EDMOND DE ROTHSCHILD

MARKET FLASH: MARKETS FACE MIXED ECONOMIC DATA

• The week kicked off with a big sigh of relief after Congress reached a last-minute agreement to avoid a shutdown, even if it only put the deadline back by 45 days.

• Eurozone data was more disappointing than in United States. PMI figures may have been more resilient than expected in some countries but they remained below or close to 50, a token of prevailing weakness.

• Our equity stance is tactically neutral: investor sentiment and positioning are weak even if US growth remains resilient and the situation in China is stabilising.

The week kicked off with a big sigh of relief after Congress reached a last-minute agreement to avoid a shutdown, even if it only put the deadline back by 45 days. Unfortunately, the deal failed to reassure markets. Long-term interest rates continued to rise as economic indicators stayed strong. US manufacturing ISM came in at 49, a high not seen since November 22 and better than expected. This was a big improvement on August's 47.6 and the jobs component also rose significantly. Services ISM also beat, edging lower but remaining comfortably in positive territory. Jobs data overall was more mixed. The JOLTS survey was much higher than expected but ADP reported a decline in job creations. Eurozone data was more disappointing. PMI figures may have been more resilient than expected in some countries but they remained below or close to 50, a token of prevailing weakness. Household consumption was hit by higher prices. September's retail sales were down 1.2% over a month in volume and 2.1% over a year.

Equity markets are heavily geared to interest rate moves. 10-year US Treasury yields jumped from 4.57% to 4.73% in only 2 days to hit levels not seen since the summer of 2007. Europe followed suit with the 10-year German Bund yield testing 3% for the first time since 2011. All this weighed on risk assets at the beginning of the week and the decline initiated in mid-September continued across the globe. At the end of the period, a dip in bond yields helped equity markets stabilise.

Our equity stance is tactically neutral: investor sentiment and positioning are weak even if US growth remains resilient and the situation in China is stabilising. Over the medium term, however, growth and earnings will be affected by restrictive monetary policy and high interest rates. That is why we are upbeat on duration as it should provide protection in today's economic uncertainty.

EUROPEAN EQUITIES

Equity markets lost ground due to worrying macroeconomic statistics. Retail sales were once again weak in September (-2.1% in volume over a year). Energy stocks led losers in the Stoxx 600 as oil fell sharply following OPEC's statement that production cuts would not be increased.

French transport multinational **Alstom** cratered 38% after slashing guidance on cash flow targets for the year. The news augurs badly for the group's refinancing as it could lead to a credit downgrade.

In sharp contrast, **Bonduelle** (processed vegetables) bounced 9% after sales rose despite profitability falling short of expectations. The group said it was confident the trend would continue in the coming months. In retail, **Tesco** raised its full-year guidance after upbeat quarterly results on improved consumer confidence. Denmark's luxury group **Pandora** also rebounded by 12% after raising guidance. Management said its affordable luxury position had helped it gain market share, especially in the US, compared to rivals who are more exposed to falling household purchasing power.

US EQUITIES

Wall Street was mainly lower over the last 5 trading sessions up to Thursday. The S&P 500 shed 0.94% and the Russell 2000 3.47% while the Nasdaq edged 0.17% higher. Indices rebounded towards the end of the period after an ADP report said private sector job creations only totalled 89,000, or much less than the 150,000 expected. Wage rises also decelerated for the 12th month in a row.

On the interest rate front, markets are now factoring in a 50% probability that the Fed will raise rates by 25bp in November. This marks a big increase from the previous week's 18%. Oil prices tanked over the week. WTI fell as far as $82.13 after the US Energy Agency said inventories had risen and that it expected demand to slacken. OPEC+ countries decided to stick at current output levels.

Energy transition stocks like **AES** and **NextEra** plunged 15.26% and 13.37% on expectations rates would remain high for some time. This could be bad for investment in green infrastructure.

Lundin Mining tumbled 7.32% after its CEO resigned. He will be replaced on January 1st 2024.

In technology, computer maker **Dell** lost 3.37% after delivering disappointing long-term guidance on growth. **Booz Allen Hamilton** jumped 7.33% after signing a $630m contract with the US Space Force.

In autos, **Tesla** gained 4.05% after reiterating its long term forecasts. **Ford** (-5.25%) and **General Motors** (-8.59%) continued talks with the UAW union. General Motors said the strike had already cost it $200m.

Exxon expressed an interest in **Pioneer Natural Resources**, a shale energy specialist. A deal would represent **Exxon's** biggest acquisition since its merger with **Mobil** in 1999 and make it the biggest operator in the Permian basin.

On October 1st, Democrats and Republicans agreed on a temporary deal on spending which postpones the shutdown deadline for 45 days. The House of Representatives has until November 17 to reach an agreement on the 2024 budget.

JAPANESE EQUITIES

In another down week, the NIKKEI 225 and TOPIX shed 2.50% and 3.49%, respectively. The drop was primarily due to increasing upward pressure on interest rates globally, including the US and Japan.

For this period, no sectors gained. Mining and Oil & Coal Products tumbled 15.28% and 13.14%, respectively, due to sharp falls in the crude oil price. **Eneos Holdings** (oil and gas

development) plunged 13.38%. Iron & Steel dropped 8.74% on profit taking amid mounting risk-off sentiment.

