MARKET FLASH: HOPE RISES FOR A FED PAUSE

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• Slowing demand in the US should promote a deceleration in inflation -the figures are out new Tuesday- and help the Fed pause rate hikes, at least temporarily, when it meets next week.

• We are cautious on the least liquid risk assets. We are still on the defensive in our equity allocations but with a preference for China. We continue to like duration.

At its June 4 meeting in Vienna, OPEC agreed to rein in supply amid a slowdown in the global economy. The 2.66 million b/d cut is to be extended until December 2024. Saudi Arabia is also reducing output by an additional 1 million b/d from July. Oil prices rallied on the news. Elsewhere, the Bank of Canada surprised investors by ending a 4-month pause and increasing rates by 25bp. The Bank of Australia followed suit. Both banks said they were worried about being too complacent over inflation; economic growth, labour markets and inflation have remained too strong despite rapid tightening since last year.

Macroeconomic data were surprisingly resilient at the beginning of 2023 but recent developments have confirmed a slowdown. Recent falls in new orders in the US and Germany reflect a slowdown in manufacturing. And poor trade figures in China, particularly a sharp slowdown in exports, point to lacklustre global demand for manufactured goods. In the eurozone, retail sales fell as demand began to run out of steam. Inflation is eating into purchasing power and wage increases have only provided partial and delayed support. And now services are looking fragile. Services ISM in the US flirted with contraction territory in May due to weak data on new orders and jobs. The US labour market is returning to normal judging from weekly jobless claims which were higher than expected. Slowing demand in the US should promote a deceleration in inflation -the figures are out new Tuesday- and help the Fed pause rate hikes, at least temporarily, when it meets next week.

China's markets rebounded sharply over the period following a strong correction in May. Caixin services PMI surprised on the upside and there are hopes for new stimulus measures, especially in ailing sectors like property and industry. A visit from US Secretary of State Anthony Blinken would be a sign of easing geopolitical tensions so also good for investor sentiment.

The debt ceiling agreement may mean the end of pessimistic default scenarios but the US Treasury still needs to restore its deposit base with new issuance and that will weigh on financial system liquidity. We would therefore advise caution on the least liquid risk assets. We are still on the defensive in our equity allocations but with a preference for China. We continue to like duration: government bond yields are attractive ahead of any slowdown in inflation and they would also afford protection if the economy slowed because of a gradual contraction in lending. The end of the US monetary cycle is approaching and we have therefore increased hedging of dollar exposure, especially as the cost against the euro is at record lows.

EUROPEAN EQUITIES

European equities ended the period with no clear direction, reflecting the VIX volatility index which hit a 3-year low of 14. OPEC said it would extend production cuts up to end 2024. Saudi Arabia is also preparing an additional 1 million b/d cut in July at least, a decision which sent Brent crude higher. Inflation is still the hot topic and the ECB said consumer inflation expectations in the eurozone fell sharply in April. However, it is clear that inflationary pressure is still with us, mainly because of knock-on wage increases. Monetary tightening transmission is still not effective enough at easing labour market tensions.

In company news, a recovery in tourism has now been confirmed. IATA said airlines were enjoying strong momentum. Most of them have revised profitability higher. In consumer discretionary, ready-to-wear giant **Inditex** saw sales rise 16% over 12 months. Management also expects margins to hold up. Construction is also proving resilient. **Saint-Gobain** confirmed its full-year guidance and expects to report robust margins. France's **Soitec** benefited from strong demand for semiconductors. The group also reiterated its targets for this year but also for 2025 and 2026 thanks to strong visibility. At its investor day, Pascal Daloz officially succeeded Bernard Charles as CEO at **Dassault Systèmes** (software). The group also said it expected to double profits by 2028.

US EQUITIES

After gaining more than 20% since its mid-March lows, the S&P500 moved into a technical bull market.

The chances of a soft landing increased after job creations amounted to 339,000, or much more than the 189,000 expected, and the unemployment rate rose to 3.7% from 3.4% in April. The idea that the Fed will adopt a more nuanced approach when it meets on June 13 and 14 was also reinforced. And then weekly jobless claims rose by 29,000 to 261,00, the biggest increase since October 2021.

