Daily Note

Views, news and topics from today's markets

CANTOR Fitzgerald

Wednesday 14th March 2018

Morning Round Up

Trumps Sacks Tillerson

Donald Trump sacked the US Secretary of State Rex Tillerson yesterday. With just a week since the resignation of Trump's top economic advisor Gary Cohens, casualties in the White House are mounting . Mr Trump has named the CIA Director, Mike Pompeo, as his replacement with Gina Haspel named as the first female CIA chief. Mr Trump had repeatedly clashed with Tillerson over most major foreign policy issues with Tillerson generally believing in a more diplomatic approach, "we got along actually quite well, but we disagreed on things," Mr Trump said at the news conference. News of the sacking came just hours after the former secretary spoke openly on his support for the British Government case that Moscow was responsible for the poisoning of the ex-Russian spy Sergei Skripal and his daughter. It is likely that Pompeo will be significantly more hawkish in his foreign dealings. The latest instability has triggered some volatility in the market.

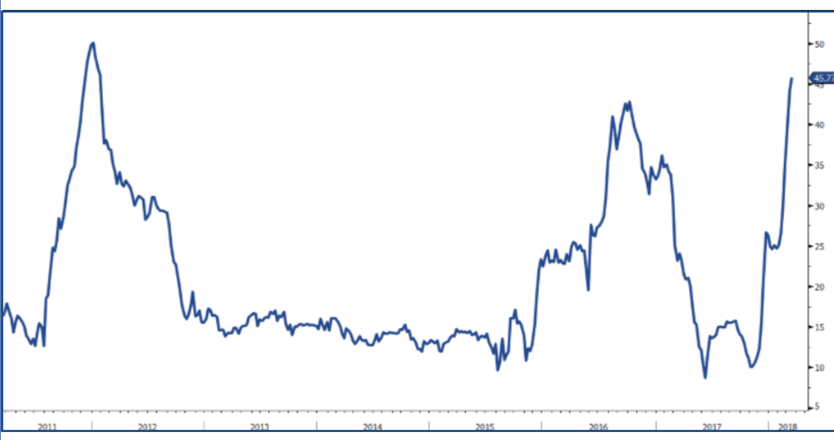
Republican electoral struggles

We had highlighted previously the possibility of the Republicans struggling in 2018 mid-terms which ultimately may affect Mr Trump's ability to implement policy. Early indicators appear to be backing this up. Firstly, Democratic Senate candidate Doug Jones defeated the Republican incumbent Roy Moore in Alabama, a fiercely red state. Last night, Democrat Conor Lamb was holding onto a slim lead (560 votes) over Republican opponent Rick Saccone in the Pennsylvania congressional election. This is important as Mr Trump won this state by 20% in the Presidential election. Mr Lamb, a former Marine and federal prosecutor, campaigned on a centrist platform and has regained some support from white working class voters. Mr Trump had visited the state recently to campaign and rolled out metal tariffs, which was sure to garner support. Several leading Republican senators and congressmen have indicated their intention to retire this year, which should ensure several elections before mid-term later on in the year.

Libor/OIS spread worth noting

A well know market stress indicator has widened recently over the past few weeks, causing analysts to sit up and take notice. The Libor/OIS spread is now at 45bps, the highest spread since the Eurozone crisis in 2012. Historically this spread was an indicator of stress in the banking system as it measures the cost of interbank borrowing versus wide market interest rate expectations. The spread has widened as Libor has moved higher. So far the consensus take is that this time it is not driven by any specific structural issues. Instead, it just the general cost of funding going up as we move into a higher rate environment. If this is the case, it does not present too much of a worry. But it does bear monitoring. A widening in this spread was one of the indicators that forewarned of the 2008 crisis.

