EDMOND DE ROTHSCHILD

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MARKET FLASH: TRADE WAR ESCALATION WEIGHS ON MARKETS

- **Volatility surged this week, resulting in a further decline in US equities.**
- **Eurozone equity markets retreated on the back of uncertainties linked to negotiations in Germany on tax reform and the easing of the debt brake.**
- **Long-term European yields continued to climb amid expectations of larger budget deficits, whereas US yields remained stable.**

Volatility rose on markets and indices fell as US equities retreated. And yet US economic data seemed reassuring as the labour market stayed strong. New job openings rose in January, weekly jobless claims fell and real wages were up by an annualised 1.2% in February. In addition, inflation and producer prices in February came in lower than expected. The CPI was up 0.2% over a month, or less than the 0.3% expected, and down on the 0.5% seen in January. The PPI was stable in February when it was seen rising 0.3%. That said, closer scrutiny suggests the picture is a little less encouraging: some goods increased in price when some services were down. Airline ticket prices in particular reflected some consumer softness.

At any rate, the figures failed to boost US risk assets; they were hit by Donald Trump and his administration proclaiming that equity market shifts were not a priority and that the US economy was perfectly capable of weathering some turbulence before recovering. The White House says the objectives for the new president are longer term.

Meanwhile, the trade war intensified with heated exchanges between the US and Canada and Washington's threat to impose 200% tariffs on European spirits. The compromise on Europe's steel and aluminium exports to the US ended on March 12 so 25% tariffs were reinstated. This reaction was due to Europe's decision to riposte in April. Nevertheless, European countries are still open to talks.

Negotiations are also going on in Germany before votes in the Bundestag and Bundesrat next week over fiscal proposals and moves to ease the debt brake. These discussions have also weighed on eurozone equities in the last few days.

And government bonds have not provided a safe haven. Government bond yields continued to rise in Europe as traders eyed increased budget deficits while US Treasury yields stabilised. However, the yield curve steepened as short rates factored in likely rate cuts to come. Nor did any currency prove defensive as both the dollar and the yen traded flat.

Against this backdrop, we have a cautious strategic vision on risk assets due to the worsening political environment in the US. But since the middle of February, equities have fallen sharply, particularly in the US, and we have taken profits on tactical sales made earlier. Given the prospects for increased budget spending in the eurozone, we are neutral on duration and continue to prefer carry strategies.

EUROPEAN EQUITIES

Europe's stock markets ended the period 2% lower. The plan unveiled by Berlin last week ran into opposition from the Greens who want it to take their demands into account. Germany's constitutional court will have to approve the changes to the country's debt brake. The new chancellor, Friedrich Merz is, however, confident the plan will go ahead. Meanwhile, industrial production in the eurozone rose 0.8% MoM in January, or more than the 0.6% progression expected by economists. The improvement was a marked contrast with the drop seen in December.

As for consumption, several companies said they were seeing a slowdown in various regions. **Puma**, for example, said consumers were spending less in the US and China, a trend the company expects to persist in coming quarters. **Porsche** also referred to a slowdown in China and revised guidance lower on margins for this year. **Zara**'s parent company **Inditex** also observed a slowdown in US sales.

However, ultra-premium brands seem to be immune. Italy's **Brunello Cucinelli** sees no slowdown and is still enjoying strong growth in every geographical region. Other luxury sector news concerned **LVMH** where CEO Bernard Arnault plans to stay until he is 85, or another 9 years; the resolution will be put to the AGM in April. **Kering** said **Balenciaga**'s artistic director Demna would now head up **Gucci** and the stock plunged more than 10% at Friday's opening. Investors see this appointment as controversial after the fuss over an inappropriate Balenciaga advertising campaign in 2021.

Elsewhere, European defence plays continued to perform well as geopolitical tensions mounted. German defence group **Rheinmetall** plans to use **Volkswagen** factories to make armoured cars as its existing facilities are not suitable. Volkswagen's CEO said the group was ready to advise other European companies wishing to adapt their sites to produce military vehicles. If this project materialises, it will showcase the problems facing Europe's auto makers as they confront increasingly tough competition from China.

US EQUITIES

Wall Street fell sharply over the period. The S&P 500 tumbled 3.7%, the Nasdaq 4.2% and the Russell 2000 3.5 %.

Uncertainty ballooned as Washington rolled out aggressive import tariffs and the economic environment suffered. The CPI came in at 0.8%, or less than the 2.9% expected, but consumer confidence tanked. The mood was reflected in consumer staple plays like **Costco** (-13.2%) and **Walmart** (-10.7%). **Delta Air Lines** (-20%) reported a steep fall in its order book with management blaming worsening consumer confidence.

Consumer discretionary was also affected by this slowdown and the decline was aggravated by persistent inflation, leading to margin compression. Sports equipment plays were also hit, with **Nike** down 6.5% and **Dick's** 13.1% lower. **Kohl's** plunged 26.9%. **Tesla** fell 8.6% as sales in Europe declined.

