EDMOND DE ROTHSCHILD

MARKET FLASH: CENTRAL BANKS SEND THEIR BEST WISHES

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• We remain neutral overall on equities with a preference for emerging country equities and in fixed income, we continue to prefer carry strategies

It was a busy week for macroeconomic data but central banks had a field day announcing their last policy decisions for the year.

On Tuesday, equity markets soared after US consumer inflation in November slowed to 0.1%, or less than the 0.3% expected. Energy prices retreated and durable goods prices fell 0.5%, leaving property as the biggest contributor to inflation. Even so, advanced data from rental sites suggests shelter inflation will see a fall back in mid-2023.

On Wednesday, the Fed slowed its rate increases as expected but insisted on staying restrictive for some time to ward off knock-on inflation. Fed Chair Jerome Powell said the figures were encouraging but insufficient as recent unemployment data showed the labour market was still robust.

Following the Fed's lead, central banks in Switzerland, the UK and Mexico hiked by 50bp and Norway by 25bp. However, they all said their economies were about to slow and inflation would soon fall back. The Bank of England was much more nuanced than before: most of its monetary policy committee members said further rate increases would perhaps be necessary but 2 out of the 9 this time voted against raising.

The ECB provided the biggest surprise by trying to dampen investor expectations with a particularly restrictive message that said it was obliged to raise rates at a strong and significant pace. ECB Chair Christine Lagarde ruled out any pivot and also said the bank would start to shrink its balance sheet by €15bn a month starting in March.

This tougher stance, which contrasted with statements from other central banks and slower US inflation, sent the Eurostoxx index tumbling 3.6% intraday. Yields on Germany's 10-year Bund jumped 14bp but fell 3bp on US 10-year Treasuries.

Economic data muddied the waters with industrial production and retail sales down but PMI staging a recovery.

We remain neutral overall on equities with a preference for emerging country equities. We are underweight the eurozone. In fixed income, we continue to prefer carry strategies. We still prefer US Treasuries to eurozone government bonds.

EUROPEAN EQUITIES

Markets sold off after ECB chair Christine Lagarde's hawkish statement following the bank's decision to raise rates by 50bp. She said policy would stay the same until inflation targets were met. On choppy energy markets, Brent crude rose and peak-rate electricity prices were volatile. Oil rose because of operating problems in the US and a statement from one of Russia's biggest energy insurance groups that it would not fill in for European insurance groups. The cold spell in Europe triggered electricity price volatility, particularly in France where electricity accounts for a large percentage of heating. Wind power was also low but the impact was offset by several of the country's nuclear power stations coming back into service. In the UK, inflation in November rose 0.4%, or less than expected after the 2% jump in October.

Several companies said demand in Europe was holding up. Despite remaining cautious for 2023, shipping giant **Hapag-Lloyd** said demand had rebounded slightly. **Lufthansa** (+4.2%) also referred to a sequential rebound and said strong demand in recent weeks had led it to raise earnings guidance for this year. In ready-to-wear, **Inditex**, which owns Zara, said demand had remained very strong despite price rises. The same trend was seen in the autos sector with new car sales in Europe up for the fourth month in a row.

US EQUITIES

Wall Street tanked on Thursday after both the US and Europe gave hawkish indications on future monetary policy trends.

FUnsurprisingly, the Fed raised its rates by 50bp to take them to 4.25 -4.50%. The bank said it had no choice but to remain restrictive and officials now expect the Fed Funds terminal rate to be 5.1% in 2023.

At his press conference, Jerome Powell said there was still a lot of work to be done in the fight against inflation. He also said the bank need more than the latest CPI to adjust its policy and that next February's FOMC decision would depend on economic data between now and then.

Meanwhile, November's retail sales fell 0.6% MoM, or much more than the 0.2% drop expected. The figures rekindled concerns that the Fed's battle on inflation could precipitate a recession.

In company news, **Moderna** gained 19.6% after positive preliminary results for the ARN messenger skin cancer vaccine it is developing with Merck.

To comply with future European legislation on software company protection, **Apple** is reportedly considering opening up its iPhone and iPad operating systems to other online app providers.

On December 19, VeriSign, Skyworks Solutions, Splunk, Baidu, Match, DocuSign and NetEase will leave the Nasdaq index and Rivian, Warner, Discovery, CoStar, Global Foundries, Baker Hughes and Diamondback Energy will join.

The M&A market perked up. **Amgen** is to pay $26bn for Horizon Therapeutics. **Microsoft** is taking a 4% stake in the **London Stock Exchange**.

JAPANESE EQUITIES

The NIKKEI 225 and TOPIX gained 1.73% and 1.67% over the period on expectations the Fed would slow its rate hikes after CPI came in lower than expected.

Marine Transportation rose 4.89% as the containership freight rate bottomed out. Electric Power & Gas gained 3.21% as oil and gas prices appeared to have peaked. Textiles & Apparel moved 2.85% higher, led by **Toray Industries** (+6.61%) on the news that United Airlines had placed a large order for Boeing 787 aircraft; Toray makes carbon fibre for the plane.

Only Air Transportation edged 0.67% lower on rising Covid-19 cases in China.

