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MARKET FLASH: MARKETS FOCUS ON OIL PRICES AND INFLATION

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• Geopolitical risk also returned over the week. The situation in the Red Sea is tense due to Houthi attacks on shipping and a US/UK riposte.

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Oil prices were partly responsible for shifts in other asset classes, mainly at the beginning of the week as investors waited for US inflation data. Oil sold off after Saudi Arabia announced a surprise price cut. The move was seen as proof of an economic slowdown which could reduce inflationary pressure. As a result, bond yields fell back after the previous week's rise.

However, various statements from central bank officials tried to avoid excessive price movements, and any further easing in financial conditions in particular. The Atlanta Fed's Raphael Bostic said any rate cut would have to wait for the second half of 2024. Loretta Mester (Cleveland Fed) thought March would be too soon for a move. In the eurozone, François Villeroy de Galhau, governor of the Bank of France, reminded investors that inflation would have to hit 2% before any rate cuts could be considered. ECB chair Christine Lagarde echoed his views.

US consumer inflation for December came in at 3.4%, up from 3.1% in November and higher than the 3.2% expected. However, core inflation fell to 3.9% vs. 4% in November and 3.8% expected, primarily because of shelter prices. The market reaction was mixed but bond and equity markets ended the session flat.

Geopolitical risk also returned over the week. The situation in the Red Sea is tense due to Houthi attacks on shipping and a US/UK riposte. As a result, freight costs are up and we will need to watch out for any knock-on effect on inflation, supply chains and oil prices.

We remain fully invested in risk assets and are sticking with our long duration position which we see as protection. We have cut dollar exposure: disinflation momentum in Europe looks less certain so the ECB will find it trickier than the Fed to start cutting rates.

EUROPEAN EQUITIES

European markets had edged higher over the week as of Friday morning but struggled to find direction.

This was partly due to bond market volatility amid uncertainty over how much inflation had fallen back. Higher-than-expected consumer price inflation in the US failed to seriously disrupt the prevailing dovish mood among investors. Markets have calmed down after the sharp gains seen at the end of 2023 and economic data will now dictate future trends.

Energy prices are providing support. Brent crude is now under pressure following Saudi Arabia's decision to cut spot oil prices. And the cold spell in Europe has had little effect as gas reserves were built up when the weather was milder.

Energy led the week's losers followed by basic resources and banks. Media topped gains, with tech in second place. Property continued to convalesce after a difficult 2023.

In company news, **OVH** reaffirmed its 23/24 and 24/25 objectives thanks to strong demand. Sales for the first quarter of FY 2023/24 rose 12% to €239.8m, or in line with expectations whereas growth in cloud activities at its US rival Oracle fell short. Management is upbeat on the future and is to open a second data centre in Singapore.

Spain's pharma giant **Grifols** hit the headlines over the week. Short-seller Gotham City Research (GCR) released a critical report that sent the share tumbling by more than 25% in one trading session. Gotham said the group used legal accounting procedures but that they could mislead investors over debt levels. Optimisation or fraud? The group riposted that its accounts had been certified with no reserves since 2018. A press release which took all of Gotham's arguments to pieces failed to reassure investors and Grifols now intends to sue GCR.

Elsewhere, **Burberry** triggered worries over the luxury sector after stating that business had decelerated sharply in December. The group once again reduced guidance. Fourth-quarter sales fell 2% on like-for-like exchange rates and by 4% on a same-store basis. The news is a token of difficulties faced by companies like **LVMH** and **Kering** as consumption falls. **Hermès** appears to be less concerned thanks to its unique positioning.

US EQUITIES

Consumer prices rose 3.4% YoY in December, or more than the 3.2% pencilled in by analysts. The increase seems to have largely been due to petrol prices and they have since fallen back.

Even so, comments from Fed officials were more guarded on any future rate cuts. Loretta Mester said March would be too early to make a move given the latest data.

Oil prices jumped 3% to $72.50 after Houthi tribes attacked commercial ships in the Red Sea.

The energy sector continued to see active deal-making. Natural gas producer **Chesapeake Energy** made its merger with **Southwestern Energy** official and now ranks as one of the three biggest in the US sector.

Berkshire Hathaway raised its stake in **Occidental Petroleum** to 34%.

