EDMOND DE ROTHSCHILD

MARKET FLASH: CENTRAL BANKS, "LOWER FOR SURE"

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Now that markets are expecting rate cuts in 2024, investors will be looking at the economy, and jobs and inflation data in particular, to back up these expectations. This week, the JOLT survey confirmed that the jobs market was slowing with fewer openings than expected. The number of openings compared to unemployed people fell sharply in October but is still not back to pre-Covid levels. Similarly, services ISM rose compared to the previous month, another indication of the US economy's resilience. The jobs component was stable and fell short of expectations.

Ahead of the Fed and ECB meetings, Fed committee members are sworn to silence. Not so in Europe. The ECB's Isabel Schnabel said that the latest inflation data had made her change her mind. She now thinks rate hikes are over and that it would be difficult to leave rates where they are in 2024. Long bond yields reacted by falling. Germany's 10-year Bund fell back to 2.20%, a level not seen since last May.

In contrast, Kazuo Ueda, governor of the very accommodating Bank of Japan, said it might be possible to raise rates. No date was given, however. His comments sent government bond yields and the yen higher but the rise was reduced when the second estimate of third quarter GDP was a 0.70% drop, the result of lower household spending.

Oil prices fell back to July levels as OPEC+ suffered a hit to its credibility. Russian and Saudi ministers showed their determination to underpin prices but they had only a limited effect. The oil price decline could also reflect lower demand due to slowing economies.

We remain fully invested in equities. We still have a preference for duration which should benefit from slowing inflation and labour markets and which should provide protection if the economy deteriorates more markedly. However, given the steep fall in government bonds, both in the US and Europe since the end of October, we have taken some profits on duration.

EUROPEAN EQUITIES

For the second week running, European markets ended the period sharply higher. Markets appear to be convinced inflation will gradually come under control, especially since jobs data in the US seems to be easing. At the same time, the ECB made reassuringly confident comments which sent long bond yields lower. Isabel Schnabel, one of the ECB's most hawkish members, pointed out the remarkable slowdown in inflation. Economic data in the eurozone seem to back up this view: retail sales for October missed expectations. In Germany, new industrial orders also fell over the month. Brent crude continued to lose ground, hitting $74 and reinforcing market optimism.

Given this macroeconomic situation, most cyclical sectors came back into vogue, led by tourism and leisure and followed by autos. In contrast, the food and beverages sector lost ground as prices returned to normal. It was the same story for the energy sector.

TUI, Europe's biggest travel agency soared after guiding on a big increase in 2024 profits thanks to strong demand for this winter and next summer.

French consultancy **Wavestone** posted a 24% increase in EBITA for its first half 2023/24 (a 13.3% margin) and a 28% jump in earnings to €23m. Management said there had been a rebound compared to the fourth quarter of 2022 and reiterated targets for the current financial year. The company is betting on growth of 7% as in the previous year.

Sanofi presented its innovation-driven strategy at its R&D Day. Unfortunately, investors took a mixed view of a very dense, almost aggressive presentation and a lack of financial detail. Sanofi seems to be looking to reassure markets on its ability to innovate compared to rivals.

Worldline gained ground after Bloomberg said **Crédit Agricole** was thinking of buying a stake to support its partner in the aftermath of a profit warning in October which caused the stock price to collapse. Both groups had signed a partnership earlier this year, a joint venture to exploit Worldline's payments expertise and the bank's distribution network. However, this good news came too late. Worldline's market cap is now under €5bn and it will leave the CAC 40 on December 18 and be replaced by Vivendi, which marks its return only 6 months after being ejected.

US EQUITIES

Wall Street ended the last 5 trading sessions slightly higher with the S&P 500 up 0.39%.

The US jobs market seemed to be cooling after 103,000 private sector jobs were created, or less than the 130,000 expected, and the pace of wage growth was the slowest since September 2021. The data were in line with the number of job openings released the previous day; they hit a low not seen since the beginning of 2021.

At the end of the week, market sentiment was dented after WTI oil prices fell below $70 for the first time in 5 months. Inventories rose more than expected and there are worries consumption will slow down.

In company news, tech stocks received a boost from the latest IA model from **Alphabet** (+5.3%) and the launch of a new generation of AI chips by **AMD** (+9.8%). **AMD's** management believes the AI chip market will exceed $400bn over the next 4 years. Chip maker **Broadcom** lost 3% after the bell due to disappointing results. The group said its main clients had reduced spending and competition was strong.

Uber gained 2.2% after joining the S&P 500. **Jabil** and Builders **FirstSource** also joined the index. They replaced **Sealed Air**, **Alaska Air** and **SolarEdge Technologies** which will join the S&P SmallCap 600 index. **Spotify** jumped 7.5% after unveiling a plan to lay off 17% of its staff. It will also cut costs due to the economic slowdown. **AT&T** chose **Ericsson**, rather than **Nokia**, to modernise its mobile phone network in the US. According to Bloomberg, the contract could be worth $14bn over 5 years.

JAPANESE EQUITIES

The NIKKEI 225 and TOPIX fell 1.88% and 0.63% as investors adjusted portfolios ahead of the year end and the yen rallied against the dollar due to the interest rate gap narrowing. The market was also concerned about slower global growth after soft data in the US, China and Europe.

Electric Power & Gas rose 5.41% on lower crude oil prices. Insurance gained 4.62%, led by **Sompo Holdings** (+7.34%), a non-life insurer, which ramped up its earnings guidance and is expected to launch a share buyback, and **Dai-ichi Life** (+5.91%), whose investment business could benefit if the BoJ were to change its monetary policy. Warehousing & Harbour Transportation rose 1.96% on buying of value stocks. On the other hand, Mining slumped 5.61% as commodity prices weakened due to concerns over slowing global economies. Machinery fell a further 3.01% as the yen appreciated. Metal products declined 2.55% on profit taking.

