



EDMOND DE ROTHSCHILD ASSET MANAGEMENT

MARKET FLASH: THE TACO TRADE IS DÉJÀ VU FOR MARKETS

- After tensions escalated over Greenland, the tone eased following Donald Trump's speech in Davos, in which he announced the suspension of planned tariff rises, the launch of talks with NATO and a tripartite meeting on Ukraine
- In Europe, France's government opted for the 49.3 guillotine measure to get its draft budget for 2026 approved. The budget assumes the deficit this year will be around 5%, a less ambitious target than originally planned.
- Amid rising geopolitical fragmentation, Beijing is trying to appear as a stable partner and has been reinforcing its diplomatic and trade ties, especially with Canada and Europe.

A surge in tensions over Greenland following Denmark's refusal to sell the island to the US rekindled fears of a transatlantic trade war. Donald Trump threatened to impose new tariffs on the European Union, targeting the 8 countries staging joint military exercises in Greenland with an extra 10% from February 1st and possibly up to 25% more by June. France was threatened with 200% tariffs on wines and champagne after Emmanuel Macron decided not to join Donald Trump's *Board of Peace*, his alternative to the UN. Brussels suggested several ripostes like suspending last summer's trade agreement, imposing €93bn in import duties on US goods and possibly activating its anti-coercion tool. As a result, risk assets wavered and government bond yields rose due to worries over inflation and increases in defence spending.

But then Donald Trump dialled down his rhetoric at Davos by declaring that there was no need for the army to get involved. He said there had been constructive talks on Greenland with NATO's secretary general and he cancelled plans to implement tariff rises from February 1st. At the same time, a meeting to discuss peace in Ukraine was planned between the US, Ukraine and Russia, a sign of geopolitical détente which helped risk assets rebound. The gold ounce dipped but flirted this week with the \$5,000 mark.

Tensions also eased over the Fed after Supreme Court hearings seemed to confirm a favourable verdict on maintaining Lisa Cook on the board. As for economic data, November's PCE reading was as expected while third-quarter GDP growth was revised up to 4.4%.

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In Asia, Japan's lower house was dissolved ahead of early elections. Government bond yields rose with the 40-year maturity hitting a record high of more than 4%. Faced with the market's reaction, government officials tried to offer reassurance that new measures would not be funded by more debt. The Bank of Japan left its rates unchanged while expecting growth to be robust with inflation close to its 2% target. In China, fourth-quarter growth

came in at 4.5% so the annual 5% target was met. Amid rising geopolitical fragmentation, Beijing is trying to appear as a stable partner and has been reinforcing its diplomatic and trade ties, especially with Canada and Europe.

We remain upbeat on equities with a preference for Japan and emerging markets. Latin American countries stand to gain from strong momentum in commodities. China's strategic positioning also provides support for the region. With budgetary risk on the rise, we are cautious on the long end of the yield curve while remaining more positive on short maturities, especially in the US. We are still keen on emerging countries' debt as the dollar weakens, short rates trend lower and capital flows return. In corporate debt, today's investment grade levels have led us to slightly reduce our weighting.

EUROPEAN EQUITIES

Market trends were dictated by an escalation in tensions between Donald Trump and the European Union with fourth-quarter results in the background.

In company news, a number of groups announced layoffs, including **BNP Paribas** following its integration of **AXA IM**, **Société Générale** and **Capgemini** which is to make 2,400 people redundant due to an acceleration in AI and persistent weakness in certain sectors. Elsewhere, healthcare rose on encouraging signals. The CEO of **Novartis** said the group should be immune to US tariffs thanks to its inventory build-up in the US and an agreement with the Trump administration. **Novo Nordisk** gained on exceptional demand for its Wegovy weight-loss drug. And **Johnson & Johnson** posted better-than-expected results with rising sales and 2026 guidance higher than consensus estimates. In the luxury sector, **Burberry** also beat expectations as its products returned to favour in China. The AI theme continued to gain ground. **ASML** said it expected the end of 2025 to be better than expected and management upped guidance for the beginning of this year thanks to orders rebounding in China.

US EQUITIES

Wall Street saw strong volatility in a holiday-shortened week for Martin Luther King Day and indices were mixed. Markets rebounded on Wednesday and Thursday after diving on Tuesday, the worst fall for the S&P 500 and Nasdaq since last October. The S&P 500 fell 0.38% and Nasdaq 0.86% but the Dow Jones edged 0.18% higher. The Russell 2000 outperformed sharply (+1.53%) to mark 14 sessions in a row where small caps outperformed the S&P 500, for the first time since 1996. Year to date, mid and small caps have outperformed large caps on average. This week's macroeconomic data confirmed that the US economy was holding up. Third-quarter GDP growth was revised up to 4.4%, weekly jobless claims stayed very low and consumer spending continued strong, including during the Christmas period. Core PCE inflation (ex-volatile elements) came in at 0.2% in October and November, underpinning the "gradual disinflation scenario with no growth shock". Markets are now only expecting 40bp in Fed Fund cuts for 2026. The Fed is now in a blackout ahead of the FOMC scheduled for the end of the month. Precious metals continued to rally with the gold ounce hitting new highs above \$4,996 thanks to political risk, central bank buying and moves by investors to diversify.

Tech was hit by disappointing prospects. Falls in **Netflix**, **Intel** and semiconductor stocks weighed on the sector. The sector recovered a little at the end of the period thanks to a

rebound in AI infrastructure and data centre equipment stocks but still ended the week down 0.51%.

