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INTERNATIONAL

Unravelling The Tesla Share Price Fall

A plethora of negative events has caused the Tesla share price to fall this year, but the company and its founder continue to find support from loyal believers

By Danielle Ecuyer

Tesla's share price fall in 2022 (at its low down -45% to US\$625) has coincided with a plethora of negative happenings.

The selloff may well prove to be noise for the brave investors, who can look beyond Tesla's controversial Founder and CEO, Elon Musk, and his personal media aspirations and political commentary.

China lockdowns and supply chain problems

Tesla Shanghai has been the beacon of Tesla's achievements to date. A greenfield leading edge electric vehicle manufacturing hub that represents the stage 2 iteration of facilities after Fremont, according to long-term Tesla shareholder Ross Gerber, co-founder and CEO of Gerber Kawasaki.

The Shanghai production fills demand for not only China's desire for electric vehicles, but the plant is also a major exporting hub.

Harsh lockdowns cratered production for Giga Shanghai in April, but manufacturing has restarted in late May with a closed loop system (workers remain on site).

Shanghai represents around 40% of Tesla's total delivery numbers, and the lower contribution will soften the June quarter production results in China, as well as Tesla's earnings in general.

Twitter circus

Dan Ives from Wedbush Securities, a positive commentator and analyst of Tesla, didn't mince his words on Bloomberg regarding the proposed US\$44bn takeover of Twitter by Elon Musk.

"It (Twitter) has been a disaster from the beginning, and he (Musk) continues to add fuel to the fire."

Twitter has and continues to be the portal for Elon Musk to communicate with the world, even though his musings can be both inflammatory and provocative.

Musk has always been controversial but loyal followers were happy to look through any transgressions from a self-confessed 'Aspergers' sufferer to the genius that was changing the world.

Through an online Zoom interview Ross Gerber stated:

"The more stress that he (Musk) comes under, the crazier he seems and if you want to invest with genius, absolute flat-out genius and you want normal, it doesn't work that way like that."

"So, you get on the ride and if you don't like it, you don't... You can bitch and moan as much as you want about it, it won't change one thing he is going to do, and he is going to change the world in ways that I haven't seen a person do in my life".

And the latter includes the revered Steve Jobs, says Gerber.

But will the Twitter circus, as Dan Ives declared, leave some "semi-permanent taints" on Tesla?

There is no doubting Musk has become a much more 'political' voice on the social media platform, however, contrary to the critics and the naysayers, Gerber retains a different view regarding the impact of the Twitter fiasco on Tesla's management and culture.

Gerber stated that "the mission is so important to the people who do it, that they do not pay attention to this stuff... the misperception between reality and what we see and read is a gulf and the gulf is gapped through

experience. Tesla management is on a mission, and everyone believes they will succeed.”

On the flipside Gerber highlighted that Elon “burns through a lot of people and it doesn’t attract everyone”.

Linking through the Twitter debacle to an impact on Tesla could well be as short sighted as not looking through the Shanghai lockdowns as a buying opportunity.



Is there smoke without fire?

In early February 2022 the California Department of Fair Employment and Housing announced plans to sue Tesla over racism and harassment of Black employees at the California, Fremont factory.

The lawsuit comes on the back of a US\$137m payout to a former Black employee for racial abuse, when he worked at the Fremont factory in 2015 and 2016.

Adding further fuel to the many fires, global ratings agency S&P has dropped Tesla from its ESG index.

Several reasons were cited but one analyst, Rick Mills from newsletter ‘Ahead of the Herd’ makes for some very compelling analysis (see link below).

Musk was recently photographed with the Indonesian President, Jokowi Widodo at Tesla’s Austin, Texas plant.

No one can criticise Tesla for wanting to secure the necessary materials and minerals, but the question needs to be asked at what cost and what is the image Tesla is trying to put out to the market?

Mills’ conclusion raises food for thought: “A company that has shown itself more than willing to make deals with the devil in Indonesia and New Caledonia, shouldn’t be masquerading as an angel when it comes to its environmental practices”.

Putting the headwinds into context

Looking beyond the China lockdowns and the Twitter sideshow, Tesla’s vehicle demand is so strong the company announced it has stopped taking orders, until the 12-month-plus backlogs can be filled.

How the other automotive companies would love to have the same problem.

With the ongoing commissioning of Giga Austin (and Berlin), the stage 3 iteration of the “machine that makes the machines”, Tesla is going to produce the Model Y with the new 4680 battery cell packs, new AMD chip hardware and full self-driving software (FSD) that is expected to reach a new level of autonomy by the end of 2022.

Musk is continuing with the Twitter takeover but has de-risked Tesla with the expiration of the margin loan over his shares for the equity portion of the takeover.

Musk formerly stated after the US\$8bn worth of Tesla stock sales that he will not sell more Tesla shares.

Wedbush's share price target for Tesla shares has been lowered to US\$1000 from US\$1400 with the lockdown impacts and slower China growth in the second half of 2022 impacting on earnings forecasts, but Dan Ives retains an Overweight recommendation.

Jefferies also cut the price target for Tesla to US\$1050 from US\$1250 and retains a Buy rating. The broker cited an "uncomfortable pile up of negative news" including China, ratings downgrades, controversial political opinions, and ethical questions.

Credit Suisse, post a visit to the Fremont factory, reiterated its US\$1125 price target and reconfirmed its Outperform rating.

General market sentiment is fragile

The economic macro-economic environment remains challenging with the Federal Reserve raising interest rates and starting quantitative tightening.

Talk of global recession remains constant and US stock markets remain fragile as witnessed by sell-offs post weak results and guidance from companies such as Walmart, Target, and Snap, to name but a few.

In a risk-off environment, high multiple stocks remain vulnerable to more selling, including those with large cash positions on the balance sheet such as Apple and Tesla.

The ever-present threat of competition and at times questionable ethical standards, in combination with the major shareholder, Elon Musk raises the risk profile for the stock.

Gerber believes 2022 is like 2019, when the company battled numerous challenges with scaling production of the now so popular Model 3.

For now, the true Tesla believers consider the selldown offers value to a company that is so much more than just electric vehicles; it is energy, battery storage, insurance, software, Robo-taxis and even Optimus, the robot, if one is willing to accept the Musk aspirations.

To read Rick Mills' analysis: [Stripped of its ESG credentials, Tesla continues to pursue dirty nickel in Indonesia](#)".

Danielle Ecuyer has been involved in share investing in Australia and Internationally for over three decades, both professionally and personally and is the author of 'Shareplicity. A simple approach to investing' and 'Shareplicity 2. A guide to investing in US stock markets'.

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AUSTRALIA

What Now For AGL?

The abandonment of AGL Energy's demerger plans and subsequent board upheaval has left the company in an uncertain position due to its need to act on its substantial debt burden.

- Post no spin-off, AGL Energy now in limbo
- A new-look board required
- Debt remains the company's pressing issue
- What will Mike do?

By Greg Peel

In early 2017, AGL Energy ((AGL)) traded at \$26.76 per share. In November last year it traded at \$5.13. Straining under the weight of debt, the company was able to begin a bounce off the bottom when oil and coal prices began to surge, implying higher gas and electricity prices for the power generator.

That thesis remains in place, with the regulator recently approving substantial power price increases.

But AGL's problem remained one of being perceived as an ESG pariah, indeed the lowest of the low in Australia given it is the country's biggest carbon emitter. To that end the board came up with a plan - demerge the company into two separate entities. AGL Australia would take the company's energy retailing business and renewable energy assets and Accel Energy would keep the legacy coal-fired power plants.

The perception was that AGL Australia would be ESG-viable and a valuation re-rating would follow. Accel would be sold off to solve the company's debt problem. Simple. Brokers for the most part agreed the strategy was in shareholder interest, although the question of securing a buyer for the coal plants remained in some doubt.

Then in stepped Atlassian co-founder and billionaire green warrior Mike Cannon-Brookes who, via his Grok Ventures and in consortium with private equity firm Brookfield, made a takeover offer at \$7.50 per share. The proposal was swiftly rejected by the board. The offer was then upped to \$8.25, and again rejected.

Cannon-Brookes' primary goal was to shut down the coal plants. AGL's CEO suggested, in comparison to the demerger plan, "The alternative is a lot of rhetoric but little detail from someone who has not provided a plan, and whose interests are not aligned with the interests of thousands of our other long-standing shareholders".

Cannon-Brookes pointed to the long term share price decline.

Then having been knocked back at \$8.25, he secured 11.27% of AGL shares instead, and became its largest shareholder.



Counting the Beat

A shareholder vote on the demerger proposal was scheduled for June. Yesterday the board announced it had abandoned the demerger plan. Four of eight board members announced their resignations, including the chairman and CEO.

Cannon-Brookes' shareholding clearly brought the board unstuck, as it insisted the proposal "would have been supported by a majority of shareholders, both retail and institutional". Given the proposal required a 75% majority of shares on issue, that shareholder majority obviously did not add up to 63.73%, or 75% minus Cannon-Brookes.

Conceding a groundswell of opposition, brokers had warned that were the vote to have been to reject the demerger plan (not anticipating an abandonment beforehand), the risk was AGL's share price would collapse into a fog of uncertainty. As it was, the stock lost only -1.7% on yesterday's announcement.

The assumption is a takeover is now back on the table.

For what's left of the AGL Board (although they're not all leaving immediately), the challenge is now to find replacements, ahead of a planned strategy update in September. The abandonment has cost the company -\$160m, although that would have been -\$260m had the demerger gone ahead.

Then there's that debt load

Ord Minnett believes establishing new debt facilities for the combined entity will be AGL Energy's key near-term focus given what had been arranged for the demerged entities will be cancelled. This may be difficult and more expensive considering the current interest rate environment and increased environmental focus.

All brokers nevertheless agree the outlook is currently positive for the company thanks to higher electricity forward prices.

But Morgan Stanley cautions against over-capitalising AGL's price tailwinds in view of fuel cost headwinds and smelter contract renewals over FY26-28, as well as lower anticipated plant output and/or reliability generally (noting the ancient Loy Yang A coal-fired plant suffered an outage in early May and may not be back online until August, potentially costing the company -\$73m).

Is Cannon-Brookes just a nutter?

It would be easy to dismiss Cannon-Brookes as just a young environmental warrior who after listing his co-founded Atlassian software business on Wall Street, found himself with too much money and too much time on his hands. In recent months he has been seen running around buying up rural properties to convert into carbon sinks, particularly in the highly-prized Southern Highlands region of NSW.

UBS decided it would be a good idea to have a chat to the guy, or more specifically, to Grok Ventures.

“We believe that in addition to wanting a stronger decarbonisation pathway, Grok sees considerable value in AGL’s underlying business as a platform to develop a new Distributed Energy Resource product that orchestrates power behind-the-meter (BTM) and aggregates it onto a new scalable trading platform. While we do not believe a scale product exists yet in Australia, the right tech could fundamentally change the future of energy generation & retailing .

