Institute

May 2022

The psychology of inflation and money

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Confidence must be earned

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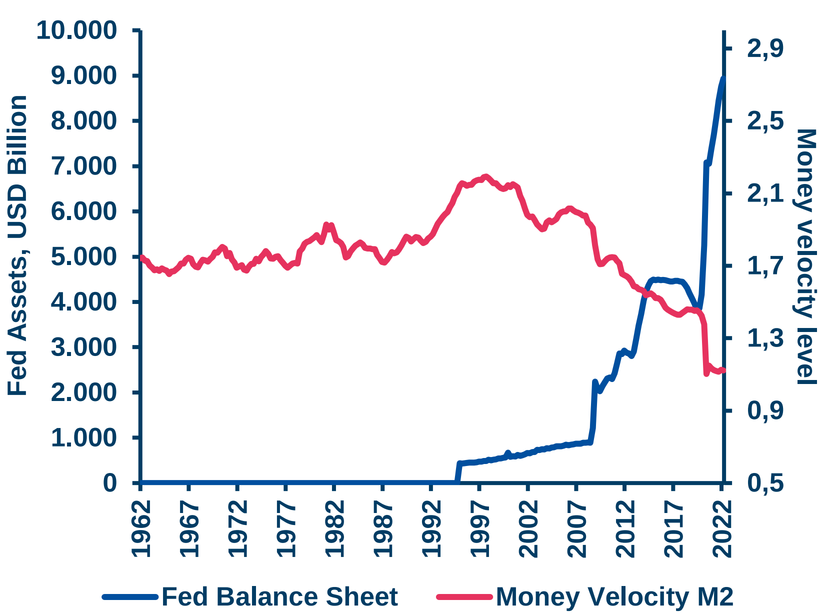
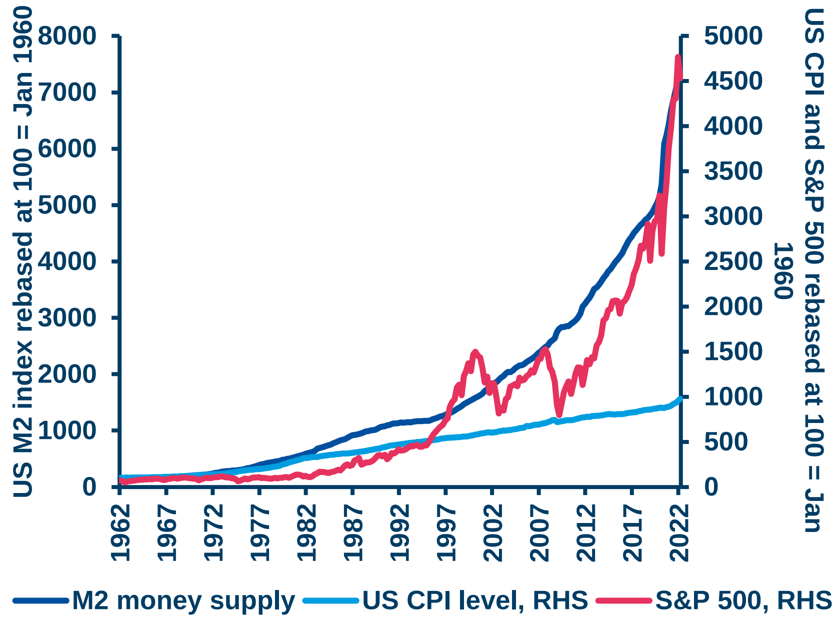
Inflation – the monetary side of the equation

With QE money velocity has collapsed



Monetary base vs. real & financial inflation



Real sphere

Vr: *the velocity of money in the real sphere has decreased in past decades*

Financial and real spheres links

Financial sphere

Vf: *the velocity of money in the financial sphere has increased in past decades*

Source: Amundi Institute calculations on Bloomberg. Data is as of 7 January 2022.

