EDMOND DE ROTHSCHILD

# MARKET FLASH: MARKETS ENJOY A BREATH OF FRESH AIR

- **Underlying inflation in the US has slowed more than expected.**
- **In the United States, investors are now anticipating a rate cut in June rather than October.**
- **The fall back in Treasury yields revived equity markets, with European indices doing particularly well.**

**Markets were starting to sag due to high government bond yields, and real yields in particular, but then better-than-expected US consumer inflation triggered a rally. Underlying inflation was 0.2% MoM, or less than the 0.3% expected, taking the tally over 12 months to 3.2% when analysts were going for 3.3%. This was largely due to services ex shelter, a sub-index on which the Fed keeps a very close eye. The news helped stifle doubts over future rate cuts. Investors are now expecting the next move lower in June rather than in October and yields on 10-year Treasuries tumbled 16bp to 4.60%. Fed officials speaking in recent days welcomed the figures. Christopher Waller struck a particularly accommodating tone by suggesting the Fed might cut in March and make three adjustments this year. This is, however, not the majority view on the rate-setting committee. Most members are concerned about the possible inflationary effects of Donald Trump's programme but US indicators continued to suggest the economy is already running hot even before he takes office. The Atlanta Fed's GDPNow has been revised up to 3% for the fourth quarter amid an acceleration in consumer spending.**

**The fall back in Treasury yields revived equity markets, with European indices doing particularly well. Bond markets naturally rallied and even in the UK where inflation unexpectedly fell while remaining above the Bank of England's target. UK growth, on the other hand, offers a big contrast with the buoyant US: retail sales data were disappointing and there are worries over stagflation. Even so, investors think the BoE will be forced to cut despite inflation so as to offer some stimulus to the economy. 91% now think there will be a move this month compared to 60% at the beginning of the week.**

**One of the factors keeping total inflation above central bank targets is the oil price. Crude Brent moved above $81 to levels not seen since last July. Oil prices were already rising because of higher gas prices and strong demand and they made further gains when President Biden unveiled fresh sanctions against Russian oil groups, the broadest plan since the war in Ukraine started. The move will disrupt supplies to China, and especially to India, with both countries being forced to find more expensive alternatives.**

**We are sticking with our neutral view on equity markets as there is for the moment no visibility on Donald Trump's measures and their impact on government bond yields. In fixed income, we prefer investment grade corporate debt.**

## EUROPEAN EQUITIES

In a slow week for economic data, inflation in France and Italy came in at 1.3% in December, or in line with expectations. The Stoxx 600 jumped by more than 2% over the period thanks to the luxury sector, communication services, property and financials. Defensives like consumer staples and healthcare underperformed.

The surge in luxury plays was triggered by **Richemont**'s impressive figures. The group enjoyed a much bigger recovery in the US than expected. Sales overall rose 10% when analysts were going for a meagre 1% rise. Sales in Europe were also strong but they continued to fall in China. The stock soared 16% and galvanised other luxury plays like **LVMH** (+9%), **Hermès** (close to 5%) and **Kering** (+6 %).

In telecoms, **Cellnex** announced a share buyback programme for a maximum of €800m, or around 3% of its market cap. This follows its decision to leave Ireland with completion due at the end of the quarter. The stock rose by more than 10%.

French naval engineering firm **Gaztransport et Technigaz** won an order for six large tankers, each with 271,000 m³ in capacity. The deliveries will be made from mid-2028 to end 2031. These tankers are exceptionally large -standard tankers hold 174,000 m³- so the order positions the group as an essential player in large scale tanker construction.

## US EQUITIES

At the end of the first week in the earnings season, the Russell 2000 had jumped 3.3%, the S&P 500 was 1.71% better and the Nasdaq 100 had gained 1.5%. The catalyst was provided by strong bank earnings and inflation which came in at 0.2%, or below the 0.3% expected.

Every major US bank beat expectations and they all expect companies to step up borrowing to fund future growth. **Citi** ended the period 7.9% higher after unveiling a $20bn share buyback representing 13% of its market cap. **JP Morgan** gained 4.1% and **Goldman Sachs** surged by 8.9%. The results reflected very strong growth in investment banking and trading.

In tech, quantum computing stocks rebounded from last week's sell-off following unfavourable comments from **NVIDIA**'s CEO. The bounce was prompted by good news from **Microsoft**. Doubts over the future growth pattern for data centres emerged following the CES 2025 but **McQuarie** invested $5bn in **Applied Digital** (+15.7%) to build AI infrastructure. Nevertheless, tech hardware plays remained under pressure and **Apple** fell 2.6% with **Texas Instruments** down 1.9%.

In software, **TikTok** could be in an awkward position if the US Supreme Court upholds a law to ban its use in the US. There are now rumours that **ByteDance** might sell the network to Elon Musk or to **Amazon**.