“We believe Grok sees a major future opportunity in orchestrating BTM power flows at scale (power generated via rooftop solar and stored in home batteries/EVs). If a new scalable trading platform could be developed, using AI to solve multiples of instantaneous customer load profiles into trading algorithms, it could win the race for orchestration. AGL’s industrial customer book and low-cost wholesale generation portfolio may provide an ideal testing ground for such a product and its 4.5m energy and telco customers an opportunity to apply at scale if successful.”

So no, he’s not just a nutter. Other FNArena database brokers are so far happy to wait and see what comes out of September’s strategic update, and to find out who might end up on the board of AGL.

UBS expects the stock to trade range-bound to the last bid price from the Grok/Brookfield consortium (\$8.25) and anticipates reinvigorated corporate interest in AGL.

UBS retains its \$8.50 target and Neutral rating, and similarly Ord Minnett retains Hold and \$8.70.

Two years of higher electricity margins leads Morgan Stanley to increase its price target to \$9.38 from \$8.48, but the broker concedes higher-end user prices also leads to a higher risk of policy intervention for all utilities.

Macquarie is advising so it is currently on research restriction.

Credit Suisse has an Outperform rating and Morgans Add, as of earlier in the month, but have yet to update on yesterday’s developments.

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AUSTRALIA

Climate Costs Burden Heaviest For Aussie Insurers

Australia's overweight exposure to natural catastrophes is weighing on insurers, with steadily increasing catastrophe costs likely to impact on margins moving forward.

- Australian insurers remain more exposed to catastrophe risks than insurers in other geographies
- Morgan Stanley warns catastrophe events should be considered structural moving forward
- Insurers may look to increase premiums to offset catastrophe costs, market experts warn high prices could leave Australians underinsured

By Danielle Austin

Increasing numbers of natural catastrophes are set to continue to impact on insurers, but Australian insurers have a larger burden to bear than international peers.

With climate change driving natural catastrophe occurrences to be more frequent and intense, analysts from Jarden noted catastrophe activity drove a -\$200m loss for Australian general insurers over the third quarter.

With Australia's unique geological conditions providing exposure to risk from climate change-driven natural catastrophes including flash flooding, hail events, storms and east coast lows, bushfires, as well as the dangers presented by rising seas levels, Jarden analysts expect general insurers will look to increase their catastrophe budgets in the coming years, which coupled with inflation is likely to support strong rate momentum in the coming year.

With the general insurance industry reporting annual increases in natural catastrophe losses since 2008, Morgan Stanley is now of the belief that catastrophe risk should be considered structural rather than cyclical.

The recent climate-change driven La Nina weather events, which included the Queensland and New South Wales floods earlier this year, could result in insurance industry losses of over -\$4bn globally, making it the largest insured loss event to date.

Insurers have been working to increase awareness of the industry impacts of climate change driven catastrophic events in a bid to stabilise earnings, but any impact will likely be the result of a multi-year journey requiring government support according to Morgan Stanley, and for this reason the broker expects catastrophe risks to worsen before they improve.

Some market experts are anticipating catastrophic costs could increase 5-7% annually moving forward

At a topline level, Morgan Stanley analysts expect increasing instances of catastrophic events and associated claims will drive increased earnings volatility for insurers, and we can likely expect those insurers to look to offset this with higher premiums and investment income, changes to risk selection, and through further purchasing of reinsurance which will likely also become more expensive.

Additionally, while insurers currently rely on reinsurance to reduce exposure to these events, moving forward they may need to hold more capital to buffer catastrophe risk.



Australian insurers bear the burden of climate change catastrophes

Jarden analysts noted the insurance trading ratio for domestic general insurers compressed to 2.8% in the third quarter off the back of catastrophe floods and weather events, while the experts from Morgan Stanley noted Australia currently appears to have almost eight times more exposure to natural catastrophe events than the global average, equating to around \$38bn in economic costs annually since 2020.

Not only is the country as a whole more exposed to natural catastrophes, the Climate Council estimates Australians are five times more likely to become displaced by these events than those in Europe, and that by 2030 one in every twenty-five homes will be considered uninsurable. Morgan Stanley warned that increased costs from insurers could lead to Australians being underinsured, or without insurance all together, leaving them at further risk.

Those insurers more exposed to natural catastrophes, such as Suncorp ((SUN)) and Insurance Australia Group ((IAG)), will naturally be more impacted by increasing instances of catastrophe events. Jarden noted both Suncorp and Insurance Australia's insurance trading ratio lagged peers with more commercial exposure in the third quarter.

The broker remains Overweight rated on Suncorp and Buy rated on Insurance Australia Group.

Both Suncorp and Insurance Australia Group have shifted their respective business mixes towards short-tail insurance over the last decade, with the insurers now reporting business mixes comprised of 80% and 85% short-tail insurance, with short-tail insurance more prone to catastrophe risk.

The Morgan Stanley analysts noted Suncorp has higher exposure to Queensland, the state predicted to have the largest number of uninsurable properties by the end of the decade and the highest current catastrophe risk, but also remains a more diversified company than Insurance Australia Group.

Accounting for increased catastrophe events, Morgan Stanley has reduced its net profit forecasts for Suncorp by -6% and -4% for FY23 and FY24 respectively, as well as increasing its forecast catastrophe budget to 12% of earned premiums in FY23.

For Insurance Australia Group, the broker reduced its net profit and earnings per share forecasts -6-7% over FY23 and FY24, and also lifted its forecast catastrophe budget to 12% of earned premiums in FY23.

What do other brokers say?

Ord Minnett has similarly commented on the impact of increased catastrophe risk to insurers, and noted a preference for insurers with commercial exposure over personal exposure.

The broker recently anticipated Suncorp will increase its costs and perils allowances materially as a response to the recent catastrophe event season, which it expects could impact on company margins by -1.5 percentage points. Ord Minnett anticipates premium increases are ahead for Suncorp's personal insurance lines.

Looking at Insurance Australia Group, the broker noted this insurer increased its expected full year perils claims to \$1.1bn from \$1.045bn following the catastrophe event season, with the company receiving 25% of claims related to recent east coast flooding and weather events.

Ord Minnett expects Insurance Australia Group will face higher reinsurance premiums, with renewal due in July. The broker remains Buy rated on both insurers.

The sentiment was again echoed by analysts from UBS, noting east coast flood events have driven insurance industry margins down -1% and that indicators from these weather events are not supportive of a strong pricing response from domestic insurers. While UBS is Buy rated on Suncorp, it retains a Sell rating on Insurance Australia Group.

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COMMODITIES

Game Over For Lithium?

Brokers have swiftly come to the conclusion lithium prices will soon peak and pull back substantially, though the outlook is a little more complex.

- Calls for lithium spot prices to peak
- Global EV demand growth remains critical
- Chinese lockdowns cloud the outlook
- Inflation may lead to demand destruction

By Greg Peel

“Chinese electric vehicle maker BYD Co Ltd is in talks to buy six lithium mines in Africa with total resources of lithium oxide at 2.5% grade estimated at more than 25 million tonnes, Shanghai government-backed media *The Paper* reported on Tuesday, citing sources”. Reuters reported the news but “has not verified this story and does not vouch for its accuracy”.

That was just one piece of news that rattled Australia’s listed lithium miners yesterday, leading to share price falls across the sector of -8-22%.

Another was Bloomberg reporting that Argentine customs will set a reference price of US\$53,000/t for lithium carbonate exports, with prices currently around US\$57,000/t.

Citi analysts responded to this news by suggesting this is essentially a mechanism for customs to request the integrity of contract pricing where there is a large variance. Given this is not a floor or ceiling price, nor will it change the prevailing royalty regimes, Citi does not expect any fiscal impacts for its lithium miner coverage.

As Shaw and Partners notes, there is no “benchmark” price for lithium. Prices are published by several providers of spodumene and a number of lithium chemicals. These prices are provided in various currencies and are based on product quality and despatch or delivery location.

Lithium markets are opaque, but Shaw expects there will be a move towards a standard convention within two to three years.

That said, lithium spot prices have declined from a high of around US\$69,000/t in April to US\$57,000/t currently, largely due to lockdowns in China leading to a drop in EV production (including at Tesla’s gigafactory in Shanghai). But as Shanghai begins to reopen this month, presumably lithium prices will rebound?

Not necessarily. Exacerbating yesterday’s plunge for lithium miner stocks was specifically a report out from Goldman Sachs, but Goldman is not the only broker to warn of trouble ahead.



Some History

It's not hard to understand why lithium prices have surged during 2022. Macquarie has provided some hard data this week, revealing global EV light vehicle sales rose 65% year on year over January-April, while total light vehicle sales fell -11%. The fall in total sales cannot be blamed on the global chip shortage, as this is affecting both EV and internal combustion engine (ICE) vehicles.

Citi notes EV sales are expected to be underpinned over the coming years by rising economies of both scope (increasing range between charging) and scale (falling manufacturing costs), as well as global government support. EVs and related infrastructure will be one of the first sectors to be stimulated in a downturn, Citi suggests.

In fact, demand for lithium is expected to double every three years over the coming decade, placing “phenomenal” pressure on the supply side and keeping prices elevated in order to stimulate investment in mine capacity. Citi notes that by comparison, copper demand doubles every 25-30 years and aluminium demand every 15-20 years.

Parabolic price surges for the “hot” exotic *metal du jour* have not been uncommon in the twenty-first century. The Kyoto Protocol signed in 1997 was a trigger for a speculative uranium price spike in the noughties that soon ended in tears (before Fukushima). The use of rare earths in everything from smart phone screens to wind turbines prompted a premature spike in rare earth prices soon after as well as a spike in sales of periodic

tables. Only now are rare earths coming back from the subsequent bust.

Nor is this lithium's first experience of a price spike. When a bloke called Elon Musk first proved the commercial viability of EVs in a market dominated by ICE vehicles, speculators took notice. China then followed with government subsidies on EV sales, and in 2016-17 lithium prices took off.

Prematurely. A collapse followed when it became obvious the world was not yet ready to drive large-scale lithium demand. Since then we've seen governments across the globe pledging net-zero emissions timelines, and also timelines for the regulated end of ICE production, particularly in Europe. Automakers have responded by setting their own, earlier, timelines.

And global EV take-up is only accelerating.

End of the Beginning

"The battery metals bull market has peaked," declared Goldman Sachs in a report published late last week. Yesterday, Credit Suisse followed up with its own sector update, with similar underlying conclusions. The timing was exquisite, coming alongside the China-Africa and Argentine news.

