WEEK 41

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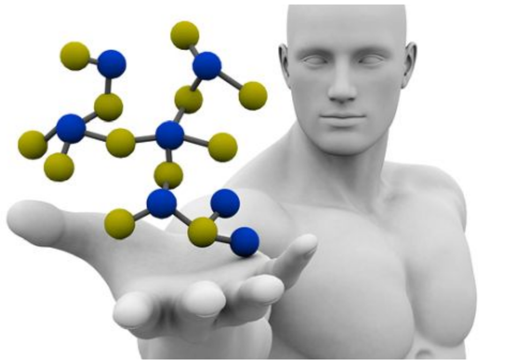
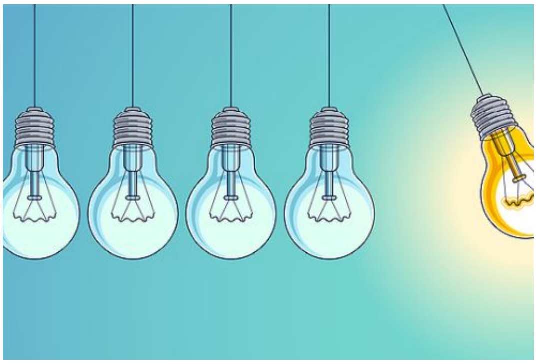


Life Sciences' New Tools: AI, IoT, Data & M&A

CBA: Expensive And Justified, Or Maybe Not?



Rudi's View: Market Momentum Switch, A Messy Affair

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INTERNATIONAL

Life Sciences' New Tools: AI, IoT, Data & M&A

A sector outlook by Deloitte reveals how life sciences companies are turning towards machine learning, data gathering & analysis, artificial intelligence, and other modern day tools to create value for patients and shareholders

-US$1.8trn prescription drug sales forecast to grow at 6.9% per annum (CAGR) by 2024
-China aiming to source domestically 70% of all medical devices used by hospitals by 2025
-AI & machine learning are feeding into ongoing innovation, as well as time and cost efficiencies
-M&A deals remain firmly in focus

By Carole Goldsmith

The global life sciences sector is surging upwards to great heights, with widespread international investment opportunities on the table. Deloitte's 2020 Global Life Sciences Outlook *Creating new value, building blocks for the future*, 61-page report, takes a detailed look at the factors driving this sector and its investment predictions across the globe.

The report outlines how biopharma and med-tech organisations can use Artificial Intelligence (AI) to increase value for companies and shareholders. There's also a move by technology companies to get into medical research and climb aboard the life sciences wagon.

The comprehensive report is written by Greg Reh, Deloitte's Global Life Sciences & Health Care Industry leader, who has more than 27 years of experience working with pharmaceutical, biotechnology and chemical manufacturing organizations.

This article raises valuable highlights from the report, which attempts to answer questions around creating new value, leveraging opportunities and investing in the future. If you are not investing in life-sciences companies currently, this report shines a light on this exciting innovative sector with predicted statistical data to 2025.

The life sciences field is booming with US$1.8trn prescription drug sales expected world-wide, between 2019 and 2024, providing a projected Compound Annual Growth Rate (CAGR) of 6.9% by 2024.

Drivers of this growth are predicted to be an increase in drug approvals, increasing oncology therapy sales and potentially US$109bn from orphan drug sales (treatments for rare diseases). AI in drug discovery alone accounted for the largest market size, rising from US$159.8m to US$2.9bn in the forecast period.

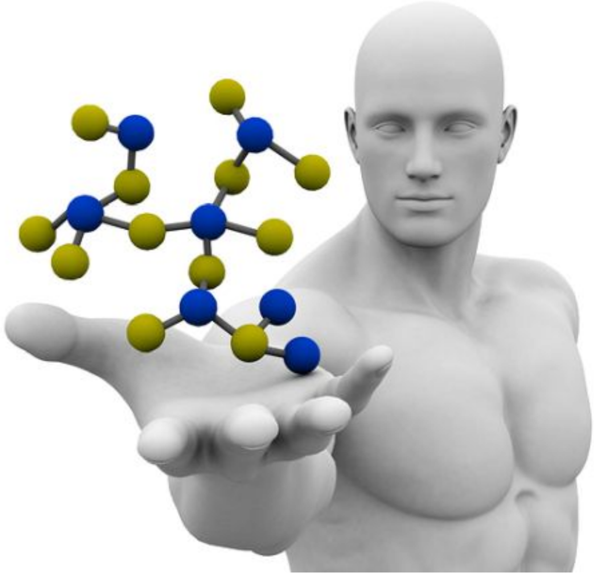
In 2018, the global medical devices market was valued at US$425bn rising to its expected 2025 value of US$612.7bn, growing at a CAGR of 5.4% over the period. The USA leads the global medical device market, while Japan is the second largest, revealing a 4.6% CAGR forecast over the same research period.

Globally the in vitro diagnostics (IVD) segment is the largest med-tech sector accounting for 12.9% market share in 2018, and predicted to remain the leading device area in the future.

The US Food and Drug Administration (FDA) explains that IVD products are intended to be used for collection, preparation and examination of specimens taken from the human body. All companies who manufacture, repackage, relabel and, or import medical devices sold in the USA, are regulated by FDA's Center for Devices and Radiological Health.

Deloitte's report adds that under the **"Made in China 2025" campaign**, China wants its domestically made medical devices to account for 50% of the medical devices used by hospitals in 2020. By 2025 this is expected to rise to 70%. With the US-China trade war in action, the highest value medtech segments to keep an eye on, for potential trade risks and competition, include the high value medical consumables, gene sequencing, and IVDs.

Reh advises in the report that, "MedTech companies have the potential to drive efficiencies and tackle challenges by applying solutions such as IoT, (Internet of Things) machine learning, additive manufacturing, and augmented reality. A new breed of AI start-ups is leading the way on how new drugs are being developed."



Global life sciences M&A deals and IPOs

Total value for mergers and acquisitions (M&A) deals for the global life sciences sector surged to US$181.7bn in 2019's first three quarters, significantly higher in comparison with the US$135bn recorded over the same period in 2018.

During the first three quarters of 2019, USA companies were acquirers (A) in 537 deals and targets (T) in 480. Chinese companies were close behind, as A in 382 deals and T in 411.

The other eight leading countries' deals listed in the report, for the same period are, South Korea (A119, T130), Canada (A118, T130), Japan (A102, T121), France, (A85, T78), UK (A 84, T90), India (A56, T48), Italy, (A56, T48) and, surprisingly, Germany, at the number 10 spot (A56, T44).

The largest life science's acquisition last year saw US multinational pharmaceutical company Bristol-Myers Squibb complete its US$74bn acquisition of biopharma company Celgene in November. Following on in December, Swiss multinational pharmaceutical and diagnostics company Roche, finalised its US$ 4.4bn deal to acquire gene therapy company Spark Therapeutics, which became a wholly owned subsidiary of the Roche group.

The top three biotech Initial Public Offering's (IPOs) for 2019 are:10X Genomics – US$390m, Bridge Bio Pharma -US$348.5m and Gossamer Bio – US$317.4m.

The medtech sector had already passed the previous year's M&A, by mid-2019, including eight deals for a total of US$29.5bn, the four largest deals were by businesses that supply hospitals.

Verily Life Sciences, Alphabet Inc's research organisation and a former division of Google X recorded the largest Venture Capital (VC) round ever in medtech and bio-pharma history in the first half of 2019. The US$1bn venture round was only Verily's second round.

Life sciences companies announced deals to acquire 37 technology companies in 2019, however, by September more than half the deals were still pending. Most of the acquisitions were software companies, followed by advertising/marketing businesses and IT consulting/services.

The acquirers include six pharmaceutical and two biotech companies as well as 29 health care equipment and supply businesses. Life sciences businesses are doing deals with technology companies to digitalise the business, add new value, enhance innovative practices and, ultimately, achieve domestic and global success.

One of these deals is France- based Dassault Systemes' US$5.8bn acquisition of US based Medidata Solutions, to create an end to end life sciences' business and scientific platform. Atrys Health's acquisition of Real-Life Data SLU (both based in Madrid) was another deal. Real Life Data specialises in health big data and real-world evidence solutions. The deal is expected to enhance Atrys' work in predictive medicine and deepen knowledge about pathologies, diagnosis trends and treatments.

The report also case studies the human value of technology acquisition for New York healthcare and technology services company Flatiron Health. Extracting the most useful information from pathology and clinical notes from cancer treatment and research still requires humans to completely analyse the data.

To handle this, Flatiron Health hired trained medical professionals to curate unstructured data and train its machine learning models. Electronic health records' data were normalised, making them more useful for clinicians and researchers. By speeding up cancer research, Flatiron Health created new value between humans and technology. The company was acquired by Roche for US$1.9bn in 2018.

Deloitte’s Insights reflections

Tailing at the end of Reh’s report, *Deloitte’s Insights, A short take on the 2020 Global Life Sciences Outlook*, provides some valuable reflections on the issues raised in the report. Insights was compiled by the editorial team, Ramani Moses, Blythe Hurley, Anya George Tharakan, and Nairita Gangopadhyay.

They advise, “The promise of cell and gene therapies is being delivered to patients and rare diseases, previously believed to be incurable, are on the precipice of real cures. AI and machine learning approaches are raising expectations that therapy discovery may not only be more innovative, but also time and cost effective.”

Among the other issues raised are: Medical grade sensors are in many consumer wearables, remote monitoring, telemedicine and virtual trials are cutting complexity for patients and connected devices/medical algorithms are delivering data everywhere. They also suggest that in 2020, biopharma and medtech organisations will be examining new ways to create value and new metrics to interpret all the delivered data.

What will sell? The Insight’s authors analyse what will sell: Global prescription drug sales are projected to achieve a 6.9% CAGR from 2019 to 2024 and oncology drugs are expected to reach almost 20% of the world-wide market with 11.4% CAGR by 2024.

Worldwide, orphan drug sales are predicted to be double the CAGR of nonorphan drugs over the same period. Also, the IVD market will be the largest medtech segment globally, holding a market share of 12.9% in 2018, and it’s expected to remain the number one device area in the foreseeable future.

This article’s author, Carole Goldsmith owns shares in Alphabet Inc.

AUSTRALIA

Can Reliance Worldwide Maintain Growth?

After a September quarter that reflected home-bound households undertaking renovations, will Reliance Worldwide maintain strong growth in plumbing sales as city activity returns to normal?

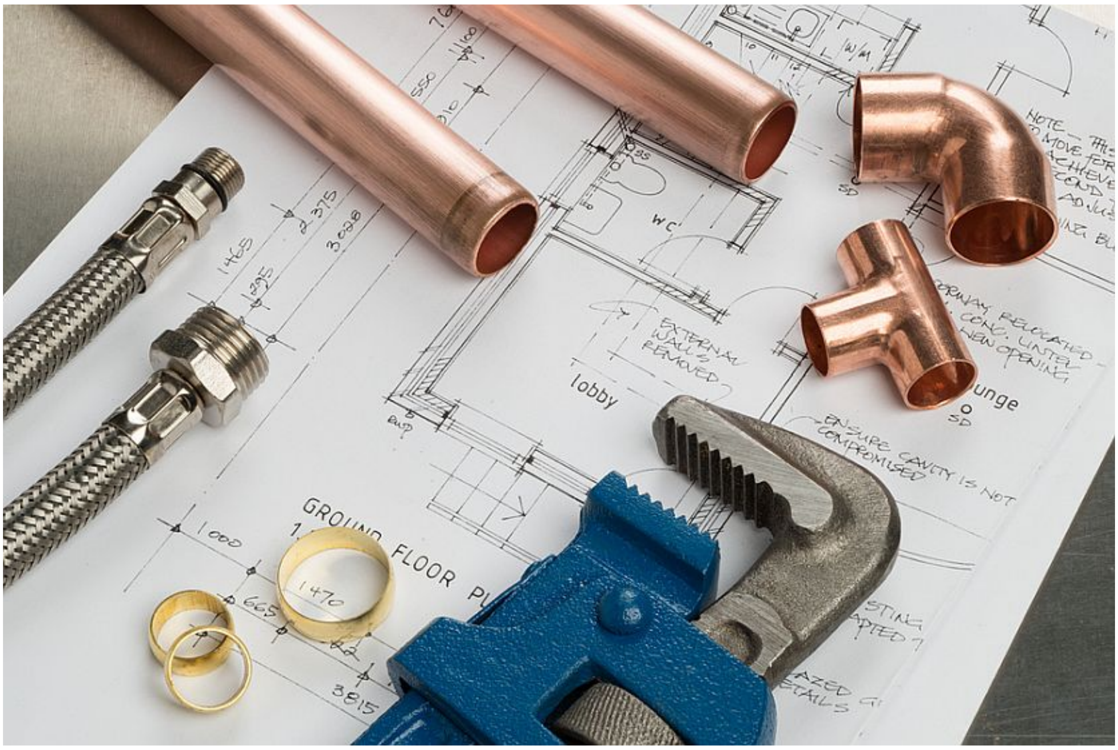
-Current strength in plumbing supplies heavily related to DIY
-Plans to diversify into the new commercial construction market
-Margin expansion expected in FY21

By Eva Brocklehurst

Plumbing fittings supplier Reliance Worldwide ((RWC)) has provided some solace to the market, outlining its long-term growth expectations and how this will be achieved. Product innovation and an expansion of ranges is underway, to leverage the company's strong distribution network.

A target of 3-5% long-term revenue growth for the US and 2-6% for Europe/Middle East/Africa (EMEA) was provided. However, revenue growth is dependent on initiatives taken with customers and products and, UBS points out, this does not include any possible lasting impact from the pandemic.

Reliance is aware that the professional user has relied on retail more often during the lockdowns, an area where its products are more highly represented. There has also been more consumption because of the increase in working from home as households undertake DIY projects.



Large diversified retailers in the US agree much of the current strength related to incremental demand is coming from customers that are homebound, Macquarie notes. The broker expects a focus on efficiency and disciplined R&D investment should help mitigate macro risks for the company, while acknowledging some pulling forward of orders may be occurring and visibility is poor.

Reliance is cautious about claiming any sustained benefit from pandemic-related factors, suspecting a **normalisation of activity away from plumbing could follow as cities recover**.

Caution is justified, in Morgan Stanley's view, although this does not discount the fact this has been a very strong year for the company. The main risk is to the upside, in the broker's view, although it is difficult to be confident until a "new normal" is established.

