



MARKET FLASH: EACH WEEK AT THE MOMENT LOOKS LIKE THE LAST.

July 13, 2018

On the markets

Each week at the moment looks like the last. Investors are split between persistently good fundamentals and trade tariff developments.

Sentiment picked up in the previous week on news that auto industry talks were to be held but then Donald Trump said he would be adding another \$200bn in Chinese imports to be taxed after Beijing reacted to the first tariffs becoming effective on July 6. The move looked discounted and talks could be held before this additional amount comes into force, but equity markets still saw some big drops and the renminbi weakened. The NATO summit opened at the same time amid fears the US president would remain on the offensive

The same split can be seen in economic data. On the one hand, the NFIB small and medium sized company index in the US remained at lofty levels while investor sentiment in July's ZEW survey in Germany fell.

Meanwhile, the earnings season looks promising. US companies are expected to see profits rise by more than 20% compared to the second quarter of 2017 while European company earnings are seen rising by close to 9%. Company statements and guidance when figures are reported will be scrutinised to assess the initial microeconomic impacts of trade war fears.

Against this backdrop, we continue to maintain a slight pro-risk asset bias -but with less geographical distinctions- and have used options to hedge against any possible peaks in volatility. As for government bonds, we continue to believe that interest rate risk in core eurozone countries offers very poor rewards and that investors should steer clear.

▶ EUROPEAN EQUITIES

Markets advanced on strength in media, technology, pharmaceuticals and leisure while telecoms and banks lagged further. **Comcast's** sweetened bid on **Sky**, an attempt to beat rival **Fox Century 21**, illustrated how content was now being rerated.

The news that Washington was to slap import duties on another \$200bn in Chinese imports only sent markets lower for a day, with luxury and cyclicals leading declines. German bond spreads moved against all other European countries after Donald Trump's attack on the country. Aerospace stocks hit new highs due to increased US pressure on NATO to spend more

on defence. The strengthening dollar also helped with the euro dropping after Germany's ZEW survey hit a 6-month low and French industrial production declined for the third month in a row.

News that **Nissan** had falsified emission data weighed on the entire autos sector and on **Renault** in particular. **Sanofi** came under pressure after being ordered to comply with pollution standards in one of its factories. Investors cheered **Michelin's** acquisition of a Canadian off-road tyre producer. **Altran** plunged after its US acquisition Aricent was shown to have issued fake invoices. What's more, earnings at Aricent also failed to grow.



▶ US EQUITIES

It was an excellent week on Wall St with the S&P up 1.4% and the Nasdaq hitting new records after rising 1.8%. CPI for June rose 2.9% over 12 months with core inflation (ex food and energy) up 2.3%. This was the biggest rise in inflation since the beginning of 2017. Fed chairman Jerome Powell said he was optimistic that the Trump administration's tax cuts and spending programmes would have a lastingly beneficial impact on growth rates.

Broadcom made a surprise all-cash acquisition of CA Technologies and the stock plunged by up to 19% on the day. The deal was seen as a reversal in strategy for the giant semiconductor group which had previously said that it would avoid transforming deals, raising hopes for a share buyback.

The earnings season began with several consumer stocks. **Costco** reported upbeat figures, but **Limited Brands** fell short and the stock plummeted 12%. Banks like **Citigroup**, **JP Morgan** and **Wells Fargo** are due to report this afternoon.

Tech stocks gained 3.6% on the week thanks to US 10-year Treasury yields stabilising towards year lows of around 2.85%. Defensives were the worst performers with telecoms and utilities down 0.5%.

▶ JAPANESE EQUITIES

Japanese equities were at the mercy of developments in the US-China trade dispute. After rebounding on Monday after Washington actually activated its planned tariffs on \$34bn of China's high-tech products, the market again turned lower on Wednesday following the US announcement that a further \$200bn in goods were to be targeted. But later in the week, the market rallied when the Yen weakened to 112 against the dollar.

The TOPIX ended the week 1.07% higher with domestic demand stocks relatively firm.