Pilbara Minerals ((PLS)) fell -22.0%, Liontown Resources ((LTR)) -19.1%, Allkem ((AKE)) -15.4% and IGO ((IGO)) -11.7 (after Western Areas ((WSA)) shareholders approved IGO's merger proposal) and Mineral Resources ((MIN)) fell -8.2%.

Battery equipment and services company Novonix ((NVX)) fell -12.7%.

"Battery metals - cobalt, lithium and nickel - will power the green industrial revolution, facing a wave of demand comparable to that of copper and iron ore during China's rapid growth in the 2000s. With climate change top of mind, investors are fully aware that battery metals will play a crucial role in the 21st century global economy, just as bulk and base metals did before them. Yet despite this exponential demand profile, we see the battery metals bull market as over for now."

Goldman wasn't mucking around.

The 2016-17 lithium price spike proved too early a jump on the battery demand call. But in the interim the supply-side response to the assumed trajectory of EV sales has been swift.

"A surge in investor capital into supply investment tied to the long term EV demand story, essentially trading a spot driven commodity as a forward-looking equity, Goldman suggests. "That fundamental mispricing has in turn generated an outsized supply response well ahead of the demand trend in focus".

With the lithium spot price currently around US\$60,000/t, Goldman is forecasting a 2022 average price of US\$53,982/t and a 2023 price of US\$16,372/t.

Over 2022-25, the broker forecasts global lithium supply to grow by 33% year on year. Chinese lithium project expansions are expected to multiply rapidly, in particular integrated hard rock projects, just as ex-China spodumene supply continues to strengthen.

Shaw points out that 95% of global lithium supply comes from the world's top four producers - Australia, Chile, China and Argentina. Hard rock spodumene deposits are considered the most commercially viable, and Western Australian miners account for more than 50% of the current lithium supply.

No wonder our producers were so hard hit yesterday. But one important point should be noted - the cost of production of lithium, as Citi points out, is only US\$5,000-10,000/t.

Consensus View

Like Goldman, Citi's base case is for prices to moderate further from extreme levels, but, unlike Goldman, remain "higher for longer" - averaging US\$35,000/t through 2025 - supported by solid growth in electric vehicle sales on the back of improving economies of scale and scope in battery and vehicle production.

Macquarie agrees there are growing signs of a major correction in prices for lithium, nickel and cobalt after the boom of the past year, reflecting mainly the Chinese slowdown. For cobalt and lithium, this could be temporary, the broker suggests, once China bounces back, while nickel prices could continue to fall due to rising Indonesian supply.

Credit Suisse now sees a balanced lithium market in 2023-24, and believes surpluses threaten from 2025, which is a major change from previous deficit forecasts. The broker previously considered the deficit was intractable, but notes the world has changed with inflation, war and lockdowns souring the demand outlook, whilst the pace of supply response to spiking prices has been more rapid than anticipated.

Credit Suisse also highlights demand destruction as battery costs climb 30-40% (driving a shift in demand from battery EVs to plug-in hybrid EVs), lockdowns delaying production, and inflation eating into consumer discretionary budgets - including for EVs.

The broker thus suggests lithium prices may peak in the next few months: Received prices may climb further in coming months to close the gap with spot (given longer term supply contracts), but should then roll over. The March quarter of 2023 may signal the biggest price drop if the Chinese EV subsidy ceases as planned.

"We see scope for the market to become oversupplied from 2025, so prices may slide to deter potential oversupply. Of course, much depends on the demand outlook."

Demand for lithium has grown at around a 20% compound annual growth rate through 2017-22. Shaw and Partners forecasts the same rate of demand growth to persist through to 2030, expecting EVs to represent 50% of global new car sales by that time.

Which stock?

Credit Suisse has today downgraded Allkem to Neutral from Outperform, to leave five Buy and four Hold equivalent ratings among FNArena database brokers. However, most broker updates go back to April, so ratings, and a consensus target of \$15.80, suggesting 37% upside, may soon be subject to review - a la Goldman Sachs and Credit Suisse.

Credit Suisse has also downgraded Pilbara Minerals to Neutral from Outperform, while Macquarie has today left its rating at Outperform. The two other brokers covering each have Buy ratings as at end-April, for a consensus target of \$3.71 suggesting 60% upside.

Only two database brokers cover Liontown Resources. Macquarie has today retained an Outperform rating while Ord Minnett initiated coverage in May with Hold. Their average target is \$1.90, suggesting 61% upside.

Macquarie's research update today stipulates the broker anticipates Liontown might have a binding supply agreement with Tesla this month after the company extended its termination date for the binding offtake until June 6th.

Valuation becomes more clouded in the case of Mineral Resources, which also produces iron ore and also operates a Crushing Mining Services division that provides a level of defensiveness. Credit Suisse and Morgan Stanley have today reiterated Outperform and Overweight ratings respectively, and all five covering brokers (not counting Ord Minnett, on restriction) have Buy-equivalent ratings. The consensus target is \$69.75, suggesting 21% upside.

It's a similar situation with IGO, which is primarily a nickel producer, and more so now since Western Areas ((WSA)) shareholders yesterday approved a merger proposal.

Credit Suisse has today retained an Outperform rating on IGO, and two other brokers updating in May also have Buy-equivalent ratings. Ord Minnett bucks the trend with a Lighten rating, while Macquarie is on restriction. Consensus target is \$12.82, suggesting 11% upside.

In a final word we might note the market panicked last year when the iron ore price plunged swiftly from a record high around US\$220/t down as far as under US\$90/t, before stabilising currently around US\$130/t. Given Australia's big iron ore miners have such low costs of production, they were able in the last reporting season to hand out record dividend payments.

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ESG FOCUS

ESG Focus: Why Financial Institutions Hold The Keys To ESG Success

FN Arena's dedicated ESG Focus news section zooms in on matters Environmental, Social & Governance (ESG) that are increasingly guiding investors preferences and decisions globally. For more news updates, past and future:

<https://www.fnarena.com/index.php/financial-news/daily-financial-news/category/esg-focus/>

Why financial institutions hold the keys to ESG success

By Matthew Talbot, Head of Financial Services in APAC & Japan, ServiceNow

Banks and insurers wield much power in fostering sustainable change for all sectors. Here's how they can do it.

Most transactions that take place today can be completed in a matter of seconds. But what comes next often wreaks long-term damage on the environment.

In a detailed analysis of financed emissions last year, CDP, a non-profit climate organisation, found that greenhouse gas emissions associated with the investing, lending and underwriting of loans to carbon-heavy industries were, on average, more than 700 times higher than the direct emissions of financial institutions themselves.

The funds that the likes of banks and insurers provide for such industries contribute to emissions that often outstrip their own, such as flying an executive to meetings or the carbon footprint generated by their office buildings. This astonishing difference can often be attributed to a lack of transparency. For instance, [the report](#) found that many companies had underreported their portfolio emissions, masking the actual impact of their financial activities.

Financed emissions amounted to [1.04 gigatons](#) of CO2 in 2020, or about 3 per cent of the total global emissions. That is roughly the annual emissions of nearly 216 million cars on the road. But the true figure is likely higher.

These staggering numbers make it clear that financial services and organisations play a pivotal role in the fight against climate change. Just as importantly, they can make a big difference in other areas beyond the environment.

From gender equality to corporate transparency, companies today are expected to place environmental, social, and governance (ESG) issues at the core of their business objectives. As a key source of funding for many sectors, financial institutions wield much power in effecting the desired changes.

While having to address their own ESG impacts, financial services organisations also have the unique opportunity to finance the world's ESG projects at scale.



Staying trendy and following regulations

ESG is the key buzzword of today's investment world, with people increasingly prioritising values over profits when deciding where to place their money. Younger investors, in particular, are spurring the growth of ESG investing.

In fact, ESG funds grew by US\$596.2 billion in 2021, with Bloomberg Intelligence estimating that such assets are set to reach a mammoth US\$41 trillion by the end of this year. A CNBC article credited millennials with driving this trend of responsible investing over the last decade.

"We see increasing trends in the investment space whereby consumers are looking at investment funds embedding ESG considerations," said AIA Singapore's Chief Investment Officer Liu Chun-Yen. "If we haven't been on this journey, we'll be missing out on a major customer trend."

But ESG goals are not only good to have. Increasingly, they are also must-haves. The past decade has seen an uptick in ESG-focused regulations - there were more than 200 new global regulations in 2020, up from 128 in 2019.

For instance, the Monetary Authority of Singapore - the country's financial regulator - has set up a Green Finance Industry Taskforce that aims to accelerate green finance nationwide, such as by improving disclosures among financial institutions.

In 2021, it rolled out a [guide](#) that outlines specific climate-related disclosure practices. This aims to help improve the quality and consistency of climate disclosures across the entire sector, paving the way for better standardisation when it comes to ESG issues.

ESG's key challenges

But adopting ESG programmes can be challenging for companies. One of the biggest difficulties is trying to incorporate ESG initiatives into their core businesses, said National Australia Bank's (NAB) Non-Executive Director Ann Sherry AO.

"In many organisations, I still see it (ESG) sitting as a core central function that advises the businesses, but sits outside the decision-making process," she observed. "ESG needs to be embedded within the business and strategy."

The second challenge is a classic case of more haste, less speed, when companies move too quickly to achieve their ESG targets.

"Companies are trying to jump 12 steps ahead in terms of what they want to achieve and deliver their ESG targets," noted EY Oceania's Climate Change and Sustainability Partner Emma Herd. "But they are stumbling along the way because they're not taking the time to understand the issues, risks and implementation

strategies.”

Moving too quickly also runs the risk of greenwashing, where products labelled as green or sustainable are actually not.

And while plenty of regulations are popping up in a bid to enforce ESG, this presents a third challenge: a lack of consistency in measuring ESG performance. With more than 200 global frameworks and standards, disclosures are often inconsistent and incomparable.

This has led to concerns about organisations reporting different things, noted Sherry. “We don’t want to be accused of reporting stuff that over-promises or makes us look good, when we need to be consistent across as many sectors as possible,” she said.

“That is the outstanding challenge - to get consistency of measurements that everybody is accountable for.”

Fostering collaboration and building capabilities

Beyond establishing a universal set of global standards, there are other steps that financial institutions can take to adopt ESG initiatives and facilitate sustainable agendas for other sectors.

First, the top brass has to act. “The tone from the top is crucial,” said Liu. “The board needs to start forming the strategies. The group executive committee needs to embrace and embed ESG in these strategies... that’s how to kick off and generate momentum.”

Having ESG embedded in all levels of the organisations was how AIA came to successfully launch its recent “1 billion by 2030” initiative, which aims to improve the physical, mental and financial health of one billion customers by the end of this decade.

While the board of directors conceptualised the core ESG strategies, having individual ESG management committees across its local business units allowed AIA to implement this enormous mission on the ground in various countries.

