EDMOND DE ROTHSCHILD

MARKET FLASH: INFLATION CONTINUES TO FALL BACK

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US jobs data for March showed just how resilient the market is. And a sharp slowdown in inflation proved that monetary tightening had fed through to the economy.

True, employment is not yet in line with the Fed's targeted normalisation as it is still too robust compared to natural population growth. The participation rate was higher but the unemployment rate fell to 3.5% with wage increases only slowing a little.

Slowly but surely, inflation continues to move towards disinflation, especially in areas like property, logistics and energy.

In the banking sector, the alarm over SVB and Signature going bankrupt is slowly abating. The Fed reported that US bank calls on emergency liquidity had fallen by $10bn to $332bn while amounts drawn on the new Bank Term Funding Program had increased by $15bn, amid, however, a slowdown in deposit withdrawals. Small commercial banks have even managed to take in net new money.

The latest FOMC minutes showed that bank tensions and systemic risk to the economy were still a concern but that the Fed's priority was getting inflation lower.

China's central bank continued to provide economic stimulus amid a further drop in inflation. Prices rose 0.7% over 12 months in March, a sign that demand is only gradually recovering amid a drop in producer prices. This suggests monetary policy could be eased again, especially as the country is facing a complicated geopolitical environment due to mounting tensions with the US over Taiwan.

Meanwhile, foreign trade rebounded sharply with dollar exports up 14.8% and imports down 1.4%. The rebound was mainly due to improving supply chains with the economy reopening and a recovery in high value-added exports like electric vehicles and solar panels. Even so, the real growth driver should remain household demand. Global demand should stay modest as a US recession is possibly on the horizon but Chinese households are sitting on savings amassed during sanitary restrictions.

We are maintaining our preference for Chinese equities. Our overall equity stance is cautious as we see a risk that lending in the US could contract and set the stage for a recession. We are still neutral on duration with a preference for US Treasuries.

EUROPEAN EQUITIES

Markets rose sharply thanks to upbeat reports from luxury goods makers and reassuring inflation data in the US. Sentiment was also driven by lower-than-expected price rises in China which led some investors to bet on additional stimulus from Beijing.

More generally, investors are now taking on board the global economy's improved resilience amid comforting indicators in the banking system. Even so, investments in France's commercial property continued to fall in the first quarter. CBRE said investment volumes had fallen by 35% over a year (after a 49% plunge in the fourth quarter of 2022). The drop represents a 39% fall compared to the five-year average and is the lowest amount since 2014. The culprits are rising interest rates and working from home.

In stark contrast, **LVMH** and **Hermès** had a bumper quarter with sales up 17% and 22%. All geographical zones enjoyed the same momentum. The figures are a token of the industry's ability to maintain strong growth even in less favourable economic circumstances. Elsewhere, **Tesco** and **Carrefour** reported reassuring figures with relatively stable margins and modest demand destruction despite recent price rises to combat inflation. Carrefour said volumes had fallen 2% in France with food inflation running at more than 15%. In semiconductor materials, **Soitec** announced over Easter that it was sticking with its objectives but warned on results for 2023/24 and its midterm targets (2025/26). In autos, **BMW** remained upbeat despite lower sales in the first quarter: sales rose slightly in the US but were cancelled out by drop in Europe and in China. The group said performance was still being hit by parts shortages but that the situation should return to normal before the end of the year.

US EQUITIES

Equity indices ended the period higher, spurred by producer prices which only rose 2.7% YoY in March, down from 4.6% in the previous month. It was the biggest monthly drop in 3 years. In addition, jobless claims rose, a harbinger of the rate rise cycle coming to an end,

The FOMC minutes showed governors had unanimously decided to raise rates by 25bp in March and that they were still closely watching for inflation despite recent bank turmoil. This suggests the May 3 meeting will decide on another 25bp rise, in line with today's market expectations.

The minutes also showed that committee members thought recent bank difficulties would lead to a slight US recession. US banks lent $105bn less in the two weeks ended March 29, the most in Federal Reserve data back to 1973.

In company news, memory chip maker **Micron** jumped 8% after its rival **Samsung Electronics** said it would be cutting production. In pharma, **Moderna** slipped 3.1% after announcing that its ARN messenger flu vaccine had not been as successful as hoped. In gold mining news, **Newmont Mining** sweetened its bid on Australia's **Newcrest Mining** from $17bn to $19.5bn. **Boeing** lost 5% after suspending 737 Max production following problems with a component in one of its factories. The focus will switch on Friday April 14 to quarterly earnings reports from groups like **BlackRock**, **Wells Fargo**, **JP Morgan**, **Citigroup** and **UnitedHealth**.

JAPANESE EQUITIES

After a weak start to the period on concerns over global growth and the stronger yen, the NIKKEI 225 and TOPIX rose 1.24% and 1.21% after US jobs data came in better than expected and new BOJ governor Kazuo Ueda stuck to accommodating monetary policy, sending the yen lower.

Marine Transportation rose 5.58% on attractive valuations and high dividend payouts. Wholesale Trade gained 4.54%, led by general trading companies, after Warren Buffet revealed that **Berkshire Hathaway** had been investing in them and was likely to add to positions. Insurance advanced 3.23% as long-term bond yields rebounded, a plus for the sector.

Transportation Equipment fell 0.88% on the weaker yen. Air Transportation slipped 0.61% on profit taking. Oil & Coal Products edged 0.21% lower also on profit taking after a sharp run up in oil prices following the decision by OPEC+ to cut production.

