EDMOND DE ROTHSCHILD

MARKET FLASH: CHINA MAKES ITS FIRST REOPENING MOVES

• In China, easing restrictions should make budgetary and monetary stimulus more effective

• In the US, jobs data and sharply higher services ISM suggest the economy is proving resilient

• We remain neutral on equities and in fixed income, we continue to prefer carry strategies

Shanghai's composite index rebounded sharply from 13-year lows on hopes China would reopen more rapidly than expected. Tech stocks led the rally. Sanitary restrictions were once again eased in Beijing and Shanghai, a move that could drive a rebound in activity after a new low in the Caixin services PMI for November. The State Council also said it was essential to speed up Covid vaccinations for the old; their protection had been the main brake on reopening. Easing restrictions should also make budgetary and monetary stimulus more effective.

Even so, China's exports were down 8.7% over a year, an indication of soft global demand but also disruption in Chinese factories due to Covid restrictions. Imports plunged 10.6% over a year due to falling commodity prices and lower coal imports. Oil imports, however, increased in volume.

The oil price tanked by more than 10% over the week as traders fretted about a global recession. US inventories hit a 1986 low due to weak demand expectations.

G7 countries and Australia slapped a $60 cap on Russian oil. Moscow retorted that it would not make deliveries to any country that applied it. As OPEC decided to maintain its output, international markets could end up missing Russian oil, especially after China's decision to reopen which should logically increase demand over the short term.

In the US, jobs data and sharply higher services ISM suggest the economy is proving resilient. Consumption and industrial order books are also up. For the Fed, this means sticking to its restrictive stance. In the political arena, Raphael Warnock won Georgia's run-off, giving the Democrats an absolute Senate majority and reinforcing the party's clout on commissions and especially federal judge appointments.

Philip Lane, the ECB's chief economist, said several more rate hikes would be needed to fight any knock-on inflation from wage demands. He nevertheless thought that eurozone inflation was close to a peak so the ECB might decide to slow the pace of future rate increases.

The Bank of Canada said it could possibly put monetary tightening on hold, fuelling hopes of a synchronised slowdown in rate hikes.

We remain neutral on equities but with a preference for emerging countries. We are still cautious on Eurozone equities, especially after the recent rally and with the euro's ongoing appreciation in mind. In fixed income, we continue to prefer carry strategies. In government bonds, we prefer US duration to the eurozone as the ECB will have to deal with persistently high core inflation.

EUROPEAN EQUITIES

After several good weeks, European markets fell back. November's retail sales in the eurozone fell by a sharp 2.7% YoY, returning to last June's levels. The drop reflected the impact of inflation on household purchasing power. Petrol prices may have fallen but households are still paying more for gas and electricity. The market is still worried about the EU's decision to cap prices paid for Russian oil. As for gas, the regulator said that consumption would have to fall 20%, or more than the 10% drop seen so far this year, to offset the end of Russian gas. He argued for structural changes in Europe's use of Russian gas. All this led to a slight rise in risk aversion after several weeks of a rally.

In company news, **Stellantis** offered to increase wages by 5.3%, or less than the 8.5% demanded by the unions. The demands reflect significant pressure in companies to raise wages. In aerospace, **Airbus** confirmed that persistent supply chain problems would prevent it hitting its aircraft delivery target this year. The group expects output to slow further which suggests the problem could persist in 2023. In contrast, **Beneteau**, which makes sailing boats, revised guidance higher. Margins continued to rise thanks to strong demand and the company's pricing power. Companies continued to adapt to falling demand: Sainsbury's unveiled a plan to beat inflation by keeping prices low in an attempt to preserve volumes. Online grocer **Ocado** backtracked on its investment programme as demand continued to fall.

US EQUITIES

Wall Street ended the last 5 trading sessions lower as investors waited for various inflation indicators. Oil fell sharply on fears of an economic slowdown and energy stocks were dragged down in its wake. Defensive sectors outperformed, led by healthcare.

The latest jobs data showed wages rising from 4.7% to 5.1%, or much more than the 4.6% expected. Services ISM for November came in at 56.5, up from 54.4 in October, and significantly above the 53 expected.

