



MARKET FLASH: MARIO DRAGHI STICKS TO HIS GUNS

April 7, 2017

On the markets

Equity and bond markets edged higher over the week. The big news items were the Fed's minutes and Mario Draghi's statements. The Fed suggested that it might no longer reinvest coupon payments if the US economy continued to pick up speed. The news sent equity markets lower over the day but they recovered when Mario Draghi said the ECB was sticking with its accommodating stance.

Markets were also reassured by the US dollar strengthening a little and oil enjoying a strong bounce. Trading was calm on bond markets. There was even some genuine easing in eurozone government bond yields with 10-year yields in France falling back below 0.9%. We are maintaining our preference for eurozone equities.

▶ EUROPEAN EQUITIES

Europe drifted lower in the first week of the second quarter amid a wait-and-see mood and a dearth of company results. Manufacturing PMI in the eurozone was barely in line -slightly under in France and even significantly lower in the UK- but at least the minutes from the last ECB meeting struck a very accommodating tone. And on the Thursday Mario Draghi reaffirmed that no policy change was on the cards.

In other news, **Unilever** announced the conclusions of its strategic review following the board's rebuttal of the **Kraft Heinz** bid. As expected, the group intends to sell its margarine business, launch a EUR 5bn share buyback in 2017 and target a underlying margin of 20% in 2020, with EUR 3.5bn in restructuring costs in 2017-19 and ND/EBITDA of two times. That should leave EUR 15-17bn for acquisitions and a 12% increase in the dividend. The group also said it would be looking at its dual UK-Dutch structure.

In a sector awash with M&A options, **Reckitt Benckiser** said it was exploring all possibilities for its food business and **Danone** got the legal go-ahead to complete its acquisition of **WhiteWave**.

In other European M&A news, **Schneider** is to sell its US data software subsidiary **DTN** to a financial investor in Europe for EUR 840m in enterprise value and **ABB** is buying Austria's **Bernecker & Rainer Industrie** (industrial automation) which makes sales estimated at USD 600m. This will propel ABB to global N° 2 behind Siemens in a field in which it was previously a minor player.

In the ongoing **AkzoNobel-PPG** saga, the US group has officially reiterated its merger proposal after its EUR 21 and 22bn bids both failed.



▶ US EQUITIES

The S&P edged 0.2% lower on profit taking. The FOMC minutes sent a chill through markets as they broached the subject of shrinking the Fed's USD 4,500bn balance sheet (25% of US GDP) as early as this year. Markets also fell on Paul Ryan's comments on the legislative agenda and the time needed for any fiscal reform. It looks like being more complicated than healthcare reform. The problem is not only the difficulty in achieving some consensus on reforming a tax code untouched since 1986 but the fact that Congress will be very busy with debt ceiling talks and the return of a revamped version of the bill to reform Obamacare. Fiscal reform could be pushed back until the fourth quarter.

In economic data releases, manufacturing ISM was in line and remained high at 57.2. Non-manufacturing ISM slipped from 57.6 to 55.2. ADP said private sector job creations hit 263,000 or much higher than the 185,000 expected. The only worrying data was a drop in car sales to 16.5 million, the lowest level since February 2015, which fuelled worries over a slowdown in the US market.

In company news, **JAB Holding** bid USD 7.5bn (a 35% premium) for **Panera Breads**. **Sunoco** soared by more than 20% after selling 1,100 station services to 7-Eleven for USD 3.3bn. **Constellation Brands** gained more than 6% after beating estimates. **L Brands** bounced more than 10% after its March sales turned out not as bad as expected.

Over the last 5 trading sessions, property, utilities and energy advanced while most sectors declined. The telecoms sector suffered most after **Comcast** arrived with an aggressively priced MVNO offer on **Verizon's** network.

▶ JAPANESE EQUITIES

The Japanese equity market declined and the Nikkei 225 hit a four-month low on April 6 when the TOPIX tumbled 3.1%. Sentiment was affected by the FOMC minutes that led to the Yen strengthening against US dollar to 110 as well as negative overseas factors such

as mounting geopolitical risk in North Korea and concerns over the US missile attack on Syria's military bases.

All sectors lost ground and the worst two performers were Securities & Commodity Futures and Banks which declined by a significant 6% and 5.8% respectively.

Mega bank group stocks dropped to a year low and other financial institutions like **Resona Holdings, Inc.**(8308), **Dai-ichi Life Holdings, Inc.**(8750) and **Nomura Holdings, Inc.**(8604) also suffered steep drops.

In contrast, retail stocks were buoyant. **Rakuten, Inc.**(4755), which operates the biggest e-commerce platform in Japan, rose by 3.9%.

Seven & i Holdings Co., Ltd.(3382), Japan's largest convenience store chain, rose by 1.9% after announcing earnings for the year ended February 28 and upbeat estimates for the current fiscal year.

▶ EMERGING MARKETS

Emerging markets advanced despite the FED saying it would shrink its balance sheet by year end. In **China** the most relevant news was the announcement of a plan to develop a new economic zone baptised Xiogan in the Beijing-Tianjin-Shijiazhuang triangle. This could add more than 0.2% 0.2ppt to annual GDP growth over the next 15 years. Cement companies exposed to this region rallied (**BBMG** jumped more than 40%).

In other news, the PBoC's foreign exchange reserves increased by USD 4bn and the services PMI contracted slightly in March.

