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# MARKET FLASH :
# TEMPORARY WEAKNESS

**After a strong January rally, risk assets turned more volatile and edged lower over the week after Washington said there was now no reason for Donald Trump to meet Xi Jinping before the March Ist deadline when new tariffs kick in. The downbeat mood was reinforced after the European Commission downgraded its growth forecasts. The eurozone is now seen expanding by 1.3% this year, down from November's forecast of 1.9% and by 1.5% in 2020 (vs. 1.6%). US-Europe tensions over trade talks also increased a little after Washington said that Europe had promised to include agriculture. Europe issued a denial. Meanwhile, strong job creation data confirmed that the US was holding up well whereas Europe continued to slow although less than expected (January's composite PMI data beat estimates and have practically stopped falling). China, too, continued weaker with January's Caixin PMI falling 1.3 points to 50.9.**
**We view the short term situation as a little more fragile. We cut equity market exposure in January to neutral but remain invested as central banks are once again providing protection and we expect China to stop slowing, a development that would significantly improve sentiment on global economic trends.**

## EUROPEAN EQUITIES

The equity market rally finally hit the buffers when news broke that Donald Trump and Xi Jinping might not after all meet before the deadline for new import tariffs. Sentiment was also hit when growth in the eurozone was cut from 1.9% to 1.3% and Germany's industrial production fell in December. To cap it all, several companies reported disappointing results.

Cyclicals had led the rally so naturally suffered sharp declines. Autos in particular suffered after poor new registration figures in Europe in January. Results at **Fiat-Chrysler** and **Daimler** were hit by mounting electric motor costs. **Leoni** (cables) plunged after the company passed on its dividend for 2018 and said 2020 targets would be missed. **Publicis** plummeted after like-for-like growth fell 0.3% in the fourth quarter despite a better-than-expected improvement in its operating margins; its fall dragged down the entire media sector. **BNP** and **Société Générale** dropped after revising their ROTE targets lower. Only **ING** stood out for beating fourth quarter estimates.

In contrast, defensives reported rather encouraging figures. **Pernod Ricard** revised up its 2021 outlook slightly and now expects operating leverage to increase by 50-60bp by then. **Carlsberg**'s strong Asian sales and favourable weather helped results beat estimates and there were signs that investments were starting to generate growth. **L'Oréal** beat fourth-quarter estimates while margins were announced in line. The stock also rode higher after Estée Lauder posted excellent earnings.

The luxury sector was boosted after **Hermès** reported robust figures. **Dassault Systèmes** jumped after licences rose 11% and investment fell. **Total** gained on higher oil prices and production.

**Wirecard** remained centre stage due to its ongoing dispute with the Financial Times and ahead of the external audit's results.

## US EQUITIES

Donald Trump used his State of the Union speech to call for unity but refused to abandon his Mexican wall project. Other salient points in his address included comments on the trade talks with China, an appeal to cut prescription drug prices, tough talk on military spending and calls for Congress to temper its investigative zeal.

This week's data included manufacturing ISM which came in at 56.7, or slightly below the 57 estimated, and industrial orders which fell 0.6% instead of the 0.3% increase pencilled in by analysts.

Close to half of S&P500 companies, representing 70% of its total market capitalisation, have now reported results. In line with the historic mean, almost 50% have beaten earnings expectations and 30% have reported sales above consensus estimates. Companies which have beaten have outperformed the index by 240bp on average or more than the 100bp historic mean. Over the week, **Estée Lauder** and **Ralph Lauren** outperformed after reporting better-than-expected sales and upbeat prospects for 2019.

Regional banks also rose after **SunTrust** and **BB&T** said they were to merge in an all-equity deal to create the 6th largest bank in the US. The S&P500 ended the period practically unchanged. Industrials, property and tech advanced while healthcare, energy and materials lost ground.

## JAPANESE EQUITIES

At the peak of third quarter (to end December) earnings, Japanese equities were relatively firm despite worse-than-expected profits and downward revisions for the full financial year to March 2019. The TOPIX edged up 0.28% for the week. Programme trading was much in evidence but price moves were limited as the bad news had already been factored in.

**Softbank Group** surged 17.89% due to better-than-expected earnings, news of a share buyback and possible future deleveraging. Economic sensitive stocks such **Keyence** (+8.71%), **SMC** (+6.33%) and **Murata Manufacturing** (+3.98) were among outperformers. In addition, China-related names such as **Shiseido** (+8.22%), **Kao** (+4.40%), **Unicharm** (+4.00%) also rebounded.

On the other hand, **Sony** tumbled 14.29%, despite delivering record earnings, on concerns that profits from its key game business had peaked. Pharma stocks **Daiichi Sankyo** (-9.56%), **Mitsubishi Chemical** (-8.03%) and auto manufacturer **Honda Motor** (-7.49%) were weak.

In a reflection of the sharp global slowdown in the October to December quarter, aggregate earnings for the year to March are now seem moving into marginally negative territory.

In the future, investment performance gaps are expected to expand, depending on whether companies have solid growth prospects or not.

## EMERGING MARKETS

**China**'s markets remained closed for the New Year holidays. Nevertheless, Chinese ADRs came under pressure after news that Donald Trump was unlikely to meet Xi Jinping before March 1, escalating fears that no trade agreement would be reached before the deadline.

On the corporate front, **AIA** announced it had received regulatory approval to sell in services centres in Tianjin and Shijianzhuang, the capital of the Hebei province. This is crucial if AIA is to accelerate its long-term growth.

