EDMOND DE ROTHSCHILD ASSET MANAGEMENT

MARKET FLASH: POOR VISIBILITY IS STARTING TO WEIGH ON THE US ECONOMY...AND ENCOURAGING THE FED'S WAIT-AND-SEE APPROACH.

- **Donald Trump ended up abandoning his threat to raise EU tariffs to 50% in June and instead returned to talks on an agreement by July 9, the same date the White House expects to see other agreements reached.**
- **European inflation came in at 1.9% in May, or below the ECB's target so the bank was able to make a fresh 25bp cut this month.**
- **In Asia, activity is weakening, with Caixin manufacturing PMI, an indication of momentum among export SMEs and private sector companies, moving into contraction territory.**

Market trends are still being dictated by ups and downs stemming from Donald Trump's tariff policy. On May 28, the Court of International Trade in the US suspended reciprocal tariffs but they were reinstated temporarily on appeal the day after with the White House claiming it had grounds for a real appeal. Then, on May 30 the administration doubled extra tariffs on steel and aluminium from 25% to 50%. The European Union said it would announce reprisals on July 14.

At the same time, Donald Trump ended up abandoning his threat to raise EU tariffs to 50% in June and instead returned to talks on an agreement by July 9, the same date the White House expects to see other agreements reached. Meanwhile, the US seems to be willing to continue talks with Beijing despite accusing China of not respecting the end-of-May agreements on deliveries of critical minerals. The fact is that anti-China restrictions caused some companies to sound the alarm of possible production stoppages.

These twists and turns are typical in a long-term negotiation with nearer-term deadlines. Trade talks are weighing on US Treasury yields whereas their result is tied in with financing the budget with Republican senators reluctant to approve Donald Trump's budget proposal on a lack of financing.

Elsewhere, the decision by OPEC + to extend production increases at 411,000 b/d in July has kept prices and inflation low. But the decision was not unanimous so there is less likelihood it will be extended in August.

The Fed is still cautious. Mary Daly at the San Francisco Fed said the coming months were still uncertain even if inflation seems to be running at an annualised 2.5%. Tariffs have not yet appeared in the statistics as companies have relied on inventory. Moreover, consumer confidence improved to 98 in May, or much more than the 87.1 expected, despite the Conference Board saying consumers are still worried about prices and inflation expectations are running at 6.5% over a year. On the other hand, new orders, ex defence and aerospace, fell 1.3%, or more than the 0.1% drop expected. Business seems to be suffering in this

environment. Manufacturing ISM fell to 48.5% in May from 48.7 and Services ISM dropped to 49.9 from 51.6. Companies have slashed imports with ISM tumbling from 47.1 in April to 39.9 and the Dallas Fed surveys show that 50% of companies plan to pass on tariff rises to end consumers. The jobs market is mixed: the ADP survey showed that private sector job creations in May amounted to only 37,000, or significantly less than the 114,000 expected, but JOLTS data said unfilled job offers had risen in April.

In Europe, the ECB is enjoying better visibility on inflation. Wages rose 2.4% in the first quarter compared to +4.1% in the last quarter of 2024, helping services inflation to rise by an annualised 2.1% in May vs. +2.4% in April. European inflation came in at 1.9% in May, or below the ECB's target so the bank was able to make a fresh 25bp cut this month. Even so, the ECB's tone was more restrictive than expected. The bank highlighted a lack of visibility and said there were various scenarios depending on ongoing trade talks. A pause in rate cuts was a possibility at the next meeting.

In Asia, Caixin manufacturing PMI, an indication of momentum among export SMEs and private sector companies, fell from 50.4 in April to 48.3 in May. In Japan, 30-year government bond yields rose above 3% amid worries over debt sustainability. But real rates are still low which limits the risk and helps monetary policy stay accommodating.

Given today's demanding valuations, we remain cautious on equities and prefer investment grade corporate debt. We are still negative on the dollar.

EUROPEAN EQUITIES

Political uncertainty, with a slight glimmer of optimism, persisted in the US due to trade tensions and budget wrangling in the Senate. The mood was darkened further by additional tariffs on steel and aluminium imports while the economic slowdown was reflected in manufacturing ISM and a drop in the ADP survey of private sector job creations. A phone conversation between Xi Jinping and Donald Trump provided some relief with talk of imminent trade discussions but markets remained under pressure.

