EDMOND DE ROTHSCHILD

MARKET FLASH : AHEAD OF THE G20

Markets rallied over the week after a resumption in US-China trade talks and a change in tone from the Fed chairman. The US and China seemed to be examining a trade agreement that would amount to a ceasefire over new tariffs and both sides have broached essential aspects of China's growth model. But we are still in the dark over the possibility of the G20 summit resulting in an agreement, failing which markets will be worried that the US might add 25% in duties on practically all Chinese imports by the first quarter of 2019.

Donald Trump has already reapplied pressure on the autos sector. Amid news of a restructuring plan at General Motors, Washington is said to be mulling new duties on car imports, a move that would very likely force the European Union to retaliate with sanctions. However, Washington and Brussels are still talking. The aim is to extend free trade between the two zones and increase US exports to Europe so as to reduce the continent's trade surplus with the US. The week saw a sharp fall in confidence indicators in Europe, a reflection of uncertainty over the extent of the ongoing trade war.

In monetary policy news, the FOMC minutes from the November 7/8 meeting confirmed expectations that another rise in December was probable. But a few members also opined that policy was now "neutral", i.e. not likely to put the brakes on, or stimulate, economic growth, a comment that was echoed by chairman Jerome Powell last Thursday. His more accommodating stance inevitably bolstered the thesis that the Fed was going to be more attentive to today's less favourable economic conditions.

Financial conditions have toughened considerably since the spring but the recent fall back in the US dollar and Treasury yields after the Fed's inflection could underpin trends on global markets, especially as valuation levels have returned to attractive levels.

EUROPEAN EQUITIES

Markets advanced at the beginning of the week thanks to the EU validating the Brexit withdrawal conditions and signs that Rome might be prepared to backtrack on Italy's draft budget. Italian financials led rebounds. But the enthusiastic mood quickly waned on uncertainties over the outcome of the G20 summit on international trade and a risk that customs duties might rise.

Autos continued to suffer amid news that Washington was looking at introducing new duties on car imports and statements from **Valeo** and **Continental** that end demand in China was slowing and clouding the outlook for 2019. Telecoms, however, rose after **T-Mobile** made a bid for **Tele2** in the Netherlands, a deal that could be approved by the European Commission with no strings attached. The transaction could also be a significant catalyst for the European sector as a whole as it shows that the Commission is willing to accept that operators per country can be cut from four to three.

Travel agent **Thomas Cook** dived after issuing its second profit warning in two months. But several stocks gained on good news: **Accor** was strong after it doubled its EBITDA objective for 2022. **Axa** raised its dividend payout and ROE targets in its 2020 strategic plan update. The group also reiterated its debt reduction objectives.

Safran rebounded after its investors' day: its 2022 plan has ambitious growth targets and markets viewed its free cash forecasts as conservative. **Trigano** gained ground after improving its free cash flow and cutting debt more rapidly than expected.

Saint-Gobain launched its Transform & Grow plan which aims to improve operating margins by 100bp by simplifying its organisational structure and disposing of low margin businesses. **Bayer** said it planned to sell assets and cut jobs as part of its refocusing on core agro and pharma activities. Its restructuring plan should also help cut costs by €1.6bn by 2022.

US EQUITIES

US indices enjoyed a strong bounce over the week with the S&P jumping 4% and the Nasdaq ending 4.8% higher. Consumer confidence in November remained at a lofty 135.7, or the same level as the previous month, and third quarter GDP was announced at +3.5%. The only disappointing macro news came from new home sales which were well below expectations. PCE inflation came in at 1.8%, or slightly below consensus expectations, fuelling hopes of a shift in the Fed's monetary policy trajectory.

Speaking to the Economic Club in New York, Jerome Powell said interest rates were close to neutral. (This was a big change from his previous comments that rates were well below that level, a statement that seemed to suggest further tightening.) The markets inevitably interpreted this new tone as an indication that the bank might mark a pause in its rate tightening cycle in 2019. The release of the last FOMC minutes reinforced this view as they pointed to a more flexible approach to any tightening. All this led to US Treasury yields easing and moving down towards 3%.

