MARKET FLASH: INFLATION: THE LAST MILE IS ALWAYS THE LONGEST

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- ***At the same time, the momentum gap between the US and Europe seems to be getting wider. US inflation has accelerated while in Europe it has decelerated***
- ***We remain invested in risk assets after recently raising eurozone weightings.***

Global markets were boosted by another batch of encouraging growth and inflation data. Activity and household consumption figures in the US were upbeat and investors were relieved to see that US inflation came in as expected.

If we examine recent inflation trends, we see that it fell more than expected in the second half of last year. However, the trend has been less marked since the beginning of 2023 but inflation has still fallen in the US, the eurozone and even in the UK.

As expected, core PCE in the US was up 0.3% MoM or 2.4% over 12 months, its lowest level since February 2021. But the PCE base was at a 12-month higher of 0.42% mainly because of a rise in services ex shelter. The message is that core inflation is still running above Fed targets and that some 6-month projections, which had previously indicated that inflation was trending towards the target level, are now not as favourable. For example, the base 6-month PCE index projection was previously at an annualised 1.9% but it is now, after January's figures were released on Thursday, back up to 2.5%. Similarly, the overall consumer price index rose from 2.1% to 2.5%. Note that this monthly 0.42% increase is the highest since the 1990s if we exclude the pandemic period and the month following the September 11 attack.

At the same time, the momentum gap between the US and Europe seems to be getting wider. US inflation has accelerated while in Europe it has decelerated (core CPI came in around an annualised 3.1% in February, down from +3.3% in January). That said, Europe is suffering from the same persistent inflation in services as in the US. And the risk of inflation pressures from robust wage rises suggests the ECB could remain vigilant. For the same reason, bond markets have been sending yields higher. In fact, the worry is that wages are catching up with overall price rises, a contrast with the last 3 years where total inflation was running higher than wage gains. Bond yields are rising today mainly because of the risk inflation might move more slowly towards central bank targets.

We remain, however, convinced that disinflation will continue, especially in the eurozone where GDP is rising more rapidly than domestic demand.

We remain invested in risk assets after recently raising eurozone weightings. In fixed income, we reduced duration in US bond holdings a few weeks ago because of US economic resilience. Even so, we are still long duration overall, but essentially in the eurozone because we continue to believe the ECB will inevitably start a rate-cutting cycle this year.

EUROPEAN EQUITIES

Trading lacked direction over the week and indices drifted slightly lower on Friday morning ahead of the eurozone consumer price index to be released that afternoon. In addition, mixed results failed to offset the move higher in bond yields due to worries over persistent inflation. Traders lie in wait for macro indicators and volumes remain thin in the meantime.

Autos and construction led gains thanks to upbeat figures from **CRJ** and **Eiffage**. Insurance plays were also boosted by results from **NN Group** in the Netherlands. Property, of course, was hit by rising bond yields while consumer goods suffered from soft demand.

Nexity symbolised the problems in France's property sector from a sharp downturn. The share tanked after a redundancy plan was unveiled and management decided to pass on the 2023 dividend. The group expects 2024 to mark the bottom.

Payments company **Worldline** also sold off due to changes in consumer patterns. Because of inflation, households now prefer big stores to small shops and the group's margins are higher in smaller outlets.

On a more positive note, **Interparfums** bucked the trend in a sector which is also seeing a drop in spending. The momentum seen in its 2023 results is expected to continue this year thanks to reduced supply chain problems.

In a record deal, **CMA CGM** (maritime transport) is to pay €4.85bn for **Bolloré Logistics**, a company with 14,000 employees and sales of €7.1bn in 2022. It is the group's largest acquisition since it was set up in 1978 and should help it develop its logistics business as a complement to its core shipping business.

US EQUITIES

Results from big hitters in the US ended with **Nvidia** last week (a few, less important, companies still have to report).

Markets cheered **Stericycle**'s results which showcased the company's execution quality, its efforts to simplify its business model and its deleveraging drive. But **Viatris** fell on merely moderate guidance for 2024. Growth is expected to be soft and margins could edge lower. **Chart Industries** reported excellent figures thanks to a steep rise in earnings, a strong order book and upbeat prospects for the next three years, a token of a robust LNG market.

