Inflation Perspective

October 2012

AXA IM has launched the AXA WF Universal Inflation Bonds fund during the course of July 2012. This new fund completing our Inflation Linked bonds offering offers access to developed as well as emerging markets inflation linked bonds using a transparent approach in order to enhance diversification.

Latest releases

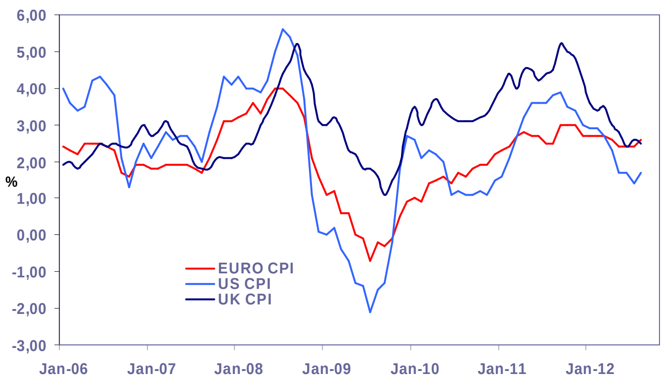
Indicators	Country	Previous	Next release
RPI (annual)	UK	2,90%	16-Oct-12
CPI (annual)	US	1,70%	16-Oct-12
	UK	2,50%	16-Oct-12
	Euro	2,60%	16-Oct-12
	FR	2,40%	11-Oct-12
PPI (annual)	US	2,00%	12-Oct-12
	UK	2,20%	16-Oct-12
	Euro	2,70%	06-Nov-12
	FR	2,60%	31-Oct-12

Source: Bloomberg, as at end of September 2012

Economy & Markets

Global growth indicators remained weak during September even though financial markets displayed more confidence following the ECB's announcement of its "Outright MonetaryTransactions" programme. The reduction in peripheral government bond spreads and the further tightening of credit spreads reflected the market's view that the extreme scenario of a Euro break-up was significantly less likely in the wake of the ECB's actions. The good mood in markets was also fuelled by the decision of the US Federal Reserve to extend quantitative easing through $40bn per month of purchases of mortgage backed securities. In addition, the Bank of Japan also extended its asset purchase programme.

These monetary policy actions should eventually boost global growth. However, at the moment the macro environment remains weak and there is little evidence of a resumption of credit growth. In the United States the ISM manufacturing index rose slightly above 50 in September but has languished at levels indicating very little expansion of manufacturing output since the middle of Q2.

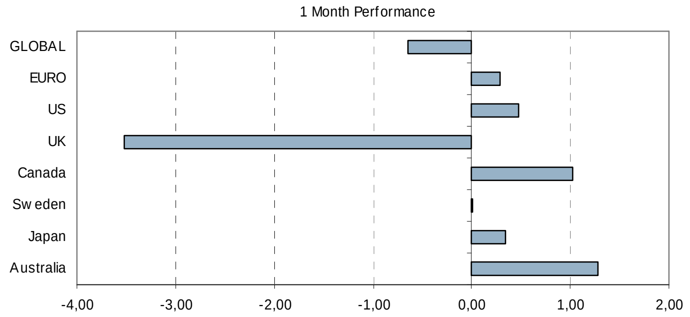


Source: Bloomberg, as at end of September 2012

Euro Area indicators of manufacturing were even weaker with the EU PMI index at just 46.1 in September and the region's unemployment rate also edging up further to 11.4%. The Japanese Tankan survey for Q3 also weakened, adding to the view that the global manufacturing sector has lost all momentum since earlier this year. Most current economic data for China confirm this.

Despite the disappointing ISM index, the US has the most potential to deliver better economic data in the near term.

Personal spending has been better in recent months and the labour market has continued to improve, albeit at a pace that is below what the Fed feels is necessary. Housing market activity is slowing recovering with both sales and housing starts improving over the summer. The major uncertainty in the outlook is the election and how the "fiscal cliff" will be dealt with. This appears to be holding back the corporate sector from taking decisions on capital investment and employment.



