The Cut - Edition 86

Introducing the very best of Independent Research from the IRF Providers

Edward Blad - Founder & CEO of IRF, was recently interviewed by The European Association of Independent Research Providers (EURO IRP) - He has provided his thoughts on the current dynamics of the Independent Research marketplace - Transcript

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Please find below summaries of recent calls:

Simon White - Variant Perception - Macroeconomics, strategy and thematics - specialising in leading indicator forecasts across countries and sectors
A dance with a depression - Transcript - Audio - Slides

Simon believes that the BoE suggesting a 14% decline in growth is on the optimistic side. For comparison, the Atlanta Fed's GDPNow Tracker is looking at a 35% decline for Q2 in the US. Variant's leading indicators are beginning to register the shock - their 6 month indicator in the US has turned down sharply with no sign of an upturn. Feels like markets have priced everything in. Base case for companies is different - some will experience an L shape trajectory towards bankruptcy, U for those that will trickle back to profitability and V for those that can soak up the Fed stimulus and recover quickly. If we see a protracted embrace of social distancing measures, then there is a decent chance we could see depression-like conditions in the US and other countries. Simon discussed how vaccines are extremely difficult to produce. There have only been 17 successful vaccines in history. Rotavirus was identified in 1971 and there was no vaccine until 1993; HIV discovered in 1983 and there is still has no vaccine. Therefore 12 to 18 months to produce a vaccine is far too optimistic. Vaccines are not a high probability event and policymakers are giving a false sense of security and keeping social distancing measures in place. Whilst in the US you can see lockdowns easing and rate of infections falling, this is not the case in Emerging Markets which are easing lockdowns, but are seeing new cases rising.
The over 55's in the US, which equates to around 40% of spending, are severely reducing their expenditure. Meanwhile, for the younger generation, protracted use of social distancing limits their ability to spend. As a result, this is going to be detrimental for smaller businesses. Companies earning less than $20m

annually, can survive with 'no income' days for only 27 days on average - 16 days for restaurants. Variant surveys show that up to 50% of companies in the Russell 2000 could go bust; unemployment would reach depression levels (over 25%). Meanwhile, the large investment grade companies are on the receiving end of the fiscal stimulus. This increase in IG and even HY debt could be a tailwind for equities as they will suddenly become under owned. So, you could have this extraordinary situation when there are all these bankruptcies, yet the S&P is at all-time highs. This is not Variant's base case, but if social distancing measures are not lifted in a timely and orderly way, it could become very real. Lockdowns are very easy to get into, but very difficult to come out of. Investors should therefore have tail hedges in their portfolio such as buying put options in iShares Russell 2000 and selling calls or call spreads in S&P 500. Also, shorting US smaller banks exposed to smaller businesses and commercial real estate. If we look at Europe, Italy's debt to GDP level is going to get considerably worse; a major strain on the Euro. A cheap way of playing this with positive convexity and limited downside is the Euro Danish peg. The Danish krone has been pegged tightly to the Euro since the seventies, interest rates are very similar, so you can put on forwards for a portfolio tail hedge. Protect from inflation risks by investing in deep, out of the money call options, in gold, gold miners and silver. Libor curve should steepen so put on Euro-Dollar trades. Finally, Simon touched on China and believes there is a massive fiscal package coming, which is likely to be misallocated in infrastructure projects, but will boost commodities.

Charles Su - Horizon Insights - China macro and micro research, based in Shanghai, with emphasis on China primary data collection
China's growth in the post-pandemic world - Transcript - Audio - Slides

