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HORIZONS

3rd quarter 2020

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An affiliate of: NATIXIS INVESTMENT MANAGERS

ECONOMIC POLICY PUT TO THE TEST BY POST-LOCKDOWN PERIOD

Philippe Waechter
Chief Economist

After the recent health crisis sent out shockwaves, the macroeconomic challenge we now face is the speed at which economies can converge towards full capacity utilization. The stakes are high, as the faster they move towards 100%, the sooner they will iron out the dents from the health shock. The challenge for economic policy is thus to curb the lasting effects of the crisis on the economy.

Governments therefore need to take an extremely active approach, and the plan presented by Angela Merkel in Germany, along with industry programs for the automotive and aerospace sectors outlined in France, are steps in the right direction. Meanwhile, the Europe-wide plan is also a move forward — even if it will not be rolled out straight away — and has already shifted perception of Italian risk.

> ***«The third quarter is poised to see activity catch up considerably, with growth likely to come out above 10%.»***

To get a better grasp of this situation, we must bear in mind that economic activity contracted abruptly and drastically over the first two quarters of 2020, and we cannot rule out a plunge of between 10% and 20% in the economy (depending on the country) in the second quarter, on a non-annualized basis, as a result of the lengthy lockdown period in April and part of May. However, the third quarter is poised to see activity catch up considerably, with growth likely to come out above 10%. Lower but nonetheless positive figures are expected for the last quarter of the year.

Recovery for services is more challenging

The emergence from lockdown logically propels the economy to catch up, as consumers can naturally make the purchases they had put on hold during isolation: this is particularly evident in the manufacturing sector. Purchases of durable — and expensive — goods are usually delayed when uncertainty increases. But when the situation eases, consumers rush out to buy these products, in a standard mechanism that we have seen both in France and elsewhere since lockdown ended. French statistical body INSEE indeed shows that consumer spending caught up, but the current crisis is unusual in that the effects were primarily felt in the services sector. The closure of stores and restaurants, and the standstill for tourism and certain other activities plunged indicators in this sector to entirely unprecedented levels. By way of comparison, the manufacturing sector's low in April is on a par with the trough hit during the 2008-2009 financial crisis. However, the services indicator at that time was well above the manufacturing figure, so when manufacturing recovered, services were driven up accordingly. Conversely, during the recent health crisis, the services sector plummeted to greater depths than manufacturing, and this low starting point means that the upturn for services is taking longer to materialize. Unlike the manufacturing sector, there is no build-up of delayed purchases, and hence not the same scope for the sector to make up for lost

be too costly over time. Once countries emerge from lockdown, a very proactive policy approach is then required to restrict the effects of the health crisis to the greatest possible extent, as we outline above.

> ***«Public debt issues spread out the effects of the shock over time.»***

activity. Business in the services sector is therefore set to remain moderate for the months ahead.

Economic policy must therefore drive the economy forward to converge towards full capacity, and the challenge will be to stage a recovery of an equivalent magnitude to the economic contraction in 2020. The sooner countries can stage this convergence, the smaller the economic contraction will be. However, looking beyond this aspect, the point the economy hits at the end of the year will also dictate the pace of growth in 2021 and beyond.

If convergence is very swift, then GDP at the end of the year will considerably outstrip the average figure across 2020. Growth carryover for 2021 will be substantial, growth in 2021 will be robust and economies will more rapidly make up for the losses caused by the health crisis. However, if activity does not improve after the recovery staged in May and June, growth carryover will be lackluster and growth for 2021 will be very sluggish. It will then take much longer for the economy to make up its lag: rather than revisiting 2019 GDP figures in the space of 2-3 years as the most optimistic assumptions suggest, it will instead take much more than 5 years. Meanwhile, the labor market profile would also look entirely different.

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Threat of fresh lockdown

There have been several stages in the development of the crisis, with the same trends seen across European states. Firstly, governments stepped in to take over the reins of the economy and offset the effects of lockdown that paralyzed the economy, but also curbed the spread of the virus. Secondly came the general acceptance that public deficits would be severely inflated to absorb these government measures to buttress the economy. Public debt issues spread out the effects of the shock over time to ensure that adjustments to the shock are not all focused on the current period alone, which would carry a hefty cost.

Alongside this public debt issue policy, the central bank has also intervened to purchase this debt and keep interest rates low: this debt must not

At this point it is worth remembering that public debt outstanding — as measured by its ratio to GDP — will remain lofty for a very long time, as the economy's underlying growth is pedestrian. This will force the central banks to pursue their proactive approach for a very long time to come, to keep interest rates low.

