EDMOND DE ROTHSCHILD

MARKET FLASH: UNCERTAINTY IS THE WORD OF THE WEEK

- **In France Michel Barnier's government fell, ushering in a fresh bout of uncertainty. The technical government option now seems to be the most likely scenario. However, peripheral eurozone countries are enjoying some momentum, which has offset the negative impact of French and German difficulties.**
- **Economic indicators in the US are still buoyant but less so as the economy gradually returns to normal.**
- **In China, the situation is improving but gradually, with the Caixin manufacturing PMI rising for the second month running.**

In France Michel Barnier's government fell, ushering in a fresh bout of uncertainty. The leftist NFP coalition and the National Rally on the extreme right clubbed together to get a no-confidence vote approved after the government rushed through a social security financing bill. The technical government option now seems to be the most likely scenario as no political grouping has a majority in the French parliament. If no social security bill or 2025 budget is passed before the end of December, a special law to carry forward this year's budget could be approved in parliament by virtue of article 47 in the Constitution. The ministry of finance is already working on the text. It would mean that the same taxes would be levied each month by simple decree. It would also allow the government to sell bonds, make contributions to the European budget and continue spending. Unless special corrective measures are introduced, this scenario would, in the opinion of the outgoing administration, take the deficit from this year's 6% to 7%, or worse than the 5% Michel Barnier had previously envisaged for 2025.

However, investors do not seem to be panicking as the chance of a complete budget freeze is still low. The OAT-Bund spread initially widened by 10bp after the government fell but then narrowed to 80bp. The CAC 40 index even rose, albeit less than other European indices.

The fact that peripheral eurozone countries are enjoying some momentum -high productivity and attractive labour costs- has offset the negative impact of French and German difficulties. Nevertheless, political tension in France and Germany could dampen the eurozone's economic rebound. In this case, the ECB could be encouraged to assume an accommodating monetary stance in 2025.

Meanwhile, economic indicators in the US are still buoyant but less so as the economy gradually returns to normal. Manufacturing ISM rose to 48.4, or better than the 47.5 expected and services ISM stayed above the 50 level even if it came in at 52.1, instead of the 55.7 pencilled in by analysts, due to new orders and unemployment. Recent jobs data reflected robust conditions. Unfilled positions rose to 7.74 million, or more than the 7.52 expected. The vacancies/unemployed ratio was unchanged at 1.1 which suggests the jobs market is normalising. That said, Donald Trump's immigration policy could result in a new jobs shortage and drive wage and inflationary tensions. Elsewhere, the Beige Book presented a moderate vision of the economy: stable activity and rising optimism among companies even if they are struggling to pass on higher costs. Several Fed officials are in favour of a rate cut but they are still cautious due to political uncertainties ahead. Jerome Powell thinks the fact

that the economy is doing well gives the Fed time to decide, even if it has to keep on eye on persistent inflation.

In China, the situation is improving but gradually. Thanks to an increase in new orders, Caixin manufacturing PMI rose for the second month in a row to 51.5, its highest level since June. The rise was in part driven by fears of future customs duties from the Trump administration. China's equity markets also rose on fresh press reports that Beijing was preparing more stimulus for goods made in the country. Note that services, which have benefited less from government schemes, slowed in November according to the Caixin PMI survey.

In our portfolios, we are still fully invested in equities, with a positive tactical score, and continue to prefer the US. In fixed income, we still like carry, especially in investment grade. We prefer exposure to European companies as they should benefit from further rate cuts as disinflation proceeds.

EUROPEAN EQUITIES

France took centre stage this week as Michel Barnier's government collapsed after a no-confidence vote. The situation could be serious for French companies. **Safran**, for example, issued guidance below expectations for 2028 due to worries Paris would have to roll over this year's defence budget. But despite this political uncertainty, European equities managed to rise. Cyclicals like autos led gains. The sector bounced from losses incurred after **Stellantis** CEO Carlos Tavares was sacked by the board after disagreements over strategy. Even so, the entire autos sector is suffering from poor profitability.

In tech, Dutch semiconductor giant **ASML** maintained guidance on net sales for 2025 at €30-35bn in spite of export restrictions. Management thinks China will account for 20% of sales. In material, **Saint-Gobain** sold its pipe business subsidiary to Bpifrance and a French investment fund. The sale was expected as it featured in the group's Grow & Impact strategic plan.

The decision by **BNP Paribas** to acquire **AXA**'s asset management business seems to have started a trend: **Amundi** has now expressed an interest in **Allianz Global Investors**. The combined entity could have €2.75 trillion under management. Elsewhere, various private equity funds including **Bain** are eyeing **Worldline**, a company which is now trading at a significant discount to its payment company peers.

