



Carmignac Sécurité: Letter from the Fund Manager



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+2.31%

Carmignac Sécurité's
performance
in the 4th quarter of 2022
for the AW EUR Share
class

-0.71%

Reference indicator's
performance in the 4th
quarter of 2022 for ICE
BofA ML 1-3 years Euro All
Government Index (EUR)

+3.02%

Outperformance of the
Fund
over the quarter compared
to the reference indicator

Carmignac Sécurité gained +2.31% in the fourth quarter of 2022, while its reference indicator was down -0.71%¹

The bond markets today

Bond markets posted record-breaking declines all year long and the fourth quarter was no exception. Conditions even worsened in Q4, **making 2022 the bleakest year for sovereign bonds since the indices were first created** European sovereign indices were down by nearly 17% – and by close to 19% in France – underperforming a number of other asset classes and segments: corporate bonds, which shed almost 13% over the year; US Treasuries, which also fell by nearly 13% and recorded their worst losses since 1928; and, perhaps most surprisingly, most equity indices, which also ended 2022 in negative territory.

What we're actually experiencing is an abrupt normalisation after nearly 15 years of large-scale liquidity injections and negative interest rates. This marks the end of an era of financial repression and opens up attractive prospects for fixed income, with levels of carry that we haven't seen in over a decade.

The reasons for the abrupt normalisation in bond yields and credit spreads are the same as those outlined in our previous quarterly report:

Inflation, and especially core inflation (i.e. excluding food and energy prices), is stubbornly high. This has given rise to worries about knock-on effects. Headline inflation in the eurozone was down slightly, at just over 10% year over year in December, and core inflation should remain at around 5% in the first half of 2023.

Central banks have picked up the pace of monetary tightening in response, in order to restore their credibility and prevent inflation expectations from becoming unanchored. That's in spite of the damage higher interest rates can cause to jobs and growth. The trend of monetary policy tightening around the world marks a real shift away from the policy of the past 15 years and is something we haven't seen the likes of since the 1970s.

Governments have rolled out poorly targeted – and in any case probably not temporary – fiscal stimulus measures in order to help consumers cope with the higher cost of living. As we've seen in the UK, governments can lose their credibility quickly and with hefty consequences.

There has been no respite in the war between Russia and Ukraine This is adding uncertainty, increasing inflationary pressure (e.g. through higher food and energy prices), and fuelling economic growth worries as a result of embargos (on oil) and disruptions to the supply of natural gas, minerals, fertiliser, and more.

At the ECB's last meeting of the year, President Christine Lagarde surprised market participants who had become relaxed about inflationary risks and the prospects of monetary tightening. She took an unexpectedly hawkish stance – first, by announcing that the central bank would embark on a round of quantitative tightening (that is, winding down its balance sheet by not reinvesting the proceeds from maturing securities) to the tune of €15 billion per month starting in early March; **and second, by indicating that the ECB will carry out additional 50-bp rate hikes in the first quarter of 2023**, meaning its key policy rate could end up at over 3%.

What's more, the Bank of Japan – which until now had been the only major central bank to maintain an accommodative stance – changed course on 20 December by expanding the range in which Japanese 10-year bond yields are allowed to fluctuate by 25 bp. **All these factors pushed up sovereign bond yields around the world, after they had eased in the wake of good news about US inflation.** Yields in Europe jumped by 70 bp in Q4 and ended the year at or near their 12-month highs. Italian bonds in particular suffered sell-offs, with the spread on 10-year BTPs relative to German Bunds widening from 180 bp at end-November to nearly 210 bp a month later.

In corporate bonds, spreads on both high yield and investment grade issues narrowed in Q4 after reaching record highs, although they did edge up following the ECB's December meeting. Corporate bond prices have been underpinned recently by a levelling-off of US interest rates and brighter prospects for global growth now that Beijing has opened up China's economy sooner than expected.



Performance

Carmignac Sécurité generated a positive return in the fourth quarter despite the challenging climate and record losses in fixed-income markets. That allowed us to erase all our underperformance relative to the reference indicator. **We took advantage of the interest rate volatility in Q4 by increasing our modified duration to 2 in November and then lowering it to just under 1 ahead of both the ECB's December meeting and the record volume of sovereign bond issues planned for January 2023.** Our corporate bond holdings benefitted from the narrowing spreads in Q4 after what proved to be a difficult year for this segment. **But one of our main performance drivers during the quarter (and for the months and quarters to come) is clearly the carry on our portfolio,** which includes an annual yield to maturity of over 4.5% – a level we last achieved during the 2008–2009 financial crisis.

Positioning

We still believe that central banks won't let their guard down just yet, especially in Europe, given that inflation has proven to be stubborn and monetary policy-makers are eager to restore their credibility. We will keep our portfolio positioned accordingly as we head into 2023. It's also worth noting that an unprecedented volume of new issues is expected in the eurozone in 2023, right when two big purchasers of those bonds are withdrawing from the market: the ECB, which will begin a quantitative tightening cycle in March, and Japanese investors, who are finding attractive opportunities in their domestic market. Another factor that will maintain upwards pressure on bond yields is that the timing for a probable recession has been pushed back, given that China's economy is opening up more quickly and more broadly than anticipated and that the latest macroeconomic readings were sanguine in both Europe and the US. **Our portfolio's modified duration is therefore still a low 0.9, reflecting short positions mainly on German and French sovereign bonds,** all around the 10-year segment, so as to benefit from a renewed steepening of the yield curves after they inverted to an extent not seen in over 20 years.

Our corporate holdings are still mainly in the financial and energy sectors and in CLOs, since we believe they'll gain the most from today's inflationary environment and climbing interest rates. Almost 65% of our fund's assets are currently allocated to corporate paper, including 8.8% to CLOs and 8% to high yield issues. Our portfolio's average yield to maturity was 4.8% at end-December and will certainly be a key asset for our fund's performance in 2023.

¹ Reference indicator: ICE BofA 1-3 Year All Euro Government Index (coupons reinvested).

² Source: Carmignac, Bloomberg, 31/12/2022. Performance of the AW EUR Acc. unit Until December 31, 2020, the reference indicator was the Euro MTS 1-3 years. KIID (Key Investor Information Document) risk scale. Risk 1 does not mean a risk-free investment. This indicator may change over time. Past performance is not a reliable indicator of future performance. Performance may change, either upwards or downwards, due to currency fluctuations. Performance is net of fees (excluding distributor's front-end load). ISIN code of the AW EUR Acc share class: FR0010149120

Carmignac Sécurité

Flexible, low duration solution to challenging European markets

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Carmignac Sécurité AW EUR Acc

ISIN: FR0010149120

Recommended
minimum
investment horizon



Main risks of the Fund

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.

RISK OF CAPITAL LOSS: The portfolio does not guarantee or protect the capital invested. Capital loss occurs when a unit is sold at a lower price than that paid at the time of purchase.

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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