WEEK 13

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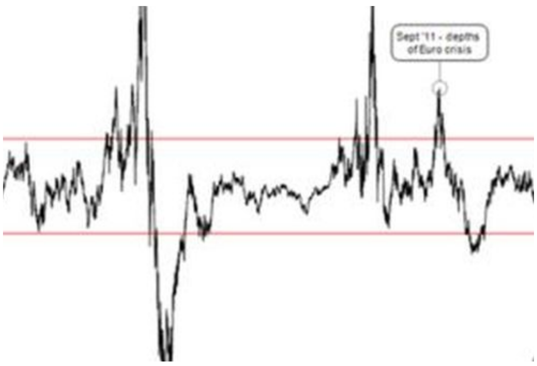

Rudi's View: Investing In 2021 - The World Upside Down

CONTENTS

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AUSTRALIA

How Can AGL Energy Broaden Its Appeal?

An oversupply of electricity looms, putting pressure on wholesale power prices. Could separating Loy Yang A be the panacea for AGL Energy?

-Electricity market likely in chronic oversupply till 2030
-Have wholesale power prices found a bottom?
-Could separation of Loy Yang A be a much-needed strategic shift?

By Eva Brocklehurst

What has happened to electricity prices? Soft demand resulting from the pandemic and the breaking of the drought have combined with additional renewable sources and government policies to encourage further supply away from coal-fired (thermal) generation.

Macquarie notes the current renewables push makes it impossible for thermal incumbents such as AGL Energy ((AGL)) and Origin Energy ((ORG)) to compete where they do not qualify for support.

Around 46 terawatt (TW) hours of thermal generation, or 25% of the National Electricity Market, will exit in the next nine years. State governments and corporate entities are behind the changes which will, the broker assesses, leave the market in chronic oversupply.

Macquarie calculates an electricity generation price of $50/megawatt-hour (MWh) in 2023 and through to 2030, thereafter the forecast price is $60/MWh as imbalances are reduced. The broker assumes, after 2030, that more rational behaviour emerges as the first round of thermal plants are retired and the quantum of oversupply moderates along with government subsidies.

Still, **a lack of clarity over the short term will undermine investor confidence** and thus mar the performance of the relevant stocks. Morgan Stanley agrees policy uncertainty will have a dampening impact and deliver risks to the downside.

AGL Energy has signalled structural change is on the horizon and Macquarie upgrades the stock to Neutral from Underperform, suspecting broader investment appeal could be in the company's sights.

Morgan Stanley also considers upside risk centres on a new transformational growth initiative. Other upside risks include a sustained rise in pool prices either from higher gas prices or competitor closures along with retail margin expansion and lower input costs.

Power Prices

Power prices have been pivotal to both AGL Energy and Origin Energy. AGL acknowledged this with recent write-downs of the thermal fleet. Macquarie notes AGL has tied its share price to the forward contract pricing in NSW and Victoria, which appear stronger in a down cycle versus an up cycle.

The main issue the broker highlights is whether a bottom in pricing has been found. Spot wholesale power prices have been around four-year lows, often dropping to $45-55/MWh in NSW, Victoria and South Australia and even lower in Queensland.

The elements that will weigh on a recovery in power prices include state-based policies such as NSW's support for a transition to renewable from thermal, and firming capacity being built ahead of coal retirements. This will translate to price pressure between 2023 and 2028 when the Vales Point power station retires.

Closure of Yallourn and replacement of its 9TW hours of production with renewables is in line with Victoria's target for 50% renewables by 2030. Macquarie also points out federal policy is creating a vicious circle of subsidy, as a gas-led recovery is being pushed amid demands that industry replace closed thermal capacity with gas or large batteries.

To date the government has sponsored the Snowy Hydro 2 gigawatt (GW) hydro battery and is threatening construction of the 750MW Kurri Kurri (NSW) gas terminal to replace lost capacity from Liddell.

What can push wholesale power prices higher? A disorderly, fragmented closure of coal-fired power stations could do the job, but the National Energy Market plan is for a step-by-step replacement, which suggests to Macquarie prices in the 2030s would remain below $60/MWh.

In writing down its thermal generation fleet, Macquarie assumes AGL has revised its long-term power price assumption down to $60/MWh. The NSW guarantee, nevertheless, could mean NSW prices are closer to $50/MWh.

At such prices thermal generators are generating at below cost and, the broker points out, **there must be a supply-side response and/or closure dates brought forward**. What about AGL's MacGen (NSW), as undertakings associated with the acquisition expire in August, seven years after the portfolio of thermal assets was acquired?

Over the short term, Macquarie notes MacGen is the lowest cost producer in NSW through to 2026 and holds a hedge with Tomago (aluminium) smelter, for 8TW hours of its 13-17TW hours of production.

On the subject of smelters, Morgan Stanley notes the Portland smelter (Victoria) has renegotiated its electricity supply until July 2026. AGL will supply 275MW and the balance of requirements will be supplied by Alinta and Origin Energy.

The federal government will pay up to $76m in grid support payments over four years with the Victorian government providing a similar amount. Morgan Stanley considers this a marginal positive for both stocks.

Terms of the deal are confidential but the broker calculates, given the Victorian 2022 baseload futures price is $37/MWh, the new arrangements are likely to be lower, which suggests an operating earnings (EBITDA) headwind for FY22 to the tune of -6% for AGL and -2% for Origin.

Loy Yang A

For AGL, a separation of Loy Yang A could be the strategic shift required, Macquarie asserts which, along with the closure of Liddell, could reduce the company's emission intensity to the market average.

An in specie distribution of Loy Yang A shares would be positive and broaden the investment appeal of the stock. In terms of its operations, AGL would move from being long baseload to a more balanced offering.

Macquarie also assesses AGL has captured material value from the asset which it acquired in 2011. Loy Yang A as a separate, low-geared entity would have a fully franked yield close to 4.0-4.5% and this should be enough cash flow to engage in buybacks.

As the lowest-cost thermal generator the business will have leverage to normalised electricity prices as demand recovers and supply is rationalised. Macquarie expects the equity value of Loy Yang A is in the range of $ 1.4-1.8bn, depending on the hedging profile.

The broker further asserts AGL, without this “ugly duckling” brown coal-fired generator, could appeal more to ESG-oriented investors as the business transitions towards renewable energy and firming capacity improves, justifying a higher rating for the stock.

Meanwhile, AGL has also announced its participation in the acquisition of Tilt NZ assets through the POWaR fund. As part of the scheme the NZ business will be divested to Mercury NZ ((MCY)), which leaves the Australian assets to the POWaR fund. The Australian assets comprises 0.506GW of established renewables, 1.7GW of wind projects and 0.3GW of solar projects.

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AUSTRALIA

Insurers Tackle More Risk As NSW Floods

Just over a year ago it was bushfires, now floods in NSW have put the spotlight once again on the insurance industry

-Has increased reinsurance mitigated downside risk
-Aggregate reinsurance cover proving costly
-Pressing need to re-price insurance premiums

By Eva Brocklehurst

Rain, more rain and flooding, largely in heavily populated coastal NSW, has put the wind up the insurance industry, with the Insurance Council noting storm-related claims have started to flow although it is too early to estimate the amount of damage.

The damage appears to be manageable, although brokers are well aware the situation could deteriorate. The Insurance Council is yet to call it a "catastrophe", the highest grade of disaster. JP Morgan also notes listed insurers have reduced their exposures to flood significantly over the years.

A similar event a year ago, albeit with stronger winds, caused $900m in gross claims although, while acknowledging this is already a 1-in-50 year event, Macquarie points out floods historically cause fewer losses compared with cyclones, hail damage or earthquakes.

While not suggesting the current flood is a maximum event for either **Insurance Australia Group** ((IAG)) or **Suncorp Group** ((SUN)), UBS assesses there is some downside risk to earnings.

The broker calculates Suncorp can absorb a maximum large event in its allowance while two maximum events would result in FY21 earnings downgrades of -3-5%. In the case of IAG, a maximum large event can be absorbed, but if there were two in FY21 there would be an earnings downgrade risk of around -10%.

Credit Suisse believes the market is not ascribing sufficient value to future earnings growth, as **confidence has been affected by too many "surprises",** yet earnings risk is manageable because of increased reinsurance cover and natural peril allowances.

The broker expects investor scepticism will ease as higher earnings are realised and the focus turns towards the upside potential going into FY23. Industry profits have been cut substantially and it should take a few years to recover meaningfully.

IAG's next large loss is capped at $169m by reinsurance while, Suncorp's is capped at $250m. Morgan Stanley suspects the former's is below the company's FY21 catastrophe budget while the latter's is above.

QBE Insurance's ((QBE)) Australian flood budget is capped at $125m. Goldman Sachs notes QBE Insurance's share of any industry loss is likely to be a fraction of the home/contents damage claims for the other two, as at this stage the event does not signal material risk of commercial property claims.

Although there is likely to be "sticker shock" should any further announcement be made regarding these events, Macquarie encourages investors to look through any potential losses. Morgan Stanley is not so confident, amid feedback from all reinsurers suggesting aggregate cover is proving costly so the current event adds to pressure on the July renewals.

UBS also suspects, if two or more large events occur before the insurers need to renew aggregate reinsurance cover on July 1, 2021, questions regarding earnings could be raised. The broker allows for -20-30 basis points of insurance margin headwinds in its FY22 forecasts and an additional -100 basis points for a higher natural perils allowance for IAG.

UBS points out IAG is transitioning its reinsurance cover to a financial year end from a calendar year, which has resulted in overlapping aggregate protection. Meanwhile, Suncorp has done some substantial work on its natural hazard allowance in recent years and bought additional reinsurance.

This has come at the cost of the underlying insurance margin but, UBS believes, it should help minimise the downgrades resulting from weather events that the company suffered over the past decade.

Premium Rates

Credit Suisse agrees with Macquarie the current scenario presents opportunities and disagrees with a view that the current depressed cycle has at least 12-18 months to run.

Buying when the market is capitalising cyclically low earnings levels could result in outperformance. The broker has resumed coverage on the three major listed general insurers with Outperform ratings, anticipating improving premiums and underlying claims ratios will stand them in good stead.

Moreover, multiples are favourable. IAG has sufficient reserves for its recent covid-19 event and capital levels support future dividends, in the broker's opinion.

In the case of Suncorp, the earnings predictability is higher than general insurer peers while Credit Suisse notes QBE has the most leverage to premium increases, given a bias to commercial lines. More so, too, because of its international exposure where hardening rates are even better.

There is a pressing need to re-price higher because of increased natural perils, reinsurance costs, provisions for covid-19 claims and lower investment yields. At least one of these factors has driven a hard premium cycle historically and now, Credit Suisse asserts, all factors that drive hard markets are occurring simultaneously.

The broker notes risk capital, mainly from overseas insurers, has been withdrawn from parts of the commercial market in Australia in recent years so there is less insurance capacity available.

This capital is unlikely to return any time soon to compete away higher margins, the broker adds, because these insurers have suffered heavy losses. Channel checks also reveal some small insurers have had to sustain extremely large increases when renewing reinsurance premiums.

AUSTRALIA

Surging Coal Prices Underpin New Hope

New Hope Corp is facing the prospect of putting New Acland on the shelf while strengthening coal prices have boosted cash flow and a resumption of dividends

-Surging coal prices underpinning FY21 outlook
-M&A now features in the company's plans
-New Acland expansion appearing increasingly unlikely

By Eva Brocklehurst

Coal prices have moved in a favourable direction for New Hope Corp ((NHC)) as it battles a declining production profile at New Acland and more court proceedings. The company's key operations, Bengalla in NSW, could be affected by adverse weather in the third quarter, although the company has stated it is yet to experience any major disruptions.

As weather and legal issues create headaches for the company, Macquarie is cautious about the outlook, even as thermal coal prices surge, although acknowledges there is earnings upside currently in a spot price scenario.

Credit Suisse points out recent weather events affecting the coal hub at Newcastle are only likely to tighten the coal market further, underpinning New Hope's pricing potential, although the legal wrangling creates uncertainty and New Acland in Queensland is now somewhat of a "value option".

Lower costs helped first half results which translated to free cash flow that was stronger than expected. The earlier-than-expected resumption of a 4c interim dividend was the best news for most brokers. In hindsight, Credit Suisse points out this was really no surprise, given where the coal price has gone over the past few months, and lifts earnings estimates for FY21 by 20% as a result.

The broker considers the stock fairly priced but **with upgrades likely and more dividends to come acknowledges the upside risk is now more visible**. Thermal coal prices have now exceeded US$100/t which compares with spot pricing closer to US$50/t just six months ago.

As a result, Goldman Sachs considers the business is well-positioned to capitalise on price recovery as is one of the lowest cost producers, pricing in a long-run coal price of US$60/t. The broker, not one of the seven stockbrokers monitored daily on the FNArena database, retains a Buy rating and $1.90 target believing the stock is undervalued, even with when removing New Acland from consideration.

Goldman Sachs continues to envisage Bengalla will deliver resilient margins, increasing to 51% in the second half of FY21 on the broker's forecasts. Morgans, too, considers cost reductions at Bengalla combined with stronger price realisation underpin valuation.

The broker points out NSW coal producers will suffer from deferral of sales as a result of rain disruptions but the impact on cash flow is likely to be offset by higher prices. Moreover, customer sentiment supporting higher prices is likely to be longer lasting.

The broker highlights New Hope's purchase of its first tranche of Bengalla at the bottom of the last cycle in 2016 and estimates the asset has generated around $1.90bn in operating earnings (EBITDA) since then. Morgans suggests investors can buy Bengalla's base case cash flow and a material discount and receive New Hope's hard asset base and growth options with free.

M&A

Management has indicated it has no gearing target and will seek accretive M&A, specifically a producing asset. Morgans believes the appeal of acquisitions has risen with an improving balance sheet and fewer competitors for coal assets. There is also the strategic logic of diversifying operations, product and geographic risk. In this way, the broker suggests some of BHP Group's ((BHP)) non-core assets may fit the bill.

New Acland

The company has further impaired New Acland assets with an onerous charge of $37.3m on a take-or-pay rail contract. Australia's High Court has upheld an appeal and ordered the New Acland matter to be heard in the Queensland Land Court for a third time.

The company has signalled there is a risk the project will be placed on care and maintenance as it has been unable to secure required approvals and licences for stage 3. The ramping down of New Acland stage 2 caused impairments of -$10.1m in the first half.

Goldman Sachs believes the long delays may now mean the company explores other accretive growth options and envisages an increasing likelihood New Acland will not re-start if it is not in receipt of all permits within the next 12-18 months.

Liquidators have also commenced legal proceedings against New Hope in relation to the Colton project with claims of $174m plus interest and costs. Proceedings are to commence in connection with insolvent trading, asset transfers and breaches of directors duties. Goldman Sachs notes this follows a dispute in 2019 with the liquidators and the WICET port, which was dismissed by the NSW Supreme Court and Court of Appeal.

FNArena's database has three Hold ratings and one Buy (Morgans). The consensus target is $1.46, suggesting 8.3% upside to the last share price. The dividend yield on FY21 and FY22 forecasts is 5.2% and 4.6%, respectively.

AUSTRALIA

M&A Now On Sigma Healthcare's Agenda

Having completed its efficiency drive, Sigma Healthcare is looking to M&A to enable future growth

-Diversification should enable margin expansion
-Dividend reinstated
-M&A increasingly in focus

By Eva Brocklehurst

Having reinstated a contract with Chemist Warehouse as a distributor, Sigma Healthcare ((SIG)) is now pondering its future growth path. The company's FY21 results were heavily boosted by the pandemic as well as the introduction of the new Chemist Warehouse contract. Hospital sales grew 15% but were well below FY20 growth of 26% because of reduced elective surgeries.

Gross cash conversion of 18% disappointed Credit Suisse as inventory rose, while growth in operating earnings (EBITDA) of 10% out to FY24 is anticipated, amid cost reductions and increased efficiencies.

Sigma Healthcare now has around 50% exposure to non-PBS (pharmaceutical benefits scheme) earnings, and more diversity in its income profile should enable continued margin expansion in the broker's view.

Macquarie notes 17% of consumer expenditure is now within the Sigma Healthcare network of branded pharmacies, making it the next largest group after Chemist Warehouse. Moreover, FY22 should benefit from being the first full-year of the Chemist Warehouse contract renewal.

The contribution to revenue from Chemist Warehouse is expected to reach $800m/year by June 2021, having provided $759m in FY21.

The company has reiterated an underlying operating earnings target of around $100m in FY23 and reinstated the dividend with a 70% fully franked pay-out ratio. Still, after a recent move in the share price Citi considers the stock fairly valued and downgrades to Neutral from Buy.

Upside risks, the broker observes, include higher pharmacy market growth and M&A, while the downside risk encapsulates a more rapid normalisation of pharmacy market growth and execution in the case of the earnings target.

Sigma expects organic growth in wholesale revenue at above market rates over the next 12 months, although

Citi suspects this will probably not be double digits.

Market growth is likely to be subdued in FY22, Macquarie agrees, while prescription items are expected to grow 3-4%. Over-the-counter sales could be muted as well as the market is in decline, reflecting lower export demand and the impact of the pandemic on specific categories.

An over reliance on the Chemist Warehouse contract for growth does pose a **medium-term risk if Chemist Warehouse gains enough scale to manage supply independently**, the broker asserts.

M&A

Management has indicated M&A is increasingly in focus now that the capacity exists on the balance sheet following the sale/lease back of two distribution centres. The more efficient network is now expected to deliver a 30% improvement in productivity. There is also a 12% improvement in logistics costs per unit anticipated as the company leverages infrastructure investment.

Areas of interest the company has alluded to include medical consumables and devices. Credit Suisse suspects acquisitions could focus on the hospital segment.

Project Pivot restructuring has also been completed with attention now turning to digital implementation of the ERP system. While a share buyback remains an option the company is not active and growth/dividends are to the fore.

FNArena's database has four Hold ratings and one Buy (Credit Suisse). The consensus target is 68c, signalling -1.4% downside to the last share price.

AUSTRALIA

No Such Thing As Too Much Bling

With a better than expected first half and prospects of an even better second half, the only way from here is up for Lovisa Holdings

-Lovisa continues to benefit from a cash-laden bored consumer
-The company's first half was better than expected driven by cost management
-Going ahead, the aggressive expansion policy may slowdown
-Lovisa may be your early global store rollout story

By Angelique Thakur

Barring a few bumps along the way, things may be looking up for Lovisa Holdings ((LOV)) if the company's first-half results and trends are anything to go by.

The worst might be behind the fast-fashion retailer, is the unanimous consensus opinion of brokers including Morgan Stanley, Citi and Canaccord Genuity.

Of course, that does not imply it will be smooth sailing, especially since the company is smack in the middle of some very hard negotiations with landlords in the US and Europe.

A beneficiary of spare cash and boredom

Lovisa has emerged as a prominent if unexpected beneficiary of resurgent discretionary demand post the havoc covid wrecked last year.

The upbeat demand, miles ahead of the rest of the world according to Canaccord Genuity, is driven by a combination of spare cash and a willingness to spend on the part of bored domestic consumers itching to indulge in some retail therapy.

Both Macquarie and Citi consider the stock well placed to benefit from a reopening post-covid. That the recovery does not really depend on the border reopening but on normalising activity levels domestically contributes heavily to Macquarie’s investment thesis.

Filling the fast fashion void

Born in 2010 out of an idea to provide trendy fashion jewellery at “ready to wear” prices, Lovisa has grown to be one of Australia’s biggest fast-fashion accessories retailers. The company has made a name for itself in the “buy now, wear now and move on” category and targets fashion-conscious females aged 25-45.

