Week
24

Stories To Read From FNArena
Friday, 14 June 2019

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Cash Flow The Key For Syrah Resources

Syrah Resources has downgraded production guidance for the June quarter, although brokers note stability in cash flow appears to be emerging.

-Guidance & unchanged recoveries reflect no benefits of optimising the plant -Slower ramp up to the final product mix -Long-term outlook dependent on progress at the BAM project

By Eva Brocklehurst

Production of graphite at Balama, Mozambique, continues to be affected by delays to Syrah Resources' ((SYR)) production improvement plan and the company has downgraded guidance to 45-50,000t from 50-55,000t for the June quarter. This is a -10% reduction in guidance, while recoveries are unchanged at 69% and reflect no benefits of optimising the plant, Credit Suisse points out.

Product split is still 86% fines and 14% coarse and UBS notes an eventual lift in coarse flake production is the key to better margin and cash flow, given current price differentials.

The broker reduces realised prices by -9% for 2019/20 to reflect a slower ramping up to the final product mix of 68% fines. Product mix is important, Macquarie agrees, in order to achieve realised prices. The broker had expected a 30% contribution of the higher-value coarse product.

The company has indicated pricing to date is US$466/t, below expectations that were based on commentary in February when management said legacy contracts would largely be completed in the June quarter.

UBS expects pricing should lift in the second half and cash flow is likely to be positive in the September quarter, based on realised pricing moving above US$500/t. This should be achieved if legacy contracts have been eliminated by that time. Until the stock is positive in terms of cash flow, UBS suspects the market will remain cautious about the outlook.

The company has managed to maintain cash within projections, at US$43m at the end of June. Credit Suisse believes this is an indicator of good control of costs and agrees it is a positive, given production constraints and lower sales prices. The broker expects the draw down of cash in the September quarter should be significantly reduced and cash flow should stabilise from there.

The March quarter cash outcome of US$62m may have bettered guidance, but the broker points out this was temporary and achieved because of the favourable timing of working capital. Around US$5m worth of payments in the first quarter were deferred to the second. March quarter cash consumption included US$6.5m on the BAM (battery anode material) project in Louisiana.

The long-term outlook is dependent on progress being made at the BAM, in Macquarie's view. The commercialisation of BAM and funding are key to the broker's valuation of Syrah Resources. UBS also has BAM accounting for around 60% of valuation.

FNArena's database has three Buy ratings and two Hold (Deutsche Bank and Morgan Stanley, yet to comment on the production update). The consensus target is $2.17, signalling 110.7% upside to the last share price. Targets range from $1.20 (Deutsche Bank) to $3.30 (Credit Suisse).

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Confidence Dims For The Star

Brokers have taken the knife to Star Entertainment forecasts but most see valuation support.

-Market share lost in slots because of the construction of the new Sovereign Room -Cost reductions expected to insulate earnings in difficult revenue environment -Global operator interest may pose a catalyst

By Eva Brocklehurst

A weak trading update from The Star Entertainment ((SGR)) sent brokers scurrying to review earnings estimates and the outlook for the domestic gambling sector. The company has guided to operating earnings of $550-560m versus $568m in FY18. Second half VIP revenue is forecast to be down -30%, as weak economic conditions have affected player confidence.

UBS points out, unlike the first half, Star Entertainment is no longer taking meaningful market share. The broker lowers main floor and VIP assumptions to reflect growth in line with the broader gambling market and this results in downgrades to estimates of -16-21% in FY19-21.

Credit Suisse points out the company has lost market share in slot machines in Sydney because of the construction of the new Sovereign Room, which has forced the moving of banks of machines. Weaker premium mass play has also affected this segment.

Guidance compares to prior forecasts for operating earnings of $587m and Morgans downgrades to Hold from Add because of the uncertainty. Early broad-based improvement in the second half, reported at the first half result, has eased back and the broker notes domestic revenue from January 1 to June 8 was up just 0.3%. Slots revenue was up 1.6%, as Queensland experienced increased market share. Table game revenue, meanwhile, was down -0.8%.

Domestic conditions such as low wages growth, falling house prices and higher petrol prices as well as lower VIP turnover have all affected the second half, Ord Minnett suggests. Construction in Sydney and lower hold rates may be partially to blame, yet the broker deduces that the broader slowdown in discretionary expenditure is affecting the whole domestic casino market.

Macquarie was surprised by the intensity of the downturn in domestic business but envisages a strong focus on cost containment will provide greater leverage to a recovery and cushion the downside risk.

Cost Reductions

A cost reduction program of $40-50m per annum from the December quarter has been flagged and UBS believes this is prudent in the current environment. Cost savings will help achieve FY20 forecasts, Morgan Stanley agrees, but suspects it will be challenging if economic headwinds persist and the VIP market remains dormant.

Credit Suisse incorporates just half of the forecast savings into its numbers, believing execution may not be easy. The program aims to eliminate 15-20% of the company's salaried, overhead positions. The broker also assesses net debt will peak at 2.6x operating earnings in FY23, when Crown Sydney ((CWN)) will affect earnings the most, and the investment in Queen's Wharf in Brisbane will be fully expended.

Multiplex has been selected as the preferred contractor for the shell, core and façade work on Queen's Wharf, subject to Queensland government approval. Terms and costs are in line with budget, which Morgans suspects will allay some investor concerns. Importantly, around 60% of all project works will have either been completed or locked away at a fixed cost post the Multiplex contract.

The cost reductions are expected to be achieved by the end of the first quarter in FY20 and Morgans expects the boost to earnings will help insulate earnings in a difficult revenue environment. The company will employ a centralised approach for a number of support functions going forward.

Deutsche Bank is sceptical that the company can execute on its cost reductions and expects threat of a second Gold Coast casino licence to weigh on the share price. While anticipating a slowing in domestic revenue growth in the second half, the broker acknowledges the extent could be larger than previously expected. Still, Deutsche Bank finds the valuation attractive and retains a Buy rating.

Takeover Interest?

Ord Minnett notes there has been increased interest in Australian assets recently and calculates valuation support for Star Entertainment at $3.80, versus a sum-of-the-parts valuation of $4.80. Thus, the broker maintains a Buy rating and assesses valuation infers the Sydney casino could almost entirely support the share price. The slump in the shares after the downgrade is considered overdone, as rival Crown Resorts is likely to be facing similar domestic headwinds in Victoria.

Ord Minnett suggests global operators running the ruler over Australian gambling assets may pose a catalyst for the near term, although agrees macro economic headwinds and concerns over consumer confidence and tourism exist.

UBS believes comparisons with Crown Resorts and Sky City ((SKC)) multiples are becoming less relevant while the Gold Coast casino licence process is underway. The broker bases forecasts and valuation on no change to the competitive environment, and a tax outcome in Sydney which assumes no reduction in main floor tax revenue. As a result, share price upside is assumed if these outcomes are realised, although this is likely to occur in 2020.

FNArena's database has six Buy ratings and one Hold (Morgans) for The Star Entertainment with a consensus target of $4.86, signalling 24.5% upside to the last share price. The dividend yield on FY19 and FY20 forecasts is 5.5% and 5.3% respectively.

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Is AGL's Bid For Vocus A Game Changer?

As earnings levels peak, AGL Energy has sought a tie-up with telco infrastructure, making an offer for Vocus Group.

-AGL is filling a prospective earnings “hole”, amid lack of growth options in core business -Investors query whether this is the best use of AGL's capital -Risk that AGL sparks a price war in broadband, potentially spilling to electricity, gas

By Eva Brocklehurst

Interest in the link between energy and telecommunications infrastructure is heightened as AGL Energy ((AGL)) becomes the latest suitor for Vocus Group ((VOC)), filing a proposal just weeks after Sweden's EQT Infrastructure pulled its offer. This is the first time an energy company has made a bid public for Vocus. AGL's $3bn cash offer, at $4.85 a share, is less than the $5.25 offered by EQT and there is now four weeks of exclusive due diligence.

Ord Minnett estimates AGL Energy is offering a multiple of 9.5-10.0x enterprise value/operating earnings (EBITDA) and assesses this to be "full", because earnings accretion would depend largely on a lower cost of debt. While there are cost savings and revenue benefits from the combination, the proposal also highlights the lack of growth available in AGL's core business and the broker is concerned that other parties have conducted due diligence and decided against a transaction.

Citi estimates the acquisition could be 4-14% accretive to FY22 earnings, based on AGL Energy being able to deliver on consensus earnings forecasts for Vocus, before considering further growth in the assets in the longer term.

Several brokers assert AGL Energy is intent on filling an earnings “hole”, as earnings are at a peak. This creates revenue synergy around retail growth and a new avenue for growth in enterprise and wholesale data, Macquarie explains. The latter enables AGL, as one of the main four network providers in Australia, to avoid being a second or third-tier player in the telco space.

Balance Sheet Utilised

Headroom in the balance sheet is now fully utilised, e.g. new acquisitions in upstream gas would require equity, and Citi believes consensus expectations have some way to fall in FY20. The broker points out investors are concerned about whether this is the best use of capital.

While execution risks are high – this acquisition is outside the company's core competency -- Citi believes they are manageable, asserting that the defensive nature of fibre earnings as well as the lack of correlation to wholesale electricity prices reduces the risk.

Macquarie expects buybacks are likely to become a distant memory, as AGL Energy seeks to develop a telco business. In justifying the company's viewpoint, standing still is not an option. The broker expects net profit will fall to $750-850m over the next five years, from $1.01bn, as the benefits of the LREC contribution and Liddell power station decline.

At the same time super profits from legacy gas and coal contracts will end and there will be tighter regulation around power prices. A capital return would, therefore, add value but not address the fundamental challenges.

Credit Suisse retains an Underperform rating, noting the outlook is for diminished capital returns, should the bid eventuate, which compounds an already weak earnings outlook. Macquarie agrees the risk is significant, although migrating Vocus retail customers is logical and relatively low risk. The main issue is migrating enterprise customers from 6-7 individual platforms to a single platform.

Morgan Stanley believes this bid is the latest to highlight the strategic value in telco infrastructure assets, increasing its conviction in a non-consensus Overweight call on Vocus and Superloop ((SLC)). There is unlikely to be a foreign investment risk in this transaction, which was a potential hurdle in the EQT bid. Macquarie points out the ACCC (Australian Competition and Consumer Commission) will still review the transaction, although it is hard to find signs of market concentration.