Expansion

Ord Minnett downgrades to Hold from Accumulate, although remains comfortable with an estimate for FY21 net profit of $160m that is at the top of consensus forecasts. The broker notes the company's intention to diversify its exposure, particularly into the new commercial construction market.

Credit Suisse suspects Reliance will extend the PTC (push-to-connect) range in the UK and notes the company's belief that John Guest will not provide a platform for growth in continental Europe without further M&A, while Morgans anticipates any deal is likely to be bolt-on rather than transformational.

September sales growth was ahead of most expectations. Sales in the Americas rose 29% while EMEA rose 24%. Macquarie suspects pent-up demand and restocking have played a significant part in sales growth in the latter and the UK.

Meanwhile Asia-Pacific was up a more modest 4%, given a lesser impact from lockdowns on construction activity. Of note, the company has not experienced a significant slowdown in Victoria, despite the extended lockdown.

Credit Suisse assesses FY21 is likely to be an exceptional year for margins, calculating around 430 basis points in group earnings (EBIT) margin expansion of which 210 basis points can be attributed to operating leverage.

Ord Minnett agrees a reduction of 60 personnel in EMEA in October and consolidation in the US plant should boost margins. Also, the commodity and currency environment remain favourable although should reverse in the second half. **Costs should be lower in the first half because of limited travel and trade exhibitions.**

Macquarie suspects the company will be manufacturing at heightened levels ahead of the northern winter to build up inventory, which will lead to leverage benefits and strong constant FX outcomes in the first half.

While copper prices have rallied, the delayed impact on the Reliance supply chain means this is more likely to be a headwind in the second half, the broker points out. Fortunately, zinc prices are favourable relative to a year ago resulting in smaller increases in the cost of brass.

FNArena's database has two Buy ratings and four Hold. The consensus target is $4.26, suggesting 3.3% upside to the last share price.

AUSTRALIA

September In Review: Cyclicals Disappoint

The ASX200 fell -3.7% in September with energy, financials and communication services leading the fall, stemming from concerns around global recovery and a possible second wave of covid-19 cases.

-The ASX200 declined by -3.7% in September, ending at 5816 points
-Cyclicals underperformed, a phenomenon mirrored across global markets
-Vaccine beneficiary stocks gained
-Outlook for Australia remains optimistic, brokers maintain

By Angelique Thakur

The ASX200 ended the month of September -3.7% lower to close at 5816 points. Thus broke the chain of consecutive gains the Australian stock market had been accumulating since April.

On an international comparison, the ASX200 underperformed the average return of -2.9% for developed market equities. Seen in USD terms, the fall for the ASX200 is sharper at -6.6%.

As global markets retreated through September, the MSCI developed world GICS sectors saw cyclicals fall with energy, financials and communication services the main victims. Utilities, industrials and materials saved the day (or rather the month) with the industrials sector emerging the best performing sector globally.

In contrast, the S&P500 in the US was dragged down by mega-cap technology companies. It fell -3.8% and underperformed all major global markets. Unsurprisingly, the technology-focused Nasdaq fared worse, ending the month down -5.7% for its worst September since 2008.

Global recovery concerns

Reasons for the decline in the Australian stock market, according to Macquarie, include concerns the global recovery could stall in the absence of more US stimulus, concerns about the upcoming US election, and the risk of a contested outcome that could delay much-needed fiscal stimulus.

Also cited were Europe’s rising covid cases coupled with the risk of another US wave this winter. All these potential threats made investors turn risk-averse, causing a strengthening of the US dollar and a rise in high yield credit spreads.

Macquarie expects the “noise” to last until the US presidential election and suggests investors should look past all things temporary.

Taking a broader view, the ASX 200 has been range-bound since the Fed’s balance sheet peaked in June. Macquarie reassures investors more stimulus will follow and forecasts the Fed’s balance sheet to rise to a new high by early November, which could support an upside breakout.

Major themes: Healthcare and vaccine beneficiary stocks ruled September

In Australia, the health care sector rose 0.9% in September while industrials and REITs performed well in a relative sense. The steepest fall was reserved for the energy sector at -11.1%, followed by IT and consumer staples.

Noting the performance of the ASX300 in terms of industry group performance, Macquarie highlights the consumer services group which climbed 0.8% in September. This rise is attributed to vaccine beneficiaries across leisure stocks like Ardent Leisure ((ALG)), SeaLink Travel Group ((SLK)), and Event Hospitality and Entertainment ((EVT)).

Other beneficiaries include gaming stocks like Skycity Entertainment Group ((SKC)), Aristocrat Leisure ((ALL)), Star Entertainment Group ((SGR)), and travel stocks including Corporate Travel Management ((CTD)) and Flight Centre ((FLT)).

Coca-Cola Amatil ((CCL)), Cochlear ((COH)), Qantas Airways ((QAN)) and Sydney Airport Holdings ((SYD)) are some other vaccine plays that equally posted gains.

The construction materials sector posted strong gains with Boral ((BLD)) the top performer in the ASX100 and James Hardie Industries ((JHX)) the fourth-best performer. Macquarie points towards improving sentiment towards housing.

Given the energy sector’s dismal performance, Macquarie was surprised at investors' willingness to lean towards airlines and travel agents, anticipating higher earnings and yet staying away from oil companies even though any increase in the former is likely to boost demand for the latter.

Winners and losers

The top-performing stocks in the ASX100 were Boral, Washington H. Soul Pattison ((SOL)) and Orora ((ORA)).

The worst performers were Virgin Money UK ((VUK)), Origin Energy ((ORG)) and Oil Search ((OSH)).

Inside the Small Ordinaries, Ardent Leisure outperformed the index the most, followed by Skycity Entertainment Group and Ioneer ((INR)). The laggards here were Zip Co ((Z1P)), Unibail-Rodamco-Westfield ((URW)) and Virgin Money.

A-REITs: Investors avoid CBD exposure

As noted earlier, A-REITs performed relatively well during September, but as a group they still lost -1.5% over the month.

Sector outperformers included APN Industria REIT ((ADI)), Home Consortium ((HMC)), Arena REIT ((ARF)), Rural Funds Group ((RFF)), and Charter Hall Social Infrastructure REIT ((CQE)).

On the other hand, laggards included Lendlease ((LLC)), Shopping Centres Australasia ((SCP)), Vicinity Centres ((VCX)), Stockland ((SGP)) and National Storage REIT ((NSR)).

If looked at from a 12 months perspective, A-REITs provided a total return of -16.65%, underperforming the ASX200 Index by -6.44%.

UBS points out REITs with alternative sector exposure did well while those who lagged were exposed to regional malls and CBD Offices.

Credit Suisse prefers grocery-anchored retail centres like Charter Hall Social Infrastructure and Shopping Centres Australasia. For those not too keen on CBD office exposure, the suggestion is to go for metropolitan-office-focused Centuria Office REIT ((COF)) and Growthpoint Properties Australia ((GOZ)).

Within the large-cap diversified REITs, Mirvac ((MGR)) is preferred over Stockland while Dexus Property ((DXS)) is preferred over GPT Group ((GPT)) on a 12-month view.

Even though Credit Suisse rates both Goodman Group ((GMG)) and Charter Hall Group ((CHC)) as Neutral, the broker does have a preference for the former over the latter. In the regional malls category, Credit Suisse prefers Scentre Group ((SCG)) over Vicinity Centres.

Small Ordinaries: Energy leads the way

The Small Ordinaries managed to beat the ASX100 by 0.9% in September, yet the Small Ordinaries Accumulation Index still fell -2.8%.

In a twist, energy was the best performing sector while financials found themselves on the other end of the spectrum as the worst-performer, dropping -10.7% during the month.

As mentioned earlier, Ardent Leisure enjoyed its moment in the sun following the conclusion of court proceedings relating to the 2016 Dreamworld incident. Other outperformers include Skycity Entertainment and Ioneer.

Zip Co underperformed, in response to the news PayPal is launching a competitive product.

UR-Westfield fell after announcing a EUR9bn debt issue and Virgin Money suffered after new pandemic-related restrictions were imposed in the UK.

Outlook

Citi is worried about a second covid wave and a potentially chaotic US election. But Citi analysts would still buy the dips, especially since central banks will continue to provide support.

Citi recommends investors stay Overweight US and Emerging Market equities, but cut continental Europe to Underweight.

Ord Minnett sees the situation improving in Australia with its analysts pointing towards a marked improvement in Victoria's case rate. Its positive view is centred around the progressive opening of state borders along with a significant savings buffer among Australia's households.

Ord Minnett highlights a lift in consensus earnings per share revisions, noting September marked the strongest month-on-month improvement since May 2010.

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AUSTRALIA

How Far Will Budget Stimulus Go?

An extremely stimulatory Australian government budget was expected after the economic destruction wrought by the pandemic. Where are the stock market beneficiaries/victims likely to be?

-Pro-growth budget supportive of equities, particularly resources & infrastructure
-Tax concessions to benefit a range of medium-sized enterprises
-Industrial A-REITs the likely beneficiaries of manufacturing strategy

By Eva Brocklehurst

Is it business as usual for financial markets in the wake of the much-hyped Australian government budget for 2020/21? As expected, this was an extremely stimulatory budget, brought on by the economic destruction wrought by the pandemic.

Commonwealth Bank economists welcome the broad array of stimulatory measures and the goal of increasing local capacity in a range of industries, along with a focus on jobs.

Crestone expects further gains in those equity sectors linked to the consumer and infrastructure while the preservation of Australia's AAA credit rating, although on “watch” with Standard and Poor's, should be positive for the Australian dollar.

Bond yields are likely to remain low and constrained because of easy policy globally and additional debt issuance. Crestone also expects the banking sector, currently trading at depressed price-to-book levels, should experience better sentiment, to the extent an economic recovery can be priced and bad debt exposure reduced.

Combined with a positive trend in commodities globally, Macquarie believes the stimulus measures will be positive for resources. While the quantum of the deficit and debt looms large, as expected, the broker assesses this is a pro-growth budget and supportive of equities.

One key element Macquarie highlights is that the economic situation appears not as dire as many anticipated back in July. Yet National Australia Bank economists point out the recovery in capacity utilisation has been quite modest, which signals there is some way to go before a full recovery can occur.

Forward orders are weak and, at face value, this signals the work available continues to shrink. As a result, the NAB economists expect confidence will remain fragile and business investment could fall sharply over the next year.

They suggest structural reform would have been useful but acknowledge fiscal stimulus was the necessary component. The main "surprise" observed is the absence of the stage 3 tax cuts or a permanent increase to the JobSeeker payment.

The government has a more optimistic view on the labour market than Westpac economists assess, as well as a more constructive view on consumption, dwelling and business investment.

Westpac economists put greater emphasis on potential headwinds, such as the weak wages growth that was occurring ahead of the pandemic and the legacy of a severe recession in terms of high unemployment and low confidence.

Highlights

Stage 2 tax cuts featured, having been brought forward, and retailers may benefit, Macquarie asserts, along with other **discretionary consumer businesses to the extent they are not constrained by social distancing**.

However, CBA economists were disappointed there was no consideration of voucher schemes that may better target consumer expenditure, and point out there are no guarantees the stimulus will be spent.

Companies with turnover up to $5bn will be able to deduct the full cost of eligible assets in the first year and there are other benefits from loss "carry-back" provisions. Credit Suisse highlights **Domino's Pizza** ((DMP)), **Metcash** ((MTS)) and **Harvey Norman** ((HVN)) among those that will benefit from the write-offs, as well as chemicals & agriculture stocks.

Morgan Stanley considers the measures should benefit all stocks under its coverage with the exception of **AGL** Energy ((AGL)) and **Origin Energy** ((ORG)), which have turnover in excess of $5bn, and foreign earners such as **Auckland Airport** ((AIA)) and **Atlas Arteria** ((ALX)).

The JobMaker plan worth $74bn includes a $4bn hiring scheme while JobTrainer involves measures to improve skills, including a 50% wage subsidy available to those businesses employing new apprentices and trainees. For small-medium enterprises, the refundable R&D tax offset on annual cash refunds has been removed, while for larger firms the non-refundable R&D tax offset is increased from July 2021.

Nevertheless, the Australian Small Business ombudsman, Kate Carnell, remains disappointed that **the government failed to clarify the position on software R&D** and missed a "golden opportunity" to commit to prioritising small business when it comes to procuring work.

Infrastructure/Housing

A major theme is the bringing forward of infrastructure expenditure, which the CBA economists welcome as the stimulus has trickle-down effects across the economy. The package includes major road, rail, road safety and community infrastructure enhancements.

This underpins not just construction/mining but also the support/services business in the towns and regions where projects are located. The Master Builders Australia welcomes the productivity-enhancing infrastructure commitments as well as the $1bn for construction of new affordable housing.

Transport infrastructure investment has been raised to $110bn and beneficiaries are likely to be **Downer EDI** ((DOW)), **Monadelphous** ((MND)), **CIMIC** ((CIM)), **Service Stream** ((SSM)) and **Transurban** ((TCL)), as well as **CSR** ((CSR)), **Adbri** ((ABC)) and **Boral** ((BLD)) in terms of construction, in Macquarie's view.

The broker also considers manufacturing the "new logistics" which should increase demand for industrial assets. This would be positive for developers such as **Goodman Group** ((GMG)), **GPT Group** ((GPT)), **Stockland** ((SGP)) and **Dexus Property** ((DXS)).

For the listed property sector Macquarie suggests retail stimulus should help those retailers and landlords exposed to discretionary expenditure, singling out **Aventus** ((AVN)) as a beneficiary.

However, Morgan Stanley notes the infrastructure expenditure of $49bn over FY21-24 does not contain any new projects with a direct connection to stocks under its coverage, while construction aspects of the budget are in line, supporting a preference for Adbri, and housing-related measures are "negligible".

Manufacturing

Industrial A-REITs (Australian Real Estate Investment Trusts) are considered by Macquarie the most likely beneficiaries of the government's manufacturing strategy. The initiatives focus on six major sectors including defence; aerospace; food & beverages; recycling & clean energy; medicines; and resource technology & minerals processing.

Health Care

UBS considers the budget of little consequence for the listed Australian healthcare sector. Additional funding for diagnostics was already in train while the R&D tax incentive is of greatest relevance to **Cochlear** ((COH)) as R&D is forecast to be around 25% of its expenses in FY22.