Source: Bloomberg as at end of September 2012

The outlook for 2013 is not that encouraging from the macro point of view. Fiscal austerity in major developed economies will hold back resumption in world trade growth. If European policy makers can make further strides in dealing with the debt crisis there will be some improvement in confidence but still aggregate spending will be weak. On the plus side, weak inflationary pressures will allow central banks to continue to follow very supportive policies for an extended period of time. This will provide a solid anchor for interest rate expectations.

Fund Manager's comment

Economics textbooks always refer to Paul Volcker as the one that clamped down on US inflation using high real interest rates. He takes a lot of credit for that. Alan Greenspan should be known as the one who ran the Fed whilst it had no official inflation target but everybody knew that he wouldn't miss the golden 2.25%... and after all in the good old days unemployment wasn't any real kind of issue in the US.

Now the question is how will Ben Bernanke be remembered? He could very well be the one that avoided a repeat of the Great Depression for the US Economy hence the name "Great Recession". Alternatively he could be the one that granted himself an official inflation target (2.25% core PCE) combined with a labour market objective whilst disappointing on inflation. There are tons of things to say about the current situation with the Fed engaging in "QE Infinity", below are the most important issues.

First, Quantitative Easing is a positive for risk assets in general and for TIPS is particular. When the Federal Reserve expands its balance sheet, breakevens tend to rise. You can say the same for any "risk on product". Operation Twist doesn't quite work that well because the balance sheet doesn't grow.

Secondly, we are often asked about that official 2.25% Core PCE target. When a central bank grants themselves a target (as it hasn't been voted in by Congress) and explicitly says that they will keep their accommodative stance when the Economy starts to pick up, we're facing a credibility situation. What we think is that this target rhetoric is part of the plan because the Fed has to support the government while it adjusts its debt load. More than supporting the Government to make the "inflate the debt away" strategy work, the Fed also needs to surprise to the upside on inflation expectations because otherwise – if, say the Fed had granted itself a 4% inflation target like the IMF suggested 3 years ago – interest rates would quickly adjust higher and the efficiency of the strategy would vanish.

It currently seems like Ben Bernanke will be remembered as the one that saved us from a Double Dip Great Recession, but didn't tell the public how!

The final legitimate question is the one of the debt burden. Looking at past experiences and especially to Sweden which is a very good example of successfully fighting a real estate debt mess, we find that we shouldn't expect the debt to be paid back or even the debt load to fall in dollar term over time. Growth and inflation will help bringing down Debt to GDP ratios progressively and that process will probably take more than a decade for G7 economies…

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To achieve this, inflation helps – a lot – and we believe that in the future the cruise speed for inflation should be 1% to 2% higher than it used to be in the last decade.

Where does this leave us in terms of positioning?
We believe that there is value globally as Central Banks have shown their support to markets but this is probably well anticipated already in the US and hence we prefer to go for value in places where this global theme is underpriced. We believe that this is the case in the UK where the market has suffered from the upcoming changes to the RPI calculation methodology (see box) and Germany because we need much lower real yields in Europe to have any chance of a real recovery. This is a chase for value that might suffer a bit over the short term if the US TIPS frenzy doesn't cool down but should do well in a global "reflation" scenario.
From a credit perspective we still like to underweight French real yields as we believe that current growth forecasts are too optimistic in the wake of a massive fiscal adjustment and the deficit target should be revised higher.
Globally we like the short ends of real yield curves that are a good proxy for rising breakevens given the commitment of Central Banks to keep yields low for long.
Like our CIO said last month, austerity isn't working, however it still seems that this is what markets want to see!

Upcoming supply

Issuer	Type	Amount
Sweden	ILBs	SEK 0.5bn
UK	UKTi 2024 (new)	GBP 1.3
France	OATi, OATei, BTANei	EUR 1-1.5bn
US	TIPS 30Y	USD 7bn
Italy	BTPeis	EUR 1-1.5bn

Source: Bloomberg as at end of September 2012

UK RPI vs CPI

As anticipated in last month's Perspective, the September meeting of the UK Consumer Prices Advisory Committee (CPAC) has brought some clarity to the future of calculating the RPI. The National Statistician has launched a consultation which laid out four alternatives for addressing the differences between RPI (to which UK index-linked gilts are indexed) and CPI (which is the inflation rate targeted by the Bank of England). However the CPAC made it clear that they are in favour of the changes which would have the largest downward impact on the RPI and it seems unlikely that respondents will be able to present sufficient statistical counter-arguments to dissuade them.