M3 (healthcare services) and **Tokyo Electron**, a semiconductor manufacturing equipment maker, tumbled 9.69% and 6.62%, respectively, as large-cap growth stocks were sold in a volatile week. **Panasonic** (electronic products) shed another 6.31% as the yen continued to strengthen against major currencies.

The dollar continued to fall from the low-148s to the high-143s against the yen, mainly due to the narrowing interest rate gap. Comments from BOJ governors triggered market speculation that negative interest rates might soon end and the yen pushed even higher.

EMERGING MARKETS

In **China**, November's Caixin Services PMI rose to a three-month high of 51.5, or ahead of the 50.5 estimated. The Politburo pledged to strengthen the government's fiscal measures and make monetary policy more effective, bolstering efforts to stabilise growth. CPCA reported a strong 29% YoY increase in NEV deliveries (+6% MoM). Moody's Investors Service cut its outlook for Chinese sovereign bonds to negative from stable while retaining a long-term rating of A1. Singapore and China plan to establish a 30-day visa-free travel arrangement between the two countries. Third-quarter results at **NIO** were in line: revenues rose 117% QoQ to RMB 19bn and the net loss narrowed by a significant 27.8%. **Wuxi Biologics** issued a profit warning on weaker-than-expected trading due to funding challenges faced by biotech customers. **Tesla** is reportedly planning to resume the construction of its Shanghai Phase III factory.

South Korea: the US unveiled rules for foreign entities in its electric car tax credit eligibility. Korean battery players would need to adjust their JV holding structures with Chinese partners accordingly. **SK Group** rolled out a major senior management reshuffle with seven SK companies having new CEOs.

In **India**, November services PMI dropped to a year low of 56.9 against 58.4 in October due to lower demand but remained in expansion territory. **GST** revenue collection for November was INR 1.67 trillion, + 15% YoY or the highest growth rate ever. **Siemens AG** is to acquire an 18% stake from **Siemens Energy Holdings**. **HCL** Tech is to sell a stake in a UK joint venture to State Street. **Paytm** announced plans to materially scale back smaller-ticket loans due to macro uncertainty and RBI regulatory guidance. **Apple** expressed a preference for sourcing batteries for the upcoming iPhone 16 from Indian factories.

In **Brazil**, third-quarter GDP expanded 2% YoY and 0.1% sequentially, or above estimates. The increase was driven by the agricultural sector. The government accepted IOC but limited the assets that can be classified as shareholder equity; the bill has been sent to Congress. Weg will invest 1.2 billion reais over the next 3 years to expand transformer production capacity in Brazil, Mexico and Colombia. **The Sabesp** privatisation bill was approved by the Legislative Assembly. According to the FT, **Natura** has explored divesting most of its Avon International businesses, following sales of **TS** and **Aesop**. **Anima** confirmed its intention to sell Sao Judas University and a stake in **Inspiralli**. Sugar futures fluctuated near a three-month low as upward revisions to production estimates in Brazil eased concerns over supply shortages in the near term.

In **Mexico**, CPI 2H/November came in below expectations, with the headline figure in deflationary territory. The government announced increases of 20% in the minimum wage, starting in January 2024. Oil exports increased 14% in October.

Argentina: according to the local press, Santiago Bausili will lead the Central Bank. Bausili worked with Luis Caputo (future Minister of the Economy) in the Macri administration. Bausili is an economist with experience in global banks and was finance secretary during the Macri administration. Fintech **Ualá**, the Buenos Aires-based fintech backed by George Soros, Steve Cohen and **Tencent Holdings**, will begin offering no-fee credit cards Friday to its five million customers in Argentina.

CORPORATE DEBT

CREDIT

It was another very strong week on credit markets thanks to tumbling yields. On the 5 and 10-year German Bund, they fell by 10bp and 12bp to 2.17% and 2.23% (as of Friday morning). Spreads were mainly unchanged with investment grade (IG) at 143bp and high yield at 430bp. The Xover was also unchanged at 368bp and traded in a narrow 368-372bp range all week. After a month of tightening, CoCo spreads too were stable around 740bp.

New issuance naturally slowed down ahead of the year end but some companies seized the opportunity of lower rates and stable spreads to refinance. In high yield, **Loxam** (BB-) raised €600m at 6.375% due 2029 and Iliad (BB) €650m at 5.375% also due 2029. In the investment grade segment, **ASR** (BBB+) sold a €600m green bond at 3.62% due 2028 and **Unibail** (BBB) raised €750m at 4.125% due 2030.

Riding on falling rates, investment grade returned 1.29% over the week (+6.48% YTD) and high yield 0.26% (+9.8%). Actuarial yields for investment grade were 3.9% and 7% for high yield, or still good entry points for carry strategies.

CONVERTIBLES

December got off to a good start for convertibles thanks to falling rates and more equity market gains. Yields on the 10-year US Treasury approached 4% while the European equivalent trended down towards 2%. The Euro Stoxx 50 equity index hit a year high of 4,495 and the S&P 500 flirted with 4,600. Credit spreads tightened.

On the new issues market, 11 deals raised more than $4bn. Clean energy company **Evergy** raised $1.2bn at 4.5% due 2027 and with a 22.50% premium. In Japan, **OSG** (cutting tools) raised JPY 22bn due 2030. In Hong Kong, **Microport** raised $220m at 5.75% due 2028 and with a 30% premium. The proceeds will go on buying in its 2028 bond at 99%.

The US also saw two buy-ins: **Lending Tree** spent $200m to buy in its 2025 convertible at 81.4% and **3D System** $135m to buy in its 2026 issue at 74%.

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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