Daily Note
Views, news and topics from today's markets
CANTOR Fitzgerald
Thursday, 15th August 2019

Morning Round Up

US 2s - 10s spread inverts for the first time since 2007

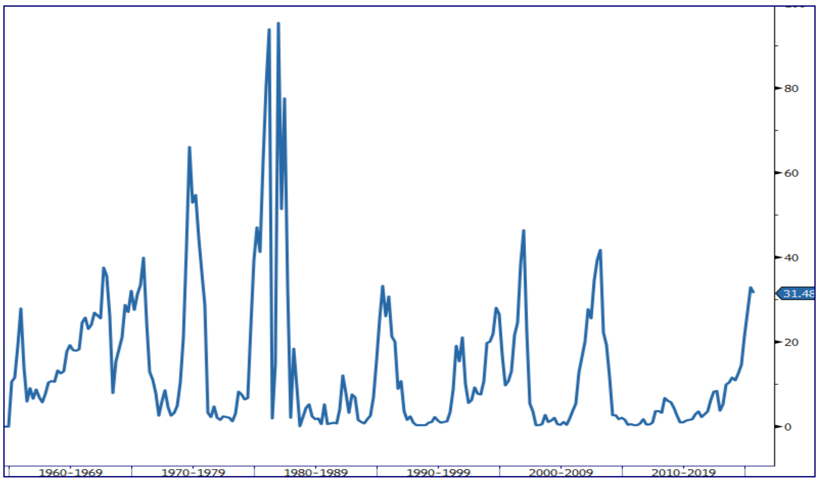
The US 2s - 10s spread inverted yesterday for the first time since 2007. This subsequently led to a heavy sell off in risk assets yesterday afternoon. Traditionally the inversion of this portion of the yield curve has acted as one of the best signals of an oncoming economic recession. In fact, the inversion of the 2-10s has preceded a recession on the last seven occasions. One would have to go as far back as the mid 1960s to find an occasion for which a recession did not follow this inversion. On a more optimistic note, there has traditionally been on average a 15m lag between inversion and recession. Interestingly, the S&P 500 has historically peaked about 7 months on average after the recession. Historically, equity markets initially sell off following the inversion before staging a final rally. The change in the global economic and finance environment over the past 12 years (most notably the “strange” phenomenon of anchored inflation, low growth, negative interest rates and inequitable levels of global debt) has led numerous central bankers and investment practitioners to explain how the circumstances have now changed. They now question the reliability of 2s - 10s spread as a recession indicator. Regardless, its record over the past 50 years is more than sufficient to warrant a more pessimistic outlook over the next 6m—2yrs. The curve has since moved back into positive territory this morning at 1bps.

Further adding to the gloom was the drop in the US 30 year treasury yield, falling below 2% for the first time in its history. Meanwhile, global negative yielding debt surpassed $16tn. European and China data released yesterday was the catalyst for the global bond rally. In Europe, the German economy recorded negative quarter on quarter growth (+0.4% yoy) as exports stalled and European industrial production fell by –2.6% yoy. In China, following on from poorer than expected credit data released on Monday, industrial production, retail sales and fixed asset investment all underwhelmed. This continued deterioration of global economic data, which began in 2018, has seen the NY Fed probability of a recession over the next 12m indicator rise to 31.5%, its highest level since 2008.

Industrial action returns for Ryanair

Ryanair's Irish pilots have voted in favour of strike action next Thursday and Friday. The Irish pilots union has made the decision after both parties failed to reach an agreement over pay and working conditions. This follows the decision by Spanish cabin crew, Portuguese cabin crew and UK pilots to strike. The series of challenges have continued to weigh on Ryanair share price. We expect weakness to continue over the coming months.

NY Fed Probability of Recession over the next 12 months since 1960



Source: Bloomberg, CF Research August 2019

Key Upcoming Events

21/08/2019 FOMC Minutes
01/09/2019 US China Tariff increase
06/09/2019 US Nonfarm payrolls

Market View

European shares have opened slightly higher this morning. Risk assets sold off heavily yesterday on the back of a series of weak economic readings globally and the subsequent inversion of the US 2-10s spread. Meanwhile, trade tensions between the US and China continue to escalate despite Trump blinking earlier in the week by extending the implementation date on a number of goods. Bond markets have continued to rally despite negative rates across numerous countries. The German 10 year bund has dropped to –67bps. Retail sales from the US, the NY Empire State Manufacturing Index and earnings from Walmart will be watched today.