Second, change needs to come from within. “We need our people across all departments, from financial services to business technology, to be understanding of this issue (ESG targets),” said Herd.

To gain buy-in, EY has rolled out a Masters in Sustainability programme that serves as an incentive for staff to upskill and become a force multiplier. “The more people we can inform, upskill and train in sustainability, the more impact we think we can have,” added Herd.

From setting targets to tracking performance, digital platforms can also help foster this change by embedding ESG activities within organisations.

Lastly, there needs to be collaboration across the value chain. “The best way to tackle ESG issues is to work with our customers and suppliers,” said Herd. “Don’t try to do everything yourself.”

For instance, NAB is supporting 100 of its largest greenhouse gas-emitting customers in developing or improving their low-carbon transition plans by 2023. “It’s about finding the areas where you think you can make the most difference, and focusing on those areas,” said Sherry.

While pursuing ESG goals takes time and entails many challenges, taking the first step in this transformation journey is crucial. “Doing nothing is currently the biggest risk in the current environment,” said Sherry. “Most of our customers want to transition (to ESG), and they need help to do it.”

FNArena’s dedicated ESG Focus news section zooms in on matters Environmental, Social & Governance (ESG) that are increasingly guiding investors preferences and decisions globally. For more news updates, past and future:

<https://www.fnarena.com/index.php/financial-news/daily-financial-news/category/esg-focus/>

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WEEKLY REPORTS

Weekly Ratings, Targets, Forecast Changes - 27-05-22

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

By Mark woodruff

Guide:

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

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

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

Summary

Period: Monday May 23 to Friday May 27, 2022

Total Upgrades: 7

Total Downgrades: 8

Net Ratings Breakdown: Buy 60.07%; Hold 33.41%; Sell 6.52%

For the week ending Friday May 27 there were seven upgrades and eight downgrades to ASX-listed companies covered by brokers in the FN Arena database.

Following the demerger of The Lottery Corp, brokers last week were busy removing forecasts for the Lotteries & Keno spin-off from financial models for Tabcorp. Thus it was not surprising to see the company atop the tables for the largest percentage reduction in target price, and the largest percentage fall in forecast earnings by brokers last week.

Tabcorp is now a wagering, media and gaming business, and while the stock price is initially trading below expectations Credit Suisse maintained its Outperform rating and has faith in a potential transformation.

On the other hand, Macquarie was less sanguine and downgraded its rating to Neutral from Outperform in the belief investors will be cautious around structural challenges. It's thought additional capital may be required for license renewals and the WA TAB tender.

Nonetheless, the broker is hopeful a covid recovery will drive near-term growth and earnings will stabilised in FY23 prior to attaining 2% long-term annual growth.

Following the release of FY22 results in the prior week, brokers continued to update forecasts for Webjet, and the company topped the list for the largest percentage increase in forecast earnings last week. Morgan Stanley's FY24 estimates are above 2019 levels and incorporate market share gains that management has referenced.

Citi pointed out in last week's article the key metric for Webjet in the current environment is revenue, which was slightly ahead of the consensus expectation. Meanwhile, UBS noted all the company's businesses were profitable in April, and May profitability is expected to be significantly higher versus April.

Next on the earnings table was Superloop, following a trading update which showed strong organic sales momentum in the core business, according to Morgans. In addition, earnings accretion is expected in FY23 from the acquisition of Melbourne-based white label platform and managed service company Acurus.

While FY22 results were in-line with prior guidance, ALS had the third largest percentage increase in forecast

earnings, ousting Serko from that position on the table below, following a data glitch.

Despite few surprises in the result, Morgans believed shares were looking cheap and upgraded its rating to Buy from Hold. Organic revenue growth in Life Sciences and a strong outlook for volumes were considered highlights of the result.

Morgan Stanley assessed inflationary pressures are being handled well and management continues to target margin expansion via increased pricing (especially in Commodities) and procurement savings.

After a halving of share price in the last nine months, Nanosonics received forecast earnings upgrades from Morgans. As part of a trading update, management now expects the consensus estimate for FY22 revenue will be met.

The transition to a direct sales model with GE is on-track, according to the Add-rated broker. The company has expanded its sales and clinical applications team to meet an end-of-June transition-completion date.

Total Buy recommendations take up 60.07% of the total, versus 33.41% on Neutral/Hold, while Sell ratings account for the remaining 6.52%.

Upgrade

ABACUS PROPERTY GROUP ((ABP)) Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 2/2/0

Ord Minnett sees emerging value in the REIT sector due to a stabilisation of long-term bond yields and moderating market cash rate assumptions over the past few weeks.

The broker upgrades its rating for Abacus Property to Hold from Lighten on relative valuation grounds after outperformance in 2022. The \$3.20 price target is unchanged.

ALS LIMITED ((ALQ)) Upgrade to Add from Hold by Morgans .B/H/S: 3/3/0

Morgans believes ALS looks cheap on recent share price weakness and upgrades its rating to Add from Hold following a FY22 result which contained few surprises. Underlying profit met the upper end of the guidance range and was in-line with the consensus estimate.

A highlight for the analyst was 13.4% organic revenue growth in Life Sciences and a strong outlook for volumes.

Overall, while inflation pressures were offset by price rises and strong volume leverage via additional capacity, the broker expects margin contraction in FY23. Target rises to \$14.38 from \$13.57.

EVOLUTION MINING LIMITED ((EVN)) Upgrade to Neutral from Sell by UBS .B/H/S: 0/5/2

UBS retains its US\$1,500/oz long-term gold price forecast and expects supply chain pressures and opex/capex inflation to persist, along with the shortage of skilled labour.

For the producers, the broker retains a preference for new(er) mines benefiting from new infrastructure, highest grades and limited or brownfield capex.

While Evolution Mining is not the broker's preferred play at current prices, much risk is already priced-in and the rating is upgraded to Neutral from Sell. The target price slips to \$4.05 from \$4.13.

IGO LIMITED ((IGO)) Upgrade to Buy from Neutral by UBS .B/H/S: 3/0/1

IGO has announced consistent first production of battery-grade lithium hydroxide at its Kwinana Lithium Hydroxide factory.

UBS says this is a key de-risking event for the TLEA joint venture.

The broker updates realised spodumene price forecasts (-1.7% in FY22 and -11.3% in FY23) and remains structurally bullish on lithium and nickel in the medium and long term.

Upgrade to Buy from Neutral given the recent share-price retreat. Target price dips to \$12.15 from \$12.40.

MIRVAC GROUP ((MGR)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 4/1/0

Ord Minnett sees emerging value in the REIT sector due to a stabilisation of long-term bond yields and moderating market cash rate assumptions over the past few weeks.

In looking at large cap relativities, the broker now prefers Mirvac Group (upgraded to Accumulate from Hold) over Dexs ((DXS)), which is downgraded to Hold from Buy.

The target price for Mirvac Group slips to \$2.50 from \$2.60.

MACQUARIE GROUP LIMITED ((MQG)) Upgrade to Buy from Accumulate by Ord Minnett .B/H/S: 3/2/1

Following recent results for the major banks, Ord Minnett revises its interest rate forecasts and increases its EPS estimates, despite higher cost inflation and the potential for normalisation of impairments over FY23 and FY24.

Net interest margins (NIM) stabilised in the 2Q, lending more confidence to guided 2H increases for NIMs, explains the analyst. Of the four majors, CommBank ((CBA)) is estimated to have the greatest interest rate leverage.

Outside of the majors, Ord Minnett upgrades its rating for Macquarie Group to Buy from Accumulate on valuation grounds, and retains its \$218 price target.

WESFARMERS LIMITED ((WES)) Upgrade to Buy from Neutral by UBS .B/H/S: 2/3/1

UBS upgrades its rating for Wesfarmers in recognition that non-retail divisions were the source of upside in the 1H, and are becoming a larger share of earnings.

The broker estimates the Chemicals Energy & Fertilisers (WesCEF) business along with an exposure to lithium upside can counter the mixed outlook for retail. The target price rises to \$56 from \$54.

Downgrade

CHALLENGER LIMITED ((CGF)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 1/4/1

Challenger left its profit guidance unchanged at its investor day though suggested a return on equity (ROE) enhancement from yields may be delayed and pointed to a weaker capital position.

The analyst explains the capital position has gone from being strong to just at the target range over the past five months.

Following a 53% rise in share price over the last year, Ord Minnett lowers its rating to Lighten from Hold and reduces its target price to \$6.90 from \$7.00.

CROMWELL PROPERTY GROUP ((CMW)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 0/2/0

Ord Minnett sees emerging value in the REIT sector due to a stabilisation of long-term bond yields and moderating market cash rate assumptions over the past few weeks.

Nonetheless, the broker downgrades its rating for Cromwell Property to Hold from Buy on relative valuation grounds after recent underperformance, and reduces the target to \$0.85 from \$0.95.

DEXUS INDUSTRIA REIT ((DXI)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 1/1/0

Dexus Industria REIT has divested of a Sydney property at 17% above book value, with proceeds to be used to fund the development pipeline. Macquarie estimates the divestment is -0.6% dilutive to FY23 earnings.

The broker has nevertheless taken the opportunity to update its model for rising rates and low hedging. FY23-24 forecast earnings fall by -9%-plus.

Despite being attracted to the REIT's development pipeline, Macquarie warns higher construction and interest costs could impact returns. Downgrade to Neutral from Outperform. Target falls to \$3.25 from \$3.59.

DEXUS ((DXS)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 2/2/0

Ord Minnett sees emerging value in the REIT sector due to a stabilisation of long-term bond yields and moderating market cash rate assumptions over the past few weeks.

In looking at large cap relativities, the broker downgrades its rating for Dexus to Hold from Buy and now prefers Mirvac Group ((MGR)), which is upgraded to Accumulate from Hold.

The target price for Dexus also falls to \$12.00 from \$12.50.

INTEGRAL DIAGNOSTICS LIMITED ((IDX)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 2/3/0

Medicare benefits data highlighted weaker trends for Jan-Feb 2022 with modest recovery in March, Macquarie notes. For the March quarter, combined benefits in key states for Integral Diagnostics fell -9% quarter on quarter and -6% year on year.

Commentary from peers has highlighted operational challenges and elevated costs associated with covid in

early 2022, and in addition, the broker sees supply chain constraints as presenting potential upside risk for consumables/equipment expenses in the near-term.

Downgrade to Neutral from Outperform, target falls to \$4.15 from \$4.30.

INCITEC PIVOT LIMITED ((IPL)) Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 4/2/0

First half earnings (EBIT) were in-line with Morgan Stanley's estimate but -8% below the consensus forecast. An increased Henry Hub gas price forecast is the main reason for a -5% cut to the broker's FY22 earnings forecast.

The broker downgrades its rating to Equal-weight from Overweight and sees a more challenging backdrop for short-term performance.

