EDMOND DE ROTHSCHILD

MARKET FLASH: BACK TO BONDS?

• The tamer inflation, combined with a sharp economic slowdown in Europe - as demonstrated by the 0.1% contraction in GDP during Q3 - should provide the ECB with the reassurance needed to halt its monetary tightening.

• In the US, corporate earnings have continued to surprise positively, with upward revisions to earnings growth forecasts. In Europe, meanwhile, the data has been disappointing.

• We have taken profits on our tactical hedging positions and remain rather cautious on risk assets in the mid-term, considering the time needed for restrictive monetary policies to be transmitted and weigh on economic activity.

European inflation ebbed faster than expected, retreating from 4.3% last month to 2.9% as energy prices continued to ease. The tamer inflation, combined with a sharp economic slowdown in Europe - as demonstrated by the 0.1% contraction in GDP during Q3 - should provide the ECB with the reassurance needed to halt its monetary tightening.

In Japan, the BoJ is dismantling its bond yield control policy. From now on, the 1% cap on the 10-year bond yield will be a target rather than a strict upper limit. This paves the way for a possible key rate hike in 2024.

As far as the Fed is concerned, Jerome Powell appeared to be using a much more neutral tone, insisting on the tighter monetary conditions, and referring to the lull in wage increases, which could corroborate the scenario of a return to the 2% inflation target in the near future. Productivity data has substantiated these claims, with a 4.7% rise enabling unit labour costs (to produce one unit of output) to fall by 0.8%, while the cost of labour rose by a further 1.1% during the quarter.

Furthermore, in its “quarterly refunding statement”, the US Treasury has substantially reduced long maturities in favour of shorter-dated securities, considering the premium to be excessively high. It has also scaled back its overall issuance programme, as a result of high tax revenue.

Consequently, yields on 10-year Treasuries eased by 20 bp during the week, while yields on 2-year bonds have remained stable.

In the US, corporate earnings have continued to surprise positively, with upward revisions to earnings growth forecasts. In Europe, meanwhile, the data has been disappointing. Lifted by easing rates and robust corporate earnings in the US, the world’s leading equity indices rose 4%.

Finally, on the geopolitical front, the risk of the conflict between Israel and Hamas flaring up seems relatively contained for the time being. The price of oil has retreated to $85/bbl and volatility is becoming more muted.

In this environment, we have taken profits on our tactical hedging positions and remain rather cautious on risk assets in the mid-term, considering the time needed for restrictive monetary policies to be transmitted and weigh on economic activity. On fixed income, we are positive on duration which we believe is attractive and will protect our investments in periods of economic slowdown and geopolitical instability in the Middle East.

EUROPEAN EQUITIES

European stock markets have ended the week in positive territory, lifted by the real estate and automotive sectors, and as the restrictive monetary policies implemented by central banks are beginning to tame inflation. while economic growth contracted in Q3 (-0.1%). These signals have comforted equity investors, who are interpreting this slowdown as a pause in central bank monetary tightening, as demonstrated by the Bank of England which held its key rates at 5.25% (as expected) and pushed back its 2% inflation target to the end of 2025 (previously Q2 2025), while still ruling out the scenario of a recession.

This week's winners included French construction giant **Bouygues**, which sent out encouraging signals for the real estate sector, reporting higher than expected earnings for its subsidiary **Colas**, which specialises in civil engineering and construction works. The group also pointed out that the outlook for the industrial sector was promising, despite the headwinds faced by the housing industry.

The automotive sector performed well within the European market index thanks to German manufacturer **BMW**, which reported a margin of 9.8% in Q3 (beating forecasts) and reiterated its objectives for 2023. The same can be said of Italian auto supplier **Stellantis**, after the company reported a 7% growth in revenue, supported by volumes, and kept its annual objectives unchanged.

Within the chemicals industry, German company **BASF** warned that its outlook for 2023 would be at the lower end of its target range, while remaining above consensus forecasts, particularly as the group announced it would be making more cost cuts.

The energy sector was shaken by disappointing corporate earnings, notably from **BP** due to a large write-down on a wind farm project in the US and to a drop in revenue from its gas business.

Last Friday saw major disappointment within the healthcare sector, as French pharmaceutical giant **Sanofi** reported lower-than-expected operating income and downgraded its earnings forecasts for next year, while raising its R&D spending.

