Week

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Stories To Read From FNArena

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FNArena
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GPO Box 3145
Sydney NSW 2001

info@fnarena.com

Your editor
Rudi Filapek-Vandyck

Your dedicated team of journo's
Greg Peel
Eva Brocklehurst

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QE For Life?

As the world slides back into easy monetary policy to avert slowing growth, Saxo Bank contemplates the potential for another decade of quantitative easing.

-Fed, ECB step away from monetary tightening -Germany at risk of recession -Global QE may be necessary for some time -Shift to de-globalisation

By Greg Peel

“Our country’s doing unbelievably well economically,” President Trump told reporters on Friday after US data showed a forecast-beating 196,000 jobs were created in March.

Yet Trump said that he believes the Fed “really slowed us down” in imposing four rate hikes last year which he said were unnecessary because there is “very little if any inflation.”

“In terms of quantitative tightening, it should actually now be quantitative easing,” Trump said. “I think they should drop rates, and they should get rid of quantitative tightening. You would see a rocket ship.”

The US Federal Reserve implemented “quantitative easing” -- using money printed by the US Treasury to first buy government bonds and then corporate bonds and mortgage-backed securities – in 2009 as a means of providing further stimulus to a US economy in the wake of the GFC when dropping its cash rate to zero had not proven sufficient. Further QE programs continued through to 2013, at which point the Fed decided it was time to start “tapering” its bond purchases.

Eventually the Fed stopped buying more bonds, but continued to replace maturing bonds in order to maintain its balance sheet. In December 2015, the Fed implemented its first post-GFC rate hike. By December 2018, the Fed had hiked nine times, and also commenced a wind-down of its balance sheet by no longer replacing maturing bonds – a process dubbed “quantitative tightening”.

The catch-phrase for 2017 – the first Year of Trump – was “synchronised global growth”. There was little argument from markets that the Fed was justified in returning its policy stance to “normal”. By 2018, which we might dub the Year of Tariffs, synchronised global growth had swung to solitary US growth. By late 2018 it began to appear even the US could not remain isolated from a global slowdown. Stock markets tanked in the December quarter.

The Fed responded by “pivoting” to a neutral stance, implying no more rate hikes unless data suggest otherwise.

Now Trump is suggesting the Fed not only cut its cash rate, but reinstate QE, despite an economy “doing unbelievably well”. Two points to note:

The US stock market (S&P500) is currently not far off its all-time high of last September, which represented a 340% rally from the 2009 low.

Global debt levels have now exceeded US$250trn. The peak prior to the Global Financial Crisis was US$175trn.

Europe

The Fed was quick to move in response to the GFC. The European central bank was not. Only when the eurozone threatened to implode did new ECB president Mario Draghi vow to do “whatever it takes”, which ultimately meant a negative cash rate and a QE program.

In 2017 – the year of synchronised global growth – Draghi began preparing the market for the end of QE and a first post-GFC rate hike. Last month Draghi declared the ECB “ready to act” to avert slowing growth. Trump’s radical suggestions aside, the Fed has lifted its cash rate incrementally to 2.25-2.50% and if needed, can incrementally reduce it once more. The ECB cash rate remains negative. Nowhere to run to.

Throughout the post-GFC period, Germany has carried the can as the eurozone’s largest economy (one third of eurozone industrial ouput), bailing out basket case smaller economies such as Greece and demanding strict fiscal austerity measures in return. But now, even Germany is in trouble.

“The most important factor, says Saxo Bank’s chief economist Steen Jakobsen, “is the collapse of German growth. We see a risk of recession there by Q4 even without a trade spat with the US”.

Underinvestment in the technology sector leaves Germany unprepared, Jakobsen suggests, and its internet speed ranking is just one of many symptoms. Germany needs to catch up in terms of digitalisation, programs for working women and infrastructure spending.

The lapse of Germany will make the debt issue a pan-European issue and not one of Germany versus the PIIGS (Portugal, Italy, Ireland, Greece, Spain) or austerity versus free spending. Germany is after all, says Jakobsen, “perfectly positioned to benefit from automation, AI, digitalisation and a capital market that is cheap by any standard”.

But one of Europe’s biggest problems remains its banking sector. Saxo Bank calculates the nominal return on the sector since 2003 as zero, or -28.5% adjusted for inflation – an “ugly parallel” to Japan’s “zombie banks” in the wake of the 1990s meltdown. And in response to the GFC, Europe has agreed to implement stricter banking regulations, driving up costs for an already weak sector.

