CARDIF LUX VIE
BNP PARIBAS GROUP

FINALISED ON 6 JULY 2020

GENERAL FUND

CARDIF LUX VIE

Unprecedented!
Certainly the word most often used to describe the crisis we are currently going through. Let us review to which extent this term is relevant to illustrate the macroeconomic environment in the first half.

First, from a health point of view, given the scale of global trade and the movement of people, the virus has now spread to every corner of the planet, with the number of reported cases topping 11.4 million and more than 530,000 deaths recorded. If we compare this to recent history, circa 50 years ago the Hong Kong flu killed 1 million people worldwide without being the subject of intense media coverage or strict lockdown measures.

Within one month, weak growth has metamorphosed into a severe recession. The introduction of successive lockdown measures initially hit supply chains, shortly after, consumers in the affected regions and ultimately final demand. It has led to an extraordinary revision of global growth figures. The worst-affected countries are those that imposed a strict lockdown while being heavily dependent on both tourism and international demand. According to the latest IMF forecasts, global growth is expected to contract by more than 4%, with GDP set to fall by 6% to 8% in the United States, Japan and the Eurozone, while only China can hope to see a slight uptick in activity. In terms of the main Eurozone countries, France and Italy (both recording falls of around 10%) are expected to post the worst results, while Germany is set to outperform, albeit with a fall in GDP of more than 6%.

In the face of this unprecedented shock, the reactions of central banks were also remarkable, far exceeding in magnitude and speed all the announcements made in the months after the collapse of Lehman Brothers. For example, the ECB has unveiled an additional €870 billion asset purchase programme (the Pandemic Emergency Purchase Program, or PEPP) alongside a massive liquidity injection for banks through a negative rate TLTRO III. It has also strengthened its forward guidance at press conferences by reiterating that it is ready to do more if necessary and that its policy will remain accommodative until it is confident of a return to its inflation target. At the same time, the Federal Reserve reacted swiftly with a 1.5% cut to its federal funds rate, providing unlimited liquidity to the financial system and relaunching its large-scale quantitative easing programme (expanding purchases to include some high-yield bonds).

In parallel with this monetary activism, all governments have put in place measures to support their economies, equating to several percentage points of GDP. Between direct transfers to businesses (recapitalisation, reductions in costs and social contributions) and individuals (furlough schemes, helicopter money) and government-backed loans, the final bill will mean an unprecedented increase in public debt. This despite the fact that some stimulus plans are yet to be announced or approved.

A possible mutualisation of European debt! A major European support plan for the hardest hit countries and sectors, lobbied for by France and Germany and backed by the European Commission, is under discussion and could amount to some €750 billion (€500 billion in grants and €250 billion in loans). However, this is being countered by the "frugal four" (Denmark, the Netherlands, Austria and Sweden) and several Eastern European countries, fearful that the distribution of subsidies will be to their disadvantage.

WM-Mot du gerant-en-08072020

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Germany, which will hold the rotating presidency of the European Union for the next six months, is intent on reaching a historic agreement at the next EU summit due to take place on 17 and 18 July. If the negotiations are successful, they will demonstrate to eurosceptics in southern countries the advantages of remaining united.

An unprecedented slump followed by a historic recovery? These measures and the current exit from lockdown seem to bode well for the shape of the recovery in developed countries. Although not all countries are ready to emerge from lockdown (see the complicated situation in the United States and South America), leading indicators (PMI, ISM, IFO, Michigan), retail sales and job creation have in some instances rebounded sharply. Yet in order to know what growth will look like in 2021 (V, √, U, L or W), we need to know whether there will be a second wave of the virus and if so, how well governments will cope with it. One thing is certain: many sectors (leisure, transport, etc.) will not be able to return to their pre-crisis level of activity until a safe and effective vaccine is universally available.

Extreme market volatility! Rarely have market movements been so dramatic and unpredictable (the Great Depression and the subprime crisis being notable exceptions). Between end-February and mid-March, equity markets underwent a correction of 25% to 40%, depending on the indices, with some daily changes exceeding -10%. Similarly, credit spreads have risen sharply, exacerbated by illiquid markets and have reached levels not seen since the peripheral debt crisis. Commodity prices have also plummeted, as evidenced by oil prices, which entered negative territory for a few hours due to the unwinding of futures, at a time when supply and stocks far exceeded expected demand with the world's major economies in strict lockdown.

Since the announcement of a raft of support measures at the end of March, high-risk asset classes have returned with much fanfare, as illustrated by the performance of US indices, which recorded their best quarter in 33 years. All in all, falls have been limited and have had little impact on indices with a significant weighting in tech stocks. Thus, the Eurostoxx 50, the S&P 500 and the Topix are down 13.76%, 4% and 9.4%, respectively, while the Nasdaq has surged by almost 13% since the beginning of the year!

