EDMOND DE ROTHSCHILD

MARKET FLASH: INTEGRATION OF THE FED PAUSE

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• As the earnings season draws to a close, the results are upbeat in the US where annualised growth in the third quarter came in around 3%.

• We remain cautious over the medium term due to persistently tough financial conditions which will be having an impact on the real economy.

Following Jerome Powell's more accommodating stance and a sharp drop in bond yields in the previous week, the period under review was more restrained, even if volatility persisted. Several Fed officials stepped up to say another rate hike could not be totally ruled out. Any large drop in interest rates would lead to easier financial conditions and the Fed is not keen on that. The effect of the Fed's pause on lending was shown in the quarterly survey of US banks. It revealed that conditions had tightened and demand was still falling but less than in the previous quarter. Australia's central bank raised rates by 25bp after a 4-month pause, citing inflation which was more persistent than expected and the long road ahead before inflation targets would be met. In China, the reverse happened: CPI fell 0.2% in October or more than expected. Exports also fell more than expected, reinforcing concerns over growth. The economic slowdown is also visible in the eurozone where retail sales fell 0.3% in September (-2.9% over 12 months).

Equity markets also calmed down after the previous week's strong rally. As the earnings season draws to a close, the results are upbeat in the US where annualised growth in the third quarter came in around 3%. The picture is more disappointing in Europe where earnings fell by close to 10% over a year, dragged down by energy and commodities.

We remain somewhat cautious over the medium term due to persistently tough financial conditions which will be having an impact on the real economy. Last week's Fed pause, however, could underpin risk assets over the short term so we have tactically raised our equity weightings. We still like duration. Its appeal has been enhanced by the wait-and-see attitude adopted by central banks and it still offers protection against geopolitical risks and an economic slowdown.

EUROPEAN EQUITIES

Upbeat macro data and falling inflation pushed markets higher in the previous week but this week was more mixed. The Stoxx 600 trod water faced with contradictory indications. On the one hand, some companies results have been encouraging and investors are now gradually abandoning concerns that the conflict in the Middle East could spread. As a result, Brent crude fell back below $80 for the first time since july. On the other, the picture was clouded by weak Chinese growth and increasing pressure on government bond yields due to cautious statements from central banks. Consumer spending is retreating according to

macro indicators but several ECB officials said they were not minded to talk about future rate cuts. Jerome Powell in the US said much the same thing.

At any rate, media stocks led gains this week. UK publishing giant **Pearson** reported good figures and raised guidance for the full year. Property, in contrast, led losers due to the prevailing high interest rate environment.

In tourism and leisure, **Ryanair** jumped after posting record profits. In an illustration of its strong pricing power, the group raised prices while also increasing passenger numbers. As a result, it made €2.18bn in the six months up to the end of september.

In banks, **UBS** posted lower numbers but the share rose. Its third quarter loss was bigger due to provisions for its acquisition of **Credit Suisse** but its redundancy plans pleased investors.

German pharma giant **Bayer** posted disappointing results due to poor trading in its agrochemicals division. The group is looking at several restructuring options and its CEO suggested its agricultural and consumer health divisions might be spun off.

Renault is to slash the number of its voting rights in **Nissan** from 43% to 15%. The French auto manufacturer has created a French trust to house its 28% stake in **Nissan**. This new arrangement is set to mark the end of the initial **Renault**-**Nissan** alliance which was tainted by the Carlos Ghosn affair.

Results at Italian electronic payments specialist **Nexi** reassured investors after the difficulties of its French rival **Worldline**. Third quarter sales were €841.1m, or in line with consensus expectations while EBITDA came in at €495.8m, or slightly higher than the €491m expected.

US EQUITIES

Wall Street had another positive week thanks to a slight deterioration in macro indicators which investors read as a sign that the Fed's recent pause was justified. The S&P 500 and Nasdaq gained 0.72% and 1.82%, the longest winning streak since january with 8 up sessions.

Non-farm payrolls increased by 150,000 in october, or 20,000 less than expected, but mostly because of the Detroit auto strikes which are now ending. Weekly jobless claims totalled 217,000, or just below the 218,000 expected. As a result, bond yields eased and equities rose. However, low take-up at the 30-year Treasury auction on thursday rekindled worries about demand for US debt. Long bond yields then rose and the equity market's winning series was broken. In addition, Jerome Powell said the Fed would not hesitate to raise rates if needed.

