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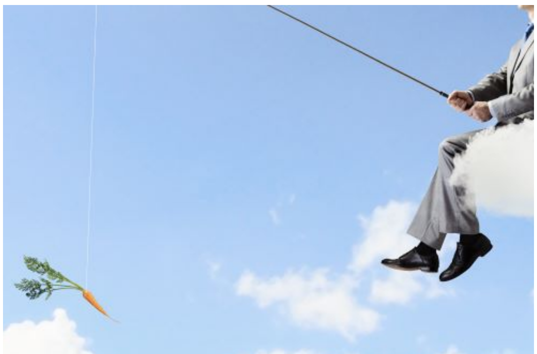

Rudi's View: The Market Has A Carrot

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INTERNATIONAL

Why Sell Great Businesses For The Mediocre?

By Bob Desmond, CFA, Head of Claremont Global & Portfolio Manager

Within the last 12 months the market narrative has switched from fears of deflation to concerns of inflation.

This narrative is often coupled with the forecast that “value” is likely to outperform “growth”. In this article, I discuss why rather than focusing on economic predictions, or market themes such as value or growth, we prefer to focus our efforts on a concentrated portfolio of 10-15 high quality companies whose earnings are likely to be materially higher in 5-10 years and whose current price should allow the fund to meet its long-term return objectives of returning 8-12 per cent per annum (p.a) ? regardless of what economic outcome prevails.

Let’s start with the inflation/deflation question.

Those arguing that inflation is on the way like to point to the following factors - a rapidly growing money supply, artificially low interest rates, growing budget deficits, wage pressures and rising commodity prices. It makes for a pretty convincing argument.

However, when I talk to the deflationists, they like to point to ageing demographics, record debt levels and the ever-present deflationary forces coming from technology. They also note that after the global financial crisis (GFC) the same narrative that quantitative easing (QE) and high commodity prices would lead to inflation, has so far been wrong.

Those arguing for inflation will point to the Austrian economists and the experience of the 1970s, while the deflationists will point to Japan and more recently the period following the GFC.

To be honest, I find both camps make reasonable arguments. This is why, when asked by clients, my answer is quite simply “I don’t know”. Experience over many years has taught me that things the “experts” tell us are “obvious”, often don’t come to pass.

Below I list some “obvious” events that never came to be.

One. In the late 1980s it was “obvious” Japan would come to dominate the global economy, just before they entered a 30-year period of relative economic decline.

Two. The stock market crash of 1987 that would usher in what some people thought was a new “Great Depression”. In reality, share indices were up in that year and the economy did not experience a recession for another three years.

Three. The GFC that would lead to a new “Great Depression” and a lost decade. In reality, the US achieved record low unemployment of 3.5 per cent in 2019 and the stock market is up over six times from its 2008 lows.

Four. The exit of Greece from the Eurozone and the impending collapse of the Euro in 2012.

Five. The collapse in oil prices by over 60 per cent in 2014, when “experts”, including the Federal Reserve, said oil would remain above $100 per barrel indefinitely.

Six. Less than one third of the “expert” pollsters actually predicted Brexit.

Seven. Only two major polls predicted that Trump would win the US Presidential Election in 2016 and ? even if you got that forecast right ? who then predicted that the market would rise by 14 per cent p.a. during his Presidency? As an aside, I also remember the narrative ? very similar to now ? that Trump would spend large amounts on infrastructure and reduce the market dominance enjoyed by the large technology companies. This actually provided a very nice buying opportunity for large cap technology.

Eight. In 2008 I did not see one single economic forecast that suggested in 2021 we would have negative yielding bonds, double-digit budget deficits and people talking about modern monetary theory (MMT).

Nine. The “experts” at the Treasury who forecast that COVID-19 would see the Australian economy shrink by

20 per cent, only to see output at a new record high in Q1.

The legendary Ben Graham was not one for economic or market forecasts:

> *"I have never specialised in economic forecasting or market forecasting either. My own business has largely been based on the principle that if you can make your results independent of any views as to the future, you are that much better off."*

Like Ben Graham, our investment process is totally devoid of any economic or market forecasts. You will not see our daily investment meetings start with an analysis of the latest musings from the Federal Reserve or the latest production numbers from China. It is not to say we don't read newspapers and have our own personal views, but we deliberately exclude projections about the economy, markets, themes or sector "bets".

Focus on quality companies

We control our overall risk through the quality of our portfolio companies. Rather than forecasting economics or markets, we simply prefer to focus on earnings power, balance sheet strength and sustainable competitive advantage.

To look forward, we always start by looking backwards, and our first point-of-call is to analyse how our businesses have fared in tough times – the GFC usually provides an excellent case study. Not one of our companies got into any form of financial difficulty, was forced to cut its dividend, or raise emergency capital.

Over the last decade, the average earnings growth of the companies in the portfolio has been 12 per cent p.a. and across the portfolio, the weighted debt/EBITDA is 0.5x.

As to sustainable competitive advantage, the operating margin across our portfolio is 25 per cent ? nearly two times the average US-listed business, and the average age of companies in the portfolio is over 80 years, with the oldest dating back to 1866. This does suggest some form of sustainable competitive advantage and resilience!

As a result, this financial resilience and earnings power allows us to be confident that our companies are well placed to weather the inevitable adverse economic events when they occur. Knowing this, we are free to spend our time looking for companies with long-term sustainable competitive advantage and earnings power, rather than trying to forecast how economies and markets will affect the short-term cyclical prospects of what we own.

Growth versus value

And as for all the talk about buying traditional, beaten down "value" stocks? For argument's sake, let's assume the "experts" crystal ball is in good order ? should we switch from "growth to value"? What does this actually mean in practice?

Well, first of all, we would be forced to sell a portfolio of competitively advantaged businesses (and pay a lot of tax and brokerage) to put together a portfolio that had exposure to banks, oils and other more cyclical businesses. This collection of businesses would have lower margins, higher balance sheet leverage and reduced long-term earnings power.

An alphabetical perspective

To take it one step further, let's assume you owned all of Alphabet (the parent company of Google) – would you really be happy to sell a business currently growing revenue at over 20 per cent, with over 90 per cent market share, a rapidly growing Cloud business and net cash of $120 billion?

Would you really be happy to buy a collection of European banks, where instead of net cash, your equity is leveraged 10+ times; you have limited visibility of the loan or derivatives books and decreasing confidence in times of stress; your profits are at the whim of Central Bank interest rate policy experiments; and where capital allocation is also determined by the same regulatory authorities, bearing in mind banks were required to suspend dividend payments by the European Central Bank during the COVID-19 pandemic.

Alternatively, would you really be happy to sell your dominant search engine monopoly to buy an oil business, whose profits are determined by a volatile commodity price input ? and in the long-term may potentially become extinct owing to new technology or inadequate reserve replacement. Any rational business owner would tell you this makes no sense at all!

> *To put this in terms most Australians can understand – this is like selling the Vaucluse mansion with harbour views to move to a remote suburb, as it's "better value" and could have better short-term relative performance.*

Carrying on with the Google example. The company listed in 2004 at $85 a share and has since delivered a return of 22 per cent p.a. Over that period the Fed has met 136 times, which provides plenty of fodder for the economic and market prognosticators. How many of those "experts" predicted the GFC, the Euro crisis, Brexit, Trump becoming US President, COVID-19, negative yielding bonds, MMT etc?

It did not require a huge leap of faith to see the Google search business was clearly superior to any alternative, with an increasing economic moat, driven by an incredible network effect, informational advantages and capital resources to hire the best talent and maintain its technological dominance.

A long-term investor (as opposed to short-term speculator) would have generated a more predictable and healthier return by just buying what was clearly a great business and doing nothing. But no Doctor ever really achieved fame and fortune by recommending two aspirin and an early night!

In summary, we believe what makes sense as a business owner, makes sense as an investor. We try not to forecast hard-to-predict events ? and even more importantly we don't sell great companies that we know intimately, to buy mediocre ones based on economic or market forecasts that are quite likely to be wrong.

As Warren Buffett so aptly puts it:

> *"I am a better investor because I am a businessman and a better businessman because I am an investor. Time is the friend of the great business, the enemy of the mediocre."*

The story above was originally published on the Claremont Global website:https://www.claremontglobal.com.au/insights/why-sell-great-businesses-for-the-mediocre

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INTERNATIONAL

Factor Powerhouse: Value Plus Quality

Research by The Leuthold Group suggests better returns await those investors who combine cheaper asset prices ('Value') with a Quality assessment.

Q'Val: A Factor Powerhouse

By Scott Opsal, The Leuthold Group

Quant researchers widely agree that Value offers a return premium over time (although not recently) and that High Quality also offers excess returns.

The Quality angle seems contrary to intuition, in that investors generally prefer Quality companies and are willing to pay up for them, yet Quality regularly outperforms. Value and Quality are both well-respected investment factors, and we were curious to explore the interaction of these two smart beta stalwarts.

Is Value enhanced by adding a layer of Quality, thereby avoiding value traps, or are Value investors better off buying junky, unattractive companies that have the most room to rebound from depressed prices?

Our study measures the interaction of Value and Quality using a two-stage methodology. First, we quin-tile companies based on the Value factor and focus on the cheapest basket. Second, we divide the cheap-est Value basket into the 40% of companies with higher Quality ratings (Quality Value or Q'Val), and the 60% of companies with lower Quality ratings (Junky Value or J'Val).

The Quality and Value signals in this study are proprietary multi-factor models employed in our own portfolio management processes.

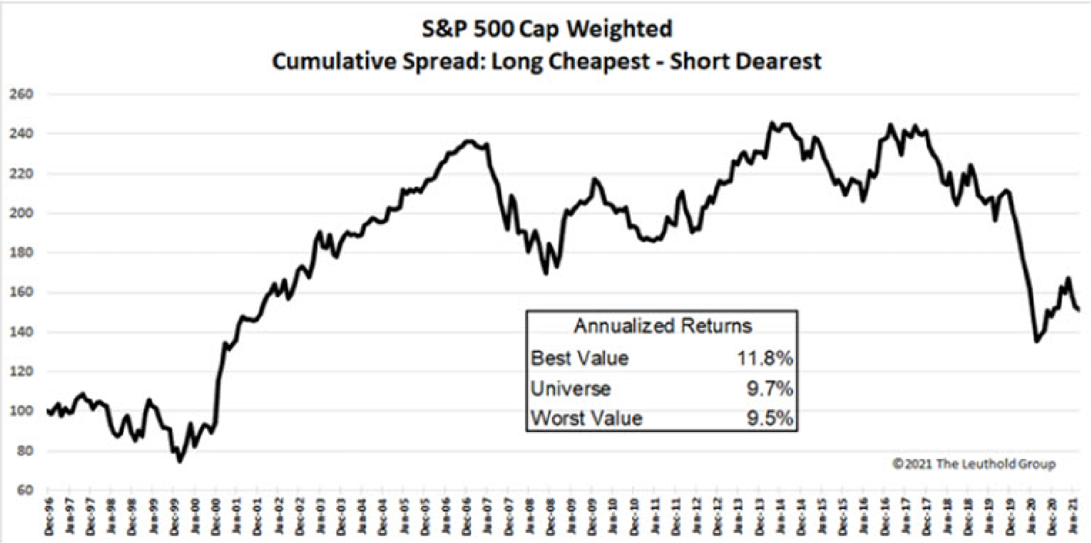
Quality-Enhanced Value

Again, our objective is to determine whether Value investors are better off tilting toward Quality companies, or if owning the junkiest companies offer the best bargain opportunities.

We begin with an analysis of the basic Value factor using the cap-weighted S&P 500 universe from 12/31/1996 through 8/31/2021. Chart 1 plots the return spread between the cheapest and most expensive S&P 500 quintiles, rebalanced monthly.

It paints the familiar story of Value's outperformance up to the Global Financial Crisis, followed by a sideways decade and the recent drop caused by the outperformance of Social/Mobile/Cloud growth companies. While conventional Value signals that rely on price to book peaked in late 2006, multi-factor Value metrics based on other well-regarded ratios only succumbed to the mega-cap growth boom in 2017.

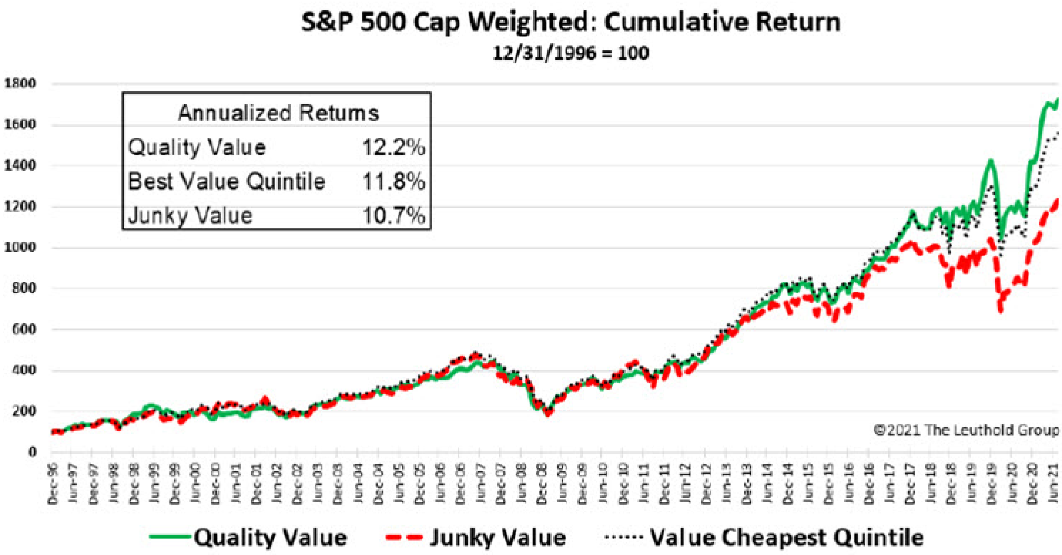
Chart 1



This study focuses on the “best value” sleeve comprised of the cheapest quintile of companies. Our next step is to separate the cheapest Value stocks into two Quality sleeves to determine which, if either, provides an extra boost to the Value factor’s excess returns over the long run.

Chart 2 begins with the best Value quintile’s 11.8% annualized return, then adds the returns for the Quality and Junky sleeves of the cheapest Value companies. On a long-short factor basis, Q’Val outperformed J’Val by 1.5% annually. Even on a long-only basis, it added another 0.4% on top of the return from the Value style itself.

Chart 2



The Cyclicality of Quality Value

One of Leuthold’s fundamental beliefs is that most indicators cycle over time, and that style and asset class leadership rotates based on economic and market conditions. Our next two charts delve into the cyclicality of Quality Value minus Junky Value by relating it first to the overall market and then to the Value cycle itself.

Chart 3 plots the Q’Val – J’Val spread over the last 12 months on the left axis, matched against the in-verted S&P 500 return on the right axis.

Other than the TMT bubble in the early section of the chart, the two series demonstrate an obvious correlation in directional shifts. Strong gains in the Q’Val metric are associated with periods of weaker market returns, whereas Q’Val lags J’Val when the market re-turn surges toward and beyond +20%.

Chart 3

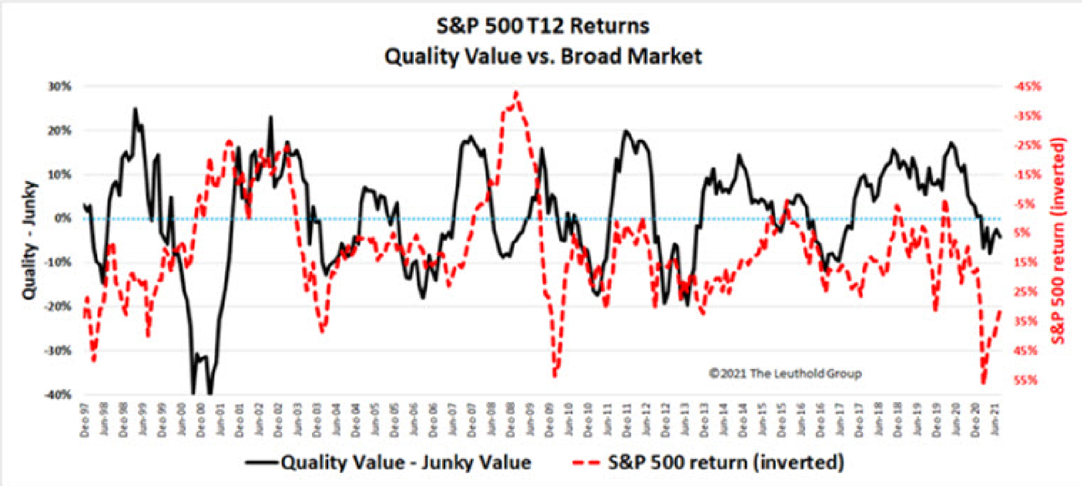
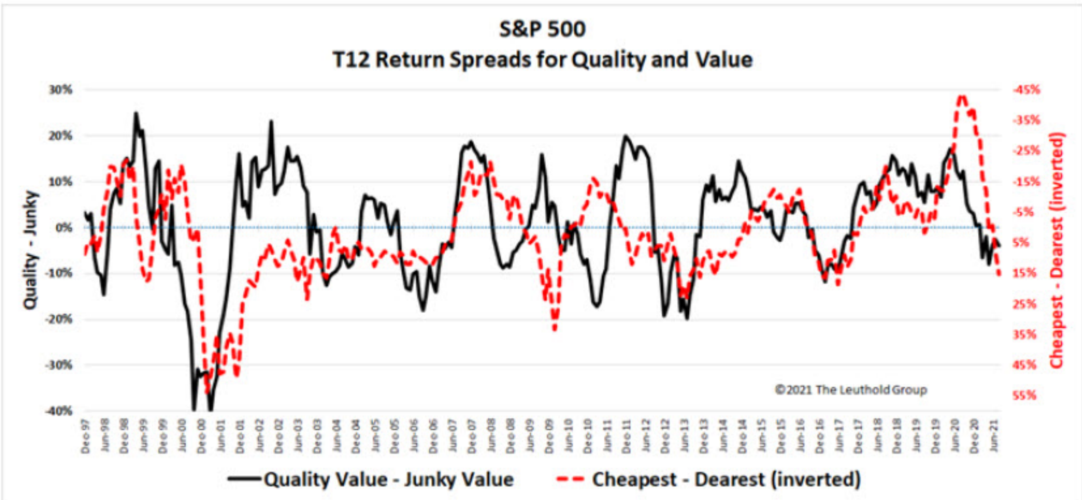


Chart 4 repeats the Q'Val minus J'Val spread, this time compared to the broader Value cycle.

The red dashed line plots the T12 spread of the cheapest Value quintile minus the dearest quintile, inverted. When the red dashed line is lower in Chart 4, it indicates periods of strong returns to the overall value factor.

In this case, Q'Val tends to lag J'Val. When the red line is higher in the chart it means the Value factor is underperforming Growth, and Q'Val tends to perform much better in this scenario. We again find a strong directional correlation, this time between Q'Val and the relative style performance of the Value factor.

Chart 4



It seems clear that Quality Value has a definite cyclical flavor to its performance:

1. Q'Val outperforms during weaker market returns and underperforms when market returns are particularly strong, and
2. Q'Val outperforms when Growth is the dominant style theme but underperforms when the Value factor is dominating Growth.

This pattern takes us back to our original question; should Value investors prefer Quality or Junky? When the Value factor is "in gear" investors looking to maximize their tactical bet on a Value style rally should prefer J'Val.

Similarly, when the market is in rip-roaring bull mode, J'Val tends to give investors a bigger bang for their buck. However, the 1996 to 2021 period suggests that such occurrences are not frequent enough to give J'Val the edge over time.

Quality Value In Broader Indexes

The S&P 500 Universe has three biases that could potentially influence the results of our study.

First, companies must be profitable to be added to the Index, and we believe the S&P Index committee is biased toward companies of above-average quality. Second, the largest Index members are growth companies which gives this cap-weighted index a clear tilt toward that style. Third, the S&P is a large cap index, and it is quite possible that the factors we are studying behave differently in mid and small caps.

We examine the S&P's quality growth bias by extending our research to the Leuthold 3000 universe. This brings in companies that are smaller, unprofitable, mature, and cyclical to give us a fuller picture of the Quality Value phenomenon.

Our Leuthold 3000 baskets include a) the largest 1000 companies by market cap, b) 800 midcap companies that rank below the largest 200, and c) small cap companies ranked below the top 1000.

Rather than charting each universe, we summarize the results in tabular form.

Table 1 reflects the Value factor across universes, indicating that the valuation effect becomes stronger as we work down the market cap spectrum. A curious aspect of Table 1 is that the majority of the Value effect in large caps is on the long side of the trade, while the biggest gains in mid and small caps come from being short the dearest companies; an important distinction for constructing portfolio strategies.

Table 1

		Leuthold 3000 Universe		
	S&P 500	Top 1000	Mid Caps	Small Caps
Best Value Quintile	11.8%	11.0%	12.2%	14.3%
Universe	9.7%	9.8%	11.1%	10.6%
Worst Value Quintile	9.5%	9.1%	8.6%	6.3%
Long-only Spread	**2.1%**	**1.2%**	**1.1%**	**3.7%**
Cheapest - Dearest	**2.3%**	**1.8%**	**3.6%**	**8.0%**

Table 2 then divides the best Value quintile into Quality and Junky. The effectiveness of this combined measure also improves as we move down in market cap. We also note that all three of our Leuthold 3000 baskets contain unprofitable, lower-quality companies, and that the mid and small cap baskets have a much flatter distribution of company weights than does the S&P 500.

We believe each of these distinguishing characteristics contribute to the increased effectiveness of Quality Value in these broader universes.

Table 2

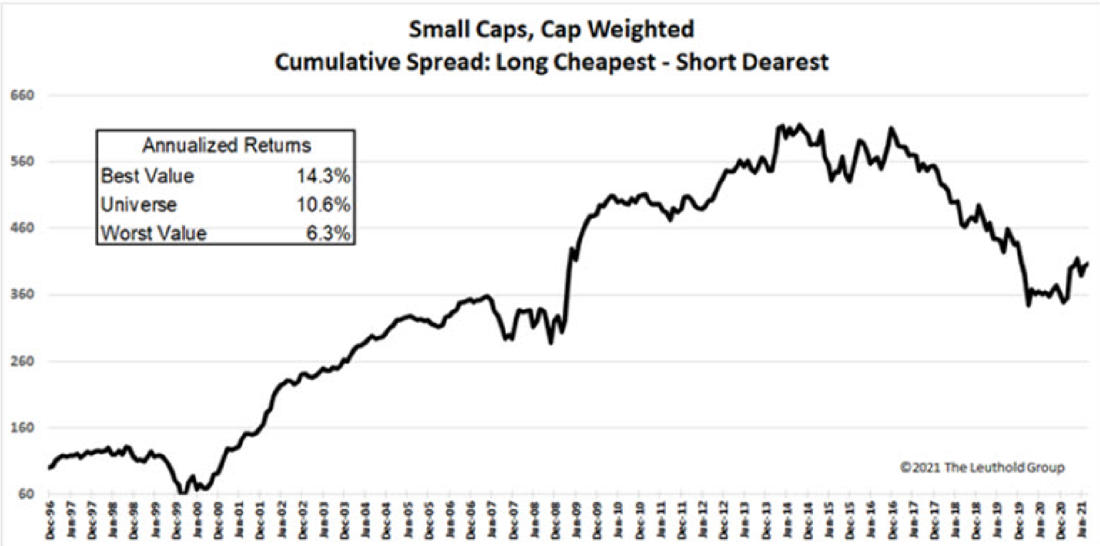
		Leuthold 3000 Universe		
	S&P 500	Top 1000	Mid Caps	Small Caps
Quality Value	12.2%	12.3%	13.2%	16.8%
Best Value Quintile	11.8%	11.0%	12.2%	14.3%
Junky Value	10.7%	10.3%	10.7%	12.2%
Long-only Spread	**0.4%**	**1.3%**	**1.0%**	**2.5%**
Quality Value - Junky Value	**1.5%**	**2.0%**	**2.5%**	**4.6%**

Remember, these two tables are additive in that the Q'Val premium comes on top of the Value factor premium. For example, in the largest 1000 companies, the Value factor outperforms the universe by 1.2% per year, and Q'Val outperforms the cheapest Value quintile by another 1.3% for a 2.5% combined advantage.

