Daily Note

Views, news and topics from today's markets

CANTOR Fitzgerald

Tuesday, 19th September 2017

Morning Round Up

"Boris is Boris"

On Friday evening Boris Johnson published a 4,000 word essay outlining his "glorious" vision for post Brexit Britain in the Daily Telegraph. In this article he argued that the UK shouldn't pay to access the single market for goods and services. This view is in direct contrast to the plan floated by Chancellor of the Exchequer Philip Hammond and Brexit Secretary David Davis. It could be argued that if such vocal outbursts are allowed to continue they could undermine negotiations and May's power to assure the European Union delegation that May's team have the authority to broker such deals. On Monday May reacted to his article and to the suggestions that she has lost control by stating that the "government is driven from the front" and "Boris is Boris". Time will tell if this re-emergence of Boris Johnson's dissenting voice will manifest itself as a conservative party leadership bid, or if he is willing to resign if May softens here Brexit stance.

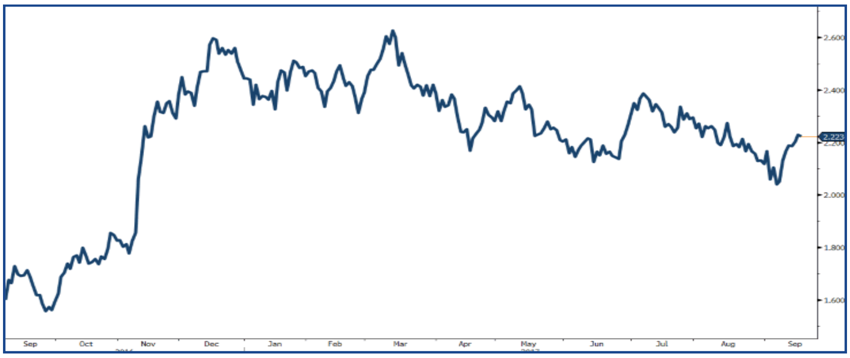
Fed expected to leave rates unchanged this week

The Federal Reserve is expected to leave interest rates unchanged at its meeting this week. The Fed is also expected to begin winding do their $4.5 trillion balance sheet in October. They will announce their intended actions on Wednesday following its two day meeting in Washington. Concern the Fed might delay a third rate hike this year following a spate of weak inflation readings eased after the consumer price index rose 1.9% in the 12 months through August. Economists have speculated that the Fed will still pencil in three hikes for 2018, but with the first of those not projected until June, versus March in the Fed's previous set of forecasts.

US Treasury Department funding gap

The Federal Reserve is on the about to embark on the unwinding of $2.5trillion of government debt the US Treasury must enact a plan to deal with the funding gap this will open. Strategists have predicted that this would result in a long term tilt toward more coupon issuances. How the Treasury responds to the Fed's tapering is a great unknown facing investors. The Treasury's selected strategy, the mix of yields and maturities will have far reaching implications on the US bond market, with the potential to shape the yield curve for many years to come.

US 10 year - price chart



Source: Bloomberg, CF Research September 2017

Key Upcoming Events

24/09/2017—German General Election

26/10/2017—ECB Meeting

Market View

Markets were flat yesterday as investors deferred major decisions ahead of the Fed's policy meeting that is expected to focus on unwinding its $4.5tn balance sheet. Asian equities overnight were down in advance of the meeting. The pound continues to strengthen in the wake of the recent hawkish BOE release. Markets appear at ease about potential Fed tapering plans but the devil is in the detail with most analysts focused on the speed of the process and also any potential changes to 2018 interest rate guidance. US construction data and home sales are the major data points today.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	22331	63.01	0.28%	13.00%
S&P	2504	3.64	0.15%	11.84%
Nasdaq	6455	6.17	0.10%	19.91%
Nikkei	20,299	389.88	1.96%	6.20%
Hang Seng	28,107	-52.88	-0.19%	27.76%
Brent Oil	55.56	0.08	0.14%	-2.22%
WTI Oil	50.17	0.26	0.52%	-6.61%
Gold	1307	-0.17	-0.01%	13.92%
€/$	1.1994	0.0040	0.33%	14.04%
€/£	0.8858	0.0002	0.02%	3.78%
£/$	1.354	0.0045	0.33%	9.72%