The period saw a record amount of bond issuance in Eurozone bond markets, with €331 billion issued at the end of the first half (up 52% from the first half of 2019), corresponding to 75% of the total amount issued in the whole of 2019. Evidently this was possible due to the massive support of the ECB, which is also enabling governments to increase their public debt significantly without triggering a rise in long-term interest rates. Like equities, peripheral and credit spreads have eased significantly, with the Italian 10-year narrowing by about 100 bps against the German 10-year since mid-March, while credit indices have on average offset almost two thirds of their prior widening. Long-term risk-free rates, having hit record new lows (-0.86% for the German 10-year government bond), ended the first half some 20 bps down on end-2019 at -0.44%.

What are the risks to a V-shaped recovery of the global economy?

- The emergence of a second wave in the most developed countries, impacting consumer discretionary.
- Materialisation of the refinancing risk for emerging countries, whose debt levels have soared in recent years.
- A resurgence of geopolitical tensions between the United States and its trading partners (China, EU, etc.) in the wake of the US presidential elections and while Donald Trump is down in the polls.
- An inability to reach an agreement on the orderly exit of the United Kingdom from the European Union.
- In the Eurozone, the ECB's stimulus measures being blocked by Germany's Constitutional Court. However, this risk seems to have been averted given the current stance of the German government and Bundesbank members.
- An inability of EU Member States to agree on a large-scale recovery plan.

In the longer term, it is possible that the crisis could call globalisation as we know it into question, and particularly the spread of mass tourism and the excessive offshoring of manufacturing supply chains. In any event, the global economy is not expected to return to its pre-crisis level until 2022 at the earliest.

Echoing our last half-yearly communication (see Letter from the Manager for the second half of 2019), our positioning in high-risk asset classes at the start of 2020 was prudent. We therefore reduced our exposure to equities at the very beginning of the year before the dramatic correction occurred in March. We also reduced our sensitivity to certain cyclical issuers that were still present in our portfolio, while also lowering our exposure to those with weaker ESG ratings. We made up for these sales by buying core government securities.

This meant that we entered the crisis in a generally favourable position with less than 8% sensitivity to equities and very limited exposure to the most cyclical and less highly rated bond issuers. In terms of sectors, in the fixed-income portfolio, we were indeed entirely absent from the Automotive, Tourism and Aviation sectors and very underweight in Oil and Gas, which account for only 0.5% of our total portfolio.

Consequently, as the equity markets fell and credit spreads widened, we were able to seize opportunities by selling government bonds previously purchased at very low yield levels.

The strong rally in high-risk asset classes in recent weeks, with no real fundamental basis, has prompted us to take profits on equities and continue focusing on less cyclical companies when investing in the bond market. In addition, we took advantage of the yield curve flattening to increase our exposure to floating-rate securities and supplement our

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purchases of upside macro-hedges. Our variable component (floating-rate securities, macro-hedges, money market, etc.) now stands at more than 20%.

In terms of diversification assets, we made a commitment to three infrastructure and private equity funds, one of which specialises in ocean preservation. In real estate, we suspended some subscriptions awaiting improved visibility. However, we continued to invest in retirement homes in Germany and made a commitment to an open-ended fund specialising in social real estate (education, healthcare, student housing, etc.).

For the rest of the year, as long as core long-term rates remain negative, we will maintain lower interest rate sensitivity than our benchmark. In addition, given the current uncertainties, we will maintain the money market segment above 1%.

In equities, we are now close to neutrality and will take advantage of any sharp downturn to strengthen anew our beta. Conversely, if the rally were to intensify and take the markets close to their end-February levels, then we would shift underweight.

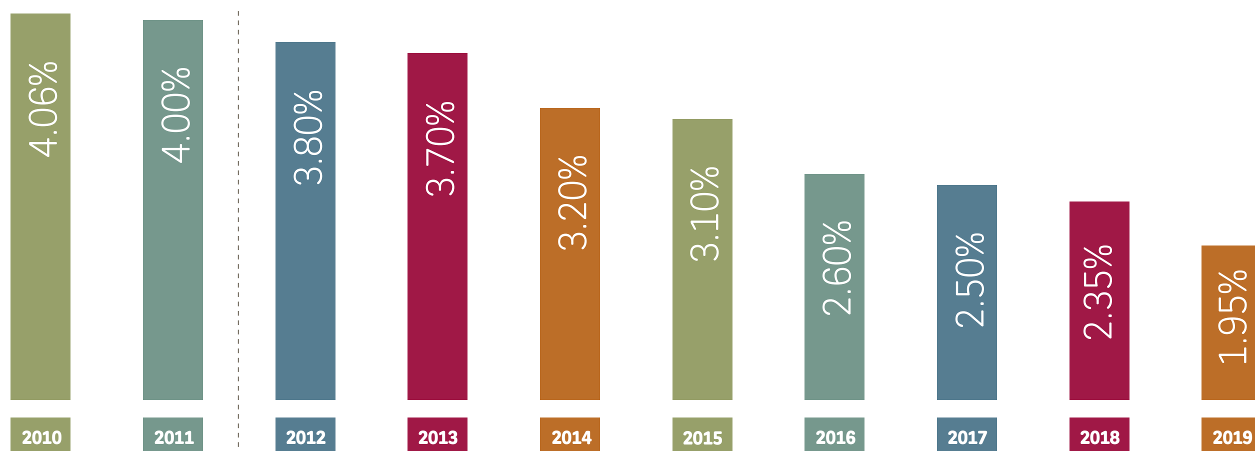
In other asset classes, we will take advantage of the current environment to make commitments to secondary private equity funds and private debt funds, a segment we have not invested in for more than three years. With regard to real estate, we are currently considering investments in city-center office space, healthcare and even hotels with a view to possibly benefiting from the sharp drop in valuations expected in this segment. Our target is to achieve an allocation of more than 4% by the end of 2021.

