NIC

— Nova Investment Club —

Newsletter

March 2018

NIC

Nova Investment Club

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Foreword

This Month:

In our Macro Overview section, Analysts from both divisions will cover broad macro themes while reviewing major economics news from the previous month. In our Deeper Dive section Philipp P. Breitbach evaluates Michel Barnier's protocol for the Brexit negotiations, while Giovanni Parravicini provides an overview about the current Italian elections. This is followed by a new segment which we call Current Trends in which Nick Dörner investigates the rise of energy storage.

Our Investment Banking Division will guide you through February's M&A overall activity. Moreover, read about General Mills' bid for Blue Buffalo, Blackstone's bid for a majority stake in Thomson Reuters Unit and Qualcomm's increasing bid for the NXP takeover. Additionally, read a detailed overview on what happened to Daimler AG and General Electric. Lastly, get an insight on Private Equity investment returns, written by our analyst Raphaël Agbanrin.

Our Financial Markets Division will present the monthly results of the NIC Fund, an active relative return fund investing across four different asset classes: Equities, Fixed Income, Commodities and Currencies. In addition, the analysts will provide commentary on each of the four major asset classes through analysis of the past month´s major market moves. For the month's Hot Topic, Hoang Nguyen examines Trump's protection plan to control Chinese investments. He will look at reforms that would give the Committee on Foreign Investment in the United States (Cfius) broad jurisdiction over major outbound investments by US companies. Lastly, Julius Nimtz goes on an excurse on the impact of tax cuts on the capital structure of companies. He investigates how CFOs reacted so far and might change their decisions going forward.

The following content is original and created by the Nova Investment Club, which is run by students from Nova SBE's Master's in Finance. The reports may contain inaccurate or outdated information and should not be used as an exclusive mean for investment decisions.

Macro Overview

Monthly

March 3rd, 2018

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Market Moves

		Last Close	-1W	-3M	YTD
	S&P 500	2.659	6,28%	0,45%	-0,53%
	DJIA	24.278	8,63%	0,02%	-1,79%
	Nasdaq	7.144	11,16%	3,93%	3,49%
	MSCI World	2.944	4,20%	0,37%	-1,19%
	MSCI EM	4.473	6,33%	6,57%	1,36%
	Russell 2000	1.507	3,85%	-2,42%	-1,88%
	Euro Stoxx 50	3.324	-6,15%	-6,90%	-5,15%
	FTSE 100	7.083	-3,11%	-3,32%	-7,86%
	Nikkei 225	21.182	4,36%	-6,79%	-6,95%
	Hang Seng	30.583	9,69%	4,82%	2,22%
basis points	US 10Y Yield	2,855%	60,53	44,55	44,98
	GER 10Y Yield	0,640%	19,30	27,30	21,30
	JPY 10Y Yield	0,068%	3,40	2,90	2,00
	UK 10Y Yield	1,457%	10,20	12,70	26,70
	PT 10Y Yield	1,967%	-47,00	9,50	2,40
	Dollar Index	90,05	-2,30%	-3,22%	-2,25%
	EUR/USD	1,231	3,01%	3,42%	2,55%
	GBP/`EUR	1,119	-0,96%	-1,52%	-0,64%
	GBP/USD	1,378	2,01%	1,85%	1,94%
	USD/JPY	105,48	-5,81%	-6,27%	-6,40%
	USD/CHF	0,938	-3,27%	-4,68%	-3,77%
	Brent Crude	63,47	11,63%	-0,16%	-5,08%
	Gold	1.321,3	2,17%	3,78%	0,92%

**Source: Bloomberg, as of 2018-02-28*

In Focus

February

The month started off turbulent with the CBOE Volatility Index reaching 39.60. Equities sold off (the S&P 500 was down 4.01%) on higher inflation expectations triggered by a higher CPI and increase in hourly wages. Higher levels of inflation may prompt central banks to raise interest rates which have a negative impact on companies' valuations. Additionally, highly indebted companies, with variable interest rate loans, will experience more difficulty in meeting their obligations.

On the 14th of February, Mr. Zuma announced his resignation as president of South Africa. The resignation was made in live television broadcast after days of pressure from his own party, the African National Congress (ANC). To succeed him comes Cyril Ramaphosa that faces the challenge of fighting many of the structural problems that impede growth (GDP growth rate decreased from 3% to 0.3% during Zuma's period), such as poorly educated workforce and inflexible labor markets, but also of firing incompetent cabinet ministers without rupturing the ANC party.

Indonesia issued the world's first green Sukuk bond. The Southeast Asia country has borrowed USD 1.25 bn through a five-year Sukuk bond, designed to comply with the Islamic law. Due to strong demand for this product the yield of the bond decreased to 3.75%. The green finance market has been rising rapidly, with issuance reaching a record of USD 177 bn in 2017. The proceeds of green bonds are assigned to climate or environment-related projects.

Oil prices dropped in the February after a report from the US Energy Information Administration (US EIA). After a 5 month winning streak, crude oil price dropped on the 29th of February after the US EIA released a report with data showing data US crude stockpiles had grown by more than expected (3m barrels versus analyst predictions of 2.1m barrels). A barrel of Brent traded at 1.17% down and WTI fell 1.2%. In the same report, gasoline stockpiles were showed to be above predictions while the distillates decline below the expected value.

Jerome Powell's speech leads to equity sell-off and dollar appreciation. After his first public utterance, in which Powell mentioned a strengthening in the US economy and inflation moving towards the target of 2%, analysts expectations shifted towards a faster and heavier rate cycle (with four rate hikes instead of three). The market's reaction, with stocks selling off after having been recovering from a dip at the beginning of the month, suggests that investors had been cynical about a more hawkish move from the Fed that could hurt the stock market. As the equity market plunged, the dollar index rallied, consolidating the dollar appreciation that started in the middle of the month. As for the bond market, 10-year Treasury Yields went momentarily down to go back to their 2.9% territory.

India became the world's fastest-growing economy. India grew by slightly more than 7% on annualized basis in the last three months of 2017, overtaking China's growth (6.8%). India recovered from a poor performance in the first half of 2017 due to two Narendra Modi's failed policies with the objective to create growth: demonetization to fight against tax evasion and an increase in taxes.

Sofia dos Samtos Nunes
Financial Markets Division

Deeper Dive

One year until Brexit

Philipp P. Breitbach
Investment Banking Division

With Michel Barnier's protocol the Brexit negotiations have a basis of discussion which was very controversially discussed in Britain as well as among EU officials. Many feel that the proposed solution for Northern Ireland is an extreme position and some are even argue that it is comparable to "giving territory away". Nevertheless, this proposal will lay the groundwork for the coming negotiation rounds, which need to be finished by March 20, 2019.

About one year before the official Brexit date, Michel Barnier, the chief negotiator for the EU presented as he called a protocol. This can be seen as the first draft of a contract which will set the frame for the EU-GB relationship after the United Kingdom will leave the Bloc.

The reactions to the offer in the contract were mainly focused on the EU's answer to the Irish border question. Both parties agree, that any measure which could threaten the peace on the island needs to be avoided. Since Ireland will continue to be part of the European Union and Northern Ireland will leave the European Union together with the other states of Great Britain, this is easier said than done. What Mr. Barnier proposed in the protocol is compared by some to asking Britain to "cede territory". The idea on the table is bold: take legal control of a large part of Northern Ireland's economy.

Legal arrangements would allow seamless movement of goods across the island and therefore, the external border of the EU would become a sea instead of a land border. Even though he said: "I'm not trying to provoke or create any shockwaves." Politicians in the UK strongly disagreed with the paper, as Prime Minister Theresa May put it during a speech to the house of commons: "No UK prime minister could ever agree to it" and she added that she made her refusal "crystal clear" to Jean-Claude Juncker, the European Commission president. Since last elections, May depends on the support of Northern Ireland's Democratic Unionist party, whose leader called the draft "constitutionally unacceptable" and "economically catastrophic".

The Prime Minister is in a trilemma, first she needs to reach an agreement with the EU on the terms of separation, the transition phase, and future ties, additionally she needs to please the Eurosceptic Members of Parliament from her own party and lastly, she needs the support of the small party from Northern Ireland. However, Mr. Barnier pointed out that this is supposed to be a last resort measure to avoid a hard border in Ireland after the Brexit. This was underlined by other EU officials calling it a "maximalist" approach to put "maximum pressure" on London.

What is the EU's negotiation strategy by presenting this protocol? Much like Ms. May, the European Commission needs to have different interests within its member states. Many of the 27 countries remaining in the EU have an economic interest to remain in a customs union with Britain. An idea which was also supported by British Labour leader Jeremy Corbyn.

Boris Johnson, Britain's foreign secretary, is suspecting a conspiracy since he sees the proposal as a plan to "try to keep the UK in the customs union, effectively the single market, so we cannot really leave the EU". However, this might not be the only reason why the EU is presenting such an extreme position. Brussels also wants to see a British reckoning.

