QUARTERLY REPORT

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Carmignac Sécurité: Letter from the Fund Manager

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Lengt
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+0.56%

Carmignac Sécurité's performance

in the 2nd second quarter 2023 for the A EUR Share class

-0.24%

Reference indicator's performance

in the 2nd second quarter 2023 for ICE BofA ML 1-3 years Euro All Government Index (EUR)

1st quartile

Of its Morningstar category

over 1 year Morningstar category: EUR Diversified Bond – Short Term

*In the second quarter of 2023, **Carmignac Sécurité** gained 0.56%, while its reference indicator[1] was down -0.24%.*

The bond markets today

Events in March threw a spotlight on weaknesses in the US regional banking system with the near-simultaneous bankruptcies of four institutions, including Silicon Valley Bank (SVB). This fuelled worries about contagion that could potentially undermine the country's financial stability and economy more broadly. But instead, the US economy made a show of resilience in Q2. America's job market held firm – as did core inflation.

US GDP growth for Q1 was revised sharply upwards, to 2%, and this pace slowed only slightly in Q2. Jobs and consumer spending were buoyed by the excess savings that households, businesses, and local governments had built up during the pandemic; these savings also mitigated the effects of tighter lending conditions. With economic indicators running hot, many economists pushed back their forecasts for a US recession (even though there was a consensus on this in Q1) and upped their core inflation expectations. The US Federal Reserve had to reiterate its hawkish stance; in June, Chairman Powell indicated a terminal fed funds rate of 5.50%–5.75%, signalling two additional rate hikes. That pushed up US Treasury yields – both nominal and (especially) real – across the yield curve over the quarter, with a more marked increase in the shorter-dated segment. The nominal yields on 2-year and 10-year Treasuries rose by 87 bp and 37 bp, respectively, while the corresponding real yields rose by 132 bp and 47 bp. Risk assets held up well despite these movements; spreads on high-yield paper narrowed by 33 bp.

The macroeconomic climate in Europe was similar to that in the US, with sticky core inflation and a robust job market, but differences began to emerge in Q2. The Euro Area Bank Lending Survey showed that credit standards are getting tighter and loan demand is falling, which suggests the ECB's monetary policy is being transmitted efficiently to financing conditions. In addition, the central bank's unprecedented rate hikes are starting to weigh on the real economy, as reflected in a marked downturn (sharper than that in the US) in leading economic indicators – initially in manufacturing, but now also in services. Consumers' purchasing intentions are weak in the eurozone, and German unemployment is starting to rise.

Yet the ECB remains firm in its belief that higher interest rates are needed to curb core inflation, which remains above 5%. President Lagarde indicated that a July rate hike is almost certain and all options are on the table for September. Investors have priced in a terminal rate of around
4% – reasonable in our view, although it could end up higher. European bond yields were up in Q2 and, owing to the more marked downturn in the eurozone's macroeconomic outlook, outperformed their US counterparts considerably. The 2-year German Bund yield rose by 51 bp while that on the 10-year Bund edged up just 10 bp. Credit spreads benefitted from the favourable climate for risk assets, which stemmed from a variety of factors: the uncertainty surrounding SVB's bankruptcy is fading, investors have dry powder to deploy, and yields are once again attractive, for example. The iTraxx Crossover index fell by 36 bp and the spreads on Italian sovereign debt narrowed by 14 bp.

Performance

Carmignac Sécurité performed well in Q2, in both absolute and relative terms. Our return was boosted by the renewed effectiveness of carry strategies, coupled with an average yield-to-maturity of around 5% – the highest it's been since the sovereign debt crisis. Carry strategies should remain our primary performance driver in the coming months. Our credit book was also lifted by a narrowing of credit spreads as worries surrounding the US regional banking crisis abated. We reduced our credit positions slightly in the first half and shortened the maturity of our credit book, putting our focus on high-quality issuers with a combination of historically attractive yields and lower interest-rate risk. That said, our portfolio was impacted by the rise in core yields in Q2, since we had kept our overall modified duration relatively high, at around 3. But thanks to our overweight position on longer-dated German yields (5-year and 10-year), we benefitted from the pronounced flattening of the yield curve and were able to outperform benchmark bond indices.

Positioning

Our modified duration was close to 3.0 in early July, up from 0.9 at end-December, and credit (ex-CLOs – Collateralized Loan Obligations) accounted for nearly 50% of the fund's assets, down from 56% end-December. That means our portfolio is positioned for an economic slowdown in Europe and to take advantage of the exceptionally high yields on high-quality corporate debt. The ECB's monetary-policy tightening over the past year is starting to affect lending conditions as well as the real economy. GDP growth will probably remain sluggish and core inflation should start declining sharply in the autumn, paving the way for the ECB to close the door on its rate hikes by year-end. Meanwhile, attractive opportunities are still to be found in credit, through investments that factor in a high possibility of recession (the iTraxx Crossover index implies an annual default rate of nearly 7% in Europe, whereas the historical average is close to 2%) and that offer yields close to their
10-year highs, thus providing a safety margin should credit spreads widen. What's more, the mechanisms introduced in 2008 and then reinforced after SVB's bankruptcy should help prevent a genuine banking crisis.

Our allocation is currently focused on the more defensive segments – mainly short-dated maturities and investment grade issues – and we've reduced our exposure to high-yield bonds. We favour the energy sector (9% of the fund's assets; 6.2% average yield), financials (18% of the fund's assets; 5.8% average yield), and CLOs (8.8% of the fund's assets; 6.3% average yield). 25% of the fund's assets are invested in money-market instruments (Treasury notes and corporate debt instruments; 3.3% average yield). Our portfolio's annualised average yield was approximately 5.3% at the start of the second half.

Source: Carmignac, 30/06/2023. Performance of the AW EUR acc share class ISIN code: FR0010149120. [1]Reference indicator: ICE BofA ML 1-3 Year All Euro Government Index**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 Sécurité

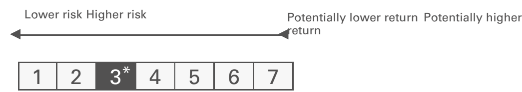
Flexible, low duration solution to challenging European markets

Discover the fund page

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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