



MARKET FLASH: HOLD ON

- Due to prolonged output cuts from Saudi Arabia and Russia, Brent crude briefly topped \$95, rekindling worries over inflation.
- As expected, the Fed left rates unchanged but the tone turned more hawkish. The bank raised its benchmark rate forecasts for 2024 and 2025, citing improved growth prospects.
- We had already reinforced our equity exposure for the short term when markets were falling. Over the medium term, we remain somewhat cautious on risk assets as restrictive monetary policy will take time to feed through to the real economy.

Due to prolonged output cuts from Saudi Arabia and Russia, Brent crude briefly topped \$95, rekindling worries over inflation. European oil prices have gained 30% over the last three months and 10% alone so far this month. This is clearly a supply problem as other commodity prices have stayed relatively unchanged.

The oil price surge is already feeding through to transport and energy items in some inflation indices. Canada's CPI, for example, is up 0.4% over a month. However, we feel the global disinflation trend is structural. Excluding transport, the UK's CPI has all items either falling or stable.

As expected, the Fed left rates unchanged but the tone turned more hawkish. The bank raised its benchmark rate forecasts for 2024 and 2025, citing improved growth prospects. The Fed wants to maintain restrictive interest rates for some time, i.e. until the economy shows more substantial signs of weakness.

Bond markets reacted by sending real US 10-year rates above 2%. This naturally pushed the dollar higher and undermined global equity indices.

But in Latin America, which has been more proactive in monetary tightening, countries can afford to trim benchmark rates. Brazil, for example, cut its rates by 50bp to 12.75%. In contrast, Norway and Sweden raised rates by 25bp. The surprise came from the Bank of England and Switzerland's national bank which opted for a pause.

In Japan, the BoJ stuck to its ultra accommodating stance despite inflation running at 3.2% and a yen flirting with the psychological level of 150 against the dollar.

We had already reinforced our equity exposure for the short term when markets were falling. Over the medium term, we remain somewhat cautious on risk assets as restrictive monetary policy will take time to feed through to the real economy. In fixed income, we remain overweight duration, a stance which should provide protection during the economic slowdown.

EUROPEAN EQUITIES

The optimism following the ECB meeting soon fizzled out. Markets wiped out almost all the gains made in the previous week. This followed central bank comments that high rates would be around for longer than expected due to persistent inflation. High real rates put the Stoxx 600 index on a particularly low forward 12-month PE of close to 12.

Telecoms and banks were the best performing sectors in Europe despite **Société Générale's** severe sell off when new CEO Slawomir Krupa disappointed investors with his "attainable goals strategy."

In the UK, **JD Sports** gained after sales rose more than 8% to £4.78bn, or 3% better than expected by analysts.

Bouygues is to delist its construction and transport infrastructure COLAS subsidiary by offering €175 a share, a 52% premium to the price over the last three months. The total cost for Bouygues will be around €180m.

In M&A, **Engie** is paying £64.8m for UK-based Ixora Energy, a leading biomethane producer. The acquisition will add 3 new production facilities to Engie's portfolio. Norway's Adevinta confirmed that a private equity consortium created by Blackstone et Permira had made a bid. **Adevinta** then traded 20% above its previous closing price.

US EQUITIES

Wall Street had a difficult week, largely due to the Fed's more restrictive tone. The S&P shed 3.89% over the period and the Nasdaq lost 5.04%. Twelve out of nineteen members of the Fed's rate-setting committee argued in favour of another rate hike before the end of 2023.

James Bullard said another hike would probably be necessary and suggested the Fed should keep rates high for rather a long time to ward off any chance of inflation reaccelerating. On Thursday, former Treasury Secretary Larry Summers said he thought the Fed's economic forecasts were too rosy.

Economic indicators also fuelled fears of persistent inflation pressure: weekly jobless claims fell to an 8-month low of 20,000 in another sign of US labour market resilience. The probability of a Shutdown increased after a majority in the House of Representatives refused for the third time to approve a Federal budget text. Congress has up to September 30 to reach an agreement. Oil prices added 1% on Friday morning following Russia's decision to ban diesel fuel exports.

