

Week

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Stories To Read From FNArena

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Interest In Gold Sector Ramps Up

Gold has found a solid footing, as several features in the global environment combine, and this underpins a strong revenue outlook for gold stocks.

-Gold to benefit as the easing era of US monetary policy ends
-Regis Resources a top pick amongst several brokers
-Value envisaged in offshore gold producers

By Eva Brocklehurst

Gold and gold stocks have experienced increased interest recently, amid economic uncertainty and global trade conflicts. In this setting, it has not surprised brokers that gold would re-assert its traditional role as a safe-haven asset. With the combination of a US slowdown, as US interest rates move to a more neutral setting, conflict in geopolitics and the rest of the world becoming relatively stronger, gold is forecast to set new cycle highs.

Along with higher gold price forecasts, Macquarie also incorporates a lower Australian exchange rate, expected to remain broadly around the low US\$0.70 region over the next couple of years. A gold price of US\$1319/oz in 2019 and US\$1431/oz in 2020 is forecast. A higher gold price directly translates to higher earnings in the sector and the broker lifts earnings estimates for FY19 across the sector by 2-13%, making a larger increase of 16-53% for FY20.

Canaccord Genuity, too, upgrades gold price assumptions, which includes a 4.1% increase for the long-term forecast to US\$1474/oz. The broker's Australian dollar forecast has also slipped for the long-term, to US\$0.71, resulting in an increase to the Australian long-term gold price, to \$2076/oz.

Bell Potter suspects a more dovish outlook from the US Federal Reserve, as the trajectory of interest-rate hikes in 2019 and 2020 has ebbed versus prior expectations, is supporting the gold sector. A technical view also looks to be in favour of the gold price.

In the short term, the "fear trade" has been overdone but Macquarie believes it remains a curtain raiser to more deep-seated "trouble" that is likely to come in the second half of 2019 and into 2020. The broker notes jewellery demand in the larger physical markets is weak but believes a new era is being ushered in for central bank purchases of gold, amid a potential pick up in demand for gold coin.

Oz Gold Stocks

Australian dollar-exposed gold producers benefit most from the updated price expectations although, to some extent, Canaccord Genuity points out this is already priced into mid-cap producers.

Increased revenue, because of the generally flat production profiles, translates directly to higher earnings and, therefore, the gold price upgrades favour the larger producer, Macquarie adds. Perseus Mining ((PRU)), which is most leveraged to the gold price, experiences large upgrades in the broker's forecasts.

Bell Potter notes gold equities have begun to outperform the underlying metal and, while hastening to add this is not providing material for a raging bull market, agrees there are plenty of strong signs.

A strong performance has been noted in larger names, suggesting to the broker mid-sized producers have work to do to catch up. Mid-cap stocks appear to have the highest valuation multiples, owing to superior asset quality, balance sheet strength and free cash flow.

Canaccord Genuity notes an average return of over 10% in the last month and 17% over two months. As a result, the broker downgrades ratings for OceanaGold ((OGC)), to Sell from Hold, St Barbara ((SBM)), to Hold from Buy, and Saracen Mineral ((SAR)), considered to be the most overvalued, to Sell from Hold.

The broker's top picks remain Regis Resources ((RRL)), considered to be trading at the largest discount to peer averages, Perseus Mining, which offers the best upside from a valuation standpoint, and Dacian Gold ((DCN)).

Bell Potter also cites Regis Resources as a top pick amongst ASX-listed gold producers because of its strong balance sheet, capital efficient growth and high shareholder returns. Gold Road ((GOR)) is also noted for higher forecast annual average gold production, based on the inclusion of the shallow gold reserves from the nearby Attila and Alaric

deposits. The Gruyere deposit is also on track to produce first gold in mid 2019.

Bell Potter likes Dacian Gold, as the Mount Morgans project commenced production last year and commercial production was targeted for the end of 2018. Meanwhile, Westgold Resources ((WGX)) is ramping up Central Murchison, targeting 300-320,000 ounces at an average cost of \$1300-50/oz in FY19.

Macquarie upgrades Saracen to Outperform which, along with Northern Star Resources ((NST)), is a preferred domestic gold producer. The broker also envisages value in offshore producers such as Alacer Gold ((AOG)) and Resolute Mining ((RSG)), as they are about to start commercial production at new projects, the Copler sulphide and Syama SLC, respectively. Bellevue Gold ((BGL)) is also a key pick for exploration.

The broker assesses the disconnect between the share price performance of domestic producers and those offshore has been large and long-lived. Higher gold prices could mean risk appetites increase, and there is potential for investors to be enticed offshore as they seek value. Developers and explorers, both offshore and domestically, should benefit from the more bullish conditions.

Macquarie does not expect a higher gold price will mean more M&A activity, domestically and, where there is activity it is likely to be offshore, particularly North America. Australian companies are noted to be actively looking for assets offshore.

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How Will Rio Tinto Carve Up Its Cash Pie?

Broker views centre on how Rio Tinto will carve up the cash pie stemming from asset divestments, as revenue continues to benefit from strong commodity prices.

-Brokers suspect a combination of more buybacks, special divs likely at the miner's February results -Alumina division remains vulnerable to raw material price inflation -Strong fundamentals have been matched by share price performance

By Eva Brocklehurst

Rio Tinto ((RIO)) performed strongly in the December quarter, particularly in terms of healthy volumes in both copper and iron ore. Copper production was the main surprise for brokers, exceeding forecasts because of an unexpected contribution from Grasberg, a resurgent Escondida and higher grades at Kennecott.

Iron ore guidance for 2019 indicates shipments of 338-350mt, which Macquarie notes is a wider range than has been the case historically. Mined copper production was 20% above what the broker expected because of a stronger performance from Oyu Tolgoi and the unexpected contribution from Grasberg, which has now been sold.

Mined copper guidance for 2019 is 550-600,000t. Guidance for the energy and minerals division is in line, bauxite is at the lower end of expectations. The results provided no game changers, in Credit Suisse's view. Iron ore continues to hold up a better than expected and should drive free cash flow. The broker expects the company will be slightly net cash into 2018.

Capital Management

Interest centres on capital management at the upcoming results announcement. Proceeds from asset sales during 2018 totalled US\$8.6bn. Macquarie assumes the company will declare a US\$2 special dividend and return US\$3.3bn to shareholders from the sale of Grasberg.

UBS calculates there is US\$4.4bn in divestment proceeds still to be allocated and this could be returned to shareholders by topping up the buyback, with either a special dividend or an off-market buyback of ASX-listed stock, although the latter would require shareholder approval at the April/May AGM.

Credit Suisse assumes a forecast 65% pay-out of second half earnings, noting there is an incremental US\$1.7bn in existing programs that is still to be bought back. The broker suspects pursuing acquisitions would be viewed cautiously by the market unless there was a strong upside investment case.

Deutsche Bank expects another \$4bn boost to shareholder returns at the February result, unless M&A arrives sooner than expected, and this will most likely be proportionally shared across the dual listing.

Citi also points to the US\$1.7bn in existing buybacks, suspecting this will increase, given the sale proceeds from assets such as Grasberg, Kitimat Wharf/land and Dunkerque were not reflected in the prior announcements.

Commodities Outlook

Prices are buoyant for the key commodities the company produces and this is driving earnings momentum. Macquarie envisages an earnings upgrade cycle that will support the share price, maintaining an Outperform rating. Citi's Buy rating is driven by upside risk to estimates for spot commodity prices, particularly iron ore, and the potential for additional capital management.

On the other hand, Deutsche Bank, while positive about the stock, finds limited upside potential. The broker highlights the potential for a boost to copper volumes via acquisitions and remains positive on aluminium, expecting profitability to return over 2019 to this, the company's second largest business.

Citi also pulls back estimates slightly to allow for lower-than-expected realised aluminium prices. Nevertheless the broker still envisages upside to forecasts. UBS points out the weakness in the division reflected the transition from East Weipa to Amrun, although the company has noted a continuation of raw material price inflation, particularly in aluminium. The focus will now be on the ramp up at Amrun.

Credit Suisse downgraded the stock in December to Neutral, based on the macro environment, amid considerable concerns around China's steel markets. The broker asserts the call remains appropriate, expecting the next move in iron ore prices will be down. That said, Credit Suisse acknowledges there is plenty to like as a holder of the stock, most notably the balance sheet but also continued discipline on M&A and capital allocation.

Volumes in the alumina division, outside of bauxite, were flat and Morgans highlights weak prices and persistent cost pressures as a focus for the next result. Rio Tinto has built up a strong position, the broker accepts, after several years of refining and streamlining its business.

While there is some uncertainty about the future direction of the company's strategy the stock is, in the meantime supported by strong fundamentals that are matched by a positive share price performance. As a result the broker downgrades to Hold from Add.

FNArena's database has four Buy ratings and three Hold. The consensus target is \$86.08, signalling 6.9% upside to the last share price. Targets range from \$79 (Credit Suisse) to \$94 (Macquarie). The dividend yield for 2018 and 2019 forecasts, at present FX values, is 5.6% and 5.0% respectively.

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Sims Metal Immersed In Volatile Market

Market volatility and increased competitor activity have once again driven Sims Metal to downgrade expectations. Most brokers, while disappointed, still favour the longer-term outlook.

-Scrap margins observed to be under pressure across all operations -Company may have been wrong-footed by scrap market developments -Technology benefits, infrastructure upgrades appear outweighed by macro economic headwinds

By Eva Brocklehurst

Difficult market conditions have persisted for scrap merchant Sims Metal Management ((SGM)), and a further downgrade to earnings expectations has been provided for the first half. Operating earnings (EBIT) of around \$110m are now expected, -12% below the prior corresponding half.

The downgrade was driven by higher purchase prices for completed scrap sales, stemming from market volatility, and increased competitor activity at certain sites. European metals earnings have been sharply lower, as scrap purchase prices did not reflect a fall in the Turkish deep sea market, and there is a requirement for higher quality scrap that has led to lower collection volumes.

The company's first half result due on February 20 is expected to provide greater clarity on the issues and more visibility around the second half. Brokers are disappointed, particularly in the light of the earlier downgrade and management comments at the AGM. Conditions are expected to eventually improve but it appears likely the impact will persist beyond the first half.

Several brokers still appreciate the longer-term dynamics, while Morgan Stanley asserts there is opportunity for investors that are prepared to look through the current conditions. The broker adjusts forecasts, with the net result being a downgrade of -22.0% and -13.6% to FY19 and FY20 estimates respectively.

The complex market affects the clarity on earnings, Macquarie points out, although, in general, margins were observed to be pressured across all operations, some affected by competitive activity and others influenced by macro conditions. Credit Suisse was most surprised by the strength in North American operations, where earnings have been sustained despite the challenges in the market.

Also, the other surprise the broker points to is the collapse of the already-weak UK operations, amid sequential volume declines and low Zorba (mixed metal) prices. The broker suspects the company has been wrong-footed by developments and was slow to roll out the Zorba to Twitch strategy (conversion to higher metal content) globally.

Macquarie flags the fact the company has made changes to its segment reporting, which hampers comparisons, and a reallocation of internal charges complicates matters further. Europe was notably weaker than Macquarie expected, as Turkish domestic conditions were exacerbated by competitive dynamics. The broker, nonetheless, does expect investment in scrap quality will eventually be seen to be justified.

UBS is not so optimistic, and remains cautious on the outlook for the scrap market because of increasing disruption. Municipal recycling was weak, suffering from an unfavourable contract at a time when waste paper values have plummeted. Poor margins in Europe reflect under-investment and increased competition, in the broker's view. UBS downgrades to Sell from Neutral, believing the outlook for non-ferrous scrap is not likely to improve any time soon.

China

There is also downside risk to non-ferrous pricing, as China starts its next round of bans on imported scrap. While details on this are limited, it appears that eight more categories have been moved into the restricted category. UBS suspects this could result in quotas or approvals being applied to category 6, or furnace-ready scrap, such as Zorba and Twitch.

The broker suspects China is moving along a path towards a total ban on all scrap imports by December 2020. That said, UBS believes a combination of recovery in US steel production and a decline in Chinese exports of semi-finished steel products will support demand for US ferrous scrap, although an economic downturn in Turkey could put prices and volumes under further pressure.

Credit Suisse points out ferrous purchase prices have not fallen enough to offset the weaker revenue from the slump in Zorba prices. The broker believes the industry is competing with prices for feed volumes, which indicates that volume leverage on fixed costs remains more important than the purchase price under current market dynamics, which include US trade wars and Turkey's difficulties.

Technology

The company's second half is expected to benefit from technology and infrastructure upgrades, but the deeper challenge, Credit Suisse ascertains, is the US trade protection that has supported an historically higher US steel price relative to Asia, and funded a higher US scrap price relative to other global markets.

The company's US business is largely an export business while the factors identified as headwinds appear broader than just the export discount that currently prevails. Hence, the broker considers the stock extremely volatile and hard to predict.

