

Week
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News

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Friday, 9 November 2007

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Currency, Competition Constrain ResMed Earnings

By Chris Shaw

Sleep disorder group ResMed ((RMD)) has posted a mixed quarterly result, the company lifting revenues for the period but continuing to struggle in the face of a competitive market and adverse foreign exchange movements.

For Deutsche Bank the result was enough to justify a downgrade in rating to Hold from Buy, the broker pointing out while revenues recovered in line with its expectations much of the improvement was the result of the weaker US dollar during the period. In constant currency terms the broker notes revenues for the quarter were actually flat.

When the currency issue is added to pricing pressure from a competitive market the broker expects margin pressure to intensify in coming months, which pushes out the timing of any recovery in earnings. This has prompted the broker to cut its earnings forecasts slightly this year and by around 10% in 2008, which supports the decision to downgrade its rating.

The broker hasn't been the only one to make such a change as Citi has downgraded the stock to Sell from Hold, also on the back of a lower growth outlook resulting from increased competition in the key US market.

Other brokers have also revised forecasts for the company following its quarterly report, Macquarie cutting its earnings estimates by 5-8% through to FY10 and GSJB Were by 2-4% for FY08 and FY09.

Both brokers have retained their Buy ratings on the stock, as has Credit Suisse given what it sees as scope for the company to return to generating growth of 15-20%, which is in line with the industry's historical growth rate.

It takes the view the recent release of new products by the company should allow for improved performance in coming months, particularly as the market's fundamentals are stabilising after a recent period of volatility characterised by price discounting and product recalls.

ABN Amro also expects improved performance in coming months, seeing a stronger second half result driven by the release of the company's new CPAP machine and because the first half result is cycling stronger comparatives from last year.

Despite this positive view the broker has cut earnings for FY08 and FY09 by 8-9% to account for the stronger Australian dollar. This brings down its price target to \$5.20 from \$6.40, the FN Arena database now showing an average price target of \$5.54 compared to \$5.83 prior to the quarterly result. According to Thomson One Analytics the median price target for the stock prior to the report was \$5.98.

The FN Arena database shows the company is now rated as Buy six times, Hold three times and with Citi as the lone Sell recommendation. So far the broker is being proven correct as in trading today ResMed shares are slightly weaker and as at 12.30pm were down 14c to \$4.46.

Where's The Value In ASX?

By Chris Shaw

Equity and derivative investors may be concerned about the market outlook given a couple of sizable sell-offs in recent sessions but it is all good for the Australian Stock Exchange ((ASX)), as increased volatility means trading volumes remain high.

The group's update for October shows a fourth successive month of strong equity volumes, with the increase more than 100% from the previous corresponding period. While this is positive, Merrill Lynch notes the smaller transaction size means equity trading values rose a more subdued 47%.

The increase has been enough to offset modestly weaker futures volumes, resulting in the broker edging up its earnings forecasts in coming years. It has not been alone as others such as UBS and Credit Suisse have followed suit, though revisions have been modest.

The end result is EPS (earnings per share) estimates are now clustered around 215c for FY08 and 240c for FY09, which compares to 187.7c in FY07. While this suggests strong earnings growth there remains a valuation issue, particularly given recent strong gains in the share price.

As Credit Suisse points out, the stock is now trading at around 27x FY08 earnings, this despite the expectation relatively conservative hurdles for equity market rebates will significantly dilute the contribution to earnings from the stronger volumes the group is enjoying.

As a result the broker sees the stock as fully valued at current levels, a view shared by Merrill Lynch on the basis there is evidence total capital raisings will moderate from this month, suggesting a flatter FY08 for the proceeds from such equity raisings.

Deutsche Bank adopts a similar view, pointing out while the year to date has been better than expected comparable growth rates become tougher through the rest of the year, making it more difficult for the company to continue delivering growth above expectations.

The lack of apparent value can be seen in comparing the current share price to the average target price in the FN Arena database, which currently stands at \$56.41, up from \$54.26 prior to the update. The shares remain at a premium, having traded at more than \$58 recently and at close to \$57.00 today, which is significantly above the median price target according to Thomson One Analytics of \$50.61.

Investors appear to agree upside is limited as despite a stronger overall market this morning shares in ASX are weaker and at 11.00am were down 37c at \$56.93.

Cash In On Nufarm, Watch Incitec

By Greg Peel

It's been a big year in the agricultural sector, driven by soaring global grain prices and the inherent volatility that only the weather can bring. There has been a mad rush to plant crops for ethanol production, particularly in the US, while the changing appetite of emerging economies has provided an added impetus to grain demand, both for direct consumption and for the feeding of livestock.

Star performer has been fertiliser company Incitec Pivot ((IPL)) which has proven that even the most unpleasant of concepts can be a big money spinner. Incitec's share price has close to quadrupled for the year. While less spectacular, another beneficiary has been crop chemical company Nufarm ((NUF)) which surprised no one yesterday when it announced a much anticipated takeover offer. So where to from here?

In the case of Nufarm, a consortium of China National Chemical, Blackstone and Fox Paine Management has made a conditional offer for the company at \$17.25 with a 30c dividend thrown in for existing shareholders. This is roughly a 35% premium from starting price and just goes to show that private equity is alive and well as long as China's involved. In other markets proposed deals are been withdrawn with increasing speed.

The deal represents an FY08 price/earnings of about 22.3x which means analysts consider it to be a good one for Nufarm shareholders. Of the five FN Arena brokers airing their views this morning, four suggested shareholders take the money and run. Only Credit Suisse saw scope for another bidder to emerge, while the others all thought this unlikely given the already substantial premium. Nufarm's board has suggested shareholders accept the offer, but only in lieu of another bid emerging.

Macquarie analysts have been caught out by the bid, having up to now largely scoffed at the constant rumours that preceded the trading halt. But yet they are still offering a warning, suggesting that recent history shows those who hold out for more, or speculators who jump in on the basis of a battle, have been burnt. Rinker ((RIN)) and Orica ((ORI)) are two examples.

Ratings and targets now become largely meaningless, although it is notable both Macquarie and UBS are sticking to Sell to emphasise their advice. The average target also moves up to match the bid. The market in general looks like it's settled on Nufarm being sold to the consortium, with the stock at \$17.36 in late morning trade. That splits the \$17.25-\$17.55 spread on the share bid plus dividend, given new buyers won't qualify for the dividend.

While the same sort of takeover speculation hasn't really greeted the runaway Incitec, there's no doubt a little bit of premium in there. But according to the analysts at Credit Suisse the question is not one of takeovers but of fertiliser prices. The prices of both diammonium phosphate (DAP) and urea are continuing to firm in global markets.

