

BREAKINGVIEWS

Predictions 2019

High Anxiety



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High Anxiety

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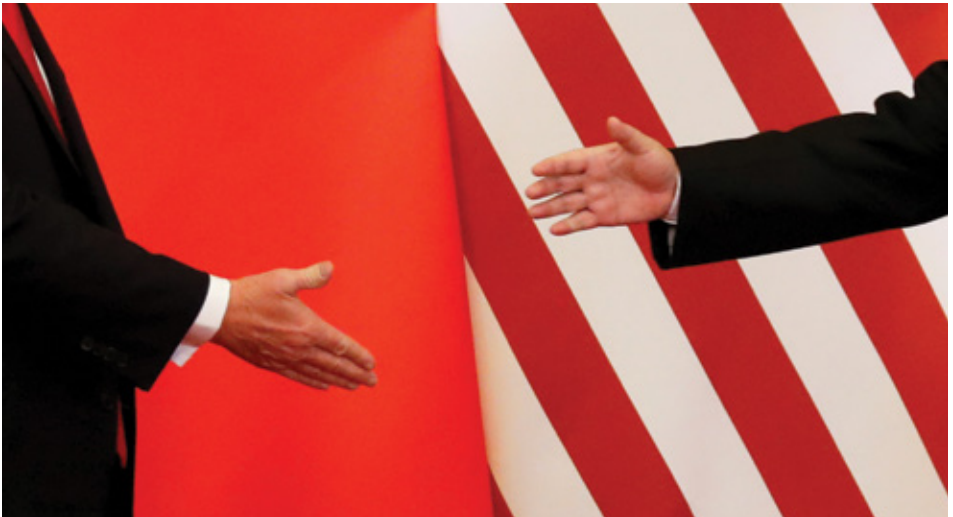
Introduction

In Mel Brooks' seminal 1977 Hitchcock parody "High Anxiety", much of the action revolves around the Psycho-Neurotic Institute for the Very, Very Nervous. Investors may feel the need to book into a similar establishment in 2019. Too many huge decisions need to be called correctly to feel relaxed about the year ahead.

Ninety years after the Wall Street Crash, global geopolitics and markets are like the person scaling a building on our front cover — in an exposed and precarious position. And it's a long way down. That's why Reuters Breakingviews' Predictions 2019 book is also titled "High Anxiety".

Most investors already understand that Federal Reserve Chairman Jerome Powell and his fellow central bankers could get it wrong on rates, and exacerbate an outlook in which major economies are likely to expand more slowly. What may be less obvious is which companies will roll with the punches, and which will finish 2019 laid out on the canvas.

Private equity, where deals are being done at high prices with lots of debt, is the perfect starting point. Our view is that the real fall guys from lower returns won't be storied buyout barons like Blackstone, but those who have advanced them credit on generous terms. An exception is Masayoshi Son, whose \$97 billion Vision Fund



U.S. President Donald Trump and China's President Xi Jinping shake hands after making joint statements at the Great Hall of the People in Beijing, China, Nov. 9, 2017. REUTERS/Damir Sagolj/File Photo



Federal Reserve Chairman Jerome Powell gives his semiannual testimony on the economy and monetary policy before the Senate Banking Committee in Washington, United States, July 17, 2018. REUTERS/James Lawler Duggan

will have some difficult conversations with its investors as it writes down a spate of overpriced purchases.

This could be happening at the same time as geopolitical strains draw parallels with another classic film, “High Noon”. A December détente between U.S. President Donald Trump and his Chinese counterpart Xi Jinping is a step forward, but relations between the two largest economies remain tense, and could worsen. In the corporate corral, guns will be drawn between activist investors and the French establishment, where we predict Vivendi and others are vulnerable.


Britain’s attempts to leave the European Union could yet avoid disaster, but a GDP-sapping no-deal in March is still a major risk. Italy will continue to rile the European Union, which could branch off in a more eurosceptic direction with European Parliament elections in May. Italian banks will bear the brunt of any return of “Quitaly” risk.

And the potential for the U.S. Congress to do what Trump won’t — sanction Saudi Crown Prince Mohammed bin Salman for the murder of journalist Jamal Khashoggi in October by Saudi agents — could destabilize the Middle East. But Trump now has the leverage to push MbS to undo many of his blunders — and keep oil prices low — and would be foolish not to use it.



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For some, 2019 will be a year of recovery, and even success. Long-suffering Deutsche Bank has the scope to surf a wave of higher fixed-income trading revenue if rates keep rising. Italy's woes could give Moncler boss Remo Ruffini a chance to remake his firm into an Italian version of Bernard Arnault's LVMH. Rio Tinto will finally turn big miners into big spenders, Facebook could turn out to be the JPMorgan of tech, and Airbnb will succeed where others failed in China.

Meanwhile, businesses will continue to wrestle with the need to embrace environmental, social and governance issues — one area to watch is how actively banks use their bully pulpits to lobby gun manufacturers. With its traditional U.S. relationship in flux, look out for Saudi oil to be priced in yuan, boosting Beijing's attempts to create a non-dollar hegemony. And a quarter-century after genocide, Rwanda will show the world that a single market with Ethiopia is better for growth than trade barriers.

What gives us the confidence to make these calls in an era when experts are shouted down? One reason is that they often turn out to be correct — witness last year's forecast on bitcoin's big wipeout. The cryptocurrency dropped from over \$18,000 to under \$4,000 during 2018. True, only half a side of SLAW was delivered with the IPO of Spotify and filing by Lyft to go public — but we'll watch for Airbnb and WeWork to complete the acronym in 2019. And we said Amazon would bid for EU soccer, but didn't expect football rights to fall in value.

Our overriding motivation is to provide thought-provoking, research-based predictions that don't follow the herd. In 2019, investors can only hope that Powell and his central bank peers are similarly independent-minded.

George Hay

Associate Editor, Reuters Breakingviews

January 2019

High Level

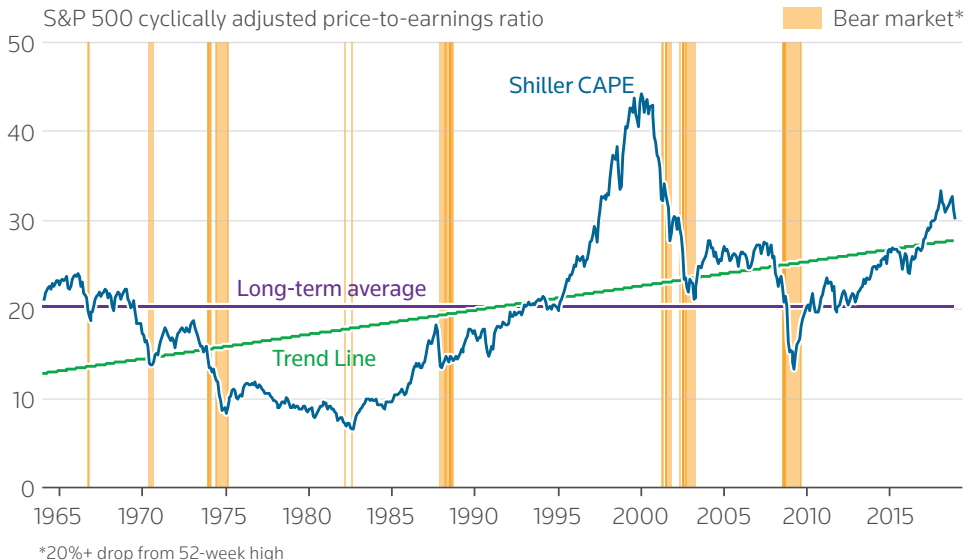
Global equities offer value trap in 2019

By George Hay

Are global equities cheap yet? After two sharp corrections in February and October 2018, investors will be running their rules over stock-market valuations. They should be wary of falling victim to a value trap.

On one measure, U.S. equities still look eye-wateringly overpriced. Economist Robert Shiller's cyclically adjusted price-to-earnings ratio, or CAPE, which smooths the S&P 500 Index PE ratio over the prior 10 years, is running above 30 times based on data for November 2018. That's in line with where it stood 90 years ago as the Wall Street Crash commenced, and second only to the 40-odd multiple seen in 1999 to 2000 during the dot-com era.

That's not the whole story, though. After declines in 2018, U.S. equities in the Russell 1000 trade at 15.4 times next year's estimated earnings, roughly in line with their 10-year average, according to FTSE Russell as of early December. And the CAPE picture looks more reasonable applying the upward-sloping trend line since World War Two. Assuming reversion to that trend, S&P 500 earnings per share would only need to increase 10 percent in 2019 for the market to grow into its current valuation, FTSE Russell reckons.



That's less than half the 24 percent profit growth U.S. companies are on track for in 2018, albeit with a boost from tax cuts, according to Refinitiv data. As of early December, analysts are forecasting S&P 500 earnings expansion of 8.4 percent in 2019. The danger, though, is that at this stage of the cycle they are routinely too optimistic. Revenue, which turns into earnings, usually lags nominal GDP — where growth could slow in 2019. Leading indicators like the U.S. ISM Manufacturing Index may be peaking, too.

What about everywhere else? Forward earnings multiples in Europe and emerging markets are also in line with 10-year averages, and their discounts to U.S. stock prices remain in place. Emerging markets are relatively more heavily exposed to banks and big technology groups, and they tend to suffer an outsized response when the U.S. lurches down — a risk given the hoariness of the U.S. economic recovery, uncertainty over interest rates and trade tensions.

In fact, only in the UK and Japan do stocks look relatively cheap on an expected earnings multiple basis, but they come with extra layers of cloud covering the outlook. In 2019 there could be plenty of falling knives, and a dearth of safe bets.

First published Dec. 11, 2018.

China-U.S. trade war will get a lot more personal

By Pete Sweeney

American executives who prayed for a trade war truce are a disappointed lot. Following the arrest of Huawei's chief financial officer in Canada, they've been sent to the front lines.

President Donald Trump is focused on the trade deficit. But administration hawks also want to thwart Beijing's "Made in China 2025" plan to build state-subsidised global champions in sectors like aviation, artificial intelligence, and communications. The 90-day tariff freeze Trump negotiated with Xi Jinping has only halted hostilities in one corner of a vast battlefield.

Meng Wanzhou could be the first big casualty of American extraterritorial force. The United States alleges the Huawei executive violated its sanctions on Iran. Whether she did or not, arresting the daughter of the telecommunications equipment maker's iconic founder Ren Zhengfei fires a loud shot across China Inc's bow. Ditto for the October extradition of a Chinese intelligence agent from Belgium to face U.S. industrial espionage charges.

China could retaliate. It has already detained Canadian ex-diplomat Michael Kovrig, according to Reuters; his employer, International Crisis Group, says it is seeking his

release. Huawei's American rival Cisco Systems told employees not to travel to the Middle Kingdom after Meng's arrest, although it later backtracked. Reuters reported the U.S. State Department is considering warning citizens not to visit the People's Republic.

That might be prudent. Because it can be difficult to succeed in China without cutting corners, U.S. executives who have done so — or looked the other way while local employees did — are vulnerable, and can be held responsible for their company's sins. Economic forces might also generate inadvertent flare-ups. Detention is a semi-legal negotiation tactic in the People's Republic, usually the result of business disagreements over cancelled orders or price changes. In the past, upset Chinese managers have held foreign representatives involuntarily inside offices or hotels until they concede. Police rarely intervene. Foreigners can also be banned from leaving China until a dispute is settled. Reports of such incidents rose sharply during the global financial crisis.

As rising costs, tariff threats and general anxiety cause U.S. companies like GoPro to move parts of their supply chains out of China, more detentions could ensue. Even legitimate arrests will feed conspiracy theories. The popular emotions such incidents unleash could easily undermine efforts for lasting peace.

First published Dec. 12, 2018.



China's President Xi Jinping is seen on a big screen in the media centre as he speaks at the opening ceremony of the first China International Import Expo in Shanghai on Nov. 5, 2018. Johannes Eisele/Pool via REUTERS

Private equity returns will drop a digit

By John Foley

Disappointment is coming for the clients of private equity firms. Companies which use debt and management wiles to take businesses private typically target an annual yield — the so-called internal rate of return — of at least 15 percent. It's hard to see recent deals matching that. Instead of 15, investors should steel themselves for more like five.

For one, purchase prices are looking expensive. Deals struck in 2018 were at a median valuation of 13 times EBITDA, according to Refinitiv, compared with an average of 10 between 2010 and 2016. They're getting bigger too. Blackstone's purchase of a majority stake in the financial data business of Thomson Reuters — the parent company of Breakingviews — was the largest leveraged buyout since the financial crisis, worth \$20 billion.

With generous debt, reasonable growth and a buoyant market in which to exit investments, that should be just fine. In a sign of what might be confidence, many buyout firms even include future cost-cuts in their measure of current profit when borrowing money from the debt market. The trouble is, it's not likely the benign conditions will all hold for much longer.

Imagine a company taken private at 13 times its EBITDA of \$1 billion, juiced up with \$6.5 billion of debt, and held for five years. If its EBITDA grows at 6 percent a year, it will amass a total of \$6 billion. Say a fifth of that goes to capital expenditure, in line with industrial norms according to CSIMarket, and just over one-third is eaten up by interest payments, leaving \$2 billion after tax to pay down debt. If the private equity firm can sell the company at the same 13 times EBITDA, the fund would make a return of 15 percent a year, according to a Breakingviews calculator. That just about cuts the mustard.

What if things aren't so buoyant? If valuations fall back to their historical average of 10 times EBITDA during that five years, and the growth in the company's profit falls just slightly to 5 percent a year — which is hardly conservative — the annualized yield drops sharply, to 5 percent. Moreover, investors would still have to pay fees, cutting their returns further. An extra sting in an already unhappy tale.

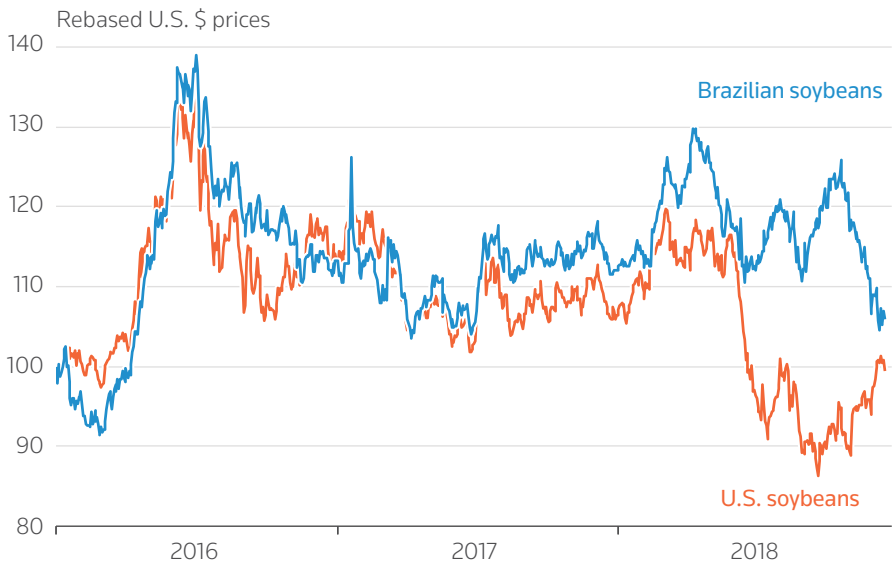
First published Dec. 19, 2018.