Until now it is not exactly clear which solution the British government is aiming for, by putting something on the table the EU forces the British government to "explain to voters what you want from Brexit and then face the consequences." as one EU official explained. In roughly one year, on March 30, 2019, Britain will leave the European Union. Until then many points need to be discussed and both parties need to agree on a direction for the time after Brexit. The presented protocol from Mr. Barnier is the first step and can be seen as a basis for discussion, not more but not less.

Philipp P. Breitbach
Investment Banking Division

Regional View

Italian elections

Giovanni Parravicini
Financial Markets Division

Elections in Europe have been problematic in recent years. Italy is the only large European country where there is the possibility of a nationalist government majority. Furthermore, what happen when the ECB completely interrupt the QE and the BTP's yield stop to be held artificially low as it has been in recent years?

Elections in Europe have been problematic in recent years. Germany held its elections in past September and is still striving to find a Government after 5 months; Netherlands required 7 months to give birth to a Government after its March 2016 election; Spanish voted for 2 years in a row in 2015 and 2016 without achieving a representative majority; and then there is Italy. This article does not focus on past controversies of Italian politics, but on the future outcome of next elections: March 4th 2018.

Italy is the only large European country where there is the possibility of a nationalist government majority. Nationalism is a common factor among the majority of movements even though it spreads within the parties' manifestos assuming different shapes. Different from the British independentism, Italy cannot afford an abrupt separation from the Union, but they all criticize and attack, in *primis*, the Eurozone. Lega's programme says "the euro is the ultimate cause of our economic decline as of monetary system tailored on German and Multinational size". For this reason, "we always looked for partners in Europe to start a shared and consolidated exit programme". Fratelli d'Italia's denounce euro as the main cause of Italy's huge debt. Cinque Stelle's programme says: "we support the idea to introduce in the treaties, specific procedures that allow states member to exit the monetary union or to separate from it by invoking permanent opt-out clauses". Relative to monetary union, another party worth mentioning is Liberi e Uguali, which is implicitly against the monetary union, as in its programme they do not even mention an European programme.
Another point in which Italian politicians found field for their echoes is immigration. The Schengen treaty, granting the free movement of individuals within the EU, is another regime to exit they all agree on. Lega harshly criticises it, Cinque Stelle is in favour to "revise" the Dublin rules in particular (without any explicit solution) and Fratelli d'Italia is supporting managing intervention like imposing controls at the boarders.

Ideologist nationalism (Lega), state nationalism (Fratelli d'Italia), Anti-political nationalism (Cinque Stelle) and social nationalism (Liberi e Uguali). From such a non diversified election only one outcome can result: nationalism. Even if Renzi's PD reaches a majority, they will have to ally with one of the above. These Governments protracted with artificial and controversial majorities lead to corruption, judicial inefficiency and government interference in the Economy as a whole. A study from Pellegrino and Zingales (2017) claims that Italian productivity lag, compared to European peers, is caused by such system. After the industrial boom in 1980s, Italy simply could not keep pace with the ICT revolution. After 1995 GDP per hour has dropped significantly compared to France, USA and Germany. To fully exploit benefits of ICT, firms should reorganise the working place using a performance-oriented, meritocratic management model (Bloom et al. 2012): not what happened so far.

However questionable the Italian movements are, there is another structural problem that drags down the underlying economy: the Debt level, which is the highest in EU, second only to Greece. All the parties came out with creative suggestions on hot topics to increase the basket of voters: Flat Tax, basic income for all, anti-extreme poverty condition measures and cancellation of previous pension reform. Could the elected Government afford to finance new expenditures and keep the promises? With a public debt at about 133% of GDP, neither there is room to increase spending, nor the EU would support it. An additional question is puzzling the markets about Italian debt. What happens when the ECB completely ends QE and BTP's yield stop to be held artificially low as it has been in recent years? There are high probabilities that the cost of public finance increases and, when it happens, the weight of debt will slow the economy growth further, hopefully not at the end of economic cycle. But this is no current topic, it is too early to think about consequences. Now Italians have to choose which candidate makes louder promises.

Giovanni Parravicini
Financial Markets Division

Current trends

Energy storage – loading up

Nick Dörner
Financial Markets Division

"We are planning to be leaving totally the dependency [on oil] that we have been living for the last 40, 50 years. Hopefully by even 2030, I would not care if the oil price is zero".

- Mohammed Al-Jadaan, finance minister of Saudi Arabia

Recently, Canada and Britain have led an initiative for developed countries to stop using coal for power generation by 2030. Another example of the latest decarbonising trend in energy is New York state's plan to stop its pension fund making further investments in fossil fuel companies. Next to governmental actions, the most fundamental moves in favour of a more sustainable world are being made by the private sector. Investors are pressuring companies to reduce emissions and the rapid decline in cost of renewable energy is making it a competitive option for power generation. Companies otherwise unrelated to the energy industry, like Apple and Walmart, have been investing in renewables, storage and efficiency. And major car manufacturers like Germanys Daimler AG or Japans Mitsubishi Motors are considering to build whole battery factories to catch the trend of "green energy" and electric vehicles.

In times where many industries and even whole countries are pursuing to switch from fossil fuel to renewable sources of electricity, energy storage can be seen as the missing link between intermittent renewable power from hydro, solar and wind, and reliability.

What is energy storage?

Energy storage absorbs and on command releases power so it can be generated at one time and used at another. There are different forms of storage technologies but the most interesting one for commercial purposes is battery storage. There are multiple benefits of energy storage. It can be used to smoothen the flow of power and costs, as a backup in case of blackouts or to save overflow of energy which otherwise would be lost. Historically, companies, grid operators, independent power providers, and utilities have invested in energy-storage devices to provide a specific benefit, either for themselves or for the grid. Since storage costs are plummeting, ownership broadens and many new business models emerge. The gradual implementation of supportive policies lets the market grow in a rapid fashion. In combination with advances in technology, this paves the way for a much wider use of storage. The current global investments in clean energy and capacity installations are increasing annually and totalled USD 287 bn in 2016. The installed capacities in 2004 were capable of producing 20GW of clean energy versus 160GW in 2016 which equals an average annual growth rate of approximately 30%. Considering the fact that renewable energy currently only contributes a small fraction to the energy mix of developed countries and that they are mostly planning to increase that fraction by a substantial amount, prospects a huge growth potential.

Battery storage

The future of the energy storage market looks especially bright for battery related technology. Most of the easily deployable projects in the upcoming years will be led by lithium-ion batteries. This is due to an increasing demand for grid-connected solutions, the growing electric vehicle market, a high requirement of lithium-ion batteries in various applications, and the support of various governments for related projects.

Like mentioned above, especially car makers are investing heavily in battery technology in order to supply the growing demand of electric vehicles. Recent examples are Daimler's USD 562 m lithium-ion battery factory in Kamenz, and of course Tesla's Gigafactories. Investments in this segment are expected to be huge in the upcoming future, as car makers and other industries want to become independent of battery manufacturers like LG and Panasonic. The battery storage market is definitely loading up.

Nick Dörner
Financial Markets Division

Macro Overview

Economic Calendar

Economic and Political Events

German Coalition Results

On **March 4rd**, SPD members will vote on whether to endorse a decision by party leaders to continue the "Grand Coalition" with Angela Merkel's conservative bloc. If the "no" vote wins, Germany may be left with a weak minority government.

Russian Elections

On **March 18th**, Russians will attend the ballots to vote for the Kremlin's position. With Vladimir Putin's victory as highly probable, the Kremlin's biggest problem now is to ensure that the turnout percentage is suitable enough to prevent a boycott from the opposition.

G20 Meeting in Buenos Aires

The G20 meeting of Finance Ministers and central bankers will take place on **March 17th - 20th** in Argentina. Topics such as cryptocurrency's financial stability and international regulation should be addressed.

Central Bank decisions

ECB Governing Council Meeting

On **March 8th,** the ECB will hold a monetary policy meeting in Frankfurt, followed by a press conference. Decisions regarding the European central bank's base rate for deposits and refinancing will be decided upon.

Norges Bank Monetary Policy Meeting

On **March 15th**, the Norwegian Central Bank will release its decision regarding interest rates and a Monetary Policy Report. Norges Bank recently lowered its inflation target from 2.5% to 2%.

FOMC Meeting

On **March 21th**, the Federal Open Market Committee announces the Fed's decision regarding interest rates. A interest rate hike is expected with 83.1% probability, according to the CME estimation.

Inflation and Deflation

US Consumer Price Index

On **March 13th**, the US CPI will be published, which is the main economic indicator for inflation. If this indicator goes up, interest rate expectations also go up and thus, central bank decisions (i.e. interest hikes) can be induced.

UK Consumer Price Index

On **March 20th**, the National office for national statistics in the UK will publish the CPI report with potential influence on the BoE decisions.

Japanese Core CPI Release

On **March 22nd**, the Japanese Core CPI will be published. BoJ has a 2% inflation target. Last Core CPI results were 1.4%. Japan has been struggling to achieve a faster rise in prices even when data shows strong economic growth.

Labour Market

Us Job's Report

On **March 9th**, a job's report containing information about new hiring, wage growth and average hourly earnings (Non-farm Payrolls) will be released. These are closely followed indicators of economic activity. Wage growth is expected to have decreased in February.