The Fed's apparently more accommodating stance sent tech stocks higher while energy and commodities were once again the worst performers over the week. **Amazon** soared 10% after the group announced record Cyber Monday sales. **Tiffany**, in contrast, tumbled 12% after posting disappointing quarterly sales.

JAPANESE EQUITIES

Japanese equities rebounded on speculation over progress at the US-China summit talks and thanks to the Fed's hint that it might to slow the pace of its interest rate hikes. The TOPIX gained 1.87%. The Nikkei 225 index had consistently outperformed the TOPIX and so the NT Ratio (Nikkei 225/TOPIX) was at a relatively high point in its historic range.

By sector, Other Products was the top performer, led by **Nintendo** which surged by 10.98%. A few growth stocks like **Daikin Industries** (+10.44%), **Nidec** (+6.93%), **Kyocera** and **Murata Manufacturing** rebounded after suffering from recent negative trends.

SoftBank Group also climbed 8.32% ahead of the IPO of its telecommunication subsidiary, SoftBank, which is down to be listed on December 19. In contrast, domestic demand-related stocks in the pharmaceutical, retail and transportation sectors underperformed.

The good news for Japan is that Osaka was selected to host the 2025 International Exposition. This is expected to have a positive effect on Japan's economy and industries.

EMERGING MARKETS

Jerome Powell said interest rates were “just below” the neutral range, softening previous comments and seeming to suggest that the Fed was increasingly open to pausing hikes next year. This is good news for emerging markets.

In **China**, November manufacturing PMI came in at 50, or lower than October’s 50.2. The new order sub-index fell by a further 0.4% to 50.4%, implying further slowing in coming months. Markets are now focusing on the Xi-Trump G20 meeting. White House trade adviser Peter Navarro, who has advocated a tough stance against China, will also attend the meeting.

Weibo’s third quarter results beat market expectations on both the top line (+44% YOY) and the bottom line (+49% YOY). But revenue guidance was revised down to +35-38% for the current quarter due to macro headwinds.

Taiwan’s market reacted positively this week to the local election results, with key gains from opposition party KMT, which is viewed as more business and China friendly.

Elsewhere, **Airports of Thailand**’s fourth quarter revenue only increased by 4% due to lower-than-expected passenger numbers.

In **India**, ICRA’s recent downgrade of **Shapoorji Pallonji**’s bank facilities due to muted real-estate sales triggered market worries over bank exposure to commercial real estate and fears that a systemic crisis might be brewing.

There was further noise in **Mexico** over banking commissions, pension fund nationalisations and referendums. The incoming finance minister totally denied rumours that the Afores pension fund regime was to be changed. And the new administration is promising more domestic oil refining as part of an effort to become energy self-sufficient. The focus is on next year’s budget which is scheduled for December 15th. **Cemex** announced a share buyback programme.

In **Brazil**, the **Suzano** and **Fibria** merger was approved by the European Regulator.

CCR announced a leniency deal with prosecutors for R$81m, or much less than expected. **Petrobras** sold its shallow-water fields for $823.1m. **Ultrapar** provided positive guidance for next year’s fuel margin distribution.

In **Colombia**, a new tax reform bill was sent to Congress without increasing VAT on basic food. The main changes are: (i) corporation tax to be reduced from 33% in 2019 to 30% in 2023, (ii) VAT for capital good purchase to be deductible from corporation tax and (iii) an increase in individual income and wealth taxes.

COMMODITIES

Brent crude stabilised at $59 and WTI at $51, unchanged on the week after seven down weeks in a row. Investors remained focused on statements from Donald Trump and energy ministers in oil-producing countries. The market is currently unbalanced with an estimated surplus of 1.5 million b/d, but the situation reflects expectations that OPEC will cut output when it meets on December 6. The G20 meeting could in the interim provide us with some clues as several top level one-on-one meetings are probable. Donald Trump has, however, cancelled his scheduled talk with Vladimir Putin.

Saudi Arabia is pressing for cuts and is ready to do its utmost to achieve them but Riyadh will not go it alone. The Saudis essentially want to keep as much of their market share as possible. Russia seems to be more in wait-and-see mode as its budget will not be threatened even with oil at $60. Donald Trump has often tweeted his determination to keep prices low as he sees cheap petrol as a tax cut. The non-stop rise in US inventories in the last 10 weeks gives him another reason.

