# MARKET FLASH: CHINA RAISES CONCERNS

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**Risk assets have lost ground since the beginning of August. As August 15 is a national holiday in some countries, thin summer trading was accentuated as bond yields revisited recent highs and worries mounted over China's property sector. This followed property group Country Garden's failure to pay two coupons on dollar bonds. In addition, China's retail sales and industrial production in July fell short of expectations. The central bank immediately cut its rates but failed to reassure investors.**

**In the US, however, July retail sales rose 0.7% when they were seen only up 0.4%. Advanced indicators delivered contradictory messages. New York's Empire Manufacturing survey fell sharply while the Philly index came in much higher. The FOMC minutes were released on Wednesday evening and bond yields rose. The rate-setting committee debated the lag in the impact of rate rises on the economy but still thought inflation was too high. As a result, yields on the benchmark 10-year Treasury briefly shot above 4.3%.**

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## EUROPEAN EQUITIES

After the rush of half-year results, the week was the quietest so far this year. However, M&A continued, first with Abu Dhabi National Oil Co (ADNOC) sweetening its bid for **Covestro**. After a first move in the spring, it raised its bid by 20% in an attempt to win over the German company's management team. And then Exor, the Agnelli family's holding, bought a stake in **Philips** as part of a long-term partnership. Philips' share price has fallen significantly over the last two year due to a product recall.

There were few earnings announcements, but payment specialist **Adyen**, formerly a European star, tumbled 45% over the week after mixed results undermined its high growth status. Elsewhere, **Wienerberger** (building materials) warned on a sharp slowdown in residential building, especially in Eastern Europe. Italy is still discussing a new version of its bank tax that could prove acceptable.

## US EQUITIES

Wall Street continued to lose ground as long term bond yields moved higher and more and more bad news came out of China.

July's retail sales rose by a surprising 0.7%, another token of consumer resilience in the US. True, the figures benefited from Amazon's Prime Day but consumer discretionary categories like clothing, sports articles and restaurants performed particularly well. The Atlanta Fed now sees retail sales rising by an annualised 5% in this quarter. The FOMC minutes, released mid-week, highlighted the intense debate among committee members who said there were still significant inflation risks which could mean further rate hikes.

Some stocks saw increased volatility in thin summer trading. Health insurance plays like **CVS**, **Cigna** and **United Health** sold off as investors questioned their business model after the loss of contracts.

The week also saw results from leading retailers like **Home Depot**, **Walmart** and **Target**. They pointed to inventory normalisation, a slight recovery in big ticket items and more market share gains by Walmart.

In tech, **Cisco**'s reassuring figures showed no signs of a slowdown. The order book was marginally down on last year but was up 30% on the previous quarter.

UAW, the largest trade union in the autos industry, has approved a strike next week if no wage agreement is reached. A stoppage looks unavoidable as they are asking for a 40% rise over 4 years with 20% this year. Production could be seriously impacted in the fourth quarter.

## JAPANESE EQUITIES

The NIKKEI 225 and TOPIX fell by 1.80% and 1.29% on concerns over further US rate hikes and China's economic deterioration.

Mining rose 6.61% led by **Inpex**, an oil and natural gas company, which jumped on better-than-expected guidance for this year and a share buyback. Construction edged 0.86% higher as investors moved from export to domestic demand stocks on Chinese weakness. Insurance gained 0.69% on expectations of higher US rates. On the other hand, Precision Instruments tumbled 7.72%, led by **Olympus** (endoscopes and therapeutic equipment) which cratered 17.97% after a first-quarter earnings miss. Iron & Steel and Wholesale Trade lost 3.46% and 3.39% on profit taking as markets turned risk-off.

**Japan Post Holdings** gained 5.01% after unveiling a bumper share buyback. **Subaru** (autos) rose 3.49% on the weaker yen. **Fujifilm** (photography, medical care, liquid crystal display materials and copying machines) gained 3.22% on a first quarter earnings beat. Elsewhere, **M3**, a healthcare platform provider, plunged 8.54% as large-cap growth stocks were sold off. **Terumo** (medical supplies) fell 7.18% as China is one of its main sources of revenue.

The dollar strengthened from the high 143s to the high 145s against the yen and even spiked above 146 on US rate hike expectations.

## EMERGING MARKETS

The MSCI EM Index was down 2.34% during the week as of Thursday. India (-0.55%) outperformed while Brazil, China and Korea led declines, falling 4.37%, 3.33% and 3.1%, respectively.

July's macro data from **China** continued to reflect a weaker-than-expected summer: retail sales growth decelerated to 2.5% YoY, versus market estimations of 4%, and 3.1% in June.

