EDMOND DE ROTHSCHILD

MARKET FLASH : MARKETS STILL MIRED IN UNCERTAINTY

Equity and bond markets seem to have parted ways.
Equities have risen since January thanks to the Fed's more accommodating stance. But with the yield on US 10-year Treasuries at 2.4%, creating a curve inversion with 3-month rates, and the German Bund yielding a negative 0.07%, fixed income markets suggest a cyclical slowdown is in the offing. This contradiction left equity markets with no real direction over the week.

Meanwhile, a US-China trade agreement seems to be taking shape, one that would take Washington's demands into account. At the same time, US GDP growth for the fourth quarter of 2018 was revised lower to +2.2%, a sign that protectionism had had a bigger impact on the economy than expected.

The US quarterly earnings season starts at the beginning of April. US companies have apparently been struggling to pass on higher labour, transport and raw material costs to their customers and thus expected to report the first fall in earnings since 2015. According to a survey from the National Association for Business Economics (NABE), 58% of companies polled said they had seen higher labour costs and only 19% said they had managed to raise prices. As a result, the consensus view is that margins will fall, particularly in some sectors. This will represent a real test for US markets as their cyclically adjusted P/E (CAPE) is currently running at 77% above its historic mean.

In Europe, the focus remained on Brexit developments. A vote which might break the deadlock was scheduled for March 29 but only concerned the exit agreement. Theresa May's third attempt to get her agreement approved was to divide it into two parts, first a motion on the exit and therefore the thorny Irish backstop issue, and then subsequently a political declaration on future relations. Were the motion to be rejected, the actual Brexit deadline would be pushed back until the summer to allow time to find an agreement on a customs union or arrange for another referendum to be held.

Improved visibility on Brexit and a US-China agreement could restore confidence among European companies and investors.

EUROPEAN EQUITIES

Europen equity markets ended the week with no clear direction, unsure of how to read macroeconomic data and still confused over Brexit developments.

Banks, however, rallied after **Mario Draghi** suggested the ECB was mulling various ways of offsetting the significantly negative impact deposit rates of minus 40bp were having on their cash deposits. But **Swedbank** fell sharply on suspicions of money-laundering for Russian clients in its Estonian affiliate.

Emblematic profit warnings from **Infineon** and **Osram Licht** underlined persistently difficult trading conditions in China, and particularly in the autos sector. Infineon slashed guidance on sales from +9% to +5% and margins from 17.5% to 16% due to auto and industrial sector softness in China. And Osram Licht, citing the same problems in China, now expects sales to fall by 11-13%, a radical shift from its previous guidance for flat to +3%. Both companies no longer seem to be banking on a rapid rebound in their Chinese businesses.

On a more cheerful note, civil aviation momentum remained robust. The visit of China's President Xi Jinping to France resulted in a mega order of close to €30bn for **Airbus**, 290 Airbus A 320 models and ten A350 planes.

In M&A news, **Immarsat** (satellites) received a bid from a consortium of investors. And there were several press reports that **Peugeot** and **Renault** might both be interested in buying **Fiat Chrysler**. In retail, **FNAC Darty** was reportedly in talks to buy **Nature & Découvertes**. The governance crisis at **EssilorLuxottica** became official after the holding company of Leonardo del Vecchio, the group's largest shareholder and executive president, said it had appealed to the International Chamber of Commerce to recognise that infringements of the 2017 merger agreement between France's Essilor and Italy's Luxottica had occurred.

US EQUITIES

US markets edged higher with the S&P up 0.5% and the Nasdaq 0.35% better. US-China trade talks resumed and markets took heart. A signature is still scheduled for some time in April. Macro data were less upbeat. Manufacturing and services PMI both missed expectations, US consumer confidence fell in March and housing starts were also down.

Cyclicals led gains with materials up 1.3%, industrials 1.8% higher and consumer discretionary ending 1.3% better. Utilities led losses, down 1.1%. In consumer stocks, **PVH** (+18.7%) and **Lululemon** both soared after beating expectations. **Ralph Lauren** (+7.63%) and **Capri** (+6.7%) rose in sympathy. Accenture jumped 5.2% after beating the consensus and raising guidance. In M&A, Centene (healthcare insurance) plunged 7.6% after bidding for **WellCare Health Plans**, a move that weighed on drug store chain **CVS**. **Viacom** gained 8.3% on fresh rumours of a tie-up with **CBS**. **Lyft** (Uber's US rival) was due to start trading on March 29 on the Nasdaq. The $72 issue price values the company at $25bn.

JAPANESE EQUITIES

Japanese stocks were volatile following declines in the US on yield curve inversion and Brexit confusion in the UK, both of which suggested the global economy was deteriorating. The TOPIX lost 2.12% and economic sensitive sectors such as Oil & Coal Products and Marine Transportation underperformed. Oil producer **JXTG Holdings** plunged 8.65%.

