Week

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Stories To Read From FNArena

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Contents

Banks: The Squeeze Is On

Margins continue to be squeezed, as banks compete to retain deposits and borrowers struggle to afford loans. Traditional banks are also being confronted by new digital entrants.

-Improving outlook for the housing market, although households still struggling -Business credit holding up because of lending to larger institutions -Changes have allowed new banking entrants to make better-informed decisions

By Eva Brocklehurst

Banks are facing a challenging operating environment as their retail margins are being squeezed, yet while housing loan growth is at record lows it appears to be stabilising. Morgan Stanley sees indications a rebound is on the way, although notes ongoing headwinds for mortgage growth. Annualised growth in the major banks' housing loans in the past three months was 1.5%.

Housing sentiment has improved since the federal election but as to whether this will translate into an increase in system growth, Morgan Stanley is looking for a sustained rebound in auction clearance rates, an increase in house prices on a month-on-month basis and an increase in auction volumes. Reductions in official interest rates should also support sentiment.

Credit Suisse believes it is too early for a post-election recovery in credit. The broker encapsulates a modest slowdown in housing credit growth into its figuring, while continuing to believe business lending will accelerate. JPMorgan considers the early signs of stabilisation in the housing market and removal of the interest rate floor point to a modest pick up in housing loan growth over the next 12-18 months.

Housing credit increased by 0.2% over May, according to Reserve Bank of Australia data. Business credit increased by 0.1% and personal credit decreased by -0.6%. Data from APRA (Australian Prudential Regulatory Authority) also showed stable conditions in the property market over the March quarter. Growth in commercial real estate was modestly stronger.

JPMorgan found the latest financial aggregates disappointing, particularly business credit. Major banks appear to be still ceding share to smaller banks and non-banks in housing, while gaining slightly in the business segment. Macquarie agrees system mortgage credit growth appears to be stabilising, at around 3%, and with an improved outlook for the housing market,the downside risk to credit growth has moderated.

Housing

Meanwhile, owner occupied housing credit grew slightly in May while it was another flat outcome for investor credit. The latter has borne the brunt of falling house prices and tighter lending criteria, with reduced access to refinancing. The factors that continue to weigh on loan growth include high household leverage, restrictions on lending and very high debt-to-income levels. There is also reduced borrowing capacity, given loan-to valuation-ratio constraints and lower house prices.

The Reserve Bank has highlighted that while housing arrears are high, they are still below the levels of the 1990s recession. Credit Suisse calculates the increase in arrears has been generated by nominal income growth for the past five years, around half the long-term average. This has not compensated for other factors that have caused households to struggle to make mortgage repayments.

Properties are also taking longer to sell, making it more difficult for borrowers to avert arrears by selling their property and repaying the loan. While tighter lending standards should lead to lower arrears, measures being taken may temporarily increase arrears as some borrowers face difficulties refinancing loans. Nevertheless, the RBA believes that, with strong lending standards, so long as unemployment remains low, arrears should not rise to levels that pose a risk to the financial system or cause harm to the housing sector.

Upon meeting mortgage brokers over the past month, Morgan Stanley notes client inquiry numbers are up, but not consistently, and maximum loan capacity is down substantially over recent years. Household expenses are limiting the capacity to borrow and checks on living expenses are expected to tighten. There is strong competition for new loans as well.

The broker finds falling property valuations are still an issue, as some buyers are unable to borrow as much as they had expected, particularly for off-the-plan apartments. Buyers appear to be applying to several banks and then choosing the one which has the highest property valuation.

If a buyer still has a valuation shortfall and does not have the deposit, non-banks are offering unsecured loans to cover the deposit shortfall and interest rates tend to be around 10% on these loans, Morgan Stanley points out.

Business

Business lending growth has declined in May and, for the first time since August 2018, is growing below housing credit growth. Reports from the RBA suggests that business credit has held up because of lending to larger institutions, given that smaller businesses are more likely to have credit secured by residential property and this is affected by tighter mortgage conditions.

JPMorgan remains constructive on business investment but notes much of this seems to be funded outside of the bank lending channel. This means monthly outcomes in business credit are more dependent on a smaller number of larger-value lending outcomes.

Macquarie envisages downside risk to those banks overweight on business, such as National Australia Bank ((NAB)) and ANZ Bank ((ANZ)). ANZ's challenges have persisted despite actions to arrest market share losses, while National Australia Bank's housing credit growth turned negative in April and the rate of decline accelerated in May. Meanwhile, Commonwealth Bank ((CBA)) and Westpac Bank ((WBC)) were able to regain housing credit momentum and are now growing at 1.3-1.5x system.

JPMorgan points out ANZ's credit growth was weak again in May and there are few signs of a turnaround in its mortgage operations. The broker expects National Australia Bank's home loan growth will improve, as it has matched the other major banks in offering cash back on new home loans since mid-April. The broker expects a pick up in both housing and business credit later this year as cash rate reductions and improved sentiment post the election come into effect.

Macquarie expects the next cut to the cash rate will reduce the major banks' profitability by -3-4% and there is downside risk to bank earnings in the near term. Falling interest rates are detrimental to profitability, mainly because of squeezing margins relating to deposit pricing elasticity.

Neo-banks

APRA, in 2018, introduced a restricted route for granting a banking license to new entrants. The intention was to balance competitive opportunities for new entrants while protecting deposit holders. Neo-banks can apply for a full banking licence immediately or piggy-back off another bank's licence. A neo-bank is a digital bank, as opposed to one with a shop front, that communicates and provide services exclusively through an application or online.

Since May 2018 a combination of six new licenses have been granted in retail and business banking. The providers leverage the benefits of technology and market themselves as being more efficient and cheaper.

Credit Suisse assesses the addressable revenue pool of around $60bn is focused in the consumer arena and the smaller end of business banking. Lending makes up the majority but there are also opportunities in deposits. The main threat to incumbents is that open banking and comprehensive credit reporting allow new entrants to make better-informed lending decisions from data that is available to all.

The broker highlights that accessing data is one hurdle while correctly analysing it is another. Credit Suisse believes major banks will ignore these new institutions at their own peril. Still, in the UK, which is five years ahead, these neo-banks are yet to disrupt the traditional banking industry when it comes to vanilla products and the incumbents maintain the majority of market share.

Investment Platforms Suffering Exodus

In the fallout from the Royal Commission, investment platforms are suffering major funds outflows. Not all, however, are losers.

-March quarter sees funds fleeing platforms -Independents gaining share from majors -Near term margin pressures weighing on performance

By Greg Peel

At the end of 2018, Australian investment platforms were administering $811bn of investor funds. Platforms cater for superannuation and non-superannuation products and provide the ability to acquire, hold and administer a range of investments as well as provide comprehensive reporting to clients and advisers.

Of that total, the big five banks and AMP ((AMP)) boasted a net 83% of funds. The balance was held by smaller, independent platforms.

The $811bn total at the end of December represented a -$933m net outflow of funds over the December quarter. Outflows can occur for two reasons: either the investor wants to take funds out of the market, or the investor wants to remove those funds from that platform to either move them elsewhere or simply manage funds personally.

Funds outflows in the December quarter could be attributed to the fact the ASX200 lost -9% in the quarter, as global stock markets tanked, prompting selling. However the ASX200 rallied 9.5% to the end of March, yet March quarter funds flow data, the most recent released by ASIC, showed a net -$2.7bn in platform outflows.

That’s the weakest quarter since 1991.

The Fallout

Clearly it’s not about stock market performance. Rather it is about the Royal Commission, and all its ramifications. Not only are disgruntled investors bailing on investment platforms, in light of RC horror stories, the number of financial advisors on platforms is rapidly diminishing.

RC reforms have meant advisors have lost what were previously grandfathered commissions. In other words, a big chunk of income. Cause enough for more veteran advisors to call it a day. Moreover, as of January 1 this year advisors were required to satisfy new education standards, not only discouraging existing advisors but also raising the bar for any aspiring newcomers.

Over the five months to May, reports UBS, the total number of advisors exiting the market numbered 628 or -2.2%. The major financial institutions collectively lost 439, or -5%, reducing their advisor market share to 30%. With Westpac ((WBC)) set to exit from advice, losses can only grow. AMP and IOOF Holdings ((IFL)), the two biggest advisor groups, lost 99 and 21 respectively. Commonwealth Bank ((CBA)) and its funds management business Colonial First State lost 128.

Independent financial advisors lost 189, or -1%, despite an influx of advisors previously with the major platforms.

In the March quarter, a total of -$6bn in funds outflows was suffered collectively by the Big Four banks, Macquarie Group ((MQG)), AMP and IOOF. IOOF’s flows were actually positive, but net of ANZ Bank’s ((ANZ)) sale to the fund manager of its wealth management division (not finalised).

The Rise of the Independents

Independent platforms, by contrast, enjoyed $2.1 of inflows. The likes of Netwealth ((NWL)), Hub24 ((HUB)), Praemium ((PPS)), Onevue Holdings ((OVH)) and Xplore Wealth ((XPL)) are clearly gaining market share in the post-RC environment, Citi notes.

That said, total funds under administration (FUA) numbers for the independents was largely unchanged at the end of the March quarter from a year before, at $9.6bn. UBS notes specialist funds flow growth has dropped to 28% from 40%.

For the independents, it’s a matter of swings and roundabouts. While investor disgust with the majors is supporting market share gains, the majors have responded by cutting fees as competition heats up. On the other side of the ledger, regulatory reforms have meant higher costs, so margins are being squeezed from both sides. And RBA rate cuts put further pressure on margins on cash deposits, Morgans notes.

Analyst consensus has the independents continuing to win market share from the majors as the structural shift continues. But in the near term, ongoing advisor disruption and margin pressures appear set to continue. Citi thus has a Sell rating on Netwealth and a Neutral on Hub24, for the time being.

Morgans recently initiated coverage on both. Morgans is in line with consensus in expecting significant long term earnings growth, noting Netwealth's advisor numbers have grown by 46% in the past two years and Hub24's by 90%. This growth provides "embedded" FUA growth, the broker notes, as advisors increasingly use the platforms.

But near term margin pressures mean the stocks are currently trading at fair valuations. Hence the broker has initiated with Hold ratings on both.

Morgans' initiations bring the number of FNArena database brokers covering Netwealth to six, split by one Buy (or equivalent) rating, four Hold and one Sell. The consensus target is $8.44.

Five now cover Hub24, split by one Buy, two Holds and two Sells. Target $13.59.

Morgans already covered Praemium, and retains a Buy rating (Add). Target 60c.

Onevue Holdings and Xplore Wealth are not covered by database brokers.

South32 Makes Progress At Illawarra Coal

Brokers acknowledge the effort made by South32 to turn around the Illawarra Coal operations. Nevertheless, a return to three longwalls requires a substantial lift in development rates.

-New enterprise agreements helping to optimise operations -Higher coal prices have enabled South32 to address issues at Appin -Dendrobium extension likely to consume considerable capital

By Eva Brocklehurst

South32 ((S32)) is motivated to improve its Illawarra Coal asset at Appin, NSW, conducting a site visit and showcasing plans to return to a three-longwall operation. The asset has a high fixed cost base and its success will be predicated on an ability to restore production levels to a targeted 8mtpa by FY21.

A key feature of the showcase was new enterprise agreements, as costs remain high, with labour contracts accounting for 50%. Ord Minnett notes the company intends to continue optimising its operations, which may take time given the importance of the mine to the community and a heavily unionised workforce.

Illawarra Coal's quality is sound but the assets are ageing and there is extensive infrastructure to maintain, both underground and on surface. Citi also notes management/labour relations have historically been difficult but South 32 has worked hard to finalise new enterprise agreements that have improved its right to manage.

Deutsche Bank, overall, was pleased with the turnaround in operations at the Appin underground coal mine although remains disappointed about the outlook for costs and capital expenditure.

The mine has a long production history but has been volatile over recent years. Peak production of 9mt was achieved in FY15 but had fallen by more than -50% by FY18. This reflected the problems with the ramping up of the Appin 9 longwall mine, as the company was unable to operate both longwalls in parallel, largely because of elevated gas levels.

South32 has now reconfigured Appin's operations to reduce its footprint and complexity. UBS was disappointed with the Appin mine after the decision to run two longwalls, as low coal prices exacerbated the problems with the simultaneous operation. However, higher coal prices have now allowed management to address the issues and production over FY19 exceeded original expectations. Guidance has been lifted to 6.5mt.

Five development units are currently operating and Citi envisages this is the biggest risk for a two-longwall operation at Appin, given historical development rates. Macquarie agrees. The ability of the company to return to a three-longwall operation requires a material lift in development rates and the broker's production forecasts remain below guidance until this is achieved.

Dendrobium

The Dendrobium project expenditure, which extends the mine by 12 years, is budgeted at US$650-800m, well ahead of most broker estimates. UBS calculates the extension could mean capital expenditure is closer to US$250-300m per annum. Studies will continue for another year.

Citi assesses sustaining capital expenditure of around US$30/t. The broker considers this is high for an 8mtpa production outcome, as the company is running substantial service infrastructure and a large workforce.

The capital intensity of the project could deliver an internal rate of return of only 11.4%, yet Ord Minnett suspects there is some incentive in terms of the whole operation. While the project does not pass a typical return hurdle when viewed in isolation, if the company did not proceed, there would be a negative unit cost at Appin, as 80% of Illawarra Coal's costs are fixed.

Macquarie expects the company will proceed with the extension but, given the capital expenditure budget, assesses Illawarra Coal will now be a consumer of cash as opposed to a positive contributor to group cash flow. Cumulatively, over the next five years the broker expects capital Illawarra Coal will consume US$460m in cash versus a positive US$570m contribution to cash flow previously.

Capital Management

Going forward, Credit Suisse suggests the next catalyst will be further details on capital management as well as the June quarter production outcome. Cash will need to be deployed towards Eagle Downs, with an investment decision possible in the second half of 2020. While not modelling beyond the current program of buybacks, which is almost complete, Credit Suisse assesses plenty of scope for further distributions.

FNArena's database has five Buy ratings and three Hold for South32. The consensus target is $3.70, suggesting 13.1% upside to the last share price. Targets range from $3.20 (Macquarie) to $4.10 (Deutsche Bank). The dividend yield on FY19 and FY20 forecasts, at current FX values, is 5.1% and 4.5% respectively.

More On Investment Platforms Suffering Exodus

Yesterday's RBA rate cut has prompted more brokers to reassess their recommendations on listed independent funds management platforms.

-RBA rate cut threatens negative cash returns -Brokers disagree on extent -Industry funds the big post-RC winners

By Greg Peel

Yesterday FNArena published Investment Platforms Suffering Exodus, which highlighted the largest outflow of funds in decades from investment platforms and a large number of financial advisors leaving the market.

The Big Four banks, Macquarie Group ((MQG)), AMP ((AMP)) and IOOF Holdings ((IFL)) all suffered an extensive exodus of both funds and advisors in the wake of Royal Commission findings and subsequent regulatory tightening. Some of this money flowed into listed independent platform managers such as Hub24 ((HUB)) and Netwealth ((NWL)).

But while the independents have gained market share against the majors, they too have their own post-RC issues to deal with. On one side of the ledger, the majors have attempted to ease fund outflows by reducing fees, forcing the independents to respond to maintain market share growth. And greater regulatory requirements imply additional costs, hence margins are being squeezed from both sides.

