MARKET FLASH: THE FED NOW HAS MORE REASSURING DATA

- ***After several months of rising inflation, the pace seemed finally to slow, the first drop this year.***
- ***This trend lower was underpinned by some slowing in services ex-shelter.***
- ***For the time being, we are still overweight equities in the US and Europe amid hopes that a rate-cutting cycle could soon start in advanced economies.***

After several months of rising inflation, the pace seemed finally to slow, the first drop this year. The MoM increase was below expectations according to recent figures and underlying inflation (ex-food and energy) also slowed as expected. This trend lower was underpinned by some slowing in services ex-shelter. We expect this trend to continue, especially as the first signs of the labour market running out of steam have started to appear as well as reduced pressure on wage demands. In the circumstances, companies could be less keen to increase prices for consumers. Recent retail sales figures also pointed to stagnation, in all likelihood because household demand is being affected by inflation, the recent drop in surplus savings and restrictive funding conditions. April's industrial production and property market trod water, a sign of an incipient slowdown in the US economy. Even if New York Fed chair John Williams declared that recent inflation data would not change US monetary policy significantly -and that other indications were required- the Fed could still use recent data to cut rates in July. Treasury yields could then fall further.

For the time being, we are still overweight equities in the US and Europe amid hopes that a rate-cutting cycle could soon start in advanced economies. We are still keeping a close watch on the impact of higher rates, today's main risk factor, but we feel the drop in real interest rate volatility is an encouragement to take on risk. In fixed income, we are mainly overweight the middle of the yield curve as we are confident that central banks will cut base rates given recent progress on inflation.

EUROPEAN EQUITIES

European markets made significant gains over the period and even hit new highs. Sentiment was mainly driven by Wednesday's CPI print in the US. Following some surprising moves higher, the figure was in line with expectations so investors were reassured on inflationary momentum. Government bond yields in the US and Europe promptly fell and equity markets surged. Several indicators suggest the US is slowing, a good point, but Europe continued to rebound with a MoM increase of 0.6% in March. And the ECB has made no secret of its intention to cut rates in June.

Cyclical sectors and those sensitive to funding conditions easily outperformed, led by property which rallied after a big sell-off. Telecoms and utilities were next, along with banks which are still enjoying high net interest income. Energy, however, was hit by downward pressure on oil prices in the absence of any deterioration in the geopolitical situation. However, there were press reports that some OPEC+ countries were keen to revise output levels. Slowing demand for luxury goods, especially in China, continued to depress the consumer goods segment even if losses were concentrated on less well-positioned companies like **Burberry**. The British fashion house saw continental China sales slump 21% and profits tumble 45% over a year.

Nevertheless, with 75% of European company first-quarter results now in, 59% beat expectations, or more than the historic mean of 54%.

Veolia reported a 5.7% like-for-like increase in first-quarter EBITDA to €1.62bn and the EBITDA margin came in at 14%, or more than the 13.6% expected. Management confirmed that the group had made big efficiency gains and benefited from synergies. Full-year guidance was maintained.

In contrast, Germany's **Siemens** fell sharply due to difficult trading in its **Digital Industries** division. Sales in the 2023/24 second quarter were €19.13bn (vs. €19.28bn expected) and EBIT was €2.51bn, or below the €2.67bn expected. The EBITDA margin came in at 14% vs. 14.8% expected. Sales at its **Digital Industries** fell 11% like for like with EBITA down 41% to €741m. The problem stemmed from lacklustre demand in China due to overcapacity and destocking. The situation in Europe is better but the rebound has so far failed to offset the damage.

US EQUITIES

This week offered a reminder of Covid era speculation among retail investors: **GameStop** soared briefly at the beginning of the week and heavily shorted companies and meme stocks like **AMC** and **Sunpower** followed suit.

Tech and small caps then took over leadership thanks to CPI coming in as expected and despite PPI overshooting. The Nasdaq (+2%) hit another record and the Russell 2000 ended 1.5% higher.

The market cheered **Walmart's** figures: margins improved more than sales, inventory was in great shape and prospects for the e-commerce business improved. Management said customers were looking for cheaper products and also pointed out that high-revenue customers had returned to shop with the store. In healthcare, sales at **Kenvue** fell less than expected and a strong 5% price increase offset the decline. Medical platform **Doximity** jumped before the opening after management revised earnings guidance higher for 2024 as a whole. In the energy sector, first-quarter results at **Valaris** were better than expected and management was upbeat on the outlook for the rest of the year despite a certain lag in contracts with Brazil's **Petrobras**.

Sam Altman's nuclear fission start-up **OKLO** started trading last week ($OKLO ticker), following the successful merger with its SPAC.

In this week's 13F filings, Warren Buffet started a position in **Chubb** and **Google** quadrupled its stake in **Gitlab**.

EMERGING MARKETS

The MSCI EM index had gained 2.56% this week as of Thursday. **Taiwan** (+4.62%) led outperformance. **China**, **India** and **Korea** also performed well, up 2.97%, 2.28% and 2.40% respectively. Brazil edged 0.14% higher while Mexico was down 0.13%, both underperforming.