Market Moves

	Value	Change	% Change	% Change YTD
Dow Jones	25479	-800.49	-3.05%	9.23%
S&P	2841	-85.72	-2.93%	13.31%
Nasdaq	7774	-242.42	-3.02%	17.16%
Nikkei	20406	-249.48	-1.21%	1.95%
Hang Seng	25495	193.18	0.76%	-1.36%
Brent Oil	58.67	-0.81	-1.36%	9.05%
WTI Oil	54.7	-0.53	-0.96%	20.46%
Gold	1518	1.45	0.10%	18.35%
€/$	1.1147	0.00	0.07%	-2.79%
€/£	0.9212	0.00	-0.26%	2.48%
£/$	1.21	0.00	0.33%	-5.13%

	Yield	Change
German 10 Year	-0.664	-0.01
UK 10 Year	0.447	0.00
US 10 Year	1.5691	-0.01
Irish 10 Year	-0.085	0.00
Spain 10 Year	0.143	0.00
Italy 10 Year	1.51	0.0020

Source: Bloomberg, CF Research August 2019

GVC - Online and US growth to deliver in H2 2019

Closing Price: £5.47

News

GVC holdings reported interim results following a pre-trading update last month. The highlights of the result were that management raised their full year EBITDA guidance by c.2% and reported that online gaming revenues grew by 17% of a like for like basis. Group balance sheet reported to end the year better than expected with net debt to EBITDA of c.2.9x.

GVC reported H1 2019 revenue of £1.8bn (+6% YoY), EBITDA of £366m (+56% YoY driven by Ladbrokes acquisition) and interim dividend was raised by 10% to 17.6p.

The UK retail division reported a much better than expected result as wagers held up in the face of new FOBT limits. European organic revenue growth was solid at mid-single digits. The growth in online was the stand out with management commenting that organic EBITDA growing by 22% YoY in this division.

The US JV with MGM resorts, Roar Digital, will launch in September ahead of the upcoming sporting season.

A new Chair will be appointed over the coming months.

Comment

We have been recommending GVC in the weekly trader on the back of low valuation, strong online growth, integration synergies and the US JV launch. This result reinforced our view.

Darren McKinley, CFA | Senior Equity Analyst

Vestas Wind Systems - 37% order growth

Closing Price: 528.60 DKK

News

Vestas Wind Systems released Q2 2019 financial results, reporting revenue of €2.1bn (-6% YoY) and EBIT (€128m) declined by c.50% as EBIT margin fell from 11.5% to 6%. EBIT margins have been impacted by competitive markets, tariffs and higher material costs.

Management did report the highest ever quarterly order intake and an all-time high order book for wind turbines – now at €31.5bn (+€8bn/+37% YoY on last year). Q2 order intake was up 50% YoY to 5.7GW and pricing achieved was up over the same period. Deliveries and order intake in the lesser penetrated US market was key to growth in Q2. In addition, the service division reported 15% revenue growth and a 28.4% margin. The MHI Vestas offshore JV continues to report growth in profits as this JV ramps up.

Vestas raised the midpoint of their FY 2019 guidance for revenue by 2.2% but lowered their EBIT margin guidance by 50bps to 8.5% at the midpoint. Management are now focused on delivering on extraordinarily busy H2 2019 and expect increased activity in 2020. Balance sheet remains very strong with the group in a net cash position

Comment

The improvement in revenue and profitability at MHI Vestas JV is notable given that this offshore market is expected to grow sevenfold over the next 10-12 years with Vestas well positioned again. We have no doubt that Vestas will dominate this market as they have the onshore market having fitted 66,000 turbine through 2018 across 80 countries. The pace of growth in its order book is startling at +37%.

With European carbon costs increasing significantly over the last twelve months, we expect utilities to continue to ramp up investment in wind energy. In 2017, 55% of new installed capacity in Europe was Wind Energy. Globally, Wind Energy accounts for 10% of electricity supply and we expect this to grow to 20%-25% through 2025.

We consider an investment in Vestas Wind Systems to be a structural investment in Wind Energy. The company is becoming integrated along the value chain by offering additional services and taking equity interest in some wind farm projects. Over time, Vestas EBIT margin will expand as services is a larger contributor to group revenue.

