MARKET FLASH: THE CHANCES OF A MARCH RATE CUT HAVE FALLEN

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More than half of the world's countries will be holding elections this year. Taiwan kicked off last Saturday by electing an independence champion from the DPP, the party which has been in power since 2016. China reacted by organising fresh military manoeuvres around the island.

In the US, Donald Trump had a landslide 51% win at the Iowa caucus, the first of a series of votes to pick the Republican candidate against Joe Biden in November's elections. The shutdown planned for January 20 has once again been avoided. Both parties in Congress agreed on a temporary budget to extend funding for the state and its agencies up to March 1st and 8th.

Government bond yields rebounded due to heavy new issuance and various central bank comments suggesting markets should be less optimistic about monetary easing. The Bundesbank and Austria's central bank argued for policy makers to wait until inflation was trending near to targets before starting rate cuts. Markets had been hoping for proactive cuts to avoid Europe's economies slowing too much. For example, Germany's third-quarter contraction was confirmed.

Fed governor Christopher Waller also played down the need to cut quickly and sharply, citing the US economy's strong showing and the risk that a rushed move to ease might have to be followed by the Fed backtracking. He reaffirmed the need to use macroeconomic data to decide on monetary policy.

The problem is that surveys are coming in mixed. The New York Fed sounded an alarmist note while the Philly Fed report was more upbeat. At any rate, retail sales, industrial production and weekly jobless claims all suggested that the US economy is resilient. Bond markets are now only 50% betting on a March rate cut, down from 80% only last week.

We remain fully invested but underweight the dollar. We still prefer fixed income for its yield. Our overweight duration position looks attractive and should also offer protection amid ongoing disinflation and mounting geopolitical risk.

EUROPEAN EQUITIES

It was a mixed week for European equities as the first quarterly earnings started to arrive. Tech rose in Europe thanks to Taiwan's chip giant **TSMC** which said AI chips had made a big contribution to its figures. Energy remained under pressure on mounting port congestion due to instability in the Red Sea. **Shell** said all its tankers had stopped using this route for the moment.

Capital raisings and external growth took centre stage. France's **Orpéa** (old people's homes) launched a €390m rights issue to fund its makeover and restore margins.In results news, luxury group **Richemont** announced reassuringly good results. Fourth-quarter sales beat expectations in the US and China, bucking recent downturn trends in the Chinese economy.

But the picture was more mixed across the luxury sector. The UK's **Watches of Switzerland** issued a profit warning and management said macroeconomic conditions looked like being tricky in 2024. There was also caution from ready-to-wear company **Hugo Boss.** Fourth-quarter operating results were disappointing due to significant investment as well as special offers designed to make up for lagging demand. And production cuts were announced by Michelin and Stellantis. **Michelin** blamed commodity shortages due to tension in the Red Sea and **Stellantis** said demand for electric vehicles was slowing.

US EQUITIES

M&A dominated the headlines over the week. The **JetBlue-Spirit Airlines** was blocked by a Massachusetts court on fair trading grounds. Spirit Airlines is now looking at a restructuring. And a European once again blocked **Amazon's** acquisition of **iRobot**. Elsewhere, Japan's **Sekisu House** agreed to buy house builder MDC Holdings for $4.95bn, a 19% premium on the last quoted price.

Healthcare insurance companies fell after **Humana** cut 2023 earnings guidance, citing higher-than-expected medical costs.Chip makers benefited after **TSMC** reported excellent results and said it expected strong demand this year. **AMD** hit a high not seen since 2021 after a research report from **Barclays** said demand for its AI chips was robust. **Super Micro Computer** jumped after the company raised EPS guidance for its second quarter by more than 20%.

Banks and financials were, as usual, the first to report quarterly earnings. **Schwab's** EPS beat expectations but revenues fell short. **Morgan Stanley** and **Goldman Sachs** both had revenue beats while **Citigroup** missed slightly, mainly due to its trading and its wealth management divisions and in spite of serious cost-cutting efforts. Results at **JP Morgan** hit a record high. EPS at **Bank of America** were 7% below expectations due to high operating costs and revenues ex lending which fell short. The sector's results overall suggest credit quality is still good and there were few cases of increased provisioning.

Mines came under pressure after **Barrick Gold** said production costs were higher than expected in the fourth quarter. Elsewhere, redundancies continued **Citi** expects to lay off 8% of its workforce. **Macy's** is to let 3.5% of its staff go and plans to close 5 stores. **Google** said fresh redundancies were in the offing this year. **Boeing's** agony continued. The US regulator extended the 737 Max 9 groundings and inspection period.

JAPANESE EQUITIES

The NIKKEI 225 and TOPIX rose 1.19% and 0.37% on new money, especially from foreign investors hoping for strong corporate earnings, corporate management reform and generous P/B ratios as well as domestic investor buying under the new NISA programme (tax exemptions for individual investors). However, later in the week, investors locked in profits over concerns that revisiting record highs every day in a short period was asking too much.

Marine Transportation and Mining rose 8.38% and 2.24% on rising container freight rates and higher oil prices due to mounting tension in the Red Sea. Wholesale advanced 2.80% led by general trading stocks after **Sumitomo Corporation's** CEO said **Berkshire Hathaway** had been steadily increasing its stake in Japan's five largest general trading companies. **Mitsubishi** jumped 7.32%. On the other hand, Textiles & Apparel and Air Transportation fell 2.43% and 2.01% due to yen weakness which will drive commodity and fuel costs higher. Pharmaceuticals shed 2.24%, led by **Eisai** (-7.70%) on profit taking as defensives were undermined by the risk-on mood.

