EDMOND DE ROTHSCHILD

MARKET FLASH: THE ECONOMY OVERSHADOWS THE US PRESIDENTIAL LINE-UP

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• The environment is still upbeat for risk assets given economic momentum in the US and less risk of a lasting recession in the eurozone.

The Super Tuesday result was crystal clear: barring some surprise event, Joe Biden will face Donald Trump in November's presidential election. For the moment, the news has had little impact on markets. Investors are more focused on the economy and inflation and when central banks will move.

In the US, growth is still resilient but statistics are delivering slightly fewer pleasant surprises. Manufacturing ISM fell in February after rebounding in January. Services ISM also edged lower and missed expectations even though it stayed above 50. It was affected by the jobs and prices paid components (new orders rose). In contrast, European ISM data was revised higher but the overall level was still low, certainly in Germany and, to a lesser extent, in France. For the Eurozone, Composite ISM moved back above 50 to 50.2.

After its monetary committee meeting, the ECB said it would watch wage moves closely before confirming the down trend in inflation. Its latest comments suggest a rate-cutting cycle could start in June. The next FOMC is scheduled for March 20 but chair Jerome Powell appeared this week before Congress. He too wants to be more confident inflation is really trending down towards 2% before the Fed shifts monetary policy. He reiterated that rates would probably fall this year but that the number of cuts would depend on the economic environment.

Japan is an exception. With the gradual end of electricity subsidies, inflation bounced to 2.5% after a 1.8% low in January. The increase should warrant a rate rise and an exit from the negative rate regime but the Bank of Japan wants to act cautiously.

As for our asset allocation, the fact that the ECB has revised its growth/inflation scenario lower means we continue to be overweight fixed income, notably at the short end and middle of the eurozone yield curve.

We expect to see an ECB rate cut in June as the bank says it will have more visibility in June than in April. We are still underweight US Treasuries as there is more risk of a bounce in inflation there than in Europe. We remain neutral on equity markets even though risk premiums are now more stretched and liquidity is less favourable. The environment is still upbeat for risk assets given economic momentum in the US and less risk of a lasting recession in the eurozone.

EUROPEAN EQUITIES

European stock markets gained significant ground over the period, driven by a resolutely dovish tone from the ECB. Christine Lagarde may not have cut rates but her comments suggested the inflation outlook was more favourable than expected and that the economy was performing in line with the bank's targets. Government bond yields then fell sharply. The bank said it wanted to see inflation returning to 2% before easing but its approach remains data driven and it hopes to have better visibility in April, and even more so in June.

Logically, interest-rate sensitive sectors like property, tech and utilities benefited the most. Healthcare was pushed higher by Denmark's **Novo Nordisk**, a European index heavyweight, after positive clinical trials of its new obesity drug. Novo Nordisk is now the biggest market cap in Europe, followed by **LVMH** in second place.

The luxury sector is doing well. Growth at **Prada** in the fourth quarter was 18% on a constant currency basis, or in line with sector stars like **Hermès**, **Zegna** and **Brunello Cucinelli**. But more mass market players are struggling. **Hugo Boss** fell sharply after revising down its 2024 objectives. The group said inflation was eating into purchasing power.

Lufthansa echoed this view. The group sees operating profits treading water with stronger demand offset by the impact from strikes and higher fuel prices. **Deutsche Post** also sold off after poor fourth-quarter results and management caution over the outlook due to no positive indications in its logistics division, an area often seen as a barometer of global growth momentum.

On a brighter note, **Scor**'s profitability and solvency ratios improved, a token of the insurance sector's good health. The group also raised its dividend thanks to rising premiums and lower catastrophe claims.

US EQUITIES

The S&P 500 edged 0.4% higher over the period, driven by strong performance from semiconductors. **Nvidia** moved above the $2 trillion market cap mark for the first time.

Among the last big caps to report quarterly results, retailer **Target** gave investors a pleasant surprise by revising its sales guidance higher. Unlike **Costco** whose fourth-quarter revenues missed expectations.

Mastec (engineering and construction) bounced sharply after reporting strong cash flow in the fourth quarter and a bulging order book for the coming quarters. The group also sees EBITDA margins rising this year. US lithium producer **Albermale** fell after announcing its results and issuing a convertible. The sector is now trading at its lowest levels since 2021. In software, fourth-quarter results at **CrowdStrike** (cybersecurity) beat expectations and the company raised guidance for this quarter. In semiconductors, **Broadcom**'s results were mixed but they showed that AI demand was stronger than forecast. **Marvell** posted disappointing infrastructure and corporate sector figures.

In the latest New York Community Bank development, the bank said it had raised $1bn from a group of investors including Steven Mnuchin's investment firm.

In IPO news, **Reddit** is expected to go public before the end of March. The company is valued at $6.5bn, or less than its pre-Covid valuation. An IPO in the US from Swedish fintech **Klarna** is also expected before the end of this year.

JAPANESE EQUITIES

The NIKKEI 225 and TOPIX rose by 1.10% and 1.60%, respectively. In February, the Japanese equity market performed strongly. The faster-than-expected market rise was driven by expectations of a delayed rate cut in the US, yen weakness, and anticipation of strong AI demand. The NIKKEI 225 hit 40,000, up about 22% in the two months since January 4th.

So far in March, the NIKKEI 225 has stayed around 40,000, slipping to 39,600 on March 7th. Investors are seeing a dramatic change in Japanese equities, a situation which is likely to continue as foreign investors rerate the market. There is also lots of liquidity. The uptrend may look to some extent like a bubble but there is no irrational exuberance. Of course, semiconductor stocks appear to be somewhat overvalued so were the Bank of Japan to exit negative interest rates at its March Meeting, there is still a risk that the market could see temporary shocks.

