



## EDMOND DE ROTHSCHILD ASSET MANAGEMENT

### MARKET FLASH: WORRIES OVER AN AI BUBBLE RESURFACE

- Nvidia's excellent results failed to stem profit taking on the Nasdaq and assuage some concerns around AI.
- Doubts over a Fed rate cut in December only amplified market worries.
- Volodymyr Zelensky rekindled ceasefire hopes by declaring that he was prepared to work with the peace plan put forward by the US and Russia.

Nvidia's excellent results failed to stem profit taking on the Nasdaq and assuage AI bubble worries. CTA selling sent US indices sharply lower towards the close. The euphoria after Nvidia's results were released was short-lived. Although the spending boom on data centres should last in 2026, we are probably moving towards a more mature phase in the investment cycle, one that will see investors looking more closely at companies. AI theme uncertainties justify higher risk premiums: there are concerns over how much investments will translate into profits, how capex is funded (circular investing, worsening cash flow generation and increased leverage) and how data centres will manage energy and water supplies.

Doubts over a Fed rate cut in December only amplified market worries. The FOMC minutes and various comments from committee members suggest no move next month. Futures are running at 30% probability, down from 40% last week and close to 70% at the beginning of November. September's jobs report, the only one available to the Fed before December's FOMC, suggest the same. After August's poor figure, 119,000 jobs were created in September, or more than the 55,000 expected, with construction, healthcare and restaurants predominating. But the unemployment rate increased to 4.44% due to a slight increase in the participation rate.

Europe is acting as a diversification tool. Volodymyr Zelensky rekindled ceasefire hopes by declaring that he was prepared to work with the peace plan put forward by the US and Russia.

In Japan, the JPY 21.3 trillion stimulus plan (3.2% of GDP) rapidly sent government bond yields higher, and especially very long-dated bonds. The yen also softened. New JGB issues are expected to increase and we should keep an eye on any currency market intervention.

There are also rumours of Chinese fiscal stimulus to revive a property market that has been in the doldrums for 4 years.

We are glad to see signs of US-China tensions abating, strong developed economy performance and resilient company margins but we are concerned about massive private investment in AI and historically high valuations across global stock markets, and particularly in the US. Equity markets have lost ground in recent days due to worries the Fed can continue to cut rates over the short term so valuations have returned to levels more consistent with company fundamentals.

**If we base our expectations on the risk-management approach the Fed has used since September, we believe that the chances of a fresh rate cut are now greater than the risk of no move at the December FOMC. If so, equity markets could be underpinned. As a result, we think it is time to gradually reduce our defensive stance on equities.**

**And also turn more positive on duration. The long end of the yield curve is still prey to the Supreme Court's upcoming decision on Donald Trump's tariffs but US short-dated bonds are more attractive; they also offer more protection in the event of a negative surprise when the next salvo of economic data appears.**

## EUROPEAN EQUITIES

The third-quarter earnings season neared its end amid mounting AI worries and incipient sector rotation out of tech stocks. With more than 85% of European company reports now in, EPS have now beaten consensus expectations by around 55%, or in line with historic averages.

The UK was this week a big concern: the government undermined budget credibility by backtracking on tax rises but inflation decelerated in October and the labour market showed signs of weakening so the Bank of England has more room to consider a rate cut in December. In the eurozone, exports to the US rose again, led by chemicals and pharmaceuticals but momentum is still fragile. Elsewhere, hopes of a Ukraine ceasefire resurfaced thanks to a US peace project, albeit one that is short on detail and drafted without consulting Kiev or European countries. Nevertheless, the defence sector saw profit taking. But rumours that Ukraine might buy 100 Rafale fighter planes lifted **Dassault Aviation**.

In company news, **Airbus** was centre stage at the Dubai Air Show. The group is reportedly about to win an order for around 150 A321neo planes from Flydubai, an airline which previously only used Boeing. **TotalEnergies** signed an agreement to spend €5.1bn on acquiring 50% of a European energy asset portfolio to reinforce its presence in gas and biomass power stations. The European digital sovereignty theme loomed large: **SAP** unveiled a cloud joint venture with **Capgemini**, **Bleu** and **Mistral AI**.

Capital Market Days are gradually replacing earnings season news. **ABB** confirmed its target of 5-7% in like-for-like growth and **Siemens Energy** showcased solid prospects in gas and networks thanks to its record order book. **Renk** reaffirmed its growth trajectory focused on reinforced execution with most value creation timed for 2027-28.

## US EQUITIES

Wall Street ended the period sharply lower with the S&P 500 down 2.9% in USD and the Nasdaq 3.8% lower. The correction was due to investors turning more defensive after several weeks of mounting worries over the AI rally and tech megacap valuations. September's jobs report was finally released and showed 119,000 jobs had been created, or more than expected, but the unemployment rate rose to a 4-year high of 4.4%. The probability of a December rate cut fell to around 33%, suggesting the next moves will be in 2026. Meanwhile, Donald Trump's repeated criticisms of Jerome Powell, his fierce attacks on Democrat politicians and his manipulation of the Epstein dossiers helped rekindle the debate on the Fed's independence and the US institutional framework. Elsewhere, with China boosting imports of Russian and Middle East crude oil, the US drew closer to Saudi Arabia with agreements involving around \$30bn in energy deals, sales of F-35 fighter planes, massive data centre and sovereign cloud

projects between **Microsoft** and local players and the authorisation of advanced AI chip sales to the Gulf.

