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MARKET FLASH: STAYING THE COURSE

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Volatility resurfaced this week on concerns over regional banks in the US after New York Community Bancorp ramped up provisioning for bad loans amid a decline in lending prospects.

The KBW regional bank index tanked. Bond yields rose as there were similar, albeit very localised, fears over exposure to US commercial property among banks in Japan and Europe. As we see it, the problem results from the US regulator adopting very conservative loan provisioning requirements after ailing banks were acquired in March 2023. In NYCB's case, provisioning increased by 0.73%, or more than the 0.073% sector average (source Bloomberg). Markets now want to know if the problem is restricted to a few banks which are late in adopting prudential measures, or whether the problem might spread.

At any rate, the FOMC was not affected by these new banking sector issues. As we saw in 2023, the Fed has various tools to manage financial market tensions. During the March 2023 banking crisis, it provided emergency liquidity through its Bank Term Funding Program and it still has similar tools.

The Fed left rates unchanged but the communique mentioned the possibility of rate cuts to come. We are certain they are in the pipeline. Jerome Powell did, however, say it was too early to act and that the Fed would wait until inflation was moving decidedly towards the 2% target.We can expect to wait a few months before a decision is taken. Recent labour market data provided encouraging signals: the ADP survey indicated a sharp slowdown in job creations in January and the Bureau of Labor Statistics said unit wage cost rises had slowed over a year.

Discussions on reducing the pace of the Fed's efforts to shrink its balance sheet have begun and should intensify in March. The Fed seems to be moving towards making a first cut in the second quarter. This would involve reducing the amount of maturing Treasuries which are not reinvested each month.

To sum up, the Fed is more confident but still treading cautiously. The bank wants to see more inflation/labour market evidence before cutting. Markets are expecting a little less than 150bp in cuts this year. We think it almost certain that the Fed will talk about bigger cuts than its current 75bp average projection.

With inflation falling and labour markets slowing both in the US and Europe, we are staying the course and are still overweight fixed income, a defensive asset amid ongoing disinflation and geopolitical instability. We raised exposure to German government debt at the end of the previous week after the ECB's more dovish stance. The bonds were also more

attractively valued than at the beginning of the year. We are fully invested in risk assets and have continued to rebalance allocations between US and European equities while maintaining some dollar hedging. The gap between the 7% expected in earnings growth in the US and the 4% drop in Europe looks skewed to us and we have begun looking at European equities again, and especially small and midcap stocks.

EUROPEAN EQUITIES

Markets struggled to find direction faced with conflicting news: a more dovish stance from the ECB, a more measured message from the Fed but mixed company results.

Fourth-quarter figures were disappointing overall but autos and auto suppliers stood apart, riding on robust growth

Volvo Cars rebounded sharply after its upbeat results. Sales of **SEK** 109.4 were as expected, marking the company's best-ever year. Operating profits slightly missed but volumes showed a surprising increase. The group now expects a 15% jump in 2024 sales, with electric cars making a big contribution. Gross margins in the EV segment rose from 9% to 13% between the third and fourth quarters of 2023.

France's **Vallourec** (steel tubes) gained ground after preliminary results swept past guidance which had already been raised in November. EBITDA in 2023 should come in above €1.19bn compared to the €1.13bn expected. FCF is expected to be above €559m, or much higher than the €443m expected. The CEO said the group had pulled off its best EBITDA and FCF performance in close to 15 years. Increased deliveries, especially in North America, better execution and, to a lesser extent, cheaper iron ore prices were behind the improvement.

H&M announced the surprise departure of its CEO and the stock sold off. Sales have fallen sharply due to intense competition with **Zara** and Chinese giant **Shein**. The entire specialist distribution sector was dragged down.

Danish giant **Novo Nordisk** confirmed its position as sector leader by hitting a new market cap record. It is now Europe's largest market cap, ahead of **LVMH**, thanks to huge sales of its obesity drug Wegovy. In contrast, results at **Novartis** failed to reach expectations.

In bank news, **BNP Paribas** fell sharply due to lower ROE guidance for 2024. Revenue growth will be hit by interest rates falling faster than expected. The report was considered as particularly disorganised: the fact that the property division was lost in asset management information only fuelled concerns over its health.