Ord Minnett had assumed the company's position as a global market leader in early adopter of non-ferrous technology would assist in insulating it from a difficult operating environment. However, the significant macro economic headwinds suggest earnings will likely be challenged going forward.

The broker's new forecasts assume no improvements in trading conditions for at least a year. Ord Minnett also assumes margins do not recover until the second half of FY21, at which point the potential exists for some improvement, given the expected start up of Zorba separation facilities in the UK and Australia.

There are four Buy ratings, two Hold and one Sell (UBS) on FNArena's database. The consensus target is \$12.15, signalling 33.2% upside to the last share price. Targets range from \$8.50 (UBS) to \$14.65 (Macquarie). The dividend yield on FY19 and FY20 forecasts is 4.5% and 5.0% respectively.

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Saracen Stock Price Overgilded?

Record gold production was a highlight for Saracen Mineral Holdings in the December quarter, although several brokers consider the stock overpriced.

-Capital expenditure intensifies so cash position likely to stagnate -Gold production increase to come from Carosue Dam expansion -Is the stock too expensive?

By Eva Brocklehurst

Carosue Dam has elevated Saracen Mineral Holdings' ((SAR)) outlook, with gold production at the Karari and Deep South deposits underpinning a record outcome in the December quarter.

Higher milled grades at Carosue Dam, 13% above Macquarie's estimates, drove the strong result, and the company's aspirations now centre on expanding the Carosue Dam mill as well as underground studies at Thunderbox.

Current capital projects include underground development at both operations, an airstrip and paste plant at Carosue Dam and Kailis stage 2 open pit. The reduced processing volumes that occurred at Thunderbox over the quarter stemmed from a mill shutdown for refurbishment.

Saracen will spend an extra \$35m in FY19 to accelerate underground development at both Carosue Dam (Karari/Dervish) and Thunderbox, which will lift total capital expenditure to \$175m over FY19. The company has pointed out that, during this intensive capital expenditure phase, the cash position is likely to stagnate before growth resumes.

Production in the quarter comprised 88,800 ounces of gold at an all in sustainable cost (AISC) of \$1067/oz. Guidance has been lifted to 345-365,000 ounces for FY19, which Canaccord Genuity finds unsurprising, given how the company has performed in the year to date and the fact that ore purchases at Carosue Dam have accounted for around 15,000 ounces in the first half.

Meanwhile, gold production was relatively steady at Thunderbox, with 35,725 ounces at an AISC \$1149/oz. Around one third of the ore at Thunderbox was sourced from stockpiles and the balance from open pit mining.

At Carosue Dam the next increase in production will be driven by the outcome of the mill expansion feasibility study. However, Deep South will probably cease production in the current quarter as the Dervish underground source comes on line.

Citi concedes the December quarter results were better than expected, with a 15% increase in production from the prior December quarter. Production for the December half year equates to a record 107,800 ounces. Operating expenditure guidance is maintained at \$1050-1100/oz.

Over Priced?

The stock's share price performance has been the best among the gold stocks that Bailieu Research covers, up 95% over the last 12 months and 23% over the last three months. The analysts suspect the market is factoring in delivery on the growth targets. While the cash position allows the company the ability to fund growth, Bailieu does not factor in "blue sky" and hence downgrades to Sell from Hold. The target is unchanged at \$1.95.

While Saracen is a quality gold stock, Citi concurs it is too expensive for a producer that is offering less than 400,000 ounces per annum. The broker notes a 12-month forward enterprise value/operating earnings (EBITDA) ratio of around 9x, the highest multiple of the ASX miners under coverage. Hence, Citi retains a valuation-based Sell rating and a \$2.10 target.

Canaccord Genuity expects the outcome of the updated resource and reserve, expected in the September quarter, will provide the important detail to underpin the growth ambitions, including the plan for the Thunderbox underground.

Currently the broker models a sub-level cave operation but notes the increase commentary on selective stoping, which may ultimately point to a re-cut of the reserve and/or a hybrid of the two mining methods. The underground

studies at Thunderbox will be used to enhance understanding, ahead of any stoping activity.

Considering that ore from the Thunderbox underground accounts for over 50% of production assumptions for FY21, Canaccord Genuity suspects a firmer take on the development strategy and capital requirements could have a material impact on forecasts. Still, the broker agrees the stock is expensive and maintains a Sell rating and \$2.35 target. In contrast, Macquarie has a \$3.30 target and Outperform rating.

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BHP Maintains Momentum, Despite Outages

A host of items are expected to negatively affect BHP Group's first half profit, although most brokers acknowledge there is still enough momentum to meet full year guidance.

-Production guidance reiterated, except for copper which has increased -Strong second half is required to meet expectations -Potential for additional capital management

By Eva Brocklehurst

BHP Group ((BHP)) has sustained a significant impact from outages in the first half that were unplanned, resulting in weaker production outcomes versus expectations.

A host of items will affect half-year profit and include increased unit costs, exploration expenditure and non-cash adjustments. The company has reported US\$700m in additional taxes will be payable, also notching up a -US\$300m loss on its former US onshore assets and a US\$125m impairment.

Nevertheless, guidance for FY19 has been reiterated, except for copper, which is increased by 2% to account for the retention of Cerro Colorado. The outages that were unplanned relate to a train derailment in WA, plant downtime at Olympic Dam and fires at Spence and Nickel West.

Roughly two thirds of the US\$600m impact from outages came from the copper tonnage lost at Olympic Dam and Spence, so the company needs a stronger second half in order to hit guidance, particularly in coal and iron ore.

Macquarie suggests the latter requires a mild wet season in the Pilbara and could be a stretch. Thermal coal requires a material lift in volumes to hit the upper end of the forecast range, and the broker suggests seasonal factors could also make achieving this a difficult task.

Meanwhile, copper guidance at Escondida can be achieved with a flat result, although both Olympic Dam and Spence need to experience increased volumes. The broker reduces estimates by -7% to reflect lower price realisation for metallurgical (coking) and thermal (energy) coal, copper and iron ore.

Petroleum volumes were the main positive for Macquarie, beating estimates by 4%, while thermal coal was below forecasts and the main weak spot. Importantly, the extra petroleum production was driven by higher oil volumes and, as oil production is generally more profitable than gas, this should improve the mix.

Ord Minnett agrees a strong second half will be required to achieve budget and expects the stock will be affected by macro economic factors in the near term, while global growth conditions will deteriorate. Hence, no re-rating catalysts are likely to emerge. While estimates are downgraded for FY19, the stock is trading with a free cash flow yield of 6.5% and dividend yield of 5.5%, so Citi retains a positive view.

Capital Management

Macquarie believes the earnings upgrade momentum remains strong, underpinned by buoyant iron ore and coking coal prices, while there is potential for additional capital management over FY19. A US\$2bn on-market buyback of London-listed stock is considered possible under a spot price scenario.

Despite the increased disclosure and the potential for a messy first half, the valuation and multiples, as well as net debt position, all signal to Credit Suisse that the stock is far from expensive. However, as is the case with competitor Rio Tinto ((RIO)), a conservative house view regarding China overlays the outlook and a Neutral rating is maintained.

UBS points out that despite the company highlighting full-year unit costs for all major assets in line with guidance, these were trending higher in the December half as a result of the outages. The broker expects first half underlying earnings of US\$3.86bn and interim dividend of US\$0.53 per share, in addition to the US\$1.02 per share special dividend to be paid on January 30.

Deutsche Bank, the broker on the FN Arena database with a Sell rating, also remains cautious about costs. Otherwise, there are five Buy ratings and two Hold. The dividend yield for FY19 and FY20 consensus forecasts, on present FX values, is 8.7% and 5.1% respectively.

The consensus target is \$35.52, signalling 9.5% upside to the last share price. Targets range from \$28 (Deutsche Bank) to \$40.66 (Morgans, yet to update on the production report).

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Value To Be Found In Defensive A-REITs

Increased volatility in markets and downgraded economic growth expectations are a positive backdrop for defensive names among A-REITs. Brokers embark on a round of stock picking.

-Growing income, assets in office & industrials vs weak retail & residential segments -Citi maintains its highest conviction in the funds management subset -Brokers note some life left in office rental growth in Sydney, Melbourne

By Eva Brocklehurst

In 2019 the outlook for Australian real estate investment trusts (A-REITs) is segmenting, as retail and residential are under pressure while funds management, office and industrial are now the main areas favoured by brokers.

Citi forecasts a low-return year ahead for A-REITs with the main risk to the downside, including falling shopping centre values and the risk that capitalisation rates (income divided by value or purchase price) will start to rise in office/industrial segments.

While a synchronised commercial property downturn is not in the base case, the broker points out it could arise if global and domestic economic growth risks recede and there is a resumption of upward pressure on global security yields.

Citi expects investors to pay attention to a turn in the cap rate cycle, a major multi-year cyclical risk that has been flagged for the past two years. This is also considered to be the major driver of A-REIT returns, and there is growing evidence the cycle is ending, at least for certain types of listed property assets.

Macquarie suggests the increased volatility in equity markets, and the downgrade in growth expectations for both the Australian and US economies, is a positive for defensive stocks, such as A-REITs, as in times of rising volatility, historically these outperform the broader ASX.

Expectations for higher interest rate and yield curves have moderated as well. Earnings growth is expected to be relatively strong across the sector, which the broker notes at 4.8% compares to the broader industrials growth rate of 5.4%.

Offsetting factors are acknowledged, such as the outlook for retail assets, given structural challenges, and the weakness in the residential market, which will be a headwind for those exposed to both retail and residential segments.

Fundamental headwinds include reduced GDP growth and consumer spending. Debt spreads have also increased which will affect the cost of funding. The broker emphasises the strong negative correlation between the relative performance of A-REITs and the 10-year Australian government bond remains intact, and actually increased in 2018.

Defensive Names In Focus

CLSA asserts defensive stocks are back in fashion, and this means A-REITs should outperform. Office and industrials are expected to show both growing income and net tangible assets (NTA), although lower-quality retail will report weak rental growth amid risks of NTA downside.

This translates to expectations for fund managers such as Goodman Group ((GMG)) and Charter Hall ((CHC)) to report strong assets under management and earnings growth. Development completions and valuation uplift should be the main driver for Goodman Group, while Charter Hall should reflect growth from acquisitions. Ord Minnett concurs and upgrades Charter Hall to Accumulate.

Both CLSA and Ord Minnett upgrade Cromwell Property ((CMW)) to Outperform and Accumulate respectively, given increased funds under management and M&A potential. Ord Minnett upgrades Carindale Property ((CDP)) to Hold and SCA Property ((SCP)) to Accumulate based on valuation.

Despite a modest outlook for the sector, Citi asserts A-REITs will still offer opportunities over 2019 and has the highest conviction in the funds management subset. Therefore, exposure is warranted to both momentum, in terms of fund managers Goodman and Charter Hall, and value, in terms of Stockland ((SGP)), Abacus Property ((ABP)) and

LendLease ((LLC)).

Growing opportunities among A-REITs exposed to residential markets are expected, as the broker asserts the Australian housing is not slumping and the stock prices are down -20-30% over 2018. Hence, Citi upgrades Stockland, LendLease and Abacus Property to Buy.

In contrast, CLSA downgrades LendLease to Underperform and reduces the multiples for all its business segments. The broker lowers residential settlement forecast for FY19-22 and reduces the company's construction/engineering margins for Australia.

Developers, Mirvac ((MGR)) and Stockland, are expected to be able to maintain FY19 guidance despite the fall in residential prices and volumes, although a skew to the second half is expected. Mirvac is also supported by its commercial development profits and office income growth.

Office

UBS has analysed office rents and the outlook is mostly positive. Sydney delivered 15% net effective rent growth in 2018 and the forecast for 2019 is 12%. In Melbourne the forecasts is 4% after 7% was delivered in 2018. This rental data supports the an upgrade of Dexu Property ((DXS)) to Neutral, as UBS is attracted to the low gearing and flexible balance sheet.

The broker had expected office supply would pick up more quickly and was, therefore, cool about rental growth expectations. Now, supply is expected to remain constrained amid another good year for rental growth in Sydney and Melbourne.

Citi agrees Sydney rental growth, while remaining a tailwind, is potentially moderating, although landlords will continue to experience positive rental growth on expiring leases. A move back to long-term averages in rental growth could represent some downside for office stocks.

Additionally, the broker suggests current valuations reflect some of the upside already and, thus, downgrades Dexu to Neutral from Buy. Ord Minnett also downgrades Dexu to Lighten based on the elevated multiples and Charter Hall Long WALE ((CLW)) to Lighten because of the reduced growth outlook.

The broker suspects market cap rates in Sydney are at risk of reaching an inflection point in 2020, because of slowing rental growth and a lack of affordability that may force decentralisation.

