Friday, 18th January 2019

# Morning Round Up

**Shutdown clouds outlook for consumer-driven US economic growth**
After tax cuts, rising incomes and buoyant stock markets set off a consumer boom in 2018, signs are emerging that the main engine of US economic growth could sputter, and a record-long government shutdown further muddies the waters. Federal Reserve officials and many economists have long counted on continued robust consumer spending to keep the economy chugging along, despite headwinds from recent financial market turbulence, trade conflicts and weakening global growth. Now they fear the consumer boom could be on the cusp of a reversal. The warning signs span the income spectrum - from the well-heeled possibly cutting back after their stocks got hammered last Autumn, to the poor potentially getting squeezed if a lingering government shutdown delays food assistance payments. Economists are also not certain, for example, whether last year's personal income tax cut will lead to higher refunds and boost big-ticket purchases, such as home appliances, typical for this time of year, or whether the windfall was already spent last year when pay-cheque withholding declined. The shutdown, now in its 28th day, could delay refunds and hit companies that rely on consumers spending a chunk of that money on their goods or services. Economists had already anticipated that higher interest rates and trade tensions would slow growth in household spending on goods and services after it hit $13 trillion last year. The question is how much and the shutdown has made the answer more difficult.

**Gloomy forecast for Davos: crises aplenty, but few world leaders**
An array of crises will keep several world leaders away from the annual World Economic Forum (WEF) in Davos, Switzerland, next week, which takes place against a backdrop of deepening gloom over the global economic and political outlook. Anxiety over trade disputes, fractious international relations, “Brexit” and a growth slowdown that some fear could tip the world economy into recession are set to dominate the January 22-25 Alpine meeting and the mood will be sombre. The WEF's own Global Risks Report set the tone this week with a stark warning of looming economic headwinds, in part due to geopolitical tensions among major powers. Some 3,000 business, government and civil society chiefs are due to gather in the snow-blanketed ski resort, but among them are only three leaders of the Group of Seven most industrialised countries: Japan's Prime Minister Shinzo Abe, German Chancellor Angela Merkel and Italian Prime Minister Giuseppe Conte. Donald Trump, who stole the Davos limelight last year with a rare appearance by a sitting US President, pulled out of this year's event as he grapples with a US government shutdown. His French counterpart Emmanuel Macron is also skipping the meeting as he seeks to respond to the "yellow vest" protests, while Theresa May battles to find a consensus on “Brexit”. Outside the G7, the leaders of Russia and India are shunning Davos, while China - whose President Xi Jinping was the first Chinese leader to attend the elite gathering in 2017 to offer a vigorous defence of free trade - is sending his deputy instead. That will leave the likes of US Treasury Secretary Steven Mnuchin and his British colleague Philip Hammond, as well as China's Vice-President Wang Qishan and a host of central bankers, with the task of trying to reassure business chiefs.

Source: Bloomberg, CF Research January 2019

## Key Upcoming Events

23/01/2019 Bank of Japan
24/01/2019 ECB
30/01/2019 Fed

## Market View

US markets advanced yesterday, with the S&P 500 breaking above its 50 day moving average (DMA) for the first time since December. Asian markets advanced on reports of progress in trade relations between the US and China. Europe opened strong this morning, while futures are pointing to a positive day in the US. Yields remain stable at current levels with the US 10 year at 2.76%. The pound has held steady over the week around the £0.88 level. The market will be watching the US for movement on trade and the government shutdown. On the data front, the UK has retail sales data, while the US has industrial production data this afternoon.