While fertiliser prices appear to have peaked they are expected to remain supportive.

Orica ((ORI)) is preferred in the sector. The target price falls to \$4.05 from \$4.70. Industry view: In-Line.

The analyst expects a period of share price range-trading while demerger discussion rages following the decision to separately list the Fertilisers and Dyno Nobel businesses. It's considered a moot point whether strategic benefits outweigh one-off and ongoing costs.

SHOPPING CENTRES AUSTRALASIA PROPERTY GROUP RE LIMITED ((SCP)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 0/3/0

Ord Minnett sees emerging value in the REIT sector due to a stabilisation of long-term bond yields and moderating market cash rate assumptions over the past few weeks.

Nonetheless, the broker downgrades its rating for Shopping Centres Australasia Property to Lighten from Hold on relative valuation grounds after recent underperformance. The \$3.00 target price is unchanged.

TABCORP HOLDINGS LIMITED ((TAH)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 2/2/0

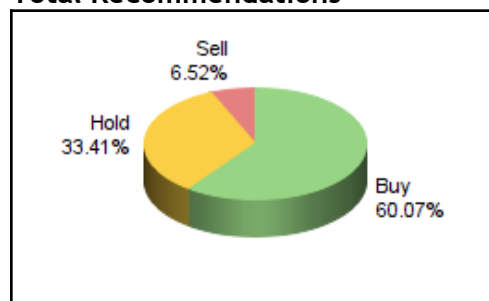
Following the demerger of Lottery Corp ((TLC)), Tabcorp has closed its first day of trading with a market capitalisation of \$2.4bn. Macquarie expects investors to take a cautious view of Tabcorp given structural challenges to be overcome.

The broker noted additional capital may be required for license renewals and the WA TAB tender. Macquarie expects covid recovery to drive near-term growth, and hopes the company can stabilise earnings in FY23 before achieving long-term annual growth of 2%.

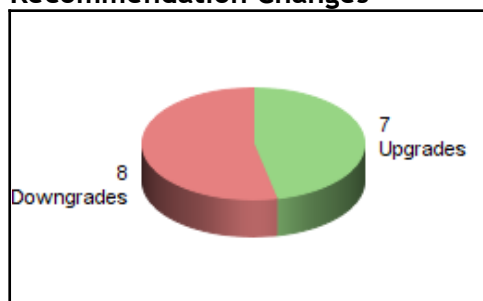
Notably, with Tabcorp closing out its first day of trading at a price of \$1.06 per share and Lottery Corp at \$4.70 per share, the combined value implies the creation of more than \$900m compared to the previous price.

The rating is downgraded to Neutral from Outperform and the target price decreases to \$1.00 from \$6.00.

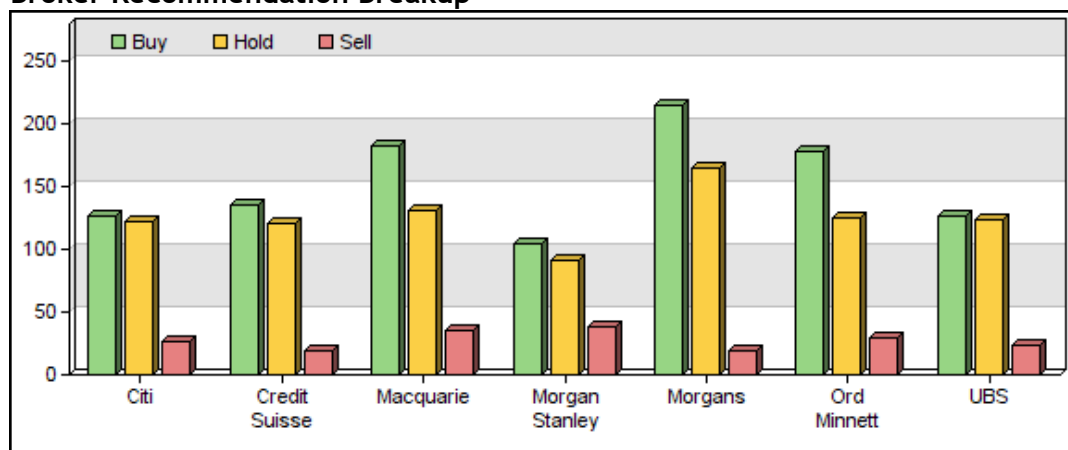
Total Recommendations



Recommendation Changes



Broker Recommendation Breakup



Broker Rating

Order	Company	New Rating	Old Rating	Broker
Upgrade				
1	ABACUS PROPERTY GROUP	Neutral	Sell	Ord Minnett
2	ALS LIMITED	Buy	Neutral	Morgans
3	EVOLUTION MINING LIMITED	Neutral	Sell	UBS
4	IGO LIMITED	Buy	Sell	UBS
5	MACQUARIE GROUP LIMITED	Buy	Buy	Ord Minnett
6	MIRVAC GROUP	Buy	Neutral	Ord Minnett
7	WESFARMERS LIMITED	Buy	Neutral	UBS
Downgrade				
8	CHALLENGER LIMITED	Sell	Neutral	Ord Minnett
9	CROMWELL PROPERTY GROUP	Neutral	Buy	Ord Minnett
10	DEXUS	Neutral	Buy	Ord Minnett
11	DEXUS INDUSTRIA REIT	Neutral	Buy	Macquarie
12	INCITEC PIVOT LIMITED	Neutral	Buy	Morgan Stanley
13	INTEGRAL DIAGNOSTICS LIMITED	Neutral	Buy	Macquarie
14	SHOPPING CENTRES AUSTRALASIA PROPERTY GROUP RE LIMITED	Sell	Neutral	Ord Minnett
15	TABCORP HOLDINGS LIMITED	Neutral	Buy	Macquarie

Target Price

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	TPG	TPG TELECOM LIMITED	7.127	6.912	3.11%	6
2	ALQ	ALS LIMITED	13.780	13.770	0.07%	6
3	IDX	INTEGRAL DIAGNOSTICS LIMITED	4.430	4.428	0.05%	5

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	TAH	TABCORP HOLDINGS LIMITED	2.368	5.830	-59.38%	4
2	ALL	ARISTOCRAT LEISURE LIMITED	43.133	46.250	-6.74%	6
3	IPL	INCITEC PIVOT LIMITED	4.030	4.204	-4.14%	6
4	DXS	DEXUS	12.035	12.160	-1.03%	4
5	MGR	MIRVAC GROUP	2.828	2.848	-0.70%	5
6	NUF	NUFARM LIMITED	6.873	6.910	-0.54%	7
7	IGO	IGO LIMITED	12.820	12.870	-0.39%	5
8	EVN	EVOLUTION MINING LIMITED	4.321	4.333	-0.28%	7
9	CGC	COSTA GROUP HOLDINGS LIMITED	3.630	3.638	-0.22%	4
10	OSH	OIL SEARCH LIMITED	5.173	5.184	-0.21%	3

Earning Forecast

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	WEB	WEBJET LIMITED	15.427	-13.146	217.35%	7
2	SLC	SUPERLOOP LIMITED	-2.300	-4.667	50.72%	3
3	SKO	SERKO LIMITED	-19.022	-26.380	27.89%	3
4	ALQ	ALS LIMITED	62.633	52.988	18.20%	6
5	NAN	NANOSONICS LIMITED	-0.800	-0.967	17.27%	3
6	NUF	NUFARM LIMITED	36.136	32.747	10.35%	7
7	ELD	ELDERS LIMITED	93.475	88.000	6.22%	4
8	ALL	ARISTOCRAT LEISURE LIMITED	161.617	153.417	5.34%	6
9	BPT	BEACH ENERGY LIMITED	30.534	29.820	2.39%	7
10	HLS	HEALIUS LIMITED	59.598	58.265	2.29%	6

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	TAH	TABCORP HOLDINGS LIMITED	9.350	17.343	-46.09%	4
2	OSH	OIL SEARCH LIMITED	27.973	30.656	-8.75%	3
3	29M	29METALS LIMITED	10.303	10.878	-5.29%	4
4	NHC	NEW HOPE CORPORATION LIMITED	105.775	110.400	-4.19%	4
5	GOR	GOLD ROAD RESOURCES LIMITED	10.200	10.533	-3.16%	3
6	SQ2	BLOCK INC	186.039	191.789	-3.00%	4
7	IDX	INTEGRAL DIAGNOSTICS LIMITED	13.614	13.974	-2.58%	5
8	GUD	G.U.D. HOLDINGS LIMITED	73.052	74.574	-2.04%	5
9	NST	NORTHERN STAR RESOURCES LIMITED	27.303	27.848	-1.96%	6
10	WDS	WOODSIDE ENERGY GROUP LIMITED	437.710	446.107	-1.88%	5

Technical limitations

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WEEKLY REPORTS

Uranium Week: Follow The Leader

As global financial markets bounced from their sell-offs last week, so too did spot uranium.

- Spot uranium price bounces
- SPUT ready to re-enter market
- European energy sector unions push for nuclear power

By Greg Peel

Interest from speculative investment trusts in uranium as a financial instrument has led to the alignment of spot uranium prices with general financial market volatility in 2022. The Sprott Physical Uranium Trust in particular was most influential in driving the uranium spot price up to a post-Fukushima high of US\$64/lb earlier this year.

But turmoil in financial markets has since flowed over to spot uranium, causing the SPUT to take a hiatus from the uranium market thus allowing industry consultant TradeTech's weekly spot price indicator to fall as far as US\$45.50 two weeks ago, opening up a wide gap to TradeTech's term contract price indicator of US\$61.00/lb, which is supported by actual end-user demand.

Last week financial markets saw rebounds, exemplified by the S&P500 rallying over 6%, and again this volatility was reflected in the spot uranium price. TradeTech's weekly spot indicator rose US\$1.65 to US\$47.15/lb.

There was nevertheless further impetus for a rally last week when increased investor interest at lower prices allowed the SPUT to raise additional funds in the last two days of the week. As a result, sellers expect the fund to enter the market this next week to acquire additional pounds of uranium.

These expectations caused a number of sellers to move their firm offers to indicative offers or withdraw from the market altogether, TradeTech reports, leaving a limited number of sellers willing to commit to sales as the week came to a close.

Union Support

In a joint letter to members of the European parliament, 20 major trade unions in the European energy sector signalled their support for political candidates in favour of including nuclear power in the bloc's sustainable finance taxonomy.

The unions said nuclear should be included in the taxonomy on the basis of science-based evidence and the aim of the taxonomy to be "technology neutral", TradeTech reports. Furthermore, they stated that nuclear power has a key role in enabling Europe to achieve carbon neutrality.

The EU is seeking approval from member nations and from the European Parliament to approve the taxonomy, which classifies nuclear and natural gas as sustainable, environmental investments.