Three key indicators to watch like a hawk in 2019

By Richard Beales and Vincent Flasseur

Want to know whether there's going to be a U.S. recession, a flare-up in the trade war, or a spate of corporate implosions? You could stay glued to the news and social media. Or, if you have better things to do, just stay focused on these three proxy indicators.

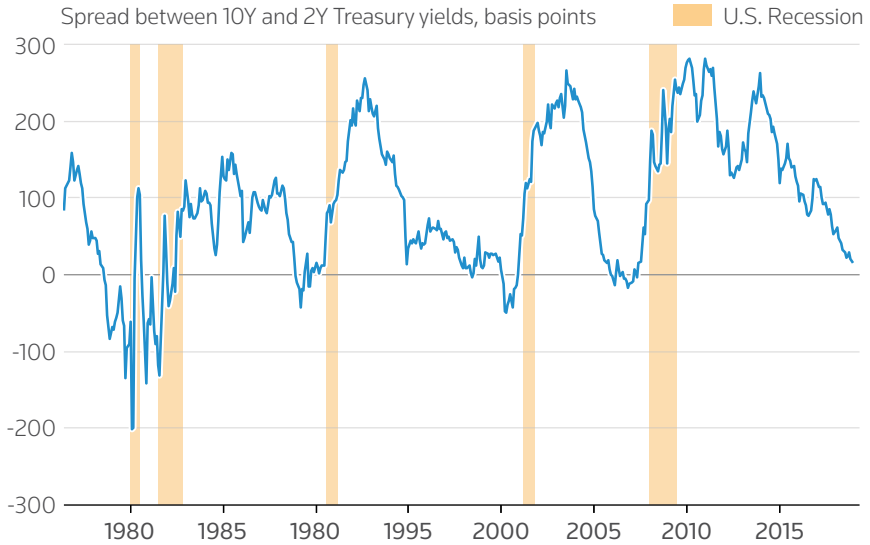
First, take soybeans. American farmers have been early victims of the escalating response to President Donald Trump's import levies. When crops from other countries like Brazil are relatively more valuable, it suggests traders are more worried tariff barriers will persist.



Source: Thomson Reuters Datastream, data to Dec. 13, 2018

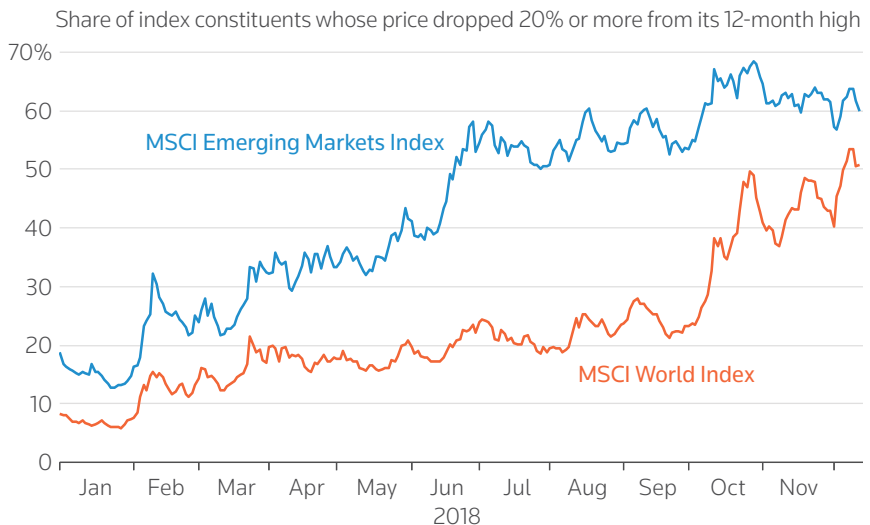
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Then there's the U.S. yield curve. Different experts pick different comparisons, but in the past when the yield on 10-year Treasury bonds has dipped below the return on two-year government paper, a recession has followed. As 2018 draws to a close, the gap is once again very thin.



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Third, corporate health. One hint at sentiment comes from indexes that track how many stocks in given markets are in bear territory, meaning they have fallen 20 percent or more in value from their peak prices in the last 12 months. About half are in that zone in developed markets and more in emerging economies. That might mean shares are cheap. Or it might signify negative sentiment and an accelerating slide in 2019.



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Tech to disrupt supply chains more than trade wars

By Liam Proud

U.S. President Donald Trump has a knack for claiming credit for others' achievements. In 2019, his use of trade tariffs to boost domestic manufacturing will look like it's working. But technologies such as factory automation are going to be the real reason global companies will manufacture more products locally.

Trump's tariffs on China and other trade partners like Europe are a headache for companies that ship goods between the world's three major economic blocs. Manufacturers like carmakers and pharmaceutical groups built low-cost, cross-border supply chains in the 1990s and 2000s, during which time worldwide trade doubled as a share of global economic output. BMW and Daimler import more than half the vehicles they sell in America, but also export more than half the vehicles produced at their U.S. plants, according to Moody's.

That's changing. BMW, for example, is mulling making more SUVs in China rather than incurring levies by shipping them halfway across the world from its South Carolina plant. And medical supplier Philips said in October it was "rearranging" its supply chain to make more American and Chinese products locally to avoid higher U.S. and Chinese tariffs.

But trade wars are only the latest force braking global trade growth. Having peaked at almost one-third of world GDP in 2008, trade flows shrank to just over one-quarter of output in 2016, according to McKinsey. And while the volume of global trade in goods grew at more than twice the pace of real GDP between 1990 and 2010, both grew at roughly the same average rate between 2012 and 2017, World Trade Organization data shows.

The aftermath of the global financial crisis bears a chunk of the responsibility. But a more structural change is that the benefit of making goods in distant countries with low wages is falling as machines replace people. High-tech plants run by software are easier to re-tool to make different products according to demand or geopolitics. Meanwhile consumer goods companies like Inditex, the owner of "fast-fashion" brand Zara, can quickly boost supplies of popular designs by producing them close to customers. That trend should spread beyond retail as 3-D printing techniques allow manufacturers to build complex, customised products more quickly.

Companies will produce goods closer to customers in 2019. Given the trend has as much to do with the switch from humans to machines as trade wars, the workers that Trump claims to be helping may not reap as many benefits as he touts.



Humanoid robots work side by side with employees in the assembly line at a factory in Kazo, north of Tokyo, Japan, July 1, 2015. REUTERS/Issei Kato

Japan is stealth threat to 2019 market stability

By Swaha Pattanaik

What's the biggest threat to global markets in the coming year? It's not a rise in U.S. interest rates, or the end of the European Central Bank's bond buying. Rather, it's the Bank of Japan. Even small adjustments by Governor Haruhiko Kuroda to ultra-loose monetary policy could agitate global asset prices more than other, widely expected changes.

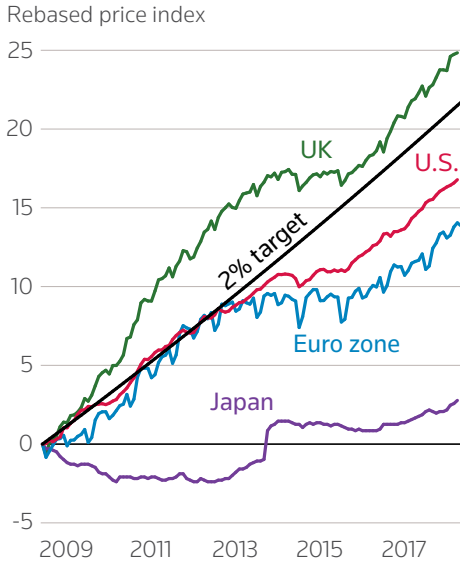
The BOJ already owns assets collectively worth more than the country's entire GDP. Even so, it will keep growing its balance sheet after other major central banks have stopped. Any hints of a shift could alarm investors, whose assessments of risk and reward have been distorted by years of global central bank liquidity injections.

Reports in 2018 that the BOJ was debating scaling back stimulus triggered bond and currency volatility.

Kuroda is, in one sense, damned either way. Japan’s central bank is some distance from hitting its 2 percent inflation target. BOJ monetary policy is, however, aggravating the problems of regional banks. Roughly half of them have reported losses in the past two years or more on their lending business as the gap between what they pay for funding and what they get from making loans to customers has been squeezed.

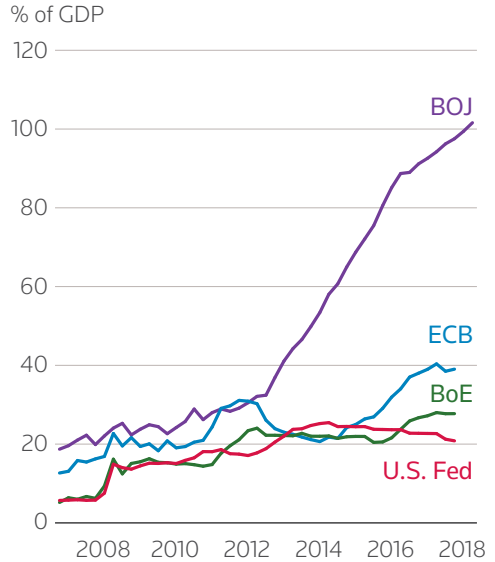
If monetary policy risks doing more harm than good, the BOJ may be tempted to signal it’s willing to allow 10-year government bond yields to move in a wider range around zero or even raise short-term interest rates from minus 0.1 percent. Yields on Japanese government bonds would immediately jump. Nearly half are owned by the central bank and trading can be illiquid. Other markets will also feel the chill. Japanese investors have gone abroad to earn better returns, and will

Inflation targeting



Source: Thomson Reuters Datastream

Central bank balance sheets



V. Flasseur | @Breakingviews

return if domestic yields rise enough. For example, Japanese investors bought about 4.7 trillion yen (\$42 billion) of foreign currency bonds in September alone.

French and Spanish government debt, as well as U.S. credit, have proved popular relative to the size of the markets and could therefore face outside hits. Currency hedging costs have risen so Japanese investors may bail out of overseas assets instead of paying for expensive protection. Those who have left their exposure unhedged to avoid paying for such insurance will be even quicker to do so.

Doubtless, U.S. Federal Reserve chief Jerome Powell, who is likely to keep raising rates throughout 2019, carries a big stick. But his actions are widely trailed already. That's why Kuroda has the greater potential to jangle the market's nerves.

High Noon

SoftBank writedown will cloud Son's way forward

By Liam Proud and Karen Kwok

SoftBank's Vision Fund is due a writedown. The Saudi Arabian-backed tech investor, with \$97 billion at its disposal, reported a 27 percent gain on \$28 billion of investments as of September. That success will reverse in 2019.

Since its inception in 2017, the fund has invested at optimistic-looking valuations. Take WeWork, the money-losing office sublessor. The Vision Fund and SoftBank invested at a \$20 billion valuation in 2017, according to the Wall Street Journal, or 13 times 2018 sales using Moody's Investors Service estimates. SoftBank bought chip designer ARM in 2016 for around \$31 billion and transferred a stake to the fund.

Those prices might make sense to Chief Executive Masayoshi Son, who touts his 300-year investment vision. But they look topky through the lens of traditional venture-capital and private-equity methods, which SoftBank says it uses. The enterprise value of IWG, WeWork's listed competitor, is just below one times its 2019 sales, using Refinitiv estimates, making WeWork's multiple look stratospheric.



Japan's SoftBank Group Chief Executive Masayoshi Son attends a news conference in Tokyo, Japan, Nov. 5, 2018. REUTERS/Kim Kyung-Hoon

ARM's valuation is set to suffer from a recent tech selloff and a slowdown in sales of Apple's iPhones, which contain its chip designs. Shares in semiconductor rival Nvidia, in which the Vision Fund also owns a stake, fell more than 40 percent in the two months to Nov. 30. That has left Nvidia's enterprise value at about seven times estimated 2019 sales, using Refinitiv data. Even at a generous 50 percent premium, debt-free ARM would be worth about \$24 billion using Bernstein's 2019 sales estimate, one-fifth less than SoftBank's acquisition price.

Venture funds take writedowns all the time. Yet SoftBank is unusually vulnerable. Its size means marking down holdings could create a domino effect. The Vision Fund is also using debt, which totalled about \$5.6 billion in September, to help fund its activities. Its capital structure unusually also includes preferred instruments, amplifying losses for other investors and requiring it to make cash distributions.

Moreover, Son's partners, including Saudi and Emirati sovereign-wealth funds, might take fright at writedowns. Any losses risk undermining Son's investing logic, which includes the notion that huge investments in emerging tech stars in and of themselves improve the chances those companies become winners. Both providers and recipients of funds, as well as investment staff, could lose faith. That would slow Son's momentum and force him to think about the shorter term for a change.

First published Dec. 17, 2018.

Activism anxiety will grip French establishment

By Rob Cox

France knows a thing or two about meddling investors. The government regularly sticks its nose in private industry's affairs. Moguls like Vincent Bolloré have long thrown their weight around public boardrooms at home and abroad. But few large French companies have undergone the cage rattling that regularly rocks their American cousins. Pernod Ricard, the booze group, got a taste of that when Elliott Advisors turned up with a 2.5 percent stake on Dec. 12. More is coming.

Executives of enterprises included in the benchmark CAC-40 index can partly blame President Emmanuel Macron for their rising activism anxiety. As economy minister in 2015, the former Rothschild banker ordered a stealth stake increase in carmaker Renault to double the state's voting rights. That not only legitimised hedge-fund style manoeuvres in Parisian capital markets. It also set the stage for the current standoff with Nissan, in which Renault owns a large stake.

Similarly, attempts to take control of Telecom Italia by Vivendi not only backfired in 2018, they signalled vulnerability up the chain of command. Bolloré owns 25 percent of the media conglomerate, which may be worth about 30 percent less than the sum of its parts. A breakup could unlock that discount.

Investors could also gain by lobbying Renault to sell its 43 percent stake in Nissan. The shareholding is worth \$16 billion, almost as much as Renault's total market cap of \$20 billion. The arrest of Chairman and Chief Executive Carlos Ghosn in Tokyo exposed a disparity in governance between the two partners. Should that lead to a rupture in the automakers' alliance, investors will pressure Renault to release money tied up in Nissan.

Then there's Danone. The 44 billion-euro yogurt juggernaut has no controlling shareholder and has underperformed rivals Unilever and PepsiCo, its one-time predator, for five years running. Or Saint-Gobain, whose shares have trailed those of Asahi Glass over the past half-decade. In late November the 18 billion-euro building materials group rushed out a plan to accelerate asset sales and cost savings — a telltale sign of boardroom agitation.

In the past, the French establishment has closed ranks to protect domestic champions from unwanted foreign intruders. Yet whether it's in glass, cars, music or dairy, corporate France needs to brace for an activism unlike its home-grown variety.

First published Dec. 12, 2018.



Vincent Bolloré, chairman of the supervisory board of media group Vivendi, attends the company's shareholders meeting in Paris, France, April 19, 2018. REUTERS/Charles Platiau

Facebook might be the JPMorgan of the tech world

By Gina Chon

If Facebook can negotiate a difficult year ahead, it may be on its way to becoming Silicon Valley's version of JPMorgan. A decade ago, financial firms were taking a whipping from politicians, just as tech companies are today. As Jamie Dimon's bank shows, those who survive the process can end up even stronger.

