EDMOND DE ROTHSCHILD

MARKET FLASH: A SLOWDOWN IS TAKING SHAPE IN THE US

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The US failed to take the opportunity of falling oil prices to rebuild its strategic stocks and now OPEC has surprised markets by cutting output by 1.6 million b/d. The move should correct the current supply and demand imbalance. In any case, oil prices immediately jumped to over $80.

Elsewhere, the Fed's monetary tightening is starting to have an impact, judging from recent data. Manufacturing ISM fell to 46.5 and new orders were down to 44.3, both signs of a slowdown in manufacturing. Services ISM for March was still in expansionary territory but fell to 51.2 from 55.1 in February. The jobs market is very gradually moving back to normal. Job offers fell back below 10 million in February, taking the ratio of unemployed people to job openings below 1.7. ADP's March report showed a sharp slowdown in private sector job creations to 145,000 compared to an average of 300,000 over the last 12 months. US equities then fell while yields on 2 and 10-year Treasurys retreated to 3.70% and 3.3%. The yield curve now suggests a rate cut as early as the next FOMC in July. We think that is optimistic. We see rates being kept at high levels rather than a pivot.

The plateau in benchmark rates that we foresaw already seems to be taking shape in Australia and India where central banks left rates unchanged at 3.6% and 6.5%. Since the spring of 2022, Australia had raised rates by 350bp and India by 250bp.

In China, the recovery following the end of the zero-Covid policy, seems to be on a surer footing. Caixin PMI data have been recovering since November 2022, more because of domestic demand than exports which are struggling with a slowdown in demand from abroad. Consumers are sitting on significant savings and seem to be spending on services rather than durable goods. Despite rising input and labour costs, pressure on the price of goods sold seems to be limited for the moment. This leaves room for Beijing to deploy budgetary and monetary stimulus to underpin the recovery.

Measures taken by monetary authorities have helped reassure markets on liquidity risk. The bank crisis was quickly resolved. We do not view the incident as systematic but as a typical problem after emerging from 15 years of low interest rates. That is why we have used market rebounds to reinforce our negative bias on equities, especially in the US. We prefer China. We are still neutral on duration and we are now more cautious on maturities of less than 2 years because there is too much optimism on a Fed pivot. We took advantage of recent dollar weakness to reinforce positions against the euro; the dollar provides protection in periods of market stress.

EUROPEAN EQUITIES

In a mixed week, defensive sectors like telecoms, healthcare and utilities proved resilient while industrials and tech lost ground. At the beginning of the week, OPEC said it would be cutting production from May. The news sent Brent crude 6% higher to a month-high of $85.

In company news, **Credit Suisse**'s sale to **UBS** continued to make waves. The new entity could lay off 20-30% of the workforce, or between 25,000 and 36,000 people. Credit Suisse had previously planned for "only" 9,000 redundancies.

Elsewhere, this week's auto industry data were very encouraging. New registrations jumped 24% in France (vs. 9% in February), 41% in Italy, 66% in Spain and 17% in Germany. This resulted in a stellar month for sales by manufacturer: **Stellantis** +26%, **Renault** +26%, **Nissan** +33%, **Volkswagen** +22%, and **BMW** +76%.

In collective catering, **Sodexo**'s results showed momentum was still strong, both for sales and margins. The group also announced that its voucher business would be spun off and listed separately.

In M&A, **L'Oréal** is to acquire Australia's **Aesop** (luxury soap and skincare) for $2.5bn, or close to 5 times sales. Even if the deal is not significant compared to L'Oréal's size, it will still reinforce its brand portfolio.

Invexans, the biggest shareholder of global cable leader **Nexans**, sold 4.2 million shares at €80, a 9.4% discount to the previous closing price. The move was a surprise as Invexans had reiterated its long-term commitment to the group as recently as last October.

US EQUITIES

The Dow ended the first quarter flat while the S&P 500 gained 7% and the Nasdaq jumped 16.8%, its best quarterly performance since 2020. The Dow gained 1.9% in March compared to 4% for the S&P and 7.4% for the Nasdaq.

But for the first week in April, indices were hit by disappointing data that fuelled fears that a recession was looming. Services ISM hit a 3-month low of 51.2 (vs. expectations of 54.4) while private sector job creations came in at 145,000 (210,000).

February's *Job Openings and Labor Turnover Survey* (JOLTS) showed job openings falling below 10 million for the first time in 2 years, a possible indication of the impact the Fed's actions have had on the labour market. Even so, the Cleveland Fed said it saw no rate cuts this year and expected a terminal rate above 5%.

Elsewhere, Bitcoin soared 70% over the first quarter, its best quarterly performance since March 2021.

Trading volumes were 20% below average before the long Easter weekend and ahead of the results season next week which will, as usual, kick off with banks.

JP Morgan Chase & Co CEO Jamie Dimon said the banking crisis was not yet over and would have repercussions for several years to come. He also said he was now much more worried about geopolitical risk.

OPEC surprised markets by announcing a 1.1 million b/d cut from May, rising to 1.6 million from July. WTI jumped 6.3% to $80.4.

In company news, **Walmart** stuck to its cautious guidance of a 4.5-5% rise in sales over the first quarter compared to 2022.

Artificial intelligence stocks like **Nvidia** and **Microsoft** fell 2% and 1% on Wednesday after Joe Biden said he was concerned about AI's dangers. The president stressed that tech firms would be liable for product safety.

In pharma, **Johnson & Johnson** gained 4.4% on Wednesday after unveiling an $8.9bn settlement to end litigation on its Baby Powder talc over cancer risks.

