Week

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Stories To Read From FNArena

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Beach Energy Lays Out Future Plans

Beach Energy has provided production guidance out to FY23 and expects to achieve 100% replacement of reserves over that period.

-Growth expected from the Western Flank, Cooper and Otway Basins -Beach Energy expects to be net cash by end 2020 -Farming down of Otway expected over the next few months

By Eva Brocklehurst

In its first investor briefing for some years Beach Energy ((BPT)) has laid out its plans for the future, outlining capital commitments and a production target. Production guidance of 34-40mmboe is expected by FY23, providing the market with upside following the Lattice transaction. The company also expects to achieve 100% replacement of reserves over that period.

To fund growth, Beach Energy will spend more than $3bn over five years, mostly on developments, with the projects expected to achieve an internal rate of return of more than 40%. Management has not been specific regarding where actual growth will come from, but generally it is expected from the Western Flank, Cooper and Otway Basins.

RBC Capital Markets notes investors have rewarded the company's growth targets, with the stock running on a further 8%, after a very strong rally since the Lattice acquisition was announced a year ago.

The broker believes the decision to fund the Lattice transaction through existing cash and debt has proven to be the right one, as the stock has benefited from financial leverage during the surge in the oil price over the past year. Citi suggests a higher oil price could translate into more surprise on the upside.

Macquarie believes the growth target is ambitious, as it relies on exploration success, although achieving such production levels will generate significant upside. As expected, Beach Energy has guided to higher capital expenditure over the new forecast period.

Cash Flow

Capital expenditure is expected to average $575-650m over FY20-23. Macquarie assesses that a successful divestment could reduce capital expenditure by around -$100m per annum. Despite higher production, the high expenditure is expected to weigh on overall cash flow.

The company now expects gearing to fall below 20% by the end of the year, six months earlier than previously anticipated. Beach Energy has a goal of being net cash by the end of 2020, which RBC finds comfortable in light of forecasts for Brent at US$86-88/bbl in 2019-20.

The broker believes de-gearing will afford material capital management potential and/or M&A. RBC Capital Markets, not one of the eight stockbrokers monitored daily on the FNArena database, upgrades to Sector-Perform from Underperform, raising the target to $1.95 from $1.55.

FY19 guidance surprised Macquarie as its estimates are slightly ahead of the company's 26-28mmboe because of continued success in the Cooper Basin and, thus, guidance may end up being conservative. The main catalyst for the near term is the drilling of Black Watch in late FY19 amid exploration at Artisan and Enterprise. Still, the major de-risking of exploration will not take place until FY20-21. Hence, it could be two years before the potential from the company's plan is revealed.

Macquarie increases expectations for capital expenditure in the offshore Otway Basin because of the inclusion of an additional well and changes to development costs, as well as reduced capital commitments at Kupe as the company anticipates no further drilling at that project.

Replacement Target

RBC Capital Markets acknowledges the 100% replacement target is a bold move. Yet significant reductions since 2015 in gas well drilling and unit production costs at the Cooper Basin JV have enabled the possibility of expanding the existing resource and expediting future replacement of reserves.

Management has also indicated exploration activities are planned in the Perth Basin, south-east of Waitsia at Beharra Springs Deep and Trieste. The broker suggests this brownfields location and existing infrastructure should help commercialise any future exploration success.

Morgan Stanley's bull case is $2.50 a share, based on the belief that the company can build a bigger, more sustainable business over time. Conviction, post the investor briefing, has increased, as Beach Energy expects to generate $2.3bn over the next five years in free cash. The broker expects a farming down of Otway over the next few months with 30-40% being divested.

RBC points out the 5-year outlook assumes Beach Energy retains its current equity interest in offshore Otway assets, although notes the intention to explore s sell-down of its holding has been reiterated.

The company also provided an assessment of the implications of multiple LNG import terminals on Australia's east coast. The broker concurs with the assessment that the proposals signal a tight market and afford opportunities for domestic gas developers to undercut import proposals. RBC's long-term south-east Queensland reference gas price is $7.50/gigajoule to which a further $1/gigajoule is added as a premium for Victoria/South Australia supplies.

FNArena's database shows two Sell ratings, one Hold (Ord Minnett) and one Buy (Morgan Stanley). The consensus target is $1.86, suggesting -12.7% downside to the last share price. Targets range from $1.59 (Citi) to $2.10 (Ord Minnett).

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Fortescue At The Mercy Of China's Steel Mills

Chinese steel mill profitability has surged, signalling to Morgan Stanley why the iron ore price achieved by Fortescue Metals has remained relatively flat.

-Morgan Stanley suspects an extended period of wider low-grade discounts is likely -Improvement in product grade unlikely to come without reversal of cost reductions -Iron ore prices not keeping up with steel prices, which are at seven-year highs

By Eva Brocklehurst

The iron ore price achieved by Fortescue Metals ((FMG)) continues to perplex. China's stimulus program and reform agenda has driven the 62% iron ore price index to US$69.50/t in September, from US$56/t in March. During this period, the discount for Fortescue's 58% iron ore has risen to -43% from -17%.

This means the price Fortescue Metals has received is relatively flat, at the mercy of the elevated profitability of Chinese steel mills. Morgan Stanley continues to expect these steel margins will be well supported because of the shutdown of China's outdated capacity and enforcing of the winter steel production cuts.

China's iron ore is typically low-grade and production has been curtailed by -3% over 2018 because of environmental restrictions, while imports remain strong.

Morgan Stanley believes it is important to understand what is causing the recent spike in iron ore discounts in order to appropriately value Fortescue Metals. The broker finds limited evidence that metallurgical coal prices are driving the widening discount, rather it is supply-side reforms by China and the elevated profitability of steel mills.

This elevated profitability has altered the incremental value placed on each unit of grade. Based on the broker's channel checks, when steel margins dropped towards RMB300/t back in March, the Chinese mills started to use more low-grade iron ore.

Shipping

The latest shipping data from Australia's ports signals shipments in the September quarter are down significantly. The average shipping rate for Fortescue Metals in the quarter was -11% lower than Macquarie expected. The company hit its 170mtpa target for FY18 because of a record 200mtpa in June. Hence, Macquarie is not surprised that the shipping rate has fallen back, as maintenance is undertaken at the mines as well as the port and rail network.

Even so the decline has been larger than expected and July's shipment rate was the weakest in three years. Macquarie has reduced shipment forecasts for the first quarter of FY19 by -11% to reflect this weak start. The broker also notes that while the shipping rates from Australia's ports have declined from the peak achieved in June, Fortescue's low-grade price has been stable, trading in a tight range of US$40-46/dmt since April.

Cost Savings

Morgan Stanley expects an extended period of wider low-grade discounts is likely and, while Fortescue may be able to ameliorate this by changes in product mix, it will not be without some cost savings being reversed.

Over the past five years the company has achieved cost savings through low average product grades, and production costs have dropped -70% since FY12 because of product blending and wet processing. This allowed for a reduction in cut-off grades and strip ratios at its Chichester hub while keeping the end product unchanged.

Morgan Stanley has reinstated coverage of Fortescue Metals with an Underweight rating, suspecting there will be negative revisions to consensus earnings estimates as high discounts persist until FY21.

Deutsche Bank downgraded to Sell from Buy recently, suggesting the whole steel complex may turn before the discount for iron ore narrows. The broker also recognises steel prices are at seven-year highs and iron ore prices are not keeping up, despite the weaker supply.

Fortescue Metals is the fourth-largest supplier of iron ore in the global seaborne market. FNArena's database shows five Buy ratings, one Hold and two Sell. The consensus target is $4.62, suggesting 23.6% upside to the last share price. On present FX values, the dividend yield on FY19 and FY20 forecasts is 8.5% and 7.6% respectively.

See also Capex Plans To Feature For Fortescue Metals on Jul 30, 2018.

RC Poses More Questions For Financial Sector

Rather than a set of recommendations, the interim report from the Financial Services Royal Commission has presented a list of questions for the financial sector, extending the period of uncertainty.

-Incentives for profit the main cause for concern of Hayne Royal Commission -Debate likely to continue regarding the required level of separation in wealth management -AMP likely to be the biggest loser from RC-instigated changes in wealth management

By Eva Brocklehurst

After the hue and cry of the proceedings, the interim report from the Royal Commission into Misconduct in Banking, Superannuation and Financial Services appears softer than many in the financial markets expected.

Commissioner Kenneth Hayne has presented questions for the financial sector for further discussion at later hearings, which extends the period of uncertainty over recommendations until the final report is delivered. The Commissioner has noted changes are already underway in the industry. Most of the major banks are in the process of reducing their footprint in wealth management.

Credit Suisse observes Westpac ((WBC)) will become the only major bank owning a platform and no bank will own an asset manager. ANZ Bank's ((ANZ)) exit of wealth management is the most advanced while Westpac has gradually reduced its holding in Pendal Group ((PDL)) over the last few years to around 10%, and plans to exit its remaining position at some point in the future.

Nevertheless, the interim report has highlighted major concerns around culture, incentives, conflicts of interest and regulation. The report covered consumer and small-medium enterprise lending as well as financial advice but did not cover insurance and superannuation.

Greed was the overriding issue, as incentives for profit were largely the cause of transgressions and regulators received blame for not pursuing transgressors more thoroughly.

Vertical Integration

Specifically, JPMorgan suggests the main risks lie with the Royal Commission requiring the financial services industry to prove why vertical integration should be allowed. The Commission noted that some clients have ended up paying higher platform fees because of a reduction in competition.

Furthermore, while banks may be leaving wealth management this does not necessarily reduce vertical integration, Credit Suisse points out. Two of the planned spin-offs - CFS, owned by Commonwealth Bank ((CBA)), and MLC, owned by National Australia Bank ((NAB)) - will operate across the value chain in advice, platform and asset management. From a technical point of view, these divestments do little to reduce vertical integration.

The Commission did not signal a desire for an outright ban on vertical integration and Credit Suisse suspects there will be continuing debates about the level of separation required in wealth management. If vertically integrated business models persist, costs are expected to rise. Dealer groups are also expected to provide greater choice of platform to advisers through less conflicted arrangements.

The broker believes IOOF ((IFL)) has an operating model which is an example of a less-conflicted vertically integrated model, where advisers can choose between platforms and use their own in-house platform. However, the company's advice practice is expected to face a new challenge, as price reductions from BT Panorama (Westpac) eliminate revenue share for dealer groups under the new pricing structures.

Grandfathering

The Commission also questions whether stronger probity tests are needed for advisers to move clients into aligned products, and grandfathered commissions and commissions on life insurance also came under scrutiny.

Credit Suisse observes the main impact of ceasing such commissions will be increased product switching, which could mean higher flows into contemporary products, and this could benefit Netwealth ((NWL)) and HUB24 ((HUB)).

Shaw and Partners considers the biggest loser is likely to be AMP ((AMP)) as its business model is based on vertical integration and grandfathered commissions, and allows for a substantial risk of conflicted advice.