The price of urea is currently averaging US\$310-345/t while DAP is fetching \$459-480/t. CS reveals industry insiders are looking at a DAP price of US\$500/t by year end. Every US\$10/t in DAP price means A\$12m in earnings to Incitec, while every US\$10/t in urea adds A\$4m, says CS. On the flipside, every US\$1c in the Aussie knocks off A\$6m.

Credit Suisse analysts are at the top of consensus forecasts by about 20%, but still they believe there is more upside to their forecasts given they are not even assuming spot prices for fertiliser. This would add A\$25m or just under 10% to their profit forecast. They suggest that like other commodities, such as metals and oil, fertiliser has made a secular shift upwards in value and prices are likely to stay robust for at least the next five years. This is where everyone got metals wrong, constantly assuming a reversion to mean prices.

CS is currently restricted on its rating given another part of the bank is dealing with Incitec on something or other. But it would likely be Outperform on the strength of its view - a view that has changed in recent

times given CS's rating was Neutral for a while there. An Outperform would give Incitec a B/H/S rating of 3/4/1 with the Holds a bit concerned about the strong share price and Deutsche Bank (Sell) suggesting the stock is 47% over fair value. That's Deutsche's fair value however, and at \$60 Deutsche's target is both way behind the curve and a good deal below Citi's high mark of \$103.30.

The average target is \$84.14, and the stock is trading around \$88.25 at present. Will fertiliser confound everyone just like copper did?

Austin Engineering Riding The Commodities Cycle

By Chris Shaw

Record or near record oil and gold prices suggest the commodities cycle is still far from running out of steam, which means the old adage of looking at stocks that supply shovels to miners remains an attractive way of playing the resources sector.

Intersuisse has used such an approach in recommending Austin Engineering ((ANG)) as an Accumulate at current levels given the group's strong project pipeline and opportunities to grow the business.

The company designs, manufactures and services equipment for the mining, oil and gas and industrial sectors including items such as excavator buckets, dump truck bodies, mineral processing equipment and parts for aluminium smelters.

It has a national presence in the Australian market with its largest exposures in Queensland and Western Australia, meaning it is well situated to capitalise on the strong mining sectors in both states. There is also a joint venture based in Oman offering some international exposure, the broker suggesting this also offers some growth potential given scope to expand into markets such as Qatar and the United Arab Emirates. Acquisitions are also expected, with management indicating an interest in expanding into raw material sourcing.

Adding to the attraction of the stock in the broker's view is its competitive advantages over rivals, including scale efficiencies, strong relationships with the company's blue-chip client base, continued product innovation and the automation of its processes, which was internally developed.

About 30-40% of group revenues are from product replacement and maintenance work, with the broker expecting this to increase to around 50% in coming years. One advantage this offers is such work is booked well in advance, making it easier for management to predict future earnings.

The broker sees solid growth in coming years, with FY07's return on capital of 20% a good guide as to the sort of returns expected in coming years. It forecasts EPS (earnings per share) will come in at 16.1c in FY08 and 18.5c in FY09, compared to 11.7c in FY07. This puts the stock on a P/E (price to earnings ratio) of 14.9x in FY08 and 13x in FY09 at a price of \$2.40.

Yield is not so attractive as the company paid out just 4c per share in FY07 though the broker anticipates this increasing to 6c in FY08 and 8c in FY09, which equates to a FY09 yield of a little over 3%.

Short-term the stronger Australian dollar should actually prove to be a benefit as it reduces the cost of raw materials the company imports, though longer-term the broker notes it would be a problem if the overseas operations grow their contribution to overall earnings as expected.

With a market capitalisation of just over \$111m at current prices the stock receives little coverage, the FN Arena database showing none of the major brokers or equity researchers cover the company.

Shares in Austin Engineering today are slightly weaker along with the broader market and as at 11.20am were down 6c at \$2.39.

Emeco Cuts Guidance, Brokers Cut Forecasts

By Chris Shaw

Strong commodity prices suggests companies supplying services to the sector should be doing well, but downgrades to earnings guidance by Downer EDI ((DOW)) at its recent AGM and by Emeco Holdings ((EHL)) at its AGM yesterday shows exposure to a strongly growing sector is no guarantee of earnings growth.

The issue for Emeco according to UBS is there is no evidence the company's model of renting heavy equipment to mining operations actually works, especially in overseas markets.

This is reflected in the company's reasons behind the revised guidance of a flat first-half earnings outlook, as management indicated the international operations and particularly those in the US and Canada are falling short of expectations.

The disappointment is this comes after the company spent more than \$300 million on acquisitions and fleet upgrades in FY07, suggesting either the money was not well spent or the model itself is questionable.

On the plus side the broker notes the domestic rental operations, which accounted for around 80% of EBIT (earnings before interest and tax) in 2007, are performing as expected, though growth in earnings is being hampered by infrastructure constraints.

The result is cuts to earnings forecasts across the market, with UBS lowering its estimates by 7% in FY08 and by similar amounts in future years, putting its EPS (earnings per share) forecasts at 13c this year and 14c in FY09.

JP Morgan has reacted in similar fashion and cut its FY08 estimate by 6% to 12.9c and in FY09 by a more substantial 12.5% to 15.1c, while Credit Suisse's forecasts now stand at 12.7c and 13.7c respectively. Prior to the AGM consensus forecasts were 14c and 15c.

Even allowing for the revised earnings JP Morgan notes the stock offers excellent value, the problem is there is little to suggest this value will be realised anytime soon given the earnings growth issues.

As a result it has retained its Neutral rating, while UBS has downgraded the stock to Neutral from Buy. Credit Suisse has gone the other way and upgraded its recommendation to Outperform from Neutral, but the change is more a reflection of its (stringent) ratings model than a more positive view as it is based on recent relative share price weakness relative to the broader market. Citi has retained its Buy rating given it sees the stock as cheap on fundamentals.

Overall the FN Arena database shows Emeco as rated Buy three times, Accumulate once and Hold twice, with an average price target of \$1.55, down from \$1.72 prior to the AGM.

Shares in Emeco today are weaker in line with the broader market and as at 1.25pm were down 5.5c or 4.5% to \$1.18, which compares to a 12-month trading range of \$1.17-\$2.06.

Optus Struggles But SingTel Meets Expectations

By Chris Shaw

Largely forgotten in recent months compared to Telstra's ((TLS)) ongoing battles with the government over broadband and Austar's ((AUN)) improved performance has been Singapore Telecom ((SGT)), which owns the Optus brand in Australia.

With Telstra beginning to deliver improved performance in recent months it is becoming clear some of the improvement has been at Optus's expense, as yesterday's quarterly report showed the division made in Macquarie's view a disappointing contribution to SingTel's earnings for the three months to the end of September.