On oil markets, prices continued to fall and WTI fell 8.15% to within reach of $75, a low not seen since july. Demand seems to be slowing and the Middle East conflict looks like being contained.

In healthcare news, the Food and Drug Administration (FDA) approved a weight loss drug made by **Eli Lilly** (+1.90%). The market is potentially huge.

Elsewhere, results at **Stelco** (+7.89%) were better than expected thanks to strong demand for steel.

General Motors (-7.47%) lost more ground, this time after recalling several hundred driverless cars following a robotaxi collision with a pedestrian.

In consumer products, **Coty** (+1.45%) raised full-year guidance thanks to higher prices and better-than-expected demand.

In tech, **Datadog** (+26.49%) had a better-than-expected third quarter and raised guidance for the current quarter, citing robust demand for new logos. **OpenAI** unveiled GPT-4 Turbo, its latest GPT-4 update. It boasts a much larger context window and has knowledge of world events up to april 2023.

WeWork (coworking spaces) filed for bankruptcy, an illustration of difficult trading conditions in commercial property. Numerous commercial leases in cities like New York and San Francisco are now at risk.

Markets are still focused on long bond yields and macro indicators.

The US has until november 17 to reach an agreement on the Federal budget and avoid an administration shutdown.

JAPANESE EQUITIES

In a volatile week, the NIKKEI 225 and TOPIX indices rose by 3.31% and 1.06%, respectively. The initial rally was driven by the the Federal Reserve's decision to leave interest rates unchanged at its november FOMC meeting and weak US employment data. However, markets then faced downward pressure due to concerns about a potential global economic slowdown after a sharp decline in WTI oil prices and soft nctober China exports. They ended the period higher on Wall Street strength and the weaker yen.

Other products rose 6.22% led by **Nintendo** (+13.3%) after it raised guidance on this year's earnings. Air transportation advanced 4.58% on higher foreign visitor numbers and an improvement in hotel **RevPar**. Electric appliances gained 4.35% on sector strength in the US after a sharp fall in long bond yields. On the other hand, pulp & paper and marine transportation tumbled 8.38% and 6.72% as investors unloaded cyclicals on concerns over global growth. Banks declined 6.64% on falling interest rates in the US and Japan.

LY, an internet platform provider previously known as **Z Holdings**, soared 16.53% on much better-than-expected july-september earnings. **Sumitomo Electric Industries** (wire harnesses and optical fibre) jumped 11.32% after the group raised operating profit guidance. Elsewhere, **Resona Holdings** and **Dai-ichi Life** (life assurance) plunged by 9.80% and 8.69% on falling bond yields. **Tokyo Gas** plunged 9.15% on profit taking as risk-on sentiment hit defensives.

The dollar weakened to the low-149s after US long bond yields slumped following the Fed's decision to stay put. The yen later weakened to flirt with 151 as markets started to think the US bond rally had gone too far.

EMERGING MARKETS

The MSCI EM Index was up 0.9% as of thursday. China (+0.2%) slightly underperformed while Korea and Taiwan gained 1.8% and 1.5%. India ended the period 1% higher.

In China, CPI inflation turned negative again in october, falling 0.2% YoY, mainly due to wider pork price deflation. PPI deflation (-2.6% YoY) also widened slightly due to lower crude oil and nonferrous metal prices. Trade data for October was a mixed bag with imports in USD rising 3% vs. an expected 5% drop, while exports fell 6.4% vs. 3.5% expected. CPCA data

showed october NEV retail sales jumped over 37% YoY to 767,000. Total NEV PV export volume reached 112,000 during the month (+23% MoM/+8% YoY), beating market consensus and driven by strong export sales at **Tesla**. President Xi and Biden are expected to hold talks at the San Francisco APEC summit thisweek. **Vanke** got strong support from a major shareholder and reaffirmed its commitment to repay offshore and onshore debts on time. **Ant Group**, **Alibaba Group's** fintech affiliate, received approval for products powered by its large language model. **Li** Auto posted strong third-quarter results, beating market expectations across the board. The group also revised up its full year delivery target.

Korea's financial regulator issued a more than 6-month short selling ban to appease retail investors ahead of parliamentary elections next year.

