MARKET FLASH: SOFT LANDING OR SOFT LENDING?

• Jerome Powell boosted hopes for a soft landing while pouring cold water on chances of a Fed pivot.

• The Fed’s quarterly survey of bank lending showed companies were facing tougher conditions, mortgage demand had fallen and demand for consumer loans was also down.

• We continue to prefer corporate debt to equities and in fixed income, we like total return carry strategies.

In an interview after the latest FOMC, Jerome Powell said the disinflation process had begun in the US despite the strong jobs market. He boosted hopes for a soft landing while pouring cold water on chances of a Fed pivot: the conditions for monetary easing will not be in place before 2024 and disinflation is too gradual to hit the 2% target in 2023. Markets reacted by pushing bond yields and the dollar higher.

Rate hikes in 2022 have started to slow growth down. The Fed’s quarterly survey of bank lending showed companies were facing tougher conditions, mortgage demand had fallen and demand for consumer loans was also down, especially for car purchases. With average credit card interest now running above 20%, buying on credit should slow down this year after driving consumption in 2022.

In the eurozone, December retail sales fell 2.7% in volume after a 1.2% rise in November. Consumers offset higher prices by buying less. And an ECB survey showed consumers expect purchasing power to decline more this year amid a 1% rise in nominal revenues and 5% inflation.

In Brazil, the restrictive monetary policy which took benchmark rates to 13.75% is also starting to weigh on consumer spending. Retail sales fell 2.6% in volume in December.

Countries where domestic demand has not fallen quickly enough, or where inflation has pushed higher, raised rates in a surprise move. Australia's central bank raised rates by 25bp to 3.35% and said more rises were on their way. India tightened by 25bp and the Bank of Mexico took benchmark rates 50bp higher.

Japan, the only country to have shunned monetary tightening, registered a record 4.8% rise in total remuneration in 2022, the sort of increase not seen since 1997. Basic full time wages rose 1.3% and those under contract by 1.8% (the most since 1995). The new governor of the Bank of Japan will have the tough job of steering a monetary policy shift that is at odds with other central banks.

We are sticking with our cautious stance on allocation. We continue to prefer corporate debt to equities where we favour emerging markets rather than the developed zone. In fixed income, we like total return carry strategies. In government debt, we prefer the US to the eurozone.

EUROPEAN EQUITIES

European equities retreated a little from the previous week's highs. The move was influenced by expectations of higher interest rates, especially after the Bank of England's Catherine Mann said she was in favour of higher benchmark rates to stifle inflation. Even so, investors were more interested in company results. There were good surprises overall but some disappointments.

Results at **BNP** and **Société Générale** were in line but **Crédit Agricole** beat expectations. The long-term outlook for all three is upbeat even if companies will face problems with maximum interest rates and a less rosy environment for investment banking. In energy, **TotalEnergies**, **Equinor** and **BP** reported record profits after a stellar year for energy prices. Investors might have been surprised by Equinor's intention to raise production this year by at least 3% and BP's volte face in slowing investment in renewables in favour of fossil fuels to cope with energy security problems. In consumer discretionary, **Ralph Lauren** and **Tapestry** reported reassuring figures. Results were much better than expected due to strong consumer spending and in spite of the adverse economic environment. Disappointments included shipping giant **Maersk** which reduced guidance for 2023 on expectations of a poor year for global trade. Elsewhere, poor figures at Denmark's **Rockwool** (building insulation) suggested construction was facing difficulties.

US EQUITIES

Nervousness over US monetary policy took Wall Street lower over the period.

A total of 517,000 new jobs were created in January, or close to three times more than the 187,000 expected. The unemployment rate fell to 3.4%, a low not seen since October 1953.

Jerome Powell said the disinflation process had begun but said more rate hikes would be needed if the jobs market were to stay so strong. Several Fed officials then intervened to suggest new rate rises were in the pipeline.

At the same time, Services ISM rose from 49.2 to 55.2, its biggest monthly jump since June 2020 while the prices paid index stayed at a very high 67.8.

In a busy week for company news, starting in the gold mines sector, **Newmont Mining** acquired Australia's Newcrest Mining, for $17bn. Retailer **Nordstrom** jumped 25% after activist investor Ryan Cohen bought a stake with the firm intention of shaking up the board. In media, **Disney** gained 5% after unveiling a restructuring plan to lay off 7,000 people and reduce costs by $5.5bn.

In video games, **TakeTwo Interactive** and **Activision Blizzard** gained 7.8% and 5.6% after beating quarterly expectations. But Activision Blizzard then fell after the UK's competition watchdog, the CMA, said its sale to Microsoft could jeopardise innovation and competition.

There were a number of presentations of IA tools among **GAFAM** companies but **Alphabet**, Google's parent company, tumbled 7.7% after a rather unconvincing presentation of its *Bard* artificial intelligence search engine. Meanwhile, **Microsoft** said its ChatGPT tool would soon be integrated into its search engine Bing to step up competition with Google

JAPANESE EQUITIES

The NIKKEI 225 and TOPIX rose 0.67% and 1.01% over the period, driven by assumptions global interest rates had peaked and China's reopening. There was also speculation that the Bank of Japan's new governor might be dovish. The uptrend was, however, offset by worse than expected company results and deep-rooted concerns over a possible global recession.

Wholesale Trade rose 3.97% led by **Marubeni Corp**, a major general trading company, which revised FY2022 earnings guidance higher and said the dividend would be increased. Other Financing gained 3.22% on attractive valuations. Marine Transportation gained 2.67% as investors continued to target companies with generous payouts.

