EDMOND DE ROTHSCHILD

MARKET FLASH: SOFT ECONOMIC DATA COULD INFLUENCE THE FED

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Markets rallied after the Jackson Hole Symposium. The Fed and ECB stuck to their cautious stance on inflation but said any rise would be data dependent. But then, key economic news concerning jobs and consumption in the US came in somewhat below expectations. The JOLTS (Job Openings) data fell from 9.17 million in June to 8.83 million in July, accentuating a trend first seen in January. And in a sign that staff were less confident about finding a new job, the number of resignations also fell. As for consumers, the Conference Board gauge fell more than expected in August. For the moment, these indicators suggest a return towards normal levels; they are in fact still high. Household spending, for example, rose 0.6% in July compared to June. The definitive GDP figure in the US was revised down to an annualised 2.1% which was less than expected. And PCE inflation indicators in the US rose by 0.2% MoM for the core element and 4.2% over a year, or in line with estimates.

The situation in eurozone countries varies but aggregate inflation was stable at 5.3% due to rising oil prices. More reassuringly, underlying inflation (ex-food and energy) fell from 5.5% to 5.3% over a year. In addition, the latest ECB minutes and comments from committee member Isabel Schnabel underlined the risks facing growth in the eurozone.

As a result, bond yields fell both in the US and Europe as the economic data reinforced expectations that the rate-tightening cycle was nearing an end. Equity markets rebounded and developments in China also helped. Beijing and the PBoC intervened several times to stop the slowdown and underpin markets and the renminbi with rate cuts.

We reinforced our equity exposure as markets fell and are holding onto these positions for the short term. Looking further out, we are more cautious as we expect restrictive monetary policy to continue and that is likely to accentuate the slowdown that is taking shape. In fixed income, we are upbeat on duration which we believe should offer protection in such an uncertain climate.

EUROPEAN EQUITIES

Inflation for August came in as expected at 5.3% (-20bp) and markets ended the period on the front foot. Members of the ECB's rate-setting committee, however, were still divided on the right monetary policy to adopt. Is the slowdown coming to end, making the 2% inflation target harder to reach over the short term? Or is the pace of the slowdown compatible with a more dovish approach? Last week's poor PMIs suggest the second option should be preferred but this week ECB committee member Robert Holzmann said the bank would continue rising rates to 4% and that the first cut would be in 2025 and not in 2024.

As a result, financials performed well, led by **UBS** which released upbeat figures and guidance after absorbing Credit Suisse. In insurance, Holland's **NN Group** was also optimistic about the outlook. Momentum in the autos sector continued, with new registrations rising for the 12th month in a row in Europe. July saw a 15.2% increase.

Elsewhere, Denmark's **Orsted**, one of the world's largest wind turbine makers, spoke of persistent supply chain problems and said rising interest rates had hit its offshore activities in the US. **Carrefour**'s CEO Alexandre Bompard said he was worried about French consumers being forced to limit spending, even on essential items. And **Pernod Ricard** said slowing demand in the US and China would result in sales falling short of expectations.

US EQUITIES

Wall Street ended the last 5 trading sessions much higher, with the S&P500 gaining 3% and the Nasdaq 4.2%. Hopes for an end to monetary tightening drove buying after the ADP survey said US companies had created only 177,000 jobs in August, the lowest tally in 5 months. and the JOLTS programme came in well below expectations. GDP grew by an annualised 2.1% in the second quarter, or less than the 2.4% expected. And the Personal Consumption Expenditures Price Index reported its lowest monthly gain in more than 2 years.

After **Wells Fargo** predicted around $10bn in hurricane damage, insurance groups, utilities, travel agencies and DIY merchants were all in focus as Idalia headed for the Florida coast on Wednesday. In banking regulation, regional banks with more than $100bn in assets will now have to increase debt issuance to ward off default risk. The new rules are similar to those for the biggest global banks. In pharma, Washington is to impose price controls on 10 drugs which cost Medicare $50bn. The measures will come into force in 2026.

