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The day in the markets

What you need to know

- **Wall Street gains amid optimism over end to US rate-rise cycle**
- **Dollar extends downturn to slide to weakest level since September**
- **European stocks edge higher after strong performance from energy sector**

Wall Street stocks rose and the dollar fell to an 11-week low yesterday as investors remained optimistic that the US Federal Reserve had finished raising interest rates, ahead of the release of the bank's latest minutes today.

The benchmark S&P 500 index added 0.5 per cent in early afternoon trading in New York while the technology-dominated Nasdaq Composite rose 0.8 per cent.

Having ruled out the possibility of a rate rise in December, investors will be on the lookout for hints about the direction of monetary policy from the minutes from the Federal Open Market Committee's latest policy meeting, when interest rates were held at a 22-year high.

Investors' newfound belief that rates have peaked has weighed on the dollar.

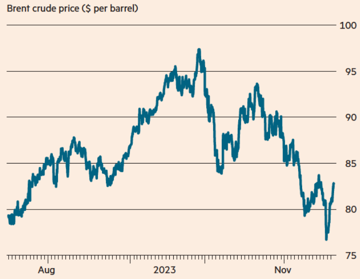
A measure of the currency's strength against a basket of six peers dropped 0.4 per cent to a level last hit on September 1, extending a downturn that began at the start of November.

The currency is now trading close to where it began the year. "We're in a dollar-unfriendly environment," said Kit Juckes, a currency strategist at Société Générale, who added that currency speculators nevertheless remain "just about net long [the dollar] overall".

The dollar's decline — which has coincided with an equity and bond rally — comes as investors grow increasingly confident that the Fed will begin to lower rates early next year.

Oil prices rally ahead of Opec+ meeting on Sunday

Brent crude price ($ per barrel)



Source: Bloomberg

Oil prices continued to rally, rebounding from last week's four-month low of $77 a barrel. Brent crude, the global benchmark, rose 2.8 per cent to $82.83 a barrel while US marker West Texas Intermediate rose 2.9 per cent to $78.05 a barrel.

The rally comes as the Opec+ group of major oil producers weighs extending and deepening production cuts when they meet in Vienna on Sunday.

Saudi Arabia, the group's de facto leader, is planning to extend its 1mn barrel-a-day cut into 2024, the FT reported.

European equities edged higher thanks to strong performance among energy stocks, despite large falls for individual companies in some other sectors.

The region-wide Stoxx Europe gained 0.1 per cent even as shares in Frankfurt-listed Bayer plunged to their lowest level in more than a decade.

London's FTSE 100, which dropped 0.1 per cent, was pulled lower by a slide for equipment rental company Ashtead.
George Steer and Stephanie Stacey

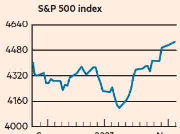
Markets update

	US	Eurozone	Japan	UK	China	Brazil
Stocks	**S&P 500**	**Eurofirst 300**	**Nikkei 225**	**FTSE100**	**Shanghai Comp**	**Bovespa**
Level	4533.81	1803.13	33388.03	7496.36	3068.32	125716.38
% change on day	0.44	0.05	-0.59	-0.11	0.46	0.76
Currency	**$ index (DXY)**	**$ per €**	**Yen per $**	**$ per £**	**Rmb per $**	**Real per $**
Level	103.579	1.094	148.355	1.250	7.176	4.864
% change on day	-0.325	0.459	-0.816	0.563	-0.967	-0.600
Govt. bonds	**10-year Treasury**	**10-year Bund**	**10-year JGB**	**10-year Gilt**	**10-year bond**	**10-year bond**
Yield	4.462	2.609	0.739	4.287	2.669	10.722
Basis point change on day	-0.100	2.400	-0.400	2.100	0.600	-6.000
World index, Commods	**FTSE All-World**	**Oil - Brent**	**Oil - WTI**	**Gold**	**Silver**	**Metals (LMEX)**
Level	454.76	82.84	78.33	1981.05	24.00	3640.80
% change on day	0.53	2.77	3.01	0.05	1.37	0.06

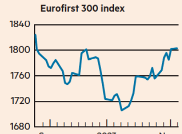
Yesterday's close apart from: Currencies = 16:00 GMT; S&P, Bovespa, All World, Oil = 17:00 GMT; Gold, Silver = London pm fix. Bond data supplied by Tullett Prebon.