In tech, investors punished **Apple** (-10.9%) due to a delay in its AI integration. In contrast, semiconductors stocks rallied, feeding on last week's upbeat figures from Broadcom. **Intel** jumped 14.2% after Lip Bu Tan was appointed as CEO.

Despite a bad week on Wall Street, the energy sector rose 1.4% and utilities ended the period 1.9% better.

EMERGING MARKETS

The MSCI EM index was down by 1.94% as of Thursday. Korea gained 0.5%. Brazil, Mexico and India outperformed, down 0.43%, 0.61% and 0.88% respectively. Taiwan and China retracted by 3.57% and 2.94%. By outperforming the MSCI World index, emerging markets have proved resilient to Donald Trump's tariff plans and concerns over a US slowdown.

In **China**, February CPI declined 0.7% YoY compared to a 0.5% rise in January. PPI in February was also down 2.2% YoY vs. a decline of 2.3% in January. Core CPI reflected deflation for the first time in 4 years, mainly due to the staggered shift of the Spring Festival. February's M2 money supply rose 7% as expected. New bank lending totalled ¥6.14 trillion, year to date, but fell short of the ¥6.37 trillion seen in the same period in 2024. Excavators had a strong month with February domestic sales up 100% YoY. Retail sales of passenger NEVs in February were up almost 80% YoY, or better than expected, but down 7.8% from January. Several provinces introduced child benefits after the NHC said it was drafting new birth subsidy plans. **BYD** launched a 1000V ultrahigh voltage fast charging unit. **Li Auto**'s fourth-quarter results missed market expectations with a drop in profits despite record revenues. **Huawei** will be trialling a EUV machine in Q3-25 with mass production in 2026.

In **Taiwan**, **TSMC** revenue climbed 39% YoY in the first two months. TSMC pitched to US chip designers **Nvidia**, **AMD** and **Broadcom** about taking stakes in a joint venture that would operate Intel's factories. The government started anti-dumping probes into beer and certain steel products from China. **Uber** terminated its deal to acquire **Delivery Hero SE**'s **Foodpanda** business.

In **Korea**, unemployment in February was 2.7%, or less than the 3% expected. The regulator introduced new measures to boost foreign currency inflows, including raising hedging limits for FX derivatives and allowing domestic institutions to buy foreign currency-denominated bonds. The trade minister will meet US counterparts in Washington for trade negotiations.

In **India**, industrial production for January grew 5% YoY, or ahead of the 3.5% expected. February headline inflation declined to a seven-month low of 3.6% YoY, or more than the 4% expected, driven by a sharp decline in food inflation. **Sunpharma** is to acquire **Checkpoint Therapeutics**. **Airtel** announced an agreement with **SpaceX** to bring Starlink's internet to its customers in India. **IIB** highlighted some discrepancies in derivative book accounting, with a 2.35% impact on net worth. **Thermax** formed a joint venture with Brazil's **OCQ** to manufacture specialty chemicals in India.

In **Mexico**, industrial production in January declined 2.9% YoY, or more than the 1.7% drop expected. Nominal wages grew 7.8% in February. Economy minister Marcelo Ebrard will be travelling to Washington to discuss tariffs. **MercadoLibre** will be investing a record $3.4bn in Mexico this year to develop its logistics capacity.

In **Brazil**, industrial production in January grew 1.4%, or less than the 2.3% expected. February's IPCA inflation came in as expected at 1.31% MoM. The government will maintain its target of generating a primary surplus of 0.25% of gross domestic product, excluding interest payments, when it sends its 2026 budget guidelines proposal to Congress next month.

CORPORATE DEBT

CREDIT

Despite volatile markets and a rash of contradictory announcements, government bond yields were relatively stable at 4.29% for 10-year US Treasuries and 2.92% for the equivalent German Bund. Risk assets, however, had a trying week with the S&P 500 down 1.39% and the Dax 0.32% lower. EUR credit spreads had held up as yields rose but this week saw profit taking. Compared to March 7, EUR IG spreads rose 6bp, EUR HY 21bp, Corporate hybrids 11bp and CoCos 18bp. With the exception of corporate hybrids, USD spreads underperformed, with IG spreads widening by 8bp and HY by 43bp. Derivatives finally started to outperform cash bonds with the Main up 3bp and the Xover up 17bp. Despite the volatility, new issuance continued. Even property companies like **British Land** and **Alstria** sold new bonds. There were also financial subordinated deals (**Mediobanca** T2, **ACafp** RT1, **ACAFP** T2, **BCPPL** T2, **BKIR** AT1, **RCI** T2). Issue premiums returned.

Fixed income is still proving resilient as its defensive status returns but traders will be watching for any sign of stagflation.

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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