The ASX200 component fashion accessories retailer expanded into South Africa in 2011 and by 2012 had more than 100 stores across five countries. In 2013, Lovisa debuted in Dubai and continued to expand through the Middle East till 2015 when it forayed into the UK and then subsequently into the US and France. Today Lovisa has more than 400 stores across 15 countries.

While the brand has made significant progress into offshore territories, Australia remains the retailer’s largest market exposure.

The brand has a voracious appetite for growth, following an aggressive expansion strategy, adding yet another new feather to its well-accessorised cap late last year when it added 90 plus stores to its kitty from the beleaguered European distributor Beeline.

The entire deal is expected to complete between March-May this year. What’s remarkable about the deal is Lovisa ended up paying a mind-blowing sum of sixty euros for Beeline! In fact, Lovisa is effectively being paid to acquire the Beeline stores in Europe, highlight both Canaccord Genuity and Citi.

Of course, it’s not all peaches and cream since Lovisa will be taking over substantial lease liabilities. And this is what makes Citi skeptical of achievable sales per store.

Citi seems to think the underperformance of the Beeline stores probably has to do with factors like store locations which for obvious reasons are difficult to change for Lovisa.

Another potential thorn is international travel, which remains on life support while increasing the probability of facing integration risks, especially with key personnel unable to travel.

Added to this are doubts regarding jewellery demand in the Beeline regions and thus, Citi retains a healthy dose of scepticism and wants to see some action before turning more hopeful.

Macquarie is a tad more positive, pointing out the cash inflow of EUR11m on handover will go quite a long way in de-risking the transaction.

The first half result

While definitely better than expected, Lovisa missed the mark on revenue back in its February release, posting flat growth in A&NZ. Revenues in Asia, Africa and Europe remained covid-afflicted and shrank over last year. The US was the only exception where same store sales grew by 23.5%.

The company saw a strong performance from stores in the Southern hemisphere, somewhat offset by a subdued northern hemisphere with 42 stores in the UK and 23 in France remaining shut during the first half.

So, then what explains the better-than-expected result?

Three words: Better cost control.

Mostly led by the reduction in employee expenses which saw Lovisa standing down hundreds of jobs during the pandemic, a necessary if highly unpleasant step in the company's bid to survive during one of the most unprecedented crises of our times.

Thanks to this, Lovisa was able to exit the first half with a strong cash balance of $42.5m despite the US being the only region to note a rise in same-store sales.

Overall, the company did better than Canaccord Genuity, Citi, Macquarie and Morgan Stanley had dared to hope. In fact, the company was able to achieve Morgan Stanley's operating income forecast for the entire financial year in the first half.

But what really got Citi excited was Lovisa reinstating its dividends with an interim dividend of 20c which went a long way in reinstating confidence in the company's prospects.

All in all, the first half result makes Canaccord Genuity more confident about an eventual recovery in Lovisa's offshore markets.

Not that there are no pitfalls to having global exposure, as Lovisa has realised. Back in 2018, the company was hit by weak consumer sentiments in the UK owing to Brexit fears and more recently in mid-2020 when it was forced to exit Spain owing to covid.

The exit has Citi worried since this highlights the possibility that Lovisa's model may not work in all markets as was thought previously by the broker.

And there are fears of things slowing down in the US amidst covid cases which may be a little inconvenient especially since US contributed more than 20% in same-store sales in the first half.

A notable feature of the first half result was the huge bump in online sales, rising 335%. While partly the result of a small starting base, the growth nevertheless suggests people continued to engage with the brand on other channels during store closures, in Citi's view.

Citi also suggests the rising online sales may just be the leverage Lovisa is looking for in its negotiating with the landlords.

What lies ahead:

Things are definitely looking a lot better for Lovisa into the second half, with sales up 12% in the first seven weeks.

Going by strong discretionary spending tends in Australia alone, Citi expects like for like sales to go up 40% in the second half.

And there could be a lot more in store especially if the fashion retailer manages to clinch better rent negotiation terms.

Even though the company has been following an aggressive offshore expansion policy, going from 0 to 435 stores across 15 countries, the pace may slow down going ahead, warn Jarden, Citi and Canaccord Genuity, hit by covid and an inability to be on the same page with the landlords.

Thus, undoubtedly, negotiations with landlords is expected to remain a notable feature of the second half in the US and the UK.

Citi believes Lovisa may also be limited by maturing markets like A&NZ and South Africa. Macquarie remains positive and dismisses the slowdown as just a temporary blip.

The company is experimenting with offering products between $100-$200 as against its previous cap of $50, something Canaccord Genuity finds interesting and is observing keenly.

Lovisa's cash in hand provides a sort of safety net with Citi forecasting a cash conversion of 105% in the second half .

Bell Potter in particular believes the company should have no issue whatsoever in continuing to successfully navigate through the covid quagmire and has an optimistic view on long term prospects.

So, should you buy Lovisa?

In Canaccord Genuity’s view, the only way is up from here and this might be a good time to buy more of the stock. As a result, Canaccord Genuity has upgraded its rating to Buy.

Bell Potter retains its positive view and holds on to its Buy rating.

Citi is more reserved, noting the stock is already trading at a “demanding FY22 P/E” and retains its Neutral rating.

Jarden also prefers to play it safe for now what with the execution risk surrounding the integration and the relatively lagging online penetration. The broker prefers to stick to Underweight.

Morgan Stanley suggests the company offers investors an early global store rollout story. Impressed by Lovisa’s resilience and quality management, Morgan Stanley upgraded to an Overweight rating in February.

The FNArena broker database, which includes none of Canaccord, Bell Potter or Jarden, shows three Buy or equivaleent ratings and one Hold, with a consensus target of $15.44, suggesting 9.3% upside from yesterday's closing price. Targets range from Citi's (Hold) $13.30 to Morgans' (Add) $17.95.

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AUSTRALIA

Premier Investments Reaps Margin Bonanza

Rental reductions and government subsidies underpinned strong first half earnings for specialty retailer Premier Investments. Yet, how will growth stack up in the second half, or FY22?

-Growth in FY22 appears increasingly challenged
-Material margin benefits in shift to online
-Continuing to invest in a global online presence for Smiggle

By Eva Brocklehurst

Online growth is key to specialty retailer Premier Investments ((PMV)), driving expanded margins across its portfolio of brands as rental savings are incurred with fewer bricks & mortar stores.

First half earnings were ahead of most expectations, including the company's guidance, with revenue up 7% and retail earnings (EBIT) up 89%. Furthermore, momentum appears to have continued into the second half, Morgan Stanley points out, although comparable growth in FY22 looks increasingly challenged and a transition in CEO adds further uncertainty.

The first half numbers were boosted by rent and wage subsidies stemming from the pandemic, both in Australia and the UK. Government support aside, Credit Suisse ascertains the results are still a reflection of the strong portfolio of brands and online capability.

While the leader in the apparel brands, Peter Alexander, will cycle 22% sales growth in the second half, the broker notes other apparel brands will cycle a particularly weak sales period in the second half.

Gross margins missed Macquarie's estimates, despite the expansion to 65.4%, because of investment in inventory and building the supply chain, while Citi expects margins will structurally re-set 400 basis points higher, given the savings in rents and the shift to online.

Retail margins are, therefore, expected to settle at 17% by FY22 with most of the uplift in profitability

driven by lower rents. Rent is expected to fall from 17.7% of sales in FY19 to 13.7% of sales in FY22. Half of this reduction in occupancy costs is stemming from lower rent per square metre while the other half is from the movement of sales to online.

Ord Minnett believes retail earnings margin expansion, stemming from the mix in channels to online and the mix in brands to Smiggle, will position Premier Investments well for a difficult comparable period ahead.

Moreover, growth options for 2021 exist in a business that is enjoying a lower rent to sales ratio as well as growth in its higher margin businesses of Peter Alexander and Smiggle. The broker, as a result, upgrades to Accumulate from Hold, finding the risk/reward now compelling.

Macquarie ponders wholesale exposure, which is immaterial at the moment, as a capital-light option for growth post the pandemic.

Store Closures

The broker notes the global store network for Smiggle has been reduced, with the closure of the remaining four stores in Hong Kong. Around 17 stores closed in the UK in the first half with the potential for a further 10-16 to close in the second half. Meanwhile, the company continues to invest in a global online presence for Smiggle.

Online sales growth in the first seven weeks of the second half was 61%, yet further afield Macquarie expects online penetration will be lower while physical store sales are enhanced relative to prior expectations.

All up, online penetration is expected to ease from peak levels albeit remain in excess of pre-pandemic levels. As a result margin benefits should still continue to materialise.

Citi expects online sales will increase to 30% over the next five years while the main uncertainty in Credit Suisse's view lies with the sales trajectory. The performance of Smiggle will be largely dependent on students returning to school in international markets.

Like-for-like sales in Malaysia in the first four weeks post a back-to-school announcement were up 143%, an encouraging number, yet the broker still is uncertain about a recovery in the Smiggle performance and outlook given the impact of the pandemic. As Smiggle is a significant driver of valuation, this cautious view supports Credit Suisse's decision to retain a Neutral rating.

There are two Buy ratings and four Hold on FNArena's database. The consensus target is $26.26, signalling 5.5% upside to the last share price targets range from $24 (Morgan Stanley) to $31 (Macquarie).

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AUSTRALIA

Computershare Hikes Long-Term Potential

Computershare will break into the US corporate trust industry with a substantial acquisition promising long-term earnings potential

-Acquisition doubles Computershare's exposure to margin balances
-Low capital intensity versus mortgage services but benefits long-dated
-Short-term impact could be slightly negative

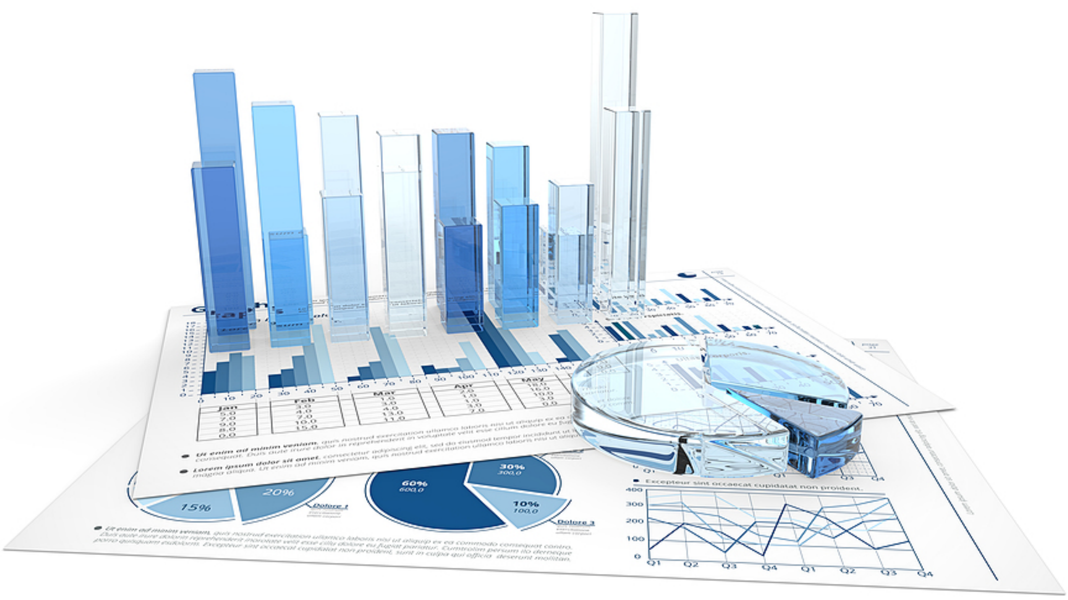
By Eva Brocklehurst

A significant US acquisition by Computershare ((CPU)) offers substantial earnings potential, over the long term. In the short term, without the anticipated synergies, the company will be saddled with a transition period that will last for several years.

Computershare will acquire the Wells Fargo Corporate Trust business for US$750m, raising $835m (US$634m) through a rights issue with the remainder of the purchase price funded by debt.

Morgans notes the acquisition does have large transaction and regulatory costs which lift the overall acquisition capital deployed to US$1bn. Overall, the broker believes this deal makes strategic sense as Computershare already has a large presence in this market in Canada.

The business is also light on capital and aligns with existing operations in the US. The main risk is the length of time to separate the Corporate Trust entity from Wells Fargo, around two years, meaning the timeline to achieving synergies is 3-5 years.



Citi also points out, during the transition phase, Computershare will not have full control in order to improve products and extract cost synergies. The acquisition will double Computershare's exposure to margin balances, to US$35.3bn from US$17.6bn, mostly leveraged to shorter term rather than longer term rates.

Citi highlights **Computershare now has very material leverage to rises in shorter term interest rates, if and when these occur**. The acquisition price looks expensive but once adjusted for the potential for material accretion this is less the case, and the broker calculates the acquisition has the potential to add 30% to earnings per share by FY25 or FY26.

Ord Minnett agrees the real rationale underpinning the acquisition is a strong bet on rising interest rates, with half of the uplift in organic earnings by FY25 expected to come from margin income, yield curve steepening and moving US$6bn in balances to earn a higher yield.

Returns?

Computershare expects the transaction to be 15% accretive, post synergies and Morgans notes a fair amount of the route to achieving this target is predicated on organic growth. Moreover, the broker points out revenue growth for this division in Wells Fargo has trailed client balance growth, signalling some revenue pressure may have existed previously.

Investors may welcome the pivot towards US corporate trusts yet, while this is a cash generating business with low capital intensity, Citi suspects organic growth is relatively modest, noting the business seems to have lower organic growth compared with its Canadian counterpart.

The broker concludes the risk of material customer attrition is partly countered by Computershare's deep knowledge of the acquired business and the long life of existing contracts.

Long Term Potential

The impact on the short term is less clear to brokers and it remains possible accretion will not start to appear until FY23. One feature that could deliver earlier accretion would be quicker-than-expected margin income enhancement and, for Citi, this is probably the main swing factor.

Otherwise, the impact on the short term could be slightly negative, as the broker points out there will be three months in both FY21 and FY22 when equity has been raised but there are no earnings from the acquired business.

Macquarie considers the changes to margin income mix and duration, as well as leverage to an improving interest-rate environment, will provide the upside for earnings as there are no hedges on the Wells Fargo book.

Yet, the broker agrees **accretion from the acquisition is heavily reliant on long-term synergies** although the company has a strong track record when it comes to acquisitions. Computershare successfully integrated the US Shareowner Services acquisition in 2011.

Macquarie also welcomes the reduction in Computershare's reliance on the more capital intensive US Mortgage Services business. Wells Fargo Corporate Trust business is one of the top four operators in the US market and generated revenue of US$477m in 2020.

While acknowledging capital-light earnings compared with mortgage servicing, which requires investment, Ord Minnett considers the scale benefits are too long dated to be assessable by investors.

The broker ascertains the company is expecting a pick-up in second half earnings, with respect to FY21 guidance which was re-affirmed on a pre-entitlements basis. This implies a 27% improvement in the operating environment, excluding seasonality, which Ord Minnett asserts is a stretch.

FNArena's database has three Buy ratings, two Hold and two Sell for Computershare. The consensus target is $15.42, signalling 2.9% upside to the last share price. Targets range from $10.75 (Ord Minnett) to $21.00 (Macquarie).

See also, Treasure Chest: Rates Key To Computershare on March 8, 2021.

COMMODITIES

Material Matters: Super Cycle, Moly & Tin

A glance through the latest expert views and predictions about commodities: Another super cycle?; Molybdenum on the move; oil picks; tin demand; coal prices rising

-Commodity boom ...not yet
-Tight supply critical to maintaining molybdenum prices
-Drop in oil price a tactical opportunity, Morgan Stanley asserts
-Solder applications a source of strong demand for tin
-Thermal coal prices at highest level in two years

By Eva Brocklehurst

Super Cycle

While global growth is likely to push demand for most commodities above long-term levels, ANZ Bank researchers also anticipate supply-side issues will limit production growth. As a result prices should be well supported although a long-term cyclical uptrend is considered unlikely at this stage.

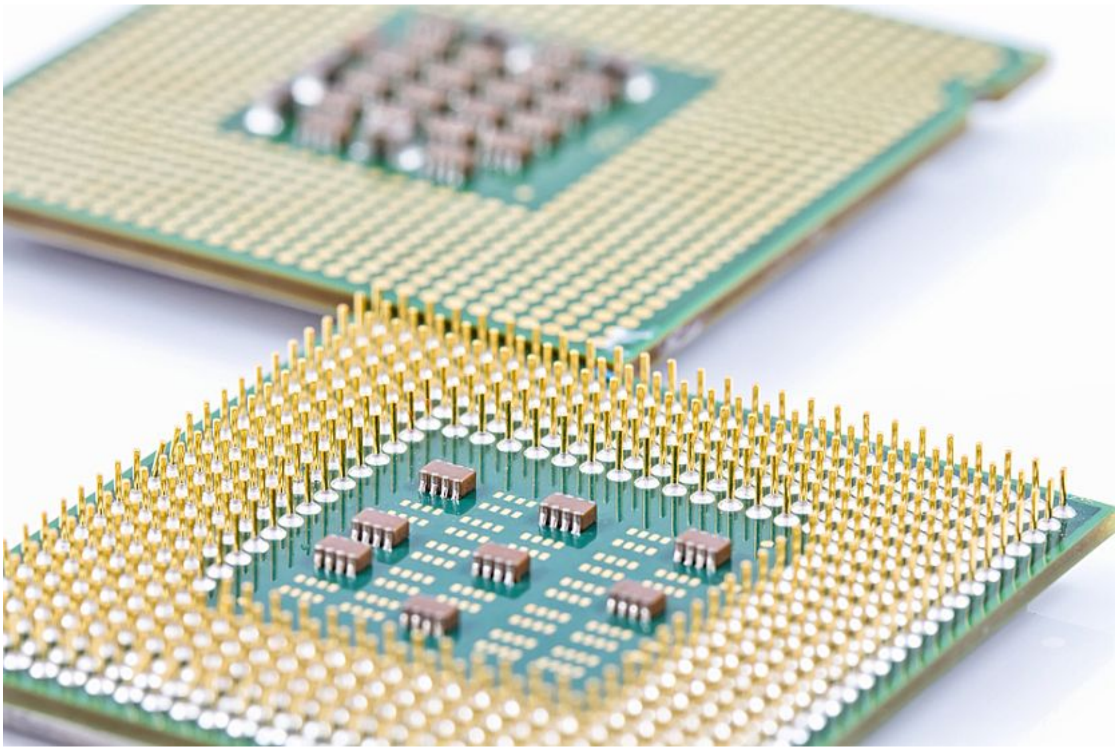
While the current cycle has hallmarks of previous booms, in particular synchronised growth in industrial production globally, there are some unique features. Climate change policies are pushing demand for some commodities even higher, while China has indicated it will ease back on stimulus measures later this year.

In sum, the performance of individual commodities will start to diverge and this makes it far from a super cycle, the analysts assert.

A super cycle is considered an extended period of strong demand for a wide range of commodities which leads to a surge in prices that end up facing a collapse in demand and subsequently falling. There have been three booms in commodity market since World War II: 1950-55, 1972-80 and 2005-09.

This time around, after the global economy slumped during the pandemic, fiscal and monetary support meant a relatively quick economic rebound. Yet, labour supply issues have intensified in some areas and decarbonisation is also now in the mix.

Investment in technology and innovation including semiconductors, 5G networks and electric vehicles should stimulate demand for certain metals. These all consume more metal than **fossil fuel** power generation and conventional vehicles.



The analysts highlight nearly 5-6 times more **copper** is required to build renewable infrastructure compared with conventional power generation, and electric vehicles need significantly higher amounts of copper as well.

