

Daily Note – Fake boobs, real money



Summary

Tech: The comeback of Larry Page

Botox: Beauty is in the eye of the shareholder

Ukraine: serious escalation in past 24 hours

Turkey: Posh restaurants and unsold apartments!

United States: Durable goods better than expected

Good morning

Hope you are in good form this morning! I am back in Dublin on a lovely spring morning, dog is already walked and I am sitting at my desk re-reading an article I picked up early this morning on the comeback of Google's Larry Page in the often brilliant Business Insider. Have a read of it [here](#).

I met Page last year at Google's Zeitgeist conference in Arizona last year and was stuck by his coldly impressive focus on a brave new world. This man is a dreamer, who actually wants to change the world in the way all inventors do. In a sea of corporate suits, Page's geekiness stood out refreshingly, not the fake, put-on geekiness so common these days but the serious version of someone who understands what the future looks like. The article is well worth a read if you have 15 mins today.

Sticking with the brave new world theme, what do you make of what is going on in Big Pharma now? Let's focus on what is happening in this industry, particularly in light of the hostile takeover bid for the fake boobs and Botox manufacturer, Allergan.

Years ago I visited the Allergan factory in Mayo where a rare outbreak of botulism in the local hospital was cured by an antidote taxied from the Botox factory. (The Castlebar hospital didn't have any antidotes – which is hardly surprising.) The link between botulism and Botox has always interested me, when I see the unlined, smooth faces of some of those around me who should, at the very least, be showing some of the ravages of their Dublin lives!

Recent Developments in big Pharma

This week's news that a hedge fund and a rival company have mounted a takeover of Allergan is a first. It is one of the first times that the balance sheet of a hedge fund of activist shareholders is being deployed to muscle in on an industry deal. It could mark the beginning of a new era of mergers in the pharma sector.

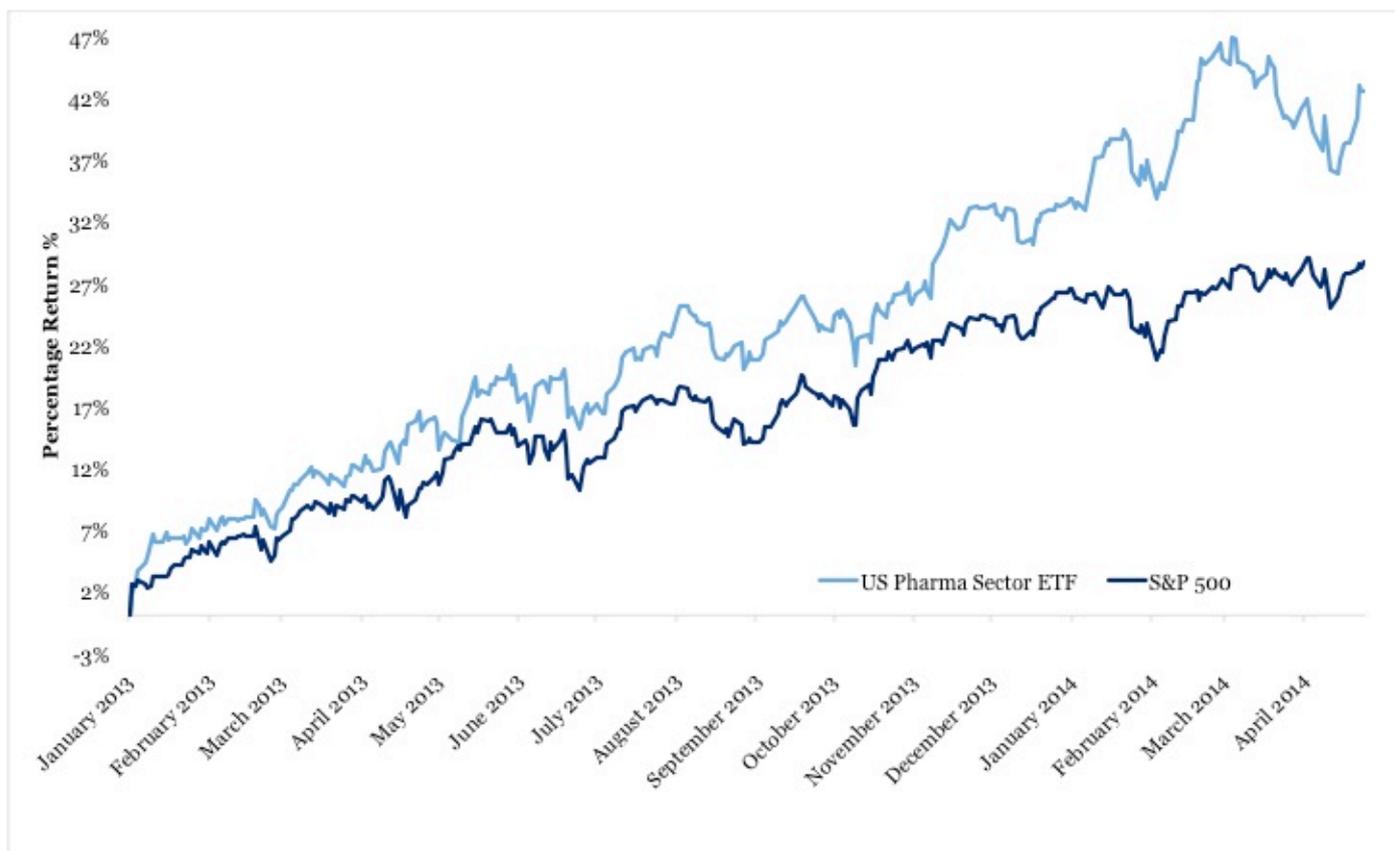
This prospect has set the European pharmaceuticals sector alight, sending shares in some of the UK's biggest drugs groups soaring.

