WEEK 38

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Friday, 18 September 2020

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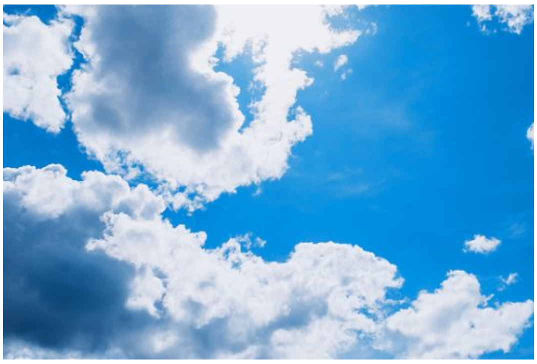

Rudi's View: Plenty Of Clouds, Diverging Scenarios

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AUSTRALIA

# Spotlight On CSL Revenue Targets

CSL is highly likely to be looking for other avenues of revenue to meet targets in FY21, given a prospective shortfall in plasma collections.

**-Plasma collection levels present a risk to the near-term revenue outlook**
**-There are several strategies to deal with a shortfall in plasma**
**-Robust demand for flu vaccine likely to provide revenue counterweight in FY21**

By Eva Brocklehurst

Why are plasma collection volumes so vital to revenue targets for CSL ((CSL))? Over the period from February, when the coronavirus pandemic commenced, to June, the company's plasma collections were heavily affected by mobility restrictions as donors were less likely to front up to collection centres.

Citi, which recently upgraded CSL to Buy, assesses demand for plasma products will remain robust, so an imbalance will continue over the short term as collections are disrupted by restrictions related to the pandemic. The broker assumes collections return to normal from October 2020.

Macquarie has taken a look at foot traffic at 100 US-based collection centres to get an indication of plasma collection volumes. While foot traffic has improved from the lows of late June, current levels still appear below average.

Macquarie assumes a recovery in plasma-derived earnings in FY22 but believes collection volumes present a risk in relation to the near-term outlook. Given the lag between plasma collection and the manufacture of immunoglobulin, collection trends over September quarter will be significant in terms of the effect on FY21 revenue, while trends over the December quarter will affect the first half of FY22.

Why? UBS explains that there is a 6-9 month lag from plasma collections to the recognition of revenue from finished product and, therefore, at the end of FY20 there should be visibility over a large proportion of FY21 revenue.

**Hence, reaching the top end of the company's guidance for 6-10% revenue growth implies a US$114m revenue uplift in immunoglobulin (finished product), or about a 3% increase on FY20**. At the lower end of guidance this implies a decline of -US$252m in immunoglobulin revenue, or -6%.

Plasma Shortfall

UBS is bearish in terms of the plasma shortfall and estimates collections declined -32% in the final quarter of FY20. A -20% decline in immunoglobulin and albumin volumes is calculated for the second half of FY21 and a -7% decline in the first half of FY22, before a normalisation from the second half of FY22.

While no data has been provided for plasma collections in August, Morgan Stanley suspects there was as much as a -10% shortfall relating to access limitations as a result of the pandemic. The broker calculates a shortfall in 2020 of around -6m litres of plasma which equates to around -24m grams of immunoglobulin, but highlights there are potential strategies to deal with a shortfall, such as prioritising diagnoses.

CSL has also led the way in the number of new collection centres being opened in the US and Citi calculates the company should be able to process over 20m litres of plasma over the next few years. Typically it takes around three years for a collection centre to "mature".

In FY21, Citi expects immunoglobulin revenue growth of 4%, implying a decline of -5% in plasma volumes, to be offset by a combined 9% increase in pricing/mix. Also, it is likely some substitution of product in certain circumstances will occur while supplies constrained, although the broker suspects this will not have a long-term impact.

UBS agrees there are multiple levers that can be used to achieve growth in immunoglobulin volumes, including drawing down inventory. The broker is also forecasting flu vaccine revenue to be a counterweight, up 17% in FY21, along with an average immunoglobulin price increase of 5.3%.

**Awareness of flu vaccine and demand for such is expected to be higher because of the risks associated with co-infection of coronavirus**. Hence, a sustained period of robust demand for flu vaccine is considered likely and CSL's Seqirus is well-placed to benefit.

Covid-19 Vaccine

Citi expects there will be a Covid-19 vaccine available by the end of 2020 and the vaccination of healthcare workers and the elderly will allow the economy to normalise in 2021. CSL has two Heads of Agreement, along with a funding deed with the Australian government, to manufacture potentially up to 81m doses of Covid-19 vaccine.

The total value equates to around $21 per dose or $42 per patient, as two doses are required. Citi ascribes no value to any of these partnerships at this stage given the uncertainty of clinical trials and expects the impact on profit to be neutral or marginally positive at best.

First doses from the University of Queensland vaccine candidate are scheduled for release from mid 2021, assuming successful clinical trials. The second agreement with AstraZeneca for supply of the Oxford University candidate to Australia is scheduled for early 2021, assuming successful clinical trials.

The funding deed with the Australian government will be used to establish those components required to produce commercial quantities of recombinant vaccine including specialised equipment, recruitment, training and redeployment of personnel.

FNArena's database has three Buy ratings and four Hold. The consensus target is $310.39, suggesting 9.5% upside to the last share price. Targets range from $282 (Morgan Stanley) to $346 (UBS).

See also Tight Plasma Supply A Benefit For CSL Pricing on June 18 2020.

AUSTRALIA

# Bank Recovery Likely To Be Drawn Out

The current state of the economy suggests a recovery for Australia's banks is likely to be a drawn-out affair, featuring margin headwinds, weak credit growth and elevated costs.

**-Bank valuation still “reasonable” compared with historical downturns**
**-Large increases in household savings, expenditure below long-run averages**
**-Risk to the downside until more clarity on credit quality, dividends, capital**

By Eva Brocklehurst

While the current state of the economy appears manageable for Australia's banks, a recovery is likely to be drawn out. Asset quality is dominating discussions and margins are under pressure amid subdued credit growth and elevated costs.

Yet JPMorgan finds asset quality trends actually hard to ascertain, given the subjectivity of bank provisioning and vastly different reporting of arrears, credit risk and loan loss charges. Still, in an international context, Australia's major banks appear relatively attractive, CLSA asserts, given their income perspective compared to the rest of the market and bond yields.

Regional banks continue to be challenged, nevertheless, and the broker points out both **Bendigo & Adelaide Bank** ((BEN)) and **Bank of Queensland** ((BOQ)) are trading close to long-term averages. Valuations appear reasonable among the major banks when compared with historical downturns and CLSA prefers **National Australia Bank** ((NAB)) and **ANZ Bank** ((ANZ)) over **Westpac** ((WBC)) and **Commonwealth Bank** ((CBA)).

While NAB's provision coverage is at the low end of peers, its capital position is strong. Meanwhile, ANZ offers greater leverage to an improving economy as and when asset quality concerns subside. **Bank stocks appear too cheap to short, JP Morgan asserts, as most are trading below book value, and greater macro certainty is required in order for stocks to re-rate meaningfully higher**.

Recent guidance from APRA (Australian Prudential Regulatory Authority) provides some clarity on what investors can expect in terms of dividends. Still, a re-emergence of dividends, while helpful, is not enough in JP Morgan's view.

Morgan Stanley believes ANZ will show the strongest recovery in dividends over the next two years, although assumes major bank dividends in FY22 will still be at an average of -25% below pre-pandemic levels.

On the other side of the ledger, CLSA, while acknowledging it deserves a premium, believes CBA is too stretched and there is more leverage from an improving economy in the other banks. The broker assesses Westpac continues to face underlying earnings pressure and there is uncertainty surrounding the matters raised by the Australian financial intelligence agency, AUSTRAC.

Asset Sales

**Morgan Stanley agrees Westpac appears to have the smallest margin for error on capital but notes a preference to sell assets in its specialist division**. CEO Peter King has indicated there is plenty of interest in these assets although a sale process is likely to take time.

Citi agrees that asset sales hold the key for Westpac, analysising a potential sale of Westpac's BT business. Westpac is the laggard in offloading of wealth management, a process undertaken by the major banks over recent years.

The complete exit by other major banks has represented sound strategy and execution but the broker believes the implications for Westpac are mixed. BT remains the “jewel in the crown” of those assets that are still in bank hands.

BT is number two in Australia terms of funds under administration. Moreover, there are options available to improve, such as shutting down and migrating Asgard, along with synergies from combining with any platform that is below it in terms of industry structure.

There is also the issue of whether Westpac could sell the whole business. It is not straightforward for a buyer to find what Citi calculates could be a $3bn price tag. Hence, the strategic value of BT is growing in terms of its scarcity value.

Westpac remains the broker's top pick in the sector, given the quality of its book, potential long-term returns and the feasible asset sales that can unlock capital.

Loans

The state of the economy will be the biggest driver of the outlook for loans. CLSA notes the banks all have slightly different definitions of deferral arrangements. Still, the majority have experienced a greater proportion of home loan deferrals from Victoria and, unsurprisingly, fewer in Queensland.

Major bank deferred loans range across 7-12% of balances for home loans and 14-16% of balances for business loans. The most affected sectors for the latter are those in consumer and property-related industries.

The next date of significance comes at the end of September when the initial six-month deferral period ends. The banks will then find out whether deferred customers are able to move to some form of repayment.

Morgan Stanley notes ANZ and CBA are winning share in mortgages while growth rates at NAB and Westpac have bounced around. Bendigo & Adelaide and **Macquarie Group** ((MQG)) continue to win share in the mortgage market, growing at double-digit annualised rates.

Meanwhile, there has been a large increase in savings, with household deposits up 3% in July, month on month. Expenditure intentions remain well below the long-run average and the national savings rate was up to 20% in the June quarter, from 6% in the March quarter. This also likely reflects a significant one-time boost to cash flow from superannuation withdrawals.

Morgan Stanley highlights deposit growth is less beneficial for the banks when interest rates are low and loan growth is subdued. The recent reporting season suggests there will be further headwinds in this regard and higher liquidity has reduced margins by more than -5 basis points in the June quarter. Meanwhile, the decline in lending to corporates continues.

However, JPMorgan notes spreads on savings products and term deposits have improved over the last three months and this should provide a meaningful tailwind for major bank interest margins. It remains to be seen whether management commentaries, which pointed to pressures from competition and low rates during the August reporting period, are overly conservative.

The broker's top pick remains NAB, although its position on small-medium enterprises (SMEs) feels like "right place at the wrong time". In the longer term, JPMorgan believes the bank's status as a lender to SMEs will be the positive differentiator that will allow revenue to outperform peers.

CET1

CLSA expects **FY21 CET1 ratios to be weaker across the sector, with the exception of CBA, because of the benefits from divestments**. This in turn reflects expectations that bad debts will remain elevated.

Major banks should be able to accommodate this scenario, and the ratios are still envisaged on average at around 10.9% by the end of FY22. Beyond the current crisis, banks are expected to face headwinds to revenue which justifies them still trading at a discount to historical averages, CLSA concludes.

Morgan Stanley continues to assume there will be no more capital raisings from the banks and that CET1 ratios will remain above 10.5%. Nevertheless, the potential for lower profitability and higher risk weight density creates uncertainty about the outlook for capital.

While estimating higher risk weight density is likely to have a negative -120 basis points impact on ratios over the next 2-3 years, the impact is diffused, the broker assumes, as the regulator has provided temporary relief for loans, allowing deferred payments or restructured loans.

Moreover, APRA has indicated it would be comfortable with CET1 ratios dropping below 10.5%, if this is needed to absorb the impact of stress. Morgan Stanley asserts the risk for banks is to the downside until there is more certainty on credit quality, capital requirements and dividend pay-out ratios, considered unlikely before 2021.

Negative Rates

Amid increased discussion around negative interest rates, Credit Suisse notes the Reserve Bank of New Zealand has asked its banks to examine the ability to cope with zero or negative rates, although the Reserve Bank of Australia continues to view negative interest rates as highly unlikely.

In New Zealand, Australia's major banks are still the largest operators. The NZ operations of ANZ and NAB contribute around 20% to group earnings while the other two major banks take a smaller contribution.

The broker describes a negative interest rate, in its simplest form, as a tax on reserves held with the central bank which impacts the profitability of the bank. Negative rates are used to influence the short-term wholesale money market rates.

However, the transmission mechanism is uncertain, as banks would be reluctant to charge a negative interest-rate on deposits, particularly retail. It would also impact the willingness of the bank to lend, as deposits would be switched to cash and therefore affect funding. Net interest income was a driver of 81% of Australian bank revenue in FY19. Moreover, deposits are the main sources of funding for banks and also one of the cheapest.

AUSTRALIA

# Macquarie Group Confirms A Difficult First Half

Macquarie Group has confirmed the prospect of a weak first half, with a continued focus on provisioning and supporting clients through the pandemic.

**-Even stronger seasonal skew to the second half in FY21**
**-Outlook for "deals" challenging, particularly cross-border transactions**
**-Prospect of the sell-down of Nuix could underpin second half**

By Eva Brocklehurst

Amid a highly-anticipated reduction in transactions as well as travel restrictions, Macquarie Group ((MQG)) has confirmed ongoing provisioning in banking and financial services with a continued focus on supporting clients through the pandemic.

Pressure has mounted on investment income that affects both Macquarie Asset Management and Macquarie Capital, and the group has guided for the first half profit to be around -35% below the prior corresponding first half, which implies a cash profit around $950m.

In the absence of asset sales the impact of higher provisioning will be keenly felt and the short term outlook remains heavily dependent on the duration of the pandemic, the shape of the global economic recovery and government support.


Still, Morgans asserts Macquarie Group is well-positioned to ride out the downturn compared with other financial stocks, while taking advantage of opportunities when they occur. The broker highlights two factors that may have slightly changed since the AGM.

**First half investment-related income in Macquarie Capital has declined significantly**, and in commodities and strong client activity in commodities and global markets did not continue in the second quarter, the latter being a prospect the group had previously flagged.

There is also an even stronger seasonal skew to the second half this year, given the timing of gains on sale and impairment charges and Ord Minnett envisages a wide range of possible outcomes for the full year, depending on the level of volatile items and impairments in the second half.

The broker continues to factor in a strong recovery in the second half based on a return to asset recycling towards the end of the financial year. The broker remains attracted to the growth drivers in Macquarie Infrastructure and Real Assets (MIRA), green energy and Australian mortgages.

Ord Minnett now forecasts a second half net profit of $1.45bn, up 14% on the prior corresponding half, to reflect higher gains on sale and performance fees as well as lower investment impairments and provisions.

