FLASH NOTE

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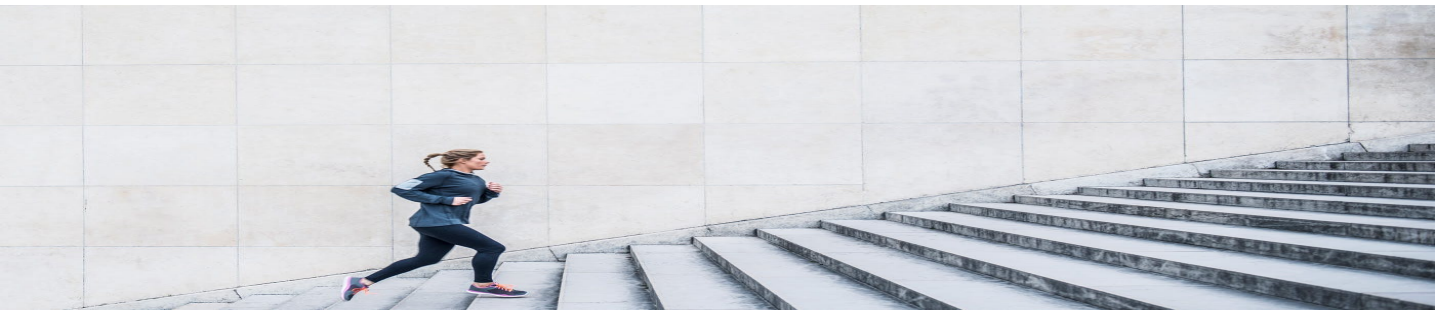

The benefits of active management

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Under active management, the portfolio manager makes investments based on their own convictions, which may differ from underlying stock market indices[1]. This approach requires forming opinions through hard work, the courage to implement and stand behind the resulting strategy, and the independence and freedom to do so.

Doubt and uncertainty are financial markets' worst enemies, as they feed investor fears. Events such as soaring inflation, the war in Ukraine and the COVID-19 pandemic are all stress factors for financial markets, as they may have a major impact on the global economy.

In such challenging times, it can be particularly difficult for investors to decide when and how to invest. But, for professionals who practise "active" portfolio management, these periods can present genuine opportunities.

What is “active” management? How does it differ from “passive” management?

Passive management seeks to replicate a stock market index as best as possible: this is what’s referred to as index-linked management. Under this approach, the portfolio manager can’t choose which stocks to invest in, and room for personalisation is very limited, even non-existent.

Under “active” management, however, a portfolio’s composition may differ considerably from that of the benchmark indexes, as the manager is aiming to outperform them.

To achieve this, the manager must define analysis-backed convictions under which they focus on certain countries and sectors, and select financial assets classes (equities, bonds, currencies, etc.) that they believe will generate the best performance. To do this, they need to buy or sell at the most opportune moment. They may also choose to implement risk hedging[2] strategies.

To help them define their strategy and decide which investments to make, “active” managers often apply a solid macroeconomic approach[3].

But aside from economic aspects, managers also need to take geopolitical factors into account, as well as companies’ financial positions and market sentiment (through charts, studies on investor positioning and sentiment, etc.). They also need to refer to central bank policies, which are primarily concerned with maintaining prices for sustainable growth.

How can an uncertain environment benefit active management?

Active management is most effective when economic changes are predictable: during periods of inflation and recession, a manager’s ability to anticipate and adapt, as well as their convictions, are well suited to this management style. Given its limits, passive management would be restricted in its ability to seize opportunities and withstand financial market downturns.

An active manager can also make use of “hedging” instruments. These products offer protection against fluctuations in equity market and raw material prices, as well as exchange rates and interest rates. They can also help the manager retain stocks in which they have strong convictions, while reducing the portfolio’s overall exposure to market risks[4] .

Active management at Carmignac

The success of Carmignac's active management approach is based on managers' ability to anticipate changes in the economic cycle (expansion, recession or depression, recovery). This should help them correctly position themselves for the next stages in the cycle.

Central to Carmignac's investment strategies, active management proved its worth during the crises of 2002, 2008 and, more recently, 2020, three periods that saw our funds successfully withstand financial market downturns. In addition to this performance, these episodes also illustrated our ability to support our clients, helping them avoid the pressures of a stock market crash or having to sell assets at rock bottom, which in turn meant that they were able to take advantage of a subsequent financial market upswing.

At Carmignac, active management is based on:

the dedicated commitment of a highly experienced and qualified management team, and a global view of the economic environment, enabling managers to establish their convictions and identify opportunities
the courage to implement strategies that may differ from those of other investors
the independence to be free in our choices and decisions

Our active management style isn't just limited to the selection of financial assets. As active shareholders, we aren't afraid to speak out when companies' environmental, social or governance (ESG) policies aren't in line with our values or commitments.

The return of inflation also marks the return of economic cycles that had been suppressed by central banks for over a decade, due to artificial economic support measures (very low interest rates, liquidity injections on financial markets). Rising inflation, and with it the return of financial market volatility, should be an opportunity for active management to demonstrate its ability to manage clients' savings over the long-term.

[1] A stock market index groups together equities, making it possible to assess the performance of a market or sector. It is an essential instrument of asset management that is often used as a benchmark to measure portfolio managers' performance.

[2] The main risks a fund is exposed to are: risk of loss, due to fluctuations in the market value of the portfolio (market risk), the risk of an issuer defaulting and not repaying its debt (credit risk), the risk of a counterparty not being able to meet its obligations (counterparty risk), risk of non-compliance with investment constraints, and the risk of a temporary or permanent inability to sell one or more portfolio assets (liquidity risk).

[3] Macroeconomics is the global study of the economy through external factors that impact businesses: household consumption, investment, inflation, GDP growth rates, unemployment numbers, ageing populations, technological advances, taxation, income levels, etc.

[4] Varying interest rates, currency fluctuations, loss of value, raw material price volatility, etc.

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