Carmignac Portfolio Patrimoine Europe : Letter from the Fund Managers

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Carmignac Portfolio Patrimoine Europe A EUR Acc lost -0.20% in the third quarter of 2021, below the +0.43% of its reference indicator[1], bringing the fund's performance to +6.74% year-to-date versus +6.47% for the reference indicator.

-0.20%

Carmignac Portfolio Patrimoine Europe's performance

in the 3rd quarter of 2021 for the A EUR Share class.

+0.43%

Reference indicator's performance

in the 3rd quarter of 2021.

+6.74%

Performance of the Fund Year to date

versus +6.47% for the reference indicator.

Quarterly Performance Review

Markets proved quite variable over the third quarter of 2021, with mixed performance overall. On European equities, the reporting season for second quarter results was broadly supportive with a high proportion of earnings beating estimates. During this phase the environment favoured an increasingly narrow group of stocks in the luxury goods or semiconductor sectors. However, this positive momentum, also driven by the recovery post-Covid crisis as well as fiscal and monetary support, stopped beginning of September. Rising inflationary pressures and the perspective of a slowing global pace of growth driven by China have weighted on investors' enthusiasm. Indeed, this combination making the near-term market outlook uncertain has taken a toll on risky assets as easy Central Bank policy may not be longer a given. Similarly to equities, European rates experienced a bumpy quarter. Although nominal rates hardly moved over the quarter (-0.20% for German 10-year rate), they hit their low point in early August before moving up in the last few weeks. After all, the stability of nominal rates over the quarter have brought real rates to historically low levels (German real 10-year rate close to -2%[1]).

Over the quarter, the Fund used all the flexibility within its mandate to find performance drivers. We maintained a relatively prudent level of equity exposure (~30% in average) which cost us in relative terms. Our equity investment selection that focuses on businesses with high and stable profitability, reinvesting internally to generate secular growth performed well until end of August and, like the European equity markets, struggled in September. Regarding stock selection, the biggest positive contributors to our fund's performance came from the sectors where we have the largest exposures namely Technology, Healthcare and Industrials. ASML, the semiconductor equipment maker continued to perform well, rising 12% for the quarter and 63% for the year to date[1], benefiting from 3 powerful trends: its latest technology, EUV, is seeing accelerating demands from chip makers who use it to improve chip performance and power; semiconductors worldwide are seeing more demand than supply leading to ongoing commitments to build more capacity; and finally the prospect of near-shoring of semiconductor manufacturing leading to additional investment due to geopolitical tensions. The company is in a very strong position, but we felt that a lot of this was reflected in the stock at the start of September, and so we reduced our holding significantly. On the negative side we had no exposure to the strongly performing Bank sector which rose more than 5% in third quarter[2] . This was the largest negative sector impact. We also had some stock specific setbacks. Luxury goods have been a strong sector for some time now. In particular LVMH has benefited from strong ongoing demand for its key brands Louis Vuitton and Dior among fashion and leather goods. The stock suffers from the Chinese premier announcing a desire for "common prosperity" and likely tax increases on the wealthy in China, who are significant buyers of luxury goods. This sent luxury stocks tumbling.

Regarding European rates, the market believes that the risk of European Central Bank stepping away is realistic. The messaging of the Central Bank in the coming weeks around the forward path after the end of Pandemic emergency purchase programme (PEPP) -meaning after March will be key. In that environment, we think that the whole fixed income market is at risk (core rates, periphery bonds and credit) requiring a very strict risk management policy. Indeed, the riskiest part of the European rate market (credit and non-core sovereign rates) still benefit from spreads that are closed to record-low, therefore they do not offer any cushion in case of sell-off in rates. Consequently, we have been very careful and flexible over the period to seize attractive entry point such as our tactical investment in non-core European debt at the beginning of the summer which offered attractive opportunities at that time.

Our Positioning and Outlook

Since Covid hit in early 2020, different areas of the European equity market have gone through volatile movements at different times, but at the end, the asset class has grown above 2019 levels and the volatility it has experienced created great opportunities. At the moment, within our equity portfolio, we maintain the bulk of our investments with a bias to quality secular growth companies that have the resilience needed to weather possible disappointments regarding GDP growth or inflation expectations. Selected industrials, health care, consumer discretionary, and technology are the areas where we see the majority of these opportunities. Europe has hidden gems in promising sectors such as digitalization or renewable energy, and as long-term investor, we use the current period of stock price weakness to add new names if we feel their stock prices have fallen too far. On top of that, we currently have a small net short in core duration, preparing the fund as ECB manages rates higher as the balance of risks on medium-term inflation is tilted to the upside. However, we maintain a cautious yet flexible approach to adjust to any shifts in monetary and fiscal policy by using our full range of modified duration (from -4 to 10). To conclude, our portfolio construction manages the risks of the fixed income markets through an extreme level of cash (50%) and short positions on core rates while taking advantage of businesses with high and stable profitability, reinvesting internally to generate secular, visible and stable growth.

At quarter-end, net equity exposure was around 42%, government bond exposure was around 11%, and cash around 49%. Euro currency risk was 89% (including pegged DKK), with the remaining 11% spread across GBP, SEK, and CHF denominated equity investments. Overall, the fund’s net modified duration was around -111bp[3].

Strategy Reminder

A socially responsible mixed fund focused on European equities and fixed income. The investment process balances long-term, bottom-up stock and bond picking, with a dynamic macro overlay. Stock selection is focused on companies with the best long-term growth prospects, as demonstrated by their high, sustainable profitability, and internal reinvestment potential. Bond selection is focused on mispriced or improving corporate leverage and cash flow, and sovereign credit, inflation or policy outlooks. The strategy seeks to positively contribute to society and also looks to minimize its environmental impact by having a reduced carbon footprint. At least 50% of the assets are permanently invested in fixed income securities. The Fund aims to outperform its reference indicator over 3 years, while mitigating downside risks.

Source: Carmignac, as of 30/09/2021