MARKET FLASH: TOWARDS A SLOWER PACE OF RATE HIKES

• The Fed wants to keep monetary policy restrictive throughout 2023, dousing hopes of rapid rate cuts

• Inflation slowed both in the US and in Europe

• We remain neutral on equities and we continue to prefer carry strategies in fixed income

Demonstrations in China against Covid restrictions initially worried investors but government support for property companies and an apparent move towards gradual easing of sanitary conditions helped calm nerves. Chinese equities bounced sharply but the move had only a marginal impact on developed markets. Only oil started rising again after several weeks of declines. US and European markets were underpinned by Jerome Powell's comments on Wednesday that the pace of interest rate hikes would slow, starting with the FOMC meeting this month. Nevertheless, he said that he wanted to keep monetary policy restrictive throughout 2023, dousing hopes of rapid rate cuts.

Economic data reinforced the idea of slower rate increases. Inflation slowed both in the US and in Europe. In the eurozone, it slowed from 10.6% over 12 months in October to 10% in November, mainly thanks to energy price falls since the summer. However, core inflation was stable and still high at 5%. In the US, the Fed's preferred inflation gauge, the Personal Consumption Expenditures index or PCE, fell from 6.3% YoY in September to 6%. Core inflation also fell from 5.2% to 5%. At the same time US jobs data gave conflicting signals. Job vacancies fell and the Challenger survey pointed to a steep rise in layoffs, mainly due to cost-cutting. But nonfarm payrolls rose more than expected in November and so did hourly wages. Advanced ISM indicators for November also showed a slowdown in manufacturing, new orders, prices paid and jobs. Over the week, government bond yields eased by around 20bp in the US and Europe, a reaction to Jerome Powell's comments and the economic slowdown but they headed north again after the jobs data.

We remain neutral on equities. We prefer emerging country equities and are cautious on the eurozone after its recent outperformance and more challenging conditions since the euro rallied. In fixed income, we continue to prefer carry strategies. In government debt, we favour US duration to the eurozone. The ECB will have to deal with stubbornly higher core inflation.

EUROPEAN EQUITIES

Markets trended higher but at a slower pace. Improved risk appetite continued to boost highly cyclical stocks while the “end-of-rate-hikes” narrative drove high duration picks like technology.

Gas consumption data showed that demand destruction had really started in Europe. The EU's targeted 15% drop in consumption was easily beaten. The data suggest Europe could get through this winter but the outlook for fourth-quarter GDP is worrying. Note that although Europe plans to reduce its dependency on Russian gas, Norway has postponed new gas exploration and production permits for 3 years, a move that can only accentuate the midterm problem with replacing Russian gas. Even so, Germany's third-quarter GDP was revised up from 1.1% YoY to 1.2%, a reassuring development for household spending. It suggests some households can still afford to dip into savings and that wage increases for others are helping consumption to hold up at lofty levels.

In company news, **BMW** paused several production lines in Germany and said it was worried about the possibility of additional restrictions. The group said there was poor visibility on Berlin's capacity to engineer an exit from the crisis. In aerospace, **Airbus** might have to revise down its 2023 forecasts due to persistent supply chain problems.

In M&A, **Sanofi** said it had begun tentative bid talks with Horizon the US pharma company. **LVMH** acquired the Pedemonte group, a jewellery maker based in France and Italy. **Heineken** (beer and spirits) gave reassuring guidance on growth in 2023. Lower volumes in Europe could be offset by growth in other geographical zones.

US EQUITIES

The S&P 500 ended the period up 1.22% while the Nasdaq gained 1.75%. Since its October 14 low, the S&P has jumped 14%.

Both indices were buoyant after Jerome Powell's comments on Wednesday that the pace of future rate hikes could slow. He suggested that this month's FOMC could decide on a 50bp rise. Nevertheless, monetary policy is set to remain restrictive for some time and until there are real signs of inflation slowing.

Jobs data would seem to make a soft landing possible. According to ADP, the private sector only created 127,000 jobs or less than the 200,000 expected.

Jerome Powell also said that the Fed did not want to trigger a hard landing with an over-restrictive monetary stance, the first sign of a change in central bank priorities.

