NIC

— Nova Investment Club —

Newsletter

November 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 past month. In our Deeper Dive section Philip Hunold elaborates on the new regulations for Facebook, Amazon & Co., by explaining the main reasons behind Europe's assertive role in setting the bar for data privacy regulation. Furthermore, in our regional view Sérgio Ferrás examines the UK Budget and how it may impact globalization.

Our Investment Banking Division will guide you through October's M&A overall activity. Moreover, you may read about T-Mobile´s merger with Sprint Corporation, Energy Transfer Equity's bid for Energy Transfer Partners and Barrick's bid for Randgold. Additionally, get a detailed overview on what happened to ThyssenKrupp and Royal Dutch Shell.

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. The active positioning of the NIC Fund in October saw one of the worst sell-offs since the financial crisis, a development we would like to reverse over the upcoming months. More precisely, NIC Fund's significant exposure to equity markets (i.e. the single worst performer of the month) made it shrink down by 4.63% in October.

Lastly, Francisca Anselmo analyses to which extent BoJ's quantitative and qualitative monetary easing program (QQE) has impacted Japanese asset prices, Duarte Alves Pereira examines and comments on Brazil's newly elected President Jair Bolsonaro, and Rita Silva Marques evaluates the final negotiations for Brexit and Irish backstop.

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Macro Overview

Monthly

November 3rd, 2018

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Market Moves

Market moves

% change

	Last Close	-1W	-3M	YTD
S&P 500	2 723	2,52%	-3,31%	1,85%
DJIA	25 271	2,80%	-0,57%	2,23%
Nasdaq	7 357	3,50%	-4,10%	6,57%
MSCI World	2 780	2,64%	-6,96%	-6,70%
MSCI EM	3 608	4,21%	-8,63%	-18,24%
Russell 2000	1 548	5,40%	-7,35%	0,81%
Euro Stoxx 50	3 214	2,69%	-8,82%	-8,26%
FTSE 100	7 094	1,88%	-8,45%	-7,72%
Nikkei 225	22 244	0,69%	-1,37%	-2,29%
Hang Seng	26 486	4,90%	-7,34%	-11,47%
Dollar Index	96,54	0,11%	2,10%	4,80%
EUR/USD	1,139	-0,04%	-2,59%	-5,14%
GBP/`EUR	1,139	0,71%	1,43%	1,13%
GBP/USD	1,297	0,69%	-1,17%	-4,02%
USD/JPY	113,2	0,84%	1,20%	0,45%
USD/CHF	1,004	0,56%	1,33%	3,00%
Brent Crude	72,83	-4,38%	-1,91%	8,91%
Gold	1 233	0,45%	0,78%	-5,80%

Generic bond yields

change in bps

	Last Close	-1W	-3M	YTD
US 10Y Yield	3,212%	10,9	25,2	80,7
GER 10Y Yield	0,428%	3,2	-1,5	0,1
JPY 10Y Yield	0,129%	-0,6	6,7	8,1
UK 10Y Yield	1,494%	3,7	16,4	30,4
PT 10Y Yield	1,884%	-9,6	14,3	-5,9

**Source: Bloomberg, as of 2018-10-31*

In Focus

October

US employment situation tops estimates. In October, US unemployment rate remained at a 45-year record low of 3.70%, with non-farm payrolls increasing by 250,000, well-ahead of estimates of only 190,000 new jobs. Additionally, private payrolls also rose by 227,000, and average hourly earnings surged 3.10%, breaking the 3.00% barrier for the first time since 2009.

US economy continues to grow at accelerated pace. US GDP increased by 3.50% in Q3, topping analysts' estimates. Growth in GDP was mainly driven by the 4.00% increase in consumer spending. Despite that, PCE price index only rose by 1.60%, a number significantly lower than the expected 2.20%.

FED leans towards gradual interest rate rises. Fed's vice-chairman Clarida pointed to an optimistic outlook on the US economy. Improvement in productivity and business investment, healthy household finances and higher capital spending, resulting from recent tax cuts, support FED's decision of not to pursue aggressive hikes in short-term interest rates.

Eurozone inflation rises to highest levels since 2012. YoY inflation rate reached 2.20% in October, the highest value since December 2012. This represents a 0.1 pp hike from last month. Consumer prices were mainly driven by the increase in energy prices, that rose 10.60% over the last 12 months. Nonetheless, core inflation reached only 1.10%, below analysts' expectations. As a consequence, long-term inflation pressures remain week.

Unemployment in Eurozone at lowest levels since 2008. Eurozone Labour Market remained strong in September, boosting policy makers sentiment. Average unemployment rate for the 19 Euro Area countries dropped to 8.10%, the lowest level since November 2008.

BoJ revises inflation forecasts down. BoJ decreased its inflation forecasts to 1.40% and 1.50% for 2019 and 2020 respectively, as momentum in Japanese economy is not sufficiently firm to ensure price stability.

Chinese GDP growth slows down. Chinese economic YoY growth decreased for Q3 to 6.50%, a drop of 0.2 percentage points from the previous quarter. The result comes 0.1 pp short of the 6.60% expected target. On a quarterly basis, Chinese economy grew 1.60%. However, recent results have been drawing increasing scepticism among experts as 6.50%-6.70% growth rates every quarter clash with the deleveraging trend in China and with the recent US-China trade war.

Bolsonaro set to be Brazil's next President. Far-right candidate, Jair Bolsonaro, won on the 27th of October 2018 election with 55.10% of the votes against the PT party candidate Haddad. Despite concerns over unorthodox policies, investors reacted well to the news, with the Bovespa index jumping to a new record high.

IMF predicts worse-than expected outlook for LatAm. Latin America is projected to be the weakest economy among EMs, growing only 1.20% in 2018 and 2.20% in 2019. Argentine GDP contraction was revised to 2.60% in 2018 and 1.60% in 2019, worse than the country's official forecasts (2.40% and 0.50%).

Gonçalo Marques
Financial Markets Division

Deeper Dive

GAFA: New regulations for Facebook, Amazon & Co.?

Philip Hunold
Investment Banking Division

Why has Europe taken such an assertive role in setting the bar for data privacy regulation?

"In Europe, there is a belief that the increased economic and societal importance of data processing warrants strong legal protection of individual privacy"

- Christopher Kuner, Professor of Law at the Vrije Universiteit Brussel (VUB)

The recent controversy including Cambridge Analytica and Facebook, demonstrate a new and higher public sensitivity to new regulation proposals for US tech giants. We can divide the regulations and concerns into the two main segments: Data privacy policies and unbridled growth and influence in their specific market.

The European Union made the first step into the right direction through launching the GDPR (General Data Protection Regulation) in May 2018, to protect clients and their data. Other practical examples of EU data-actions and an increase in sensitivity are the €13bn in tax re-payments from Apple on the Irish government, €2.7bn fine levied against Google for unfair search practices and some investigations against Facebook´s data privacy policies.

What are the reasons why the EU, and not the US, prioritizes the data regulation?

Elenor Fox, a professor and antitrust expert at NYU School of Law, sees cultural differences and historical precedent as main reasons for this trend. She drains this off the fact, that the EU is more sceptical, whether the markets will work efficient without any intervention from the government or not.

Under a historical perspective, the competition law used to play a key role in driving European Union integration. According to Fox, the EU system is less reliant on the courts and has a lower threshold for proving dominance, the European equivalent of monopoly power. As a result, EU policymakers have both more will and more viable pathways for regulating tech.

The investment bank Goldman Sachs expects that the impact of compliance with GDPR will be manageable for key internet companies like Facebook, Amazon or Google. Heather Bellini, Software and Select Internet Analyst at GS finds that Google's search business—which bases advertising primarily on search queries rather than personal data—should be particularly well-insulated. While Facebook is more exposed, Bellini thinks the company may be able to mitigate the adverse impact on ad revenue if it succeeds in obtaining the necessary consent from its users. In addition, costs associated with GDPR compliance may pressure smaller competitors, unintentionally strengthening the position of bigger companies.

Another question that should be asked in terms of regulation is if the size - market capitalization - and the relevance - market power - is considered as a problem for other industry players and clients. Through a practically unprecedented growth and reach, companies like Facebook, Google and Amazon will almost certainly continue to raise concerns about market power and could grow, if wrong regulations are placed.

What risks, associated with regulations, should investors consider?

All that said, given the Tech sector's outsized influence on the broader stock market, the risk to investor portfolios with Tech leadership during a market crumble could be caused by regulatory (or other) concerns. Tech's 25% weight in the S&P 500 is on par with the share of Energy in the early 1980s, Tech in the late 1990s, and Financials in the mid-2000s—all episodes that didn't end well.

Today, we already see a slow increase in sell-off movements in the index, meaning investors cut their exposures to it, without reallocating.

Philip Hunold
Investment Banking Division

Regional View

UK Budget: Tipping point for globalization?

Sérgio Ferrás
Financial Markets Division

"We are at a turning point in our history and we must resolve to go forwards, not backwards"

– Philip Hammond, Chancellor of the UK

On Monday, the UK chancellor Philip Hammond presented the budget for 2019. Public spending is expected to increase GBP 500 m for the next year, setting the largest giveaway budget since 2010. Amongst many new ideas, a new digital tax policy for large technology companies stands out.