Hungary Unemployment Rate

On **March 28th**, the Hungarian Central Statistical Office will release data regarding the unemployment rate in February. In January a new unemployment low was settled with a 3.8% rate.

Japan's Jobless Rate

On **March 30th**, Japan will release the Jobless rate of February. The previous value for this indicator was 2.4%, the lowest rate in a quarter of a century. This indicator paired with wage growth is watched by the investor to infer about future inflation and economic growth.

Sofia dos Santos Nunes
Financial Markets Division

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Investment Banking

M&A

Overall Activity

Global

Acquisition volumes in both 2016 and 2017 have been at record levels, and as disruptive technologies continue to emerge faster than ever, it is expected that the demand for assets and capabilities intensifies. This year started as 2017 ended: With cheap financing and high levels of fundraising allowing increasingly larger acquisitions and LBOs to take place. Because of such opportunities, J.P Morgan and Goldman Sachs are setting their sights on consolidating their leadership position on what seems to be an increasingly attractive business segment, the mid-market M&A advisory. In addition to positive economic developments, underlying strategic drivers like the search for growth and yield, the use of consolidation to achieve synergies, the deployment of unspent capital, and the use of M&A to drive business model changes will certainly aid the increase of M&A activity in 2018. Over the past quarter, however, M&A activity has decreased relative to the same period one year ago. Nonetheless, this smaller deal volume is not due to a staggering decline in deal flow but to the record volumes achieved throughout 2017. In January 2018, global deal volume decreased by 31% to USD 324 bn, while the number of deals increased by 9.9% to 3,118.

Selected Regions

North America
In January the number of announced deals increased from December 2017 by 11.10%. However, the total amount spent on M&A deals decreased by 29.60% in the same period. Due to the planned deregulation of the financial sector under President Trump´s policies, an increased number of deals in that sector might be a major M&A trend in 2018.

EMEA
The value of M&A targeting companies in the Middle East and North Africa managed to reverse some of the losses recorded in January after deal making slumped from USD 5,181 m to USD 1,499 m by pulling back marginally to USD 1,653 m in February. In Central and Eastern Europe, the deal volume increased 28% in February MoM.

Asia
In January the number of deals in the APAC region decreased by 5.00% and the total value of the deals decreased by 3.00% on a YoY comparison. China, the largest economy in the region, was a major driver of this development. The country suffered from a decrease of 27.00% in the number of deal YoY. Those numbers are conflicting with the overall optimistic APAC M&A outlooks for 2018.

M&A

Deals of the Month

Announced Date	Target	Buyer	Target region	Target business	Value (USD m)	Status
23 Feb 18	Blue Buffalo Pet Products	General Mills	US	Cat and dog foods manufacturer	8,00000	Completed
12 Feb 18	Impact Biomedicines	Celgene	US	Cancer treatment research	7,000.00	Subject to conditions
21 Feb 18	Nornickel	RUSAL	RU	Mining	15,394.00	Completed
12 Feb 18	AmerisourceBergen	Walgreens	US	Pharmaceutical products wholesaler	20,000.00	Proposed
1 Feb 18	Dr Pepper Snapple Group	Keurig Green Mountain	US	Consumer Non-Durables	25,188.50	Completed
1 Feb 18	Thomson Reuters	Blackstone, GIC and Canada Pension Plan	US	Finance	17,000.00	Completed
20 Feb 18	NXP Semiconductors	Qualcomm	NL	Semiconductor manufacturer	53,000.00	Proposed
12 Feb 18	YOOX Net-a-Porter Group	Richemont	IT	Online clothing retailer	3,296.00	Proposed
27 Feb 18	Microsemi	Microchip Technology	JPN	Technology (AI)	7,500.00	Proposed
22 Feb 18	Gas Natural SDG	CVC	ES	Gas exploration	4,685.00	Completed

Tiago Marques & Christoph Beck
Investment Banking Division

M&A: Top Deals

General Mills to acquire Blue Buffalo

The American manufacturer of branded consumer foods, General Mills, announced on 23rd of February 2018 its entrance into pet food market through an acquisition of American company Blue Buffalo Pet Products. The deal amounts to USD 8 bn.

Buyer vs Seller

General Mills, headquartered in Minnesota in the US, was founded in 1856. It is a marketer and manufacturer of consumer foods with a portfolio of more than 89 leading brands. Blue Buffalo operates since 2002 in the pet-care industry. It is a manufacturer of healthy dog and cat food by life stage, type of products and special product lines under the BLUE brand. Blue Buffalo is the fastest growing natural pet food company and the leader in Wholesome Natural segment.

Industry Overview

Currently, the US pet food market is valued at USD 30 bn and it is expected to grow at 3 - 4%. Due to the subscription-based purchase pattern it attracts traffic and repeat purchases. Blue Buffalo is present in the Wholesome Natural segment, which accounts for 10% of the pet food market and 20% of the market value. Similarly as with human food, the trend shifts towards more natural and premium pet products.

Peers	Currency	Market Cap (CUR m)
Lamb Weston Holdings Inc	USD	7,963.36
Hain Celestial Group Inc/The	USD	3,542.57
General Mills Inc	USD	28,776.54
Kraft Heinz Co/The	USD	81,525.66
TreeHouse Foods Inc	USD	2,134.25

Deal Rationale

General Mills introduced a new portfolio reshaping strategy, as the demand for sugary, preservative-filled items declines. The aim is to focus on healthier nutritious brands, among other including the attractive pet market. Through the transaction General Mills becomes the leader in the US Wholesome Natural pet food segment. According to research firm Euromonitor, US retail pet food grew more than three times faster as packaged food sales last year, which were estimated at 1.2%. General mills expects from the acquisition a growth in sales and increase in its earnings within two years.

Market Reaction

General Mills

On the announcement date, February 23rd, the stock price decreased by 3.70% to USD 54.95. As of the end of February, it dropped even further to USD 50.78 reflecting the scepticism of the amount offered for Blue Buffalo.

Blue Buffalo

Blue Buffalo's stock climbed 58% within the last 6 months supported by the firm as well as industry-wide growth. After the acquisition announcement, the stock price jumped from USD 34.12 to USD 39.76 (+16.50%).

Future Challenges

General Mills will pay USD 40 per share, offering Blue Buffalo's shareholders a 17.2% premium. Analysts consider the deal too costly - according to Jefferies, it will be hard to extract value from the deal after such premium paid. Additionally, there is uncertainty whether General Mills will manage to successfully integrate Blue Buffalo, as it struggled to implement growth strategies of Yoplait yoghurt after acquiring a majority stake in it in 2011.

Katerina Rybarova
Investment Banking Division

M&A: Top Deals

Blackstone to acquire majority stake in Thomson Reuters Unit

Blackstone, together with Canada Pension Plan Investment Board and Singapore's sovereign wealth fund as co-investors, has agreed to acquire a 55% stake in Thomson Reuters' Financial and Risk Unit. The deal will consist of USD 3 bn from the Blackstone Group and USD 14 bn in debt and preferred equity.

Buyer vs Seller

For Blackstone it is a way of entering Wall Street's financial information industry. Through the partnerships both companies aim to increase the financial and risk business. Blackstone will engage further in cost-cutting to turn around a business unit struggling with a shrinking and budget conscious customer base. The firm is also one of the world's biggest investors with relationships across all major Wall Street players, who also happen to be clients of Thomson Reuters' flagship desktop product Eikon.

Industry Overview

Despite Bloomberg facing declining terminal revenues, the firm still holds a tight grip on the sector with a market share of 33.4% compared to Thomson Reuters' 31.1%. Yet the firm is with a market cap of USD 27,801.00 m in a competitive market position. The industry is likely to see further consolidation and mergers, as users of data and research products become increasingly wary of high fees while intense regulatory pressure continues.

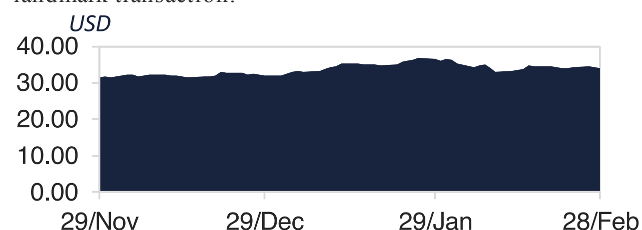
Peers	Currency	Market Cap (CUR m)
Dun & Bradstreet Corp/The	USD	4,611.94
S&P Global Inc	USD	48,460.62
Verisk Analytics Inc	USD	16,752.89
FactSet Research Systems Inc	USD	7,890.24
MarketAxess Holdings Inc	USD	7,545.60

Deal Rationale

In a joint press release both firms announced that the partnership allows to further cut costs, while increasing efficiency in hand with revenue growth through innovation and new F&R product developments. The buyout is a huge opportunity to increase data pools and data analytics thereby increasing the overall value that is extracted from data and delivered to clients. This in turn will increase the content offered on Thomson Reuter's platforms. Blackstone who sees further growth potential in F&R's foreign exchange and trading platforms also believes that the firm has greater potential to improve its operations quicker as a private firm.

Market Reaction

Blackstone
Following the announcement Blackstone stock fell by 2% to USD 35.83. This reflects some negative market sentiment despite the private equity group calling it a landmark transaction.



