The Cut - Edition 98

Introducing the very best of Independent Research from the IRF Providers

Dear <<First Name>>,

IRF Podcast

IRF are pleased to announce that their podcasts are now available on Apple Podcasts and Google Podcasts by clicking on the links or searching for ‘The IRF Podcast’. Our latest podcast with François Boutin-Dufresne of Sustainable Market Strategies is now available, please click below to listen.

Podcast 9
“How ESG Investing Can Consistently Generate Alpha”
François Boutin-Dufresne, Sustainable Market Strategies

Company & Sector Research

Sector Rotation & Technical Analysis

The Belkin Report - **Rotation Inflection Point** - An economic recovery is underway setting up for a sustained migration out of virus haven stocks. Upgrades the US energy sector (XLE) to 'outperform' (from underperform - achieved 19% alpha since early Sept initiation) as well as EURO STOXX banks (including **Santander**, **Standard Chartered**, **Barclays**) and oil & gas (**Repsol**, **Tullow**, **Saipem**) which offer great opportunities to gain significant alpha. EMs are also favoured; Mexico, Brazil, Chile and Argentina to see major bounces.

RenMac - **US Industrials Deepdive: Airlines surge, now what?** - Airlines reached their first overbought condition since June. It is a positive development, but not one that forces RenMac to add exposure at current levels. The group looks to be bottoming, but this will require more time for confirmation. For Industrials broadly, their optimism remains. Relative performance is firm, internal metrics are improving and credit spreads have provided bullish signals. Economic data, including RenMac's Market Cycle Clock and the collapse in capacity utilisation, support further outperformance. Capital Goods, excluding A&D, remain an overweight; highlights **Terex**, **Timken** and **Parker-Hannifin**.

Messels - **FTSE 100 Technical Review: Breakout!** - The additional positive momentum in heavyweight stocks required for the index to break above its 5-month downtrend has now occurred. New buys include **Shell** and **HSBC**, both of which develop 2-month price and relative bases at long term support. **Barratt Developments**, **L&G** and **Hargreaves Lansdown** are also upgraded. A rotation away from momentum names is occurring (many of which find resistance at prior highs). Close longs in **Polymetal**, **Smurfit Kappa**, **Bunzl**, **Reckitt Benckiser**, **Just Eat** and **Autotrader**.

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— Europe

Hiscox (HSX LN)

Financials

A mispriced franchise business in an industry ripe for disruption. Boasts an impressive track record of prudence and innovation. Management have deftly allocated excess capital into new market developments - strong analogies with D2C pivots that Holland Advisors have studied in other industries - HSX to become the Geico of small commercial insurance? Recent fears over business interruption claims and an FCA court case provide investors with a fantastic opportunity to invest in a business that has achieved +15% median ROE since 2002. TP £16.00 (+50% upside).

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Holland Advisors

Lifco (LIFCO SS)

Healthcare / Industrials

The CEO's latest share purchase bodes well for investors - Per Waldemarson recently acquired €300k worth of stock at SEK 620. This is his fifth purchase and his prior 4 boast an extremely impressive average six-month return of +32%. Not only is this a large purchase for Waldemarson, but it is the highest price he has paid for the shares. Stock rank +1 (highest rating).

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Smart Insider

Heijmans (HEIJM NA)

Industrials

This E&C company has become the largest position in Mike Churchill's highly successful Classical Insights portfolio. His bullish view is based chiefly on strength in the Dutch housing market as well as increasing confidence in management who have done an impressive job turning the company around over the last few years. Despite meaningfully increasing his earnings forecasts for the next three years, they remain conservative as Mike sees further upside potential especially re. operating margins. TP €13.8 (67% upside).

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Churchill Research

— North America

Tech & Politics

Technology

Another interesting piece from Adnaan as he discusses the impact of politics on tech stocks, including how the recent House Panel report puts ~33% of **Apple**'s operating profit under scrutiny. The recent **Ant Group** fiasco demonstrates that China Inc. wields the power and puts ~50% discount on Ant's pre-IPO valuation. The US-China tech cold war will continue under Biden, however the approach taken will be far more pragmatic - hardware and semiconductor groups to benefit the most as well as Chinese listed Internet stocks.

