

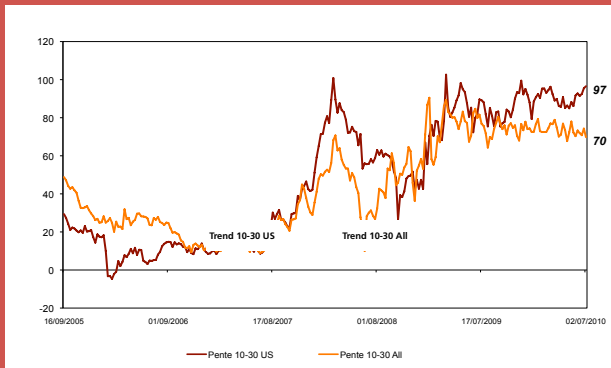
FIXED INCOME MANAGEMENT

Eurozone

SHORT RATES

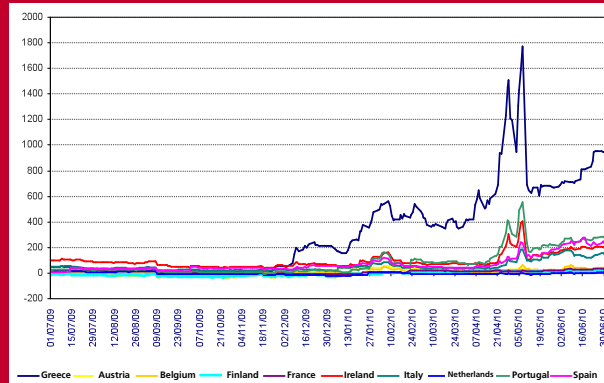
The BCE meeting on 10 June, unlike the previous one, fully reassured the markets. Of course, this was not because of concerns as to the refi rate, which is soundly anchored to the 1% mark and for which expectations of upward movement are very low. It was because liquidity at the beginning of the end of the long-term refinancing had engendered so much discussion the previous year. In fact, all the analyses show that the market's excess liquidity is currently due to the Central Bank alone, and that inter-bank exchanges remain anaemic, hence the markets' attention to the forthcoming refinancings. Investors were fully reassured by both the speech and the measures that were implemented, but particularly by the major test on 1 July. Indeed, this was quite successful, with a drop of €440 billion in the one-year refinancing and a renewal level considerably lower (€160 billion), and specifically lower than expected (>€200 billion). All of that is in line with our expectations and projections, which we therefore maintain unchanged.

Change in 10-30 yr slopes for Germany and the United States



Source : Bloomberg

Evolution of 2 year interest rate spreads in the eurozone*



Source : Bloomberg

*The rates used are generic rates, a change in the benchmark obligation could result in an increase in yield

that of core countries. We are also keeping our portfolios neutral with regard to rate sensitivity, in the belief that in the short term, yield trends are expected to remain within a very narrow range, centred on current levels. Thus, we project short-term rate stability at, for example, 3% for the 10-year OAT, with very slight 12-month tension at 3.50%, down from our previous targets.

Inflation indexed

Once again this month, the continuous decline in core or global inflation figures and risk aversion have had an impact on the asset class. Indexed assets thus under-performed their nominal counterparts over the past month on all markets, with the exception of Japan, which benefited from direct purchases by the Finance Ministry. Given our expectations as to the market situation, as described above, there is no reason why the market is improving in the short term in this class of assets. We are therefore maintaining a zero weighting in our aggregate funds and a cautious position in our indexed funds.

LONG RATES

With Moody's lowering of Greece's LT rating, the emergence of slightly worse economic indicators and increasing concerns about Spain, risk aversion remains quite high on the bond markets. Thus, German bond yields returned to their previous low points, and peripheral sovereign debt saw risk premiums jump sharply, some to beyond their previous high points at the beginning of May. The reassuring factor that limited this increase was that the new government bond issuances occurring during the month, led by Spain, continued to be well received and accepted by the market, signalling very attractive yields. What is more, announcements by the various Treasuries offered indications of the completion status of their refinancing plans, which overall are quite advanced, with a few exceptions. We do not anticipate any major changes over the next few weeks in terms of either market psychology or macroeconomic environment, which is even expected to deteriorate in the second half. We therefore maintain a defensive country positioning, under-weighting peripheral debt and overweighting

FIXED INCOME MANAGEMENT

United-States

SHORT RATES

At the last FOMC meeting, Mr. Bernanke sent an important cautionary signal regarding the US economic recovery. Expectations of increases in the Fed Funds rates were then once again put to rest. The first increase is now expected in the summer of next year. Nevertheless, dissent remains among the governors with a vote that continues to push for normalisation of the curve, both to restrict the creation of a bubble in certain assets, and to give the Fed further room for manoeuvre in the context of potential asset sales. We acknowledge this change of tone, however, and are therefore revising our 12-month target to 0.75%.

