



EDMOND DE ROTHSCHILD ASSET MANAGEMENT

MARKET FLASH: TENSION ESCALATED IN ANOTHER WEEK DOMINATED BY THE MIDDLE EAST CONFLICT

- **The week was dominated by escalating tensions between the United States and Iran over the Strait of Hormuz, followed by a relative lull with the postponement of the US ultimatum.**
- **Negotiations with Iran remain highly complicated, as Tehran's demands are largely incompatible with those of the United States and Israel, despite indirect contacts via intermediaries.**
- **Several central banks have adopted a more hawkish tone in response to inflationary fears linked to rising energy prices, particularly the ECB, which now expects more than three rate hikes by the end of 2026.**

Tension escalated in another week dominated by the Middle East conflict. The US issued an ultimatum for Monday morning that Iran's energy infrastructure would be attacked if the Strait of Hormuz remained closed. Tehran refused to move and Donald Trump rapidly postponed the threat for 5 days, claiming that talks had resumed with Iran. Risk assets immediately rebounded and oil prices tanked. Investors wanted to believe things were improving after a few tankers were allowed through and Iran said boats from "friendly countries" were authorised. Tehran flatly denied that talks with the US were going on but it would seem indirect contacts have been made through countries like Pakistan. The US announced a 15-point peace plan and Iran a 5-point proposition. Tehran insists on (i) a total end to air strikes, (ii) guarantees that the war will not resume, (iii) payment for all damage to installations and interests, (iv) the end to all conflicts connected with Iran, including in Lebanon and (v) recognition of Iran's sovereignty in the Strait of Hormuz. The negotiations are complicated as all these points clash with US and Israeli demands.

In this environment, economic data was naturally less in focus. Advanced indicators showed that concerns were turning into fact: composite PMI in the eurozone and the UK fell more than expected, largely because of services. It was the same trend in the US but was not as pronounced. In addition, comments from central bank officials turned more hawkish due to worries that the conflict would fuel serious inflation, starting with energy prices. Statements from ECB chair Christine Lagarde sent interest rates higher. Investors are now expecting more than three rate hikes from the ECB this year.

Given today's volatility, we believe that the underlying state of the global economy is still relatively resilient and we note that Iran and the US are in contact, even if the exchanges are indirect. We are still keen to buy when risk assets suffer big falls and we have raised our credit rating to neutral/slightly positive as the recession scenario has not yet reached our warning threshold.

EUROPEAN EQUITIES

Trading was particularly volatile over the week. Markets rebounded and then fell back as geopolitical events played out. As the Iran conflict got bogged down, Ukraine's president Volodymyr Zelenskyy made a visit to the Middle East and offered his country's anti-drone expertise in exchange for more aid in defending his country against Russian attacks. Mounting tension rekindled energy and commodity worries. **Shell's** CEO said there was a risk of fuel running short from April. Jet fuel has already doubled in price since the war began. Elsewhere, Europe's manufacturing PMI came in above estimates in France, Germany and the UK but services fell short. A surprising lift to investor sentiment came from France's debt to GDP in 2025 which was announced at 5.1%, or less than the 5.4% expected.

In a busy week for company news, **AstraZeneca** announced positive Phase 3 results for its treatment for smoker's cough and chronic obstructive pulmonary disease (COPD) and **Novartis** reinforced its allergy treatment pipeline by acquiring **Excellergy** for CHF 1.6bn. In consumer goods, first-quarter sales at **H&M** were lower than expected but gross margins remained robust. **Asmodee** pursued its growth strategy by buying **ATM Gaming** for €180m. **Pernod Ricard** confirmed that it was in preliminary talks with **Brown-Forman** for a merger of equals. In defence, **Rheinmetall** is reportedly thinking of bidding for **EM&E** after the failed merger with **Indra**. **Volkswagen** is said to be in discussions with **Rafael Advanced Defence Systems** to convert a car plant into a factory making anti-missile defence systems. In other news, Italy's antitrust body is investigating **Edenred** for alleged abuse of a dominant position. Results for 2025 at **Jungheinrich** missed expectations but margin guidance for this year was higher than consensus. **Eiffage** increased its Getlink stake to 29.4%. **Veolia** acquired Australia's **Enviropacific** (PFAS treatment), significantly reinforcing its position in the soil remediation market. The rumoured **Kone-TK Elevator** merger could be subject to antitrust risks. In the semiconductor segment, **ASML** fuelled speculation that it might be moving into Hybrid Bonding and Advanced Packaging, thereby reviving consolidation rumours with **BESI**.

