Daily Note

Views, news and topics from today's markets

CANTOR Fitzgerald

Tuesday, 5th December 2017

Morning Round Up

Brexit Ups & Downs

Yesterday was a dramatic day for the UK and sterling. Initial reports in the morning implied that the UK and EU had come to an agreement on the one outstanding issue that is preventing the start of trade talks: the Irish Border. Sterling rallied vs euro as a result with EURGBP moving from £0.883 to £0.876. However, in the afternoon the DUP leader Arlene Foster stated that the North must leave the EU under exactly the same regulatory regime as the UK. Sterling promptly sold off with EURGBP moving back to £0.8823. This morning it has moved slightly higher to £0.88366, indicating the market remains sceptical of a solution being found this week. However, following the meeting, Jean Claude-Juncker was uncharacteristically optimistic, stating that a lot of progress had been made he expected a resolution by the end of the week. If this occurs sterling should rally along with stocks that have a high degree of sterling exposure including Ryanair and Bank of Ireland.

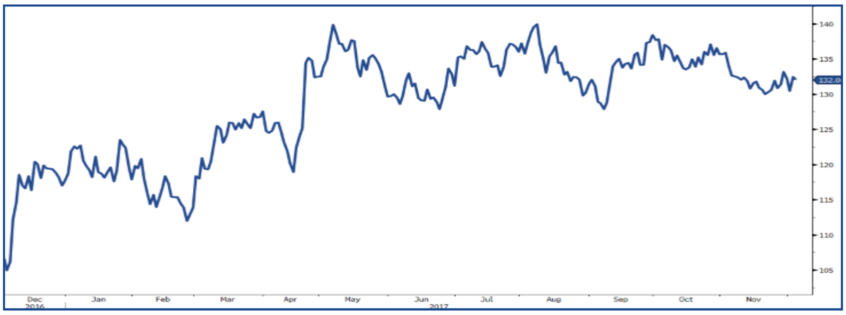
ECB Set to Rethink NPL Plans

The ECB is likely to re-evaluate its plans to force Eurozone lenders to deal with bad loans after it hit a stumbling block in the European Parliament and Commission. The ECB's enforcement arm, the Single Supervisory Mechanism (SSM) had drafted proposals in October to make it more expensive for banks to hold non-performing exposures (NPEs). The proposals were put out for consultation, which ends this Thursday. However lawyers for the Parliament and the Council have said that the SSM has exceeded its mandate with its current proposals. The ECB has no power to issue broad rules applying to the whole banking system. Privately the SSM have acknowledged the plan will have to be re-worked but will likely be delayed and be softer in its approach.

Tax Reform Scepticism

As US tax reform currently goes back and for the between the Senate and the House, analysts are now turning to the impact of the bill, with many expressing doubts over its ability to transform an economy that is already running close to full employment. Longer term it is sure to have a serious impact on the deficit which ultimately will be negative for government spending and the US dollar. It arguably leaves longer term challenges such as higher inequality levels, poor educational standards, slower labour force growth and declining demographics unanswered. The majority of analysts expect there to be 0.3% boost to GDP in 2018 and 2019 but for the effect to flatten off with no visible uplift from 2020 on. Critics of the bill have argued it is very skewed to the richest in society and will have little discernible impact on the spending power of the average US worker.

European Banking Sector



Source: Bloomberg, CF Research November 2017

Key Upcoming Events

08/12/2017 US Debt Ceiling Deadline

12/12/2017 Federal Reserve Board Meeting

14/12/2017 ECB Council Meeting

21/12/2017 US Quarterly GDP

Market View

US equity markets yesterday saw a continuing rotation out of the Tech sector into some of the more unloved sectors this year, including Industrials, Telecoms and Utilities. This is being driven by both profit taking and investors re-allocating to sectors they believe will benefit from US tax reform. In Europe, Brexit continues to dominate headlines on an hourly basis. Discussions are set to continue for the remainder of the week. Focus today will be on a slew of PMI data out of Europe, those Brexit negotiations and the continuing push in Washington to get tax reform across the line.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	24290	58.46	0.24%	22.91%
S&P	2639	-2.78	-0.11%	17.89%
Nasdaq	6775	-72.22	-1.05%	25.86%
Nikkei	22,622	-84.78	-0.37%	18.35%
Hang Seng	28,843	-295.48	-1.01%	31.10%
Brent Oil	62.35	-0.10	-0.16%	9.73%
WTI Oil	57.23	-0.24	-0.42%	6.53%
Gold	1276	-0.22	-0.02%	11.19%
€/$	1.1859	-0.0007	-0.06%	12.76%
€/£	0.8832	0.0030	0.34%	3.48%
£/$	1.3427	-0.0053	-0.39%	8.81%

	Yield	Change
German 10 Year	0.33%	-0.018%
UK 10 Year	1.26%	-0.023%
US 10 Year	2.38%	0.007%
Irish 10 Year	0.53%	-0.022%
Spain 10 Year	1.40%	-0.010%
Italy 10 Year	1.70%	-0.016%

Source: Bloomberg, CF Research November 2017

AIB - Very strong trading update

Closing Price - €5.55

News

AIB released a trading update this morning that was very strong on all fronts. Fully loaded CET1 ratio came in at 17.6%, a 230bp increased from the 15.3% at the end of 2016. That represents a very strong quarterly gain of 100bps and is well ahead of management's medium term target of 13% and 0.6% ahead of our own year end estimates. Net Interest Margin (NIM) came in at 2.56%, up from 2.54% in H1 and 2.25% in 2016. It was also ahead of management's strategic target of 2.4% and our own forecasts of 2.48%. Impaired loans declined by €0.5bn to €7.3bn. This is down 20% from year end 2016 and now represents approx. 11.2% of overall loans, implying management remain on track to reduce this to the European average by the end of 2019.