Similar data for the mid cap universe show a 1.1% Value factor edge and a 1.0% Q'Val gain for a 2.1% total. Small caps rack up a 3.7% advantage for Value and another 2.5% for Q'Val for a 6.2% combined win.

Investors able to short the least desirable baskets can realize even larger gains. Summing the long-short spreads for each table reveals a combined 3.8% gain for the S&P 500 and the Top 1000, 6.1% for mid-caps, and 12.6% for small caps.

We suspect one reason the Q'Val is so strong in small caps is that the percentage of unprofitable smaller companies hovers near 40%. While money-losers have speculative appeal during periods of extreme optimism, they have generally not represented a successful long-term strategy.



Finally, our examination of the cyclical charts for each universe (similar to Charts 3 and 4) confirms that Quality Value's outperformance in weaker markets and growth-driven markets is consistent across each cohort of companies.

In fact, the fit appears tighter in the mid- and small cap universes, to the extent that we believe tactical calls could be implemented using this powerful combined quant factor. Charts for our Small Cap universe are shown in the Appendix; compare their patterns to the S&P 500 charts shown in the body of the report.

Research Takeaways

Value and Quality are cornerstones of the smart beta world, and together they create a powerhouse quant metric. Adding a Quality overlay to the Value factor produces enhanced returns across the market cap spectrum, with the greatest impact in smaller companies.

Quality Value, like most styles, is cyclical. Q'Val works best in weaker markets and in markets driven by growth leadership. Junky Value performs well in spirited bull markets and in periods when the Value factor is exceptionally strong.

Over the long run, Q'Val carries a meaningful advantage, and this combined factor can be utilized in either a strategic or tactical investment discipline. We are particularly intrigued by the possibilities for Value managers who are looking to avoid value traps or gain extra protection in bearish environments.

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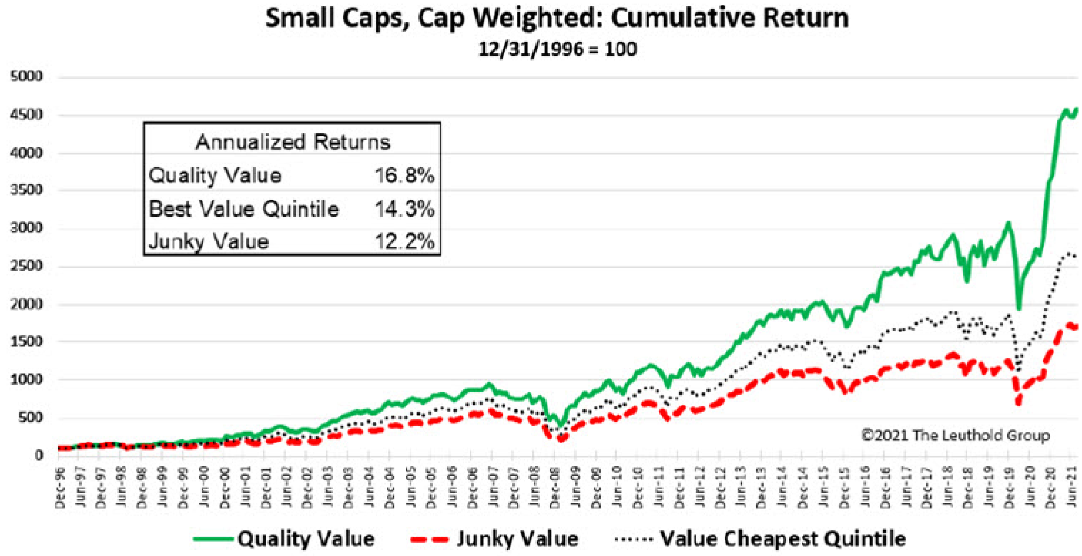
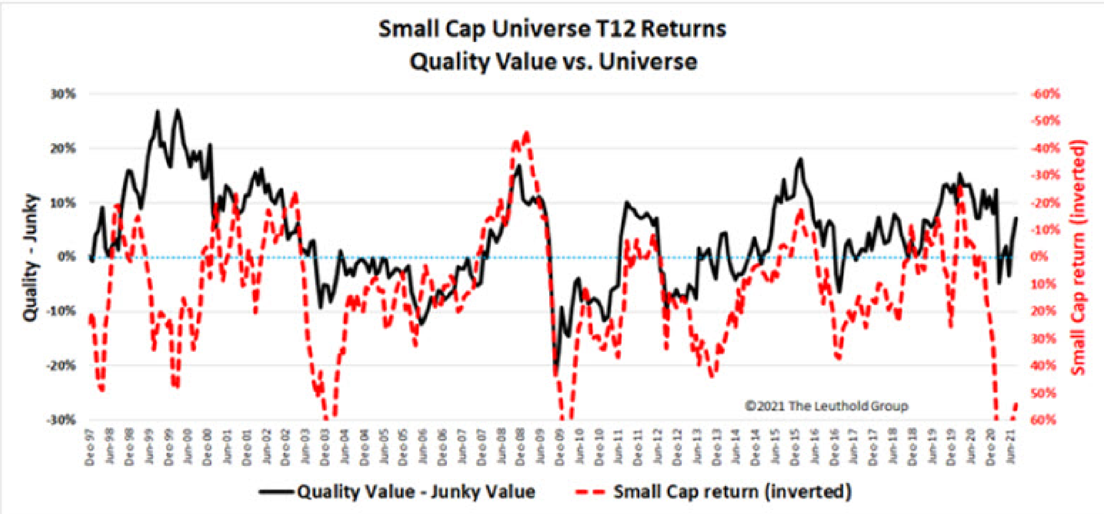
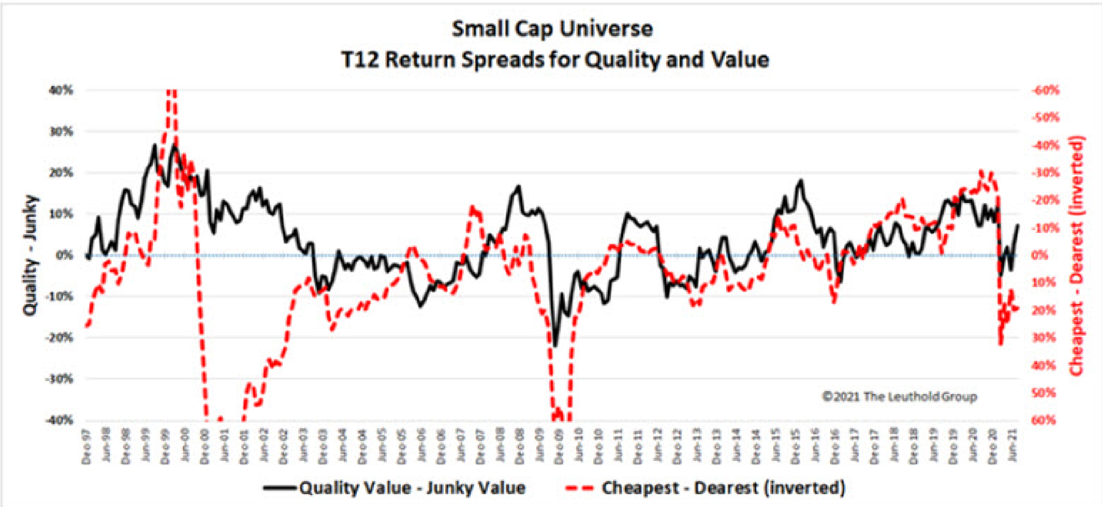
Appendix







Technical limitations

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INTERNATIONAL

Unstable Foundations: The Risks In Relying On A Post-Pandemic ‘Snapback’ In Infrastructure

The fact superfunds and other large asset managers are now scrambling to obtain ownership of listed, long-duration infrastructure assets does not prevent that society post-covid might remain different from pre-covid, with consequences for some of these assets.

-Super funds have lately been very hungry for infrastructure assets
-There is no doubt a post-pandemic era will see an increase in the patronage of these assets
-Yet it’s far from certain the levels of use will be anything like they were pre-pandemic anytime soon

By Ed Kennedy

It’s been a huge month for infrastructure in Australia.

September has seen Brookfield’s $9.6bn offer for AusNet Services ((AST)) quickly being trumped by APA Group ((APA)) with the unexpected bidding war for what is usually considered the boring end of the share market joining news of other big ticket moves like the $23.6bn bid for Sydney Airport ((SYD)) from the Sydney Aviation Alliance consortium, and Transurban’s ((TCL)) deal worth north of $10bn for the acquisition of a 49% stake in Sydney’s WestConnex.

This month follows what’s already been a very busy year surrounding fundraising and deal making in the sector.

The high level of activity being seen this year has many causes. The shifting priorities of super funds is a particularly notable factor in it, and is essential to unpack in order to give context to the frenzy. Yet it’s also clear the covid-19 pandemic continues to be a key driver in this area.

What’s much less clear is how post-pandemic dynamics will impact the use of numerous pieces of infrastructure in Australia - many of the very same assets which have recently attracted showstopping price tags.

<u>Is Acquiring Infrastructure Really a Super Idea Right Now?</u>

Australian super funds have been very busy this year. Although the initial outbreak and uncertainty caused by the pandemic generated some timidity in the sector, 2021 has seen them bolt out the gates with designs on a number of huge acquisitions.

The relatively limited supply of infrastructure either assets available or coming up for sale - with the NBN being a notable exception - means Australian super funds have also been looking offshore for assets.

The low returns bonds are currently generating has been a key contributor to this, pushing funds to look elsewhere in the market for alternative assets that nonetheless come with a (supposed) predictability surrounding their returns.

The takeover bid for Sydney Airport serves as a key example of the current keen interest in infrastructure by super funds. Members of the bidding Sydney Aviation Alliance include IFM Investors, QSuper, and AustralianSuper. It’s the third such bid the consortium has made for the airport, with prior bids rejected in August and July offering $22.8bn and $22.3bn respectively.

But for all the headlines activity by super funds in infrastructure is generating, considerable uncertainty also reigns surrounding the future. Even investors who have the luxury of (a long) time on their side have to reckon with the reality that old presumptions surrounding infrastructure use are now being undercut by a pandemic-driven change to daily life and work globally.

To really grasp the undercurrents of this environment it’s first necessary to look back.

The Trends Pre-Pandemic

In 2018 a United Nations (UN) report made a startling prediction surrounding the future of population movement. The UN said that by 2050 68% of the world's population would live in an urban area.

Recent years and decades provided plenty of evidence to justify this claim. Western nations had been seeing a decline of traditional industries such as manufacturing, which was once the bedrock of countless rural communities. Similarly, the booming economic growth being seen across rapidly developing economies had drawn people to cities.

Perhaps no city encapsulates this as well as Shenzhen. It's estimated in 1985 the Chinese city had a population under 200,000, yet it took just 20 years from then for it to exceed 10 million.

Certainly there are particular factors - such as the establishment of its Special Economic Zone and location just over the mainland border to Hong Kong - which contributed to Shenzhen's startling growth. This said, the trend of rapidly rising populations in urban areas (so often accompanied by population decline in provincial areas) has been seen all across the world.

Offices to Remain Empty Post-Pandemic?

PWC has declared "The traditional workplace is behind us". EY says "remote working is the way forward". An abundance of other businesses now hold similar positions, and authoritative data into the impact of the pandemic supports this trend.

According to the ABS survey done in February of this year, 41% of those employed were doing work from home (WFH) at least once a week. This is in contrast to a rate of 24% pre-March 2020.

Furthermore, 47% of those surveyed at that time expected their WFH arrangement to continue throughout the year, and this was before the upheavals of the current extended lockdowns in NSW and VIC. Not every worker can WFH now or will WFH in future, but many who have made the move to using their kitchen table or garage bench as a workplace won't be returning, and this has huge implications for infrastructure use going forward.

Of course there are shades of grey in the demographic trends we've seen borne out of the pandemic. While a huge group of Australians are now well and truly adjusted to the WFH lifestyle, many of those who work in construction, health care, and other sectors have more or less continued working their jobs in a similar way in 2021 as they were doing so pre-pandemic.

But even so, it appears highly unlikely at present that even if all the stars align favourably in combatting the pandemic - such as a speedy completion of vaccination programs and a plummeting of covid cases accordingly - for a 'snapback' once it ends that'll see a like-for-like return to life as it was before it. Too much has changed, and too much is set to change yet.

A Snapshot of Change: The Melbourne Experience

When Premier Daniel Andrews announced the Victorian Government's huge suburban train loop in August 2018, undoubtedly his government's greatest attention was on a short-term goal.

The state election of November 24 that year saw his government re-elected in a landslide. Many voters who backed Labor were enticed by a 'spiritual sequel' to the Andrews government's popular Level-Crossing Removal Project brought to the 2014 Victorian election, and the Metro Tunnel Project commenced in 2015, which was set to create five new train stations (total) in and around the Melbourne CBD among other amenities, in a quest to address growing pressure on the existing five CBD stations.

Just as the level-crossing removal project meant Melburnians would experience temporary disruption surrounding stations where works were going on, the closure of parts of the Melbourne CBD to pursue the Metro Tunnel Project - with completion due around the middle of this decade - was done with the promise that it'd be in the long-term benefit of a city that in recent years has been Australia's fastest-growing, and for a CBD which had also been seeing a soaring growth in density in nearby surrounds like South Yarra and Southbank.

Then the pandemic hit, and with it all the old certainties about a CBD's role in the future of daily life and business went out the window.

Many Melburnians who once relished living in the CBD for its proximity to work and cosmopolitan attractions - even if it came with a trade-off of having less space in their residence in comparison to a suburban home - found the closure of commercial offices freed them to WFH instead of face-to-face. In turn, restrictions which limited their ability to leave the home each day whenever a lockdown was on saw a significant number ready to trade a CBD pad for a suburban domicile with a backyard in tow.

Some went further, eyeing in provincial Victoria the chance to get their foot on the property ladder for the first time, and prepared to spend the remaining years of their career as (predominantly) remote workers if need be, feeling the rise of WFH-ready roles across the economy offers new bargaining power in seeking to end their Monday to Friday commute of old.

In future these people may indeed pop back into their - previously daily - CBD workplaces for face-to-face meetings sometimes, but they've now put down roots far beyond skyscraper-laden streets, and represent a group of (in many cases now permanently *former*) Melburnians who will strongly resist returning to a job and lifestyle where the CBD is their focal point.

The experience of Melbourne and wider Victoria is certainly not unique in this regard. But it does provide an illustration of just how profoundly the outbreak of covid has altered the landscape when it comes to assessing the future need and use of infrastructure.

Missing the 'Public' in Public Transport

Trains and planes serve as a key example of the new challenge for infrastructure use. In the pre-pandemic era, an Australian worker catching a peak hour train into their CBD office or an international flight for an overseas conference was second nature. Numerous indicators suggest many years of the 2020s (at least) will be dominated by factors that inhibit the use of such transport.

With great concerns surrounding the enhanced threat the delta variant (alongside other mutations) can pose even to those who are fully vaccinated, there's the anticipation it will be a long while before train passengers may cram in shoulder to shoulder once more. International travel is a similar equation in a larger context. Even if lots of borders open there's the expectation it'll be many, many years - if at all - before airlines across the world are running at full capacity in a way that resembles pre-pandemic activity.

Ultimately the greatest hindrance to a return to business as usual in future may simply be the lack of desire among the masses for it to occur. Doubtless corporate junkets toasting their way through entertainment epicentres like Las Vegas will have a comeback in some fashion. Yet justifying the expense - especially when an array of businesses are needing to trim their operating budgets - for a worker's business class round trip ticket and hotel accommodation for a quick face-to-face meeting with a colleague overseas seems unimaginable now, especially given the ease and universality of videoconference meetings has been proven.

This means accordingly the underlying presumptions that justified an abundance of infrastructure projects require a rethink. In turn, the presumptions around demand for them in future. Yet ultimately, it's not just infrastructure projects already progressing today that must factor in this new dynamic. The pandemic redefining the use of infrastructure means future projects must now cater to changes in behaviour.

The Anticipated Demand for Different Types of Infrastructure Amidst Decentralisation

Just as the pandemic forever changed how we live and work, and this is anticipated to result in a decline in the use of certain transport infrastructure in future, greater demand for other types of infrastructure can be expected to arise.

Owing to their importance to the WFH revolution, communication networks have taken on a new value. Toll roads are also looked at in a new light, given the growing population in provincial areas of former CBD workers, who'll nonetheless still commute into the CBD occasionally. Renewable energy assets also hold much promise in the minds of many, given their increasing use and the corresponding decline in fossil fuel sources, especially given the former is in numerous locales now cheaper to source power from than the later.

There's little doubt that major infrastructure projects will continue to occur in some form, albeit their design could be examined through a different lens. One that factors in the decentralisation that is occurring as a result of the pandemic.

In certain locales history may come to show the pandemic's silver lining was that it helped deliver a 'circuit breaker' needed to depressurise reliance on a CBD, and open up a new chapter where decentralisation could bring many benefits to various groups in the community, such as increased housing affordability and reduced congestion in their day-to-day driving.

But even so, a new challenge in this era could be posed by the reality that major infrastructure in Australia will essentially always take years to build. The sweeping trend of decentralisation means nobody could envy urban planners in this regard in the work they've before them planning projects throughout the remainder of the 2020s amidst such uncertainty.

Watching Out for the Next Wrecking Ball

At present investors presuming a 'snapback' from the pandemic do so when it's far from certain it will occur. What's more, there's substantial evidence to suggest it will not. Some stakeholders in this dynamic have the ability to play the long game, but this approach can still be very questionable when alternative assets that are anticipated to see a spike in demand due to the pandemic exist.

Although some may see light at the end of the tunnel - and it coming soon - in a best-case scenario, such a view should fairly take into account a worst-case scenario ahead.

While it was a century that separated the 1918 H1N1 pandemic with 2020's covid outbreak, there is the rueful expectation that the next pandemic could be along far sooner given the interdependent nature of the global economy in the 21st century in comparison to 1918, not only in terms of exchanging goods and services, but also the necessary movement of people additionally to drive and sustain new growth.

Undoubtedly many jurisdictions will pursue more sophisticated and successful measures in years ahead to resist any new outbreak making its way into their territories.

But the ongoing challenge of containing covid and its variants - in addition to the different approaches taken to squashing it from Sweden to the UK to Australia's various states and territories - means the unfortunate reality is it's not a question of if, but when the next pandemic occurs. And when it does, we can anticipate another huge blow to the patronage of trains, planes, and similar transport.

AUSTRALIA

Premier Investments Ready For Re-Opening

Optimism prevails at Premier Investments, which is ready for an expected surge in customers as stores re-open and a fresh new year beckons

-Brands to benefit from stores re-opening & online expansion without need for large investment
-Will Premier Investments' earnings growth be affected by margin decline?
-Or have retail margins stepped up anyway because of increased online penetration?

By Eva Brocklehurst

Despite lockdowns infringing on store sales throughout FY21, Premier Investments ((PMV)) remains optimistic as FY22 unfolds, procuring inventory in anticipation customers will be trooping in when stores reopen.

FY21 results delivered record sales across both Peter Alexander and apparel brands as well as online, despite the lockdowns. Yet the impact of school closures was severe in the case of Smiggle for which FY21 sales were down -16.8% globally.

By mid May all stores in Europe had resumed trading and Smiggle achieved double-digit like-for-like sales growth during those periods when school was operating. Like-for-like sales in FY22 are currently up 69% in the UK, 64% in Ireland and 131% in the Middle East wholesale channel. The Australasian business, therefore, is expected to recover in a similar way.

In the first seven weeks of FY22 Premier's global sales are down -9.5%, largely as a result of lockdowns, while strong online sales and a rebound Smiggle Europe have provided a counter point. Brokers assess **the business is well-positioned for such uncertain times because of the online capability, strong inventory and cash balance.**

While the stock is trading at a premium to discretionary peers, Citi considers this reasonable because key brands will benefit from reopening and the increasing adoption of online shopping without the need to reinvest significantly.

Macquarie, too, assesses a net cash balance of $376.5m will support plans to expand the distribution centre in 2022 while the current macro environment provides opportunities.

Bell Potter expects a rebound will occur in Australasia in FY22 across apparel brands as well as Smiggle. All five apparel brands achieved like-for-like sales growth of 18.7% in FY21. Peter Alexander outperformed, with like-for-like sales up 34.7%.

Premier has consistently exceeded Morgan Stanley's expectations over the last 12-18 months, amid solid execution. Yet earnings growth in FY22 may be challenged by lower demand and a normalisation of margins, the broker suggests, while the change in CEO is adding further uncertainty.

Store Closures

Goldman Sachs highlights the impact of one-off items as well as store closures on FY21 earnings and expects the first half of FY22 will be subdued because of the lockdowns in Australia. The broker is concerned about the outlook for Smiggle, amidst permanent store closures, as well as the ability of Peter Alexander to cycle previous stellar growth rates.

Premier has closed 46 stores in the last 12 months and 158 stores over the past seven years, Macquarie points out, as it homes in on individual store profitability because of the growing preference for customers to purchase online.

The broker also notes over 75% of the global store network is either in holdover or with leases expiring in less than 12 months, providing flexibility to review the network.

Profitability at a store level is driving decisions about optimising the physical store network and Credit Suisse agrees that as online sales attract a higher profit margin, and assuming the shift to online continues, there could be further downward pressure on rent. Still, it will be unclear as to whether elevated promotional activity affects in-store trading until the second quarter.

Margins

Regardless, Goldman Sachs suspects gross profit margins are likely to decline as the promotional environment normalises throughout 2022. Macquarie also expects FY21 will turn out to be a record year in terms of margins, given the concessions the company obtained, and expects margins will normalise in FY22 along with earnings (EBIT).

Gross margin was 64.3% in FY21 and resulted in a 25.1% increase to gross profit to $927.9m. Credit Suisse forecasts a return to pre-pandemic gross margins in FY22, assuming a margin benefit from sales recovery in Smiggle is offset by promotional activity in apparel.

Ord Minnett slates gross margin expansion of 50 basis points in the first half, easing back over the long-term, and further notes rents were the major driver of margin expansion in FY21, while Citi asserts retail EBIT margins have made a step-change to the top side from pre-pandemic levels because of the increased penetration of online sales and rent renegotiation.

Management's argument is that rent should fall to preserve in-store profitability and as a result the broker expects Premier to retain around 380 basis points of EBIT margin benefit from rent by FY23.

Bell Potter considers Peter Alexander unique in the market and positioned to expand offshore, although acknowledges a recovery in Smiggle tops management's priority list. The broker, not one of the seven monitored daily on the FNArena database, upgrades to Buy from Hold with a target of $31.25, assessing a re-basing of FY22 earnings is priced in and robust growth should resume from FY23 onwards.

Goldman Sachs, also not one of the seven, is at the other end of the spectrum, maintaining a Sell rating with a $23.40 target. The broker believes the stock is trading at a premium to its peer group on the basis of the growth outlook as well as excluding the market value of associates – Breville Group ((BRG)) and Myer ((MYR)).