Thomson Reuters
The initial market reaction for Thomson Reuters has been favorable, as its share price rose by 6.7% to USD 46.32., showing that shareholders see the upsides of the acquisition.

Future Challenges

The greatest challenge for the parties involved will be to solve the question of which battles to fight and which ones to drop. One needs to bear in mind that this is a massive and complex business with countless people, locations, products and exchanges involved. At the same time the firm is strongly in need to go beyond its existing product range in order to increase market share and revenues alike.

Manuela Boeck
Investment Banking Division

M&A: Top Deals

Qualcomm rises the bid for NXP takeover

Qualcomm River Holdings increased its offer to purchase NXP Semiconductors from USD 38 bn to USD 44 bn in an attempt to complete a takeover first announced in October 2016. The further USD 6 bn will be financed with cash and new debt issuances.

Buyer vs Seller

Qualcomm's brand is frequently connected to chipmakers that power gadgets such as Samsung Galaxy or Google's Daydream VR, being an American multinational that markets not only telecommunication products but also semiconductor equipment. Similarly, the Dutch NXP is the leader in high-performance semiconductor electronics across several industries (automotive, wireless networks, security, etc). With Qualcomm on board, it would be one of the most controversial technology deals in history ever done.

Industry Overview

Considering Qualcomm's legal battle with its major client (Apple), the bid for NXP reflects company's effort to diversify its business away from smartphones, being regulatory approval the only prevailing barrier to close the deal. The semiconductors industry is progressively consolidating, with Qualcomm acquiring NXP and Broadcom bidding USD 146 bn for Qualcomm – the latter comprising the largest merger in the industry, if pursued.

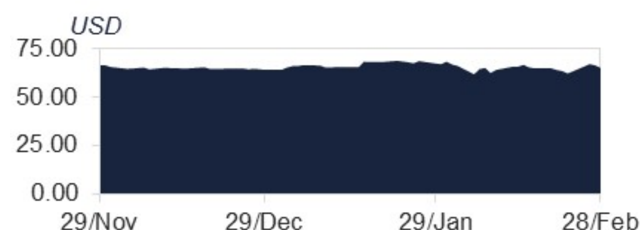
Peers	Currency	Market Cap (CUR m)
Infineon Technologies AG	EUR	24.476,98
Skyworks Solutions Inc	USD	19.450,84
Maxim Integrated Products Inc	USD	17.125,93
ON Semiconductor Corp	USD	10.151,01
Microsemi Corp	USD	7.557,31

Deal Rationale

NXP's operational performance improved since 2016 and, together with activists demands, Qualcomm has been forced to up its bid to seal the deal, further putting pressure on fellow chipmaker Broadcom, which has been chasing a hostile bid for Qualcomm since late 2017. Nevertheless, NXP's buyout will allow Qualcomm investors to better judge the standalone value of the firm, as well as to expand its business in the fast-growing automobile chip-market and reduce its reliance on telecommunication services. Under new sweetened terms, it is required to purchase at least 70% of NXP's outstanding shares in a tender offer, 10% less than agreed earlier.

Market reaction

Qualcomm River Holdings
The buyer stock is down 1.6% since mid-February, reflecting a message from markets regarding the lower chances of Qualcomm being acquired by Broadcom in the near future.



NXP Semiconductors
Since the announcement, February 20, due to activist Elliot Advisor's involvement, NXP stock has raised 6%, though shares had already climbed above the original bid price.

Future Challenges

In hopes of stopping Broadcom's takeover attempt, Qualcomm's increased bid for NXP represents a 16% premium to the original transaction price, which might actually lead Broadcom to walk away from the hostile takeover. With a new focus on mobile markets, driven by the real rationale under NXP's takeover, Broadcom may face difficulties in the future maintaining growth out of the assets found under Qualcomm's balance sheet, particularly in case the global economy falls down.

Inês Patrício
Investment Banking Division

What happened to

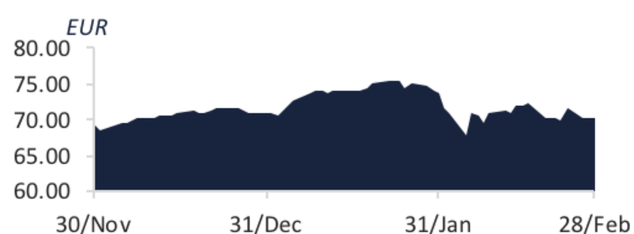
Daimler AG

Daimler AG is a German multinational automotive corporation. The Group is headquartered in Stuttgart and employs currently more than 289 thousand people. The German automotive manufacturer has production facilities in a total of 19 countries and more than 8,500 sales centres worldwide.

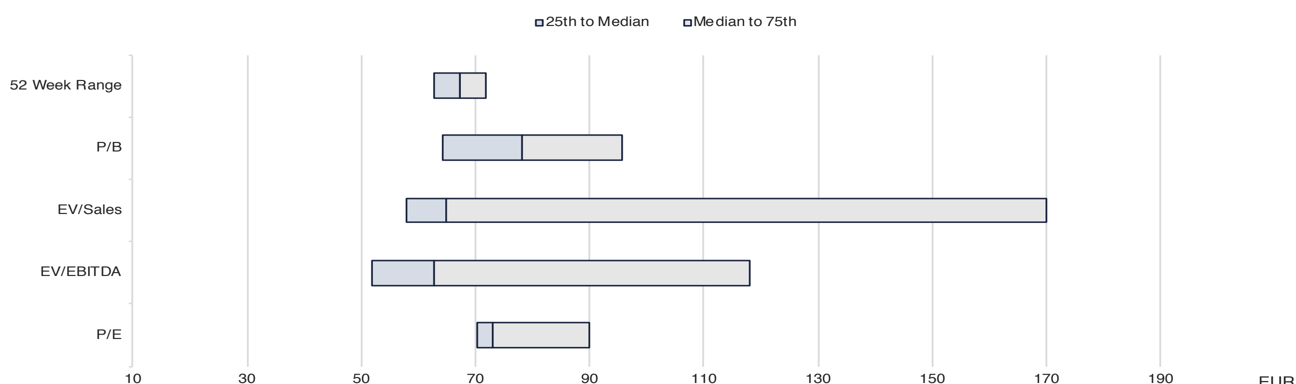
Corporate News

Geely, a Chinese automaker founded by Li Shufu, announced last week that it had acquired 9.69% of Daimler for about USD 9.0 bn. The German Group has already shared a press release welcoming Li Shufu as a new shareholder, claiming to be pleased of having secured a new long-term investor, particularly one well established in China. However, it is yet unclear if Daimler sentiments regarding the new joiner are genuine since, back in October, Daimler refused to issue new shares for Geely to buy. The Chinese Group has ambitions to forge an alliance with Daimler, obtaining access to its technology. In fact, Geely seeks to strengthen its presence in the electric sector which is expected to grow rapidly, especially in China, where the air quality is a serious concern for the government authorities. Daimler could also benefit with this cooperation by boosting its presence in Asia. However, sharing its technology with Geely is something that Daimler may not be willing to do.

Price (28 Feb 18, EUR)	69,48
Targe Price (EUR)	80,00
3M Performance	-0,25%
Market Cap (EUR m)	74 332,31
Enterprise Value (EUR m)	55 534,31
**Target Price is for 12 months*	



Valuation Analysis



Daimler AG was, at the end of the month, trading at EUR 69.48. If we make a quick analysis at the share price development, we can immediately see that the German automaker's stock price plunged during the beginning of the month following the big correction that equity markets experienced. The valuation analysis above indicates a fairly concentrated median valuation between EUR 60.0 m and EUR 80.0 m for all ratios, however, when looking at the EV/Sales, one can see much higher dispersion.

The automotive industry has been going through several changes both in trends and legislation. In fact, after VW's emissions scandal back in 2015, automakers face increased legal and regulatory scrutiny over pollution levels generated by their diesel-engine cars. The shift in demand from Diesel vehicles to gasoline or electric alternatives is imposing Daimler a vast shift in terms of production and supply. Nevertheless, the German Group is perceived as one of the most likely car manufacturers able to adapt to the fast-changing industry.

Peers	Currency	Market Cap (Cur m)
Volkswagen AG	EUR	80,217.49
Bayerische Motoren Werke AG	EUR	55,488.10
Peugeot SA	EUR	17,861.31
Ferrari NV	USD	23,222.43
Fiat Chrysler Automobiles NV	USD	

José Paula
Investment Banking Division

What happened to

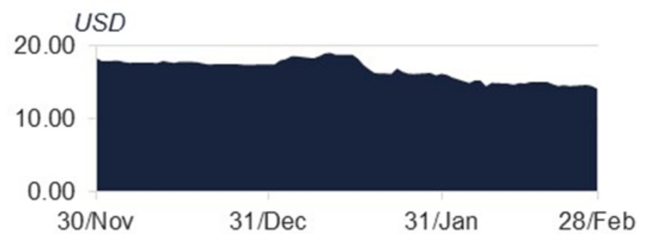
General Electric

General Electric, an emblem of the American corporate landscape, is an industrial conglomerate offering products and services in numerous segments notably in Power Generation, Renewable Energy, O&G, Aviation and Transportation among others. With USD 125 bn, GE remains one of the most valuable company in the United States of America.