The broker estimates, the sooner grandfathered commissions are terminated, the quicker the higher-margin wealth management products become lower-margin new products issued by another provider and, the sooner intermediaries are not allowed to sell AMP products, the less the company is worth.

All up, JPMorgan believes all wealth managers face significant risk until these questions are resolved and, while IOOF has not received the same attention as AMP during the hearings, this is not necessarily because there are no issues with its business.

Credit Suisse believes HUB24 will attract significant flows in coming years because of its superior offering and a shift to specialist platform providers, however, there is increased risk from broader price competition and greater scrutiny of superannuation fees. The broker has a Neutral rating on the stock but considers it offers better value than Netwealth (Underperform) as it trades on a similar multiple yet offers higher earnings growth.

While Netwealth is making the most of the opportunities from the disruption in the wealth management industry, the broker believes it is constrained by low rates of switching and increased competition.

Credit Suisse also increases Magellan Financial ((MFG)) estimates because of a strong performance in its funds over the September quarter, upgrading the stock to Outperform, with its conviction driven mostly by valuation and an opportunity for re-rating in the short term.

Regulation

The Commissioner is also asking whether there should be more adversarial action by regulators in response to financial misdemeanours. Shaw and Partners suspects the potential for further damage to banks is likely to come from a "wounded" Australian Securities and Investments Commission (ASIC) with a point to prove, while fines and penalties are likely to be higher.

The Commission also questions whether new laws would ignore the fact that most of the complaints it confronted involved transgressions of existing laws, and could be dealt with by firmer enforcement.

Bailieu Holst expects the outcome may be larger fines for misconduct, prosecutions and higher operating/compliance costs. While banks have already substantially modified their approach to lending Shaw and Partners also suggests executives may find an unwelcome adverse impact on remuneration.

There will be another hearing in November when submissions will be sought before the final report is released in February. A key issue is whether costs from a more adversarial process and zero tolerance for errors will be offset by better outcomes for consumers. JPMorgan suspects wealth stocks will not show any recovery until there is clarity on the final findings and government policy.

Higher Costs Entrenched For Bank Of Queensland

The impact of rising costs featured in the Bank of Queensland FY18 results and brokers suspect higher expenses are likely to become entrenched after the Royal Commission.

-Bank of Queensland increases focus on commercial segments -Below-the-line cost accumulation disappoints brokers -RC may help level playing field and stabilise Bank of Queensland share

By Eva Brocklehurst

The outlook for Bank of Queensland ((BOQ)) remains static, amid subdued revenue growth, while the bank's cost burden is likely to increase. Brokers observe earnings quality has deteriorated markedly.

Costs are growing at a difficult time and higher compliance expenses are expected following the recent Royal Commission as well as increased amortisation. Higher project expenditure and software amortisation are here to stay, Citi asserts.

Business banking was the bright spot in the FY18 results and is expected to bode well for the future as the mix shifts towards business lending. Cash net profit was $372m, underpinned by one-offs and margins, as costs were taken below the line. An accounting policy change also supported margins.

Net interest margins were the highlight of the second half, UBS observes, driven by a boost from falling funding costs as the bank reduced term deposit pricing and grew transaction deposits. Going forward, the broker expects reduced deposit costs and changes in the mix towards higher margin commercial and leasing business should be supportive.

Ord Minnett has long expected significant upside, should the bank become better at gathering deposits, and there was some evidence this occurred in the second half. The ability to manage deposit costs also improved, and if the gap to major banks can be narrowed in this way it should help insulate margins from competition pressures. Net interest income increased by 4%, reflecting 2.5% growth in average loans and a five basis points increase in net interest margins.

Morgan Stanley suggests the bank did a good job navigating margin challenges and agrees a key feature of the second half was better management of deposits. Meanwhile, the main positives in the outlook Citi envisages are strong capital, the dividend and the prospect of participating in regional bank M&A.

Morgans believes the bank's relatively inferior mortgage fulfilment times in the broker channel will work against credit growth. For this reason, the broker suggests it will be hard for the bank to achieve system home loan growth without compromising on margins.

Costs

Significant costs in the results included software amortisation as well as regulatory and compliance costs. Brokers were disappointed because typically the major banks take these costs above the line and Bank of Queensland appears to take only positive items above the line.

Shaw and Partners makes the point that these items should now be considered part of normal operations and the concept of cash expenditure and non-cash profit treatment is "nonsensical". "The larger the expenditure, the larger the nonsense," the broker asserts.

UBS calculates, since the financial crisis, Bank of Queensland has taken a net -$355m in below-the-line charges across 57 items considered 'one-off' in nature. This equates to 16% of the profit the bank has reported over the last decade. The broker believes a better indication of the results in the second half was the fall of -11 basis points in the CET1 ratio to 9.31%.

Capital accumulation was the main area of disappointment for several brokers. Moreover, the sale of the St Andrews life insurance business appears in limbo. Still, the valuation appears fair and Ord Minnett upgrades to Hold from Lighten. The broker acknowledges the return on equity is weak, at around 10%.

Morgans had expected a special dividend to be declared but believes the absence of one is explained by a weaker CET1 ratio and the uncertainty around the sale of the St Andrews business to Freedom Insurance. If the transaction proceeds Bank of Queensland expects a 17 basis points boost to its CET1 ratio.

At this stage, Morgans continues to assume the transaction will proceed and expects special dividends in FY19 and FY20. Shaw and Partners, on the other hand, is not expecting the sale of St Andrews to be approved, as Freedom Insurance had an "interesting experience" at the Royal Commission.

The broker, not one of the eight monitored daily on the FNArena database, maintains a Hold rating and $11 target. Morgan Stanley agrees Bank of Queensland's capital options are contingent on completing the sale of St Andrews and that, as Freedom Insurance has suspended all direct insurance sales, there is a risk the St Andrews sale is delayed or does not proceed.

Digital Disruption

Software amortisation expenses associated with the transformation agenda are expected to become an increasing contributor to the growth in costs. Bank of Queensland will increase expenditure on digital technology in response to the growing threat of disruption, although Morgan Stanley suspects this will only partially address the reinvestment burden.

Expenditure on regulatory requirements also continues to rise, and while some of this may be one-off in nature, the broker estimates it will consume around 10 basis points of capital in FY18-20. Morgan Stanley also considers the stock too expensive, given current trading multiples, and maintains an Underweight rating.

Macquarie believes the low returns and elevated pay-out ratio could put pressure on the capital position and there is a risk the dividend is cut. The broker considers the balance sheet outlook is constrained while the most significant part of the portfolio, mortgages, is experiencing outflows.

Outflows in retail housing loans for the Bank of Queensland brand accelerated in the second half and Macquarie does not believe the multiples are justifiable in the current challenged retail banking environment.

In its defence, UBS notes Bank of Queensland has fully verified both income and living expenses of all mortgage applications, placing it at a competitive disadvantage to less prudent peers.

As the Royal Commission is likely to recommend full verification for all mortgages going forward the broker believes this should level the playing field and stabilise Bank of Queensland's market share. For the time being, UBS suspects the bank can maintain its dividend but will need to keep the discounted reinvestment plan for the foreseeable future.

FNArena's database shows three Buy ratings, two Hold and three Sell. The consensus target is $10.64, signalling -3.7% downside to the last share price the dividend yield on FY19 and FY20 forecasts is 6.9%.

Copper's Dirty Secret

Katusa Research outlines a number of reasons to be bullish on copper, including one little known market secret.

By Marin Katusa, Katusa Research

Avoid the Con Artists. Here's the Critical Demand Secret in the Copper Market

Copper is a vital element used in nearly everything around you.

It's used for plumbing in houses and factories. Since copper is also a wonderful conductor of electricity, it is used in power lines, electric motors, wiring, cars, and appliances as well.

This aspect - copper's excellent electrical conductivity - makes it a critical part of the electric vehicle (EV) revolution.

For example, an electric vehicle requires three times more copper than conventional internal combustion engine vehicles.

On average, a car with an internal combustion engine uses 55 pounds of copper. A hybrid uses about 110 pounds, and an EV uses 165 pounds of copper.

I'm long term bullish on copper, especially companies that produce a specific kind. Which I'll get to in a moment.

What are the Copper Signals Flashing?

In the last ten years there have been 9 major copper discoveries, totalling 319 billion pounds. This may sound like a lot, but it's not. From 1990 to 1999, there were 106 major copper discoveries, totalling 1.1 trillion pounds.

Below you'll see the total quantity of copper discovered annually from 1990 to 2018.

Not only are there less pounds being discovered, it's costing a lot more to find them too. Below is a chart which shows the cost of the copper discovered, based on annual exploration budgets.

Costs have jumped from less than US$0.01 per pound to US$0.07 per pound of copper discovered. That's a 7-fold increase in 2 decades.

That's alarming.

And it's not like you can just say "hey, we need more copper, let's turn on the next copper mine."

Copper production is not like the shale oil and gas sector, where you can drill multiple wells and increase the production from the same patch.

At a mine, your production is fixed. And rarely do mines achieve 100% production because things always go wrong.

Mining is a tough, tough business. And when you look at the previous 3 years, there was no major global copper discovery. For two reasons:

First - there's less money in the sector to be spent on exploration.

Second - these projects are getting harder and harder and deeper and deeper to find. Because we've been really benefiting from prior generations of exploration.

That's generally the cyclical nature of these things. Because the resource markets have been so horrible the last five years, there's been very little money going into it to replace pounds produced.

Hence, why you've seen the reserve grade go from just under 1% 15 years ago to 0.37% today. As shown in the chart below.

This chart gives you a good idea of how tough it's going to be to produce copper in ten years.

And if you take a look at the copper days of supply over the long term, the supply is starting to dry up. Yet, the price isn't responding.

So what gives?

Copper's Dirty Secret – What Majors Look for in World-Class Projects

It's called "clean concentrate."

Copper concentrate is what a miner sends to a smelter after the rock that contains the copper is crushed and ground. Following that, the copper is extracted and concentrated.

The smelter turns that copper concentrate (which is usually anywhere between 22.5 – 30% copper) into the copper we use in buildings and manufacturing.

When a copper producer sends its concentrate to a smelter, it can contain nasty stuff like mercury, arsenic, and antimony.

When copper concentrate has high levels of these "nasties," it is called "dirty" concentrate.

A producer can get "penalized" for dirty concentrate (meaning it gets less per pound of copper than it does for "clean concentrate"). And some smelters flat out refuse dirty concentrates when there is an excess supply of it.

The global smelters are in high demand for "clean concentrate."

You probably didn't know this, but for years, smelters have been dealing with this secret by "blending" the dirty concentrate with clean concentrate.

Chile is the world's largest copper-producing country. And its giant Escondida mine is showing higher nasties compared to when it first started producing many years ago.

Many of the large copper-producing mines will go through the same thing.

The Asian smelters who are now dealing with a high supply of dirty concentrate can dictate smelting fees, which means the dirty concentrate producers are getting slaughtered. This means that BHP, Rio Tinto, MMG, and Freeport are all dealing with this very dirty secret.

Nobody is talking about this, but they will be soon.

