The Cut

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

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IRF works with 85 Research Providers covering all geographies, asset classes, industry sectors and methodologies

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or **Via Bloomberg IB**

Events associated with IRF

- **Sponsors of Global Independent Research Conference, 9 March, 1 Wimpole Street.** Complementary tickets available - please contact us if you are interested in attending - www.researchforinvestors.com
- **CAGE (Consumer Analysis Group Europe) Conference, 20-22 March, Hilton London Metropole** - www.cag.eu.com/cage-conference

Researchers visiting London in the coming month

- **Insight Investment Research** - Global Infrastructure, Robert Crimes, Founder & Senior Analyst, **20-21 February**
- **Hedgeye** - Defence Policy, Lt Gen USMC (Rey) Emo Gardner, Defence Analyst, **20-21 February**
- **Hedgeye** - Industrials, Jay Van Sciver, Sector Head, **22-24 February**
- **Summit Redstone Partners** - Semiconductors & Hardware, Srini Nandury & Jagadish Iyer, Senior Analysts, **23-24 February**

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Macro Research

1. AAS Economics - Is the coming Swiss contraction the biggest macro trade of 2017?

IRF Note *– AASE have just produced a brand new monthly report, 'The Macro Maverick', involving direct and highly specific market and portfolio positioning driven by their monetary and econometric modelling. Taken from their first edition, AASE believe Switzerland is now opportunity-central after the unprecedented collapse in Swiss money supply in 2015-16. Their models forecast real GDP growth to nosedive, deflation to intensify, bond yields to drop and the Swiss franc to strengthen. Some of the key points are outlined below (see attachment for charts):*

- Swiss AMS (Adjusted Money Supply, their unique money supply measure) has seen one of the sharpest policy-induced declines in AMS growth in any advanced country in recent history.
- As a result, AASE thinks there will be a sharp contraction in the Swiss economy. By the end of 2017 yearly growth in real GDP could fall to minus 2.1%; and it will not improve in 2018 either!
- Switzerland continues to experience deflation, and while AASE expect a slight short term pick-up, their monetary modelling is forecasting CPI deflation to intensify.
- Their Swiss bond models are reflecting these monetary trends. Their Long-only Swiss model shows a 2016 return of 5.24% with the Long/Short model 7.28% (vs benchmark 3.24%).
- AASE also highlight a situation of dramatically divergent money supply growth rates – sharp increases in the US (and Japan) versus a sharp contraction in Switzerland. This, they say, sets the stage for some significant currency movements, with the Swiss franc rallying 20% by year end!
- As the Swiss business cycle turns down during mid-2017 the equity market is also likely to feel the impact. Their Business Cycle Sector model shifts to non-cyclicals, utilities and healthcare.

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2. DeSaque Macro Research - Is Trump's trade policy going to have the desired effect?

IRF Note *– Said DeSaque, founder of DeSaque Macro Research, examines the implications from Trump's so-called border tax, which aims to boost import substitution by forcing US companies to embrace domestic supply chains. He says the same legislation also proposes exempting US exports from any corporate tax and that understandably, there has been a huge push back by Corporate America, which has spent billions of dollars building global* *supply chains. House Speaker Paul Ryan is sponsoring these border tax proposals and so they could be tough to derail. Some of the key points are outlined below:*

- Said thinks capacity utilisation rates in the US will be significantly affected, as a major shift towards domestically-sourced production, without a significant increase in capacity, could quickly result in bottlenecks.
- Therefore companies that benefit from import substitution will enjoy higher operating margins and will deserve a higher valuation.
- However, Said believes a significant rise in supply constraints would be both inflationary and bearish for corporate profits, as well as forcing the Fed to be much more hawkish in its policy conduct.
- As for productivity, Said highlights the fact that even when productivity growth was strong during the late-1990s, unit labour costs started rising once full employment was breached in 1997 and the ensuing result was a major compression in corporate profit margins, compounded by weak pricing power.
- Currently, labour productivity is nowhere as stellar and rising labour compensation pressures could have a similar impact on profit margins in the absence of higher selling prices.
- Globally, Said sees these proposals as a potential death knell for countries that have relied heavily on exports to the US as a source of economic growth.