The picture from a lending perspective was also quite strong. Overall new lending drawdowns to Q3 2017 were 11% higher year-on-year. ROI sectors were up 15%. Mortgage market share came in at 34%, a slight tick down from 35% in H1 but still very strong and in line with management's strategic goal of keeping this in the mid-30s range. Mortgage drawdowns were up 29%. The loan to deposit ratio was 93%. Management also stated that its three year strategic investment programme is on track and will conclude in 2017, with normalised levels of investment spending thereafter. This implies that it remains on course to bring its sustainable cost-income ratio down below 50% by the end of 2019, a previously stated strategic goal. Regarding the tracker mortgage issue, management guidance was also positive stating "any change in provisioning levels, as we conclude, is not expected to have a material impact".

Comment

Overall this was a very strong set of numbers from AIB. All the important metrics including CET1 Ratio, NIM and loan growth came in ahead of ours and the market's expectations. We would expect to be upgrading our forecasts and price target as a result. We would also expect there to be upgrades across the board.

Management continues to make very good progress regarding its strategic goals. Impaired loans now stands at approx. 11.2% of the overall loan book with NPEs coming in at €11.5bn (approx. 18% of overall loan book) . The well flagged Project Redwood is likely to reduce that by $2bn, making management's target of reducing NPEs to the European average of 5% by the end of 2019 ambitious. Management has proven very adept in this space with resolution strategies working very effectively. Further improvements will come through strengthening collateral (an ESRI report on the 14th November forecasts 20% increase in Irish property prices over the next 3 years), improved repayment capacity of its customer base (wage growth, and improved Irish consumer and business confidence data on the rise). The improvement in asset quality as a result will only enhance the banks capital position and ability to grow lending.

Likewise, its capital position is very strong with a CET1 ratio of 17.6% well ahead of our own and market expectations. Prior to this release, we already viewed it as a sustainable dividend play. This has only been improved by the level of organic capital generation this quarter. Its consensus dividend had been 2.61% in FY17, 3.25% in FY18 and 5.44% in FY19. These forecasts are likely to be upgraded on the back of these results. Once management gets NPEs down to the European average we would expect it to gradually redistribute excess capital in the form of dividends, which ultimately will improve the ROE outcome.

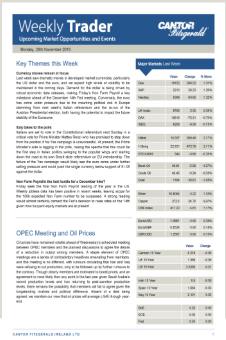
AIB is due to complete its €870m IT investment programme this year with a return to more normalised levels of investment from 2018 onwards. This is another positive catalyst which should improve the operational efficiency of the group and help achieve management's goal of a cost to income ration less than 50%. Concurrently, as the stock of NPEs decline, the Group should be able to reduce headcount with its Financial Solutions Group (GSG) which deals with customers in arrears.

On mortgage lending, we would expect AIB to continue to maintain its market share in the mid-30's in the medium term. It currently offers very attractive rates relative to its main competitors. It remains to be seen in the longer-term if the Irish market attracts new players, which considering the premium associated with Irish rates vs their European counterparts is a very real possibility. But in the medium term at least we would expect AIB to continue to lead the market. Based on estimated rent appreciation, we expect there to be sustained growth in the mortgage market for the next 3-5 years, which should ultimately benefit AIB.

In the short term the tracker mortgage scandal had weighed on Irish banking shares. This update should give investors assurance on that matter with management guiding that it expects any necessary increase in provisioning to not be material. Lastly, the economic backdrop for AIB remains very healthy with strong GDP growth and low unemployment allied with households who have deleveraged significantly since the financial crisis. We see AIB as a pure play on the Irish economy and we maintain our Outperform.

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

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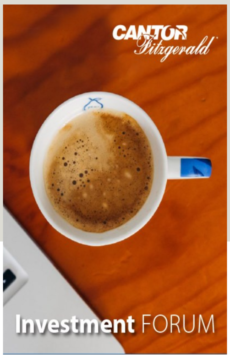

Investment Forum

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

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Regulatory Information

Issuer Descriptions: (Source: Bloomberg)

AIB: Allied Irish Banks plc (AIB) attracts deposits and offers commercial banking services. The Bank offers mortgage, automobile, business, plant and equipment purchase, and lease financing loans, investment banking, securities brokerage, asset management and treasury services, and discounts invoices. AIB operates in Ireland, the United Kingdom, and the United States

Historical Recommendation:

AIB: We moved our rating from under perform to out perform on the 23/06/2017

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