

## Fixed Income Management

### LONG RATES

■ **The Greek situation is still fuelling the news cycle**, once again raising worries and increasing risk aversion and volatility in the markets. Greece is unable to seek refinancing from the markets in 2012, as provided in the initial rescue plan in 2010. It therefore now needs a new financing plan for the next two years.

Discussions on the arrangements of the new plan have been initiated and the private sector's participation has been mentioned. At present, it appears that the states are struggling to reach an agreement on the terms of the private sector's involvement. All of this should still take a few weeks, which will sustain a high degree of uncertainty. However, the IMF is ultimately expected to agree to pay out the fifth tranche of the 12 billion package against assurances that new austerity measures will be voted in before the end of June to avoid triggering the country's default during the summer.

Persistent worries about Greece and pressure from rating agencies on eurozone countries have fuelled the flight to quality, favouring lower interest rates in the core European countries and the United States. The fall in rates was also guided by economic fundamentals which recorded a sudden deceleration of U.S. activity. The slowdown in the U.S. economy caused us to revise our

expectation for the 3-month rate in the U.S. and the eurozone (France). Factors favouring higher interest rates, including rising inflation in the coming months, the end of QE2 (reduced flows from U.S. debt buyers), and difficulties in reaching an agreement to raise the statutory ceiling for U.S. public debt, will be tempered by the slowdown under way in the U.S. and continuing risk aversion. We are revising our 3-month target to 3.3% for the U.S. 10-year rate, and to 3.5% for the 10-year French rate.

### CREDIT

■ **The escalation of risk aversion has reached the credit market**, which up to now had shown good resistance. Spreads are widening, particularly on subordinated debt and "high beta" debt which have posted the best performances year-to-date. Despite the context of widening risk premiums, the primary market stayed very active until the beginning of June, albeit against a backdrop of significant redemptions. Some technical and fundamental factors remain positive for the credit market; nevertheless, the pressure on states from rating agencies, European difficulties in finding a short-term resolution to Greece's problems and the sudden slowdown of the U.S. economy are weighing on spreads. We are returning to a neutral stance on this asset class.

### INFLATION-INDEXED

■ **Inflation-indexed bonds are underperforming nominal bonds.** The context of risk aversion, the recent decline in oil prices and a less favourable carry trade for the coming months is weighing on indexed assets. Current valuations nevertheless reveal low expectations (1.8%) in terms of inflation rates. We are maintaining our neutral position on the eurozone.

### A WORD ABOUT THE INVESTMENT STRATEGY

■ **The climate of risk aversion and a slowing U.S. economy have led us to re-establish a neutral exposure** to interest rates in the portfolios.

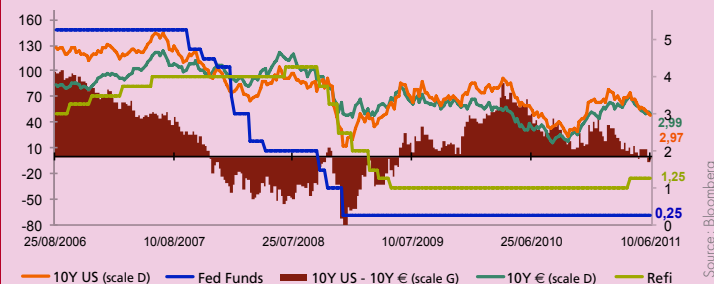
The position on the flattening of the 2-to-10 year segment has been strengthened. Short maturities remain underweighted in anticipation of the upcoming rate hike by the ECB in July and the 10-year zone has been raised to a slight overweight.

Our country allocation continues to underweight the three countries that have called on European aid. In order to limit expected volatility in the coming weeks, we are returning to neutral on Italy and Spain.

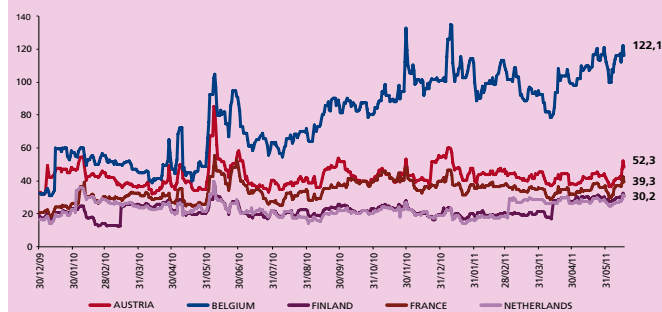
On credit, we are reducing our sensitivity to 100 % due to the environment.

G.M

Change in the short and long rates in the United States and the Eurozone



10 year Core Sovereign Spreads



10 year Peripheral Sovereign Spreads

