

MARKET FLASH: POLITICAL DEVELOPMENTS REMAIN CENTRE STAGE

Political declarations took centre stage this week, starting with the usual twists and turns on the trade war front. Following a tit-for-tat escalation in customs tariffs, the mood turned more conciliatory and talks will now probably resume. However, Donald Trump's pressure on the Fed hit a new high with his tweet describing Jerome Powell as an enemy.

Meanwhile, Italy witnessed an extraordinary reversal following Matteo Salvini's attempt to trigger fresh elections. Instead, the populist 5-star movement and the centre left Democratic Party buried the hatchet and teamed up to form a new government with Giuseppe Conte remaining as prime minister. The alliance means no new elections will be held and it also will prevent any automatic rise in VAT. It should also end the confrontation with the European Commission over the budget. Italian bond prices rose sharply with the 10-year government bond yielding less than 1%, down from 1.5% at the beginning of August.

And then in the UK, Boris Johnson surprisingly decided to prorogue parliament for 5 weeks so as to prevent any Commons debates on Brexit. The move triggered vigorous protests and attempts to find some way of legally blocking the decision which do not have much chance of succeeding. Sterling's reaction was limited and lack of visibility led us to avoid taking any significant positions.

Elsewhere, GDP in the US grew by 2% with consumer spending up by an impressive 4.7% and company profits rebounding by 5.3%. The resilient economy was reflected in consumer confidence levels which remained close to all-time highs. In contrast, Germany sank further into the red. The 0.1% drop in second quarter GDP was confirmed, a decline that was attributed mainly to a fall in exports, lower investment and weak consumption. And the drop in business confidence to 94.3 heralds a further fall in GDP in the current quarter. Calls to counter any risk of sliding into recession became more insistent, especially as Germany's budget is in surplus.

Faced with these economic uncertainties, the Fed and Bank of Japan are reluctant to go for excessive stimulus even if the new ECB chair thinks there is still room for European bond yields to drop further into negative territory.

Amid such an unsettled political environment, we are maintaining our cautious and defensive stance.



EUROPEAN EQUITIES

Reduced political and trade tensions sent European markets higher. Sentiment was lifted in particular by statements from Donald Trump and the spokesman for China's trade secretary that talks would resume in September. After underperforming for several weeks, cyclicals with the most exposure to current concerns rallied and markets flirted with 2019 highs. There was also support from Christine Lagarde's reassuring message that accommodating monetary policy would be maintained in Europe as well as from the agreement between Italy's 5-star movement and the Democratic Party to form a new coalition government. Italian spreads narrowed sharply on the news and highly leveraged plays like **Poste Italiane**, **CNH**, **Telecom Italia** and **Italgas** gained ground. However, Boris Johnson's request to prorogue parliament, which was immediately given the Queen's assent, sent a chill through markets. The suspension could prevent opposition MPs from offering an alternative solution to a no-deal Brexit.

Elsewhere, upbeat company results lifted a number of stocks. **Bouygues** had a convincing first half, especially in its mobile division due to less aggressive sales drives across the industry. **Pernod Ricard**'s annual figures beat consensus expectations on strong sales in China and India. **Eiffage** reported robust results despite a public works/concessions mix which weighed on overall margins. **Eurofins** rose on a broker recommendation after its results suffered less than expected from a cyber-attack. The tech sector was, however, hit by several profit warnings from companies like **Autodesk** and **Dassault Systèmes** even if the latter managed to limit the impact. **BASF** rose on news that it was to sell its pigments unit to Japan's **DIC Corp**.

US EQUITIES

US equity markets ended the week noticeably higher, with the S&P 500 and Nasdaq gaining 2.7% and 3.2% as at Thursday's close. Market strength reflected de-escalating trade tensions after China confirmed that it would not retaliate (for now) to the latest tariff increases. Instead, a new round of face-to-face trade talks between US and Chinese officials is scheduled in September.

The macroeconomics calendar was light. US second quarter GDP growth was revised modestly lower from 2.1% to 2%.

This week's rally was more evenly spread across S&P sectors. Leaders included communication services (+3.5%), industrials (+3.2%), consumer discretionary (+3.2%) and technology (+3.1%). Consumer staples (+1.8%) and real estate (+1.7%) lagged but both sectors were nonetheless the best performers over the month, up 1.8% and 4.5% respectively.

On the corporate front, **Autodesk** (3D design and engineering software) cut guidance to reflect forex headwinds and an increasingly difficult macro backdrop. **Hewlett Packard** missed on revenues but delivered a positive EPS surprise as an improved product mix drove margins higher. **Tiffany**, the jewelry company, gained on its results which were better on the bottom than the top line. Sales rose to mainland China but suffered disruptions in Hong-Kong during the quarter. The group maintained its guidance for the rest of the year.

In M&A news, **Philip Morris** and **Altria** were reportedly holding talks to reunite their tobacco businesses. The deal would still need to overcome US regulatory challenges and investors questions on the costs and benefits of the merger.



JAPANESE EQUITIES

An escalation in the US-China tariff-hike war and the yen's subsequent rise to 104 against the US dollar took the market lower on Monday. Most traders thought both countries would be looking to reach an agreement on the lingering quarrel, but tit for tat moves dampened expectations for an early settlement. The TOPIX ended the week 0.80% lower. In contrast, Japan and the US reached a basic understanding for a final trade agreement scheduled for September.

Domestic-demand sectors such as Electric Power & Gas and Real Estate posted positive returns. **Mitsui Fudosan**, which is trading on a relatively low P/B ratio, rose on robust office rents in the central Tokyo area.