## Market Moves

| | Value | Change | % Change | % Change YTD |
|---|---|---|---|---|
| Dow Jones | 24370 | 162.94 | 0.67% | 4.47% |
| S&P | 2636 | 19.86 | 0.76% | 5.15% |
| Nasdaq | 7084 | 49.77 | 0.71% | 6.77% |
| Nikkei | 20666 | 263.80 | 1.29% | 3.25% |
| Hang Seng | 27091 | 335.18 | 1.25% | 4.82% |
| Brent Oil | 61.68 | 0.50 | 0.82% | 14.65% |
| WTI Oil | 52.58 | 0.51 | 0.98% | 15.79% |
| Gold | 1285 | -6.63 | -0.51% | 0.23% |
| €/$ | 1.1397 | 0.00 | 0.07% | -0.61% |
| €/£ | 0.8805 | 0.00 | 0.39% | -2.06% |
| £/$ | 1.2944 | 0.00 | -0.32% | 1.49% |

| | Yield | Change |
|---|---|---|
| German 10 Year | 0.27 | 0.03 |
| UK 10 Year | 1.366 | 0.03 |
| US 10 Year | 2.7698 | 0.02 |
| Irish 10 Year | 1.012 | 0.01 |
| Spain 10 Year | 1.347 | -0.02 |
| Italy 10 Year | 2.71 | -0.0580 |

Source: Bloomberg, CF Research January 2019

## Ryanair - Cuts FY19 guidance to €1.0-1.1bn

Closing Price: €10.07

### News

Ryanair released disappointing news this morning as they lowered their full year profit guidance (ex Lauda) to range between €1.0bn-€1.1bn from €1.1bn - €1.2bn, a c.8.7% downward revision. This downward guidance comes as a result of lower winter fares which are now expected to fall by -7% versus previous guidance of –2%. On a positive note traffic numbers guidance for the year has been revised up to grow by 9% to 142m (previous guidance of 141m), ancillary sales are notably stronger, H2 unit costs are better than expected and start-up costs for Laudamotion have been revised down from €150m to €140m.

Commenting Michael O'Leary highlighted his disappointment in this lower guidance, citing short haul over capacity in Europe however he noted that he expected a further shake out in the market and further consolidation, noting failures WOW, Flybe and Germania. He did not rule out further cuts if there are unexpected Brexit or security developments. They will report Q3 results on the 4th of February.

### Comment

This was disappointing news however given recent downgrades and the recent fall in the stock price it has somewhat already been priced in (stock is down just 1.5% this morning). We are also closing in on yearend (31/03/2019), therefore investors are taking solace in the clarity provided (with this guidance potentially above some expectations)

Contrary to general perception the recent drop in oil prices has been a negative for Ryanair and the bigger airlines in the sector. With a lower oil environment, smaller, less profitable, airlines with poorer balance sheets have been able to survive the difficult winter period, maintaining excess capacity in the market, creating downward pressure on fares. This is quite clear when we look at autumn. Oil prices peaked and numerous smaller airlines, Skyworks, VLM, Azur Air, Cobalt and Primera Air all failed in a short space of time. Our expectation was for this to accelerate into the winter, when airlines traditionally fail, however the sudden drop in oil prices bought a number of unprofitable, unhedged airlines more time, ensuring they were able to carry capacity into the spring/summer. This has therefore decreased our expectations for fares this summer.

This is clearly negative for Ryanair in the short term as the process of consolidating has been elongated, however capacity growth rates are falling (note larger competitors reducing growth rates) and should traffic rates (historically 3x GDP growth) hold up the summer period may surprise to the upside. Upcoming results for Ryanair and peers will therefore be important as we are provided more clarity going into the summer.

As we have highlighted since the beginning of the financial year (April 2018), FY19 has seen an accumulation of headwinds. However longer term, Ryanair remains the structural winner in the sector and the medium term story remains intact. Ryanair maintains its dominant cost structure, expanding ancillary revenues, leading balance sheet and longer term growth with 200m passengers expected by 2024 (through its new cost efficient Boeing 737 Max 200s). Management has made significant progress with trade unions, signing agreements (recognition or full CLA) across all of its major markets for both cabin crew and pilots, reducing the likelihood of further strike action.