Yesterday the RBA threw another spanner in the works for the independents. It was hardly a shock rate cut, but yesterday's article highlighted the risk of lower rates potentially swinging returns on cash balances held on platforms into the negative. And as such brokers have today published reports assessing the situation, particularly in light of the expectation of at least one more rate cut to come by year-end.

To make it more difficult for investors in independent platforms, analysts are in disagreement.

Negative Cash

An example is required to explain this risk. Bell Potter has conveniently provided one.

Netwealth recently won a contract to administer funds for fund manager ANZ Private ((ANZ)). ANZ pays Netwealth a "healthy" margin above the RBA cash rate and Netwealth passes on a discount to underlying clients. When the cash rate is cut, the amount paid to the client is also cut, so there is no impact on Netwealth's margin.

But wait, says Macquarie. Our analysis highlights cash returns on cash allocations if fully passed through will be a gross 50 basis points, but subtract the platform's administration fee and Netwealth's cash return becomes -9 basis points and Hub24's -6. Given the platforms are unlikely to expect clients to effectively "pay" to have a cash allocation in their portfolios, amidst a competitive environment the independents will be forced to lower their own margins.

Citi has joined the argument by suggesting Netwealth's cash margin is not directly impacted by a change to the RBA cash rate as the platform earns a spread from its banking facilities and the interest rate offered to clients, but believes the independents would need to sacrifice cash margins to offer a better rate to clients on their cash balances if interest rates go lower.

Bell Potter concedes there will be a modest impact if rates go lower, but only if the cash rate falls below 0.5% (from 1.0%) now.

Cash return arguments aside, the consensus view of analysts more generally is that the independent platforms will indeed continue to grow market share over time and as such are an attractive longer term investment. But in the short term, fee competition, ongoing advisor disruption and increased regulatory costs will all weigh on margins and thus on earnings.

Citi's report today echoes that sentiment, and supports the broker's Neutral rating on Netwealth.

Macquarie has cited both the abovementioned cash return issue in Australia, and an even greater squeeze going on in the UK where margins are already lower, in maintaining an Underperform rating on Hub24 and downgrading Netwealth to Underperform.

Bell Potter has gone the other way on Netwealth. Based on its dismissal of cash return issues, and marking to market to adjust for stronger equity and bond prices, and taking into account the share price fall which the broker sees as RBA rate cuts-driven, Bell Potter upgrades Netwealth to Buy.

Credit Suisse remains "hesitant" to be positive on "any" of the platform or wealth manager names at this stage, but from a different angle.

One palm up and one palm down

Brokers covering wealth managers and platforms have together acknowledged their surprise at the sheer extent of funds under management outflows in the March quarter – the most since 1991 – despite expecting the majors specifically to lose customers in the wake of the RC. The exodus of advisors was also foreseen, but it appears this outflow is also even more pronounced than expected.

But while brokers have highlighted the market share the independent platforms are gaining as a result, Credit Suisse has specifically noted that it's not a case of flows all heading the independents' way. Otherwise net flows would be flat, not the worst in decades.

So where has the money gone?

Well, aside from investors deciding, with disgust, that they might as well manage their own money rather than trust to the sharks exposed in the RC (note that as funds flow out of wealth managers, money invested in exchange traded funds is growing in total by the day), many have similarly decided that industry funds are the better option.

Yes, those relentless ads are working.

"While HUB and NWL are benefitting from the disruption in the market, the data demonstrates that the industry funds are getting the bulk of the money while the retail platforms fight over fees and the small flow remaining."

With regard the majors, Credit Suisse also points out the obvious that AMP and IOOF are still facing as yet unknown remediation costs while watching funds flood out the door and spending more to satisfy stricter regulations.

That's why Credit Suisse is hesitant to be positive on any of the platform or wealth manager names at the moment.

Credit Suisse has Neutral ratings on both Netwealth and Hub24.

So to update from yesterday, FNArena database brokers now have one Buy (or equivalent), three Holds and two Sells on Netwealth and one Buy, two Holds and two Sells on Hub24. Note that the lonely Buy in each case is Ord Minnett, who has not updated its view since May, and indeed on Netwealth, Ords downgraded in May to "Accumulate" from "Buy" in its five-tier system.

Because Ords is unique among FNArena brokers in having a five-tier rating system rather than the typical three, FNArena counts both "Buy" and "Accumulate" as "Buy".

Bell Potter is not an FNArena database broker.

Outlook Dour As Headwinds Buffet SpeedCast

Headwinds galore are buffeting SpeedCast International, as the company endures a substantial downgrade to earnings guidance. Brokers have taken shelter on the sidelines.

-Volatility likely to persist and maintain pressure on the stock -Over-geared balance sheet hinders upgraded ratings -A rebound in deepwater energy operations could improve satellite communications segment

By Eva Brocklehurst

Hampered by a range of negatives, SpeedCast International ((SDA)) has issued a substantial downgrade to earnings guidance, sending the stock sharply lower and brokers scurrying to pull back forecasts.

There are multiple sources for the downgrade to the current half-year. The company expects first half operating earnings (EBITDA) of US$60-64m, which compares with US$60m in the prior corresponding half and comes despite a US$8-10m contribution from Globecomm.

Full-year operating earnings guidance has been reduced to US$140-150m from US$161-170m. This requires a relatively stronger second half skew versus recent years, although Credit Suisse notes it does have a tailwind of an additional US$5-10m in reduced costs.

Macquarie points to a confluence of risks that have come to bear on the company. The maritime and cruise segment has been hit by churn, there was slower implementation of the VSAT backlog and technical issues with the Carnival contract. Also NBN contract delays and slightly lower energy revenue made their contribution.

The broker had foreshadowed these risks, having downgraded the stock to Underperform in April and, while operating issues and the risk of an equity raising overhang the stock still, valuation support could be provided by potential corporate activity.

Nevertheless, Macquarie acknowledges that while the business could be an attractive target, the likelihood is reduced in the near term because of volatility in current earnings. Hence, the rating returns to Neutral.

Positives?

A more positive view requires delivery of sustained organic revenue and earnings growth and confidence that recent operating issues are not structural in nature.

Credit Suisse reduces its estimates for earnings per share by -26% for 2019, making less severe adjustments to the outer years in the hope that the issues identified are indeed temporary. While the valuation appears appealing, an over-geared balance sheet does not support an upgraded rating and Credit Suisse sticks with a Neutral rating.

The broker points out there is limited downside flexibility before covenants are threatened. The main concerns centre around Globecomm, where the level of churn within the existing book is unsettling, being only six months into SpeedCast International's ownership. Credit Suisse is also concerned about the fact the Carnival upgrade is taking longer and there is no line of sight on remediation.

Moreover, the commercial maritime segment was considered a dependable growth engine but it appears the VSAT conversion is taking longer and there is higher customer churn.

The slump in the share price could prove to be an over-reaction, UBS accepts, although investors now have additional concerns beyond the near term, as bandwidth costs appear to be outpacing revenues. Most divisions appear to be growing revenue and the company is executing on its synergies and cost reductions. Yet operating earnings are still falling.

Covenants

Credit Suisse points out there is limited downside flexibility before covenants are threatened. If the company misses full year guidance again (a warning for 2018 results was also issued over the Christmas period), UBS agrees this could test covenants, which are around 4x, although in this scenario SpeedCast International could seek lender relief.

Even if the company cuts the dividend to zero, free cash flow could stay low in the second half. The broker calculates, if the lower end of the operating earnings guidance range is hit, net debt/EBITDA could be around 3.9x.

The company has indicated it is not considering a capital raising or asset sales at this point.

The broker assesses one key acquisition, Harris Caprock, is now the main driver of earnings. If an energy rebound eventuates and this delivers benefits to the deepwater operations then the upside could be material. Harris Caprock is now around 60% of the earnings base. UBS also wants more signs of stability before considering turning more positive, noting energy markets are volatile and an elevated debt profile could weigh on performance.

Canaccord Genuity assesses the stock is too highly geared for its current growth profile but does not expect banking covenants to be an issue. The broker calculates operating earnings would need to fall below US$122m in 2019 for a breach and given the natural skew to the second half, along with first half guidance, this should be achievable.

The broker, not one of the eight monitored daily on the FNArena database, maintains a Buy rating with a $2.79 target. Canaccord Genuity believes it is rare for global leaders in the satellite communications industry to remain this cheap and the most likely outcome is either a recovery in the share price or a takeover bid.

The database has three Hold ratings. The consensus target is $2.25, suggesting 26.4% upside to the last share price. Targets range from $2.20 (Credit Suisse) to $2.30 (UBS).

Is The Party Over For Australia's Insurers?

Is the party over for Australia's insurance sector? Catastrophe budgets need to rise, amid elevated compliance costs, and the question is whether price increases can continue to mitigate the downside.

-Falling yields require premium rate increases to neutralise margin risks -Market share losses could accelerate as new operators enter the market -General insurers have capital options and cost reductions as a positive

By Eva Brocklehurst

After two years of increasing premium rates Australia's insurance sector could be at a fork in the road. Will the defensive traits of general insurers counter elevated volatility and the continued uncertainty that overhangs the wealth sector more broadly?

Catastrophe budgets will need to rise amid elevated compliance costs, although general insurance remains Morgan Stanley's preferred exposure, despite falling yields and slowing premium rate momentum. Reasons behind the broker's view centre on momentum in commercial premiums, margin upside and capital options. Admittedly, falling yields require premium rate increases to neutralise the margin risks.

Australia is the only major market to have increased prices for commercial lines since 2013, which leads Macquarie to believe the pricing cycle could be over sooner than previously expected, and price increases should moderate over the next 12 months. Australian insurance pricing cycles typically last 7-8 years and insurers have been re-pricing at above-industry averages, which could accelerate market share losses as new operators enter the market.

Traditional reasons for premium rate increases such as reinsurance costs, offshore events and man-made incidents do not hold in the Australian market at present, and Macquarie suspects this explains why international insurers such as AIG, Zurich, Liberty and Chubb are expanding risk appetite in Australia.

Macquarie believes companies with a skew towards strata and SME (small-medium enterprise) risks such as Steadfast Group ((SDF)) and QBE Insurance ((QBE)) could experience a more extended cycle, while those with an emphasis on personal lines such as Insurance Australia Group ((IAG)) and Suncorp Group ((SUN)) in the direct channel could have a shorter cycle.

Insurers Versus Insurance Brokers

Macquarie's analysis shows the premium rate cycle, which occurs as premiums are written, is a strong leading indicator for the investment case of insurance brokers, while margin expansion, as premiums are earned, is a better indicator for insurers.

M&A and increased commissions from placement platforms may extend the cycle this time for insurance brokers, the broker contends, while the need to increase the perils allowance could mean insurers miss out on the benefits typically awarded at the top of the cycle.

The myriad issues plaguing insurers are behind the broker's continued preference for insurance brokers such as Steadfast and AUB Group ((AUB)) over IAG and Suncorp.

Stock Picks

QBE Insurance, which continues to exhibit strong fundamentals, is Morgan Stanley's top pick, with more than 5% earned rate increases and improving attritional losses. The broker also points out relatively benign catastrophe costs over the year to date can provide the capacity to absorb any crop losses.

On the other hand, Morgan Stanley believes IAG has had a strong run and downgrades to Equal-weight. While the investment case is robust, on the back of momentum in commercial rates, cost reductions and capital initiatives, the company is considered at risk of a rising catastrophe budget, amid lower yields and elevated compliance costs.

Suncorp is also downgraded to Underweight, as Morgan Stanley suspects the second half will show the business struggling to meet expected volumes in personal lines. There is also the need to re-price for a higher FY20 catastrophe budget as well as the impact of lower yields.

Credit Suisse has no Outperform ratings in the large cap insurance sector, continuing to envisage earnings risks across the board. The broker agrees with Morgan Stanley in that, if one has to hold an insurer, there is some support for QBE at current levels, albeit interest-rate reductions in the US remain a negative overhang.

That said, for the sector overall, the downside may not be all that significant. Domestically, Credit Suisse prefers Suncorp over IAG at current levels, as the valuation gap has opened up again and there is near-term earnings risk for Insurance Australia.

AMP ((AMP)) is without a strategy, in the broker's view, and difficult to own on a fundamental basis. Beyond general insurers, Credit Suisse retains an Underperform rating for Medibank Private ((MPL)), which faces a period of lower earnings growth while trading well above the rest of the sector.

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

Woolworths Takes A Gamble

Brokers assess the merits of a new entity, Endeavour Group, that will be formed from Woolworths' hotels and liquor businesses.

-Allows Woolworths to focus more on food & groceries -Enables Woolworths to distance gambling and liquor from its food business -Progress on leveraging business beyond food & groceries has been slow

By Eva Brocklehurst

As conglomerates continue to lose favour, Woolworths ((WOW)) has set about detaching its hotels and liquor business from the core supermarket chain. This eventually will leave discount department store Big W as the company's remaining non-food division.

A new entity called Endeavour Group is expected to be in place by the end of 2019, incorporating ALH hotels (a joint venture with Bruce Mathieson Group) and the Woolworths' liquor arm (Endeavour Drinks). BMG will swap its interest in ALH for a 14.6% stake in Endeavour Group versus its current 29% economic entitlement. Macquarie calculates this implies a slight value transfer to BMG.

The spin-off could mean Woolworths is debt free by FY21, Ord Minnett asserts, with a BBB credit rating for Endeavour Group supporting net debt of $1.4-1.8bn. Moreover, further capital management could be available to re-distribute some of the estimated $2bn in franking credits, post a $1.7bn off-market buyback.

UBS believes the separation, merger and subsequent sale planned for Endeavour Group is likely to mean $2bn in net debt is retained in Endeavour, in turn signalling the company can undertake further capital management in 2020. Endeavour Group, historically, accounted for around 25% of operating earnings (EBITDA) but around 15% of capital expenditure, suggesting relative under-investment.

Assuming the transactions go ahead, Morgans believes this will allow Woolworths to focus on food & groceries, where there is rising competition and higher costs as well as changing consumer preferences. It will also allow Endeavour Group to pursue growth opportunities and accelerate the store renewal program.

Management has admitted that investment has been constrained in this area because of the higher returns on offer in the food business. Morgans suspects the separation will allow Woolworths to exit its gambling exposure entirely in the future.

As a stand-alone entity the broker values Endeavour Group on an enterprise value of $10.5-11.5bn, based on a 14-15x multiple for FY20 forecasts. The valuation range represents a discount to the Australian food business, given lower returns. The broker notes Coles' ((COL)) sale of its Spirit Hotels business was executed at around 15x enterprise value/earnings.

The company expects one-off costs to be less than $275m and any additional or stranded costs to be offset through cost savings or growth. Yet Deutsche Bank does not believe the separation will be that simple, given the interdependence of property, loyalty programs, and the supply chain. A de-merger will add additional costs. Furthermore, cost savings and growth initiatives plan to mitigate costs could have been pursued even without a de-merger, in the broker's view.

