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CARMIGNAC ABSOLUTE RETURN EUROPE: LETTER FROM THE FUND MANAGERS

16/04/2024 | DEAN SMITH, JOHAN FREDRIKSSON

Over the first quarter of 2024, ***Carmignac Absolute Return Europe*** *realized a positive performance of +4.95%.*

MARKET COMMENTARY

After a strong year-end rally in 2023, markets came into 2024 screening overbought. Subsequently a stronger than expected US inflation print in January, drove a sudden reversal of bond markets with yields quickly rising from the December lows, which in turn, catalysed a quick rotational correction in European equities with cyclicals giving back some of their Q4 gains and underperforming defensives by more than 5%.

From a macro standpoint the dominant theme through the quarter was the timing of Fed interest rate cuts being repriced, shifting from March to June and at time of writing even putting July in question. In Europe, by contrast CPI' readings have continued to be more supportive to a cut with the first one anticipated to come in June. Despite US rate cuts being 'pushed out', market seems to be taking this in its stride as it is being accompanied by increasing evidence that the US economy remains robust and a number of the leading indicators including PMI's and Zew survey (EU) are showing sequential improvement at the same time as inflation data although hotter than expected is still trending down. **This backdrop has created a positive environment for equity markets which now increasingly looks to price a benign 'Goldilocks ' soft landing scenario which has continued through Q1 and driven the market rally**. Within Europe during Q1, cyclicals outperformed defensives with the best performing sectors being Autos, Technology, Banks and Industrials while the main laggards were Basic Resources, Utilities and Real Estate.

PERFORMANCE COMMENTARY

The fund produced a positive return of +4.95% net of fees and since taking over the management of the fund in September last year, we are pleased to report 6 consecutive months of positive investment returns, putting us well on track to achieve our long-term objectives (10-12% pa performance net of fees).

As we continue to gain evidence that our investment process is working well, we recently begun as per our plan to increase the size of the funds gross exposure by increasing position sizes across both our long and short positions. Our gross exposure has now gone up from around 100% to apr.135%. Our net exposure was gradually increased throughout the period to around the mid 20's%, but it remains a moving target depending on how we navigate risk from one week, month to another. Our typical range for our adjusted net exposure during the period has been 20-30%.

At the stock level, with growing confidence in a more constructive backdrop to the market we continued to add to our positions in technology, consumer discretionary and banks. Within technology we have continued to build on the theme of AI beneficiaries. We've added to our existing semiconductor positions, including AI and more recently added new positions in manufacturers of processors and memory, essential for the operation of the AI models along with software beneficiaries.

In consumer discretionary we added to low-cost airlines where we believe the backdrop of short haul pricing is likely to continue to surprise the market to the upside. The EU short haul market continues to be very tight given the ongoing delays for new airplanes being delivered to airlines (Boeing's issues). This continues to drive higher airfares, which in turns will give rise to further earnings upgrades against share prices which are still trading significantly below their pre Covid valuations. Similarly, we believe the stock market is pricing in an overly conservative outlook for Autos against their much too low valuations. Also, both these sectors are deep value which is a factor we want to add exposure to.

Profits were taken in some of our luxury goods names which have performed well and now face slowing growth with difficult year on year comparable. However, once we are through the H1 period, comps again get easier and we would look to add back exposure on the long side, possibly as soon as after / during the Q1 reporting season. Elsewhere we added to retail banks where we see opportunities in names with still too low valuations and with surplus capital that will be returned to shareholders. Across the industrial sectors we added to long cycle businesses with strong order books in areas such as Aerospace.

Whilst it has been very important to ensure that we got our long book stock selection right, it has been equally important to carefully manage our short stock portfolio in rising market and at a time of potential economic inflections, making sudden burst of short squeezes potentially very costly. We have reduced or covered a number of cyclical shorts positions to protect the portfolio against unnecessary losses but will certainly look to revisit these later in the year.

Within the portfolio the largest positive returns YTD have come from technology, banks, consumer discretionary, industrials and healthcare. The main detractors at the sector level were Utilities, Real Estate and Staples with small losses.

Winners:

- Nvidia: Long-Significant earnings beat and strong order growth for the world leader in chips to power AI.
- Prada: Long-earnings ahead of expectations with margin improvement confirming successful restructuring and turnaround for this iconic luxury brand.
- Micron: Long-Memory cycle reaccelerating after an18 month down cycle with strong orders for AI applications.
- Novo Nordisk: Long-Positive earnings revisions from GLP-1 weight loss drugs and new applications for Seraglutamide.
- Adyen: Long-Top line recovery after a disappointing q3 report due to scaling up of new customer wins.

Losers:

- Snap: Long-reported advertising growth below expectations.
- Norwegian industrial: Short-short covering rally for industrial stock with challenged fundamentals.
- Telecom Italia: Long -disappointing guidance on cash generation at capital markets day.
- Prudential: Long-Negative sentiment towards China exposed businesses, Asian growth slower than expected.
- Puma: Weak demand and inventory correction in the global sports shoe market.

OUTLOOK

As stated with our monthly update last week, the early part of April is expected to be relatively quiet from a corporate news flow stand point, and instead most of the focus well be on the macro, political developments (middle east, and particularly any potential impact on oil prices) & various Fed speaker commentary. The ongoing debate on rates and inflation expectations continue to dominate with macro data being mixed. Indeed, with the most recent soft macro data having surprised to the upside, Fed rate cut expectations continues to be pushed out. Therefore, this week's CPI print will probably mark the most important data point for the Fed YTD. Should we yet again get a 'hotter' inflation print for March, the risk is that the market will quickly push out Fed cuts even further and fueling the debate to whether we get any cuts at all this year?

