LETTER FROM THE CIO AM

MARKET ANALYSIS
AND PRINCIPAL INVESTMENT THEMES

SEPTEMBER 2023

MISTS GATHER OVER EUROPE

BENJAMIN MELMAN
Global Chief Investment Officer, Asset Management

► It was all too easy to presume the downturn would start in the US. After all, the US was at the forefront of the global cycle, enjoyed the sharpest post-Covid rebound and then suffered the biggest number of rate hikes. Add in banking instability at the beginning of 2023. But assumptions have turned out wrong: the Atlanta Fed's GDP Nowcast sees growth of more than 5.5% in the third quarter.

ZONES ARE NOW TAKING DIVERGENT CYCLICAL PATHS

In stark contrast with the US, China and Europe have seen a marked economic downturn. Growth in the US is exceeding even the most optimistic expectations but China is facing increasing signs of deflation and Europe is, at the very least, moving towards contraction territory.

THE IMPROBABLE SYSTEM OF EUROPEAN EQUATIONS

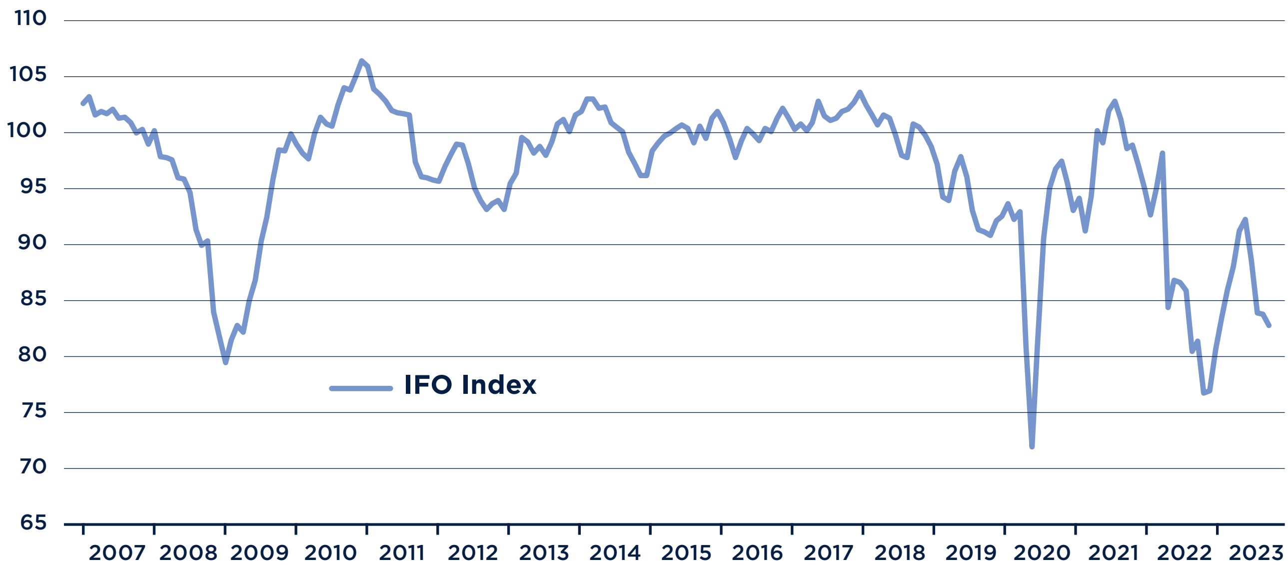
- How can an economy grow by 4% without borrowing? Bank lending to the economy has contracted, albeit very slightly, since November 2022. The ECB's Bank Lending Survey suggests that demand for loans, particularly from companies, has fallen just as much as supply from banks. Tougher lending conditions are not in any way due to banks facing difficulties but to various other developments. Since the end of negative rates, margins on deposits have risen so banks have less need to lend, especially in such an uncertain environment. And with the TLTRO[1] reimbursements, banks no longer have one incentive to lend. ECB surveys suggest lending conditions will not get much tighter but there is no reason to think lending will recover, especially as higher rates are weighing on demand. We think this situation is untenable so the outlook is clouded: if bank lending fails to recover, growth and/or inflation could surprise on the downside.

- How can Germany extend the disinflation cycle and fund a 6.6% rise in wages over 12 months, as seen in the second quarter, when hourly productivity is down by 1.3%? Logically, company margins should come under pressure. Naturally, we will have to wait for all European data to get a reliable overview but Germany's statistics could be taken by investors as a sign of a possible stagflation/end-of-cycle scenario.

At the same time, Europe will have to cope with China's extremely weak growth rates. Growth will only bottom out when Beijing manages to turn the property market around. So far it has failed. The outlook for Europe is not yet certain but the zone will need to be closely watched.

1. Targeted Longer-Term Refinancing Operations

GERMAN MANUFACTURING COMPANY EXPECTATIONS ARE ALMOST AS DOWNBEAT AS IN THE PERIOD FOLLOWING THE LEHMAN BROTHERS COLLAPSE



Source: Bloomberg. Data as of 4/09/2023.

INVESTMENT POLICY

The situation described above reflects increased uncertainty over European earnings prospects but it would be dangerous to draw hasty conclusions. We will wait for more information before assessing these new risks. However, in the meantime, the available data makes us prefer US to European equities.

We have maintained our exposure to Chinese equities because there is pressure on Beijing to go for more stimulus, valuations are cheap and investors are underweight China. There is significant rebound potential but the investment case is still speculative. In today's more uncertain and fragile environment, we are increasing exposure to healthcare. The sector is only marginally sensitive to today's economic issues. What's more, it has underperformed significantly since the beginning of 2023.

The current disinflation trend could in time be undermined by US activity reaccelerating and German wages increasing again. Bond yields reacted to this eventuality in August but we feel these trends will not last and we continue to focus on fixed income.

KEY POINTS

We continue to prefer bonds to equities.

We prefer US to European equities.

We like healthcare as the sector is only marginally sensitive to economic developments.

We have maintained our Chinese equity exposure.

	Our convictions*	Changes compared to the previous month
ASSET CLASSES		
Equities	-	→
Fixed Income	+	→
Dollar	=	→
Cash	=	→
EQUITIES		
US	=	→
Europe (ex-UK)	-	→
UK	-	→
Japan	=	→
China	+	→
Global Emerging	=	→
Convertibles	=	→
SOVEREIGN BONDS		
US	+	→
Euro Zone	+	→
Emerging Markets	=	→
CORPORATE BONDS		
US Investment Grade	+	→
Euro Investment Grade	+	→
US High Yield	=	→
Euro High Yield	=	→

*Range of investment committee ratings on the asset class/geographical zone (from -/- to +/+). Source: Edmond de Rothschild Asset Management (France). Ratings at 31/08/2023.

EDMOND DE ROTHSCHILD ASSET MANAGEMENT (FRANCE)

47, rue du Faubourg Saint-Honoré, 75401 Paris Cedex 08

Société anonyme governed by an executive board and a supervisory board with capital of €11,033,769 -
AMF registration No. GP 04000015 - 332.652.536 R.C.S Paris

www.edram.fr