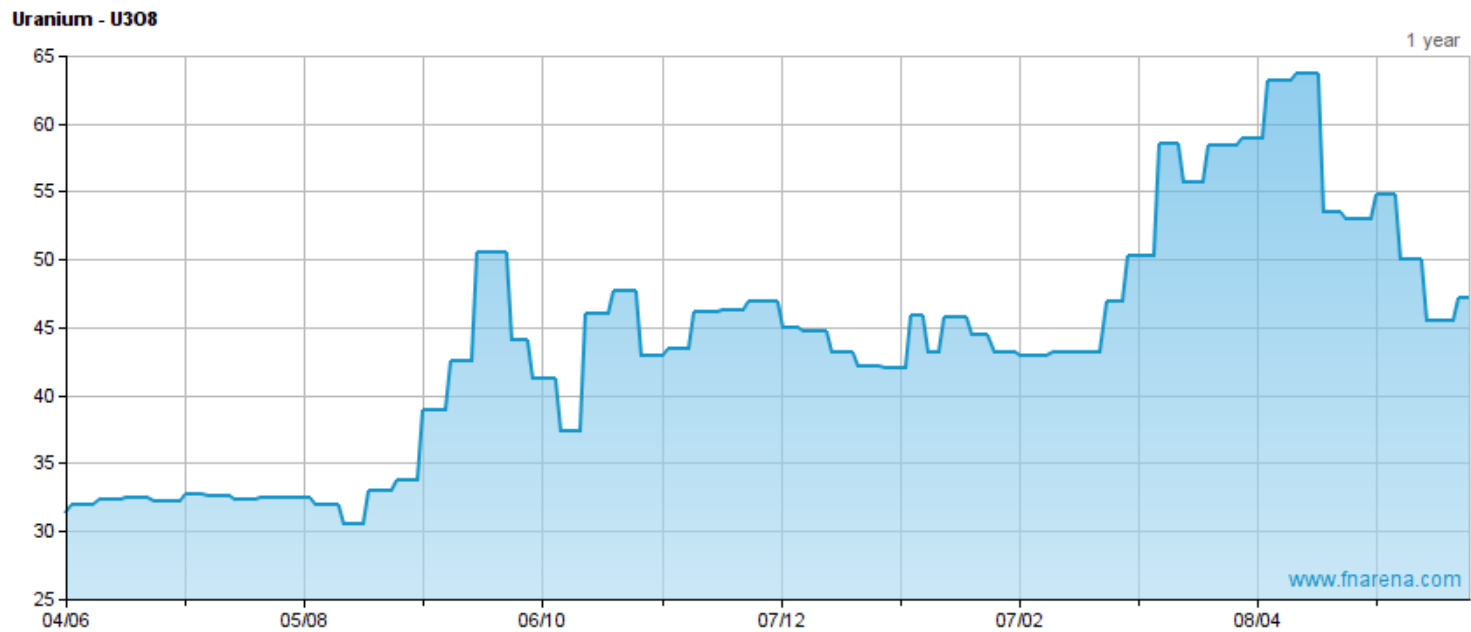
The initial move to do so preceded the war in Ukraine. While the EU has now moved to ban 90% of all Russian oil imports by year-end as a response, Europe still relies heavily on Russian pipeline gas ahead of securing alternative sources, such as LNG from Qatar.

Europe relies heavily on electricity from gas-fired power plants. Having initially responded to the Fukushima disaster by seeking to move away from nuclear power, the pendulum has since swung back in nuclear's favour.

Uranium companies listed on the ASX:

ASX CODE	LAST PRICE	% MOVE	52WK HIGH	52WK LOW	P/E	CONSENSUS TARGET	UPSIDE/DOWNSIDE
BKY	0.3700	0.00%	\$0.64	\$0.14			
BMN	0.2300	0.00%	\$0.44	\$0.12			
BOE	2.4300	0.00%	\$3.10	\$0.14		\$3.200	▲31.7%
ERA	0.2800	0.00%	\$0.58	\$0.25			

PDN	0.8000	▲ 2.56%	\$1.12	\$0.41	-81.5	\$1.000	▲ 25.0%
PEN	0.1800	0.00%	\$0.35	\$0.12			
VMY	0.2000	0.00%	\$0.33	\$0.09			



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WEEKLY REPORTS

The Short Report - 02 Jun 2022

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

Summary:

By Greg Peel

Week Ending May 26, 2022.

Last week, after the excitement of pending Chinese reopening gave way to a US-led consumer discretionary wipe-out, the ASX200 managed to post only a slight net gain.

A brief return to calm for the market was reflected in a quiet week for short interest movements, as none of the changes noted below reflect moves of one percentage point or more.

Don't be fooled by Webjet ((WEB)) and Appen ((APX)) dropping out of the 10%-plus club after appearing the week before - decreases were negligible.

It was on the last day of our week that Appen received a takeover offer and jumped around 20%, and before the next day that offer was withdrawn already, resulting in an equivalent retreat.

It was also the day after our week closed that PointsBet Holdings ((PBH)) spiked 16% on M&A speculation. We see below PointsBet shorts actually fell beforehand, but only to 7.9% from 8.1%.

Little more to say, other than we might note healthcare stocks were in the frame last week, with Imugene ((IMU)) and Pro Medicus ((PME)) appearing at the bottom of the table.

Weekly short positions as a percentage of market cap:

10%+

FLT 17.3
BET 13.7
NAN 12.5
PNV 11.4

Out: **WEB, APX**

9.0-9.9

WEB, APX, KGN, AMA

In: **WEB, APX, AMA**

Out: **EML, RRL**

8.0-8.9%

RRL, SQ2, Z1P, EML, ING, MSB

In: **RRL, EML**

Out: **AMA, PBH**

7.0-7.9%

PBH, OBL, CUV

In: **PBH**

6.0-6.9%

MP1, DUB, NEA, PDN, RBL, VUL, TYR

In: **PDN, RBL**

5.0-5.9%

MFG, IMU, TPW, ANN, NHC, CHN, IEL, CCX, PNI, BOQ, ADH, A2M, ASM, PME, DEG

In: **IMU, PME**

Out: **PDN, RBL, HUM**

Movers & Shakers

Nothing this week.

ASX20 Short Positions (%)

Code	Last Week	Week Before	Code	Last Week	Week Before
ALL	0.3	0.1	NAB	0.7	0.6
ANZ	0.6	0.6	NCM	0.8	0.7
BHP	0.2	0.2	RIO	0.6	0.7
CBA	0.6	0.6	STO	0.2	0.2
COL	0.5	0.5	TCL	0.9	0.8
CSL	0.2	0.2	TLS	0.2	0.2
FMG	1.4	1.5	WBC	1.5	1.4
GMG	0.5	0.3	WES	0.5	0.5
JHX	0.4	0.4	WOW	0.3	0.3
MQG	0.4	0.3		0.0	0.0

To see the full Short Report, please [go to this link](#)

Guide:

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

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

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

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

Often large short positions can be attributable to a listed hybrid security on the same stock where traders look to “strip out” the option value of the hybrid with offsetting listed option and stock positions. Short positions may form part of a short stock portfolio offsetting a long share price index (SPI) futures portfolio - a popular trade which seeks to exploit windows of opportunity when the SPI price trades at an overextended

discount to fair value. Short positions may be held as a hedge by a broking house providing dividend reinvestment plan (DRP) underwriting services or other similar services. Short positions will occasionally need to be adopted by market makers in listed equity exchange traded fund products (EFT). All of the above are just some of the reasons why a short position may be held in a stock but can be considered benign in share price direction terms due to offsets.

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

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

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

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

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

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WEEKLY REPORTS

In Brief: House Prices, Food Crisis, Packaging

Weekly Broker Wrap: house price decline begins, geopolitical tensions spark food crisis, Australian packaging producers underinvest in capital.

- Anticipated house price declines begin, experts predict a -15% drop ahead
- Food insecurity looks to increase as geopolitical tension impacts food imports
- Capital expenditure underinvestment by Australian food packaging could lead to competitive disadvantage

By Danielle Austin

House prices decline, soft building approvals suggest risk to construction industry

The -0.3% decline in national house prices in May looks to be just the start of house price declines according to analysts from Morgan Stanley, who predict prices may fall by a further -15% over the next eighteen months. It marks the first decline in house prices since September 2020, and while prices remain 11.7% higher than they were a year ago it is the view of the Morgan Stanley analysts that it is no coincidence the first decline in national house pricing in more than two years has coincided with the first cash rate hike in more than a decade.

Morgan Stanley predicts the cash rate will rise to 1.75% by December, noting imminent rate hikes will have a direct impact on loan serviceability costs and warning investors to expect a -5% decline in house pricing in 2023 and a further -10% decline in 2024.

Declining house prices could also indicate further risk for the construction industry according to the broker. Noting forward building approvals have softened significantly, down -2.4% month-on-month and -32% year-on-year in April, Morgan Stanley anticipates approvals will decline further as house prices fall. While around 230,000 construction projects remained in the national pipeline at the end of 2021, Morgan Stanley highlighted risk around the completion of these projects as costs increase and prices decline, with risk to construction activity translating to risk to the 9% of the workforce directly employed by the industry.



Food import constraints could drive global food crisis

With constraints on global food exports, analysts at ANZ Bank are anticipating food protectionism to increase and food insecurity to worsen, driving a global food crisis that will be detrimental to the United Nation's goal of zero hunger by 2030.

According to ANZ, the Russia-Ukraine conflict is a major driver of an ongoing global food crisis. Grain exports in particular look to be a challenge, with both Russia and Ukraine major grain exporters having supplied 30% of global wheat supply in recent years. Coinciding with a series of poor grain harvests, particularly in North and South America, inventories of the soft commodity are precarious. With the conflict impacting energy and fertiliser availability, ANZ anticipates another challenging grain harvest ahead.

With global grain inventories set to shrink to the lowest level since 2016 this year, ANZ noted China hold nearly 58% of global grain stocks in a bid to protect itself against food insecurity, and will serve the country well as other nations look to import product at inflated prices. Africa, where the World Food Program estimates up to 20 million people are facing severe hunger, is highly dependent on food imports, and more vulnerable to food inflation and a global food crisis. The broker noted other developing countries are also exposed to food inflation, and with the FAO Food Index surging to a new record level the United Nations anticipates 660 million people will face hunger in 2030 due to lasting impacts of the covid pandemic.

For investors, it worth noting food exporting nations like Australia and New Zealand may continue to benefit from elevated soft commodity pricing, in a net sense.

Australian packaging companies lag peers on capital expenditure investment

Analysts from Jarden have warned investors to consider the impact to free cash flow and valuations of Australian packaging companies should they need to lift their capital expenditure investment near-term. Market analysis from Jarden suggests Australian packaging companies are underinvesting in capital expenditure compared to their US counterparts, which could leave them at a competitive disadvantage over time according to the broker.