Despite expectations for further gains in **oil** prices amid the global economic recovery, the ANZ analysts do not expect US oil companies will start chasing volume growth just yet. US output is expected to remain below pre-pandemic levels in 2021.

Moreover, with **gasoline and distillate** making up around half of all crude oil consumption, developments in the electric vehicle industry are likely to have a sizeable effect on oil demand.

China's transition to a low-carbon economy is also likely to reshape the landscape over the course of 2021. The analysts expect growth in **steel** demand will moderate over coming years and production will rise only 3% in 2021.

Longer term, the rapid growth in China's urbanisation will come to an end and this is likely to weigh on the price of steel-making raw materials such as **iron ore and coking (metallurgical) coal**.

Copper/Molybdenum

Two thirds of **molybdenum** production is via a byproduct of copper production and can make a big difference to producer operating costs. Molybdenum is a key ingredient in **alloy steels** and used in construction and process industries, namely transport, oil & gas and power generation.

Macquarie notes a dramatic rise of 11.5% in byproduct production of molybdenum in 2020 as primary production fell by -7.7%. This is all the more remarkable since global copper mine production dropped slightly.

This was accompanied by major rise in prices and an increase in Chinese imports of molybdenum. In summary, the broker points out the entire surplus created by the rise in molybdenum production and collapse in demand outside of China was bought up by China.

Macquarie assesses a major rise in the production of molybdenum containing grades of alloy steels and/or stockpiling of **ferromolybdenum** has occurred in China.

The main issue for 2021 is whether the buying will continue. Kennecott, Codelco and Armenia are expected to mine less molybdenum this year, which can reduce combined production by -27% year-on-year. Other copper byproduct mines are likely to maximise copper production at the expense of molybdenum because of a rise in copper prices.

If Macquarie's numbers are right, the rise in prices since August 2020 is likely to be sustained. Yet the broker warns, what is critical, is a decline in byproduct supply. If this does not occur as projected, then prices could come under pressure.

Oil

Oil prices have fallen significantly just recently, ending a steady rise since November 2020. Morgan Stanley considers this a tactical opportunity, particularly as energy stocks on its calculations are pricing in a low US$50/bbl.

The broker's key choices in the sector are **Santos** ((STO)), **Karoon Energy** ((KAR)) and **Viva Energy** ((VEA)). Morgan Stanley acknowledges Karoon Energy has not had a good year so far in 2021 but expects the discount should narrow as growth programs are delivered.

In terms of catalysts, Santos is expected to push ahead with its Barossa project and there is potential for further farming down that would lower capital commitments and reduce concerns regarding the balance sheet.

For **Oil Search** ((OSH)) the farming down process in Alaska has commenced so it will take some time before the market can understand how successful the process has been. Morgan Stanley also wonders whether the pandemic in PNG, which remains out-of-control, will further delay Papua LNG.

Meanwhile, **Beach Energy** ((BPT)) has been under pressure in 2021 amid concerns regarding lower oil production from Western Flank. The broker suspects this will be taken negatively by the market and Western Flank will be "doing well" to remain flat over the near term.

Tin

Tin prices have risen quickly, Macquarie points out, amid a supply/demand imbalance because of the pandemic. Prices on the London Metal Exchange have increased 26% over the year to date. The broker envisages positive structural drivers that should sustain for tin demand over the coming years.

Solder applications are a source of strong growth in demand for tin with the key themes of 5G and decarbonisation. Tin consumption is expected to follow growth in semiconductor shipments increasingly closely, benefiting from the roll-out of 5G networks which should accelerate post 2023.

The main issue now is whether the high prices will enable expansion of supply in China and Indonesia. Yinman, one of the largest producers in China, suspended production in February and this removed 500t/month of supply which should resume later in the year.

Against this, Chinese refined tin production capacity should still grow as Yunxi has completed the expansion project to lift total capacity to 70,000tpa. In Inner Mongolia, Weilasituo, with reserves of 58,000t of tin and tin concentrate capacity of 7000tpa, had planned for commissioning in the second half of 2020 but this is now suspended pending a licence issue.

Macquarie ascertains Indonesia, the second-largest refiner of tin, could be a key swing factor for the supply/demand balance and exports will need to be watched, along with shifting LME inventory in Malaysia as a potential proxy for marginal supply changes.

Coal

Seaborne coal shipments, overall, led by weakness in South Africa, are down -10% over the year to date. Shipments from Australia are down -6%. UBS notes metallurgical coal prices are continuing to drift and the market remains structurally out of balance because of China's import bans.

Coke prices have been reduced again in China as demand weakens because of limits in blast furnace capacity in Tangshan, while Mongolian supply into China has recently been cut drastically because of coronavirus infections there.

Meanwhile, **thermal (energy) coal** prices are at their highest since March 2019 as supply is disrupted and demand resumes. Newcastle 6000 calorie thermal prices rose 2.8% over the past week to US$90.50/t.

UBS assesses this will support a higher annual contract price from April, which is currently being negotiated with Japanese buyers. A recovery in global growth is increasing electricity consumption and subdued seaborne supply means the market remains tight.

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ESG FOCUS

ESG Focus: Materiality Matters - Part 2

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ESG Focus: Materiality Matters - Part 2

The "S" in ESG is more than a pleasant sentiment - its roots run deep into materiality - hence FNArena flags the social themes that will eventually hit corporations on their operational and strategic front lines - mental health, gender and modern slavery.

ESG Focus: Tallying social materiality

-Developing tools for accountability
-The true cost of mental health
-Gender materiality in spotlight
-The price of modern slavery

By Sarah Mills

In Part 1 of this series (link below), FNArena examined the materiality and outcomes nexus, as outlined by First Sentier Investments. This article spotlights the fund manager's approach to determining materiality and ensuring outcomes are achieved in its specific areas of focus.

In its webinar: *Navigating Investment in a Post-Covid World*, First Sentier explored the materiality of mental health, gender and modern slavery to investors, and the challenges of building meaningful metrics in this area.

For example, the funds manager is building its own set of more universal diversity measures; and is developing tools such as materiality maps, holistic metrics, and new workplace health and safety measurements.

If anyone doubts the materiality of social issues, one need look no further than the recent fall from the grace of the aged care industry.

Or for a recent indivual example: the Swiss National Contact Point for the OECD Guidelines for Multinational Enterprises has accepted a human rights complaint against UBS for Uighur labour camp contractor ties through its exposure to surveillance firm Hikvision.

Where this will go has yet to be seen, but it is an example of potential liability exposures that investors face globally; and particularly for investors in finance.

The European Union Commission legislated to pass its Taxonomy Regulation for the finance industry last June and financial institutions will have to report on the sustainable finance taxonomy criteria by December 31.

This will affect financiers globally and investors will have to fine-tune their social materiality receivers, given all the white noise in the market.

Tools for accountability

First Sentier is working to improve corporate accountability through collaborating with corporations and tying investment to remuneration, and structure, and reports on progress.

Engagement and collaboration are of increasing importance, particularly when investing in emerging economies.

“Trustworthiness of management is a key determinant for our decisions,” says FSSA Investment Managers investment analyst Angus Sandison.

“Long-term investors look for long term track records - how do they perform in times of stress, such as the financial crisis?”

Modern slavery repository – a quick update

Sandison says that First Sentier’s modern slavery ambitions received a setback from covid.

This was witnessed globally, as governments' modern slavery ambitions took a back seat to the covid crisis.

Australia’s rollout of its modern slavery repository was delayed by nearly a year, and the government published its first batch of 121 supply chain statements from Australian corporations in November, with the deadline for laggards extended to as late as March 31, 2021.

The Modern Slavery Act requires all businesses with an annual turnover of $100m to publish “modern slavery statements” each year.

Coles Group ((COL)) and Wesfarmers ((WES)) were among the early reporters.

There are many economic and geopolitical factors driving the global anti-modern slavery push, which we covered in Part 1 of this series.

Sorting the wheat from the chaff

Back to First Sentier, the institution started mapping modern slavery risks a year ago, but FSSA Investment Managers investment analyst Angus Sandison says it became difficult to determine the short and medium-term impacts to companies of covid when supply chains were so chaotic.

First Sentier is concentrating its efforts on corporations with Asian supply chains.

“Investing in Asia is a minefield,” says Angus Sandisson. “62% of slavery occurs in Asia, so this is an area of focus.”

He says many “truly global” Indian businesses have been crippled in recent years after failing to meet basic workplace conditions.

This in turn bounced back on those within the supply chain.

In a bid to manage this risk, First Sentier's approach is to first engage the business, given many businesses will blatantly misreport metrics.

The institution doesn't expect perfection but if the company is demonstrating progress then First Sentier continues to engage.

"The important thing to be aware of is gaps and materiality," says Sandison. "Some issues are likely to gain more traction than others, depending on how material they are (to the company)."

"We try to know first and why it is important. Engagement occurs early, divestment only happens later in the journey when other avenues are exhausted."

Again Sandison emphasises the importance of trustworthiness of management and long track records in getting a handle on social sustainability.

"What we typically look for are companies where sustainability and stewardship is part of the DNA. "

Mental health - the trillion-dollar materiality issue

First Sentier is also focusing on the more novel metric of mental health and is pushing corporations to report on mental health injury rates.

"Employers who had previously thought of workplace health in terms of 'lost time incident rates' have been prompted to consider physical and mental health more holistically," says First Sentier's responsible investment specialist Kate Turner.

"With employees feeling isolated, stressed and overwhelmed, employers have been challenged to take proactive steps to support the mental wellness of their people."

Mental health is an interesting choice of metric given that to date, mental health has been an area of very low corporate focus, despite its obvious materiality.

Bullying, harassment, toxic work environments can all affect productivity and increase staff churn and turnover.

This increases operational expenses, enhances the prospect of lawsuits, and generates a health bill and domestic productivity toll that affects the broader economy.

As the oil supercycle played out, it may have been there was enough fat on the bone to sweep these costs under the carpet.

Regardless of the reason, Institutions managing trillions in funds are less likely to continue accepting it.

Sickness-related absences alone are costing the western world billions, if not trillions of dollars.

Turner says corporations are not managing mental health well at the moment, given it is difficult to measure quantitatively, but expects this will change as measurement tools improve.

First Sentier notes that UK consultants are working to create a mental health benchmark for FTSE100 companies.

In November, CCLA, a public sector and charities investment manager launched a benchmark for investors to measure the management of employee mental wellbeing in large companies, according to *IPE Magazine*.

The benchmark assesses whether a company promotes mental health awareness among employees and contractors, or considers related safeguarding in job design, and whether managers are trained to provide positive mental health support in the workplace.

Shortly after covid hit, CCLA mobilised a coalition of investors managing GBP2.2trn in assets, including the Church of England Pensions Board, Norwegian Church Endowment Fund, Brunel Pension Partnership and Aviva, and wrote on their behalf to the chief executive officers of every FTSE100 company.

CCLA says it is the first health benchmark covering companies globally.

"There are mental health indices available elsewhere, but because they are voluntary, the worst performers are neither captured nor held to account," says CCLA's stewardship lead Amy Browne.

The benchmark will rank companies regardless of disclosure.

Britain appears to be the epicentre of the mental health accountability push, and FNArena examines Britain as an augur for how this theme may play out globally.

Prince William, The Duke of Cambridge, supports the cause, and has addressed FTSE100 employers at several events about mental health and wellbeing in the workforce.

On materiality, he points out that mental health issues are the leading cause of sickness absence in the UK, costing GBP26bn a year.

Unilever estimates that about half of all long-term sick leave in the UK is due to stress, depression and anxiety; and 95% of employees who call in sick with stress give a different reason.

ACAS says almost 9 in 10 FTSE-100 employers under-report mental health problems in the workplace.

Change would require a considerable revamp of the hierarchical industrial relations policies that have guided human capital management for centuries.

But some believe the institutional focus on materiality in this area could revolutionise workplace relations.

The first thing that comes to mind when one thinks of mental health and materiality is casualisation of the workforce, a trend that has accelerated in the West over the past 30 years.

The affects of casual work on mental health are well documented and, given the availability of ABS and other data providers, it would represent relatively low-hanging fruit as a metric for institutions serious about accelerating progress on both mental health and gender issues.

Women are usually the first victims of this practice, thanks to child-bearing and rearing; and often arbitrary and biased advancement criteria which damage their full-time career prospects. So one assumes casualisation is also relevant to gender issues, ticking another SDG box.

There has been some discussion about improving work security to improve mental health; but FNArena has yet to find any indicators or benchmarks monitoring this, and it is unlikely to be an issue for the market within the next 18 months, especially given the prioritisation of renewables.

Gender represents a potential $3trn productivity grab

Gender equality is another material factor for institutional consideration, according to First Sentier.

The European Union argues gender equality will boost gross domestic product by generating higher employment and productivity.

The EU estimates that by 2050, improving gender equality would boost EU GDP per capita in the region of 6.1% to 9%, which equates to a staggering 1.95trn to 3.15trn euros.

Given ageing populations and the sagging growth profile of the West, institutions are scouring the planet for just such contributors to GDP.

A multitude of global studies have also consistently linked greater sustainability and profitability to board diversity, especially through gender representation.

One only has to observe the outstanding performance of Australia Post's Christine Holgate to acknowledge the truth of this, for which, by the way, she was rewarded with a witch-hunt for being so audacious as to stand up to Australia's cosy male-dominated banking and political stalwarts, in her bid to drive even greater profitability and innovation by turning Australia Post into a bank.

It was not a battle her male predecessor, who presided over a considerable decline in the organisation, chose to fight; and like most women, Holgate was treated apallingly for daring to step out of line.

Fortunately, gender diversity and workplace diversity generally is one area in which institutions feel they can make a swift impact.

First Sentier's Turner says institutions have been very active in the gender space for the past few years and are now contemplating how they can take lessons learnt and apply them to broader diversity issues.

"In terms of gender diversity, using a metric like 'proportion of women in managerial positions' is a way to track progress and measure success," says Turner.

"But in order to achieve this, a number of underlying issues need to be addressed, including the impact of casualisation of the workplace on women, flexible working, access to effective and affordable childcare and aged care etc."

"So whilst the metrics are important, what is more important are the implementation plans in order to achieve those metrics and targets."

First Sentier says that when it comes to gender diversity, the first target is to gain 40:40:20 (male: female: other) representation on ASX200 boards and management.

Corporations are being required to report on their progress towards these metrics and how they are achieving them and why.

It should be some years before governments legislate, and institutions hold corporations accountable, on more material corporate operational issues such as casualisation.

Meanwhile, the EU gender report finds that improvements in gender equality could generate up to 10.5m additional jobs by 2050; jobs that will be sorely needed as the union's population ages.

One just hopes they aren't all in aged care, nursing, teaching and childcare. We could do with some more Holgates in Australia.

Part 3 of this series on materiality focuses on the environmental sustainability choices that form the focus of First Sentier's ESG portfolio.

Materialty Matters Part 1
(https://www.fnarena.com/index.php/2021/03/16/esg-focus-materiality-matters-part-1/)

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ESG FOCUS

ESG Focus: Water Emissions And Copper Mining

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Sandfire, ICAA Target Water-Related Emissions

As the UN publishes its *World Water Development Report 2021* titled 'Valuing Water' for World Water Day, Sandfire Resources and The International Copper Association Australia launch a project to deal with water emissions.

-Valuing water on the cards
-Water accounts for 20% of emissions
-Water dependent copper industry rushes for solutions
-A case study in both additionality and circularity

By Sarah Mills

World Water Day fell on March 22 this week, so it seemed fitting to give readers an update on what will soon become one of the most critical ESG issues.

To commemorate World Water Day, the United Nations published the 2021 edition of its *World Water Development Report*, entitled 'Valuing Water' – a harbinger of what is to come for corporations globally.

"Recognising, measuring and expressing water's worth, and incorporating it into decision-making are fundamental to achieving sustainable and equitable water resources management and the UN's Sustainable Development Goals for 2030," says the report.

"Those who control how water is valued control how it is used.

"Values are a central aspect of power and equity in water resources governance. The failure to fully value water in all its different uses is considered a root cause, or a symptom, of the political neglect of water and its mismanagement.

"All too often, the value of water, or its full suite of multiple values, is not prominent in decision-making at all."

The report leaves little doubt that that is all about to change; and it is likely to start with water-related emissions.

[Note: CO2 and other nasties are emitted not just into the air but also into soil and water.]

The International Copper Association Australia (ICAA) also chose World Water Day to announce the industry's efforts to improve its water management, offering an opportune case study on just this subject.

Zero Emissions project addresses additionality and circularity

Copper miners Sandfire Resources ((SFR)) and Anglo American have combined forces with the ICAA and the Global Copper Alliance to create the Zero Emissions project.

The ICAA titled the press release a '*Water Led Path to Zero Emission Mining*'.

Water-related emissions is an area to which green investors are rapidly turning, given climate change is going to be the first cab off the ESG rank – well before water per se.

Water accounts for 20% of industry emissions but is also critical to the copper industry's operations, a major issue given the industry is vulnerable to a new user-pays model for water.

The Zero Emissions project is focused on six processes: baseline water balance; dewatering of mine sites; desalination; tailings and recycling.

The project is interesting from an ESG perspective because it speaks to material ESG concepts of additionality and circularity, while killing two birds with one stone (water and emissions) – the type of innovation that is considered likely to yield the coveted sustainability premium.

The project is in the research stage, examining systemic problems, individual issues, global innovations and options, and expects to hand down a report in May.

The report will isolate the industry's 6-7 main technological challenges; which will be narrowed down to three critical challenges.

The industry then plans to take the project to various Federal and State governments in the hope of engaging in a collaboration on an in-situ incubator project, possibly in NSW's central west.

Smaller producers take collaborative approach to compete

It is interesting that Sandfire Resources and Anglo American have funded the project and not two of Australia's biggest copper producers BHP and Rio Tinto.

The majors are likely to keep any developments that will give them a competitive advantage in-house; but water is largely considered such an intractable, yet pressing problem that a collaborative approach is considered by many as the best solution.

Emissions are also a major issue. For example, while electric cars boast far lower emissions over their lifetime, building a Tesla Model 3 generates more emissions to build than a Rav4, according to the Wall Street Journal, because of the metals needed for its lithium-ion battery.

Even though copper is not the major component in a lithium-ion battery it is also used in other parts of an electric vehicle. It is estimated that the production emissions of copper have to fall by a factor of roughly five by 2050, if not more, if climate targets are to be reached.

The Zero Emissions project is a good path for smaller producers with lower economies of scale given they will need to find innovative ways to remain competitive destinations for ESG capital in a world of user-pays and water pricing.

Water is the critical issue for copper industry's Social Licence to Operate

The copper industry's water management, or lack thereof, has, in the past, been highly controversial and a source of reputational damage.

Problems have ranged from highly contaminating tailings disasters such as BHP Group's ((BHP)) Ok-Tedi, and more recently the Rio Tinto's ((RIO)) Panguna mine in Bougainville in Papua New Guinea; and Grasberg mine in West Papua; to competition with communities for water resources in drought-prone areas, such as in Chile.

In an ESG world, these past failures represent risks for investors.

A 2020 report titled *Cut and run: How Britain's top two mining companies have wrecked ecosystems without being held to account* by the justice advocate London Mining Network singles out BHP and Rio Tinto's activities in the global south as requiring restitution; and argues they should not be allowed to offload those responsibilities onto governments or via shelf companies.

The network calls for much stricter regulation of transnational mining companies and supports international efforts to establish a United Nations Binding Treaty on corporations, arbitrated by an independent body; although how they will ensure independence defies explanation given the parlous records of many independent arbitrators in many industries in the past.

Amnesty International has singled out BHP and Rio Tinto for human rights violations and environmental destruction, particularly those arising from tailings.

Even were companies protected against restitution for past offences, regulations enforcing accountability for clean-ups of existing mines would come at a cost.