The database has somewhat of an each way bet with three Buy ratings and three Hold. The consensus target is $30.20, suggesting 3.6% upside to the last share price.

See Also, [Premier Investments: All About The Margin] on June 16, 2021.

AUSTRALIA

Will MATSA Bring Value To Sandfire?

To counter the decline at its DeGrussa copper mine and before Motheo ramps up, Sandfire Resources has splurged on the purchase of a mining complex in Spain. Is it good value?

-MATSA targeting plant debottlenecking and increased exploration expenditure
-Is Sandfire Resources taking on too much debt?
-Motheo still likely to be the main driver of value

By Eva Brocklehurst

Sandfire Resources ((SFR)) is tweaking its production outlook, attempting to smooth the profile to first production at Motheo in Botswana from when its mainstay, DeGrussa in Western Australia, winds down.

To do this, the company will acquire the MATSA (Minas De Aguas Tenidas) mining complex in Spain for US$1.865bn. This will be paid for by a $1.25bn equity raising, split between a placement and entitlement offer, US$650m in syndicated debt and some short-term debt & cash.

Morgan Stanley believes the deal, at first glance, is good value at 4.8x operating earnings (EBITDA) on an FY21 basis. The transaction would counter the decline in production at DeGrussa until Motheo ramps up from FY24 onwards.

The broker's main concern is whether reserve life could be extended beyond the current six years at MATSA as the resource life is potentially more than 20 years. Morgan Stanley accepts it is too early to determine the cost of any extensions.

Citi believes, strategically, this is a sensible move, noting Sandfire is expecting group copper equivalent production of 175,000tpa including with Motheo when DeGrussa finishes.

MATSA is a well-established copper producer in Spain and there are three mines that provide feed to a 4.7mtpa processing plant, producing two copper concentrates (59% of production) plus silver, lead and zinc.

There is a six-year reserve and 12-year resource life based on a 122mt resource base. MATSA is anticipated producing 100-120,000tpa of copper equivalent at C1 costs of US$0.40-0.50/lb for FY22.

The process plant is targeting more than 5mtpa via debottlenecking and increased exploration expenditure, the latter expected to accelerate resource conversion and bring access to higher grade ore to the fore.

There is an offtake agreement with SWiss-based commodity trader Trafigura for 100%, although Credit Suisse points out it is unclear what this actually means. That said, Sandfire does have a relationship with Trafigura which takes Degrussa concentrate.

Credit Suisse accepts the acquisition is accretive on a reserve and resource basis yet highlights the dilution for shareholders on a net asset value per share basis, calculating **the stock requires a re-rating to 6.5-7x FY23 EBITDA to make this transaction accretive, based on the cost**.

Balance Sheet Strain?

Moreover, the broker now envisages a risk that debt amortisation, coupled with the current capital expenditure timeline at Motheo, could put strain on the company's balance sheet, with gearing likely to step up to 26% in FY23 amid risk of project delays, unless prices remain robust.

Credit Suisse acknowledges it does not factor in hedging, operating improvements or significant extensions to the mine but points out MATSA is a technically challenging operation and **the mill is underutilised because of low mining rates**.

While there are plenty of opportunities for Sandfire to improve the mining rate, the broker does not believe this acquisition will be easy to tuck in, given the technical and cultural challenges, and downgrades the stock to Neutral from Outperform.

Motheo

Canaccord Genuity, on the other hand, believes Sandfire has a driver of value in Botswana. The maiden reserve for the A4 deposit at Motheo is 9.7mt at 1.2% copper.

Exploration results have revealed a strong case to either lift overall grades or extend the mine life beyond 2030 and the broker increases the valuation of Botswana to $806m from $626m. Production is expected to peak at 60,000tpa with a 5.2mtpa plant, as outlined in the pre-feasibility study. The overall grade will rise towards 2027, reaching 1.2% copper before easing back.

Moreover, Canaccord Genuity forecasts DeGrussa will contribute $350m in free cash flow over the next 18 months as the mine comes to an end. The broker calculates, even without debt, the cash balance will not fall below $200m.

There are options, too, in the Old Highway gold deposit, and Canaccord Genuity expects Sandfire will assess this asset and, given there has been no copper discovery, ultimately may choose to divest.

Canaccord Genuity, not one of the seven stockbrokers monitored daily on the FNArena database, has a Buy rating and $8.75 target. The database has two Buy ratings and three Hold. The consensus target is $7.05, signalling 28.9% upside to the last share price. The dividend yield on FY22 and FY23 forecasts is 5.6% and 0.5%, respectively.

AUSTRALIA

Beach Energy Steps On The Gas

Beach Energy is playing into an increasingly tight gas & LNG market, so a refreshed outlook and production target have been welcomed

-Production growth is coming from committed development projects
-Target for FY24 does not include any exploration upside
-Can the stock outperform during a period of investment risk?

By Eva Brocklehurst

Gas markets are tightening, great for Beach Energy ((BPT)), which is increasingly exposed to not only Australasian gas markets but also global LNG. Market confidence has improved as more detail on growth prospects has been provided, particularly for the Otway Basin in Victoria and the Waitsia stage 2 LNG project in Western Australia.

Ord Minnett notes these projects should more than offset what looks to be like significant declines in Western Flank production (Cooper Basin) and in the absence of any exploration success.

The broker believes the market should be satisfied with a presentation that goes some way to re-establishing any credibility Beach Energy lost during a year of disappointments and write-downs. Moreover, production growth is coming from development projects which have already been committed.

The company is expected to benefit from its diversified gas projects which include eight processing plants located in five basins. Bell Potter expects gas and LNG as a share of sales will increase to 74% by FY24 from 56% in FY21.

The strategy is positive, in Citi's view, offering investors a fresh look at growth. The update has minimal impact on short-medium term estimates but the broker finds the future is now more promising.

FY24 total production is expected to reach 28mmboe, supported by Otway and Waitsia stage 2. Waitsia net production is expected to increase to 5.4mmboe by FY24 from 0.8mmboe in FY21 and Otway production to 7.5mmboe from 2.8mmboe.

Morgans believes Beach can readily exceed FY24 forecasts as these excludes any exploration upside or production from projects such as Trefoil, which are still subject to final investment decisions.

The total target is below prior guidance and will entail downgrades to consensus expectations, yet Credit Suisse acknowledges it provides a more comfortable view for the market. Furthermore, the recovery in the stock over recent weeks is a reversal of an overshoot to the downside and the broker envisages more upside once Otway and Waitsia are performing in late 2022.

That said, **limited catalysts over the next six months could temper enthusiasm as established production declines and the risks from new construction take precedence in the market views**.

Successful gas discoveries across the Perth Basin indicate there is more upside within this acreage and Beach Energy has identified 14 prospects with potential to create a significant change in resource inventory.

There are 3-6 wells considered for drilling in the FY23 campaign so this is where Credit Suisse assesses there could be upside heading into 2023. Macquarie agrees exploration will be the driver of upside, also highlighting up to 15 exploration wells being drilled in the Western Flank in FY22.

While accepting there is some upside at current levels, Morgan Stanley questions whether the stock can outperform during a period of higher investment. Capital expenditure for FY23 is expected to be $700m-1bn. The broker holds the view that investors reward companies generating cash and returns to shareholders, with the exception being those investing in very high-returning potential projects.

Free cash flow yields are expected to increase significantly when Waitsia reaches full production so the issue is whether investors will board the stock today or consider it too early because of the execution risks.

<u>BP Agreement</u>

Beach has also announced an agreement with BP to cover all 3.75mt of Waitsia LNG volumes. Specific commercial terms were not disclosed yet the agreement offers flexibility about when LNG supply can commence as well as protection against any delays in construction and commissioning.

Canaccord Genuity also emphasises the offtake with BP, noting the agreed LNG price is linked to both Brent and Japan/Korea Marker and includes downside price protection.

As a result, the broker upgrades its unrisked valuation of the asset as LNG and oil prices continue to stage a substantial recovery. Canaccord Genuity had been concerned that FY22 and FY23 would be "lost years" but now describes these as "transitional".

Pricing of the agreement appears attractive to Macquarie, which notes the balance sheet is in strong shape and the corporate debt facility has been refinanced and increased to $600m.

<u>Financing/Returns</u>

All up, Morgan Stanley assesses the company has done a good job to re-set expectations but, in noting the upcoming investment phase is substantial, with offshore drilling in the Otway Basin followed by onshore drilling at Waitsia as well as construction, **it may be some time before Beach Energy considers a higher dividend or share buyback**.

Beach expects current operations will fully fund its growth targets and gearing is not expected to exceed 10% through the growth phase. Bell Potter expects free cash flow to improve from FY24 onwards which should enable more material shareholder returns as the company benefits from tightening east coast gas markets and international LNG markets.

The market may be assuming LNG prices that are too low, with Credit Suisse noting Woodmac envisages LNG spot prices could remain somewhat above US$10/MMBtu on average over the next few years.

Perth Basin, given the speculative nature and commercial uncertainties regarding gas demand in Western Australia, is assigned a 25% risk weighting to Citi's base case valuation.

The broker understands investor hesitation to pay for exploration, given the recent downgrades, but expects a growth component will creep back into the share price as positive news starts to flow in FY22, assuming success in Western Flank drilling.

Beach does not have the depth of 2C resources some of its larger peers enjoy but there is a portfolio of high-margin projects so Morgans focuses on the free cash flow yields of 16% that are expected in FY24.

RBC Capital Markets, not one of the seven stockbrokers monitored daily on the FNArena database, has re-rated Waitsia on the back of the new contract with BP, as it has removed concerns about the ability to deliver an LNG sales agreement, upgrading to Outperform with a target of $1.50.

Among others not monitored daily, Bell Potter reiterates a Buy rating with a $1.62 target and Jarden has a Buy rating, raised from Overweight, and a $1.60 target. Jarden has become more positive about some of the longer-term growth opportunities, which it did not believe were being valued by the market.

Canaccord Genuity is cautious about the production targets because of past disappointments but acknowledges the increased production forecasts and higher price assumptions, upgrading to Speculative Buy from Hold with a $1.60 target.

FNArena's database has four Buy ratings and two Hold. The consensus target is $1.52, suggesting 12.0% upside to the last share price.

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

COMMODITIES

Material Matters: Steel, Base Metals And Oil

A glance through the latest expert views and predictions about commodities: outlook; steel; iron ore; base metals; oil; and gold

-Delicate balance emerging in commodity markets
-Steel demand in China expected to remain positive in 2022
-Has the peak in iron ore prices passed?
-Copper tightly balanced, nickel subdued, potential for more upside in aluminium
-Oil inventory being drawn down at higher rates than previously assumed
-Bullish narrative on gold being challenged

By Eva Brocklehurst

Commodity Outlook

A delicate balance is developing after the recent boom across most commodities and Citi is not surprised that many are outperforming, as this regularly occurs when the world economy emerges from a recession. The pandemic has created supply shortages that could last into 2023.

A sell-off in the third quarter appears to have been driven by a combination of weakening signs in the world's two largest economies, the US and China, particularly China. Yet, as the broker points out, China has limited ability to affect prices of **natural gas, thermal or coking coal**, which are more related to global and localised conditions.

Restricting **steel** manufacturing could take some of the heat out of coking coal yet higher demand for power generation has put pressure on China to increase natural gas and even thermal coal use.

In sum, Citi's most bearish medium-term view is on **fossil fuels** while remaining bullish for **crude, global gas, aluminium, palladium**, thermal coal and **soybeans** for the rest of 2021.

Steel

Credit Suisse believes Beijing will be less inclined to "heavy" the steel industry next year. The crackdown on property amid the Evergrande crisis and a restriction on manufacturing because of power shortages is not expected to be the "new normal".

Why? Urbanisation has not finished and infrastructure has been a driver of the country's 14th five-year plan. China will find it hard to achieve GDP growth without further investment, particularly after an economically-depressed and power-restricted winter.

Assuming China will not relax its stance against property speculation, Credit Suisse believes investment in infrastructure will need to grow by 5% to achieve 5% GDP growth. This should be positive for steel demand in 2022. More than half of China's steel is used in construction and participants in its steel markets do not believe peak steel will occur until 2025.

Morgan Stanley notes steel has the most immediate exposure to China's property sector and disruptions are likely to persist through the fourth quarter, with a gradual normalisation in 2022. The broker forecasts zero steel output growth in China in 2022.

Iron Ore

The sharp correction in **iron ore** has been driven by curbs to China's steel production amid weakening demand and Morgan Stanley is bearish on iron ore going into the northern winter because of continued cuts to steel production.

Some upside is envisaged by the second quarter of 2022 because of a tighter market yet the broker finds few reasons to expect a bounce in iron ore demand and prices.

Morgan Stanley retains a recommendation to avoid low-grade iron ore producers and is Underweight on **Fortescue Metals** ((FMG)) and **Mineral Resources** ((MIN)). Selective exposure could be considered for **Deterra Royalties** ((DRR)) or **Rio Tinto** ((RIO)) for those with a bullish iron ore view.

China's steel output is a major influence on iron ore prices and with the drop in construction in the second half and the issues with steel production, Credit Suisse now asserts there is a perceived excess of iron ore. This should mean prices go below US$100/t yet supply issues have kept the price above that level so far. Despite weaker demand, Chinese port stocks have also not built.

Credit Suisse expects iron ore prices may well decline to US$90/t at times but recover ahead of holidays such as Chinese New Year. The price could push back towards US$120/t in 2022 during the northern spring as Australia and Brazil should be immersed in their wet seasons when supply usually softens.

Subsequently, in the second half, Brazilian output is likely to recover and the iron ore price settle below US$100/t. Hence, Credit Suisse believes the peak has passed.

Base Metals

China has made cuts to **stainless steel** production because of energy shortages and this has caused prices to rise sharply higher. Morgan Stanley suspects limited impact on stainless from a lack of China steel output growth in 2022, as increased scrap use across the market mitigates the effect of production controls.

The broker believes the **copper** market is tightly balanced and vulnerable while Citi is bullish on copper over the medium to longer term, advising clients to buy any dips below US$8800/t over the next quarter as global growth stalls.

Strong consumption related to decarbonisation and global restocking of manufactured goods are the reasons the broker expects copper demand will grow over the medium term.

Against this backdrop, Macquarie retains a preference for **OZ Minerals** ((OZL)) and **29 Metals** ((29M)) for copper leverage and **Chalice Mining** ((CHN)) for exploration. **Sandfire Resources** ((SFR)) is highlighted, given a binding agreement to acquire Spain's MATSA, which consists of three underground mines that can produce 100-120,000tpa of copper equivalent.

Meanwhile, **Sunrise Energy** ((SRL)) offers unique long-term leverage to **cobalt**, in the broker's view, although there are downside risks because of uncertainty over the timing of the project.

Macquarie notes **nickel** prices have fallen despite the prospect of cuts to China's nickel pig iron production. The net impact has pushed the market into a significant surplus and remove some of the upward pressure on nickel prices. The broker maintains a cautious view on nickel miners, and prices that vary compared with forecasts are the main risk to earnings estimates for **Nickel Mines** ((NIC)).

Morgan Stanley prefers **aluminium** because of rising cost pressures and ongoing power constraints in China. This provides a significant uplift to forecasts for aluminium prices and, in turn, support for **South32** ((S32)) which has around 34% of FY22 revenue exposed to aluminium and 19% to **alumina**.

The broker asserts **Alumina** ((AWC)), while rallying recently, still has potential upside and is likely to benefit from improving margins and inflationary environment.

Citi also remains bullish on aluminium, expecting over 25% in upside potential from current forward prices. China is enforcing targets at levels that are not consistent with rising energy-intensive aluminium production, and the broker points out this is a large change to the market, as China has represented 90% of refined aluminium supply growth.

Oil

Morgans asserts the majority of oil market indicators are now bullish as the fundamentals improve and a supply deficit grows. Oil prices appear to have disconnected from the marginal cost of supply and are moving to a level where demand destruction will start to materialise, at around US$80/bbl.

The broker observes inventory is being drawn at high rates, suggesting the market is more under-supplied than previously understood. Mobility statistics are also improving as are jet fuel crack spreads.

There is more improvement to the latter likely on the way, too, as the US government this travel restrictions for vaccinated passengers from the EU and UK. Refining margins are now sufficiently high to incentivise refiners.

Gold

Citi believes the bullish narrative for **gold** is being challenged. While understanding the inflation narrative amid concerns about debt loads and fiscal balance sheets, the broker ultimately believes this just lifts the long-term floor price for gold as opposed to underpinning a rally.

Gold is outperforming against commodity-linked currencies such as the Australian dollar and Canadian dollar but underperforming in US dollar terms. This is unlikely to change without a more dovish turnaround by the US Federal Reserve, as the broker notes a slightly hawkish June FOMC statement and strong July US payrolls number have reversed the gold/US dollar dynamic in 2021.

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FEATURE STORIES

Rudi’s Comprehensive August 2021 Review

A compilation of stories relating to the August 2021 corporate reporting season in Australia, including FNArena’s final balance for the season.

Content (in chronological order of publication):

By Rudi Filapek-Vandyck, Editor FNArena

August Results: Anticipation & Trepidation

Prima facie, Australian shareholders have plenty of reasons to feel excited ahead of the upcoming August results season.

Most companies have recovered more quickly than forecast from last year's lockdowns and pandemic, and profits and dividends are in a strong uptrend with Macquarie analysts observing consensus forecasts in Australia are now in their 11th consecutive month of upgrades, and expectations are building there's more of the same on the horizon.

February was on most market analysts' assessment one of the best local results seasons ever. Corporate Australia not only delivered strong recoveries in profits and dividends, but -uncharacteristically for Australia- it also handsomely beat analysts' forecasts, even though they had been lifting for multiple months already.

On FNArena data, the percentages of earnings "beats" over the past three reporting seasons (before, during and after February) have been at 49%, 47% and 55%, respectively; well above the circa 33% average we measured over the twenty seasons prior.

According to stockbroker Morgans, corporate Australia is currently experiencing one of its strongest upgrade cycles since late 2004. Over the past three months, upgrades have outnumbered downgrades by two-to-one with both miners and energy companies enjoying the strongest momentum.

Recent corporate market updates have equally contributed further, as did Cimic Group's ((CIM)) interim results release last week. It wasn't exactly a shoot-the-lights-out performance from the former Leighton Holdings, but it was good enough for slightly increased forecasts, a small bump up to analysts' valuations (already well above the share price) and the share price has risen slightly too.

For a company that hasn't exactly been kind to its shareholders over the past two years, it most have felt like a welcome relief for many, and a possible early indicator of the turnaround stories that August might present.

One minor disappointment, ironically, would have come from numerous mining companies not meeting production forecasts or failing to contain costs, including BHP Group and Rio Tinto, but the sector continues to enjoy stronger-than-expected prices for its products, which offers plenty of compensation, plus some.

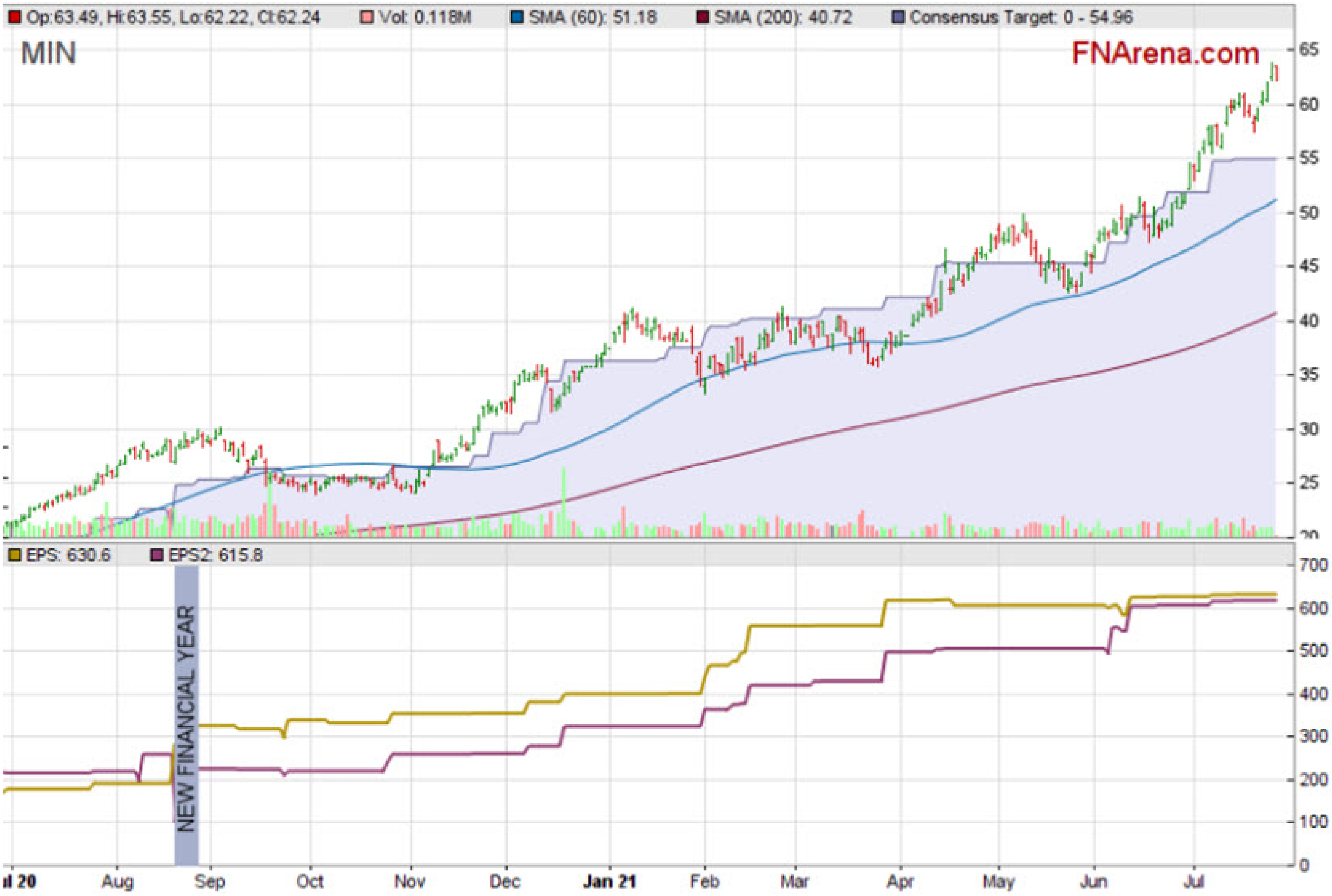
When resources analysts put today's spot prices into their modeling, they see share prices trading on double digit percentages in free cash flow, which then feeds into questions such as: how high exactly might dividends be next year?, but also: how long before those share prices start pricing it in?

It is for this exact reason, I believe, that share prices have remained remarkably resilient over the weeks past, even as governments globally encountered set-backs in their quest to quell the pandemic, including 60% of Australians back in lockdown, and with the climate causing chaos and havoc in parts of Europe and Asia.

Corporate profits are recovering rapidly. Forecasts keep rising, while expectations for the years ahead remain positive. Dividends are coming back, and growing. There's potential for bonus payouts, for buybacks, and for M&A.

Only a few weeks out from August, it would take a lot of negative news to convince investors they'll be better off selling shares in, say, Fortescue Metals ((FMG)) and Mineral Resources ((MIN)), but equally in REA Group ((REA)), Telstra ((TLS)) and Charter Hall ((CHC)).

Clearly, it hasn't happened, and I'd wager this is because the same positive prospects are currently supporting optimism in Europe and the US, where corporate performances are equally surprising to the upside.