Retail

Citi is increasingly negative on retail and envisages share price downside of over -10% for this segment. The broker has a Sell rating for Scentre Group ((SCG)) and Sell ratings on all three small cap retail stocks, which are trading above NTA despite growing pressure on shopping centre values. This includes Charter Hall Retail ((CQR)), SCA Property and BWP Trust ((BWP)).

Ord Minnett downgrades Scentre Group to Hold, expecting its retail capitalisation rates to expand. Charter Hall Retail is also downgraded, to Lighten from Hold. While acknowledging structural headwinds in retail A-REITs, UBS retains a Buy rating for both Scentre Group and Vicinity Centres ((VCX)), assessing the valuation discount in the latter is too large to ignore.

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The Real Price Of LNG

Richard (Rick) Mills Ahead of the Herd

As a general rule, the most successful man in life is the man who has the best information.

"This is a spectacular day for all British Columbians, again not one that happened today, not one that happened yesterday but one that has happened over the past few decades. I can't tell you how proud and pleased I am to have the opportunity to lead the government to work with all levels of government to make life better for British Columbians. I can't stop smiling.

That was John Horgan, the Premier of British Columbia, declaring his support for, what, a plan to tackle unaffordable housing? Ending the fentanyl crisis? A major infrastructure project that will lower the frustration of Lower Mainland commuters?

No, what Premier Horgan was smiling about on October 2nd, was the signing of a final investment decision by LNG Canada. Flanked by industry leaders and Prime Minister Justin Trudeau, Horgan said that despite belching out 3.45 megatonnes of carbon emissions a year, BC would meet its climate change goals of cutting greenhouse gases by 40% by 2030 and 80% by 2050. The Pembina Institute estimates that between LNG Canada and Woodfibre LNG, the other, so far, approved BC liquefied natural gas project, the plants will increase annual carbon pollution by 9.1 megatonnes by 2030 and 10.2MG by 2050. But the targets will be met, somehow. Trust us.

To actually meet the province's climate change goal, massive carbon cuts would have to be made elsewhere. The government says it's currently rolling out a new climate plan. We're not expecting any dramatic revelations.

China, Russia and Canada's current climate policies would drive the world above a catastrophic 5C of warming by the end of the century, according to a study that ranks the climate goals of different countries.

Of course, it was the lure of the buck that made Horgan and his Cabinet become sudden converts to LNG, despite opposing it while in Opposition to the Christy Clark Liberals (Horgan said at the time that LNG was giving up too much revenue to attract foreign investment - ironic now, considering the NDP gave LNG Canada a \$5.3B tax break), who came up with the idea with much fanfare - even promising to pay off the provincial debt with the windfall of LNG cash.

The NDP says the LNG Canada project will bring in \$22 billion over 40 years.

That sounds pretty good, but it assumes there are no costs associated with building a new LNG industry in BC. A fossil-fuel-intensive industry that goes against the prevailing mood (excluding the Trump Administration) of weaning ourselves off carbon through the use of cleaner technology like nuclear energy and renewables.

But there are costs. And they could be huge. Much greater than \$22 billion. Why? Because the BC LNG industry is being built at exactly the wrong time. We know that climate change is upon us. Yes, even in beautiful British Columbia. The evidence is everywhere, and we have written on it extensively. Rising ocean levels and temperatures, frequent and more intense storms, droughts, forest fires, retreating glaciers, calving ice sheets, mudslides, newly active volcanoes, melting permafrost in the Arctic leaving bubbling cauldrons of methane - a much more potent greenhouse gas than carbon dioxide.

Plus the negative effects of the natural gas industry that continue to be seen in the form of methane escapes into the water and atmosphere, benzene poisoning among the people of northeastern BC who live near fracking wells, polluted lakes, more CO2 and other toxins that are emitted permanently into the atmosphere when natural gas is burnt to produce energy.

In 2017, global economic losses from natural disasters and man-made catastrophes were the highest ever amounting to US\$337 billion.

This article will take a closer look at those costs, and poses the question: How are we going to address climate change by encouraging the development of a fossil-fuel driven LNG industry in British Columbia?

Forest fires and climate change

It doesn't take a scientist to notice that forest fires and droughts (the two being inter-related) have been getting worse over the years. BC entered its third consecutive year of serious wildfires. This summer was the worst fire season on record and anecdotally, there was a lot more smoke than in 2017. So much that there was a run on HEPA air filters in the Lower Mainland, usually immune from the smoke "up north" or "in the Interior". People were checking daily air quality warnings like we were living in China. In fact Kelowna hit a record one day as having worse air quality than Beijing.

Close to 13,000 square kilometers were burnt, breaking the previous record set in 2017; that year, the government spent \$568 million on fire suppression. This year is estimated to come in at over \$300 million.

While the forest fire season is over in Canada, state-side they continue to rage. In California this week [November], over 100 people, many of them seniors, are missing as firefighters battle the Camp Fire, the largest in the state's history. Fifty people have perished in two major fires burning in California. According to CNN the Camp Fire and Woolsey Fire - one in northern and the other in southern California - have so far destroyed 8,083 homes or structures and scorched 232,620 acres.

So what to make of these fires? Are they caused by climate change? That seems to be the narrative in the press, although the problem is more complicated than that. Prescribed burns, as forest companies used to do, are no longer government policy in the United States or Canada, leaving hundreds of hectares/acres of dangerously dry tinder, easily ignited by a match or a lightning strike. Prescribed burns are bad for tourism. Residents don't care much for them either.

But warming temperatures and an extended drought in the western United States are certainly major factors. The Guardian reports that of the 20 largest wildfires in California's history, 15 of them have been since 2000, during which time forests have become warmer and drier. Since 1970 the temperature increase in the west is about double the global average.

"Given strong relationships between climate and fire, even when modified by land use and management such as fuel treatments, projected climate changes suggest that western forests in the United States will be increasingly affected by large and intense fires that occur more frequently," a government report states.

The Union of Concerned Scientists notes that higher temperatures in the summer and spring are causing soils to be drier for longer, increasing the likelihood of droughts and a longer wildfire season. In the US southwest, it's predicted that the fire season will soon be all year long rather than just seven months. A NASA study states that droughts caused by climate change are getting worse and could become more frequent in the western US.

See below for a current drought map. Almost everything west of Montana, Wyoming, Colorado and New Mexico now ranges from abnormally dry to exceptional drought.

In the summer over half of the United States fit this description.

In BC, similar conditions prevailed this year. Two weeks of hot weather in July drove up the fire danger rating, followed by widespread lightning in early August.

Not only do wildfires chew through forests/ agricultural land, drive people from their homes, destroy property and sometimes kill people, they also cause flash floods, in areas where all the vegetation has been burnt, leaving nowhere for water to be absorbed; and drive a climate change feedback loop.

The loop happens when forest fires burn the carbon stored in trees, emitting a toxic brew of carbon dioxide, methane and carbon monoxide. These gases trap heat in the atmosphere, causing further warming, drier forests, and more fires.

An independent report released by the BC government states that in 2017, wildfires emitted 190 million tonnes of carbon into the environment - six times the total from other sources and almost triple BC's annual carbon footprint.

Another effect of global warming is the increasing intensity of forest fires. This past summer some fires in BC were so hot, they couldn't be put out with water alone. CBC quotes Mike Flannigan, a professor of wildland fire at the University of Alberta, saying that many large fires are spreading in BC, year after year, due to a ridge of high pressure that is stuck over the province for much of the summer. The ridge forms along the West Coast due to melting Arctic sea ice, and the air beneath it is warm and dry, creating the perfect conditions for a "raging inferno" according to Flannigan.

Governments backing LNG

Apparently though, Premier Horgan didn't make the connection between the fires, and the onslaught of greenhouse gases that LNG is set to unleash on British Columbians in coming years, as he sat grinning in a room with Trudeau in October.

Why is LNG Canada going ahead while the Trans Mountain pipeline expansion (TMX) is tied up in more consultation? An Alberta Cabinet minister says the LNG project will have a greater environmental impact than TMX. We agree.

"It's going to result in about 177-per-cent increase in tanker traffic compared to TMX which will result in a 14 per cent increase," Economic Development and Trade Minister Deron Bilous told reporters at the Alberta legislature, via CBC.

A Globe and Mail article put the two projects side by side to examine the impacts - both economic and environmental. In terms of CO2 emissions, the Globe analysis assigns a much heavier footprint to LNG Canada - 3.45 million tonnes annually - versus just 0.4 million tonnes from TMX.

Maybe the politicians don't realize it, but developing an LNG industry in BC requires widespread fracking. Of all the natural gas reserves left in BC, only 22% are conventional, with the rest found in unconventional formations, known as "tight gas".

At Ahead of the Herd we have done extensive research into fracking, and recently reviewed the history of the practice in BC. We revealed a number of disturbing occurrences. Among them: earthquakes; rules to protect caribou were broken and unenforced by the Oil and Gas Commission; unsustainable (and possibly illegal) draw-downs of water; and the most disturbing of all, heightened levels of benzene, a dangerous carcinogen, found in pregnant native women.

We also found evidence of a BC Liberal government cover-up of the risk fracking presents to dam safety:

"Senior BC Hydro officials have quietly feared for years that earthquakes triggered by natural gas industry fracking operations could damage its Peace River dams, putting hundreds if not thousands of people at risk should the dams fail. Yet the Crown corporation has said nothing publicly about its concerns, opting instead to negotiate behind the scenes with the provincial energy industry regulator, the BC Oil and Gas Commission."

In spite of all this, Premier Horgan says he's okay with fracking.

"We've been fracking in B.C. for decades and we do it fairly well. I've been to a number of frack sites, and I'm comfortable with the technology," Horgan said in 2012, when asked whether the NDP supports fracking.

Although the current BC government denies it, it seems pretty clear that Horgan's NDP was thinking of LNG when it agreed to let the controversial Site C dam project go ahead last year - despite railing against it in Opposition.

That's because Site C will be needed to power LNG Canada and future LNG plants that are in the works. Add in the cancellation of Kinder Morgan, the fact there are only so many pipeline routes through mountainous BC, and a \$5.3 billion tax break given to LNG Canada, and the evidence only points in one direction: the BC NDP.

The proof? A year ago it was reported that BC Hydro expects at least three LNG projects will need power from Site C.

It's also interesting to note that the nascent LNG industry in BC is being encouraged by the federal Liberals. In 2017 Trudeau's Liberals passed Bill C-48, the Oil Tanker Moratorium Act, which stops crude oil tanker traffic on the northern coast of BC - thus formalizing a "voluntary" Tanker Exclusion Zone that's existed since 2015.

Excluded from the bill, though, are gasoline, naphtha, jet fuel, propane and liquefied natural gas (LNG) - allowing the unfettered expansion of a new LNG industry in BC.

Recall back in 2016, the federal government made a questionable bargain with the oil industry and Canadians - approving the \$36 billion Pacific NorthWest LNG project near Prince Rupert, while at the same time assuring Canadians that the massive increase in greenhouse gas emissions from the project (later cancelled by Petronas), would be part of a national climate plan. As we now know, that plan includes a carbon tax that all provinces must buy into.

So it seems that the feds have been on board with LNG since 2016, or perhaps earlier, obviously without much knowledge of the science - or maybe our Provincial and Federal politicians just don't care?

Once the gas is fracked and put in a pipeline, it arrives at the terminal - however in a form unsuitable for tanker transport. To turn it into a liquid, it must be cooled to 163 degrees below zero. To do that requires a great deal of power, with massive compression units running 24/7.

It's estimated that if LNG Canada were to use only hydro-electric power to convert NG to LNG, would require 40% of the capacity of the Site C dam currently being built. The more likely scenario is that LNG Canada will use a combination of hydro electricity and natural gas to power the plant - the same fracked gas that came via pipeline to the terminal. And it makes sense to do that, since NG is a lot cheaper than hydro.

The bottom line? LNG is not clean energy, it's dirty energy - pumped up from the ground with the help of chemicals that leach into the water supply. When burned for electricity, natural gas gives off emissions that are in the atmosphere forever, contributing to the greenhouse effect of global warming.

"Today's announcement is a new form of climate denial: The idea that we can build new fossil fuel projects that will cause millions of tonnes of additional emissions while reducing our emissions at the same time," said Sierra Club B.C.'s climate campaigner, Jens Wieting, the day of the LNG Canada announcement. "By sweetening the pot for fracked gas export, the government is laying out a red carpet for investors to help destroy our climate."

The real costs of LNG

\$22 billion seems like a lot of revenue to glean from one LNG project. Imagine if two more projects of similar size could be built. That would wipe out BC's current debt of around \$67 billion.

But this is just the "gross revenue". To find the net, we have to calculate the costs of LNG, to our health, our environment, and natural disasters that could easily occur as a result of an industry that is really a ticking time bomb. Then subtract them from the gross. Let's give it a try.

