CARDIF LUX VIE
GROUPE BNP PARIBAS

FINALISED ON 8 JULY 2022

GENERAL FUND

CARDIF LUX VIE

The central banks in an unstable equilibrium between inflation and recession.

As has often been the case in recent years (think of Brexit, the election of Donald Trump, deglobalisation, the closure of economies in response to Covid, etc.) optimistic views have been thoroughly discredited. For example, the war in Ukraine was a feared prospect, but few of us thought that Russia might wage an all-out war on European soil that would remind us of the grimmest hours of the 20th century.

Beyond the ongoing humanitarian disaster and the risks of escalation that this entails, this situation has amplified inflationary pressures that have been building since 2021. These pressures were caused by the reopening of Western economies in combination with bottlenecks in the global supply chains.

Headline inflation, at over 8% in the US and the Eurozone, is back to the levels of the mid-1970s and early 1980s after the oil crisis. Yet again, all the economic and financial players failed to anticipate that the supply shock for manufactured goods would be followed by a supply shock for all raw materials.

The impact of inflation obviously differs for different economic actors and their exposure to gas and oil. US consumers, buoyed by the strength of the labour market (unemployment rate at 3.6% with continued strong job creation), still seem inclined to spend because they believe their future income will increase accordingly.

Nevertheless, household confidence has fallen in recent months and the anticipated slowdown in activity can be expected to alter this upbeat outlook. In addition, the US savings rate, at only 5.4% in May compared to 7% on average before Covid, is already at a low level. This situation of overconsumption is unlikely to continue.

In Europe, the savings rate remains above pre-Covid levels and household confidence, which is often gloomy, has deteriorated even more rapidly than in the US due to a weaker recovery in incomes and a less favourable outlook, particularly for energy.

On the corporate side, strong order books and the capacity to pass on a large part of the increase in production costs have so far supported corporate results. However, as demand is expected to decline, particularly in the consumer goods sector, it is relatively likely that pricing power will start to erode, which will impact margins and consequently investment.

To counter this inflationary risk, which is ultimately more persistent than was initially expected, the main central banks, with the exception of the BoJ (Bank of Japan) and the PBOC (People's Bank of China), have taken a harder line and have started to trim their balance sheets and/or to implement initial rate hikes. They fear that inflation expectations could be thrown off their target (around 2% for the Fed and the ECB) and that second round effects could materialise. As a result, the Fed raised its key rate three times in the first half of the year, including a spectacular 75 bps increase (the first since 1994) on the 15th of June. The refinancing rate now stands at 1.75% and J. Powell, during his most recent speech at the Sintra symposium, reiterated that his main concern is to fight inflation, even if this means having a significant impact on growth.

CARDIF LUX VIE Société Anonyme | Siège social : 23-25 avenue de la Porte-Neuve - L-2227 Luxembourg | Adresse postale : B.P. 691 - L-2016 Luxembourg
TVA : LU163 196 59 | RCS Luxembourg N° B47240 | Tél. : +352 26 214 - 1 | Fax : +352 26 214 - 9371 | info@cardifluxvie.lu | www.cardifluxvie.com

So, as not to trigger further panic in the financial markets before another 75 bps hike, Fed officials are starting to talk about the possibility of not pushing as far as the markets expect (3.5% at the end of 2022).

For her part, C. Lagarde, while playing for time in the face of a growing number of increasingly hawkish ECB governors, also telegraphed an initial rate hike in July of 25 to 50 bps, which will probably be followed by two additional 50 bps hikes in the months to come, while the massive buybacks under the Pandemic Emergency Purchasing Program (PEPP) have already been discontinued without putting an end to reinvestments. The sharp widening of peripheral spreads, particularly in Italy, prompted the ECB to announce an "anti-fragmentation" safety net to ensure that the effects of future monetary tightening would be acceptable to the less robust and more indebted Eurozone economies.

These continuing monetary restrictions, coupled with the loss of household purchasing power, the squeeze on manufacturing margins and the negative impact on the housing market of rising long-term interest rates, are expected to reduce global growth by at least 3 percentage points to around 3% in 2022 compared to the forecast at the end of 2021. Specifically, the US and the Eurozone are expected to grow by close to 2%, whereas GDP growth had been previously forecast at around 4%. In China, the perceived risk of strict confinements also materialised, undermining growth for at least the first part of the year. GDP growth in China is now expected to be only 4%, which is also half of what was expected at the end of 2021.

Even if the core scenario that the main zones will slow down without falling into recession is still the case, we must again ask ourselves what could jeopardise this ultimately relatively favourable scenario. This would probably require:

- The reduction in supply chain tensions that is currently being experienced to be undermined by a return to a highly restrictive health policy in China.
- That energy access be made even more problematic, including a clear cut-off of Europe's gas supply by next winter.
- That central bankers overreact to these supply shocks, resulting in a sharp slowdown in access to credit, effectively limiting investment by households and businesses.

