FIVE MINUTES WITH CHARLES ZERAH

by Charles ZERAH
Fund Manager
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2017 was a trying year for global bond markets, marked by mild upward pressure on the main sovereign yields and a steeply rising euro. How did you confront those challenges with Carmignac Portfolio Unconstrained Global Bond?

Our convictions on the non-core Eurozone government bonds and emerging-market debt proved rewarding

Our active approach to currency management allowed us to focus our allocation on the euro so we could cushion the impact of foreign currency depreciation, although our reduced allocation to the US dollar and the yen detracted somewhat the performance in absolute terms. But in any case, those adverse forex trends were entirely offset by solid returns on our various bond-market performance drivers.

While we maintained our cautious exposure to core rates, especially German rates, we stepped up our allocation to non-core government bonds, especially after the French elections. Our performance got a boost from those positions. That was particularly true of government paper from Greece and Portugal, two countries whose economic fundamentals showed substantial improvement. In addition, throughout the year we kept our holdings of local-currency and hard-currency emerging-market bonds, which combine attractive risk premia with the advantages of fast-growing economies. As a result, our Brazilian and Argentine government bonds contributed to our overall performance.

Lastly, the corporate credit themes we pursued throughout the period significantly enhanced our returns as well.

What is your investment strategy for 2018?

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We are maintaining our cautious approach to bond markets

With a strong and synchronized global growth, medium-term inflation expectations rising modestly, the global liquidity outlook deteriorating significantly, and political momentum pointing to greater Eurozone integration, we are maintaining our cautious portfolio construction through a low modified duration and a reduced credit allocation. Over the medium-term, we believe that our positioning is appropriate to manage the alignment of economic, political, and liquidity cycles that all call for an upward correction of German rates, where we have short positions.

How did your Fund pull through the latest market turbulence? What if any adjustments have you made?

It all started with the release in early February 2018 of improved US employment data. 200,000 jobs were created in January and wages were up 2.9% year-on-year. Those numbers sparked fears of a comeback in inflation that might induce the Fed to hike its benchmark interest rates sooner than planned. Nevertheless, fundamental concerns regarding rising inflation may have sparked the move, but they did not feed the bigger move, as the sell-off was technical in nature with volatility-related strategies and passive investment pouring additional fuel on the fire.

Convinced that central banks were inevitably going to withdraw their support, we moved early to reduce the Fund’s modified duration and pare back corporate credit risk in our portfolio. Our higher exposure to the yen – a safe-haven asset in the current turmoil – also made us more resilient against the recent spike in volatility. Though we haven’t changed our outlook for the medium term, in the near term we will go on actively managing our German and US duration exposure, and have tactically scaled back our allocation to non-core Eurozone government bonds given the strong rally experienced since the beginning of the year.

What are your primary convictions in the portfolio?

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We have remained long on non-core Eurozone and emerging-market government bonds and are selectively invested in corporate credit