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3. MacroMavens - The USD is the No.1 risk/opportunity of the year

IRF Note *– Stephanie Pomboy, founder of MacroMavens, questions in disbelief how investors continue to totally ignore Trump's call for a weaker USD. Instead speculators have increased their massive long USD exposure! In the appropriately named, 'This message specially recorded for the hearing impaired', some of the key points are outlined below:*

- USD bullishness rests on the case that the Fed would be forced to accelerate from its snail paced tightening, with confidence further boosted by Trump's pro-growth policies.
- But Stephanie argues many of the key economic variables are still weaker than they were when the Fed was using for QE2/3! The deceleration seen in employment growth has always led to cuts in the Fed Funds Rate previously.
- Stephanie recognises the expectation is that Trump's policies will see employment pick up, but highlights the fact that the corporate sector has shown no interest in expanding. CapEx growth has logged nine months of consecutive YoY declines, that's worse than the Great Recession!!
- Companies will only hire/expand if they expect an increase in demand. But Stephanie believes the US consumer is not strong at all, evidenced by weak discretionary spending, based on the one measure that is beyond repute, income tax receipts.
- Contrary to popular perception, Stephanie explains that companies still have a lot of destocking to do anyway! The current trend in inventories has historically being associated with cuts in the Fed Funds rate, not hikes.
- Stephanie has long rallied against the idea that the US economy can withstand higher rates. It needs more and more credit to generate each marginal dollar of growth ($4.80, in 2013 it was $2.00), so low interest rates are required not high.

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4. Mi2 Partners - Short French OAT's on surging growth and inflation

IRF Note *– Julian Brigden, founder of MI2, has been increasingly focusing on Europe, where he says that since Draghi's flailing appearance at the last ECB press conference it would appear that the blinkers have started to drop away from bond investor's eyes as they realise they and they alone face the risks of surging growth and inflation over the next couple of months. He thinks you should be shorting French OAT's (Gov. bonds). Some of the key points are outlined below:*

- Julian believes most pundits are watching Bunds or BTP's as a signal for a breakdown in the broad European bond complex. But he thinks French OAT's may hold the key.
- France has been a drag on European growth over the last four years, but thanks to surging confidence, that is set to change.
- This, Julian thinks, would be a significant challenge for Draghi, because while he can keep BUBA's Weidmann in check and tell the German's to "be patient", if Europe's second largest economy suddenly kicks in, it will materially change the whole European narrative.
- .87 to .92 was a huge level in French 10 year OAT's and MI2 suggested buying the break, and the market has accelerated away from those levels. If sustained, this break will target the 1.70 to 2.00 area in the coming months as the multi-year downtrend reverses (see attachment for chart).
- Julian says that may seem an overly aggressive call. But if inflation is returning to the levels of 2014 having simply completed a round trip, courtesy of oil, why shouldn't bond yields?

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5. Third Year - Potential downturn a major risk for China in 2017

IRF Note *– As part of Third Year's (TYG) global macro strategy, this article is taken from their 'China Strategy' thesis, where they examine how an increasing alignment of factors make a cyclical downturn or even a financial crisis in China more likely. Some of the key points are outlined below:*

- Following excessive growth, the PBOC imposed tighter rules on Wealth Management Products (WMP), which account for the shadow banking's biggest share. TYG believe this could actually provoke the financial turmoil it seeks to avoid. Bad performance of WMP's causes lower WMP sales, leading to increased sell-offs in bond markets.
- As far as house prices are concerned, after last year's excessive increases, TYG show growth rates appearing to roll over, similar to the period before the last downturn in growth (*see attachment for chart*).
- They highlight the fact that the pace of credit growth remains unsustainably high, resulting in a concerning credit/GDP ratio. This is becoming more expensive as

interest rates adjust upwards reacting to both temporarily stronger growth, inflation and the increasing pace of capital outflows.
- TYG think this increasing pace of capital outflows limits policy options. While other issues include China having a very large share of global exports and must expect policy pressure from the new administration in the US.
- So what are the investment implications? A downturn in China could cause major volatility, because the required repricing would be in the opposite direction of most of the 'Trump trades'. TYG advise not to invest in China, the currency is a short and to pursue for a more defensive global asset allocation.

