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MARKET FLASH: INFLATION REALLY IS DECLINING

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• European inflation was lower than expected. Inflation is falling throughout the continent and across the board (food, energy, goods and services) so there will be less pressure on European monetary policy in 2024.

• We are still upbeat on government bonds as we expect to see rate cuts in 2024. As for corporate debt, we are still keen on carry strategies and we are maintaining our equity upgrade with a more positive outlook.

The rebound in US third-quarter growth was already surprisingly good and now GDP has been revised even higher. Note, however, that growth as measured by GDP has been significantly different in the last 3 quarters, an indication of how fragile this US statistical approach is. There are more and more signs that the US Is slowing: consumer spending has slowed and weekly jobless claims rose the previous week. The Fed's Beige Book confirmed that the economy was facing mounting risks of a slowdown.

But inflation is really slowing. The Fed's preferred PCE index rose 3% in October, its lowest increase since the beginning of 2021. In June 2022, it peaked at 7%. This disinflation is primarily due to falling energy prices and some stabilisation in the prices of goods. It is also reassuring to see that inflation in services, and rents in particular, has been trending lower towards 2%. So much so, that even Fed hawks like Christopher Waller now think that rate cuts are a possibility in 2024, not to prop up the economy but to accompany falling inflation with benchmark rates that match monetary policy rules. All this reinforces our expectation that the Fed has probably finished raising rates and that it now has enough leeway to consider cutting in 2024.

Meanwhile, European inflation was lower than expected. Inflation is falling throughout the continent and across the board (food, energy, goods and services) so there will be less pressure on European monetary policy in 2024. Japan is the only country with higher inflation: consumer price inflation accelerated to 3.3% in October and services were up 2.3%, a 3-year high. Even if Japan's inflation is in no way comparable to levels seen in the US and Eurozone, the Bank of Japan will be under increasing pressure to exit its negative benchmark rate policy. The yen has rebounded since the middle of November for this reason.

Elsewhere, the OPEC+ summit showcased differences of opinion. Saudi Arabia extended its 1 million b/d cuts and managed to persuade others to extend also but no official cartel agreement was reached.

Falling inflation will give central banks more leeway. And since the economic slowdown looks like being a middle-of-cycle phenomenon, we think all asset classes (government bonds, credit and equities) should do well over the medium term. We reduced cash in

portfolios after the early November FOMC -to recognise the fact that the Fed was becoming more flexible- and raised exposure to equities and government bonds.

We are still upbeat on government bonds as we expect to see rate cuts in 2024. As for corporate debt, we are still keen on carry strategies and we are maintaining our equity upgrade with a more positive outlook. Geographically, we prefer US and Emerging Markets equities as a whole: equity market rises will be more widespread than in the past thanks to bigger-than-expected stimulus in China and resilient growth in developed countries. Valuations have jumped over the last month but there are still opportunities in lagging sectors and zones.

EUROPEAN EQUITIES

Falling bond yields and more accommodating comments from central banks in the US and Europe boosted European indices. Reassuring inflation data also helped the trend. European inflation in November slowed to 2.4%, or better than the 2.7% expected. Oil prices were volatile over the week. They rose ahead of Thursday's OPEC summit but fell back when the meeting failed to agree on an official statement. Even so, Saudi Arabia confirmed that it would extend its 1 million b/d cut.

In company news, **Rémy Cointreau**'s profits missed expectations due to a steep fall in US demand and the results of a promotional war. **EasyJet** returned to profit thanks to strong demand but the group sounded a note of caution over instability in the Middle East which had forced it to stop flights to Israel and Jordan.

In IT, France **Capgemini** surprised the market by changing its finance director. In 2024, Carole Ferrand will be replaced by Nive Bhagat, former CEO of **Capgemini** Cloud Infrastructure Services.

