BREWIN DOLPHIN

The Week in Perspective

5th October 2018

Market Roundup

UK shares started October on a downbeat note, with the FTSE100 falling by 0.19% to 7,495.6 on Monday. The index underperformed other global markets which were buoyed by reports of a deal on a revamped North American trade agreement.

Royal Mail shares tumbled by 18% after it issued a profit warning in an unscheduled trading update.

The FTSE100 fell slightly again on Tuesday, weighed by worries about Italy's debts. That sent investors to safe haven stocks, with United Utilities the top beneficiary, its shares rising by 2.1%. In the US, the Dow Jones hit a record high, helped by positive news around a North American trade agreement. Shares such as Boeing and Caterpillar, which are sensitive to trade, led the way.

The FTSE100 managed a 0.5% gain on Wednesday but shares in supermarket giant Tesco fell by 8.5% after its profits fell short of expectations (see below).

Aston Martin made its debut on the stock market after listing with a value of £4.3billion and shares priced at £19, but they fell 4.7% on their first day of trade to £18.10.

Thursday saw a sell-off in the US bond market following positive economic data and hawkish comments from Fed Chair Jerome Powell. It pushed yields on bonds up, which makes shares relatively less attractive. The UK market followed suit, with gilt yields rising and defensive shares such as utilities falling. But banks did well, with the UK's big four all higher.

In early trade on Friday, shares were trading lower ahead of crucial jobs data due out from the US.

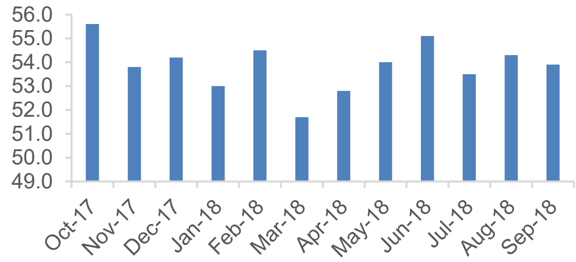
Company Focus: Tesco

Tesco reported operating profits of £933million on Wednesday, up by nearly 24 per cent but less than the £978million analysts had been expecting. During the first half of the year, Tesco's pre-tax profits were up by 2.2% and like-for-like sales rose 4.2% in the second quarter.

Booker, the wholesaler that Tesco acquired last year, saw sales jump by 15.1%, and the UK business performed strongly. But its overseas operations in Thailand and Poland were the focus of investors' concerns. In Thailand, government-issued welfare cards can be redeemed against groceries, but not those from internationally-owned supermarkets, a fact which contributed to a 29.1 per cent fall in profits to £100 million, with like-for-like sales falling by 9 per cent across its Asia division. Tesco's problems in Poland are largely due to a government change to Sunday trading regulations. In the first half, like-for-like sales in central Europe fell by 1.5 per cent. Profits slid 3.3 per cent to £59 million.

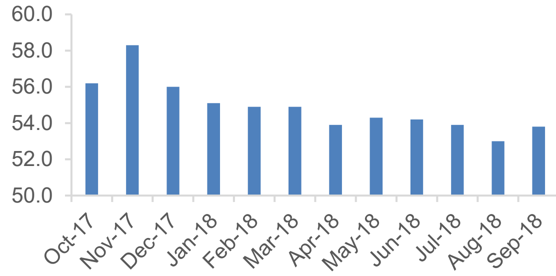
CEO Dave Lewis said that Tesco was working on "resetting" the Polish business, and has also set up a discount division in the UK, called Jack's, to compete with Aldi and Lidl. But investors were unimpressed at the figures and shares fell by 8.5% on the day of the announcement. Lewis remained defiant. "When you look at the group, sales are up, profits are up, cash generation is up, we are paying down debt and paying more to shareholders in dividends. The interim dividend is up 67 per cent, which is, dare I say it, exactly what we said we would do."

Chart 1: UK Monthly Services PMI readings



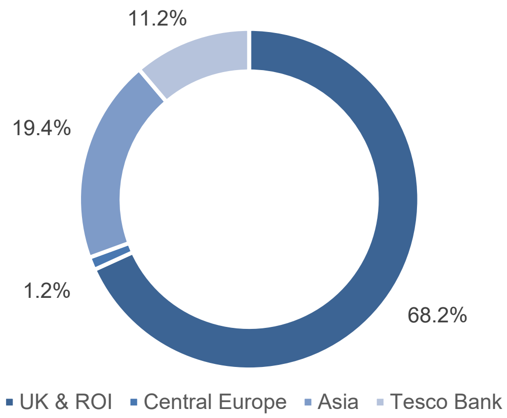
Source: Bloomberg Data at 04/09/2018

Chart 2: UK Monthly Manufacturing PMI readings



Source: Bloomberg Data at 04/10/2018

Chart 3: Tesco - Operating Profit by division



Source: Brewin Dolphin client note Data at 04/10/2018

Economic Roundup

UK manufacturers enjoyed an uptick in output and orders in September, according to the latest purchasing managers' index reading compiled by IHS Markit.

The index reached a level of 53.8 in September, up from 53 in August. Any reading above 50 shows the sector is expanding. It is welcome news for the sector after data had shown that output fell for the first two quarters of the year. However, the survey showed that companies were increasing production to meet new orders, were clearing backlogs of work and were rebuilding inventories.