Tech stocks remained in nervous focus. **NVIDIA** lost 5 % in spite of a spectacular third quarter with sales soaring 62% over a year. The stock accounts for around 8% in the S&P 500 index but the AI saturation theme is more broad-based and continuing to grow. Investors are concerned about circular investment flows and the returns massive capex among hyperscalers might make. Warnings on sector over-investment are weighing on overall sentiment.

**Alphabet** (+4.7%) bucked the trend and jumped at the beginning of the week on news **Berkshire Hathaway** had bought a stake. The launch of its Gemini 3 new generation AI model also contributed. **Tesla** (-2.3%) asked its suppliers to avoid using Chinese components, another sign of supply chains being reshaped. Elsewhere, **Walmart** (+4.6 %) reported a robust increase in sales and strong e-commerce momentum. **Target** (-7%), however, saw sales fall more than expected and management revised guidance lower. **Home Depot** (-8.2%) also missed expectations and cut annual guidance. Demand was weaker than expected and the US property market is still sluggish. In financials, **Citigroup** (-2.7%) continued with its massive restructuring plan. A new finance director was appointed and the bank announced a plan to lay off 20,000 people. In healthcare, **Johnson & Johnson** (+3.6%) acquired **Halda Therapeutics**, a company which develops innovative cancer treatments. The healthcare sector is seen as a safe haven in an increasingly uncertain environment.

## EMERGING MARKETS

The MSCI EM index was down by 1% in USD this week as of Thursday. India and Taiwan were up by 0.75% and 0.22%. China, Brazil, Korea and Mexico were down by 3.10%, 2.56%, 1.22% and 0.85%, respectively.

In **China**, the PBoC kept its benchmark LPR unchanged for the sixth consecutive month, maintaining the one-year rate at 3% and five-year rate at 3.5%. The government is reportedly considering new measures to support the property market. Diplomatic tensions with Japan escalated over Taiwan-related remarks by Japan's prime minister. The Dutch government suspended its seizure of chipmaker **Nexperia**, handing back control to its Chinese owner. Xiaomi's results were in line but the company faces margin and growth pressure into 2026 given higher smartphone costs and uncertainty over new EV capacity. PDD's third-quarter revenue slightly beat estimates while management remained cautious on competition and long-term investment. **Trip.com**'s third-quarter revenue and operating profit were all ahead of consensus. **Sony Pictures** reportedly acquired screen rights from **PopMart** to develop a LABUBU feature film.

In **Taiwan**, October export orders rose 25.1% YoY, or below the 28% expected. **Foxconn** announced partnerships with OpenAI, Nvidia, and Alphabet's Intrinsic to strengthen its AI supply chain role. The government approved **Nvidia**'s plan to establish a subsidiary and build a new office.

In **Korea**, exports for the first 20 days of November rose 8.2% YoY while imports were 3.7% better. October producer prices rose 1.5% YoY, driven by higher costs for computers and electronic equipment. South Korea and the UAE signed a framework agreement for strategic AI collaboration. **Samsung** announced a major leadership reshuffle.

In **India**, core industry output was flat YoY in October, marking the slowest pace in 14 months. PM Modi's NDA party achieved a resounding victory in the Bihar state election. The government released the 21st instalment of the PM-KISAN scheme, providing ₹18,000 crore

to 90 million farmers across the country. **TPG** committed \$1bn to an AI data centre joint venture with **TCS**.

In **Brazil**, economic activity fell 0.24% month-over-month in September, or slightly worse than the expected 0.2% drop. Congress approved spending cuts and tax credit caps aimed at saving R\$15bn by 2026. **XP Inc.** reported strong third-quarter results with adjusted net income beating estimates.

In **Mexico**, foreign direct investment hit a record \$41bn in the third quarter, a 15% YoY rise. Banxico minutes showed that most members see weak economic growth with the next rate cut expected in December. **SQM** plans to invest \$2.7bn in 2025-2027 in a plan that includes expanding production capacity in Chile.

## CORPORATE DEBT

Equity market sentiment and risk appetite were volatile but fixed income markets proved more resilient. Low beta on credit markets compared to equities was striking. It is interesting to note that this volatility was driven more by sentiment than actual newsflow as US jobs data was good, **Nvidia** released excellent results and **Alphabet** successfully launched its Gemini 3 AI model. A recent credit market theme is that corporates are safer than sovereign bonds. One example is **Banca Commerciale Romana** which issued a senior bond this week at a lower yield than government bonds. While it is not uncommon to see non-financials issue at such levels, seeing a bank doing so is a much more unusual feat.

Primary markets remained fully open and active, especially in subordinated debt markets. **Ardagh Metal packaging** (HY issuer) **Vivion** Hybrid (HY real estate issuer), **Saturn** T2 (UK insurance challenger) and **Banca Transilvania** (AT1) all sold bonds. Supply seems to be exhausting demand, but new virgin issues from companies like **HASI** and **Spire** (both hybrids and **NLB** (AT1) as well as deals from quality issuers like **Merck** (hybrid) were well received. Credit market returns were flat over the week. Derivatives underperformed cash bonds with the Itraxx and CDX slightly wider vs. flat cash spreads. Corporate hybrids slightly underperformed, a change from recent outperformance.

On the single-name front, chemical issuers remained under pressure: **Iron Mountain** is the new target of a short seller campaign. **Worldline** and **Ubisoft** bonds bounced just by not delivering additional bad news.

## 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.
- CTA: quantitative strategy which uses futures to invest in a wide range of financial assets, including equity indices, short-term and long-term interest rates, currencies, and commodities.
- 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.
- RT1s: perpetual bond issues with early redemption possible after 10 years. Coupon payments are discretionary and non-cumulative.

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