Synergies Long-Dated

Credit Suisse assesses earnings accretion is easily achieved because of AGL Energy's willingness to permanently increase gearing while retaining a Baa2 credit rating. The company is opting to acquire exposure to data at scale,

while the value-creating synergies appear to be a secondary driver.

Aside from some portion of corporate expenses, immediate cost synergies appear limited and Credit Suisse considers the only other true value driver is revenue/margin synergies from bundling energy and telco services. Hence, the bid should be viewed as a customer retention/lifetime value opportunity.

Diversifying from peak earnings in energy markets is probably, in Citi's view, a good move and there are international precedents for telco/energy integration, such as TrustPower in New Zealand, where multi-product offerings reduced churn significantly. The risk, the broker suggests, is more around whether a return above hurdles can be achieved.

Leveraging billing systems should add little to the cost of servicing a customer but, while this sounds simple, Macquarie points out it is the equivalent of 12% of NBN market share shifting, or being converted.

Historically, this would spark a price war, squeezing minor players and pushing other larger operators to discount. All up, Macquarie cautions that synergies will be hard to deliver and typically take time. And there is a real risk that AGL does spark a price war in broadband that potentially spills over into electricity and gas.

Citi also notes the AGL share price did not react materially to the bid. As Loy Yang A is an issue for the first half of FY20, Citi argues it should be capitalised by the market, as investors question the ongoing reliability of ageing coal plants. The broker reduces earnings estimates materially, on the back of the Loy Yang A utilisation levels as well as higher spot coal prices, and maintains a Sell rating.

FNArena's database shows two Hold ratings and six Sell. The consensus target is $19.68, signalling -0.1% downside to the last share price. Targets range from $17.78 (Citi) to $22.25 (Deutsche Bank). The dividend yield on FY19 and FY20 forecasts is 5.8%.

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Wesfarmers Nets Catch Group

Online retailer Catch Group is the purchase of the day for Wesfarmers, expected to enhance the offering from Kmart and Target.

-New verticals have recently been introduced by Catch -Replaces potential future capital expenditure to improve online offer -Opportunity to leverage the distribution centre network and fulfill marketplace products sold on Catch

By Eva Brocklehurst

Another month, another acquisition. Following its plays for Kidman Resources ((KDR)) and Lynas Corp ((LYC)), Wesfarmers ((WES)) will purchase online retailer Catch Group Holdings for $230m, one of Australia's largest online retailers.

In Citi's view, this adjacent acquisition presents better value for shareholders, as the prize is the expansion potential for the e-commerce offering of the company's Kmart and Target discount department stores. There are also likely to be synergy and scale benefits to the supply chain.

The acquisition will be funded by existing debt facilities and Catch should operate as an independent business unit under the Wesfarmers grouping. It will be overseen by the Kmart managing director, Ian Bailey. The acquisition price compares with FY18 revenue of $262m and operating earnings (EBITDA) of $6m. Credit Suisse notes gross transaction value was $250m for the six months to December 31, 2018, generated via in-stock retailing.

New verticals in mobile, personal loans, insurance and energy have also been recently introduced. The company operates two distribution centres in Melbourne, the most recent secured in October 2018. Citi expects these distribution centres will complement the existing supply chain, which is currently geared around store delivery.

The benefits, outlined by UBS, include the utilisation of these two highly-automated centres, the leverage for Kmart/Target sourcing and buying, as well as the opportunity to sell Kmart, Target or Bunnings products through the Catch online portal.

Credit Suisse agrees the acquisition provides important capabilities and, with an automated supply chain, strong online marketing and data, it is easy to envisage the opportunities for Kmart and Target. Moreover, if in the longer term the company decides to divest the discount department stores, the inclusion of Catch would create a more attractive proposition, the broker observes.

The acquisition, essentially, replaces future capital expenditure that would have been required to improve the "rudimentary" online offer from Kmart and Target, and Citi envisages benefits from scaling as the online channel grows and bricks-and-mortar like-for-like sales growth slows. While difficult to quantify, productivity benefits should also be available across the supply chain, fulfillment and online execution. Kmart's Anko brand could also be introduced into the Catch marketplace.

Risks

The main risk for Catch Group comes from local peers, such as Kogan.com ((KGN)) and Amazon/eBay for the marketplace business. Scale and funding are also issues for online retailers, although UBS believes Catch Group will avoid this pressure by adding existing retail products to the platform from the Wesfarmers stable, with the potential to invest further in price and service.

Credit Suisse assesses the investment is unlikely to generate an adequate return on financial metrics on a stand-alone basis in the near to medium term. Rather, the acquisition likely reflects a view by Wesfarmers that certain capabilities are required for success in the new retail environment. Positive indicators, in the broker's view, are the intention to maintain independence for the organisation and retain key management. A potential synergy is the Wesfarmers' Fly Buys program.

Limited Financials

No financial details were released. UBS estimates Catch should generate over $15m in earnings (EBIT) in FY20, although this is likely to be immaterial to earnings per share. From a cash flow perspective, the broker suspects there will still be further investment required in the new distribution centre.

Credit Suisse notes profit margins declined to 2% in FY18 from 5% in FY17 for Catch, amid pressure from higher personnel, sales & marketing expenses. Gross margin was steady at 35% of sales. The broker assesses cash flow was reasonably attractive up to FY18, the point where working capital expanded because of a reduction in trade payables. Inventory, as a percentage of the cost of goods, has been declining, which likely reflects improved supply chain efficiency.

Catch Group is primarily a "daily deal" retailer that sells branded goods through limited promotional offers. A marketplace was launched in 2018 and, while growth is strong, it is a small part of the revenue mix. Club Catch offers member-exclusive deals, club discounts and free standard shipping for eligible orders over $45 through a monthly or annual subscription.

Catch Energy offers electricity to customers in Victoria, NSW and south-east Queensland and gas to customers in Victoria through a partnership with 1stenergy. Catch also offers deals on pre-paid mobile plans by leveraging a partnership with Optus, and personal loans through a partnership with NOW Finance.

FNArena's database shows four Hold ratings and three Sell for Wesfarmers. The consensus target is $32.25, signalling -12.8% downside to the last share price. Targets range from $29.00 (Citi, Morgan Stanley) to $37.13 (Macquarie, yet to comment on the acquisition). The dividend yield on FY19 and FY20 forecasts is 7.5% and 4.2% respectively.

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Ultra-Low Interest Rates Hobble Challenger

Disruptions to the adviser group and ultra-low interest rates are providing significant headwinds for Challenger. Brokers, while disappointed, welcome the re-setting of targets.

-Offsetting pressures in retail channel via expenditure on consumer education and improving processes with independent advisers -Difficult to ascertain timing of a recovery in domestic sales -Heightened margin pressure unlikely to abate in low interest rate environment

By Eva Brocklehurst

A difficult operating environment continues to hobble Challenger ((CGF)). The company has disclosed further details on its front book margin and the impact of disruptions to advice. Brokers suspect a large earnings headwind will not dissipate in the near future.

Challenger now expects FY19 pre-tax profit at the lower end of the prior guidance of $545-565m. For FY20 the company has guided to pre-tax profit of $500-550m. This reflects lower normalised growth assumptions for equities and lower interest rates on shareholder capital.

Headwinds consist of significant disruption to the adviser group which has affected the company sales, along with the increased allocation of superannuation funds to the industry sector where the company has a low penetration. A prolonged low interest rate environment has also thinned investment spreads.

Bell Potter points out the prospect of a three-month BBSW (bank bill swap) rate approaching zero is a real possibility, as it currently sits at 1.35%. Moreover, the adviser disruption appears to be worsening. Hence, the broker, not one of the eight brokers monitored daily on the FNArena database, downgrades to Hold from Buy and lowers the target to $7.34 from $13.77.

The company is seeking to offset the pressures in the retail channel by increasing expenditure on consumer education and improving its processes with independent financial advisers. Ord Minnett is surprised the company is pushing growth in retail and believes it will take some time to benefit from the actions to drive sales. Regardless of the efforts to re-set earnings, the risk-adjusted returns envisaged are also considered likely to be insufficient.

Deutsche Bank, on the other hand, welcomes the update to targets and considers the company is taking a more sensible approach to earnings expectations in the new interest rate environment. Although disappointed, Macquarie acknowledges a re-set was necessary and considers the medium-term growth prospects remain attractive.

Credit Suisse had estimates that were already below consensus and makes no changes to its FY19 forecasts, although decreases expectations for net profit in FY20 by -5%. The broker had expected this downgrade and re-set were looming. The valuation has become more appealing but, for the market to regain confidence in the growth story, domestic sales need to demonstrate signs of a recovery and the broker considers the timing for such remains unclear.

UBS notes the company has reacted to insulate product margins by lowering annuities rates but these reductions have lagged lower bond yields and estimates spread margins could fall to 3.15% over the next three years.

Front Book

Credit Suisse notes there were a lot of questions around the front book margin over recent years and a large driver of the contraction has been the run-off in very high margin bonds. Besides this, the product spread, which has held constant at 3% for some time, has now deteriorated.

This is largely from a change in asset mix - away from the higher margin property class - but also because of some margin pressure from low interest rates, the broker assesses.

Macquarie had expected around -25 basis points of margin decline over the next three years and therefore retains unchanged expectations, given the average duration of around five years.

Returns

The company has set its return-on-equity (ROE) target to the Reserve Bank cash rate plus 14%, which compares with a prior target of 18% through the cycle. Brokers calculate this implies an 11% normalised ROE target, post tax.

Equity capital growth assumptions have also been reduced to 3.5% from 4.5%.

Credit Suisse appreciates the company's willingness to provide an ROE target but calculates that, given where its capital sits at the moment, this will be a struggle to achieve.

Macquarie had suspected the company would reduce capital growth assumptions for equities, albeit more likely at the FY19 result. The broker calculates the -1% reduction in the growth assumption reduces normalised earnings by around -4%.

UBS believes the pressure on the life spread margins and domestic sales prospects will constrain improvements in earnings, despite any one-off annuity distribution sales initiatives in FY20. The broker estimates life spread margins could fall below 3.2% by FY22. Moreover, as annuity rates decline there are downside risks to sales volumes, which is a trend that played out in the US after the GFC.