At that stage it will then be for the Bank of England to determine whether the change is materially detrimental to index-linked gilt holders. They are likely to rule that this is the case and so it will then rest with the Chancellor to approve the change. Although it is difficult to confidently predict what will be a political decision, it is worth pointing out that the change would save around £2billion per annum at a time when the continued weakness of the economy has stretched the UK Government's finances.

Hence it seems likely that changes will go through with effect from March 2013 (although the whole timetable does seem tight). In the mean time this background, together with market weakness following the syndication of a new 40 year index-linked gilt has enabled us to buy UK breakevens at levels close to three year lows.

AXA Fixed Income
An AXA Investment Managers Expertise

Inflation Perspective

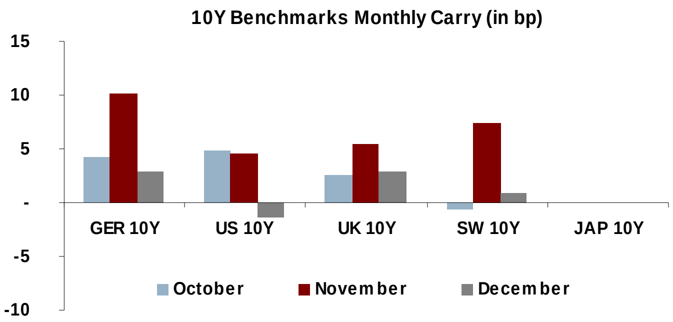
October 2012

AXA WF Global Inflation Bonds

September supply

September 2012								
Issuer	Type	Date	Amount Allotted (in Billions)	Amount Tendered	Bid to Cover Ratio	Reference Yield (%)	Coupon (%)	Maturity
France	OAT ei	20/09	0,94 €	1,77 €	1,88	0,28%	1,10%	25-Jul-22
France	OAT ei	20/09	0,44 €	0,94 €	2,14	0,67%	1,85%	25-Jul-27
France	OAT i	20/09	0,18 €	0,59 €	3,28	0,62%	3,40%	25-Jul-29
France	OAT e i	20/09	0,22 €	0,72 €	3,30	0,76%	3,15%	25-Jul-32
Germany	DBR ei	12/09	0,58 €	1,10 €	1,91	-0,27%	0,10%	15-Apr-23
Italy	BTP ei	25/09	1,00 €	1,75 €	1,75	2,46%	2,10%	15-Sep-16
Italy	BTP ei	25/09	0,50 €	1,12 €	2,26	3,68%	2,10%	15-Sep-21
UK	UKT i	11/09	1,25 £	1,93 £	1,55	0,13%	0,75%	22-Mar-34
US	TIPS	20/09	13 $	30,64 $	2,36	-0,86%	0,13%	15-Jul-22
SW	ILBs	06/09	0,5 SEK	6 SEK	12,00	-0,29%	0,50%	1-Jun-17
SW	ILBs	20/09	0,5 SEK	4,4 SEK	8,79	-0,38%	0,50%	1-Jun-17
AU	ACGBi	9/18	0,2 A$	0,74 A$	3,72	1,04%	2,50%	20-Sep-30

Prospective Carry Figures



Inflation	Portfolio Breakeven	Performance Indicator Breakeven
Australia	2,46	2,45
Canada	2,17	2,12
France	1,96	1,97
Germany	1,67	1,62
Japan	0,72	0,69
Sweden	0,92	0,92
United Kingdom	2,59	2,57
United States	2,29	2,29

Portfolio overview

Top five portfolio holdings					
Security name	Coupon (%)	Maturity	Currency	Nominal	%
Ukti 1 7/8 11/22/22	1,875	22-Nov-22	GBP	67,200,000	6,44
Tii 0 1/8 01/15/22	0,125	15-Jan-22	USD	128,000,000	5,53
Tii 1 3/8 07/15/18	1,375	15-Jul-18	USD	75,000,000	3,67
Tii 2 5/8 07/15/17	2,625	15-Jul-17	USD	65,000,000	3,43
Tii 2 01/15/26	2	15-Jan-26	USD	56,300,000	3,34

