



The Cut

**Bringing the latest views from a selection of
Independent Research Providers working with IRF**

Edition 1 - 6th January 2017

Editor's Note - Welcome to the first (bumper!) edition of the The Cut from Independent Research Forum (IRF) in which we will bring the latest views from a selection of Independent Research Providers working with IRF

We highlight outside the box thinking, contrarian viewpoints and specific investment recommendations across macro, sector and single stock research

Currently IRF works with 80 Research Providers

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Researchers visiting London this month:

Off Wall Street - Mark Roberts, Founder, **11-13 Jan**

Hedgeye - Jordan Leisure, Lodging and Gaming Analyst, **16-18 Jan**

Hedgeye - Neil Howe, Demographics Analyst, **16-18 Jan**

Huber Research - Craig Huber, Founder, **18-24 Jan**

Boyar Research - Jon Boyar, MD, **23-26 Jan**

Macro Research

1. **AAS Economics** - Dr. Frank Shostak sees a reality check for Trump
2. **Andrew Hunt Economics** - Andrew Hunt offers his thoughts in a perfect world, where Trump could actually assist Chinese reform

3. **CrossBorder Capital** - What the real reasons are behind the bond market sell-off
4. **Forest For The Trees** - Luke Gromen asks why LIBOR hasn't stopped rising? (It was supposed to!)
5. **Hedgeye** - Enjoy the Chinese economic stabilisation because it will not last!
6. **MacroMavens** - Stephanie Pomboy turns her attention to the issue of US unfunded pension liabilities in 'Senior Stampede'
7. **Macro Intelligence 2 Partners** - Julian Brigden predicts a final explosive move for bonds
8. **Prattle** - Providing tradeable Sentiment Data from Global Central Bank communications
9. **Macro News Snippets - Asbury Research** - Bearish on copper; **Longview Economics** - European equities look cheap; and **Topdown Charts** - Philippine equities look good value

Company Research

1. **Boyar Research - BUY Anthem** (ANTM US) on very attractive risk/reward profile after share price sell-off following news of court battles
2. **Cha-Am Advisors** - David Scott believes that the recent **outperformance of banking stocks** will continue, **JP Morgan** (JPM US), **HSBC** (5 HK) and **BNP Paribas** (BNP FP) are highlighted
3. **Huber Research Partners** - remains **overweight**, but lowers EPS for **Moody's** (MCO US) and **S&P Global** (SPGI US), due to weak near term debt issuance trends
4. **Messels - RELX** (REL LN) is a **BUY** as it rallies from medium term price and relative uptrend support
5. **Off Wall Street - SELL Roper Technologies** (ROP US) on flawed strategy
6. **SmartInsider** - sees a 'Smart Buyer' director **purchase** as a positive at **Cone Midstream Partners** (CNNX US) while a **sale** at **Ingenico** (ING FR) is cause for concern
7. **Spin-Off Research - Upgrades Hilton Worldwide Holdings Inc.** (HLT US) to **BUY** based on the asset-light business model post the spin-off and expectations of margin improvement
8. **Summit Redstone Partners - Downgrades Diodes Inc.** (DIOD US) to **SELL** after multiple facilities fires!
9. **The Analyst - Strong BUY IG Group** (IGG LN) after FCA regulation change shock
10. **Company & Sector News Snippets - Belkin Report** - Go defensive!
Underweight Money Centre Banks such as **Bank of America** (BAC US) and **Overweight Utilities** such as **Iberdrola** (IBE SM); **Gimme Credit - Downgrades Hertz** (HTZ US) to Stable; and **Libra Investment Services - adds Genmab** (GEN DC) to their 'best ideas' list

Macro Research

1. AAS Economics - Dr. Frank Shostak sees a reality check for Trump

IRF Note - *Dr Frank Shostak, the founder of AASE, argues that Trump's loose fiscal policy relies on there still being something left in the kitty, if not his plan will have to be aborted. Some of the key points are outlined below:*

- Trump's entire focus is to generate an increase in employment regardless of whether this increase in employment is in response to genuine wealth generating activities or not. Trump's plan is a contradiction since it is not possible to effectively lower taxes without a corresponding reduction in government outlays.
- He suggests that it is quite possible that Trump's loose fiscal policy may lead to an increase in the pace of monetary pumping by lifting the government borrowings, which would ultimately be monetized by the US central bank.
- There is the risk that the pool of real wealth in the US may stagnate, having been damaged by decades of reckless monetary policies. Any additional burden (such as that proposed by Trump) could push wealth production into declining territory. Banks could then curtail lending, leading to an economic collapse, price deflation and liquidity issues. Private sector sale of Treasuries would likely force yields higher.
- If fiscal policy did work in the short term then Frank believes that there could be a short term, artificial boost in measured economic activity. Following this, however, as a result of the severe distortions that this and the ongoing monetary injections have caused, the bubble will burst and price deflation will ensue.