Mark Zuckerberg's social network faces a world of pain from Washington in 2019. A new Democratic majority in the U.S. House of Representatives has tougher privacy rules on its agenda. Several Democrats want to see those modelled after Europe's new data protection law, known as GDPR. Facebook's stock has tumbled, partly because of the Washington spotlight.

Now think back to the period after the financial crisis, when Congress was drawing up onerous Dodd-Frank legislation designed to make banks safer. JPMorgan was the poster child for bad behaviour. It faced a renewed backlash after a \$6 billion trading loss in 2012, and paid \$13 billion a year later for mis-selling mortgage securities. Dimon's bank had to hire thousands of additional compliance personnel.

Yet now, JPMorgan is back on top. Dimon is head of the Business Roundtable, a Washington group made up of the chief executives of the largest U.S. companies. And its market capitalization of around \$370 billion is almost twice its peak before the crisis hit. Meanwhile, community lenders' share of U.S. commercial banking assets declined at a faster pace after Dodd-Frank was passed in 2010, according to a Harvard study.

Banks have advantages that social networks don't — governments need them to exist, for starters. Yet there are still parallels with tech. About 60 percent of companies said they plan to spend at least \$1 million to comply with GDPR, according to a recent survey by PricewaterhouseCoopers. At around \$400 billion in market capitalization, Facebook can keep up far more easily than the average startup.

That's not to say 2019 will be fun. Facebook's growth in North America is flat, and lawmakers will insist on grilling Zuckerberg and his peers in public — which is tough because he lacks Dimon's charisma. Even if a divided Congress can't pass substantive laws, Europe might. But if doing so puts a moat around companies like Facebook they could come out even tougher.

First published Dec. 17, 2018.

Italian banks to bear populism's burden next year

By Lisa Jucca

May 27, 2019. It's 6:25 a.m. on the U.S. East Coast. Mike P., a portfolio manager at Boston's OMG Capital, messages a dealer contact in Milan via WhatsApp after checking the markets on his Eikon app.

Mike. P

Hey, what is going on in Italy? The 10-year BTP-Bund spread heading for 350!! It was below 300 when I checked on Friday. UniCredit shares are below 10 euros. Intesa below 2 euros??

6:25 AM

Marco

Don't you know? Matteo Salvini almost scored a home run in the European parliament elections 🍌

6:25 AM

Mike. P

You mean the anti-immigration guy who runs Italy's League?

6:25 AM

Marco

Yep. He got 39 percent of Italian votes, more than twice than in the March 2018 ballot 🍌

6:26 AM

Mike. P

NFW!

6:26 AM

Marco

If this was a national vote, he could probably control both chambers of parliament. We think he is going to seek an early vote to break away from his partners in the government, the 5-Star Movement 🌟

6:28 AM

Mike. P

Is this good or bad? I'm still long Italian banks ...

6:28 AM

Marco

Well, our banks hold collectively like 320 billion euros of sovereign Italian bonds. For every 100 basis points in the spread, a listed Italian bank can lose 30 to 40 basis points of core capital. That means arrivederci dividends 🙌

6:30 AM

Mike. P

Can they handle that?

6:30 AM

Marco

Big players like Intesa and UniCredit are in better shape than in 2011, when we had the last big sovereign debt scare. They have raised enough capital to sustain a severe shock, as the last stress test shows. And they sold lots of dud loans. But smaller ones, like Carige, are not out of the woods yet 😞

6:31 AM

Mike. P

So I should calm down?

6:31 AM

Marco

Not yet. There are other issues. The cost of refinancing is becoming prohibitive. UniCredit had to pay 420 bps of premium to issue a senior note in November. Before the League and 5-Star formed a government, the bank paid just 70 bps more 🙄

6:32 AM

Mike. P

Should I sell then?

6:32 AM

Marco

You need to watch Salvini. If he wins an early election hands down, he may tone down the EU-bashing and focus on pro-business reforms liked by his entrepreneurial base. But he still surrounds himself with eurosceptics like EU Affairs Minister Paolo Savona and MP Claudio Borghi 😞. If he sticks with this crowd, the Quitaly risk will stay.

6:35 AM

Mike. P

You're killing me here, Marco. Should I just bite the bullet, buy Deutsche Bank stock and get out of Italy?

6:35 AM

Mike. P

Marco, you still there? Marco?

6:36 AM

Mike. P

Marco?

6:40 AM

Marco



6:40 AM

Trump can get what he wants from Saudi in 2019

By George Hay and Lauren Silva Laughlin

Even by his own standards, Donald Trump has been contradictory on oil. The U.S. president spent much of 2018 berating the Organization of the Petroleum Exporting Countries for keeping crude prices high by undersupplying the market. At the same time, he exacerbated the problem by reinstating export sanctions on Iran. An early December cut by OPEC and fellow producers including Russia is an irritant, but relatively low prices still look attainable.

On current projections, the reduction of 1.2 million barrels per day removes much of a potential glut caused by epic pumping by Saudi Arabia, Russia and the United States. Combining the International Energy Agency's forecasts for oil demand in 2019 and its estimate for non-OPEC supply, the oil-producing bloc only needs to pump 31.6 million bpd to balance the market — 1.4 million below its November output.

Given Trump's targeting of Iran's 3 million bpd of production, the reduction by OPEC and its peers is unhelpful. At worst, the combination could leave supply too tight, pushing prices up again.

Yet there are reasons the president can hope for a more favourable outcome. Demand growth could undercut IEA expectations — Wood Mackenzie estimates an increase of



U.S. President Donald Trump and Saudi Arabia's Crown Prince Mohammed bin Salman are seen during the G20 summit in Buenos Aires, Argentina, Nov. 30, 2018. REUTERS/Marcos Brindicci

just 1.1 million bpd for 2019 while U.S. crude production is seen jumping to 12 million bpd, up from 9.4 million in 2017. Most powerfully of all, Trump has greater scope to tell Saudi's Crown Prince Mohammed bin Salman what to do.

The White House gave MbS a pass in November on whether he was involved in the murder of Saudi journalist Jamal Khashoggi. The president could use this leverage to call for an end to the 18-month-old blockade of Qatar or even of the war in Yemen, which the Brookings Institution says costs Saudi \$50 billion annually.

But the most obvious power play involves oil, where Trump could insist MbS resist future OPEC cuts. That would make any potential squeeze temporary, and allow Trump scope to enforce sanctions against Tehran.

The fly in the ointment is the U.S. Congress, which could yet override Trump and punish MbS and Saudi. To keep prices low as a 2020 election nears, that may necessitate keeping Iranian crude flowing by renewing waivers allowing big importers to continue buying. That would make Trump look inconsistent — although that's not something that appears to bother him.

First published Dec. 14, 2018.

Memo to Theresa May: How to save Brexit as well

By Peter Thal Larsen

Theresa May has survived a confidence vote from her party. Now officials in the British prime minister's office are trying to save her deal to leave the European Union. Breakingviews has obtained a copy of their make-believe memo.

Dear Prime Minister,

Congratulations on winning the no-confidence motion. We always suspected that Conservatives, who had trouble counting the 48 letters required to call the vote, would never find the 158 members of parliament they needed to remove you. Still, it's reassuring to know that your political enemies are even more inept than the ones in your cabinet.

You asked for new ideas about how to salvage your plan to leave the European Union. After more than two years of Brexit debate, we regret to inform you the cupboard is bare. However, now you have saved your job, we have a proposal that could save the deal. It requires you to call a referendum.

Wait! Before you file this in the rubbish bin, consider your position. Your Brexit plan was heading for a hefty defeat in parliament until you postponed the vote on Dec. 3. A whirlwind tour of European capitals produced little except footage of your car door not opening as you pulled up in Berlin. At least Angela Merkel realises how awkward it is to be stuck in a transition period.

The best you can hope for from the EU is vague reassurances on the Northern Ireland backstop, or some kind of legal appendix. That's unlikely to win over the Brexit fanatics in your party, including the 117 who voted against your leadership, or the Democratic Unionist Party on whom your government's slender majority depends. So despite the triumph, parliament will still reject it when it finally comes to a vote.

You could keep delaying the decision, maybe even until the last minute on March 28, and hope your opponents buckle. But the longer you wait, the bigger the risk of a chaotic and damaging "no deal" will loom. The pound will tumble back down, and the economy will suffer even more. Meanwhile, opposition MPs could always intervene by voting to reverse the Brexit process. And even though you've seen off the no-confidence vote in your leadership, parliament could still launch one in your government. You cannot count on Jeremy Corbyn, the Labour leader, being hopeless indefinitely.

That's where the second referendum comes in. If you wait, parliament might take over and launch one. Better to seize the initiative and call it yourself. Doing so would allow you to dictate the timing, and the question on the ballot. We recommend offering the people a simple choice between your deal or staying in the EU. Advocates of a "no deal" Brexit won't like it, but after their defeat they have little choice but to back you. And you'll put Labour in a tight spot. Will Corbyn risk alienating his pro-Brexit supporters by campaigning to remain?

True, this strategy has several drawbacks. For one, you have ruled out a second referendum. But you insisted you would not call an election in 2017, and then called one. You spent two years insisting that a "no deal" Brexit was better than a bad deal, but now warn it would cause "significant economic damage". You said your deal was the best on offer, before heading to Europe to ask for improvements. The public won't be surprised if you change your mind again. It's what you do.

Finally, you might lose the referendum. It won't be so easy to charm voters with false promises of extra money for healthcare, or to scare them by suggesting Turkey is about to join the EU. The pro-Europeans will be more organised. You

might finally have to come clean about the costs of Brexit. Amazingly, though, despite the mayhem of the past two-and-a-half years, opinion polls suggest about half the country is still in favour of leaving the EU. And this time the government will be campaigning to leave, not remain.

You keep saying that you want to deliver Brexit. You will either go down in history as the prime minister who took Britain out of the EU, or the prime minister who tried and failed to do so. Now that you've promised not to contest the next general election, another referendum is your best — and maybe your only — chance of it being the former.

Yours,

The Last Resort Unit, Downing Street

First published Dec. 12, 2018.



A giant scaffolding sculpture with an image of Britain's Prime Minister is seen on top of the cliffs overlooking the south coast of England and the Channel, June 5, 2017. REUTERS/Simon Hare

High and Dry

Goldman Sachs will spend 2019 in velvet handcuffs

By John Foley

David Solomon is like the owner of a Ferrari who hasn't been given the keys. The new Goldman Sachs boss starts 2019 with one of Wall Street's most prestigious jobs, and something to prove. This could be the first year in over a decade that the \$63 billion bank starts with a smaller market capitalization than its chief rival, Morgan Stanley.

Goldman set out in 2017 to create \$5 billion of new revenue streams, and Solomon starts with half that figure already in the bag. But there's a lot to play for. Morgan Stanley boss James Gorman runs a bank with earnings that are lower but less subject to the vicissitudes of the market. Goldman makes around 57 percent of its revenue from predictable businesses other than trading and investment. At Morgan Stanley it's nearly two-thirds.

Solomon is growing Goldman's private wealth business, which services the ultra-rich, adding almost one-third more advisers by 2020. He could go further by addressing one of Goldman's least lustrous businesses: asset management. That generates stable, predictable fee income. But its operating margin of just over 20 percent is half what



Goldman Sachs Chief Executive David Solomon performs at Schimanski night club in Brooklyn, New York, United States, Oct. 14, 2018. REUTERS/Trevor Hunicutt

the group's investment bank makes, and below the 33 percent industry average, as measured by McKinsey.

The bar for doing a big deal is extremely high, Solomon has said. But buying a rival like the \$22 billion T. Rowe Price, which has double Goldman's profitability in asset management, would help. It would take Goldman's client assets to \$2.6 trillion and boost stable revenue sources to over 60 percent of the total.

There's one big, shadowy problem: 1MDB. Goldman is being investigated by the Department of Justice and the Federal Reserve for its role raising funds for the Malaysian fund in 2012 and 2013, some of which ended up paid out as bribes. Two former Goldmanites have been indicted; others knew about the misdeeds, the DOJ says. A 10-digit fine is likely, but a time-suck for Solomon is certain.

Expect Goldman to settle as early as it can. But Solomon will probably have to oversee a sweeping internal cleanup, and — even though not implicated in 1MDB himself — could be called to Washington to answer publicly to a newly Democrat-run House of Representatives. All when he'd rather be growing his way to greatness, and showing Morgan Stanley a clean pair of heels.

First published Dec. 18, 2018.

Buyout lenders will enter a new world of pain

By Neil Unmack

Leveraged buyout lenders are in the firing line in 2019. With central banks raising rates and shrinking balance sheets, the happy times for the likes of Blackstone, KKR and Apollo Global Management will subside. But buyout barons will be laughing compared to those who financed their deals.

Low rates and the hunt for yield in recent years triggered a boom in risky lending. The volume of leveraged loans in particular reached \$1.3 trillion in the United States and Europe in 2018, versus \$734 billion in 2007, according to LCD, part of S&P Global. The average U.S. leveraged buyout piled debt equivalent to almost seven times EBITDA in 2018, only marginally below the record in 2007, according to Refinitiv data.

The fuel powering bigger and riskier deals should now dissipate. Helped by the downgrading of General Electric, BBB-rated debt is at record levels. Now that investors can earn yields of nearly 5 percent from companies deemed investment grade, junk-fueled buyouts will get harder.

Yet dealmakers have less to fear than in 2007. Assuming 2019 is a slowdown rather than a 2008-style financial crash, companies are less likely to suddenly run out of cash. That

will keep defaults far lower than the 13 percent they reached in 2009. And it may help that collateralised loan obligations (CLOs), a kind of securitised investment vehicle that buys loans, account for half of the market now. These vehicles create a stable demand for credit, reducing scope for fire sales.

Creditors face a much trickier time. Senior lenders who provide the bulk of the funding are in particular more at risk than in the last cycle, because they now provide a bigger share of the credit. With U.S. deals' senior debt on average 5.2 times EBITDA, according to Refinitiv, versus 4.4 times in 2007, those at the top of the capital structure will absorb more losses if companies implode.

But creditors also have less control. In previous cycles, a company in danger of failing a so-called maintenance covenant would need to keep lenders on side, and pay them extra fees. Now, most deals are "cov-lite". Debt documents give companies more freedom to take risks or siphon off assets, even when they are struggling. Private equity-held companies can also sell assets without repaying debt and pay themselves dividends. They can even move assets out of creditors reach, and use them to borrow more. That's what happened with TPG Capital and Leonard Green's acquisition of retailer J.Crew.

The upshot is that there will be fewer defaults, but losses will be much higher than the roughly 20 percent that senior lenders are used to. Unpredictable recoveries mean that loans will be harder to value, and vulture funds will pay lower prices for distressed debt.

There's also still a way for both dealmakers and funders to get hosed. A sudden spate of low recoveries could spook the market and cause prices to collapse. Investors in CLOs, particularly those in the lower-ranking tranches, could lose their income and take severe losses, freezing new securitisations and funding for new deals. But of the two, lenders have far more to fear.