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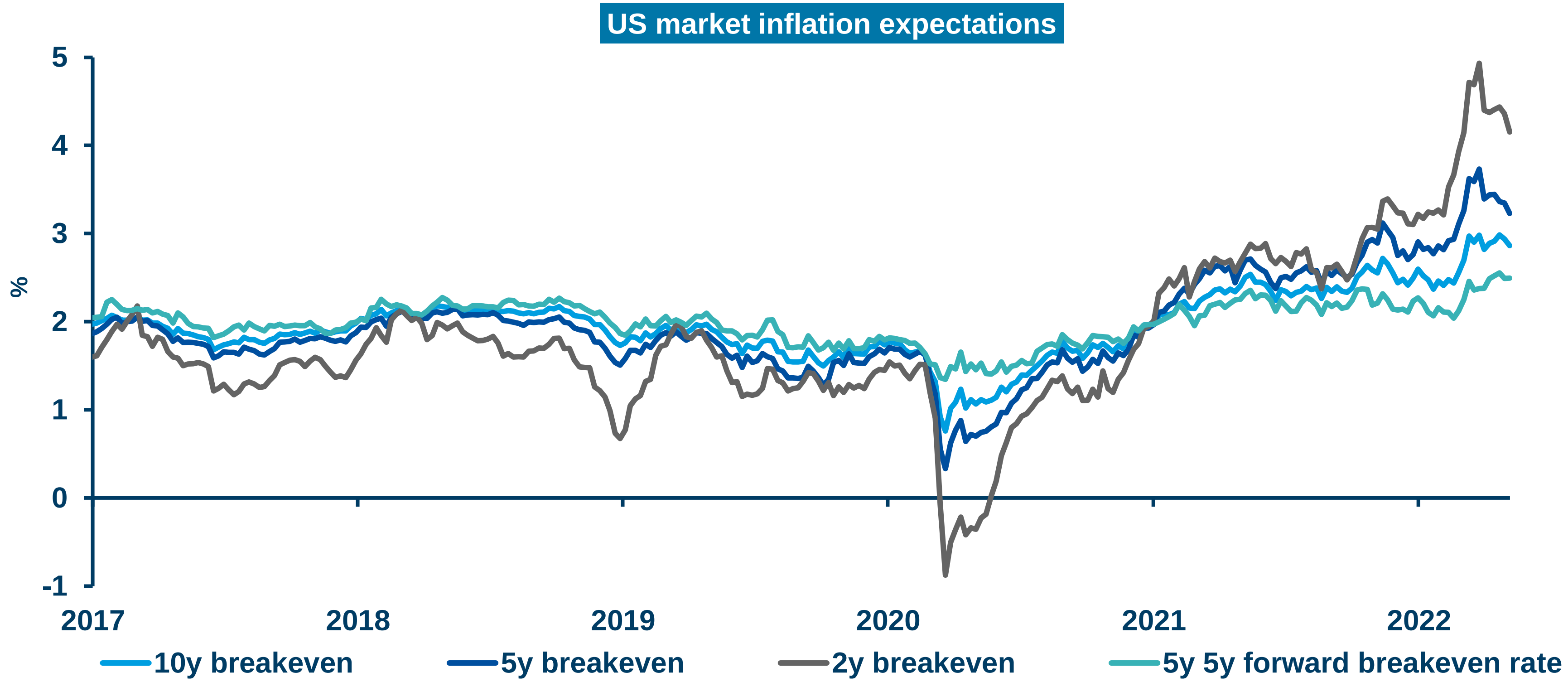
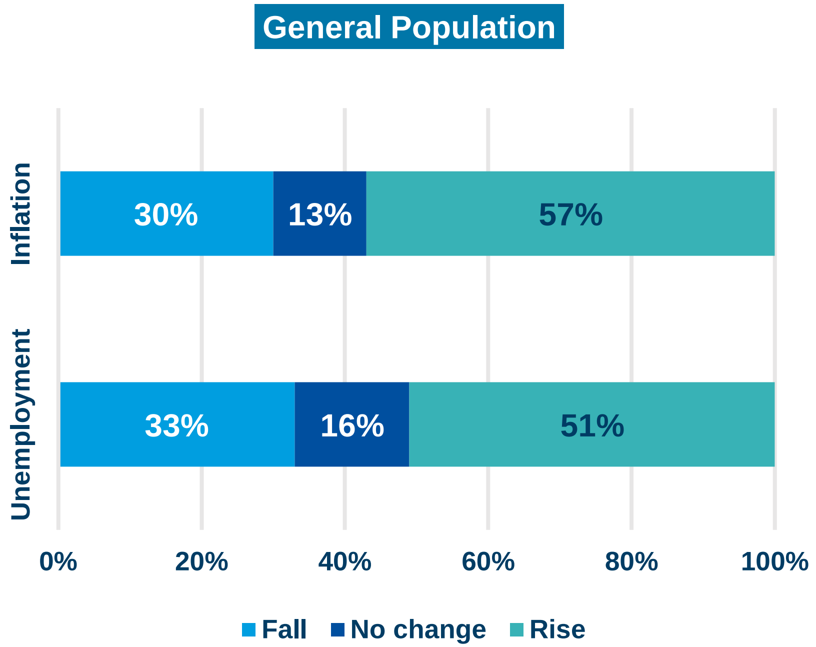
Psychological dimensions: Medium-term consumer expectations are awakening