Elsewhere, the House of Representatives presented a bill to avoid a national rail strike from December 9. The Senate will debate this issue immediately but could refuse to approve a measure to increase sick leave.

The first indications on Black Friday sales showed only a 2.3% YoY rise in e-shopping despite significant special offers. The most sought-after items were **Apple** products like the AirPod, MacBook and Apple Watch as well as the PS5 and Xbox Series X consoles.

Tesla shares rose after its Chinese sales doubled in November thanks to lower prices for the 3 and Y models. Elon Musk's start-up **Neuralink** said it would start testing brain chip implants on humans within the next 6 months.

Horizon Therapeutics, a rare autoimmune disease specialist, soared 27% on Thursday after revealing that it was in talks to be bought either by Amgen, Sanofi or a Johnson & Johnson subsidiary.

Blackstone limited withdrawals at its $125bn property fund. Only 43% of redemptions were approved in November. The stock tumbled 7% on the news.

JAPANESE EQUITIES

The NIKKEI 225 and TOPIX fell 0.55% and 1.60% over the period on 1) profit-taking as indices flirted with August highs, 2) concerns on Zero Corona Policy protests in China and 3) hawkish comments from US Fed officials. However, markets rebounded sharply on December 1 on the back of Fed Chairman Powell's comment on a possible slowdown in policy rate rises at this month's monetary policy meeting

Marine Transportation rose 3.07% as freight rates bottomed out and investors continued to buy high dividend yield stocks. Air Transportation and Land Transportation gained 1.02% and 0.17% on increasing domestic travel thanks to the Nationwide Travel Discount Programme and more foreign visitors after border controls were eased.

Electric Power & Gas fell 3.27% on news that 3 major electric power companies will be ordered to pay record surcharges for violating the Antimonopoly Act. Real Estate and Wholesale Trade slipped 3.19% and 2.85% on profit taking.

Food company **Ajinomoto** gained 5.56% on price rises along with strong guidance for 2023. In pharma, **Eisai**, added 3.11% thanks to its joint research project with Shimadzu for the early detection of Alzheimer's disease. **First Retailing**, a clothing company, rallied 2.74% after recent falls.

M3, a healthcare platform provider, and **Sumitomo Realty & Development** fell 5.95% and 4.58% on a broker downgrade. **Kansai Electric Power** lost 4.51% for breaching the Antimonopoly Act although the company escaped administrative punishment as it voluntarily reported the case.

The yen continued to rally against the dollar, moving from 138.54 to 135.35 yen as US Treasury yields fell on weak US economic data and Jerome Powell's dovish comments.

On November 29, Health Minister Kato said Japan would consider reclassifying COVID-19 as a less-severe infectious disease like winter flu. If that happens, government authorities would drop their requests to the public to refrain from going out and restrictions related to work and business operations would also no longer apply.

EMERGING MARKETS

The MSCI EM Index had outperformed the developed market by almost 4% as of Thursday's close. China led, rebounding strongly by 8.5% as more cities eased Zero-Covid control measures. India gained 2.7%, while Brazil rallied by a further 5.5%.

In **China**, November's Manufacturing PMI remained in contraction territory at 48, or weaker than the 49 expected and down from 49.2 in the previous month. Non-Manufacturing PMI was short of expectations, down to 46.7 vs 48 expected and 48.7 in October. The CSRC announced five measures to facilitate equity financing for property-related companies. The government also asked its top four state-owned banks to issue offshore loans to help developers repay overseas debt. China CDC hosted a media conference focusing on promoting Covid vaccinations to old people. More cities -Beijing, Guangzhou, Shijiazhuang- started to ease restriction measures, despite record daily Covid cases.

Meituan's third-quarter results beat market expectations, especially on margins. Both order volume and monetisation rate in core delivery services posted resilient growth. **PDD** delivered better-than-expected third-quarter revenue growth, unlike its competitors. Topline growth at **BiliBili** was in line with estimations but net profit beat on stricter cost controls in marketing and other investments. **Moutai** announced its first special dividend payout since its listing and said its controlling shareholder Moutai Group plans to increase its stake through a share buyback.

