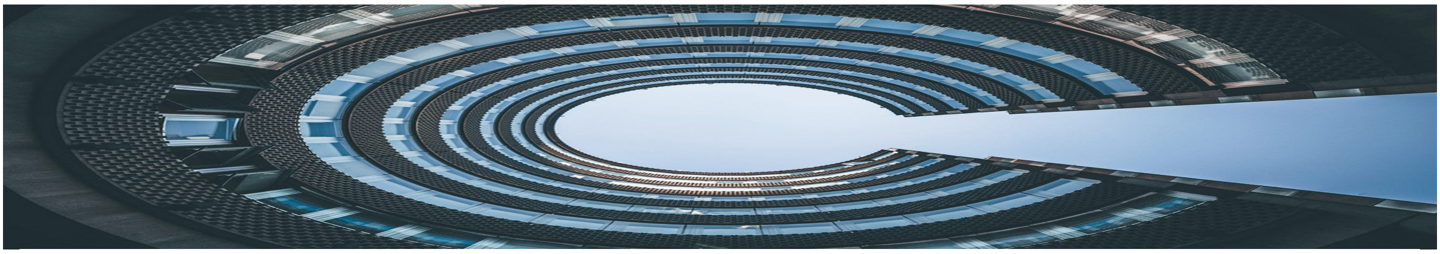

Our monthly investment review: September 2022


Author(s)
Kevin Thozet

Published
October 11, 2022

Len

September showed no respite from this year's slump in financial markets. The month will likely go down as (another) one for history books.

What a month!

Inflation set new records, reaching double digits in Germany for the first time in almost 40 years. The European Central Bank stepped up the pace of monetary tightening with its first-ever 75 basis point hike. GDP growth forecasts were again revised downwards, with the OECD now predicting a further slowdown in global growth in 2023, to just 2.2% for the full year. Even the resilient US economy experienced the biggest fall in house prices in over a decade.

The above factors triggered knee-jerk price action in financial markets, regardless of the quality of the assets in question. Even those considered the safest (i.e. with little or no risk of default) suffered steep price declines – German 10-year bonds, for instance, lost 7% over the month – while riskier assets became even more volatile. The number of times the Nasdaq has recorded monthly losses of this magnitude can be counted on one hand. Equity and bond prices are correlating to the downside.

These sell-offs are threatening market stability. Liquidity has contracted as a result of the tighter financial conditions (by some measures, liquidity conditions are as bad now as they were in March 2020), prompting concerns about market dislocation. This is especially salient in markets where the price movements have been the most severe.

The UK provides a cautionary tale

When the British government under new Prime Minister Liz Truss unveiled its tax-cutting mini-budget, UK sovereign bond yields accentuated their already upwards trend and jumped by 1.5% within days. This in turn threatened financial-market stability and the ability of pension funds to meet their obligations.

Whenever financial markets are subject to this kind of Value at Risk (VaR) shock (i.e. the total loss a market could incur over a given period), central bankers move quickly to avoid a liquidity crunch at all costs. In this case, the Bank of England immediately announced it would buy up to £65 billion in outstanding long-term debt over a two-week period – an amount equivalent to what the BoE had planned to sell over all over the next 12 months.

A stark reminder of how quickly central banks can change course

In the current inflationary environment, governments cannot keep funding their unconditional fiscal deficits with public debt, since neither investors nor central bankers are willing to play ball.

They will eventually come around, but their pain threshold is likely to be higher, meaning market conditions and the macro climate will have to get worse before they change their tune. In other words, stock prices will have to hit lower lows before central banks inflect their monetary policy - which would lead to a reversal of the downward market trend that has characterised the last nine months.

September movements in our portfolios

We kept our equity allocation in the lower end of our permitted range; the net equity exposure of Carmignac Patrimoine was maintained between 4% and 20%.

Looking at specific stocks, we took advantage of the market downturn to seize opportunities in quality companies that have historically been expensive and whose businesses should up hold well as the recession approaches. In the personal care and cosmetics sector, for example, the most cyclical categories are fragrances and make-up, while the most defensive one is skincare. We therefore added L'Oréal to our portfolio; skincare accounts for 40% of the company's revenue, and 22% of its revenue comes from China, making it the EU consumer-staples company with the second-largest exposure to the country.

Price multiples are now down by approximately 30%, which is consistent with a recessionary environment. In contrast, earnings forecasts have shed a mere 2%, whereas in previous recessions they generally dropped by 25% (and our own macroeconomic models point to a decline of 10%). This suggests a prudent approach to stock selection is called for.

We have maintained a cautious on credit markets, hedging some of our investments in our long-term convictions by implementing broad synthetic protection on indices. We're also keeping our modified duration at a conservative level. We have extended our hedges on Japanese and German interest rates: the Bank of Japan is one of the last remaining central banks with a dovish stance, and the German government is rolling out stimulus programmes to boost consumer demand.

Although market sentiment is extremely negative – with a widespread bearish mood and investors positioned for bad times ahead – true market lows generally occur only when central banks capitulate, which for now is a highly unlikely prospect. But the cracks starting to appear imply that active fund managers should be increasingly ready to redeploy their capital.

To read our latest analyses

Click here

Carmignac Patrimoine A EUR Acc

ISIN: FR0010135103

Lower risk Higher risk

Recommended minimum investment horizon

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.