EDMOND DE ROTHSCHILD

MARKET FLASH :
BREXIT DEVELOPMENTS KEEP INVESTORS ON EDGE

It was a busy week for economic, monetary and political developments. In Europe, the Brexit soap opera kept investors on edge. Theresa May's battle in Westminster continued after another defeat in the Commons for her Brexit solution and the Speaker's refusal to allow her to submit it to a third vote unless it underwent substantial changes. The clock continued to tick. As the EU does not want to be held responsible for a no-deal, it agreed to a 2-month extension but conditional on Westminster approving the plan next week. If not, the March 29 deadline will be put back only to April 12. This new uncertainty triggered a pullback in sterling.
Elsewhere, this week's European figures were not exactly encouraging. PMI data in both Germany and France was very disappointing. European growth is struggling to stabilise, at least among industrials.
US data also suggested a slowdown was on the cards. Consumer confidence rose but production and home sales were disappointing. As a result, the Fed reinforced its accommodating bias at its latest FOMC, saying that it now expects there will be no rate hikes this year and only one in 2020. The bank also said it would stop shrinking its balance sheet in October and reduced its growth and inflation forecasts. In short, the global economy and central banks are in wait-and-see mode.
Equity markets started the week higher but reversed when European data and Brexit uncertainty sent bond yields lower. German Bund yields actually moved into negative territory.
Over the week, we continued to reduce equity exposure while maintaining short duration in portfolios. We are now slightly underweight equities. We take the view that, following the sharp rise at the beginning of the year, markets need to pause before making any further moves higher.

EUROPEAN EQUITIES

After several up sessions, momentum stumbled due to fresh US-China tensions, uncertainties over Brexit after the EU gave the UK an extra fortnight, and a very disappointing 44.7 reading for German's manufacturing PMI.

The culprit behind this poor PMI performance was the autos sectors. Following on from **Leoni**'s decision to suspend its guidance for this year, **BMW**'s forecasts for 2019 were more cautious than expected. And yet the sector had risen at the beginning of the week after the **Peugeot** family said it was open to further acquisitions after **Opel**, a declaration that sent **FCA** much higher. Germany's Dax index was also dented when **Bayer** plunged on news that a Californian court held RoundUp responsible for a cancer. This could open the way for more litigation.

Banks reversed gains due to falls in long bond yields after the FOMC struck a more dovish tone than expected. The sector had previously been buoyed by confirmation that **Deutsche Bank** and **Commerzbank** were discussing a merger even if there is not yet any political consensus on the move.

Online payment companies were boosted after **FIS** bought **Worldpay** at a lofty multiple and **Nexi** launched its IPO proceedings. **Wirecard**, however, was soon engulfed in fresh rumours over management misconduct with the conclusions of the external audit still to come.

EssilorLuxottica fell sharply after leading shareholder Leonardo Del Vecchio gave an interview which showcased how serious the group's governance crisis really was. **Elior** also tumbled after investors viewed the €1.5bn received for the disposal of its Areas concession subsidiary as not high enough. But there was also some good news this week. Semiconductor stocks rose after **Micron** said demand might recover in the second half.

Smiths Group's first-quarter results were slightly better than expected and the group maintained its guidance for the full year. **Smiths Medical** was a brake on overall improvement but the group confirmed that it was to be spun off and listed separately in the UK. After intense competition in France in 2018, **Iliad** said it might sell some of its mobile reception masts to raise some cash.

US EQUITIES

The S&P500 rose 1% and the Nasdaq 2%. **Tech** and **consumer** stocks gained 3% while **financials** lost 2%. Although the Fed had already indicated a shift in policy back in January, the March FOMC turned out even more accommodating in tone than expected. Chairman Jerome Powell said he was not convinced inflation would return symmetrically to its 2% target.

Elsewhere, **energy** stocks rose after WTI edged 0.6% higher to trade at over $60 for the first time this year.

In company news, **Nike** reported an upbeat 7% rise in sales thanks to strong online performance in the fourth quarter. The company reaffirmed expectations of an 8-10% rise in 2020. **Google** unveiled its new Stadia platform as part of its aim to move into the online game market. **Nvidia** revised its forecasts for its cryptocurrency activities lower but remained upbeat on 2020 results. **Biogen** came under serious attack after it halted clinical tests for an Alzheimer drug due to poor results.

