EDMOND DE ROTHSCHILD

# EDMOND DE ROTHSCHILD ASSET MANAGEMENT

# MARKET FLASH: MARKETS KEEP THEIR COOL DESPITE SEVERAL CENTRAL BANK MEETINGS

- **A meeting scheduled for this weekend between US and Chinese delegations suggests that both countries are ready to negotiate.**
- **Divergences are appearing among central banks: the Bank of England has cautiously cut rates, while the Fed has chosen to maintain rates, navigating between signs of slowing growth and inflationary pressures.**
- **In Germany, Friedrich Merz was elected Chancellor after two votes in Parliament, an unprecedented event, but his determination reassured investors of future political stability.**

It was a quiet week for markets despite several central bank meetings. Investors were reassured when Services ISM in the US came in better than expected at 51.2. New orders and job indices rose but prices paid rebounded sharply so the outlook for inflation is in doubt. In the eurozone, the definitive composite PMI reading was revised slightly higher for April, moving from 50.1 to 50.4 thanks to services, especially in Italy which increased more than others. In China, however, Caixin Services PMI was a disappointing 50.7 in April due to trade disruptions. The impact of ongoing trade talks showed up in the US trade deficit which hit another new high in March at $140bn. Chinese data showed exports to the US were slowing but increasing to other Asian countries.

However, trade war news this week was on the positive side. A US delegation is to meet Chinese representatives this weekend and Beijing has indicated its willingness to talk. And an agreement between the US and the UK was signed: most UK imports to the US will be taxed at 10% and import duties on US goods to the UK will be reduced.

Central bank action varied. The Bank of England cut its benchmark rates by 25bp but its less accommodating tone reduced hopes for further action. The Fed is split between slowing but still resilient growth and advanced indicators pointing to inflationary pressure. Its decision to leave rates unchanged was expected and Jerome Powell said nothing about future meetings. He reaffirmed the Fed's dual mandate, inflation and jobs, and said risks were trending higher for both.

The first quarter earnings season has so far been satisfactory with positive surprises running around historic averages. That said, the figures reflect the past and companies are being somewhat cautious on guidance for coming quarters.

In Germany, politics resurfaced after Friedrich Merz needed two rounds of voting to be elected chancellor, the first time this has ever happened. Fortunately, the second round was on the same day and the new chancellor's determined tone reassured investors.

Equities have now rebounded to end-of-March levels so we are maintaining our cautious stance on risk assets. Washington's tariff announcements at the beginning of April and ongoing trade talks are bound to have some impact on global growth and company results. In fixed income, we are still neutral on duration and continue to prefer carry strategies.

## EUROPEAN EQUITIES

Despite a deal with the UK, Donald Trump's declarations on trade failed to convince markets, leaving his aggressive, protectionist stance against China and other countries in place. As a result, markets trod water and focused on ailing sectors like consumer discretionary. The Fed showed it was preoccupied by the mounting economic uncertainties generated by trade tensions by leaving its rates unchanged. In Germany, the Dax stumbled briefly when Friedrich Merz initially failed to get approval as chancellor. The incident showed how little leeway the new administration really has. It will also be some time before stimulus plans have any visible impact on growth.

Elsewhere, **Coface** reported stable first quarter revenues but earnings fell due to increasing bankruptcies and the company's investments. Management pointed to exceptional economic uncertainties but the share looks like a reliable investment despite the mixed outlook for this year. **Amplifon** achieved record profitability but with no like-for-like growth. Management expects profits to accelerate due to new French regulations. **Legrand**'s first quarter sales beat expectations thanks to 30% growth in datacenters, with a 40% jump in the US, but financial charges weighed on the net result. As expected, **Siemens Healthineers** had a solid second quarter and EPS was on track even if geopolitical tensions have led companies to broaden guidance. **BMW** underpinned the autos sector on hopes customs tariffs would fall by July. The group also has factories in the US, an advantage in the current climate. **Ferrari** also reported upbeat results despite a sharp fall in sales in China. **Outokumpu**'s first quarter was in line but the outlook is mixed due to stainless steel sales coming in softer than expected.

In M&A, **GTT** acquired **Danelec** to reinforce its maritime data analysis. Belgium's **Aedifica** (healthcare property) launched a bid on Belgian property company **Cofinimmo**.

## US EQUITIES

Wall Street made further gains thanks to a rebound in cyclicals amid hopes that tariff issues would gradually be resolved. Intraday, the S&P 500 moved above its April 2 high and is now up 14% from recent lows. The Russell 2000 gained 2% in USD. In only a few weeks, investors have switched from drastically reducing risk asset exposure to trying feverishly to cash in on the market rebound. The S&P 500 rose for 9 sessions in a row, a performance not seen since 2004.

At the end of the period, Washington announced a trade deal with the UK and suggested tariffs on Chinese imports might be cut. Talks between American and Chinese representatives are expected to take place in the coming days. The midweek Fed meeting reassured markets. Chair Jerome Powell left rates unchanged and argued for patience.