Main equity markets

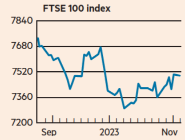
S&P 500 index



Eurofirst 300 index



FTSE 100 index



Biggest movers

%	US		Eurozone		UK	
Ups	Paramount Global	5.69	Saipem	2.40	Diploma	11.19
	Enphase Energy	5.08	Merck	2.23	Ocado	6.28
	Palo Alto Networks	4.47	Wartsila	1.94	Flutter Entertainment	2.95
	Solaredge	3.98	Inditex	1.88	Spirax-sarco Eng	2.80
	Boeing	3.85	B. Sabadell	1.82	Antofagasta	2.10
Downs	Nrg Energy	-3.08	Bayer	-17.72	Ashtead	-10.49
	Int Paper Co	-2.85	Intesa Sanpaolo	-4.54	Smurfit Kappa	-3.16
	Bristol-myers Squibb Co	-2.45	Oci	-2.87	Compass	-2.01
	Estee Lauder Companies (the)	-2.38	Henkel	-2.19	Convatec	-1.59
	Ebay	-2.20	Kbc	-1.50	Associated British Foods	-1.51

Prices taken at 17:00 GMT. Based on the constituents of the FTSE Eurofirst 300 Eurozone

All data provided by Morningstar unless otherwise noted.

Wall Street

Tech giant **Microsoft** hit a record high on news that it had hired ousted OpenAI chief Sam Altman and fellow co-founder Greg Brockman to lead a team conducting artificial intelligence research.

This followed a breakdown in crisis talks over their possible return to OpenAI.

The US-listed shares of Argentine oil group **YPF** surged after the presidential victory of Javier Milei, a libertarian economist and first-term congressman.

Buenos Aires electricity group **Pampa Energia** also jumped after the defeat of economy minister, Sergio Massa, of the centre-left Peronist government.

In the wake of the winding-up of Bayer's late-stage trial studying the efficacy of asundexian, its blood-thinning drug, **Bristol Myers Squibb** fell to near the bottom of the S&P 500 index.

The biopharma group's experimental milvexian, which is also in a late-stage trial, belongs to the same class of drugs as asundexian known as XIa inhibitors.

Andrew Baum, an analyst at Citi, placed "a high probability" that a study looking at milvexian for atrial fibrillation, a heart condition, could disappoint. "On the positive side, we remain optimistic for the potential of both drugs" in the area of stroke prevention, said Baum.

Equipment rental group **United Rentals** slid on the back of softer results from UK-listed peer Ashtead. *Ray Douglas*

Europe

Germany's **Bayer** dived following a "double whammy" for the chemicals and pharma multinational, said Peter Verdult, an analyst at Citi.

Verdult was referring to Bayer losing a Roundup weedkiller case in Missouri and the termination of a late-stage trial for asundexian, its experimental blood-thinning drug.

Charlie Bentley, an analyst at Jefferies, said the clinical setback was a "significant blow" given the drug was set to replace Bayer's xarelto "as it faces its patent cliff".

Julius Baer, the Swiss wealth manager, fell sharply after warning that its 2023 profits would be lower than last year owing to a "rise in credit provisions in November" and a higher tax rate, it said.

The lender set aside SFr82mn ($93mn) for bad loans, of which SFr70mn was booked against its credit portfolio after October 31 — a development that came "as a surprise", said Anke Reingen, an analyst at RBC Europe.

Julius Baer, which said the overall quality of its loan book and balance sheet was "unaffected", is reportedly a lender to Signa, a luxury developer that has been facing financial difficulties.

Spain's **Cellnex** rallied after Cinco Días newspaper said the wireless infrastructure group was evaluating a total or partial sale of its subsidiaries in Ireland and Austria. *Ray Douglas*

London

Topping the FTSE 100 index was technical products and services provider **Diploma**, which issued full-year results that beat Shore Capital's forecasts by about 3 per cent on an earnings basis.

The broker flagged a "stronger than expected operating margin" of 19.7 per cent, up from 18.9 per cent in 2022, with Diploma highlighting its "disciplined cost control and accretive acquisitions".

At the opposite end of the blue-chip benchmark was **Ashtead**, the equipment rental company, which lowered its full-year guidance for rental revenue growth, a change that would result in its earnings being up to 3 per cent below market expectations.