In Europe, the ECB cut rates as expected since total inflation had fallen below the bank's targets. Nevertheless, government bond yields rebounded after Christine Lagarde's press conference comments which were seen as restrictive even if she promised to remain sensitive to economic and trade developments. Prevailing uncertainty meant defensives like healthcare outperformed over the week while cyclicals like consumer discretionary and autos underperformed.

In company news, EQT Transition Infrastructure plans to acquire 54.1% (69.5% of the voting rights) of **Waga Energy** with a €21.55 bid, a 27% premium. The offer could be raised depending on how US tax credits are monetised. Elsewhere, **BioMérieux** launched VETFIRE, a PCR kit that can detect respiratory diseases in horses. **Wavestone's** results were in line. Margins came in at 12.6% with robust cash generation. Management reaffirmed like-for-like growth guidance and said profitability in 2025/26 would be higher than expected by the consensus. As for **GTT** (containment systems), GNL demand provides total visibility up to 2030 even without a significant replacement market. **EssilorLuxottica** is to acquire one of Malaysia's largest opticians with 90 shops under the A-Look, Seen and OWL brand names. The French group is already present in Malaysia's wholesale and retail market. French software group **Dassault Systèmes** is holding its Capital Markets Day today June 6 and has already said it has put back its medium term profit target. The change has already been mostly factored in by markets.

In M&A, **Sanofi** has acquired Blueprint Medicines, a deal which will consolidate its specialisation strategy in immunity and inflammation (I&I) and strengthen its immunology pipeline in systemic mastocytosis (SM), a rare immunological disease, and other KIT-driven diseases,

US EQUITIES

Wall Street ended the period higher with the S&P 500 up 0.5%, the Nasdaq 1% higher and the Russell 2000 1.5% better.

The dollar slid 0.9% against the euro in highly volatile trading.

Tech was in favour as demand for AI chips continued to rise. Chip-maker **Broadcom** (+7.4%) reported upbeat quarterly results which showed strong AI chip demand had offset the impact of the tariff war with only a limited impact on the group's business. **Nvidia** (+3.6%) was also on form and **Meta** jumped 5.7% after unveiling plans to develop AI-generated ads, a segment which makes up 97% of its revenues.

In contrast, consumer discretionary lost ground. **Ford** (-2.7 %) and **General Motors** (-4.5%) were hit after the Trump administration raised customs tariffs on steel and aluminium to 50%. US car companies are also facing a possible shortage of rare-earth magnets and continue to suffer from China's domination of the components market.

In consumer staples, food company **Campbell** (+0,2%) reported mixed figures with a sharp drop in snack sales. The group said tariffs and consumer worries over budgets and revenues were responsible. **Procter & Gamble** (-4.2%) said it would be laying off 7,000 people in the next two years, or 15% of its non-manufacturing personnel. On a brighter note, retailer **Dollar General** (+17%) had an excellent first quarter and revised up full-year guidance. However, management warned that consumers were being hit by higher prices due to tariffs.

This week's gainers were energy (+0.2%), healthcare (+0.3%), materials (+1.4%) and communication services (+1,3 %) while financials slipped 0.5% and utilities ended 1.4% lower.

EMERGING MARKETS

The MSCI EM index had risen 2.25% in USD this week as of Thursday's close. South Korea (+6.93%) led gains. China, Taiwan, Brazil and Mexico were up by 2.88%, 1.90%,1.68% and 0.97%. India was flat.

In **China**, May official manufacturing PMI ticked up to 49.5, led by front-loaded production and shipments to the US, while Caixin manufacturing PMI surprised on the downside, coming in at 48.3 vs. consensus estimates of 50.7. Caixin services PMI was 51.1, or in line with expectations. Donald Trump and Xi agreed to further trade talks to resolve disputes over tariffs and rare earth minerals. Beijing pledged to accelerate innovation and application of AI and mentioned fiscal stimulus for the sector. The government launched the "NEV going to the countryside" campaign to support car demand. Macau May GGR came in at 5% YoY, or higher than the April print of 1.7% YoY. **Ping An Insurance** is seeking to raise $1.5bn with a zero-coupon CB. **Nio**'s first quarter missed after lower GPM and higher OPEX

In **Taiwan**, **TSMC** maintained its 2025 sales growth outlook of mid-20% in USD. **IDC** revised down 2025 smartphone unit growth from 2.3% to 0.6% and increased PC unit growth from 3.7% to 4.5%.