FNArena's database shows one Buy rating (Macquarie), six Hold and one Sell (Ord Minnett). The consensus target is $7.36, suggesting 10.5% upside to the last share price. This compares with $8.14 ahead of the update.

See also Mixed Responses To Challenger's New Deal on March 27, 2019.

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The Season For Gold

Richard (Rick) Mills Ahead of the Herd

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

The season for gold

Gold was riding high last Monday on bad news regarding the US economy, causing stocks to fall and Wall Street traders to pile into bullion.

US markets were choppy on the first trading day after June 1, when the United States increased the tariff on $200 billion of Chinese imports from 10% to 25%. Shares of the so-called 'FAANG' stocks slumped, pulling the S&P 500 and the Dow with them, after media reports that the Department of Justice is weighing actions against Google and Apple, and the Federal Trade Commission said it wants to conduct a probe against Facebook for improper use of data.

Roller coaster Dow Jones

Contributing to the jitters was a white paper from China published over the weekend that blamed the US for escalating the trade war (ie. imposing 25% tariffs following an accusation that China backtracked on commitments agreed to earlier):

"The U.S. government accusation of Chinese backtracking is totally groundless. It is common practice for both sides to make new proposals for adjustments to the text and language in ongoing consultations," the white paper read. "In the previous more than 10 rounds of negotiations, the U.S. administration kept changing its demands. It is reckless to accuse China of 'backtracking' while the talks are still under way."

US President Trump responded that the tariffs on China are working, with Chinese firms leaving the country to avoid paying tariffs, no visible increase in inflation, and the US "taking billions." (the IMF showed that the billions in tariffs are actually being paid by US companies, not Chinese firms as Trump has argued) He also accused China of subsidizing its industries to help them cope with the trade war.

All the uncertainty was enough to propel gold to a two-month high.

As of last Monday, the precious metal was holding at $1,324.38 - a climb of nearly $43 since May 1, when gold finished at $1,281.40.

The price was helped by a 0.1-point drop in the US dollar index. Since May 31 the index has dropped over a full point, from 98.12 to the current 97.06. Gold and the USD normally move in opposite directions.

There are plenty of other reasons to believe we are heading into a summer exploration season backstopped by some very bullish signs for gold. This article gets into the nitty-gritty of each and concludes that now is a very good time to be owning promising junior gold stocks as a wager on rising gold prices and some spectacular drill results.

Forward- looking indicators

The first reason is a set of forward-looking indicators that show the US economy has all but stopped growing from the 3.2% it managed in the first quarter: the PMI, the ISM manufacturing index, and orders for durable goods.

Orders for durable goods are down and the Purchasing Managers Index (PMI) of the countries that count are, frankly, sucking wind; Wolf Street called the US PMI figure, 50.2, "the cleanest of the dirty shirts." Germany, Japan and China were all lower.

The finance publication notes that orders for durable goods like cars and appliances have steadily ticked down since December and have shown no growth for three months in a row. The PMIs for US services and manufacturing in May were the lowest since recessionary 2009.

After the data was released GDP forecasts for the second quarter were slashed from 2.2 to 2% in the best case scenario (Barclays Plc) to 2.25% to 1% in the worst case (JPMorgan Chase).

Pouring more kerosene on the fire was another bad report released on Monday by the Institute for Supply Management. Its manufacturing index read 52.1% in April, weaker than consensus forecasts which expected 53%.

Readings above 50% are seen as a sign of economic growth.

Zero Hedge notes that the 52.1% figure was the weakest since October 2016, despite a kick of new export orders and employment. The fact that three of five ISM components - production, inventories and supplier deliveries - declined, is a worrying sign that stagflation is looming, when unemployment and inflation both rise and economic growth falls.

No trade deal

The lack of a trade deal between the US and China, of course, it's what scaring everybody into thinking that we could be in for a long, protracted jag of protectionism.

China's President Xi Jinping said as much when he compared the current conflict to the 'Long March' of 1935 and urged citizens to prepare for hardship.

Kitco quotes Scotiabank saying "A bigger move in gold" will occur when the market digests a "no trade deal scenario" whereby global growth continues to fall, inflation rates rise, equities weaken and the risk of a recession increases.

"The widening cold war accelerated with a 'no trade deal' now the base case, after Huawei was blacklisted, tariffs were upped and China continues to retaliating most recently with weaponizing rare earths; we are in a sustained global economic 'us' vs 'them' war (see Copper note which goes into more detail) with dire implications for both global growth (now) and inflation (later)," Scotiabank commodity strategist Nicky Shiels wrote in a macro update last week.

The US president isn't helping matters by his erratic, careless messaging that is putting the country at odds with its so-called allies.

On Monday Trump kicked off a state visit to the United Kingdom by calling London's mayor a "stone cold loser" after Mayor Sadiq Khan said Trump is "one of the most egregious examples of a growing global threat" to liberal democracy from the far right.

Trump ended last week by impetuously threatening Mexico with 5% tariffs on June 10, if moves are not made to stem migrants from Central America. CNN Business noted that Mexico is now the United States' largest trading partner and that the tax on imports would affect just about every sector of the American economy including autos, electronics, oil, food products and appliances. [These tariffs have since been suspended indefinitely]

Yield curve inversion

In May the yield curve between 10-year and 3-month Treasury notes re-inverted, after dipping in March into negative territory for the first time since 2007. MarketWatch reported the yield on the 10-year note fell to 2.402%, below the 3-month note's 2.406% yield. An inverted 10-year/ 3-month yield curve is a reliable recession-indicator.

The yield curve is the difference in returns between short-term and long-term bonds. The curve has been inverted since May 23. The yields on long-term Treasury bills are getting worse. They should be much higher than short-term notes because investors demand a higher interest rate for holding bonds long term. On Monday the yield on the 10-year note fell below 2.07% - the lowest in 20 months - while the 30-year bond also slumped, to 2.53%.

Forbes quotes an economist at Moody's Analytics saying that the yield curve inversion spells bad news ahead for the US economy:

Generally, the yield curve inverts when investors are worried about the long-term outlook of the economy, said deRitis. Most economists say an inverted yield doesn't cause a recession but reflects negative sentiment about growth.

Meanwhile in Canada, which takes its cues from the US economy, the yield curve on government bonds inverted the most since 2007, on worries that Trump's threat to impose tariffs on Mexican imports could mean the demise of the new NAFTA agreement. Ten-year bond yields last Friday fell five basis points to 1.51%, and 17 points below the three-month notes.

Trade war with Europe?

The US Federal Reserve pays close attention to the yield curve as it is a measure of investors' confidence in the economy. The Fed had planned to raise interest rates this year on the strength of a growing economy but has since backed off considering the negative outlook for global growth and concerns over the US economy.

Now, the Fed is watching bond yields to see if a further yield curve inversion will drag the dollar down, which would be good for gold prices.

A little out of left field, Morgan Stanley thinks it's not the US-China trade dispute investors should be paying attention to but a looming trade conflict with the European Union, that could seriously dent the economy.

The Trump administration was planning on slapping a 25% tariff on European car imports on May 18 but has deferred a decision for six months. The Morgan Stanley analysts said in a report that a trade war with Europe would cause so much economic pain it would force the Fed to lower interest rates to juice growth.

As for the Fed, its board of governors is hinting that a potential rate cut is being considered as a way to bolster a flagging economy. The New York Times states:

"If the incoming data were to show a persistent shortfall in inflation below our 2 percent objective or were it to indicate that global economic and financial developments present a material downside risk to our baseline outlook," officials would take that into account in assessing whether interest rates should continue to remain unchanged, the Fed's vice chairman, Richard Clarida, said during a speech in New York on Thursday.

Depression analog

In fact some would say the Fed is downplaying a far greater risk to the economy, heralded by the disturbing yield curve inversion and the trade war which appears to escalate by the week.

Clive Maund states in an editorial that "what is going on now is very similar to what went down in the 1930's with protectionism, trade wars and then depression leading to a major war…" Maund thinks a war between the US and Iran is the most likely scenario, given the neo-conservative alliance with Israel.

We agree with the first part and that Iran is certainly a powder-keg, but the drama will be contained, a more regional rather than global affair. At Ahead of the Herd we prefer to place our bets on a military confrontation with China, which certainly by the Trump administration, is seen as the enemy.

Other authors agree.

Over at Project Syndicate, economics professor Nouriel Roubini argues that China and the US are gradually moving towards war - maybe not a hot war, although the constant tensions in the South China Sea suggest otherwise - but likely a cold war, which is what historically happens when an emerging power (China) confronts an established power (the US), something called "the Thucydides Trap".

What started as a trade war now threatens to escalate into a permanent state of mutual animosity. This is reflected in the Trump administration's National Security Strategy, which deems China a strategic "competitor" that should be contained on all fronts.

Flashpoint Taiwan

We have written extensively on the tensions between the US and China in the South China Sea, where China holds historical claims despite international treaties to the contrary (ie. the UN Convention on the Law of the Sea). Ongoing maneuvers in the South China Sea demonstrate that Beijing is willing to flex its muscles in a region it sees as strategically and economically important.

China has been dredging seabed and building islands, on which it has constructed outposts including missile batteries, despite claims of ownership by Vietnam, Malaysia, Philippines, Taiwan and Brunei.

In 2016 Steve Bannon, President Donald Trump's former chief strategist, declared that there was no doubt, in his mind, that the US would go to war with China in the South China Sea in the next five to 10 years.

There's also Taiwan. The United States supplies weapons to Taiwan despite not having diplomatic relations with the island and its government. China sees Taiwan as a breakaway territory that must be re-united with the Chinese mainland; its independence is not recognized by Beijing. A forced annexation of Taiwan to China would almost certainly cause a war between China and the US; the Americans would never allow Taiwan, a key tentacle of US influence, to be overtaken by the Chinese.

Yet that is exactly what Beijing appears willing to go to war over.

Shao Yuanming, a senior official of the People's Liberation Army, reportedly said after a speech by Acting US Defense Secretary Patrick Shanahan, that China would defend its sovereignty over Taiwan should anyone ie. the US, try to keep it separate from the mainland.

"China will have to be reunified," Shao said on Saturday. "If anybody wants to separate Taiwan from China, the Chinese military will protect the country's sovereignty at all costs."