Scandals such as the Cambridge Analytica one question the role of tech giants on our society, putting them under great scrutiny. Questions also arise regarding the industry's low effective tax rates. The European Commission concluded in a study that Facebook paid 0.005% tax to the Irish authorities on 2014, compared to the corporation tax rate of 12.50%.

The problem of taxing foreign tech firms generalizes through the entire world. Their level of digitalization makes it hard to track revenues' origin, complicating their business taxation. Amazon, eBay, Facebook and Google all came under criticism over their low corporate taxes.

In order to rebalance things, the UK government is set to introduce a new taxation on digital services, with a levy of 2.00% on big tech companies revenues. Analysts' concerns about possible impacts on home digital businesses were relieved as the chancellor stated the tax would only target large, profitable companies with global revenues higher than GBP 500.0 m. According to Mr Hammond, the new levy could raise GBP 400.0 m per year, helping to finance higher public spending. The tax is set to start on April 2020, if no international agreement is reached until then.
At a time when Mrs May and her European counterparts seem to have difficulties finding an agreeement for Brexit, this move could represent a step further in shutting down the UK to the world. Despite several countries having issues with tax evasion from big tech companies, the UK's higher independence of international scrutiny allows it to act quicker. Earlier last month, Spain showed intentions of introducing a similar levy on companies which generate more than EUR 750.0 m revenues globally and EUR 3.0 m in Spanish territory. If the measure was viewed as protectionist, it could trigger an investigation from the European Commission.

Most of the big tech companies are US based, and Mr Trump is reevaluating all his country's trade deals. The UK could suffer a backlash if the US believes the digital tax attacks its most successful businesses.

With the uncertainty regarding Britain's future after 29th of March 2019, official Brexit date, Mr Hammond seems to be rolling the dices for the UK's economy. S&P Global Ratings warned last week that a no-deal Brexit would spark a long recession and a likely further reduction on Britain's credit rating. The UK is in extreme need of good allies, and such a bold move on the budget represents a huge risk for international trade.

On Wednesday, Brexit secretary Dominic Raab announced expectations of a deal before 21st November. On Thursday, Mrs May stated she had struck an agreement allowing British financial services companies to have continued access to European financial markets after Brexit, causing a sharp rise on the sterling, finishing at USD 1.2969. It seems the government is playing a huge bet on a retaliation-free Brexit, with Mrs May, Mr Hammond and Mr Raab trying to speed up negotiations. "We are at a turning point in our history and we must resolve to go forwards, not backwards", said the chancellor.
However, several diplomats in Brussels played down the prospects of a rapid breakthrough. Mr Hammond's budget is based on expectations of good economic conditions for the UK, although he says there is a backup plan ready to hold next Spring if his fiscal plans were blown off course by a no deal exit. Can Britain sustain its continued growth, or will a blow off in the negotiations severely damage its financials?

Sérgio Ferrás
Financial Markets Division

Macro Overview

Economic Calendar

Economic and Political Events

US Midterm Elections

Midterm elections tend to signal popular satisfaction towards the performance of the president and incumbent party. Democrats are set to be the grand winners in the historical **6th of November** midterm election.

Chinese Trade Balance

On the **8th of November**, China announces its international trade results. Trade Balance results and YoY variation of Exports and Imports signal to investors the ability of the Chinese economy to adapt and overcome the current trade war.

OPEC Monthly Oil Market Report

The OPEC releases analysis on recent world oil market developments and the outlook for the crude oil market on the **13th of November**. The report comes after a month of continuous losses in the major oil benchmarks.

Central Bank Decisions

BoE Rate Decision and Minutes

On the **1st of November,** the BoE will publish the Inflation Report and simultaneously announce the decision regarding interest rates. Note that BoE ability to conduct monetary policy operations is severely limited by the outcome of the Brexit.

BoJ Release Minutes

On the **5th of November**, the Bank of Japan will release the minutes of the 31st of October meeting. It will summarize opinions that led to the decision of maintaining monetary policy steady and to revise inflation forecasts downwards.

FOMC minutes

On the **29th of November**, the Federal Open Market Committee issues the minutes of the meeting 3 weeks ago. Essentially, analysts parse each word looking for clues to policy and hence, the minutes bear the potential for a market mover.

Inflation and Deflation

Chinese Producer Price Index

On the **9th of November**, the Chinese National Bureau of Statistics will announce the PPI. The index is particularly important to industry-heavy, commodity-based economies, to help defining interest and exchange rate targets.

US Consumer Price Index

US CPI will be published on the **14th of November**, translating the growth in consumer prices in October. Monthly inflation is expected to remain close to September values, at 2.40%, justifying expected future FOMC interest rate hikes.

Eurozone HICP YoY

On the **16th of November**, the ECB will publish the HICP. This Index measures inflation in Eurozone, using a standard methodology for all countries. Besides the price stability purpose, the HICP is used to determine if a country is ready to join the EURO area.

Labour Market

US Employment Situation

Developments of the US Labour Market in October will be published on the **2nd of November**. Outlook for October is positive, with unemployment expected to remain at 3.70%, average hourly earnings expected to increase 0.20% and with Non-Farm Payrolls expected to increase between 175k to 190k.

UK Unemployment Rate

UK ILO Unemployment rate will be announced on the **13th of November**. Jobless rate is calculated under International Labour Organisation standards and is set to remain at 4.00%.

Eurozone Unemployment Rate

On the **30th of November**, EU countries average jobless rate will be announced. It is expected to remain at current levels, with Q4 unemployment rate predicted to be 8.20%. This represents a 0.1 pp drop against the previous quarter.

Gonçalo Marques
Financial Markets Division

Investment Banking

M&A

Overall Activity

Global

The global M&A activity in October followed the trend already observed throughout the third quarter of 2018. M&A value decreased by 1% compared to year-on-year gains of 41% in Q2 and 23% in Q1. In the third quarter, there were 3,918 deals globally, worth a total of USD 709.5 bn which presented the lowest quarterly value since Q1 2016 (USD 627.9 bn) and which was 35.4% lower than Q2 (USD 1.09tn). The main cause for this decline can be attributed to growing geopolitical tensions, protectionism and particularly the trade war, with tariffs introduced by the US and China. In the third quarter, just four deals worth more than USD 10 bn were recorded after 28 such deals were announced during this year's first half. Moreover, Energy, Mining & Utilities saw the most deal value of any sector at USD 196.8 bn spread across 320 transactions. More than half of this total came from five megadeals for oil and gas targets, three in the midstream segment and two in exploration and production. As of Q3, Citi holds the leading position, in value terms, as number one global financial advisory with a total value of USD 173,671 m while Goldman Sachs & Co secured the first place, in volume terms, advising a total of 80 deals.

Selected Regions

North America

1,406 deals were announced in October 2018, representing the lowest deal flow for the current year. However, M&A value has recovered from recent months and grew from USD 95.1 bn in September to USD 113.2 bn in October. This increase was mainly driven by two deals, IBM's acquisition of Red Hat and Harris Corp's merger with L3 Technologies, which together accounted for roughly 44% of overall value.

EMEA

In the MENA region, M&A deal value spiked in October to USD 6.3 bn with Saudi British Bank's acquisition of Alawwal Bank being the largest Saudi banking M&A deal recorded thus far. Comparatively, both volume and value of M&A deals based in Central and Eastern Europe declined over the month under review, decreasing from 362 deals with a value of EUR 10.1 bn in September to 284 deals worth EUR 5.4 bn in October.

Asia

In the first half of 2018, the value of China's M&A activity declined to USD 348 bn (18.00% decrease) compared to the second half of 2017. This slowdown may reflect the Chinese government's commitment to deleveraging, which has had some impact on M&A, especially among listed companies. The impact of the current trade war may be limited, as deals with the US have already been at low levels for the past 18 months.

M&A

Deals of the Month

Announced Date	Target	Buyer	Target region	Target business	Value (USD m)	Premium (%)
28 Oct 18	Red Hat	IBM	US	Computer Software	34,000.00	63.00%
14 Oct 18	L3 Technologies	Harris Corporation	US	Computer Software, Defence, Industrial Products and Services, Telecommunications (hardware)	15,704.00	-
22 Oct 18	Magneti Marelli	Calsonic Kansei Corporation	IT	Automotive	7,125.00	-
18 Oct 18	OppenheimerFunds	Invesco Ltd	US	Financial Services	5,715.00	-
04 Oct 18	Alawwal Bank	Saudi British Bank	SA	Financial Services	4,773.00	10.20%
23 Oct 18	Peoples	Aqua America	US	Natural Gas	4,275.00	-
11 Oct 18	BMW Brilliance Automotive (25.00% Stake)	BMW AG	CN	Automotive	4,193.00	-
25 Oct 18	Nexperia (75.86% Stake)	Wingtech Technology	NL	Computer (Semiconductors)	4,070.00	-
10 Oct 18	Esterline Technologies Corporation	TransDigm Group	US	Defence, Chemicals and Materials, Industrial Automation, Electronics, Products and Services	4,000.00	38.00%
08 Oct 18	Rowan Companies	Ensco	US	Energy	3,765.00	26.40%

Viktoria Wagner & Cong Tuan Phuoc
Investment Banking Division

M&A: Top Deals

T-Mobile and Sprint Corporation to merge

The third and fourth largest mobile network operators in the US agreed to merge in an all stock transaction at a fixed exchange rate of 9,576 shares of Sprint for each of T-Mobile , valuing Sprint and T-Mobile at, respectively, USD 26.5 bn and USD 54.8 bn.