The first half of the year in the West was one of the worst for balanced equity and bond portfolios in the last 100 years.

This is because the correction on the equity markets was driven by the rise in long-term interest rates, depressing the valuation of growth companies, whose proportion had risen sharply in the main world indices.

The Nasdaq fell by nearly 30% in dollar terms (-23% in euro terms), while other European and US indices were down between 16% and 20%. It should be noted that Chinese and Japanese indices clearly outperformed their Western counterparts due to continued accommodative monetary policies. By sector, the only European stocks that performed positively were, unsurprisingly, Oil & Gas (+12.6%) and Telecoms (zero performance for the half year). Among the underperformers, in addition to technology (-32%), retail and real estate stocks also fell sharply (-37% and -32% respectively), reflecting the expected reduction in margins and the drop in consumption in the case of retail, and the rise in interest rates and the price of building materials in the case of real estate.

On the bond side, risk-free rates have risen sharply in the wake of the slippage in inflation indices and the tightening of monetary policies. German and US 10-year yields rose by 150 bps compared to the end of 2021, reaching 1.34% and 3.01% respectively, after hitting highs of over 1.8% and 3.5% in mid-June, and returning to the highest levels experienced in the last ten years. This very sharp movement, which was of a scale and speed rarely seen, was coupled with a very violent flattening, or even inversion, of the rate curves, which is often a warning to market participants that the economy is likely to go into a recession. In anticipation of reduced ECB purchases and the contraction of activity, credit spreads have also tightened significantly: spreads in the highly rated investment grade segment has widened by 40 to 60 bps depending on the sector, while the BBB segment has seen its spreads widen by an average of 80 bps against swaps. Unsurprisingly, the high yield segment experienced the widest spreads with an increase of nearly 400 bps, with the average spread for the euro market standing at over 750 bps at the end of June. These violent movements have produced the kind of performance we are used to seeing in severe equity corrections.

On the General Fund, we started the year cautiously, both in terms of interest rate sensitivity and in terms of our positioning on equities and credit.

From being slightly underweight equities at the beginning of the year, we returned to neutral before the Russian invasion, in the wake of the small corrections experienced at the very beginning of the period. Since then, with the exception of a few tactical movements, we have preferred to maintain a beta of between 8 and 9%.

On credit, as mentioned in our previous publications, we were also relatively under-exposed, after two years in which we had avoided investing in the secondary market while credit spreads were historically very unattractive and had increased the proportion of core government securities (Germany, Netherlands, Austria, etc.) in our bond portfolio.

CARDIF LUX VIE Société Anonyme | Siège social : 23-25 avenue de la Porte-Neuve - L-2227 Luxembourg | Adresse postale : B.P. 691 - L-2016 Luxembourg
TVA : LU163 196 59 | RCS Luxembourg N° B47240 | Tél. : +352 26 214 - 1 | Fax : +352 26 214 - 9371 | info@cardifluxvie.lu | www.cardifluxvie.com

During the first half of the year, we took advantage of spread widening and rising risk-free rates to selectively re-enter highly rated primary credit issues to arbitrage securities purchased at low yields. At the same time, we gradually moved our modified duration back above 5 (from 4.75 at the end of 2021) by favouring core countries, given our expectation that the interest rate levels reached in the last few weeks of the half-year were probably close to annual highs in both the US and Europe.

In view of the highly uncertain situation and the impact of US monetary tightening on a number of vulnerable countries, we have stayed away from Emerging Debt.
Among diversification assets, we invested in a new office building with a BREEAM "Excellent" label. With potential new investments in the Healthcare segment, this new purchase will allow us to reach our target of 4% in this asset class by 2024. We did not make any new investments in the other non-listed asset classes.