Oil maintained its gains after rising over 5 days on falling US inventories and speculations that OPEC+ might extend output cuts. Major discount retailers were in focus after **Dollar General** (-12.2%) cut guidance on sales and EPS when it released its quarterly results.

In Tech, **Alphabet** gained 2.7% thanks to its IA offer and new partnerships for its parent company Google. **HP** tumbled 6.6% after the group cut cash flow and earnings guidance for the full year; the recovery in the PC segment is proving longer than expected. **CrowdStrike** (+9.3%) and **Okta** (+13.5%) surged on robust earnings.

JAPANESE EQUITIES

After profit taking at the start of the week ahead of Jackson Hole, the NIKKEI 225 and TOPIX gained 1.03% and 1.99% as US interest rates retreated from peak levels due to soft economic data and Chinese markets rebounded on more favourable figures.

Transportation Equipment and Machinery rose 4.14% and 3.85%, respectively, due to the weaker yen and better Chinese figures. Real Estate gained 3.42% after the **Real Estate Economic Institute** said July new condominium sales in the Tokyo metropolitan area had increased by 14.2% YoY, the first rise in 9 months On the other hand, Air Transportation and Retail Trade edged 0.45% and 0.18% lower on profit taking among inbound tourism stocks.

Kubota, an agricultural machines maker, jumped 6.96% after a leading broker upgraded its rating from underweight to overweight. **Olympus**, an endoscopes and therapeutic equipment maker, bounced 6.80% from weakness after a first-quarter earnings miss. **Recruit Holdings** (recruitment advertising and staffing services) advanced 6.75%, after signing a promising business partnership with several companies. Elsewhere, **Softbank** (9984, communication and internet business) lost 3.47% as it is the largest shareholder in **WeWork** which is verging on bankruptcy. **Bandai Namco Holdings** (toys and game machines) fell 2.54% on profit taking after a strong run on a broker upgrade. **Aeon** (GMS stores) shed 2.33% on concerns Chinese tourists would be less likely to visit Japan after Beijing protested about treated water from the Fukushima Daiichi nuclear power plant being released into the sea.

The dollar traded between the high-145s to the mid-146s against the yen on assumptions Fed chair Jerome Powell would deliver a hawkish message at the Jackson Hole symposium but then fell back to the mid-145s following weak US economic data.

EMERGING MARKETS

The MSCI EM Index continued the rebound +0.9% during the week as of Thursday; China outperformed, up 2.6%, in response to a series of supportive measures. India closed almost flat up 0.2%, while Brazil corrected 1.2% during the week.

In **China**, official PMI manufacturing in August improved to 49.7, or ahead of expectations, and reduced the contraction for the second consecutive month. Non-manufacturing PMI fell from 51.5 in July to 55. The government unveiled a series of stimulus measures during the week to help the economy and address market dynamics. For example, the PBoC cut down payments for 1st and 2nd time home buyers and approved a rate cut on existing mortgages for first homes. Guangzhou became the first tier-1 city to ease its mortgage curbs.

Regulators cut stock trading stamp duty for the first time since 2008, and tightened IPO approvals. The preferential income tax policies for foreigners working in China will be extended up to the end of 2027, a move that sends an encouraging signal to foreign businesses in China. There were also encouraging geopolitical developments: the US Commerce Secretary Gina Raimondo visited China as part of ongoing efforts to mend US-China relations. Australia started to send barley shipments to China post-tariff removal.

On the corporate front, 8 LLM providers, including **Baidu**, **Douyin** and **SenseTime**, were approved for the mass rollout of LLM services, a move that unlocks immediate monetisation opportunities. **Zeekr**, **Geely**'s EV brand, obtained regulatory approval for an IPO in the United States. **PDD**, one of the largest e-commerce platforms in China, delivered strong second-quarter results on improving domestic consumer sentiment and rapid overseas expansion via TEMU. **Yadea**, the top e-scooter manufacturer, also reported robust second quarter earnings, with revenue and volume up 21% and 33% YoY, respectively.