Nor would it necessarily protect against future offences and clean-ups.

Amnesty International notes that the Rio Tinto's QIT Minerals Madagascar mine has breached the limits of an environmental buffer zone – sound familiar?

Pushing boundaries at Juukan Gorge did not work out well for Rio Tinto in Australia; and it may be that investors can expect more pressure to bear on "pushy" miners in future.

Copper has been designated a critical transition metal, so perhaps majors expect they can shelter behind that fact.

That and the fact that, unlike steel, there is simply not enough recyclable copper in the West to meet demand, let alone Asia.

But already BHP and Rio Tinto are encountering opposition; the US government recently rescinding US Forestry approval for their joint venture Resolute Copper's Oak Flat mine on Apache land in Arizona.

The US Government's final decision on Oak Flat in about six months time will provide investors with a clearer view of the expectations for copper miners globally; as well as likely policy and the likely longevity of copper's influence in the transition.

In the meantime, the industry will have to move fast to lift its ESG credentials and it will be interesting to see what future the Zero Emissions project yields.

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FEATURE STORIES

Rudi’s Comprehensive February 2021 Review

The story below is a compilation of stories relating to the February 2021corporate reporting season in Australia, published between late January and early March. Attached is FNArena's final balance for the season.

Content (in chronological order of publication):

By Rudi Filapek-Vandyck, Editor FNArena

Corporate Reports To Provide (Some) Answers

As per standard practice, the upcoming reporting seasons in the US and here in Australia next month (February) might reveal various timely insights for investors. Though it is likely market optimism regarding Australian housing markets, including construction and building materials, and consumer spending will over-rule minor operational hiccups in February and March if companies are leveraged to those favourable themes.

Though investors always look towards reporting seasons to provide both health checks and insights about new and upcoming trends, in past years broad share market trends have predominantly been determined by the macro-picture, often in contravention to specific outcomes during February and August reporting seasons in Australia.

February: Reason For Optimism

The in-between earnings season running from September until late December might have already given away the big surprise awaiting investors in February, but general optimism among analysts and professionals has been building that corporate results are likely to come in the form of more beats than misses, and with the need for increased forecasts continuing to fuel investor optimism.

All shall be revealed over the next four weeks, of course. And suffice to say: there will still be the occasional shocker that triggers a serious shellacking of the share price.

What is markedly different this time around is analysts are continuously upgrading their forecasts. If this is not triggered by rising commodity prices or by improving sector prospects, it is being triggered by corporate market updates. Think discretionary retailers. Think financial platforms. Think Buy Now, Pay Later service providers.

Ord Minnett Senior Investment Analyst Sze Chuah reports this big shift in market dynamics has led to market consensus for FY21 growth in earnings per share (EPS) to lift from a negative -2.2% to a positive average of 11%. Note: this average has predominantly been carried higher by banks and resources companies, but irrespectively the trend and investor optimism are very palpable.

At least until hedge funds in the US quickly turned into forced sellers of large cap equities

Ord Minnett has lined up its favourites for a positive surprise in February: CommBank ((CBA)), Rio Tinto ((RIO)), Amcor ((AMC)), James Hardie ((JHX)), Vocus Group ((VOC)), and Sonic Healthcare ((SHL)).

Candidates likely to disappoint include Crown Resorts ((CWN)), Flight Centre ((FLT)), Qantas ((QAN)), and Sydney Airport ((SYD)), predicts the broker. Travel restrictions have remained in place, hence.

Do note: if current market forecasts prove correct and the average EPS in Australia has declined by -19.5% in FY20, and FY21 will see a rebound in the order of 11%, this still implies overall profits remain well below FY19 level, and the market will need at least another year to fully catch up with the losses incurred by the global pandemic.

Sze Chuah doesn't think it's unreasonable to expect the -19.5% for FY20 will be recouped in the following two or three years.

Pre-Season Conviction Calls

Stockbroker**Morgans**believes plenty of opportunities abound in today's share market. One need not look any further than the list of "**Current Best Ideas**" that has been updated ahead of the February reporting season. This list contains no fewer than 45 ASX-listed stocks.

Stocks mentioned include Aristocrat Leisure ((ALL)) and Coles Group ((COL)), as well as Macquarie Group ((MQG)), Westpac ((WBC)) and Orica ((ORI)), not to forget BHP Group ((BHP)), ResMed, NextDC ((NXT)), and Incitec Pivot ((IPL)).

A few of the lesser known names include Booktopia Group ((BKG)), Universal Store ((UNI)), Kina Securities ((KSL)), Strandline Resources ((STA)), and HomeCo Daily Needs REIT ((AQR)).

Equally important, perhaps, is the fact the market strategists only recently added Booktopia, Universal Store and HomeCo Daily Needs REIT. Key ASX20 removals include Amcor and Rio Tinto.

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The team of**Quant analysts at Credit Suisse**has tried to identify major surprises for the February reporting season in Australia and the one stand-out observation is the team has identified only one candidate that is likely to both disappoint in financial performance and receive a negative share price response Appen ((APX)).

Credit Suisse's fundamental analysts are still in doubt about top line growth, plus AUDUSD is adding to the company's headwinds.

A few other candidates are seen delivering not so good financial results, but the quant analysts are not anticipating a firmly negative share market response. Those companies include Altium ((ALU)) and Iress ((IRE)), and to a lesser extent Infomedia ((IFM)), WiseTech Global ((WTC)), and Ansell ((ANN)).

Candidates likely to deliver a positive surprise and receive a positive reward include Coles Group, JB Hi-Fi ((JBH)), Harvey Norman, Audinate Group ((AD8)), Aurizon Holdings ((AZJ)), Sonic Healthcare, Charter Hall, and Goodman Group ((GMG)).

Kogan ((KGN)) is equally mentioned, but the Quant analysis is not sure about the subsequent share price response.

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Ord Minnetthas updated its**Super 7**list; stocks that stand out from the pack and should reward investors handsomely in the year ahead, a call made with High Conviction:

-Charter Hall
-James Hardie
-National Australia Bank ((NAB))
-Rio Tinto
-Santos ((STO))
-Super Retail Group ((SUL))
-Transurban ((TCL))

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At**Wilsons**, the overriding view is that analysts' forecasts for the year ahead will be proven too conservative in light of improving conditions for Australian companies.

Wilsons has updated its**Australian Equity Focus List**ahead of February, with the expectation that none of the current inclusions are likely to issue a profit warning or deliver such a negative surprise that analysts need to go back to the drawing board and re-assess their positive view with the sole exception of Appen.

Similar to analysts elsewhere, Wilsons fears the stronger Aussie dollar might weigh on the company's guidance for the year ahead this month. Appen is still included in the selection.

The selection of stocks essentially represents Wilsons' highest conviction recommendations and currently comprises of ResMed, News Corp ((NWS)), Macquarie Group, James Hardie, CommBank, Northern Star Resources ((NST)), Transurban, CSL ((CSL)), BHP Group, Aurizon Holdings, OZ Minerals ((OZL)), National Australia Bank, Seven Group ((SVW)), Super Retail Group, Santos, Goodman Group, Reliance Worldwide ((RWC)), EML Payments ((EML)), Worley ((WOR)), Aventus Group ((AVN)), Aristocrat Leisure, Telix Pharmaceuticals ((TLX)), ANZ Bank ((ANZ)), and Xero ((XRO)).

2021, The Year Of Earnings Recovery

Calendar 2021 will be the year of earnings recovery in a broad sense, analysts at Macquarie agree with Ord Minnett and others. Such positive outlook for corporate earnings should, all else remaining equal, translate into a positive environment for the share market overall, suggests Macquarie.

Most favourited stocks leading into the February reporting season are: Telstra ((TLS)), Nine Entertainment ((NEC)), Star Entertainment Group ((SGR)), Ramsay Health Care ((RHC)), and Downer EDI ((DOW)). All these have suffered from the pandemic last year and are poised for a firm recovery next, on Macquarie's analysis.

Macquarie also likes BHP Group, Rio Tinto and Fortescue Metals ((FMG)), for their prospective dividends, while Qantas has been singled out for a likely dividend disappointment.

In a broad sense, this year's global optimism on top of the post-covid recovery should see limited downside risk for equities, but with rising bond yields, predicts Macquarie. This will dramatically change dynamics for equities in that the momentum now favours cheaper priced 'value' stocks, away from richer priced Growth & Value.

Among covid-losers (Macquarie's own terminology), and outside of the five candidates mentioned earlier, Macquarie likes Healius ((HLS)) and Suncorp ((SUN)) with the added notion the latter might report a weak set of financials this month, but Macquarie would treat share price weakness as a buying opportunity.

In the basket of Quality stocks, Macquarie still very much likes James Hardie and Charter Hall ((CHC)). Among the covid-winners, the broker's three favourites are Harvey Norman ((HVN)), Woolworths ((WOW)), and Domino's Pizza ((DMP)).

Embedded deeper inside the research report, Macquarie expresses some reservations about Zip Co ((Z1P)) and Bravura Solutions ((BVS)), both expected to disappoint for different reasons in February, while AGL Energy ((AGL)) is described as a "structural short".

Resources are projected to generate the strongest sector growth in FY21, but not in FY22 (negative forecasts thus far) while Property Trusts remain the Big Laggards this year, following the negative performance in FY20. The come-back sector this year is, however, the banking sector with three consecutive years of negative EPS growth to be transformed into a positive outlook.

February Is Feeding Market Optimism

As the February reporting season in Australia is slowly warming up, investors are anticipating stronger-than-expected profit results, leading to increased market forecasts, opening the gates to higher valuations and less downside risk.

At face value, they do have a few strong indicators on their side, including:

-quarterly corporate results in the US where circa 80% of all companies reporting to date have managed to beat market forecasts;
-historic precedents, including 2009, showing analysts are too conservative when the big economic turnaround arrives;
-Australian corporate results post-August last year (Sep-Dec) saw 49% beating expectations versus a long-term average of circa 33% (*)

Other factors to consider include ongoing policy support from major central banks and governments, including a fresh stimulus package from the Biden administration in the US; further progress in rolling out vaccinations; and robust consumer spending as many households are left with spare cash and limited avenues for spending.

These are all positives and probably explain why equity markets have seldom paused to take a breather over the past four months. Earnings forecasts are on the rise and companies are expected to not only justify those increases, but add more reasons for further upward adjustments.

REA Shows The Way

The case for ongoing optimism was once again highlighted by local leading property portal REA Group ((REA)) on Friday. While the company's financial result has triggered further upgrades to analysts' forecasts, and to valuations and price targets, everyone can see from Stock Analysis the share price had already well and truly anticipated this would be the case.

This, however, has not stopped REA shares to continue rising post Friday's release. Today, as I am writing these sentences, the shares are up a further 3.5% highlighting the one question that has at least part of the investment community nervous: are markets not expressing too much optimism and at what point willthe musicstop playing?

For the time being, such secondary considerations are being dismissed and it is very likely that ongoing positive corporate results and updates will continue to feed in ongoing market optimism.

As the**FNArena Corporate Results Monitor**shows, of the 15 local companies that have reported in February thus far, only two have missed expectations and 10 did better for a 66.7% "beat" thus far. It's not quite the 80% achieved in the US, but then nobody outside the US knows how to work financial markets as well as do American CEOs.

The bottom line here is that market optimism feeds off positive input, and investors are currently presented with a large and varied smorgasbord of positive inputs.

Market Momentum Remains Divided

One important lesson to be learned from the REA exampleis that investors better not stare themselves blind on valuations, price targets and forecasts pre-results as the current trend suggests most will reset at a higher level post release.

To what extent, of course, remains an open question and ultimately dependent on what exactly is being reported and subsequently adopted by analysts to spice up their expectations.

Then, of course, there is always the question: what will the market do with the freshly updated insights?

Credit Corp ((CCP)) shares pretty much had the same experience as REA Group, as did Nick Scali ((NCK)) and Pinnacle Investment Management ((PNI)), but producer of nickel, copper, zinc and precious metals, IGO ((IGO)) did not despite also delivering a robust earnings "beat", while shares in ResMed ((RMD)) are equally struggling despite its quarterly triggering further increases to this year's consensus forecast.

Probably the best example in this regard was provided by global leading packaging company Amcor ((AMC)) as management lifted FY21 guidance for the second time together with releasing a better-than-forecast financial performance.

After an initial positive response, the share price was clobbered on day two but did manage to resume its uptrend since. The shares are still trading more than -12% below updated consensus price target of $16.99 while promising a dividend yield in excess of 4%.

The problem a stock like Amcor is facing is that investor optimism is feeding into more risk taking and this means smaller caps and mining stocks are seen as a lot more interesting. Amcor is also a rather defensive business, which is another no go, unless markets go through conniptions or the economic recovery story is in doubt.

And while management at the company would not necessarily agree, Amcor is also seen as a covid-beneficiary by investors, and this year's trend is all about buying covid-victims who stand to benefit from vaccines, recovering activity and borders re-opening.

None of this means Amcor shareholders will not be rewarded for the excellent performance delivered by management last week; what it does show is that companies like Amcor will need to work harder for a possible lesser reward, or at least less quick, than for others that are currently at the centre of market momentum.

As per always, corporate reporting season is believed to be all about corporate results, but it seldom is only about corporate results.

Dividends Are Back!

Apart from strong results and forward guidancefrom companies operating under robust operational momentum, such as mining companies, banks, building materials, financial services and platforms and discretionary retailers, the big positive surprise everybody is preparing for concerns dividends.

Australian investors traditionally enjoy the world's most consistent and attractive cash dividends, but the past two years have brought about the rather unusual phenomenon of subsequent declining payouts, in particular from trusted income providers the Big Four Banks.

Insurance companies, energy producers, regional lenders and infrastructure owners have equally severely disappointed those shareholders looking out for their semi-annual or quarterly cash payouts.

Not to forget: the owners of shopping malls.

All are expecting to start paying a (higher) dividend again this year, and in the case of iron ore producers and major banks, expectations are building for a lot more than simply the return of juicy yield.

On current forecasts, ANZ Bank ((ANZ)), for example, will pay out 111.4c in total dividends for the year ending in September, which equals a yield of circa 4.4%. But the dividend is expected to grow to 128.9c next year, and that takes the implied yield beyond 5%, or what shareholders used to enjoy before the sector hit a snag or two.

For good measure: ANZ Bank paid out 160c in FY19, so there still remains a large gap to close with the prior trend, but expectations are building current estimates, even though on the rise, might prove too conservative and some of the banks might even have the luxury to pay out a special dividend or announce a share buyback.

For a sector that genuinely looked down and out one year ago, 2021 is likely to witness a remarkable come-back on the back of a much quicker recovery from the pandemic fall-out, plus banks stand to benefit directly from a steepening yield curve in bond markets.

The latter is one key reason as to why prior champion stocks including CSL ((CSL)), Xero ((XRO)) and Carsales ((CAR)) have found the going a lot tougher since October last year.

CommBank ((CBA)) is scheduled to report on February 10th. Market consensus is aiming at $1.44 in final dividend, but the market response is equally dependent on what Australia's premium lender has to say about costs.

Iron ore producers know what it is like to operate inside the land of milk and honey. On my observation, most analysts are now reverting to yet another chapter of stronger-for-longer.

The Chinese would love to stick up their finger to Australia, as they have done through coal, wine, lobsters and other imports from the land Down Under, but they cannot unless they risk crippling their own economic recovery.

Part Two shall dig deeper into expectations for specific sectors and market segments, including analysts' most favourite candidates for upward and downward surprises this month. See the FNArena website on Friday.

(*) Paying subscribers can access the archive of past Corporate Results Monitors via a dedicated section on the website:

https://www.fnarena.com/index.php/reporting_season/

The Monitor for February is now being updated daily.

February: Early Days, Full Of promise

By Rudi Filapek-Vandyck, Editor FNArena

Only in Australia, I think, can one be in the middle of reporting season, calendar-wise, but with only one-sixth of all companies having reported.

Or to put this in more concrete terms: by early March, when the current February corporate reporting will be done and dusted, FNArena expects to have updated on circa 318 ASX-listed companies.

Today, as I write this week's Weekly Insights, February 15th, the total number of companies included in our daily Corporate Results Monitor still only tallies 52 companies.

I think everybody can do the math. There are more than 260 corporate results still waiting to be released, ex quarterly trading updates such as from the banks outside of CommBank ((CBA)) and Bendigo and Adelaide Bank ((BEN)), and ex the handful of companies that reported on Monday, today, and whose general assessment will be included in tomorrow's Monitor update.

No, I have no clue either, other than that the skew towards the second half of each reporting season in Australia has noticeably worsened in recent years. This skew seemed logical when businesses were under the pump, forced to cut dividends and issue profit warnings, as they found it increasingly more difficult to live up to market expectations.

We should be edging closer to 100 by now, on pre-2019 schedules, but maybe Australian companies are simply finding it difficult to change the new habit?

Whatever the reason, investors will find out what is going on inside corporate Australia over the next two weeks. So far, the early numbers look very promising with the percentage of market beating financial results at roughly 55% and the percentage of clear disappointments at around 15.5%.

To put these numbers in context: total "misses" since August 2013 have never been below 19% and usually are in the low to middle 20s range while the best reporting seasons, September-December last year and March prior, generated exceptional numbers of 49% and 43% respectively.

It's still looking very promising, but we have to take into account that on 52 companies thus far only, and with more than 260 yet to follow, today's statistics can change quite dramatically. One observation to make is that some of yesteryear's favourites are genuinely facing a much tougher environment in 2021 (see: Altium ((ALU)) on Monday) while negative secular trends remain the bugbear for owners of shopping malls and office properties, see Mirvac Group ((MGR)) and Unibail-Rodamco-Westfield ((URW)).

In between, a large number of companies are performing better-than-expected, forcing analysts' forecasts higher. At least, this is the picture for the first two weeks of this February, on a thinner than usual sample.

A Different Environment For Dividends

The addition of Telstra ((TLS)) shares to the**FNArena-Vested Equities All-Weather Model Portfolio**has led to a number of questions from readers and subscribers.

It is true, I am usually not a big fan of investing in low quality propositions, much preferring to avoid getting caught in something like Unibail-Rodamco-Westfield ((URW)) and then hearing management declare there will be no dividend for years to follow. Telstra shares have caused many a loyal shareholder continuous headaches for extended periods since its listing in the late 1990s.

As I have tried to explain since returning from the end-of-year break in January, this year's prospect of rising global bond yields will have a direct impact on bond proxies and share prices of many an income providing stock in the share market. As such, it is my forecast that financials and industrials that are in a position to grow their earnings and dividends will prove a much better investment than most property owners or your typical REIT.

Following on from this forecast, the All-Weather Portfolio has reshuffled its exposure to dividend paying stocks, adding Telstra and Super Retail ((SUL)) while sticking with Aventus Group ((AVN)) and Waypoint REIT ((WPR)). Aventus Group has continued to perform strongly, while Waypoint REIT has clearly been impacted by the rise in global yields.

Investors should also note many of the stocks held in the portfolio are regular and solid providers of growing dividends, including Amcor ((AMC)), Iress ((IRE)) and Coles ((COL)) while, of course, the likes of CSL ((CSL)), ResMed ((RMD)), TechnologyOne ((TNE)) and REA Group ((REA)) equally pay out growing dividends, though their yields are too low to feature in any specific dividend-oriented investment strategy.

Telstra's inclusion might well prove but a temporary decision, in that I believe the prospect of selling off equity in its towers and other infrastructure assets is minimising risk and most likely to unleash value for shareholders. It is on this specific consideration that Telstra is temporarily back in the portfolio, offering circa 4.7% yield after the recent share price appreciation. Lucky me, also, Telstra's financial interim performance did not disappoint this time around.