Janet Yellen still thinks the US can avoid a recession, arguing that supply chain bottlenecks are clearly starting to ease. However, the CEOs of **Bank of America** and **Wells Fargo** warned of a drop in credit card purchases and a possible slowdown amid plans by the Fed to continue raising rates.

Elsewhere, the US is reportedly working with European countries to reduce carbon emissions by introducing new customs duties on Chinese aluminium and steel. Spot prices for both metals then rose 3%. The Securities and Exchange Commission asked companies issuing stocks to reveal their exposure to cryptocurrency markets.

In company news, **Blackstone** rebounded by 5% after a sell-off due to the company's restrictions on redemptions in one of its credit funds. The Pentagon awarded its $9bn cloud contract to **Google**, **Oracle**, **Amazon** and **Microsoft**. This followed the cancellation of the JEDI programme which had been awarded to Microsoft alone.

Apple fell on press reports that the group had pushed back its autonomous car production by a year to 2026. Second-hand car prices fell again in November, taking the year-to-date decline to 14.2%.

After some hesitation, the FTC eventually confirmed it would be suing to block Microsoft's acquisition of **Activision Blizzard.**

JAPANESE EQUITIES

The NIKKEI 225 and TOPIX fell 2.31% and 2.26% over the period, dragged down by poor US economic data and the stronger yen. However, in the middle of the week markets were supported by Beijing's relaxation of Covid-19 restrictions.

Iron & Steel rose 1.29% as investors focused on high dividend stocks. Air Transportation gained 0.42% as investors continued to buy tourism related plays.

Mining fell 5.05% on falling commodity prices. Precision instruments shed 4.92% on a sharp fall in **Olympus** after higher costs hit results. Electric Appliances dropped 4.34% on fears of a global slowdown.

Cosmetics giant **Shiseido** gained 4.34% after China eased Covid-19 restrictions. **Nippon Steel** rose 3.44% on the shift to high dividend stocks. Insurance group **Dai-ichi Life** rose 3.42% as strong US data pushed back any Fed decision to cut interest rates.

Z Holdings, an internet platform provider, and **Tokyo Electron**, tumbled 5.67% and 5.33% as high-tech stocks retreated ahead of the interest rate hike at the upcoming FOMC. **Nissan** lost 5.64% on the yen's appreciation.

The yen traded between 134.31 and 137.00 yen on profit taking after its strong rally on falling US bond yields.

China seems to have relaxed its zero-Covid policy. The National Health Commission said that people with Covid-19 who have mild or no symptoms could quarantine at home. The directive also instructed officials to halt temporary lockdowns and ended testing and health code requirements for people entering Beijing.

EMERGING MARKETS

The MSCI EM Index was down 0.5% as of Thursday's close, outperforming the developed zone. China rallied 4.8%, continuing to lead outperformance. India fell 1.7% and Brazil ended the period 4% lower after the previous week's rally.

In **China**, CPI in November eased again to 1.6% YoY from 2.1%, its lowest level since March, leaving more room for further consumption stimulus. The export contraction deepened in November, dropping 8.7% vs. -0.3% YoY in October and -3.6% expected. Imports slumped 10.6%. The Politburo held a meeting outlining 2023 priorities and setting the tone for development goals. The meeting said economic growth, and not Covid containment, would be the top priority in 2033, a significant change of tone. NHC unveiled 10 new Covid-19 measures to further accelerate the reopening. Country Garden and Midea Real Estate are planning bond deals with derivative protection in the latest signs of regulatory support to help ease the liquidity crunch for some construction companies. JD Tech is reportedly preparing to list in HK.

HK is considering further relaxing Covid restrictions, including scrapping mandatory outdoor masks and easing tests for arrivals. In **Taiwan**, November exports fell sharply by 13.1% YoY while imports dropped by 8.6%, both weaker than expected.

In **India**, November Services PMI rose to 56.4 from 55.1 last month. The RBI hiked rates by 35bp as widely expected, while also cutting its FY23 GDP growth target from 7% to 6.8%. FIIs bought S4.4bn worth of Indian equities in November.

