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Amundi ASSET MANAGEMENT

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REAL ASSETS IN AN INFLATIONARY CONTEXT

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CONTENTS

Amundi
ASSET MANAGEMENT

Current macroeconomic context

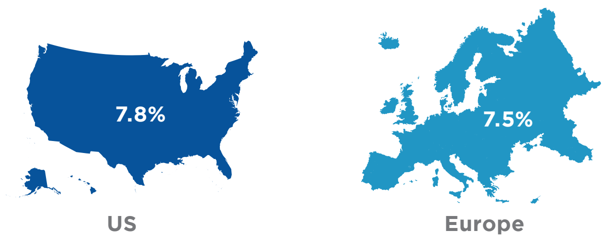
The world is witnessing **a significant shift** in global markets. Recent years have been characterised by **reduced growth, scarce inflation and an accommodative monetary policy stance** both in the US and in Europe. Covid-19 has been a turning point for global economies, and one of the legacies of the pandemic (coupled with geopolitical tension)[1] is in our opinion the sharp increase in prices leading to a **new inflationary regime.**

Even if signs of this trend were already present in 2021, this sudden pickup on prices is a new phenomenon. Geopolitical tension between Russia and Ukraine has contributed to the **hike in energy prices**, especially natural gas, oil, and food and has exacerbated pre-existing supply-chain bottlenecks[2].

In our opinion, the inflationary trend has been aggravated by this conflict, and it may persist longer than expected, well above the developed countries Central Banks targets[3]. Economic growth may slow down during the second half of the year, with the US better equipped to face this issue in comparison to Europe, also due to some countries (i.e. Germany and Italy) dependency on Russian energy[4].

The policy mix will have to find a new balance, as the Central Banks of developed countries have already started **increasing rates** to balance the Covid-19 monetary accommodation[5].

Figure 1. CPI (yoy) comparison



The drivers guiding the increase in inflation are different in the developed economies, as inflation is more demand-driven in the US, where the consumer price index (CPI)[6] hit 7.8% year-over-year (yoy), while supply constraints and the energy shock are pushing up prices in Europe, as CPI increased 7.5% yoy[7].

In general, in our view real assets have historically shown[8] the potential to provide a combination of inflation protection features and higher returns when compared to more traditional asset classes.

Recent years have been characterised by **reduced growth, scarce inflation and an accommodative monetary policy** stance both in the US and in Europe.

[1]*Inflation is back portfolio strategies in inflationary times, Amundi, as at May 2022*
[2]*Commodity prices surge due to the war in Ukraine, World Bank blogs, as at May 2022*
[3]*Global Investment Views – August 2022, Amundi*
[4]*Global Investment Views – August 2022, Amundi*
[5]*Monetary policy decisions, European Central Bank, 21 July 2022 and FOMC statement, Federal Reserve Board, 27 July 2022*
[6]*The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services*
[7]*Macroeconomic picture – July/August 2022, Amundi*
[8]*Past performance is not a guarantee or indication of future results*

What are real assets?

The term "real assets" refers to a broad range of investments that can behave in different ways, depending on the sector.

Investments in or linked to raw materials, energy, basic resources, real estate or infrastructure are usually directly connected to an economy's productive capacity.

In general, real assets are investments that have a tangible value, are typically capital-intensive and generate stable and long-term cashflows, which are distributed as dividends or coupons. The value of real assets is often tied to the development of price levels.

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The table below lists some examples of real asset sectors, their link to inflation and how they may contribute to creating value in a portfolio.

