Week

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Stories To Read From FNArena

Friday, 27 January 2017

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Contents

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1 **Australia**

Better Outlook For Woolworths Supermarkets

Industry feedback suggests Woolworths supermarkets had a better time than Coles over Christmas. Woolworths has also announced it will divest its petrol stations business to BP.

-More focus on sales versus margin at Woolworths, with turnaround in train -Question of how Coles responds to Woolworths' improvements -Woolworths petrol divestment to BP could help Metcash

By Eva Brocklehurst

Woolworths ((WOW)) increased both the frequency and depth of discounting in the Christmas quarter and the company appears far more focused on sales as opposed to margins, Morgan Stanley observes. Higher promotional activity and the successful launch of the loyalty program should boost second-quarter supermarket like-for-like sales growth.

The broker now forecasts Woolworths' supermarkets delivering like-for-like sales growth of 1.5% versus 1.0% for Coles ((WES)) food and liquor in the second quarter of 2017. This signals the first time since 2009 Woolworths has outstripped Coles. Morgan Stanley retains a Underweight rating, suspecting FY17 margins will be disappointing.

From its surveys of supermarkets, UBS believes the turnaround has begun for Woolworths and the projected pace of relative improvement versus Coles may prove too conservative. The question is whether, and how, Coles responds. Woolworths has lifted its overall score on the broker's survey and closes the gap to Coles, with a strong performance across the board. Importantly, Woolworths improved in key customer-facing areas such as price, on-shelf availability and in-store compliance.

Staff morale also lifted, which signals to UBS a better performing business with a clearer direction. To some extent these trends were expected, given the magnitude of the company's investment in this area over the past 18 months, but the pace of the turnaround has come quicker than that implied by UBS estimates.

The broker notes Coles still leads the market in its ranges, formats and marketing but that lead is shrinking. UBS expects sales at Coles to revert to mean unless it incorporates a strategy to again leap ahead of both Woolworths and Aldi.

UBS highlights the performance of Coles, with relative declines across all nine of the survey themes, does not signal the company is doing anything wrong, rather it means no change in the company's strategy to combat a better-capitalised and more customer-focused Woolworths, as well as the step-up in intensity by Aldi in fresh food. Should current trends continue, UBS believes Coles may need to react in the form of margin investment or capital expenditure, particularly given both Aldi and Woolworths are accelerating refurbishments.

Suppliers were clear in signalling to UBS that Woolworths traded better over Christmas and while the broker envisages only modest downside risk for Coles' like-for-like sales in the second quarter, the pace of improvement at Woolworths signals both sales and margins could recover more quickly than previously realised. Nevertheless, UBS has not made revisions to its estimates as yet. The test will be for Woolies to maintain the momentum in 2017 as price investment eases.

The fresh food sector was the only negative for Woolworths in the survey, a surprise to UBS. This is an area the broker hopes will improve, particularly given the investment Aldi is making in fresh food. The broker believes a price war is looking less likely as Woolworths has undertaken major investment and has signalled it would be more rational beyond the first half.

Moreover, input pressures are rising via raw material costs, logistics and labour and suppliers are also now forecasting flat shelf price inflation over the next 12 months compared with the 0.2% deflation noted in the June survey.

Macquarie revises its expectations for comparable store sales growth in the second quarter, reflecting its own feedback from a broad range of channel checks. While Woolworths has improved its execution on a very poor performance from the prior Christmas, Coles is likely to find further improvements a tough hurdle, given its outstanding execution in the prior year.

While the second-quarter performance is likely to favour Woolworths, Macquarie does not believe this is an indication of the medium-term trend. The broker forecasts comparable store sales growth of 2% for both companies in FYI 18 and FY19.

Increased competition and the use of loyalty programs, with improved availability of stock, are expected to dampen margins over the first half. The broker expects first half earnings margins at Woolworths food and liquor will decline around 50 basis points to 5.0%. Margins at Coles are expected to decline 16 basis points to 5.1%. Macquarie maintains an Outperform rating for Wesfarmers, given the upgrades to its resources business in its first half guidance, with a Neutral rating for Woolworths.

Woolworths Petrol Divestments To BP

On December 28 Woolworths announced it would divest the 527 fuel convenience sites it owns and the 16 development sites to BP for $1.79bn. The transaction is subject to regulatory approvals and is not expected to be completed earlier than January 2018. The deal will still provide Woolworths with a fuel offer and the potential to expand its convenience offer through BP.

Woolworths will use the proceeds to reduce its bank debt and, using FY16 continued operations data, Citi calculates the deal will be 1% diluted to earnings per share. Woolworths has announced that as part of the transaction, it will pilot a “Metro at BP stores” format and, assuming the pilot is successful, roll out up to 200 stores under the format.

As Woolworths does not currently participate in wholesaling, Morgan Stanley suspects BP will require an alternative supply of food products. In this case, as Metcash ((MTS)) supplies a significant proportion of the food for BP sites the company is well placed to expand its business.

Morgan Stanley believes the divestment of the fuel business is rational and will alleviate balance-sheet stress. It should dilute earnings per share by 4-5% on a full year basis, on the broker's estimate that the business is sold for 10 times earnings (EBIT) and based on Woolworths part funding petrol discounts.

The broker is unconvinced about the proposal for up to 200 stores in the metro format, given the lack of historical evidence on execution. Petrol stations either tend to generate profit by petrol being sold at barely above cost to drive traffic amid profitable food sales or they sell petrol at a reasonable margin with negligible food sales. They don't do both, Morgan Stanley attests. The broker awaits clearance from the ACCC and FIRB on the divestments before including the proposed transaction in its forecast.

Morgan Stanley suspects Metcash will be the main winner from this petrol deal as it supplies the existing 1400 BP petrol stations and Woolworths does not wholesale. The broker estimates revenue uplift for Metcash could be around $400m which, at a conservative 3% margin, equates to $12m of EBIT, or a 3.8% uplift with very little incremental capital deployed.

There is one Buy rating on FNArena's database (Deutsche Bank), with two Hold and four Sell for Woolworths. The consensus target is $22.31, suggesting -8.5% downside to the last share price. Targets range from $19.10 (UBS) to $27.00 (Deutsche Bank).

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Brambles: Brokers In The Dark

Brokers can only speculate on the real issues facing Brambles, but believe they may not be structural, suggesting value following the share price tumble.

-US inventory reductions, delayed new business affecting sales, margins and profits -Sell off now suggesting substantial upside in the stock from current levels -Questions arise regarding the quality of recent growth in the Americas

By Eva Brocklehurst

As US retailers sharply reduced their inventories late in 2016, Brambles ((BXB)) needed to make a sizeable downward revision to its first half guidance. The lack of clarity on ramifications of the downgrade, in what the market considers is a very stable business, has irked brokers. Also, new customers have taken longer to come on board, while there has been pricing pressure in the recycled pallets business.

Expectations for sales and underlying profit in the first half have been cut and Brambles is now expecting constant currency revenue growth of 5% and operational earnings (EBIT) growth of 3%. As such, the company does not expect to reach prior full year guidance of 7-9% and 9-11% respectively.

The largest impact is in the Pallets Americas segment, where margins are likely to have been reduced. Pallet returns following unexpected de-stocking have meant higher up-front transport and plant costs, without an ability to recognise revenue on returned pallets.

Deutsche Bank downgrades its FY17 estimates for earnings per share by around 8.8%, in line with the trading update. The company's long-term target of reaching a 20% return on invested capital by 2019 requires a much stronger contribution in FY17 compared with what now looks like being achieved.

Management has indicated the issues with inventory de-stocking peaked in December but the broker is concerned the second half is likely to experience a continuation of the trends. Also the company is now indicating that new sales in North America, expected to drive stronger growth in the second half, have now been deferred from the original time frame.

Goldman Sachs points out the lack of detail regarding the revisions means the stock will be subdued until the results briefing and revises its North American growth and cost estimates, reducing its target to $12.41. Goldman, not one of the eight stockbrokers monitored daily on the FNArena database, retains a Buy rating, as the stock now offers around 20% upside from current levels.

The fall in the price suggests the market has taken a more risk averse approach to valuation but the broker believes the additional discounting has been overdone. Ultimately, the impact of the issues could be short lived and a rebound is likely in coming months, although a lack of clarity makes any conclusion difficult.

Downgraded Guidance At Odds With Data

Morgan Stanley finds the downgraded guidance at odds with the positive data on US retail sales. This suggests there are other less defined factors which contributed to the warning and, in turn, raises further valuation and earnings risks. Although the stock is at its lowest price/earnings ratio in the last seven years, the broker maintains an Equal-weight recommendation.

The update raises more questions than answers for the broker as, assuming other regions grew in line with their first quarter run rates, it implies the Americas revenue declined by up to 3% in the second quarter alone. This potentially represents the first negative growth in the broker's data set since 2011.

Management's commentary on subdued demand and inventory de-stocking is also inconsistent with the data, in Morgan Stanley's view, which shows a benign environment for both. The broker notes US retail sales remain above average and continue to trend positively, particularly in key product segments such as food, alcoholic beverages and health-care products.

The broker suspects other factors such as contract re-pricing and market share may have contributed to the weak revenue growth in the first half. Hence, it raises questions around the quality of growth in the Americas recently and the fact this has absorbed a significant portion of the company's growth capital expenditure.

Value Emerging?

Morgan Stanley envisages potential for further downside to the FY17 earnings outlook, maintenance capital expenditure and the FY19 returns target. Nevertheless, and despite the near-term risks, the broker believes value is emerging, particularly if the downgrade is from explainable factors. Until the first half result the broker expects little visibility around new business, pricing and recycling conditions.

Of importance, Macquarie notes that Brambles believes the drop in business wins is not a reflection of failed tenders but rather delayed agreements because of extended decision-making processes.