Table 1: Global Big Pharma

Name	Country	Current Price	Return YTD	Price Earnings	Market Cap \$
JOHNSON & JOHNSON	US	99.96	9.14%	17.72	282,719,267,640
PFIZER INC	US	30.71	0.26%	13.32	196,345,274,546
ROCHE HOLDING AG-GENUSSCHEIN	SZ	255	2.37%	19.38	193,669,228,019
NOVARTIS AG-REG	SZ	74.7	4.92%	21.31	178,035,803,077
GLAXOSMITHKLINE PLC	GB	16,515	2.48%	14.65	134,966,435,826
S&P 500 INDEX	US	1878.61	1.636586	17.22	

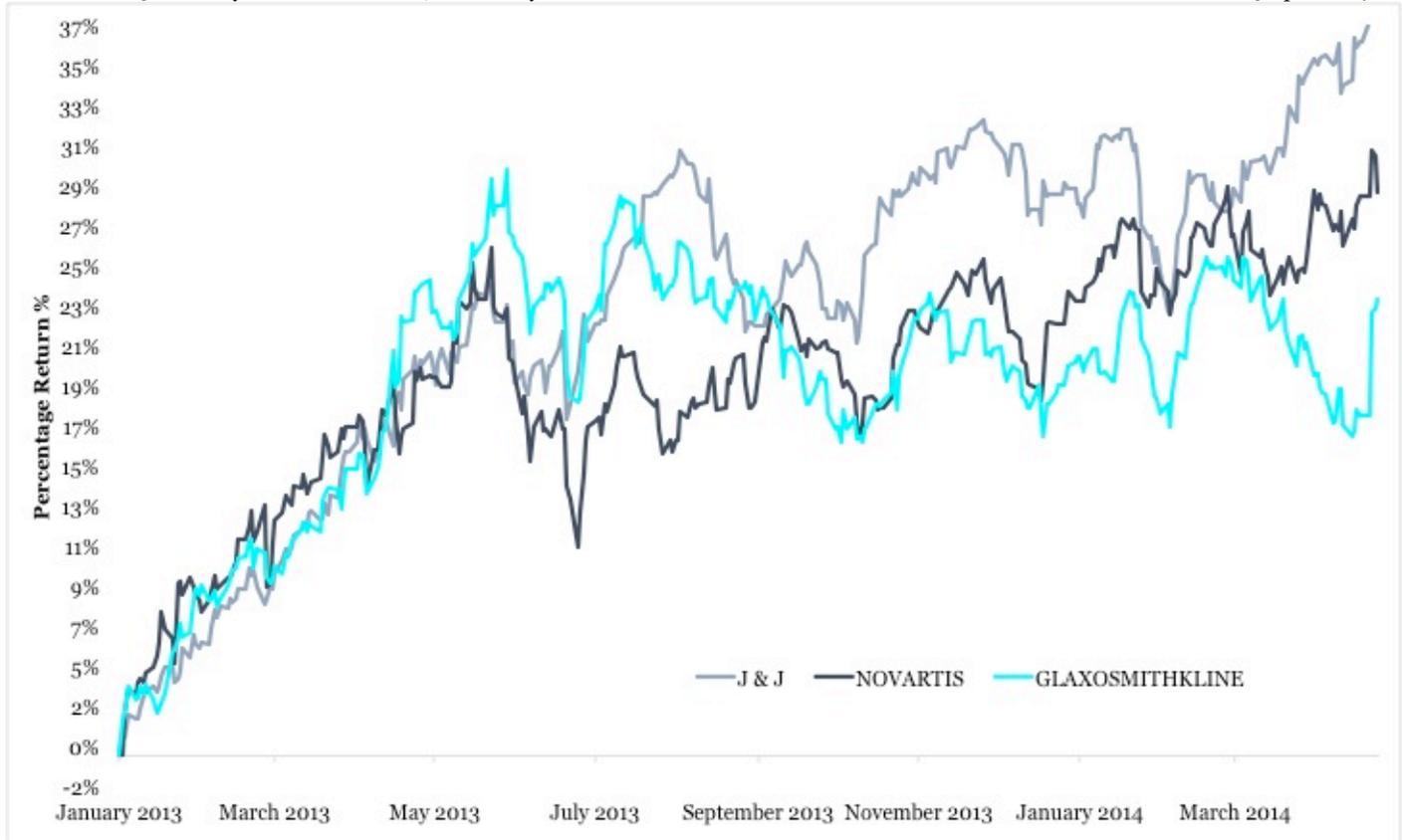
We can see clearly from figure 1 just how Pharma has out performed.

