EDMOND DE ROTHSCHILD ASSET MANAGEMENT

MARKET FLASH: EUROPE STAYS AHEAD OF THE USA

- **In the United States, the Senate, with some Democrat support, managed to avoid a "shutdown" and prolong the budget until September, but some Trump administration decisions are fuelling worries.**
- **Germany's spending plan is revitalizing the German and European economies, driving up European stock market indices.**
- **The week was also marked by several central bank meetings.**

The US Senate, with some Democrat support, managed to avoid a shutdown and prolong the budget until September. However, some Trump administration decisions are fuelling worries over the economy after disappointing retail sales figures and confidence indicators. Despite February's slight recovery in retail sales, the figures were only 0.2% higher or below the 0.6% expected. And industrial confidence figures plunged, with the Empire State index down 20, or significantly worse than the minus 2 expected, due to lower new orders and a substantial rise in company prices. In house building, the NAHB index lost more ground, falling to 39 from February's 42. This is all a big contrast with the optimism in Europe following Germany's decision to boost spending. The CDU/CSU, SPD and the Greens agreed to set up a €500bn fund which will last 12 years, rather than 10 years as initially suggested. €400bn will go on infrastructure. To satisfy ecologist demands, the remaining €100bn will go towards climate change measures. The debt brake reform will exclude defence spending above 1% of GDP and include areas like civil protection, IT security, intelligence services and aid to countries like Ukraine. The plan is a boost for Germany and Europe and it sent European equity markets higher. However, we need to exercise some caution over when the money will actually be spent.

As for the Ukraine conflict, Donald Trump's phone conversation with Vladimir Putin led to a 30-day ceasefire for energy infrastructure sites alone. There was also an agreement over exchanging prisoners but the deal fell far short of the terms Washington agreed with Kiev last week. The new US foreign policy stance makes it all the more necessary for Europe to reinforce its defence capacities.

Several central banks held meetings over the week. The Fed left rates unchanged and said it expected to cut twice this year. But it revised up its inflation forecast by 30bp to 2.8% and shaved 40bp off its growth outlook to 1.7%. On a more positive note, it also reduced the pace of its moves to shrink its balance sheet, moving from $25bn a month to $5bn for Treasury notes from April. Jerome Powell's message was seen as slightly dovish overall. He said uncertainty over the economic outlook had increased but that Michigan University's inflation expectations were an "outlier" and he insisted the macroeconomic data remained strong. The Bank of England and the Bank of Japan also left rates unchanged; inflation in the UK is proving resilient and underlying inflation in Japan is accelerating even if services inflation is slowing. The Swiss National Bank cut its benchmark rate by 0.25% thanks to soft inflation but Brazil's central bank took its rates to 14.25% to fight high inflation.

Given today's uncertainty and the likelihood import tariffs will prove inflationary, investors have been turning to safe havens like gold. The ounce hit an all-time high of $3,057 this week.

All these factors have encouraged us to remain cautious on risk assets. Advanced indicators have been falling in the US and geopolitical uncertainty is high. However, the market correction, especially in the US, has led us to turn tactically neutral on equities. Given the prospects for increased budget spending in the eurozone, we are still neutral on duration and continue to prefer carry strategies.

EUROPEAN EQUITIES

It was a crucial week for European investors as a vote on Germany's debt brake amendment agreed between the CDU and the Greens took place. After lengthy discussions, the Bundestag approved what is a significant shift to Germany's economic strategy, one which offers exciting prospects for European companies.

Optimism quickly resurfaced, especially in Germany where the ZEW economic sentiment index is expected to come in at 51.6 this month, a level not seen since the war started in Ukraine. Moreover, German producer prices rose by an annualised 0.7%, or less than the 1% economists had pencilled in. Elsewhere, the Bank of England left rates unchanged as expected. The bank thinks inflation might return. Europe's equity markets ended the period higher with energy outperforming.

The defence sector hogged the news headlines. The European Commission published its *Future of European Defence* white paper, putting the accent on the need to reinforce the continent's defence capacities. That said, the paper lacked any concrete elements or hard figures and defence stocks fell, with **Rheinmetall** off 4% and **Hensoldt** down 9%. France's **Exosens**, in contrast, slightly outperformed the sector, partly because of the announcement that it was shortly to join the SBF 120 index.

In this week's earnings news, **Sodexo** plunged 16% due to a slowdown in the US in the group's health and education divisions. Management was forced to cut guidance for 2025 and confirmed that, like other European companies, it was seeing signs that US consumers were not as dynamic.

US EQUITIES

Following a tricky start to the month, Wall Street rallied. The S&P 500 gained 2.6%, the Nasdaq 2.3% and the Russell 2000 3.8%.

At the beginning of the week, the gold ounce moved above $3,000 for the first time ever. Donald Trump's tariff and trade war has reinforced gold's safe haven status.

In the tech sector **Meta** (-0.7%) joined the other Magnificent 7 companies by falling into negative territory year to date. Semiconductor manufacturer **Micron** jumped 8.6% after revising 2025 guidance higher thanks to strong demand for its high-bandwidth memory chips. **Alphabet** (+0.02%) boosted the M&A space with its $32bn purchase of cybersecurity company Wiz, its biggest ever acquisition. Google hopes the deal will help it make up ground lost to rivals in cloud activity while reinforcing its cybersecurity business.

