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Stories To Read From FNArena
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FNArena
Financial News, Data & Analysis

GPO Box 3145
Sydney NSW 2001

info@fnarena.com

Your editor
Rudi Filapek-Vandyck

Your dedicated team of journo's
Greg Peel
Eva Brocklehurst

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Nearmap Advancing On North America

The realisation that Nearmap will accelerate its investment in growth in FY20 and FY21 has provoked some negative revisions to forecasts. Yet brokers are confident in the outlook.

-Current weakness in stock price considered a buying opportunity -Breaking even on cash flow in FY19 -Expanding into a multi-product operator in location intelligence

By Eva Brocklehurst

Map imaging company Nearmap ((NEA)) is at the front line of an advance on its North American opportunity, yet its market update produced a negative reaction in the stock. Brokers attribute this to several factors, including the realisation that Nearmap will accelerate its investment in growth during FY20 and FY21, which has likely led to negative earnings revisions.

Monetisation of new products and markets provide upside potential and brokers agree the company is in a strong capital position. The company has guided to North American annualised contract value (ACV) of US$22.7m and Australasian ACV of $57.9m, up 19%. Nearmap will report its FY19 results on August 21.

Canaccord Genuity notes exceptionally strong unit economics. Business conditions in Australia have undoubtedly weakened through the second half, however the broker suspects growth was derived from reduced churn and up-selling products, as well as new customer additions.

Following the enhanced investment in growth initiatives, Canaccord Genuity revises up FY20 and FY21 forecasts for ACV by 4% and 10%, respectively, primarily on the back of US growth. This in turn reduces like-for-like FY20 and FY21 estimates for operating earnings (EBITDA) by -45% and -35%, respectively.

Citi reiterates a Buy rating, assessing the current weakness in the stock price as a buying opportunity. Macquarie agrees with this assessment, and considers the FY19 outcome, slightly lighter than expected, is fully reflected in the share price.

The company has furnished its preliminary FY19 numbers but, with only high-level insights, Citi does not know for sure whether volume or price was the primary driver of growth. Assuming gross margins remain flat, this implies churn has continued to fall. The company is intent on capitalising its position in the US, planning a second US office in New York.

In anticipation of ongoing expenditure, Citi lifts FY20 estimates for sales and marketing expenses growth to 50%. This may dampen earnings in the short term but the company will be intent on converting that investment into earnings as quickly as possible, in the broker's view.

Cash flow break-even was achieved in FY19 and year-end cash was $76m. As the company swings from profit to loss in FY20, Citi factors in much stronger investment in the US market.

Nearmap has completed its first capture program in Canada, covering 62% of the population and pre-commitments have been received from existing customers, expected to produce sales in the first half of FY20. Production content expansion has continued, including the launch of 3D online and beta artificial intelligence "Insights".

Accounting Changes

An increase in growth investment and its impact on earnings has been exacerbated by the company shifting to a more conservative accounting policy. Nearmap has re-assessed the amortisation period for capture costs. This is been reduced to two years from five years, in light of the growing need for the most recent imagery, as the company evolves from a single-product aerial imaging business to a multi-product operator in the location intelligence market.

Morgan Stanley notes the more conservative accounting and suspects it may have some impact on the profit & loss statement but, when assessing the company on a cash flow basis, this has no impact on cash earnings estimates. Macquarie assesses customers continue to derive benefits from a large and growing library of historical content and this differentiates the business from its competitors.

While the stock has, historically, been volatile, Canaccord Genuity points out that capital deployed has been highly accretive to shareholders over the medium term. The broker, not one of the seven monitored daily on the FNArena database, maintains a Buy rating and a $3.50 target. The database has three Buy ratings. The consensus target is $4.25, signalling 27.2% upside to the last share price.

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Improving Outlook For Oz Housing Prices, BIS Oxford

BIS Oxford Economics sees prices for houses and apartments stabilising, then rising in the years ahead. The forecasters provide projections for housing prices across Australia's major cities and regions.

By Greg Peel

Sydney

BIS Oxford Economics estimates Sydney house prices fell -18% in the two years to June 2019. The pullback has improved housing affordability, and the easing of credit conditions – two RBA cuts and a reduction in APRA's mortgage serviceability threshold – should lead to price growth stability through FY20.

Not to mention the threat of negative gearing being scrapped now past.

However the pipeline for dwelling completions will remain relatively high in FY20, BIS notes, which will dampen price growth. The economists forecast a 6% rise in the median house price to June 2022.

Investor demand remains constrained by tighter credit conditions, and new housing supply is concentrated in the apartment sector, hence BIS sees apartment prices rises only 1% in the same period. Supply will nonetheless fall away sharply from FY21, hence price growth should accelerate beyond this time.

We might also note that by FY21, there may be few new apartment blocks left uncondemned.

Newcastle/Wollongong

The NSW government's stamp duty exemption for first home buyers did little to support entry into the Sydney market, given a cap of $700,000 of property value. The satellite cities of Newcastle and Wollongong nevertheless benefited, BIS notes.

Prices in each centre did not rise by as much as those in Sydney and as such have not fallen as sharply. Of the two, Wollongong is closer to Sydney and thus more influenced by Sydney pricing, hence BIS forecasts a 5% price rise to June 2022.

Greater affordability in Newcastle should lead a 9% price increase.

Melbourne

Melbourne house prices have followed Sydney's down in falling -15% from the December 2017 peak. And like Sydney, Melbourne will remain constrained by the level of new supply over FY20 before an FY21 supply drop-off provides a price boost.

BIS forecasts a 7% gain for Melbourne house prices to June 2022 and, like Sydney, only 4% for apartments.

Brisbane

Brisbane has been hit not only by a surfeit of supply but also by a weak Queensland economy, however this means prices in Brisbane remain comparatively affordable. To that end, BIS sees lower rates and easier credit conditions as providing a boost as the economy improves and the market moves into an increasing deficit.

The economists forecast a 20% price rise to June 2022 for Brisbane, mostly concentrated in latter part of the period. Apartment prices are expected to lag, rising 14%.

Regional Queensland

The Gold Coast and Sunshine Coast have seen solid price rises as strong migration flows have met undersupply. Vacancy rates are low but supply is now rising, BIS notes. This will drag on prices.

BIS forecasts a 9% price rise on the Gold Coast to June 2022 and 7% for the Sunshine Coast.

Further north, the collapse in mining investment has weighed on Townsville house prices. Investment has now troughed, nonetheless, and vacancy rates are beginning to tighten. This should lead to rising prices.

BIS forecasts 9% to June 2022.

Cairns is not exposed to the mining sector and has enjoyed moderate house price growth in recent years. To June 2022, the economists forecast 6%.

Adelaide

Strong South Australian economic growth has met undersupply in Adelaide, leading to modest house price growth. Affordability remains attractive and should improve on lower rates and easier conditions.

BIS forecasts house price growth of 11% in Adelaide to June 2022 and 6% for apartments.

Perth

The downturn in mining investment has led to an extended house price downturn in Perth of -27% from the March 2007 peak. Affordability has improved significantly but the Western Australian economy remains weak, there is excess supply and population growth is tepid.

BIS sees no near term improvement ahead of FY21, as the economy finally picks up and excess supply is absorbed. A house price rise to June 2022 of 7% is forecast, and given undersupply, an 8% rise for apartments.

Canberra

House price growth in the capital has been muted since FY18 due to record apartment supply, a looming federal election, and the NSW stamp duty exemption luring buyers across the border.

Now that the election has been run and won, and the ACT plans to introduce its own stamp duty exemption, some price growth is expected to return.

BIS sees a 10% increase for both houses and apartments to June 2022, weighted toward the latter end of the period.

Hobart

Surging prices in Sydney and Melbourne have sparked an exodus south in recent years, in search of a quieter lifestyle and more affordable housing. However, demand has pushed prices up 36% since June 2018.

So now affordability is more challenging, and hence the exodus is expected to slow. BIS forecasts 4% price rises for both houses and apartments to June 2022.

Darwin

Worst hit by the downturn in resource sector investment has been Darwin, leading to high unemployment, low migration and population growth, and a house price decline since FY15.

The market is in oversupply and vacancy rates are high, making the city very affordable. However, without a strong turnaround in the economy and improvement in the demand/supply balance, BIS expects only modest house price growth.

The economists forecast 7% for houses and 8% for apartments out to June 2022.

More Dividends Likely From Whitehaven Coal

Brokers look forward to more stable operating conditions for Whitehaven Coal in FY20 and expect higher dividends are likely until the company's growth projects require the cash.

-Strong performance at Narrabri expected to alleviate concerns going forward -Macquarie assesses scope for special dividend, pay-out above policy -Share price implies overly bearish outlook for coal prices, Morgans suggests

By Eva Brocklehurst

Whitehaven Coal ((WHC)) finished FY19 with robust production outcomes and brokers look forward to the dividend announcement in the FY19 result. There were operating challenges that affected FY19 and expectations for FY20 centre on more stable operations.

Morgan Stanley believes the FY19 production results are positive and there is good value in the stock at current levels while Credit Suisse observes no material disappointments with production, noting dividends are likely to be paid out above the policy range until growth projects demand the cash.

Management has indicated that projects are likely to be sequential in nature and can be managed within current facilities. Yet Shaw and Partners asserts this overlooks a conundrum: should excess cash be distributed to shareholders or retained for future growth?

The company has built up a large coal inventory as run-off-mine production was ahead of saleable coal production in FY19. An inventory of 3.4mt is expected to unwind over the first half of FY20.

The main positive for Shaw and Partners was better coal prices but this was countered by a miss on saleable production and sales. The broker believes, with a couple of the smaller/maturing mines depleting soon, core assets need to deliver less volatile production.

While Shaw and Partners likes the assets and the valuation uplift since the low in early 2016, headwinds to coal prices, issues with operations and delays to growth projects mean it has been "short" for some time.

The -40% retracement in the share price from its mid 2018 highs has been noted yet the broker, not one of the seven stockbrokers monitored daily on the FNArena database, retains a Sell rating with a target of $2.99.

The strong performance from Narrabri should alleviate investor concerns, Wilsons suggests. The broker believes the market will like the fact that Narrabri production was well above guidance (5.6-6.0mt) for FY19 at 6.4mt. Wilsons, also not one of the seven, has a Buy rating and $5.20 target.

A reassessment of Vickery's projected timeline, while disappointing, signals to UBS that any delay to construction should mean the dividend pay-out ratio remains above the stated 20-50% of earnings. Despite the higher pay-out the broker still expects the company to reduce debt through FY20.

Dividend

UBS is forecasting a record profit, with FY19 net profit of $530m, up 1%. The broker suspects Whitehaven Coal disappointed investors at the interim result, as the dividend was lower than expected. This is likely, therefore, to be made up at the full year result.

The company now expects to make a decision on Vickery in early 2020, as opposed to the end of 2019, and South Winchester resource estimates are expected later this year. Credit Suisse assumes a $0.23 dividend in August, a 100% pay-out of second half earnings.

Given the delay at Vickery and strong free cash flow Macquarie believes there is scope for a special dividend. The broker forecasts a final dividend of $0.27, which includes $0.12 as a base and $0.15 as a special. The production outlook for FY21 and FY22 is flatter, resulting in a -2% and -4% reduction to estimates, respectively.

Prior production issues at Maules Creek and Narrabri appear to be under control yet Morgans suspects there may be upside risks to costs in the second half, because of lower saleable production.

Price Outlook

The outlook for thermal coal is weak. In the June quarter realised thermal coal prices were US$84/t. Tepid demand, poor producer discipline in some fuel switching into gas are affecting the price. Thermal coal prices, ex Newcastle, have corrected by around -40% from peak above US$120/t in mid 2018. Prices are now driving marginal tonnage out of the market and Morgans assesses spot pricing is heading towards US$80/t.

The impact to the broker's estimates and valuation from pricing is partially offset by lower assumptions for the Australian dollar. However, the company share price implies a flat coal price of US$75/t in perpetuity and no value to either Vickery or Winchester. This appears overly bearish, Morgans asserts.The stock needs a coal price catalyst as the physical market is sluggish and the broker suggests this provides an accumulation opportunity for patient investors.

Credit Suisse assesses capital management in August and the pricing of thermal coal are the near-term drivers of the stock. The challenge for holders of the stock, as well as management, the broker asserts, is whether the equity market will continue to discount pure-play coal exposures, despite strong free cash flow yields and balance sheets.

Metallurgical (coking) coal realised prices were well ahead of UBS estimates, at US$107/t in the June quarter, supported by the Maules Creek premium and helping to offset lower sales volumes. Yet, relatively weak price realisations for metallurgical coal highlight the constraints in pushing additional volume into a small market, in Citi's view.

Metallurgical coal production at Maules Creek in FY19 represented 25% of output but was just 17% in the June quarter. Maules Creek thermal coal obtains a fixed US dollar premium for low ash so, as Citi points out, when coal prices are lower the percentage premium is higher. In contrast, Narrabri thermal coal was sold at a discount in the quarter, reflecting its higher ash content and given earlier mining difficulties.

There are seven Buy ratings on FNArena's database. The consensus target is $4.83, signalling 26.5% upside to the last share price. The dividend yield on FY19 forecasts 10.6% and on FY20 is 6.5%.

Capital Crisis For AMP

Selling its life business was critical to rebuilding AMP and, with the RBNZ finding fault with the Resolution Life deal, the company's problems are compounded.

-First half dividend scrapped and capital now seen constrained -A significant reduction in valuation expected if the deal is resurrected -Significant changes required to stabilise cost base and rebuild advice

By Eva Brocklehurst

Wealth manager AMP ((AMP)) is between the devil and the deep blue sea, as the sale of its life business to Resolution Life is now highly unlikely to proceed. This has led to the scrapping of the company's first half dividend.

The Reserve Bank of New Zealand has signalled the current terms of the sale agreement are unlikely to be approved which implies, while AMP is trying to find a way to make the transaction work, revised terms are likely to be worse. So, in the end, the life business may be retained.

Selling the life business was critical to rebuilding the company and Morgan Stanley notes three critical issues needed to be resolved to stabilise the platform. Clients must be recompensed for inappropriate advice and fees charged over the last 10 years, planner productivity issues must be addressed and separation of the life business must be successfully executed.

To salvage a sale, new terms need to be renegotiated, likely on less favourable terms for AMP. Morgan Stanley notes industry data reveals the Australian disability income market has deteriorated significantly over the past year and downgrades the company's FY20/21 life earnings by over -50%.

Any future deal is likely to be affected by valuation assumptions after changes to the Protecting Your Super legislation. Bell Potter suggests Resolution Life has been delivered a "get out of jail free card" as the valuation of the life business has significantly deteriorated in the year since the deal was announced.

The main impact that AMP has flagged is a deterioration in value of -$700m, comprised of a deterioration in best estimate assumptions of -$400m and the requirements of Protecting Your Super legislation of -$300m. This is coupled with the -$100m, Bell Potter points out, that AMP has spent separating its life and mature businesses.

