QUARTERLY REPORT

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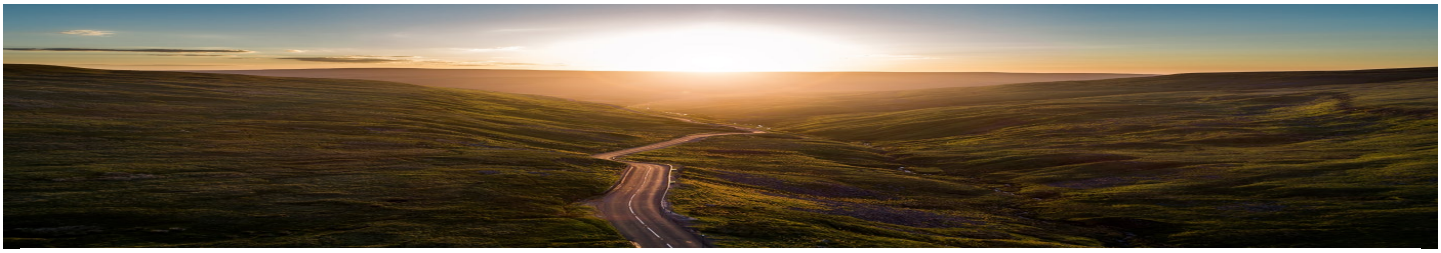

Carmignac Patrimoine: Letter from the Fund Managers

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-1.04%

Carmignac Patrimoine's performance

in the 3rd quarter of 2022 for the A EUR Share class

-0.81%

Reference indicator's performance

in the 3rd quarter of 2022

+6.3%

1-year volatility of the Fund

versus +8.6% for the reference indicator

Over the period, Carmignac Patrimoine recorded a performance of -1.04%, in line with its reference indicator[1] (-0.81%).

Market environment

The global macroeconomic backdrop is worse today than it was at the beginning of the quarter. Worldwide, an increasing share of economies are going into contraction, as inflation begins to pressure margins and purchasing power and tighter financial conditions weigh on demand.

The deteriorating growth outlook first led markets to anticipate an earlier than expected return to accommodative policies, resulting in a sharp rebound in risky assets as well as lower core rates across the board, most likely supported by investors' extreme positioning. However, Central banks, chief among them the Federal Reserve, have been steadfast in their hawkish posture, reiterating the intention to bring inflation down "whatever the cost". China remains an exception, maintaining accommodative policies to support faltering growth, worsened by the ongoing "zero covid policy".

Sharp tightening by Central banks and markets' disillusion stirred chaos, with some of the most volatile moves across asset classes. The yield on the US 10-year bond first dropped 1 percentage point to 2.5% before rallying to 4% over the rest of the period. Yields on British bonds rose almost 3%. The MSCI World rallied 20% from its low, then corrected 16% from its August high. Oil prices increased by $10 before losing $20 to $90 a barrel. Finally, the Dollar rallied 9% against a basket of currencies.

How did we fare in this context?

We pursued a consistent strategy throughout the quarter, allowing us to significantly reduce the strategy's volatility over the period, in line with our *Patrimoine* mandate.

Among the positive contributors:

Our **limited exposure to equities** (15% on average), via short positions on indices, **worked well** as markets were volatile but down over the period.

Our legacy prewar Russian assets appreciated as European banks followed US banks and resumed trading in Russian bonds in August. We are committed to selling the remaining Russian securities in our portfolios, as market conditions allow, as protecting our clients' interests remains our primary objective.

Among the negative contributors:

Our gold exposure, initiated to manage risk of further geopolitical escalation, suffered from rising real rates and a strengthening dollar. We believe the anticipated staglfationary environment will be positive for gold.

Our exposure to the long end of the German and US curve, initiated to manage the risk of stagflation after the Q2 rally in rates, were penalized by the sharp market reversal in August.

Our Chinese equity names, as accommodative policies in China struggled to materialize and the country continued to be crippled by Covid measures. We remain confident that an easing of covid restrictions and a positive policy mix will eventually be a strong impulse for the real economy.