Despite the soft commentary and guidance being weaker than expected, CLSA continues to believe this is a high quality business with structural growth trends over the medium term. Yet caution prevails for the short term given the drawn-out potential for the pandemic and the broker, not one of the seven monitored daily on the FNArena database, reiterates an Underperform rating with a $120.25 target.

At the other end of the spectrum, Bell Potter, also not one of the seven, remains confident the business is a long-term "cash and growth" story and retains a Buy rating and $135.00 target.

Guidance was actually better than Morgan Stanley expected. The broker calculates net profit in FY21 will fall -17%, which implies a rise in earnings in the second half of 3% as an easier comparable is cycled and market conditions stabilise.

UBS believes as deals are required to feed the "Macquarie machine" the outlook is challenging, particularly in the case of cross-border transactions for which physical due diligence is essential. Moreover, given a 72% cost-to-income ratio a sharp reduction in transaction-related revenue has an exaggerated impact on earnings despite some protection from a lower bonus pool.

Nuix

Several brokers consider the prospect of a sell down of the Nuix data security software business. in which Macquarie Group has a 70% stake, could support the second half. In recent months there has been speculation this may occur and, given an increase in revenue from this source as well as high multiples being paid for technology companies, UBS assesses it could lead to a substantial gain on sale.

Citi takes a stronger stance and includes in estimates a 50% IPO sell-down of the Nuix stake, to be completed before March 2021, while UBS expects the sale, if it occurs, would take place in tranches.

Otherwise, transaction volumes for hard asset sales have fallen and have reduced the ability to generate gains on sale. This will have an impact on the ability to generate performance fees within Macquarie Group's unlisted funds. **The ability to recover revenue is likely to be a function of activity as the global economy recovers and travel resumes and is more an issue of timing**, the broker adds.

Morgans calculates Nuix, if floated on an equity value of $1.5bn as per press speculation, could generate a net profit contribution of $300m. Furthermore, Citi anticipates the remainder of the stake will be sold over the following 12-24 months after being released from a 12-month escrow.

Pulling forward of the sale into FY21 means the broker upgrades net profit estimates by 4% and lowers estimates for FY22-23 earnings by -7-8%. Citi considers the deployment of the balance sheet will emerge as the critical way of restoring meaningful profit growth from FY22.

FNArena's database has three Buy and three Hold ratings. The consensus target is $125.15, which signals 4.1% upside to the last share price. The dividend yield on FY21 and FY22 forecasts is 3.2% and 4.7% respectively. Targets range from $107.50 (Credit Suisse, yet to update on the guidance) to $133.00 (Morgan Stanley).

See also, Subdued Period Ahead For Macquarie Group on July 31, 2020.

AUSTRALIA

# Reinsurance Key To Insurer Pandemic Claims

The UK has taken the first step in clarifying insurance coverage for businesses interrupted by the pandemic. What are the implications for Australia's insurers?

**-Projected losses for UK insurers appear to be lower than worst-case expectations**
**-UK insurers reclaiming on reinsurance for pandemic-related business interruption claims**
**-QBE Insurance domestic business interruption cover incorporated in its global aggregate**

By Eva Brocklehurst

A business interruption test case against insurers, brought by the UK Financial Conduct Authority (FCA), has been found largely in favour of policyholder arguments. While different legal debates have occurred in the UK compared with Australia, the UK High Court judgement has raised concerns.

Macquarie points out this is just the first step in clarifying insurance coverage for business interruption policies globally and, although the findings do not have international jurisdiction, they could be relied on for interpreting Australian policies with similar wording.

Initially, Ord Minnett notes **QBE Insurance** ((QBE)) appears to have suffered adverse findings for one policy type and more favourable findings for two others. The FCA test case covered 21 sample policies across eight insurers, including QBE Insurance.

**QBE's UK business insurance claims are capped at $75m net of reinsurance, although as a result higher FY21 reinsurance costs are likely next year**, UBS points out**.** Across the UK industry, around 370,000 policies will be affected and estimates of aggregate claims costs are in excess of GBP4bn.

Still, Ord Minnett points out UK insurer share prices have reacted reasonably well despite the findings, as projected losses appear to be lower than worst-case scenarios.

Macquarie assesses the ruling is not as bad as headlines would suggest, as interpretations of “denial of access” have been found broadly in favour of insurers, and should result in losses that are lower than provisioned.

Moreover, QBE was identified as having stronger wording than its peers in a number of circumstances. The company's radius clauses were interpreted as contemplating specific localised outcomes and, therefore, considered less likely to incur claims.

Certain other UK policies with denial of access clauses could still provide cover but the wording was less clear and these are likely to be dependent on how each business was affected by the government response.

The main interpretation, in Ord Minnett's view, is that other insurers in the UK are claiming on reinsurance, which should limit concerns about any special treatment for QBE from reinsurers.

UBS also points out that the company's domestic business interruption claims exposure is insulated under its global catastrophe aggregate program, and overall Covid-19 claims costs of US$650m have been well flagged.

Australian Impact

Although there could be similarities between business interruption issues in the UK and Australia, such as access to property, **the concern locally is whether a reference to the Quarantine Act (no longer in effect) would allow extension to the Biosecurity Act**. The latter is the recent enactment (2016) which encapsulates all powers to declare a disease quarantinable and to take steps to ensure public health and safety.

In this instance individual policy wordings are likely to be crucial, Ord Minnett suggests. The first Australian test case will be heard in the NSW Court of Appeal on October 2.

UBS notes the view of insurers is that pandemic exclusions referencing the Quarantine Act are enforceable, and any negative outcome on this issue would mean **Insurance Australia Group** ((IAG)) is most exposed relative to **Suncorp** ((SUN)).

While both businesses may have limited scope for catastrophe reinsurance recovery the benefits from lower motor vehicle frequency pay-out could temper the impact, the broker adds.

UK Findings

The intention of the UK FCA was to clarify contract uncertainty stemming from business interruption policies where the coverage included notifiable diseases and denial of access clauses.

Key findings: diseases clauses could be triggered from a national response to a widespread outbreak, with cover not limited to outbreaks within a policy area because of the widespread nature of the infectious disease; prevention of access clauses could be deemed more restrictive, with government action being required in response to a local outbreak as well as a delineation between government advice and the imposition of mandatory restrictions; and a requirement to put an insured in the same position as they would have been had the particular instance not occurred.

AUSTRALIA

# Positioning Equity Portfolios For Recovery

While shares have rallied from March lows, there are several sectors of the market awaiting a V-shaped recovery.

**-Are we on the cusp of an equity boom?**
**-Domestic exposures versus offshore earners**
**-Supplementing well diversified portfolios**

By Mark Woodruff

There remains a consensus view that both the global and Australian economies will recover in 2021. The fact we haven't as yet experienced a traditional V-shaped recovery suggests the potential to position an equity portfolio for its arrival.

Descriptions vary on the type of recovery the Australian stock market has experienced since the March lows. Stockbroker Morgans likens it to an extended V-shaped recovery. Similarly, Wilsons notes the market is in a holding pattern, and is not pricing in a V-shaped recovery. To illustrate this, the broker constructs a covid-19 recovery basket that includes impacted stocks across seven market sectors. This 'recovery index' is clearly lagging the ASX200's performance.

The catalysts for the recovery index to rally are considered to be a re-opening scenario for Victoria and a successful vaccine. However, before contemplating a rotation toward stocks benefiting from a recovery, we should discover where we are placed now.

<u>The Current Position</u>

Instead of the prospect of another extended financial crisis and another recession, governments and central banks were able to reduce the pandemic to a problem such that it was much more like a global natural disaster rather than a global financial crisis. The difference between those two, explains Morgans, is a recovery from a global natural disaster is much faster.

During the recent August reporting season, the broker concludes earnings generally tracked ahead of some very depressed expectations. It appeared that equity markets were not as dislocated from reality as the market had anticipated. Consensus is forecasting market earnings to fall around -20%-25% in 2020 before rebounding toward 2019 levels by 2022. Hence, the derivation of the label "extended V-shaped recovery".

Generally speaking, domestic cyclicals were considered to have surprised (retail, travel), while larger defensives underwhelmed prior expectations (utilities, telcos). Smaller stocks also recorded their highest rate of surprise (28%) and lowest rate of disappointment (18%) for several seasons. Expectations here were clearly more fearful than for larger-cap peers due partially to questions over short term liquidity. The surprise positive impact of fiscal stimulus also had a larger proportional benefit in this segment.


The Economic Outlook

Morgans assures us not only are we are going to come out of the pandemic malaise, but also we may come out of it much more rapidly than previously thought.

In somewhat of a replay of the years following the global financial crisis in 2008-09, the broker expects we are on the cusp of another boom. The even bigger fiscal stimulus this time around is going to generate over the next two years downward pressure on the US dollar. That means the euro, the Australian dollar and commodity prices will go up.

In short, a portfolio encapsulating a recovery trade, with a weather eye on the impact of the Australian dollar, may be prudent.

Where To Invest

Macquarie also sees foreign exchange risk for offshore earners as commodity prices lift the Australian dollar. Utilities, financials and communications are considered the sectors with the most domestic exposure, which lessens currency risk. As a result, the broker has some preferred domestic exposures including:

Charter Hall Group ((CHC)), Cleanaway Waste Management ((CWY)), Aurizon Holdings ((AZJ)), Challenger ((CGF)), Telstra ((TLS)), Stockland ((SGP)) and Transurban Group ((TCL)).

There are three additional stocks that make the list of preferred domestic exposures and are also stocks most negatively impacted by covid-19. This makes them preferred plays on a vaccine as well.

The stocks are Crown Resorts ((CWN)), The Star Entertainment Group ((SGR)) and Sydney Airport ((SYD)).

In the wake of the reporting season, Morgans nominates key stock ideas exposed to the recovery play thematic. It is considered the best opportunities from here are likely to be those stocks that have higher operational linkages to economic activity, and low expectations. These stocks are likely to be in the travel, gaming, energy or commercial services sectors.

The stocks chosen are Sydney Airport, Corporate Travel Management ((CTD)), ALS Ltd ((ALQ)), Aventus Group ((AVN)), Santos ((STO)), Beach Energy ((BPT)), Eagers Automotive ((APE)), and Incitec Pivot ((IPL)).

The Wilsons basket of 23 recovery stocks contains those exposed to international travel, inbound tourism, banking, selected resources (mostly energy), real estate and transport infrastructure.

**Energy**

Oil Search ((OSH)), Origin Energy ((ORG)), Santos, and Woodside Petroleum ((WPL))

**Financials**

ANZ Bank ((ANZ)), Bendigo & Adelaide Bank ((BEN)), Challenger, National Australia Bank ((NAB)), Westpac ((WBC))

**Metals and Mining**

Alumina Ltd ((AWC))

**Real Estate**

Dexus Property Group ((DXS)), GPT Group ((GPT)), Lendlease ((LLC)), Mirvac Group ((MGR)), Scentre Group ((SGR)), Vicinity Centres ((VCX))

**Resource Services**

Worley ((WOR))

**Tourism and Entertainment**

Aristocrat Leisure ((ALL)), Crown Resorts, Flight Centre ((FLT)), Qantas Airways ((QAN)), The Star Entertainment Group

**Transport Infrastructure**

Atlas Arteria ((ALX)), Sydney Airport

Consider Investing - But Be Wary

Macquarie highlights ASX100 stocks guiding to growth were quite rare during the reporting season, but many were offshore earners. The broker suspects these stocks could deliver a positive surprise in local currency, but again notes the positive surprise could be offset by a stronger Australian dollar.

These included WiseTech Global ((WTC)), Goodman Group ((GMG)), Amcor ((AMC)), CSL ((CSL)), Brambles ((BXB)) and James Hardie Industries ((JHX)).

Two Headwinds

Macquarie estimates international sales/revenues for the ASX300 Industrials is around 30%. Sectors with the highest foreign exposure and hence higher foreign exchange risk are Healthcare (83%), Basic Materials (67%) and Technology (51%).

In contemplating the twin scenario of a recovery trade and a strengthening Australian dollar, Macquarie highlights a double negative for two stocks. ResMed (( RMD)) and Ansell ((ANN)) are current covid-19 beneficiaries that also have high offshore exposure. To add insult to injury, they are both already rated Underperform by the broker.

Conclusion

With valuations stretched in “safe” areas of the market, a spread of recovery trades is a worthwhile consideration to supplement already well-diversified portfolios.

This is deemed wise as there are still substantial questions around what the “new normal” will look like. This would suggest holding both global and domestically exposed plays across the range of sectors currently impacted by covid-19, as also suggested by Wilsons recently.

AUSTRALIA

# Spark NZ Aiming To Counter The Growth In Fibre

Spark New Zealand has outlined its strategy out to FY23, including completing a roll-out of 5G while expanding its wireless offering and digital analytics

**-Spark New Zealand's business turnaround enables stock re-rating**
**-Fibre growing at a faster rate than fixed wireless**
**-Steady growth in debt**

By Eva Brocklehurst

Spark New Zealand ((SPK)) will become predominantly a wireless broadband provider leveraging 5G spectrum and, in simplifying its business, reduce a dependence on legacy technology.

The company's FY21-23 financial targets include a higher number of enhanced mobile broadband subscribers, NZ$500m in free cash flow and a 5G roll-out completed by the end of the period. Brokers assess the free cash flow target is achievable by FY23.

The company has ascertained that wireless is increasingly able to meet most customer needs and intends to participate in extended data analytics to unlock better customer experiences.


Spark NZ expects to be value accretive in the short term through its core business of wireless broadband and the cloud, and in the long-term through new markets such as digital health, Internet of Things and sport.

Confidence is justified, Credit Suisse asserts, as the company has turned around its business and provided modest revenue and operating earnings growth. The stock has re-rated and benefited from the reduction in interest rates, trading at a similar premium to ten-year government bonds as it did three years ago.

**The 5G plan is to cater to customers with high data needs and free up 4G spectrum to increase capacity in**

**regional and rural areas**. Macquarie notes management's disciplined approach to capital expenditure with a target of 10-11% of revenue, which will focus on the phased roll-out of 5G and investment in rural communities.

In addition, a long-term investment will be required in mobile spectrum in FY21 of NZ$50m and again in FY23 to secure long-term rights to critical 5G C-band spectrum. Nationwide coverage by FY23 in 5G is envisaged and the higher subscriber targets signal to UBS peak industry wireless broadband subscribers of more than 350,000.