US EQUITIES

Trading was volatile after Fed chair Jerome Powell confirmed that the pivot point had been reached but suggested markets would have to wait for the summer to see any rate cuts. **Meta**'s exceptional figures stole the show from the Fed. Results swept past expectations and a dividend is to be paid out for the first time. What's more, a $60bn share buyback was announced. **Amazon** and **Microsoft** also reported solid results thanks to an acceleration in the contribution from their **AWS** and **Azure** cloud services.

On the other hand, **Apple** and **Google** lost ground even if their results were in line. Dating giant Match reported excellent results thanks to a 50% surge in growth at **Hinge**. In construction, **Pulte Home** reaffirmed its comfortable position. The group sees volumes rising between 5% and 10% this year. In contrast, **Johnson Controls International** revised down guidance for 2024, citing persistently weak Chinese demand. **Cliffs Natural Resources** (steel) jumped when its results confirmed it was paying down debt and benefiting from an ongoing recovery in demand, especially in the autos sector.

It was the same story at **General Motors** where its non-EV segment did surprisingly well. Sentiment on the segment had been negative. It was another up week for indices but not for oil companies like **SLB** after **Saudi Aramco** said it had put its 1 million b/d production increase on hold.

New York Community Bancorp, which rescued Signature, lost close to 50% over two trading sessions after its results revealed its exposure to the commercial property sector. Memories of last year's events briefly weighed on the entire sector.

JAPANESE EQUITIES

The NIKKEI 225 fell by 0.62% while the TOPIX was practically flat (+0.08%). Tech stocks fell at the beginning of the week after **Intel** revised sales guidance down and investors took profits ahead of end-of-month rebalancing. But the markets subsequently recovered thanks to upbeat US economic data pointing to a soft-landing and better-than-expected earnings from Japanese companies.

Air Transportation rose 2.49% led by **ANA Holdings** as the company significantly revised up FY2024 ordinary profit guidance. Iron & Steel gained 2.42% on rising commodity prices. Other Products gained 2.02%, led by **Nintendo** which is releasing a new Switch console this month. On the other hand, Metal Products fell 2.23%, led by semiconductor stocks like **SUMCO**.

Precision Instruments lost 1.03% led by **Hoya** after it delivered disappointing FY2024 net profit guidance. Electric Appliances slipped 0.98%, mainly over Chinese economy concerns. **Fanuc** (automation) and **Nidec** (small motors, automotive products and consumer electronics) tumbled 7.25% and 5.04%.

Daiichi Sankyo, a pharmaceutical company, and **Canon** (office equipment, imaging systems, medical systems etc.) jumped 8.14% and 7.03% on strong guidance for this year and increased dividend payouts. **Suzuki Motor** gained 6.90% after its Indian subsidiary **Maruti Suzuki** announced a significant jump in fourth-quarter earnings. But healthcare platform **M3** plunged 15.59% due to disappointing results in the same quarter.

The dollar slid from around 148 to the low 146s against the yen when the Fed took an open stance on future rate cuts, highlighting the difference between it and the BoJ.

EMERGING MARKETS

The MSCI EM Index was down 0.8% this week as of Thursday. **China** fell 3.3%, giving back last week's rebound. **India** edged 0.2% higher. **Korea** outperformed on hopes of reforms to improve shareholder returns, followed by **Brazil** (+0.7%).

In **China**, Manufacturing PMI for January came in at 49.3, or in line with estimates and slightly better than in the previous month; Non-manufacturing PMI stayed in expansionary territory at 50.7. Shanghai relaxed property policies and eased restrictions on home purchasing as a T1 city. **Evergrande** was ordered to start the liquidation process by a **Hong Kong** court. **Tencent** received a surprise approval for long-anticipated mobile title DNF, which could be a big boost for its 2024 game pipeline. **Wuxi Biologic** and group companies had volatile sessions this week on a proposed US senate bill to block federal contracts with Chinese biotech companies because of alleged military ties. Elsewhere, **Wuxi Apptec** announced a **RMB** 1bn share buyback and **Wuxi XDC** delivered an upbeat profit forecast. **CATL**'s preliminary results beat market expectations. **Tesla** is reportedly planning to open a **US** battery plant with equipment from **CATL**. Preliminary net profits for 2023 at **BYD** were in line and production has started in **Hungary**, marking a significant breakthrough in its localisation efforts in Europe.