Figure 1: US Large Cap Pharma vs S&P 500



AstraZeneca shares surged earlier this week by 8% at one stage amid frenzied speculation that US rival Pfizer was preparing a mega-bid. This comes after a \$100 billion approach turned down by the UK company earlier this year. If a deal were to go ahead, it would be by far the biggest ever takeover of a UK company by an overseas buyer and one of the largest deals seen in the global pharma sector.

Figure 2: Large Cap Pharma both sides of the pond



But mega-mergers are not the only way forward for Big Pharma.

Rival drugs groups, GlaxoSmithKline and Novartis, unveiled their own deals on Tuesday, swapping assets and creating a new force in consumer healthcare by combining brands that included GSK's household names like Aquafresh toothpaste, Beechams cold remedies and Savlon antiseptic, with Novartis's Tixylix cough medicine and the Nicotinell quit smoking products.

Mega-mergers swept the global pharma industry in the 1990s and 2000s, including the record-breaking \$70-billion plus merger of GlaxoWellcome and SmithKline Beecham in 2000 and Pfizer's \$68 billion takeover of Wyeth in 2009.

However, such giant deals have fallen out of favour because they destroy shareholder value rather than create it. Investors have figured out that the biggest winners tend to be the army of investment bankers, accountants and lawyers brought in to broker the transactions.

But now that Allergan has received a separate takeover approach from Canada's Valeant Pharmaceuticals in partnership with activist investor Bill Ackman, it may signal another bout of mergers.

Their unsolicited \$47bn bid for Allergan could create one of the world's five biggest drug companies.

This is one to watch.

