October 2018

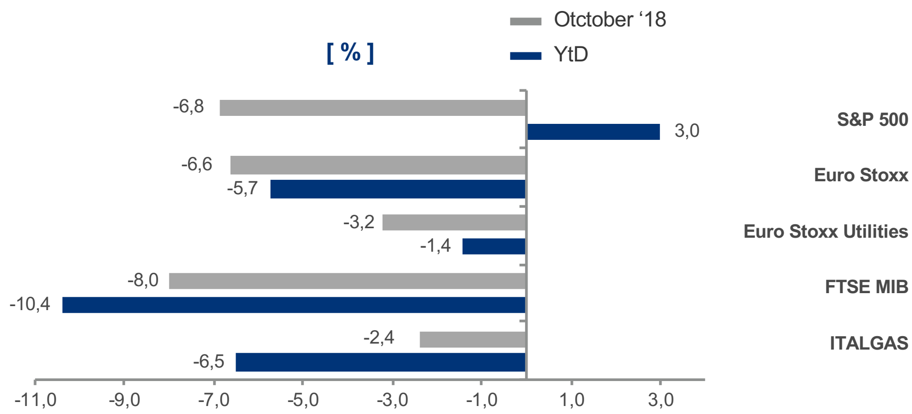
Financial Markets Review

The equity market has taken a heavy fall due to fears of a slowdown caused by standardisation of the FED monetary policy. The US ten-year yield at its peak of over 7 years

The Financial Markets

The global equity market took a heavy fall in October as it reflected fears of an economic slowdown due to: 1) standardisation of the FED monetary policy and resulting rally of US yields, which touched their peak of over 7 years based on the vigorous economic picture, with oil prices and implied inflation at maximum levels of the past 4 years and the unemployment rate at the lowest level of the last 48 years; 2) weakness in the emerging markets caused by the escalation of the US/China customs duties; 3) continuing marginal concerns in the Eurozone and 4) profit taking on Wall Street in the aftermath of the approximately 75% rally during the last 3 years. S&P 500 and Euro Stoxx closed with a drop of about 7%, while the FTSE Mib (-8%) was also affected by the new rise in sovereign spread after the sequential GDP contraction and conflicts with the EU on the manoeuvre. Divergence between sovereign core yields, with 10y UST yield that after touching its peak for over 7 years and despite the heavy equity market fall, closed on an upward trend of 8 bps due to the FED's restrictive verbal tones, with several FOMC members pushing for an increase in rates to block the overheating of the economy and inflation.
The 10y Bund yield, on the other hand, contracted by 9 bps, reflecting moderation in the ECB's expectations and weak Eurozone macro data, and a flow of capital escaping from the periphery

Performance of major Stock Exchange indexes



Source: Italgas processing of Bloomberg data

Notwithstanding confirmation of Moody's investment grade rating, the BTP-Bund spread closed up by 37 bps, at its peak for over 5 years, thus reflecting disagreements on the manoeuvre with the EU Commission and a risk of starting up infringement proceedings over excessive deficit, and Italy's GDP is down for the first time in 4 years.

EUR/USD -2.5%, at the lowest point in over 1 year, due to the expected acceleration in the FED's monetary standardisation path versus a slowdown in growth displayed by the ECB, and persistent peripheral fears in the Eurozone. EUR/GBP -0.5% because of the mentioned peripheral Eurozone newsflow and renewed talks to simplify UK-Ireland customs controls.

