

## Carmignac Gestion

# 2010 Economic Outlook and Investment Strategy

### I – 2010 Economic Outlook

#### ► Recovery in the United States is confirmed.

At the start of the year, a more positive recovery is continuing in the developed countries, particularly in the United States. After 7.2 million jobs were destroyed in just 18 months, the US economy is now seeing its unemployment rate stabilise. As productivity is highly unlikely to rise faster than in the past nine months (7% quarterly average), a sharp rise in recruitment over the course of the next three months seems to us inevitable. With its positive effect on consumer morale, on revenues and thereby on consumption itself, this improvement in the jobs picture may amplify the current rebound. The foreseeable increase in the final resulting demand is likely to encourage companies to rebuild their inventories, which should contribute to the rebound in GDP. However, beyond a short-term rebound, medium-term growth will remain timid.

#### ► Growth in developed countries remains timid.

Although economic recovery in the developed countries is well underway, there remain powerful brakes on any solid medium-term upturn. The banks, scrutinising borrower quality more closely now, are preferring to rebuild solvency by buying government debt at nearly zero cost, rather than increasing their lending. This restriction of bank credit, although partially offset by recourse to bond and stock markets, is reducing economic growth potential. Moreover, after being stimulated by US tax provisions to benefit first-time buyers, the residential real estate market is once again showing signs of fragility. Finally, even though the deterioration in the job market in the United States seems to have abated, nonetheless the “real” unemployment rate - taking into consideration non-working people who no longer claim unemployment and people who are involuntarily working only part time – is more likely closer to 17% of the active population than the official 10%.

#### ► This soft economic growth allows accommodating policies to continue and keeps inflation risk at bay.

Weakness in the job market, a condition common in all the developed countries, will continue to exert constant downward pressure on pay. There is thus little basis for fearing a rise in consumer prices apart from food and energy. In this context, the authorities seem to consider it legitimate to maintain accommodating monetary policies. They intend to ensure that the withdrawal of fiscal and monetary stimuli is not implemented before dynamic self-sustaining growth takes hold in the private sector. Without positive momentum, any growth runs the risk of being immediately interrupted by the end of stimulus measures. Recent statements by monetary authorities in the main developed countries indicate that they do not think the time is right yet to end support measures, even though the IMF is ready to raise its global growth forecast for 2010 to over 3.1%.

► **World growth is resynchronising.**

The US growth recovery, accompanied by, to a lesser extent, the major European countries, is contributing to the vigour of the main emerging countries and/or exporters of raw materials. Inevitably, the strong rise in economic activity in China, India and Brazil is creating inflationary pressures and risks of overheating. Although controlling the inflationary pressures in these countries will undoubtedly necessitate tighter monetary policies, these should not endanger their continuing growth.

► **Market behaviour will be more dictated by fundamentals.**

The rise in equity markets which, since March, has been fuelled mainly by central banks saturating the system with superabundant liquidity, is becoming more fundamental, more dependent on expectations of a more favourable economic upturn. Although the engine will change from abundant liquidity to established economic growth, we think the environment is still conducive to investment in equities. The risks associated with this change in behaviour – withdrawal of stimuli, and increased rates – are real, but, while requiring more discernment, selecting stocks in a two-speed world based on estimated results will become more comfortable as the crisis recedes behind us, making estimates less random.

## II – 2010 Investment Strategy

### I – International Equities

► **Although timid, the growth in developed countries will allow a strong rebound in profits.**

Although the growth in developed countries continues to be soft, it should be reflected in a strong rebound in companies' profitability. In fact, the particularly drastic cost cutting undertaken by companies (massive reductions in inventories, lay-offs, reductions in interest expenses due to lower credit margins and weak capital expenditure) will give the slight growth in expected sales higher profit margins, potentially very favourable for equity investments.

► **The US recovery theme represents 8.6% of Carmignac Investissement net assets.**

The confirmation of a more positive economic climate in the developed countries, led by the United States, along with expectations of a moderate but synchronised rebound of the global economy, has led us to take a position that aims to participate more strongly in the US recovery. This has been financed primarily by a marked reduction in our holdings of gold from 13.2% to 4.3% of Carmignac Investissement assets. We intend to take advantage of more proven US dynamism via electrical equipment companies Emerson Electric and Alstom, car maker Ford, air carrier Delta Airlines, and credit card company Mastercard. Also part of this theme are emerging country exporters of goods and services that are well-positioned in the US market: Infosys (India) in IT services, and Hon Hai (Taiwan), an assembler of computers and consumer retail electronic products such as the Apple iPhone.