Source for all charts & tables on this page: AXA IM, Bloomberg as at end of September2012

The AXA WF Global Inflation Bonds fund does not have a reference index. The fund's performance indicator, the Barcap World Inflation Linked Bond Hedged, is given as a basis for comparison only

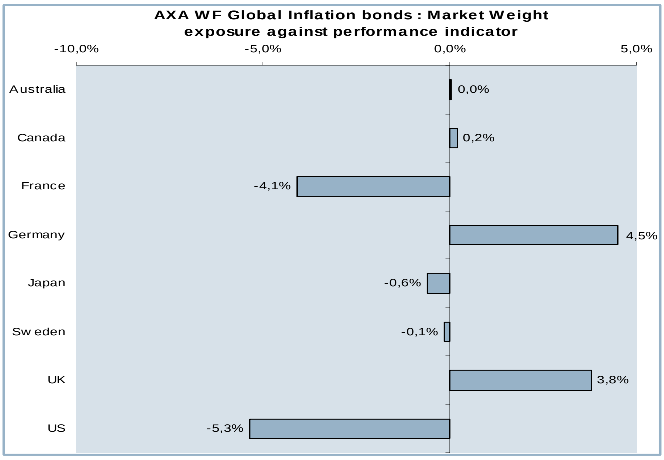
Portfolio Overview

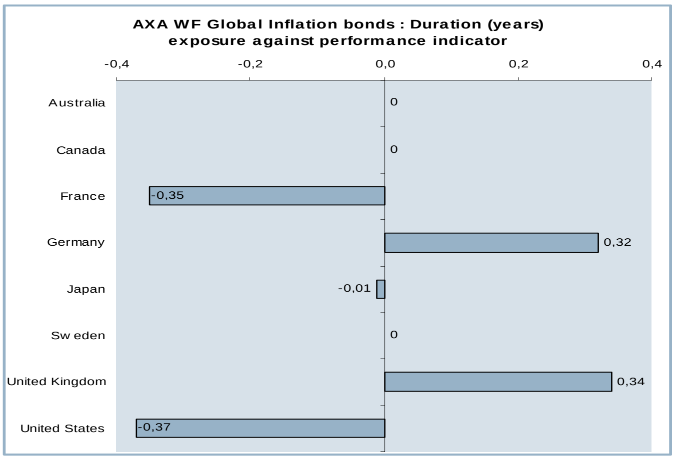
Characteristics	Fund
Average Years to Maturity	12,71
Yield Before Indexation (%)	-0,54%
Annual Yield (%)	1,59%
Standard shareclass duration (in years)	11,04
Redex shareclass duration (in years)	1,93
Average Rating	AA+
Average Coupon (%)	1,71%
Cash Position (%)	1,58%
Number of Positions (ex. Futures, Cash and FX)	74

Source: AXA IM, as at end of September 2012

% of NAV	AXA WF Global Inflation bonds	Barclays World Inflation All Mat
Australia	1,5%	1,4%
Canada	3,7%	3,5%
France	7,7%	11,8%
Germany	7,8%	3,4%
Japan	2,1%	2,7%
Sweden	1,8%	2,0%
UK	31,1%	27,3%
US	42,6%	48,0%
	100,0%	100,0%

