



EDMOND DE ROTHSCHILD ASSET MANAGEMENT

MARKET FLASH: GEOPOLITICAL RISK HAS RETURNED CENTRE STAGE

- **Israel conducted an attack targeting nuclear sites in Iran, leading to tensions and threats of retaliation; however, the impact on financial markets has remained limited.**
- **Inflation figures in the United States are below expectations, aided by inventories that cushion the impact of import taxes.**
- **Markets are responding to geopolitical risk by adopting a cautious stance on American equities and maintaining neutrality on corporate credit.**

Israel launched an unprecedented attack on Iran on Friday morning. Air strikes targeted nuclear sites and also killed several military leaders. Benjamin Netanyahu said the attack was warranted as Iran's nuclear programme had made substantial progress and, according to some sources, was only weeks away from making atomic bombs. Tehran has already said it will retaliate in the coming days so the conflict could deepen and even lead to a regional flare-up. This eventuality cannot be ruled out for the moment but market reactions have so far been relatively limited. Investors no doubt hope that an escalation could once again be avoided as with past incidents between Iran and Israel. Crude Brent jumped on the news but stayed around \$74, a level which is hardly damaging for the global economy or likely to trigger a fresh wave of inflation.

We will have to wait to see how this geopolitical crisis plays out and its economic impact. In the meantime, consumer and producer inflation data in the US came in much lower than expected by most economists. It appears that companies had built up inventory in anticipation of tariff rises so they can spread out the extra costs. But this will not last and next week's retail sales figures could show us if consumer spending has cooled a little. On the jobs front, indicators continue to diverge. After ADP's disappointing job creation figures were countered by a more resilient monthly report, weekly jobless claims indicated a slightly faster deterioration than is normal for the season. The data led investors to factor in more rate cuts from the Fed, sending Treasury yields lower before geopolitical risk emerged, but we note that equity markets failed to make serious gains. And naturally equity markets fell after the Israeli raid on Iran.

In the UK, the economy is clearly faltering while overall inflation indicators are still reassuring so there is a possibility that the Bank of England might cut more than currently expected. The Chancellor of the Exchequer also reassured investors by promising to keep budget spending under control.

With the return of geopolitical risk, we continue to be cautious on equity markets and are still underweight the US. We are also staying neutral on bond duration and still prefer corporate debt. We are keeping a close watch on the US dollar as it is struggling to provide protection for portfolios, even when geopolitical risk is on the rise.

EUROPEAN EQUITIES

To start the week, markets were focused on US-China trade talks, and especially provisional access to rare earths and lower customs tariffs. But the results are still not clear and investors remain cautious. European stock markets toyed with resilience but eventually ended the period lower on Middle East tensions, leading to Israeli air strikes against Iran on Friday morning; Investors were also disappointed that no trade agreement had been reached with the EU. The US Secretary of Commerce said such an agreement would probably be one of the last to be signed.

In company news, **Inditex**'s disappointing quarterly sales sent the specialist retail sector lower. The Spanish group's results fell short of expectations, and management sounded a cautious note, citing a slow start to summertime sales and the impact of currency fluctuations. At the Vivatech show, **Novo Nordisk** announced two AI partnerships with exclusive global rights, one with **Nvidia** for R&D and the other with **Deep Apple** on weight-loss treatments. **Carrefour** has teamed up with **Vusion Group** to roll out EdgeSense technology. The French group is the first European food retailer to harness digitalised shelves with AI and smart rails systems. In spite of strong financial performance, **Edenred**'s stock price has halved since end-2023 on regulatory concerns over luncheon voucher commissions, particularly in Italy and possibly in Brazil.

In M&A, **Prysmian** finalised its acquisition of **Channell Commercial Corporation**, a specialist in connectivity and optical fibre solutions. The deal, which was first announced before the group's capital markets day in March, will reinforce **Prysmian** in optical fibre and 5G while underpinning datacentre growth.

US EQUITIES

Wall Street advanced and the S&P 500 gained 1.8%, the Nasdaq 1.9% and the Russell 2000 2.1%.

Once again, the dollar was highly volatile and slid 1.1 % against the euro to 1.16. Volatility was fuelled by moderate inflation data and attacks on the Fed chairman by the Trump administration.

Tech continued to ride on persistent chip demand for AI applications. **Nvidia** (+3.6%) signed more contracts in Europe, notably with Mistral AI and Perplexity to build more datacentres. **Micron Technology** (+9.3%) jumped after a decision to invest more than \$200bn in US chip production; 90,000 new jobs will be created. **Meta** (+1.3%) said it wants to acquire Scale AI to reinforce its AI presence. On the other hand, **Apple** once again pushed back the launch of its AI innovations.

Energy jumped 6% over the week due to tensions between Israel and Iran. Israeli raids on Iran's nuclear sites sent Crude Brent up to \$73. The trend benefited **Schlumberger** (+7.7%), **Baker Hughes** (+4%) and **Exxon Mobil** (+7.8%).

