Lazard
Credit Opportunities

Q3 2022
Fund update

Investment objective

The fund's investment objective is to reach, over the minimum recommended 3-year investment period, an annual performance net of fees exceeding capitalised €STR +1.25% for RC EUR, capitalised €STR +2.00% for TC EUR, PC EUR and PD EUR, capitalised €STR +2.40% for PVC EUR, Daily Effective Compounded Federal Funds Rate +2% for PC USD and PC H-USD and Daily Effective Compounded Federal Funds Rate +1.25% for RC H-USD and RD H-USD. The fund is actively managed. Fund performance is benchmarked against the index that the Fund Manager has deemed the most appropriate. Fund performance is intended to exceed that of the designated benchmark index. The fund is not strictly limited to the benchmark index because it can invest in securities and asset classes that are not included in the index.

Fund description

- Lazard Credit Opportunities is a global, flexible and non-benchmarked fixed income fund.
- The fund can invest across the entire fixed income spectrum to seize the numerous opportunities offered by the various sub-asset classes (sovereign debt, investment grade and high yield corporate debt, senior and subordinated financial debt, and emerging market debt).
- Lazard Credit Opportunities is underpinned by our macroeconomic analysis and integrates our experts' most strongly held convictions in high yield and financial sector debt.
- This strategy uses a multitude of performance drivers, including yield curve positions, geographic and sector diversification, subordination levels, and actively managed interest rate and credit risk.

Third quarter 2022

Between 30 June and 30 September 2022, **Lazard Credit Opportunities posted a performance net of fees in euros of +2.59% versus +0.49% for the benchmark index**.

Key takeaways

- **The rise in interest rates continued during the quarter amid inflation and central bank monetary policy tightening**.
- **Our negative duration** was the main contributor to performance during the period. **We adjusted the fund's profile by neutralising our overall duration in early October. Portfolio duration now stands at +0.6** (Portfolio Euro natural duration: +1.8 | US duration: -4.1 | Euro duration: +2.9).
- **Despite solid credit fundamentals, massive outflows from European credit funds continued over the quarter.**
- **Performance remains robust overall[1]. The fund ranks in the first quartile over all periods:** year to date, 1, 3 and 5 years.

Market backdrop

- Summer kicked off with a constructive quarterly earnings season. Broadly speaking, both **corporates and financial institutions published results that encouraged investors back to credit**, particularly investment grade. High yield was also in favour, but to a lesser extent. This held true until Fed Chair Powell's Jackson Hole speech at the end of August. **Investors had no doubt been betting on a more dovish tone and a slowdown in the pace and/or size of central bank interest rate hikes** as fears of economic recession grew.
- In reality, **Chair Powell stood firm** during the Economic Symposium and made clear the Fed's **commitment to stamping out inflation**.
- In early September, on the other side of the Atlantic, **ECB chief Lagarde echoed this determination to fight inflation**. Following the ECB's 50 bps rate hike in July, the central bank decided to raise rates by a further 75 bps, the largest ever increase in its key benchmark rates.
- At the end of the quarter, US 5-year and 10-year sovereign yields stood at 4.09% (+105 bps) and 3.83% (+82 bps) respectively. German sovereign yields closed the period at 1.96% for the 5-year bond (+90 bps) and 2.11% for the 10-year equivalent (+78 bps).

Source: Lazard Frères Gestion as of 30 September 2022. 1. Morningstar: the comparison universe is composed of open-end funds marketed in Europe that are referenced in the Morningstar database at the calculation date in the EUR Flexible Bond category, with priority given to the institutional unit class. **Past performance does not guarantee future performance. Performance is provided as an indication only and should be assessed at the end of the recommended investment period.** The opinion expressed above is correct at the time of writing and liable to change. For further information on the funds' characteristics, risks, and fees please refer to the prospectus available upon request or online at www.lazardfreresgestion.fr.

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Main relative performance contributors[1]

- The interest rate effect contributed to fund performance over the third quarter: +256 bps. **Our negative duration profile (+395 bps) offset the adverse impact of rising interest rates (-166 bps)** and in particular our short positions in 2-year (+46 bps), 5-year (+178 bps) and 10-year (+166 bps) US futures.
- **The credit effect also contributed to performance** (+38 bps), particularly the corporate high yield segment (+57 bps).

