

Wednesday, 12th September 2018

Morning Round Up

May pushing ahead with Brexit despite internal plotting

Recent optimism surrounding EU/UK Brexit negotiations has led to the pound strengthening against the euro, a trend we would expect to continue if the recent soundings regarding progress on a soft Brexit deal are to materialise. Mrs May is expected to address the remaining 27 EU leaders in Salzburg next week and there is an expectation that she will deliver the UK's final position. The remaining 27 leaders will then discuss the EU's response. An announcement on a Brexit deal summit is also expected to be scheduled for mid-November, which would be further confirmation for the market that negotiations are close to getting a final exit deal on the table.

There are two major hurdles facing a smooth run to a signed Brexit deal by November. The Irish border issue and Mrs May's leadership position within the Tory party. A credible solution is yet to be outlined on how to solve the Irish border issue. The Irish government are insisting on no physical border on the island of Ireland, while the UK will need to impose customs checks on goods and people moving across the border post exit. The obvious solution is for a sea border. However the DUP, who's parliamentary votes are critical for the Tory party's majority in Westminster, are strongly against Northern Ireland being governed under different laws to the rest of the Union. The second issue regarding Mrs May's leadership could also derail any progress. Anti-Europe sentiment in a segment of the Tory party has increased pressure on May to push for increased autonomy from the European Union, whilst plotting to oust her as leader in favour of a harder Brexit supporter in Boris Johnson or Jacob Rees-Mogg. Ultimately, we would expect a general election in the case where Mrs May is ousted as Prime Minister.

A worsening sentiment on either of these issues has the potential to drive the pound back above £0.90 into year end. However, if the [current positive sentiment](#) continues we could see the pound strengthening further to levels close to £0.87. We will be keeping a close eye on next week's EU leaders summit and the Conservative Party Conference at the end of the month as key milestones in the near term for our Brexit outlook.

Central bank policy meetings flying under the radar

This week sees two major central banks meeting to discuss monetary policy with little expectations for any change in policy from markets. Firstly, the BOE is not expected to make any changes to policy after pushing ahead with a rate hike in August. UK data has continued to be weak over the summer with the exception of employment data as Brexit uncertainty weighs heavily on growth prospects. The committee's views on the impact of emerging market volatility on UK growth will also be of interest. There was some positive news this week relating to Governor Carney extending his tenure to January 2020. Continuity in the bank's leadership through the Brexit negotiations is a positive for markets.

Similarly, there is not much to expect from Frankfurt. The ECB has flagged a reduction in its bond buying program at the end of this month to €15bn from €30bn with guidance on reducing asset purchase to zero into year end. Weaker European data (albeit [improving lately](#)) will be a cause for concern and the governing council's take on this weakness will be important. The ECB is scheduled to release updated economic forecasts for the Eurozone with the impact of Brexit, trade and emerging markets again being closely watched.

German based Ryanair pilots take action

German based Ryanair pilots and cabin crew are staging a 24-hour strike today, in the latest flare-up of a Europe-wide battle for better pay and conditions. The airline said it was cancelling 150 out of 400 scheduled flights to and from Germany because of the action.

Source: Bloomberg, CF Research August 2018

Key Upcoming Events

13/09/2018 ECB Monetary Policy Meeting
 13/09/2018 BOE Monetary Policy Meeting
 19/09/2018 EU Leaders Summit
 26/09/2018 Fed Interest Rate Decision
 30/09/2018 Conservative Party Conference

Market View

US markets advanced marginally yesterday brushing off trade tensions with the Tech heavy NASDAQ leading gainers. Asia has not shown similar resilience, with markets across the region posting losses. The Hang Seng Index is now in a bear market more than 20% down from January highs. The US 2 year yield has moved down from 10 year highs of almost 2.75% back to sub 2.74%, with 2s10s spread remaining tight at 22bps. Europe has opened positive this morning with US trade policy remaining the focus for market participants.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	25857	-59.47	-0.23%	4.60%
S&P	2877	5.45	0.19%	7.61%
Nasdaq	7924	21.62	0.27%	14.79%

Nikkei	22665	291.60	1.30%	-0.44%
Hang Seng	26434	-179.79	-0.68%	-11.65%

Brent Oil	77.89	0.52	0.67%	16.48%
WTI Oil	67.72	0.18	0.27%	12.08%
Gold	1196	0.35	0.03%	-8.18%

€/\$	1.1633	0.00	0.34%	-3.10%
€/£	0.8901	0.00	0.01%	0.23%
£/\$	1.3069	0.00	0.33%	-3.29%

	Yield	Change
German 10 Year	0.418	0.02
UK 10 Year	1.496	0.03
US 10 Year	2.9479	0.02

Irish 10 Year	0.892	0.01
Spain 10 Year	1.465	0.01
Italy 10 Year	2.88	-0.0340

Source: Bloomberg, CF Research August 2018

Inditex - Results bode well for H2/18

Closing Price - €25.40

News

Inditex released half year results (covering the period from the 1st February to 31st July) that were positive and indicate a better H2/18 ahead. Overall net sales were up 3% on the same period last year at €12bn. In local currency terms sales grew 8%. Lik-for-like (LFL) grew 4% and were positive across all geographies. Store openings accounts for 3.5% growth while currency was a -4.7% drag. EBITDA came in at €2.3bn (+2% yoy & +14% in local currency) while EBIT was €1.8bn (+2% yoy and +17% in local currencies). Overall gross profit was up 4% to €6.8bn (+10% in local currency). Importantly gross margin moved up by 30bps to 56.7%. All of the above numbers were broadly in line with consensus while [recent margin improvement](#) was again ahead of expectations.

Interestingly, management also provided specific guidance for an upcoming period for the first time. H2/18 LFL sales was guided to be +4-6% (ahead of current consensus) while H2/18 gross margin growth is expected to be 50bps. If management achieves this guidance it will be a strong result.

Management also normally provides updates on current trading (i.e. how trading has gone in the weeks after the quarter end) but it declined to do so with these results. This may mean trading has started off poorly in Q3 (very tough comps from last year) but management did state that "Autumn/Winter initial collections have been well received". We expect the call to focus on this as it will determine whether or not sales need to accelerate in coming months in order to meet the guidance stated above.

Cash generation remains solid (+9% to €6bn) and inventories are very healthy (up just 2% yoy).

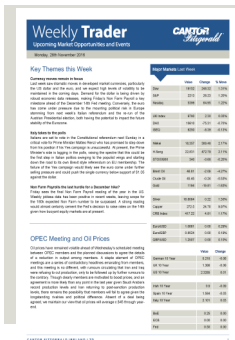
Comment

These results were in-line with consensus, which is welcome considering the stock had traded down recently on fears of a miss. Management continues to exhibit good cost control, managing to expand margins while all of its peers are suffering the reverse. This is mainly due to the nature of the [Inditex model](#) which results in far less sale items and allows for less pressure on item prices, even with the advent of online.

Year on year comparatives should now [get easier](#) given the USD rebound (management had implemented favourable USD hedges within COGS) and given euro levels in H2/17. Any clarity given by management on the call regarding trading in the weeks from July up until now is likely to look at intensely. There is currently 17% upside to consensus price target of €30.54, with the stock up 3% in early trading. We maintain our Outperform.

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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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)

Ryanair: Ryanair Holdings plc provides low fare passenger airline services to destinations in Europe.

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:

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

Inditex: We maintain an outperform rating on the stock and it is a member of our core portfolio.

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