Quarterly Commentary

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" You have the watches, we have the time "
— Old Taliban Proverb
"The most important thing in a negotiation is to allow the other person to save face."
— Henry Kissinger

Off-Ramp

One of the most frequent critiques from the intelligence and security community, which has increasingly made its way into Wall Street commentary, regarding the current conflict with Iran is the alleged lack, from the outset, of a defined plan with clear objectives and a credible exit strategy (an "off-ramp"). In our view, the main weakness of that argument is the assumption that the current U.S. Administration continues to operate under the same strategic logic as its predecessors.

For Biden, Obama or Bush, among others, military engagements carried, at least in the public narrative, a meaningful ideological component: the expansion of liberal democracy and, by extension, the defence of the rules based international order, so frequently invoked in recent weeks. That framework enabled prolonged campaigns supported by allies who acted as genuine force multipliers, while also making them easier to justify domestically.

In today's **neo-mercantilist era**, the Administration appears to view conflict very differently. Across publications and public appearances, it has suggested a lens in which war, or even the threat of war, becomes a negotiating asset: a way to **monetise tension**, project power, secure strategic resources, correct trade imbalances through coercion and, ultimately, reinforce the dollar's reserve currency primacy within the logic of the **petrodollar system**. Put plainly, it is an approach that is distinctly transactional.

Under this logic, global security is being reframed as an almost compulsory subscription model. Allies are no longer partners bound by shared values, but rather customers of a defence umbrella whose price is ultimately settled, one way or another, in Wall Street terms.

What may initially look like a direct and positive boost to the earnings outlook for major defence, technology and related sectors, which have seen sales surge in recent quarters, is also generating **unintended consequences.**

From the perspective of U.S. allies, the shift is clear. Once the "toll" has been paid, they no longer view themselves as automatically committed to participate in conflicts that are difficult to legitimise domestically, a dynamic that, judging by his statements, appears to frustrate Trump.

There are also potential second order effects, particularly in the sphere of domestic security. In parallel, this dynamic has intensified the debate around the merits of developing independent nuclear deterrent capabilities, even as their relative effectiveness has been called into question by developments over the past year involving Russia, Israel or Pakistan. It also reinforces the case for effective diversification of geopolitical risk, both in trade exposure and in asset allocation.

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From Trump's own standpoint, the strategy also entails drawbacks. The United States is not currently positioned to sustain protracted conflicts, either fiscally or given the economic and political pressure they create. If war is framed in predominantly economic terms, a prolonged deterioration in financial markets and in 401(k) plans, one of Trump's preferred yardsticks for policy success, together with a persistent rise in gasoline prices and interest rates, would ultimately undermine both the rationale for the strategy and the sustainability of U.S. public debt.

Against that backdrop, it would be a mistake to assume that Trump cannot declare his objectives achieved unilaterally, while still providing an off-ramp to adversaries and shifting to third parties the logistical burden and cost of overseeing oil flows through the **Strait of Hormuz**. Such a stance would also be difficult to justify to the U.S. taxpayer, given the cost of protecting flows primarily destined for Europe and Asia.

Ultimately, whereas other presidents relied on the economy to finance wars, Trump uses war, or the threat of war, to finance the economy. The risk is clear: a radically transactional approach could hollow out long-standing alliances, erode the ability to project power over the long term and reduce allies to the status of mere clients.

PERFORMANCE

The fund returned -0.49% in Class A over Q1, versus the Bloomberg Global Aggregate at -1.07% (+0.84% in EUR) and the Euro Aggregate at -0.64%.

As in previous quarters, the period was a round trip. In March we saw a clear risk unwind in the themes and regions that had performed best in recent months, with selling pressure in European and emerging assets and currencies, and a rotation back towards the U.S. dollar and U.S. assets. Markets reacted not only to higher geopolitical uncertainty, but also to the risk that energy, trade and foreign policy could once again act simultaneously on growth, inflation and rates, bringing the stagflation narrative back into focus.