Finally, Danish brewer **Carlsberg** came under pressure after issuing warnings on low consumer confidence levels in Europe and Asia, which could weigh on the group's sales. Similar weakness was observed for Belgian company **AB InBev**, which benefited, however, from recent price increases.

US EQUITIES

US equities rose this week as the Fed proved less hawkish than expected and held its rates at current levels after its meeting on November 1st. As a result, equity indices rebounded sharply during the week, with the S&P500, NASDAQ and Russell 2000 indices rising +4.39%, +5.76% and 3.47% respectively.

On the macro front, private sector job creation came in below expectations at 113K versus 142K, while the manufacturing ISM slipped to 46.7, falling below the consensus forecast of 49. In the current environment, with the market interpreting "negative" macroeconomic newsflow as a sign that the Fed's restrictive monetary policy is proving effective, weaker-than-expected data supported the easing of bond yields during the period. Yields on 10-year US Treasuries fell from 4.93% to 4.67% during the week.

Meanwhile, fossil fuel prices also eased on hopes that the conflict between Israel and Palestine will run out of steam, as tensions remain contained so far. The price of WTI crude oil has retreated to 82.44$/bbl.

The earnings season is still under way. Over 3/4 of the companies that have reported so far have beaten estimates. While earnings publications have been rather robust until now, companies are more cautious and tempered on their growth outlook and capex plans.

Within the materials industry, **First Quantum Minerals** (-43.71%) tumbled after the president of Panama announced a referendum would be held to settle the future of the contract signed with the company on the Cobre Panama mine.

Within healthcare, the earnings reported by **Eli Lilly** (+2.15%) are encouraging and the company has kept its guidance for FY 2023 unchanged. In contrast, **Moderna** (-6.25%) suffered after reporting lower-than-expected revenue and a $1.3 billion write-down due to its unused Covid vaccines.

In technology, **Apple** slipped in after-hours trading on lower-than-expected sales forecasts in Q4, fuelling fears that the company may lose market share in China to its rival **Huawei**. **ON Semiconductor** (-19.52%) stumbled after reporting weak Q4 guidance due to heightened risk on demand from the automotive industry in a high interest rate environment. **Intel** (+15.93%) was up during the week, having commented on the long-term benefits of the ongoing adoption of AI.

Detroit's Big Three automakers - **Ford** (-9.29%), **General Motors** (+0.88%) and **Stellantis** - have reached tentative agreements with the United Auto Workers (UAW) union, ending the six-week coordinated strikes in their assembly plants. These agreements are considerable victories for the trade union, which has successfully negotiated record wage increases (estimated at +30%).

As the season enters its 4th week, all eyes will be on corporate earnings and long-term interest rates, largely driven by macroeconomic indicators. In this environment, investors shall also keep a close watch on US labour data, due to be released on Friday.

JAPANESE EQUITIES

The NIKKEI 225 and TOPIX indices experienced notable increases of 3.27% and 3.89%, respectively. Initially, Japanese equity markets exhibited sideways trading patterns leading up to the Bank of Japan's (BOJ) monetary policy meeting held on October 30th and 31st. The decision was well-received by market participants who anticipated a continued weakening of the yen and persistently low Japanese interest rates, leading to a sharp market recovery.

Securities and commodities futures sector rose 7.60% led by **Daiwa Securities Group Inc**. which announced a large-scale share buyback and strong april–september 2023 results. Banks sector increased by 5.52% as relaxation of the cap of long term interest rate under the YCC framework was decided at the BOJ's policy meeting. Glass & ceramics sector gained 5.30% as major companies in this sector announced better-than-expected results. No sector fell for this week.

Fujitsu Ltd. and **Keyence Corp**., both known as large-cap growth stocks and their share prices have been soft, rebounded sharply by 17.09% and 13.46% supported by better-than-expected results. **Daiwa Securities Group** Inc. increased 12.88% due to the reason explained above. Meanwhile, **Panasonic Corp**., a comprehensive manufacturer of electronic products,

Takeda Pharmaceutical Co., **Ltd**., and **Komatsu Ltd**. fell 8.38%, 5.15% and 4.95%, respectively, as FY2023 operational profit guidance missed the market consensus.