Source: AXA IM, as at end of September 2012





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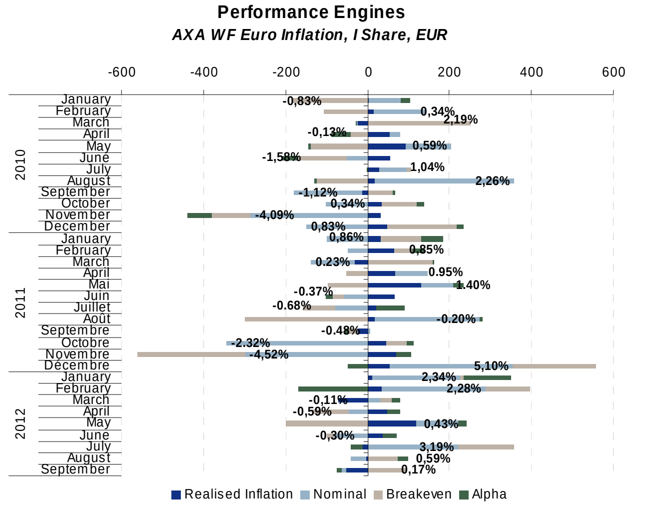
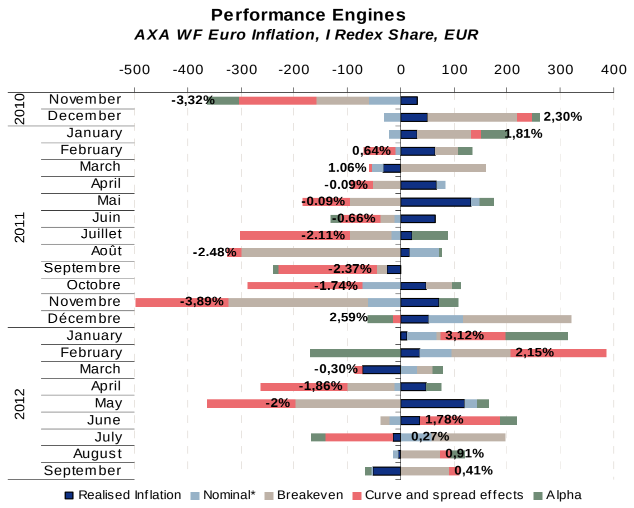
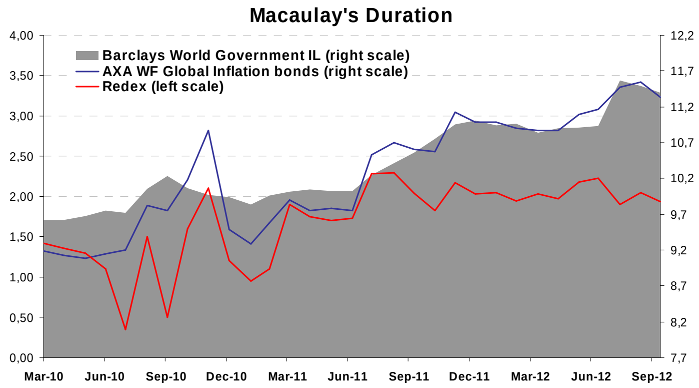
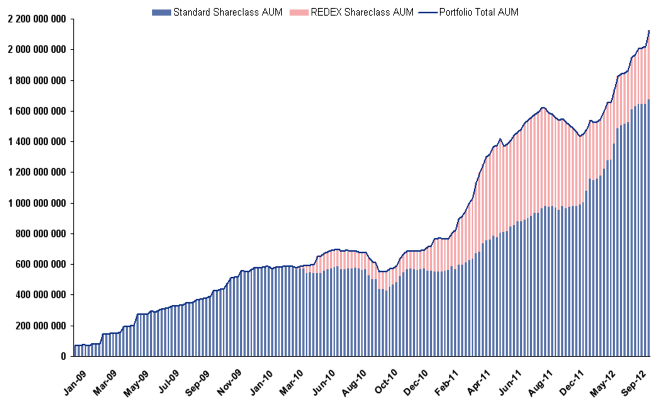
Focus on Redex Shareclasses









Source for all charts on this page: AXA IM, as at end of September 2012

Risk on Cross Class Liabilities for all share classes (standard and Redex): Although there is an accounting attribution of assets and liabilities to the relevant Class, there is no legal segregation with respect to Classes of the same Sub-Fund. Therefore, if the liabilities of a Class exceed its assets, creditors of said Class of the Sub-Fund may seek to have recourse to the assets attributable to the other Classes of the same Sub-Fund. As there is an accounting attribution of assets and liabilities without any legal segregation amongst Classes, a transaction relating to a Class could affect the other Classes of the same Sub-Fund