Charles was already expecting that there would be no explicit GDP growth target at the NPC meeting and this was what played out. The soft target is now to maintain normal functioning of society given the huge hit to the economy. Leadership is cautious about stimulus that encourages a rise in macro leverage levels such as the one back in 2008/9 and is also recognising the drop in China's trendline growth rate and is therefore less focused on keeping growth unrealistically high. Charles would not be surprised to see China drop away from giving GDP targets permanently going forward. The headline GDP measure does not capture the quality of the growth, which is the focus from now on. The PBOC did not lower the LPR rate or repo rate this month, as the economy is rebounding from the low and the rebound is quite solid. The high frequency data such as power output YoY is close to 5% in the first 3 weeks of May. Charles would expect to see 6-8tn yuan (after leverage applied to the official stimulus number) of extra spend on regional infrastructure. So far, the loosening of credit has been concentrated mostly in infrastructure sectors and now we are seeing infrastructure growth this year will be up 1-2% thanks to stimulus. But the infrastructure multiplier effect has usually been lower than in the property sector. When people buy homes, they often buy home appliances and autos. Without stimulating property, the multiplier effect is going to be smaller. There is a chance that at some point the govt will decide to ease via the property sector, but it does not seem that they are feeling compelled to do this right now. Given several trillion yuan of extra loan issuance this year, it implies that the major banks may have to raise around 1.5tn yuan in capital this year or next. In the absence of further escalation of US/China tensions, you may have expected to see RMB appreciate against USD, but it now seems wise for the next 6 months to expect the Trump campaign to keep up anti-China pressure, which may lead to a weaker RMB. The RMB has depreciated by more than 1% in the last few weeks and in light of the HK situation, it seems possible to see RMB drop to 7.3 to 7.5 range if the US follows through with countermeasures following the passing of the new HK security law. Charles views the FX depreciation as an orderly process that China has allowed to occur in order to offset some of the tariff impact and something that would probably only accelerate further as a deliberate countermeasure if the US brought much more punitive tariffs. In the medium/longer term, despite high debt to GDP at over 300%, the GDP growth rates can likely remain around the 4-5% level thanks to some large regional transformation programmes, as well as the investment in domestic technology supply chain self-sufficiency.

Manoj Pradhan - Talking Heads Macro - Global macro
EM: What will it take to get to 'whatever it takes' - Transcript - Audio - Slides

Manoj described how the dollar turns from a global automatic stabiliser in times of stress into a global accelerator when the crisis is past. He reiterated his long-standing view of China - short the consumer and long manufacturing. Cyclically, the only thing that matters is the social compact and so far we have seen only 50% of the stimulus. Expectations for growth are 8%+ in a quarter or two. Manoj has been long China equities since mid-March (as well as Korean equities and FX). Generally, he is bullish the triple unwind framework seen in EM: US rates/FX diverge (both rise only in a tantrum), China growing/easing and EM excesses are minimal. He advocated an EM barbell strategy - strongest and weakest economies in WIT club, a cross-asset barbell - WIT vs laggards and sustainable FX for WIT - high-beta laggards. Manoj predicted rate cuts will lead to stronger FX according to their (g-r) framework. Top trades highlighted included long Mexican rates (Banxico to cut 250 more this year), long RUBTHB (oil collapse priced in, fiscal space to be used for referendum, cuts will help), Indian and Polish equities. ZAR and BRL to be the new 'escape valves' after a high-beta bounce.

Please find details below of upcoming calls:

Francesco Galietti - Policy Sonar - Political risk consultancy focused on Italy
Hassan Ahmed & Pete Skibitski - Alembic Global Advisors - Chemicals, Aerospace & Defence sector & company analysis
Martin Murenbeeld - Murenbeeld & Co. - Gold price analysis & forecasts
David Ranson - HCWE & Co. - Macro & market forecasts using leading indicator methodologies
Philip Rush - Heteronomics - UK macro
Manu Bhaskaran - Centennial Asia Advisors - Asia macro, political risk analysis & behavioural strategy
Capital Alpha Partners - **US Policy Experts** - Macro, Health, Financials, TMT, Defence, Energy

For further details on these calls please see our Events page

Macro Research

Can QE be 'infinite'?

Have we reached the limits of QE? Can the Fed really ride to the rescue again if markets correct? It appears that we are now at a crucial point in global monetary history. Policymakers must soon choose between trusting and allowing the markets to work, or socialising the system.

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Andrew Hunt Economics

Europe steps into the Rubicon

The Covid-19 crisis, like the GFC, has highlighted the structural fragility of the Eurozone. It is fragile because it is a currency union without a fiscal union. The EC's proposed recovery fund is potentially the first step towards fiscal union. If Europe crosses that Rubicon it could lead to more aggressive fiscal policy - as Gerard expects elsewhere - which would transform the medium-term outlook.

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Minack Advisors

The coming attack on bonds

Remains negative re. government bond markets. Aside from potential future inflation risks from excessive monetary growth, CBC's concern centres on the changing supply/demand imbalance in the bond markets and on the coming surge in the effective supply of 'safe' assets. This is what drives term premia - the scale of the policy impulse could easily add 150bps to long-dated US yields. This warns that the 10-year US Treasury note could test 2% over the next 12 months.

