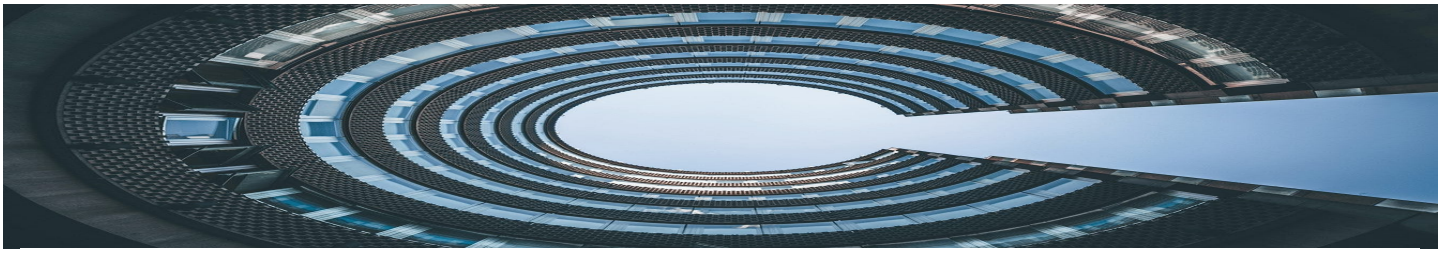

Investment Strategy - December 2022

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Central banks in the developed world kicked off a super-cycle of rate hikes in December 2021, and now, one year later, they've underscored their resolve with a decidedly hawkish stance.

The US Federal Reserve has indicated that its monetary policy isn't yet tight enough, and that once it is, it will stay that way through the end of 2023. The European Central Bank (ECB) has raised its inflation forecasts substantially and suggested that its terminal rate for this hiking cycle will exceed 3%. Meanwhile, the Bank of Japan surprised analysts by widening the range in which the yield on Japanese 10-year bonds is allowed to fluctuate, essentially paving the way to higher rates.

The decisiveness of central banks triggered a steep decline in bond indices (the yield on 2-year German Bunds jumped 30 bp in a single day) and in equity indices (with the Nasdaq 100 shedding 9% over the month). December was emblematic of a trend that occurred throughout the year: namely, a correlated, downwards slide in both stocks and bonds, depriving investors of the safe haven that can be typically found in fixed income, and which had historically been useful in times of stock-market turmoil.

2022 also confirmed a shift that we first mentionedover a year ago: it's now inflation, rather than central banks, that is setting the level of interest rates. This is reflected in the fact that central bankers are racing to keep up with inflation, which points to a more cyclical economy going forward and highlights the merits of active investment approaches. Such approaches are better able than passive ones to respond and adapt to swings in the trajectories of economic growth and inflation.

The one development that really stood out in late 2022 was Beijing's decision to put an end to its zero-Covid policy. By removing border restrictions in China, the government took the final step in fully reopening the country, a process that had started in November when measures were first eased but which was not expected to conclude before the end of 2023.

Local stock markets rallied on the news, despite the swift pace of this policy reversal and the country's subpar vaccination efficacy . Many investors were surprised by Beijing's decision. It means that China will soon return to its role as a driver of the global economy; it will also have an impact on both growth and inflation, which is something investors will need to factor into their investment strategies in 2023.

Main portfolio movements

Central bankers appear determined to fight inflation – but this doesn't mean the "whatever it takes" mantra still applies. In Europe, for example, the ECB seems ready to raise its key interest rate to 3.5% and shrink its balance sheet in the coming quarters. But it won't want to risk seeing the borrowing costs for the eurozone's most heavily indebted countries rise too suddenly, especially since a hefty volume of new sovereign-bond issues is scheduled to hit the market in early 2023 (over €100 billion in January alone). A steep rise in interest rates in those countries would carry too high a risk of eurozone fragmentation.

We continued to gradually deploy our cash in December. We built up our holdings of Italian sovereign bonds, as the yield on 10-year maturities has risen to over 4.5%, providing a particularly attractive carry opportunity. Monetary policy in the eurozone will return to normal only if policymakers can find a way to limit the rise in spreads in peripheral countries.

This observation also prompted us to further increase our euro exposure, which stood at 85% in ourCarmignac Patrimoine fund at end-December 2022. Inflation will be stronger in the eurozone than in the US in the coming quarters, meaning the EUR/USD interest-rate differential should narrow. In addition, the single currency had been dragged down by skyrocketing energy prices until last autumn, but those prices have fallen to below where they were before the war in Ukraine broke out.

We actively managed both our stock-market and our interest-rate risk in December. Carmignac Patrimoine's net equity exposure hovered between 20% and 28%, where it ended the year, and the fund's modified duration ranged between 3.2 and 2.7.

We believe this new year will bring rewarding opportunities for thosebold enough to return to sectors and regionsthat most investors have overlooked or even forgotten in recent years.

Read our latest analyses

Carmignac Patrimoine A EUR Acc

ISIN: FR0010135103

Recommended minimum investment horizon

Lower risk Higher risk

1	2	3*	4	5	6	7

Main risks of the Fund

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.

CREDIT: Credit risk is the risk that the issuer may default.

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.

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.

Past performance is not necessarily indicative of future performance. Performances are net of fees (excluding possible entrance fees charged by the distributor). The return may increase or decrease as a result of currency fluctuations, for the shares which are not currency-hedged.

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