Rob Dobson of IHS Markit urged caution, however. He said that conditions in the sector remained "relatively lacklustre" and that, based on historical correlations with official data, the survey results indicated only moderate output growth.

Some said that Brexit was increasingly driving corporate decisions, and many were now stockpiling to avoid the expected supply disruptions in the run up to the Brexit deadline. Some companies were reducing their inventories because they envisaged less opportunity for sales around the Brexit deadline.

The UK's dominant services sector also grew more slowly in September, as the IHS Markit PMI reading hit 53.9, down from 54.3 in August. Although down, it remains slightly above the 2018 average of 53.6, with new orders holding up well.

Finally, among the big three sector reports this week, construction activity expanded at its slowest rate in six months in September. Every element of the construction sector took a hit, with civil engineering contracting, while growth in residential and commercial building slowed. The overall index level hit 52.1 in September compared to 52.9 in August. A spokesman for IHS Markit said the data across the three sectors suggested that UK GDP rose by just under 0.4% in the third quarter - in line with expectations.

Meanwhile in the US, manufacturing activity also slowed slightly in September as tariffs appear to be taking their toll. The Institute for Supply Management said on Monday that its manufacturing index fell to a reading of 59.8% in September from 61.3% in August.

Manufacturing data from China showed that export orders were falling at the fastest rate in two years, appearing to confirm suspicions that the US tariffs were having an impact. The Caixin/Markit Manufacting PMI for September fell to 50 in September from 50.6 in August.

In the US, more positive news: the number of Americans filing for unemployment benefits dropped by more than forecast last week, according to data from the Labor Department. US initial jobless claims dropped by 8,000 to 207,000. Economists had been expecting a smaller drop to 213,000.

UK house prices rose gradually in September but the London market continued to fall, according to the latest house-price report from Nationwide. The data showed an average 2% annual price increase across the UK, with an average 0.3% rise in August/September. However, average London prices fell by 0.7% in the same period. Yorkshire & Humberside was the UK's strongest region, with prices up by 5.8% over the year. Commentators say that until the threat of a no-deal Brexit is gone, buyers and sellers will hold back from the market.

Company announcements that caught our attention this week

Date	Company	Comment
24/09/2018	**Royal Mail**	Royal Mail shares plummeted this week after it warned its profits would be lower than expected in an unscheduled trading update. The former state monopoly said cost savings would be only £100m this year instead of the £230m it had forecast. Volumes of letters fell by 7% in the first half, and productivity performance was described as "significantly below plan". Adjusted operating profit before transformation costs would be between £500m and £550m, much lower than last year's figure of £694m. Rico Back, chief executive, said trading conditions in the UK were "challenging", with the number of letters posted was in structural decline, particularly marketing mail as a result of recent regulations limiting how companies can contact customers (GDPR). However, the parcels business was performing well with revenue and volume up by 6 per cent in the first half.
24/9/2018	**Ryanair**	Ryanair cut its full-year profit guidance by up to 12%, saying the impact of staff strikes and a rising oil price were to blame. It expected profits of between of €1.1-€1.2bn, down from previous guidance of €1.25bn-€1.35bn, for the 12 months to the end of March. It also said it could not rule out further downgrades, citing weaker traffic and lower fares last month caused by two days of staff strikes in Germany, the Netherlands, Belgium, Spain and Portugal. The industrial action had, in turn, affected customer confidence, leading to lower bookings for the half-term and Christmas periods. As a result, Ryanair said it was trimming its winter flights capacity by 1 per cent and shutting bases at Eindhoven and Bremen, while reducing operations at Niederrhein. Shares fell by 10% after the announcement.

Key Company Diary Dates

Wed 10 Oct	**Whitbread**	Trading update
Thur 11 Oct	**WH Smith**	Full year results
Thur 11 Oct	**Hays**	Trading update
Thu 11 Oct	**Greggs**	Trading update

Economic highlights over the next week

Tue 9 Oct - BRC retail sales monitor - Retail sales as measured by the British Retail Consortium grew by 0.2% in the year to August. The September reading will show if momentum is sustained.

Weds 10 Oct - UK GDP monthly figure for August - the previous month showed growth of 0.3%, it is expected to come in at 0.4% in this reading.

Weds 10 Oct - Industrial output year-on-year data - Previously 0.9% in July as Brexit fears kept a lid on growth.

Index Movements*

Index	Value	%Change
FTSE 100	7,418.34	-1.68
FTSE 250	20,088.70	-1.40
AIM	1,081.42	-1.35
Dow Jones	26,627.48	0.71
S&P 500	2,901.61	-0.43
Hang Seng	26,623.87	-3.94
Nikkei 225	23,975.62	0.75

Currency Movements*

Currency Pair	Value	%Change
£:$	1.30	-0.01
£:€	1.13	0.01
£:¥	148.14	0.00

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

Sector	%Change
Basic Resources	2.72%
Oil & Gas	2.52%
Healthcare	1.19%
Chemicals	-2.44%
Auto's & Parts	-2.45%
Retail	-3.36%

Best & Worst FTSE 100 performing stocks*

Company	%Change
Randgold Resources	4.49%
Rentokil	3.83%
Micro Focus Intl.	3.14%
easyJet	-9.85%
Tesco	-11.67%
Royal Mail	-25.25%

*Weekly movements up until close of business Thursday