That said, there is always the possibility this positive undercurrent might turn or exhaust itself and investors will thus be on the lookout for clues both here and overseas: are business leaders confident enough? What are the effects of transitory inflation on profit margins? Is the consumer prepared to spend more from savings? Are governments able to navigate their way out of this? Did anyone mention central banks and less stimulus?

There is always the dreaded elephant behind the curtains: what will bond yields do in the months ahead?

Not to be dismissed: investors are reminded corporate performances are always judged against forecasts and expectations. While multiple signals point towards ongoing potential for positive surprises, it remains yet to be seen whether corporate Australia can maintain the exceptionally high percentages of "beats" we all have experienced post August last year.

I am inclined to think the numbers of "Beats" and "Misses" will look a lot more "normal" by the beginning of September and this by default means there is potential for a lot more portfolio damage even without macro-influences and left field occurrences.

Analysts are starting to preview and re-assess their forecasts and assumptions, and I expect a lot more to be released over the two weeks ahead (early August is quiet in the season). Next week will thus dig deeper into anticipated beats and misses.

This week we preview with three themes that seem poised to feature prominently in reporting season, and beyond.

Theme 1: Cost Inflation And Margin Pressure

It has the potential to become one of the defining features of the August results season: how much does transitory inflation impact on companies' profit margins, including through rising wages?

Sectors that have investors' attention: retailers and mining services providers.

Stockbroker Morgans has selected a number of companies with a question mark about their margins: Super Retail ((SUL)), JB Hi-Fi ((JBH)), Jumbo Interactive ((JIN)), Reliance Worldwide ((RWC)), GUD Holdings ((GUD)), and Accent Group ((AX1)).

On the other hand, the broker also believes investors might currently be underestimating the potential for margin expansion at: Afterpay ((APT)), Orora ((ORA)), Link Administration ((LNK)), Ramsay Health Care ((RHC)), Chorus ((CNU)), Tabcorp Holdings ((TAH)), Domain Holdings ((DHG)), Amcor ((AMC)), and IDP Education ((IEL)).

Theme 2: M&A Is Back!

With Sydney Airport and Oil Search firmly in play, both investors and analysts are starting to look for who could be next?

JP Morgan has identified the most likely candidates among the large REITs in GPT (GPT)), Dexus ((DXS)), and Lendlease ((LLC)). There is, as per always, seemingly more potential among the smaller cap players in the sector: National Storage REIT ((NSR)), Abacus Property ((ABP)), Irongate Group ((IAP)), Hotel Property Investments ((HPI)), and Waypoint REIT ((WPR)).

Morgans has identified no fewer than 35 potential M&A opportunities for investors:

-Acrow Formwork and Construction Services ((ACF))
-Aerometrex ((AMX))
-Earlypay ((EPY))
-Cooper Energy ((COE))
-Karoon Energy ((KAR))
-a2 Milk ((A2M))
-GrainCorp ((GNC))
-Treasury Wine Estates ((TWE))
-United Malt Group ((UMG))
-Tabcorp Holdings
-Japara Healthcare ((JHC))
-Mach7 Technologies ((M7T))
-Regis Healthcare ((REG))
-Volpara Health Technologies ((VHT))
-Blackmores ((BKL))
-Dalrymple Bay Infrastructure ((DBI))
-Silk Logistics Holdings ((SLH))
-Nufarm ((NUF))
-iCar Asia ((ICQ))
-Iress ((IRE))
-Praemium ((PPS))
-National Storage REIT
-Bapcor ((BAP))
-Baby Bunting ((BBN))
-MyDeal.com.au ((MYD))
-Redbubble ((RBL))
-The Reject Shop ((TRS))
-Data#3 ((DTL))
-LiveHire ((LVH))
-NextDC ((NXT))
-Over The Wire Holdings ((OTW))
-Superloop ((SLC)

-Qube Holdings ((QUB))
-APA Group ((APA))
-Spark Infrastructure ((SKI))

Theme 3: Dividend Super Cycle

On Morgans' data, the percentage of ASX-listed companies who paid out a dividend in February rose to 57%, from 53% in August. Market forecasts for earnings and dividends have risen by approximately 14% since then, which pulls back total dividends domestically to equal the total payout from 2019.

What has improved is the average payout ratio: circa 70.5% now versus 75% two years ago, leaving businesses with more to invest for the future.

No surprises here when all and sundry are once again looking at the banking sector to reinstate dividends and add additional payouts and share buybacks on top due to excess liquidity. ANZ Bank ((ANZ)) already surprised early this month, will CommBank ((CBA)) follow suit next month?

No surprise, also, many eyes are staring at BHP Group, Rio Tinto, Fortescue Metals and other iron ore producers for positive surprise potential on excess cash and little appetite to spend it on operations and/or M&A.

Insurers could surprise too. And Ampol ((ALD)) is everybody's favourite this year to splash out on extra shareholder benefits.

As per standard practice, FNArena will be paying close attention over the coming six weeks. Our dedicated year-around Corporate Results Monitor is empty, but won't be for long:

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

(There is an archive to research past reporting seasons for paying subscribers)

Predicting The Next Index Changes

Better early than late seems to be the motto at Wilsons as quant analyst Angus Stains has already published his predictions for the next update on Australian share indices. Index manager Standard & Poor's is expected to update on the composition of Australia's leading indices on September 3, with any changes only taking place on September 17th, after the market close.

Starting from the top, Wilsons is not expecting any change to the current ASX20, but since the ASX50 now has 51 constituents (Woolworths ((WOW)) and Endeavour Group ((EDV)), at least one change is to be announced. Wilsons sees potential for multiple changes.

Most likely to be dropped are a2 Milk ((A2M)) and AGL Energy ((AGL)), with Ampol ((ALD)) seen as a possible drop-out too. In their place, Seek ((SEK)) and BlueScope Steel ((BSL)) are seen as likely candidates to join. Were S&P to also remove Aurizon Holdings ((AZJ)) and Origin Energy ((ORG)), then ResMed ((RMD)) and Mineral Resources ((MIN)) seem best placed.

The ASX100 is expected to see fewer changes with only Beach Energy ((BPT)) identified as a likely drop-out, and no one to be added (because of Woolworths-Endeavour). Wilsons thinks it is possible Link Administration ((LNK)) might be dropped too. In that case, Steadfast Group ((SDF)) seems most likely for inclusion.

Traditionally, changes in the ASX200 tend to have more noticeable impact on share prices, as funds managers literally jump off and on board in case of exclusions and additions. Here, Wilsons sees Nuix ((NXL)), NRW Holdings ((NWH)), G8 Education ((GEM)) and Westgold Resources ((WGX)) all losing their membership in September. S&P could also decide to drop Spark New Zealand ((SPK)).

Most likely candidates to fill in the newly vacant spots have been identified as Pinnacle Investment Management ((PNI)), SeaLink Travel Group ((SLK)), De Grey Mining ((DEG)), Event Hospitality & Entertainment ((EVT)) and, at a lesser chance, Piedmont Lithium ((PLL)).

As is traditionally the case, there might be more changes coming up for the ASX300, but because of tie-ups such as between Orocobre and Galaxy Resources, the September reshuffling should see noticeably more inclusions than removals.

Have been identified as most likely to be added in September are: Paladin Energy ((PDN)), Imugene ((IMU)), Liontown Resources ((LTR)), Betmakers Technology ((BET)), Novonix ((NVX)), Johns Lyng Group ((JLG)), Strike Energy ((STX)), Australian Strategic Materials ((ASM)), Dubber Corp ((DUB)), and HomeCo Daily Needs REIT ((HDN)).

The six candidates who might find themselves friendless, at least immediately after the announcement, are Bubs Australia ((BUB)), Synlait Milk ((SM1)), Integrated Research ((IRI)), Maca Ltd ((MLD)), Medical Developments ((MVP)), and Humm Group ((HUM)).

Wilsons sees an outside change that SSR Mining ((SSR)) too might be dropped from the ASX300, in which case Syrah Resources ((SYR)) is expected to make a come-back.

Conviction Calls

Morgan Stanley's Australia Macro+ Focus List (read: stocks most positively viewed with extra conviction at this particular point in time) currently consists of the following ten inclusions:

-Ansell ((ANN))
-APA Group ((APA))
-BlueScope Steel ((BSL))
-Downer EDI ((DOW))
-Qantas Airways ((QAN))
-QBE Insurance ((QBE))
-REA Group ((REA))
-Scentre Group ((SCG))
-Telstra Corp ((TLS))
-Westpac ((WBC))

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A collective effort among **Macquarie analysts** has identified 16 investment ideas ahead of the August reporting season; 14 positive ideas with Domino's Pizza ((DMP)) and Suncorp ((SUN)) as the two negative outliers.

Returning to the positive "**Best Analyst Ideas**"; Amcor ((AMC)), Brambles ((BXB)), Coles ((COL)), Transurban ((TCL)) among defensives, Afterpay ((APT)), Charter Hall ((CHC)), ResMed ((RMD)) and Seek ((SEK)) among the local growth stocks. Favourite ideas for capital return: Ampol ((ALD)), BHP Group ((BHP)), Deterra Royalties ((DRR)) and Fortescue Metals ((FMG)).

Plus two cyclical ideas to round up the list: Eagers Automotive ((APE)) and BlueScope Steel.

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Last week's update on stockbroker **Morgans Model Portfolio** certainly provided some eye brow-raising suggestions such as that the Core Model Portfolio is holding on to its shares in Sydney Airport ((SYD)) in anticipation of a higher offer to shareholders.

Portfolio managers also decided to top up their ownership in Woolworths-spinoff Endeavour Group, while switching into Santos ((STO)) and out of Woodside Petroleum ((WPL)) and slightly trimming the position in Brickworks ((BKW)).

Morgans' Growth Model Portfolio waved good bye to outperformer Collins Foods ((CKF)) and initiated a new position in TechnologyOne ((TNE)) instead, welcoming the latest addition as "a great steady earnings compounder well suited to the Growth portfolio".

August Bonanza, But What's Next?

The upcoming August corporate reporting season should offer plenty of positives for Australian shareholders.

With both banks and large cap mining companies swimming in cash, there should be plenty of additional rewards on top of a strong recovery in post-2020 dividends. Both ANZ Bank and National Australia Bank have already indicated as much and Rio Tinto's larger-than-usual payout, including a bonus dividend, is equally but the first sign of what is likely to follow over the coming four weeks.

But the benefits that await from August stretch much wider; the quicker than anticipated economic recovery has fueled a much quicker than forecast recovery in corporate profits and balance sheets, and thus Australia awaits **an even greater recovery in dividends** across the board.

But wait, there is more, a lot more. Asset sales are providing the proverbial cherry on the cake with REITs and companies including Waypoint REIT, Telstra and Insurance Australia Group selling off parts of the business with the intention of (at least partially) passing on the proceeds to shareholders.

And, would you believe it, there is more, still. Increased confidence in that the world will overcome the challenges provided by covid, has interest in pursuing **mergers & acquisitions** spiking noticeably on the ASX. The latest such announcement came from Afterpay on Monday morning, informing investors its board had agreed to a full take-over by US-listed Square.

We already knew about suitors for Sydney Airport, Oil Search, Japara Healthcare, Spark Infrastructure, iCar Asia, and Iress among mid and larger cap names, but chances for the next suitor to announce itself for an ASX-listed target are improving by the day, or so it seems.

Can Treasury Wine Estates be next? Or Challenger or Praemium, maybe? How about Aerometrex, Bapcor or NextDC? Is Altium now fully off the hook? *(See also last week's Weekly Insights for a list of potential targets)*.

Corporate Profits

In terms of corporate profits, the general expectation is that profits in aggregate are back to where they were pre-pandemic, though this won't be the case for every company individually, of course. Strong underlying support is provided by continuous upgrades to market forecasts which have now been rising for eleven months uninterrupted.

On average, earnings per share for the financial year that ended on June 30 are expected to have risen by circa 26%; this percentage is projected to rise to 45% for the year to December 31st, but for FY22 ending in June next year projected growth sits around 10% and by December 2022 it is close to zero.

One year ago, the average EPS in Australia fell by -19.3%. At the start of 2021, the forecast was for 8% EPS growth in FY21 (showing just how strong those upgrades have been since, carried by resources and financials).

What Comes Next?

The numbers above show the challenge for the Australian share market beyond August: how much growth is left beyond the initial V-shaped recovery?

The answer to that question might prove all-important because share markets are not cheaply priced. The local market's average Price Earnings (PE) ratio is still around 20x if current forecasts for the year to June 30 prove correct. But share markets are forward looking and that PE ratio falls to 17x-something by year-end and will shrink further by June next year if/when current growth forecasts improve further.

But can they?

The question will remain on investors' mind as countries struggle to vaccine populations and contain the virus, central bankers are looking for signs to start reducing liquidity and monetary stimulus, and bond yields might not stay at current depressed levels forever and always.

It would be a big ask for domestic companies to provide all the necessary answers in August, quite unrealistic to be frank about it, but share buybacks, bonus dividends and an explosion in M&A announcements at the very least show there is a lot of (quiet) confidence on display.

And confidence, as every economist and central banker will assure us, is extremely important for financial markets and economies alike. Investors will be hoping inflation will prove transitory and governments will figure out how to deal with the virus, as with climate change.

Bottom line: the outlook for equities won't be solely determined by profits and dividends, but for the four weeks ahead they are nearly all that matters, with the general framework set for a genuine cash splash bonanza on the ASX. Incidentally, data accumulator FactSet reports the second quarter in the US is generating the best outcomes on multiple metrics since FactSet started its US corporate data series in 2008.

US share markets are in a similar position as the ASX: not cheap, but with strong underlying support, and with multiple serious question marks ahead, though few will question the resilience of the mega-trends in the background.

Dividends In Strong Up-Trend

When it comes to specific sectors and individual companies, the key difference between Australia and the US cannot possibly be more accurately illustrated as through Rio Tinto's ((RIO)) super-dividend announcement last week.

As the shares are essentially trading on a double digit yield percentage, because the market doubts iron ore priced above US$200/tonne is sustainable, Rio Tinto's half-yearly payout amounts to a 5%-plus cash distribution; or what shareholders pre-pandemic came to expect from their beloved banks is now being paid out over six months only, with more to follow.

The yield on Fortescue Metals' ((FMG)) dividend in August should be even higher, while a more diversified BHP Group ((BHP)) should still pay out more than each of the banks this year.

Sure, there is every chance this year marks the peak in payouts for these companies, but it remains an open question how long iron ore prices keep feeding into excess capital and exactly how quickly the transformation to a more normal payout will ensue for the sector.

Other candidates to surprise with their dividends in August include Deterra Royalties ((DRR)), Iluka Resources ((ILU)), OZ Minerals ((OZL)), QBE Insurance ((QBE)) and Santos ((STO)).

As the likes of JP Morgan will remind their clients over the weeks ahead: Australia is only at the start of a **Super Cycle in Dividends** that goes well beyond this year's extraordinary payouts from iron ore producers.

As per usual, Australian investors should not allow themselves to be blinded by high yields only, as history shows superior investment returns are achieved through combining yield with growth.

In Focus: Margins

History also shows the better investment returns come from owning companies whose profit margins are on the rise. It is for this reason that investors remain uncertain about what the year(s) ahead might look like, even if the economic recovery continues unabated. Rising costs, already showing up in "transitory inflation", can play havoc and become a major impediment for companies unable to pass on or contain costs.

A recent analysis by Wilsons suggests an extra complicating matter might present itself as covid might lift or lower margins for certain sectors, with potential consequences for how investors value companies in these sectors.

Wilsons' analysis suggests margins might now be lower-for-longer for industrials and consumer staples, while there appears to be a bias for higher margins in sectors information technology and materials.

An interesting role in this context might be reserved for the Australian dollar. Earlier forecasts had AUD/USD at 0.80c if not 0.85c but instead the cross seems to have settled below 74c and more iron ore weakness and a dovish RBA could well push it closer to 70c.

Morgan Stanley pointed out recently some 27% of the ASX ex-resources is made up of foreign growers who should all benefit from a weaker domestic currency. Think Amcor, ResMed, Cochlear and Aristocrat Leisure, but also Ansell, Pro Medicus and QBE Insurance.

Nominations: Winners & Losers

As happens for every season, analysts pick their potential winners and losers ahead of the real event. This year, those lists are more extensive than usual. The overall bias is unmistakably for more upside surprises relative to negative disappointments. Apart from all of the above, maybe the big hint lays with the so-called **confession season** that precedes each February and August in Australia; it has virtually gone quiet.

When was the last time a big profit warning shocked the market? Not so long ago the likes of Canaccord Genuity kept an overview of profit warnings and that list would swell to above 100 companies. But that was pre-pandemic. Post-pandemic we have a different dynamic, as also illustrated by the statistics that coloured the past three reporting seasons: before, during and after February.*(see archive for the FNArena Corporate Results Monitor on the website)*.

On my observations, not backed up by any firm statistical analysis, most incorrect predictions usually involve analysts fearing the worst. Companies tend to find a way to smooth things out, or to combine disaster with a positive twist (extra dividend, restructuring, asset sales, lay offs, etc).

Hence, for what it's worth, companies that tend to get mentioned in a negative sense ahead of their August reports ("downside risks") include:

-AMA Group ((AMA))
-Boral ((BLD))
-Domain Holdings ((DHG))
-Elmo Software ((ELO))
-Flight Centre ((FLT))
-InvoCare ((IVC))
-PolyNovo ((PNV))
-REA Group ((REA))

Companies perceived to have a predilection for upside surprise in August:

-Adore Beauty ((ABY))
-Audinate Group ((AD8))
-ARB Corp ((ARB))
-Breville Group ((BRG))
-Computershare ((CPU))
-Downer EDI ((DOW))
-IDP Education ((IEL))
-Integral Diagnostics ((IDX))
-NextDC ((NXT))
-NRW Holdings ((NWH))
-Ridley Corp ((RIC))
-Resimac Group ((RMC))
-Seven Group ((SVW))
-South32 ((S32))
-Universal Store Holdings ((UNI))
-Whitehaven Coal ((WHC))

There is always a list that attracts both cons and pros. It would not be fair to mention them in either of the above lists:

-CSL ((CSL)
-EML Payments ((EML))
-Lendlease ((LLC))
-ResMed ((RMD))
-Super Retail Group ((SUL))
-Seek ((SEK))

Candidates for fresh capital management announcements:

-Ampol ((ALD))
-BHP Group
-CommBank ((CBA))
-Fortescue Metals
-South32
-Telstra ((TLS))
-Woolworths ((WOW))

Lastly, a company that happens to disappoint in results season is not by definition not worth buying or holding on to, just like not every winner in the season is an excellent longer term investment. Every reporting season builds a narrative and there will always be fresh insights and conclusions that can prove vital later on.

Conviction Calls

Stockbroker **Morgans** has updated its **Best Ideas** pre-August reporting season.

This has led to the inclusion of five new names: Treasury Wine Estates ((TWE)), Transurban ((TCL)), AusNet Services ((AST)), Tabcorp Holdings ((TAH)), and Hotel Property Investments ((HPI)).

In the stockbroker's own words, Best Ideas are those that come with the highest risk-adjusted returns over a 12-month horizon, supported by above-average confidence.

Early Days, But Plenty Of Signs

The August reporting season in Australia is still very young. The FNArena Corporate Results Monitor only contains 19 updates on Monday, August 9th (see further below), but already the main themes of the season are there for all to see:

-A humongous dividend from Rio Tinto, including a bonus payout
-A special dividend from Suncorp (plus share buyback)
-The promise of a share buyback from News Corp
-Asset sales are in full swing, as is M&A
-Industrial bricks and mortar assets continue enjoying revaluations
-Just under half (9 out of 19) of companies performed better-than-expected
-Covid-losers are achieving the strongest bounce-backs (unsurprisingly), but covid-winners are not by default turning into losers
-Those who miss market expectations (only a few to date) are likely to do so because of higher costs
-Covid and lockdowns continue having an impact, as expected
-Overall, companies remain reluctant to provide quantitative guidance
-Analysts remain conservative in their forecast upgrades given lockdowns and other uncertainties

Take a short stroll through the aforementioned Corporate Results Monitor and all of these themes will be found. It's early days still, but it is well possible the rest of August will simply provide investors with more of the same.

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When it comes to share price action, however, August might be a lot trickier to navigate than usual. Witness: shares in Rio Tinto ((RIO)) are down more than -4% since the announcement of that Grand Dividend; REA Group ((REA)) lost -8% in a heartbeat and ResMed ((RMD)) shares too opened some -3% lower on Friday but have subsequently recovered to a small gain.

And macro factors haven't genuinely commanded a primary role over that brief period.

The share price weakness in Rio Tinto shares is closely correlated with movements and market sentiment concerning the price of iron ore. One would assume most investors are well aware virtually nobody, including the producers themselves, believes this year's elevated prices are sustainable. Hence, those market beating dividends might well include some compensation in the form of share price erosion.

The investment case for Friday's three reporting companies looks equally tricky as all of News Corp ((NWS)), REA Group and ResMed were trading at or near an all-time record high, similar to Rio Tinto. Does it matter? Well, News Corp shares, despite the promise of share buybacks coming under consideration and potentially a better year ahead, has equally seen selling pressure emerge after the market update.

Clearly, there are limits to investor optimism, at least in the short term. Note also: News Corp shares remain well below most broker price targets, so there's no natural safety in a share price that isn't maxed out when the financial result doesn't fully satisfy.

The difficult task ahead for investors is to assess the real importance of these short term moves in share prices, and whether they tell us anything about the way forward. Within this context it is good to keep in mind that companies that manage to beat expectations, and force analysts to lift forecasts and valuations, usually see their share price outperform for up to four months after the market update.

The future profile for those that miss is a lot less straightforward, history suggests, and punishments can be immediately, savagely, or through persistent underperformance over a prolonged period of time.

The best way to handle the information that is updated during results season is thus by forming a view about the longer-term future of the company behind the share price. And here, dare I say it, the fundamentals for ResMed and REA Group continue to look a lot more solid than for most other companies that have reported thus far.

It is no coincidence, both are proud members of my selection of **All-Weather Performers** on the ASX, and they have been since the inception of my research.

The Strong Are Getting Stronger

Whenever investors ask me: what makes a true All-Weather Stock? My knee-jerk response is usually: a company that consistently invests in its business.

The longer I observe the share market and its multitude in business models, the more I come to this very simple conclusion: from the moment a business starts cutting corners and stops investing in itself, it is gambling on the possibility that nothing unforeseen happens to its customers, its markets, its products and its competitive strengths.

This does not mean nothing untoward can happen. What it does mean is that if something negative occurs, this type of business can handle it, or it knows how to respond relatively quickly. In most other cases, the damage might well be terminal.

Which brings me to one theme that was not mentioned in the list above: recessions and pandemics cause the strong to become stronger. There is, of course, a strong correlation between being a market leader that does all the right things, like investing substantially in the business, and witnessing one's prospects improve on the back of global misery.

The share market may not necessarily always like it, not in the immediate term, but eventually the benefits reaped from those investments will translate into healthy and sustainable rewards for shareholders.

The best example that comes to mind in this regard is that of Seek ((SEK)), whose market leadership for job advertisements in Australia has come under threat from multiple corners on multiple occasions over the past decade, and every time management at the helm responded with: we need to crank up the level of investment.

On each occasion the share price has come under pressure in the immediate aftermath of yet another "disappointing" market update, but look where it ultimately has taken the share price.

Seek shares set an all-time high in July; they are a little lower now. The former is what counts in a long-term oriented portfolio; the latter is only important in the here and now.

Seek, too, has been on my list of All-Weather Performers since inception.