This portrayal of future economic trends hinges on an easing of the current health risks: the description can apply to Europe, where countries are all paying close attention to the risk of a second wave in the epidemic, but not to the US, where the surge in new cases since mid-June is in danger of triggering fresh — and disastrous — lockdown measures.

Text completed on June 26, 2020

OPPORTUNITIES ABOUND AS WE EMERGE FROM THE CRISIS

Fixed Income Management Team

The fixed-income markets have been hit by an unprecedented crisis, with implied volatility soaring in March to hit 2008 figures. Investors were thrown into a panic and rushed headlong into risk-free assets — dollar-denominated more generally speaking — fueling a hefty outperformance for US Treasuries, posting +7.5% vs. a mere +1% average for the other G7 countries YTD. Fears of a supply shock subsequently dented expectations, as did the prospect of forthcoming issues to finance vast deficits, while the oil counter-shock played its part in pushing yields to lows right across the world. As soon as the Fed resumed its massive and near-unlimited purchase program, the US 10-year returned to its floor at 0.60%, and at the same time central banks across the globe reiterated their famous refrain of "low interest rates for a long time".

Central banks step up

One of the key aspects of this crisis was the steepening in yield curves, and by way of example, the US had to reintroduce auctions of 20-year Treasury issues, thereby heightening term premium pressure. Differences between the various yield curves also emerged, as the extent of the pandemic and the magnitude of official responses varied between countries. In the euro area, periphery country premiums rose sharply, particularly in Italy, which was severely affected by the epidemic. The ECB's purchases have amounted to €70bn since January, and these moves helped stabilize the Italian Treasury's 10-year yield at around 1.50%, while the creation of a rescue fund that pools contributions to pay out subsidies to European states marks a historical move that will fuel sentiment on the reconvergence of sovereign yields.

A number of themes will dictate our fixed-income investments for this forthcoming third quarter. Firstly, the central banks will continue to fend off a sharp surge in yields by staging yield curve control on the long end, similar to practices in Japan and Australia. The ECB ramped up its asset purchase program to unprecedented levels of €1.35

trillion and also pledged to continue reinvesting proceeds until end-2022. The central bank will make net issues negative in 2020 for all countries in the zone, and this situation will probably continue into 2021. The ECB will thus implicitly target intra-European yields. The Fed will very probably decide to adopt a policy targeting medium-term

«We expect the US yield curve to steepen further, particularly on very long maturities.»

yields in order to limit the increase in its $7 trillion balance sheet and thereby prevent long-term rates getting out of control prematurely. However, the US central bank will think twice before targeting maturities of more than 10 years, due to a potential risk for its balance sheet, as well as the threat on valuations for pension funds' liabilities. We therefore expect the US yield curve to steepen further, particularly on very long maturities.

Severe geographical disparities

The fixed-income markets are more cautious on the profile of the economic recovery than risky asset markets, such as equities. We still expect an improvement in the pandemic situation on a three-month timeframe, along with a decreasing likelihood of a return to lockdown. We feel that market confidence on the economy's ability to stage a rebound will be further shored up, but investors will also become increasingly selective between geographical areas, adding to existing discernment between business sectors. Additionally, unconditional and virtually unlimited support from authorities has now been tried and tested and this will ward off more bearish strategies. However, the financial system is obviously not immune to a second shock — this time from credit as a result of the debt figures being notched up — while geopolitical risk cannot be overlooked either. We think that long-term rates will find their equilibrium at moderately higher levels of between 0.8% and 1% for the US 10-year, depending on the Fed's moves to control the curve. Furthermore, we still have a preference for fixed-income markets in certain countries that will recover more slowly and will thus benefit from greater backing from the monetary authorities, i.e. the UK, which is embarking on a period of uncertainty regarding Brexit, as well as Canada, Italy and Spain. We will also focus on some Scandinavian countries, where credit was fairly unaffected by the crisis.

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Despite proven macroeconomic risks, emerging market external debt managed specifically harbors value for both technical and valuation reasons. In view of US-Chinese tension and the recovery cycle, investment on Chinese fixed income will not be flavor of the month, having acted as a safe haven at the height of the crisis. However, we still expect investment flows on emerging debt from countries such as Indonesia (in local currencies), South Africa, Mexico or even Russia. In light of technical factors, we think that the quest for yield will be a driver for some emerging markets. With a lower dollar and oil prices stabilizing, emerging market external debt carries an attractive risk-return profile as compared with G4 yields in our view.

