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EDOUARD CARMIGNAC'S LETTER

Edouard Carmignac writes on current economic, political and social issues each quarter.

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Dear investor,

After two years in the grips of Covid and its protean variants, we had reason to hope for a more rejoicing spring. Alas! The barbaric invasion of Ukraine has undermined the prospects for a brighter political and economic outlook. However, taking a closer look, these twin evils may in fact bode a more promising world order than one may fear.

The Russian army's failure in Ukraine has been surprising. In our eyes, it reveals a hard-to-believe reality. Today's Russia is similar to the Russian Empire in the early 20th century, in that it has become again a giant with feet of clay. Just as Catherine the Great was meant to be deluded by the façades her minister Potemkin erected along the railway lines to hide the true poverty of many villages, we've been misled by appearances. Yet scathing figures on the health of the Russian

economy are available for anyone to see. With a gross national product that's less than Italy's, and a territory that spans an entire continent, it's hard to imagine that Russia could have a modern army equipped with state-of-the-art technology. Defence spending accounts for nearly 5% of the country's fiscal budget yet is less than 10% of the amount spent by the United States. The drain from Russia's military expenditure, along with the nearly 10% of national wealth "distributed" to oligarchs, brings the economy at best to a standstill. Worse, per capita income has fallen by 25% in recent years – even before the invasion of Ukraine. Accordingly, it's highly unlikely that Vladimir Putin will embark on a lengthy military conflict, unless he's willing to risk the collapse of the Russian economy and his regime.

By the same token, China's poor handling of the pandemic is ostensibly surprising. How could the government deny its people access to foreign vaccines, given that they have not been immunized by an effective one, that hospital infrastructure is lacking, and that the Omicron variant is clearly highly contagious? This makes a strict lockdown policy inevitable. The government's claims about a nationalistic approach to public health are hard to swallow. More convincing is the advantage to Chinese authorities of being able to track everyone with a positive QR code, when it comes to controlling citizens' movements. The true cost of this strict lockdown policy is still hard to gauge. Few lives have been lost so far according to the official figures, but the blow to the economy has already been considerable. Many cities have practically ground to a halt. If Beijing were to be next on the list after Shanghai, the political ramifications could be significant.

Should we therefore, as French writer Marc Lambron suggests, "dispel the impending twilight with the hopes of dawn"? The prospects of a new world order in which freedom enjoys greater prominence are indeed encouraging. What about financial markets? For the near term, the invasion of Ukraine and the pandemic in China are clearly bad news, since they are both fuelling underlying inflationary pressures and putting the brakes on global growth. The war in Ukraine is pushing up food and energy prices in addition to stoking geopolitical uncertainty. The partial shutdown of China's factories is handicapping the world's biggest manufacturing economy and aggravating supply-chain bottlenecks in a number of industries worldwide. Portfolio risk management has become paramount against this market backdrop, all the more so as key central banks plan to fend off the threat of unbridled inflation by turning the screws on their monetary policies.

Hoping to bring you some peace of mind in these unsettling times, yours truly,

Edouard Carmignac

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