While Jarden's analysts noted capital investment has been at a cyclical low for Australian packaging between FY17-22, their US peers have increased reinvestment in the same period. Further, they highlighted the high reliance on fixed capital productivity and capacity of the packaging industry, with domestic companies now

utilising older technologies and less productive assets with shorter remaining lives.

Of the relevant packaging companies in their coverage, Jarden noted consensus expectations are that both Amcor ((AMC)) and Orora ((ORA)) capital investment will remain low in relation to US companies over the next three years, meaning an increase in expenditure above current guidance could see cashflow differ significantly from market estimates. If increased capital investment is assumed, marking likely spend to US peers, Amcor ((AMC)) offered the greatest upside to forecasts, followed by Orora ((ORA)) and Pact Group ((PGH)).

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TREASURE CHEST

Treasure Chest: The Bull Case For Jumbo Interactive

FN Arena's Treasure Chest reports on money making ideas from stockbrokers and other experts. Morgan Stanley sets a higher target price and outlines its bull case scenario for Jumbo Interactive.

By Mark Woodruff

Whose Idea Is It?

Analysts at Morgan Stanley.

The subject:

Assessing the likelihood of Jumbo Interactive ((JIN)) achieving an ambitious FY26 target.

After analysing management's goal of achieving software earnings that will comprise 50% of overall earnings by FY26, (from 18% in FY23), the Outperform rated-Morgan Stanley lifts its 12-month price target to \$25.50 from \$22.00.

While the target price relates to a base case scenario, the broker also assigns a 20% probability to its \$46.00 bull case scenario playing out.

The company is an internet lottery business that currently sells national lottery games via its OZLotteries.com website and app and has a Software-as-a-Service (SaaS) product - "Powered By Jumbo" - which provides other lottery operators globally a software system to power ticket sales and leverage their existing customers.

The analysts estimate the optionality of Jumbo Interactive's software growth has not been incorporated into the share price at all, and suggest there's currently a compelling entry point for such a long-term compounding business.

Shares have fallen by more than -20% year-to-date and are trading on an attractive multiple, according to Morgan Stanley.

The broker also likes the company's defensive demand characteristics, leverage to digitisation, strong EPS growth, as well as cash flow conversion of around 100% of earnings.



More info:

Software earnings for Jumbo interactive comprise the SaaS and Managed Services segments. The analysts believe it is a plausible goal by management to grow these earnings to the same size as Lottery Retailing by FY26 and achieve its 50% target.

Among the key drivers for Morgan Stanley's bull case scenario is SaaS expansion which may derive from becoming the sole vendor to a major existing customer or selling the solution to novices in the online lotteries space. Expansion may also occur by displacing a legacy online solution for a lottery business.

Further, Managed Services acquisitions and subsequent cost synergies also helps support the bull case.

The flagship Oz Lotteries consumer business is the lowest cost external distributor of lottery tickets, explains the broker, due to a favourable reseller arrangement with the Lottery Corp ((TLC)). It's thought the company has exposure to an early-stage online migration of lottery sales. In addition, there are favourable shifts in consumption habits, including more social (Lotto Party) and more convenient solutions, via autoplay, mobile and voice.

Neutral-rated Goldman Sachs, not one of the seven brokers updated daily in the FNArena database, agreed on positive domestic lottery trends when it lifted its target price to \$18.00 from \$17.40 in early May. Upside for Lotteries was anticipated due to a shift toward higher-margin digital and an upcoming OzLotto game change.

Macquarie also initiated coverage of Jumbo Interactive in March with an Outperform rating and highlighted recent UK and Canada acquisitions have allowed for geographical diversification of earnings. The broker expected further acquisitions to support international growth and set a \$20 target price.

The FNArena database has three broker Buy ratings (or equivalent) and one Neutral rating, with an average target price of \$21, which suggests 34.8% upside to the latest share price.

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TREASURE CHEST

Treasure Chest: Media Beholden To Cyclical Downturn

FN Arena's Treasure Chest reports on money making ideas from stockbrokers and other experts. Brokers are downgrading their expectations for listed media companies as the economy slows amidst RBA tightening, impacting all of TV, radio, online classifieds and outdoor advertising.

By Greg Peel

Whose Idea Is It?

Analysts at Macquarie and Morgan Stanley.

The Subject:

Downturn ahead for Australia's listed media companies.

The Argument:

Of all the cyclical sectors in the market, media is one of the most tied to economic ups and downs, reflected in demand for advertising. As the RBA begins to tighten policy from covid emergency levels in order to fight inflation, economic growth is set slow.

Typically the central bank would be looking to slow the economy with higher rates when it's running too hot, leading to inflation, but in this case the economy is already impacted by the covid overhang causing supply and labour shortages, and is thus slowing from its initial resurgence out of 2020-21 lockdowns.

Which is why there is still talk of stagflation. Macquarie's Macro Strategy team is currently forecasting a 60% probability of a mild recession.

A review of the experience of the GFC, after which Australia avoided two quarters of negative growth but as the economy improved, the RBA began to raise rates, Macquarie concludes the media sector PE multiple tends to decline ahead of earnings revisions with reasonable accuracy. The market is currently implying a sector earnings downgrade of some -20%.

As we are currently at the beginning of the downgrade cycle, Macquarie has shifted its sector stance to negative, moving to Underweight from Neutral. The sector covers companies in the business of television and radio, newspapers, online classifieds and outdoor advertising.

Macquarie notes Carsales ((CAR)) is typically more resilient, enjoying higher listings even as demand fades, hence an upgrade to Outperform from Neutral.

Seek ((SEK)) is the most cyclically exposed, with job ads highly correlated to economic indicators, hence a downgrade to Underperform from Neutral.

REA Group ((REA)) and Domain Group ((DHG)) face real estate-specific headwinds from rising rates. REA is downgraded to Underperform but Domain hangs onto Neutral.

Television and radio earnings are very much linked to advertising spend. Seven West Media ((SWM)) and Southern Cross Media ((SXL)) are downgraded to Neutral from Outperform and Nine Entertainment ((NEC)) remains on Neutral.

News Corp ((NWS)) is on the other hand less exposed to advertising hence Macquarie retains Outperform.

Outdoor advertising should be included as suffering an impact from weaker advertising demand but the reopening of air travel meeting pent-up demand implies primary airport billboard advertising demand should remain supportive. Hence Macquarie retains an Outperform on oOh!media ((OML)).

HT&E ((HT1)) is involved in both outdoor advertising and radio, so it has been downgraded to Neutral.



Seven West

Morgan Stanley concurs that the cyclical and economic outlook is softening.

Seven West Media has undergone restructuring in the last two years leading to outperformance on higher TV ratings coupled with a reduction in debt. The company has made the most of the post-covid recovery in TV advertising, Morgan Stanley suggests, reflected in a strong bounce-back in earnings.

But at its core Seven West remains a TV business, and every 10% increase/decrease in the TV ad market moves earnings by plus or minus 30-40%. Morgan Stanley sees the TV advertising market as mature in the medium term, and declining over the longer term.

Having recently acquired regional TV broadcaster Prime Media, Seven West's free-to-air TV business, including video on demand, accounts for some 85% of revenues.

The broker has resumed coverage of Seven West Media with an Underweight rating.

The same argument applies to Nine Entertainment but Morgan Stanley retains an Overweight rating, based on a stronger balance sheet and greater digital exposure. The broker believes the strategic value of Stan, as part of a wider TV/screen asset portfolio, is substantial.

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RUDI'S VIEWS

Rudi's View: Quo Vadis, Corporate Profits?

In this week's Weekly Insights:

- Quo Vadis, Corporate Profits?
- Conviction Calls
- FN Arena Talks

By Rudi Filapek-Vandyck, Editor FN Arena

Quo Vadis, Corporate Profits?

Bad things tend to happen when global economic growth dips below 3%. In recent days I have been alerted to this historical observation by multiple economists and market analysts, so I thought it is worthwhile highlighting this point.

GDP forecasts around the globe are in decline, with many a forecast now sitting marginally above 3% for the global economy this year and next. This makes that historical observation potentially even more important.

One key ingredient to those forecasts is, of course, how much central bank tightening needs to occur to bring consumer price inflation back under control.

Truth is, we don't know. Which is why traders, investors and central bankers are all watching the data very closely.

Markets Oversold In May

Global equities had looked technically oversold for a number of weeks, but that interview by Fed Chair Jerome Powell to the Wall Street Journal mid-month had kept a firm lid on overall enthusiasm to start piling back in.

'Don't fight the Fed' has a different meaning this time around.

Investors needed a bit of extra time to fully digest the new Fed narrative. Controlling inflation is now of the uppermost importance (see also further below).

When markets are oversold, the smallest hint of optimism can trigger the next rally. Last week US indices rallied more than 6% to post their best week for the calendar year to date. According to the latest economic data, the all-important US consumer remains eager to spend, even if this means he/she has to dip into savings.

And there are quite a few suggestions that inflation is no longer poised to keep surprising to the upside, despite expectations for higher energy and materials prices in the quarter(s) ahead.



Peak Inflation Anxiety?

Reduced anxiety about inflation in particular might be the most important development in May, if it proves to be accurate. It implies that bond yields might have peaked already, as also shown by the US ten-year yield declining towards 2.75% from 3.10% earlier.

A more relaxed US bond market might allow equity markets to become less volatile, in a general sense, but it will also allow those market segments that had previously de-rated to shift back onto investor radars.

Think bond proxies such as REITs, property developers and infrastructure owners, but also Quality and Defensive Growth stocks that traditionally trade on higher valuation multiples.

In Australia, I note both Carsales ((CAR)) and Goodman Group ((GMG)) shares are back above \$20, while the likes of Cochlear ((COH)), NextDC ((NXT)) and IDP Education ((IEL)) are well off their lows.

One cannot argue with 'hope' and it is very likely equity markets will adopt the view that if central bankers can relax more about further momentum for inflation, they don't have to stick with their intentions for aggressive tightening. This reduces the risk for over-tightening, and thus for an economic recession.

Not everybody is on board with this reasoning, as also illustrated by the latest comment from the economics desk at Citi:

"Markets are increasingly reflecting the idea that slowing growth will lead to a more dovish Fed policy rate path. We disagree with this assessment and see risks still balanced toward a more extended period of above-target inflation requiring a further tightening of financial conditions."

I still remain a bit wary myself, not in the least because the Federal Reserve will also embark on Quantitative Tightening (QT), i.e. actively selling bonds. Nobody knows what the impact of additional liquidity withdrawal will look like, but we are going to find out.

