



## EDMOND DE ROTHSCHILD ASSET MANAGEMENT

### MARKET FLASH: THE US SHUTDOWN IS NOTHING NEW

- The US shutdown may deprive the Fed of the necessary visibility on the job market ahead of its next monetary policy meeting, but further rate cuts are nevertheless expected.
- In Europe, ECB chair Christine Lagarde thinks current benchmark rates are adequate. Her views were backed up by a slight increase in eurozone inflation.
- Gold hit a new all-time record above \$3,800/oz while oil prices retreated on expectations the October 5 OPEC+ meeting will decide to increase production.

Despite an interruption to non-essential federal services, the budget deadlock between Democrats and Republicans had no impact on Wall Street which ended the period higher. Today's situation resembles previous shutdowns, especially the 16-day episode in 2013 over the Obamacare bill and the 35-day stoppage in 2018-19 on building a wall between the US and Mexico. The shutdown will prevent the release of jobless figures for September. Donald Trump is also putting pressure on Democrats by threatening to reduce infrastructure and renewable energy spending by Democrat-run states to the tune of \$26bn and to lay off thousands of federal employees, a threat that could further undermine the economy. Meanwhile, the ADP survey showed that 32,000 private sector jobs had been lost, a figure which shows how fragile US jobs are. Moreover, trade tensions are still with us. New tariffs will target wood and furniture imports and they will focus on countries which have no agreement with the US.

The shutdown could mean that the Fed will not have the visibility it needs at its next FOMC but we continue to believe the Fed will base its decision on the most recent data, despite the absence of nonfarm payroll data due today. In Europe, ECB chair Christine Lagarde thinks current benchmark rates are adequate. Her views were backed up by a slight increase in eurozone inflation from 2% to 2.2%. In the UK, political unrest continued and Keir Starmer's speech at the Labour party's congress called for unity to deal with difficult decisions over significant budget efforts.

In Asia, China's PMI data were encouraging with services in expansionary territory and a rebound in foreign demand which is driving production. Political uncertainty in Japan continued ahead of the October 4 elections for LDP party chief. The winner will be the new prime minister and he will play a key role amid mounting disagreements over whether or not the Bank of Japan should be allowed to continue tightening. In the meantime, Japanese equities ended the period lower.

Elsewhere, gold hit a new all-time record above \$3,800/oz while oil prices retreated on expectations the October 5 OPEC+ meeting will decide to increase production. Government bond yields have fallen because of reduced inflationary pressure from energy prices.

**We are still optimistic about government debt, especially in emerging countries, and also upbeat on investment grade bonds. We remain cautious on the dollar and US equities. Given today's demanding valuations, equities could be hit by labour market difficulties.**

## EUROPEAN EQUITIES

Various crucial economic data were due to be released in the US this week but the US shutdown, affecting non-essential federal services, intervened so the Fed will not obtain information on labour market developments. The shutdown only increases uncertainty on labour market momentum and therefore the Fed's reaction. After several directionless weeks, Europe hit fresh records at the end of the period due to various positive catalysts.

Following incursions by Russian drones into NATO's airspace, European leaders met to discuss cooperating over security, sending defence stocks like **Thales, Indra Sistemas, Rheinmetall, BAE Systems** and **Leonardo** higher.

Consumer discretionary also made strong gains, led by luxury plays **LVMH, Hermès** and **Moncler** following a broker recommendation.

European pharma stocks **Sanofi, Sartorius, Roche** and **AstraZeneca** rebounded on Wednesday after the Trump administration reached an agreement with **Pfizer** on lowering drug prices. But Pfizer will enjoy a three-year grace period during which time certain Pfizer products will not face tariffs.

In the autos space, **Stellantis** saw US sales increase by 13% in September. This followed 8 quarters in a row of falls. **Tecnicas Reunidas** surprised investors with new guidance for this year and next. New projects are accelerating and the group has a gigantic pipeline.

## US EQUITIES

Despite the US shutdown, Wall Street made significant gains in USD. The S&P 500 advanced 1.08% and the Nasdaq ended the period 1.59% higher. Shutdowns, which Donald Trump describes as opportunities to cut costs, have historically had little impact on markets even if official statistics go quiet, leaving the job to private agencies. The Supreme Court allowed Lisa Cook to continue as a Fed governor and rate cut expectations firmed further.

