MARKET FLASH: CHINA IS BACK !

• Beijing's will to get the economy rolling again is more important than sanitary considerations

• The Fed reaffirmed its determination to raise rates in smaller increments but ruled out any rate cut in 2023

• We adopt a tactically defensive stance on equities and in corporate debt, we continue to prefer carry strategies

China's Covid management keeps on surprising us. The much-criticised zero-Covid approach with its rigorous lockdowns were suddenly replaced by an uncontrolled reopening which completely swamped the healthcare system. Official sources in China say 70% of Shanghai's 25 million population has already been infected.

For the moment, China's PMI have fallen, particularly services which fell to 41.6, or much lower than the 45 expected. But Beijing's will to get the economy rolling again is more important than sanitary considerations so we should be seeing a rebound in demand for commodities and activity returning to normal.

In Europe, spot gas prices collapsed due to an unusually mild start to winter and energy savings. Prices are now back to pre-Ukraine war levels but the structural supply problem has not gone away: December 2023 gas futures are still double this level. Europe's PMI improved slightly with the composite index flirting with expansionary territory at 49.3, or better than the 48.8 expected.

Inflation surprised on the downside. Germany's CPI fell back to 9.6% vs. 10.2% expected, helped mainly by temporary energy measures. Similarly, French inflation moved down to 5.9% on falling energy prices when analysts expected it to rise to 6.4%. Services, however, saw inflation rise 0.3% over a month.

In the US, the FOMC minutes registered a fall back in inflation and worsening growth prospects but insisted the Fed should stay vigilant over possible knock-on inflation due to a persistently robust labour market. The Fed reaffirmed its determination to raise rates in smaller increments but ruled out any rate cut in 2023, contrary to market expectations.

A series of better inflation figures pushed European equities higher and government bond yields lower. We nevertheless think that, after the latest upbeat job creation data in the US, both the Fed and the ECB will stick with restrictive policies for some time. Company margins should suffer as a result.

This has led us to adopt a tactically defensive stance on equities with a preference for emerging country equities. We are underweight the eurozone. In corporate debt, we continue to prefer carry strategies. As for government debt, we prefer the US to the eurozone.

EUROPEAN EQUITIES

European markets concentrated on the good news to start the new year, prolonging their outperformance of US markets which started last September. Sharp falls in energy prices were the main drivers. The worst of the energy crisis appears to be over and its impact on European growth might be less severe than expected. The upbeat mood was also driven by Beijing's volte-face on Covid and hopes that Chinese growth might rebound if its property market were to recover. Indicators continued to point to an improvement in logistics and supply chains. And Vladimir Putin declared a 36-hour ceasefire to mark the Orthodox Christmas while calling once again for talks with Ukraine.

Investors piled into last year's worst performing stocks and sectors like autos (**Faurecia**), industrials (**Kion**) and distribution (**Zalando**) while defensives were pushed to the sidelines. Oil & Gas stocks were hit by falling prices. **Atos** announced that it was in advanced talks with **Airbus** to sell a minority stake in its subsidiary Evidian (cybersecurity and digital transformation). Evidian is due to be spun off this year. **Interparfums** had a better-than-expected December as demand remained buoyant. The group also agreed on a 15-year with licence with Lacoste to start at the beginning of 2024. **Ryanair** reported a fourth-quarter loss but said there had been a strong upturn in demand for the holidays, the first time in 3 years. **Trigano** said its first-quarter sales were down due to supply chain problems.

US EQUITIES

Wall Street got off to a mixed start to the year despite a difficult 2022. The MSCI world index tumbled 20% in 2022, its third worst year since 1974. The S&P plunged 19%, its 5th worst drop ever. Volatility over the year was 24%. Big Tech stocks (**Apple**, **Microsoft**, **Google**, **Amazon**, **Tesla**, **Facebook** and **Nvidia**) lost a total of $4.9 trillion in market cap, the equivalent of all S&P sectors ex IT and Healthcare, and more than the Nasdaq's total losses after the Internet bubble burst.

Manufacturing ISM in December saw a surprising deceleration in prices paid, down to 39.4 compared to 43 in the previous month.

The latest FOMC minutes reassured investors. The Fed wants to make smaller rate increases and remain flexible over future decisions. However, the bank sees rates staying higher until significant progress is made in reducing inflation and no monetary committee member sees a rate cut this year.

After the ADP report showed the private sector had created more jobs than expected in December, traders are now split over the chances of a 25bp or 50bp hike in February.

