

Fixed Income Management

LONG RATES

■ **Two weeks to save the euro....** Phases of extreme risk have characterised the market in recent weeks, fuelled, among other things, by the procrastination of European states on ratifying the plan to extend the EFSF, and the postponement to a later date of payment of the sixth tranche of aid to Greece.

Statements by politicians and European authorities in recent days have revived the hope of forthcoming announcements of new measures to resolve the crisis. Any news reporting on considerations or progress of new actions is hailed with great relief by the markets, leading to a decline in risk premiums and an upturn in interest rates in the core European countries.

Confidence in the markets and in economic actors must be restored. Decisions by political authorities are awaited with bated breath. In the meantime, uncertainty will remain very strong and volatility very high.

The sustained recovery of confidence will, in our view, depend on the kind of announcements issued about the recapitalisation of European banks, the power of the EFSF to limit any future risk of contagion, and the handling of Greek debt.

The risk of disappointment is likely, however, in light of expectations and provisions for implementation.

Against this backdrop, we expect rates in the core countries to remain low at the 3-month horizon, especially since we believe that the market is underestimating the reality of the economic

downturn. Over the longer term, improvement in the situation of the banking system, progress on resolving the sovereign debt crisis and a willingness to nudge treaties toward greater economic and fiscal integration should drive core-country interest rates higher.

CREDIT

■ **Phases of extreme risk resulted in a further rise in risk premiums in the market for private debt.** Such a widening of spreads, in the context of major distrust of the financial sector, has mainly materialised on bank debt and subordinated insurance debt.

Corporate industrial debt, on the other hand, has shown some resilience. The primary market is very gradually re-opening to corporates. However, financiers are not in a position to seek funding on the bond market.

Meanwhile, the secondary market has still not returned to normal. The ECB nevertheless gave a positive signal with the reactivation of purchases of covered bonds and of 12- and 13-month LTROs, easing pressure on the liquidity of the European banking system.

From a valuation perspective, current levels already incorporate a recessive scenario on credit. In the short term, the lack of visibility and still-high volatility continue to urge caution on the asset class.

INFLATION-INDEXED

■ **Strong risk aversion and a negative carry trade continued to penalise inflation-indexed assets.** Nevertheless, it appears that inflation break-even points have bottomed and valuations are attractive on a medium-term horizon. The carry-trade outlook is favourable at 3 months. We are adopting a neutral stance on this asset class.

A WORD ABOUT THE INVESTMENT STRATEGY

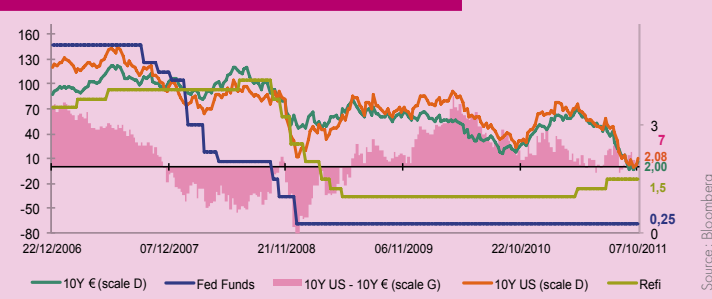
■ **The coming weeks will be crucial, and uncertainty will be the watchword in the short term.** Faced with this lack of visibility, we are maintaining a neutral position on exposure to rates and a slight bias toward the flattening of the 2-10 year segment.

In terms of country allocation, the preference for core countries is maintained, but to a lesser degree versus Italy and Spain.

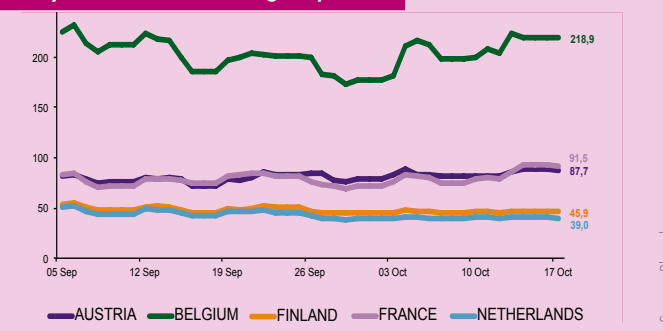
On credit, we are maintaining an asset allocation of 95%, conserving our bond positions, and managing volatility pending crucial deadlines in Europe.

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