Shaw and Partners believes it reasonable to conclude that the life business is on track to earn very little profit in 2019, just as it did in 2018. If the sale is rekindled on terms that are likely to be at least -$700m inferior then the cash return to AMP on sale may be less than zero, reflecting the loss in value. The broker, not one of the seven monitored daily on the database, has a $1.50 target and a Sell rating.

No Interim Dividend/Capital Constrained

Ord Minnett always believed the original deal was poor value for AMP shareholders, even taking into account expected legislative changes and claims deterioration. So, while winding back the sale may be positive for shareholders and earnings, it would leave the company constrained on capital and in need of investment.

Retention of the life business would require substantial investment in technology and, while the company may avoid a capital raising by scrapping its dividend, the outlook has not improved. Other brokers suggest meaningful changes in provisions may result in the need for an equity raising. For now, Bell Potter includes a further $250m provision in the accounts.

Bell Potter, not one of the seven stockbrokers monitored daily on the FNArena database, believes confidence in the forward estimates for AMP is significantly diminished by the lack of information, which it hopes will become clearer when the company reports on August 8. Following the asset write-downs the broker reduces the target to $1.45 and retains a Sell rating.

Citi agrees there is little transparency on the earnings impact of the collapse of the sale, also noting the company's statement that cumulative earnings/losses of the businesses for sale are "not substantial". The broker also questions whether the removal of any interim dividend provides sufficient capital to meet the company's target surplus.

Citi had presumed AMP would use most of the sale proceeds to fund the transition of its advice model, which require substantial capital over time. AMP has, therefore, been left with a stark choice of either delaying the implementation of its strategy or coming to the market to raise capital. Macquarie expects AMP to increase its advice remediation provisions, which could be the catalyst for such a capital raising.

Revised Deal Or No Deal

AMP may be in discussions in an attempt to resurrect some kind of deal but Citi strongly suspects a significant reduction in the previously proposed $3.3bn purchase price is likely. Resolution Life also appears to be the only bidder, seemingly putting it in a strong negotiating position.

Should revised terms be agreed, Macquarie would also expect a material reduction in the previously agreed consideration. Assessing legislative changes and reduced assumptions, combined with a higher capital cost of ring-fencing assets in New Zealand, the broker calculates consideration closer to $2bn. This would negate any potential capital return that had been flagged following completion of the sale.

In terms of the option to retain the life business, managing it in run-off would entail significant management distraction and UBS agrees that this could curtail the company's strategic agenda. The broker believes weighing up whether AMP is better off retaining life, rather than exploring revised terms with Resolution Life, should be balanced against delaying the transformation in the wealth business.

UBS asserts it will take one-two years to restore stability of AMP and the numerous risks and challenges cannot be quantified. Morgan Stanley agrees the company needs to stabilise the cost base and rebuild its advice proposition, while quantum of change required is significant, simply to maintain the status quo.

FNArena's database shows five Hold ratings and two Sell. The consensus target is $1.97, signalling 8.3% upside to the last share price. This compares with $2.10 ahead of the announcement. Targets range from $1.50 (Morgan Stanley) to $2.35 (Credit Suisse, yet to comment on the update). The dividend yield on 2019 forecasts is 3.0% and for 2020 forecasts, 7.5%.

Oil Search Vulnerable To Delays In PNG

Oil Search is facing a nervous wait as the PNG government reviews the fiscal terms of the PNG LNG agreement.

-P'nyang gas agreement to be negotiated once government review completed -Critical items need to be de-risked before stock can re-rate -Timing critical in a competitive marketing environment

By Eva Brocklehurst

The PNG government has thrown a spanner in the works for Oil Search ((OSH)), creating uncertainty in an environment in which delays could be critical in obtaining the necessary capital to forge ahead with expansion plans.

The PNG government will review the fiscal terms of the PNG LNG agreement, signed back in April 2019, which may lead to more onerous fiscal terms. The new minister for petroleum has indicated the government is not looking to revoke the agreement, unless there is fraud or non-compliance.

Once this review is completed the P'nyang gas agreement will be negotiated. Morgan Stanley points out a P'nyang agreement is required to underpin the train-3 expansion and will also drive the timing for the Papua LNG project, given the integrated nature of the two projects. The company has confirmed that both agreements are prerequisites for downstream front end engineering design (FEED) entry.

Oil Search remains confident in the fiscal stability of PNG, Macquarie asserts, having provided briefings on the expansion of LNG projects to the new government during the June quarter. The broker continues to believe the market is overly cautious about PNG as it incorporates little value for the PNG LNG expansion and Papua LNG projects.

Uncertainty

2019 production guidance has been revised down marginally to 28-31 mmboe, which relates to the company's operated assets. Production costs guidance has been increased to reflect additional costs associated with earthquake-related damage.

2019 capital expenditure guidance is been revised down -8% to $555m at the mid point. This reflects revised timing for FEED entry for the PNG expansion and, UBS suspects, while the company continues to make progress on pre-FEED activity, there is a risk that PNG expansion could be delayed as other joint-venture partners allocate attention elsewhere.

While the current price looks attractive, the broker remains Neutral on the stock, given the uncertainty. Morgan Stanley agrees there are certain critical items that need to be de-risked before there is potential for a multi-year re-rating of the stock.

In this, timing is important, as there are a number of global LNG final investment decisions pending. The broker also cites concerns about the balance sheet, although has become incrementally more positive on Oil Search, given the de-rating versus peers over the last 1-2 years and the possibility that expansion plans become clearer in the next 3-6 months.

The best case scenario, Ord Minnett suggests, is a short delay in the project proceeding, while the worst-case scenario is where more onerous fiscal terms are imposed that test the viability of the project. Of most concern to the broker is the fact that these developments comes at a time when project returns are being tested by weak global LNG prices.

Prepared For Delays?

Credit Suisse suspects that, as an organisation, Oil Search has not been prepared for the era post the departure of former CEO Peter Botten. The broker suspects Oil Search may lack internal structures and processes to enforce disciplined decision pathways, as Peter Botten was far more central to its internal functioning compared with peers.

Hence, the company is going through internal changes at a critical point in PNG's political and project development and this presents a risk.

Credit Suisse does not rule out the new minister taking a tough approach to the review, given questions about the fair share of government tax take. Should the review of the PNG LNG agreement prove benign, the broker still envisages potential delays at P'nyang that could bear the brunt of political misgivings and, in turn, mean the site access agreements are re-negotiated.

Hence, a delay of around 6-9 months is a real risk and, if this eventuates, could mean the project is pushed back several years on the dictates of project sequencing and capacity limitations. Partner Santos ((STO)) may also seek to open up access agreement negotiations again for P'nyang, if the government extracts tougher terms, which could delay decisions further, Credit Suisse asserts.

Citi does not believe the review will result in a worse position for the JV. If the government needs to increase fiscal terms, for the optics of claiming more economic rent, then the P'nyang gas agreement provides a better path, as this has long-dated cash flows that won't affect the economics of expansion. Citi is more concerned about the timing, as delays are not helpful in a competitive marketing environment.

On another issue, Osaka Gas is reported to be pursuing arbitration with the PNG LNG JV over contractual price reviews, which Credit Suisse notes is the first time a Japanese operator has taken such a step. The broker suggests other buyers will watch this arbitration closely, maybe taking a view to piggy-backing on the result. Moreover, Oil Search may be the JV partner most exposed.

There are two Buy ratings on FNArena's database, with four Hold and one Sell (Credit Suisse). The consensus target is $8.13, signalling 16.6% upside to the last share price. Targets range from $6.96 (Credit Suisse) to $10.54 (Morgans, which has not updated since May and is a substantial outlier to the rest).

Headwinds Build For Insurers And Wealth Managers

As FY20 unfolds, falling global bond yields will produce headwinds for the general insurance sector while wealth managers could enjoy a short-term uplift to recurring revenue.

-Exposed cost bases, rising commissions place general insurer profitability at risk -Few products across Australian commercial insurance consistently profitable -Difficult to find many "buy" ideas across the diversified financial sector

By Eva Brocklehurst

The Australian general insurance sector's days in the sun are likely to be fading. At the upcoming reporting season attention will turn to FY20 and the global drop in bond yields, which represents an earnings headwind.

Wealth managers, on the other hand, could enjoy an uplift to recurring revenue. Brokers diverge somewhat in regard to which diversified financials will have greater leverage. Goldman Sachs expects underlying margin expansion will be evident for the insurance sector when companies report results in August.

Beyond this, risks to earnings are becoming more negative, as lower global and domestic interest rates will be difficult to price. Regulatory and compliance cost increases in the building industry will also be reducing efficiencies.

The broker notes multiples for Suncorp Group ((SUN)) and QBE Insurance ((QBE)) have begun to reflect these risks - Insurance Australia Group ((IAG)) less so - yet valuations are becoming stretched as the market continues to attribute high multiples to a shrinking number of defensive domestic financials.

Macquarie agrees there is limited scope for further multiple expansion after two quarters of supportive market conditions. Not only is gross written premium at risk for the major insurers but so is profitability, from an exposed cost base, rising broker commissions or lower loss ratios. Morgans also assesses the potential for a softer outlook looms large for FY20, amid the impact of falling bond yields.

UBS is more positive, believing there is still scope for premium rate momentum to drive general insurance underwriting margin expansion, and offset lower yields. QBE Insurance and Computershare ((CPU)) are considered most exposed to lower interest rates.

Citi also expects lower cash rates and lack of organic earnings growth in FY20 is likely to weigh on the stock. The broker remains upbeat on the medium-term prospects for both Suncorp Group and QBE Insurance.

Macquarie expects continued market share losses for Australian general insurers across their three most profitable products - home/motor/business pack - imposing further re-pricing pressure. Moreover, the only means likely to stem these losses is via cost cutting and launching low-cost outsourced models to compete with new entrants.

The broker's analysis identifies an underwriting cost base of 16.9% for the largest commercial insurers and new entrants are targeting 10% for this ratio, at much smaller scale. This could expose a $100m cost base for incumbent insurers, specifically business pack, in Macquarie's calculation.

New insurers are also prepared to offer higher broker commissions while running a lean outsourced underwriting expense base. Macquarie envisages continued consolidation of the distribution market and, thus, an increased chance of higher commission rates in coming years.

The broker concludes that very few products in the Australian commercial insurance market are consistently profitable and business pack is one of them, assessing there are $350m in earnings at risk in business pack over the next 3-5 years, particularly for Insurance Australia Group, Suncorp Group and QBE Insurance.

On the latter Morgans believes, while the first half catastrophe environment was generally benign, a difficult US crop insurance season creates risks for the second half of 2019. While the impact of falling bond yields is being exacerbated by other factors, Morgans retains Add ratings for both QBE Insurance and Suncorp Group. Link Administration ((LNK)) tops the broker's "buy" list.

Health Insurers

Morgans points out, while sector risks are tilted to the downside heading into reporting season, the exception is health insurers. Upside risks to the broker's call on nib Holdings ((NHF)) come primarily from continued low claims inflation and successful execution of the company's growth agenda in newer ancillary businesses.

Upside risk for Medibank Private ((MPL)) would stem from management delivering on better cost reductions or accelerating growth in market share gains.

Goldman Sachs expects the election outcome, while positive for the health insurers, will only provide limited reprieve for the outlook. Pressures on policy holder incomes and the mix of policy holders remain unchanged. Hence, holding margins in line will be difficult. The broker has downgraded nib Holdings to Sell as it is now at a peak valuation for the decade.

Buy Ideas

Currently, Goldman Sachs envisages upside to targets for only two names across the insurance sector, Suncorp and Challenger ((CGF)). For the latter, Citi suspects it may take a while for conditions to improve.

While market conditions were supportive in the June quarter, with market movements increasing funds under management by 1-8% across the sector, Magellan Financial ((MFG)) appears to be the only one achieving net inflows, Macquarie asserts. The broker has downgraded Magellan Financial to Underperform on valuation grounds.

UBS has also downgraded Magellan Financial to Sell, as current momentum appears over capitalised with the PE almost doubling in the year to date, despite maturing growth drivers.

Perpetual ((PPT)), at the other end of the scale, is experiencing the most material outflows. Citi is awaiting tangible evidence of progress at Perpetual, given the outflows, mixed investment performance and lack of traction in global equities.

Across the less capital-intensive wealth managers UBS believes equity-based managers will benefit the most, supporting its Buy rating on Janus Henderson ((JHG)). With the exception of Magellan Financial, Netwealth Group ((NWL)) and IOOF Holdings ((IFL)) the broker expects net outflows to persist across the sector.

Citi concludes diversified financials are a tough bunch when it comes to "buy" ideas. Quality stocks are expensive. The broker has no Buy ratings for the sector and, of its Neutral-rated stocks, retains a preference for Janus Henderson.

Industry data indicates retail fund outflows are easing, albeit still elevated, yet the overall investment performrmance appears reasonable. The company also has an ongoing buyback. Still, Citi acknowledges the stock remains hard to favour while outflows are so large.

Nickel Takes The Limelight, But Will It Last?

Nickel prices have surged recently but, as some brokers assess, fundamentals do not appear to be supporting the rally. Hence, a retracement is considered highly likely.

-Price exceeds economic rationale of even a moderate 2019 deficit -Trade signals are mixed for nickel, inventory not yet low enough to spark anxiety -Likely to be caused by a speculative shift in buying nickel

By Eva Brocklehurst

Brokers are underwhelmed by the jump in the nickel price, which has risen 23% since recent lows in June and is sitting at around a one-year high of US$6.54/lb. Momentum is expected to slow and prices moderate.

Citi points out that standing in the way of this rally too early would have been costly. Nickel has moved from discount to over a 10% premium to marginal producer costs, a level which far exceeds the economic rationale of even a moderate 2019 deficit in the metal.

UBS, too, does not believe the move has any fundamental backing, although nickel remains one of the broker's favoured commodities on a three-year view. Nickel is expected to US$8/lb in 2020, driven by a step-change in demand from electric vehicles, but the broker emphasises that demand from this source is not yet making a big impact.

Meanwhile, the stainless steel outlook, which drives two thirds of nickel demand, is mixed. In China, production of stainless steel is at record highs and so too is Chinese-backed Indonesian production. However, UBS points out, this appears to be displacing stainless steel production elsewhere. Stainless steel production in the rest of the world, which tends to procure higher grade nickel feed, is contracting.

Furthermore, China/Indonesian stainless steel appears well supplied by low-grade nickel units, which by itself is bearish for both the metal demand and the London Metal Exchange nickel price, UBS points out.

Last week, the Indonesian Ministry of Energy and Mineral Resources confirmed a ban on nickel ore exports from 2022. Citi struggles to believe that this is the sole cause of the rally as some are suggesting, as one statement is unlikely to convince the market that such a ban is set in stone two years hence.

Moreover, as learned in 2014, Chinese nickel pig iron output is unlikely to completely collapse if this were the case. At most it would temporary slow, but not derail, the pace of growth. As the cheapest and quickest nickel supply response, the broker suspects the ban is likely to merely relocate production to Indonesia.

Canaccord Genuity acknowledges new Indonesian supply will influence the outlook for the price over 2019 as Tsingshan, Delong and Jinchuan ramp up. The broker believes the lift in in nickel prices is reflecting recent supply disruptions from flooding in Indonesia, which provides 25% of global supply, combined with low stockpiles on the LME.