The broker also believes the impact of de-stocking is short term in nature, particularly in the light of the supportive macro indicators and expectations for a boost in consumer confidence post the US election. Macquarie believes the share price reaction was excessive, given the strength of the company's growth outlook and the stock is a good buying opportunity.

The issue bugging UBS is how long the impact of de-stocking continues, noting the company is waiting to see January numbers before assessing the full year impact. In the meantime, UBS takes the view that it is a one-off step change lower in earnings and extrapolates the impact into the second half ,such that estimates for operating earnings growth are around 2% for the full year, compared with a previous forecast of 8%.

Despite the lingering uncertainty, the broker considers the business model intact, with its high barriers to entry still deserving a premium to the market. UBS upgrades its rating to Buy from Neutral. The broker considers this industrial growth stock has lower than average risk and its reliance on consumer staples and developed markets - with 45% from North America - provides a stable source of growth.

Potential For Further Negative News

Citi, too, is concerned about the lack of clarity, particular when there is another 28 days before there is more detail emanating from the first half results and the indications for the second half are outlined. Nevertheless, the broker does not envisage the issues as being structural and they should correct. As a result, Citi expects the share price reaction will prove to be an over-reaction.

CLSA is less sure and suspects something has gone wrong in the US business quite quickly. The broker acknowledges it was already sceptical regarding management's ability to achieve prior earnings guidance, but believes the increasing deviation between earnings and cash flow over the last two years is something a new CEO/CFO team needs to address after the February results.

The broker, not one of the eight monitored daily on the database, upgrades to Underperform from Sell. Investors are advised to take a medium-term view and be comfortable with the risk for further negative news.

FNArena's database has a consensus target of $12.05, suggesting 14.8% upside to the last share price. This compares with a target of $12.94 ahead of the update. There are four Buy and three Hold ratings.

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Brokers Applaud BlueScope

BlueScope Steel has upgraded earnings estimates for the first half and brokers welcome the work done to improve the outlook and balance sheet.

-Higher steel and iron ore prices, productivity improvements fuel guidance upgrade -Management actions seen delivering on the upside, with capital management options looming -Demand and supply in China's steel market could re-assert pressure in the second half

By Eva Brocklehurst

BlueScope Steel ((BSL)) has materially upgraded earnings estimates, with the biggest surprise for brokers emanating from building products, dominated by a stronger performance in the company's US operations, given higher steel prices and margins. India was also stronger.

The main drivers of the upgrade, with first half earnings guidance now $600m versus the “at least” $510m proffered at the AGM in November, are higher steel prices and spreads, particularly in Australasia. Stronger iron ore prices are also supporting the iron sands business along with productivity improvements and cost reductions. Management will recognise an impairment charge of around $65m, largely from the restructuring of the China buildings and Indian engineered businesses.

Progress In Debt Reduction

Macquarie retains its Outperform recommendation, noting a broad-based improvement which suggests the company's cost reductions are being realised and progressing ahead of plan. While the stock has had a good run, momentum is still considered positive in the near term. Market conditions are supportive, while management actions appear to be delivering to the upside, in the broker's view.

The stock continues to trade at a meaningful discount to global peers yet the investment case is not without risk, Macquarie acknowledges. The main issues are the demand and supply dynamics in China, which could reassert pressure on the steel market in the second half. Also, a maturing residential building cycle in Australia could present challenges. The broker notes the strong progress made in re-positioning the balance sheet, with net debt of $530m as of December 30 a little better than expected.

Nevertheless, stronger earnings have not generated a correspondingly strong cash flow, in Credit Suisse's view, confirming a suspected increase in working capital to fund higher iron ore, coking coal, scrap, coating metals and steel prices. Credit Suisse acknowledges that further debt reduction offers an opportunity for a more generous dividend while, in light of Chinese cuts to steel capacity and a stronger domestic outlook, surplus Asian steel seeking an export market is declining.

Credit Suisse downgrades to Neutral from Outperform on valuation grounds, also flagging the risk that a foreign owner could acquire Arrium's steel making and distribution assets and use this as a conduit to the domestic market.

More Value To Come

While acknowledging it is difficult to value the stock against recent history, because of the structural change in the cost profile of the steel assets in Australasia, UBS believes there remains inherent value within the franchise. The broker calculates that value exists even if steel maker spreads moderate from current peaks. Moreover, UBS expects US steel maker margins are likely to remain elevated for a longer period because of effective protectionist measures against imports, which may be underscored by the incoming US administration.

This means the broker's average US steel spread assumptions in FY17-19 rise to US$320/t from US$260/t, and this is the key driver of upgrades to its EBIT forecasts. Morgan Stanley also envisages building products have the largest area of upside in terms of the company's divisions, particularly in North America because of higher steel prices and margins.

Capital Management?

City is bullish, believing the company is firmly on track to exceed the key $1bn earnings (EBIT) mark in FY17. The broker considers the stock a story of quality and low financial leverage. Several options exist for BlueScope, including opportunistic acquisitions, capital returns or an increase to the pay-out ratio. The broker lauds the work that has been done to re-shape the steel industry in Australasia and a raft of benefits from extremely challenging, but necessary, decisions which are now aligning to reward shareholders.

Ord Minnett raises its rating to Accumulate from Hold, noting most divisions are performing to expectations and capital management is likely to be a positive catalyst as debt rapidly reduces. The broker believes valuation screens as attractive on both a fundamental and relative basis.

Trade indicators have been positive, with Chinese net exports falling and BlueScope benefitting from increased trade action and price improvements. While Australian steel remains exposed to a peaking residential cycle improved diversity in earnings should reduce volatility, in the broker's opinion.

Deutsche Bank is more conservative, continuing to believe earnings, particularly in the New Zealand business, will face headwinds in FY18 should iron ore prices decline as expected. The broker upgrades FY17 net profit forecast by 25% and retains a Hold rating because of downside risk in FY18 and valuation.

FNArena's database shows five Buy ratings and two Hold. The consensus target is $11.97, suggesting 9.7% upside to the last share price. This compares with $10.37 ahead of the update.

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Australian Banks: Valuations Stretched

Bank analysts all agree there is limited upside for Australian bank share prices since their recent re-rating.

- Subdued earnings outlook remains - Picture at least brighter than 2016 - Capital raising risk has eased - Consensus suggests limited upside

By Greg Peel

Remember the GFC? It was over eight years ago. In the wake of public bail-outs of "too big to fail" banks across the globe (but not in Australia, beyond a temporary deposit guarantee), the international bank regulator based in Basel decided banks deemed "too big to fail" must carry more capital as an offset to systemic risk.

How much capital? The Basel Committee sat down and started to figure that out. After eight years, and no doubt a sigh of relief there hasn't been another GFC in the meantime, the Basel IV regulation updates were expected to be made known by around about now. But the news from Switzerland is committee members are struggling to find common ground. Hence Basel IV has been delayed. The committee has only had eight years to think about it.

We nearly did have another GFC, around this time last year. While US banks acted swiftly, post bail-outs, to rebuild their balance sheets, European banks did not. By this time last year, shares in European banks were sliding dangerously. And not just the shares of small Italian banks – when Deutsche Bank was hit with a massive US fine (also GFC-related, seven years on), there was a very real risk the one-time German leviathan would become insolvent. Switzerland's iconic banks were also looking shaky.

Australian banks entered 2016 with a dire backdrop for the global banking sector. Adding insult to injury at a local level were tumbling commodity prices, a slowing Chinese economy, and an ambiguous suggestion from the local regulator, APRA, that the balance sheets of Australian banks will be required to be "unquestionably strong". This suggested Australia's big banks would need to carry even more capital than Basel IV levels, and thus threatened a very real risk of further capital raising requirement.

Just when it couldn't get any worse, some local 'big name" companies were hitting the wall, the New Zealand dairy industry was in crisis, and the economies of the Australian mining states were in a tailspin thanks to the end of the mining investment boom and the collapse of key commodity prices. After seven years of winding back GFC bad debt provisions and handing out those reserves as dividends, suddenly it looked if Australian banks may have to quickly top up provisions once more.

After flying so high on the "global search for yield" in the years leading up to 2016, Australian banks share prices were being trashed. To put things into perspective, Commonwealth Bank ((CBA)) opened the year on $85 (having seen $95 in 2015) and dropped to under $70 in August.

August represented the bottom in commodity prices. Earlier in the year, US regulators decided to reduce the fine they had imposed on Deutsche Bank. The second half of the year failed to produce any more "big name" defaults as had been the case in the first half. APRA eased back on its tough talk of earlier in the year, and while introducing housing investment loan restrictions, managed to ease fears of significant bank capital requirements. The banks, loaded up with mortgages, took advantage of further RBA rate cuts to "reprice" their mortgage books, meaning not passing on the full amount. Bank share prices consolidated.

Then in November, along came The Donald. The immediate response was a surge in US bond rates and a surge in the share prices of US banks. Trump would return the US to solid economic growth and that would be good for all the world. Bank shares rallied across the globe, including in Australia.

Commonwealth Bank is today trading at $85.

Australia is not the US

While significant, the share price recovery post US election for Australian banks has not been quite as spectacular as the rallies in the US and Europe. And with good reason.

Banks typically benefit from higher interest rates, as higher interest rates allow for wider spreads between borrowing rates and lending rates (net interest margin). Trump's campaign promises have led to a "reflation" trade in the US on the prospect of better economic growth, sending interest rates rising and US banks shares rising in tow. However, higher interest rates are not necessarily a good thing for Australian banks right now.

Australia's 26-year run of economic growth has led, notes UBS, to significant household leverage and inflated housing prices. The housing boom has the RBA worried. Would rising interest rates potentially trigger cascading mortgage defaults?