[Click here](#) for a short overview of this researcher

2. Andrew Hunt Economics - Andrew Hunt offers his thoughts in a perfect world, where Trump could actually assist Chinese reform

IRF Note - *Andrew Hunt, the founder of Andrew Hunt Economics (AHE), takes a philosophical look at what could be done to help China move to a more sustainable growth model based on profits and returns rather than credit. With China having manipulated its currency over the last couple of years he argues the currency would be 20-30% lower and if the world wants China, Korea and even Japan to reduce their trade surpluses, it must encourage these economies to begin closing their excess capacity. Some of the key points are outlined below:*

- China should devalue its currency significantly while at the same time not reducing its dollar denominated export prices therefore boosting Chinese corporate profitability while also at least moderating any "flation" worries around the world.
- This would allow the country to restructure and deregulate its economy towards a more efficient utilisation of resources which is in the global economy's best interests.
- Unfortunately Andrew believes a more likely outcome is that when the RMB falls (note 'when not 'if') China's companies will take the opportunity to reduce their dollar-

denominated selling prices (evidence is Japan), with deflationary consequences for the world.

- But notes there is an (outside) chance Trump brokers some deal with China that allowed for a weaker RMB while at the same time limiting the deflationary consequences of the depreciation by demanding that China maintained its level of export prices in USD terms.

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3. CrossBorder Capital - What the real reasons are behind the bond market sell-off

IRF Note - *CrossBorder Capital (CBC) are unconvinced that rising inflation expectations are to blame for the bond market rout seen so far. They argue Chinese reflation and reversing term premia look to be better answers, and these are more worrying since they suggest that government yields could jump by far more. Some of the key points are outlined below:*

- 10y UST's may be still at least 100bp too low.
- Bond real term premia, largely ignored by bond investors, are ultimately driven by liquidity and volatility factors, and the Chinese flight capital seen over the last 18 months may now be reversing. CBC believe that the re-starting of the World's Greatest Credit Boom by the PBoC monetary stimulus from early 2016 has major future implications for bond yields far more than any Trump effect.
- Although government bond yields stand roughly around their five-year averages, the real term premia that underlie these yields are around 100bp lower. So risk-adjusted 10y yields must have risen by the same amount. These term premia are already turning higher and are visibly pulling up yields.
- Inflation cannot be ignored either (despite an historically low correlation) since Chinese wholesale prices have just broken up higher and out of their 4 year deflationary phase. So the two features may be connected because they both reflect the renewed policy-easing mentioned above.

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4. Forest For The Trees (FFTT) - Luke Gromen asks why LIBOR hasn't stopped rising? (It was supposed to!)

IRF Note - *Luke Gromen, founder of FFTT, examines the rather worrying implications as to why LIBOR (which was supposed to stop rising after US Money Market Fund (MMF) reforms went live in Oct) has not actually done so. At the time, and in a previous article Luke had even questioned the motive of the reforms. Some of the key points are outlined below:*

- Luke says MMF Reforms driving LIBOR higher were more about forcing the MMF sector to fund now-structurally-widening US Federal deficits than "reforming the MMF sector" and since US Federal deficits have not stopped growing while US foreign creditors remain on a buyer's strike, US commercial banks and the global private

sector more broadly must fund US Federal deficits. This is the classic definition of “crowding out” of the private sector.

- He argues that rising LIBOR and UST yields are not signs of some “US growth/reflation trade,” they are a sign of an incipient and worsening US Balance-of-Payments (BoP) crisis.
- Explaining that as long as FX reserve balances are not rising (let alone falling at the pace they have been for the past 2 years), US funding stresses will continue to grow and LIBOR and 10y UST’s will continue to have upward pressure to them, as will the USD...until something breaks.
- Possible solutions include removing US commercial bank capital restrictions or even a return to QE! But perhaps more likely considering who Trump has been hiring, is to target a (massive) devaluing of the USD. Either way, Luke argues something must be done or 2017 may turn out to be extremely ugly!

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5. Hedgeye - Enjoy the Chinese economic stabilisation because it will not last!