Mixed Signals

Yet, trade signals are mixed. Cancelled warrants, which can show whether consumers are resorting to the LME for physical nickel, are around 50,000 tpa and quite neutral, UBS highlights.

Another fundamental aspect that is not underpinning the price surge is the trend decline in inventory. UBS does not believe this is low enough to induce anxiety about oversupply. The steady decline does signal, nevertheless, the market has a small ongoing deficit, which is bullish for nickel and will matter in the next 1-2 years.

Furthermore, if electric vehicle demand suddenly stepped up, UBS would expect the nickel sulphate premium to lift. Instead it has contracted. Canaccord Genuity expects recent changes to Chinese electric vehicle policy are likely to reduce the assumed premium for sulphate.

As nickel is increasingly directed to growth segments, the broker likes those producers that have long life, low-cost sulphide projects and can drive value from exploiting downstream refining strategies.

This includes Independence Group ((IGO)), with its added exposure to gold, which remains the top pick over Western Areas ((WSA)). Canaccord Genuity notes CleanTeq ((CLQ)), a Class 1 developer, is likely to sell down up to 50% of its Sunrise project, aligning with a final investment decision by the December quarter of 2019.

Macquarie believes Western Areas has the most significant leverage to a rally in base metals. Nickel is currently trading 13% above the brokers first quarter FY20 estimates. Under a spot price scenario there is 38% and 59% upside, respectively, to the broker's operating earnings forecasts versus its base case for Western Areas and Panoramic Resources ((PAN)).

Speculative Shift

So, what is the cause of the rally? There just appears to be a speculative shift in buying nickel, Citi asserts and, if the fundamentals do not warrant a further price spike, then this might provide an attractive opportunity for volume sellers.

Both the Shanghai and London exchanges have experienced a lift in open interest and financial buying. Financial operators have sought 90,000t of nickel on the LME since mid June, which UBS agrees is a large shift in sentiment and may not be maintained in the short term if not backed by fundamentals.

Citi believes volumes and reduced tightness in LME spreads will be the best indicators the rally is turning. The broker recommends the LMESelect 3M for tracking the cleanest real-time subset of LME activity. Slowing volumes will signal that buying is fading, whereas high volumes and limited price moves would signal active resistance.

The broker is also of the view that tight LME spreads have not been shared by the Shanghai exchange. Given the more volatile Shanghai positions Citi is looking for fresh open interest falling as traders bank profits.

ESG Focus: NSW Modern Slavery Act Postponed, Part II

FNArena's dedicated ESG Focus news section zooms in on matters Environmental, Social & Governance (ESG) that are increasingly guiding investors preferences and decisions globally. For more news updates, past and future: https://www.fnarena.com/index.php/financial-news/daily-financial-news/category/esg-focus/

This is Part Two in a two-part story on the postponement of the NSW Modern Slavery Act, which provides a great platform to discuss one of the most emotive and interesting economic issues in environmental, social and governance investing today, and its ramifications for investors and corporations.

Accounting for slavery in a supply chain is an extremely difficult task, but the world is increasingly focused on addressing the problem The current target is to remove slavery from the supply chain by 2030 Most companies in Australia will not have to report on their efforts to eradicate slavery until the second half of 2020 By Sarah Mills

Baby steps in the first instance.

It is not surprising that the NSW legislation has been delayed. While the government cited inconsistencies with Federal legislation as one of the causes for the delay, the fact that it was pecuniary and compliance difficult would have made its implementation a nightmare for businesses.

Accounting for slavery in a supply chain is an extremely difficult task, and even those companies with extremely deep pockets would be sorely tested to be able to confidently comply with the legislation within the allocated time frame.

However, its simple passing was a flag to businesses of the kind of enforcement to come: enforcement that may include rising fines and possibly criminal sentences if necessary to achieve the end result.

Already, the Law Council and Antislavery Australia Labor and Greens are pushing for penalties and suggest it should be made a crime to fail to prevent slavery in supply chains. This sentiment is echoed globally.

If history is any guide, it would be naïve to doubt the conviction of those driving the modern anti-slavery charge. One only has to recall the American Civil War to sense the steely resolve that can be brought to bear in this issue.

The target is to remove slavery from the supply chain by 2030.

After being given a free reign for nearly three decades, corporations have received notice that they can no longer disregard the social impact of their operations.

Global movement

While essentially a toothless tiger, the Federal Modern Slavery Act represents the first step towards ensuring Australia's compliance within the global context.

Much of the Act is taken from the British Act, which was implemented in 2015, and is part of a widening global net to improve social stability.

California's Transparency in Supply Chains Act of 2010 took affect in 2012 and several bills are being pushed onto the Washington senate – the first, dealing with agricultural goods, was knocked back earlier this year. Canada is reported to be poised to follow California's suit.

Human trafficking and slavery is illegal in most western democracies and is becoming increasingly linked to forced labour (as opposed to sexual slavery).

Back to Australia

Anti-slavery efforts are nascent. The British bill, introduced in 2015, has gained little traction with four out of five companies failing to comply. Many fear this will be the case in Australia, now that the more pecuniary NSW law has been postponed indefinitely.

Under the legislation, companies will have to report to the government on the steps they have taken to deal with slavery in their supply chains. The reports will be kept on the Modern Slavery Registry.

Most companies will not have to report until the second half of 2020.

The reports must:

Identify the reporting entity Describe: the structure, operations and supply chains of the entity; the risk of modern slavery practices in the operations of the entity and any entities it owns or controls; the actions that the entity and any entities it owns or controls have taken to assess and address the risks identified including due diligence and remediation processes; how the entity assesses the effectiveness of those actions; the consultation process with any entities the entity owns or controls; and Include any other information that the entity considers relevant. Australia is considered particularly vulnerable given two thirds of the world's slavery occurs in the Asia Pacific.

Fortescue Metals' Andrew Forrest, a leading proponent of the Modern Slavery Bill says slavery is endemic in Australia's supply chains.

Direct slavery exists in Australia today, largely on construction sites, in agriculture, in the food and beverage industry, and the sex industry. It is poorly prosecuted, partly because of the fear of the victims but also due to the lack of criminal enforcement focus.

ESG

From an ESG perspective, investor pressure is expected to be brought to bear on corporations to ensure information from these reports are included in annual general reports.

A quick glance at Macquarie Group's 2019 annual report shows that while many pages were devoted to ESG, slavery didn't rate a mention, pointing to the sensitive nature of the issue as well as the difficulties in tracking this information. No one is jumping the gun.

Generally speaking, only those that are already reporting on the issue in Britain, such as Rio Tinto and BHP Group, and those who have already suffered a scandal such as Qantas, are issuing early statements.

While much of the environmental, social and governance (ESG) investment focus has, to date, been on the E – the environment – the Act is a reminder of the quiet but growing focus on the social consequences of corporate activity, and the growing sense that corporations must earn a social licence to operate.

As with all ESG investing, there will be winners and losers. Those with deeper pockets can generally pay more to track supply chains. In this sense, reporting can create a barrier to entry and favours the strongest and most efficient organisations. Those with single direct suppliers as opposed to complex chains will also be at an advantage.

Increasingly, a poor track record in this respect may prove a flag to investors of a company's instability as an investment – a suggestion that they are incapable of competing at minimum wage level, have weak reserves and are on unsturdy capital footing. In a post-ESG world, capital is king.

Given the emotion and potential reputational damage associated with slavery, there will be an initial advantage to being a reporting laggard but that is likely to change as the anti rises. Once much of the environmental issues, particularly around coal and plastics, are dealt with, ESG investor sights will turn more fully to social issues – in about five years time.

The Australian Council of Superannuation Investors's CEO Louise Davidson says investor pressure will be brought to bear.

"Minimal or legalistic compliance (to the new legislation) is unlikely to yield change. I anticipate that investors will need to apply pressure to ensure meaningful reporting," says Davidson.

As with all ESG developments, slavery comes with its own suite of advisers and lawyers to assist both corporations and investors.

The Human Rights Due Diligence in supply chains project (HRDD) is helping map a path in this area to create a legal and regulatory framework, to help with the identification of human rights impacts, identifying avenues for mitigation, and tracking and monitoring software and processes.

Considerable time and money will be needed to map supply chains, engage stakeholders and human rights experts, and develop: human rights impact statements, supplier onboarding processes, codes of conduct, contractual protections, training, grievance mechanisms, remediation and termination protocols, reviews and investigations, third party vetting, a local presence, transparency, reporting, and internal legal expertise.

Sectors that are most vulnerable to slavery

The Australian Council of Superannuation Investors (ACSI) published a report earlier this year titled Modern Slavery, Risks, Rights and Responsibilities – a guide for companies and investors.

The report examines Australia's corporate landscape and aims to prepare Australian businesses to meet new regulations for public disclosure and to understand the risks in their operations.

"Somewhere in the supply chain of most business, forced labour or related practices are present," says ACSI CEO Louise Davidson. "Eradicating slavery is a mainstream corporate responsibility. Every industry is exposed, and every company has a responsibility to act. The new law sends a clear message that Australian businesses must not unwittingly condone or facilitate slavery."

The report says that, due to their reliance on imported goods particularly those from South-East Asia, Australian companies are significantly exposed, and highlights five sector that are carry a particularly high risk:

Financial services Mining Construction and property Food, beverage and agriculture Health care. FNArena will be reporting on each of these sectors in the next 12 months prior to introduction of the Federal reporting requirements. One would assume that retailers would also be vulnerable.

The ACSI report points to four intersecting factors that increase the risk to companies in these sectors:

Vulnerable populations Business models structured around high-risk work practices High-risk product and service categories; and High-risk geographies. In instance where these factors intersect, the risks rise sharply.

"Where multiple high-risk factors co-exist, there is a higher likelihood of modern slavery and additional controls are required to ensure that risk doesn't materialize," says the report.

So for now, it's softly, softly. The commencement of the more pecuniary NSW Modern Slavery Legislation has been stayed but its very existence sends a clear message to businesses. It is unlikely that any major developments will occur on this front for the next two years, save perhaps for individual scandals. We will keep readers updated on developments.

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FNArena is proud about its track record and past achievements: Ten Years On

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 July 8 to Friday July 12, 2019 Total Upgrades: 9 Total Downgrades: 17 Net Ratings Breakdown: Buy 39.23%; Hold 44.45%; Sell 16.31%

The good news: stockbroking analysts continue to upgrade recommendations for individual ASX-listed stocks. The flip side: they also continue to issue more downgrades than upgrades.

For the week ending Friday, 12th July 2019, FNArena counted nine upgrades against 17 downgrades. Among the stocks receiving upgrades we find a few retailers, a2 Milk and small cap miners. Among the downgrades we find numerous gold miners, Commbank (twice) and more miners.

Investors should note: both downgrades for CommBank shares moved to Sell. Evolution Mining equally received two downgrades during the week, alongside a number of other small cap gold miners.

Magellan Financial stands a-top of the week's table for positive amendments to price targets, followed by Northern Star, Goodman Group and NextDC. On the negative side, Pact Group stands out, as do South32, Orocobre, Virgin Australia and Village Roadshow. Here the good news is the average increase is larger than the reductions on display.

The reverse picture opens up in the two tables for revisions to earnings estimates. The positive side has Fortescue Metals in pole position, followed by Healius, Orocobre, Insurance Australia Group, and OceanaGold. Reductions tend to be larger with the week's biggest cuts reserved for Galaxy Resources, followed by Nearmap, Michael Hill International, OZ Minerals and Alumina ltd.

With only two weeks left before August, analysts are starting to update and review their modeling and assumptions ahead of corporate earnings reports, soon to be unleashed upon Australian investors. In the shorter term, quarterly production reports from miners and energy producers will require attention.

Upgrade

THE A2 MILK COMPANY LIMITED ((A2M)) Upgrade to Buy from Neutral by UBS .B/H/S: 2/3/1

UBS believes a2 Milk is in a unique position, with a differentiated premium brand that is well regarded yet under-penetrated in the largest and most profitable infant milk formula market globally.

The main risk is further regulation and greater disruption from changes in Chinese e-commerce laws. Still, A2 Milk is considered well positioned to mitigate the risks.

The broker upgrades to Buy from Neutral. Target is raised to NZ$17.50 from NZ$14.00.

EBOS GROUP LIMITED ((EBO)) Upgrade to Add from Hold by Morgans .B/H/S: 1/2/0

Ebos recently raised NZ$175m to reduce gearing ahead of further acquisitions and organic growth, and Morgans notes the company has delivered 12% compound annual earnings growth over the past four years, with 10% forecast for the next two, partly driven by the new CWG supply agreement.

Upgrades to FY20-21 earnings forecasts lead to a target increase to $24.07 from $20.43. This takes forecast total shareholder return to over 10%, which on Morgans' scale prompts an upgrade to Add from Hold.

FLIGHT CENTRE LIMITED ((FLT)) Upgrade to Buy from Neutral by Citi .B/H/S: 4/3/0

Citi believes the retail outlook is improving for the first time in four years on the back of tax cuts, rate cuts, lower cost of living and a stabilising housing market. The broker still anticipates some weak earnings reports from the sector ahead of such improvement, and believes downside risk provides buying opportunities.

Flight Centre upgraded to Buy on an improving domestic backdrop, and strong growth in corporate and international leisure. Target rises to $49.20 from $42.30.

GOLD ROAD RESOURCES LIMITED ((GOR)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 1/0/0

Macquarie upgrades to Outperform from Neutral. The company recently poured its first gold at Gruyere and, despite some delays to commissioning, the broker has moved the target to the blended mix used for producers.

Target is raised to $1.40 from $1.05.

HARVEY NORMAN HOLDINGS LIMITED ((HVN)) Upgrade to Neutral from Sell by Citi .B/H/S: 0/5/1

Citi believes the retail outlook is improving for the first time in four years on the back of tax cuts, rate cuts, lower cost of living and a stabilising housing market. The broker still anticipates some weak earnings reports from the sector ahead of such improvement, and believes downside risk provides buying opportunities.

Harvey Norman upgraded to Neutral from Sell. Target rises to $4.00 from $3.20.

JB HI-FI LIMITED ((JBH)) Upgrade to Neutral from Sell by Citi .B/H/S: 1/5/1

Citi believes the retail outlook is improving for the first time in four years on the back of tax cuts, rate cuts, lower cost of living and a stabilising housing market. The broker still anticipates some weak earnings reports from the sector ahead of such improvement, and believes downside risk provides buying opportunities.

JH Hi-Fi upgraded to Neutral from Sell. Target rises to $27.80 from $21.10.

PREMIER INVESTMENTS LIMITED ((PMV)) Upgrade to Neutral from Sell by Citi .B/H/S: 3/2/0

Citi believes the retail outlook is improving for the first time in four years on the back of tax cuts, rate cuts, lower cost of living and a stabilising housing market. The broker still anticipates some weak earnings reports from the sector ahead of such improvement, and believes downside risk provides buying opportunities.