Corporate Profits: The Next Concern

In the background of this year's Grand Debate about inflation, interest rates and bond yields, and the impact of it all on housing markets and economies in general, investor focus is already turning towards corporate margins and profits - the next Big Challenge for equities this year.

It is this second challenge that keeps me worried about the outlook for equities.

Simply put: markets have devalued on a normalisation in bond yields, which has pulled down the 'P' in average

Price Earnings (PE) ratios. But now we will have to deal with the 'E', earnings (profits), and outside of energy producers and bulk commodities coal and iron ore, the trend has already turned negative - globally.

These are slow-moving processes, and more downside should be expected, if only because inflation is slow-moving too, and multiple challenges remain amidst slower economic momentum.

In the US, where super-margins and super-profits previously combined with outsized gains and valuations, the simple observation is the Q2 reporting season failed to inspire. In about six weeks, US companies start releasing their Q3 financials.

It's going to be interesting, to say the least.

In Australia, we don't have extensive quarterly reporting and the 50-odd, mostly mid-cap companies that report in between February and August are not representative for the bulk of the local share market.

Investors have seen a number of profit warnings coming through, mostly issued by companies of questionable quality or of a relatively small size, bringing home the old truth that smaller companies are more vulnerable to economic challenges.

I do expect to see a lot more "confessions" as the financial year draws to a close and the August reporting season beckons.

It is not always easy to spot the next profit warning coming, and many a share price has received quite a shellacking already, for general fears of lower profits or otherwise.

Analysts at UBS recently pointed out commodity-related costs for their universe of companies throughout the Asia-Pacific have gone up by 29% year-to-date.

Conclusion: "With operating leverage fading and the impact of cost increases typically taking three months to feed into margins, the risk to earnings remains substantial at least over the next quarter".

Even more concerning is that UBS has placed Australia in the least favoured basket for the APAC region, suggesting ASX-listed companies are likely to fare worse than those in China, Singapore, Indonesia, Philippines and Malaysia.

Differences in pricing power means some companies are better equipped to deal with rising cost challenges than others. This is why, for example, packaging company Amcor ((AMC)) is trading near an all-time high when energy and commodity prices are running hot on supply constraints.

Unfortunately, the UBS research focuses mostly on companies in China, Japan and elsewhere, with only a small number of ASX-listed names mentioned. Imdex ((IMD)) is seen as a potential candidate for the next profit warning, while a2 Milk ((a2M)), Bega Cheese ((BGA)), Synlait Milk ((SM1)) and KMD Brands ((KMD)) have been nominated as likely beneficiaries for any sustained decline in commodity prices.

Another noteworthy observation relates to the latest global update by Citi which reveals Australia is one of few markets where average EPS growth is forecast to be negative in 2023. The reason is that following a stellar increase in EPS forecasts this year for the Energy and Materials sectors, Citi forecasts have both sectors retreating into negative growth next year.

That'll be the next challenge for investors; assessing for how long exactly may the current favourable environment last for what are, in essence, highly leveraged, cyclical businesses.

Meanwhile, **Citi's Bear Market Checklist** has improved on the back of lower share prices with only 6 out of 18 components flashing red or amber warning signals. At the end of last calendar year, the score was 8.5 or nearly 50%. Back in October 2007 the score was 13, while in March 2000 the list had 17.5 out of 18 indicators calling Mayday, Mayday!

The market sentiment indicator previously known as Citi's Panic/Euphoria Index, now relabeled as Levkovich Indicator, is not signalling equities are in Panic mode, but the indicator is not that far off, and a long while from the Euphoria that characterised 2021.

Citi's indicator has no bearing on short-term sentiment or market direction but at current level Citi suggests there should be good buying opportunities for investors taking a 12-months view or longer.

Market strategists at Morgan Stanley tend to agree with that assessment. They also believe equity indices are likely to face more downward pressure depending on how much lower corporate profits might fall.

And that, history suggests, is now the most important question of all: quo vadis, corporate profits?

Australian investors might have to wait a little while yet to find out, but the next US corporate results season is only 1.5 months away.

More Reading:

-Don't Fight The Fed: <https://www.fnarena.com/index.php/2022/05/26/rudis-view-dont-fight-the-fed/>

-Trend Is Turning For Corporate Profits:
<https://www.fnarena.com/index.php/2022/05/12/trend-is-turning-for-corporate-profits/>

-A Bear Market Anomaly That Confuses:
<https://www.fnarena.com/index.php/2022/05/05/rudis-view-a-bear-market-anomaly-that-confuses/>

-Peter's Portfolio Reviewed:
<https://www.fnarena.com/index.php/2022/04/13/rudis-view-peters-portfolio-reviewed/>

-2022, The Big Adjustment:
<https://www.fnarena.com/index.php/2022/02/17/rudis-view-2022-the-big-adjustment/>

FNArena Corporate Results Monitor:

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

Conviction Calls

It's one of the calls that will generate a lot of attention, both from financial media and from investors the world around.

Goldman Sachs has called the peak in **modern battery metals** lithium, cobalt and nickel, now forecasting steep falls in prices over the coming two years.

The suggested trajectory in respective prices is different with the analysts projecting a fall-off-the-cliff experience for lithium, a meaty price fall for cobalt and an ongoing rally for nickel into year-end, then followed by a serious correction.

With spot lithium currently priced around US\$60,000/tonne, the broker's year-average estimate declines to US\$53,982/tonne for 2022, with an average of US\$16,372/t penciled in for 2023.

For Cobalt, the current spot price of circa US\$87,000/t compares with the broker's year-average estimate of US\$78,500/t for 2022, and US\$59,500 for 2023.

Nickel is currently priced around US\$31,000/t but Goldman Sachs anticipates another rally to US\$36,500/t over the rest of the calendar year, with its price averages at US\$31,000 and US\$30,250/t respectively for this year and next.

The good news is, on Goldman Sachs' projections, the forthcoming deep correction will sow the seeds for the next Super Cycle for these materials, likely to commence by the second half of this decade, with supply struggling more severely to catch up on strong growth in demand.

By 2030, estimated market deficits are around one third for cobalt, more than one fifth (22%) for nickel and 13% for lithium with the broker highlighting these forecasts incorporate active recycling of materials by then.

Global strategists at Morgan Stanley believe the Bear Market for equities has further to run with a close eye on aggressive central bank tightening and a deteriorating outlook for corporate profits.

Morgan Stanley's preferred setting is now relatively Underweight equities, with Australia left as the sole Overweight allocation because of the ASX's leverage to materials as well as its high dividend yield. The RBA is not as aggressive as the Fed, which feeds into the more defensive narrative of the local economy.

More support is seen from the Australian dollar which, short-term, is expected to fall to US67c and climb back to US70c into 2023.

Morgan Stanley favours Energy, Healthcare and Materials on the ASX over housing linked and consumer-related exposures. Banks have recently been lowered to an underweight position. Value is preferred over Growth.

Talking about ongoing risks in a Bear Market that doesn't seem near its end by half, last week Greg Galton, director Private Wealth Research at **Canaccord Genuity**, summarised the key risk for equities as follows:

"If the rate of increases in US inflation drops sharply in coming months, the Fed may at least pause its rate hike plans after June or July. This could avoid recession and might allow equities to at least grow in line with still-positive corporate earnings."

"If inflation remains stubbornly high, however, the Fed won't stop, even if the economy edges closer to recession. Equities would likely drop at least another 20 to 30%. Earnings would fall while panic potentially causes PE ratios to move from current levels (average) to well-below average levels."

"We are still some months away from a clearer picture on the speed of US disinflation."

Analysts at Citi seem convinced the market has treated consumer-related equities on the ASX too harshly, instead suggesting the outlook remains relatively robust for household goods throughout the rest of 2022, while momentum in food retailing is "normalising".

Citi used the latest research update to highlight it currently has Buy ratings for Coles ((COL)), Woolworths ((WOW)), Super Retail ((SUL)), Harvey Norman ((HVN)), Beacon Lighting ((BLX)), Nick Scali ((NCK)), Premier Investments ((PMV)), City Chic Collective ((CCX)), Lovisa Holdings ((LOV)), and Michael Hill International ((MHJ)).

Rising concerns about a global recession have combined with a severe de-rating for **ASX-listed technology stocks** and sector analysts at **Goldman Sachs** have directed their focus towards identification of those technology companies that look well-placed to navigate what looks like a much tougher environment ahead.

Free cash flow, balance sheet health and recurring revenues are thus top of the priority list with a minimum market cap of \$250m required.

Interestingly, TechnologyOne ((TNE)) came out as the best-positioned among all Buy-rated stocks, however... if we can ignore the current valuations and recommendations then the two best placed companies are Pro Medicus ((PME)) and WiseTech Global ((WTC)), on the broker's analysis.

Because of its high valuation, still, Pro Medicus is Sell-rated by the broker, while WiseTech is currently rated as Neutral.

Equity strategists at UBS have updated their list of **Best Stock Ideas** in Australia; essentially those stocks that are believed to represent the broker's team of analysts most and least preferred investment ideas for the 12 months ahead.

Broader picture, UBS retains a preference for so-called late-cycle sectors, as well as companies that should benefit from higher inflation. In addition, the strategists seem convinced the chosen companies will be able to achieve solid earnings growth even as the outlook in general is deteriorating.

Wesfarmers ((WES)) and Qantas Airways ((QAN)) have replaced Harvey Norman ((HVN)) and Brambles ((BXB)) on the most preferred list, whereas growing concern about the cost of doing business for building materials and food producers has led to the inclusion of AdBri ((ABC)) and Inghams Group ((ING)) to the least preferred selection.

That Least Preferred list further includes Charter Hall Long WALE REIT ((CLW)), Insurance Australia Group ((IAG)), Magellan Financial Group ((MFG)), Telstra ((TLS)), and Woolworths ((WOW)).

As far as the list of Most Preferred Best Stock Ideas goes, resources are represented by BHP Group ((BHP)), Northern Star Resources ((NST)), Origin Energy ((ORG)), South32 ((S32)) and Santos ((STO)), while for Financials, UBS has selected Computershare ((CPU)), QBE Insurance ((QBE)) and Westpac ((WBC)).

Other inclusions are Amcor ((AMC)), GUD Holdings ((GUD)), IDP Education ((IEL)), James Hardie Industries ((JHX)), NextDC ((NXT)), Nine Entertainment ((NEC)), Select Harvests ((SHV)), Seven Group Holdings ((SVW)), Stockland ((SGP)), and Treasury Wine Estates ((TWE)).

FNArena Talks

Last week's presentation on the outlook for equities is available via the FNArena Talks section on the website (51 minutes):

<https://www.fnarena.com/index.php/fnarena-talks/2022/05/30/2022-outlook-when-cash-is-king/>

Subscribers can download the slides via the Special Reports section on the website (scroll down).

(This story was written on Monday 30th May, 2022. It was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website).

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