Credit Suisse agrees Spark NZ still needs full access to spectrum to make the necessary investment in 5G and this will be an issue that should be watched over coming years.

Competition

Competition remains a key threat to dividend growth, the broker asserts. A benign competitive environment in mobile is countered by the potential for further competition in broadband, which may mean pressure on margins.

Credit Suisse notes Spark NZ has significant gross margins embedded from fixed input bypass and the large copper base, and with 5G coming on stream can understand why the company is confident it can grow fixed wireless further.

Nevertheless, if Spark NZ is to ultimately sustain 30-40% of its broadband base on fixed wireless, and retain the margin that accompanies this, competition coming from fibre will increasingly need to be addressed.

**An "emboldened" Chorus ((CNU)) is looking to embed fibre as the broadband network of choice**, the broker asserts, and fibre is growing at a faster rate than fixed wireless. Fixed wireless lags fibre on latency although Spark NZ is confident in its ability to close the gap.

Analytics

To leverage the trends, Macquarie asserts the company needs to anticipate customer needs and in this requires a future-facing technology plan to support the growth of data, AI and machine learning capability.

UBS also highlights customer analytics as key, which in turn should reduce marketing, advertising discounting and, possibly, churn. The broker retains a Neutral rating and NZ$4.55 target and valuation is based on medium-term dividends growing to NZ31c by FY28.

While there is a lot to like about the investment case, Credit Suisse has a Neutral rating and NZ$4.38 target and is mindful of the steady growth in debt over the last five years as well as in working capital.

Dividends have supported the yield above cash earnings, but the company cannot continue to increase debt with such modest earnings growth, the broker asserts, all the while keeping working capital and investment in check.

Macquarie, with a Neutral rating and NZ$4.80 target, assesses the target for free cash flow potentially supports a dividend of NZ27.5c, consistent with the company's intentions of delivering a sustainable dividend over time.

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COMMODITIES

# Iron Ore: Soaring And Roaring

China's economic growth strategy will be dominated by steel-intensive sectors and have led to a rebound in iron ore prices; Simandou's impact on iron ore prices in the medium to long term.

**-Implications of the China-led steel demand rebound**
**-The Simandou project: a potential flashpoint**
**-Iron ore stocks to consider**

By Angelique Thakur

The art of bouncing back

The rebound in China's steel demand, considerably faster than expected, has left Macquarie analysts surprised. But that's not all. Citi economists expect China to set a growth target of 5.5% in its 14th five-year plan. Admittedly, it is less than the 6.5% rate of growth aimed for by China in its 13th five-year plan. But, as Citi points out, indicates moderation as opposed to collapse of growth as was feared.

China has also indicated this growth will mostly be led by its domestic market. But what pleases Citi is the ***how*** of it. It looks like China will be focusing on developing its infrastructure. In particular, steel-intensive sectors like infrastructure, property, and automotive will be the key pillars for China's economic growth.

This leads Citi analysts to expect steel end-use demand to increase by 1-2% (year on year) per annum during 2021-23 versus the -1% decline that was forecast earlier.

There's more. Macquarie points towards a steel demand recovery in the US, EU and Indian markets. According to Macquarie, the three catalysts for iron ore and steel include a continued recovery in the auto sector, stimulus by countries like China (focused on infrastructure development) and new proposed construction guidelines in China that could boost steel intensity in buildings (although there is no firm timeline for this).


So what does that mean for iron ore?

While Citi expects to see a moderate pullback in iron ore prices from the US$130/t price recorded recently (the highest in over five years), iron ore will likely be range-bound between US$100/t-US$120/t for the rest of

2020. This implies a higher average price forecast of US$100/t from the previously expected US$90/t.

Macquarie follows suit, taking into account positive leading indicators (along with buoyant iron ore prices) such as low port stocks and positive steel margins, and is bullish on iron-ore exposure.

How iron ore does in the future mostly rests on the Chinese demand for steel, asserts Citi.

Citi's best-case scenario assumes steel demand growing at an annual rate of 5% in 2020-21, which will see its iron ore price forecast surge to US$110/t in 2021. The analysts' bear case assumes steel demand falling -1% year on year in 2020 and beyond. This will prompt iron ore prices to drop below US$80/t by 2020 end and further to US$60/t by the end of 2021, forecasts Citi.

JP Morgan expects 2021 iron ore price to touch US$105/t from a US$100/t forecast earlier. JP Morgan also envisages iron ore prices will remain elevated until Simandou comes into the picture, which is expected to be in about five years. This brings us to a potential threat - the Simandou project - which may be the next battleground in the war for iron ore market share.

<u>The next battle</u>

Guinea's (West Africa) Simandou project could be a game-changer, suggests a report by Morgan Stanley. The broker contends unlocking the world's largest high-grade iron ore deposit may unsettle the "truce" in the iron ore market. It could result in the major players abandoning their present "value-over-volume" stance and trigger the next "market share battle".

If this plays out as Morgan Stanley predicts, it may lead to adding another 200mtpa of low-cost supply to the market. And this is excluding the 110mpta expected from Simandou North. This will hit the price of iron ore with Morgan Stanley forecasting an impact of -US$7-12/t in the long term.

The fact that the project has a high investment cost may not be enough to deter its development, feels Morgan Stanley, seeing as China has more important things on its mind than mere project economics (namely a reduction in dependency on Australia's ore).

Citi analysts also reckon the rising availability of Chinese steel scrap may pose a danger. On the whole, however, Citi feels steel scrap recycling and processing activities will probably struggle to ramp up fast enough to lead to a collapse in the prices.

Post-2023, Morgan Stanley expects China's steel output to decline and no sufficient ex-China growth to offset this. Even without Simandou, the long term iron ore price is expected to be on the lower side. This is in sync with Citi analysts who think iron ore prices will fall back to around US$60/t in the next decade.

Which stocks look good?

Citi likes pure-play iron ore names like Fortescue Metals Group ((FMG)) and Mount Gibson Iron ((MGX)). Rio Tinto ((RIO)) is expected to give the highest absolute increase in earnings given the size of its iron ore footprint. Citi rates both Rio and Mount Gibson as Buy and highlights Rio as its preferred pick given the opportunity for higher dividends over the next three years.

Macquarie likes Fortescue Metals Group in large caps and Mineral Resources ((MIN)) in smaller caps. BHP Group ((BHP)) is another preferred pick. JP Morgan also likes Fortescue Metals Group and upgrades its rating to Overweight. JP Morgan notes both BHP and Rio Tinto also offer compelling valuation metrics.

COMMODITIES

# Material Matters: Gold, Copper & Thermal Coal

A glance through the latest expert views and predictions about commodities. Gold; copper; iron ore; and thermal coal.

**-Continued upward pressure on gold price underpins sector**
**-Copper supply risk may have peaked in 2020**
**-Steel output in China underpinned by infrastructure recovery**
**-Still, surplus may develop in seaborne iron ore**
**-High inventory keeping demand for thermal coal suppressed**

By Eva Brocklehurst

Gold

JPMorgan expects a strong finish to 2020 for gold, anticipating prices of US$2000/oz in the fourth quarter and prefers **Newcrest Mining** ((NCM)), **Alacer Gold** ((AQG)) and **Gold Road Resources** ((GOR)) in the space.

Credit Suisse is also bullish and increases its 2021 gold price forecast to US$2500/oz, from US$1800/oz, and 2022 to US$2200/oz, from US$1650/oz. The upgrade is underpinned by a number of supportive macro economic factors, principally an expectation that yields on US Treasury Inflation-Protected Securities (TIPS) will fall to -2.5% amid further declines in the US dollar. The broker suggests a -5% decline in the US dollar equates to a 10% increase in the gold price.

**Northern Star Resources** ((NST)) is Credit Suisse's preferred ASX gold exposure on valuation grounds, offering superior 1-3 year production growth and free cash flow yield. **Evolution Mining** ((EVN)) is upgraded to Outperform with the broker lauding its position as the lowest cost, highest margin operator among peers.

**Regis Resources** ((RRL)) is also upgraded to Outperform while **Perseus Mining** ((PRU)) jumps two levels to Outperform from Underperform. In mid-caps Credit Suisse prefers **St Barbara** ((SBM)) which offers growth and optimisation opportunities.

Bellwether Newcrest is also appreciated for its superior resource base and long-term growth options although its weaker free cash flow yield and higher copper exposure is likely to mean it lags peers.

Base Metals

JPMorgan notes forward curves for **copper**, **nickel** and **aluminium** are up 4-16% through 2020-23 as the outlook for global growth improves. The broker remains bullish on both **IGO Ltd** ((IGO)) and **Western Areas** ((WSA)) for nickel and in copper prefers **OZ Minerals** ((OZL)) over **Sandfire Resources** ((SFR)).

UBS notes second quarter results have signalled that most copper miners in Latin America have adapted to social distancing, as mine supply recovers to pre-pandemic levels.

The concentrate market is tight, although the impact on smelter production has been limited so far. As the highest risk period for mine disruption from nationwide mobility restrictions has passed, the tightness in concentrate is likely to ease in coming months and disruptions to refined copper supply are likely to be less severe.

Nevertheless, while copper supply risk may have peaked in 2020, the broker continues to envisage risks to 2021/22, as project developments are more severely affected by the pandemic compared with operating mines, and the backlogs in stripping & maintenance increase the risk of unplanned outages/downgrades to guidance. Still, the broker is constructive on copper over the medium term.

Iron Ore

UBS quotes Mysteel, which assesses first half 2020 **steel** output has been under-reported and growth could be nearer to upside estimates. Steel demand has been well supported by a marked increase in special-purpose bond issuance, which has underwritten a strong recovery in infrastructure in China.

Mysteel also assesses China's options outside importing **iron ore** are limited as domestic output growth is capped and scrap supply will not keep up with the expected lift in demand.

Hence, tensions between China and Australia are not expected to spill over into the iron ore trade. As a result, the build in iron ore that has occurred outside some of China's ports is attributed to bad weather and pandemic-related delays. Iron oil prices are expected to moderate but not drop below US$100/dmt in 2020.

Despite a positive view on Chinese steel production, Goldman Sachs still estimates the seaborne iron ore market will move into a sizeable surplus. Shipments from non-traditional suppliers such as India, Kazakhstan, Russia and Ukraine as well as China's domestic mines have responded to the higher prices.

However, the surplus is likely to be temporary and a balanced market ensue in 2021. Goldman Sachs remains positive about the medium-term outlook for iron ore and lifts 2021 price forecasts to US$90/t and 2022 to US$75/t. Over the longer term the broker forecasts a growing surplus on rising shipments from Vale and new production from Simandou in Guinea.

As a result of the hikes to iron ore forecasts, Goldman Sachs upgrades **BHP Group** ((BHP)) to Buy and retains a Buy rating for **Iluka Resources** ((ILU)), the owner of the Deterra iron ore royalty, as well as Canadian producer **Champion Iron** ((CIA)). The broker assesses elevated iron ore prices are already factored into **Rio Tinto** ((RIO)) and **Fortescue Metals** ((FMG)).

Thermal Coal

Morgan Stanley notes, despite production reductions in **thermal coal**, demand for seaborne supply still needs to improve to allow for a higher price. Newcastle thermal coal is around US$50/t and China's withdrawal from the seaborne market amid high inventory is keeping demand suppressed.

Moreover, the focus on a recovery in Indian demand may be thwarted by high stocks at Coal India's mines and utilities. High inventory is also an issue for Japan, the main importer of Australia's high-energy coal.

Despite a return to normal power generation, Australian exports to Japan were down -20% in July and the broker suggests imports could remain subdued until November. Across the globe, cuts to production continue but more are likely to be needed.

In the 2015-16 downturn the price stayed close to the US$50/t level for nine months, Morgan Stanley points out, until supply-side reforms in China helped imports.

No such catalyst is envisaged this time around and high stocks may just need to be worked down before a price recovery occurs. Morgan Stanley envisages downside risk to its fourth quarter 2020 price forecast of US$58/t.

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COMMODITIES

# Material Matters: Oil, Lithium & Iron Ore

A glance through the latest expert views and predictions about commodities. Oil; China oil/gas; lithium/cobalt; iron ore; and LaserBond

**-Do oil reserves already exceed the sum of future consumption?**
**-China's oil/gas demand ramps up again**
**-Reasons to be more optimistic for the lithium outlook**
**-Iron ore price likely peaking**

By Eva Brocklehurst

Oil

Is BP right about **oil** demand? If so, Morgan Stanley suggests this weakens arguments around the rates of decline in global oil demand. It may also change how OPEC manages the market.

BP has outlined long-term scenarios (to 2050) in which two of the three cases suggest oil reserves already exceed the sum of all future consumption. This is a softer outlook than Morgan Stanley itself had estimated.

The broker assesses, once demand recovers from the effects of the pandemic, the trend rate of growth will still be well below historical averages. Furthermore, when demand does recover, OPEC is likely to start increasing production in fear of losing market share.

The forecasts from BP amplify this prospect and, in Morgan Stanley's view, this would leave little room for non-OPEC, in particular US shale, to grow production. If these scenarios span the range of possible outcomes, the broker questions the need for oil prices to rise over the longer term.

In the BP "business as usual" scenario oil demand recovers to 2019 levels but then grows no more than 0-0.2mb/d per year until 2030 before declining, while the "rapid" and "net-zero" scenarios have demand declining exponentially from 2021.

<u>China Oil/Gas</u>

Macquarie observes the build up of crude oil inventory in China has slowed with the tapering of crude oil imports in August indicating healthier oil demand. The recovery has been solid, with July gasoline demand turning positive, up 8.0% compared with down -2.7% in June, and diesel demand up 21% year-on-year.

Meanwhile, demand for **gas** in China rebounded, as the impact of flooding subsided. However, Macquarie suspects over the year to date the 6.8% growth in apparent gas demand is largely on the back of more aggressive underground gas storage.

Hence, gas demand growth is likely to slow again in September/October before recovering in November/December once the heating season commences. LNG imports compared with total gas imports increased to an historical high of 86% in August which is likely in the broker's view the cause of Asian spot LNG prices more than doubling to US$4.55/MMBtu.

<u>Lithium/Cobalt</u>

The pandemic has exacerbated high inventory levels in **lithium** and the continuation of market surpluses, Canaccord Genuity observes. Sustained low prices have produced significant reductions to plant capacity additions but, with signs of a pick up in demand, the broker envisages the market will be entering its nadir and a recovery is possible into 2021.

