Press release

Paris, 9 May 2011

Economic Outlook and Investment Strategy for Q2 2011

I – Economic Outlook

▶ Cyclical economic slowdown on the cards in the US

The cyclical recovery seen since mid-2009 seems to have obscured the fact that reducing over-indebtedness is a highly deflationary and potentially very slow process if it is not facilitated by an appropriate economic policy. There is thus increasing pressure in the US for an immediate return to fiscal virtue and, at the same time, for a less expansionist monetary policy. The scheduled end in June to the Fed's liquidity injections and the likelihood of a less growth-orientated budget could thus come on top of the deflationary effects of higher oil prices and a possible cyclical slowdown that can already be detected from a number of leading economic indicators. Fortunately, the calls for a scaling back of stimuli by authorities may be thwarted. From a fiscal perspective, the US presidential elections on the horizon could hold things back until end-2012. In terms of monetary policy, the scepticism shown by the Fed Chairman as regards the underlying health of the US economy will ensure that at the very worst monetary policy normalisation will be very gradual even if it is pretty clear that the massive liquidity injections will cease at end-June.

▶ In Europe, the ECB's monetary tightening will weigh on the weakest eurozone countries

The current growth has markets feeling that the recent measures taken to help struggling countries will be enough to get the eurozone through the crisis. The political backing for the European project is undoubted, but can the public finances of the member countries being bailed out and the political backing itself survive the cyclical slowdown underway, the rise in ECB rates that is further weakening Spain, the strengthening of the euro that has amplified deflationary risk everywhere except in Germany and oil prices that won't come down any time soon? We have our doubts. Thus, even if the risks weighing on developed economies are not all imminent, there are lots of them. The coming end to QE2 may well see investors factoring them into their valuations of mature equity markets.

▶ The issue of inflation is in the process of being resolved in emerging countries

Emerging countries do not have to deal with the problem of the withdrawal of fiscal and monetary stimuli. On the contrary, it would appear that the end of QE2 in the US will reduce imported inflationary pressures there and will facilitate their monetary and foreign exchange policies. Any future rate rises will be less frustrated by unwanted inflows of foreign capital, thereby enabling a more effective fight against inflation, optimised by a controlled strengthening of their currencies. Similarly, the inflationary effects on agricultural prices of the La Niña weather phenomenon will gradually subside, with the appearance of favourable base effects over the coming months. Unless there is further disruption in the oil supply, the issue of inflation thus seems to be in the process of being resolved in emerging countries, all the more so in that the expected slowdown in the mature economies will help reduce pressure on industrial commodity prices.

▶ Emerging countries enjoy continued growth momentum, further driven by domestic demand

Unlike developed countries, the emerging universe continues on its own economic cycle, unconstrained by over-indebtedness. In our core scenario, inflation will not undermine emerging market growth but will stabilise at levels above those seen before the 2008 crisis. In addition, the spreading of a possible slowdown in developed countries to the emerging universe would in no event be comparable to that seen in 2008, when emerging economies and markets were hit particularly hard for at least three reasons. 2008 resulted from a sharp drying up of global liquidity, which naturally had more of an impact on areas and assets deemed to be more at risk. In addition, exports to developed countries, which were in crisis, were a major growth driver for many emerging countries, which is less true now, with notably no expected contribution from Chinese net exports to GDP over the coming two years. Finally, stock markets in emerging countries had outperformed mature stock markets for ten consecutive years. Now, most emerging markets, with China at the forefront, have seen a period of underperformance and seem to us to be less vulnerable.

▶ Risks are concentrated in the developed universe

In the current climate, the balance of risks is thus very much against the developed universe. The recovery in developed countries is undermined whereas control of inflation in emerging countries no longer seems to depend solely on oil price fluctuations. The current climate thus argues for ongoing confidence in the emerging universe and for investments in developed countries that are indexed to emerging market growth or defensive in nature.

II – Investment strategy

I – International equities

▶ The theme of rising living standards in emerging countries has been increased

Following what was clearly a difficult quarter for the emerging universe, we are looking to benefit from opportunities created in this sector by the underperformance of the Chinese stock market over the past number of months since we believe monetary tightening is coming to an end. The theme of improving living standards in emerging countries was thus increased slightly, from 33.4% the previous quarter to 34.1% of Carmignac Investissement's assets. The main purchases involved our Chinese financial stocks: China Life Insurance, Industrial and Commercial Bank of China and China Construction Bank. Conversely, we reduced our exposure to our two markets that are most vulnerable to high oil prices, namely India and Turkey, by selling off Bahrat Heavy and Garanti Bankasi.