In **Korea**, exports in May declined 1.3% vs. expectations of a 2.4% drop while imports fell 5.3% or more than the 1.8% fall expected. Jae Myung Lee of the Democratic Party was elected president.

India's Reserve Bank cut interest rates by 50bp, or more than the 25bp expected, to 5.5% and reduced the cash reserve ratio for banks by 100bp to 3%. GDP growth for the first quarter came in at 7.4%, or above the 6.9% expected. Manufacturing PMI for May was 57.6 vs. 58.2 in April. Services PMI for May was 58.8 vs. 61.2 in April. The government lowered the import duty on palm oil from 20% to 10%. **Zydus Lifesciences** is set to acquire **Agenus Inc**.'s biologics manufacturing facilities in California, marking its entry into the global biologics CDMO sector. **Larsen & Toubro** secured significant orders from the Rajasthan government for water supply projects.

In **Brazil**, GDP growth for the first quarter came in at 2.9% YoY, or below the 3.1% expected. Manufacturing PMI May was 49.4 vs. 50.3. Industrial production in April edged 0.3% lower vs. 0.4% expected. **TotalEnergies** raised its stake in Brazil's Lapa offshore field in an asset swap with **Shell.**

In **Mexico**, April unemployment was 2.55%, or in line with expectations. May manufacturing PMI was 46.7 vs. 44.8. The courts held their first ever elections to elect Supreme Court judges; the participation rate around 10%, or less than expected. Monthly data from the regulator (CNBV) as of April reflected loan growth of 11.6%, decelerating from March, although still showing double digit growth, despite 0% GDP growth. OMA said terminal passenger traffic rose 7% YoY in May (international passenger traffic was up 19%).

In **Argentina**, the IMF announced that they would postpone the first inspection of their reserves accumulation goal from June to July, as the central bank has not accumulated enough reserves.

CORPORATE DEBT

CREDIT

Credit markets are in "carry-on as before" mood. European IG returned 0.1% and HY 0.3% over the period, taking YTD gains to 1.7% and 2.6%, respectively.

As expected, the ECB cut its benchmark rate by 25bp to 2% while signalling a probable pause in cuts for the rest of the year. Markets, however, are still betting rates will fall to 1.67% by end December.

Inflows remained buoyant. JP Morgan noted $1bn in new money earmarked for IG (with the same focus on short duration) and $500m for HY. Favourable technical positioning is still solid.

In EUR, money market funds are yielding 2%, IG 3.1% and HY 5.2%, still very attractive yields compared to the last 10 years (80th percentile over the period).

The new issues market remained very busy, with an accent on auto makers as they rushed to refinance short maturities and boost cash ahead of a second half which looks like being just as complicated for the sector. There were deals from **Stellantis** (BBB 6Y €700m 3.875%; 10Y

€800m 4.625%), **Volvo** (BB+ €500m 4Y 4.20%), **ZF** (BB- €1.25bn 5Y 7%) and **Power Solutions** (BB- €800m 6Y 4.75%).

Elsewhere, the **Thames Water** soap opera in the UK continued and got even more bogged down. The group is saddled with close to £17bn in debt. Now, the KKR fund has finally withdrawn its £4bn recapitalisation offer. KKR's official reason is political instability but, unofficially, it thinks returns would be complicated given the amount of investments needed to get the company back to normal.

Good news for French satellite company **Eutelsat**. A €1.5bn increase of capital is being discussed, with the French government raising its stake from 17% to 30%. The consolidation of space divisions at **Airbus**, **Thales** and **Leonardo**, Eutelsat's recapitalisation and the IRIS² European satellite programme are all signs of very strong momentum in Europe's space business.

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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