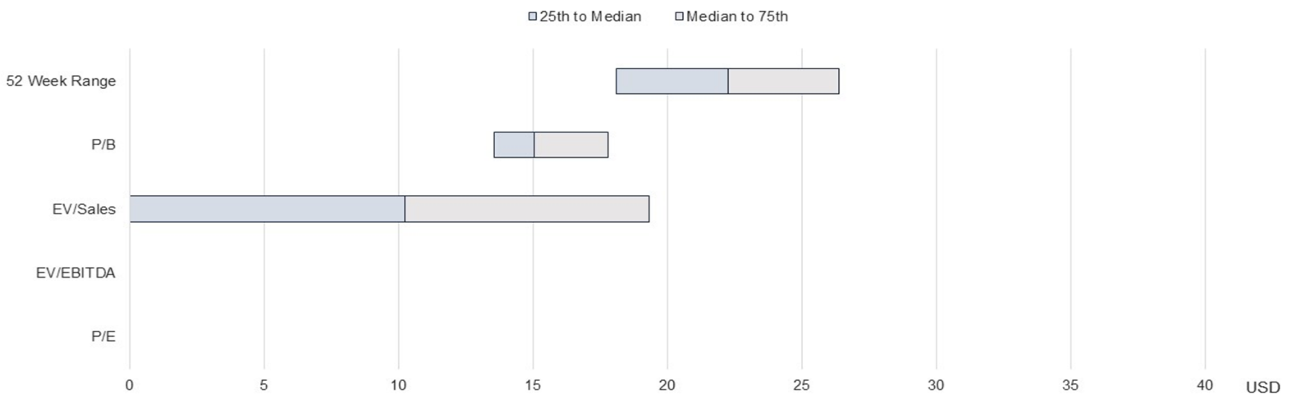
Corporate News

General Electric saw its value decrease quite substantially in the past year. Its current stock price, previously used as a proxy for the American market, has decreased 20% year to date compared to -0.17% for the SPX. GE's fall from grace has numerous explanation but mostly highlights poor strategic decision combine with management painting a rosier picture than reality. For example, GE tried, in the previous years, to restructure their financial arm by making the division simpler, leaner and more profitable after it almost brought the company down during the last financial crisis. However, GE Capital continues to cause serious trouble as it still generates significant losses. In their last earning, GE had to report a USD 15 bn loss on their insurance business. Furthermore, management had bet on fossil fuel power and loss. Management had forecasted strong growth and profitability even though the industry has flat demand and is going through a fundamental shift towards renewable energy.

Price (28 Feb 18, USD)	14.02
Targe Price (USD)	17.00
3M Performance	-23.35%
Market Cap (USD m)	121,729.72
Enterprise Value (USD m)	205,769.72
Target Price is for 12 months	



Valuation Analysis



General Electric was, on the day this piece was written, trading at USD 14.02 on the NYSE. By making a quick comparable analysis, we see that GE is currently trading at a lower valuation than its industrial peers. Only its P/CF metric is higher, which indicates the inability of the company to generate cash flow which helps explain why the company relative value is lower. Its multiples is a clear sign that the market does not believe in the ability of the management to get the company out of its bad performance.

However, even with GE operational problems, the company has the potential to offer some great value. By looking at its division individually, we can see that the sum of its part is greater than its combine value. Hence, by divesting its trouble assets, notably its financial and power generation arm and focus on its profitable segment, GE would be able to create substantial shareholder value. Or, it might be time to break down the company by selling some of its core assets, which some well known investors like Buffet have express interest, or spinning-off some of its division.

Peers	Currency	Market Cap (Cur m)
Siemens AG	EUR	89,488.00
Hitachi Ltd	JPY	3,964,890.02
Toshiba Corp	JPY	2,021,419.18
Eaton Corp PLC	USD	35,035.52
United Technologies Corp	USD	104,211.11

Mathieu Bourque
Investment Banking Division

NIC's view on

Private Equity investment returns, touched but not sunk

Raphaël Agbanrin
Investment Banking Division

Low interest rates on other asset classes and attractive conditions to borrow money are driving up investors enthusiasm for private equity. According to Bain & Company, all 10 of the largest funds closed during the year raised more than their targets, and they easily could have raised even greater amounts. The inability of private equity managers to put money to work have led the industry to be awash with cash. The competition for deals is fierce, considering the deals are being done at record-high multiples, requiring PE funds to accept lower returns in the future.

In 2017, the total deal value of the private equity industry increased by 19%, to USD 440 bn. It is reflecting the growing size of the average deal and a stream of large public-to-private deals. But the increase in deal value is not large enough to satisfy investors hunting for higher returns in our current environment of low interest rates and cheap liquidity.

The amount of dry powder – amount of cash reserves or liquid assets available to deploy – is increasing the already fierce competition among private equity funds to find suitable investments and deliver acceptable returns. At the end of 2017, buyout funds were sitting on an all-time high of USD 633 bn in uncalled capital that turns out to be a plague for the industry. This competition is embarking the private equity industry to close deals at record-high multiples, which is likely to generate lower returns in the coming years. According to Willshire Associates assumptions – a global advisory company specializing in investment products - private equity managers will generate annualised returns of 9.4% in the next decade, down from its 11.2% 10-year estimate in 2017.

The landscape seems to become more obscure in the private equity industry. These amounts of uncalled capital should not be invested by hook or by crook. In the aftermath of 2008, a string of private equity groups collapsed in part under the weight of their own unmanageable debt and poorly-executed deals. Nevertheless, the 2008 scenario is not inevitable. First, highly leveraged private equity structures must be mindful of the upcoming rise in interest rate. Moreover, the right sort of diligence and a better value creation from the inside out, through better leadership and execution, could avoid both lower returns and poorly executed deals that could lead PE firms to collapse.

Carving back the massive amount of uncalled capital will require private equity firms to execute more and larger deals that are not missing. As Prakash Melwani, Blackstone chief investment officer for private equity said at the SuperReturn conference – the world largest private equity event – "They are always pocket of opportunities". The largest alternative investment firm in the world sees opportunities in emerging economies such as Greater China and India, and large buyout in energy sector.

In 2017, only 13% of the value and 8% of the number of companies bought were made through private equity funds. M&A-based deals are indeed an untapped potential on which private equity firms could claim a bigger share.

As the SuperReturn opened in Berlin on February 26th, private equity professionals are looking at new area to overcome the structural challenges they are now facing. As larger deals are needed to put properly money at work and rise above competition, larger private equity investors will have an advantage over smaller ones. Therefore, it remains to be seen if the competition is likely to drive a concentration of the actors in the industry in the coming years.

Date	Recent News
23 Jan 18	Private equity: flood of cash triggers buyout bubble fears *https://www.ft.com*
26 Feb 18	Global Private Equity Report 2018 (9th edition) http://www.bain.com
26 Feb 18	Cash-Rich Investors Are Hungry for Deals as SuperReturn Begins https://www.bloomberg.com

Raphaël Agbanrin
Investment Banking Division

NIC Fund

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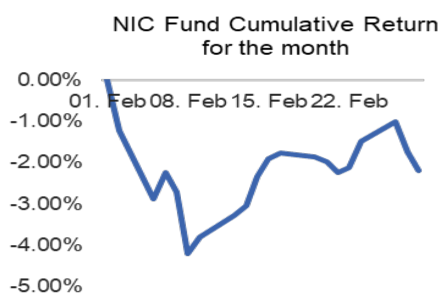
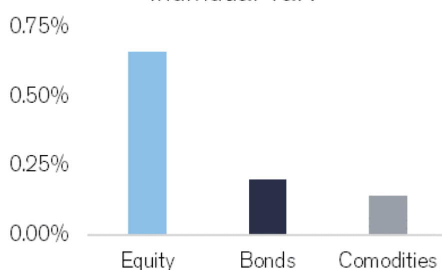
Portfolio Overview



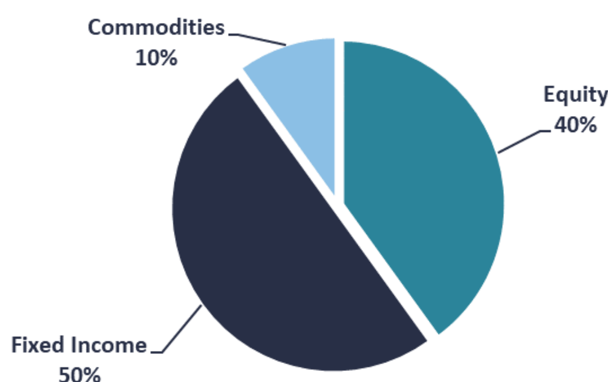
Portfolio Statistics	
Cumulative Return	2.85%
Annualized Return	6.84%
Annualized St. Dev	7.8%
Info Sharpe	0.97
Skew (Daily)	-1.72
Kurtosis (Daily)	4.18

Benchmark	
iShares 3-7 Year Treasury Bonds	55%
iShares MSCI World ETF	30%
Powershares DB Commodity Index	10%
MSCI Emerging Markets	5%



Portfolio Snapshot

During February, 40% of the fund remained devoted to Equities, 50% to Fixed Income and 10% to Commodities. Yet, 13% of the Equities are now allocated to thriteen specific stocks across the US, Hong Kong and Europe, using an equally weighted strategy. In February, two new stock picks were made. In terms of commodities, all of the portfolio was allocated to the benchmark. At the end of the month we opened a long position in Brent.