Superannuation

Superannuation funds will undergo an annual performance test with poor performing funds required to notify members and those that underperformed over two consecutive annual tests prohibited from receiving new members.

Australians will also now automatically keep their superannuation fund when changing employers and a new super account will no longer be created when a worker changes jobs.

Macquarie sees some small impact for **Link Administration** ((LNK)) as the stapling of accounts is relevant as it charges fees based on the number of accounts. However, there is no significant changes to the broker's estimates or outlook.

AUSTRALIA

Northern Star/Saracen Create Gold Giant

Northern Star Resources and Saracen Mineral Holdings have agreed to merge and will become a dominant player in Australia's key gold districts.

-Should attract more generalist investors
-Pairing expands growth options
-Scope for further expansion via M&A

By Eva Brocklehurst

In one for the gold bugs, Northern Star Resources ((NST)) and Saracen Mineral Holdings ((SAR)), owners of the Kalgoorlie Super Pit, have agreed to combine their holdings in a nil premium deal.

The geographic concentration in Western Australia's gold districts will allow for optimisation of mine sequencing, infrastructure and growth investment and the merged company, operating under Northern Star, is targeting over 2m ounces of annual production by FY27.

This is one of the most logical pairings, in Credit Suisse's view, as it **brings together to miners well known to each other with co-located assets across two regions** (Kalgoorlie, Yandal) that offer flexibility and optimisation benefits.

Skills are also complimentary with Northern Star's strength in underground and offshore mining and Saracen's in open pit. Thunderbox (Saracen) will combine with Yandal (Northern Star) for 600,000 ounces and Pogo (Northern Star, Alaska) is expected to contribute around 300,000 ounces down the track.

Synergies are guided at $1.5-2.0bn pre-tax over 10 years, which the broker calculates, on a post-tax basis per share, equate to $0.91-1.21/share. Northern Star remains Credit Suisse's preferred large gold exposure, based on valuation, growth and leverage to the gold price.

The merger will be by way of a scheme of arrangement and Northern Star will offer 0.3763 shares for each

Saracen share held. Saracen will also pay special fully franked dividend of 3.8c. The first court hearing for approval of the scheme will be in December 2020 and implementation is set for February 2021.

Morgan Stanley assesses the merger provides new scale that will attract more generalist investors. The merged business will boast the sixth largest market capitalisation and eighth largest gold production, globally.

Given the absence of a premium, Citi asserts Saracen will need to sell the idea to shareholders as a valuation uplift in order to make the deal look attractive. The broker agrees the combined business makes sense operationally, particularly in Western Australia, and scale will attract generalist investors and higher multiples.

While cognisant of the compelling rationale, Ord Minnett requires further detail on the proposed merger before amending its view, retaining a Lighten rating on Northern Star and a Hold rating on Saracen.

Super Pit

For the first time, the Super Pit, currently 50:50 owned, will be under a consolidated team combining both operations to create a production centre of more than 1mozpa, offering sizeable reserve and growth opportunities. Post completion, Northern Star shareholders will own 64% of the merged business.

UBS explains Northern Star had planned to grow Yandal but there was a capital cost decision regarding whether to expand milling capacity at Jundee or refurbish the mothballed Bronzewing mill. Jundee has better infrastructure but is located to the north of the tenements so trucking costs are greater. Hence, **a merged entity may choose to expand the Thunderbox mill instead of refurbishing Bronzewing**.

In Macquarie's view, the most significant synergies/optimisation will be obtained with Fimiston South stage 2 along with the potential for the mill at Thunderbox to process Yandal ore. Goldman Sachs, not one of the seven stockbrokers monitored daily on the FNArena database, agrees the Fimiston underground provides further options down the track and retains a Buy rating for Saracen and a Neutral rating for Northern Star.

More M&A?

Canaccord Genuity, also not one of the seven, moves to a Buy rating on Northern Star based on the enlarged production profile, noting free cash flow yields increase to 9% over FY22-23. The broker also envisages scope for the new entity to expand further via M&A, highlighting companies such as Bellevue Gold ((BGL)), Apollo Consolidated or Tanami Gold ((TAM)) as logical bolt-ons.

Ord Minnett, too, expects further M&A in the gold sector, noting growing urgency across peers with maturing portfolios and less organic options compared to those of Northern Star and Saracen.

UBS asserts this is a rare example of a mining merger that has clear and material synergies along with scale, diversity and three production centres located in tier-1 locations. In this regard, Citi points out the wording surrounding the third production centre, North America, leaves open the interpretation regarding further acquisitions in the Americas.

FNArena's database has one Buy rating and three Hold for Saracen with a consensus target of $5.83 that suggests 1.7% upside to the last share price. Northern Star has a target of $14.39 that suggests -5.6% downside to the last share price with one Buy (Credit Suisse), three Hold and one Sell (Ord Minnett) rating.

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AUSTRALIA

Budget Puts Downer EDI In The Front Seat

The infrastructure splurge in the latest federal budget augurs well for Downer EDI, Australia's largest road construction and maintenance provider, and Morgan Stanley upgrades to Overweight.

-Budget emphasis on infrastructure positive for Downer EDI's urban strategy
-Potential re-rating once divestment of mining, laundries occurs
-Exposure to economic recovery should allow margins to improve

By Eva Brocklehurst

A renewed focus on infrastructure in the federal budget puts transport contractor/engineer Downer EDI ((DOW)) in the front seat going into 2021, with around $14bn allocated for new and accelerated infrastructure projects along with road safety funding.

Downer is Australia's largest operator in terms of road construction and maintenance, and included in the allocation is $7.5bn for new road and rail links as well as upgrades to highways.

Around 80% of the company's earnings come from Australian infrastructure development, operations and maintenance. Hence, UBS points out, any increase in the overall size of the infrastructure asset base provides for a positive earnings outlook.

Moreover, water infrastructure has also been given a $2bn impetus over 10 years which should also help the utilities division. Downer also provides maintenance services to Australia's power stations and its customers supply 60% of the national energy market.

The earnings fillip for the company's new urban services division will come from ongoing public sector investment and, so far, federal and state governments have accelerated job-intensive projects worth around $8bn from existing budgets.

Further stimulus programs targeting defence, social housing, education or road maintenance should also provide benefits. Moreover, Morgan Stanley assesses the enlarged federal budget deficit will be an opportunity for more private/public partnerships.

The company currently has future work in hand for transport of $3.5bn for FY21 and $3.2bn in FY22, and the broker suspects the latest **"use it or lose it" direction for funding from the federal government to the states will mean activity is front-loaded and, importantly, carry a higher degree of labour intensity**.

Urban Services

The budget emphasis on infrastructure is also a positive catalyst for the move to an urban strategy. The core urban services division will include transport, utilities, facilities management and asset services.

These operations are less capital intensive than mining and provide more predictable revenue. The outcome will be better visibility, brokers assert, and an even stronger skew to government clients.

All up, Morgan Stanley suspects a more reliable earnings stream will enable the stock to re-rate higher, hence the broker upgrades to Overweight from Equal-weight. Downer trades at a -5% discount to its long-term average and the broker considers it possible a multiple re-rating will occur if a successful exit of mining occurs.

UBS suspects the volatility related to the pandemic has slowed the company's process of divestment of both its laundries and mining businesses. With respect to the latter, the broker also surmises Downer may want to break up operations to facilitate an orderly exit, such as the separation of mining from drill & blast operations. Downer Mining is Australia's second largest contract miner.

A restructure bodes well for a re-rating, and UBS recently upgraded to Buy, modelling a restructured portfolio of urban services that could deliver $350m in free cash flow, which compares with the recent average of $200m.

The broker also points out the share price has declined -45% over the year to date, significantly underperforming the -12% fall in the ASX200. This has been underscored by concerns regarding the balance sheet which have now been addressed following an equity raising.

The restructured business will be less cyclical and capital intensive, and also relatively lower risk as the company winds down "problematic" construction operations. Underperforming construction contracts have been largely resolved, Macquarie notes, such as the wind farm at Clare and solar farm at Murra Warra as well as the Orbost gas plant upgrade.

The stock is cheap, the broker asserts, given its exposure to a recovery post the pandemic and a solid customer base. Margins should also recover somewhat in FY21. Group earnings (EBITA) margins fell to 3.1% in FY20, from 4.2%, which reflected the impact of the pandemic on productivity and efficiency as well as the shutdown in New Zealand.

Downer does not expect a drop off in utilities demand will occur even after the NBN construction winds down, anticipating ongoing maintenance and demand in telecommunications.

FNArena's database shows five Buy ratings and one Hold (Ord Minnett). The consensus target is $5.10, suggesting 7.9% upside to the last share price. The dividend yield on FY21 forecasts is 3.1% and on FY22 forecasts, 5.0%.

AUSTRALIA

CBA: Expensive And Justified, Or Maybe Not?

Commonwealth Bank's retail and business divisions rank highly and, Bell Potter believes, should justify a premium to other major banks. Other brokers are not so convinced.

-Asset sales could be a differentiator
-Budget support for business a positive
-Is the stock too expensive?

By Eva Brocklehurst

Is Commonwealth Bank ((CBA)) deserving of its premium to other major banks? Bell Potter believes so, assessing the bank's returns are still the best among peers. Moreover, the bank's retail and business divisions have the underpinnings of long-standing outperformance and rank highly in terms of productivity and efficiency.

CBA is also managing costs to drive profitable growth as opposed to "blindly pushing for volume and market share", the broker asserts, highlighting a Buy rating and $73.50 target.

The bank's FY20 result showcased a strong balance sheet and good underlying asset quality as well as a "decent" final dividend and the broker, not one of the seven stockbrokers monitored daily on the FNArena database, considers the trading premium is justified.

Macquarie differs, believing margin pressures and a lack of volume growth mean the outlook for major banks is challenging. The broker recently upgraded peers ANZ Bank ((ANZ)) and Westpac ((WBC)) but kept Commonwealth Bank on an unchanged Underperform rating, assessing the stock is too expensive.

Citi has pointed out asset sales could be the differentiator in terms of dividend and capital, although this will ultimately be determined by credit quality. Moreover, there is no certainty that loan provisioning will be enough given the economic impact of the pandemic continues to play out.

Divestments could add 58-68 basis points to the level 2 CET1 ratio of 11.6% upon completion but, even so, Morgans does not expect capital returns until there is more assurance regarding the macro economic outlook.

Morgans lingers between the two extremes in terms of its rating, accepting the quality of the retail franchise was evident in the FY20 results but continuing to believe the stock is expensive relative to the other major banks.

The broker is of the view that **home lending will prove to be more defensive from an asset quality perspective compared with institutional and business lending** and this augurs relatively well for CBA.

Credit Suisse prefers those banks that are trading below book value and ranks the other major banks ahead of CBA, while Morgan Stanley, in the wake of the FY20 results, considers there are still several issues outstanding regarding credit quality.

The latter has ascertained the federal budget will accelerate business investment and loan growth and this should provide a benefit for banks. Nevertheless, the **support for business will not materially reduce the risk of failures in those industries most adversely impacted by the pandemic**, and which are relying on loan repayment deferrals and/or JobKeeper.

Positive Catalysts

If bad debt charges are -25% below current estimates over the next three years this could add around $0.83 per share to Macquarie's valuation for the stock. Nevertheless, while recognising reduced capital intensity is a likely catalyst for long-term sustainable returns, the broker would rather wait until March/April 2021 in order to become more confident.

An impairments experience 25% better than currently forecast should provide for 7% upside to current valuations across the major banks, Macquarie calculates, with the greatest upside envisaged for ANZ, National Australia Bank ((NAB)) and the smallest for CBA.

The FNArena's database has six Hold ratings and two Sell ob Commonwealth Bank. The consensus target is $67.09, signalling -1.1% downside to the last share price. Targets range from $58.50 (Macquarie) to $74.80 (Credit Suisse). The dividend yield on FY21 and FY22 forecasts is 3.9% and 4.5%, respectively.

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COMMODITIES

Material Matters: Iron Ore, Gold And Nickel

A glance through the latest expert views and predictions about commodities. Iron ore, coal, gold and nickel.

-Brokers remain upbeat on the iron ore sector
-Rising steel demand augurs well for metallurgical coal
-Gold equities lagging gold price strength
-Stainless steel trajectory largely what matters for nickel

By Eva Brocklehurst

Iron Ore

In tracking physical ship loadings from most of the Brazilian **iron ore** miners, UBS notes shipments fell -6% last week. However, Brazilian iron ore shipments have sequentially increased since the first quarter which explains an uptick in Chinese port inventory.

Iron ore inventory at Chinese ports rose to 120mt in July, the highest level since March, although that's -5mt lower year-on-year. Port congestion issues appear to be easing.

The run-rate of shipments from Vale is still below production guidance according to estimates and, as management did not revise guidance down during its investor briefing, UBS suspects Vale could be building inventory in Brazil.

The broker has data that reveals a higher proportion of non-traditional imports to China, up 36% in the year to date compared with traditional markets of Australia, Brazil and South Africa which are up 8%. Most of the incremental volumes come from India, Ukraine and Russia, although this flow is expected to moderate as **steel** production recovers in India and the EU.

UBS retains a base case for iron ore prices of US$105/t in the second half of 2020 and US$85/t in 2021. A preference for Vale over **Rio Tinto** ((RIO)) is maintained. In Australia, the broker's tracking of daily iron ore shipments shows these are back to weekly highs.

Despite weakening steel margins, Macquarie is positive on the iron ore sector, noting the major miners in Australia are operating close to capacity. The broker is confident iron ore prices will hold above US$100/t for the next year and notes iron ore miners are generating strong free cash flow at current prices.

At spot prices, the broker calculates free cash flow yields in FY21 are 12% for **BHP Group** ((BHP)), 14% for Rio Tinto, 19% for **Fortescue Metals** ((FMG)), 8% for **Mineral Resources** ((MIN)) and 12% for **Champion Iron** ((CIA)).

Credit Suisse also expects iron ore prices will sustain another year above US$100/t as steel demand in China has again surged. China's dominance of global steel production has increased further with 2020 output now expected to be 58% of global output.

Ultimately, a decline in the iron ore price will occur. The broker's case is for steel demand to remain broadly static in 2021 and decline at an accelerating pace in 2022 which implies surpluses for iron ore.

Credit Suisse prefers BHP to Rio as it not only provides upside to iron ore but has a more attractive diversified portfolio. **Copper**, at $3/lb and strengthening **metallurgical (coking) coal** prices provide additional support.