Libor/OIS spread



Source: Bloomberg, CF Research March 2018

Key Upcoming Events

15/03/2018 Eurozone Inflation

Market View

Asian markets followed the US downward last night as the market digested the news of the sacking of Rex Tillerson. The Secretary of State departure overshadowed the in-line US inflation data. European stocks have opened relatively flat this morning. Yields in the US and have remained at about 2.84%. Gold is down slightly while oil has increased marginally. Overnight the dollar has strengthened slightly.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	25007	-171.58	-0.68%	1.16%
S&P	2765	-17.71	-0.64%	3.43%
Nasdaq	7511	-77.31	-1.02%	8.80%
Nikkei	21,777	-190.81	-0.87%	-4.34%
Hang Seng	31,435	-166.44	-0.53%	5.07%
Brent Oil	65.04	0.40	0.62%	-2.74%
WTI Oil	61.01	0.30	0.49%	0.98%
Gold	1325	-1.10	-0.08%	1.74%
€/$	1.2376	0.00	-0.11%	3.09%
€/£	0.8867	0.00	-0.08%	-0.16%
£/$	1.3957	0.00	-0.04%	3.29%

	Yield	Change
German 10 Year	0.621	0.00
UK 10 Year	1.477	-0.01
US 10 Year	2.8371	-0.01
Irish 10 Year	1.054	0.01
Spain 10 Year	1.406	0.01
Italy 10 Year	2.00	0.0050

Source: Bloomberg, CF Research Mar 2018

Permanent TSB - FY17 results confirm a lot of work to do

Closing Price - €1.94

News

Net interest income was up €11mln, to €405mln, with Interest income down €64mln to €504mln. Interest expense was down €75mln to 99mln. Other income was down €33mln to €38mln, mostly due to €29mln gain on the sale of Visa shares in FY16. Overall revenue was broadly in line with expectation at €448mln. Total costs were slightly down, with a headline cost income ratio of 74% and on an adjusted basis down to 64% (excluding regulatory costs and bank levy). NIM was slightly down on half year and 5 bps behind expectations at 180bps, improvements of 10bps due to asset pricing, with the remainder due to reduced funding costs. Reported net income came in at 40mln which was a miss on expectations of 70mln, and represents an EPS of 6.4c which was only marginally up on half year EPS of 5.6c. PTSB took a large impairment charge in the H2 with a FY charge of €49mln compared to a half year charge of €5mln. Reversing out the impairment charge, exceptional items and adjusting for AT1 coupon, NI comes in at €90mln or an EPS of 20.1c. On the balance sheet total assets were down €830mln at €20.5bn while total liabilities fell by a similar amount. Total earning loans are down €194mln to €15.6bn, while net of provisions, total loans are down to €18.3bn, a reduction of €516mln from FY16. New lending volume was up €1bn which did not deliver net loan growth. Non performing exposure (NPE) was down €446mln to €5.4bn but this still stands at a very high 26% of gross loans and only a marginal improvement in percentage terms on FY16.

Comment

NII and NIM have improved yoy in line with other Irish banks but at an absolute level still well behind the sector with most of the improvements coming in the way of lower funding cost. A headline contraction in Net Interest Income (NII) is disappointing. Similarly on the cost side, there very little in the way of yoy improvements. Total Cost Income ratio was stable and high at 74%. A lot of the good news from PTSB seems to have come in the first half of FY17, with only marginal increase in EPS from half year to full year. This seems largely due to impairments recognised in H2. Balance sheet is still contracting with net loans falling; again this was expected but disappointing in the wider context of the Irish banking sector. On the upside, PTSB showed some good performance in new lending with increases across mortgage, consumer and SME lending. Market share in the mortgage market increased from 9.1% to 12.6%. In addition there was marginal improvement in NPEs in the period. The big news on NPEs will be how Project Glas, the sale of a €3.7bn loan book, proceeds during the year. This will have a significant impact on the headline percentage bringing it close to 10%.

On the regulatory front, CET1 was 15% marginally down on half year while liquidity ratio were also good. Further improvements in capital will be generated by the Project Glas sale which will help in normalising the balance sheet. Management's outlook notes a return to net loan growth in 2019, but they are not expecting significant uplift in NIM and operating costs are broadly expected to be stable. Ultimately we see PTSB as too small a lender to produce improved profitability. The C/I ratio of 74% is considerably higher than EU average of 50%. Its net lending margins are also considerably behind peers, with management offering little guidance on any strategic improvements. PTSB needs to significantly adjust its cost base in order to justify a valuation at normal European levels levels. Current P/B is 0.45x, almost half the sector level at 0.86x, which we see as justified. We see these results as further evidence of how far behind their peers PTSB are. We maintain our Underperform.