Health

The best way to measure the health effects of LNG is to look at the natural gas industry in the United States, where fracking has been done with gusto for nearly a decade - using the same techniques that will be done in BC.

It's been found that people who live near areas where hydraulic fracturing is taking place, are more likely to be hospitalized for heart conditions, neurological illness and cancer. That's according to a study done in 2015 by the University of Pennsylvania and Columbia University, where researchers looked at hospitalization rates in Pennsylvania in areas with fracking versus those without.

"The technology to recover natural gas depends on undisclosed types and amounts of toxic chemicals. A list of 944 products containing 632 chemicals used during natural gas operations was compiled. Literature searches were conducted to determine potential health effects of the 353 chemicals identified by Chemical Abstract Service (CAS) numbers. More than 75% of the chemicals could affect the skin, eyes, and other sensory organs, and the respiratory and gastrointestinal systems.

Approximately 40-50% could affect the brain/nervous system, immune and cardiovascular systems, and the kidneys; 37% could affect the endocrine system; and 25% could cause cancer and mutations.

These results indicate that many chemicals used during the fracturing and drilling stages of gas operations may have long-term health effects that are not immediately expressed. In addition, an example was provided of waste evaporation pit residuals that contained numerous chemicals on the CERCLA and EPCRA lists of hazardous substances." Natural Gas Operations From A Public Health Perspective, wv4mom.org

A 2017 study at the University of Montreal found that fracking releases volatile organic compounds (VOCs) like benzene into the environment:

The researchers tested urine samples of 29 pregnant women in Chetwynd and Dawson Creek, two small communities near heavily-fracked shale gas fields in BC's Peace River Valley. They measured two "biomarkers" that our bodies produce when we're exposed to benzene, a carcinogen that's been linked to low birth weights and some defects.

Environmental

Fracking defenders say the process is perfectly safe and contained. The reality is that pollutants are released throughout the process - into the air and water.

Tens of thousands of wells will be drilled, then a concoction of chemicals, water and frac sand will be pumped in at high pressure to break apart the shale rock in order to create fissures that release the natural gas. The fracking fluid and natural gas will then be pumped back up and "burped" for several weeks, while the gas is separated from the fluids. Sour gas is burned, releasing carbon dioxide, sulfur dioxide, methane and nitrous oxide into the environment. Thirty to 40% of the fracking fluid is left in the well. The "flowback liquid" that is left after the gas is extracted contains water and a number of contaminants, including radioactive material (like radium, which can cause

leukemia), heavy metals, hydrocarbons, bromide and other toxins.

This wastewater is then stored in pits, injected deep underground, or treated off-site.

The wastewater pumped underground goes into oil and gas waste wells or saline aquifers. There are serious concerns about the ability of these caverns and aquifers to handle the increased pressure and the evidence is showing that deep-well injecting is linked to the occurrence of earthquakes.

Benzene, a cancer-causing carcinogen mentioned above in the study on pregnant women, can seep into the groundwater, helped along by further cracks in the Earth if the procedure results in tremors.

Wastewater stored on surface is no better. The toxic ponds continue to off-gas for years and poisons may leach into the water supply. In the Netherlands, methane was found in the drinking water supply of the nearby aquifer, 50 years after a blow-out occurred in an underground natural gas reservoir.

Methane in water is explosive and can cause asphyxiate people if it's not detected. Methane concentrations are 17 times higher in drinking-water wells near fracturing sites than in normal wells.

Then there's the extreme water use.

Each well uses between 1.5 million and 15 million gallons (American Geosciences Institute) of locally-sourced fresh water (an estimated 28,000 wells have been drilled so far in Northeastern BC, that number could easily double), which will be permanently contaminated by toxic chemicals contained in the fracking fluid, in ground contaminants and the mixing of the two to create new toxic substances. This is water that could be used for drinking, by animals or humans, or for irrigating crops and pastures. Billions of gallons of fresh water will be destroyed.

A recent study from Duke University found a huge increase in water use for fracking operations over the past five years. The paper published in *Science Advances* revealed that water use per well increased by up to 770% between 2011 and 2016. Wastewater volumes rose by 1,440% in two Texas shale formations.

Keep in mind, this water is being taken by oil and gas companies for free. Pretty galling considering most of us have to pay for our water. Imagine how much it would cost if they had to pay for it? Billions. In BC we pay an average \$37.50 a month for water. In drought-stricken areas, it's a lot higher. Water rates in California have been going up. Multiply \$37.50/mo times 2.4 million (the 4.8 million population of British Columbia conservatively divided by two to account for multiple-person households) and you get \$2.167 billion a year.

When it comes to air pollution, natural gas is, *prima facie*, better for the environment than coal. NG plants emit about half of the carbon dioxide compared to coal-fired plants, and a natural gas-powered vehicle will release 15 to 20% less pollutants than one powered by gasoline.

But there will still be emissions, lots of them, plus, the really negative effects of natural gas occur at the drilling, extraction and transportation phases. This is because the industry can't stop the escape of methane, the main component of natural gas. Methane is terrible for the atmosphere, and a large contributor to global warming, because it is much more efficient than CO₂ at trapping heat. Scientists estimate methane contributes about 25% to global warming.

Fugitive methane emissions run from 1% to 9% of total natural gas life cycle emissions. In order for natural gas power plants to be cleaner than coal, methane emissions over the plant's life cycle must be kept below 3.2%, according to one study.

Most methane leaks come from flaring excess NG instead of putting it into a pipeline. Think methane emissions are no big deal, just a cost of doing business? The journal *Nature* earlier this year published a study saying that the US oil and gas industry emits 13 million tonnes of methane a year, which is 60% higher than the EPA's estimate.

The biggest methane leak in US history occurred in California in 2015. It took SoCal Gas nearly four months to plug the leak at the Alison Canyon gas field - during which an estimated 109,000 tonnes of methane was released into the atmosphere. While that sounds bad, the methane emissions from one natural gas field - the sprawling San Juan Basin in the US southwest - emitted 291,162 tonnes of methane in 2014, according to the EPA. The Front Range tight gas formation in Colorado reportedly leaks 19.3 tons of methane an hour.

In some areas where fracking occurs, there have been increases in other hazardous pollutants besides methane - namely particulate matter and ozone. Living under half a mile from an unconventional gas well puts you at greater risk of respiratory symptoms, cardiovascular disease and cancer, according to one study quoted by the Union of Concerned Scientists.

On top of the methane gas escapes and other toxic emissions, methane in the water, ruined fresh water that could be put to productive and healthy uses, dangerous health risks including benzene poisoning leading to cancer and birth defects, earthquakes, the risk to dams and other large structures, we added two more detrimental effects of fracking in a recent article: danger to killer whales from much higher LNG tanker traffic, and the exacerbation of global warming witnessed by retreating glaciers and a newly active volcano right here in BC.

Mount Meager just north of Vancouver is a ticking time bomb, with glacial retreat exposing "fumaroles" or vents spewing hydrogen sulfide, carbon dioxide and steam.

Of course we can't attribute fracking to venting and retreating glaciers on Mount Meager, the site of a massive mudslide in 2010 - the second largest in Canadian history. But if fracking goes ahead in northeastern BC, as it undoubtedly will with two LNG projects on the runway and 12 more proposed according to Natural Resources Canada, there will be more carbon dioxide, methane and other greenhouse gases released, increasing the likelihood of another disaster at Mount Meager, and other BC volcanoes coming to life.

Conclusion

Climate change is real. We don't know whether it's human-caused or a function of natural cycles, or maybe a combination of both. Actually we don't care. We only know that it's here, and we need to plan for it. Most of the population is happy to go on with their lives, knowing that the Earth is warming, but without much concern it will affect them. This includes politicians who are the gate-keepers of our natural resources, our air and our water.

With the acceleration of an LNG industry in BC, these gate-keepers have given the keys to large, foreign multi-nationals who don't care about BC. They only want to buy our gas and ship it overseas, supposedly to get Asia off of coal and onto cleaner natural gas. But as we have shown, NG is anything but clean. When burned, it emits noxious pollutants. These emissions are part of the problem of climate change, not the solution. Methane release makes the problem many times worse. The more methane in the atmosphere, the warmer the planet will get. It's just science.

The only way to get the liquid natural gas is to frack it, which comes with a whole host of problems, presenting huge risks to human and animal health, and the environment. Is it worth it? Is 20 billion dollars over the 40-year life of one project worth the risk of what we're going to do to northeastern BC?

Not from the economic side...The financial cost to us BC residents is massively lopsided. BC politicians are giving them, the LNG multinationals, none of which are Canadian Companies, a \$5.3 billion tax break and \$86.68 billion in free water over the 40 period they supposedly give us \$20 billion. The Feds are giving them another \$250m. Hmmmmm.

And what price will BC residents pay for failing to reach our stated carbon footprint reduction goals? We at Ahead of the Herd believe that the costs to human health of fracking natural gas, pipelining and burning it to get LNG, in terms of increased hospitalizations, and drains on the Medical Services Plan, plus the many negative effects on the environment - contributing to global warming causing earthquakes, landslides, volcanoes erupting, the extinction of BC's Killer Whales etc - to name a few will cost a great deal more than \$20 billion, over the next 40 years.

What is the net benefit to BC of just one LNG project, let alone two or three more and a massive pipeline system that would have to be built to move all that gas around? I strongly suggest there is none.

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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 January 14 to Friday January 18, 2019 Total Upgrades: 16 Total Downgrades: 9 Net Ratings Breakdown: Buy 46.49%; Hold 40.92%; Sell 12.60%

While macro-optimism has pushed up share prices over the first three weeks of the new calendar year, investors in Australia might be heartened by the observation that stockbroking analysts locally are equally supporting the upward move in share prices by issuing more recommendation upgrades than downgrades for individual ASX-listed stocks.

For the week ending Friday, 18th January 2019, FNArena registered 16 upgrades versus nine downgrades. Alas, due to technical problems this week's report contains no insights on price targets & valuations, and consensus earnings estimates, but anecdotal observations suggest both are trending south ahead of the February reporting season.

Most upgrades are inspired by weak valuations with both Michael Hill and News Corp receiving two upgrades during the week. That's two times up to Neutral/Hold for the former, and two times up to Buy for the latter.

All but two downgrades have moved to Neutral/Hold; the two "unlucky" ones, so to speak, to receive fresh Sell ratings are Platinum Asset Management and Sydney Airport.

Technical problems are hopefully resolved before the end of this week, which will allow this weekly update to resume in its usual format by next Monday.

Upgrade

ADELAIDE BRIGHTON LIMITED ((ABC)) Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 1/4/1

Morgan Stanley observes Adelaide Brighton has de-rated meaningfully and is now below its five-year average. The broker believes, at this level and still trading at a premium to peers, the stock is more attractive from a relative valuation perspective.

Given the changes to management and timeline for any updates to strategy, the broker does not envisage any urgency in owning the stock.

Rating is upgraded to Equal-weight from Underweight. Target is steady at \$4.75. Industry view: Cautious.

ANSELL LIMITED ((ANN)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 3/5/0

Macquarie finds macro economic data is broadly supportive of organic revenue growth, while further moderation in raw material prices offers the potential for gains in margin.

In view of the flexibility in the balance sheet and incremental benefits from the company's transformation program, as well as undemanding valuations, Macquarie upgrades to Outperform from Neutral.

Target is reduced to \$26.50 from \$27.20 to reflect lower long-term growth assumptions.

BEACH ENERGY LIMITED ((BPT)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 3/2/0

Credit Suisse believes Beach Energy is uniquely situated as a domestic gas player, with the potential to capture east coast gas trading and consolidation. Potential acquisition candidates include Cooper Energy ((COE)) and Bass Strait interests.

Credit Suisse is also comfortable with Seven Group ((SVW)) increasing its stake in Beach Energy.

The broker upgrades to Outperform from Neutral, and expects price support over the next 18 months from continued cost reductions as well as modest production growth in the Cooper Basin. Target is raised to \$1.75 from \$1.25.

COSTA GROUP HOLDINGS LIMITED ((CGC)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 3/2/0

Last week's trading update gave investors reasons to reconsider long-term assumptions, Credit Suisse points out, although the net profit impact for 2018 is immaterial to valuation.

The new material in the announcement was regarding domestic berry pricing, which was soft in late December and early January. However, the broker suggests the big swing in profit between 2019 and 2018 will be driven by citrus and international business, not berries.

Credit Suisse shifts its valuation technique to DCF and takes more conservative long-term assumptions. The rating is raised to Outperform from Neutral as the share price has dropped below the target. Target is reduced to \$5.60 from \$7.30.

CORPORATE TRAVEL MANAGEMENT LIMITED ((CTD)) Upgrade to Buy from Neutral by UBS .B/H/S: 4/1/0

The stock has fallen -31% since its peak in September and UBS remains convinced of the growth opportunity. The broker asserts nothing is being priced in for future acquisitions.

