EDMOND DE ROTHSCHILD

MARKET FLASH: IS EUROPEAN EXCEPTIONALISM A POSSIBILITY?

- **Wall Street is down close to 4% due to mounting trade uncertainties and waning optimism over the AI theme.**
- **D. Trump is fuelling uncertainty and volatility on the markets with his contradictory statements on tariffs, maintaining the March 4 date for the application of tariffs on Canada and Mexico, while increasing those on China by 10%.**
- **The geopolitical context is prompting European countries to increase their defense budgets, which could lead to an easing of European fiscal constraints.**

Despite the increasingly fraught international environment, European equities continue to prove remarkably resilient. They have only retreated a little while US equities have accelerated declines. Wall Street is down close to 4% due to mounting trade uncertainties and waning optimism over the AI theme following Nvidia's results. Meanwhile, Donald Trump continues to blow hot and cold over import tariffs, accentuating confusion and volatility on financial markets. The first indication suggested tariffs on Canadian and Mexican imports would be put back to the beginning of April but now the US president has confirmed March 4 as the start date while raising tariffs on Chinese imports by another 10% They had already been raised by 10% last month. This latest development represents a serious escalation in the trade war between Washington and Beijing. China's equity markets had held up well so far but this fresh salvo finally triggered investor concerns and sent domestic indices lower at the end of the week.

The contrast with European equity markets is striking: they barely flinched when Donald Trump threatened a 25% hike on European imports, notably autos. Apparently, investors are not taking this threat seriously. The US president is famous for about-turns and markets are probably betting on some compromise being reached. In the meantime, traders are bidding up good news in "old Europe" and notably an improvement in economic data. Germany's retail sales, for example, came in much better than expected and there are particularly reassuring signs on inflation, especially in France where the annualised reading came in at a 4-year low of +0.9%. There is little doubt the ECB will cut rates next Thursday but these developments reinforce hopes for further easing in the rest of 2025. Markets are now expecting an 87bp cut in benchmark rates by December and government bond yields have already fallen back significantly.

The other source of optimism in the eurozone is the chance of a peace deal in Ukraine. Volodymyr Zelensky finally accepted Donald Trump's plan for Ukraine's mineral deposits so the door is open to talks with Moscow over an end to the war. Whatever happens, European countries will have to boost spending on defence and that could mean some easing in fiscal constraints within Europe.

In the US the Republican motion to prolong the tax deductions from Donald Trump's first period in office advanced in the House of Representatives. It was, however, a difficult ride because of criticism that the $4.5 trillion package was not offset by cuts to the budget. The plan does not, however, represent, additional support for US companies so it should not have much impact on growth rates. But the other measures introduced by the Trump administration are expected to slow growth.

We believe these risks have not been sufficiently factored in by equity markets so we are maintaining our cautious, underweight stance. We have a relative preference for China which will benefit from measures announced by Beijing in recent months and from renewed interest in the domestic tech sector.

EUROPEAN EQUITIES

European equities had been among the best performing markets since January 1st but paused this week for breath and ended the period flat after US tariff threats hit already weak sectors like autos. **Stellantis** then released disappointing figures and management sees no improvement in sales this year. The index continued to be underpinned by banks and insurance groups: financials have made the best returns year to date but mixed results from tech plays stopped the index rising.

In semiconductors, equipment supplier **Aixtron**'s guidance for this year fell short of expectations and the stock plunged 12%. **ASM International** also said its order book was on the thin side but the group insisted it was more optimistic about the outlook and a lower contribution from China. Results at French IT consultancy **Sopra Steria** were in line but guidance was disappointing; the CEO said the first quarter should be the low point. In advertising, **WPP**'s forecasts for 2025 were lower than expected. Management blamed economic uncertainty, weakness in China and its clients' discretionary spending. The stock dragged down the entire sector including **Publicis**.

In contrast, the picture is becoming rosier for high growth companies. **VusionGroup**, the leading manufacturer of electronic store labels, hit an all-time high after its results and guidance swept past expectations. Figures at **Technip Energies** also beat expectations and the group reiterated its guidance. And **GTT** rebounded by 16% on inspiring guidance for 2025 with management also confirming that the future was looking bright for its LNG business.

US EQUITIES

US indices tumbled this week. The S&P 500 fell 4.2%, the Nasdaq 6.8% and the Russell 2000 5.4%.

The tech sector's "magnificent seven" have decidedly not have a good start to 2025. **Apple** (-3,9%) said it would be investing $500bn in the US over the next four years to drive AI, the silicon industry and R&D headcount. **Tesla** plunged 14.7% over the period due to a sharp slowdown in European sales. Chinese companies benefited, and especially **SAIC** which saw its sales jump 30%. In addition, chip giant **Nvidia** (-8.4%) announced better-than-expected results but investors were clearly expecting even more. The drop occurred just a month after its Chinese rival **DeepSeek** burst onto the scene while uncertainty persists over the Trump administration's trade policy, particularly as concerns China.