Return Metrics

The overall performance of the portfolio was negative, with a cumulative return of -2.11%. Equities had the worst performance, contributing with a negative return of 1.5%. In the same way, Fixed Income contributed negatively to the portfolio, with a loss of 0.16%. Commodities lost over the month, contributing -0.40%

In terms of equities, besides being invested in the MSCI World and MSCI EM, the portfolio was also invested in other 13 individual stocks. From these, the best performers were Micron, Amazon.com and Bank of America with a performance of 11.64%, 4.24% and 0.31% respectively, which translated in a contribution to the portfolio of 0.1%, 0.04% and 0.003%. On the other hand, Blackstone was the worst performer, with a negative return of 6.85%. Finally, the MSCI World yielded a negative return of 4.27%, decreasing the Fund's returns by 1.33% and MSCI EM yielded a return of -4.61% contributing -0.13% to the portfolio.

Risk Metrics

In terms of risk, our portfolio registered a daily VaR of 0.66%, taking into consideration the benefits of diversification. On the other hand, also during the same period under analysis, the non-diversified VaR was at 1%, below the maximum established threshold of 2.5%.

Equities were the asset class with the highest individual VaR, which was around 0.66%. On the other hand, Equities and Commodities had slightly lower VaRs of 0.20% and 0.14% respectively.

Mahomed Vali
Financial Markets Division

NIC Fund

Assets in brief

Asset Class	Symbol	Comments
HK Equity	**700:HK**	Tencent decreased 2.3% during February. However, Tencent is slated to announce its latest quarterly earnings results in late March. Tencent owes its growth prospects to a number of new initiatives. For example, it plans to expand its brick-and-mortar shopping operations through a stake in Carrefour's China unit. Along with local retailer Yonghui Superstores, Tencent recently signed a term sheet for an undisclosed stake in Carrefour China.
US Equity	**BAC**	Bank of America dropped 3.14% during the month. While the market is busy reacting negatively to the Congressional testimony from Federal Reserve chairman Jerome Powell, his reiteration of the Fed's commitment to higher interest rates is a huge win for banks. In fact, it's a huge win for Bank of America specifically, given its massive base of customer deposits. As interest rates go higher, the bank is able to make more money on these deposits.
US Equity	**AMZN**	Amazon's stock price increased 7.44% in February. The combination of the recovering consumers around the world and further disruption of traditional retail will benefit the e-commerce giant. Expansion into more traditional retail and grocery business through the Wholefoods integration are interesting as well as the expanding cloud computing business known as AWS.
US Equity	**GS**	Goldman Sachs, a new addition to our portfolio, is expecting to perform well in this high volatility environment in the markets, since it means higher trading revenue. Goldman can also benefit from increasing M&A activity that is expected to happen during this year.
US Equity	**EVBG**	The company's stock increased 0.22% during the month. The technology company reported (USD 0.02) earnings per share for the quarter, meeting the consensus estimate of (USD 0.02). The firm had revenue of USD 29.18 m during the quarter, compared to analyst estimates of USD 28.49 m, showing positive revenue growth surprise during the period.
US Equity	**BX**	Blackstone decreased 7.65% in February. However, we continue to be bullish on the PE business in the short-term as the macroeconomic conditions remain favourable, making it a good value investment and diversification element.
US Equity	**MU**	Microns stock price increased 12.07% in February, making it one of the fund's top performers during the month. Looking into the future, Wall Street analysts are increasing their earnings estimates for the company, both in the coming quarters and next year. This is indicating that the analysts following the stock consider that the acceleration in performance is sustainable into the future.
US Equity	**BABA**	Alibaba decreased 5.32% during the month. Despite lower margins in result of several investments in retail and logistics, Alibaba's overseas expansion and offline push should further expand its huge user base and lay the foundation for future growth opportunities across a variety of businesses, as the company monetizes its newer business segments.
EU Equity	**UMI**	Umicore, another new addition to our portfolio, generates the majority of its revenues and dedicates most of its R&D efforts to clean technologies, such as emission control catalysts, materials for rechargeable batteries and recycling. Resource scarcity offer growth opportunities for the companies as well as the push into electronic vehicles. Furthermore, through supplying catalyst, the company is essential in ensuring low emissions in traditional cars.

*Besides these stocks, the portfolio was also allocated in Visa, NVIDIA, Walt Disney and Adidas AG

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Financial Markets Division

NIC Fund

Equities

World Equities

Global equities have closed the second month of the year with a negative monthly return of -4.41% for MSCI ACWI (All Country World Index). The February's market correction, which started in the US, rapidly spread to other parts of the world.

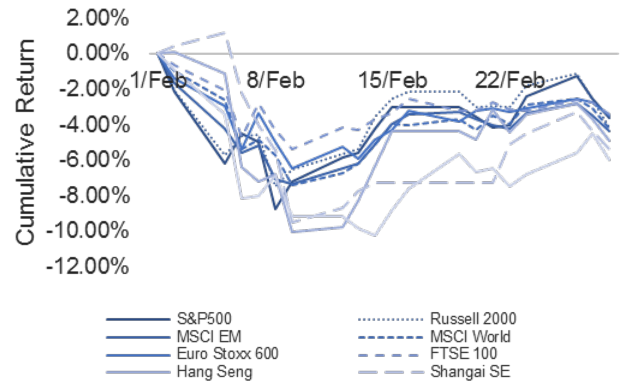
On February 2nd, a stronger than expected jobs report, showing higher wage growth, fuelled expectations for a faster pace of inflation and monetary policy tightening. In response, the US benchmarks Dow Jones and S&P 500 declined for the first time in 11 months, ending the longest winning streak since 1959.

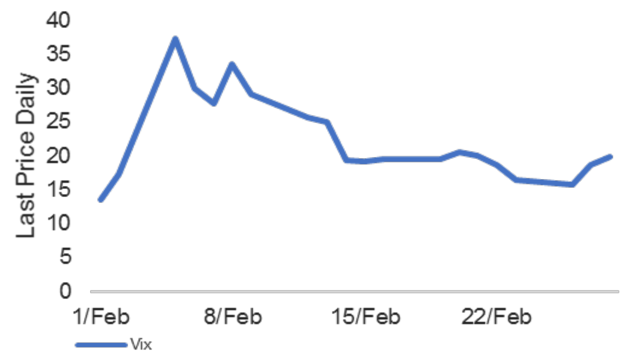
During the turmoil, the S&P 500 was, at its worst, down 9.7% from its all-time high in January, while the Dow Jones did enter technical correction territory, being down more than 10% from its high.

Both indices had their worst month in two years. S&P 500 finished February at 2713.83 (monthly decrease of 5.39%) and Dow Jones exhibited losses of 4.62%. Tech-heavy NASDAQ Composite had a less negative performance this month, declining by 1.55%. Nevertheless, the strong economic performance and soaring corporate profits fostered a rapid recovery in the US, as all three major indices are up again for the year.

Affected by this headwind, Japanese NIKKEI 225 declined by 6.42% in February and European STOXX Europe 600 Index returned -3.54%, while U.K.'s FTSE 100 Index lost 3.57% on the monthly basis.

During the crash, investors betting against the VIX volatility index, were wiped out of the market. Indeed, volatility targeting trading strategies might have played a role in the tumult. VIX, measuring implied volatility, which increases in times of uncertainty, was responsible for the collapse of two exchange-traded products, exacerbating a sharp drop in share prices.



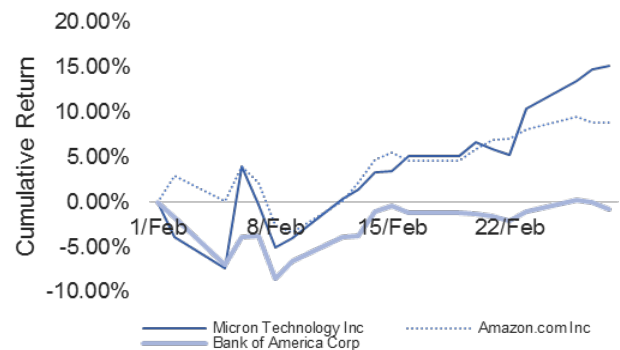


In depth

In March, rising interest rates could continue to spook the market, after new Fed Chairman Jerome Powell's more hawkish comments sent yields higher and increased expectations that the US will have four rate hikes in 2018.

In a time equities are entering the latter stages of a bull market, higher volatility will become normal. Nonetheless, corporate earnings remain robust and the synchronized global growth is expected to continue. Hence, a bear market is not expected.