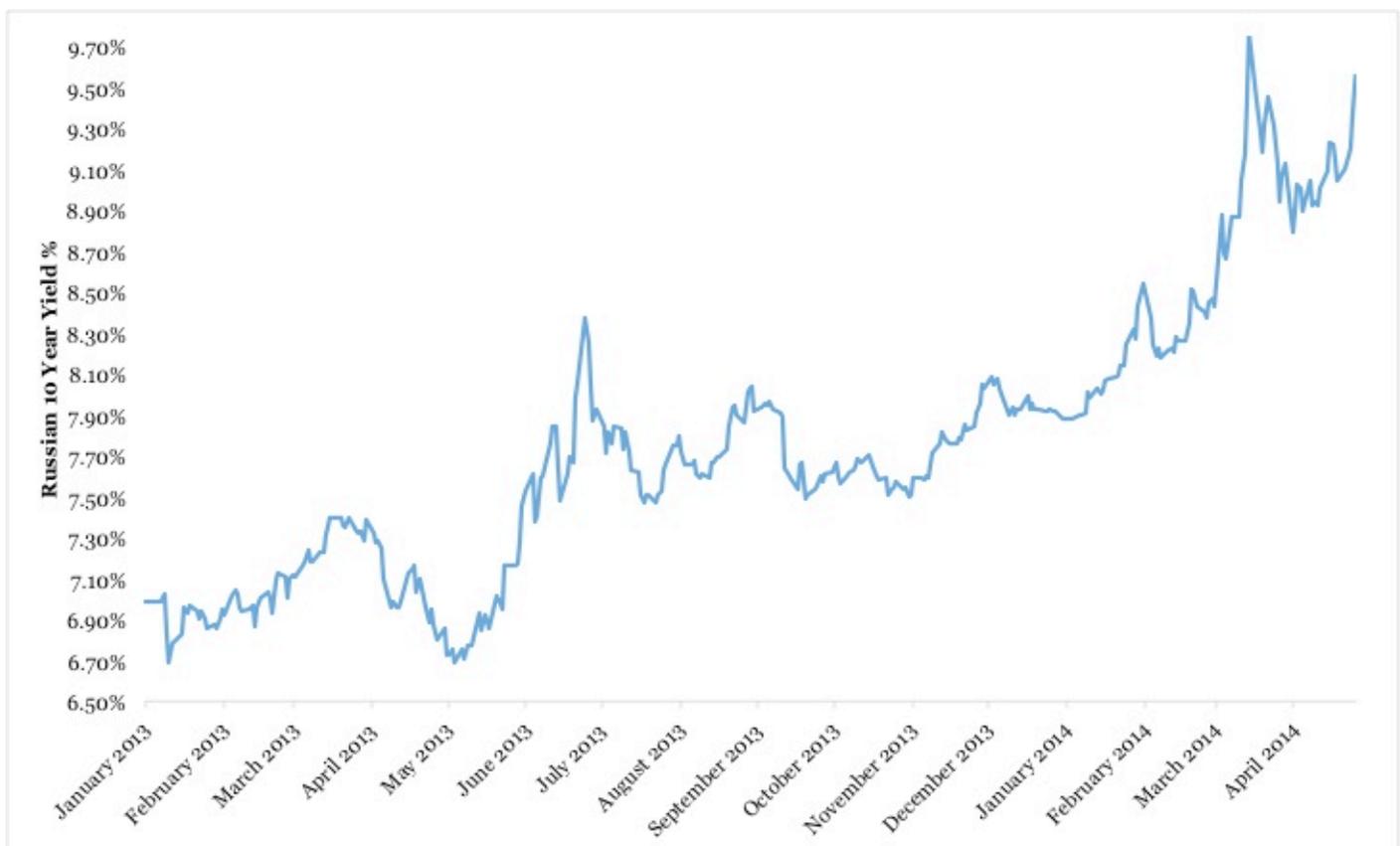
Global risk takes a wobble as Ukraine moves against breakaway towns

President Putin has warned of unspecified "consequences" in retaliation for a security crackdown against pro-Russian militants. His spokesman says the crackdown raises questions over the legitimacy of the May 25 presidential vote. Russia has started military exercises near the Ukrainian border. There have been clashes in the eastern town of Slavyansk as Ukrainian troops set up checkpoints around the town. At least two pro-Russia separatists have been killed.

Obama has warned that the US has another round of economic sanctions already "teed up". But he acknowledged those penalties may do little to influence Vladimir Putin's handling of the crisis in Ukraine. Obama is also struggling to get the Europeans to agree, as pressure is being put on both Germany and Italy to agree to a wider set of sanctions. As I said yesterday, the image of trade along the Bosphorous stopping for the sake of the backwaters of eastern Ukraine doesn't seem likely.

Overnight, S&P cut Russia's rating to BBB- from BBB after lowering its outlook to negative in March. This has sent Russian risk back towards the highs seen in March. (see chart below). This morning the Russian central bank raised rates to stem currency outflows. As always, higher rates in a weaker economy have precisely the opposite effect to what's intended. Expect more, not less outflows.