Buyer vs Seller

T-Mobile US is a wireless network operator and is a subsidiary of Deutsche Telekom. Deutsche Bank and PJT partners are providing financial advisory to T-Mobile. The parent company recently approved the deal, being Goldman Sachs the advisor. Sprint also provides wireless services and is owned by SoftBank. Raine and JPMorgan advised SoftBank and Sprint, with Centerview helping the special committee of directors. To prepare for regulatory proceedings Marcelo Claure was replaced by Michel Combes as CEO.

Industry Overview

The next era of the telecom industry lies in the 5G network, similarly to 4G in the past. The infrastructures needed are costly, opening the door for concentration. Namely, AT&T, who recently acquired Time Warner, a media company, for USD 85.0 bn.

Regulatory costs in the US were reduced to incentivise further investments in 5G infrastructures, since China has outspent the US in the last 3 years by USD 25.0 bn.

Peers	Currency	Market Cap (CUR m)
AT&T Inc	USD	222,353.55
Verizon Communications Inc	USD	231,599.45
TELUS Corp	CAD	27,116.45
United States Cellular Corp	USD	4,064.55
Telephone & Data Systems Inc	USD	3,351.70

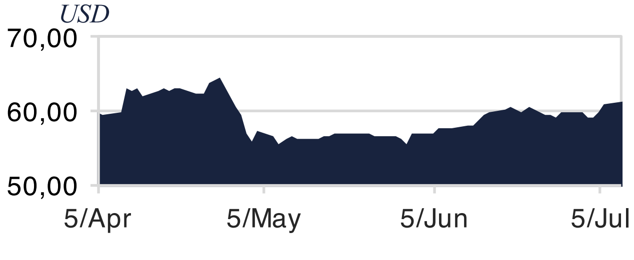
Deal Rationale

The merged company, New T-Mobile, will be capacitated to rapidly create a strong 5G network. New T-Mobile plans to invest USD 40.0 bn in the first three years, 46% more than T-Mobile and Sprint combined. Run rate cost synergies are predicted to be USD 6.0 bn, yielding a net present value of 42.0 bn. As competition increases, prices will drop and the new company cost structure would be able to sustain the heat. Customers will amount to 70.0 m, shortening the distance to Verizon and AT&T. The group would have Pro Forma adjusted earnings before interest, taxes and depreciation of USD 22.0-23.0 bn.

Market reaction

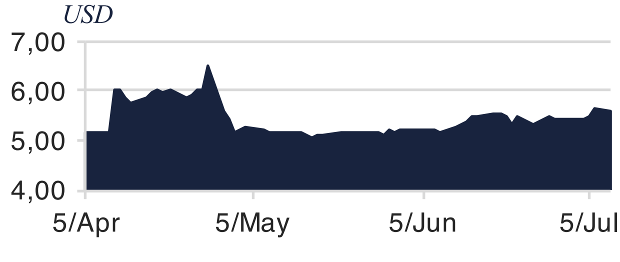
T-Mobile

Upon the announcement of the merger on April 29th the T-Mobile´s stock price dropped more than 13% in the following 3 days. The drop occurred as it was overpriced in comparison to Sprint at the fixed exchange rate.



Sprint

Sprint´s prices dropped nearly 20% from 30th Abril to 3rd May, hitting minimums of USD 5.21 . On the following months prices stabilized since it is pegged to T-Mobile´s stock.



Future Challenges

The deal is contingent on Federal Communications Commission approval. The merger is expected to face antitrust backlash, since it implies decreasing the major number of telecom carriers from 4 to 3. In the past 2014, both parties entered talks but the agreement was cut lose by the regulator. With Trump in the Oval Office, pressure to outpace China and a liberal views on the economy may swing the votes this time.

Vasco Lupi
Investment Banking Division

M&A: Top Deals

Energy Transfer Equity, LP. acquired Energy Transfer Partners, LP

The American master limited partnership Energy Transfer Equity (ETE) completed on the 19th of October an agreement to acquire Energy Transfer Partners (ETP) for USD 25.0 bn, making it the largest transaction in the pipeline industry to date. The deal has simplified the overall structure of the companies, increasing transparency for investors in the Transfer Energy family.

Buyer vs Seller

Energy Transfer Equity is through their ownership of general partners and incentive distribution rights in several companies, including ETP, exposed to a variety of segments dealing with natural resources, including storage and transportation of natural gas and crude oil. Energy Transfer Partners is a diversified energy market player, with complementary operations in the same segments. The market capitalizations of the companies were 25.0 bn and 20 bn, respectively, on the announcement day.

Industry Overview

Despite an industry standard of long-term contracts with fixed fees, the midstream energy market follows behind commodity prices; oil and gas prices have currently stabilized at levels which encourage increased exploration activity, leading to favourable market conditions for pipeline suppliers. In addition, record high demand for clean energy and impending sanctions on Iranian oil underscore strong future growth in capital expenditures.

Peers	Currency	Market Cap (CUR m)
Tallgrass Energy LP	USD	6,080.27
SemGroup Corp	USD	1,541.25
EQGP Holdings LP	USD	4,812.12
Energy Transfer LP	USD	41,426.49
MPLX LP	USD	27,394.13

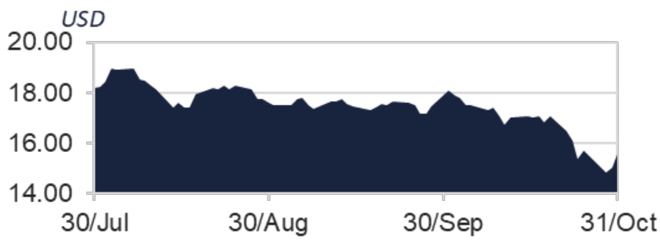
Deal Rationale

The deal serves to further align the economic interests of the Energy Transfer Family; an immediate consequence of the deal is the improvement of distribution coverage, as ETE agreed to cancel their incentive distribution rights in ETP. This will, in turn, improve the company's ability to pay off debt and result in lower cost of capital, facilitating future growth. The acquisition agreement of 1.28 units per unit, implying a share price of USD 23.59, provided a premium for ETP's shareholders of 15% on 10-day VWAP while at the same time serving ETE's shareholders by having an accretive effect on distributable cash flow.

Market reaction

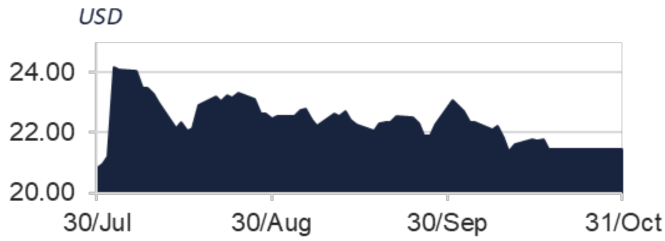
Energy Transfer Equity, LP

The initial market reaction to the announcement was a price increase of 4.00%, but later movement has seen a steady decrease to USD 15.54. Nonetheless, Moody has placed the company's rating under review for upgrade.



Energy Transfer Partners, LP

The share price rose to USD 24.18 following the announcement, overshooting the transaction's acquisition premium. The final price of the stock before the takeover was USD 21.47.



Future Challenges

US President Barack Obama stated during his presidency that "[American companies] have added enough new oil and gas pipeline to circle the Earth and then some." However, previous years' fear of overcapacity in the midstream energy market is currently replaced by a very solid near-term outlook for the industry. Depending on commodity prices, the pipeline industry is likely to either see continued high M&A-activity or accelerated deleveraging, fuelled by demand and change in interest rates.

Birk Carlenius
Investment Banking Division

M&A: Top Deals

Barrick to acquire Randgold

The Toronto-based gold miner Barrick Gold has placed a bid to acquire London-listed Randgold for a striking USD 6.0 bn. The merger between the two majors in gold mining is set to place Barrick at the top of the gold producer stack.

Buyer vs Seller

Barrick Gold operates gold mines and projects in ten countries and 75.00% of its gold production comes from the Americas. Reflecting its comparatively modest size, Randgold Resources Ltd manages just five mines in three African countries. For the purpose of the deal, Morgan Stanley and M. Klein and Co. are the financial advisors for Barrick, while CIBC and Barclays are supporting the South African company throughout the share-to-share merger.

Industry Overview

The 2000s witnessed a rally that drove gold prices above USD 1,800 an ounce, leading miners to take on huge amounts of debt to fund optimistic investments. As prices dropped to less than USD 1,200 an ounce over the past 7 years, gold companies consequently underperformed the market with some struggling to fulfil their financial commitments. Barrick's bid is an effort to create a global player that can leverage the strength of both companies.

