



EDMOND DE ROTHSCHILD ASSET MANAGEMENT

MARKET FLASH: THE SCREWS TIGHTEN ON PRIME MINISTER BAYROU'S GOVERNMENT

- Despite the current political uncertainty, French government debt is still easily finding buyers, with the France's treasury department successfully raising € 11bn.
- Fiscal risk weighed on the UK's long bonds, with 30-year gilt yields reaching highs not seen since 1998.
- US Treasury yields were under pressure this week, as the 30-year bond revisited 5% before poor economic data caused it to fall back.

In France, the plan was to get parliament to approve -before mid-December- a draft budget respecting a promise to the European Commission to reduce the government deficit from 5.4% this year to 4.6% in 2026. With a minority government since last June's dissolution, the project would already have been very complicated but now winning a confidence vote on September 8 looks impossible. Unlike no-confidence votes under articles 49.3 and 49.2 of the Constitution, using article 49.1 means abstaining is not seen as a vote in favour of the government. It now looks likely that the prime minister and his government will have to resign. Appointing a new prime minister could take time and push back any vote on the budget.

And yet despite this political uncertainty, French government debt is still easily finding buyers. On Thursday, France's treasury department managed to raise € 11bn, the upper end of the volume spread, but admittedly for long maturities (10, 15 and 30 years).

Fiscal risk also weighed on the UK's long bonds. PM Keir Starmer, who seems to be making a habit of upsetting Rachel Reeves, his Chancellor of the Exchequer, appointed top economists to his cabinet, thereby further weakening her role as guardian of the country's finances. The 2026 budget is to be unveiled on November 26 and investors are once again worried that the UK might struggle to bring its finances under control. Yields on 30-year gilts are now running at highs not seen since 1998.

US Treasury yields were also under pressure this week. The 30-year bond revisited 5% before poor economic data caused it to fall back. Manufacturing ISM fell for the sixth month in a row as factories tried to deal with the consequences of the Trump administration's customs duties. Services ISM, however, rebounded and the bounce in the new orders indicator, both for manufacturing and services, is encouraging. ADP sees a less dynamic labour market with weaker job creations than previously expected.

Meanwhile, Donald Trump took offence at Beijing's celebrations to mark the end of the second world war. He accused Xi Jinping, Vladimir Putin and North Korea's Kim Jong Un of conspiring against the US and he now wants to change the Pentagon's name to War Ministry. The Chinese celebrations will be remembered for marking closer ties between India and China, a sign of Beijing's diplomatic power.

We remain slightly underweight equities, and particularly US equities which we think are expensive. We are still neutral on fixed income but with a preference for corporate rather than government debt. We continue to be negative on the US dollar because of threats to the Fed's independence.

EUROPEAN EQUITIES

Investors returned from holiday with a mix of caution and optimism. Hopes for peace in Ukraine fell as it became clear that Volodymyr Zelensky and Vladimir Putin are not yet ready to meet so a few allocation shifts occurred to start the week. The mood in Europe was dominated by political instability in France and the UK. The chances of a dissolution in France followed by elections abated and the OAT-Bund spread tightened. Markets in the US, meanwhile, focused on a rash of important statistics. Services ISM was upbeat but jobs data were slightly less favourable and the JOLTS report fuelled fears unemployment would worsen. The Fed is now expected to adopt a more accommodating tone.

In company news, **Derichebourg** cut guidance for 2025, citing high customs tariffs for European exports to the US and especially on steel, aluminium and copper.

The luxury sector generally benefited from something of a safe haven status but **LVMH** nevertheless lost ground following some broker downgrades.

In defence, **Rheinmetall** said it had enough strategic commodity stocks to cover 5 years of production, a strong indication of management's determination to secure supply chains.

Ryanair said 21 million passengers had flown with the airline in August, or 96% capacity, an indication of a strong environment for tourist flights in Europe.

In healthcare, **Sanofi** and **BioMérieux** had a difficult week. Sanofi unveiled disappointing results in advanced tests for an experimental drug. Biomérieux reduced annual guidance, citing lower demand in Asia.

US EQUITIES

In another positive week on Wall Street, the S&P 500 gained 0.65% to hit a new record close and the Nasdaq 100 rose 0.93%. In spite of weaker job creations suggesting a labour market slowdown, the trend was underpinned by better-than-expected indicators in services and an upward revision in productivity. As such, the likelihood of a Fed rate cut this month increased as did the debate over the Fed's independence from political pressure.

In tech, **Alphabet** jumped when the conclusions of an antitrust case were less severe than expected. **Apple** also rose as payments from **Google** will now continue. **Amazon**, which is accelerating AI investment, led megacaps. AI equipment and network plays like **Ciena** also advanced but the mood among semiconductor companies was more cautious. The software sector underperformed due to more conservative guidance.

Consumer discretionary led gains in consumption with retailers and apparel leading the way. **Macy's** and **American Eagle** raised guidance.