Macau's government renewed the licenses of the city's six operators for another 10 years. **Taiwan** President Tsai Ing-wen resigned as head of the ruling party following local election losses. **South Korea**'s exports in November fell 14% YoY, or worse than expected, their worst annual drop in 30 months. The decline was due to cooling demand in major markets led by China and a downturn in the semiconductor industry. As expected, **Thailand**'s central bank hiked its key interest rate by 25bp to 1.25%.

India grew 6.3% YoY in the third quarter, or slightly above the 6.2% expected. Private consumption made a strong contribution. November Manufacturing PMI was 55.7, up from 55.3. **Singapore Air** and **Tata Sons** agreed to merge Air India and Vistara, creating India's largest international and second largest domestic airlines.

Brazil, grew by 0.4% in the third quarter, or slower than expected as higher interest rates hit household spending. The unemployment rate fell to 8.3% in the three months ending in October.

Mexico's third-quarter GDP was up 0.9%, boosted mainly by the primary sector and despite the ongoing aggressive monetary tightening cycle. It posted a record $5.36bn in remittances from US workers in October. The government announced a 20% increase in the minimum wage from 2023

Supply chain relocation: **TSMC** is reportedly to offer advanced 4-nanometer foundry services when its new $12bn plant in Arizona opens in 2024. This represents an upgrade from its previous public statements.

CORPORATE DEBT

CREDIT

The rally continued, boosted by Jerome Powell's markedly less hawkish comments. The Fed is now expected to slow the pace of rate increases when the FOMC meets this month. On the other hand, it will probably indicate a higher terminal rate than in September and say that restrictive levels will be with us for some time.

In any case, yields on the 10-year German Bund eased by 12bp while the Xover tightened by 16bp and the Main by 5bp. This left the investment grade credit index 1.07% better between Monday and Thursday while high yield returned 0.3%.

In company news, property company **Aroundtown** eventually decided not to call its 3.75% Perpetual bond (Call January-23). The news caused other property company hybrid bond issues to be repriced.

In third-quarter results news, **Picard** not only posted a sold 4.2% rise in sales but also a 5.3% increase in its gross margin, a sign that the group managed to pass on inflation.

Sales at **Atalian** (facility management) also rose by a creditable 9.5% to €809m but liquidity worsened with €86m in free cash flow consumption over the quarter. The group also suffered from the delay in its sale to the CD&R private investment fund which was due to close on December 16.

Casino Guichard (supermarkets) continued to reduce leverage by selling its 10.5% stake in Brazil's Assai (cash and carry) for €490.8m.

Like the rest of the market, financial bonds benefited from falling bond yields. The 10-year Bund yield dropped from 1.97% last Friday to 1.78%. Credit premiums remained stable overall after tightening significantly in October from a 1,300bp peak. For Euro CoCos they traded between 790 and 800bp. For senior debt, they improved by 5bp to 195bp.

Financial new issuance remained robust but, for a change, there were two large hybrid corporate deals. **EDF** sold a 7.5% perpetual non call 6 raising €1bn and **Orsted** a 5.25% perpetual non call 6 (€500m). We noted **Eurobank**'s T2 issue at 10%. And **Investec** sold a sterling T2 bond at 9.12%.

Pending its looming increase of capital, **Credit Suisse**'s share price plunged 12% over the period and its CDS traded above 400bp in spite of the CEO's claims that outflows were coming to an end.

CONVERTIBLES

Another week, another new convertible deal. Spain's **Iberdrola** raised €450m with a Senior Green convertible due 2027 which came at a 20% premium. The proceeds will go on refinancing eligible green projects. November's global issuance totalled $7.2bn, the best month this year, mainly driven by the US and Europe.

Along with the broader market move, secondary market activity picked up after Jerome Powell's latest comments. Activity was also driven by earnings announcements. Software company **Okta** jumped more than 25% on Thursday after stronger-than-expected fourth quarter forecasts. It was the same trend for **Splunk**, whose third-quarter results came in ahead on all guided metrics and delivered annual recurring revenue (ARR) for the quarter that was in line with consensus estimates. The full year free cash flow outlook was raised by $20m thanks to CEO Gary Steele reinforcing expense management discipline.

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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