«In light of technical factors, we think that the quest for yield will be a driver for some emerging markets.»

Text completed on June 18, 2020

DISPERSED SHOWINGS ON THE CREDIT MARKETS

Credit Management Team

With the world facing a recession that is very different to all previous crises — both more sudden and more widespread — the credit markets look well prepared to tackle future phases of volatility, and we think that investors should play periods of volatility by riding the rally wave.
States have offered an unprecedented response — in both quantitative and qualitative terms — to the threat of economic paralysis and fears that a demand shock would add to the supply shock. Central banks' monetary policy has therefore taken on a whole new dimension, and highly expansionary fiscal policies have gradually been rolled out.

Tailwinds for investment grade credit

First and foremost, it is important to bear in mind that the European investment grade credit benchmark has shed only 0.9% YTD during the largest economic shock seen in more than a decade, testifying to its strength. The investment grade market is the main beneficiary of central banks' unconventional policies (Fed/ECB) with their corporate bond purchase programs, and in this respect, we think that investment grade credit is becoming the new safe haven on the financial markets, as it provides much better returns than sovereign debt, but carries much more diversified risk and is less affected by political ups and downs. Investment flows on the asset class confirm this, as they turned very positive again with a recent uptick.

> ***«We think that investment grade credit is becoming the new safe haven on the financial markets»***

The investment grade universe is also decreasing in size as many lower-rated issuers slide towards speculative category, and this enhances its average credit quality. We expect corporate IG companies to have much lower financing needs in the third and fourth quarters, automatically making this asset class more scarce. On top of this, competition to source bond investments is growing between buyers — including the ECB — so investment grade credit should enjoy very positive technical factors in the second half of 2020.

But high yield struggling

However, momentum on the high yield market is different. There is no direct central bank action on this market, and concerns over a swell in default rates continue to prevail. The Covid-19 crisis has put certain companies in a tricky position after their business plunged dramatically, particularly in the transport and leisure sectors. But at the same time, governments have offered a great deal of support, providing tax relief and encouraging banks to support refinancing. Struggling companies have also been able to obtain state-guaranteed loans. It is difficult to accurately estimate default rates, as we must take on board the impact of a decline in business as well as the effects of state support. However, we think that defaults on the European high yield market could come to as much as 6% out to the end of the year, if there is not a significant second surge in the epidemic.
The second crucial factor on the high yield market for the quarter ahead will be the extent of downgrades in the investment grade universe — the so-called fallen angels. These heavyweight issuers — such as Ford — will break into

> *Defaults on the European high yield market could come to as much as 6% out to the end of the year.*

the market, leading to significant reallocation in benchmarked portfolios. This additional market supply combines with a primary market that is relatively moderate for the moment. On the demand side, we are admittedly witnessing positive inflows again, but they are still moderate compared with the massive outflows amassed in March and April. Overall, these technical factors could point to relatively stable — but volatile — spreads over the quarter ahead.
Absolute showings on the investment grade benchmark index remain historically high, but it has retraced 66% of its underperformance YTD. Historically investment grade spreads remain attractive, particularly as they price in a lot of negative expectations and default rates are set to be below figures currently priced in by the market. Since the start of the year, the high yield market has hit a low at -19% on BB and B ratings, but it has since stabilized at -4% on the back of the rebound. However, we must not fail to see the wood for the trees, and it is crucial to take a selective investment approach. Dispersion has increased and differences have steadily amplified between the lowest and highest ratings, and between the most exposed sectors and the rest of the market. Investment opportunities abound, on condition that we analyze the credit quality outlook by sector, issuer and points on the curve in detail and on an individual basis.
Investors picking securities on the high yield market should seek to steer clear of the most shaky companies that do not have sufficient available cash to make it through the crisis. We should see an increase in debt renegotiation proposals on the most exposed sectors and the most fragile companies. Spreads are also attractive as compared with figures at the start of the year, but dispersion between issuers may increase depending on publications of contrasting financial results. However, a lot of good news already seems to be priced in on the high yield market and volatility could still remain. But yield is still attractive at 3.9% and finding the right market entry point will be decisive for investors' performances.