In software, **Salesforce** (-4.3%) saw earnings rise in the fourth quarter but announced disappointing guidance for 2025. **eBAY** (-9.3%) had a modest fourth quarter and gave lukewarm guidance, a reflection of uncertainty over the outlook for the US economy. **Warner Bros** (-0.8%) continued to lose steam in linear TV (50% of sales) and is to focus on streaming and production studios.

In the defence sector, aerospace and electronics company **Heico** (+12.8%) reported upbeat results thanks to the commercial and military aftermarket. Another winner was **Kratos Defense** (+7.7%) which makes satellites and drones.

In today's uncertain environment, defensives like defence, healthcare and consumer staples are holding up well. WIthin the S&P 500, healthcare returned 0.03%. The rotation out of tech is boosting Biopharma majors (**Bristol Myers** +5.4%, **Merck** +3.3%) as well as medical equipment makers. **Baxter**, for example, gained 4.9% thanks to a rebound in sales of its pharmaceutical and surgical products. But the Biotech XPI index plunged 6% along with small caps.

EMERGING MARKETS

The MSCI EM index was down 0.8% this week as of Thursday's close. China jumped 3.6%, while Taiwan, India, Mexico and Brazil fell 2.5%, 3%, 3% and 6% respectively.

In **China**, the market continued to rise, fuelled by gains in the technology sector. **Alibaba** announced that its AI and cloud capex would exceed RMB 380bn over the next three years (more than $50bn). **DeepSeek** is likely to accelerate the release of its next-generation R2 model, targeting to launch the model before May as previously expected. **Nvidia** announced that its GTC 2025 conference will host a China AI Day. **ByteDance**, Volcano Engine, **Alibaba Cloud**, **Baidu**, **ANT GROUP CO.**, **LTD.**, **JD.com**, **Meituan**, **Kuaishou**, Baichuan Technology, **Laie Technology**, and **Votee AI** are among the companies attending. On the macro side, all eyes are on next week's National People's Congress, for a definition of GDP growth target, budget and other important economic figures.**T COM** reported solid results with 24% revenue growth, beating expectations.

In **Taiwan**, stocks corrected after **Nvidia**'s results and the management's conference call which indicated margins below expectations. The stock tumbled 8%.

In **India**, January CPI inflation softened to 4.3% due to moderation in food prices. Core inflation went up to 3.7%. In a more dovish movement to motivate credit growth, the RB, reduced risk weightings on bank loans to NBFC and micro finance institutions. In the auto sector, February's registrations fell 2% for 2W, 5-7% for PV/trucks and 12% for tractors. **Ultratech** announced plans to invest INR 18bn ($200m) in the cable and wires business over the next 2 years. The news triggered a correction across the sector. However, Ultratech's net capex is considered small to the size of the cable and wire industry and future market share gains are expected to come from unorganized segments and weaker brands.

In **Thailand**, **CPALL** made an official statement that it would not participate in **Seven&I** investments, removing an important overhang. The company reported upbeat results with EPS up 31% YoY and 28% QoQ, thanks to a better mix.

In **Brazil**, the market reacted negatively to the news of a possible new fiscal stimulus, as inflation remains elevated. Weg reported good results: the top line grew 26% and 14% QoQ, but the EBITDA margin decreased sequentially, disappointing consensus expectations.

Mexico: President Trump reiterated his intention to place 25% tariffs on Mexican imports from March 4th. **Oma** reported better-than-expected results, driven by non-aero revenues, but disappointed on higher financial expenses Traffic is expected to continue strong. **Walmex** will launch a financial service to leverage its network of stores in the US and Mexico to bolster remittance services.

In **Poland**, retail sales rose 6.1% in January (vs. 2.7% in December), reflecting a strong rebound in consumption, mainly driven by the food sector. The market has been pricing a higher probability of a ceasefire between Russia and Ukraine, benefiting Polish equities.

CORPORATE DEBT

CREDIT

Little by little, questions are being raised about how exceptional the US economy really is. Growth estimates for the second half of this year are trending lower. Doubts were fuelled this week by: (i) **Nvidia** whose results beat expectations but not enough for equity markets, (ii) worries that core PCE might come in higher than expected and undermine the chance of rate cuts and (iii) more and more declarations from the Trump administration on plans to impose import duties. As a result, interest rate volatility rose, the S&P 500 lost 2.5% and the US CDX HY widened by 11bp.

However, European credit markets remained resilient. The Xover only widened by 4bp, HY gained 0.15%, IG 0.22%, Euro CoCos 0.08% and USD CoCos 0.17%.

Financial new issuance was more active than corporate deals but **Metro AG**'s success in raising €600m over 5 years at 4% stood out as the order book amounted to more than €6bn! Elsewhere, upbeat results from supermarket chain **Auchan** and **Deutsche Pfandbriefbank** were cheered by investors and their bonds outperformed sharply. In other news, an agreement was reached between **Altice**'s owner Patrick Drahi and the group's creditors on a restructuring of the telecoms group.

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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