



FINALISED ON JUNE 30, 2023

GENERAL FUND

CARDIF LUX VIE



Too much complacency

The first half of 2023 defied the laws of gravity. While central banks have stepped up their restrictive monetary policies initiated in 2022, economic fundamentals and financial markets have more than resisted the rise in rates and the central banks' hammer blows to get the

inflation 'genie' back in the bottle.

We believe that the central banks' relentless fight against inflation will outweigh the relative resilience of economic activity, and that a market correction is likely before the end of the year.

The hawks in top form

In June, hawkish decisions or statements by central banks largely prevailed, with unexpected or larger than expected increases: Australia +25bp (to 4.10%) and Canada +25bp from its key rate of 4.75% at the beginning of the month, the UK (+50bp), Norway (+50bp) and Switzerland (+25bp) last week. The need to ensure price stability over the medium term has been consistently emphasised. In the middle of the month, the announcements by the US Federal Reserve (Fed) - a standstill in the range 5.00% - 5.25% (i.e. a cumulative rise of 500bp since March 2022) - and the European Central Bank (ECB) - a 25bp rise in the refinancing rate to 4% - were in line with expectations, but Jerome Powell and Christine Lagarde clearly indicated that their tightening cycle was not over. Only the Bank of Japan (BoJ) looks set to remain aloof from the widespread tightening of monetary policy in the developed economies.

It was by chance, no doubt skilfully orchestrated, that Andrew Bailey (BoE), Christine Lagarde, Jerome Powell and Kazuo Ueda (BoJ) met on Wednesday 28 June for a conference organised by the ECB in Sintra (Portugal) on the subject of macroeconomic stabilisation in a volatile inflationary environment:

«I don't think inflation will return to 2% this year or next, but in 2025» (J. Powell); «We don't see enough hard evidence that underlying inflation, particularly domestic prices, is stabilising and coming down» (C. Lagarde); «The cumulative data - particularly on the labour market and inflation, which showed clear signs of persistence - led us to conclude that we needed to make a strong move» (A. Bailey). «The central bank would have good reason to change its monetary policy if it became reasonably sure that inflation would accelerate in 2024 after a period of moderation, but the uncertainties surrounding this scenario remain significant» (K. Ueda).

Inflation, nothing but inflation

Having dismissed it as temporary, suffered its sudden acceleration, raised their key rates and waited for the first signs of a downturn, central bankers now want to see the slowdown in inflation with their own eyes and be certain that it will not accelerate again in the near future.

We have heard their message and, even though we remain convinced that the astonishing resilience of the US economy will eventually give way to less sustained growth at the end of the year, and that the eurozone will see several more quarters of very modest GDP growth, we do not believe that key rates will be cut any time soon.

For a start, the monetary policy tightening cycle is not quite over (even if, by definition, the end is drawing ever closer). Furthermore, persistent underlying inflation will lead

central banks to keep their key rates at restrictive levels (i.e. above the neutral rate) even in the face of sluggish growth.

The days of «pre-emptive» monetary policies are well and truly over: the argument of the time lag (generally estimated at six months) between action on key rates and its effects on the economy is unlikely to be used to trigger easing until we are sure that inflation is back towards 2%. In this respect, the slowdown in private sector credit growth in the eurozone and the repayment of targeted long-term refinancing operations will not be the trigger for a turnaround in monetary policy. Since last November, banks have repaid, early or otherwise, a total of €1,489.1 billion of these TLTROs (including €506.3 billion on 28 June), a move that could eventually lead banks to tighten lending conditions (even though excess liquidity remains very abundant).

What about business? Do we still need to keep an eye on that?

Yes, of course, but bearing in mind that, in the coming quarters, central bankers will be monitoring price trends more closely ('dissecting', to use Christine Lagarde's term). The latest news from the eurozone countries is also rather encouraging, with consumer price indices for June slightly below expectations in Italy, Spain and several German regions. However, one swallow does not make a spring, and one or two pieces of data do not create a trend.

Just a few months ago, investors would no doubt have used these results, coupled with the deterioration in business surveys in the eurozone, as an excuse to abandon their expectations of a further rise in key rates.

The preliminary results of the Purchasing Manager Index (PMI) surveys for the eurozone showed a sharp fall in the Composite index from 52.8 to 50.3 (the lowest since January), with declines in both the manufacturing and services sectors. The fall in the services sector index was spectacular in France (from 52.5 to 48, the lowest in 28 months). At the same time, French consumer confidence has recovered, but the index remains well below its long-term average (and below the levels reached during the pandemic), and business sentiment in industry is slightly better than in May. The level of the PMI indices in the 2nd quarter corresponds historically to a contraction in GDP of 0.5%, while in its latest business climate report, INSEE forecasts very modest GDP growth for the rest of the year (+0.1%) in the 2nd and 3rd quarters, followed by an increase of 0.2% in the 4th. The Banque de France also forecasts a rise of 0.1% in the 2nd quarter.