Industrial production growth also slowed to 3.7% in July from 4.4% in June. China has officially moved into deflation territory given the 0.3% drop in June's CPI and the only bright spot is the service sector: July's Caixin PMI Service index rebounded to 54.1. Credit woes returned as **Country Garden**, once the largest private property developer in China, sought to extend the early September due date of a bond and **Zhongzhi Trust** triggered fresh anxiety about China's shadow banking industry after missing payments on multiple high-yield products with property developer exposure. Although more 2nd and 3rd-tier cities such as Nanchang, Zhengzhou and Xiamen started to loosen or even stimulate the property sector, the real effect nationwide is yet to be seen. The PBoC also lowered MLF rates, defended the renminbi and promised to optimise property policies and make credit growth more stable. The central bank also expects CPI to rebound from August. Company wise, internet companies **Tencent**, **Alibaba** and **JD** all reported better-than-expected results thanks to a slight recovery in consumer sentiment and cost-cutting efforts. Their guidance remained cautiously optimistic for the rest of the year.

**Korea**: while **LG Chem** consolidated on the news of Tesla price cuts, **Hynix** continued to benefit from upbeat AI momentum. China's weak economic figures also weighed on **Samsung Electronics**.

In **India**, companies generally beat top-line expectations in the first quarter of fiscal 2024. Ebitda margins expanded significantly, albeit in line with consensus. Excluding the oil sector, revenues and net profit growth rose 11% and 30%, or better than expected. Despite the quarter-on-quarter top line deceleration, the figures were better than feared. Consumer discretionary (including autos) reported the best earnings growth, while materials and export sectors (IT) disappointed. The earnings beat improved to 58% QoQ. After the results, consensus earnings expectations were revised upwards. Elsewhere, **Hyundai India** announced the acquisition of some GM plants, expanding its Indian capacity to 1mn units by 2025. **Hon Hai** approved investments of $400m for its new plant in India for Apple AirPods (mass production is expected in December 2024).

In **Brazil**, higher US bond yields put additional pressure on the central bank to accelerate the pace of interest cuts. NB: next week's Lower House vote on the new fiscal framework is at the same time as a government decision on the 2024 budget bill. Despite **Natura**'s better-than-expected results driven by a higher gross margin, the market was disappointed by the company's failure to give a clear target for Wave2 implementation in Brazil. **Nubank bank** CEO Valez sold a $191m stake in the firm.

In **Chile**, **SQM** reported weak 2Q23 results. EBITDA and net profit were 18% below expectations due to lower prices, despite sequential volume recovery thanks to restocking in China.

## CORPORATE DEBT

### CREDIT

A typical summer week with no new deals and no specific issuer news. However, SFR and its parent company **Altice** had a turbulent time on markets due to fraud allegations. They recovered after Patrick Drahi issued a statement.

In the event, macroeconomic events dominated the news, with somewhat negative figures out of China - growth faltering, property companies verging on bankruptcy and renminbi weakness - which were offset by the looming end to the rate hike cycle and big drops in inflation. Government bond markets were volatile. On Friday morning, yields on the 10-year German Bund were 2.62%, down from 2.72% the day before. Credit premiums widened a little to 426bp on the Xover, up from 400bp at end June, and 440bp on cash HY bonds, vs. 430bp in July. Investment grade premiums rose to 152bp compared to 146bp at the end of July. Euro CoCos followed suit, widening by around 80bp to 820bp.

As of Thursday evening, interest rate and premium moves left investment grade 0.53% lower over the week, taking YTD gains to 2.3%. High yield edged 0.27% lower but was still up by 5.3% year to date. These returns demonstrate the wisdom of carry strategies as net yields after 8 months are already equal to approximately two-thirds of the actuarial yield at end 2022. Actuarial yields for investment grade are currently 4.4% and 7.5% for high yield, i.e. still good entry points for carry strategies.

## CONVERTIBLES

Since the beginning of August, convertibles have fallen as much as equities due to widening spreads and more rate hikes. Valuations have fallen by around 0.5% across all geographical zones. The US and Japan are now at fair value while Asia and Europe are trading at a discount of more than 1%.

The month has also seen a sharp upturn in new issues in the US after a deal-free July. So far 8 deals have raised $5bn, taking the year-to-date tally to $31.1bn or more than the $29.7bn for 2022 as a whole.

The week's new deals included **Akamai** (infrastructure software) which raised $1.1bn at 1.125% due 2029 to prepare for the refinancing of its 2025 maturity. And software company **Workiva** raised $625m at 1.25% due 2028 while offering to buy in $397m-worth of its 2023 1.125% convertible.

**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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