The good news on this front is there's no sign of the RBA hiking rates anytime soon. But that same good news limits the opportunity for Australian banks to increase their net interest margins. The Australian economy may not have known an official recession since the nineties but there is little doubt pockets of recession have featured in various sectors. The rebound in commodity prices have been a saviour for the economy but we are not about to see another mining investment boom to the extent we did in the noughties. The housing sector has carried the can in recent years but will shortly cool.

The reality is a Trump-driven US economic recovery, if that is what is about to transpire, will not flow through significantly to Australia. This is particularly the case if Trump makes good on his protectionist threats. Australia is its own economy – hamstrung by fiscal stasis, at the mercy of the Chinese economy, and overly indebted at the household level.

So Australian banks are not about to shoot the lights out in 2017. Analysts agree that 2017 will be better than 2016, but not spectacularly so.

Remaining Subdued

Deutsche Bank's analysts are forecasting an average of 2% earnings growth for the banking sector in FY17. That's "relatively modest," Deutsche notes, but it's a lot better than the FY16 outcome of a -3% earnings decrease.

UBS has this week upgraded its earnings forecasts, but warns the "subdued medium term outlook remains". Macquarie agrees the outlook has improved, but slow growth environment will likely only deliver low single digit earnings growth.

Macquarie believes the easing of competitive pressures between the banks for loans and deposits will mean net interest margins should be at least stable or may rise above consensus expectations. Morgan Stanley acknowledges an easing of competition, but believes margins will remain under modest pressure.

The bottom line is Australian households and businesses are not about to rush out and borrow heavily in 2017. Households are already up to their eyeballs and despite low rates, the economic environment is not sufficiently inspiring for businesses. In the meantime, the banks are currently undertaking what Citi describes as a one-in-thirty year IT upgrade phase which is elevating costs at a time revenues are limited.

A brighter picture nonetheless

One of the biggest concerns of 2016 was the likely need for the Big Banks to raise new capital, again, to satisfy global and local regulations. While there was disagreement among bank analysts throughout 2016 as to whether, and to what extent, fresh raisings would be necessary, all now agree the immediate threat has eased.

As to how long it will take the Basel Committee to agree on new capital requirements is anyone's guess but given the delay, and the fact the committee has itself played down the potential harshness of new requirements, there is a greater possibility Australian banks can get by on organic capital growth and dividend reinvestment plans. And there's always the possibility of further non-core divestments, such as selling off wealth management and life insurance divisions.

There remains the question of just what is meant by "unquestionably strong", but APRA, too, has moved to allay fears. The regulator has suggested 2017 will be a year of consultation, suggesting no new requirements will be imposed before talking it through with the banks. Even then, the banks will be given plenty of time to comply. APRA can't impose a capital buffer requirement over Basel regulations until the Basel regulations are known.

Another feature of 2016 was collapsing commodity prices, which threatened defaults on loans to the mining sector right through to defaults on the mortgages of former mineworkers. While many had decided by August commodity prices had likely bottomed, no one foresaw the strength of the rebound. Strike that particular risk off the list for now.

There still remain "pockets of weakness" in the Australian and New Zealand economies but these are not significant, and while the Dick Smiths of the world seemed to be dropping like flies early last year, it appears we just saw a coincidental blip in "big name" defaults rather than a trend. Bank analysts have factored in a cyclical rebound in bad & doubtful debts, but suggest earnings upside is a possibility if such assumptions prove too aggressive.

There also remains the possibility of earnings upside if the banks were further to "reprice" their mortgage books. A lot will depend on the RBA, and here the picture for the official cash rate has never been murkier.

On the one hand, we had the scare of the Australian economy suffering negative growth in the September quarter, following the scare of disinflation earlier in the year. We have also had, for a long time, expectations Australia's unemployment rate must rise. But on the other hand, the recovery in commodity prices has eased fears on both counts.

Some, but not all, economists still expect the RBA will need to cut further. There is at least agreement that if the next move is up, it won't be this year. A lot will depend on global rates, specifically the US, and thus the Trump effect. If the RBA does cut, another opportunity is provided for the banks to reprice mortgages.

So the upshot is risks have diminished for the banking sector, there may be upside opportunities, but the likely outcome is still a subdued credit growth environment in 2017. So where does that leave bank share price valuations?

All in the price

While the recovery in Australian bank share prices has not been quite as spectacular as those of offshore peers, it's been a solid run nevertheless. At the very least, the valuation gap to the industrials sector, which had yawned at the depths last year, has all but been closed.

We have also seen a bit of a pullback from the highs in recent sessions, likely because one by one bank analysts have come out with reports suggesting the banks are now at least at fair value, all things considered, or overvalued given the outlook.

Macquarie pulled its sector view back to Neutral. UBS is currently maintaining a "relatively neutral view". Deutsche suggests the brighter outlook is "largely in the price". Morgan Stanley notes Australian bank valuation metrics look elevated compared to history. Last week Citi declared quite boldly "sun to set on bank share price rally".

Shaw & Partners, not an FNArena database broker, has told institutional investors and short-term traders it's time to sell, while long term investors should just ride it out. In other words, long term investors should not buy the banks unless lower share prices are on offer.

The recommendations and forecasts of the eight major brokers in the FNArena database are tabled below.

The first point of note is that CBA and National Bank ((NAB)) have exceeded consensus targets (based on yesterday's closing prices). Westpac ((WBC)) and ANZ Bank ((ANZ)) are not far off. History shows that whenever targets are exceeded, a share price pullback follows unless analysts are given cause to upgrade their forecasts.

Judging by consensus of a subdued earnings outlook, the latter seems unlikely the case in the near term.

We also note a total of ten Buy (or equivalent) ratings, eighteen Hold and four Sell. While the number of Hold ratings is consistent with a general view of fair to overvaluation, ten Buys to four Sells appears contradictory, and indeed is not a lot different to the 13/17/2 Buy/Hold/Sell split in place in September last year (following bank reporting season). There are three points to note here.

Firstly, these are individual bank recommendations, relative to the sector. Secondly, analysts are always disinclined to offer Sell ratings given it upsets the company they are rating and potentially leads to limited access to management. Thirdly, stock brokers do not make money by encouraging investors to sell.

Next month will provide the opportunity for bank analysts to update their forecasts. CBA will report first half FY17 earnings while Westpac, NAB and ANZ will update on first quarter FY17 performance.

Technical limitations

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Material Matters: Iron Ore, Oil And Tin

A glance through the latest expert views and predictions about commodities. Iron ore optimism; oil market re-balancing; and a rally in tin.

-tight steel market expected to support iron ore prices -observable down-trends in oil production and inventory needed -semiconductor growth sees demand for tin surge

By Eva Brocklehurst

Iron Ore

Optimism in China's steel industry is the main driver of iron ore prices over the short term but the domestic iron ore industry could also have an impact on prices, keeping these around current levels in 2017, ANZ analysts contend. Iron ore is expected to be affected by the country's policy on industrial over-capacity. China's State Council announced last year it would reduce steel production capacity by 150m tonnes by 2020.

China is also intent on eradicating illegal steel making capacity as it battles pollution and emissions in its major cities. Hence, tightness in the steel market should support iron ore prices and the analysts expect underlying Chinese steel demand to remain robust in 2017. Steel production growth is expected to contract this year, although be matched by a similar fall in growth the net exports from the major exporters.

Growth in exports of iron ore from the Australian producers, Rio Tinto ((RIO)), BHP Billiton ((BHP)) and Fortescue Metals ((FMG)) is expected to fall to its lowest level in five years. Another indicator underscoring this expectation is the forecast from Australia's Bureau of Meteorology for an above-average number of cyclones during the local season, which lasts from November to April. This, the analysts suspect, could impact exports by as much as 15% quarter on quarter.

Still, the main potential game changer for iron ore is the Chinese domestic industry. Since iron ore price highs of US$180/t were encountered in 2009-14 Chinese output has fallen by more than 60%, as the high cost producers shut down when the price fell below US$100/t.

As iron ore prices have pushed above US$80/t in recent weeks, the analysts observe this raises the possibility of a recovery in Chinese iron ore production. If supply pushes up to when prices were last at this level, another 50mt of iron ore capacity could potentially be reactivated in China, in turn sending prices back below US$60/t.

Yet, the analysts believe the probability of this occurring is relatively low, as exporters have established strong relationships with buyers in China and now provide nearly 90% of the country's total iron ore consumption.

Oil

UBS has reduced its long-term oil price assumption to US$70/bbl from US$75/bbl. This reflects a view regarding the cost of developing a marginal barrel outside of the US, although the ultimate range could vary from US$60-80/bbl. Assuming reasonable compliance with OPEC output cuts, the physical oil market appears under-supplied for the second quarter of 2017.

The speed of a US response to the OPEC production cuts suggests significant tightening is most likely a 2018 event. The main uncertainties, the broker envisages, revolve around US shale and its capacity to ramp up quickly and be the marginal producer as conventional supplies decline globally. Other variables include the return of Nigerian supply and whether annual demand continues to grow at over 1mmbbl/d.

The reduction in long-term oil prices has reduced the broker's forecasts for earnings per share for the oil stocks. The broker expects oil companies to be conservative regarding organic investment in 2017 and mergers and acquisitions are again likely to feature.

UBS retains a preference for Woodside Petroleum ((WPL)) with its modest gearing and low-cost LNG production as well as Origin Energy ((ORG)), with its ramp-up of APLNG and and rising electricity prices. The broker has reduced its rating on Santos ((STO)) to Neutral after the recent equity raising and and downgraded Horizon Oil ((HZN)) to Neutral after a 35% rally in the share price.

Shaw and Partners also expects the market to rebalance if OPEC delivers on its supply cuts. The trends are already under way with non-OPEC supply falling and demand remaining robust. If OPEC delivers then this should underpin an oil price recovery in 2017. The analysts note inventory levels are still near historical highs and, without OPEC cuts, it would take around two years for the oil market to rebalance.