The broker points out mobile margins in Australia were weak as the company attempted to build its customer base, which over the full year is likely to make achieving the target of flat EBITDA (earnings before interest, taxes, depreciation and amortisation) for the year difficult to achieve.

GSJB Were also noted the company has lost at least 50,000 fixed line customers in the Australian market during the quarter, which is good for Telstra but makes the Optus earnings targets something of a stretch.

Luckily SingTel is not reliant solely on Optus for its earnings, as stronger results from its Singapore operations and subsidiaries in India and Indonesia meant profit overall was in line with forecasts in the market.

Merrill Lynch estimates the quarterly earnings equated to like-for-like earnings per share growth of 22%, which puts the company on course to generate a total return of around 19% for the full year.

Management re-iterated full year guidance with the quarterly result, the target being single-digit revenue growth and 2.5-3% growth in Australian revenues. As GSJB Were notes, the company's Australian returns are being impacted at present by investment for top-line growth, the benefits of which won't become apparent until FY09.

Overall the group's result was enough for forecasts to be increased marginally, Merrill Lynch lifting its forecasts by around 1% and GSJB Were by 1.0-2.5% through to FY09. Macquarie was more aggressive in FY08 and has lifted its current year estimates by 2.5%, while its price target now stands at S\$4.30.

UBS has increased its price target to S\$4.75 from S\$4.25, while Merrill Lynch has not adjusted its target of S\$4.61. Overall the FN Arena database shows the stock is rated as Buy six times and Hold twice, the positive view not surprising if Merrill Lynch's estimate of almost 20% in total returns proves accurate.

Shares in SingTel today are slightly weaker and at 3.05pm were down 7c at \$2.88.

Brokers See Limited Potential For Aussie Share Market

By Rudi Filapek-Vandyck

Two brokers updated their thoughts on the direction and valuation of the Australian share market today and there are some good and some not so good elements in both updates.

JP Morgan has zoomed in on what appears a widely carried trend of earnings cuts across the market. At the same time the share market has done its best to move higher - as we pointed out earlier this week, once the S&P/ASX200 index moves past the 6700 level the going gets tougher and we've now seen five attempts and an equal amount of failures since mid last month.

Could this possibly have to do with the fact that as earnings estimates move lower and share prices higher that the overall price earnings ratio (PER) increases much faster than usual? JP Morgan for its part notes that the combination of the two has moved the market to a forward PER of 16.3 - the highest level in five years.

Well, that probably explains it then.

Uhm, not necessarily. JP Morgan also notes that some earnings forecasts, like for retailers and certain banks, have actually increased over the past few weeks, so it is not just one way traffic. Even more so, while colleagues at other brokerages may have been busy cutting their estimates for the coming year, at JPM things remained relatively quiet.

The broker notes FY08 consensus earnings growth as amalgamated by IBES has fallen from 12% as at the end of September to 8.3% at the end of October. This is quite significant, in particular since it didn't seem to affect the market as a whole during that period. But at JP Morgan earnings estimates have only dropped by some 0.5% to 12.4%. Equity strategists Martin Duncan and Charles Jones fail to explain this large difference, other than making a remark that the other experts may well be too bearish at this stage, but they're happy to keep their index target for mid-2008 at 7010.

By then the assumed PER for the broader market would be around 15.8. However, the broker clearly assumes that's all there is for investors in the Australian share market as the index target for December 2008 stands at 7000. For December this year, which is only a few weeks away now, the target stands at 6850.

All in all, if these forecasts prove accurate investors might find it hard to generate a return of 10% on their investment portfolios over the next twelve months. If, however, developments will prove to be closer to Macquarie's outlook then investors will be happy with anything above the zero line.

Macquarie happens to be one of those colleagues who has been wielding an axe lately, cutting off 2% of its earnings growth forecasts with the average number for the broker now at 8%, below market consensus as cited by JP Morgan.

It will therefore not surprise anyone that Macquarie's forecasts for the index is lower too. The broker's model projects total shareholder returns for the S&P/ASX 200 of minus 2.1% for the year head. This return combines an estimated capital return of minus 5.8% with a forecast dividend yield of 3.8%. Resources are forecast to deliver a total return of 0.6% and industrials a negative return of 3.0%.

In Macquarie's view, the Small Ords would perform a little better: total shareholder returns should be a positive 3.9%, comprising a capital return of minus 0.1% and a dividend yield of 4.0%.

Macquarie notes that industrials and property trusts are the most expensive on the basis of current forward looking PERs. But what may surprise some investors is that on current forecasts the banks seem poised to generate the highest earnings growth in the Australian share market.

It is on the basis of this superior earnings growth profile that Macquarie suggests the banks are relatively cheap compared with the rest of the market, even though they are equally expensive on an historical comparison.

All in all, the broker believes the potential for the Australian share market to generate high returns for investors and shareholders in the coming six months is “clearly limited”.

(See also Rudi on Thursday from this week and Weekly Analysis from Tuesday).

Can David Jones Maintain Q1 Sales Growth?

By Chris Shaw

Retailer David Jones ((DJS)) has delivered a solid set of first quarter sales numbers in reporting growth of 9.7% and like-for-like sales growth of 6.7%, but broker opinion remains divided as to whether or not such results can be maintained and if there is value in the stock at current levels.

In the yes camp are Merrill Lynch, UBS and Deutsche Bank, all of which rate the stock as a Buy. For Merrills the quarterly result sets the company up to beat FY08 profit guidance, as like-for-like sales in particular should continue to be stronger than the level on which the earnings guidance has been based.

The broker expects continued good performance leading into Christmas, a view Deutsche Bank shares given the strong current momentum implied by the first quarter result.

UBS points out the like-for-like sales result was better than it had expected and this means the company is likely to lift full year guidance when it reports its half-year result next February.

In addition it notes the stock has underperformed the broader market over the past few months, creating an opportunity for investors to get set now before the expected increase to earnings guidance.

Earnings per share forecasts for the three brokers suggest an EPS (earnings per share) outcome of around 27c this year and between 29-32c in FY09, which puts the stock on a FY09 P/E (price to earnings ratio) of less than 16x for next year. The yield also looks attractive at a little over 5% in FY08 based on Deutsche Bank's estimates.

Citi doesn't agree with such an optimistic assessment of the company's outlook though, suggesting instead like-for-like sales are likely to trend lower in coming periods as the company will be recycling tougher comparable numbers. ABN Amro made the same point in its assessment of the sales result but has retained its neutral rating.

Citi suggests the stock is fully priced at current levels, as investors are already paying up for growth options likely to be considered over the next three years. In its view the stock is a Sell.

