

Weekly Digest

14 October 2019

Marque down

– Alex Harvey, CFA

Who is your favourite Bond? Ask ten people and you're likely to get a couple of names back. Connery of course polls highly but I've always admired Roger Moore's quintessentially British charm and resolve. When it comes to his car though there's no dispute about that: the Aston Martin DB5. The carmaker is synonymous with British style, class and manufacturing excellence. In a nutshell – quality. However, in the case of Aston Martin, beauty is in the eye of the bondholder, and a recent \$250m funding cost them a whopping 12% in US dollars to finance. The tank is almost empty.

The equity listing of Aston Martin Lagonda Global Holdings PLC (ticker AML) came to the market almost exactly a year ago. Since its founding in 1913 ownership has changed several times and financial hardship is nothing new to the firm. Since listing the shares are down 77% and their credit rating has been cut to CCC+ by S&P, considered deep into 'junk' territory. The recent cash raise was somewhat pre-emptive to ensure liquidity ahead of the 2020 launch of a new SUV model, but with the 12% coupon split between cash and payment-in-kind ('PIK' financing sees the notional amount of debt increase in lieu of paying coupon), the company's finances are precariously balanced. With hopes pinned on the new DBX model, the offering needs to be strong to compete against other luxury brands already in this space. However, get it right and there are rich rewards.

The fortunes of Ferrari (ticker RACE, of course) are enough to make the British carmaker blush. In the year since AML listed in London, the shares of the 'Prancing Horse' have returned nearly 40%. As my colleague Andrew noted in last week's blog, Ferrari's recent launch of the remodelled Spider sold out

in a matter of days. Since the Maranello based firm came to market in January 2016 the shares are up over 300% but like their English sector cousins that wasn't before falling sharply post their IPO. Like AML, Ferrari is not without debt, but with an average fixed coupon of 0.79% versus AML's 7.15% (in EUR and GBP respectively), the latter faces a significant financial drag. With the DBX expected to come to market in 2020, Aston can steal a march on Ferrari, whose Purosangue SUV is not expected until 2022. Both though play catch up to the likes of Bentley, Lamborghini and Porsche, whose Bentayga, Urus and Cayenne SUV models are already on the market.

Having an allocation to quality businesses has long been central to our portfolio construction process and is most evident through our equity manager allocations. As the above demonstrates though, quality is about more than just an iconic brand. To be considered a high-quality franchise deserving of a premium valuation you must build and retain a defensible competitive position, earn a consistently high return on capital and generate cold hard cash. These are not traits generally associated with the autos sector but Ferrari's high margins and near 30% return on capital highlight its appeal. The same rigour needs to be applied in credit where the quality of the balance sheet in its purest form is embodied in a company's credit rating, and we task our managers to look under the bonnet and kick the tyres on all the bonds they buy. Indeed, credit ratings themselves can be a source of price inefficiency that can be exploited by thorough research. It may be a few years yet before we see Mr Bond in an SUV. Much will depend on whether Q thinks the new DBX really has the X factor.

The Marketplace

- UK pound sterling rallies as Brexit talks advance
- Benchmark indices rose due to reported progress in the US-China trade war
- Brent crude oil gained 3.7% ending the week at \$60.5 a barrel
- Gold fell 1.6% ending the week at \$1485.1 an ounce

Market Focus

US

- Chairman of the Federal Reserve, Jerome Powell, emphasised that the new balance sheet expansion is just a technical adjustment, seeking to ease cash shortages that caused a recent spike in the overnight cost of borrowing, and not a new QE programme.
- The latest core producer price index figure was 50 basis points lower than expected, reporting -0.3% month-on-month. The consumer price index showed no change in prices for September.
- The Job Openings and Labour Turnover Survey, carried out to measure job vacancies, fell to a 17-month low of 7 million in August signalling lower demand for labour.
- US equities gained 0.7% over the week following reported progress on the US-China trade war as export-sensitive sectors rallied.

Europe

- German factory orders fell by -0.6% month-on-month in August, bringing the year-on-year rate down to -6.7%.

- European equities gained 2.5% over the week, resulting from a positive turn in Brexit negotiations.

UK

- As Brexit talks turned to a more positive tone, UK equities gained 1.4%.
- Sterling advanced by 2.7% against the dollar. Friday's intra-day gain was the largest observed against the dollar in seven months.
- Productivity statistics reported that output per hour fell by 0.5% year-on-year in Q2, the fastest decline since Q2 2014.
- The Irish and UK Prime Ministers made a joint statement saying they "agreed that they could see a pathway to a possible deal".

