INFLATIONARY RESURGENCE: BAD NEWS OR AN INVESTMENT OPPORTUNITY?

08/04/2025

While economists on both sides of the Atlantic were still targeting a drop in inflation to below the 2% threshold a few months ago, it would appear that price indices are once again on the rise. While excess inflation is generally considered harmful for financial assets, we advocate that a flexible bond strategy can take advantage of this type of adverse scenario.

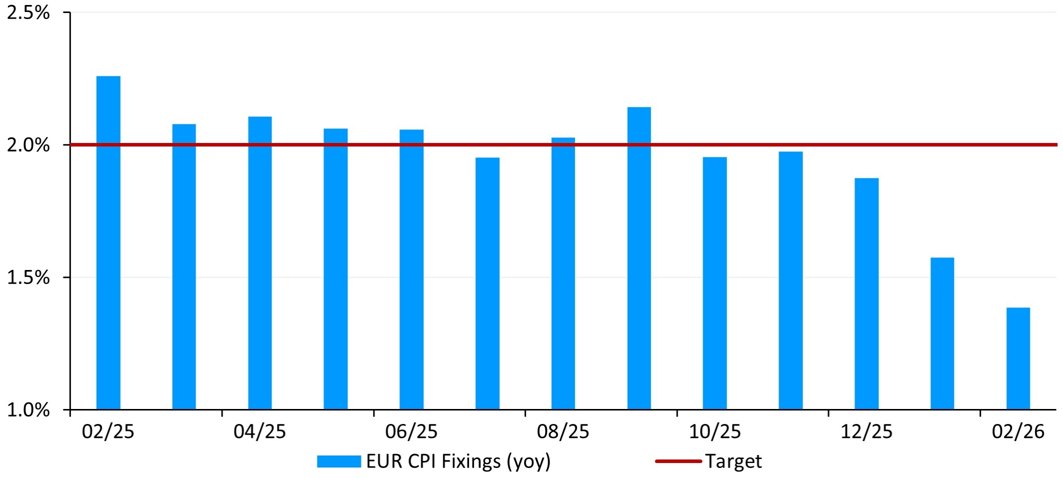
1) INFLATION, ALIVE AND KICKING

- Although the market deliberately buried inflation last summer, preferring to rally behind the theory of a slowdown in the growth of major economies, **it must be said that the price indices are ultimately showing more resistance than expected.**
- On the one hand, the strong economic activity across the Atlantic has helped boost American consumers, **as shown by the US core consumer price index[1], which recorded its 58th consecutive monthly increase in February** (and also accelerated sharply to +0.4% over the month of February).
- On the other hand, **the disinflationary lifeline provided by the decline in the price of raw materials seems to have run out of steam**, no longer allowing for favourable base effects in the calculation of inflation (see figure 2).
- This resurgence of inflation is not unique to the US economy, as the **euro zone has also been faced with an acceleration of price indices since September 2024**, despite a much more modest growth regime.

Figure 1: Long-term (5-year) inflation forecasts in the United States are at their highest level in more than 30 years
Source: University of Michigan, Bloomberg, March 2025.

Figure 2: Price dynamics of certain commodities (basis 100)
Source: Carmignac, Bloomberg, February 2025.

2) WHAT IS THE OUTLOOK FOR 2025?



Source: Citi, 24 Mars 2025.

- The common denominator of the latest meetings of the central bankers on both sides of the Atlantic **was an upward revision of the year-end inflation outlook**, which is now 2.3% for the European Central Bank (ECB) and 2.7% for the Federal Reserve (Fed).
- In addition to the resilience of core inflation, the recent announcements of tariffs on the trading partners of the United States, the willingness to relocate production chains in addition to the various stimulus plans for infrastructure and defence in the euro zone **are all bullish catalysts for inflation.**
- So, while a consumer price shock equivalent to that of 2022 seems unlikely in the near future, **the assumption of inflation persistently above the 2% target seems tangible.**
- Thus, as investors continue to expect a return below the inflation target in major economies (see figure 3 below), **euphoria could give way to neurasthenia, as it seems that 3% is the new norm for inflation.**

Figure 3: Investors remain very enthusiastic about the prospects for disinflation

3) HOW TO IMPLEMENT AN INFLATIONARY ENGINE IN A FIXED INCOME STRATEGY

- Although inflation generally erodes the value of bonds as a result of a loss of real return on investments, **there are various instruments available to protect or even benefit from an inflationary rebound.**

Strategy via inflation-indexed bonds

In order to protect their investments from the inflationary effect, investors could purchase inflation-indexed bonds, i.e. with a principal and also a coupon that are indexed daily to changes in consumer price indices. Thus, if inflation increases, then the coupon of the instrument will increase as will the valuation of the principal of the bond.