Mitsubishi Heavy Industries, Japan's largest weapon maker, jumped 6.47% after the defence budget was increased. **Tokyo Gas** rose 4.27% as gas prices seemed to have peaked.

Sekisui House fell 2.40% after earnings for the August-October quarter fell over 12 months due to commodity price rises. **Secom** (security services) dipped 1.53% on profit taking. **Japan Exchange Group** slipped 1.38% as Japan's retail investors switched to foreign equity investments.

The yen had a volatile week, starting at 136.67 to the US dollar and ending at 137.83 after weakening to 135.48 after FED Chairman Powell suggested the terminal interest rate in the US would be higher.

The BoJ said the wholesale price index was up 9.3% YoY to another higher in November due to rising energy costs and the weaker yen. It has now risen for 21 months in a row and stuck above 9% for almost a year. As a growing number of companies have passed on higher costs by hiking retail prices, consumer inflation has also stayed above the BoJ's 2% target in recent months. However, the bank maintained its view that recent inflation would not last long and that the current ultra low rate policy should be maintained.

EMERGING MARKETS

The MSCI EM Index was 1.8% lower as of Thursday's close. China fell 3.2% after last week's rally. India was down 1%, while Brazil (-5.7%) underperformed.

In **China**, November RMB loans and Total Social Financing missed market expectations while M2 surprised on the upside. The deceleration of total RMB lending was mainly caused by slower corporate loan growth due to covid disruption and softer credit demand in November. China reopened more rapidly than expected and road and air traffic rebounded sharply. Pfizer signed an agreement with a SOE to sell Paxlovid in China; it is already available from online pharmacies. Vice Premier Liu He said new measures were being considered to support the property sector. The US PCAOB said it had full access to audits and personnel data, significantly reducing the risks of ADRs delisting. The US blacklisted semiconductor chipmaker **YMTC** and AI champion **Cambricon** as well as 34 other Chinese companies while removing both Wuxi and the Shanghai sites of biotech service provider **Wuxi Biologics** from the UVL list. Liquor maker **Moutai** announced a 35% capacity expansion plan to meet future demand. **Hon Hai** is reportedly ending the closed loop restrictions at its Zhengzhou plant to normalise production for Apple.

Hong Kong is to scrap some of its last remaining Covid restrictions, including a three-day monitoring period for arrivals and the requirement for people to scan a QR code.

In **South Korea**, Kepco is in discussions with the Turkish government to develop four nuclear power plants.

In **India**, November CPI decelerated to 5.9% from 6.8% in October, or below the 6.4% forecast, led by lower-than-expected food prices. Exports rose 0.6% in November while imports were 5.4% higher. Indian and Chinese troops clashed at the Himalayan border between the two countries, the first incident since July 2020.

In **Brazil**, IPCA inflation rose 0.4% in November, or below market expectations of 0.5%, driven by goods and Black Friday promotions. As expected, President Lula appointed Fernando Haddad as finance minister. The lower house of Congress voted to change the SOE law, which will make it easier for politicians to take roles at state-run firms. The Senate delayed the final vote of the law change to next year. The Bank of **Mexico** hiked its key interest rate by an expected 50bp to a record 10.5%. **Peru**'s new President Boluarte called a general election for 2024 instead of 2026.

CORPORATE DEBT

CREDIT

Bond markets had a varied week. On Tuesday, US consumer inflation delighted markets but statements from the Fed and ECB chairs following their monetary policy meetings poured cold water on any enthusiasm. Long bond yields rose 25bp in Europe over the week but fell 9bp in the US. Between Monday and Thursday, the investment grade index fell 0.57% while high yield rose 0.28% even if risk premiums on the Xover gained 11bp.

In high yield issuance, Belgium's **House of HR** raised €415m at 9% due November 2023. In company news, there were some positive developments. **Lufthansa**, for example, raised its EBIT guidance from €1bn to €1.5bn, citing resilient reservations. Elsewhere, Spanish pharma group **Grifols** is mulling the sale of its stake in Shanghai RAAS. Any disposal would bring in €2bn that the group would use to pay down debt.

Short seller Muddy Waters struck again this week, triggering an 18-point plunge in the bonds of Luxembourg property company **Vivion**. Carson Block's fund said its short was based on suspect transactions and false occupancy rates. In recent months, Adler Real Estate and SBB had already been targeted by the activist Viceroy fund.

Newsflow and deals slowed as the end of the year approached. There were no sizeable CoCo or T2 deals over the week but the market remained upbeat thanks to good CPI data in the US. Despite the ECB's rate rise on Thursday, CoCo premiums stayed close to 750bp, or 40bp less than on the previous Friday, enabling the segment to end the period higher. It was the same story in senior financial debt: credit premiums fell from 188bp to 177bp, helping offset the negative impact from interest rate hikes.

CONVERTIBLES

New issuance declined ahead of the Christmas break but new generation vaccine maker **Novavax** still raised $125m due 2027. The US biotech is known for its Covid-19 vaccine Nuxaxoid which it marketed in the US and Europe. In Canada, **Storagevault** raised C$ 100m at 5% due March 2028.

In company news, **Coupa Software** (Business Spend management) reported a strong, better-than-expected rise in results. Third-quarter sales jumped 17% over 12 months to $217.3m. The company has just been acquired by the Thoma Bravo fund for $8bn.

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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