“Ten years since Leman Brothers’ bankruptcy and Europe’s banking sector has still not healed”.

Commodity Economies

“Our least favourite currencies in a weakening global growth environment are the commodity dollar currencies,” notes Saxo head of FX strategy, John Hardy, “where housing bubbles are in various stages of unwinding, inevitably impacting the credit and therefore growth outlooks. Our longer-term bullish call on commodities should eventually offset downside risks, but these risks will prevail until central bank policy in these countries looks like it does for the rest of the developed markets – i.e. more or less ZIRP [zero interest rate policy] and central bank balance sheet expansion to clean up the private credit mess”.

Zero interest rate policy for Australia? Current consensus is leaning towards two Reserve Bank rates cuts in 2019, to 1.0%.

“Taking the world back to looser monetary policy and lower yields will be bullish for bonds and equities, notes Saxo global market strategist, Kay Van-Petersen. “Expect new cyclical lows in bond yields. For example, Australian 10-years are already taking out the 1.81% lows. Structurally speaking, I also expect a much weaker USD over the course of the year. The world needs a weaker USD to flourish and what the world needs, it tends to eventually get.”

A weak US dollar would not be good news for Australia. If the RBA is not forced to cut rates to avoid a domestic-led recession (“housing crisis”), a too-strong Aussie dollar in the face of a slowing global economy must surely tip the scales.

The swing factor is of course China, but let us also not forget Japan.

Growth risks remain a concern for emerging markets,” says John Hardy, “but we think China provides a backdrop of stability as it seeks to maintain a stable currency and attract capital inflows to deepen its capital markets and accommodate its transition to becoming a deficit country (a key step in shifting the CNY to an eventual reserve asset). The JPY could do well during bouts of risk deleveraging this year, but the Japanese government is perhaps the most ready to switch on the fiscal stimulus, with the Bank of Japan happy to cooperate as it seeks to avoid yen volatility.”

Macro Shift

There has been a huge shift in the global macro backdrop over the last six months, Saxo Bank suggests, and it has huge structural significance for both Asia and the world as a whole. The crux of the matter is that central bankers, led by the Federal Reserve and European Central Bank, have “unequivocally failed to attain escape velocity from quantitative easing”.

While Saxo is not that surprised the world has failed to escape QE, given the rising level of global debt it has encouraged, the speed in which the world has been “pulled back in” has come a surprise. The implication is now that until there is a “great debt reset”, through “haircuts” (bond holders accepting some level of cents in the dollar), restructuring and a “debt jubilee” (debt simply forgiven, for poorer countries in particular), which could still be five to ten years away, “it’s back to QE for life”.

Saxo suggests investors take note that dovish central bank policies may prolong the late-cycle period (supporting bonds and equities) but that they will not be sufficient to avoid the recession Saxo believes is coming by late 2019 or early 2020.

But it’s not just the economic outlook that is shifting.

“From Trump and the China-US trade war to Brexit and the gilets jaunes [yellow vest protests in France], the threats of this regime shift are evident” says Saxo. “The tectonic plates are shifting, even if we are yet to feel the consequences of the extremist versions of these movements, like a hard Brexit. After a 30-year spate of

deregulation and laissez-faire economics, this new paradigm will create a different business and investment environment and the implications will be far-reaching, creating fresh headwinds and therefore risks."

That shift is towards "de-globalisation". As the backlash against globalisation intensifies it will be increasingly difficult to price risk and determine a policy response against a complicated and polarising backdrop, suggests Saxo market strategist Eleanor Creagh.

"Any response that will bring real improvement and tackle the misfortunes of those caught on the wrong side of globalisation seems a long way off. The current new political era is the result of decades of societal shifts and the solution could itself take decades to work though."

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Separating Malt Appeals To GrainCorp

Separating out GrainCorp's malt business has its appeal, brokers acknowledge, but the devil is likely to be in the detail for the remaining integrated grains & edible oils.

-Malt de-merger and separate listing considered straightforward -No update on the LTAP proposal -Grain derivative product being explored to reduce volatility

By Eva Brocklehurst

GrainCorp ((GNC)) has proposed separating its malting assets from grain handling and oil processing operations. The global malt business, 57% of the FY18 operating earnings (EBITDA), will be de-merged and listed separately.