In company news, more layoffs were announced. **Amazon** is to make 18,000 people redundant. **Salesforce** is laying off 10% of its 80,000 employees and plans to streamline its property portfolio.

Microsoft shares also came under pressure on worries over cloud computing licences. **Apple** (-3.4%) dropped back below $2 trillion in market cap on concerns over iPhone 14 sales as China's sanitary crisis worsened. **Tesla** plunged by more than 12% after fourth-quarter sales fell short of expectations. The group said it was reducing prices for its Model 3 and Y cars in China by 10% in an attempt to drive sales. The price gap between China and the US for these models is now 40%.

Medical equipment maker **GE Healthcare** jumped 8% for its first day of trading after being spun off from its parent company, General Electric.

JAPANESE EQUITIES

The NIKKEI 225 and TOPIX lost 1.05% and 1.39% over the period on fears of a possible global economic slowdown and yen strength after the BoJ's policy shift.

Banks gained 1.34% on rising global interest rates including in Japan, a plus for their lending and investment businesses. Glass & Ceramics and Securities & Commodities edged 0.79% and 0.16% higher.

Mining and Marine Transportation tumbled 6.38% and 6.17% on worries over a possible economic slowdown. Pharmaceuticals lost 4.76% led by **Ono Pharmaceutical** and **Eisai**.

Z Holdings, an internet platform provider, and **Tokyo Electron**, a semiconductor manufacturing equipment maker, rose 2.26% and 2.15% after a bounce in the Philadelphia Semiconductor Index (SOX Index). Cosmetics giant **Shiseido** added 2% on hopes for more foreign tourists and China's reopening.

Ono Pharmaceutical plunged 9.65% on a broker downgrade. **Unicharm**, a personal care products maker, declined 6.76% on valuation worries. **Eisai** shed 6.73% on profit-taking ahead of the approval date for its Alzheimer drug.

The yen strengthened to as much as 129 against the dollar, its best level since June before retreating to around 133, on a possible rate hike after the BoJ widened its Yield Curve Control policy.

After China's surge in Covid cases, PM Kishida said Japan would strengthen its Covid-19 border control measures for travellers from China on January 8. A negative Covid test within 72 hours will be required for passengers boarding direct flights from China.

EMERGING MARKETS

The MSCI EM Index was up 2.9% as of Thursday's close. China led with a 7.5% jump for the first week of the year. India edged 0.4% lower while Brazil (-3.9%) underperformed.

In **China**, December manufacturing PMI weakened further to 47 from 48 on supply-side bottlenecks amid surging Covid cases after the country reopened. Non-manufacturing PMI also dropped to 41.6, vs. 45 expected. The government announced several measures to support real estate demand including a potential relaxation of the "three red lines" policy on leverage. The PBoC and CBIRC are to lower mortgage rate floors for new first-home sales. China will reopen its borders from January 8, removing the last hurdle to full reopening. The authorities are discussing plans to resume some imports of Australian coal after a ban lasting more than two years. China and the Philippines agreed to resume talks on oil and gas exploration and discuss maritime disagreements amicably. In company news, **Ant Group** received approval from the CBIRC to raise $1.5bn. GSK started a licensing deal with **WuXi Biologics** for a preclinical bi-specific T cell engaging antibody.

In **Taiwan**, **Hon Hai**'s December revenues came in ahead of expectations, a sign that production and operations may have returned to normal.

Korea's December exports were down 9.5% YoY, or better than consensus of minus 11.1%, while imports were down 2.4% vs. -2.2% estimated.

India's manufacturing continued to expand in December with PMI rising to 57.8 from 55.7 in November, its highest level in 26 months. Services PMI also rose, up from 56.4 in November to 58.5. The government launched a green hydrogen policy, with an outlay of $2.3bn and a target to produce 5mmt by 2030. **HDFC** pre-announced 3QFY23 numbers with strong loan and deposit growth. **Baja Finance**, on the other hand, saw AUM growth decelerating from +31% YoY in the previous quarter to +27%.

In **Brazil**, President Lula signed a 60-day extension to the fuel tax break.

In supply chain relocation news, Seoul unveiled large tax breaks for semiconductor and other technology companies investing within South Korea. The broader plan could reduce the tax burden on companies by more than $2.8bn.

