Press release
Paris, 27th of July 2011

Economic Outlook and Investment Strategy for Q3 2011

I – Economic Outlook

▶ Developed countries are at risk of “Japanisation”

Due to public over-indebtedness, recessionary pressure from ongoing deleveraging could weaken developed countries’ growth for some time, as was the case in Japan after the credit crisis broke out in the early 1990s. Austerity policies implemented or indeed just recommended are intensifying the risk of developed economies “Japanisation”. Faced with long-term deflationary conditions, the return of fiscal discipline is indeed problematic. Premature austerity measures could generate recessionary effects on growth, making it very hard to absorb public deficits.

▶ European authorities’ indecisiveness is deepening the crisis and creating contagion effects

In Europe, where the risk of a deflationary spiral is particularly high for several member states, the IMF and the eurozone's most virtuous countries are imposing suicidal fiscal austerity on growthless countries while the ECB is adding to their stress by raising its interest rates. The Japanese example demonstrates irrefutably the dangers of this policy. Weakened countries' inability to devalue their currency leaves them no other choice than a restructuring of their debt - as orderly as possible - alongside bold measures to improve economic competitiveness. The markets' repeated attacks make this obvious but with each passing day the ECB's dogmatic resistance makes the future adjustment harder and costlier for peripheral countries. It also presents a formidable risk of contagion to Spain, Italy and maybe one day France.

▶ Delaying the inevitable restructuring of Greek debt is weighing on European government bonds

For once, the outlook for European interest rates could differ from that across the Atlantic. The economic slowdown in the United States is hitting our economies with its usual 3-to-6-month lag, limiting the potential for long rates to pick up. At the short end of the yield curve, the further weakening of Europe's peripheral countries argues for a less intransigent monetary policy at the European Central Bank, which we think reduces the likelihood of another rate hike this year. In contrast, disastrously putting off the inevitable restructuring of Greek debt will weigh on all European countries' credit. The need to support a growing list of weakened countries, on which the euro's survival depends, will come at a cost to AAA rated sovereign issuers.

▶ The US economic slowdown will go on longer than the consensus expects

In the United States, the slowdown that began in the second quarter is still generally viewed as a mid-cycle lull caused by destocking, which is usual at this point, and by temporary exogenous factors. Although we think macroeconomic data could improve over the coming months due to lower oil prices and the positive effects on output of the Japanese production chain getting back up to speed, there are at least three reasons why we think the rebound will be short-lived. The first is that leading indicators of US growth have fallen too much in recent months to suggest anything more than a slight, temporary upturn in the cycle. The second is that some current sources of growth are already making their maximum possible contribution. For example, retail sales are unlikely to go on rising by 7.5% a year. The third - and biggest - reason for our scepticism concerns the persistent deflationary effects of deleveraging on the economy, leading companies to take as little risk as possible, the most visible symptom of which is the continued weakness of the US labour market, further reducing the potential for domestic demand and sustaining the slump in the property market.

▶ Once again, the emerging universe could offer a counterbalance to the problems in the developed world

Although we acknowledge that we were too optimistic in predicting that inflation would ease last quarter, we are convinced that Chinese monetary policy tightening will soon come to an end and that inflation will peak there in the next two months. For global growth, the end of monetary tightening will provide a massive counterbalance to developed economies' foreseeable weakness. The robust growth we are expecting will make it possible to tackle provincial debt, just as it allowed banks' non-performing loans to be dealt with a few years ago. If it proves capable of refocusing growth on domestic consumption, the emerging world may even benefit from persistently slower growth in developed economies whose limited demand for commodities would help alleviate inflationary pressures. These emerging countries, which do not have to overcome major public debt problems, still have very high potential growth and in some cases are about to see inflation stabilise or even fall. Given these conditions, stock market valuations seem particularly attractive with a 2012 P/E of 13x in India and 9x for Chinese equities listed in Hong Kong. We prefer these markets to South Korea and Taiwan, whose economies are more dependent on exports to developed countries.

CARMIGNAC GESTION

II – Investment strategy

I – International equities

▶ We are keeping significant exposure to emerging countries

For developed economies, caught in a vice-like grip between the European crisis and deleveraging, growth potential is lower while risks are higher. This observation means we remain widely exposed to emerging markets, some of which are capable of offsetting the weakness of mature economies. Exposure to currencies other than the euro will also allow the global funds to benefit from such currencies' appreciation against an overvalued euro that has been weakened by major uncertainties. Carmignac Investissement thus began the new quarter with an increased cash weighting of 6.2% and exposure to the dollar and emerging currencies at 56%. The theme of improving living standards in emerging countries was increased from 34.1% to 38.6% of Carmignac Investissement's assets, reflecting our greater confidence in a victory in the fight against inflation.

