QUARTERLY REPORT

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Carmignac P. Emerging Patrimoine: Letter from the Fund Managers

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-6.8%

Relative performance
of Carmignac P. Emerging Patrimoine A EUR Acc versus its reference indicator[1].

10.37%

Volatility of the fund
over 5 years.

+2.67%

Annualized performance of the Fund
over 3 years.

In the second quarter of 2022, Carmignac Portfolio Emerging Patrimoine recorded a performance of -2.97%[1], compared to a -3.43% decline in its reference indicator (40% MSCI Emerging Markets NR USD (Reinvested net dividends) + 40% JP Morgan GBI-EM Unhedged (EUR, Coupons reinvested) + 20% ESTER capitalised. Quarterly rebalanced). Year to date, the Fund has delivered a performance of –13.65%, versus –6.85% for its reference indicator. During the first half of 2022, emerging-market assets continued the slide. This downturn stemmed from decisions made by the world's main central banks – particularly the Fed and the ECB – to start normalizing monetary policy after years of quantitative easing. The war in Ukraine also led to a dual shock, with impacts on food and energy prices. The combination of these two factors is creating challenging backdrop for emerging market assets.

Quarterly Performance Review

The second quarter continued to be largely driven by what we saw in the first quarter of 2022, namely the aftermath of the Russian invasion of Ukraine on risky assets and commodities, and the monetary tightening that led to a volatility shock in the rates markets.

During the quarter, the USD reaffirmed its dominance in a risk-off environment and a Fed in advance in its hiking cycle relative to the ECB or the Bank of Japan. High commodity prices, higher rates, a slow restart of the Chinese economy and the uncertain energy supply for Europe all have contributed to increased fears of a global recession.

In this context the EM FX despite its high rates and carry has performed largely negatively in the second quarter. Commodity exporters in particular, have not been able to continue their strong Q1 performance against the USD. For instance, the CLP, ZAR, and BRL are some of the worst performing currencies were affected by a slower Chinese reopening and global growth fears translating to commodities.

Local Rates have continued to move higher along developed rates with the GBI-EM index inching above 7% by the end of the quarter. Following the war, the inflation peak, that the market expected closer to the summer, has not materialized in EM, also, the poor performance of FX over the quarter pressures central banks to continue to hike to protect from further inflation transmission via the currency.

The credit asset class has been under significant stress in DM and EM. Over the quarter, we have seen a further deterioration of the liquidity conditions stemming from the high rates volatility that we continued to observe during Q2 2022. In this asset class, an increasing share of credits are pricing as distressed (defined by a yield superior to 10%) going from 15 country sub-index of the EMBIG (EM External Debt) at the end of Q1 to 23 by the end of Q2. A number of the new joiners are paradoxically important oil exporters (such as Nigeria or Angola) and should be benefitting directly from the high energy prices.

While Chinese equities have benefitted from the reopening along with several state measures to support economic growth, the rest of EM has performed poorly. Indeed, the tightening of rates along with recession fears while margins are being compressed by higher input costs has driven valuations lower. Generally speaking, we believe we have entered a period in which growth names will outperform again vs. value names and this has benefitted our equity portfolio.

Portfolio adjustments and current positioning

In this difficult context, we have reduced the risk of the fund across all asset classes, especially in June when volatility in rates increased. On the FX, we have started the quarter with a relatively low allocation to commodity currencies and decreased it throughout. During the month of June and the important risk-off we increased the USD allocation in the fund and shorted several EM currencies to provide protection to the rest of the portfolio notably ZAR or MXN which tend to correlate to risk or INR a country particularly sensitive to its energy imports.

On the local rates we had several long rates positions in EM thinking that we were reaching peak inflation and that there was a start of “hike-fatigue” in several countries such as the Czech Republic or Brazil. These positions have cost the fund in terms of performance; however, we have maintained them as we believe that rates will be the first movers as the narrative shifts towards recession.

In Credit we have trimmed our corporates exposure throughout the quarter, for the sovereign credit we have remained invested in countries which offer significant value such as Romania. We still maintained protection during the period to navigate the high volatility and the fall in market liquidity.

As for Equity, we have maintained our allocation to Chinese stocks that we saw as having already corrected. However, with global markets in turmoil we remain cautious on the asset class and have maintained a low equity exposure via index futures notably in India which had help up relatively well since the start of the year.

Outlook for the next months

Going forward, we believe there will be a battle between the need to hike to prevent further inflation and the need to implement supportive measures to lessen the impact of a recession. If China’s economic rebound starts to bear fruits, it can dampen the effect of a developed market slowdown for Emerging Markets.

For the currencies, with recession fears looming, we expect to see continued pressure on the commodity exporter countries. That is why, we will maintain a defensive stance on the FX asset class, unless we see signs of a strong China rebound.
Similarly, with recession approaching, we are more constructive on local rates, as Developed Markets rates start to incorporate the risk of recession, we should see less pressure on Emerging markets. We think that the countries that have hiked the most and are showing signs of “hike-fatigue” will be the most willing to change the policy messaging, going from a hawkish tilt to a dovish tilt. Note that we do not expect fast and sharp rate cuts for the remainder of 2022, but more of a change in dynamic. For these reasons, we prefer Czech or Brazilian rates that have already hiked a lot.
On the credit side, we remain cautious for the time being, because rates will most likely remain volatile and thus keeping investors away. Recession accompanied by lower commodity prices will be negative for commodity extracting economies, while the energy complex is likely to continue to perform given the likely long-lasting tensions between the West and Russia. We are going to maintain exposure to credits that we see as cheap while actively protecting the portfolio via CDS.
And finally on the equity side, we maintain a cautious positioning, as we expect to see an economic slowdown is the short term. We keep our exposure to Chinese quality growth companies, especially those that have very attractive valuations despite their solid fundamentals. However, we are mindful of the potential risks, that can come from a slowdown in the Chinese recovery, or from global markets reeling from higher rates and recession. That is why, we are maintaining our Equity index hedges (shorts) to protect from major shocks in global markets.

Sources : Carmignac, Bloomberg, company data, EM Advisors Group, CICC, JPM Research, 30/06/2022.[1]The reference indicator comprises 40% MSCI Emerging Market NR USD index, 40% JP Morgan GBI-EM Global Diversified Composite Unhedged EUR index calculated with coupons reinvested and 20% ESTER capitalised. It is rebalanced each quarter. Past performance is not necessarily indicative of future performance. The return may increase or decrease as a result of currency fluctuations. Performances are net of fees (excluding applicable entrance fee acquired to the distributor Until 31 December 2012, the reference indicators' equity indices were calculated ex dividend. Since 1 January 2013, they have been calculated with net dividends reinvested. Until 31/12/2021, the reference indicator was 50% MSCI Emerging Markets index, 50% JP Morgan GBI - Emerging Markets Global Diversified index.

Carmignac Portfolio Emerging Patrimoine

An all-inclusive, sustainable Emerging Market solution

Discover the fund page

Carmignac Portfolio Emerging Patrimoine A EUR Acc

ISIN: LU0592698954

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.

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 presents a risk of loss of capital.