EDMOND DE ROTHSCHILD

MARKET FLASH : MOMENTUM TURNS LOWER

Markets retreated in spite of yet another week of accommodating central bank comments. After the Bank of Canada left its rates unchanged and sounded a dovish note, the ECB in its forward guidance followed on by declaring that both its deposit and refinancing rates would not be raised before the end of this year. Previously, the deadline had been mid-2019. And a new 2-year cheap loan scheme for banks (TLTRO) will be introduced next September, an announcement that helped Italian spreads narrow.
These decisions are in tune with the ECB's downward revisions to growth and inflation which it says are due to protectionist and Brexit risks as well as persistent, temporary factors which are hurting Europe's economy. The ECB's caution surprised and amplified falls in sovereign bond yields as well as in the euro against the US dollar.
Persistently negative interest rates and further yield curve flattening suggest further downward pressure on eurozone bank profitability. Unsurprisingly, banks sold off sharply when the news came out. But the drop in interest rates is better news for long-duration sectors like property and healthcare. They outperformed just as they had during the previous 2 TLTRO episodes.
Market falls were also due to more fundamental aspects. Manufacturing ISM and its sister, the Michigan University index, came in below expectations and the gap with services grew even wider.
In China, the list of stimulus measures is a long one. And yet the country's official growth target was revised down after the annual National People's Congress. China's gloomy trade report added to fears over the extent of the slowdown and dragged Asian markets lower. February exports dived by more than 20%, or much more than expected, to a 3-year low while imports remained in negative territory for the third month in a row. Note, however, that lending improved markedly and that the Caixin PMI data staged a slight recovery.
In our asset allocation, the downward shift in market momentum reinforces our view that there is no reason to remain overweight equities for the moment. Valuations have returned to normal but there are still some risks. This week's trend lower could mark a turning point. Once central bank easing has been digested, investors will be forced to pay more attention to economic data.

EUROPEAN EQUITIES

After a buoyant start to 2019, European equity markets had a choppier week. News of a new TLTRO for banks to help them get a better return on cash than minus 0.4% did not have the expected effect. Instead, investors focused on the ECB's decision to slash growth forecasts for this year from 1.7% to 1.1% while inflation was cut from 1.6% to 1.2%. The bank also made clear that there would be no rate hike this year.

Banks were particularly hard hit when long-bond yields logically fell on the news and the euro also dropped sharply. But performance in the banking sector was very varied amid fresh rumours that a Baltic bank, at the heart of an alleged money laundering scandal, had opened correspondent accounts in several European banks.

The autos sector also plunged on concerns that the US might turn on Europe once its dispute with China had been settled. Nor was **Schaeffler**'s guidance warning any help.

Defensives with good visibility naturally outperformed the market while technology continued lower. Fortunately, this week's earnings reports were generally robust.

US EQUITIES

US markets lost ground with the S&P down 1.24% and the Nasdaq 1.47% lower.

After taking optimistic indications on the US-China trade talks into consideration, markets are now looking for fresh catalysts to boost the global economy. Investors showed concern after the ECB reduced growth forecasts for the eurozone, Beijing introduced new stimulus measures and the Fed's released its Beige Book, revealing the damage done by the Federal shutdown.

From the macroeconomic standpoint, Services ISM came in at 59.7, or better than the 57.3 estimated new home sales hit 621,000, or higher than the 585,000 expected by the consensus, and weekly jobless claims were in line (223,000 vs. 225,000 expected).

Thee S&P sectors advanced: **communication services** (+0.71%), **utilities** (+0.52%) and **property** (+0.21%). Losers were led by **industrials** (-2.54%), **healthcare** (-2.27%) and **financials** (-2.17%).

In retail, **Target**, **Costco** and **Kohls** all beat consensus estimates and gave upbeat guidance. In contrast, **GE**'s CEO said its industrial division would continue to burn cash this year and **Kroger**'s disappointing figures depressed the food retail sector.

JAPANESE EQUITIES

Japanese manufacturing stock prices remained weak due to the aggravated slowdown in the global economy, especially decreasing exports to China. The TOPIX lost 0.87%. The Composite Index, which is a comprehensive economic indicator, has declined for three months in a row in recognition of the slowdown. Production is decelerating while employment remains sound.