With oversupply, the value of marginal production is zero, and there is no reason to spot prices to rally. The analysts believe, for the current rally to continue, observable down-trends in production and inventory data are needed. OPEC and non-OPEC cuts, if delivered, should eliminate up to 1.8m bpd of supply and result in deficits through 2017.

The analyst expect this would result in meaningful reductions in inventories throughout the year, for the first time in four years. Assuming demand remains robust the market should "normalise" by the end of the year, Shaw and Partners estimates.

Tin

The lowest volume metal of the base metals traded on the London Metal Exchange, tin, was second only to zinc in terms of its recovery in 2016, rallying 45% to trade at US$21,000/t by the end of the year, Macquarie notes. Refined stocks of the metal in warehouses are at low levels, although producer inventories have lifted and mine supply appears to be improving, notably in Indonesia.

Key reasons behind the recovery in the tin price include low visible levels of stock on exchanges and reduced export volumes from key producer Indonesia, as well as lower production in China and Myanmar. The broker estimates Indonesian mine production was down 13% in 2016 after price-related mine closures at the start of the year.

While Indonesian production looks to be improving, Macquarie suspects Myanmar production growth is slowing. Meanwhile, Chinese metal output was affected from July by environmental shut-downs and data up to October implies there has been no real recovery.

The supply developments are not that dynamic and the broker concludes the 2016 rally was mostly driven by one factor that did change dramatically, demand. There was a surge in end-use semiconductor shipments in the second half of 2016 while tinplate production was boosted by stronger-than-anticipated demand from the Chinese steel sector. Together these two features account for around two thirds of global demand.

Moreover, Macquarie's semiconductor analysts are projecting global sales growth of 9% in 2017 on a continued recovery in the sector, particularly with wafer fabrication capacity being added aggressively. The broker upgrades its outlook for demand, which should push tin into a deeper deficit over the next few years. Accordingly, price forecasts are raised on average by 5-21% out to the end of the decade.

Find out why FNArena subscribers like the service so much: "Your Feedback (Thank You)" - Warning this story contains unashamedly positive feedback on the service provided.

Weekly Ratings, Targets, Forecast Changes

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

The FNArena database tabulates the views of eight major Australian and international stock brokers: Citi, Credit Suisse, Deutsche Bank, Macquarie, Morgan Stanley, Morgans, Ord Minnett and UBS.

For the purpose of broker rating correlation, Outperform and Overweight ratings are grouped as Buy, Neutral is grouped with Hold and Underperform and Underweight are grouped as Sell to provide a Buy/Hold/Sell (B/H/S) ratio.

Ratings, consensus target price and forecast earnings tables are published at the bottom of this report.

Summary

Period: Monday January 16 to Friday January 20, 2017 Total Upgrades: 10 Total Downgrades: 14 Net Ratings Breakdown: Buy 44.04%; Hold 41.92%; Sell 14.04%

The week ending Friday, 20th January was the first that saw some normalcy returning to the Australian share market. Volumes picked up as stockbrokers returned from their annual holiday.

Share prices were largely indecisive and gradually gave back some of the strong gains made in the post-US election rally. Analysts issued 14 downgrades in ratings for individual stocks against ten upgrades.

Amongst the downgrades, banks featured prominently. National Australia Bank is the only among the Big Four not having received a downgrade during the week. ANZ Bank received two. Bendigo and Adelaide Bank was included too.

Nickel miners were, unsurprisingly, among the stocks receiving downgrades. Sims Metal's profit upgrade was met by two downgrades.

All-Weather, multi-decade star-performer CSL crowned itself to be the week's stand-out receiving three upgrades, of which two went to Buy or an equivalent, thanks to a serious, and unexpected, upgrade to profit guidance.

In terms of target prices, Sims Metal was the clear winner for the week (+11%), followed by insurer Steadfast and biotech CSL. Loser for the week was infant formula trouble child Bellamy's whose consensus target dived by -41%, at a healthy distance followed by AWE Ltd, Western Areas and Asaleo Care.

In terms of positive adjustments to earnings estimates, Sims Metal was handsomely beaten by Whitehaven Coal and South32, while Alacer Gold, Graincorp, Rio Tinto and CSL also enjoyed positive revisions. Not so for Western Areas, Bellamy's and Ardent Leisure who all suffered significant reductions.

Upgrade

BASE RESOURCES LIMITED ((BSE)) Upgrade to Speculative Buy from Hold by Ord Minnett .B/H/S: 1/0/0

Ahead of the release of the December quarter production report, Ord Minnett analysts have upgraded to a Speculative Buy while lifting the price target to 34c from 25c. The view is that balance sheet risk is more than accurately reflected in the weaker share price.

Ord Minnett believes the pricing outlook for ilmenite continues to strengthen and this will assist in debt reduction. The analysts are toying with the idea of accelerated de-leveraging if price momentum builds as they expect it will.

CSL LIMITED ((CSL)) Upgrade to Outperform from Neutral by Credit Suisse and Upgrade to Accumulate from Hold by Ord Minnett and Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 5/2/0

The company issued an upgrade to previous FY17 guidance and Credit Suisse analysts are suggesting CSL is benefiting from supply issues among competitors. Specialty products and raw plasma in particular are being singled out.

The crux in this story is that CSL has recorded a substantial increase in plasma collection capacity in recent years. This now is enabling the company to meet additional demand requirements and gain market share, point out the analysts.

Upgrade to Outperform from Neutral. Target jumps to $119 from $110. Estimates have lifted.

CSL revising upwards its profit guidance for FY17 has triggered an upgrade to Accumulate from Hold, alongside a boost to the price target to $120 from $100 prior. Ord Minnett analysts admit they were taken by surprise.

The analysts note the company's strategy of "aggressively investing" in collection and fractionation capacity is allowing CSL to again take advantage of a supply issues among competitors. They see further upside to the implied underlying growth rate for H2.

Ord Minnett has now taken the view CSL stands to enjoy above-market growth from its core plasma operations for at least a further 18 months. This prediction has now been reflected in forecasts.

Morgan Stanley's longstanding Underweight rating on CSL was driven by a (correctly) assumed period of downward earnings revisions. Recently the broker has seen earnings risk dissipating, and this has been confirmed by CSL's guidance upgrade, largely due to leaving competitors in the dust.

History suggests it takes a long time for the competition to recover, thus while valuation still looks stretched to the broker, an upgrade to Equal-weight follows. Target rises to $106 from $96. Industry view: In-line.

CALTEX AUSTRALIA LIMITED ((CTX)) Upgrade to Buy from Hold by Deutsche Bank .B/H/S: 5/1/0

On Deutsche Bank's observation, Caltex shares have underperformed the broader market in Australia by some 30% over the past twelve months. This now creates an opportunity for investors, say the analysts, as too low expectations ("unrealistically low") have been priced in.

Much easier comp virtually guarantees a return to growth in 2017, suggest the analysts. Price target of $35 suggests the potential for double digit return. Upgrade to Buy from Hold.

G8 EDUCATION LIMITED ((GEM)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 3/1/0

An apparent stabilisation in margins and a new CEO has Ord Minnett analysts speculating whether this could be the early beginnings of a new chapter for this company? The idea becomes attractive as the current share price doesn't seem to account for any upside, in the analysts' view.

Ord Minnett thinks management's new strategy doesn't require a lot of capital, but if successful, material gains could be made. Not in the share price at present level. A new analyst has resumed coverage and he has upgraded to Accumulate from Hold. Target rises to $3.78 from $3.25 on increased forecasts.

ORIGIN ENERGY LIMITED ((ORG)) Upgrade to Overweight from Equal-weight by Morgan Stanley .B/H/S: 2/3/2

Origin is close to full operations at APLNG, a sustainable capital structure, and reduced corporate complexity, Morgan Stanley notes. The company's balance sheet repair process, simplification plans and incremental earnings growth for the Energy Markets division see the broker upgrade to Overweight.

Divestment of conventional gas assets will leave a simpler business more able to weather lower oil prices, Morgan Stanley suggests. Origin remains energy retail leader by customer market share. Target rises to $8.75 from $6.04.

REGIS RESOURCES LIMITED ((RRL)) Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 3/5/0

Regis' Dec Q production met the broker's forecast and costs were 6% lower. Operations are stable and cash is building from earnings margins nearing 50%.

The broker's Underweight rating had been in place on the basis of the market fully pricing in assumed mine life extensions. The broker concedes mine lives may well be increased and/or gold prices can move higher and as such has upgraded to Equal-weight, while still preferring other junior gold exposures. Target $3.05.

See also RRL downgrade.

TREASURY WINE ESTATES LIMITED ((TWE)) Upgrade to Overweight from Equal-weight by Morgan Stanley .B/H/S: 2/4/1

The broker has conducted an extensive review of Treasury Wine and as a result has upgraded to Overweight.

Having surveyed Chinese consumers, the broker believes the market continues to under-appreciate the company's opportunity in China.

Treasury is also well leveraged to wine price increases which have been underway, and an underperforming Americas business is poised to turn around, the broker believes. Target rises to $13 from $10.

WOODSIDE PETROLEUM LIMITED ((WPL)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 3/4/1

Ord Minnett has turned more positive on the resumption of growth at Woodside Petroleum and has upgraded the stock to Accumulate from Hold, while lifting the price target to $36 from $30.

On a risk-weighted basis, the analysts project attributable production could grow 25% over the next decade to 115–120m barrels of oil equivalent (mmboe) in 2025. One note of caution: Royal Dutch/Shell's 13% equity stake remains an overhang for the stock.

Downgrade

ASALEO CARE LIMITED ((AHY)) Downgrade to Neutral from Buy by Citi .B/H/S: 1/2/0

On Citi's observation, competition remains high in the tissue categories in Australian supermarkets and this should keep the pressure on Asaleo Care. Revised forecasts now assume group earnings to decline in both FY16 and FY17.