The broker has a Neutral rating on Rio as the valuation gap that opened to BHP post the Juukan Gorge incident is likely to continue to overshadow the new leadership team. There is also subsiding momentum for iron ore.

<u>Coal</u>

Credit Suisse expects seaborne metallurgical coal prices will undergo a sustained recovery from recent lows as blast furnaces are re-started outside of China after the lockdowns.

The current rise in prices appears to have been driven by bidding in anticipation of import restrictions in China lifting in 2021, although the broker acknowledges there are risks in attempting to predict government policies.

Beyond China, Credit Suisse is encouraged by the rise in steel demand in India, Japan, Europe and Brazil, and believes metallurgical coal has passed its nadir. The broker expects a gradual increase in prices away from the 2020 lows towards a long-term incentive price that does not impinge on the cost curve.

Moreover, there is no sign of the Australia/China dispute affecting coking coal. There are few alternatives of similar quality and there is possibly a greater need for premium coal given the big lift in blast furnace steel production.

Meanwhile, **thermal coal** prices are also recovering from their lows because of improving demand for power as well as rising spot LNG factors. The broker suspects the push against energy coal because of climate concerns is gaining traction, with potential to limit price upside.

Going forward Credit Suisse envisages demand will grow but at a slower rate after 2021 as the larger usage of thermal coal in the developing nations of Southeast Asia is offset by a slowdown in developed countries.

<u>Gold</u>

Gold equities peaked in July and have pulled back -15-25%, JPMorgan observes, despite gold prices being steady. Only **Saracen Mineral Resources** ((SAR)) and **Evolution Mining** ((EVN)) have materially outperformed the Australian dollar gold price. Hence, generally valuations are less stretched and the broker considers this is an attractive entry point for some names.

The broker also notes a more liberal interpretation of the "sustaining" in the designation of all-in sustaining costs (AISC), emphasised by the current period of minimal inflation, which now makes it a less useful metric in determining cash generation.

JPMorgan has a long-term gold price estimate of US$1600/oz at an Australian dollar rate of US$0.74 and is attracted to those projects/operations that are leveraged to continued higher prices.

The broker assesses North American major gold producers are the most expensive on an enterprise value/operating earnings (EBITDA) of basis while those in higher risk destinations such as Africa and Russia are the cheapest. Australian stocks are in the middle.

Given the size and quality of North American portfolios they may be deserving of some premium but the broker assesses this is less pronounced in FY22 estimates. Among Australian names, JPMorgan prefers **Newcrest Mining** ((NCM)) and **Gold Road Resources** ((GOR)).

<u>Nickel</u>

Macquarie concludes that the direction of Chinese **stainless steel** prices is all that matters for **nickel** at the moment, despite the hype surrounding electric vehicles in the aftermath of Tesla's battery briefing.

Both nickel and stainless steel pricing have weakened in recent weeks and there appears to be an easing of order books beyond October. The slightly weaker stainless steel price in recent weeks appears to be in line with the small rise in inventory that has been reported.

Stainless steel's share of primary nickel demand has increased to 74% in 2020 and 81% of all primary nickel consumed for stainless steel production is in China, or Chinese controlled plants in Indonesia.

A recovery in stainless production in Europe and the US is helping scrap supply more than primary nickel, Macquarie adds. Furthermore, there has been a large rise in the price of the main ingredient in nickel pig iron in China, nickel ore, and the broker assesses the selling price is rising to intolerable levels.

This reflects the Indonesian ore ban and lower ore inventory since the start of 2020. However, whether this really matters in the long run is questionable, Macquarie asserts, if stainless steel prices in China weaken further towards the end of the year.

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COMMODITIES

Glimmer Of Light For Coal, But Short Term

A tightening market has procured a rebound in coal prices, likely to hold up with a wet and stormy Australian summer ahead, but uncertainty prevails for the long-term.

-Floor under coal prices as demand recovers
-La Nina event signals potential for price spikes
-Bearish outlook prevails for long-term coal-fired power

By Eva Brocklehurst

Is coal on the rebound? Demand appears stronger and supply reductions have underpinned a tightening market. Certainly, the Newcastle thermal coal price has been reinvigorated, with Morgan Stanley noting a recent rally generated by an increase in spot buying from Chinese end-users.

The thermal price, having been around US$50/t since early May, has risen to US$55.50/t. Still, the broker assesses developments in China are somewhat confusing.

Customs authorities in Shanghai are contemplating a ban on coal discharging in the final months of the year while some in southern China have secured additional clearance quotas. China is aiming to limit coal imports but domestic production is also constrained because of the clampdown on illegal output.

This has generally tightened the market. Power generation from coal for key importers such as India, Japan and South Korea is returning to normal, although high inventory could limit the level of winter stockpiling in the broker's view.

Meanwhile, Glencore is curtailing supply in Australia and in June, Morgan Stanley points out, almost half seaborne coal exporters were loss-making, although this has reduced to around 15% at the spot price. Hence, **a lapse in supply discipline and a quick return of curtailed capacity could put the recent recovery at risk**.

On the metallurgical (coking) coal front, Australia's hard coking coal price has risen to US$139/t, also sustained by Chinese buying and a recovery in steel production. India's steel production is almost back to normal, Morgan Stanley observes, although coal imports have not kept up with output.

The broker believes a floor is settling under both coal pricing systems but favours metallurgical over thermal coal as there is a more robust recovery in demand, less inventory around, and potential for seasonal supply disruptions ahead.

Short-Term

So, what about the weather? The Australian Bureau of Meteorology has assessed a La Niña event now prevails in the Pacific Ocean. This signals higher rainfall on the eastern seaboard over the next few months.

As the number of tropical cyclones is also likely to increase, this brings the focus of risk to the largely metallurgical coal basins of Queensland. Credit Suisse assesses a risk of price spikes for coal in the event of supply disruptions and insufficient inventory, given improving demand.

While Australian coal producers are better equipped to deal with severe weather these days, having invested in mitigation, the extent and location of events are difficult to predict adequately.

The Bowen Basin coalfields are the most exposed to severe rain events from tropical cyclones, Credit Suisse notes, while further west base metals operations could be hampered by disruptions to Queensland rail networks. Hence, steel mills and coal traders are likely to be watching the weather closely, to ensure they are ready in terms of sourcing required volumes of metallurgical coal.

Higher prices will come from further tightness in the market, while the downside for miners occurs with interruptions to production amid requirements for remediation and maintenance after flooding.

All up, the broker envisages severe weather is likely to add to demand and improve pricing, and the best way to play this scenario is via **Coronado Resource**s ((CRN)). Larger names include **BHP Group** ((BHP)) and **South32** ((S32)), both of which have significant exposure to Bowen Basin coal. Earlier in 2020, BHP Group's large Blackwater, mine was heavily affected by flooding of pits and haulage roads.

Long-Term

From a bearish perspective, UBS points out in the first half of 2020 global coal-fired power capacity shrank for the first time ever, affected by ageing generation fleet in developed economies and better renewable economics. A glut in LNG and evolving public and lender views that are negative on coal also helped.

The retiring of old power plants continues unabated while renewable sources of energy are forcing coal power generators to cycle, which makes them less economic. Moreover, since 2015, the broker notes there has has been a sharp drop in the amount of new coal power capacity being planned or constructed.

After hosting a call with the founder of Global Energy Monitor, UBS highlights that to achieve the goals of the 2015 Paris Agreement, closures of coal-fired power production will need to accelerate.

The IPCC (Intergovernmental Panel on Climate Change) indicates a near-total reduction in coal use for electricity generation is required by 2050 to limit global warming to 1.5 degrees above pre-industrial levels and to avoid more extreme weather.

China is restricting new coal plants and India prioritising renewables, while Korea and Vietnam intend to switch more coal-fired power to gas over the next 10 or so years. **China, which produces more than 50% of global coal-generated power, has indicated its emissions will peak before 2030 and expects to be carbon neutral by 2060, considered a significant target.**

Does carbon capture present upside for coal? UBS notes the benefit of clean coal technology is limited at present, while recent studies suggest carbon capture is ineffective and expensive, and probably will not offset emissions from coal in the required timeframe.

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COMMODITIES

Material Matters: Bulks, Base Metals & Gold

A glance through the latest expert views and predictions about commodities. US election; bulks; base metals; and gold.

-Looming US election enhances commodity volatility
-Momentum should support coal stocks while iron ore even more buoyant
-Demand out of China underpins September quarter gains in base metals
-UBS switches preference back to gold stocks from base metal stocks

By Eva Brocklehurst

US Election

ANZ Bank analysts assert, as a major event in 2020, nothing compares with the pandemic in terms of the effect on global economies. Nevertheless, the election of a US president can agitate markets.

The last 25 years of US elections show few trends in commodity markets, yet using **copper**, **gold** and **crude oil** as guides, the analysts note a trend to higher returns for copper and gold one month leading into the election date. Oil is slightly lower. One month after an election the average return is generally negative for all three.

In terms of the policy platform, from a growth perspective, a win for Joe Biden would be the best outcome and the analysts expect commodities such as copper and crude would benefit the most.

Joe Biden has a softer stance on sanctions against Iran and Venezuela and an aggressive climate agenda that could hurt fossil fuel demand. However his infrastructure plan should benefit metals such as copper and **nickel**.

Should President Trump win, headwinds for industrial commodities are anticipated while gold would be well supported. The main uncertainty is a disputed result which is likely to stimulate demand for safe-haven assets.

Bulks

Macquarie notes China's **thermal coal** spot price has lifted to RMB599/t, just shy of the "red zone". A sustained lift into this zone would require the authorities to intervene "somehow", which typically involves a supply-side measure.

Still, the broker notes it is difficult for the government to start capping local coal prices as the country's vast domestic industry is reporting weak supply growth and import restrictions remain in train.

Moreover, winter re-stocking is about to begin. Policy adjustments for the short term are anticipated to include a lift in production rates at certain mines and a relaxation of import restrictions, which would be bullish for seaborne thermal coal.

Nevertheless, buoyant **iron ore** prices and positive leading indicators underpin Macquarie's bullish stance on iron ore exposures, which are preferred to pure coal stocks.

Citi notes that while the common wisdom suggests if the price of the underlying commodity rises the stock follows, this is often not true. Over the long-term this may hold but in the short term there is frequently a divergence.

Citi expects **Whitehaven Coal** ((WHC)) could benefit from a lift in thermal coal prices as the northern hemisphere re-stocks along with a relaxing of China's import restrictions. The broker notes Whitehaven Coal currently trades at a deep discount to discounted cash flow and risk appetite.

Momentum in coal prices over the next few months should support **South32** ((S32)) as well, from winter restocking and a rolling forward of 2021 quotas in China. **Metallurgical (coking) coal** is also expected to benefit from a recovery in steel production outside of China.

What would it take for iron ore pricing to hold at US$90/t through to at least 2023? This is the question Credit Suisse contemplates, given its base caseis for a high of US$105/t in 2021 before the price rapidly descends. This view is based on expectations that steel demand in China will subside and result in large surpluses of iron ore.

However, what if demand in China simply plateaus and an iron ore surplus does not eventuate? Then, the price outlook would be more constructive and perhaps average US$90/t, the broker suggests.

On the supply side, little in the way of expansions are planned. Vale is expected to recover to 400mtpa by 2023 and an increase to 450mtpa will probably proceed as will the development of **Rio Tinto**'s ((RIO)) Simandou mine, but Credit Suisse assesses these are propositions beyond 2025.

Hence, pricing really depends on demand out of China. China's per capita steel consumption is high at 720kg per person but has not yet reached the peak level experienced in Japan the 1970s.

<u>Base Metals</u>

The London Metal Exchange **base metals** complex experienced quarterly gains across the board in September, which Macquarie notes is an unusual occurrence. This is indicative of macro drivers such as a weaker US dollar and a recovery in the Chinese economy.

The overwhelming importance of demand out of China has meant the metals moved into positive territory very quickly as a recovery came into view. Copper and zinc led the way for gains in the quarter, rising 21% and 18.9%, respectively.

However, gains were eroded somewhat later in the month amid concerns that China's stimulus may have peaked and worries over a second wave of coronavirus in Europe, as well as the outcome of the US presidential election.

Despite continuing disruptions resulting from the pandemic, **zinc** concentrate treatment charges have fallen sharply over September that reverses a three-month upward trend. This has put pressure on traders and smelters to cover short positions, the broker asserts.

Meanwhile, Macquarie is puzzled by the huge flow of primary **aluminium** into China over this year, given the country is a net exporter of the metal. Russia was the biggest contributor to the imports and the broker assumes most of this is been stockpiled.

Moreover, for aluminium alloy the picture is even more puzzling, as lower liquidity products are not suitable for financing and tend to go straight to industrial use rather than stockpiling. There is also little evidence that this material is scrap or secondary material.

UBS suggests the pace of materials imports is stronger than underlying demand in China, in part driven by the strategic initiatives taken by central provisional governments. While visible metal inventory is low the broker suspects copper inventory within goods such as cars and appliances has lifted.

Prices over the September quarter were generally higher than expected and are now above cost support levels.

The broker factors in a flat price outlook for copper and nickel but acknowledges this view carries downside risk.

<u>Gold</u>

Following the strong performance in base metals in the September quarter and the looming uncertainty, UBS has switched its preference back to precious metals following a pullback in both the gold price and gold equities.

The broker prefers gold stocks which offer production growth, quality assets and robust free cash flow. **Saracen Mineral Holdings** ((SAR)) and **Northern Star Resources** ((NST)) offer the strongest production growth. [Note, UBS is writing before yesterday's merger announcement between the two, which was well-received by the market.]

Newcrest Mining ((NCM)) is perceived as having passed peak production but actually, the broker observes, it offers growth via the development of both Red Chris and Havieron. UBS believes the potential of Havieron is not fully understood.

The broker prefers **SSR Mining** ((SSR)) for its sector-leading yield and Saracen for production growth at an attractive valuation. Newcrest Mining and **OceanaGold** ((OGC)) appear the least expensive while **Evolution Mining** ((EVN)) the most expensive.

