EDMOND DE ROTHSCHILD

MARKET FLASH: THE EARNINGS SEASON HAS BEGUN

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• China's first quarter GDP data surprised on the upside. The economy grew by an annualised 4.5%, or more than the 4% expected. In addition, the fourth-quarter figure was revised up.

• We are sticking with our cautious stance on risk assets. We still prefer corporate debt, preferably short-dated bonds, and are taking advantage of rising government bond yields to gradually reinforce duration.

Equity markets were range bound over the period but government bonds saw wider fluctuations. The New York Fed's manufacturing ISM index had a surprising rebound in April and moved back into positive territory after 4 months below the bar. The bounce was mainly due to new orders. Along with persistent inflation and diminishing concerns over systemic risk, the news rekindled expectations of more rate hikes. Treasury yields started to trend northwards again although the move was slowed by higher-than-expected jobless claims. In Europe, several ECB officials reiterated the message that more rate hikes would be needed to beat inflation. Friday morning's PMI showed a slowdown in manufacturing but a reasonably strong rise in services.

The first quarter earnings season kicked off. The first reports were encouraging but expectations for growth in 2023 are undemanding. Reports from Europe's luxury sector confirmed that sales in China and the US were recovering. Major banks reported reassuring figures and most beat expectations.

China's first quarter GDP data surprised on the upside. The economy grew by an annualised 4.5%, or more than the 4% expected. In addition, the fourth-quarter figure was revised up. The post-Covid rebound is effectively under way and driven essentially by domestic consumption: retail sales jumped 10.6% in March, or more than the 7.5% expected. However, the good news was not reflected in share indices. We are still positive on Chinese equities with a preference for domestic plays as they should benefit from the upturn in the economic environment while suffering less from any geopolitical developments.

Overall, we are sticking with our cautious stance on risk assets given gains since the beginning of 2023. We still prefer corporate debt, preferably short-dated bonds, and are taking advantage of rising government bond yields to gradually reinforce duration.

EUROPEAN EQUITIES

European indices ended the week more or less flat. Utilities, banks and tourism pushed higher while manufacturing, technology and basic resources retreated. The ECB's chief economist said getting inflation back to the 2% target would necessarily mean more rate hikes. The ECB minutes shone some light on the recent decision to increase rates. In the UK, March inflation, and especially core elements, failed to slow as expected. As a result, markets are now going for a terminal rate of 5%.

After reassuring messages from luxury companies like **LVMH** and **Hermès**, **Porsche** reported a record rise in quarterly sales in China. **L'Oréal**'s sales jumped 13% thanks to strong momentum in the US and Europe. And there was encouraging news for airlines: **EasyJet** raised its earnings guidance for 2023 following strong reservations for the coming weeks. Semiconductor giant **ASML** however, sounded a cautious note. In spite of an excellent first quarter, management said customers were being more careful and new orders were down. It was the same story at **Michelin** which said global tyre sales had fallen 1% in March, taking the year-to-date tally to minus 2.1%.

US EQUITIES

The S&P500 slipped 0.40% and the Nasdaq 0.88% over the last 5 trading sessions. Sentiment was dented on Thursday by a sharp drop in the Philly Fed index to minus 31.3, a return to May 2020 lows, and a 2.4% drop in sales of existing homes. And yet the Empire Manufacturing index released at the beginning of the week turned sharply higher.

Meanwhile, regional Fed presidents made hawkish noises. Raphael Bostic at the Atlanta Fed, said he was in favour of keeping rates above 5% for some time to get inflation lower. James Bullard (St Louis) even argued for a 5.5-5.75% spread, or more than consensus expectations.

Earnings reports also weighed on sentiment, with **Tesla** plunging 9.7% and **AT&T** 10.4%.

Tesla cut prices by 5% to offset the impact of rate rises on consumers and said it would continue to lower prices to boost demand.

Netflix fell when new subscribers came in at 1.75 million, or lower than the 2 million expected. Management partially offset selling pressure by raising guidance for the second half thanks to code-sharing coming to an end.

Alphabet lost 3% after a New York Times article said **Samsung** was looking into replacing **Google** with **Microsoft** as a search engine on its smartphones.

IBM gained 2% after the bell when results came in as expected and management said it was still targeting a 3-5% increase in sales and $10.5bn in free cash flow.

JAPANESE EQUITIES

The NIKKEI 225 and TOPIX rose 1.78% and 1.58% over the period on a soft Producer Price Index (PPI) in the US, a better-than-expected April Empire State Manufacturing Survey and yen weakness.

Banks, Insurance, Securities and Commodity Futures jumped 5.03%, 3.49% and 3.09%, respectively, as concerns over a financial crisis receded and US bond yields moved higher. Among banks, **Sumitomo Mitsui Trust** and **Resona**, gained 6.04% and 5.40%.

Mining and Metal Products fell 1.37% and 0.19% on lower commodity prices due to concerns over a possible global economic slowdown. Marine Transportation edged 0.42% lower on profit taking after a sharp run-up on attractive valuations and high dividend payout ratios.

Fast Retailing, parent company of the **Uniqlo** clothing chain, jumped 7.53% after operating profit guidance for this year was revised upwards. Strong retail sales in China (+10.6% Y/Y in March) also contributed to the rise.