The inclusion of Super Retail adds a high yielding stock that should be supported by the prospect of a prolonged period of buoyant consumer-related spending while, admittedly, also creating some overlap with one of my long-standing favourites, Bapcor ((BAP)).

As far as the All-Weather Model Portfolio itself is concerned, this is something we set up with a financial partner on an external platform (now: Wealth O2), so no specific details are available on the FNArena website. The Portfolio chooses from the same lists that are available through the dedicated All-Weather Stocks section on the website. It owns most, though not all of the stocks mentioned.

Sometimes an exception is made, as with Telstra and Super Retail, stocks that wouldn't feature on my lists. I haven't as yet figured out how best to communicate this switch in focus when it comes to dividend stocks, other than mentioning it here in Weekly Insights.

Suffice to say, while the five names mentioned under Dividend Champions on the website will continue to pay out dividends, and grow those dividends over the years ahead, with low risk of having to reduce or scrap payouts, they are unlikely to perform well if bond yields keep tilting higher.

This is the one perspective investors should simply be aware of.

February 2021: Banks Are Back!

In a reporting season that is about to beat all reporting seasons from the past ten years on important key metrics (see further below), the**stand-out winners are Australian banks**, showing investors the true meaning of "better-than-expected" with a glimpse of what old glory days used to be like.

The most remarkable achievement, probably, is that banks have become the main contributor to rising EPS growth forecasts in Australia, which is no mean feat considering the ongoing stronger-for-longer environment for the three large cap iron ore producers on the Australian stock exchange.

Banks and iron ore producers are at the forefront of what is characterising February 2021for Australian investors: financial results that beat market estimates, forcing forecasts to rise further, and with a strong come-back for large cash dividends.

All of BHP Group ((BHP)), Rio Tinto ((RIO)) and Fortescue Metals ((FMG)) have surprised with much larger dividend payouts than had been expected. If the iron ore price retains its stronger-for-longer momentum, there should be more of the same in August and again next year, though most analysts would assume dividends will still fall from this year's peak-payouts. These are commodity producers, after all.

No such holding back is prevalent when it comes to analysts' views on Australian banks this season. If anything, many see plenty of opportunity and ongoing upside risks. The faster economic recovery on top of government support programs, combined with rising bond yields and a widening beneficial spread between short-term and longer-dated government bonds is turning banks into the undisputed winners of February 2021. If analysts' forecasts are anything to go by, this sector revival has a lot further to go.

Not only are implied (forward looking) yields on bank shares already approaching levels similar to the good old days, with all three of the Majors outside of CommBank ((CBA)) now promising 5% or more (plus franking) on current share prices, analysts see excess cash and potential for special dividends on the horizon.

This truly is one remarkable come-back, if ever investors have witnessed one in Australia.

A Supercycle In Dividends

The best way to illustrate just how strong this February reporting season has been up to this point (Monday, 22nd) is through**equity strategists at JPMorgan**. Before February, Jason Steed and Emily Macpherson had been expecting a strong turnaround in earnings and dividend expectations.

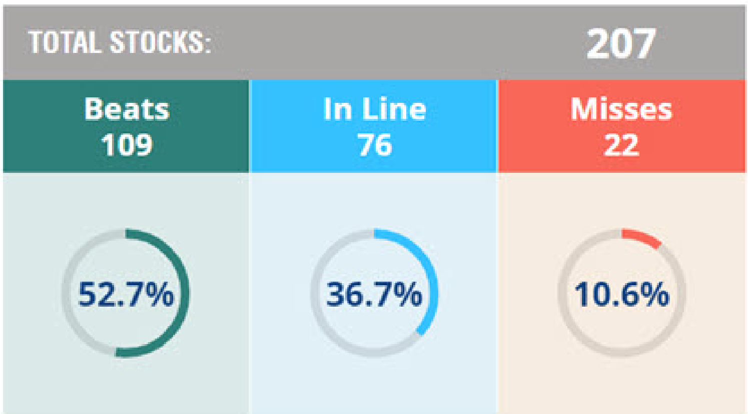
On Monday, the duo exclaimed: "*The reality, thus far, has exceeded our elevated expectations.*"

The team at JPMorgan is now predicting a**Supercycle in Dividends**is building on the ASX. Their favourite seven names to invest in this new supercycle are: Fortescue Metals, Charter Hall ((CHC)), Rio Tinto, Super Retail ((SUL)), BHP Group, ANZ Bank ((ANZ)), and National Australia Bank ((NAB)).

Note: all seven stocks have been selected with a three-year horizon in mind (also showing how bullish above-consensus forecasts are at JPMorgan).

Last year, Australian yield-seekers were extra hard hit as companies cut dividends more dramatically than the average fall in profits, but this year that trend is reversing and, thus far, the comeback in dividends on average is far greater than the big recovery in profits. Citi points out miners including OZ Minerals ((OZL)) and Newcrest Mining ((NCM)) and scrap collector Sims ((SGM)) equally delivered positive dividend surprises this month.

Best Set Of Numbers In A Decade



Total Rating Upgrades:	40
Total Rating Downgrades:	26
Total target price movement in aggregate:	6.65%
Average individual target price change:	5.57%
Beat/Miss Ratio:	4.95

Two sentences stand out in analyst research reports this month: "better-than-expected" and "best results season of the past ten years". Macquarie has said it. JP Morgan has said it. And the numbers here at FNArena certainly back up that claim.

As of Monday, February 22, the**FNArena Corporate Results Monitor**covers 155 earnings results reported and, on our assessment, 57.4% (89 results) proved better-than-expected, which is well above average of around 33%. Equally important, only 17 companies (11%) disappointed through missing market forecasts which is well below the percentages of past seasons (varying between 19%-37%).

Target prices have thus far risen by an average of 6.15%. In aggregate, targets are up 7.01% since the start of the month. Both numbers are near the highest increases recorded since 2013 (when FNArena started recording these stats).

One clear divergence from past seasons is that the numbers for the ASX50 are no longer lagging the numbers for the ASX200, which also shows the strong come-back from the banks. Of the 31 companies in the Top50 who have reported so far, 64.5% (20 reports) delivered a "beat" against 12.9% (4 companies only) missing expectations. For the ASX200 the corresponding numbers are 60.4% (58) and 11.5% (11) respectively.

Or to put this in the simplest lingo possible: beating expectations and forcing analysts to lift forecasts and valuations is no longer the sole domain of small and midcap technology companies alongside healthcare and REITs. As a matter of fact: the opposite is happening in this February results season when the likes of Altium ((ALU)) and Appen ((APX)) have been showing vulnerability and weakness, while trustworthy quality stalwarts including ResMed ((RMD)), CSL ((CSL)), and the ASX ((ASX)) have been noticeably out of favour, regardless of their financial performance.

The latter is not completely true. It has been more acase of: if ResMed comes out with another strong result, investors merely shrug their shoulders, and move on. But in case of the ASX, it appears nothing was going to be good enough to stop the slide in the share price. The ASX share price has now lost in excess of -20% since September last year, and it is far from the only victim from the market's all-dominating switch in focus; **away from covid-winners, towards covid-victims**that stand to gain from this year's global recovery.

Viewed from this angle, corporate results from the first three weeks of the February reporting season can be used as justification for the switch in market momentum in favour of miners, energy producers, banks and other laggards and cyclicals. Though that would be too simplistic a statement to make. The prospect of re-opening economies, and reviving social habits, on the back of vaccine roll-outs this year means investors are happy to buy and wait for the eventual recovery to play out, not disheartened at all by any delays that occur in the meantime.

Price action in the likes of Webjet ((WEB)) and Corporate Travel Management ((CTD)) is the tell-all within today's context. It also once again shows that corporate performances are important, but expectations trump everything. February provides plenty of examples to back up that statement.

The main counter-argument to all of the above is that as of today, with only one more week left in this season, we are still only half-way through the total number of corporate reports for the month. I do think the current trends are too broad-based to reverse throughout the final week. In terms of combined market capitalisation for the companies that have already reported, we are well past the 50% and closer to the two-thirds mark (as also illustrated by 31 out of the Top50 companies having reported).

The Market Is A Duck Pond

The sharp rotation in a heavily polarised share market has turned the ASX into a duck pond. Viewed from the top, not much seems to be going on with the ASX200 meandering in between 6600 and 6900 with occasional a bit of heightened volatility because some hedge funds end up in trouble, but nothing much to upset the writers of tomorrow's headlines.

Underneath the surface, however, quite a different spectacle has opened up. I already mentioned the ASX. Shares in Magellan Financial ((MFG)) have lost around one third since peaking upon the release of FY20 financial performance numbers in August last year. CSL shares are no longer that far off from the depth of the temporary panic selling carnage that occurred in March last year. It seems but a distant memory, but Appenshares rallied to near $44 in August last year (they are more than -50% lower today).

These are but a very select few of examples. Those investors keeping cash on the sidelines in anticipation of that big share market correction that needs to happen eventually might be missing the point. On my observation, that share market correction is happening in the here and now, but we need to look below the surface to see the damage and where it is taking place.

As per always, this extremely bifurcated market behaviour can inflict a lot of pain and gut wrenching despair for holders of impacted shares, in particular since the share market overall seems to be trending upwards, creating quite a pronounced gap between this year's winners and laggards. The alternative view is, of course, that the market always does what the market does best, and that is exaggerating to the downside as much as it is likely exaggerating to the upside elsewhere.

In other words: opportunities are likely opening up for investors not necessarily looking to join today's obvious momentum trade. Many of last year's popular favourites are today trading at -12%, -16%, -20%, -25% below consensus price target. Sure, there might be a longer-lasting impact from the strong Aussie dollar and bond yields, they are on the rise, much quicker and steeper than most among us were anticipating only weeks ago, but many of today's victims are high quality, solid business models with ongoing profitable prospects.

Within this context, I note**Longview Economics**recently highlighted the fact US bond yields are approaching key technical resistance levels, probably indicating it is time for a pause and possibly a counter-trend move lower. Such a pause would provide a breather, if not more, for those prime victims that have seen quite the selling pressure descending upon them during the first two months of the new calendar year.

When Gold Meets Its Master

Talking about victims, has anyone else noticed those in favour of owning gold have gone really, really quiet of late. In fact, I hear more and more stories about your typical gold bug re-allocating money out of bullion and into crypto currencies.

Owning gold, and crypto currencies, is all about believing in the key narrative and in gold's case one of the narratives that gets repeated over and over again is that it protects against inflation, which, of course, is something it doesn't do, unless under the right circumstances.

Ultimately, gold's direction is dependent on what happens in the US bond market. Yes, I am as surprised as most of you that this is almost never mentioned by most experts when talking about gold as an investment, or portfolio security for that matter.

In the current context, when inflation adjusted bond yields are negative but they might rise into positive territory as global inflation expectations are picking up, gold is not your watertight protector against price erosion through inflation. In fact, as clearly shown on backward looking price charts, gold in USD has done exactly what happened to share prices of the ASX, Magellan Financial, CSL, etc and that's because they are all victims of the same source; rising bond yields.

Gold in USD peaked mid-last year above US$2000/oz and is now below US$1800, and in a visible down-trend. The reason as to why gold hasn't fallen more thus far is because it is also a direct beneficiary of a weakening US dollar, which offers some form of compensation.

The team of technical analysts at Citi last week informed their clientele that were gold to close below US$1765/oz it would create a set-up similar to that of April 2013 when the precious metal lost -US$200 of its value in the course of three trading days.

Historical parallels don't make for a guaranteed exact repeat, as we all should keep in mind. Regardless, I think the underlying sentiment remains correct: gold's movement in 2021 is much beholden to whatever happens with US Treasuries. For some reason, crypto currencies have managed to steal some of gold's narratives (alternative against floundering fiat currencies, protection against excessive money printing, etc) without the historical connection with real US bond yields.

No, I don't know what that means either. And I certainly cannot explain it (other than, maybe, old world relic versus new world promise, maybe).

For those wanting to know more: I wrote a whole chapter on gold in**Who's Afraid Of The Big Bad Bear**, available for all paid subscribers through**Special Reports**on the website.

Bond Yields Won't Rise Forever

As I have been writing since my very first 2021 market commentary in January, bond yields are the giant shadow lurking over asset markets this year. If they go up too high too rapidly equity markets will stumble, and possibly sell-off, but under a more mild scenario, which is what we've seen thus far, it'll trigger a de-rating for most of the winners from the past years.

As bond markets are as much dominated by algo-trading, technicals and momentum followers as any public market these days, it is unfortunately not possible to make watertight predictions about how exactly this year's scenario will unfold. But we've come a long way already with 10-year bond yields rising above 1.4% in Australia and the comparative yield in the US now above 1.3%.

Put a gun against any bond experts' head and he/she will probably say:*"I think around 1.50% this year*". (Assuming that's the question you wanted to ask?)

The underlying message here is: bond yields won't rise forever, and their projected move upwards won't even happen via an uninterrupted, straight line. Thus there will be bargains and opportunities along the way.

One such example, I believe, this month is presented through**Charter Hall**, whose share price has continued weakening ever since the start of the new calendar year. For good measure, Charter Hall is a diversified, extremely entrepreneurial and experienced property investor and developer, and there are weaker parts inside the group, but these should be more than compensated for through the booming parts, which includes the funds management and asset allocation.

These past two weeks or so the Charter Hall share price has literally weakened every single day. The price is now sitting on top of the simple 200 days moving average (for those who pay attention to these things). Of more importance, for how I look at the share market, the consensus price target is now more than 25% above the share price.

And that consensus price target is derived from freshly updated forecasts and valuations by analysts post a financial results release that not only beat market expectations, but also included an upgrade to full year guidance by company management that is by and large considered conservative by most analysts covering the company.

But the share price keeps falling every day.

It is this disconnect in a share market that is extremely focused on up-trending stocks, with no interest or attention to others, that has my personal attention this reporting season. Charter Hall is far from the only one whose performance and outlook are being ignored these days, but I am mentioning it because it has been included into the FNArena/Vested Equities All-Weather Model Portfolio, for the reasons mentioned.

A second reason is that I suspect the above mentioned strategists at JPMorgan made a mistake when they included Charter Hall in their list of most preferred dividend exposures for the upcoming three-year long supercycle. Looking into the finer details, I suspect they mixed up Charter Hall with Charter Hall Retail REIT ((CQR)), which is related though not quite the same.

Charter Hall Retail REIT offers a much higher yield of 6.6% for the running financial year, projected to rise to 7.1% in FY22. Sounds more like supercycle dividend material to me, but hey, I am now back on board with Charter Hall and I think that's a keeper for the next three years too.

A February For The Record Books

It has been a while since a corporate results season in Australia was mostly about corporate performances. The last time this happened was, according to my memories, February 2018.

Back then, investors weren't so sure whether strong share price performances for companies including Altium and Appen could be maintained, but their financial market updates proved the doubters wrong.

Every subsequent season since has been overshadowed by macro forces, albeit to different degrees and mostly through attempts to rotate away from Quality and Growth into Banks, Value and Cyclicals.

The February 2021 season has proved a little different. That oft attempted, but seldom sustainable market rotation into banks, miners and energy producers is by now five months old, and it has been solidified throughout the month with investors unambiguously showing their preference for share market laggards that stand to benefit from the rollout of vaccines globally and the re-opening of regional and international borders.

At times it was almost heartbreaking to observe how strong performances from covid-winners would receive no reward, at best, while for companies such as Webjet ((WEB)) and Flight Centre ((FLT)) it almost didn't matter what financial results were being released as investors are keeping their attention firmly focused on the fact that global borders will re-open, exact timing unknown.

In 2021, the return of broad-based optimism about the economic recovery ahead has started to translate into higher bond yields which, in turn, have looped back into a weakening US dollar (stronger AUD) and a universal approval for investors to again start accumulating shares in small mining companies, banks, oil & gas producers, steel, construction and building materials, contractors and mining services providers, and other industrial cyclicals.

The sharp rise in bond yields was the big shadow hanging over February this year. Not only did it provide too big a headwind for most covid-beneficiaries, it also reignited market debate whether unprecedented stimulus and government support programs are heralding the return of consumer price inflation, which would justify even higher yields.

Central bankers joined the debate. They said: no, it doesn't. The alternative view is that bond yields fell in 2020 because of the global pandemic and as market optimism grows, those yields are simply pricing out the virus impact. On the first Monday of March, the RBA used its money printing power to put a halt to what risked becoming an unruly trend that could well grow beyond control. The Fed had been signalling similarly on the final February Friday.

Whether this settles this debate once and for all is highly unlikely, but if the temperature on bond markets cools down, which would be the prime target for central banks the world around, then at least equity investors can start focusing again on corporate earnings, balance sheets, quality of business models, structural trends and valuations.

For investors, maybe the key challenge is to find a portfolio balance between direct winners from higher bond yields and this year's economic recovery and those robust business models that might be temporary out of favour, also because they performed so well in the past, but whose runway for growth continues to be supported by new structural mega-trends and tectonic shifts into tomorrow's technology-driven new economic reality.

Certainly, a less dominant theme of rising bond yields will much easier allow companies such as ResMed ((RMD)), Xero ((XRO)), Charter Hall ((CHC)) and Altium ((ALU)) to regain firmer footing, and thus investors' attention.

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Having said all of the above, there is no denying a rather large number of highly popular, highly valued, strongly growing businesses have come up short these past few weeks, which has weighed upon share prices irrespective of bond market shenanigans.

The aforementioned Altium is one of them, but we can easily add a2 Milk ((A2M)), Appen ((APX)), Nanosonics ((NAN)), and many of the smaller cap technology sweethearts, including Aerometrex ((AMX)), Bravura Solutions ((BVS)), Catapult Group ((CAT)), Infomedia ((IFM)), ResApp Health ((RAS)), Temple & Webster ((TPW)), and others.

During a time when share market laggards -from the banks to Western Areas ((WSA)), and from Lynas Rare Earths ((LYC)) to Telstra ((TLS))- proved they are still worth investor attention, as long as the economic recovery remains on schedule, many of the former can-do-no-wrong share market darlings revealed some of their own vulnerabilities and weaknesses. When taking a broad view, this even includes Australia's Champion among Champions, CSL ((CSL)).

No doubt, for some investors this has further galvanised their appetite for more cyclicals and less Quality, Defensives and Growth, but one needs to keep in mind the theme of backing last year's covid-victims will run its course at some point, while central banks remain convinced there is no sign of sustainable inflation on the horizon. I also believe there is one important message that should not be ignored from several of this season's failures, and that is that disruption and tectonic shifts that used to dominate the landscape until late last year are still around.

Beyond the short-to-medium term focus of the market sentiment pendulum, those shifting tectonic plates will continue to challenge moribund, under-invested business models even though there is equally a valid argument in that the accelerating shift towards decarbonisation of economies is creating a whole set of fresh dynamics, while it should be easier for companies to restructure, re-align and reinvent themselves when economic growth is strong (or so goes the theory).

Every reporting season opens up a list of major failures and disappointments and this time AGL Energy ((AGL)) delivered one of the eye-catching, negative performances. Investors best not be bamboozled by the seemingly high dividend yield on offer. AGL's share price has been in decline for over four years as the power network operator and electricity generator struggles to combine old world coal fired power stations with new world renewables and the need for more grid flexibility. It is but an existential dilemma for all to witness; one that is unlikely to be resolved by simply separating the dirty coal operations.

In the same vein, Unibail-Rodamco-Westfield ((URW)) might be the proud owner of several of the highest quality shopping malls around the world, but burdened by too much debt, lockdowns, the shift to online and the threat of ongoing asset devaluations, management's task of manufacturing a successful transformation is not being made any easier, irrespective of this year's recovery. Those who jumped on board because of the perceived value in the assets, while the shares looked exceptionally cheap, are now facing the prospect of two years of no dividend payments.