Figure 3: Russian 10 Year Yield

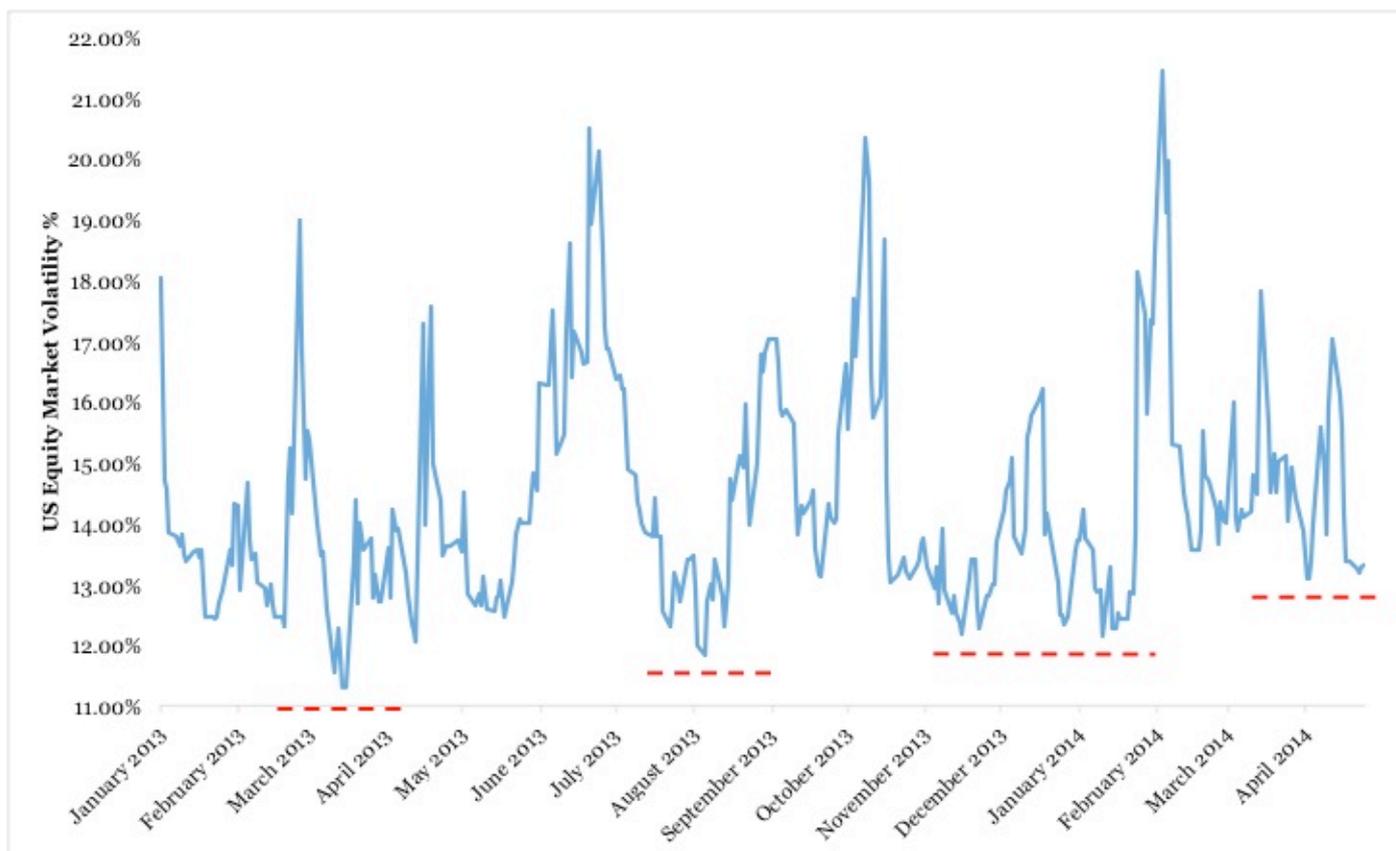


My bias from the start of the year was to look for periods of volatility in global equities (see launch note [here](#) for more). In the note, we also highlighted Ukraine as a flashpoint (see [here](#)).

The situation in Ukraine has gathered a life of its own.

If you had been following us on Twitter yesterday afternoon, you would have taken the prudent move to hedge a portion of our book and buy the US VIX (volatility index). This will move higher if volatility picks up in markets (see chart below).

Figure 4: US Equity Market Volatility



I took this exposure through an ETF. The initial allocation is 100%.

[iPath S&P 500 VIX Short-Term Futures ETN](#)

my other ones. As it is a hedge, it could well be sold for a loss if the situation in Ukraine stabilises. This will be a far more short-term investment than my other ones. As it is a hedge, it could well be sold for a loss if the situation in Ukraine stabilises.

In addition, I have taken our CAC short investment up 150% to match the size of my long China investment. While I believe the eventual move to QE in Europe will boost the CAC (and all other Euro equities) in the short-term, the driver for markets is the Ukraine.

Like the VIX investment, this CAC move is purely short term.

