

Economic Outlook and Investment Strategy for Q1 2012

I – Economic Outlook

► Europe remains fraught with challenges

The situation in both Greece and Spain continues to highlight the inadequacy of the economic and monetary response to the problems plaguing debt-burdened eurozone countries. In the case of Greece, the debt reduction facilitated by the planned default will rapidly prove insufficient given the country's inability to generate growth and raise taxes. Does this mean that Greece be forced to leave the eurozone? As for Spain, the drastic remedy it is inflicting upon itself to reduce the budget deficit is killing growth, thereby preventing any improvement in the fiscal situation. The risks posed by Greece and Spain, combined with the upcoming elections in France and the economic outlook in Germany, which is expecting negative growth this quarter as in the previous one, make the European landscape a rocky one indeed.

► The ECB's active role has nevertheless temporarily alleviated the systemic risk weighing on the eurozone

The ECB's deployment of an unlimited three-year long-term refinancing operation (LTRO) for commercial banks was a positive step. What is essentially a different take on quantitative easing has temporarily alleviated systemic risk by enabling the ECB to provide the banking system with the liquidity it needs and a mechanism whereby the ECB would no longer be called upon as lender of last resort for sovereign issuers. It also offers banks the chance to get back on their feet with advantageous carry trades, assuming a lasting solution to the European crisis. This mechanism can help provide safe passage through a quarter laden with maturing sovereign issues and inspire a more constructive sentiment towards European equity markets in the short-term. It is our view that for the eurozone to survive it will require both a more expansionist monetary policy and a growth-focused fiscal policy. The former will help by setting key interest rates very low and displaying an ability to buy up unlimited amounts of the most beleaguered countries' government bonds in order to slash the cost of refinancing public debt and considerably reduce the euro exchange rate. The latter is needed in order to stimulate investment, which brings with it hope of growth and future job creation.

► United States: the economic recovery has taken shape in the short term

There is no denying that the United States enjoyed an economic upturn over the fourth quarter, prompting 2012 growth forecasts to be raised to around 2%. Gradual yet consistent improvements in the job market combined with the initial signs of stabilisation in the housing market, even though they are yet to be confirmed, are contributing to this upturn. However, we consider it unlikely that these forecasts will be revised upwards in 2012, for three reasons. Firstly, the decline in the savings rate cannot continue to boost consumer spending: the global economic climate in no way justifies a savings rate of 3.5%, a level only ever seen during the formation of the property bubble, which created a false illusion of wealth. Secondly, industrial production is strong as a result of the catch-up process following the return to normality of the production chain, which had been brought to a halt by the Japanese tsunami. Lastly, for companies, the non-renewal of the depreciation acceleration mechanism could weaken investment from January onwards. Although we may be sceptical of the United States' ability to maintain this trend in the current climate, we have taken note of its resilience.

► Chinese inflation, now under control, will allow for a gradual easing of its monetary policy

As we had anticipated, Chinese inflation peaked at 6.5% in spring, before dropping back to 4.2% in November. Growth should ease off to 7%-8% in 2012 as monetary tightening and the slowdown in global trade start to make themselves felt. Activity is expected to remain at a high level, thereby affording monetary authorities the luxury of very gradually reversing their restrictive policy in a bid to cut inflation expectations as much as possible. Thus, we should not expect to see China easing its monetary policy any more quickly than at present, unless there is a significant downturn in international trade. Its economic policy, which is ever more clearly focused on increasing domestic demand in China, requires strict anti-inflationary discipline and guarantees a boost to global growth over time. It also bodes well for the yuan, which should continue to strengthen along with other currencies in the region relative to those of developed economies. Such an increase in exchange rates serves as an effective weapon in the fight against inflation, which will ultimately bolster the most virtuous countries' local debt.

II – Investment strategy

I – International equities

- ▶ We have opted to enter 2012 with an offensive stance

In an environment where Chinese monetary policy is no longer unfavourable, where American politicians appear to have decided to avoid implementing any unpleasant measures in the build up to the November elections and where liquidity in Europe has considerably improved on the back of the ECB's three-year credit facility, we have decided to adopt a more offensive positioning at the beginning of 2012. These breakthroughs may well push market valuations up towards their equilibrium and have prompted us to raise the level of equity exposure of our global funds. First, we believe that the Chinese stock market will make up for lost ground, at least in relative terms, owing to the reversal under way in its monetary policy. Furthermore, the inevitability of the ECB stepping in as the lender of last resort will compound the euro's depreciation, which began last summer. This second conviction allows us to be confident in the returns on our investments made mainly in foreign currency even before a strict change in the ECB's modus operandi has produced a positive confidence shock on equity markets.