In Germany, the PMI for the manufacturing sector fell to 41, its lowest level for 37 months, and the services index fell from 57.2 to 54.1, a 3-month low. In addition, the business climate measured by the IFO fell, particularly markedly for the component reflecting the outlook. The indices have wiped out all the improvement seen since the start of the year, and the levels reached in June are consistent with a recession in the German economy. Despite this, the Bundesbank is forecasting a slight increase in GDP in the 2nd quarter.

When growth is weak, it's better to avoid inflation!

What are the consequences for the main asset classes?

Bonds

What more is there to say other than to reiterate that central banks don't know any more than we do, and should be judged on their actions and stated intentions rather than on their forecasts or the potential success of their actions. So, in our view, it is too early to think about any rate cuts or an imminent reversal in monetary policy, unless there is an exogenous event of the geopolitical (or health, etc.) type.

As a result, our positioning on long rates remains measured and we consider that it is still a little too early to position ourselves in larger quantities on these long maturities of the curve. In fact, reference rates are still much lower than the monetary reference rate, which creates an inverted curve synonymous with falling rates and therefore at odds with the long-term action of central banks. Credit premiums are lower than on short maturities because only good quality issuers are present, which means that yields are not high enough to absorb the potential volatility of such maturities, for example if the markets become aware that the central banks are not going to backtrack and the curve flattens out, or even returns to a 'classic' slope. Finally, there are three types of positioning on the long end of the curve, none of which is linked to the search for the best risk/return ratio:

- A regulatory issue: many institutional investors have increased their credit risk over the past decade to compensate for very low market rates, while reducing their duration. The rise in interest rates, massive in relative terms but ultimately moderate in absolute terms, led to a wave of buying in good-quality, long-dated bonds.
- Worry: after the extreme volatility of recent years, which culminated in the general fall of 2022, many investors or third-party managers lost confidence and saw in good quality long bonds at 3% or 4% the guarantee of a new-found peace of mind.

- Speculation: after a decade of low interest rates and repeated and massive action by central banks to support the financial markets, many operators considered that they could not adopt a more restrictive stance and bet on the continuation bias and the optimism bias. This is forgetting that the crises have already occurred and are therefore already taken into account, that inflation is the number 1 issue for a central bank, that this inflation is favourable for reducing public debt and can therefore be maintained slightly above the targets at the cost of a policy that is slightly less restrictive than necessary but lasts much longer, and that this inflation in Europe is largely exogenous and partly compensated for by the States, which keeps it high and limits the recessionary effects.

Two final points to note in terms of risk allocation and management:

- While long maturities are generally relatively unattractive in our view, financial bonds, because of their large issuance needs and the crisis last March, can offer very large premiums on these maturities and represent a significant investment category, particularly for Tier 2 subordinated bonds. We will qualify our positioning in this category by pointing out that we only invest in straightforward retail banks, often mutual banks, and not in investment banks or banks that are too closely linked to the financial markets or to a particular sector or asset class.
- At a time when interest rates have recovered significantly, we have a protective position in bonds that will help limit portfolio volatility in the event of renewed stress (linked in particular to the effects of rising interest rates, which are still poorly reflected in valuations).

Equities

The value of a share is the discounted sum of its expected future earnings, reflecting the time value of money and the risk inherent in realising these future earnings.

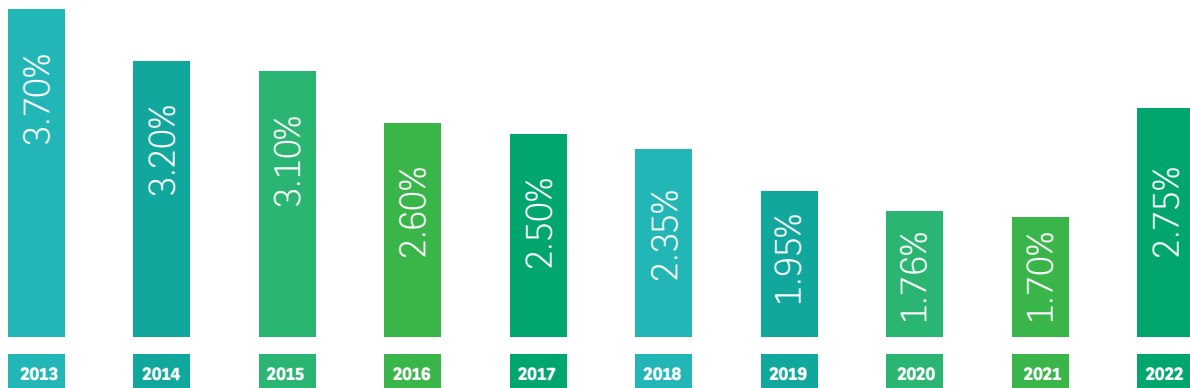
Monetary policy and close monitoring of the monetary policy cycle are at the heart of our process of observing the business and credit cycles. In this way, the fiscal stimulus applied by central banks to combat the disruption caused by COVID provided the economy with a temporary cushion against the restrictive actions of these same central banks. It has helped to offset the negative effects of restrictive monetary policies on economic activity. In the same way, it only delayed our defensive positioning on equities.