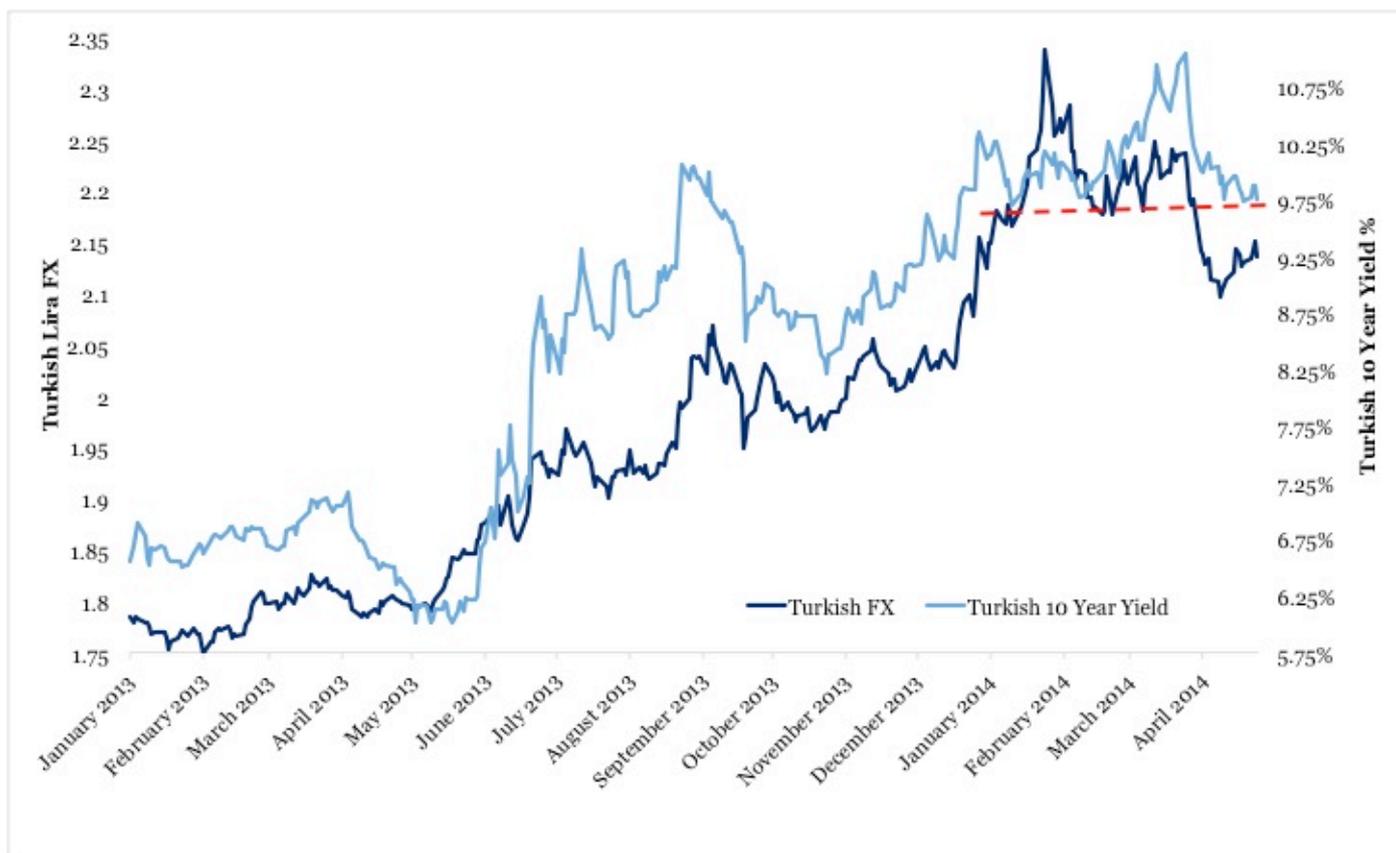
Turkey: MPC 'on hold', for now

Table 2: Turkey Economic Data

Event	Period	Surv (M)	Actual	Prior
Benchmark Repurchase Rate	Apr-24	10.00%	10.00%	10.00%
Overnight Lending Rate	Apr-24	12.00%	12.00%	12.00%
Overnight Borrowing Rate	Apr-24	8.00%	8.00%	8.00%

The Turkish MPC kept key policy rates on hold, with the O/N lending rate at 12%, the 1-week repo at 10% and the borrowing rate at 8%. However, Turkey’s problems are now much more political than purely economic. Having lunch in a swanky Istanbul restaurant the other day, looking at unsold up-scale apartment blocks overlooking the city, it struck me that we’ve seen this before. Posh restaurants and unsold apartments are not good signs!

