Week

40

Stories To Read From FN Arena

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Contents

Asia

1 Asian Growth Forecasts Cut
2 Latest Data Suggests A Slowing Chinese Economy
3 Don't Blame The Carry Trade For Yen Weakness
4 Current Conditions Don't Favour Emerging Markets
5 Expect More Action In Currency Markets This Quarter
6 Changes In Chinese Policy Likely If US Slowdown Impacts On Exports

Australia

7 Aussie Dollar Oversold On Currency Concerns
8 History Suggests The Bond Market Is Best In October
9 Coca Cola Amatil Negotiating With Maxxium
10 Oz Economy Solid But Trending Lower
11 More Possible Bad News For AWB
12 Brambles In The Spotlight

Commodities

13 Australian Uranium Market Update
14 Stainless Steel Market At Risk Of Overheating
15 Onward Ever Upward For Uranium
16 Steel Prices Likely To Trend Down Over Next 12 Months
17 More Pain Before Gain Likely In Gold
18 Accusations Fly In The Gold Market

FYI

19 Rudi on Thursday
20 Go Europe, Says Citigroup

Asian Growth Forecasts Cut

By Greg Peel

The US housing market slump has claimed another victim, with HSBC economists slashing their US 2007 GDP growth number from 2.6% to 1.9%. Given the global dichotomy of Asia as the centre of manufacturing, and the US as the centre of spending, the economists have reassessed their growth forecasts for the Asian region.

In analysing the impact, HSBC took into account direct exposure of Asian countries to the US economy, as well as interactive effects within the region. The economists also considered each country's macroeconomic policy flexibility.

On a purchasing power parity basis, the economists have cut the region's total growth by 0.2% to now be below consensus. However, they note that GDP impacts are expected to vary greatly amongst countries. The large, closed economies of China, India and Japan will not suffer as greatly as the small, open economies of Hong Kong, Singapore and Taiwan.

HSBC further predicts that a round of rate cutting is imminent in Asia. This will benefit the yen and renminbi but adversely affect the Indonesian rupiah, Korean won and Taiwan dollar.

HSBC has outlined its views on a case by case basis.

China is still "hot". With industrial output continuing to grow at a rapid pace the pressure is on the government to tighten further, so China will likely persist with interest rate rises. However, the economists see the situation reversing later next year as the impacts of a US slowing flow through to the substantial manufacturing industry.

Government revenue has been growing at 25% pa or twice that of the GDP, so HSBC suggests government spending on rural infrastructure, health and education will soften the economic blow. Investment also remains strong. The economists are factoring in 8.5% GDP growth for 2007, down from the 10% level of the past three years.

Domestic demand in Hong Kong is firing along as cautiousness gives way to confidence, HSBC notes. While a US slowdown will impact, domestic demand should provide a buffer.

India has put in its best ever performance over the last four years, averaging 7.35% GDP growth. HSBC sees this gaining speed, and are tipping 8.5% growth for 2006-07. Industrial output has offset an agricultural sector weakened by changing weather patterns. As the government has indicated its vigilance against inflation, HSBC expects a rate rise before year end. However, that will likely be the peak.

Indonesian government spending jumped a massive 35% in the second quarter and is expected to keep growing despite tighter monetary conditions. Indonesia will be impacted by a US slowdown to some extent but also by a stronger rupiah. HSBC sees GDP growth dropping from 5.1% to 4.8%.

HSBC expects Korea to raise rates one more time before falling consumption leads to monetary easing in 2007. Growth was up 5.3% in the second quarter but the economists expect a slowdown from here.

The Malaysian government is determined its economy should grow, and is projecting 6% for 2007. It is likely to be disappointed, suggests HSBC, as Malaysia has a high proportion of exports flowing directly to the US. The economists believe Bank Negara has finished raising rates, and will be looking to ease in 2007.

The Philippines continues to grow briskly, but HSBC expects a significant softening of exports in 2007.

Singapore growth has softened from 10.8% to 8.1% from the first quarter to the second, and will continue to soften, HSBC suggests. Rate cuts are expected next year.

Taiwan is also expected to slow, but policy decisions will be more difficult given the country's tardiness in raising rates to date.

HSBC expects the Bank of Thailand to bring forward its intended rate cut to the fourth quarter this year, due to the coup. Otherwise the economy is holding up rather well in spite of some political uncertainty.

Latest Data Suggests A Slowing Chinese Economy

By Chris Shaw

For several months Chinese authorities have been introducing new measures designed to slow the pace of expansion of the economy, only for subsequent data to continually show these measures have had little effect.

But there are signs the measures, which include higher interest rates and restrictions on bank lending, are finally beginning to impact at least according to CLSA Asia Pacific Markets. The group notes its latest Purchasing Manufacturers Index (PMI) figures for September show a decline to 52.4 from 52.6 in August, an outcome that is the lowest since March this year.

The PMI attempts to provide a broad measure of the health of the manufacturing sector, so a fall in the figure indicates conditions aren't as strong as had been the case. In CLSA's view this can be attributed to both output and new orders rising at their slowest rates for six months, while export orders also rose at a slower pace than the previous month.

This decrease in the pace of growth in exports has CLSA suggesting the Chinese economy now appears more exposed to external demand than had previously been the case. As global growth looks likely to slow and the US faces a potential downturn thanks to recent declines in its housing market, the potential remains for Chinese growth to slow further in coming months.

The other point of note from the figures according to CLSA is the significant increase in input costs thanks to higher prices for steel, chemicals, textiles and oil in particular. While companies have attempted to pass this on through higher prices this appears to have been only partly successful, meaning input price inflation has accelerated since August. The seasonally adjusted Input Price Index rose to 62.3 from 60.4 in September.

In CLSA's view this implies competitiveness in the Asian region is now moving south, so the advantages China enjoyed in terms of lower wage costs and the ability to produce goods more cheaply than other countries is now being challenged.

Despite this, it notes employment overall grew at its fastest pace for almost two and a half years in September, meaning demand overall remains solid. It also reflects longer delivery times for products, indicating production performance is deteriorating as companies struggle to deal with stronger demand.

Don't Blame The Carry Trade For Yen Weakness

By Chris Shaw

While signs such as this week's Tankan survey of business conditions suggest the economic outlook in Japan continues to brighten, the yen continues to confound currency analysts by remaining weak, as in real terms the currency is trading close to its weakest level since 1985.

This is often attributed to the carry trade, but as Morgan Stanley points out such a summation is actually at odds with the evidence, leading the broker to suggest there are alternative reasons why the yen may stay weaker for longer than it had expected.

Firstly, the broker points out none of the three main forms of the carry trade, where fixed income outflows take advantage of interest rate differentials; where investors fund their Japanese bond positions with short-term credit and loans; and where non-Japanese residents borrow in Japan to invest elsewhere; have actually increased in size over the course of this year.

