MARKET FLASH: MARKETS SHOW RESILIENCE

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Geopolitical risk was in the limelight after Hamas terrorists attack opened a new, bloody chapter in the Israeli-Palestinian conflict. The US immediately sent its largest aircraft carrier to the area in an attempt to stop the conflict escalating. For the moment, most Middle East specialists think a war between Israel and Iran is unlikely as the economic repercussions could be devastating. The most probable scenario is a regional conflict with only a limited impact on global oil supplies. Markets have opted for this scenario: oil prices have been stable, equity markets are higher and overall asset volatility is down.

Elsewhere, the US labour market held up and inflation surprised on the upside, rising 0.4% over a month vs. 0.3% expected. The big surprise was a 0.6% rise in property but we think this will be temporary. Nevertheless, such resilient inflation has rekindled the possibility of yet another rate hike before the end of the year. It is, however, interesting to see that two Fed officials think recent long bond yield rises will reduce the need for further rate hikes.

In Europe, the ECB minutes suggested that benchmark rates had peaked but that they would stay high until inflation returned to normal. China, meanwhile, is mulling a fresh round of fiscal stimulus for a little less than 1% of GDP. The aim is to underpin growth with spending on infrastructure. As we approach the earnings season, expectations in the US are very slightly higher while in Europe they are much lower, dragged down by energy stocks.

Our equity stance is tactically neutral: investor sentiment and positioning is weak while US growth remains resilient and the situation in China is stabilising. Over the medium term, we remain somewhat cautious on risk assets as restrictive monetary policy will take time to feed through to the real economy. In fixed income, we remain overweight duration, a stance we feel should provide protection during any economic slowdown.

EUROPEAN EQUITIES

In the previous period, European markets hit a 3-month low following a spate of disappointing economic indicators. We could have presumed that the trend would continue following the new Middle Eastern conflict. However, the rush into quality sent government bond yields lower and ended up boosting markets. Energy led gains due to higher crude oil prices. Defence also benefited with strong gains for **Thales**, **Saab** and **Leonardo**.

In stock news, **Novo Nordisk**, Europe's biggest market cap, jumped after very encouraging results for its Ozempic drug used in kidney failure cases.

Elsewhere, **LVMH's** third quarter missed expectations and the stock tanked. The slowdown in sales growth revealed softer consumer discretionary spending in its main markets as customers turned more cautious. Management insisted that the drop was mainly in Europe and the US but investors were unconvinced.

In contrast, third-quarter sales at **Publicis** once again beat the consensus, coming in at €3.24bn vs. €3.21bn expected. Management is confident like-for-like growth will accelerate and duly raised its target for this year.

Accor unveiled a €400m share buyback. This represents 4.9% of its equity and is part of the group's commitment to return €3bn to shareholders over the 2023-27 period.

US EQUITIES

Wall Street gained ground over the last 5 trading sessions up to Thursday evening. The S&P 500 rose 2.18%, the Nasdaq 3.13% and the Russell 2000 edged 0.17% higher.

Markets focused on long bond yield shifts rather than the Israeli-Palestinian conflict. Investor sentiment was initially lifted by comments from some Fed officials that tighter financial conditions could reduce the need for more rate hikes. But bond yields started rising again after consumer prices rose 0.4% rather than by 0.3% as expected. Apparel and second hand car prices eased but shelter and services continued to rise. Weekly jobless claims came in almost as expected (209,000 vs. 210,000). Shifts in 10-year Treasury yields suggest rates will remain higher for some time.

Meanwhile, WTI oil was stable (+0.74%) amid US refinery maintenance.

In company news, **ExxonMobil** (-2.31%) is to merge with **Pioneer Natural Resources** in a $59bn deal. The deal is another sign of consolidation in the shale energy sector. In oil industry equipment makers, Halliburton jumped 9.64% and Schlumberger ended 5.36% higher. In software, **Adobe** (+8.36%) unveiled significant developments in artificial intelligence at its annual Adobe MAX conference. Datadog dipped 1.74% as demand eased. Microsoft gained 3.69% after the UK's competition watchdog approved its acquisition of Activision, the biggest video game deal ever.