Consumer confidence continued to fall in the consumer discretionary sector. **Tesla** fell by another 1.8% after being forced to recall 46,000 cybertrucks due to defective trim parts. **Boeing** jumped 8.5% after management said it saw no short term impact on its business from customs tariffs.

Consumer staples gloom persisted. **General Mills** (-2.57%) said quarterly sales had fallen 5%. The group is worried the weak US economy will make shoppers cautious.

Banks rose 5.9% thanks to Fed comments after its monetary policy meeting. **Bank of America** was up 7% and **Morgan Stanley** ended the period 7.9% higher. **JP Morgan Chase** gained 6.14% after increasing its dividend from $1.25 to 1.40.

The energy sector (+6.81%) was also buoyant, partly due to Washington's ambition to boost national oil output. **Exxon Mobil** gained 6.6% and **Chevron** 7.3%. Donald Trump's promise to significantly raise US oil production by up to 3 million b/d while easing environmental regulations, aims to cut energy prices for Americans hit by inflation.

EMERGING MARKETS

The MSCI EM index had rebounded by 1.97% this week as of Thursday. India and Korea gained 5.07% and 3.24%. Brazil, Taiwan and China rose 2.55%, 2.30% and 0.68%, respectively. Mexico edged 0.35% lower.

In **China**, macro numbers surprised on the upside. Industrial production grew 5.9% YoY in January and February vs. expectations of 5.3%. Retail sales rose 4% YoY, vs. 3.8% expected, thanks to government stimulus. Fixed assets investments grew by 4.1% YoY, or ahead of expectations. The central bank left the 5 year Loan Prime Rate unchanged in March at 3.60%. Global CEOs will meet Xi in the coming weeks. **Tencent**'s print showed an overall solid beat and an acceleration of AI capex. **PDD** reported better earnings growth ahead of expectations. Quarterly figures at **CATL** were in line with prelims and management announced a partnership with Nio to establish a battery-swapping network for cars. **TME** delivered a profit beat for the fourth quarter and a solid outlook for 2025 despite macro uncertainty and competition concerns. **BYD** unveiled a new battery and charging system that can provide around 400km of range in 5 minutes. **Xiaomi** recorded stellar results with a strong beat across the board and EV shipment guidance was revised up.

In **Taiwan,** export orders jumped 31.1% YoY in February vs. expectations of 24.3%. The central bank held its benchmark interest rate at 2%, its highest level since 2008, citing potential chip tariffs and inflation risks. In a military overhaul, the president said the defence budget would exceed 3% of GDP. Mediatek won a design partnership with Google for its next TPU generation.

In **Korea,** semiconductor exports to China, including Hong Kong, fell 31.8% YoY in February. The government will implement a temporary visa exemption for Chinese group tourists within the third quarter. Officials met in Washington to address trade issues including tariff measures. Regulators tightened home transaction rules again to the market down. Samsung finished its HBM3E memory device last month, with possible revenues from Nvidia starting in the third quarter of this year.

In **India,** wholesale price inflation rose to 2.38% in February 2025 vs. 2.31% in January. The trade deficit for February dropped to -$14bn, led by a fall in non-oil and non-gold imports. Net direct tax collection for FY25 was up 13% YoY. DMART announced a Rs 1.75bn investment in its e-commerce subsidiary. Allianz will be exiting two existing insurance JVs. Blackstone made an offer to acquire Akzo's India paints business.

In **Mexico**, China delayed the approval for BYD to build a plant in Mexico over concerns of technology leaks. State oil company Pemex plans to settle a debt with suppliers totalling up to $6.4bn between March and April.

In **Brazil,** economic activity in January grew 3.58%, or more than the 2.35% expected. As expected, the central bank lifted rates by 100bp to 14.25%. The finance ministry's CPI forecast for 2025 was raised to 4.9% from 4.8%. The government unveiled its Income Tax Relief program. The fourth quarter at Eletrobras missed expectations due to higher costs.

CORPORATE DEBT

CREDIT

Trading was quiet on credit markets. On Wednesday, the Fed left its rates unchanged as expected but the accompanying message was rather reassuring as the bank thinks Donald Trump's new tariff policies will only have a transitory effect on inflation. The statement resulted in volatility falling on global markets. Investment grade and high yield indices returned 0.3% and 0.4%, respectively over the past week.

Spreads traded in a narrow band and the yield on Germany's 10-year Bund gradually fell back to 2.75%.

In new issuance, **Faurecia** raised €750m at 5.625% over 5 years and **Allianz** issued a long-dated subordinated bond. In an even rarer move, the **Banque Cantonale de Genève** (AA- !) raised €500m over 5 years at mid-swap +95bp, or 3.41%.

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.

• 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.

• AT1s belong to a family of bank capital securities known as contingent convertibles or “Cocos”. Convertible because they can be converted from bonds to shares (or depreciated entirely) and contingent because this conversion only occurs if certain conditions are met, such as the issuing bank's capital strength falling below a predetermined trigger level.

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