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# MARKET FLASH: POLITICAL ISSUES DOMINATE

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September 14, 2018

## On the markets

Politics continued to hog the limelight. The main news was the resumption of US-China trade talks, a development which prompted gains for risk assets. Elsewhere, Italian bonds continued on their bounce but the run was disrupted by rumours that tensions between Giovanni Tria, the finance minister, and the 5-Star party over budget discussions might lead to his resignation. In this somewhat motley administration, he is seen by investors as the only guarantee of a reasonable economic policy aimed at maintaining financial order.

In Turkey, the central bank ended up raising rates to 24% from 6.25%, or much more than expected, after dithering for some time as the lira tumbled, inflation rose and President Erdogan launched violent attacks on high interest rates. Turkey's government has lost a lot of credibility in recent months, but this monetary tightening clearly marks a break. It will naturally take more than this to make up for the lost ground but such a move can only assuage investor concerns over European bank exposure to the country.

Meanwhile, talks between the UK and the EU on Brexit have resumed and the communiques are a little more encouraging on the chances of reaching an agreement on complex issues like Ireland. However, it is not a done deal and it is far from certain that Theresa May will manage to get parliamentary approval should a deal be reached. The ruling Conservatives are still very divided over how to manage the process.

## ▶ EUROPEAN EQUITIES

The ECB painted a rosy economic picture and confirmed that its quantitative easing programme would gradually be wound down. Its monthly purchases will drop from €30bn to 15bn from October 1st and will end altogether on January 1st 2019. There will be no rate increase before mid-2019. The euro rebounded on the news and moved above 1.17 against the US dollar.

Elsewhere, amid lingering trade war worries, semiconductors were particularly hard hit with **Infineon** and **ASML** falling sharply.

Autos also continued to suffer, dragged down by news that new registrations in China had fallen 7% in August. **Valeo**, which has high exposure to the country, hit a 3-year low. Oil stocks, in contrast, rose as prices increased on US stock news and the expected consequences of Hurricane Florence. Momentum remained strong in the luxury sector with **Hermès** announcing strong first half figures and record operating margins. The entire sector moved up in sympathy.

In an active week for corporate transformation news, **Ferragamo** gained ground after a private equity fund showed an interest in the company and despite the group's head of investor relations saying the family had no intention of selling.



**FCA** rose on news that its auto parts **Marelli** subsidiary might be sold for more than \$7bn. The Tiger Global fund has doubled its stake in FCA to more than \$1bn. The chances of **Commerzbank** and **Deutsche Bank** merging their domestic retail and investment banking divisions rose after an interview with Germany's finance minister in Der Spiegel. **Leonardo** bounced after saying it could find other buyers for the ATR to replace Iran. **TF1** rose despite denying merger talks with **Mediaset**. **Natixis** is selling its specialist financing activities to **BPCE** for €2.7bn. The deal will have a positive impact of 200bp on its CET1.

## ▶ US EQUITIES

Markets enjoyed a slight bounce and flirted with their all-time highs. The S&P gained 1.1% and the Nasdaq 1.4%. CPI came in at 2.2% ex food and energy, or below the +2.4% expected. The market benefited from a slight fall in trade tensions while **Apple's** strong performance on its new launches gave momentum to tech stocks.

According to the Wall Street Journal, Washington is considering fresh meetings with Chinese officials before applying new customs tariffs. Beijing said it was open to talks resuming. Donald Trump said there was no urgency. Reduced trade tensions caused US 10-year yields to move close to 3% while the dollar slipped to 1.17 against the euro vs. 1.15 at the beginning of the week. The euro gained after Mario Draghi said economic conditions were strong.

On September 25, the US attorney general, Jeff Sessions, might decide to launch an official investigation into internet giants. In the meantime, the US justice department will be looking to see if **Google**, **Facebook**, **Apple** and **Twitter** are infringing rules in areas like consumer protection. Donald Trump is known to suspect companies like Google of bias.

Sector rotation into defensives continued even if the index moved higher. Telecoms and healthcare gained 3% and 1.5% respectively while financials lost 1% despite some yield curve steepening.

## ▶ JAPANESE EQUITIES

Japan's real GDP (Apr-Jun) was revised upwards from a preliminary 1.9% to an annualised 3% on robust capex. And July machinery orders rose 11% MoM or better than expected. Stock market sentiment was still cautious due to external factors but economic fundamentals and corporate investment in labour-saving automation were strong. The TOPIX ended the week 1.53% higher as concerns over US-China trade disputes receded.

By sector, Mining, Oil & Coal Products outperformed, and domestic demand sectors such as Information & Communication, Pharmaceuticals and Retail Trade were also strong. **SoftBank Group** surged 10.56% and **Seven & i Holdings** gained 7.82%.

On the other hand, Electric Appliances slipped 0.85% with **Murata Manufacturing** down 7.57% and major SPE producer **Tokyo Electron** 5.17% lower.

In the coming days, some uncertainty should lift after an LDP governor election on September 20 (PM Shinzo Abe is highly likely to win) and resumption of US-Japan trade talks the day after. The market is still worried by Washington's unreasonable stance and the gap between cautious market sentiment (as seen in undervalued stock) and robust earnings has been expanding.