European stock markets are taking longer to recover, which can signal instability (due to uncertainty) over the Italian elections, Brexit negotiations and the German coalition outcomes. In such an environment, Bridgewater, the world's largest hedge fund, placed a USD 22 bn bet against the European market. Nevertheless, the old continent is still in an earlier stage of the recovery cycle, which signales a larger upside potential.



Our performance

In February, equities' contribution to the overall portfolio performance was negative, with a cumulative return of -1.66%. Among the best performers were Micron, Amazon and Bank of America.

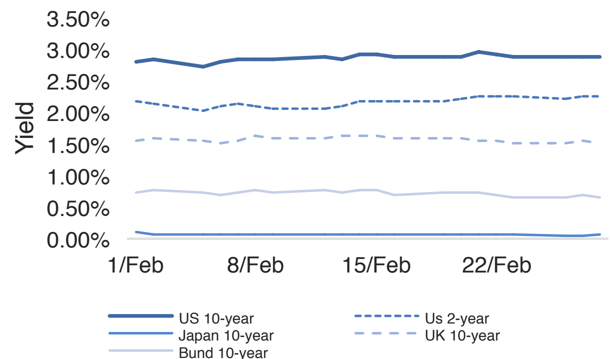
Tomás Ambrósio
Financial Markets Division

NIC Fund

Fixed Income

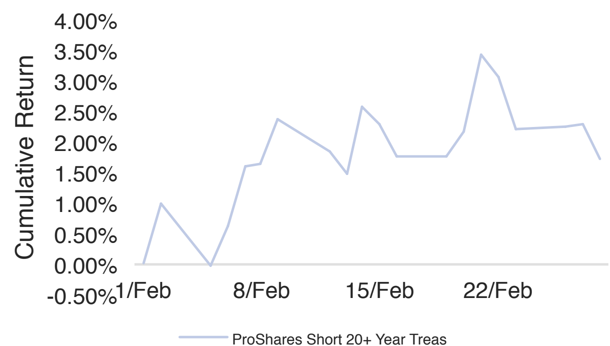
World Yields

As a result of the growing inflationary expectations and a booming economy, yields in the US are increasing and are putting pressure on the Japanese market to rise. Japanese companies continued to sell long bonds expecting that the BoJ governor, Haruhiko Kuroda, will prolong the monetary stimulus with 10-year bond yield being pinned close to zero. It yielded a loss of 5 basis points, amounting to 0.05% by the end of February.



The US January job data generated new fears of inflation and speculation of aggressive monetary policy tightening. Additionally, a spending deal reached by US lawmakers earlier this month has prompted faster-than-expected rate hikes. As a result, the Fed might raise interest rates four times this year instead of only three times, as initially announced. The yield on 10-year treasuries gained 5 basis points to reach 2.86%.

On the other hand, Germany's 10-year government bond yield fell to a one-month low at the end of the month owing to the uncertainty towards the Italian election on March 4th and the result of the German social Democrat party vote on a coalition deal. Both events boosted demand for safe-haven German bonds. Bund yield fell by 7 basis points to as low as 0.66%. Finally, in the UK, the 10-year gilts lost 3 basis points and yielded 1.50% in February.



In depth

The fixed income space has been out of investors' favor this year so far, piling up heavy losses. This is especially true as Treasury yields have been on a rise with two-year yields climbing to their highest level in nearly 10 years at 2.25% and 10-year yields jumping to the highest level in more than four years at 2.86%. However, having a long position in US bonds such as iShares 20+ Year Treasury Bond ETF (TLT), will be beneficial if bond yields fall as yields are inversely correlated with prices.

Nevertheless, for those who believe that interest rates will continue to rise in the near term, shorting US long bonds would be an option. In order to do so, one could invest into the ProShares Short 20+ Year Treasury ETF (TBF) which is an exchange traded fund that does the exact opposite of TLT. As presented in the graph, the TBF yielded 1.73% in February yielding 8.60% YtD.

Our performance

The IEI ETF, tracking 3-7 year US Treasury Bonds, our benchmark fund for fixed income, contributed negatively to our portfolio with a loss of -0.18% in February.

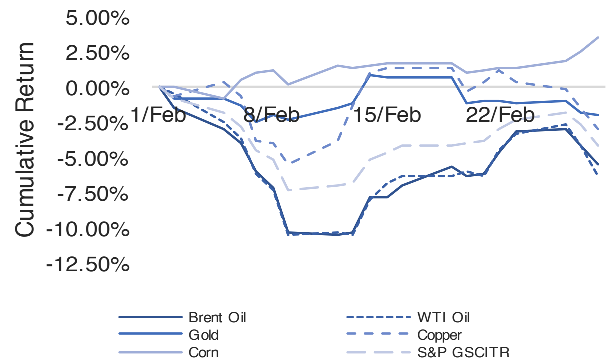
Sophie Pourinet
Financial Markets Division

NIC Fund

Commodities

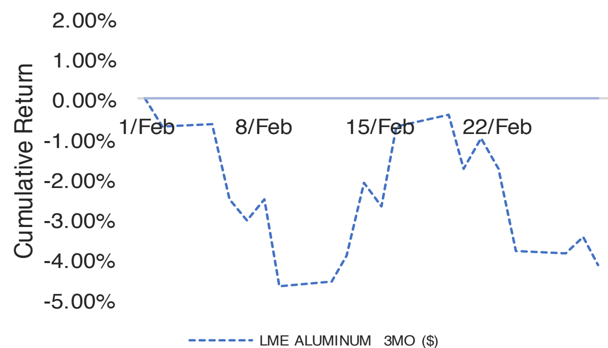
February Round-up

After a high-flying performance in January, with prices hitting USD 70.53, Brent crude oil realised the first monthly loss after a 5-month period of gains. The global benchmark slipped to USD 65.78 by the end of the month. WTI, the US marker, was trading at USD 61.64 end of February, falling by as much as 6.32%. Both grades were negatively affected by a stronger dollar by the end of the month, reacting to Fed chair Powell's remarks on gradually increasing interest rates to prevent the economy from overheating, if necessary. Additionally, the release of the US crude stockpile data put pressure on oil, as crude inventories have grown by 3 m barrels, 0.9 m barrels more than what analysts have expected. The drop in prices came despite the announcement that OPEC and non-OPEC producers further restrain from production to prop up prices beyond the set expiration at the end of 2018.



Looking at precious metals, palladium was the only positive performer with a slight gain of 0.23%. Gold dropped by 1.93% to USD 1,348.79 whereas the dollar index, which is inversely related to the metal, increased to 90.613. Silver decreased by 4.77% and Platinum lost 2.40%.

The US agricultural sector faces an extended period of dryness in the US plains, leading to a price increase of US wheat by 6.18%. Corn prices rose 3.50% and Soybean futures soared to USD 10.68 per bushel, reaching a 13-month high after signs of strong export data. By the end of February the US Agriculture Department reported soybean export sales of 979,900 t per week, beating even the most optimistic forecasts of 800,000 t.



Outlook for March

This month a close look on aluminium will be essential as US president Donald Trump declared to impose tariffs on aluminium imports. The announcement prompted US aluminium buyers to fill up stocks before the tariff could be imposed, thereby lifting the aluminium premium, which is paid in order to get immediate delivery, to a 3-year high. The Midwest Aluminium Premium Futures Contract increased by 11.8%.

In light of the introduction of the tariffs analysts expect the global aluminium price to suffer in the long-term. Global shares of aluminium manufacturers were hit hard as the announcement raises fears of future trade wars.

Our performance

Given our optimistic view on the oil price development, we decided to add Brent futures to our portfolio Moreover, as we expect volatility on the markets to increase in the beginning of March, we also included the VSTOXX Future. The overall return to our portfolio amounts to 1.23%.

Johannes Weissensteiner
Financial Markets Division

NIC Fund

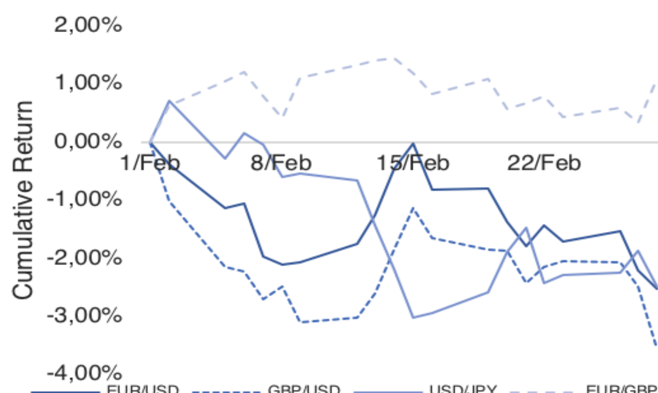
Currencies

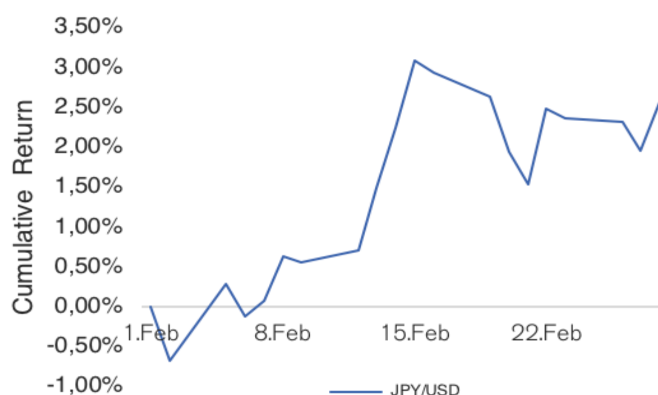
World Currencies

A dollar rally in the second half of February was fueled by a more hawkish language at the FED. The FOMC had marked up the growth forecasts since the previous month, encouraged by optimistic inflation outlook (progress towards 2% target), robust global growth, supportive financial markets and the potential for US tax cuts to boost the economy more than expected. With this, markets anticipate four interest rate hikes instead of previously forecasted three. This sent DXY index, a US dollar measure relative to a basket of U.S. trade partners, to its highest level in seven sessions, 90.209, on February 22nd (2.19% up over the month). As USD gathered pace, European currency went down 0.1% to USD 1.2264, while the pound decreased 0.3% to USD 1.3878 in post Fed minutes session.