Another one of February's spectacular disappointments was delivered by machine learning and artificial intelligence data and services provider, Appen. While the need for such data and services will remain high in the years ahead, Appen's small base of key customers seems to have injected more price competition among suppliers and Appen, valued as a high growth company with sheer unlimited potential, has felt the repercussions through a gigantic share price devaluation, taking the price down by more than -50% since August last year but, and this remains the sad indictment for those who are still holding on, with ongoing risk for further negative surprises.

Investors equally did not respond in kind when Coles Group ((COL)) suggested it had to invest more to future-proof the business, while growth might temporarily turn negative when compared to last year's big boost from covid lockdowns. As such, the supermarket operator might as well have rung the bell for last year's covid beneficiaries in general which are facing tough comparables to beat in 2021, while the opposite remains the case for last year's laggards including the banks, who managed to crown themselves as the Super-Duper Come Back Kids in February, with ongoing promise of higher dividends, and even special payouts, as the recovery materialises.

All in all, it has to be said, February delivered very few true disappointments, unlike most reporting seasons. After combining 335 reporting companies over the month, the FNArena Corporate Results Monitor has placed less than 12% (40 companies in total) in the sin bin for missing market expectations, and many of those are perennial underperformers and repeat offenders, including Ardent Leisure ((ALG)), iSentia ((ISD)), 3P Learning ((3PL)), Cimic Group ((CIM)), and Humm Group ((HUM)).

The local technology sector was a magnet for reductions in forecasts this season.

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At the other end of the spectrum, 160 companies, or nearly 48% beat market expectations and that's an achievement we have never witnessed since we started keeping reporting season statistics here at FNArena. Or have we? Strictly taken, last year's 49 reporters in between September and December generated 49% "beats" but also 29% in "misses" so I think we can still call **February 2021 the best reporting season in Australia post-GFC.**

It can also be argued both seasons are two peas from the same pod, so to speak. Usually the percentage of beats ranges between 24% (bad) and 38% (very good).

Banks, Materials (ex-mining), Insurance and Retailers enjoyed the strongest forecast upgrades over the season. Analysts at Macquarie believe the first three will continue to benefit from improving global growth and vaccines, while retailers will face headwinds due to vaccines and spending being redirected back to services, which explains some of the hesitant share price movements post results.

On Macquarie's analysis, "true" upgrades were delivered by Nine Entertainment ((NEC)), Bendigo & Adelaide Bank ((BEN)), Suncorp ((SUN)), Treasury Wines ((TWE)), BlueScope Steel ((BSL)), JB Hi-Fi ((JBH)), Woolworths ((WOW)), Northern Star ((NST)), Wesfarmers ((WES)), Star Entertainment ((SGR)), Tabcorp Holdings ((TAH)), Vicinity Centres ((VCX)), Commbank ((CBA)), Boral ((BLD)), and Seek ((SEK)) among the ASX100 companies.

Outside the ASX100, the analysis identified Lovisa Holdings ((LOV)), Nearmap ((NEA)), Pinnacle Investment Management ((PNI)), Codan ((CDA)), Platinum Asset Management ((PTM)), Sims ((SGM)), nib Holdings ((NHF)), Pact Group ((PGH)), Seven West Media ((SWM)), ALE Property ((LEP)), Estia Health ((EHE)), Nick Scali ((NCK)), Cooper Energy ((COE)), Mayne Pharma ((MYX)), ARB Corp ((ARB)), and Wagners Holding Company ((WGN)).

I don't want to be super-mean about Wagners, but any objective observer will agree with me it hasn't been a great success since listing on the ASX. The fact this company is being nominated as one of the stand-out positive performers in February shows us all these are all but unusual circumstances.

The minor disappointment is both numbers for beats and misses looked simply spectacular throughout the opening two weeks of February. In particular the number of beats shrunk noticeably as the end of the season approached. Note to myself: companies that are ready to release not-so-fantastic results prefer to hide in the later parts of the season. Overall, however, earnings growth projections rose throughout the month (usually they fall during reporting season) with iron ore miners and banks major contributors.

The average individual target price increase was 5.64% while all 335 targets in aggregate rose by 6.29%. These are not the highest increases on record, but still high.

If it wasn't for the acceleration in bond market sell-offs (yields rallying higher), investors might have enjoyed stronger and longer-lasting share price responses to match February's above-average outcome. At the same time, it's good to remind ourselves expectations were low across the board and many businesses responded to last year's challenge by cutting back on expenses, including capex in many cases, while also enjoying extraordinary support through rent relief and the federal government's Jobkeeper program.

And while market strategists at Macquarie believe many of this season's surprises were caused by higher-than-forecast profit margins, supported by better-than-anticipated sales and revenues, the December quarter business indicators in Australia, released on Monday, revealed company profits fell sharply by -6.6% as government stimulus payments ceased.

Even though some economists had penciled in a potentially worse outcome, this extra data insight can serve as an unofficial warning this is by no means a time to allow complacency to creep in.

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

P.S. I - All paying members at FNArena are being reminded they can set an email alert for my Rudi's View stories. Go to My Alerts (top bar of the website) and tick the box in front of 'Rudi's View'. You will receive an email alert every time a new Rudi's View story has been published on the website.

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WEEKLY REPORTS

Weekly Ratings, Targets, Forecast Changes - 19-03-21

Weekly update on stockbroker recommendation, target price, and earnings forecast changes.

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 March 15 to Friday March 19, 2021
Total Upgrades: 7
Total Downgrades: 4
Net Ratings Breakdown: Buy 53.30%; Hold 38.88%; Sell 7.82%

For the week ending Friday 19 March there were seven upgrades and four downgrades to ASX-listed companies by brokers in the FNArena database.

In a relatively quiet week there were no material adjustments by brokers to company price targets.

Dalrymple Bay Infrastructure was atop the table for the largest percentage increase in earnings forecasts by brokers for the week after Citi noted two potential near-term catalysts. The first is inclusion in the ASX300 today (March 22) and also the Queensland Competition Authority is due to decide around a light-touch regulatory structure. This would allow the company to negotiate the price with miners for use of its terminal instead of having the regulator set maximum prices.

Next in terms of percentage increase to forecasts earnings was Oil Search after both Citi and UBS revised up forecast oil prices for the sector. Although UBS notes the company has the highest sensitivity to changes in the oil price, it is the broker's least preferred of the energy stocks due to few near-term catalysts.

Japara Healthcare was the only company in the FNArena database to experience a material percentage fall in forecast earnings for the week. After reviewing the final report from the Royal Commission, UBS was underwhelmed by potential delays to much needed regulatory clarity until the FY22 Budget (to be delivered in May this year).

Total Buy recommendations take up 53.3% of the total, versus 38.88% on Neutral/Hold, while Sell ratings account for the remaining 7.82%.

Upgrade

BWP TRUST ((BWP)) Upgrade to Neutral from Sell by UBS .B/H/S: 0/2/2

UBS upgrades to Neutral from Sell given the recent underperformance in the stock, while downgrading FY21 earnings estimates by -2% and FY22-25 by -4-5%.

The downgrade to estimates stems from the fact around two thirds of the leases are expiring in 2021-25 and this presents an elevated level of risk. Target is steady at $3.86.

CLOVER CORPORATION ((CLV)) Upgrade to Buy from Neutral by UBS .B/H/S: 2/0/0

UBS upgrades Clover Corp to Buy from Neutral rating with the target price dropping to $2 from $2.10.

The broker views the stock as a recovery play offering a best-of-breed product and a unique growth story despite a covid-hit weak result with revenues down -22% versus last year.

The company's FY21 revenue guidance also implies a -16-37% downgrade to UBS's second-half expectations. Even so, the broker expects a gradual recovery with FY20 revenues and net profit expected to return by FY23.

GOODMAN GROUP ((GMG)) Upgrade to Buy from Neutral by UBS .B/H/S: 6/0/0

Demand for space from tenants has accelerated amid a ramping up of development work in progress. Still, UBS notes the size of the development pipeline is still up 40% in terms of square metres.

The flexibility on the balance sheet, meanwhile, allows the business to capitalise on structural tailwinds and establish a longer-dated development strategy.

The stock is now trading at a significant discount to the broker's $18.70 target and, given the acceleration, the risk/reward is now skewed to the upside. Hence UBS upgrades to Buy from Neutral.

QANTAS AIRWAYS LIMITED ((QAN)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 5/0/1

Macquarie expects vaccine rollouts in Qantas' key international destinations to be largely completed by the end of 2021. Supported by border policies, government stimulus and the vaccine, the broker expects domestic capacity to overshoot pre-covid levels in the near term.

In the broker's view, Qantas has structurally improved the business through covid and has a higher skew towards the more attractive domestic and loyalty businesses and the cost-out which reduces downside risks within international.

The broker upgrades to Outperform from Neutral with the target rising to $6.35 from $5.05.

RIDLEY CORPORATION LIMITED ((RIC)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 1/0/0

Credit Suisse assesses Ridley is generating a reliable record of delivery on its strategy. Optimisation has started to yield benefits and the broker is also comfortable with the organic growth story. First half operating earnings were ahead of estimates, up 16.5%.

As the valuation is undemanding and there is increasing conviction in the medium-term growth profile, Credit Suisse upgrades to Outperform from Neutral and raises the target to $1.15 from 85c.

TELSTRA CORPORATION LIMITED ((TLS)) Upgrade to Buy from Accumulate by Ord Minnett .B/H/S: 3/1/1

With the national broadband network rollout affecting fixed margins, Ord Minnett notes the mobile retail sector is the most important earnings driver for Telstra Corp.

According to the broker's assessment of the market, Telstra will lose share of the prepaid market to mobile virtual network operators (MVNO). The postpaid market remains lucrative for Telstra with the company better placed given its head start in the rollout of 5G infrastructure.

Noting the company offers good subscriber growth, quality cellular service and an attractive valuation, Ord Minnett upgrades its rating to Buy from Accumulate with the target price rising to $4.05 from $3.75.

WOODSIDE PETROLEUM LIMITED ((WPL)) Upgrade to Buy from Neutral by UBS .B/H/S: 5/2/0

UBS lifts Brent oil price forecast for 2021 to US$65.50/bbl, from US$57/bbl, and 2022 to US$62/bbl from US$60/bbl.

This reflects the market's desire to price in a faster recovery in demand, along with the outcome of recent OPEC meetings where producers agreed to defer raising production.

In turn, earnings estimates raised for Woodside Petroleum and the rating is upgraded to Buy from Neutral as the risk/reward is now considered appealing, given the stock has underperformed Brent over the year to date. Target is raised to $26.70 from $26.05.

Downgrade

BORAL LIMITED ((BLD)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 3/1/0

Ord Minnett lowers the rating to Lighten from Hold as the valuation appears stretched and the company's new $300m earnings (EBIT) benefit target, tied to a transformation program, seems ambitious.

In addition, the broker highlights a risk to the US business are rising US mortgage rates, which may temper demand for housing as the year progresses.

The analyst acknowledges upside risk should the US Building Products business be sold for $1.5bn. It's considered the majority of this could be returned to shareholders. The target is increased to $5 from $4.90.

FLIGHT CENTRE LIMITED ((FLT)) Downgrade to Underweight from Equal-weight by Morgan Stanley .B/H/S: 1/3/3

Morgan Stanley notes significant momentum in recent weeks amid the announcement from the federal government of a stimulus package for the broader tourism sector.

Nevertheless, the Flight Centre stock price is now 5% ahead of pre-pandemic levels, adjusting for the capital raising.

Morgan Stanley assesses fundamental upside from this point requires the view that earnings will materially improve post the pandemic.

The broker downgrades to Underweight from Equal-weight, partially stemming from a preference for Qantas ((QAN)) within the travel coverage. Target is $17.50. Industry view: Attractive.

STOCKLAND ((SGP)) Downgrade to Neutral from Buy by UBS .B/H/S: 1/4/0

UBS assesses Stockland has benefited significantly from government policy aimed at strengthening the new residential sector as well as a structural shift from urban centres caused by the pandemic.

Nevertheless, the strength in residential markets means risks around macro prudential policy are heightened and the broker downgrades to Neutral from Buy. Target is steady at $4.50.

UBS also notes, with gearing of around 24% and momentum in residential generating strong cash flow, the balance sheet is sound.
Developments are likely to have capital partners and be long dated.

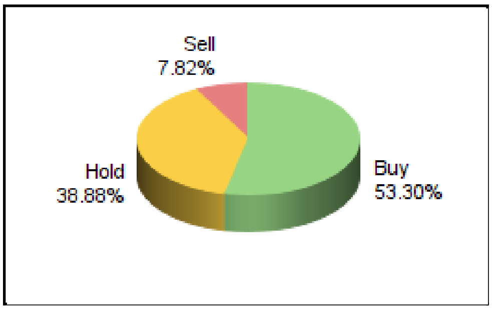
VICINITY CENTRES ((VCX)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 0/4/2

Ord Minnett downgrades Vicinity Centres to Hold from Buy with a target price of $1.80.

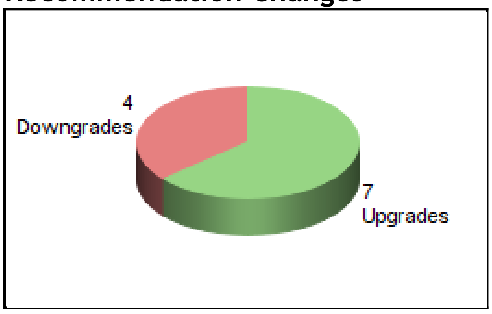
Vicinity Centres' share price has risen about 40% since October's low of $1.21 as the stock recovered from the impact of covid. Ord Minnett believes there may be a further -10% softening in Vicinity Centres' stock price.

While retail conditions are improving, Ord Minnett expects net property income to rebase -13% below pre-covid levels in 2021 due to lower footfall, particularly in the CBD assets.

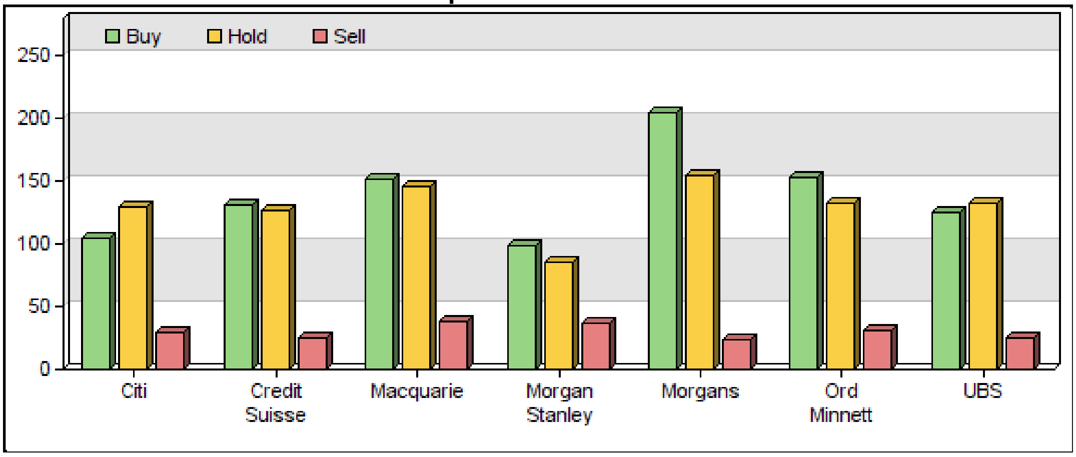
Total Recommendations



Recommendation Changes



Broker Recommendation Breakup



Broker Rating

Order	Company	New Rating	Old Rating	Broker
Upgrade				
1	BWP TRUST	Neutral	Sell	UBS
2	CLOVER CORPORATION	Buy	Neutral	UBS
3	GOODMAN GROUP	Buy	Neutral	UBS
4	QANTAS AIRWAYS LIMITED	Buy	Neutral	Macquarie
5	RIDLEY CORPORATION LIMITED	Buy	Neutral	Credit Suisse
6	TELSTRA CORPORATION LIMITED	Buy	Buy	Ord Minnett
7	WOODSIDE PETROLEUM LIMITED	Buy	Neutral	UBS
Downgrade				
8	BORAL LIMITED	Sell	Neutral	Ord Minnett
9	FLIGHT CENTRE LIMITED	Sell	Neutral	Morgan Stanley
10	STOCKLAND	Neutral	Buy	UBS
11	VICINITY CENTRES	Neutral	Buy	Ord Minnett

Recommendation

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	QAN	QANTAS AIRWAYS LIMITED	67.0%	33.0%	34.0%	6
2	BWP	BWP TRUST	-50.0%	-75.0%	25.0%	4
3	GMG	GOODMAN GROUP	100.0%	83.0%	17.0%	6
4	WPL	WOODSIDE PETROLEUM LIMITED	71.0%	57.0%	14.0%	7
5	TLS	TELSTRA CORPORATION LIMITED	40.0%	30.0%	10.0%	5
6	BKL	BLACKMORES LIMITED	-17.0%	-20.0%	3.0%	6

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	SGP	STOCKLAND	8.0%	25.0%	-17.0%	6
2	VCX	VICINITY CENTRES	-33.0%	-17.0%	-16.0%	6
3	FLT	FLIGHT CENTRE LIMITED	-29.0%	-14.0%	-15.0%	7
4	BLD	BORAL LIMITED	50.0%	60.0%	-10.0%	5
5	APA	APA GROUP	71.0%	80.0%	-9.0%	7
6	GXY	GALAXY RESOURCES LIMITED	-33.0%	-25.0%	-8.0%	6
7	SUN	SUNCORP GROUP LIMITED	43.0%	50.0%	-7.0%	7
8	JHC	JAPARA HEALTHCARE LIMITED	13.0%	17.0%	-4.0%	4

Target Price

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs

1	QAN	QANTAS AIRWAYS LIMITED	5.790	5.462	6.01%	6
2	TLS	TELSTRA CORPORATION LIMITED	3.586	3.526	1.70%	5
3	APA	APA GROUP	10.829	10.654	1.64%	7
4	VCX	VICINITY CENTRES	1.637	1.627	0.61%	6
5	WPL	WOODSIDE PETROLEUM LIMITED	27.574	27.440	0.49%	7

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	GXY	GALAXY RESOURCES LIMITED	2.417	2.550	-5.22%	6
2	SUN	SUNCORP GROUP LIMITED	11.619	11.897	-2.34%	7

Earning Forecast

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	DBI	DALRYMPLE BAY INFRASTRUCTURE LTD	8.117	6.360	27.63%	3
2	OSH	OIL SEARCH LIMITED	17.630	16.005	10.15%	7
3	WPL	WOODSIDE PETROLEUM LIMITED	167.204	157.759	5.99%	7
4	STO	SANTOS LIMITED	45.779	43.689	4.78%	7
5	SXY	SENEX ENERGY LIMITED	0.812	0.778	4.37%	6
6	KAR	KAROON ENERGY LTD	3.367	3.233	4.14%	3
7	QAN	QANTAS AIRWAYS LIMITED	-68.533	-70.650	3.00%	6
8	TPG	TPG TELECOM LIMITED	17.448	17.048	2.35%	6
9	VCX	VICINITY CENTRES	11.370	11.167	1.82%	6
10	BLD	BORAL LIMITED	22.048	21.715	1.53%	5

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	JHC	JAPARA HEALTHCARE LIMITED	-4.100	-3.800	-7.89%	4
2	APA	APA GROUP	25.160	26.220	-4.04%	7
3	GPT	GPT GROUP	30.413	30.967	-1.79%	6
4	EVN	EVOLUTION MINING LIMITED	24.871	25.300	-1.70%	7
5	NHF	NIB HOLDINGS LIMITED	29.843	30.171	-1.09%	7
6	CSL	CSL LIMITED	709.436	714.386	-0.69%	7
7	RIO	RIO TINTO LIMITED	1488.171	1496.453	-0.55%	7
8	PPH	PUSHPAY HOLDINGS LIMITED	3.591	3.609	-0.50%	3
9	S32	SOUTH32 LIMITED	13.512	13.579	-0.49%	7
10	NIC	NICKEL MINES LIMITED	11.717	11.775	-0.49%	3

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WEEKLY REPORTS

Uranium Week: Uranium Price Drivers

A jump in the weekly spot price focuses the minds of uranium participants on both short and medium-term price catalysts.

