

TOMORROW'S NEWS TODAY

Monday, July 03, 2017

Market Snapshot*

DJIA	21479.27	+129.64
Nasdaq	6110.06	-30.35
S&P 500	2429.01	+5.6
10-Year	2.3483%	-13/32
30-Year	2.8678%	-19/32
Euro	\$1.13635	-0.0056
Nymex Crude	\$47.07	+1.03

Source: SIX Financial Information, ICAP plc *preliminary values subject to adjustments

Stocks

Rallying energy and financial stocks lifted the Dow Jones Industrial Average on the first day of the third quarter. Trading was quiet in Monday's session, which ended early ahead of the July 4 holiday in the U.S.

Treasurys

Prices of U.S. government bonds fell on Monday, sending the yield on the two-year Treasury note to the highest level in more than eight years.

Forex

The dollar rallied Monday after a strong U.S. manufacturing report bolstered confidence in the economy. Investors are awaiting key data later this week on jobs and the minutes from the Federal Reserve's latest meeting.

Commodities

U.S. crude futures climbed Monday, on track for their longest stretch of daily gains in nearly eight years amid indications that U.S. oil output may not be as resilient as many anticipated in the face of lower prices. U.S. crude futures recently traded up 54 cents, or 1.17%, at \$46.58 a barrel on the New York Mercantile Exchange. Brent, the global benchmark, rose 50 cents, or 1.03%, to \$49.27 a barrel on ICE Futures Europe.

Tomorrow's Headlines

Reader Notice

Due to the holiday in the U.S., this newsletter will not publish on Tuesday, July 4.

U.S. Auto Sales Fall as Fewer Vehicles Go to Rental Chains

Auto sales continued to slide in June, as car buyers react to higher vehicle prices and Detroit backs away from dumping unwanted inventory into rental-car lots.

General Motors Co., Ford Motor Co. and Fiat Chrysler Automobiles NV reported steep monthly sales declines compared with the same period in 2016. While retail demand is losing steam, each of Detroit's players also reported significant reductions in deliveries to daily-rental companies, long the Motor City's biggest customers.

Sales to Enterprise Holdings Inc.'s Enterprise Rent-A-Car or Hertz Global Holdings Inc. traditionally were a way for auto makers to keep factories rolling even as dealership traffic slowed. But that business has traditionally dented profits and soiled brand reputation.

The move away from rental sales reinforces a newfound discipline for domestic players that have been riding a seven-year growth streak since GM and Chrysler sought bankruptcy protection in 2009. The Detroit 3 reported tens of billions in profits during that span, bolstered by tailwinds from falling gas prices and surging demand for profit-rich trucks and SUVs.

Overall industry demand softened over the first half of 2017, however, falling about 2% through six months, according to JD Power. The development ushers in an expected plateau for auto sales, an important driver for the broader U.S. economy.

Manufacturing-Sector Activity Accelerated In June

The strongest reading on U.S. factory activity in nearly three years signaled underlying health in the economy headed into the second half of 2017.

The Institute for Supply Management on Monday said its index of U.S. manufacturing activity rose to 57.8 in June, its highest level since August 2014. A number above 50 indicates expansion; economists had expected a more modest rise from May's 54.9.

The closely watched gauge is now just above its level early this year, when it and other survey-based economic indicators had jumped following the 2016 presidential election. This time, the solid reading is accompanied by evidence of a pickup in actual economic growth during the second quarter.

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Tomorrow's Calendar

N/A	Marianas: U.S. Independence Day
N/A	U.S. Independence Day. Financial markets closed

Tomorrow's Headlines

continued

"The improvement across many of the sub-components seems to be consistent with what we've seen in the hard data for the domestic economy," said Michael Gapen, chief U.S. economist at Barclays. "I would tie it to more of a real improvement than expectations of big changes."

The index has signaled expansion in the manufacturing sector for 10 consecutive months, and the details of the latest report were broadly upbeat.

Danone to Sell Stonyfield to Lactalis For \$875M

French dairy company Danone SA said Monday that it entered a binding agreement to sell its U.S. dairy business, Stonyfield, to Lactalis for \$875 million to address U.S. competition concerns.

The sale of Stonyfield is part of an agreement reached with the U.S. Department of Justice in connection with Danone's recent acquisition of WhiteWave. Danone and WhiteWave together have big chunks of the yogurt market with brands including Dannon, Oikos, Actimel, Silk, Wallaby and Horizon Organic, which led to concerns from the Justice Department about concentration in the dairy sector.