As a result the broker suggests there are other reasons for the currency's weakness, with any recovery in the yen requiring a reversal in such factors. The first is a sharp downturn in net equity inflows into Japan – the broker notes from the middle of 2003 to the end of 2005 inflows averaged US$7.7bn per month but this year the average has fallen to US$4.2bn per month and in July the flow was actually negative.

Secondly, the broker notes the fact cross-border investment has increased and countries now hold more of each others assets than previously was the case means it makes sense to reduce the risk from these holdings via hedging. Given the differential in interest rates between the US and Japan for example, it suggests Japanese investors rightly look to reduce their hedge ratios on US assets and for non-Japanese investors to do the same for their Japanese assets.

Finally, the broker refers to what it classes as the funnelling of money globally, which is a reflection of the US dollar's position as the global currency. As excess savings from oil exporters and Asian exporters are funnelled into US dollars because this is the currency of settlement, the impact in the broker's view is for the yen to be artificially depressed as there is a constant transfer of other currencies into the greenback (and to a lesser extent the euro and pound). As an example of this, the broker notes the UK pound has now overtaken the yen as a reserve currency in official holdings.

What this means in the broker's view is fundamentals are, for the time being at least, not the drivers of the yen's value, as if they were driving the currency the yen would be stronger than is currently the case. Evidence of this comes as the broker estimates two-thirds of Japan's growth in recent years is due to an increase in total factor productivity growth, which means both aggregate supply and demand have rising in tandem.

The effect of this is to reduce inflationary pressures, which in turn has allowed the Bank of Japan (BoJ) to act more slowly in normalising interest rates than might otherwise have been the case.

This leads the broker to suggest the fundamentals supporting a stronger yen are currently being ignored and the state of the economy is allowing this to be the case. Eventually it expects such a situation will correct itself and fundamentals will again dominate, so while in time the yen should go up it now appears likely this will take longer to occur than it had previously expected.

Current Conditions Don't Favour Emerging Markets

By Chris Shaw

The correction in global equities during the September quarter has been all but forgotten in developed markets, which have bounced back to be trading at or near their highs of May. Emerging markets have found the going much tougher though, Lehman Brothers estimating they remain about 7% below their peaks of a few months ago.

In the broker's view all signs point to a continuation of this underperformance relative to developed markets over the next 12 months, so its global strategists continues to recommend investors remain underweight emerging markets.

Lehman lists several reasons in support of this view, the first being a period of strong fund inflows into emerging markets, as has been the case recently, has historically been followed by a period of underperformance relative to more developed markets. Looking at this in more detail for the past year, the broker notes the funds flow has been consistent with forward 12-month performance in line with developed markets, which is not a strong enough return to justify going overweight emerging markets.

At the same time, corporate earnings growth in these markets is lacklustre relative to that being generated in developed markets, a trend also unlikely to reverse in the next year given the apparent loss of global economic momentum.

Despite this apparent earnings risk the broker notes valuations are not overly supportive, as even allowing for interest rate differentials the respective valuations are only consistent with emerging markets performing in-line with developed markets, which is not a good enough outcome when the additional risks of investing in such markets are factored in.

In terms of weightings in the various asset classes the broker's view of likely poor relative performance from emerging markets has not impacted on its equities position, which remains overweight compared to benchmark. The broker suggests 70% of funds be invested in equities compared to the benchmark of 60%, with the remaining 30% in bonds, a slightly underweight position compared to benchmark of 35%. Cash is also underweight, the broker recommending no cash weighting compared to the benchmark of 5%.

Looking at various equity markets, the broker's top picks are Japan and continental Europe, the former as the economic recovery should drive an extended profit cycle and yen strength will boost US dollar returns and the latter given the expectation corporate profits can continue to grow. The broker is also recommending a slight overweight position in Asia Ex-Japan, while it is underweight the US and emerging markets, including Latin America. Large capitalisation stocks are preferred, as the broker regards them as cheap relative to historical multiples.

In sector terms the broker is positive on growth stocks such as healthcare and technology, while it has moved underweight on cyclical stocks given relatively full valuations at current levels. The broker also suggests being underweight both consumer staples and utilities, as stocks in these sectors look expensive unless they can generate earnings growth above the levels currently being forecast.

Expect More Action In Currency Markets This Quarter

By Chris Shaw

The last few months have offered investors a wild ride in both equity and commodity markets but the excitement has not been matched in currency markets, where the dominant feature has been the lack of a dominant theme.

As DBS notes this moved the focus onto yield carry strategies, possibly helping explain why the Japanese yen for one was so weak during the quarter. Fortunately for currency traders DBS is expecting this quarter will produce some more interest, as it expects events to unfold that generate some changes in valuations among the major currencies.

It points to history as a guide for the US dollar by noting it has a track record of depreciating leading into the US mid-term Congressional elections, which come up before the end of the year. On average the currency depreciates by around 3% under such conditions, though the bank notes until it becomes more clear what the future direction in interest rates is in the US (and the market is now betting it is down) the currency is likely to remain in its consolidation range of 125-129 against the euro. DBS is forecasting 128 by year end and 130 by June next year.

While seeing upside for the euro against the greenback the bank has the opposite view for the currency against the yen, suggesting any move above 150 is a good selling point. It points out the euro has moved higher recently on an expanding interest rate differential, but with the Japanese looking set to officially announce the end of deflation it sets the scene for future rate hikes, meaning the yen should strengthen.

It also sees the yen moving higher against the US dollar, as in its view the Japanese economy is stronger than it appears and three successive months of increases in core consumer prices is also supportive for further rate hikes. DBS is forecasting a yen rate against the US dollar of 114 by year end and 112 by the middle of next year.

In terms of the Chinese currency the bank suspects there may have been a deal done between the Chinese and the Americans where in return for America dropping a bill proposing import tariffs there will be a move to widen the daily trading band for the yuan. This in turn is likely to precede further appreciation of the currency, the bank forecasting a full year gain of 3%, which implies a rate at the end of the year of 7.83 against the US dollar. Further strengthening can also be expected next year, as DBS expects a June 2007 rate of 7.72 yuan to the dollar.

Changes In Chinese Policy Likely If US Slowdown Impacts On Exports

By Chris Shaw

Latest data seems to have increased the level of confidence in the prospects for the US economy to achieve a soft landing rather than slide into recession, which has given renewed confidence to equity investors in the American market in particular in recent sessions.

But as HSBC notes, even a soft landing in the US means lower demand from the world's largest consumer market, so there will almost certainly be a flow through impact on the Chinese economy given its position as the world's largest manufacturer of consumer goods.

The bank is actually quite negative on the US growth outlook, having recently cut its GDP growth estimate for 2007 to 1.9% from 2.6% previously, a forecast well down from this year's likely outcome of a 3.6% increase. It has also cut its forecast for US private consumption to 2.1% next year, which compares to an average of 3.4% in 2003-2005. At the same time it sees growth in both Europe and Japan slowing, which will add to the pressure on China's export performance.