Cruise companies and hotels gained ground but airlines were more muted. Financials outperformed, led by banks and asset management companies. Healthcare, biotech and utilities underperformed. Energy fell as the oil price retreated ahead of a monthly OPEC

meeting this weekend which could result in increased production and therefore pressure on prices. **ConocoPhillips** said it would be laying off 25% of its workforce. Gold fell back slightly after the ounce's recent non-stop gains.

EMERGING MARKETS

The MSCI EM index had gained 0.25% in USD as of Thursday's close. Mexico, India, Korea and China were up by 1.57, 1.56%, 0.37% and 0.10%. Brazil and Taiwan declined by 0.79% and 0.27%

In **China**, August manufacturing PMI came in at 49.4 and non-manufacturing PMI at 50.3; both were in line with expectations. Xi Jinping met several world leaders and hosted a military parade in Beijing. A major **Gazprom** project was announced to provide China with discounted gas. **Alibaba** announced quarterly earnings with an upbeat outlook on e-commerce, quick commerce and AI. **Wuxi Lead Intelligent** unveiled a successful production line solution for solid-state batteries, encouraging customers' capex plans. **Midea** reported solid second quarter earnings, with improvements in revenue growth and margins. **China Merchant Bank's** earnings featured better-than-expected profit growth and an improvement in wealth management.

In **Taiwan**, August manufacturing PMI was 47.4, up from 46.2. The US revoked **TSMC's** waiver for China shipments of chipmaking equipment and technology.

In **Korea**, July industrial production rose 5% YoY, or ahead the 3.9% expected. August exports rose 1.3% YoY, missing the 2.3% increase expected, while imports fell 4.0% YoY or more than the 2.5% drop expected. **ASML** and **SK Hynix** announced that they had assembled the industry's first high NA EUV system (*High Numerical Aperture Extreme Ultraviolet Lithography*) from ASML for commercial use.

In **India**, second-quarter GDP rose 7.8% YoY, or better than the 6.7% rise expected. Seasonally adjusted manufacturing PMI rose to a 17-year high of 59.3 and services PMI rose to a 15-year high of 62.9 on strong domestic demand. The government announced the overhaul of the central taxation system, reducing taxes on key consumer goods. **Ashok Leyland** partnered with China's **CALB** group to invest 5000 cr in a battery production plant. The Competition Commission of India approved **Sumitomo Mitsui Banking Corporation's** proposed acquisition of the share capital and voting rights in **Yes Bank**. **Kaynes** signed an agreement with Infineon for OSAT services. **Syrma SGS** signed a JV with **Elemaster** to expand business offerings across railways, defence and medical devices.

In **Brazil**, August manufacturing PMI came in at 47.7, down from 48.2. Second-quarter GDP was up 2.2% YoY, or in line with expectations. Chinese investments doubled in 2024 to 4.2bn, making Brazil the third-biggest destination for Chinese FDI. Steel imports are expected to reach record high after jumping 32.2% YoY in July. **MELI** announced the launch of a B2B platform within the ecosystem where companies and government entities can trade with each other in volume at wholesale prices.

In **Mexico**, August manufacturing PMI was 50.2, up from 49.1. Gross fixed Investment NSA in June fell 6.4%, or more than the 4.6% drop expected. The government unveiled a \$540M industrial hub to lure investments. **OMA** continued to post strong passenger traffic growth with a 7.4% YoY increase in August. **Banorte** announced the sale of its digital-native bank **Bineo** to **Klar**, a Mexican fintech firm

CORPORATE DEBT

The mood was jittery at the start of the week due to economic uncertainty and political instability in Europe. The Xover initially widened by 6bp but the release of the JOLTS report on Wednesday confirmed that the US labour market was slowing, raising expectations of a Fed rate cut this month. Risk assets then turned higher and the Xover had tightened by 6bp by the end of the period.

Investment grade and high yield in Europe edged 0.03% and 0.09% lower.

The new issues market was very busy across the board, and especially in France where companies were keen to act before the confidence vote in the government on September 8. In High Yield, **Rexel**, **Iliad**, **Air France** and **Forvia** issued new bonds, although the high yield primary market activity segment was less active, with some refinancing deals from mainly well-known BB issuers

On a busy hybrids markets, **Danone**, **Unibail** and **Evonik** sold euro-denominated bonds at 3.95%, 4.75% and 4.25%, respectively.

In financials, bonds issued by French banks and insurance companies were the most volatile. Senior bank debt had widened by 10-15bp since France's prime minister announced the confidence vote but as markets turned away from extreme scenarios the spread fell to 3bp. AT1 bonds continued to widen over the week, falling by 0.2% due to French country risk weighing on banks at the beginning of the week. AT1 new issuance was also very busy: **Credit Agricole**, **ING** et **Nordea** sold USD-denominated bonds, with long calls, at 7.1025%, 7% and 6.75%, respectively. All three deals were heavily oversubscribed (6 to 7 times) and subsequently performed very well on the secondary 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.
- CTA: quantitative strategy which uses futures to invest in a wide range of financial assets, including equity indices, short-term and long-term interest rates, currencies, and commodities.
- 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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