Wednesday, 10th July 2019

Morning Round Up

Sterling continues to weaken as Brexit uncertainty builds

In the wake of the recent Brexit uncertainty, sterling has weakened against the Euro, back to Dec-18 levels and is trading at £0.90. In conjunction with the move in sterling, fears of a "no-deal" exit have not been as high since that December period when the first "meaningful vote" was delayed. Since then, we have had several failed attempts to pass the withdrawal agreement, but we have had a Prime Minister and a parliament not willing to leave without a deal. Markets now fear that this stance may change with the new Tory Prime Minister. Both candidates have committed to leaving with or without a deal on October 31st. In a ray of light for Remainers, the Labour party led by Jeremy Corbyn, have clarified their policy position and will now be calling for second referendum. Mr Corbyn also confirmed the party would campaign for remain if there was a referendum on a Tory Brexit. Finally, yesterday saw the Irish government step up its "no-deal" preparations outlining a very grim scenario including increased consumer prices, possible job losses and lower house prices. The unwillingness of either side to concede ground into the October 31st deadline will build uncertainty in financial markets and generate volatility across UK and Irish assets. Sterling will likely be particularly volatile with parity remaining a possibility. We remain cautious and would not advise clients to increase allocations to assets exposed to the fallout of a hard Brexit.

European airlines drop as France plans environment tax

European airlines fell yesterday (Ryanair -5%) after it emerged that France is set to introduce an "eco-tax" for all flights exiting the country (not incoming). The tax, which is due to be introduced from 2020, will vary depending on the form of flight. Economy class tickets on flights within the EU will have a tax of €1.50 imposed. Business class tickets for international flights out of the EU could be as high as €18. The airline industry has continued to face scrutiny for pollution as it represents 2% of the world's total carbon emissions. It is the most polluting method of transport per kilometre travelled. Taxes on the sector are likely to continue to emerge across Europe with the Dutch planning to introduce a tax per passenger from 2021. There have been calls for the EU to introduce this country wide. For Ryanair specifically, France is its biggest underweight country in Europe with c.4% capacity allocated. However, it has been increasing its presence here with a number of bases opening in the south of the country. Due to Ryanair's high load factor (97% in June) and younger fleet it is actually more carbon efficient than the vast majority of its peers. However, a tax per passenger, which does not reward this efficiency, would weigh on Ryanair more than its peers due to this high load factor.

Pepsico beat estimates on strong growth

Pepsico delivered Q2 earnings per share (EPS) of $1.54 (est. $1.50) along with $16.44bn in revenue. Demand in its water segment offset sluggish volume growth in traditional soft drinks, while the overall unit posted 2.5% revenue growth. Its Snacks division also saw growth with positive pricing across its brands (Walker, Lays and Doritos), as volume growth was sluggish. The results were well received despite the stock finishing lower on the day and should be a positive read ahead of results form our Core Portfolio name Coca Cola.

Source: Bloomberg, CF Research July 2019

Key Upcoming Events

23/07/2019 UK PM Announcement
25/07/2019 ECB Decisions
30/07/2019 BoJ Decision
31/07/2019 Fed Decision

Market View

European shares have opened slightly lower this morning with US futures pointing to a similar start. Jerome Powell, the Fed Chairman, will testify in front of congress later today. The market will be looking for clarity on the direction of the Fed at the next meeting at the end of July. Expectations remain for at least a 25bps cut despite the stronger than expected jobs number last week. Global bond yields have risen with the US 10 year and the German 10 year reaching 2.10% and –29bps respectively. Elsewhere the pound has extended its decline. EURGBP has reached 0.90 for the first time since January. Oil is up over 2% following a bigger than expected drop in US inventories.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	26783	-22.65	-0.08%	14.82%
S&P	2980	3.68	0.12%	18.86%
Nasdaq	8142	43.35	0.54%	22.70%
Nikkei	21533	-31.67	-0.15%	7.59%
Hang Seng	28202	85.41	0.30%	9.12%
Brent Oil	65.02	0.86	1.34%	20.86%
WTI Oil	58.89	1.06	1.83%	29.69%
Gold	1392	-5.15	-0.37%	8.57%
€/$	1.122	0.00	0.11%	-2.15%
€/£	0.9000	0.00	0.09%	0.12%
£/$	1.2466	0.00	0.01%	-2.26%