Motivation

Macquarie suggests, as Woolworths is currently facing action from the NSW Independent Liquor and Gaming Authority regarding the illegal provision of alcohol to gambling customers, this was a likely consideration in deciding to divest. Woolworths has been under pressure to divest this business because of the adverse social consequences of problem gambling. Deutsche Bank agrees the main benefit in the de-merger will be the isolation of the gambling exposure.

The separation of gambling operations from food will allay some investor concerns, Morgan Stanley acknowledges, although Woolworths will retain up to a 15% minority stake. Earnings in both liquor and hotels declined in the first half of FY19, reflecting the challenges these businesses face, so the broker expects management to focus on generating sales/earnings momentum ahead of the de-merger.

Credit Suisse points out the Woolworths' Dan Murphy's liquor chain is lagging in digital, online and delivery initiatives and there is growing demand for a stronger convenience offering, so management appears to be addressing some of the complexity associated with running the hotels and liquor businesses.

Woolworths' Future

Ord Minnett observes the company has become more open about plans to leverage the broader business beyond food. This is evident in the Marley Spoon ((MMM)) stake and the wholesale and rewards arrangements with the sale of the petrol business. However, progress has been slow and execution risk is higher, while these are long-dated drivers in the broker's view.

Citi has pointed out German competitor, Kaufland, is entering the Australian grocery market and this may be a catalyst for a resumption of price war for private-label groceries. Meanwhile, there is a pending rent review for some of the ALH hotel properties. ALE Property ((LEP)) owns around 26% of the ALH pubs and a review of 79 out of the 86 assets is ongoing.

FNArena's database has four Hold ratings and three Sell. The consensus target is $29.96, signalling -12.0% downside to the last share price. Targets range from $26.84 (Macquarie) to $32.90 (UBS).

Why Are Central Banks Buying Gold?

Richard (Rick) Mills Ahead of the Herd

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

Why are central banks buying gold and dumping dollars?

The US Federal Reserve, the country's central bank, did what many expected last Wednesday, and held interest rates steady, while signaling that a rate cut is on its way.

Despite pressure from President Trump to lower interest rates, the Federal Open Market Committee (FOMC) concluded after a two-day meeting that it will stay pat for now, meaning no change to the 2.25% to 2.5% range on the federal funds rate. Nine of 10 FOMC members voted to keep rates unchanged.

Language here is important. The Fed reportedly dropped its pledge to be "patient" on widely anticipated rate cuts, meaning it could be poised to act. Also, Reuters said, Fed Chair Jerome Powell stopped referring to below-target inflation as "transient".

Reading between the lines gold traders took the message and ran with it, with the precious metal's price hitting a five-year high.

Gold runs to $1,366

The result was an immediate jump in the gold price at 2 pm EST, with spot gold spiking to around [USD]$1,354 an ounce, then continuing its upward climb to set a new record of $1,360.10 - its best close since Jan. 25, 2018. [Subsequently rising to $1423/oz] The rise in gold futures was even more dramatic, with gold for delivery in August rocketing to a fresh high $1,366.60. The last time bullion was priced that high was just over five years ago.

"The Committee continues to view sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective as the most likely outcomes, but uncertainties about this outlook have increased," the Fed's statement said.

That's putting it mildly. Read Dancing close to the exits to learn about all the economic headwinds blowing in America's direction right now, including weak jobs numbers, trade war jitters, deteriorating business confidence and a yield curve inversion (10-year versus 3-month) which is an almost flawless recession indicator.

In short, everything we as gold investors want to see, along with a falling dollar which is likely to occur as well if interest rates are lopped.

Bonds getting crushed

According to the CME Group's FedWatch tool, traders are pricing in an 80% chance of a rate cut in July and a 70% of another reduction in September.

Gold's gains were at the expense of bond yields. The yield on the 10-year benchmark fell to a 21-month low (ie. September, 2017) at one point during the day, 2.017%, before recovering a tenth of a point to finish trading at 2.02%. The 10-year hasn't fallen that low since Trump was elected on Nov. 8, 2016. [Subsequently falling to 2.00%]

10-year T-bill yields are a key economic indicator, because they gauge investors' confidence in the economy.

When confidence in the economy is low, investors would rather park their money in bonds than riskier stocks - causing bond prices to rise and yields to drop. When confidence is really low, investors prefer to invest in short-term bonds, knowing the government is more likely to pay them back with interest on a short-term versus a long-term bond.

Long-term Treasuries normally have a higher yield than short-term T-bills, because it takes a higher interest rate to attract investors to stay in a bond for 10 to 30 years. However right now, some yield curves (eg. 3-month, 3-year) have inverted, meaning short-term Treasuries pay higher interest than long-term Treasuries. This is known as a yield curve inversion; it has predicted every recession of the last 60 years, and is therefore closely watched.

Things are even worse in Europe's sovereign bond markets. Mario Draghi, the president of the European Central Bank, said that "in the absence of any improvement", referring to low growth and low inflation, more stimulus will be needed to goose the European Union's economy. That could include interest rate cuts or a return to quantitative easing, where the ECB, like the Fed, prints currency to purchase government bonds.

After Draghi signaled two rate cuts this year as the solution, the euro sunk 0.3% against the dollar, prompting Trump to complain on Twitter that a weaker euro made it easier for Europe to compete against the US. "They have been getting away with this for years, along with China and others," the president wrote.

However, if the ECB does decide to cut rates, they will be falling further into negative territory - a situation far different from when rates were higher and had more room to drop, post-financial crisis. Hard to imagine too many investors will be lining up for a bond whose rate of interest is actually declining...

But they are. Global tensions such as a potential war with Iran, unresolved trade disputes and anemic global growth, just to name three problems, are forcing investors into safe havens like government bonds, even though their rates are abysmal.

Incredibly, the European Central Bank has already whittled its rates down to below zero, as have four other central banks: Swiss National Bank, Denmark, Sweden and the Bank of Japan. The rates range from -0.1% to -0.8%.

Bond prices have surged and yields have tumbled (the two move in opposite directions) especially in Europe; the yield on Germany's 10-year bond sunk to a record low, and the yield on France's 10-year briefly turned negative, Marketwatch reported.

The value of government bonds with negative yields has reportedly swelled to $11.8 trillion, as of June 17. In fact, sovereign debt is more popular right now than tech stocks. "The move is part of a larger trend that saw the [Bank of America Merrill Lynch Fund Manager Survey]'s 79 participants move away from risk and toward positions that reflect fear of a coming economic slowdown spurred by a spreading trade war," said CNBC.

Clash of currencies?

Trump's comments re Draghi in Europe and his continual belittling of Jerome Powell - the president reportedly sought a way to fire him for keeping interest rates too high - is actually nothing new.

They are part of a larger plan by the Trump administration to keep interest rates and the dollar low. This is a shift from his predecessors in the White House who have lobbied for a strong dollar.

But for Trump, a low dollar is the way to bring jobs back to the US after many were exported abroad to take advantage of lower labor costs, and therefore rebuild the US manufacturing sector, primarily, through cheaper exports. He's particularly targeted China for competitively devaluing its currency, the yuan, to dump cheap exports into the US.

Here's what Trump said on the campaign trail in 2016: "You look at what China is doing to our country in terms of making our product. They're devaluing their currency, and there's nobody in our government to fight them… they're using our country as a piggy bank to rebuild China, and many other countries are doing the same thing." "Our country's in deep trouble. We don't know what we're doing when it comes to devaluations and all of these countries all over the world, especially China. They're the best, the best ever at it. What they're doing to us is a very, very sad thing."

The question is, have we moved from a trade war to a currency war, and if so, what would that mean? Trump's comments about Draghi appear to suggest a hardening of his stance against competitive devaluations. (The ECB chief responded, by the way, by saying "We don't target the exchange rate" of the euro).

But as one commentator writes, Trump is playing a dangerous game that could lead to a currency war, in which countries keep slashing the value of their money in order to gain a trade advantage ie. lower-priced exports.

"Any economy that is suffering from a prolonged bout of undesirably low inflation is likely to favor a weak currency," Jane Foley, a senior foreign exchange strategist at Rabobank, was quoted by CNN Business. "If several economies find themselves in the same boat coincidentally, the prerequisite conditions for a currency war are set."

A communique from a G-20 meeting earlier this month states that finance ministers and central bankers have agreed that a currency war is in no country's interest, and reaffirmed a commitment to refrain from competitive valuations.

However Trump, never one to bow to convention, could easily break the toothless commitment. A Bloomberg article on the subject notes that if the euro keeps dropping it may incite Trump to follow through on a threatened tariff on imported cars and car parts from the EU. Presumably the same spiral of currency devaluations and tariffs could apply to the China-US trade war, if China decides to devalue the yuan to gain an advantage over the US.

Central Bank gold buying

Along with the expectation of a looser economic policy, ie., lower interest rates, the gold price is also currently being supported by major central bank buying. The buying is taking place at the expense of US Treasuries.

Why are they buying? Gold prices usually go up when real interest rates turn negative, in other words, when interest rates minus the rate of inflation go below zero. While we aren't there quite yet, taking a look at the 10-year benchmark Treasury yield reveals a rate of interest that has been dropping for some time.

Central banks purchase US Treasuries to bulk up their foreign exchange reserves. They do this especially during periods of unrest, or when the economic forecast is bleak. Gold's role as a safe haven is well-documented. Of course Treasuries are as much or more sought-out by investors in a crisis or pending crisis, but lately, Treasuries have become much less popular as a means of storing wealth.

The reason is simple: T-bills don't offer a good return, and neither do other sovereign debt instruments - as mentioned, five important central banks are offering negative rates.

Looking at the 10-year yield chart, we see the yield starting to go down last November, falling steadily all the way to its current 2.02%. Subtract 1.8% inflation and the yield, just 0.22% begins to look pretty skinny.

There's an old saying on Wall Street "Six percent interest will draw money from the moon." And it's true, but what is also true is 1. As long as real interest rates are below 2% gold is in a bull market and 2. Real interest rates below 2% draws investors to gold.

Central banks know this, so do educated gold buyers.

With Treasury notes paying such low net yields, gold becomes an attractive investment. And while the precious metal offers no yield, its status as an inflation hedge and store of value not subject to fiat currency manipulation are good reasons for central banks to purchase gold.

It doesn't take an economist to see what's happening here. Central banks see Treasury yields slumping and real yields low, and likely on their way negative, so they are backing up the truck for gold. They see gold continuing to increase in value.

According to the World Council, central banks are continuing a buying spree that stretches back to 2018. A total of 651 tons of gold was accumulated last year, 74% more than 2017 and the highest amount since the end of the gold standard in 1971.

So far in 2019, central banks have squirreled away 207 tons in bank vaults, the highest year-to-date purchases since central banks became net gold buyers in 2010. (before that they were net sellers, selling more gold than purchased).

On a quarterly basis, central banks bought way more gold in the first quarter of 2019 than Q1 2018. The WGC reports first-quarter purchases were the highest in six years, rising 68% above the year-ago quarter. It was the strongest start to a year for gold buying since 2013.

Russia and China were the top two purchasers, particularly Russia which has been trying every means available to diversify away from the US dollar - such as selling US Treasuries and signing energy deals with China whereby the transactions are in yuan or rubles, not USD. The Central Bank of Russia loaded up on 274 tonnes.

China has increased its monthly gold purchases by nearly 50%, to 15 tonnes a month, according to Kitco, with the Philippines' central bank announcing plans to buy up to 30 tonnes of bullion a year. Other leading purchasers were Turkey, Kazakhstan, India, Iraq, Poland and Hungary, the World Gold Council report states.

The annual survey also said none of the central banks plan on reducing their exposure to gold over the next year from May, with 18% saying they plan to increase their bullion holdings.

The 2018-19 gold-buying spree is being driven by the de-dollarization of countries like Russia, China and Turkey which have an axe to grind with the US. They want to get out from under the thumb of Uncle Sam.

Forbes notes central banks' motivations for buying gold are different than they were in previous decades when the financial system was back-stopped by gold:

In the distant past, central banks had to buy gold because of its vital role in the global financial system. Now they are choosing to do so because they are worried about the dollar. In other words, they've been scared into this bullion buying binge.

Jeff Christian, managing partner at CPM Group, a New York-based commodities consultancy, agrees. "Today central banks are buying gold to diversify their monetary reserves," says CPM's Christian. "Most central banks want to diversify away from the dollar."

He gives the example of Russia where, as Forbes reports, the change may be partly driven by the need to ditch dollars and unentangle their countries from the US banking system.

Dumping Treasuries

Central bank gold buying is only one half of the equation we are presenting. The other half is the buying and selling of US Treasuries. Is it safe to assume that if central banks are buying gold, they are also selling, or buying, less Treasuries? If only it were so simple.

Russia and China certainly fall into that category. The Central Bank of Russia sold 85% of its Treasuries last year while at the same time loading up on gold. China resumed adding gold to its reserves last December (and has continued to do so) while at the same time it dumped $69 billion in Treasuries in 2018.

However, foreign investors of US debt, including central banks and private companies, reportedly raised their holdings of US Treasuries between April of last year and April of this year, by $253 billion, to a total of $6.43 trillion.

Here's where it gets complicated. Wolfstreet tells us that over the same period, the US national debt climbed by $960 billion to around $22 trillion. So the share of the debt held by foreign investors actually dropped to 28%, from 34%.

That means some other entities must have bought the $707 billion difference ($960B minus $253B). According to Wolfstreet, of the $22 trillion national debt, foreign investors including central banks only own $6.4 trillion. The majority of US government paper is held by US government entities, which piled on $102 billion, and American institutions and individuals, which bought a whopping $876 billion in T-bills, year over year until April 30. This latter group represents $7.6 trillion of the national debt, or 34%. The remaining $5.8 trillion is held by US government entities, with the Federal Reserve owning just $2.1 trillion.

The two takeaways here, are that since 2015, foreign debt holders have been gradually moving away from T-bill purchases. Whereas the percentage of the national debt owned by foreign entities rose almost every year from 2001 to 2015, since then, it has gradually dropped, to 28%. And second, it's American institutions and US citizens who own most of the country's mounting pile of debt, not central banks or the Federal Reserve.

Conclusion

The US dollar is the most important unit of account for international trade, the main medium of exchange for settling international transactions, and a store of value for central banks.

Yet central banks no longer consider the USD the "gold standard" of foreign exchange. As large Treasury holders like China and Russia "de-dollarize" in favor of other debt instruments that don't tie them to the US banking system, the dollar is losing its "exorbitant privilege" we have written about before. Gold is the beneficiary of this change.

Central banks backed up the truck for gold in 2018, buying 651.5 tonnes versus 375 tonnes in 2017. That's the largest net purchase of gold since 1967. And the buying spree appears to be continuing.

Wednesday's spike in the gold price shows that gold is the play for investors right now. We know that gold prices go up when real interest rates go negative. The net 10-year yield hasn't yet gone below zero but it's pretty close, currently 0.22%. Central banks have some very smart people working for them. They see real yields dropping, a yield curve inversion predicting an energy spike (war with Iran) and gold climbing. Why buy a bond that pays you 0.22% real interest, or possibly going to a negative rate of interest?

