MARKET FLASH: UNCERTAINTY REIGNS IN EUROPE

Investors wait for the Jackson Hole Symposium

Sentiment in the Eurozone improved slightly over the week. Although the likelihood of a hard UK exit from the European Union increased, other developments helped reduce risk perception. First, Giuseppe Conte resigned as Italy's prime minister, ending the Salvini-Conte ruling coalition and opening the way to a possible coalition of the 5-star movement and the Democratic Party. Investors were reassured by this possibility as it would mean compliance with Italy's commitment to reduce budget deficits and also help soothe relations between Italy and the EU. However, talks between the two parties have only just started and look like being complex and difficult; they have until Tuesday to reach an agreement. Second, with a recession looking increasingly likely, Germany confirmed that a stimulus plan was imminent. The first measure was to exempt almost 90% of people from paying the 5.5% solidarity tax.

Meanwhile, the latest European PMI data came in better than expected, in contrast to the US where manufacturing PMI dipped below the 50 watershed to 49.9. Markets, however, brushed off the news, partly because US-China tensions decreased following a 90-day extension to exemptions for Huawei, and partly due to investors turning their attention to the approaching Jackson Hole meeting and Jerome Powell's intervention. Markets are now expecting more visibility on the Fed's future monetary policy amid slower global growth. The FOMC minutes revealed strong differences of opinion between committee members. The chairs of the Boston, Philadelphia and Kansas Feds struck less accommodating tones.

Investors are now pricing in a quarter point cut at the next Fed meeting on September 17/18 but the chances of a 100 basis points fall by the end of the year have diminished. Government bond yields rose by 10 basis points both in the US and Europe and equity markets advanced by more than 1%. We took some profits on duration following the rise. We remain cautious on equities.

EUROPEAN EQUITIES

Despite the late summer lull, there were a number of political and economic developments in Europe.
First, Giuseppe Conte's administration in Italy collapsed and he handed in his resignation to President Sergio Mattarella. Parties now have a few days to arrange a new coalition before fresh elections are called for the autumn.

That will be a dangerous zone for markets as Brexit is scheduled for October 31 unless, of course, it is once again postponed. Prime Minister Boris Johnson had talks in Berlin and Paris and was given 30 days to come up with an alternative solution within the framework of the current agreement, notably as concerns the Irish backstop.

All these political uncertainties occurred amid an economic slowdown, with Germany looking poised to announce a €50bn budgetary stimulus package. Nevertheless, August's PMI readings for France and Germany suggest the manufacturing sector had stopped the rot while services were relatively robust.
Meanwhile, consensus EPS growth estimates for 2019 for the Stoxx600 continued to be revised lower, falling from June's 4.5% to 2.3%.

In this week's batch of company results, **Sunrise** unveiled upbeat figures while raising guidance on synergy gains from its acquisition of **UPC Switzerland** if the deal goes ahead, and **Pandora** and **Rockwool** issued profit warnings. **CRH** (cement) beat first-half estimates and confirmed that its US business was doing well and that cash flow generation was solid.

In another busy week for M&A, **Hasbro** paid £2.8bn for **Entertainment One**, **AMS** offered €4.3bn for **OSRAM**, or more than the **Bain and Carlyle** €4bn bid, and press reports said **Thyssenkrupp** might acquire **Kloec.**

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US EQUITIES

Indices ended the week on a positive note with the S&P500 and Nasdaq up 1.2% and 1.4%. Treasuries were weaker across the curve with some focus on very narrow 2-10 US Treasury spreads. Several Fed chairmen made hawkish comments ahead of the Jackson Hole meeting of central bankers.

Flash manufacturing PMI for August indicated weakness, but the press devoted some space to possible stimulus from the Trump administration in the form of payroll, capital gains, and corporation tax cuts.

Most sectors, apart from materials, ended the week higher. On a relative return basis, tech and consumer discretionary were the biggest outperformers on the back of strong earnings releases among some US retailers. Target jumped by around 20% on Thursday as revenue and earnings beat consensus and management raised guidance for the coming quarter. Home improvement company **Lowes** also boasted strong growth metrics with same-store sales rising 3.2% in the second quarter. **Estee Lauder** leapt 15% after earnings for its latest quarter rose 19%, or above the 14% expected. The group also said the outlook was positive for 2020.

JAPANESE EQUITIES

Against the backdrop of a relatively stable JPY/USD exchange rate, Japanese stocks made small gains in thin trading with most investors staying on the sidelines ahead of the Jackson Hole Economic Policy Symposium. The **TOPIX** rose 0.86% for the week. The Nikkei 225, whose P/B had fallen to very cheap 1.00 levels and is currently at 1.02, seems to be acting as a market support factor.

In a stark contrast to its previous concerns, the Japan National Tourism Organization said the number of tourists to Japan rose 5.6% YoY in July 2019, a new record for a single month. Although tourists from South Korea fell 7.6% due to mounting tensions between Seoul and Tokyo, this was completely offset by a significant 19.3% YoY surge in visitors from China, the biggest weighting at 35.1%. Meanwhile, tourism from South East Asia, US, Europe and Australia continued to trend higher.

