Lazard
Euro Corp High Yield

Q3 2022
Fund update

Investment objective (PC EUR Units)

The fund's investment objective is to achieve performance net of management fees over the recommended three-year investment period that exceed the ICE BofAML BB–B Euro High Yield Non Financial Fixed & Floating Rate Constrained Index. The benchmark is denominated in euros. Net dividends are reinvested.

The fund is an 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

- Investment in euro-denominated high yield corporate bonds that are issued by primarily European companies (excluding financial institutions) in the OECD.
- A rigorous security selection process spanning the full rating spectrum.
- An active and flexible approach both in terms of alpha (security selection) and beta (market direction).

Third-quarter 2022

Between 30 June and 30 September 2022, **Lazard Euro Corp High Yield posted a performance net of fees in euros of +0.45%, an outperformance of +53 bps** compared to -0.08% for the HEAG index.

Key takeaways

- Companies are currently in **good financial shape** but **credit ratios can be expected to deteriorate due to the recession** expected in quarters ahead.
- At the end of September, **risk premia (658 bps) were pricing in a 6.8% default rate**, which we believe is consistent with the scenario of initially healthy businesses, expectations of a modest recession and defaults that are currently close the Covid peak of 4.9%. We keep in mind that spreads reached higher levels in previous recessions (800 bps minimum).
- **Investors** can be expected to remain **cautious** as alternative investment opportunities now exist within the bond universe.
- **Lazard Euro Corp High Yield continues to outperform its index over all periods.**

Market backdrop

- Apparently stable performance in the asset class over the quarter (-0.8%) masked **fierce volatility**.
- **Interest-rate changes fuelled the fluctuations in spreads**. A fall in rates that began in mid-June had boosted confidence in the credit market by early July given expectations of less monetary tightening to avoid hampering growth. By 16 August, spreads had narrowed from 673 bps to 545 bps.
- Subsequently, **interest-rate rises in mid-August** triggered a correction in risk premia. Indeed, **the energy crisis put the spotlight on inflation issues** and led to **tougher central bank messaging**. Spread widening peaked at the end of September with the **UK's mini-budget fiasco**. Risk premia retraced to the levels seen at the end of June (658 bps as of 30 September).
- **Against this backdrop, the asset class remained stable over the quarter, with the sharp rise in yields** (+91 bps on the German 5-year bund over the period) **being offset primarily by carry** (7.6% as of 30 June) **and modest risk premium tightening** (-15 bps). The performance illustrates the **asset class's significant buffer against market shocks**.
- Somewhat counter-intuitively given the uncertainty, **CCC credit outperformed** (again due to high carry) over the period, **while BB credit slightly outperformed the single-B segment**.

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- Corporate earnings releases were positive, **demonstrating corporate robustness**. Broadly speaking, **businesses are managing to pass some or all of their higher costs through to their customers**, as demand levels remain healthy. Many companies have confirmed their 2022 guidance and some have even revised targets upwards
- While July and August seemed to ride the wave of positive momentum, **some profit warnings emerged in September**. This suggests that **demand is starting to falter** in, for example, the chemicals and retail sectors, which in turn makes it more difficult for companies to pass inflationary pressures through to consumers. The **next earnings season could take a turn for the worse,** with the situation deteriorating in subsequent quarters.
- That said, **default rates currently remain at very low levels** (1.9%) and there were no noteworthy events across the investment pool. Moody's forecasts a rise in default rates to 3.3% by the end of August 2023 in line with the deteriorating macroeconomic situation.
- Indeed, in addition to an economic slowdown or recession, **businesses will face higher financing costs**. The good news is that for the past two years, **the primary market has been extremely busy**. Companies have been able to **fix their financing costs at attractive levels, reducing their short-term financing needs**. For the few issuers that do need to refinance, alternative solutions (syndicated loans, private 'Schuldschein' placements) are proving less expensive than a primary market that is either virtually closed (€2.4 billion in the third quarter) or very expensive (9% minimum for single-B credit).
- Some companies are even taking advantage of their ample liquidity levels to **buy back below-par debt** (Softbank, Sappi). This technique **avoids higher financing costs in the future** by using balance sheet cash to **reduce gross debt levels** (Tendam).
- The rise in interest rates now means less risky assets are offering attractive returns (investment grade, Govies, even money market funds). Many investors have left the investment universe, leading to **significant outflows**: -14% of AUM at the end of September, which is as much as for the whole of 2018.

