EDMOND
DE ROTHSCHILD

MARKET FLASH :
THE FED BOOSTS RISK ASSETS

Risk assets made further gains after the Fed made its shift to a much more neutral stance official. It will now be 'patient' over hike rates and said it would be shrinking its balance sheet less than expected. This bolstered the rally set off by Jerome Powell's more accommodating tone on January 4. The Fed, in fact, proved just as decisive in triggering the January rally as it was in creating the fourth quarter sell-off.
Elsewhere, economic data failed to show any overall improvement that would signal the end of the slowdown, but nor did they suggest any significant decline. Italy, however, appears to be struggling. The country is technically in recession after two consecutive quarters of GDP contraction in the second half of 2018. Its manufacturing PMI in January also fell further to 47.8.
Meanwhile, the UK's exit from Europe is fast approaching and a compromise over the conditions is still up in the air. Nevertheless, UK assets are holding up: sterling has lost a little ground but UK equities rebounded over the week. US-China trade talks continued and Donald Trump claimed they were going well.
We decided to take some tactical profits on US and European equities and are now back to neutral weightings. We have, however, remained overweight emerging country equities. They are catching up quickly and this momentum could well last.

EUROPEAN EQUITIES

Amid uncertainty over Brexit and US-China trade talks, microeconomic data boosted indices.

France outperformed significantly due to record profits from **LVMH** which saw EBIT hit €10bn and sent the entire sector higher. The mood was also improved by news that **Atos** shareholders were to be given 23.4% of **Worldline**'s equity. This should leave Worldline free to achieve it strategy as a consolidating force in Europe's payment services sector.

Bank stocks suffered after the European Union said it had launched an enquiry into 8 banks for manipulating the sovereign debt market between 2007-12. No names were given. **Banco Santander**'s poor results were of no help and Italian banks tumbled after Italy went into technical recession. Its GDP contracted by 0.2% in the fourth quarter after falling 0.1% in the third.

In Germany, **Wirecard** reported prelims in line but then fell out of bed after a Financial Times article once again raised the possibility of fraudulently backdated contracts. These are old rumours and the company issued a formal denial. **SAP** posted a jump in sales but fell after disappointing fourth-quarter licence revenues and persistently ailing margins due to the product mix move towards the cloud business. Germany's DAX index, which has high chemicals weightings, was hit when **DowPont** said it expected 2019 to be difficult. However, **Covestro** bucked the trend and its Chinese rival **Wanhua Chemical** even said it was ready to raise MDI prices.

Basic resources remained strong after a tragic dam bust in Brazil sent iron ore prices higher. Pharma stocks released robust figures. **Roche** said profitability was better than expected and **Novartis** posted results and guidance in line with expectations.

Unilever was among companies cutting guidance for 2019. **Nokia**, after a second quarter in which sales rose across the board, also expects to see a less buoyant first half in 2019.

Elsewhere, the **Nasdaq** group offered 5% more for **Oslo Bors** than **Euronext**. The Elliott fund said it had increased its stake in **Telecom Italia**. Canada's **Brookfield** Asset Management is considering buying **KPN**, in concert with some Dutch pension funds.

US EQUITIES

The S&P500 gained 2.34% and the Nasdaq 2.94%. For the S&P, it was the best January in thirty years. Consumer discretionary and staples and tobacco led gains while communication services and telecoms suffered the biggest falls.

The market cheered the Fed's decision to put rate hikes on hold and the signal that any future action would depend on economic data. There were 253,000 new weekly jobless claims last week, or more than the 210,000 expected. New home sales hit 657,000 units, or much higher than the 566,700 pencilled in by analysts. The US-China trade talks seemed to be going well. With one month to go before the truce ends, Donald Trump said huge progress had been made last Wednesday and Thursday and Beijing seemed to agree.

In quarterly earnings news, 41% of S&P500 companies reported over the busiest week of the season. **NVidia Corporation** (semiconductors) warned that its sales would be $2.2bn and not $2.7bn due to soft demand in Chinese data centres (approximately 25% of sales) and the gaming sector (55% of sales). Industrial barometer **Caterpillar** was also hit by lower Chinese demand: EPS fell 14.5% YoY and the group was cautious for fiscal 2019.

