EDMOND DE ROTHSCHILD

MARKET FLASH: SOFT LANDING IN SIGHT

• ***US Treasury yields continued to fall after labour market data***

• ***The risk of gas shortages in Germany diminished***

• ***We are sticking to our neutral stance on the equity market and our focus on carry assets***

The IMF may have cut its global growth forecasts for 2023 from 2.9% to 2.7% but investors now seem to favour a soft landing scenario, especially in the US.

US Treasury yields continued to fall after labour market data. Surprisingly, unemployment fell to 3.5% but markets focused on signs that wage increases had peaked and a contraction in non-manufacturing ISM for the first time since 2020, due mainly to a fall in new orders.

CPI fell from 7.1% to 6.5% as expected and core inflation fell to 5.7%. The only problem was that shelter ex energy re accelerated after decelerating for 3 months in a row. But other components like transport ex energy suggested more disinflation ahead in the coming months.

The dollar reacted by quickly falling against the euro and emerging currencies. Overall, the data offered some relief and triggered a rebound in global equity markets.

The risk of gas shortages in Germany diminished. According to INES, the association of German gas and hydrogen storage operators, rebuilding stocks for next winter would be possible even if Russian gas deliveries were completely halted. Mild temperatures and efforts by companies and households to reduce consumption mean no shortage is expected for the current winter. Gas prices fell sharply to €70/MWh, down from €140 at the beginning of December and a €330 peak over last summer.

To offset measures in Washington's Inflation Reduction Act, Berlin could clear the way for a stimulus plan in favour of European industry. This would underpin confidence in Europe's growth prospects and avoid structural damage to competitiveness.

China, meanwhile, continues to expect a rebound in the Spring. Beijing is still proceeding with a complete reopening and has ended quarantine measures for foreigners entering China. Passports and visas are once again being delivered. Covid cases have, as a result, exploded but recent composite PMI data suggest this could be offset by growth.

We consider the current equity market rally as a technical rebound and are sticking to our neutral stance. We believe that the risks of an economic slowdown and reduced inflationary pressure are now well balanced. Meanwhile, inflows into corporate bonds add support to our focus on carry assets for 2023.

EUROPEAN EQUITIES

The New Year rally continued after upbeat US macroeconomic data. Investor optimism was justified after consumer price inflation came in as expected, reinforcing the case for a rapid fall in inflation in the US with Europe following a few months later. Optimism in Europe was also underpinned by energy price falls sticking. European gas prices fell back below pre-Ukraine war levels, sending one-month electricity prices a massive 72% lower to €188/MWh.

Meanwhile, Emmanuel Macron and France's finance minister Bruno Le Maire encouraged electricity suppliers to help small companies cope with higher energy bills. **TotalEnergies**, **Engie** and **EDF** agreed to cap average electricity prices at €280/MWh in 2023. Elsewhere, Belgium's government and Engie confirmed that the country's two nuclear reactors would remain in service for 10 years.

Rolls-Royce and **Bentley**, both in the BMW Volkswagen stable, reported record sales, another sign of luxury items defying recession risk. In retail, **JD Sports** reported exceptional sales over the Christmas period with the World Cup also playing its part.

In stark contrast, **Ubisoft** issued a profit warning and slashed guidance. The video games company was not alone in revising expectations lower: **Electrolux** (electrical household goods), semiconductor group **TSMC** and software company **LogiTech** did the same. And UK recruitment company **Robert Walters** warned that its earnings would be hit by companies unwilling to hire ahead of a possible recession.

US EQUITIES

Over the last 5 trading sessions, the S&P500 jumped 4.6%. The eagerly awaited consumer price print came in at 6.5% as expected.

On the eve of the CPI release, Jerome Powell, speaking in Stockholm, refused to be drawn on the Fed's future monetary policy. He simply said that getting back to price stability when inflation was high could mean adopting measures that would be unpopular over the short term.

In labour market news, **Uniqlo** unveiled an up to 40% increase in average wages to $2,270 but not every company followed suit. On the contrary, the financial sector was hit by several redundancy plans, including from major players like Goldman Sachs and BlackRock. And in the tech sector, **Coinbase** announced another restructuring plan that will affect 20% of its workforce.