► **The theme of improvement in living standards in emerging countries remains preponderant.**

The vigour of domestic growth in the principal emerging countries, along with weak external global demand, pleads in favour of companies addressing domestic demand. This theme remains preponderant in our global management. It represents 24.3% of Carmignac Investissement assets, and continues to focus primarily on the best-placed countries, which are China, India and Brazil.

► **In a context of synchronised global growth we have increased our weighting in commodities.**

We increased commodities this quarter from 23.7% to 27% of Carmignac Investissement assets. The robust demand for commodities in the emerging countries, along with the prospects for a rebound in the US economy in particular, should have a positive impact on the oil sector.

► **We maintain a defensive mix representing 20% of Carmignac Investissement assets.**

Alongside the 80% invested in growth themes, Carmignac Investissement maintains a defensive compartment representing 20% of net assets, made up of 9.6% defensive stocks (health, non-cyclical consumer goods, etc), 6.5% cash and 4.3% gold mines.

## **II – Bond Performance Drivers**

► **Analysis of sovereign risk will be critical in 2010**

In a context where the slow process of reducing leverage is reflected in the phenomenon of a transfer of private debt to public debt, sovereign borrowing should suffer tendentially from the ongoing parlous state of the public purse. All the more so as the contribution of central banks as marginal buyers diminishes. Runaway budgets have also revealed islands of fragility among sovereign issuers. Every country's credit will therefore evolve on the basis of its own merits. Nonetheless, we do not think there is any reason to doubt that long rates will take off. But central banks will not let long rates run free and risk compromising the recovery under way. We would therefore be very surprised if 10-year government bonds offered more than 4.5% and 4% in the United States and Europe, respectively, in upcoming months. On any hypothesis, Carmignac Patrimoine's flexible approach will allow it to position itself the best possible way in view of opportunities. In particular, the Fund has a wide sensitivity range that can vary between -4 and +10. Sovereign borrowing has dropped to 9% of Carmignac Patrimoine assets.

► **Corporate borrowing benefitted from the restoration of company balance sheets.**

We are maintaining our corporate bonds allocation at 30% of Carmignac Patrimoine assets (including 25.2% in "investment grade" and 4.6% in "high yield" debt). During the past year, the entire asset class contributed to portfolio performance thanks to the combined reduction in credit risk premiums and reduction in liquidity. Although current credit premium levels (between 50 and 250 basis points) will drive 2010 performance down to more moderate levels, corporate debt will benefit from a less risky environment. Thus, in 2010 European companies will achieve free cash flow levels in line with 2008, thanks to reductions in capital expenditure and dividend payout rates. The soft growth environment is proving to be favourable for this asset class as it combines a low rate of defaults and cautious corporate behaviour. To these fundamentals must be added a major technical factor: the reduction in supply. Issues of corporate debt denominated in euros are expected to

fall 25% to 40%. We continue to prefer corporate debt to sovereign debt in order to profit from the portage effect.

► **Opportunities in private “high yield” debt.**

We also perceive opportunities in high-yield bonds in both the United States and Europe, in which we intend to strengthen to 10% of Carmignac Patrimoine assets. The risk premiums offered on these issuers range between 250 and 600 basis points above sovereign debt, while default rates are expected to fall sharply. Market forecasts are counting on a 4% default return for 2010, after the peak of 10.2% reached in 2009.

► **Emerging countries continue to outperform developed economies.**

In 2010, emerging countries should continue to outperform developed countries, due to their lower debt levels and lower deficits. We intend to reinforce our emerging strategies (local debt, foreign debt and currencies) to 10% of Carmignac Patrimoine assets.

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***About Carmignac Gestion***

Founded in 1989 by Edouard Carmignac, Carmignac Gestion is one of the leading independent asset management companies in Europe today. The company's shares are held entirely by its managers and staff. In this way, the company's long-term viability is ensured by a stable shareholding structure, reflecting its spirit of independence. This fundamental value ensures the freedom required for its successful and renowned portfolio management.

Managing over €33 billion of assets, Carmignac Gestion has developed a range of 19 funds across all asset classes, including equity funds and balanced funds, as well as a mandate offering.

Our funds are actively distributed in nine European countries: France, Luxembourg, Switzerland, Belgium, Italy, Germany, Austria, Spain and the Netherlands. As a platform for its international development, the company has had a subsidiary in Luxembourg since 1999. In 2008 it opened representative offices in Madrid and Milan.