In short, the **market's valuation levels now seem attractive in absolute terms** (8.5% yield at the end of September). This should help to **absorb some of the shocks** that will likely occur as economies enter recession and leaves hope for **positive performance in the medium term**.

Main risks to monitor

- **Heightened geopolitical risk**
- **Energy supplies and prices**
- **Central bank policy errors**

Third-quarter 2022 fund performance

The fund posted a **performance of +0.45%**, outperforming its benchmark (HEAG) by +53 bps.

- This outperformance is due to:
    - **lower modified duration than the index** due to the decision to invest in shorter maturities
    - **more judicious selection of single-B securities**.

Positioning

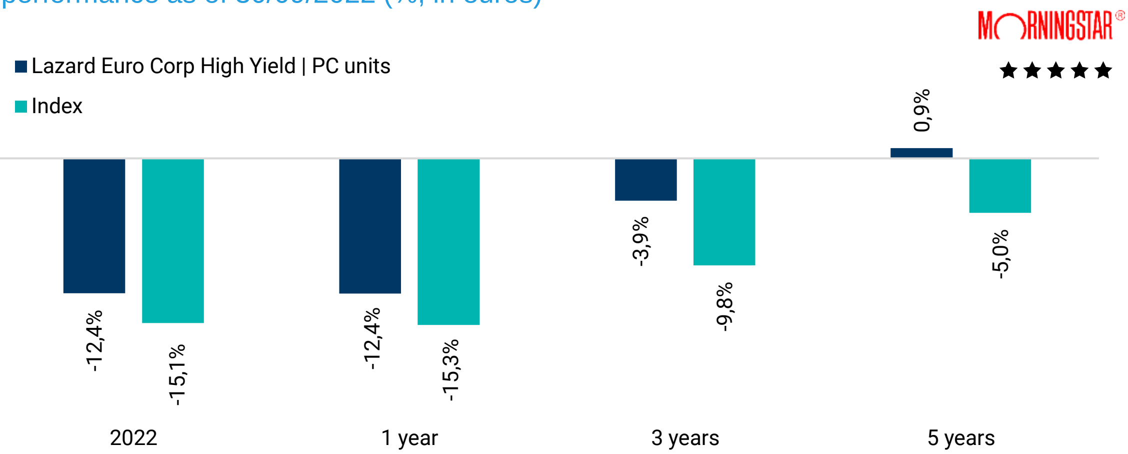
- **Positioning remains cautious**:
    - **Lower modified duration** than the index (despite a marginal increase)
    - **Underweight single-B credits** compared to the index
    - **High liquidity** at the end of September (10%), slightly reduced at the beginning of October (8%)
    - **Credit protection** (CDS) for 3% of the portfolio to hedge exposure to CCC credit (3%)
    - **Overweight defensive sectors** (healthcare, TMT) and sectors that remain buoyant in the third quarter (leisure).

Key figures as of 30/09/2022

AUM	Number of issuers	Average spread vs. Sovereign	Average issue rating[1]
€110 M	129	523 bps	BB

Yield to maturity	Modified duration	Spread duration
7.1%	2.6	2.6

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



	2022	1 year	3 years	5 years
Quartile[2]	1	1	1	1

Calendar performance and risk indicators (%, in euros)

Annual performance (%)	2021	2020	2019	2018	2017	2016	2015	2014	2013
Lazard Euro Corp High Yield PC units	**3.4%**	**4.3%**	**9.8%**	**-3.4%**	**6.1%**	**10.7%**	**-1.5%**	**5.5%**	**9.6%**
Index[3]	2.9%	1.5%	10.0%	-3.1%	5.7%	10.0%	0.2%	5.6%	8.4%