JAPANESE EQUITIES

The NIKKEI 225 and TOPIX edged 0.11% and 0.03% higher over the period as concerns over systemic risk subsided. However, they plunged on the last day (April 5) on profit-taking and uncertainty over the global economy from slowing banking activities and weak economic data, especially in the US. The stronger yen was also a factor.

Mining, Precision Instruments and Other Manufacturing gained 4.07%, 2.62% and 2.07%, respectively, as investors bought cyclicals on the assumption that the bank turmoil was over and inflation had peaked.

Rubber Products and Air Transportation fell 2.79% and 1.74% on profit taking. Marine Transportation declined 1.52% on uncertainty over future dividend policies.

Olympus, a medical equipment maker, jumped 7.40% on expectations of solid earnings growth in FY 2023. For the 10th day on a row, **Mitsubishi Heavy Industries** advanced, adding 5.36%; the group is considered to be the biggest beneficiary of increased spending on defence. **Panasonic** gained 5.31% on reports that the group was in talks with **Stellantis** and **BMW** to build automotive battery factories in the US.

Tyre giant **Bridgestone**, **Unicharm**, sanitary products and airline **ANA** fell 3.18%, 2.77% and 2.50%, respectively, as investors took profits.

The dollar fell from the high 132s to low 131s due to poor US economic indicators.

The Japanese government said that it would end current border controls on incoming travellers on May 8. This is in line with its decision to categorise COVID-19 as a common disease, a major shift towards normalising social and economic activities. On Wednesday, Japan allowed travellers from mainland China to enter the country with a certificate showing they had had 3 COVID-19 vaccine injections.

EMERGING MARKETS

The MSCI EM Index was more or less flat (-0.19) as of Wednesday's close. India (+1.1%) led the pack while Chile, Mexico, and China fell 5.03%, 2.06% and 1.40%. Brazil and Korea slipped 0.50% and 0.54%, respectively.

In **China**, the SME/private sector-oriented Caixin manufacturing PMI fell to 50.0 in March from 51.6 in February, diverging from the official NBS manufacturing PMI, which is more large/public sector-oriented. Caixin service PMI rose to a near decade high in March at 57.8, or much better than expected and up from February's 55. Sales of the top 100 property developers in China rose 31% YoY and 38% MoM, taking the increase to 8% in the first quarter and 4% YoY. Domestic travel demand saw strong growth momentum as the Labour Day holiday approached: booking volumes increased 390% YoY, while domestic flight bookings were up 292% YoY.

In **India**, the RBI pressed the pause button after six repo rate hikes in a row and left rates unchanged at 6.50%. India's current account deficit narrowed in the October-December quarter to 2.2% of gross domestic product from 4.4 % in the previous quarter. India's March manufacturing PMI rose to 56.4 from 55.3 in February. The **Jio** Financial Services demerger from **Reliance Group** was approved and will be followed by a listing, expected in September.

In **Brazil**, rumours on revolving bank credits being capped punished financials and consumers companies. **L'Oréal** completed the acquisition of **Aesop** from **Natura** for US$2.5bn. The news was followed by the government announcing reduced tax benefits for retailers to increase tax revenues and meet the targeted primary fiscal deficit of 0.5% this year. Current estimates are for a deficit of around 1.5%. The retail sector is one of the sectors which will be the hardest hit by the measure. Other alternatives to raising these extra tax revenues range from taxing online gaming, small-value imports (e-commerce cross-border would be affected), and even exclusive investment funds. The proposed adjustments are subject to congressional approval.

In **Korea**, **SK Hynix** raised $1.7bn with a new convertible issue at 1.75%. The deal was upsized from $1.5bn. The proceeds should ease concerns about a short-term liquidity squeeze.

In **Mexico**, OMA (Mexico's airport) reported a solid, above-forecast 21% increase in traffic in March. The highlight of the month was international passenger traffic in Monterrey, which showed a sequential acceleration relative to 2019.

On the supply-chain-relocation front, Korean battery material suppliers **LG Chem** and **Ecopro** plan to expand battery cathode materials capacity in Europe and in South Korea, respectively, after IRA clarity.

CORPORATE DEBT

CREDIT

A slight deterioration in European PMIs and ISMs in the US halted a marked move towards tighter risk premiums. In new issuance, **Orange** raised €1bn at 5.5% with a subordinated perpetual bond. There were no high yield deals in Europe over the period. In the US, a large banking pool raised $3.8bn to refinance (at a loss) the acquisition of Cloud Software Group (Citrix) by Elliot Management and Vista Equity Partners. The bonds have a 9% coupon and a yield of 14% thanks to a 21 point discount.

In financials, the subordinated market bounced sharply towards the end of March amid reduced wariness of European banks following the collapse of **Credit Suisse**. As a result, **BNP** sold a senior bond and insurance group **Axa** even issued a subordinated T2. The market nevertheless remained volatile ahead of the first quarter results season. Banks will be the first to report and investors will have the opportunity to reappraise the investment case.

CONVERTIBLES

Rising equity markets and some stabilisation on bond markets meant convertibles had a good week.

Tech sector convertibles performed well, and especially cloud computing and semiconductor companies. Globally, renewable energy outperformed and the sector also saw some new issues. In Europe, **Nordex** sold its first convertible, raising €350m with a green bond. The company focuses on wind turbines and its biggest shareholder is Spain's Acciona SA, a specialist in renewable energy. In the US, **Duke Energy**, a major electricity generation holding, raised $1.5n with a senior convertible due 2026. The proceeds will go on refinancing debt.

In South Korea, **SK Hynix** raised $1.7bn with a convertible that triggered heavy investor demand.

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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