Premier Investments upgraded to Neutral from Sell. To be more positive the broker needs to see evidence of success for the Smiggles wholesale rollout strategy. Target rises to $16.40 from $15.50.

ST BARBARA LIMITED ((SBM)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 1/3/0

Macquarie maintains its forecasts for gold prices although moderates its AUD/USD expectations, with the net result a modest upgrade for gold forecasts, to $1667/oz, in Australian dollar terms for the next five years.

The broker upgrades St Barbara to Neutral from Underperform and raises the target to $3.10 from $2.50. The broker assumes a cautious view on the larger Australian gold producers.

SANDFIRE RESOURCES NL ((SFR)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 2/5/0

Credit Suisse concludes the acquisition of MOD Resources ((MOD)) is accretive and raises the target to $6.75 from $6.40. Sandfire Resources has agreed to a 45% premium, in cash and scrip for the company, which owns the undeveloped T3 copper project in Botswana.

The broker expects the company to deliver at the top end of production guidance in the June quarter. Rating is upgraded to Neutral from Underperform.

See also SFR downgrade.

Downgrade

ADELAIDE BRIGHTON LIMITED ((ABC)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 1/2/2

Given continued weakness in residential approvals data in April and May, Ord Minnett believes the second half result will underperform estimates. Net profit in 2019 is now expected to fall -17%.

Trading multiples remain elevated and the broker downgrades to Lighten from Hold. The target is lowered to $3.90 from $4.00.

ALUMINA LIMITED ((AWC)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 2/3/1

Macquarie downgrades the outlook for alumina prices, which has a significant impact on its earnings outlook for Alumina Ltd. The broker now envisages downside risk to consensus expectations for both the dividend and earnings.

Rating is downgraded to Underperform from Neutral, although an 8% dividend yield should provide some downside protection. Target is $2.00.

COMMONWEALTH BANK OF AUSTRALIA ((CBA)) Downgrade to Sell from Neutral by Citi and Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 0/4/3

Commonwealth Bank is challenged, Citi believes, as it offsets the headwinds from lower portfolio returns. Its leading market position in mortgages and deposits, however, provides a platform for actively re-pricing.

As the leader in retail banking, Commonwealth Bank is well-placed to reap the benefits from the easing of front book competition, in the broker's view.

Nevertheless, the stock has run hard and is fully priced. Rating is downgraded to Sell from Neutral. Target is raised to $73.25 from $70.50.

Credit Suisse now incorporates a lower net interest margin to account for the lower cash rate. The broker downgrades to Neutral from Outperform because of the recent strong performance in the bank's share price.

Earnings forecasts are reduced but lower long-term bond yields are now assumed in the three-year model for the target, and the target has increased to $79 from $76 as a result.

DACIAN GOLD LIMITED ((DCN)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 0/2/0

The company has provided FY20 guidance and a new life of mine plan for Mount Morgans, with 170,000 ounces signalled for the next five years.

The updated plan assumes mill throughput of 2.9mtpa and recovery of 94.3%. These metrics are 16% and 4% higher than respective nameplate capacity and feasibility study outcomes.

Incorporating the updated outlook, Macquarie makes material downgrades in the near term and upgrades in the long term. The broker lowers the target to $0.70 from $0.80 and downgrades to Neutral from Outperform.

EVOLUTION MINING LIMITED ((EVN)) Downgrade to Hold from Add by Morgans and Downgrade to Underperform from Neutral by Macquarie .B/H/S: 0/4/3

Evolution Mining has pre-released quarterly production numbers and updated guidance. FY19 production met guidance but exceeded Morgan's forecast, while costs came in above guidance. Cost guidance has increased for both FY20 and FY21, as capex guidance. A lower Aussie partially offsets the impact.

Target falls to $3.44 from $3.55. Evolution remains the Morgans' preference in the space, and the broker believes a gold allocation is required in any portfolio in uncertain geopolitical times. Recent share price strength nevertheless triggers a downgrade to Hold.

Macquarie maintains its forecasts for gold prices although moderates its AUD/USD expectations, with the net result a modest upgrade for gold forecasts, to $1667/oz, in Australian dollar terms for the next five years.

The broker downgrades Evolution Mining to Neutral from Outperform, assuming a cautious view on the larger Australian gold producers. Target is raised to $4.30 from $3.90.

GALAXY RESOURCES LIMITED ((GXY)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 4/1/1

The cost of production for spodumene producers remains important over the short to medium term, given pressure on margins created from the softer pricing environment. Macquarie now expects 6% lithium spodumene prices to fall to US$550/t towards the end of 2019.

The broker downgrades Galaxy Resources to Underperform from Neutral. Target is $1.20.

MAGELLAN FINANCIAL GROUP LIMITED ((MFG)) Downgrade to Sell from Neutral by UBS .B/H/S: 0/5/2

The business continues to enjoy considerably stronger net flows relative to peers but UBS suspects this growth driver is moderating. With the shares up 135% in 2019 to date, the broker notes the FY20 dividend yield outlook is compressed to 3.5%, notwithstanding the increased pay-out policy.

Valuation metrics appear increasingly stretched and UBS downgrades to Sell from Neutral. Target rises to $42.00 from $35.50.

MEDIBANK PRIVATE LIMITED ((MPL)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 0/3/4

Macquarie assesses Medibank Private needs to continue outperforming industry claim trends to maintain its lofty margins. The broker believes gross margins and investment returns will be very strong in the second half.

However, the stock appears overpriced at current levels and the rating is downgraded to Underperform from Neutral. Target is raised to $3.05 from $2.85.

NORTHERN STAR RESOURCES LTD ((NST)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 0/3/3

Macquarie maintains its forecasts for gold prices although moderates its AUD/USD expectations, with the net result a modest upgrade for gold forecasts, to $1667/oz, in Australian dollar terms for the next five years.

The broker assumes a cautious view on the larger Australian gold producers and downgrades Northern Star to Neutral from Outperform. Target is raised to $11.60 from $10.30.

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

Macquarie maintains its forecasts for gold prices although moderates its AUD/USD expectations, with the net result a modest upgrade for gold forecasts, to $1667/oz, in Australian dollar terms for the next five years.

The broker downgrades Regis Resources to Neutral from Outperform and raises the target to $5.70 from $5.60. The broker envisages the upcoming production/earnings and FY20 guidance cycle a potentially risky period.

SOUTH32 LIMITED ((S32)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 4/2/1

Macquarie cuts alumina and base metal price forecasts which have a negative impact on the earnings outlook for South32. The broker downgrades to Underperform from Neutral.

The weaker price outlook translates to -12% and -30% reductions to FY20 and FY21 forecasts, respectively. Target is reduced to $2.70 from $3.20.

SARACEN MINERAL HOLDINGS LIMITED ((SAR)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 0/1/1

Macquarie maintains its forecasts for gold prices although moderates its AUD/USD expectations, with the net result a modest upgrade for gold forecasts, to $1667/oz, in Australian dollar terms for the next five years.

The broker downgrades Saracen Mineral to Neutral from Outperform and raises the target to $3.80 from $3.30. The broker envisages the upcoming production/earnings and FY20 guidance cycle a potentially risky period.

SANDFIRE RESOURCES NL ((SFR)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 2/5/0

Macquarie has reduced base metal price forecasts, which has driven material downgrades to the more leveraged base metal stocks. As a result the broker downgrades Sandfire Resources to Neutral from Outperform.

The stock has consistently outperformed the copper price over the past 18 months. Target is reduced to $7.10 from $8.00.

See also SFR upgrade.

SIMS METAL MANAGEMENT LIMITED ((SGM)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 3/2/1

Operating conditions remain challenged and Ord Minnett expects no reprieve in the near term.

Barring any material macro changes, such as a truce in the US/China trade dispute, China relaxing non-ferrous scrap restrictions or a strengthening Turkish economy, the broker suggests the stock may struggle to outperform.

Despite strength in iron ore, ferrous scrap pricing remains weak. Ord Minnett downgrades to Hold from Buy and reduces the target to $11.00 from $13.20.

WOODSIDE PETROLEUM LIMITED ((WPL)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 2/3/1

Marginal returns from development projects, Scarborough and Browse, are hampering the company's ability to convince its JV partners to proceed and Ord Minnett ascertains this is likely to be causing delays to the investment decision schedule.

The risk is that one or both of the projects will be shelved indefinitely which means the trains at the Karratha gas plant will need to be shut down.

The stock is now trading above the broker's target, leading to a downgrade to Lighten from Hold. Target is reduced to $33.85 from $34.60.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 EBOS GROUP LIMITED Buy Neutral Morgans 2 FLIGHT CENTRE LIMITED Buy Neutral Citi 3 GOLD ROAD RESOURCES LIMITED Buy Neutral Macquarie 4 HARVEY NORMAN HOLDINGS LIMITED Neutral Sell Citi 5 JB HI-FI LIMITED Neutral Sell Citi 6 PREMIER INVESTMENTS LIMITED Neutral Sell Citi 7 SANDFIRE RESOURCES NL Neutral Sell Credit Suisse 8 ST BARBARA LIMITED Neutral Sell Macquarie 9 THE A2 MILK COMPANY LIMITED Buy Neutral UBS Downgrade 10 ADELAIDE BRIGHTON LIMITED Sell Neutral Ord Minnett 11 ALUMINA LIMITED Sell Neutral Macquarie 12 COMMONWEALTH BANK OF AUSTRALIA Sell Neutral Citi 13 COMMONWEALTH BANK OF AUSTRALIA Neutral Buy Credit Suisse 14 DACIAN GOLD LIMITED Neutral Buy Macquarie 15 EVOLUTION MINING LIMITED Neutral Buy Morgans 16 EVOLUTION MINING LIMITED Sell Neutral Macquarie 17 GALAXY RESOURCES LIMITED Sell Neutral Macquarie 18 MAGELLAN FINANCIAL GROUP LIMITED Sell Neutral UBS 19 MEDIBANK PRIVATE LIMITED Sell Neutral Macquarie 20 NORTHERN STAR RESOURCES LTD Neutral Buy Macquarie 21 REGIS RESOURCES LIMITED Neutral Buy Macquarie 22 SANDFIRE RESOURCES NL Neutral Buy Macquarie 23 SARACEN MINERAL HOLDINGS LIMITED Neutral Buy Macquarie 24 SIMS METAL MANAGEMENT LIMITED Neutral Buy Ord Minnett 25 SOUTH32 LIMITED Sell Neutral Macquarie 26 WOODSIDE PETROLEUM LIMITED Sell Neutral Ord Minnett Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 GEM G8 EDUCATION LIMITED 80.0% 50.0% 30.0% 5 2 PMV PREMIER INVESTMENTS LIMITED 60.0% 33.0% 27.0% 5 3 LNK LINK ADMINISTRATION HOLDINGS LIMITED 79.0% 56.0% 23.0% 7 4 NXT NEXTDC LIMITED 58.0% 36.0% 22.0% 6 5 ORE OROCOBRE LIMITED 71.0% 50.0% 21.0% 7 6 QBE QBE INSURANCE GROUP LIMITED 64.0% 44.0% 20.0% 7 7 FLT FLIGHT CENTRE LIMITED 57.0% 38.0% 19.0% 7 8 REA REA GROUP LIMITED 50.0% 31.0% 19.0% 7 9 MND MONADELPHOUS GROUP LIMITED -10.0% -25.0% 15.0% 5 10 SCG SCENTRE GROUP -20.0% -33.0% 13.0% 5 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 MPL MEDIBANK PRIVATE LIMITED -57.0% -25.0% -32.0% 7 2 SGP STOCKLAND -40.0% -17.0% -23.0% 5 3 FPH FISHER & PAYKEL HEALTHCARE CORPORATION LIMITED -100.0% -80.0% -20.0% 4 4 S32 SOUTH32 LIMITED 43.0% 63.0% -20.0% 7 5 RRL REGIS RESOURCES LIMITED -50.0% -31.0% -19.0% 7 6 EVN EVOLUTION MINING LIMITED -43.0% -25.0% -18.0% 7 7 CBA COMMONWEALTH BANK OF AUSTRALIA -43.0% -25.0% -18.0% 7 8 WPL WOODSIDE PETROLEUM LIMITED 7.0% 25.0% -18.0% 7 9 GXY GALAXY RESOURCES LIMITED 42.0% 58.0% -16.0% 6 10 PTM PLATINUM ASSET MANAGEMENT LIMITED -40.0% -25.0% -15.0% 5 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 MFG MAGELLAN FINANCIAL GROUP LIMITED 42.579 37.969 12.14% 7 2 NST NORTHERN STAR RESOURCES LTD 9.542 9.029 5.68% 6 3 GMG GOODMAN GROUP 14.906 14.148 5.36% 5 4 NXT NEXTDC LIMITED 7.868 7.530 4.49% 6 5 GEM G8 EDUCATION LIMITED 3.562 3.418 4.21% 5 6 MND MONADELPHOUS GROUP LIMITED 17.000 16.383 3.77% 5 7 FLT FLIGHT CENTRE LIMITED 46.906 45.305 3.53% 7 8 SYR SYRAH RESOURCES LIMITED 1.438 1.390 3.45% 4 9 CBA COMMONWEALTH BANK OF AUSTRALIA 73.250 71.125 2.99% 7 10 WES WESFARMERS LIMITED 33.040 32.091 2.96% 6 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 PGH PACT GROUP HOLDINGS LTD 3.020 3.266 -7.53% 4 2 S32 SOUTH32 LIMITED 3.484 3.624 -3.86% 7 3 ORE OROCOBRE LIMITED 4.363 4.518 -3.43% 7 4 VAH VIRGIN AUSTRALIA HOLDINGS LIMITED 0.177 0.183 -3.28% 3 5 VRL VILLAGE ROADSHOW LIMITED 3.323 3.418 -2.78% 3 6 BLD BORAL LIMITED 5.617 5.771 -2.67% 6 7 SGP STOCKLAND 3.950 4.058 -2.66% 5 8 SGM SIMS METAL MANAGEMENT LIMITED 11.358 11.621 -2.26% 6 9 AMC AMCOR LIMITED 16.492 16.850 -2.12% 6 10 WPL WOODSIDE PETROLEUM LIMITED 35.304 35.939 -1.77% 7 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 FMG FORTESCUE METALS GROUP LTD 124.344 114.301 8.79% 7 2 HLS HEALIUS LIMITED 15.566 14.423 7.92% 5 3 ORE OROCOBRE LIMITED 9.778 9.135 7.04% 7 4 IAG INSURANCE AUSTRALIA GROUP LIMITED 42.543 39.871 6.70% 7 5 OGC OCEANAGOLD CORPORATION 18.286 17.479 4.62% 5 6 RIO RIO TINTO LIMITED 1052.781 1012.068 4.02% 7 7 MFG MAGELLAN FINANCIAL GROUP LIMITED 197.057 189.529 3.97% 7 8 ILU ILUKA RESOURCES LIMITED 97.052 93.635 3.65% 6 9 SBM ST BARBARA LIMITED 29.158 28.258 3.18% 4 10 SIQ SMARTGROUP CORPORATION LTD 59.572 57.988 2.73% 6 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 GXY GALAXY RESOURCES LIMITED -3.011 -1.623 -85.52% 6 2 NEA NEARMAP LTD -1.100 -0.967 -13.75% 3 3 MHJ MICHAEL HILL INTERNATIONAL LIMITED 5.225 5.925 -11.81% 4 4 OZL OZ MINERALS LIMITED 56.491 63.426 -10.93% 7 5 AWC ALUMINA LIMITED 22.117 23.734 -6.81% 6 6 WHC WHITEHAVEN COAL LIMITED 54.200 57.591 -5.89% 7 7 WSA WESTERN AREAS NL 5.683 6.033 -5.80% 6 8 STO SANTOS LIMITED 54.348 57.672 -5.76% 7 9 PLS PILBARA MINERALS LIMITED -0.913 -0.870 -4.94% 3 10 LOV LOVISA HOLDINGS LIMITED 34.375 35.800 -3.98% 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: 232 Rejected

President Trump has rejected a request under section 232 to force US utilities to buy a quota of uranium from US producers.