Other companies that come to mind include Aristocrat Leisure ((ALL)), Breville Group ((BRG)), Cochlear ((COH)), CommBank ((CBA)), IDP Education ((IEL)), and Woolworths ((WOW)), though there is a valid argument to be made I should mention all companies listed as All-Weather, potential All-Weather and All-Weather with question marks in the dedicated section on the website.

Not all report in August, and CommBank is not on my lists, but investors' portfolios would be well-served through exposure to any of these high quality businesses that know the secret sauce for staying on top of the corporate ladder.

Short Term Versus Long Term

Of course, we still want management to harbour a positive culture, to stay aligned with shareholders, to invest in the right places and at a favourable return, and we prefer markets that are non-cyclical with a less volatile structure, but all these characteristics still need to be complemented with substantial investments that are not one-offs and do not simply patch up various weak spots in the corporate armour.

Where things get a little trickier, once again, is that most companies I selected have been enjoying favourable long term trends, such as an ageing population, comfort food and the eternal popularity of automobiles. Some of these trends are ripe for disruption, some of the trends are arguably already under threat.

Here the most obvious victim is probably Ramsay Health Care ((RHC)). Up until 4-5 years ago, this leading operator of private hospitals provided better growth and better financial metrics than CSL ((CSL)), would you believe it? But dynamics for that industry have changed, and quite profoundly so, and this is why the share price has essentially trended side-ways, after the plunge from $80-plus.

Make no mistake, last year's pandemic and lockdowns have plausibly created a runway for growth that may well last two-three years because of the freeze in low priority surgeries, but there are also higher costs to be dealt with and it remains still to be seen how governments respond to the prospect of ever higher costs for general healthcare services.

Ramsay Health Care is still held in the All-Weather Portfolio, but I have to admit the thought has crossed my mind, on multiple occasions, that its name should probably be removed from my list. For now, the prospects for next year and beyond have kept this stock in the portfolio. Management has a major challenge at hand. I am not sure whether they can pull it off, beyond the immediate horizon.

And herein lays the true challenge for investors: at face value, Ramsay Health Care shares look a lot cheaper than the likes of Seek, ResMed and REA Group on very basic measurements such as the one-year forward looking Price-Earnings ratio, though I wouldn't call Ramsay particularly "cheap".

It is possible this gap in relative valuation helps Ramsay shares perform better if the FY21 financials beat forecasts, but I remain more confident in keeping ResMed and REA Group in portfolio and if/when their share prices weaken significantly, I'll be ready to increase portfolio exposure.

This is, ultimately, how you play the share market to your own advantage. Know what you are interested in, and why. Give confidence to the companies that deserve it. Keep a firm eye on the longer term.

Understand that quantifiable quality is rare and extremely valuable, and that 'valuation' is the one and only consideration for unproven, lower quality and cyclical companies (which is: most of them), but merely a short-term item for those exceptional businesses that are also listed on the ASX.

Not To Be Forgotten: The Bond Market

Results seasons are supposed to direct investors' attention to what really matters on the share market, and that is how business leaders at the helm of ASX listed companies create durable shareholder benefits and rewards, usually through growing the company's revenues, profits, cash flows and dividends.

But results seasons are seldom only about individual companies. Anno 2021 we can count the global pandemic and bond markets as two potential forces that can have a profound impact, either on individual companies or on markets in general. In particular the bond market can cause some serious tribulations, if/when global bond yields start rising once again.

Nobody really knows what has driven bond yields down since mid-March. All explanations I have come across seem partial influences, at best. What we do know is that bond yields are a lot lower than where they seemed to be trending towards up until March, and this has allowed Quality and Growth and Defensive stocks to once again show their most favourable colours.

Investors should, however, not underestimate the potential impact from bond market yields rising, as we all witnessed during the opening weeks of this calendar year. We don't know when or why exactly, but it seems but a fair assumption this will happen again, possibly before year-end.

What this means is that diversification in portfolios remains of paramount importance. Don't stare yourself blind on the strength of profits and dividends and capital returns this season; equally consider what a quick run up in bond yields might do to the share price.

This might be an opportune time to secure profits on the winning side and start looking at adding some laggards that might come to life on the back of bonds selling off (yields rising).

Whatever the strategy: don't make it a one-way bet on the direction of bond yields.

Also, keep in mind: companies that are capable of achieving sustainable strong growth will come out positively on the other end of bond market headwinds, though probably not immediately.

Conviction Calls

Last week's surprise takeover agreement between US fintech Square and local BNPL market leader Afterpay ((APT)) has triggered a genuine "Who Could Be Next?" research drive inside the local stockbroker community.

Whereas Morgan Stanley doesn't think investors should get too excited post-Afterpay, **RBC Capital** has weighed in with a three-tiered assessment, dividing potential ASX-listed technology targets over three baskets: Highly attractive targets, medium attractive names, and lowly attractive peers.

In the highly attractive basket we find: NextDC ((NXT)), Infomedia ((IFM)), Pushpay Holdings ((PPH)), Altium ((ALU)), and Hansen Technologies ((HSN)). The latter already is providing due diligence to a potential suitor.

Medium attractive targets include: Appen ((APX)), EML Payments ((EML)), Megaport ((MP1)), Macquarie Telecom ((MAQ)), and Fineos Corp ((FCL)).

Not so attractive, apparently, are: Xero ((XRO)), Pro Medicus ((PME)), Nearmap ((NEA)), and Elmo Software ((ELO)). Not all for the same reasons though. The first two are trading on elevated valuations, which acts as a natural deterrent, while for the latter two the future looks a lot less predictable with RBC Capital anticipating ongoing negative cash flows.

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Not a big fan of picking high dividend yielders whose shares look attractive because of operational headwinds and serious question marks that depress the share price, but it is one of the selections that always has investors' interest in Australia.

Morningstar has come up with the following "**10 Franked Income Ideas for Australian Investors**". Stocks selected are:

-Aurizon Holdings ((AZJ))
-Perpetual ((PPT))
-Link Administration ((LNK))
-GWA Group ((GWA))
-Westpac Banking ((WBC))
-APA Group ((APA))
-Telstra ((TLS))
-Magellan Financial Group ((MFG))
-Dexus ((DXS))
-Medibank Private ((MPL))

Morningstar seems confident there are no dividend traps included in that list.

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Morningstar also updated its selection of **Best Stock Ideas**, involving a switch out of Spark Infrastructure ((SKI)) and into Aurizon Holdings.

The 15 Best Stock Ideas are:

-a2 Milk ((A2M))
-AGL Energy ((AGL))
-Aurizon Holdings
-Brambles ((BXB))
-Challenger ((CGF))
-Cimic Group ((CIM))
-G8 Education ((GEM))
-InvoCare ((IVC))
-Lendlease Group ((LLC))
-Link Administration ((LLC))
-Southern Cross Media ((SXL))

-TPG Telecom ((TPG))
-Viva Energy Group ((VEA))
-Whitehaven Coal ((WHC))
-Woodside Petroleum ((WPL))

August: It's A Joke

Corporate reporting season in Australia; in most investors' mind that is only February and August, every year.

In practice, however, the bulk of companies tends to release its market update in the second half of each month, so we might as well call it the second-half-of-August reporting season.

I am not even exaggerating, not by the slightest. When the team at FNArena started updating the **Corporate Results Monitor**, some eight years ago now, we had to account for a lopsided schedule from day one, but -for reasons unknown- things have only grown even more lopsided since.

From memory, eight years ago we'd end up with some 100 companies having reported by mid-month, which meant there were a further 150-plus left for the closing two weeks of the season. The numbers have since gradually become slimmer and slimmer for the first two weeks, and thus larger and larger for the second half. Also because the stockbrokers we monitor have broadened their coverage over time.

Four years ago, we'd have 80-plus companies in the Monitor by mid-month. Last year that number had shrunk to a little over 50. This time around we ended up with 44. At this pace -dropping -50% in four years- we might as well shorten the whole season to two weeks only from next year onwards. Nobody's going to notice the difference!

Post-2018, my suspicion had been this shift to reporting later in the season was due to more and more local companies having to report bad news for shareholders. If it wasn't a big miss on forecasts, it'd probably involve a capital raising, or a dividend reduction, or a large write-down (non-cash, thus not-so-bad).

But if this were the case over the past three years, businesses clearly do not feel optimistic or confident enough to pull forward the timing for their financial results release. See the numbers this year. Or maybe this is simply a case of: it'll never revert back to a more spread-out scheduling worthy of its common label.

Once we've created a new habit, maybe there is no turning back from it.

Is two weeks long enough to talk about a results "season"?

What this lopsided scheduling does prevent is the ability to draw in-depth, far-reaching conclusions at the half-way point. By early September we expect to have covered off on circa 350 companies. So far, we have hardly scratched the surface in terms of numbers.

Hence, it's getting busy from here onwards. I do not precisely know what the coming two weeks might bring, nor what the exact impact will be on writing Weekly Insights on the coming two Mondays.

I'll do my best.

BHP, Dividends, And Breville Group

So far, so good. Eight days from the end of the domestic corporate results season (six trading sessions plus one weekend) and genuine 'beats' are outnumbering disappointing 'misses' by almost a factor of two-to-one.

More companies feel comfortable enough to provide some kind of guidance, though that is to be read as 'more than feared' beforehand, not a reference to the majority. Many companies are swimming in cash, and they have not hesitated to reward shareholders through increased payouts, special dividends, share buybacks, and M&A.

The share market as a whole is up for the month and local indices would have performed a lot better if not for the global growth scare that is unfolding in the background, which is partially why specific price charts for the likes of Fortescue Metals look like a fall-off-the-cliff experience -suddenly, quickly and savagely- but this also explains why AUDUSD has been below 72c instead of nearer to 80c.

Also, typically for Australia, the FNArena Corporate Results Monitor still only comprises of 140 reports, or an estimated 40% of the total number of individual companies. This goes a long way in explaining why most stockbrokerages are no longer publishing intermediate running updates on the season.

We still await more than 50% of financial results from the companies scheduled to report in August. Apparently, it's the bottleneck in accountants domestically we should blame for this out-of-kilter, heavy skew.

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Some of the early indications have solidified and gained more traction as the numbers to date have accumulated to 140 corporate updates. Many a company in Australia can report its sales, if not profits and dividend, have recovered to pre-pandemic level, or it anticipates to achieve full recovery over the year ahead.

This observation is incredibly important for a share market that has continued to trend upwards, setting new all-time record highs along the way. Most surprises, however, have come through cash dividends for shareholders with company boards lifting payout ratios much sooner than anticipated, despite ongoing challenges posed by the global pandemic.

In hindsight, it can be concluded both ANZ Bank ((ANZ)) and National Australia Bank ((NAB)) gave local investors the earliest indications that corporate Australia was gripped by quite an optimistic mindset in June.

August is not solely providing bliss and happiness, of course. While June-half financial numbers have been better-than-forecast on balance, the outlook for the December-half for many companies is a lot more circumspect as lockdowns across Australia remain in place.

Estimates are thus falling for retailers, travel agents, leisure companies, et cetera. The market is drawing confidence from the past in that once lockdowns end, a strong recovery should follow. This is why, so far, reduced forecasts because of renewed impact from lockdowns has not been met with savage punishment this month.

The market looks forward. One observation is that share prices remain supported by confidence that temporary lockdowns, even when extended, shall be followed up by a swift recovery in sales. This confidence is fueled by numerous companies reporting they were performing better-than-expected up until new lockdowns were announced in NSW, then Victoria and elsewhere.

Unsurprisingly, companies announcing a share buyback usually are rewarded through additional outperformance, though not in every case. Note, for example, the differences in share price performances for Janus Henderson ((JHG)), Suncorp ((SUN)) and Telstra ((TLS)) -all very strong- with the negative outcomes for Fletcher Building ((FBU)) and Emeco Holdings ((EHL)).

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The Big Surprise this season has come from dividends and here, Janus Henderson reports, we are witnessing a global phenomenon. Global dividends experienced a sharp fall in 2020, but Janus Henderson forecasts total payout will rise above the pre-pandemic high in the year ahead.

Global dividends rose by 26% in the second quarter ending June 30th, so this month's sharp increases announced in Australia are not even included yet. On the fund manager's calculations, global dividends have now recovered to $628.3bn (US$471.7bn) for the quarter, which is only -6.8% below the level paid out in Q2 last year.

A few key observations to consider:

-Companies restarting cancelled payouts contributed three quarters of the underlying surge;
-84% of companies increased their dividends or held them steady compared to Q2 2020;
-In Asia Pacific ex Japan, three quarters of companies increased or held their dividends with Australia boosted by banking dividends (pre-August);
-In a seasonally quiet quarter for Australia, payouts more than doubled (+103.6%) on an underlying basis;
-Janus Henderson has upgraded its 2021 forecast to $1.85trn (US$1.39trn) from $1.81trn (US$1.36trn); this new forecast is just -3% below the pre-pandemic peak, implying next year global dividends are set to rise to a new all-time record.

The dividend numbers are receiving an extra-boost from companies paying out a special dividend, as also witnessed in Australia this month, while an offset comes from companies cutting dividends in emerging markets. Underlying, estimates Janus Henderson, dividends globally are set for 8.5% growth in 2021.

One interesting observation was made by analysts at JPMorgan who observed that 33% of Australian companies reporting thus far have subsequently seen forecasts being downgraded with all sectors, except Staples, experiencing negative revisions this month.

A sign of growing wariness or a realisation company boards have pulled forward their reward for shareholders in order to sugarcoat for the headwinds and uncertainties that lay ahead? Worst hit sectors have been Utilities and Materials and the reasons for both seem pretty straightforward: energy markets and the price of iron ore.

All of AGL Energy ((AGL)), BHP Group ((BHP)), BlueScope Steel ((BSL)) and Mineral Resources ((MIN)) have suffered a decline in dividend forecasts this month, as have several of the more troubled names including AMP ((AMP)), Lendlease ((LLC)), and Vicinity Centres ((VCX)).

Macquarie, quite casually, observes prospects for growth in profits remain superior in the USA compared to Australia.

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In terms of individual companies, irrespective of what happens between now and early September, August 2021 will be marked down as the season when the Big Australian made that Big Dividend announcement; US$15bn, the largest in its corporate history, but BHP Group also made a seminal deal with Woodside Petroleum ((WPL)) and pulled its share market listing back home to the Big Southerly homeland.

In terms of truly historic announcements, it'll be plain impossible to beat BHP this season. There has been plenty of coverage by FNArena and media elsewhere, so I'll simply point out what I haven't seen mentioned elsewhere as yet.

Confronted with several opposing challenges and options, the current C-suite team at BHP has found solution in a narrative that should be on every long-term thinking investor's mind. Instead of milking its world-class assets in oil and gas during a time when the price of iron ore is likely heading down quite sharply from lofty US$200-plus per tonne levels, BHP has chosen for a hundred-year long journey into a sector it believes is primed for natural growth in the century ahead, fertiliser, with the ambition of becoming a powerful, low-cost disruptor.

On the other side of the deal we find a super-enthusiastic Woodside Petroleum, and for obvious reasons. Today's share price is a long way off from the highs seen in Q2 2008 and while Woodside stands to lose the mantle of Australia's largest oil and gas company because of the merger between Santos ((STO)) and Oil Search ((OSH)), the company has spent post-GFC in vain to find growth and to develop new projects at a satisfactory return.

Time to reel out my most favourite market observation: the energy sector, in Australia and elsewhere, has been by far the worst performer post-GFC. Santos once was seemingly destined for that elusive $20. Origin Energy (ORG)) shares equally used to trade in the mid-teens. Woodside used to be revered for its stable and attractive dividend.

Remove the movements in the price of oil and gas from the picture and what is left at Woodside Petroleum? A company ex-growth, struggling to find the capital without a large, shareholder-dilutive capital raising; a position it has been in for years. The deal with BHP will inject new momentum into the business that can possibly reverberate for many years.

But it won't last forever, of course, and most certainly not as long as BHP's entrance into Canadian potash. Deep down, below the surface, there is a real message in there for every investor. Short-term versus long-term. Instant reward against investing for longevity.

We all make those choices, or at least: we should.

Incidentally, the energy sector stands out so far this month with the weakest updates and the largest disappointments, as also illustrated through share price falls for Beach Energy ((BPT)) and Cooper Energy ((COE)). Woodside's half-yearly update was labelled as "weak" by all and sundry too.

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One company that caught my attention is Breville Group ((BRG)), proud manufacturer of iconic Australian household brands Breville, Kambrook and Sage. Less known, probably, is that Breville considers itself an innovator; it is Australia's first and foremost bridge into the Internet of Things (IoT), a future era when household goods start communicating with each other through the ether.

Management at the company decided to cut the dividend for shareholders, traditionally seen as 'blasphemy' among Australian investors, in order to ramp up investments into the company's future. On the day of the FY21 report release the share market responded with a good old shellacking, to which the**All-Weather Model Portfolio** responded with: I'll have some, thank you.

Breville Group has been on my radar for a long while. Those who are familiar with my research know it ranks as a 'Prime Growth Story' alongside the likes of Macquarie Group ((MQG)), Aristocrat Leisure ((ALL)) and Pro Medicus ((PME)). One cannot own them all at the same time and while the Breville share price has been cheaper, the All-Weather Portfolio was previously happily filled with plenty of durable, quality performers.

One of the names currently no longer held by the Portfolio is Pro Medicus, whose shares put on another big rally following the release of FY21 financials. This remains one of the highest quality growth stocks on the ASX, but it's also valued to the max.

Which simply means Pro Medicus remains on the radar for when a similar opportunity at the right time presents itself.

Next week we shall look into more companies that stood out or caught my attention this reporting season. Plus we will finally be able to draw conclusions by then that stand the test of time.

It's The End Of The Trend

Investing revolves around numbers. Investors like to focus on numbers, though sometimes, dare I say it, with too much emphasis. Successful investing goes beyond the temporary, static analysis of data, but we'll leave this topic for further discussion another time.

As per always, the August corporate reporting season in Australia has generated series of fresh statistics and numbers. Now the end of the month is beckoning, we might as well start off with the numbers that provide us with fresh new trends and updated, deeper insights.

Observation number one is that corporate Australia remains a bifurcated, multi-speed organism and many of the generalised statistics hide the fact that, underlying, the gap between Winners and Laggards remains large. Whether this swings the pendulum in favour of the positives or the not-so-positives -your typical glass-half-full or half-empty proposition- is very much dependent on the angle one starts off from.

The overall positive impetus from corporate results mostly meeting or slightly beating expectations, showing sharp recoveries and a clear bias towards rewarding shareholders, has ostensibly faded as the month matured.

On the FNArena Results Monitor assessment, as the number of corporate reports increased significantly throughout week 4 of the season, the percentage of 'beats' gradually moved away from the 39.1% it had risen to over the three weeks prior (128 companies in total).

On Monday, with the total number of companies having accumulated to 293, the percentage of 'beats' has fallen below 35%. This still indicates a positive reporting season, still above the pre-2020 average of 33%, though no longer as exceptional as the reports that had been delivered over the 11 months post August last year.

Of course, we must also take into account that analysts' forecasts had been rising for 11 months uninterrupted and so it was always a bigger challenge to keep beating those forecasts, in particular when growth in China, momentum in the US and lockdowns in Australia have started presenting fresh headwinds and challenges.

Irrespectively, the negative news that is hiding underneath the numbers from August is that **earnings momentum in Australia is now probably past its peak**. When all modeling and forecasts have been freshly updated over the coming days, it is likely that August will mark the first month of net negative earnings revisions, in aggregate, ending the strongest and longest positive trend the ASX has experienced over multiple decades.

Investors will be on the look-out for further signs that a new trend might be in the making; one that can have negative implications for the next six or twelve months ahead.

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According to CommSec, whose data analysis runs until last Friday, 84% of Australian companies are back in profit, which marks a significant improvement from last year, but the long term average is higher, at 88%. Moreover, and best not forgotten, for many ASX-listed companies government support and central bank stimulus have been key contributors to the sharp recovery in profits and cash flows.

This fact remains somewhat masked by the never dissipating desire among Australian boards to pamper and reward shareholders, and August witnessed a fierce recovery in dividends, accompanied by share buybacks and special/bonus payouts. Nevertheless, CommSec reports 18% of all reporters in August are not paying out anything to shareholders. This compares with a long-term average of 15%.

A year ago 31% did not pay out a dividend; by February that percentage had dropped to 21%. So, 82% of companies are now paying a dividend pushing up the aggregate cash pay out by 70%. Almost 60% of companies increased their dividend, only 13% had to cut it.

Capital returns through special payouts and share buybacks have become one of the stand-outs this month, and both banks and bulk commodity producers in particular featured prominently. When it comes to lifting dividends in general, all of financial institutions, food retailers, mining companies and telcos have contributed.

The total in dividends paid out to shareholders from this August reporting season might end up nearly double the total amount of last year (up 98% thus far).

Aggregate revenues lifted by 5% over the year to June, with 77% of companies on average increasing their top line by 18.1%. The aggregate net profit rose by 32% on the year prior. Cash holdings improved by $154bn to a record $210.7bn, but only 58% of companies are responsible for that increase.

On FNArena's assessment, thus far only 21.5% of companies delivered a 'miss' on market expectations, which is at the lower end of historical statistics, but the percentage has been climbing throughout the week past.

Rising costs, if not because of difficulties in finding skilled labour, have been held responsible for most disappointing performances, but covid and renewed lockdowns had a significant impact too, in particular when companies were asked to quantify guidance for the year ahead.

Unsurprisingly, those companies that came out with a quantified FY22 guidance, in particular if that guidance carried a positive undertone, have been rewarded this season, including the likes of WiseTech Global ((WTC)), James Hardie ((JHX)), Charter Hall ((CHC)), Goodman Group ((GMG)), Amcor ((AMC)), Mirvac Group ((MGR)), Telstra ((TLS)), and Stockland ((SGP)).

Forward guidances that were not so well received, at least not initially, included CSL ((CSL)), AGL Energy ((AGL)), Seek ((SEK)), Ansell ((ANN)), Origin Energy ((ORG)), Aurizon Holdings ((AZJ)), and Link Administration ((LNK)).

On Macquarie's analysis, some 16% of all companies to date did not issue guidance because of covid.

It is Macquarie's view that when it comes to highlighting some of the best corporate results that have been released thus far, investors should direct their attention towards WiseTech Global, Reliance Worldwide ((RWC)) and Medibank Private ((MPL)), but also Perenti Global ((PRN)), City Chic Collective ((CCX)), ReadyTech ((RDY)), Uniti Group ((UWL)), Macmahon Group ((MAH)), Eagers Automotive ((APE)), and AdBri ((ABC)).

As far as prominent sissers and missers are concerned, a2 Milk ((A2M)), AGL Energy, Appen ((APX)), Boral ((BLD)), Bravura Solutions ((BVS)), Kogan ((KGN)), Lendlease ((LLC)), Link Administration, Monadelphous ((MND)), nib Holdings ((NHF)), oOh!media ((OML)), Origin Energy ((ORG)) and Platinum Asset Management ((PTM)) spring to mind, as well a number of smaller cap miners and energy producers, with special mentioning of Afterpay ((APT)) and Woodside Petroleum ((WPL)) whose share prices proved immune but only because of pending deals in the making.

Remarkable, also, is that the numbers of 'beats' versus 'misses' for the ASX50 look decidedly different. FNArena's Monitor currently stands at 35.7% in beats against 31% in misses. Clearly, smaller cap companies are still outperforming their large cap peers on the ASX. At least that trend of the past couple of years has remained unchanged.

This observation is backed up by Macquarie, whose analysis shows more negative revisions to forecasts have gone to Top100 companies with ex-100 smaller caps faring better. Financials have been outperforming all other sectors on this aspect in August.

