QUARTERLY REPORT

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Carmignac P. Credit: Letter from the Fund Managers

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+1.30%

Carmignac P. Credit's performance

in the 1st quarter of 2023 for the A EUR Share class

+1.85%

Reference indicator's performance

in the 1st quarter of 2023 for the 75% ICE BofA Euro Corporate Index et 25% ICE BofA Euro High Yield Index

+4.87%

Of annualized performance

over 3 years for the fund, compared to -0.36% for its reference indicator[1]

Carmignac Portfolio Credit is up 1.30% since the beginning of the year versus 1.85% for its reference indicator[1].

Quick overview of 2023 first quarter

The first quarter has been rich in eventful developments, the highlights of which were the failure of a number of banks in the United States as well as Credit Suisse in Europe. **Although tensions in the banking sector may persist and more dominoes could fall, we do not expect these incidents to lead to a cardiac arrest of the financial system similar to what we had in 2008**. Paradoxically, we think what transpired in the past weeks was that the reforms and regulations put in place over the last 15 years function (on this topic, it is very interesting to note that SVB demise has been made possible by a loosening of the regulations under the previous US administration). SVB and Credit Suisse were certainly not the best managed among their peers but there were the buffers in place necessary to absorb the consequences of their mistakes, absent a crisis of confidence. We also witnessed that regulators, far from being asleep at the wheel, were ready to act with determination and pragmatism to avoid any contagion.

More specifically we certainly do not think the Additional Tier 1 market will disappear following the absorption of Credit Suisse (CS) by UBS. The initial reaction, the following Monday morning, was poor, probably more due to the effective subordination of CS AT1 bonds to equities than on the zeroing of AT1. The market wasn't surprised by the full write-down of those junior subordinated bonds, arguably those instruments have been designed precisely to facilitate shotgun weddings. The $3bn+ payout to shareholders was problematic though, even perceived as potentially killing the additional tier one market. European regulators (EBA, SRB, ECB, BoE) were quick to reiterate that equities take losses before even the riskiest bonds, and participants realized that it was not only a Swiss specificity, but also most likely an idiosyncratic and diplomatic negotiation with CS main shareholder. After reaching levels not seen since March 2020 on Monday the 20th of March, bailinable bank bond spreads quickly came back to levels tighter than the close of the previous week. It is not surprising for senior holdco/non-preferred senior and Tier 2 (even CS coco tier 2 have been spared in its resolution, and market participants realized how difficult writing-down bonds outside of AT1 would have been). Most AT1 spreads are currently wider than their resets, implying it would not be economic for most to be refinanced were they callable today, but they are within range of those resets as spreads have stabilized 100-150 bps wider for high quality issuers vs. early March. It's a significant achievement for this market to remain stable considering that c.7% has been zeroed over a week-end.

If the dominant headlines of the quarter were not a symptom of broader rot within the financial system, they were certainly illustrative of what always happens in the credit cycle when capital becomes costlier. **This is consistent with our long-term view that we will witness more credit accidents in the coming years, which is healthy and will generate performance. Some cans become too heavy to kick down the road and, on closer inspection, turn out to be full of worms. This particular turn of the cycle is especially accentuated as we are exiting a long period of financial repression where capital, for all intents and purposes, was almost free**. For regular and extended periods of times during the past 10 years, investment grade companies could borrow for close to 0%. **At this cost, capital allocation can quickly become undisciplined and when 0% turns into 5%, adjustments are certain to be in order**. Similarly, during the last decade, single B rated companies could regularly borrow below 5%. Even with a difficult business position, issuers could deal with very high leverage. This is not the case anymore when this 5% becomes 10% or more (and we have seen solid HY companies issuing at more than 13% during the quarter!). Inevitably, thus, we are going to see defaults pick up from their unusually low baseline in recent times.

Outlook

This is excellent news for bond pickers. **Fundamental risk is now competitively remunerated across the board, sometimes even handsomely if one is willing to put in the analytical work to get comfortable with more complex investment cases**. Carmignac Portfolio Credit's portfolio is well diversified, constructed in a balanced fashion with still c.10% of hedging through CDS on high yield indices , sports a BB+ average rating and yields in excess of 10% (source: Carmignac, 31/03/2023). This is before considering the exercise of early refinancing options by many of our issuers: in many cases, it will make rational sense for them to address their maturities before the final date, which could potentially add an extra 1% or 2% to this yield. With such a high yield, the prospects of returns are exciting and we believe that the downside from potentially volatile markets will be limited (as the carry quickly offsets potential drawdowns). **The fund is meaningfully exposed to the natural resources and financial sectors, where credit quality structurally improves in times of inflation, as well as to attractive (floating rates) tranches of CLOs**. As a result, it should behave well even if inflationary pressure persists longer than expected.

Beyond the current favourable setup, we are excited by this ongoing regime change. With some perspective, the years since the Great Financial Crisis have seen a financial repression unique in the 5 000 years of recorded history of interest rates. There was literally no known worse period (in peace time) to invest in credit. Returning to a world where the cost of capital is not suppressed anymore and good businesses with bad balance sheets have to go through bankruptcy, offering potential asymmetric opportunities, is immensely exciting for bond pickers.

Source: Carmignac, Bloomberg, 31/03/2023. Performance of the A EUR acc share class ISIN code: LU1623762843. [1]Reference indicator: 75% BofA Merrill Lynch Euro Corporate Index, 25% BofA Merrill Lynch Euro High Yield Index. [2]31/07/2017. Past performance is not necessarily indicative of future performance.**The return may increase or decrease as a result of currency fluctuations. Performances are net of fees (excluding possible entrance fees charged by the distributor). Marketing communication**. Please refer to the KID/prospectus of the fund before making any final investment decisions

Carmignac P. Credit

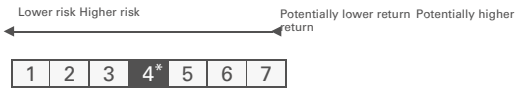
Access the entire credit spectrum for maximum flexibility

Discover the fund page

Carmignac Portfolio Credit A EUR Acc

ISIN: LU1623762843

Recommended minimum investment horizon



Main risks of the Fund

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

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

LIQUIDITY: Temporary market distortions may have an impact on the pricing conditions under which the Fund might be caused to liquidate, initiate or modify its positions

DISCRETIONARY MANAGEMENT: Anticipations of financial market changes made by the Management Company have a direct effect on the Fund's performance, which depends on the stocks selected.

The Fund presents a risk of loss of capital.

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