IRF Note - *The team at Hedgeye, say recent data is consistent with Chinese economic growth peaking at the moment. Specifically, broad measures of Chinese demand (think retail sales/Industrial production) showed sequential strength and/or stabilization recently. But dig a little deeper and there are some troubling signs. They also offer reader's food for thought on how a trade war with China would likely cripple the US economy! Some of the key points are outlined below:*

- All is not well from a leading indicator perspective (highlighted in previous articles) and they believe the nascent trend of deceleration across key property market statistics brought on by recent monetary and macroprudential tightening is something that will spill over into the rest of China’s high-frequency growth data.
- Key measures of supply, demand, price and credit availability all slowed sequentially recently.
- Property developers have been shut out from issuing debt on the Shanghai Stock Exchange since curbs were implemented in Oct. which they argue is worrisome in the context of this market having hosted 40% of new issuance for the sector and that a record \$17.3bn of developer bonds come due next year.
- Last year China held a \$367bn surplus advantage and while Trump blames bad trade deals, Hedgeye don't! They say the US doesn't have a series of bilateral issues with key trading partners; in 2015 it ran trade deficits with 101 trading partners. It's more likely the result of a country that consistently runs a net national savings deficit – it either over-consumes, over-invests or both. So, applying duties or taxes will do little to correct these imbalances over the short-to-intermediate term and may in fact provoke a trade war!

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6. MacroMavens - Stephanie Pomboy turns her attention to the issue of US unfunded pension liabilities in 'Senior Stampede'

IRF Note - *Stephanie Pomboy, founder of MacroMavens, typically pulls no punches and in her own amiable style (think utter dismay mixed with sarcasm today!) once again draws our attention to the massive problem of unfunded pension liabilities which are soaring and when markets deflate (as they inevitably will) the carnage it will cause. Some of the key points are outlined below:*

- 45% of working age households had no retirement savings in 2013. At least they are aware of the problem. The rest are dwelling under the illusion of retirement security from employer sponsored pensions.
- Stephanie has highlighted this issue in previous articles pointing out that the corporate pension deficit is worse than at the depths of the crisis while the State and local funding deficit is an all-time record. These figures, she argues, would be even worse when using return assumptions that are 'rooted on planet earth'!!
- A pension crisis is a question of when not if.
- The ability to kick the can down the road is being compromised in cities like Dallas where, awareness by their Police force that the pension is in shortfall has seen a doubling in those wishing to retire and collect their 8% amid fear of a run on the money. How long before the coffers will be drained? Which city is next?!
- But fear not Policymakers can't/will not let it happen! Instead these obligations will get tacked onto the balance sheet and the Fed prints money to fund them – problem solved then!! (Note the sarcasm!)

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7. Macro Intelligence 2 Partners - Julian Brigden predicts a final explosive move for bonds

IRF Note - *Julian Brigden, founder of Mi2Partners, believes that having not seen any discernible bounce despite the massive relative move in fixed income and equities seen recently, there could be a final disorderly acceleration of the bond move. Some of the key points are outlined below:*

- Their fair value model for 10y UST yields is over 3%.
- Julian points to stronger data, especially PMI's which suggests growth, and most critically secondary inflation pressures continuing to build.
- He believes the real money has not yet adjusted its position meaningfully, drawing reader's attention to the fact that US mutual and ETF flows up to the end of November show that while bond flows have stalled there's been no major reduction.
- This suggests a final powerful move before risk-off fallout from other markets ends the trend.

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8. Prattle - Providing tradeable Sentiment Data from Global Central Bank communications

IRF Note – *With the investing community hanging on every word of central banks, Prattle provides unbiased, quantitative, and tradable evaluations of these communications through an interactive user portal, email alerts, and an API. Prattle’s data is built on the historical relationship between central bank language and market reaction. Using this foundation, Prattle evaluates new communications, scoring each communication relative to its expected market impact. The scores are normalized around zero and range between -2 and 2, negative numbers indicating dovishness and positive numbers indicating hawkishness. Based on this data, Prattle also provides policy forecasts in its weekly online publication, the Macrocast. Here are a couple of examples from their most recent Macrocast:*

- US Federal Reserve - Prattle says financial conditions have continued to improve since December’s FOMC statement - the second-most-hawkish in years - and they anticipate the minutes on January 4th will echo that tone.
- With Fed momentum¹ already at 0.21, Prattle believes the markets will likely not be surprised by a hawkish set of minutes. However, if the minutes are (slightly) more hawkish than the statement, it could, according to the SF Fed, cause a larger than usual boost in yields.
- Evans, Powell, and Lacker are all speaking this week, and Prattle expect them to strike a neutral tone.
- European Central Bank - While the ECB’s sentiment leveled off during December, the bank’s momentum is still slightly hawkish (0.15).
- The only scheduled speaker this week is Yves Mersch, who Prattle believe is likely to focus on technological innovation and strike a positive tone in line with his current momentum: 0.21.

