II. A DIVERSIFIED APPROACH TO EMERGING MARKETS

Carmignac Portfolio Emerging Patrimoine: The power of choice within the emerging universe

13.07.2017

In recent years, emerging markets have regained their rightful place with investors as part of the strategic asset allocation of their portfolios. Investors with a higher risk appetite have increased their exposure to emerging market equities, while more cautious investors have opted for emerging market debt. Yet, there are growing numbers of investors that require a more all-inclusive emerging markets proposition, for example, equity investors that would prefer a more cautious approach within the emerging markets universe, or debt investors wishing to spice up their emerging markets asset allocation with a hint of equity holdings. Carmignac Portfolio Emerging Patrimoine caters to the needs of both types of investors.

The uniqueness of this Fund lies in its differentiated approach. Not only does it provide exposure to emerging markets through a diversified allocation across equities, bonds and currencies, but it also places a particular emphasis on active risk management. The Fund is therefore comprehensively Emerging (see Chapter 1), Diversified and Cautious.

This second chapter focuses on how Carmignac Portfolio Emerging Patrimoine benefits from its three performance drivers.

Combining three performance drivers

Carmignac Portfolio Emerging Patrimoine **deploys an active asset allocation across emerging market equities, bonds and currencies. Through the combination of a fundamental top-down[1] approach and a disciplined bottom-up[2] analysis, we choose investments that match our strict selection criteria and where we have a strong belief that they will continue to grow over the long term.**

Equities

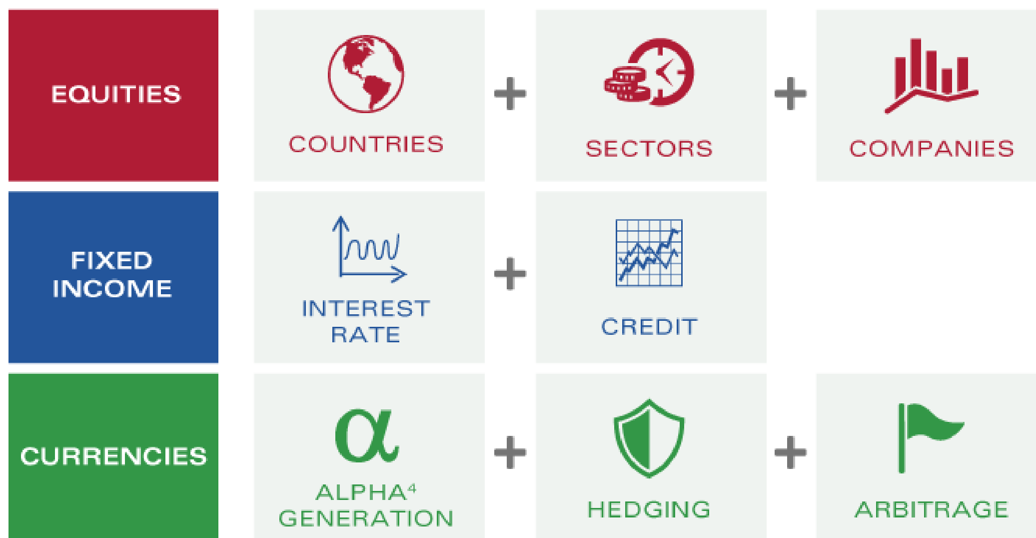
We believe that within emerging market equities, the best way to achieve strong performance, regardless of market direction, is to pinpoint the most attractive countries, sectors and companies. We identify countries with healthy macroeconomic fundamentals, domestic growth and sound balances of payments. Then, we seek underpenetrated sectors that stand to benefit from long-term growth themes. Within these industries, we target those companies that we believe have decades of growth ahead of them and are able to grow without having to sacrifice profitability. We look for capital-light companies with sound balance sheets that are offering attractive and sustainable cash generation and that are capable of self-financing their growth. Carmignac Portfolio Emerging Patrimoine may invest in companies of all capitalisations[3] but for liquidity purposes favours large-caps and mid-caps.