Macquarie agrees the shares are fully priced at present but considers the outlook for the company remains positive, so rather than sell the shares it advises investors to Hold the stock at current levels.

The FN Arena database shows of the nine brokers to cover the company four rate it as Hold, two as Sell and three as Buy, but current momentum is on the Buy side given UBS and Deutsche upgraded their recommendations following the sales figures.

Early trading this morning confirms this as the stock as at 11.20am was 13c or 2.7% higher at \$4.93. This compares to an average price target according to the FN Arena database of \$5.05 and a median price target according to Thomson One Analytics of \$4.33.

U3O8 Spot Price Continues To Rise

By Rudi Filapek-Vandyck

Confidence is rising among sellers of uranium oxide (U3O8) that prices will move up and will continue doing so in the times ahead. This is not our personal assessment but the view from industry consultant TradeTech as expressed in its latest weekly update on the uranium sector.

TradeTech has picked up from the market place that speculators are moving back in and sellers have become reluctant to commit to any offers received as they have the impression that waiting a little while can do wonders for the price achieved for their product.

TradeTech puts it as follows: "The majority of sellers expect spot uranium prices to strengthen over the next few months, and as a result, are very hesitant to commit to sales at this time."

It is because of this reason that TradeTech has decided to add another US\$3 to its weekly spot price indicator to take it to US\$93 per pound on Friday. Last week the consultant raised its price indicator to US\$90 from US\$84 the prior week.

Ux Consulting, the other sector consultant who sets a weekly spot price indicator, raised by US\$5 to US\$85/lb last week.

This week TradeTech's judgement, on the basis of information received from buyers and sellers in the market place, is that it will require a price above last week's benchmark of US\$90 to successfully conclude a transaction.

No transactions were recorded in the long term market and this explains why the long term price indicator has remained unchanged at US\$95/lb.

(See also yesterday's story "Uranium Heating Up Again, Says Wizard", in FN Arena Technicals).

Spot Uranium On The Move As Sellers Turned Smarter

By Rudi Filapek-Vandyck

The weekly spot price for uranium oxide, or U3O8 for the aficionados, has now risen US\$19 in four weeks. Considering this has taken the spot price from US\$75 per pound to US\$93 per pound -a gain of 24%- there can be little dispute the label "impressive" applies once again.

That is if one uses TradeTech's assessments as a guidance. The other industry consultant that sets its own weekly spot price indicator, Ux Consulting, only increased its benchmark price to US\$90 per pound this time, up US\$5 from the previous week. Ever since spot uranium has bounced from its lows at US\$75 per pound last month UxC's price setting has been lagging TradeTech's, but one should probably not draw too many conclusions from this. Earlier this year the roles were simply reversed.

But even on UxC's numbers the rapid price recovery -20% in four weeks only- still easily deserves the tag "impressive".

And one only has to look at today's share prices of uranium stocks in the Australian share market to conclude that investor interest in the sector has truly returned. Shares of Paladin Resources ((PDN)) moved beyond \$9 again today while Energy Resources of Australia ((ERA)) did even better: up more than 5% to \$24.79 at around one hour before the closing bell on Wednesday.

Both consultants have left their long term price indicators unchanged at US\$95 per pound since early calendar 2007.

And similar to this time around last year, Cameco's Cigar Lake project features once again prominently in the global rumour mill that links miners and utilities with investors and speculators. UxC reports this week some of these speculators suspect that even Cameco's latest assessment that first production from Cigar Lake may not happen until 2011 may still prove to be too optimistic. Apparently, some experts believe it is safer to assume a date sometime in 2012-2014.

UxC does mention that even though its weekly spot price indicator rose by US\$5 for the second week in a row, the industry is awash with reports about "much higher offer prices". This obviously feeds expectations of further price rises in the near future.

The consultant points out a few offers are currently under evaluation by some sellers and it can therefore be expected that the spot U3O8 will be up another notch or two (three?) once the results will be made public.

But probably the most interesting observation in this week's report on the industry is the fact that UxC believes sellers of uranium have changed their attitude in order to avoid the price excesses that captivated the industry until June this year.

Instead of offering as much as possible and aiming to achieve a price above the spot price for it, sellers of uranium are offering smaller lots these days to prevent things getting out of hand once again, while still benefiting from tight market circumstances.

The general idea seems to be that by cutting the lots of uranium into smaller pieces one can still benefit from rising prices without trying to achieve it all in one go.

It is easy to see why some market experts believe uranium prices are once again on an upward path.

Looking At Gold From Different Angles

By Greg Peel

"Mervyn King's effective guarantee of the liabilities of the British banking system is much more significant than declining South African gold production." John Hathaway, Tocqueville Gold Fund (New York)

This particular comment goes a long way to explaining why gold is currently trading at nearly US\$825/oz - a 28-year high. Mervyn King is the governor of the Bank Of England, and the comment refers back to the Northern Rock crisis when, under instruction from the Chancellor of the Exchequer, and against his previous judgement, King guaranteed all bank deposits in all banks in the United Kingdom. It was the height of the credit crunch.

There are a number of influences affecting the price of gold. Firstly, it has to be remembered that 70-80% of gold production ends up as jewellery, particularly around the necks, arms and fingers of Indian brides, Chinese entrepreneurs, Middle Eastern oil sheiks and the odd Fifth Avenue socialite. While gold is desirable simply for its beauty and status it is, in this sense, a commodity. The amount of gold used for actual industrial purposes is negligible.

The rest ends up as coins and bars, and in this sense (apart from the collector value of coins) gold is a currency. Of course, if you were short of currency you could always melt down (or hock) your jewellery. Gold is the only "true" currency as a store of wealth, because fiat currencies such as the US dollar are simply government IOUs. Silver, and to some extent the platinum group metals, are also "precious" enough to have currency value. By the time you get to copper there's just too much of it about.

One reason the gold price is much higher now than it was at the turn of the century is because global production is on the decline, and jewellery demand, particularly out of Asia, has increased. Another reason is that global inflation fears have been spurred by the rise in the price of oil and other commodities. While fiat currencies are devalued by inflation, gold is not. Another reason is that it is a lot easier to invest in gold these days through various listed funds, rather than having to buy actual metal.

The last time gold was at the level it is now was in the late 1970s - the last time the oil price ran amok. Back then, inflation was well into the double digits. But this time global inflation, while creeping up, is much, much lower. Here we are worrying about 3% when 20% inflation was the story of the '70s. Inflation is much lower through a combination of technology advances, which make everything from phones to televisions continuously cheaper, to the China phenomenon, which has meant significantly lower production costs.

