MARKET FLASH: THE US AND EUROPE CONTINUE TO DIVERGE

- **The latest developments in Europe have failed to improve political visibility.**
- **In the US, the economy is still proving resilient.**
- **We are sticking with our tactically positive stance on equities with the accent on the US and China. Our strategic view on investment grade credit is unchanged.**

The latest developments in Europe have failed to improve political visibility. After Moody's decision to downgrade France's debt, the appointment of François Bayrou as prime minister may not succeed in widening the government to include people on the left of the political spectrum. The Socialist party refused to join the government, refusing the deal not to vote against the government in any no-confidence vote in exchange for a government promise not to resort to the 49.3 clause to get measures approved. On the other hand, the law to extend this year's budget month after month next year went through unanimously. In Germany, the Bundestag confirmed its no-confidence vote in Olaf Scholz so elections will be held in February. The CDU is ahead in the polls but the situation is confused. Its candidate Friedrich Merz recently said he was in favour of reforming the "debt brake" but the party then released a programme arguing against both the reform and taking on any extra debt whether in Germany or in Europe. This means the reform has simply become a bargaining chip in coalition talks. Any change in the constitution would require a broad agreement between the CDU, the SPD and the Greens.

This political uncertainty is reflected in persistently soft manufacturing data, In France, the index fell further to 41.9 and in Germany to 42.5. In the eurozone as a whole, it was unchanged at 45.2. Services, however, improved slightly to 48.2 in France and to 51 in Germany but less than the 51.4 for Europe as whole. And if we take the eurozone excluding France and Germany, the gap is even bigger as the composite index rebounded from 50.6 in November to 52.6. In addition, Germany's IFO business confidence survey came in at a disappointing 84 when 87.5 was expected.

Faced with this situation, and in contrast to the Fed, the ECB is likely to accelerate rate cuts to underpin the economy next year.

In the US, the economy is still proving resilient but with increasingly divergent trends due to the effect of Donald Trump's election. Manufacturing PMI slowed to 48.5 while services rose to a 3-year high at 58.5. Retail sales rose 0.7%, or better than expected, while industrial production fell short with a mere 0.3% rise.

The Fed proceeded with a 25bp rate cut but sounded a cautious note over future rate cuts. The bank has revised inflation and benchmark rate expectations higher and now only expects two rate cuts in 2025, down from four when it last met. As a result, bond yields and the US dollar rose and equity markets fell. Some of the rate-setting committee members expect Donald Trump's plans for immigration restrictions and import tariffs to fuel inflation.

Elsewhere, the Bank of Japan and the Bank of England left rates unchanged. The Bank of Japan prefers to protect growth by postponing any rate increase to 2025 while the BoE decided against another rate cut due to strong wage growth.

In China, the timid rise in retail sales suggests the recovery in domestic demand is stalling. As a result, Beijing is expected to adopt more generous budgetary stimulus, especially given today's protectionist threats.

We are sticking with our tactically positive stance on equities with the accent on the US and China. Our strategic view on investment grade credit is unchanged.

EUROPEAN EQUITIES

Following on from last week's move from the ECB, the Fed cut its rates by 25bp. However, the bank's cautious tone over the number of future cuts sent Europe's indices lower. As for economic data, the eurozone's composite PMI for December improved slightly from 48.3 to 49.5. Most European sectors trended lower this week due to drops on Wall Street but healthcare bucked the trend and moved higher.

France's Exosens, which makes high tech detection and imaging systems for the defence industry, confirmed that it had won a big contract to provide Germany with image intensifier tubes. The tubes will be delivered in 2026. Exosens was listed in June this year and analysts following the stock had not expected this development so the news triggered a close to 10% surge in the share price.

In bank news, UniCredit increased its stake in Commerzbank to 28% using derivatives. It holds 9.5% in actual shares. The German government, which is a shareholder in Commerzbank, added to tension by asking UniCredit to sell its stake The Italian bank is also pushing ahead with plans to merge with rival Banco BPM as part of its efforts to expand in Europe.

Elsewhere, the European Space Agency signed an agreement to compete with Starlink by developing a multi-orbit constellation of about 300 satellites The project is expected to cost more than €10bn with a combination of government and private funding. France's Eutelsat will contribute €2bn and has chosen Airbus to build 100 satellites with delivery scheduled for the end of 2026. Deutsche Telekom, Thales and Orange are also involved.

US EQUITIES

For the first time since Donald Trump won the presidential elections, US markets had a down week. The downturn was prompted by Jerome Powell's prudent stance over inflation with the US economy doing so well. He said the pace of future rate cuts would be slower than previously indicated. Markets had been expecting low volatility around the FOMC but instead the S&P 500 plunged by almost 3%, its biggest one-day drop due to Fed comments since March 2020. The Nasdaq also lost close to 3% and the Russell 2000 tanked 5%. Recent rises on Wall Street were driven by tech mega caps and actually overshadowed selling elsewhere. The S&P 500 Value, for example, has only seen down days so far this month. Wednesday's drop was driven by a surge in volatility with investor positioning at extreme levels. Last week, the founder and chairman of Interactive Brokers had expressed concerns about record margin levels among the firm's clients with markets at very high levels. Property was particularly badly hit by the selling due to a rise in long bond yields. House builder Lennar's results showed that orders had slowed in the fourth quarter. The group reacted by increasing promotional sales and margins suffered. In semiconductors, Micron fell because higher-than-expected capex in 2025 will hit margins. In consumer foods, General Mills cut its 2025 forecast for profitability as it will be spending more on special offers. Lamb Weston, one of the biggest suppliers of frozen food to restaurants, also cut its forecast for 2025. In healthcare, Merck joined the obesity drug race by announcing an oral GLP-1 pill for the future.

