



EDMOND DE ROTHSCHILD ASSET MANAGEMENT

MARKET FLASH: GEOPOLITICAL TENSIONS MOVE BACK TO CENTER STAGE

- **Geopolitical tensions remain high with the failure of Ukraine-Russia negotiations, the prolongation of US-Iran talks, the continued deployment of the US armada in the region, and the risk of a partial closure of the Strait of Hormuz.**
- **In the US, the FOMC minutes reveal differences of opinion among governors regarding inflation, which remains above target but is slowing, and resilient growth, which argues for patience before further rate cuts.**
- **In the UK, unemployment rose to a 5-year high of 5.2% so markets are now expecting two rate cuts before June.**

International political tension remained intense and in focus. Talks between Russia and Ukraine in Geneva once again collapsed due to fundamental disagreements over territory. And talks between the US and Iran were extended by two weeks but the US armada continued its roll out in the Gulf. Donald Trump's comments only reinforced the chance of a US strike. The risk of a partial closure of the Strait of Hormuz, through which 20% of global oil production passes, underpinned oil's risk premium with Brent crude moving close to \$70-72. Safe havens like the Swiss franc and gold also gained ground.

This week's macroeconomic data were mixed. Despite the expected growth slowdown in the fourth quarter of 2025, the US economy is still proving remarkably resilient. Industrial production is robust and job market momentum is reasonably stable. The recent FOMC minutes reflected mounting differences of opinion. Inflation is still running above target but is decelerating more than expected and growth remains resilient. All in all, the data suggest the Fed should be patient before another rate cut.

In the UK, unemployment rose to a 5-year high of 5.2% so markets are now expecting two rate cuts before June.

In Japan, PM Sanae Takaichi unveiled a multi-year budget framework designed to bring government debt under control while boosting growth through strategic investments. Her plan reassured markets and government bonds yields retreated while the yen rose. Inflation slowed to 1.5% in January, helping the Bank of Japan to put back any rate hikes for the moment.

We believe today's environment is good for equities. Company results have been upbeat and nominal GDP growth is still strong. In addition, there have been positive surprises in inflation readings. Over the shorter term, geopolitical tensions could drive volatility so diversification is the watchword. Sectors and themes like small cap and value as well as physical segments like oil have been snubbed in recent years but are now holding up well. Fixed income once again offers diversification opportunities. Amid today's ongoing

disinflation, the negative correlation between equities and bonds has returned, restoring Treasuries as a portfolio diversification and protection tool. We remain upbeat on US Treasuries and IG bonds. The US dollar is another asset which could once again offer diversification. We were underweight the dollar in 2025 but have now turned neutral versus the euro.

EUROPEAN EQUITIES

Risk aversion from AI's potential impact and deployment eased thanks to positive news in the sector but the threat is still there. The AI rollout will continue nevertheless before investors get more reassurance. As a result, software companies like Dassault Systèmes and media plays continued to suffer from potential AI disruption. The geopolitical situation remained tense. Talks between Russia and Ukraine once again broke down and joint military exercises between Russia and Iran led to the Strait of Hormuz being partially closed.

In company news, **BAE Systems** provided confirmation that the sector was riding a wave. The UK group said its order book was at record levels due to numerous countries accelerating military spending. The group's sales beat estimates and management raised free cash flow guidance for 2024-26. **Exail** also said visibility for this year was high as its order book had never been bigger. In contrast, aerospace giant **Airbus** disappointed the market with what was seen as cautious guidance. And yet its results were in line thanks mainly to strong results in the Defence & Space division. In telecoms, **Orange** saw its share price rise thanks to its new *Trust the future* strategic plan which is focused on maintaining and developing services. Results at **GTT** were in line with group objectives. Guidance for this year was cautious but in line with consensus and business conditions are expected to return to normal. **Renault's** figures were in line with expectations. The group's financial division slightly offset weakness in the vehicle business.

US EQUITIES

Wall Street gained ground thanks to macroeconomic resilience and in spite of mounting geopolitical tension and the ongoing AI disruption debate. In a shortened week because of the President's Day holiday, the S&P 500 gained 0.38%, the Nasdaq 0.6% and the Russell 2000 0.69%. But behind these statistics, market dispersion remained strong with wide share price swings. Major tech stock leadership waned in favour of more cyclical and value segments.

This week's data reinforced the scenario of a US economy that was returning to normal but still robust. As expected, December's durable goods orders fell 1.4% but segments other than transport and basic capital goods did better than expected. And in a sign that manufacturing was still strong, January's industrial production rose 0.7% MoM, or better than the 0.4% progression expected.