So if inflation is comparatively negligible, why are we about to see a new high in gold?

The simple answer is that the real value of the US dollar has fallen a long way, and gold is denominated in US dollars. The dollar has declined all 2007, and initially it was all to do with the burgeoning US current account deficit and America's thirst for spending and lack of savings. Basically that IOU had a lot of someone else's debt behind it. But oil, grains, metals and bulk commodities are all denominated in US dollars, meaning that perceived inflation is really a closed-loop equation. Dollar goes down, oil goes up, that's inflationary, thus dollar goes down, oil goes up...

The problem is the "other" inflation. Nobel prize winner Milton Friedman once famously said "Inflation is always and everywhere a monetary phenomenon". While economists today all drink a toast to old Milt, his theories have long ago been relegated to historical curiosity. What Friedman was on about is that the only thing affecting inflation is the supply of fiat currency - the money supply - which is the preserve of central banks and their printing presses.

Even celebrated author and writer of the Hitchhiker's Guide series, Douglas Adams, paid homage to Friedman. In Book III of the five-book trilogy, a space ship lands on an unknown planet and a colony begins.

Given lack of any specific fiat currency, the ship's captain declares the colony's currency to be the leaf - any old leaf. The monetary system works fine briefly, until the price of one packet of ship's peanuts soon becomes "the equivalent of three deciduous forests".

In other words, the more abundant the currency, the lower its value. The US Federal Reserve's printing presses have rarely had a moment's respite as enough dollars have been produced to offset US debt. But when the credit crunch hit, the Fed turned off the safety valves and the printers have been smoking ever since. The only way to unfreeze credit and save the global financial system has been to print US dollars - pump liquidity into the system and lower the cash target rate by 0.75% (with probably more to come). That is the current monetary policy, and the more abundant US dollars have become the more their value has diminished. This is the "other" inflation - this is what old Milton was on about.

Returning to our opening statement, the governor of the Bank of England has guaranteed all bank deposits. The only way to do that in this environment is to print pounds. On that basis gold is not just responding to the US dollar, it is responding to the collective diminishment in value of all fiat currencies. The US is not alone.

And it doesn't matter that if the US has a massive current account deficit it is offset by massive surpluses elsewhere in the world. Last month equity analysts at Credit Suisse noted "there is a danger of devaluation [of the dollar] because of the behaviour of the emerging market central banks".

"China is a good case in point. To keep the yuan pegged at an undervalued level relative to the US dollar, Chinese authorities need to expand their money supply aggressively. This is the same as adding US dollar liquidity to the global financial system, effectively devaluing the US dollar relative to real assets such as gold and base metals."

Credit Suisse notes that world economic growth is surely driving commodity prices, but just as important are liquidity and relative scarcity. [The unbelievable price rise in our ship's peanuts lent much to the demand for peanuts, but much more to the excessive abundance of leaves]. Continued US dollar monetary supply expansion [more leaves], says Credit Suisse, will continue to devalue the US dollar [leaf] against gold, base metals, the euro and the Aussie dollar [peanuts].

The scary part is that this whole situation is a bubble that must surely burst, just as our colony must eventually reach a point where its forests are totally denuded. The burst will likely come from China, whose runaway economy simply can't just keep running away. But that is a story for another day.

Let's go back to the introductory comment as made by John Hathaway, portfolio manager of the US\$1 billion Tocqueville Gold Fund in New York. John Dizard of the London Financial Times spoke to Hathaway this week.

The Tocqueville fund achieved a 38.2% return in the twelve months to September. But in that time, net purchases of fund shares totalled US\$330m while withdrawals totalled US\$280m. That's only a net inflow of \$50m. Said Hathaway: "If the public had really bought into this bull market story, then we would be looking at something better than annual net inflows of 5-6 per cent".

What's more, Hathaway points out that one month volatility for gold is currently about 20%, while back in 1980, when prices were last at these levels, it was 50-60%. As far as he is concerned, this is signal that the bull market hasn't actually started yet.

"The relatively subdued interest of the investing public, if not the investment newsletters and columnists, is actually good news for those long the metal. It means there are a lot of people left to buy the stuff, which is not the case at bull market peaks."

Dizard notes that in recent years gold has not risen nearly as much as, for example, nickel copper or lead. While the immediate demand coming out of emerging markets has been for consumables, so too have portfolio managers repositioned themselves as investors of commodities in order to keep the funds flowing in. Dizard suggests it's time they reposition once more. It would be misleading to simply look at jewellery demand and mine supply, he believes. It's all about currency.

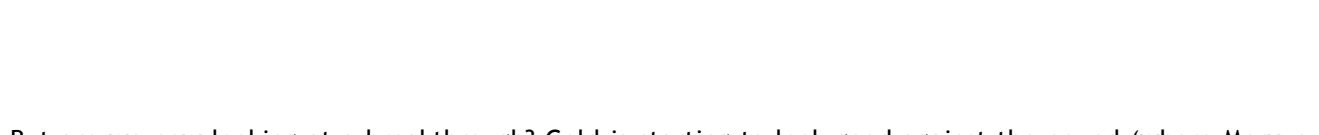
But whether or not gold is on the move to ever greater heights, every investor still needs fiat money to buy

bread and milk. If gold is rallying on a collapsing US dollar, but so too is the euro, the pound, the loony (Canada) and the Aussie, what good is gold investment unless you're trying to buy bread and milk in Manhattan?

The answer is that with its most recent rush from US\$700/oz through US\$800/oz, gold is not just a US dollar story but a fiat currency story in general. This is what a chart of the US dollar looks like:



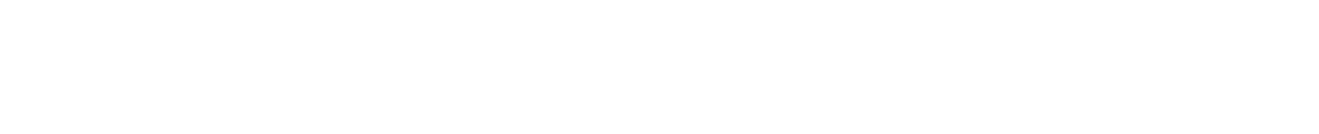
But this is what a chart of gold in euros looks like. Until this last spike, the rise in US dollar gold has not been able to add value to gold in euros, due to the falling US dollar:



But are we now looking at a breakthrough? Gold is starting to look good against the pound (where Mervyn King has guaranteed bank deposits):



It has always looked good against the yen, because the carry trade has kept downward pressure on the yen against the US dollar (ie the dollar has not fallen as much against the yen):



The flipside of the carry trade has been a serially strong Aussie, much stronger than the simple fall in the US dollar suggests. Hence Aussie dollar gold has struggled to reach new heights:



And the story in equally commodity-rich Canada has been even worse:

(Source of non-US dollar charts: jsmuneset.com)

So the question now is: will gold break up against every fiat currency, thus establishing itself as the "true" global currency? The flight to quality appears to have begun in earnest.