At **JP Morgan**'s Healthcare Conference, Medtech companies like **Medtronic** (+6.6%) or **Intuitive Surgical** announced upbeat results and favourable guidance for this year. Deal making in the sector continued with **J&J** bidding $14.6bn for **Intra-Cellular Therapies** and **Biogen** offering $450m for **Sage Therapeutics**. The CMS unveiled some good news for the HMO sector with a 2.92% increase in Medicare reimbursements, or more than the zero-to-2% rise expected. **UNH**'s results, however, contrasted with the news as it reported a disappointing medical loss ratio which will hit its operating margins. Finally, **Eli Lilly** disappointed with quarterly sales of its obesity treatment, which came in below expectations.

## EMERGING MARKETS

The MSCI EM index had rebounded 0.9% this week as of Thursday's close. Brazil and China outperformed, gaining 3.6% and 2.8%, respectively. Korea also gained 1.3% while India shed 1%.

In **China**, GDP growth in the fourth quarter accelerated to 5.4% YoY (consensus: 5.0%, 3Q: 4.6%), Industrial output was up 6.2% YoY in Dec, ahead of the 5.4% expected. Retail sales were also slightly better than forecast, up 3.7% YoY. Exports in December accelerated due to a potential front loading effect amid trade tensions; they rose 10.7% YoY in USD vs. 7.5% estimated, and +6.7% in November. Imports rose 1%, the strongest move since July 2024. On the geopolitical front, the US added 37 companies to its UFLPA list. Joe Biden's latest chip control sets limits based on specific tech in an effort to stop **TSMC**/**Samsung** from making AI chips designed by Chinese players. In response, China launched an anti-dumping probe into US mature-node chips. "Tiktok Refugees" swarmed Chinese social media app Xiaohongshu ("RedNote"), sending it to the top of app stores. **China Merchant Bank**'s fourth quarter preliminary results beat expectations on strong investment income. **BYD** launched in Korea and is partnered with **Grab** to expand in the South Asia market, including the Philippines.

In **Taiwan**, **TSMC** fourth quarter results were mostly in-line with bullish market expectations. Management denied the CoWoS order cancellation rumors and delivered upbeat guidance for AI semis. **Mediatek**'s fourth quarter revenue beat on better-than-expected margins thanks to a favorable mix. Mainland China is to resume group tours to Taiwan soon.

In **Korea**, the central bank left rates unchanged while expectations were for a 25bp cut. Investigators are seeking a new warrant to extend the detention of impeached President Yoon Suk Yeol over his martial law declaration.

**India's** inflation eased to 5.4% YoY in December from 5.5% in November, with lower food and gold inflation. November industrial production rose 5.2% YoY. Exports declined 1% YoY in December (-4.9% in November), while imports rose 4.9% (16% in Nov). The December quarter at **Avenue Supermarts** missed on higher discounting in FMCG and said the CEO was being replaced. Quarterly results in IT services provided a mixed picture. **Infosys** was in line, with the January 2025 quarter remaining weak owing to elevated third party costs, but guidance was raised. **HCL** also reported in line on most parameters but with no upward guidance revision. **TCS**'s management gave more encouraging comments, pointing to early signs of a revival in discretionary spending, especially in North America. However, the results suggest the recovery in growth may be gradual. **Reliance** had a beat driven by strong performance across **Jio**, Retail and E&P. **Axis bank**'s third quarter saw muted loan and deposit growth. Earning at **Havells**'s (home appliance) showed demand trends remained challenging but management guidance was more upbeat and demand is expected to catch up with the real estate cycle.

In **Indonesia**, the central bank surprised the market with a 25bp cut to 5.75%.

In **Brazil**, December inflation was 4.83% YoY, or in line with expectations, and slightly lower than November's 4.87%.

**Peru**'s GDP rose 4% in November, or more than expected.

In **Argentina**, headline CPI was 2.7% MoM in December, or in line with expectations, although core inflation was slightly higher.

## CORPORATE DEBT

### CREDIT

Bond markets saw volatile trading as investors were caught between cloudy prospects and attractive yields. US jobs data came in sharply above expectations and the yields on 10-year US Treasuries flirted with 5%. In the UK, however, inflation came in lower than expected, and especially in services, so the Bank of England left rates at accommodating levels. As US inflation was better than expected, bond markets staged a massive relief rally taking US 10-

year Treasury yields tumbling 19bp to 4.59% and equivalent gilt yields 24bp lower to 4.64%. Risk assets generally also rallied. Markets were also reassured about France after risks the Bayrou government might lose a no-confidence vote abated.

Spreads easily absorbed this volatility so returns were essentially driven by yields. EUR IG gained 0.28%, Corporate Hybrids 0.15%, EUR HY 0.19% and CoCos 0.40%. The new issues market remained active despite volatility. Modest issue premiums showed that bonds were still in demand. Among this week's deals, Italy's energy group **Iren Spa** issued a hybrid bond and Germany's **Aareal Bank**, which is a commercial property specialist, sold a new AT1 to refinance an existing bond.

## 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.

EDMOND DE ROTHSCHILD ASSET MANAGEMENT (FRANCE)

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