EDMOND DE ROTHSCHILD

MARKET FLASH: DISCERNING THE TREND AMID THE NOISE

• The latest US inflation figure upset the consensus narrative on disinflation. After a run of resilient US economic data, inflation is now proving resilient.

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The latest US inflation figure upset the consensus narrative on disinflation. After a run of resilient US economic data, inflation is now proving resilient. Core inflation in January came in at 0.4% instead of the 0.3% expected. But it was the super core components (services ex property) and property which caused the most surprise by jumping 0.7% and 0.6%. Goods and energy continued to trend lower.

One figure is not a trend but doubts on inflation's move back to normal levels have resurfaced and rate cut expectations have been pushed back. We still believe disinflation will continue due to property market normalisation, labour market easing and reduced budgetary support.

In Europe, the latest inflation readings were again surprisingly low. Prices rose by 0.2% in Switzerland in January, or less than the 0.6% expected, and by 1.5% in the Czech Republic (2%). In the UK, they fell by 0.6%, or more than the 0.3% dip expected. As bond markets had already readjusted downwards in previous weeks for over-optimistic rate cut expectations, yields were more or less unchanged over the week.

Meanwhile, the UK and Japan officially entered a technical recession after contracting for two consecutive quarters. Nevertheless, growth in the UK and the eurozone should be underpinned by rising PMIs, more favourable lending conditions and the lagging rise in real wages. US growth continued to prove resilient even if patches of weakness showed up in retail sales and a NFIB survey of small companies indicating a more muted outlook. Services remained robust.

With no deterioration in geopolitical risk, equity markets pushed higher.

We remain invested in risky assets, and especially US and European equities, but underweight the dollar. We still prefer fixed income for its yield. We believe in being overweight duration as it should offer protection amid ongoing disinflation and geopolitical instability.

EUROPEAN EQUITIES

European equity markets ended the week higher. More than 50% of companies have now reported results and the picture is somewhat disparate. Cyclicals like material and financials have done well while consumer discretionary and property have generally missed expectations.

This week, tourism group **TUI** said demand was strong. The company's results beat expectations and management said coming quarters were looking promising despite the economic situation. In tech, **Capgemini**'s results jumped thanks to strong demand for artificial intelligence as clients rushed to implement solutions. The autos sector is flourishing: **Stellantis** and **Renault** reported excellent results and solid operating margins and both are optimistic for this year. Tyre manufacturer **Michelin** also posted upbeat figures but was more cautious on the outlook with the possibility of a drop in free cash flow. The market, however, pushed the stock higher. HR consulting firm **Randstad** also performed well and plans to return cash to shareholders.

But Holland's **Heineken** disappointed as higher prices failed to offset lower beer sales. The group was cautious for 2024. Germany's **ThyssenKrupp** also cut guidance due to soft demand and falling prices.

Short sellers targeted software company **Temenos**. **Hindenburg** released a report based on interviews with former Temenos employees, partners and clients citing accounting irregularities and defective products.

Delisting is still in vogue: **Cegedim** acquired **Visiodent**, the leading supplier of dental surgeries and clinics with sales of €10m. Digital music company Believe was approached by a consortium including its founder and CEO. **Believe**'s board is in favour of the bid which values the company at close to 1.2 times estimated 2024 sales. And the **Della Valle** family bid for fashion house **Tod's**. The price values the group at 2.1 times estimated 2024 sales and still needs shareholder approval.

US EQUITIES

With the earnings season drawing to a close, 70% of S&P 500 companies have beaten expectations.

This week's surprise was an historic jump in **Shake Shack**. The fast-food chain had a beat across all metrics and raised guidance for 2024. **Toast**, which supplies restaurant management software, also beat expectations thanks to new sites. Even so, the company said it was laying off 500 people. Clearly, the cost rationalisation trend is still with us. **Cisco** is getting ready to lay off 5% of its workforce after cutting annual guidance due to reduced demand. Deere (agricultural machinery) also issued a profit warning due to farmers having less to spend following a drop in cereal prices like corn.

CBRE (commercial property) rebounded as international growth resulted in better-than-expected results. Nevertheless, investors still view the sector as a serious cause for concern.

In tech, **Akamai** reported good figures and gave upbeat guidance. The company expects sales to rise 8% YoY in 2024.

M&A deals continued apace. **Masonite**, the leading door manufacturer, was bought by **Owen Corning** at a premium of more than 50%. And in the energy sector, **Diamondback Energy** acquired **Texan Endeavor Energy** to become the biggest operator in the Permian Basin.

Elon Musk bought more **Tesla** shares in the fourth quarter, taking his stake to 20% and nearing the 25% level which he considers essential if AI products are to be developed in the company.

The headline news this week was US inflation. Core CPI came in at 3.9%, or higher than expected, due to rising rents and a sharp jump in insurance premiums over the year. Markets initially tanked on the news but the equity market soon rallied.

JAPANESE EQUITIES

The NIKKEI 225 and TOPIX gained 3.42% and 1.33%, hitting a 34-year high at the February 14 close. Japan's GDP contracted by 0.1% in the fourth quarter compared to the previous quarter, following a revised 0.8% shrinkage in the July-September quarter. Japan lost its spots as the world's third largest economy after slipping into recession. Nevertheless, bullish sentiment prevailed on equity markets with investors ready to buy on any dips. This suggests that any falls will be short-lived and indices could reach new highs. Better-than-expected results, corporate actions and TSE reforms seem to be underpinning a strong market uptrend.