Why The Fed Will Continue Cutting Rates (Says John Mauldin)

By Chris Shaw

Last week forecasters of US employment figures were surprised when it was revealed the US economy added around 166,000 new jobs, which was about twice the expected outcome.

This gave pause for thought the US economy may actually be stronger than was thought and so could see the US Federal Reserve finish with rate cuts, but this is unlikely to be the case according to John Mauldin, president of Millennium Wave Advisors and publisher of the InvestorsInsight e-newsletter.

Mauldin argues the Fed will cut and then cut again, as the better than expected jobs outcome was a misleading indicator in terms of the actual state of the US economy. While commentary from the last Fed meeting when it cut rates 0.25% made it appear concerns over inflation and the state of credit markets were easing, Mauldin suggests the key sentence was the one indicating the economy is slowing down.

When this is added to the fact the government's estimate of job creation is in Mauldin's view inaccurate because it overstates the numbers when the economy is slowing down (and understates them when it is accelerating) and because it shows a markedly different outcome to the households survey, which for October showed a contraction in the labour force of more than 210,000, it becomes more clear the Fed monetary policy setters have not finished easing rates this cycle.

This is because employment is a lagging indicator, so it doesn't start to turn down until after the economy has already begun to contract. This means future employment data are likely to show rising unemployment, says Mauldin, which implies a slowdown in consumer spending, which in turn implies a slowing in the overall economy and so forces the Fed into further action. He is targeting a Fed funds rate of less than 4.0% within the next two meetings.

The other reason supporting further cuts to rates going forward is the credit crunch is far from over, as Mauldin expects more write-downs and more downgrades of mortgage-backed paper.

This, in his view, implies round two of the credit crisis is approaching, with the full exposure of financial company holdings to sub-prime paper unlikely to be known before the middle of next year.

This means uncertainty, says Mauldin, and markets hate uncertainty.

Just an illusion

“Fiat currencies don’t float. They just sink at different rates.” - Unknown.

Money illusion affects people, and markets, in different ways. The primary form of money illusion, of course, is that we always believe we have more money than we actually do - too much month left, in other words, at the end of our money.

Other current examples of money illusion include thinking that a 2 bedroom flat in Chesterford Gardens, Hampstead is worth £1,400,000 in September when it isn’t selling in November for £1,200,000 (according to PropertySnake). Or that the fair market value for responsibility for an \$8 billion writedown and the biggest quarterly loss in your brokerage’s 93-year history is an early bath bonus of +\$161.5 million. (To be fair to Stan O’Neal, when he promised in December that Merrill Lynch’s \$1.3 billion acquisition of subprime mortgage lender First Franklin would provide “revenue velocity”, he didn’t explicitly state whether those increasingly rapid revenues would be positive or negative, though now we know.)

But perhaps the most dramatic form of money illusion is the belief that a 2.6 inch x 6.1 inch 1 gram rectangle of linen and cotton that costs 4.2 cents to manufacture and that represents „money” without any material backing (other than linen and cotton) is worth anything at all.

Financial markets have started to get wise to this ‘money’ fabrication business. One might almost say that this process of enforced wisdom-getting has accelerated. The ‘velocity’ ((c) Stan O’Neal) of ‘money’ may be increasing, but its direction would appear to be: downhill. Say you want to invest your ‘money’ in a barrel of WTI crude oil. In 2002, you would have needed to part with 20 of your 1 gram rectangles of 25% linen, 75% cotton. Now, to buy the same barrel of oil, you need to part with over 90 of those same rectangles. Of course, given that the composition of this barrel is unchanged, the apparent deterioration in value of those rectangles probably makes you happier to part with them to exchange them for something at least more tangible and economically useful.

“Parting is such sweet sorrow,” as that great behavioural economist Shakespeare once wrote. Amazingly, we can also use these rectangles to purchase finite assets with a several thousand year history of acting as a store of value though admittedly, now that everyone has woken up to this rectangle depreciation story, it costs more of them to do so. Seven years ago, you could have bought an ounce of pure gold with just 257 green rectangles. Now it takes almost 800 of them to secure access to that same ounce. It’s as if the market had belatedly discovered that green rectangles and money were not necessarily the same thing.

The prices of other assets as expressed in green rectangles have also been on the rise. As Manuel Hinds and Benn Steil reminded readers in last week’s Financial Times (“History’s warning about the price of money”),

“People react to the “growing insolvency” of a reserve currency, such as the dollar, by acquiring “gold, land, houses, corporate shares, paintings and other works of art having an intrinsic value because of their scarcity”.. Indeed, this is the story of our present decade, one in which alternatives to the dollar as a store of value have soared even while the CPI has remained subdued.”

It is the reference to the Consumer Price Index that throws you off your stride. Notwithstanding the hedonic adjustments and other statistical legerdemain that have created inflation ex-inflation, official inflation rates, that handily excise troublesome price rises in obviously trivial sectors like food and energy, have been the dogs that haven’t barked. Yet. As Hinds and Steil point out, there are historical precedents:

“This phenomenon is well-known in developing countries, where asset booms combined with low CPI inflation have preceded monetary and financial crises. In Mexico, for example, share prices rose 12-fold between January 1989 and November 1994, while inflation fell from 35% to 7%. Inflation then soared as the Tequila crisis exploded.

“Prices of shares and real estate more than doubled from 1993 to 1996 in Indonesia and South Korea while

CPI inflation rates were declining. In May 1997, just weeks before the currencies collapsed, inflation was only 4.5% in Indonesia and 3.8% in South Korea." Comparisons between Indonesia and South Korea on the one hand, and North America on the other, are obviously unfair. Investors are queuing up to invest into Asia.

Notwithstanding the recent flood of foreign investment, we are a long way from the end game there. Less so for the US, whose currency is being dumped by legions of investors in favour of euros, shares, oil and gold. Not to worry, though: US Treasury Secretary Henry Paulson reminded investors last week that the United States is committed to a strong dollar policy. He just didn't say whose dollar.

To this extent, the extraordinary bull run by equities in the teeth of a US property market slowdown, in the midst of a significant dollar depreciation, and in the face of a raging gale in credit markets is explicable, inasmuch as it reflects the last gasp of investors determined to spend their rectangles on something, indeed anything, as opposed to other rectangles.