Portfolio positioning and changes

- Lazard Credit Opportunities is **primarily invested in offensive credit** (26% corporate high yield, 5% hybrid corporate high yield, 32% subordinated financial debt, 8% senior financial debt).
- We remain **positioned on short maturities**: 77% of portfolio holdings have a maturity of 3 years or less.
- **At the start of July**, and in light of concerns over gas supplies to Europe, we decided to adjust our duration profile. We halved our short European duration in favour of a short US duration position:
    - We bought back our entire short position on 10-year European interest rates and reduced our short position on 5-year European interest rates by one third.
    - We maintained our short position on 2-year European interest rates.
    - We initiated a short duration position on 2-year and 5-year US rates.
    - **The portfolio's modified duration remained unchanged at -4.6.**
- **A few days later,** following the start of maintenance work on the Nord Stream 1 gas pipeline, we readjusted our duration profile:
    - We scaled back our short position on short-term European interest rates (2 and 5 years) from -3.2 to -1.9.
    - We initiated a long position on long-term European interest rates at +1.6 (spread across 10-year and 30-year interest rates).
    - We maintained our short position on US 2-year and 5-year interest rates.
    - **The portfolio's modified duration went from -4.6 to -1.7.**
- **On 12 July**, given concerns over gas rationing and the negative impact this would have on economic growth, we **neutralised both our interest rate and credit exposure**:
    - We increased our long position on long-term European interest rate exposure from +1.6 to +2.8 (across German, French and Italian 10-year interest rates and the German 30-year interest rate). The fund's European duration accordingly moved into positive territory at +1.3.
    - We maintained our short duration on US 2-year and 5-year rates.
    - **The portfolio's modified duration went from -1.7 to 0.0.**
    - We also increased our **credit risk hedging to 50% of the portfolio's net assets** (index CDS) in order to bring spread duration closer to 0.
- **On 25 July** and given the diminishing probability of drastic cuts to Europe's gas supplies, we **repositioned the portfolio to adopt a negative duration profile** (approximately -4.7 via short positions on US and European 2-year and 5-year interest rate futures) and we unwound our credit hedges.
- **Investors regained an appetite for investment grade** credit during the summer months. As a result, we **sold Main (investment grade) protection in order to increase tactical exposure to the asset class**. At the beginning of August, while our fundamental view remained unchanged, credit risk spreads then narrowed such that we **took profit on these tactical positions**.
- Exposure to European inflation-linked bonds was scaled back (from 15% to 9%) in order to **reposition ourselves on solid BB-rated issuers and subordinated debt** yielding above 4%. In mid-September, we slightly raised our exposure level to the asset class to approximately 12%.
- Mid-August, **we set up a credit hedge** (Index CDS for approximately 30% of the portfolio's net assets) and in mid-September, this was **increased to 60% of net assets**. At the end of September, following credit spread widening, we took profit and scaled the hedge back to 40%.
- Our **liquidity level is high**, standing at approximately 7% of net assets.

Source: Lazard Frères Gestion as of 30 September 2022. **1.** Gross performance contribution estimates. **Past performance is no guarantee of future results. Performance is for indication only and is calculated at the end of the recommended investment period.** For more information on fund characteristics, please refer to the prospectus, which is available upon request from Lazard Frères Gestion, or on the website www.lazardfreresgestion.fr.

- **At the beginning of October**, given the **greater likelihood of European recession** and an alarming geopolitical backdrop, we decided to reverse our overall under-exposure to interest rates. **We accordingly neutralised the portfolio's modified duration with a long European interest rate position and a short US interest rate position[1].**
- **The portfolio's modified duration went from -4.0 to +0.6:**
    - Natural Euro portfolio duration: **+1.8**
    - Euro interest rate duration: **+2.9:**
        - 2-year rates: **-2.6**
        - 10-year rates: **+2.9**
        - 30-year rates: **+2.6**
    - US interest rates duration: **-4.1** (10 years: -2.8 | 30 years: -1.3)

Outlook

- In the United States, the **labour market is not currently displaying any real indication of a downturn**, which will likely encourage the Fed to push ahead with interest rate hikes.
- In the eurozone, **signs of an economic downturn are materialising** (PMI, German employment figures) but the **decline remains moderate at this stage**.
- In terms of credit, **third-quarter earnings** will soon be published and **open to scrutiny**.
- **Euro high yield credit outflows** are a key element and should be monitored going forward.
- **Credit carry is becoming more attractive, but we expect risk premium spreads to widen further**.

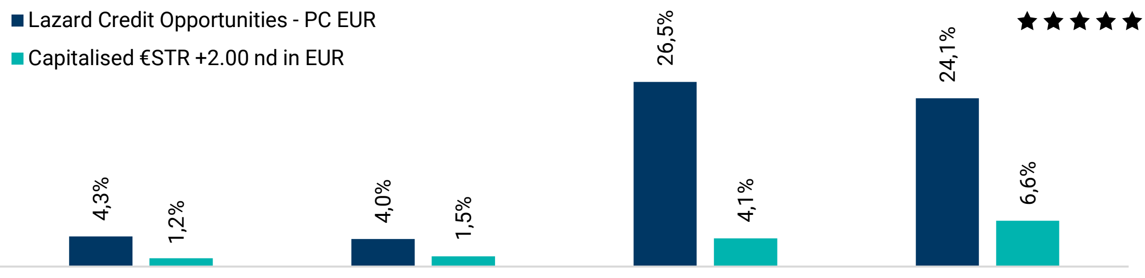
Key figures as of 30/09/2022

AuM
€691 M

Yield to maturity / to worst[1]	Modified duration	Credit exposure	Average rating issuers/issues[2]	Number of issuers/issues
Gross 6.5% / 6.2%	-4.0	0.1	BBB- / BB+	127 / 196

Net performance as of 30/09/2022 (%, in euros)