Figure 5: Turkish Lira vs 10 Year Bond Yield



United States: Durable goods better than expected

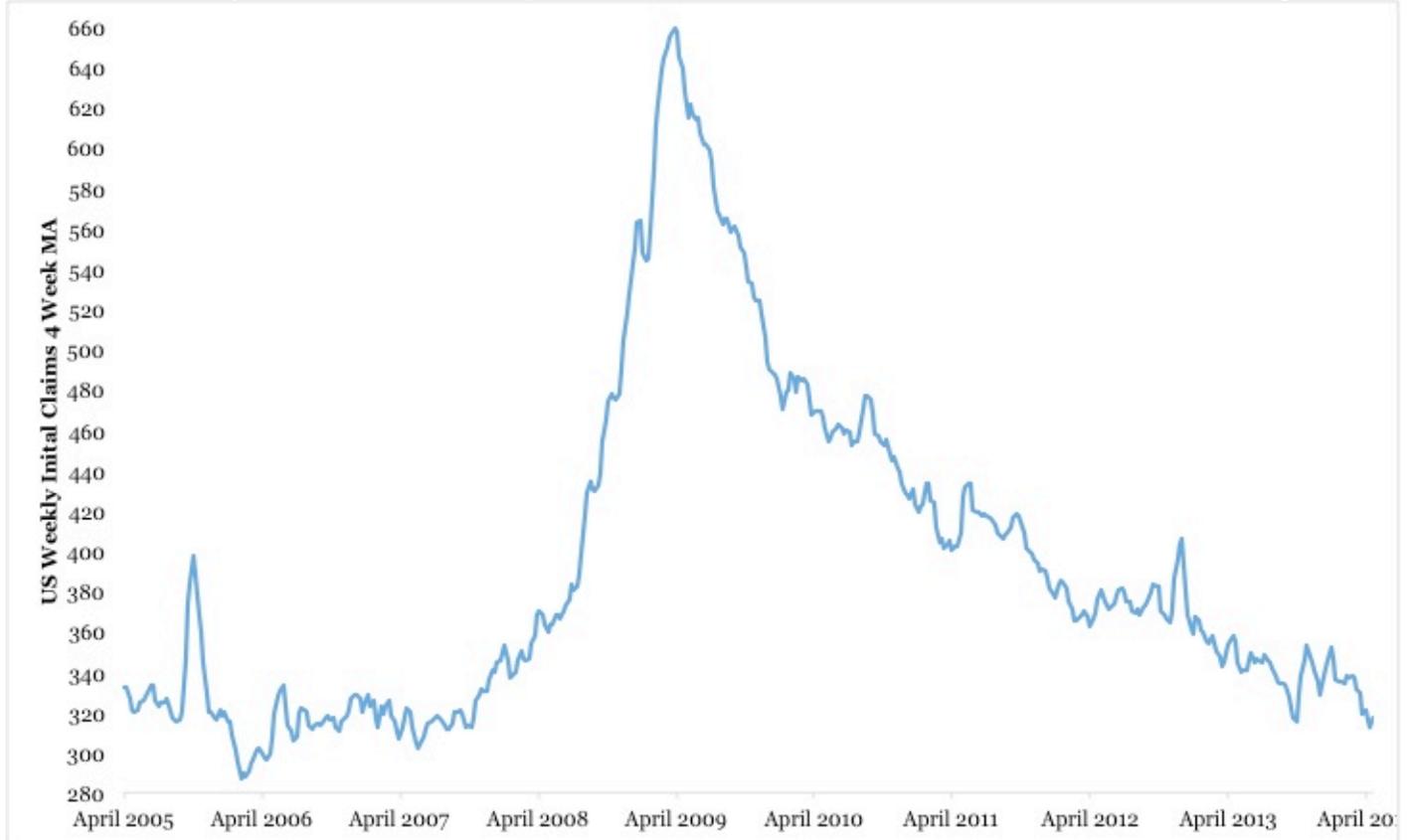
Table 3: US Economic Data

Event	Period	Surv (M)	Actual	Prior	Revised
Durable Goods Orders	Mar	2.00%	2.60%	2.20%	2.10%
Durables Ex Transportation	Mar	0.60%	2.00%	0.20%	0.10%
Cap Goods Orders Nondef Ex Air	Mar	1.50%	2.20%	-1.30%	-1.10%
Cap Goods Ship Nondef Ex Air	Mar	1.00%	1.00%	0.50%	0.70%
Initial Jobless Claims	Apr-19	315K	329K	304K	305K
Continuing Claims	Apr-12	2745K	2680K	2739K	2741K

Headline durable goods orders increased 2.6% (vs. consensus 2.0%).

Elsewhere, weekly Initial jobless claims rose to 329,000 in the week ended April 19 (vs. consensus 315,000), an increase of 24,000 from the previous week.