If its estimates are correct the bank forecasts China's export growth will fall below 15%, which compares with its average over the past three years of 30%. This will have an impact on its overall economic growth, as the bank points out exports account for 36% of GDP and as much as 40% of employment in the larger cities. In the absence of any policies to offset the decline in exports, the bank estimates such an outcome could lower China's GDP by as much as 3%.

This means there are policy implications for the People's Bank of China (PBOC) as it attempts to counter the decline in growth. One possibility in the bank's view is a reversal of recent tightening measures for credit introduced in an attempt to slow the rate of investment growth. While such a reversal is unlikely to boost consumption the bank expects it would support fixed asset investment growth at more than 24%, helping offset the export decline and so cushioning any slowdown in growth overall.

Such measures are most likely because in the bank's view this approach is easier than lifting domestic consumption, which is already growing by around 10% annually. Additionally, a fall in exports is more likely to put pressure on wages rather than boost them, so higher spending in preference to saving appears unlikely.

While in the last year or more there has been significant pressure on the PBOC to allow the Chinese currency to appreciate to help address not only global imbalances but the level of investment growth, the bank suggests with the export picture looking more clouded an appreciation to limit excess investment could actually prove counter-productive. A widening of the daily trading band is considered likely though, which would set the stage for currency appreciation in the future.

While expecting less balanced growth next year the bank is forecasting an outcome of more than 8.5%, down from this year's expected level of around 10%. There are implications for the rest of Asia too, as much of the region's exports to China are used as inputs for export processing and so would also be likely to fall if China experienced a decline in total exports. The bank suggests then it is less likely China can take over from the US as the engine of growth for Asia as a whole.

On the plus side, the bank expects if China is forced to maintain high levels of investment it will continue to be a buyer of raw materials and capital goods, which is a positive for Australia, India and the Latin American nations who fill this need.

Aussie Dollar Oversold On Currency Concerns

By Chris Shaw

Australia's position in global commodity markets ensures its currency is seen as a commodity based one, so recent weakness in commodity prices is given as the main reason the Australian dollar has fallen from 77.2c against the US dollar at the beginning of September to around 74.5c now.

The Reserve Bank of Australia's (RBA) Index of Commodity Prices, released earlier this week and showing a fall of 0.7% in September from record levels in August, would appear to support such a view of the Aussie dollar, but chief strategist Stephen Koukoulas of TD Securities suggests it is a case of the market overreacting.

While noting this index is the best indicator of the influence of commodity prices on the currency, Koukoulas also notes the last few years has seen a break-down in correlation as the currency has done little despite the run in commodity prices.

He points out commodity prices (before last night's fall anyway) were still only about 1% from their record highs, so the impact on the Australian economy from recent commodity price falls has actually been minimal and so should not have driven down the dollar.

At the same time other drivers of the currency such as the interest rate differential, growing momentum in domestic demand and strong export performance continue to be supportive, so the weakness is essentially the world saying it is over for commodities and thus over for the Australian dollar.

In Koukoulas's view this offers an opportunity, as he expects a further tightening in interest rates by the RBA before the end of the year and a surplus in the international trade balance for the first time in five years, both of which he expects will be enough to push the currency higher. He suggests buying the Aussie dollar now for a move back up through previous levels of around 77.2c against the greenback, with the potential for further moves to around 80c.

History Suggests The Bond Market Is Best In October

By Chris Shaw

North Korea threatening a nuclear test isn't the ideal way to start October, particularly for equity investors given the historical link between this month and significant stock market crashes.

For those with nervous dispositions Barclays Capital points out the data doesn't support the theory of equity market weakness in October though, as history shows the Dow Jones Industrial Index and the FTSE are among the major markets to have traditionally posted gains this month. While this is a positive given the current uncertainty, it isn't enough for Barclays to suggest equities are most likely to generate positive returns this October, even though it considers such an outcome to have a better than even chance.

That honour goes to fixed income, the bank noting October is traditionally a bullish month for the asset class as yields trend lower in most markets. Assessing most 10-year bonds available to global investors the bank estimates only in Switzerland is there a better than 50% chance of the yield moving higher (meaning the bond price falls), compared to a 43% chance in the US and a 38% chance in Australia.

At the other end of the scale are the commodities, which with the exception of natural gas, traditionally struggle in October. The bank gives gold only a 42% chance of pushing higher this month based on historical data, while it estimates both oil and aluminium have a less than 40% chance of posting gains. This suggests last night's sharp falls in commodity prices are unlikely to be followed by equally sharp bounces.

Conversely, October has proven to be a good month for the commodity based currencies, with the New Zealand dollar in particular being a solid performer in previous Octobers. The data also supports a move higher by the euro in particular against the US dollar, though equally it points to the currency traditionally struggling against the yen, meaning a downward move is possible against the Japanese currency over the next few weeks.

The US dollar on the other hand traditionally suffers from seasonal weakness in October, with most major currencies gaining against the greenback in previous years and seen as likely to do so again this year.

Coca Cola Amatil Negotiating With Maxxium

By Rudi Filapek-Vandyck

Expect some positive speculative news flow regarding Coca Cola Amatil (CCL) over the next few days as Macquarie analysts report this morning the company is in the process of negotiating a "distribution" agreement with Australia's fourth largest alcoholic beverages company Maxxium Australia.

Maxxium's largest brand is Jim Beam. Its market share in so-called ready-to-drink mixes (RTDs) is 22%, in unmixed spirits its 20%. Jim Beam is Australia's largest-selling spirit and RTD brand, Macquarie adds.

The Macquarie announcement seems to indicate Coca Cola Amatil management is working hard on expanding its reach into the alcoholic sector. An alliance with Maxxium would follow on from the recent creation of a local venture with SABMiller.

The company is also thought to be in the race to acquire Independent Liquor (IDL) in New Zealand.

Macquarie believes an arrangement with Maxxium could see Coca Cola Amatil take responsibility for the sales, distribution and marketing implementation for the Maxxium portfolio of brands. This could add more than $10m to CCL's earnings before interest and taxes (EBIT), the analysts estimate.

Oz Economy Solid But Trending Lower

By Chris Shaw

National Australia Bank has released its Quarterly Business Survey for the July-September period, the document containing few real surprises in terms of the state of the economy. The bank notes Australia's overall economic performance remains solid, though performance across regions and sectors continue to show significant variation.

The recent interest rate increases appear to have had the desired effect, the bank noting confidence is clearly moving lower. For the quarter its confidence index fell six points to a +2 reading, while it also points out business investment intentions have been revised down noticeable over the past three months.

Adding weight to the bank's view confidence is declining is a three point fall in forward orders, which it suggests is an indicator domestic demand will trend lower in coming months. The bank is targeting an outcome of 3% for domestic demand by the end of the year, though it expects a return to 3.5% in 2008.

This in turn implies a weaker December quarter, the bank expecting this to be most noticeable in the more cyclical sectors. On the plus side, while capacity utilisation remains strong and actually hit a record reading of 83.3% in the September quarter, there are some signs profits and employment are slowly trending lower. It is forecasting unemployment to return to around 5.25% by late next year.