As we see it, things are only going to get worse for Treasuries and better for bullion. Think about it. We have a number of indicators pointing to an economic slowdown, both globally and in the US. We have an inverted yield curve on 10-year/ 3-month Treasuries); inversion presages a recession within 14 months with almost 100% reliability. There are several hot spots in the world that boost safe haven demand, like Iran, the South China Sea, Yemen, just to name a few. We have an unresolved trade war with China and a revised NAFTA agreement that has yet to be ratified. A trade fight between the US and the EU over autos is also brewing. Central banks are dumping Treasuries and buying gold. There's a global movement afoot to increase stimulus to goose flagging economies, evidenced by low inflation. If the Fed does go ahead and lower rates, the dollar will follow suit. It may keep falling if a currency war ensues, which becomes more and more likely the longer we go without a China-US trade deal.

Unless something drastic happens, like Trump finding religion in "Xism", or backs off on Iran (Iran shot down a US drone and the US will retaliate), or the Fed reverses course and raises interest rates, it's the perfect storm for gold.

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

Material Matters: Gold, Base Metals & Iron Ore

A glance through the latest expert views and predictions about commodities. Gold; base metals & miners; and iron ore.

-Gold stocks find support and now trading at significant premiums -Copper price weakens despite improving fundamentals -Nickel price recovers but not considered buoyant -Aluminium surplus expected to wind down from 2020 -Fortescue Metals best performer on ASX 300 metals & mining index in March quarter

By Eva Brocklehurst

Gold

Credit Suisse increases near and medium-term gold price forecasts because of supportive macroeconomic and geopolitical factors. While the broker has been positive about gold since late 2018, forecasts for mid to late 2019 were proving conservative relative to spot and forward prices.

Credit Suisse now estimates gold prices will average US$1327/oz in 2019, rising to US$1350/oz in 2020, while long-term forecasts for US$1300/oz are unchanged. All gold stocks are trading at significant premiums to the broker's base case valuations with Newcrest Mining ((NCM)) the most expensive on a spot basis. Credit Suisse continues to assess Alacer Gold ((AQG)) is offering the most upside and it is the only Outperform

in the broker's gold coverage.

Base Metals

Citi is bullish on a three-month basis for base metal prices, assessing there are benefits from the "handshake" between US President Donald Trump and China's Xi Jinping. On a 12-month basis the broker envisages the highest upside is in copper. Credit Suisse revises forecasts for base metal prices, mostly lower, given deteriorating global economic conditions and tensions between the US and China. Copper is the most affected by sentiment because of its traditional use as an investment in global growth and the macro outlook is poor.

The copper price has weakened this year despite improving fundamentals from the emergence of a sizeable underlying deficit because of mine underperformance. From 2020, the broker expects mine expansions will exceed modest global consumption growth so copper should move back into surplus.

Credit Suisse forecasts a deficit in 2019 of around -500,000t, because of widespread reductions in copper production. Copper forecasts have been lifted, albeit modestly, and the broker forecasts US$6255/t in 2019 and US$6173/t in 2020, upgraded by 2% and 8% respectively.

Credit Suisse prefers OZ Minerals ((OZL)) over Sandfire Resources ((SFR)) although both are trading at premiums to value. Macquarie is forecasting a modest decline in output at Prominent Hill, although its 2019 forecasts for Oz Minerals remains within guidance. Progress on Carrapateena is likely to overshadow the June quarter production result. Sandfire is expected to report an improved production outcome at DeGrussa although the focus in the quarterly is likely to be the recent acquisition of MOD Resources.

Nickel prices have recovered from lows in late 2018 but these are also less buoyant. A glut of stainless steel sheet continues to put pressure on the market as China, which has high levels of inventory, reduces imports from Indonesia. Nickel now faces the challenge of rapid growth in Indonesian supply and a threat to global consumption arising from the US/China trade war.

UBS believes the opportunity in nickel remains intact although battery demand is still one-two years away. The broker does not necessarily believe that long-term nickel prices need to be higher, with new nickel units from Chinese facilities in Indonesia possibly not requiring super-high incentive prices.

Credit Suisse now delays an expected rise to US$6/lb to 2021, when the current wave of nickel plant developments may have slowed. In nickel, the broker prefers Western Areas ((WSA)) to Independence Group ((IGO)) on valuation and mine life.

Macquarie expects the upcoming quarterly reporting period will be positive for Independence Group and expects it to beat production guidance for FY19. Nova is expected to lift output of nickel and copper over the top end of the company's guidance ranges.

Western Areas has delivered consistent results, the broker observes, and production and cost guidance should be comfortably achieved. Macquarie retains a preference for both OZ Minerals and Independence Group, given strong operating margins and exposure to gold. Of interest, progress on the raise bore is critical to excess in Panoramic Resources' ((PAN)) higher-grade Savannah North project.

Aluminium prices have been reduced to the lowest levels since 2016. Credit Suisse highlights, as aluminium is not as widely used for investment as copper, a lot of the weakness may reflect fears about supply and demand. Large surpluses continue to be experienced in China.

From 2020, the broker expects the surplus should begin to wind down as China's domestic demand and exports weaken. The broker envisages little prospect of the aluminium price achieving and sustaining US$0.90/lb soon but maintains a more positive medium-term outlook amid steadily-rising Chinese capacity utilisation.

Credit Suisse reduces alumina forecasts as a return of Alunorte to full production has caused a swift retracement in prices, despite no tonnage having reached the market as yet. Citi agrees Alunorte's move to full production has reduced visibility on 2020 alumina prices and the pace of China's refinery re-starts will be key. The broker downgrades Alumina Ltd ((AWC)) to Neutral as the shares are near the target.

In 2020, Credit Suisse expects global trade flows of alumina will have been been re-established and the Australian price should average US$360/t, based on import price parity with Shanxi costs and an Australian premium of RMB70/t. Yet, even with a high alumina price, the broker suspects there will be insufficient bauxite supply in Shanxi.

Low inventory at exchange warehouses has supported the zinc price, while Credit Suisse suspects a shift to a surplus market has only been delayed. Much of the lack of refined material has been blamed on the curtailment of Chinese smelters, as opposed to a fundamental lack of supply. The broker remains cautious about prices, suspecting smelters are now incentivised to produce more. The broker expects increases in output to continue, lifting inventory and putting further pressure on zinc prices.

Iron Ore

Rio Tinto's recent guidance on output signals lower Pilbara fines supply from Australia over coming months, Citi observes. This could further tighten the high-grade iron ore market and support benchmark prices at higher levels than previously anticipated. Citi now forecasts benchmark prices of US$100/t and US$95/t in the September and December quarters of 2019. Tightness may also continue into 2020 if the company's grade issues persist.

UBS notes the best performer in the March quarter from the ASX 300 metals and mining index was Fortescue Metals ((FMG)), up 33%, followed by Iluka Resources ((ILU)), up 21%, and BHP Group ((BHP)) coming in third, up 7%. Citi has downgraded Iluka Resources to Neutral as a result of reaching the broker's target.

Laggards in the index were Galaxy Resources ((GXY)), down -30%, Syrah Resources ((SYR)), down -20%, and South32 ((S32)), down -13%, reflecting weak lithium and graphite prices over the quarter.

UBS finds the mining industry has continued to be disciplined over the period, repairing balance sheets, and shareholder returns should now be the focus. Key to base metals, in the broker's view, is a move towards resolution of the US/China trade conflict, while iron ore port stocks in China should be watched for signs of a more balanced market.

UBS has upgraded forecasts for metallurgical coal, gold and iron ore (2019 only) while reducing forecasts for base metals, thermal coal, lithium and graphite. The broker expects further price pressure in the latter two as additional supply enters the international market.

Weekly Ratings, Targets, Forecast Changes

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

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

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

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

Summary

Period: Monday June 24 to Friday June 28, 2019 Total Upgrades: 13 Total Downgrades: 19 Net Ratings Breakdown: Buy 39.52%; Hold 44.44%; Sell 16.03%

Against a background of equities enjoying a stellar ride higher, stockbroking analysts are unusually busy issuing downgrades and upgrades for individual ASX-listed entities. For the week ending Friday, 28th June 2019, FNArena registered no less than 13 upgrades in recommendations and 19 downgrades.

Irrespective of the quite impressive looking tally, the underlying observation remains that individual stock ratings are trending towards the Neutral/Hold zone.

Out of all recommendations for the eight stockbrokers monitored daily by FNArena, more than 44% are now carrying a Hold/Neutral rating versus 39%+ in the Buy zone and the remaining 16% on Sell. This marks quite an unusually large gap between Hold/Neutral ratings and Buys.

A reflection of positive sentiment ignoring the tough macro-environment that is keeping a lid of corporate profits?

All of the eight stockbrokers are now carrying more Hold/Neutral ratings than Buys.

Nevertheless, a positive trend seems to be emerging in valuations and price targets where analysts are lifting their numbers for stocks including Collins Foods, Northern Star, Bingo Industries, Growthpoint Properties, and Mirvac. With exception of perennial underperformers Syrah Resources and Metcash, there is literally not much happening on the negative side.

But then, this week's tables for earnings estimates show a busy crowd of analysts equally cutting estimates at high speed, just as companies including Pushpay Holdings and Alacer Gold are enjoying noticeable increases. Here, however, the balance is overwhelmingly weighted to heavy reductions with stand-out names Galaxy Resources, Syrah Resources, Caltex Australia, Aveo Group, and Viva Energy Group.

Investors will be hoping the upcoming reporting season in August will turn the trend in corporate profits. How else can this year's share market buoyancy continue for much longer?

Upgrade

CALTEX AUSTRALIA LIMITED ((CTX)) Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 3/4/0

Caltex's operations have been under pressure causing the share price to fall and investors adopting a more negative view. Morgan Stanley analysts think Caltex management will respond. In anticipation, they have upgraded to Equal-weight from Underweight.

The analysts do add success from management's response will depend on the extent of fuel margin compression across the industry versus cost-out initiatives and/or property divestments.Target is $24. Underweight. Industry view: In-Line.

Note: Both EPS and DPS estimates have received a noticeable haircut.

CROWN RESORTS LIMITED ((CWN)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 1/5/0

Macquarie has examined the strategic rationale for the Crown Resorts-Melco Resorts bid and has given it the thumbs up, pointing to the resulting revenue synergies and stronger penetration into the Asian premium market.

The broker believe the deal could offer 17% upside to the Crown share price, on a valuation basis. However, the broker notes that the near-term fundamentals are underwhelming as the US/China trade war continues to hurt VIP trade and the domestic environment faces its own hurdles.

The broker cuts earnings-per-share estimates -2% out to FY21 to recognise the removal of the share buy-back. Price target rises to $12.60 to reflect a 50:50 spread across fundamentals ($11.20 a share) vs Melco Resorts takeover at $14 a share.

Given the potential for a higher bid, the broker upgrades to Outperform from Neutral.

DOMINO'S PIZZA ENTERPRISES LIMITED ((DMP)) Upgrade to Buy from Neutral by Citi .B/H/S: 2/3/2

Domino's Pizza has been upgraded to Buy from Neutral at Citi with a slightly reduced price target of $44 (was $45.60) on the observation this stock offers excellent exposure to further store roll outs in Europe.

Citi analysts are forecasting 13% EPS CAGR between FY18 and FY22. They do think FY19 guidance seems "stretched", but also that this is already reflected in the share price.

All in all, Citi suggests the risks in Australia are well understood by investors while the upside from European store openings is not yet priced in.

GROWTHPOINT PROPERTIES AUSTRALIA ((GOZ)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 0/2/1

Growthpoint Properties has announced a $150m institutional placement and a $15m share purchase plan.

The company reaffirmed FY19 guidance and guided to an FY20 rise of 1.8%.

Macquarie breaks this down into 4% dilution from the placement; 2.6% accretion from a $475m breaking of swap contracts to a lower hedged debt rate; and 1% accretion from the acquisition of a $50m metro office building. Combined, the broker estimates the impact to be a less-than -1% dilution in earnings before the deployment of proceeds.

The broker tinkers with earnings-per-share estimates and the target price rises 15.3% to $4.08 from $3.54 to reflect stronger cap rate compression assumptions.

Broker upgrades to Neutral from Underperform, expecting the company to benefit from the rosier bond outlook.

GALAXY RESOURCES LIMITED ((GXY)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 3/2/0

Macquarie downgrades Galaxy Resources earnings-per-share estimates -20%, -3% and -3% across FY21-23 following news of delayed spodumene shipments, recent softness in the seaborne spodumene market, and higher debt and associated interest expenses following the Alliance equity investment.

Twp shipments of spodumene concentrate have been shipped from Mt Caittlin this quarter, another has been pushed into the September quarter. The target price falls to $1.30 from $1.50. Upgrade to Neutral from Underperform on valuation grounds.

See also GXY downgrade.

MYER HOLDINGS LIMITED ((MYR)) Upgrade to Neutral from Sell by UBS .B/H/S: 0/3/2

Myer has underperformed the index by -24% in June, which leads UBS to suggest the current valuation is fairly pricing in upside potential from the company's turnaround strategy. The broker sees the opportunity to hand back 18 floors of leased space for a saving of $18m by FY23, and further opportunities around cost-outs and exiting unprofitable categories.

Nonetheless, the broker warns a lack of improvement in trading post-election suggests the risks are balanced. Enough for UBS to upgrade to Neutral. Target unchanged at 59c.

NRW HOLDINGS LIMITED ((NWH)) Upgrade to Hold from Sell by Deutsche Bank .B/H/S: 1/2/0

The share price has now fallen far enough to warrant an upgrade to Hold from Sell, report analysts at Deutsche Bank. No other changes have been made.

PACT GROUP HOLDINGS LTD ((PGH)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 2/3/0

Pact Group has refinanced a $380m July 2020 debt facility out to January 2022, reducing the likelihood of an equity raising. Given guidance has been confirmed, Macquarie upgrades to Neutral from Underperform and increases the target price to $2.81 from $2.66.

The broker says the company can now look forward to higher earnings to reduce debt levels, rather than equity, and says it should be aided by a slow recovery in raw material costs, network redesign, full-year impact of the TIC acquisition, and crates expansion with Aldi.

Macquarie downgrades earnings-per-share estimates -6% and -4% to account for the expected growth trajectory, awaiting input from the new chief executive officer Sanjay Dayal.

SANDFIRE RESOURCES NL ((SFR)) Upgrade to Hold from Reduce by Morgans and Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 3/4/1

Sandfire Resources has agreed to buy MOD Resources ((MOD)) for a cash and scrip equivalent of $167m. The cash component is $42m and the scrip component is 45c per share.

Morgans says, at first glance, the deal offers exploration upside and strategic value given the provincial tenure. Morgans increases its target price to $6.96 from $6.84, primarily to reflect lower $A forecasts.

The broker upgrades to Hold from Reduce to reflect the share-price retreat following the announcement.

Ord Minnett has upgraded to Accumulate from Hold on the news Sandfire Resources intends to acquire MOD Resources ((MOD)), noting the proposed deal will increase the company's share count by about 12%.

Clearly, the broker likes the deal, citing net addition to Net Present Value of potentially up to $1 per share, an internal rate of return of 15% post acquisition costs and upside from further exploration.

The analysts do acknowledge there now is additional geopolitical risk along with added development risk associated with a project based in Africa (Botswana). Target price unchanged at $8.

