



EDMOND DE ROTHSCHILD ASSET MANAGEMENT

MARKET FLASH - THE CYCLOPS EFFECT: MARKETS ARE TEMPTED TO VIEW EVENTS FROM ONE ANGLE ONLY

- **The rebound in risk assets following tensions in the Middle East is more a case of technical repositioning, rather than an improvement in fundamentals. It illustrates a market reflex that has become almost Pavlovian: automatically rush to buy on weakness.**
- **Behind the façade of market rebounds, the energy shock is still acute and now spreading to the most dependent economies, particularly in Europe and Asia. This disconnect between buoyant financial markets and the real economy is the main weakness today.**
- **Maintaining exposure to risk assets should not be a case of excessive optimism but simply recognition that the cycle is still in place. However, we need to be more vigilant and more selective, notably with more exposure to the US and China.**

In recent weeks, markets have gone back to a pattern that investors know only too well, swinging from overdone worries to sudden relief rallies. After a period of severe geopolitical tensions in the Middle East, the rebound in risk assets was more vigorous and faster than is usual. The fact that the surge occurred in just a few trading sessions suggests it was more a case of technical repositioning, as systematic investment funds covered shorts or corrected underexposure, rather than a fundamental reassessment.

This reaction reflects what is now entrenched behaviour on financial markets: they are capable of absorbing any shocks and then automatically rush to buy on weakness. Each phase, be it a pandemic, trade tensions or an energy crisis, has reinforced the belief that things will quickly return to normal. But today, this almost Pavlovian reaction tends to mask a much more complex reality.

Behind the façade of market rebounds, economic fundamentals have been gradually deteriorating. The energy shock is still acute and now spreading to the most dependent economies, particularly in Europe and Asia. The prolonged rise in gas and commodity prices will hit growth and company margins. This disconnect between buoyant financial markets and the real economy is the main weakness today. It is as if investors, like the Cyclops, see the world through a single prism with no regard to what is actually a very complex picture.

At the end of March, we chose to gradually upgrade our equity and corporate debt positions. We believed that the market had overdone the prolonged crisis scenario. While markets always have the ability to look beyond current crises, it would be just as rash to give into euphoria. The current rebound does not validate an optimistic scenario. Instead, it reflects a failure to appreciate that destruction of oil production capacity carries extreme risk. That is why equity volatility has fallen and why the market rally has persisted.

The global cycle is for the moment still on track but there has been a shift in how major economic zones are ranked. In relative terms, the US looks like the main beneficiary of the current situation. It enjoys energy independence and resilient domestic demand while investment in technology is still robust, notably in the artificial intelligence space. China, despite a structural slowdown, still has room to make serious adjustments thanks to its state-run regime and the fact that it is less exposed to the energy shock. Europe and Japan, on the other hand, are facing a number of problems: they depend on energy imports, suffer from budgetary constraints and have more limited monetary leeway. This is not a cyclical shift but a gradual reshuffle of winners and losers in a more fragmented world.

Looking ahead, we see three possible pitfalls. First, today's exceptionally serious energy shock could last some time. Price tensions will continue to drive inflation and eat into purchasing power as long as supply chains remain disrupted and adjustment capacity limited. Second, increasing leverage and financial fragility is another concern. With today's elevated interest rates, both public and private debt sustainability is more fragile. And any shock could be amplified by some private credit areas in the US. Third, sector concentration increases the risk of instability. Equity indices are increasingly dependent on a limited number of sectors like technology and artificial intelligence. This creates a situation where growth is unevenly spread, with the risk of a K-shaped economy as seen in recent quarterly results.

We need to stay invested but without being led astray by illusions. Markets look stable but this is largely a false impression, one that assumes that the shock is merely transitory and that central banks will continue to provide support. But in fact energy, budgetary and financial imbalances persist and are shifting.

Maintaining exposure to risk assets should not be a case of excessive optimism but simply recognition that the cycle is still in place. However, we need to be more vigilant and more selective, with more exposure to the US and China than to Europe and Japan. Credit is still a benchmark asset, whether investment grade, and particularly hybrid debt, or European and emerging country high yield bonds and subordinated financial debt.