This means the high utilisation levels are yet to translate into significant wage pressures, so limiting the inflationary environment. As a result the bank continues to forecast an inflation rate of 3.25% by the end of the year, before moving back into the Reserve Bank of Australia's (RBA) targe range of 2-3% by the middle of next year. At the same time it has not changed its forecast for GDP growth for Australia of 2.5% in the 2007 financial year, improving to 3.0% in the 2007 calendar year.

As has been the case in recent months, the solid growth outcome is not evenly distributed across the country, as Western Australia and Queensland continue to perform better while confidence in New South Wales and Victoria is further eroded. In the bank's view this complicates the policy outlook for the RBA, meaning it now attaches only a 25% chance to any further increase in official interest rates, as there is the risk further hikes could significantly impact on the larger states.

Taking a global view the bank's outlook is little changed, as it continues to see signs global activity has peaked, particularly given the risk the slowdown in the US will impact on the global economy by more than is currently expected. The bank continues to forecast global growth of 5% this year, slowing to 4% in 2007, while it expects the US to slow from growth of 3.5% this year to 2.5% next year. It cautions the risk to this forecast appears to be on the downside.

Given the weak outlook for US growth the bank anticipates the US Federal Reserve will be aggressive in cutting rates next year, seeing potential for 75 basis points worth of cuts over the next 12 months or so. Again here it suggests the potential for weaker than expected data means the risk is earlier and/or more aggressive cuts than it is forecasting.

Growth in Europe is expected to continue to be solid, though the bank notes the outlook is for the pace of expansion to slow next year. Interest rates are likely to be normalised, which it suggests means an official rate of 3.5% by the end of this year. Further increases appear unlikely though as inflationary pressures look set to ease, so the bank doesn't see rates reaching as high as 4%.

A similar slowing in the pace of growth is considered most likely in Japan, though given growth history of the past decade or more the bank suggests the likely outcome of 2.25% GDP growth in 2007 would represent a good performance. Interest rates in Japan are also likely to move higher as the Bank of Japan also moves to normalise official rates, but recent mixed data leads the bank to suggest the pace of further increases should be slow.

With some signs emerging of a slowing in sectors of the Chinese economy the bank continues to forecast a slowing in overall growth, its forecast being for growth to slow from this year's expectation of 10.75% to 9.25% in 2007.

More Possible Bad News For AWB

By Chris Shaw

Since the bribes scandal engulfed AWB (AWB) several months ago the risk profile of the stock has increased, as there has been no clear view as to how the whole affair would play out.

The latest developments indicate things may get even worse before they get better, as JP Morgan notes the company is potentially facing a bill from the Australian Tax Office for a re-assessment of deductions claimed under the Oil-for-Food program.

At issue are deductions covering as much as $426m in payments made by the company, which the broker estimates could translate into a liability of between $252-$322m or $0.73-$0.93 per share.

While an appeal would be expected, 50% of any liability would still need to be paid up front. As a result the broker sees potential for the quality of earnings to come down, as such a payment could impact on the company's credit rating, in turn increasing its cost of funding for the current harvest loan book. Any such increase would likely translate into lower profits in the current year.

The broker also notes there is potential for the current wheat export system to be deregulated, which would reduce the company's market share going forward. In a best case scenario the broker's valuation would be little changed at around $4.04, while a worst-case outcome, where its market share falls to around 40%, implies a valuation of about $3.00. This compares to the current share price of $3.24, down 1c from yesterday.

Given the uncertainty the broker continues to rate the stock as Neutral, with a target price of $4.00. The FN Arena database shows the rest of the market feels similarly, as the stock is rated as Hold/Neutral four times compared to one Avoid rating. The average share price target is $3.92, which compares to the median price target according to Thomson One Analytics of $3.50.

Brambles In The Spotlight

By Greg Peel

"Neither a borrower nor a lender be; For loan oft loses both itself and friend, And borrowing dulls the edge of husbandry."

So said Lord Polonius to Hamlet, but one assumes wise old Lord Polly probably held no shares in a listed Danish transport company with as good as a global monopoly in pallets.

Following the announcement last month that Brambles (BIL) would unify its Australian and UK operations and then re-list on both the ASX and LSE, analysts have been quick to point out that the company is suffering from a lack of debt. A lack of debt so serious that if the board doesn't keep one eye open it will wake up one morning taken over.

About three weeks ago, when the Coles rumour mill was in full swing, Merrill Lynch analysts suggested a private equity firm such as KKR might be ready to have a good look at Brambles. Merrills believes Brambles is undervalued if for no other reason than the accounting method used for CHEP overstates, in the analysts' opinion, depreciation, meaning earnings could be underestimated by 5-15%.

The other reason was that post unification, Brambles would be severely under-geared. At the time, the stock was trading at $12.08 and the analysts thought a bid of $15.00 would be credible. They did not, however, believe the board would roll over at that price.

Here we are three weeks later, and the rumour mill has been at it again. Brambles is $1.00 higher based largely on news coming out of the UK last week. The Independent tipped Wesfarmers (WES) as a buyer at 600p ($15.25), while Reuters had General Electric in the frame, also at 600p.

While the stock price has rallied locally, it has not been quite a Coles affair. The market is still some $2.00 below the rumoured prices. In terms of the plausibility of a bid, a couple more brokers have weighed into the argument.

Last Friday Macquarie suggested a suitor could pay $15.00 (a 17% premium) for an internal rate of return of 15%. This would put Brambles at 13.4x FY07 and that's a 50% premium to the industrials, but Macquarie suggests CHEP should be seen more as an infrastructure business given its competitive advantage and high barriers to entry.

Macquarie had earlier set a target price of $13.20, and as the stock nears that level it would be normal for the analysts to pull the Outperform rating in to Neutral, but given the possibility of a takeover bid, Macquarie has decided to retain both target and rating.

JP Morgan has carefully analysed the situation in a report released this morning. The analysts decided that Brambles could not be realistically taken over for anything less than $18.00.

That puts things into a different perspective. (And probably gives Brambles' board weight of argument to reject anything else).

Both the JP Morgan Brambles analysts and the Wesfarmers analysts agree that WES is an unlikely contender. It would not pay $18.00, they have little in common, Brambles is not a typical "unloved" company favoured as targets by Wesfarmers, and Brambles shareholders are hardly likely to accept scrip in a diversified industrial as reward.

GE, on the other hand, is a credible contender, JP Morgan believes. A decade ago GE became interested in pallets and tried to take CHEP on in its home market by creating Loscam. It failed. Pallet rental is just too

entrenched a market and the only way to win, including in the US market, would be to buy CHEP. And the only way to buy CHEP is to buy Brambles.

Morgans believes the "collapsing" of the dual-listing provides the first real opportunity for Brambles to be taken over since the GKN merger. One of the reasons is the company's extremely low debt levels. If Brambles is going to defend itself then Morgans suggests it borrows with its ears pinned back.