The next day, Defense Minister Wei Fenghe equated President Lincoln's efforts to prevent the secession of the union, during the Civil War, to China's approach to Taiwan. It sees the island as integral to its territory. Bloomberg reported:

"American friends told me that Abraham Lincoln was the greatest American president because he led the country to victory in the Civil War and prevented the secession of the U.S.," Wei said on Sunday at the Shangri-La Dialogue, a security conference in Singapore. "The U.S. is indivisible, so is China. China must be and will be reunified."

Tensions over Taiwan have escalated in recent months, with the US regularly sailing warships through the Taiwan Strait.

Gold-backed Asian currency?

China has recently taken steps towards moving away from the US dollar as the world's reserve currency. In May 2018 the country launched a Shanghai-based oil futures contract denominated in the national currency, the yuan or renminbi - and backed by gold.

The oil futures contract would be a way for oil producers like Saudi Arabia to circumvent the US "petrodollar" - which derives much of its value by being the currency used to buy and sell oil. Currency observers say the oil futures contract is a way for China to challenge the petrodollar and to set the stage for the yuan as the world's dominant currency.

Later in 2018, China announced that it signed a cross-border pact with Russia to work out a new payments system - the idea being that national currencies could be used in bilateral trade, to cut out the US dollar and thereby allow Russia to bypass US sanctions and China to get around US tariffs.

The Malaysian prime minister has taken this idea a step further in suggesting a common Asian currency, presumably similar to the euro of the European Union. Last week Prime Minister Mahathir Mohamad said common currency for East Asia could be pegged to gold, and used for settling imports and exports, though not for domestic transactions.

The concept was a reaction to what Mohamad said was the manipulation of local currencies by external factors, and came on the heels of a statement by the Trump administration that included Malaysia among nine countries to watch for currency manipulation.

Peak gold

At Ahead of the Herd, among the reasons we like gold as an investment, is that gold companies are finding less of it. Last month, AngloGold Ashanti announced plans to sell its last remaining gold mine in South Africa, the Mponeng mine southwest of Johannesburg, due to ore depletion.

We are now facing "peak gold" where gold production from here-on will keep falling. The experts agree the industry is seeing a significant slowdown in the number of large deposits being discovered. It used to be that major gold miners were looking at 5-million ounce projects to buy and develop; now they'd be happy with a million ozs in the ground.

One of the most well-respected CEOs in the industry, Mark Bristow, who headed Randgold before it merged with Barrick, remarked on the tight gold supply in a recent interview with The Northern Miner. Asked to comment on how the gold industry could look in five to 10 years, Bristow had this to say:

The industry is in decline. We've got ourselves into a really tight spot because we haven't invested in exploration and our future.

Now when you look at the average life of mine, it's less than the time it takes to discover and develop a world-class asset. The supply side of our industry is very tight. The demand side … and I disagree with some of the talk presenters here today, in that gold is an inelastic industry just like everything else.

When we overdid the hedging and dumped twice as much gold into the market that we were actually producing, the gold price went to US$255 an ounce. We stopped doing it, and it started going up. The Chinese started buying gold, and it went even further.

Then all we did is we took lower and lower grades and produced more and more gold and we put a roof, a ceiling on the gold price and we've driven it down since then to a point now where we are staring at tightening in the market.

Conclusion

The result, as we see it, has to be continuing strength in the gold price, with major producers like AngloGold Ashanti seeing the end of gold mining in South Africa, a lack of discoveries in recent years, and as Bristow points out, the length of time needed to build a gold mine these days, being longer than the time it takes to mine it out.

That's really something, when you think about it. The lives of gold mines have become so short, it takes longer to discover one and put it into production than the time from the onset of mining to closure.

Combine these supply factors with the demand-side reasons for owning gold right now. To recap, they include the series of economic indicators showing that US growth is grinding to a halt; worsening yield curve inversion; a potential trade spat with Europe waiting in the wings, as the US-China trade war appears no closer to a resolution; and the increasing tension between China and the US over Taiwan and the South China Sea, raising the possibility of war and a flight to safe havens like gold, and you have all the makings of a powerful and prolonged bull market for gold just as we are entering the most active time of the year for junior resource companies.

With all that is going on in the world, we believe the gold price will do well over the next few months.

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Richard is the owner of Aheadoftheherd.com and invests in the junior resource/bio-tech sectors. His articles have been published on over 400 websites, including:

WallStreetJournal, USAToday, NationalPost, Lewrockwell, MontrealGazette, VancouverSun, CBSnews, HuffingtonPost, Londonthenews, Wealthwire, CalgaryHerald, Forbes, Dallasnews, SGTReport, Vantagewire, Indiatimes, ninemsn, ibtimes and the Association of Mining Analysts.

If you're interested in learning more about the junior resource and bio-med sectors, and quality individual company's within these sectors, please come and visit us at www.aheadoftheherd.com

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

Material Matters: Aluminium, Rare Earths & Coal

A glance through the latest expert views and predictions about commodities. Iron ore; aluminium; oil; rare earths; and thermal coal.

-Iron ore prices expected to hold up until December quarter -Bearish outlook for aluminium prevails -Trade tensions fuel choppy oil market, amid indications of broader economic slowdown -What are the potential implications if China restricts US access to rare earths -Thermal coal prices lose buoyancy, now trading into the cost curve

By Eva Brocklehurst

Iron Ore

Ord Minnett upgrades forecasts for iron ore to US$89/t and US$75/t for 2019 and 2020 respectively. The broker expects strong prices to remain in place through the balance of the June quarter and into the September quarter. The broker's revised 2019 shipment estimates from Brazil are at the lower end of Vale's guidance and the global supply/demand deficit is now estimated at 85mt. Moreover, Chinese steel output has surprised to the upside, up 11% in April.

The broker expects the Brucutu mine will ramp up in 2020 and chances for a full re-start should improve once the risk of the Gongo Soco pit wall slippage fades. Coupled with decelerating global growth and a recovery in shipments to China, prices are expected to retrace into the US$80/t region by the December quarter.

The impact is not material for forecasts with estimated earnings per share rising 1-3% for BHP Group ((BHP)) and Rio Tinto ((RIO)). Fortescue Metals ((FMG)) earnings estimates are now 4-5% higher. Given the leverage to an elevated pricing environment, Ord Minnett maintains a Buy rating for Fortescue Metals.

Aluminium

Macquarie found the mood bearish at the Harbor aluminium conference in Chicago. The broker assesses the accelerating US/China trade war and the prospect [now resolved] of escalating tariffs being applied to Mexico appear set to harm global growth rates and demand. The lifting of Canadian tariffs on aluminium also raises a question of whether the premium for US midwest product will hold.

Already underperforming the LME complex, Macquarie notes aluminium has move much lower since the trade talks between the US and China started to unravel. High-level economic data from China has started to deteriorate although this is not yet bad enough, the broker points out, for stimulus measures.

Factors in favour of higher aluminium prices include investors being very short as well as a lift in alumina prices. Business continues regardless, with active buying of primary aluminium in Asia ex-China, the broker understands. Meanwhile, Europe remains weak and automotive segments continue to be a drag on that market.

Oil

ANZ analysts note the market is finding it difficult to form a consensus view on the oil outlook. Sentiment is being affected by trade tensions and weak economic growth, although supply outages have increased and there are risks of further disruptions. To test the market resilience against a global recession, the analysts' modelling indicates that world GDP growth below 3% would mean global oil consumption falls by -1%.

While under such a scenario the call on OPEC (Organisation of Petroleum Exporting Countries) crude drops to only 30m b/d in 2019 the risks around supply issues are higher. Iran and Venezuela are likely to exceed bearish estimates while US supply is unlikely to fill the gap, the analysts contend. All up, base case forecasts show a tightening market in the second half of 2019.

Morgan Stanley also observes a rise in trade tensions,amid indications of a broader economic slowdown and fears this will overtake supply outages. Brent declined -12% during three trading days recently, a relatively rare and significant fall for a three-day period, the broker points out.

Morgan Stanley lowers forecasts for oil demand and now envisages Brent peaking at US$65-70 in the second half. The broker has growing evidence of a sharper-than-expected slowdown in demand as well. Data from eight early-reporting countries, which collectively account for around 50% of global oil demand, reveal year-on-year growth ground to a halt over March and April.

Moreover, refining margins and product crack spreads have recently been falling, even as crude prices were falling. Weaker demand growth is consistent with a broader economic slowdown, the broker suggests, reflected in a range of indicators, including recent inversion of the US yield curve and weaker purchasing manager surveys.

Rare Earths

China, the dominant supplier of rare earth metals, has hinted it may be about to restrict US access. Citi sizes up the potential implications, noting it is China's dominance in processing rare earths that makes the supply chain so reliant on its product. Of the 50,000t mined ex-China last year 41,400t still went via China. Lynas Corp ((LYC)) is currently the only major ex-China integrated minor/refiner.

However, several mining and processing projects could reduce China's dominance in coming years, although this will need more government and investor support. The broker observes a blocking by China of US direct metal/alloy exports is manageable if ex-China processing is built swiftly, but becomes more serious if China attempts to impose restrictions across the supply chain. China provided 80% of US rare earth imports in 2018 and this is unlikely to be fully replaceable, Citi asserts.

Thermal Coal

Macquarie observes thermal coal, after a short lived bounce in mid April, is now trading into the cost curve. At current prices, a fifth of seaborne trade is out of the money. In Australia, small marginal mines, accounting for around 40mt of supply, are affected.

A structural headwind, the LNG surplus, amid slowing power demand in Asia and high coal inventory across the globe make it hard for the broker to envisage when the market will turn around. Higher grade indexes, which outperformed in 2018, have fallen the most and are now approaching 2016 levels.

While thermal coal power generation remains healthy, in most markets it is being displaced by other sources, namely hydro in China and gas in Europe. In China, Macquarie notes growth in thermal power generation fell to zero in March & April. In Europe, LNG imports are on track to double in 2019 while gas prices have fallen to multi-year lows.

While demand is expected to revive over the northern summer, Macquarie finds it hard to assess how this could provide a lasting boost to prices. Cuts in supply have been few and far between and generally confined to the Atlantic market, Macquarie notes. Total seaborne thermal coal supply, nevertheless, is growing, mainly from Indonesia.

Australian exports are also growing, although a moderation in exports is considered likely now that more thermal producers are switching to the semi-soft coking coal market. The main bullish offset is underperforming Chinese supply, as authorities have stepped up supervision of domestic mines after deadly accidents while new capacity additions have slowed.