¹ Residual scores represent the tone of a communication compared to the rolling, 12-month average for that individual communication type or speaker. Raw scores represent the tone of a communication compared to the average of all communications. Momentum is the average of the last ten residual scores.

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9. Macro News Snippets -

Asbury Research - turns bearish on copper with the copper futures daily chart showing a potential double top having failed to break 275 cents per pound. Smart money hedgers are betting on a price decline with their most aggressive short hedge since 2003! [Click here](#) for a short overview of this researcher

Longview Economics - Chris Watling, founder of Longview Economics, highlights how Europe has become considerably cheaper relative to the US market in recent months, although it is not yet at a -1 standard deviation level. He also says that Countries such as Germany, Japan and Turkey are the cheapest stock markets on a relative PER (relative to the US). [Click here](#) for a short overview of this researcher

Topdown Charts - Callum Thomas, founder of Topdown Charts, says despite Duterte deterrents, Philippine equities look good as valuation has improved (currently at bottom end

of range), economic fundamentals look sound, and investor sentiment looks washed out (investors have been dumping the US listed ETF). [Click here](#) for a short overview of this researcher

Company Research

1. Boyar Research - BUY Anthem (ANTM US) on very attractive risk/reward profile after share price sell off following news of court battles

IRF Note – Boyar believe the stock market is utterly brain-blocked by the uncertainty regarding ANTM's lawsuits against the DOJ (regarding the Cigna acquisition) and Express Scripts (ESRX - regarding its PBM contract). Boyar has provided extensive research on Anthem, the second largest managed care organisation in the US, actually covering six different scenarios in their thesis! They conclude that on a 2 year view, fair value is \$197, representing 59% upside. Boyar first initiated their BUY recommendation Sept 16 with the share price at \$124 (current price is \$144). Key points include:

- ANTM shares are trading at just 11.5x management's 2016 EPS guidance (at the low end of their historic trading range).
- Boyar argue that the DOJ antitrust argument is based on perception with 4 large cap health insurers consolidating into 2, but the reality is that almost 60% of the fully-insured market is held by smaller insurers and so there is no problem!
- With regards to ESRX, Boyar thinks there is a good chance the two companies will settle, with ANTM gaining the most as they are ESRX's largest customer (and will be even more important if the Cigna deal completes) and so ESRX will not want to lose such a key client.
- Boyar also highlight previous success with regards to the WellPoint acquisition in 2004, the shares sold off initially on news of the California DOI controversially blocking the deal, only for ANTM to win the case and the share price quickly rallied. Having understated the benefits the enlarged company performed ahead of expectations from the start.

[Click here](#) for a short review of this researcher

2. Cha-Am Advisors - David Scott believes that the recent **outperformance** of **banking stocks** will continue

IRF Note - In David Scott's Strategist's Diary, with banks performing strongly since Trump's victory and using **JP Morgan** (JPM US) as an example, where there has been a chart breakout, with the shares up 16% in the past month alone and on huge volume to

back it up, David firmly believes there is more to come. He is also bullish on other banks including **HSBC** (5 HK) and **BNP Paribas** (BNP FP). Key points include:

- David's bull arguments for banks in general include - the burden of compliance and regulation creates a huge "moat". Banks' cost bases represent an enormous field for on going cost-cutting. The threat from new technologies and new entrants is over-rated, he asks: are 60 year olds with a life-time of savings really going to bother with Bitcoin?!
- As interest rates rise banks will get paid more for taking on Duration Risk and people will rediscover just how powerful the operating leverage effects can be for them.
- Banks like HSBC look cheaper on a Market Cap to deposits basis than on a Market Cap to revenue basis. David thinks this is bullish as earnings have been suppressed by years of low interest rates. But argues that as we regress to the mean ie the ratio of revenues to deposits now rises, banks will be rerated on the Market Cap to deposit metric while the Market Cap to revenue metric remains constant. This situation is even more pronounced at BNP.
- While David is not a fan of all banks e.g. **DBS** in Singapore (DBS SP/Mcap 44.1bn SGD), he believes all financial shares will continue to rally.

