EDMOND DE ROTHSCHILD

MARKET FLASH: SANTA CLAUS IN ADVANCE

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• The ECB, however, is not yet ready to talk about pivoting. The bank reduced its growth and inflation outlook but is worried about persistent wage pressure and so was keen to calm market wishes for rate cuts.

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In a radical shift, the latest Fed meeting opened the door to rate cuts. Nobody on the rate-setting committee now expects a hike in 2024 and the dot plot average is for a 75bp cut by the end of the year. Jerome Powell's comments were particularly accommodating. He insisted a rate cut was needed before hitting the 2% inflation target to ward off a recession.

This about-turn was made easier by a sharp retreat in inflation -thanks to energy- and the prospects of next year's presidential elections.

The ECB, however, is not yet ready to talk about pivoting. The bank reduced its growth and inflation outlook but is worried about persistent wage pressure and so was keen to calm market wishes for rate cuts. At the same time, the bank said it would be shrinking its balance sheet to the tune of €7.5bn a month, or less and later than expected.

The Bank of England is on the same wavelength and has also opted for a prolonged pause in rate decisions because of wage inflation. In fact, three committee members were even in favour of a fresh hike. Even so, markets think the Bank of England will rapidly follow the Fed's lead and decide on a rate cut in mid-2024.

The Bank of Norway indulged in its last rate hike, taking the benchmark to 4.5%. This goes against the global trend and the Norwegian kroner naturally rose.

And yet, falling European PMIs show that the continent is weaker than the US. In the UK, a remarkably resilient jobs market and strong retail sales are reinforcing the soft landing scenario.

The Fed's shift and upbeat economic data sent yields on 2-year US Treasuries 40bp lower. The dollar shed 2% and equity markets were generally higher, especially small caps.

With the fallback in inflation and the Fed's pivot, we raised exposure to risk assets and are now overweight small caps. In fixed income, we are still keen on duration which should provide protection as inflation and growth retreat and the Middle East continues to be unstable.

EUROPEAN EQUITIES

The month-long rally continued thanks to a sharp slowdown in inflation, falling government bond yields and market optimism that rate cuts could occur as early as March 2024. Jerome Powell's post FOMC comments reinforced sentiment by talking of cutting in 2024. In Europe, the ECB's Christine Lagarde was more cautious but her tone made only a slight dent in market enthusiasm.

Almost all sectors gained ground but property was especially strong, followed by construction and materials. Energy suffered from downward pressure on Brent crude prices while insurance was hit by falling bond yields.

At its investor day, **Wendel** unveiled a road map for higher and recurring dividends. The holding company now wants to be seen as an investment house. It is now targeting Fee Related Earnings (FRE) of €150m by 2027 from its third-party asset management business, more than 10% in IRR on the existing portfolio (ahead of an increase to 15%) and a dividend increase to 2.5% of revalued net assets for 2024 and 3.5% over the longer term. The company also announced a new share buyback in addition to the October 27 €100m buyback. The dividend for 2023 should be raised by 20%, or much more than the 4% expected.

A study of phase 3 results published in the JAMA review sent **Novo Nordisk lower**. The pharma group had been riding for months on the success of its weight loss drug Wegovy. The study concerned Tirzepatide, a GLP-1 agonist, which shows patients tend to regain weight after coming off Wegovy. Wegovy's efficiency is not in question but the news poured some cold water on the market's love affair with the drug.

According to German daily Handelsblatt, **Volkswagen** is in talks with several possible partners including **Renault** (well-placed with its AMPERE project) to develop a platform for electric cars costing less than €20,000. Reaching such a low price would entail pooling production as well as development.

Air France bounced after its cost reduction plan was announced. The airline is confident the plan and strong demand will help profitability rise by 2028.

US EQUITIES

The Dow jumped 2.92% over the last five trading sessions to Thursday while the Nasdaq ended 2.94% higher. The Fed's latest message was more accommodating than expected with 3 rate cuts pencilled in for 2024 to take benchmark rates down to the 4.50-4.75% range The committee observed that inflation had slowed but was still high.

In the energy sector, **Occidental Petroleum** bought **CrownRock** for $12bn. This follows **Chevron**'s acquisition of Hess. And in the retail sector, **Macy's** was the target of a bid from a consortium to take it private.