The consumer discretionary sector was lifted by a 12.1% rise in **Tesla** following a climb down in the Musk-Trump dispute. News that Tesla's much-expected robotaxi might be rolled out at the end of this month also helped the stock. **General Motors** (+4.6%) announced a \$4bn

investment to make more vehicles in the US. The move is intended to reduce the group's exposure to import duties. **Starbucks** (+8.4%) said it wants to reopen 10,000 coffee shops in the US that were closed after the pandemic.

All sectors ended the period higher, led by healthcare (+2.7%), communication (+1.3%) and materials (+0.9%).

EMERGING MARKETS

The MSCI EM index had advanced by 1.83% in USD this week as of Thursday. Taiwan, Korea, Brazil, China and Mexico advanced 5.31%, 3.90%, 2.15%, 1.53% and 0.92%, respectively. India declined by 0.27%.

In **China**, CPI for May fell 0.1% YoY, or better than the expectations for a 0.2% drop. May exports rose 4.8% YoY, or less than the 6% expected. Imports declined 3.4% YoY when they were seen 0.8% lower. May M2 money supply rose 7.9% YoY vs. the 8.1% estimated. Donald Trump and Xi Jinping held discussions focused on US-China trade relations, including issues related to rare earth supplies, tariffs, and economic cooperation. EV makers pledged to standardise payment periods below 60 days to alleviate concerns on supply chain financing. **Tencent Music** is to buy long-form audio platform **Ximalaya** for around \$2.5bn, partly in cash and partly with new shares. **CSPC** and **AstraZeneca** signed a \$5.33bn AI-led research deal for pre-clinical candidates for chronic conditions.

In **Taiwan**, May imports rose 25% YoY as expected. Exports were up 38.6% YoY, or ahead of the 23.3% expected as exports to the US soared 87.4% YoY. **TSMC's** May revenue surged 40% YoY.

In **South Korea**, May unemployment was 3.5% as expected. President Lee held phone calls with leaders from China, Japan and Vietnam in a bid to increase stability and cooperation in the region.

In **India**, May headline CPI inflation declined to a six-year low of 2.8% YoY, driven by a decline in food inflation also to a six-year low, vs. consensus of 3%. Indian and US negotiators made progress in their latest round of talks in New Delhi on a bilateral trade deal. National Securities Depository Limited plans to launch its initial public offering (IPO) in July, aiming to raise around \$400m. **Motherson** is preparing for the \$2bn acquisition of **Marelli's** holdings. **Tata Group** will now manage iPhone and MacBook repairs in India, expanding Tata's role in **Apple's** supply chain. **Mizuho Financial Group** is set to acquire KKR-backed **Avendus Capital** for \$700m; this is Mizuho's largest investment in India.

In **Brazil**, May inflation came in at 5.32%YoY, or slightly below the 5.39% expected. Retail sales for April rose 4.8% YoY, or ahead of expectations for 3.6%. The government proposed, through a Provisional Measure, an increase in the social contribution income tax (CSLL) for certain financial institutions. The proposed new higher rates of 15-20% (compared to the previous 9-15%) will affect payment institutions (IPs), consumer finance entities (SCFIs), and exchanges. This proposal is still subject to approval. The Strategic Bitcoin Reserve Bill passed the first committee stage.

In **Mexico**, May inflation was 4.42%, or in line with expectations. Industrial production for April contracted by 4% YoY, or worse than the 3.5% drop expected. **Heineken** is to invest \$2.75bn in Mexico.

In **Poland**, Prime Minister Donald Tusk won a vote of confidence.

CORPORATE DEBT

CREDIT

Credit markets continued on their rally to start the week but then on Thursday a lack of progress on US-China trade talks intervened, followed on Friday by Israeli air strikes on Iran's nuclear sites. The Main and Xover hit recent lows of 55bp and 288bp before widening to 58bp and 301bp when markets opened on Friday, June 13. Even so, risk aversion on Friday seemed relatively tame and inflows continued apace. And government bonds failed to benefit as is usually the case in a move to risk-off positions as higher oil prices carry the risk of higher inflation.

In news on financials, **BPCE** is to buy 75% of Lone Star's stake in **Novo Banco** (valued at €64bn for 100%). This is the first transborder deal in a while (BPCE is not present as a bank in Portugal).

In new issuance, **BNP** and **Generali** sold Tier 2 bonds. There were also deals from less frequent issuers: German insurance company **Barmenia-Gothaer** sold a Tier 2 bond in EUR at MS+250bp and **Malakoff-Humanis** (a specialist in supplementary pension plans) is set to issue Tier 2 debt at the end of the week.

There were also three corporate hybrid deals in 5 tranches. New paper is being easily absorbed but investors are becoming pickier over pricing. Order books are substantially thinner when issuers tighten coupon indications. **Orange** and **SSE**'s two tranches are good examples. In contrast, the order book for two tranches from RWE was more than €10bn.

In High Yield, tour operator **Edreams-Odigeo** raised €375m with a B+ bond at 4.875% due 2030. Finland's **Mehiläinen** (social and healthcare services), which is owned by the CVC and H&F funds, sold two 2032 maturities, one floating-rate bond (EUR 350m) at **Euribor** +3.375% and the other (€740m) at a fixed rate of 5.125%. The proceeds are to fund the acquisition of **Regina Maria** and **MediGroup**.

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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