In **India**, January auto sales were weak. **Royal Enfield** volumes declined 6.6% YoY but were better than expected. **Tata** posted weak third-quarter results with Ebitda down 24% YoY or more than expected due to soft demand in India and China. On the other hand, **Britannia** reported a solid 11% increase in sales and 14% in earnings. Elsewhere, India's central bank surprised the market and cut interest rates, clarifying its focus on headline inflation.

In **Brazil**, Lower House president Rodrigo Maia said pension reform could be voted on before the first week of June. **Lojas Renner**'s fourth quarter results beat expectations with strong same-store sales growth of 12% and higher margins. In contrast, **Itau** missed expectations as EPS rose only 3% YoY, NIM fell and provisions for corporate lending increased. Guidance for 2019 was lower than expected, implying 13% EPS growth, but lending should accelerate, and asset quality improve.

## COMMODITIES

Since the dam on the Feijão mine site burst with serious loss of life, the **iron ore** price has steadily risen. Parent company **Vale** rapidly said 10 other tailings dams with the same characteristics would be dismantled for a long-term impact of 40m tonnes. The group expects to offset this by using its 50 million tonne a year latent capacity. However, the regulatory authority in the Brazilian state where the disaster occurred has revoked its operating permit and suspended operations at the Brucutu mine which produces 30 million tonnes. Vale could lose 75m tonnes this year, or 4% of global exports, and with no compensation. Iron ore prices have quickly gained 15% to $101/t for top quality ore (65%) and 23% to $61/t for inferior grade ore (58%). Steel makers, particularly in China, will be tempted to use inferior ore to maintain margins, especially as steel prices have been falling for several months.

At the same time, **ArcelorMittal** sees global economic risks hitting demand for steel in China and, to a lesser extent, in the US and Europe. The group has revised down global demand growth from 2.8% this year to 0.5-1%. After rising 3.5% in 2018, Chinese demand growth is now expected at 1.5%, down from 2% previously. As a result, any iron ore price increase should be capped, especially for the 65% representing superior grade ore. 62% grade ore, produced mainly in Australia, could still advance over the short term from today's $80/t to the $90-100 region.

Elsewhere, **oil** prices remain underpinned by steep falls in OPEC production over the last 2 months. However, Alberta province in Canada, which had announced a 325,000 b/d reduction due to falling oil prices in the country, could rapidly return to normal output as prices have recovered. Libya's output fell to 700,000 b/d in January, compared to last October's high of 1.25 million, after rebel militia took control of the Sharara field (300,000 b/d). The regular army has since recovered the field so production should resume in the coming weeks.

# CORPORATE DEBT

## CREDIT

In a mixed week, eurozone PMI January avoided recessionary territory but the European Commission revised its 2019 growth forecasts lower. Spreads were also affected by fresh worries over the US-China trade talks. The Xover widened by 8bp and the Main by around 2bp.

**SoftBank** (Ba1/BB+) posted upbeat sales and EBITDA for the first 9 months, up 5.2% and 11.3% respectively. **Thomas Cook**'s first quarter sales were disappointing due to a sharp increase in net debt and bigger operating losses. But news that its was to conduct a review of its airline seemed to reassure investors.

Zinc producer **Nyrstar**'s bonds plunged by up to 15 points last Monday after a profit warning. The group's EBITDA will probably be negative in the fourth quarter due to more expensive commodities and operating problems at its main Port Pirie site.

In an eventful week for **Dia**, its main shareholder, LetterOne, launched a bid at €0.67 a share for the rest of the equity. A minority shareholders defence association then said the bid undervalued the company and it would appear a group of investors representing 3.25% of the shares is now mulling a counter bid. The company's bonds rose over the week despite S&P cutting its rating from CCC+ to CCC on the rescue plan's execution risk.

**BNP Paribas** posted disappointing figures due to a €222m operating loss at its Global Markets division. The bank revised its 2020 guidance and intends to restructure its Corporate and Institutional Bank division in depth.

In M&A, Switzerland's **Sunrise** (telecoms) is in talks with **Liberty Global** to buy its **UPC Switzerland** subsidiary. UPC's bonds rose on the news.

**Santander** sold a $1.2bn AT1 with a 7.5% coupon. The economic conditions attached to the issue could warrant calling its PNC19 AT1 bonds but the bank has so far not said anything about this.

**Bankia** raised €1bn with a 10-year Tier 2 bond at 3.75%.

## CONVERTIBLES

Amid earnings reports, it was another quiet week on the new issues market with only 2 modest deals from small healthcare companies in the US.

**OPKO Health**, a medical test and medication company focused on diagnostics and pharmaceuticals ($1.5bn market cap), is a serial convertible issuer. It raised $200m with a 2025 convertible at 4.5%. The company intends to use the net proceeds to fund research and development to further develop and commercialise its proprietary pharmaceutical and diagnostic product portfolio and for general corporate purposes.

**Tabula Rasa Healthcare**, a $1bn market cap active in medication risk management, pharmacy cost management, and Medicare risk adjustment services, is raising $250m over 7 years with a coupon of between 1.75%-2.25% and a 27.5%-32.5% premium. The proceeds will be used to repay an existing revolving credit facility and general corporate purposes including potential acquisitions.

In the rest of the news, **Sony** rallied on its first-ever share buyback plan (JPN 100 billion). **AMS**, a European semiconductor company, released preliminary annual results in line with estimates but delivered a disappointing outlook for the current quarter. The company announced a reduction of capex and a suspension of its cash dividend policy for fiscal year 2018 which was a good signal for its bonds. In the US, **Microchip Tech** reported solid third-quarter results with revenues at $1.42bn, or slightly above consensus. While guiding below consensus for its fourth quarter revenues, management stressed that a successful conclusion to trade talks with China would be a bonanza for the business. The stock jumped 7.3% after the results.




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