- ▶ The theme of improving living standards in emerging countries has been increased

The theme of improving standard of living in emerging countries has again been increased from 34% to 37.3% of Carmignac Investissement's assets. Indeed, we believe that the risk aversion which penalised emerging markets in 2011 has created quite an attractive opportunity. We have therefore more than doubled our holding in Gome Electrical, a retailer currently undergoing a recovery and well positioned to benefit from the strength of Chinese consumer spending and the development of social housing. We have also added the brewer Ambev, a pan-American leader in beers and soft drinks, to the portfolio. In addition, we strengthened our exposure to China via the American company Yum! Brands, which operates a rapidly expanding fast food chain, and through further investment in Mead Johnson, a leader in infant nutrition which generates 60% of its turnover in emerging countries.

- ▶ The weighting of defensive stocks has been increased slightly while that of innovation has been considerably reduced

The weighting of defensive stocks has been increased from 13.3% to 14.2% of Carmignac Investissement's assets through the addition of hard discount retailer Dollar Tree. Conversely, we have closed our position in Vertex, whose hepatitis C treatment faces fierce competition. The theme of innovation has been significantly scaled back from 10.7% of assets to 7.1%.

- ▶ We have left our exposure to gold mining unchanged and increased the energy component

The energy sector has seen its weighting raised from 12.2% to 13.9% of Carmignac Investissement's assets, mainly as a result of the strengthening of our position in Ensc0 and the relative re-rating of the sector, which stands to benefit from the easing of Chinese monetary policy and the economic recovery under way in the United States. The weighting of gold mining stocks has been held at 14.4% of assets. The introduction of a position in Franco Nevada in this

component offsets the sector's consolidation over the last quarter. The interventions of central banks all over the world have encouraged us to maintain our hedge on gold, particularly as gold mines have a lot of catching up to do relative to the metal's price.

► **The cash component represents 9% of assets and contributes to the overall balance of the portfolio**

Our cash reserve of 9% along with gold mines and defensive stocks make up a defensive component of 37.6% of the Carmignac Investissement portfolio, with the remaining two thirds dedicated to themes exposed to economic growth. Composed in this way, the portfolio should benefit from the improvement in equity investment conditions. The absence of any exposure to the euro should safeguard it against the persistent risk of further deterioration in Europe, to which the ECB is now responding with measures that are devaluing the single currency. This cash may gradually be invested if the recent trend continues.

II – Bond performance drivers

► **Our corporate bond positions look set to generate value in 2012**

Corporate bonds should be a major source of performance for the bond component of Carmignac Patrimoine in 2012. First of all, the ECB's three-year credit facility offered to banks has eased volatility, creating an environment likely to boost investors' appetite for risk. Furthermore, with an average rating of BBB-, our credit portfolio enjoys an attractive yield of 6.4% for an average duration of 5.6 years. Lastly, companies' fundamentals remain solid owing to the very prudent attitudes of companies on either side of the Atlantic. In conclusion, the technical aspects of the market remain favourable and investors have, for the most part, rebuilt significant cash positions. This component represents 26.3% of Carmignac Patrimoine's assets.

► **We are keeping exposure to government bonds of developed countries unchanged**

Given that the risks surrounding the resolution of the European crisis will remain high, we are sticking with our cautious approach to European government bonds. As regards US bonds, ten-year yields may now be considered a by-product of monetary policy. If monetary authorities were to change tack, this would trigger a cycle of rising yields. As this seems unlikely for the time being, we shall hold on to US bonds for their safe-haven appeal. Against this backdrop, our allocation of developed countries' government bonds has remained stable at 10.4% of Carmignac Patrimoine's assets.

► **Our weighting of emerging government bonds shall be selectively increased**

The emerging government bond component has also remained unchanged at 2.5% of assets with 1.7% invested in local emerging debt. We plan to rebuild this component through selective investment. The environment should gradually begin to favour emerging local debt owing to a considerable drop in inflation indices, thereby allowing further interest rate cuts.

► **We are maintaining low exposure to the euro**

Over the course of Q4 2011, our exposure to the euro was kept very low and stood at 10% at the end of the year. In an

environment where European monetary policy is bound to become more expansionist, we believe the euro's depreciation relative to the dollar and yen will soon pick up pace. Our cash component, which is predominantly invested in US and Japanese treasury bills, grew considerably in H2 2011 and amounted to 24% of assets at year-end. What constituted a safety net in 2011 should now allow us to benefit from attractive risk premiums on both equities and corporate bonds in 2012.

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With over 45 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 two subsidiaries in Luxembourg and Frankfurt and two offices in Madrid and Milan, and recently registered its range of products for professional investors in Singapore.

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