US EQUITIES

Wall Street had yet another choppy week as traders grappled with the ongoing oil shock, no clear signs of any de-escalation in the Middle East and the Fed's more restrictive tone. Over the week, the S&P 500 lost 0.45% and the Nasdaq Composite 1.11% but the Russell 2000 jumped 2.25% as small caps rebounded sharply.

The Middle East war remained centre stage. The US continued to deploy troops in the region. Indices sank on "troops on the ground" fears but then Donald Trump postponed his plan to strike Iran's energy infrastructure by 10 days. WTI oil prices yoayed, slumping 10% on Monday to \$88.8 \$, rebounding by more than 4% on Tuesday to \$91.9 and then moving higher to \$94.2 on Thursday.

The Fed's message is that inflation is proving difficult to tame amid robust economic growth. Austan Goolsbee (Chicago Fed) said that energy prices meant he was now more worried about inflation than jobs. But for Stephen Miran, the scenario of several rate cuts this year was still in play and he said that for the moment overreacting to short term oil shocks would be misguided. This week's data were mixed. Construction spending was softer than expected and productivity was revised down but wages and import/export prices rose sharply, fuelling the debate over possible stagflation.

In returns over the week, materials (+4.52%) and energy (+4.28%) led gains. Both segments are riding on higher oil prices and expectations prices will rise for a broad range of commodities due to geopolitical tension and supply constraints. Groups like **Dow** will be able to pass on costs while North American producers like **Chevron** and **ConocoPhillips** should see cash flow increase with a protracted rise in oil prices and despite strong intraday volatility. Utilities (+2.31%) performed well thanks to the segment's safe haven status amid surging volatility and geopolitical worries.

Consumer discretionary (+1.18%) and consumer staples (+0.46%) also advanced but with significant dispersion. Consumer discretionary plays like **Chewy** rose on upbeat figures and guidance while more cyclical stocks exposed to household spending like **MillerKnoll** are seeing more hesitant demand. Among consumer staples, **Brown-Forman** gained on speculation that **Pernod Ricard** might be mulling a bid. **Estée Lauder** fell back on concerns over short-term value creation after confirmation that the group was in talks with **Puig**, Healthcare (+0.71%) saw strong dispersion, especially in biotech. **Sarepta Therapeutics** and **Apogee Therapeutics** surged on positive clinical trial results while **Maze Therapeutics** and **Wave Life Sciences** tumbled after reporting disappointing results.

Information Technology (-1.47%) and Communication (-5.04%) weighed heavily on the Nasdaq due to rising interest rates and tougher regulation. And in what is becoming a "big tobacco" narrative, **Meta** and **Alphabet** are being targeted by lawsuits over children being addicted to social media. What's more, popular memory stocks like **Micron** were hit by profit taking after Alphabet unveiled the TurboQuant algorithm which supposedly reduces AI model memory requirements.

EMERGING MARKETS

The MSCI EM was down 0.97% in USD as of Thursday's close. Mexico, Brazil and India gained 5.40%, 4.57% and 0.60% while Korea, China and Taiwan shed 6.63%, 1.65% and 0.16%.

In **China**, industrial enterprises saw profits jump 15.2% YoY in January-February, the fastest start to any year since 2018. President Trump will travel to China on May 14-15 for a summit with President Xi Jinping, following a delay due to the Iran conflict. Fourth-quarter revenue at **Xiaomi** rose 7.3% YoY, just edging past estimates, but profit fell 27% as rising memory chip costs pressured smartphone margins. **Kuaishou's** fourth-quarter revenue was up 12% YoY beating estimates, with adjusted net income up 16%, but the group gave weak 2026 guidance forecasting only 4% revenue growth and a 15-18% profit decline amid higher AI capital expenditure. Fourth-quarter revenue at **PDD Holdings** rose 12% YoY, or in line with estimates, but net income fell 11% as the company invested heavily in supply chain improvements amid the end of the US "de minimis" tax exemption.