Several factors were to blame for this downgrade including the Hollywood strikes by actors and writers, which hit its film and TV business in Canada "significantly", it said.

MusicMagpie, the "re-commerce" group that buys and sells consumer tech and physical media, surged after confirming that it was in the early stages of talks with both telecoms company BT and Aurelius Group, an investment firm, over a possible sale.

BT deals with a large volume of phones, said AJ Bell's Russ Mould, "so having an in-house refurbishment business in the form of musicMagpie would make sense". *Ray Douglas*

Private equity's net asset value loans bring risks

Holden Spaht

Markets Insight

After big rises in US interest rates since March last year, debt is more expensive now than it's been in more than 20 years. The ensuing squeeze hasn't just reshaped the strategic direction of private equity firms — it's testing the its relationship with risk.

Blame it on the human psyche. While today's market conditions may be new for many, the way in which we behave under such conditions is anything but.

The foundations of behavioural economics show that people and organisations have a built-in decision bias at moments such as these. As psychologists Daniel Kahneman and Amos Tversky said in Nobel Prize-winning research, some take more risk when facing losses to avoid even bigger losses.

Confronted with macroeconomic headwinds, an intolerant initial public offering market and lower valuations, the psychology of investors and other decision makers tends to tilt towards greater risk acceptance. So under heightened market pressures, it's increasingly important to remind ourselves that there are no shortcuts when it comes to responsible risk strategies.

Yet signs of eroding risk discipline can be seen in the rise of net asset value (NAV) borrowing, so-called because of leverage of the collective valuation of a firm's portfolio groups as collateral. Although we have not relied on such loans to date, they're being used by others in our industry. In a pinch, these loans can seem like an easy (albeit expensive) way to access new capital.

The newfound prominence of NAV borrowing is driven by challenging business conditions that have hamstrung private equity firms' once-promising portfolio companies. Combined with an abating appetite for buyouts and the rising demand for liquidity among investors in funds, some may see NAV loans as a nimble stop-gap. Others may see them as financial engineering designed to cloak failing portfolio companies — simply, and perhaps dangerously, throwing good money after bad.

Whether those concerns are merited depends entirely on how the proceeds of NAV loans are deployed, and equally how that deployment is communicated to limited partners (LPs), the investors in funds. The funds can be used in a way that investors may be amenable to — say to create liquidity that in turn expedites the return of their capital in advance of pending realisations.

> Some see NAV loans as a nimble stop-gap; others as financial engineering to cloak failing holdings

Likewise, in older funds NAV loans could be used to finance a performing portfolio company's add-on acquisition. The alternative — raising incremental debt capital from the group's existing lenders — might cause its entire facility to be repriced, something worth avoiding in today's rate environment.

But those approaches endorsed by LPs are different to using an NAV loan to recapitalise an underperforming portfolio company with "equity", particularly when that is not clearly communicated to the business's investors. Using money to facilitate an acquisition in a performing portfolio group isn't the same as deploying it to prop up underperforming businesses unable to service existing obligations, or those losing money with no path to profitability.

Critics call the prop-up approach "pray and delay". Firms bet on a different future: either the ability to turn a group's margins up to meet today's profitability demands, or the hope that an impending turn in the economic cycle will boost top-line growth and company valuations. Time will test the sustainability of defensive NAV borrowing — but if we're truly looking at "higher for longer", that's quite a gamble.

As with many technologies (financial and otherwise), NAV loans themselves are neither good nor evil; that judgment should be reserved for how they're put to use. LPs deserve to make that judgment after receiving a clear explanation of NAV borrowing. If the money is going to be used to turn around a group, LPs should see a detailed map for the journey — and know why taking leverage in this form and contributing it as equity is the preferred alternative to, say, calling equity from the fund and investing it.

LP transparency doubles as a hedge against short-term, reactive decision-making, thus helping general partners — the managers of funds — stay true to investment theses. And it protects our groups, our investors and ourselves against the human behavioural inclination towards excessive risk acceptance under pressure — discipline that is more important now than ever.

While an NAV loan can buy time, no financial engineering can impede the inevitable — those pricey loans will come due, and if the businesses haven't improved, the portfolio — and its investors — will be left holding the bag.

Holden Spaht is managing partner at Thoma Bravo