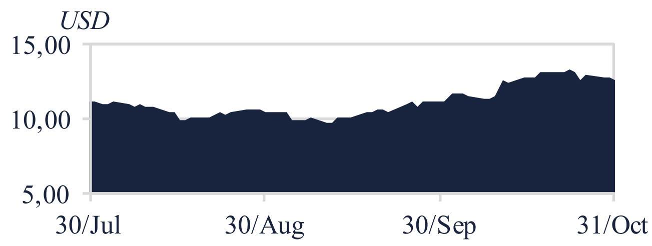
Peers	Currency	Market Cap (CUR m)
Polyus PJSC	RUB	554,078.30
Newcrest Mining Ltd	AUD	15,741.50
AngloGold Ashanti Ltd	ZAR	58,054.81
Cia de Minas Buenaventura SAA	PEN	12,632.04
Kinross Gold Corp	CAD	4,563.34

Deal Rationale

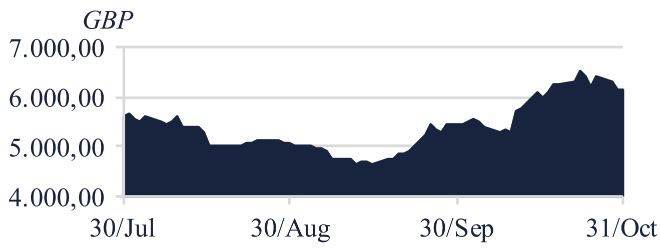
Barrick Gold is looking to tap into Randgold's high quality assets and experience navigating African politics, while the South African miner could benefit from its acquirer's global presence and infrastructure. The mega-merger will create the world's largest gold miner, with a market capitalisation of USD 19.4 bn. The combined company would own five of the world's ten lowest-cost gold mines and the highest adjusted EBITDA in the sector. However, some investors in Barrick are wary of its sudden exposure to the volatile African markets, while Randgold's shareholders are bound to hold some resentment over the no-premium deal.

Market reaction

Barrick Gold Corp.
Upon the merger announcement on September 24, Barrick's stock rose 5.40%, later soaring to a three-month maximum of USD 13.34 per share on October 23.



Randgold Resources Ltd.
Having declined to its lowest value since 2016, the Africa-focused company's share price shot up by 6.00% following the announcement, hitting GBP 6,534 in October 23.



Future Challenges

A significant part of the deal's success hinges on Randgold CEO Mark Bristow's ability to transpose his asset picking talents to a global scale and whether his expertise in African politics will unlock some of Barrick's unproductive mines. Amid Randgold's shareholders scepticism, Barrick has made and will likely keep making efforts to guarantee their approval, such as recently announced increased dividends. It remains to be seen if this African adventure was a bold investment or a dangerous bet.

Vera Teixeira Wahnon
Investment Banking Division

What happened to

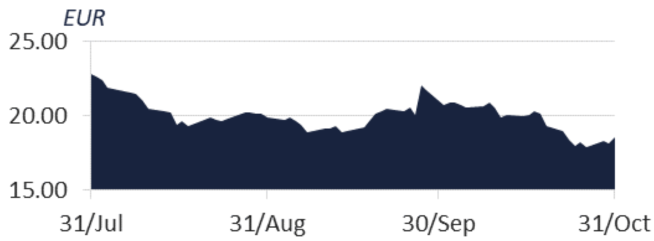
ThyssenKrupp

ThyssenKrupp is a German diversified industrial conglomerate focused on five business areas: Components Technology, Elevator Technology, Industrial Solutions, Material Services and Steel Europe. The company employs more than 158 thousand people in 79 countries, making it one of the biggest European companies.

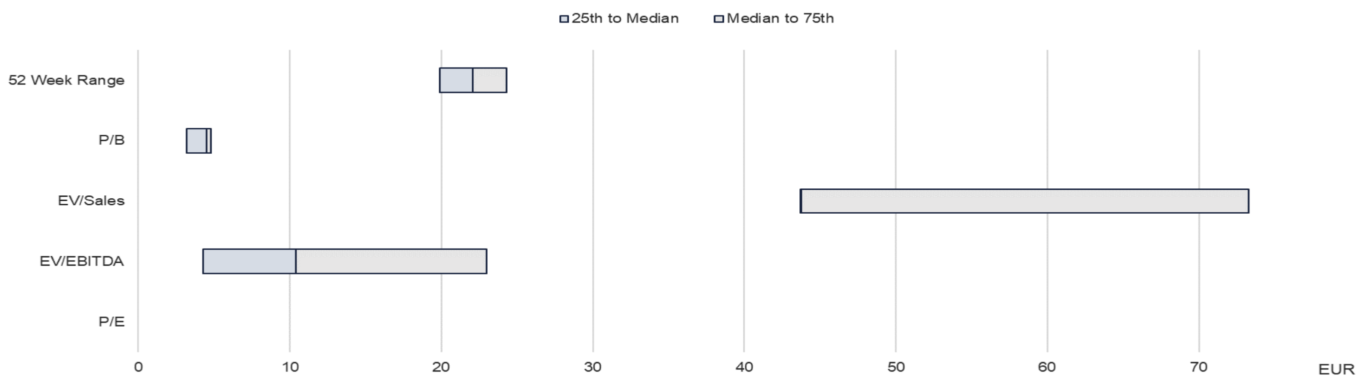
Corporate News

As of end September 2018, ThyssenKrupp announced its strategic new set-up initiating the separation of the company's business into two independent listed companies. The first independent entity, ThyssenKrupp Industrials, shall comprise the Components Technology, Elevator Technology and Industrial Solutions while the second one, ThyssenKrupp Materials will inherent Material Services, Industries, Marine Systems and the Steel JV with the Tata Group. The separation paves the way to delink the company's faith from the cyclical steel business which still makes up nearly 44% of its operative earnings. Further the move unites majority stakeholders like the Krupp Foundation and Cevian Capital which paralyzed the company with their different views and expectations on the future strategy. The implementation of the greatest restructuring in the company's history will be governed by the new CEO Guido Kerkhoff which is backed by the recently appointed chairman Bernhard Pellens.

Price (31 Oct 18, EUR)	18.83
Targe Price (EUR)	26.00
3M Performance	-17.51 %
Market Cap (EUR m)	11,719.16
Enterprise Value (EUR m)	16,400.16
Target Price is for 12 months	



Valuation Analysis



ThyssenKrupp was, on the day of writing, trading at EUR 18.35 (close to the stock’s 2-year low). By looking at the football field overview a dispersed picture can be observed, which indicates an overvaluation of the stock. But even more interesting than the overall current valuation is the question whether the two companies which are about to be created will do better than the existing one. The lag of a clear positive stock price trend underlines the uncertainty about that.

ThyssenKrupp has gone through a long crisis in the recent past. The split of the business may now be the turning point which could reveal the true potential of the some of the business units. Nevertheless in the short-term view risk from excess capacities in the mentioned steel sector, leveraged by the political crisis in the US and anti-trust issues with regards to the steel JV with Tata should be observed closely by investors.

Peers	Currency	Market Cap (Cur m)
Salzgitter AG	EUR	2,130.44
SSAB AB	SEK	32,738.33
Vallourec SA	EUR	1,944.62
Ternium SA	USD	6,209.21
Tenaris SA	EUR	

Tim Borneck
Investment Banking Division

What happened to

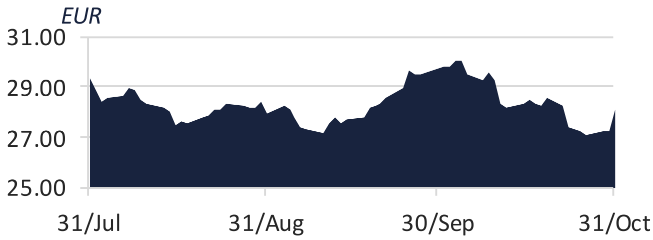
Royal Dutch Shell PLC

Royal Dutch Shell, the world's second largest listed oil and gas company, announced third-quarter earnings that rose by more than 35% compared to a year ago, helped by higher oil prices and its gas trading division, but still fell below analysts' expectations. Investors are keeping an eye on the firm for its highest quarter results in four years aligned with the buyback programs ahead.

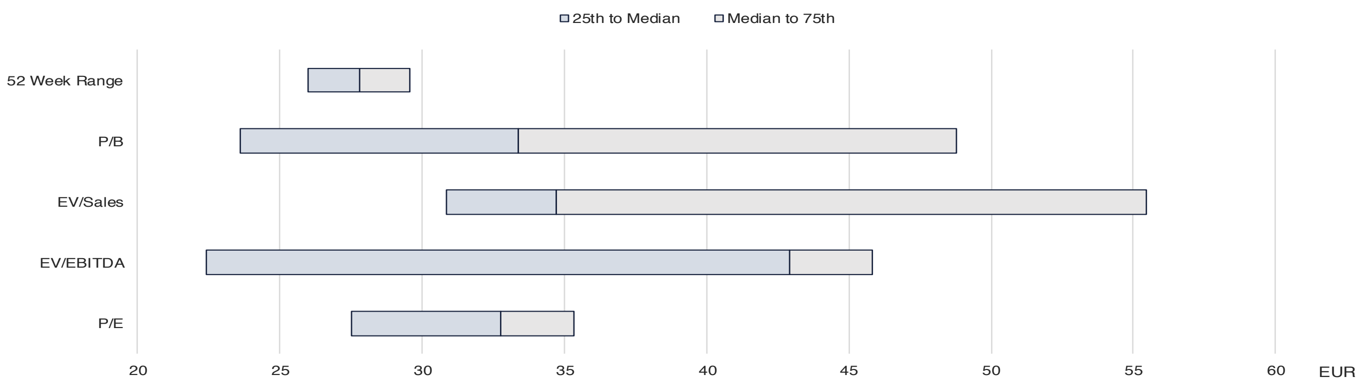
Corporate News

Since the 2014 oil price crash, the company has focused on reducing costs, pulling back on spending and selling almost USD 30.0 bn of assets to cut its debt pile. Additionally, the WTI average crude oil price for this quarter was recorded at USD 70.0 per barrel compared to an average of USD 48.0, the year-ago respective price. This way, Shell was able to record a 60% rise of its cash operating profit to USD 12.1 bn, yielding a USD 5.6 bn net income for this quarter, 39% more than a year ago. Despite stronger oil and gas prices as well as bigger contributions from trading operations, Shell's profits were offset by weaker refining margins, tax and currency exchange effects. Shell launched a USD 25 billion share buyback program in July, making good on a promise to boost shareholder returns following the 2016 acquisition of BG Group, in a show of confidence in its future cash generation and profit growth outlook. The firm completed the first tranche of buybacks in October for USD 2.0 bn.