A made-in-America market will be a distorted one

By Richard Beales

U.S. President Donald Trump's "America first" mantra involves barriers to trade and immigration and a sort of manufacturing nationalism. Experiences like Argentina's show that this approach creates market dysfunction and can hit economic output and jobs. More of that kind of fallout is likely in 2019 as the White House rolls out further protectionist measures.

Agricultural tariffs have already hit American farmers, prompting the promise of \$12 billion in aid to offset the damage – one glaring market distortion.

Car prices, meanwhile, could increase by up to 20 percent if the U.S. administration imposes the threatened 25 percent levy on foreign content and manufacturers pass this

through to U.S. consumers, the Peterson Institute for International Economics calculated in July. This is bad news for automakers and their employees. The increased cost would also vaporize up to a quarter of the tax reductions handed to car buyers in the 2017 cuts, the PIIIE reckons.

That shows how import tariffs interact with global supply chains, also critical in consumer electronics. Several analysts have suggested the cost of Apple's \$1,000 iPhone X might double if the gadget could be made entirely in the United States — assuming the company didn't absorb any of the extra cost.

There's more to it, though. When President Cristina Fernandez insisted in the early part of this decade that electronics be made inside Argentina, then-trendy BlackBerry gave it a go. Despite Fernandez's Trump-worthy photo opportunity when the first handset rolled out, the device was already out of date as well as too expensive, National Public Radio explained in a 2017 podcast. BlackBerry production ended within a few years.

Apple Chief Executive Tim Cook has noted that the company's outsourcing — much of it centred on China — is these days not so much about cost savings. It's about the quantity and skill level of labor that's available. That, along with certain kinds of manufacturing know-how, can be hard to replicate at scale, even in the United States.

Uncle Sam has resources Argentina can only dream of, but the basic lessons still apply. The United States' own history shows the failure of episodes of protectionism, the Cato Institute argued in 2017, highlighting the steep economic costs researchers have identified. A made-in-America market will be a badly distorted one.



General Motors Chairman and Chief Executive Mary Barra unveils a Chevrolet Bolt EV during a keynote address at a trade show in Las Vegas, Nevada, Jan. 6, 2016. REUTERS/Steve Marcus

General Electric can go from bad to worse in 2019

By Lauren Silva Laughlin

General Electric has had a terrible year: the stock has lost more than half its value and is flirting with financial crisis lows. It can get worse. As its power business struggles and its finance unit consumes cash, the \$60 billion conglomerate is heavily reliant on its aviation arm. The risk is that cyclical, financial and competitive headwinds kick the strongest leg of the stool out from under shareholders.

That's a painful prospect after its annus horribilis, which included writing down assets and the firing of its chief executive, replacing him with the first outsider in the job, Larry Culp. With other operations struggling, plane product sales and repairs accounted for some 60 percent of segment earnings in the first nine months of 2018.

Aviation is GE's pride, benefiting from booming air travel and robust engine orders, particularly from Middle Eastern customers. These included longstanding contracts with Saudi Arabia's carrier to build and fix airplanes, and a 2018 deal to provide engines to Turkish Airlines.

What could go wrong? Start with geopolitics. Increased tensions between the Saudis, Iranians, Turks, Qataris and others could dampen travel and slow new orders. A general economic slowdown, amid unresolved trade disputes, would do the same. Air travel is cyclical: More than a dozen U.S. cargo and passenger airlines filed for bankruptcy during the last U.S. recession.

There's also the albatross of GE Capital. To help finance the sale of engines, GE Capital uses its parent as the backstop. That worked fine when it carried an A rating, enabling the finance arm to tap short-term markets with low rates. But ratings agencies downgraded the company after fresh writedowns in October, forcing it to slash its use of commercial paper.

This gives competitors like Rolls-Royce and United Technologies' Pratt & Whitney an opportunity. Pratt & Whitney may be especially eager to poach GE customers following its merger with Rockwell Collins, and its parent's decision to spin the company off as an independent entity.

Growing engines sales over the past decade could keep GE relatively busy fixing them. The global economy may continue to hum along. GE Capital may right itself, and rivals fail to chip away at GE's aviation dominance. But like any jet trying to make a safe landing with a single engine, an unhealthy dollop of faith is required.

First published Dec. 11, 2018.

Brazil will get energy mostly right; Mexico won't

By Martin Langfield

Energy-sector reform is up in the air in both Brazil and Mexico. In the coming year, new regimes in Latin America's two biggest economies will wrestle with balancing 1970s-style nationalism against the need to open up to foreign and private capital to exploit their oil and gas resources. Jair Bolsonaro, Brazil's far-right president-elect, has better prospects of getting it right than left-winger Andrés Manuel López Obrador in Mexico.

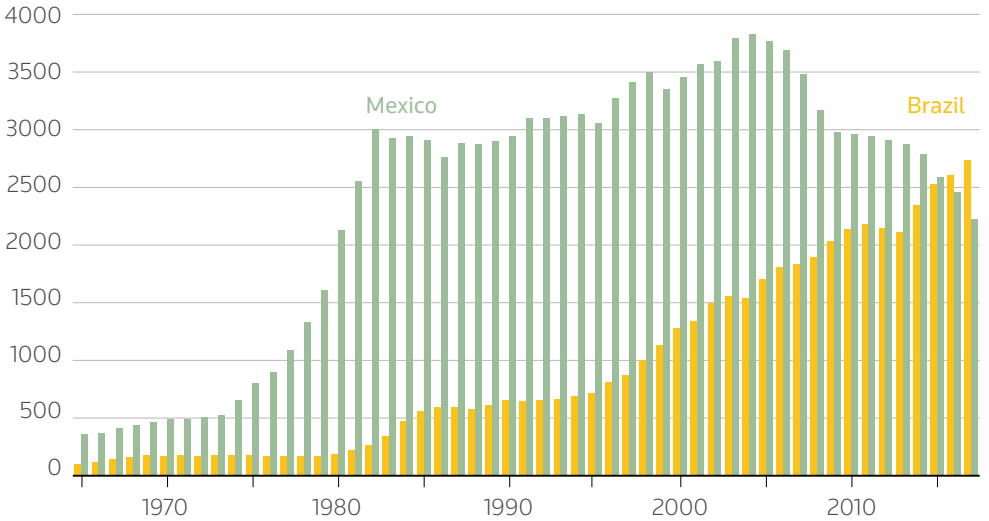
There is a strong nationalist element in ex-army captain Bolsonaro's thinking about Brazil's natural resources, which include massive untapped oil and gas reserves. Yet the appointments he has announced before taking office on Jan. 1, 2019 show that the influence of his pro-market economic guru, Paulo Guedes, is powerful too.

The outcome will be a compromise. Petroleo Brasileiro, the state-controlled oil firm, won't be privatized, as Guedes and the company's chief executive-designate, Roberto Castello Branco, have argued in the past it should be. But Petrobras will sell off non-core businesses, shedding refineries and distribution operations worth billions of dollars and paying down more of its net debt of some \$78 billion. A successful program of auctions that has lured oil majors such as Exxon Mobil, Royal Dutch Shell and BP to invest in Brazilian oil fields is likely to continue.



A person stands during a visit to Brazil's Petrobras P-66 oil rig in the offshore Santos basin in Rio de Janeiro, Brazil, Sept. 5, 2018. REUTERS/Pilar Olivares

Oil production, thousands of barrels per day*



*Includes crude oil, shale oil, oil sands and natural gas liquids

Source: BP World Energy

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Prospects are murkier in Mexico, where the man widely known as AMLO, a populist like Bolsonaro though of opposite ideology, took over as president on Dec. 1. The new leader has chilled investor sentiment by saying his government will examine more than 100 contracts awarded since liberalization of the oil and gas sector five years ago. He will respect them if no corruption is found, he says, but has shown little enthusiasm for more auctions.

Instead of private and foreign investment, López Obrador wants to rely on state oil company Petroleos Mexicanos to boost dwindling production by some 40 percent during his six-year term. After decades of neglect, Pemex is in poor shape to do so. To help boost gasoline production, meanwhile, AMLO pledged to build a new \$2.5 billion crude refinery in the southern state of Tabasco, a plan approved in an informal referendum in late November, albeit with a turnout of just 1 percent of voters. Not only is that no way to run an energy policy, it also leaves the sector even more stubbornly under government control.

Lyft, Uber IPOs will drain Tesla's scarcity value

By Antony Currie

Initial public offerings by Lyft and Uber Technologies will drain Tesla's scarcity value in the next 12 months. Elon Musk's electric-vehicle maker, whose market value hit \$64.8 billion in August 2018, has, to date, been virtually the only way to invest directly in the car industry of the future. But the two ride-hailing firms will give U.S. public shareholders who factor in environmental, social and governance concerns new options.

What started as very different business models — app-enabled taxi services and vehicle production — are now converging, also joined by traditional players like General Motors and upstarts like Alphabet's Waymo. The common vision of the future is autonomous, electric-powered vehicles that are shared, not owned.

Tesla only produces electric cars, making it an obvious choice for environmentally conscious investors. Lyft and Uber, by contrast, currently rely on people driving predominately gasoline-powered vehicles.

But the two have a lock on other car-of-the-future components. Lyft, for example, had 1.4 million drivers at the end of 2017. Assume they drive just half of the historical average for traditional U.S. taxi drivers of 70,000 miles a year. That means the company co-founded and run by Logan Green was responsible for almost 50 billion miles driven in 2017 in America, five times more than Tesla owners have clocked globally in total. Uber accounts for even more. That's critical data for the autonomous-vehicle race.

And ESG investment, as it's known, is not just about the environment. The "G" is for governance, and here Tesla is a laggard. The majority of its directors are friends and family of Musk. A series of missteps culminated in the chief executive's cack-handed tweets in August about a possible buyout, resulting in the Securities and Exchange Commission imposing fines and forcing Tesla to replace Musk as chairman.

Uber had a poor record under founder and former boss Travis Kalanick, too, although current CEO Dara Khosrowshahi has tried to turn a new page. At Lyft, by contrast, Green has been more of a cooperator than a bull-in-a-china-shop disruptor, working with authorities rather than challenging them and earning social bragging rights, too.

Lyft has also long invested in measures to offset its drivers' fossil-fuel dependence. As of April all of its rides, Green says, are carbon neutral. For ESG-minded investors eyeing the car market, a publicly traded Lyft could be the most desirable ride.

Financing drought cracks farmers' loyalty to Trump

By Gina Chon

A financing drought may crack farmers' loyalty to Donald Trump. The U.S. president's trade war has evaporated export markets for a number of crops, leaving growers struggling even more than before.

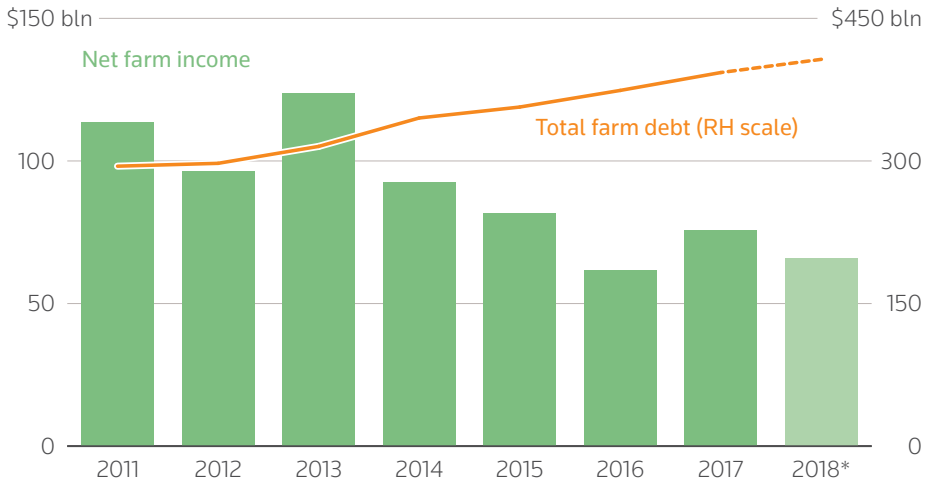
Sales of soybeans, the biggest U.S. agricultural export to the Middle Kingdom, were down 98 percent through mid-November 2018, according to Deutsche Bank. Wheat, pork and cherry sales have also been hurt. The Trump administration set aside \$12 billion to offset the pain, but only about \$840 million has been doled out.

Yet people in rural U.S. states have largely stuck by Trump. Montana farmer Lyle Benjamin told Breakingviews that he supports the president's efforts to take on China. That echoes the general feeling among his peers, who tend to agree with the president's criticisms of China's unfair trade practices and believe he can deliver a better deal. They'll take heart from the U.S.-China détente at December's G20 summit. Trump said the People's Republic will immediately start buying U.S. agricultural products. But Beijing has not confirmed that — and its 25 percent tariff remains.

Benjamin also noted, though, that credit has become tight and many farmers have used what liquidity they had. In the first few months of 2019 they'll be looking for financing for the next harvest.



U.S. President Donald Trump holds "Make Our Farmers Great Again!" hats during a "Make America Great Again" rally in Evansville, Indiana, United States, Aug. 30, 2018. REUTERS/Kevin Lamarque



Note: *2018 USDA forecasts

Source: U.S. Department of Agriculture, 2018 forecasts

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Thanks to tariffs worsening the pain low commodity prices have already inflicted, it'll be hard to get. U.S. net farm income in 2018 is expected to almost halve to \$66.3 billion compared to five years ago, according to U.S. Department of Agriculture forecasts. During that same period, farm debt rose by 30 percent to \$410 billion.

That has pushed the farm sector's return on assets down to 2.6 percent, well below the nearly 30-year average of 7.1 percent. Interest rates and delinquencies on agricultural loans are steadily increasing. In the year to the end of June, farm bankruptcies in the Midwest more than doubled to 84 compared to two years ago, according to the Minneapolis Federal Reserve.

U.S. farmers will be at a bigger disadvantage when the new Trans Pacific Partnership goes into effect at the end of 2018. It no longer includes the United States, and American products face higher tariffs than competitors. Without a quick resolution to trade tensions, farmers' doubts about Trump may start to grow like a weed.

High Flyers

ByteDance will take over B in China's BAT

By Alec Macfarlane

ByteDance would add some oomph to China's BAT. The fast-growing creator of news and video apps is already privately valued at \$75 billion, putting it on par with web search outfit Baidu, whose public equity in early December was worth some \$65 billion. A 2019 merger between the two will modify the constituent parts of the acronym shared with Alibaba and Tencent.

Software engineer Zhang Yiming started ByteDance in 2012 with Toutiao, an app that uses artificial intelligence to deliver bespoke individual news feeds. When the company learned how Chinese youth love to share short video clips with each other, it developed TikTok, known locally as Douyin. The video services claim over 500 million monthly active users, creating fresh expectations that ByteDance can spot the next big thing and use its algorithms to design new market-leading apps.

Competition for online advertising is cutthroat in China, however. About 10 companies, including Tencent and web portal Sina, share most of a pie estimated by iResearch to be some \$73 billion. Pressure will only increase as China's economy cools. Marketing



Robin Li, co-founder, chairman and chief executive of Baidu, speaks at the 2018 Baidu World conference and exhibit to showcase its latest artificial intelligence technology in Beijing, China, Nov. 1, 2018. REUTERS/Jason Lee

budgets are often among the first to be cut. Baidu is in particularly bad shape. Revenue growth is abating and efforts to diversify have been slow.