TELSTRA CORPORATION LIMITED ((TLS)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 3/3/2

Macquarie notes Optus has increased its post-paid pricing, suggesting competition in mobile is stabilising. Recent competition will still need to flow through, the broker notes, but Telstra will benefit if mobile returns to growth.

Macquarie has ticked up its mobile growth and thus earnings expectations and reduced its valuation discount rate due to lower bond prices. Target rises to $3.75 from $2.90. Upgrade to Neutral.

VIVA ENERGY GROUP LIMITED ((VEA)) Upgrade to Overweight from Equal-weight by Morgan Stanley .B/H/S: 5/1/0

Morgan Stanley upgrades to Overweight from Equal-weight on the expectation that forecasts are close to bottoming. In addition, refining offers potential for significant upside medium term, argue the analysts.

The analysts also suggest greater evidence of Viva Energy's retail strategy expansion delivering positive results should start emerging. Lower margins in comparison with rival Caltex Australia ((CTX)) are seen as a form of protection in difficult times.

Target lifts by 5c to $2.35. Industry view is In-Line.

VOCUS GROUP LIMITED ((VOC)) Upgrade to Buy from Neutral by UBS .B/H/S: 2/5/0

UBS suggests the reason Vocus has de-rated is the swiftness with which recent suitor AGL Energy ((AGL)) and others before it, had walked away from a deal after access to due diligence, raising concern in the market. But the broker believes the key reason AGL bailed is that it could not hit its rate of return requirement at the $4.85 bid price.

While UBS still has its own reservations about the business, the broker upgrades to Buy now the stock has pulled back far enough that returns for a suitor are more achievable, implying an unpriced option value on enterprise execution. Target unchanged at $3.85.

Downgrade

ALUMINA LIMITED ((AWC)) Downgrade to Neutral from Buy by Citi .B/H/S: 1/4/0

A general update on metals producers in Australia has revealed a downgrade for Alumina ltd to Neutral from Buy. This is the result of the share price moving near the broker's price target, which has remained unchanged post the general sector update.

BINGO INDUSTRIES LIMITED ((BIN)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 2/1/0

At its investor day, Bingo noted the integration of Dial-a-Dump is going well and -$5m of cost savings have been realised thus far. Ahead of Queensland introducing a waste disposal levy from July1, Bingo plans to increase NSW pricing by 20-25%, however visibility on traction, the broker notes, is thus far low.

With the closing of the Dial-a-Dump deal mitigating risks and progress in capacity additions underpinning Bingo's growth trajectory, Macquarie lifts its target to $2.35 from $2.00. The share price has now enjoyed a recovery off its lows to a 24% premium to the ASX200 Industrials and here Macquarie sees valuation as fair. Downgrade to Neutral.

COLLINS FOODS LIMITED ((CKF)) Downgrade to Hold from Add by Morgans .B/H/S: 2/1/0

Collins Foods' FY19 result met the broker, with the Australian KFC business outperforming by roughly 3%, thanks to improved margins. Morgans notes strong cash conversion helped fund a 50% dividendend payout, $63m in capital expenditure and pay down roughly $15m in debt.

The broker estimates the 25 Australian stores set to open in FY20 should yield 10% top-line growth. However, a weaker performance from KFC Europe, on top of a higher tax bill and share dilution, have caused the broker to cut earnings-per-share forecasts -2.9%, -3.8% and -3.1% across FY20/FY21/FY22.

The broker appreciates the company's defensive growth profile and believes it justifies the FY20 price-earnings multiple of 18.6x, but downgrades to Hold from Add to account for the recent share price strength. Target price rises to $8.20 from $7.78.

FLEXIGROUP LIMITED ((FXL)) Downgrade to Hold from Add by Morgans .B/H/S: 4/2/0

FlexiGroup has issued new profit guidance and a review of its commerical strategy, which will involve divesting its equipment finance book. The broker views the May addition of major retailers including Myer to its Humm Buy Now Pay Later platform as positive but remains cautious.

Morgans believes the divestment of the equipment finance book is sensible, and would see it join Eclipx Group ((ECX)) and Thorn Group ((TGA)) on the market, possibly triggering private equity interest.

Broker cuts earnings per share forecasts -12% and -10% across FY20/21 to reflect a slower recovery in the AU Card impairments, and lower Commercial earnings following the equipment finance divestment.

Morgans moves to Hold from Add, awaiting greater certainty on the earnings trajectory. Target price eases to $1.80 from $1.83.

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

Genex Power is raising another $16m from sophisticated investors and $3m from shareholders, which, on top of the recently announced JPower deal, has diluted shares by -9%, well beyond the broker's estimate.

This has triggered a downgrade from Morgans to Speculative Buy from Add. Target price falls to 32c from 33c.Morgans says the extra raising may simply be for a buffer, given debt figures have yet to be determined.

Meanwhile, KS1 is to be refinanced with new debt. Morgans believes there is still upside, but the amount of upside has been reduced while the risks have risen.

GALAXY RESOURCES LIMITED ((GXY)) Downgrade to Neutral from Buy by UBS .B/H/S: 3/2/0

UBS downgrades Galaxy Resources to Neutral from Buy to reflect continued weakness in the lithium-carbonate market.

The broker says the company's operations have improved and its cash position is strong enough to develop Sal de Vida (Galaxy said it was formally closing the sale process) but the probability of it moving forward has been reduced to 25% from 75%.

Downward revisions to the broker's lithium carbonate forecasts of -8% in 2019 and -21% in 2020 have resulted in cuts to the company's 2019 and 2020 net profit estimates of -33% and -255% respectively.

Net present value falls -41% to reflect Sal de Vida issues. Target price cut to $1.40 from $2.30.

See also GXY upgrade.

ILUKA RESOURCES LIMITED ((ILU)) Downgrade to Neutral from Buy by Citi .B/H/S: 4/2/0

Iluka Resources' shares have rallied 20% over the month past and Citi analysts think it's time for a breather; they have downgraded to Neutral from Buy.

Also, the analysts believe it will be challenging for Iluka to continue to outperform into a slowing China property sector in 2H CY19. Price target lifts to $11.40 from $11.

MAGELLAN FINANCIAL GROUP LIMITED ((MFG)) Downgrade to Underweight from Equal-weight by Morgan Stanley .B/H/S: 0/6/1

Recommendation has been downgraded to Underweight from Equal-weight as the analysts at Morgan Stanley believe market expectations have risen too high, while also observing the share price is already up more than 100% year-to-date.

Countering market enthusiasm, Morgan Stanley states it thinks growth options in retirement products are not certain to succeed, expansion to US is unlikely to accelerate, and Magellan's business mix remains narrow.

Target is raised to $38 from $28.60. Industry view: In-Line. Both EPS and DPS forecasts have received a serious boost.

METCASH LIMITED ((MTS)) Downgrade to Hold from Accumulate by Ord Minnett and Downgrade to Underperform from Neutral by Macquarie .B/H/S: 2/2/3

The FY19 result missed the analysts' expectations with fingers pointing at the lower food result and slightly higher corporate, net interest and tax charges. Also, the tougher environment is now catching up with the Hardware division, suggests the broker.

Reduced earnings forecasts have pulled down the price target; to $2.85 from $3.30. Recommendation is downgraded to Hold from Accumulate. The analysts continue to see valuation support for the share price.

Metcash's FY19 result missed the broker and consensus, deteriorating cash flow triggering a downgrade to Underperform from Neutral.

Macquarie notes that Metcash must spend money just to stand still and asks, in the midst of a capital expenditure war, "when is 'investment' simply a higher cost of doing business?"

Adding insult to injury the banner count fell another 2.5%. Earnings per share estimates fall -1% and target price eases -1% to $2.44.

MONASH IVF GROUP LIMITED ((MVF)) Downgrade to Hold from Add by Morgans .B/H/S: 1/1/0

Morgans downgrades Monash IVF to Hold from Add to reflect recent share price strength.

The broker remains optimistic on the stock, believing guidance for 15% net-profit-after-tax growth will be met and industry feedback suggests competition is moderating.

Morgans adjusts longer term growth rates and raises the valuation-based target price to $1.37 from $1.25.

NEWCREST MINING LIMITED ((NCM)) Downgrade to Neutral from Buy by Citi and Downgrade to Underweight from Equal-weight by Morgan Stanley .B/H/S: 0/3/5

A general update on metals has forced Citi analysts to upgrade their prior price forecasts for gold, with positive impact on all Australian producers under coverage. Newcrest Mining, however, has nevertheless been downgraded to Neutral from Buy.

Citi believes, despite the positive impulse from higher gold price forecasts, the share price has run too far. Price target lifts to $33.25 from $28.50. Estimates have received a boost.

Morgan Stanley's downgrade for Newcrest Mining was hidden inside a commodities sector report, which is why we failed to spot it initially. Morgan Stanley is not a big fan of owning gold stocks as the analysts believe the rally this year has incorporated average gold prices of US$2000/oz or more, and this makes gold stocks expensive.

Target price has been revised up to $24.25, from $23, but this remains well below the share price. All four gold stocks under coverage in Australia are now rated Underweight. Newcrest is the only one receiving a fresh downgrade. Industry view remains Attractive, but commentary infers this applies for the rest of the commodities space, not for gold producers.

NORTHERN STAR RESOURCES LTD ((NST)) Downgrade to Sell from Neutral by UBS .B/H/S: 1/2/4

UBS downgrades Northern Star to Sell from Neutral after the recent 50% run in the share price.

The broker notes the prognosis remains positive for company, and expects a big rise in production for the June quarter and a maiden reserve at Pogo in August.

A 7% upgrade to the broker's gold-price forecasts (and lesser upgraded operating assumptions for Pogo) triggers a 30% upgrade to net-profit-after-tax estimates.

The target price rises to $10.60 from $9.

OROCOBRE LIMITED ((ORE)) Downgrade to Neutral from Buy by UBS .B/H/S: 5/2/1

UBS downgrades Orocobre from Buy to Neutral to reflect the malaise in the lithium-carbonate market.

Delays to commissioning downstream capacity, downgrade revisions to lithium carbonate prices, and the move of China to a net exporter (seaborne prices continue to outperform domestic prices), all played their part.

Add to that cash issues and flat production, the broker expects an uneventful year.

The broker has downgraded lithium carbonate forecasts -8% in 2019 and -21% in 2020. Net present value falls -17% as UBS increases the discount rate from 10% to 12%.

Target price falls to $3.50 from $4.20.

PRO MEDICUS LIMITED ((PME)) Downgrade to Hold from Add by Morgans .B/H/S: 0/2/0

Morgans downgrades Pro Medicus to Hold from Add in the light of recent share-price strength and is awaiting a better entry point.

The broker expects a good FY19 result struck on revenue and margin growth but suspects the adoption of ASC606 accounting standards around contracts may create some volatility.

The broker believes that once the market better understands the accounting rebasing, the market can expect consensus upgrades to the outer years.

Target price is $25.46, previously $23.69.

STOCKLAND ((SGP)) Downgrade to Sell from Neutral by Citi .B/H/S: 2/1/3

Citi's team of property specialists has been negative on the outlook and risks for owners of retail property, and they have again reiterated that view in the latest sector update. They point out their price targets for many a retail landlord in Australia is at least -10% below the share price.

In an attempt to emphasise the risk, Citi analysts state they expect falling underlying values to weigh heavily on retail landlords' share prices, similar to what has occurred in markets such as the US and the UK.

Stockland has been downgraded to Sell from Neutral. Price target falls to $3.80 from $3.88.

SYRAH RESOURCES LIMITED ((SYR)) Downgrade to Neutral from Buy by UBS .B/H/S: 2/3/0

UBS downgrades Syrah Resources to Neutral from Buy to reflect downgrades to the broker's graphite prices forecasts. The broker has lost patience on the Balama project, which has yet to reach positive cash flow despite yet another capital raising.

UBS doubts the company can expand production without further diluting the price and says a slow ramp-up of Balama will extend the cash burn period. Nevertheless, operations capacity is sufficient, the underlying problem is weak market demand, with anode producers favouring synthetic graphite to natural flake.

Graphite forecasts fall -14% to -19% across 2019-2022, resulting in downgrades to FY19 and FY20 net profit forecasts of -16% and -419%. Net present value falls to 62% after a rise in the discount rate of 18% and the inclusion of the one for five equity raising.

Target price more than halves to 90c from $2.40.

VIRTUS HEALTH LIMITED ((VRT)) Downgrade to Hold from Add by Morgans .B/H/S: 1/2/0

Morgans downgrades Virtus Health to Hold from Add given the share price has rallied 18% over June to reflect fair value. The broker remains positive on the company and is awaiting a better entry point.

The broker expects the company to outpace consensus primarily because of a contribution from a licence fee for its artificial intelligence software called Ivy that can predict viable pregnancies in embryos, from the Swedish company Embryoscope and Australian company Harrison AI. The technology supports elective single embryo transfers and shorten pregnancy times.