In Taiwan, **MediaTek** delivered better-than-expected fourth-quarter results and first-quarter guidance, driven by strong smartphone restocking momentum and flagship ramps for **Android** into 2024.

Korea's finance minister vowed to narrow the "Korean stock discount" with further measures set to improve shareholder returns, perhaps based on policies adopted by the Tokyo Stock Exchange. Results at battery companies **LG Chem** and **SDI** fell short due to cyclical challenges.

In **India**, the finance minister announced the Interim budget for 2024, delivering on the path to fiscal consolation and with a pleasant surprise on capex allotment (+16% YoY). January Manufacturing PMI was at 56.5 vs. 56.9 in the previous month. January gross GST revenue was INR 1.72 trillion, up 10.4% YoY. 2 Wheelers and Passenger Vehicle data for January enjoyed strong growth: sales jumped 15% and 14% YoY, respectively. RBI released a circular halting much of **Paytm Payments Bank's** business. **Ola** founder Bhavish Aggarwal said Krutrim had become the first $1bn Indian AI startup after securing $50 million in funding. **Disney** reached a preliminary agreement to sell 60% of its **Indian** media business to Reliance. Profits at **JSW** (steel) jumped fivefold YoY on buoyant Indian demand. **Bajaj finance** reported a 23% YoY increase in net income but still missed estimates. **Maruti** reported a beat on EBITDA margin and net profit, as the SUV mix improved.

In **Brazil**, the central bank cut interest rates by 50bp to 11.25%. **Santander** said recurring net income had missed estimates due to higher provisioning. Fashion firms **Arezzo** and **Grupo Soma** confirmed talks for a potential tie-up.

In **Mexico**, GDP data showed faster than expected deceleration in economic activity in the fourth quarter. The economy grew 2.4% YoY and 0.1% sequentially, or less than the 3.0% and 0.3% expected. Total bank lending grew 5.6% YoY in real terms led by consumer lending.

In **Chile**, the central bank cut interest rates by 100bp to reflect lower inflation and economic activity

CORPORATE DEBT

CREDIT

Despite a mid-week pause, the downward trend in bond yields continued amid disinflationary indications and expectations for central bank easing. The Fed's somewhat dovish tone took 10-year US Treasury yields down from 4.13% to 3.89% (as of Friday morning). Yields on the German 10-year Bund fell from 2.29% to 2.17% over the same period.

Due to a slight worsening in macro data, investment grade spreads widened to 135bp (+5bp over the week) to return to their 5-year mean. High grade widened by 20bp to 390bp. **Bank CoCos** lost 40bp to 605bp. Profit taking set in after US regional bank **NY Bancorp** cut its dividend to meet regulatory capital requirements, triggering worries over the segment.

BNP Paribas, **Santander**, **Sabadell**, **Julius Baer**, **DB**, **Bawag** and **ING** reported overall positive results but issued measured guidance for this year due to the fall back in interest rates. 2023 was nevertheless a good vintage as far as organic capital generation is concerned.

The new issues market remained active. **Volvo** (A) raised €500m at 3.125% due 2029 **Cirsa** (B) €450m at 6.5% due 2029, **Thom** €500m at 6.75% due 2030 and **Ineos** (BB) €850m at 6.375% due 2029.

Investment grade gained 0.64% over the week, taking YTD returns to 0.09%. High yield slipped 0.10% due to widening spreads but has still returned 0.70% since the beginning of January.

CONVERTIBLES

Eurozone convertibles ended January in the green while global convertibles had slightly negative returns due to poor performance from Asian equities.

Among this week's numerous company reports, **LVMH** rebounded with better-than-expected figures. Operating margins at **Elis** (linen hire and hygiene) hit 34.2% in 2023, or better than the 33.6% expected. But **BNP Paribas's** fourth-quarter results missed expectations and the bank revised down growth prospects for this year.

In the US, attention was focused on megacap figures. **Alphabet** disappointed the market and the share price fall weighed on tech and infrastructure convertibles.

In a relatively quiet week on the new issues market, the US biotech **Immunocore** raised $350m at 2.5% due 2031 and with a 40% premium. In Europe, holding company **Orpar** returned to the market with a bond exchangeable into Rémy Cointreau. The issue raised €200m at 2% due 2031 and came with a 40% premium. Orpar also bought in its June 2024 exchangeable bond at a 1% premium.

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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