All up, and before all reports are in the open with subsequent re-modeling and updates by stockbrokers' analysts, it looks like FY21 will place average growth in earnings per share for ASX200 companies on circa 26.5%. This compares to a -20% decline a year ago and circa 10% growth expected for the year ahead. But as said: the latter number is now under downward pressure, thanks to delta.

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To showcase the market's ability to look beyond the immediate and over the hill on the horizon, look no further than travel agent Flight Centre ((FLT)). The release of its FY21 financials has been highlighted as a particularly weak set of results, though strictly taken it proved in-line with market forecasts, probably illustrating how low those forecasts had been set.

Flight Centre has been in existential crisis for most of the past 18 months, and the business is still struggling under the duration of renewed lockdowns in NSW and Victoria, but the share price is refusing to lay down. On current forecasts, the consensus price target sits at $16.66 and that's exactly where the shares are trading at as we approach the end of August.

The apparent resilience in Flight Centre shares matches a similar resilience for other covid-victims and shows investors are prepared to sit and wait in anticipation of a change in fortune which should arrive as soon as lockdowns are being lifted and the prospect of borders re-opening becomes a realistic point of focus.

Of course, when it comes to picking Winners from winning the war against covid, companies immediately on investors' mind would be the airports, travel agents, airlines, hotels, cinemas and leisure activities, but today's share market contains many more companies that stand to benefit from the prospect of successfully morphing into more 'normalised' societies yet again, including the likes of CSL, Ramsay Health Care ((RHC)), IDP Education ((IEL)), Audinate Group ((AD8)), and others.

In contrast, investors have become more cautious towards those companies that benefit from lockdowns and closed borders. Here it is good to realise by now today's covid-beneficiaries also include BlueScope Steel ((BSL)) and Sims ((SGM)), point out analysts at Macquarie. They believe current elevated US steel prices are not sustainable with a direct warning to investors: rapid falls in prices of lumber and iron ore show that when market dynamics change, the trend reversal downwards can come quickly and without proper warning beforehand.

Having said so, indications are coal producers might be the next commodity segment temporarily swimming in cash in the year(s) ahead.

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Allowing people to again move around and opening up borders will no doubt inspire a rally in stocks that are part of the so-called 'Value' trade on equity markets, but will it lead to a repeat of what happened between October and March when news about vaccines triggered a seldom seen sharp turn in market momentum in favour of financials, resources and other cyclicals, with Quality and Growth temporarily in the sin bin?

For that to happen, and to be sustained, the Value trade must be backed up by government bonds selling off, I believe, with sharply rising bond yields providing the necessary motivation to move money out of highly valued Quality/Growth and into lower valued cyclicals.

The problem with that scenario is that global growth is currently decelerating while market participants seem content with the general sentiment that this year's spike in price inflation is but a temporary phenomenon. Yet, many a forecaster is still projecting 10-year US treasuries at 1.80% or higher by year-end.

The enigma of the coming months does not stop with central banks or bonds. So far, equity indices haven't had a decent correction because underlying market momentum has simply flip-flopped between Value and Quality & Growth, and back and forth again. Will this remain the scenario for the months ahead?

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Analysts at CommSec are cautious for the year ahead, though still positive. They expect the ASX200 to move inside a range of 7500-7700 by mid-2022.

In the background, however, sits Macquarie's observation the latest OECD leading indicator suggests the US cycle is slowing faster than after the GFC. And the Federal Reserve is preparing for less monetary stimulus ("tapering").

It's probably a fair assumption to make that things are likely to become less straightforward, more volatile now that earnings forecasts are no longer rising, effectively removing one solid piece of support that has kept share market indices in a firm uptrend since last year.

I would as yet not be too worried about it all, but a bit of cash on the sideline might come in handy before the year is over.

September Blues

Last year, September was simply a pause in between the recovery from the pandemic sell-off and the subsequent low-volatility up-trend that still remains in place today.

In 2019, however, September delivered a lot more volatility and share market weakness. Things werent't looking too bright for the old economy parts of the Australian economy, and banks and cyclicals began announcing dividend cuts soon after.

In 2018, economic data started rolling over and the Federal Reserve seemed hell-bent on continuing to lift the official cash rate. Equities started to weaken and soon in quite the violent way, until the US Fed backtracked from its intention, but not before late December.

Pick your pick. September historically is the weakest month for US equities and more often than not does the month inject more volatility into financial markets, if only because we, the human participants, expect it to do exactly that.

Usually, the weakest and potentially most volatile period for the year announces itself between the second week of September and the second week of October. Roughly from mid-month to mid-month. Nobody knows exactly why.

So should we be worried?

As per the above mentioned three years past, the scenario for September is never set in stone. And only once in the three years did September open up the floodgate for something more serious to unfold than a pause or a temporary retreat.

This year, the focus is on decelerating global growth. How serious is it? How long will it last? I suspect most market participants are still quite sanguine about it. And there's a very straightforward reason for it: covid and lockdowns are to blame.

Media and commentators are constantly asking the question whether inflation is to remain 'transitory' or not, but I think most investors see the second half slump as 'transitory', and that's in itself an important observation.

It means investors are by definition looking beyond the months ahead and focusing on January 2022, and beyond. Covid and lockdowns are excruciatingly tough on small businesses and the most vulnerable in societies, but many consumers are running up their savings and are expected to re-emerge while wildly swinging their wallets, once they are allowed to.

It is this prospect, I believe, that will act as a natural deterrent to seeing markets drop into a violent black hole, irrespective of pockets of market exuberance, in particularly in the US, and generally elevated valuations, more so in the US than elsewhere.

My advice is therefore the same as with every other period of share market volatility: investors should use this period to reshuffle their portfolios.

Excellent long-term performers might become available at share prices that seemed impossible only a week ago.

And aren't we extremely lucky in Australia in that the August reporting season has only just finished; all data, forecasts, insights and views have been freshly updated.

Post-August: Five Themes For The Year Ahead

Corporate reporting seasons are the ideal event to update thoughts, views, even whole strategies. **Ord Minnett**'s Australian Equities Strategist, Sze Chuah, has taken the opportunity to review key investment themes for the year ahead. An exercise that should benefit us all.

Investment Theme #1 – Reopening societies and recovering economies:

-Consumers will increase their spending, but probably more towards restaurants, travel and entertainment, and probably more domestically as international travel won't be as popular or even available;
-Increased mobility will lead to a pick-up in energy usage and transport;

-This theme is most likely to favour the so-called 'Value'-trade

Ord Minnett's list of stocks to play this theme already contained ANZ Bank ((ANZ)), Origin Energy ((ORG)), Ramsay Health Care ((RHC)), SeaLink Travel ((SLK)), Star Entertainment ((SGR) and Tyro Payments ((TYR)). Post-August, Webjet ((WEB)) has now been added to the selection.

Investment Theme #2 – Income remains important

Interest rates and bond yields remain exceptionally low, hence investors' demand for income through the share market remains strong.

Post-August, Amcor ((AMC)) has been removed from Ord Minnett's list of preferred stocks to play this theme, but only because a rising share price had pushed Amcor's prospective yield below 4%. Weakness in September can make this assessment redundant quite quickly.

The four remaining favourites under theme #2 are APA Group ((APA)), Bank of Queensland ((BOQ)), Charter Hall Retail REIT ((CQR)), and Waypoint REIT ((WPR)).

Investment theme #3 -Financials that benefit from rising asset values

As an aside: the fact this remains one of the key themes on Ord Minnett's strategy menu tells us a few things about where the broker sees financial markets heading to over the year ahead. Merger and acquisition deals are equally included.

Ord Minnett's four theme favourites remain unchanged: Hub24 ((HUB)), Macquarie Group ((MQG)), Magellan Financial ((MFG)), and Perpetual ((PPT)).

Investment Theme #4 – Infrastructure investment

Ord Minnett remains of the view that governments, both in Australia and overseas, will continue their push for increased investment in infrastructure. This creates demand for raw materials and offers fresh opportunities for services providers through new contracts.

Ord Minnett has added Cleanaway Waste Management ((CWY)) to its selection of preferred exposures, with the stock joining Alumina Ltd ((AWC)), Orocobre ((ORE)), Rio Tinto ((RIO)), Service Stream ((SSM)), and Telstra ((TLS)).

Investment Theme #5 – Downside Risks

The fifth and final theme is a negative one; companies to avoid or to sell as it appears the risks are to the downside.

Post significant share price weakness -from near $7.50 to below $6- Boral ((BLD)) shares are now no longer included in the broker's Best to Avoid-list, but the following still are: AusNet Services ((AST)), Reece ((REH)), Orora ((ORA)), and OZ Minerals ((OZL)).

August: The Final Numbers

There are but a few certainties in life. Death. Taxes. And more disappointments are hiding in the tail end of each local corporate reporting season.

Now the dust has settled on the August season in Australia, the **FNArena Corporate Results Monitor** has determined that, out of the total of 346 companies covered by the seven stockbrokers that make up the Australian Broker Call Report, some 117 companies (33.8%) delivered a positive surprise ('beat'), while 75 companies (21.7%) surprised to the downside ('miss'), with the remaining 154 (44.5%) reporting broadly in-line with market expectations.

Historically, this still categorises as a net positive season, especially as estimates had been in an up-trend for 11 consecutive months prior to August, but the numbers looked a lot better two and three weeks into the season, as they always do.

Of more importance is that the exceptional numbers from post-August last year -when up to 49% managed to beat expectations- are now in the distant past, potentially to never be repeated ever again.

The percentage of negative disappointments fell as low as 13% in February.

Last week I reported Macquarie's forecasts had been revised down to 10% growth on average, and in aggregate, for the year ahead for the ASX200. This week I can add according to data-service Refinitiv market consensus has 20% EPS growth penciled in for FY22. Morgan Stanley sits at 19.4%. UBS, on the other hand, has post-August only 7% left for FY22.

It goes without saying, the local index looks a lot less/more attractive depending on whose numbers we take guidance from. Equally noteworthy: UBS sees dividends per share (DPS) only growing by 2% in FY22 following the spectacular rise of 59% in FY21, which was preceded by last year's -37.3% decline.

Somewhat disappointing, I found, Ord Minnett's most favourite themes for the year ahead did not include **Megatrends** or **Structural Growth**, which features prominently in my own research, strategy and share market approach. **Strategists at Wilsons**, on the other hand, do pay attention to this theme and their observation matches mine in that large numbers of companies that enjoy structural growth might be looking "expensive" on static looking data; they do continue delivering the goods.

On Wilsons' assessment, such companies include: Xero ((XRO)), Domino's Pizza ((DMP)), James Hardie ((JHX)), Charter Hall ((CHC)), Goodman Group ((GMG)), Afterpay ((APT)), ResMed ((RMD)), CSL ((CSL)), Carsales ((CAR)), REA Group ((REA)), and Fisher & Paykel Healthcare ((FPH)).

Among so-called emerging business models, Wilsons points at ARB Corp ((ARB)), Breville Group ((BRG)), Nick Scali ((NCK)), NextDC ((NXT)), Rural Funds Group ((RFF)), ReadyTech Holdings ((RDY)), Telix Pharmaceuticals ((TLX)), and Clinuvel Pharmaceuticals ((CUV)).

The overlap with my own research into All-Weather Performers is noticeable (see dedicated section on the website for paying subscribers, 6 and 12 months).

Wilsons has equally lined up its favourite stocks to position for benefit from reopening economies: Qantas Airways ((QAN)), Crown Resorts ((CWN)), Star Entertainment, APA Group ((APA)), Cochlear ((COH)), CSL, Computershare ((CPU)), Insurance Australia Group ((IAG)), IDP Education ((IEL)), Ramsay Health Care, Seek ((SEK)), Tabcorp Holdings, Transurban Group ((TCL)), Worley ((WOR)), Vicinity Centres ((VCX)), and Boral.

But also the following emerging companies (smaller caps): Integral Diagnostics ((IDX)), Silk Laser Australia ((SLA)), Costa Group ((CGC)), and Select Harvests ((SHV)).

And then there is the flipside of the coin: companies that might find life tougher once covid and lockdowns are less of a dominant factor in our societies: Coles Group ((COL)), Metcash ((MTS)), Woolworths ((WOW)), Amcor, Sonic Healthcare ((SHL)), Reece, Reliance Worldwide ((RWC)), Fisher & Paykel Healthcare, JB Hi-Fi ((JBH)), Harvey Norman ((HVN)), Wesfarmers ((WES)), and BlueScope Steel ((BSL)).

And among smaller cap companies: Eagers Automotive ((APE)), ARB Corp, Autosports Group ((ASG)), Motorcycle Holdings ((MTO)), Marley Spoon ((MMM)), Collins Foods ((CKF)), Nitro Software ((NTO)), Breville Group, and Aroa Biosurgery ((ARX)).

Macquarie observes growth in FY21 mostly related to resources and banks, but both stories are labeled "one-offs" and growth's pendulum in Australia is expected to again tilt towards offshore earners. While shares in most of these companies are trading on higher valuations, Macquarie believes their EPS growth is equally poised to come out (much) higher than the market average.

Stocks to consider include: James Hardie, Ramsay Health Care, Cochlear, Brambles ((BXB)), Amcor, Seek, and Computershare.

Macquarie has also lined up a small selection that, based on their history, is likely to upgrade FY22 guidance later on: James Hardie, Charter Hall, Amcor, and Goodman Group.

Morgan Stanley has a target for the ASX200 of 7200 by mid next year. No surprise, the firm's local share market strategist is preaching caution.

All-Weathers In August

August, would you believe, marked the sixth consecutive month of relative outperformance with the **All-Weather Model Portfolio** returning 3.17% ex of fees for the month. The return over the past three months has risen to 12.27%.

I always feel inclined to add these returns are achieved without taking on above average risk. On my observation of the past 6.5 years (since inception) reporting seasons tend to mostly benefit the Portfolio. Maybe Quality has a habit of mostly performing well?

Changes made were few and far between throughout August. The Portfolio used weakness in Ansell to buy additional exposure and following weakness in Breville Group it was decided to initiate inclusion for the latter.

It is not expected the lists of companies on my personal radar will undergo a lot of changes post-August, as per tradition. A number of stocks did catch my attention, and they are mostly situated in the smaller segment of the share market, which means higher risk, even if management at the helm does nothing wrong.

Investors should always conduct their own research, but post-August they might well direct some of their attention towards: Audinate Group ((AD8)), Aussie Broadband ((ABB)), Class ((CL1)), Codan ((CDA)), EML Payments ((EML)), Fineos Corp ((FCL)), Hub24 ((HUB)), Jumbo Interactive ((JIN)), MNF Group ((MNF)), PWR Holdings ((PWH)), Silk Logistics ((SLH)), and Uniti Group ((UWL)).

Unfortunately, financial updates by the likes of Appen ((APX)), Altium ((ALU)) and Bravura Solutions ((BVS)) once again proved many inside the local technology sector are finding market dynamics a lot tougher these days, but then WiseTech Global ((WTC)) delivered one of the big upside surprises for the season. Gone are the days that offshore and local shorters seemed to have the last laugh.

Conviction Calls

Key large cap stocks to own on a 6-12 months view post the August reporting season, according to **Wilsons**, are: CSL, Goodman Group, Insurance Australia Group, James Hardie, National Australia Bank ((NAB)), News Corp ((NWS)), OZ Minerals, ResMed, Telstra, and Xero.

Key smaller cap stocks: Adairs ((ADH)), ARB Corp, Aroa Biosurgery, Collins Foods, Countplus ((CUP)), EML Payments, NextDC, Plenti ((PLT)), Pacific Smiles ((PSQ)), ReadyTech Holdings, and Universal Store Holdings ((UNI)).

****

Macquarie's favourites to play the re-opening through vaccines trade are: Qantas Airways, Webjet, Star Entertainment, SkyCity Entertainment ((SKC)), Ramsay Health Care, Cochlear, Transurban, Dexus ((DXS)), Mirvac Group ((MGR)), Seek, IDP Education, and Cleanaway Waste Management.

****

Morgan Stanley's ten selections for the Australia Macro+ Focus List remain: Ansell, APA Group, BlueScope Steel, Downer EDI ((DOW)), Qantas Airways, QBE Insurance ((QBE)), REA Group, Scentre Group ((SCG)), Telstra, and Westpac ((WBC)).

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WEEKLY REPORTS

Weekly Ratings, Targets, Forecast Changes - 24-09-21

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 September 20 to Friday September 24, 2021
Total Upgrades: 9
Total Downgrades: 3
Net Ratings Breakdown: Buy 53.72%; Hold 38.41%; Sell 7.87%

For the week ending Friday 24 September, there were nine upgrades and three downgrades to ASX-listed companies covered by brokers in the FNArena database.

Sandfire Resources had the largest percentage fall in target price last week after announcing the acquisition of the MATSA underground copper mine and production plant project in Spain for $2.6bn. This will add around 110,000 tonnes per annum copper production in FY22 and will be funded by a $1.2bn equity raising, $1.1bn in debt and existing cash. Credit Suisse estimates the deal may be -30% dilutive to shareholders and downgrades its rating to Neutral from Outperform.

Meanwhile, New Hope Corp had the largest forecast percentage rise in both target price and earnings by brokers in the FNArena database, after a FY21 result that was largely in line with expectations. Nonetheless, Credit Suisse reacted by lifting its coal price forecasts, which in turn increased FY22 earnings estimates by 29%. Assuming no M&A or major investment in the near-term, Morgans sees upside for both capital and shareholder returns.

Coming second on the table for a rise in forecast earnings was Kathmandu Holdings. Management announced an offshore launch of the Kathmandu brand, with expansion into Europe and Canada due in FY22. While Macquarie does not include this expansion in estimates, a successful execution is thought to deliver upside to forecasts. A recovery later in FY22 is expected, assuming no lockdowns and a moderation of supply chain headwinds.

Next up was Transurban Group after announcing a $5.6bn acquisition cost for a 49% stake in WestConnex via a 1-for-9 entitlement offer at $13 to raise $4.2bn. Ord Minnett considers the transaction is positive, given the group's expertise, intimate knowledge and control of the asset. Management emphasised the acquisition will mean a further $600m in capital is released in coming years that will be used to offset dilution caused by the acquisition.

After FY21 results, Karoon Energy received a material percentage increase in earnings forecast by brokers. Macquarie (Outperform) notes production guidance was better than expected from Bauna and highlights strong cash flow at spot oil prices.

A technical glitch has put Crown Resorts atop the table for earnings downgrades, so best to ignore.

The largest percentage fall in forecast earnings by brokers in the FNArena database last week went to Premier Investments. The final dividend of 46cps was below consensus of 54.7cps and the forecast for 64.5cps by UBS. Retail earnings margins were also slightly lower than the analyst's forecast. Morgan Stanley feels earnings growth in FY22 is looking increasingly challenged due to lockdowns, lower demand and lower margins.

Total Buy recommendations take up 53.72% of the total, versus 38.41% on Neutral/Hold, while Sell ratings account for the remaining 7.87%.

__Upgrade__

AGL ENERGY LIMITED ((AGL)) Upgrade to Buy from Hold by Ord Minnett .B/H/S: 1/2/2

With shares now trading below the estimated value for AGL Australia (Retail) alone, Ord Minnett upgrades its recommendation on AGL Energy to Buy from Hold, while the target price reduces to $7.55 from $7.80.

The company remains committed to separating its business into retail and generation (Accel Energy) by mid-2022.

While the broker sees potential for strong corporate appeal in AGL Australia, there's likely to be very little interest in Accel Energy. This is because of its exposure to coal, its leverage to wholesale prices and its sizeable rehabilitation costs, explains the analyst.

AUSNET SERVICES LIMITED ((AST)) Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 0/6/0

The potential for corporate activity, with the company receiving an offer from Brookfield, highlights for Morgan Stanley the cost of capital differential between listed and unlisted investors.

This drives the broker to upgrade to Equal-weight from Underweight. Target is raised to $2.41 from $1.77.

Should the proposed transactions proceed, the de-listing of both AusNet Services and Spark Infrastructure ((SKI)), Morgan Stanley points out, will mean there is no pure regulated utility left on the ASX.

The main concern is that the Australian Energy Regulator may perceive the premium in the proposed transactions a sign that regulated allowances are overly generous and seek to reduce them accordingly, suggests the analyst. Industry view: Cautious.

BAPCOR LIMITED ((BAP)) Upgrade to Buy from Neutral by Citi .B/H/S: 5/1/0

Citi considers the risk/reward trade-off has become favourable now the share price has declined substantially from its August peak. The emergence from lockdowns in NSW and Victoria should start from October and the company obtain a benefit.

Rating is upgraded to Buy from Neutral and the target raised to $8.25 from $8.20.

BABY BUNTING GROUP LIMITED ((BBN)) Upgrade to Buy from Neutral by Citi .B/H/S: 4/1/0

Citi upgrades its rating for Baby Bunting Group to Buy from Neutral with the risk/reward tradeoff seen as more favourable following the -12% share price decline since the FY21 result. The target price rises to $5.98 from $5.90 on higher market multiples.

The analyst feels the group is well placed to report a relatively stronger AGM trading update compared to most listed retail peers, given the non-discretionary nature of its products.

Ord Minnett forecasts gross margins to expand by 68bps in FY22. This is driven by a forecast increased share of higher margin private label and exclusive product sales, and supply chain efficiencies from the new national distribution centre in Melbourne.

CHAMPION IRON LIMITED ((CIA)) Upgrade to Buy from Neutral by Citi .B/H/S: 2/0/0

While Citi lowers its price target for Champion Iron to $6.40 from $7.25, the broker raises the rating to Buy from Neutral after recent share price underperformance. It's thought iron ore may hold at greater than US$100 per tonne levels for longer than the market expects.

The analyst believes China's lead indicators are stabilising and have turned up off recent lows. The fact steel prices have stayed high is considered to point to consumption being driven more by state imposed production cuts than weakness in underlying demand.

EVENT HOSPITALITY & ENTERTAINMENT LIMITED ((EVT)) Upgrade to Buy from Neutral by Citi .B/H/S: 2/0/0

Citi sees the company as materially undervalued and raises its rating to Buy from Neutral and lifts the target to $17.70 from $13.45. This is predicated on likely strong pent-up demand after lockdowns and lesser structural concerns surrounding cinemas than initially thought.

Additionally, there has been a successful property divestment program and a material cost-out program, explains the analyst.

A $2.1bn property portfolio (worth $12.76 per share) implies to the broker that investors are paying circa 4x FY23 earnings for the operating business.

FONTERRA SHAREHOLDERS FUND ((FSF)) Upgrade to Outperform from Underperform by Macquarie .B/H/S: 1/1/0

Fonterra reported towards the top end of the guidance range and better than the last update implied. The last quarter was nevertheless slight loss-making, Macquarie notes, on lower milk prices.

The company has revealed its long-term strategy, targeting 40-50% underlying earnings growth by FY30, which would drive around a 75% increase in earnings per share, the broker calculates.

This is driven by increased focus on value-add, including “Active Living”, supported by higher capital investment and ramp up in R&D spending. On this positive outlook, and on current valuation, the broker double-upgrades to Outperform from Underperform.

Target rises to NZ$4.28 from NZ$4.25.

NEW HOPE CORPORATION LIMITED ((NHC)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 4/0/0

Macquarie continues to prefer iron ore and metallurgical coal amongst the bulk commodities. The broker is positive about coal, given the upside from buoyant spot prices.

While upgrading to Outperform from Neutral, the broker notes movements in thermal coal prices present the main risk to its base case valuation of New Hope. Target is raised to $2.40 from $2.20.

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

Transurban in consortium is acquiring the remainder of WestConnex from the NSW government for $11.1bn. This will take its stake to 50% from 25.5% at a cost of $5.6bn.