Over 2020 to date, electric vehicle (EV) deliveries are annualising at down -3% compared with 2019 while strong sales volumes in Europe are offsetting weakness in China. Hence, Canaccord Genuity finds reasons to be optimistic. The broker models flat global sales in 2020 and a somewhat flatter adoption curve for EV. The 2025 forecast penetration rate remains at 13%. Chinese sales could also benefit from an extension to subsidies out to 2022.

The broker estimates more than 400,000tpa of lithium supply in existing and planned capacity has been shut, cancelled or deferred in response to the low pricing. However, based on revised supply/demand forecasts, Canaccord Genuity now expects smaller surpluses over 2020-23 and the oversupply condition should largely reverse by 2023. Upside risk is envisaged to prices from 2021 onwards.

The broker's long-term pricing (2027) is based on incentive levels of US$13-15,000/t. The slowly improving outlook should mean some positive sentiment returns to lithium equities although Canaccord Genuity is wary of the potential for "false starts".

The broker prefers those companies with low-cost operations such as **Orocobre** ((ORE)) and **Galaxy Resources** ((GXY)). The rating on **Pilbara Minerals** ((PLS)) is upgraded to Hold from Sell largely as a result of the updated lithium price deck.

Citi notes increased client interest in exposure to EV demand and remains bullish on lithium for a medium-term view. Demand for EVs is seen picking up, particularly in Europe where preliminary estimates suggest sales hit a 6.7% share in the first half of 2020, more than a year ahead of the broker's prior base case.

Pressure to build stocks and commit to **cobalt** tonnage is also expected to intensify, as many consumers are finding that much of the non-artisanal cobalt supply has been tied up in offtake deals. As more long-term deals are signed, the spot market in cobalt will become even smaller.

Chinese imports from the world's main supplier, the Democratic Republic of Congo, were down -50% in May/June and there is evident tightness upstream at Chinese smelters. Moreover, prices remain in the lower 20th percentile of an almost 30-year real price range and are unlikely to keep the market imbalances intact over the longer term, Citi observes.

The broker's long-term US$55,000/t cobalt price forecasts is around the long-term average. Citi also points out US dollar depreciation, the reflation trade and stimulus all apply to cobalt as this is a metal where diverse end uses still outweigh EV demand.

Iron Ore

**Iron ore** prices may have hit a peak for the short term, Citi notes, as falling blast furnace margins have started to drive steel mills away from mainstream fines into blended fines, lump and pellets. This is likely to mean iron ore benchmarks ease back below US$120/t. Moreover, the Chinese Iron and Steel Association has expressed concerns about elevated iron ore prices which appear to have left China as the largest importer at a strategic disadvantage.

Incremental easing of quarantine rules at Chinese ports should relieve the ongoing congestion, the broker suggests. Nevertheless, much of the strength in Chinese steel demand has been priced in ahead of the peak construction season and it is hard for Citi to envisage another big rally in steel prices that will push iron ore up further.

That said, the broker does not expect iron ore will fall below US$100/t over the rest of 2020 given a broadly balanced seaborne market. Citi lifts price forecasts for 2021-23 based on a more constructive outlook for Chinese steel demand and expects iron ore will drift to US$90/t in 2021, US$80/t in 2022 and US$75/t in 2023.

LaserBond

Canaccord Genuity initiates coverage of **LaserBond Ltd** ((LBL)), an Australian engineering technology business, with a Buy rating and $0.90 target. The board has established a revenue target of $40m for FY22 which would mean revenue nearly doubles over the next two years. The broker considers the growth outlook robust, as in addition to its current customer base there are options in international markets.

Expanding operations to those states rich in resources would open up new opportunities. The business has three segments, including services which offers surface treatments to machinery parts which are worn out from use, sale of products such as surface-treated components, and consumables.

Canaccord Genuity estimates the recent acquisition of United Service Technology should contribute around $4-5m to the FY22 revenue forecast.

ESG FOCUS

# ESG Focus: Rio, Cleanaway Boards Break A Sweat

Corrected version. When this story was initially published it mistakenly referred to the Australian Financial Review which should be The Age. This has now been corrected.

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

The resignation of Rio Tinto's corporate chiefs and the recent chastising of Cleanaway's CEO Vic Bansal have shifted the corporate spotlight from the "E" and the "S" to the "G" for governance - and boards are feeling the pressure.

By Sarah Mills

Anyone might be forgiven for thinking FNArena slightly obsessed with the resources and waste-management industry, following a series of articles recently.

But it is only because the pair continue to grab ESG headlines, and often for different reasons every time.

The ESG interest this time lies with the “G” governance, both incidents pointing to potential sweeping change in board cultures across all industries.

The most recent news on Rio Tinto last week was the resignation of its chief executive Jean-Sebastien Jacques, and iron-ore chief executive Chis Salisbury - and interestingly, the corporate affairs chief Simone Niven - in response to the Juukan Gorge incident.

Cleanaway chief Vik Bansal, meanwhile, was reprimanded by the board for multiple instances of “unacceptable conduct” after an investigation revealed he had created a “culture of bullying and harassment” and placed on final notice.

Such pressure on CEOs, previously almost unheard of, appears to be becoming more frequent. More interesting, is its reflection on the state of mind of boards.

Starting with Rio Tinto, most people shrugged when its CEOs were issued with salary penalties, and there was a general, if slightly uneasy, confidence, that boards and CEOs could rest assured of a return to business as usual.

Then the resignation bombshells were dropped. The playing field tilted. The rules of the game had changed. This signalled strong and serious intent by the powers that be on ESG; or so I thought.

But then I was dining with a fellow board colleague (BC) yesterday, who advised that CEO sackings were not the solution and that the buck may not have stopped at the CEO on the Juukan Gorge incident. There was still the “G” to consider.

Firing the CEO is buck-passing, BC reminds me. Boards cannot continue to use management as scapegoats or nothing changes. Everything is top down and comes from the board, including the culture. The corporate playbook is crystal clear on this.

Whether heads will roll on Rio Tinto’s board has yet to be seen, but the *London Daily Mail* reports that the Chairman Simon Thompson’s “flaccid” handling of the incident is understood to have erupted into a boardroom row. It seems at least a few board members have broken a sweat.

The faint odour of fear is detectable in both the Rio Tinto and Cleanaway responses.

After 30 years of an apparent accelerated purge of ethics from business, it appears the tables are turning.

Historians of purges will remember that, particularly under police state principles conceived by Ivan the Terrible and enacted with regularity in Communist Russia and Chinese dictatorships, purges are regularly employed for the soul purpose of shaking up the status quo and reminding the inner circle of who wields the power.

It will be the consistency of enforcing standards set and punishments meted that will distinguish ESG as more than just a purge instrument and a genuine tool for change.

Boards are on notice, and they know it. Shareholders are starting to catch on.

The Cleanaway board has acted swiftly on complaints about Vic Bansal, a state of affairs that, in an industry as dirty as waste management (excuse the pun), would have been unheard of 10 years ago.

The share price fell sharply following the news.

As noted in previous articles, the waste-management industry occupies a pivotal space in the transition to a circular economy and it is likely that it will continue to attract close board and cultural scrutiny over the next few years.


…

Another interesting takeout from the Juukan Gorge incident is how poorly structured politically companies are to deal with ESG issues, given most ESG issues pivot around concepts of engagement.

*The Age* points out that a few disastrous forays in Africa had led Rio Tinto to embark on rounds of cost-cutting in its operations. As usual, the marketing and communications departments were among the first casualties. The AFR suggests these cuts led to the breakdown in communications with indigenous landholders and other errors.

The interesting thing about the Rio Tinto incident is that it draws attention to the long-term trend of persecution towards these strategic communications subject-matter experts within the corporate sector.

Not being profit centres, marketing and communications, although vital to company profits, have largely been sidelined in all but fast-moving consumer goods companies in which their contribution to the bottom line, while no more quantifiable than in B2B companies, would never be questioned.

Large pools of knowledge and experience have been destroyed and many corporate affairs departments have been reduced to the fluffy top-down message purveyors that the largely legal, accounting and IT management fraternity perceive them to be. That and crisis management, which is often outsourced to hedge internal political communications risk, and because it is rarely called upon.

(It is fair to say that in a post-ESG age crisis management in its current incarnation appears as an anachronistic, reactive modus operandi – one that often relies heavily on a lack of corporate ethics and moral courage for its very existence.)

The marketing and communication industry's representation on boards is also parlous.

Houston, we have a problem. Big data and e-tailing are changing all that even for the boffin-denominated B2B market. And now boards can add ESG to that mix.

Engagement and communication (both up and down; and respectfully among external stakeholders) may end up being the deciding factor between those boards and management that survive in a post-ESG world and those that don't.

***FNArena's dedicated ESG Focus news section zooms in on matters Environmental, Social & Governance (ESG) that are increasingly guiding investors preferences and decisions globally. For more news updates, past and future:***
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WEEKLY REPORTS

# Weekly Ratings, Targets, Forecast Changes - 11-09-20

By Mark Woodruff

***Guide:***

*The FNArena database tabulates the views of seven major Australian and international stock brokers: Citi, Credit Suisse, 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 September 7 to Friday September 11, 2020*
*Total Upgrades: 16*
*Total Downgrades: 2*
*Net Ratings Breakdown: Buy 49.09%; Hold 40.00%; Sell 10.91%*

The week ending Friday 11 September proved a positive one for stockbroking analysts' company ratings on individual ASX-listed stocks. There were sixteen upgrades, of which twelve went to a direct Buy and only two downgrades, all to a direct Sell.

Most of the upgrades related to the mining sector. This mining bent was in evidence when reviewing the largest percentage change in earnings forecasts for the week. OZ Minerals had the largest change, driven by the company's unique growth options and the bullish outlook for copper. There is no such optimism for the oil price. However, Oil Search is benefiting from downsizing its Alaskan Nanushuk oil development to phased self-funding. Third on the table for a percentage earnings increase is Fortescue Metals Group after brokers raised iron ore price forecasts.

Nearmap led percentage earnings downgrades for the week after announcing a capital raising. This will both support the balance sheet and allow the acceleration of growth plans in the US. Graincorp came second on the table for percentage downgrades. Brokers weighed up an increase to the winter crop forecast versus the insurance payout required by the company, as it attempts to smooth earnings in good years and bad.

Mineral Resources was in the leading bunch of target price upgrades from brokers, along with the aforementioned OZ Minerals. Mineral Resources gained favour due to the expectation of stronger steel production in China. As a result, expected future iron ore prices have been ratcheted up in the models used by analysts.

Blackmores suffered the only notable percentage downward adjustment to a target price, as outlook comments after the FY20 result were weaker than expected. Debate now centres on large variables including brand value and whether the company deserves a potential takeover premium. Additionally, Chinese distribution and regulatory shortcomings need to be addressed.

Total Neutral/Hold recommendations take up 49.09% of the total, versus 40% on Neutral/Hold, while Sell ratings account for the remaining 10.91%.

**Upgrade**

**APPEN LIMITED ((APX)) Upgrade to Neutral from Underperform by Credit Suisse** .B/H/S: 3/2/0

Credit Suisse has become more balanced in its view of the stock and upgrades to Neutral from Underperform. The rating change is more about the share price than any fundamental difference.

Valuation still appears stretched at 51x 2020 price/earnings, although the broker notes the industry structure remains healthy. Credit Suisse increases 2021 sales forecasts on higher productivity assumptions. Target is raised to $30 from $29.

At this stage, the broker believes guidance for 2020 is achievable and leaves its forecast for $125.5m in operating earnings unchanged.

**BEACH ENERGY LIMITED ((BPT)) Upgrade to Outperform from Neutral by Macquarie** .B/H/S: 4/2/0

With Beach Energy's share price down -15% since May, Macquarie notes the company has underperformed the energy sector on account of its reduced five-year free cash flow guidance.

The broker considers the Waitsia-North West Shelf contract win a positive surprise. Earnings forecasts for FY21-23 have been increased due to higher expected oil production and gas contract prices.

Macquarie has upgraded its rating to Outperform from Neutral with a target price of $1.70.

**FORTESCUE METALS GROUP LTD ((FMG)) Upgrade to Buy from Hold by Ord Minnett** .B/H/S: 3/2/2

Ord Minnett expects 2021 iron ore price to increase to US$105/t from US$100/t due to higher China steel production estimates. This compels the broker to upgrade Fortescue Metals Group's rating to Buy from Hold with the target price increased to $20 from $18.80.

Iron ore price estimates for the group have been increased to US$51/t from US$48/t. The group offers a dividend yield of 9% over the next three years, according to the broker.

See also FMG downgrade.

**MAGELLAN FINANCIAL GROUP LIMITED ((MFG)) Upgrade to Outperform from Neutral by Credit Suisse** .B/H/S: 1/4/2

Since the FY20 result Magellan Financial has dropped around -10%. Yet the infrastructure franchise has built a core offering which accounts for around half of its assets under management and Credit Suisse believes there is scope for a similar market in global equities.

The broker upgrades estimates by 1-2% to account for higher net flows and believes the company's products offer attractive characteristics that appeal to institutional investors and flows should remain robust.

Rating is upgraded to Outperform from Neutral and the target raised to $65 from $60.

**MOUNT GIBSON IRON LIMITED ((MGX)) Upgrade to Buy from Neutral by Citi** .B/H/S: 2/0/0

Citi expects a modest pullback in the iron ore price in the near-term but believes the price will be rangebound between US$100-US$120/t range for the rest of 2020. Iron ore price forecasts for 2021-23 have been lifted due to a more constructive Chinese steel demand outlook.

The broker notes pure-play iron ore names like Mount Gibson Iron will benefit the most from higher prices with near term earnings almost doubling.

Citi upgrades its rating to Buy from Neutral given the expectation of strong free cash flow generation at the new iron ore price deck. The target price rises to $1 from $0.75.

**NEWCREST MINING LIMITED ((NCM)) Upgrade to Accumulate from Hold by Ord Minnett** .B/H/S: 3/3/1

Ord Minnett is positive on the outlook for gold and maintains a US$2,000/oz gold price forecast for the December half.

However, a strengthening Australian dollar has been playing spoilsport, adds the broker, eroding margins and leading to near-term downgrades in earnings forecasts.

The broker has upgraded its rating for Newcrest Mining to Accumulate from Hold with the target price increasing to $35 from $34.

**NUFARM LIMITED ((NUF)) Upgrade to Add from Reduce by Morgans** .B/H/S: 5/2/0

Nufarm reports its FY20 result on September 23. The company has recently provided preliminary underlying earnings guidance of $290m-$300m for FY20, slightly below Morgans estimates.