Stocks sensitive to tourist spending rose on the news. Cosmetics producer **SHISEIDO** surged 7.85% and **KOSE** gained 3.47%.

EMERGING MARKETS

Emerging Markets were slightly up this week on the back on a reprieve in market sentiment but with a notable dispersion of returns across countries and regions as **India** and **Argentina** underperformed the MSCI EM whilst **China** and **Russia** were strongly up.

In **China**, **Huawei**'s temporary general license was extended for 90 days, allowing American companies to continue to do business with the Chinese telecom company.

In an effort to support the economy, the PBoC launched an interest rate reform through a revamp of the Loan Prime Rate (LPR), to lower borrowing costs and inject more liquidity in the banking system. The National Interbank Funding Center will announce the LPR on the 20th every month, allowing banks to set rates on new loans by mainly referring to the LPR and use the LPR as the benchmark for setting floating lending rates.

On the corporate side, **Weibo**, the internet software company announced positive second quarter results beating consensus expectations, driven by a cutback on marketing spending, but gave a more modest growth outlook 3Q19. **Baidu** also beat earnings expectations on tight cost control and strong underlying core search engine **BTE**. **Wuxi Biologics**, in the healthcare segment posted a 78% EPS growth thanks to R&D contracts milestone fees, and a +160% YoY order backlog.

Indian equities were sensibly down this week on persistent fears of a slower domestic growth and lack of fiscal stimulus so far to address the situation.

In **Taiwan**, second quarter GDP expanded to 2.40%, in line with estimates, while on the company front, **Mediatek**, the semiconductor company, is said to have ordered **TSMC** to start manufacturing 7nm technology products in 1Q 2020 for its first 5G chips.

The **Japan**/**South Korea** rift saw further concerning development as South Korea scrapped the military intelligence-sharing pact with Japan. Russian equities were up on the an increase of the ruble and on President Trump's comments on his wish of **Russia** rejoining the G7.

In Argentina, the equity market was still under pressure due to Finance minister Dujovne's resignation, and comments by Fernandez that the country will struggle to repay the IMF loan and needs to renegotiate. All this comes ahead of another $5.5bn IMF disbursement expected to come late September and crucial for confidence in all short term paper that expires until October, and with an IMF team set to visit Argentina next week.

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CORPORATE DEBT

CREDIT

Markets turned risk-on, making up some ground lost in the previous week, thanks to encouraging European PMI data and favourable technical elements. The Xover tightened by 17 basis points to 261 and the Main by 3 basis points to 49.

Flows into investment grade bonds remained at a healthy €880m (0.4% of AUM) over the week, taking the year-to-date gain to €18.4bn (8.5% of AUM). But high yield saw outflows of €105m (0.2% of AUM) taking year-to-date inflows to €6.5bn (9.8% AUM).

In a very quiet week on the new issues market, **Swedbank** launched an AT1 PCN5 (Ba1/BBB) for $500m at 5.625% vs. initial guidance of 6.25%. The order book amounted to $7bn.

Note that Italian telecom operator **Wind Tre**'s repayment of its 2023 and 2025 maturities, for a total of €3.5bn, provided some significant market support. Investors were forced to reinvest some of the proceeds on the secondary market due to a becalmed primary market.

There was also some good news over the week, first from **Jean-Claude Naouri's Rallye**/**Casino**. Casino's board decided to sell another €2bn in assets, mainly in France. The disposals will be carried out by the end of the first half of 2021. The group has so far sold €2.1bn of assets in its first €2.5bn plan. Rallye and Casino jumped 24% and 11% after the news while Casino's bonds gained 5-8 points over the week.

Tele Columbus (B2/B-) saw preliminary second-quarter results rise and confirmed its full-year objectives. Sales rose 8.4% YoY to €126m and EBITDA was 10.9% higher at €85m.

CONVERTIBLES

Trading was rather quiet on the convertible bond market and there was only one deal.

In the US, **Proofpoint** (cyber security) raised $800m at 0.25% and with a 37.5% conversion premium. The proceeds will go on general corporate purposes but might also be used to make strategic acquisitions.

In results news, international port operator DP World saw first-half sales rise 31.9% YoY to $3.5bn thanks to its acquisition of terminals in Chile and Peru and the **Unifeeder** group in Europe.

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EDMOND DE ROTHSCHILD ASSET MANAGEMENT (France)
47, rue du Faubourg Saint-Honoré - 75401 Paris Cedex 08
Société anonyme governed by an executive board and a supervisory board with capital of 11,033,769 euros - AMF Registration number GP 04000015 - 332.652.536 R.C.S. Paris
T. +33 (0)1 40 17 25 25 - F. +33 (0)1 40 17 24 42
www.edram.fr