This is a small nuance that can have huge effects on a copper investment. A company can have a lot of copper in the ground, but dirty concentrate production can kill it. And your investment.

Smelter logistics play another important role. Where will the copper company send their copper concentrate to? Access to a port is just one of the many concerning issues to check off the list.

What happens if the closest smelter already has enough copper concentrate? This will mean additional transportation costs and lower copper producer profits.

To sum it up I am very bullish on top-tier, world-class copper deposits that have the following qualities:

Low-cost production, Clean concentrate, Located in safe jurisdictions. It's by owning assets with those qualities that safe, large capital gains will be made. It's by owning those assets that copper investors can make a fortune in the electric vehicle boom.

And, as the metallurgy and the geology changes, copper has a lot more impurities in it. So, the copper price the producer receives will be subjected to additional penalties stemming from down blending and treatment charges by the smelter.

Smelters are going to need clean concentrate to blend with this dirty concentrate.

You've got to know what the final product is. It's not just geology. It's not just the engineering, the logistics, and the cost.

You have to understand the metallurgy.

The Copper Buyouts Have Begun

In this phase of the cycle, I think we're going to continue to see some major consolidation from the bigger companies.

Take the recent $6 per share offer for Nevsun (one of my top 2017 recommendations) by China's Zijin Mining. Because they're seeing exactly what I'm publishing and they know internally that they haven't replaced their reserves that they've produced.

And now, large copper producers don't want to play a game of catch up which could take upwards of 15 years. Right now, they can buy something at a 50%, 60%, or 70% discount to what it would cost them to go and find themselves.

That's where I think the sweet spot right now in the current market is.

And it's where I'm going to be putting my big bets.

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Material Matters: Iron Ore, Zinc And Energy

A glance through the latest expert views and predictions about commodities. Australian miners; iron ore; zinc; and energy.

-Controlled supply of bulks and an uplift in metals should underpin commodity markets -Falling demand expected to mitigate drop in China's iron ore supply -Zinc rally not expected to last through 2019 -Citi urges caution regarding LNG growth forecasts

By Eva Brocklehurst

Miners

Despite a poor quarter for Australian miners, UBS still advises an Overweight position because commodity prices should remain buoyant and the sector is focused on capital discipline. The broker does not expect cost pressures to abate and volatility should continue, given varying views on supply/demand dynamics as well as an ongoing frustration in the market with over-promising and under-delivering by producers.

Commodity markets should remain strong because of a controlled market supply in bulks and an uplift in metals from China's stimulus. Meanwhile, balance sheets are healthy and returns are solid.

China's infrastructure construction is expected to accelerate and lift demand for commodities. China's capacity reforms on coal, steel and aluminium continue. There are also supply-side factors which are supporting the market, such as capacity closures and China's environmental curtailments, along with producer discipline.

The broker notes capital expenditure in new capacity is increasingly needed in trades such as metallurgical coal and nickel, which in turn will need higher prices. Meanwhile, seaborne coal remains tight as trading volumes hit all-time highs and China maintains tight domestic supply.

The broker expects the iron ore price to hold up at around US$65/t as the cost curve lifts and steepens because of quality discounts.While copper and nickel, particularly, felt the brunt of concerns regarding a trade war the fundamentals remain strong, with low inventory and higher premiums.

Nickel remains the broker's preferred base metal on a longer-term view because of strong prospects for battery demand. Alumina price forecasts have been upgraded but are expected to fall when Alunorte eventually returns to production.

Iron Ore

Production of iron ore in China has declined. China's iron ore is typically low-grade and small in scale, requiring expensive processing. This year production has slowed by -3% because of environmental restrictions while imports of iron ore are holding up. If too much domestic supply from China drops out of the market, lower-cost seaborne producers will move in and reduce the marginal cost of production.

Furthermore, the broker notes supply from China is typically slow to respond to a falling price and the market can be oversupplied in times of rapid seaborne growth, putting downward pressure on the price.

Morgan Stanley does not envisage China's domestic supply will disappear completely. The broker forecasts China's demand for iron ore to peak at 1.28bn tonnes in 2018 and then gradually decline to 1.1bn by 2023 because of falling crude steel production and increasing use of scrap.

Domestic supply from China is expected to decline to 40mt by 2023 but remain at around 16% of China's total iron ore demand. Hence, seaborne iron ore will need to find another home or be reduced. Morgan Stanley retains a bearish view on the price, estimating US$61/t CFR China in 2019.

Zinc

The zinc price is now running hard and Citi has raised its short-term target price to US$2800/t. A major sell-off in zinc in February at US$3575/t had reduced the price to US$2300/t by mid September.

Chinese zinc producers restricted output and consumers are now starting to rebuild refined stocks. Chinese output declined -6% over the two months to August, with domestic and bonded stocks being drawn down sharply.

Citi suggests the tightness in China is likely to spread and envisages some upside in the near term, yet does not expect the rally will last through 2019. The broker's base case envisages prices falling to US$2400/t by the December quarter of 2019.

A low-probability bull case is a delay in ex-China supply while China's infrastructure stimulus comes through stronger than expected. This would maintain a zinc deficit during 2019 in which case zinc can trade sustainability around US$2800/t.

Energy

A long-term contract between QatarGas and PetroChina has been signed and firming LNG markets have benefited both Woodside Petroleum ((WPL)) and Oil Search ((OSH)), Citi observes. Nevertheless, there are risks to LNG markets and the broker cautions investors not to pay full value for LNG growth at present.

Growing liquidity and transparency in the LNG spot market may lead to price discovery in the contract market because the risk of exposure reduces. The broker suggests this would then be deflationary for contract prices. Around 30% of Citi's forecasts for LNG demand growth are based on an orderly increase in demand from emerging markets China.

The broker also urges caution regarding emerging markets calculating that, if all uncommitted LNG import infrastructure does not progress, new LNG supply requirements would reduce to around 40mtpa in 2025 from around 80mtpa, crowding out prospective projects.

In other words, investing in the above two stocks is just dependent on countries such as Bangladesh and Pakistan materially increasing gas imports as it is on China doing the same. Citi downgrades Woodside to Sell given the recent rally in the share price along with long-term commodity forecasts. The broker still prefers Woodside over Oil Search among LNG stocks.

Uranium's Ugly Step-Sister

Richard (Rick) Mills Ahead of the Herd

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

Most junior resource investors know uranium, and many got in on the action when NexGen Energy and Fission Uranium made their discoveries in the Athabasca Basin of Saskatchewan, the region with the highest grades of uranium in the world. Smart, or lucky, shareholders of NXE enjoyed a cumulative share price rise of around 430% between 2014 and 2016, while Fission Energy - famous for its Patterson Lake South property that yielded the open-pittable Triple R deposit - jumped from 91 cents in November 2013 to $1.62 a share in April 2014, for a gain of 78%.

Uranium is the fuel needed to create the nuclear reaction that can either create nuclear power or nuclear weapons. To make nuclear fuel from uranium ore, the uranium is first extracted from the rock, then enriched with the uranium-235 isotope, before being made into pellets that are loaded into assemblies of nuclear fuel rods. In a nuclear reactor, several hundred fuel assemblies containing thousands of small pellets of uranium oxide are in the reactor core. The nuclear chain reaction that creates energy starts when U-235 splits or “fissions”, which produces a lot of heat in a controlled environment.

In a conventional nuclear reactor, the pressurized water reactor, fuel rods containing uranium pellets are placed in water. Visualized as a giant kettle, the heat generated from the pellets boils water to create steam, which turns turbines to generate electricity. But the downside of conventional nuclear power stations is the nuclear reaction also produces plutonium, which is highly radioactive, and other wastes, causing a problem for disposal. Strontium-90 and cesium-137, contained in nuclear waste, have half-lives of about 30 years, but plutonium-239 takes 24,000 years to fully decay.

When it works well, the nuclear reaction is an efficient form of energy creation. One uranium pellet weighing just 6 grams is said to produce the same amount of energy as a tonne of coal. But it also leaves a lot of radioactive waste that needs to be incinerated, encased in concrete, or buried deep underground for centuries.

When nuclear power goes wrong, the fallout is catastrophic. Nuclear meltdowns like Chernobyl in Russia, Three Mile Island in the US, and Fukushima in Japan are burned into the collective consciousness and serve as constant reminders of the dangers of nuclear power that drive the anti-nuke movement.

While nuclear energy generation will never be without risks, proponents argue these are manageable and small compared to the risk of increased greenhouse gas emissions caused by the continued burning of fossil fuels for power, that are warming the planet. For this reason, nuclear is always in the mix of energies required to make the transformation from an oil-based economy to one where renewable and nuclear energies make up a larger proportion of our global electricity. The question is, must we keep using uranium in our nuclear power plants, or is there another option? There is. It’s uranium’s ugly stepsister, a little-known element known as thorium.

Some scientists believe thorium is key to developing a new version of cleaner, safer nuclear power. So why hasn’t thorium entered the popular and investor lexicon like uranium has? The silvery-white metal has a fascinating history, and despite taking a back seat to uranium as the primary nuclear fuel, it is making a comeback. This is the story of thorium, the wünder-fuel that wasn’t, but could be.

History

Thorium is named after Thor, the Norse god of thunder. It was first discovered in 1815 by Jöns Jakob Berzelius, a Swedish chemist, but a few years later it was determined that the mineral was actually yttrium phosphate. In 1828 Berzelius was given a sample of a black mineral found on an island off the coast of Norway by Hans Esmark, a Norwegian mineralogist. The mineral contained several known elements including lead, tin, iron, manganese and uranium, but 60% was an unknown substance that was subsequently named thorite. Thorium was first isolated by mixing thorium oxide with carbon, creating thorium chloride. When reacted with potassium, the result was thorium and potassium chloride, according to Chemicool. It took another 70 years for scientists to realize that thorium was radioactive. The discovery was made by Gerhard Schmidt, a German chemist, and Marie Cure, a Polish physicist, who are often credited with its discovery.

Thorium oxide (ThO_2) has the highest melting point of all oxides (3300°C) so it’s not surprising that its early applications were in lantern mantles, arc-light lamps, welding electrodes and heat-resistant ceramics. Thorium oxide is also used in camera lenses and scientific instruments.

Abundance

Thorium is actually fairly common on Earth. According to Livescience it occurs in the Earth's crust at 6 parts per million - about as much as lead and three times more abundant than uranium; it is the 41st most abundant element on Earth.

However it is thought to be rare because thorium is normally found as minor constituents of metals. Interestingly though, natural thorium occurs as almost pure 232Th, the most stable thorium isotope, which has a half-life comparable to the age of the universe (14 billion years), and whose radioactive decay is the largest contributor to the Earth's internal heat. Right now it's estimated the planet still has about 85% of the thorium present when the Earth was formed. Scientists at Los Alamos National Laboratory - where the first nuclear weapons were designed as part of the Manhattan Project - think that thorium was created in the cores of supernovae (the last stages of a star's life), then scattered across the universe when the stars exploded.