That makes a union of Baidu and ByteDance a tantalising prospect. Aside from the potential cost savings, Baidu would provide ByteDance with a stepping stone to business customers. The web group led by Robin Li also has some powerful artificial intelligence of its own to contribute. And it would give ByteDance, backed by Sequoia Capital, KKR and other investment firms, an easier path to capital markets, which have become increasingly difficult for new tech ventures to enter at the exuberant valuations they want.

For Li, owning a slug of the combined company would give him a stake in a bigger, more promising group. What's more, both ByteDance and Baidu are among the few sizeable Chinese technology enterprises not funded by either Alibaba or Tencent. Together, they would prove a more formidable force. The challenge will be for two strong, rival personalities to see eye to eye. Such bountiful opportunities, though, suggest a double-B deal is meant to be.

Airbnb will succeed where U.S. peers failed: China

By Sharon Lam

Airbnb will emerge an outlier among Silicon Valley upstarts in China in the coming year. Internet giants from Alphabet to Facebook, lured by growth, have tried without success to crack the People's Republic. But unlike other American internet firms, Airbnb's business dovetails with the Communist Party's interests in ways that lend it unusual political cover.

Beijing's censorship controls have kept big tech out of the Middle Kingdom. Google's Chinese search engine was shut down in 2010 amid cyberattacks. Twitter and Facebook have also struggled with regulators. Mark Zuckerberg's social network retreated in 2009. Job-search platform LinkedIn has had measured success, but others like Uber and Amazon found the going too tough.

Airbnb's business model already aligns nicely with President Xi Jinping's vision for Chinese real estate. Xi, who once proclaimed that "houses are built to be inhabited, not for speculation," wants to cool rising home prices and combat a glut of unaffordable housing. Beijing has moved, for instance, to cap new private homes in property hotspot Shenzhen at 40 percent of supply. By helping put excess housing capacity to work, Airbnb becomes part of the solution.

Airbnb's community-centric model also fits with Beijing's designs to generate social credit scores for citizens. The group valued at \$31 billion in its last funding round willingly shares host and guest information with government agencies and stores its data in local servers. Airbnb has also struck partnerships with local city authorities and municipal governments. Initiatives like promoting tourism through home-sharing in rural Guilin could be looked favourably upon by authorities.

So far, Airbnb's political savvy is working: in the third quarter, the number of guest arrivals increased by 91 percent in Beijing. Airbnb still faces fierce competition from homegrown rivals like Tujia, backed by travel firm Ctrip; and Xiaozhu, which raised nearly \$300 million in a recent round. But Airbnb's global network, which has seen over 400 million guest arrivals around the world, gives it a leg up.

As the company prepares to go public in 2019, the China story will become central to Airbnb's success. It already forecasts more guests will come from the country by 2020 than any other. An American business model, designed with Chinese characteristics, will allow Brian Chesky's creation to go farther in China than his internet brethren have gone before.



Airbnb contest winners Wu Hao and Tang Di of China pose before spending a night among sharks in an underwater structure installed in the Aquarium of Paris, April 13, 2016. REUTERS/Charles Platiau

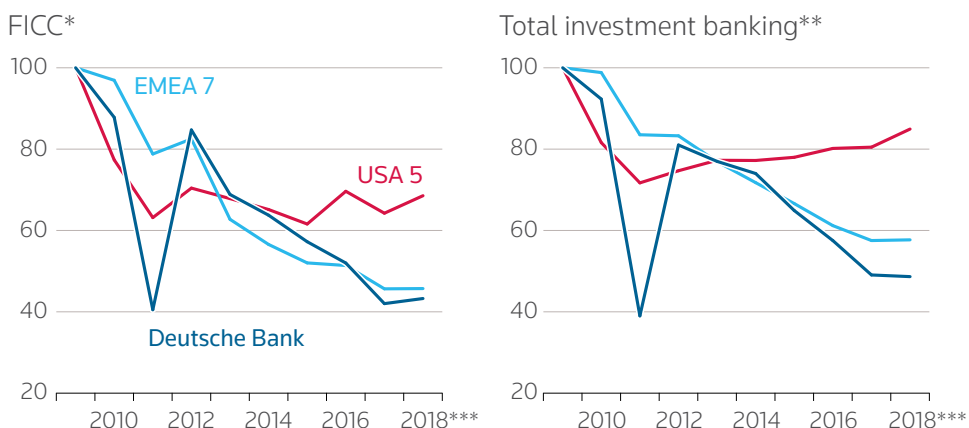
Deutsche Bank will be unlikely 2019 trading star

By Christopher Thompson

Whisper it gently: Deutsche Bank shareholders might finally have something to cheer about. The German lender has in recent years seen seemingly irreversible declines in trading revenue that have outpaced cost-cuts. In 2019 its business mix, and the potential for currency volatility and rising European rates, should make it a relative winner.

Ever since the financial crisis Europe's investment banks have resembled a car crash in slow motion. The region's lenders have seen their overall investment banking revenue decline by 27 percent since 2010, according to UBS, compared to an 18 percent decline globally. Deutsche has been even worse – at its bedrock fixed-income trading division, which in 2017 accounted for 17 percent of group net revenue, turnover has dropped by 28 percent over the last two financial years alone. Its shares trade at a pitiful, Greek bank-style valuation of just 0.3 times tangible book. Deutsche Bank executives have had to repeatedly deny reports that a defensive merger with Commerzbank is in the offing.

Rebased global post-writedown revenue in U.S. dollars



*FICC: FX, Rates, Credit, Commodities, Securitisation. **FICC + Equities (cash, derivatives, converts, prime services) + Banking (fees from ECM, DCM & M&A advisory). USA 5: Bank of America, Citigroup, Goldman Sachs, JPMorgan & Morgan Stanley. EMEA 7: Barclays, BNP Paribas, Credit Suisse, HSBC, RBS, SocGen & UBS. ***H1 2008, annualized.

Fixed-income traders tend to thrive when there is a trend. The last time this occurred in Europe was when European Central Bank President Mario Draghi introduced quantitative easing in 2015 and guided steadily lower interest rates. Consequently, asset managers increased buying and selling and companies purchased more hedging products. As the ECB prepares to scale down its asset purchases, the next trend is rising yields. Given that Deutsche has the biggest market share in European rates apart from JPMorgan, its top line should benefit disproportionately from heightened client demand.

Political volatility could add some additional gloss in currencies. Continued geopolitical uncertainty in Europe — think Brexit and Italy — and elsewhere should lead to wider currency spreads and, all else being equal, greater profits.

Chief Executive Christian Sewing has zero room for complacency. A boost in European trading income will be somewhat offset by falling U.S. revenue due to cutbacks in Deutsche's U.S. rates and equities business. At the same time, Sewing must find another billion euros in cost savings, and firefight Deutsche getting dragged into questions over money-laundering controls.

Analysts only forecast a 3 percent return on tangible equity for Deutsche in 2019. But the bank's increasingly diverse shareholder register — which encompasses Qatari, Chinese and U.S. hedge fund investors — doesn't need rising European rates to lead to a miraculous resurgence. Just a transition from terrible to merely bad.



Deutsche Bank building before the bank's annual news conference in Frankfurt, Germany, Feb. 2, 2018. REUTERS/Ralph Orlowski

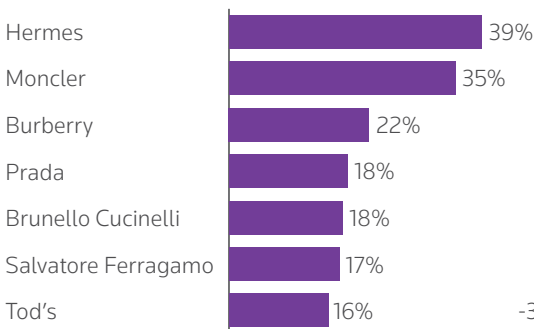
Italy's woes could spell LVMH moment for Moncler

By Lisa Jucca and Karen Kwok

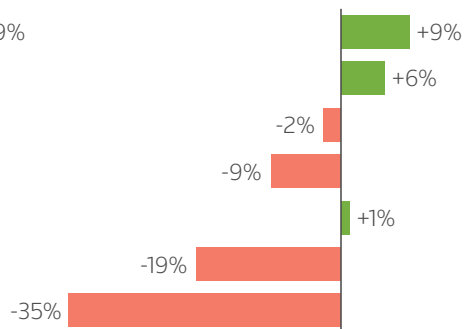
Remo Ruffini could be Italy's answer to Bernard Arnault in 2019. Since rescuing Moncler in 2003, the entrepreneur has rejuvenated the brand into a goose-down success story. There's a long way to go before he can use the growing strength of 7.5 billion euro Moncler to create anything like Arnault's LVMH, worth 130 billion euros. But if he fancies building the first Italian luxury aggregator, now is a good time.

Italian luxury is fragmented and valuations are historically cheap — the sector trades on 25 times expected earnings, compared to a five-year average of 28 times, Refinitiv data shows. Sales at upscale shoemaker Tod's have been falling since 2014. Salvatore Ferragamo also struggles with revenue, and is in flux after matriarch Wanda Ferragamo's death. Unlisted players like handbag-maker Furla may also come up for sale.

EBITDA margin, last 12 months



Share price performance, 2018 YTD*



Source: Thomson Reuters Eikon, data to Dec. 14, 2018

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U.S. and Chinese buyers have noticed. Michael Kors paid a hefty \$2.1 billion for struggling Versace in September. China's top textile player Shandong Ruyi and conglomerate Fosun snagged Swiss brand Bally and French couture house Lanvin respectively.

Still, the rise of an EU-sceptic government in Rome embracing shaky budget policies could put a brake on global buyer enthusiasm. That gives Ruffini an opportunity to consider going beyond Moncler. The Italian is doing something right: sales jumped by 15 percent in 2017 and should do so again in 2018. His skills could be deployed to battle the generational shifts and changing consumer habits undermining some storied Italian brands.

Investors who bought Moncler shares when it debuted in 2013 have seen total returns double, beating all listed peers bar Hermes. At 35 percent, Moncler's EBITDA margins are second only to the famed French handbag maker among luxury players in Europe. And Ruffini is no stranger to M&A: in October his family vehicle Archive bought a 49 percent stake in small Italian fashion brand Attico.

LVMH and peers Kering and Richemont are so shaped because their size brings economies of scale and diversification benefits. Although Moncler's flagship jackets are in vogue, acquiring leather goods or watches could hedge against fickle tastes. If Ruffini can overcome Italian luxury's traditional rivalries and get second-generation potential sellers onside, the path to Arnault-style status could be his.



A video installation is displayed at the Moncler catwalk show during Milan Fashion Week Spring 2019 in Milan, Italy, Sept. 19, 2018. REUTERS/Stefano Rellandini

East Africa will buck global great rift trend

By Ed Cropley

Twenty-five years after genocide, German cars are rolling off production lines in Rwanda. To keep motoring the tiny, landlocked East African country needs access to markets. Luckily, one on its doorstep is set to buck the global trend towards balkanisation.

Africa has 1.2 billion people, but they are fenced off in over 50 individual countries. Trade barriers crimp opportunity and investment. Attempted regional trade areas stretch from Cape Town to Cairo, but only the East African Community has made real headway. In 2010 this bloc, which now includes Uganda, Tanzania, Rwanda, Burundi, South Sudan and Kenya, its spearhead, launched a common market for goods, services, labour and capital. It even dreams of monetary union in five years.

In 2019, 100 million Ethiopians could give the EAC real impetus. After a year of dramatic political reforms, the regional giant synonymous with 1980s famine could be ready to join the local trade bloc. That would create a common market of 250 million people.

The combination of Rwandan leader Paul Kagame, standard-bearer for African free trade, and an Ethiopia stirring from decades of socialist slumber could be transformational. On a GDP-weighted basis, Rwanda easily attracts the most foreign



Newly elected President Sahle-Work Zewde addresses the House of Peoples' Representatives in Addis Ababa, Ethiopia, Oct. 25, 2018. REUTERS/Tiksa Negeri

direct investment in Africa, according to consultancy firm EY. Kenya and Ethiopia also fare well. Most investments are in manufacturing, supporting the view that as Chinese wages rise factories in East Africa, where labour is cheap, can become viable alternatives. Being part of a large regional market only boosts the logic for companies making everything from boots to bicycles.

Other bits of the jigsaw are also falling into place. The first leg of a Chinese-funded rail network from the Kenyan coast to Kigali was completed in late 2016. In June, Ethiopia and Eritrea ended 20 years of hostilities and opened their border. And the region's economies are buzzing. The IMF predicts growth of 8.5 percent for Ethiopia in the year ahead, alongside 7.2 percent for Rwanda and 6 percent for Kenya. Of course, there are risks. Sovereign debt levels are creeping up, and toxic ethnic politics could yet poison the well. But in one corner of Africa at least, barriers are heading down, not up.

Rio will turn big miners back into big spenders

By Clara Ferreira-Marques

Rio Tinto will be first on the spending trail. The Anglo-Australian giant and peers like BHP have been steadily churning out cash, but investors have understandably fretted this will be wasted on overpriced deals — as happened during the last boom. Expect that to change in 2019.

Rio boss Jean-Sébastien Jacques has multiple reasons to concentrate on copper. Long-term, the price outlook is more appealing than its current main focus, iron ore. With big new deposits rare, slow and expensive, supply of the red metal will eventually lag demand as the world further electrifies. In the short-term, though more a gauge of sentiment, copper for three-month delivery was trading around \$6,100 in December, below the level required to encourage miners to dig for more.

What Jacques needs is a target. The most likely candidate is \$15 billion Freeport-McMoRan. The world's largest listed copper producer faces a debate over who will lead it when current boss Richard Adkerson, 71, retires. It also operates largely in the right places — Chile and Peru, plus the United States, which will put off rival Chinese suitors.

For Western names, Freeport's exotic mines have been poison pills. But it sold Congo's Tenke Fungurume in 2016, and has unpicked a knot in Indonesia too. Grasberg is one of the world's richest mines but challenging, and Rio agreed to sell its own interest in 2018. Having agreed to cede its majority stake to a local group, though, Freeport has also paved the way for an eventual full exit.

There are complications. One is price: Freeport's shares are worth roughly a fifth what they were in 2011, but copper deals are so scarce that Rio may have to pay a premium of at least 30 percent. That would mean an equity value of over \$19 billion, representing a punchy 17 times expected 2019 earnings. Still, back-of-the-envelope calculations imply a return on investment roughly in line with a 10 percent cost of capital, even without cost savings.

Rio would certainly have to woo investors. But its debt burden is light. Plus, it could spin off some of the U.S. mines. It could also accelerate efforts to list a majority stake in Iron Ore Company of Canada.

Jacques has other options, like First Quantum or even the Latin American copper assets of Anglo American, if a long-awaited carve-up happens. But Freeport is his most obvious quarry.