Tokyo Electron (semiconductor equipment), and bicycle parts maker **Shimano**, slipped 1.91% and 1.81%, as rising bond yields in the US undermined growth stocks.

The dollar moved from the high 132s to low 134s on receding risk averse sentiment and the better-than-expected April Empire State Manufacturing Survey.

According to the Japan National Tourism Organization, the number of incoming foreign visitors for business and leisure stood at 1.82 million in March, up from 1.48 million in February. Chinese visitors more than doubled to 75,700.

EMERGING MARKETS

The MSCI EM Index was down 1.05% as of Thursday's close, led by Brazil (-3.4%) and China (-2%). Chile and Taiwan fell 1.16% and 1.83%, while India and Mexico were relatively flat at -0.56% and -0.05%.

In **China**, first-quarter GDP growth accelerated to 4.5% YoY, or much better than expected from +2.9% in the fourth quarter. The rise was mainly due to a 10.6% rebound in retail sales over 12 months. Industrial production rose 3.9% YoY and fixed assets investment 5.1% but both fell short of high expectations. The urban jobless rate improved slightly to 5.3% from 5.6% in February. Out of 70 major Chinese cities, 64 reported MoM price hikes for new homes in March.

In regulatory news, the NPPA (National Press and Publication Administration) issued the 4th batch of license approvals for 86 domestic games in 2023.

Geopolitical rumblings returned this week with President Biden reportedly seeking G-7 endorsement for investment curbs on China's high tech industries. This follows the visit of the Brazilian president to China, where he defended stronger ties with Beijing.

In company news, **New Oriental** reported better-than-expected good-quality results on all fronts, showcasing its education division's strength and growth sustainability. **Li Ning** also reported above consensus mid-single-digit retail sales growth in the first quarter. Management also sounded more upbeat thanks to a better-than-expected recovery in sportswear sales in April.

In **India**, wholesale price inflation eased to 1.34% in March. SIPs flows continued to rise, reaching an all-time high of Rs143bn ($1.7bn). Debt schemes benefited from inflows prior to the sunset clause on taxation. 3 more companies signed MoUs with the Ministry of Steel as part of Specialty Steel PLI; cumulative capex under PLI so far is $6.4bn. Fourth-quarter results at **TCS** missed slightly- revenue was up 1.7% QoQ and margins were 24.5% instead of 25% - due to macro headwinds but the order book remained at a healthy 10bn. Results at **Infosys** had a rare miss on account of unplanned project ramp downs. Management lowered guidance for revenue growth and EBIT margins to 4-7% (vs. 5-8%) and 20-22% (21-23%)

In **Taiwan**, first-quarter results at **TSMC** came in stronger-than-feared thanks to higher margins from better cost controls. Management kept its full-year capex plan unchanged but revised down 2023 revenue guidance, citing a slower pace of semi inventory adjustment in the first half which could stretch into the third quarter before bouncing back to a healthier level.

In **Brazil**, the government said the fiscal framework draft might be changed towards improved enforceability.

In **Mexico**, **Banorte** reported better-than expected results. Lending saw double digit growth and asset quality was stable. **Vesta Industial** (real estate) also reported upbeat figures.

CORPORATE DEBT

CREDIT

In a week with no major news, credit premiums were more or less unchanged with high yield at 455bp, investment grade at 155bp and synthetic indices at 445bp. 5-year German Bund yields remained at 2.5%.

Unsurprisingly, returns were equally flat over the period with investment grade up 0.11% while high yield was unchanged. Since January 1st, investment grade has gained 1.7% and high yield 3.1%. Actuarial yields for investment grade are now 4.24% and 7.4% for high yield, still good entry points for carry strategies.

Calm trading resulted in a busy week for high yield issuance. **Monitchem** (B-) raised €450m at 8.75% due 2028, **Allwyn Entertainment** (BB-) €500m due 2030 and **Porsche** €750m at 4.5% due 2028. We subscribed to all three deals and they were largely oversubscribed, another sign that investors are hungry for spread issues.

In financial debt, premiums on Euro CoCos were unchanged at around 1,050bp. This is much higher than the historic mean, a token of the sector's attractive valuations.

In earnings reports, **Bankinter** once again surprised the market with a better-than-expected 20% rise in quarterly profits. Its costs-to-revenue ratio hit a record low of 38% and CET1 added 0.2% to 12.2%.

CONVERTIBLES

Earnings reports drove activity on convertible bond markets while new issuance remained busy.

In Europe, **Heineken** rose thanks to an upbeat first quarter despite persistent inflation in many key markets. **Jet2** was also stronger after the company raised guidance following buoyant key performance indicators for the summer.

In new deals, Austrian steelmaker **Voestalpine** raised €250m at 2.75% over 5 years to strengthen its balance sheet and compares with its 2026 bond at 3.9%.

In the US, Las Vegas Sands surged on strong Macau visitors numbers, **Wynn Macau** shares in Hong Kong also benefited. Korea's **L&F**, a company that develops and manufactures battery materials, raised $500m at 2.5% over 5 years. The deal came at 30% premium and the proceeds will go on working capital requirements. This was L&F's first convertible issue and it offers exposure to the electric vehicle sector.

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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