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Adnaan Ahmad Research

Oil & Gas: A new era for E&P's

Energy

The COVID pandemic is the final nail in the coffin for North American E&P's quest for growth. With few opportunities to profitably drill, and balance sheets in desperate need of repair, firms must adapt to a new era that promotes FCF. Sell ratings remain on **Crescent Point**, **Ovintiv**, **Vermilion** and **Enerplus** (only one whose leverage looks sustainable). Veritas see better risk-adjusted returns from best-in-class oil sands producer, **Canadian Natural Resources**, and gas-weighted E&P, **ARC Resources**.

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Veritas Investment Research Corp.

Retail Tracker Holiday 2020: Celebrating, Carefully

Consumer Discretionary

People are tired of COVID and while they are not out partying, they are going to find ways to make the holidays feel normal. This is seen in retail as holiday like fashion items are selling quickly. Retailers that offer clear focused assortments with clear gifting are going to win. Cosy, comfy, home, fitness and anything for socialising outside remain top sellers. Store inventory levels are very lean in preparation for a historical shift online. Favourite holiday stocks: **L Brands**, **Dick's Sporting Goods** and **Steve Madden**.

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The Retail Tracker

A.O. Smith (AOS)

Industrials

Construction markets, which drive incremental water heater/boiler demand, have peaked for this cycle. AOS suffers from an unfavourably shifting product mix and a slowing of product replacement cycles; margins to come under increasing pressure. The firm also has a worrying ongoing demand problem in China (27% of revenues) where management's excuses for poor performance lack credibility. The company's valuation is detached from reality.

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Two Rivers Analytics

Capri Holdings (CPRI)

Consumer Discretionary

CPRI moves to the top of the Hedgeye Retail team's best ideas list. A 3-bagger in 3 years. Stellar results recently, yet people are still grossly underestimating the growth and underlying margin trajectory of the portfolio and ultimately CPRI's earnings power. Consensus has the company earning $1.25 for the balance of the year - it'll do that in 3Q alone - with another $0.70 in 4Q. For next year, Hedgeye has increased their Street-high estimate by $0.50 to $3.66.

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Hedgeye

Genworth Financial (GNW)

Financials

A significant mis-pricing of the stock offers investors a great opportunity with the transaction risk relating to GNW's acquisition by **Oceanwide** remaining hugely overpriced. AlphaSituations see a 90% probability of the deal closing (end of this month or shortly after). The c.30% merger spread offers tasty triple-digit IRRs. At the same time, their conservative value SOTP assessment of GNW as a standalone company indicates that the firm is worth more than it is currently being valued by the market.

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AlphaSituations

JFrog (FROG)

Technology

Growth will slow much faster than investors currently expect. Acquiring new customers will be very difficult; faces intense competition and limited differentiation with other products in the market. With digital transformation underway many enterprises will move to cloud DevOps, where solutions such as AWS, GitHub and GCP will have an advantage. No clear growth strategy and an incredibly expensive valuation (48.5x EV/NTM sales) means there is only one way for the stock to move - down.

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Summit Insights Group

Tapestry (TPR)

Consumer Discretionary

Yet another successful call from Retail sector specialists, JJK Research, whose bull thesis that Coach’s innovative assortments, promotional pull-back, and -$300m in expense reduction played out as TPR impressively beat 1Q consensus forecasts. Management’s -LDD 2Q revenue guidance appears very conservative leading JJK to raise their F21 EPS forecast to $2.40 (from $1.95) and set F22 at $2.75. Other recent successful calls have included **Gap**, **L Brands** and **Ulta**.

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JJK Research

Zscaler (ZS)

Technology

According to Sales Pulse's latest channel checks the company's sales teams are outperforming. Despite concerns re. the large turnover in sales force, they have closed several large deals over the last few months. ZS is winning a high percentage of greenfield opportunities, while many of its large deals are in Check Point accounts where they don’t have to face **Palo Alto**’s incumbency.