Sysmex (healthcare) and **Shimano** (bicycle parts) gained 3.30% and 2.66%, respectively, on bargain hunting after severe falls in large-cap growth stocks. **Japan Exchange Group** added 2.42% on expectations of more volume in financial markets thanks to Prime Minister **Kishida's** new policy enhancing asset management businesses. Elsewhere, **Kansai Electric Power** skidded 12.12% on profit taking among value plays. **Nissan Motor Co., Ltd.** also sank 11.13% on profit taking after gains driven by the weaker yen.

The yen traded briefly at 150 against the dollar on strong US job data and high interest rates. But it then strengthened to the mid-148s as US bond yields fell back and traders began to eye possible action from the Japanese government.

EMERGING MARKETS

In line with developed markets, the MSCI EM Index was down 5.42% this week as of Thursday. The decline was due to bond market turbulence as US yields surged to 16-year highs. India (-0.2%) outperformed other regions while Brazil plunged by 7.8%. Mexico (-12%) underperformed significantly due to a sharp sell-off in the country's main airport operators following surprise changes to their tariff base regulations. Mainland China was closed during the week for national holidays.

In China, September's official PMIs suggested most of the economic downturn was behind us, with manufacturing PMI returning to an expansionary 50.2, and services PMI improving to 51.7. However, the slightly softer Caixin PMI numbers showed that the recovery remained fragile. Sales at the top 100 property developers rose 24.8% MoM in September but were still down 24.1% YoY. The government will resume visa-free policies and consider adding more countries to its visa-exemption list to help boost the country's post-pandemic tourism business. The EU commission formally started a probe into China's EV subsidies. China is removing barriers to Australian hay imports, the latest step towards normalising trade relations. Domestic tourism rose 75.8% YoY and revenues soared 125.3% YoY during the first 3 days of the Golden Week holiday. **Ctrip** said outbound order volume on the first day of the GW jumped 54% compared to Labor day. Average daily services and retail spending on the **Meituan** platform during the holiday was on track for a 153% increase on 2019 levels, making it the best GW data in 5 years.

In Korea, manufacturing PMI bounced back to 49.9 in September. Exports fell 4.4% vs. -9.3% expected, while imports fell 16.5%, also milder than the 22.8% drop in the previous month and the 17.6% expected. **Hana Micron** is to invest $1bn in Vietnamese chip production. **LGES** agreed to supply batteries to **Toyota** in the US from 2025 and will invest $3bn in expanding its Michigan plant.

In India, the RBI kept its key lending rate steady for a fourth consecutive time as widely expected. Manufacturing saw a mild slowdown in growth in September with PMI at 57.5. Tax revenues on goods and services rose 10% YoY during the month. **Google** will begin manufacturing Chromebook laptops in India. **Dmart's** second quarter results showed new stores and sales growth were in line with expectations. **HDFC** bank's preliminary 2Q24 results revealed better-than-expected deposit growth, with the gap with loan growth narrowing.

Mexico's market was hammered. The most negative news came from the airports. The three airport operators were notified by the Federal Civil Aviation Agency (AFAC) of an immediate change in the tariff base regulations for airport concession agreements; there had been no previous discussion with any of the players. The airports are important beneficiaries of the nearshoring trend. The market tanked with airport stocks and concession companies selling off. August remittances saw a sequential decline of 1.6% MoM (+8.6% YoY).

Brazil delayed a decision on the ending of the IOC due to no consensus on this (positive) proposal. August official job creations (CAGED) came in better than expected.

CORPORATE DEBT

CREDIT

Both government bonds and premiums were weak due to soft European PMI data. Manufacturing came in at 43.4 and services at 48.7, or still well below the key 50 threshold. At the same time, interest rates continued their mad gallop to new records. For the first time since 2011, yields on the 10-year German Bund briefly moved above 3%.

After showing resilience in September, credit spreads started to weaken due to the pressure on corporate refinancing from high interest rates and worries over an economic slowdown. Investment spreads widened by close to 10bp to 158bp over the week and by close to 20bp to 465bp for high yield. It was the same story for financial and Euro Coco spreads, now trading at 940bp to call compared to an average of 600bp over the last 5 years.

All this volatility naturally hit new issuance both in the high yield and financial segments. The big deal of the week was a hybrid bond from **Accor** (BB- senior, BB hybrid) which raised €500m at 7.05%. We subscribed.

Investment grade fell 0.33% over the week due to interest rates and spreads (leaving YTD gains at 2%) and high yield finished 0.61% lower (+5.5%). At the time of writing, actuarial yields for investment grade were 4.6% and 7.8% for high yield, or still good entry points for carry strategies.

CONVERTIBLES

Convertibles lost 1% over the period due to risk-off sentiment and rising bond yields. Valuations fell due to equity market falls and widening credit spreads.

In new issuance, the week saw the first US deal since September 20: **Rivian** unveiled a $1.5bn convertible issue at 3.375% and a 30% issue premium. The stock plunged more than 20% on the news.

In Japan, **Taiyo Yuden** (semiconductors) raised JPY 50bn due 2030 with a 10% premium and a 105% issue price. The company makes ceramic capacitors, inductors and hybrid integrated circuits.

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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06/10/2023

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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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