In company news, **Apple**'s virtual reality headset hogged the limelight. Investors were disappointed that the launch is only to take place next January and be priced at $3,500, or three times what its rivals are asking. **Intel** lost 4.6% as a collateral victim of Apple's announcements as the new MacBook Pro will use Apple's own M2 ultra chip. Elsewhere, Taiwan's **TSMC** said capex this year would be around $32-36bn, or at the bottom of the spread, due to persistently weak demand for smartphones and computer chips.

Broadcom gained 3.6% after a results beat. The group said 25% of revenues next year would come from AI. **Visa** and **Mastercard** were under pressure after some members of Congress said they wanted to revive a bill to allow cards to be processed by other networks. **Amazon** is reportedly thinking of launching a mobile phone for its Prime subscribers at a reasonable price, or even for nothing. The news sent Telco operators 3.96% lower.

A short squeeze sent **Carvana** rocketing 56% after the group raised its guidance and reported a 63% surge in second-quarter profits. **General Motors** followed **Ford** in opening up its charging stations to **Tesla** vehicles. Tesla gained 5% after the bell. **Boeing** lost ground after Reuters said the group would have to reduce B878 Dreamliner deliveries due to a stabiliser system problem on its production lines.

JAPANESE EQUITIES

The NIKKEI 225 and TOPIX gained 1.58% and 1.96% thanks to the US debt ceiling bill getting Congressional approval, relatively attractive valuations and the weaker yen. The NIKKEI 225 surpassed 32,000 for the first time in almost 33 years and the TOPIX has now risen by 2,200 points since August 1990.

Mining and Iron & Steel rose by 6.42% and 5.23% respectively, benefiting from the recovery in commodity prices. Wholesale Trade added 5.14% as general trading companies remained in favour. Only Precision Instruments fell, down 1.77% on profit taking.

Pharma group **Eisai** soared 13.87% after the FDA in the US acknowledged that its Alzheimer's drug "Lecanemab", developed in collaboration with **Biogen**, reduced the rate of clinical symptoms in patients. **Panasonic** jumped 10.04% as large-cap stocks benefited from index fund buying. **Mitsubishi Heavy Industries** rose 9.38% on news that the ruling parties are thinking about easing "The Three Principles on Transfer of Defense Equipment and Technology" to enable Japan's military industry to export weapons. In semiconductors, **Tokyo Electron** fell 4.74% on profit taking after a good run on US tech stock strength. **Nitori**, a furniture chain store operator, fell 3.52% as May same-store sales came in lower for the second month in a row. Pharma company **Shionogi** slipped 2.41% on expectations of a major broker downgrade.

The dollar initially strengthened from the high 138s to low 140s on position unwinding ahead of central bank meetings next week but then fell back to the high 138s due to a large number of US Jobless Claims.

EMERGING MARKETS

The MSCI EM Index was up 1.04% this week as of Thursday's. Brazil (+3.29%) and Mexico (+3.16%) led gains. China slightly outperformed, rising 1.17%. India, Korea and Taiwan index underperformed as they were little changed during the week.

In **China**, macro data continued to diverge: Caixin services PMI came in at 57.1, or higher than both consensus and the previous month while May exports fell 7.5% YoY, or much more than the 1.8% drop expected. May CPI edged up to 0.2% YoY, or in line with expectations, but PPI fell 4.6%, or more than expected. China is extending its EV purchase tax exemption, previously set to end this year. Major banks including **ICBC** and **BOC** cut deposit rates to 0.2% from 0.25% as more easing is being considered to boost the weak recovery trend. Regulators are considering reducing down payments in some non-core neighborhoods of major cities, lowering agent commissions on transactions, and further relaxing restrictions for residential purchases under the guidance of the State Council. US Treasury officials met China's ambassador and said the meeting was candid and constructive while Anthony Blinken aims to travel to Beijing for talks this month according to media reports. On the corporate side, **Trip.com**'s first-quarter results and second-quarter guidance both beat expectations and the company said 2023 summer bookings would exceed 2019.