Danone said that the sale price represented a multiple of about 20 times the 2016 earnings before interest, tax, depreciation and amortization for Stonyfield.

Lactalis, based in the town of Laval, about 175 miles southwest of Paris, is a family-owned company whose cheese, milk and other dairy products are sold under well-known brands such as President and Bridel. It said it has 75,000 employees spread across 85 countries.

Tesla CEO Elon Musk Details Model 3 Production Ramp

Tesla Inc. Chief Executive Elon Musk signaled an even tighter timetable for the auto maker's ambitious plans to ramp up production on its new Model 3 sedans.

In a late-night missive on Twitter, Mr. Musk said he aims to have 30 vehicles ready to hand over to customers July 28, followed by 100 cars in August and 1,500 in September. The \$35,000 sedan is far less expensive than Tesla's two existing models, and is central to the company's plans to sharply increase total sales.

That initial plan appears slower than one Mr. Musk laid out in February, when he said he was pushing suppliers to be ready for a weekly run rate of 1,000 vehicles in July, to 2,000 in August and 4,000 in September.

However, Mr. Musk's tweet, sent shortly after 11 p.m. Pacific time Sunday, said Tesla plans to hit a rate of 20,000 Model 3s a month in December, in line with his previous pledge of having 5,000 vehicles a week by year's end.

In February, Mr. Musk suggested the targets were set for suppliers, knowing they could slip. "These are parts orders and the parts need to arrive, then you can turn into a car and the car needs to be delivered to customers," he said in February on an earnings conference call. "None of these things occur instantaneously."

Total Plows Into Iran, Leaving Shell, BP on Sidelines

The \$1 billion pledged Monday by French oil giant Total SA in an Iranian gas field is a breakthrough for the resource-rich country, but it is unlikely to unleash the flood of foreign energy-industry investment that Tehran is seeking.

Total executives signed a contract Monday to press ahead with developing the country's massive South Pars gas field, in which the company holds a 50% operating stake. The contract is the first Iranian exploration and production project awarded to a major European company in 10 years, after a deal with global powers last year ended Western sanctions on Tehran over its nuclear program.

To make it happen, the Paris-based company spent years maintaining relationships in Iran even after Western sanctions were tightened in 2012, and then took months to negotiate the details after announcing a preliminary agreement last year.

"We were here 20 years ago. We've come back today," Total Chief Executive Patrick Pouyanne said at a Tehran news conference. "And again it's a long history for the company."

Total was in a stronger position to make a deal than competitors like Royal Dutch Shell PLC, which has long eyed going back into Iran. BP PLC, which helped build the Iranian oil industry, remains on the sidelines.

GE's Baker Hughes Deal Deepens Its Stake in Energy

General Electric Co. closed its deal to combine its long-suffering energy business with Baker Hughes Inc. on Monday, creating one of the largest companies in the oil-field services industry.

The new publicly traded company, which will retain the Baker Hughes name, will pursue further cost cuts as it awaits an elusive recovery in oil prices. Majority-owned by Boston-based GE, it will trade on the New York Stock Exchange under the symbol BHGE, with dual headquarters in Houston and London.

While oil services wasn't a core part of GE's industrials business, the new Baker Hughes could be better equipped to compete with industry leaders Halliburton Co. and Schlumberger Ltd. in providing equipment and services to major oil producers.

"We are really filling one of the gaps that GE oil and gas had with oil-field services," said Lorenzo Simonelli, who is CEO of the new company after having run GE's oil and gas operations. "It evens out the total exposure in the portfolio."

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Tomorrow's Headlines

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GE has been cutting costs for years but plans to trim another \$1.2 billion from the combined company by 2020. It has declined to say how many employees could lose their jobs as a result of the merger.

Barclays Ex-CEO In Court On Fraud Charges

Former Barclays PLC Chief Executive John Varley and three other former executives appeared in a West London court Monday to face fraud charges over deals struck to secure emergency Mideast funding during the financial crisis.

Lawyers representing Mr. Varley and Roger Jenkins, a former senior Barclays investment banker, said their clients intended to plead not guilty to the charges. A lawyer representing Barclays, which was also charged, said the bank hadn't yet come to a decision on its own position.

Britain's Serious Fraud Office has spent five years investigating how Barclays wooed Qatari investors to prop up the bank. In total, Barclays raised 11.8 billion pounds (\$15 billion) from investors through two emergency cash calls in June and October 2008. Its examination has focused on 322 million pounds in "advisory services" that were paid to Qatari investors as part of the cash injection, an agreement that wasn't initially disclosed to shareholders. The SFO also scrutinized a \$3 billion loan facility to the state of Qatar made by Barclays just weeks after the October equity raise.