In tech, a Californian jury unanimously decided in favour of plaintiff **Epic Games** that **Google's** mobile app monopoly was illegal. The decision is a threat to the **Google**/**Apple** duopoly on a market estimated at $200bn.

Software company **Oracle** tumbled 8% after third-quarter sales growth slightly missed expectations. Cloud revenues were just as disappointing as IT material and services results.

Adobe fell 6.4% on weaker-than-expected full-year guidance. The group said the IA contribution to earnings would take time to feed through. Sentiment was also affected by news of a Federal Trade Commission investigation into the company over its cancellation of subscriptions.

Warren Buffet's **Berkshire Hathaway** halved its stake in computer maker HP.

X, formerly **Twitter**, should see revenues of $2.5bn in 2023 (i.e. $600m a quarter) compared to $1bn previously.

Apple hit a market cap record of $3.1 trillion, or almost as much as the entire market cap of the Paris Bourse ($3.2 trillion).

In healthcare, **Moderna** jumped 9.2% on Thursday on positive test results for its skin cancer vaccine. FDA approval could come in 2025.

JAPANESE EQUITIES

The NIKKEI 225 and TOPIX slid by another 0.52% and 1.63% as the yen strengthened against the dollar and concerns on slower global growth weighed on the market.

Services rose 2.49%, led by **Recruit Holdings** (+9.72%), a company mainly engaged in human resource (HR) technology, after it announced share-buybacks amid a growth stock rally on falling US bond yields. **Land Transportation** gained 1.30% led by Japan Railway on expectations that passenger numbers over the New Year holiday would exceed pre-Covid levels. Precision Instruments gained 0.66%, led by Hoya which is seen as a growth stock. On the other hand, Transportation Equipment tumbled 7.58% as the yen appreciated. Mining shed another 5.83% due to weaker commodity prices. Insurance fell 5.37% on falling US bond yields with **Dai-Ichi Life** down 8.40%.

LY Corp., an internet services platform provider, and **Tokyo Electron**, a semiconductor manufacturing equipment maker, soared 9.27% and 7.13%, respectively, as investors moved into large-cap growth stocks on falling US interest rates. Car maker **Subaru** and **Shimano** (bicycle and fishing equipment) shed 8.36% and 8.14% as the stronger yen hit export stocks.

The dollar fell further against the yen, moving from the low-144s to the low-141s, mainly due to sharply lower US bond yields. Comments from the FOMC and Fed Chair Jerome Powell practically suggested the end of US rate hikes.

EMERGING MARKETS

The MSCI EM index was up 1.84% in USD this week as of Thursday's close. Mexico (+5.51%) led followed by Brazil (+3.72%) and South Korea (+3.65%), up 3.72% and 3.65% respectively. India (+1.63%) underperformed. China was flat.

In **China**, November's macro data remained mixed: CPI was back to deflationary territory at -0.5 % YoY vs. -0.2% estimated. Credit trended below expectations with RMB 1.09 trillion in new loans but above the previous month's RMB 738.4bn. Industrial production was up 6.6% YoY, or better than the 5.7% estimated, while retail sales growth decelerated sequentially to 10.1 % YoY vs. 12.5% estimated. Auto production and sales jumped 29% and 27% YoY. CEWC set a pro-growth tone for a third consecutive year, targeting around 5% in GDP growth. Beijing relaxed home-buying curbs in Beijing/Shanghai and the PBoC injected a net RMB 800bn in 1-year MLF policy loans (one of the highest injections in the past 5 years). **TikTok** took over **GoTo**'s in a $1.5bn deal to return to Indonesia's e-commerce market. **Haier** announced it would acquire a 100% stake in **Carrier Refrigeration** for $640m, implying 11x 22 P/E, or in-line with historical transaction valuations.

In **Korea**, unemployment for November was 2.8%, or the 2.6% estimated.

Taiwan's local press said the German government would honour its subsidy plan for **TSMC**'s European fab site, and **TSMC** named its most advanced 1.4nm process 'A14', with mass production to begin in 2027 at the earliest.