Oil and Coal Products (+5.58%), Information & Communication (+3.73%), Precision Instruments (+2.39%), Electric Appliances (+2.07%) and Pharmaceuticals (+1.93%) outperformed the TOPIX. **Eisai** (pharma, +16.88%) and **Softbank** (+13.06%)

made strong gains. **SONY** and **Rakuten** advanced 6.31% and 5.84% respectively, and Shiseido rebounded by 5.04%.

On the other hand, Textiles and Apparels (-2.60%) and economic sensitive sectors such as Land Transportation (-1.59%), Marine Transportation (-1.58%) and Warehousing and Harbor Transportation (-1.51%) underperformed. **Komatsu** lost 3.42% and **Nissan Motors** shed 2.81%.

▶ EMERGING MARKETS

Chinese export growth slowed slightly to 11.3% in June but well above the 9.3% expected. This took the trade surplus to \$41.6bn, its highest level year to date. Trade war impacts will be more visible in the second half. Donald Trump this week raised the stakes by adding another \$200bn in Chinese goods to be taxed at 10%. China's riposte was inevitably more measured as it only imports \$130bn of US goods.

Also in China, **Sunny Optical** saw smartphone lens sales soar 83% in June. The company's first half sales were up 54% or much better than initial management expectations of +35%. In construction, companies have revised earnings expectations for the first half higher due to excess capacity being reduced: **Anhui Conch** now expects +80%/100% and **Weichai Power** +50/70%.

South Korea's central bank unsurprisingly left its benchmark rates unchanged at 1.5% while reducing its GDP growth forecasts from 2.9/3% to 2.8/2.9%. Exports were stable at an annualised -0.1% in June, or lower than expected.

Taiwan's export growth has started to tail off a little despite a robust YoY increase of 9.4%.

India's inflation for June was 5%, or lower than the 5.3% expected but industrial production for May only rose by a disappointing 3.2%. **IndusInd Bank's** earnings rose as expected by 24% on productivity gains from its online banking division and stable asset quality with NPLs at 1.15%. **Tata Consultancy's** earnings rose 26.1%, or slightly better than expected and in spite of higher wages. Its digital investments, which already represent 25% of sales and are rising 4% a year, are paying off and helping the company's



margins prove more resilient than its rivals. The weak Rupee also benefited the bottom line.

Brazil's economic data in June were better than expected with industrial production down 10.9% MoM, or less than the 13.2% expected, and retail sales 0.6% lower (compared to expectations for a 0.8% drop). Despite a 21% MoM bounce in car production in June, Brazil's ANFAVEA car association revised down its growth forecasts for the sector from 13% to 12% due to the weaker Argentine peso.

Mexico's new president, Andres Obrador (AMLO for short) and his advisors reassured investors by declaring they would maintain a cautious approach to the budget and respect the central bank's independence. Nevertheless, the president said raising the minimum wage without fuelling inflation was a priority.

In Argentina, most economic data have started to worsen, including industrial production and car sales. A sharp slowdown in construction has also begun. The central bank left its benchmark rates unchanged at 40%.

Colombia's **BanRep** also left rates unchanged due to worries over international financial conditions but also because June inflation was in line and still on a favourable trend. The economy continued in recovery mode with both retail sales and manufacturing enjoying robust growth.

As the trade war is likely to harden and markets remain choppy over the summer, we remain cautious over the short term.

▶ COMMODITIES

On July 11, Brent crude spot prices tumbled \$4.8, or -6.1% and lost as much as \$5.9 intraday, a rather exceptional sell-off. We have to go back as far as 27/11/2014 for a similar drop (\$4.6) or 02/09/2016 for the same percentage drop (-7.4%, or \$2.4). The trigger for the plunge was a decision by Libya's national oil company (NOC) to reopen its 4 export terminals. They had been threatened by the self-styled Libyan National Army since mid-June, disrupting 80% of the country's 1 million b/d output. This development removes one source of supply side pressure and one which eventually only had a fleeting impact on oil prices.

