EDMOND DE ROTHSCHILD

MARKET FLASH: COULD WALL STREET'S DOMINANT POSITION FALTER?

- **Persistent inflation in the US complicates the Fed's 2% target, while Trump's protectionist policies heighten trade tensions, delaying potential rate cuts.**
- **In Europe, discussions surrounding the Ukrainian conflict, despite the uncertainty of outcomes, have provided short-term support to European assets.**
- **Caution remains warranted for equities, and a neutral allocation is maintained for bonds, with a preference for the eurozone due to its attractive valuations and clearer ECB policy outlook.**

The global economy is still dominated by (i) resilient activity and (ii) rising tensions, chiefly in US inflation data and international trade relations. The latest CPI print came in hotter than expected with a surge in underlying factors like services ex shelter. The figure makes it complicated for the Fed to reach its 2% target, at least in the short term. Sticky inflation is running parallel to mounting trade tensions which have been exacerbated by the Trump administration's protectionist drive, resulting in targeted tariff increases.

Apart from their direct impact, these duties are clearly being used to generate tax dollars while reinforcing the bargaining power of the US internationally. However, this trade war environment is generating uncertainty and forcing the Fed to adopt a cautious stance. Any rate cuts could be pushed back to the second half of 2025. Markets are now expecting only a 32bp cut in rates for this year as a whole.

Meanwhile, Europe is engaged in crucial talks on the Ukraine conflict, following calls between Donald Trump and Vladimir Putin. The news briefly underpinned exchange rates but the outcome of these talks is still uncertain. Russia is still the object of economic sanctions and there looks like little chance of them being lifted in the near term. However, this slow de-escalation is already boosting European asset prices, over the short term at least, and in spite of the industrial sector suffering from high energy prices. Basic material and chemicals have been the hardest hit.

International reactions to these new US policies vary: some countries want to keep the dialogue open while others want to stand firm. The economic outlook may be cloudy but the Fed is being patient, especially as the US economy is proving resilient. This strength is in part responsible for strong momentum on global stock markets. The earnings potential for US and European companies has not been challenged so far and the latest quarterly results have helped justify increasingly tight risk premiums.

But despite the political climate cooling down, we consider that markets are underestimating the possibility of a trade war. At the same time, inflation data suggest the Fed will be in no hurry to ease monetary policy. We remain more cautious on equities. We continue to be neutral on bonds but with a preference for the eurozone because of its attractive valuations and much better visibility on how the ECB will proceed.

We tend to prefer protected equities, which should prove more resilient to any sudden shocks, and companies less exposed to US tech. In fixed income, we are still keen on carry strategies across all European bond segments.

EUROPEAN EQUITIES

The UK grew by a surprising 1.4% in the fourth quarter, or more than the 1% expected by economists. The AI conference in Paris saw several significant announcements concerning investments. President Macron said private investments in France would amount to more than €100bn while Ursula von der Leyen, head of the European Commission, promised a €200bn plan. Stock markets gained more than 2% over the week as hopes for a ceasefire between Ukraine and Russia rose. Industry, luxury and IT sharply outperformed in Europe.

Among earnings reports from leading luxury groups, **Kering**'s results were in line. Investors are now waiting to see who the group will appoint a new designer. The stock gained 15% over the period. Fourth-quarter sales at **Moncler** rose 8%, with Asia up 11%. Management made upbeat comments on the Chinese market. **Hermès** reported an 18% jump in sales, or much more than expected. The luxury sector as a whole is still riding high as Europe's big players have announced reassuring figures since the beginning of the year.

France's GazTransport & Technigaz (membrane containment systems for the transport and storage of liquefied gas) unveiled a strategic repositioning for its **Elogen** subsidiary. It will stop producing hydrogen after honouring recent orders and focus instead on research and development. There will be a job protection scheme and around 100 redundancies. The market expected the news but was surprised to learn that the CEP Jean-Baptiste Choimet had resigned, less than a year after being appointed. Elsewhere, **Airbus** postponed the development of its new hydrogen aircraft which was scheduled for 2035. No new dates were given and the project's budget was reduced.

Industrials gained more than 5% this week on upbeat reports from **Legrand** and **Siemens**. Both groups confirmed promising trends for electrification products and data centre equipment.

US EQUITIES

After three up weeks in a row on Wall Street, small and midcap companies in the Russell 2000 index registered a slight 0.24% fall. Big caps, on the other hand, continued to shine. The S&P500 added 0.82% and the Nasdaq 100 gained another 1.26% with strong performance in commodities and consumer plays.

Coca-Cola (+7.67%) saw like-for-like solidity in the fourth quarter thanks to a favourable price mix. Unlike **PepsiCo** (+0.16%), the group sees 5-6% growth this year. Markets also liked optimistic management comments at **McDonald's** (+0.52%) on a resumption in growth in the coming quarters. In e-commerce, fourth-quarter results at **Shopify** (+6.52%) beat already demanding expectations. These upbeat results contrasted with a higher-than-expected CPI print which raised questions on how robust US consumers would prove in coming months.

