MARKET FLASH

September 16, 2016

On the markets

Although it was not a particularly busy week for economic statistics and results, markets turned hesitant ahead of next Wednesday's Fed and Bank of Japan meetings. It is highly unlikely the Fed will hike rates in September but investors will be watching for any statements so as to anticipate a later move. The Bank of Japan's statements will also be scrutinised as it wants to get inflation higher and preserve the bank sector by helping to restore the yield curve. In fact, some strengthening of the curve occurred in Japan as well as in Europe and the US at the beginning of the week before stabilising mid-week. In Europe, spreads between peripheral countries and Germany widened in recent days as risk aversion increased across the board.

As far as asset allocation is concerned, we view year-to-date underperformance in European equities as unwarranted. Results have been in line with US stocks, earnings expectations are being revised higher and lending has resumed to households and non-financial companies.

EUROPEAN EQUITIES

Europe started and finished the week on the back foot as volatility rose, trading volumes fell and the oil price retreated. This took place just a week ahead of a Fed decision on an interest rate hike which looks increasingly unlikely. Bank, insurance and energy stocks were the worst hit while defensives fared better.

In company results, luxury stocks came under attack despite **Richemont** reporting in line with expectations. Watch industry figures continued to reflect problems with inventories and were not offset by jewellery sales. **Hermès** decided to stop issuing detailed guidance on sales, the only company which had hitherto done so, and markets interpreted the decision as a profits warning. The stock plunged 8% on the news despite upbeat half-year figures which showcased improved sales and profitability. **H&M**'s August sales were disappointing (+7% when the consensus was expecting +12%) and its stock levels looked risky. **Zodiac** returned to 3.9% in like-for-like growth in the fourth quarter and other company announcements suggested that the group had returned to normal trading conditions. A new CFO has been appointed. **Renault** said global sales had risen 8.6% in July and 22.2% in August, a performance that reflected strong momentum in its new range and a good balance between Europe and the rest of the world. Ongoing growth rates and cost reductions scheduled for the second half suggest 2016 results could be good.

In M&A, **Monsanto** finally succumbed to **Bayer**'s bid proposals after weeks of talks. The USD 66bn deal will be funded by debt and a rights issue. Bayer expects the tie-up to be earnings enhancing from 2018, the new entity's first full year. In contrast, **Praxair** and **Linde** abandoned talks over a friendly merger due to disagreements over the location and role of the future head office.

US EQUITIES

Markets edged higher after the previous Friday's steep fall when volatility surged. Retail sales ex autos and energy slipped 0.1% when they were expected to rise

0.3%. August industrial production fell 0.4% compared to the previous month while industrial capacity utilisation was in line with the 75.5% expected.

Among a crop of acquisitions in the semiconductor sector, **Renesas Electronics** acquired **Intersil** for USD 3.22bn, a 43.9% premium. Renesas hopes to complete the deal before June 2017. Elsewhere, the **Monsanto/Bayer** deal is the largest ever all-cash bid.

Apple jumped 9% after operators Sprint and T-Mobile said the new iPhone 7 was seeing very strong demand (Apple had refused to communicate on the subject). **General Motors** unveiled the characteristics of its future electric car, the Bolt, in a sign of its determination to unseat Tesla. Bolt will be marketed this year and will run for 380km after a full charge. This is more than Tesla's Model 3 which is expected to be launched in 2017 with a range of 345km. Bolt will be priced in the same USD 37,500 range as Tesla models.

Over the last 5 trading sessions, only technology managed to advance thanks to Apple. Energy and commodity stocks both fell sharply.

JAPANESE EQUITIES

Following a decline in US stock and oil prices, Japanese indices ended the week at a three-week low with the Topix down 3,3%. Financials were the worst performing sector. As speculation grew that the BoJ might deepen its negative interest rate policy at next week's committee meeting, major banks such as **Resona**, **Sumitomo Mitsui Trust**, **MUFG** and **SMFG** fell sharply on the potential hit to margins. The Real Estate sector was also hit with three mega developers, **Mitsubishi**, **Sumitomo** and **Mitsui** down by 4%, 4,9%, and 5,7% respectively.

On the other hand, market participants now expect the central bank to reduce purchases of long term 20/30-year bonds so as to steepen the yield curve. That would benefit investors in long term debt, particularly life assurance companies. As a result, the yield on 20 year **JGB**s increased to a six-month high and **T&D Holdings** rose by 4%, making the life assurance company the week's top performer among Topix large 100 names. **Nintendo** initially climbed on news that it would be launching a new Mario game series for iPhones, but ended the week 3,7% lower as investors locked in profits.

EMERGING MARKETS

Emerging market stocks continued to fall throughout the week as growing concerns over the ability of central banks to stimulate global growth led to their worst run in three months. However, losses were pared towards the end of the week as the odds of a Federal Reserve interest-rate hike receded.

China's credit expansion saw a strong rebound in August with new loans coming in at RMB 2.4 trillion. Near-term growth was mainly fuelled by a property boom in the biggest cities. August macroeconomic data showed an improvement in the country's economic outlook. Industrial production (IP) grew 6.3% YoY in August, beating expectations of +6.2% and July's +6%. Two of the bright spots were higher manufacturing and increased electric vehicle production.

Record-breaking winds and heavy rains disrupted transport and led to power outages as super typhoon Mirant cut a path across **Southern Taiwan** and headed towards China.

