# Daily Note

Views, news and topics from today's markets

CANTOR Fitzgerald

Thursday, 19th January 2017

## Morning Round Up

**Brexit - Appeal Decision Set for Jan 24th**

The market may have gotten their fill of Brexit related news this week but there is more on the horizon next week. January 24th has been set as the date for the Supreme Court decision on the government appeal against a successful legal challenge against Brexit brought by businesswoman Gina Miller and others. The government was seeking to overturn an earlier High Court decision that the Prime Minister could not trigger Article 50 without a parliamentary vote. Downing Street sources have acknowledged that they may very well lose this case and are currently preparing a legislative bill which should work around the problem. However the decision may still rattle the markets and result in another volatile trading day for sterling.

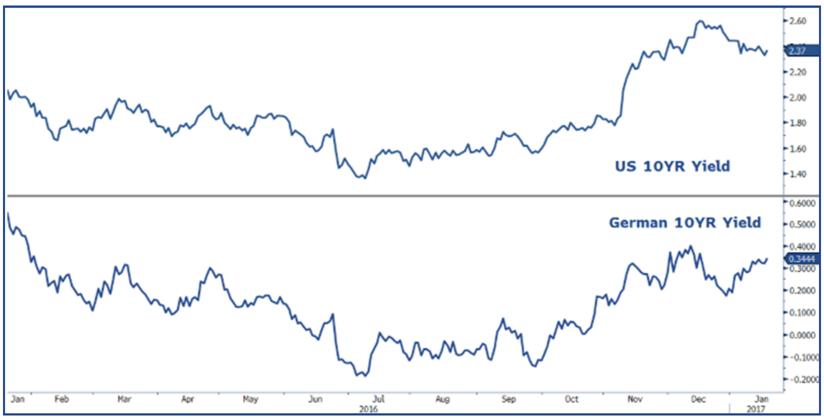
**Oil Production Cuts - Problems Mount for OPEC**

One of the major questions in the aftermath of the OPEC deal was whether or not the members would cheat on what was agreed. After an initial shaky period it appeared as if members were adhering to the necessary production cuts. However, new issues have emerged of late and they may be beyond OPEC control. There have been indications that several non-OPEC members are planning on increasing production. Of an even more pressing nature to the Saudis is the reaction of the US shale industry. A recent IEA report stated that “the higher oil prices will trigger a significant boost in US shale output”. Some estimates have put this at an extra 600k barrels per day. Shale oil has become increasingly cost efficient over the past few years and is profitable in the $50 – $55 a barrel range. If this occurs the options open to OPEC to counteract this are limited.

**Yields - Where to Now?**

It is true to say that US yields had already began to tick up prior to the Trump election due to increasingly strong US economic data and probability of Fed rate rises. However it received a shot in the arm from the election and surged as expectations of inflation under a Trump Presidency increased dramatically pushing the ten year yield up to 2.596%. The nature of the move meant that it was always highly likely that there would be some form of retracement. This was further exacerbated by lack of clarity regarding fiscal spending by the President-elect. Unlike the US 10 Yr the German 10 Yr has staged a recovery as Eurozone data continues to look inflationary. It is likely that the spread will continue to compress until the market sees some details on US fiscal spending plans or US rate hikes. ECB policy will also play its part.

**US and German 10 Year Yields - 1 Year Chart**




### Key Upcoming Events

19/01/17 - ECB meets in Frankfurt

20/01/17 - Donald Trump’s Inauguration

24/01/17 - UK Supreme Court Brexit Appeal

27/01/17 - Next Fed Meeting

### Market View

Asia was broadly flat apart from Japan which was up 1% on the back of a weaker yen. Major moves overnight were in the US dollar and US yields as Yellen warned of the dangers of rates rising too slow. She also stated she expects multiple rates rises a year until 2019. Spreads between US and German yields narrowed as a result. US financials rallied in the wake of the yield spike, much more so than from good US financial earnings earlier in the day. Oil rallied as an internal OPEC report confirmed cuts were on schedule. However the impact of potential US shale production should keep the price tempered. Market focus today will be on ECB rate decision, where the status quo is likely to remain in place, US Housing Starts & Philly Fed Manf. Index.

### Market Moves

| | Value | Change | % Change | % Change YTD |
|---|---|---|---|---|
| Dow Jones | 19805 | -22.05 | -0.11% | 0.21% |
| S&P | 2272 | 4.00 | 0.18% | 1.48% |
| Nasdaq | 5556 | 16.93 | 0.31% | 3.21% |
| Nikkei | 19,072 | 177.88 | 0.94% | -0.22% |
| Hang Seng | 23,050 | -48.30 | -0.21% | 4.77% |
| Brent Oil | 54.64 | 0.72 | 1.34% | -3.84% |
| WTI Oil | 51.68 | 0.60 | 1.17% | -3.80% |
| Gold | 1202 | -2.21 | -0.18% | 4.76% |
| €/$ | 1.0651 | 0.00 | 0.20% | 1.27% |
| €/£ | 0.8657 | 0.00 | -0.15% | 1.43% |
| £/$ | 1.2303 | 0.00 | 0.34% | -0.30% |

| | Yield | Change |
|---|---|---|
| German 10 Year | 0.38% | 0.03 |
| UK 10 Year | 1.37% | 0.04 |
| US 10 Year | 2.42% | 0.00 |
| Irish 10 Year | 0.96% | 0.01 |
| Spain 10 Year | 1.46% | 0.02 |
| Italy 10 Year | 1.98% | 0.02 |

## Citi, Goldman Sachs - US Financial Space

**News**

Q4/16 earnings season picked up pace this week with the majority of US Investment Banks reporting results. Citigroup, JP Morgan, Goldman Sachs and Morgan Stanley beat analyst's earnings expectations primarily driven by a strong performance in each bank's Fixed Income, Currencies and Commodities (FICC) division due to increased client activity arising from President-elect Donal Trump's victory in November 2016. Citi saw bond, currency and commodity related income increase 36% on the quarter YoY to $3.01bn and was the highest level since before the financial crisis, however trading revenue within its equity division rose 15% to $694bn. Tight cost controls is a continued focus of management, and Citi's operating expenses fell 9% YoY to $10.1bn, coming in below analyst's forecasts of $10.2bn. The key question for investors is to see whether this jump in trading revenue is a one off benefit or can be sustained for many years to come due to a structural shift in fiscal and monetary policy in the US.

