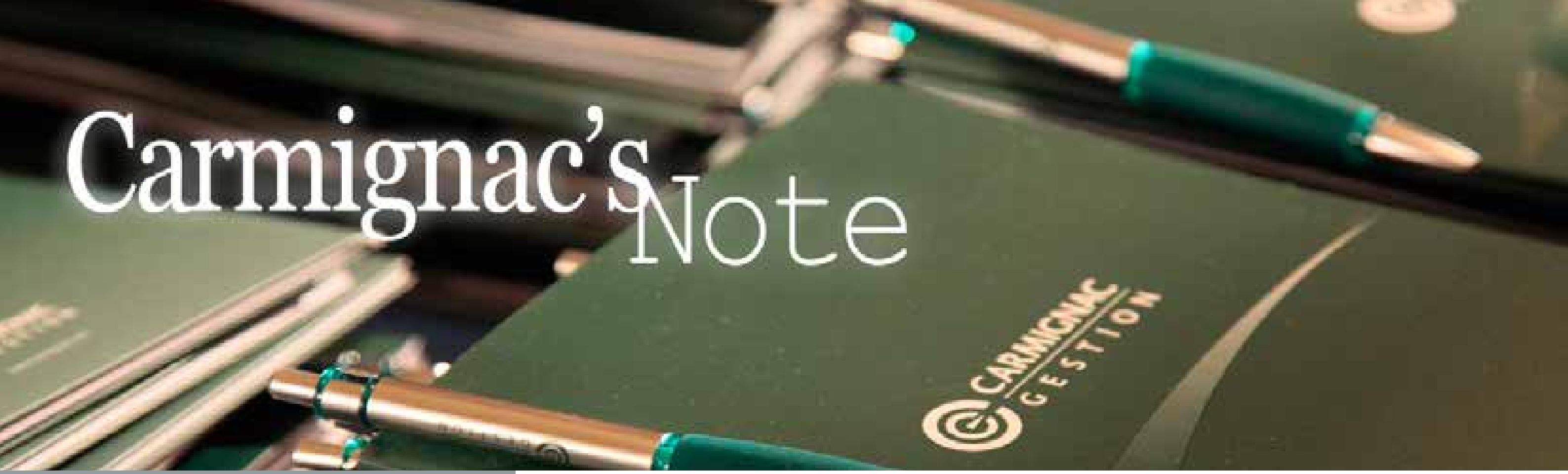


Carmignac's Note

OCTOBER 2014 // N°74

BY **DIDIER SAINT-GEORGES**
Member of the Investment Committee

Our concerns

Financial markets' strong performance over the last five years reflects economies' recuperation after the deep crisis of 2008 and the unprecedented intervention of central bankers. It is entirely possible that the rose-tinted scenario of a modest but prolonged global economic cycle, with interest rates kept relatively low under central banks' watchful eye, would continue. Equity markets would then carry on performing respectably, while bond prices would undergo a modest correction. However, this scenario is built on numerous imbalances which we fear might prove difficult to resolve peacefully. The recent accumulation of risk factors has made us even more alert.

The challenges of eurozone growth

A scenario of massive deflation in the eurozone is certainly over-the-top and Mario Draghi's determination to do whatever it takes to stimulate the region's economy is a considerable asset. But very low inflation, which Draghi himself admits is bedding down for the medium term, and very sluggish growth cast doubts over the future of countries burdened by heavy public debt and a lack of competitiveness. In this regard, we find the cases of Italy and France worrying. Whereas in Spain, Portugal and Ireland disinflation is largely the result of a bold productivity drive now underpinning an upturn in foreign trade, in France and Italy a lack of economic activity is to blame. Italy may still have a fiscal surplus of 2.3% before interest charge but by our estimates it would have to double this primary surplus to start bringing its public debt ratio down (currently 135% of GDP). This challenge presents a greater risk to economic growth, heightened by Matteo Renzi's attempts to implement his much-needed structural reforms. France's public debt will soon be hitting 100% of GDP and, unlike Italy, the country is suffering from a structural budget deficit before interest charge. So with inflation very low, the adjustments required to regain control of French public finances will continue to weigh on growth. Germany has seen its business climate deteriorate considerably since the beginning of the year and the German government has confirmed its commitment to balancing the budget, thereby ruling out fiscal support for its European partners. There just remains the positive impact that a sharp fall in the value of the euro following the ECB's initiatives (see Carmignac's

Note for September) would have on export-based economies. We should not kid ourselves though: Germany will be the main beneficiary given its strength in foreign trade, while this depreciation of the single currency will further erode Italian and French consumers' purchasing power. The safety net provided by the European Central Bank should retain foreign investors' confidence in the stability of the European financial system. And the introduction of measures to encourage bank lending could marginally improve the funding of medium-sized companies. But it

> *"A slide into very weak inflation would be a major challenge for the most heavily indebted European countries."*

will take more than that to set the eurozone back on a convincing path over the medium term. We recently further reduced our exposure to European economic risk.