The offset is the company is expected to appease shareholders with a high dividend payout (10c, stable), hence why Citi thinks a Neutral rating is more appropriate than moving to Sell. The 7%-plus yield should provide support. Target drops 10c to $1.50.

AUSTRALIA & NEW ZEALAND BANKING GROUP ((ANZ)) Downgrade to Neutral from Buy by Citi and Downgrade to Neutral from Outperform by Macquarie .B/H/S: 2/6/0

Banking analysts at Citi published not one but a few reports on the Australian banking sector today. The bottom line is that share prices have run hard while the analysts remain of the view there is no operational improvement on the horizon to justify the rally.

Citi has downgraded ANZ Bank to Neutral from Buy. Target price lifts to $31.50 from $31.25. The broker's pecking order for the sector remains unchanged: (most to least preferred) ANZ, NAB, WBC, CBA.

Note: DPS estimates have been slightly increased from a previous view they were to remain at 160c for years to come.

The broker has upgraded bank forecast earnings to reflect the rising yield environment sparked by Trump's election, but notes locally the banks continue to operate in a slow growth environment. The risk of capital raisings has diminished, but the market has pushed bank share prices higher on that basis.

The broker has thus downgraded its sector recommendation to Neutral. Incorporating the recent divestment of Shanghai Rural Commercial Bank, ANZ's individual rating has been downgraded to Neutral. Target rises to $31 from $30.

ALACER GOLD CORP ((AQG)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 3/2/0

Alacer enjoyed a heap leach grade breakthrough in the Dec Q having resolved earlier issues, leading to production beating Macquarie by 9%. Revised 2016 guidance was achieved. While 2017 should now see much improved cash flow, it will also see peak capex for the sulphide project, the broker notes.

Macquarie has lifted its target to $2.40 from $2.30 but given strength in the share price, downgrades to Neutral.

AURIZON HOLDINGS LIMITED ((AZJ)) Downgrade to Sell from Neutral by Citi .B/H/S: 2/4/2

Aurizon's trading update revealed a strong December, but Citi analysts are quick to point out other months, October and November in particular, were weak if not negative.

Citi is of the view the performance does not justify the current share price. Downgrade to Sell from Neutral. Price target moves to $4.75 from $4.60.

BENDIGO AND ADELAIDE BANK LIMITED ((BEN)) Downgrade to Sell from Hold by Deutsche Bank .B/H/S: 1/2/3

While acknowledging the bank's prospects have improved in recent quarters, Deutsche Bank analysts are simply of the view the share price has run way too hard. Downgrade to Sell from Hold. Price target lifts to $11.40 from

$10.70, still well below the share price.

COMMONWEALTH BANK OF AUSTRALIA ((CBA)) Downgrade to Sell from Neutral by Citi .B/H/S: 1/5/2

Banking analysts at Citi published not one but a few reports on the Australian banking sector today. The bottom line is that share prices have run hard while the analysts remain of the view there is no operational improvement on the horizon to justify the rally.

Citi has downgraded CommBank to Sell from Hold. Target price remains $75. The broker's pecking order for the sector remains unchanged: (most to least preferred) ANZ, NAB, WBC, CBA.

Note: CBA is still expected to cut its dividend to 357c in FY18.

INDEPENDENCE GROUP NL ((IGO)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 1/4/1

The lifting of the Indonesian nickel export ban has come as a surprise to the broker, who notes recent government rhetoric has been to the contrary. Given the lift extends only to those producers who can demonstrate plans to develop downstream processing facilities, it is uncertain as to what the impact will be.

The broker has thus left nickel price forecasts unchanged for the time being, while noting substantial downside risk. Independence is downgraded to Neutral. Target falls to $4.40 from $5.00. Earnings forecasts unchanged for the time being.

REGIS RESOURCES LIMITED ((RRL)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 3/5/0

Regis' Dec Q numbers were broadly in line with Macquarie's expectation, with higher grades at Duketon providing a production boost. First ore from Gloster and Erlistoun will further boost grades.

Strong cash generation is ongoing and exploration remains in focus. While Macquarie believes Regis' consistent delivery justifies a premium to peers, the share price has run ahead of valuation. Downgrade to Neutral. Target rises to $3.00 from $2.90.

See also RRL upgrade.

SIMS METAL MANAGEMENT LIMITED ((SGM)) Downgrade to Underperform from Neutral by Credit Suisse and Downgrade to Neutral from Buy by Citi .B/H/S: 2/3/2

The company has upgraded its guidance for FY17 and Credit Suisse analysts have been forced to upwardly adjust their forecasts. Yet, they remain of the view the only way forward for the iron ore price is down, and this means prices for scrap will follow.

On this basis, downgrade to Underperform from Neutral. Target price remains $9.90. A second factor underpinning the downgrade is the fact the share price is trading well above target.

On Citi's observation, the share market had already anticipated the improvement in market dynamics for scrap steel collector and seller, Sims Metal. The analysts have updated forecasts and lifted the price target to $13.70 from $11.20.

As the revised price target is only marginally above the share price, the rating is downgraded to Neutral from Buy. Note: Citi's estimates are some 23% ahead of consensus EPS estimates for FY17.

SANTOS LIMITED ((STO)) Downgrade to Neutral from Buy by UBS .B/H/S: 4/3/1

UBS has lowered its 2018-20 oil price forecasts by 6-7%. While 2017 will see OPEC/non-OPEC production cuts have their effect, this will quickly be offset and surpassed by an aggressive US shale response, supported by falling costs, the broker believes. Forecasts nevertheless remain above consensus.

A US$60/bbl (Brent) forecast remains in place for 2017. A fall in LNG storage levels leads to an increase in natgas price forecasts. The broker has adjusted for Santos' surprise raising and suggests a clear focus on cost reduction provides for few catalysts in 2017.

Target falls to $4.60 from $4.90. Downgrade to Neutral.

WESTPAC BANKING CORPORATION ((WBC)) Downgrade to Sell from Neutral by Citi .B/H/S: 4/3/1

Banking analysts at Citi published not one but a few reports on the Australian banking sector today. The bottom line is that share prices have run hard while the analysts remain of the view there is no operational improvement on the horizon to justify the rally.

Citi has downgraded Westpac to Sell from Neutral. Target price loses 50c to $30.50. The broker's pecking order for the sector remains unchanged: (most to least preferred) ANZ, NAB, WBC, CBA.

Note: Citi still expects the dividend to be cut to 160c in FY18.

WESTERN AREAS NL ((WSA)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 1/2/3

The lifting of the Indonesian nickel export ban has come as a surprise to the broker, who notes recent government rhetoric has been to the contrary. Given the lift extends only to those producers who can demonstrate plans to develop downstream processing facilities, it is uncertain as to what the impact will be.

