EDMOND DE ROTHSCHILD

MARKET FLASH: CENTRAL BANKS START TO DIVERGE

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After the previous week's indications of labour market resilience in the US, this week saw inflation proving sticky. March's CPI increased by 0.4% vs. 0.3% expected, the third month in a row in which it had come in hotter than consensus expectations.

Getting down towards the Fed's inflation target requires property prices to return to normal but that is still not happening. In fact, the element that really stood out was "supercore inflation", or ex-housing core services, which took the segment's inflation up to 0.65%.

Fed chair Jerome Powell had previously played down the significance of the two previous readings but he will now have to justify the pace of upcoming rate cuts. Markets are now expecting the first move to come in September with a total of two cuts this year. Back in January, traders were betting on six cuts.

There are even some querying the need to cut in the first place. They are worried about the risk of another inflation wave driven by energy prices. Bond markets are under pressure and yields on 2-year Treasuries jumped 20bp to 4.95%. We think this is an overreaction considering other data: the producer price index, for example, normalised at 2.1% a year. That should limit the PCE inflation index to 0.3% MoM. The figure is due out on April 26.

The situation in Europe is different. The ECB said it was delighted with ongoing disinflation. Barring any rebound, we could see a rate cut in June, regardless of what the Fed decides. However, the ECB has said nothing about the pace of future rate cuts even if markets expect one move down in each quarter.

The ECB is now singing from the same hymn sheet as the Bank of Canada and the Swiss National Bank as far as disinflation is concerned. All three are now convinced the monetary easing cycle has to start. Elsewhere, disinflation continues in major developing economies like Brazil, Mexico and China.

Given today's reduced visibility, we have already tactically reduced exposure to risk assets. Risk premiums are too low to cope with any disappointment over the disinflation scenario. We continue to prefer yields offered on bond markets and remain overweight duration

EUROPEAN EQUITIES

European markets were flat over the period up to Friday morning with no clear trend. And yet the week ahead will be full of company reports. Bond market shifts had little impact on equities as yields had played yo-yo over the week. Government bond yields initially rose after CPI in the US came in higher than expected. US inflation is proving sticky and the trajectory of rate cuts in Europe could have been affected. But Christine Lagarde on Thursday offset the trend by reaffirming her determination to act independently of the Fed. She also said she was confident disinflation would continue. Elsewhere, commodity prices surged, led by gold and oil due to geopolitical uncertainty in Ukraine, and even more so in the Middle East following the threat of an Iranian attack on Israel.

In the circumstances, basic resources sharply outperformed, led by energy. Property and telecoms wavered due to uncertainty over bond yields.

In company news, **Publicis** continued to outperform. First-quarter sales rose 4.9% to €3.23bn, or better than the €3.17bn expected. The CEO said this performance was largely due to the group capturing increased demand for IA-driven trends in marketing, an area in which it had enjoyed double-digit growth.

In healthcare, **Biomérieux** also did better than expected. First-quarter sales rose 9.8% like-for-like to €965m vs. €957m expected thanks to an 18% like-for-like jump in its molecular biology division. Guidance for this year was as expected, i.e. 7% in annualised sales growth for the period 2024-28 with the dividend payout maintained at 25%.

US EQUITIES

The S&P 500 ended a volatile period almost flat. A hotter-than-expected CPI reading triggered a sell-off but indices recovered the day after when the PPI reading came in lower than consensus expectations. After a month of strong performance, cyclicals fell and tech benefited from the rotation. The Nasdaq 100 gained 1.10% over the period.

The first-quarter earnings season kicked off with a few surprises. **Fastenal** (industrial product distribution) fell after results were hit by weak demand, a contrast with the upbeat trend in previous quarters. Used car retailer **Carmax** also lost ground when sales were hit by tepid demand. In contrast, **Delta Airlines** beat expectations and raised guidance for the second quarter due to demand coming in higher than expected. In addition, expectations are relatively low for the sector.

In M&A, **Vertex Pharmaceutical** paid $4.9bn for **Alpine Immune Sciences**, a 27% premium on the last quoted price. And **Johnson & Johnson** completed its $13.1bn acquisition of **Shockwave Medical**.

EMERGING MARKETS

The MSCI EM Index had gained 0.9% this week as of Thursday. **China** and **India** were up 1.83% and 1.17%, respectively, while **Brazil** was flat, **Korea** underperformed by falling 1.22%.