In India, the government released an additional Rs100bn for the Mahatma Gandhi National Rural Employment Guarantee Act 2005 (**MNREGA**) scheme while fuel demand rose 5.5% MoM in october. **Tata Group** acquired a 100% equity stake in Wistron India to join the Apple supply chain. Intel is working with eight electronics manufacturing companies in India to accelerate laptop manufacturing. **Zomato** reported a strong beat on higher profitability across business segments and strong sequential growth. **Titan** reported another solid quarter with margins surprising positively. Quarterly results at **Nykaa** were in line amid weak demand, with signs of a turnaround in the fashion vertical.

In Brazil, manufacturing PMI declined by 0.4pt to 48.6 while services PMI rose 1.3pt in October to 51.0. The Senate approved the tax reform bill to simplify the tax system. Brazil must pursue a fiscal target of zero deficit, according to finance minister Fernando Haddad. Iron ore exports jumped 27% YoY in october. **Itau** reported a better-than-expected third quarter driven by a 12% increase in NII and better asset quality; however, loan growth was only up 4.5% YoY. Results at **Banco do Brasil** were in line with lending up 10% YoY, or better than peers but higher, albeit one-off, provisions due to its Americanas exposure. **Hapvida** reported a better-than-expected third quarter driven by a higher EBITDA margin thanks to stronger MLR improvement.

In Mexico, manufacturing PMI fell from 51.1 to 50.5 in october. **Banxico** kept rates at 11.25% as expected by everyone. Car sales rose 21.2% YoY in october, their highest level in 5 years. Third-quarter earnings remained resilient with 53% of companies beating EPS estimates.

In Chile, press reports said **Tesla** was taking its first steps to begin operations in Chile, a country with the world's biggest lithium reserves.

CORPORATE DEBT

CREDIT

After the previous week's sharp drop in government bond yields, markets calmed down. Yields on 10-year US Treasuries rose by 3bp while the 10-year German Bund added 4bp. Credit markets were stable in a period without any major news items and the Xover was unchanged at 413bp. High Yield credit premiums tightened by 9bp leading to returns of 0.3% over the week.

In financial debt, the new issues market reopened with **Société Générale** selling a dollar-denominated ATI at 10%. But the focus was on **UBS** which returned to the CoCo market for the first time since buying **Credit Suisse**. The deal came in two tranches, 5 and 10 years, and was a big success. Bids totalled $36bn and the bank raised $3.5bn at 9.25%. The enthusiasm for the deal boosted CoCo risk spreads which tightened by 24bp.

CONVERTIBLES

This week the primary market, earnings, and Korea were the main focus in global convertibles bonds. In Europe, chemicals companies were lifted by a report of a German energy price deal. **AstraZeneca** gained after it raised its profit outlook for the year and clinched a deal to develop a diabetes and obesity drug. **Amadeus** reported solid third-quarter results and reiterated its 2023 sales and EBITDA guidance for 20%-22.5% growth and EBITDA margin expansion, respectively. **Siemens Energy** talks on loans guarantees are still ongoing with the German government and main shareholder **Siemens AG** on billions in loan guarantees are still ongoing with the German Chancellor Olaf Scholz saying he's confident a deal can be reached if the various parties agree to shoulder a sufficient part of the burden. A new €750m EUR exchangeable issue was priced this week, **Simon Property** convertible into **Klepierre**. The new deal with a 3.5% coupon, 20% premium and a 5 year maturity offers a defensive exposure to the name with and investment grade rating and a high bond floor.

In the US, **DataDog** soared, as the company delivered strong results, and raised its guidance for the year by double the size of the quarter's beat. These results also brought relief to the broader consumption names in the space (**Mongo DB**, **Zscaler**). **BioMarin Pharmaceutical** was on the spotlight, as it was reported that the activist investor Elliott Investment has built a stake in the company, which is seen as a positive event that could lead to operating leverage & M&A. **Spirit AeroSystems** issued $200m in 3.5% coupon convertible bonds maturing in 2028.

In China, **Wynn Macau** reported a recovery in casino activity that came up short of expectations, even as they said gambling in the regional hub will likely grow in the final months of the year. **Wynn Macau's** revenue in the third quarter was about seven times the amount it posted a year earlier, the net loss improved and EBITDA recovered to about 85% of pre-Covid levels.

In Korea, the equity short sell ban has meant a broad 2-3 point cheapening in convertible bond names, given new borrow considerations. This happens even as convertible bonds underlying equities squeezed aggressively on the ban**: Posco** +19%, **LG Energy** + 23%. **Hynix** +6%, **L&F** +25%, among others.

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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