The broker has thus left nickel price forecasts unchanged for the time being, while noting substantial downside risk. Western Areas is downgraded to Neutral. Target falls to $3.00 from $3.60. Earnings forecasts unchanged for the time being.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 BASE RESOURCES LIMITED Buy Neutral Ord Minnett 2 CALTEX AUSTRALIA LIMITED Buy Neutral Deutsche Bank 3 CSL LIMITED Buy Neutral Credit Suisse 4 CSL LIMITED Neutral Sell Morgan Stanley 5 CSL LIMITED Buy Neutral Ord Minnett 6 G8 EDUCATION LIMITED Buy Neutral Ord Minnett 7 ORIGIN ENERGY LIMITED Buy Neutral Morgan Stanley 8 REGIS RESOURCES LIMITED Neutral Sell Morgan Stanley 9 TREASURY WINE ESTATES LIMITED Buy Neutral Morgan Stanley 10 WOODSIDE PETROLEUM LIMITED Buy Neutral Ord Minnett Downgrade 11 ALACER GOLD CORP Neutral Buy Macquarie 12 ASALEO CARE LIMITED Neutral Buy Citi 13 AURIZON HOLDINGS LIMITED Sell Neutral Citi 14 AUSTRALIA & NEW ZEALAND BANKING GROUP Neutral Buy Macquarie 15 AUSTRALIA & NEW ZEALAND BANKING GROUP Neutral Buy Citi 16 BENDIGO AND ADELAIDE BANK LIMITED Sell Neutral Deutsche Bank 17 COMMONWEALTH BANK OF AUSTRALIA Sell Neutral Citi 18 INDEPENDENCE GROUP NL Neutral Buy Macquarie 19 REGIS RESOURCES LIMITED Neutral Buy Macquarie 20 SANTOS LIMITED Neutral Buy UBS 21 SIMS METAL MANAGEMENT LIMITED Neutral Buy Citi 22 SIMS METAL MANAGEMENT LIMITED Sell Neutral Credit Suisse 23 WESTERN AREAS NL Neutral Buy Macquarie 24 WESTPAC BANKING CORPORATION Sell Neutral Citi Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 CSL CSL LIMITED 64.0% 29.0% 35.0% 7 2 SDF STEADFAST GROUP LIMITED 100.0% 67.0% 33.0% 3 3 AAD ARDENT LEISURE GROUP 29.0% 14.0% 15.0% 7 4 CTX CALTEX AUSTRALIA LIMITED 64.0% 50.0% 14.0% 7 5 TWE TREASURY WINE ESTATES LIMITED 7.0% -7.0% 14.0% 7 6 GEM G8 EDUCATION LIMITED 63.0% 50.0% 13.0% 4 7 CWN CROWN RESORTS LIMITED 60.0% 50.0% 10.0% 5 8 WPL WOODSIDE PETROLEUM LIMITED 19.0% 13.0% 6.0% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 AHY ASALEO CARE LIMITED 33.0% 67.0% -34.0% 3 2 BAL BELLAMY'S AUSTRALIA LIMITED -67.0% -33.0% -34.0% 3 3 SGM SIMS METAL MANAGEMENT LIMITED -7.0% 21.0% -28.0% 7 4 CBA COMMONWEALTH BANK OF AUSTRALIA -13.0% 13.0% -26.0% 8 5 ANZ AUSTRALIA & NEW ZEALAND BANKING GROUP 19.0% 44.0% -25.0% 8 6 AQG ALACER GOLD CORP 60.0% 80.0% -20.0% 5 7 BEN BENDIGO AND ADELAIDE BANK LIMITED -36.0% -21.0% -15.0% 7 8 WSA WESTERN AREAS NL -36.0% -21.0% -15.0% 7 9 STO SANTOS LIMITED 38.0% 50.0% -12.0% 8 10 WBC WESTPAC BANKING CORPORATION 38.0% 50.0% -12.0% 8 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 SGM SIMS METAL MANAGEMENT LIMITED 11.901 10.671 11.53% 7 2 SDF STEADFAST GROUP LIMITED 2.533 2.350 7.79% 3 3 CSL CSL LIMITED 116.136 108.990 6.56% 7 4 WPL WOODSIDE PETROLEUM LIMITED 31.710 29.973 5.80% 8 5 TWE TREASURY WINE ESTATES LIMITED 10.839 10.410 4.12% 7 6 GEM G8 EDUCATION LIMITED 3.683 3.550 3.75% 4 7 ANZ AUSTRALIA & NEW ZEALAND BANKING GROUP 29.338 28.606 2.56% 8 8 BEN BENDIGO AND ADELAIDE BANK LIMITED 10.750 10.579 1.62% 7 9 AAD ARDENT LEISURE GROUP 2.295 2.274 0.92% 7 10 CTX CALTEX AUSTRALIA LIMITED 34.204 33.990 0.63% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 BAL BELLAMY'S AUSTRALIA LIMITED 4.073 6.937 -41.29% 3 2 AWE AWE LIMITED 0.662 0.716 -7.54% 6 3 WSA WESTERN AREAS NL 2.514 2.629 -4.37% 7 4 AHY ASALEO CARE LIMITED 1.533 1.567 -2.17% 3 5 STO SANTOS LIMITED 4.725 4.811 -1.79% 8 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 WHC WHITEHAVEN COAL LIMITED 46.169 33.580 37.49% 8 2 S32 SOUTH32 LIMITED 30.445 24.155 26.04% 7 3 SGM SIMS METAL MANAGEMENT LIMITED 58.480 52.111 12.22% 7 4 AQG ALACER GOLD CORP 11.906 10.896 9.27% 5 5 GNC GRAINCORP LIMITED 58.843 55.077 6.84% 6 6 RIO RIO TINTO LIMITED 366.788 344.377 6.51% 8 7 CSL CSL LIMITED 402.752 378.333 6.45% 7 8 WES WESFARMERS LIMITED 259.400 246.200 5.36% 8 9 IPL INCITEC PIVOT LIMITED 17.488 16.938 3.25% 8 10 SUN SUNCORP GROUP LIMITED 95.025 93.988 1.10% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 WSA WESTERN AREAS NL 0.187 0.987 -81.05% 7 2 BAL BELLAMY'S AUSTRALIA LIMITED 16.000 32.367 -50.57% 3 3 AAD ARDENT LEISURE GROUP 4.933 6.131 -19.54% 7 4 RRL REGIS RESOURCES LIMITED 24.534 26.696 -8.10% 8 5 SBM ST BARBARA LIMITED 29.100 30.480 -4.53% 3 6 AIZ AIR NEW ZEALAND LIMITED 29.135 30.121 -3.27% 4 7 GBT GBST HOLDINGS LIMITED 19.833 20.500 -3.25% 3 8 STO SANTOS LIMITED -6.766 -6.594 -2.61% 8 9 BPT BEACH ENERGY LIMITED 5.633 5.776 -2.48% 6 10 VRT VIRTUS HEALTH LIMITED 40.400 41.400 -2.42% 4 Technical limitations

If you are reading this story through a third party distribution channel and you cannot see charts included, we apologise, but technical limitations are to blame.

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Uranium Week: There Can Only Be Upside

It appears 2017 may prove a brighter year for uranium, but it's a very long way back.

By Greg Peel

This week sees the global Nuclear Fuel Suppliers Forum held in Washington, which typically slows down market activity given participants are absent. Last week saw only modest volumes traded in the spot market. Industry consultant TradeTech reports only four transactions totalling 600,000lbs U3O8 equivalent.

The good news is that TradTech's weekly spot price indicator has risen, again, this time by US25c to US$22.75/lb. Indeed, since hitting a 12-year low of US$17.75/lb in December, the spot uranium price has rallied a healthy 24%.

Out of context, that sounds inspiring. In context, that's a US$5/lb rally following a -34.5% price drop in 2016, or about -US$17/lb. The price of uranium, note the commodities analysts at Macquarie, is currently trading at 50% of its price of 40 years ago in nominal terms, before one even accounts for inflation.

Meanwhile, the price of uranium's energy rivals – LNG and coal – surged back in 2016 following earlier tumbles. Uranium was the worst performing commodity in 2016. No other commodity is trading at 50% its nominal value of 40 years ago.

A Picture Of Weak Demand

Uranium has now suffered the same fate as oil/gas and coal suffered in 2015. With spot prices falling below the cost of marginal production, supply has been wound back. But not enough to make a significant dent in the global surplus. On the other side of the equation, 2016 featured weak demand.

In the US, demand is falling as legacy reactors are being shut down, due to their inability to compete commercially with alternative energy sources (gas, renewables) and despite the low cost of fuel. With Japanese reactor restarts moving at a barely discernible pace, the global demand burden falls on China, where a major reactor construction phase is underway.

The problem is, as prices have fallen steadily since the Fukushima disaster, China has been opportunistically stockpiling the uranium needed to fire up new reactors. While Chinese stocking continues, the peak rate of China's inventory build is now past, Macquarie notes.

In Japan, there are now ten reactors out of a pre-Fukushima 40-odd that have satisfied new safety standards and are therefore restart-able. But as the fifth anniversary of Fukushima approaches, only three are currently operating (and one of those is actually down for maintenance as we speak), two more were restarted and then closed down again due to court injunctions (safety concerns at the local level), and the fate of the other five is in the hands of local governments, or "the people", as it were, and as such unknown.

Too Much Supply, Still

On the supply side, last week saw major global producer, Canada's Cameco, issue a profit warning due the intended write-down of the value its production assets. The company will also lay off 10% of its workforce. Last year Cameco idled its Rabbit Lake operations. Similar care & maintenance curtailments have been the story for Australia's Paladin Energy ((PDN)) over 2016.

Yet Cameco's Cigar Lake mine continues to ramp up, and the Husab mine in Namibia continues to ramp up, where Rio Tinto's ((RIO)) Rossing mine is also expected to recover production levels. While 2017 should see the lowest level of uranium production since 2010, Macquarie notes, the 2% growth rate in demand required to keep reactors operating is not enough to mean a surplus will be avoided. Macquarie does not see a balanced market until at least 2020.

That said, Macquarie sees more upside potential for uranium prices in 2017 than downside – a view the analysts are not alone in taking. Outside of Chinese construction and Japanese restarts, one positive may be provided on the demand side if shutdown plans for legacy US reactors are reversed due to favourable state legislation.

TradeTech's term price indicators remain unchanged at US$22/lb (mid) and US$30/lb (long).

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Trump Trade With A Twist

By Kathleen Brooks, Research Director, City Index

The Trump trade is back on as the key US stock indices post record highs as politics and earnings growth boosts the mood in the markets. Donald Trump's flurry of executive orders this week have given financial markets clarity about the economic direction of the Trump Presidency, and this clarity is being rewarded with stock market gains.

Looking to the inevitable sell-off…

Of course, markets don't go up in a straight line, and even the perma-bulls out there will be expecting a pullback at some stage, the question is when will this happen? While we don't have a crystal ball in the City Index offices, the market does give us some clues. Firstly, the lead stock market indicators, such as the Russell 2000 and the Dow Jones transportation Index. These indices reached record highs in mid-December, and led the way for the Dow to break its milestone figure on Wednesday. But if they start to roll over, then we would expect the major indices to follow suit.

Can volatility tell us where stocks will go next?

The other area to watch is volatility. As we have mentioned before, the current post-election rally in stocks has been accompanied by a decline in volatility. The Vix index fell to 10.70 on Wednesday, its lowest level since 2014, when it hit 10.28. If we breach this level, then some may get nervous that a stock market sell off could be in sight. However, the record low for the Vix was 8.89 in 1993, so even if we fall below 10.0, there is precedent for the Vix to go lower, and potentially for stocks to eek out further gains.

Another area to watch is Treasury yields. The 10-year yield rose 8 basis points on Wednesday, which is a large daily move for this market. Experts (if you trust them) have been calling 2.65% a line in the sand for the 10-year yield, and if it breaches this level then it may herald the start of a multi-year bear market for US bonds. If we breach this level then it is worth watching what stocks do, as rising borrowing costs could trigger a sell off in stocks, albeit with a bit of a lag.

Dollar proves Trump trade could be fading

The "twist" to the Trump trade, as mentioned in the title, is the dollar. Post the election, the dollar, bond yields and stocks all rose together. In normal cycles, bond yields rise, which pushes up the dollar, both of which weigh on stocks. However, in recent days stocks and bond yields have risen yet the dollar has slumped; it is the worst performer in the G10 so far this year. The decline in the dollar can be attributed in part to concerns voiced by President Trump and his choice of Treasury Secretary, Steven Mnuchin, who both raised concerns about a strong dollar and the negative impact on the US economy. Thus, US politicians talking down the greenback is a key risk for FX traders in the coming weeks.