> *We should see an increase in debt renegotiation proposals on the most exposed sectors and the most fragile companies.*

Defaults increase on leveraged loans

After an abrupt halt in late March, leveraged loan issues are gradually resuming on the European market, although they are still down 18% vs. 2019 at this stage: issues currently mostly involve deals that had to be withdrawn or had not been launched due to the mounting health crisis. For such times as this backlog of deals structured before the crisis — such as the financing for the buyout of ThyssenKrupp's Elevator Technology business, or of BASF's Construction Chemicals business — is not cleared, it is difficult to expect the market to truly get back to normal. Meanwhile on the secondary market, the S&P ELLI has recovered considerably after its 19.7% nose-dive between December 31 and March 24, with a dip of only 4.9% at June 17.
The market for CLO issues also closed in late March, with spreads soaring on the secondary market, ruling out any arbitrage moves. Issues have now resumed, but these are deals for arrangers to sell portfolios of warehouse capital built up before the crisis, with CLOs that often have inadequate size (€200-250m) and still carry high coupons.
Rating migrations also put pressure on existing CLOs with the sharp increase in the proportion of Triple C in portfolios, pending the forthcoming increase in default rates: the quality of credit research and projections of borrowers' liquidity risk will be decisive in getting through the crisis and ultimately minimizing losses on portfolio loans.

Text completed on June 19, 2020

BEWARE OF EXCESSIVE CONFIDENCE ON THE EQUITY MARKETS

Equities Management Team

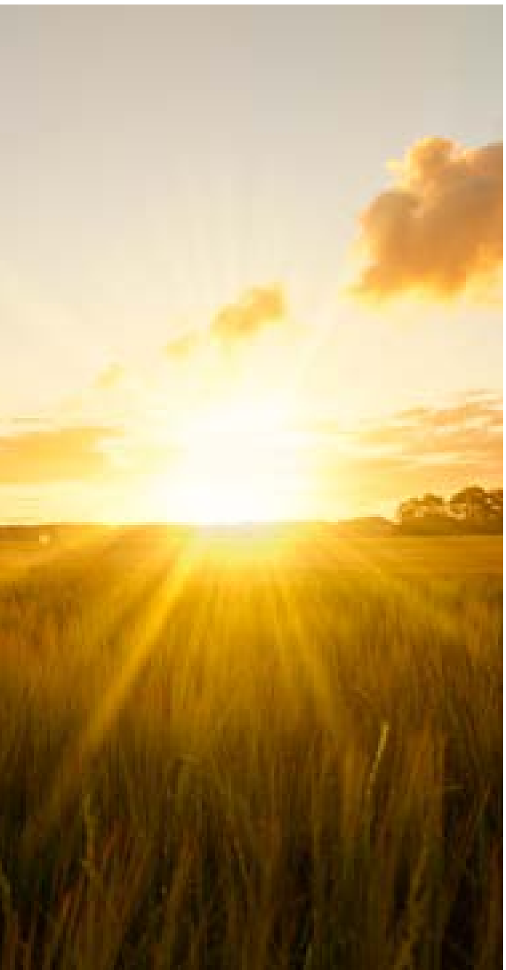
The Covid-19 epidemic has plunged the world economy into a deep recession, and the outcome still remains highly uncertain, despite government intervention. Monetary easing has put paid to the downward spiral on the European equity markets, with the Euro Stoxx 50 now trading almost 800 points above figures at closing on March 18, at 2,410 points, its lowest in 2020. The rescue plan put forward by the European Commission and massive liquidity injections from the central banks have driven stock-market valuations up again, triggering a sharp rally at the start of June, with non-resident investors now revisiting the European markets.

Valuations detached from fundamentals

However, individual investors' recent return to the equity markets raises fears of excessive confidence on the financial markets: these late flows often mark the end to a market rally. Realized volatility remains high, which can sound the warning bell, despite renewed investor confidence. An analysis of the stock-market rally since March 18 also points to a hefty slant in portfolio managers' approach. Over recent weeks, quality stocks — often defined by clear visibility on margins and leverage kept in check — gave up part of the outperformance built up during the correction phase. Meanwhile, portfolios seeking out minimum volatility also suffered a significant underperformance. Stocks with high dividends and without sustainable growth have deteriorated as compared to the market. However, the quest for quality and growth will be vital in generating value in the medium term, and these stock-picking criteria should be a focus for the next market phase, particularly in the event of fresh horizontal or downward market consolidation.

«The quest for quality and growth will be vital in generating value in the medium term.»