Iron & Steel lost 3.13% on profit-taking and JFE Holdings' surprising downward revision of FY 2022 earnings guidance. Other Products and Pulp & Paper fell 2.42% and 1.70%, respectively, due to concerns over poor Japanese economic data amid sharp price rises.

Marubeni jumped 11.99% (see above). **Z Holdings Corp**, an information and communications company, gained 8.76% on speculation the merger of its subsidiaries Line and Yahoo! would enhance management decisions. **Chugai Pharmaceutical** rallied 7.04% on yet another record year for earnings in 2022.

Eisai, a pharmaceutical company, fell 4.61% due to lower revenues and net profits for the first nine months of 2022. **Nitori Holdings** shed 3.65% as the weaker yen will increase the cost of imports from its overseas companies. **Mitsubishi Heavy Industries** slipped 3.60% on a sharp drop in profits for the first nine months of 2022.

The yen weakened from the mid-128s to mid 132s against the dollar on speculation over the new BoJ governor but then fell back to the mid 131s after Fed Chairman Jerome Powel's comments turned out to be not as hawkish as expected.

EMERGING MARKETS

The MSCI EM Index had lost 1.4% as of Thursday's close, China was one again flat while India stopped falling and ended the period slightly higher. Brazil (-2.8%) underperformed.

In **China**, January PPI was down 0.8%, while CPI rose 2.1% as expected. The number of Covid related deaths and severe cases at hospitals have now both declined by 98% from peak levels reached in early January. Group tours for mainland China residents to 20 countries resumed this week. President Biden said US-China relations had not been weakened by the balloon incident and Janet Yellen hopes to visit China. China and Australia are discussing a pathway to full resumption of trade and both stressed the need to keep talking. Wuhan city eased a key restriction on housing purchases, allowing local families to buy an additional home in areas with purchasing caps. MIIT announced a pilot programme to increase NEVs used in areas including public transport, taxi services and postal deliveries. It also issued a "Robot +" action plan and expects the industrial robot density ratio to double by 2025. Major tech giants in China like **Baidu**, **Alibaba** and **Tencent** confirmed they were developing ChatGPT-related developing programmes. **Yum China**'s 4Q22 results came in above expectations and same store sales during Chinese New Year improved to within 6% of 2019 levels.

Taiwan exports dropped 21% in January, the fifth down month in a row. **Mediatek** reported weak 4Q22 results and 1Q guidance as expected but said there were incipient signs of healthy smartphone restocking in China. **Airtac**'s 4Q results were in line and came with encouraging guidance for 2023. The **South Korean** government is considering lifting short-term visa restrictions for Chinese nationals.

In **India**, the RBI hiked rates by 25bp to 6.5% as expected. It lowered its CPI projections to 5.7% and trimmed its GDP growth forecast to 6.4% for 2023. Easing of price pressures is to be led by softening global commodity prices provided there is a normal monsoon. MSCI adjusted net weightings for **Adani group** stocks and cut weightings for 4 companies.

In **Brazil**, the battle between Lula and the central bank continued to generate a lot of noise. **Itau** reported solid 4Q22 results with strong 2023 guidance. **Mexico**'s CPI rose 0.68% MoM in January, or in line with expectations.

On the **supply-chain-relocation** front, South Korean solar company **Hanwha Solution** is reportedly looking to invest in Germany to take advantage of subsidies.

CORPORATE DEBT

CREDIT

The market slowed down after the strong rally at the beginning of February. The main reason was a surge in 10-year Bund yields from 2.15% to 2.35%. But credit premiums on good quality corporate debt were stable at around 150bp while they slipped by 10bp to 405bp for high yield issues.

Investment grade lost 0.48% between Monday and Thursday (or +2.5% year to date) while high yield edged 0.02% higher (+4.46%).

In financial bonds, fourth-quarter reports remained strong thanks to higher interest rates. **Intesa, BNP, Sondrio, SocGen, ABN Amro** and **BPER** all reported excellent results and a sharp improvement in their CET1. **Credit Suisse**, however, stayed on watch due to mounting losses as the bank undergoes a restructuring programme. Moves to deleverage are well under way so there is only a limited need to refinance. After the previous week's big tightening, Euro CoCo premiums were unchanged around 580bp.

The high yield segment consolidated its strong momentum with several new issues: **Isabel Marant** B(8% 2028), **Ford** BB+ (4.867% 2027), **Iliad** BB 5 (5/8 2030), and **Ineos** BB (6.5/8% 2028.) Renewed interest in the carry trade meant the issues were generally largely oversubscribed.

CONVERTIBLES

Markets continued to move on company results.

In Europe industrial materials and autos were the best performing sub-sectors, led by **Siemens** which topped estimates after posting strong margins and upbeat guidance on revenue. On the contrary, results from **Adidas** and **Delivery Hero** disappointed, as the former expects to report an operating loss of €700m EUR in 2023 and the latter missed estimates on gross merchandise value for the quarter.

In the US, convertible issuers posted strong figures. **Royal Caribbean** beat estimates and said demand was still robust. **Dexcom**, the medical devices company, beat earnings and sales estimates. In cybersecurity, **Cloudflare** delivered a first quarter earnings forecast above estimates.

The primary market continued to be active. This week, we had the first new issue from Japan, **Park24** raised JPY 35bn due 2028 to refinance existing debt; the stock has recovered well thanks to the reopening theme. **Citigroup** raised HKD 2.35bn in bonds exchangeable into **AIA Group**, a Hong Kong insurance company. In the US, **Nabors** raised $200m in senior unsecured convertible bonds due 2029.

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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