-Increasing short-term transaction volumes
-Bullish 12 month view
-Spot uranium rises over 8% to $US29.65/lb

By Mark Woodruff

The weekly spot uranium price showed renewed volatility this week, spiking 8% to US$29.65/lb.

Industry consultant TradeTech cites increased transaction volumes driven primarily by producer and investor activity as one catalyst for the **short-term** rise. When combined with cuts and reductions to primary production, there is potential for considerable influence on the uranium market.

Investor interest from funds has undergone a recent resurgence with Uranium Participation Corp (UEC) and Yellow Cake plc acting as first movers to take physical positions in the uranium market, by sequestering uranium concentrates. This may be termed a "buy and hold" strategy.

In addition, select emerging producers have supplemented this strategy with a "buy and deliver" revenue model, notes TradeTech. By way of example, Canadian-listed uranium explorer and developer Denison Mines Corp announced a deal to raise approximately US$75 million to fund the strategic purchase of physical uranium concentrates to be held by the company as a long-term investment.

In turn, this could support the potential development of Denison's 90% owned Wheeler River Project. Planned spot uranium purchases made by Denison are targeting the accumulation of approximately 2.5 million pounds U_3O_8.

When taken together, purchases by Denison, UEC, and Yellow Cake in 2021 total 7.8m lbs in a spot market that had seen approximately 15.7m lbs transacted to date this year, calculates TradeTech.

In relation to the **medium term**, investment banking and financial services company Canaccord Genuity recently held a global uranium market panel discussion that painted a very bullish outlook for the uranium market.

Discussion centred on a number of catalysts for rising prices over the next 12 months.

A structural shift to emerging nuclear power growth in Eastern Europe and Asia from a North America and Western Europe-centric past was highlighted. Of particular note is China's commitment to carbon neutrality by 2060 and an aggressive build-out of its reactor fleet to 70Gwe by 2025 as part of its 14th Five Year Plan.

Also detailed were the difficulties faced by European countries, such as Germany and France, in reducing nuclear penetration, and signs of a more supportive stance on nuclear from the Biden administration, along with a shift to bipartisan support.

As a result of climate change being at the forefront of government policy, Canaccord Genuity considers sentiment toward the uranium market has improved dramatically over the last 12 months.

The significant challenges faced by producers is clear with marginal costs well above current spot prices and an absence of long-term contracts at the prices required for economic production. Future supply is considered to look fragile with mines shutting down due to depletion and a lack of investment in new primary mine supply.

The presence of long-term contracts has masked the discord between spot prices and production costs, according to the panelists. However, this is expected to change as utilities re-enter the market in 2021 to re-contract.

With significant supply having already been removed from the market and a slow ability to respond by producers, a tighter environment than over the last decade is expected to arise.

As to why the price should start appreciating soon, it was felt utilities had reached a point where they had no choice but to again recommence large scale contracting.

Company News

The world's largest producer and seller of natural uranium, **Kazatomprom,** released financial results on March16, reporting annual production of 50.6m lbs for 2020, which was -15% lower than 2019 output, due to second quarter actions to protect employees during the pandemic.

Production guidance for 2021 is 58.5-59.3m lbs. The company also noted it may purchase material in the spot market after investor Yellow Cake plc exercised an option to purchase uranium.

ASX-listed **Paladin Energy** ((PDN)) last week announced a $218.7 capital raise. At the time of writing $192.5m had been successfully completed via an institutional placement and the institutional component of the entitlement offer. The balance of funds will be raised (also at $0.37) via a fully underwritten retail entitlement offer which opens on March 24.

The reset of capital structure delivers optionality on future funding structures to restart the Langer Heinrich uranium mine at an estimated cost of US81m, with prudent debt levels.

Uranium pricing

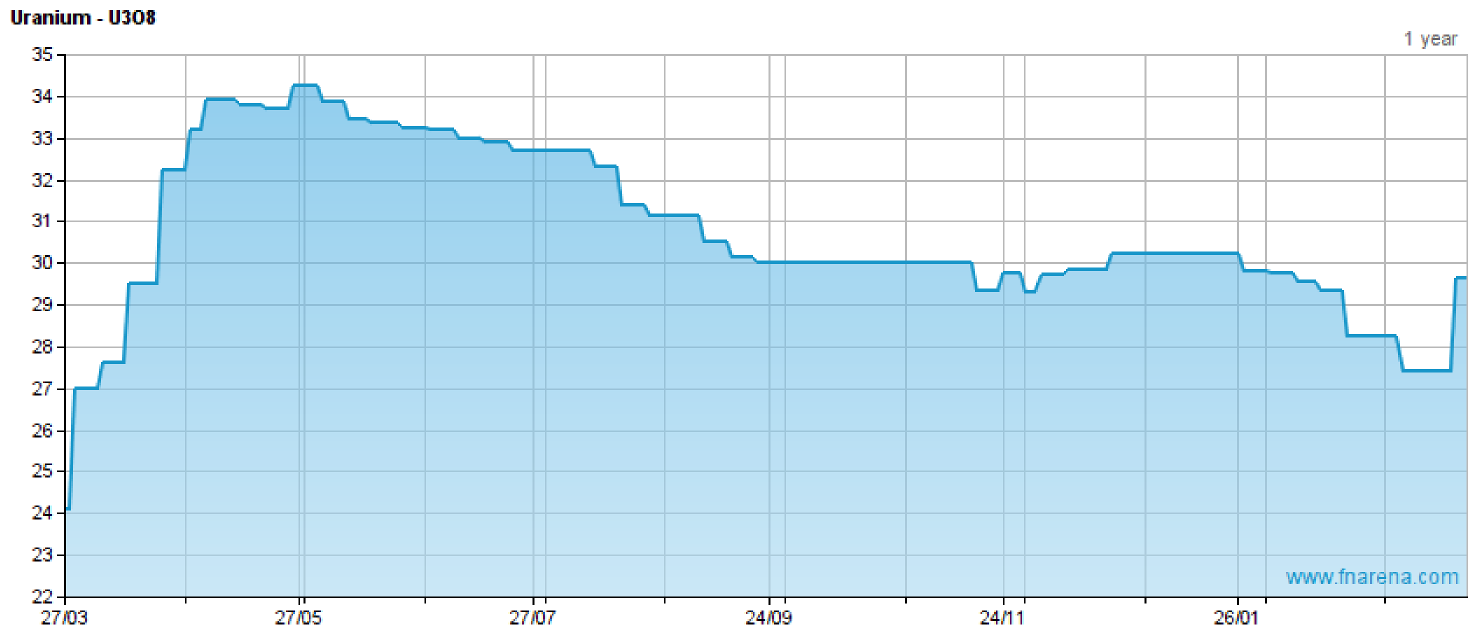
TradeTech's Weekly **Spot Price** Indicator is US29.65/lb an increase of US$2.25/lb from last week's value.

The weekly spot uranium price had exhibited limited volatility recently, steadily declining to US$27.40 from US$30.40/lb over the last ten weeks. However, this week the price showed renewed volatility, rising 8.2% on increased transaction volumes driven primarily by producer and investor activity.

The weekly spot uranium price is nearly 24% higher than a year ago and is down nearly -2.5% in 2021. The average weekly uranium spot price in 2021 is US$29.16/lb, US$0.55 below the 2020 average.

A total of approximately 3.2m lbs U3O8 was purchased during the week.

TradeTech's **term price** indicators are US$31.25/lb (mid) and US$35/lb (long).



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WEEKLY REPORTS

The Short Report - 25 Mar 2021

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

Summary:

Week ending March 18, 2021.

Whoever was slapping down the Australian stock market the week before last appeared to have stopped as last week began, allowing the ASX200 to reclaim 6800. It didn't last long though.

As saw-tooth but net-sideways action continues for the ASX200, shorters continue to retreat into their shells. Last week saw the total number of stocks shorted by 5% or more reduce by another two, leaving 20. It was not that long ago a total of over 40 was common.

If we were to take out Tassal Group ((TGR)) and Webjet ((WEB)), Australia's shorting landscape would look very benign indeed. Those two remain stubbornly atop the table nonetheless.

In last week's report I noted Tassal's stock price had been falling, with shorters responding by reducing positions to 11.5% from 13.0%. Last week they were back at 13.0% -- possibly an ASIC data blip.

The stock has since rallied sharply on insider buying (not to be confused with insider trading) but that was this week.

The only other stock to see a short position change of one percentage point or more last week was Bravura Solutions ((BVS)). Shorts in the wealth management software company rose to 7.7% from 6.6%.

Since tumbling on a weak earnings report back in February, the stock has been slowly grafting back but not in any hurry. This week the share price has dipped back after the company was relegated from the ASX200 in the quarterly reshuffle announced mid-March, which may explain the shorters' intentions.

No Movers & Shakers this week.

Weekly short positions as a percentage of market cap:

10%+
TGR 13.0
WEB 10.8

No changes

9.0-9.9

No stocks, no changes

8.0-8.9%

No stocks, no changes

7.0-7.9%

ING, FLT, BVS, RSG, MTS

In: BVS Out: MYR

6.0-6.9%

SSM, FNP, IVC, AVH, MYR, BEN, A2M

In: MYR, BEN Out: BVS

5.0-5.9%

ALK, JBH, EOS, MP1, PNV, MSB

Out: BEN, WSA, TPW

ASX20 Short Positions (%)

Code	Last Week	Week Before	Code	Last Week	Week Before
ALL	0.2	0.1	MQG	0.7	0.7
ANZ	1.1	1.0	NAB	1.2	1.2
APT	1.4	1.3	NCM	0.4	0.4
BHP	3.7	3.6	RIO	0.3	0.3
BXB	0.2	0.2	TCL	0.7	0.7
CBA	0.7	0.6	TLS	0.3	0.3
COL	0.2	0.3	WBC	0.9	1.0
CSL	0.2	0.2	WES	0.5	0.5
FMG	0.6	0.5	WOW	0.3	0.3
GMG	0.2	0.2	WPL	0.8	0.8

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: APRA Tightening, REITs, Rain, Banks

Weekly Broker Wrap: Macroprudential measures questioned; Stockland stands out, SME's are luddites, Ag sector boost, bank headwinds, Qantas, online real estate

-Jarden: Previous macroprudential measures will be ineffective
-Stockland is the standout REIT
-Bumper crops for Ag sector
-Banks shed superior return on equity profile

By Mark Story

Macroprudential tightening: Previous measures won't work

Having concluded that APRA's (Australian Prudential Regulation Authority) previous macroprudential measures aimed at cooling surging house prices – including limits on investor and interest only lending - would likely be ineffective in the current environment, Jarden thinks the bank regulator has four options to tighten macroprudential policy.

Firstly, the broker believes APRA could mirror the Reserve Bank of NZ, and place limits on the share of high loan-to-value ratio (LVR) lending, plus limits on the share of high loan-to-income and debt-to-income (DTI) lending.

Two other measures APRA may wish to deploy, adds Jarden, include increasing the loan serviceability buffer from 2.5%, and increasing the counter-cyclical capital buffer (CCyB) from 0%.

While limits on higher LVR lending are arguably the most conventional choice, Jarden believes this would go against the government's own First Home Loan Deposit Scheme which specifically facilitates higher LVR lending.

As a result, the broker thinks the most likely option would be a limit on very high (greater than 6x) DTI lending, potentially limiting them to 20% of new loans.

But if APRA was less concerned about the proliferation of specific higher risk lending, yet wanted to simply moderate house price/lending growth, it could instead, adds Jarden, implement a modest increase in the countercyclical capital buffer.

Jarden notes APRA has previously flagged the likelihood of a non-zero default level in the future for the CCyB to bolster the resilience of the banking sector during periods of heightened systemic risk.

There are five tell-tale indicators Jarden suggests watching to track high risk lending, and the risk of macroprudential tightening.

The first of these is investor credit growth - currently 0.1% year-on-year (YoY), and well below the prior 10% YoY cap. Then there are Interest only (IO) loans which have increased to 20%, but remain below the 30% cap.

After declining from 2012, the share of higher LVRs (greater than 80%) has increased since 2018, with the share of very high LVRs (great than 90%) increasing by 2% since end-2019.

Similarly, while share of very high loan-to-Income (LTI) lending (greater than 6x) has increased from 5% to 7% in two years, it remains below the 10% share prior to 2017.

While the share of very high (greater than 6x) DTI lending has increased from 15% to 17%, Jarden think APRA would likely become concerned if this approached 20%.

Despite the modest rise in higher risk lending, Jarden still regards macroprudential tightening as unlikely till late-2021 at the earliest.

But were APRA to implement effective macroprudential tightening, the broker thinks it would likely see growth in both loans and house prices moderate and be a marginal negative for housing-exposed sectors; in particular banks, consumer discretionary, residential developers and building materials.

Retail property: Stockland looks best placed to recover

Having analysed the local economy for each postcode within which retail REITs (under its coverage) operate, Morgan Stanley believes it has a rough feel for how each shopping centre is positioned for recovery post JobKeeper cessation.

Originally, all qualifying businesses were paid $1,500 per fortnight per eligible employee, reducing to $1,200 per fortnight from 28 Sept 2020. For the period January 2021 to 28 March 2021, the rate dropped to $1,000 per fortnight per employee (assuming 20hrs+ work per week).

While Morgan Stanley admits its analysis isn't perfect, the broker’s work simply indicates how businesses located in the same postcodes as the 150 shopping centres under coverage are performing, relative to the qualification for JobKeeper handouts.

With JobKeeper handouts due to be wound up at the end of this week, the broker asserts that the best retail portfolio may be the one with assets located in areas where JobKeeper applications have declined the most. What this could signal is that local businesses in the region have generally improved to the point where turnover has trended towards pre-Covid levels.

Based on Morgan Stanley’s analysis, Stockland ((SGP)) looks the best placed retail REIT relative to peers, for recovery once JobKeeper ends completely .The broker’s work also supports the perception that Vicinity Centres' ((VCX)) Melbourne bias means its portfolio is the worst positioned to recover.

The number of merchants seeking handouts in the postcodes where Stockland has shopping malls dropped by around -52% over nine months to December 2020. By comparison, JobKeeper applications only fell -15% across Vicinity Centres Victorian postcodes, over the same nine month period.

Morgan Stanley suspects considerably lower JobKeeper fallout experienced by Vicinity Centres' Victorian postcodes reflects the impact the extended lockdowns have had on businesses, with Victoria comprising around 45% of Vicinity Centres' portfolio.

SMEs: Lost in the 50s

CPA Australia’s recently published Asia-Pacific Small Business Survey reveals Australian small businesses (SMEs) as less likely to invest in, use, earn from or offer customers the use of digital technologies than their Asia-Pacific counterparts.

After surveying 4,227 businesses across 11 markets, CPA data identified Australia’s SMEs as least likely to: Begin or increase online sales during COVID-19; use social media for business; invest in technology in 2020; profit from their investment in technology, and review cyber-security in past six months.

Australian SMEs were also the second least likely to earn revenue from online sales and third least likely to offer customers the choice of digital payment technologies.

While Australian SMEs recorded the lowest result (8.3%) when it came to adding employees, slightly over a fifth, (22.3%) grew their businesses last year – the second lowest result of any market surveyed.

Despite the impact of covid, 36.1% of Australian small businesses reported making no "major change" in response to the pandemic, the highest result of any market surveyed. Nor did they access government support, negotiate rent reductions or loan holidays, delay taxation payments or reduce capital expenditure.

Australian SMEs expect to fare better in 2021, however, they may still underperform other Asia-Pacific businesses. For example, only 41.4% of Australian SMEs expect to grow this year compared with the survey average of 60.8%. Meantime, 13% expect to increase employees numbers, compared with the survey average of 35%.

Only 6.7% of Australian small businesses stated they will introduce a product, process or service that is unique to their market or the world in 2021, compared with 23% in other markets.

Extreme rainfall: Bumper crop production predicted

Improved soil moisture content levels for the inland farming regions, notably in NSW, Queensland and Victoria following recent rainfall, after being significantly impacted by drought over the past three years, is expected to underpin a solid agriculture recovery. Equally encouraging, significant rainfall has been observed across the coastal regions of NSW over the past week.

As a result, agriculture industry body ABARES is forecasting a 27% increase in planted hectares in Australia in FY21. Improved agriculture conditions have also coincided with a significant increase in key soft commodity prices, which together have driven a rapid improvement in farmer economics and sentiment.

UBS highlights wheat prices, which make up around 60% of Australian crop production, are up circa 50% versus last year.

Underpinned by the strengthening outlook for international fertiliser prices (DAP and Ammonia), plus improving conditions for the company's domestic fertiliser distribution business, UBS has a Buy-rating on Incitec Pivot ((IPL)) and a target price of $2.85.

The broker is forecasting Incitec Pivot to deliver FY21 earnings (EBITDA) of $70m, up 111% versus the weather-affected previous period. However, UBS notes key risks, which include shifts in global commodity prices, the ability to source economic gas feedstock, foreign exchange volatility, mining sector customer concentration risk, adverse weather patterns impacting mining/agricultural activity, and changes to ammonium nitrate market supply/demand balances.

UBS also has a Buy-rating on Nufarm ((NUF)) - target price of $5.70 - where recovering agriculture conditions, reversal of cyclical input cost pressures and the re-basing of the group's cost base are driving a significant earnings recovery. UBS has factored in Nufarm's exposure to volatile agriculture markets with the broker's use of an elevated cost of equity at 10% versus 7% market cost of equity.

Risks highlighted by UBS include a potential glyphosate litigation, adverse weather across key regions of North America, Europe and Australia, foreign exchange volatility, shifts in global soft commodity prices, and general global economic downturn risks.

<u>Australian banks: Margin headwinds</u>

Having hit a sweet spot in 2021, the Big Four banks are expected to benefit from lower funding costs of between -16 and -22bps. However, Macquarie expects margins to be broadly flat (-2bps to 2bps) in 1H21 and resume their modest decline in later periods.

Macquarie attributes pressure on margins to headwinds and pressures on the lending side as banks compete more aggressively for new business.

While stretched valuations and longer-term headwinds make it difficult to be bullish, Macquarie recognises the relative appeal of banks in the current environment. However, the broker suspects well-known headwinds, namely, impact of lower rates and impact of asset price competition have been underestimated by the consensus expectations.

The broker believes the 42% premium Australian banks are trading at versus global banks (18%) is no longer justifiable given a superior return on equity (ROE) profile has largely disappeared. Macquarie retains a Neutral sector view but has switched preference for the regionals over the majors, due to greater leveraged to improving deposit pricing.

Macquarie has upgraded its recommendation on Bendigo & Adelaide Bank ((BEN)) to Outperform, which along with ANZ Bank ((ANZ)) are the broker's two preferred exposures. Underpinned by higher operating leverage, the broker believes ANZ continues to offer more upside than peers on a relative basis.

Following recent underperformance, Commonwealth Bank ((CBA)) has been upgraded to Neutral from Underperform, while Macquarie has downgraded Westpac ((WBC)) to Neutral from Outperform following its re-rating. Macquarie retains a Neutral recommendation on National Australia Bank ((NAB)) which appears fully valued at current levels.