Outlook

Central banks across the developed world have consistently reiterated that they are prepared to maintain tight monetary policies to reduce inflation, even if it meant causing a recession. The consequences of these hawkish monetary policies are not fully reflected yet in asset prices leading Carmignac Patrimoine to maintain a very cautious portfolio construction.
In the consumer-driven economy of the US, the rebound in real wages and a tight labor market should enable the avoidance of a near term recession. However, we anticipate a broadening and worsening of the profit contraction (already underway for the SME sector) and a collapse in capex. Additionally, the fed will need to push the unemployment rate higher for inflation to be under control. We therefore anticipate a profit recession leading to an economic recession as we approach mid-2023.
In Europe, recession could come as early as end of 2022 due to the energy shock. The severity of the recession will be dependent on the fiscal response and its magnitude – provided there is fiscal headroom. Indeed, potential for fiscal support is unevenly distributed across the Eurozone and risks to be somewhat offset by bond vigilantes or ECB hawkishness, the latter having to fend off the inflationary impact of energy prices and consequential risk of persistent inflationary pressure, along with the fall in the Euro effective FX rate.

In **equity markets**, we have already had a significant multiple contraction with the Forward S&P 500 multiple now at 15.6x down from 22x at the start the year. However, several factors lead us to believe that equity markets could go even lower. If analysts have trimmed their overly optimistic earnings estimates slightly in recent months, they're still nowhere close to acknowledging the likelihood threat of a recession. Additionally, the level of long-term real rates (up 100 bp this year), the pace of this hiking cycle (fastest ever), the US Dollar strength and the unknown negative effects of accelerating QT keep us cautious. The TINA (There Is No Alternative) mantra for equities is likely to get increasingly challenged given the level of yields on the short term both in real and nominal terms.
This backdrop validates both a low equity exposure (around 8%) as well as lower exposure to high-multiple stocks. We continue to favor companies in recession-resilient sectors, including healthcare and consumer staples. Strong thematics like softwares and cloud computing and inflation beneficiaries like energy and materials. Despite the energy sector being cyclical, our view is that demand recovery and tightness in supply should lead to a multiyear cycle of capital spending by oil companies.

Fixed income markets remain dependent on monetary policies, but this should be less the case in 2023 considering the front load of interest rate hikes having been priced already. In fact, markets are currently pricing a peak at around 4.5% in terms of Fed funds terminal rate (as of 29.09.2022).
In the US, the odds of a recession are increasing as the stickiness of core inflation should lead the Fed to maintain a very tight monetary policy. Consequently, we are gradually building up a position on the long end of the curve. In Europe, we have no exposure on rates as the multiplication of fiscal policies across the continent are putting upwards pressure on long term rates.
On credit, if investors are already well compensated in terms of yield given the current default risk, the combination of slow growth, high inflation, elevated interest rate volatility and fears of gas supply interruption should continue to weigh on credit markets, despite increasingly attractive valuations. Therefore, we maintain a significant level of credit protection (13%) to hedge our investments (20%). We also hold 6% of CLOs (collateralized loan obligation), due to their floating rate structure backed by investment grade loans (BBB), offering both an interesting carry and some form of protection against rising rates.

Finally, **on the currency front**, FX moved are largely Fed dependent as few central banks will be able to follow the Fed in its hiking path. Everyone has an inflation problem, but the pain threshold is higher in the US than elsewhere. Therefore, we maintain a significant allocation to the USD (50%).

Carmignac Patrimoine

Looking for best asset allocation in all market conditions

Discover the fund page

Carmignac Patrimoine A EUR Acc

ISIN: FR0010135103

Lower risk Higher risk

Recommended minimum investment horizon

1	2	3*	4	5	6	7

Main risks of the Fund

EQUITY: The Fund may be affected by stock price variations, the scale of which is dependent on external factors, stock trading volumes or market capitalization.

INTEREST RATE: Interest rate risk results in a decline in the net asset value in the event of changes in interest rates.

CREDIT: Credit risk is the risk that the issuer may default.

CURRENCY: Currency risk is linked to exposure to a currency other than the Fund's valuation currency, either through direct investment or the use of forward financial instruments.

The Fund presents a risk of loss of capital.

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