In **China**, March CPI was below estimates at +0.1% YoY, and PPI fell 2.8%, extending its decline. Meanwhile, per capita tourism spending during the Qingming holiday topped 2019 levels for the first time, a sign of resilience in tourism. March exports and imports were below expectations, down 7.5% and 1.9% YoY, respectively. March retail passenger vehicle sales soared 53% MoM (+6% YoY), according to PCA. NEV sales jumped 29.5% YoY and NEV exports surged 71% YoY. Fitch cut its China outlook to negative on steady rise in debt. Yellen said “major steps” had been taken to improve relations after her visit to **China**. The government issued an action plan for appliance trade-in programmes and also aims to accelerate replacement of industrial equipment. The regulators approved 14 imported online games in April, including from **Tencent**. **NetEase** announced the renewal of an agreement to bring **Blizzard** titles back to **China** and broader collaboration with **Microsoft Gaming**.

In **Taiwan**, export growth rose to 18.9% in March, hitting its highest level since April 2022. **TSMC** reported a strong 16% jump in March quarter sales, helped by demand for HPC and AI. **TSMC** will build a third factory in the **US**, in addition to two facilities that are expected to begin production in 2025 and 2028.

In **Korea**, the opposition led by the Democratic Party won a majority of seats in the National Assembly election, a result that was in line with earlier polls. The first 10 days of export numbers beat market expectations: +21.6% YoY led by a 45.5% jump in semiconductors.

In **India**, hydro power generation capacity is to increase from 42Gw to 67Gw by 2031. Online travel agency **MakeMyTrip** made a push to go global and extended its services to over 150 countries. Supply chain diversifying to **India** continued: **Apple** has now doubled its iPhone assembly in **India** to $14bn in the last fiscal year. **Pegatron** plans to sell a 65% stake in its iPhone manufacturing plant in India to **Tata Group**. **Tesla** is in early discussions with **Reliance** about a possible JV to build an EV manufacturing facility in India. **Titan** reported a strong 17% YoY jump in fourth-quarter revenue growth.

Brazil's retail sales expanded for the second straight month in February, rising 1% MoM albeit below expectations. **Petrobras** will appeal against a court decision that suspended its chairman.

CORPORATE DEBT

CREDIT

Investment grade spreads were unchanged at 112bp and at 376bp for high yield. Credit derivatives underperformed: in line with yields on 10-year Treasuries which broke above 4.50%, the Xover widened by 20bp to 318 and the Main by 3bp to 56 The ECB's meeting reassured investors on the chance of a rate cut in June, a decision which could diverge from the Fed's timing for a first move.

Inflows continued apace with investment grade taking in €930m and high yield €269m. New issuance demand stayed strong. **Auchan** raised €750m (BB+) at 5.875% due 2028. The proceeds will go on refinancing existing debt.

Subordinated financial debt held up relatively well amid renewed interest rate volatility. Euro CoCo spreads widened by 8bp and $ CoCos tightened by 5bp. News flow was thin so with little impact on markets. **Société Générale** launched a business rationalisation plan with the sale of Societe Generale Equipment Finance (SGEF) and its Moroccan affiliate. The **Swiss government** released its long-awaited systemic bank report. It includes numerous suggestions on how to reinforce the country's regulatory framework and learn from the **Credit Suisse** debacle. But it is still too early to draw conclusions. Markets will now be eyeing first quarter results, starting with US banks.

Investment grade fell 0.47% over the period, due to rate shifts, taking YTD gains to 0%. High yield edged 0.01% lower (+1.73% YTD). As of April 12, investment grade was yielding 3.7% and high yield 6.2%.

CONVERTIBLES

Yields on 10-year Treasuries pushed above 4.50% after the CPI index in the US came in higher than expected. As a result, convertibles fell over the week but mainly due to falls on equity markets.

In company news, **Total Energies** added another 3% over the week as oil prices rose and geopolitical risk intensified. **Edenred**, in contrast, tumbled more than 10% after analysts cut estimates, citing a less favourable environment for the company.

New issuance was largely becalmed with only one big deal. Japan's **Röhm & Co** (semiconductors) raised JPY 200bn with a 2029 maturity (25.97 premium) and a 2031 tranche (21.04% premium).

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.

• Markit publishes the Main iTraxx index (125 leading European stocks), the HiVol (30 highly volatile stocks), and the Xover (CrossOver, 40 liquid and speculative stocks), as well as indices for Asia and the Pacific.

• 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.

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