The euro could be one to watch in the coming days after German 10-year bond yields reached their highest level for a year. Treasuries tend to lead global bond markets, so watch out for further upside in European bond yields. Inflation in Germany is at a 3-year high, yet bond yields are very low, this could be the perfect mix for a sharp spike higher in European yields, which could boost the euro.

Trump's Wall fails to knock peso

The Mexican peso rose more than 2.5% against the dollar on Wednesday, seemingly triggered by Trump's comments about Mexico, including his issuing an executive order to build the wall on the Mexico/ US border, something he promised on his campaign trail. However, the more Trump talked about the wall on Wednesday, the more the Mexican peso seemed to rally. Talk about sell the rumour, buy the fact. Perhaps Trump's new mantra should be buy the peso, as this would help to make American goods attractive to one of its closest trading partners.

Watch out for our UK GDP preview coming out later. Overall, we are on high alert for signs that this stock market rally is coming to an end. Right now we don't see any signs that suggest an end to the rally is in sight in the short term.

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The Short Report

Guide:

The Short Report draws upon data provided by the Australian Securities & Investment Commission (ASIC) to highlight significant weekly moves in short positions registered on stocks listed on the Australian Securities Exchange (ASX). Short positions in exchange-traded funds (ETF) and non-ordinary shares are not included. Short positions below 5% are not included in the table below but may be noted in the accompanying text if deemed significant.

Please take note of the Important Information provided at the end of this report. Percentage amounts in this report refer to percentage of ordinary shares on issue.

Stock codes highlighted in green have seen their short positions reduce in the week by an amount sufficient to move them into a lower percentage bracket. Stocks highlighted in red have seen their short positions increase in the week by an amount sufficient to move them into a higher percentage bracket. Moves in excess of one percentage point or more are discussed in the Movers & Shakers report below.

Summary:

Week ending January 26, 2017

Last week saw the ASX200 on the slide from its highs, largely due to analyst calls on banks being overvalued, before rebounding on the renewed Trump rally on Wall Street.

Movements in short positions on the ASX were limited last week, with a couple of notable exceptions.

Super Retail Group has jumped into the table at 13.8% shorted from under 5% shorted the prior week. There has been no new news out of the company since its AGM in October. There is no capital raising on the cards, so I will reserve my judgement on whether this number is real, or a blip in the ASIC data, until next week. Unfortunately such blips are common.

Or does someone fear Amazon?

Aconex' ((ACX)) stint at the top of the table has proven short-lived. The shares drifted lower last week and short positions fell to 15.4% from 16.6%, putting Myer ((MYR)) back into its familiar number one spot.

Shares in Vocus Communications ((VOC)) nevertheless continue to build, to 11.8% last week from 10.7%.

Shares in graphite prospect Syrah Resources ((SYR)) also drifted lower last week, and shorts fell to 9.6% from 11.0%.

REA Group has jumped into the table at 6.1% shorted from under 5% the week prior, and similarly Paladin Energy has jumped back in at 6.6%.

Weekly short positions as a percentage of market cap:

10%+

MYR 16.0 ACX 15.4 SUL 13.8 WSA 12.1 VOC 11.8 TFC 11.2 NEC 10.5 MTS 10.1

Out: SYR

9.0-9.9%

SYR, WOR In: SYR

8.0-8.9%

NWS, HSO, FLT, MYX

In: MYX Out: NXT, MND

7.0-7.9%

DOW, AWC, MND, NXT, BAL, MYO, EHE, ORE, ISD

In: MND, NXT Out: MYX, IVC

6.0-6.9%

IVC, BEN, SGH, RWC, PDN, PRU, GTY, JHC, MTR, REA, CTD, CSV, BKL, SEK

In: IVC, PDN, REA Out: ILU, OSH

5.0-5.9%

RIO, BGA, OSH, MSB, WOW, ILU, IFL, OFX, AAD, GEM, CSR, AWE, A2M, KAR, CAB, SRX, IGO, AAC

In: OSH, ILU, KAR, SRX Out: ORI, IPH, MLX

Movers and Shakers

Super Retail ((SUL)) held its AGM last October and has not given analysts any cause to update since. At the time, Credit Suisse suggested Bapcor's ((BAP)) expansion may challenge Super's supremacy in auto while similarly, the entry of Decathlon and JD Sports into the market will offer competition in the sports space. Another retailer planning to expand in Australia is Amazon.

Amazon likely has all retailers feeling uncomfortable. But as to whether this justifies a jump in shorts in Super Retail to 13.8% from oblivion in a week is questionable. This may just be a data blip.

REA Group ((REA)) sold its European assets late last month in a move that surprised analysts. This may explain why shorts in REA have risen to 6.1% from under 5% the week before.

Paladin Energy ((PDN)) is no stranger to the 5% plus shorted table, often appearing at the low end. With spot uranium prices continuing to wallow, and Paladin's legacy supply contracts at higher prices now exhausted, the risk is the company will need to raise fresh capital in order to meet its upcoming debt repayment obligations.

Last week Paladin shorts rose to 6.6% from under 5%.

ASX20 Short Positions (%)

To see the full Short Report, please go to this link

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It is wrong to assume that short percentages published by ASIC simply imply negative market positions held by fund managers or others looking to profit from a fall in respective share prices. While all or part of certain short percentages may indeed imply such, there are also a myriad of other reasons why a short position might be held which does not render that position "naked" given offsetting positions held elsewhere. Whatever balance of percentages truly is a "short" position would suggest there are negative views on a stock held by some in the market and also would suggest that were the news flow on that stock to turn suddenly positive, "short covering" may spark a short, sharp rally in that share price. However short positions held as an offset against another position may prove merely benign.

Often large short positions can be attributable to a listed hybrid security on the same stock where traders look to "strip out" the option value of the hybrid with offsetting listed option and stock positions. Short positions may form part of a short stock portfolio offsetting a long share price index (SPI) futures portfolio – a popular trade which seeks to exploit windows of opportunity when the SPI price trades at an overextended discount to fair value. Short positions may be held as a hedge by a broking house providing dividend reinvestment plan (DRP) underwriting services or other similar services. Short positions will occasionally need to be adopted by market makers in listed equity exchange traded fund products (EFT). All of the above are just some of the reasons why a short position may be held in a stock but can be considered benign in share price direction terms due to offsets.

Market makers in stock and stock index options will also hedge their portfolios using short positions where necessary. These delta hedges often form the other side of a client's long stock-long put option protection trade, or perhaps long stock-short call option ("buy-write") position. In a clear example of how published short percentages can be misleading, an options market maker may hold a short position below the implied delta hedge level and that actually implies a "long" position in that stock.

Another popular trading strategy is that of "pairs trading" in which one stock is held short against a long position in another stock. Such positions look to exploit perceived imbalances in the valuations of two stocks and imply a "net neutral" market position.

Aside from all the above reasons as to why it would be a potential misconception to draw simply conclusions on short percentages, there are even wider issues to consider. ASIC itself will admit that short position data is not an exact science given the onus on market participants to declare to their broker when positions truly are "short". Without any suggestion of deceit, there are always participants who are ignorant of the regulations. Discrepancies can also arise when short positions are held by a large investment banking operation offering multiple stock market services as well as proprietary trading activities. Such activity can introduce the possibility of either non-counting or double-counting when custodians are involved and beneficial ownership issues become unclear.

Finally, a simple fact is that the Australian Securities Exchange also keeps its own register of short positions. The figures provided by ASIC and by the ASX at any point do not necessarily correlate.

FNArena has offered this qualified explanation of the vagaries of short stock positions as a warning to subscribers not to jump to any conclusions or to make investment decisions based solely on these unqualified numbers. FNArena strongly suggests investors seek advice from their stock broker or financial adviser before acting upon any of the information provided herein.

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The Wrap: CPI, Housing, USD & Commodities

Weekly Broker Wrap: Implications of Dec qtr CPI; housing downturn but crash unlikely; gold outlook; US dollar strength; and commodity prices in 2017.

-Downside risk emerging to RBA growth and inflation forecasts -Housing activity seen peaking, developers become cautious and credit tightens -Uncertainties underpinning gold but upside limited -US dollar strength likely to ebb after March quarter -Supply side factors to drive commodity prices in 2017

Consumer Price Index

Inflation is uncomfortably low. This is the message brokers take from the December quarter CPI. The trimmed mean CPI rose by just 0.4%, taking the core inflation rate for the end of the year to 1.6%. Headline CPI was also weak, rising by 0.5% and lifting to 1.5% for the year 2016. Fresh produce posted inflation of 5.6% in the quarter while packaged groceries posted deflation of -1.1%. Pricing power remains weak as consumers continue to experience a squeeze in cost of living.

Inflation is below the Reserve Bank's target band of 2-3% per annum across the cycle. The RBA appears prepared for a prolonged under-shooting of its target. Credit Suisse envisages downside risk emerging to the RBA's forecasts in coming quarters. The broker expects the RBA to downgrade official growth forecasts and possibly tweak inflation forecasts to reflect downside risks. This is consistent with more rate cuts, the broker believes.

Morgan Stanley agrees that the RBA is likely to trim its growth forecasts in February. The broker considers Australian growth and fiscal policy are out of sync with developed market peers and, as a result, expects inflation to only gradually recover to the low end of the target band. The broker expects the RBA will be patient with the below-target inflation rate, as strong dwelling price growth continues in Sydney and Melbourne.

Deutsche Bank expects the cash rate to be unchanged at the February board meeting and does not expect revisions to the central bank's broader view on inflation in the following Statement on Monetary Policy. The broker finds few reasons for core inflation in Australia to lift in coming quarters, given the Australian dollar trade weighted index is higher than a year ago and also because wages growth continues to either make new lows or run near record low levels.

The data, plus the broker's supermarket index, indicate that Wesfarmers ((WES)) and Woolworths ((WOW)) are continuing to drive weaker prices through investment, particularly in packaged groceries. On balance, Deutsche Bank expects the RBA to ease the cash rate this year, with the risk around May in terms of timing.

