MARKET FLASH: FALLING US INFLATION REINFORCES RATE CUT EXPECTATIONS

• US Treasury yields fell sharply in a reflection of changing rate cut expectations. Markets now expect two moves this year.

• Ahead of the earnings season and following a strong showing from risk assets, we remain close to neutral.

• We are still upbeat on duration: slowing US inflation and growth justifies current bond yield shifts.

The results of France's election surprised most investors and none of the three power blocs to emerge has a working majority. It is increasingly likely that a coalition or technocratic administration will be formed but it will be difficult to set up and struggle to last. In the meantime, the outgoing government will stay on to manage everyday business.

At the beginning of the week, Jerome Powell appeared before the Senate and the House of Representatives. His tone remained cautious. He acknowledged that the inflation trajectory was looking more favourable but said it would take time to hit the 2% target. He also reiterated the Fed's dual inflation-jobs mandate amid a recent rise in unemployment. He gave no schedule for future rate cuts and reminded markets that other indications of a fall back in inflation would be needed before acting. Cue June's lower-than-expected inflation print which was taken as a green light for the Fed to start cutting in September. Total inflation came in at 3%, down from 3.3% in May and lower than the 3.1% expected. Underlying inflation was 3.3%, or below the 3.4% seen in May and expected this time. The breakdown, as well as monthly readings, are moving in the right direction. Goods prices actually fell over a month as did, for the second month running, Supercore CPI, the indicator that had pushed inflation higher in the first quarter of 2024. What's more, property prices also trended lower for the first time since February.

US bond yields fell sharply on the news, a reflection of a big change in Fed rate cut expectations. Markets now expect two moves this year. US equity markets witnessed strong style and sector rotation. Mega caps underperformed significantly while small and mid caps, as well as interest rate sensitive sectors like utilities, telecoms and healthcare, rose.

Elsewhere, the Bank of Japan intervened to prop up the Yen. Coupled with US dollar weakness after the US inflation data, the bank helped the yen jump 2% against the dollar.

Ahead of the earnings season and a strong showing from risk assets, we remain close to neutral. We remain upbeat on duration as slowing US inflation and economic growth justify the current easing in bond yields.

EUROPEAN EQUITIES

Europe ended the week higher ahead of the earning season on a slight lift to sentiment on equity markets. The Euro VIX volatility index remained at historically low levels of slightly higher than 13 thanks to easing bond yields and reduced political risk in Europe. The OAT-Bund spread fell but remained around 65bp, or 15bp wider than before the dissolution of

France's parliament. This reflects uncertainty as talks over the formation of the country's next administration drag on. Several rating agencies warned that France's rating could be downgraded if costly budget choices were made. US inflation data also helped to assuage worries. The CAC 40 underperformed other European indices but still edged higher.

Interest-rate sensitive sectors outperformed, led by property, consumer staples and telecoms. Energy was the worst performing sector as Brent crude fell and **BP** revised down guidance due to weak refining margins. Tech also suffered, and especially **Dassault Systèmes** which issued a profit warning on its results due to softness in preliminary second-quarter sales. The group said the quarter's sales would now be €1.49bn, down from €1.52bn previously. Guidance on the full year figure was also reduced from +8-10% to +6-8% (on a like-for-like currency basis). The revision was prompted by some large contracts being put back due to geopolitical uncertainty. The rest of the software sector also fell on fears slack demand would spread.

Veolia said it had reached an agreement with Morocco's competition body to sell **Lydec**. The deal is expected to complete by the end of 2024. The subsidiary manages drinkable water and electricity distribution as well as street lighting and sanitation services for Casablanca and its region. Annual sales are around €700m. Veolia said the sale would have no impact on 2024 targets. In stark contrast, **Verallia** (glass packaging for beverages and food products) cut operating profit guidance as the recovery is taking longer than expected. The group has been hit by difficulties in the beer and spirits sectors and its share price has plunged.

US EQUITIES

Wall Street had a mixed week. Encouraging inflation figures continued to suggest a Fed rate cut. Investors piled into small caps while mega tech plays tumbled after stellar returns so far this year. The earnings season will soon start with banks like **JP Morgan**, **Wells Fargo** and **Citigroup** the first to report.

Thursday's trading session was memorable: the S&P 500 fell 1%, its first drop since June 28, but 400 stocks in the index ended higher.