Insurance jumped 11.64% led by **MS&AD Insurance Group** (+25.24%), **Tokio Marine Holdings** (+13.34%) and **Sompo Holdings**. The Financial Services Agency asked the four major non-life insurance companies to accelerate sales of cross-shareholdings. Buying was also driven by indications shareholder returns could be boosted by share buybacks. Marine transportation rose 4.36% as logistics tighten and freight costs rise. Wholesale trade gained 2.54%, led by **Mitsubishi** due to its positive attitude towards shareholder returns. On the other hand, Pulp & Paper tumbled 7.18%, led by **OJI Paper** and **Nippon Paper Industries** after earnings downgrades. Real Estate lost 2.93%, led by **Mitsubishi Estate** on poor results. Mining slipped 2.58% on profit taking.

Tokyo Electron soared by 18.33% on hopes for growth from generative AI after certain US semiconductor stocks rocketed. Elsewhere, **Bandai Namco Holdings**, a multinational video game and entertainment company, fell 13.33%, due to disappointing fourth-quarter results. **Shiseido** (cosmetics) shed 8.03% after fourth-quarter results plunged 76.1% YoY. **Orimpus** (optical and electric equipment) ended 6.08% lower after cutting full-year guidance.

The dollar strengthened from the mid-149s to 150.80 against the yen. Japan's retail investors have added to yen weakness by buying foreign assets through the new NISA investment programme. However, we are now at levels where investors fear a BoJ intervention.

EMERGING MARKETS

Most of the Asian markets were closed until Tuesday/Wednesday for the Lunar New Year and **Brazil** was closed for carnival.

In **China**, the market rebounded strongly due to higher spending during the holidays. Macau travel hit a record high and food deliveries surged more than 30% YoY. China's property sector was mixed. Retail sales fell 14% MoM in January. The first reliable indication will come after the holidays in March.

Taiwan also rebounded, catching up with AI plays. **Quanta**'s January sales missed estimates and the company gave weaker guidance. **CoWoS** plays were strong as **TSMC**'s CoWoS capacity is expected to remain tight in the second half of 2024.

In **India**, January Inflation softened to 5.1% YoY, down from 5.7% in December and an expected 5.3%. Industrial production growth continued to improve from 2.4% in November to 3.8% in December. According to local news outlets, Elon Musk's **Tesla** is on the verge of entering the Indian market as the government is finalising a policy to extend concessional import duties on electric cars exceeding Rs 30 lakh (about $36,000) for 2-3 years. In results news, **Amber** missed expectations on sales and profits due to soft revenues at its RAC refrigeration and air conditioning unit, higher interest payments and depreciation. Results at **Hero**'s were in line: sales were up 20% and EBITDA soared 47%. **Eicher** beat consensus on higher realised prices and lower marketing expenses. EBITDA jumped 27% and net profit was up 34% YoY.

Indonesia had its presidential, parliamentary and regional elections on February 14th. The definitive results were not out at the time of writing but unofficial quick counts showed Prabowo Subianto leading with 58% of votes, or comfortably above the 50+1% votes needed to win the presidency.

In **Mexico**, direct investments hit $36.1bn in 2023, a 27% increase on 2022. Industrial production contracted 0.7% in December, or worse than the 0.3% decline expected. Chinese EV maker **BYD** said it was considering building a new factory in **Mexico**. **Banorte**'s management said January had been a solid month for the bank with strong credit demand and good asset quality.

CORPORATE DEBT

CREDIT

Despite unsettling inflation data in the US, it was a good week on credit markets which ended the period unchanged. The Xover index even tightened by 10bp. High yield, investment grade and financial **CoCos** all returned around 0.25% over the period.

Worries over commercial property remained but were still restricted to banks with the widest exposure to US and German property. The new issues market provided support. **BNP Paribas** sold a dollar-denominated AT1 at 8% and the order book totalled $11bn. Banks continued to talk up their fundamentals for this year. The earnings season caused a lull on new high yield issues. Deals are expected to resume at the end of February.

In company news, **Renault** posted upbeat figures which suggest it should regain its investment grade status. Semiconductor company **Ams-OSRAM** reported good 2023 results and reassured the market on the outlook for 2024. Swedish property company **Balder** launched a rights issue with the proceeds to go on repaying its subordinated hybrid bond via a tender. S&P downgraded **Atos** from B- to CCC with a negative outlook and **Eutelsat** from B+ stable to B stable. **Atalian** reached an almost unanimous agreement with its creditors to extend its debt maturities. Almost 90% were in favour of the exchange offers.

CONVERTIBLES

The equity market correction sparked by the hotter-than-expected US CPI print was rather short lived. Major equity indexes recovered during the week before data on US producer prices was due. Convertible bonds gained ground, driven mainly by the earnings season. One of the most important surprises in our universe this week was **Uber** which reported its first yearly profit. It had also recently joined the S&P 500 index, and on February 14 its board authorised a plan to return as much as $7bn to shareholders. In contrast, **Airbnb**, despite another share buyback programme for up to $6bn, fell after the company lost around $1bn in the fourth quarter.

In Europe, **TUI** advanced after earnings topped estimates and the company maintained guidance. Its credit rating was recently upgraded to B+ from B at S&P. In Japan, **Sony** had its biggest fall in two years after cutting sales projections for the PlayStation 5 gaming console. The company also confirmed that its financial unit would be partially spun off in October 2025 as part of a plan to focus on growth in its other businesses including entertainment.

The primary market was muted throughout the week.

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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EDMOND DE ROTHSCHILD ASSET MANAGEMENT (FRANCE)

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

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332.652.536 R.C.S. Paris