Bankrate to be Acquired by Marketing Firm Red Ventures

Red Ventures LLC said Monday it has agreed to buy personal finance website operator Bankrate Inc. in a \$1.24 billion all-cash deal, as it seeks to expand its presence in the financial-services industry.

Red Ventures, a Fort Mill, S.C., data company that connects financial services, home services and health-care businesses to consumers, plans to pay Bankrate shareholders \$14 a share, an 8.9% premium to Friday's closing price. Bankrate shares are up 16% so far this year.

Red Ventures said it plans to leverage Bankrate's "millions of users across multiple brands" to deepen its footprint in the industry.

The deal, already approved by Bankrate's board of directors, still needs approval from Bankrate shareholders. The companies said they expect the deal to close later this year.

Bankrate's flagship sites include CreditCards.com, Bankrate.com and Caring.com. The company also owns and operates other specialist sites, apps and social platforms including NextAdvisor.com and Interest.com. In addition, it provides content, tools and services to more than 100 online partners and licenses editorial content to major news organizations.

Jana Takes Roughly 5% Stake in EQT

Jana Partners LLC has taken a roughly 5% stake in EQT Corp. and is seeking to scuttle the energy company's proposed \$6.7 billion acquisition of Rice Energy Inc.

Instead of buying Rice, Jana wants EQT to fully separate its pipeline operations, according to a securities filing and people familiar with the matter. The goal would be to make EQT a pure exploration-and-production company. While that could happen after a Rice deal, tax rules mean it could take years.

Jana questions the benefits of the deal and believes the price is too high, the people said.

In a statement, EQT said the deal would further its efforts to improve operations and tap the value of its natural-gas resources.

Caterpillar Faces New Questions In Probe

Federal investigators believe Caterpillar Inc. failed to submit numerous required export filings with the government in recent years, adding to questions facing the manufacturing giant, people familiar with the matter said.

The findings are preliminary, these people said, but offer an avenue for investigators to examine whether missing export submissions were part of a possible effort by the Peoria, Ill.-based maker of yellow bulldozers, mining trucks and other heavy equipment to avoid paying taxes.

The possible missing export filings were discovered as part of a continuing criminal probe into potential export and tax violations at Caterpillar, according to the people familiar with the matter. The probe is the latest in a series of inquiries centered largely on a Swiss subsidiary that U.S. Senate investigators have found was part of a longtime Caterpillar strategy to lower its U.S. tax bill. The Swiss unit has been involved in overseas sales of Caterpillar replacement parts. While the tax-angle of the probe is in its very early stages, investigators believe it could be the beginning of a yearslong investigation, people familiar with the matter say.

Eurozone Manufacturing Accelerates as Greece Joins In

Eurozone factories had their busiest month in more than six years during June, with the expansion even spreading to Greece, a persistent laggard.

The pickup is consistent with other indications that economic growth in the currency area accelerated in the three months to June, having already speeded up in the first quarter.

Data firm IHS Markit Monday said its Purchasing Managers Index for eurozone manufacturing — which is based on a survey of 3,000 companies — rose to 57.4 from 57.0 in May, reaching a 74-month high. That was slightly higher than the preliminary estimate of 57.3.

The pickup in manufacturing was led by Germany, Austria and the Netherlands, but also saw activity increase in Greece for the first time since August 2016, albeit very slightly.

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Talking Points

What Is Fear Gauge Telling Us?

Some dates deserve a place in market history. Black Monday 1987 and Black Thursday 1929 occurred before the Vix fear gauge was created, but the volatility index's three biggest intraday rises also resonate: August 2015's China fears. May 2010's flash crash. February 2007's subprime concerns mixed with another China panic.

Last Thursday shouldn't merit being on the list. Central bankers kind of maybe indicated that just possibly they might do what they previously said they would do, and tighten monetary policy if the economy improves. Yet the Vix, a measure of the volatility expected over the next 30 days, had its fourth-biggest ever rise of 55% from open to peak, before recording its eighth-biggest fall from peak to close. By its low on Friday it was back in the lowest 1% of Vix readings ever. The Vix was created in 1993.

The outsize reaction to so little news tells us three things, all worrying.

First, investors are very concerned about any signs that central banks might pull back from super-easy monetary policies. Second, when volatility starts to go up it can go up a lot faster than anyone thought. And third, complacency still rules, with "buy the dip" firmly embedded in investor psychology after an eight-year bull market.