Upside risk to earnings is considered likely, given the company's acquisition history, and the broker upgrades to Buy from Neutral. Target is reduced to \$31.20 from \$32.20.

CLEANAWAY WASTE MANAGEMENT LIMITED ((CWY)) Upgrade to Buy from Neutral by UBS .B/H/S: 5/1/0

UBS highlights Cleanaway Waste as a defensive play in a market where investors are concerned about the slowdown in consumer spending. The broker suggests the recent win at Sydney Council is an indication the company is gaining share.

Toxfree is also likely to provide synergy benefits over the next three years. Cleanaway is expected to be at the forefront of structural change in the Australian waste industry.

UBS upgrades to Buy from Neutral. Target is steady at \$2.15.

HT&E LIMITED ((HT1)) Upgrade to Buy from Neutral by Citi .B/H/S: 1/3/1

Citi upgrades to Buy from Neutral as valuation is considered attractive at current levels. There is further upside potential if the company can obtain a favourable outcome on its tax dispute.

Citi maintains a target of \$1.90.

MAGELLAN FINANCIAL GROUP LIMITED ((MFG)) Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 5/1/0

While asset managers are cheap Morgan Stanley suspects ongoing outflows will mean a re-rating in the near term is unlikely. In contrast to global peers, Australian stocks appear at a premium, even accounting for flows.

Morgan Stanley upgrades Magellan Financial to Equal-weight from Underweight, given its stronger investment performance versus peers. Target is raised to \$25.00 from \$21.50. Industry view: In-Line.

MICHAEL HILL INTERNATIONAL LIMITED ((MHJ)) Upgrade to Neutral from Sell by Citi and Upgrade to Hold from Reduce by Morgans .B/H/S: 2/2/0

Citi analysts observe the decline in like-for-like sales has stopped and Michael Hill actually achieved positive growth over the Xmas period. They have upgraded to Neutral from Sell in response.

There is potential for new management to actually turn this ship around, the analysts suggest. Estimates have been lifted short term, but reduced for FY21 and FY22. Target falls to 63c from 65c.

The company's first half trading update has signalled 1.3% same-store sales growth over the key November/December months.

Morgans is now more confident, given the return to positive sales growth over the crucial Christmas period, although retains some concerns about the outlook for gross margin going forward.

Rating is upgraded to Hold from Reduce and the target raised to \$0.62 from \$0.60. The company did not provide its usual regional growth metrics but a strong performance is still envisaged for Canada.

NINE ENTERTAINMENT CO. HOLDINGS LIMITED ((NEC)) Upgrade to Buy from Neutral by Citi .B/H/S: 5/0/0

Citi reduces earnings estimates for the entire traditional media sector, primarily to reflect more conservative growth forecasts.

Nine Entertainment's rating is upgraded to Buy from Neutral, entirely because of valuation, with the drop in the share price considered excessive. Target is reduced to \$1.60 from \$1.85.

NEWS CORPORATION ((NWS)) Upgrade to Buy from Neutral by Citi and Upgrade to Buy from Neutral by UBS .B/H/S: 3/1/1

Citi reduces earnings estimates for the entire traditional media sector, primarily to reflect more conservative growth forecasts.

The broker upgrades News Corp to Buy from Neutral, believing the stock represents an attractive entry point at current levels. Target is reduced to \$20.00 from \$21.45.

UBS has data which shows that price was the main reason why consumers either left Foxtel or never subscribed. However, with around 70% of households taking at least one pay-TV/SPAD product, consumers appear willing to pay for reasonably-priced content.

Kayo Sports has a lower price point and the broker believes it can significantly grow Foxtel's household penetration. The risk of cannibalisation exists but may be less than feared.

Following the recent underperformance of the share price, UBS upgrades to Buy from Neutral and raises the target to \$20.75 from \$20.50, to allow for the upside potential.

SEVEN WEST MEDIA LIMITED ((SWM)) Upgrade to Neutral from Sell by Citi .B/H/S: 0/4/1

Citi reduces earnings estimates for the entire traditional media sector, primarily to reflect more conservative growth forecasts. The broker expects Seven West Media will continue gaining market share in FY19, despite a flat TV market.

Owing to the recent decline in the share price, the stock appears significantly cheaper and the broker upgrades to Neutral from Sell. Target is reduced to \$0.60 from \$0.70.

SOUTHERN CROSS MEDIA GROUP ((SXL)) Upgrade to Neutral from Sell by Citi .B/H/S: 2/1/1

Citi reduces earnings estimates for the entire traditional media sector, primarily to reflect more conservative growth forecasts.

The broker believes growth in regional revenue should offset any decline in TV and Metro radio. Earnings forecasts are reduced by -8-11% to account for a sharper decline in regional TV.

Despite the downgrades, the broker believes substantial weakness is already incorporated in the price and upgrades to Neutral from Sell. Target is reduced to \$1.05 from \$1.10.

SENEX ENERGY LIMITED ((SXY)) Upgrade to Buy from Accumulate by Ord Minnett .B/H/S: 4/1/0

Ord Minnett adjusts oil price forecasts, lowering assumptions to US\$60/bbl for 2019-21. The broker's forecasts are now at the lower end of consensus estimates, implying there could be market downgrades.

Ord Minnett upgrades its recommendation for Senex Energy to Buy from Accumulate on valuation. The broker reduces the target to \$0.41 from \$0.42.

Downgrade

AGL ENERGY LIMITED ((AGL)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 2/3/3

The share price appears to have caught up with higher wholesale forward prices and, while Ord Minnett does not believe AGL will risk upgrading full year guidance at the interim result, higher electricity prices should be positive for earnings.

The broker suspects an upgrade to full year guidance would risk even greater scrutiny from federal politicians.

Energy and electricity prices are expected to be the main focus for both political parties leading up to the May 2019 election and the broker believes it will be difficult for the share price to outperform throughout that period.

Rating is downgraded to Hold from Accumulate and the target is reduced to \$23.20 from \$23.40.

AUB GROUP LIMITED ((AUB)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 1/1/0

As a result of the uncertainty generated by the Hayne Royal Commission and the Australian Securities & Investments Commission submission, Credit Suisse lowers the target to \$13.45 from \$14.50. Rating is downgraded to Neutral from Outperform.

While the issues are in relation to certain retail products, the debate in recent months highlights one of the broker's biggest concerns: that a ban on conflicted remuneration could be extended to general insurance products.

FORTESCUE METALS GROUP LTD ((FMG)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 5/2/1

Ord Minnett believes the path of least resistance for iron ore prices is lower, amid a forecast increase in 2019 supply and lower Chinese steel prices.

Fortescue Metals has rallied almost 30% since its September low and is now approaching valuation. Hence, the broker downgrades to Hold from Accumulate. Target is raised to \$4.90 from \$4.80.

MAYNE PHARMA GROUP LIMITED ((MYX)) Downgrade to Neutral from Buy by UBS .B/H/S: 1/1/1

UBS changes the lead analyst covering Mayne Pharma and re-models earnings drivers. Revised estimates for FY19-21 reflect a decline of -11-33% on prior estimates. Methodology has also shifted to a DCF valuation.

Despite a relatively robust earnings outlook, UBS downgrades to Neutral from Buy and considers the stock now fairly valued versus historical levels and peers. Target is reduced to \$0.83 from \$1.15.

PLATINUM ASSET MANAGEMENT LIMITED ((PTM)) Downgrade to Underweight from Equal-weight by Morgan Stanley .B/H/S: 0/1/3

While asset managers are cheap Morgan Stanley suspects ongoing outflows will mean a re-rating in the near term is unlikely. Looking forward, the broker believes Platinum Asset Management faces the greatest risk of de-rating as flows are expected to deteriorate.

The stock is also trading at a high on the broker's FY19 forecasts. Morgan Stanley downgrades to Underweight from Equal-weight, as this is the most expensive stock in the group under coverage.

Industry view is In-Line. Target is reduced to \$3.50 from \$6.00.

ST BARBARA LIMITED ((SBM)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 2/2/1

Ord Minnett remains positive on the ASX gold sector, believing the macro economic backdrop will accommodate further gold price movements.

The broker believes ASX gold stocks are robust and should provide an excellent hedge into reporting season.

Ord Minnett downgrades St Barbara to Hold from Accumulate on valuation grounds. Target is raised to \$4.70 from \$4.50.

STEADFAST GROUP LIMITED ((SDF)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 1/2/0

The ASIC submission to the Hayne Royal Commission has indicated the regulator believes a ban on conflicted remuneration should be extended to general insurance products.

While the response was in relation to retail products, Credit Suisse believes this will create uncertainty and it could

take some time before there is clarity on the issue.

Rating is downgraded to Neutral from Outperform and target reduced to \$3.00 from \$3.15.

SYDNEY AIRPORT HOLDINGS LIMITED ((SYD)) Downgrade to Sell from Buy by Citi .B/H/S: 3/3/2

Citi has a weaker organic growth outlook, resulting in reductions of -7% and -12% for distributions in 2019 and 2020, respectively.

The broker also believes regulatory uncertainty is likely to drive underperformance. The broker downgrades to Sell from Buy, believing headwinds are gathering pace.

The broker prefers property and utility companies which have more appealing distribution growth rates and lower leverage. Target is reduced to \$6.00 from \$7.74.

WHITEHAVEN COAL LIMITED ((WHC)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 7/1/0

December quarter operations were strong, with record production at Maules Creek. The company has guided to cost increases and this results in large reductions to Macquarie's estimates for earnings per share.

As a result the broker cuts the target to \$4.70 from \$5.60 and downgrades to Neutral from Outperform.

The saving grace is that the company could pay an above-average dividend but Macquarie suspects the surprise increase to costs will outweigh this.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup 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: No Show

Uranium market participants were left frustrated last week when US government officials failed to provide a section 232 update.

-Uranium spot price unchanged -No update on section 232 -Utility demand evident

By Greg Peel

Welcome to the first FNArena Uranium Week report for 2019.

We left 2018, just before Christmas, noting that activity in uranium markets typically slows to a crawl over the Christmas-New Year period. And so it came to pass. Having left with a spot price of US\$29.00/lb, there was a late 2018 dip to US\$27.90/lb as traders ditched the last of their year-end overhang before interest returned from producers and utilities in the new year.

To that end, industry consultant TradeTech's weekly spot price indicator recovered to US\$28.85/lb two weeks ago and remained unchanged last week, thus the net result since before Christmas is a -US5c/lb loss.

TradeTech's term price indicators, as of end-December and still current, were US\$29.00/lb (mid), down -US\$1.00 from November, and US\$32.00/lb (long), up US\$1.00 from November.

2018 was a strong year for uranium prices but not particularly driven by utility demand. The primary drivers of demand were speculative interest via listed uranium funds and producer purchases required to cover contract obligations at a time said producers had shut down operations given uranium was cheaper at spot than it was to produce.

As we enter 2019, it appears, so far at least, not much has changed.

Despite consistently rising prices over 2018, one reason utilities were reluctant to commit to major purchase agreements was the uncertainty created by the US Section 232 investigation, which hung over the market for the better part of the year.

To recap:

Early in 2018 two major US uranium producers petitioned the Trump administration to investigate the importation of cheap uranium from foreign sources (such as Russia) which served to shut out demand for more expensive local product. The petition called the issue a matter of "national security". It is "national security", and section 232, the Trump administration is using to justify trade tariffs.

The US Department of Commerce is due to issue its report on the matter in April, after which the president has another further 90 days to make a decision.

The petition suggests US nuclear power companies should be forced to purchase a minimum of 25% of their uranium needs domestically (and thus by implication at a higher price). Yet due to the abundance of cheap shale gas for gas-fired power generation and subsidies afforded to renewable energy the nuclear power industry has found itself unable to compete despite what have been, over the prior couple of years, historically low uranium prices. Legacy reactors have been shutting down as a result and new reactor plans abandoned.

Catch-22.

Last week brought the annual Nuclear Fuel Supply Forum in Washington. This year's Forum was a particularly hot ticket affair as it was hoped the DOC might be able to provide some hint as to what the department's report might suggest come April. But as it turned out, no one from the DOC bothered to turn up.

They are US government workers. You wouldn't turn up either if you weren't being paid.

Presumably the longest US government shutdown in history must throw doubt over whether the DOC report will indeed be delivered by April. Perhaps it will be delayed. Either way there's still another ninety days to wait for the

president's decision so at best it won't be until July when anything concrete might be known.

The DOC absence in Washington did not, nevertheless, deter interest last week from utilities and others in the spot market last week as 1.5mlbs U3O8 equivalent changed hands, albeit at an unchanged price by week's end. Spot demand is currently being supported by several term market offers out for tender.

In 2019 to date (as of Friday last), 3mlbs U3O8 equivalent has changed hands in 17 transactions.

It could be an interesting year.