However, we are mindful that the key factors for recession are all present: (i) an inverted yield curve, (ii) year-on-year changes in leading economic indicators (indicators that change before the economy shows signs of change, such as consumer confidence, building permits and inventories) and (iii) the gap between the Federal Funds rate and our estimate of the equilibrium rate.

We expect equity prices to fall before the end of the year and remain underweight this asset class. In recent weeks, we have regularly reduced our exposure to equities to reflect a more cautious view. The earnings outlook does not reflect the most likely scenario, i.e. a moderate recession resulting from the monetary tightening initiated by the Federal Reserve in March 2022. Companies have managed to maintain their margins by passing on price rises to their customers, but this momentum is likely to come to an end. Finally, liquidity, which has underpinned the performance of equities (highly concentrated in technology stocks), is likely to become less abundant.

Arnaud MIROUDEL
Director of Asset Management

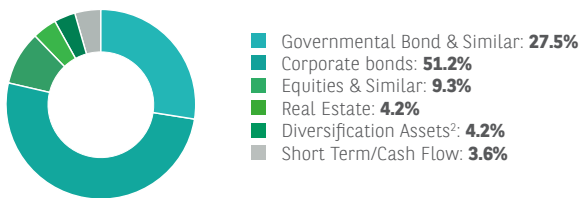
HISTORY OF THE GENERAL FUND'S GROSS RETURNS¹



MANAGEMENT OF THE CARDIF LUX VIE'S GENERAL FUND AS AT 30/06/2023

Capitalisation of the General Fund in market value: 7.3 billion EUR.

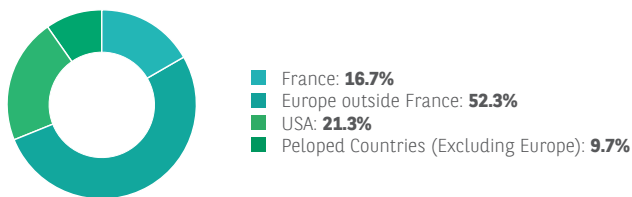
COMPOSITION OF THE CARDIF LUX VIE'S GENERAL FUND



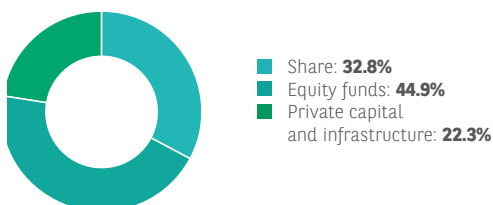
COMPOSITION OF THE EQUITIES COMPARTMENT

Exposition au risque actions limitée proche de 9,3%.
La sensibilité au marché action (bêta) du portefeuille est de 7,6%.

EQUITIES COMPARTMENT DETAIL BY GEOGRAPHIC ZONE



DETAILS OF THE EQUITY SECTOR BY NATURE



COMPOSITION OF THE BOND COMPARTMENT

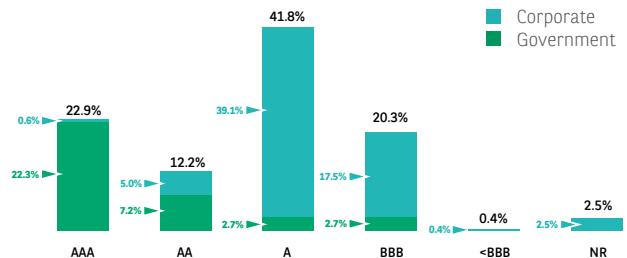
The global sensitivity to the rates of our portfolio is close to 5.2.

BOND COMPARTMENT DETAIL BY RATING

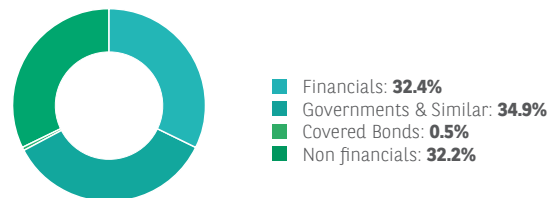
The bond portfolio has an excellent quality rating with an average rating of "A".

Rating³ of the Government State Bonds in portfolio at 30/06/2023 :

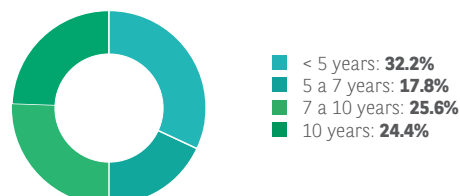
- AAA:** Luxembourg, Germany, Netherlands, USA, European agencies
- AA:** Finland, France, Belgium, Austria
- A:** Slovakia, Spain, Chile
- BBB:** Italy



BOND COMPARTMENT DETAIL BY ISSUERS



REPAYMENT SCHEDULE OF THE BOND COMPARTMENT



1- Details of past returns provide no guarantee or limitation of future returns. Returns do not take account of the management costs for investment instruments.
2- Emerging debt, high yield and alternative Funds.
3- Median rating of the 3 agencies Standard & Poor's, Fitch and Moody's.