However, the broker expects FY20 earnings to be the low point given improved seasonal conditions in Australia. Additionally, the company said FY20 will be the trough for the European business.

Given material share price weakness and a more attractive valuation, Morgans upgrades the rating to Add from Reduce and the target price is increased to $4.85 from $4.76.

**NEXTDC LIMITED ((NXT)) Upgrade to Outperform from Neutral by Macquarie** .B/H/S: 6/1/0

Macquarie upgrades its rating of NextDC from Neutral to Outperform, as the share price has retraced around -12% from recent highs.

The broker explains it is one of the few companies benefiting both short and long term from covid-19, as enterprises globally accelerate digital transformation plans.

The target price is unchanged at $12.30.

**POINTSBET HOLDINGS LTD ((PBH)) Upgrade to Neutral from Underperform by Credit Suisse** .B/H/S: 0/2/0

The company, in its deal with NBCUniversal, is now placed to be a national operator in the US sports betting and internet gaming industry. While the company will be paying for national advertising, Credit Suisse understands the deal allows for flexibility in terms of where the expenditure on marketing occurs.

The broker increases its US sports betting market share assumptions for PointsBet to 10% in states where it becomes operational. FY23 estimates are upgraded by 38% as costs are offset by increased revenue forecasts.

Rating is upgraded to Neutral from Underperform and the target lifted to $10.50 from $6.50.

**RIO TINTO LIMITED ((RIO)) Upgrade to Buy from Neutral by Citi** .B/H/S: 3/3/1

Citi expects a modest pullback in the iron ore price in the near-term but believes the price will be rangebound between US$100-US$120/t range for the rest of 2020. Iron ore price forecasts for 2021-23 have been lifted due to a more constructive Chinese steel demand outlook.

The broker forecasts Rio Tinto to have the highest absolute increase in earnings given the size of its iron ore footprint. Rio is Citi's preferred pick for iron ore exposure given a very under-geared balance sheet presenting an opportunity for higher dividends over the next 3 years.

Citi upgrades its rating to Buy from Neutral with the target price increasing to $115 from $100.

**REGIS RESOURCES LIMITED ((RRL)) Upgrade to Hold from Sell by Ord Minnett** .B/H/S: 2/4/1

Ord Minnett is positive on the outlook for gold and maintains a US$2,000/oz gold price forecast for the December half.

However, a strengthening Australian dollar has been playing spoilsport, adds the broker, eroding margins and leading to near-term downgrades in earnings forecasts.

Regis Resources' rating has been upgraded to Hold from Sell with a target price of $4.80.

**SARACEN MINERAL HOLDINGS LIMITED ((SAR)) Upgrade to Hold from Lighten by Ord Minnett** .B/H/S: 1/3/1

Ord Minnett is positive on the outlook for gold and maintains a US$2,000/oz gold price forecast for the December half.

However, a strengthening Australian dollar has been playing spoilsport, adds the broker, eroding margins and leading to near-term downgrades in earnings forecasts.

FY21 production guidance for Saracen Mineral Holdings has been downgraded led by the Super Pit JV. Ord Minnett upgrades its rating to Hold from Lighten with a target price of $4.70.

**SIGMA HEALTHCARE LIMITED ((SIG)) Upgrade to Outperform from Neutral by Credit Suisse** .B/H/S: 2/1/1

Sigma Healthcare's -8% fall in underlying earnings was a solid result under the circumstances, Credit Suisse suggests. No dividend was declared and no guidance offered.

The broker forecasts 21% compound earnings growth over FY20-23 driven by cost-outs, the full ramp-up of the Chemist Warehouse
contract and continued above-market growth in retail, aided by diminished regulatory headwinds. The end of the company's capex investment cycle leaves sufficient balance sheet capacity for growth.

Credit Suisse upgrades to Outperform from Neutral. Target rises to 70c from 64c.

**SANTOS LIMITED ((STO)) Upgrade to Buy from Neutral by UBS** .B/H/S: 6/1/0

UBS expects Santos to achieve its target free cash flow breakeven in 2020 which will help it reduce its gearing levels over FY20-22. The broker points out Santos has better access to existing infrastructure than its peers that will help it reduce its capex.

The company has three diversified growth projects that are near-term catalysts and provide Santos the best leverage to near-term growth, highlights the broker.

Considering Santos as its most preferred energy exposure stock, UBS upgrades its rating to Buy with the target price increasing to $6.50 from $6.

**TECHNOLOGYONE LIMITED ((TNE)) Upgrade to Add from Hold by Morgans** .B/H/S: 1/1/1

The FY20 result for TechnologyOne is due on November 24 and Morgans expects it to be in-line with guidance and to contain no major surprises.

The broker notes the share price has fallen around -20% in the last four months, despite nothing much changing for the business.

The analyst reiterates key strengths including a resilient business model, which comes from having long sales cycles and deeply embedded enterprise grade software. Additionally, the customer base is large, diversified and very well-funded.

Some concerns may have arisen over the company’s education vertical and weakness in international students. Morgans reminds investors that the company’s revenue stream is not linked to international students.

The rating is upgraded to Add from Hold and the target price is decreased to $8.76 from $9.16.

**WOODSIDE PETROLEUM LIMITED ((WPL)) Upgrade to Add from Hold by Morgans** .B/H/S: 5/2/0

Morgans views Woodside Petroleum’s share price as trading at a discount to the value of its existing operations. As a result the broker upgrades the rating to Add from Hold and maintains the target price of $23.40.

The pursuit of growth opportunities and maintenance of an elevated dividend payout ratio raises the spectre of the need for additional external capital, the broker acknowledges.

However, under various equity raise scenarios, Morgans shows the company’s value is more sensitive to an eventual recovery versus future dilution risk.

The analyst points out a key risk would be a more severe regional economic hit from covid-19, than currently assumed by the broker.

**Downgrade**

**FORTESCUE METALS GROUP LTD ((FMG)) Downgrade to Underweight from Equal-weight by Morgan Stanley** .B/H/S: 3/2/2

Morgan Stanley expects the iron ore market to be in surplus from the last quarter of 2020. However, the broker also expects stronger steel production in China and dismisses concerns about any buildup in China's port ore stocks.

This also prompts Morgan Stanley to raise its fourth-quarter 2020 and 2021 iron ore price forecasts to US$100/t and US$81/t but long-term projections remain unchanged.

The broker notes some equity valuations are starting to look stretched like Fortescue Metals Group. This translates to a negative risk-reward skew, believes the broker, downgrading its rating to Underweight from Equal-weight.

The target price rises to $14.50 from $12.70. Industry view is Attractive.

See also FMG upgrade.

**MINERAL RESOURCES LIMITED ((MIN)) Downgrade to Underweight from Equal-weight by Morgan Stanley** .B/H/S: 1/0/1

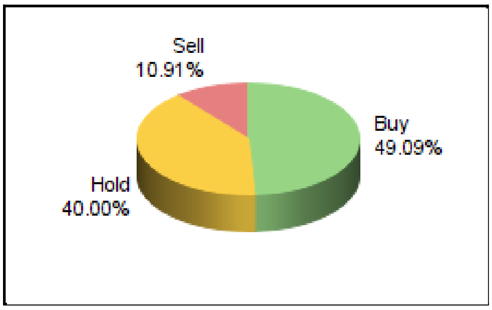
Morgan Stanley expects the iron ore market to be in surplus from the last quarter of 2020. However, the broker also expects stronger steel production in China and dismisses concerns about any buildup in China's port ore stocks.

This also prompts Morgan Stanley to raise its fourth-quarter 2020 and 2021 iron ore price forecasts to US$100/t and US$81/t but long-term projections remain unchanged.

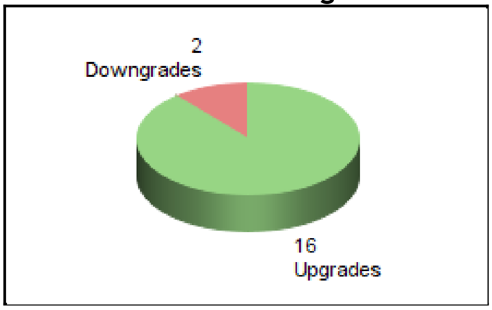
The broker notes valuation for Mineral Resources is starting to look stretched. This translates to a negative risk-reward skew, believes the broker, downgrading its rating to Underweight from Equal-weight.

The target price rises to $23.50 from $21. Industry view: Attractive.

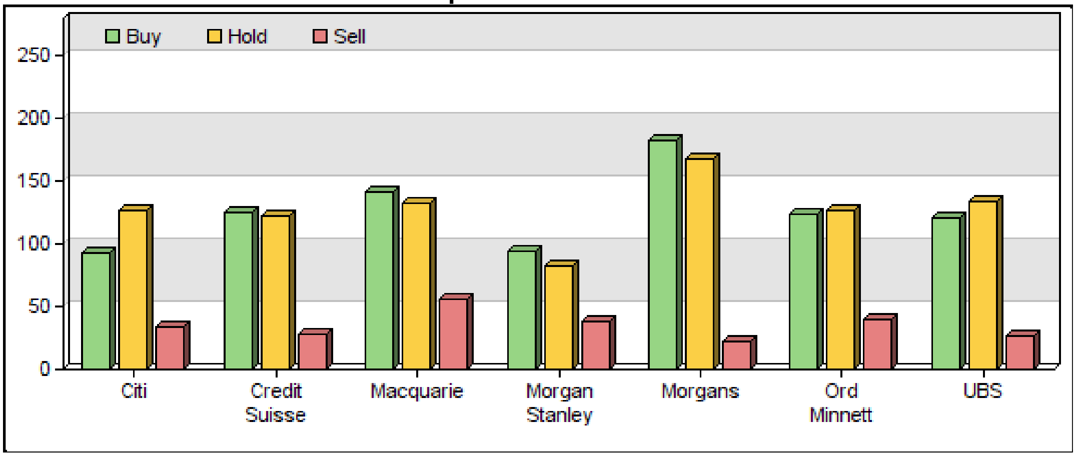
**Total Recommendations**




**Recommendation Changes**




**Broker Recommendation Breakup**




# Broker Rating

| Order | Company | New Rating | Old Rating | Broker |
|---|---|---|---|---|
| Upgrade | | | | |
| 1 | APPEN LIMITED | Neutral | Sell | Credit Suisse |
| 2 | BEACH ENERGY LIMITED | Buy | Neutral | Macquarie |
| 3 | FORTESCUE METALS GROUP LTD | Buy | Neutral | Ord Minnett |
| 4 | MAGELLAN FINANCIAL GROUP LIMITED | Buy | Neutral | Credit Suisse |
| 5 | MOUNT GIBSON IRON LIMITED | Buy | Neutral | Citi |
| 6 | NEWCREST MINING LIMITED | Buy | Neutral | Ord Minnett |
| 7 | NEXTDC LIMITED | Buy | Neutral | Macquarie |
| 8 | NUFARM LIMITED | Buy | Sell | Morgans |
| 9 | POINTSBET HOLDINGS LTD | Neutral | Sell | Credit Suisse |
| 10 | REGIS RESOURCES LIMITED | Neutral | Sell | Ord Minnett |
| 11 | RIO TINTO LIMITED | Buy | Neutral | Citi |
| 12 | SANTOS LIMITED | Buy | Neutral | UBS |
| 13 | SARACEN MINERAL HOLDINGS LIMITED | Neutral | Sell | Ord Minnett |
| 14 | SIGMA HEALTHCARE LIMITED | Buy | Neutral | Credit Suisse |
| 15 | TECHNOLOGYONE LIMITED | Buy | Neutral | Morgans |
| 16 | WOODSIDE PETROLEUM LIMITED | Buy | Neutral | Morgans |
| Downgrade | | | | |
| 17 | FORTESCUE METALS GROUP LTD | Sell | Neutral | Morgan Stanley |
| 18 | MINERAL RESOURCES LIMITED | Sell | Neutral | Morgan Stanley |

# Recommendation

## Positive Change Covered by > 2 Brokers

| Order | Symbol | Company | New Rating | Previous Rating | Change | Recs |
|---|---|---|---|---|---|---|

| | | | | | | |
|---|---|---|---|---|---|---|
| 1 | NUF | NUFARM LIMITED | 71.0% | 43.0% | 28.0% | 7 |
| 2 | TNE | TECHNOLOGYONE LIMITED | -13.0% | -38.0% | 25.0% | 4 |
| 3 | APX | APPEN LIMITED | 60.0% | 40.0% | 20.0% | 5 |
| 4 | BPT | BEACH ENERGY LIMITED | 58.0% | 42.0% | 16.0% | 6 |
| 5 | SHL | SONIC HEALTHCARE LIMITED | 29.0% | 14.0% | 15.0% | 7 |
| 6 | NXT | NEXTDC LIMITED | 79.0% | 64.0% | 15.0% | 7 |
| 7 | MFG | MAGELLAN FINANCIAL GROUP LIMITED | -14.0% | -29.0% | 15.0% | 7 |
| 8 | STO | SANTOS LIMITED | 79.0% | 64.0% | 15.0% | 7 |
| 9 | WPL | WOODSIDE PETROLEUM LIMITED | 71.0% | 57.0% | 14.0% | 7 |
| 10 | RIO | RIO TINTO LIMITED | 21.0% | 7.0% | 14.0% | 7 |

### Negative Change Covered by > 2 Brokers

| Order | Symbol | Company | New Rating | Previous Rating | Change | Recs |
|---|---|---|---|---|---|---|
| 1 | MIN | MINERAL RESOURCES LIMITED | -17.0% | 17.0% | -34.0% | 3 |
| 2 | OZL | OZ MINERALS LIMITED | 21.0% | 50.0% | -29.0% | 7 |
| 3 | BKL | BLACKMORES LIMITED | -33.0% | -17.0% | -16.0% | 6 |
| 4 | NWL | NETWEALTH GROUP LIMITED | -33.0% | -17.0% | -16.0% | 6 |
| 5 | SGP | STOCKLAND | 8.0% | 17.0% | -9.0% | 6 |