General Electric's operating results were mixed: industrial margins and Power segment orders fell and there was no guidance issued, but the stock jumped 10% as expectations were low and no new charges in its insurance business were announced.

Facebook soared 11% after beating expectations with record earnings and **Amazon** released robust fourth quarter figures although guidance for 2019 was a little light.

JAPANESE EQUITIES

Japanese equities stabilised after pricing in the economic slowdown and investors stayed on the sidelines ahead of October-December quarter earnings. Stocks rebounded later in the week after the Fed put its expected interest rate hike and balance-sheet contraction on hold. The TOPIX edged up 0.09% for the week.

Investors remained cautious because of earnings surprises like **Nidec**. FA producer **Fanuc** slashed third-quarter earnings 42% due to a sharp slowdown in orders from China. However, electronic parts manufacturer **Murata Manufacturing** posted a 40% surge in net profits for the first three quarters to December due to solid demand for auto equipment, more than offsetting a decline in smartphone components. Both stocks performed relatively well in January after a poor December.

Small cap upside was capped by the Tokyo Stock Exchange's decision to review criteria for first board listings. Investors were concerned that some of the small names might be excluded from the TOPIX. The index has seen substantial buying thanks to the Bank of Japan's ETF purchase programme.

Economic sensitive sectors were relatively firm on buybacks. Securities & Commodity Futures Sector (-3.94%) underperformed led by **Daiwa Securities Group** (-8.60%) and **Nomura Holdings** (-2.94%).

EMERGING MARKETS

The Fed's new dovish tone boosted emerging markets.

Beijing said significant progress had been made on a wide range of issues in the ongoing trade talks, but Washington said further negotiations were needed. After talks with Liu He at the White House, Donald Trump sounded an optimistic note on a big trade deal by March 1. He raised the possibility of two meetings with President Xi: (i) in China, after his late February meeting with North Korea's Kim Jong-un and (ii) in the US to close the deal.

China's January PMI improved marginally to 49.5 from December's reading of 49.4. The earnings highlight came from **Alibaba** which saw revenues up 41%, or in line with consensus estimates, but EBITDA and earnings beat expectations by 4% and 6% respectively due to operational leverage. Despite a tough macro environment in the last quarter, core customer management and commission revenue surprised positively with a 27% YoY increase. Cloud revenues grew 84% YoY. Adjusted EBITA increased 9% YoY compared to 1% YoY in the September quarter.

At **Samsung**'s fourth quarter earnings conference call, the group said that DRAM demand would increase gradually from the second quarter so capex would be maintained.

In India, **ICICI Bank**'s third quarter profits fell 3%, or better than expected, due to higher NII, better asset quality and treasury gains. Loan growth rose by a robust 14% YoY. Most importantly, slippages declined and NPL coverage increased to 68%, raising visibility of loan costs halving and a turnaround in earnings from 2020.

Brazilian news flow was focused on **Vale** after the tragic dam burst in Brumadinho. Financial concerns focused on the short-term impact on production, possible litigation and changes in top management. **Bradesco** posted outstanding results. Earnings beat expectations due to a combination of stronger margins and fees. The delinquency rate contracted further. 2019 guidance will probably trigger an upward revision in earnings to 10% above current consensus, suggesting loan growth acceleration and a 22% increase in EPS. **Cielo** reported a 30% drop in EPS but new prepayment legislation introduced this year offers a strong base for results to improve.

Santander Mexico's results were upbeat but expected. Management guided loan growth lower and said EPS would rise between 5-7%.

We remain positive on emerging markets.

COMMODITIES

Reuters said OPEC production in January had fallen by 890,000 b/d, or more than stipulated in the December 7 agreement. Unsurprisingly, Saudi Arabia made the biggest effort by cutting by 350,000 after a 450,000 reduction in December. It also said its output would fall further from January's 10.2 million b/d to 10.1 million, or still below the 10.3 million quota. The strongest impact appeared to be on exports as OPEC export tanker activity was 24 million b/d in January, down 1.8 million over a month, and the lowest since October 2015.