Macquarie notes Australia's inflation outlook is in stark contrast to that of the US, where a tight labour market has meant wages have grown, housing rents are rising. The divergence is likely to persist into 2017 and reinforces the broker's outlook for monetary policies to diverge. The trimmed mean was in line with Macquarie's forecasts, which has diminished expectations for a reduction to official rates in February.

The broker expects the RBA will deliver two additional rate reductions in 2017, with May and August being the key months, while a shift in either the Australian dollar or fiscal policy could alleviate the need for further rate cuts.

UBS notes the 0.5% gain in the quarter shows a clear rebound from inflation in the first half of 2016, only in part because of volatile fruit, petrol & tobacco prices. With an improvement in the economy's macro drivers and fading headwinds across commodities, UBS believes the RBA could be on hold for an extended period and argues against any need to lift rates before mid 2018. Citi also does not expect to receive further weakness in yearly prints on the CPI.

Moreover, the first quarter result in 2017 should be boosted by the fall in the CPI in the corresponding first quarter in 2016, and beyond that even a continuation of soft quarterly growth - at around 0.5% - should be enough to keep headline inflation above the bottom of the target band for most of 2017.

Still, given the economic inertia and low inflation expectations, the broker acknowledges a risk that its forecast of a pick up in inflation to 2% by mid year may not be reached. Citi, therefore, believes any move to price in a partial rate hike by the end of the year is premature.

Housing

Housing activity is now peaking, UBS observes, with housing commencements falling in the September quarter to the lowest level since 2014. The broker believes a multi-decade low in the commencements-to-approvals ratio for multi-unit dwellings suggests developers have become cautious and/or credit has tightened. While a correction is expected, the broker still believes a soft landing will ensue and a typical cycle is now underway.

UBS expects around a -30% peak-to-trough drop in commencements, similar to prior cycles, and that it should not get much worse. Meanwhile, house prices keep rising faster than income, as the RBA's official rate cuts in mid-2016 helped lift loan demand and pushed auction clearance rates to a record high. While the broker expects both commencements and activity to turn down sharply until the end of 2018 the lack of official rate hikes reduces the likelihood this downturn in housing activity will evolve into a crash.

Gold

The yellow metal continues to find support from safe-haven buying along with some near-term weakness in the US dollar. Yet ANZ Bank analysts suggest weakness in the physical market and rising interest rates should keep upside limited in the near term. The economic policy uncertainty emanating from the UK's prospective exit from the EU and President Trump's trade policies should continue to attract investor demand for gold.

This is unlikely to be enough to negate the headwind from increasing interest rates in the US. As a US Federal Reserve becomes more hawkish, the analysts expect US 10-year yields to push towards 3% in 2017. Hence, gold prices are expected to trade in a tight range of US$1200-1240/oz over the next couple of quarters.

US dollar

CIBC analysts believe the US dollar has one more bout of strength available but after the first quarter the currency will underperform as, in the absence of aggressive trade restrictions or greater-than-expected fiscal easing, it should depreciate against a number of major currencies.

The analysts note the surge in the US dollar post the election of Donald Trump has transformed into a sideways trend over the past month. They believe President Trump's protectionist stance will square off against his desire for a weaker currency and, given that the two are incompatible, something will have to give.

At this point, the analysts suggest the more aggressive US rhetoric on trade policy is unlikely to become a reality while fiscal policy is not shaping up to be a major boon for the economy, as more conservative members of Congress are expected to keep a lid on the deficit. As long as Twitter remains the favourite medium for comments on protectionism, and fiscal easing is offset by spending restraint, the analysts look for the US dollar strength to ebb from the March quarter.

Commodities

Commonwealth Bank analysts expect supply-side factors to drive commodity prices this year. Demand should ease as Chinese property construction slows. Prices should also decline as the hype fades surrounding Donald Trump's infrastructure spending plans. The analysts make notable changes to forecasts, including an upgrade to thermal coal prices, as China is targeting a domestic price of around US$65/t. Forecasts for gold are downgraded as markets price in multiple increases in the US Fed Funds rate.

Overall, the analysts consider the picture mixed, as only a mild contraction in Chinese construction activity is forecast. Analysis suggests that nickel and thermal coal prices are exposed to upside risks if global demand surprises on the upside, while China's steel and aluminium sectors are the most vulnerable to supply cuts.

The analysts note producer margins across most commodities currently signal deficit conditions. In some, such as iron ore and traded coal, nearly all suppliers are making cash profits. The analysts suspect a normalisation of margins would imply an end to these deficit conditions at the very least. The analysts expect commodity producer margins to decline throughout 2017 and normalise next year.

They observe there is still a great reluctance among producers to deploy risky capital, as suppliers are cautious about the outlook for the Chinese economy, which accounts for 40-60% of demand for most major mining commodities. While it is hard to call Chinese stimulus and producer reluctance to add supply temporary factors, they are acting to keep margins at elevated levels.

The analysts argue that, a producer's strategy to keep production stable and enjoy higher margins is fundamentally sound if most other producers are doing the same. As a result, a normalisation of margins will be driven by easing demand, an outcome that is dependent on slower Chinese consumption.

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Potential To Boost Farm Animal Yields

Anatara Lifesciences will soon offer a treatment for meat animals such as cattle and pigs, designed to reduce gastrointestinal disorders and increase meat yield.

-potential solution to significant problem of antibiotic resistance -global demand for meat expected to grow significantly -potential human applications in IBD and IBS

By Eva Brocklehurst

Anatara Lifesciences ((ANR)) will soon be offering its first product to the market -- Detach -- a treatment for production animals such as cattle and pigs, designed to reduce gastrointestinal disorders and increase meat yield. The company filed for Australian approval of the product in October and expects to be selling it commercially to pig farmers in 2017.

NDF Research envisages significant upside for the company with an option granted last year to the animal health company Zoetis over a worldwide licence for Detach. The product's mechanism does not involve killing the pathogens directly, which makes it a potential solution to the significant emerging problem of antibiotic resistance.

The company is looking at human applications for Detach, including inflammatory bowel disease (IBD) and irritable bowel syndrome (IBS), that are in need of new anti-inflammatory approaches. NDF Research values Anatara at $2.22 as its base case and $5.94 as an optimistic case, using a discounted cash flow approach. The price target of $4.00 is around the midpoint of the valuation range.

How does the drug work? It uses a natural product called bromelain by harnessing the notable anti-infective properties of the substance. This is a protein digesting enzyme which is obtained from the fruit or stem of pineapples. Researchers over the years have identified numerous potential therapeutic applications in conditions as diverse as osteoarthritis, angina and even cancer.

One of the product specific, anti-infective properties arises from its ability to prevent the attachment of pathogenic gut bacteria to various receptors located on the intestinal mucosa. When unable to attach to these receptors such bacteria are rendered harmless and, as bromelain does not kill the offending bacteria, there is no opportunity for drug resistant strains to emerge.

Detach is a patented formulation of bromelain protease and, while NDF Research acknowledges this is far from novel, since the early 1990s no other company has advanced the use of bromelain in animal health in a serious way, so Anatara is considered a leader in the field.

Why this product interests cattle and pig producers is that it cuts the level of mortality and antibiotic use, which has demonstrable economic benefits. A field trial has signalled this product could lower the incidence of scour in post-weaning pigs by 40% as well as increase weight gain, while reducing antibiotic use.

Given global demand for meat is expected to grow significantly the over the next two decades, producers of cattle and pigs are expected to seek new tools to lower the rate of infectious diseases which do not involve antibiotics. Detach represents one such tool, NDF Research believes.

Anatara also envisages potential for partnering discussions around various human indications in 2017. The prevalence of IBD and IBS suggest a significant pay-off for the company should Detach be found to have utility in such a setting. NDF Research notes big pharmaceutical companies are seriously interested in treatments for IBD, a serious chronic inflammation of all or part of the digestive tract which is characterised by severe diarrhoea, pain, fatigue and weight loss.

The company is fully funded through to its first revenues, having raised $9m in a placement at $0.78 per share in July 2015. NDF Research believes the stock is undervalued on its numbers and expects Anatara to be re-rated by the market as further data emerges on the utility of Detach in pig farming and the deadlines for first regulatory approvals approach.

The researcher also notes that when Anatara Lifesciences listed on the ASX in October 2014, it was the third public company to have been involved in the development of bromelain as an anti-infective in animal health. NDF Research believes perseverance and investment in the project through all three companies by the developer, Tracey Mynott, should bode well for an eventual commercial pay-off for shareholders.

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ASX200: Nervous Times

By Craig Parker, asset manager, Moat Capital

As mentioned last week, caution was on the short-term agenda and the question now is whether we have seen the end of the counter trend. I did mention last week that I would like to see our market move further down, possibly between the 5500-5600 levels which would be a good technical level to kick off back into the overall uptrend. We are also a little way off getting back to the 60-day moving average on the daily chart below. Not that this necessarily means the recent move down will hit the 60-day average as it could be the next move down whilst the 60-day average is catching up to the market.

If you look at the monthly chart there is a clear Bullish moving average crossover and the MACD and RSI are in the mid-range so not oversold or overbought. This is a good technical sign for the medium to long term outlook. The US market (S&P 500) had a little jump on Friday although we will get a better indication going into this week. The S&P 500 still hasn't broken up through its 2-month trading range. Our market will be watching for a breakout up through this range or further resistance resulting in a move down. The S&P/ASX 200 VIX below has some room to move up to the downtrend line which would mean some downside for our market in the short term. Overall our market from a technical perspective is still looking a little nervous in the short term and remains positive over the medium and long term.

ASX200 daily

ASX200 monthly

S&P500 daily

ASX200 VIX

Authorised Representative Sentinel Private Wealth AFSL 344762

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