JAPANESE EQUITIES

Japanese stocks remained firm as excessive worries over China's economy receded and in spite of the government revising the macroeconomic outlook lower on sluggish exports to China and some weak production data. The TOPIX rose 0.73% for the week.

Japan's average official land prices increased for the fourth year in a row (+1.2% YoY). In commercial areas, they even accelerated to +2.8% YoY, especially in Tokyo, Osaka and Nagoya (+5.1% YoY), and four key cities in other regional areas (+9.4% YoY). Other areas which are attracting foreign tourists such as the Niseko ski resort in Hokkaido also saw a substantial increase in land prices.

Over the week, **Sumitomo Realty & Development** gained another 3.72% on growth in office building developments in cities as well as expectations the BoJ would go for more monetary easing. On the other hand, **Seven & i Holdings** lost 4.48% following its decision to halt 24-hour openings at some convenience stores because of difficulties finding staff to work nights.

EMERGING MARKETS

Emerging markets performed well this week after the Fed reassured markets that rates would remain unchanged for longer. US and Chinese negotiators are planning new rounds of talks starting next week for further progress towards a final agreement. In **China**, the NPC concluded with an earlier-than-expected implementation timeline of announced cuts in VAT and social pension contributions starting 1st April and 1st May respectively. President Xi Jinping started his EU visit in Italy, which may become the first G7 country to sign an MoU on the Belt Road Initiative.

Tencent reported a 28% rise in fourth quarter revenues with net earnings 13% higher. The PC game segment has slowed less than markets expected, while Fintech and payment businesses continued to deliver decent growth. **3SBio** missed topline (+22.7%) and bottom-line growth for FY18, but management is still guiding for 20-25% in revenue growth while expecting more products will be added to the next National Drug Reimbursement List. **Wuxi Biologics** posted full-year revenue growth of 57% with net profits 150% higher. **China Mobile** published inline results but the 49% payout ratio without a special dividend disappointed the market. **Geely**'s earnings rose 18% YoY or in line with the consensus.

Korean DRAM makers outperformed this week on news of a capex cut at Micron after another weak quarter due to high inventories. Indian exports moderated to +2.4%YoY in February vs +3.7% in January due to a broad-based slowdown. The trade deficit narrowed to a 17-month low and the current account deficit is at 1% of GDP. **Larsen & Toubro** made a hostile bid for the IT outsourcing company **Mindtree**, which posted a 2.4% QoQ increase in revenue and projected a strong quarter ending March, citing a pick-up in its deal pipeline.

Thailand will have its election on March 24th with most parties offering minimum wage hikes as a key election promise.

Brazil's central bank once again voted unanimously to keep its benchmark Selic rate at 6.5%. Brazilian equity markets underperformed their EM peers due to a combination of factors: the arrest of former President Michel Temer, a lacklustre proposal for military pension reform and the Ibope poll which said Jair Bolsonaro's popularity had declined by 16% since January. **CCR** reported mixed results, with EBITDA 11% above consensus, but the company missed the bottom line due to higher financial expenses. **TOTVS** said that it had signed a partnership agreement with **Rede**, a positive development.

In **Mexico**, **América Movil** announced the acquisition of **Nextel Brazil** for $905bn in cash.

In **Argentina**, consumer confidence fell 3.5% MoM and 20.6% YoY in March according to Di Tella University.

COMMODITIES

WTI prices traded at $60 for the first time since November 13, reducing the spread with **Brent** from $10 (February 15) to $7.86, or the same level as at the beginning of January. Meanwhile, pressure on Venezuela and Iran increased. Iran's March exports are running at a year to date low of close to 1 million b/d, a 1.5 million drop since April 2018 and 200,000 less over a month. Washington's exemptions on Iran's crude exports will end on April 30 and traders will be watching for any extension. The US has, in fact, just granted Iraq a 90-day extension for electricity and natural gas imports from Iran to be used in its power stations and oil production.

India, meanwhile, which is still importing close to 300,000 b/d in Iranian crude, down from 400/800,000 before sanctions depending on the season, has halted imports of Venezuelan crude. India's demand growth is still robust - +3.8% over a year and +5% in February MoM - and could thus gain from an extension over Iranian crude imports. Faced with such uncertainty over possible extensions, OPEC has cancelled its planned summit in April. This means it will continue to reduce output up to June when it holds its 6-monthly meeting.