Macquarie has upgrade earnings across the Big Four by around 1-2%, while upgrades for the regionals are more significant, up to 17%.

Due to the differences in banks' starting points, the broker expects headline margin benefits are more significant for CommBank and Westpac, while the impact on earnings is biggest for Westpac, followed by ANZ and NAB, with CommBank deriving the smallest uplift.

The broker remains restricted on Bank of Queensland ((BOQ)), with earnings changes driven by incorporating the completed equity raising, the acquisition of ME Bank, and management-disclosed synergies.

Macquarie forecasting earnings per share (EPS) changes of -11%, 13%, and 17% in FY21, FY22, and FY23 respectively. The broker also expects all banks to lift their dividends in FY21 and FY22, and is forecasting dividend yields of around 4-5%.

Airlines: Qantas leveraged to aviation recovery

Based on The Bureau of Infrastructure, Transport and Regional Economics' (BITRE) domestic airfare data for March 2021, the 'best discount" fares declined by -23% year-on-year (yoy), while 'Restricted Economy' declined by -18% yoy.

Goldman Sachs highlights volatility of fares as a key characteristic over the past six months, with airlines continually adjusting fares to fill scheduled capacity amid uncertainty around state borders remaining open. This uncertainty saw consumers defer travel and the 'cheapest available' airfare prices declined -13.8% yoy with declines experienced across most routes.

However, through the past six months airlines have been relatively proactive in restricting capacity to accommodate lower demand for travel, and reducing discounts on airfares to manage profitability. On a full year to date basis, prices remain up 1.9% yoy.

Goldman Sachs notes increases on the Canberra-Melbourne (up 63% yoy); Melbourne-Perth (up 54% yoy) and Perth-Sydney (up 41% yoy) routes, which the broker believes highlights the inelasticity of government and resource sector led demand.

As border restrictions are relaxed and as airlines increase scheduled capacity ahead of the April holiday period, Goldman Sachs sees growing need for the carriers to increase discounting to incentivise travel (in particular leisure).

Based on its leveraged exposure to the aviation recovery trade, the broker reiterates a Buy rating on Qantas ((QAN)) with a 12-month target price of $6.38. While average ticket prices are falling, Macquarie notes that a greater proportion of this travel is being taken on leisure routes and for Qantas, expects greater penetration of the low-cost Jetstar brand.

Goldman Sachs regards Qantas a strong recovery investment with Qantas/Jetstar brands forecasting capacity to return to around 80%-100% of pre-covid levels during the upcoming April holiday period.

Online real estate portals: REA to outperform Domain

Having reviewed its investment theses for the two listed online real estate portals, REA Group ((REA)) and Domain Holdings Australia ((DHG)), Macquarie has upgraded the former to Outperform from Neutral, while the latter has been downgraded to Neutral from Outperform.

Underpinning Macquarie's investment thesis on REA is a mix-shift opportunity into the medium term; higher quality business with greater audience/network effect; and valuation spread between REA and Domain which is at an historical low. The broker believes REA has greater pricing power given its market leading position, and notes that its 115 million monthly visits to its website and apps represent around 3.3 times that of Domain.

To reflect higher mix-shift, Macquarie is forecasting REA to deliver earnings per share (EPS) growth in FY21, FY22, and FY23 of 2.6%, 6.7%, and 10.9% respectively, and has lifted its price target 8.7% to $171.70 from $158.00.

Despite strong revenue and earnings (EBITDA) growth from the residential cycle, what underpins the broker's downgrade for Domain is relatively softer yield growth.

While Domain has been successful at closing the listings inventory gap with REA over the last few years, Macquarie notes that the audience differential remains material with 7.1 million unique digital audience as at November 2020 (compared with REA's 12.3m).

To reflect slightly softer mix shift growth, Macquarie is forecasting Domain to deliver EPS growth for FY21, FY22, and FY23 of -4.4%, -4.9%, and -4.6% respectively, and has cut the target price by -26% to $4.33 from $5.81.

After surveying around 1,000 agents nationally to understand key motivations behind using each platform, Macquarie found that while 78% of agents use both platforms, 81% indicated they would use REA if they had a choice of only one platform.

The broker believes REA can lift prices higher due to a larger audience and incentive to capture a larger share of marketing budgets. While REA has a unique audience of 12.3m, 1.7x that of Domain's 7.1m, Macquarie notes similar trends for other ratios such as time on site, app downloads, app openings, and site visits (2.5x in last six months).

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RUDI'S VIEWS

Rudi's View: Investing In 2021 - The World Upside Down

In this week's Weekly Insights:

-Banks: Bonds & Yields Versus Targets & Valuations
-Investing In 2021: The World Upside Down
-Pharma & Biotechs in February
-FNArena Talks
-Conviction Calls

By Rudi Filapek-Vandyck, Editor FNArena

Banks: Bonds & Yields Versus Targets & Valuations

My update on Australian banks last week elicited a few questions from subscribers which can be split in two:

-why are banks back in favour when their businesses haven't genuinely changed much?
-are banks truly 'expensive', even if we ignore the fact that analysts' price targets can move higher later in the year?

My combined responses to these questions:

It does make a humongous difference whether banks are facing a recessionary environment or, as is the case in 2021, the tailwinds of an economic recovery.

In addition, the pricing of the bond market makes it infinitely easier for banks to lift their profit margin on loans. Specifically, when short-dated bond yields are near zero and longer-dated bonds are rising, approaching 2%, this makes making money from lending money a lot easier than when everything is priced within a narrow range.

Not surprisingly, rising bond yields have triggered a repricing of equities. Banks, previously "cheaply" priced being local and international share market laggards, have thus benefited from a re-rating. History shows cyclicals, including banks, enjoy their moment in the sun when the economic recession is in the rearview mirror.

This is because share markets are always forward looking. They don't care where profits and dividends come from (low base?) but focus solely on where both are heading. Markets also do not necessarily care about what comes next. Though it would appear the sector locally can now potentially look forward to 2-3 years of unexpected buoyancy after 5.5 years of (mostly) hardship.

It is the latter prospect that currently feeds into forecasts of higher dividends, plus extras, for the years ahead. Admittedly, if banks do not use this period to restructure and re-align with the many challenges that lay ahead, as I am sure many companies are not, then they will be facing the same quagmire all over again in a few years' time.

Thus far, however, one can only conclude banks in Australia are trying to reinvent themselves to stay relevant in the New Age of disruption and technology. Witness how they are all selling off low yielding operations (asset management, insurance, etc) while investing in areas such as BNPL, while also seeking out younger and more flexible partners in business.

On top of all of the above comes the sharp difference in property market dynamics throughout Australia today, which cannot be underestimated in terms of how beneficial this is for the banks (and other parts of the Australian economy).

Inside a general context of rising bond yields and -potentially- an environment of higher inflation, it makes perfect sense for Australian banks to regain favour with investors. Financial reports and quarterly updates from the sector in February have vindicated the market's newfound obsession.

With so many SMSFs and retirees continuing on the lookout for yield and income, it must also be noted forward dividend yields are again approaching 5% (4.5% for Commbank ((CBA)); this remains attractive for many.

But, as per always, banks are not without risk. Any interruption or slowing down in the economic healing process will weigh down share prices. And, of course, banks are still being penalised for breaching laws and all kinds of malpractices, while local authorities are no doubt working towards taming the animal spirits that currently push up house prices throughout Australia.

When it comes to putting a "valuation" on the sector...

While forward looking price-earnings ratios (PEs) might occasionally prove too optimistic, in particular at negative turning points, backward looking PEs don't tell you anything about the future.

Pick your poison.

In the current context in which banking operations are recovering from last year's short though deep recession, I'd easily say last year's PEs are next to useless. You wouldn't calculate dividend yield from last year's payout, so why do it for EPS growth?

As I always try to emphasise: context is important.

Historically, a sector PE range of between 9x and 15x has long been a reliable guide, with 9x the bottom during recessions and bear markets and 15x the top during the boom years.

Boom years usually see PE ratios between 13-15x. Bear markets are characterised by 9-11x. This places the long term average at around 12.5x with the added observation that banks very, very seldom trade on the long term average PE.

Firstly, to avoid all miscommunication, these PEs are forward looking, not backwards. In the current set-up, three of the Big Four are trading within the historical range while CommBank, traditionally at a sector premium, is trading outside of the range.

An important factor to add here is the PE range does not account for the relative yield the sector offers compared with REITs, other yield providers, and bond market yields. Forward looking, three banks are back on implied dividends of 5%-ish (plus franking) while the market average is circa 4.5%, with CommBank shares trading around the average.

These yields, however, do not account for the additional cash that will probably flow into shareholders coffers in the two years forthcoming.

I think the above suggests that on ex-yield measurement, banks look fairly fully valued. In line with this assessment, bank share prices have been retreating for the past week or so. Measured by the yield, however, it can be argued banks are merely fairly valued, but certainly not overly expensive looking.

My market sentiment indicator (see last week's Weekly Insights) is based upon share prices versus price targets, which in essence measures bank share prices with where sector analysts believe they should be in 6-12 months from today. On this basis, share prices seem due for a pause, at the very least, and this too feeds into the retreat in prices we are witnessing.

I do think banks have the ability to report strong financials during the upcoming bank sector reporting season, which might lead to increased valuations and thus higher price targets, maybe even higher dividend forecasts. The latter, however, is still multiple weeks away, and in the meantime market sentiment is all about economic data and bond market movements.

One additional consideration is that inside the traditional 9-15x PE range it was usually the case that CommBank, the sector leader, would reach the top of the range, maybe slightly exceed it, with the others following at a distance. In the current context, two of the three other major banks are near the top of the PE range, while CommBank shares are trading well outside of the range.

This in itself suggests a higher sector valuation than traditionally has been the case, which also translates into fuller rather than fairer valuations for local bank shares. Share prices in general are trading on higher valuations during times of low bond yields and low inflation. At present, the banks are not an exception. Also note, share prices still are below the levels seen pre-covid. They are well off from the peak reached in April 2015.

In general terms, I would conclude banks seem well-priced in the short term, but they should be able to rise to higher share price levels over the medium term.

The importance of the above is dependent on one's horizon and specific strategy.

For more insights on the outlook for local banks, I strongly recommend:

https://www.fnarena.com/index.php/2021/03/19/australian-banks-strong-tailwinds/

Investing In 2021: The World Upside Down

Last week I presented to members of Gold Coast Retirees on how much market dynamics have changed for investors in 2021. We can all blame (or thank) the bond market for that.

Paying subscribers can access and download the Powerpoint slides I used via the **SPECIAL REPORTS** section on the website, which also includes the bonus reports that come with a paid subscription (6 or 12 months). A video recording is available via FNArena Talks (see also further below).

Below is a brief summation of the key topics I touched upon, with the occasional slide included.

One of the stand-out observations that preceded late last year's global recovery momentum switch in equities is that the relative valuation gap between Winners and Laggards had never been as wide as during the emergence of covid.

Pre-pandemic it had already become widespread public knowledge that investors had fallen in love with the New Economy growth stocks, which also included local healthcare stocks such as CSL, ResMed and Nanosonics, but when the covid bear market arrived that relative gap between loved and unloved parts of the market simply blew out further to a level probably never before witnessed in the history of share markets.

Data analysis by Morgan Stanley (see chart above) takes the gap between Value (Laggards) and Growth (popular Winners) to an extreme that puts the dotcom era of the late 1990s deep in the shade. This situation had to correct -sometime, somehow, somewhere- and markets found a trigger with the arrival of vaccines, foreboding the ability to revert back to "normal" (sort of), while bond markets soon followed as the logical back-up for market optimism about a better future ahead.

It is not too difficult to see why your typical value-investor gets extremely excited when looking at this type of research. Imagine the further potential for value-laggards to outperform were this gap to revert back to its historical equilibrium!

The offsetting, alternative view remains that economies will continue to transform over the decade(s) ahead and the current five-month long resurgence of cyclicals and many an old economy stock is simply a correction in a trend that had overstretched itself too far. Fact remains, the bond market is likely to decide for how long this trend-correction might last, potentially also how far this trend might correct.

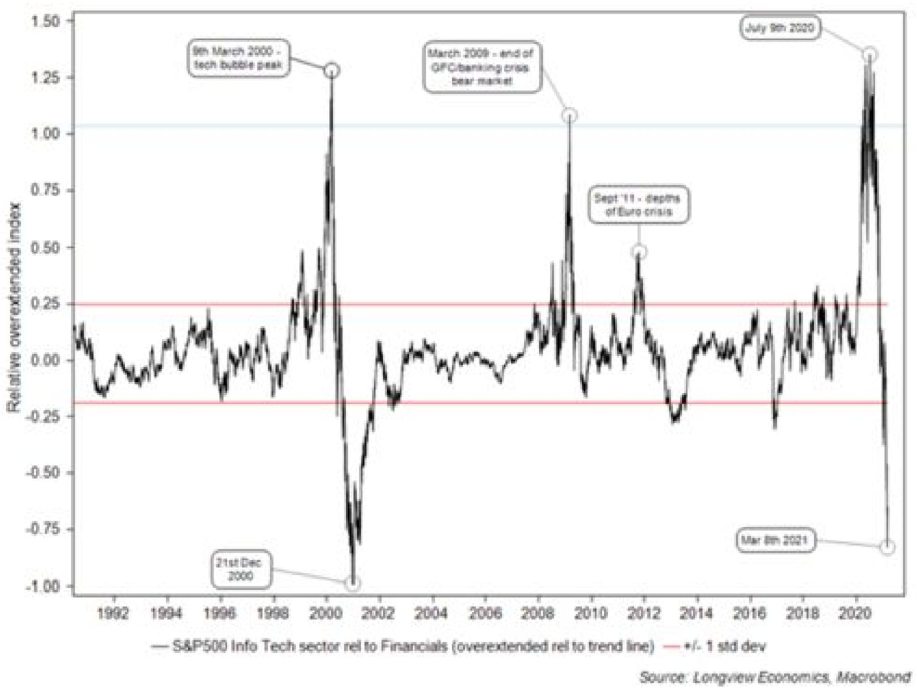
But relying on the bond market is a two-edged sword: if bonds keep selling off, and thus yields continue to rise, this will eventually trigger a major correction for equities in general. Under such a scenario it may well be this relative gap closes further as banks and cyclicals weaken less than growth stocks trading on higher valuations, but that's not exactly considered an ideal scenario by most.

For good measure: bond yields can rise to higher levels, of course, and they've at times done exactly that, but it cannot happen at breakneck speed. As I always say: compare with crude oil markets. Too strong too fast triggers a recession, and the impact from a fast running bond market will be equally pronounced.

When it comes to picking Winners and Losers from rising bond yields, most research, backed up by historical data analysis, shows financials (not just banks) in various shapes and forms are the key Winners, as well as Energy companies. While the technology sector (again: in various variations) can be reliably identified as the prime loser.

Gold is a major loser too, though it is virtually never mentioned in this context (except, increasingly, this year), probably because history shows multiple drivers and it is not always easy to establish which driver outweighs others or loses its influence, temporarily or otherwise.

Comparing banks versus technology stocks over the past thirty or so years provides us with a rather fascinating insight; one that suggests by mid-last year market momentum had swung too far in favour of technology, but this situation has been corrected in a brutal and violent manner, with the momentum monitor below (compiled by Longview Economics) now suggesting momentum in favour of banks has, for the time being, swung too far.



Incidentally, the effects from the swing in market momentum out of last year's Winners has nowhere been as strong and pronounced as on the ASX. We can all create our own little narrative around why this is the case, but holding on to technology, staples and healthcare stocks has been multiple times more damaging than in overseas markets, including Emerging Markets.

Another intriguing observation is the large gap between central bank statements and policies and what bond markets are pricing in. There is no grey zone here. Either central banks will change course, or bonds must give up part of what has been gained over the past half year. My five cents is that bond markets are running ahead of themselves, and I am far from the only one with this view, but supply chains the world around have been disrupted and businesses cannot source sufficient materials to satisfy consumer demand.

Inflation is coming.

The global debate is not whether this is the case or not. It's about whether the coming spike in inflation will prove nothing but a temporary phenomenon, see supply chains and unexpected strong consumer demand, or whether we truly are experiencing the start of a new era in which inflation makes a come-back when governments and central banks are still stimulating economies.

Most of us are too young to remember what investing was like in the 1970s and the early 1980s. This, by no means, implies we should start treating the pre-Volcker years as the natural reference period for the years ahead. On contrary, the global economy has changed dramatically since then. Economics is not an exact science. We are still trying to understand why exactly inflation has been as low as it has been in years past. It remains possible, of course, inflation might make a come-back and it surprises us all, including financial markets and central bankers, but that's not a scenario most of us are pining for.

No, seriously, we most definitely are not.

Other identifiable dividers for the share market this year are the strong Aussie dollar, benefiting domestic oriented cyclicals rather than international success stories, and the prospect of re-opening borders which keeps a bid under travel and leisure-oriented franchises rather than covid-beneficiaries, including Fisher & Paykel Healthcare, Goodman Group, and Woolworths.

One straightforward reason as to why share price movements have been so erratic and unpredictable, even seemingly illogical in the first three months of calendar year 2021 is because all of the above mentioned influences do not necessarily move in tandem. On some days the AUD might weaken while bond yields strengthen. On other days a third wave is announced while the currency firms along with the price of oil.

One observation has remained intact and that is asset prices are far from cheaply priced. While history suggests this is what one should expect, given the broader context of low yields and low inflation, there is always at least a little bit of doubt in every investor's mind: what if this truly is a bubble, and we cannot see it because we're in the middle of it?

-Powerpoint slides: see Special Reports on the website
-Video: see FNArena Talks on the website

Pharma & Biotechs in February

With apologies for the delay as IIR's latest sector update was supposed to be included in last week's Weekly Insights. Instead, the full report can be downloaded this week:

https://www.fnarena.com/downloadfile.php?p=w&n=6CA70EF1-9E37-C978-3D1C6958158F4C44

FNArena Talks

As mentioned above, last week I presented views and insights about bonds, equity markets and investing to Gold Coast Retirees.

That presentation is now available to everyone with an appetite for circa 50 minutes of graphics and slides with the occasional quip in between:

https://www.fnarena.com/index.php/fnarena-talks/2021/03/18/investing-in-2021-world-upside-down/

Conviction Calls

Bond yields continue to focus on higher levels and in the share market this means investors will continue to favour Value over Growth, with an emphasis on companies that benefit from higher inflation.

Stockpickers at **Wilsons** have specifically crunched the numbers to find beneficiaries outside the ASX50, while also providing investors with one stern warning: avoid bad quality.

After adding in factors such as recent changes in market forecasts, analyst recommendations and short positions, Wilsons' short list of stocks to benefit from current market momentum includes Adairs ((ADH)), Champion Iron ((CIA)), Nick Scali ((NCK)), Sky City Entertainment ((SKC)), Super Retail ((SUL)), Pact Group ((PGH)), and oOh!media ((OML)).

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While bond market volatility is disconcerting, the move up in (depressed) bond yields is a positive signal around economic growth, which is ultimately positive for markets, assures stockbroker **Morgans**.

Recent updates on Model Portfolios revealed a strong performance by Cleanaway Waste Management ((CWY)) has led to the Balanced Model Portfolio waving goodbye and instead loading up on Suncorp ((SUN)).

The Growth Model Portfolio, on the other hand, has sold out of Orica ((ORI)) following more disappointment from the company and instead decided to buy Hub24 ((HUB)) and more of ALS Ltd ((ALQ)).

(This story was written on Monday 22nd March, 2021. 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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In addition, since FNArena runs a Model Portfolio based upon my research on All-Weather Performers it is more than likely that stocks mentioned are included in this Model Portfolio. For all questions about this: info@fnarena.com or via the direct messaging system on the website).

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