New issue momentum continued with video game company Ubisoft raising €500m with a convertible bond due 2031. The Guillemot brothers said they would participate in the concurrent accelerated bookbuilding. The proceeds will go on giving the company some financial flexibility and refinancing debt. French chip material maker **Soitec** raised €72m with a placement of 430,000 shares, or 1.2% of its share capital.

US EQUITIES

Wall Street notched up its best monthly gain in more than a year in November. The Dow jumped 8.7% (its biggest advance since October 2022) while the S&P 500 and Nasdaq gained 8.9% and 10.7%, their best performance since July 2022.

Third-quarter growth in the US was revised up from 4.9% to a 2-year high of 5.2% YoY, another indication of a strong economy.

House prices also proved surprisingly resilient in September, up 0.6% MoM and 6.1% YoY. And for the first time in 4 months, the consumer confidence indicator rose, moving to 102 from 99.1 in the previous month.

Black Friday sales rose 7.5% to $9.8bn, or more than expected. US consumers spent $12.4bn (+9.6%) on Cyber Monday, the biggest daily take ever according to **Adobe** which compiled the data. Average price reductions amounted to 30%, up from 24% in 2022.

Markets were helped by significant easing on Fed Fund futures. They are now factoring in a 45% chance of at least a 25bp cut next March. The probability at the beginning of the week was only 21%.

WTI fell 2.4% to $75.90 after the OPEC summit failed to hold a press conference and reach a unanimous decision on extra output cuts.

In company news, chip producer **Micron** dipped 1.8% after the group cut guidance due to higher-than-expected operating costs.

Software had a good week after **Salesforce** (+9.3%) raised guidance and cloud data management company **Snowflake** (+6.9%) reported an earnings beat.

Ford fell 3.1% on Thursday after increasing the estimated cost of its recent union agreement by $1.7bn to $8.8bn.

On the same day, cancer treatment specialist **ImmunoGen** soared 82% after **AbbVie** paid $10.1bn to acquire it.

Disney will restore a 30 cent dividend per share for the first half of this year.

Tesla unveiled two cybertrucks. The cheapest version will go on sale in 2025 at $61,000, or more than 50% above the price Elon Musk indicated in 2019.

JAPANESE EQUITIES

The NIKKEI 225 edged 0.1% higher and the TOPIX dipped 0.14% as traders reacted to yen shifts, rising when it fell and falling when it appreciated.

The NIKKEI 225 index briefly touched an intraday year high but then retreated on profit taking ahead of the festive season.

Rubber products and metal products rose 2.63% and 1.61%on yen strength. Marine transportation gained 1.41% following a sharp rise in the Baltic Dry Index and value stock buying. On the other hand, pulp & paper fell by 2.82% on a major broker downgrade of the sector's biggest companies. Air transportation shed 2.28% on profit taking. Machinery slipped 1.35% led by **Daikin Industries Ltd** (air conditioners and refrigerators) after a broker downgrade.

Chugai Pharmaceutical gained another 5.63% on a broker buy recommendation. **Recruit Holdings** (human resource technology and staffing) gained 3.83% after **ValueAct Capital Management** in the US bought a stake. **Tokyo Gas** rose 3.53% on lower gas prices and the stronger yen. Elsewhere, **Shiseido** tumbled 9.20% on poor results due to China's struggling economy. **Panasonic** (electronic products) fell 4.40% on profit taking as the yen rallied against major currencies.

The dollar plunged from the mid-149s to the low-147s against the yen after Fed governor Christopher Waller said he thought US interest rates had peaked and that a cut might come earlier than markets expected.

EMERGING MARKETS

The MSCI EM Index was up 0.7% in USD this week as of Thursday. Korea and Brazil closed in line with the broader emerging markets. India and Taiwan edged up 1.88% and 1.86%, respectively, and outperformed, while China (-1.3%) underperformed.