	Yield	Change
German 10 Year	-0.304	0.05
UK 10 Year	0.762	0.04
US 10 Year	2.0978	0.03
Irish 10 Year	0.164	0.04
Spain 10 Year	0.433	0.01
Italy 10 Year	1.73	-0.0050

Source: Bloomberg, CF Research July 2019

Grafton Group - Lower our target price further post very weak trading update Closing price:£7.83

News

Grafton Group, the merchanting and DIY Group with operations in the UK, Ireland, the Netherlands and Belgium, issued a trading update for the half year to 30 June 2019 ahead of its interim results which will be announced on Friday 30th August.

Group revenue increased by 2.4% (3.9% LfL) to £1.48bn in H1 2019. The pace of growth dropped off significantly in the most recent quarter, a function of tougher comparative data and softer than anticipated trading conditions in UK and Ireland retail.

Like for like UK merchanting growth fell from 4.8% in Jan-April, to -0.5% in May-June. Other European markets highlighted a similar trend of weaker growth but avoided contraction. Irish retail (Woodies) reported that organic revenue growth declined from +12.2% (Jan-April) to -8.4% (May-June). As a function of this, group organic growth eased from 6.4% in Jan-April, to 3.9% in the Jan-June period due to group revenue contracting by 0.3% in the May-June period.

Grafton's group revenue growth has now slowed from 9% at FY 2018, to 2.4% for H1 2019.

This follows SIG results last week which reported a marked deterioration in UK construction activity resulting in its shares falling by 14%.

Comment

We downgraded our recommendation on Grafton to "Sell" in early May when its shares traded up to £8.95, concerned by industry construction data and the knock on impact of Brexit uncertainty. We also noted that recent acquisitions have diluted group return on equity which should weigh on group fair value.

Since we downgraded Grafton, both UK and Irish economic data has slowed at an increasingly rapid pace. For instance, both UK and Irish vehicle sales are now falling year over year – with this often a leading indicator given it is a discretionary spend. Pagegroup, a recruitment agent, today also reported a deterioration in the UK recruitment market.

Given the weaker than expected result, we lower our fair value further to £7.85 and expect further downside in Grafton shares in the short term as Brexit uncertainty continues to weigh on the UK business and consumer. £6.25 was seem to be the next big technical level on the chart which would imply c.10x trailing earnings – possibly appropriate given no certainty on earnings in 2020.

Darren McKinley, CFA | Senior Equity Analyst

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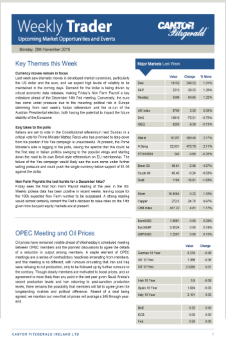

Weekly Trader

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

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.

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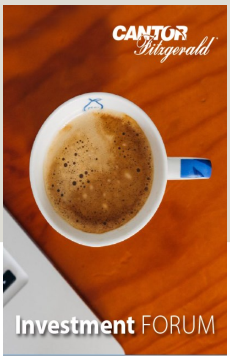

Investment Forum

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)
Grafton Group: Grafton Group PLC manufactures and retails building supplies
Ryanair: Ryanair Holdings plc provides low fare passenger airline services to destinations in Europe.

Historical Recommendation:
Grafton Group: We lowered our recommendation from Outperform to Underperform on the 08/05/2019
Ryanair: Ryanair was added to the Core Portfolio at inception in and have had an Outperform recommendation since then

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Dublin: 75 St. Stephen's Green, Dublin 2. Tel: +353 1 633 3633.
email : ireland@cantor.com **web :** www.cantorfitzgerald.ie
Twitter : @cantorIreland **Linkedin :** Cantor Fitzgerald Ireland