	Infrastructure	Materials	Real Estate	Commodities	Inflation-Linked Bonds
Investment Examples	Companies owning toll roads, airports, electric & water utilities, mobile networks	Companies that produce metals, agricultural goods, fertilizers, timber, oil and gas	Companies that own and operate Real Estate (i.e. logistics or apartments)	Energy, precious & industrial metals, agricultural goods	US TIPS, Index-linked Gilts, EM inflation-linked Government Bonds
Supportive Economic Environment	Sector specific: consumer demand, traffic	Pick-up in economic activity, rise in commodity prices	Inflationary environment with stable yields	Dependent on sector, energy and metals benefit from acceleration	Rising inflation expectations, declining interest rates
Link to Inflation	Cash flows and asset values might be directly linked to inflation	Inelastic demand structure may enable producers to pass on higher prices to customers and improve cash flows and profits	Property values tend to rise with higher price levels; rents also tend to increase in inflationary environment	Rising commodity prices may trigger inflation and could respond quickly to changes in supply and demand	Coupons and/or notional values are regularly adjusted toinflation measures
Portfolio Benefits	Total return and stable cash flows	Total return and diversification[9]	Total return and stable cash flows	Diversification[9]	Diversification[9] and regular cash flows

Source: Amundi Asset Management as of August 2022

[9]*Diversification does not guarantee a profit or protect against a loss.*

Investing in real assets

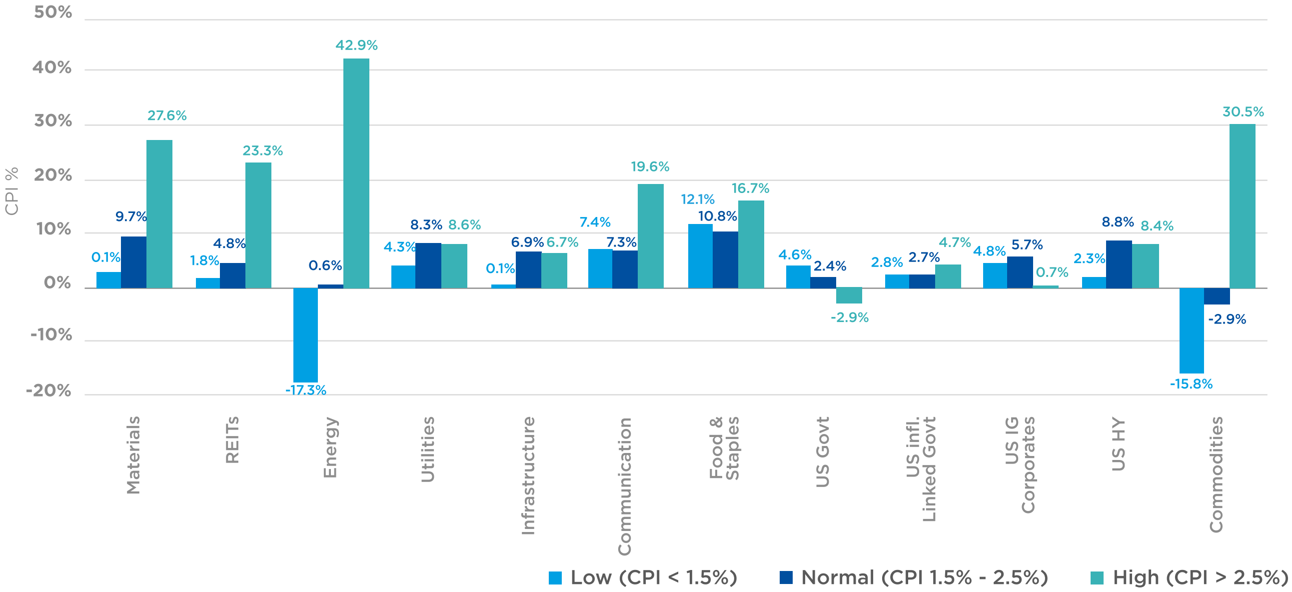
We believe Real Assets could offer portfolio protection in inflationary times. There are three tangible real benefits to back this belief:

1. Aims to protect purchasing power in a period of rising inflation
2. Seek to provide attractive and sustainable income potential
3. Acts as a portfolio diversifier[9] through investments linked to tangible assets

1. Aims to protect purchasing power in a period of rising inflation

As indicated in the analysis below, real assets reacted positively to inflation during times in which inflation was surprisingly on the upside or trending up, such as the current period.