Price (31 Oct 18, EUR)	27.69
Targe Price (EUR)	32.60
3M Performance	-5.62%
Market Cap (EUR m)	231 234.27
Enterprise Value (EUR m)	326 918.56
**Target Price is for 12 months*	



Valuation Analysis



Shell was trading at EUR 27.69 in 31/10/2018 in the Euronext Amsterdam. After the announcement of the quarterly results, its shares plummeted as earnings fell below the expected USD 5.7 bn. However, the 52-week change of the stock price is 4.30%, which emphasizes the investors' belief in the company. The price valuation analysis above indicates a median valuation of approximately EUR 35.0 for all ratios, suggesting that Shell is undervalued compared to its peers.

The energy industry has been going through several changes both in trends and legislation. The company, which has shifted its business heavily away from oil amid a global shift towards cleaner fuels, last month approved a massive USD 12 bn investment in a liquefied natural gas project to send the supercooled fuel from Canada to China. This emphasizes the fact that Shell is not only following the industry but also shaping it.

Peers	Currency	Market Cap (Cur m)
Repsol SA	EUR	24 652.90
BP PLC	GBp	110 040.72
Equinor ASA	NOK	718 146.03
MOL Hungarian Oil & Gas PLC	HUF	2 463 215.07
Galp Energia SGPS SA	EUR	

João Sousa Mendes
Investment Banking Division

NIC's view on

Tesla's Q3 Earnings: A breath of fresh air or a turning point for the company?

Pedro Leão
Financial Markets Division

"Our goal is to produce electric cars everyone can afford (…) We're probably less than six months from that."

– Elon Musk

Tesla released last month its third quarter earnings, delivering a net income of USD 1.75 per share, beating analysts' estimated losses of USD 0.19 per share. These are great news for investors after reporting a loss of USD 4.22 per share last quarter and a loss of USD 3.70 per share a year ago. Revenues increased 129% from Q2 levels to USD 6.8 bn, on 83,500 delivered cars this quarter (55,840 of which were Model 3's) and average production of roughly 4,300 cars a week, clearly lower than the initial goal of 10,000 per week and slightly under the revised goal of 5,000 a week (producing 5,300 Model 3's in the last week of Q3). What made such results possible was the surprising gross profit margin of over 20% (an important figure when it comes to profit sustainability in the long-run) beating Tesla's own prediction of 15%, which was more conservative after a negative figure in the previous quarter. Even more relevant is the fact that Tesla increased its total cash by USD 731 m and had USD 881 m in Free Cash Flow (ending Q3 with USD 3.0 bn of cash and cash equivalents). Thus, an investors´ fear of refinancing in the short term was warded off.

The timing for the release was perfect after months of uncertainty, due to the SEC's investigation of Elon Musk's tweet from the 7th of August saying he was "considering taking Tesla private at $420. Funding secured." with the shares trading around USD 343, that led to accusations of market manipulation with the intent to "burn shorts". As a result of the investigation (and the funding not being secured after all) both Elon Musk and Tesla were fined USD 20 m each. Also, Elon had to step down as Tesla's chairman for three years, Tesla will have to elect two new independent board directors and put processes in place to control its CEO's communications.

Tesla has also struggled with internal problems in the past two years as more than twenty executives left the firm. The most recent ones were the company's chief people officer Gabrielle Toledano, the vice-president of communications Sarah O'Brien and the chief accounting officer Dave Morton, who upon leaving on the 4th of September triggered a selloff in Tesla's stocks. This was complemented by Elon Musk´s appearance at Joe Rogan's podcast the night before, where he smoked marijuana with the host, raising concerns among investors about the CEO's mental state.

Tesla still faces challenges going forward, having to maintain its profitability with the cheaper versions of Model 3. Musk already mentioned the company has moved from "production hell" to "delivery logistics hell" at a time where competition is rising (Saudi Arabia's sovereign fund just invested USD 1 bn in Lucid Motors, a Californian EV rival; Nio, a Chinese competitor, raised USD 1 bn in September at the NYSE; and Audi just unveiled the E-tron, a sports-utility EV).

Nonetheless, Q3 was a huge victory for Tesla. The company still has the potential to revolutionize the electrical vehicle market in the short-term and the autonomous car market in the long-run, being one of the front-runners (together with Waymo and others) in a market that may be worth USD 7 trillions in a couple of decades (according to Strategy Analytics and Intel).
To achieve this, the company still plans to build other Gigafactories in places such as China and Europe, and will have to invest heavily in R&D in the next decade to develop new products. The company will still have to raise a lot of capital, but now that it is cash flow positive, it is one step closer to achieving its goals.

Pedro Leão
Financial Markets Division

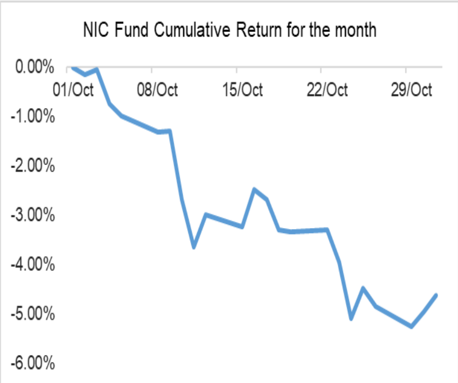
NIC

Nova Investment Club

NIC Fund

NIC Fund

Portfolio Overview

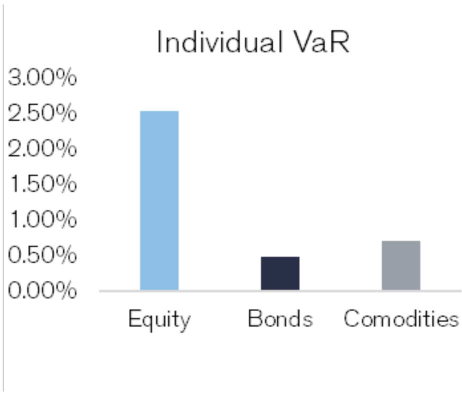


Portfolio Statistics

Cumulative Return	2.62%
Annualized Return	2.42%
Annualized St. Dev	6.27%
Info Sharpe	0.18
Skew (Daily)	-1.11
Kurtosis (Daily)	2.82

Benchmark

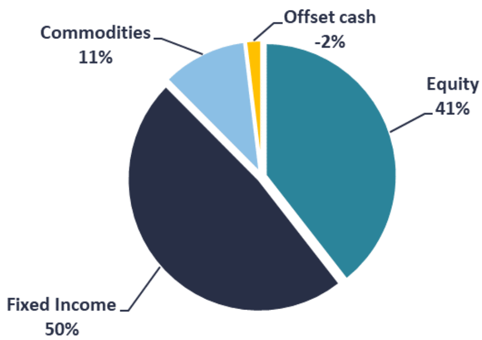
iShares 3-7 Year Treasury Bonds	55%
MSCI World ETF	30%
MSCI Emerging Markets ETF	5%
Inveso DB Commodity Index	10%



Portfolio Snapshot

Although the structure of the NIC Fund remained similar to benchmark fund, NIC Fund has had bigger exposure to Equities (41% of the fund), at the expense of Fixed Income (50%). Our commodities position represents 11% of the portfolio.

Within Equities, fourteen individual stock picks amount to almost 15% of the total allocation, while the remaining 26% were allocated to broad index funds. In Fixed Income, our duration remains underweighted. Commodities allocation is split between an index ETF (9%) and Brent futures (2%).



Return Metrics

Proving its infamous reputation, October saw one of the worst sell-offs since the financial crisis. S&P 500 lost over 6.9%, representing its worst month since September 2011. NIC Fund's significant exposure to equity markets made it shrink down by 4.63% in October. Equities alone were the single worst performer, responsible for a loss of 3.78%, while Commodities lost 0.95%. Meanwhile, Fixed Income provided marginal positive returns of only 0.09%.

While none of the stock picks gave positive return in October, the tech sector was arguably one of the biggest losers. Amazon crashed by 20.2%, contributing 25 bps negatively to the portfolio performance, and Nvidia was down by 27%, contributing 28 bps of losses. Financial sector was also particularly hurt. HSBC closed the month with -6.00%, HDFC Bank with -7.46% and Bank of America with -7.25%. These stocks contributed losses of 5 bps, 7 bps and 7 bps respectively.

Risk Metrics

During the October downturn, VaR of the NIC portfolio jumped to 2.7%. This level is above the established threshold of 2.5% and reflects the damage from the equity markets crash. Following the breach in VaR, necessary adjustments will be made to reduce the risk of the NIC Fund.

Among all investment classes in our allocation, Equities displayed the highest individual VaR — 2.55%. VaR for Fixed Income and Commodities was 0.49% and 0.72% respectively.