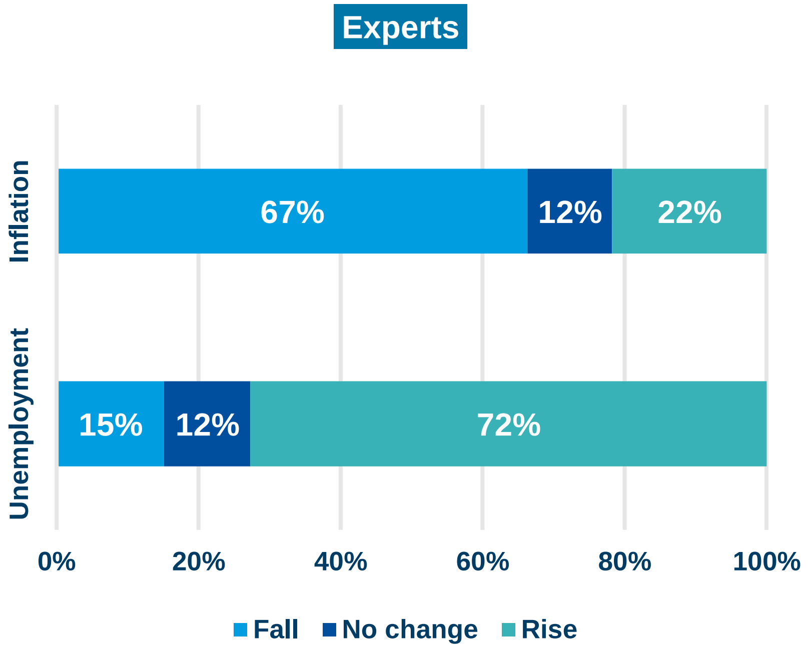


Market inflation expectations are rising as well: this trend could revive long-term memory patterns and activate the inflationary process.

Source: Amundi Institute, Bloomberg. Data is as of 11 May 2022.

Perceptions of what a Fed hike implies, for the general population and for the experts