In healthcare, **Veeva** cut revenue guidance for 2024 but raised its earnings outlook. Growth at **Vertex** beat estimates with the biggest advance since 2020: management reaffirmed guidance for 2024 which is above consensus expectations, a relatively rare occurrence these days. In another problem for the healthcare insurance sector, the Justice Department launched an anti-trust enquiry into **UnitedHealth.**

Cloud star **Snowflake** plunged after reporting a sales miss and the departure of its CEO. In contrast, software publisher **Okta** rebounded after an upbeat fourth quarter and a promising outlook for 2025. **NetApp** had an excellent quarter thanks to an improvement in its gross margin and significant AI product momentum.

In renewables, **Shoals** showed that difficulties in the solar utilities sector were not completely over: its fourth-quarter results missed revenue and earnings expectations and guidance for 2024 was cut due to project delays. **First Solar**, however, continued to buck the trend: the company beat fourth-quarter estimates thanks to lower-than-expected costs per watt, a trend which is seen continuing in 2024 and expected to underpin full-year expectations.

In inflation news, Thursday's PCE price index was in line with expectations and the market rallied. Traders now seem more interested in inflation than growth.

JAPANESE EQUITIES

The NIKKEI 225 and TOPIX rose by 0.17% and 0.56%, respectively. After three lost decades, the NIKKEI 225 reached a milestone by surpassing the bubble era high of 38,915 for the first time in 34 years. As Japan enters a new era, stock prices seem to have broken free from the constraints of the Showa era. An economy characterised by stagnant prices, wages, and interest rates, appears to be at a turning point ahead of a more dynamic period. With the spring union negotiations underway, significant wage increases are expected for the second consecutive year and there are prospects for the Bank of Japan to move out of negative interest rates. Japan is embracing a model where global companies take the lead. Over the week, stocks fluctuated around the 39,100 level on weakness in some AI companies in the US as risk appetite abated.

Banks rose 3.38%, led by **Mitsubishi UFJ** and **Sumitomo Mitsui Financial** on expectations higher interest rates would result in strong earnings. Machinery gained 2.11% led by **SMC**. and **Mitsubishi Heavy Industries** after China cut rates. Precision Metals gained 1.78% led by Hoya and **Terumo.** On the other hand, Marine Transportation fell 2.58%, led by **Nippon Yusen** on profit taking. Foods lost 2.33%, led by **Ajinomoto** and **Asahi** on a results miss. Other Manufacturing slipped 0.84%, led by **Bandai Namco** (-5.05%) on disappointing results.

Otsuka Holdings (pharma) jumped 7.88% thanks to a technical rebound. **Chugai Pharmaceutical** gained 6.23%, bouncing after a fall due to the release of an Eli Lilly Form 10-K containing financial terms for orforglipron. **Mitsubishi Estate** advanced 5.62%. Elsewhere, **Aginomoto** (food) tumbled 6.08% after April-December 2023 results jumped less than expected. **Asahi** (beer) fell 5.95% on profit taking after reporting flat December 2023 results but with higher guidance for this year.

The dollar was largely unchanged against the yen around 150. However, the feeling was that the yen could depreciate further due to central bank comments suggesting easing was not an urgent matter. Even so, buying dollars at these levels strikes some as adventurous.

EMERGING MARKETS

The MSCI EM Index had fallen 0.66% this week as of Thursday. Both **China** and **India** retreated after a rally, ending 1.27% and 1.1% lower. Korea and Brazil were both down 0.5%. Taiwan outperformed by staying almost flat for the week.

In **China**, February official manufacturing PMI was 49.1 while services PMI was 51.4, or ahead of the 50.7 expected. **Caixin** manufacturing PMI, which is more private sector and export-oriented, was 50.9. The **NPPA** approved 111 domestic games, bringing monthly average games approved in 2024 to a three-year high. **Baidu**'s fourth-quarter results were broadly in line, with encouraging AI monetisation progress and an improvement in core profitability. However, the short term outlook and capital returns announced were below expectations. **NetEase**'s fourth-quarter results were slightly below consensus on low seasonality and weaker legacy game revenue but the 2024 pipeline remains solid. **Li Auto** delivered a strong quarter, beating estimates on margins and cash flow; new product launches will continue to support strong growth in 2024. **Xpeng** and **Volkswagen** signed a deal to co-develop two EV models.

In **Hong Kong**, **Samsonite** received takeover interest from a private equity firm and is considering different options, including re-listing in the US.