# Target Price

### Positive Change Covered by > 2 Brokers

| Order | Symbol | Company | New Target | Previous Target | Change | Recs |
|---|---|---|---|---|---|---|
| 1 | NWL | NETWEALTH GROUP LIMITED | 10.715 | 10.073 | 6.37% | 6 |
| 2 | MIN | MINERAL RESOURCES LIMITED | 26.400 | 25.367 | 4.07% | 3 |
| 3 | OZL | OZ MINERALS LIMITED | 14.041 | 13.498 | 4.02% | 7 |
| 4 | ILU | ILUKA RESOURCES LIMITED | 9.940 | 9.690 | 2.58% | 6 |
| 5 | RIO | RIO TINTO LIMITED | 106.643 | 104.000 | 2.54% | 7 |
| 6 | STO | SANTOS LIMITED | 6.623 | 6.523 | 1.53% | 7 |
| 7 | SHL | SONIC HEALTHCARE LIMITED | 34.106 | 33.706 | 1.19% | 7 |
| 8 | MFG | MAGELLAN FINANCIAL GROUP LIMITED | 61.124 | 60.410 | 1.18% | 7 |
| 9 | TCL | TRANSURBAN GROUP | 14.281 | 14.197 | 0.59% | 7 |
| 10 | APX | APPEN LIMITED | 36.580 | 36.380 | 0.55% | 5 |

### Negative Change Covered by > 2 Brokers

| Order | Symbol | Company | New Target | Previous Target | Change | Recs |
|---|---|---|---|---|---|---|
| 1 | BKL | BLACKMORES LIMITED | 67.375 | 70.592 | -4.56% | 6 |
| 2 | WPL | WOODSIDE PETROLEUM LIMITED | 23.269 | 23.669 | -1.69% | 7 |
| 3 | TNE | TECHNOLOGYONE LIMITED | 8.440 | 8.540 | -1.17% | 4 |
| 4 | SGP | STOCKLAND | 3.913 | 3.930 | -0.43% | 6 |
| 5 | BPT | BEACH ENERGY LIMITED | 1.902 | 1.910 | -0.42% | 6 |

# Earning Forecast

### Positive Change Covered by > 2 Brokers

| Order | Symbol | Company | New EF | Previous EF | Change | Recs |
|---|---|---|---|---|---|---|
| 1 | OZL | OZ MINERALS LIMITED | 53.216 | 44.744 | 18.93% | 7 |
| 2 | OSH | OIL SEARCH LIMITED | 2.763 | 2.385 | 15.85% | 7 |
| 3 | FMG | FORTESCUE METALS GROUP LTD | 250.923 | 224.960 | 11.54% | 7 |
| 4 | SGM | SIMS LIMITED | 18.325 | 16.975 | 7.95% | 6 |
| 5 | BHP | BHP GROUP | 292.088 | 274.090 | 6.57% | 7 |
| 6 | STO | SANTOS LIMITED | 24.458 | 23.036 | 6.17% | 7 |
| 7 | WPL | WOODSIDE PETROLEUM LIMITED | 79.567 | 75.253 | 5.73% | 7 |
| 8 | BKL | BLACKMORES LIMITED | 175.580 | 166.800 | 5.26% | 6 |
| 9 | BSL | BLUESCOPE STEEL LIMITED | 49.373 | 47.290 | 4.40% | 6 |
| 10 | SHL | SONIC HEALTHCARE LIMITED | 147.271 | 141.414 | 4.14% | 7 |

### Negative Change Covered by > 2 Brokers

| Order | Symbol | Company | New EF | Previous EF | Change | Recs |
|---|---|---|---|---|---|---|
| 1 | NEA | NEARMAP LTD | -3.433 | -2.633 | -30.38% | 3 |

| | | | | | | |
|---|---|---|---|---|---|---|
| 2 | GNC | GRAINCORP LIMITED | 1.263 | 1.788 | -29.36% | 4 |
| 3 | WSA | WESTERN AREAS NL | 6.190 | 6.840 | -9.50% | 6 |
| 4 | NUF | NUFARM LIMITED | -8.857 | -8.286 | -6.89% | 7 |
| 5 | ILU | ILUKA RESOURCES LIMITED | 47.712 | 50.762 | -6.01% | 6 |
| 6 | IDX | INTEGRAL DIAGNOSTICS LIMITED | 18.744 | 19.455 | -3.65% | 5 |
| 7 | QUB | QUBE HOLDINGS LIMITED | 5.737 | 5.903 | -2.81% | 6 |
| 8 | MIN | MINERAL RESOURCES LIMITED | 316.667 | 324.667 | -2.46% | 3 |
| 9 | BXB | BRAMBLES LIMITED | 56.308 | 57.378 | -1.86% | 6 |
| 10 | ORA | ORORA LIMITED | 15.026 | 15.311 | -1.86% | 7 |

**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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WEEKLY REPORTS

# Uranium Week: Spot Price Down -12% Since May

The uranium price continues its gradual slide as the World Nuclear Association holds its Strategic e-Forum.

**-Weekly spot prices fall just over -1%**
**-Resolution approaching on the Russian Suspension Agreement**
**-News from the World Nuclear Association Strategic (e-) Forum 2020**

By Mark Woodruff

Market participants await news regarding ongoing negotiations between the US Department of Commerce and Russia. Negotiations concern the possibility of extending and limiting the amount of Russian separative work unit allowed into the US under the current Russian Suspension Agreement (RSA), which is set to expire on December 31. The DoC has set a deadline of October 5 for the parties to reach a resolution, and the parties are reported to be very close to announcing their agreement.

If the parties are unable to reach agreement soon, there will be a lack of clarity about the quantities of Russian-origin material that US utilities would be allowed to purchase in the future. Industry consultant TradeTech notes as the deadline approaches for 2021 delivery notices under existing agreements, an element of uncertainty would certainly be introduced into the enrichment market, and potentially lead to market turmoil.

World Nuclear Association Strategic e-Forum 2020

With covid-19 prohibiting travel for much of the industry, the World Nuclear Association (WNA) held a Strategic e-Forum 2020 last week, in place of its annual Symposium. According to TradeTech, there were wide-ranging discussions on how nuclear energy can address some of the most pressing issues in the world today. Other topics included how to attract investment for future growth and promote the socio-economic and environmental benefits of nuclear energy.

At the forum, Polish climate minister Michal Kurtyka discussed his plan to construct six new nuclear power units by 2040, as the country transitions to a clean energy economy. With a growing economy and an energy policy that calls for nuclear power to constitute 14% of its energy mix by 2040, Poland has launched a US$40 billion initiative to build new nuclear power capacity beginning in the 2030's. Coal currently accounts for nearly 74% of Poland's electricity generation, notes TradeTech. Poland's energy policy for 2040 aims to reduce coal's contribution to the electricity mix to between 11% and 28% by 2040.

Commenting on the environmental benefits of reliable, carbon-free nuclear energy in the US, GE Hitachi President and CEO Jay Wileman said, "Thanks to the nuclear energy we have here, we avoided over 476 million metric tonnes of carbon just last year. That's the equivalent to taking 100 million cars off the road. So think about that across the world with the more than 450 units that we have as an existing installed base, and the work that we have to do to continue to grow that with new nuclear."

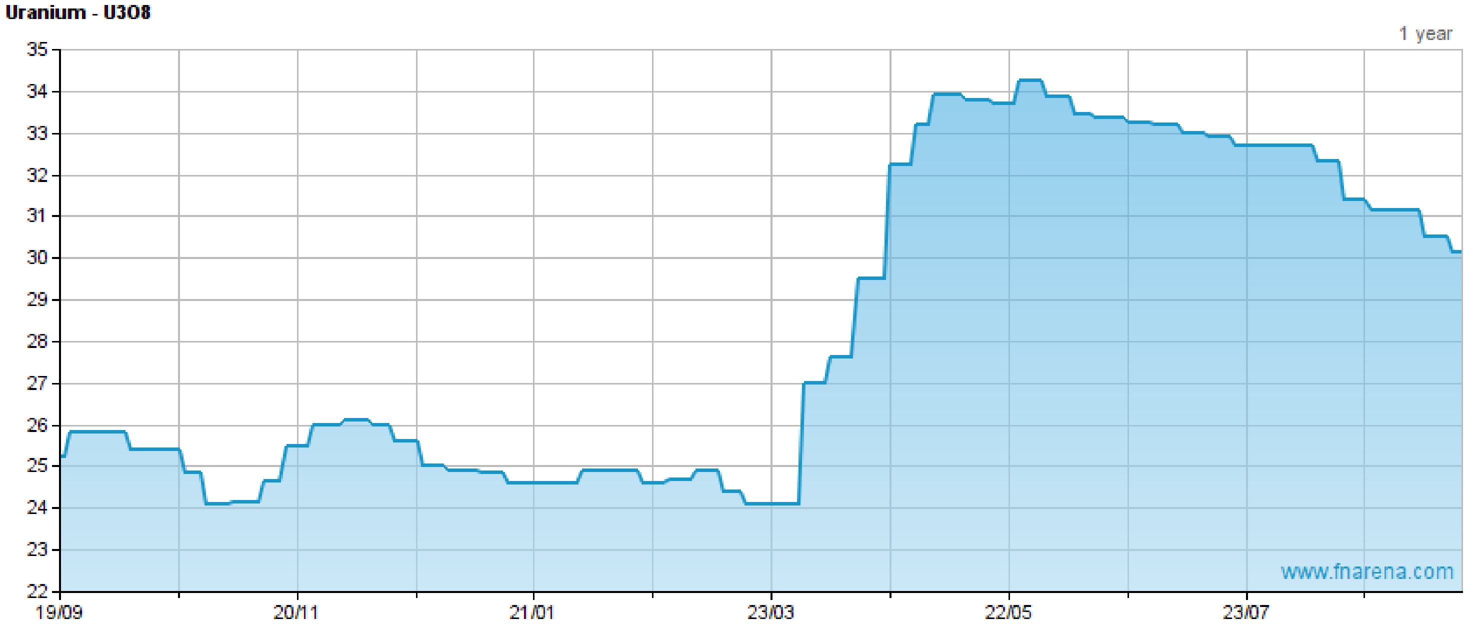
Uranium Pricing

TradeTech's Weekly Spot Price Indicator fell to US$30.15/lb U3O8 last week. This was a decrease of -US$0.35 from last week's value.

Total transactional volume for the week totaled approximately 750,000lbs U3O8, with utilities, traders, and producers all participating as buyers.

The weekly spot price currently sits 21% above its January 3 value of $US24.85/lb but has declined by -US$4.10/lb or -12% since reaching a year high of US$34.25/lb in May. The average weekly uranium spot price for 2020 is US$29.68/lb, US$3.82/lb above the 2019 average.

TradeTech's term price indicators remain at US$34.50/lb (mid) and US$37.00/lb (long).

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WEEKLY REPORTS

# The Short Report - 17 Sep 2020

See **Guide** further below (for readers with full access).

**Summary:**

Week ending September 10, 2020

Last week on the ASX was all about a tech sector we don't have correcting from a parabolic rally we didn't experience triggering a correction in an unrelated index, being the ASX200.

Despite the volatility, short-side traders did not notably respond. All the red and green movements on the table below represent nothing more than bracket creep.

There was nevertheless one position change of one percentage point or more. Webjet ((WEB)) rose to 16.8% shorted from 15.4% the week before.

In historic terms, 16.8% is a far cry from the 20%-plus positions seen in other stocks in years gone by. But this position stands out significantly on the basis that the next most shorted is Myer at 10.8%, then InvoCare at 9.5%, then only three stocks over 8% and only two over 7%.

In days gone by there could be more than ten stocks 10%-plus shorted, let alone in the nines, eights and sevens.

So why is Webjet the shorters' pin-up boy? Stablemates Flight Centre ((FLT)) and Corporate Travel Management ((CTD)) are only 6.7% and 6.5% by comparison.

Analysts noted following the result season just past that Webjet is more exposed to domestic borders remaining closed, more so relatively than the international border remaining closed. While there is a concerted push to re-open state borders, it remains clear Queensland and WA will continue to dig in their heels.

Webjet has been forced to go to the market once, post covid, for emergency capital, and the 16.8% short position suggests shorters are expecting another round will be needed.

No Movers & Shakers this week.

**Weekly short positions as a percentage of market cap:**

**10%+**

WEB 16.8
MYR 10.8

In: MYR

**9.0-9.9**

IVC

Out: MYR

**8.0-8.9%**

ING, CUV, FXL

In: CUV, FXL Out: IFL

**7.0-7.9%**

BOQ, ORE

Out: CUV, FXL, NEA

**6.0-6.9%**

FNP, PNV, NEA, FLT, MTS, A2M, CTD, GXY, AVH, JIN, SGM, BIN

In: NEA, AVH, JIN Out: EOS

**5.0-5.9%**

LOV, HUB, SUL, EOS, SEK, ALG, BEN, SXL, NEC, PGH

In: EOS, HUB, SXL, NEC

Out: AVH, JIN, Z1P, BUB, JBH

**Movers & Shakers**

See above.

**ASX20 Short Positions (%)**

[Note: ASX20 index changes announced recently will not have become effective until next week's Short Report].

| Code | Last Week | Week Before | Code | Last Week | Week Before |
|---|---|---|---|---|---|
| ALL | 4.2 | 4.2 | NCM | 0.3 | 0.1 |
| ANZ | 0.9 | 0.8 | RIO | 1.8 | 1.7 |
| BHP | 4.2 | 4.3 | SCG | 1.7 | 1.3 |
| BXB | 0.3 | 0.2 | SUN | 0.7 | 0.6 |
| CBA | 0.7 | 0.6 | TCL | 0.8 | 0.5 |
| CSL | 0.4 | 0.3 | TLS | 0.5 | 0.3 |
| GMG | 0.4 | 0.5 | WBC | 0.8 | 0.7 |
| IAG | 0.9 | 0.8 | WES | 0.5 | 0.5 |
| MQG | 0.4 | 0.3 | WOW | 0.3 | 0.3 |
| NAB | 1.2 | 1.1 | WPL | 1.5 | 1.3 |

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

**Guide:**

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

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

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

***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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WEEKLY REPORTS

# The Wrap: Contractors, Financials & Accounting

Weekly Broker Wrap: health care & the US election; contractors; financials; and accounting software

**-Heightened focus on pharmaceutical, biotech as US election gets underway**
**-Oz contractor sector underperforms during the pandemic**
**-Variable outlook for diversified financials, negatives largely factored into banks**
**-Xero challenging Sage in the UK, most recommended in Oz**

By Eva Brocklehurst

Health & US Election

Janus Henderson asserts the coronavirus pandemic has cast a more positive light over the US healthcare sector. The urgent need to define treatments has helped focus attention on innovation in the pharmaceutical and biotech industries.

Based on early data, a vaccine is expected to be approved by early 2021. While healthcare remains a key campaign issue in the upcoming US federal election, sentiment has improved and stocks in the sector have benefited as a result.