History may not repeat itself, but previous events set an ominous precedent. As Hinds and Steil also point out, between August 2001 and August 2007, the dollar price of gold rose by 144%, versus a rise in CPI of just 17%. In two periods, from 1971 to 1975 and from 1977 to 1980, "the increase in the price of gold and other commodities presaged substantial increases in CPI inflation as well as significant falls in the international value of the dollar." While the dollar then survived as the least-worst standard of value, it did so in part because of Paul Volcker's discipline (as opposed to Greenspan's and Bernanke's indiscipline) at fighting inflation, and in part because no other currencies were up to the task. We now have a world of euros (and, ultimately, yuan) and a liquid supply of gold - what Hinds and Steil call "a viable private alternative that has permanent intrinsic value".

The Weimar era hyperinflation is not the only example in Europe of currency value dwindling away into absurdity, nor is it the most recent. In Yugoslavia by the early 1990s, the government had exhausted its hard currency reserves and started pillaging the hard currency savings of its citizens. Restrictions were imposed on private hard currency savings in government banks. There was a run on all goods, notably gasoline. All government gasoline stations were eventually closed and gasoline became available only from roadside entrepreneurs operating a) a parked car and b) a plastic canister of gasoline.

According to Thayer Watkins of the Department of Economics, San Jose State University, this gave rise to at least one tragic episode. After repeated attempts to withdraw his Deutsche Mark deposits from a government bank, one man announced that he was going to kill himself in front of a government building by dousing himself with gasoline and setting fire to himself. On the appointed day he turned up with a canister of gasoline. The media were in attendance. As were the police, who promptly arrested him.

Soon afterwards, the television station received a number of calls asking what had happened to the canister of gasoline.

In another alleged incident as the supply of goods continued to diminish, someone passed by a queue of pensioners waiting in line for mundane supplies. This person was carrying bags of groceries from the free market. Two pensioners got so upset at seeing someone else with household goods that they had heart attacks and died on the spot. By the end of December 1993, the exchange rate was 1DM=3 trillion dinars. By January 4 of 1994 it was 1DM=6 trillion new dinars. The government then announced a new new dinar equivalent to 1 billion of the old dinar. By mid-January the rate was 1DM=700,000 new new dinars and soon 10 million new new dinars. On January 24 the government introduced the super dinar, equivalent to 10 million new new dinars.

All of which is not to suggest that the US dollar is going to go the way of the old dinar, only that in matters of fiat currency even more than in commodities, price changes can go further and faster than ever seems remotely possible in reality. Until such time as the Bush administration genuinely engages with an ever-weakening dollar ("our currency, but your problem", in the words of the Nixon administration), investors will find some solace in inflation-protected debt and precious metals.

Tim Price Director of Investment PFP Wealth Management LLP 5th November 2007.

Email: tim.price@pfpg.co.uk Weblog: <http://thepriceofeverything.typepad.com>

FNArena wishes to thank Tim Price and PFP Wealth Management for the privilege of republishing this story.

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Beware Of Global Currency Intervention

By Greg Peel

In the last thirty years, all but one of the significant trend changes in the direction of the US dollar have been caused not by natural economic forces but by multilateral currency intervention, Morgan Stanley economists Stephen Jens and Charles St Arnaud point out. The way things are shaping up, another such intervention is not beyond the realms.

The two believe the dollar is likely to weaken further from here, despite it already being at historical lows on an index basis since the index's inception in 1973. If that is the case, then intervention can't be ruled out. The decline may continue "unless it's stopped". Weakness in the dollar is a result of a slowing US economy which has lead to lower interest rates and a desire from investors to diversify into developing countries.

America lose its hegemony? We simply can't have that.

There has not been a currency intervention during the current president's reign and given US Treasury secretary Hank Paulson is ex-Goldmans, it's no surprise he advocates a currency set by market forces. However, he has also echoed the words of predecessors in saying a strong dollar is in America's interest.

From the point of view of the other major players - Europe and Japan - the same is true. The euro has appreciated 13% against the dollar in the past year and threatens to undermine the European union's export industry which has just started to hit its straps again. In Japan's case, while it has never been happy being a source of cheap funds to the world via the carry trade, a swift and painful unwinding of those positions could see the yen skyrocket as it has in the past. That is not desirable either. Policy makers can intervene in currency markets by arranging purchases and sales of foreign exchange.

At present, the US has been in a monetary policy tightening phase while Europe has been raising and Japan treading water. If these trends stop, and the dollar keeps falling, then it may be time to intervene, Jens and St Arnaud warn. This is unlikely to happen while the euro remains under US\$1.50 (it has hit US\$1.45) and the dollar stays above 100 yen.

The European Central Bank bought euros back in 2000 as the euro slipped below US\$0.90 only a year after its launch. Japan bought yen in 1998 when it had fallen to 146.78 to the dollar, but sold yen in 2004.

Gold traders be warned.

Rudi On Thursday

What do you think would be the biggest threat to this year's end of year rally?

More bad news from Citigroup?

Crude oil above US\$110?

Higher inflation in the US?

The Aussie dollar at parity with the greenback?

Or maybe a fierce come back from the US dollar?

While each of these events would have a clear negative impact on the Australian share market, the biggest threat, as is so often the case, may well come from inside the financial markets instead of outside.

Emerging share markets, base metals, energy and precious metals have all generated such good returns for many professional investors that some have already started taking away some of their investments from these markets. As the Australian share market has been among the good performers so far this year, one can only assume some money is equally being withdrawn from the likes of BHP Billiton ((BHP)) and Woodside Petroleum ((WPL)).

This is not something I just made up. Earlier today, after reading yet another reference to some institutions shifting their funds, it dawned on me that I have come across several references to the above scenario in various publications, market commentaries and research reports this week.

And the reason why I mention it here is because it makes sense. (Some might argue that because it makes sense it is by definition happening).

If you're in the business of keeping your clients happy, and you're bound to do so by showing a nice performance figure at key dates, such as the end of the calendar year, you're probably looking right now at de-risking your performance for the remainder of the year.

After all, we're only a few weeks off from Christmas. Probably equally important is that many assets are widely believed to be expensive and while that doesn't necessarily mean these assets will lose value tomorrow, it does suggest that further upside may become more difficult to achieve.

In practical terms such a dilemma would translate into something like: am I prepared to lose a big chunk of the gains I made so far this year for a potential two or three percent more on my performance sheet?

The answer given is probably dependent on what your performance sheet looks like thus far. If you went big in Japan, or in Sweden or Switzerland, or in US financials you probably need to be in the market until the very last day. In all other scenarios you're probably thinking what I am thinking and that is: better to look forward to a relaxing and tranquil Christmas break instead of risking too much.