Ryanair (and the broader sector) experienced a combination of a derating and falling earnings this year causing the sharp drop in the share price. However it should still return to profit growth next year given flatter unit costs and rising traffic numbers. The big question remains fares, should capacity come off the market, we expect Ryanair to both grow quicker and at a higher average fare. This would lead to a blue sky scenario of a significant jump in earnings and a sizeable rerating back toward its longer term average (c.14x 12m forward P/E vs 9.5x at present), creating a sizeable jump in the stock price. We maintain our Outperform rating as it is likely are approaching a bottom. However, short term we cannot rule out a further drop in the share price. We our putting our 12m price target (previously €16) under review and will update once this has been updated.

David Fahy, CFA | Investment Analyst

## Netflix - Inflection point for the streaming model?

Closing Price: $353.19

**News**

Netflix released a mixed set of Q4 results after the bell yesterday, pushing the stock c. 4% lower in after hours trading. The headline number's relating to subscriber growth were mixed. Q4 net adds came in ahead of managements guidance (+7.6mln) but behind consensus est. (+9.9mln) at 8.84mln. Revenue came in marginally behind estimates at $4.19bn (est. $4.21bn), while earnings per share was ahead of expectations at 30c (est. 24c). Earnings were down on Q3 as (Q3 EPS 89c) due to launch of so many new original shows. On a full year basis, revenue grew 35% to $16bn, while operating profit almost doubled to $1.6bn, with 29mln net new subscribers in the year.

Q119 guidance was again mixed, with revenue and EPS missing estimates but subscribers came in ahead of expectation. Q1 Revenue and EPS are guided at $4.49bn (est. $4.60) and 56c (est. 85c). Net adds was guided at 8.9mln (BB est. 8.5mln) with some accusations that management are intentionally underestimating guidance. Recent announced price rises are not expected to take effect in Q1 for existing customers which will contain revenue growth for the quarter. Cash flow continues to be negative, with guidance for FY19 to be flat on FY18 at -$3bn, with incremental improvements year on year thereafter. Bird Box, starring Sandra Bullock, was seen by 80mln households in its first four weeks, showing Netflix's ability to draw large audiences.

**Comment**

We see two major risks to Netflix, competition and funding. As major content producers follow down the streaming platform route (Disney, which includes Marvel and Star Wars franchises) Netflix losses content increasing requirement for originals, which increases funding pressures. Addressing the negative cash flow issue should be a primary concern for management as the business cannot fund c. $3bn annually from the high yield credit markets. Deterioration of credit conditions could see management turn to equity markets to fund its cash burn. The interesting point to watch over H1 will be the impact of the prices hikes on subscriber numbers, in conjunction with Disney launching Disney+.

After a 50% rally in price since mid December, we would advise clients to take profits at current levels as it looks stretched from a technical perspective. However, we remain positive on the stock as we assess the impact of price hikes have on subscriber numbers. The stock currently trades at c. 76x FY19 earnings, prior to the tech route in H2 it traded in a range of 80-100x. Netflix is expected to produce c. 45-50% annual growth in earnings over the next three years. We see sub $310 (c. 67x earnings) as a good entry point and retain our Outperform rating on the stock.

Pierce Byrne, CFA | Investment Analyst

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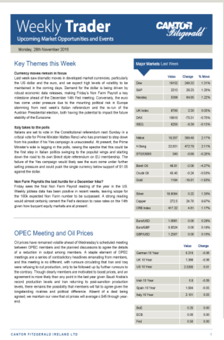


## Weekly Trader

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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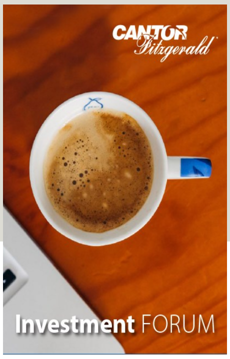


## Investment Forum

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)**

**Netflix:** Netflix Inc. is an Internet subscription service for watching television shows and movies.

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

**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.

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

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