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3. Huber Research Partners - remains **Overweight** but lowers EPS for **Moody's** (MCO US) and **S&P Global** (SPGI US) due to weak near term debt issuance trends

IRF Note - Craig Huber trims estimates due to weaker than expected debt issuance trends (tables provided for clients to examine) so far in 4Q16 as a result of concerns around the US elections and likelihood of higher interest rates from the Federal Reserve. But says the weakness is a buying opportunity and still sees c.25% return on both stocks over a twelve month period with targets for MCO of \$123 (this includes the recent DOJ investigation news) and SPGI of \$142. Key points include:

- US elections caused debt issuance trends in the week ending November 5th to decline 38.9% YoY and the week of the elections to drop 70.6%. Exclude them and 4Q-to-date is up 13.4% with the main strength being European high yield (up 56.1% in USD), European RMBS (up 59.2%) and US munis up 35.2%.
- Both companies remain among their top investment ideas out of the 23 media and financial information stocks that he covers.
- Craig argues they should be trading at a 40-50% PE premium to the S&P 500 for reasons such as each have: 40% global credit ratings market share, over 40% operating margins in Ratings businesses, high growth, pricing power, high barriers to entry and low credit spreads.
- US and European scheduled debt refinancing's in each of the next four years, are higher than the preceding year led by US high yield bonds and bank loans, which should significantly help Ratings revenues at both companies.

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4. Messels - **RELX** (REL LN) is a **BUY** as it rallies from medium term price and relative uptrend support..

IRF Note – Messels have recently added REL to their FTSE 100 momentum portfolio, which is a select list available to clients providing them with access to over 50 years' worth of industry knowledge. Investors can often become bogged down in technical analysis but Messels has proved that the key to success is in the analysts themselves, their ability to cut through the noise by interpreting the correct meaning of share price activity and not in complex indicators or fancy names of chart patterns! The evidence is in the fact that they have consistently generated alpha over the long term (UK Model Portfolio outperformance: 2010: +9.32%; 2011: +0.55%; 2012: +11.60%; 2013: +14.14%; 2014: +5.60%; 2015: +9.90%; 2016: +5.10%). The following chart provides a simple example of their work and was taken from the Messels Weekly FTSE 100 Stocks & Sectors Review. 3 other reviews are also available through each week (click on the link for more details).

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5. Off Wall Street (OWS) - **SELL Roper Technologies** (ROP US) on flawed strategy

IRF Note - OWS this week criticise the debt fuelled M&A strategy which now includes the very expensive acquisition of Deltek and have a price target of \$121 for ROP (current price \$183). Key points include:

- They do not think expectations of growth in the Medical & Scientific Imaging segment are likely to be met. The same applies to organic growth in the RF Technology segment.
- This low organic growth will now be exposed as additional acquisition's are put on hold so management can maintain their investment grade rating on debt.
- From speaking to industry sources they argue Deltek like ROP may already be underinvesting in R&D compared to peers who told them that Deltek have boosted margins by cutting expenses to the bone (like ROP have been doing) so savings maybe minimal and lower investment provides opportunities for competitors to take market share.

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6. SmartInsider - sees a 'Smart Buyer' director **purchase** as a positive at **CONE Midstream Partners** (CNNX US) while a **sale** at **Ingenico** (ING FR) is cause for concern

IRF Note - Here are two recent examples of the type of analysis SmartInsider offer their clients. Key points include:

- CNNX - Minas is a "Smart Buyer" for her past activity in DCP Midstream Partners, as well as OCI Resources.

- The first purchase in this stock is her only mistake when using a six month window as measure. It should be noted that she is also buying shares in Westlake Chemical Partners, LP (WLKP) where she is a new director.
- They conclude by assigning a +1 rank (positive insider pattern).
- ING - SmartInsider are concerned that this is Leger's most aggressive sale so far having made two prior modest sales in the past.
- This stock is trading close to its 52 week low after a big move down in September.
- So far, Leger is the only seller and there was buying in this stock in September and October, and this is a year end sale.
- They conclude by assigning a -N rank (negative side of neutral).

