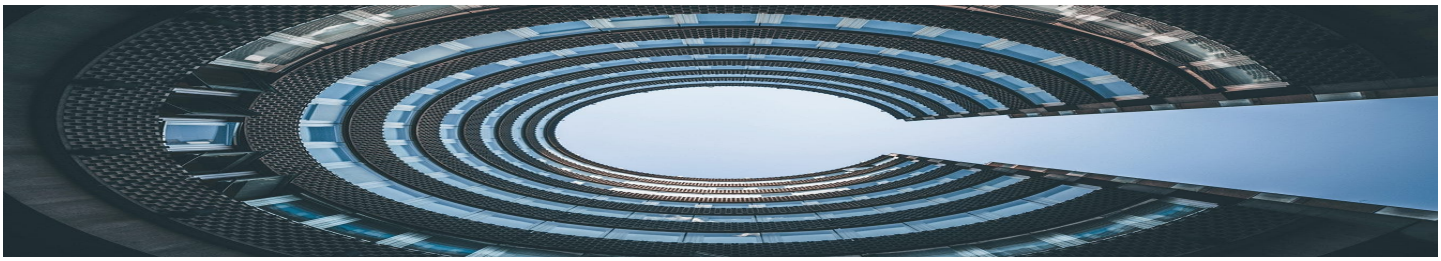

Our Monthly Investment Review : June 2022

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June was a particularly turbulent month as a number of consumer and business confidence indicators fell[1] and inflation readings once again soared to record highs[2]. Now the prospect of monetary policy tightening in the developed world in the midst of a cyclical slowdown has become a real worry for investors.

High volatility in fixed income

Volatility in the fixed income market reached unprecedented levels in June. The price of 10-year Bunds recorded daily swings of +/-2% – something rarely seen in the past two decades. Risk premiums grew exponentially in credit markets and among the peripheral eurozone countries, with the yield on 10-year Italian sovereign bonds, for example, jumping from 3% to over 4% in a matter of days.

As a result, the European Central Bank (ECB) – already eager to tighten its monetary policy as quickly as possible – met urgently and announced it would create a new instrument to shield the eurozone from fragmentation risk and to ease market tension. We're still holding on to our short positions on European sovereigns, however, because: 1) the ECB's existing asset purchase programme will soon come to an end; and 2) future fiscal stimulus measures which are not funded means we'll see a flurry of new sovereign-bond issues this summer, especially by France and Italy. That will push up the yields on those countries' bonds.

A cautious stance on equities

We have maintained our relatively conservative stance on equities, with a net exposure of our mixed funds that hovered between 5% and 20% in June. This decision comes in response to persistently high inflation, the slowdown in global growth, and the effects of those two factors on demand and on companies' profit margins. We have increased our holdings in defensive sectors (which make up a good chunk of our equity portfolios given their resilient nature) such as healthcare, consumer staples, and the segments of consumer discretionary with the least elastic demand.

The key exception to our highly defensive bias is China, whose stocks have recorded some of the highest gains among the major world economies since the start of the year. Indications that Beijing is softening its stance on mobility restrictions, regulation, and fiscal and monetary policy stand in welcome contrast to the stricter tone being adopted (or likely to soon be adopted) elsewhere in the world.

Actively managing our EUR and USD exposure

We also actively managed our currency strategies in June, cutting our EUR exposure significantly and increasing that to USD. Beyond the interest-rate differential between the US and the eurozone, what stands to weigh on the single currency is the prospect of even higher prices for energy imports and of emergency plans, rolled out in the event of a cut-off of Russian supplies, limiting European exports.

We initiated short positions on the British pound, since the UK economy is now flirting with a recession after three months of zero or negative GDP growth – at a time when domestic inflation is still in the double digits.

Today we believe our low exposure to fixed income, the asymmetric upside potential of our equity portfolio – in particular through the gradual reintroduction of Chinese stocks – and our USD holdings will be drivers of a rebound in performance. This rebound could gain traction once the decline in European inflation expected in the coming months clearly materialises.

To read our latest market analyses

Sources : Carmignac, Bloomberg, 06/07/2022

[1] *The University of Michigan's Consumer Sentiment Index fell to its lowest level since it was created over 40 years ago, with the same record being set in the UK, and the flash PMI estimates for the US came in well below expectations*

[2] *10% year-over-year in Spain (the highest since 1985), 8.6% in the US, and 8.6% in the eurozone.*

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