Lastly, we are continuing to work towards reducing the carbon footprint of our investments and have substantially increased our purchases of green bonds. In addition, we are still considering how best to implement an investment in reforestation.

François LUCCHINI
Director of Asset Management

KEY TAKEAWAYS

HISTORY OF THE GENERAL FUND'S GROSS RETURNS[1]

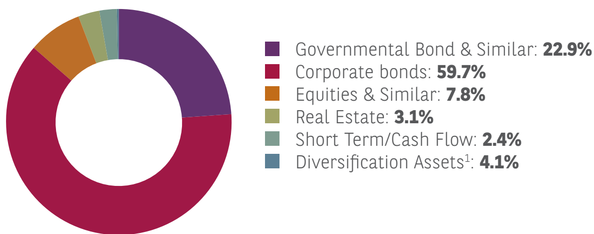


1- The performances reported up to the end of 2011 relate to the General Fund offered by Cardif Lux International (part of BNP Paribas Cardif assets). Since 2012 the General Fund has been under the direct management of Cardif Lux Vie. Details of past returns provide no guarantee or limitation of future returns. Returns do not take account of the management costs for investment instruments.

MANAGEMENT OF THE CARDIF LUX VIE'S GENERAL FUND AS AT 30/06/2020

Capitalisation of the General Fund in market value: 9.43 billion EUR.

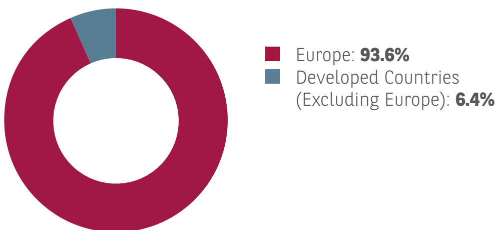
COMPOSITION OF THE CARDIF LUX VIE'S GENERAL FUND



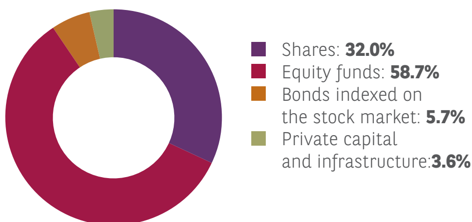
COMPOSITION OF THE EQUITIES COMPARTMENT

Share risk exposure around 8% (beta).

EQUITIES COMPARTMENT DETAIL BY GEOGRAPHIC ZONE



DETAILS OF THE EQUITY SECTOR BY NATURE.



COMPOSITION OF THE BOND COMPARTMENT

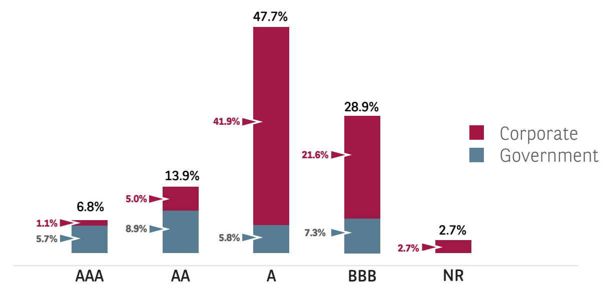
The global sensitivity to the rates of our portfolio is close to 4.9.

BOND COMPARTMENT DETAIL BY RATING

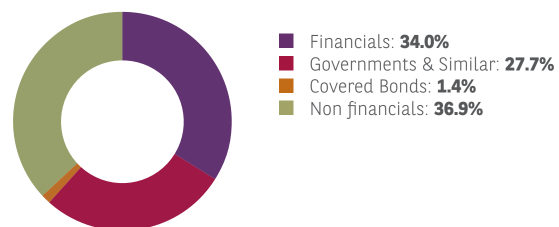
The bond portfolio has an excellent quality rating with an average rating of "A".

Rating[2] of the Government State Bonds in portfolio at 30/06/2020 :

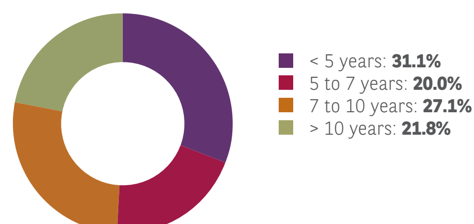
AAA : Luxembourg, Germany, Netherlands and European agencies
AA : Finland, France, Belgium, Austria
A : Slovakia, Spain, Poland, Ireland
BBB : Italy and Mexico



BOND COMPARTMENT DETAIL BY ISSUERS



REPAYMENT SCHEDULE OF THE BOND COMPARTMENT



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

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