Other sectors also saw M&A deals. In healthcare, **Boston Scientific** is to pay $3.7bn for **Axonics** (sacral neuromodulation solutions), **Johnson & Johnson** $2bn for **Ambrx Biopharma** (cancer treatments), and **Merck** is reportedly in advanced talks to acquire **Harpoon Therapeutics**.

In the internet space, activist fund Elliott bought a $1bn stake in online dating company **Match Group** (Tinder/Hinge). The fund wants to improve Match's operating performance. **HP** is also in advanced talks to buy network equipment maker **Juniper Networks** for $13bn. Juniper soared 21% on the news.

In tech, **Nvidia** jumped 6.4% after saying mass production of its new IA chip for China would start in the second quarter. **Apple** also gained ground after announcing the arrival of its Vision Pro virtual headset on February 2 in the US at $3,499 apiece.

The bad news is that layoffs have resumed. **BlackRock** is to make 3% of its global workforce redundant, i.e. around 600 people. **Amazon** subsidiary Twitch is to lay off 35% of its staff (around 500 people).

JAPANESE EQUITIES

The NIKKEI 225 and TOPIX jumped 5.29% and 4.38% on new money inflows, especially from foreign investors, banking on strong earnings at a time when deflation seems to be finally ending, generous P/B ratios and domestic inflows under the new NISA tax exemption programme for individual investor which starts this month. Solid US equity markets led by technology stocks and the weaker yen also supported the market. Japan's indices including the NIKKEI 225 and TOPIX revisited 34-year highs.

Securities and Commodities Futures soared 7.35% on rising stock prices and higher trading volumes. Other Products advanced 7.26% led by **Nintendo** (+10.51%) on talk of a new Switch console. Transportation Equipment gained 6.36% on the weaker yen. Only Marine Transportation and Mining sectors lost ground over the week, the former down 1.55% on profit-taking after a surge due to rising container freight rates, the latter ending 0.75% lower as crude oil fell when Saudi Arabia decided to cut prices.

In pharma, **Daiichi Sankyo** rocketed 12.14% on news that its coronavirus vaccine, Daichirona, could be used from December 2024. **Sony** jumped 9.51% on the falling yen. Elsewhere, **Fujitsu** (information tech) shed 3.29% on the possibility that London might reexamine government contracts as the company's subsidiary could be behind the Post Office's faulty accounting software. **Shiseido** (cosmetics), fell 2.48% on concerns over China's economy. **Shin-Etsu Chemical** dipped 2.08% on profit-taking after a long rally.

The yen traded between the mid-143s and the high-145s against the dollar.

EMERGING MARKETS

The MSCI EM Index retreated 0.73% this week and was down 2.1% YTD as of Thursday. India (+0.17%) outperformed while China, Brazil and Korea all closed in negative territory, down 1.5%, 1.26% and 2.74% in USD, respectively.

Weak macro conditions persisted in **China**: December's CPI edged up by 20bp to -0.3%, and PPI narrowed the decline by 30bp to -2.7%, or in line with market expectations. Both imports and exports were better than expected with sequential growth in December: exports were up 2.3% YoY and imports 0.2%. December aggregate financing was RMB 1.94 trillion, or short of market expectation of 2.16 trillion. Some cities are using low-cost funds to buy housing and convert them into rental properties. The government issued a basket of new policies to further relax entry and visa procedures. US and Chinese defence officials met at the Pentagon for the first time since 2020 amid a slight thaw in relations.

WuXi Biologics unveiled a research service agreement with BioNTech. It also raised FY24 top line growth guidance and its new projects target, driven by stronger year-end momentum in China. **Tesla** cut the price in China of its Model 3 and Model Y by 5.9% and 2.8%.

In **Taiwan**, December 23 exports rose 11.8% YoY, the largest increase in 17 months and better than expected. Taiwan is holding elections during the January 13th weekend and the market expects the DPP to win. **TSMC**'s operating data outperformed in December and fourth-quarter revenue was 2% higher than consensus. **Mediatek**'s fourth-quarter 23 sales beat expectations on stronger-than-expected smartphone SoC momentum and inventory restocking demand.