In tech, **Cisco** (+1.64%) reported good figures, notably on AI-driven orders across its client base. **Apple** (+6.10%) unveiled a partnership with Alibaba to integrate AI in its products sold in China. The news showcased the need for US companies to reach agreements with Chinese groups to ensure future growth in their respective local markets.

In healthcare, the new CEO at **CVS** (+22.20%) delivered a positive account of his first 100 days and struck a positive note for 2025. It could be even better if operating margins return to normal. In biopharma, **SpringWorks Therapeutics** jumped 8.50% after the FDA approved its Gomekil oncology treatment. An OPA from **Merck** (-2.29%) is also a possibility.

Zillow (-10.53%) said a slowdown in property purchases, sales and rentals was a possibility. The WSJ also said the market for senior residences was stable. That is good news for established players like **WellTower** (+5.82%) and **Brookdale** (+17.74%) as their existing assets benefit from a valuation boost.

EMERGING MARKETS

The MSCI EM index had edged 0.45% high as of Thursday's close. China rallied by a further 2.9%. AI remained as the dominant theme. Mexico and Korea gained 2.9% and 2.5%, respectively. The correction in India and Taiwan continued with falls of 1.8% and 1.3%, mainly due to Donald Trump's reciprocal tariff threat.

In **China**, CPI rose 0.5% YoY while PPI was down 2.3%, reflecting mixed consumer spending and weak factory activity. President Xi Jinping is reportedly planning to chair a symposium that will be attended by **Alibaba** co-founder Jack Ma and other tech entrepreneurs. The MIIT said that 3 Chinese telecom companies had fully integrated the **DeepSeek** open source LLM model. The government is mulling a RMB 50bn funding plan this year to help **Vanke** repay debt. **BYD** unveiled its "God's Eye" DiPilot feature, bringing the smart driving rollout to mass-market models. Auto giant **Dongfeng** and **ChangAn** are planning to restructure with other SOE OEMs. **CATL** filed a Hong Kong listing application to raise at least $5bn. **AK Medical** announced a positive profit alert, with 2024 net profit growth of 50% YoY. **Sunny Optical** also reported strong preliminary results, with net profits surging on intelligent driving penetration.

In **Taiwan**, **TSMC** is considering building an advanced packaging plant in the US. Washington had previously asked **TSMC** to send engineers to **Intel** fabs to help its foundry business and invest in a joint venture.

In **Korea**, the opposition party proposed an extra budget worth $21bn to prop up an economy strained by political uncertainties and tariff threats.

In **India**, CPI fell sharply to 4.31% in January from 5.22% in December on slowing food price inflation. Industrial output growth dropped to a four-month low of 3.2% in December. Narendra Modi and Donald Trump agreed to negotiate a trade deal and finalise a new defence framework during the Indian prime minister's visit to the US. BJP pulled off a victory in Delhi in a sign of Modi's continuing popularity. **Eicher Motors** posted an EBITDA miss on lower core brand margins despite an improvement in volumes. **Apollo Hospital**'s quarterly results also marginally missed expectations, despite their capacity scale-up remaining on track.

In **Indonesia**, **Apple** suppliers are taking steps to make iPhones in the country.

In **Brazil**, December's broad retail sales shrank 1.1% MoM, dragged down by construction inputs and apparel. **Suzano**'s fourth-quarter results beat analysts' estimates.

In **Mexico**, December's industrial production declined 2.5% YoY. Weakness was broad-based across components with construction, mining and manufacturing posting declines.

In **Argentina**, CPI for January came in at 2.2% MoM, or slightly below expectations. The annual print was down to 84.5%, from 117.8% in December.

CORPORATE DEBT

CREDIT

Interest rate volatility continued after US inflation came in higher than expected, pushing back rate cut expectations, and Washington announced customs tariffs.

Credit markets performed well due to hopes for a ceasefire in Ukraine. The Xover tightened by 12bp over the period and cash spreads also narrowed. Spread assets outperformed, with Euro high yield returning 0.21% and Euro AT1 bonds 0.18%.

Appetite for new issues stayed strong with oversubscribed new deals and issue premiums close to zero, and even sometimes negative. **Barry Callebaut**, for example, issued a 3 and 6.5-year bond which saw its yields tighten by 20bp in subsequent trading.

Among financials, **Société Générale** and **BNP Paribas** sold Tier 2 debt and **Crédit Agricole** issued a euro-denominated AT1 at 5.875% with a 10-year call. The deal reflected investor interest in duration.

In high yield, Italy's facility management group **Rekeep** (B3/B) raised €360m at 9% to refinance its 2026 bonds. The issue was a big success and gained 2 points on the secondary market. Elsewhere in the high yield bracket, **Celanese** was downgraded from Baa3 to Ba1 with a negative outlook.

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.

• 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.

• AT1s belong to a family of bank capital securities known as contingent convertibles or "Cocos". Convertible because they can be converted from bonds to shares (or depreciated entirely) and contingent because this conversion only occurs if certain conditions are met, such as the issuing bank's capital strength falling below a predetermined trigger level.

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EDMOND DE ROTHSCHILD ASSET MANAGEMENT (FRANCE)

47, rue du Faubourg Saint-Honoré 75401 Paris Cedex 08

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332.652.536 R.C.S. Paris