.P. Morgan CEMBI Broad Diversified 1-3 Year.

Definitions

- **Asset purchase programme:** a type of monetary policy wherein central banks purchase securities from the market to increase money supply and encourage lending and investment.
- **Basis points:** one basis point is a unit of measure equal to one one-hundredth of one percentage point (0.01%).
- **Breakeven inflation:** difference between the nominal yield on a fixed-rate investment and the real yield on an inflation-linked investment of similar maturity and credit quality.
- **Correlation:** the degree of association between two variables; in finance, it is the degree to which assets or asset class prices have moved in relation to each other. Correlation is expressed by a correlation coefficient that ranges from -1 (perfectly negative correlated) through 0 (absolutely independent) to 1 (perfectly positive correlated).
- **Credit spread:** differential between the yield on a credit bond and the Treasury yield. The option-adjusted spread is a measure of the spread adjusted to take into consideration possible embedded options.
- **Cyclical vs. defensive sectors:** Cyclical companies are companies whose profit and stock prices are highly correlated with economic fluctuations. Defensive stocks are less correlated to economic cycles. Cyclical sectors are consumer discretionary, financial, real estate, industrials, information technology, and materials, while defensive sectors are consumer staples, energy, healthcare, telecommunications services, and utilities.
- **Diversification:** Diversification is a strategy that mixes a variety of investments within a portfolio, in an attempt at limiting exposure to any single asset or risk.
- **Duration:** a measure of the sensitivity of the price (the value of principal) of a fixed income investment to a change in interest rates, expressed as a number of years.
- **FX:** FX markets refer to the foreign exchange markets where participants are able to buy and sell currencies.
- **Quantitative easing (QE):** QE is a monetary policy instrument used by central banks to stimulate the economy by buying financial assets from commercial banks and other financial institutions.
- **Standard deviation:** A measure of return variability (risk) above and below an average rate of return. A higher standard deviation suggests more variability in return over the period.
- **Value style:** It refers to purchasing stocks at relatively low prices, as indicated by low price-to-earnings, price-to-book, and price-to-sales ratios, and high dividend yields. Sectors with dominance of value style: energy, financials, telecom, utilities, real estate.
- **Volatility:** a statistical measure of the dispersion of returns for a given security or market index. Usually, the higher the volatility, the riskier the security/market.

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