The disconnection between companies' fundamentals and their valuations is most likely the main risk for the financial markets in the medium term, and the forthcoming quarterly earnings reporting season looks set to be challenging. Analysts' earnings projections for next year remain optimistic when compared with economic uncertainty. Projections reflect a near-instant recovery in listed companies' profitability in Europe: expected EPS for 2021 point to a 40% recovery in profits as compared with the 25% decline propelled by the current recession. Against this backdrop, valuation multiples have increased beyond 20x for the euro area's Euro Stoxx index. All European sectors are trading on historically high 2020 P/E multiples, leaving little headroom for earnings disappointment. The energy sector has regained 50% from its low, while oil prices are in danger of hitting an upper limit at $40/bbl. Manufacturing, chemicals and automotive are banking on a V-shaped recovery, while cyclical



Analysts' earnings projections for next year remain optimistic when compared with economic uncertainty.

sectors have become considerably pricier. Valuations remain decisive for equities' total return in the medium term.

In addition to the inevitable contraction in profits in the second quarter of 2020, the financial markets will pay particular attention to corporate guidance. The priority is still to keep abundant liquidity — to the detriment of investment — while growth prospects still hinge on the uncertain development of the epidemic. However, the deterioration in dividends now seems to be fully priced in, and dividend futures on Euro Stoxx 50 stocks could even end up being overly pessimistic on payout prospects: according to these instruments, dividends paid are still set to be 24% below 2019 levels out to 2023.

Weakness remains in the United States

The European equity markets still dance to the tune of US market trends. The S&P 500 has made it back above 3,100 points and is lifted by the Federal Reserve's active approach and its unspoken goal of staging a recovery in asset prices. Stocks that are most subject to short selling have considerably outperformed during the recovery. Individual investors' activity has led to distortions, particularly on stocks that are close to bankruptcy. From a sector standpoint, US banks are doing better than their European counterparts, despite massive provisions for credit losses booked in the first quarter of 2020. Companies with the highest debt have fully enjoyed the easing in credit conditions, with the risk of encountering a fresh downturn again. Defaults are expected to increase, especially in the energy sector, as well as in transport, tourism and leisure. Weaknesses remain, despite encouraging indicators since the economic low in April. Valuations across the pond — just as in Europe — do not harbor any clear upside for the medium term. In the US, the S&P 500 is also driven by GAFAM — large tech stocks — to the detriment of small caps in particular.

Companies with the highest debt have fully enjoyed the easing in credit conditions, with the risk of encountering a fresh downturn again.

Against this backdrop, our targets for the end of the year are lower than current levels. The S&P 500 could return below the 2,900-point mark, while the Euro Stoxx 50 looks poised to fluctuate in a range of 2,850-3,150 points.

Text completed on June 17, 2020

NATIXIS AND LA BANQUE POSTALE CREATE EUROPEAN ASSET MANAGEMENT LEADER

Natixis and La Banque Postale signed, on June 28th, an agreement to combine their fixed-income and insurance-related asset management businesses, as announced in December 2019, creating a European leader with over €415 billion in assets under management for large institutional clients as at end of May 2020.
The combination of the fixed-income and insurance-related asset management businesses of Ostrum Asset Management and La Banque Postale Asset Management within a joint entity is expected to be completed in the fourth quarter of 2020, subject to obtaining required regulatory approvals.
Natixis (via its subsidiary Natixis Investment Managers) and La Banque Postale (via its subsidiary La Banque Postale Asset Management) will own 55% and 45% respectively of the joint entity, as part of a balanced governance structure.
Philippe Setbon, Chief Executive Officer of Ostrum Asset Management, will head the future entity. Mathieu Cheula, who will join La Banque Postale AM's management board from September 1st this year, will be Deputy CEO of the future joint entity and will join Ostrum AM upon the closing of the transaction.

OSTRUM AND ITS STAFF SUPPORT THE AP-HP FOUNDATION FOR RESEARCH IN ITS FIGHT AGAINST COVID-19

We are all affected by the current Covid-19 epidemic. In this unprecedented context, it is vital to stand together and help one another.
Ostrum AM is an asset manager that works alongside major institutional clients, and as such it takes a resolutely long-term approach. The company has therefore decided to support the AP-HP Foundation (Public Assistance – Paris Hospitals) in its research into combating the virus for a period of three years.
This initiative will help support one or several research projects selected by the Foundation across all areas: patient treatment trials, prevention for caregivers, research into patient homecare, etc.
We have also decided to set up a collection so that all staff can each individually contribute if he wants to this initiative. All donations collected will be used to support the AP-HP Foundation's research in a very practical way.