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6. TrimTabs Investment Research - Global Equity Funds Draw Heavy Buying in January

IRF Note *– Extracts taken from their 'Weekly Liquidity Review', where TrimTabs examines demand, supply and macroeconomic trends. Some of the key points are outlined below:*

- TrimTabs research shows global equity funds are drawing heavy buying in January. Global equity MFs had their first monthly inflow in nearly a year, while global equity ETFs had their biggest inflow since May 2015 (*see attachment for charts*).
- Also traders are finally starting to notice big gains in precious metals. Precious metals commodities ETFs issued $550m in the past week.
- TrimTabs believes Corporate America seems less upbeat about the future than market participants. They highlighted that in the past four weeks, announced buybacks averaged just $1.8bn daily, well below the average of $3.2bn in the previous 12 earnings seasons. This earning's season's data continues what has been a two-year downward trend.
- Margin debt fails to confirm record highs on S&P 500. As margin debt has fallen, TrimTabs believes unwillingness from traders to borrow is a cautionary signal. Their research indicates that margin debt is an excellent intermediate-term leading indicator for the US stock market.
- However, according to the TrimTabs Macroeconomic Index, the outlook for the US economy has brightened. The index is a correlation-weighted composite index of leading macroeconomic variables, and it climbed 1.6% in the past eight weeks and sits just below a record high.
- Their intermediate-term demand indicators remain depressed. The TrimTabs Demand Index (TTDI), which uses regression analysis of fund flow and sentiment variables for market timing, stood at 25.5 on Feb 2, little changed from 25.8 recorded a week earlier. Since the TTDI is between 25 and 50, the TTDI Model Portfolio is 100% in cash.

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7. Macro Research Snippets:

Andrew Hunt Economics - Sees evidence big European banks have begun to reduce their net exposures to certain countries within the Euro Zone as we head towards key European elections. One of the examples provided, is over the last year German banks have reduced their level of claims on non-German but Euro Zone resident entities by around EUR70bn (~10% of the stock). It appears the European banking system is indeed showing signs of fragmenting once again. **Click here** for a short overview of this researcher

Asianomics - Singapore's Strait Times Index (STI) has broken out after forming a double bottom (2011-2016). Following this double bottom, a 9-month ascending triangle formed and has recently been completed, targeting 3,250+ (+8%), but the next significant chart resistance is higher at 3,400-3,550, suggesting greater gains are possible. A daily close below support at the Dec 16 low of 2,857, would negate the STI's breakout from the ascending triangle and can be used as a stop loss for index longs (*see attachment for chart. There is also a sample video from one of their recent 'Two-minute Chartists' webcasts*). **Click here** for a short overview of this researcher

Horizon Insights - The NDRC recently issued their latest Five-year Plan (2016-2020) on oil and natural gas development, which increases natural gas production growth from 7.2% to 8.9% and decreases oil production growth from 4.83% to 1.52%. This raises two key points. Natural gas and alternative energy can't meet the current energy demand. Successful reform will also be required in order to meet the high target on natural gas development, which Horizon Insights believe will require subsidies to attract investment given high project costs. Projects should also be open to private companies to ensure the most competitive cost structure. **Click here** for a short overview of this researcher

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Company Research

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1. Belkin Report - Sector rotation, top **long** is **precious metals**, you should also be **overweight defensives** and **short** all **financials** and **retailers**!