Figure 6: US Weekly Initial Claims 4 Wk MA

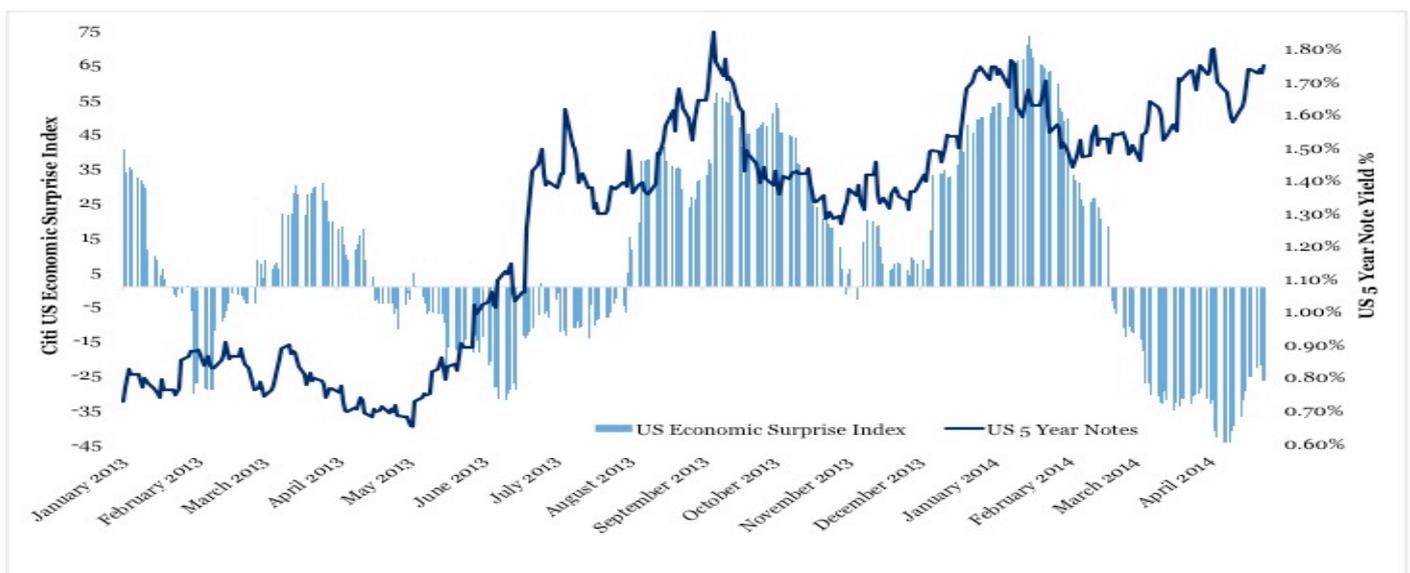


While this rise in people looking for benefits was a disappointment to US bulls, if we look at the big picture, people in the US are working much more and claiming fewer benefits.

In terms of the bigger picture (outside of the geo-political risks talked about), we see upside to the US economic outlook and thus bond yields. As you can see from the chart below, US economic data has begun to surprise to the upside again.

If the data was to really begin to surprise the market, we can see the US 5 Year note trading up and through the key 1.80%.

Figure 7: Citi US Economic Surprise Index vs 5 Year Yield



Portfolio: Positioning for a period of volatility

Table 4: Our Portfolio

Trade Date	Pos	Market	Exposure	Trade Price	Current Price	P&L %	Price Target
27/12/2013	S	Euro Spot	100%	1.386	1.3835	0.18%	1.32
13/01/2014	L	IPATH US TREASURY 5 YR BEAR	150%	39.543	40.28	2.79%	46
				1.549%	1.7101		
11/02/2014	L	ISHARES CHINA LARGE-CAP ETF	150%	35.207	35.08	-0.54%	Spread
20/02/2014	L	LYXOR UCITS ETF DAILY SHORT	150%	36.243	35.89	-1.46%	Spread
24/02/2014	L	IPATH S&P 500 VIX S/T FU ETN	100%	40.950	41.55	1.47%	Spread
		Open Position Return				2.44%	
		Closed Position Return				0.00%	
Total Portfolio Return						2.44%	

Disclaimer: The statements, opinions and analyses presented in the articles, newsletters, and other materials appearing on this website are provided as general information and for educational purposes. Opinions, estimates and probabilities expressed herein constitute the judgment of the author as of the date indicated and are subject to change without notice. Nothing contained in this website is intended to be, nor shall it be construed as, investment advice, nor is it to be relied upon in making any investment or other decision. Prior to making any investment decision, you are advised to consult with your broker, investment advisor or other appropriate tax or financial professional to determine the suitability of any investment. David McWilliams shall not be responsible or have any liability for investment decisions based upon, or the results obtained from, the information provided.