By Greg Peel

Last Friday it was revealed President Trump has reached a decision on a request from US uranium producers to force US utilities to purchase 25% of their requirements domestically as a matter of "national security" under section 232 of the relevant Act. However, by close of business on Friday no official announcement had been made by the White House.

Media outlets nevertheless suggested in reports that the president had rejected the request. Uranium market participants therefore took the risk, and market activity suddenly surged after weeks of doldrums brought about by 232 uncertainty. Even if the media reports were unfounded, the end of uncertainty would at least allow US utilities to know where they stand and return to the market to start making required purchases.

Eight transactions totalling 900,000lbs U3O8 equivalent were concluded in the spot market last week, industry consultant TradeTech reports, and TradeTech's weekly spot price indicator rose US$1.00 to US$25.50/lb.

Utilities did not suddenly jump in – it was mostly uranium traders taking the punt.

The Conundrum

The "national security" banner has been flying high over the White House ever since Trump imposed tariffs on imports of steel and aluminium early last year. Section 232 is also the law under which tariffs on specific imports from China have been implemented. One presumes that US uranium producers thus saw an opportunity.

The US currently imports 93% of its commercial uranium. The biggest producer is Kazakhstan, accounting for 40% of global production. But imports also flow from the likes of Russia and Canada. The bottom line is US producers cannot compete at the price. Put Russia and Kazakhstan together, at least, and one might see where a "national security" argument can be made.

Canada? Well Trump did initially include Canada in early steel and aluminium tariffs, on national security grounds, but this was most likely to gain leverage in the so-called Nafta 2.0 negotiations rather than a declaration that America's closest ally and trading partner posed a serious security threat.

No doubt US uranium producers assumed the president would be on board, given their request played right into the Make America Great Again theme, but this would be to overlook the one conundrum apparent in any such national security decision. In short, which is the greater security need? Locally produced uranium or secure, reliable electricity production? The uranium, whether being mined or not, would always be there.

Despite lower prices offered by global uranium exporters, US nuclear power generators cannot compete with cheap coal-fired gas and subsidised renewable energy. Legacy reactors have been shutting down across the US and new reactor plans have been shelved. Some states have offered financial incentives, but the White House has yet to settle on an energy policy that might include specific support for nuclear power generation.

If reactors cannot compete at low prices, how are they to compete when forced to purchase material at higher prices?

And that's what the president saw. The US Department of Commerce supported either uranium quotas or a tariff on imported uranium but Trump did not concur, Canaccord Genuity reports, seeing rather reduced costs for US utilities being realised if such protections were rejected.

Frankly I would have thought it was a no-brainer.

The Fallout

US uranium producers saw their shares fall an average of -30% on the stock market.

Australia is not currently an exporter of uranium to the US, but a lifting of restrictions in the US, which to date is the world's largest consumer of uranium (some 30% of global supply) until China catches up, could open the door, Canaccord suggests, to Australian "near term" developers, being those with projects currently sitting on care & maintenance or new projects advanced in the permitting stage.

Australia, after all, does have a "special relationship" with the US.

To that end, Canaccord highlights:

Boss Energy Resources ((BOE)), which is looking to restart the Honeymoon project in South Australia, once the fourth of the then federal government's four permitted uranium mines;

Paladin Energy ((PDN)), which, having now repaired its balance sheet, is looking to restart its flagship Langer Heinrich mine in Namibia;

Hylea Metals ((HCO)), which has proposed the acquisition of Paladin's other mine – Kayelekera in Malawi – which had been put into care & maintenance; and

Vimy Resources ((VMY)), which is progressing the Mulga Rock project in Western Australia – one of only four WA projects allowed to advance after a new state government reinstated a prior ban on uranium mining, given the level of investment in those projects to that time.

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 July 11, 2019

Last week saw the ASX200 trough and then run higher again, achieving a lower high than a week earlier before slipping back again.

Once again there was very little movement in short positions. Only one stock saw a short position change of one percentage point or more.

We recall last month satellite company Speedcast International ((SDA)) fell -56% on a profit warning and as expected, last week's data showed a fall in shorts to 7.9% from 9.9% as profits were taken.

This week's data show, as the share price continues to drop away, shorts building up again, to 8.9% from 7.9%.

Short activity typically begins to wane ahead of a results season, and this appears to be the case, although stock-specific events can still have an impact, such as profit warnings.

No Movers & Shakers this week.

Weekly short positions as a percentage of market cap:

10%+ SYR 19.3 NUF 17.9 ING 16.3 BAL 16.0 ORE 15.6 GXY 14.7 NXT 14.2 JBH 13.9 BWX 12.4 DMP 11.0 PLS 10.8 MTS 10.6 BIN 10.4

No changes

9.0-9.9

BGA, HUB, HVN, SGM

Out: RWC 8.0-8.9%

SDA, IFL, CGC, IVC, RWC, PPT, CSR, BKL, KGN

In: RWC, SDA, KGN

7.0-7.9%

SUL, WSA, BOQ, MYR, AMP, CGF

In: WSA Out: SDA, KGN, DCN

6.0-6.9%

DCN, ELD, GMA, A2M, NEC, GWA

In: DCN Out: WSA

5.0-5.9%

MSB, SXY, COE, LNG, CLQ, CTD, OML

In: OML

Movers & Shakers

See above.

ASX20 Short Positions (%)

Code Last Week Week Before Code Last Week Week Before AMC 1.5 1.8 RIO 4.5 4.5 ANZ 0.5 0.5 S32 0.9 0.8 BHP 2.8 2.9 SCP 0.8 0.9 BXB 0.1 0.2 SUN 0.4 0.4 CBA 1.1 1.1 TCL 0.9 0.7 COL 1.4 1.4 TLS 0.4 0.4 CSL 0.4 0.4 WBC 1.3 1.3 IAG 0.8 0.7 WES 1.4 1.5 MQG 0.8 0.9 WOW 1.4 1.5 NAB 0.5 0.5 WPL 0.7 0.7 To see the full Short Report, please go to this link

IMPORTANT INFORMATION ABOUT THIS REPORT

The above information is sourced from daily reports published by the Australian Investment & Securities Commission (ASIC) and is provided by FNArena unqualified as a service to subscribers. FNArena would like to make it very clear that immediate assumptions cannot be drawn from the numbers alone.

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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FNArena is proud about its track record and past achievements: Ten Years On

The Wrap: Utilities, Retailing & Supermarkets

Weekly Broker Wrap: utilities; automotive retailers; building materials; housing-related retailing; and supermarkets.

-Risks emerging for traditional energy supplier profits -Rebound in house prices could signal a recovery in car sales -US-exposed building material stocks have more favourable outlook -Improving outlook for retail sales as FY20 gets underway -Promotional intensity, deflation easing for the supermarkets sector

By Eva Brocklehurst

Utilities

Utilities are changing. Morgan Stanley has conducted a survey that reveals disruption to the conventional utility-consumer model is looming sooner than many expect. One in three consumers is planning to generate their own electricity in the next five years and most expect to trade excess energy in future.

The broker assesses this trend will accelerate once energy technology is installed, as it increases the likelihood consumers will want additional technology. Young consumers show higher awareness and interest in the prospect and, as time passes, costs will come down even further.

Morgan Stanley believes this means risks for traditional energy supply profits will emerge more strongly. The broker has a Cautious industry view on Australian utilities, supported by the probability that incumbents with vertical integration will face structural challenges.

AGL Energy ((AGL)) and Origin Energy ((ORG)) can benefit from higher prices but, absent any counter measures, the broker suspects they are likely to sell less to fewer customers out of growing cost bases as ageing plants require replacement.

Automotive Retailers

Total sales for motor vehicles fell -9% in the June quarter and UBS expects sales to remain in negative territory until the June 2020 quarter. Prestige/luxury car sales are likely to return to growth earlier, forecast to lift 4% in 2020, after suffering more severe declines over the past 16 months.

As Australian house prices are likely to be nearing a nadir, the broker calculates that a 10% rebound in house prices could mean total new car sales rise by 8% over two years. While ride sharing and robo-taxis (autonomous vehicles) would mean lower new car sales in the future, UBS believes volumes are still likely still grow globally until at least 2030.

The broker considers the improved outlook is positive for Automotive Holdings ((AHG)). That company's merger with AP Eagers ((APE)) is pending an ACCC decision on July 26. The preliminary view asserted the proposed merger was unlikely to substantially lessen competition, although the effects on the Newcastle/Hunter Valley region were still being assessed. As an option, AP Eagers has proposed the divestment of its Kloster Motor Group business.

Building Materials

JPMorgan notes housing starts have fallen short of expectations in 2018 in both Australia and the US. Housing starts fell -26% in the March quarter and approval volumes are firmly in decline, while leading indicators are weak. JPMorgan expects housing starts to fall -18% in 2019 and a further -3% in 2020 before recovering in 2021.

This is expected to provide a tough backdrop for Adelaide Brighton ((ABC)) and CSR ((CSR)), which are exposed 55% and 32%, respectively, to residential construction activity. The broker envisages significant support for both James Hardie ((JHX)) and Reliance Worldwide ((RWC)), expecting earnings growth will materialise in coming years.

This stems from leading indicators in the US, which signal mortgage rates and application volumes are improving and comparables becoming easier. The broker is also overweight on Boral ((BLD)), believing the implied valuation for North America is too low.

Housing-Related Retailing

Housing finance declined -16% in May, a weakening of the three-month trend, Citi observes. The broker believes churn, including refinancing, is an important indicator of expenditure in housing-related retail categories and this points to weak sales persisting into the first three months of FY20. Until there is a significant pick-up in the volume of home purchases, retail expenditure is expected to remain soft.

Still, the broker takes a positive stance on household incomes in FY20, believing the benefit from the Commonwealth government's tax offset is likely to be most evident in August through to October. The broker expects the tax offset to buttress sales for retailers of food, apparel and smaller electronics.

Furniture, hardware and white goods are more likely to wait until 2020 for sales to improve. The broker retains Buy ratings on Super Retail ((SUL)) and Flight Centre ((FLT)) and remains more cautious about JB Hi-Fi ((JBH)) and Harvey Norman ((HVN)).

Supermarkets

The latest survey from UBS found loyalty has overtaken price as a driver of expenditure for supermarkets. Momentum is building at Woolworths ((WOW)) while Coles ((COL)) has stabilised it share overall. Meanwhile, Aldi's share is growing at the expense of the Metcash's ((MTS)) IGA group.

What surprised the broker was the revelation that consumers were experiencing promotional fatigue and demanding more differentiated offers. The broker queries whether Metcash is being rewarded for investing in promotions, given its share was down because of perceived poor pricing.

The broker is watching the performance of Aldi carefully as new formats appear to be resonating with customers. Overall, UBS believes the results were positive for Woolworths and, while the read-through for Metcash was negative, this is currently priced into the stock.

The broker has evidence that deflationary pressures have eased in the June quarter, which is a positive for the supermarket sector. A study of weekly prices found deflation was -0.4% for Woolworths versus -0.9% in the March quarter. The broker suspects that, adjusting for a more material reduction in promotional breadth, Woolworths may have actually experienced inflation in the June quarter.

The broker was most surprised by the size of the fall in promotional intensity, particularly at Woolworths, which is consistent with the company's comments that promotional intensity is down around -17% for the past two years. Signs of dry goods inflation are also considered positive.

UBS forecasts food and liquor industry growth to accelerate to 4% over 2019/20 from the 3% recorded in FY18. This is driven by more rational pricing, slowing share gains for Aldi and supplier expectations for inflation across both fresh and dry goods.

UBS also believes Coles needs to lift its capital expenditure materially, while Metcash has an opportunity to spend more to lift wholesale sales. The broker is upbeat about the market becoming more rational and deflation trends easing, but suspects upside is being priced in from the improving backdrop and valuations are becoming full.

Lithium Glut Undermines Galaxy Resources

Lithium producer Galaxy Resources is at the mercy of weak fundamentals for spodumene, which comprises all of its production output.

-Difficulties perceived in running down inventory over the next year -Market imbalances likely to weigh on pricing and sentiment -Cost reductions key to minimising margin compression

By Eva Brocklehurst

Strong production in the June quarter has created a problem for lithium producer Galaxy Resources ((GXY)), which now has to sell its output over coming months into a heavily over-supplied market.

Mount Cattlin spodumene production was up 35% in the June quarter versus the prior quarter, at 56,000t. 2019 production guidance is unchanged at 180-210,000t. Concentrate grade was also higher, at 5.9%, which improves marketability and realised pricing versus benchmark.

Credit Suisse points out that higher concentrate grade comes with further structural recovery decline. On the other hand, strong results for unit costs in the quarter are evidence of what can be achieved if recoveries continue to improve, as it offsets the inevitable grade decline.

Macquarie also notes the company is now prioritising product quality to the detriment of recoveries. Cost reductions remain key to minimise margin compression, the broker asserts, given the weak spodumene pricing environment.

The company now expects recoveries of 60-65% and expects to wind down around -59,000t of inventory over the second half of 2019. Macquarie is more cautious, assessing a sell-down of around -30,000t over the second half is more likely, with a further -9,000t in the first quarter of 2020. Canaccord Genuity estimates it will take around 15 months for inventory to return to more normal levels.

Morgan Stanley will be looking for a return to normalised shipment schedules at Mount Cattlin in the current quarter, also noting a significant uplift in shipments will be required to reach the mid point of 2019 production guidance.

Sales guidance for the September quarter is for 60-70,000t and there is 120,000t of committed second half sales but Credit Suisse finds it difficult to share management's conviction this will be achieved, given the macro weakness. While growth options are a good problem to have, the broker is cautious about deploying a large amount of capital to fund these projects, given long-dated periods over which to recover capital in the current climate.

Sal De Vida

The Sal de Vida development remains the core catalyst for the company, the broker adds. Citi agrees, from an earnings and valuation perspective, that finding the right partner for a stake in Sal de Vida would provide upside to valuation.

Nevertheless, the broker points out spodumene has the weakest fundamentals within the lithium supply chain because of low barriers to entry and the dependence on conversion capacity as well as near-term oversupply.