EUROPEAN EQUITIES

Trading continued to be dominated by uncertainty in the Middle East conflict and by the earnings season. Hopes for geopolitical de-escalation were rapidly replaced by fears the conflict would get bogged down. Little progress was made in resuming talks, Washington's rhetoric became more aggressive and the blockade in the Strait of Hormuz continued. As a result, Brent crude rose above \$100. European gas became more expensive and rekindled inflation fears even if mounting economic constraints suggested there might be a gradual de-escalation rather than a total breakdown. April's PMI data in the eurozone missed expectations, particularly for services in Germany. This was due to increasing uncertainties for companies and inflationary pressures from the Middle East situation.

In company news, the earnings season got into full swing with some upbeat figures from luxury companies. **L'Oréal** had an excellent first quarter on a recovery in China and strong momentum in key divisions. **Moncler** reported strong sales thanks to the Asia zone. In agrifood, results at **Danone** and **Nestlé** were in line. Danone's specialised nutrition division was surprisingly upbeat with better-than-expected sales despite a recall campaign for a baby milk product.

AI and semiconductor stocks also performed well. **STMicroelectronics** confirmed that data centre chips were one of its key advantages. Results at **Dassault Systèmes** reassured the market and management said its AI development had moved into decisive large-scale industrialisation. **ASMI** announced a results beat and said it expected the trend to continue. **ABB** raised guidance after its first quarter results beat expectations on strong demand for data centre electrification products. Defence and aerospace continued to perform well as international tensions persisted. **Saab, Safran** and **Thales** reported strong operating momentum with vigorous growth in defence divisions. 2026 targets were reaffirmed even if Thales warned that supply chain constraints continued. In contrast, groups like **Reckitt** and **Heineken** gave more explicit details on the impact from the Middle East conflict. Results in the healthcare sector were more mixed: **Biomérieux** and **Roche** fell after missing expectations while **Sanofi's** upbeat figures were driven by Dupixent.

US EQUITIES

US equities edged lower after their recent rebound. The S&P 500 slipped 0.25%, the Nasdaq Composite 0.12% and the Russell 2000 0.06%.

Macroeconomic and monetary data remained generally favourable for risk assets. Retail sales came in much better than expected as consumption held up. Labour market statistics remained solid with no sign of a trend change. Pending home sales recovered despite elevated interest rates. PMI data were surprisingly upbeat. The rise in new manufacturing orders was the best since 2022 and services stayed in expansionary territory. The Fed is in blackout before its early May meeting. Fed chair nominee Kevin Warsh struck a cautious note at his Congress hearing and avoided predicting where future rate decisions would head.

Energy (+3.47%) dominated sector returns. The sector gained on higher oil prices but also from more upbeat comments from oil services companies like Halliburton and better capex visibility. **Patterson-UTI** confirmed that shale oil production had recovered. And demand for offshore drilling resumed especially for private operators. More rigs were in operation and there was a slight rise in day rates. Activity in the second half of 2026 is expected to rise. Tech and IT (+0.61%) outperformed as the AI/data centre theme returned in force. Semiconductors racked up a record-breaking run in session gains. Results at **Texas Instruments** reinforced the impression of robust demand in data centre and industrial segments. Software, however, ended the week more mixed with hefty profit taking after a strong rebound. **ServiceNow** plunged on its disappointing results while **Adobe** was saved by a big share buyback programme. Cybersecurity and digital identity stocks like **CrowdStrike** and **Okta** rose on persistently positive comments on AI. Industrials (+0.32%) gained as investors rotated into quality cyclicals. **United Rentals** surprised the market with its strong growth and margin outlook while groups like **Dover** benefited from improving instrumentation orders.

Several sectors performed less well. Healthcare lost 1.74% over the week but with large segment disparities. In insurers, results at **UnitedHealth** and **Molina Healthcare** were cheered by markets after medical ratios came in better than expected. Both reaffirmed guidance, underpinning the managed care theme. In precision medicine and medical devices, **Boston Scientific** and **Intuitive Surgical** reported strong figures on brisk momentum in procedures. But companies more exposed to tools, diagnostics and pharma weighed on the sector. **Thermo Fisher** fell on disappointing like-for-like growth in certain segments. Uncertainties on reimbursement, notably for obesity and GLP-1, reduced investor appetite for the sector as a whole. Financials shed 1.25% on some interest margin disappointments and

deposit trends in regional banks like **Zions** and **BankUnited**. There was also some unfavourable news on insurance groups like **Prudential**. Communication services (-1.64%) and consumer discretionary (-1.63%) fell due to a more volatile environment for platforms, media and cyclical consumption plays. **Meta** and **Snap** fell on cost and governance concerns. Moves in **Lululemon** and **Tesla** reflected increased investor sensitivity to growth expectations and strategic announcements. Consumer staples (+1.59%) held up well thanks to reassuring like-for-like growth and margins in companies like **Keurig Dr Pepper** and **Philip Morris** and by some moves into more defensive stocks.