Figure 2. Average 12-month performance in different inflation scenarios



Source: Amundi, Bloomberg. Data is as of 30 April 2022. Analysis horizon for rolling 12 month returns: July 2012 – April 2022. Equity performance is based on MSCI USA Sub-Indices. Fixed Income performance is based on ICE BofA Merrill Lynch indices. Commodities represents returns of the Bloomberg Commodity Index. The US CPI headline inflation was used as inflation measure. Low inflation environment: 12M CPI < 1.5%. Normal inflationary environment: 12M CPI within 1,5% to 2,5%. High inflation environment: 12M CPI > 2,5%. Past performance is not a guarantee or indication of future results.

In the past[8], the performance of real assets has been particularly strong during times of higher inflation, when the US CPI exceeded 2.5%. Commodities also saw sustained increases during periods of high price pressures, but in our opinion they tend to underperform when inflation is low or at normal levels.

It is important to note that returns of real assets may also be driven by factors other than inflation, such as the economic activity or interest rates.

[8] *Past performance is not a guarantee or indication of future results*
[9] *Diversification does not guarantee a profit or protect against a loss.*

2. Seek to provide attractive and sustainable income potential

Real assets could offer inflation-linked income potential. In fact, some of the income streams of real asset companies are often connected to inflation, due to the regulatory frameworks or contractual agreements.

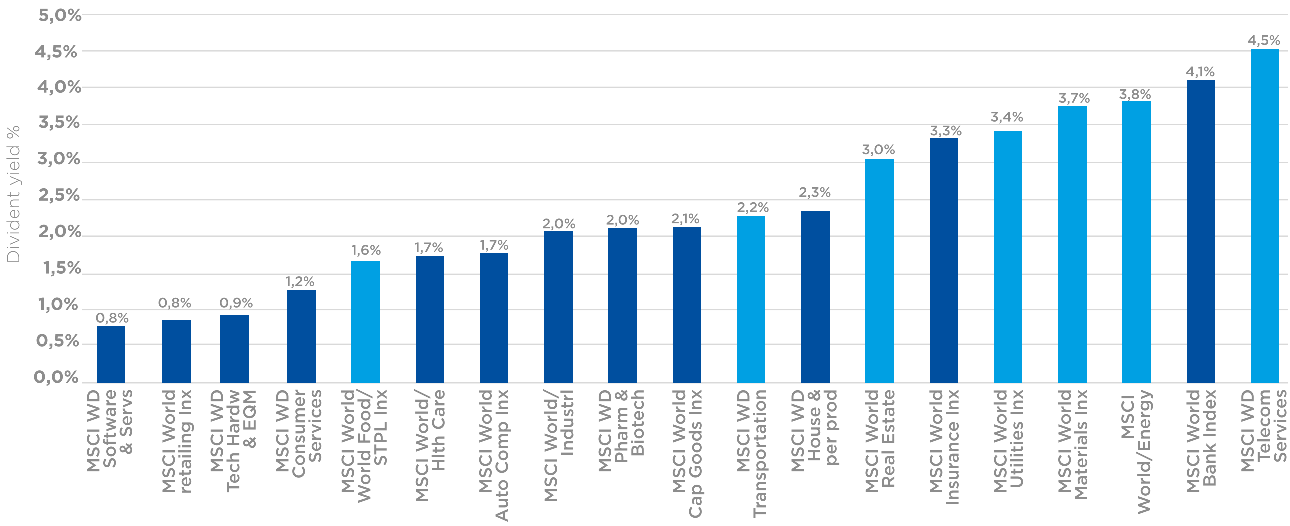
For example, some concession agreements allow certain toll roads and airport operators to link their tariffs to inflation[10]. Additionally, some utilities and pipeline operators are authorised by regulators to adjust their tariffs to cost-price inflation, to ensure that can they earn a real return on their asset base, which is usually higher than their cost of capital.

Some of these companies seek to generate strong cashflows and sustain high dividend payouts, making their distributions potentially more bond-like and hence more predictable over the long-term.