Trace elements are found in rocks, soil, water, plants and animals, with higher concentrations contained within thorite, thorianite, monazite, allanite, and zircon. The element is mined mostly in Australia, Brazil and India. The rare earth mineral monazite contains between 6 and 12% thorium phosphate.

According to the World Nuclear Association (WNO) world monazite resources are estimated at around 16 million tonnes, 12MT of which are found in mineral sands deposits in India. A large vein deposit of thorium and rare earth elements is in Idaho. Recovering thorium from monazite involves leaching it with sodium hydroxide at 140°C followed by a process to precipitate pure ThO2. The WNO states that under 10,000 tonnes a year of monazite are extracted per year from India, Brazil, Vietnam and Malaysia, and "without commercial rare earth recovery, thorium production is not economic at present."

Use in nuclear energy

The story gets really interesting when thorium was found to be radioactive - just two years after the discovery of uranium radioactivity by French physicist Henry Bequerel. Initially thorium's radioactivity was thought to have health benefits, and was promoted as a cure for rheumatism, diabetes and even impotence. However in 1932 these uses were banned due to a federal investigation that found that people injected with thorium suffered from leukemia and abnormal chromosomes.

Attention then turned to the use of thorium in nuclear energy. During the Cold War the US looked at using 232Th to create 233U - which was being investigated as both a reactor fuel and to build nuclear bombs. But the US Military rejected a bomb built with 233U because it did not have "technical advantages" over uranium-plutonium bombs and especially since it it is difficult to produce pure 233U states a 1966 technical report.

Uranium's chief advantage over thorium, as a nuclear fuel, was that it could be used to produce both atomic weapons and nuclear power, while thorium, unlike uranium, is not "fissile" – meaning it cannot be split to make a nuclear chain reaction – and could only be applied to nuclear power.

With the United States in the early stages of an arms race against the former Soviet Union to develop a nuclear arsenal, it was easy to see which element would win out. While thorium was used in a later version of America's first civilian nuclear power plant - headed up by Hyman Rickover, the US admiral responsible for creating the world's first nuclear-powered submarine - it would take a back seat to uranium as the primary fuel for nuclear reactors.

Thorium nuclear reactors were developed at the Oak Ridge National Laboratory to support nuclear-powered long-range bombers, but the program was scrapped in 1961 in favour of other technologies according to a 2009 NASA paper. This is because the liquid fluoride thorium reactors did not produce as much plutonium, needed for developing nuclear weapons, as uranium-powered reactors.

Nonetheless, the first thorium-based nuclear reactor was built at the Indian Point Energy Center, New York, in 1962.

As mentioned thorium is not able to split an atom to produce the nuclear reaction; instead, when thorium is exposed to neutrons, it eventually emerges into the isotope U-233, which splits and releases energy. In this way thorium is said to be "fertile" rather than fissile. Recycled plutonium can also be used with thorium.

Uranium vs thorium

Other than the fact that uranium is better than thorium in building nuclear weapons, how do the two nuclear fuels stack up against one another? According to the Royal Society of Chemistry, thorium's benefits include:

• Thorium is three to four times more abundant than uranium. There is estimated to be enough thorium on the planet to last 10,000 years.

• Thorium is more easily extracted than uranium.

• Liquid fluoride thorium reactors (LFTR) - a type of molten salt reactor - have very little waste compared with reactors powered by uranium.

• It is more efficient. One tonne of thorium delivers the same amount of energy as 250 tonnes of uranium.

• LFTRs run at atmospheric pressure instead of 150 to 160 times atmospheric pressure currently needed for water cooled reactors.

• Thorium is less radioactive than uranium.

The 2011 Fukushima disaster in Japan soured the world on nuclear, and started scientists looking more closely at thorium as a “greener” alternative. While conventional nuclear plants are only able to extract 3-5% of the energy in uranium fuel rods, in molten salt reactors favoured by thorium proponents, nearly all the fuel is consumed. Where radioactive waste from uranium-based reactors lasts up to 10,000 years, residues from the thorium reaction will become inert within 500. Lastly, because plutonium is not created as a waste product in a thorium reactor, it cannot be separated from the waste and used to make nuclear weapons. Although, the World Nuclear Association points out that the United States made about two tonnes of U-233 during the Cold War and detonated a nuclear weapon containing U-233. The explosive yield though was less than expected, just 22 kilotons. In 1998 India detonated a small nuclear device from U-233.

As far as disadvantages, thorium takes extremely high temperatures to produce nuclear fuel (550 degrees higher than uranium dioxide), meaning thorium dioxide is expensive to make. Second, irradiated thorium is dangerously radioactive in the short-term. Detractors also say the thorium fuel cycle is less advanced than uranium-plutonium and could take decades to perfect; by that time, renewable energies could make the cost of thorium reactors cost-prohibitive. The International Nuclear Agency predicts that the thorium cycle won’t be commercially viable while uranium is still readily available.

Molten salt nuclear reactors

Molten salt reactors (MSRs) are well suited to thorium fuel, and while they were first conceived of in the 1940s, as noted above, to fuel aircraft, there has been a renewed interest in them. In the Liquid Fluoride Thorium Reactor (LFTR), the fuel is not cast into pellets like uranium, but is rather dissolved in a vat of liquid salt.

According to ZME Science, since molten salt reactor technology was revived in the 2000s, interest has grown quickly, with four companies in the US announcing plans for MSRs, as well as in Japan, Russia, France and China. In Norway, Thor Energy started producing power from thorium at its Halden test reactor in 2013, with help from Westinghouse. The third phase of a five-year thorium trial operation got underway in January.

India’s thorium program is well advanced. The country envisions meeting 30% of its electricity demands through thorium-based reactors by 2050. With large quantities of thorium and little uranium, India wants to use thorium for large-scale energy production. It plans to construct and commission a fleet of 500 sodium-cooled fast reactors - which burn spent uranium and plutonium - in order to breed plutonium to be used in its advanced heavy water reactors that employ thorium as the nuclear fuel. A prototype of the 500-megawatt fast breeder reactor (FBR) in Kalpakkam, India was supposed to be finished in late 2017 but has been put off to later this year.

One of the main advantages of MSRs is the reactor cannot melt down, as we saw in Fukushima when electric pumps were inundated by the tsunami, failing to cool the fuel rods, which overheated and caused radiation emissions. MSRs can also be made cheaper and smaller than conventional reactors, since they do not have large pressurized containment tanks, meaning they could be used in factory settings. MSRs use molten salt instead of water as a coolant, allowing them to reach temperatures over 80°C, three times hotter than a conventional nuclear plant cooled with water.

Another advantage is that nuclear waste (ie. plutonium) can be recycled to recover the fissile materials needed to create the nuclear reaction. In this way, thorium reactors not only generate less waste than conventional reactors, but also help to rectify the nuclear waste disposal problem.

Work continues

Examples of companies and countries that are testing thorium’s viability as a nuclear fuel keep growing. Last summer a Dutch nuclear institute started experimenting with MSRs. NRG, the name of the facility, on the North Sea coast of the Netherlands, launched the Salt Irradiation Experiment in collaboration with the EU. New Scientist reports the researchers will use thorium as the nuclear fuel for the reactor where both the reactor fuel and the coolant are a mixture of molten salt. The experiment will also examine how to deal with the nuclear waste.

Indonesia, which has a large amount of thorium contained within monazite, signed an agreement three years ago with US company ThorCon Power, to develop molten salt reactors. A 1,000-megawatt thorium-based reactor would be used for base-load power and produce 5 gigawatts a year. The country wants around 20% of its energy mix to come from thorium molten salt reactors by 2050.

In the United States, the Department of Energy is partnering with TerraPower, Vanderbilt and the Oak Ridge National Lab, among others, to build a molten chloride fast reactor - a type of MSR - Oilprice.com reported. Southern Company in 2016 was the second firm to receive a grant from the DOE.

China, seemingly always on the leading edge of new energy, has put aside US$3.3 billion to build two molten salt reactors in the Gobi Desert, to be up and running by 2020, the South China Morning Post said in December. The reactors could spawn new uses for the radioactive element, including applications in warships and drones.

Conclusion

If there hadn't been an urgent need to develop nuclear weapons for the Cold War, there's a reasonably good chance that thorium rather than uranium would have become the nuclear fuel of choice. The ability of uranium to kick start the nuclear reaction makes it one of the most strategically important minerals on Earth. If the world was running out of uranium, thorium demand, and the technology to make molten salt reactors, would probably be much farther advanced than it currently is. But we are not running out of uranium. According to the World Nuclear Association (WNA), in 2017, world uranium production totalled 59,531 tonnes, which satisfied 92% of world demand. The top producers are Kazakhstan, Canada and Australia. Total known, recoverable uranium resources as of 2015 were 5.718 million tonnes.

Contrast this with thorium. The WNA states there are 6.555 million tonnes of thorium resources in the world - with most thorium held in India, Brazil and Australia/the US (tied for third). That's a bit more than total uranium resources. But how much thorium is mined? According to the USGS, in 2017, only 2.2 tons of thorium (mostly monazite) were imported into the United States; thorium compound exports were 83 tons. Obviously the tiny numbers are because there is currently no market for thorium. But if there was, there are around 6 million tonnes of resources waiting to be converted into reserves. Quite an opportunity for thorium explorers should molten salt reactors ever catch on enough to augment, let alone replace, conventional uranium-based reactors. The demand for thorium fuel, and its price, would skyrocket.

For now, thorium is a theoretical solution to our energy dilemma, but it could be much more than that. A concerted effort to develop thorium reactor technology could provide stable, clean, base-load power for millions, something that is not possible with renewables due to the intermittency factor (ie. power can only be generated when the sun shines and the wind blows) and the current early stages of renewable battery storage technology. It is safer and better for the environment than uranium, and can even use radioactive waste as feedstock for the nuclear reaction, thus killing two birds with one stone. The market isn't yet ready for thorium, but when it is, a whole new mining sector and supply chain will be born.

Thorium and its potential for resource exploration are on my radar screen.

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Oz Gold Stocks Underappreciated

Bullish signals are emerging for gold while Australian gold stocks appear underappreciated on the world stage, yet brokers suspect it may be too early to sign off on any rally.

-Long US dollar/short gold trade should revert to the mean at some stage -Gold's appeal to central banks may be widening -Australian gold stocks tell strong stories at Denver conference

By Eva Brocklehurst

The gold price may not be ready to rally, despite several presenters at the Denver gold conference suggesting the US is ripe for a downturn. The US dollar remains strong and JPMorgan observes investors appear unperturbed by an increasing risk in emerging markets.

Both the World Gold Council and industry consultant CPM Group forecast US growth to slow in 2019, with a US recession considered possible. The gross COMEX short position in gold has reached record highs, yet the presenters were unsure about a catalyst, or when this position would unwind, although acknowledge the long US dollar/short gold trade should revert to the mean at some stage.

Macquarie questions whether expectations of rising interest rates from the US Federal Reserve are as bearish for gold as they once were. The US employment report due out this week will be keenly observed, as it may raise expectations of a rate hike.

In the past, the prospect of higher interest rates was an indicator that fears regarding an economic slump were fading but now it is signalling concerns over inflation and may be bullish for gold. However, the main bullish sign for gold at present is rising purchases by central banks.