In company news, **Cisco** lost 3.8% after spending \$28bn, or \$157 a share, for software company **Splunk** (+20.8%). This is Cisco's largest-ever acquisition. **Broadcom** shed 2.7% after a newspaper article alleged that Google was considering manufacturing its own AI chips from 2027. **ARM** lost ground for the 5th day in a row. The share has now lost \$12bn in market cap since its recent IPO. **Amazon** intends to hire 250,000 seasonal workers in the US over the Christmas season, or 100,000 more than last year. **Walt Disney** lost 3.6% after saying it would invest a massive \$60bn in theme parks and cruises over the next 10 years, or double the amount invested over the last 10 years

In healthcare **Pfizer** (-3.81%) and **Moderna** (-11.15%) continued to fall after indications that less than 25% of people in the US were likely to have the new Covid vaccine. In consumption, **Coty** (+6.88%) raised guidance on growth amid strong momentum for perfumes in the US. And Instacart seized on fresh interest in IPOs to start trading on Wall Street. In autos, the UAW union threatened to extend strikes from today if no serious progress was made in talks with Detroit's Big Three (**GM, Ford and Stellantis US**).

JAPANESE EQUITIES

The NIKKEI 225 and TOPIX indices fell 1.80% and 0.92%, respectively. They had a strong start for the first two days but declined after the September 18th public holiday. The downturn was due to further declines in US semiconductor stocks and additional upward pressure on interest rates in both the US and Japan. There was also a feeling that the Bank of Japan (BOJ) might find it challenging to implement measures to keep interest rates low. Nevertheless, there are still positive developments on the horizon, including interim dividends and efforts to revitalise the equity market such as increasing Return on Equity (ROE).

Marine Transportation rose 5.58%. Iron and Steel gained 2.32% on solid commodity prices and hopes for upbeat results. Electric & Power increased 2.30% due to higher electricity and gas prices. **Tokyo Gas**, a gas provider, gained 4.44%. In contrast, Precision Instruments fell 4.62% due to semiconductor stock weakness in the US. Services and Retail Trade ended the period 2.87% and 2.66% lower due to soft consumption and rising bond yields in Japan.

Nissan Motor jumped 5.26% on the weak Yen. It is also possible that the UAW strikes could drag on, leaving room for Japanese car manufacturers to expand in the US. In insurance, **Sompo Holdings** rose 4.35% on assumptions the Big Motor scandal issue had been discounted. Elsewhere, sporting gear company **Shimano** tumbled 7.96% as selling continued. **Nidec**, a manufacturer and distributor of electric motors, fell 6.50% on economic weakness concerns. **Hoya Corporation** (optical products and medical equipment) shed 6.30% on profit taking.

The yen fluctuated between the mid-147s and low-148s against the dollar. The FOMC meeting led to worries that another hike was possible this year with a slower pace for any rate cuts in 2024, an assumption that naturally weakened the yen.

EMERGING MARKETS

The MSCI EM Index was down 2.9% as of Thursday's close. Major Asian markets underperformed as the prospect of higher US interest rates crimped the appeal of risk-driven assets: Taiwan and Korea fell 4.7% and 4.3%, respectively, while China closed 3.5% lower. India ended 1.8% lower and Brazil shed 2.9%, consolidating the previous week's gain.

In **China**, the PBoC kept one- and five- year loan prime rates (LPR) unchanged at 3.45%/4.2% for September, or in line with expectations. More easing measures were announced on the property front with Guangzhou being the first tier-1 city to relax buying rules for non-residents, while Chongqing eliminated first home tax for new buyers. The CSRC pledged to intensify the crackdown on illegal shareholder sales by speeding up investigations and imposing heavy penalties. China is considering raising foreign ownership limits to promote non-domestic investment. Beijing and Shanghai also released rules to ensure free cross-border money transfers for foreign businesses.