EMERGING MARKETS

The MSCI EM index was down 1.05% this week as of Wednesday's close. Taiwan (+1.07%) outperformed while China and Korea edged 0.52% and 0.82% lower. Brazil tumbled 6% during the week while India lost 2.04%.

In **China**, November retail sales rose 3%, or less than the 5% expected and down on October's 4.8% increase. This was due to the shopping festival starting early. Industrial production rose 5.4% YoY in November from 5.3% previously, partly driven by faster output growth in the automobile sector. November Fixed Asset Investment growth slowed to 2.4% YoY, still led by SOE capex. November's youth unemployment rate was 16.1%, an improvement from October's 17.1%. High-frequency data suggest that the property market recovery continued into December with new home sales in 30 major cities up 17% YoY in the first 15 days. The government extended Visa-Free Transit Stays from 6 to 10 days. CATL will provide financial support to its suppliers to stabilise the supply chain. The company is considering a second listing in HK to raise at least $5bn.

In **Taiwan**, Hon Hai will start producing AirPods in India from the first quarter of 2025. The company is reportedly in talks with Renault to buy its 35% stake in Nissan.

In **Korea**, Trump's transition team is reportedly looking to cut support for EVs and impose tariffs on all battery materials.

India's trade deficit increased from $27bn in October to $37.8bn in November due to weak exports and an increase in gold imports. Dixon signed an agreement with China mobile phone company Vivo to manufacture smartphones. JSW Energy is in talks with LGES to establish a $1.5bn joint venture to manufacture EV/ESS batteries.

In **Brazil**, the ANS regulator presented studies and a proposal of regulatory changes. Eletrobras delayed the date for a settlement with the federal government over voting rights.

In **Mexico**, real GDP accelerated in the third quarter to 1.08% QoQ. Cofece levied a $5m fine on Walmex and ordered it to stop some negotiation clauses with suppliers but this was better than feared.

In **Argentina**, third-quarter GDP rose 3.9% QoQ (-2.1% YoY) or better than the 3.4% (-2.6%) expected. Argentina delivered another nominal surplus in November. YTD, the primary surplus is at ~2% of GDP, with the nominal surplus at 0.6%. The unemployment rate also continued to improve: 6.9% in the third quarter, down from 7.6% in the previous quarter.

CORPORATE DEBT

CREDIT

Christmas is almost on us but the Fed jolted a market that had been a little stretched by end-of-year technical elements, i.e. thin trading books and bond subscriptions. The monetary trajectory in Europe is more or less clear but the US is stoking uncertainty. Donald

Trump's election had effectively clouded the picture. And following the Bank of England's decision to maintain rates at 4.75% -with only 3 out of 9 members of the rate-setting committee arguing for a cut- Jerome Powell opened a new chapter in monetary easing: more convincing economic data will be needed to warrant rate cuts. As a result, the Xover widened by 11bp to 310bp and markets are now only expecting the Fed to cut rates by around 35bp in 2025 as a whole!

Fortunately, French reassurance group Scor had issued an RT1 at the beginning of the week, raising €500m at 6% with the order book attracting €3bn in bids. This was probably the last big deal in 2024. Even so, the cash market is doing well with no serious selling as we approach the year end.

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.

• 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.

• 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.

DISCLAIMER

This is a marketing communication.

19/12/2024

This document is issued by the Edmond de Rothschild Group. It is not legally binding and is intended solely for information purposes. This document may not be communicated to persons located in jurisdictions in which it would be considered as a recommendation, an offer of products or services or a solicitation, and in which case its communication could be in breach of applicable laws and regulations. This document has not been reviewed or approved by a regulator of any jurisdiction. The figures, comments, opinions and/or analyses contained herein reflect the sentiment of the Edmond de Rothschild Group with respect to market trends based on its expertise, economic analyses and the information in its possession at the date on which this document was drawn up and may change at any time without notice. They may no longer be accurate or relevant at the time of reading, owing notably to the publication date of the document or to changes on the market. This document is intended solely to provide general and introductory information to the readers, and notably should not be used as a basis for any decision to buy, sell or hold an investment. Under no circumstances may the Edmond de Rothschild Group be held liable for any decision to invest, divest or hold an investment taken on the basis of these comments and analyses. The Edmond de Rothschild Group therefore recommends that investors obtain the various regulatory descriptions of each financial product before investing, to analyse the risks involved and form their own opinion independently of the Edmond de Rothschild Group. Investors are advised to seek independent advice from specialist advisors before concluding any transactions based on the information contained in this document, notably in order to ensure the suitability of the investment with their financial and tax situation.

Past performance and volatility are not a reliable indicator of future performance and volatility and may vary over time, and may be independently affected by exchange rate fluctuations.

Source of the information: unless otherwise stated, the sources used in the present document are those of the Edmond de Rothschild Group. This document and its content may not be reproduced or used in whole or in part without the permission of the Edmond de Rothschild Group.

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 euros

AMF Registration number GP 04000015

332.652.536 R.C.S. Paris