In **China**, November's official manufacturing PMI stayed in contraction territory at 49.4, slightly missing the 49.8 estimate. The private sector oriented Caixin PMI rose to 50.7 from 49.5 previously. Industrial profits climbed for the third straight month, coming in at 2.7%, albeit at a slower pace from September's 11.9% gain. Xi Jinping's Shanghai visit was seen as support for the private sector and markets. Shenzhen released several new measures to promote **NEV**, including a vehicle purchase tax reduction and exemption for **NEV** to be continued. On the geopolitical front, US congressional negotiators are likely to abandon plans to tighten controls on US investment in Chinese technology. The US is also considering changes to rules that limit tax credits for autos using Chinese materials. China is reviewing tariffs on Australian wine which have been in place since early 2021. On the corporate side, PDD third-quarter results were a strong beat thanks to **Temu's** strong growth overseas. **Meituan's** third-quarter results came in slightly above estimates on cost cuts but forward guidance disappointed the market.

Taiwan's **TSMC** is planning a third plant in Japan for 6nm process technology. In Korea, exports rose 7.8% YoY in November, or better than the 5% forecast, while imports dropped 11.6%, or more than the 8.6% expected.

In **India**, 3Q23 GDP growth came in at 7.6%, or ahead of the estimated 6.8%. Core industrial sector output jumped 12.1% YoY in October after 9.2% in September. The cabinet approved a five-year extension of the free food programme for 800 million people. Bank loans continued on their strong growth pattern in October, up 19.7% YoY. Foreign portfolio investments in the domestic debt market hit a 27-month high. India is in talks with **Boeing** and **Blue Origin** on space partnerships. **Tata Electronics** is looking to expand its existing iPhone-casing unit in Hosur by up to twice the current size. **Alipay** sold its 3.4% stake in Zomato. **JSW Group** is to acquire a 35% stake in **MG** Motor India.

Latam showed resilience to high interest rates: in **Brazil**, unemployment fell to 7.6%, or in line with the estimates. The government increased the fiscal deficit to 177.4 bn reais. More than 190,000 jobs were added to the economy last month, sweeping past the 135,000 analysts had pencilled in. **Mexico**'s jobless rate dropped 2.75% in October. **Colombia**'s unemployment rate slid to 9.2% in October, hitting its lowest level since November 2018.

CORPORATE DEBT

CREDIT

Credit markets had an excellent week on the back of tumbling yields. Europe's CPI came in at 2.4% on November 30, suggesting the rate hike cycle had come to an end. Yields on the German 5 and 10-year Bund fell 28bp and 22bp to 2.34% and 2.42%, respectively. Spreads were more or less unchanged at 145bp for investment grade and 430bp for high yield.

New issuance for both corporates and financials calmed down after weeks of exceptionally high volumes but **Piraeus Bank** raised €500m at 6.75% with a senior preferred bond due 2029 and **Phoenix Assurance** raised £350m with a T2 30NC10 at 7.75%. French utility **EDF** raised €1bn with a green bond at 3.75% due 2027 and in high yield, **Crown Holdings** raised €500m at 4.75% with a BB+ issue due 2029. The primary market should gradually dry up as we approach the festive season and reopen in the new year.

Investment grade returned 1.11% over the period, largely because of falling yields, and is now up 5.1% YTD. High yield returned 0.78% (+8.9% YTD). Actuarial yields for investment grade were 4.1% and 7.2% for high yield, or still good entry points for carry strategies.

CONVERTIBLES

November ended well for convertibles after three up weeks in a row. Recent central bank comments led to lower bond yields and tighter spreads, helping equity markets to continue rebounding.

More than €4bn was raised on the new issues market. In the US**, PG&E Corporation** (gas and electricity distribution) raised $1.9bn at 4.25% due 2027 and with a 35% premium.

In Europe, **Bechtle** and **Ubisoft** raised a total of €800m. France's video game maker raised €500m at 2.875% due 2.31 and with a premium of 47.5%. The group also bought back €250m-worth of its 2024 convertible.

Asian deals were concentrated in Japan with 2028 and 2030 maturities from **Kobe Steel**, and 2028 convertibles from **Sosei** and **Sanrio**.

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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