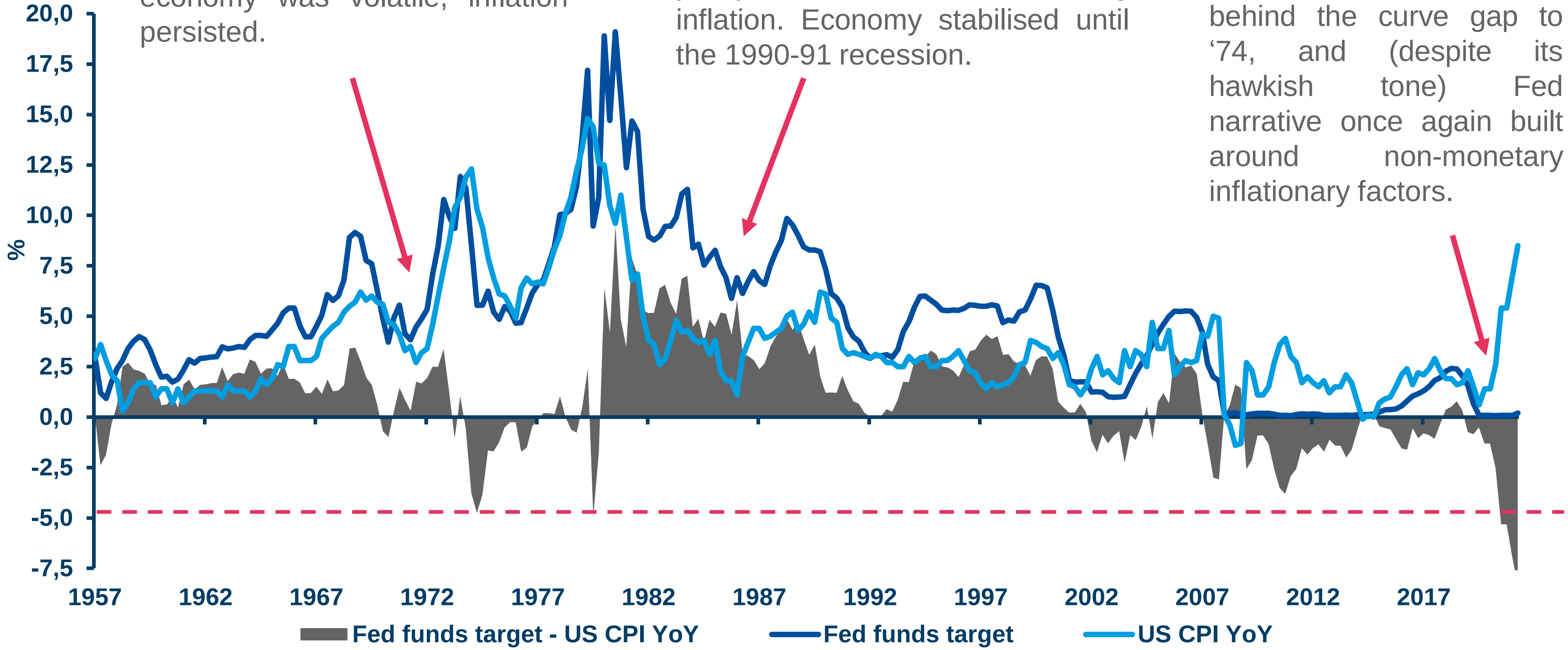


» Inflation is a self-fulfilling phenomenon: by publicising the presence of inflation by raising interest rates the existence of the threat is recognised, and thereby accelerated. A sudden shift in data builds up the short term memory that brings the long term reference back to the forefront.

Source: Andre et al. (2022), Subjective Models of the Macroeconomy: Evidence from Experts and Representative Samples. Based on a sample of about 6,500 respondents representative of the US population, and about 1,500 academic and non-academic experts.

Central Banks' reactions are critical: they are behind the curve – the Fed and the historical precedent of 1974

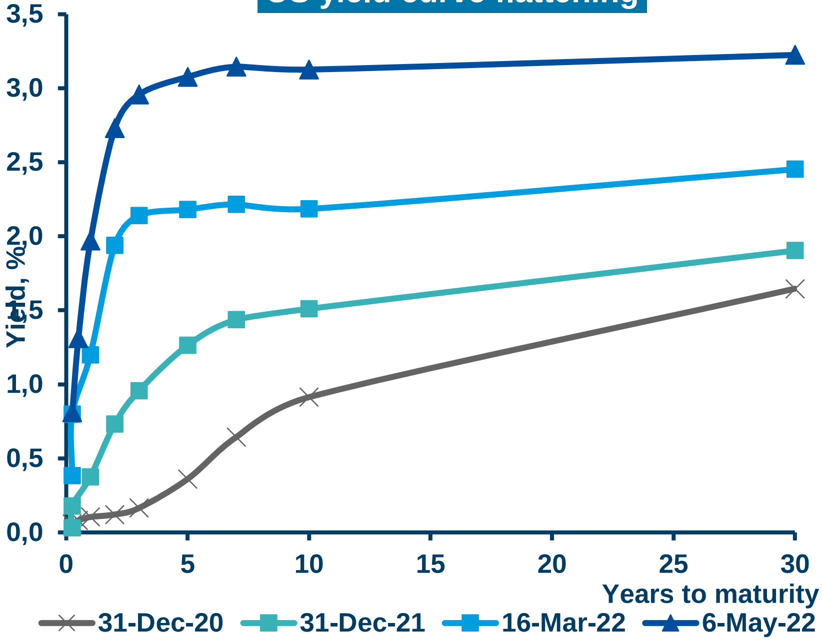
- **1974:** Fed downplayed the monetary factors and erred on the benign-neglect side. The real economy was volatile, inflation persisted.
- **1983:** new policy approach focused on monetary factors: high policy rates in the face of declining inflation. Economy stabilised until the 1990-91 recession.
- **2022:** behind the curve like never before. Similar behind the curve gap to '74, and (despite its hawkish tone) Fed narrative once again built around non-monetary inflationary factors.