Vadim Nikitin
Financial Markets Division

NIC Fund

Assets in brief

Asset Class	Symbol	Comments
EM Equity	**EEM**	Emerging markets (EM) across the globe have had a rather disappointing year so far. In the three months to September, governments and companies raised the lowest amount of capital in seven years. YoY, Asia was the only region to expand its capital raising. Furthermore, the discount in emerging market equities to their developed world counterparts widened to 37%, its maximum value in three years. Due to the trade war´s impact, we underweight EM by 2 pp relative to the benchmark.
US Equity	**AMZN**	In its quarterly report Amazon, expressed conservative guidance for the next quarter, which includes highly important holiday season. Investors did not take it lightly and, despite growth in overall profits, Amazon stock dropped 9% on the news. Meanwhile, the company raised minimum wages for its workers in the US and the UK amid concerns over its compensation policies.
US Equity	**GE**	After the sudden departure of John Flannery, the company's ex-CEO, General Electric has announced a new restructuring plan and cut dividends to just 1 cent, down from 12 cents. GE faces increasing pressure from regulators, as its accounting practices are currently investigated by SEC.
EM Equity	**HK 700**	We decided to close our long position on Tencent, as the company's fundamentals look unfavorable. Formerly in the world's top 10 most valuable companies, Tencent was hit by the Chinese government campaign against video games, as well as the US-China tensions. The group's music streaming arm, Tencent Music Entertainment, decided to postpone its IPO in New York.
EU Equity	**HSBC**	HSBC surpassed earnings estimates for Q3, growing profits 8.3% YoY to USD 13.8 bn. Much of this can be attributed to the bank's efforts in cutting costs. In its push in Asia, the bank plans to become the first foreign company to list in China.
EU Equity	**BNP**	In the third quarter, BNP Paribas grew its net income to USD 2.12 bn, up 4% from the same quarter last year. This, however, was overshadowed by a lackluster performance in fixed-income trading. The bank was also highly exposed to troubled markets of Turkey and Italy.
EU Equity	**VOW**	Volkswagen saw its operating profits drop from EUR 4.3 bn to EUR 3.5 bn, as the company was hit by a slowdown in China and stricter regulation in Europe. Yet the German carmaker managed to beat analysts' estimations, as the market expected operating profits of EUR 3.2 bn.
EM Equity	**BABA**	Long on Alibaba was another position that we decided to close this month. Trade wars, China's slowing growing and increased internet control all contribute to the e-commerce giant's decline. Ant Financial, its fintech affiliate, fell from profit to loss in the last quarter.
US Treasury Bonds	**IEI ETF**	Our benchmark bond index, IEI invests in treasuries with maturities from 3-7 years. Across global markets, the concern over tighter monetary policy is growing, as the economy is posting strong results in terms of employment and wages growth. While IEI is the only fixed income position in the benchmark, 10.09% of the NIC Fund is invested in SHY - iShares 1-3 Year Treasury Bond ETF.
Commodity	**DBC ETF**	Our primary commodities index, DBC tracks a basket of 14 commodities. Oil, a major component of the index, fell below USD 73.0 a barrel as the market has grown accustomed to the upcoming US sanctions on Iran. Saudi Arabia, Russia and the US all increased their output over the past month. In the metals market, central banks bought USD 5.8 bn worth of gold in the third quarter — maximum since 2015 — following the strive to diversify their reserves.

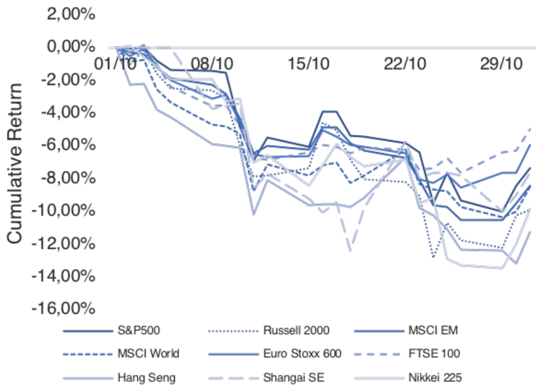
Vadim Nikitin
Financial Markets Division

NIC Fund

Equities

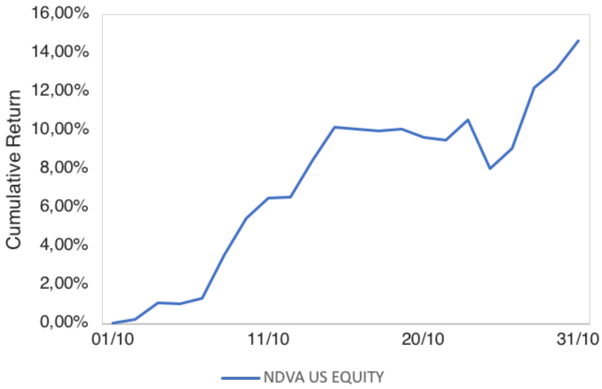
World Equities

Global equities have suffered in October, with a loss of 7.75 % for MSCI ACWI (All Country World Index). In early October, the market recorded a slight decline until the US Treasury bond yields peaked on 9th October and the markets reacted with an enormous downswing. The S&P500 decreased by 3.3 % on the 10th, with further indices following. Throughout the month the swoon was driven by computer-powered algorithmic investment strategies that readjusted their market exposure up and down according to the level of volatility, as leading experts of the industry said, even though investors also became more anxious. The biggest loss of -9.92 % was a recorded by Russel 2000. In November equity markets can expected to become bullish again as many companies beat analysts' expectations following the publishing of their latest quarterly results.



In depth: NVIDIA a high potential stock

NVIDIA has a huge growth potential because it is at the centre of two growth markets: gaming and artificial intelligence (AI). One major revenue driver is gaming, which is roughly 57% of revenue in 2018. Due to the popularity of graphical intense 3D games the demand for NVIDIA's GPU's is increasing. The company continues to roll out new technologies such as the Max-Q technology which is used on leading gaming laptops to stay one step ahead of the competition. Even though the market lowered its expectations of NVIDIA after the release of the second quarter report 2018, it remains a stock with huge potential. NVIDIA has a high exposure to the automotive industry collaborates with Volvo, Mercedes and Audi to evolve self-driving cars. Taking into account current gross profit margins of 60% with high growth potential and a Debt/Equity ratio of 22% the company is able to highly reward its equity investors, currently trading at USD 217.72 with a target price of USD 289.17 for 2019 according to the street consensus.



Our performance

In October, equities contributed negatively to the overall portfolio performance with a cumulative return of -3.78%.

The tech sector showed the biggest losses, e.g. Amazon dropped by 20.2%. The financial industry suffered as well, when shares of HSBC suffered a loss of -6.85%. With a capital allocation of 41% in equities of the fund, the especially bearish October for equities had a major impact on the overall fund performance.

Jan Schroff
Financial Market Division

NIC Fund

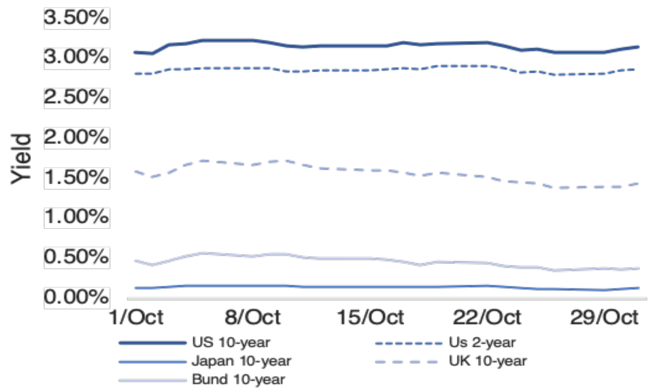
Fixed Income

World Yields

The 10-year US Treasury yield reached its highest level since 2011 at 3.23%, having remained consistently well above 3.00% in October. The increase is mainly explained by the rise in the federal funds rate to 2.25%, the expectations of a future hike by the Fed at the end of 2018 and the change from a QE to a QT strategy. October's stock sell-off, the strong dollar, a 3.50% GDP growth and rising wages also help to explain the recent yield performance.

The European bond market was marked by the rejection of the Italian budget draft by the European Commission and the downgrading of Italy by Moody's and S&P's negative outlook. However, it should be emphasized that Italian bonds have not been downgraded to junk so that the Italian debt can still be used as collateral at the ECB. The yield spread between the 10-year Italian bond and the 10-year German bond peaked on 18 October at 333 basis points. The ECB is holding interest rates unchanged but confirms its intention to phase out its QE program in 2019. At 1.71%, the 10-year yield on UK government bonds was the highest since 2016. Uncertainty about a worst-case scenario "no-deal Brexit" continued to affect the UK and the EU.

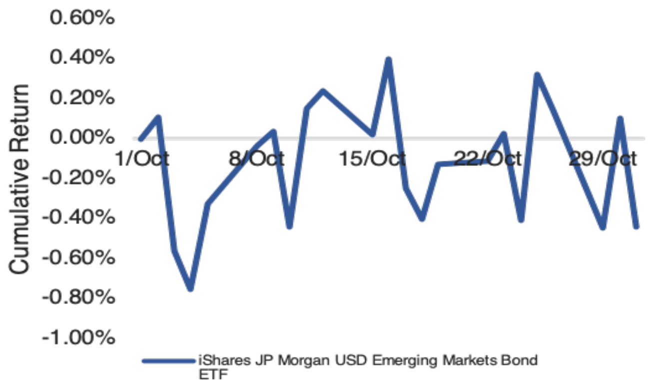
After a rise in July, the BoJ left yields on 10-year government bonds close to zero, so that a range between 0.11%-0.16% can be observed in October.