	Yield	Change
German 10 Year	0.45%	-0.003%
UK 10 Year	1.30%	-0.001%
US 10 Year	2.22%	-0.005%
Irish 10 Year	0.73%	-0.004%
Spain 10 Year	1.59%	0.000%
Italy 10 Year	2.07%	-0.004%

Source: Bloomberg, CF Research September 2017

Ryanair - Update on conference call with analysts Closing Price - €16.74

News

Ryanair's CEO, Michael O'Leary hosted a conference call yesterday afternoon to give investors and customers more colour surrounding several recent negative events which has seen a material retracement in Ryanair's share price. His efforts did partially alleviate investors' concerns as its share price is currently trading above the lows of yesterday.

Comment

There has been several events in recent weeks that have led to a 16% reversal in Ryanair's share price off its all-time highs posted on the 16th August. Firstly, Ryanair acknowledged that it will not be bidding for any of Air Berlin's assets which became available following its recent insolvency. Investor's may have got ahead of themselves forecasting a possible uplift to earnings as a result, although yields could still improve in Germany as a result. The removal of its two bag policy got a lot of negative media attention post its announcement which could of had a marginal impact on customer sentiment and the brand's reputation but no material impact on its bottom line. Oil prices have recovered to $55 a barrel while the recent terror attack in Barcelona dented investors sentiment further. Ryanair acknowledged that up to 12 airlines are likely to bid for Alitalia's assets which also recently declared bankruptcy. However, Ryanair's market leading position in Italy could create competition problems for regulators which might be a headwind for Ryanair. Mr O'Leary said the likes of Lufthansa would only be buying the airline to re-direct traffic through its international hub, and would have no interests in growing the airline. The final bid is due by the 3rd of October and it seems Ryanair wants to grow the transatlantic routes of Alitalia and reduce its short haul commitments while renegotiating aircraft leases, and employment contracts. The whole process will likely take up to between 3 to 6 months, but if successful this could be a near term catalyst for the stock.

Last week, negative sentiment was further compounded following the European Union's Court of Justice ruling on Ryanair's employment contracts. Some analysts feared this could increase Ryanair's staffing cost base by as much as 15% which O'Leary said was completely untrue on the conference call. Last week, O'Leary said this ruling would not impact Ryanair's cost base by 1 cent and said all Irish employment contracts currently abide by EU laws, and that all staff have the opportunity to join a union if they please, so it was not in breach of any rules.

The main negative event was the announcement that Ryanair would be cancelling 50 flight a day for the next 6 weeks. Ryanair currently operates c. 2, 500 flights a day, so this only accounts for 2% of its daily flights. However, roughly 360,000 passengers could be impacted over the next 6 weeks which Mr O'Leary acknowledged will have a material impact to the brand's reputation which they have tried incredibly hard to improve in recent years and have been quite successful in doing so in our opinion. This event combined with punctuation levels dropping to 80% of late and Ryanair's decision to drop its two bag carry on policy could knock consumer confidence in the airline but this is very hard to quantify at present. This issue arose due to errors in generating the airline's upcoming rostering schedule as pilots begin to take their 4 week holiday period after the peak summer months. This error will cost Ryanair roughly €5m in lost profitability, and roughly €20m in compensation damages. European law suggests that each effected customer could be entitled to €260, and given that 360,000 passengers will be effected this translates to €93.6m. The real cost will be the reputational hit on the back of this event which will remain in the headlines over the next 6 weeks. Ryanair has 4,200 pilots and acknowledged that it will need to bulk up the number of standby pilots on its books to avoid these situations in the future. Ryanair does not have any issues retaining or attracting pilots, and its pay for pilots is quite competitive. Generally the airline only see a 5% churn in its pilot base each year.

O'Leary maintained Ryanair's net income guidance for the year despite several negative events which is impressive, and has avoided more weakness in the stock. Over the medium term, Ryanair admitted it might have to hire more staff and cabin crew which might increases its cost base by c. €20m to €30m per annum, which would be 2% of next year's profits. Near term focus for the airline is to fix the rostering error and ensure this never happens again.