Against a background of accelerating capex, notably in AI and infrastructure. AI's increasing use is a core theme. Investments in data centres and semiconductors are boosting infrastructure stocks like **Cadence Design Systems** (+7.6%) and **Analog devices** (+2.6%). Both companies posted strong results and showcased AI demand. On the other hand, some software and cyber security stocks were hit by investors becoming more selective. For example, despite good operating momentum **Palo Alto Networks (-6.8%)**, sold off after cutting earnings guidance. Meanwhile, Donald Trump's comments at his first Board of Peace

meeting maintained geopolitical tensions. He said a decision on an Iran strike could be taken in the next ten days so the Strait of Hormuz looks increasingly risky.

The week saw rotation out of some defensive areas and into cyclical and investment segments. Energy gained 1.53% as WTI traded around \$65-66 on US-Iran tensions. The sector was also lifted by strong figures from **Occidental Petroleum** (+9.4%) which beat expectations and also announced lower-than-expected capex. Industry rose 1.25%. Equipment and infrastructure performed well, benefiting companies like **Deere** (+11.6%) which raised its targets and said the cycle would probably bottom this year. Quanta Services (+6.7%), was boosted by record orders for electrical networks. Financials rallied by 0.93% but remained under watch because of private credit concerns. **Blue Owl Capital's** decision to sell assets worth around \$1.4bn and end quarterly redemption windows for one of its funds, rekindled liquidity and valuation fears over non-listed funds and weighed on private equity and alternative investment stocks. Consumer staples fell 2.06% after **Walmart** posted robust results but gave cautious guidance linked to prospects for low-income household spending. Utilities slipped 0.84%, listed property 0.69% and materials 0.9%. Healthcare edged 0.26% lower. All four remained under pressure from persistently high real interest rates, the strong dollar and switches into more cyclical sectors.

EMERGING MARKETS

Most Asian markets were closed during the week for the Lunar New Year holidays. The MSCI EM index edged 0.54% higher in USD. Brazil also advanced 1.58%, while India and Mexico retreated by 0.41% and 1.5%, respectively.

China. The US Defense Department added companies like **Alibaba, Baidu, BYD, Huawei, Nio,** and **TP-Link** to a list of firms that it identifies as connected to the Chinese military. But it removed **YMTC** and **CXMT**, two of China's largest memory-chip makers. Xi Jinping said China should anchor economic growth to domestic demand as its "main driver," urging China to "coordinate efforts to boost consumption and expand investment". The IMF urged China to slash state support for its industries. **Meituan's** preliminary results were in line with expectations and management said losses might persist into the first quarter of this year.

In **Korea, Samsung** hit a fresh high on reports suggesting strong pricing for HBM3 memory chips.

In **India,** the trade deficit widened to \$34.68bn in January from \$25.05bn a month earlier, compared with a \$25.4 billion deficit forecast, mainly driven by gold imports. **Reliance** won a US license to import Venezuelan oil without sanctions. AI related investment of over \$277bn (6.3% of GDP) was announced at the India AI summit this week, mainly for data centre construction.

Brazil. President Lula arrived in India for a state visit targeting \$20bn in bilateral trade deals for the year, up from \$15.2bn in 2025. **Axia Energeia** said it would join **Novo Mercado,** improving its terms of corporate governance.

In **Mexico,** Chinese electric vehicle giant **BYD** and fellow Asian automaker **Geely,** alongside Vietnamese manufacturer **VinFast** are among three finalists bidding to acquire a plant **Nissan** which is closing in Mexico. **Fintech Plata** received final approval for a banking license, leapfrogging peers including **Nubank** and **Mercado Pago.** **Vesta** reported solid results driven by rental revenues. 2026 guidance beat expectations. **Walmex** reported better-than-expected results, driven by the Ebitda margin.

In **Peru**, the impeachment of President Jore Jeri, although unexpected, was not a complete surprise as the country had been going through a long period of political instability. Jose Maria Balcazar was appointed as interim President. The market's attention is on the copper price and the next presidential election in April.

In **Argentina**, January's fiscal balance posted a surplus of \$2.3bn.

CORPORATE DEBT

Credit markets calmed down as concerns over AI's impact on software companies eased. But US-Iran tensions resurfaced and sent risk premiums higher and government bond yields lower. US inflation data continued to reassure investors.

Both investment grade and high yield indices ended the period more or less flat. The Crossover index widened by 4bp to 250bp while the 10-year risk-free rate fell 5bp to 2.74%.

In company news, **Eramet** reported a steep drop in results but announced a €500m capital increase to bolster its balance sheet. The group is also mulling a bond issue. There were no new high yield deals over the week. In financials, Denmark's **Nykredit**, which has 0.6% exposure to Greenland, sold an AT1 bond at 5.25%. In the hybrid segment, US company **Nextera Energy** is on a roadshow for a €1.75bn perpetual debt issue.

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.
- CTA: quantitative strategy which uses futures to invest in a wide range of financial assets, including equity indices, short-term and long-term interest rates, currencies, and commodities.
- 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.
- RT1s: perpetual bond issues with early redemption possible after 10 years. Coupon payments are discretionary and non-cumulative.

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