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WEEKLY REPORTS

Weekly Ratings, Targets, Forecast Changes - 02-10-20

By Mark Woodruff

Guide:

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

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

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

Summary

Period: Monday September 28 to Friday October 2, 2020
Total Upgrades: 13
Total Downgrades: 6
Net Ratings Breakdown: Buy 50.91%; Hold 38.63%; Sell 10.46%

For the week ending Friday October 2, there were thirteen upgrades by FNArena database stockbroking analysts for individual ASX-listed stocks. Of those thirteen, ten received an upgrade to a Buy. Six stocks received a downgrade with none going to a Sell. Corporate Travel Management featured on both sides of the ledger by receiving both an upgrade and a downgrade after an acquisition and simultaneous capital raise. Both brokers regarded the acquisition favourably. However, one broker considered that key catalysts, previously envisioned for the stock, have now taken place.

There were several material percentage increases in target price for the week, led by Australian Finance Group. The company is set to control around 40% of the mortgage broking industry, with the pending consolidation with the number one operator. One broker has initiated coverage of the company with a price target well above other brokers, thereby elevating the average price target.

With the easing of virus risk, a former valuation discount for Synlait Milk was removed by one broker. So despite a rating downgrade during the week due to a number of factors including a weak FY21 outlook, the price target actually went up. A similar dynamic occurred for Reliance Worldwide. Despite posting an exceptionally strong first quarter result and receiving a general lift in target price from brokers, the company still received a rating downgrade based on the company’s current valuation. Boral proved the stars can align with a valuation upgrade to Buy and a significant rise in target price, as housing construction begins to rebound.

The most significant reduction to price target in percentage terms befell The a2 Milk Company. This was attributable to a larger disruption from the pandemic to its corporate daigou channel over September than previously anticipated. This compounds the weakness in retail daigou and the further unwinding of pantry stockpiling. FNArena's database showed six of seven Australian and international stock brokers reducing the target price for the company. However, one of those six countered with a valuation upgrade on the assumption the virus situation normalises in Australia. If so, it’s considered the second half should see a return to double-digit sales growth.

The largest percentage earnings upgrades for the week accrued to two resources companies in Coronado Global Resources and OceanaGold Corp. The former was due to a lift in forecast metallurgical coal prices by one broker, while the latter was the result of an equity raise. The proceeds will be used by OceanaGold Corp to fund growth projects and exploration and for corporate and working capital purposes. After a challenging 2020, it’s considered the company is over the worst of it.

With lithium market conditions to remain challenging, Galaxy Resources received a large percentage downgrade to forecast earnings. The same occurred to Brickworks as concerns arose about prospects for earnings in some parts of the portfolio, including the Investments segment.

Finally, Crown Resorts featured among the highest downgrades to earnings estimates. Nervousness grows over the Independent Liquor and Gaming Authority's (ILGA) investigation into whether the company is a suitable candidate for holding a casino licence in NSW. The Authority will report its findings formally by 1 February, 2021.

Total Neutral/Hold recommendations take up 50.91% of the total, versus 38.63% on Neutral/Hold, while Sell ratings account for the remaining 10.46%.

Upgrade

THE A2 MILK COMPANY LIMITED ((A2M)) Upgrade to Add from Hold by Morgans .B/H/S: 4/0/2

a2 Milk's guidance downgrade was weaker than expected but not particularly surprising to Morgans. The impact on daigou sales given international travel restrictions and the Victorian lockdown is to blame, which the broker assumes will prove but a short term blip.

Management is of the same opinion, suggesting the first half of FY21 will be weak but assuming the virus situation normalises in Australia, the second half should see a return to double-digit sales growth.

Target falls to $18.14 from $18.45, but as this is still a long way above the current price, Morgans upgrades to Add form Hold.

ATLAS ARTERIA ((ALX)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 2/3/0

France has allocated EUR30bn for ecological improvement, including toll roads. The opportunities for APRR include expansion of the recharge network for electric cars and development of the hydrogen refilling network.

Macquarie observes Atlas Arteria has an attractive yield and is benefiting from an early recovery in France. Some slowdown because of a second wave of coronavirus is observed but this is not considered material.

Meanwhile, economic policy in France is likely to generate material benefits through concession extensions as APRR can better use its latent debt capacity. Rating is upgraded to Outperform from Neutral and the target is raised to $6.99 from $6.81.

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

In the last 6 months, Citi observes Alumina Ltd's share price is down -6% while the ASX300 Metals and Mining index is up 29% and the
market (ASX200) is up 15%. Additionally, over six months the US alumina price is up 2% and is now around US$270/t.

As a result, the broker upgrades the rating for the company to Buy from Neutral and the target price of $1.80 is unchanged.

Cit lowers 2021 and 2022 profit (NPAT) forecasts by -10% and - 8%, respectively. This is a result of a higher forecast for the Australian dollar and lower alumina forecasts.

BHP GROUP ((BHP)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 5/2/0

Credit Suisse increases estimates for China's steel consumption to around 1bn tonnes per year until 2022. This drives a more constructive view on iron ore and iron ore price forecasts are revised up by 30% and 18% for 2021 and 2022, respectively. The broker also has a more constructive view on coking coal.

BHP Group remains the broker's preferred pick compared with Rio Tinto ((RIO)) as the valuation premium is likely to widen, given a more balanced materials portfolio and less public focus on ESG issues.

Moreover, unlike Rio Tinto there is no uncertainty about the management team and there is less potential public pressure to limit dividends. Rating is upgraded to Outperform from Neutral and the target lifted to $39 from $37.

BORAL LIMITED ((BLD)) Upgrade to Buy from Neutral by Citi .B/H/S: 2/2/0

Citi assesses Boral is in an earnings trough, although construction markets are rebounding. Most upside is envisaged in detached housing in Australia and the US, which is partially offset by sharp declines in commercial building.

In valuing the surplus property portfolio, the broker believes this could deliver post-tax earnings in the range of

$1.4-2.9bn over the next 20 years. The main issue is whether Boral can crystallise value from Penrith Lakes and Waum Ponds which have been long-standing assets on the balance sheet.

Rating is upgraded to Buy from Neutral as the broker assesses investors are looking through to a turnaround. Target is raised to $5.30 from $4.35.

CORPORATE TRAVEL MANAGEMENT LIMITED ((CTD)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 4/2/0

Corporate Travel will acquire Travel & Transport for $275m, undertaking a $375m equity raising in the process. Macquarie considers this a strategically sound acquisition which materially increases the company's scale in the US.

The broker believes the industry is "right for consolidation" and, moreover, the balance sheet capacity is there.

While forecasting a recovery in corporate travel is difficult, the broker believes creating significant value for the medium term could cement Corporate Travel's position globally.

Rating is upgraded to Outperform from Neutral and the target raised to $16.40 from $14.40.

See also CTD downgrade.

CLEANAWAY WASTE MANAGEMENT LIMITED ((CWY)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 5/2/0

Reports of a board investigation into CEO Vik Bansal's methods and the sale by the CEO of shares for the first time after five years with the company has triggered concerns, with the resultant shakedown in the share price, Credit Suisse observes.

The broker notes the CEO has been extremely effective and there is also the retirement of respected CFO Brendon Gill looming.

However, Credit Suisse thinks it unlikely the CEO will be forced to resign and believes the board has dealt with the issues appropriately. Rating is upgraded to Outperform from Neutral and the target is steady at $2.45.

DOWNER EDI LIMITED ((DOW)) Upgrade to Buy from Neutral by UBS .B/H/S: 4/2/0

UBS sees Downer EDI as a restructuring story that will position the company to deliver free cash flow of at least $300m.

The broker's scenario analysis envisages a plan that is consistent with Downer's plan to divest its capital-intensive mining and laundries operations and wind down its problematic construction operations.

The broker notes after the restructure, Downer will be focussed on its core urban services businesses, with its business model less cyclical and providing more predictable revenue.

UBS thinks the divestment of mining and laundries operations will be a key catalyst. The broker upgrades its rating to Buy from Neutral. Target is raised to $5 from $4.50.

FORTESCUE METALS GROUP LTD ((FMG)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 4/2/1

Credit Suisse increases estimates for China's steel consumption to around 1bn tonnes per year until 2022. This drives a more constructive view on iron ore and iron ore price forecasts are revised up by 30% and 18% for 2021 and 2022, respectively.

Hence, the broker lifts earnings estimates 64-70% over the next two financial years and upgrades to Neutral from Underperform. Credit Suisse also assesses the yield might be enough for investors to start reconsidering entry points in the stock. Target is raised to $16.50 from $15.00.

NORTHERN STAR RESOURCES LTD ((NST)) Upgrade to Neutral from Sell by UBS .B/H/S: 2/3/0

Looking at Northern Star Resources' Strategy Day, UBS asserts its Sell recommendation no longer holds true.

Northern Star Resources expects to see its production to increase by 40% over the next three years led by Jundee/Yandal and Pogo. Costs are expected to decline and noting its forecasts were too conservative, the broker has reduced its cost outlook.

UBS upgrades its rating to Neutral from Sell with the target price raised to $14.20 from $14.

RIO TINTO LIMITED ((RIO)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 3/4/0

Credit Suisse increases estimates for China's steel consumption to around 1bn tonnes per year until 2022. This drives a more constructive view on iron ore and iron ore price forecasts are revised up by 30% and 18% for 2021 and 2022, respectively.

This should flow to large earnings increases for Rio Tinto. The broker believes Rio Tinto will be able to generate free cash flow yields of over 10% in 2021.

Credit Suisse envisages capacity for a "fruitful" dividend in February although acknowledges there are plenty of unknowns including the next CEO and the potential changes in the aftermath of the Juukan Gorge incident.

Rating is upgraded to Neutral from Underperform and the target raised to $95 from $88.

SUNCORP GROUP LIMITED ((SUN)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 3/4/0

Macquarie considers the risks of business interruption are over stated and the bank provisions are fair. Hence the discount of -33% compared with the ASX100 is considered excessive.

The broker understands Suncorp has provisioned -$70-75m, post reinsurance, for Australian business interruption losses. While Macquarie's estimate is closer to -$225m, pre-reinsurance, this is considered substantially less than the discount currently encapsulated in the stock price.

Rating is upgraded to Outperform from Neutral and the target is raised to $11.00 from $10.40.

WEST AFRICAN RESOURCES LIMITED ((WAF)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 1/0/0

West African Resources' first round of drilling at Sanbrado’s M1S deposit produced strong results, extending known mineralisation about 400m below current underground reserves.

The results lead Macquarie to lift its M1S underground inventory to 50% above current reserves, translating to an additional circa 2-years of underground life.

Based on the improved mine life assumptions, the broker upgrades its rating to Outperform from Neutral. Target rises to $1.30 from $1.20.

Downgrade

CORPORATE TRAVEL MANAGEMENT LIMITED ((CTD)) Downgrade to Accumulate from Buy by Ord Minnett .B/H/S: 4/2/0

The purchase of Travel & Transport for $275m and associated $380m capital raising highlights the difficult corporate travel industry, in Ord Minnett's view.

The target was obvious given its scale, while the price on face value represents an aggressive move in the current climate. Nevertheless, Ord Minnett considers this a once in a lifetime opportunity for Corporate Travel to build scale on reduced acquisition multiples.

The broker downgrades to Accumulate from Buy as the key catalysts that were envisaged have largely played out. Target is raised to $19.04 from $15.51.

See also CTD upgrade.

HUB24 LIMITED ((HUB)) Downgrade to Hold from Add by Morgans .B/H/S: 2/2/1

Morgans continues to be attracted to the long-term growth in Hub24 but considers the current valuation is full and is looking for a more attractive entry price. Rating is downgraded to Hold from Add.

Nevertheless, the broker continues to believe the business can deliver the expected step change in earnings over the next three years. Target is raised to $18.10 from $16.60.

JAMES HARDIE INDUSTRIES N.V. ((JHX)) Downgrade to Accumulate from Buy by Ord Minnett .B/H/S: 5/1/0

Ord Minnett interprets the update by Louisiana Pacific as positive for James Hardie, boding well for the exteriors business.

James Hardie was targeting 7-11% volume growth for North America exteriors in the September quarter.

Based on valuation, the broker downgrades to Accumulate from Buy. Target is steady at $34.

RELIANCE WORLDWIDE CORPORATION LIMITED ((RWC)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 2/4/0

Looking at Reliance Worldwide Corp's trading update, Ord Minnett thinks the company is on its way to a very strong first-half FY21 result. However, the current operating environment, though very favourable, is considered unsustainable. This has also been pointed out by management.

The broker is comfortable with its top-of-consensus FY21 net profit forecast of $160m.

Based on the company's valuation, Ord Minnett downgrades its recommendation to Hold from Accumulate with the target price rising to $4.20 from $4.

SEALINK TRAVEL GROUP LIMITED ((SLK)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 1/1/0

Macquarie believes SeaLink Travel Group's recent share price strength necessitates caution on accumulating the stock at current levels. Long term, the broker remains convinced of the group's defensiveness, especially looking at Transit Systems' track record.

Rating has been downgraded to Neutral from outperform although the broker clarifies its long-term thesis on SeaLink Travel remains intact. Target price is unchanged at $5.37.

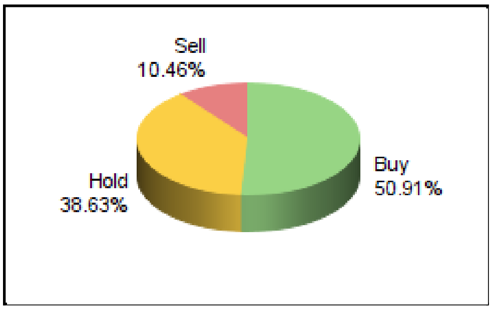
SYNLAIT MILK LIMITED ((SM1)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 2/2/0

Credit Suisse observes a solid second half, although net profit in FY20 was slightly below expectations. The main surprise was a material downgrade to the FY21 outlook, a combination of daigou disruption and the significant cost drag from recent diversification investment.

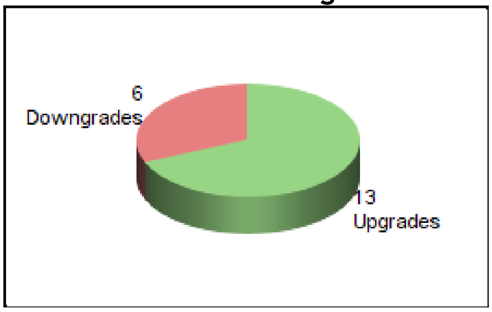
The company has noted it is close to finalising a new global customer for packaged products. This should have a positive contribution from FY23 onwards, the broker points out, and provide some offset to the tail risk from a2 Milk ((A2M)), which was recently heightened by the potential entry of the latter into manufacturing with Mataura Valley Milk.