Sales Pulse expect strong growth in the market in 2021 and will be monitoring to see which competitors emerge as contenders/impact they have.

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Sales Pulse Research

— Japan

Storm Virtual Conference: Presents 5 companies exposed to long term structural changes in Japan

Mon 16th - Fri 20th Nov

Media Do (3678) - No.1 eBook agent; **Nihon Jyoho Create** (4054) - No.1 real estate SaaS; **SERAKU** (6199) - rapid growth IT dispatch; **Sansan** (4443) - leading business card management SaaS; **Dip** (2379) - online recruitment and AI/RPA. Click here for further details and to register.

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Storm Research

Nikon (7731 JP)

Technology

Short thesis continues to play out - underperformed the Nikkei 225 by ~50% since Gradient initiated coverage (30 Apr 2020). Concerns re. the rapidly deteriorating demand for the firm's flagship product (interchangeable-lens cameras) and its ability to maintain market share in the lithography industry. From an earnings quality perspective, flagged how the company was artificially inflating sales; alarmingly high levels of inventory and the fact that they had begun to store an abnormal portion of operating expenses on the B/S.

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Gradient Analytics

— Australia

Fresh Offerings: Costa Group (CGC) & Ingham's (ING)

Consumer Staples

Rimor has published major reports on CGC and ING, the next in a series on fresh offerings being a key source of differentiation for supermarkets. The two companies have proved reliable suppliers of quality offerings during

COVID volatility and with food service channels reopening are well placed to grow with operating leverage. Both have stock-specific tailwinds that will add to strong medium-term earnings growth and attractive valuations.

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Rimor Equity Research

— Emerging Markets

China Autos: Data confirms the early stages of a cyclical recovery

Consumer Discretionary

Auto metrics continued to perform better-than-expectations. Registrations saw DD growth for the fourth month in a row (longest streak since 2017); NEV wholesale growth surged to +119.8% Y/Y. Notes that dealers have recently begun to complain about a shortage of inventory of popular models - some customers are now even willing to pay a premium to MSRP for certain models, a dynamic SRR have not seen in over 3 years. OEM-specific standouts in monthly growth trends include **JAC** (Oct +64.1% Y/Y) and **Chang'an** (+55.9%), **Chang'an Ford** (+47.2%), **BYD** (+38.9%) and **GAC Honda** (+34.4%).

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Silk Road Research

Zhengzhou Yutong Bus Co. (600066 CH)

Industrials

China pushing urbanisation and transportation integration bodes well for this leader in EV bus manufacturing. Believes the industry has reached a positive inflection point and the company will see a substantial boost in sales/profit in 2021 as a new energy bus replacement cycle begins. They will continue to gain market share as the competition landscape is consolidating (government cancelling subsidies) and deliver higher quality support services vs. competitors aided by their significant R&D/supply chain investment.

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Horizon Insights

Itausa (ITSA4 BZ)

Financials

Prior caution here has turned to enthusiasm for Financials & Fintech expert, Victor Galliano. Itausa provides investors with discounted access (at a very attractive 24% discount to NAV), to **Itau Unibanco** and the future spin-off of its holding in **XP** (expected to take place in 1Q21). Also highlights medium term potential re. improved fundamental performance and higher dividends.