The analysts believe Brambles could borrow $2.5bn over the next 12 months, still pay out $2.50 in special dividends and maintain about 5 times interest cover. Without re-gearing, Morgans suggests dividend payments could rise from 25c now to 43c by FY10.

As a result of their analysis, the analysts have increased their discounted cash flow valuation from $13.38 to $15.90, raising the price target to $15.67. This puts JP Morgan way ahead of the pack (a position JP Morgan analysts often feel comfortable with), 19% ahead of the FNA database average at $13.12 and 12% ahead of nearest rival Credit Suisse at $14.00. The database currently shows a 7/2/1 ratio (B/H/S).

Australian Uranium Market Update

By Greg Peel

Resource Capital Research reports that the analysts' selection of 67 Australian uranium juniors has returned minus 1% in September, +25% in the September quarter and +47% over 12 months. Canadian juniors (93), by comparison, have returned minus 6% in September, +9% for the quarter and +85% for the year.

Unlike Australia, if you find uranium in Canada you can mine it.

Results were mixed amongst the majors over the quarter, with Cameco (CCO) down 7%, Energy resources Australia (ERA) unchanged and Paladin (PDN), which is about to commence production in Namibia, up 12%.

The uranium spot price continues its merry surge, rising 33% over the quarter from US$40/lb to US$53.25/lb.

In its June quarter review, RCR had forecast a spot price of US$54/lb by the end of 2006 and US$60/lb by May 2007. The roll-forward forecasts have now been increased to US$65/lb by May 2007 and US$88/lb by September 2008.

The long term forecast price has been raised from US$30/lb to US$35/lb to reflect higher capital and operating costs.

The biggest news on the Australian uranium front has been the agreement signed in April to clear the way for sales of Australian uranium to China. (Predictions are that if BHP Billiton (BHP) triples the scale of its Olympic Dam project, as intended, this will still only cover Chinese demand alone).

In addition to the supply agreement, the Chinese have been busy sniffing around for direct investment in Australian uranium exploration and mining, and this quarter saw China's Sinosteel take a 60% stake in South Australia's Pepinnini (PNN), and Chinese interest in the pending float of UraniumSA, which combines the resources of Stellar (SRZ) and Marathon (MTN).

Consolidation continues apace across the sector with Canada's Mega Uranium making an offer for Redport (RPT) and Paladin taking a swing at Valhalla (VUL). The latter is subject to a court battle with Summit (SMM).

Valhalla's resources lie in Queensland, which currently prohibits uranium mining but might have a change of heart, and Redport's lie in Western Australia, which will continue to ban uranium mining unless there is a change of state government.

In general news, RCR reports the UK is moving towards the construction of new nuclear power plants, SXR Uranium One's Honeymoon project in South Australia has commenced its development as Australia's fourth uranium mine, and Paladin, as noted, is presently commissioning in Namibia.

RCR also states "The Federal leader of Australia's Labor Party (ALP) announced the intention to repeal the Three Mines Policy at the ALP National Conference April 2007". FN Arena suggests this comment is slightly misleading.

The leader of federal Labor party has only suggested he is open to the repeal of his party's long standing policy. Such an action will be discussed and possibly voted on at the April conference, but there are no guarantees the repeal will go ahead.

The significance of such a repeal is not as great as offshore observers appear to have implied. The Labor Party is in opposition federally, and the governing Coalition has already lifted its uranium bans. However,

the federal government does not have jurisdiction over state governments, only over the Northern Territory, home to ERA.

All Australian states are governed by state Labor parties, but the federal party has only the power to influence state policy, and not direct it. The Queensland premier has hinted he might be prepared to lift the state ban if the federal party is so inclined, but the Western Australian premier will do no such thing.

That leaves only South Australia with an open mining policy, but this is home to about three-quarters of the countries known reserves.

Stainless Steel Market At Risk Of Overheating

By Chris Shaw

An increase in the nickel price from around US$20,000 per tonne in June to close to US$30,000 per tonne in August has ensured prices in the stainless steel market continue to push higher, though steel industry consultant MEPS suggests there is now a risk of overheating.

The risk comes from alloy surcharges, which the industry consultant notes have risen by more than 150% since January and now stand at more than US$2,500 per short tonne in the US market and at 1,900 euros in the European market.

MEPS expects the surcharges will remain at such high levels for at least another two months, as the nickel market continues to show signs of a shortage. The exact cause of the shortage remains uncertain, as MEPS notes there are arguments for both a structural shortage or as a result of speculators taking positions in the market.

Either way there has been little impact on the stainless steel market as production remains at record levels, MEPS noting for the first half of the year crude stainless output rose 6.5% year-on-year to almost 13.9m tonnes. Much of the increase occurred in the June quarter, as production in this three months was 12.6% higher than for the same quarter in 2005.

In MEPS's view September quarter figures are likely to show ongoing strength, as it expects buyers have increased orders to beat the increases in surcharges coming into effect in September and October.

But it is this rush for orders which poses some downside risk, as MEPS suggests many orders were double bookings and stand to be cancelled, meaning demand may fall short of expectations. If this occurs there could be some signs of weakness emerging in the market, which in turn is likely to encourage buyers to hold off in the expectation of achieving lower prices in coming months if surcharges fall as volumes decline.

Onward Ever Upward For Uranium

By Greg Peel

The rapid return to focus of nuclear energy as an alternative in a world stricken by higher fossil fuel prices and environmental crises has highlighted a leap in demand for uranium in the face of tight supply. US$16.50/lb now seems a relic of a distant past when the China Syndrome meant something very different to what it means now.

Deutsche Bank reports September saw the greatest ever single month increase in the reported spot price of uranium oxide (11.3%) setting the current price at US$54/lb. This level has been reached must faster than most analysts, including Deutsche, expected. Each new contract presented is being settled at slightly higher levels.

While global demand for uranium has taken a step up, production has not yet followed. Production is set to ramp up across the world, but this won't happen overnight. In the meantime, the previous vital source in the secondary market – decommissioned Soviet weapons and other Cold War supplies in Russia – is on the wane towards its 2013 exhaustion.

While attention has been drawn to the nuclear power ambitions of China and India, current customers France, Japan and the US are also looking to gear up. These three countries already represent 50% of the market. Britain, too, is now moving towards revitalising an industry that is reaching its use-by date. Scandinavian countries are well into nuclear mode.

The US has 27 new plants on the drawing board with around 12 old ones looking to extend their licenses. Current US policy is to provide loan guarantees for any alternative energy form that will "avoid, reduce or sequester greenhouse gases", so with hundreds of millions of dollars of savings in the offing, the nuclear rush is on.

Japan is in the process of reducing its coal-fired electricity generation in favour of nuclear, with a target of 40% nuclear by 2015.

As new reactors are commissioned pressure will come to bear on existing uranium supplies. The Australian Bureau of Agriculture and Resource Economics (ABARE) notes that a nuclear reactor typically requires 600 tonnes of uranium for its initial core, with supply requirements falling thereafter as the reaction is brought to a steady state.

