The Week in Perspective

08 April 2016

Brewin Dolphin Research

Market Roundup

THE UK's FTSE 100 index edged up slightly on Monday, adding 0.27% as investors managed to shrug off a declining oil price. Payments company Worldpay gained over 1% as its management underlined its strong potential as we head towards a "cashless society". Miners including Anglo American and Rio Tinto both appeared in the list of top 10 risers on the day, helping to extend the bullish mood around commodities.

But gains were reversed on Tuesday as some downbeat economic data about the UK services sector – which looked like good news at first glance – damped investors' spirits. Concerns about the volatile oil price saw commodity stocks fall once again, echoing the volatility in the price of the underlying commodities. Tesco lost ground as its stock was downgraded by Deutsche Bank from "buy" to "hold". It appears the retailer, along with Sainsbury's, has lost yet more ground to rival chains. The FTSE 100 closed 1.09% down, with the broader FTSE 250 off by 0.72%.

Wednesday saw a swing back into positive territory as talks about freezing oil production helped bolster oil prices and pushed up commodity stocks. Pharmaceutical companies jumped on some speculative buying after Pfizer's planned merger with Allergan, the Irish pharma company, was called off. This was largely due to US regulators who announced plans to clamp down on so-called "inversions", where a company merges with another in a country with a lower tax rate. A note by Bank of America-Merrill Lynch concluded that the news may turn London-listed pharmaceutical companies in to bid targets. Shire, AstraZeneca and GlaxoSmithKline all rose on the news and the FTSE 100 closed up by 1.1% at 6,161.63.

But it was back in the red for the FTSE 100 on Thursday as the oil price fell again on global concerns about oversupply. Marks & Spencer was a good performer on the day after fourth-quarter figures exceeded analysts' forecasts. Although sales were down, they fell less than expected.

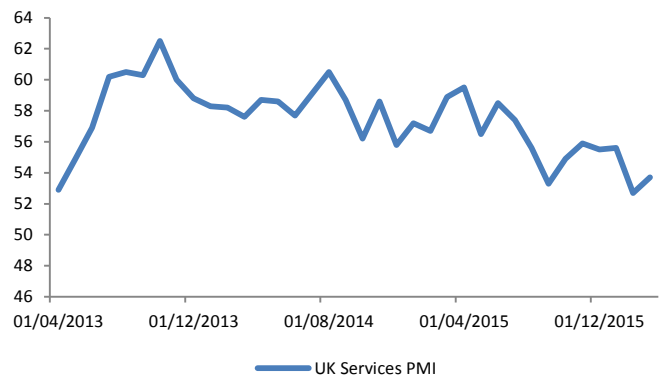
In early trading on Friday shares were fractionally up as oil and copper prices rallied. Miners and oil giants, unsurprisingly, led the field.

Company focus: Marks & Spencer

During the week the retailer reported a mixed but generally good set of fourth quarter sales (no profit number reported) to 26 March 2016. In General Merchandise, like-for-like sales were down 2.7% which was better than consensus and our expectations (down 3.5%). In the press release, new CEO Steve Rowe noted that while there was an improvement in the like-for-like sales decline in the division, there is more to do. Turning around the Clothing and Home business by improving the customer offer is going to be Mr Rowe's first priority. Just like Next, Marks & Spencer faced availability issues in the third quarter (too much clothing for the cold weather, while the autumn was mild) – which may mean higher inventories. In Food, like-for-like sales growth was flat vs consensus of a 0.5% increase, although the company continues to open stores, with 80 outlets opened during the year.