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ESG Focus: Plastic – Not So Fantastic But Pretty Elastic

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Plastic – Not So Fantastic But Pretty Elastic

This article (part 1 & 2) is the first in a three-part series. It examines the global plastics context, the regulatory and tax landscape, the consumer and the ESG situation. The second article examines the core economic, technological and digital changes transforming the industry, such as recycling and competition from other substances. The third examines the plastics value chain, and which sectors and stocks will be hardest hit, and which are best placed to profit.

• Profound disruption is about to hit the plastic sector • Plastic is problematic from both a pollution and carbon perspective and falls foul of Sustainable Development Goals (SDG) 6, 12, 11, 13 and 14 • There are many plastics, and not all plastics are equal under ESG investing • Global regulations are mounting with single-use plastics in the spotlight

By Sarah Mills

Plastic has been rated public enemy No.2, second only to coal, by most of the world's governments. While single-use plastics are the prime targets, the world is being forced to rapidly rethink its approach to the material, and the industry is preparing for a period of profound disruption within a very short timeframe.

It is estimated that single-use plastics could be banned within five years. At least 50% of plastics worldwide will be re-used or recycled by 2030, and all problematic plastics will be phased out.

Yet, unlike coal, which is to be eliminated, plastics are still perceived to have a future – it will be a matter of which plastics and which industries. So the imminent disruption represents both a risk and an opportunity for investors. Plastic falls foul of the United Nations' Sustainable Development Goals (SDGs): 6, clean water and sanitation; 12, responsible consumption and production; 11 sustainable cities and communities; 13, climate action; and 14, life below water.

But it is also has the potential to contribute to the achievement of many SDGs, such as: 7, affordable and clean energy; 9, industry innovation and infrastructure; and 11, sustainable cities and communities.

Change will come from many quarters, ranging from regulation to innovation, and every move is likely to have a sizeable impact on companies in service to the product. Some analysts estimate that a shift from disposable to durable plastics for products such as water bottles will result in a -65% reduction in polymer volume alone. That's a lot of dollars.

The scale and complexity of the world's plastic problem is confronting and confounding, and its solutions are varied and often complex.

The problems with plastic

Plastic is the most prolific material on the planet, and boasts an extremely stable molecular composition. It is designed to be indestructible yet only 10% of global production is recycled. As a result, the world is literally choking in plastic: single-use plastics, micro-plastics, bio-plastics, industrial plastics and other plastics with distinct chemical compositions used for distinct purposes.

Mountains of plastic waste are building in the West after China stopped importing the world's waste for recycling. Much of this is now being illegally dumped on foreign shores, thanks to rogue operators, and is becoming a point of conflict between nations.

It is also presenting a social/sanitation problem. Plastic packaging is clogging city sewer systems, causing flooding. Abandoned plastics create breeding grounds for mosquitoes in tropical regions, and can leach toxic chemicals such as styrene and benzene as they decompose, posing a health risk.

The devastating affect on the world's oceans and bird-life has been well documented.

As if litter were not bad enough, plastic also has a very high carbon footprint. Its production is energy intensive, and options such as incineration of waste yields carbon dioxide emissions and other toxins.

There are many plastics, and not all plastics are equal under ESG investing.

There are also many different types of plastics: For starters, there are macroplastics and microplastics, both of which will require separate solutions.

Macroplastics are the large, visible plastics such as bottles, plastic bags and fishing lines. It is meant to be destined for landfill but often finds its way into the oceans through fishing, littering and poor waste management.

The worst macroplastic offenders are single-use plastics. They comprise about 50% of the world's plastic production, are used once and tossed on the rubbish heap.

They include plastic bags, cotton buds, cutlery, plates, straws, drink stirrers, and balloon sticks. Litter audits have found Coca-Cola to be the world's top plastic polluter, followed by PepsiCo, Nestle and Colgate-Palmolive.

Microplastics appear to have a lower-level of impact in the ocean but are more insidious, making their way into the bodies of every animal on the planet. They are the particles caused by erosion on plastic products: tyres, synthetic clothes (from washing) and plastic shoes are the main offenders. Plastic paints on buildings and road markings are also problematic.

Polystyrene is also on the hit list given it is at present unrecyclable. IKEA, for example, started using fungi packaging, made from mushrooms, as a replacement last year. Mycelium packaging can be moulded to any shape and it decomposes in weeks. It is just one of many plastic packaging alternatives. At present, alternative packaging constitutes just 1% of the global market but this is expected to rise to $142bn in coming years.

Seven sectors account for almost all primary plastic waste generation: packaging; construction; consumer and institutional products; electronics, electrical and machinery; transportation; and footwear, textiles and apparel. These will be a key focus for ESG investing and companies making the smartest decisions around plastic are likely to represent the better investments as regulations toughen.

Single-use plastics first target in government sights

Governments around the world are addressing plastics as a matter of urgency after China executed its National Sword Policy and stopped recycling the world's plastic. A swathe of second-world countries have followed suit, after being inundated with China's reject waste.

All plastic-use will be reviewed but single-use plastics are first on the chopping block.

China, India and many western states have had bans on plastic bags for decades. Past success with such initiatives – a rapid -80% reduction in plastic bag use has been recorded at minimal economic cost (less than 1% of turnover) – makes bags low-hanging fruit; and they are the first on governments' single-use plastic hit list.

The East African legislative assembly, for example, has banned the manufacture, sale, import and use of certain plastic bags across six members states with a combined population of about 186m people.

Nearly 200 United Nations countries are signatories to the UN plastic bag ban.

Other single-use plastics are set to follow, with many of the world's major polluters planning to phase them out within five years.

All 193 UN countries have signed a resolution to eliminate plastic pollution. More than 60 countries and many more local jurisdictions have introduced bans and levies to curb single-use plastic waste.

Britain plans to ban all single-use plastics by the end of this year. Closer to home, the Australian government plans to ban single-use plastics by 2025, and Tasmania became Australia's first state to ban their use by 2020.

Regulations on the way but plastics have power

These are just the first drops in a deluge of regulation about to bear down on the entire plastic industry. Bans are just one component of a much larger strategic approach to the plastic issue.

The global plastics industry is huge, employs large numbers of people and touches nearly every sector in the economy. Plastic is used in packaging, 3D printing, manufacturing and construction and in every sector from health to education.

In the West, the majority is used for packaging (30%), building and construction (17%), and transportation (14%). Governments will regulate in that order.

Given the pivotal role of plastics in the economy, governments need to tread carefully and are turning to circular models to deal with the plastic disposal issue.

This year, the European Commission reaffirmed their support for the Circular Economy Package targets:

• Zero plastics to landfill by 2025 • 55% plastic pack packaging preparing for re-use and recycling by 2025 • Mandatory separate collection of all packaging from residual waste by 2025 • A regulated uniform methodology for the calculation of re-use and recycling targets • An EU wide standards for plastic waste and treatment • Innovation in technologies to be enhanced across the value chain

Australia too is taking steps to address the plastic problem. Last year, the Federal Government published the National Waste Strategy, which commits to promoting a circular economy, and endorses a target to make all Australian packaging recyclable or compostable or reusable by 2025.

Most governments are aiming for an 80% recycling rate within five-10 years. That’s a lot of change in a short time, particularly given much will rely on innovation and extended producer responsibility schemes, in which producers pick up the cost of collection and treatment.

There is also talk of a global plastic treaty. The Montreal protocol to rid the world of fluorocarbons proved highly successful, although China’s recent FCF bloom has raised a few eyebrows, and other initiatives have proved less so. It would certainly help streamline and standardise responses to the problem, which is likely to be cost-effective for the global economy and producers.

To be continued in Part 2.

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

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

Weekly Ratings, Targets, Forecast Changes

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

The FNArena database tabulates the views of eight major Australian and international stock brokers: Citi, Credit Suisse, Deutsche Bank, Macquarie, Morgan Stanley, Morgans, Ord Minnett and UBS.

For the purpose of broker rating correlation, Outperform and Overweight ratings are grouped as Buy, Neutral is grouped with Hold and Underperform and Underweight are grouped as Sell to provide a Buy/Hold/Sell (B/H/S) ratio.

Ratings, consensus target price and forecast earnings tables are published at the bottom of this report.

Summary

Period: Monday June 3 to Friday June 7, 2019 Total Upgrades: 9 Total Downgrades: 11 Net Ratings Breakdown: Buy 40.29%; Hold 43.30%; Sell 16.41%

The local share market continues to defy the headwind from stockbroking analysts issuing more downgrades than upgrades for recommendations on individual ASX-listed entities.

Admittedly, the tally for the week ending Friday, 7th June 2019, carried nine upgrades versus 11 downgrades; so while the balance leans towards more downgrades, it's not a big gap between negative and positive revisions.

Six out of the nine upgrades switched to Buy, while only two downgrades moved to Sell. The week's two unlucky ones are Boral and City Chic.

Resurrecting EclipX Group took the week's honours in terms of target price increases, followed by Village Roadshow and Metcash. Negative adjustments proved bigger, but all in all both sides are only showing limited numbers affected.

Dacian Gold's price target suffered most, not surprising given the company's severe profit warning, affecting the outlook for many years into the future. Then follows Link Administration, also impacted by a profit warning. Then follows gold producer St Barbara who equally issued a negative news update.

Positive revisions to earnings estimates remain few and far between, with GBST, Village Roadshow and News Corp all enjoying increases during the week, but with considerably more happening on the negative side of the week's ledger.

Dacian Gold's target suffered most (see above), followed by another perennial disappointer of late, Costa Group, followed by EclipX Group, Link Administration, St Barbara and Freedom Foods Group, who also issued a profit warning.

The number of profit warnings being issued against a background of an outperforming local share market reminds investors about the two-speed dynamics at play, irrespective of RBA rate cuts and short covering keeping general sentiment bullish.

Upgrade

AURIZON HOLDINGS LIMITED ((AZJ)) Upgrade to Buy from Hold by Deutsche Bank .B/H/S: 2/5/1

Management is carrying out a structural review, including an assessment of the legal and capital structure. An update is expected at the FY19 results.

Deutsche Bank believes there is limited opportunity to gear up, given the cyclical nature of the resources sector, and there is greater upside from selling an equity stake in the network. The broker upgrades to Buy from Hold and raises the target to $5.40 from $4.80.