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CrossBorder Capital

The China-US cold war is upon us

It is unfolding as expected, but the pace is now accelerating. It means 'containing' rather than 'accommodating' China is now the new normal. Investment implications: Reduce equity exposure globally, particularly in tech manufacturing. Remain short EM assets and currencies, including across the Asia region. Add the Chinese yuan to EM currency shorts. Increase physical gold to 10% of portfolios. Remain short HK equities.

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Independent Strategy

Introducing the CEIC Leading Indicator (CLI): An early warning system for key economies

This is a recently launched proprietary dataset designed by CEIC Insights to precede the development of major macroeconomic indicators and predict the turning points of the economic cycle for key markets. Sign up for free access to monitor indicators and view economic reports here.

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CEIC

Company & Sector Research

Accelerating manufacturing diversification away from China comes with its own set of challenges

Prior to the US-China trade war, multi-nationals had been shifting manufacturing out of China to countries in Southeast Asia - COVID-19 will accelerate this trend. However, many companies will still need to remain reliant upon China for raw materials and certain parts needed for final assembly. Coupled with a less efficient workforce, weaker infrastructure and development challenges, investors and corporations must ensure that they fully assess the cost benefits of relocating.

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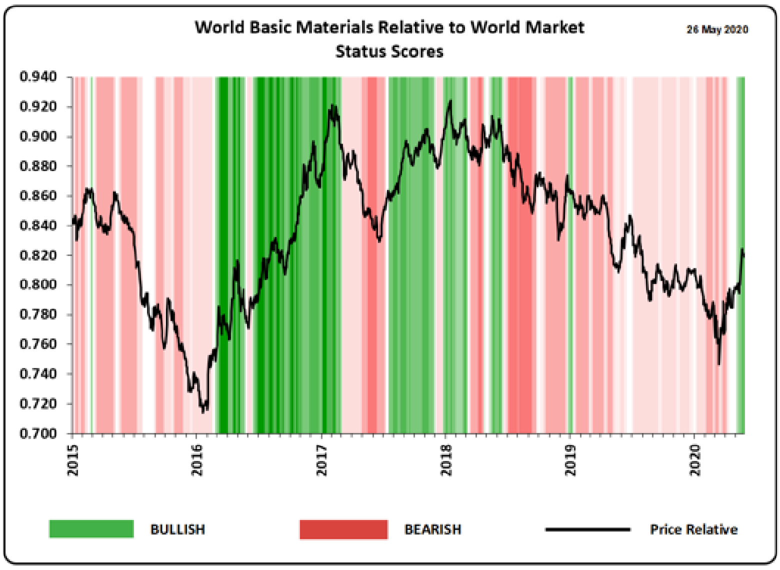
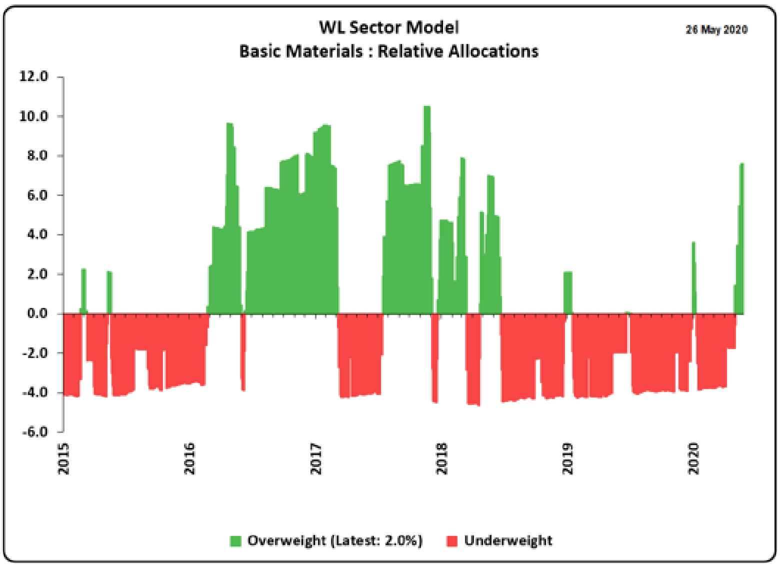
Gryphon

Basic Materials: Time to be bullish

At the start of May, the Ekins Guinness Global Sector Model moved overweight (green shading) in basic materials. After 2 years of underperformance and being relatively oversold in mid-March, sentiment has turned up (rising relative moving averages) and Relative Value Yield is now at the highest (i.e. most attractive) level for 15 years.