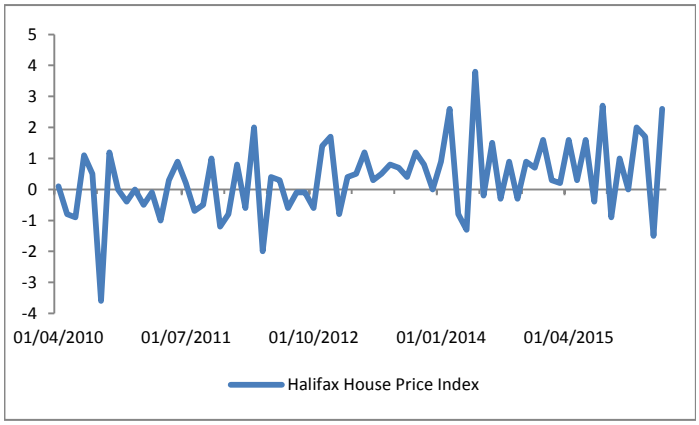
In the longer term, we believe Marks & Spencer has reasonable upside and have consequently upgraded our rating to 'Outperform'. Sales in the higher profit General Merchandise division have been volatile since 2011 and are generally trending downwards. On the other hand, the previous CEO Marc Bolland has made significant inroads in cutting costs, mostly by streamlining its distribution system and changing the way it buys apparel. This process has led to some improvement in gross margin, although we believe there is more that can be done to improve profitability.

Chart 1: UK Services PMI



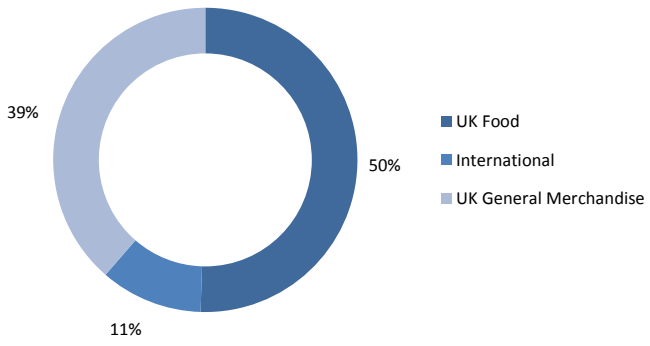
Source: Bloomberg — Data released Week of 29/03/2016

Chart 2: Halifax House Price Index



Source: Bloomberg — Data released Week of 29/03/2016

Chart 3: M&S revenue by division 29/03/2015



Source: Brewin Dolphin, client notes — Data to 31/12/2015

Economic Outlook

With UK manufacturing and construction purchasing managers' indexes (PMIs) already coming in below par, the latest of these reports highlighted the uninspiring state of the UK services industry. Although the Markit services PMI for March was slightly better than expected at 53.7 (over 50 indicates expansion), it was the weakest three-month period of output growth since the first quarter of 2013 – which will likely drag overall economic growth and keep GDP advancement muted. The EU referendum uncertainty doesn't help. And on Friday UK annual industrial production also came in much worse, shrinking 0.5% in February, the largest fall since August 2013. The general conditions means that UK GDP growth could struggle to reach the forecast 2% (by the Office for Budget Responsibility) this year, after growing 2.3% last year.

Lack of growth is not a problem in the UK's housing market – unless you rent or are trying to get on the ladder. The Halifax House Price Index revealed that house prices in the UK soared 10.1% in the year to March. This was up from the 9.7% annual rise reported in February and ahead of the 9.5% predicted. Month-on-month growth is also zipping along, leaping ahead 2.6% in March from the previous month.

Meanwhile, the services picture is not much better in Europe. The Markit eurozone services PMI was knocked down to 53.1 for March after an earlier estimate of 54. This revised figure (from a representative panel of around 2,000 private sector firms) was the lowest reading in 14 months, since January 2015. Of the constituent countries, France was the worst performer, contracting for the second month in a row with a reading of 49.9. The German and Italian numbers were also downgraded, although their service sectors still showed growth.

In the US, however, the services sector appears to have picked up at a gallop. The Institute for Supply Management's (ISM) non-manufacturing PMI climbed to 54.5 in March, nipping nicely ahead of February's 53.4. The reading also halted a series of declines for the sector that started in October and is paired with a revival in the US manufacturing sector. However, it's not all rosy in the US camp: the country's trade deficit swelled to a heady $47bn in February, the highest since last August. It was the threat of headwinds that prompted last week's market-pleasing comments (urging caution) by US Federal Reserve (the Fed) Chair Janet Yellen. This stance was reinforced this week when the minutes of the Fed's last interest rate meeting were released.

The statement was more dovish than had been expected. This means there has been a disconnect between what was said at the meeting and how it was communicated. There are plenty of theories as to why this might be. The important thing to note, though, as we have done in the past, is that it reflects the data-driven, short-horizon decision-making at the Fed. Indeed, it arguably intensifies that problem.