Fast Retailing (clothes shops) and supermarket group **Aeon** gained 5.93% and 5.38%, after upping 2024 earnings guidance. Elsewhere, healthcare platform **M3** tumbled 8.40% on uncertainty its bid for **Benefit One** would be successful. **Shimano** (cycle components) shed 6.02% on disappointing 2024 guidance.

The dollar strengthened from the low-145s to the low-148s against the yen due to rising US bond yields. Fed Governor Christopher Waller argued for the Fed to take its time easing monetary policy and market expectations for an early rate cut were pushed back.

EMERGING MARKETS

The MSCI EM Index was down 3.4% this week as of Thursday. **Korea** and **India** outperformed by ending flat. In USD, **China** ended 5.1% lower and **Brazil** shed 1.22%.

China's fourth-quarter GDP was up 5.2%, or broadly in line with expectations. It took full-year growth to 5.2% YoY, up from 3% in 2022. Industrial production in December rose 6.8%, up from 6.6% in November, while retail sales were 7.4% higher, marginally lower than the 8% expected. Fixed-asset investment climbed 3% over the year. The urban jobless rate was 5.1% in December and 14.9% among young people when excluding current students. **Beijing** is to grant **Switzerland** unilateral visa-free treatment. The tourism industry witnessed a surge in the run-up to the Spring Festival, with outbound and inbound tours for the Lunar New Year holiday period up more than ten times YoY. **Ping An Bank** issued a white list for refinancing, including 41 SOE, quasi-SOE and non-distressed POE developers.

In **Taiwan**, the Democratic Progressive Party (DPP) candidate Lai Ching-te was elected as the next president, marking the party's record third win in a row. The government will resume group travelling to China starting March 1. **TSMC** reported a net income beat, supported by the continued strong ramp-up of industry-leading 3-nanometer technology. Management stuck with its capex guidance for 2024 but announced another delay to its $40bn US site in Arizona.

In **India**, December inflation was 5.7%, or below expectations of 5.9%. The government is to levy 50% export duty on molasses and extend lower import duties on edible oil till March 2025. The RBI proposed tighter regulations for housing finance firms: deposit taking HFCs will be subject to an upper cap. **Foxconn** and **HCL Group** are to form a chip packaging and testing joint venture in India. **HDFC** bank reported a mixed quarter, with results in line but lower-than-expected deposit growth. **Asian Paints** reported a miss on the top line but beat on EPS thanks to a multi-quarter high EBITDA margin of 22.6% on lower input costs and operating leverage.

In **Mexico**, real wage growth remained high with formal sector wages reported to the social security system up 10.5% YoY in December. The minimum wage increased by 20% (effective Jan 1, 2024), after large increases in 2023 (20%) and 2022 (22%). **Banorte** reported mixed results with a slight miss on EPS growth (1%) and both NIM and NPL flat QoQ. However, 2024 guidance was reassuring.

CORPORATE DEBT

CREDIT

Trading was volatile but not because of uncertainty over long-term trends but because of uncertainty over the timing of future FED and ECB rate cuts. UK inflation was slightly higher than expected and weighed on bond yields. Yields on Germany's 5-year Bund rose from 2.07% to 2.25% (as of Friday morning). The equivalent US Treasury yield jumped from 3.82% to 4.04% and the yield curve steepened.

Credit markets were more or less stable with IG spreads still hovering around 135bp while HY spreads widened by roughly 10bp to 383bp after a strong showing in the previous week. **Euro bank CoCos** also stabilised around 635-640bp, or slightly above the 5-year average of 620bp.

After a busy fortnight, the new issues market calmed down a little. **ENEL** raised €1.75bn at 3.875% with 2028 and 2035 maturities. **ENBW** raised €500m with a hybrid bond at 5.25% which will be callable in 2029. After the **Iberdrola** issue earlier this month, the deal was another indication of rising appetite for the asset class. New deals in financials started to dry up with the arrival of the earnings season. However, we subscribed to the new €1.25bn **Santander** T2 at 5% due 2034 and callable in 2029 and the **Eurobank** T2 at 6.25%, also due 2034 and callable in 2029. Elsewhere, the trend was towards improved ratings in the aerospace sector. **Lufthansa** is now BBB-, so entirely investment grade.

Returns over the week were negative amid stable spreads but increased yield volatility. Investment grade shed 0.58% over the week (-1.16% YTD) and high yield dipped 0.4%, wiping out the previous week's gains and taking YTD performance to zero.

CONVERTIBLES

All convertible bond sectors lost ground over the week due to equity market falls, widening spreads and rising yields. In company news, Switzerland's solar panel company **Meyer Burger Technology** slumped 50% over the week due to a strategy shift which could see a German site closing and an increase of capital. The group also made an operating loss in 2023.

In the US, **Spirit Airlines** cratered 60% after its merger with **JetBlue** was blocked by a court. With $5.5bn in debt, management is looking at a restructuring. The convertible bond lost 30 points to trade below 40%. The new issues market was relatively quiet. Through its European subsidiary, Taiwanese chip maker **GlobalWafers** raised €350m at 1.5% due 2029 and with a 30% premium.

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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