Thailand's central bank kept its benchmark interest rate unchanged for its 11th consecutive meeting, the longest streak on record, as an economic recovery continued to gain momentum.

Although **Indonesian exports** fell 0.7% in August from a year earlier, this was far better than the 10.6% drop forecast by economists and could signal a turnaround for a sector that had been in decline for almost two years.

The Indian telecoms sector saw some consolidation when **Reliance Communications** announced the demerger of its wireless operations into a 50/50 joint venture with **Maxis** (Aircel's promoter) to create the 4th-largest telecom operator. The deal is likely to be completed in the first half of 2018. India's trade deficit remained at a low USD 8bn in August or within the range seen in the last couple of months.

COMMODITIES

This week's headline event was the sharp fall in the **oil** price on worries over excess supply. Trading in metals was more mixed.

Brent crude lost USD 2 to 45. The sell-off was primarily on rising concerns of increased production in Nigeria and Libya. The Nigerian situation seems to be improving -Exxon resumed exports from Qua Iboe in July- and Libya's national company NOC lifted force majeure in the country's ports after the national army under General Hafter took over the oil terminals. NOC also said it could increase output by 300,000 b/d by next month from today's 300,000 b/d. Pre-revolution levels were at 1.4 million b/d.

The IEA, OPEC and the EIA all released their monthly reports. The IEA had the biggest market impact after revising down demand growth expectations for 2016 by 0.14 million b/d to 1.28 million. The agency cited slowing demand in China and India. We confess we are rather surprised by this move as Chinese demand and future prospects still look positive: crude imports rose 24% in August and domestic production has not stopped declining and fell 9.9% YoY in the same month. And according to the China Association of Automobile Manufacturers (CAAM), auto sales have also risen 12.7% to 14.2 million YTD. Demand in India is equally strong and even increased to 11.4% YoY. The agency also revised down its forecasts for demand in 2017. All 3 agencies have revised up non-OPEC output for 2017 to reflect US drillers resuming production.

After last week's plunge in inventories due to tankers being unable to dock in the US, the market was expecting stocks to return to normal. Instead, they slipped a little but investors preferred to focus on a 35,000 b/d rise in US production, 30,000 of which came from Alaska.

CORPORATE DEBT

CREDIT

September 21 is the new target date for any decision on rates from the Bank of Japan and the US Fed. In the meantime, credit markets saw fresh volatility and indices widened. The Main ended at 72 while the Xover widened to 336. In investment grade, inflows remained strong thanks to the ECB and also the CSPP which has bought more than EUR 23bn in bonds since it was launched in June. The new issues market was calmer. **Novartis**, **BP** and **ENI** sold debt with rather long maturities and **Saint-Gobain** issued a zero-coupon bond with a 3 and- a-half year maturity.

The week was notable for high volume on the High Yield new issues market as it reopened after the summer break. There were 7 new issues including **Ziggo**, the Dutch cable operator (JV Liberty/Vodafone) which raised more than EUR 3bn to refinance and cover the payment of a dividend. As well as **GFKL** (financial services) and **Thom Europe** (jewellery), car rental company **Hertz** refinanced its euro and US dollar debt by raising more than EUR 1bn.

Financials were affected by the USD 14bn+ fine levied by the US Department of Justice on **Deutsche Bank** for mortgage mis-selling during the 2007-8 crisis. **SwissLife** issued a perpetual NC 10 bond with a 4.5% coupon.

CONVERTIBLES

"Like London buses…" After months of waiting, we saw the third successive week of robust primary activity in the convertible bond market, this time in all regions around the world. Having said last year that it wanted to sell **Vimpelcom** (one of the world's largest integrated telecom operators, primarily operating in Russia), **Telenor** came to market with a jumbo deal – a USD 1bn 0.25% 3-year convertible bond - which proved a huge success and rose as far as 106 in early trading.

In the US, **Oasis Petroleum (OAS)** issued a USD 275m 2.625% senior unsecured 2023 maturity, the proceeds of which will be used to tender for a portion of the company's 2019-2023 unsecured notes. In Asia, just before the mid-Autumn Festival, **Charoen Pokphand Foods PCL** (Thailand's largest meat and feed producer) offered USD 300m of 5Y convertibles exchangeable into **CP All** shares (the country's largest convenience store operator); the proceeds will be used to repay existing debt and/or on general corporate purposes.

In Japan, after being placed with domestic retail investors on September 7th in conjunction with a share placement, **Aeon Financial**'s 3-year, JPY 30bn convertible was made available to global investors to trade on exchanges from September 15th. The company runs the consumer credit services of the Aeon Group (one of the largest retail groups in Japan) both in the domestic market and across South-East Asia.

Given recent movements in equities and interest rates, we expect the primary market to remain active in the weeks to come. **Bayer**, for example, says it intends to issue a mandatory convertible bond, partially to finance its planned tie-up with **Monsanto**. The strength in the primary market, coupled with recent stabilisation in fund flows, supports our upbeat view on the asset class up to the end of the year.

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EDMOND DE ROTHSCHILD ASSET MANAGEMENT (France)
47, rue du Faubourg Saint-Honoré, 75401 Paris Cedex 08
Société anonyme governed by an executive board and a supervisory board with capital of 11,033,769 euros
AMF Registration number GP 04000015 - 332.652.536 R.C.S. Paris –
Tél: +33 (0)1 40 17 25 25 - Fax: +33 (0)1 40 17 24 42
www.edram.fr