In **China**, headline CPI edged up from 0.1% YoY in March to 0.3% in April while PPI deflation moderated slightly from -2.8% YoY in March to -2.5% in April. Exports rebounded from -7.5% YoY in March to +1.5% in April and imports jumped from 1.9% YoY in March to +8.4% in April on a favorable base effect. Money and credit data came in way below expectations in April, with M1 YoY growth registering its first negative print and net flows of Total Social Financing dropping to a record low. The government announced support measures for both the demand and supply side: easier financing conditions nationwide for home purchases and more liquidity support to developers at local levels. On the geopolitical front, the **US** is to add tariffs to $18bn-worth of Chinese imports, narrowly focused on steel, semiconductors, EVs, and battery/solar cells. The updated BioSecure Act will allow an 8-year grace period to cut ties with Chinese biotech suppliers. Tencent reported an all-around beat. **Alibaba** announced an inline quarter with $4bn in dividends and $12bn in buy backs. **Samsonite** reported an improvement in profitability while guidance was revised down on weaker-than-expected global travel.

In **Taiwan**, **TSMC's** April sales were ahead of expectations, and the company remains confident of receiving subsidies from the German government for the **Dresden** fab. **Hon Hai** reported weaker-than-expected profits as demand for iPhones remained sluggish in **China**, though it projected significant growth in the current quarter. **Uber** is buying **Delivery Hero SE**'s business in **Taiwan** for $950m.

In **Korea**, April imports rose 2.9% YoY vs -0.4% estimated and exports rose 6.2% YoY, or ahead of the 2.9% expected. The unemployment rate for April was in line with estimates at 2.8%. The government unveiled measures to support real estate project-finance debt. The cabinet is preparing a $7.3bn programme to strengthen the country's semiconductor industry.

In **India**, headline inflation hit an 11-month low of 4.8% YoY in April from 4.9% in March, driven by a decline in fuel inflation. In April, exports were up 1.08% YoY and imports jumped 10.27% YoY. The number of active SIP accounts increased by 20 million in FY24, or almost double the 10.8 million net additions in FY23. **Zomato** reported better-than-high-expectation results with a quick commerce business breakeven in March. The management guided for more than 40% YoY topline growth. EBITDA at **Varun beverages** came in ahead of consensus on improving gross margins and strong volumes in international markets. **MakeMyTrip** reported a beat on revenue with continued momentum on gross bookings. **Siemens India** also beat on margin expansion thanks to more profitable projects and expectations of a strong step-up in private capex over the next five years.

In **Brazil**, the central bank's hawkish comments implied higher terminal rates. **Hapvida** reported a beat on improvement in the medical loss ratio. **NuBank** delivered strong quarterly revenue growth, but NPLs were ahead of expectations. The **Petrobras** CEO resigned abruptly. Magda Chambriard, former head of Brazil's National Oil Agency, was named as Prates's successor.

In **Mexico**, nominal wage growth for April was 7.6% YoY. Chinese EV giant **BYD** unveiled its Shark pickup truck in **Mexico City**, the first time it has launched a vehicle outside its home market.

CORPORATE DEBT

CREDIT

Thanks to CPI in the US coming in as expected at 3.4%, mixed retail sales and a slight rise in jobless claims, US 10-year Treasury yields fell to 4.35% as of Thursday evening, down from 4.50% the preceding Friday. Yields in the eurozone also fell but by not as much. In Germany, 10-year Bund yields moved from 2.51% to 2.42%. Traders are still expecting the ECB to announce a 25bp rate cut in June.

Credit inflows continued apace with IG spreads falling to 110bp and to 340bp for high yield. Overall returns are still driving buyers as IG offers a yield of around 4% and high yield roughly 6.5%.

It was another good week for both corporate and financial new issuance. New deals included **Ford** 2028, **Air France** 2029, **Lottomatica** 2030, **Finnair** 2029, **AIB** 2035 (T2), **Unipol** 2034 (T2) and a hybrid issue from **Centrica** which will be callable in 6 years. The high yield market saw its first CCC deal in 2 years with a 2029 maturity from **Fedrigoni** at 10%.

Between May 10 and May 16, IG returned 0.33%, taking YTD gains to 0.4%. Note however that spreads have so far this year provided a cushion for investment grade as government bond indices have fallen by around 1% since January 1st. High yield returned 0.3% over the period, taking YTD gains to a creditable 2.5%.

CONVERTIBLES

The convertible market had a good week thanks to a strong rebound in risk assets. CPI in the US and central bank comments reassured markets. Traders expect inflation to retreat and a Fed rate cut before the end of the year.

Investors were also reassured by a crop of upbeat company results.

However, video game company **Ubisoft Entertainment** plunged 13% after warning markets that first-quarter reservations would be lower than expected by analysts. **Siemens**, too, lost ground, tumbling 6% after cutting guidance for its Digital Industries division. The group said the recovery in its Chinese automation business was slower than expected.

In new issuance, **MKS Instruments** in the US raised $1.4bn at 1.25% and with a 30% premium. The proceeds will go on repaying a $1bn bank loan.

Elsewhere, RAG-Stiftung raised €468m by selling a block of **Evonik** shares at a 3% discount. **RAG-Stiftung** still owns more than 47% of **Evonik**.

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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