Noting an updated project delivery plan and timeline is expected in the December quarter, which should provide some clarity for medium-long term growth, Canaccord Genuity currently assumes construction commences in 2021 with first production in 2023.

The broker, not one of the seven monitored daily on the FNArena database, expects imbalances in the lithium concentrate market will weigh on pricing and affect sentiment. Still, in the longer term, the broker continues to believe the asset base has strategic and inherent value that is well in excess of the current valuation, maintaining a Buy rating with a target of $2.65.

The company's current earnings are 100% exposed to spodumene and this presents downside risk to Citi's forecasts. The broker expects a lower-for-longer lithium price scenario and downgrades the stock to Neutral/High Risk from Buy/High Risk.

Citi reduces it its risk weighting for Sal de Vida and James Bay to 50% from 75%, in light of the weak macro backdrop for funding within the lithium sector. This could affect the timing of a final investment decision and the commissioning of these two projects.

Supply Glut

Credit Suisse highlights analysis that shows the pace at which lithium demand is building is slower than supply. The broker notes Galaxy Resources and Pilbara Minerals ((PLS)) are selling less concentrate than they are producing, a clear sign of demand weakness. This comes despite neither operations being at full nameplate production rates.

Sales challenges are expected to persist through the remainder of 2019, as production builds up and new material comes on line. This has led to a multi-year low for spodumene pricing with the latest spot reading from China around US$615/t. Credit Suisse envisages downside risks to this price in the second half and into 2020.

FNArena's database shows two Buy ratings, three Hold and one Sell (Macquarie). The consensus target is $1.74, signalling 29.0% upside to the last share price. This compares with $2.13 ahead of the quarterly. Targets range from $1.30 (Macquarie) to $2.50 (Credit Suisse).

SMSFundamentals: 10 Reasons Why Many Fund Managers Are Now Blank Spaces

SMSFundamentals is an ongoing feature series dedicated to providing SMSF trustees with valuable news, investment ideas and services, in line with SMSF requirements and obligations.

For an introduction and story archive please visit FNArena's SMSFundamentals website.

10 reasons many fund managers are now blank spaces

Graham Hand, Managing Editor of Cuffelinks, explains why so many fund managers fail in today's market.

by Graham Hand on July 10, 2019

So it's gonna be forever Or it's gonna go down in flames You can tell me when it's over If the high was worth the pain Got a long list of ex-lovers They'll tell you I'm insane 'Cause you know I love the players And you love the game

-Taylor Swift, Blank Space

Yes, Taylor, we loved the players and we loved the game. Swiftly, it's over, leaving a blank space.

It looks easy from the outside, but asset management is a tough game. Winners can win big, but there are far more strugglers. In a concentrated portfolio, a heavy overweight position in a losing stock can mean "it's gonna go down in flames".

Recently, an unprecedented number of fund managers have closed their businesses or some of their funds, including:

KIS Capital Sigma Funds JCP Investment Partners Dual Momentum Janus Henderson Australian equity funds MHOR Asset Management Discovery Asset Management Denning Pryce Adam Smith Asset Management Concise Asset Management Arnhem Investment Management Ellerston Global Macro Colonial First State Global Asset Management 'Core' funds (transferred to other managers UBS Asset Management Australian equity funds (transferred to Yarra Capital) Altair Asset Management

For many years, I managed the 'alliance' business for Colonial First State (CFS), where we would partner with portfolio managers to establish new operations. We saw all types of potential come across our desks, from a couple of people wanting to set up their own boutique, through to large global managers establishing an Australian business.

How hard can it be? While there are some overlaps in the following reasons, here are 10 industry hurdles to overcome. These may or may not apply to the above names.

1. The growth of index investing

In 2018 in the US, passive index funds (including unlisted mutual (managed) funds and Exchange-Traded Funds (ETFs)) enjoyed a net inflow of US$431 billion, while active mutual funds experienced net outflows of $418 billion, as shown below. Given the large fee difference, that represents a loss of hundreds of millions of dollars in fees to the asset management industry. It's also become widely-accepted wisdom that most active managers do not beat the index.

In Deloitte's 2019 Investment Management Outlook, 16 of the top 20 global funds by net flows were passive mutual funds and ETFs, gathering a net US$143 billion.

Source: Bloomberg and BetaShares

In the US, it is estimated that 34% of mutual funds and ETFs are passively managed. This number is only about 12% in Australia, but momentum is well-established. Most local ETFs are index-based and in the final quarter of FY2019, ETFs listed on the ASX exceeded $50 billion for the first time.

It is not only the fund flows that hurt active managers, but the price competition. Institutions can achieve index management on large portfolios for 1 or 2 basis points (0.01 to 0.02%), forcing active managers to compete as low as

20 basis points (0.2%). It is difficult to finance a fully-functioning active operation of portfolio managers, analysts and support functions at such low fees unless billions of dollars are held.

Even a good $250 million mandate would bring in only $500,000, which would barely cover the cost of a senior portfolio manager.

2. In-house management by large institutions

Many of the largest superannuation funds in Australia are boosting their in-house asset management capabilities and withdrawing mandates from external managers. The most high-profile in the last year was AustralianSuper's move of $7.7 billion internally from Perpetual Investments, Fidelity International and Alphinity Investment Management. These are not small boutiques but long-term successful fund managers with substantial operations of their own.

CIO, Mark Delaney, explained the change:

"We found there was an overlap in the shares held by the different managers. Over the last three or four years, we found that in Australian equities, in terms of the stocks held, we had the same stocks in the top 50 and these holdings did not change much. This is the nature of the Australian market. It has a narrow number of stocks and a narrow number of sectors."

Currently, about 58% of AustralianSuper's Australian equities assets are managed internally, and most of the external management is in the cheaper index funds.

The large superannuation funds now attract top talent receiving market-comparable salaries. While most of the leading CIOs could earn more in the private sector, the super sector's guaranteed inflows, stability of funding, lack of need to continually pitch for new money and clarity of a single stakeholder appeal to many. The top-earning CIOs in Australian super funds (according to Investment Magazine) are:

3. Extreme variations in performance

Most investors are prepared to tolerate short-term underperformance from their fund manager, but others are impatient and bail out after a year or two. It's worse when the manager has a significantly-poor year.

The financial year 2018/2019 experienced some rapid price rises in companies where investors were willing to bank on future growth, including the Top 5 for the year: Nearmap (ASX:NEA) up 233%, Clinuvel (ASX:CUV) up 206%, Afterpay (ASX:APT) up 168%, Magellan (ASX:MFG) up 119% and Appen (ASX:APX) up 109%.

Managers without these types of high flyers in their portfolio have experienced significant underperformance as they stick to their valuation principles. For example, consider the NAOS Small Cap Opportunities Company (ASX:NSC). It operates under a Listed Investment Company (LIC) structure. In its April 2019 Investment Report, in explaining why it has not invested in these big winners, it says:

"… the main concern for us is the significant faith that is being placed in the earnings trajectory of these businesses for many years into the future."

As NAOS admits, the permanent capital of a LIC has protected it from heavy redemptions, due to this relative performance.

The Zenith 2019 Australian Shares Long/Short Sector Report for the year to 31 March 2019 reported an average return of 5.2% for the funds they rate, versus 11.7% for the S&P/ASX300 Accumulation Index.

Zenith Investment Analyst Jacob Smart said:

"In 2018, the spread between the cheapest and most expensive stocks reached record highs and, even after the fourth quarter correction last year, remained at elevated levels. The cheaper segment of the market continued to become even cheaper throughout 2018."

4. Managing with an out-of-favour style

Every fund manager must have fundamental beliefs about how to manage money and select investments.

The most obvious style variation is 'growth versus value', and others such as 'small cap versus large cap' and 'long/short versus long only' move in and out of favour.

Growth has been rewarded for at least five years as the market chases companies with blue sky earnings potential, even when the revenues are not yet realised. The WAAAX* stocks are all classic examples, where the market assigns massive P/E valuations and two of them do not even make a profit. Value managers look for companies which are inexpensive relative to a fundamental value, with sustainable earnings and low valuations, such as 'buying $1 of value for 80 cents'.

*[WiseTech Global, Appen, Altium, Afterpay Touch, Xero – known as Australia's "FAANG"]

According to JP Morgan, there has never been a worse time to be a value investor. In the US, value stocks are trading at the largest discount to the market in history. They measure the median forward P/E ratio of value stocks in the S&P500 and compare it with the broader S&P500 and the spread is now at a record 7 points.

Another segment which is out-of-favour is small cap investing, trailing large cap. As shown below, in the last 10 years, the S&P/ASX100 index has substantially outperformed the Small Ordinaries index, leaving many small cap managers struggling to deliver decent returns.

S&P/ASX Small Ordinaries Index vs S&P/ASX100 Index, 10 years to 30 June 2019

Source: Bloomberg, CFSGAM. Cumulative total returns 30 June 2009 to 30 June 2019.

Long/short investing is also battling on with many casualties. KIS Capital launched in 2009 and its funds peaked at around $300 million, but it closed recently after a difficult 2018 where results were "disappointing". It advised its clients:

"Given the state of the market, KIS Capital directors have concluded that the best course of action at this point is for us to close both funds and return capital to all investors on an equitable basis."

5. Inadequate marketing and distribution

Build it and they may not come. Most fund managers would prefer to sit at a desk all day, study their screens and analyse companies. However, especially in a small boutique which relies on the profile of one or two managers, they must wear out the shoe leather and tell their story. It's a tricky balance. Their main skill may be stock picking, but they need to become extrovert marketers, not simply hire a Business Development Manager with a Rolodex. They must establish themselves as thought leaders. Research by leading consultants, Tria Partners, concludes:

"… thought leadership is the single most important factor that underpins improvement of buyers' understanding and perception of external asset managers – i.e. it's the most value adding activity marketing can undertake."

Significant resources are needed to cover institutions, middle market gatekeepers and retail sectors properly. Many fund managers have realised in recent years that they need a direct conversation with end investors, and they particularly target SMSF trustees. The combined value of ETFs and LICs listed on the ASX is now $100 billion, and SMSF trustees often manage their own portfolios directly through the listed market. Previously, some managers confined their marketing to institutional investors, believing it was better to win a $100 million mandate than source thousands of smaller investments. Now those mandates are drying up, the fees are lower and the competition is intense. Marketing through dealer groups to find financial advisers is also not enough, as increasingly, advisers are acting independently and not following the central directive of an Approved Product List.

Tria released the following research on the most effective forms of marketing.

6. Lack of institutional and retail investor support

When MHOR Asset Management announced the closure of its Australian Small Cap Fund in June 2019, it advised:

"… it has not been able to grow the funds under management to a sustainable level and does not expect any material growth in the short-medium term … We will commence the realisation of the Fund's assets, which is consistent with an orderly closure of the Fund."

The Fund had achieved an impressive annualised return of 24.2% net of fees since inception on 1 August 2016, managed by former Vocus CEO James Spenceley and former Renaissance Asset Management Portfolio Manager, Gary Rollo. MHOR was added to the ASX's mFund service in 2018 to improve investor access, but they gathered only $25 million in total. Clearly, the problem is not simply a performance or access issue.

At CFS, when we assessed portfolio managers wanting to set up a new boutique, we would always check whether they had any major institution willing to back them. Often, these portfolio managers worked at large wealth businesses managing many billions of client capital across multiple portfolios. They developed close relationships with their clients and became friendly with each other. A nod and a wink from a large investor can lead people to believe if they set up on their own, then maybe a $200 million slice could seed a new fund. New boutiques will often offer clients a fee discount to come in at the start, and $200 million at 0.3% is a healthy $600,000 to cover some fixed costs. The test comes when the portfolio manager actually leaves.

When John Sevior departed Perpetual Investments to set up Airlie, many clients went with him. But John Sevior is one of the few 'rock star' managers in Australia. If a new boutique cannot deliver immediate institutional support, it can take years of pitching and building up a track record before decent money flows. The retail market is a tough slog full of gatekeepers who must support the new business long before a fund features on a major platform. Research analysts, rating agencies and asset allocators all need convincing.

Going directly to a LIC is difficult for fund managers without a proven track record. Although this looks like direct-to-market distribution, behind the scenes are brokers and financial advisers who are paid fees to support the issue, and they must be convinced there is a story to tell.

7. Misunderstanding the business model

Portfolio managers in large businesses are supported by a phalanx of helpers, from accounting, tech, call centre, compliance, legal, documentation, marketing, business development … on it goes. They can indulge their passion for investing.

Then they set up their own businesses. Suddenly, they become involved in finding premises, negotiating leases, hiring staff, selecting systems to prevent cyber attacks, finding new investors … and all the drudgery of owning a business where the buck stops with the founder. What a pain! Previously, they were Masters of the Universe in a big dealing room, where they blasted the tech guys if the internet went down for 10 minutes. Now the fundies are responsible for making sure their tech is good, and there's nobody on staff to shout at.

Which is why many talented fund managers sell part of their equity to groups like Pinnacle, Fidante, Channel Capital or Bennelong. In exchange for say 40% ownership, these companies provide support services for boutique managers, leaving them to focus more on investment management. They still need to perform a marketing role but it is done with considerable business development support.

How much does it cost to open the doors? It depends mainly on how much the portfolio managers pay themselves. Remember, many have been highly paid in a previous role and have big mortgages and private school fees to cover, so it's not easy to take the start-up route of no salary for a couple of years. So let's say they are senior portfolio managers on $500,000 (if that seems too much, consider the salaries of the super fund CIOs listed above, and the CIO of a major retail business can earn $5 million or more a year). Let's say three other staff cost $500,000, then there are premises, systems, legal, advertising, etc.

There's not much change out of $50,000 to be a major sponsor at a leading industry event. That's a total of $2 million on the credit card.

Revenues come from clients paying fees. Not only are the big clients pushing down fees, but retail investors can access funds management for free (products such as HostPlus Balanced Indexed Fund – the 'Scott Pape Fund' – are effectively free, and the cost of many index ETFs is negligible, less than 0.1%). This new boutique business will need, say, $300 million of institutional money at 0.3% and $300 million of retail money at 0.4% to break even. That is not easy in a market with hundreds of competitors all essentially doing the same thing while striving to sound different.

And the sobering outlook is that for most fund managers, fees are only going in one direction.

8. Inadequate product diversity

Many small fund managers have only one fund based on the skills of one or two people. For the first few years, all their efforts will go into promoting and managing that one fund. It leaves them vulnerable to poor performance and an out-of-favour style. Which is why larger managers branch into income funds, infrastructure, alternatives, ethical or a completely different asset class like an equity manager hiring a fixed interest specialist. The diversity can reduce the business risk.

A comment on relying on performance fees to make a profit. Not only are the fees elusive in a period of underperformance, but such fees are usually structured with a 'high water mark'. This means the previous underperformance must be recovered before the fee kicks in again. Therefore, a poor year can set back the profitability of the business for many years.

9. Loss of key personnel

Funds management is an industry with massive key person risk. Especially in small boutiques, there are often one or two portfolio managers who have investor support, backed by talented analysts and trainees with little or no market profile or reputation. As funds under management grows, the team increases and resilience builds for long-term survival.