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Performance objective: Medium-term capital growth
Recommended investment horizon: Minimum 3 years
Investment zone: OECD
Investment universe: Inflation-linked bonds and any other related debt securities issued by OECD governments, corporations or public institutions worldwide (at least two-thirds of assets).
Redex shareclass risk factor relating to interest rate

Practical information

PRACTICAL INFORMATION

Share Class		A	A RedEx	E	E RedEx	I	I RedEx
Investor Type		All Investors	All Investors	All Investors	All Investors	For Institutional Investors only	For Institutional Investors only
ISIN Code (Capitalisation)	EUR	LU0266009793	LU0482270153	LU0266010296	LU0482270401	LU0227145629	LU0482270666
	CHF (H)	LU0397279430	LU0482270237	-	-	LU0397279356	LU0482270740
	GBP (H)	LU0420068156	-	-	-	LU0420068404	LU0482271045
	USD (H)	LU0266009959	LU0482269908	-	-	LU0266010452	-
ISIN Code (Distribution)	EUR	LU0451400831	LU0645061374	-	-	LU0227145975	-
	GBP (H)	-	-	-	-	LU0814370507	-
	USD (H)	-	-	-	-	LU0266010379	-
Minimum Initial Subscription		None	None	None	None	1000 000	1000 000
Minimum Subsequent Investment		None	None	None	None	10 000	10 000
Maximum Subscription Fees		3.00%	3.00%	None	None	None	None
Maximum Redemption Fees		None	None	None	None	None	None
Maximum Annual Management Fees		0.60%	0.60% + 0.05%[1]	0.60%	0.60% + 0.05%[1]	0.30%	0.30% + 0.05%[1]
Real Annual Management Fees		0.60%	0.60% + 0.05%[1]	0.60%	0.60% + 0.05%[1]	0.30%	0.30% + 0.05%[1]
Maximum Distribution Fees		None	None	0.65%	0.65%	None	None

(H) This share is protected against exchange rate fluctuations (at least 95% hedged) between the fund's reference currency and that of the share class.
(1) Maximum Annual Fees linked to reduction of duration exposure of the RedEx share classes.
Please refer to the Prospectus for details of other available share classes.

Risk and Reward Profile

Lower risk ← → **Higher risk**

Potentially lower reward — Potentially higher reward

1	2	3	4	5	6	7

The risk category is calculated using historical performance data and may not be a reliable indicator of the Sub-Fund's future risk profile. The risk category shown is not guaranteed and may shift over time. The lowest category does not mean risk free.

Why is this Sub-Fund in this category?
The capital of the Sub-Fund is not guaranteed. The Sub-Fund is invested in financial markets and uses techniques and instruments which are subject to some levels of variation, which may result in gains or losses.
Additional Risks
Credit Risk: risk that issuers of debt securities held in the Sub-Fund may default on their obligations or have their credit rating downgraded, resulting in a decrease in the Net Asset Value.
Counterparty Risk: risk of bankruptcy, insolvency, or payment or delivery failure of any of the Sub-Fund's counterparties, leading to a payment or delivery default.
Impact of any techniques such as derivatives: certain management strategies involve specific risks, such as liquidity risk, credit risk, counterparty risk, legal risk, valuation risk, operational risk and risks related to the underlying assets.
The use of such strategies may also involve leverage, which may increase the effect of market movements on the Sub-Fund and may result in significant risk of losses.

Legal form: Sub-fund of AXA World Funds, a Luxembourg-based SICAV***
Reference currency: EUR
Type of share: Capitalisation and Distribution
Valuation: Daily
Subscription/Redemption: Forward price, daily (D) before 3:00 pm (CET)
Settlement: D+4 working days
Management company: AXA Funds Management SA
Investment manager: AXA Investment Managers Paris
Custodian: State Street Bank Luxembourg
*** AXA WORLD FUNDS's registered office is 49, avenue J.F

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Kennedy L-1885 Luxembourg. The Company is registered under the number B. 63.116 at the "Registre de Commerce et des Sociétés" The Company is a Luxembourg SICAV UCITS IV approved by the CSSF.

Completed on 09/10/2009 - Last CSSF approved prospectus February 2012.
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The index Barclays World Government Inflation Linked bonds is the fund's performance indicator. The fund has no reference index.

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