Overall, there has been several events which added together have materially affect sentiment towards the stock. However, we still remain positive in the long term growth prospect of a generally well run airline. Even if it does have to hire more pilots in the future it will still have a material cost advantage over peers as it takes delivery of Boeing 737 Max 800 planes which are 16% more fuel efficient with 8 additional seats, meaning its unit cost base per passenger should continue to fall while peers' cost base increase. The stock currently trades at 12x calendar 2018 earnings which we view as attractive for a best in class operator. The airline has roughly c. €100m left to run on its existing share buyback programme which will give marginal support to the stock in the near term.

Stephen Hall, CFA | Investment Analyst

Green REIT - Strong results highlight healthy Dublin office sector Closing Price - €1.547

News

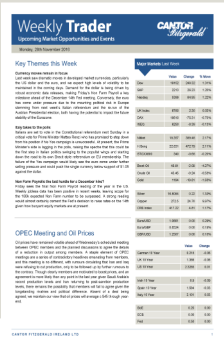
Green REIT released half year results yesterday that were very strong. EPRA NAV came in at €1.656, 3% ahead of €1.66 FY17 estimate and up 9% YoY. Profit after tax came in at €129.8m, down 11% YoY but ahead of expectations. This was driven by revaluation gains that were much more than we had forecase, approx. €97m, €47m of which came from new developments and the remainder from portfolio properties. EPRA EPS came in at 4.8c, slightly behind consensus estimate of 5c but was still up 31% YoY. EPRA earnings came in at €33m, which was ahead of estimates and up 33% from the same period last year. Overall return was 12.9% which is a very strong return for a REIT invested in primarily Dublin commercial real estate. Valuation of the overall portfolio now stands at €1.381bn, up 11% YoY. Overall NAV value of the portfolio was €1.15bn ahead of estimates of €1.112bn and up 10% YoY. Rental roll growth was also very healthy up 12% to €68.9m.

Comment

We have been guiding clients to increase exposure to Dublin commercial office space since the start of the year. Any clients who did have done quite well. We believed a number of tailwinds were gathering that would produce a very good year for Dublin REITs and so far this has been the case. We would continue to recommend clients to hold onto Green REIT into the second half of the year. Management guidance for the remainder of the year was optimistic with all developments on track for stated delivery date and office space take-up rates remain quite high. Expected rental values should increase next year to €65 per sq. ft. as underlying demand remains robust and Brexit related moves of UK firms begin to take place. We maintain our Outperform rating from a 12 month perspective. For our more active clients however we would recommend taking some profit at these levels. Green REIT is up 12% YTD and was up 5% just yesterday alone. It is now trading at €1.55 which represents just a 3.7% discount to FY17 NAV and 8.8% to FY18 NAV. It is also trading at just a 5.5% discount to consensus price target of €1.64. We would recommend active clients to lighten up at these levels as it is now has moved into overbought territory and is due a retracement.

Will Heffernan | Investment Analyst

Cantor Publications & Resources



Weekly Trader

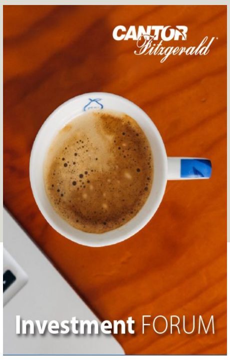
On Mondays, we release our weekly note in which we provide a view on equity markets for the coming days, and highlight a number of equities which we believe provide exposure to the important themes unfolding in the markets. Our in-house Investment Committee meets on a weekly basis to craft this strategy,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

[Click Here]

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.

[Click Here]



Investment Forum

Through our investment Forum we bring you the latest market news, investment insights and a series of informative articles from our experts.

[Click here]

Regulatory Information

Issuer Descriptions: (Source: Bloomberg)

Ryanair: Ryanair Holdings plc provides low fare passenger airline services to destinations in Europe. ICG: Irish Continental Group plc markets holiday packages and provides passenger transport, roll-on and roll-off freight transport, and container lift on and lift-off freight services between Ireland, the United Kingdom and Continental Europe

Green REIT: Green REIT plc operates as a property investment company. The Company invests in a portfolio of long-lease and freehold, primarily commercial and mainly Dublin-based properties.

Historical Recommendation

Ryanair: Ryanair was added to the Core Portfolio at inception in and have had an Outperform recommendation since then

Green REIT: We have an Outperform rating for Green REIT since 09/02/15 and no changes to the recommendation have been made in the last 12 months

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

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