**Comment**

US bank shares significantly outperformed the broader S&P 500 in Q4/16 following the victory of Mr. Trump due to a rising yield environment which saw 10 year Treasury yields move from 1.55% to a high of 2.60%. Anticipation of tax reforms, looser regulation through the potential dismantling of Dodd Frank Wall Street Reform and Consumer Protection Act boosted sentiment. The KWB Index, an index of US banks rose c. 20% in the following 2 months since his victory, but has retraced in recent days as yields have retraced ahead of Trump inauguration on Friday the 20th January. Goldman Sachs also beat on earnings primarily due to strong bond trading revenue similar to Citi. EPS excluding litigation expenses came in at $5.48 a share, 13% ahead of markets expectations. Goldman is keeping a very close eye on costs which fell 23% YoY to $4.77bn, however the market was expecting a greater decline to $4.48bn, but still a solid performance which is ultimately beneficial in calculating Return on Equity calculations. However, its compensation ratio which is a wages expressed as a percentage of revenues rose to 30% from 28.3%. Goldman has performed strongly over the past 2 months helped by the numerous ex-Goldman employees who have been elected to Trump's senior team. Goldman reported a 9.4% return on equity in the quarter which is expected to increase to 9.8% in 2017 which is key for a sustainable rally in its share price.

Stephen Hall, CFA | Investment Analyst

## Netflix (Outperform) - Huge Beat Across the Board — Closing Price: $133.26

**News**

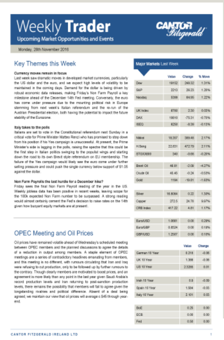
Netflix reported a huge beat across the board last night after the US close, which saw its share price post new all-time highs rallying 9% after hours. Netflix signed up a record 7.05 million customers in the fourth quarter of 2016, well ahead of analyst's estimates of 5.2 million. It now has 94 million paying global subscribers. Revenue grew 36% YoY to $2.48bn in Q4/16 helped by price increases and strong subscriber growth. It was also bullish on its outlook for new subscriber growth in Q1/17, forecasting to add 3.7 million new customers, 200k ahead of analyst's 3.5 million forecasts. In the whole of 2016, it added 19 million customers worldwide after expanding its service offerings to an additional 130 countries meaning it is now available in 190 countries. Netflix CEO, Reid Hastings estimates that international subscriber could account for as much of 70% - 80% of total subscribers in the future

**Comment**

The company was also very bullish on the profitability outlook for 2017, saying Q1/17 EPS would come in at 37c, 94% ahead of analyst's estimates of 19c. It forecasts negative free cash flow of $2 billion in 2017, wider than the year just ended, and said it will continue to borrow as needed. The company expects to spend $6bn on original content in 2017, up from $5bn in 2016. It expects to create 1,000 hours of original content (42 days of continuous watching). Original content means the company owns its licence and can release the content globally at the same time in each of the 190 countries the company operates in. Netflix will release 42 titles through the end of the Q1/17, spanning dramas, comedies, documentaries, movies, kids' shows and stand-up comedy. Key to the company's success it growth of its international subscriber base, as its domestic US market is very mature and has been in operation since 2010. The Group still trades at very expensive valuation metrics, however the pace of future earnings growth is exceptionally high to compensate for these valuations. Earnings are anticipated to double in 2017 and yet again in 2018. The biggest risk for the company is its ability to service $14bn in off-balance future licencing payments. The shift in consumer trends towards watching streaming TV over the internet away from traditional cable TV appears to be gathering momentum and this trend looks set to remain in place for many years to come as Comcast Corp. announced last night Esquire cable network will shut down. It currently trades at 58x FY17e EV/EBITDA, which drops dramatically to 25x by FY19e as subscriber growth and profitability improves. We maintain our bullish outlook.

Stephen Hall, CFA | Investment Analyst

# Cantor Publications & Resources




## Weekly Trader

On Mondays, we release our Weekly note in which we provide a view on Equity markets for the coming days, and highlight a number of Equities which we believe provide exposure to the important themes unfolding in the markets. Our in-house Investment Committee meet on a weekly basis to craft this strategy, thereby allowing clients to dynamically position portfolios to take advantage of the most up to date market developments

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## Monthly Investment Journal

Each month our Private Client and Research departments collaborate to issue a publication which highlights the performance of our flagship products, funds and our core portfolio, including the Green Effects fund, most recent Private Equity deals and structured product investment opportunities.

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# Regulatory Information

**Issuer Descriptions: (Source: Bloomberg)**
**Netflix:** Netflix Inc. is an Internet subscription service for watching television shows and movies.

**Historical Recommendation**

**Netflix:** We have been positive on the outlook for Netflix since 23/04/14 and no changes to our recommendation have been made since then **AIB:**

All regulatory disclosures pertaining to valuation methodologies and historical records of the above recommendations can be found on the Cantor Fitzgerald Ireland website here:

http://www.cantorfitzgerald.ie/research_disclosures.php

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