The Ekins Guinness approach is based on Value and Trends/Momentum in an objective rules-based approach that is independent of opinion, emotion and forecasts. It identifies valuation extremes and potential turning points in asset allocation, global sector and regional equity rotation, currencies and commodities.

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Ekins Guinness

— Europe

Beverage stocks: More like consumer cyclicals than consumer staples

COVID restrictions have hit the sector hard and despite seeing lots of downgrades and weak share prices, margins for error remain uncompelling. The pace at which volumes will return is uncertain. Faces both supply and demand issues. This report focuses on three names - all would require significantly lower share prices before warranting a buy rating: **Diageo** (current price £29.54) - only considered a buy at £22.00. **Heineken** (€84.00) at €65.00 and **Pernod** (€143) at €125.

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Willis Welby

BHP Group (BHP LN) vs Rio Tinto (RIO LN)

Materials

Other than gold stocks, both companies have performed well YTD relative to the broader mining sector and are outperforming many non-mining stocks. Examines commodity exposure, earnings momentum/sensitivity and production growth. Near-term GMR prefers RIO (iron ore price tightness re. China), but 6-9 months out BHP will take the lead on an anticipated recovery in other commodities.

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Global Mining Research

Deutsche Telekom (DTE GR)

Communications

Increases TP to €19.5 - the highest on the Street. **T-Mobile** still looks extremely cheap (believes DT should increase their stake through the partial purchase of

SoftBank's shares) and rump DT now offers an implied 18% EFCF yield. This yield does not make sense given the fact that the German telecoms market has been more robust than the rest of Europe.

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New Street Research

Electrolux Professional (EPROB SS)

Industrials

Commercial food service and laundry business spun off from **Electrolux** in March. Reported negative organic growth in 4Q19, and -14% in 1Q20 while inventory rose 6%. Trajectory unlikely to improve anytime soon as customers include hotels, restaurants, etc. EBIT margins under long-term pressure, yet the stock trades at 17.4x 2021 earnings.

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Vision Research

SIG Combibloc (SIGN SW)

Industrials

Recently IPOd from private equity and benefitting from misperceptions of its quality and safety with lots of flattering adjustments to earnings. True capex is actually much higher than presented with capital intensity rising. There is evidence of front loading sales to more risky customers which calls into question the sustainability of current growth rates.

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StockViews

— North America

The network connection

Adnaan runs the rule over the investment cases for the networking vertical given their recent under-performance as well as the US Administration's latest move to block key technology to **Huawei**'s Hi-Silicon subsidiary. He highlights **Cisco** due to under-ownership, valuation, order decline stabilisation, strong product cycle and increased traction with Hyperscale players. Turns bearish **Arista** once again; continues to short **Juniper** and prefers **Nokia** over **Ericsson**.

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Adnaan Ahmad Research

Hertz (HTZ): Bankruptcy implications

Consumer Discretionary

The company's Chapter 11 US filing adds further downside for automakers, as the rental sector buys 20% of US output. This volume has already disappeared and now most of HTZ's 700k fleet will likely go on fire sale - hammering new/used car prices.

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The pH Report

Shopify (SHOP): Facebook Shops - Opportunity or threat?

Communications

In the future, the bulk of e-commerce may well take place within the walled gardens of **Amazon**, FB, **Pinterest**, etc. threatening SHOP's Merchant Solutions revenue stream and potentially consigning them to a diminished role within the e-commerce ecosystem. This is a key threat that Veritas discussed in their initiation report 'Taming Expectations'.

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Veritas Investment Research

Apple (AAPL)

Technology

Analysis of Apple's Glass project, which is all about cementing the company's already enormous lead in augmented reality. Also believes health will be a huge focus - Blood pressure/heart rate from retina measurements, vision/concussion readings, brain/neurological performance from eye patterns, alcohol/drug usage and much more. FDA approval would drive a significant increase in sales.

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Cascend Securities

GSX Techedu (GSX)

Technology

Chinese education-tech firm listed on NYSE. JL Warren explain why they believe GSX only has minimal market share; ~90% fake enrolment and unlawful operations. Has previously highlighted to clients how 'Brushers' are hired by GSX management to inflate class enrolments and publish glowing reviews for the teachers. Considers the company to be another **Luckin Coffee** (96% downside).