IRF Note *- Michael Belkin, founder of the Belkin Report, noted Trump recently taking credit for the Dow hitting 20,000, but says this is a bad move as people will only blame him when the inevitable market retracement occurs. Michael believes the US stock market is living in a fool's paradise, where robotic buying of financial and cyclical stocks on the premise of a Trump boom is about to run into the wall of a consumer-led slump. You have been warned! Some of his views on sector rotation are outlined below:*

- Michael says **Goldman**, **Morgan Stanley** and **JPMorgan** executives have sold $100m of personal stock since the election and all three stocks should be shorted, as well as all financials!
- Retailers also remain top sell and short recommendations, with the S&P500 multiline retail group underperforming the index by ~13% ytd. Michael highlights **Sears** (SHLD US) among others, down 26% ytd and says probably headed into bankruptcy!
- Credit card stocks are also seen as vastly over-inflated and vulnerable; citing the fact that Capital One recently announced its provision for credit losses surged 27% from a

year ago. Michael says this is a warning (along with retailers plunging) of a consumer downturn.
- So what should you do? Michael recommends being overweight defensives, **utilities**, **real estate** and **consumer staples**.
- But his top long remains precious metals mining stocks, where he thinks a secret bull market is occurring and most investors are missing it. The XAU gold share index is up 13%, but individual stocks on their buy list are up a great deal more, e.g. **Ivanhoe Mines** (IVN CN) up 64% and **Northern Dynasty Minerals** (NAK US) up 45%. Buy the pullbacks!

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2. Bios Research - Sees a unique pair-trade opportunity in the gene therapy space

IRF Note *– According to Bios, over the past 9 months the market has determined a winner in the gene therapy space for Hemophilia B while ignoring safety issues, market size, and economics of* ***Spark Therapeutics*** *(ONCE US) program. Simultaneously the market has seemingly declared Netherlands based* ***uniQure*** *(QURE US) the loser despite the same clinical outcomes of removal of costly recombinant FIX protein, better manufacturing, and further ahead in development. Bios notes this divergence has occurred due to Spark's focus on its molecular level FIX expression profile which is higher than uniQure's despite uniQure's clinical outcomes being the same. Some of the key points are outlined below:*

- uniQure is currently valued at ~$150M and has $150M in cash and enough cash for at least the next two years. uniQure also has a collaboration with Bristol-Myers with the first asset in development expected to begin clinical trials in 12 months and BMY is paying for R&D and ~$250M in milestones.
- Spark on the other hand is valued at ~$2bn with ~$325m in cash on hand.
- uniQure owns 100% of the US rights to its Hemophilia B program while Spark only gets 13% royalty rights from Pfizer. Additionally, Spark's program uses a vector that ~33% of the population has immunity against and therefore can't be used. In short uniQure has 100% economics to 1/3 of the multi-billion dollar Hemophilia B market while Spark has 13% economics to 2/3's of the market.
- Bios notes that Spark's therapy has had safety issues despite significant patient screening uniQure has not had screening failures and just received FDA Breakthrough Status for its Hemophilia B program. uniQure also has the strongest manufacturing program in gene therapy and a Huntington's program and large collaboration with Bristol-Myers.

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3. EquiVal Research - **BUY Fielmann** (FIE GY) on valuation grounds, a stable company with an impressive track record, to ride out any potential volatility in European markets

IRF Note *– Piers Nestler, founder of EquiVal Research, provides a valuation insight into*

Fielmann, the German retail optics company, which he says is set to continue its impressive track record. Given the overall stability and predictability of the business, Piers believes the prospects for earnings and ROC can be modelled on past performance. Some of the key points are outlined below:

- According to Piers, their success is based on price leadership which results from cost leadership through backward integration, cutting out the wholesaler.
- Another factor is high productivity. Fielmann stores sell on average 35 pairs of glasses a day, compared to less than 2 at a traditional optician while it outsells big optician chains by at least a factor of 2x!
- Piers highlights multifocal lenses as a key growth area (four times the price of single vision lenses). Contact lenses are also a potential source of growth given their low market penetration in Germany compared to other countries.
- Looking at valuation, Piers calculates the average return on net assets of ~17%. The capital structure is dominated by equity, accounting for more than 90% at market value.
- He says, given a 10-year bond yield of 0.3%, an equity risk premium of 4% and a beta factor of 1.4, this results in a cost of equity of just under 6% and a WACC of around 5.5%. Using this as the long-term cost of capital yields a fair value of EUR 70 per share.
- Therefore an implied equity return of about 6% might be seen as adequate compensation for the opportunity cost, but Piers makes it clear there is an interest rate risk to the valuation.