Rating is downgraded to Neutral from Outperform and the target is reduced to NZ$6.15 from NZ$7.70.

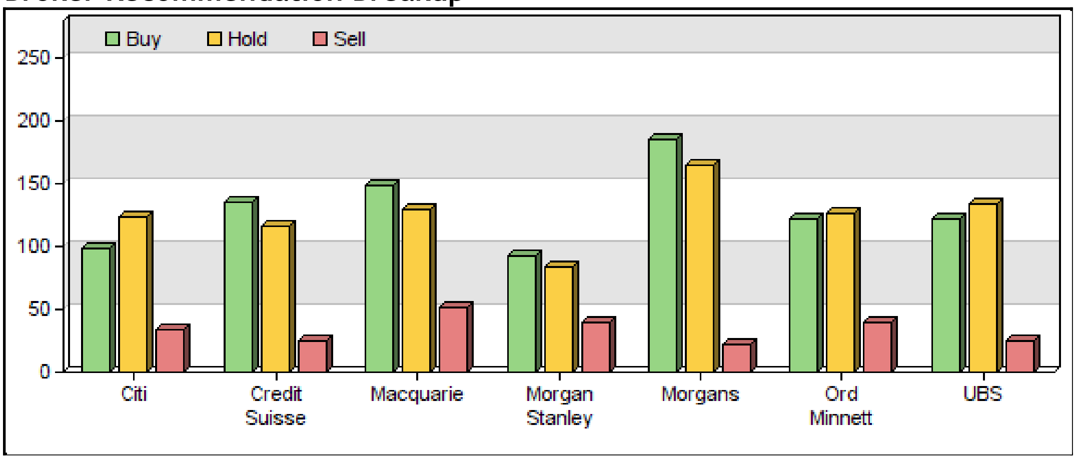
Total Recommendations



Recommendation Changes



Broker Recommendation Breakup



Broker Rating

Order		Company	New Rating	Old Rating	Broker
Upgrade					
1		ALUMINA LIMITED	Buy	Neutral	Citi
2		ATLAS ARTERIA	Buy	Neutral	Macquarie
3		BHP GROUP	Buy	Neutral	Credit Suisse

4	BORAL LIMITED	Buy	Neutral	Citi
5	CLEANAWAY WASTE MANAGEMENT LIMITED	Buy	Neutral	Credit Suisse
6	CORPORATE TRAVEL MANAGEMENT LIMITED	Buy	Neutral	Macquarie
7	DOWNER EDI LIMITED	Buy	Neutral	UBS
8	FORTESCUE METALS GROUP LTD	Neutral	Sell	Credit Suisse
9	NORTHERN STAR RESOURCES LTD	Neutral	Sell	UBS
10	RIO TINTO LIMITED	Neutral	Sell	Credit Suisse
11	SUNCORP GROUP LIMITED	Buy	Neutral	Macquarie
12	THE A2 MILK COMPANY LIMITED	Buy	Neutral	Morgans
13	WEST AFRICAN RESOURCES LIMITED	Buy	Neutral	Macquarie
Downgrade				
14	CORPORATE TRAVEL MANAGEMENT LIMITED	Buy	Buy	Ord Minnett
15	HUB24 LIMITED	Neutral	Buy	Morgans
16	JAMES HARDIE INDUSTRIES N.V.	Buy	Buy	Ord Minnett
17	RELIANCE WORLDWIDE CORPORATION LIMITED	Neutral	Buy	Ord Minnett
18	SEALINK TRAVEL GROUP LIMITED	Neutral	Buy	Macquarie
19	SYNLAIT MILK LIMITED	Neutral	Neutral	Credit Suisse

Recommendation

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	BKW	BRICKWORKS LIMITED	100.0%	75.0%	25.0%	4
2	ALX	ATLAS ARTERIA	40.0%	20.0%	20.0%	5
3	BLD	BORAL LIMITED	30.0%	10.0%	20.0%	5
4	NST	NORTHERN STAR RESOURCES LTD	25.0%	8.0%	17.0%	6
5	SM1	SYNLAIT MILK LIMITED	50.0%	33.0%	17.0%	4
6	AFG	AUSTRALIAN FINANCE GROUP LTD	67.0%	50.0%	17.0%	3
7	MHJ	MICHAEL HILL INTERNATIONAL LIMITED	67.0%	50.0%	17.0%	3
8	DOW	DOWNER EDI LIMITED	67.0%	50.0%	17.0%	6
9	AWC	ALUMINA LIMITED	58.0%	42.0%	16.0%	6
10	SUN	SUNCORP GROUP LIMITED	36.0%	21.0%	15.0%	7

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	PMV	PREMIER INVESTMENTS LIMITED	40.0%	60.0%	-20.0%	5
2	HUB	HUB24 LIMITED	20.0%	40.0%	-20.0%	5
3	UMG	UNITED MALT GROUP LIMITED	50.0%	67.0%	-17.0%	4
4	RWC	RELIANCE WORLDWIDE CORPORATION LIMITED	33.0%	42.0%	-9.0%	6
5	JHX	JAMES HARDIE INDUSTRIES N.V.	75.0%	83.0%	-8.0%	6

Target Price

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	AFG	AUSTRALIAN FINANCE GROUP LTD	2.380	2.070	14.98%	3
2	SM1	SYNLAIT MILK LIMITED	5.530	4.900	12.86%	4
3	RWC	RELIANCE WORLDWIDE CORPORATION LIMITED	4.257	3.807	11.82%	6
4	BLD	BORAL LIMITED	4.450	4.074	9.23%	5
5	PMV	PREMIER INVESTMENTS LIMITED	20.822	19.250	8.17%	5
6	CTD	CORPORATE TRAVEL MANAGEMENT LIMITED	16.223	15.185	6.84%	6
7	BKW	BRICKWORKS LIMITED	19.403	18.230	6.43%	4
8	HUB	HUB24 LIMITED	16.208	15.908	1.89%	5
9	DOW	DOWNER EDI LIMITED	4.935	4.852	1.71%	6
10	FMG	FORTESCUE METALS GROUP LTD	17.314	17.029	1.67%	7

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	A2M	THE A2 MILK COMPANY LIMITED	16.123	18.075	-10.80%	7
2	MHJ	MICHAEL HILL INTERNATIONAL LIMITED	0.540	0.563	-4.09%	3

3	UMG	UNITED MALT GROUP LIMITED	4.463	4.610	-3.19%	4
4	AWC	ALUMINA LIMITED	1.883	1.892	-0.48%	6

Earning Forecast

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	CRN	CORONADO GLOBAL RESOURCES	-12.639	-15.348	17.65%	3
2	OGC	OCEANAGOLD CORPORATION	-8.040	-9.557	15.87%	4
3	PMV	PREMIER INVESTMENTS LIMITED	95.360	84.152	13.32%	5
4	RWC	RELIANCE WORLDWIDE CORPORATION LIMITED	20.500	18.668	9.81%	6
5	AFG	AUSTRALIAN FINANCE GROUP LTD	15.233	14.100	8.04%	3
6	FMG	FORTESCUE METALS GROUP LTD	288.217	266.888	7.99%	7
7	WHC	WHITEHAVEN COAL LIMITED	-6.649	-7.186	7.47%	7
8	BHP	BHP GROUP	318.274	300.223	6.01%	7
9	QUB	QUBE HOLDINGS LIMITED	5.987	5.737	4.36%	6
10	NST	NORTHERN STAR RESOURCES LTD	84.600	81.233	4.14%	6

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	VEA	VIVA ENERGY GROUP LIMITED	-1.390	0.375	-470.67%	5
2	GXY	GALAXY RESOURCES LIMITED	-21.726	-5.184	-319.10%	6
3	BKW	BRICKWORKS LIMITED	53.850	171.320	-68.57%	4
4	CWN	CROWN RESORTS LIMITED	6.018	9.393	-35.93%	6
5	CTD	CORPORATE TRAVEL MANAGEMENT LIMITED	6.580	8.580	-23.31%	6
6	MHJ	MICHAEL HILL INTERNATIONAL LIMITED	4.567	5.200	-12.17%	3
7	A2M	THE A2 MILK COMPANY LIMITED	50.740	57.560	-11.85%	7
8	BOQ	BANK OF QUEENSLAND LIMITED	47.100	53.086	-11.28%	7
9	STO	SANTOS LIMITED	22.209	23.772	-6.57%	7
10	WBC	WESTPAC BANKING CORPORATION	98.186	102.571	-4.28%	7

Technical limitations

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

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WEEKLY REPORTS

Uranium Week: Trump Lessens China Dependence

As the weekly uranium price remains unchanged, President Trump declares a mineral supply chain national emergency.

-Over reliance by US upon “foreign adversaries” for imports
-Pending uranium supply contract between Kazakhstan and India
-Weekly spot prices are unchanged

By Mark Woodruff

US President Donald Trump signed an Executive Order on September 30, aimed at expanding domestic production of rare earth minerals vital to critical manufacturing sectors in an effort to reduce dependence on imports from China.

The Executive Order declares a national emergency in the mining industry and directs the US Department of the Interior (DOI) to explore using the Defence Production Act to speed the development of mines.

“A strong America cannot be dependent on imports from foreign adversaries for the critical minerals that are increasingly necessary to maintain our economic and military strength in the 21st century," Trump said in the Executive Order".

The Executive Order refers to a list of 35 critical minerals, including uranium, drawn up by the DOI in response to a 2017 Executive Order by President Trump, explains industry consultant TradeTech. These minerals are identified as being essential to the economic and national security of the US and having supply chains that are vulnerable to disruption. Additionally, they are identified as serving "an essential function in the manufacturing of a product, the absence of which would have significant consequences for our economy or our national security."

While the Executive Order is not likely to affect US uranium trade or imports, notes TradeTech, the critical minerals list also includes zirconium, which is used in nuclear fuel fabrication, and vanadium, which is a by-product of certain uranium deposits.

Mark Chalmers, president and CEO of US uranium and vanadium producer Energy Fuels, said the company strongly supported the President's declaration. However, he added that despite expressing strong support for domestic uranium producers, the Administration has not yet turned this into "definitive" actions. "Energy Fuels will continue our efforts in Washington DC towards seeing that last night's announcement results in real, tangible support for US uranium, vanadium and rare earth element producers."

Country News

Kazakhstan and India have held talks on cooperation in the field of peaceful use of atomic energy, the press service of the Kazakh Energy Ministry said on October 1.

During a recent meeting, government officials discussed issues related to the supply of Kazakh uranium to India and outlined agreements for a new contract that will be finalised by year end, according to a Kazakh Energy Ministry statement.

As the leading producer since 2009, Kazakhstan produced 43% of the world's uranium last year, notes TradeTech. The government of India is committed to expanding the nation's nuclear power program as part of a broad infrastructure development program. The government has set ambitious targets to grow nuclear capacity.

Uranium Pricing

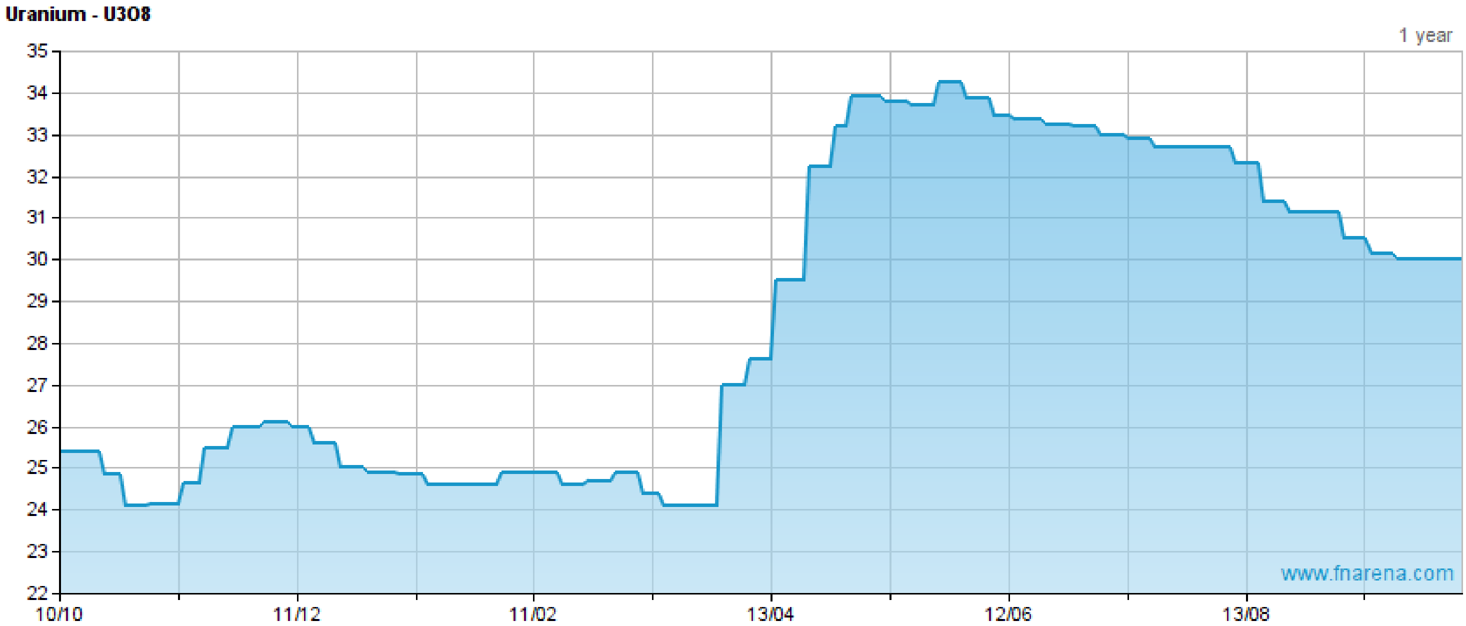
TradeTech’s Weekly Uranium Spot Price Indicator was unchanged at US$30.00/lb last week.

Although the weekly spot price has trended downward since May, the indicator has increased nearly 21% overall in 2020, averaging a 0.5% weekly increase in 2020. TradeTech's average weekly uranium spot price for 2020 is US$29.68/lb per pound, US$3.85/lb above the 2019 average.