Strategy via "breakeven inflation"

Breakeven inflation represents the difference in yield between nominal and real rates. It thus corresponds to the average inflation expected by the market over a given period. If we return to Fisher's equation[2] and isolate this breakeven inflation, we obtain:

Expected inflation = nominal rate – real rate

So, if you anticipate a rise in inflation without wanting to take interest rate risk, you can position yourself solely on this break-even inflation rate. To do this, you buy inflation-indexed bonds and sell nominal rates, thus neutralizing the rate movement, and position yourself solely on inflation.

If you want to position yourself on a fall in inflation and therefore in the break-even inflation rate, you can simply sell real rates and buy nominal rates. Note that it is also possible to do this with derivatives such as inflation swaps.

Strategies via nominal rates

Nominal rates can also be used to express a view on inflation; however, because nominal rates are used rather than real rates, it also implies a view on duration. A rise in inflation generally leads to a tightening of monetary policy, resulting in rate hikes. Selling positions on nominal rates can therefore be a way to take advantage of this. It is also an adequate tool, in terms of liquidity, for intervening in certain emerging market countries.

- Finally, the sectoral allocation also plays an important role within credit spectrum. **Certain sectors such as energy or financial are generally more inclined to benefit from this type of inflationary dynamic.**Conversely, sectors with low levels of profitability or significant leverage such as distribution, automotive or real estate are more sensitive to inflationary shocks or upward movements in interest rates.

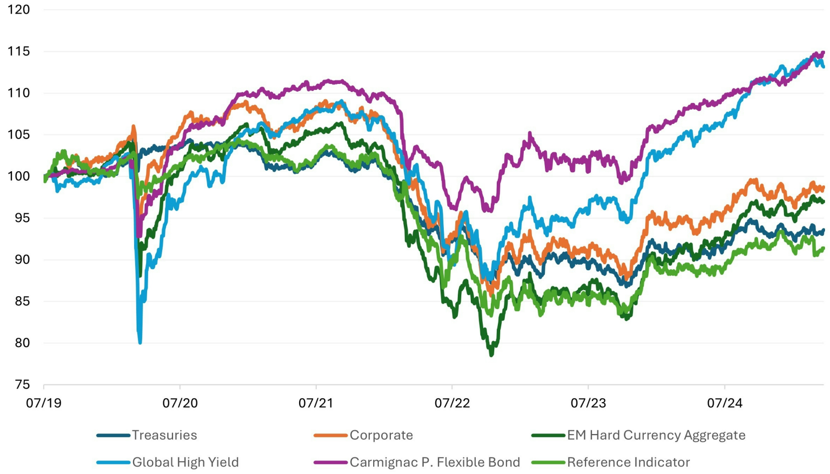
4) THE FLEXIBLE FUND IN RESPONSE TO A HIGHER INFLATIONARY ENVIRONMENT: CARMIGNAC PORTFOLIO FLEXIBLE BOND

- The benefits of a flexible bond portfolio in inflationary market regimes are clear, particularly thanks to the selection of inflation-indexed instruments, but also by adopting the fund's rate sensitivity and overall exposure to a risk-averse environment.
- Over the last 14 months, **our inflation-indexed instruments have contributed +162bp to the fund's performance**, i.e. more than 20% of the fund's total performance (see figure No. 4).
- This exposure has been achieved dynamically through inflation-indexed bonds in the euro zone and the United States (which account for 18% of net assets to date) and inflation swaps.
- Finally, **the management team (Guillaume Rigeade and Eliezer Ben Zimra) has also implemented short nominal interest rate strategies, particularly in Japan**, which have proven particularly successful in view of the inflationary pressure within the archipelago (see figure No. 5).