Rio Tinto Chief Executive Jean-Sébastien Jacques poses for photographs before announcing Rio Tinto's results in London, Britain, Aug. 2, 2017. REUTERS/Hannah McKay

Starbucks will start brewing a venti Chinese deal

By Jeffrey Goldfarb

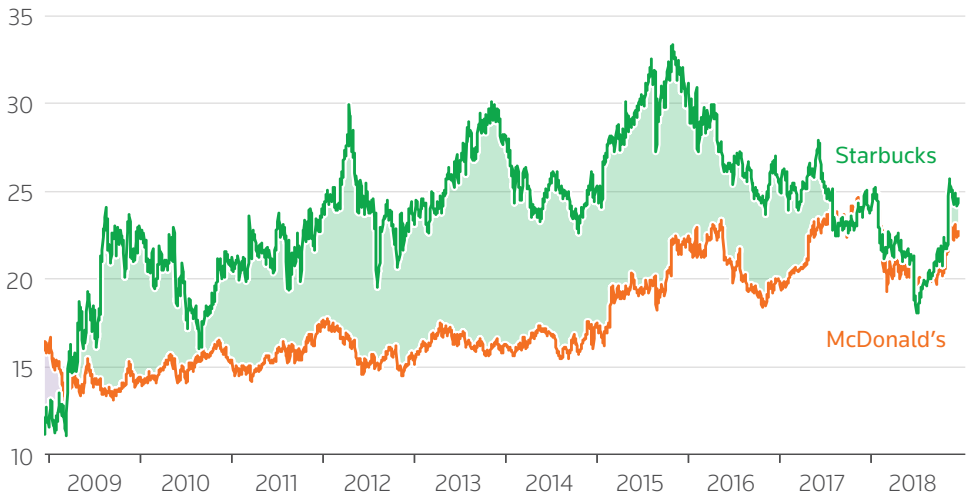
The Starbucks Reserve Roastery in Shanghai stands as a hulking symbol of the company's Chinese ambitions. The 30,000-square-foot caffeinated wonderland represents just one of 6,000, mostly smaller stores the chain plans to roll out across the mainland by 2022. Such bold plans will run up against stiffer competition and trade-war-related pressures in 2019. Local backers will help preserve this fledgling Bean Dynasty.

Cracking China has been tough for outsiders, including in fast food. McDonald's sold a controlling stake in its Greater China restaurants to state-owned conglomerate CITIC in 2017. And as part of a wholesale spinoff of Yum China, the U.S. parent of KFC and Taco Bell offloaded a slug of the operation to Fred Hu's Primavera Capital and Jack Ma's Ant Financial.

For now, Starbucks is touting its independent growth ambitions in the People's Republic. At a full-day presentation focused on the country in May, it forecast tripling revenue there in five years. The company doesn't break out China figures, but Morningstar estimates by then the top line would reach \$6 billion, generating some \$1.2 billion in operating profit, or nearly a fifth of the total for both.

Investors don't yet seem convinced. As of mid-December, Starbucks was trading at almost 24 times anticipated earnings for the next 12 months, a discount to recent historical levels. And the hefty premium it has fetched over the Golden Arches for much of the last decade has mostly vanished. That suggests Chief Executive Kevin Johnson isn't getting credit for his great leap into China.

Price to forward earnings valuation multiple



Source: Thomson Reuters Datastream, data to Dec. 12, 2018

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A woman drinks a cup of Starbucks coffee as she leaves a store in central Beijing, April 19, 2012. REUTERS/Jason Lee

There are valid reasons to be sceptical. Homegrown startups such as Luckin Coffee are expanding rapidly with the help of deep-pocketed backers. American brands are also in perpetual danger of getting swept up by geopolitical headwinds. Mergers have been caught in the crossfire, and targeted economic retaliation is a weapon China has used before. Starbucks founder Howard Schultz's dream of becoming U.S. president remains a distant hedge.

Stronger financial ties with well-connected allies, beyond just collaborations like the one with Alibaba for deliveries, could provide some insurance, as well as useful local knowhow as Starbucks extends deeper into the country. It recently bought out its Taiwanese partners in an East China joint venture, clearing the way for a venti-size deal to start brewing.

High Stakes

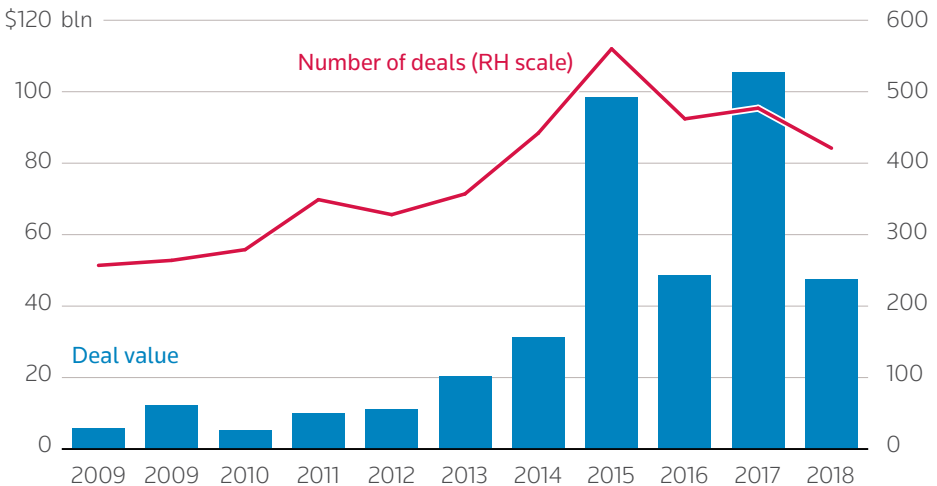
Chinese startups will get thrown an M&A lifeline

By Alec Macfarlane

China's startups will need — and receive — a mergers-and-acquisitions lifeline in 2019. Regulatory tightening, rough public markets and a slowing global economy mean many tech hatchlings will struggle to raise money. With serial acquirer Tencent's deal machine slowing, that creates a buyer's market for the likes of Alibaba, SoftBank and Xiaomi. Enterprise software, artificial intelligence and electric-car companies offer the most vulnerable targets.

Some \$45 billion was raised in the first three quarters of 2018 by Chinese startups, CB Insights reckons, 40 percent more than the year before. Yet just a tenth of the 25-odd Chinese internet firms that went public in Hong Kong and New York this year are above water, making it difficult to justify funding pre-initial public offering rounds. New laws have also battered the stocks of gaming, education and fintech companies, as have the effects of the U.S.-China trade war and a mainland slowdown on domestic consumption and tighter credit access. Valuations will fall further.

Acquisitions of Chinese technology companies by global acquirers



Source: Dealogic, 2018 data to Nov. 21

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A man is silhouetted in front of Nio cars at the auto show, in Shanghai, China, April 20, 2017. REUTERS/Aly Song

For cashed-up corporations, that's shopping time. The 800-pound M&A gorilla had been Tencent, whose acquisitions have fallen amid a sliding stock price, regulatory pressure and restructuring. Alibaba's \$30 billion cash pile and enterprise software and cloud ambitions make it a go-to shop for sell-side bankers. But a lack of sizeable targets makes for slim pickings.

More opportunity lies in overcrowded sectors where all but the best companies may struggle to raise money. SoftBank-backed artificial intelligence upstart SenseTime could look to buy smaller peers like 3D-imaging company Deep Glint. Fresh from its successful IPO, electric-vehicle maker Nio may Hoover up rivals like Chehejia. Faced with falling advertising spending and the poor debuts of Aurora, Gridsum and Mobvista, smaller and weaker ad-tech companies that can't go public may merge with competitors.

Companies like news aggregator Qutoutiao that have struggled since floating could end up being bought by content-hungry ByteDance or even Xiaomi, which wants to better engage users of its mobile phones. Niche e-commerce companies like Babytree, which has also performed poorly, may end up selling to cash-rich buyout firms like Hillhouse or KKR. China's baby tech pandas could soon find themselves in new habitats.

First published Dec. 14, 2018.

Saudi oil will grease China's currency ambitions

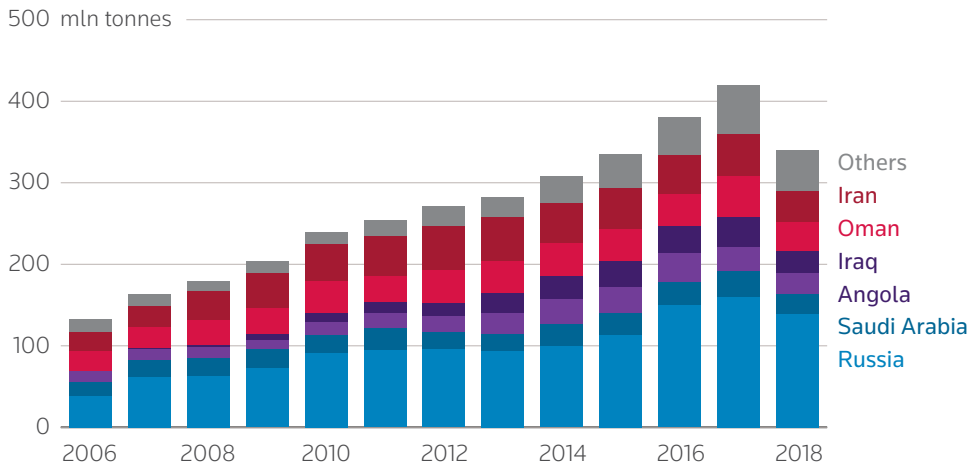
By Clara Ferreira-Marques

Riyadh can fast-track Beijing's currency ambitions in 2019. A new Shanghai crude contract has nibbled at dollar benchmarks over the past 12 months: a win for China, which wants more clout. Saudi Arabia can help it go further by agreeing to price and sell some of its \$30 billion in annual oil exports to the People's Republic in yuan. Russia is already edging this way, and there are benefits to diversity.

Yuan internationalisation has not gone smoothly. Enthusiasm for foreign exchange reform in Beijing has waxed and waned: the currency still accounts for barely 1 percent of global payments. The success of the Shanghai futures contract, launched in March, is hence all the more notable. It is becoming a credible benchmark, with volumes rivalling the Dubai Mercantile Exchange contract.

China's status as the world's largest consumer of commodities is its trump card in motivating foreigners to use renminbi — the currency's official name — for trade and investment. Overseas investors can trade oil and iron ore on the mainland already; more metals, or even soybeans, could be next. Crude, however, remains overwhelmingly traded in dollars. Encouraging more Shanghai trading with market makers and better trading hours will help, but the real catalyst is for suppliers to invoice more in yuan.

China crude oil imports by country



Sources: China Customs, Thomson Reuters Eikon, 2018 data to September

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Saudi is key. Other than Russia, the kingdom is already the largest oil exporter to the People's Republic. President Trump may have exonerated Crown Prince Mohammed bin Salman after Saudi agents killed journalist Jamal Khashoggi, but Riyadh must prepare itself for flashpoints. One might come in the year ahead, when U.S. sanctions intended to target Iran's 3 million barrels per day of output are due to kick in properly. If prices spike up again, Trump might blame Saudi and other oil producers for a Dec. 7 decision to cut 1.2 million bpd from the market.

Converting even a small fraction of Saudi exports to China from greenbacks to yuan would be a big step, and could bring Chinese investment into oil giant Aramco. Capital controls make the yuan riskier to hold than dollars, but payments to Chinese contractors on ambitious infrastructure projects can absorb at least part.

Russia, under pressure from U.S. sanctions, has said it will price some gas in the currency, and could do more in oil too. Iran and Angola may follow. If Saudi starts moving in the same direction, the cogs could really start turning.



Saudi Arabia's Crown Prince Mohammed bin Salman poses for a selfie during the Future Investment Conference in Riyadh, Saudi Arabia, Oct. 23, 2018. REUTERS/Stephen Kalin

Jeff Bezos starts to resemble Sam Walton

By Jennifer Saba and Robert Cyran

Two behemoth retailers are beginning to morph. Amazon founder Jeff Bezos is changing the e-commerce company by selling shelf space, opening stores and launching catalogs. Old-school rival Walmart, meanwhile, has refreshed Sam Walton's model with recent online acquisitions like Jet.com. The market is bound to pick up on the similarities.

Amazon's growth, while enviable, is slowing. Wall Street expects revenue to increase about 20 percent in 2019, down from over 30 percent the previous two years, according to Refinitiv data. That's because there are fewer new markets to create or consumers to win over. The threat of looming regulation of tech giants and greater scrutiny of their dominance by trustbusters pose growing risks to M&A. That's why Bezos is increasingly imitating what others have been doing.

Consider Amazon's advertising effort. Lumped with some other services, this business should more than double in 2018 and looks set to continue its rapid ascent. A product on the second page of a customer's search results might as well not exist. But is this any different than companies paying for eye-level shelf placement at Walmart? Likewise, Amazon continues to push its own-label goods, just as grocers have done for decades.



Jeff Bezos, president and chief executive of Amazon and owner of The Washington Post, speaks at the Economic Club of Washington, D.C.'s "Milestone Celebration Dinner" in Washington, United States, Sept. 13, 2018. REUTERS/Joshua Roberts

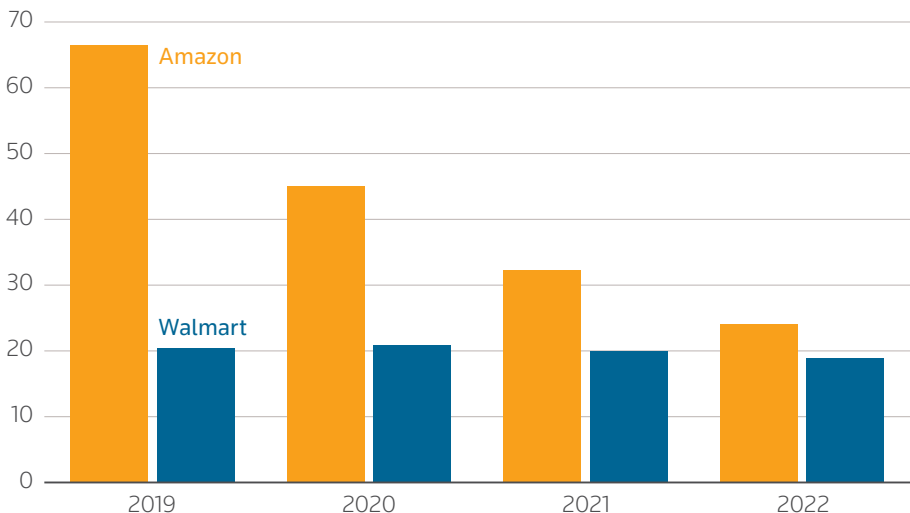
Plans for a toy catalog in time for the holidays echo newspaper circulars. And the rapid growth of Prime has parallels to membership fees at retailers like Costco.

Online retailers find that having stores near shoppers increases digital sales. That's one reason Amazon bought Whole Foods Market. Yet this dynamic also helps Walmart's push into online shopping.

The Bentonville, Arkansas outfit has juiced its digital strategy by spending nearly \$20 billion on Jet.com and a controlling stake in India's Flipkart. The former helped Walmart boost U.S. e-commerce revenue by 40 percent year-over-year in the third quarter and take market share. Its huge physical footprint provides leverage for continued growth. So far, it has rolled out more than 2,000 pickup points for digital shoppers at its stores in the United States.