★★★★★



	2022	1 year	3 years	5 years
Quartile[3]	1	1	1	1

	New Strategy									
Annual performance (%)	**2021**	**2020**	**2019**	**2018**	**2017**	**2016**	**2015**	**2014**	**2013**	**2012**
Lazard Credit Opportunities PC EUR	**2.8%**	**13.2%**	**8.8%**	**-7.2%**	**6.5%**	**6.5%**	**-1.6%**	**2.2%**	**7.2%**	**24.4%**
Benchmark[4]	1.2%	1.3%	1.4%	1.4%	-0.4%	-0.3%	-0.1%	0.1%	0.1%	0.2%

Risk[5]	Volatility	
	Fund	Index
1 year	8.0%	0.0%
3 years	9.6%	0.0%

Fund Manager–Analyst[6]

Eléonore Bunel
Managing Director
Head of Fixed Income
Fund Manager–Analyst

Sources: Lazard Frères Gestion as of 30 September 2022.
Yield to maturity and yield to worst, excl. credit hedging.
1. Excluding the tactical CDS position.
2. Average issue rating excl. liquidity
3. Morningstar: the comparison universe is composed of open-end funds marketed in Europe that are referenced in the Morningstar database at the calculation date in the EUR Flexible Bond category, with priority given to the institutional unit class.
4. Capitalised Eonia +2.00%
5. Calculated weekly over 1 year and 3 years.
6. While turnover at our teams tends to be very low, we cannot guarantee that the fund managers referred to above will remain throughout the product's life cycle. **Past performance is no guarantee of future results. Performance is for indication only and is calculated at the end of the recommended investment period.** For more information on fund characteristics, please refer to the prospectus, which is available upon request from Lazard Frères Gestion, or on the website www.lazardfreresgestion.fr. **Marketing material for professional investors only.**

Main risks

Risk of capital loss: the SICAV is not guaranteed or protected, and therefore, there is a possibility that you may not get back the full amount of your initial investment.

Interest rate risk: there is a risk of a fall in the value of bonds and other fixed-income securities and instruments, and hence in the portfolio, resulting from a change in interest rates. The value of this component of the portfolio may decrease due to the sensitivity range applied.

Credit risk: credit risk is the risk that the issuer of a bond may default. This could decrease the SICAV's net asset value. Even in cases where the issuer has not defaulted, changes in credit spreads could give rise to a negative performance. The decrease in the NAV may be even greater if the SICAV is invested in unrated or speculative/high-yield debt.

Risk associated with investment in the futures markets: the SICAV may invest up to 100% of its assets in forward financial instruments. Such exposure to markets, assets or indices through forward financial instruments may lead to falls in the NAV that are significantly more pronounced or faster than the change in the underlying assets.

Counterparty risk: this is the risk associated with the SICAV's use of over-the-counter financial forwards. These transactions, entered into with one or more eligible counterparties, potentially expose the SICAV to a risk of insolvency of any such counterparty, which may lead to default on payment or cause the SICAV's net asset value to fall.

Liquidity risk: this is the risk that a financial market can absorb the volumes of sell (or buy) transactions only by significantly decreasing (or increasing) the price of assets when trade volumes are low or when there are market tensions, resulting in a possible decrease in the Fund's net asset value.

Risk associated with investment in the futures markets: The use of derivatives may cause exposure to an upward or downward change of the Fund's net asset value.

Risks linked to contingent or subordinated securities (CoCos): the Fund may be exposed to contingent or subordinated securities. Subordinated debt and contingent convertible bonds are subject to specific risks of non-payment of coupons and capital loss in certain circumstances. At a certain solvency threshold, referred to as the "trigger" threshold, the issuer may or must suspend the payment of coupons and/or reduce the nominal value of the security or convert such bonds into shares. Notwithstanding the thresholds specified in the issuing prospectuses, the supervisory authorities may apply these rules preventively if the circumstances require, based on a subjective threshold known as the "point of non-viability". These securities expose holders to either a total or partial loss of their investment following their conversion into shares at a predetermined price or because of the application of a discount provided for contractually in the issuing prospectus or applied arbitrarily by a supervisory authority. Holders of these securities are also exposed to potentially large price fluctuations in the event that the issuer has insufficient equity or experiences difficulties.

Foreign exchange risk (on an ancillary basis): the SICAV may invest in securities and UCI that are themselves permitted to purchase stocks denominated in currencies other than the euro. The value of such UCIs' assets may fall if exchange rates fluctuate, which may lead to a fall in the SICAV's NAV.

Sustainability risk: The risk that an environmental, social or governance event or situation will occur that could have a material adverse effect, actual or potential, on the value of an investment.

Risk scale* :

Lower risk, returns are likely to be lower — *Higher risk, returns are likely to be higher*

1 2 3 **4** 5 6 7

*Exposure in the interest rate and exchange explains the UCITS ranking in this category. The used historical data could not give a reliable indication of the future UCITS risk profile. Nothing guarantees that the above category remains unchanged, and the ranking may evolve in the time. The lowest category is not synonymic of risk-free investment. Capital is not guaranteed.

For more information about fund's other characteristics and risks, please refer to the prospectus available from the company on request or on www.lazardfreresgestion.fr

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