Future Opportunities in Emerging Markets

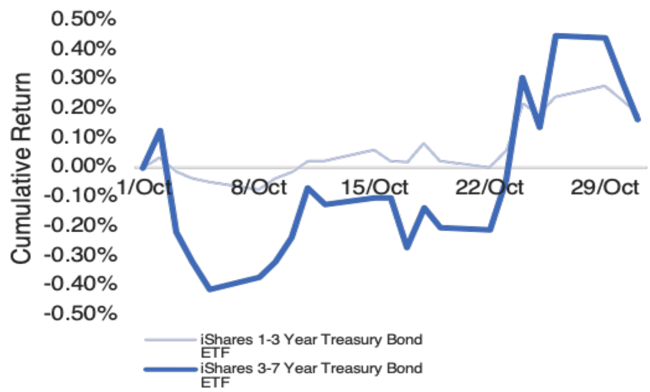
After a turbulent and painful period, Emerging Markets are expected to regain investors' trust, offering again attractive investment opportunities in the coming months. Sentiment is shifting as markets seem to have fully priced in potential trade wars and the current strong dollar. The current trade war between China and the US appears to be less severe than originally predicted, and the possibility of an agreement between US President Trump and Chinese President Xi Jinping seems increasingly viable. A normalization of the US trade relationship with Mexico and Canada on the basis of the US-Mexico-Canada Agreement (USMCA), which will replace the NAFTA trade agreement, is very predictable. Argentina benefits from a $57 bn loan from the IMF, in an attempt to stabilize its economy.

In this context, the JP Morgan USD Emerging Markets Bond Index, which contains government bonds from emerging markets such as China, Argentina, Mexico, Russia and Indonesia, could be of particular interest for the coming months. Additionally, not only US and European high-yield and leveraged loans, but also Short-term securitized credits could be further promising investment opportunities, as US and EU companies continue to show good growth, cost discipline and accelerating earnings, and US consumers have the strongest balance sheets in decades.



Our Performance

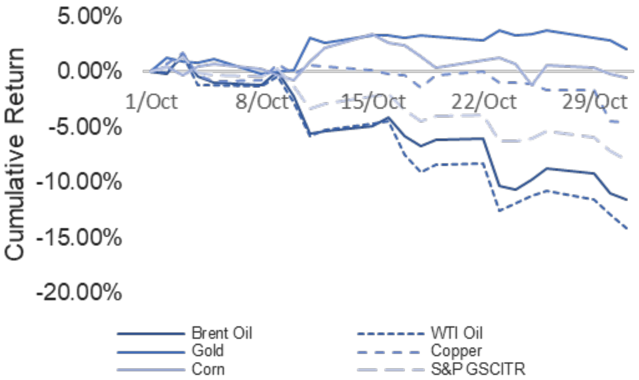
Our current position shows a 10% overweight in SHY ETF, tracking 1-3-year US treasuries, against the IEI ETF, tracking 3–7-year US Treasury Bonds, which we are therefore underweight by 10%. Over the month, the IEI index gained 0.16% and the SHY index gained 0.20%, leading to a total positive contribution of 4 basis points.



Lisa Preußler
Financial Markets Division

NIC Fund

Commodities



Commodities world

As a result of geopolitical and macro economic events *energy* prices rose by 3%, what is 40% higher than in 2017 same period. High volatility of oil prices with Brent crude oil prices reaching its low USD 70/bbl in August and four-year high USD 86/bbl in early October. The rise of oil prices was mainly led by the decision to leave production volumes unchanged at OPEC´s Meeting of the Joint Ministerial Monitoring committee at the end of September 2018.

A drop of almost 10% was recognized in metal markets, due to weaker global demand and concerns about the impact of U.S.-China trade dispute, as China represents 50% of global metals demand. On the other hand, concerns about tightened environmental regulation in China, the worlds biggest supplier of alumina, drove prices further up.

The largest quarterly decline of agricultural prices (nearly 7%) since Q4 2011 was reported for the third quarter Q3 2018. The market was hit by several events, most important voluminous supplies for most oilseeds and grains, trade tension which affected many agricultural prices mainly soybeans and EM/DM currency depreciation, especially the Brazilian real appreciated against USD this month.

Outlook

The optimistic position of crude oil is expected to stabilize within the range USD 72-76/bbl after the continuous growth from August 2018. The flat range is due to several factors: The Sanctions on Iran are reducing supply despite the waivers given to eight countries as these require gradual reduced oil imports. Thus, after decreases of 1m bbl/day of Iranian crude exports, a further drop by 800k bbl/day to 1m bbl/day of exports is expected. While Saudi Arabia increased supplies slightly, this leaves little room for increases by this crucial swing producer if necessary. This might provide an upside for crude as doubts are casted on the ongoing supply from Venezuela, Libya and Nigeria.

Metal prices are predicted close with a gain 5% in 2018 and stabilize in 2019, underperforming its forecasts from the beginning of the year. The underlying events are trade tension between U.S. and China with negative impact, but positive effect should be caused by stronger demand from China, based on the policy stimulus, tighter environmental constraints and policy actions that limit its production.

Agricultural prices are expected to close 2018 similar as in 2017 and grow in 2019. The intuition behind this is rising prices of other agricultural inputs as fuel cost and fertilizer costs and poor harvest. This is expected to increase the price of biofuels production as well.

Our Performance

We are still long on Brent futures which have appreciated nicely in line with overall increases in oil prices. We think oil prices have more room to grow and retain our position.

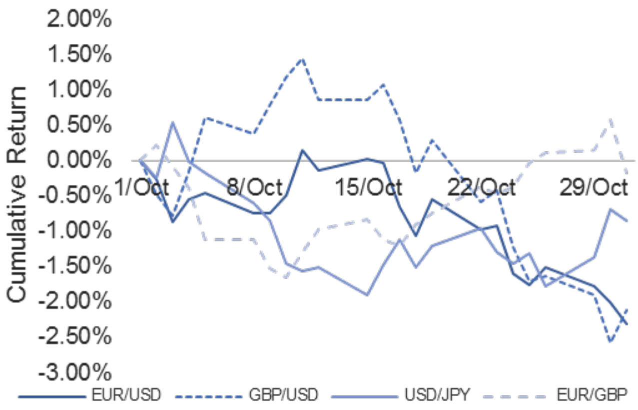
Nina Kusnirova
Financial Markets Division

NIC Fund

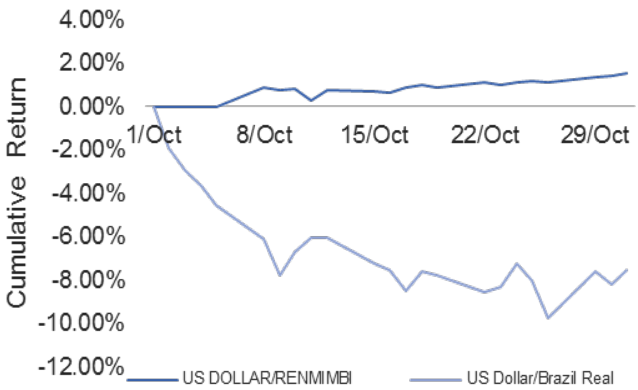
Currencies

World Currencies

The “safe haven” US Dollar has seen modest gains against most major currencies during October’s equity sell-off. Nevertheless, the only moderate appreciation might reflect some repricing of FED expectations. Market implied probability for a rate hike at the FOMC meeting in December has come down during the stock market tumult but is still highly likely with a 75% chance. The Euro lost ground against the Dollar in the second half of the month which was mainly due to raising concerns and tensions about Italy’s 2019 budget. The EU required Italy to revise its budget, the first time ever. The debt/GDP ratio of the country has reached 130%, a hardly sustainable level that undermines the trust in Europe’s shared currency. However, Mario Draghi reassured market participants about the ECB’s course for the following months. The QE program will end in December and the first rate hike is expected to happen in summer 2019. One step ahead is Sweden’s Riksbank which could initiate the path towards rate normalization with a first rate hike in December, up from current levels of -50 basis points.



The Brexit stalemate showed very little progress over the month what kept and will keep the British Pound fairly volatile. March 2019 is coming closer and the chance of a no-deal Brexit is growing by the day. This risk is obviously restraining the GBP. However, if the parties can find an agreement, this could trigger a GBP rally in the backdrop of then rising rates and less uncertainty for investors.



In depth

Although the US treasury stopped short of calling China out as a currency manipulator, they expressed their discontent with the weak performance of the Renminbi after the public holiday at the start of October. Right now, the market seems to consider a CNYUSD level of 7 as an important psychological threshold. Depending on the outcome of the meeting between Trump and Xi Jinping in November, China could turn the trade war into a currency war. If Trump shows no willingness to ease on tariffs, China has still the option to let the Renmimbi move above 7 and support their export-focused economy in that way. This would probably drag other emerging market currencies down which makes us stay cautious on China and EM in general.