Industrials and transport managed to perform well on small cap outperformance, improving sentiment on growth prospects and the chance of the US economy staying resilient but under control. Trading in energy stocks was choppy. Oil briefly moved back above \$60 but then fell back due to signs of de-escalation in Ukraine and adjustments to demand expectations. However, oil majors and some oil service stocks helped the sector gain 2.56%.

Financials were more mixed, ending down 1.16% overall. Banks and credit card companies were still under pressure due to talk of capping rates and charges while asset management companies and stock exchanges gained on rising trading volumes and market activity. Healthcare (+1.64%) once again ended higher thanks to a biotech rebound and news that **Boston Scientific Corp** was buying **Penumbra**.

EMERGING MARKETS

The MSCI EM index was up by 0.69% in USD this week as of Thursday. Brazil, Mexico, Korea and Taiwan gained 8.25%, 2.99%, 2.55% and 0.73%. India and China declined by 2.75% and 1.01%. EM inflows have been strong so far this year at almost \$15bn, compared to \$30bn for 2025 as a whole.

In **China**, the Fourth-quarter GDP grew 4.5% YoY, meeting estimates, while full-year 2025 GDP expanded 5.0%. December retail sales rose 0.9% YoY, missing the 1% estimate, while January-December fixed investment fell 3.8% YoY, or worse than the estimated 3.1% decline. The authorities have purchased approximately 12 million tons of US soybeans over the past three months, fulfilling a key trade commitment made to the Trump administration. **TikTok** sealed a deal to operate in the US after years of drama. China's regulators are considering tightening rules for firms to list in Hong Kong. The government told **Alibaba** and other top tech companies to ready orders for H200 AI chips. Elsewhere, Alibaba is reportedly planning an IPO for its AI chipmaking unit T-Head. **Popmart** announced a share buyback programme.

In **Taiwan**, export orders in December surged 43.8% YoY, significantly exceeding estimates of 35.5% and marking the fastest growth since February 2021. Information and communication products led the surge, rising 88.1% YoY, with growth fastest to ASEAN countries followed by the US. For full-year 2025, Taiwan hit a record \$743.7bn in export orders, up 26% YoY

In **Korea**, the fourth-quarter GDP unexpectedly contracted by 0.3% QoQ, missing estimates of 0.2% growth. President Lee is pushing for the swift passage of the 3rd Commercial Code Revision. **SK Telecom** filed an administrative lawsuit arguing that the 134.8 billion won penalty imposed by the Personal Information Protection Commission (PIPC) in October related to a hacking incident is unjust.

In **India**, Key industry output rose 3.7% YoY in December, accelerating from a revised 2.1% in November. India and the UAE signed a comprehensive deal with both countries agreeing to double bilateral trade to \$200bn by 2032. **Eternal** reported a strong beat in a highly competitive environment with adjusted breakeven in the quick commerce business. **Wipro** reported an inline quarter but had weak deal wins and guidance. **KEI Industries** reported strong top line growth of 20% but was still below expectations due to capacity constraints.

In **Brazil**, Federal tax revenue hit a record high of R\$2.89 trillion in 2025, representing a 7.5% inflation-adjusted increase from 2024. The European Parliament referred the Mercosur-EU

trade agreement to the European Court of Justice, a move that could freeze the deal. **Banco do Brasil** approved a 30% payout ratio for 2026, to be distributed through dividends or interest on equity in eight instalments. All eyes are on next week's Central Bank decision on interest rates.

In **Mexico**, Bi-weekly inflation rose 3.77% YoY in the first half of January, coming in below the consensus estimate of 3.87%. November retail sales surged 4.4% YoY, significantly beating the 2.8% estimate and accelerating from October's 3.4% rise. **Grupo Carso** agreed to acquire **Lukoil's** remaining stake in two Gulf of Mexico oil fields for \$600m.

CORPORATE DEBT

Trading was highly volatile as markets fell due to renewed trade and political tensions over Greenland and rallied as Davos interventions gradually toned down the rhetoric and more positive moves for peace in Ukraine emerged.

European government bonds generally tightened with the 10-year France-Germany spread down 6bp as budget discussions in France advanced. The ECB and Fed are expected not to reduce rates over the short term. For 2026 as a whole, ECB rates are seen as stable with 2 cuts from the Fed.

Investment Grade and High Yield returned to 0.03% and 0.13% over the period. The euro-hedged ICE COCO index ended 0.16% higher. The Xover ended the period unchanged thanks to a post-Davos rally but had tanked by as much as 10bp at the start of the week.

High yield new issuance resumed with **Betclik** (BB-) which raised €1bn at 5.125% due 2031. The bond was already trading at 101.5 two days later, a token of persistent investor interest in corporate debt carry.

There were few financial deals as the results blackout approached and markets turned volatile. Nevertheless, some peripheral banks and challengers rushed to issue bonds on Thursday, the only window of opportunity in the week. **Eurobank** and **Investec** sold Tier 2 bonds while **Credito Agricola** and **Erste Bank Hungary** issued senior debt. Thursday's activity showed that investor appetite had not been affected by volatility earlier in the week and order books were strong. **Bankinter** kicked off the fourth-quarter earnings season with upbeat figures and sound prospects for 2026.

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.
- RT1s: perpetual bond issues with early redemption possible after 10 years. Coupon payments are discretionary and non-cumulative.

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