Vestas trades on c.13x2020 net income when market cap is adjusted for the net cash on the groups balance sheet. Over the last c.18 months, Vestas has returned c.5% to shareholders via dividend and buybacks. Having downgraded Vestas Wind Systems to market perform in January, we use the recent correction to DKK511 as an opportunity to raise our recommendation again to outperform with a stop loss at the 200dma of DKK490 for active clients. Our twelve month fair value for Vestas Wind Systems is set at DKK580. For longer term clients we suggest taking a “neutral” 3% portfolio position at current levels and adding a further 3% on broad market weakness toward DKK450 on recession concerns as we believe that wind power generation should grow through any recession.

Darren McKinley, CFA | Senior Equity Analyst

Prudential - Asia continues to grow above trend

Closing Price: £14.34

News

Prudential announced H1 results yesterday morning delivering operating profit growth and announcing the expected finalisation of the demerger of M&GPrudential. The demerger, which is subject to shareholder approval, is set to be completed in Q4 with Prudential plc regulation transferring to the Hong Kong Insurance Authority. Operating results were encouraging across the US and Asian businesses (the continuing business) growing operating profits by 14% (21% on a constant currency basis), while the Europe business (discounted operations or M&GPrudential) saw a 7% decline in operating profits.

Asia saw +10% growth from 8 of its 12 markets, with operating profits up 14%. The business is focused on Health and Protection (71% of Asian Life revenues). Asset management in the region also performed well. Eastspring saw total assets grow by 12% to £165.5bn with external assets up 14%. Revenues grew by 5%, while its cost income ratio fell to 51% resulting in operating profits up by 12% to £103mln. The US also performed well, with operating profits up 14% to £1.21bn on better than expected deferred acquisition costs. Fee income was stable, while spread income was 27% lower due to lower core income spreads and lower swap income. The European business (M&GPrudential) saw a decline in profits one the back of weaker asset management results. M&G posted a 12% decline in operating profit to £239mln, while the Life business delivered 2% growth to £496mln.

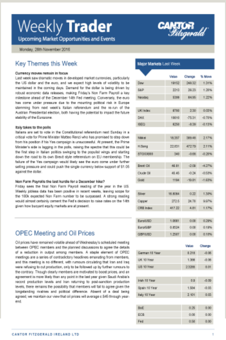
The balance sheet remains strong with a Solvency II cover ratio of 222%. The board announced a 5% increase in its interim dividend to 16.45p.

Comment

Yesterday's results showed continued progress from its Asian franchise, while the US business posted stronger than expected results. The structural tailwind in Asia should continue to support above trend growth. The balance sheet remains strong, with the possibility of a mix of M&A and increased shareholder distributions a possibility. Valuations have trended lower as sector pressure continue to weigh. At c. 9x forward earnings it remains cheap against the broader European insurance sector. Given its growth prospects we would expect Pru to return to trading at a premium to the sector. However, the uncertainty caused by both Brexit and the upcoming restructuring will likely see valuations lag historic norms. How the market capitalisation is split between the two new entities will be critical. We would expect the market to favour the structural growth trends within the Asian business and be less enthusiastic regarding the European business. We remain positive on the longer-term outlook for Prudential. However, we await further details on how the demerger will be structured and value assigned to the separated entities.

Pierce Byrne, CFA | 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

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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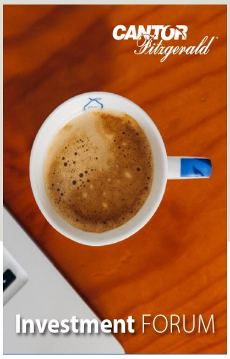

Investment Forum

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)

GVC: GVC Holdings is an e-gaming operator in both B2C and B2B markets. The company's line of business includes the provision of internet gaming, sports betting, casino, poker and bingo services.

Vestas Wind Systems: Vestas Wind Systems A/S develops, manufactures, and markets wind turbines that generate electricity

Prudential: Prudential is an international company which provides a wide assortment of insurance and investment products and services. Prudential's services include personal and group pensions, equity plans, mortgages, and deposit accounts

Historical Recommendation:

GVC: This stock is currently not rated

Vestas Wind Systems: We upgraded our rating to Outperform on 15/08/2019

Prudential: We have an "Outperform" rating on Prudential as of 01/03/2018

http://www.cantorfitzgerald.ie/research_disclosures.php

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