In **India**, the Reserve Bank of India increased the reverse repo to rein in high liquidity from monetisation and keep its repo rate unchanged in order to contain inflation. The government also intervened in the telecoms sector to avoid price gouging from **Reliance**, a positive move in our view. In Latin America, **Chile** has been the best market YTD (+20%), since interest rates are going down faster than expected due to inflation coming under control; copper prices are up,



and polls of voting intentions turned more favourable for Sebastian Pinera.

Last week we attended a conference in **Brazil** and **Argentina**. The impression was generally positive. In Brazil, companies were, as expected, already seeing some recovery in the first quarter, capex was down to the lowest possible level, but reforms, especially on social security, need to be voted in May 2017. If that happens, interest rates will see a structural fall and confidence could return more quickly. In Argentina, the scenario is also positive. Inflation should go down this year (after hitting 40% in 2016), and the economy is recovering. Banks are saying that lending should grow by 15% in real terms. The main risk, and an important catalyst for the country's long term investment case, is the mid-term election. In the short term, Argentina is expected to join the EM-MSCI index in June.

▶ COMMODITIES

Amid improving fundamentals, **Brent crude** advanced further, hitting USD 55. The EIA's monthly report said US output only increased by 60,000 b/d in January compared to December. Based on actual data, this reading was significantly lower than (modellised) weekly statistics of 178,000 b/d and the figure shows that US production is increasing less than the market feared. It will also help efforts by OPEC and non-OPEC over production cuts to have a positive impact on inventories. In fact, US output fell by 56,000 b/d in March compared to February, a sign that confirms that the biggest non-OPEC producer is increasingly complying with quotas. Iraq, meanwhile, said it was 98% compliant but we should keep an eye on the country's increased capacity as it wants to reach 5 million b/d by end 2017, or more than its 4.3 million quota and current capacity of 4.7 million.

Nevertheless, the impact is being felt in the US where imports fell in recent week and inventories rose less than is normal for this time of the year. US strikes on Syria's military bases have added a geopolitical angle that will help oil prices recover. Syria's oil production is a low 30,000 b/d, and in an area controlled by Islamic State, but the risk is that the entire region might become embroiled.

At any rate, the surge in tension has lifted the **gold** price which hit an end-of-week high of close to USD 1,270/oz, a level not seen since November 10 2016 in the aftermath of Donald Trump's first speech as President.

Base metal prices, in contrast, fell as risk aversion resurfaced on financial markets. And yet global manufacturing PMI rose further in March, gaining 0.1 point to 53.9, the highest level since the first quarter of 2011, even if the pace of improvement slowed.

▶ CORPORATE DEBT

CREDIT

The HY market was in wait-and-see mode despite the rebound in oil prices, upbeat US jobs data and manufacturing in the eurozone which rose 0.7% in February and 1.8% over a year. The iTraxx Main was unchanged at around 75bp while the Xover tightened slightly to 285bp, probably because of the ECB's reassuring message on maintaining QE which overshadowed news from the Fed.

New issuance slowed sharply. **Loxam** (BB-) raised EUR 850m with three bonds. **Schmolz-Bichenbach** (steel, B2/B+) raised EUR 200m with Senior Secured Notes 5NC2 and **Antolin** (car parts) EUR 400m with Senior Secured Notes 7NC3. Both issues were to refinance existing debt. **Fromageries Bel** (BBB+) sold a EUR 500m Senior Unsecured 7 bond. In financials, **Erste Bank** raised EUR 500m in Additional Tier1 debt.

Eurofins Scientific (specialised in food, pharmaceutical and environmental testing) is acquiring Finland's **Ahma Ymparisto Oy** (EUR 7m in sales in 2016). **Banco Popular** (Ba1/B+) is mulling the sale of its 49% stake in **WiZink** (credit cards). WiZink's valuation could be close to EUR 2.5bn.

CONVERTIBLES

This week convertible investors appreciated the arrival of a new Chinese issuer on the primary market. Toll roads operator, **Zhejiang Expressway**, issued a EUR



350m, zero coupon, 5-year convertible bond to refinance existing RMB-denominated debt. In the US we saw two new issues, first from **GoPro Inc**, the ubiquitous manufacturer of wearable cameras, which issued a USD 175m 3.5% coupon, 5-year convertible and, second, from well-known business development name, **Prospect Capital**, which issued a USD 225m, 4.95% coupon, 5-year convertible.

Although there were no new issuers in Europe ahead of the Easter break, corporate activity in the region continued with another tender, this time from investment manager, **Azimut Holdings**, which offered to buy back its 2.125% subordinated convertible bond due 2020.

Elsewhere, **Telenor** sold 70 million shares of **Veon** (formerly known as Vimpelcom) at a 6% discount; reducing Telenor's stake in the Russian telecoms operator to 19.7% including the shares underlying its exchangeable bond.

In other news, **Tesla** this week surpassed **Ford** in terms of market capitalisation after the electric car manufacturer reported it had delivered 25,000 vehicles in the first quarter, or more than expected. **Jazz Pharmaceutical** rallied over 9% after it announced a settlement with **Hikma** allowing the latter to launch an authorized generic of Jazz's narcolepsy drug, Xyrem. In Europe, **Prysmian** rallied almost 4% on the week on news that it had won a EUR 350m contract from IFA2 SAS, a joint venture between the UK's National Grid and France's RTE to install a cross-channel high voltage submarine and land-power cable.



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Société anonyme governed by an executive board and a supervisory board with capital of 11,033,769 euros

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