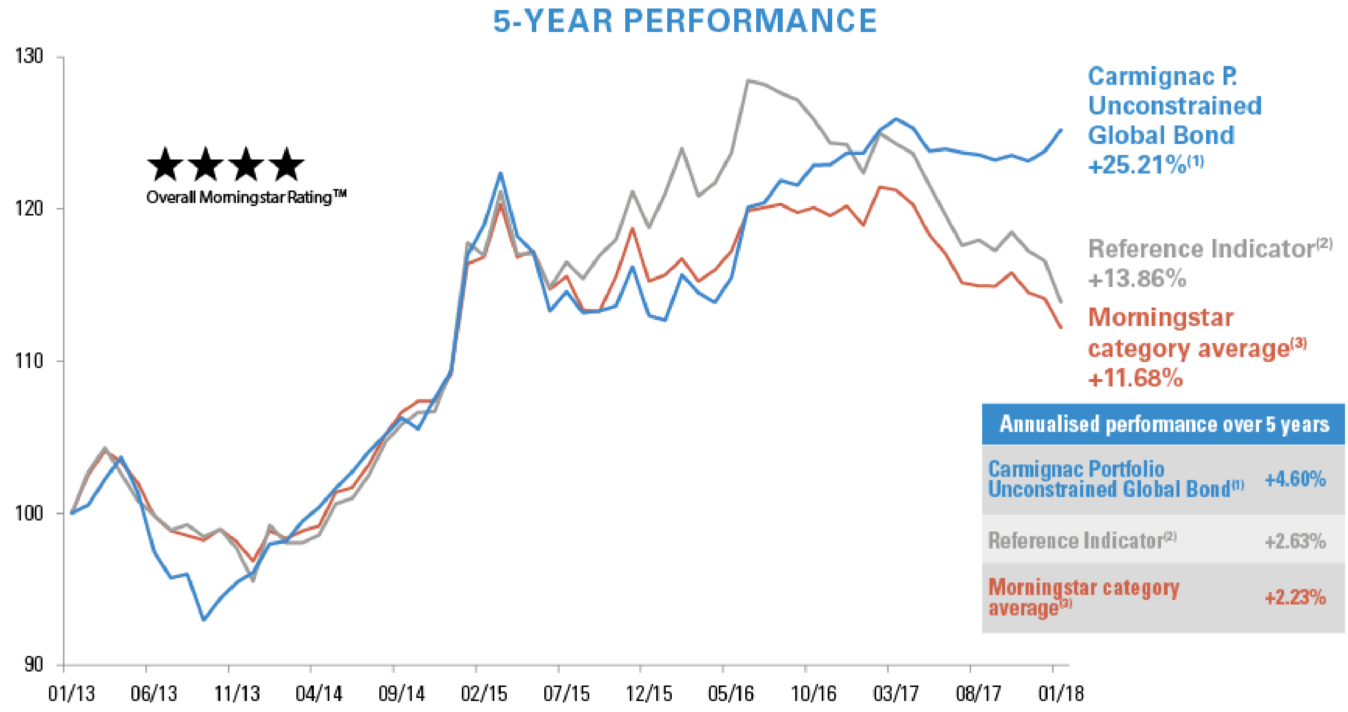
Despite upward pressure on yields in the leading developed countries, bond markets still offer ample opportunity. We expect spreads on non-core Eurozone government bonds to tighten further now that the economic recovery is gaining ground and political risk is on the wane. In particular in Italy, spreads to Germany have materially lagged the risk premia compression seen across other European asset classes, including Italian equities and subordinated bank credit, which we feel carry unjustifiably high political-risk premia.

Our corporate credit investments have three clear-cut, highly selective focus areas: subordinated bank bonds from Europe, structured credit and energy-sector bonds issued mainly in emerging markets. We also continue to believe that emerging-market debt still offers attractive opportunities. Most of the major emerging economies can look forward to accelerating growth and moderate inflation, so they should be getting further large investment inflows, as they did in 2017.

How do you view the forex market?

We continue to favour the euro over the US dollar. The euro is poised to benefit from an increasingly broad-based economic upswing in the currency bloc, which should eventually bolster expectations for monetary policy normalisation. In addition, the more credible cooperation taking shape between France and Germany could well enhance the geopolitical standing of Europe's common currency. We have maintained a highly selective approach to emerging-market currencies. The Indian rupee and the Mexican peso currently account for a large share of our exposure.

Now that monetary policy normalisation is a foregone conclusion, it will be essential to take a flexible and unconstrained approach that comprises latitude to face challenged markets and to seize arising opportunities across the globe. Carmignac Portfolio Unconstrained Global Bond can successfully navigate these turbulent times, as vividly demonstrated since the summer of 2016. In addition our conviction driven, non-benchmarked and flexible philosophy has also generated compelling returns in the long-run.



Annualised performance over 5 years	
Carmignac Portfolio Unconstrained Global Bond[1]	+4.60%
Reference Indicator[2]	+2.63%
Morningstar category average[3]	+2.23%

Source: Carmignac, Morningstar 31/01/2018. (1) Share class: A EUR Acc (2) Reference indicator: JP Morgan GBI Global (Eur) (3) Morningstar category: EAA OE Global Bond. Past performance is not necessarily a guide to future performance. Returns are reported net of fees and expenses (excluding possible upfront fees). The return may increase or decrease as a result of currency fluctuations.

Charles Zerah

Portfolio Manager – Global Fixed Income

Prior to Carmignac, Charles Zerah gained his in-depth experience in global bond market working for AXA Investment Managers, Crédit Lyonnais AM and Crédit Agricole AM. He holds a Master's degree in Banking and Finance and a DESS postgraduate diploma from the University of Paris II Panthéon Assas. Charles adopts a global approach to fixed income, with strong expertise in emerging sovereign and corporate debt. He also co-manages Carmignac Portfolio - Emerging Patrimoine.

MAIN RISKS OF THE FUND

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

INTEREST RATE RISK: Interest rate risk means that the Fund's net asset value could decline in the event of changes in interest rates.

DISCRETIONARY MANAGEMENT RISK: The Fund management company's expectations as to financial markets trends have a direct impact on the Fund's performance, which depends on the assets held in the portfolio.

CURRENCY RISK

The Fund presents a risk of capital loss.

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