The yen remained stuck around 150 against the dollar from February 29th to March 5th. US long-term interest rates fell in response to Fed chairman Jerome Powell's testimony to Congress and US employment indicators. The yen then traded around the 148-149 level as the interest rate differential between Japan and the US narrowed.

EMERGING MARKETS

The MSCI EM Index was up 0.57% this week as of Thursday. **Taiwan** (+5.88%) continued to outperform due to AI stocks. **India** rose 0.8%, while **China** (-2.23%) underperformed. **Mexico** and **Brazil** were down by 0.53% and 0.31%, respectively.

China exports rose 7.1% YoY in the first 2 months, or ahead of the1.9% rise expected. Imports were up 3.5%and also better than the 2% forecast. NPC unveiled its 2024 economic development plan with a 5% GDP growth target and 3% fiscal deficit, both in line with market expectations. Policymakers reiterated their supportive stance, hinting at more room for further RRR cuts while rolling out a large-scale consumer goods and equipment upgrade programme. The US Homeland Security Committee approved the Biosecure bill that could restrict business with Chinese biotech companies on national security grounds. Elsewhere, **AstraZeneca** signed an agreement to build a plant in **Wuxi**'s high tech zone. **Nio** reported widening net losses in the fourth quarter of 2023 and weak guidance for the current quarter. **JD** delivered a beat with revenue growth at 4% YoY; the company also surprised the market with a newly approved share buyback programme. Fourth-quarter figures at **Bilibili** were in line and the company gave an incrementally positive outlook and is targeting operating margin break even in the third quarter of this year.

Taiwan's exports over the first two months of this year hit $68.6bn, +9.7% YoY. **TSMC** received CIS orders from **SONY** for its new fab, which may contribute to earnings in the fourth quarter. Its 3/4nm capacity is reportedly fully booked by **NVIDIA**'s latest AI accelerators H200 and B100.

In **Korea**, February exports were up 4.8% vs. 1.4% expected. **Samsung SDI** announced plans to begin mass production of solid-state batteries for EVs and other applications in 2027.

In **India**, Composite PMI remained strong at 60.6, while services PMI moderated slightly from 62 to 60.6 in February. GST collection in February surged 12.5%, thanks to the automobile sector (highest monthly sales) and manufacturing. India's power consumption rose 8% in February vs. 7% in CY23. **Tata Motors** approved a proposal to demerge its businesses into two separate listed companies, housing commercial vehicle and passenger vehicle business.

Kaynes Technology signed a binding Technology Provision pact with **ISO Technology** to set up a supply chain for OSAT business in **India**.

In **Brazil**, **Toyota** confirmed it would invest $2bn by 2030. Mercado Pago increased the yield on current account deposits to 105% of CDI.

CORPORATE DEBT

CREDIT

Markets trended higher in a week marked by ECB comments that suggested a rate cut was due in June. The bank also said that it should hit its 2% inflation target by the beginning of 2025 and hoped to see 2.3% in the coming quarters. Bond yields eased significantly. Between the March 1st close to the March 8th open, yields on the 10-year German Bund fell by 13bp to 2.28% and to 2.79% on the 2-year Bund.

Investment grade spreads were unchanged at 120bp, and at 350bp for high yield. However, the Xover broke below 300bp and hit 294bp when trading started on Friday March 8, a token of investor appetite.

Largely oversubscribed new issues indicate that credit market inflows are still massive, allowing issuing companies to tighten coupons on new bonds. This week, **Telefonica** raised €1.1bn with a perpetual hybrid bond at 5.75% and **Orsted** €750m with a perpetual hybrid at 5.125%. In financials, **NN Group** raised €750m with an RT1 at 6.375% and Italy's **Banco Sondrio** raised €300m with a new T2 bond 10NC5 at 5.5%.

In earnings news, Germany's **LBBW** and **Deutsche Pfandbriefbank** reported upbeat results. Both had caused concern among investors due to their exposure to US property but they reassured markets that they could set aside provisions without harming their capital bases. **PBB** reduced its dividend but continued to pay out coupons on its AT1 debt.

Investment grade returned 0.13% over the week (-0.25% YTD) while high yield gained 0.68%, or +1.46% since January 1st thanks to spread resilience.

CONVERTIBLES

Convertibles moved even higher thanks to buoyant equity markets.Wall Street continued to be driven higher by tech stocks. **Nvidia**, for example, jumped 12% over the period. However, despite good results from **CrowdStrike**, cyber security stocks like **Palo Alto** and **Zscaler** lost ground.

In Europe, **Spie** and **Saipem** gained 6 and 8% over the week. **DPost** and **Nexi**, in contrast, tumbled 7 and 6%. **AMS** said a big project involving two factories in **Kulim** (Malaysia) had been unexpectedly shelved and that it would have to provision €600-800m in this quarter, albeit with no impact on its cash position. Nevertheless, mid-term growth guidance was slashed. The market thinks the project concerns micro-LED screens for the **Apple** watch, a facility that was meant to be operational in 2026. Management is now considering selling the factory's second phase after investing €800m in it in 2022.

On the primary market, $6.5bn was raised in the first week of March taking year-to-date issuance to $21bn. The pace is particularly strong in the US and almost all new deals this week were based there. The US alone has raised $17bn since January 1st.

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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