In company news, general trading companies **Marubeni** and **Sumitomo**, jumped 8.99% and 6.04% after Warren Buffet's move. **Oriental Land**, which operates **Disney Lands** in Japan, gained 6.88% after joining the Nikkei 225.

Z Holdings, an internet platformer, and **Fujitsu**, an ICT provider, fell 2.44% and 1.98% as IT stocks fell across the globe. **Suzuki Motor** declined 2.22% on the stronger yen.

The dollar strengthened from the low 131s to mid 133s on buoyant US economic and employment data but then slipped back to the mid 132s after the US CPI print came in below market expectations.

At his first news conference last Monday, Kazuo Ueda confirmed that he would not rush to change the bank's accommodating stance, including the yield curve control (YCC) programme.

EMERGING MARKETS

The MSCI EM Index was up 0.86% as of Thursday's close, led by Brazil (+7.97%), Chile (4.64%) and Korea (+3.33%). China and Taiwan fell 0.62% and 1.36%. India and Mexico gained 1.28% and 2.05%.

China lifted mandatory masks in public transport, workplaces and schools, as the country moved on from zero-Covid restrictions. China's March CPI slowed to +0.7%, vs. +1.1% estimated and +1% in February. Core CPI was below 1% for the 12th straight month. New RMB loans increased to a higher-than-expected RMB 3.89 trillion in March (Consensus: RMB 3.3 trillion) from RMB 1.81 trillion in February. This was higher than the RMB 3.13 trillion seen in March 2022 and was driven by strong corporate and household demand. Exports for March surged 14.8%, or much better than consensus expectations, while imports fell 1.4%. The renminbi advanced to a three-week high on dollar weakness with decent onshore stock inflows from foreign investors. Chinese authorities are planning to require a security review of generative AI services. First quarter shipments at **Sunny Optical** fell 36% YoY although auto lens volumes continued to see robust growth (+23% YoY in March and 28% over the first quarter) on increasing demand for cameras in cars.

In **Korea**, **LG Energy Solution** (LGES) officially decided to include the advanced manufacturing production credit (AMPC) under the US Inflation Reduction Act (IRA) in its OP from the first quarter. **Samsung** reduced memory output significantly, besides wafer loading reduction from line optimization and engineering runs.

In **Taiwan**, YoY March exports fell 19.1% (vs. a 17.1% drop previously). Exports of electronic products (including semiconductors) exports improved slightly to minus 14.6% YoY (-17.8%).

In **India**, mobile phone exports doubled to $11.12bn in FY23 from FY22 with **Apple** accounting for around half of total exports. Inflation slowed from 6.4% in February to 5.7% in March, or below the central bank's upper comfort zone band. The country's aviation industry continued to recover, with a 60% rise in passengers to 1,360 lakh (852 lakh flyers reported in FY2022). Fourth quarter results at **TCS** missed the top line and EBI margins slightly on slowing global macro and a one-off expense on payroll hiring choices. **Infosys** missed expectations across the board due to a onetime impact from project cancellations and some client specific issues.

In **Brazil**, March IPCA inflation came in at 0.71% (versus 0.77% expected and 0.81% in February). The government sent the new fiscal framework to be approved by congress. The main debate concerns ending tax benefits to increase the tax revenues. **Hapvida** concluded its equity offer.

In **Chile**, first-quarter preliminary results at **Banco Santander Chile** showed better trends sequentially, driven by lower provisions and higher fees.

In **Mexico**, ANTAD (Association National de Tiendas de Autoservico y Departamentales) reported a 4% rise in SSS data for March 2023, a sequential deceleration and a 2.8% contraction in real terms.

On the supply-chain-relocation front: Chinese battery producer **SVOLT** announced a major European expansion drive to build at least five new battery plants totalling 50 GWh in production capacity.

CORPORATE DEBT

CREDIT

It was a relatively calm week on corporate bond markets. The Xover tightened to 430bp from 450bp and cash bond premiums moved to 470bp. Investment grade premiums edged 10bp lower to 160bp. Yields on Germany's 5-year Bund gained around 25bp to 2.4%. This is another illustration of a return to a negative correlation between bond yields and credit premiums which cushion bad news and underpin the attraction of carry strategies.

Investment grade bonds fell 0.6% over the period due to rising bond yields, reducing YTD returns to 1.76%. High yield gained 0.24%, taking YTD gains to 3.01%. Actuarial yields for investment grade are currently 4.2% and 7.4% for high yield, still good entry points for carry strategies.

The black-out period precluded any new high yield issuance ahead of quarterly earnings reports.

After a strong return to normal at the end of March, Euro CoCos stabilised around 1050, a historically high level compared to the 5-year average of 570bp.

On April 13, **Generali** raised €500m at 5.4% with a Tier 2 bond.

CONVERTIBLES

In a good week for global convertible bonds, Europe's consumer sector led performance. **LVMH**'s solid results drove other consumer groups higher, especially groups like **Kering** which is focused on China. **Volvo** was also a strong performer after management said the supply and cost pressures that had challenged the company over the past few quarters had peaked, possibly setting the stage for stronger-than-expected earnings this year.

In China, there were some signs of a recovery in the property sector. **Country Garden** reported results which slowed core profit declining in line with its profit warning but also an improvement in deliveries and cost efficiency while leverage trended lower.

The primary market was active in the US with a new deal from **Mirum Pharmaceuticals**. The company, which develops treatments for cholestatic liver diseases, raised $275m at 4% due 2029.

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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