EDMOND DE ROTHSCHILD

MARKET FLASH: THE YEAR END BRINGS SOME BAD SURPRISES

- **As expected, the ECB cut its deposit rate by 25 basis points.**
- **In China, the lack of concrete details from Beijing regarding economic support measures disappointed investors, which weighed on the stock markets.**
- **In the United States, the release of inflation statistics held no surprises, with the CPI index aligning with expectations.**

Market volatility was driven this week by disappointing comments from Christine Lagarde and Beijing. The ECB may have cut rates by 25bp as expected but its head then delivered a message that was less accommodating than expected. She mentioned upward pressure on inflation from wages and risks to already soft economic growth. And she highlighted the inflationary threat from any trade war with the US, suggesting that the impact of uncertainty on confidence levels and economic prospects was minimal. Government bond yields in Europe then rose sharply as her statements seemed to suggest that it would take a lot for the ECB to accelerate rate cuts. Subsequent press reports said the ECB was going for a 25bp cut at its next two meetings.

In China, investors were hoping for some hard and fast details on a stimulus package this week but Beijing simply said it wanted to increase spending to boost consumption. No further details were given and this vague message weighed on China's equity markets at the end of the period. Clearly, investors have high hopes of some action and the need for Beijing to act on promises is pressing.

Inflation data in the US held no big surprises. CPI came in as expected both overall and at the underlying level. And though producer prices accelerated slightly, shelter and services ex shelter finally started to slow so the Fed should go ahead and reduce rates by 25bp next week. That said, Jerome Powell's comments on the interest rate trajectory will be pivotal. Donald Trump's plans could be inflationary so the Fed might be tempted to mark a pause at the beginning of 2025.

We remain upbeat on equity markets, especially in the US. The country should continue to enjoy high nominal growth rates next year.

EUROPEAN EQUITIES

As expected, the ECB cut its deposit rate, the benchmark for lending in the eurozone, by 25bp to 3%. Elsewhere, Beijing suggested it might adopt a more accommodating budgetary policy. Despite these positive indications, Europe ended the period slightly lower. Energy and consumer stocks nevertheless performed well.

Italian luxury brand **Brunello Cucinelli** raised growth prospects for this year from 10% to 11-12%. The upgrade was due to expectations US sales would rise as well as positive momentum elsewhere. The group expects margins to widen by the end of the year, a sign that its upmarket positioning makes it less sensitive to difficult economic conditions, and especially in China. The stock jumped 8% on the news, extending an outperformance run in the luxury sector since the beginning of 2024.

In Germany, the **Adidas** head office at Herzogenaurach was raided in connection with a long-standing tax probe. The investigation concerns the 5-year period starting in October 2019 and targets customs and tax rules on imports into Germany. An Adidas official confirmed that several of the group's offices had been searched on Tuesday.

Elsewhere, travel operator **Tui** reported better-than-expected quarterly figures. Sales were up 12% compared to the previous year. The group's cruise division made a particularly strong contribution. Management raised its growth forecasts for 2025 to between 5-10%.

US EQUITIES

Tech stocks once again outperformed, sending the Nasdaq 1.3% higher and taking the index to over 20,000 for the first time ever. The S&P 500 edged 0.5% lower and the Russell 2000 ended the week 2% down. The Magnificent 7 hit new highs as the market broadening trend evaporated.

The AI theme seemed recently to be waning but apparently not: **Broadcom** is soaring ahead of the opening today following its results. Management says AI could mean $60-90bn in business thanks to orders from 3 hyperscalers. The group also said it was working with Apple over AI chips.

In retail, **Costco** continued to perform with second-quarter sales up 5.1%. Restoration Hardware raised revenue guidance for the full year and the stock jumped.

This week's main underperformer was in the software sector. Adobe had a satisfactory fourth quarter but the stock fell after management cut revenue guidance for 2025. The move raised questions on AI monetisation and its pricing power. Magnificent 7 star Google took centre stage over the week after launching its quantum Willow chip. It can perform standard benchmark computation in under five minutes, an operation that would take one of today's fastest supercomputers 10 septillion years.

In the autos sector, **General Motors** said it was scrapping its Cruise robot taxi division. The news sent **Uber**'s share price lower. There was also speculation that Donald Trump might cancel the **Oshkosh** contract with the United States Postal Service.

In an S&P 500 reshuffle, **Workday** and **Apollo group** joined the index while **Qorvo** and **Amentum** left.

EMERGING MARKETS

The MSCI EM index was up 0.8% this week as of Thursday's close. China (+2.8%) led outperformers while Korea rebounded by 2%. Brazil gained 1.2%.Taiwan and India dipped by 0.5% and 0.4%, respectively.