By sector, automobile-related sectors such as Transportation Equipment (-2.88%) and Rubber Products (-2.61%) underperformed. Auto producers such as **Isuzu**, **Suzuki Motor**, **Mazda**, **Subaru** and **Nissan Motor** lost ground. Semiconductor producer **Renesas Electronics** fell on news of a partial suspension of production after inventory adjustments caused a slump in global demand.

On the other hand, truly competitive companies in global markets such as **Murata Manufacturing** and **Kyocera** rose on the positive news that **Huawei** has asked them to increase supplies of their essential electronic parts for new models made by major Chinese smartphone producers.

EMERGING MARKETS

Emerging markets saw profit taking this week. While the trade negotiations made progress, neither the US or China is expecting an imminent trade deal given that no date for the Trump-Xi summit has yet been set.

In **China**, February trade data fell 20.7% YoY, or much worse than the minus 5% expected. The news acted as a wake-up call for the strong Chinese market rally which had mainly been driven by policy easing and trade deal expectations.

Combining January and February data, exports dropped 5% YoY after rising 10% in 2018. The latest government report set the GDP growth target for 2019 at 6%-6.5%. Monetary policy should underpin economic growth; the fiscal deficit target is 2.8% of GDP (vs. 2.6% in 2018). VAT for manufacturing will be reduced from 16% to 13% and corporate social security contributions will be lowered by 3-4%. The government aims to reduce tax and fee burdens by RMB 2 trillion in 2019.

CTRIP had a better-than-expected fourth quarter with 22% YoY top-line growth thanks to the accelerated recovery of its transport business. Revenue guidance was given at an encouraging +20% this year. **Weibo** reported fourth-quarter results in line while management highlighted headwinds in the first half of 2019 from weakness in key accounts and SMEs.

Korea's latest market data indicated that the first quarter DRAM price decline had accelerated to around 30% QoQ due to slower-than-expected inventory digestion.

In **India**, NHB (National Housing Bank) proposed standards to improve regulation of home financing companies including raising capital adequacy ratios from 12% to 15% in 2022 and capping the overall borrowing limit to 12 times net capital levels. **Matahari Department Store** published disappointing fourth-quarter results with further same-stores sales growth slowdown to below the original guidance, a contrast with the recovery seen by other retailers. The company also lowered its dividend payout ratio from 70% of net profit to 50%.

In **Brazil**, the market was closed part of the week due to the carnival holiday. A quick report from the BTG Conference: Brazilian companies still see the economy recovering in the first quarter of this year with higher same store sales, increased light and heavy vehicle traffic and improved demand for loans. Nevertheless, all eyes are how Pension Reform, which is expected to be voted through on August 19, is rolled out. In a more negative vein, **CCR** has agreed to pay R$750m, or more than expected, to settle corruption charges in Parana. And, according to a local newspaper, the State of Sao Paulo may start a new investigation over contract amendments. **Vale**'s CEO, Fabio Schvartsman, and other executives stepped down after the recent dam disaster.

In **Argentina**, inflation remained much higher than expected due to last year's Peso depreciation which mainly hit food prices. **GF Galicia** results were 9% above expectations due to higher interest margins but Argentine stocks mainly moved on macroeconomic considerations.

COMMODITIES

In a mixed week for **oil** prices, Brent crude and WTI hit highs of $66.5 and $56.9 before falling back and ending only 0.5% higher for Brent and 1.5% better for WTI.

This marked volatility was due to oil-price specific news on supply as well as other macroeconomic factors. The latest OPEC export figures backed up the trend seen since December. OPEC exports fell by 500,000 b/d over the month to 24.2m, a low not seen since October 2018 due mainly to Saudi Arabia and the UAE. The cumulative drop since December is now running at 1.8 million b/d, one of the largest falls in OPEC history and one that is likely to continue given Saudi Arabia's comments on exports.

Current tension in Algeria has not yet hit exports which actually rose over the month by 257,000 to 760,000 b/d.