Source: Amundi Institute, Bloomberg. Data is as of 27 April 2022.

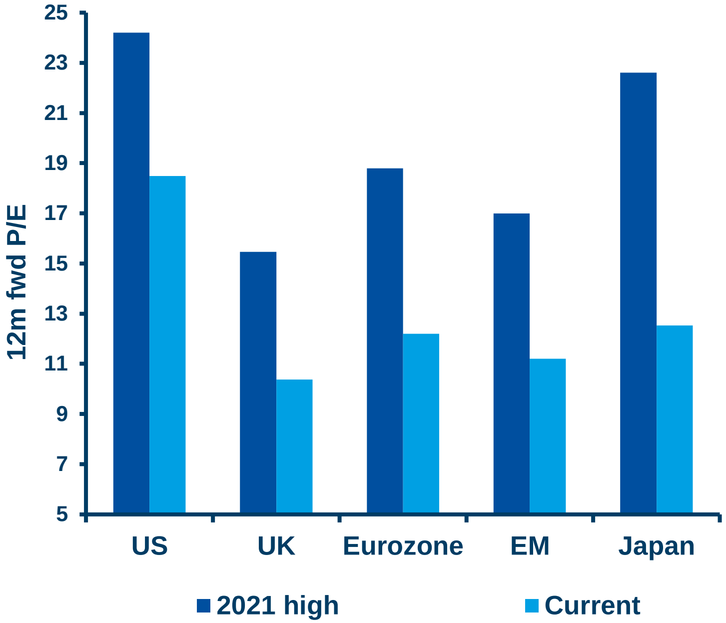
What does this mean for markets? Global repricing of risk underway, with further to go

US yield curve flattening



Source: Amundi Institute, Bloomberg. Data is as of 6 May 2022.

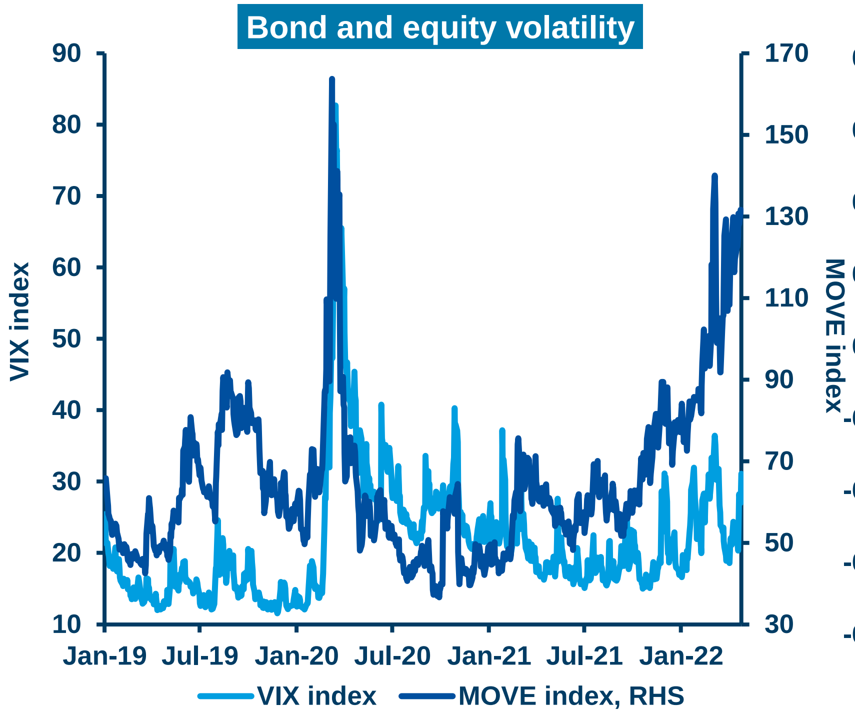
P/E derating from 2021 highs: key regions