ECLIPX GROUP LIMITED ((ECX)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 4/1/0

Credit Suisse believes a strong positive reaction in the share price to the first half result stems mainly from evidence that the underlying fleet and novated lease business is holding a relatively flat trajectory.

There is increased comfort that the company should be able to repair its balance sheet. Disposal of the non-core businesses, Right2Drive, Grays and commercial equipment finance, should enable a reduction in debt.

Credit Suisse upgrades to Outperform from Neutral and raises the target to $1.40 from $0.88.

GENEX POWER LIMITED ((GNX)) Upgrade to Add from Speculative Buy by Morgans .B/H/S: 1/0/0

JPower, one of Japan's largest hydropower operators and developers, will acquire up to 20% of Genex Power and up to $25m following financial close of K2-H. The company has conditional approval on the bulk of its required funding and the main outstanding issue is a final investment decision from Energy Australia.

Morgans is now a lot more confident that project will proceed and, having upgraded to Speculative Buy from Hold in late May, now upgrades to Add. The broker raises the target to $0.35 from $0.29.

MICHAEL HILL INTERNATIONAL LIMITED ((MHJ)) Upgrade to Buy from Neutral by Citi .B/H/S: 4/0/0

Citi upgrades to Buy from Neutral based on the valuation appeal and strategic initiatives being undertaken, including the new promotional strategy and increased focus on Canadian store productivity.

The share price has fallen -25% from its recent peak, the broker observes. Target is steady at $0.63.

METCASH LIMITED ((MTS)) Upgrade to Hold from Sell by Deutsche Bank .B/H/S: 3/2/2

The re-signing of Drakes in Queensland for another five years signals to Deutsche Bank that an economically viable alternative for supply could not be found at this stage.

Moreover, the extension of the Drakes contract in South Australia by four months highlights the complexity of establishing a new distribution centre.

While top-line growth looks challenging, the broker notes more cost reductions have been confirmed and food inflation is becoming real.

Deutsche Bank upgrades to Hold from Sell. Target is $2.80.

NRW HOLDINGS LIMITED ((NWH)) Upgrade to Buy from Neutral by UBS .B/H/S: 1/1/1

NRW client Gascoyne Resources has gone into administration. Work will continue and NRW will continue to be paid while the administrator explores all options, but UBS suspects NRW will write off the $35m at risk despite this being the worst case scenario.

The broker cuts FY19 forecast earnings but leaves FY20-21 largely unchanged, noting a forecast win-rate for new iron ore contracts offers material upside. UBS believes selling has been overdone and upgrades to Buy. Target falls to $3.05 from $3.10.

ST BARBARA LIMITED ((SBM)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 2/2/1

The company downgrades FY19 production guidance to around 355,000 ounces, back to where it started at the beginning of the year prior to guidance revisions in January and March. The reason is a slippage of around a month in accessing the high-grade stopes at Gwalia.

No explicit revisions to costs have been provided other than acknowledging lower production will affect unit costs. Credit Suisse upgrades to Neutral from Underperform, on share price weakness. Target is steady at $2.72. The broker notes a strong performance has continued at Simberi.

SANTOS LIMITED ((STO)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 3/5/0

Credit Suisse believes Santos is less exposed than Oil Search ((OSH)) to risk around LNG price reviews. Santos has the strength in its balance sheet to mitigate the risk.

The broker models a -0.5% slope drop at PNG LNG in its base case or a -5c/share impact. The Darwin LNG price review presents a negligible impact, given limited remaining life but could set a precedent, the broker suggests.

Rating is upgraded to Neutral from Underperform. Target is reduced to $6.35 from $6.40.

WORLEYPARSONS LIMITED ((WOR)) Upgrade to Buy from Neutral by UBS .B/H/S: 6/1/0

UBS upgrades to Buy from Neutral as the stock appears more attractive on a valuation basis after a -15% reduction in the share price in the last quarter. The broker expects earnings (EBIT) growth of 96% in FY20 and 13% in FY21, supported by the acquisition of Jacobs ECR.

UBS notes an upbeat assessment of end-market capital expenditure from the investor briefing, with potential revenue synergies emerging from the cross-selling of the Worley/Jacobs ECR service platforms. Target is reduced to $16.00 from $17.10.

Downgrade

ACCENT GROUP LIMITED ((AX1)) Downgrade to Neutral from Buy by Citi .B/H/S: 0/2/0

Citi remains a supporter of the company's growth strategies, including the increase in vertical brand/accessory penetration and the acquisition of The Athlete's Foot franchises.

However, the broker downgrades to Neutral from Buy as the share price has increased 24% in the year to date.

Moreover, future growth could be more challenging as the company has largely cycled the benefit of reduced discounting. Citi reduces the target to $1.61 from $1.75.

BORAL LIMITED ((BLD)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 5/1/1

The company has not explicitly confirmed guidance and, given weak residential activity in both Australia & the US and poor weather in the US, Credit Suisse suspects a result in line with guidance would be good.

Management has conceded the growth in infrastructure and non-residential activity would not be offsetting the decline in residential activity in FY20. Weakness is expected to be particularly acute in NSW, the company's largest revenue region.

Credit Suisse reduces FY20 estimates for earnings (EBIT) by -17% and downgrades to Underperform from Neutral. Target is reduced to $4.40 from $4.80.

CARSALES.COM LIMITED ((CAR)) Downgrade to Neutral from Buy by UBS .B/H/S: 6/1/0

UBS believes the opportunity for Carsales.com lies with lifting depth contributions, repairing display and growing internationally. In South Korea there are many drivers for longer-term growth, the broker observes, including greater penetration of the dealer base.

Forecasts are raised to factor in improved execution, although UBS suspects the market is already pricing in success. Hence, rating is downgraded to Neutral from Buy. Target is raised to $14.00 from $12.50.

CITY CHIC COLLECTIVE LTD ((CCX)) Downgrade to Sell from Neutral by Citi .B/H/S: 0/0/1

While the growth prospects are good, Citi finds there is insufficient margin of safety at current prices. Moreover, the company has an element of fashion risk and the broker believes the share price needs to be lower to provide a satisfactory reward.

Rating is downgraded to Sell from Neutral. The broker increases estimates for earnings per share by 3% for FY19 and 9% for FY20. Target is raised to $1.60 from $1.45.

CENTURIA METROPOLITAN REIT ((CMA)) Downgrade to Hold from Add by Morgans .B/H/S: 1/1/0

Following strong appreciation in the security, Morgans downgrades to Hold from Add. The broker assesses the stock continues to offer an attractive yield which will appeal to income investors.

FY19 guidance is unchanged, comprising a distribution of 17.6c per security. On this basis a fourth quarter distribution of around 4.36c is expected. Target is raised to $2.64 from $2.51.

DACIAN GOLD LIMITED ((DCN)) Downgrade to Neutral from Buy by Citi .B/H/S: 2/1/0

Citi only initiated coverage with a Buy/High Risk rating and a $3 target in May, about three weeks ago, so there will be a number of unhappy faces at the office. Company management has downgraded production guidance in significant manner.

Citi analysts today respond by saying they are "disappointed"; what else are they supposed to say? The recommendation has been pulled back to Neutral/High Risk. Target price falls to (wait for it) $0.60 as the analysts express their concern about the "low Reserve-to-mill reconciliation for gold ounces across the whole operation".

Estimates have been reset, with the analysts explaining what essentially has occurred is that projected output in ounces went down -30% on +41% in costs, while valuation multiples were reduced on top.

IRESS MARKET TECHNOLOGY LIMITED ((IRE)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 1/4/0

The company will acquire QuantHouse, which provides low-latency market data feeds, hosting infrastructure and algorithms services. While the business is currently generating a slight loss, Ord Minnett suggests this is likely a reflection of being sub-scale.

As cost synergies and scale benefits should drive improvement, the broker believes the risk is low for IRESS achieving an acceptable return from the purchase.

Rating is downgraded to Hold from Accumulate, given the performance of the stock of late. Target is reduced to $12.92 from $13.09.

JB HI-FI LIMITED ((JBH)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 1/5/2

The stock has risen materially since the federal election and over the past 6-12 months. This leads Ord Minnett to downgrade its rating to Hold from Accumulate and raise the target to $29 from $27.

JB Hi-Fi has reiterated FY19 guidance at a recent investor conference and the broker notes June 2018 will be a tough comparable period to cycle because of the FIFA World Cup, while category trends are more benign and competition is mixed.

LINK ADMINISTRATION HOLDINGS LIMITED ((LNK)) Downgrade to Neutral from Buy by Citi .B/H/S: 6/1/1

Citi lowers estimates for earnings per share by -12% for FY19 and by -16% for FY20. The company has downgraded forecasts, predominantly because of factors outside its control, such as Brexit and the earlier-than-anticipated implementation of superannuation legislation.

Citi believes the issue for the company is the decreased perception of earnings predictability. Rating is downgraded to Neutral from Buy and the target lowered to $6.00 from $8.20.

SUPER RETAIL GROUP LIMITED ((SUL)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 2/6/0

The share price has risen materially over the past 6-12 months and since the federal election and Ord Minnett downgrades to Hold from Accumulate, raising the target to $9.50 from $9.00.

The broker considers Super Retail is anchored by a strong and resilient automotive business while the consumer environment appears to be having less of an impact than previously feared.

Macpac is proving to be a strong performer although the turnaround in BCF is less certain.

VIVA ENERGY REIT ((VVR)) Downgrade to Hold from Add by Morgans .B/H/S: 1/2/0

Following appreciation in the stock, over the past year it has risen 35.7%, Morgans downgrades to Hold from Add. The base earnings year is moved to FY20 and, as a result, the target increases to $2.61 from $2.52.