In **Taiwan**, **Foxconn** founder Terry Gou announced his intention to run for the presidency as an independent, potentially splitting the KMT party's voter base. In **Korea**, **Hyundai Motor Group** bought a 5% stake in Korea Zinc to ensure access to key metals used in making electric-car batteries. **Samsung Electronics** is reportedly to start supplying HBM memory chips to Nvidia in the fourth quarter of this year.

India's second quarter GDP grew 7.8% YoY as expected, up from 6.1%. Manufacturing PMI rose to a 3-month high of 58.6 in August. India's Met Office sees normal rains (91-109% of average) in September. This may not compensate for the seasonal deficit (77%) which is running at a below normal 91% (vs. the Met's 96%). Inflation spiked to 7.2% in July from 4.8% in June. Rice and wheat inflation is running at 10-year high. Dell, Lenovo, HP and 29 other companies applied to manufacture laptops in India; a programme aiming to boost domestic production.

Brazil's government presented its 2024 budget proposal. It includes eliminating the IOC tax benefit for all sectors. The jobless rate fell to 7.9% in the three months to July vs. 9% a year ago. Consumer confidence rose again in August after a 19.2% gain in July. New loans decreased in July following two months of recovery. The beauty giant **Natura** is mulling a sale of The Body Shop business. **WEG** announced the acquisition of new land in **Mexico**.

CORPORATE DEBT

CREDIT

The end of the summer break led to a significant increase in new corporate and financial deals, notably **LVMH** A+ 3.25% 2029 (€1bn), **Engie** BBB+ 3.75% 2027 (€500m) and **Telefonica** with a perpetual hybrid (6.75% BB NC8 for €750m). We subscribed to two new CoCo issues, a perpetual from **KBC** at 8% NC5 for €750m and an **Intesa** perpetual at 9.125% NC6, both of which were easily placed. On the other hand, there were no new high yield deals. **UBS** pulled off its first statement following the merger with **Credit Suisse**: outflows from the failed bank have stopped, a quarterly €750m cost savings plan was unveiled and the bank's CET1 is still at a comfortable 14.4%.

Along with higher deal volume, credit premiums improved. The Xover had moved from 415bp to 395bp as of Thursday evening. High yield cash premiums tightened by 10bp to 445bp. Investment grade, meanwhile, was unchanged at 155bp due to the impact of more paper being issued. Soft landing expectations and poor Chinese data helped the government bond rally accelerate. Yields on the 10-year German Bund fell 10bp to 2.46% over the week. The central bank victory against inflation seems to be taking shape. Economies have slowed a little but the impact is difficult to assess for the moment.

As of Thursday evening, returns were all positive thanks to interest rate movements. Investment grade gained 0.46% over the week, taking YTD gains to 3.23%. High yield rose 0.32% or +5.78% since the beginning of 2023. These returns demonstrate the wisdom of carry strategies as net yields after 8 months are already equal to approximately two-thirds of the actuarial yield at end 2022. Actuarial yields for investment grade at the time of writing were 4.3% and 7.5% for high yield, i.e. still good entry points for carry strategies.

CONVERTIBLES

The convertibles market made positive returns over the week thanks to tighter credit spreads and an equity market rebound. In the US, **Okta** (identity and access management) reported revenues and operating margins that were both better than expected. The stock jumped more than 15% over the week. In Europe, **Delivery Hero**'s results missed expectations and the company registered a loss but management sees operating margins improving in 2024.

The new issues market remained active. Japan's **Daifuku** (material-handling equipment) raised JPY 60bn with one tranche at 32.48% due 2028 and another at 29.98% due 2030. Italian oil exploration company **Saipem** raised €500m at 2.875% due 2029. The issue came at a 37.5% premium.

Since the beginning of 2023, more than $32bn has been raised on the convertibles market, or more than the $29.7bn raised in 2022 as a whole.

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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EDMOND DE ROTHSCHILD ASSET MANAGEMENT (FRANCE)

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