Credit Suisse believes the deal is attractive as it will provide Transurban with control of all Sydney's toll roads and places the company in a good position to deliver value. Rating is upgraded to Outperform from Neutral and the target raised to $15.10 from $14.00.

Downgrade

INCITEC PIVOT LIMITED ((IPL)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 6/1/0

Credit Suisse expects fertiliser pricing will peak in 2021. Pricing is expected to remain above the mid-cycle average in 2022 as markets appear to be well supplied. Meanwhile, the outlook for the explosives business seems stable.

The broker downgrades to Neutral from Outperform and reduces the target to $2.98 from $2.99, adjusting for fertiliser pricing expectations. Production assumptions are reduced to allow for the outage at Waggaman.

SANDFIRE RESOURCES LIMITED ((SFR)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 2/3/0

Sandfire Resources' acquisition of the Aguas Tenidas copper/polymetallic mining complex for $2.64bn is expected to close in the March quarter. Credit Suisse notes the transaction is expected to add around 110,000 tonnes per annum copper production in FY22.

It is Credit Suisse's view that the acquisition presents a dilution risk, estimating the deal may be 30% dilutive to shareholders.

The rating is downgraded to Neutral from Outperform and the target price decreases to $6.00 from $7.70.

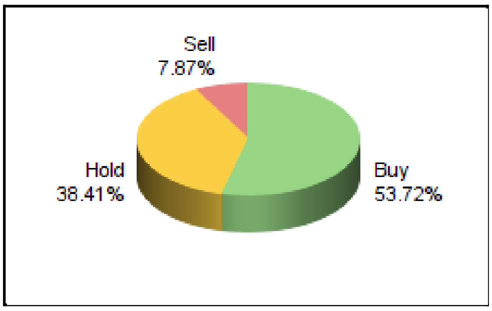
SIGMA HEALTHCARE LIMITED ((SIG)) Downgrade to Neutral from Buy by Citi .B/H/S: 1/3/0

Citi downgrades its rating to Neutral from Buy as a result of lower-than-expected margins and guidance. The company downgraded FY23 earnings (EBITDA) guidance to $95-100m from $100m. The target price falls to $0.60 from $0.70.

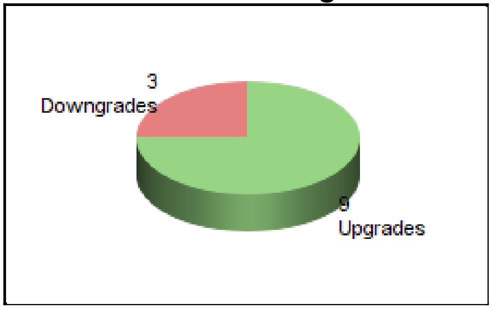
The company reported first half underlying profit around -10% below consensus due to a lower-than-expected gross margin on a normalisation of the sales mix, explains the broker.

While it's too early to see an impact, the analyst feels the potential acquisition of Australian Pharmaceutical Industries ((API)) by Wesfarmers ((WES)) is unlikely to be positive.

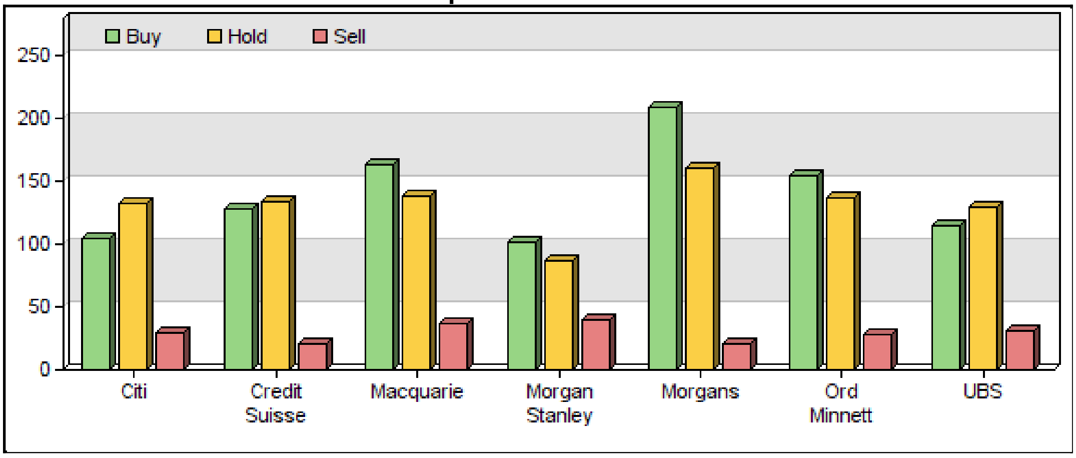
Total Recommendations



Recommendation Changes



Broker Recommendation Breakup



Broker Rating

Order	Company	New Rating	Old Rating	Broker
Upgrade				
1	AGL ENERGY LIMITED	Buy	Neutral	Ord Minnett
2	AUSNET SERVICES LIMITED	Neutral	Neutral	Morgan Stanley
3	BABY BUNTING GROUP LIMITED	Buy	Neutral	Citi
4	BAPCOR LIMITED	Buy	Neutral	Citi
5	CHAMPION IRON LIMITED	Buy	Neutral	Citi
6	EVENT HOSPITALITY & ENTERTAINMENT LIMITED	Buy	Neutral	Citi
7	FONTERRA SHAREHOLDERS FUND	Buy	Sell	Macquarie
8	NEW HOPE CORPORATION LIMITED	Buy	Neutral	Macquarie
9	TRANSURBAN GROUP LIMITED	Buy	Neutral	Credit Suisse
Downgrade				
10	INCITEC PIVOT LIMITED	Neutral	Buy	Credit Suisse
11	SANDFIRE RESOURCES LIMITED	Neutral	Buy	Credit Suisse
12	SIGMA HEALTHCARE LIMITED	Neutral	Neutral	Citi

Recommendation

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	NHC	NEW HOPE CORPORATION LIMITED	100.0%	75.0%	25.0%	4
2	BBN	BABY BUNTING GROUP LIMITED	80.0%	60.0%	20.0%	5
3	AGL	AGL ENERGY LIMITED	-20.0%	-40.0%	20.0%	5
4	SLK	SEALINK TRAVEL GROUP LIMITED	67.0%	50.0%	17.0%	3
5	BAP	BAPCOR LIMITED	83.0%	67.0%	16.0%	6
6	ORG	ORIGIN ENERGY LIMITED	67.0%	57.0%	10.0%	6

7	TCL	TRANSURBAN GROUP LIMITED	60.0%	50.0%	10.0%	5
8	CWN	CROWN RESORTS LIMITED	33.0%	25.0%	8.0%	3
9	QUB	QUBE HOLDINGS LIMITED	38.0%	30.0%	8.0%	4

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	SFR	SANDFIRE RESOURCES LIMITED	40.0%	67.0%	-27.0%	5
2	TAH	TABCORP HOLDINGS LIMITED	60.0%	80.0%	-20.0%	5
3	PTM	PLATINUM ASSET MANAGEMENT LIMITED	-75.0%	-60.0%	-15.0%	4
4	IPL	INCITEC PIVOT LIMITED	86.0%	100.0%	-14.0%	7
5	CLW	CHARTER HALL LONG WALE REIT	50.0%	60.0%	-10.0%	4
6	NSR	NATIONAL STORAGE REIT	-33.0%	-25.0%	-8.0%	3
7	SXY	SENEX ENERGY LIMITED	60.0%	67.0%	-7.0%	5
8	CAR	CARSALES.COM LIMITED	33.0%	40.0%	-7.0%	6

Target Price

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	NHC	NEW HOPE CORPORATION LIMITED	2.478	2.220	11.62%	4
2	CWN	CROWN RESORTS LIMITED	11.933	11.450	4.22%	3
3	IPL	INCITEC PIVOT LIMITED	3.147	3.056	2.98%	7
4	SLK	SEALINK TRAVEL GROUP LIMITED	10.003	9.755	2.54%	3
5	TCL	TRANSURBAN GROUP LIMITED	14.982	14.628	2.42%	5
6	NSR	NATIONAL STORAGE REIT	2.177	2.128	2.30%	3
7	SXY	SENEX ENERGY LIMITED	3.842	3.788	1.43%	5
8	CAR	CARSALES.COM LIMITED	24.322	24.026	1.23%	6
9	ORG	ORIGIN ENERGY LIMITED	4.917	4.880	0.76%	6
10	QUB	QUBE HOLDINGS LIMITED	3.308	3.286	0.67%	4

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	SFR	SANDFIRE RESOURCES LIMITED	7.052	7.818	-9.80%	5
2	PTM	PLATINUM ASSET MANAGEMENT LIMITED	3.850	3.920	-1.79%	4
3	AGL	AGL ENERGY LIMITED	7.342	7.392	-0.68%	5

Earning Forecast

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	NHC	NEW HOPE CORPORATION LIMITED	45.195	17.855	153.12%	4
2	KMD	KATHMANDU HOLDINGS LIMITED	10.933	8.113	34.76%	3
3	TCL	TRANSURBAN GROUP LIMITED	10.319	8.429	22.42%	5
4	VEA	VIVA ENERGY GROUP LIMITED	13.548	11.290	20.00%	6
5	KAR	KAROON ENERGY LIMITED	7.500	6.340	18.30%	3
6	29M	29METALS LIMITED	9.520	8.087	17.72%	3
7	WSA	WESTERN AREAS LIMITED	3.175	2.725	16.51%	5
8	NST	NORTHERN STAR RESOURCES LIMITED	28.720	25.780	11.40%	5
9	ORE	OROCOBRE LIMITED	11.560	10.500	10.10%	5
10	PLS	PILBARA MINERALS LIMITED	8.215	7.640	7.53%	4

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	CWN	CROWN RESORTS LIMITED	-7.400	1.000	-840.00%	3
2	PMV	PREMIER INVESTMENTS LIMITED	126.983	160.617	-20.94%	6
3	BKW	BRICKWORKS LIMITED	132.820	149.480	-11.15%	5
4	SIG	SIGMA HEALTHCARE LIMITED	3.367	3.590	-6.21%	4
5	AGL	AGL ENERGY LIMITED	41.517	43.183	-3.86%	5
6	IDX	INTEGRAL DIAGNOSTICS LIMITED	18.468	19.134	-3.48%	5
7	RIO	RIO TINTO LIMITED	1964.933	2019.043	-2.68%	7

8	PTM	PLATINUM ASSET MANAGEMENT LIMITED	23.575	24.060	-2.02%	4
9	RMD	RESMED INC	83.839	85.468	-1.91%	6
10	WBC	WESTPAC BANKING CORPORATION	172.000	174.550	-1.46%	6

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WEEKLY REPORTS

Uranium Week: Spot Price Retraces From Highs

As the weekly spot uranium price has its first fall in six weeks, upward projections are made to potential growth of world nuclear capacity.

-Potential for nuclear power capacity to double by 2050
-Two ASX-listed companies in the news
-Uranium spot price falls nearly -13% for the week

By Mark Woodruff

For the first time since Fukushima a decade ago, the International Atomic Energy Agency (IAEA) has revised up its projections for the potential growth of world nuclear power capacity in the coming decades.

Under the bullish scenario, the IAEA now expects capacity to double to 792GW by 2050. Reaching that goal would require significant effort, including an accelerated implementation of innovative nuclear technologies. Compared with the previous year's high case projection of 715GW by 2050, the estimate has been revised up by just over 10%.

The low case projections indicate that world nuclear capacity by 2050 would remain essentially unchanged at 392GW.

Also, the head of the IAEA also has joined with thirteen global nuclear industry CEOs to form the Group of Vienna. The aim is to advance the case for nuclear energy in addressing climate change and to advance sustainable development.

The group will support the IAEA in its mission to accelerate and enlarge the contribution of nuclear technologies to meeting environmental, social, and economic objectives and to improve the health and well-being of the population.

Company news

Canadian-focused ASX-listed exploration company **92 Energy** ((92E)) last week announced the discovery of a new zone of uranium mineralisation on its 100% owned Gemini Project in the Athabasca Basin, Saskatchewan.

The Athabasca Basin has some of the largest and highest grade uranium deposits in the world, including Cameco's Cigar Lake and McArthur River mines. The company has a 100% interest in its 28 mineral claims in the area.

As mentioned in last week's article, Shaw and Partners initiated coverage on ASX-listed **Silex Systems** ((SLX)) with a Buy rating and price target of $2.60. On Monday September 27, the company announced the completion of a $33m placement at $1.27 per share.

The funds will primarily be used to advance the SILEX uranium enrichment pilot demonstration project in the US. This is focused on Global Laser Enrichment, a business venture comprising Silex Systems (51%) and Cameco (49%).

Uranium pricing

TradeTech's Weekly **Spot Price** Indicator is down -US$6.40/lb from last week to US$44.10/lb -- a decline of nearly -13%. It's the first fall in six weeks and equals the third-largest decline in percentage terms in the Indicator's history.

The Indicator is up nearly 45% since mid-August, and is over 60% above the 2021 low point of US$27.40/lb. The average weekly Spot Price, calculated by TradeTech, is US$32.03/lb in 2021, US$2.32/lb above the 2020 average.

Significant volatility over the last six weeks has pushed TradeTech's annualised volatility value to a historical high. China's Evergrande has had an effect on broader equity markets (including uranium and all other metals) though no specific impact on uranium/nuclear power.

The property developer's prospects and impact on China's economic health remain uncertain as future debt payments loom. Share prices were down over -10% for most uranium-focused equities last week.

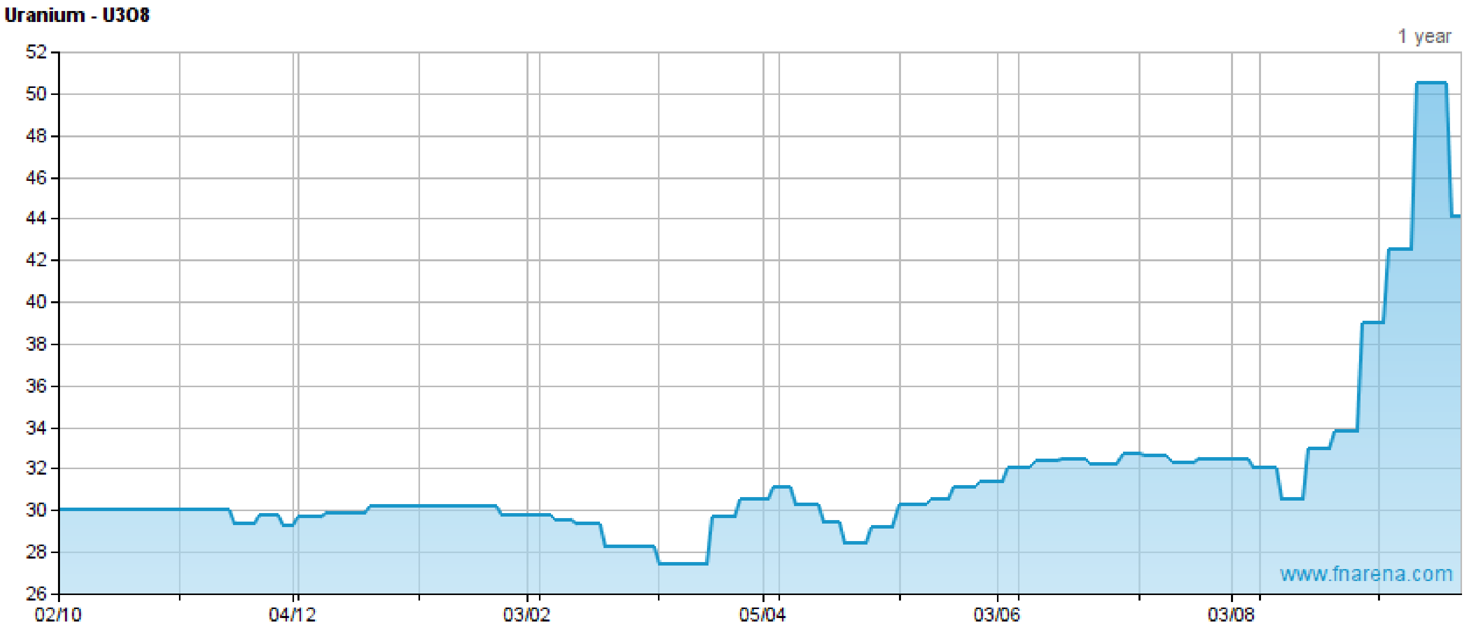
Activity in the spot uranium market stalled with a total of 1.2mlbs U3O8 purchased last week compared to over 4.7mlbs for the prior week. Buyers included utilities, producers, traders and financial entities.

TradeTech's **term price** indicators are US$35.75/lb (mid) and US$35/lb (long).

The previous run-up in the spot price has prompted a number of utilities to examine their contract portfolios to determine when they should enter the term uranium market, according to TradeTech.

The majority of utilities are well covered for the next several years. However, the increase in the spot uranium price is having a direct effect on those holding term uranium contracts with a market-related component, with many having already reached the ceiling price for the market-related component.

Thus, several utilities are fast tracking their off-market discussions with suppliers in order to lock in additional quantities, while the term uranium price still lags behind the spot uranium price.



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WEEKLY REPORTS

The Short Report - 01 Oct 2021

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

Summary:

By Greg Peel

Week Ending September 24, 2021.

If you're wondering why this week's Short Report is on the Friday and not the usual Thursday apologies, but yesterday morning ASIC data had not updated.

So strictly this report covers eight days, but we'll be back to the Thursday next week, presumably.

Last week opened with the Evergrande saga hitting the market and ended with a sharp rally back for the ASX200 before Fed policy issues set the pullback off once again.

What immediately stands out on the table below is the sudden entry of Ansarada Group ((AND)) at 13% shorted. An obvious assumption would be that the M&A SaaS platform provider has announced a capital raising but with no ASX notice, and no update from Morgans – the one FNArena database broker covering the stock – since the company's earnings result last August, and nothing in the news, I can't help you.

Otherwise, last week the travel agents took off on the prospect of state borders reopening before Christmas but while Webjet ((WEB)) shorts slipped to 8.9% from 9.9%, Flight Centre ((FLT)) shorts remained unmoved.

The way things are going, reopened borders may yet be a pipedream.

I noted in last week's Report that all lithium miners took off the week before, leading to some short-covering in Piedmont Lithium ((PLL)). They've all seen some give-back since but this hasn't stopped Piedmont disappearing out of the 5%-plus shorted table from 7.3%.

I also noted Karoon Gas ((KAR)) had popped up into the 5%-plus shorted table ahead of its earnings result last week, which subsequently had it popping out again.

Gold prices have been rather volatile as well, and so have short positions in Resolute Mining ((RSG)), which saw its shorts drop to 5.2% last week from 7.8%.

We nonetheless welcomed back old friend Bellevue Gold ((BGL)) into the bottom of the table, along with Omni Bridgeway ((OBL)) and Perenti Global ((PRN)).

And the sharks continue to circle AGL Energy ((AGL)).

Weekly short positions as a percentage of market cap:

10%+
AND 13.4
FLT 11.0

In: AND

9.0-9.9

KGN, Z1P, EOS

Out: WEB

8.0-8.9%

WEB, MSB, ING

In: WEB

7.0-7.9%

COE, RBL, TGR, AGL

In: AGL Out: RSG, PLL, AMA

6.0-6.9%

AMA, A2M, TPW

In: AMA Out: AGL

5.0-5.9%

BHP, PNV, BGL, OBL, RSG

In: RSG, BGL, OBL, PRN Out: IVC, KAR

Movers & Shakers

Nothing this week.

ASX20 Short Positions (%)

Code	Last Week	Week Before	Code	Last Week	Week Before
ALL	0.1	0.1	MQG	0.2	0.3
ANZ	0.6	0.5	NAB	0.5	0.5
APT	1.0	1.1	NCM	0.1	0.1
BHP	5.8	5.6	RIO	0.3	0.2
BXB	0.5	0.4	TCL	0.5	0.5
CBA	0.4	0.4	TLS	0.2	0.2
COL	0.6	0.4	WBC	0.6	0.5
CSL	0.2	0.1	WES	0.3	0.2
FMG	1.7	1.9	WOW	0.2	0.2
GMG	0.1	0.1	WPL	1.6	1.6

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.

WEEKLY REPORTS

The Wrap: Artificial Intelligence, Construction Industry, Rising Bond Yield Winners & Small Cap Ideas

Weekly Broker Wrap: ASX-listed companies investing in AI; construction industry cost inflation; rising bond yield beneficiaries; and post reporting season small cap ideas.

-Which ASX-listed companies are investing in AI?
-Construction industry cost inflation
-Rising bond yield beneficiaries
-Post reporting season small cap ideas

By Mark Woodruff

Which ASX-listed companies are investing in AI?

In Australia companies are significantly increasing the amount of money they are spending on artificial intelligence (AI) in an effort to drive efficiency gains and derive better insights from their customers.

Firms that make the investment are more likely to disrupt their competitors, take market share and realise efficiency gains within their businesses. Deploying the technology often results in better predictions, recommendations or decisions. Additionally, there can be streamlined production processes, tailored product offerings, targeted online advertisements and price discrimination.

Unsurprisingly, UBS identifies the IT sector is leading the investment charge though the Financials and Consumer sectors are also prominent. Driven by access to data, companies within more 'traditional' industries like banking and bricks and mortar operations like supermarkets and other retailers are leveraging automation and gaining better insights.

Overseas experience indicates larger firms with higher sales mark-ups and cash reserves tend to invest more in AI. They then, in turn, experience faster growth in sales and employment, which translates into growth at the industry level.

As a result, the positive effects are concentrated amongst the largest firms leading to a positive correlation between AI investments and industry concentration. Thus, investing in AI increases the scale of the most productive firms and contributes to the rise of 'superstar' firms.

This is where things become interesting as UBS asks: Which Buy or Neutral-rated Australian companies under its research coverage are both data driven and investing accordingly in data and technology?

Given they are more data-driven than other sectors, Shopping Centre mall owners Scentre Group ((SCG)) and Vicinity Centes ((VCX)) are prominent. Their usage is higher given the need to understand customer shopping behaviours to ensure an optimal leasing mix, explains the broker. Their expenditure is increasing on data/technology in order to offer incremental product and services, and merge the physical and digital worlds.

Within the Energy sector, Z Energy ((ZEL)) rates a mention by UBS for investing the most into data capabilities relative to peers. This has resulted in new ways of paying for fuel, more targeted advertising and the ability for retail consumers to hedge fuel price risk.

Downer EDI ((DOW)) also utilises data analytics to drive greater efficiency within its Transport and Infrastructure operations and maintenance business, according to the analyst. Meanwhile, within Resources, BHP Group ((BHP)) is leading the way by leveraging autonomous haulage and drilling, as well as real-time monitoring of iron ore operations.

Other highly-data driven companies covered by UBS that are investing heavily in AI include Seek ((SEK)), Qantas

Airways ((QAN)), IDP Education ((IEL)), Megaport ((MP1)), Origin Energy ((ORG)) and Woolworths Group ((WOW)).

Construction industry cost inflation

Despite strong demand and volume growth in the construction industry, profit growth for builders is likely to be limited, due to severe cost inflation and a limited ability to pass on higher costs. Overall project costs are up around 5% over the past six months and are expected to rise again.

In league with the Australian Institute of Building, Jarden participated in an August 2021 survey which asked builders across Australia questions relating to profitability, order book, pricing and business performance.

Survey results appear to be in-line with the broker's view that cost pressure in the construction sector is higher than previously expected and unlikely to abate in the coming six months. As the impact of HomeBuilder fades in the next 12 months, it's expected new dwelling costs will become a key driver of inflation.