Fixed income

On the fixed income side, we seek to capture the most promising opportunities through both interest rate and credit strategies. Our interest rate strategies are based on Carmignac's core macroeconomic scenario, and aims to select the most appropriate countries for sovereign bond investment (local or external debt). Our credit strategies within international and local currency denominated emerging market corporate bonds add an extra layer of potential investment opportunities.

Currencies

Our currency exposure is managed separately from the fixed income and equity positions, making it a real performance driver for the Fund. Currency strategies are used for alpha[4] generation, hedging and arbitrage purposes. Alpha[4] generation strategies are used to enhance the performance of the portfolio by increasing or decreasing an exposure to a currency to which the portfolio might not been exposed. We make use of hedging strategies to protect all or part of the portfolio from market volatility, during times when we anticipate weakness from the currencies we are invested in via our equity or bond positions. Our currency positions may be used for arbitrage purposes, due to their correlation or decorrelation with equity or bond markets.



The power of choice

Having a non-benchmarked approach (see Chapter 1) and three performance drivers within

CARMIGNAC RISK MANAGERS

the emerging universe gives us freedom of choice. Most asset managers form a view on a specific country and then assimilate that country view to all asset classes. Our approach is different. We develop a clear and distinct view on each asset class within each country, noting that the opportunities, valuations and risks can be different in each instance. To illustrate this, let's consider the investment case for Brazil and China.

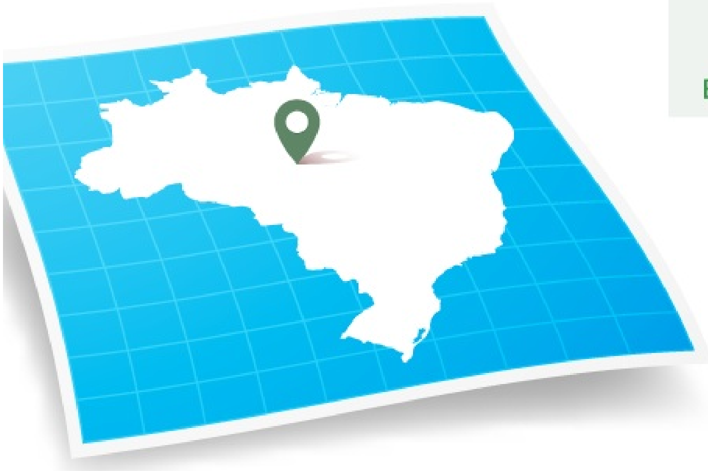
A closer look at Brazil

Brazil's fundamentals have considerably improved. Inflation has been falling fast and consistently, the global scenario is more supportive, and the monthly activity index (a proxy to Brazil's gross domestic product (GDP)) is showing a recovery. Moreover, Brazil's current account deficit has gone down and foreign direct investments (FDIs) have increased, so Brazil has no external financing needs.

• Equities: Brazil offers attractive investment opportunities on the equity side. Macroeconomic fundamentals are improving, companies are less leveraged and the banking system is relatively stable. We have been active participants in the local equity market since the impeachment of former president Dilma Rousseff and we are sticking to our optimistic, yet cautious stance. Given current valuations and political risk, we favour "bond proxies", such as power transmission companies, which offer long-term inflation-adjusted and guaranteed revenues, independently of the power volume transported.

• Bonds: We are positive on Brazilian bonds, which offer very attractive risk-adjusted returns in local currency terms. The country has adjusted its balance of payments and, the combination of the cyclical upturn with the disinflation the country is witnessing (as opposed to higher inflation in the developed world) remains supportive for Brazilian fixed income assets.

• Currency: We view the Brazilian real to be expensive and unattractive at current levels. Furthermore, recent corruption scandals remind us that political uncertainty remains a key consideration when investing in these markets, therefore the currency can be a suitable tool to hedge attractive equity investments.



