



MARKET FLASH: THE DOW BREAKS ABOVE 22,000

August 4, 2017

On the markets

US equity markets continued to outperform European bourses (in local currency) as the US dollar fell. Given an acceleration in its decline, a technical rebound is possible. US dollar weakness owed more to Donald Trump's difficulties in getting reform measures through than any differences in monetary policy prospects, economic growth or company results.

Second quarter earnings reports confirmed both profits and sales expectations. The oil price rebound remained intact. Bond yields were stable following recent central bank messages. All this supports our preference for equities, particularly in Europe and Japan. Bond management must remain tactical. Subordinated bank debt in Europe still looks interesting.

▶ EUROPEAN EQUITIES

The euro continued to gain ground despite weak inflation expectations in the eurozone. Leading indicators remained at lofty levels but without picking up speed: manufacturing PMI came in at 56.6 and second quarter GDP rose 0.6% as expected. The Bank of England maintained interest rates at 0.25% but cut its growth forecasts from 1.9% to 1.7% for this year and from 1.7% to 1.6% in 2018. Sterling subsequently fell and there was a knock-on effect on long European rates.

It was another busy week for company earnings reports. So far, quarterly sales are up 3.8% like-for-like or almost in line with the 4.5% seen in the first quarter despite a less favourable basis of comparison. Financials reported upbeat results which failed to trigger market enthusiasm apart from **UniCredit** and **Natixis**.

Industrials generally fell short of expectations.

Siemens (weak margins, a disappointing order book and much lower free cash flow) said it was to list its healthcare division. **Tenaris** suffered from much higher working capital requirements.

Autos continued to underperform despite an agreement with Germany's regulatory authorities only to modify diesel engine software packs. **Peugeot's** sales rose 13% and the acquisition of Opel was finalised while **Renault** disappointed investors as there was no operating leverage on a 13% increase in sales.

Prosieben was hit by persistently downbeat trends in TV advertising (-4.6% in the second quarter) but management said it was confident in a future upturn. **Lufthansa** maintained guidance on operating growth and expects its cargo business to make money and Eurowings to break even. **Vivendi** is reportedly considering spinning off the Telecom Italia network. **Bic** rebounded after quarterly figures improved.



▶ US EQUITIES

US indices ended the week at record highs with the Dow closing above 22,000 on Thursday. Macroeconomic data like manufacturing ISM and services PMI remained at high levels and the PCE price index showed no sign of accelerating.

Quarterly earnings met with diametrically opposed investor reactions. On the one hand, energy stocks were sold off although they generally reported in line with expectations, while on the other, certain tech and consumer stocks like **Apple** and **Tesla** pushed even higher as management expressed confidence in growth prospects.

Healthcare performed in line with the market but with certain sub-sector disparities. Medical insurance and big pharma advanced but generic plays were badly hit after **Teva** said it had had to cut prospects due to persistent price erosion.

▶ JAPANESE EQUITIES

The TOPIX rose 0.8% over the week. The market gained on brisk corporate earnings reports and the TOPIX hit a year high before dropping slightly on Thursday on profit taking as the Yen traded higher against the US dollar. Electronic component stocks advanced after US tech giant Apple announced robust results. Prime Minister Shinzo Abe's cabinet reshuffle on Thursday had little impact on the market.

By sector, the best performers were Air Transportation (+5.8%) and Iron & Steel (+3.0%). **Toshiba** rebounded 8.3% after it was demoted to the TSE second section. The major domestic airline **ANA** (+7.6%), trading companies **Sumitomo** (+6.7%) and **Mitsubishi** (+5.8%) were buoyant on the back of robust April-June quarter results and upbeat estimates for the whole fiscal year. Electronic component plays like **Nitto Denko** (+7.9%), **Nidec** (+6%) and **Murata Manufacturing** (+3.1%) were also strong.

In contrast, Real Estate(-0.8%) and Foods (-0.6%) were relatively weak. **Ajinomoto** tumbled 6.3% and **Mitsubishi Heavy Industries** ended the period 4% lower.

▶ EMERGING MARKETS

China's PMI was a bit lower than consensus, but still in expansionary territory.

In **India**, **Godrej Consumer** had a first quarter miss due to GST down stocking and a sharp fall in Indonesian sales. We believe this was a blip due to a one-off in India. On the macro side, the RBI cut interest rates by 0.25bps or in line with expectations.

Korea's new Government proposed redistributive measures including raising the corporate tax rate from 22% to 25% and also the personal income tax rate. These measures are expected to be approved in September. If so, we expect a 4% impact on EPS at **Samsung** and **Hynix** which lost 3% and 6% respectively on the news. Moreover, Apple's results indicated that iPhone production delays had been exaggerated and the company now sees better-than-expected iPhone shipments in the third quarter. The news had a positive impact on Apple's Asian suppliers.

