MARKET FLASH: BARNIER GOVERNMENT IN JEOPARDY: MARKETS' CONFIDENCE SHAKEN

- **Political tensions in France and also in Germany are inevitably weighing on PMIs.**
- **Eurozone inflation has been slowing so the ECB can continue to reduce rates.**
- **Economic activity in the United States remains strong, while in Japan, inflation has resumed its upward trajectory.**

The French government's future is now in question. The OAT-Bund spread widened to as high as 82bp this week, leaving France borrowing at the same rate as Greece. The reason behind the move was the looming no-confidence vote in Michel Barnier's government if he resorts to the 49.3 mechanism to get his draft budget adopted without a vote. Markets are now edgy over the possible consequences. To stop the National Rally voting against the government and bringing it down, the prime minister withdrew a planned rise in electricity prices but Marine Le Pen's party is pushing for even more concessions. There is now a risk that the government could fall. That would trigger an institutional crisis in France. President Macron could, of course, appoint a technical government but with no certainty that it would succeed in getting a new budget draft approved. And by law, no new parliamentary elections can be called before next summer. However, there is no real risk of a US-style shutdown as the government could extend the previous year's budget as a last recourse. But whatever happens, this political uncertainty will continue to make investors -as well as rating agencies- wary of France's debt. And today, S&P is due to release a review of France's rating, currently at AA- with a stable outlook. Markets are already expecting the agency to downgrade the outlook to negative.

Political tensions in France and also in Germany are inevitably weighing on PMIs. The eurozone's composite PMI is now back in contraction territory at 48.1. Household spending is also suffering: Germany's retail sales had been recovering in recent months but fell 1.5% in October. In France, they retreated by 0.4%.

However, eurozone inflation has been slowing (+2.3% over 12 months, minus 0.3% in November) so the ECB can continue to reduce rates. That said, there are intense debates over the pace and the final destination ahead of the next rate-setting committee meeting on December 12. Isabel Schnabel poured cold water on expectations for a 50bp cut. She said she preferred a gradual approach, wanted to avoid pushing rates below neutral territory and refused to use monetary policy as an aid to economic activity.

In sharp contrast to Europe, the US continues to thrive. Household spending rose 0.4% in October while PCE inflation accelerated slightly to 2.3% over a year.

In Japan, inflation started to rise again so another rate hike is likely in December. As a result, the yen rose against the dollar and the euro.

We have reinforced equity exposure in our portfolios and still prefer US and Chinese equities. In bonds, we prefer European corporate debt as the segment should benefit from further rate cuts as disinflation proceeds.

EUROPEAN EQUITIES

Markets were affected this week by several big-ticket news items, notably Donald Trump's intention to impose import duties on goods from Canada, Mexico and China. Europe's auto sector was particularly hard hit and lost 1.7% last Tuesday. Nevertheless, economic sentiment on the continent rose compared to the previous month and was better than expected.

Falling interest rates helped property stocks outperform. The sector ended the week 5% higher vs. a gain of 0.5% for the index. Other defensive sectors like communication, healthcare and consumer staples also outperformed.

Elsewhere, Italy's banking structure is on course to change significantly. On Monday, **UniCredit** launched a bid on **Banco BPM** but with no premium on the current valuation. **Crédit Agricole**, which owns 9.9 % in Banco BPM, is now in talks with UniCredit. Bloomberg said insurance giant **Generali** was in talks with Natixis Investment Managers to merge their asset management businesses.

In spirits, **Rémy Cointreau** revised its outlook for 2025 and now expects sales to fall 15-18%. The stock plunged 5% initially but then ended up rising after management made optimistic comments on growth prospects in the US. For the moment, the company is one of the few in the sector to entertain this possibility.

Aramis (used cars) reported strong growth and said margins had returned to positive territory. The group also announced its 2027 objectives and will be focusing on getting margins significantly higher.

US EQUITIES

In a Thanksgiving holiday-shortened week, Wall Street continued to gain ground overall. The move away from market concentration continued with the Nasdaq 100 treading water while the S&P 500 gained 0.4% and the Russell 2000 0.7%. Markets were reassured by Donald Trump's latest appointments, and particularly the choice of Scott Bessent as Treasury secretary. On the other hand, the news that the new administration intended to impose 25% import duties on goods from Mexico and Canada triggered a sell-off in auto stocks like **General Motors**.

Elsewhere, the rotation out of semiconductor plays continued as investors moved into software stocks. **Autodesk** posted better-than-expected growth in billings even if profitability fell a little short of investor expectations. **Workday**'s margins rose significantly but the stock fell as growth continued to slow. Cybersecurity stock **CrowdStrike**'s results were a token of its strengths: in just ten years, the group has become the world number one. Disappointing results in IT equipment accelerated the rotation out of semiconductor and AI plays. **Dell**, for example, tumbled after disappointing AI equipment sales, pending the arrival of **Blackwell**, and the group's PC orders are still not recovering. In consumer stocks, growth at **Best Buy** was disappointing but management said demand had picked up after the election. It is now **Microsoft**'s turn to face an antitrust probe.