The oil market

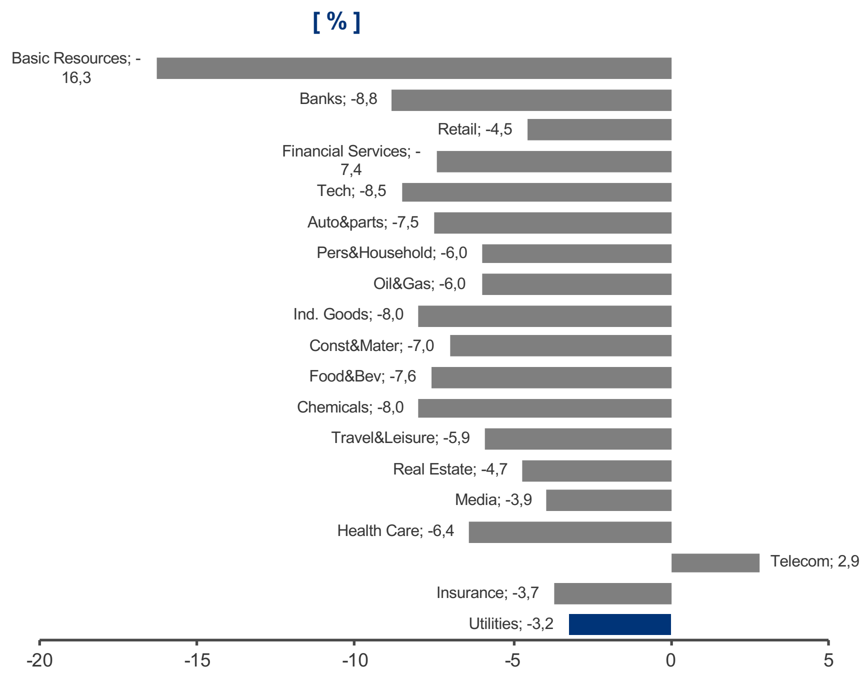
After having updated the 4-year maximum levels, backed by fears of a supply crunch, the dated Brent prices retreated by 11% during the month, reflecting fears of a slowdown of the economic cycle due to the monetary policy standardisation started up by the FED, 6th consecutive weekly rise in US oil stocks, with US output going back to touch historical highs, despite the production unavailability in the Gulf of Mexico in the wake of Hurricane Michael, and growth estimates of world demand slashed by OPEC and statements of Saudi Arabia on the plan to increase the output on new historical high prices to offset the production deficit generated by the sanctions the US enforced on Iran.

Trend of the sectors

The dynamics in the sectors reflected the above-mentioned fears of an economic slowdown, with resulting underperformance of the cyclical sectors

The dynamics in the sectors reflected expectations of an economic slowdown caused by the core yield levels and standardisation of the monetary policy launched by the FED, with a consequent underperformance of the cyclical sectors, and particularly of the mineral/iron and steel sector (also due to the profit warning issued by Voestalpine because of the slowdown in demand resulting from international trade tensions), the technological and banking sectors, with the latter also penalised by exposure to peripheral sovereign debts, Italy's in particular.
On the opposite side, on the other hand, the defensive sectors – telecommunications in particular – are pointed out, backed by break-up speculation for BT and expectations of a green light for DT to acquire the Dutch branch of Tele2, and the utilities sectors.

Trend of the main sectors, October 2018



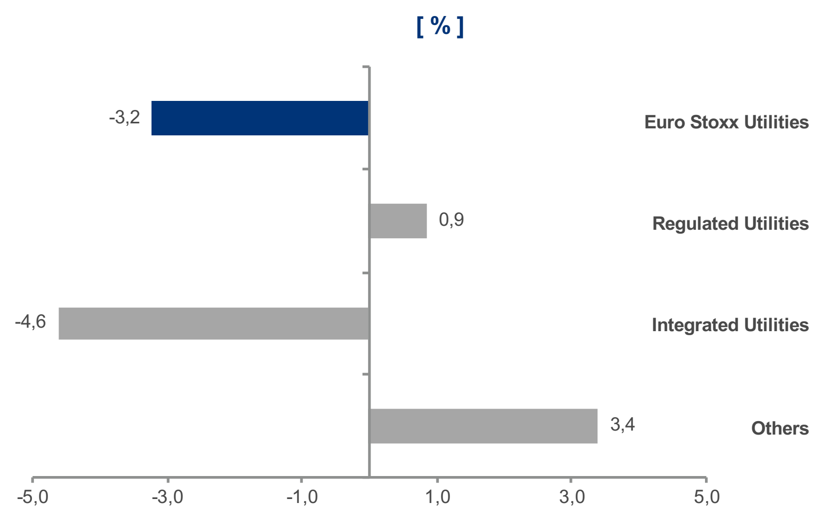
Source: Italgas processing of Bloomberg data