Asia/Rest of The World

- The US is sanctioning eight additional Chinese technology companies over their involvement with China's treatment and surveillance of the Uighur minority group.
- Reports of China being open to a "partial trade deal" despite the technology blacklists led to markets advancing.
- The Turkish lira fell -2.5% against the US dollar on Monday, its worst session in six months, following a tweet by President Trump.

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Asset Class/Region	Currency	Currency returns			
		Week ending 11 Oct. 2019	Month to date	YTD 2019	12 months
Developed Market Equities					
United States	USD	0.7%	-0.2%	20.8%	10.4%
United Kingdom	GBP	1.4%	-2.0%	11.4%	7.6%
Continental Europe	EUR	2.5%	-0.5%	20.6%	13.3%
Japan	JPY	1.4%	0.5%	9.3%	-3.8%
Asia Pacific (ex Japan)	USD	1.6%	0.7%	8.9%	9.8%
Australia	AUD	1.4%	-1.2%	20.9%	17.2%
Global	USD	1.2%	0.0%	18.5%	8.7%
Emerging markets equities					
Emerging Europe	USD	2.2%	0.6%	18.4%	17.8%
Emerging Asia	USD	1.7%	1.1%	7.6%	9.2%
Emerging Latin America	USD	0.4%	1.4%	7.6%	4.5%
BRICs	USD	1.8%	1.5%	10.7%	13.3%
MENA countries	USD	-1.2%	-2.7%	1.7%	3.1%
South Africa	USD	4.2%	5.4%	2.9%	10.6%
India	USD	1.1%	-1.8%	3.8%	16.5%
Global emerging markets	USD	1.5%	1.1%	7.4%	8.7%
Bonds					
US Treasuries	USD	-1.5%	-0.4%	8.0%	11.0%
US Treasuries (inflation protected)	USD	-1.3%	-0.2%	7.9%	8.1%
US Corporate (investment grade)	USD	-1.3%	-0.4%	13.0%	13.2%
US High Yield	USD	0.3%	-0.2%	11.4%	7.3%
UK Gilts	GBP	-3.3%	-2.8%	8.8%	13.2%
UK Corporate (investment grade)	GBP	-1.9%	-1.8%	9.2%	10.1%
Euro Government Bonds	EUR	-1.0%	-1.0%	8.9%	11.6%
Euro Corporate (investment grade)	EUR	-0.4%	-0.4%	6.4%	5.9%
Euro High Yield	EUR	0.3%	-0.3%	9.1%	5.7%
Japanese Government	JPY	-0.4%	-0.3%	3.1%	4.8%
Australian Government	AUD	-1.0%	-0.1%	10.6%	13.7%
Global Government Bonds	USD	-1.2%	-0.2%	6.6%	9.0%
Global Bonds	USD	-0.8%	-0.1%	6.6%	8.2%
Global Convertible Bonds	USD	0.5%	0.6%	7.0%	4.9%
Emerging Market Bonds	USD	0.0%	0.7%	9.6%	11.2%

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Asset Class/Region	Currency	Currency returns			
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Property					
US Property Securities	USD	-0.6%	-0.3%	25.6%	23.2%
Australian Property Securities	AUD	0.2%	0.2%	14.1%	16.7%
Asia Property Securities	USD	0.1%	0.6%	9.7%	16.8%
Global Property Securities	USD	0.4%	0.7%	20.3%	20.2%
Currencies					
Euro	USD	0.6%	1.4%	-3.4%	-4.5%
UK Pound Sterling	USD	2.7%	3.1%	-0.3%	-4.0%
Japanese Yen	USD	-1.4%	-0.2%	1.9%	3.6%
Australian Dollar	USD	0.5%	0.8%	-3.4%	-4.4%
South African Rand	USD	1.8%	2.8%	-2.6%	-1.2%
Swiss Franc	USD	-0.1%	0.2%	-1.2%	-0.4%
Chinese Yuan	USD	0.9%	0.9%	-3.0%	-2.8%
Commodities & Alternatives					
Commodities	USD	2.0%	1.7%	6.2%	-7.4%
Agricultural Commodities	USD	1.9%	1.8%	-4.5%	-7.3%
Oil	USD	3.7%	-0.4%	15.9%	-24.6%
Gold	USD	-1.6%	1.0%	16.1%	21.7%
Hedge funds	USD	-0.1%	-0.1%	6.1%	2.4%

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