A closer look at China

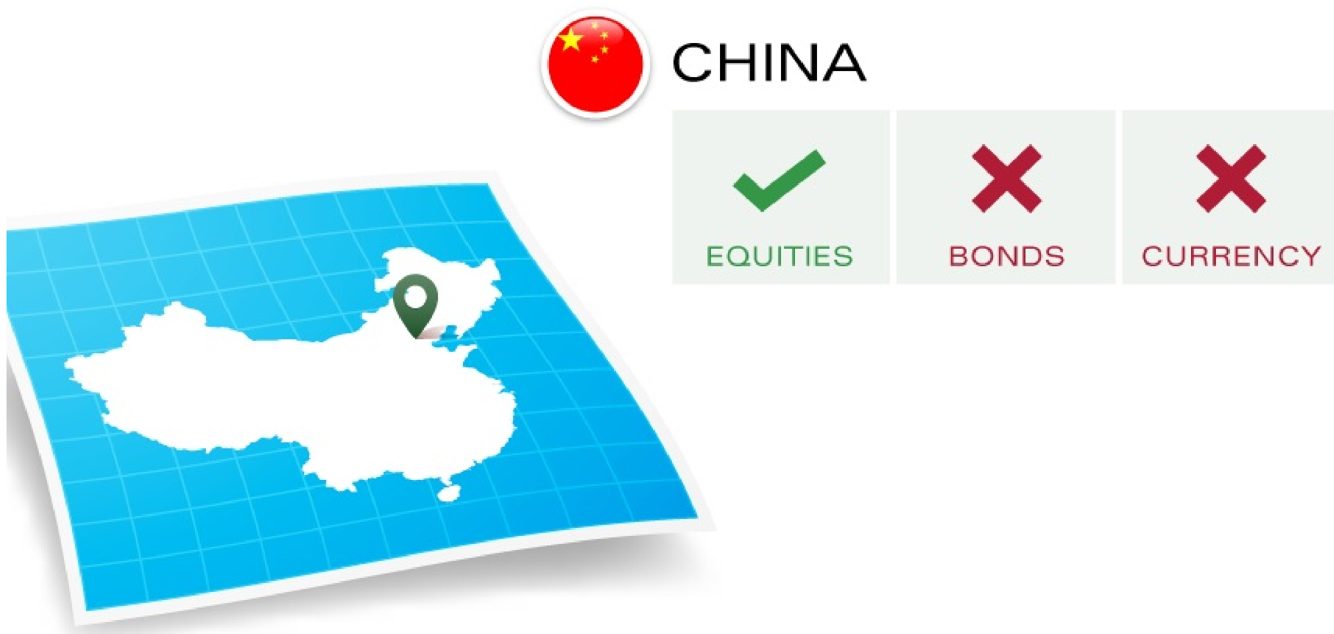
Despite persistent macroeconomic risks and the "Damocles sword" of high corporate indebtedness, China still manages to paint a reassuring picture for investors. Economic indicators are improving while monetary and fiscal stimuli have helped heal the country's economic wounds. China appears to have staunched the haemorrhaging of capital that had been undermining its balance of payments for months. Moreover, the depressive effect of recent property market restrictions has been offset by the expansionary impact of the many infrastructure projects that are currently under way.

• Equities: We are convinced that China offers secular equity investment opportunities. Although the state of the economy is not restored to full health, it has ceased to be a cause for alarm. We seek to focus on structural reforms and trends, and to identify sectors with limited credit risk and long-term compounding growth perspectives, like e-commerce and insurance (insurance penetration is six times lower than in developed countries).

• Bonds: To be on the safe side, we are currently avoiding any exposure to Chinese debt. As a percentage of gross domestic product (GDP), Chinese corporate debt today exceeds the equivalent figures for other Asian countries in previous financial crises. More debt means more volatility, but what worries us most is not just the magnitude of credit, but how ineffective it is. Capital is poorly allocated among the various economic agents. Households and the central government do not need capital and are pretty much debt-free. Companies – mainly state-owned enterprises (SOEs) – are the epicentre of China's excessive leverage concerns.