Janus Henderson notes the NASDAQ biotechnology index has gained 11%, nearly double the return of the S&P 500. In comparison, during the 2016 presidential election, biotechnology declined -12.5% while the S&P 500 gained 8.6%.

While the Trump administration has joined a case brought to invalidate the Affordable Care Act, the analysts note this appears to have been political theatre rather than a real policy initiative. Furthermore, Republicans have not crafted alternative legislation.

In terms of what would happen if the Democrat Joe Biden was swept to power, his plan to roll out a public health option could still face an uphill battle. The ability to push reimbursement rates significantly lower could be limited by the poor financial state of many not-for-profit hospitals.

While volatility in healthcare stocks is likely, and the market typically trades on fear of healthcare reform long before any concrete details, Janus Henderson believes neither side wishes to undermine pharmaceutical innovation. Ultimately a solution to limit out-of-pocket costs and improve access to medicine should occur, benefiting the industry in the long run.

Contractors

Macquarie observes the contractor sector has underperformed the ASX200 since the start of the pandemic, noting that **Downer EDI** ((DOW)) and **Worley** ((WOR)) actually outperformed as SARS was encountered and contained back in 2003.

The broker considers Downer EDI cheap, with exposure to a recovery post the pandemic and a solid customer base. Moreover, the company's move to a services business is working, with a lot more alliance-based contracts that reduce the risk profile.

Worley has equally good leverage to a medium-term recovery, and Macquarie notes the worst of capital expenditure reductions is being encountered in 2020. The main catalyst will be a stabilisation in the workforce and new contracts, particularly renewables.

Meanwhile for **Monadelphous** ((MND)), iron ore is now 32% of revenue and there is a healthy pipeline of work. The company also envisages margins can return to pre-pandemic levels of 6.9% although Macquarie is slightly less upbeat.

**Seven Group**'s ((SVW)) WesTrac has outperformed, with new equipment contracts in iron ore and gold. While the WA market is strong, the east coast infrastructure market is likely to be flat as the broker notes project delays continue, although a $1.5bn stimulus should become visible in the second half of FY21.

For **Cimic Group** ((CIM)) the focus is on the negotiations with Elliott Advisers regarding the sale of 50% of Thiess. Macquarie has Outperform ratings for all contractors with the exception of Cimic, which is rated Neutral.

Financials

Shaw and Partners describes the **QBE Insurance** ((QBE)) first half result as "awful" as it featured a decline in the attritional claims ratio that is dependent on the company's determination of the impact of the coronavirus pandemic. In contrast, total claims substantially increased. Hence, the broker has a Sell rating.

A Sell rating is also pinned on **Insurance Australia Group** ((IAG)) with the share price getting close to fair value but not close enough. **Suncorp** ((SUN)), while not leading the market, is avoiding the calamities of the previous two stocks, Shaw and Partners asserts.

The broker expects continued improvement and retains a Buy rating on the stock. Suncorp is also Bell Potter's preferred regional/diversified financial, considered to have the best credit profile in the sector, given conservative policies and after the clean-up of the non-core bank several years ago.

**Macquarie Group** ((MQG)) is taking a cautious approach and its success is dependent on the state of the equity and debt markets. While the share price implies high expectations, Shaw and Partners points out this business has a habit of achieving. Macquarie Group is also Bell Potter's top pick among the financials.

Shaw and Partners asserts, if **AMP** ((AMP)) is not broken up, further declines in the share price are likely. Regardless, a Sell rating is allocated to the stock.

**Challenger** ((CGF)) faces shrinking margins and net outflows and is not considered cheap enough yet. Another Sell rating from Shaw and Partners. Yet, Citi believes Challenger, Neutral rated, offers considerable value, although acknowledges it requires 9% growth in retail sales to generate positive book growth in FY21.

The broker also assesses **Janus Henderson** ((JHG)) continues to trade on an inexpensive multiple but acknowledges investors may need stronger evidence of a recovery in flows before the stock can gain momentum.

Citi expects the market will await further developments with **Perpetual**'s ((PPT)) acquired businesses before deciding on whether to back the transformation to a major skew to US equities and lower dividend pay-out.

For **Computershare** ((CPU)), Citi observes some promise in servicing delinquent loans post the pandemic, although this is likely to be a longer-term opportunity. While understanding the **ASX** ((ASX)) has many qualities, including relative defensiveness, Citi finds the outlook inconsistent with the current elevated multiple. The broker retains Sell ratings on the latter two stocks.

In the case of the major banks, the market is cognisant of the negatives and this is factored into share prices. Hence, the issue for Shaw and Partners is how much more deterioration will occur. In turn, this will be governed by how long the economic lockdown continues in Victoria and when state borders open.

Bell Potter asserts, if home and business loan exposure to Victoria is considered a risk factor, then **ANZ Bank** ((ANZ)) and **National Australia Bank** ((NAB)) would be at the riskier end of the spectrum and **Commonwealth Bank** ((CBA)) at the lower risk end. Similarly, this is also the case in terms of exposures to hospitality, accommodation and property/consumption.

Accounting Software

UBS assesses the main impact of this year's pandemic, at least in the short term, is likely to be on non-subscription revenue for accounting software providers. Business closures over the next year could be around 50% above historical levels.

The broker has surveyed 240 accountants across the US, UK and Australia covering their views on accounting software for small-medium enterprises and the impact of the pandemic.

Intuit is dominating the US while disruptor **Xero** ((XRO)) is challenging Sage in the UK and is the most recommended brand in Australia. The survey also provided further evidence of cloud penetration growth.

SMSFUNDAMENTALS

# SMSFundamentals: Diversified ETFs Continue to Surge

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

**For an introduction and story archive please visit FNArena's SMSFundamentals section on the website.**

Australian exchange traded funds posted a record in August as the product of choice for investors wishing to capture exposure to a more flexible investment product.

**-First proposal to convert an Australian LIC to an ETF**
**-International exposures dominate Australian ETF flows**
**-Globally, ETF investments break US$7trn in August**

By Eva Brocklehurst

Australia's exchange traded fund (ETF) industry continues to grow rapidly, exceeding $70bn for the first time in August. Since the inception of ETFs in 2001, annual growth of around 45% compares with listed investment company (LIC) growth at a far less rapid 11%.

Importantly, given the banning of sales commissions for the distribution of LICs that came into effect in May 2020, BetaShares expects the trend to continue and has witnessed the first proposal to convert a closed-end LIC into an ETF.

BetaShares notes growth over August stemmed from an equal share of market movements and net new money. Industry funds under management (FUM) grew by $3.6bn, the third largest monthly increase on record.

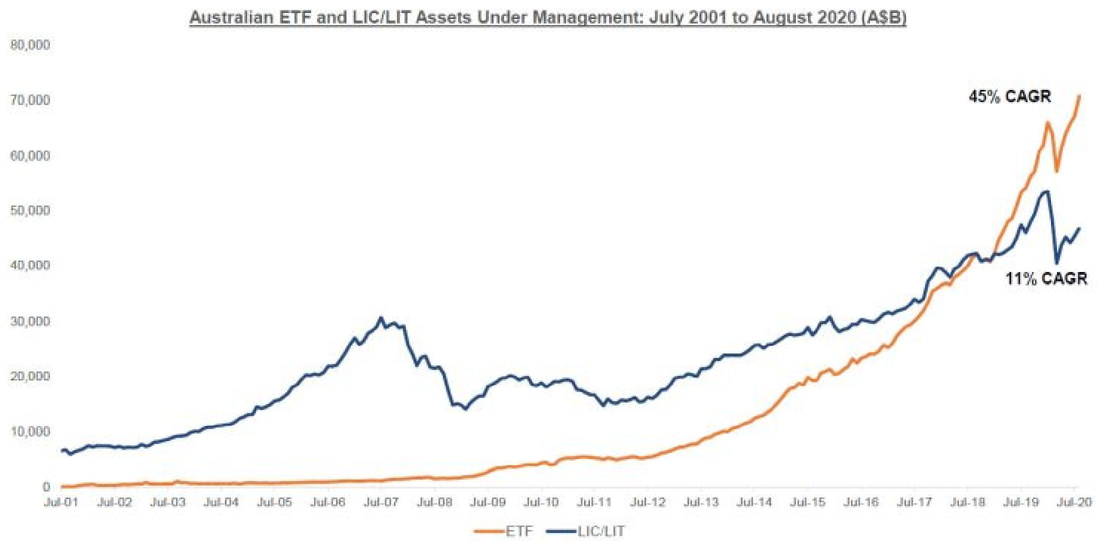
The best performance came from US technology exposures as well as geared US equity exposures. The

Australian Technology ETF was a top 5 performer and recorded a 13.2% return for the month.

Flows were robust across a number of asset categories and international exposures dominated. BetaShares notes, however, that **investors continue to diversify portfolios away from equities**, with around $370m into fixed income and $200m into cash and commodity ETFs, the latter being largely gold products.

Outflows were limited due to US dollar products, even as the US dollar fell in value, as investors apparently assessed that more Australian dollar strength was likely.

The number one product for flows in August was the Australian High Interest Cash ETF, which in the current circumstances provides an attractive return above the record low Reserve Bank cash rate.



Source: BetaShares, ASX, Chi-X

Meanwhile, on a global scale, assets invested in ETFs, as noted by UK-based consultancy ETFGI, broke through US$7 trillion at the end of August. Assets invested in global ETF industries have increased by 5.1% over the month.

The consultancy notes the S&P500 produced the best August since 1986, gaining 7.2% in the month. The 24 developed markets outside of the US were all stronger as well and emerging markets gained 2.7% in August, as US dollar weakness and the response to the pandemic affected performances.

August is the fifteenth month of net inflows and equity products attracted the great majority, at US$24.92bn. Net flows for 2020 so far are significantly higher than for the equivalent period in 2019.

Breaking down the inflows, fixed income garnered US$19.99bn and active funds reported US$7.82bn in net inflows. The consultancy points out substantial inflows can be attributed to the top 20 ETFs by net new assets.

### Top 20 ETFs by net new inflows August 2020: Global

| Name | Ticker | Assets (US$ Mn) Aug-20 | NNA (US$ Mn) YTD-20 | NNA (US$ Mn) Aug-20 |
|---|---|---|---|---|
| iShares Core MSCI EAFE ETF | IEFA US | 72,029.90 | 2,484.19 | 2,178.90 |
| Vanguard Total Bond Market ETF | BND US | 60,517.97 | 9,261.02 | 2,164.41 |
| Invesco QQQ Trust | QQQ US | 140,246.24 | 14,662.32 | 2,086.58 |
| Vanguard Total Stock Market ETF | VTI US | 164,828.02 | 14,188.55 | 2,000.53 |
| Vanguard Short-Term Corporate Bond ETF | VCSH US | 31,746.54 | 5,153.75 | 1,702.25 |
| TOPIX Exchange Traded Fund | 1306 JP | 117,712.11 | 19,264.30 | 1,577.86 |
| iShares TIPS Bond ETF | TIP US | 23,648.50 | 1,274.46 | 1,309.64 |
| iShares Russell 2000 ETF | IWM US | 41,699.75 | (4,210.72) | 1,201.11 |
| ARK Innovation ETF - Acc | ARKK US | 8,485.16 | 3,533.69 | 1,135.17 |
| Vanguard Intermediate-Term Corporate Bond ETF | VCIT US | 38,741.18 | 11,109.93 | 1,079.20 |
| Xtrackers USD High Yield Corporate Bond ETF | HYLB US | 6,258.76 | 2,225.55 | 1,025.56 |
| Kamnd | KMND1 | 1,969.92 | 1,926.75 | 984.96 |
| iShares Edge MSCI USA Value Factor ETF | VLUE US | 6,807.54 | 2,675.73 | 973.72 |
| Financial Select Sector SPDR Fund | XLF US | 18,566.12 | (1,783.19) | 966.70 |
| Vanguard Total International Stock Index Fund ETF | VXUS US | 24,658.10 | 6,167.06 | 962.31 |
| Listed Index Fund TOPIX | 1308 JP | 54,280.59 | 10,222.77 | 899.20 |
| Goldman Sachs ActiveBeta U.S. Large Cap Equity ETF - Acc | GSLC US | 10,425.69 | 2,056.04 | 879.68 |
| Vanguard Short-Term Bond ETF | BSV US | 26,634.63 | 3,177.60 | 838.61 |
| Utilities Select Sector SPDR Fund | XLU US | 12,132.08 | 2,567.62 | 810.52 |
| Industrial Select Sector SPDR Fund | XLI US | 11,524.30 | 1,690.71 | 788.78 |

Source: ETFGI data sourced from ETF/ETP sponsors, exchanges, regulatory filings, Thomson Reuters/Lipper, Bloomberg, publicly available sources and data generated in-house.Note: This report is based on the most recent data available at the time of publication. Asset and flow data may change slightly as additional data becomes available.

The top 10 ETPs by net new assets collectively gathered $3.40 billion in August. The iShares Gold Trust - Acc (IAU US) gathered $897.02 million alone.

**Top 10 ETPs by net new inflows August 2020: Global**

| Name | Ticker | Assets (US$ Mn) Aug-20 | NNA (US$ Mn) YTD-20 | NNA (US$ Mn) Aug-20 |
|---|---|---|---|---|
| iShares Gold Trust - Acc | IAU US | 31798.01 | 8263.88 | 897.02 |
| SPDR Gold Shares - Acc | GLD US | 77588.80 | 20047.81 | 662.09 |
| Invesco Physical Gold ETC - Acc | SGLD LN | 13730.64 | 3967.50 | 314.30 |
| SPDR Gold MiniShares Trust - Acc | GLDM US | 3519.32 | 1841.26 | 296.42 |
| ProShares Ultra VIX Short-Term Futures | UVXY US | 1387.46 | 404.84 | 262.70 |
| Xtrackers Physical Silver ETC (EUR) - Acc | XAD6 GY | 1201.55 | 439.18 | 214.36 |
| iPath Series B S&P 500 VIX Short-Term Futures ETN - Acc | VXX US | 1039.23 | (709.28) | 199.35 |
| Aberdeen Physical Swiss Gold Shares - Acc | SGOL US | 2793.50 | 1129.72 | 197.34 |
| Invesco DB Agriculture Fund - Acc | DBA US | 608.27 | 287.18 | 182.71 |
| iShares Silver Trust - Acc | SLV US | 15693.91 | 3801.93 | 169.74 |

Source: ETFGI data sourced from ETF/ETP sponsors, exchanges, regulatory filings, Thomson Reuters/Lipper, Bloomberg, publicly available sources and data generated in-house.Note: This report is based on the most recent data available at the time of publication. Asset and flow data may change slightly as additional data becomes available.