Since 1979, we have to go back to October 2008 to find a session where the small cap Russell 2000 rises by more than 3% and the S&P 500 ends down. The Russell 2000's 5.8% outperformance of the Nasdaq 100 was its best showing since November 2020.

The Magnificent 7 suffered their worst sell-off since 2022, wiping out $600bn in market cap. Property, the worst performing sector in 2024, had its best day this year. After such a significant rotation out of tech, we may well wonder if markets are at a turning point.

EV maker **Tesla** lost more than 8% on Thursday after postponing the launch of its Robotaxi service from August to October. Management said the project's team needed more time. Elsewhere, Tex-Mex chain **Chipotle** ended the week 6% lower after a strong 28% rise since January 1st. This followed the decision by the long-standing CFO Jack Hartung to stand down by 2025. Since joining the group in 2002, he has nursed Chipotle through the **McDonald** sale and the 2015 sanitary scandal while catapulting the company into the best-selling fast/casual restaurant chain in the US. In the tech sector, **Hubspot** tumbled 12% after **Google** said it was no longer interested in bidding. **Delta Air Lines** fell 4.9% in Thursday after guiding on a drop in third-quarter profits.

In IPO news, Bill Ackman's **Pershing Square** fund hopes to raise up to $25bn in what could become the largest closed-end fund ever listed in the US. The IPO will list at $50 per share on the New York Stock Exchange and will more than double assets managed by Ackman.

EMERGING MARKETS

The MSCI EM index was up 1.94% in USD as of Thursday. All major emerging markets indices closed higher for the second week in a row. Outperformance was led by Mexico and Taiwan, up 6.28% and 5.16%. Brazil, Korea, China and India advanced by 2.88%, 1.17%, 1.16% and 0.04%, respectively

In **China**, June CPI came in at 0.2%, or below expectations. PPI remained in deflationary territory at -0.8% YoY, narrowing from a previous reading of -1.4%. June exports rose 8.6% YoY vs. expectations of 8.0% while imports fell 2.3% vs. expectations of +2.5% which took the surplus to an historical high. Exports of passenger vehicles rose 28 % YoY. The State Council approved a plan to support the development of innovative drugs. MIIT issued rules tightening investment regulations for solar PV manufacturing projects. **BYD** will invest $1bn in Turkey to set up an EV and plug-in hybrid vehicle factory with an annual capacity of 150,000 units. **Naura** reported strong second-quarter results, with net income guidance ahead of expectations.

In **Korea**, exports jumped 33.8 % YoY in the first 10 days of July. The unemployment rate for June was stable at 2.8%, or in line with expectations. The BoK held the base rate at 3.5%. The largest union at **Samsung Electronics** staged a three-day walkout. The government introduced a new battery recycling scheme to boost EV affordability. **Hanwha Qcells** broke ground on a 267 MW solar project in Colorado.

In **Taiwan**, June exports jumped 23.48% YoY to a 28-month high vs. expectations of 13.4%. **Apple** is reportedly targeting to ship 10% more iPhones in 2024. **Intel** unveiled a new 4nm flagship GPU made by TSMC. **TSMC** briefly surpassed the $1 trillion market cap mark this week after better-than-expected June sales data on stronger-than-expected demand.

In **India**, Prime Minister Narendra Modi held talks with President Vladimir Putin during his Moscow visit to boost ties in energy, trade and defence. Net inflows in pure equity schemes for June were $4.9bn vs. $4.2bn in May. SEBI is looking to tweak derivatives rules for retail. The Uttar Pradesh regional government announced a tax cut on hybrid cars. **Havells** will expand its cable manufacturing capacity by investing INR 3.75bn. **Adani Ports** will invest $1.2 bn in a new transshipment terminal. **Paytm** won regulatory approval to invest $6m in its Paytm Payment Services arm. **TCS** reported an above-consensus quarter with hiring resuming after three declining quarters.

In **Brazil**, June IPCA was 4.23%, or slightly below expectations of 4.32%. Retail sales for May rose 8.1% YoY, or above the 4.4% expected. **Petrobras** signed a master agreement with yara brasil fertilizantes. Parliament approved a tax reform with a cap of 26.5%.

In **Mexico**, CPI for June rose 4.98% vs. expectations of 4.87%. Nominal wage growth for June was 9.7%. The US tightened trade rules for steel and aluminum exports from Mexico that have been imported from China.

In **Chile**, **Santander Chile** reported better-than-expected results on lower provisions.