In the foreign exchange market, USD/JPY was traded sideways ahead of monetary policy meetings of the BOJ and the Fed. Later, yen was sold to high-151s as the BOJ's policy adjustment remained minor, and it has become clear that FX intervention has not been carried out recently even on 150s.

EMERGING MARKETS

The MSCI EM Index moved up 1.2% this week as of thursday. China underperformed other regions, down 1.4% from its strength last week, while India and Brazil edged up +0.8% and +1.1% respectively. Both Korea and Taiwan rebounded strongly by 4% and 2.4% from the weakness of previous week.

In **China**, october PMI data missed market expectation in both manufacturing at 49.5 and non-manufacturing at 50.6 versus estimation of 50.2 and 52.0 respectively despite that business sentiment has shown signs of stabilization since Sept. on Beijing's accelerated stimulus efforts. On the geopolitical front, flight frequency between the US and China has been increased to 70 per week as the pandemic restrictions ease. US FDA clears the first China-developed cancer drug, offering globalization hopes for China biopharm firms. **Kweichow Moutai**, China's high-end white alcohol producer, announced its first ex-factory price hike in 6 years with an average 20% price increase for its signature products. On the renewable side, **Longi** reported 3Q23 earnings results miss on lower-than-expected shipments and a higher opex ratio. **Sungrow** reported a strong beat with historically high GPM despite pressure among inverter peers. Flat glass beats expectation on ASP hikes and material costs easing.

In **Taiwan**, **Mediatek** reported a net income beat in 3Q23 as smartphone restocking drives healthy 4Q guidance and 2024 outlook for global smartphone demand recovery.

In **Korea**, **LG** chem reported a better than expected operating profit for 3Q23 despite a steep decline in battery metals price. The company confirmed that **LGC** will enter lithium carbonate/hydroxide production, potentially in Morocco. **Samsung** published an in-line quarter with higher-than-expected DRAM/NAND bit growth guidance for 4Q23F.

In **India**, S&P Global India manufacturing PMI remained strong at 55.5. **Tata Group** officially becomes the first Indian iPhone maker, after Taiwan's **Wistron** board approved the sale of **Wistron InfoComm Manufacturing** to **Tata Electronics** for an estimated $125 million. Fiscal deficit in September at INR 0.6tn, driven by capital expenditure (+29%yoy). **Amazon** announces a new 198-megawatt wind farm in India. **SoftBank**-backed online retailer **FirstCry** plans to file for an IPO of $600 million. **Maruti Suzuki** reported a strong beat with improving market share and commodity tailwinds while the market remains skeptical about moderating demand. **Supreme Industries** beats est, on continued momentum from government, capex push and better margins on benign input costs. **DLF** reported a beat as demand for luxury housing stays buoyant and the pipeline seems promising. Reliance reported robust results across segments, driven by a beat on our retail and O2C estimates, while upstream saw a miss due to MJ1 commissioning costs.

In **Brazil**, the government indicated that 2024 budget deficit pledge could be renegotiated, with fiscal target moving from zero to -0.5%. **Mercado Libre** beats expectations across the board, EBIT margin of 18.2% was the main positive surprise.

In **Mexico**, Business confidence and PMI manufacturing improved to 54 and 52.1 from 53.8 and 49.8 respectively. **Banorte** beats expectations with strong 3Q23 results driven by higher NIM, loan growth, and stable asset quality. **Banorte** has recently increase its guidance for 2023. In **Chile**, **Santander Chile** reported weak 3Q23 results, as expected but provides positive guidance for 4Q23 and 2024. In **Peru**, **Credicorp** reported weaker than expected results due to higher provisions and higher NPL ratio.

CORPORATE DEBT

CREDIT

This week saw a sharp market turnaround for both risk-free rates and credit premiums. Yields on 10-year US Treasuries retreated heavily from 4.90% on monday to 4.66% at the market close on thursday. This easing was supported by the Fed's decision to hold its rates at current levels, while beginning to point out the impact long-term rates are having on economic activity. The ISM also came in at 46.7, indicating a relative slowdown. Meanwhile, yields on 10-year German bonds lost 10 bp, sliding from 2.82% to 2.72%.