In **Brazil**, the central bank kept interest rates unchanged at 13.75% but with a hawkish tone due to fiscal uncertainty. Petrobras cut diesel and gasoline prices at refineries by 9% and 6%, respectively. The Senate approved a constitutional amendment for R$168bn (1.6% of GDP), expanding government spending for two years to fund an extension of social welfare payments for poor families (Auxilio Brasil, cash transfer programme), scientific innovations and other expenditures. The amendment goes to the Lower House to be voted before the end of the month.

In **Mexico**, October loans rose 12.9% YoY, up from 11.7% in the previous month with stable asset quality. Mexican airport operator OMA reported a strong 20% YoY rise in terminal passenger traffic for November. **Argentina** agreed a cap on fuel price increases with major oil firms operating in the country. **Peru**'s President Castillo was impeached and arrested after he attempted to dissolve Congress.

Supply chain relocation: **TSMC** is to revise up its US fab capex from $12bn to $40bn in total. **GM** and **LG** will invest an added $275m in its Ultium battery production facility in Tennessee and expects to boost production by 40% to 50GWh. LG is also in advanced talks with the Czech government over the construction of a gigafactory. **Volkswagen** is currently in the process of choosing the location of a battery factory in Eastern Europe and the Czech Republic is one of the possible locations.

CORPORATE DEBT

CREDIT

Ahead of the last FOMC of the year, investors focused on the economic slowdown, and especially in Europe. There was, however, some good news from China which seems to have abandoned its zero-Covid policy for good and is now gradually reopening its economy. Risk premiums widened over the week, taking the Xover and Main 27bp and 4bp higher. Between Monday and Thursday, investment grade returned 0.43% while high yield slipped 0.26%.

In the absence of any striking macroeconomic developments, credit markets concentrated on company news. In new high yield issuance, **888 Holdings**, owned by bookmaker William Hill, raised €200m at a fixed rate due 2027 and €150m with a floating rate bond. The proceeds will go on refinancing some of its sterling-denominated debt. Free's holding company **Iliad** raised €750m at 5.375% due 2027 to extend its debt maturity.

In company news, prospects at Germany's **Adler Real Estate** improved after the group's creditors agreed on a new €938m rescue loan. There was also good news for Italian oil services group **Saipem** which was upgraded from BB to BB+ by S&P. This follows a successful increase of capital over the summer and the sale of its onshore drilling business. The group can now press on with its plan to pay down debt and improve liquidity.

In results news, **Tereos** benefited from rising commodity prices to report a 35% jump in full-year sales to €2.97bn. Ebitda soared 132% over a year to €464m. France's **Derichebourg** (waste disposal) finally managed to buck a trend with sales rebounding 46% over a year to €5.3bn with Ebitda 31% higher to €510m. Sales at its multi-service arm rose 7.9% but recycling drove the trend thanks to the integration of Ecore and soaring metal prices.

In financial debt, US dollar CoCo spreads tightened by 130bp, outperforming Euro CoCos which were stable. After strong returns since the middle of October, the Euro CoCo market paused for breath. For the US dollar market, the week could hardly have got off to a better start after **UBS** surprised markets by calling its 5% $ AT1 even though the cost of extending it was small. Another piece of good news was the decision by Greece's **Alpha Bank** to redeem its preferred senior 3% 24NC23 at par. The bank issued a new 25NC24 bond at 7%, extending its maturity by a year to continue creating a regulatory debt cushion to absorb losses.

CONVERTIBLES

The new issues market hotted up with 6 new deals in the US. **Axon Enterprise** (formerly Taser International) raised $690Mn. The company makes non-lethal weapons for personal protection. **NextEra Energy** raised $500m at 2.5% due 2026. Both companies will use the proceeds on external growth. NextEra will take a stake in a renewable energy portfolio. **Lantheus** (medical imaging) and **Marriott Vacations** both raised $500m.

Elsewhere, **Engie** is to make an early call on its exchangeable into GTT shares, a very surprising decision as only a year ago it wanted to sell its stake. GTT makes membrane containment systems dedicated to the transport and storage of liquefied gas worldwide.

EDF had to extend its buy-in offer to minorities after they demanded €15 a share instead of the €12 offered.

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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