MARKET FLASH: THE FED MAKES THE SOFT LANDING SCENARIO CREDIBLE

- **The Fed cut its rates by 50 bp at the meeting on 18th September.**
- **The Bank of England chose to leave rates unchanged due to underlying inflation.**
- **Data in China confirmed that domestic and foreign demand was being hindered by structural factors.**

The week began with signs the US economy was proving more resilient than expected, with medium term inflation edging higher to 3.1% (+10bp). Thanks to a rebound in new orders, the Empire State survey was a positive 11.5 compared to minus 4.7 in July, the Michigan University index advanced to 69 and industrial production rose 0.8%. Retail sales came in at +0.1% when they were expected to fall 0.2%.

The figures did not prevent the Fed from opting for a 50bp cut rather than a 25bp move. The bank is keen to adjust its monetary policy quickly as it thinks risks are now evenly balanced between its inflation target and efforts to support the economy. Jerome Powell chose to focus on employment data so this is the main point markets will now have to look at. At the same time, he managed to reassure Wall Street that a soft landing was a credible option. The Fed was keen to point out that the 50bp cut was simply "recalibration", its new buzz word, so it is not committed to accelerating rate cuts, a potential source of worry for markets. It has raised its long-run equilibrium interest rate, or neutral rate, and the dot plot suggests another 50bp in cuts by the end of 2024, 25bp less than market expectations and 50bp less for end 2025. Growth expectations are unchanged at 2% for 2025-26 and core PCE inflation has been cut to 2.3% and 2.1% in 2024 and 2025, down from 2.6% and 2.3%.

The Bank of England, however, chose to leave rates unchanged due to underlying inflation accelerating to 3.6% from 3.3%. Services inflation was behind the rise. And the Bank of Brazil actually raised its rates by 25bp due to worries inflation might run out of control.

Data in China confirmed that domestic and foreign demand was being hindered by structural factors. Industrial production growth slipped to 4.5%, investment to 3.4% and retail sales to 2.1%, all less than expected. Unemployment rose to 5.3%.

The Fed's move -and its effective communication - sent markets higher with the S&P 500 hitting a new all-time record. The reaction on bond markets was more restrained and yields stayed higher than lows seen earlier this month.

We are still neutral on equities as valuations have already factored in a soft landing and markets are going for bigger rate cuts than the Fed actually intends. We also have an overall neutral rating on bonds but with a preference for carry strategies in emerging markets and the investment grade segment.

EUROPEAN EQUITIES

European equities ended the period higher, thanks mainly to the Fed's 50bp rate cut. The news galvanised cyclicals with retail and commodities leading gains in the Stoxx Europe 600. But, as expected, the Bank of England left its rates unchanged. The governor said inflation had to be kept low.

EssilorLuxottica, which makes the exclusive **Ray-Ban** range, extended its partnership with **Meta**. The aim is to drive smart glasses production by combining Meta's advanced technology with Ray-Ban's style. The news followed persistent speculation that Meta might take a stake in EssilorLuxottica.

In tech, France's **Esker**, a management software specialist, confirmed that private equity firm **Bridgepoint** was bidding for it. The news came out when Esker released its quarterly figures on September 19. The bid price is €262, a level that reflects the company's growing appeal.

In autos, **Mercedes** cut its annual guidance, citing the worsening situation in China as the main reason. The group's significant downgrade of operating margin guidance follows a similar move from **BMW** in the previous week. The news put the entire auto sector under pressure this week.

Elsewhere, the sudden departure of **Campari**'s CEO triggered a 10% slump in the share price. He had only been in the post for 5 months. A transition committee has been tasked with finding a replacement.

Technip Energies won a major contract to build an LNG export platform on Lake Charles in Louisiana. The LNG infrastructure will be one of the biggest in the US and is a token of Technip Energies' increasing strategic focus on a crucial sector.

US EQUITIES

The Fed was expected to cut rates but the big question was by how much. In the end, the bank reduced its base rate to the 4.75-5% bracket, a 50bp cut that boosted markets.

The Nasdaq jumped 2.4% over the week and the S&P 500 gained 1.43% to hit a new all-time high. The Russell 2000 ended the period 2.9% better. All sectors rose but tech and consumer discretionary led gains. Communication also climbed.

Brent crude bounced 2.5% and WTI 2.3% after Jerome Powell assuaged fears of an economic slowdown, thereby rekindling the appeal of cyclical plays.

In results news, quarterly figures at **Fedex** missed expectations due to lower premium sales and higher wage costs. Premium services generally concern healthcare and semiconductor companies so this points to an industrial slowdown.