With the Fed so unsure of which way it should be jumping we are happy to admit that we can see both arguments, too. At the moment the potential of inflation drivers like energy and the current progression of core inflation mean an overshoot on headline inflation is a distinct possibility. How the Fed reacts to this is a more open question. Would they tolerate higher inflation to avoid a strong dollar hurting exports? This statement hints that to some extent they would.

Company announcements that caught our attention this week

Date	Company	Comment
05/04/2016	**Tate & Lyle**	The sugar and sweetener group issued a short trading statement stating that full-year trading is in line with consensus and with the guidance given at the trading statement on 11 February. In that statement, management said that volume growth in the Speciality Food Ingredients division had improved in the second half as Europe and Asia Pacific grew and offset a softer North American performance. Sucralose (its well-known sweetener) also posted growth, although pricing remained under pressure. Guidance and consensus are for flat profit before tax (compared to 2015). We still see headwinds for Tate and rate the shares 'Underperform'.
05/04/2016	**The AA**	The motoring association reported profits that fell heavily on the back of upgrading its technology to attract a younger generation of drivers – with pre-tax profit for the year falling to £17m from £61m in 2015. Years of neglect under private equity ownership saw its technical infrastructure suffer and debts soar. Now the floated company is looking to readdress the weaknesses, but this may take some years. While the insurance business saw an 8% decline in revenue the more profitable roadside assistance business improved its customer retention rate by 2% to 81%.
05/04/2016	**BP**	The oil giant finally put to bed the Macondo accident this week with Judge Barbier signing off the $20.8bn settlement originally agreed in 2015. The fees and penalties will be paid off over a period of 16 years. This now means that the vast majority of the payments and penalties to cover the spill in the Gulf of Mexico have now been covered. While a spokesman said that BP was pleased that the court had finalised the historic settlement, the firm did not release a formal press statement. In our view, this indicates that BP has finally put the terrible accident behind it and can look forward to implementing its ongoing restructuring programme in response to lower for longer oil prices.

Key Company Diary Dates

Mon 11 April	Vedanta Resources	Finals
Tue 12 April	ASOS	Interims
Wed 13 April	Tesco	Finals
Wed 13 April	WH Smith	Interims
Thu 14 April	Unilever	First quarter results

Economic highlights over the next week

Tue 12 April – **UK inflation**– Among the various pricing indicators being released for March the UK's year-on-year inflation rate will be one of the closest watched. The figure edged up 0.3% in February (the same as January's rise), but below the expected 0.4%. Housing and utilities were among the biggest price drivers.

Wed 13 April – **US retail sales** – In the land where the consumer is king, and drives the economy, any sign of faltering spending confidence can send tremors. Although the month-on-month figures for January and February showed drops this was mainly due to falling energy prices (prices at the pump).

Thu 14 April – **UK interest rate decision** – Nobody is expecting any change to the record low figure of 0.5% settled on since March 2009, but the minutes may show if there are pressures to the consensus or whether there are tangible concerns over the EU referendum vote in June.

Index Movements*

Index	Value	%Change
FTSE 100	6,136.89	-0.62
FTSE 250	16,714.23	-1.25
AIM	717.02	0.88
Dow Jones	17,541.96	-0.81
S&P 500	2,041.91	-0.87
Hang Seng	20,266.05	-2.46
Nikkei 225	15,749.84	-6.02

Currency Movements*

Currency Pair	Value	%Change
£:$	1.41	-1.93%
£:€	1.24	-1.81%
£:¥	152.10	-5.85%

Best & Worst performing sectors (rel. to FTSE 350)*

Sector	%Change
Healthcare	6.14%
Technology	1.93%
Retail	1.85%
Basic Resources	-3.10%
Banks	-3.47%
General Industrials	-5.66%

Best & Worst performing stocks*

Company	%Change
Shire	8.44%
AstraZeneca	6.79%
Marks & Spencer	6.60%
Anglo American	-8.33%
Antofagasta	-9.05%
Glencore	-16.02%

*Weekly movements up until close of business Thursday

Important Notes:
Main source of information: Company Report and Accounts, Bloomberg

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