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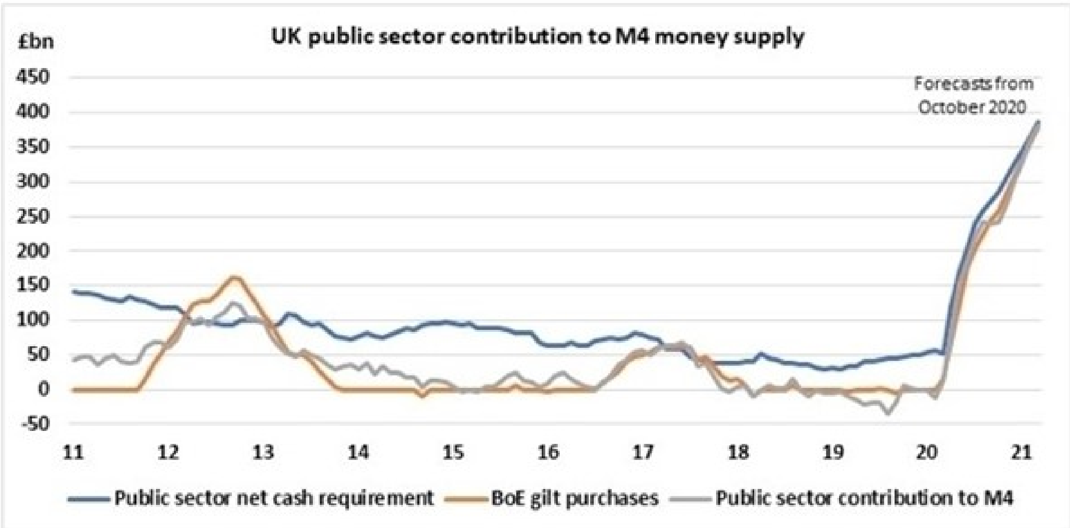
Galliano's Latin Notes

Macro Research

— Chart of the fortnight

UK: Unsettling spending

The announcement of a further £150bn of gilt purchases by the Bank of England will send the public sector's contribution to money supply growth to almost £400bn in the 2020-21 financial year, taking the annual growth rate to around 17% by next March. It would be astonishing if this development did not unsettle the inflation expectations of the UK public.



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Economic Perspectives

— Developed Markets

US: 2021 capital investment boom

Next year there will not be an election; increased tariffs and non-tariff barriers are unlikely; pandemic effects should diminish; TCJA is unlikely to be reversed; trade is recovering, and the supply chain management will evolve. We will see manufacturing capital spending continue towards multi-decade highs, with upside to corporate margins, productivity growth, and a strong year for the equity market.

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Ironsides Macroeconomics

The debt/liquidity spiral & the era of monetary dominance

Financial markets are spinning around a fragile debt/liquidity axis that is vulnerable to rising credit risk and higher inflation. Policymakers can cushion credit risk but, in doing so, their liquidity injections risk creating monetary inflation. On top, the Baby Bust and the Great China Decoupling are raising the stakes by increasing cost inflation and forcing savings ratios lower. Despite this, 2021 may still be a decent investment year. Equities look far better than bonds, with gold and Bitcoin sound alternatives.

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CrossBorder Capital

Wastefulness is inflationary

COVID has seen budgetary controls and audit processes have been bypassed in the US and UK to make way for extraordinary state intervention. “Whatever it takes” has been augmented by “whatever the cost”. Such schemes will cripple productivity and exacerbate inflation - we have seen consumable durable goods inflation jump to 8.5% in Q3 as the GDP deflator propels to 3.6%, the fastest since 2007.

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Economic Perspectives

US: Calm to the divide

Best-selling author, Jared Dillian, has been incessantly writing about political polarisation for six years. Things may seem worse than ever, but Jared assures us we’ve reached the peak. The new trend is now towards moderation; with consistent party-line votes in Congress pretty much over, we are now on the path to 1996 when the differences between the two parties was infinitesimally small. Give it 20 years, and we’ll be there.

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The Daily Dirtnap

Biden joining "Emily in Paris"

The Biden administration will not revert to the Clinton and Obama bonhomie with Europe and the “number to call” will change from +44 and +49, to +33. The tone of the relationship will certainly shift back to that of an ally, but the foreign policy pivot will remain on Asia. Albeit Macron to gain politically on the back of this regional shift - a crucial win for him ahead of 2022. The UK is probably the biggest relative loser geopolitically from this new US administration, as well as making it difficult for the negotiations of the US-UK trade deal.