Disney announced governance changes after Nelson Peltz's activist Trian fund increased its stake. Mark Parker, a **Nike** executive, will now head up the board. The fund aims to overhaul Disney's allocation of capital and its remuneration structure. It also wants to find someone to succeed the current CEO Bob Iger who has only just returned to the company.

According to Bloomberg, **Apple** is developing new chips and modems in-house in an attempt to slash dependency on suppliers like **Qualcomm** and **Broadcom**. Apple is reportedly also working on offering touch screens for its next iMac computer generation, a break with Steve Jobs' philosophy of only using them on iPads.

Pharmaceutical distribution giant **CVS** is said to be in advanced talks to buy its rival **Oak Street Health** for more than $10bn.

The Wall Street Journal said restaurant chain **Subway** was considering a sale of the group for around $10bn.

JAPANESE EQUITIES

The NIKKEI 225 and TOPIX ended the period 2.44% and 2.10% higher after US equity markets rose on hopes that weak economic indicators would lead to softer inflation. Sentiment was also driven by China's reopening.

Iron & Steel, Non Ferrous Metals and Marine Transportation gained 7.77%, 6.73% and 6.12%, respectively, on expectations the global economy, and especially China, would gain from reopening. Defensive sectors like Electric Power & Gas and Land Transportation lost 2.57% and 1.74% as investors turned risk-on. Real Estate fell 1.68% on fears of a possible interest rate hike in Japan as the BOJ widened its yield curve management trading range, a de facto rate rise for markets.

Sumitomo Metal Mining and **Nippon Steel** jumped 12.86% and 9.66% as commodity prices rose on expectations growth would recover. **Tokyo Electron**, a semiconductor manufacturing equipment maker, rallied by a sharp 9.54% after a bounce in the Philadelphia Semiconductor Index. **Kansai Electric Power** and **West Japan Railway** fell 4.59% and 3.67% as investors turned away from defensive plays. **Mitsubishi Estate** declined 3.69% on interest rate fears.

The yen moved from 133.41 to 129.20 yen against the US dollar on expectations of a rate hike from the Bank of Japan.

EMERGING MARKETS

The MSCI EM Index was up 3% as of Thursday's close. China continued its rally and ended 2.6% higher. India rose 1.4%. Brazil outperformed, rebounding by 4.9%.

China's December CPI rose 1.8% YoY, or in line with consensus, while PPI was down 0.7% due to the Covid outbreak. December exports fell 9.9% YoY and imports were down 7.5% but both better than the minus 11% and 10% expected. December credit data was weaker than expected, with RMB 1,310bn in aggregate financing, or lower than the RMB 1,850bn estimated. The government drafted a new action plan to improve the balance sheets of "high quality" property developers. China Covid inflections peaked earlier than projected with more than 64% of the population already infected, according to the latest research paper from Beijing University. PCR tests are no longer required for inbound travellers since January 8. Pfizer said locally produced Covid pills might be available in China within the next few months. On the regulation side: Jack Ma is ceding control of **Ant Group**, which is a key step towards any IPO. PBoC officials confirmed that the crackdown on fintech operators was over and "healthy" development of internet platforms is the next priority: Ride-hailing app **Didi** will be back on the domestic app store as soon as next week. **Alibaba** signed a strategic partnership agreement with Hangzhou city government while a government filing showed Cyberspace Admin taking a 1% stake in an Alibaba Guangzhou subsidiary. **CATL**'s preliminary FY 22 net profits soared by 83-98% YoY, or better than consensus estimates. **Anta**'s fourth-quarter operational update was in line with market expectations.

In **Taiwan**, **TSMC** reported record fourth-quarter net profits, but also guided on slowing sales in the first half of this year, due to the impact of demand softness and inventory correction. The group expects a rebound in the second half and positive growth for 2023 as a whole.

In **Korea**, **Samsung Electronics** delivered weaker-than-expected fourth-quarter pre earnings, impacted by lower memory prices, higher inventories and weak smartphone demand. The news triggered speculation of a capex cut in the memory division.