Suzuki Motor rose 4.06% on news that it and **Toyota Motor** would be buying stakes in each other. **Recruit Holdings** fell 6.71% due to criticism of a subsidiary's poor personal data management and news that 13 companies including **Toppan Printing** were to trim their holdings in the company. Japan's tradition of political purpose investments and cross shareholdings are on the wane due to corporate governance concerns.

EMERGING MARKETS

Indices were down 0.37% week to date (as at Thursday's close), underperforming developed markets with noticeably broad dispersion of performance across regions. China underperformed whilst Brazil, Mexico, India and Russia all ended the week in positive territory.

The week saw more volatility over the US/China trade dispute. Beijing announced the resumption of 25% tariffs on US autos from December 15, and retaliatory tariffs on another \$75bn of US goods effective in two batches, one on September 1 and the other on December 15. Donald Trump retaliated by saying the current 25% tariff on some \$250bn in Chinese imports would rise to 30% on October 1. He also warned that the US planned to raise tariffs to from 10% to 15% on \$300bn of Chinese goods with the first tranche on September 1 and advised US companies to stop trading with China. Both sides eventually tried to strike a more conciliatory tone, giving the markets hope for renewed discussions.

In an effort to provide further economic stimulus, **China's** State Council issued a policy package focusing on promoting consumption, with one of the 20 policies specifically for autos. It urged local governments to gradually loosen or cancel license plate restrictions and support the purchase of New Energy Vehicles.

In **India**, Narendra Modi's government unveiled several measures to boost demand in the financial services and auto sectors and announced the lowering of FDI restrictions in the retail, manufacturing and coal mining industries. The Reserve Bank of India announced a larger-than-expected INR 1.76 trillion dividend to be paid to the government for the 2019 financial year; this is significantly higher than the budgeted INR 0.9 trillion.

Korea's supreme court ordered the retrial of the bribery case involving JY Lee, **Samsung Electronics'** Vice Chairman. The retrial is likely to run for several months, creating uncertainty over Samsung

In **Brazil**, July credit data revealed that private banks had increased lending by 13% compared to a 5% drop for state-owned banks. However, delinquency in the corporate segment increased more than expected. In company news, **Petrobras** announced a new dividend policy in a move to enhance payment transparency to shareholders and establish a closer link between debt levels and cash flow.

The highlight in **Mexico** was the agreement between the government and the country's major natural gas pipelines operators to solve an ongoing tariff dispute about tariffs. The deal is positive as it reduces regulatory uncertainty. Mexico's July's trade deficit was \$1.1bn, or wider than consensus expectations of \$0.5bn. Mexico's share in the US import market hit record highs, with the most recent up leg coinciding with the broadening of US tariffs on Chinese goods.

In **Argentina**, finance minister Hernan Lacunza surprised the market by announcing the forced renegotiation of short-term Treasury bills with institutional investors and a proposal for a voluntary re-profiling of external and local debt

CORPORATE DEBT

CREDIT

Despite a lull during the week, US-China trade tensions continued to worry investors. Brexit fears rose after Boris Johnson received the Queen's assent to prorogue parliament up to October 14. Credit markets nevertheless showed resilience with the Xover tightening by around 23bp between Monday and Thursday and the Main by 5bp. Italian markets outperformed on investor relief that a new coalition government had been formed.

A court decision ordering **Johnson & Johnson** pay a £572m fine to the State of Oklahoma for the company's part in the opioid crisis was not as bad as markets had feared. **Teva**, which is also involved in the scandal, actually rose last Monday although the rebound fizzled out on press reports that the **Purdue** group was working towards a friendly settlement to halt any further court cases by paying out a substantial \$10-12bn. Elsewhere, **UniCredit** was reportedly in talks to eventually take direct control of its 41% stake in Turkey's **Yapi Kredi** bank. The move would facilitate the sale of the holding to reinforce capital ratios and reduce its exposure to Turkey. **Lecta**, which had been under pressure for some weeks, launched a restructuring plan and hired **Evercore** et **Rothschild & Co** to advise it. **Thomas Cook** agreed a £900m rescue plan which will see **Fosun** subscribing to a £450m increase of capital while creditor banks and bond holders will inject the same amount. **Casino** made progress in its attempts to simplify its Latin American structure. The audit committee of its South American subsidiary **Exito** approved the parent company's proposal to buy **Exito**'s indirect 50% stake in **Segisor**.

In results news, **Selecta** maintained the strong momentum seen at the beginning of 2019 and reported a 6.7% rise in revenues on strong volumes. Management maintained guidance on both EBITDA and revenues and expects no complications from Brexit. **Picard** reported an upbeat 3.2% rise in sales while EBITDA jumped 37%



The financials new issuance market was busy, particularly in Senior Non Preferred debt with new deals from banks like **BNP**, **Svenska Handelsbanken** and **Nykredit**. **BBVA** raised \$1bn with an AT1 at 6.5%. The proceeds might go on an early reimbursement of its 6.75% CoCo which has its first call date in 2020. **Swiss Re** sold a perpetual Tier 2 bond at 4.25%. Demand was strong and the bond performed well when it started trading.

CONVERTIBLES

In the last week of the August break, trading was rather thin and the new issues markets was, as usual, becalmed.

However, a decent amount of new issuance is expected for the start of September, in the US at least.

In this week's news, German real estate company **Deutsche Wohnen** jumped by close to 10% on Friday on a Bild article that claimed the planned rent freeze in Germany would leave landlords some leeway to make "moderate increases"; by how much will depend on talks in progress.

In Asia, the focus was on **China Evergrande** which was down close to 6% mid-week following first half earnings and mounting concerns on its ability to keep refinancing more than \$100bn in gross debt.

In Japan, **Sony** announced the sale of its entire 5.03% stake in **Olympus** worth around 80bn and the stock rose by more than 2%. Sony denied that this decision was influenced by **Third Point**'s restructuring proposal.

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