EMERGING MARKETS

The MSCI EM index was up by 0.14% in USD this week as of Thursday's close. Korea and Taiwan were up by 3.48% and 3.21%. Mexico, India, Brazil and China were down by 2.63%, 2.14%, 2.02% and 1.85%

In **China**, the authorities kept the LPR unchanged as expected. Shanghai's GDP reached \$198.24bn in the first quarter, up 5.9% YoY. **DeepSeek** is in talks to raise at least \$300m at a valuation of at least \$10bn and rolled out preview versions of its V4 Flash and V4 Pro AI model. **New Oriental Education** reported net revenue up 20% year-on-year, or more than expected. **Naura Tach's** 2025 result missed expectations on weaker margins from the non-core business and higher R&D spend.

In **South Korea**, first-quarter GDP rose 3.6% YoY, significantly beating the estimate of 2.6%. **SK Hynix** reported a five-fold jump in first-quarter profit, reaching a record \$27.28bn or slightly above expectations.

In **Taiwan**, March export orders rose 66% year-on-year, the fastest growth since 2010, beating the estimates of 44%. The financial regulator is planning to ease the limit on how much funds can invest in a single stock: local equity funds and active exchange traded funds will be able to hold up to 25% of their net assets in any listed company whose weighting exceeds 10% in the Taiwan Stock Exchange.

In **India**, March key industry output fell 0.4% YoY vs. the previous reading of 2.3%. Nearly 92% of electors turned up to vote in the first phase of the West Bengal assembly elections. Fourth-quarter net profits at **ICICI Bank** rose 8.5% year-on-year, beating estimates. The bank continued to gain market share with loan growth accelerating to 16% year-on-year. Quarterly results at **HDFC Bank** were in line, with management shifting focus to ROA improvement. Large cap IT companies in India mostly missed street estimates in FY 2026 fourth-quarter earnings and delivered conservative guidance.

In **Mexico**, April bi-weekly CPI rose 4.53% year-on-year, or in line with estimates. **Banorte** said first-quarter net interest income had risen 10% year-on-year, or more than expected. Higher provisions were offset by better operating results, with management expecting better trends ahead. **Vesta** reported solid results, with rental income up 13% YoY, driven by strong performance in Monterrey. Occupancy remained stable at 89.7%.

In **Brazil**, the government is asking Congress for authorisation to use extraordinary oil revenue to cut taxes on fuel such as gasoline, diesel, ethanol, and biodiesel. The government also agreed with fuel retailers to maintain a maximum diesel price of 28 pesos per litre. Colombia's **Ecopetrol** signed an agreement to buy a 26% stake in Brazilian oil firm **Brava Energia**, with plans to reach a controlling stake. **Banco do Brasil's** management reiterated its 2026 guidance

for an ROE in the low-mid teens, and earnings between R\$22bn and R\$26bn, implying 6% to 26% YoY growth. Agribusiness credit quality is improving at the margin.

CORPORATE DEBT

Credit markets were mixed this week. Euro investment grade fell 0.38% over the week as government bond yields rose. Yields on Germany's 10-year Bund rose 8bp to move back above 3%. But CoCos and high yield were practically unchanged (+0.01% and 0.02%, respectively), proving relatively resilient despite widening risk premiums. The Xover widened by 17bp to 292bp but was still some way off the end of March stress levels of 360bp.

In new issuance, we saw some senior financial deals. Hybrid deals came from **Amprion**, **Abertis**, **Var Energi** and **Grand city**.

There were three Euro high yield issues. Denmark's **TDC Brands** (digital services) refinanced, raising €550m at 8% due 2031. Italy's **Lottomatica** reimbursed its floating rate debt with a fixed-rate issue for €765m at 4.625% due 2032. **Kiloutou** (building site material rentals) extended its 2030 bond maturity with a fixed tranche (€350m at 5.125% due 2032) and a floating rate tranche (€450m, at E+300 due 2033).

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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