In autos, the strike at Detroit's Big Three intensified. The UAW union escalated the conflict by beginning a strike in **Ford's** truck factory in Kentucky. **Tesla** dipped 0.64% after reporting lower-than-expected deliveries in the third quarter. German sandal market **Birkenstock** fell 12.61% on its first day of trading in New York. The third quarter earnings season kicks off today, October 13, with banks as usual reporting first. Consensus expectations are for sequential drops in their EPS for leading banks over the quarter.

JAPANESE EQUITIES

The NIKKEI 225 and TOPIX jumped 4.57% and 3.48% after US interest rates eased on soft economic data and statements from Fed officials suggesting the next hike would be put back for some time.

Oil & Coal Products and Wholesale Trade (including general trading companies) rose 6.65% and 5.94%, respectively the last week, due to stronger commodity prices including oil. **Sumitomo**, for example, rose 7.92%. Transportation Equipment gained 5.98% after auto sales in China increased for the first time in 4 months. On the other hand, Air Transportation fell by 0.69% over oil price concerns. Fishery, Agriculture & Forestry edged 0.13% lower as major seed companies announced poor third quarter sales after an extremely hot summer this year.

Mitsubishi Heavy Industries, a heavy machinery company and a leading weapons manufacturer, soared 10.47% on defence stock strength in the US and Europe after the outbreak of the Israel-Hamas War. **SMC**, an automatic control equipment maker, rebounded by 7.51% on solid capital expenditure in Japan. Elsewhere cosmetics giant **Shiseido** and **Unicharm**, a sanitary goods maker, fell 4.06% and 2.77%, respectively, due to concerns over China's deteriorating economy. **M3**, a healthcare platform provider, slipped 2.66% after several leading brokers reduced their target price.

The yen was range-bound between mid-148s and low-149s against the dollar due to mixed US economic data. However, on Thursday, it weakened to almost 150 following a higher-than-expected September US CPI.

EMERGING MARKETS

The MSCI EM Index had rebounded 2.7% this week as of Thursday's close. Brazil (+5.3%) and China (+3.7%) outperformed. India edged 0.6% higher. Mexico (+2.9%) also recovered from last weeks' sell-off.

In **China**, September CPI was unchanged, vs +0.1% in August. PPI fell 2.5% YoY, narrowing from a 3% drop in the previous month. Excluding food and energy, core CPI was up 0.8% YoY. The decline for both export and import growth in September shrank to 6.2% in USD, easing from 8.8% and 7.3% drops in August. Aggregate financing in September was RMB 4.12 trillion, or above the 3.7 trillion estimated, partly due to seasonality and recent stimulus. The government is considering increasing its 2023 budget deficit with stimulus measures and might set up an equity market stabilisation fund. President Xi emphasised the importance of China-US relationships with the US Senate majority leader Chuck Schumer and his delegation. The US accepted China's invitation to attend a top security forum in Beijing this month, another sign that ties between the economies are starting to normalise. In September, retail sales of passenger cars rose 6% YoY, and +21% for NEVs.

NEV exports surged 95.8% YoY in September to 96,000. Golden Week tourism saw moderate growth with total tourism traffic and revenues up 4.1% and 1.5% vs. 2019 while Macau's gaming turnover exceeded expectations. **CTG Duty Free** released preliminary third quarter results with sales up 28%, or more than expected, but from a low base. **BYD** is taking over a former **Ford** factory in Brazil with plans to invest more than $3bn. Anta 's third quarter sales saw sequential improvement continuing into the Golden week holidays.

In **Taiwan**, **TSMC** received a one-year waiver extension from the US to continue supplying chip production equipment to its plants in China without additional licenses. The US government also granted an indefinite waiver for Korean memory producers **Samsung** and **SK Hynix's** Chinese chip plants. **Samsung's** third quarter results were slightly better than expected thanks to memory price stabilization; management also signalled earnings momentum for the fourth quarter. **LGES** reported slightly better-than-expected preliminary third quarter operating profits. **LG Chem** won a $2.1bn cathode material order from **Toyota**.