But very soon the attention will swiftly again shift back to corporate earnings and the key question most investors will be asking is whether momentum can continue to deliver. We have already seen some stalling of Technology and the Nasdaq itself losing relative performance over the last month, and the question is, if this is just an 'air pocket' or the start of new leadership emerging and a more sustainable broadening out of the market? The argument for the latter would be that the macro data (PMI's, employment etc.) continues to improve, with the economies around the world slowly improving.

However, even if the top-down macro picture is giving us ‘hints’ of improving economic activity, which in turn is beginning to drive relative performance of value and cyclicals (especially in EU), we now need to closely monitor whether corporate earnings / forward expectations commentary of those companies can ‘accompany’ and support that performance? Have these sectors ‘travelled too far too soon’, without giving us the earnings revisions the market might now be pricing? In our view, the Banks, Chemicals & Autos are likely to deliver enough in Q1 to support ongoing performance and we continue to be weighted accordingly. In addition, all eyes are now firmly back on China. China’s PMIs have also started to show signs of improvements.

Therefore, taking all this into account, especially considering how most global investors are still very narrowly positioned to a few selective sectors, (Tech, Quality growth etc.) we think it is sensible to start selectively broadening out our exposure to a more balanced and ‘bar-belled’ portfolio. In part, as our regular readers will know, we do already have decent exposure to Value & Cyclicality in our book (which is already contributing to our YTD performance, through Banks, Cyclical chemicals, Airlines, and deep value Autos. And to us, the question is now whether we continue to add to these sectors? The decision to do that will be dependent on the upcoming macro news unfolding on inflation expectations and above all, Q1 corporate earnings. In addition, as per usual during Q2 we will be spending quite a bit of time meeting with corporates at various upcoming conferences. Usually these meetings prove to be very timely and valuable in terms to how to balance the risk of the portfolio and individual stock positions into the usually tricker to navigate months during the summer. Expect us to comment more on this In upcoming monthly letters.

However, not to confuse any of our readers, **we still very much believe in the structural stories within Tech, AI & semis in particular, which continues to make up our single largest core Long exposures**. In addition to AI linked stock positions, we have continued to increase our longs in memory names. We firmly believe that the amount of compute required, not only into the cyclical upturn in the sector, but above all due to the structural drivers will be enormous. As such, even if several of these stocks have done v well YTD, we continue to see material upside from here. And we believe that the news flow will not only be supportive, but that earnings upgrades will accelerate. We continue to believe that the current environment provides a fertile hunting ground for long short investors.

CARMIGNAC ABSOLUTE RETURN EUROPE A EUR ACC

(ISIN: FR0010149179)

SFDR - Fund Classification** :

Article 8

Recommended minimum investment horizon

MAIN RISKS OF THE FUND

RISK ASSOCIATED WITH THE LONG/SHORT STRATEGY: This risk is linked to long and/or short positions designed to adjust net market exposure. The Fund may suffer high losses if its long and short positions undergo simultaneous unfavourable development in opposite directions. **EQUITY**: The Fund may be affected by stock price variations, the scale of which is dependent on external factors, stock trading volumes or market capitalization. **INTEREST RATE**: Interest rate risk results in a decline in the net asset value in the event of changes in interest rates. **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.

*Risk Scale from the KID (Key Information Document). Risk 1 does not mean a risk-free investment. This indicator may change over time. **The Sustainable Finance Disclosure Regulation (SFDR) 2019/2088 is a European regulation that requires asset managers to classify their funds as either 'Article 8' funds, which promote environmental and social characteristics, 'Article 9' funds, which make sustainable investments with measurable objectives, or 'Article 6' funds, which do not necessarily have a sustainability objective. For more information please refer to https://eur-lex.europa.eu/eli/reg/2019/2088/oj.

FEES

Entry costs : 4,00% of the amount you pay in when entering this investment. This is the most you will be charged. Carmignac Gestion doesn't charge any entry fee. The person selling you the product will inform you of the actual charge.

Exit costs : We do not charge an exit fee for this product.

Management fees and other administrative or operating costs : 2,30% of the value of your investment per year. This estimate is based on actual costs over the past year.

Performance fees : 20,00% max. of the outperformance if the performance is positive and the net asset value exceeds the high-water mark. The actual amount will vary depending on how well your investment performs. The aggregated cost estimation above includes the average over the last 5 years, or since the product creation if it is less than 5 years.

Transaction Cost : 0,98% of the value of your investment per year. This is an estimate of the costs incurred when we buy and sell the investments underlying the product. The actual amount varies depending on the quantity we buy and sell.

PERFORMANCE (ISIN: FR0010149179)

Calendar Year Performance (as %)	2014	2015	2016	2017	2018
Carmignac Absolute Return Europe	+2.5 %	-8.0 %	+8.9 %	+14.6 %	+4.4 %

Calendar Year Performance (as %)	2019	2020	2021	2022	2023
Carmignac Absolute Return Europe	-1.3 %	+5.2 %	+12.6 %	-6.4 %	+0.0 %

Annualised Performance	3 Years	5 Years	10 Years
Carmignac Absolute Return Europe	+2.0 %	+3.9 %	+3.3 %

Source: Carmignac at 31 Oct 2024.
Past performance is not necessarily indicative of future performance. Performances are net of fees (excluding possible entrance fees charged by the distributor).

Marketing communication. Please refer to the KID/KIID, prospectus of the fund before making any final investment decisions. This document is intended for professional clients.

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