However, the good news was that semiconductor inventory adjustments advanced and are expected to start bottoming out. Some semiconductor and electronic part stocks were relatively firm. **NIDEC** gained 2.71% and **SMC** (pneumatic control systems) rose 2.15%.

On the domestic front, Prime Minister **Shinzo Abe**'s JPY 101 trillion budget plan, which includes JPY 2.28 trillion of fiscal measures to combat the potentially negative effects from the consumption tax hike, was approved by parliament. Furniture retailer Nitori Holdings gained 5.30% but Eisai (pharma) plunged 18.63% with a series of limit-downs after suspending clinical trials for a new Alzheimer drug.

EMERGING MARKETS

Emerging markets sold off on increasing fears of contagion from Turkey's market volatility and weak macro figures, especially in Europe and China. There was market speculation of a possible RRR cut by the Chinese central bank during the coming weekend. The local A-share market had a 3.86% bounce on Friday to finish the month with a 5.53% gain. Over the quarter it jumped 32%. Chinese industry profits dropped 14% YoY in Jan-Feb after rising 10% last year. Online sales in China for Jan-Feb decelerated to +19.5% YoY vs +30% previously. The national electric vehicle subsidy was cut by between 50% and 100% according to ranges and the local subsidy was totally abandoned. **Moutai**'s 2018 earnings rose 30% YoY. Full-year revenue growth was 26% suggesting sales grew 34% in the fourth quarter, a significant increase from the 4%rise in the previous quarter. **Mengniu** also reported solid results for 2018 with 15% top-line growth while the gross margin rose by 70bp YoY. Management continued to target core net profit growth above topline growth, which should be in the low teens for 2019. **Haier**'s 4Q18 result missed the market consensus, with flattish revenues and net profit growth due to weak consumer demand and squeezed margins due to its accent on gaining market share. Management guided for single digit top-line growth with operating profit targeting double-digit growth.

Industrial production in **Taiwan** contracted further by 1.8% in February after a 1.1% fall in January on weak electronic parts production (-6.1% YoY in February), which contributes 41% to total industrial production.

In **Korea**, **Samsung** announced a first quarter profit warning due to weakness in DRAM and Display.

In **Thailand**, the election first count pointed to a weak coalition with **General Prayut** as Prime Minister which is more of a status-quo outcome. The current account surplus widened to a higher-than-expected level in February due to a sharp drop in import growth (-7.3% YoY).

In **Brazil**, the market was extremely volatile and banks sold off. During a talk in the Senate, the Minister of Finance, Paulo Guedes, threated to step down if pension reform was not approved. We expect volatility during pension reform debates in the Congress (expected to be voted in the Congress's special commission in April/May). On the macro side, credit continued to accelerate in February to 5.5% (versus 5% in January), especially lending to individuals and companies. In company news, Vale reported in line results, with strong cash flow generation, despite a significant rise in capex.

In **Argentina**, Pampa announced a buyback programme after this week's sell off.

Turkey's currency saw strong volatility this week and banks lost 15% due to severe and unexpected drop in CBT reserves. In the weekend election, the question is whether the AKP-MHP will retain at least 52% of the seats nationwide. In Argentina, Pampa announced a buyback program, after this week's sell off.

We remain upbeat on emerging markets.

COMMODITIES

Markets fretted about growth due to falling manufacturing PMI, yield curve inversion in the US and the more accommodating tone adopted by the Fed, the ECB and the Bank of Japan. Oil prices dipped on March 22 but recovered and eventually proved less volatile than equity markets.

Venezuela suffered another electricity outage and oil production was hit further. China is taking advantage of the situation and continuing to buy cheap Venezuelan and Iranian oil that is unavailable to other countries because of US sanctions. Demand for refined products in China rose 7.5% over a year or more than expected. Trends on Brent and WTI futures (the gap between one-month and 6-month prices) showed some tightening in physical markets as demand began to outpace supply. Donald Trump took to Twitter to say prices were too high and to order OPEC to increase its production. Country dispensations from Iranian sanctions will soon run out and OPEC is unlikely to make the same mistake as last year when it increased production before sanctions came into force. Instead it will wait until Washington makes a move. After an interruption between November and January, Japan resumed imports of Iranian crude in February. It imported 76,000 b/d, down 50% over a year, as part of the dispensation scheme, a decision that has no bearing on the chances of an extension. Russia is expected to reach its scheduled reduction of 230,000 b/d by the end of March but the impact will be largely psychological.

Gold saw profit taking, losing 1.5% in March 28 and moving back below $1,300 on US dollar strength.