The second of these is the biggest danger to the growing group of investors who have been betting on low volatility. They're convinced it is safe because in the past the markets have given plenty of warning before a spike. When low-volatility regimes have ended in the past, they've typically trended higher before turning really nasty, giving investors time to get out. If volatility is no longer predictable, the "short-vol" strategies used by hedge funds, pension funds and institutional investors—and available through exchange-traded products, too—are riskier than their advocates suggest.

Just how risky was evident last week. The VelocityShares Daily Inverse VIX exchange-traded note, known by its ticker XIV, tumbled 15% intraday on Thursday. Investors must decide if this is advance warning of danger ahead, or merely a move to be expected after gains of 263% in the previous 12 months.

In some ways, this is the same assessment investors always have to make. Is the market signaling complacency, or is volatility low — and stock and bond prices high — for a good reason: Because profits are strong, inflation low and the economic outlook sunny? Christian Mueller-Glissmann, a strategist at Goldman Sachs, says in past periods of low-inflationary growth such as the 1960s and 1990s, volatility stayed low.

But in another way the decision is specific to volatility. It is one thing to put money on volatility staying low as a high-risk, high-reward bet that nothing upsets the calm in the next 30 days. It is quite another to do it on the basis that when markets start to become more volatile there will be a shift to a higher volatility regime before a major VIX spike.

The losses to the strategy when the VIX does jump can be torture. The August 2015 panic meant those who had continued selling volatility — despite a warning from a smaller VIX rise earlier that summer — lost more than half their money. The XIV exchange-traded note took until January 2017 to recover all its losses.

New Iraqi Export: Effective Leadership

Three years ago, Abu Bakr al-Baghdadi proclaimed the existence of an Islamic State caliphate and proceeded to sweep his forces through northern Iraq and toward Baghdad, threatening the viability of the fragile country.

Today, the leader declaring an end to the caliphate is someone few would have imagined in the position, Iraqi Prime Minister Haider al-Abadi. A man seen as the favorite of none but acceptable to all, the 65-year-old former electrical engineer has managed to turn that tepid sentiment into a defining strength.

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Talking Points

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Over nearly three years in office, Mr. Abadi has narrowed gaps between Iraq's warring Shiite and Sunni politicians. He balanced competing interests among geopolitical rivals Iran and the U.S., and spearheaded an overhaul of Iraqi security forces, who had fled advancing Islamic State fighters. Iraq is close to retaking Mosul, Islamic State's psychologically important stronghold.

"Abadi has magnificently shifted between leading and balancing," said Jon Alterman, director of the Middle East program at the Center for Strategic and International Studies in Washington. "If he led too much then there'd be too many alienated people, and if he balanced too much there would be no forward progress."

Today, Iraq's security forces are on the verge of defeating Islamic State, the key requirement if the nation wants to enjoy a stable and cohesive future, despite daunting challenges that remain. Sectarian anger still simmers, and the country's economy and infrastructure have been devastated by years of fighting.

"Abadi is riding high," said one U.S. official in Washington. "But the government needs to show that it can act to make people's lives better, and probably the window for that is pretty limited. If it doesn't, all that goodwill Abadi built up will diminish."

There wasn't always such a sense of possibility in Iraq. Before Islamic State swept to power in 2014, the country was at its most-fractious since the fall of Saddam Hussein. Mr. Abadi's predecessor, Nouri al-Maliki, was a polarizing figure, accused of fueling sectarian conflict and packing ministries with loyalists.

Transparency International ranked the country near the bottom at 171 of 177 countries world-wide for corruption, with such pervasive problems that the country has only moved up a few positions after years of attempted overhauls. Mr. Maliki didn't respond to a request for comment, but Sunday released a public statement praising the military and militias.

When the festering Syrian civil war next door bled across the border, Iraq's military crumbled. In June of 2014, militants exploited Iraq's problems to blitz into Mosul — grabbing nearby land, stores of weapons and oil fields. In Islamic State's advance, millions of civilians came to live under the Sunni extremist group's rule.

Some Sunnis initially welcomed the militants as an alternative to the predominantly Shiite government of Mr. Maliki. The implementation of Shariah law followed, where people could be jailed for smoking or executed for unauthorized use of a cellphone.

Amid the turmoil, the conciliatory Mr. Abadi was tapped to become prime minister, an antidote to Mr. Maliki's divisive rule. He faced growing alarm among Iraq's allies.



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