Until this point is reached, however, if the main man or woman wants to leave, the business has nowhere to go. It's simply not possible to bring in a new person at short notice and expect investors to stay.

The highest-profile demise of all was the closure in 2010 of 452 Capital when Peter Morgan was misdiagnosed with brain cancer. Peter was a doyen of fund managers following his time at Perpetual (Disclosure: I set up the CFS alliance with 452 and was on the Board for a while). At its peak, 452 Capital managed $9 billion, rapidly raising money from 2001. But much of the money exited during Morgan's time off and with the impact of the GFC, the remaining staff were managing less than $3 billion when the business closed. The Sydney Morning Herald reported:

"Yesterday another high-profile Australian business in this industry, 452 Capital, became the talk of the financial services industry when it was revealed that this business had essentially imploded."

Fast forward to the recent closures. In 2019, when the AFR reported that Discovery Asset Management was returning funds to its clients, it said the move was driven by the co-founder and Managing Director, Stuart Jordan's decision to retire. A message to clients said:

"Over the last week, Stuart has cemented his decision to head down the retirement path after a long and successful career in the Australian investment management industry. Given this, and also that Discovery have a small number of institutional clients (only), we have communicated to each of them that Stuart is planning to retire, and we are now working with these institutional clients to 'hand back' or transition out, their mandates with Discovery."

It is believed that the loss of a mandate from UniSuper contributed to the decision.

A larger ($5 billion under management) and long-established business, Ellerston Capital, closed its Global Macro Fund in June 2019, following the departures of economist Tim Toohey and one of the portfolio managers, Robert Chiu. This was not an under-resourced fund. Former Reserve Bank Governor, Glenn Stevens, was an adviser, with Ellerston announcing on his hire:

"Our main focus is on his international perspective and how other central banks see their economies. He's here to challenge and debate all of our investment theses".

The Head of the Global Macro Fund, Brett Gillespie, is himself a high-profile figure, frequent presenter at conferences and writer of a detailed monthly newsletter on global macro conditions. Yet the loss of key clients took the Fund from $190 million to $30 million and not commercially viable. Returns since inception in 2017 were flat, as shown below.

10. Failure to manage expectations

Every fund manager will underperform at times, but not every fund manager faces large redemptions.

Those who emerge into better markets have often spent years explaining their process and when it might not work, and why it will pay off to stay with them.

One manager who has experienced torrid performance in the last year is Steve Johnson's Forager. A year ago, its LIC was so popular that it was trading at a premium, and his presentations filled conference rooms. The net asset value of the Australian Shares Fund has fallen from $1.82 a year ago to $1.30 now (after a $0.21 distribution). That's a fall of 19% in a market that is up 12%, a whopping 31% underperformance. Making it worse, the LIC now trades at a discount as some investors have exited, but also as LICs generally have struggled.

Forager has been at pains in the past to stress its investment approach is to buy out-of-favour or unpopular companies, and to ride out the recovery. It has warned that company turnarounds can take longer than expected, and this has been the case. In its recent newsletter, Johnson said:

"Since we started Forager almost 10 years ago, we have told our investors to expect significant periods of underperformance. That's one promise we have delivered on over the past year … We have made genuine mistakes over the past year. Part of our poor performance has nothing to do with industry turmoil. But periods of dramatic underperformance like this are not just part of investing with us. They are an essential prerequisite to future outperformance."

Forager is supported by believers prepared to wait for better days, although it helps that the main fund is a LIC with permanent capital.

Why does this matter to you?

There are three reasons why investors may be adversely impacted by a fund closure, putting aside the impact on the lives of the staff directly affected.

1. Costs of realising the portfolio

Although a small cap manager may not own a substantial portfolio in the overall size of the market, it may be a significant shareholder in some small companies. When it is announced that the funds business will close, the market knows there is a substantial seller of certain companies and the bid price can drop away rapidly. Spreads open. So in addition to other closure costs such as brokerage, the value of the portfolio may fall during liquidation. And, of course, anyone else who owns those stocks will also be hit.

Even where a fund is not closed but transferred to another manager, using a 'transition manager' to sell the old portfolio and buy a new one, the realisation costs can be substantial as most transition managers just want to do the job and move on.

2. Unplanned capital gains or losses

Money is returned unexpectedly to investors, and this might deliver a taxable capital gain or a capital loss which cannot be tax-effectively managed at a convenient time.

3. Lack of access to liquidity while the fund closes

Most fund managers announce their closure and immediately suspend redemptions to prevent a run and to allow for a more orderly share sale process. Investors wanting the capital for other purposes may be denied the expected liquidity.

Briefly, on the other hand …

In case this article paints too glum a picture for fund managers, let's mention the other extreme, Magellan (ASX:MFG). Its funds under management at 30 June 2019 reached $86 billion, up an extraordinary $4 billion in one month since 31 May 2019. This was mainly due to market movements and the fall in the AUD, but retail inflows were $132 million and institutional $356 million across global, Australian and infrastructure assets. A year earlier, on 30 June 2018, funds totalled $59 billion. That's up $27 billion in one year.

But here's the clincher to show how wonderful (or cruel) this business can be for creating wealth. On 2 March 2009, Magellan shares reached a low of 33 cents during the GFC. It recently traded at $55. Ignoring dividends, buying 10,000 shares for $3,300 would now be worth $550,000, only a decade later. Market capitalisation (gulp!): $10 billion.

To offer hope to the strugglers, I remember when Hamish Douglass and Frank Casarotti could gather only a couple of dozen people to Magellan's presentations, and CFS refused to put their global fund onto the main FirstChoice platform.

Graham Hand is Managing Editor of Cuffelinks. This article is general information and does not consider the circumstances of any individual. Subscription to the newsletter is free: https://cuffelinks.com.au/newsletter-invite/

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FNArena is proud about its track record and past achievements: Ten Years On

Treasure Chest: G8 Education Faces Difficulties

FNArena's Treasure Chest reports on money making ideas from stockbrokers and other experts. Brokers suspect G8 Education faces difficulties as its acquisitions underperform.

-Excess supply of new childcare centres negatively affecting the company's existing portfolio -Consensus estimates may be downgraded at the first half result -Acquisitions made in 2019 face minimal competition to date

By Eva Brocklehurst

Childcare centre operator G8 Education ((GEM)) is facing an uphill battle, amid surging growth in new childcare centres. Brokers had been expecting occupancy growth would continue to improve in 2019 as the supply of new centres abated.

However, Moelis notes growth in new childcare centres nationally was 3.9% as of June 30 and there were 71 net new centres added in the second quarter, versus 47 in the previous corresponding quarter.

This reverses the trend of declining supply rates observed since the September quarter of 2018. In adjusting estimates to reflect this increase in new supply, the broker reduces G8 Education's earnings forecasts by around -3% for 2019, to $149m. Like-for-like occupancy growth forecasts have been reduced to 1.6% from 2.0%.

Wilsons believes the company's cohort of 2019 acquisitions have also underperformed expectations. Admittedly, acquisitions can take up to two years to trade at sustainable levels but the broker suspects medium-term earnings momentum will be challenged. Combine this with excess supply of new centres negatively affecting the existing portfolio, as well as ambitious consensus estimates, and forecasts are expected to be downgraded at the first half results on August 26.

Wilsons has looked at the most competitive suburbs for child care operators nationally and the level of direct competition faced by the company. G8 Education has significant operations in five of the 10 most competitive suburbs by number. The broker calculates, in the last four years, childcare centre developers have, on a consolidated basis, built and opened 1.6x the required annual demand.

Acquisitions have also underperformed historically, as the company acquired 74 centres between 2016 and 2018, which should now be achieving annual earnings of $46.5m, and in 2018 they delivered just $17.5m. Furthermore, the analysis shows that, despite micro issues, these 74 centres are competing with a total of 757 within their suburbs of operation.

The company expects earnings from prior acquisitions to be $27.0m in 2019, which implies earnings underperformance of the majority of the acquisitions. This is attributed to the significant competition each faces. The broker is not that surprised by the likely underperformance. The 2017 cohort of 37 centres took almost two years to trade to sustainable levels and, while the 2019 occupancy levels for this cohort started more positively, Wilsons assesses the 2017 cohort faces the most competition.

Of the 2019 cohort only three out of the 19 centres were operating in July. The remainder are likely to be opened late in the second half and could strategically shield the company from additional headwinds to earnings over the rest of the calendar year. This cohort is better situated and faces minimal competition to date, Wilsons points out, although it is still being rolled out. Still, the 2019 cohort is not expected to make a large difference to earnings in the near term.

Inflation Risk

Wilsons forecasts earnings (EBIT) of $145.9m in 2019 and $150.1m in 2020, below consensus and makes no changes to forecasts. The broker attributes stronger consensus forecasts to expectations for more bullish price increases, at 3.5% versus 2.5% (Wilsons).

However, the main risk to numbers, given broad sector feedback, is cost inflation, particularly staffing costs, which the broker assesses could be running as high as 5.5%. G8 Education has not provided quantitative guidance but had advised at its AGM that the second half is likely to be stronger than the first. Wilsons, not one of the seven brokers monitored daily on the FNArena database, has a Sell rating and $2.46 target.

Moelis, also not one of the seven, downgrades to Hold from Buy and lowers the target to $3.38. Regardless of the downgrade, the broker continues to expect "decent" earnings growth for the company in the medium term and concludes that the combination of internal quality investment in the new subsidy, favouring the company's low-middle income parent cohort, will continue to drive incremental demand.

Nevertheless, Moelis would like to observe either occupancy growth exceeding estimates at the half-year result or evidence of supply moderating, in order to upgrade the outlook.

Regular brokers on FNArena's database have not updated recently, and there are four Buy ratings and one Hold (Morgans). The consensus target is $3.56, signalling 31.4% upside to the last share price. The dividend yield on 2019 and 2020 forecasts is 5.2% and 6.2% respectively.

In Search Of 'Value', Avoiding 'Cheap Junk'

In this week's Weekly Insights (published in two parts):

-In Search Of 'Value', Avoiding 'Cheap Junk' -All-Weather Portfolio Update -Unveiling The US Corporate 'Secret' -Three Charts -Conviction Calls -Rudi Talks -Rudi On Tour -Rudi Talks

In Search Of 'Value', Avoiding 'Cheap Junk'

By Rudi Filapek-Vandyck, Editor FNArena

The sharp division between investors in "Growth" and in "Value" has added yet another chapter over the past six months, despite a notable resurgence for banking stocks and iron ore miners throughout the half.

But, as highlighted in the graphic below from a recent market analysis released by Morgan Stanley, there is more to the persistent market division between "winners" and "losers" than simply the concept of investors continuing to buy Growth Stocks because, well, they are growing strongly, while largely ignoring the companies that are struggling.

Morgan Stanley correctly points out today's popular Go-To Stocks do not simply comprise of "Growth" stocks like a2 Milk ((A2M)), Altium ((ALU)) or Nearmap ((NEA)), they equally include "High Quality" names such as CSL ((CSL)), REA Group ((REA)) and TechnologyOne ((TNE)).

And on the losing side, among the laggards while share market indices have done nothing but surge higher, the story is not just about "Value" having fallen out of fashion against "Growth"; this is equally about the division between "Low Quality" and "High Quality" companies.

For most investors, professional or otherwise, the concept of using a "Quality" mark for listed equities is a rather uncomfortable one. No stockbroking analyst will ever put on paper that the company under scrutiny is of Low Quality because management at the helm will take offence, leading to negative consequences for the analysts or their employer.

Similarly, there's no value investing funds manager in the country, or elsewhere, who runs the marketing slogan: we buy the lowest quality of listed businesses, but only when their stock looks really cheap. While, in reality, that is exactly what buying "deep value" translates to in the share market.

High Quality names such as CSL, REA Group and TechnologyOne might be just as susceptible to market sentiment and equally be impacted by market volatility, their equities are never as "cheap" as, for example, AMP ((AMP)), Retail Food Group ((RFG)), EclipX Group ((ECX)), Speedcast International ((SDA)), iSentia ((ISD)), Freedom Insurance ((FIG)), The Reject Shop ((TRS)), and many, many others.

While cheap, beaten down share prices can potentially start a rally anytime, and at a moment's notice -just look at Retail Food Group recently, or Eclipx Group- the experience of the past years shows these rallies are rather unlikely to stick around for long.

Witness how shares in Myer ((MYR)) more than doubled between February and April this year, but they've subsequently lost half of that rally. In the case of AMP, the end destination has continually remained a share price at a lower level. Now speculation is rife a dilutive equity raising might be unavoidable.

But the Morgan Stanley graphic makes a good point in highlighting today's share market laggards do not solely consist of Low Quality operations with a gigantic chip on the shoulder. There are plenty of listed companies out there that are regrettably operating inside the wrong sector at the wrong time, or battling temporary set-backs that won't hold them back forever and ever.

The steep come-back for Ramsay Health Care ((RHC)) shares over the past seven months would be one such fine example, as is the even steeper recovery enjoyed by InvoCare ((IVC)) shares. Let's not forget that prior to June last year, nobody seemed very much interested in owning shares in TechnologyOne. Or try Cochlear ((COH)) shares up until April.

The timing for such a share price recovery is never easy to predict. Most investors who own "value", deliberately or through misfortune, don't sell when the timing for recovery is delayed, unless the investment case changes. Part of the underperformance of large swathes of professional funds managers can thus be traced back to sectors and stocks that seem undervalued, but for whom the time to shine has not arrived just yet.

Another way of looking at this is through the concept of a rolling, evolving and shifting bear market in today's share market. When I published Who's Afraid Of The Big Bad Bear?" in December 2016, the final page of the book contained the following conclusion:

Whereas most market participants still carry lively memories (and possibly traumas) about what happened between late 2007 and early March 2009, and maybe about the period 2000-2002 as well, the Grizzly Bear nowadays travels through specific sectors and segments of the share market.

Hence, part of understanding the dynamics in today's share market is the realisation (acceptance?) that parts and sectors will alternate between falling out of favour and joining the raging bull market. Next comes trying to understand what is keeping sentiment low and investors not interested.

Let's first draw up a list of themes and sectors that mid-2019 remain out of favour (in no particular order):

-Building materials; Boral ((BLD)), Reliance Worldwide ((RWC)), Adelaide Brighton ((ABC)), etc

-Automobiles; Bapcor ((BAP)), GUD Holdings ((GUD)), Motorcycle Holdings ((MTO)), etc

-Travel & Tourism: Sealink Travel Group ((SLK)), Event Hospitality and Entertainment ((EVT)), Flight Centre ((FLT)), etc

-Value investors: Platinum Asset Management ((PTM)), Janus Henderson ((JHG)), Pendal Group ((PDL)), etc

-Retail landlords: Vicinity Centres ((NVC)), Unibail-Rodamco-Westfield ((URW)), Scentre Group ((SCG)), etc

-East Coast Infrastructure Boom: Lendlease Group ((LLC)), Wagners Holding ((WGN)), Fletcher Building ((FBU)), etc

-Electric Vehicles and new batteries: Orocobre ((ORE)), Galaxy Resources ((GXY)), Syrah Resources ((GXY)), etc

-Thermal coal: New Hope Coal ((NHC)), Whitehaven Coal ((WHC)), Metro Mining ((MMI)), etc

This list is by no means complete, but probably covers the most obvious parts of the share market that simply refuse to fully participate in the 2019 equities bull market, the occasional exception notwithstanding.