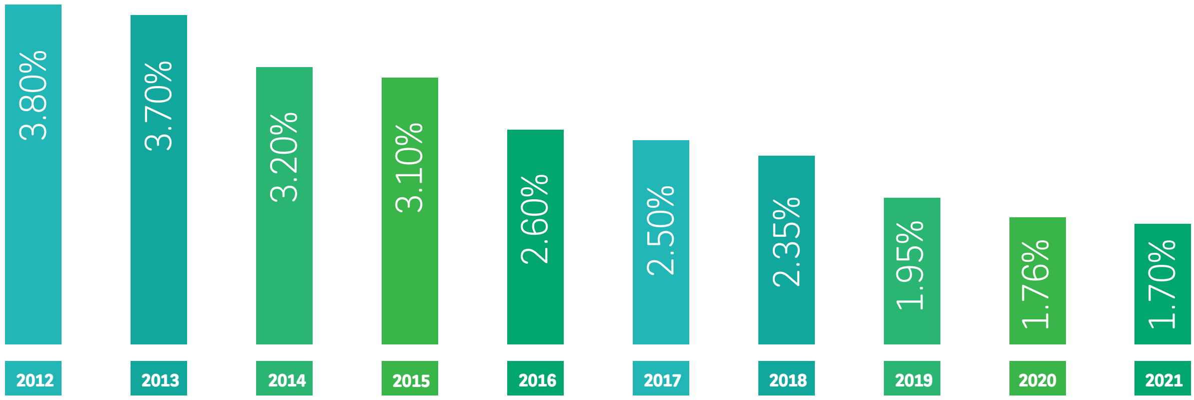
Any significant pressure on long rates in the coming months could be used to further increase our modified duration, as we expect long rates to fall early next year, reflecting lower inflation figures and more accommodative central bankers.
In equities, given the lack of visibility and current volatility, we will focus on small tactical moves around our strategic target allocation while continuing to improve diversification.
In the non-listed sector (excluding real estate), we intend to make commitments to private equity and infrastructure funds with exposure to renewable energy and the energy transition, in line with our desire to increase our positive impact investments.

François LUCCHINI
Directeur de la Gestion d'Actifs

KEY TAKEAWAYS:

- Central bankers ramp up their fight against inflation
- A significant deterioration in the macroeconomic environment is now expected
- Valuations of risky asset classes becoming attractive again in the medium term

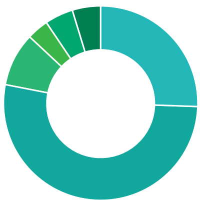
HISTORY OF THE GENERAL FUND'S GROSS RETURNS



MANAGEMENT OF THE CARDIF LUX VIE'S GENERAL FUND AS AT 30/06/2022

Capitalisation of the General Fund in market value: 9.2 billion EUR.

COMPOSITION OF THE CARDIF LUX VIE'S GENERAL FUND



- Governmental Bond & Similar: **25.8%**
- Corporate bonds: **52.3%**
- Equities & Similar: **9.1%**
- Real Estate: **3.6%**
- Short Term/Cash Flow: **4.6%**
- Diversification Assets[1]: **4.6%**

COMPOSITION OF THE EQUITIES COMPARTMENT

Share risk exposure around 9.26%.

EQUITIES COMPARTMENT DETAIL BY GEOGRAPHIC ZONE

- France: **17.4%**
- Europe outside France: **65.1%**
- USA: **11.6%**
- Peloped Countries (Excluding Europe): **5.9%**

DETAILS OF THE EQUITY SECTOR BY NATURE

- Share: **33.6%**
- Equity funds: **54.3%**
- Private capital and infrastructure: **12.1%**

COMPOSITION OF THE BOND COMPARTMENT

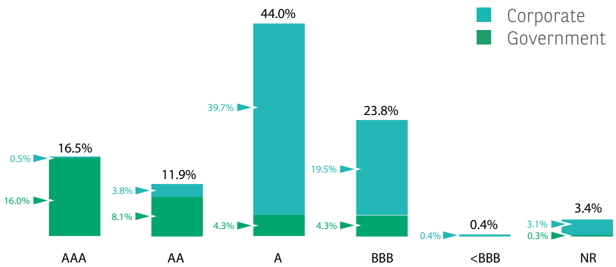
The global sensitivity to the rates of our portfolio is close to 5.

BOND COMPARTMENT DETAIL BY RATING

The bond portfolio has an excellent quality rating with an average rating of "A".

Rating[2] of the Government State Bonds in portfolio at 30/06/2022 :

AAA: Luxembourg, Germany, Netherlands, USA, European agencies
AA: Finland, France, Belgium, Austria
A: Slovakia, Spain, Chile
BBB: Italy



BOND COMPARTMENT DETAIL BY ISSUERS

- Financials: **32.3%**
- Governments & Similar: **32.9%**
- Covered Bonds: **0.8%**
- Non financials: **34.0%**

REPAYMENT SCHEDULE OF THE BOND COMPARTMENT

- < 5 years: **33.3%**
- 5 a 7 years: **17.2%**
- 7 a 10 years: **28.0%**
- 10 years: **21.5%**

1- Emerging debt, high yield and alternative Funds.
2- Median rating of the 3 agencies Standard & Poor's, Fitch and Moody's.

CARDIF LUX VIE Société Anonyme | Siège social : 23-25 avenue de la Porte-Neuve - L-2227 Luxembourg | Adresse postale : B.P. 691 - L-2016 Luxembourg
TVA : LU163 196 59 | RCS Luxembourg N° B47240 | Tél. : +352 26 214 - 1 | Fax : +352 26 214 - 9371 | info@cardifluxvie.lu | www.cardifluxvie.com