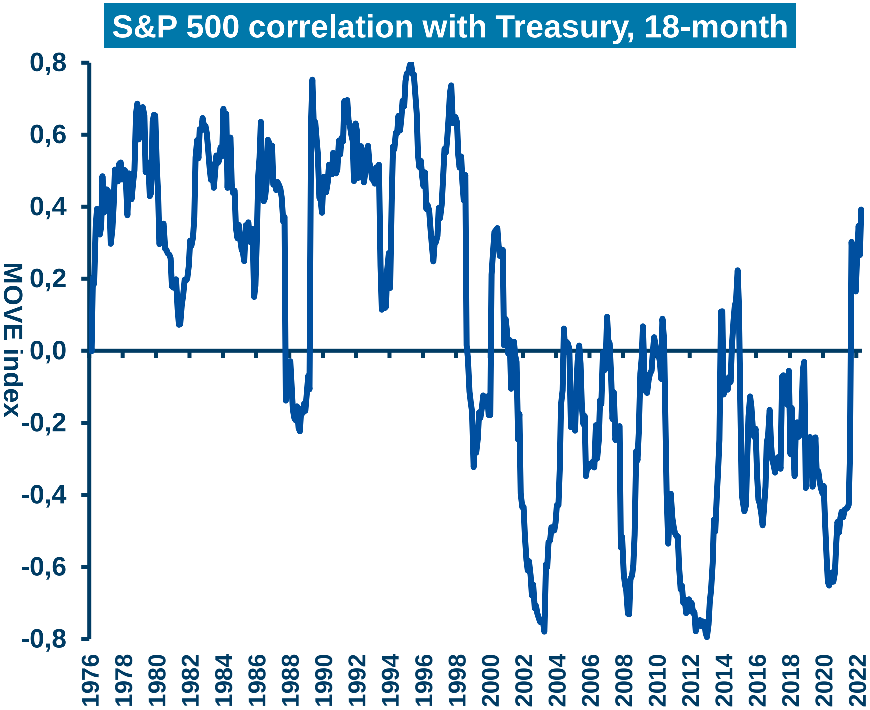


Source: Amundi Institute, Bloomberg. Data is as of 6 May 2022.

Uncertainty on central banks' action is impacting markets, with global repricing of risk assets, and a flattening yield curve. Investors need to rethink their strategic asset allocation in order to adapt to a world of heightened uncertainty regarding inflation and central banks' reactions.

Higher volatility and changing correlations challenge traditional portfolio construction





» Higher volatility and changing correlation dynamics between bonds and equities are key features of the new regime and challenge traditional portfolio construction paradigms.

Source: Amundi Institute, Bloomberg. Data is as of 26 April 2022.

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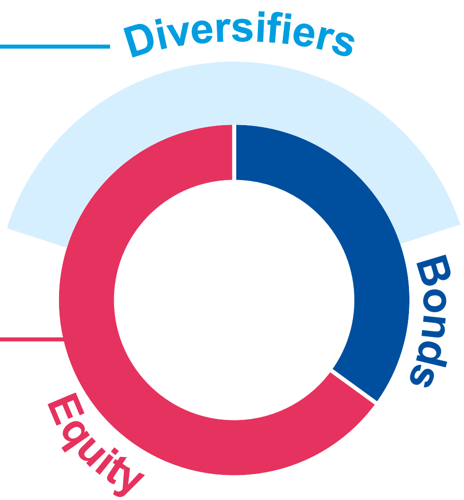
Rethinking portfolios around a regime shift and a “real” mind-set

Real income assets and liquid alternatives

- These assets should help enhance the risk-return profile of a global portfolio: this will be crucial, as a higher equity allocation will raise the overall risk.

Quality value, dividend, and stock selection resilient to inflation

- Equities as a proxy for real assets, playing the growth-to-value rotation as a multi-year trend.
- Factor in inflation risk and more diversified equity exposure in this respect: dividends and quality value.



Multiple strategies to cope with higher rates

- Traditional bond benchmarks face a duration problem (high duration with low yields).
- Investors should consider unconstrained strategies in search for opportunities across the board.
- Core bonds may be relevant for liquidity purposes only.
- Positioning: short-duration stance with some tactical flexibility.

Source: Amundi Institute. Data is as of 6 May 2022.

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