EMERGING MARKETS

MSCI EM index was slightly down by 0.7% this week as of Thursday. Both India and China outperformed, +0.75% and 0.38% respectively, while Brazil and Taiwan underperformed, retreated by 5.88% and 2.89%.

In **China**, industrial profits fell -10% yoy in October, narrowing from -27% yoy in September. CPC Central Committee issued an opinion supporting the development of digital trade with a goal for digital trade to reach 45% by 2029. Brussels and Beijing continue the negotiation over tariffs on Chinese electric vehicle exports. Trump threatens 10% more tariff for China exports. Biden administration expected to announce more restrictions on AI chips next week. Several big cities in China issued new round of consumption vouchers to stimulate consumer electronic products demand. China published 2024 National Reimbursement Drug List (NRDL) with an average price cut of 63%, largely stable to 2021-23 level. China's National Immigration Administration announces more incremental travel easing measures for Chinese visitors to come to Macau and Hong Kong. **AIA** announced having received approval to establish a new branch in Zhejiang province, 4th new branch approvals within one month. **Meituan** reported better-than-expected 22% sales growth for 3Q24, signaling a gradual recovery in online commerce and travel.

In **Korea**, BoK surprisingly cut rate by 25bps, to 3%, and lowered its full year 2025 GDP growth outlook to 1.9% from 2.1%. **Hyundai Motor** announced to buyback shares, amounting to 1.7% of total share outstanding. **Hynix** posted its new shareholder return policy for 2025-2027, raising DPS as part of its value-up program.

In **India**, GDP growth for the 3Q reached 5.4% yoy. Kerala signed a supplementary concession agreement with **Adani Vizhinjam Port**. Dark store orders witnessed an uptrend during the festive season. **Mahindra&Mahindra** launched two new electric SUVs. **Zomato** has unveiled the 'District' app, a one-stop destination for going-out, a theme for the next decade per management.

In **Brazil**, IPCA-15 headline inflation 0.62% mom (4.77% yoy) vs consensus at 0.50%. Market sold off on increasing uncertainties after government spending cuts announcement was lower than expected.

In **Mexico**, Trump announced 25% tariff for all products imported from Mexico.

CORPORATE DEBT

CREDIT

Falling interest rates and stable investment grade spreads left the segment 0.43% higher over the period while high yield was more or less flat (+0.09%). In a low-volatility week for credit indices, the Xover tightened slightly to 305bp after US trade restriction threats looked like being less damaging than initially thought. German and French inflation also came in lower than expected, reducing the risk of a fresh bout of inflation in Europe.

With volumes down due to the US Thanksgiving holiday, the focus was on the OAT-Bund spread. It widened to 90bp intraday and had a knock-on effect on French banks and insurance companies. However, the move was less pronounced than over the summer. Bank senior debt spreads widened by 4bp and French bank AT1 bonds were down 0.5 points on average over the period. The rest of the subordinated debt market actually gained 0.25%.

The big talking point remained M&A moves in financials. **UniCredit** bid for **Banco BPM** which rejected the offer for being too low. **Aviva** bid for **Direct Line** and **Generali** and **Natixis** are reportedly in discussions over an asset management tie-up.

The property market mood remained upbeat with **Heimstaden Bostad** raising €500m with a hybrid issue at 6.25%. It was the first property market issue in 3 years. **Aroundtown**'s hybrid bonds also performed very well after the company reported its results (+2.5 points to 7 points).

In high yield issuance, **Asmodée** (video games) raised €900m in its debut on the market.

GLOSSARY

• Investment Grade: bonds rated as high quality by rating agencies.

• High Yield: corporate bonds with a higher default risk than investment grade bonds but which pay out higher coupons.

• Senior debt benefits from specific guarantees. Its repayment takes priority over other debts, known as subordinated debt.

• Debt is considered to be subordinated when its redemption depends on the earlier payment of other creditors. To offset the higher risk, subordinated Senior debt has priority over other debt instruments.

• Tier 2 / Tier 3 : subordinated debt segment.

• Duration: the average life of a bond discounted for all interest and capital flows.

• The spread is the difference between the actuarial rate of return on a bond and the rate of return on a risk-free loan with the same maturity.

• The so-called "Value" stocks are considered to be undervalued.

• EBITDA: Earnings before Interest, Taxes, Depreciation, and Amortization.

• Quantitative easing describes unorthodox monetary policy from a central bank in exceptional economic conditions.

• Stress Test: a process which simulates extreme but possible economic and financial conditions so as to assess any impact on banks and measure their resilience to these events.

• The PMI, for "Purchasing Manager's Index", is an indicator of the economic state of a sector.

• AT1s belong to a family of bank capital securities known as contingent convertibles or "Cocos". Convertible because they can be converted from bonds to shares (or depreciated entirely) and contingent because this conversion only occurs if certain conditions are met, such as the issuing bank's capital strength falling below a predetermined trigger level.

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EDMOND DE ROTHSCHILD ASSET MANAGEMENT (FRANCE)

47, rue du Faubourg Saint-Honoré 75401 Paris Cedex 08

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332.652.536 R.C.S. Paris