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ABP Invest

Live long and prosper

Llewellyn Consulting's latest *Technology Series* looks at the future of life extension. Despite issues including regulation and current overinterpretation of results, the rise of research - from anti-senescence drugs and stem cells to parabiosis and even cryonics - is ramping up and could bring a range of benefits to humanity. This is a relatively new field and fraught with over-promise. However, distinct lines of ageing research are taking shape and the interest is high.

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Llewellyn Consulting

— Emerging Markets

Laos of cards

The debt-ridden country, having seen its illness worsened by the pandemic, is cosying up further to China to ease its woes. Changes in leadership will come in the LPRP congress although this will not usher in political or economic reform. Arrangements with China to ease the debt burden will be insufficient as the nation falls deeper into the grasp of Beijing's sphere of influence.

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Oxford Analytica

Bull(ish) in a China shop

China is the only major economy recording positive GDP growth this year and only central bank signalling policy normalisation ahead. Strong growth and potentially higher interest rates usually push up the currency, but China's yuan is managed against a trade-weighted basket, with policymakers not keen to see one-way bets on currency appreciation. Asset inflation will be an inevitable outcome of this "impossible trinity". Investors should be overweight Chinese stocks in global and EM portfolios, despite there being no evidence of a broad-based earnings rebound.

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MRB Partners

On the road to recovery

A synchronised global recovery is coming as the US election drama ends and vaccine hopes are boosted. Although the pandemic will ravage many EM throughout 2021, they will benefit from risk-on sentiment in global markets. Fears over threatened monetary stability and debt trajectories due to the massive stimulus programmes can be placated; such risks will be contained in South Africa, India, Indonesia and Egypt. Despite some EM overspending (Turkey) opportunities are in abundance.

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Greenmantle

Turkey: The Purge

Erdogan's removal of another central bank governor and the resignation of his son-in-law from the finance ministry points to a significant change in view at the heart of government. This isn't some voluntary awakening, instead it's a function of mounting pressure on the currency and dwindling resources to manage it. Providing the central bank is given a free hand to try and sort out the mess - i.e. allowed to hike rates - this purge should lead to a steadier lira. After falling 25% closes short lira position vs. the euro.

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Independent Strategy

China: Improving financial conditions

Updates to PRC Macro's business cycle and financial stress indicators for China show a combination of stable activity levels and improving financial conditions through the end of October. The former has received a boost from manufacturing restocking and a likely acceleration to fiscal disbursements last month, with the latter benefiting from the return of a potentially significant amount of fiscal funding to the banking system.

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PRC Macro

EM growth sizzles, can earnings pop?

2021 EM growth momentum will be strong, with Asia leading - upgrade to overweight EM in global equity portfolio. The robust recovery will be driven by a bounce back in domestic demand and global trade. Indonesia and India will see superior earnings and equity performance from economic rebounds, and China, Korea and Taiwan will display the best current prospects for earnings growth.

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MRB Partners

ESG

EM ESG investments offer better value

ESG themes in DM have seen their valuations increase at a faster rate than the rest of the market. ESG-minded investors may want to consider allocating some capital to EM, where the prices have started to go up due to important inflows, but are still cheaper than in DM. In particular, the Forestry, Renewables and Energy Efficiency sectors are very appealing as they show strong technical and fundamental characteristics - a few names in these sectors would go well on an investor's list of "EM ESG darlings".

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Sustainable Market Strategies

Commodities

Rising oil prices in the long term

In the near term the oil price is facing a number of headwinds, namely high inventories in the PRC and elsewhere, in combination with an increasing likelihood of a double dip in the global economy. However, the current lack of CAPEX in the oil industry and modest valuations mean that in the longer term we will see a rise in oil prices to $60/b for WTI, with significant implications on Western inflation and real incomes.

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Andrew Hunt Economics

Copper: Powering on?

Copper's impressive rally over the last seven months reflects a dramatic repricing of Chinese (and global) economic growth expectations. Three key barometers of Chinese economic activity - the RMB, Chinese short rates and the Chinese equity market - have moved sharply higher, all of which act as key inputs in Longview Economics' copper price multi-factor model.

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Longview Economics

IRF works with 260 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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