CORPORATE DEBT

CREDIT

Europe and the US parted ways in the first week of 2023. Europe benefited from a larger-than-expected fallback in inflation in Germany and France as well as falling gas and oil prices. In the US, the mood was less upbeat after the labour market proved more dynamic than expected and the Fed remained somewhat hawkish. Between Monday and Thursday, the euro HY debt index bounced by 0.83%. The investment grade index (+0.93%) benefited from a roughly13bp drop in long bond yields. Risk premiums tightened over the week, taking spreads on the Xover and Main 27bp and 4bp lower.

In a week of zero high-yield issuance, attention focused on companies. Commercial property giant **Unibail-Rodamco-Westfield** sold two non-strategic assets in the US for $196m as part of its ongoing move to reduce US exposure. This took total disposals since 2021 to $1.3bn. The US currently represents 24% of its holdings.

In Italy, the privatisation decree for airline group ITA (ex-Alitalia) was published so the door is now open for bids. **Lufthansa** looks like being the favourite as it would give the company strategic slots in several large European airports.

Low-cost **Ryanair**'s share price soared after the company upgraded guidance on its net earnings for FY 2022-2023. It now expects to make €1.32-1.42bn, a 10-20% increase on the previous forecast (€1-1.2bn). Management said demand was heavier than expected at the end of 2022, allowing it to charge more for peak dates over Christmas and the New Year.

Retailer **Casino Guichard** remained in the headlines with its decision to revamp its legal structures in France. It aims to bring all its brands under the same holding group which will be 100% owned by Casino. The move will give investors and banks better visibility.

In financial debt, we expected the first week of 2023 to be active and we were not disappointed. €3bn was raised in CoCos (**Crédit Agricole, BNP** and **Sabadell**), €2.2bn in Tier 2 issues and, most significantly, €25bn in senior debt. Such heavy volumes inevitably weighed on secondary issues but this was offset by some good news: **Barclays** called a Tier 2 bond with only partial refinancing and Sabadell's CoCo suggests there will be a call on an outstanding bond that was not called at its first date. This non-economic refinancing is a positive sign that Europe's regulatory authority is being pragmatic. Dollar and euro CoCo spreads tightened by 11bp to 636bp and 38bp to 800bp, respectively.

CONVERTIBLES

Convertibles started the new year on the front foot. Easing bond yields fanned investor appetite for growth stocks which are among the biggest convertible issuers. Over the week, the Convertibles World and Europe indices gained 0.7% and 1.23%, respectively. The MSCI World rose by 1.16%. There were no new issues but **BNP Paribas** added €75m to its June 2022 €450m issue.

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.

DISCLAIMER

06/01/2023

This document is issued by the Edmond de Rothschild Group. It is not legally binding and is intended solely for information purposes.

This document may not be communicated to persons located in jurisdictions in which it would be considered as a recommendation, an offer of products or services or a solicitation, and in which case its communication could be in breach of applicable laws and regulations. This document has not been reviewed or approved by a regulator of any jurisdiction.

The figures, comments, opinions and/or analyses contained herein reflect the sentiment of the Edmond de Rothschild Group with respect to market trends based on its expertise, economic analyses and the information in its possession at the date on which this document was drawn up and may change at any time without notice. They may no longer be accurate or relevant at the time of reading, owing notably to the publication date of the document or to changes on the market.

This document is intended solely to provide general and introductory information to the readers, and notably should not be used as a basis for any decision to buy, sell or hold an investment. Under no circumstances may the Edmond de Rothschild Group be held liable for any decision to invest, divest or hold an investment taken on the basis of these comments and analyses.

The Edmond de Rothschild Group therefore recommends that investors obtain the various regulatory descriptions of each financial product before investing, to analyse the risks involved and form their own opinion independently of the Edmond de Rothschild Group. Investors are advised to seek independent advice from specialist advisors before concluding any transactions based on the information contained in this document, notably in order to ensure the suitability of the investment with their financial and tax situation.

Past performance and volatility are not a reliable indicator of future performance and volatility and may vary over time, and may be independently affected by exchange rate fluctuations.

Source of the information: unless otherwise stated, the sources used in the present document are those of the Edmond de Rothschild Group. This document and its content may not be reproduced or used in whole or in part without the permission of the Edmond de Rothschild Group.

EDMOND DE ROTHSCHILD ASSET MANAGEMENT (FRANCE)

47, rue du Faubourg Saint-Honoré 75401 Paris Cedex 08

Société anonyme governed by an executive board and a supervisory board with capital of 11.033.769 euros

AMF Registration number GP 04000015

332.652.536 R.C.S. Paris