India's CPI eased to 5.7% in December, or lower than the 5.9% expected, while IP jumped 7.1% in November, or more than the 2.8% forecast. Third-quarter revenues at **Infosys** for FY 2023 were better than expected thanks to a better pass-through; strong deal wins resulted in revenue guidance being raised. **TCS** delivered a resilient performance in a seasonally weak quarter, with revenue growth ahead of consensus. Despite macro challenges, the qualified pipeline grew sequentially.

In **Brazil**, retail sales were up 1.5% YoY in November, or less than the 1.9% expected. Finance Minister Fernando Haddad announced a new economic plan to offset some of the fiscal expansion approved in December. Although most of the measures are focused on the revenue side, the signal was positive. Pro-Bolsonaro rioters stormed Brazil's Congress. **Americanas**' CEO and CFO stepped down after accounting inconsistencies.

Mexico's gross fixed investment grew by 6% YoY last October, or ahead of the 4% estimated, driven by rises in the machinery and equipment sector.

In **supply chain relocation**, **Apple** exported more than $2.5 billion-worth of iPhones from India from April to December 2022, or nearly twice as many as in 2021. Korean solar company **Hanwha** is to spend $2.3bn on a solar factory in the US which will benefit from the IRA. **Tesla** is near a preliminary deal to set up a factory in Indonesia. **Ford** is to shift from SK Innovation to LG Energy Solution to build a 45GWh battery plant in Turkey. At the North American leaders' summit in Mexico, all three countries promised to deepen economic cooperation, particularly in semiconductor supply chains.

CORPORATE DEBT

CREDIT

The rebound continued as bond yields eased on signs inflation was falling back. Investor optimism was buoyed when CPI in the US came in as expected at 6.5% over 12 months. US 10-year Treasury yields fell 12bp and by 9bp for the eurozone equivalent. Risk premiums were down 17bp and 4bp over the period. Between Monday and Thursday, the high yield index returned 1.08% and investment Grade 0.54%

On the new issues market, **Air France KLM** sold two €500m tranches, at 7.25% and 8.125% due 2026 and 2028. The proceeds will go on improving the group's financial flexibility by repaying government loans. Both bonds are Sustainability Linked Bonds (SLB) with coupons indexed on the group's target of a 10% reduction in greenhouse gas emissions from using kerosene.

Elsewhere, **Apollo Global Management** is planning to monetise part of its stake in Italy's **Lottomatica** with a listing. Selling 20% of the shares could raise $1bn at current valuations.

The pre-result blackout period is fast approaching but the new issues market in financials remained active. In CoCos, **Lloyds** raised €750m with an AT1 at 8.5% and **Société Générale** €1bn at 7.875%. In insurance, **CNP** raised €2.5bn over 30 years at 5.25% with a Sustainable Tier 2 bond, callable in 10 years. Euro CoCo spreads narrowed by an appreciable 68bp over the period. The UK's non-life insurance company **Direct Line** issued a profits warning for the last quarter of 2022, citing higher-than-expected auto and bad weather claims.

CONVERTIBLES

It was a good week for the segment as rates eased and consumer inflation in the US slowed. The ICE BofA Global 300 Convertible index gained 2.42% vs. 2.65% for the MSCI World Equities.

It was also another busy week for new issuance. France's **Spie** raised €400m at 2% with an "Orane" due 2028. The proceeds will go on reimbursing its outstanding 2024 convertible, thus extending its debt maturity and reducing interest charges. In China, **GDS Holding** (data centres) raised $580m at 4.5%.

In results news, preliminary fourth-quarter sales at US biotech **Exact Sciences** were $550.7m, or better than the $505.8m expected. In contrast, French video game maker **Ubisoft** issued a serious profits warning for FY 2022/2023. The group now sees revenues falling 10% instead of rising 10%. EBIT is expected to be a negative €500m instead of +€400m. The downward revision is due to several delays in releasing its new *Skull & Bones* game and asset writedowns in its R&D division.

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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EDMOND DE ROTHSCHILD ASSET MANAGEMENT (FRANCE)

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

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332.652.536 R.C.S. Paris