The broker asserts there is a sustainable distribution yield and the stock is attractive for income investors. One third of the portfolio is independently revalued every three years.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 AURIZON HOLDINGS LIMITED Buy Neutral Deutsche Bank 2 ECLIPX GROUP LIMITED Buy Neutral Credit Suisse 3 GENEX POWER LIMITED Buy Buy Morgans 4 METCASH LIMITED Neutral Sell Deutsche Bank 5 MICHAEL HILL INTERNATIONAL LIMITED Buy Neutral Citi 6 NRW HOLDINGS LIMITED Buy Neutral UBS 7 SANTOS LIMITED Neutral Sell Credit Suisse 8 ST BARBARA LIMITED Neutral Sell Credit Suisse 9 WORLEYPARSONS LIMITED Buy Neutral UBS Downgrade 10 ACCENT GROUP LIMITED Neutral Buy Citi 11 BORAL LIMITED Sell Neutral Credit Suisse 12 CARSALES.COM LIMITED Neutral Buy UBS 13 CENTURIA METROPOLITAN REIT Neutral Buy Morgans 14 CITY CHIC COLLECTIVE LTD Sell Neutral Citi 15 DACIAN GOLD LIMITED Neutral Buy Citi 16 IRESS MARKET TECHNOLOGY LIMITED Neutral Buy Ord Minnett 17 JB HI-FI LIMITED Neutral Buy Ord Minnett 18 LINK ADMINISTRATION HOLDINGS LIMITED Neutral Buy Citi 19 SUPER RETAIL GROUP LIMITED Neutral Buy Ord Minnett 20 VIVA ENERGY REIT Neutral Buy Morgans Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 MHJ MICHAEL HILL INTERNATIONAL LIMITED 100.0% 75.0% 25.0% 4 2 VRL VILLAGE ROADSHOW LIMITED 50.0% 25.0% 25.0% 4 3 ECX ECLIPX GROUP LIMITED 80.0% 60.0% 20.0% 5 4 SBM ST BARBARA LIMITED 10.0% -10.0% 20.0% 5 5 WOR WORLEYPARSONS LIMITED 86.0% 71.0% 15.0% 7 6 MTS METCASH LIMITED 7.0% -7.0% 14.0% 7 7 STO SANTOS LIMITED 38.0% 25.0% 13.0% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 VVR VIVA ENERGY REIT 33.0% 67.0% -34.0% 3 2 DCN DACIAN GOLD LIMITED 67.0% 100.0% -33.0% 3 3 CAR CARSALES.COM LIMITED 86.0% 100.0% -14.0% 7 4 BLD BORAL LIMITED 50.0% 64.0% -14.0% 7 5 LNK LINK ADMINISTRATION HOLDINGS LIMITED 56.0% 69.0% -13.0% 8 6 ANN ANSELL LIMITED 38.0% 50.0% -12.0% 8 7 IRE IRESS MARKET TECHNOLOGY LIMITED 20.0% 30.0% -10.0% 5 8 JBH JB HI-FI LIMITED

-13.0% -6.0% -7.0% 8 9 SUL SUPER RETAIL GROUP LIMITED 25.0% 31.0% -6.0% 8 10 VCX VICINITY CENTRES 10.0% 13.0% -3.0% 5 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 ECX ECLIPX GROUP LIMITED 1.440 1.046 37.67% 5 2 VRL VILLAGE ROADSHOW LIMITED 3.605 3.230 11.61% 4 3 MTS METCASH LIMITED 2.843 2.786 2.05% 7 4 CAR CARSALES.COM LIMITED 14.041 13.827 1.55% 7 5 VVR VIVA ENERGY REIT 2.550 2.520 1.19% 3 6 JBH JB HI-FI LIMITED 24.615 24.365 1.03% 8 7 IRE IRESS MARKET TECHNOLOGY LIMITED 13.446 13.378 0.51% 5 8 SUL SUPER RETAIL GROUP LIMITED 9.141 9.110 0.34% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 DCN DACIAN GOLD LIMITED 1.483 3.050 -51.38% 3 2 LNK LINK ADMINISTRATION HOLDINGS LIMITED 7.181 8.059 -10.89% 8 3 SBM ST BARBARA LIMITED 3.144 3.262 -3.62% 5 4 BLD BORAL LIMITED 5.771 5.829 -1.00% 7 5 WOR WORLEYPARSONS LIMITED 18.411 18.569 -0.85% 7 6 ANN ANSELL LIMITED 26.491 26.654 -0.61% 8 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 GBT GBST HOLDINGS LIMITED 17.650 13.300 32.71% 3 2 VRL VILLAGE ROADSHOW LIMITED 11.733 10.267 14.28% 4 3 NWS NEWS CORPORATION 57.295 53.068 7.97% 5 4 AMC AMCOR LIMITED 82.469 81.093 1.70% 7 5 WOR WORLEYPARSONS LIMITED 59.503 58.777 1.24% 7 6 BLD BORAL LIMITED 40.620 40.128 1.23% 7 7 CSL CSL LIMITED 581.652 579.401 0.39% 8 8 STO SANTOS LIMITED 57.427 57.224 0.35% 8 9 CBA COMMONWEALTH BANK OF AUSTRALIA 487.486 486.057 0.29% 8 10 QBE QBE INSURANCE GROUP LIMITED 87.778 87.595 0.21% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 DCN DACIAN GOLD LIMITED -5.000 4.250 -217.65% 3 2 CGC COSTA GROUP HOLDINGS LIMITED 19.228 23.775 -19.13% 6 3 ECX ECLIPX GROUP LIMITED 12.460 14.540 -14.31% 5 4 LNK LINK ADMINISTRATION HOLDINGS LIMITED 37.143 43.339 -14.30% 8 5 SBM ST BARBARA LIMITED 28.138 30.745 -8.48% 5 6 FNP FREEDOM FOODS GROUP LIMITED 7.933 8.267 -4.04% 4 7 IRE IRESS MARKET TECHNOLOGY LIMITED 45.495 46.220 -1.57% 5 8 MHJ MICHAEL HILL INTERNATIONAL LIMITED 5.925 6.000 -1.25% 4 9 SGR THE STAR ENTERTAINMENT GROUP LIMITED 28.335 28.668 -1.16% 7 10 REG REGIS HEALTHCARE LIMITED 15.975 16.125 -0.93% 4 Technical limitations

If you are reading this story through a third party distribution channel and you cannot see charts included, we apologise, but technical limitations are to blame.

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Uranium Week: Finding A Level

The uranium spot price has posted its first weekly increase in almost two months.

-Buyers Emerge -Uranium market remains fractured -Finland gets ambitious

By Greg Peel

After a long, steady decline in the spot uranium price in 2019 on section 232 uncertainty, buyers finally emerged from the woodwork last week in the form of both utilities and investors. While US utilities continue to remain mostly on the sidelines, non-US utility interest has prompted sellers to cast their nets wider.

US utilities who are interested in purchases continue to target material acceptable for delivery in the US as opposed to that sourced from the likes of Russia, Kazakhstan or Uzbekistan which remains subject to potential 232 restrictions.

Industry consultant TradeTech reported 650,000/lbs U3O8 equivalent changing hands in the spot market last week. As the buyers stepped in, the sellers retreated as the week progressed, and so the buyers backed off again. Regardless,TradeTech's weekly spot price indicator rose US60c to US$24.60/lb – the first weekly increase in almost two months.

Two transactions were also concluded in term markets last week. TradeTech's term price indicators remain at US$27.35/lb (mid) and US$30.00/lb (long).

Outside of the open markets, London-based investment firm Yellow Cake last week purchased a further 1.175mlbs U3O8 from Kazakhstan's Kazatomprom under the option agreement between the two.

Say no to carbon

In Japan, an energy white paper was last week accepted by Cabinet which notes that the country faces an "urgent task" of reducing carbon emissions from utilities heavily reliant on the burning of fossil fuels. Japan was forced to return to elevated coal and gas-fired electricity production when all nuclear plants were shut down in 2011, and the pace of restarts remains glacial.

The government is targeting an increase of renewable production to 22-24% of its energy mix from a current 16% by focusing on reducing its cost, and a similar target has been set for nuclear power in the mix. In 2017, nuclear contributed only 3%.

The plan is to reduce carbon emissions by -26% from 2013 levels by 2030. To date only a -7% reduction has been achieved, hampered by a current 74% level of coal/gas-fired production to make up for lost nuclear.

To reach its energy mix target, up to 30 reactors would need to be in operation. Of the 35 reactors in the country which are operable, only nine are currently operating, six have received initial restart approval, twelve are under review and eight have yet to file for restart.

If Japan's carbon reduction target looks at all ambitious, Japan has nothing on Finland. The newly appointed government in Finland has pledged to reduce carbon emissions to zero by 2035.

Moreover, Finland is set to take over the rotating EU presidency in July, just as an ambitious pan-European climate deal remains in negotiation.

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The Short Report

Guide:

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

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

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

Summary:

Week ending June 6, 2019

Well. As one might conclude from the table below, in which only Challenger ((CGF)) saw any rise in short position amidst an overwhelming sea of green, that last week saw a substantial wave of short-covering. However, I'm just a little sceptical.

While the sheer number of stocks seeing short position reductions in one week is, I believe, unprecedented in the history of this Report, it is the magnitude of short positon changes that has me prepared to seriously doubt ASIC's data.

One stock saw shorts reduce by almost five percentage points, three stocks by three-four percentage points, seven by two to three pps and three by one to two pps. One drop of three or more points usually rings alarm bells, and moves of more than two are not unusual but uncommon.

It is true to say that the ASX200 has undergone an extremely sharp rally, peaking at over 260 points from the June 4 low, when Trump threatened tariffs on Mexico, and that sharp rallies of this nature often feature a short-covering scramble. However, this Report cuts off at June 6, at which point only 50 points of that rally had been booked.

While I have tabulated all the positon changes below, I'm not going to bother listing all the stocks with big down-moves. For I fear that in this Report next week, everything will be back where it was. I've been bitten too many times by erroneous ASIC data.

That said, Amcor ((AMC)) was the stock dropping almost 5pps, to 2.7% from 7.5%, and given its acquisition of Bemis was completed in the week, justification is possible. However, similar stories don't exist for every single stock.

If, by some quirk of fate, these numbers are indeed accurate, well there's still nothing more specific to say than: short-covering rally.