Central Banks

Taken at face value, purchases in 2018 suggests gold's appeal to central banks may be widening. India's reserves have been rising in recent months and Poland has added to its reserves, which Macquarie suggests may be the first by an EU member this century. The reason why Poland bought gold is not yet known.

Using IMF and national central bank data the broker estimates central banks bought 36t of gold in August taking year-to-date purchases to 264t, the most at this stage of the year for any period in the last six years.

As the gold market has been struggling with too much supply and not enough demand Macquarie suggests this has thrown a lifeline to the yellow metal. So far, purchases in 2018 are dominated by Russia and some other former Soviet states such as Kazakhstan and Tajikistan.

Their motives for buying gold appear specific, such as economic or geopolitical marginalisation. Turkey has been added to the list of buyers this year and can also be considered internationally marginalised.

The merger of Barrick and Randgold was announced on the eve of the gold conference and UBS observes many corporates and investors have, therefore, suggested a period of consolidation among the mid-cap sector may be looming, with potential to do scrip-based mergers rather than cash deals.

UBS also notes a number of companies were concerned that the market was not recognising the value of their assets, production or earnings outside of top jurisdictions such as the US, Canada and Australia. Examples the broker cites include Alacer Gold ((AQG)), Alamos and Eldorado which remain positive about projects in Turkey but are trading at levels below their peers because of perceived sovereign risk.

Perhaps, UBS speculates, if their value is not recognised by the market these stocks may present an opportunity for a major company, which could disperse the perceived risks via diversity of operations.

Australian Gold Stocks

JP Morgan observes there is lingering optimism among North American corporates which does not reconcile with their cash flows or equity performance, unlike the Australian stocks which have strong stories to tell.

The broker believes marginal investment dollars should be allocated to Australian companies which are trading on 4.5-6x enterprise value/operating earnings (EBITDA) ratios and have net cash positions on their balance sheets.

Australian gold companies are in strong demand, JP Morgan observes from the gold forum, but still do not command the spotlight in the North American investment community. The common theme among Australian gold stocks is sector-leading cash flow and organic production growth.

Northern Star Resources ((NST)) discussed its Pogo acquisition, believing this to be a transforming asset. The company intends to release an updated resources statement shortly, while accelerating infill and exploration drilling. Meanwhile, Regis Resources ((RRL)) has indicated it will not pursue the acquisition of Capricorn Metals ((CMM)) as the largest shareholder has rejected the offer.

The TSX-listed Lundin Gold, in which Newcrest Mining ((NCM)) has a 27% interest, has indicated construction on schedule and the processing plant is 30% complete. Commercial production is targeted for May 2020. Evolution Mining ((EVN)) also presented a solid investment story at the conference, JPMorgan observes.

Weekly Ratings, Targets, Forecast Changes

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

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

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

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

Summary

Period: Monday September 24 to Friday September 28, 2018 Total Upgrades: 7 Total Downgrades: 6 Net Ratings Breakdown: Buy 42.18%; Hold 42.12%; Sell 15.70%

Approaching the end of the September quarter, including macro uncertainty and the release of the interim report of the Royal Commission into banks and wholesale investors, broker downgrades and upgrades pretty much kept each other in balance during the week ending Friday, 28th September 2018.

FNArena registered seven upgrades for individual ASX-listed equities versus six downgrades. The difference was Whitehaven Coal which received two upgrades to Buy. Only one upgrade (Orocobre) moved to Neutral. Four of the six downgrades moved to Sell.

Miners and steel companies are more dominant among upgrades, which probably has a a thing or two to do with the fact the sector has sold down hard, with a number of investors/experts anticipating a bounce, at a minimum.

National Storage leads the week for positive target increases, enjoying a gain of 6.6%, followed by Santos, Goodman Group and APA Group. On the flipside, Nufarm's target suffered a blow of -14.2%, followed by Sims Metal's -3%. The good news is: there are only three stocks suffering negative adjustments for the week, and the third one (Western Areas) is hardly worth mentioning (-1.3%).

A lot more is happening with earnings forecasts, led by miners and energy companies. Gold producer Alacer Gold enjoyed the largest increase for the week, followed by Nufarm, Syrah Resources, and Fortescue Metals. Most increases are large, but so too are the reductions.

Largest reduction to earnings forecasts for the week went to NextDC, followed by Perseus Mining, Transurban, Sims Metal Management, and Telstra.

Upgrade

CHARTER HALL GROUP ((CHC)) Upgrade to Overweight from Underweight by Morgan Stanley .B/H/S: 3/2/0

Morgan Stanley envisages upside for Australian property stocks over the next 12 months. The broker focuses on those with better risk-adjusted returns and more visible catalysts. The broker envisages more than 10% upside to the real asset business of Charter Hall.

Rating is upgraded to Overweight from Underweight. Strength in retail flows, ongoing execution and accelerating earnings growth in FY19 and FY20 are the factors driving outperformance. Target is raised to $7.60 from $6.95. Industry view is Cautious.

OROCOBRE LIMITED ((ORE)) Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 7/1/0

Morgan Stanley updates its model to allow for the temporary changes to the Argentinian export tax, applying it to all exports out to 2020 at an assumed rate of 8%.

Given the disparity in the Chinese and Chilean lithium carbonate price forecasts the broker now uses an average of the two until the end of 2019. As a result earnings estimates for FY19 and FY20 are reduced slightly.

Morgan Stanley upgrades to Equal-weight from Underweight. In-Line industry view and $4.20 target maintained.

SIMS METAL MANAGEMENT LIMITED ((SGM)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 3/3/0

Sims has downgraded first quarter earnings guidance due to a weaker performance form its Sims Adams recycling JV, a result of lower volumes and challenges in selling low-grade "zorba" (unseparated mix of non-ferrous metal scrap). It is not clear whether this is due to competition or weaker scrap prices, Credit Suisse notes.

The JV will now look to install new zorba processing equipment to lift grades. Credit Suisse suggests the downgrade is a hit to management's credibility given recent assurance that selling zorba would not be a problem.

Target falls to $14.45 from $14.80 but rating upgraded to Outperform with no explanation, most likely given yesterday's share price fall.

WHITEHAVEN COAL LIMITED ((WHC)) Upgrade to Outperform from Neutral by Credit Suisse and Upgrade to Buy from Neutral by Citi .B/H/S: 6/2/0

Whitehaven Coal's share price has recently come off the boil after a stellar run post-result, Credit Suisse notes. The broker has upgraded coal price assumptions, driving material earnings upgrades. Credit Suisse reminds that the company is a cash generating machine that at current spot prices, could buy itself back in under six years.

At the very least Whitehaven could afford to double its dividend, the broker points out. Upgrade to Outperform from Neutral. Target rises to $6.00 from $5.10.

Citi has upgraded to Buy from Neutral with a revised price target of $5.90 from $5.40. The broker observes equity prices are being driven more by negative sentiment towards base metals than physical strength in bulks.

Thus earnings upgrades, combined with lower share prices, have driven an upgrade to the recommendation.The broker notes, after a number of years of strong growth driven by the ramp-up of Maules Creek, production has plateaued this year because of lower production from Narrabri. Growth is expected to improve from FY21 and be boosted by Vickery, if approved.

WOOLWORTHS LIMITED ((WOW)) Upgrade to Buy from Neutral by Citi .B/H/S: 1/5/2

Citi analysts are suggesting Coles' ((WES)) successful Little Shop promotion has temporarily interrupted sales momentum at Woolworths' expense, but momentum will swing back into the latter's favour.

Better execution and management stability will allow Woolworths to return to like-for-like sales growth leadership in H2 FY19, predict the analysts. Target retained at $32 but following share price weakness the recommendation is upgraded to Buy from Neutral.

WESTERN AREAS NL ((WSA)) Upgrade to Buy from Neutral by Citi .B/H/S: 5/1/1

Citi observes equity prices are being driven by negative sentiment towards base metals. The broker upgrades Western Areas to Buy from Neutral after a pullback in the share price. Target is raised to $3.50 from $3.20.

Citi remains keen to view the definitive feasibility study on Odysseus as at first glance resource grades appear on the low side for an underground nickel mine. The study has been delayed by a month, to the end of October, but the company has reassured the market that this is logistical and not technical.

Downgrade

AUSTRALIAN PHARMACEUTICAL INDUSTRIES ((API)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 0/0/2

Australian Pharma has risen 29% since the Clearskincare acquisition, Credit Suisse notes, simply on multiple expansion. This is despite an increasingly challenged operating environment in which both PBS and retail revenues are under pressure.

The broker expects current 16.6x forward PE to compress following the company's October result release when focus on the challenging environment is renewed. Downgrade to Underperform from Neutral, target falls to $1.55 from $1.63.

INDEPENDENCE GROUP NL ((IGO)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 1/2/3

Macquarie has downgraded gold price forecasts which affects Independence Group's earnings materially and the rating is downgraded to Underperform from Neutral. The broker retains a preference for Western Areas ((WSA)) in nickel.

Incorporating changes to nickel price forecasts and the AUD/USD profile also translates to a -20% cut to the company's FY19 earnings estimates. Target is reduced to $4.20 from $4.70.

NEW HOPE CORPORATION LIMITED ((NHC)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 0/3/0

A weaker Australian dollar is offset by an increase in Macquarie's coal price forecasts. The broker downgrades New Hope to Neutral from Outperform. Target is steady at $3.80.

NUFARM LIMITED ((NUF)) Downgrade to Hold from Add by Morgans .B/H/S: 4/1/1

Morgans observes, while Nufarm usually benefits from strength in geographic diversity, in FY18 everything that could have gone wrong did go wrong. Consequently earnings were downgraded and the balance sheet stretched.

The broker suggests, given the amount of new capital raised, negative publicity and litigation, any re-rating is likely to take time. The broker downgrades to Hold from Add and reduces the target to $6.85 from $9.00. Morgans recommends shareholders take up the entitlement offer, given the 17% upside.

VICINITY CENTRES ((VCX)) Downgrade to Underweight from Overweight by Morgan Stanley .B/H/S: 3/1/1

Morgan Stanley envisages upside for Australian property stocks over the next 12 months. The broker focuses on those with better risk-adjusted returns and more visible catalysts.

While the broker still envisages further upside for Vicinity Centres this is expected to take time to deliver. Moreover, recent commentary by retailers, citing a desire for smaller stores in more convenient locations, indicates an increasingly challenged landscape for landlords.

Consequently, Morgan Stanley downgrades to Underweight from Overweight. Target is steady at $2.85. Industry view: Cautious.

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

Ord Minnett doesn't like the combination of a more risky profile (as management is on the lookout for acquisitions) with lofty expectations and a full valuation. The analysts point out the company's track record is unproven when it comes to acquisitions.