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The Short Report

Guide:

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

Please take note of the Important Information provided at the end of this report. Percentages 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:

Month ending January 17, 2019

Welcome to the first Short Report for 2019. Even Short Reports need a break, and this one is now back well rested and ready for excitement in 2019.

Given the break, this first Report covers changes in short positions over the period of a month rather than the usual week. Next week's Report will revert to the usual week to week analysis.

When last we left the ASX200, it was heading for a bottom of 5493 on Christmas Eve, before rebounding to 5850 last Thursday, being the date of the latest short position data provided by ASIC.

We shall first note that in the interim, S&P/ASX has deigned to recalibrate the Top 20 index of largest cap stocks, short positions for which appear in the table below. Out goes Origin Energy ((ORG)), after only a brief stay, and out goes QBE Insurance ((QBE)). In come Coles ((COL)) and South32 ((S32)).

One reason the Australian stock market is not enormously popular with foreign investors, and the reason why Australian passive investors should be wary of simple index investment, is the extreme overweighting of the Top 20 stocks in the ASX200 by market cap, and the lack of diversification thus offered.

We note that last year Wesfarmers split into Coles and The Rest, yet individually both companies are still bigger than Origin and QBE. The other newcomer is South32, itself a spin-off of then BHP Billiton not that long ago. The Top 20 is thus even more concentrated than it was before.

The previous Top 20 contained no less than eight financial sector stocks (you wouldn't want to have a Royal Commission if you were a passive investor). QBE's departure leaves that at seven, while the swap of Origin and South32 leaves resource sector representation at four. There are now four retailers, if we count Shopping Centres ((SCP)), a REIT that lives and dies on Westfield mall traffic, as retail. Diversification beyond these three sectors is left to just five stocks.

Never mind, Canada is much the same.

Of the Top 20, Amcor ((AMC)) is by far the most heavily shorted at 7.6% and at the end of 2018 the only Top 20 stock more than 5% shorted. But say hello to BHP Group ((BHP)), which has since snuck in at 5.5%.

Amcor shorts likely represent a pairs trade with takeover target Bemis in the US. BHP shorts may relate to a play around the special dividend, now paid, so we'll see where they stand next week.

Outside of the Top 20, there's been a little bit of a shuffling of the deck chairs among those stocks 10% or more shorted, but nothing of significance. Nufarm's ((NUF)) entry to the club is a dry argument.

In the 5-9% brackets, only one stock has seen a change in the period of one percentage point or more. Nanosonic ((NAN)) shorts have fallen to 6.0% from 8.3% before Christmas. There is a lot of shuffling around in the lower brackets but nothing of particular note.

At least for the time being, we say goodbye from the 5%-plus table to Carsales ((CAR)), Blue Sky Investments ((BLA)), CleanTeq ((CLQ)), Sigma Healthcare ((SIG)), Perpetual ((PPT)) and Corporate Travel Management ((CTD)).

Movers & Shakers will return next week.

Weekly short positions as a percentage of market cap:

10%+ SYR 17.2 GXY 17.1 JBH 15.8 ING 14.3 ORE 13.4 MTS 13.0 IVC 12.8 NXT 12.1 BWX 11.8 MYR 11.6 NUF 10.0

In: NUF

9.0-9.9

DMP, IFL, HVN, BAL, SDA, SUL

Out: NUF 8.0-8.9%

PLS, MSB

In: MSB Out: NWS, NAN

7.0-7.9%

AMC, NWS, MND, BKL, CGF

In: NWS, BKL, CGF Out: MSB, KDR, FLT

6.0-6.9%

CCP, A2M, FLT, AMP, HT1, BGA, GMA, BEN, BOQ, APT, KDR, NAN

In: NAN, KDR, FLT, BEN Out: BKL, CGF, RWC, AHG, AAC, MLX, GEM

5.0-5.9%

SEK, ARB, BHP, A2B, MLX, RSG, LYC, PTM, AAC, DHG, KAR, CLH, RWC, BIN, VOC

In: MLX, AAC, RWC, BHP Out: BEN, CAR, BLA, CLQ, SIG, PPT, CTD

Movers & Shakers

See above.

ASX20 Short Positions (%)

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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The Wrap: Insurers, Fund & Wealth Managers

Weekly Broker Wrap: general insurers; health insurers; fund managers; wealth managers; Labor policy; and building materials.

-Heightened probability of greater insurer oversight and increased disclosure requirements from RC report -nib better placed to manage a cap on health insurance premiums -Challenging market conditions for fund managers -Higher remediation charges likely for wealth managers -Interest rates and China's outlook likely to be the driver of Australian markets, not ALP policy -JPMorgan prefers building stocks with earnings leverage to offshore markets

By Eva Brocklehurst

General Insurers

Macquarie believes the risks surrounding the regulatory reviews of insurers are not incorporated into consensus earnings forecasts. Additional costs for both Insurance Australia Group ((IAG)) and Suncorp ((SUN)) could lead to -5-10% downgrades to earnings per share, if implemented fully. The Hayne Royal Commission final report is due for submission to the government by February 1.

The Royal Commission has highlighted a number of case studies where cash settlement was suggested by insurers when it may not have been in the best interests of the customer. Macquarie believes the likely outcome could be that the industry adopts a higher rebuild proportion of claims as best practice to avoid further regulatory oversight.

The broker believes there is a high probability of greater powers for oversight bodies as well as increased & simplified policy disclosure, and guidelines on appropriate customer segmentation. These are potential headwinds for the former two companies, and to a lesser extent QBE Insurance ((QBE)).

General insurance remains Morgan Stanley's most preferred exposure in the sector amid the uncertainty that overhangs wealth managers and the outlook for downgrades to health insurers. The main attractive features are improving top-line growth, margin expansion in commercial/SME lines and strong balance sheets.

The broker believes IAG's investment case is robust. Margin guidance is expected to be reiterated, despite the December hailstorm in Sydney. Morgan Stanley believes Suncorp's 10%-plus cash returns target was always going to be a stretch and elevated catastrophe budgets now make it more unlikely. Despite the risks, underlying margins in the company's general insurance division are expected to show improvement.

Health Insurers

Morgan Stanley believes a 2% cap on premium increases for private health insurers in 2020 and 2021 is now the most likely outcome. Private health has emerged as a key area of debate for the upcoming federal election. The broker forecasts net margins to fall to 5.4% in FY22 for Medibank Private ((MPL)) from 8.0% in FY19. Margins are expected to fall to 4.5% for nib's ((NHF)) ARHI division from 6.4%.

Morgan Stanley also notes that a number of well capitalised, unlisted insurers are budgeting the negative margins from FY20. The broker assesses, with 40% of earnings in unregulated businesses, nib Holdings ((NHF)) is better placed to manage this development. Medibank, on the other hand, is less so as it derives 90% of earnings from regulated profit pools post the loss of the ADF contract.

Fund Managers

Challenging market conditions characterised the December quarter for fund managers, Macquarie observes. Market performance reduced funds under management by -6-8% across the sector and flows continued to be stock specific. Magellan Financial ((MFG)) produced consistent retail inflow during the quarter and its relative performance to the market was strong. Macquarie retains an Outperform rating although recognises the stock may have captured some of the potential upside.

The broker expects flows for Pandal Group ((PDL)) to improve more broadly and this is now its preferred exposure in the sector. Meanwhile, there is limited scope for near-term relative outperformance at Perpetual ((PPT)) and Macquarie maintains a Neutral rating. Platinum Asset Management ((PTM)), also Neutral rated, has downside risk for

near-term flows, in the broker's view.

CLSA has initiated on the sector, noting revenue is largely dependent on the outlook for assets under management, which are likely to grow strongly over time. CLSA forecast 7% compound growth rates in 2020-25, underpinned by active specialty management and alternatives. Active management is expected to remain a growth story in strategies that move away from index tracking and large market-cap benchmarks.

The broker rates Magellan Financial and Janus Henderson ((JHG)) Outperform, noting an excellent track record in the former and strong medium-term prospects for a re-rating in the latter. Underperform ratings are allocated to Pandal Group, Perpetual and Platinum Asset Management.

The broker is concerned about the near-term earnings revisions for Pandal Group and anticipates expansion of Perpetual's investment division will come at a cost. Market volatility is also expected to weigh on Platinum Asset Management.

Wealth Managers

Macquarie observes wealth companies, besides IOOF ((IFL)), have made material provisions for remediation across their adviser networks. Estimating the additional level of remediation expenses is difficult and the broker recognises the margin of error could be significant. Macquarie estimates the overall level of remediation charges over the next four years may reach \$400m-1.5bn.

AMP ((AMP)) is likely to need to increase remediation, potentially by around \$1.5bn in addition to the \$778m that has been recognised. The broker considers IOOF's guidance for \$5-10m in remediation is insufficient and there is a potential to recognise around \$600m. The broker has \$300m incorporated into its valuation.

Following recent asset sales AMP has additional capital flexibility but would have to liquidate some of the income-generating assets impacting investment income. The broker believes OnePath custodians will block the IOOF acquisition of the Pensions & investments business. In this scenario, IOOF would comfortably fund any remediation expenses.

If, however, the transaction were to go ahead, and debt was used, this would increase net debt to operating earnings (EBITDA) to elevated levels of around 2.0x. This could put pressure on IOOF to raise equity at a material discount.

Labor Government

Morgans identifies the potential impacts from Labor policies, should the party win government of the next federal election. Key policies would assist in financing higher public-sector expenditure and contain the budget but are considered attacks on investment. Proposed changes to negative gearing are a risk to an already softening housing market, the analysis contends.

This is the most dramatic impact Morgans identifies but would not be surprised if the policy was dropped, as proposed changes are likely to prove unpopular with home owners.

The proposal to scrap cash refunds of surplus franking credits may bring forward the plans by corporates with large franking balances to buy back shares and/or pay special dividends. Those with the potential to release surplus franking credits via buybacks or special dividends include Woolworths ((WOR)), Wesfarmers ((WES)), JB Hi-Fi ((JBH)) and Flight Centre ((FLT)).

The analysis notes many proposals have been watered down since they were first announced and, while these may have alter the relative appeal of some asset classes, ultimately the larger forces such as normalising interest rates and China's outlook will be the dominant driver of Australian market fundamentals and returns. Morgans believes policy risk is already priced into some sectors, such as the banks.

Building Materials

The background for Australia's building materials sector has become more challenging, as residential construction is pulling back and the US housing market has softened. Activity in New Zealand appears set to moderate. JPMorgan prefers stocks with valuation support and earnings leverage towards offshore markets such as Boral ((BLD)), James Hardie ((JHX)) and Reliance Worldwide ((RWC)).

Meanwhile, as Adelaide Brighton ((ABC)) and DuluxGroup ((DLX)) have reached price targets, ratings are upgraded to Neutral. Still, JPMorgan is cautious about the outlook for these two as well as CSR ((CSR)) and Fletcher Building ((FBU)).

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Brokers Diverge On Wagners' Potential

While agreeing that a slow start to project work has taken its toll on the FY19 outlook for concrete business Wagners, broker views diverge on the growth potential.

-Investment in capacity for growth considered a positive development -But can the core domestic concrete/cement market support such aggressive investment? -Substantial tender pipeline, both domestic and offshore

By Eva Brocklehurst

As Wagners Holding Co ((WGN)) builds a bigger business, a slow start-up for projects has combined to affect FY19 guidance. Guidance, reduced by -7.5% at the mid point, is for an operating earnings (EBIT) range of \$35-38m. Macquarie asserts this is principally a consequence of trading profit not covering the increased depreciation charges associated with investment in capacity, as well as the delay in major projects getting off the ground.

While expecting the negative market reaction, Credit Suisse points out project timing was already a known issue and investment for growth is a positive development. At its November AGM, the company had flagged that delays to major projects would affect near-term earnings. As such, Credit Suisse believes the focus should be on the signal that the investment intentions send.

Domestic Gap

The near-term earnings hole centres on the domestic cement and concrete business, with the uncertain timing of projects and a competing cement import terminal. However, looking offshore, with two LNG projects in Mozambique holding promise, amid the prospect of next-generation building materials, the broker envisages potential to double earnings.

Morgans also highlights a need to invest in capacity ahead of the next growth phase, up-scaling to compete for the large infrastructure projects being tendered, both domestic and offshore.

The broker does reduce concrete, cement, aggregate and crushing sales assumptions in line with the update. Assumed margin differences between products means forecasts for revenue remain stable while operating earnings (EBIT) forecasts have declined.

Morgans suspects FY19 will be the low point for the earnings, as this is the first time in several years the company does not have any major project work. If Wagners were incapable of growing earnings beyond current levels then the broker would accept the current share price is justified.

This is not likely to be the case, and Morgans envisages Wagners winning some project work and continuing to roll out the fixed concrete network. Still, considering four weather-affected months at the start of FY19, the broker acknowledges earnings are not likely to be significantly better until FY20. The stock appears cheap to Morgans, nonetheless.