▶ We took some profits in the commodities sector

We took some profits in the commodities sector, which went from 12.4% to 9.3% of Carmignac Investissement's assets. The rise in oil prices together with the likely end to QE2 led us to scale back the positions that were most exposed to an economic downturn plus a reduction, however slight, in liquidity. We nevertheless do not plan to completely withdraw from this sector, since it is strategic to the growth of the emerging universe.

▶ Our energy sector weighting remained stable

At 15.6% of Carmignac Investissement's assets, the energy theme remained stable. Growing fossil fuel demand and the obstacles to expanding production over the long-term are unwavering trends. Following the Fukushima disaster, we built up a position in Woodside Petroleum, an Australian gas producer likely to benefit from the anticipated sharp increase in Japanese gas imports, and in Uranium One, a promising mining group that we felt was oversold. On the other hand, we took profits on the bulk of our oil services stocks: Schlumberger, National Oilwell, Transocean, but also on the producer Anadarko following its very strong recovery in the aftermath of the Macondo disaster.

▶ Our gold positions continue to benefit from their safe haven status in light of monetary turmoil

The weighting of gold mining stocks was reduced by 1%, from 12.3% to 11.3% of Carmignac Investissement's assets. We remain fully confident in this theme, which is more than ever seen as a safe haven in light of monetary turmoil and the growing and broadening sovereign debt issue.

▶ The US growth theme has been reduced

In order to reflect our scenario of an upcoming economic slowdown, the US growth theme was scaled back to 6.1% of Carmignac Investissement's assets, primarily by reducing some of our banking positions (Citigroup and Mastercard). In addition, the innovation theme saw its allocation rise to 15.1% of assets, while the defensive stocks theme remained stable (4.9%).

▶ We cut our exposure to the dollar

Our currency allocation management led us to partially hedge our dollar assets (52% including dollar-linked currencies) within Carmignac Investissement. Given the conflicting factors weighing on the euro/dollar exchange rate, we nevertheless continue to very closely monitor factors that could buck the euro's upward trend.

II – Bond performance drivers

▶ Our corporate bond allocation remains key

Our corporate bond allocation remained virtually stable at 34% of Carmignac Patrimoine's assets. As we had been expecting the previous quarter, the corporate bond component showed good resilience to the headwinds hitting bond markets. We are rolling over our strategy this quarter with bonds that are relatively insensitive to interest rate risk (short maturities) and offer a high risk premium. Fundamentals continue to play an active role in our approach: corporate deleveraging is ongoing, leading to rating upgrades. Over the coming months, the corporate bond component's contribution to performance should continue to improve, especially with a stabilisation of yields that should more than offset the effects of the economic slowdown we foresee.

▶ The developed country government bond component was reduced

The developed country government bond component was cut from 6.6% to 3% of Carmignac Patrimoine's assets. The issue of the solvency of the eurozone's weakest members means that we continue to avoid government bonds issued by peripheral European countries. In the previous quarter, the outlook for interest rate rises led us to close all our positions on 10-year German, US and UK government bonds. For the period ahead, however, pressure on German yields could recede as and when the economic cycle slows, with short-term yields having already been revised up. Over the next few weeks, we will be seizing opportunities to increase the assets held in this segment.

▶ The emerging government bond component accounts for 8.2% of assets

Emerging government bonds account for 8.2% of Carmignac Patrimoine's assets, with 6.7% invested in local debt. Emerging countries' public finances suggest we should increase our allocation. Eastern Europe, somewhat neglected in 2010, offers opportunities considering recent adjustments enjoyed by certain countries in this region.

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About Carmignac Gestion

Founded in 1989 by Edouard Carmignac, Carmignac Gestion is one of the leading independent asset management companies in Europe today. Its share capital is entirely held by its management team and staff. In this way, the company's long-term viability is ensured by a stable shareholding structure, reflecting its spirit of independence. This fundamental value is of upmost importance to the company as it ensures the freedom required for successful and renown portfolio management.

With more than 50 billion EUR in assets, Carmignac Gestion has developed a comprehensive range of 18 funds across all asset classes - equities, bonds and multi-strategy, as well as mandate offering. Our funds are actively marketed in 11 European countries: France, Luxembourg, Switzerland, Belgium, Italy, Germany, Spain, Austria, The Netherlands, Sweden and United Kingdom. Within the context of its international development, Carmignac Gestion has a subsidiary in Luxembourg and two offices in Madrid and Milan, and recently registered its range of products for professional investors in Singapore.