Survey respondents expect to see an around 10% steel product price increase in the coming six months, which is seen by Jarden as positive for BlueScope Steel ((BSL)), while cement costs are also likely to rise circa 5% (which is similar to the past six months). In keeping with this, separate industry feedback to the broker suggests input costs are up across the board (8% estimated since January 2020), with a 25% increase for structural timber (another 15% expected) and steel rising by 30%.

Over 60% of respondents noted the rise in project costs could not be passed on to customers. With building material and labour costs likely to rise further in the coming months, Jarden suggests the best contractors or project managers can do is to build in a higher "buffer" when bidding for new projects.

Boral ((BLD)) announced its intention to lift prices in October 2021, while Adbri ((ABC)) is yet to announce any change.

Another potential risk to watch out for is delays in construction completion due to tight shipping schedules.

Jarden's property research team has noted delays in getting imported goods (such as elevators, glass) from overseas have caused difficulties for developers in apartment completion.

On top of this, wage increases of 10-15% are becoming increasingly common. However, so far this has been limited largely to more skilled labour, with increases for unskilled/entry-level positions limited by industry awards, explains the analyst.

However, major developers, such as Mirvac Group ((MGR)) and Stockland ((SGP)) are more likely to be concerned about rising land costs than rising building material costs, with the ability to pass through costs to the end-buyer. It's thought subcontractors are the most likely to be squeezed.

In a positive for Mirvac Group, according to the broker, 30% of respondents expect strong residential apartment construction activity after covid has passed. Meanwhile, Home Consortium ((HMC)), Goodman Group ((GMG)) and Centuria Industrial REIT ((CIP)) should benefit as Healthcare property, detached housing and industrial property demand is also expected to remain strong.

The residential outlook is more positive than the common view among listed construction and building material company executives, who appear to indicate that potential strong multi-residential construction activity depends on a return of immigration.

Anecdotal evidence from Jarden's property research team aligns with the survey results, in pointing to strong recent demand for residential apartments in Sydney, despite the lockdown.

The weakest outlook from the survey was across retail and tourism-related property.

Survey results also highlight to Jarden a significant opportunity to improve penetration of trade for the likes of Wesfarmers ((WES)), Reece ((REH)) and CSR ((CSR)).

Finally, Boral, CSR and Mitre10 ((MTS)) rated the lowest for service, while Beacon Lighting ((BLX)), James Hardie Industries ((JHX)) and Harvey Norman ((HVN)) rated the highest.

Rising bond yield beneficiaries

Share market strategists at Macquarie recommend a basket of ten (Outperform-rated) stocks positively correlated to bond yields. This comes as real yields are beginning to rise, after the US Federal Reserve has given advance warning of tapering at its September meeting.

There are two stark differences between now and 2013, when yields rose by more than 120bps in the seven months between the warning and the formal announcement.

Firstly, with a taper announcement possible in November or December this year, there is potentially only one or two months warning. Hence, there is a risk of a 2013-style taper tantrum, which saw ASX stocks fall around -9% in a month. During this period, Health was the best performing sector while Mining was the biggest underperformer, notes Macquarie.

The second difference is that the expected rise in bond yields is policy driven and counter-cyclical. The cycle is already slowing, the commodity cycle has likely peaked and tapering should support a stronger US dollar. Under normal circumstances in a slowing economy Defensives would be preferred, but rising yields may negatively weigh this time around.

So the hunt is on for two categories of stocks, under Macquarie's coverage that benefit from higher US real yields and are Outperform rated:

-Stocks with a direct positive earnings link; this group includes Insurers Suncorp Group ((SUN)) and Insurance Australia Group ((IAG), as well as Computershare ((CPU)) and Link Administration ((LNK)).

-Stocks with an indirect earnings impact in an improving cycle; the broker likes Energy shares including Woodside Petroleum ((WPL)) and Origin Energy, as well as Worley Group ((WOR)), Downer EDI, Qantas and Incitec Pivot ((IPL)).

On the flipside, stocks with negative correlation to real yields include a range of Growth, Defensive, Infrastructure and Gold sector stocks. A group of ten that Macquarie would be wary of are as follows:

Underperform-rated stocks include Domino's Pizza Enterprises ((DMP)), Commonwealth Bank ((CBA)) and Xero ((XRO)).

Neutral-rated stocks include JB Hi-Fi ((JBH)), Fisher & Paykel Healthcare ((FPH)), Ansell ((ANN)), Wesfarmers ((WES)), Carsales.com ((CAR)), Magellan Financial Group ((MFG)) and Sonic Healthcare ((SHL)).

All the above caters to the correlation between share prices and real yields. In a similar, but quite separate analysis, Macquarie looks at the correlation between forward Price Earnings (PEs) and bond yields.

On this basis, the broker concludes rising real yields could be a potential valuation headwind for 75% of the ASX100.

Again Macquarie filters through Outperform-rated stocks under coverage, that benefit from higher US real yields, where there is a direct earnings benefit. These include Computershare, Suncorp Group and Link Administration. Neutral-rated stocks include Challenger ((CGF)) and Virgin Money UK ((VUK)).

Underperform-rated names, for which PEs have a high negative correlation with real yields are Commonwealth Bank, Alumina ((AWC)), Altium ((ALU)) and Reece. Neutral-rated stocks are JB Hi-Fi, Magellan Financial Group, Wesfarmers and Woolworths Group.

In addition to the top ten Outperform-rated stocks, Macquarie outlines its overall strategy portfolio in terms of higher yield beneficiaries. Those upon which there is a direct earnings impact and have positive weights in the portfolio are:

QBE Insurance Group ((QBE)), IAG and Suncorp, while Banks are represented by ANZ Bank ((ANZ)) and Westpac ((WBC)). Janus Henderson ((JHG)) and Computershare are also included.

Also, for Energy sector exposure, the strategy portfolio is overweight Woodside Petroleum, Ampol ((ALD)) and BHP. It’s thought these stocks are well positioned given oil demand was negatively impacted by covid and should be supported by re-opening. The Energy sector also considered to have a low valuation on cyclically low earnings.

The broker believes defensive positions are necessary, given the slowdown and prefers Staples and Health though acknowledges these stocks could be negatively impacted by rising yields.

The Staples exposure is obtained via Coles Group ((COL)), Endeavour Group ((EDV)) and Woolworths, while Health includes Ramsay Healthcare ((RHC)), Healius ((HLS)), Cochlear ((COH)) and Resmed ((RMD)).

Reporting season winners

Small cap specialists at Jarden have weighed up the profit reporting season and have separated high-conviction ideas into three silos:

-Online retail; long-term winners that have emerged from the pandemic with an enhanced business model and market position. These companies include Adore Beauty ((ABY)), Adairs ((ADH)), City Chic Collective ((CCX)) and Temple & Webster ((TPW)).

-Auto; with NSW approaching the vaccination rate needed for a reopening, the broker expects sentiment to swing in favour of the dealers. Ongoing supply constraints are conducive to margins per vehicle holding into 2022, with the preference in the sector being Peter Warren Automotive ((PWR)).

-Other key picks; include document management firm Class Ltd ((CL1)), helped along by the recent Topdocs software acquisition; charity donor-management company PushPay ((PPH)) after the Catholic segment in particular has gained traction more quickly than envisaged; and the covid-recovery play of IDP Education.

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

TREASURE CHEST

Treasure Chest: Opportunity In Codan

FNArena's Treasure Chest reports on money making ideas from stockbrokers and other experts. Codan has a track record of overachieving on forecasts and FY21 sales were robust, so with a subdued share price is there a buying opportunity?

-Codan in a strong position in terms of distribution and growth potential
-Strong demand for the company's latest metal detection products
-Acquisitions likely to transform the communications division

By Eva Brocklehurst

Codan ((CDA)) has a dominant position in metal detection globally amid limited competition, and sales for its products across all categories in FY21 were strong. Furthermore, the company is experiencing strong demand in artisanal mining (independent amateur prospectors) and has made significant investments in manufacturing capacity.

Inventory has more than doubled to around $66m in order to minimise supply disruptions and reduce freight costs. Underlying net profit of $97m was up 52% and sales up 26% in FY21, supported by a material increase in communications and tracking solutions as well as strength in metal detection.

With this backdrop, Moelis questions why the share price has de-rated, noting it has fallen -32% since before the FY21 result and suspecting this was largely because CEO Donald McGurk's retirement was looming. Moreover, Codan had provided its usual conservative FY22 outlook.

The broker brushes aside the retirement of Donald McGurk, who will leave within the next few months, although acknowledges the impact, highlighting the business is in its strongest-ever position in terms of product and distribution.

To the other point, while management has suggested the organic growth outlook is fairly flat, **the broker points out Codan has a five-year record of overachieving on guidance**. Thus, Moelis, in flagging the growth opportunity, upgrades to Buy from Hold with a target of $17.12.

Codan had indicated it was too early to provide guidance at the FY21 result yet Macquarie, with an Outperform rating and $17.50 target, points to a record sales run rate being maintained into the early part of FY22.

In the broker's view, **the main uncertainty surrounds the supply chain in tactical communications because of the pandemic**. Canaccord Genuity agrees the tactical communications division does not have a substantial pipeline while the acquisitions of Zetron and DTC are only in the early stages of being integrated.

Management rarely provides much in the way guidance early in the financial year so the broker was not surprised at the cautious approach, given FY21 was a record year in terms of metal detection sales. Moreover, the balance sheet is accumulating cash with $80-90m estimated for the end of FY22.

Canaccord Genuity, maintaining a Buy rating with an $18.40 target, considers the soggy reaction to the FY21 result a buying opportunity as current pricing does not reflect the attractive growth profile nor the upside risk to earnings and the ungeared balance sheet.

Metal Detection

Canaccord notes July saw record sales of the company's GPZ7000 detector and demand for metal detection products is robust, with Minelabs expected to benefit from the new GPX6000 gold detector sales.

The company has a good record for new product development and launching in global markets and the broker does not expect the GPX6000 will be any different. Sales are currently around 700-800 per month, largely in the developed world, and Canaccord suspects this will be significantly higher in developing markets.

Moelis estimates at least $5m in organic operating earnings (EBITDA) growth is achievable in FY22, largely because of incremental sales from the GPX6000 gold detector.

Around 14% growth in earnings per share over FY21-24 is expected, arising from new products and the opening up of new markets such as South America and India. New distribution channels are also anticipated along with a post-pandemic rebound in tactical radio communications in FY23.

Communications

Canaccord Genuity believes FY22 will be "transformational" for the company's radio communications division as a result of acquisitions and, while smooth integration will be key, believes new capabilities and scale will provide a wider platform to grow.

In FY21 contract deferrals featured in tactical communications as governments elected to direct their funds to fight the pandemic. Hence, revenue in FY21 was around $50m compared with $80m in the prior year.

Nevertheless, the broker notes the order book in FY22 is similar to FY21 and there will be a full contribution from acquisitions. Canaccord Genuity expects revenue growth of 158% and earnings growth of 134% in FY22 for the communications division. Codan will hold its AGM on October 27.

RUDI'S VIEWS

Rudi's View: The Market Has A Carrot

In this week's Weekly Insights:

-The Market Has A Carrot
-No Weekly Insights Next Week
-Conviction Calls

By Rudi Filapek-Vandyck, Editor FNArena

The Market Has A Carrot

If the year past has shown investors one thing, it is that taking too bearish a view on the outlook for equities and bonds is seldom and only briefly rewarded.

Equity indices, including the ASX200 in Australia, might well be staring at their first negative monthly performance since... September last year!, but it's hardly looking like disaster-territory given the seasonal pattern and the potential worries that are on investors' minds.

Yet, it might equally be folly to assume this market will simply keep on powering on, and ignoring everything that could change the landscape dramatically; from slowing economic growth, to central banks moving in tightening mode, to the Evergrande fall-out, higher bond yields and the rising awareness of downward pressure on corporate profit margins.

Probably the most straightforward observation to make is that most economic insights and indicators, be they here in Australia, or offshore in China, the US, UK or Europe, are no longer surprising on the upside; they have a tendency to now fall short of market forecasts, and they have been doing so for a number of weeks.

The message here should be clear: **global economic momentum is softening**, and it is likely to soften further over the weeks and months ahead. The more optimistic forecasters see momentum recovering in the final quarter of this year, if one's less optimistic this could be the return to the low growth environment that persisted pre-covid.

What happens at the macro-level impacts the micro and company earnings estimates have stopped trending upwards in Australia.

As I reported a few weeks ago, the August reporting season in Australia broke the eleven month-long trend in Australia and earnings forecasts are now falling.

This process has accelerated in September as companies such as Clover ((CLV)), Kathmandu ((KMD)) and Sigma Healthcare ((SIG)) missed expectations with their FY21 performances, but most of all because of a sharp -50% fall in the price of iron ore.

Earnings estimates for US companies are now starting to trend downwards as well as analysts are looking forward to an unfavourable combination of rising costs and slowing sales.

Historically, such periods of negative earnings momentum tend to last about six months and, unsurprisingly, there's usually not much on offer in terms of net positive return as investors, understandably, tend to become more cautious during such times of greater uncertainty and greater potential for negative surprises.

Analysis by Morgan Stanley makes it very clear: the Australian share market's average return during periods of positive earnings revisions is circa 10%, but during periods of negative momentum the average net return reduces to -2%.

2021 Might Be Different

This year, however, the overall picture is a lot more blurred with most investors and analysts considering the virus and renewed lockdowns responsible for the negative impact on growth and forecasts.

Thus far, this has translated into far more lenience offered to those companies under the spell of the virus, as better times surely are but a matter of patience?

Look no further than the share price of travel agent Flight Centre ((FLT)) to back up that statement.

On my observation, **share markets can remain stronger-for-longer as long as there is a carrot dangling in front of them**. Think Trump tax cuts, for instance. This year and last, the prospect of a successful vaccine-rollout, leading to re-opening borders and economies with cashed-up consumers ready to unleash their wallets on travel, leisure and other services, is likely acting as one such giant carrot.

Regardless, the prospect of higher input prices against a background of tougher sales growth will put a number of businesses under pressure from here onwards and it is anyone's guess who will be issuing the first serious profit warning, and when?

The old saying is that no profit warning is ever fully priced-in. Investors might be reluctant to sell the market as a whole, at a time of growing nervousness and generally elevated valuations, I doubt whether individual profit warnings won't be punished in the good old fashioned manner: quickly, fiercely and without thinking twice about it.

Straightforward logic tells us the most vulnerable business models should be the cyclicals and the lesser-quality business models; those with no pricing power - see iron ore in recent times, but the current context is that **US bond yields are still expected to rise to 1.60%-1.80% by year-end** and this should, all else remaining equal, reinvigorate the reflation trade, i.e. commodities, cyclicals and financials.

Why would bond yields break-out after two months of largely low-volatility, sideways movement?

Last week's FOMC meeting might just have provided enough impetus for US bond yields to move higher as the time-schedule for tapering has been brought forward and with chair Jerome Powell providing sufficient clues that tapering -i.e. reduced buying of bonds by the Federal Reserve- should be interpreted as the first step towards higher interest rates (albeit not anytime soon).

A "tightening" Fed, ahead of all other major central banks, and rising bond yields, also supported by the prospect of additional borrowing by the Biden administration later this year, should translate into a stronger US dollar, which might somewhat keep the brakes on commodity prices, but also bring **major disappointment for the gold bugs**.

As I never tire to point out, US bond yields are the major determinant for the direction of gold priced in USD. Rising bond yields accompanied by a firmer USD might prove too strong a combination for gold in the months ahead, especially in the absence of a major share market sell-off or otherwise major investor discomfort or panic.

The latter two scenarios are by no means completely out of the question.

<u>Plenty Of Reasons For Reduced Comfort</u>

Financial markets have remained quite sanguine about China's major property developer Evergrande facing corporate failure, but investors would be wise not to become too complacent about what is happening inside

China. Authorities are likely to find ways to prevent this from becoming a local melt-down event, but not all repercussions can be avoided.

As some of the smarter market observers have already pointed out: corporate bond yields in China have responded and the sector overall will be facing tougher scrutiny and higher financing costs, maybe indefinitely. Chinese construction is slowing, with flow-on impact for the Chinese economy and demand for materials generally.

It's almost a guarantee **there will be more corporate failures** in the sector.

Evergrande's failure has equally placed the Chinese property sector in the global limelight; with valuations in places like Shenzhen, Hong Kong, Beijing, Shanghai and Guangzhou, when measured against average total household income, multiple times more expensive than properties in, say, Tokyo, London, Vancouver and Sydney.

Chinese property ownership has drastically changed in recent years with investors and speculators now commanding most of the buying activity against mostly owner-occupiers previously.

To those wary because of macro concerns, Evergrande is but the canary of what can be expected once central bank tightening moves further down the process. The world is laden with debt and leverage. Central banks are starting to tighten against a background of rising costs and slowing economic momentum.

It would almost be a miracle if there were no more casualties, in particular in emerging economies. But also: remember it is estimated some 18% of all corporates today could be zombie companies, i.e. not able to meet interest payments out of operational cash flow.

And yet, it might just be that good old crude oil is readying itself to play an active role in the ongoing 'transitory versus permanent'-inflation debate. **The price of Brent** has rallied to a fresh new high since October 2018, once again approaching US$80/bbl, and quite a number of sector analysts are anticipating ongoing upward pressure.

Further interruption from hurricane Ida and the flow-on impact from rising natural gas prices are, apparently, meeting a faster-than-projected recovery in demand, ahead of winter in the Northern hemisphere. Goldman Sachs just upgraded its year-end price target to US$90/bbl from US$80/bbl previously.

Markets have thus far remained quite confident this year's spike in consumer price inflation will prove largely transitory, but persistently higher prices for energy have the ability to disrupt the market's -and central banker's- confidence. This time last year, the price of oil was temporarily circa -50% lower than today.

Market Strategists Are Divided

Meanwhile, in the background of all of the above, strategists at the likes of Citi and Morgan Stanley keep reminding their clientele equities have seldom, if ever, looked as richly valued as they are in 2021, in particular in the US. Moreover, index targets set for year-end or even mid-2022 have already been exceeded, with those strategists refusing to lift their targets.

Australian equities might be in a different position, but that's entirely dependent on the outlook for resources and financials. Certainly, that same carrot is hanging in front of local investors.

Market strategists at Ausbil Investment Management, while acknowledging the shorter-term uncertainties and challenges, report their view is that corporate Australia will post yet two more years of strong EPS growth as balance sheets are in great form and vaccination targets and re-openings are set to release pent-up consumer demand.

Inflation is not expected to spoil the party, though Ausbil does admit it maintains a "diligent watch on the global inflation numbers".

As per the table below, 25 of 32 sectors in Australia are expected to generate positive earnings growth in FY22 and, as per Ausbil's confidence, growth numbers for FY23 should pick up as we progress through the year ahead.

FY22 EPS Growth Consensus by Sector

Sector	EPS Growth: Before FY21 Reporting Season	EPS Growth: After FY21 Reporting Season	Change	Market Cap ($bn)
Software & Services	58.1%	106.0%	47.9%	73
Steel	16.0%	94.5%	78.5%	15
Energy	77.9%	80.4%	2.6%	49
Infrastructure Trusts	83.3%	61.0%	-22.2%	68
Hotels Restaurants & Leisure	80.6%	55.4%	-25.2%	66
General Insurance	55.6%	51.4%	-4.2%	63
Diversified Consumer Services	35.0%	32.8%	-2.2%	7
Chemicals	31.1%	32.3%	1.2%	12
Online Services	41.4%	28.7%	-12.7%	38
Agriculture	28.6%	24.9%	-3.7%	12
Diversified Metals & Mining	21.0%	21.2%	0.2%	176
Market	17.9%	16.7%	-1.2%	2,110
Capital Goods	18.1%	16.0%	-2.2%	22
Banks	14.5%	15.7%	1.1%	458
Other Metals & Mining	11.1%	14.1%	3.1%	104
Construction Materials	15.5%	11.7%	-3.8%	39
Media	8.3%	9.5%	1.2%	4
Commercial Services & Supplies	11.7%	8.9%	-2.8%	30
Diversified Financials	9.4%	7.8%	-1.5%	120
Real Estate Investment Trusts	10.3%	7.4%	-2.9%	139
Food Beverage & Tobacco	6.2%	5.4%	-0.9%	9
Life Insurance	1.6%	4.2%	2.7%	7
Food & Drug Retailing	-0.7%	4.0%	4.8%	92
Containers & Packaging	7.9%	3.9%	-4.0%	17
Gold	24.2%	1.9%	-22.3%	50
Automobile & Components	2.7%	0.2%	-2.5%	7
Pharmaceuticals & Biotechnology	-3.4%	-1.9%	1.5%	145
Real Estate	27.4%	-6.4%	-33.8%	8
Health Care Equipment & Services	-12.8%	-7.3%	5.5%	80
Telecommunication Services	8.3%	-7.8%	-16.1%	57
Utilities	5.5%	-9.9%	-15.4%	31
Retailing	-7.5%	-12.5%	-5.0%	88
Transport (Ex Infrastructure Trusts)	-185.1%	-105.5%	79.6%	23

Combining all of the above, I think it is more than likely some hard questions will be asked from financial markets in the months ahead and only a brave man, or a fool, would pretend to know what all the responses will be.

Previously, I have written that having some cash on the sideline, for comfort, but also to jump on opportunities that might open up, seems but appropriate for investors with only a moderate appetite for risk and, let's call it that, "adventure".

I think that statement remains valid, without getting too bearish or panicky about what can possibly lay ahead.

No Weekly Insights Next Week

Weekly Insights will skip next week due to a public holiday in NSW and a bulging list of To Dos, but will return as per normal in the week of October the 11th.

Conviction Calls

Stockpickers at Wilsons have added Seek ((SEK)) to **Wilsons' Australian Equity Focus List**, believing the stock had been oversold on macro concerns.

Wilsons has grabbed the opportunity to highlight that, with the fresh arrival of Seek, around one third of the list now consists of companies that should enjoy strong structural growth support over the medium to long term.

Structural growth trends that are viewed favourably at Wilsons include healthcare and wellness, e-commerce, new technologies for payments and new technology in a broader sense.

Companies with similar trend characteristics that were already on the list include CSL ((CSL)), EML Payments ((EML)), Goodman Group ((GMG)), Telix Pharmaceuticals ((TLX)), ResMed ((RMD)), Xero ((XRO)), Afterpay ((APT)), and Silk Laser Australia ((SLA)).

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Portfolio strategists at Macquarie seem to have had a bit of a fright out of the rapid decline in the price of iron ore.

Worried that iron ore is the proverbial canary and the rest of the commodities spectrum might follow next, Macquarie's Model Portfolio has removed OZ Minerals ((OZL)) and reduced exposure to Mineral Resources ((MIN)).

Instead, a more defensive allocation has been deemed the wiser step. Macquarie's Portfolio added Amcor ((AMC)) and some extra shares in Tabcorp Holdings ((TAH)). Shares in Crown Resorts ((CWN)) have been sold.

Strategy-wise, Macquarie continues to like most offshore earners on the ASX and this translates through exposure to Aristocrat Leisure ((ALL)), James hardie ((JHX)), Computershare ((CPU)), Ramsay Health Care ((RHC)), ResMed, Cochlear ((COH)), Flight Centre ((FLT)), and Qantas ((QAN)).

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Small cap specialists at Morgan Stanley have made the extr -effort to highlight their five key picks post the August reporting season: Life360 ((360)), Peter Warren Automotive ((PWR)), Accent Group ((AX1)), Nearmap ((NEA)), and Nitro Software ((NTO)).

(This story was written on Monday 27th September, 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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