Elsewhere, **Microsoft**, aided by an investment fund consortium, unveiled a new partnership which will invest $100bn in new data centers and energy infrastructure. The AI craze seems to have peaked but this news showcases the enormous investments required for AI to develop. **Amazon** and **Intel** joined forces to produce chips from 2025. The news helped the struggling Intel share gain 1.18% over the week. In a week of conferences, **Snap** used its partners' summit to launch its augmented reality goggles, the Spectacles, but user reactions have so far been mixed. Salesforce held an event for its AI agents and invited **Nvidia** CEO, Jensen Huang to speak. In the driverless cars space, Uber and Google's Waymo subsidiary extended their partnership to include Waymor cars on the Uber app in Atlanta and Austin.

Nike announced the departure of its CEO John Donahoe. He will be replaced by Elliott Hill who ran the group up to 2020. The news sent the share higher as Hill is popular with employees and suppliers.

EMERGING MARKETS

The MSCI EM index was up 1.68% this week as of Thursday, with most indices closing higher in USD. China (+3.58%) led gains. Mexico, Taiwan, Brazil and India rose 1.37%, 1.29%, 1.05% and 0.13%, respectively. Korea was flat.

In **China**, August's economic activity data came in broadly below market expectations. Industrial production was up 4.5% YoY vs. consensus of 4.7%. Retail sales were up 2.1% YoY, or below the 2.5% expected. FAI (Fixed asset investment) came in at 3.4% YoY, or lower than the 3.5% expected. The PBoC unexpectedly left the LPR unchanged after the Fed's 50bp cut. For the mid-autumn holiday, domestic tourists and spending increased by 6.3% and 8% compared to 2019. **BYD** acquired the remaining 10% of shares and moved to full control of its JV with **Mercedes-Benz** for the premium brand **Denza**. **Midea**'s HK IPO successfully listed this week, raising $2.5bn. **Alibaba**'s chairman increased his total stake in the company to 1.44%. **Nio** officially launched its first model (L60 SUV) under its new mass market brand **ONVO**.

In **Taiwan**, the central bank kept its benchmark rate unchanged at 2%. **TSMC**'s Arizona fab is reportedly running test production of Apple's A16 chips. **Hon Hai** is reportedly planning to manufacture the iPhone 16 in Brazil for the first time.

In **Korea**, President Yoon and Czech president Petr Pavel discussed expanding nuclear cooperation and broader bilateral ties. **Hyundai Motor** is said to be in discussions with **Google**'s **Waymo** on robotaxi manufacturing.

Indonesia's central bank kick-started its easing cycle with a 25bp cut to 6%. **GoTo Group**, the Indonesian ride-hailing provider, agreed to use **Alibaba**'s cloud services.

Thailand's new prime minister boosted borrowing by 8% to $78bn to push for an economic stimulus. The tourism minister showcased the idea of reviving the domestic tourism stimulus package.

In **India**, **WPI** softened to 1.3% in August from 2% in July and below consensus expectations of 1.8%. Exports declined 9.3% YoY in August (vs -1.7% in July) while imports grew 3.3% YoY (vs. 7.5% in July), resulting in the second-highest trade deficit. **Bajaj Housing Finance** had a successful IPO listing at 5.2x its BV. **Dixon Technologies** will manufacture notebooks for **Asus** under the production-linked 2.0 incentive scheme. **Lenovo Group** started building AI servers in its southern India facility.

Brazil's central bank increased the benchmark rate by a quarter-point in its first hike since 2022. Economic activity for July rose 5.30%, or ahead of the expectations for 4.80%. Restaurant operator **Zamp** is looking to expand **Starbucks**' presence in the country to 1,000 locations — a nearly ten-fold increase from today.

In **Mexico**, the Congress will finalise proceedings on a reform overhauling the judicial system. Nominal wages increased by 8.5% in August vs. 6.5% in an initial reading.

CORPORATE DEBT

CREDIT

The Fed finally opted for a 50bp rate cut and risk assets rose. Spreads narrowed significantly. The Xover tightened by 15bp over the week and HY spreads fell from 360 to 345bp. Investment grade spreads fell back to 113bp.

10-year US Treasury yields rose by 10bp to 3.72% (as of Friday morning), ending yield curve inversion as the 2-year yield moved to 3.57%. After a good run in recent weeks, German Bund yields gained 5bp to 2.18%.

New issuance remained active. In high yield, **CPI** offered a BB+ bond at 6% due 2032. **Acqua e Sapone** (B) raised €400m at 6.5% due 2031 and **Accor Invest** €750m at 6.375% due 2029. In financials, **Nordea Bank** raised $800m with an AT1.

As for sector trends, property continued to rebound due to lower rates and easier refinancing conditions. But autos are going through a tricky patch due to major German firms like **BMW**, **Mercedes** and **Volkswagen** cutting margin guidance. The result has been pressure on spreads.

Investment grade gained 0.2% over the week, taking YTD gains to 3.4%. High Yield ended the period 0.5% higher, largely thanks to inflows and spreads. The segment is now up 6.4% YTD.

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.

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