US and Chinese officials met in Malta and discussed communication channels between the two countries. A meeting between Joe Biden and Xi Jinping in November during the APEC in San Francisco might be possible. **Cainiao**, **Alibaba's** logistic branch, is reportedly to file for a \$1bn HK IPO soon. Midea plans to issue H-shares in Hong Kong.

In **India**, the government is working on a PLI (production-linked incentive) scheme worth \$1.4bn for heavy machinery used in mining and construction. JPM said it was including India in its flagship GBI-EM Global Diversified index, a milestone event for India's bond markets.

LG Energy Solution is in talks with **JWS** to make EV batteries in India, and Foxconn plans to double the size of its business in India. **Micron Technology** intends to build several semiconductor assembly and packaging units in India in addition to its proposed production unit. So far, feedback from the festival season has been quite positive.

Brazil's central bank cut the Selic rate by 50bps as expected, but the tone was more hawkish so there is less probability the pace of cuts will accelerate. **MercadoLibre** is to redeem its outstanding convertible senior notes due 2028. In **Mexico**, **Banxico** said that 9.3% of Mexican companies had increases in their production sales or investment thanks to nearshoring. The President of the European Commission said the European Union should aim to complete a free trade agreement with Mexico this year.

CORPORATE DEBT

CREDIT

It was a good week for new issuance as demand remained strong. The biggest deal was from Bayer with two new hybrid tranches to replace its existing 2024 and 2025 bonds. This move by a leading issuer to prefinance call dates is a very positive signal for the hybrids market and we believe yet another indication that extension risk has been overdone. Bayer is buying in the two maturities at a slight discount. The two new jumbo hybrids are a 6.625% BB+ NC28 for €750m and a 7% BB+ NC31 for €1bn. The issues were five times oversubscribed, a token of strong investor appetite for high coupon deals. In the high yield segment, the best-rated companies continued to issue bonds. Italy's **Webuild** (BB) raised €450m at 7% due 2028 and **WorldPay** (BB) £600m at 8.5% due 2031.

In financials, senior debt deals continued but there was nothing of note in T2 and AT1 debt over the period. Elsewhere, Fitch followed S&P in upgrading **Banco Comercial Portugues**. The bank is once again rated 100% IG for senior debt. Moody's upgraded Greek banks **Alpha** from Ba2 to Ba1 and **Piraeus** to Ba3.

Investment grade spreads were unchanged at 147bp and at 418bp for high yield. The Xover made a technical move up to 420bp on Friday morning due to a roll over. Government bonds were very volatile with 5-year Bund yields up 6bp to 2.77% as of Thursday evening and 10-year yields up to 2.75%. The risk free rate ended the period flirting with 2023 highs.

Yield shifts left investment grade 0.19% lower over the week (+2.6% YTD) while high yield lost 0.14% (+6.4%). These returns demonstrate the wisdom of carry strategies, a focus we have recommended for more than a year. Returns as we approach the end of the third quarter have attained three-quarters of the actuarial yield for the whole of 2022. Actuarial yields for investment grade were 4.5% and 7.4% for high yield, or still good entry points for carry strategies. In risk/return terms, our strategy still looks very attractive as we can build largely investment grade portfolios yielding a gross 5% over 5 years.

CONVERTIBLES

Markets were surprised by the Fed's restrictive tone and indices lost ground. As a result, convertible returns were negative over the week.

In the US, deal-making resumed with **Cisco** making a \$157-a-share bid for Splunk. The deal values **Splunk** at \$28bn, or 31.3% above the last price. Splunk's 2025 and 2027 convertibles gained 4 and 6 points, respectively, on the news. The deal should complete by September 2024.

In new issuance, electric car market **NIO** raised \$1bn to refinance its 2024 maturities. The deal came in two \$500m tranches, a 2029 maturity at 3.578% and a 30% premium and a 2030 tranche at 4.625% also with a 30% premium.

In Europe, **Snam** returned to the convertibles market, raising €500m with a 2028 bond at 3.25% and a 20% premium which is exchangeable into Italgas shares.

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.

22/09/2023

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.

Copyright © Edmond de Rothschild Group - All rights reserved

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