Target price rises to $4.87 from $4.60.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 CALTEX AUSTRALIA LIMITED Neutral Sell Morgan Stanley 2 CROWN RESORTS LIMITED Buy Neutral Macquarie 3 DOMINO'S PIZZA ENTERPRISES LIMITED Buy Neutral Citi 4 GALAXY RESOURCES LIMITED Neutral Sell Macquarie 5 GROWTHPOINT PROPERTIES AUSTRALIA Neutral Sell Macquarie 6 MYER HOLDINGS LIMITED Neutral Sell UBS 7 NRW HOLDINGS LIMITED Neutral Sell Deutsche Bank 8 PACT GROUP HOLDINGS LTD Neutral Sell Macquarie 9 SANDFIRE RESOURCES NL Neutral Sell Morgans 10 SANDFIRE RESOURCES NL Buy Neutral Ord Minnett 11 TELSTRA CORPORATION LIMITED Neutral Sell Macquarie 12 VIVA ENERGY GROUP LIMITED Buy Neutral Morgan Stanley 13 VOCUS GROUP LIMITED Buy Neutral UBS Downgrade 14 ALUMINA LIMITED Neutral Buy Citi 15 BINGO INDUSTRIES LIMITED Neutral Buy Macquarie 16 COLLINS FOODS LIMITED Neutral Buy Morgans 17 FLEXIGROUP LIMITED Neutral Buy Morgans 18 GALAXY RESOURCES LIMITED Neutral Buy UBS 19 GENEX POWER LIMITED Buy Buy Morgans 20 ILUKA RESOURCES LIMITED Neutral Buy Citi 21 MAGELLAN FINANCIAL GROUP LIMITED Sell Neutral Morgan Stanley 22 METCASH LIMITED Sell Neutral Macquarie 23 METCASH LIMITED Neutral Buy Ord Minnett 24 MONASH IVF GROUP LIMITED Neutral Buy Morgans 25 NEWCREST MINING LIMITED Neutral Buy Citi 26 NEWCREST MINING LIMITED Sell Neutral Morgan Stanley 27 NORTHERN STAR RESOURCES LTD Sell Neutral UBS 28 OROCOBRE LIMITED Neutral Buy UBS 29 PRO MEDICUS LIMITED Neutral Buy Morgans 30 STOCKLAND Sell Neutral Citi 31 SYRAH RESOURCES LIMITED Neutral Buy UBS 32 VIRTUS HEALTH LIMITED Neutral Buy Morgans Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 GOZ GROWTHPOINT PROPERTIES AUSTRALIA -33.0% -67.0% 34.0% 3 2 MGR MIRVAC GROUP -8.0% -30.0% 22.0% 6 3 PGH PACT GROUP HOLDINGS LTD 40.0% 20.0% 20.0% 5 4 MYR MYER HOLDINGS LIMITED -42.0% -58.0% 16.0% 6 5 VOC VOCUS GROUP LIMITED 29.0% 14.0% 15.0% 7 6 DMP DOMINO'S PIZZA ENTERPRISES LIMITED -6.0% -19.0% 13.0% 8 7 SYD SYDNEY AIRPORT HOLDINGS LIMITED -13.0% -25.0% 12.0% 8 8 WPL WOODSIDE PETROLEUM LIMITED 25.0% 13.0% 12.0% 8 9 HUB HUB24 LIMITED -20.0% -25.0% 5.0% 5 10 NWL NETWEALTH GROUP LIMITED -8.0% -10.0% 2.0% 6 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 VRT VIRTUS HEALTH LIMITED 33.0% 67.0% -34.0% 3 2 CKF COLLINS FOODS LIMITED 67.0% 100.0% -33.0% 3 3 BIN BINGO INDUSTRIES LIMITED 67.0% 100.0% -33.0% 3 4 NCM NEWCREST MINING LIMITED -63.0% -38.0% -25.0% 8 5 MTS METCASH LIMITED -14.0% 7.0% -21.0% 7 6 SYR SYRAH RESOURCES LIMITED 40.0% 60.0% -20.0% 5 7 AWC ALUMINA LIMITED 20.0% 40.0% -20.0% 5 8 ILU ILUKA RESOURCES LIMITED 58.0% 75.0% -17.0% 6 9 FXL FLEXIGROUP LIMITED 67.0% 83.0% -16.0% 6 10 NST NORTHERN STAR RESOURCES LTD -43.0% -29.0% -14.0% 7 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 CKF COLLINS FOODS LIMITED 8.483 7.760 9.32% 3 2 NST NORTHERN STAR RESOURCES LTD 8.886 8.300 7.06% 7 3 BIN BINGO INDUSTRIES LIMITED 2.137 2.020 5.79% 3 4 GOZ GROWTHPOINT PROPERTIES AUSTRALIA 3.847 3.667 4.91% 3 5 MGR MIRVAC GROUP 2.895 2.782 4.06% 6 6 NCM NEWCREST MINING LIMITED 24.501 23.814 2.88% 8 7 ILU ILUKA RESOURCES LIMITED 10.792 10.558 2.22% 6 8 SYD SYDNEY AIRPORT HOLDINGS LIMITED 7.296 7.141 2.17% 8 9 RRL REGIS RESOURCES LIMITED 4.651 4.564 1.91% 8 10 VRT VIRTUS HEALTH LIMITED 4.870 4.780 1.88% 3 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 SYR SYRAH RESOURCES LIMITED 1.390 2.170 -35.94% 5 2 MTS METCASH LIMITED 2.767 2.886 -4.12% 7 3 ORE OROCOBRE LIMITED 4.518 4.605 -1.89% 8 4 AWC ALUMINA LIMITED 2.530 2.550 -0.78% 5 5 DMP DOMINO'S PIZZA ENTERPRISES LIMITED 42.196 42.396 -0.47% 8 6 FXL FLEXIGROUP LIMITED 1.765 1.770 -0.28% 6 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 PPH PUSHPAY HOLDINGS LIMITED 6.458 5.804 11.27% 3 2 AQG ALACER GOLD CORP 36.288 34.369 5.58% 3 3 CYB CYBG PLC 49.745 48.387 2.81% 3 4 FMG FORTESCUE METALS GROUP LTD 113.263 111.308 1.76% 8 5 TAH TABCORP HOLDINGS LIMITED 19.838 19.505 1.71% 7 6 ILU ILUKA RESOURCES LIMITED 93.635 92.102 1.66% 6 7 NST NORTHERN STAR RESOURCES LTD 36.233 35.850 1.07% 7 8 QBE QBE INSURANCE GROUP LIMITED 88.969 88.047 1.05% 8 9 GOZ GROWTHPOINT PROPERTIES AUSTRALIA 23.133 22.900 1.02% 3 10 BIN BINGO INDUSTRIES LIMITED 7.833 7.767 0.85% 3 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 GXY GALAXY RESOURCES LIMITED -1.621 -0.279 -481.00% 5 2 SYR SYRAH RESOURCES LIMITED -9.187 -5.289 -73.70% 5 3 CTX CALTEX AUSTRALIA LIMITED 147.400 189.833 -22.35% 7 4 AOG AVEO GROUP 9.400 12.067 -22.10% 3 5 VEA VIVA ENERGY GROUP LIMITED 11.300 14.150 -20.14% 6 6 OGC OCEANAGOLD CORPORATION 17.471 19.496 -10.39% 6 7 AWC ALUMINA LIMITED 23.718 25.569 -7.24% 5 8 MTS METCASH LIMITED 22.060 23.230 -5.04% 7 9 HUB HUB24 LIMITED 14.392 15.125 -4.85% 5 10 WTC WISETECH GLOBAL LIMITED 18.067 18.700 -3.39% 4 Technical limitations

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Uranium Week: Still Waiting

The uranium market is left hanging as Trump's 232 decision is again postponed and not yet rescheduled.

-US section 232 decision postponed indefinitely -Uranium term prices rise -Rio Tinto's Rossing sale approved

By Greg Peel

President Trump was due to be briefed by US Department of Commerce officials on its recommendation regarding the section 232 petition two weeks ago but that meeting was postponed to last week. The meeting was again postponed last week but this time has not been rescheduled.

Presumably Iran, the G20 and a stroll in the DMZ were more important.

It was thus another quiet week for the spot uranium market. Industry consultant TradeTech reports only four transactions concluded totalling 585,000lbs U3O8 equivalent.

It was enough, at least, to push TradeTech's weekly spot price indicator up US20c to US$24.50/lb, to close out the month.

Total spot volumes for the month of June rose to 3.8mlbs from 2.4mlbs in May. At US$24.50/lb, TradeTech's monthly spot price indicator rose from US$24.00/lb in May.

Uranium term markets became more active in June despite section 232 uncertainty, with nine mostly mid-term transactions reported. The demand is clearly there, but remains cautious. TradeTech's mid-term price indicator has risen US$1.15 to US$28.50/lb and the long-term indicator has risen US$1.00 to US$31.00/lb.

Questioning 232

Section 232, which concerns "national security" and is also the law behind Trump's tariffs, is clearly rattling the Democrat-led House. While the Democrats are largely onside with Trump's attempts to reel in China, it appears they are not quite so comfortable with Trump's often spontaneous tariff decisions.

Last week the Representative for Florida introduced the "Reclaiming Congressional Trade Authority Act", which would limit any new or additional tariffs imposed on national security grounds to a duration of 120 days unless approved by Congress.

Given the Senate remains Republican held, the bill's passage is far from guaranteed.

Demand & Supply

Meanwhile, lawmakers in the state of Ohio failed to reach an agreement by the June 30 deadline of whether or not the government will provide financial support to FirstEnergy Solutions – the operator of two 30-year old nuclear reactors in the state.

FirstEnergy Solutions is currently working its way through bankruptcy and will be forced to shut down the reactors if no assistance is forthcoming.

Talks will resume this month.

In other news, the Namibian competition regulator has approved the sale of the Rio Tinto's ((RIO)) 69% stake in the Rossing uranium mine to the China National Uranium Corp. Approval came with various caveats which must be adhered to by CNUC. While the Namibian government owns only 3% of the mine, it has 51% of the voting rights.

The Short Report

Guide:

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

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

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

Summary:

Week ending June 27, 2019

Last week saw the ASX200 trade sideways.

While there's quite a lot of red and green on the table below the bulk represents minor bracket creep. Three stocks nevertheless saw short position movements of one percentage point or more.

One is Centuria Industrial REIT ((CPI)) which I flagged last week would disappear off the table this week, and it has. The REIT leapt from nowhere to 15.6% shorted the week before but was easily explained by JP Morgan's institutional placement of a large parcel of stock and not representative of sentiment, rather transactional.

Otherwise, JB Hi-Fi ((JBH)) shorts fell to 12.9% last week from 15.4% and Dacian Gold ((DCN)) shorts rose to 7.6% from 5.5%. See below.

We might otherwise note that satellite company SpeedCast International ((SDA)) was 9.9% shorted last week and this week issued a profit warning that sent the stock down some -56%, so next week we'll see whether profits were taken.

I also made note last week that the longer the east coast drought lingers, the more shorts in agri-companies grow. Nufarm ((NUF)) sat in third most shorted position (16.8%) last week and yesterday its share price jumped 7.4% on takeover rumours.

We can further note that among the ASX top 20 stocks, Amcor ((AMC)) shorts, held ahead of the finalisation of the Bemis acquisition, began to be covered once Bemis was in the bag. Last week Amcor shorts fell from 4.3% to a more recognisable 1.7%.

Weekly short positions as a percentage of market cap:

10%+ SYR 19.6 ING 17.3 NUF 16.8 NXT 14.6 ORE 14.5 BAL 14.2 GXY 14.1 JBH 12.9 BWX 12.5 BIN 11.7 DMP 10.8 PLS 10.2 MTS 10.0

In: MTS Out: CIP

9.0-9.9

SDA, BGA, IFL, HVN, SGM

In: SGM Out: MTS, PPT, RWC 8.0-8.9%

IVC, PPT, BKL, HUB, RWC, CSR, CGC, SUL

In: PPT, RWC , CGC Out: SGM

7.0-7.9%

AMP, KGN, DCN, BOQ

In: DCN Out: CGC, WSA, MYR, CGF

6.0-6.9%

CGF, MYR, ELD, WSA, GMA, A2M, NEC

In: CGF, MYR, WSA , A2M Out: NEC, GWA

5.0-5.9%

GWA, COE, NEC, LNG, CTD, RSG, CLQ, SXY, OML, MSB

In: GWA, NEC Out: DCN, A2M, SEK, MIN

Movers & Shakers

Electronics retailer JB Hi-Fi was being quietly written off by investors a year ago when a behemoth called Amazon announced it would soon be lumbering onto our shores. The retail industry breathed a sigh of relief when Amazon Oz proved to be little more than a mouse that roared, offering fewer products at higher prices that online shoppers could already buy online offshore.

Normal valuations was thus restored for JB and friends and more recently JB kicked on further post the election in May. The stock has since fallen back a bit despite reiterated FY19 guidance, with brokers seeing tough comparable earnings to cycle from a soccer World Cup year (blokes, that is).

A short position reduction to 12.9% last week from 15.4% may imply some belated short covering.

Dacian Gold's share price dropped -5% earlier this month when the miner issued a larger than feared production guidance downgrade for its flagship Mt Morgans gold project, citing operational issues and poor reserve reconciliation. The share price has since recovered and pushed higher on the big rally in the AUD gold price last month.

Dacian appeared on the table the week before at 5.5% shorted but last week jumped to 7.6% shorted.

ASX20 Short Positions (%)

Code Last Week Week Before Code Last Week Week Before AMC 1.7 4.3 RIO 4.6 4.6 ANZ 0.7 0.8 S32 0.8 0.8 BHP 3.0 3.0 SCP 1.2 1.3 BXB 0.3 0.3 SUN 0.5 0.5 CBA 1.2 1.4 TCL 0.8 1.0 COL 1.4 1.4 TLS 0.5 0.6 CSL 0.4 0.4 WBC 1.4 1.6 IAG 0.7 0.7 WES 1.6 1.6 MQG 0.9 0.8 WOW 1.7 1.8 NAB 1.2 1.2 WPL 0.7 0.8 To see the full Short Report, please go to this link

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

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

The Wrap: Utilities, Consumers & Digital Media

Weekly Broker Wrap: utilities; Buy Now Pay Later; consumer stocks; and digital media.

-Minimal impact so far from default market offer on major electricity providers -Visa announces instalment payment initiative -Tailwinds improve for retailers, albeit modestly -Real estate, job and vehicle sales listings remain weak

By Eva Brocklehurst

Utilities

The government's default market offer (DMO) came into effect on July 1 2019, which means retail offers in the electricity market are now comparable. JPMorgan concludes that the difference in the offers from the big four electricity providers - AGL Energy ((AGL)), Origin Energy ((ORG)), Alinta and EnergyAustralia - is very small.

Tier-2 retailers have the highest offers but also the lowest in each state. These offers, in many cases, come with conditions. While the new default offer effectively acts as a market price it is also used as a reference for benchmarking all offers.

Credit Suisse upgrades its ratings for both AGL Energy and Origin Energy, to Neutral and Outperform respectively, as both have underperformed peers and the market. While the broker continues to envisage downside to electricity prices from renewables and government intervention, the rally over the last 12 months shows a subdued impact so far.

The introduction of the DMO illustrates that retailers have retained a freedom to re-price their back books, introducing doubt that wholesale price reductions will be passed through in full. For existing customers on discounts, the broker estimates that the two companies have retained $30-55m in costs.

In Origin Energy's case it has been re-directed to other customers. Moreover, best offers from the large retailers are now higher than in April or May, indicating an easing back in competition, although the broker suspects this may not be consistent.

Buy Now Pay Later

Shaw and Partners notes it has taken more than five years for Visa to respond to the new operators that have launched customer-centric products for instalments, lay-by and payments. Visa has announced an initiative for merchants and financial institutions to utilise existing Visa payment structures and cards for instalments.

The company has flagged instalment payment growth is above system and options in each country will vary, based on issuer and merchant. Shaw and Partners suggests the opening up one of the largest payment systems in the world increases the potential for competition globally.

Furthermore, and increase in competition would likely manifest through lower checkout merchant fees, and this may put pressure on those returning greater merchant-derived fees. The broker points out that Visa does not take on credit risk and does not originate. Therefore banks and financial institutions are the key counterparties.

In this respect, a product such as payment instalments does not solve origination difficulties for the major financial institutions, and origination remains the key issue in the industry.

Shaw and Partners points out digital payments are growing at over 10% per annum and instalments at 15%. Moreover, the broker highlights, it took Qantas ((QAN)) 15 years, along with assets and infrastructure, to build its frequent-flier customers to the level that it took Afterpay Touch ((APT)) and Zip Co ((Z1P)) three years to build their customer bases.

Consumer Stocks

Despite appearances, UBS finds no evidence yet of an uptick in discretionary expenditure following the federal election. However, with the broker recently upgrading house price forecasts to stable and taking into account the tax cuts to occur over FY20 along with recent rate cuts, a net 0.5% tailwind to household goods sales is calculated for FY20.

On the other side, risks include rising unemployment, higher savings rate and inflation pressures on food, petrol and utilities. The broker remains cautious about retailers with direct housing exposure such as hardware and household goods for the near term as falling turnover remains a risk. Favoured exposures include Flight Centre ((FLT)), Bapcor ((BAP)) and Treasury Wine Estates ((TWE)).

Digital Media

Total new real estate listings were down -22.9% for the week ended June 30, JPMorgan notes, versus a year ago. Sydney was down -29.5%, worse than the -24.6% decline over the 20 prior weeks. Melbourne was down -31.9%, worse than the -22.8% decline over the prior 20 weeks. Auction clearance rates increased to 66.5% versus 63.7% in the week prior and 52.6% a year ago.