• Currency: We remain cautious on the currency front. Chinese FX reserves continue to decrease, despite measures taken by the authorities to stem capital flight and the Chinese government drawing upon its reserves to support its currency exchange rate. We believe the most likely scenario for the Chinese currency

is a gradual depreciation of around 5-7% per year for the next few years. A weaker currency would be supportive for Chinese exporters, helping the Chinese economy to stabilise.



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.
- CREDIT: Credit risk is the risk that the issuer may default.
- INTEREST RATE: Interest rate risk results in a decline in the net asset value in the event of changes in interest rates.
- EMERGING MARKETS: Operating conditions and supervision in "emerging" markets may deviate from the standards prevailing on the large international exchanges and have an impact on prices of listed instruments in which the Fund may invest.

The Fund's capital is not guaranteed.

(1) Top-down investing: An investment strategy which finds the best sectors or industries to invest in, based on analysis of the corporate sector as a whole and general economic trends (as opposed to bottom-up investing).

(2) Bottom-up investing: Investment based on analysis of individual companies, whereby that company's history, management, and potential are considered more important than general market or sector trends (as opposed to top-down investing).

(3) Market capitalisation: A measure of a company's size, calculated by multiplying the total number of shares in issue by the current share price. Companies are commonly grouped according to size as small-cap, mid-cap or large-cap. There is no consensus on the monetary boundaries of these ranges but as a rough guide in the US market: large-cap is over $10 billion, mid-cap is $2 billion–$10 billion and small-cap is $250 million–$2 billion.

(4) Alpha: Alpha measures the performance of a portfolio compared to its reference indicator. Negative alpha means the Fund performed less well than its reference indicator (e.g. if the indicator increased by 10% in one year and the fund increased by only 6%, its alpha is-4). Positive alpha means the Fund performed better than its reference indicator (e.g. if the indicator increased by 6% in one year and the fund increased by 10%, its alpha is 4).

Promotional article

This article may not be reproduced, in whole or in part, without prior authorisation from the management company. This article does not constitute a subscription offer, nor does it constitute investment advice. The information contained in this article may be partial information, and may be modified without prior notice. Past performance is not necessarily indicative of future performance. Access to the Fund may be subject to restrictions with regard to certain persons or countries. The Fund is not registered in North America, in South America, in Asia nor is it registered in Japan. The Funds are registered in Singapore as restricted foreign scheme (for professional clients only). The Fund has not been registered under the US Securities Act of 1933. The Fund may not be offered or sold, directly or indirectly, for the benefit or on behalf of a "U.S. person", according to the definition of the US Regulation S and/or FATCA. The Fund presents a risk of loss of capital. The risks, fees and ongoing charges are described in the KIID (Key Investor Information Document). The Fund's prospectus, KIIDs and annual reports are available at www.carmignac.com, or upon request to the Management Company. The KIID must be made available to the subscriber prior to subscription. • In the United Kingdom, the Funds' respective prospectuses, KIIDs and annual reports are available at www.carmignac.co.uk, or upon request to the Management Company, or for the French Funds, at the offices of the Facilities Agent at BNP PARIBAS SECURITIES SERVICES, operating through its branch in London: 55 Moorgate, London EC2R. This material was prepared by Carmignac Gestion and/or Carmignac Gestion Luxembourg and is being distributed in the UK by Carmignac Gestion Luxembourg UK Branch (Registered in England and Wales with number FC031103, CSSF agreement of 10/06/2013). • In Switzerland, the Fund's respective prospectuses, KIIDs and annual reports are available at www.carmignac.ch, or through our representative in Switzerland, CACEIS (Switzerland) SA, Route de Signy 35, CH-1260 Nyon. The paying agent is CACEIS Bank, Paris, succursale de Nyon/Suisse, Route de Signy 35, 1260 Nyon. The KIID must be made available to the subscriber prior to subscription.