Recommendation is thus downgraded to Lighten from Hold, with an unchanged price target of $42.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 CHARTER HALL GROUP Buy Buy Morgan Stanley 2 OROCOBRE LIMITED Neutral Sell Morgan Stanley 3 SIMS METAL MANAGEMENT LIMITED Buy Neutral Credit Suisse 4 WESTERN AREAS NL Buy Neutral Citi 5 WHITEHAVEN COAL LIMITED Buy Neutral Citi 6 WHITEHAVEN COAL LIMITED Buy Neutral Credit Suisse 7 WOOLWORTHS LIMITED Buy Neutral Citi Downgrade 8 AUSTRALIAN PHARMACEUTICAL INDUSTRIES Sell Neutral Credit Suisse 9 INDEPENDENCE GROUP NL Sell Neutral Macquarie 10 NEW HOPE CORPORATION LIMITED Neutral Buy Macquarie 11 NUFARM LIMITED Neutral Buy Morgans 12 VICINITY CENTRES Sell Buy Morgan Stanley 13 XERO LIMITED Sell Neutral Ord Minnett Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 NSR NATIONAL STORAGE REIT -13.0% -50.0% 37.0% 4 2 APA APA GROUP 60.0% 33.0% 27.0% 5 3 WHC WHITEHAVEN COAL LIMITED 69.0% 44.0% 25.0% 8 4 RWC RELIANCE WORLDWIDE CORPORATION LIMITED 50.0% 30.0% 20.0% 5 5 SGM SIMS METAL MANAGEMENT LIMITED 50.0% 33.0% 17.0% 6 6 RIO RIO TINTO LIMITED 79.0% 64.0% 15.0% 7 7 WSA WESTERN AREAS NL 57.0% 43.0% 14.0% 7 8 ORE OROCOBRE LIMITED 88.0% 75.0% 13.0% 8 9 WOW WOOLWORTHS LIMITED -13.0% -25.0% 12.0% 8 10 CHC CHARTER HALL GROUP 60.0% 50.0% 10.0% 5 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 VCX VICINITY CENTRES 30.0% 70.0% -40.0% 5 2 NUF NUFARM LIMITED 50.0% 71.0% -21.0% 6 3 IGO INDEPENDENCE GROUP NL -42.0% -25.0% -17.0% 6 4 STO SANTOS LIMITED -20.0% -14.0% -6.0% 5 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 NSR NATIONAL STORAGE REIT 1.560 1.463 6.63% 4 2 STO SANTOS LIMITED 6.628 6.276 5.61% 5 3 GMG GOODMAN GROUP 10.283 9.891 3.96% 6 4 APA APA GROUP 10.472 10.097 3.71% 5 5 WHC WHITEHAVEN COAL LIMITED 5.723 5.523 3.62% 8 6 WPL WOODSIDE PETROLEUM LIMITED 36.611 35.963 1.80% 7 7 CHC CHARTER HALL GROUP 7.230 7.138 1.29% 5 8 IGO INDEPENDENCE GROUP NL 4.533 4.483 1.12% 6 9 RIO RIO TINTO LIMITED 87.474 86.953 0.60% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 NUF NUFARM LIMITED 7.685 8.960 -14.23% 6 2 SGM SIMS METAL MANAGEMENT LIMITED 14.475 15.008 -3.55% 6 3 WSA WESTERN AREAS NL 3.243 3.286 -1.31% 7 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 AQG ALACER GOLD CORP 7.621 1.049 626.50% 4 2 NUF NUFARM LIMITED 43.380 30.692 41.34% 6 3 SYR SYRAH RESOURCES LIMITED -5.186 -7.813 33.62% 5 4 FMG FORTESCUE METALS GROUP LTD 38.394 33.139 15.86% 7 5 WHC WHITEHAVEN COAL LIMITED 65.886 58.846 11.96% 8 6 AWC ALUMINA LIMITED 34.912 31.681

10.20% 5 7 S32 SOUTH32 LIMITED 36.672 33.732 8.72% 7 8 GXY GALAXY RESOURCES LIMITED 9.859 9.177 7.43% 5 9 ORE OROCOBRE LIMITED 15.623 14.566 7.26% 8 10 SGP STOCKLAND 37.050 34.700 6.77% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 NXT NEXTDC LIMITED 0.440 0.700 -37.14% 6 2 PRU PERSEUS MINING LIMITED 1.900 2.500 -24.00% 3 3 TCL TRANSURBAN GROUP 23.752 26.785 -11.32% 8 4 SGM SIMS METAL MANAGEMENT LIMITED 98.825 110.950 -10.93% 6 5 TLS TELSTRA CORPORATION LIMITED 17.667 19.417 -9.01% 6 6 SBM ST BARBARA LIMITED 31.890 34.023 -6.27% 5 7 WSA WESTERN AREAS NL 17.053 18.044 -5.49% 7 8 STO SANTOS LIMITED 34.402 36.345 -5.35% 5 9 NCM NEWCREST MINING LIMITED 106.107 111.132 -4.52% 8 10 IGO INDEPENDENCE GROUP NL 25.433 26.567 -4.27% 6 Technical limitations

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

Find out why FNArena subscribers like the service so much: "Your Feedback (Thank You)" - Warning this story contains unashamedly positive feedback on the service provided.

Uranium Week: Another Strong Month

September volumes did not quite reach the level of August but were solid nonetheless and resulted in a US$1.25/lb increase in the spot uranium price.

-More strong monthly volumes -Further increase in spot price -Rio looking to sell Rossing, maybe

By Greg Peel

At 5.9mlbs U3O8 equivalent, September's volume in the spot uranium market did not reach August's record-breaking 8.4mlbs but was healthy nonetheless. Buyers clearly outnumbered sellers, given industry consultant TradeTech's spot price indicator rose US$1.25 in the month, or 5%, to US$27.65/lb as at September 30.

The final week of the month was a little slower, featuring nine spot transactions totalling 1mlb U3O8 equivalent and a drop in spot price to Friday of -US35c to US$26.30/lb. Activity slowed, TradeTech reports, because buyers are preoccupied with a utility's tender request for delivery of 1mlbs U3O8 between now and March.

A utility also entered the term market last week seeking offers for delivery of 1.8mlbs U3O8 over 2021-27. In a reflection of the state of the world in 2018, the utility has placed a caveat on any deal in that the uranium must be able to be legally imported into the USA and is legal for use in US reactors without the imposition of any tariffs, duties, or similar charges other than those that would be charged if such material were of US origin and was being imported into the USA on the delivery date.

The caveat reflects a state of flux in the US uranium/nuclear energy markets at present as the government considers its positions on tariffs and/or mandated quotas on domestic-only purchases as is taking its time in doing so.

Another utility continues to consider offers for delivery of 10mlbs U3O8 for delivery 2021-30. TradeTech has lifted its month-end term price indicators to US$30.00/lb from US$29.50/lb (mid) and US$32.00/lb from US$31.00/lb (long).

Namibia

The Namibian government has confirmed that Australian and UK-listed diversified miner Rio Tinto ((RIO)) is discussing the sale of a majority share of its Rossing uranium subsidiary to the China National Nuclear Corp. The Namibian spokesman would not go into detail but assured that talks were advanced, while the word from Rio Tinto is that it's all just rumours and speculation.

CNNC had previously held talks with Australian-listed Paladin Energy ((PDN)) regarding a takeover of Paladin's Langer Heinrich mine in Namibia, which is currently in care & maintenance due to weak uranium prices. CNNC ultimately failed to exercise its option and Paladin has secured sufficient finance to suggest that one day Langer Heinrich might be switched back on.

Rossing is 69% owned by Rio Tinto, 15% by the Iranian government, 10% by the South African government, 3% by the Namibian government and 3% by other Namibian interests. The board meetings must be fun.

The Namibian government nevertheless holds 51% of the voting rights, and thus must approve any sale.

The Short Report

Guide:

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

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

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

Summary:

Week ending September 27, 2018

Last week saw the ASX200 continue its choppy graft higher before succumbing to risk-off selling this week.

A lot of red and green on the table below suggests a lot of bouncing around of short positions last week, but only one move exceeded one percentage point. NextDC ((NXT)) saw shorts increase to 8.6% from 7.1%. See below.

Otherwise we might note that Syrah Resources ((SYR)), having lost top spot on the table to JB Hi-Fi ((JBH)) last week, has now fallen to fourth behind the two lithium miners. But it's only incremental - Syrah shorts fell to 16.3% from 16.7%.

We may also welcome Bank of Queensland ((BOQ)) back to the 5%-plus shorted table at the low end, ahead of its result release today (the stock is up 3.6% as I write), and also welcome Lynas Corp ((LYC)) and Australian Pharmaceutical Industries ((API)). See below.

Weekly short positions as a percentage of market cap:

10%+

JBH 19.7 ORE 17.0 GXY 16.5 SYR 16.3 DMP 12.9 ING 12.6 MTS 12.0 MYR 11.1 GEM 10.1 GXL 11.1 BWX 10.0

Out: HVN

9.0-9.9

IVC, IFL, HVN, CSR, NEC, NWS

In: HVN, IVC Out:CSR, NEC

8.0-8.9%

NXT, NUF, NAN, SUL, VOC, IGO

In: NXT, NAN Out: IVC, CSR, NEC, AAC

7.0-7.9%

AAC, PLS

In: AAC, PLS Out: NXT, NAN, GMA, MLX

6.0-6.9%

MLX, RSG, FLT, SDA, BIN, SEK, GMA, HT1, KDR, MND, SIG, NWL MYO, KAR, GNC, MOC

In: MLX, GMA, SDA, KDR, NWL, BIN Out: PLS, MYO, KAR, GNC, MOC

5.0-5.9%

KAR, GNC, MOC, MSB, LYC, BAL, BLA, ALX, BOQ, API, BEN, CQR, CAB, AMP, TNE, BKL

In: KAR, GNC, MOC, LYC, ALX, BOQ, API, TNE, BKL

Out: NWL, BIN, SDA, KDR, CLQ, PPT

Movers & Shakers

Data centre operator NextDC polarises analysts. One the one hand we have a longer term story of increasing demand for data storage and cloud operations driving demand for capacity, and on the other we have a slightly disappointing earnings result posted in late August that suggests customer growth at the company's second round of capital city data centres is slower than the first round.

The Buy-raters dismiss slower growth as being a factor of larger round two centres and the initial burst of demand growth slowing as one might expect. NextDC has spent heavily to build the centres, and every new customer represents pure operational leverage.

If you build it...

NextDC shorts have risen to 8.6% from 7.1%.

It's been a tough road for rare earth mineral producer Lynas Corp over the past years. Aside from a rare earth market bubble and bust, the decision by the company to build its processing plant (LAMP) in Malaysia, where it's cheaper, than in WA, where the government was keen, has proven misjudged. LAMP originally ran into the stumbling block of environmental protest in Malaysia due to the production of by-product plutonium in the process.

Government approval was finally achieved, but now there's a new government, which has sought to review the LAMP's approval. Lynas has appeared at the bottom of the 5%-plus shorted table.

Having run up 30% since the announced acquisition of Clearskincare in June, the share price of Australian Pharmaceutical Industries took a hit last week when Credit Suisse pointed to an increasingly challenging operating environment and downgraded to Underperform. The only other FNArena database broker covering the stock, Morgan Stanley, has had an Underweight rating since April.