2007 uranium demand is expected to increase by 4% to 80,500 tonnes as new reactors are commissioned in China, India and Romania. US consumption is expected to increase by 9% as generating capacity is increased.

2006 was a slow year for production, falling 1% as uranium giants Canada and Australia both suffered production drops for various reasons, including inclement weather. Shortfalls offset increased production in Kazakhstan, Namibia and the US.

2007 production is expected to increase by 15%, with Kazakhstan, Namibia, South Africa and Canada all contributing. Canada's massive Cigar Lake project will begin a three-year ramp up, and Paladin Resources' (PDN) Langer Heinrich mine in Namibia will also commence production. Nevertheless, the production forecast for 2007 is only 56,200 tonnes, versus 80,500 tonnes of demand – a big shortfall on primary sources.

Australia's production is forecast to increase by 8% in 2007, but any real increase won't be until around 2014 when BHP Billiton (BHP) is expecting to complete its upgrade of Olympic Dam and ERA (ERA) hopes to have Jabiluka under way. Other projects in South Australia should be well into production by then but it's still anyone's guess as to what might happen to uranium in Queensland and Western Australia.

Deutsche Bank has responded to the latest demand/supply data by increasing its forecast spot prices by US$66.50/lb in 2007 and US$76./lb in 2008. ABN Amro has also adjusted forecasts recently, but at US$50/lb in 2007 and US$55/lb in 2008 the analysts are either conservative or behind the times.

As a result of increased uranium price forecasts, Deutsche Bank has adjusted earnings forecasts for Australia's two listed pure-play stocks currently offering actual production – ERA and Paladin. Deutsche has increased ERA earnings by 14%, forcing the 12-month target price up from $16.41 to $16.72. Deutsche rates ERA a Buy.

Deutsche has had a more spectacular change of heart on Paladin, which it had earlier considered to be fully priced in the 2006 rush to buy all things uranium. The analysts have lifted earnings by 24%, the target from $5.27 to $6.07 and the recommendation from Hold to Buy.

Steel Prices Likely To Trend Down Over Next 12 Months

By Chris Shaw

Weaker pricing in flat products in both Canada and China since July meant the global steel price in September was slightly below the level at which steel industry consultant MEPS had forecast it would be when it made its quarterly predictions in July.

While this has led the group to revise down its September price forecast accordingly, it expects prices globally to remain relatively steady through to the end of the year, though it continues to forecast further falls over the next 12 months.

The European Union steel market has been a good performer in recent months, MEPS noting prices there met its July forecasts. It sees potential for further increases in October as the market is still strong and this is leading to some material shortfalls. Looking further out, MEPS anticipates prices peaking in October/November, with a slow decline likely to follow on the back of an expected weakening in scrap prices and lower demand.

The fall in prices in Canada over the past couple of months meant North American prices generally were about 3% below the group's forecast, reflecting cuts to scrap surcharges and weaker sentiment. As a result MEPS is now looking for a US$200 per tonne fall in prices by January, followed by a steeper decline into the middle of next year. This reflects both the likelihood of demand from both the housing and auto sectors being weaker than expected, as well as the impact of additional cheap imports from Asia.

Part of the increase in imports from Asia is likely to be the result of weaker sentiment in the Chinese flat product market, which MEPS suggests was largely responsible for prices in the region for September coming in 1.5% lower than it had forecast in July. While it sees potential for the next six months to be somewhat below its previous expectations, MEPS remains positive longer-term as it notes activity levels in Japan remain "fair" and there is solid demand in Taiwan.

More Pain Before Gain Likely In Gold

By Greg Peel

Gold just seems to be moving down on its own now. It's not interested in global arms race tension (North Korea), in inflation (the oil price bounced last night) or in Indian physical orders. Gold seems to be on a mission to return to previous lows.

Is it moving down with base metal prices? Maybe. But last week it was oil, so that just seems like an excuse.

Is it moving down on central bank selling? This is a distinct possibility.

FN Arena has been closely following the situation in Europe of late, with regards to the European Central Bank Gold Agreement (CBGA), or "Washington Agreement" as it is known. We reported last week that banks had only sold about 400-420t of the 500t allowance when the hooter went on September 29. As it turns out, the exact figure, according to gold market monitor GFMS, was 393t.

What's more, only 2.5t of physical gold was sold in the last couple of days, "confounding", as GFMS puts it, rumours of central bank selling being responsible for gold's recent significant tumble through technical support. There is a degree of smugness in a GFMS press release which arrived in FN Arena's mailbox today, as GFMS persistently debunks suggestions that central bank selling of some description is often going on under cover of darkness. Many gold market observers, on the other hand, believe otherwise.

"There has been a lot of physical metal being dumped in London recently, which is presumed to be central bank selling," James Turk, founder of GoldMoney.com, said to Resource Investor yesterday. "Its intent seems to keep the price of gold under $600."

Turk is a strong subscriber of the view that central banks manipulate the gold markets, and his thoughts are constantly aired by GFMS' nemesis, GATA.

"So if the gold didn't come from Europe, where did it come from?"

GFMS has drawn its own conclusion:

"...although GFMS believe that this rise in official sector sales could have, at the margin, had some adverse effects on the gold price, its direct impact (as opposed to the rumour of high sales on sentiment) is believed to have been far less significant than that of investor liquidations which took place over September in gold and, in fact, across the whole commodities complex."

In other words, the butler did it.

The argument that investors sold out has definite merit, as there was reportedly a lot of investor buying when gold first breached the US$600/oz support level. When a subsequent rally failed to materialise as hoped, a lot of that investment would have been quickly liquidated. As the oil price slid, inflation fears were tempered, and it made sense for the gold price to fall.

There is more to consider, however. Resource Investor has noted a response from one European central bank as to whether its gold sales had been completed for the year:

"Please note also that the annual gold sales cover spot and forward sales transacted during the Central Bank Gold Agreement year."

Resource Investor's source remarked that he was unsure whether this was meant to imply that there were

forward sales yet to be settled, and thus yet to show up on the official numbers. (Which would thus alter the GFMS numbers).

Jon Nadler, analyst at Kitco.com, said this is neither bullish or bearish anyway, as the central banks can start selling their next year's allowance the day after 2006 deadline. Which begs the question: what does it matter if central banks are selling or investors are selling?

It matters because as Nadler points out, investors now own more gold than central banks. Private investors have accumulated some 200 million ounces of gold over the past five years, and are in the position to drive the market.

Gold buyers have always been terrified of running into central bank selling, as it's always been assumed it would be like driving a minivan into an eighteen-wheeler. But the capacity of central banks to sell gold is rapidly diminishing, lest they actually run out. The desire to sell gold may yet remain, however, in order to finance current account deficits.

To that end, GFMS does not believe European banks have stopped selling gold. Rather they are just spreading out their sales. However, it is unlikely the 500t per annum limit will ever be reached again before the agreement ends in 2009, and unlikely another agreement will be signed, suggests GFMS. On the flip side, other central banks have shown interest in actually buying gold to diversify their reserves (away from the US dollar).

