QUARTERLY REPORT

21.04.2023

Carmignac Sécurité: Letter from the Fund Manager

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Published
April 21, 2023

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-0.12%

Carmignac Sécurité's performance

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

+0.70%

Reference indicator's performance

in the 1st quarter of 2023 for ICE BofA ML 1-3 years Euro All Government Index (EUR)

1st quartile

Of its Morningstar category

over 1 year and 3 years Morningstar category: EUR Diversified Bond – Short Term.

In the first quarter of 2023, ***Carmignac Sécurité*** *fell by -0.12%, while its reference indicator[1] was up 0.70%.*

The bond markets today

European fixed income markets have beaten the pessimistic predictions of investors: while a majority of analysts warned of a plethora of paper supply that would weigh on rates, while the reduction of the Central Bank's balance sheet was expected to weigh on sovereign credit margins, and while a recession was expected to put pressure on corporate credit spreads, in the end, nothing of the sort happened. From date to date, German 10-year yields have fallen by 28bps, high yield spreads (measured by the iTraxx Crossover index) have tightened by 38bps and Italy has outperformed Germany by almost 34bps! Three major phases marked this quarter:

January with a rally in interest rates, credit spreads and country spreads, partly due to a very conservative December and investors who had prepared their portfolios well in advance;
The month of **February** with an upward movement in rates, particularly on the short end of the curve. Inflation that remains more persistent than expected, growth that finally remains strong and a hawkish ECB have pushed 2-year rates above 3.25% with the market estimating the end of the ECB rate hike cycle at 4%. At the same time, credit remains very resilient and if credit spreads stop tightening significantly, carry allows the asset class to perform well. As far as intra-country spreads are concerned, it's dead calm, especially in Italy, where the government of Mrs Meloni has achieved a perfect economic record.
Finally, **March** was a much more chaotic month. The first jolt came from the United States. The rate hikes are starting to have an effect and the weak links are showing: the US regional banks in particular are suffering from the rising cost of deposits and competition from more profitable investments. The failure of Silicon Valley Bank has brutally highlighted the possible fragility of financial stability in this context. The rapid response of the US monetary authorities initially limited the contagion. However, this American gale caused Credit Suisse to falter in Europe. The rescue of the bank by the Swiss authorities by forcing an absorption by UBS, while it had the merit of being quick, somewhat upset the expected order of creditors' seniority: the AT1 bonds (admittedly highly subordinated but still bonds) saw their value set at zero while the shareholders (in theory the most junior in the capital structure) received a (meagre) payment. Investors therefore quickly concluded that this was the death knell for aggressive monetary policy and rates corrected violently downwards, especially on the short end. At the same time, the flight-to-quality reflexes were working, with credit spreads widening, and of course particular pressure on financial debt, especially subordinated debt.

Performance

In this context, the fund performed well in January and February: the low modified duration of the fund in January was more than offset by investments in credit bonds, and the carry of this pocket allowed the fund to absorb the rise in interest rates in February. On the other hand, the first 15 days of March were very negative for the fund: our credit exposure, although substantially reduced in February, weighed on the fund (especially since financial bonds make up a significant part of the portfolio), and the hedges on the short end of the curve that we had put in place to protect ourselves from the hawkish tone of the Central Banks generated a strongly negative performance as rates fell. To adapt to this new environment, we increased the modified duration of the fund by liquidating all short interest rate positions and buying German 5- and 10-year bonds. We also put in place credit protection via indices. The last two weeks of March, which were calmer, enabled the fund to regain some colour, with portfolio construction and the carry embedded in the fund (4.9% at the end of March) resulting in a positive performance.

Positioning

At the end of March, the fund had a duration of 2.7 compared with 0.9 at the end of December, and credit represented 47% of assets (excluding CLOs) compared with 56% at the end of December. The fund is therefore positioned more defensively, with a heightened duration contribution to core rates. Indeed, the deterioration of US macroeconomic data, the deceleration of inflation and the latest turbulence in the banking sector threatening financial stability are warning signs that the end of the rate hike cycle is not far off, first and foremost in the US where we expect a recession in the second half of the year. The European economy is a few months behind the US in the growth and inflation cycle, which should allow the ECB to raise rates a little longer than the Fed. Nevertheless, monetary policy will not be able to diverge from that of the US for very long without significant consequences for the exchange rate, financial conditions and ultimately growth.

The ECB should therefore follow the Fed's lead by ending the rate hike cycle by the summer, which should support intermediate maturity sovereign bonds. On the credit side, we are also adopting a more defensive stance by reducing our overall allocation through the sale of securities and the purchase of options on the iTraxx Crossover CDS index, as a recession in the United States seems inevitable. On the other hand, the asset class continues to offer interesting opportunities, incorporating a high recession risk (the iTraxx Crossover index induces an annualised default rate of nearly 8% in Europe compared to the historical average rate of nearly 2%) and offering yields close to the highest for the decade, and therefore a cushion of protection in case of a credit spread widening.

Moreover, the mechanisms put in place since 2008 and reinforced following the Silicon Valley Bank bankruptcy should make it possible to avoid a real banking crisis. We are focusing our allocation on more defensive segments, notably short maturities and investment grade ratings, and have reduced our exposure to the high yield sector. We favour the energy and financial sectors as well as CLOs. In particular, our exposure to the financial sector is 21% (including only 2% on AT1 subordinated bonds favouring national champions). European banks benefit from stronger fundamentals than in the US, through stronger regulation and higher capitalization and liquidity ratios. The average yield to maturity of the portfolio is approaching 5% at the beginning of the second quarter.

Source: Carmignac, 31/03/2023. Performance of the AW EUR acc share class ISIN code: FR0010149120.[1]Reference indicator: ICE BofA ML 1-3 ans 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 KIID/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

Lower risk Higher risk

Recommended minimum investment horizon

1	2*	3	4	5	6	7

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.