EDMOND DE ROTHSCHILD

MARKET FLASH: BREAK TIME FOR CENTRAL BANKS?

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Markets remained firmly focused on China and its property sector woes although there were a few signs growth was stabilising thanks to imports and demand for oil.

China's biggest property developer, Country Garden, managed to make its first bond coupon payments and is now discussing rescheduling some of its debt with creditors. The problem, however, is that it has a massive $187bn in debt and its bonds are trading at default levels of 10-15% of par.

Beijing announced new stimulus measures like easing property loan conditions but investors want to see more.

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Elsewhere, Russia and Saudi Arabia decided jointly to extend their massive production cuts. The news sent oil prices surging above $90, rekindling inflation worries and clouding the outlook for growth, especially in Europe. The Euro Stoxx index fell 1.5% and the US dollar rebounded.

Government bond yields rose with the benchmark 10-year US Treasury yield up 15bp despite the Fed's Beige Book backing the thesis of a summer slowdown in activity. Even so, the rate pause scenario in the US should persist, just as in Australia and Canada. In contrast, rising oil prices and inflation falling not as much as expected should mean less consensus at the upcoming ECB meeting on September 14. Some rate-setting committee members are tempted to push for an ultimate rate hike even if the economy is slowing. We expect the euro to rise if this proves to be the case.

We reinforced our equity exposure for the short term as markets fell. Over the medium term, we remain somewhat cautious on risk assets as restrictive monetary policy will take time to feed through to the real economy. In fixed income, we remain overweight duration which should provide protection during the economic slowdown.

EUROPEAN EQUITIES

Indices lost ground over the week. Only the energy sector managed gains after Saudi Arabia and Russia extended their 1 million b/d production cuts by another 3 months. The news sent

Brent Crude surging to more than $90; it has now gained close to 20% since the beginning of July. In addition, economic data released over the week was not very encouraging. Retail sales fell in July as consumers spent less on petrol and Germany's industrial orders also dipped.

On a brighter note, another indication of a buoyant tourism sector came from **Ryanair** which reported record passenger numbers in July. The company expects passenger traffic to rise 9% up to March 2024.

Elsewhere, the consumer discretionary sector, long seen as immune to the impact of inflation on demand, began to show some negative signs. **Richemont**, for example, said it was downbeat on luxury demand in Europe despite Chinese tourists gradually returning.

In tech, the European Commission officially designated GAFAM companies (**Google**, **Apple**, **Facebook**, **Amazon** and **Microsoft**) as access controllers in the digital sphere, thereby opening the door to reinforced regulation by March 2024.

US EQUITIES

US indices retreated over the last 5 trading days up to Thursday. The **S&P500** fell 1.23%, the **Nasdaq** 2.03% and the S&P 3.37%.

Largely resilient economic data rekindled fears that the Fed would press on with rate hikes. Services ISM came in better than expected for the second month in a row, rising to 54.5 when analysts were going for 52.2. Initial jobless claims also fell to 216,000 (vs.232,000 expected), their lowest level since February 2023 and another token of labour market strength. At the same time, higher oil prices fuelled speculation that the Fed would keep interest rates elevated for some time.

Oil traded at a nine-month high after Saudi Arabia and Russia decided to extend output cuts until the end of the year. WTI ended the period at $87.54. In airline news, **United** (-0.3%), **SouthWest** (-2.6%) and **Alaska Air** (+0.5%) warned about rising oil prices leading to more expensive kerosene over the current quarter.

In tech, **Apple** tumbled 5.5% after Beijing told government agency workers to stop using iPhones and any other makes not made in China. Apple lost more than $100bn in market capitalisation during Wednesday's session alone.

In utilities, pipeline operator **Enbridge** (-5.9%) agreed to pay **Dominion Energy** (-1.8%) $9.4bn for three utilities. The deal will double Enbridge's gas activities and create North America's biggest natural gas supplier.

S&P Dow Jones Indices said **Blackstone** (+4.69%) and **Airbnb** (+7.97%) would join the **S&P 500** on September 18.

The autos sector remained in focus after press reports that talks between Detroit-based producers **General Motors**, **Ford** and **Stellantis** and the United Auto Workers union (UAW) were not going well. 150,000 workers could go on strike when the current contract runs out on September 14. The union wants a 46% wage increase, defined-benefit pensions for all workers and 32-hour work weeks.

JAPANESE EQUITIES

The **NIKKEI 225** and **TOPIX** rose 1.14% and 2.20% as non-domestic investors shifted from China to Japan on strong performance from Japanese companies and yen weakness due to persistently high US bond yields.B

Mining and Oil & Coal Products rose 9.47% and 6.20%, respectively, due to solid commodity prices including crude oil. Real Estate added 6.05% as Japanese long term interest rates came off their highs. **Sumitomo Realty & Development** jumped 10.91%, On the other hand, Pharmaceuticals and Air Transportation edged 0.98% and 0.51% lower on profit taking. **Daiichi Sankyo** shed 4%.

Mitsubishi Heavy Industries surged 10.27% on several broker upgrades after Japan and the UK signed a MOU to build a next generation nuclear power plant. Life assurance company **Dai-ichi Life Holdings** gained 9.04% on expectations rates would remain high in the US. Elsewhere, **Nidec** , which makes small motor and automotive products, fell 3.21% on profit taking, dragged down with other electronics parts stocks after Apple sold off in the US. **SoftBank Group** (communication and internet-related businesses) fell by 2.96% due to a Wall Street Journal piece on **WeWork**'s crisis. Concerns are also mounting ahead of the listing of its wholly-owned subsidiary, **Arm**.

The yen moved from the low-146s to the high-147s against the dollar as investors banked on US interest rates staying high but the market is cautious because current levels are already above last year's intervention level.