That is the situation in the official physical market. But selling physical gold is not the only way to sell gold. Another way is through gold derivatives. Such selling is difficult to monitor, is not accounted for by the IMF, and is not accounted for by GFMS as being included in official sales, if indeed the ultimate sellers were actually central banks.

(This is the "conspiracy theory", if you like. Central banks use global "gold banks" to sell into futures markets or over-the-counter markets on their behalf in order to keep the gold price down and currency values up. The weight of evidence of such practice is alarming.)

According to James Turk, there has been some "piling on in the ‘paper' market" of late (meaning futures and options). In the last few days of the CBGA agreement, Turk noted the big selling started when New York opened, and then the market rallied for the London fix (when physical deliveries are made). Investors sold off again when paper obligations were dumped on the market. Said Turk:

"It's enough to make one think that the tape is being painted for the November election" – a reference to the mid-term US congressional election.

Nadler believes the short term range for gold is US$550-600/oz, but if $550 breaks, we'll see $530. And if $530 breaks, we'll see $480. But Nadler is not concerned.

"It's working its way to more comfortable lower levels", he said, and physical demand is expected to pick up in the fourth quarter for the Indian wedding season.

Turk also makes the point that neither the US trade deficit nor the federal budget deficit is going to disappear in the near term, and that a lot of dollars will have to be printed in order to fund them. Just because the Fed no longer reports M3 (the total quantity of dollars in circulation) it doesn't mean inflation is going to go away.

Nadler is of the same opinion: "Where's the money going to come from?"

Believe it or not, James Turk is still calling gold at US$850/oz by the end of the year. His colleague Nadler is calling the 2006 average price at US$600-620/oz (currently US$601/oz).

GFMS has officially called gold at US$750 by the end of the year.

Another prominent gold observer, Peter Grandich, had this to say in the Grandich Letter last night:

"The good news is all systems remain go for new, all-time highs in 2007. The bad news is, there's not only been significant technical damage done short term, but the next few trading sessions are likely going to impact where we head for much of the balance of 2006. It will be unlikely for gold to break much below $570 on a closing basis without further declining to at least $540 (May lows). As hard as that will be to endure, it may be best so that a complete washout can occur. If the thought of $540 sickens you, then me stating gold could fall all the way to $500 but still be in a long-term bull market can only upset you even more.

"$540 and $500 have to be discussed for no other reason than being realistic on what has become an obvious trend now of selling rallies versus buying dips. Justifiable or not, this is likely to be trader's mentality until we at least close above $610, and even more importantly, above $640. Gold is in one of its more defensive positions since the bull market began several years ago. So, if you're gun shy, wait until if and when $610 is taken out to the upside. If you're ultra conservative, wait until either $640 is taken out to the upside or $500 is tested on the downside.

"Just try to remember that we remain in a secular bull market and that a four digit price target remains - even if we need to first go as much as $70 lower."

Accusations Fly In The Gold Market

By Greg Peel

Yesterday I reported ("More Pain Before Gain Likely In Gold") that respected gold market monitor Gold Fields Mineral Services (GFMS) had attempted to put to rest the notion that last week's dramatic gold sell-off was simply due to European central banks rushing to sell the shortfall in their quotas ahead of the September 26 deadline.

GFMS calculated that total central bank sales came out at 393t – short of the 500t quota. The conclusion drawn by GFMS was that gold's fall could only be attributed to investor selling. GFMS's press release did not sit well with many in the gold market.

There has certainly been evidence of hedge fund liquidation of gold since the metal breached support at US$600/oz and failed to hold. But the extent of gold's fall was enough for observers to suggest there was more going on than just hedge fund selling.

It surprises few in the market that there might be something suspicious happening (except, it would seem, GFMS) as there is plenty of evidence to suggest central banks, and the US Treasury in particular, have been active in covertly selling gold through leasing arrangements and derivative transactions in order to suppress the price for the purpose of supporting the US dollar and other currencies. (In fact, as much has been admitted in the last eight years).

Such transactions go unnoticed by the official gold market monitor – the IMF – and by GFMS. The US Treasury pays out its gold delivery obligations in freshly printed cash. This has the affect of misleading the market with respect to the amount of gold actually remaining in central bank vaults and as to the extent of obligations owed by central banks on the short side of the gold market.

If the market is misled into believing central banks were not selling gold then it is misled into believing the gold market is weak – investors are selling and there's insufficient buying from jewellery demand or from investors and speculators coming the other way. This paints an inaccurately bearish picture for gold in the short term.

In yesterday's article I reported that Resource Investor had been tipped off that the clue to the gold price weakness in fact lay in central bank forward sales which would not have been included in the GFMS calculation. While forward sales represent a future obligation, the flow through to the spot market is still immediate.

Last night Britain's Daily Telegraph reported an accusation from Barclays Capital that the banks had done just that – 100 tonnes had been sold forward in a rush to meet the quota and "disguise" the effect. Barclays is one of the world's top three bullion traders.

"We have been able to infer this from trading patterns. It has had a major impact on the markets," said Costanza Jacazio, Barclays' gold expert, "We suspect that the Banque de France has been involved".

"We believe this is actually very bullish for gold because it shows that the sell-off was not driven by investors," said Ms Jacazio.

While there has yet to be any official response from GFMS, both sides of the argument find themselves of a similar view anyway. GFMS has set an end-of-year target for gold of US$750/oz based on its belief that the US dollar is in for a big devaluation as the US economy slows.

This has been a call for some time now, but to date a big fall in the greenback has failed to materialise. The US dollar has held on to its safe haven status in the last month or so, while the reborn Japanese economy appears to have stalled at the starting gate, and the European economy has not fared much

better. However, following oil price falls and less hawkish talk from Fed chairman Bernanke, the mood in the US is now that the next interest rate move might in fact be down. This has been enough to send the Dow Jones sailing to new highs.

And just when it was thought Europe might at least go on hold as well, the European Central Bank spoiled the party by raising rates 25bps overnight to 3.25%. Furthermore, ECB president Jean-Claude Trichet indicated in his accompanying rhetoric that the latest increase may not yet be the end of it. The US dollar must now come under pressure against the euro.

This would thus see GFMS' scenario played out. GFMS chairman Philip Klapwijk is expecting gold to resume its five year bull market.

"Hot money has left the market and we've seen chart-based selling as the fall triggered stop-losses. But at this level we are going to see support from miners like Barrick that want to cut their hedge books," he said.

Canadian-based Barrick is the world's largest gold mining company, and it was reported by Reuters last night that the company has just announced a US$1bn copper-linked debt financing issue. This implies Barrick is not going to raise funds for the purpose of gold mining by hedging gold, but by hedging copper. This removes a big slug of potential gold forward sales from the market.

The Daily Telegraph also reported that the Russian central bank is expected to raise the proportion of gold in its reserves from 3% to 10%. This move alone would soak up much of global mine supply, and that's before the long-awaited physical buying out of India (much talked about, but yet to make its mark) has its impact.