JPMorgan also notes listings for Seek ((SEK)) were down -6% on average a fall of -5.7% over January to June. Total listings for Carsales.com ((CAR)) were down -11.1% and have averaged a fall of -7.7% over January to June.

Deutsche Bank likes the domestic and Asian growth opportunities presented by REA Group ((REA)). Nevertheless, the broker struggles to justify the current share price. Support is coming from record low interest rates, credit easing and a bounce in auction clearance rates but transaction volumes are likely to remain subdued.

The broker has reinstated coverage of the stock with a Sell rating and $83 target. Meanwhile, Domain Holdings ((DHG)) is considered priced for perfection. The broker believes the business is challenged to improve prices more than 5% in the medium term. Nevertheless, a 10% recovery in earnings is expected in FY20. The broker reinstates coverage with a Sell rating and price target of $2.70.

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Superloop Blames Timing Issue

After downgrading FY19 guidance substantially, Superloop has assured the market that the errant contract at the heart of the downgrade is still on track.

-Contract expected to materialise in FY20 earnings -Significant long-term upside potential -Connectivity segment growing amid underperformance in services

By Eva Brocklehurst

The end of the financial year has not favoured Superloop ((SLC)), as a significant contract failed to be finalised. The company has assured the market that negotiations are continuing.

If successful, brokers assume this will be reflected in future earnings, including FY20. The company made no comment about prior operating earnings (EBITDA) guidance for FY20 of $26-30m and, while not entirely clear, Morgans now expects this may require around $10m in transactional operating earnings in order to be achieved.

The quantum of the particular commercial agreement was not disclosed but Morgans calculates a value of $5-10m in terms of operating earnings. Further deals are also possible, providing upside risk, but Morgans stresses this is far from guaranteed.

Deutsche Bank believes the company's new strategy will take time to demonstrate traction after a period of restructuring. The ownership of unique fibre assets across Asia-Pacific provides a strong level of valuation support, although momentum remains a concern for the broker.

Morgan Stanley retains a positive view on the stock, based on the opportunity in the Asia-Pacific telco enterprise market. However, the broker agrees with Deutsche Bank that sales momentum and execution are below expectations and, hence, remain of concern.

Canaccord Genuity still finds the growth profile intact and believes the benefits of new contracts should be realised in FY20, forecasting underlying operating earnings of $9.0m. The investor community is expected to mark down FY20 operating earnings below prior guidance and the broker considers this reflected in the share price.

Canaccord Genuity, not one of the eight stockbrokers monitored daily on the FNArena database, maintains a Buy rating, lowering the price target to $1.60 from $2.00. Morgans continues to envisage significant long-term upside upon successful cost reductions and sales execution, assessing that, after spending four years building its unique assets, the pressure is now on management to deliver on the strategy.

FY19 Guidance

Superloop has lowered its FY19 earnings guidance range (EBITDA) to $8-9m from $13-18m. Prior forecasts were based on certain transactions being recognised in FY19, while the recent takeover bid has occupied substantial time and targeted cost savings have been delayed. Morgans suspects the distraction from QIC's conditional, and now defunct, bid could have delayed other small deals in addition to the cost reductions.

The connectivity segment continues to show growth but this is being offset, Canaccord Genuity notes, by the underperformance in services and, to a lesser extent, broadband. Superloop has engaged with its lenders and believes its revised guidance is within the terms of its debt agreements.

The company has also indicated a reduction in holdings of a non-core investment and stated it is not in breach of banking covenants. Canaccord Genuity expects some of the company's intangibles will be reviewed, pointing out the underperforming BigAir services business carries an estimated $40-45m in goodwill.

Morgans, too, finds it plausible that the BigAir services business could put around $53m in intangibles at risk and highlights that forecasts assume upfront cash payments are realised, which would help lower debt levels.

FNArena's database has two Buy ratings and one Hold (Deutsche Bank). The consensus target is $1.73, suggesting 27.5% upside to the last share price.

People Infra Raises Profile In Healthcare

People Infrastructure has been busy with acquisitions since its IPO, with brokers noting the higher profile in the attractive healthcare and IT sectors.

-Offers full solutions in recruitment, training and payroll, unique in disability sector -Increased exposure to healthcare de-risks the business -Margins likely to expand based on changes to revenue mix

By Eva Brocklehurst

People Infrastructure ((PPE)) has broadened its reach and is now more exposed to sectors where there is high employment growth. Around 70% of the company's earnings are now generated from the healthcare and IT sectors versus 35% at its IPO.

These sectors have leading rates of projected employment growth across the Australian economy over the next five years. Demand for these services is underpinned by trends such as an ageing population and digital expenditure. People Infrastructure also services some of the largest providers in the disability sector.

A catalyst for the business is the likely outcome of the Royal Commission into Aged Care and Disability. Likely outcomes, Moelis contends, include higher staffing levels, increased government funding, more compliance requirements and regulatory oversight. Margins and returns are increasing as the company's revenue mix shifts away from blue-collar employment.

People Infrastructure offers solutions in recruitment, training, roster management, payroll and reporting. Acquisitions provide further accretion as well as scale benefits and can be obtained at below the cost of capital. Approximately 20% of the nursing talent pool are immigrant workers, often highly transient.

The company can provide work for these employees in multiple locations with a high degree of expertise in managing the human resources function for its healthcare businesses, Ord Minnett suggests. A big uptick in demand could be on offer with the opportunity to provide a similar service to national aged care providers.

Acquisitions

Since its IPO, when the business was heavily concentrated in blue-collar Queensland segments and disability in NSW, People Infrastructure has acquired six new earnings streams at an average purchase price of around 4x operating earnings (EBITDA) for a total of $46m.

Value is being extracted via cost synergies, leveraging existing infrastructure to increase efficiency, and revenue synergies from cross-selling candidates by experience, geography and product.

Recent acquisitions include two Queensland nursing agencies for $16.8m, collectively expected to generate $3.4m in operating earnings across the next 12 months. Ord Minnett expects the agencies will open up a new vertical for the company, providing greater scale and geographical diversity.

From now on the broker expects the company will focus on integrating its new operations in order to drive organic growth. Ord Minnett believes the increased exposure to healthcare de-risks the business and maintains a Buy rating with a target of $3.50.

However, Moelis deems there is a high probability of one-two accretive acquisitions in the short to medium term, likely to be in healthcare. The company's largest competitor is Healthcare Australia but according to People Infrastructure there is no direct competition for its full workforce solution within the disability/community care sector.

In June, the company acquired the Halcyon Knights business for $13.5m, which provides IT recruitment across several verticals. Based on this acquisition Morgans increases FY20 estimates for earnings per share by 16%. The broker maintains an Add rating and $3.10 target. Morgans estimates debt capacity for further acquisitions of $8.5m, based on FY20 forecasts.

Organic earnings growth is 7-8% per annum from existing clients. Moelis expects the operating earnings margin to grow to around 8.5% by FY21, supported by a greater mix of higher gross margin revenue. Free cash flow per share is expected to increase by over 45% in FY20. Moelis initiates coverage with a Buy rating and $3.55 target.

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Do I Have A Few Surprises For (Most Of) You!

In this week's Weekly Insights (published in two parts):

-Do I Have A Few Surprises For (Most Of) You! -M&A Is Back; Who's The Next Target? -Conviction Calls -Three Charts To Mark Mid-2019 -Caveat Emptor: Retail Landlords -Rudi On Tour -Rudi Talks

Do I Have A Few Surprises For (Most Of) You!

By Rudi Filapek-Vandyck, Editor FNArena

The first six months of calendar 2019 have again superbly proved as to why this equities bull market has been dubbed "the most hated in history".

At face value, equity markets have rallied by up to 20% suggesting making money from asset price inflation via the share market has seldom been easier for investors, but a closer look reveals nothing could be further from the truth.

Imagine an investment portfolio consisting of Adelaide Brighton, Bank of Queensland, Challenger, Caltex Australia, Domino's Pizza, Flight Centre, Link Administration, Pendal Group (the old BT Investments), South32 and the old Westfield, now Unibail-Rodamco-Westfield.

An equal weighted portfolio of these ten household names in Australia generated a negative return of nearly -10% between January 1 and June 28. That's ex-dividends, but the average yield from the portfolio cannot fully compensate for the erosion in capital values. Besides, the ASX200 Accumulation index is up nearly 20% over the same period.

And that's assuming investors venturing into some of the riskier stocks on the ASX haven't been caught out by disasters experienced by Syrah Resources (down -39%) or Wagners (-42%) or Bionomics (-72%), and numerous others.

Many a self-managing investor has portfolio exposure to the big four banks, large resources and energy producers, as well as Telstra, Woolworths, and Wesfarmers-Coles. They don't necessarily need to compare their performance with a benchmark, so they most likely are feeling happy with the Big Bounce post the Grand Sell-Off during the closing months of 2018. In particular if they also managed to pick up some additional gains from smaller cap highflyers such as Afterpay Touch, Austal and Credit Corp.

For professional fund managers, however, the scenarios for share markets in 2018 and the first half of 2019 have made beating the index an extremely tough challenge; indications are most have continued to underperform. This, mind you, at a time when ETF providers offer ever cheaper alternatives and most retail investors would feel emboldened about their own talent and capabilities too.

It should thus be no surprise that, with the notable exception of Magellan Financial ((MFG)), most listed asset managers have been relegated to the basket of consistent underperformers on the ASX, with shares in Janus Henderson ((JHG)), Platinum Asset Management ((PTM)), Elanor Investors Group ((ENN)), K2 Asset Management ((KAM)), Pinnacle Investment Management ((PNI)), and others overwhelmingly in the doghouse at a time when most investors feel like celebrating.

Internationally, the first signals are becoming apparent the industry of actively managed investment funds is ripe for consolidation, or otherwise a shake-out. Locally, all major banks with exception of Westpac ((WBC)) have unveiled plans to divest their wealth management operations, while Magellan Financial acquiring Airlie Funds Management and Ellerston Capital acquiring Morphic Asset Management are but two early indications the industry locally is equally facing major transformation in the years ahead.

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But why exactly is it that most active managers cannot beat their benchmark?

One narrative that has been going around recently is that investor exuberance is largely to blame. With stocks like Afterpay Touch ((APT)), Appen ((APX)) and other smaller cap technology stocks up 100% and more in the space of only a few months, the narrative goes that institutional investors cannot own these stocks as they are trading on valuations that can never be justified, and with these kinds of share price gains, it makes beating the index a near impossible task.

Sounds plausible, yes? Except that it doesn't stand up to the test of deeper analysis.

Everyone familiar with the major indices in Australia is aware that Financials make up more than 30% of the ASX200 (of which the Big Four Banks more than 20%) while Materials + Energy adds another 23%. Combined these sectors represent more than 50% of the index. Add a few extra large cap names such as Macquarie Group, CSL, Telstra, Woolworths and Wesfarmers and the index representation rises above 66%.

In most years, underperforming or outperforming against the index is determined by how these large cap stocks perform versus exposure in investment portfolios.

But let's first tackle the misguided narrative mentioned earlier.

The WAAAX stocks as a group, comprising of WiseTech Global, Afterpay Touch, Appen, Altium, and Xero, represent a total index weight of 1.58% as of June 1st. The average gain from these five stocks is a smidgen over 80%. However, Fortescue Metals ((FMG)) alone weighs 1.35% and its shares went up by more than 117%. Plus Fortescue pays a big dividend and the WAAAX stocks don't.

In other words: Fortescue Metals shares have contributed more to the index gains than all of the WAAAX stocks combined. That's one myth gone.

This example does, however, further highlight one of the key characteristics of the local share market in recent years: the internal polarisation is enormous. The gap between winners and losers is extremely wide and both baskets contain plenty of household names each. It makes outperforming the index not only a case of picking enough winners; it's equally about avoiding the losers (see also portfolio mentioned at the beginning of this story).

This, of course, is more easily done with the advantage of hindsight. With most professional funds managers in Australia practicing a value-oriented approach, owning share market disappointments is pretty much par for the course. This year in particular, as corporate profit warnings have come out in large numbers throughout May and June.

Making matters worse, most managers have been running their funds with larger-than-usual allocations to cash and, certainly up until recently, an underweight exposure to the banks. The latter has proved unequivocally beneficial in years past as the banks underperformed the broader share market. In 2019, however, the banks have staged a notable come-back on the back of a surprise Labor election loss and the promise of RBA rate cuts.

And yet, for the six months to June 30th, the performance for the banks has not kept up with the ASX200 Accumulation index. Even if we exclude National Australia Bank ((NAB)), lagging once again, the Big Four Banks combined, and including above-average dividends, slightly underperformed the index.

Which leaves us with large cap resources stocks. BHP Group ((BHP)) shares added 21%-plus ex-dividend, which is better than the index, but Rio Tinto ((RIO)) rallied 32% ex dividend and shares in Fortescue, as mentioned, more than doubled. In the Energy sector, Woodside Petroleum ((WPL)) narrowly underperformed the index including dividend, but Santos ((STO)) shares went up by 29.43%.

What these numbers show is that underperforming or outperforming the local index over the past six months has been determined by a few large cap stocks only. In particular if we consider that Woolworths and Wesfarmers equally did not keep up with the index. In their place, large cap names Amcor ((AMC)), Brambles ((BXB)) and Telstra ((TLS)) -probably best described as "come back stocks"- all posted stronger than average gains.

Add Aristocrat Leisure ((ALL)) -up 43% ex-dividend, Goodman Group ((GMG)) -up 37% ex-div, Transurban ((TCL)) -up 25.5% ex-div- and Newcrest Mining ((NCM)) -up 51% ex-div- and it is clear most of the strong index gains this year occurred on the shoulders of no more than ten large cap stocks in Australia.

The most outstanding themes have been iron ore, gold, lower interest rates and bond yields, and structural growth stories in the case of Aristocrat Leisure, Goodman Group and the WAAAX companies. At the same time, less confidence and more investor caution has swung the market pendulum heavily back in favour of the large caps, both here as well as internationally.

Note, for example, the Small Ordinaries index barely scraped in a positive return for full financial year 2019, and only if we include paid dividends, for a total return of 1.92%. Over the past six months, the Small Ordinaries' total return was 16.81%. The Top 20 gained 26.72% ex-dividends. CSL too performed strongly, but equally could not match the index. Scentre Group ((SCG)) is responsible for the sole negative performance among Top 20 stocks.

The negative performance for stocks including Scentre Group and UR-Westfield contrasts sharply with the market beating performances for Goodman Group and Transurban. In prior times, all four would have been considered beneficiaries of lower bond yields. This time around, however, investors are excluding the structural challenges from online competition and household budgets under pressure, testing the patience -and frustration- of your typical value hunters in the share market.

After five years of notable neglect, value stocks have made a sharp come-back post late 2018 sell-off, as witnessed by (some) bank stocks in Australia, and via equally selective names among media companies, consumer oriented businesses and resources stocks. Meanwhile, the lure of disruptors and new technology-driven business models has not disappeared.

The latter remains equally one of the key characteristics of this hated bull market. Hated by you know who.