Meanwhile, India appeared to be in talks with the US for a 3-month extension of its dispensation from Iranian sanctions. This could help it continue to import 300,000 b/d of Iranian crude (compared to an average of 500,000 previously). This is key to ensuring some balance in the oil market over the short term as Washington has said it would be stricter once the dispensation period ended. We will also have to factor in the impact of fresh sanctions against Venezuela's state-owned **PDVSA** on the country's production as well as further damage to a significant revenue stream.

Gold prices rose 1.3% over the week to $1,320/oz, a level they had not broken above since May 2018. This took January's gains to 3%. The Fed's much more accommodating tone promises a long pause in the rate hike cycle and is good news for gold. In addition, the World Gold Council said demand had risen 4% in 2018. Central bank buying rose 74% over 12 months to 651.5 tonnes, its highest level since 1971. Buying came mostly from emerging countries like Russia, Turkey, Kazakhstan and China. Investment demand fell significantly due to ETF outflows but has been recovering since October.

CORPORATE DEBT

CREDIT

A US profit warning weighed on sentiment at the beginning of the week but markets recovered on optimism over US-China trade talks, Westminster's support for Theresa May to reopen Brexit discussions and the Fed's accommodating tone. The Xover tightened by 12bp and the Main by 4bp.

Sales at **SMCP** (B1/B+) rose 7.9%, or as expected, with most zones up except for France due to 'yellow jacket' unrest. **Elis** (corporate services, Ba2/BB+) saw sales rise 2.9% and results beat expectations. **Vallourec** (steel tubes) came under fresh pressure as some creditors sought to dispose of their commitments to the group's liquidity facility.

In M&A news, **CMA-CGM** (B1/B+) officially launched its €1.46bn bid for Swiss rival **Ceva Logistics**. **New Look** (Ca/CC), which recently reached a debt refinancing agreement, might be sold as part of its efforts to pursue a restructuring plan.

Spanish banks posted satisfactory results. **Santander** beat expectations with a sharp rise in commissions and net interest revenues and strong performance in Spain and Brazil. **Covea** abandoned its tie-up plans with **Scor** and the news had little impact on Scor's bonds.

The ECB upped the pressure on banks to speed up NPL provisioning. Banks with the lowest number of NPLs will have to provision 100% of unsecured loans (NPLs at least 2 years old) by 2023 and 7-year old NPLS by 2024. Banks with the biggest NPL inventories will have an extra 2 years.

New issues: **UBS** raised $2.5bn with an AT1 at 7%. **Parts Europe** (B3/B) easily placed a €175m FRN due 2022 at EUR+550bp (or very slightly above its outstanding FRN issue). **Smurfit Kappa** (BB+) issued a €400m tap on its 2026 senior secured bond with an OID at 100.75 (compared to initial guidance of 99.0-99.5). In investment grade, **Telefonica** raised €1bn over 5 years.

CONVERTIBLES

It was another quiet week on the new issues front due to the earnings blackout.

China's **NIO** (autonomous/electric vehicles) raised $650m plus a $100m green shoe with a 5-year convertible at 4.5%, a 27.5% premium and a 3-year investor put. The proceeds will go on research and development of products, services and technology, development of NIO's manufacturing facilities and roll-out of NIO's supply chain, sales and marketing as well as other working capital needs. They will also help the company enter into capped call transactions and zero strike call transactions.

In the rest of the news, Germany's **Vonovia** is selling its 4.7% stake in **Deutsche Wohnen** which is worth $799m, neutralizing any chances of a takeover for the moment.

In the US, **Silicon Laboratories** (semiconductors) missed its fourth-quarter earnings and guided lower for March amid macro uncertainty impacting its industry activity (around 50% of sales) and China (approximately 33% of sales).

In Japan, **Sony**'s third-quarter operating profit rose 8.2% YoY to JPY 374.8bn. Net profits jumped 45% YoY thanks to a remeasurement gain from the consolidation of EMI and strong performance from its Venom film.

EDMOND DE ROTHSCHILD ASSET MANAGEMENT (SUISSE) S.A.
8 rue de l'Arquebuse – PO Box 5441 – 1211 Geneva 11
T +41 58 201 75 40 – contact-am-ch@edr.com
ch.edram.com