In **China**, November CPI came in at +0.2% vs. +0.4% expected. PPI fell 2.5% vs. the 2.8% expected, hitting a five-month low as fresh food prices pulled back while factory deflation persisted. November trade data was weaker with exports up 6.7% and imports falling 3.9%, but the country still outperformed Korea and Vietnam after the global trade cycle's apparent peak in mid-2024. Both the Politburo and Central Economic Working Conference adopted the strongest tone in decades on policy stance, which aims to boost domestic consumption through fiscal expansion. More policy rate cuts are expected in 2025. Elsewhere, more cities are launching a new round of voucher programmes to encourage spending before the year-end holidays. Beijing might expand a private pension scheme nationwide as it moves to plug a pension gap due to a rapidly ageing population. On the geopolitical front, the final draft of the US National Defense Authorization Act does not include the Biosecure Act bill, a surprising fact that is seen as good news. The NBA is returning to China next season, after a five year ban. In good news for the autos sector, NEV sales jumped 50.5% YoY in November. **CATL** and **Stellantis** are to invest up to €4.1bn in a battery plant in Spain. **Xiaomi** plans to launch a new EV model (YU7) in June-July 2025. **Tencent** boss Pony Ma praised China's economic policy and stimulus for the private sector. The antitrust regulators summoned **PDD** to fix its refunds-first policy.

In **Taiwan**, **Mediatek** is expected to launch the high-end Dimensity 8400 chip which is built on the TSMC 4nm process. Monthly production **TSMC's** CoWos chip is expected to reach 70,000 wpm by 2025, representing 10% of revenues.

In **Korea**, **LGES** executives said Donald Trump might suspend some EV incentives. President Yoon's impeachment process remains unclear.

In **India**, November CPI data came in 5.5% as expected, down from 6.5% in October due to a much anticipated softening in food inflation. October IP also recovered, rising 3.5%. **PayTm's** board of directors announced the sale of **PayPay** to **SoftBank**. The price is equivalent to 4% of PayTm's market cap, and increases its cash position by 25%. Cement prices increased in early December, implying a 3Q25 price increase of 3.5% QoQ (consensus expects a 4% increase in the second half of 2025). **Amazon India** is to launch its 15-minute delivery service.

In **Brazil**, the central bank increased interest rates by 100bp to 12.25%, or more than expected, and gave hawkish guidance for next meetings which could take rates to 14.25%.

In **Argentina**, President Milei promised to lift capital and currency controls next year. The government also said it would discuss a free trade agreement with the US once Donald Trump takes office. The central bank cut rates from 35% to 32% on lower inflation expectations, the 8th cut since Javier Milei assumed office in December 2023.

CORPORATE DEBT

CREDIT

Market liquidity is quite naturally drying up ahead of the year end. The segment is still enjoying net inflows but less so, broker inventories have shrunk and the new issues market is on hold.

This week, the ECB cut rates by 25bp as expected. Switzerland's national bank went further than expected and cut by 50bp. Markets are now 100% betting on a 25bp move from the Fed next week. However, producer prices rose more than expected so traders are watching closely to see if the rate-cutting trend in the US diverges more markedly from the rest of the world.

In company news, **Scor** used its investor day to announce it would be buying back its perpetual bond at its first call date and instead issuing a new CoCo RT1 in euros. M&A deals continued apace. In Denmark, **Nykredit** paid DKK 24.7bn for **Spar Nord**. In the UK, **Aviva** reached a preliminary agreement to buy **Direct Line** for £3.6bn (275p a share). And **Nippon Life** acquired **Resolution Life** for $10.6bn. Financial sector consolidation continued in Italy.

Crédit Agricole took its stake in **Banco BPM** to 15.1% so the bank will still count in discussions over **UniCredit**'s bid on the Italian bank.

In non-financial company news, the Guillemot family is reportedly in talks with **Tencent** and other investors over financing a bid on **Ubisoft**. A clause concerning any change of control at Ubisoft stipulates that the 100% put on the bonds does not apply if a concert of investors controlled by the Guillemot family buys the company. The bond's valuation will therefore depend on post-acquisition leverage and the investors backing the family. In the apparel sector, S&P downgraded **Isabel Marant** by two notches to CCC+/stable. The agency cited difficulties in the sector and the company's stretched finances. In a private placing, Spanish medical company **Grifols** raised €1.3bn with a 2030 maturity at 7.125%. The proceeds will go on reimbursing its 2025 bond and a line of credit. The placing also increased the company's cash from €1bn to 1.7bn.

In today's markets, emerging country debt is still performing well thanks to its historically high yields.

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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