Macquarie disagrees, believing the stock is overvalued because of the complex fundamentals in the core domestic concrete/cement market and the performance of the core business cannot support the aggressive investment that is required.

Project Potential

The slow progression of south-east Queensland infrastructure projects has frustrated the company and deferred significant earnings, Morgans accepts. There is still potential work to be won, including the Adani coal project, the Bruce Highway upgrade, Kidston hydro, several wind farms, the inland rail and Surat CSG, amongst others. Winning any work in these projects should carry earnings beyond the FY19 levels, the broker suggests.

On FNArena's database there are two Buy ratings and one Sell (Macquarie). The consensus target is \$3.06, suggesting 9.4% upside to the last share price. Targets range from \$2.05 (Macquarie) to \$3.70 (Credit Suisse).

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Catalysts Loom Large For Cooper Energy

Significant catalysts exist for Cooper Energy as it completes the development of the Sole gas project in Victoria.

-A number of major de-risking opportunities exist over the second half of FY19 -Importantly, the Sole project remains on budget -Macquarie expects the Cooper Basin asset will be sold in 2019

By Eva Brocklehurst

The share price of Cooper Energy ((COE)) has significantly outperformed its peers, and brokers attribute this to increased interest ahead of the upcoming delivery of the Sole gas project in Gippsland, Victoria.

Morgans highlights market pricing, and the earnings uplift that will be soon delivered at Sole. The broker envisages large-scale upside is still on offer in the stock, given the added prospectivity in the Otway Basin (South Australia) and future advancement of Manta (Gippsland).

Full year production guidance of 1.4mmboe has been maintained. Production volumes in the December quarter missed Macquarie's expectations but are expected to recover, given the reversal of downtime at Iona and the reinstatement of the Netherby-1 well in April.

Macquarie believes the company is on track to beat forecasts, while offering a number of major de-risking opportunities over the second half of FY19. These include Sole, the drilling of Elanora and Annie wells and, further ahead, accessing petroleum rent tax credits from Manta through consolidation with Sole.

The company has 119 PJ of uncontracted 2P gas. New gas contracts are expected to be signed and Canaccord Genuity expects prices to average \$9-11/GJ. The broker lowers second half FY19 oil price forecasts, and long-term forecasts, to US\$65/bbl. As a result of lower forecast prices, operating earnings estimates (EBITDAX) are reduced for FY19 to \$41m. The broker has a Buy rating for Cooper Energy with a \$0.64 target.

If the company can achieve positive outcomes across these catalysts, Macquarie envisages upside towards \$0.75 a share while the downside is protected through the CPI-linked cash flow from the start up of Sole. Macquarie retains an Outperform rating and \$0.55 target.

Sole

The Sole development is being quickly de-risked. The project is 86% complete and remaining works are being conducted under fixed-price contracts. Sole is on track for first gas in July. Remaining work includes repairing damaged pipe, integrity confirmation, and final connection work on the offshore elements prior to gas flow.

The main risk, brokers concede, is this final development phase. Morgans maintains an Add rating and \$0.59 target and points out, importantly, the project remains on budget.

In light of the progress being made, financiers have agreed to revisit the company's borrowing base and mandatory equity requirements. This has resulted in the release of \$23m in equity funds for general corporate purposes, along with an \$18m increase in the facility.

Hence, Cooper Energy is well-placed to fund the next wave of growth projects. The first of these will be exploration drilling in the offshore Otway, with wells at Annie and Elanora to be drilled in the June quarter.

Otway

Bringing Minerva-4, the final well for the Otway field, on line along with upgraded water handling capacity has helped bring forward the expected depletion date. This is important, Macquarie asserts, as it supports the company's plans for the Otway.

Planned maintenance at Casino Henry during the December quarter had a larger impact on production compared with broker estimates. Morgans assumes the Minerva field is depleted by mid year, which would allow Casino Henry to pump gas to the Minerva plant in FY20. This should help boost Casino Henry margins, while still leaving capacity to add gas from future discoveries.

A success case at Annie-1 could also mean a development well as soon as 12 months later, Morgans assesses, given the proximity to existing pipelines at Minerva. Meanwhile, the larger Elanora-1 target is likely to attract follow-up drilling.

Macquarie agrees there is significant upside if the company can prove up the gross prospective resources at both Annie and Elanora. The company has attributed 56% and 44% success rates, respectively, to these projects.

Cooper Energy, originally an oil producer in the Cooper Basin, has been transitioning over the last six years to become a significant east-coast domestic gas producer. The final step towards this objective was the purchase of the Gippsland Basin interests, which include the Sole and Manta fields and surrounding leases.

Sole has since become the company's flagship operation. The company holds various interests in the Otway Basin, which has existing production from Casino Henry and Minerva in addition to the the other prospects outlined.

The Parsons field in the Cooper Basin continues to decline following the tie-in over the five-well infill appraisal program in late 2017. Macquarie continues to believe the company will sell-off the Cooper Basin asset in 2019 and this could yield \$40m in cash payments, less potential abandonment liabilities.

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-2018, The Year Of Shame For Fundies -Byron Wien's Ten Surprises For 2019 -Conviction Calls -Join The CSL Challenge -Waiting For February -Pub. Beer. Pitt Street Research -US Earnings Recession, But How Deep?

By Rudi Filapek-Vandyck, Editor FN Arena

2018, The Year Of Shame For Fundies

Maybe the biggest surprise from 2018 was not so much that there were so few places to hide from persistent selling orders, once they started hitting financial markets, but that so few actively managed portfolios have managed to stay clear from temporary Armageddon.

As pointedly pointed out by award-winning journalist Jonathan Shapiro at the Australian Financial Review, the official industry line that has been constantly put forward against the global trend to use more and more passive investment products is that when the day of reckoning arrives, as it did in September 2018, investors will experience with their own eyes the safer hands of the experienced professional compared with the mindless mass-produce that can only result in something akin to passive carnage.

Not so. Quite the opposite happened with many a professional fundie having to admit this month performance in 2018, and more particularly in the final four months of the calendar year, has been quite the disappointment, with minus double digit percentage returns not the exception the industry would have touted beforehand.

As far as the full year's return is concerned, I have come across -15.8%, -19% and -23.9%. And those are the ones that spontaneously spring to mind. Clearly, there are quite the number of fundies around who are now forced to eat a whole lot of humble pie, potentially for a long time too.

The FN Arena/Vested Equities All-Weather Model Portfolio achieved a narrowly positive performance in calendar 2018 (up a grand total of 0.75%), which doesn't seem much at face value, but in the context of the above this puts the All-Weather Portfolio in the better half of the industry. The ASX200 Accumulation Index returned a negative -2.84% while the median long only Australian equities funds surveyed by Mercer booked an annual loss of -4.2%.

Shapiro's story, Year Of Shame For Fund Managers, published on Monday, 21 January 2019, contains a number of hard hitting paragraphs and observations that are worth re-reading while the topic is still relevant:

"Morningstar and Lonsec both explained that having a "value" approach was the undoing of most large-cap managers. Cheap stocks simply got cheaper, while pricier ones gained. And some stocks that appeared good value at the start of the year, such as the big banks and AMP, were decimated by the unfolding Hayne commission."

"Some sophisticated investors have given up on Australian large-cap, "long-only" managers altogether. Some simply don't believe managers in this sector can add value above fees, which are being forced lower. Others believe good active managers may be out there, but identifying them beforehand is impossible."

"While a small group of funds are being hailed for navigating the toughest year in a decade, success is often short-lived in funds management. The table toppers of today are often the cellar dwellers of tomorrow."

CLSA only this week initiated coverage on the sector in Australia, predicting fund managers in Australia should still benefit from compulsory super and increased offshore distribution in the years ahead, while global equity markets might be enjoying a less negative time as well. But downward pressure on fees is here to stay, and so is performance pressure in an environment of lower returns overall and plenty of passive and lower cost alternatives around.

CLSA predicts M&A will become a feature as funds will be seeking expansion to counter lower fees.

As far as individual managers are concerned, only two received a maiden Outperform rating at CLSA; Magellan Financial ((MFG)) and Janus Henderson ((JHG)) with price targets of \$33.01 and \$30.87 respectively. Each of Pandal Group ((PDL)), Perpetual ((PPT)) and Platinum Asset Management ((PTM)) commences coverage with an

Underperform rating.

Data crunching by some also revealed that Australia's list of best performing funds is, quite frankly, virtually the exclusive domain of industry funds, which must be an incredible embarrassment for a federal government looking to change the industry structure away from union-based domination. Apparently, all fifty bottom performers in the sector are retail funds, most owned by major banks and other large and well-known financial institutions.

And when it comes to ultimate embarrassment, funds owned by Westpac ((WBC)) and ANZ Bank ((ANZ)) are at the bottom of the bottom performers.

Industry legend Jack Bogle, founder of Vanguard's market cap weighted funds and indices, passed away early in 2019. As he reminded us all in 2013, "Beating the market is a zero-sum game for investors. Money managers, as a group, must provide the market return... But that return comes only before their exorbitant fees, operating expenses, and portfolio turnover costs are deducted. The zero-sum game before costs becomes a loser's game after costs."

As it turned out, 2018 was worse, a lot worse.

Below: Performance of major asset classes lined up by Morgan Stanley, 2008-2018.

Conviction Calls

Analysts at Canaccord Genuity have updated their Top Australian Stock Picks, and we can only admit the updated selection contains a few fresh inclusions that had not attracted my personal interest just yet.

Readers who have been reading my regular updates on Conviction Calls by stockbroking analysts in Australia would be aware the team at Canaccord Genuity specialises in the smaller end of the domestic share market.

The Australia Focus List, as it is officially labeled, presently contains ten members: Audinate Group ((AD8)), CML Group ((CGR)), Dacian Gold ((DCN)), Healthia Ltd ((HLA)), Money3 Corp ((MNY)), Primero Group ((PGX)), Perseus Mining ((PRU)), Service Stream ((SSM)), Think Childcare ((TNK)), and Temple & Webster ((TPW)).

Over at Bell Potter, tech analysts Chris Savage and TS Lim have refreshed their thoughts and projections for the local technology sector. Their Top Three Key Picks for the calendar year ahead consists of TechnologyOne ((TNE)), Citadel Group ((CTD)) and Integrated Research ((IRI)).

If you are familiar with my own research into All-Weather Performers in the Australian share market, you know TechnologyOne is a long-time inclusion on my selective list, and it has been proudly held as a cornerstone investment in the FNArena/Vested Equities All-Weather Model Portfolio.

Citadel Group can be regarded as a smaller cap version of the TechOne success story, with lower marketcap and lower daily trading volumes, and with a direct link to the Australian military. Integrated Research would have disappointed many with a profit warning last year. This month's market update implies all remains well and last year was simply an aberration. Clearly, Bell Potter backs company management's confidence.

The broker recently downgraded Altium ((ALU)), after a strong rebound in the share price, while retaining WiseTech Global ((WTC)) as the sole key Sell inside the sector, which is equally value-based.

Portfolio managers at stockbroker Morgans decided to swap Ramsay Health Care ((RHC)) for a fresh exposure to Sonic Healthcare ((SHL)), while releasing a watch list for targets that may be jumped upon in case of share price weakness. This watch list consists of major banks in Australia, ResMed ((RMD)), Reliance Worldwide ((RWC)), Woolworths ((WOW)), and OZ Minerals ((OZL)).

Morgans' Growth Portfolio has added a small exposure to cheap bling retailer Lovisa Holdings ((LOV)), while rebalancing its holdings of oil and resources stocks by trimming Oil Search ((OSH)) and topping up Rio Tinto ((RIO)) and said OZ Minerals.

Elsewhere some extra shares in Telstra ((TLS)) have been purchased when a weakening share price was too much to ignore.

Its preferred plays among A-REITS are Aventus Group ((AVN)), Viva Energy REIT ((VVR)), and Centuria Metropolitan REIT ((CMA)).

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Instead, of course, stocks like CSL ((CSL)), ResMed ((RMD)) and Cochlear ((COH)) -quality if you ever saw some- have been among the most profitable, consistent and sustainable investments any type of investor could have made over the past two decades. My initiative has elicited some highly endearing messages from investors who have owned CSL shares over many years, and who are in full support of my initiative.

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US Earnings Recession, But How Deep?

If you are sceptical about the strong bounce in global equities post Christmas, you are far from the only one.

Apart from -quite literally- a whole army of technical traders and analysts sticking with a negative outlook, share market strategists at Morgan Stanley added their fundamental analysis to general market scepticism.

Economic recession. We hear commentators, economists and strategists talk about it a lot these days, usually followed by the add-on "we don't think there is one on the horizon for the US this year".

But last year's pull back might be less about the potential for US GDP growth to turn negative by year's end, as it is more about forecasts for US corporate earnings needing a significant re-set to much lower levels. In the latter case, the industry lingo talks about an "earnings recession".