Buying interest was sluggish in September and remains so as October begins. The concerted focus on securing an extension to the Russian Suspension Agreement (RSA) has occupied the attention of utilities for several months. Now that a draft agreement has been reached, many sellers are optimistic that utilities will return to the market and buying activity will increase, explains TradeTech. However, it may be several weeks before demand picks up significantly, as utilities are in the process of evaluating the current market and their individual portfolios.

The lack of significant utility demand in past months has led sellers to compete more aggressively in the mid-term market. However, utilities seeking longer-term offers are finding that sellers are far less flexible in lowering their offer prices due to their need for higher prices to adequately cover their future production costs.

TradeTech's term price indicators are at US$34.00/lb (mid) down -US$0.50/lb from end-August, and US$37.00/lb (long) unchanged.



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WEEKLY REPORTS

The Short Report - 08 Oct 2020

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

Summary:

Week ending October 1, 2020.

Last week was a net non-event for the ASX200, as again our market rallied and fell with Wall Street only to finish where it began.

As the table below suggests, there wasn't much going on in Short Land last week. We do note, nonetheless, we have a new player in the 10%-plus club.

I have noted previously in this Report that funeral services company InvoCare ((IVC)) had been slowly climbing up the charts. Once a solid dividend payer, InvoCare has become an unlikely virus victim on the balance of more customers versus fewer funeral attendees and thus lower revenues.

With the easing of restrictions moving ever so slowly across states, InvoCare shorts last week ticked up to 10.2% from 9.9%.

One stock to see a move in short position of one percentage point or more last week was...drumroll...Webjet ((WEB)). After steadily putting daylight between it and every other stock over past weeks, finally the travel agent saw some profit-taking, with shorts falling to 15.8% from 17.7%.

The other stock to see a move in short position of one percentage point or more last week was...blow me down...Flight Centre ((FLT)), the shorts of which fell to 6.2% from 7.4%. Seems to be a theme emerging.

To that end, shorts in Corporate Travel Management ((CTD)) fell to 5.9% from 6.7%.

No Movers & Shakers this week.

Weekly short positions as a percentage of market cap:

10%+
WEB 15.8
MYR 11.0
IVC 10.2

In: IVC

9.0-9.9

No stocks

Out: IVC

8.0-8.9%

GXY, ING, BOQ

In: GXY, BOQ

7.0-7.9%

CUV

Out: BOQ, GXY, FLT

6.0-6.9%

FNP, ORE, MSB, A2M, PNV, AVH, NEA, MTS, FLT, BIN, FXL, HUB

In: FLT, BIN Out: CTD

5.0-5.9%

PLS, CTD, LOV, EOS, SEK, WHC, Z1P, TGR, SUL, SGM, COE, SYR, BEN, AMA URW, ALG

In: CTD, WHC, AMA Out: URW, ALG

Movers & Shakers

See above.

ASX20 Short Positions (%)

Code	Last Week	Week Before	Code	Last Week	Week Before
ALL	3.3	3.7	MQG	0.4	0.4
ANZ	1.0	0.9	NAB	1.4	1.3
BHP	4.1	3.9	NCM	0.3	0.3
BXB	0.2	0.2	RIO	1.2	1.3
CBA	0.7	0.7	TCL	0.6	0.6
COL	0.5	0.5	TLS	0.4	0.4
CSL	0.3	0.3	WBC	0.9	0.9
FMG	0.9	0.8	WES	0.4	0.4
GMG	0.3	0.3	WOW	0.2	0.2
IAG	1.0	0.9	WPL	1.4	1.3

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

Guide:

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

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

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

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

Aside from all the above reasons as to why it would be a potential misconception to draw simply conclusions on short percentages, there are even wider issues to consider. ASIC itself will admit that short position data is not an exact science given the onus on market participants to declare to their broker when positions truly are "short". Without any suggestion of deceit, there are always participants who are ignorant of the regulations. Discrepancies can also arise when short positions are held by a large investment banking operation offering multiple stock market services as well as proprietary trading activities. Such activity can introduce the possibility of either non-counting or double-counting when custodians are involved and beneficial ownership issues become unclear.

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

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

WEEKLY REPORTS

The Wrap: Banks, REITs & Explosives

Three positive components in the federal budget sure to benefit the banking sector; Morgan Stanley prefers diversified over pure-play iron ore stocks; higher import volumes expected for ammonium nitrate.

-Banks: this week's budget provides reasons to cheer
-Iron ore surplus looming
-Explosives sector: consumers value reliability over price
-US election: how long the battle for the soul of the nation?

By Angelique Thakur

Not all that bad

Upon initial assessment, it would seem this week's federal budget provides banks with little reason to cheer. But this first impression is not entirely true, say Bell Potter analysts, as there are plenty of indirect ways the budget will help the sector.

Bell Potter highlights three components of the budget that are highly positive for banks in the current setting.

The first component pertains to measures for supporting businesses and investment. Bell Potter asserts these measures would indirectly benefit banks that lend in the SME/mid-market and smaller corporate space.

Some business support measures include wage subsidies, loss carry-back for companies with turnover of up to $5bn, small business tax concessions and loan guarantee scheme. Investment measures include the likes of temporary tax incentives and infrastructure stimulus.

Bell Potter is of the view these measures will benefit the four major banks, in particular ANZ Bank ((ANZ)) and National Australia Bank ((NAB)).

Macquarie Group ((MQG)) is equally on the list, as are regional banks Bendigo and Adelaide Bank ((BEN)), Bank of Queensland ((BOQ)) and Suncorp Group ((SUN))).

The next indirect positive stems from support for consumers in the form of lower taxes and wage subsidies. This is likely to indirectly benefit banks engaged in mortgage and consumer lending, suggest the analysts, and would include the major banks especially Commonwealth Bank ((CBA)) and Westpac ((WBC)).

Regionals expected to benefit include Bendigo & Adelaide, Suncorp , Auswide Bank ((ABA)) and MyState ((MYS)).

The third component relates to Australia's AAA sovereign rating. Bell Potter sees no immediate threat from the budget. Since the sovereign rating affects the major banks' own credit ratings, the broker expects wholesale funding costs to remain stable for now.

All things considered, Bell Potter's sector top pick is Macquarie Group with ANZ and CBA the preferred majors and Suncorp the preferred regional lender.

Too good to last

Morgan Stanley forecasts iron ore to return to surplus in the fourth quarter of 2020. The global market has been supported so far by strong Chinese demand and weaker Vale shipments.

China's second-half steel output is forecast to grow 7%, but slowing thereafter for the rest of the year as the country enters the seasonally weaker winter period.

In the fourth quarter, Morgan Stanley expects China's steel output to be -3.3% lower versus the third quarter.

Add Vale's higher shipments on top and Morgan Stanley pegs the surplus for iron ore at 16mt by the fourth quarter. This is expected to result in a price decline to US$100/t.

Morgan Stanley points out China's hot metal output (which is basically production using iron ore) is currently close to its upper limit. In 2021, this hot metal output is expected to decline by -1.4%.

Similar to 2020, Morgan Stanley assumes Vale's production will increase in 2021, leading the market into a surplus of 32mt while driving down iron ore price to US$70/t.

Diversified producers are preferred over pure-plays and Morgan Stanley is currently Underweight on Mineral Resources ((MIN)) and Fortescue Metals Group ((FMG)). Instead, BHP Group ((BHP)) is preferred with its exposure to copper over the aluminium-exposed Rio Tinto ((RIO)).

Strong demand outlook for ammonium nitrate

Ammonium nitrate (AN) data for August 2020 show the average import price in August fell for the first time in nine months (versus last year). Pricing has now fallen each month since June.

However, a longer-term perspective shows for the 11 months ending August, ammonium nitrate prices increased 10% while volumes were up 37% versus last year. Stronger volumes indicate strong demand in the domestic market, states Citi.

This has prompted the broker to forecast FY20 import volumes of circa 195kt, up from FY19's circa 140kt.

Citi feels higher ammonium nitrate import prices bode well for Orica ((ORI)) and Incitec Pivot ((IPL)) with respect to future price negotiation and margin expansion.

While the ability to sell technology had been hampered due to restricted mine access limiting trials (also offsetting margin expansion), with technology trials for Dyno Nobel (a wholly-owned subsidiary of Incitec Pivot) recommencing in the USA, Citi expects trials in Chile to commence later this year.

On a different but related matter, a survey by Citi of 30 mining professionals engaged in drill and blast procurement across Australia and North America finds safety to be the key driver of explosive technology adoption.

This is good news for Orica, Citi believes, which is the market leader in wireless technology (WebGen). Having said that, the survey indicates Orica needs to invest more in education, marketing and trials to convince the end customer.

Another finding of the survey relates to the key attribute miners look for in their explosives supplier. The survey found supplier reliability to be the key factor while price turned out to be a minor consideration.

Citi concludes the survey indicates a strong medium-term outlook for both companies, but the broker also cautions both companies will need to work to retain customers with switching likely to occur.

Citi’s Buy thesis for Orica is based on the company’s globally diversified earnings, underpinned by multi-year contracts; its leverage to intellectual property and a positive end market outlook.

Incitec Pivot is also rated as Buy and Citi sees the company’s fertiliser division well placed to benefit from more advantageous Australian weather and cropping conditions as compared to last year.

A shift towards metropolitan office REITs:

Ord Minnett has initiated coverage on two metropolitan office REITs: the Elanor Commercial Property Fund ((ECF)) and the Australian Unity Office Fund ((AOF)).

Covid-19 has negatively impacted office markets, especially in Sydney and Melbourne. There has been an acceleration in work-from-home (WFH) plans leading to a flurry of subleasing space.

This new business dynamic has forced many organisations to re-think supply chains and workplace strategies with the focus shifting to reducing costs.

Analysing the top 40 companies in Australia and their workplace strategy, Ord Minnett notes there is considerable scope for more decentralisation. 50% of Australia’s top companies have adopted some form of the hub and spoke model.

Although the true quantum of the impact remains uncertain, Ord Minnett assesses Sydney’s CBD has experienced the biggest contraction.

But that does not mean investing in office REITs is dead. Ord Minnett sees value in office REITs that have minimal exposure to CBDs.

Vacancy rates are expected to rise across most office markets over the next three years, but Ord Minnett believes the impact of covid-19 will be much more subdued for the metropolitan office markets. Thus, investors looking for exposure to office REITs should target REITs focused on metropolitan markets.

Apart from the fact that yields have held firm in the metro markets, there are other factors supporting the metropolitan office markets; namely the rise of the hub and spoke model, investor demand for metropolitan assets, and the focus on cost-cutting.

Ord Minnett likes both Australian Unity Office Fund and Elanor Commercial Property Fund.

Where the former offers 59% exposure to metro and fringe markets, the latter has an exposure of 69%. Neither have any exposure to the Sydney or Melbourne CBD.

Elanor Commercial Property Fund recorded the highest rent collection (98%) of all its office peers. Given its focus on quality tenants, fewer leases expiring over the next two years than peers and its exposure to metropolitan locations, Ord Minnett feels Elanor's is one of the better-placed office REITs.

What attracts the broker to Australian Unity Office Fund is the REIT’s exposure to Parramatta and Macquarie Park; markets expected to benefit from decentralisation.

US presidential election

The US presidential election will have far-reaching consequence, whatever the outcome. According to an Ipsos poll, a majority of US voters consider the election as a “battle for the soul of the nation”.

Unless Biden can claim a conclusive victory, things might yet get a lot more complicated, as incumbent Trump is more likely than not to dispute the outcome.

If such dispute drags into 2021, it would stall the handover and pose serious economic risks, suggests the Economist Intelligence Unit (EIU).

Latest poll numbers put Biden 8% ahead of Trump while at this point in 2016, democratic candidate Clinton led Trump by just 3%.

As of October 5, Biden was in the lead in aggregate polling in the four most important states - Michigan, Wisconsin, Pennsylvania and Florida.

Citi asserts this indicates the increasing likelihood of a Blue Wave and it looks like equity markets are less concerned about the chances of a contested election dragging on for weeks.

According to the Economist Intelligence Unit, Trump’s core support base, responsible for leading him into victory in 2016, has not expanded beyond the levels seen in his first term and will most probably not be enough to ensure a victory in the Electoral College this time around.

Due to the unique polling situation created by the pandemic, the EIU does not expect results to be declared for several days, which leaves the door open for the results to be disputed.

Elaborating on this, the EIU expects Trump to take a lead with in-person voting results; a potential premature victory if the postal votes shift the balance to the challenger. Trump might call foul play and contest the result.

The ensuing series of lawsuits in the battleground states between Trump and Biden could set the stage for a dispute that would probably go on well into December.

The worst-case scenario, according to EIU, would be a deadlock while the losing candidate refuses to formally concede defeat.

If Trump refuses to leave office, the Democrats in Congress may refuse to move the legislative agenda forward. With budgetary decisions suspended, this would lead to a government shutdown by early 2021.

This remains an extreme scenario and EIU thinks it is rather unlikely, instead expecting a clear election outcome, or one candidate will back down before Inauguration Day.

Citi notes investors are leaning towards cyclicals including industrials, materials and financials over technology, heading into 2021. Notably, investors appear to be less focused on dividends and more on the appreciation potential of stocks.

TREASURE CHEST

Treasure Chest: TechnologyOne Stumbles

As a result of extra provisioning for an adverse finding in an unfair dismissal case, TechnologyOne now expects results at the lower end of guidance.

-Higher provisioning but little impact likely for FY21
-Exposure to tertiary sector not considered problematic
-Transition to software-as-a-service progressing slowly

By Eva Brocklehurst

While most technology stocks have performed strongly during the pandemic, TechnologyOne ((TNE)) has stumbled and now results are expected to be at the lower end of guidance. Guidance is for pre-tax profit growth of 8-12%.

A court has ruled adversely in a case brought by a former employee which requires the company to pay -$5.2m, well above the -$1.6m provision TechnologyOne had already taken in relation to the case.

An appeal will be made to the Federal Court but an additional provision of around -$3.6m is now required in the FY20 result. The case involves the unfair dismissal and workplace bullying of the former Victorian office manager who sued the company in 2018 for $14.8m, claiming incentives were also not paid.

Bell Potter downgrades estimates by -2% for FY20 as a result of the adverse ruling and additional provisions, forecasting pre-tax profit of $82.5m, but makes little change to FY21 and FY22.