Weekly short positions as a percentage of market cap:

10%+ ING 16.7 SYR 15.6 JBH 15.5 NUF 13.4 ORE 12.7 NXT 12.5 GXY 12.1 BAL 11.4 MTS 10.9

Out: BWX, BIN, SDA

9.0-9.9

BWX, BIN, SUL, HVN, DMP

In: BWX, BIN Out: RWC, IFL, PLS, SGM, KGN, PPT, CSR 8.0-8.9%

PPT, CSR, IFL, KGN, MYR

In: PPT, CSR, IFL, KGN Out: HUB, BKL, IVC, BGA

7.0-7.9%

HUB, IVC, PLS, BOQ, SDA, CGF, BKL, AMP, BGA

In: SDA, PLS, HUB, IVC, BKL, BGA, CGF Out: AMC

6.0-6.9%

RWC, SGM, CGC, GMA

In: SGM, RWC Out: CGF, WSA, NEC, SEK

5.0-5.9%

MSB, SEK, NEC, CLH, MIN, COE, SXY, CLQ, CTD

In: SEK, NEC Out: MLX, OML, HT1, BEN, FLT

Movers & Shakers

Not today.

ASX20 Short Positions (%)

Code Last Week Week Before Code Last Week Week Before AMC 2.7 7.5 RIO 4.9 4.8 ANZ 0.8 0.8 S32 0.8 0.7 BHP 3.2 3.2 SCP 0.6 1.0 BXB 0.3 0.2 SUN 0.4 0.3 CBA 1.4 1.4 TCL 1.3 1.4 COL 1.4 1.4 TLS 0.6 0.5 CSL 0.4 0.3 WBC 1.7 1.7 IAG 0.4 0.7 WES 1.9 1.9 MQG 0.5 0.7 WOW 1.8 2.3 NAB 1.0 0.9 WPL 0.6 0.6 To see the full Short Report, please go to this link

IMPORTANT INFORMATION ABOUT THIS REPORT

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

It is wrong to assume that short percentages published by ASIC simply imply negative market positions held by fund managers or others looking to profit from a fall in respective share prices. While all or part of certain short percentages may indeed imply such, there are also a myriad of other reasons why a short position might be held which does not render that position "naked" given offsetting positions held elsewhere. Whatever balance of percentages truly is a "short" position would suggest there are negative views on a stock held by some in the market and also would suggest that were the news flow on that stock to turn suddenly positive, "short covering" may spark a short, sharp rally in that share price. However short positions held as an offset against another position may prove merely benign.

Often large short positions can be attributable to a listed hybrid security on the same stock where traders look to "strip out" the option value of the hybrid with offsetting listed option and stock positions. Short positions may form part of a short stock portfolio offsetting a long share price index (SPI) futures portfolio – a popular trade which seeks to exploit windows of opportunity when the SPI price trades at an overextended discount to fair value. Short positions may be held as a hedge by a broking house providing dividend reinvestment plan (DRP) underwriting services or other similar services. Short positions will occasionally need to be adopted by market makers in listed equity exchange traded fund products (EFT). All of the above are just some of the reasons why a short position may be held in a stock but can be considered benign in share price direction terms due to offsets.

Market makers in stock and stock index options will also hedge their portfolios using short positions where necessary. These delta hedges often form the other side of a client's long stock-long put option protection trade, or perhaps long stock-short call option ("buy-write") position. In a clear example of how published short percentages can be misleading, an options market maker may hold a short position below the implied delta hedge level and that actually implies a "long" position in that stock.

Another popular trading strategy is that of "pairs trading" in which one stock is held short against a long position in another stock. Such positions look to exploit perceived imbalances in the valuations of two stocks and imply a "net neutral" market position.

Aside from all the above reasons as to why it would be a potential misconception to draw simply conclusions on short percentages, there are even wider issues to consider. ASIC itself will admit that short position data is not an exact science given the onus on market participants to declare to their broker when positions truly are "short". Without any suggestion of deceit, there are always participants who are ignorant of the regulations. Discrepancies can also arise when short positions are held by a large investment banking operation offering multiple stock market

services as well as proprietary trading activities. Such activity can introduce the possibility of either non-counting or double-counting when custodians are involved and beneficial ownership issues become unclear.

Finally, a simple fact is that the Australian Securities Exchange also keeps its own register of short positions. The figures provided by ASIC and by the ASX at any point do not necessarily correlate.

FNArena has offered this qualified explanation of the vagaries of short stock positions as a warning to subscribers not to jump to any conclusions or to make investment decisions based solely on these unqualified numbers. FNArena strongly suggests investors seek advice from their stock broker or financial adviser before acting upon any of the information provided herein.

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The Wrap: Financials, Super And A-REITs

Weekly Broker Wrap: financial institutions; superannuation; A-REITs; and US demographics.

-Further increases in bank shares rely on earnings upgrades -Level of adviser departures from major superannuation funds unprecedented -Heightened level of retail A-REIT assets for sale -Demographic changes in the US support a comparatively brighter long-term outlook

By Eva Brocklehurst

Financial Institutions

Loan applications for both homes and businesses appear to be increasing after a soft six-month period and April credit growth data provided by the Reserve Bank of Australia shows the highest monthly home loan growth for the year. Moreover, Shaw and Partners points to a post-election rally in major bank share prices, which has meant they reflect long-term loan growth rates of between 3-4%, consistent with nominal GDP.

Further increases in bank shares now rely on earnings upgrades. Such upgrades, the broker contends, could come from higher loan growth forecasts, an improved outlook for net interest margins and diminishing threat of higher capital requirements by the Reserve Bank of New Zealand. The most problematic of these sources for upgrades is margins, in the broker's view, because a reduction in the cash rate typically lowers deposit margins.

Commonwealth Bank ((CBA)) and National Australia Bank ((NAB)) will pass on the latest cash rate reduction in full to variable home loan rates while the other two majors, Westpac ((WBC)) and ANZ Bank ((ANZ)) will pass on 20 basis points and 18 basis points, respectively. The ability to recover these rate cuts from depositors is likely to be challenging and Shaw and Partners expects earnings upgrades are unlikely as a result.

Ord Minnett observes a considerable shift in sentiment towards banks after the federal election, with a substantial reduction in short interest in the major banking stocks. What remains to be seen is whether the improvement is enough for domestic institutional investors to start narrowing their underweight positions.

The market is now pricing in at least two cuts to official interest rates in 2019 and, with no sign of any let up in mortgage competition, the broker suspects it will remain challenging for the banks for some time. Still, banks are expected to hold onto the most recent gains, with their 6% net dividend yields providing a base of support. In comparison, global banks have been facing rising macro economic concerns relating to trade tensions as well as flattening yield curves.

Superannuation

The level of adviser departures is now unprecedented, Bell Potter points out. The large operators, AMP ((AMP)), IOOF ((IFL)) and the major banks have lost a combined 454 advisers, and if the current loss rate continues they will shed over -20% of their adviser base in just a year. The major inputs to this trend are the final report of the Royal Commission into the financial sector as well as changes in adviser education standards.

IOOF experiences the highest number of departures in May. Bell Potter believes AMP and IOOF are in the midst of a multi-year reform of their respective organisations and AMP is further along the process. IOOF is yet to properly provision for possible client remediation for fee-for-no-service. A review has commenced and the company will provide feedback in August. Bell Potter continues to maintain a Sell rating for both stocks and prefers exposure to Praemium ((PPS)) and Onevue Holdings ((OVH)).

A-REITs

During May, the S&P/ASX 200 A-REIT index delivered a total return of 3.6%, versus the broader market of 1.5%, while Australian bond yields remained low at around 1.5%. Morgans notes investor expectations around interest rates, inflation and economic growth are being re-set lower for longer.

The broker downgrades both Viva Energy REIT ((VVR)) and Centuria Metropolitan Retail ((CMA)) to Hold following the rally in the securities. Morgans maintains an Add ratings on Aventis Group ((AVN)), which offers exposure to large format retail centres and APN Convenience Retail ((AQR)) which owns a portfolio of 70 service stations.

Citi maintains a negative view on retail landlords given the large overhang of assets on the market. The broker estimates potential for around $11bn in disposals of Australian retail assets, or close to three years of typical

transaction volume. Selling appears to be broad-based, with the usual buyers, including unlisted funds and offshore investors, having recently turned sellers. Hence, shopping centre values are expected to continue falling.

Book values typically reflect the shift in market pricing once it occurs, Citi points out, which signals the risks remain skewed to the downside. The broker reiterates Sell ratings for Scentre Group ((SCG)), GPT ((GPT)), Shopping Centres Australasia ((SCP)), Charter Hall Retail ((CQR)) and BWP Trust ((BWP)) and maintains a preference for non-retail exposures within the A-REIT sector.

US Demographics

Demographic changes in the US support a comparatively brighter long-term outlook than for other G10 economies, Morgan Stanley assesses. The broker considers the bearish belief that baby boomers are exerting a drag on growth misses the fact that America's youth, by 2034, will become the country's largest cohort.

The analysis suggests that over the next 10 years, home improvement, lodging, automotive maintenance and food at home are relatively better positioned because of the changing demographics. Headwinds are more likely for apparel, home furnishings and food away from home, with apparel the category most likely to be hurt by an ageing population.

This boost in the US from the generational change in many cases is far larger than for other G10 economies. Why? Labour force growth will start to rise on the 2020s and lift potential GDP. Morgan Stanley calculates Census Bureau data underestimates the level of potential GDP in 2040 by 2.4-4.3%. Critically, faster labour force growth should delay, or even ameliorate, the date when Social Security, absent any changes, becomes insolvent.

This youth boom is likely to drive loan growth, where analysis of borrowing habits has shown Millennials (Gen Y) and Generation Z are more like their Baby Boomer grandparents than parents (Generation X).

Total consumption growth is also expected to accelerate, although this includes accelerated expenditure on medical benefits as the population ages. On a more cautious note, consumer discretionary growth for the the younger generations appears unlikely to offset decelerating consumer spending by an ageing population.

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Wisetech Global: Hold On

By Michael Gable

In our report this week we look at an updated chart of Wisetech Global ((WTC)).

Our previous comment on WTC was on 7 May when it was trading at $22.00. We noted that "it is getting ready to break through that $24.00 level when the selling has finished. That would leave it clear to make a very strong rally on any breakout." In the last two weeks, we have seen a breakout, a retest, and a continuation of the rally. Investors in WTC are now advised to hold on as the breakout confirms that there should be even more upside. We don't have an upside target but recommend that investors run trailing stops.

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Michael is RG146 Accredited and holds the following formal qualifications:

• Bachelor of Engineering, Hons. (University of Sydney) • Bachelor of Commerce (University of Sydney) • Diploma of Mortgage Lending (Finsia) • Diploma of Financial Services [Financial Planning] (Finsia) • Completion of ASX Accredited Derivatives Adviser Levels 1 & 2

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