



Carmignac Portfolio Patrimoine Europe: Letter from the Fund Manager

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Len

-4.27%

Fund's performance
in the 3rd quarter of 2022
for the A EUR Share class

-3.64%

Reference indicator's
performance
in the 3rd quarter of 2022

1st

quartile over a 3 years
period
for both its performance
and volatility vs its peer
group

Carmignac Portfolio Patrimoine Europe A EUR Acc lost -4.27% in the third quarter of 2022, underperforming the -3.64% drop in its reference indicator¹.

European markets review

In the third quarter, the European markets underwent sharp movements and pursued the bearish trend that began at the beginning of the year.

It all began in early summer. Faced with rising inflation and weak economic data, central bankers had an unambiguous response. The European Central Bank (ECB) ended negative rates in the Eurozone by raising its rate by 50 basis points while the Federal Reserve (Fed) raised rates by 75 basis points for the second consecutive time. **And yet,** as surprising as it may seem, **investors were more focused on recession fears than on persistent inflation, to the point of hoping for a quick pivot by the Fed.** This surge in optimism led to a rebound in risky assets, with the Stoxx 600 Europe up more than 10% in 5 weeks.

This rally was nipped in the bud in the middle of the summer First of all, **central bankers had a very strong reaction and reiterated their commitment to keep inflation under control,** despite the threats to growth. On the other hand, **the macroeconomic situation continued to darken,** especially in Europe with Germany leading the way. And finally, **the US core inflation figures continued to rise, causing a significant reaction from investors.** As a result, in the second half of the quarter, European equity markets fell by more than 13%, erasing their lows of the year, while European yields posted new highs. At the same time, the euro continued its fall which began more than a year ago and ended the quarter at its lowest level in 20 years.

Quarterly performance review

In this context, **the Fund maintained a conservative portfolio construction during the quarter while actively managing equity and interest rate exposures. While this positioning helped limit the Fund's volatility, it failed to dampen the market decline.**

At the beginning of the summer, **our under-exposure to risky assets prevents us to benefit from the rebound in European equities** This market rebound led by a reversal in market sentiment seemed to us more likely to be a technical rebound in a bear market than a real environmental shift. We therefore remained under-exposed during the period by maintaining hedges on equities and credit, which impacted the Fund's relative performance.

However, **when central bankers reminded investors that they were still committed to tightening monetary policy, our caution paid off.** Thus, from mid-August to mid-September, the Fund was up 2% while its benchmark lost 3%. This outperformance was attributable to our short positions on sovereign rates and our protection on risky assets.

Finally, in mid-September, **extremely pessimistic investor sentiment, combined with a more positive news flow, led us to tactically lift our equity and credit hedges** while maintaining a defensive portfolio construction (notably through a high cash allocation). The markets nevertheless continued to decline, in the wake of the US inflation figures, thus impacting the Fund's performance at the end of the quarter.



Outlook

Europe's condition improved slightly during the quarter and the region is likely to avoid the scenario of energy rationing at the cost of a sharp rise in prices that forced a contraction in industrial demand. **The shock to the economy will be major but should be partly absorbed by governments in the form of subsidies and price caps. This interventionism will limit the ability of central banks to tackle persistent inflation due to the risk that rising interest rates will put on the solvency of governments and financial stability.** This is what we saw at the end of the quarter in the United Kingdom. This combination of constraints is likely to lead to volatility movements in risky assets and should continue to put the bulk of the adjustment on exchange rates.

On the equity markets, we have already seen a significant contraction in valuation multiples since the beginning of the yearEuropean markets, leading their US counterparts, have already hit their pre-Covid crisis levels and are being neglected by international investors. However, **while analysts have slightly lowered their overly optimistic earnings estimates in recent months, they are still far from fully recognizing the threat of a recession. This backdrop validates both a low equity exposure as well as a focus on quality companies** which have seen their earnings grow since the beginning of the year. These companies, particularly in the healthcare and consumer sectors, are expected to drive the performance of the upcoming earnings bear market. Moreover, the level of long-term real rates and the pace of the upward cycle make short-term yields increasingly attractive in both real and nominal terms. Bond markets remain dependent on monetary policy, but the bulk of the interest rate increases are already in the short end. In contrast, longer maturities may still be vulnerable to fiscal policy decisions.

This backdrop supports a defensive portfolio construction with a structurally low exposure to risky assets (equities & credit). On sovereign rates, the environment leads us to adopt a neutral position on key rates until we have more visibility. However, we remain in an extreme phase of the cycle that is likely to be highly volatile and will require short-term tactical adjustments to exploit these movements.

Carmignac Portfolio Patrimoine Europe

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