In **Taiwan**, industrial production broke a 19-month down streak and was up almost 16% YoY, or ahead of expectations. The forecast for this year was raised from 3.35% to 3.43% as export demand for high-tech products begins to recover.

In **Korea**, the authorities are looking into various ways to make companies comply with their value-up agenda, including de-listing for companies that do not improve low return metrics. **Micron** said it had begun mass production of HBM3E, ahead of **Hynix**, to supply to **Nvidia**.

In **India**, GDP growth for the third quarter of FY 2024 came in at 8.4%, beating the 6.6% expected and taking the total for 2023 to 7.6%. Manufacturing PMI inched up to 56.9 in February, versus 56.7 in January. The Indian cabinet approved 3 semiconductor projects worth $15bn and offered to shoulder half the cost of any approved projects up to an initial ceiling of $10bn. Auto registration data for February showed that two-wheelers continued to lead growth with volumes rising 8% YoY vs. 4% YoY for PVs. **TVS** reported a 33% YoY increase in February's vehicle sales. **Disney** and **Reliance** inked a binding pact to merge their media operations in **India**. **VinFast** officially broke ground on its integrated electric vehicle facility in **India**.

In **Brazil**, February IPCA-15 came in at 0.78%, or below the 0.83% expected. The labour market continued to improve with unemployment down more than expected to 7.6% and average real wages up 3.8% YoY.

In **Mexico**, the unemployment rate was 2.85% or in line. **Alsea** reported a beat on EBITDA and EPS in 2023 due to a strong 12.1% increase in same store sales and lower financing costs.

In **Chile**, **SQM** reported weak results due to lower lithium prices but the price outlook during the year was better than expected.

CORPORATE DEBT

CREDIT

Once again, the trend was dictated by a relative rise in yields as resilient macro indicators and growth forecasts were met with cautious central bank comments. The ECB is now expected to start cutting rates in June. As of Friday morning, yields on the 2-year German Bund were up 8bp over the week to 2.93% and up 10bp for both the 5-year (2.48%) and 10 year (2.46%).

But credit markets were again remarkably resilient with the Xover at 304bp, investment grade spreads at 120bp and high yield at 345bp. This is another indication that buyers are focusing on overall yields rather than absolute spread levels (which are still trading at 2-year lows).

In new issuance, there were two new hybrid perpetual bonds. **BP** raised $1.3bn at 6.45% and **NextEra Energy** $1bn at 6.70%. Both were oversubscribed, another indication of investor appetite for carry. In high yield, **Forvia** (BB) (ex-Faurecia) raised €1bn in two tranches, 2029 and 2031, to refinance its 2025 and 2026 maturities. **Tui AG** (B+) raised €500m at 5.875% due

2029. In financials, where momentum and inflows remained strong, **ABN AMRO** and **Standard Chartered** sold new AT1 debt.

Due to rising rates, investment grade slipped 0.23% over the week (-0.80% YTD) and high yield edged 0.15% lower but is still up 1.18% YTD thanks to spread resilience.

CONVERTIBLES

It was an active week for convertibles with the earnings season still driving single name moves. The primary market was as busy as in the previous week.

The focus in Europe was on mixed results. **Cellnex** reported adjusted EBITDA for the full year that met average estimates. The company will hold a capital markets day next week to provide updates on strategy, roadmap and short- to mid-term objectives. **Amadeus** reported a better profit than expected, with revenues in line and guidance that implied higher margins. The numbers should have boosted the underlying stock but it fell on rumours suggesting the company might be interested in acquiring **Shift4**, a US payments processor. Amadeus subsequently denied the rumour.

AMS-OSRAM was in focus in the European convertible bond universe, with the stock sharply correcting and bonds coming off following the company's announcement that a project underpinning their Micro-LED strategy was unexpectedly cancelled and that the company would be taking a non-cash impairment charge of €600-900m. **Nexity** and **Air France** both fell sharply after reporting their results. **Nexity** plunged 20% after the company announced significant layoffs and passed on the dividend due to poor prospects with rates at current levels.

In the US, **Okta** shares soared 23 % after the application software company reported fourth-quarter results that beat expectations and relieved investor concerns over the impact from a security breach which in fact did not occur.

On the primary market front, **Nextera Energy Capital** raised €900m due 2027. In Japan, **Ibiden,** a substrates supplier for **NVIDIA** issued JPY 70bn in a deal which was well received.

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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01/03/2024

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

AMF Registration number GP 04000015

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