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4. Etalon Investment Research - **Bioverativ** (BIVV US), spin-off opportunity, over 100% upside!

IRF Note *– According to Alex Gavrish, founder of Etalon Investment Research, recent spin-off by Biogen of hemophilia and other rare blood disorders division has all the required characteristics of a successful spin-off. Weakness in pharma and biotech sectors after the Valeant scandal has put a lot of pressure on many stocks in the sector, some of it unwarranted. The new company, named Bioverativ, started regular trading on NASDAQ in February. Some of the key points are outlined below:*

- Co expects a growth rate of 18% in revenue during 2017.
- Currently valued at an EV/EBITDA multiple of x12.3 (FY 2016 based on annualized 9M 2016 results) and x10.4 (FY 2017 estimate assuming 18% growth rate in EBITDA).
- Currently has a FCF Yield of 5.6% (FY 2016 based on annualized 9M 2016 results) and 7% (FY 2017 estimate assuming 18% growth rate in FCF).
- Assuming growth rates for the next five years of 18%, 10%, 8%, 5% and 5% in FCF and EBITDA, and a EV/EBITDA multiple of x15 at the end of fifth year, Alex calculates that this provides a five-year target price of $98.5 per share or a 122% upside to the current share price.
- Assuming expansion of EV/EBITDA multiple to x15 and using estimated FY 2017 EBITDA and FCF, provides a one-year target price of $65.6 or a 48% upside to the current share price.

- Last year's acquisition of Baxalta (spin-off from Baxter) by Shire plc should improve perception by investors.

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5. Insight Investment Research - **Bullish** on **global infrastructure** as a whole, with their highest conviction stock idea being **OHL Mexico** (OHLMEX* MM), offering 86% upside!

IRF Note *– Robert Crimes, founder of Insight, believes the market is over discounting concerns related to OHL Mexico, a developer and operator of transportation infrastructure. These concerns relate to the parent company, OHL Spain, as well as management misconduct allegations, despite all regulatory investigations now concluded. Some of the key points are outlined below:*

- Quality underlying assets – Robert highlights the fact that OHL Mexico's concessions have been performing very well recently, with 9M traffic up 5% and group EBITDA +15.1%, Q3 was particularly strong +19.8%.
- Robert says that their concessions are long duration (average 29 years), and most are strategically located in Mexico City with good long term commuter focused traffic growth prospects. Insight's long term traffic growth of 2.8% equates to a conservative GDP multiplier of only 0.93x.
- According to Robert, the attractive IRR guarantees are unique in their universe as they apply to five of seven of the toll roads (93% of their SOTP) and he estimates an average guaranteed equity IRR of 13.2%, 200bps above their cost of equity.
- Recent monetisation at premium to share price – last year OHL Mexico sold a further 24.1% stake in OPI (Conmex Hold Co.) for MX$8.64bn. On this basis, Insight has calculated that the remaining stake is currently being valued at a 19% discount.
- Sale of OHL's stake increasingly likely – Robert sees the end result being a sale of OHL Mexico, by its parent company (they hold 56%),to repay its recourse net debt unless it significantly improves the FCF generation of its Engineering & Construction division.
- Insight's valuation SOTP-based TP MX$38 (86% upside vs consensus MX$28).