Risk[4]	Volatility	
	Fund	Index
1 year	6.2%	6.9%
3 years	8.8%	9.7%

Investment team[5]

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Fund Manager–Analyst

Andreea Grecu
Portfolio Manager–Analyst

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Portfolio Manager–Analyst

Source: Lazard Frères Gestion as of 30 September 2022.
1. Average rating excluding cash.
2. Source 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 High Yield Bond category, with priority to the institutional unit class.
3. HEAG index since 30 September 2010. Capitalised Eonia previously.
4. Calculated weekly over 1 year and 3 years.
5. 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 provided as an indication only and should be assessed at the end of the recommended investment period.

For further information on the funds' characteristics, risks, and fees please refer to the prospectus available upon request or online at www.lazardfreresgestion.fr.

Main risks

Risk of capital loss: The Fund is not guaranteed or protected and therefore there is a possibility that you may not get back the full amount of your initial investment. Investors should therefore be aware that they are not guaranteed to get back the money originally invested.

Interest rate risk: Risk of a fall in the value of the assets, and hence in the portfolio, resulting from a change in interest rates. Because of its sensitivity range, the value of this component of the portfolio may decrease, either in the case of a rise in interest rates if the portfolio's sensitivity is positive, or in the case of a fall in interest rates if the portfolio's sensitivity is negative.

Credit risk: Credit risk is the risk that the borrower does not repay his debt or cannot pay the coupons during the lifetime of the security. Risk of a fall in the value of the assets, and hence in the portfolio, due to a change in the credit quality of the issuers or to a change in credit spreads. Because of its credit sensitivity range, the value of this component of the portfolio may decrease, either in the case of a rise in spreads, if the portfolio's credit sensitivity is positive, or in the case of a fall in spreads if the portfolio's credit sensitivity is negative.

Derivatives risk: The Fund may be synthetically exposed by up to 100% of its net assets to fixed-income and/or index instruments. The use of derivatives on organised or OTC markets may expose investors to sharp rises and falls in NAV, via underlyings that react strongly to market fluctuations.

Counterparty risk: This is the risk associated with the Fund's use of forward financial instruments and OTC instruments. These transactions, entered into with one or more eligible counterparties, potentially expose the Fund to a risk of failure of any such counterparty, which may lead to default in payment.

Risk related to securitisation assets: Credit risk on these instruments mainly concerns the quality of the underlying assets, which may vary in type (bank debt, debt securities, etc.). Such instruments are the result of complex structuring that may often entail legal risks and specific risks related to the characteristics of the underlying assets. If these risks materialise, they may cause a decrease in the Fund's net asset value.

Emerging market risk: The main risks relating to investments in emerging countries may be due to the sharp movements in security and currency prices in these countries, potential political instability and accounting and financial practices that are less rigorous than in the developed countries. The Fund’s net asset value could fall in the event of a downward movement in these markets.

Equity risk: The Fund may be exposed to significant fluctuations in the underlying equities through possible investments in convertible bonds. Equity risk shall be an ancillary risk (less than 10%).

Risks linked to subordinated securities: The Fund may be exposed to subordinated securities. 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.

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*:

*Exposure in the interest rate and credit 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 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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Lazard Euro Corp High Yield is a French open-ended investment company with variable capital (Société d'investissement à capital variable) authorised and regulated as UCITS by the Autorité des marchés financiers and managed by Lazard Frères Gestion SAS.

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Derivatives: The portfolio invests in financial derivative instruments ("FDIs"). While the use of FDIs can be beneficial, they also involve risks different from, and in certain cases, greater than, the risks presented by more traditional investments. FDIs may be subject to sudden, unexpected and substantial price movements that are not always predictable. This can increase the volatility of the portfolio's Net Asset Value. FDIs do not always totally track the value of the securities, rates or indices they are designed to track. The use of FDIs to gain greater exposure to securities, rates or indices than by a direct investment, increases the possibility for profit but also increases the risk of loss. The Fund is also subject to the risk of the insolvency or default of its counterparties to FDI investments. In such events the Fund may have limited recourse against the counterparty and may experiences losses.

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