India's industrial production grew 11.7% YoY, or the 10.5% estimated. Inflation for November was 5.55 % compared to 4.87% but below estimates of 5.78%. YoY exports and imports fell 2.8% and 4.3%, respectively. **Dixon Technologies** was awarded an IT hardware deal by **Lenovo** under revised **PLI**. **Foxconn Technology Group** won approval to invest at least another $1bn in a plant being built in India to make **Apple** products. Reliance is expected to sign a pact to merge its media operations with **Walt Disney**. **L&T Tech Services** announced a multi-year digital engineering deal from BP. **Ultratech** plans to increase the overall share of green energy in its energy mix from 22% today to 60%/85% by 2026/2030.

Brazil's inflation for November came in at 4.68%, or as expected. The central bank cut rates by 50bp to 11.75%. Retail sales rose 0.2% YoY, or less than the 1.8% expected. **Hapvida** CFO stepped down as planned.

In **Mexico**, there was an unexpected positive outcome for **Asur's Master Development** Plan (MDP) after a review process came up with a 23% tariff increase, therefore providing more certainty on **Asur**'s agreed concession IRR. Industrial production for the month of November was up 5.5%, or better than the 4.1% expected. Mexico's central bank kept rates unchanged at 11.25%. Tesla won a permit to build a giga factory.

CORPORATE DEBT

CREDIT

The week's big news was the Fed's pivot on Wednesday, a move that clears the way for rate cuts. The ECB was more measured: the bank opted for patience and said it would have to look at all the data before a cut was possible. Following Jerome Powell's post-FOMC comments, US and euro bond yields plunged. Yields on the US 10-year Treasury fell by 32bp to 3.91%. The equivalent German Bund tumbled to 2.04% (-22bp). In the last 2 months, it has lost almost 1% (yields briefly hit 3% in October).

Credit markets reacted very favourably to the Fed's accommodating stance, a sign of the bank's determination to avoid a recession in 2024. Credit spreads tightened from 144 to 136bp for investment grade and from 420 to 400bp for high yield. The Xover tumbled from 370 to 320bp over the week, a token of renewed confidence in credit risk assets. Similarly, bank CoCo spreads fell by almost 90bp to 640bp.

Ahead of the year end, new issuance slowed significantly both for corporates and financials and there were no big deals. Note, however, that **Air France**'s first official rating was announced as IG/HY BBB- at Fitch and BB+ at S&P.

In a very good week for rates and spreads, all segments made significant returns. Investment grade returned 1% over the week (+7.2% YTD) and high yield 1.2% (+11.2%).

CONVERTIBLES

It was a very positive week for convertibles as the narrative switched from "soft landing with no more rate hikes" to a "soft landing and pending rate cuts". Credit and equity markets toasted the surprise move and drove convertible returns over the week.

As is normal before a year end, the primary market was muted and trading was driven mainly by macro factors and single name news. In Europe, **AMS Osram** announced the completion of its comprehensive financing plan to enhance its capital structure, reduce net debt and well-balanced maturity profiles. **Air France–KLM** received inaugural credit ratings: Investment Grade “BBB-“ by Fitch; “BB+” by S&P Global Ratings a stable outlook for both. The company revised operating margin guidance upwards to above 8% for the 2026-2028 period. Precious metal miner Sibanye Stillwater was downgraded by S&P to 'BB- with a negative outlook. The company’s revenues and EBITDA for 2023 are expected to fall because of lower production due to operating challenges and recent platinum group metal price declines. **Atos** traded sharply higher after French daily Le Figaro reported that **Airbus** was in advanced talks to buy the French IT services firm’s big data and cybersecurity activities; neither company commented on the article.

In the US, **Liberty Media** announced a deal to combine **SiriusXM** with its LSXM tracking stock to eliminate the valuation gap between them and simplify the ownership structure. The board of **Affirm Holdings’** authorised the repurchase of up to $800m in convertible senior notes due 2026, leaving approximately $626m outstanding. The EV company **Rivian** announced an agreement with **AT&T** to buy electric delivery vans and other EVs; this is the first major announcement since the company ended an exclusivity deal with **Amazon**, and according to the company it could be the first of potentially numerous pilot programmes.

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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