Elsewhere, Fed chair Jerome Powell's comments that interest rates were just below neutral for the economy could have positive effects on **gold** prices. Markets have already factored in another rate rise this year but the big question today is how many hikes are likely in 2019. After being massively short oil since mid-August, Comex trader positions have been neutralised. ETF flows have also turned positive over the last month.

CORPORATE DEBT

CREDIT

Markets started the week on the front foot on hopes that Italy's budget might be revised so as to reduce the deficit. But concerns over the global trade war resurfaced and caused spreads to widen. The Xover widened by 10bp while the Main was practically unchanged at around 80bp.

In telecoms, Switzerland's **Salt Mobile** (Matterhorn, B2/B+) reported a disappointing 5.3% drop in sales with EBITDA down 5.5%, and Italy's **Wind Tre** came under pressure after results continued to deteriorate with sales down 11.2% and EBITDA 9.8% lower. **CMA CGM** (B1/B+) also posted a sharp fall in results over a year but second-quarter sales rose 6.3% thanks to higher volumes. Nevertheless, EBITDA slumped 45% over a year due to higher oil costs while WCR rose sharply. **Thomas Cook** issued another profit warning only 3 days before its annual results. Current EBIT could be announced 10% below the figure given in September.

On a more positive note, **Algeco** (modular construction, B2/B-), released robust results on rising European sales. **Burger King France** (B3/B-) remained on a growth path with consolidated sales up 1.4% over a year.

Sales dipped at **CBR Fashion** (B2/B) but results rose thanks to an improvement in operating margins. **Loxam** (BB-) released satisfactory sales with sales up 9.2% over a year in France and Europe thanks to a rebound in construction.

Buyers returned for **Fiat**'s debt on news that the group might sell **Comau**, its automation subsidiary, a disposal that could bring in €1.5-2bn. S&P maintained **Nyrstar** at CCC+ but downgraded its 2019 and 2024 bonds by one notch from CCC to CCC-, citing a very low recovery rate were the group to default. **Trafigura**'s new payment facility has better guarantees than its bonds.

On a rather active new issues market, Spain's **Sabadell** (banks) sold a Tier 2 bond at 5.375% due 2028. **UniCredit** issued its second senior non-preferred bond in a private placing, raising $3bn over 5 years. **Credit Agricole**, **Commerzbank**, **ABN Amro** and **Raiffeisen** all issued senior preferred debt.

CONVERTIBLES

The slowdown in European PMIs released on the previous Friday had pushed the euro down below 1.13 against the US dollar but Jerome Powell's more dovish tone helped it regain some ground and equity markets rallied.

The last week of November was rather active with several new deals. **iQiyi** (video entertainment services in China) is to issue $500m (upsized to $600m plus a $90m greenshoe) with a 5-year convertible yielding between 3.25% and 3.75% and a 20% premium. The proceeds will go on expanding and enhancing content offerings, strengthening technology, and on working capital.
Cosmo Pharmaceuticals NV (three revenue-generating products and several others in development) raised €175m over 5 years at 2.5% and with a 20% premium for general corporate purposes including research and development, potential acquisitions and in-licensing transactions. **Dexcom** (a medical device company focused on CGM systems for people with diabetes) raised $750m with a 5-year convertible at 0.75% coupon and a 32.5% premium. $100m of the net proceeds will go on repurchasing shares and the remainder on capital expenditure, working capital and general corporate purposes.

Ship Healthcare Holdings (health care medical equipment distribution) raised ¥25 billion with a convertible bond due 2023; ¥5.8 billion will go on repaying debt including from the acquisition of **Software Service**, ¥6billion to acquire shares in **Okkar Thiri Co** and **Snow Everest** in Myanmar, and ¥13.2 billion on investments, working capital and share buybacks. **Liberty Media Corp** issued a $350m exchangeable for shares in **Live Nation Entertainment**, with a put option in 3 years, a 2.25% coupon and a 25% premium. The proceeds will be used to repay a margin loan. **Electronics for Imaging**, which designs and markets products that support colour/black and white printing, raised $135m with a 5-year convertible at 2.25% and a 30% premium. $40m will be used to buy back shares and the remainder for general purposes.

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