Taiwan's February industrial output rose 17.83% YoY, beating the 15% estimate. A US envoy urged lawmakers to "quickly" approve a defence spending bill to boost expenditure to 5% of GDP. **Grab Holdings** agreed to buy **Delivery Hero's Foodpanda** Taiwan operations for \$600m. **Nanya** raised \$2.46bn in private placements in **Sandisk**, **Solidigm**, a unit of South Korea's **SK Hynix**, Japan's **Kioxia Corp.**, and **Cisco Systems**. Under a multi-year DRAM supply agreement, Nanya is expected to secure stable long-term demand from AI and funding for investment in factory facilities and equipment for advanced memory production.

In **South Korea**, March 1-20 exports jumped 50.4% YoY on robust chip demand. **SK Hynix** plans to purchase approximately \$8bn-worth of extreme ultraviolet (EUV) equipment from **ASML**

up to 2027 for next-generation memory production. **Trendforce** reported that **Samsung** had delayed its 1.4nm process by 2 years, preferring instead to concentrate on improving yields on its 2nm node that is currently being ramped up.

In **India**, PM Modi said the country had sufficient energy supplies to meet domestic demand. The government cut excise duty on petrol and diesel, absorbing the fiscal burden rather than passing the full oil price impact onto consumers. Japan committed \$1.7bn in loans for metro rail projects in Bengaluru and Mumbai, a horticulture program in Punjab, and health sector initiatives. **OpenAI** hired Kiran Mani, CEO of Indian streaming platform **JioStar**, as managing director for the Asia-Pacific zone.

In **Brazil**, mid-March IPCA-15 rose 0.44% MoM vs. the 0.29% estimate. The government is studying a R\$15bn credit line for Sovereign Brazil 2 and a package against the effects of the war. President Lula signed a provisional measure offering \$2.9bn in loans to help companies cope with impacts caused by geopolitical factors. **Finnair** chose Brazilian plane maker Embraer over **Airbus** to renew its short-haul European fleet. **Mercado Libre** announced its Brazil 2026 plan with R\$57bn of investment, up 50% YoY ex-FX.

In **Mexico**, first-half March bi-weekly CPI rose 0.62% vs. 0.35% estimated, pushing annual inflation to 4.63% from 4.13%. Banxico cut its key rate by 25bp to 6.75% in a split 3-2 decision, signalling concern over a weakening economy despite rising inflation. The American Society recognized the possibility that the USMCA will become a bilateral pact between the US and Mexico. **Nestlé México** will invest \$180m to build a distribution centre in Estado de México

In **Chile**, the government surprised the market by decreeing an unprecedented jump in oil prices, essentially closing the gap between international and domestic oil prices

In **Argentina**, the central bank announced a reserve requirement reduction (5%). INDEC's monthly activity index (EMAE) showed a 0.4% MoM s.a. increase in January, rising for the second consecutive month after December's 1.8% increase. We expect activity to increase by around 4% in 2026. Even so, the recovery will remain uneven across sectors, favoring agriculture, extractive industries, financial intermediation, and construction over retail and manufacturing.

CORPORATE DEBT

Trading was highly volatile amid generally risk-off sentiment. Oil prices rebounded because of the Iran conflict, even if there were a few technical rebounds during fleeting bouts of optimism, European government bond yields rose on mounting expectations the ECB would raise rates and credit spreads widened, particularly among cyclicals and energy-sensitive sectors.

European bond rates jumped overall as news on the Iran conflict fuelled volatility. Germany's 10-year Bund stabilised above 3% with rapid price moves in both directions before yields eventually opted for an upward bias towards 3.05-3.10%. The euro curve tended to flatten during stress phases despite some technical steepening moves among 2-5 year maturities.

The Xover was at 360bp on Friday morning after swinging between 330 and 370bp over the week as risk aversion rose. Cash spreads widened overall with pressure focused on subordinated financial debt like T2 and AT1 bonds and hybrid debt. At moments of stress, we saw price drops of between 0.5 to 1 on hybrid and AT1 debt.

The Euro IG index suffered from interest rate moves, ending the period between March 20 - 26 down 0.11% and taking YTD falls to 1.05%. High yield edged 0.05% lower (-1.33% YTD).

In high yield new issuance, **Electronic Arts** (BB/Ba3) raised the equivalent of \$8bn in several €/€ tranches to fund an LBO fro an investor consortium led by Saudi Arabia.

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.
- CTA: quantitative strategy which uses futures to invest in a wide range of financial assets, including equity indices, short-term and long-term interest rates, currencies, and commodities.
- 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.
- RT1s: perpetual bond issues with early redemption possible after 10 years. Coupon payments are discretionary and non-cumulative.

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