Sooner or later, shareholders will reflect the growing likeness between the two companies — bringing Amazon's valuation down to earth. It was valued at nearly 65 times the next 12 months' earnings at the end of November, compared with just over 20 times for Walmart, according to Refinitiv. In five years, analysts expect those valuations to converge, putting Amazon at a PE multiple of 20 and Walmart at 18. Granted, Amazon's earnings are expected to grow much faster than Walmart's thanks to its booming cloud-computing division. But retail disruption is becoming a two-way street.

Amazon and Walmart's forward PE ratio



Source: Thomson Reuters Datastream

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Keep an eye on Seoul for Asia's next big buyer

By Jeffrey Goldfarb

An active acquirer lurks in South Korea. Over the last couple of years, companies from Japan and China have led Asia in overseas deals. Seoul-based conglomerate SK Group could be up next. Bankers should make sure they have boss Chey Tae-won on speed dial.

The sprawling group, with a collection of listed shares worth \$110 billion, has been expanding since it bought chipmaker Hynix in 2012. It was one of the first chaebol to start cleaning up its controversial structure, even if it occurred while Chey was in prison for misappropriating company funds. With a left-leaning government turning the screws on big businesses, it makes sense for SK to seek bigger acquisitions abroad. And hailing from South Korea should make it more welcome than Chinese buyers in many places.

There are many areas for SK Group to spend its cash, much of it generated from semiconductors. Nearly 100 affiliates operate in industries ranging from pharmaceuticals and chemicals to telecoms and logistics. They recently bought a Dow Chemical division and drug ingredient maker AMPAC Fine Chemicals, and backed the \$18 billion acquisition of Toshiba's memory-chip unit. Although it is hard to discern any overarching strategy, its Super-Excellent Council, or Supex, sits atop the organisation, ostensibly guiding expansion and seeking synergies.



SK Group Chairman Chey Tae-won speaks during an interview with Reuters in Seoul, Jan. 27, 2013. REUTERS/Lee Jae-Won

A private equity-style investment arm inside parent SK Holdings has had some acquisition success, too. For example, it took control of Siltronic in 2017 for about \$530 million. In the third quarter, the silicon-wafer manufacturer's operating profit margin improved 11 percentage points from a year earlier to 29 percent. That sort of achievement may help energise SK to pursue bolder deals.

There are clues about possible targets beyond biotech and microchips. SK Holdings, 30 percent owned by Chey and his family, recently injected funds into Grab, the Singapore-based ride-hailing outfit, and U.S. car-sharing startup Turo. Chey also turned up at a gala event in Washington in late November to promote his company's stateside investments, including an electric-car battery plant. Masayoshi Son's SoftBank has been among the most aggressive dealmakers in the automotive technology arena. SK Group could give it a run for its money.

Firearms will test the mettle of woke financiers

By John Foley

If 2019 is like 2018, roughly 30,000 Americans will be killed by a bullet. And more big companies and investors will say publicly it's time to make guns safer. If they say it in the right way, it might even make a difference.

Big institutions led the charge after the February massacre at a Florida high school. Investors compelled gunmaker Sturm, Ruger to publish a report — due in March — on the reputational and financial risks of gun violence. An identical motion passed at American Outdoor Brands. BlackRock chief Larry Fink asked firearms manufacturers in March to answer questions about their contribution to gun safety. State Street called for better safety measures. It's a big shift from a group that was previously mum.

But gunmakers can mostly escape public censure by engaging with shareholders. They know BlackRock and Vanguard can't dump their stock in protest because it's held in index-tracker funds, whose primary duty is to generate decent returns. An example: BlackRock launched a guns-free fund for institutional clients. But it has attracted negligible interest.

Big banks have more power, and have started to use it. Citigroup no longer accepts gun retailers as clients unless they commit to basic safety policies and age limits on purchases. Bank of America won't lend to makers of assault-style weapons commonly used in mass shootings. It earned the banks some enemies — a senator proposed denying federal business to banks with firearm policies. Yet both institutions are big enough to brush it off.

There's room to go further. Around a dozen investors including the California Public Employees Retirement System teamed up in November to ask gun manufacturers and

sellers to make products “safer, more secure and easier to trace.” There’s no reason bank chief executives couldn’t present a tougher, collective ultimatum. They could, for example, jointly pledge to deny commercial banking or corporate finance work to gunsmiths until universal background checks become law.

Now would be a good time, too, because one thing that can be predicted with tragic certainty is that 2019 will bring more mass shootings — like the one at Marjory Stoneman Douglas High School, which killed 17 people and galvanized millions. As more people are harmed each year, getting tougher on companies whose products harm should only get easier.



A no gun sign is seen posted outside a hotel in Sikeston, Missouri, United States, May 17, 2018. REUTERS/Shannon Stapleton

Indian unicorns will feast on richer pastures

By Una Galani

Indian unicorns will feast on richer pastures in 2019. Restaurant search firm Zomato, ride-hailing firm Ola and hotel-rooms aggregator Oyo are leading the charge overseas by the country's largest tech companies. A complex home market, a big diaspora and deep-pocketed backers will ensure success rarely achieved by Asian startups in far-flung lands.

Those that have made it on the subcontinent, notching up valuations of over \$1 billion in perhaps the most challenging and diverse of large markets, are agile, and well-placed to scale up elsewhere. Their technology is unusually robust, suitable for patchy telecom coverage, offering multiple payment methods and a host of services for different income groups.

Familiarity with English helps, too. Ola, for one, is pushing into Australia and Britain. Innovations like a loyalty programme have helped keep at bay its \$76 billion U.S. rival, Uber. Oyo is adding the equivalent of an entire AccorHotels chain, Europe's largest, to its stock of rooms each year. It expects to be the biggest hotel brand in the world by 2020, as it advances into China.

Ola claims 150 million regular riders across 110 local cities, a large chunk of the market it can reasonably service, given less than one third of India's 1.3 billion people have a smartphone. That's more than the population of the United States, but low internet penetration remains a brake on growth for platforms leveraging technology to provide easy transport, clean hotels or a trendy place for dinner. By contrast, China's Didi was in many more cities before it ventured overseas. The support of wealthy foreign investors like Japan's SoftBank, its affiliate Vision Fund, and China's Ant Financial, is also encouraging Indian startups to think big.

Crucially, richer markets will help to plump the bottom line to win at home too. Even if the cut of fees demanded by Zomato or Ola is close to the take-rate in India, the absolute amount they can pocket per a delivery or taxi ride is higher almost anywhere else, because of the country's low per-capita income. There's a second windfall too: Australians eat out about 10 times more every month than a middle-class Indian. For many of these success stories, pushing overseas is as much about survival as it is about ambition.

First published Dec. 18, 2018.

Glaserberg successor will run a different Glencore

By George Hay

Who replaces Ivan Glaserberg? The internal succession battle at Glencore has investors gripped. The 61-year-old former coal trader, after all, turned the commodities trader into a mining heavyweight. He is still its second-largest shareholder and, since a 2011 listing, its public face. With the group in flux as 2019 dawns, Glaserberg will be tempted to get on the front foot.

Apart from succession, the board has two big challenges. One is handling the consequences of a U.S. Department of Justice probe into whether the group broke anti-bribery and anti-money laundering rules from 2007 onwards in Venezuela, Nigeria and Congo. The other is the company's steep valuation discount. Putting Glencore's \$7.5 billion of estimated 2019 free cash flow on rivals' 8 percent yield, the group should be worth \$94 billion. After shares dipped by nearly a quarter in 2018, it's actually worth \$51 billion.

Replacing the top man is not straightforward. To date, Glencore's approach has been Darwinian, with bosses ousted from below when they start fading. The retirement of copper trading boss Telis Mistakidis suggests space will clear for younger executives like nickel trading head Kenny Ives and newly appointed coal mine boss Gary Nagle. Glaserberg says he wants "a 45-year-old" to take the helm. Yet none of that anoints a clear successor.



Ivan Glaserberg, chief executive of Glencore, reacts during an interview with Thomson Reuters in London, Britain, Oct. 15, 2015. REUTERS/Toby Melville

Glaserberg could stay for another five years, but the recent changes suggest the company feels some pressure. As the U.S. investigation unfolds, the risk is current top managers get ensnared. If the boss feels this might involve him, it makes sense to leave sooner.

Meanwhile, even Glencore loyalists will want a better idea of its future shape before taking over. It won't be the same group Glaserberg took over in 2002, and parts of the business — assets in troublesome Congo, for example — could yet be sold off, either as part of any future U.S. settlement or to hedge against further regulatory discomfort.

There's also a chance of even bigger change. At recent valuations Glaserberg could finance a repurchase of all group shares not already held by managers or Qatar with around 3.5 years of free cash flow, Bernstein reckons. Given all the uncertainties, it's possible that Glencore exits 2019 with a new look, a new boss, or both.

First published Dec. 13, 2018.

Next ECB boss will matter less than his sidekick

By Swaha Pattanaik

Mario Draghi's successor may not be the most important appointment at the European Central Bank in the year ahead. Most of those in the running to replace the Italian as president lack his creativity in tackling existential problems, such as a breakup of the euro. Others will have more scope to sway the debate. Ireland's Philip Lane, who is in pole position to take over as chief economist from Peter Praet, is the sort of freethinker who would have outsized influence, especially in the next economic downturn.

Draghi's departure from the ECB, scheduled from the end of October, removes a key figure. Bank of France Governor Francois Villeroy de Galhau, Finland's former central bank chief Erkki Liikanen or his replacement Olli Rehn, and Klaas Knot of the Dutch central bank are all potential successors. Benoît Coeuré, the Frenchman who is already on the ECB's Executive Board, and Deutsche Bundesbank President Jens Weidmann are also contenders. However, ECB rules may prevent the former from throwing his hat in the ring while the latter may be too divisive given his past criticisms of Draghi's policies.

Besides, merit will not be the decisive factor. National haggling over who gets the job will be inextricably linked to other vacancies, such as the next president of the European Commission. And while Draghi's potential replacements are respected policymakers, few have so far matched his inventiveness.

That is why Lane would be an interesting choice as chief economist. The former academic supports the creation of so-called European Safe Bonds, synthetic IOUs that would be backed by the sovereign debt of all European Union countries. The idea, designed to break

the “doom loop” between banks and national governments, has drawbacks. Still, it shows the sort of ingenuity that will come in handy when the euro zone economy inevitably slows.

With official rates still in negative territory and likely to rise slowly, there will be little room to cut when stimulus is next needed. More bond buying or long-term loans may not do the trick. Lane is more likely to dream up a cunning scheme to stimulate the economy. The sidekick may matter more than the next president — unless he turns out to be the dark horse that gets the top job.



European Central Bank President Mario Draghi testifies before the European Parliament’s Economic and Monetary Affairs Committee in Brussels, Belgium Sept. 24, 2018. REUTERS/Francois Lenoir

High Jinks

The 2019 stock market reversal: how it happened

By John Foley and Neil Unmack

Few people would have disagreed at the beginning of the year that the nine-year-long bull market was reaching its end phase. That didn't diminish the shock when it actually happened. Here is Breakingviews' imagined account of how the good times came to an end in 2019.

Day 1 – The market opens on an unremarkable Monday. A mid-sized maker of car fan belts files for Chapter 11, blaming European tariffs levied in response to U.S. trade barriers. Three hours later, Facebook announces a data breach, which it attributes to alt-right Generation Z whiz-kids with possible links to Russia. Investors, jittery over the impact of trade war and tech-sector weakness, start to sell. The S&P 500 Index slumps 4 percent, financial and internet stocks bearing the brunt.

Day 2 – Tech stocks fall further and faster. That afternoon, President Donald Trump takes to Twitter to call Federal Reserve Chairman Jerome Powell an “ENEMY OF THE PEOPLE” for his reluctance to cut rates. Later at an event, Powell emphasizes that the Fed is not on a pre-set course, but stocks only slide further. Trump muses on replacing the Fed chief with wrestling promoter Vince McMahon. Despite confusion over whether such a thing is possible, the S&P slides 4 percent.

Day 3 – Two ratings agencies say they are downgrading a basket of BBB-rated bonds to junk status, expressing concern that a slowing economy will push up defaults. Spreads on high-yield bonds widen dramatically. Market-makers stop trading some exchange-traded funds exposed to corporate debt, and collateralized loan obligations, which buy and repackage junk-rated loans, start offloading assets. The S&P slips 3 percent.

Day 4 – Trump announces the formation of “Team America,” a group of U.S. plutocrats who pledge to invest their personal wealth in the U.S. stock market, including the chief executive of one of Wall Street's biggest lenders and Treasury Secretary Steven Mnuchin. Within hours, Tesla chief Elon Musk, who had been named as one of the group, tweets that he is looking forward to taking America private “at 420.” Stocks dive a further 5 percent.

Day 5 – Warren Buffett, whose name did not appear on the Team America line-up, tells a CNBC interviewer that he sees no buying opportunities at current levels, and is minded to use his \$100 billion cash pile buying back shares instead. Retail investors take fright. Stocks slump 3 percent. Facebook's valuation has now fallen from \$390 billion at the start of the year to just \$200 billion.

Day 6 – Over the weekend, Chinese President Xi Jinping expresses concern that, as the holder of \$1.2 trillion of U.S. debt, China’s feelings have been hurt by U.S. volatility. Starbucks branches immediately attract protests in second-tier Chinese cities, and rumors proliferate that the People’s Bank of China is preparing to sell Treasuries. Yields on 10-year debt hit 4 percent. The S&P has now fallen 20 percent in a week.

Day 7 – Talks over the acquisition of a large media company fall apart. The buyer blames uncertain markets, but reports emerge that the company’s bankers got cold feet, and withdrew a letter they had provided declaring themselves “highly confident” of arranging financing. Shares in dozens of putative takeover targets fall as much as 30 percent. Trump tells Fox News that Securities and Exchange Commission Chairman Jay Clayton could be doing more to help.

Day 8 – An open letter from Wall Street bank chief executives appears in the financial press, arguing that post-crisis banking reforms have made the meltdown worse. They argue that proprietary trading, which could have enabled banks to buy up stocks on their own account, would have stemmed losses, and call for a reconsideration of Basel 3 and Dodd-Frank Act rules. Financial stocks rise, but the S&P still ends the day down 2 percent.

Day 9 – Mnuchin announces he is standing down from the Treasury, but pledges his full support for the president. Trump says he will pick a replacement quickly, and declines to shut down reports that he is considering rapper Kanye West for the role. Stories emerge that the original selloff may have been triggered by hedge funds who had set up algorithms to trade automatically based on Trump’s tweets. Markets are flat.

Day 10 – Facebook says Buffett is investing \$10 billion as a vote of confidence, taking voting shares and generously priced warrants. The slide in stocks has stopped, as abruptly as it began. The market closes up slightly but has lost almost a quarter in two weeks. Congress begins to discuss curbs on algorithm-based trading. After markets close, the White House announces its new pick for the Treasury: first daughter Ivanka Trump.

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A Trump versus Xi wrestling match might just help

By Pete Sweeney

Can Sino-American trade disputes be settled on the mat? Don't expect Xi Jinping and Donald Trump to don tights for a Presidential SmackDown. But don't be surprised to see Tencent, China's \$370 billion technology champion, tag up with World Wrestling Entertainment to bring more American professional brawlers like Triple H and The Undertaker to the People's Republic, and build a Chinese league.