A very important factor in these considerations is the assessment of the risk balance. This year this will be even stronger so as there is still no certainty about whether the US will avoid a recession (remember US housing is expected to reach bottom from Q1 next year onwards) or when this subprime/CDO/credit problem will be dealt with (another eight months?).

Above all, there is a general sense that more and more investors are chasing fewer and fewer assets, and this, everyone knows, is by default a dangerous situation. Not so much at times of a clear upward momentum, but when the turn comes. Don't fool yourself, there's always a turn at the horizon.

Remember how I wrote over the past weeks that some of the best informed and most experienced market participants had decided to sell their exposure to the surging gold price - even though they were convinced it would go up further still?

None of them feel sorry today for the gains that have not been made.

As market strategists at GaveKal put it this week: the key question investors are now facing is whether to stick with the assets that enjoy strong momentum, or to start looking for cheaper assets with less (but still good) momentum?

GaveKal believes it may be time to consider the second option. In the strategists' view this now means equity markets such as those in India, China and Brazil have become less attractive, and so are gold, oil, resources and materials, as well as equity markets in Canada and Australia.

Instead, GaveKal believes soft commodities and technology (IT and hardware in particular) look far better alternatives. In terms of regional assets the strategists would opt for small caps in Hong Kong, and shares in general in South Korea, Singapore and Taiwan.

Expect a volatile run towards the end of the year.

Till next week!

Your editor,

Rudi Filapek-Vandyck (As always firmly supported by Greg, Chris, Grahame, George, Pat, Joyce, Sophia and Paula)

Lack Of Value? Or Too Many Investors Chasing The Same Ideas?

This story was first published two days ago in the form of an email sent to registered FN Arena readers.

By Rudi Filapek-Vandyck, Editor FN Arena

One does not need advanced software packages or many years of first hand experience around the traps to see that the Australian share market is struggling to push the S&P/ASX200 index beyond 6700.

Simply draw a chart of Australia's major shares index over the past few weeks and you instantly see the market has tried four times to push the index beyond 6700 and every time the attempt failed and shares rapidly retreated. Depending on how the market will fare over the next few sessions, we may now be experiencing a fifth attempt since mid-October.

To some market observers there is no secret why the market is finding it difficult to move higher from here: it's a valuation issue. The idea that the Australian share market is currently at fair value, if not slightly overvalued, was confirmed by a survey by two journalists of the Australian Financial Review on Monday.

Eleven out of eighteen stockbrokers and other financial institutions that provided their projections for the S&P/ASX200 index forecast the index would be at its current level, or lower, in three months from now. Six from these experts believe the index won't be higher in six months either.

The two most positive projections came from AMP and Commonwealth Bank signaling the index could be at 7000 by January and by 7200-7250 at the end of April next year. This implies further maximum upside potential of circa 5 to 8% on a three to six months horizon, dividend payouts not included.

Other indicators seem to point to a similar conclusion. Since early September the balance between recommendation upgrades and downgrades for individual stocks has swung in favour of more downgrades and the pattern has remained in place for ten weeks now. The past seven days alone saw 43 downgrades versus 20 upgrades.

Most of these downgrades are being issued because share prices are believed to have run too far ahead of their underlying valuation. Think Harvey Norman ((HVN)), or JB Hi-Fi ((JBH)), or the Australian Stock Exchange ((ASX)). Even BHP Billiton ((BHP)) and Rio Tinto ((RIO)) received some downgrades recently due to short term valuation issues.

My personal favourite indicator is the gap between price targets for the major banks and their share prices. History shows that whenever share prices for the major banks exceed brokers' price targets they are poised for a pull back - this often means the rest of the market is due for a retreat as well.

Four weeks ago I reported share prices for the likes of Commonwealth Bank ((CBA)), Westpac ((WBC)) and St George ((SGB)) were trading above average twelve month price targets while National ((NAB)) and ANZ ((ANZ)) were each staring at a small gap only. Less than a week later the market retreated.

I also wrote that the most logical way to create further upside was for the banks to positively surprise with their FY07 results. ANZ failed in its attempt, but Westpac and St George did exactly that while management at CommBank reiterated its operational targets. As a result securities analysts raised their forecasts, and price targets, for most of the banks. (National Australia Bank reports this Friday).

However, as the higher price targets were met by rising share prices, the major banks landed exactly in the same position again by mid last week. All it took was for further subprime/CDO wobbles to resurface in the US and share prices in Australia, including the banks, pulled swiftly back from new record highs.

So where are we now? With the exception of ANZ (recent disappointment) all major banks are again trading near their average price targets. This again would suggest the Australian share market is poised for another confrontation with its valuation limits, and soon.

The difference with four weeks ago, however, is there's no short term prospects left for further increases to price targets. With the exception of National Australia Bank (FY07 report on Friday) all major banks have now reported, either through FY07 results or at the annual shareholders meeting in the case of CommBank - so whereto from here?

Some market experts have argued the next upside should come from increasing price/earnings (P/E) multiples. The argument is that as confidence in China's economic resilience grows so will the market's confidence in the sustainability of demand for energy and resources. As the rest of the world views Australia as a lower-risk leverage opportunity into this Asian growth story, the market as a whole is likely to be re-valued, hence the higher PE ratios, which translates into higher share prices and an index that can confidently move beyond 7000 and higher.

But maybe the Australian share market doesn't need such an "act of investor mania".

It's not just the banks who saw their price targets move higher over the past four weeks. The same applies to many other companies, such as Telstra ((TLS)) for instance. A detailed analysis of current valuations and share price targets for all 231 individual stocks in the FN Arena database that are at least covered by five out of ten experts we monitor has revealed that current average price targets for exactly 50% of these stocks suggest further upside potential of at least 8% (dividends not included).

This group (representing about half of the S&P/ASX200 index) comprises of many financial stocks - from HFA Holdings ((HFA)) to Mortgage Choice ((MOC)) to Austbrokers ((AUB)) - and many financial service providers - from Computershare ((CPU)) to Henderson Group ((HGI)) to Tower Australia ((TAL)).

In addition, this group also contains many exporters whose earnings have been hit by the strong Australian dollar, such as Billabong ((BBG)) and ResMed ((RMD)), but also remarkably many energy and base metals companies such as ROC Oil ((ROC)), Zinifex ((ZFX)) and even Rio Tinto and BHP Billiton.

So maybe the real question is not whether Australian shares are nearing full valuations, but whether investors aren't chasing the same group of stocks - and thus a narrower scope for returns while ignoring opportunities elsewhere?

Also, the fact that BHP and Rio Tinto are still in the cheaper half of the market (determined by the difference between share prices and average price targets) suggests we're far off from a resources mania still.



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