Sterling extended its slide on Wednesday, February 28th, to its 3-week low after Theresa May hit out at Brussels' draft Brexit proposals to keep Northern Ireland under the bloc's rules. The pound sank as much as 1%, settling at USD 1.3772, which yielded a 3.53% loss for the month.

European Central Bank minutes, released on February 22nd, highlighted the fears over the weaker dollar policy. The US Treasury secretary Steven Mnuchin's claims that a weak dollar was good for the American economy, if enforced, could lower the Eurozone's exports and make it harder for the ECB to meet its inflation target. In post-minutes session, EUR has closed at USD 1.2330, with a 2.53% loss for the month. Finally, 2018 is expected to be an upbeat year for renminbi investing, as Chinese A-shares are set to be incorporated into the MSCI's EM index for the first time and "dim sum" Rmb4B bond is prepared for a launch on Hong Kong's offshore market. The internalization of yuan is pushing the Chinese currency higher against the US dollar, with renminbi increasing 0.22% against the greenback in February.





In depth

The last ten days for were described as "volatile, model-breaking and defiant of easy explanation" for the yen by FT's contributor Leo Lewis. The haven currency climbed 2.56% up versus dollar, to ¥106.68. The recent rally is arguably driven by rising safe haven demand amid the geopolitical instability, seasonal profit repatriation, expectation of domestic bond-buying by the government pension fund, and speculation that the regulators are planning to reduce the maximum leverage for retail FX trading. But more interestingly than that, since the start of quantitative and qualitative easing in Japan, JPY/USD movement had approximated the monetary base differential. The recent US fiscal stimulus may have shifted this relation from the monetary base to current account imbalances' approximation. In this case, a weak dollar may be not a temporary thing, but a new trend of the currency pair, given Japan's status of the world's largest net creditor, generating ¥358tn on its international position.

Our performance

We currently hold no currency related assets in our portfolio, however we are exposed to EUR via our asset allocation.

Anna Averina
Financial Markets Division

Extras

Hot Topic

Trump's protection plan to control Chinese investments

Hoang Nguyen
Investment Banking Division

China is a rising economic superpower with a huge savings surplus. Its government is keen on growth and influence. However, the question of Chinese takeovers is much more fraught for other companies and, indeed, governments. Hence, President Donald Trump pushes reforms that would give the Committee on Foreign Investment in the United States (Cfius) broad jurisdiction over major outbound investments by US companies.

The Committee on Foreign Investment in the United States (Cfius) is one of the most powerful regulators in the world. An inter-agency committee that brings together defence and intelligence staff with economic policymakers, it was created to vet inbound foreign investment for potential national security threats.

However, reforms being pushed by President Donald Trump and contained in a bill now working its way through Congress would, if enacted, expand its workload from a few hundred transactions a year to potentially thousands. And like so much of economic policymaking in Washington these days, it has one target in mind: China and its appetite for US intellectual property.

The planned reforms fit with an international pattern. From Australia to the EU, jurisdictions are tightening their scrutiny of inbound investment largely in reaction to what many governments suspect has been a strategically driven Chinese buying spree that in the US alone has been worth USD 116.6 bn in the past five years according to the Rhodium Group, a consultancy. The US proposals go further. For the first time, the bill now under consideration would give Cfius broad jurisdiction over major outbound investment by US companies, that since 1990 has been worth some USD 250 bn, and the overseas ventures of US-based multinationals. And for that reason, it has provoked a growing revolt from blue-chip American companies such as General Electric and IBM and a debate in Congress over how best to curtail Chinese pressure on US companies.

The plans for Cfius strike to the heart of the Trump administration's dilemma over how to deal with China, which it has called a strategic "competitor". White House officials and their allies in Congress are struggling to respond to what they see as an existential economic threat from a China that aims to be the leader in artificial intelligence, autonomous vehicles and other new industries.

The debate over Cfius reform in Congress comes as the committee and its staff are stretched by a rising caseload that is more complex than it used to be. Lawyers who work on transactions reviewed by Cfius say even simple cases have in recent years begun to face procedural delays and complain that the Trump administration was too slow to nominate many of the appointees who sit on its panel. But Cfius experts also detect signs that the balance between economic and defence interests on the committee has shifted under the Trump administration. The Pentagon and the wider intelligence community appear to have more power on the committee, lawyers say, and that has affected cases, particularly when China is involved. Opponents of the bill are also concerned it would turn a voluntary process into one mandating notification of Cfius. The move is meant to give the committee wider power including over many smaller transactions that involve minority stakes in tiny start-ups. That would mean potentially thousands of more cases on its docket. It could also put a chill on the angel investments that fuel innovation in hubs such as Silicon Valley.

Critics argue that the Trump administration, which has put deregulation at the centre of its agenda, and the bill's backers in Congress are underestimating the bureaucratic monster they are creating. Treasury officials insist they do not want to do that, but former officials are sceptical.

Hoang Nguyen
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Extras

Hot Topic

Tax cuts and capital structure

Julius Nimtz
Financial Markets Division

The US tax rate cut has been on everyone's mind. A tax rate of 21% might mean that the optimal capital structure consists of less debt than before. CFOs were wary in the past to just optimize the capital structure, paying attention to ratings and financial flexibility. Now they might have a case to reduce debt to reach the optimal capital structure.

Plenty of business students are hunted by calculation methods for the cost of capital. Many stumble about the fact, that most accounting systems in the world allow interest to be deducted as costs, reducing the tax burden. Cost of debt has therefore to be adjusted for this tax shield. A larger amount of debt and thus interest payments reduces the cost of capital till creditors charge higher interest to offset for their increasing risk. In the literature, this is a trade-off described in general between more debt and increasing cost of financial distress. However, companies seem not to follow this approach, carrying too little debt. Surveys show, that CFOs, while having this optimization in mind, rather care about maintaining a set credit rating and keeping financial flexibility high, surprising academics as companies seem to leave money on the table.

Over the last two and a half decades however, the number of S&P non-financial companies rated at BBB as more than doubled, up from 21% in 1993 to 44% in 2017. AAA rated companies are nearly non-existent with just 1% of the latest data (8% in 1993), while AA and A rated companies represent just 10% and 37% compared to 19% and 41%, respectively. Further calculations by J.P. Morgan indicate, that the Minimum WACC for a company would be achieved at a rating of BBB, given a tax rate of 35%. At 25%, this changes to A- and increases cost of capital by about 20 bps.
The latest US tax cut reduced the tax rate to 21%. However, many companies had an effective tax rate way below 35%. But the tax cut comes with a lemon as well, interest deductibility will be restricted to 30% of EBITDA (EBIT after 4 years), further reducing the benefits of higher leverage for heavily indebted companies. This new rule will overall put 26% of all companies worse off in terms of interest deductibility, according to Reuters. Most negatively impacted sectors include technology and semiconductors, wholesale distribution and healthcare services and products with 47%, 39% and 35% of companies being worse off, respectively. Without interest deductibility, companies might be incentivised to reduce leverage as incremental increases in the cost of financial distress can not not offset by reductions in the cost of capital.

Looking at how companies react to this changes is slightly surprising. Morgan Stanley analysed more than 400 earnings calls of US, investigating how they will use the cash that is freed through the cuts. While most say they want to invest in the US, the overall increase in capex against already planed numbers is limited. Most of the money will be spent on buybacks and dividends. But just 6% of companies want to reduce debt.
Data on past tax cuts did not indicate that companies to reduced debt levels, but this might be due to level of leverage still not reaching the minimum of WACC. Now, however, we might be at a turning point. Given that CFOs prefer less debt to maintain higher ratings and have more flexibility, now investors might not have the argument of cost of capital optimization to argue for higher leverage, in fact, some might argue for less debt for this purpose. This process would not happen quickly, as current surveys indicate, however, investors should keep the possibility in mind. The immediate impact might be limited, but in the long run companies might reduce leverage by less issuance activity, probably first seen by companies that repatriated cash. Furthermore, financial engineering to drive EPS growth might be limited in it effectiveness, putting the scope back to fundamental improvements.

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Thank you!

Visit www.**novainvestmentclub.com** for more updates.

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