Pierce Byrne| Investment Analyst

Inditex - Poor Start to 2018 and continuing margin pressure

Closing Price - €24.26

News

Inditex released full year FY18 (calendar year 2017) results that point to continuing difficulties ahead. Revenue grew by 9% yoy (+10% in constant currency terms) to €25.3bn, slightly behind estimates. Life for Like (LFL) sales were up 5%. Gross margin was 56.3%, slightly behind estimates (56.4%) and down 70bps yoy. In Q4 alone, gross margin was down 137bps. This was driven largely by currency effects. EBIT was up 7% yoy to €4.314bn, ahead of consensus estimates of €4.282bn. This implies EBIT margin of 17%. Net income of €3.368bn was also ahead of estimates at €3.343bn. FY18 EPS was in line with consensus at €1.082 vs estimate of €1.081. Lastly, dividend per share came in at 0.75c, ahead of estimates of 0.726c.

In terms of current trading so far in 2018, the picture is mixed. Management stated that sales are up 9% in constant currency terms from the period 1 February to 11th March. This is below our expectations for 10.5% growth. If we assume 4% of this is driven by space growth, that would imply LFL sales growth of 5%. This is below estimates. It is likely this period was affected by the recent bad weather across Europe at the end of February with approx. 10 days of sustained snowfall. Regarding guidance for the rest of the year, management did not provide too much detail in this release. It stated that it now sees gross store openings of 350-400 (down from 350-400 last year) with another 200 being absorbed. This gives a net figure of 150-200 store openings, which is approx. 6% network growth, which would imply new space sales contribution of +5%. Management also guided for 4-6% net space growth in coming years.

Lastly, management broke out the percentage of overall sales stemming from online, the first time it has ever done so. Online represents 10% of overall Group sales and grew 41% in 2017. As we have been highlighting, the Inditex model has the ability to adapt well to the needs of the online consumer and is one of the major reasons why we like the stock.

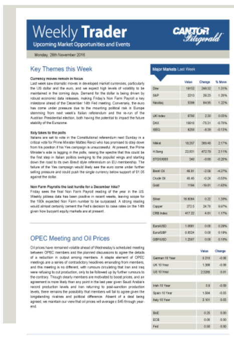
Comment

These results were broadly in line for 2017 but there is enough negatives in the release to warrant some concern. Firstly, gross margin continues to be pressurised. Inditex has always traditionally been able to sustain a much higher margin than most of its peers and it should continue to do so. But the stronger euro over the past year has seen margins consistently pressurised due the unique nature of its business model. This pressure is likely to continue if the euro continues to rally. Secondly, the LFL sales growth of 5% so far this year would represent the slowest sales growth in 3 years for the company. Bad weather aside, that is still likely to be received negatively by markets. Lastly, management's decision to break out online sales is welcome. Growth in that segment has been exceptionally strong but markets may be surprised that online represents just 10% of overall sales. There was an expectation for that to be higher.

Management host a conference call at 8.00am today and an analyst day tomorrow in London. Management will face some tough questions regarding margins, LFL sales and the online segment. The stock is down 16.5% this year and is currently trading at an FY19 P/E of 21.2x vs at Pan European General Sector at 17.9x. Historically, Inditex has always traded at a substantial premium to this sector (approx. 28x) due to its ability to stave off some of the structural issues facing the industry better its peers can. Recent pricing action indicates that a lot of this is already in the price but today's release is likely to weigh on the stock in the near-term. We are moving Inditex to Under Review and will update again post the call and analyst meeting tomorrow.

William 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.

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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)

PTSB: Permanent TSB Group Holdings Plc provides personal financial services in the Irish market with strong market positions in life and pensions, fund management and retail banking

Inditex: Industria de Diseno Textil, S.A. designs, manufactures and distributes apparel. The company operates retail chains in Europe, the Americas, Asia and Africa.

Historical Recommendation:

PTSB: We have changed our outlook on PTSB to “Market Perform” from “Outperform” on the 26th of July 2017

Inditex: We changed our rating on Inditex from Outperform to Under Review on the 14th March 2018

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