Market performance over the quarter was shaped by the contrast between a constructive first two months and a sharply dislocated March. **The ECB held rates unchanged at 2% throughout the period**, although President Lagarde's tone turned noticeably more cautious after the conflict escalated. The threat of a closure of the Strait of Hormuz pushed Brent towards $120/bbl, lifting euro area headline inflation from 1.9% in February to 2.5% in March, and reopening the debate about potential further rate increases. In the U.S., the quarter was marked by the appointment of Kevin Warsh as Chair of the Federal Reserve. His hawkish stance supported a stronger dollar and triggered a sharp correction in precious metals in January. The Fed held rates in the 3.50%–3.75% range throughout the quarter, and its projections point to at most one cut in 2026 following upward revisions to inflation expectations.

In fixed income, higher energy prices forced a repricing of expectations for inflation, growth and monetary policy. The front end was hit hardest, at points pricing more than four hikes and driving a marked curve flattening, particularly in Europe.

This repricing was global as multiple central banks shifted to a more hawkish tone, pushing breakevens higher and tightening real rates worldwide. Even so, we note that the Fed has remained relatively measured, arguing it does not see a sustained rise in inflation expectations stemming from the conflict. Despite keeping rates unchanged at its latest meeting, balance-sheet data indicate continued expansion since the start of the year at an almost $10 trillion per week pace.

During the quarter, we sought to navigate the volatility as effectively as possible, tactically reinstating duration and credit risk hedges, while also reintroducing some USD exposure.

As we have argued consistently, robust risk management remains the best tool for navigating the uncertain backdrop ahead. As Xi Jinping has put it, **"the world is undergoing changes unseen in a century."**

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We therefore run a more diversified portfolio than ever, both sectorally and geographically. In this context, we favour geographies rich in natural resources, both mineral and energy, primarily via sovereign debt and or supra-national issuers, preferably in the intermediate part of the curve. From a credit perspective, which represents around 45% of exposure, we had materially reduced the weight of banks and insurers, given the combination of spreads at historical lows and the potential consequences of a deterioration in private credit markets.

Over the quarter, the main positive contributors were high yield credit hedges, convertible bonds in names such as Eni, zero coupon positions in Brazil and Mexico, and exposure to inflation linked bonds, particularly in long dated Italian maturities.

On the negative side, the main detractors were euro corporate credit, USD hedges, Polish government debt and bonds issued by European banking institutions.

POSITIONING AND OUTLOOK

The escalation of the conflict came as a cold shock to the global investor community and has reopened the stagflation debate in a manner reminiscent of the Volcker era.

As argued above, we believe today's set-up is materially different. Oil has not quadrupled as it did then, and there are mechanisms in place that make a repeat of that episode far harder to replicate.

Unlike in the past, many countries now have strategic reserve systems that can cushion this supply shock, at least for a period of time. In addition, as has become clearer in recent weeks, Bessent and the Trump Administration have moved to ease sanctions on Russian and Venezuelan crude, as well as Iranian barrels already afloat. Perhaps more importantly, wage indexation mechanisms are largely absent today, helping to avoid the damaging wage price spiral of the past and to keep inflation expectations better anchored.

This is, in our view, what 5y5y inflation swaps are pricing. In contrast to the sharp widening in breakevens, 5y5y pricing has tightened meaningfully. We interpret this as the market anticipating adverse effects on aggregate demand from higher energy prices and tighter financial conditions, dynamics that are **more recessionary than inflationary.**

As we argued at the outset, the essentially commercial lens through which Trump approaches the use of the U.S. defence industrial base suggests the conflict is unlikely to be prolonged. As the market begins to price that outcome, alongside greater oil availability, we would expect a meaningful correction at the front end, a normalisation of financial conditions and, ultimately, a compression in risk premia. Together with fiscal support measures adopted by many governments, this could underpin a strong rebound in risk assets.

While remaining mindful of near-term risks, we believe that a reopening of transit through Hormuz would quickly shift attention back to the structural themes shaping the new cycle. The first is the reindustrialisation of the West, driven by economic security considerations. The second is the gradual reallocation of capital away from the United States towards geographies with more attractive relative valuations, less strained fiscal frameworks and, ideally, abundant critical natural resources. The third is the ongoing real adjustment of Western debt, as monetary discipline gradually gives way to **more expansionary fiscal and monetary policies** amid a larger role for the state.

As of quarter-end, the portfolio yield to maturity was 4.70%, with a modified duration of 5.55 years and a coupon carry of 3.20%. The portfolio's weighted average price was 90.1 cents on the euro. U.S. dollar exposure was reduced to 0.0% via futures hedges.

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