Nevertheless, some of the storage facilities will need maintenance before full capacity is restored.

At the same time, Donald Trump suggested that certain countries might be exempt from the ban on dealing with Iran which comes into effect on November 4. All this news is actually more psychological than fundamental. The price correction was also amplified by trading algorithms.

In its monthly report, the IEA confirmed that it was expecting demand to grow by 1.4 million b/d in 2018 and 2019. This suggests that current prices are only having a small impact on demand which the IEA sees growing by 1.5 million b/d in the first half of this year and by 1.3 million b/d in the second.

Global output rose in June, mainly due to Saudi Arabia and Russia after their decision to comply 100% with quotas. Commercial stocks at end May rose by 14m barrels, or half the seasonal average and are running at 23m barrels, or below the 5-year mean. The trend is likely to have gained traction in June.

The IEA also pointed out that only Saudi Arabia, the UAE and Kuwait have real available capacity (of around 2.1 million b/d). They are expected to raise output by 500,000 b/d this month, taking free capacity down to 1.6 million b/d. In comparison, Iran exports 2.2 million b/d. As a result, the market will remain tight unless global growth were to be seriously undermined by the ongoing US-China trade war deteriorating into something much more serious.

▶ CORPORATE DEBT

CREDIT

Spreads narrowed, especially for financials with the Xover down 7bp over the week on robust labour market data in the US and strong German exports. Even so, markets still struggled with concerns over a global trade war and political tension in the UK.

Bonds issued by wind turbine producer **Nordex (B3/B)** jumped around 2.5 points after it won its biggest-ever contract with Brazil's Lagoa dos Ventos. Senvion's bonds (B3B) outperformed in sympathy, rising by around 1.75 points.



Levi Strauss & Co (Ba1/BB+) reported excellent second-quarter figures with sales up 17% and EBIT 15% higher. The group revised its guidance higher, the second upward revision so far this year. **Mylan (Baa3/BBB-)** will have to slash prices for its generic version of **Teva's** flagship drug Copaxone as the market is expected to contract sharply in coming years.

Creditors have until July 20 to decide if they agree or not to the proposal. On the secondary market, we saw some activity on the **Steinhoff 21 and 22** which reacted well to the debt restructuring plan news. For now, the **Steinhoff 23** has not been impacted by the move.

On the new issues market, **K+S Aktiengesellschaft (BB)**, a German mining company, raised €600m over 6 years at 3.25%. **OTE**, a Greek telecom operator, raised €400m over 4 years at 2.375%. **Credit Suisse** raised \$2bn with an Additional Tier 1 bond at 7.5%.

CONVERTIBLES

France will not play against England on Sunday but against Croatia, nicknamed the "Vatreni". Of course, the final will be fair-play as during the previous games. Fair-play ... not exactly part of Donald Trump's tactics to change the international order with the possibility of another \$200bn in duties on Chinese goods and criticisms of Theresa May's aim for a soft Brexit, both of which put pressure on the equity market and rekindled volatility. Convertibles were also impacted by German 10-year bond yields rising to 0.37% on Wednesday, after ECB comments that interest rates might rise a little earlier. Despite increased volatility on convertible markets, they ended the week higher but gave back some of their gains on Thursday.

On Europe's primary market, Swiss biotech Idorsia raised CHF 200m with a 6Y 0.75% convertible bond simultaneously raising CHF 305m of new equity to finance its clinical trials. The deal was well received by the market. In the US, cyber security company **Palo Alto Networks** issued a jumbo \$1.5bn 5Y 0.75% convertible to refinance its existing 2019 issue and fund possible acquisitions. **Rocket Internet** bought back €254m of its 2022 convertible bonds at 110% of par.

Steinhoff announced a debt restructuring plan with PIK interest at 10%, a new 3Y maturity from the effective date of restructuring and 25% cash repayment for 2021 and 2022 convertible holders in 2019.



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Société anonyme governed by an executive board and a supervisory board with capital of 11,033,769 euros

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