The main threat in the United States remains that of a monetary policy mistake

While the strength of the real economy should not be overestimated in the United States, it is still undeniably reassuring. The extraordinary profusion of liquidity pumped in by the Fed over the last five years has not only avoided the worst but has given the banking system time to recapitalise and the property market time

> *"Weak growth and high public debt make economies vulnerable to external shocks."*

to stabilise. At the same time, the energy revolution and productivity gains have made the US economy highly competitive. Growth, however modest, combined with low inflation form a perfectly acceptable cocktail for equity markets. The tension lies elsewhere: the Fed's intervention has benefited financial investment much more than industrial investment or US workers' disposable income. Our concern now is the fine balance that the Fed will soon have to strike between starting to return its monetary policy to normal in order to reduce future risks of financial instability, and pursuing a highly accommodative monetary policy to sustain a precarious economic recovery. The risk of a monetary policy mistake at what is still a fragile point in the cycle justifies the emphasis that we are placing in our US investments on companies with superior earnings visibility.

Emerging countries unequal in their risk factors

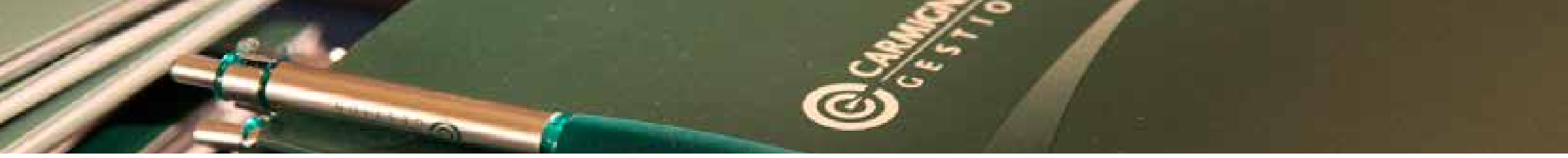
Situations now vary greatly in the emerging world. Paradoxically, the Chinese slowdown raises more problems for the rest of the world than for China. The ongoing fall in the property market is certainly worrying and explains why we pulled out of the banking sector a long time ago. But the Chinese authorities have the leeway needed to manage safely the economic deceleration. On the other hand, the slowdown amplifies deflationary pressures in Europe and presents a major hurdle for Brazil and South Korea, whose economies have traditionally been highly dependent on China's. South Africa and Turkey, which still run substantial current account deficits (unlike China, South Korea or Taiwan), would be much more vulnerable to any reduction in global liquidity and its side-effect, a sharp rise in the value of the dollar. Meanwhile, the destinies of Mexico and India depend largely on the two countries' individual merits. We are therefore positioned very selectively in this chequered investment universe.

Japan at a crossroad

Extricating Japan from a long period of very weak nominal growth, just as the West is entering one, represents a sizeable challenge for Shinzo Abe. To remain credible, the determination shown 18 months ago will have to be stepped up. The jury is still out in this respect and we will wait for confirmation of the second wave of Abenomics before strengthening our positions, which we have been reducing over the year.

The markets are embarking on a tricky new stage: at a time when weak economic growth, high public debt and global deflationary pressures are making western economies more vulnerable to external shocks (including geopolitical ones), central banks are starting to fear the risks that their extremely accommodative policies present to the stability of the financial system (Germany is making sure that Mario Draghi keeps this in mind). Added to that is the hysteresis of any deep financial crisis: credit paralysis, which stops the private sector from recovering while the public sector is hand-cuffed by its deficits. While market valuations and technical analyses do not give any particular indication that a turning point is imminent, it seems wise to factor all of these concerns into prudent asset management. This means reducing equity exposure and in particular scaling back commitments to cyclical sectors, having lower exposure to the euro and, conversely, strengthening positions in the dollar and quality growth stocks, while remaining very flexible in managing interest rate risk.

Drafting completed on 3 October 2014



INVESTMENT STRATEGY

CURRENCIES

The euro fell more steeply against the US dollar over the month, down nearly 4%. This made a significant contribution to our funds' performance. For the ECB, a cheaper euro would appear to be a key factor in countering the deflationary pressures weighing on the continent. We therefore expect this trend to continue, especially as the dollar is also supported by the prospect of US monetary policy normalisation. We are thus maintaining our long dollar allocation. Exposure to the US dollar amounted to 90% for Carmignac Investissement and 64% for Carmignac Patrimoine at the end of the month.

RATES

The ECB used some of the little leeway over interest rates that it had left, lowering its main refinancing rate from 0.15% to 0.05% during the month. The Bank is now expected to focus on asset purchases to counter the deflation risk. Eurozone banks' low participation in the first allotment of TLTRO funds raised the markets' hopes of the ECB buying assets directly to increase its balance sheet, as Mario Draghi would like. In this context, long-term peripheral sovereign bond yields continued their downtrend. Conversely, US yields were up over the month with Janet Yellen's very balanced speech suggesting that US monetary policy will start returning to normal in 2015. Our funds benefited from yields falling in Europe as they rose in the United States. Our funds' modified duration barely moved over the month, remaining modest at +2.4 for Carmignac Patrimoine, +3.3 for Carmignac Portfolio Emerging Patrimoine, +2.6 for Carmignac Portfolio Global Bond, +1.4 for Carmignac Sécurité and +0.4 for Carmignac Portfolio Capital Plus.