Real estate companies could also adjust their rental income to underlying inflation rates and often generate rental yields in excess of inflation[11] . Investment structures in the form of trusts and partnerships for real estate and energy infrastructure companies respectively stipulate a high distribution of their cashflows in exchange for tax benefits, which may help to sustain a high dividend yield.

The following chart indicates the dividend yield for a selection of real economy sectors across equity markets (highlighted in light blue). Some dividend yields, such as the ones here represented, are high in comparison to the MSCI World Index, which pays a dividend yield of roughly 2.0%.

Figure 3. Dividend yield across equity markets.



Source: Amundi Asset Management, Bloomberg. Data as at 30 April 2022.

Dividends are not guaranteed. These information are given for illustrative purposes only, may be changed without further notice. It is not possible to invest directly in an index

[10] *https://www.ibtta.org/sites/default/files/documents/10%20Years%20in%20Toll%20Roads_Fitch.pdf*
[11] *https://www.forbes.com/sites/forbesrealestatecouncil/2021/09/28/is-real-estate-a-hedge-against-inflation/?sh=730d4d3d19da*

3. Acts as a portfolio diversifier[9] through investments linked to tangible assets

Adding real assets to a more traditional bond/equity portfolio might help to increase diversification[1]. In our opinion, real assets have historically shown low correlation with bonds and equity and a negative correlation to government bonds.

Furthermore, real asset sectors such as Real Estate Investment Trusts (REITs) or commodities also have a low correlation among themselves, providing the potential to build a combined real asset portfolio. Including more components could help enhance the overall risk-return profile, compared to investing in a single real asset component.

Diversification[9] could contribute to enhancing portfolio resilience, and preferring the more liquid parts of the real asset sector could potentially result in a positive strategy. Liquid real assets, like commodities and REITs might be more easily traded on an exchange and in our opinion could potentially allow for greater flexibility in portfolio construction.

The ones listed above are the main features of real assets. It must be noted, however, that like any strategy there are also risks and performance cannot be guaranteed.

Conclusion

The world is facing a complex macroeconomic scenario in the post-Covid world, with the resurgence of inflation and concerns over economic growth. Geopolitical factors continue to dampen the outlook and Central Banks in the US and Europe have started tightening their monetary policy[2].

In this environment, real assets might be a potential option. Certain sectors are usually connected[8] to the productive capacity of the economy which could bring tangible value. They are typically[8] capital-intensive and may generate long-term cashflows.

Historic data implies that real assets might help protect the purchasing power during periods of sustained and high inflation, as historically their performance[4] has been overall positive whenever US CPI has exceeded 2.5%[12].

Additionally, due to the nature of some concession agreements[8] and regulatory frameworks, certain operators in real assets sectors may adjust their tariffs to inflation, in turn generating stronger cashflows with a more bond-like dividends distribution.

Thanks to their low historical correlation[8] with bonds and equities, real assets could also potentially contribute to portfolio diversification[9], seeking to enhance the overall resilience. Commodities, REITs and other liquid real assets that might be traded easily may allow for greater flexibility in the portfolio construction phase.

[2] Commodity prices surge due to the war in Ukraine, World Bank blogs, as at May 2022
[4] Global Investment Views – August 2022, Amundi
[8] Past performance is not a guarantee or indication of future results
[9] Diversification does not guarantee a profit or protect against a loss.
[12] Amundi, Bloomberg. Data is as of 30 April 2022. Analysis horizon for rolling 12 month returns: July 2012 – April 2022. Equity performance is based on MSCI USA Sub-Indices. Fixed Income performance is based on ICE BofA Merrill Lynch indices. Commodities represents returns of the Bloomberg Commodity Index. The US CPI headline inflation was used as inflation measure. Low inflation environment: 12M CPI < 1.5%. Normal inflationary environment: 12M CPI within 1,5% to 2,5%. High inflation environment: 12M CPI > 2,5%. Past performance is not a guarantee or indication of future results.

Important information

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