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6. Schulte-Research - **Bullish** on **Alibaba** (BABA US) as sentiment hits highest levels, driven by upcoming Ant IPO

IRF Note *– Schulte recently teamed up with Quid (a SF based start-up that uses big data to examine sentiment). They believe that the capacity to listen in on thousands of conversations at the same time means sentiment is as important as industry comparisons and valuation metrics when evaluating investment decisions. The positive sentiment highlighted, suggests the stock should rally from here. Some of the key points are outlined below:*

- The sentiment on the stock is at a record high with 57% of articles being positive. Schulte see the stock moving higher based on its relationship to these sentiment indicators in the past (*see attachment for chart*).
- Their analysis shows that innovation is at the core of interest while the counterfeit controversy and Trump are now dissipating concerns. A great deal of positive attention has been on the upcoming IPO of Ant, where 80% of the articles on the stock are either positive or neutral.
- Providing balance to their thesis, Schulte highlight a concentration on the Paytm acquisition in India that is currently seen as more of a negative than a positive. There is also some negativity on the Alibaba Pictures and whether the time and distraction in this part of the business is really worth it. Schulte think Alibaba definitely believes it is.
- Schulte were bullish on Alibaba before running this sentiment analysis as they see Alibaba as being one of the most innovative companies in the world yet it trades on highly attractive valuation comparisons against peers. The research has significantly strengthened their belief.

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7. Summit Redstone Partners - **Upgrades Micron** (MU US) to **BUY** from sell on improving fundamentals

IRF Note *– Summit's decision to reverse their view on Micron has proved a timely move so far. And following Q1 17 results recently, they have upgraded their price target by >20% to $32, offering >50% upside from current levels, based on 11x FY17 EPS of $2.93. Some of the key points are outlined below:*
EDIT - Just before publication they raised their PT again! Now $45!

- Summit think DRAM margins have now troughed. With bit growth >50% this year from 20nm ramp and cost reduction per bit of 20-25% still at the early stages, Summit estimate DRAM gross margins will climb to 40% by end of FY17 from 28% seen in Nov 16 qtr.
- Summit's recent industry checks also reveal that all the NAND makers have hiked prices 5-10% due to an ongoing supply shortage that is arising because of 2D to 3D NAND conversion. Their sources indicated that price increases may persist at least through H1 17.
- This will help NAND margins, which Summit say are poised to rise by 800bps this year with bit growth >60% in FY17, and cost reduction ~20% as Micron accelerates its second generation NAND (72 layer) ramp.
- According to Summit, overall gross margins for the entire company should improve by another 1000bps this year!
- With strong operating cash flow, Summit expects a gradual de-leveraging of debt this year. With $4bn in NOL's at its disposal, they also see Micron's earnings benefitting from lower taxes in this up-cycle.
- Acknowledging that there are some risks to their thesis, Summit recommend keeping an eye on signs of any double ordering, as this is always a risk with tight supply/demand and lean inventory in the channel.

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8. Company & Sector Research Snippets -

Hedgeye - **Hanesbrands Inc**. (HBI US) still a short from $19, as ultimate cashflow and EPS supports a single digit stock be year-end 2017. Says management credibility is blown, as apparently everything was fine three weeks before the quarter closed, and now the company puts up a 22% cash flow miss! They think Hanesbrands will be lucky to generate $400mm in CFFO this year (with a greater decline in FCF), so sell with target $5! **Click here** for a short overview of this researcher

Off Wall Street Consulting - Their short thesis appears to be playing out on **Snap-on Inc**. (SNA US). Contrary to what management claims, Off Wall Street says that the independent repair business is in long term decline, and management appear to be extracting revenue from this shrinking customer base through the increasingly aggressive use of credit, which is likely unsustainable. With underlying Tools demand slowing, the auto cycle having peaked and rising delinquencies, Off Wall Street have a price target for the stock of $100 (potential gains ~60%). **Click here** for a short overview of this researcher

The Analyst - **BUY OCI N.V.** (OCI NA) for a forecast return of ~100%. It is trading at a big discount to replacement cost and has an interesting collection of good/new assets in fertiliser and methanol industries. OCI's markets are into a cyclical upswing in pricing and they will ramp-up production and benefit from improved utilisation. EBITDA can double this year and they see $600-900m free cash flow. Other key points include, OCI being owned by the founding family and the Bill Gates Foundation, while it is also poorly covered with only a few local Middle Eastern brokers. **Click here** for a short overview of this researcher

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