In **Argentina**, the government announced that it would open airspace to competition.

CORPORATE DEBT

CREDIT

US inflation fell faster than forecast to 3% over a year and was down 0.1% over a month. The news largely contributed to a drop in risk-free rates and US 10-year Treasury yields fell 10bp. Meanwhile, uncertainty over the next French administration persisted even if the likelihood of an extreme left coalition with a costly fiscal programme is low. The OAT-Bund spread narrowed towards 65bp but is still 15bp wider than before Emmanuel Macron dissolved the French parliament. Over the week, US 10-year Treasury yields eased by 10bp to 4.20% while the equivalent Bund yield was down 5bp to 2.50% as of Friday morning. The probability of a Fed rate cut has risen with the possibility, given the US slowdown, of 2 or even 3 moves by the end of the year. In the eurozone, markets expect further cuts by the end of December.

With French political risk on the wane, credit markets rose. Spreads narrowed, especially on the Xover which has narrowed by 10bp to 286bp since last Friday. Cash bonds were stable around 335bp for high yield and 106bp for investment grade. Overall IG yields remained at 3.75% with high yield at 6.5%.

With some calm returning to markets, French groups seized the opportunity to sell debt. Insurance groups issued subordinated Restricted Tier 1 bonds. **La Mondiale** raised €500m at 6.75% with a PNC10 *(Perpetual non call 10years)*, **Groupama** €600m at 6.5% (PNC 10) and **CNP Assurances** €500m with a T2 at 4.875%, callable in 10 years. Elsewhere, Greece's **Piraeus** bank, upgraded by Moody's to investment grade, raised €650m with a 2029 senior bond at 4.625%. In high yield, new issues from **Zegona**, **Rossini** and **Logicor** took year-to-date issuance in the segment to more than €55bn. The new deals show that issuers can tap markets and thereby help assuage maturity wall fears.

Investment grade gained 0.4% between July 5-11 and is now up 1.34% YTD. Note, however, that spreads have so far this year provided a cushion for investment grade as government bond indices have fallen 0.8% since January 1st. High yield, which has shorter sensitivity, only gained 0.24% but is up 3.78% YTD.

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.

• RT1 (Restricted Tier 1) are perpetual subordinated debt securities redeemable between five and ten years after issue. They are issued by insurers under Solvency II regulations.

• Perpetual non call 10years is a perpetual bond and its first call date is 10 years away.

DISCLAIMER

This is a marketing communication.

12/07/2024

This document is issued by the Edmond de Rothschild Group. It is not legally binding and is intended solely for information purposes. This document may not be communicated to persons located in jurisdictions in which it would be considered as a recommendation, an offer of products or services or a solicitation, and in which case its communication could be in breach of applicable laws and regulations. This document has not been reviewed or approved by a regulator of any jurisdiction. The figures, comments, opinions and/or analyses contained herein reflect the sentiment of the Edmond de Rothschild Group with respect to market trends based on its expertise, economic analyses and the information in its possession at the date on which this document was drawn up and may change at any time without notice. They may no longer be accurate or relevant at the time of reading, owing notably to the publication date of the document or to changes on the market. This document is intended solely to provide general and introductory information to the readers, and notably should not be used as a basis for any decision to buy, sell or hold an investment. Under no circumstances may the Edmond de Rothschild Group be held liable for any decision to invest, divest or hold an investment taken on the basis of these comments and analyses. The Edmond de Rothschild Group therefore recommends that investors obtain the various regulatory descriptions of each financial product before investing, to analyse the risks involved and form their own opinion independently of the Edmond de Rothschild Group. Investors are advised to seek independent advice from specialist advisors before concluding any transactions based on the information contained in this document, notably in order to ensure the suitability of the investment with their financial and tax situation.

Past performance and volatility are not a reliable indicator of future performance and volatility and may vary over time, and may be independently affected by exchange rate fluctuations.

Source of the information: unless otherwise stated, the sources used in the present document are those of the Edmond de Rothschild Group. This document and its content may not be reproduced or used in whole or in part without the permission of the Edmond de Rothschild Group.

EDMOND DE ROTHSCHILD ASSET MANAGEMENT (FRANCE)
47, rue du Faubourg Saint-Honoré 75401 Paris Cedex 08

Société anonyme governed by an executive board and a supervisory board with capital of 11.033.769 euros

AMF Registration number GP 04000015

332.652.536 R.C.S. Paris