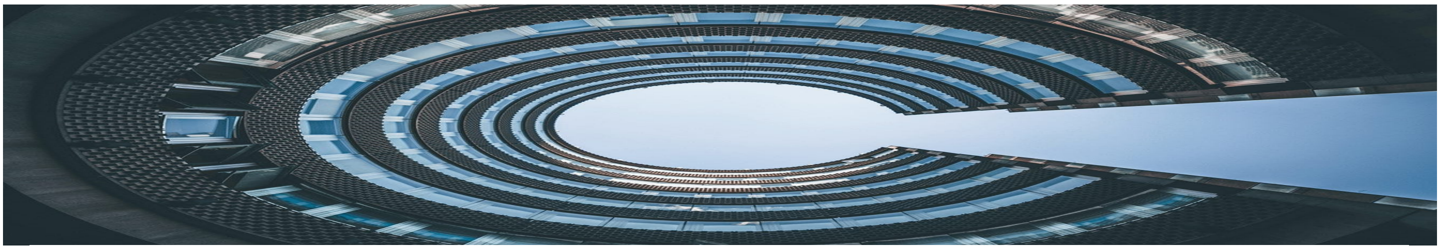

Our monthly investment review: October 2022


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How far high can you tune a guitar string before it breaks?

Last month, investors assumed that central banks would finally emulate guitarists. To tune their guitars, musicians turn the knobs on the headstock of their instrument to tighten or loosen each string and change the pitch of the sound produced. However, such an operation requires a certain amount of skill, as tightening the string too aggressively can break it. Therefore, guitarists proceed with caution, plucking one string, listening to the sound it makes, and then gently readjusting it if necessary.

Thus, investors hoped in October, that central banks would seek to “fine-tune” their decision by adjusting their monetary policy to the inflation, without “breaking a string”, i.e. preserving financial stability. After all, didn’t the Bank of England put a stop to its monetary tightening plan when UK pension funds were threatened by the exponential rise in long-term yields?

Investors were also hoping that the world’s big money men would “pluck the string and listen to the sound it makes” before they touched the knobs again, i.e. they would assess the impact of the current level of interest rates on the real economy. Indeed, this is what some central banks officials were probably hoping for as well, given the unease of some of them at the US Federal reserve (Fed) about sharp rate hikes as reported by the_ Wall Street Journal_, or the Bank of Canada’s decision to raise rates by 50 basis points (bp) rather than the anticipated 75, citing concerns about slowing demand and the housing market.

Will central bankers pay more attention to growth?

But beware, it would be unwise to anticipate any monetary pivot. Even if inflation is falling from its peak, it is still high and is likely to remain so in the future. Moreover, the tolerance threshold of governments and institutions probably varies from country to country, as economic situations are very heterogeneous. Not forgetting that the European Central Bank (ECB) raised rates by 75 bp last month – its third consecutive increase this year.

Nevertheless, central bankers and investors are likely to focus increasingly on growth, which is expected to be very disappointing as inflation continues to affect it -as illustrated by the decline in activity of big tech companies and their gloomy outlook. Therefore, while 2022 is likely to be the year of front loading and the rush by central banks to raise short-term rates, 2023 may well be the year of central banks observing and monitoring the impact of higher rates on economies.

The hope that central banks would pay more attention to economic growth gave the bond market some respite in October – the US 10-year yield reached 4.3% before falling back below 4%-, the euro recovered against the US dollar, and equities in developed countries rebounded.

In contrast, emerging markets suffered from the political situation in China, where President Xi Jinping's consolidation of power following the 20th National Communist Party Congress suggested that China's zero-covid policy and economic interventionism are here to stay. However, the Chinese government is expected to continue to roll out growth support measures, many of which may be unveiled at the Central Economic Work Conference in December.

Changes in Carmignac Patrimoine’s portfolio

Taking advantage of widespread bearishness and renewed pessimism at the beginning of October, combined with an impending inflation spike (base effects from last year, measures to limit the negative impact of high energy prices) as well as a shift in market narrative as central bankers tuned their tone, we took profits on most of our protections on equity markets. That decision was also a result of what history teaches us, namely that bear market rallies can be powerful and turn into more sustainable trends.

We believe that the current extreme pessimism and falling valuation levels that make some assets attractive should support the visible growth stocks in our portfolio until the end of the year. We have also lifted some of our protections on our credit portfolio.

The stabilisation of interest rates should offer some relief to this asset class, which we believe incorporates a lower level of implied default rate than valuations suggest. And given the current yield of our fixed income book of around 6%, the passage of time has become an ally of portfolio construction – providing meticulous bond selection.

Equity

Increased our exposure to the consumer staples sector given its resilience in the face of increasing margin pressures and a build-up of consumer spending concerns.

Increased our exposure to the food and beverage sector, which could be resilient in a recession, as suggested by Coca-Cola's earnings growth this quarter.

Bonds

Increased our allocation to long-term US sovereign bonds to cope with disappointing future growth, as we saw some form of dislocation between prices and fundamentals with 30-year yields moving to 4.4% (+1% over a month) despite a grimmer growth outlook.

Gold

Increased our exposure to gold, as lower real yields associated with the economic slowdown should help the yellow metal regain its 'store of value' status.

Markets are not one-way, and in times of extreme and widespread downturns, recognising that it can be useful to be contrarian is essential to achieving less correlated returns. In the same way that sometimes you need to know not to over-stretch a string in order to preserve it and prevent it from breaking.

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.

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