EMERGING MARKETS

The MSCI EM Index had lost 1.2% as of Thursday's close, consolidating recent gains. India (+2.6%) outperformed while China slipped 0.9%. Brazil (-2.3%) underperformed.

Caixin services PMI in **China** decelerated from 54.1 in July to 51.8 in August, or short of the expected 53.5, while manufacturing PMI was better than feared at 51 vs. 49.2 previously. August trade data also marginally improved with exports down 8.8% YoY and imports 7.3% lower, both better than expected: Export volumes are holding up well but prices have fallen. The Ministry of Finance released a document on implementing employment policies which included support for the private economy and small enterprises. China is reportedly expanding a ban on iPhone usage in sensitive departments of government-backed agencies and state companies. The 4 Tier-1 cities of Beijing, Shanghai, Guangzhou & Shenzhen, have fully implemented easier housing policy. Home transactions in Beijing doubled last weekend following the measures.

On the corporate front, **Ctrip**, the largest Chinese OTA (Online Travel Agency), reported better-than-expected results and outlook, as travel continued to recover regardless of the weak macro environment. Country Garden managed to pay a $22.5m coupon on time, thereby averting default. Following **Baidu**, 3 more LLM (Large Language Model) providers, **Tencent**, **iFlytek** and **360 Tech**, initiated public to-C rollouts of LLM services after regulatory approval. **Amer Sport**, backed by China's **Anta Sports**, filed for a US IPO, while Great Wall reportedly began preliminary discussions with **CATL** regarding the sale of a stake in **SVOLT**. In Taiwan, **TSMC** said current capacity could only fulfil 80% of CoWoS demand, with a projected 18-month timeline to fully ramp up. **Airtac**'s August sales beat expectations, possibly indicating that manufacturing activities in China had bottomed out. Korea grew 0.9% YoYin the second quarter, or in line with forecasts. Inflation in August rose 3.4% YoY, or more than the higher 2.9% expected, due to higher agricultural and manufactured goods prices. **Kia** is to build the biggest EV auto plant in Thailand with capacity of 250,000 cars a year. **Hon-Hai** and **PTT** are at 150,000 followed by **MG** and **BYD** with 100,000.

In **India**, services PMI decelerated to 60.1 in August from 62.3 in July, or lower than the 61 expected. **HCL Tech** signed a multi-year agreement with **Siemens AG** to provide cloud services and modernisation. **Corning**, the world's biggest specialty glassmaker, agreed to a JV with **Optimus Infracom** to manufacture smartphone cover glass, a strategic move to drive India's smartphone manufacturing ecosystem. **Foxconn** and **STMicroelectronics** are in talks to bid for a semiconductor factory in India.

Brazil grew more than expected in the second quarter, mainly thanks to the agricultural sector. Data from **ANS** (HC regulator) underscored a positive overview for the healthcare sector in the second quarter: MLR improved, ticket prices increased and claims were only up 6% YoY. In **Mexico**, core inflation slowed sharply to 6.08% in August, a 20-month low and below the 6.12% expected. The Morena coalition selected Claudia Sheinbaum as its presidential candidate. Mexican airport group OMA reported a 22% rise in August domestic traffic. International traffic was up 26%.

CORPORATE DEBT

CREDIT

As in the previous week, the market continued to absorb significant new issuance across all segments. The high yield market reopened too, with **ZF** BB 6.125% 2029 (€650m), **Rexel** BB+ 5.25% 2030 (€400m), and a €350m deal from **Banijay** (Endemol). Equipment rental company **Boels** (BB-) sold its first bond, raising €400m at 6.25% due 2029. In investment grade, the week's highlight was a jumbo €3bn issue from Sartorius in 4 tranches, 3,6,9 and 12 years. The deal was oversubscribed by close to €20bn. In financials, **Cajamar** sold a senior bond which we subscribed to. **Generali** (BBB) raised €500m at 5.27% due 2033 and Erste Bank €500m with an AT1 at 8.5%.

Despite this surge in activity and pressure on the secondary market, credit premiums held up well over the week. In high yield, they tightened by 10bp to 435bp while the Xover widened slightly to 403bp. Investment grade premiums stayed around 154bp and Euro CoCos were similarly largely unchanged at around 840bp. Once again, volatility came from the government bond segment which seesawed between rises and falls. The rally, initiated on August 20 when the German 10-year Bund was yielding 2.70%, ran out of steam. After closing at 2.46% on September 1, it had risen to 2.62% by Thursday evening.

As of Thursday evening, investment grade was down 0.39% over the week, taking YTD gains to 2.65%. Thanks to tighter premiums, high yield rose 0.20% or +6.02% since the beginning of 2023. At the time of writing, actuarial yields for investment grade were 4.4% and 7.4% for high yield, i.e. still good entry points for carry strategies.

CONVERTIBLES

All eyes were on the new issues market. All regions were active, with the most important volume in the United States, so there was less activity on the secondary market where valuations were unchanged.

In Europe, **ENI** raised €1bn with a sustainability linked 7-year maturity at 2.95%. The Bonds will be linked to the achievement of sustainability targets related to Net Carbon Footprint Upstream and renewable energy installed capacity by December 2025.

Japan's new issuance pipe also reopened this week. **JFE Holdings** raised JPY 90bn Yen and **NTN JPY** 30bn. The proceeds from JFE's issue will be used to fund its decarbonisation efforts.

The US saw the biggest issuance volumes, with over $4.5bn and 8 deals, notably a $1bn jumbo issue from **Liberty Media**, which is exchangeable into **Live Nation** shares, and $1.3bn from **Seagate** to refinance debt maturing in 2025.

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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