The situation is obviously more complicated in Venezuela with no exports to the US on account of sanctions whereas they amounted to an average of 460,000 b/d in 2018. Around 1.2 million b/d was loaded onto tankers but only 1 million b/d actually exported. Venezuela even seems to be struggling to find enough tankers for its exports due to a lack of financial guarantees. India and China are the natural buyers of the country's crude but neither seems to be jumping on the opportunity.

In more positive supply side news, Libya's Sharara site (315,000 b/d in capacity) returned to production after shutting down last December. Elsewhere, recent 2019 budgets from major US producers show that they will be moderating production growth to +8/10% and increasing their focus on free cash flow generation instead. **ExxonMobil** and **Chevron** have also raised their production objectives in the Permian basin, the core shale oil region. Exxon is looking to raise output there from 600,000 to 1 million b/d in 2024 and Chevron from 600,000 to 900,000 b/d in 2023.

On the macroeconomic front, the outlook for a US-China trade agreement has improved but downward revisions in growth in China and the eurozone have been negative for sentiment. The euro's fall against the US dollar amplified the fall in oil prices last Thursday and **gold** was relatively weak too.

CORPORATE DEBT

CREDIT

The upward trend early in the week reversed on Wednesday on fears of an economic slowdown. The Xover widened by 5bp and the Main by 1bp.

Financials underperformed sharply at the beginning of the week on allegations of money laundering. The previous week, **Swedbank** was dragged into the scandal. This week, there were reports the **Nordea** was also involved, with around €700m moving through its Estonian business. And a report from the Organized Crime and Corruption Reporting Project claimed that European banks like **ING**, **ABN Amro**, **Raiffeisen Bank**, **Rabobank** and **Crédit Agricole** might also be involved in a money laundering network. €3.5bn from Russia appears to have been moved through Lithuanian banks between 2006 and 2013. So far, amounts per bank have not been specified but Raiffeisen was severely hit by the news and has launched an enquiry.

Third quarter results at **Picard** (B2/B) for FY2018/19 were hit by French "yellow vest" disruption. Sales fell 1.9% and EBITDA by 5.1%. Nevertheless, EBITDA came in higher than expected by analysts thanks to good margin management. **CMA-CGM** (B1/ B+) saw annual sales rise 11.2% on higher volumes and a slight increase in average freight prices. Even so, EBIDTA plunged 45% and debt rose due to the acquisition of **Ceva Logistics** and **Containerships**. Germany's **Schaeffler** (ball bearings) disappointed the market by unveiling a restructuring programme and guiding on a difficult market in 2019 due to the switch to electric cars. **Thomas Cook** is expected to announce the sale of its **Condor** airline to **Lufthansa** in the near future. The news had a limited impact on its bonds; the disposal is good for debt reduction but will mean a bigger focus on its travel agencies.

Scientific Games (B2/B) raised $1.1bn over 7 years at 8.25%. **Erste Bank** raised €500m with an AT1 at 5.125%. **Credit Mutual Arkea** raised €750m with a 12-year Tier 2 bond at 3.375%. **BFCM** raised €1bn with a 10-year Senior Non-Preferred bond at 1.75%.

CONVERTIBLES

With the earnings season behind us, the new issues market naturally revived with 5 deals for a total of $6.5bn.

In Asia, **Link Reit** (property investment) raised HK$ 4bn over 5 years at 1.6% and with a 22.5% premium to (re)finance renewable energy projects. In the US, regulars on the convertible market returned for more. Investment company **Ares Capital** raised $350m over 5 years at 4.625% and with a 15% premium to repay its outstanding debt. **Exact Sciences** (non-invasive molecular diagnostics) raised $650m with a senior convertible due 2027 and with a coupon of 0.375% and a 27.5% premium; the proceeds will in part go on refinancing its outstanding 2025 convertible. **PluralSight** (online educational software) raised $550m, including a $85m greenshoe, over 5 years at 0.375% and a 32.5% premium.

In Europe, **Vodafone** issued the biggest sterling-denominated jumbo convertible ever, raising £3.44bn in 2 tranches, one due 2021 at 1.2% and the other due 2022 at 1.5%. The proceeds will go on funding the acquisition of **Liberty Global**'s German, Czech Republic, Hungarian and Romanian assets and on refinancing bank loans.

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