API also appeared at the bottom of the table last week.

ASX20 Short Positions (%)

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

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

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The Wrap: Housing, A-REITs And Gambling

Weekly Broker Wrap: housing; real estate; A-REITs; and gambling.

-Australian housing correction broadens and deepens -Sydney out of “bubble risk” territory but housing still overvalued -Recent results from listed retailers considered negative for retail A-REITs -UK online bookies expected to extend global reach, negative for Tabcorp market share

By Eva Brocklehurst

Housing

Across Australia house prices fell for the 12th straight month in September, to be down -3% on a year ago. Weakness is centred on detached housing, although apartment prices also fell.

Melbourne sustained the sharpest fall and, Morgan Stanley observes, it appears to be catching up with Sydney and Perth. Brisbane remains the only major city with any price growth. The broker also notes auction clearance rates remain at a level that, historically, indicates future price weakness.

PIMCO notes house prices are still 40% above levels of 2012, when credit was freely available and strong foreign demand powered the market. These factors appear set to reverse in the near future.

Falling house prices and rising costs for debt servicing reduce discretionary income and generate negative wealth affects, and the analysts suggest this will constrain consumption and prevent the Reserve Bank of Australia from raising its cash rate above 1.5% for some time.

This forms the basis for PIMCO's conservative view of a lower neutral cash rate and a benign environment for Australian bond yields. Australian banks are also expected to be negatively affected, given large exposures to the housing sector.

Bailieu Holst notes investors, on average, took 47% of the housing finance in the most recent boom which compares with just 25% of households living in private rental. Although investor loans are down -23% from their peak, a further -33% decline is required, the analysts believe, just to get back to an average share of the market.

Bailieu Holst also points to elevated political risk as the Australian Labor Party, if forming government next year, could procure changes to negative gearing and capital gains tax arrangements. Hence, the analysts suggest the housing bear market is likely to be extended.

A general uptrend in arrears in Australian mortgages is also apparent. As the correction broadens and deepens, Morgan Stanley assesses the risks in the residential mortgage-backed security asset class.

The broker's model points to another -5-10% decline in house prices over the next 9-12 months that will increase the tail of households with negative equity. This particular cohort would be vulnerable to any shock in employment, both in terms of spending and the potential for forced selling.

Thus far, Queensland and Western Australia are the main regions with an uptick in arrears, although the performance of those with mortgage loan-to-valuation ratios of over 80% are much weaker across-the-board, and arrears are tracking at 3%.

Real Estate

UBS, in its global real estate bubble index, suggests the first cracks are starting to appear, as house prices declined in half of the prior year's "bubble risk" cities. Bubble risk jumped in Munich, Amsterdam and Hong Kong.

The growing imbalance stems primarily from house prices in cities decoupling from respective national averages and local incomes. Most households cannot afford to buy property in the top financial centres without a substantial inheritance and rents continued to consume significant share of income.

Index scores fell in one third of the cities and Stockholm and Sydney experienced the steepest drop. Sydney reached bubble risk territory in 2015 because of buoyant foreign demand, low interest rates and exuberant expectations, UBS notes. Having peaked in 2017 the market has since corrected -5% in real terms because of tighter mortgage lending. Yet, despite the index score plunging, UBS considers the city still highly overvalued.

A-REITs

Australian real estate investment trusts (A-REITs) returned -1.8% in September and underperformed the market by 0.5%, UBS observes. Globally, the sector was down -2.0% in US dollar terms. In the year to date A-REITs have returned -2.3% versus the global index at 0.8%.

In September, office A-REITs outperformed both industrial and retail. The main outperformance came from Growthpoint Properties ((GOZ)), Investa Office ((IOF)) and BWP Group ((BWP)). Those underperforming included Vicinity Centres ((VCX)), Scentre Group ((SCG)) and Goodman Group ((GMG)).

At a macro level, part of the underperformance of A-REITs can be explained by rising 10-year bond yields both in the Australia and the US and Shaw and Partners also notes a switch back to risk after tariffs in the US and China trade war were lower than the market had anticipated.

The broker notes those that outperformed relatively also included Centuria Industrial ((CIP)) and Propertylink Group ((PLG)), both subject to takeover bids, as well as Arena REIT ((ARF)) and Growthpoint.

Shaw and Partners has Buy ratings on Centuria Capital ((CNI)), Vicinity Centres, Stockland ((SGP)), Scentre Group, Centuria Metropolitan ((CMA)) and Mirvac ((MGR)) although the latter two are now trading near targets. The broker maintains a Sell rating for Gateway Lifestyle Group ((GTY)), as the stock is subject to a takeover, while Centuria Industrial and Goodman are considered expensive.

Citi believes the implications of recent results from around 20 listed retailers are negative for retail A-REITs. Retailers in the sample reported modest comparable sales growth of 2.8% and only 26% grew sales at, or above, 4%, the level of rental growth embedded in specialty leases.

This indicates occupancy costs will continue to rise for many existing tenants. Retailer margins, meanwhile, declined an average of -38 basis points. Citi points out the impact of subdued sales growth can be offset if retailers enjoy margin expansion, but when margins narrow this compounds the downside risk.

The broker expects retailers will seek reduced rents when their leases expire. To the extent the broker's sample is representative, the risk remains that shopping centre owners continue to add space at a faster pace than is warranted by tenant demand.

Gambling

Despite intense regulation, Goldman Sachs estimates the world's legal gambling market, ex lotteries, was worth US$300bn in 2017 versus US$187bn 15 years ago. The broker forecasts 7.1% growth per annum in the global sports betting market, with a strong increase in the US following the easing of regulation.

Further online migration is expected and online should expand its share of the global market to 17.2% in 2023 from 13.6% in 2017, with the adoption of sports betting growing even faster.

Goldman Sachs expects those with scalable technology, diversified regulatory and product exposure and strong cash flows will expand globally while the industry will undergo consolidation. The broker expects UK online bookies will increase their global exposure outside of the UK/Europe and local heavily retail-based operators such as Tabcorp ((TAH)) and William Hill are at risk of losing market share to scale players.

Rudi's View: Ten Years On, The World Is Still Turning

Ten Years On, The World Is Still Turning

By Rudi Filapek-Vandyck, Editor FNArena

Ten years on from the largest and most iconic corporate failure in modern day USA, it has become quite fashionable to wander back through memory lane or publish Harry Hindsight flashbacks about how it all went wrong; whether there are any lessons from the sorry tale for investors today?

Not wanting to spoil anyone's party, but in the context of the Grand Bear market of that time, and it certainly was a Very Grand Global Bear Market, the demise of Lehman Brothers was by no means the most important event, and it happened quite late on the timeline as well. Today, books have been written and the event features in a number of Hollywood movies and documentaries, while the question "Where were you when Lehman went bankrupt?" sits right up there with 9/11, the fall of the Berlin Wall and the death of Elvis Presley. (I am too young to refer to John F Kennedy's assassination or the first man on the moon).

I know exactly what I was doing when Lehman went under on September 15, 2008. Only a few weeks prior I had made the bold prediction that commodities and related share prices were heading for what could possibly be the most savage sell-off for as long as anyone could remember. I was convinced and ultra-nervous at the same time.

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Truth is, the Bear Market of 2008, which includes the collapse of Lehman and freezing of the global financial system, made FNArena into what this business is today. Prior to 2008, we were one of many financial media services in Australia. Our unique selling point was that we reported on the most valuable information from each day's stockbroker research via the Australian Broker Call Report and I would write up various observations and insights from running daily through hundreds of pages of research.

But then Bear Stearns went down because of two hedge funds with exposure to collaterised debt obligations and the world took notice. What the hell are these whatever-they-are-called?

When the world started anxiously looking around for answers, FNArena became its centre of attention.

Globally.

It's almost surreal to recall today, but in those days we would receive requests for more information even from staffers inside the investment banks on Wall Street, the centre of this newly emerging problem. Stories were predominantly written by colleague Greg Peel as he and I quickly made a deal: I took responsibility for everything involving content and FNArena, and Greg would 100% dedicate himself to reading, researching, analysing and writing about this new problem very few knew anything about.

Result number one was that FNArena immediately stood diametrically opposite the ruling opinion of the day: it's nothing but a small problem in a very large market, and it won't affect Australia. Australian banks are safe. Don't sell.

Instead FNArena said: this is a cancer inside the global system and it is going to spread. Australian banks are not safe because the global financial system has now become the core of the problem. Sell your banks. Do it now.

Harry Hindsight tells us today bank share prices would not stop falling until they had lost more than -50% over the following 15 months or so, and we kept our negative view all the way through, but as we can all imagine that was a truly horrible time for investors as most had become married to their all-time favourite stocks, and many kept hoping for a long time that FNArena might be proven wrong.

It is for this reason that I have been reluctant since to reflect back in public on what was essentially a company-defining two-year period. FNArena was making its mark, and what an Olympic gold medal-effort it turned out to be, but at the same time, so much pain, regret and disappointment came through via emails and otherwise. Many were approaching or already in retirement.

We can but hope none of us has to go through a similar experience, ever again.

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There still is a strong personal connection with that time because I realised I might not have a business for much longer. The core activity at FNArena was to report what the experts were saying, but as share prices kept falling, analysts and strategists turned into frozen bunnies staring into a bright light; nothing useful was said or published. Everyone was waiting for Godot.

I realised I had to step up. Then misfortune happened. I fell off a balcony, from two stories down, landing on my head. I didn't spend much time in hospital, but my brain was in shock. At first, I barely managed to stay awake for an hour, then I had to sleep for a while, until I had enough energy for another hour, then sleep again. I used every minute available to read, research and write.

Small miracles can and do happen.

All the while, share prices kept falling and companies going bankrupt. Margin calls were called. We found out CEOs had borrowed against their shares and options. Next we focused on the short sellers, in particular those doing it "naked". And still, no sign of Lehman Brothers going bankrupt at this stage. Just a general sense of bewilderment; nobody was really sure how deep, how long, or how much?

Everything ground to a stand still. Quite literally. The Australian Financial Review was publishing poems written by fund managers who had absolutely nothing else to do. One anecdote probably describes the situation best: one day the entire telephone system at one brokerage in Australia had failed and nobody in the office had noticed until late on the day.

Stockbrokers had become used to the fact that no phone calls were incoming, and that was now "normal", and nobody felt the need to even try to call out to attract some business. And share prices, they kept falling. Every pause, or even short-term rally, was subsequently met by renewed selling. The true definition of a Bear Market.

"Well, I woke up this morning And I got myself a beer

The future's uncertain and the end is always near"

[Roadhouse Blues, the Doors]

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Equally largely forgotten today: the malfunctions inside global financials arose in the midst of a gigantic commodities boom; this still was the era of Stronger-for-Longer, the Super-Cycle. Copper miners and the like remained relatively unscathed at first, while crude oil futures kept speeding to the next level up.

It truly was the best of times combined with the worst of times. There was tightness in energy markets, but the price of a barrel was doubling in a little over six months. How could economies cope?