Utilities is one of the best performers; regulated beat integrated with a strong aversion to risk

Trend of the Utilities sector

Backed by the defensive profile in a context strongly adverse to risk, the utilities sector (-3%) proved to be the second best performer in October right behind the telecommunications sector. Because of these dynamics, the regulated shares outperformed the integrated ones, with the latter also affected by the drop in RWE (-19%) after a German court imposed environmental constraints on the company concerning coal extraction, with potential repercussions on the public debate in progress in the country to set a coal exit timetable. Worthy of note in the water and environmental sector is the Suez hike (+4%) following the Q3 results and business plan outlook better than expected.

October 2018 - Trend of the sector and sub-sectors

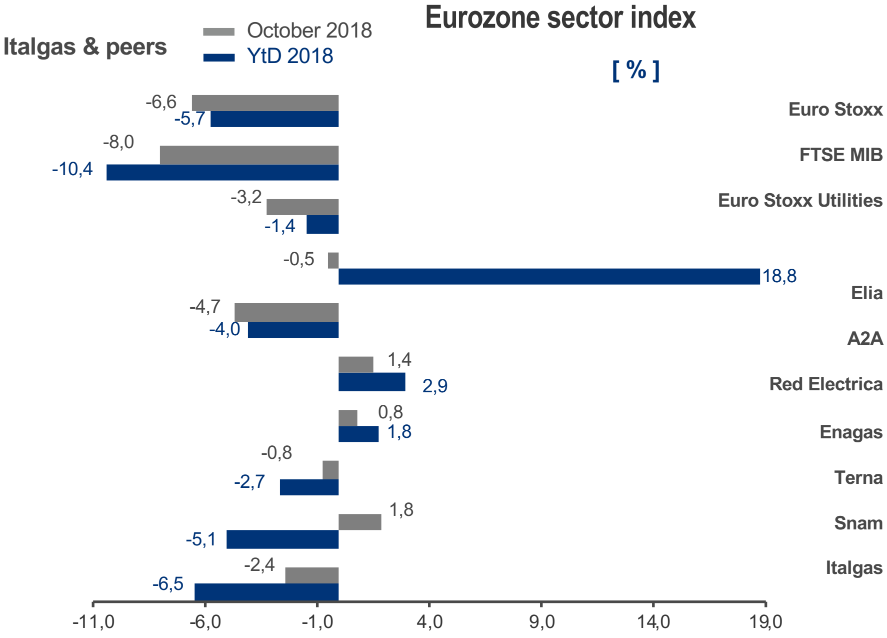


Source: Italgas processing of Bloomberg data

Italgas share and its peers

Italgas was down by 2%. Although penalised by the new rise in the sovereign spread due to the defensive profile, it outperformed both the Italian index and that of the Eurozone sector. Notwithstanding publication of Arera resolution 529 on the launch of the tariff review for the fifth regulatory period, with the market that appreciated the focus placed on a standard capex application on the network and driven toward consolidation of the sectors through allowed opex reduction for minor operators, the share outperformed its regulated Italian peers due to the continuing delays in initiating gas tenders and waiting for the updated business plan for Snam. Red Electrica and Enagas respectively benefitted from the postponement to acquire Hispasat and from the improved regulatory outlook

Italgas down by 2%, in any case outperforming on FTSE Mib and the Eurozone sector index



Source: Italgas processing of Bloomberg data

Agenda
Corporate events

November 5 BoD Q3 results, press release and conference call

Corporate News

Change in Moody's rating following downgrade of sovereign rating

On 23 October, Moody's announced that following the downgrade of the rating of Italian government bonds to Baa3 from Baa2 stable outlook, a corresponding action was adopted also on the Italgas' long-term rating, which was lowered to Baa2 stable outlook from the previous Baa1 in consideration of the connection assigned concerning the sovereign credit risk.

The rating agency emphasised Italgas' strategic position, its leadership in the gas distribution sector in Italy and its totally regulated revenue, together with a solid liquidity position and exposure limited to the risk of volatility in the financial markets, which make it possible to place the Company's rating a notch above the sovereign rating.

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