In **India**, PM Modi is considering increasing cash transfers to small farmers by 33%. Auto retail sales surged by 21% YoY in September and mobile phone exports doubled to $5.5bn up to August. CPI inflation slowed to 5.0% YoY in September from 6.8% in August thanks to a bigger-than-expected drop in fuel prices. In company news, RIL secured a $0.6bn investment from **ADIA** for a retail arm. Titan's jewelry division reported a 19% YoY increase in sales. **Nykaa's** revenue update indicated 20% YoY growth in BPC net sales for Q2FY24. Infosys trimmed its FY24 revenue growth guidance to 1%-2.5% from 1%-3.5%. **Infosys**, **TCS** and HCL made muted comments on demand but surprised on margins. **Infosys** cut FY24 growth guidance by 100bp to 1.0-2.5% YoY, citing a slowdown in discretionary spending and delays in project starts.

In **Brazil**, IPCA inflation was better than expected. The surprise was a 5.19% YoY increase in food prices, or lower than the 5.25% expected. The IMF is forecasting robust growth exceeding 3% for Brazil in 2023. The **Mexican government** released a statement confirming its intention to reduce airport fees, with no further details about the size of the reduction. Elsewhere, the government unveiled fiscal benefits for companies reallocating activities to Mexico in ten key sectors. The benefits are in the form of accelerated investment deductions. An additional 25% deduction is guaranteed for three years for worker training expenses, focusing on the development of human capital. These incentives are available in all states and municipalities in the country.

CORPORATE DEBT

CREDIT

Events in the Middle East and fears of an escalation fuelled a flight to safety on bond markets, interrupting a pronounced *bull steepener* episode in the previous weeks. Yields on the 10-year German Bund fell back to 2.75%. The rally in the US was even bigger with 10-year Treasury yields dropping to 4.65%. However, a disappointing 0.4% reading in US inflation reminded investors that the Fed would struggle to turn dovish over the short term.

Geopolitical tensions had a big impact on government bonds but not as much on credit markets. Lower interest rates caused credit spreads to narrow. Synthetic indices fell back with high yield down 35bp to 430bp and investment grade 7bp lower to 81bp.

The new issues market was calm and there were no new high yield deals. In financials, primary activity also eased as the earnings season is about to start. There were, however, some senior issues. Hungary's **MBH** bank raised €350m at 8.625%, or €50m more than initially planned. The big banking news for the last week was a £150m capital injection for the UK's **Metro** from two shareholders, plus an exchange offer for its Tier 2 and HoldCo debts. This will give the bank time to return to adequate profitability.

The previous week's underperformance was completely wiped out by a 90bp narrowing in Euro CoCo spreads to 909bp. Investment grade gained 0.5% over the last week as credit spreads narrowed by 3bp and high yield returned 0.7% with more substantial narrowing (16bp). There are still attractive returns for carry strategies with 4.5% on investment grade and 7.10% on high yield (BB-B).

CONVERTIBLES

It was a busy week for global convertibles with macro announcements, earnings and corporate activity moving the market. In Europe, the luxury sector hit the headlines due to a sharp drop in **LVMH** as shoppers reined in spending on high-end Cognac and handbags and sales growth softened in the third quarter The announcement drove the broader consumer products sector lower. Accor's share buyback was a pleasant surprise On October 13 because of its size and speed; the convertibles traded higher during the week.

The week was also eventful in Asia. In Japan, **Rohm** traded higher on news that the company had developed high-speed, highly reliable thermal printheads to help improve efficiency in logistics and inventory management. In Taiwan, **LG Energy's** better-than-expected quarterly results highlighted strong battery shipments to the US. In Australia, **Flight Centre** is to repurchase a portion of their A$400m 2.5% convertible notes due 2027 in line with its new capital management policy. In the US, **PagerDuty**, the application software company, issued $350m in convertible bonds to repurchase outstanding notes.

Healthcare sector convertibles were also very active this last week. **Alnylam Pharmaceuticals** fell after US regulators denied an application that would have expanded the use of one of its best-selling medications, a setback to the drug maker's hopes for bigger sales. Medical devices and equipment-related names were lower as **Novo Nordisk's** Ozempic trial news weighed on sector sentiment.

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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