Reports from the AIE, IEA, and OPEC show no change in demand growth, a slowdown in US production growth and the impacts of reduced OPEC and Russian production. This led to OECD inventories rising less than on average in January and there was even an unseasonal drop in the following month. US crude inventories fell by 9.6 million barrels over the week whereas on average they increase by 3.8 million at this time of the year.

After the Fed announced it would put its rate hikes on hold, the **gold** ounce moved nearer to $1,320.

CORPORATE DEBT

CREDIT

Leading furniture group **Steinhoff** gave some indication on the conclusions of the independent audit into accounting irregularities. Profits appear to have been overstated by around €6.5bn between 2009 and 2017. **Huntsman** said EBIDTA for the first quarter of 2019 had been revised down by 10% or more, but said it was still sticking to 2019 objectives. **UBS** issued a profit warning for the first quarter. The bank expects a sharp drop in investment banking and global wealth management revenues. **Dia** said that an agreement in February had allowed it to renew bank credit lines for €912m, extending maturities for all tranches from this year to 2023. Shareholders also approved a €500m increase of capital proposed by **LetterOne**, once the takeover and a stable funding arrangement with banks have been agreed.

In a busy week for M&A, **Deutsche Bank** and **Commerzbank** confirmed that they were in talks over a merger. Press reports suggested Berlin was in favour of the move in spite of the job losses entailed. **Thomas Cook**, which already operates in Russia via Intourist, is reportedly thinking of spending around €117m for **Biblio-Globus**, the country's biggest tour operator. In online payment services, the US group **FIS** is to acquire **Worldpay** in a mega $43bn deal. Over the next 3 years, FIS expects to see $500m in income synergies and $400m in cost savings. According to Spanish press reports, telecom mast specialist **Cellnex**, which has just carried out a €1.2bn increase of capital, is considering paying around €3bn for 60% of its French rival **TDF** to become a European market leader.

It was a very active week for financials on the new issues market. **Barclays**, **BBVA** and **Nordea** issued AT1 debt at 8%, 6% and 6.625%, raising $2bn, €1bn and $1.25bn. **Crédit Agricole**, **Danske Bank** and Austria's **Bawag** issued 10-year Tier 2 debt (with 5-year call options for Danske Bank and Bawag) at 2%, 2.5% and 2.375%. After being 4-times oversubscribed, the first two deals performed well on the secondary market.

In investment grade, **Schaeffler** raised €2.2bn in three tranches (3.5 and 8 years) amid heavy demand. In high yield, **PPF Arena 1** (Ba1/BB+/BBB-), a Czech telecom company, made its issue debut, raising €550m over 7 years at 3.125% to refinance part of its bank debt. The bond is currently trading above par.

CONVERTIBLES

A busy new issues market welcomed some interesting profiles. **Air France-KLM** raised €500m at an admittedly thin 0.125% over 7 years. Despite almost €5bn in mandatory convertibles from **Sika** and **Vodafone**, Europe had not seen many deals since the year began. As a result, the Air France-KLM issue triggered heavy demand, especially as its pricing made it look attractive and the French government took up €71.45m of the deal.

China Education Group Holdings (education, universities and schools) raised HKD$ 2.35bn ($300m) over 5 years at 2% and with a 30% premium to fund school building/development and school acquisitions. The convertible gained 4 points on its first day of trading thanks to Beijing's new 2035 education plan which is a strong incentive for sector modernisation.

In the US, **Chegg** (online education) is a well-known convertible issuer. The company is to issue $500m at 0.125% and with a premium between 30% and 32.5%. Strong demand caused the issue to be increased to $700m. With almost $500m in available cash, Chegg could become a buyer.

Gol Linhas Aéras Inteligentes finished the road show we mentioned last week and brought forward its convertible issue date to March 22. The premium will now be between 35% and 40%, up from 30-40% previously.

On secondary markets, **Google** made a splash by moving into video games. The group's decision to do so via the cloud, rather than through hardware, is a small revolution but potential customers will need to have the required internet speeds. The move has already had repercussions in the sector. **Sony** plunged 8% on the news as Google's cloud offer effectively ducks hardware entry barriers. **Ubisoft**, in comparison, jumped 8% on the possibility that its client base will rapidly expand.

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