Otherwise, TechnologyOne has not made any material announcements since its first-half report in May, but Morningstar notes the stock has fallen by -20% subsequently. This is made more surprising by the fact that technology stocks on the whole have performed strongly.

Morningstar is not overly concerned because at the peak in early May, the stock was materially overvalued and **the business retains a strong position in enterprise resource planning software in Australia.**

Now, with the stock no longer overvalued and trading at the lower end of the Morningstar "fair value" range, the researchers assert the business is strongly positioned and growth should continue as clients migrate to software-as-a-service from on-premises contracts.

Concerns

There have been concerns about the reported sale of around -$64m in shares by co-founder and current chairman Adrian Di Marco and co-founder John Mactaggart, but Morningstar does not consider this is significant as both have sold shares gradually over recent years.

There have been criticisms in relation to the way revenue is recognised at TechnologyOne, but the researchers point out this is not particularly new and does not justify changes to forecasts or valuation.

Another concern raised in the market recently is the company's exposure to the tertiary education sector, which is heavily affected by pandemic-related border closures. Again, Morningstar does not believe TechnologyOne will lose customers unless those customers cease trading.

The tertiary sector is also expected to recover in 2021 as the global economy re-opens and brokers have previously emphasised the company's revenue stream is not linked to international students.

Slow Growth?

Macquarie suggests the transition to software-as-a-service is progressing more slowly than previously expected and will closely note the growth outlook for FY21. An acceleration in growth is required to hit the company's target of $500m in annual recurring revenue in FY24 and provide a basis to re-rate the stock.

Macquarie assesses the **scaling back of high-margin, on-premises licence fees, combined with the ramping up of capitalised software amortisation, creates a hurdle for earnings into FY22/23,** until the software-as-a-service business scales up.

The broker points out that compared with the Small Ordinaries index, TechnologyOne is trading at historical highs, but when compared with the ASX Information Technology index it is broadly in line with historical averages.

Bell Potter acknowledges profit growth guidance of 8-12% is low for a stock that is trading on an FY22 price/earnings ratio of around 40x, but calculates underlying growth is well over 20%, when the anticipated fall in on-premises licence fees is taken out.

The broker, not one of the seven monitored daily on the FNArena database, retains a Buy rating and $9.50 target. The FY20 result is due on November 24. FNArena's database has one Buy, one Hold and two Sell ratings. The consensus target is $8.12, suggesting 1.3% upside to the last share price.

RUDI'S VIEWS

Rudi's View: Market Momentum Switch, A Messy Affair

In this week's Weekly Insights:

-Market Momentum Switch: A Messy Affair
-Conviction Calls
-Dividend Traps & Opportunities

The Economic Recovery, A Messy Affair

By Rudi Filapek-Vandyck, Editor FNArena

Under more "normal" circumstances, we'd all be talking about the economic recovery by now, with follow-on consequences for government policies, central bank focus and a decisive switch in momentum for specific segments of the share market.

But these are not, by anyone's standards, "normal" times.

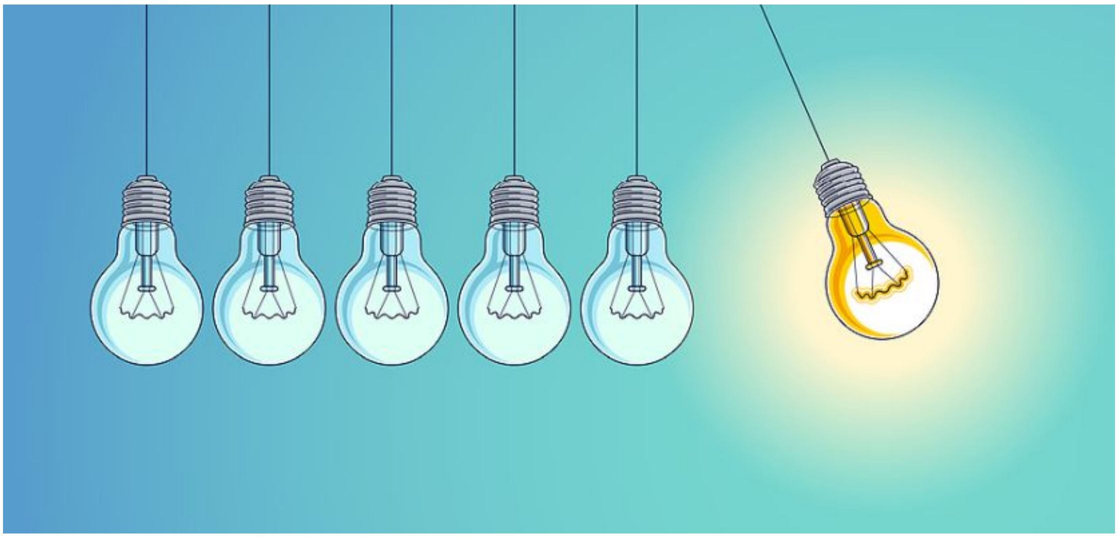
Irrespectively, if we observe price action for global equities over the past six or seven weeks, combined with forecasts and market commentaries from experts and global strategists, there is unmistakably a preference building for cyclicals and cheaply priced laggards in search of the next engine for outperformance and outsized returns.

The face value reasoning behind this anticipated switch in market momentum is built on two pillars:

-Pandemic "winners" and new era technology have become a crowded trade (everyone is in on it)

-The 'value' part of the share market is too cheaply priced, in particular on a relative comparison

So, what will shift momentum out of winners and into the laggards?



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A recent market report by Macquarie emphasised that, when economies recover from the depths of an economic recession, it is always the turn for cyclicals to shine, because of their leverage to improving economic dynamics, and the return of "growth".

For anyone who understands how investing works, and how financial markets operate in relationship to the real world out there, such a summary contains nil surprise.

One of the attractions of cyclicals and more vulnerable business models is that, by the time the economy starts picking up, their share prices have been clobbered to pulp in response to the preceding fall-of-a-cliff downturn.

The combination of extremely cheap share prices with improving prospects for growth is an enormously powerful, and attractive, proposition for investors looking over the horizon.

Most deep and gut-wrenching bear markets occur in combination with an economic recession; hence every recovery out of those bear markets has been led by banks, miners, energy companies and small caps.

But what caught my attention in Macquarie's report was the -apparent- requirement to underpin the case that the above straightforward order of events still applies.

Analysts at Macquarie had gone back in time and isolated four major economic recessions. And every time the pattern coming out of each of these four recessions has been similar, they emphasised; no exception.

Why, I wonder, why is it that Macquarie's analysis of past patterns post economic recessions needs to be supported with extra-details and emphasis?

Is it because today's investors do not understand the correlation between economic recessions and how the subsequent recoveries benefit different types of companies than the ones who outperform when confronting the recession head-on?

Or is it because investors have so much fallen in love with highly valued, outperforming, modern era technology companies, they simply cannot focus on anything else but those beloved ones?

Or is it maybe because there remains a healthy dose of market scepticism about the exact shape (speed) of the economic recovery that as yet hasn't announced itself yet, other than the initial bounce from the absolute bottom?

It's probably a combination of all of the above.

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One starts to realise financial markets are not necessarily what they appear to be at face value when strategists at Morgan Stanley -reported proponents of the V-shaped recovery scenario- feel the need to explain to their clientele that V-shaped recovery actually doesn't look like a genuine V.

Morgan Stanley's V looks a lot more like the Nike logo -the swoosh- with a much more elongated, drawn-out right-hand part after the bounce from the bottom.

It just so happens to be, this is the most preferred forecast by analysts and strategists on Wall Street.

Where the discrepancy kicks in is through the anticipated response by investors and by financial assets.

Morgan Stanley thinks the prospect of economic recovery, though not as strong as, say, post GFC, will make investor focus switch to companies benefiting from the improvement, even if it is not as strong as hoped/precedents/forecast.

Morgan Stanley also believes that, in combination with unprecedented central bank liquidity and significant government stimulus measures, the forthcoming economic recovery will create price inflation and force bond yields (long end) higher.

If correct, such a confluence of factors has the potential to create a strong self-perpetuating switch out of this year's winners and into the laggards and the cyclicals, led by banks and energy and mining stocks.

Clearly, there is still a lot of scepticism surrounding the so-called "reflation" trade as all attempts to ignite this major switch have been nothing but largely unsuccessful since late August.

Sure, frothy valuations here and there inside the technology sector have deflated somewhat, but that was always bound to happen at some stage, and banks have finally moved off their price bottoms, but Telstra hasn't, and QBE Insurance still looks "sick"; same for Nufarm, IOOF Holdings, not to mention Unibail-Rodamco-Westfield.

On the other hand, share prices for Ardent Leisure ((ALG)), SeaLink Travel Group ((SLK)) and Event Hospitality and Entertainment ((EVT)) have started to move strongly upwards.

All in all, the past six-seven weeks have created a lot of volatility, without a clear, lasting or dominating pattern in share markets, making the month of September, above all, a rather messy affair.

Incidentally, if you are worried about the second wave in the global pandemic impacting on economies and companies, as is the global strategy team at Citi, you'd be avoiding cyclicals as they remain most vulnerable to set-backs.

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Maybe the simplest way to put a rocket under the Big Portfolio Switch in global equity markets is through the successful development of a vaccine that allows humanity to revert back to life as we all knew it pre-2020.

Sure, financial markets would soon come to realise developing a vaccine is one thing, and sharing it with billions of people worldwide is quite another, but the sheer prospect of beating the virus and being able to move on seems like a guaranteed path to keep investor hopes and anticipation elevated for a prolonged time.

Which is why the likes of Morgan Stanley have their team of healthcare specialists operating on constant alert for just about anything that can generate positive newsflow regarding covid-19 and a potential vaccine.

According to that team's most recent updates, the expectation remains that one of the leading contenders in this global race can start Phase III trial preparations by November and have a potential vaccine ready by late March-April next year.

This means the outcome of the US presidential election might not even be the most important news event in November. At least for the short term.

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To read more about what sectors and stocks are most likely to benefit from portfolio rotation:

https://www.fnarena.com/index.php/2020/09/23/maximising-returns-in-a-new-equity-cycle/

See the Conviction Calls in the following Weekly Insights:

https://www.fnarena.com/index.php/2020/09/17/rudis-view-plenty-of-clouds-diverging-scenarios/

Idem for the Conviction Calls in the preceding Weekly Insights:

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

Conviction Calls

Stockbroker Morgans this month added six fresh additions to its list of **Best ideas**; buy-rated stocks that come with a higher-than-average level of confidence these will be among the highest returning exposures on the ASX over the coming twelve months.

The six newbies are (in no particular order) QBE Insurance ((QBE)), Magellan Financial ((MFG)), Nufarm ((NUF)), Volpara Health Technologies ((VHT)), Catapult Group ((CAT)), and Mach7 Technologies ((M7T)).

Stockbroker Morgans makes a regular appearance in this section and as I explained before, whereas most peers come up with a small, selective list of conviction calls for investors looking for the next profitable idea, at Morgans the total selection of Best Ideas these days involves no less than 47 companies.

Those 47 suggestions involve cheaply priced energy stocks and other cyclicals, such as Santos ((STO)), Woodside Petroleum ((WPL)), Ramelius Resources ((RMS)), and Incitec Pivot ((IPL)), though it has to be noted the bias is unmistakably in favour of beaten down oil and gas producers.

The next group is probably best defined as beneficiaries from re-opening & recovering economies, including names like Aristocrat Leisure ((ALL)), Sydney Airport ((SYD)), Westpac ((WBC)), and Super Retail ((SUL)).

There are a number of solid yield providers represented too, including APA Group ((APA)), Aventus Group ((AVN)) and APN Convenience Retail REIT ((AQR)).

Equally remarkable, I would argue, is the selection also includes lockdown beneficiaries and strong growers, such as ResMed ((RMD)), NextDC ((NXT)), Adairs ((ADH)), and Zip Co ((Z1P)).

Maybe the underlying message here is to not get fully hooked on the market's us versus them, Value versus Growth, laggards versus winners, and instead keep the portfolio diversified across a range of themes and dynamics.

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Morningstar's Best Stock Ideas consist of G8 Education ((GEM)), Link Administration ((LNK)), Southern Cross Media ((SXL)), Viva Energy Group ((VEA)), Westpac, Whitehaven Coal ((WHC)), and Woodside Petroleum.

Dividend Traps & Opportunities

Whoever writes the market strategy updates at **Wilsons**, last week shared some valuable insights for investors focused on deriving yield/income from the share market.

Don't get suckered in by seemingly attractive looking high yielders that have no growth, is one such invaluable insight. Even income investors cannot ignore the need for growth, said Wilsons in an echo of my own exclamations and warnings since GFC.

Another piece of priceless market wisdom is the combination of yield-plus-growth acts like a powerful combination over time. In Wilsons' view, this is why the Australian share market is one of the best performing over the last 100-plus years (backed up by Credit Suisse research) – globally!

Wilsons has used three key selection screens to identify 15 ASX-listed names that should not only grow their dividends in years to come, but seem poised to beat the market in terms of total investment return (share price gains plus income).

The three chosen filters are Growth (historical data), Yield (forecast dividends and payout ratios), and financial strength (return on equity, interest coverage, and commitment to dividends).

The 15 stocks that rolled out of Wilsons' modeling are (divided over three categories):

-High normalised dividend growth:

-Service Stream ((SSM))
-Cleanaway Waste Management ((CWY))
-Treasury Wine Estates ((TWE))
-Aurizon Holdings ((AZJ))
-Home Consortium ((HMC))

-Growth and yield:

-Westpac
-ANZ Bank ((ANZ))
-Coca-Cola Amatil ((CCL))
-Macquarie Group ((MQG))
-Waypoint REIT ((WPR))

-Long term reliable yield plays:

-Transurban ((TCL))
-Wesfarmers ((WES))
-APA Group
-Atlas Arteria Group ((ALX))
-Amcor ((AMC))

Investors should note Wilsons' list is definitely not without risk and seems to rely heavily on economies re-opening and recovering back to pre-pandemic growth and dynamics.

Why the decision was made to rely on growth achieved in the past is not explained in the strategy document.

(This story was written on Monday 5th October, 2020. It was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website).

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

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- Make Risk Your Friend. Finding All-Weather Performers, December 2014 (The follow-up that accounts for an ever changing world and updated stock selection)
- Change. Investing in a Low Growth World. eBook that sells through Amazon and other channels. Tackles the main issues impacting on investment strategies today and the world of tomorrow.
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