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7. Spin-Off Research - Upgrades Hilton Worldwide Holdings Inc. (HLT US) to **BUY** based on the asset-light business model post the spin-off and expectations of margin improvement

IRF Note - Joe Cornell, founder of Spin-Off Research and his team have raised their target price for HLT (consolidated) to \$30.25 per share (previously \$25.25), implying 15% upside over the next year; which is 9.6% higher than the consensus average of \$27.61. This was after its BOD approved both spin-offs (5/12/16 and to complete 3/1/17) of Park Hotels & Resorts (PK US) and Hilton Grand Vacations (HGV US), forming 3 separate publicly traded companies. Key points include:

- Ebitda rose 20% over the past year, compared with the 6.4% median increase for the group. Operating margin was 17% relative to the 13% median among its peers.
- Improving financial leverage with management expecting to lower debt to \$6.7bn (from ~\$10bn) subsequent to the spin-off.
- Spin-Off believes the move to separate HGV, the timeshare unit, is a key positive and could generate substantial shareholder value for HLT shareholders. They note that rival Marriott International did something similar which led to the spun-off timeshare unit's stock price nearly tripling.
- While they argue that the spin-off of the real estate business (PK) into a publicly traded REIT is a strategic move. As HLT seeks to benefit not just from the significantly lower corporate taxes applicable to REITs but also from the timing of the announcement which would dodge potential regulations to restrict such deals.
- To provide balance to their argument, Spin-Off do recognise the threat posed by sites such as Airbnb, by taking market share and negatively impacting the future revenue growth prospects of the industry in general.

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8. Summit Redstone Partners - Downgrades Diodes Inc. (DIOD US) to **SELL** after multiple facilities fires!

IRF Note - Summit Redstone, targets a return of over 30% as they set a 12 month price estimate of \$17 for DIOD, the American manufacturer and supplier of semiconductors. Key points include:

- Price target is equivalent to 18x their lowered EPS estimate for 2017 of \$0.96 (was \$1.37).
- The fire was due to aging equipment according to Summit's sources and caused all production to stop. Despite then repairing it, they failed to get approval from the City and Summit now believe they have 3 options, including purchasing new equipment or outsourcing, but whichever choice they make will take a significant amount of time for DIOD to deliver goods.
- DIOD notified their distributors that there would be a one month delay for deliveries but Summit believe this is unrealistic (due to the above) and will actually be longer. Their sources tell them that customers have started looking for alternatives.
- Apparently there was a fire at BCD Shanghai recently as well! But the damage is as yet unknown (at time of article).

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9. The Analyst - Strong BUY IG Group (IGG LN) after FCA regulation change shock.

IRF Note - The Analyst updates his previous bullish stance on IGG with a 2 year price target of £7.60 equating to a 55% return! (NB targets updated to include new German proposals). Key points include:

- c.30% fall in share price is overdone. Share currently rated on 9x FY19e PE, but they think a 15x multiple is more appropriate.
- Investors are pricing in loss of over half of UK profits (51% of the business), impact is likely to be less than this. European businesses should be shielded given ability to open separate subsidiaries in these countries.
- IGG is best placed among its peers due to factors such as size, reputation and the fact that their client's tend to be more experienced.
- New regulation may well encourage consolidation in the market which would be a net positive for them.
- They acknowledge that there are further risks with a domino effect in Europe (eg. Cyprus and more recently in Germany) but argue about consolidation occurring here as well.

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10. Company & Sector News Snippets -

Belkin Report - Michael Belkin, founder of the Belkin Report and owning an excellent track record with regards to sector rotation, sees his proprietary forecasting model turn defensive.

They have the exact 100% opposite S&P sector forecast of Goldman Sachs! As a result **Money Centre Banks** such as **Bank of America** (BAC US) have been added to Michael's 'Weaker US industry prospects list', whereas **Utilities** such as **Iberdrola** (IBE SM) are forecast to outperform the Eurostoxx 600 over the next several months. [Click here](#) for a short overview of this researcher

Gimme Credit - Downgrades Hertz (HTZ US) to Stable following on from their negative analysis of HTZ's Q3 performance when adjusted EBITDA fell woefully short of company guidance and consensus forecasts. The miss was mostly attributable to a significant adjustment to depreciation expense as the company misjudged the residual value of its fleet vehicles. This will be a problem in Q4 as well, with guidance for 2016 adjusted EBITDA lowered to \$575-625m (was \$850-950m). As a result they have changed HTZ's credit score to 0 from +1. [Click here](#) for a short overview of this researcher

Libra Investment Services - adds **Genmab** (GEN DC) to their 'best ideas list' and is screening as a 4-star green (this a good thing!). This is the 3rd time **GEN** has been '**Bought**' by Libra having been successful on the 2 previous occasions. The company has just raised guidance while the current discount to FV is 15% vs. a median discount of 1%. Alternatively if you are looking for a possible **Short, Nestle** (NESN VX) is screening as a 4 star red (a bad thing!). [Click here](#) for a short overview of this researcher

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