CORPORATE DEBT

CREDIT

Credit markets proved rather resilient to Brexit and economic slowdown fears. The Xover and Main were largely unchanged, only tightening by 1bp between Monday and Thursday.

Swedbank's listed instruments came under pressure after an internal audit showed serious shortcomings in the fight against money laundering. €135bn, or much more than the €10bn previously mentioned, appears to have been moved through non-resident accounts, some of them Russian, between 2008 and 2018. Moreover, the bank reportedly failed to communicate all the necessary information on the Panama Papers scandal to the US authorities The CEO in charge of Baltic countries between 2011 and 2014 resigned. We could now see a number of other regulatory probes from and rating agencies could cut the bank's rating.

In company news, **Autodis** reported a decent 4.7% rise in sales and +8.5% in EBITDA. Excluding **Oscaro**, which was integrated in the last quarter, EBIDA would have risen 13.7% as Oscaro's 2018 EBITDA represented a €17m loss. The group is, however, upbeat on prospects and has reaffirmed Oscaro's targets. **Burger King**'s sales and EBITDA rose by 5.7% and 27.6% due to new restaurant openings. **Suedzucker** saw heavy selling after a results miss. Sales fell 3% and operating profits plunged by 94% compared to the previous year. The sugar producer expects a slight recovery in sales from October this year. Its hybrid bond was particularly hard hit as it will pass on its coupon due to the cash flow event clause (no coupon if cashflow represents less than 5% of income). **Tereos** bonds were dragged down by the news. Elsewhere, Spanish press reports said an agreement between **LetterOne** and **Dia**'s banking syndicate could be concluded in the next two weeks. LetterOne is still expecting Spain's regulatory authority to rule in the near future on its bid for the group.

Altice Europe's 2018 figures were disappointing but in line with management objectives and the consensus. Sales fell 2.9% to €14.1bn and EBITDA was down 8.9% to €5.1bn. Margins fell 1.6% to 6.1%. The group expects to return to growth this year, particularly in France which accounts for 70% of sales. EBIDTA targets are a very optimistic €4 to 4.1bn, or a 6-8% rise over the year. Management is still focusing on cutting debt through an ambitious asset disposal programme and is aiming at leverage of 4.25 times within two years, down from today's 5.1 times. The share and the bonds reacted positively to the news.

S&P made some rating changes over the week. **Carrefour** (Baa1/BBB) and **Auchan** (BBB) were cut by one notch due to strong competition and the fact that restructuring was taking a long time. Jaguar was also cut from BB- to B+ on disappointing results and tougher competition.

On a quieter new issues market, **UniCredit** raised $1.25bn at 7.296% over 15 years. **Swiss Re** raised $1bn with a 30-year Tier 2 bond at 5% and Aegon €500m with an RT1 at 5.625%. In high yield, LeasePlan (Baa1/BBB-) raised €1.35bn via its investment arm Lincoln Financing (B1/BB-) in two 5-year tranches, one for €750m at 3.625% and the other a floating rate for €600m at Euribor 3 months +3.875%.

CONVERTIBLES

The primary market remained active. **iQiyi**, the Chinese online video entertainment company often referred as the "Netflix of China", announced an issue of $1.05bn in convertible senior notes (priced at 2% coupon and 32.5% conversion premium), which is tobe used for original content investments. The company has a high level of cash burn, given a highly competitive market, that is not expected to show meaningful improvements before 2020.

In Asia, **Haier**, the consumer electronics and appliances manufacturer, reported a weak start for 2019 citing intensifying competition and operational challenges, but was upbeat on VAT support, government policy and consumer tax cuts.

China Evergrande, REIT developer, reported full-year revenues that fell short of expectations and guided for a difficult 2019, raising questions that the company may need to raise more HY debt this year to meet its obligations in the next 12-24 months.

Taiwan Cement was up on the back of higher profits that beat estimations. Near-term, cement prices may have reached an inflection point, and data point to healthy structural demand that should mean stronger numbers for the second half of 2019.

In the US, **Dexcom** corrected on the back of negative comments from a short-selling focused investment firm, that questioned the strength of the business model. Exact Sciences, a molecular DNA testing company, sold off sharply during the week as a competitor conducted an M&A operation to strengthen its position on cancer screening tests.

European steel sector companies like **Outokumpu**, **Severstal** and **Salzgitter** were weak after **Osram**'s profit warning on weakness in autos. EU steels exposed to transport suffered from a negative read-through.

SGL's 2018 results showed improved revenues and EBITDA. the company completed its restructuring at the end of last year and it is starting to bear fruit. **Genfit**, the French specialty pharma company, priced 6.15 million ADS at $20.32, concurrent to a private placement outside the US. The deal raised $135m which will be used in the development of its treatment for NASH disease.

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