The last time global equities were confronted with such an earnings recession was in 2015-early 2016 and share prices trended south for the better part of a full year. Until the US Federal Reserve backed down from its tightening schedule, which hasn't as yet happened in the same fashion since 2019 may not be as much about the Fed funds rate as it is about reducing the Fed's balance sheet.

Were the Federal Reserve to unequivocally communicate it's done/on pause with lifting interest rates and running down debt on its balance sheet, this would be seen as a game-changer by strategists at Morgan Stanley.

But in the meantime, their observation is that market expectations in the US are falling, but they remain too high still, based upon Morgan Stanley research and assessments. This almost by definition means the share market will have to move lower again, and potentially testing the lows from December - all else remaining equal.

In Australia, a similar process is taking place. Earnings estimates are falling and companies are issuing profit warnings. The result is for lower valuations and price targets. This is why the February reporting season will be pivotal.

How much of an "earnings recession" has been incorporated into forecasts and into (lower) share prices; and has it been enough?

If you're siding with Morgan Stanley's conviction, you keep your enthusiasm contained, and prepare for the next leg downwards.

(Do note that, in line with all my analyses, appearances and presentations, all of the above names and calculations are provided for educational purposes only. Investors should always consult with their licensed investment advisor first, before making any decisions.)

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Byron Wien's Ten Surprises For 2019

Every year Saxo Bank draws up a list of potential surprises that might happen in the year ahead, and when they do their impact will be significant if not devastating for investment strategies and portfolios, but the chances of each of them happening are actually quite small, a feature readily acknowledged by the analysts themselves.

The Saxo Bank list is usually widely published and re-published, including by FN Arena.

There is an alternative which is likely to have a much larger impact on investment returns in the year ahead, if only because events listed have a much higher chance of happening. For the 34th year in a row Byron R. Wien, Vice Chairman in the Private Wealth Solutions group at Blackstone, released his Top Ten of probable surprises at the end of last year.

With each "surprise" given a higher than 50% chance to actually take place this year (which make them a "probable" event) investors might want to pay a little more attention to what Byron Wien has lined up for calendar 2019.

Byron's Ten Surprises for 2019 are as follows

1. The weakening world economy encourages the Federal Reserve to stop raising the federal funds rate during the year. Inflation remains subdued and the 10-year Treasury yield stays below 3.5%. The yield curve remains positive.
2. Partly because of no further rate increases by the Federal Reserve and more attractive valuations as a result of the market decline at the end of 2018, the S&P 500 gains 15% for the year. Rallies and corrections occur but improved earnings enable equities to move higher in a reasonably benign interest rate environment.
3. Traditional drivers of GDP growth, capital spending and housing, make only modest gains in 2019. The expansion continues, however, because of consumer and government spending. A recession before 2021 seems unlikely.
4. The better tone in the financial markets discourages precious metal investors. Gold drops to US\$1,000 as the equity markets in the United States and elsewhere improve.
5. The profit outlook for emerging markets brightens and investor interest intensifies because the price earnings ratio is attractive compared to developed markets and historical levels. Continuous expansion of the middle class in the emerging markets provides the consumer buying thrust for earnings growth. China leads and the Shanghai composite rises 25%. The Brazil equity market also comes to life under the country's new conservative leadership.
6. March 29 comes and goes and there is no Brexit deal. Parliament fails to approve one and Theresa May, arguing that a change in leadership won't help the situation, remains in office. A second referendum is held and the U.K. votes to remain.
7. The dollar stabilizes at year-end 2018 levels and stays there throughout the year. Because of concern about the economy, the Federal Reserve stops shrinking its balance sheet, which is interpreted negatively by currency traders. The flow of foreign capital into United States assets slows because of a softer monetary policy and a lack of need for new capital for business expansion.
8. The Mueller investigation results in indictments against members of the Trump Organization closest to the president but the evidence doesn't support any direct action against Trump himself. Nevertheless, an exodus of Trump's most trusted advisors results in a crisis in confidence that the administration has the people and the process to accomplish important goals.

9. Congress, however, with a Democratic majority, gets more done than expected, particularly on trade policy. Progress is made in preserving important parts of the Affordable Care Act and immigration policy. A federal infrastructure program to be implemented in 2020 is announced.

10. Growth stocks continue to provide leadership in the U.S. equity market. Technology and biotech do well as a result of continued strong earnings. Value stocks other than energy-related businesses disappoint because of the slowing economy.

Every year there are always a few Surprises that do not make the Ten because either Wien does not think they are as relevant as those on the basic list or he is not comfortable with the idea that they are "probable."

This year's less probable forecasts are:

11. Geopolitical tensions increase. Iran continues to destabilize the Middle East and Kim Jong Un fails to live up to his North Korea denuclearization promises. Secretary of State Pompeo and National Security Advisor Bolton make statements indicating the United States may take pre-emptive action in both places, thereby causing one of several sharp market sell-offs. But in spite of hostile rhetoric, the United States does not go to war with anyone as we approach the 2020 election. Trump's tough talk on some issues like trade works, however, and leads to successful diplomatic negotiations on national security.

12. In desperation China engages in ambitious infrastructure programs to bolster its economy. China grows at 6.5% real, but the increased debt causes concern around the world and has a negative impact on the renminbi.

13. China announces, "We want to be the world leaders in free trade." It sends envoys around the globe to negotiate better bilateral trade terms in order to offset the losses from the ongoing U.S. disagreements. Joint ventures in which foreign companies control the majority share are initiated in all sectors, from industrials and autos to raw materials. As China's influence around the world becomes greater, the U.S. further isolates itself.

14. The European Central Bank is forced to restart quantitative easing in response to a defiant Italy, a weakening Germany and Brexit. Thwarting expectations that Brexit would bring the rest of Europe closer together, Italy realizes that it can break all fiscal rules without any fear of punishment from the E.U. As a result, the Italian economy falls into recession, debt spreads surge and the ECB is forced to liquefy the system again.

For good measure, the following were Byron's Ten Surprises for 2018:

1. China finally decides that a nuclear capability in the hands of an unpredictable leader on its border is not tolerable even though North Korea is a communist buffer between itself and democratic South Korea. China cuts off all fuel and food shipments to North Korea, which agrees to suspend its nuclear development program but not give up its current weapons arsenal.

2. Populism, tribalism and anarchy spread around the world. In the United Kingdom Jeremy Corbyn becomes the next Prime Minister. In spite of repressive action by the Spanish government, Catalonia remains turbulent. Despite the adverse economic consequences of the Brexit vote, the unintended positive consequence is that it brings continental Europe closer together with more economic cooperation and faster growth.

3. The dollar finally comes to life. Real growth exceeds 3% in the United States, which, coupled with the implementation of some components of the Trump pro-business agenda, renews investor interest in owning dollar-denominated assets, and the euro drops to 1.10 and the yen to 120 against the dollar. Repatriation of foreign profits held abroad by U.S. companies helps.

4. The U.S. economy has a better year than 2017, but speculation reaches an extreme and ultimately the S&P 500 has a 10% correction. The index drops toward 2300, partly because of higher interest rates, but ends the year above 3000 since earnings continue to expand and economic growth heads toward 4%.

5. The price of West Texas Intermediate Crude moves above US\$80/bbl. The price rises because of continued world growth and unexpected demand from developing markets, together with disappointing hydraulic fracking production, diminished inventories, OPEC discipline and only modest production increases from Russia, Nigeria, Venezuela, Iraq and Iran.

6. Inflation becomes an issue of concern. Continued world GDP growth puts pressure on commodity prices. Tight labor markets in the industrialized countries create wage increases. In the United States, average hourly earnings gains approach 4% and the Consumer Price Index pushes above 3%.

7. With higher inflation, interest rates begin to rise. The Federal Reserve increases short-term rates four times in

2018 and the 10-year U.S. Treasury yield moves toward 4%, but the Fed shrinks its balance sheet only modestly because of the potential impact on the financial markets. High yield spreads widen, causing concern in the equity market.

8. Both NAFTA and the Iran agreement endure in spite of Trump railing against them. Too many American jobs would be lost if NAFTA ended, and our allies universally support continuing the Iran agreement. Trump begins to think that not signing on to the Trans-Pacific Partnership was a mistake as he sees the rise of China's influence around the world. He presses for more bilateral trade deals in Asia.

9. The Republicans lose control of both the Senate and the House of Representatives in the November election. Voters feel disappointed that many promises made during Trump's presidential campaign were not implemented in legislation and there is a growing negative reaction to his endless Tweets. The mid-term election turns out to be a referendum on the Trump Presidency.

10. Xi Jinping, having broadened his authority at the 19th Party Congress in October, focuses on China's credit problems and decides to limit business borrowing even if it means slowing the economy down and creating fewer jobs. Real GDP growth drops to 5.5%, with only minor implications for world growth. Xi proclaims this move will ensure the sustainability of China's growth over the long term.

The following predictions were seen as less probable:

11. Investors recognize that the earnings of companies in Europe, the Far East and the emerging markets are growing faster than those in the United States while the price earnings ratios in those regions are lower than those in America. Global investments become more broadly represented in institutional portfolios.

12. The Mueller investigation of the 2016 presidential election fails to implicate any members of the Trump family in collusion with Russian operatives.

13. Artificial intelligence gains visible momentum. Service sector jobs are automated, particularly clerks in legal and finance professions, as well as workers in fast food outlets and healthcare. Economists begin to question the unemployment data because the rate drops below 4% while so many people still appear to be out of work and seeking government assistance.

14. Cyber attacks become more prevalent and begin to affect consumer confidence. A major money center bank suspends deposits or withdrawals for three days because its system is penetrated. Numerous retail organizations report that customer personal information has been obtained by hackers. Those invading corporate information systems appear to be smarter and more innovative than the internal employees protecting the computer data, suggesting that the systems themselves need to be upgraded.

15. The regulatory authorities in Europe and the United States finally get concerned about the creative destruction of Internet-related businesses. As a result of pressure from retailers and traditional media companies, they begin an investigation of anti-competitive practices at Amazon, Facebook and Google. The public begins to think these companies have too much power.

16. The risks in Bitcoin are so great that regulatory authorities restrict trading. Among their concerns are: no regulatory oversight; no safety and soundness measures; no recourse in the event of mistaken or miscalculated transactions; high cyber risk; no deposit insurance.

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Waiting For February

The importance of avoiding bomb shells in the Australian share market has once again become apparent this month with small cap infrastructure and buildings materials company Wagners Holding ((WGN)) issuing another profit warning this week one day after scrap trader Sims Metal Management ((SGM)) had done the same.

February is now less than two weeks away, but stockbroking analysts are only now genuinely getting back to work, so I guess we'll have to wait a little while longer before being inundated with all kinds of previews and predictions regarding potential beats and misses throughout the February reporting season.

One team already released the results of its own set of predictions but the news from JP Morgan is not looking great; the analysts see more potential for downside than upward surprises. If correct, this could potentially translate in a lot more disappointment for investors hoping for a better experience as the February reporting season unfolds.

Among the potential candidates for a negative surprise next month feature National Storage ((NSR)), but also Aurizon Holdings ((AZJ)), Healthscope ((HSO)), Tabcorp ((TAH)), Vocus ((VOC)), Wesfarmers ((WES)), BWP Trust ((BWP)), Carsales ((CAR)), Downer EDI ((DOW)), and Woodside Petroleum ((WPL)).

Stocks that are believed to carry an elevated level of upside surprise risk include Village Roadshow ((VRL)) and Charter Hall Long Wale ((CLW)). JP Morgan's research also suggests Telstra ((TLS)) might finally surprise in a positive sense, as might LendLease ((LLC)), Qube ((QUB)), ERM Power ((EPW)), Credit Corp ((CCP)), Ramsay Health Care ((RHC)), Reliance Worldwide ((RWC)), Seek ((SEK)), and Super Retail ((SUL)).

On my own observation, earnings estimates are falling, not only in Australia, but around the world, which makes the upcoming reporting season in February doubly important as it should provide answers to questions such as have share prices fallen deeply enough, not enough, or way too far to more properly account for a more subdued outlook?

Within this context I note indiscriminate selling has pushed down share prices for companies that can be linked to falling sales for new automotive vehicles, both in Australia and abroad, as well as to discretionary consumer spending. As such, I believe investors have overlooked the resilience that should be embedded for companies such as Bapcor ((BAP)), ARB Corp ((ARB)), and GUD Holdings ((GUD)).

Carsales ((CAR)) might have a few niggles here and there in some of its marginal side-operations (such as car financing) but its core operations too should remain relatively resilient.

But as said, all should be revealed in February.

Paying subscribers should note you have exclusive access to a dedicated section on All-Weather Performers on the website. Data have been updated recently to show share price performances during the final four months of last year, and into January.

P.S. ResMed ((RMD)) and TechnologyOne ((TNE)) set new all-time highs this week.

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