EQUITIES

Equity markets underwent a sharp correction in September, putting an end to the highly optimistic market consensus. Emerging markets were the primary victims of this adjustment, especially Brazil, whose performances are fluctuating in line with opinion polls for the impending presidential election. However, Japan rallied by nearly +5% over the month. The Japanese market's idiosyncratic behaviour helped smooth the performance of our global strategy. During the month, our stock selection became even more defensive, with new positions added to our global healthcare leaders theme. Meanwhile we reduced our exposure to European domestic stocks (especially banks) to concentrate our European allocation on companies most likely to benefit from a weak euro. As well as making our portfolios more defensive, we reduced our equity exposure over the month: 44% for Carmignac Patrimoine and 39% for Carmignac Portfolio Emerging Patrimoine at the end of the month.

COMMODITIES

Carmignac Portfolio Commodities benefited from its allocation favouring energy over mining to absorb some of the shock from the equity market sell-off. We are continuing to focus our positions on solid cash flow generating companies that are poorly understood or undervalued by the market.

FUNDS OF FUNDS

Our funds of funds turned in a slightly positive performance over the month. Volatility strategies, which we implemented to protect the funds from any correction, remain our primary risk management instrument. Alongside these strategies we reduced our equity exposure somewhat: 84%, 58% and 42% for Carmignac Profil Réactif 100, 75 and 50 respectively at the end of the month. Carmignac Investissement Latitude's equity exposure stands at 89%.

FUND PERFORMANCE

	NAV	2014	1 year	3 years	5 years
Carmignac Investissement F GBP acc Hdg	**109.52**	**4.40%**	**11.36%**	**26.19%**	**-**
MSCI AC World NR (Eur)	-	*13.15%*	*19.29%*	*53.48%*	-
Carmignac Portfolio Grande Europe F GBP acc Hdg	**111.71**	**8.72%**	**14.68%**	**38.89%**	**-**
Stoxx 600 NR (Eur)	-	*7.01%*	*13.52%*	*49.61%*	-
Carmignac Emergents F GBP acc Hdg	**98.33**	**8.59%**	**11.51%**	**19.23%**	**-**
MSCI Emerging Markets NR (Eur)	-	*11.73%*	*11.77%*	*18.99%*	-
Carmignac Portfolio Emerging Discovery F GBP acc Hdg	**100.53**	**16.07%**	**16.35%**	**34.17%**	**-**
50% MSCI EM SmallCaps NR (Eur) + 50% MSCI EM MidCaps NR (Eur)	-	*14.94%*	*14.81%*	*23.66%*	-
Carmignac Portfolio Commodities F GBP acc Hdg	**69.77**	**13.06%**	**14.72%**	**-0.71%**	**-**
*Carmignac Commodities Index**	-	*8.14%*	*9.53%*	*10.10%*	-
Carmignac Patrimoine F GBP acc Hdg	**107.84**	**6.55%**	**10.97%**	**11.50%**	**-**
50% MSCI AC World NR (Eur) + 50% Citigroup WGBI (Eur)	-	*12.09%*	*13.51%*	*23.38%*	-
Carmignac Portfolio Emerging Patrimoine F GBP acc Hdg	**98.27**	**9.29%**	**8.41%**	**6.19%**	**-**
50% MSCI EM NR (Eur) + 50% JP Morgan GBI EM Global diversified	-	*10.41%*	*8.66%*	*12.43%*	-
Carmignac Portfolio Global Bond F GBP acc Hdg	**116.15**	**10.98%**	**14.89%**	**11.81%**	**-**
JP Morgan Global Government Bond (Eur)	-	*10.82%*	*7.49%*	*-2.16%*	-
Carmignac Portfolio Capital Plus F GBP acc Hdg	**1,116.14**	**2.76%**	**4.31%**	**12.63%**	**-**
Eonia compounded	-	*0.10%*	*0.13%*	*0.64%*	-

** 45% MSCI ACWF Oil and Gas NR (Eur), 5% MSCI ACWF Energy Equipment NR (Eur), 40% MSCI ACWF Metal and Mining NR (Eur), 5% MSCI ACWF Paper and Forest NR (Eur) and 5% MSCI ACWI Chemicals NR (Eur) as from 01/07/2013. Annually rebalanced as from 01/01/2012.*

CARMIGNAC GESTION

CARMIGNAC GESTION
24, place Vendôme – 75001 Paris
Tél : (+33) 01 42 86 53 35 – Fax : (+33) 01 42 86 52 10
Portfolio management company
(AMF agreement n° GP 97-08 of 13/03/1997)
Public limited company with share capital of € 15,000,000 -
RCS Paris B 349 501 676

CARMIGNAC GESTION LUXEMBOURG
City Link, 7, rue de la Chapelle – L-1325 Luxembourg
Tél : (+352) 46 70 60 1 – Fax : (+352) 46 70 60 30
Subsidiary of Carmignac Gestion
UCITS management company (CSSF agreement of 10/06/2013)
Public limited company with share capital of € 3,000,000 -
RC Luxembourg B67549