In **India**, the RBI continued the pause in the repo rate and kept it at 6.50%. India services PMI declined to 61.2 from 62.0 in April. **Tata Group** signed a $1.6bn EV battery plant deal with the Gujarat regional government. Tata Power is to set up a MW 966 hybrid renewable power project for Tata Steel. Electric vehicle sales represented 8% of total vehicle retail sales in May. The RBI released its DLG Guidelines For Digital Lenders with a cap on DLG at the equivalent amount of 5% of the underlying loan portfolio. The government approved the third revival package for **BSNL**, worth US$11 bn, through equity infusion. **Disney** is to offer free mobile streaming of cricket in India just like its rival **JioCinema**.

In **Brazil**, the IPCA rose 0.23% MoM in May. The government announced a R$1.5 billion programme to reduce the prices of economy cars, trucks, and buses. The government also mentioned that the tax reform amendment bill would be sent to Congress in the first week of July. In **Mexico**, 2H May CPI confirmed the disinflation trend. May traffic showed solid 10% YoY growth for Mexican airports Oma and GAP. **Prologis** Mexico's management announced increased investment in Mexico's northern cities to meet strong demand for warehouses. In **Chile**, the lower house rejected the pension withdrawal proposal, reinforcing the negative inflation trend.

CORPORATE DEBT

CREDIT

Credit performed well overall with a slight tightening in both investment grade and high yield to 163bp and 450bp. The synthetic index was unchanged at 410bp. Yields on the 5-year German Bund rose from 2.4 to 2.45%.

Good premium performance was offset by interest rates. As a result, investment grade, which is sensitive to rates, ended the period 0.25% lower while high yield, which reacts more to premium movements, returned 0.55%. Year to date, IG has gained 2.07% and HY 4.58%. Actuarial yields for investment grade were 4.3% and 7.4% for high yield, still good entry points for carry strategies. Current market levels reflect a soft recession scenario. Company earnings are still generally good which suggests the economy is so far resilient.

Today's conditions favour new issuance, and especially investment grade. New deals included a jumbo perpetual hybrid bond from **EDF** NC10 pour for $1.5bn at 9.125%, a **Santander** Senior Preferred A+ 4.25% 2030 for €1bn, a **Linde** A 3.625% 2025 for €500m, a **Mercedes** A 3.625% December 2024 for €500m, a **Universal Music** BBB 4% 2031 for €750m, a **Autostrade per l'Italia** BBB 5.125% 2033 for €750m, a **Banco BPM** Senior Non Preferred BB+ 6% 2028 for €750m and an **InfoPro** B 8% 2028 for €500m.

In financial debt, Euro CoCo premiums continued to slowly tighten towards less stressed levels of 816bp from 880bp in the preceding week. This is much higher than the historic mean, a token of the sector's attractive valuations. However, trading in CoCos was quiet. There has been no significant new deal since the **Credit Suisse** incident. Many companies refinanced their AT1 bonds early in the first quarter so there is no rush. Others are waiting for cheaper refinancing levels before the third quarter. New AT1 deals will be scrutinised to see how strong demand is and the impact on pricing in this post-Credit Suisse environment.

CONVERTIBLES

The primary market is back! There was intense activity this week across healthcare, consumer financing and technology, mainly in the US and Japan.

In the US, **Ionis Pharmaceutical**, which specialises in RNA drug discovery and is no stranger to the convertibles market, raised $500m at 0.125% due 2028. This is part of a refinancing deal to repay its outstanding 2024 issue. This deal was followed by a $500m deal from **Ventas Realty**, a real estate investment trust that focuses on senior housing communities and medical buildings. The deal was welcomed by the investor base, as the company offers credit exposure to a high-quality company with rising revenues.

After a lull, the primary market in Japan also made a comeback. **Ferrotec Holdings**, a company that manufactures and distributes semiconductor equipment, raised JPY 25bn due 2026. Most of the proceeds will go on capex in its Malaysian unit.

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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