▶ Our energy weighting remains stable, while we have reduced our positions in diversified metals

The energy theme was held at 15.5% of Carmignac Investissement's assets, with our additional investments in promising exploration/production companies (HRT Participacoes, Tullow Oil and Woodside Petroleum) being financed through reductions in our oil services positions (Transocean, National Oilwell, Schlumberger). In contrast, we reduced our exposure to diversified metals from 9.3% to 4.8% of assets. Indeed, we consider this sector to be particularly vulnerable to the economic slowdown and decrease in liquidity. As a result, we closed all of our positions in Freeport McMoran, Xstrata and Antofagasta.

▶ Our gold component remains unchanged

Our gold mining component remains completely stable at 11.2% of the Fund's assets. The deepening of the European crisis and ballooning US public debt are factors that are undermining currencies and government issues, and will probably result in even higher gold prices. Gold miners have rarely been so undervalued relative to gold prices. This strategic part of the portfolio's defensive structure should make significant contributions to relative and absolute performance over the coming quarters.

▶ The innovation theme has been reduced to strengthen positions in defensive stocks

The theme of innovation, which is also sensitive to global activity, was reduced from 15.1% to 11.6% of Carmignac Investissement's assets at the expense of the IT sector, in which our two jewels, Apple and Oracle, had made good progress. The defensive sector was naturally re-weighted from 4.9% to 12.4% of assets, mainly by adding to our positions in Nestlé, Mead Johnson, a US nutritionist with a strong presence in China, and Vertex Pharmaceutical, a biotech company pioneering hepatitis C treatments.

II – Bond performance drivers

► We reduced our corporate bond allocation slightly

Our corporate bond allocation has fallen very slightly, from 34% to 32% of Carmignac Patrimoine's assets. Ongoing improvements in companies' fundamentals continue to support the asset class, even if their resistance to a macroeconomic shock would probably be temporary. With inflation of around 3% in Europe and the United States, and money market rates of 1.5% and 0.25% respectively, corporate bonds remain attractive investments, with the high yield and investment grade segments yielding 7.3% and 4% respectively.

► The developed country government bond component is stable, and we are actively managing modified duration

The developed country government bond component was stable at 3.65% of Carmignac Patrimoine's assets. Over the quarter, the Fund's modified duration was managed tactically, varying between 0.5 and 6. Europe's indecisiveness in recognising the Greek default creates a dangerous situation of contagion, heightening deflationary pressures on countries weakened by high debt. Accordingly, the interest rate premium demanded of the French government as compared to its German neighbour stands at a high of +63bp. Apart from German government bonds, the portfolio has not held any European sovereign bonds for 18 months.

► We took profits on the emerging government bond component

The emerging government bond component has fallen from 8.2% to 4.3% of Carmignac Patrimoine's assets, with 3.3% invested in local emerging debt. Despite fears of a US slowdown and a worsening of the fiscal situation in Europe's peripheral countries, various emerging sovereign debt issuers (Brazil, Colombia, Philippines and Hungary) have had their ratings upgraded. This allowed us to take considerable profits on our positions in Brazil, Colombia, Mexico and Indonesia and reduce our exposure to Hungary. However, we still plan to return to some emerging countries' local debt to benefit from the imminent cycle of falling long rates.

► The cash component has been increased

Our allocation to cash instruments has risen from 13% to 17% with some of the proceeds from asset sales used to purchase US Treasury bills.

Press contacts:

CARMIGNAC GESTION
Agnès Séverin
Co-Head of Communication
Tel: +33 1 70 38 56 85
aseverin@carmignac.com

Josipa FINK

Tel: +33 1 70 92 33 74
jfink@carmignac.com

About Carmignac Gestion

Founded in 1989 by Edouard Carmignac, Carmignac Gestion is one of the leading independent asset management companies in Europe today. Its share capital is entirely held by its management team 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 is of upmost importance to the company as it ensures the freedom required for successful and renown portfolio management.

With close to 50 billion EUR in assets, Carmignac Gestion has developed a comprehensive range of 19 funds across all asset classes - equities, bonds and multi-strategy, as well as mandate offering. Our funds are actively marketed in 11 European countries: France, Luxembourg, Switzerland, Belgium, Italy, Germany, Spain, Austria, The Netherlands, Sweden and United Kingdom. Within the context of its international development, Carmignac Gestion has a subsidiary in Luxembourg and two offices in Madrid and Milan, and recently registered its range of products for professional investors in Singapore.