Two deals dominated the headlines. First, Donald Trump's son-in-law Jared Kushner, along with private equity giant **Silver Lake** and Saudi Arabia's **PIF** sovereign wealth fund, wants to buy **Electronic Arts** for \$70bn in the biggest ever LBO. This is a bet on a digital culture champion which could benefit from AI boosting production and reinforcing monetisation. Second, **Berkshire Hathaway** is paying \$9.7bn for petrochemical group **OxyChem**, a value buy in a cyclical sector as the group is trading on very low multiples. This is the first time in three years that Warren Buffet has spent so much.

The move contrasted with the Tech sector frenzy. **Microsoft** unveiled Microsoft 365 Premium which will include Copilot and exclusive AI tools. **OpenAI** finalised a secondary share sale valuing the group at \$500bn. It also drove a debate on possible software disruption after posting YouTube videos showcasing its internal tools.

**Tesla** sold a record 500,000 vehicles in the third quarter. **Global Infrastructure Partners**, a **BlackRock** affiliate, is reportedly close to acquiring AES for \$38bn.

As mentioned before, healthcare stocks rose after **Pfizer** reached an agreement with the Trump administration. In return for a three-year grace period over tariffs, the group agreed to align Medicaid prices with the OECD, join the *TrumpRx* platform, which connects patients with drug companies, and invest \$70bn in the US. The deal is a signal for the sector as similar agreements are in the pipeline. They will seek to reduce regulatory risk and broaden access to drugs through a volume effect. The healthcare sector could still be in vogue in the coming weeks.

## EMERGING MARKETS

The MSCI EM index jumped 3.2% in USD this week as of Thursday, outperforming global developed markets. With most of Asia on holiday, Korea, China and Taiwan led gains, up 5.9%, 4.6%, and 4%, respectively. India edged 0.8% higher. Brazil and Mexico fell 1.5% and 0.6%.

In **China**, NBS manufacturing PMI increased to 49.8 in September, up from 49.4 in August, or slightly ahead of expectations. Non-manufacturing PMI decelerated to 50.0 from 50.3 in July. August industrial profits rose 20.4% YoY, the first increase in four months and after a 1.5% YoY decline in July. The Fourth Plenary Session is scheduled for October 20-23, a meeting to discuss key topics related to the 15th Five-Year Plan for national economic and social development. China will deploy RMB 500bn of policy-based financial tools to accelerate investment projects. US Treasury Secretary Scott Bessent predicted a “pretty big breakthrough” in the next round of trade talks with China, with the purchases of soybeans a key point of discussion. China announced the introduction of a new “K visa” aimed at attracting young talent. India and China are to resume direct flights in October after a 5-year ban. **DeepSeek** published its experimental AI model, V3.2Exp, and cut the API pricing by 63%, making it the cheapest globally.

In **Korea**, exports rose 12.7%, ahead of the 7.8% gain expected. **SK Hynix** is reportedly expanding DRAM capacity next year, responding to demand for HBM from Nvidia and ASIC companies such as Google.

In **India**, the RBI unsurprisingly kept rates unchanged at 5.5% on lower inflation estimates and a better GDP forecast. It also announced new measures to improve credit flows. Donald Trump’s deal announcement with Pfizer was a positive read for Indian pharma, as it removes an overhang for Medicare sales reimbursements. GST collections rose 9.1% in September, in line with expectations and a four month high. India’s cement sector is showing resilience, despite a challenging environment marked by intense monsoons. The festive season has started strong with PV and 2W registration up 21-24% in the first 9 days, albeit boosted by GST cuts, effective September 22nd.

In **Brazil**, September PMI Manufacturing fell to 46.5 from 47.7 in August. The Lower House approved income tax exemption for low earners and the introduction of a minimum income tax on high incomes and dividends.

## CORPORATE DEBT

The US shutdown dominated the news this week but it was expected and risk assets continued to rise. Upbeat market sentiment was seen in credit derivative outperformance (CDX IG -2bp; iTraxx Main -2.4bp; Xover -12.5bp). Bonds also performed well but mostly because of lower yields (EUR IG +0.27%, EUR HY 0.07%, Corp Hybrids +0.19%, CoCos +0.24%).

Today's unruffled market sentiment was particularly marked in new issuance. Among HY companies, **CPI Property's** hybrid offering was four times oversubscribed and **Séché Environnement's** issue ten times. More traditional new HY issues from companies like **Ion Group** and CMA CGM were also easily placed.

As we go into the earnings season, we can expect the new issues market to slow down sharply and technical factors to be reinforced.

## **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.
- CTA: quantitative strategy which uses futures to invest in a wide range of financial assets, including equity indices, short-term and long-term interest rates, currencies, and commodities.
- 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.
- RT1s: perpetual bond issues with early redemption possible after 10 years. Coupon payments are discretionary and non-cumulative.

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03/10/2025

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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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