One of the month’s outperformers was the Brazilian Real. The market appreciated Brazil’s new far-right President Jairo Bolsonaro’s pro-business attitude. Especially incoming finance minister Paulo Guedes is expected to implement a free-market economy with Chile’s 1973 approach as a role model. Having said that our view is that the new government has to prove their ability to deliver on their promises first. Political fragmentation is high after the elections and Bolsonaro’s expected ministers lack political experience. We consider BRL as a possible trade in the future but prefer to stay at the sideline for now.

Our performance

We currently hold no currency related assets in our portfolio.

Lukas Müller
Financial Markets Division

Extras

Hot Topic

BoJ Roman-Persian War: QQE and its Implication in Asset Pricing

Francisca Anselmo
Financial Markets Division

"Many researchers argue that the BoJ can indeed affect the cost of capital of firms via a risk-based channel."

"From an aggregated perspective, the BoJ equity purchases can effectively transfer a portion of the fundamental risk from the private sector to the central bank balance sheet."

The Roman-Persian War is considered by many as one of the longest declared wars ever, having lasted for almost 700 years – from 66BC to 628 AD. Meanwhile, Japan's fight against deflation has, no differently, been a long-standing battle. By far the longest macroeconomic declared war. Its origin dates back to the mid-1990s, as the Bank of Japan (BoJ) was the first central bank to effectively take the initiative to expand the supply of money in the economy by adopting the so-called quantitative easing program (QE), by 2001.

Nonetheless, the purpose of this article is not to scrutinize the QE, but rather to understand to which extent has BoJ's quantitative and qualitative monetary easing program (QQE) impacted Japanese asset prices.

The Bank of Japan QQE pursuit was launched in April 2013, shortly after Shinzō Abe took over as the prime minister of the "Land of the Rising Sun". Once implemented, it vigorously introduced BoJ purchases in the Japanese equity market through index-linked ETFs. The main goal of such ETF purchases was to support asset prices and ultimately reduce the cost of capital of Japanese firms.

Even though QQE original target amount was set to JPY 1.0 tn, in 2014 the BoJ decided to triple the annual level, to JPY 3.0 tn. In 2016 this value reached JPY 6.0 tn. By the end of 2016 the BoJ owned more than JPY 7.5 tn worth of broad market ETFs – 1.50% of the market value of Tokyo Stock Price Index (Topix) or 1.40% of the Japanese GDP. The share of BoJ's ETFs AUM grew from 0.00% to more than 50.00% in roughly 2 years. BoJ indirectly became the largest shareholder in a quarter of Topix stocks.

Many researchers argue that the BoJ can indeed affect the cost of capital of firms via a risk-based channel. From an aggregated perspective, the BoJ equity purchases can effectively transfer a portion of the fundamental risk from the private sector to the central bank balance sheet. Likewise, theoretically, as the private sector bears less risk the required return on stocks decreases in equilibrium and, therefore, it translates into a lower cost of capital for firms.

No wonder critics blamed the QQE for distorting the market, favoring stocks in the price-weighted Nikkei 225 over those that were only in the Topix Index. Companies such as Mitsumi Electric (MIT) or Taiyo Yuden (TYO), with a market valuation quite below the Topix average, were receiving a multiple of the capital flowing to the average Topix company due to their weight in the Nikkei 225. Moreover, proponents of better corporate governance see the scheme as diluting shareholder pressure on companies.

Meanwhile, one likely scenario is that the BoJ might informally reduce the size of its purchase program from JPY 6.0 tn a year to JPY 4.5 tn, roughly maintaining the standard value of purchases but reducing their frequency by a quarter. Nonetheless, BoJ's Roman-Persian War does not seem to be reaching a near-end. Disappointing inflation numbers have been persisting, with inflation expectations downgraded from 1.50% to 1.10%.

Will the Bank of Japan sacrifice the market equilibrium in detriment of winning a Roman-Persian inflation battle? It was not so clear during the October's meeting. And amidst prospects of slowing growth such scenario might be even further away.

Francisca Anselmo
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Extras

Hot Topic

Elections in Brazil: Bolsonaro's Paradox

Duarte Alves Pereira
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Jair Bolsonaro's election leaves a question mark on Brazil's future. World's eighth largest economy will begin a new path seeking a turning point for its economy and social values. Will economic and democratic liberalism converge?

Brazil's newly elected President, Jair Bolsonaro, embodies a controversial figure, raising several debates on his politics, statements and solutions. It is clear, that he represents uncertainty. The proposals to combat Brazil's main problems, such as the high crime rate, the levels of corruption or the current recession, the worst in its history, may be a sign of hope for some, but yield fear for many.

For investors, Bolsonaro's election was well-received, increasing São Paulo's stock exchange valuation by more than 3%, along with currency appreciation and decrease in credit risk, on the first day after the election. This was backed by the liberal economic programme presented by Bolsonaro, who appointed an economist from the University of Chicago, Mr Paulo Guedes, as his "super minister". His fierce support for privatisations and key pension reforms has made investors hopeful Brazil will implement its first truly liberal economic programme in years, after successive interventionist governments led by PT, Brazil's left-wing party. In the end, markets' confidence has been regained, but there are still concerns regarding Brazil's new president. The apprehension comes from the social paradigm and whether Mr Bolsonaro will be able to implement his policies without deepening social division.

Moreover, with the social tie as the main concern, the strong conviction of Mr Bolsonaro in his solutions has seemed to increase some people's confidence. Crime and corruption are two of the deepest challenges Brazil is facing and have been worsening in recent years. Bolsonaro has taken advantage of a fragile PT, recovering from the scandals in which main figures of the party have been allegedly involved. The future president, former army captain, emerged as a strong leader, deserving voters' hope and support. In times where Brazilians seek order and peace, the proposal of traditional family values with economic liberalism, has attracted electors.

On the other side of the coin, the limits to ensure control and discipline proved to be restrictive for many. The extent to which Brazilians are willing to go was the main splitter between Jair Bolsonaro and Fernando Haddad's (PT) voters. However, with the former military, some norms of a free society might be in danger. With plenty contentious statements regarding sensitive topics, such as dictatorships, ethnicity or crime, Mr Bolsonaro presented extremist solutions to fight Brazil's biggest issues. The consequence is a mixture of conceiving his proposals as the only viable path to end such a problematic period and fear for the radical approach.

Following the same rationale, the world has witnessed the rise of extreme wings, with recent examples of Philippines and Chile. This recent flow may explain why Brazilian voters decided among two far candidates. On foreign policy, Bolsonaro seems to be aligned with a more protectionist view, with potential global implications and has attacked China's economic development, criticized Venezuela's leftist regime, threatened moving Brazil's Israel embassy to Jerusalem and promised withdrawing from UN Human Rights Council.

All in all, Brazil's upcoming days will remain unpredictable. If, on the one hand, Mr Bolsonaro seems a threat to the principles of a free society, on the other side of the paradox, Brazil needs to ensure a determined and strong leader to cease this period of chaos, danger and recession.

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Hot Topic

The backstop to the backstop

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"We have been clear that we cannot agree to anything that threatens the integrity of our United Kingdom".

– Theresa May

With just months to go until the final deal is schedule, the Brexit talks ran into a significant problem. It all centres around the contentious issue of the border between Northern Ireland and the Republic of Ireland.

The UK and the EU have both agreed that, in negotiating a deal on the relationship after Brexit, keeping the border open between the two and upholding the terms of the Good Friday Agreement is of critical importance. Nevertheless, they have been unable to agree exactly how to achieve this.

The 1998 Good Friday Agreement was created as part of a strategy for North-South co-operation between the Irish Government and the Northern Irish Assembly. That is why the UK and the EU have committed to the principle that, even if all other negotiations fail, there should be provisions in place to ensure that the border remains open, as it is today. That principle is the Irish backstop.

The backstop, designed to stop a hard border, relates to negotiations on a future trade deal during the proposed period of transition – the period after the UK officially leaves the EU (in March 2019) but before any agreed future relationship kicks in. During transition, the UK would remain tied to many of the EU's structures as they continue to negotiate a future deal. The backstop kicks in if those negotiations collapse or fail to address the Irish border question. This means that the UK, while no longer an EU member state, would maintain all the rules and regulations of the EU single market and customs union.

In June, the UK government suggested that the backstop should be time-limited - to the end of 2021. But the EU rejected the idea arguing that a time limit means it is no longer a backstop. As a result, one proposed solution is called a "backstop to the backstop".

This would be another backstop to kick in if the time-limited backstop ends without a deal being agreed. The EU has suggested that the second backstop would apply only to Northern Ireland, namely staying in the EU customs union, large parts of the single market and the EU VAT system. This would imply differences in how trade is regulated between Northern Ireland and the rest of the UK.

Theresa May has repeatedly said she would not accept a deal that treats the UK differently from Northern Ireland, "We have been clear that we cannot agree to anything that threatens the integrity of our United Kingdom". Brexit supporters are furious at being tied to the EU's customs union, without a clear end date. Meanwhile, the Democratic Unionist Party hates Northern Ireland being bound to the EU's goods regulations, creating barriers across the Irish Sea that split the UK market.

All in all, the Irish backstop is effectively an insurance policy in the Brexit negotiations between the EU and the UK. For the moment, there is no backstop solution which is agreeable to all the main parties involved. If no backstop can be agreed, the UK will almost certainly leave the EU with "no deal" in March 2019, meaning a probable return to physical checks on the Irish border.

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Thank you!

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

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