The gold price rallied US$9.70 to US$571.20/oz overnight following a 1% rally in the price of oil. Oil rallied on the news that OPEC was indeed planning a production cut.

TheStreet.com reports Matt Turner, a commodity analyst at specialist consulting firm Virtual Metals in London, has made note of the recent effects of investment in commodities as a single sector.

"Oil currently dominates the commodity complex, and the metals seem to be moving in concert. We are seeing a new type of investor in these markets that invests in the sector as a whole, rather than in individual commodities."

Because energy makes up such a large proportion of commodity indices, changes in energy prices have a disproportionate impact across the whole sector. As to why gold (a currency) should be included in the commodities complex is by the by. There is no doubt that falling commodity prices imply lower inflation which is, in theory, bearish for gold.

However (and this is where it all gets confusing), commodity prices are falling because the US economy is slowing, which should eventually see the US dollar lower, which should thus be bullish for gold. If the US dollar falls, then commodities are cheaper for foreign buyers (as the US dollar is the dominant currency of settlement) and thus importers can afford to pay higher prices – commodity prices rise.

How this all pans out is no doubt the $64 question, but either way – and it's becoming almost tiresome to say this – it's very hard to find anybody who is not ultimately bullish gold, and bullish in a big way.

Rudi on Thursday

Investors would be forgiven for thinking it's all over with the great big commodities boom. Share prices for most resources stocks peaked in April-May this year. Since then these shares have been going through one period of volatility morphing into the next one. The end result is huge losses for those who bought too late and didn't get out.

Meanwhile all of the securities analysts have simply raised their recommendations for individual stocks. BHP Billiton (BHP) and Rio Tinto (RIO) currently enjoy ten positive recommendations which is the maximum achievable given that FN Arena only covers ten leading experts in the local market. But share prices keep on going down, with the odd rebound in between the slides.

There's something not right here.

Ever had the feeling that something's not quite what it should be, or what people tell you it is; when something, somewhere tells you there's more to the story, something you haven't been able to lay your finger on?

I had a Eureka experience when I read a recent ABN Amro report on the global mining industry today. The report was published last week already but I only picked it up this morning.

I thought it would probably be a good idea to share some of the suggestions and conclusions drawn in the report as I am sure many readers are questioning their conviction regarding the Commodities Super Cycle these days. Especially with the likes of GaveKal stating it is time to say goodbye to commodities and resources stocks.

Share prices will start rebounding soon, suggests ABN Amro. History is providing us with the evidence for this thesis. ABN Amro analysts have trailed through the past few decades and found that share prices tend to bounce back and appreciate further once base metals prices have hit their peaks.

The analysts would argue that "further substantial declines in equity prices this time would be a significant deviation from the historical behaviour of the markets".

You probably heard this theme over and over and over again over the past few weeks (and admittedly FN Arena as well as myself have delivered our contributions as well) but there are simply too many compelling value reasons why resources stocks cannot remain out of favour for too long. ABN Amro has repeated the same mantra throughout their report.

There will be additional growth, and a big chunk of it will come from the excess cash flows that have been generated during the price rallies. We all know most prices will likely come down but they are to remain at historically elevated levels. ABN Amro believes major support will come from the traditional laggards in the sector, the bulk commodities.

On Monday I wrote that iron ore is likely to surprise over the next half year or so (negotiations for new contract year 2007). ABN analysts agree. They recently increased their iron ore price forecasts to unchanged for next year, from a fall previously, but they expect prices to remain at their current levels for another two years (first price decline in 2009).

Also, don't forget the healthy balance sheets and cash flows throughout the mining sector are widely expected to drive further consolidation in the sector.

So why are share prices down? Why is BHP closer to $24 than to $30 and Rio equally at 40%+ below its average twelve month price target?

ABN analysts think the market is confused. Well, that's not exactly what they're saying, but I think that is a fair summary of their thesis. The analysts suggest the sharp share price declines, after the sector appeared to have recovered from the May slaughter-fest, have now separated the true believers in the Super Cycle from the rest.

But now the market is confused as there are, as one might expect, simply less people with a true conviction in the market than there are "others". In the absence of a genuine catalyst for the sector, investors turn to macro-economic data, says ABN, and this translates into big sell-offs one day (because some GDP data disappointed, for instance) followed by a sharp rebound the next one (because inventories have fallen to critically low levels).

What the sector needs is a major catalyst, but the analysts suggest between the lines of the report that such a catalyst may well remain absent for the next year or so and investors are therefore likely to take guidance from smaller events and indicators. The result will be ongoing volatility, because one day GDP data will disappoint (or not) and the other day... I am sure you all get the picture.

Bottom line is that the big diversified resources stocks are still trading at or near their Net Present Values (depending on whose calculations we use) and ABN analysts would not think twice and simply buy at current price levels. History shows this is usually a wise investment decision (a point brought forward by quite some other experts recently as well).

Diversifieds are favoured above single commodity plays, for obvious risk reasons. ABN Amro is not a big fan of uranium, but I would add that uranium appears to have all the ingredients in place to positively surprise over the next few years as well. (without the prospects of a protracted negotiation process with the Chinese steel mills).

For those who may have missed it, Paladin Resources (PDN) is currently rated Buy three times out of three while Energy Resources of Australia (ERA) enjoys three Buys out of four.

Till next week!

Your patient as always editor,

Rudi Filapek-Vandyck (Supported by the Fabulous Three Chris, Greg and Terry)

Go Europe, Says Citigroup

By Rudi Filapek-Vandyck

If Citigroup's quantitative model for the ranking of equity markets on a country versus country basis has any merits, investors should consider shifting some of their funds towards Europe and some Asian markets.

The broker's latest Stock Market Country Selection reveals four European countries now populate its top five selection with Australia beating Italy, Spain and Germany but losing out against Belgium.

On places six to ten we find Taiwan, the United Kingdom, the Netherlands, France and Singapore.

The US and Japan are at the very bottom of the field with only Brazil rating worse.

So what's so interesting about Belgium shares? (Does anyone know any Belgian companies?)

Citigroup quantitative analysts cite the dividend yield, overall P/E, a yield gap plus short-term price momentum as factors currently in favour of the Belgian market. Apparently there are no clear negatives.

The Australian market ranks second with the analysts citing dividend yield, stable corporate earnings, improving analyst coverage and long term price momentum as supportive factors. (Notice the "long term" price momentum as opposed to "short term").

Dividend yield seems to be a highly sought after feature with Belgium shares offering on average 3.1%, Australia offering the highest yield amongst the countries selected (3.9%) together with Italy and with Spain seen offering 3.2%. German shares offer on average 2.4% only.

The total model uses 17 factors classified into 11 groups including earnings revision ratios, interest rates trends, price to book ratios as well as changes in analyst earnings forecasts.

Citigroup reports that, relative to a global benchmark, the model has outperformed by 7.4% year-to-date.

(Sub: FN Arena readers are asked to ignore the fact our esteemed editor hails from - you guessed it - Belgium.)

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