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JL Warren Capital

International Flavors & Fragrances (IFF)

Materials

IFF may look defensive, but it isn't. Mature, 'seasoned' business lines have trended flat to down, while poor capital allocation aimed at offsetting core trends have likely destroyed billions in shareholder value. Hedgeye offers their take on the **DuPont** N&B transaction/prospects; provides an update re. severe end-market declines and addresses some of the increasingly obvious disclosure issues (40% downside).

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Hedgeye

Moody's Corp (MCO)

Technology

Craig Huber raises his Street-high 2Q20 EPS estimates even further on the back of stronger than expected US and Europe investment grade debt issuance which is up 128% YoY QTD. New 2Q adjusted EPS (excluding amortisation) is $2.29. The company's 2020 EPS guidance of $7.80 to $8.40 is overly conservative - expects $9.03.

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Huber Research Partners

Service Corp International (SCI)

Consumer Discretionary

By far the largest provider of funeral-related products and services In North America. Highly fragmented market - SCI to be an industry consolidator as well as a beneficiary of an aging population. Estimates sales growth of 4.9% p.a.

(2020-25), operating profit +7.9% p.a. and EPS +12.3% p.a. 2Xideas initiation report provides detailed analysis of how and why they expect the share price to double.

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2Xideas

TJX Companies (TJX)

Consumer Discretionary

Q1 results supports Nothcoast's latest channel check work. The current environment provides a great opportunity for the TJX banners to further accelerate top-line growth in their respective markets while incrementally growing margins as they access more great deals on higher price point merchandise and draw in more moderate/high price point consumers.

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Northcoast Research

— Japan

Nintendo (7974 JP)

Technology

Where are we in the Switch business cycle? How to view Nintendo's prospects is a red-hot topic in these lockdown days. Is it a cyclical play about to hit the 'Peak Switch' buffers? Or will its opportunities in terms of formats and geographies propel it further? Pelham Smithers explains, analyses and concludes.

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Pelham Smithers Associates

— Emerging & Frontier Markets

Where's the meat among protein bonds?

Given Lucror's updated 2020 projections for the protein sector, which is one of the few LatAm industries where they still have a positive outlook this year and next, they have conducted a relative value exercise and highlight the most attractive bonds. Their 'meatiest' bonds include: **JBS** (JBSSBZ '26s), **Minerva** (BEEFBZ '26s), **Marfrig** (MRFGBZ '24s) and **BRF** (BRFSBZ '26s).

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Lucror Analytics

Indonesia: Surge in restructured loans

We all know that Q1 hardly contains any of the shutdown impact (bar China). We also know how credit costs are soaring for banks globally, even ahead of real NPL formation. However, what is unclear is how high-margin lenders in Asia will fare (subprime lenders/microfinance banks etc). This report includes analysis of **Bank Rakyat** (BBRI) - it offers intense, disturbing insights of what to expect.

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Tabbush Report

Asia ex-Japan: Active equity fund positioning analysis

Allocations in IT stocks hit another all-time high (avg. fund weight 21%; +4% in 12 months). This report details the countries, stocks and fund managers behind the move. Taiwan and South Korea dominate. Ownership has surged in **Largan Precision** and **Hon Hai Precision**, with 8.1% and 7.1% of funds opening new positions respectively. Ownership levels have fallen in **Sunny Optical Technology**, **Infosys** and **Catcher Technology**.

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Copley Fund Research

Commodities

Oil: Underestimating demand

Although oil prices may have moved ahead of fundamentals in the short-term, the decline in global oil demand is not as large as markets are expecting. Q1 demand down just 2-3% YoY, while Q2 may only have fallen 10%. The substitution away from mass transportation and flying towards driving is likely to result in a return to positive YoY oil demand growth sooner than expected, leading to much higher prices.

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Queen Anne's Gate Capital

Platinum & Palladium forecasts

Metals Focus release their flagship annual report on the PGMs market. Platinum expected to see another surplus - 247koz (7.7t); supply losses of 13% and demand 'only' down 7%; average price for 2020 to be $765, down 11% YoY. Palladium will remain in a deficit - 124koz (3.9t); this is a fraction of the shortages seen in recent years. Forecasts a 2020 average of $2,275, up 48%.

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Metals Focus

IRF works with 230 Independent Research Providers and Specialist Data Providers, which cover all the major Asset Classes, Sectors and Regions utilising a variety of methodologies.

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