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RUDI'S VIEWS

# Rudi's View: Plenty Of Clouds, Diverging Scenarios

In this week's Weekly Insights:

**-Plenty Of Clouds, Diverging Scenarios**
**-Conviction Calls**

**Plenty Of Clouds, Diverging Scenarios**

By Rudi Filapek-Vandyck, Editor FNArena

According to at least one experienced technical market analyst, global equities, including in Australia, are now due for a consolidation period that potentially can last multiple months.

Such a prediction should hardly come as a surprise. The recovery off the late-March low has been swift and strong – and those terms don't really do justice to what actually has occurred up until late August.

As is always the case, a lot of attention has been drawn to the apparent excesses along the way, with share prices in Apple and Tesla moving parabolically upwards on announcements of a stock split, while others have been doubling in price (or more) in what seemed like an awful short time to see that happening.

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Here in Australia, market volume has shifted towards stocks like Afterpay ((APT)), Zip Co ((Z1P)) and Mesoblast ((MSB)) -on some days responsible for the largest volumes- and a recent attempt by **Morgan Stanley** to identify what is happening behind the curtains is firmly pointing in the direction of re-born retail investors and traders.

I write "re-born" because anecdotal evidence suggests many trading accounts that had been dormant for a while have been re-activated during the recovery/upswing this year, but in reality, many of the additional inflows have come from freshly-minted, new market participants.

In the US, these people are being referred to as the "RobinHooders", after a no-fee, popular trading app that has seen explosive growth over the six months past.

Here in Australia, SelfWealth ((SWF)) has been one of the major beneficiaries of a similar phenomenon, but let's not discount CommSec, NABtrading and other platforms, as well as newsletters, blogs and financial data and information services, including FNArena.

To put the retail market-impact into perspective, at least here in Australia, on Morgan Stanley's analysis market shares as far as daily volumes are concerned had remained fairly stable pre-covid between Institutional, Retail Advice, Retail Online, Clearing and Other/Miscellaneous.

But the past three months show a significant increase in volumes coming from retail online, rising by 50%, to push up total market share to 10% of volume in July, up from 6.7% in January.

This may not seem like much, but by nature financial markets are dominated by short-term money flows, not by opinions, expertise, fundamental research or other forms of analysis.

So, if one large group adopts one scenario and acts accordingly, and finds other groups to follow in its footsteps, then that scenario becomes "the trend", at least for the time being.

2020 might have been the first time when cashed-up, bored mums and dads closed in at home decided to take a punt on shares -lower prices galore, must be more attractive now- and then forced the professionals -worried about losing mandates, if not their job- to join in and manufacture the quickest recovery in modern memory.

One valid point suggested by Morgan Stanley's research is that any impact from these fearless mums and dads (and many youngins) would logically be highest for less liquid, smaller cap stocks – and when institutions are sitting on their hands, like in April.

The Morgan Stanley research suggests these additional inflows have predominantly been used to execute Buy-orders. And what have these new buyers been buying? Popular themes, including EVs and BNPL, and popular household names, such as Qantas, Telstra, Flight Centre, even Oil Search and Myer.

As such, market positioning is not solely in strongly rising, high-flying market darlings, but equally so in beaten-down share prices that should benefit from the post-pandemic economic recovery.

Trading activity data from **eToro** revealed many of the new market participants have equally directed their attention to the US with Nio Inc, Tesla and Amazon the three most traded stocks on the platform in August.

Trading volume in Apple shares on eToro rose by 149% month-on-month in August, while for Nvidia the increase was 135%.

Suffice to say, the phenomenon over here has direct links to some of the truly mind boggling, parabolic momentum moves in the US, which now leaves the Australian share market vulnerable to a correction to the downside.

Pure logic tells us when stocks go crazy and rally into the atmosphere in the US, while Australian shares do not follow suit, the Australian share market does not have to sell-off in equal fashion when those US shares deflate and come back to earth, but that's simply not how market sentiment works.

If the US sneezes, the rest of the world gets covid-19 – without blinking.

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Further complicating matters is that when one trend stops, traders will look for other trends to jump on and make money from.

In the current context of a heavily polarised market, with extreme elements to it, this almost by definition means money will flow into the so-called "value" part of the market where sectors including banks and energy stocks have seriously lagged during this year's bull market.

Such a move will be welcomed by many a value investor, and Australian institutions are in large majority value investors (which worked just fine pre-May 2015), meaning they own plenty of Woodside Petroleum, Telstra, QBE Insurance and the likes, and potentially none of Afterpay, Mesoblast, Objective Corp ((OCL)), WiseTech Global ((WTC)) and others that have performed a lot better in 2020.

Some of such portfolios have outperformed in recent weeks while the super-hot segment of the US market encountered a well-overdue cooling down, but is it more than just a temporary blip?

On my observation, any of the attempts to portfolio-rotate out of Growth (healthcare, tech & other winners) and into Value (banks, cyclicals, laggards and losers) post 2014 has never lasted more than five months, with late 2016 and early 2019 the longest lasting market momentum switches.

Back in **late 2016**, the big switch quickly turned violent in either direction in response to a fierce trend that firmly kept momentum with healthcare stocks and defensives for much longer than most market experts thought possible.

In **early 2019**, the normal pattern followed after the late 2018 recession scare that saw banks, resources and other cyclicals being pummeled despite their lagging performances prior, but then outperform on solid recovery prospects.

The difference between these two big momentum switches is the first scenario saw stocks like CSL ((CSL)), Aristocrat Leisure ((ALL)) and Altium ((ALU)) on average lose -20% in quite the short timeframe.

The 2019 version saw healthcare, technology, disruptors and other strong growers still advancing in share price, but at a slower pace than banks, miners, energy stocks, et cetera.

The key difference between these two scenarios is that back in 2016, a large part of the international investment community genuinely believed the four decades' long bond market trend of ever lower yields had ended and inflation was about to make a decisive come-back.

The second time around, few experts were harnessing such thoughts and diverging momentum was simply based on the question of who benefits most from the narrow escape from economic recession.

For investors, it seems crucial to keep both scenarios in mind as the immediate outcome for the quality and strong growing companies on the ASX looks a lot different.

Ultimately, it has to be noted that while share prices for the likes of ANZ Bank, Santos, IGO and the likes can experience significant upside during these portfolio/momentum switches, it is the likes of CSL, ResMed ((RMD)) and Appen ((APX)) that have subsequently moved on to new highs.

(*Don't look at share prices for Telstra, banks other than CommBank ((CBA)), retail landlords, energy producers and the likes as it will hurt your eyes – literally*.)

A lot is being made of the recent policy change by the Federal Reserve in that US inflation is now allowed to run well past the 2%, if only to make up for the fact it hasn't been consistently near that target since the GFC (and never above it).

Never say never, but I think too many old hands are putting hope in front of reality. I do get the "never say never" part, but I also note the inflation-is-coming crowd has been consistently wrong ever since Bernanke announced QE1, and that was in late 2008.

Most economists who are not affiliated with your typical value-oriented asset manager do not see price inflation on the horizon. Full stop.

This makes me think that if, somehow, we are on the cusp of yet another switch in momentum favouring the market laggards, it'll most likely last for a limited time only, or copy the 2019 blueprint in which there is no mass-selling out of the winners.

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There is one alternative scenario which, one has to assume, is now increasingly playing on investors' mind: **<u>what if the world does develop an effective vaccine against covid-19</u>**?

This, of course, would give both traders and investors the perfect excuse to start portfolio-rotating through abandoning the winners -those benefiting from the virus and related lockdowns- and jumping on those companies who have been major victims in 2020.

Even though it won't be as clear cut as the return of inflation with subsequent higher bond yields, a world looking forward to a return to pre-covid conditions, even if this still includes lasting changes, will largely benefit the same companies, with the addition of airports, travel agents, hospitality, leisure, education platforms and tourism operators.

Equity strategists at **Macquarie**, looking forward to such a renewed market focus, have already selected their twelve **Best Ideas** to buy in anticipation of the covid-free scenario: BlueScope Steel ((BSL)), Fortescue Metals ((FMG)), Lendlease ((LLC)), Ramsay Health Care ((RHC)), Star Entertainment Group ((SGR)), Woolworths ((WOW)), and Worley ((WOR)).

Outside of the ASX100, Macquarie's Best Ideas now also include Appen ((APX)), Austal ((ASB)), Australian

Finance Group ((AFG)), SeaLink Travel Group ((SLK)), and United Malt Group ((UMG)).

As inferred from Macquarie's strategy update, the new portfolio barbell strategy is to combine some of the quality and structural growth stories on the ASX (and elsewhere) with some of the beneficiaries from re-opening economies and a potential covid vaccine.

Never say never in finance, but I think a more inclusive bull market might also keep that Big Correction MIA for much longer.

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Some of the models and indicators used internally at **Citi** suggest the time is ripe for a come-back of "value" stocks on equity markets.

Maybe the secret ingredient that will put cheaper stocks back in favour might turn out the upcoming **presidential election in the US**.

Not necessarily whether Biden (assumed likley winner by Wall Street) or Trump might win, but whether the election will morph into a drawn-out process with no certain outcome, like what happened in 2000 when neither Bush nor Gore was able to claim a clear victory on election day.

Citi strategists last week reminded investors back in 2000 the S&P500 sank by some -11% in one month on election uncertainty.

This time America is dealing with a much more polarised citizenry, and a president who might not be willing to concede anything other than his own victory.

Apart from uncertainty about any vaccines and the November 3 election, Citi also reports institutional investors in the US are very much focused on whether US parliament can agree on some kind of stimulus program to assist covid-19 victims with keeping their head above water.

Citi itself thinks no such deal is forthcoming before the election.

It is well-possible that in the face of so much uncertainty, US investors decide to secure a portion of their profits by selling out of this year's winners, which, from a general sentiment and short-term technical perspective, can potentially become a downward-oriented process in itself.

This might provide one of the crucial answers everybody is looking for in 2020: what are the newly joined participants going to do when #stonks are no longer simply trending upwards?

Beyond the immediate outlook, I continue to believe prospects of economic recovery on top of tectonic changes, which feed into stronger-growth-for-longer for corporate beneficiaries, will keep the prospects for equities positive on a medium to longer term timeline.

Of course, there will be (more) excess & exuberance along the way. Every bull market creates excesses. That's simply the price we pay for being humans.

In addition, if the global recovery truly finds traction, the US dollar is likely to weaken which strengthens the AUD, creating an additional headwind for offshore earners on the ASX.

**Conviction Calls**

And in the end, it still was a tough call to make.

Whereas **Goldman Sachs** is stoically holding on to its bullish call on Telstra ((TLS)), the managers of Model Portfolios at **stockbroker Morgans** have finally bitten the bullet and sold all shares in the ever so disappointing telco.

"Tough call", reads their latest update, "but we see better relative opportunities [elsewhere]".

Morgans' Balanced Model Portfolio has switched into Coles ((COL)) and added extra shares in APA Group ((APA)).

There is no Telstra exposure to sell for the Growth Model Portfolio which has topped up on BHP Group ((BHP)), Lovisa Holdings ((LOV)) and ALS Ltd ((ALQ)), while also adding Magellan Financial Group ((MFG)), a2 Milk ((A2M)), and Breville Group ((BRG)).

**Morgans' Best Ideas** contains no less than 42 companies, of which the following eight were added during and post the August reporting season: Sydney Airport ((SYD)), NextDC ((NXT)), Incitec Pivot ((IPL)), Coca-Cola Amatil ((CCL)), Super Retail Group ((SUL)), Breville Group, Kina Securities ((KSL)) and Alliance Aviation Services ((AQZ)).

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**Baillieu** chief investment officer, Malcolm Wood, sees the ASX200 trending towards 6750 in the year ahead.

Among the positive factors cited by Wood are the fact commodity prices are slightly stronger than pre-covid (on average) with a massive windfall awaiting the Australian economy and government from stronger-than-anticipated iron ore prices; the covid-19 super early release scheme is projected to grow to -$42bn, equal to 2.1% of Australia's GDP, on top of material stimulus by the RBA and the Australian government, with more to come.

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**Market strategists at Wilsons** have equally started looking forward towards beneficiaries of re-opening economies.

Because of many ongoing uncertainties, Wilsons is advocating investors adopt a diversified approach, opting for both domestic and global business models, spread over multiple exposures, but still within a well-diversified portfolio overall.

Wilsons has lined up 25 candidates investors can choose from:

-in the energy sector:

Oil Search ((OSH)), Origin Energy ((ORG)), Santos, and Woodside Petroleum

-among financials:

ANZ Bank ((ANZ)), Bendigo & Adelaide Bank ((BEN)), Challenger ((CGF)), National Australia Bank ((NAB)), and Westpac ((WBC))

-Metals & Mining:

Alumina Ltd ((AWC))

-Real estate:

Dexus Property ((DXS)), GPT Group ((GPT)), Lendlease, Mirvac Group ((MGR)), Scentre Group ((SCG)), Vicinity Centres ((VCX))

-Resource Services:

Worley ((WOR))

-Tourism and Entertainment:

Aristocrat Leisure, Crown Resorts ((CWN)), Flight Centre, Qantas ((QAN)), Star Entertainment Group

-Transport infrastructure:

Atlas Arteria Group ((ALX)), Sydney Airport

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Market analysts at **Morningstar** have equally bitten the bullet and removed Telstra from their Best Stock Ideas, while adding Challenger and Flight Centre.

Stocks that remain on the list: AdBri ((ABC)), Avita Therapeutics ((AVH)), Bingo Industries ((BIN)), Cimic Group ((CIM)), Computershare ((CPU)), G8 Education ((GEM)), Link Administration ((LNK)), Southern Cross Media ((SXL)), Viva Energy Group ((VEA)), Westpac, Whitehaven Coal ((WHC)), and Woodside Petroleum.

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**Tech analysts at Bell Potter** have updated their sector preferences with the revamped Top Three sector picks now consisting of (in order of preference) Uniti Group ((UWL)), TechnologyOne ((TNE)), and Citadel Group ((CGL)).

The latter has since received a take-over offer; no doubt seen as vindicating the team's view the shares were too cheaply priced.

Bell Potter also has two Conviction Sells: WiseTech Global ((WTC)) and Altium ((ALU)).

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For more Conviction Calls: see last week's Weekly Insights:

https://www.fnarena.com/index.php/2020/09/10/rudis-view-august-2020-lifts-price-targets/

**(This story was written on Monday 14th September, 2020. It was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website).**

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