US company results rose 11% in the first quarter but this pleasant surprise is unlikely to recur in the second half as the overall economic picture is cloudier. Economic uncertainties are gradually showing up in consumption and investment. Analysts now see EPS rising 8% this year compared to expectations of +10% only a month ago.

Numerous companies, including **Mattel**, **Black & Decker** and **Colgate**, said tariffs would mean substantial increases in costs. Others like Ford simply avoided providing guidance. Markets were mostly unaffected as these developments had already been factored in.

Warren Buffet finally retired aged 94. He had notched up a legendary 19.9% in annualised returns since 1935, the stuff of dreams.

## EMERGING MARKETS

The MSCI EM index had edged 0.06% higher in USD as of Thursday's close. Mexico, Korea, Brazil, and China were up by 2.01%, 0.52%, 0.45% and 0.43%, respectively. Taiwan and India were down 0.25% and 2.05%.

In **China**, April's export data surprised on the upside, probably due to trade re-routing, clocking growth of 8.1% YoY vs the 2% expected. Services PMI for April was 50.7 vs. 51.9. US-China trade talks are set to begin this weekend. President Xi Jinping visited Moscow to discuss economic and energy issues, including the proposed Power of Siberia 2 gas pipeline. The EU parliament and China fully lifted restrictions on mutual exchanges between legislative bodies, another sign of growing ties. The PBoC announced a 50bp RRR cut and a 10bp rate cut along with a broad set of easing measures. CSRC, the financial markets regulator, vowed support for capital markets. The authorities are considering an "overhaul" to the property market to curb pre-sales. Growth momentum in the hospitality sector strengthened during the Labour Day holiday: domestic visitors were up 6.4% YoY and tourism revenue up 8%. **CATL** is looking for a potential $5bn HK listing.

In **Taiwan**, the TWD experienced a historic surge over the past week, appreciating by more than 10% against the US dollar amid concerns of a US slowdown and potential trade deals.

In **Korea**, **Samsung Electronics** reported slower profit growth and softening demand for storage chips, which may be triggered by the US-China trade war.

In **India**, Manufacturing PMI for April was 58.2 vs. 58.4. Services PMI for the month of April was 58.7 vs. 59.1, taking the composite PMI to 59.7. The UK and India announced the finalisation of an FTA aimed to boost exports of textiles, autos and chemicals to the UK while providing cheaper imports of luxury cars and premium alcohols to India. So far, the escalation of the India-Pakistan conflict has been seen as quite contained. In the banking sector, **SBI** and **Kotak** banks reported muted results. **Mahindra and Mahindra** reported a strong quarter with 25% YoY revenue growth and 38% EBITDA growth. **Titian** reported a robust quarter driven by strong momentum in all business lines, with a positive outlook on growth and margins. **Britannia print** was ahead of estimates on good topline and margin improvement driven by cost controls.

In **Brazil**, the Central Bank raised the Selic rate by 50bp to 14.75%, while indicating that further movements would be data dependent. Services PMI for April was 48.9 vs. 52.5. **Itau** and, more surprisingly, **Bradesco** reported upbeat results. **Meli** reported solid results, beating expectations on Argentina's results, and higher consolidated profitability. **Lojas Renner** also reported upbeat results, driven by better-than-consensus top line growth of 12% YoY, an improved gross margin and a 22% beat in EBITDA. Campos Neto is set to join fintech **Nu Holdings Ltd**.

In **Mexico**, manufacturing PMI for April was 44.8 vs. 46.8. CPI for the month of April rose 3.93% YoY, or in line with expectations. OMA's April traffic grew by 18.8% YoY, pointing to a strong second quarter. Mexico City will invest $25m in world cup infrastructure. **Ford** is increasing sticker prices on models built in Mexico by up to $2,000.

In **Poland**, **Santander** is selling its 49% stake in its Polish bank to **Erste Group** for 2.2x P/BV

## CORPORATE DEBT

### CREDIT

Markets had rallied from mid-April as the trade war between the US and the rest of the world abated and the mood persisted in the first week of May. Despite persistent tensions, the looming 90-day deadline, mixed company results with numerous companies refusing to provide guidance, the economic situation is holding up well. In the US, for example, 177,000 jobs were created in April and the unemployment rate was unchanged at 4.2%.

The FOMC was free of any major incident and rates were left unchanged for the third time in a row; Spreads continued to narrow. Euro IG gained 0.02%, Euro HY 0.36%, Euro Corp Hybrid 0.20% and Euro CoCos 0.30% despite yields on Germany's 10-year Bund moving back above 2.5% and 10-year US Treasury yields adding 15bp to 4.3%.

New issuance rose across the corporate debt board thanks to lower volatility and the advancement of the earnings season. **Harbour Energy** sold a hybrid bond and **Lloyds Bank** issued Tier 2 debt. Only the AT1 market saw no new deals. Buoyant order books and tight issue premiums both indicate that demand is still strong.

### 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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