The main problem for investors looking for "value" in these segments is that timing the next recovery is exceptionally hard to do. And you'd want to own "Quality" when times are tough and uncertain. Moreover, while it is broadly accepted that building activity is highly cyclical, and the RBA lowering interest rates might accommodate a recovery in due course, the case for any of the other segments looks decisively less straightforward.

For example: on Monday, analysts at UBS argued the case that house prices for the main cities in Australia are probably close to bottoming, but their research into the historical correlation between house prices and Australian car sales suggests the latter might not see a noticeable recovery until the June quarter next year.

UBS also acknowledges investors are worried about the long term prospects for car sales as they anticipate ride-sharing and robotaxis ("autonomous vehicles") will be making steady inroads shortly, but the overriding view is that global new car sales are most likely to continue growing until at least 2030. Other forecasters have made similar projections when asked about the impact of Electric Vehicles (EVs).

This does not mean there is no sustainable recovery possible for individual companies inside these segments. Management teams can still pull levers such as new products, new markets, cost out, restructuring, spin-offs, and acquisitions (apart from companies becoming a corporate target themselves).

Woolworths ((WOW)) recently provided a possible blue print for others by preparing its ownership of pubs and clubs with its alcohol sales outlets for spin-off next year.

While most commentary has focused on the supermarket operator (finally) separating from its long contentious relationship with the gaming machines inside these pubs and clubs -potentially putting the stock back on the radar of ESG-filters and responsible investment strategies- I believe the board's decision was mostly led by the realisation that supermarkets are not the only part of the businesses that will be facing enormous challenges in the years ahead, including Kaufland/Lidl and online delivery orders.

The advent of online competitors for bricks and mortar bottle shops is today probably not well-understood by the broader investment community, but it won't be long before changing times/increased competition starts showing up in the sales numbers and other financial metrics of alcohol distribution channels BWS and Dan Murphy's.

Either way, it is but fair to conclude these businesses need all the support and management focus they can get to fend off the various challenges in the medium term, and stay viable and relevant further out.

Separation seems more like a necessity than a smart move by Woolworths in order to please ESG-concerned investors.

All of this sets the broader context as to why the upcoming August reporting season in Australia might prove quite the pivotal event, with investors looking for answers and for tangible evidence whether companies' resilience and earnings potential has been underestimated, or whether long loyal shareholders -frustrated as their patience continues to be tested- will have to wait (even) longer.

The one group missing on Morgan Stanley's graphic consists, of course, of REITs and other bond proxies. While most attention among investors and market commentators is usually reserved for banks, resources, IT and healthcare, or maybe large caps versus small caps, it is seldom highlighted that names like Transurban ((TCL)), Goodman Group ((GMG)) and Charter Hall ((CHC)) have become the new Superstar Stocks in an environment of mostly uninterrupted central banks support, and ever lower bond yields.

As with "Growth" and "Quality", too many value investors have been calling these "Yield plus Growth" stocks grossly overvalued, while share prices post 2013 have largely ignored these calls, and continued appreciating instead.

While everybody likes a bargain, all of the above suggests investors should be extra-careful when seeking value near the bottom of the share market. Making the accurate distinction between genuine "Value" and "Cheap Junk" might make a significant difference in August, and beyond.

In case anyone does reach the uncomfortable realisation that yesterday's promise has simply turned into today's Grave Disappointment, always remember: it is never too late to sell. One look at share price graphs for AMP, Retail Food Group, iSentia, Slater & Gordon ((SGH)) and the likes reveals just that.

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Who's Afraid Of The Big Bad Bear?" is included in the bonus items that are available to every paid subscriber (6 and 12 months). A copy can be downloaded via SPECIAL REPORTS on the website.

Rudi Talks

Audio interview on Wednesday (last week) about how much central bankers are invested in today's financial markets, and how far exactly is this going to take them:

https://www.youtube.com/watch?v=wFktIuKZji4

Rudi On Tour In 2019

-AIA National Conference, Gold Coast, Qld, 28-31 July -AIA and ASA, Perth, WA, October 1

(This story was written on Monday and Tuesday 15th & 16th July 2019. It was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website. Part two follows on Friday).

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Rudi's View: All-Weather Portfolio, Charts & Conviction Calls

In this week's Weekly Insights (this is Part Two):

-In Search Of 'Value', Avoiding 'Cheap Junk' -All-Weather Portfolio Update -Unveiling The US Corporate 'Secret' -Three Charts -Conviction Calls -Rudi Talks -Rudi On Tour -Rudi Talks

All-Weather Portfolio Update

By Rudi Filapek-Vandyck, Editor FNArena

It only took one highly unusual race at the Winter Olympics of 2002 for Australian Steven Bradbury to become a colloquial reference in modern day language.

Just type in Steven in Google search and it is the second suggestion that pops up. No additional info required.

Bradbury has become synonymous for the unexpected victor, the result that nobody expected, the win that is achieved through external and uncontrollable circumstances; when Dame Fortuna smiles upon you and luck is blatantly on your side.

Having read about how the final cricket world cup contest was decided between England and New Zealand, or the Wimbledon tennis final between Novak Djokovic and Roger Federer, I think maybe it's time we also developed a quick reference for playing the game of your life, and still ending up losing by the narrowest of margin at the final finish line.

The thought came to my mind even before both sporting finals had come to their conclusion, when I was doing the sums and calculations for the All-Weather Model Portfolio at the close of mid-2019. In isolation, the Portfolio experienced its best performance over a six months period since its launch in late 2014.

But, really, a return in excess of 13% (before fees) looks rather pale when the ASX200 Accumulation index achieves nearly 20% over the same period. Enter the New Zealand cricket team, and Roger Federer who's understandably taking a full month's rest from tennis.

Below is an overview of how the Portfolio has performed over the past twelve months. Last week, I shared some of my analysis as to why the index outperformed the Portfolio with stocks like Amcor, CSL, REA Group and TechnologyOne, but also Reliance Worldwide, Link Administration, Bapcor and Orora.

See also "Do I Have A Few Surprises For (Most Of) You" https://www.fnarena.com/index.php/2019/07/04/do-i-have-a-few-surprises-for-most-of-you/

And also: https://www.fnarena.com/index.php/2019/07/17/smsfundamentals-10-reasons-why-many-fund-managers-are-now-blank-spaces/

The news about active managers versus passive investment returns has taken another negative bend, according to data supplied by Chant West.

As reported in the Australian Financial Review on Thursday, the two best performing growth funds in Australia, QSuper Balanced and UniSuper Balanced, have achieved returns of 9.9% for the financial year ending on June 30th (FY19).

S&P/ASX 300 Index returned 11.4% over the period while the S&P/ASX 200 Index returned 11.5%. In line with my own observations, the ASX50 performed best, while small cap indices barely managed to return a positive result.

Equally typical for this year's market dynamics, data released by Mercer revealed the Martin Currie Australia Real Income Fund was the best performing over the year with a total return of 18.8% before fees. According to Mercer, the median manager among 134 strategies measured in the Australian shares category delivered a 9% return before fees.

At the bottom of Mercer's total return rankings we find Forager Australian Value with a loss of -18.8%. Next sits Bennelong Concentrated's -6.4% loss. Remarkable, because at the end of the prior financial year Bennelong had ranked the second-best Australian strategy with a 33% gain.

Not all funds are ranked and monitored by Chant West or Mercer. The worst result spotted by FNArena is -20.6%.

Unveiling The US Corporate 'Secret' - Three Charts

For many years, investors in Australia have marveled at the continuous up-trend in US equities carried by what seemed a superior class of corporate entities run by a superior class of business leaders, managing to grow profits for shareholders, year-in, year-out, year after year after year, irrespective of how high the US dollar or how low US Bond yields.

But maybe there is a lot more to this story than meets the lazy eye from far-away Australia?

Glushkin Sheff's Chief economist and strategist, David Rosenberg, always keen to highlight the finer details most bullish commentators elsewhere prefer to ignore, included the three charts below in his daily market commentary last week, and at the very least the three charts combined should answer a large number of questions, while raising a few more.

Consider, for a few seconds, that contrary to bullish market sentiment in the USA, and that one President that cannot get enough of new record highs, the fact that corporate profits, without accountancy adjustments or divided by outstanding shareholders capital, has largely remained stagnant since 2013.

Yes, correct. Stagnant. Similar to what essentially has occurred with corporate profits in Australia over the past six years. See chart number one below.

So how can we explain the American growth numbers that have been supporting this extended bull market? Charts number two and three provide a rather incisive look-in.

Corporate debt (chart number three) has steadily risen to all-time highs and chart number two suggests businesses have been using the additional balance sheet leverage on the back of the historically low cost of debt, to buy in ever more shares.

Anno 2019, the total number of outstanding equities in the US has fallen to a 19-year low (chart number two).

Basic economic theory teaches us that growing demand combined with falling supply equals rising prices, and that's exactly what US share markets have experienced over the past six years.

But these three charts combined also reveal how important the fall in bond yields and ongoing support from the Federal Reserve have been to keep this positive growth story alive.

MST Marquee investment strategist Hasan Tevfik, prior employed by Credit Suisse for many years, points out equity markets are shrinking in the US, Europe, New Zealand and this year also in Australia.

Tevfik predicts that, because of the exceptionally low cost of debt, de-equitisation is like to stay with us for longer. While this might work to the benefit of investors, it does make for an awfully challenging backdrop for business models that are leveraged to expanding volumes and expanding equities supply.

The once almighty Deutsche Bank earlier this month decided to quit trading equities. Tevfik predicts more of such decisions are in the pipeline worldwide.

I am fully aware that the title mentions three charts and one extra will exceed that number, but I nevertheless thought it apt to add the one below, published by economists at National Australia Bank on Thursday morning, as a reminder of how US equities have mostly outperformed just about every other equity market around the globe.

It's not just you, Australia.

Conviction Calls

On Wall Street, Morgan Stanley equity strategist Michael Wilson (and the rest of the strategy team) stand above the crowd in that the investment bankers' view on the outlook for equities hasn't changed in 18 months.

That view is that US equities are now capped inside a rather large trading range in between 2400 on the downside and 3000 at the upper end of the range.

Back in January last year (2018) when the S&P500 index surged towards 3000 for the first time, Morgan Stanley strategists warned their clientele to prepare for a multi-year consolidation period. As we know now, US equities sold off subsequently, then made a gradual come-back to again stare at 3000 within reach by September.

After that came the Big Sell-off, as I am sure we all still remember.

By late December, the S&P500 had fallen to around 2350 which, strictly taken, is below the 2400 suggested bottom but what are 50 points between friends, n'est-ce pas?

Approximately seven months of upwards and onwards rallying has now put the S&P500 back near the top end of the suggested range. The index last week rose slightly beyond the 3000 level.

And yet, Morgan Stanley's view has not changed. The decline in interest rates has made US stocks more attractive, acknowledges strategist Wilson in his latest market update, which largely explains why the US index is back near the top of the trading range, but the fundamentals underneath the rally have weakened considerably.

Investors should prepare for disappointment which shall pull back the S&P500 from its current lofty high, warns Wilson. Both corporate earnings and economic growth are on his assessment most likely to disappoint from here onwards. Market consensus still sees a significant resurgence into 2020, but Morgan Stanley remains of the view those expectations will be proven too optimistic.

To be continued, without a doubt.

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Sector updates are usually heavily dominated by relative valuations, and the latest update by stockbroker Morgans on local insurers and diversified financials is no exception.

Having marked-to market for all sector members under coverage, Morgans lined up its sector favourites in order of preference, and relative valuation shines through like a full moon on a stormy, dark night in Cornwall. Never been to Cornwall, but that's how I imagine it, and it sounds kinda funky.

The order of preference for investors seeking access to this sector is thus Link Administration ((LNK)) first, followed by Kina Securities ((KSL)), Afterpay Touch ((APT)), QBE Insurance ((QBE)), Zip Co ((Z1P)) and Suncorp Group ((SUN)). Other names missing on that list, such as Computershare or Perpetual, are rated Hold with one exception: the local stock exchange ASX ((ASX)) carries the sole Reduce rating due to elevated valuation.

Equally noteworthy: Morgans analysts believe the risk during reporting season for this particular sector remains to the downside; if not in actual released results, than potentially via forward guidance. Health insurers are seen as the exception.

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Sector analysts at Citi have a different take on things. Number one observation is there are no Buy ratings left for the sector at Citi.

This does not stop the Citi team for putting together a ranking order in terms of preference, but investors should note: most stocks mentioned are rated Neutral, with the exception of ASX and IOOF Holdings ((IFL)).

Citi's order of preference is Janus Henderson ((JHG)) on top, followed by Computershare ((CPU)), Challenger ((CGF)), Link Administration, Perpetual ((PPT)), then ASX and IFL.

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One most interesting High Conviction Call was released by CLSA analysts Richard Barwick and Mark Wade this week.

Interesting because, as one industry observer put it, "amazing there's still research coming out of there". For those not up to date: US competitor Jefferies has raided the CLSA office luring the core of the Australian operations over (probably offering a lot more money) and market rumour has it talks are continuing with what used to be the local equities team at Deutsche Bank, but no concrete result has been announced thus far.

Apparently, the ex-Deutsche Bank team is trying to stay together. Meanwhile, a number of industry predators are trying to cherry pick their preferred candidates. It truly is a dog-eat-dog world in equities.

Back to CLSA. This week's High Conviction Call was equally interesting because it involves Treasury Wine Estates ((TWE)), of which the share price has been failing to keep any momentum going with market speculation rife distributors are left with excess inventories in China, which must, if accurate, at some stage create a painful bottleneck for the company.

CLSA analysts toured through China, spoke with 45 wine distributors locally, of which 30 distribute Treasury Wine produce, and they have found no indications there is any truth behind the market speculation.

Instead, CLSA reports Penfolds continues to perform well, with Rawson's Retreat a distant second. US based Beringer is doing it tough because of tariffs. Forget about all the other brands in the portfolio: these are the only ones that measure in China.

Chinese consumers continue to love French wine the most, further underpinning Treasury Wine Estates' strategy to develop its own French brand under the label of Maison de Grand Esprit.

Most importantly, management is still aiming at increasing the company's distribution foot print in China by 50% over the next three years. This, CLSA explains, simplistically translates into roughly 15% growth per annum.

On the basis of these fresh on-the-ground insights, CLSA suggests Treasury Wine Estates shares could well present themselves as a huge opportunity in August. Price target is $23 (unchanged). Rating: High Conviction Buy.

Rudi Talks

Audio interview on Wednesday:

https://www.youtube.com/watch?v=BTmBz-IC8JA

Rudi On Tour In 2019

-AIA National Conference, Gold Coast, Qld, 28-31 July -AIA and ASA, Perth, WA, October 1

(This story was written on Monday and Tuesday 15th & 16th July 2019. It was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website. Part two follows on Friday).

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