A deal with WWE would give Tencent boss Pony Ma some publicity, indirect access to the administration of U.S. President Donald Trump and the opportunity to teach millions of Chinese fans the science of the slingshot suplex. WWE finally gets a partner burly enough to pry open China's market. It's a trade-war cage match made in heaven.

WWE was founded by cabinet official Linda McMahon and her husband Vince, now its chief executive. He was famously tackled to the floor and shaved bald by Trump during the "Battle of the Billionaires" in 2007. Ridiculous, perhaps, but such scripted brawls between muscle-bound actor-thugs in spandex generated \$657 million in revenue for WWE in the first nine months of 2018. Its shares were up nearly 150 percent for the year in early December, changing hands at around 60 times forward earnings. Ridiculous has won respect.

Dominant at home, WWE needs to grow abroad. It has been attacking the China market for years, bringing occasional "SmackDown" exhibitions through Shanghai and Shenzhen — Tencent's hometown — and posting matches online. Despite cultural differences, WWE's recipe of braggadocio and beatings could be copied straight out of a Chinese Qing dynasty Kung Fu television show, and has proven popular.

WWE's streaming contract with local partner PPTV comes up in 2019. Tencent would make a better match for the next round. Its WeChat app alone boasts 1 billion monthly users. It's China's largest video-game company, an important money-making channel. Tencent Video broadcasts National Football League and National Basketball Association games; its sports division is moving into events management. It can help WWE build a local league, key to winning real market traction.

One obvious way to jackhammer the deal would be for Tencent to buy a stake in the \$5 billion entertainment company. It won't come cheaply. But good-humoured headlines about China acquiring dual-use smackdown technology will help Tencent's international profile — even if a Xi-Trump cage match is out of the question.

Why I'm relocating to Paris in the year ahead

By Rob Cox

Soon after relocating to Paris I met an entrepreneur with an extraordinary ambition to challenge the technological dominance of Microsoft and Google by creating an alternative digital operating system. I also encountered an angry protester in a yellow vest, or “gilet jaune”, who wanted to overthrow the government. Welcome to the two faces of the global centre of the resistance.

When cars are burning on the Champs-Élysées, it may sound odd for the editor of an English-language financial publication to leave New York to temporarily set up shop in France, bypassing London, Frankfurt and Hong Kong. But Paris is the place to be in 2019. For starters, the task of battling the illiberalism and nativist economic thought that permeates politics in the United States, Britain, Italy and beyond has fallen, through a process of elimination, to the French president.

Whether Emmanuel Macron is up to it will become clear in the coming year. Though riots like those of the “gilets jaunes” are a French tradition, they pose an immediate threat to Macron’s ability to push through more reforms. On Dec. 4 his government suspended planned increases to fuel taxes, the first major backtrack by Macron after 18 months in office. And the protests may not end here.



A man wearing a yellow vest, a symbol of a French drivers' protest against higher fuel prices, attends the demonstration with an image of French president Emmanuel Macron, in Paris, France, Nov. 17, 2018. REUTERS/Charles Platiau

There will also be fresh challenges to Gallic capitalism, including the state's role in guiding industrial policy, as activist investors from New York and London poke around some of the country's biggest companies. Meantime, Britain's messy divorce from Europe will hand Paris a golden economic opportunity that is France's to win or lose.

There are other, more practical, reasons to choose Paris as a base. The time zone is suited to a global operation that stretches across Asia, Europe and the United States. From Paris, it's possible to speak to colleagues in Singapore or Beijing without spoiling anyone's dinner before tackling European business, and then pitching in on the New York day. The real challenge is knowing when to back away from the laptop.

It's also far easier to travel. London is effectively an extension of the Paris Metro — no harder to reach than New Haven is from Manhattan. High-speed trains link the French capital from Amsterdam to Zurich. Air France may have its fiscal woes, but its network is hard to beat. Getting to the Middle East is a cinch, and the jet lag from a trip to China is negligible compared with the 13-hour nightmare accompanying a New York-Shanghai jaunt.

True, other European cities, like Frankfurt, Amsterdam or Brussels offer similar conveniences. And taxes in these countries are less liable to shift significantly when governments change. Yet none can match Paris as a cauldron where industry, finance, media, government and culture comeingle. The ability to network across so many spheres makes Paris ideal. And the French bourse has the largest market cap on the continent, with some 850 listed companies, 30 of which rank among world leaders in their industries. This variety and heft is one reason Paris should benefit more than other European capitals from Brexit.

London will continue to be a leading global financial centre, but its current position as the hub for capital flows and information on European finance will weaken no matter how Britain executes its economically foolish split from the EU. Organisations that want to adapt could base more people in Paris to better glean insights into mergers and acquisitions and capital markets transactions. Enticing colleagues over from London for meetings with business leaders is easy from Paris. The offer of a fine French lunch works wonders.

Practical matters aside, I wouldn't be here if it weren't for Macron. In February 2017, during his campaign for president, he spoke to people like me tired of the toxicity of public discourse in the era of President Donald Trump: "I want all those who today embody innovation and excellence in the United States to hear what we say: from now on, from next May, you will have a new homeland, France."

Granted, many in France are fed up with him — and not just people wearing yellow vests. Some of the first words I learned in French (it's a work in progress), were "le

président des riches”, taught to me by taxi drivers eager to share their politics. Nobody likes change, including higher fuel levies, especially when foisted upon them by a 40-year-old former Rothschild banker lacking the common touch. Telling an unemployed gardener to go wash dishes, for instance, may be intellectually correct, but goes down like a lead balloon with most voters.

Nonetheless, Macron deserves support for leading the charge against illiberalism and in favour of the multilateralism that has brought stability to the world, whether it’s drumming up pro-EU sentiment ahead of European parliament elections in 2019 or trying to hold together the Paris Agreement on climate change and the Joint Comprehensive Plan of Action with Iran.

At the same time, Macron’s challenge is to steer his country towards the kind of market-friendly policies that have long been anathema to France. That need not mean giving up on cherished benefits like universal healthcare or the right to a decent education. But he will have to work harder to assure the yellow-vested protester from the countryside that paying a bit more at the pump will help safeguard the French way of life for the next generation as well as ensure a cleaner planet.

That also means fostering a flexible labour market where entrepreneurs like Jean-Romain Lhomme, who after a successful career in the City is working with a French engineering team to take on the giants of Silicon Valley, can attract the highest-quality talent on the planet. Leading the resistance isn’t about favouring the rich or the poor, the globetrotting city-dweller or the rooted rural worker, but binding them to a shared pursuit of a common good for the nation, as well as the world. That is today’s biggest challenge, and there’s no better place to watch it unfold than Paris.

First published Dec. 4, 2018.

A century on, bet on a new Black Sox-like scandal

By Jeffrey Goldfarb

Looking for a good bet in 2019? Put some money down on a big U.S. sports scandal.

It has been nearly a century since eight Chicago White Sox players were banned from baseball after being accused of accepting money to intentionally lose the World Series in 1919. Though none were found guilty in court, it spawned the ignominious Black Sox nickname and the biggest black mark on American athletics. The odds are now improving for a similar sort of incident.

Legalised gambling on everything from college basketball to professional football is set to soar after the U.S. Supreme Court earlier in 2018 struck down a law that mostly blocked it. New Jersey and six more states already have made it kosher. Bringing such bets out of the shadows has merit, but also considerably raises the stakes – and temptations.

Some \$150 billion is wagered illegally on sports every year in the United States, the American Gaming Association estimates. Online fantasy competitions have attracted new generations of punters. It stands to reason that more people also would give legal betting a whirl. At least one MGM casino executive predicts betting parlours could even turn up inside arenas.



A sign is seen at Monmouth Park Sports Book by William Hill, ahead of the opening of the first day of legal betting on sports in Oceanport, New Jersey, United States, June 14, 2018. REUTERS/Mike Segar

Leagues will benefit from increased gambling, too. National Basketball Association Commissioner Adam Silver is among those demanding a cut of the wagers. Indirectly, more viewers tracking bets should translate into more broadcasting and advertising revenue.

With gambling expanding the whole athletic complex, cheating will be harder to control. Alleged point-shaving and other illicit behaviour already mar sports, including incidents at Tulane and Northwestern universities. Authorities will have to double down on oversight under the new wagering regime.

Even then, preventing corruption looks like a longshot. College athletes don't get paid, making them more susceptible to monetary enticements. Their professional counterparts know their days are numbered. Most National Football League players, for example, finish their careers in just a few years and collect little in the way of severance or retirement.

Greed also doesn't discriminate. The financial sector is littered with examples of handsomely compensated bankers and traders acting unethically and illegally for a few extra bucks. It's one more reason to make book on a giant moral lapse in U.S. sports.

Cannabis will take China tech's path to propriety

By John Foley

America's cannabis growers will follow an unusual path to propriety. The subversive industry is feared by the establishment, with investors reliant on legal loopholes. Yet these companies are starting out much like China's tech giants did. In the same fashion, as they create jobs and wealth, appetite for reining them in will wane.

The budding sector is already a lesson in loopholes. Thirty-two states have legalized marijuana's medical use even though it remains strictly taboo on a national level. Federal authorities look the other way so long as producers stick to their home turf and list their shares abroad — usually in Canada, where recreational pot is legal and three companies have achieved 10-digit market capitalizations. Conventional outfits like MedMen and Scotts Miracle-Gro are getting in on the action even though doing business across state lines is forbidden and big banks won't touch the industry. Former Attorney General Jeff Sessions once said "good people don't smoke marijuana," yet he did little to stunt its growth.

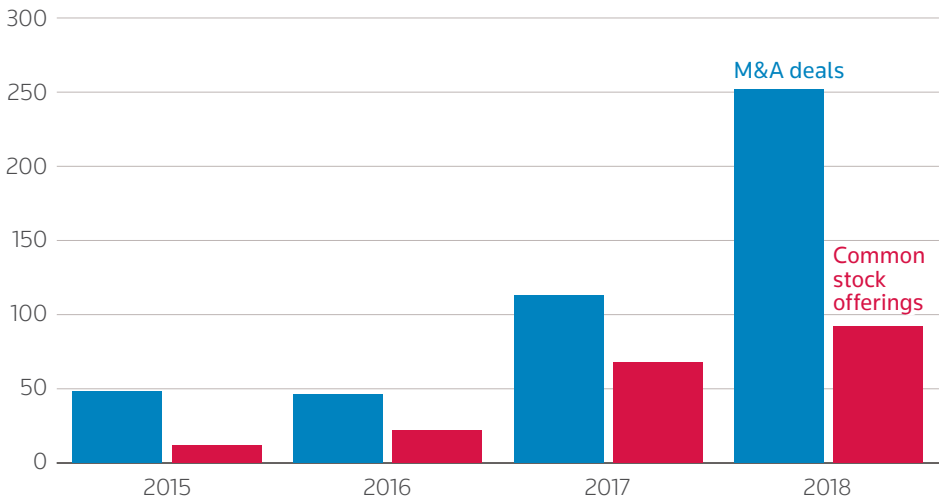
Existing in a legal limbo might sound like a red flag. There's another industry, though, that exploited multiple loopholes on its path to greatness: Chinese tech. Alibaba,

Weibo, Tencent and others grew up using structures of dubious legality and peddling products that aroused governmental anxiety. So-called variable interest entities, a way of structuring a company that is common in Chinese tech, are patently against the spirit of the law, but they enabled foreigners to invest in off-limits sectors like the internet. Without them, these online giants wouldn't be what they are today.

That ruse could have been unwound at any time by Beijing. Yet as the tech firms got bigger — and more productive — the desire to stamp them out receded. Companies like Alibaba and Tencent are now among China's best-known global brands, and some 76 percent of U.S.-listed Chinese concerns still use the variable interest entity, according to researcher Fredrik Oqvist. Alibaba founder Jack Ma is even a member of the Communist Party. At some point, governments decide it's better to co-opt them than beat them.

Cannabis growers may never achieve Alibaba's \$400 billion market value. But the industry is on course to create half a million jobs by 2022, according to Arcview Market Research, the same number congressional researcher G. B. Granger estimated to be employed in the illicit alcohol trade before the United States ended prohibition in 1933. It's also about the same as work in the utilities sector. Politicians may not agree on weed, but they know an economic good when they see it.

The number of mergers and stock issues by cannabis companies has risen sharply



Source: Refinitiv, 2018 data to Dec. 14

V. Flasseur | @Breakingviews

World will improve where it matters most in 2019

By Edward Hadas

The world economy is set to enjoy a very good year. In that, it will be much like 2018 and 2017 and most probably like 2020 and 2021. Economic growth will be fairly strong in most of the countries where such expansion does the most good. While rich countries worry about objectively tiny setbacks, poor people are overall gaining more of the dignity that comes with adequate material comfort.

Consider extreme poverty. The World Bank draws the line between the wretched of the earth and everyone else at daily consumption of goods and services worth \$1.90. The Our World in Data website at Oxford University estimates that 72 percent of the world's population lived below that line in 1950. The World Bank's preliminary estimate for 2018 is 8.6 percent, down from 10 percent in 2015.

Fewer very poor people means more are enjoying better lives. The proportion of the global population without access to electricity is declining by about 0.3 percentage points a year. The number of children not enrolled in school is shrinking by about 5 million annually. Almost every indicator of basic prosperity shows the same trend.

The good news is pretty much global. Even Africa, long the lagging continent, is starting to catch up. The proportion of African children that die before they turn five has declined from 21 percent in 1975 to 8 percent in 2015, the most recent year for which data is available. Better health comes from — and with — greater wealth. Real per person income in sub-Saharan Africa has increased by 40 percent in the last decade.

Not all the news is good. Due to war and civil conflict, primarily in Africa, the proportion of the world's population that is undernourished has risen by 0.2 percentage points in the last two years. Still, at 11.9 percent, it is 2.2 percentage points lower than a decade ago.

The prediction of more global gains in 2019 is pretty solid. There are also good reasons to believe that 2029 will be fine. Economic growth in very poor countries is becoming a virtuous circle. More education and better health creates better workers, who support stronger institutions, which make larger and more effective investments, which produce the money needed to pay for even better schooling and health.

That pattern has held in country after country for at least two decades. Bad governments do slow progress, but it takes war or total state failure, as in Venezuela, to reverse the progress.

The almost unstoppable global retreat of misery and ignorance is arguably the best news ever in economic history. For political history, however, the trends are far less clear. The old belief that greater wealth would naturally bring more open societies looks flawed. The populace of many countries, both richer and poorer, seem pretty happy with autocratic and extreme nationalist governments.

China is the prime example. The oppressive and fairly corrupt Communist Party has presided over rapid and widespread increases in prosperity. Its cross-border ambitions, both civil and military, have expanded as well.

That is worrying for many reasons. One of them is that war is probably the only force destructive enough to stop the upward march of global economic good news. The great question, for both 2019 and 2029, is whether progress will threaten prosperity by leading to the use of the world's ever-larger supply of ever more deadly arms.



A girl holds a slate with alphabets and numbers along a path in the Koluama village in Nigeria's Bayelsa state, May 15, 2012. REUTERS/Akintunde Akinleye

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Alain Robert, known as "Spiderman",
scales a 23-floor glass and steel office
building known as "World Plaza" in Mexico
City's Santa Fe district Dec. 7, 2006.
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