The answer is, of course, they could never. Historically, whenever a barrel of crude had doubled in price in such a short time, there always had been an economic recession next. No exception. Somehow in 2008 nobody made the connection.

And I mean nobody. Goldman Sachs declared US$200/bbl was the next target. One day I was invited in at the young Business Spectator and was told: "Rudi, you truly are the last man standing. We had one other oil sceptic, but he threw in the towel last week."

Crude oil peaked at US$147/bbl on July 11. Woodside shares peaked one month prior at $70.

I was consultant for a European hedge fund at the time. My most valuable contribution was discouraging them going long energy. Just like everywhere else, their investment committee was bulked up with raging oil bulls. What followed next was yet another savage chapter. More money flushing down the gutter. More pain, no gain.

By December WTI futures had sunk to US$30/bbl.

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Can you believe it, this story still has not run its full course?

By August, I genuinely and truly admire my own brazenness, I became convinced the next shoe to drop was China and thus commodities and commodities stocks. The world had hung on to the last thing that had still worked up until that point, somewhat, on relative measure, but now carnage was coming, and I was convinced there would be no place to hide.

I was ultra-nervous. Thought about it for days. I started writing:

"I am not seeking to be sensationalist just for the sake of it, but I am making the following statement with an iron conviction: if the dust has settled post the current price correction across the commodities complex it will have turned out to be the most severe correction investors have seen for many, many years."

Imagine writing that as the opening sentence of your next communication with investors, who already are low on confidence, high on losses and desperation.

My warning got picked up by the Australian newspaper. I remember the journalist during the interview, incredulous, shocked: you mean not one single stock? Equity, the magazine of the Australian Shareholders Association, printed my story opposite Robert Gottliebsen who sensed "a looming long-term investment opportunity".

My warning concluded with a semi-confidence boosting message: "Bottom-line: we seem to be at the beginning of everything, really (including the beginning of the end of the bear market)."

As it turned out, the commodities sell-down in late 2008 was yet to be followed up by two months of more savage selling as the calendar opened 2009. The Australian share market bottomed on the first Friday in March (6), before Wall Street did.

For the remainder of 2009 investors would send me gifts, cross the street to shake my hand or they gave me a big hug, saying thanks for everything. But there were plenty of other stories. Subscribers who had no money left. Who said: Rudi, I didn't read your stories. Or: I was listening to other people. How did I know? Or: I didn't want to pay capital gains tax.

While we made a large number of friends, we also lost many. One such sent us a thank you note while enjoying life on a beach in Hawaii, early in 2008: thanks for the warning, guys. Am all cashed up. Won't be needing a subscription. All the best!

I feel sorry for those who lost out, but am immensely proud, and deeply grateful, having grabbed the opportunity to excel during the darkest of times, and having been rewarded with a group of subscribers who have remained with us since, and who are still actively supporting FNArena in all its endeavours today.

It goes without saying, we don't get everything right all the time. On my observation, we are the only one around who have analysed and dissected the Lost Decade for Australian equities.

I appeared in alien costume at the ASX Investment Hour to highlight the importance of dividends long before this became a popular theme. Investors who paid attention would not have stuck with the banks post 2015, and have avoided resources between late 2011-early 2016.

My research into All-Weather Performers has guided many to stocks they would never have considered.

Quite amazing nearly one whole decade has passed. Thanks to all of you who made this adventure possible, who traveled with us, and are still traveling shoulder-to-shoulder next to us. Even if you joined more recently, I am still truly grateful for what we have achieved together.

The FNArena website states: Our quest is not to be bullish or bearish, but to correctly assess future trends. That's not just a slogan, that's our raison d'etre.

Up to the next chapter!

(Do note that, in line with all my analyses, appearances and presentations, all of the above names and calculations are provided for educational purposes only. Investors should always consult with their licensed investment advisor first, before making any decisions.)

P.S. I - All paying members at FNArena are being reminded they can set an email alert for my Rudi's View stories. Go to My Alerts (top bar of the website) and tick the box in front of 'Rudi's View'. You will receive an email alert every time a new Rudi's View story has been published on the website.

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Rudi's View: All-Weather Model Portfolio

By Rudi Filapek-Vandyck, Editor FNArena

Last week a reader sent through the following questions regarding the FNArena/Vested Equities All-Weather Model Portfolio. I have decided to share my response with a broad audience as I think many more might be interested.

1) What are the exit conditions if someone elects to exit the fund and close the SMA account? 2) I tend not to invest in stocks related to gambling, alcohol/tobacco and banks in general. Do I get to choose if the fund decides to invest in those stocks? 3) Portfolio performance of 8.35% pa since inception (close to 4 years) is good but not great so far. Do you anticipate better performance (> 10% pa) going forward?

My responses:

1) What are the exit conditions if someone elects to exit the fund and close the SMA account?

One of the key factors behind our decision to run the Model Portfolio via Separately Managed Accounts (SMAs) is the wide-ranging flexibility involved. You can open an account, transfer funds, reduce funds, add more funds, and close your account at any time and at your own volition while having day-to-day insight in which shares are kept, bought and sold, the respective allocations, changes, dividends, costs and performance.

If you decide to join through FNArena you will receive a small discount on costs, but all-in-all most costs are related to platform, admin and license which are pretty much set in stone unless competition forces the platform operator Praemium to lower its standard fee. (This is not inconceivable but hasn't happened as yet).

When asked about costs I usually respond with approximately 1.5% per annum. The "approximately" refers to the fact some costs are related to the size of the funds allocated plus a minor part stems from potential and unpredictable brokerage. The latter is a tiny cost under all circumstances.

Importantly, and directly related to your question, there is no cost for closing the account with Praemium and Vested Equities; once you withdraw all funds and close down the account you simply stop paying any further fees.

Here is the full overview of the costs involved:

Minimum participation is set at $20,000.

2) I tend not to invest in stocks related to gambling, alcohol/tobacco and banks in general. Do I get to choose if the fund decides to invest in those stocks?

Unfortunately, wide-ranging flexibility does not equal unlimited flexibility. Investment decisions are made for the Model Portfolio and they are being replicated across all SMAs connected. As said above, every investors has access and can make changes anytime about how much funds he/she allocates, but the process cannot have too many exceptions and discrepancies or it simply won't work properly.

The whole idea behind the research into All-Weather Stocks is to find high quality companies with many years of growth ahead of them, that can be owned for many years in the Portfolio. You will find that high quality mostly equals companies that take good care of their staff and clients, communicate well with all stakeholders, invest for the long run and make sure they do not destroy tomorrow's future for a quick benefit today.

Investors globally are increasingly adding Environmental, Social and Governance (ESG) filters to their toolbox when assessing present and future investments and here at FNArena we find All-Weather Performers/High Quality companies are usually already using the same blueprint.

Portfolio stalwarts like Amcor and Orora might be closely linked to tobacco, sugar and waste, but these companies are also at the forefront of new technologies and recycling initiatives for the global packaging industry. Long held Portfolio constituent NextDC has decided to equip all of its data centres with as many roof solar panels as possible.

DuluxGroup is, as I understand it, a core holding for Ethical Partners Funds Management. The company equally is putting in place solar power for a new factory. The company is involved with the 'Paintback' program which aims to be a more responsible pathway to get rid of leftover paint.

Possibly the one constituent that is most likely to trigger some controversy/criticism is Aristocrat Leisure. We thought long and hard before we added this stock to the Portfolio. It is there not because Aristocrat is part of my selection of All-Weather Stocks, but because it has transformed itself into a prime growth story that still has many more years to develop.

Note as the concept of All-Weather Performers is exactly the opposite of miners and energy companies, we automatically shun coal, steel, aluminium, fracking, and other contentious business models. Australian banks are not excluded by default. If the sector ever gets back to its mojo of the 1990s and 2000s we might reconsider them as All-Weathers, but I very much doubt whether such a scenario could possibly be on the horizon in the foreseeable future.

I share my selection, insights and updates on All-Weather Performers regularly with paying subscribers at FNArena. There is also a dedicated section on the website, as well as eBooklets and two published books. Feel free to get acquainted with the companies and sectors that form part of my research and analysis. Needless to say, my research and analysis are continuously ongoing. New insights will be forthcoming and they will have an impact on future investment decisions.

3.) Portfolio performance of 8.35% pa since inception (close to 4 years) is good but not great so far. Do you anticipate better performance (> 10% pa) going forward?

I think a little bit of context is required here. When we sat down in 2013-14 to prepare for the chosen investment mandate, we very much believed that future investment returns would be lower than the circa 11% long term average the Australian share market was exhibiting at that time. That assessment has proved to be correct.

We thought circa 8% as an average per annum looked both reasonable and achievable. Thus far, the All-Weather Model Portfolio has outperformed those expectations. A little surprising maybe, is that the ASX200 has equally performed better than 8% on average, despite going through numerous periods of difficulty and weakness.

Note the All-Weather Model Portfolio has outperformed the broader share market since January 2015 ("inception") in all six months periods except for the first, when we started with 100% in cash and the share market was rallying, and the second half of 2016 when en masse portfolio switching out of defensives & winners and into laggards & cyclicals temporarily dominated the market.

Among the promises we made to investors are lower volatility in price movements and a lower risk profile, and history thus far shows we have been able to deliver. In particular the lower risk characteristic implies the portfolio return is highly unlikely to shoot up to 25%, 30%, 40% or higher. In the fabel featuring the hare and the tortoise, the Portfolio very much resembles the tortoise who crosses the finish first, having approached it in a steady and gradual manner.

But the context equally involves other funds, portfolios and strategies. Only this morning I opened a fund manager's newsletter which showed the following performance update: one month performance -0.99%; financial year to date: 0.02%, calendar year to date: -3.22%. However, the number to advertise remains the performance since inception: 198.58%.

This is typical for the large majority of fund managers in Australia. Long-term outperformance mainly stems from halcyon times many moons ago that still compensate for the fact that returns have dropped significantly in recent years. If you visit websites for large listed managers, such as Perpetual and Janus Henderson, and look up respective funds performances in Australia you're most likely to find the numbers (even before fees) are not keeping up with the broader index.

The FNArena/Vested Equities All-Weather Model Portfolio has beaten the index. We just updated performance numbers until the end of August for our brochure (see below).

The third factor to take into consideration is the Australian share market is one of only few to not experience a negative performance to date in the running calendar year of 2018. I wouldn't necessarily exclude the fact that 2019 might turn out quite the challenge, with slowing growth, ongoing Fed tightening, rising inflation, local elections and more Trumponomics just a few factors that come to mind.

Of course, financial markets have surprised in a positive sense since the global turmoil of early 2016, and they may well do so again next year and the year(s) thereafter. But I am not sure whether anyone can confidently promise you in excess of 10% annual return on your investments. I certainly won't be making any such promises.

Regarding the performance update below, one has to take into account your personal return will also be determined by the timing of your SMA, plus for a Portfolio that has run for less than four years, the significant set-back experienced in the second half of 2016 still has a large impact on the averages. Only time can change that, assuming we can continue our track record thus far.

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