**Kansai International Airport**, which suffered disruption from a typhoon, very quickly reopened for business.

## ▶ EMERGING MARKETS

Emerging markets rebounded towards the end of the week due to US inflation data surprising on the downside and renewed hopes of a less protectionist push from the US.

In **China**, August credit data showed stable progress on financial deleveraging with M2 growth slowing to 8.2% YoY from 8.5% in July while aggregate financing rose partly due to solid corporate and local government bond financing.



Industrial production was slightly higher than in the previous month, up 6.1% in line with expectations. Retail sales in August increased by 9% or higher than the 8.8% expected, with online retail sales growth reaccelerating to 29% YoY. The State Council proposed a deleveraging target for SOEs: -2% leverage ratio in 2020 versus 2017.

Stricter regulations were announced for the education and healthcare sectors: the Ministry of Education released a special notice to reform after-school tutoring institutions with mandatory requirement of teacher licensing and standardization of class listings, on top of special inspections to begin in October 2018. State Medical Insurance in China also announced that 33 drugs under trial tendering in 11 big cities might have their prices cut by 10-40%. **Tencent** bought back a total amount of 522,000 shares over 5 consecutive days, showing strong confidence in management despite headwinds from the suspension of license approval in the online gaming industry.

**Apple** said new iPhones would retail \$50-100 higher than expected, which may limit the volume upside to the supply chain in Asia. **TSMC** is the sole supplier for the new A12 chip on 7nm. India will hold an economic review meeting over the weekend (hosted by Prime Minister Modi) to discuss how to curb the rupee sell off. **India's** July IP growth remained largely steady, moderating to 6.6% YoY in July down from 6.9% YoY in June. Wholesale price inflation moderated to 4.5% YoY in August from 5.1% previously; CPI also moderated to 3.7% YoY from 4.2% in July, led by a sharp reduction in food price inflation.

**Brazil** underperformed among emerging markets due to increasing electoral uncertainties. **Bradesco** and **Itau** (the largest private banks) said results were improving due to lower inflation, higher disposable income and higher job creation. In **Mexico**, the highlight was the acquisition of **Cornershop** by its parent company **Walmart** for \$225m. **Walmex** will then acquire Cornershop's operations in Mexico and Central America (financial details not yet available). Overall, we see this transaction as positive and a good fit for Walmex's plans of accelerating its digital transformation.

**Argentina's** central bank kept its repo rate unchanged at 60% to contain inflation. President Macri met with the governors to work on formulating zero deficit proposals. **Turkey's** central bank raised interest rates by 650bp or more than expected. This is a positive surprise, but future fiscal measures will be crucial in creating some coherent policy. Developments in Turkey and Argentina were a step into the right direction and a vote of confidence in emerging markets.

## ▶ COMMODITIES

The **oil** price rebound continued with Brent crude flirting with \$80 or at the top of the \$70-80 trading range in place since April. WTI is bang in the middle of its \$65-75 range. Monthly reports from OPEC, the IEA and the EIA showed that all three were moving towards raising estimates of demand growth for 2019. This is down to mounting worries over a trade war and weakness in emerging country currencies. The EIA has also sharply reduced supply growth estimates for non-OPEC production, especially in the US due to pipeline constraints. OECD commercial inventories edged 8 million barrels higher in July to 2,824 million or 50 million barrels below the 5-year average (they had fallen by 33 million in June).

The IEA highlighted short-term risks like further falls in Venezuela's output and incipient drops in Iran's exports. Chinese buying of Iranian crude fell by 250,000 b/d in August while India bought 380,000 b/d less. However, in both cases buying in July had risen to a 12-month high in anticipation of sanctions. Elsewhere, South Korea, which normally takes 200-400,000 b/d, bought no Iranian oil at all in August. Iran reacted by starting to stock oil in its super tanker fleet. All these developments could push Brent crude about \$80 although refinery maintenance operations mean September and October are low-consumption months.

The **gold** ounce moved back above \$1,200, after hitting an intraday low of \$1,160 a month ago but is still under pressure due to a very probable US rate hike on September 26.



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## ▶ CORPORATE DEBT

### CREDIT

Corporate bonds rose with the **Xover** tightening by 8bp to 280bp and **iTraxx Main** by 4bp to 60bp.

**CMC di Ravenna** (B2/B) said what it called temporary problems over receipts in Italy and emerging countries had led to a substantial increase in its net debt. The group nevertheless said it was in a position to honour its financial bonds. On the new issues market, **Jaguar** (Ba2/BB) raised €500m at 4.5%.

Subordinated financial debt performed well throughout the week. Press reports contained fresh news of a **Deutsche Bank/Commerzbank** tie-up. It was also reported that Deutsche Bank was thinking about creating a holding company to ease the merger process for some of its departments.

Bankia sold an AT1 at 4.625%.

### CONVERTIBLES

On the primary market, **SGL Carbon** (carbon and graphite material producer which has radically refocused its business model on car manufacturers and batteries) raised €160m over 5 years at 3% to refinance existing debt and increase financial flexibility for further growth. **DocuSign Inc.** (electronic signature solutions) raised \$500m over 5 years at 0.5% to go on purchasing a capped call, working capital and strategic investments.

**European TopSoho** issued a €165m bond exchangeable into **SMCP SA** shares (Sandro Mage Claudie Pierlot designs and markets apparel and accessories) and a concomitant €60m repurchase of the exchangeable bonds due 2019.



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