Figure 4: Monthly contributions (in bps) of inflation-indexed strategies
Source: Carmignac, 21 March 2025. Past performance is not a reliable indicator of future performance.

Figure 5: Monthly contributions (in bps) of short Japanese nominal rates
Source: Carmignac, 21 March 2025. Past performance is not a reliable indicator of future performance.

5) A FUND PARTICULARLY WELL-SUITED TO THE FUTURE CHALLENGES OF THE MARKETS



Source: Carmignac, ICE Bank of America, Bloomberg, 31/03/2025.Past performance is not a reliable indicator of future performance. Global Treasuries Index: Bloomberg Global Aggregate Treasuries Total Return Index Hedged EUR, Global Corporate Index: Bloomberg Global Aggregate Corporate Total Return Index Hedged EUR, Global Emerging Market Hard Currencies Index: Bloomberg Barclays MSCI EM Hard Currency Aggregate EUR, Global High Yield index: Bloomberg Global High Yield Total Return Index Value Hedged EUR.

- In addition to the inflation-indexed instruments that provide a diversifying performance driver, **Carmignac Portfolio Flexible Bond fund can rely on other performance catalysts.**
- Indeed, **the fund benefits from yield curve strategies that aim to take advantage of the macroeconomic dynamics of different regions.**Thus, we currently favour short and intermediate maturities in the United States and Europe, while implementing short positions on long-term rates, which we believe are riskier given the debt trajectories of the major economies.
- **We also continue to benefit from our carry strategies through credit instruments that provide an attractive yield**, while being able to absorb a possible upward movement in rates or widening credit spreads. Our team has also strengthened high-yield credit hedges through Credit Default Swaps to protect the fund in case of increased risk aversion.
- This positioning has so far proven to be highly relevant in 2025, as the **fund has posted a performance of +2.89% since the beginning of the year**(A EUR Acc share class as at 31/03/2025) compared with -0.75% for its reference indicator[3], **i.e. an outperformance of +364bp.**

Figure 6: Performance of the Carmignac P. Flexible Bond fund against the main bond indices since the arrival of the portfolio managers (09/07/2019)

[1]US Personal Consumption Expenditure Core Price Month over Month, Bureau of Economic Analysis.

[2]The Rate of Interest. Fisher, Irving (1907).

[3]Reference indicator: ICE BofA Euro Broad Market Index.

CARMIGNAC PORTFOLIO FLEXIBLE BOND A EUR ACC

(ISIN: LU0336084032)

SFDR - Fund Classification** :

Article 8

LOWEST RISK — HIGHEST RISK

1	2*	3	4	5	6	7

Recommended minimum investment horizon 3 YEARS

MAIN RISKS OF THE FUND

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. **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.

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 : 1,00% 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 : 1,22% of the value of your investment per year. This estimate is based on actual costs over the past year.

Performance fees : 20,00% when the share class overperforms the Reference indicator during the performance period. It will be payable also in case the share class has overperformed the reference indicator but had a negative performance. Underperformance is clawed back for 5 years. 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 : 0,35% 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: LU0336084032)

Calendar Year Performance (as %)	2016	2017	2018	2019	2020
Carmignac Portfolio Flexible Bond	**+0.1 %**	**+1.7 %**	**-3.4 %**	**+5.0 %**	**+9.2 %**
Indicateur de référence	-0.3 %	-0.4 %	-0.4 %	-2.5 %	+4.0 %

Calendar Year Performance (as %)	2021	2022	2023	2024	2025 (YTD)
Carmignac Portfolio Flexible Bond	**+0.0 %**	**-8.0 %**	**+4.7 %**	**+5.4 %**	**+2.9 %**
Indicateur de référence	-2.8 %	-16.9 %	+6.8 %	+2.6 %	-0.8 %

Annualised Performance	3 Years	5 Years	10 Years
Carmignac Portfolio Flexible Bond	**+3.5 %**	**+3.8 %**	**+1.2 %**
Indicateur de référence	+1.5 %	+1.6 %	+1.3 %

Source: Carmignac at Mar 31, 2025.
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/prospectus of the fund before making any final investment decisions.

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