US EQUITIES

The move away from market concentration on Wall Street paused for breath. The Nasdaq gained more than 2% over the period and the S&P 500 ended 1% better while the Russell 2000 fell by almost 2%. The Magnificent 7 grouping is back on form and breaking above highs seen over the summer.

A few late third-quarter results were announced over the week: software company **Okta** gained ground even if its results were unspectacular and suggested growth was continuing to lose pace. On the whole, it was a good week for software plays, thanks in part to **Salesforce** which raised guidance on growth, free cash flow generation and margins for 2025. **Veeva** (healthcare software) reported strong earnings and reassured investors on its growth prospects up to 2030. One exception was **SentinelOne** (cybersecurity) which fell after reporting disappointing third-quarter figures. **Synopsys**, the leading semiconductor software provider, issued lower-than expected revenue guidance and the news led to a drop in the sector's value chain. In cosmetics, **Ulta** delivered a positive surprise after sales rose slightly when they were seen falling. The recovery in 2025 could come sooner than expected.

December is a favourite investor day month: **AT&T** said it was stepping up fibre investments. **ZipRecruiter** said it expected current hiring difficulties to persist over the medium term due to poor confidence levels among companies. **Toast**'s share price fell after the company's guidance on gross margins was below investor expectations. **UnitedHealth**'s investor day was cancelled after its CEO was murdered as he left his hotel to go to the conference centre.

On a brighter note, **Google**'s self-driving taxi service **Waymo** is due to start operations in Miami in 2026; the share prices of **Lyft** and **Uber** fell as investors weighed the consequences for them.

In consumer spending news, online Thanksgiving sales jumped 14% this year.

EMERGING MARKETS

The MSCI EM index was up 2.2% this week as of Thursday's close. Taiwan and Mexico rebounded from last week, jumping 6% and 4.2%, respectively. India (+2.5%) continued to outperform. Brazil gained 1.1% and China 0.9%. Korea retreated by 2.3% on domestic political uncertainty.

In **China**, both official and Caixin PMI were above 50, 52.3 for the Caixin composite, vs. 51.9 in October. The annual Central Economic Work Conference is planned to kick off on December 11 to map out economic targets and stimulus plans for 2025. The PBoC also boosted the market with support for buyback loans and raised the financing ratio for buyback loans from 70% to 90%. The US announced the addition of 140 firms to its Entity List, reinforcing restrictions on China's semiconductor sector. Beijing retaliated by banning exports of some military materials to the US, including some rare earth metals that were already restricted. The latest property sales data indicated that the land area of new homes sold in 4 tier-1 cities rose 5% MoM in November, +57% YoY. New home sales in 2nd/3rd tier cities are still low, but with a YoY improvement. Gross gaming revenue in Macau's casinos was up 15% YoY to reach 81% of 2019 levels. **BYD**'s second export ship went into operation, transporting 5,000 EVs over to Europe.

In **Taiwan**, **Nvidia** is working with **TSMC** and other suppliers on the development of the next-generation Rubin chip, originally scheduled to debut in 2026. TSMC is reportedly trying to produce Blackwell chips at its Arizona fab.

Korea's market was hit by political uncertainty following President Yoon's fleeting imposition of martial law. November trade data showed signs of slowing momentum, with exports up 1.4%, or below the 2.8% expected.

In **India**, the RBI decided to leave rates unchanged at 6.5% as expected but cut the cash reserve ratio by 50bp. GDP rose 5.4% in the third quarter, or less than the 6.5% expected. The government is planning to raise the Goods and Services Tax (GST) on select goods such as cigarettes, by introducing a new slab of 35%.

Brazil's government is reportedly discussing whether to raise ICMS for international purchases from 17% to 25%, meeting the demands of national retail, but with a direct impact on the prices of international platforms such as **Shein**, **Shopee** and **AliExpress**. The Brazilian Mines and

Energy Ministry appointed **Petrobras** chairman Pietro Mendes to a senior position at oil regulator ANP.

In **Mexico**, the government announced a 12% minimum wage hike for 2025 to combat poverty.

In **Argentina**, the central bank lowered rates from 35% to 32% on lower inflation expectations, the 8th cut since Javier Milei assumed office in December 2023.

CORPORATE DEBT

CREDIT

With the year-end in sight, money continued to pour into the corporate debt segment. According to JP Morgan's statistics, inflows this week amounted to €2bn (€1.2bn in investment grade and €500m in high yield). Since January 1st, investment grade has taken in close to €38bn and high yield more than €13bn. Brokers point to an extremely powerful technical factor, i.e. more and more buyers and fewer sellers.

Spreads reflected this trend with Euro CoCos narrowing by 10-15bp over the week. Investment grade tightened by 6bp to 100bp and high yield by 20bp to 310bp. As is normal at the end of the year, new issuance slowed.

Euro Investment Grade returned 0.18% over the period (+3.93% YTD) and Euro High Yield gained 0.47% (+8.5% 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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