Korea's exports rose 11.2% YoY in the first 10 days of January with a rebound in China-bound shipments for the first time in 20 months. **Samsung Electronics**' preliminary fourth-quarter results missed expectations due to a lower utilisation rate and higher marketing expenses in the application business. The family holding company is selling more than $2bn in stock to pay inheritance taxes. **LG Energy Solution**'s preliminary fourth-quarter results showed operation margins falling short due to softer demand.

India's capital market regulator proposed changes in new issue and disclosure requirement rules. Infosys' results for the third quarter of FY 2024 beat expectations on better-than-expected revenues and the company revised guidance higher. **TCS** also beat expectations for the same quarter. **Softbank** backed e-commerce software maker Unicommerce filed for an IPO. Japanese carmaker **Suzuki** will invest $4.2bn to build its second car plant in India for 1 million annual capacity.

In **Brazil**, December IPCA inflation was 4.6% YoY, or ahead of consensus on rises in food prices and industrial goods. The CPI ended 2023 at 4.6% YoY, or back within the central bank's target range of 1.75%-4.75% after almost three years. Severe weather punished soybean and crop production, with the first harvests of the year well below historical averages.

In **Mexico**, **OMA** airport traffic was slightly below forecast in December and the fourth quarter as a whole due to flattish domestic passenger traffic. Growth at **Monterrey** (reshoring related) remained at a solid 22% for 2023.

Argentina reached an agreement with the IMF on the seventh review of the country's $44bn programme. The deal is likely to unlock a larger-than-expected loan.

CORPORATE DEBT

CREDIT

Bond yields went through a slight readjustment over the first fortnight of the year. Macro indicators still suggest the economy is proving resilient, particularly in the US where the labour market remains buoyant. Combined with a very active new issues market in investment grade, the impact on yields and spreads was somewhat negative. But this last week compensated partly as buyers returned to the market.

Yields on Germany's 5-year Bund hit 2.10% on Friday morning, or more than 20bp higher than on December 31. IG spreads ended 2023 at 135bp and are now at 140bp (after hitting 145bp in the previous week). High yield spreads continued to perform well thanks to the increasingly likely scenario of a shallow recession, or even no recession at all, and increased access to cheaper refinancing over the last 3 months. Cash spreads were at 380bp at the end of this week, a low not seen in almost 2 years.

Credit markets enjoyed the best new issuance January fortnight in several years. And the paper was generally absorbed with no big impact on secondary markets. Deals in financials included CoCo issues from **Crédit Agricole**, **Caixa Bank**, **Axa**, **BCP**, and **BPER** while **BFCM**, **Allianz**, **UniCredit** and **Piraeus** sold new Tier 2 bonds. **Barclays** and **Banco BPM** were among senior debt issuers. Banks led the charge before the earnings blackout period later this month. High yield issuance was less buoyant but still saw deals from **Q park**, **Stenna** and **Shaeffler**. In investment grade, there were issues from companies like **Stellantis**, **EDP**, **Vonovia** and **Mercedes**.

YTD returns for the rate-sensitive IG segment were minus 0.9% but high yield returned 0.33% thanks to shorter sensitivity and good performance from spreads.

CONVERTIBLES

It was a very active week for global convertible bonds with specific corporate events, and new issuance in the spotlight.

In Europe, **Schneider Electric** raised €1.3bn in two tranches. The proceeds will help the group extend average debt duration and bolster liquidity. **Cellnex**'s bonds may have room to tighten, as it executes its radically altered plan to swerve M&A, drive free cash flow and attain investment grade status with S&P. **Campari** completed a €650m private placement of new shares and €550m in senior convertible bonds due 2029, with the proceeds to be used to finance the company's acquisition of the Courvoisier cognac brand. The market welcomed a solid issuer and an attractively-priced new convertible bond.

In the US, the shares of drug maker **Cytokinetics** were volatile following a report at the beginning of the week speculating that **Novartis** was close to buying the company for about $9bn and then the decision by Novartis to step back.

The Japanese equity market has been performing strongly, and it was no surprise that the primary convertible market opened up for the year. Home builder **Daiwa House** announced a ¥200bn convertible bond issuance and a ¥80bn share buyback. The new deal was a success given its size and new sector exposure. In China, **Pharmaron Beijing** is to buy back $300m in its convertible bonds.

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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EDMOND DE ROTHSCHILD ASSET MANAGEMENT (FRANCE)

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

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332.652.536 R.C.S. Paris