EDMOND DE ROTHSCHILD

MARKET FLASH: A PARADIGM SHIFT

- **Germany launches a historic investment program to boost defense and infrastructure spending.**
- **D. Trump's erratic behavior, especially concerning tariffs, has created uncertainty that weighs on American morale and has led to a decline in stock markets across the Atlantic.**
- **China has unveiled its economic roadmap for 2025, maintaining a growth target of 5%, which sends a message of confidence from the authorities.**

In a move that would have been unthinkable only a few weeks ago, Germany decided to launch an historic investment programme and abandon fiscal conservatism. The measures will help Berlin sidestep most of the country's famous constitutional debt brake. We discussed the details and implication of this "whatever it takes" in a note on Friday. The programme could mean close to €1trillion in extra infrastructure and defence spending over the next ten years and promises to radically transform economies in Germany and Europe. The proposal from Friedrich Merz, the incoming chancellor, will have to be voted through before March 25, while the CDU, the SPD and the Green still have the required two-thirds majority, and before the new Bundestag convenes. A legal appeal to the Constitutional Court to oppose the proposal cannot be ruled out but it looks as if the text could clear these obstacles and give the new parliament colossal budgetary leeway to underpin growth but also boost military spending amid today's geopolitical threats. Other European countries are expected to follow suit. Brussels is also discussing raising national defence budgets by close to €800bn but it is unclear how this will be funded.

Government bond yields have soared since Friedrich Merz announced the plan, with the yield on Germany's 10-year Bund jumping by 43bp. True, this reflects the improved outlook for growth and inflation in Europe but it is also a sign of investor concerns that other countries with much higher debt ratios than Germany might also bump up issuance. These concerns were certainly not addressed by the ECB: the bank cut rates by 25bp but its chair Christine Lagarde said it would not be involved in funding these new issues. She added that the bank might have to put its rate-cutting on pause because of the impact of this fiscal stimulus on growth and inflation. Bear in mind that the ECB is also continuing with its quantitative tightening programme by shrinking its balance sheet so there is a risk interest rate tension could worsen.

Over in the US, it was another week of erratic statements from President Trump, especially as concerns import tariffs, an area where investors are in the dark. The 25% tariff hike on imports from Canada and Mexico came into force last Tuesday but duties on some products were almost immediately eased before being totally suspended. The situation is likely to be unclear at least until April 2 when the Trump administration is due to present its new trade policy for all its partners. In the meantime, uncertainty is weighing on household/corporate sentiment and fuelling expectations of a slowdown in US growth in the coming quarters. Wall Street has also suffered with sharp drops in indices and especially among small and medium companies.

Elsewhere, China unveiled its economic roadmap for 2025. Beijing is still confidently targeting 5% growth and will continue to underpin the economy to offset any fallout from the trade war. The focus is on household spending via a significant increase in aid to help consumers buy certain products.

Beijing's determination to provide economic stimulus has led us to maintain our relative preference for Chinese equities, while we remain cautious on developed-country equity indices given the risks associated with D. Trump's policies. Until we have some visibility on Europe's budgetary plans, we will remain neutral on government bonds; they are set to stay highly volatile.

EUROPEAN EQUITIES

European equities had an historic week thanks to several major decisions which redefined the economic outlook. The surprise €800bn "*ReArm Europe*" programme was a powerful catalyst for European defence companies. The sector was also boosted by Germany's plan to spend €200-400bn on defence as well as create a special €500bn infrastructure fund. As a result, defence and other companies linked to the sector largely outperformed. The ECB cut its rates but government bond yields soared as investors reacted to the prospect of massive borrowing to fund various government plans. Yields on Germany's 10-year Bund jumped 30bp in one trading session, the biggest move since 1990.

Gains were led by **Thalès** which rocketed by close to 30%, followed by **Renk** (almost 25%) and **Leonardo** (+18 %). Moreover, Germany's infrastructure plan marks a genuine turning point in policy. The aim is to reinforce the country's competitiveness and modernise infrastructure. The DAX index gained more than 3% on the news. Cyclicals, and particularly those with German exposure, were the chief beneficiaries of this new momentum. **Bilfinger** jumped 29%, **Heidelberg Materials** 18% and **Kion** 17%. In some cases, gains were amplified by hedge funds covering shorts.

Another beneficiary of today's geopolitical tensions was France's **Eutelsat**. The satellite manufacturer's market cap increased six-fold over the week after several countries discussed replacing Elon Musk's **Starlink** with Eutelsat's models. Italy, which was about to sign a €105bn contract with Starlink, was one of the countries in the talks. Eutelsat's CEO also said talks were being held with **Telesat** in Canada along with the European Parliament, whose assistance to Ukraine is currently covered by Starlink.

US EQUITIES

Wall Street started March with more losses. The S&P 500 tumbled 3.6%, the Nasdaq 4% and the Russell 2000 4.4%.

In the tech space, semiconductor manufacturers **Nvidia** (-11.4%) and **Super Micro Computer** (-10.6%) plunged not only because of prevailing uncertainty but also because of an enquiry in Singapore into possible breaches of US restrictions on exports to China. Singapore's justice minister is investigating **Dell technologies** (-9.5%) and **Super Micro Computer** to see whether servers with Nvidia chips were transferred to Malaysia and then onto China. In addition, giant **Marvell Technology** (-21.3%) suffered its biggest sell-off in 24 years after tepid sales guidance rekindled worries over AI infrastructure spending.