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Richard Coppleson, nowadays at Bell Potter, equally published analysis and stats on the performance of the Australia share market this week. Below are a few extra stats from his work to add extra colour to this week's theme:

The ASX200 Accumulation index gained 11.55% for the financial year to June 2019. This marks the third consecutive year of double digit percentage gains, which tends to be a rare phenomenon for the local share market. Last time this happened were the four financial years leading into the Global Financial Crisis of late 2007. Back then gains were 20%-plus each year rather than 10%-plus.

Top performers in terms of most index points added over the full financial year are BHP Group (+104.2 points), CommBank (+67.4 points) and Telstra (+56.5 points). To put these gains in perspective: the ASX200 added 424 points over the past twelve months. The three companies mentioned are responsible for 228 of those points.

Worst detractors have been Origin Energy, AMP and Lendlease.

Revisiting the narrative of the WAAAX stocks again: Afterpay Touch, WiseTech Global and Appen added the most index points to the Small Ordinaries of respectively 33.3, 20.4 and 20.1 points. The Small Ordinaries ultimately lost -25 points over the year (-0.90%) as stocks including WorleyParsons, Costa Group and Nufarm lost respectively -26.7, -20.9 and -19.3 points.

A long list of the past year's winners and losers shows average gains at the top of the table are larger than average losses, but average losses remain higher as one descends through the rankings.

Nearmap, Clinuvel Pharmaceuticals and Afterpay Touch (all up more than 60%) have been the top performers in FY19. Galaxy Resources, Eclipx Group (even after 100% share price rally) and Nufarm have been responsible for the largest shareholder losses.

Equally remarkable is that Healthcare (+87%) remains the best performing sector over a four year horizon, while telcos (-35.4%) and banks (-9.8%) still have a lot of catching up to do, even after this year's come-back performance. The Energy sector's performance over the period is exactly zero percent.

Similarly, all major indices have performed pretty equally; 44%-45% over the past four years, dividends included, but the Small Ordinaries still stands out with 55% in total return, whereas the Top20 lags heavily with a total return of 17.9% only.

The ASX200, up 11.5% over twelve months, beat the S&P500 (+10.5%), as well as the DJ Euro Stoxx 50 index (+6%), the FTSE100 (+1.6%), the Nikkei 225 (-2.6%), and most other indices around the world.

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As far as the FNArena Vested Equities All-Weather Model Portfolio is concerned, with nil exposure to miners and banks, and more small and medium sized companies in portfolio, the first half of 2019 has been one of few periods since inception in late 2014 wherein we felt we simply had no chance in hell to even loosely keep track of the local index.

Winding back six months in time, everybody would have been elated with the prospect of 13% in return over the subsequent six months. In comparison with what we know now, which is that the ASX200 Accumulation index added 19.73% over the period, opinions are likely to be more divided.

This puts the portfolio performance for the full financial year at 5.52% versus 11.55% for the ASX200 including dividends. The difference in relative performance reversed in January.

In line with the analysis above, it's not the lack of winners, of which we hold plenty, but the small group of laggards and disappointments that can ultimately be held responsible for what appears to be an underwhelming return when measured against the world beating performance for the Australian market.

Stocks including Bapcor ((BAP)), Orora ((ORA)) and GUD Holdings ((GUD)) simply could not muster any enthusiasm from investors thus far in 2019. We still hold them because we remain confident in the potential for each longer term. Elsewhere, two of the companies owned issued a profit warning this year which understandably made investors extra-cautious after pushing share prices down.

We have thus far elected to retain both Reliance Worldwide ((RWC)) and Link Administration ((LNK)), but continue to monitor further developments.

In line with the general elevated sense of risks and uncertainties, the All-Weather Model Portfolio has kept what might look like an overly cautious allocation to cash, currently still between 19-20%.

We are also about to lose DuluxGroup ((DLX)) from the Portfolio with shareholders having accepted the take-over price offered by Nippon Paint. According to research we encountered recently, DuluxGroup shares have been the third best performer on the ASX since separating from Orica in 2010.

Admittedly, this year's premium offer issued by the Japanese suitor has had an impact on total return over the period, but it doesn't detract from the underlying story as to why stocks like DuluxGroup have been, and still are, a core constituent of the All-Weather Model Portfolio.

Quality companies are an investor's best friend in the long run, just not all the time or under all circumstances. The past six months have marked one such exception.

Rudi Talks

Audio interview Wednesday this week:

https://www.youtube.com/watch?v=1iqrF0o8AjQ

Rudi On Tour In 2019

-AIA National Conference, Gold Coast, Qld, 28-31 July -AIA and ASA, Perth, WA, October 1

(This story was written on Monday and Tuesday 1st & 2nd July 2019. 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. Part two follows on Friday).

(Do note that, in line with all my analyses, appearances and presentations, all of the above names and calculations are provided for educational purposes only. Investors should always consult with their licensed investment advisor first, before making any decisions. All views are mine and not by association FNArena's - see disclaimer on the website.

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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Rudi's View: Charter Hall, Superloop And Whispir

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By Rudi Filapek-Vandyck, Editor FNArena

M&A Is Back; Who's The Next Target?

The latest Australian equities strategy update by stockbroker Morgans has identified no less than 48 M&A candidates listed on the local exchange.

While the broker's market strategists acknowledge buying equity in a company purely on the expectation that a takeover approach is soon to be unleashed is far from a fail safe strategy (to put it mildly), Morgans nevertheless argues M&A appeal can offer some downside protection for companies under pressure and/or operating in structurally challenged sectors, including mining services, aged care and retirement village operators, as well as bricks & mortar retailers.

The list of selected (potential) targets ranges from AGL Energy ((AGL)) to Neuren Pharmaceutical ((NEU)) and Nufarm ((NUF)), to Perpetual ((PPT)), Red 5 ((RED)), Hub24 ((HUB)), Rhinomed ((RNO)), Bapcor ((BAP)) and Santos ((STO)).

The stockbroker has highlighted six standout opportunities for investors looking to explore the theme; APA Group ((APA)), Emeco Holdings ((EHL)), Superloop ((SLC)), Qube Holdings ((QUB)), and Senex Energy ((SXY)).

Three Charts To Mark Mid-2019

As we've moved past mid-year calendar 2019 this week, I found the three charts below combined, all from various Morgan Stanley research reports, offer a great summary of the swift change in global market dynamics after 2018 ended on such a sour note.

First there is the observation the "all assets in the negative" by the end of 2018 has swiftly been followed up with an "all assets gain".

The second chart shows the origin of this shift: the US bond market quickly shifted from pricing in three more rate hikes, to now four rate cuts by the Federal Reserve.

Chart number three shows how weak manufacturing PMIs have subsequently become with both headline and new orders sinking into negative territory in June. We're back, or even below, levels last seen during economic and financial markets turmoil of early 2016. Can we have the same recovery? That's the $20m question that will determine the outlook for equities in the six and twelve months ahead.

Conviction Calls

To state that Countplus ((CUP)) has had a tough time in years past would be a grave understatement. The listed umbrella for accountants and financial advisors witnessed its share price trading near $2 up until mid-2014, but then prospects soured pretty quickly.

Countplus shares entered calendar 2019 hovering around 50c but have posted a strong rally towards 90c in recent weeks. Maybe Wilsons elevating the stock to its Conviction Calls might have something to do with it?

Wilsons lauds management for having successfully turned around the core operations. And now Countplus is buying more advisory business from Commonwealth Bank ((CBA)) at a price tag of $2.5m while Wilsons values the acquired businesses at circa $40m.

Someone's having a bargain thanks to the Royal Commission into banks, and Wilsons also believes CBA is a motivated vendor who'd want to ensure a smooth transition and little hiccups afterwards. This also applies to CBA's 35.85% in the company. Wilsons' Conviction Buy rating is accompanied by a $1.47 price target.

Even more intriguing is that ASX-newcomer Whispir ((WSP)) has also been added to the list of Conviction Calls. Whispir provides a cloud-based communications platform to over 500 users in the corporate and public sector worldwide. The company only listed on June 19, but Wilsons put it straight through to the Conviction Calls list with a price target of $2.

Whispir raised $46m at $1.60 a share in an IPO underwritten by Wilsons and Ord Minnett. The latter coincidentally has also initiated coverage with a Buy rating and $2 price target.

Other stocks still on Wilsons Conviction Calls are Bravura Solutions ((BVS)), EML Payments ((EML)), ReadyTech ((RDY)), Collins Foods ((CKF)), Ridley Corp ((RIC)), ImpediMed ((IPD)), National Veterinary Care ((NVL)), EQT Holdings ((EQT)), Pinnacle Investment ((PNI)), Noni B ((NBL)), Ausdrill ((ASL)), Mastermyne ((MYE)), and Whitehaven Coal ((WHC)).

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Small cap analysts at Canaccord Genuity equally dusted off their Australia Focus List this week, revealing the following thirteen inclusions:

AMA Group ((AMA)), Appen ((APX)), Ausdrill, Bigtincan Holdings ((BTH)), Codan ((CDA)), Cooper Energy ((COE)), Healthia ((HLA)), Independence Group ((IGO)), Kogan ((KGN)), Money3 Corp ((MNY)), OZ Minerals ((OZL)), Primero Group ((PGX), and Perseus Mining ((PRU)).

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At Bell Potter, head of research Peter Quinton has set a target of 7000 for mid-year 2020 for the ASX200. Quinton also updated his list of Champion Stocks; the kind one buys and keeps in the bottom drawer, confident they will add value to the portfolio if given enough time and breathing space.

The June update on Champion Stocks generated no changes, which makes it more of a reiteration of prior research and selections. The eight names on Quinton's list are Amcor ((AMC)), Transurban ((TCL)), Challenger ((CGF)), Lendlease ((LLC)), Goodman Group ((GMG)), Netwealth ((NWL)), CSL ((CSL)), Sonic Healthcare ((SHL)), and Brambles ((BXB)).

I noted in the past there is a parallel with the research into All-Weather Performers by myself, but different minds do not necessarily think alike. Thus Quinton's selection contains both overlap and differences.

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Late addition on Thursday: Stockbroker Morgans' update on High Conviction stocks has generated no changes, which means the selection continues to comprise of ResMed ((RMD)), Sonic Healthcare, OZ Minerals, Westpac ((WBC)), Australian Finance Group ((AFG)), Kina Securities ((KSL)), and Senex Energy.

Morgans strategists did take the opportunity to highlight what they believe are the most outstanding opportunities from recent sector updates and this selection consists of Westpac, Orora ((ORA)), Treasury Wine Estates ((TWE)) and Oil Search ((OSH)).

In addition, discretionary retail analysts at Bell Potter released their Top Three stock picks for the sector: Lovisa Holdings ((LOV)), City Chic Collective ((CCX)), and Temple & Webster ((TPW)).

Caveat Emptor: Retail Landlords

Shares in Goodman Group ((GMG)) are up more than 50% since last year October and the performance of Charter Hall ((CHC)) has been even better over the period, but Vicinity Centres ((VCX)) shares are down and Unibail-Rodamco-Westfield ((URW)) looks downright ugly on a price chart.

Welcome to the treacherous new world of investing in stocks for income and yield. UR Westfield is offering a forecast 3.8% on a payout ratio of circa 95%, whereas the forecast yield from Vicinity Centres shares sits well above the market average at 6.4%. On the other hand, Goodman Group shares post six years-plus share price rally are left offering but a paltry 2% while for Charter Hall the forward looking estimated yield has fallen to 3.8%.

Yet, the above does not by default mean Vicinity Centres is now the safest option of the four, or that the only way is down for shares in Goodman Group.

Property specialists at UBS and Citi, to name but two, have been warning for a while now that investors should be extra-careful when considering buying shares in retail landlords. UR Westfield and Vicinity Centres are but two examples of a whole bunch of listed retail assets owners, also including Stockland ((SGP)), Aventus Group ((AVN)), Shopping Centres Australasia ((SCP)), Charter Hall Retail REIT ((CQR)), and others.

The main threat comes from a rapidly changing, challenging environment for bricks & mortar retailers, and the potential implications for those who own and operate the properties from which these retailers battle for survival.

The share market already reflects a much more cautious view on how this dynamic might play out, which explains why most retail landlords have not participated in the 2019 stock market revival; or continue encountering selling pressure whenever an upswing occurs.

One of the visible impacts is the fact an estimated $12bn in retail assets are currently up for sale in Australia. UBS analysts recently estimated $7bn in retail assets are up for sale plus $5bn of unlisted equity. Analysts at Citi point out this represents close to three years of typical transaction volume. Which is why every property team in the country is closely watching who's buying and at what price.

The flow on effect of assets (potentially) being sold at a discount in order to get buyers to commit can be quite pronounced for listed REITs, which keeps a rather large question mark open ended for those with large portfolios, even if they are not looking to sell themselves.

And while current valuation discounts implied can make sector laggards look attractive for yield and/or value-oriented investors, both Citi and UBS point out things can get a lot worse still should experiences from the UK and the US be replicated in Australia. The main points of contention are to what level do rents for retailers need to fall to keep them viable and competitive; and how much more do landlords need to spend to prevent their assets from degrading?

As is so often the case in these financial matters, relatively small changes in assumptions projected into the future can have a major impact on valuations for landlords. Which is why the teams at UBS and Citi have been cautioning investors, and continue to do so.

Making matters even more complicated is the fact that examining reported numbers by the various trusts simply opens up inconsistencies and apparent contradictions. For example, UBS analysts note Scentre Group's published operational expenses (opex) are running at circa 30bps of assets, but then publicly available data for two of the group's assets, Penrith and Carindale, put the relevant number at 70bps - more than double.

Similarly, UBS finds it difficult to reconcile Vicinity Centre's opex of 50bps while GPT ((GPT)) reports its opex is 90bps and the latter is believed to operate the higher quality asset portfolio?

Property specialists at Citi firmly believe the outlook for retailers margins are to remain under pressure for much longer, while the development returns on shopping malls are now noticeably under pressure. Both factors can have a significant impact on the future value of landlord's assets.

The analysts at Citi have further reduced their valuations across the sector, now valuing retail assets some -9% below book value, or -13% when leverage is incorporated. In response, Citi analysts have decided to reiterate their Sell ratings for Scentre Group, GPT, Charter Hall Retail REIT, Shopping Centres Australasia, BWP Trust ((BWP)), and Stockland.

Citi analysts point out, discounts for comparable retail landlords in the US and the UK of -20% below Net Asset Value (NAV) have become rather common, even after NAVs already pulled back considerably. Citi's advice to investors remains firm and unchanged: buy non-retail exposure within the local REIT sector. Investors should not assume worst case scenarios are by now priced in.

Most favoured sector exposures at UBS are Lendlease ((LLC)), Goodman Group, Dexus Property Group ((DXS)), GPT, Centuria Metro REIT ((CMA)), and Rural Funds ((RFF)). Least preferred are Stockland, Mirvac ((MGR)), and Vicinity Centres.

Rudi Talks

Audio interview Wednesday this week:

https://www.youtube.com/watch?v=1iqrF0o8AjQ

Rudi On Tour In 2019

-AIA National Conference, Gold Coast, Qld, 28-31 July -AIA and ASA, Perth, WA, October 1

(This story was written on Monday and Tuesday 1st & 2nd July 2019. 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. Part two follows on Friday).

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