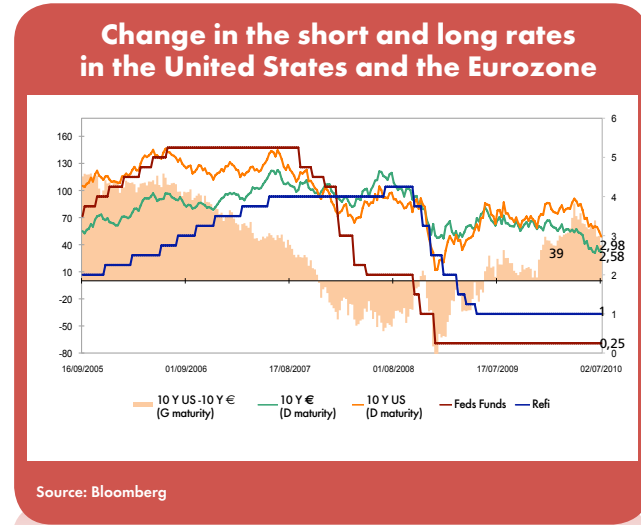
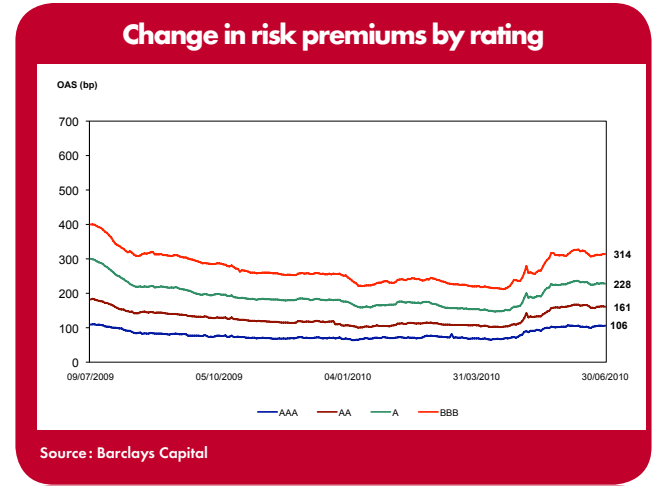
LONG RATES

In an environment favouring a flight to quality, US bonds have clearly benefited from their status as a safe haven. Thus, bond yields have continued their almost steady downward trend that began on 4 April, from 4% for 10-year rates to a low of 2.88% at the beginning of July. The publication of macroeconomic figures showing lower income also contributed to this rally. The contribution of this aversion to the risk of declining yields is expected to be gradually mitigated. However, we believe that the US recovery could be weaker, which will limit tensions. We therefore see a short-term target in line with the current 3%, and a 12-month target limited to 3.75%.

Lending

The most subordinated debts, in particular, have suffered from the environment described above, and the asset class as a whole saw its risk premiums rise slightly over the entire period. It is clearly not issuers' fundamentals that are the source of these trends – rather, these are quite good for the time being, and with a peak in default rates that now appears to be behind us – but rather the general environment and concerns about sovereign debt. We saw a slight easing of the primary market, giving us a bit of breathing space, but it was narrow in scope and of short duration.

The asset class continues to be supported by an appetite for yield that is undeniable and that limits sharp increases in risk premiums. The banks' stress tests could be catalysts for a welcome return of confidence; unfortunately the lack of coordination in defining these tests and the current lack of transparency sharply limit this reassuring aspect. By contrast, our expectations of a future decline in the global economic environment, and our fundamental worries regarding the financial sphere in the second half, appear to be of greater concern and compel us to show greater restraint towards the assets class as a whole, and specifically to lighten up on the financial sector, especially subordinated debt. Even if these concerns do not materialise immediately, the liquidity criteria for these assets have convinced us to begin this lightening process immediately.



Past performance is not a reliable indicator of future performance.



Philippe-Henri Burlisson,
Core Management Director