Markets briefly rebounded after the Trump administration suspended tariff hikes on auto imports from Canada and Mexico for a month. Canadian premier Justin Trudeau, however, stuck to his guns and said his reciprocal 25% hike would stay in place as long as the US kept theirs.

In his speech to Congress, Donald Trump mentioned a possible slowdown in US growth. The ADP survey revealed that job creation in the private sector was back to last July's low. And the new orders index in manufacturing ISM missed expectations by falling back below 50 to 48.6.

In today's uncertain economic and political environment, the healthcare sub sector in the S&P 500 remained upbeat with a gain of 4.3%. **UnitedHealth Group** rose 2.7% and Biotech rallied after last week's dip, with **Biogen** up 4.9%.

Cyclical sub sectors were the week's biggest casualties. Semiconductors plunged 9.3% while energy shed 3.1% and banks ended the period 8% lower.

EMERGING MARKETS

The MSCI EM index rebounded from last week's correction and was up 3.1% as of Thursday's close, largely outperforming DM markets. China (+7.1%) led gains with NPC headlines as a backdrop. India also rebounded 3% from a month of weak performance. Mexico and Brazil gained 2.2% and 1.9%, respectively. Taiwan shed 1.8% due to the US tech correction.

China's manufacturing activity expanded at the fastest pace in three months in February. Official manufacturing PMI was 50.2 and non-manufacturing 50.4, surpassing market expectations and previous numbers. Following a strong fourth-quarter print, China's exports weakened, only up 2.3% YoY in USD with imports down 8.4%. The NPC announced economic targets in line with expectations: GDP target at around 5% growth, fiscal budget deficit at ~4% of GDP, CPI target at 2% and RMB 4.4 trillion in special local government bond issuance. Beijing released a white paper on fentanyl and will monitor production, imports, and exports, a key claim motivating US tariffs. Premier Li said "vigorously boosting consumption" was the top priority in 2025. In company news, **BYD** announced a Hong Kong placement of around $5bn to finance its overseas business expansion. **JD.com** reported solid fourth-quarter results thanks to a favorable trade-in policy. **Alibaba** announced the launch of a new open-source AI model QwQ-32B, which achieves remarkable performance compared to DeepSeek-R1. **Baidu** offered $2bn in bonds exchangeable into Trip.com.

In **Taiwan**, February exports surged by 31.5%, or largely ahead of the 18.4% expected. **TSMC** announced a $100bn investment to build more fabs in the US, on top of the $65bn US capex plan till 2030.

In **Korea**, export performance for February revealed disappointing growth at +1% amid global trade tensions, falling short of market expectations of 3.7%. E-commerce GMV growth came in lower than retail consumption for the first time since September 2020.

In **India**, real GDP growth for 3QFY24 was in line with consensus expectations at 6.2% YoY. This comes on the high base of 9.5% YoY in 3QFY24 and was also a clear sequential improvement versus 5.6% YoY for 2QFY24. Gross goods and services tax (GST) collections rose 9.1%. Factory activity growth dipped to a 14-month low in February, owing to cooling demand, with manufacturing PMI at 56.3 vs. 57.1 in January and services PMI at 59 vs. 61. The RBI injected almost $25bn in liquidity, reducing the interbank cost of funding for banks. **Tesla** leased its first showroom in India at BKC. **Kaynes Technology** is to commission a pilot production line and begin assembly, testing and packaging of semiconductor chips in June 2025.

In **Brazil**, manufacturing PMI rose by 2.4bp in February to 53.0 thanks to domestic demand. **Eletrobras** and the federal government reached a long-awaited settlement regarding the voting rights dispute.

In **Mexico**, the US said Canada/Mexico auto tariffs would be delayed till April 2nd but was unclear on additional exemptions.

Chile's solid economic recovery continued in January (0.6% MoM vs. 0.9% in December). **SQM** delivered better-than-feared results on higher volumes, but the pricing outlook remains challenging.

In **Argentina**, negotiations between Javier Milei's government and the IMF appeared to be nearing the final stages. **Grupo Galicia** reported a strong bottom line driven by the consolidation of the **HSBC** acquisition in December.

CORPORATE DEBT

CREDIT

Government bond yields soared in Europe after Berlin unveiled a huge €500bn stimulus plan and the European Commission announced a €800bn fund to reinforce the EU's defence capacities. The measures were a reaction to Washington's suspension of military aid to Ukraine. This surprise move by Berlin jettisoned several decades of budgetary rigour in only a few hours. As a result, yields on Germany's 10-year Bund jumped 43bp to 2.83% and dragged other government bond yields higher with equivalent French and Italian yields up 39bp and 42bp to 3.55% and 3.96%, respectively. Meanwhile, the ECB cut its benchmark rate by 25bp to 2.5% as expected.

In the US, investors are still treading cautiously around the Trump administration's stop-go trade initiatives: new duties keep on being announced only to be delayed. Markets are understandably worried that growth could suffer. The S&P 500 ended the period 3.6% lower and the US CDX HY index widened by 20bp. European spreads were relatively resilient faced with this volatility. Performance over the week was largely due to interest rate movements. Euro IG shed 1.58%, Euro HY 0.48%, Euro CoCos 0.72% and Euro Hybrids 0.65%.

New issuance was less abundant and trading on the secondary market was mixed due to interest rate volatility. Of note was the jumbo issue from US chemicals group **Celanese** (Ba1/BB+) which raised the equivalent of $2.65bn across several maturities and currencies. In an indication of persistent demand, the €750m tranche at 5% was three times oversubscribed.

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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