OSTRUM AM'S GENDER EQUALITY POLICY COMMENDED BY THE FRENCH MINISTRY OF LABOR

Promoting gender equality in the workplace has long been a priority for Ostrum AM and is a key plank of its CSR policy, as the business has implemented company agreements that are renewed every three years and robustly support this approach. Ostrum AM thereby plays its role in the broader national and international policy, as gender equality is enshrined in the French Labor Code.
With this in mind, the French Ministry of Labor issues a gender equality index each year, and Ostrum AM achieved an excellent 94 out of 100 for 2019.
The index is made up of five indicators to give a total score out of 100 and assesses a range of workplace gender equality data for each legal entity on a yearly basis:

- gender pay gap;
- gap in individual pay rises;
- gap in promotions;
- percentage of women who receive a pay rise after maternity leave;
- number of employees of under-represented gender in the ten highest paid employees in the company.

Companies achieving a score of less than 75 out of 100 must outline and implement corrective measures to make progress on the indicators in question.
Ostrum AM's impressive score rewards the company's longstanding efforts in this vital area and confirms the significance of its workplace gender equality policy.

OSTRUM AM AWARDED AT QUANTALYS INSIDE FORUM

Ostrum received the award for Best regional company in the money market category during the Quantalys Inside 2020 forum.
The first Quantalys forum — under the sponsorship of Yann Arthus-Bertrand[1] — welcomed more than 300 asset management professionals and Quantalys clients at the historical Paris stock exchange building Palais Brongniart, in an event devoted to the theme "New challenges, new solutions".
The Quantalys Awards were handed out at the end of the day and applauded the leading companies in each of the categories in an overall ranking.
Quantalys divided almost 4,400 asset management companies in Europe into three clusters, comparing them to provide scores — the Quantalys Asset Management Ratings — designed to help investors assess each company and compare it to its peers:

- Local: local companies that operate mainly nationally or manage assets of less than €5 bn;
- Regional: regional companies that operate in Europe and manage AuM of more than €5 bn;
- Global: global companies that are active across all continents and manage more than €20 bn in AuM.

Ostrum AM was ranked in the second "Regional" cluster's money market category in the Quantalys Awards 2020, applauding the company's money market management excellence.

[1] Yann Arthus-Bertrand chairs the GoodPlanet Foundation.
Reference to a ranking, award and/or rating does not indicate the future performance of the fund or the fund manager.

NOTES

ADDITIONAL NOTES

ABOUT OSTRUM ASSET MANAGEMENT

A TOP TIER ASSET MANAGER IN EUROPE[1]

Global perspective and local presence

Part of the 2nd largest banking group in France: Groupe BPCE[2].

ALONGSIDE OUR CLIENTS FOR MORE THAN 30 YEARS[3]

More than 1,000 institutional clients, private banks and IFA[2] trust us.

EXTENSIVE RANGE OF HIGH-QUALITY SOLUTIONS

13 fixed income strategies / 10 equity strategies
7 alternatives solutions / 1 global insurance platform[3].

RESPONSIBLE AND COMMITTED COMPANY

One of the 1st French asset manager signatories to the UN PRI in 2008[4].

Full carbon compensation of our direct greenhouse gas emissions since 2016[3].

1 IPE Top 400 Asset Managers 2019 ranked Ostrum AM as the 68th largest asset manager, as at 12/31/2018. – 2 Source Groupe BPCE as at 03/31/2020 : groupebpce.com - 3 Ostrum AM as at 09/30/2019. – 4 United Nations Principles for Responsible Investment 2019. More details: unpri.org.

www.ostrum.com

Ostrum Asset Management
Asset management compagny regulated by AMF under n° GP-18000014 - Limited compagny with a share capital of 27 772 359 euros – Trade register n° 525 192 753 RCS Paris – VAT : FR 93 525 192 753- Registered Office : 43, avenue Pierre Mendès-France – 75013 Paris – Tèl.: 01 58 19 09 80
Ostrum AM was created by the separation of Ostrum AM's fixed-income and equity investment management operations into a separate subsidiary on October 1, 2018 (registered on the Paris Trade and Companies Register under number 329 450 738, previously Natixis AM).

Ostrum ASSET MANAGEMENT

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