After a rather jittery month in october, credit premiums recovered sharply over the last two trading sessions. Credit premiums factored in the retreating bond yields as positive news, as these will ease pressure on corporate refinancing costs. Within the HY segment, the crossover index contracted by 45 bp during the week, from 465 to 420 bp, while cash premiums shrunk from 490 bp to 470 bp. A similar momentum was observed on higher ratings, with an 8 bp contraction over the week (from 160 bp to 152 bp). This fresh appetite for risk also affected more junior debt within bank capital structures, as premiums on Euro CoCos eased 85 bp during the week, from 966 bp to 880 bp. This trend was largely driven by the persistently robust earnings published by the banking industry, with **AlphaBank**, **Raiffaisen** and **Ibercaja** reporting strong, or even very strong, earnings this past week.

Due to the earnings blackout period, the primary market was calm with very few issuances both within the HY and financials sectors. **APA** - the Australian utilities company - issued its first hybrid bond with a face value of €500 million and a coupon of 7.125% per annum up to the first call date, highlighting the strong momentum enjoyed by the asset class after the major primary issuances of the past few weeks, including **Accor** and **Bayer**.

Lifted by rates and premiums, higher quality bonds gained +0.85% during the week (+3.3% YTD), while High-Yield bonds rose +1.05% (+6.4% YTD). Yields on the Investment Grade and High-Yield bond market currently stand at 4.4% and 7.7% respectively, and still offer attractive entry points for carry strategies. In terms of risk/return, we believe the strategy remains highly compelling as it allows us to build predominantly Investment Grade portfolios, returning gross yields of 4.75-5% over 5 years.

CONVERTIBLES

Lifted by three concomitant factors - easing rates, narrowing credit spreads and the equity market rebound - convertible bonds posted strong returns during the week.

The Refinitiv Global Focus Hedged CB Euro index rose by over 1%. Despite the brighter macro environment, several convertible bond issuers reported disappointing earnings. As a result, companies such as **Sarepta Therapeutic**, **On Semiconductor**, and **Match Group** shed over 10% during the week after missing earnings expectations.

With the earnings season well under way, the primary market remained rather calm with one single issuance in the US by **Western Digital**, for a face value of $1.4 billion, maturing in 2028, with a coupon of 3% and a 30% premium. The proceeds of this issuance will be used to refinance the $1.1billion convertible bond maturing early 2024.

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.

DISCLAIMER

This is a marketing communication.

03/11/2023

This document is issued by the Edmond de Rothschild Group. It is not legally binding and is intended solely for information purposes.

This document may not be communicated to persons located in jurisdictions in which it would be considered as a recommendation, an offer of products or services or a solicitation, and in which case its communication could be in breach of applicable laws and regulations. This document has not been reviewed or approved by a regulator of any jurisdiction.

The figures, comments, opinions and/or analyses contained herein reflect the sentiment of the Edmond de Rothschild Group with respect to market trends based on its expertise, economic analyses and the information in its possession at the date on which this document was drawn up and may change at any time without notice. They may no longer be accurate or relevant at the time of reading, owing notably to the publication date of the document or to changes on the market.

This document is intended solely to provide general and introductory information to the readers, and notably should not be used as a basis for any decision to buy, sell or hold an investment. Under no circumstances may the Edmond de Rothschild Group be held liable for any decision to invest, divest or hold an investment taken on the basis of these comments and analyses.

The Edmond de Rothschild Group therefore recommends that investors obtain the various regulatory descriptions of each financial product before investing, to analyse the risks involved and form their own opinion independently of the Edmond de Rothschild Group. Investors are advised to seek independent advice from specialist advisors before concluding any transactions based on the information contained in this document, notably in order to ensure the suitability of the investment with their financial and tax situation.

Past performance and volatility are not a reliable indicator of future performance and volatility and may vary over time, and may be independently affected by exchange rate fluctuations.

Source of the information: unless otherwise stated, the sources used in the present document are those of the Edmond de Rothschild Group. This document and its content may not be reproduced or used in whole or in part without the permission of the Edmond de Rothschild Group.

EDMOND DE ROTHSCHILD ASSET MANAGEMENT (FRANCE)

47, rue du Faubourg Saint-Honoré 75401 Paris Cedex 08

Société anonyme governed by an executive board and a supervisory board with capital of 11.033.769 euros

AMF Registration number GP 04000015

332.652.536 R.C.S. Paris