Brazil's economy continued to recover in the second quarter despite the political turmoil. Industrial production expanded 0.2% and inflation continued to retreat. The central bank is expected to stick with an easing bias. **Itau** reported better-than-expected results on a 15% QoQ drop in provisions and a robust 22% in ROE. **Arezzo** reported solid results with the top line rising 11%, the EBITDA margin expanding 140bps and EPS up 30%. **Mercado Libre** missed second quarter expectations on higher shipping costs and an FX loss in Venezuela.

In **Mexico**, **Asur** reported strong traffic growth of 8% YoY in July, and +10% YTD. **Lala** announced the acquisition of **Vigor** in Brazil for 17x EV/EBITDA.

X5, a Russian retailer, reported results ahead of expectations on a strong 27% YoY surge in top line growth and a bigger EBITDA margin.



We remain optimistic on emerging markets as growth has continued to recover driven by consumption and higher exports. We expect further upward EPS revisions.

▶ COMMODITIES

Oil prices stabilised around \$51 for Brent crude and 49 for WTI. This followed a surge to almost \$53 at the beginning of the week on the US decision to impose sanctions on Venezuela, essentially by limiting imports of Venezuelan light crude oil. OPEC also released a communique on a meeting in Abu Dhabi on August 7-8 organised by Kuwait and Russia. It will discuss the problems countries like Gabon, Iraq, Algeria and the UAE are having in adjusting output to authorised levels. Once again, this type of initiative shows how seriously OPEC is taking compliance with quotas.

In the US, the rig count has stabilised and inventories continue to fall. DoE weekly data showed a 1.5m barrel drop in crude and 2.5m barrels less in petrol as the refinery utilisation rate rose further to more than 95%.

US exploration and production companies with strong exposure to the Permian field were hit sharply by a report from **Pioneer** that revised down production and mentioned an unfavourable product mix (i.e. with more gas). Investors worried that all Permian companies might be hit. Concerns mounted further when other companies like **Parsley Energy** said their product mix had deteriorated. Permian is seen as the top shale oil basin with the best geology and production costs. This may be bad for producers but it is good for oil prices as growth in US production is a major investor worry.

The declining US dollar continued to favour all commodities and metals in particular. **Iron ore** added to gains this week to hit \$73/tonne. Upbeat PMI in China confirmed the economy was in good health as did discipline over CAPEX. News of production cuts also helped bolster investor confidence.

▶ CORPORATE DEBT

CREDIT

Government bond yields edged lower at the beginning of the week before falling further on poor US figures. Core European bond yields were flat on Wednesday but continued to tighten on Thursday after the Bank of England left rates unchanged. Despite these shifts, spreads were rather stable. The Xover remained around 234bp all week while the iTraxx Main was more or less unchanged around 52.

Quarterly earnings reports were generally upbeat and better than expected. The few disappointments included **Bombardier** (B2/ B-) which reported a \$289m loss with sales down 5% due to reduced deliveries of business and commercial aircraft. **Tereos** (BB) saw EBITDA fall 10.6% over a year due to a late harvest in Brazil but nonetheless maintained its EBITDA targets for FY 2017/18. In contrast, **Nyrstar** (B3/B-) had an excellent first half with sales up 37% and EBITDA 23% higher.

Elsewhere, **Telnet** (Ba3/BB-) reported results in line with expectations. Sales dipped only 1% despite pressure in the mobile phone sector. In construction, **Astaldi** (B3/B) is well-placed to meet 2017 objectives as sales and EBITDA both rose 7.4%. This was mainly due to revenues in Italy as the international business was the weakest.

It was a quiet week on the new issues market. Orthopaedics company **Lima Corporate** (B/B2) raised €275m with a senior 6-year maturity. The proceeds will go on refinancing existing debt.

In financials, **Barclays** (Baa2/BBB) sold a sterling-denominated AT1 non call 7 years for 1.25bn with a 5.875% coupon.



CONVERTIBLES

It was another busy week in convertibles for earnings news. In Europe, **Nyrstar** reassured investors as the Port Pirie project is on track to start furnaces in October. **Fresenius** posted good second-quarter results: revenues advanced 18.5% YoY and EBIT was up 14.5% YoY, with notable organic growth of 9% at Kabi in North America.

In Japan, **Suzuki** reported first quarter operating profits at JPY 85.07bn, or significantly higher than the 72.9bn expected. This was driven by improving earnings in Europe, Japan and Asia Ex (a stronger vehicle mix), and the shares jumped 9%.

In the US, **RealPage** had a very solid quarter with revenues up 14% YoY. The company is to pay \$250m for **On-Site**, a leasing platform for property managers. **Teva** declined 24% after cutting full year sales guidance by \$1.2bn and reducing the dividend amid persistent pricing challenges facing US generics.

There were 2 convertible deals in the US this week. **Innoviva**, a healthcare-focused asset manager, raised \$175m with a 2025 maturity yielding 2.5% for refinancing purposes. Specialty finance company, **Sutherland Asset Management Corp** announced on Thursday that it was raising \$100m with a 2023 convertible to acquire mortgages.



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