Grains & edible oils (new GrainCorp) will be combined into an integrated business, being 23% and 20% of FY18 operating earnings, respectively. The de-merger would enable the malt and grains & oils entities to pursue independent operating strategies. Implementation is targeted by the end of 2019.

All up, the company is targeting $20m in cost savings from its proposals. Wilsons finds the malt side of the equation reasonably straightforward, while the outlook for the new GrainCorp is more complex.

Details of capital structure, including gearing and dividend policies, will be released once the sale of the Australian bulk liquid terminals has been completed and an evaluation of the grain derivative proposal has been finalised. Ahead of this, the broker finds a cost savings target of $20m reasonable.

Wilsons assesses that its valuation is not materially different under the de-merger proposal, although the proposed structure likely enables value to be realised much more quickly. The company has also stated it remains in consultation with parties that have expressed an interest in acquiring parts of the portfolio. Bell Potter expects some carve out of corporate costs to the malting company, offset by cost reductions.

While malt is expected to perform strongly in FY19, Macquarie flags the fact the outlook for grains has deteriorated. Rainfall to date is among the lowest recorded in most of eastern Australia's grain belt, which is likely to challenge the grains business.

UBS observes the strategic rationale is further reinforced by the lack of synergies between domestic malt production and the malting barley procurement operations in the grains division. Hence, a de-merger is likely to unlock shareholder value. Nevertheless, the broker is cautious about projecting any earnings uplift for grains, given the increase in competition.

Wilsons assesses that its valuation does not change materially under the de-merger proposal, although the proposed structure likely enables value to be realised much more quickly.

LTAP?

In December 2018 GrainCorp received a non-binding, indicative proposal from Long-Term Asset Partners (LTAP) at $10.42 a share and there has been no definitive update since then. UBS envisages limited downside risk to the current share price, despite the lack of an update on LTAP's offer. Still, it is unclear to brokers whether the de-merger proposal alters the chances of GrainCorp receiving a formal takeover offer.

Wilsons maintains an existing EV/EBITDA ratio of 9.0x, which implies a 20% premium to asset replacement value and compares well to relevant takeovers. The broker, not one of the eight stockbrokers monitored daily on the FNArena database, notees the proposed structure also enables a moderate increase in gearing. The broker's target is $9.40 and a Hold rating is maintained

Deutsche Bank finds the de-merger scenario credible, in order to unlock shareholder value should the LTAP takeover offer not materialise. On a de-merged basis the broker envisages 15% upside to the current share price.

Grain Derivative

The company will implement a grain derivative, similar to that proposed under the LTAP offer, to minimise the earnings downside to the new GrainCorp. On this subject, Bell Potter asserts the driver of value in the residual business appears to be the extent to which east coast grain volatility is removed.

The intention behind the new derivative product being explored is to find a minimum level of fixed cost recovery in domestic grains, based on the size of the east coast crop.

The derivative will have a cost component that is yet to be clarified and will still leave the new entity exposed to the underlying performance of the marketing and trading operation, which Bell Potter points out is increasingly moving offshore, and increasingly opaque in terms of its contribution.

The broker, not one of the eight monitored daily on the database, intends to reassess the value when final details emerge about the structure. Bell Potter retains a $9.45 target and Hold rating.

A higher earnings multiple may be justifiable, given the lower risk, but UBS opts to retain current valuations for the grains division. The broker increases its stand-alone malt division multiple, believing as a standalone company it will be more attractive to investors.

There are three Buy ratings and one Hold (Morgans, yet to comment on the proposal) on FNArena's database. The consensus target is $9.41, signalling -0.9% downside to the last share price.

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Confidence In Costa Reinvigorated By Berries

Several brokers suspect they are being conservative regarding the potential of the berry plantations Costa Group is developing in China.

-On track to achieve five-year plan of 240 ha of berry plantings in China -Logistical advantage with farms in China versus imports -Breeding program in northern Queensland developing suitable varieties

By Eva Brocklehurst

Confidence in Costa Group ((CGC)) has been reinvigorated following visits by brokers to the company's Chinese berry farms and its associate, Driscoll's, for packing, logistics and marketing.

Both Credit Suisse and UBS believe they have probably been too conservative in their estimations regarding the rolling out of the berry plantations in China. Costa Group is on track to achieve its five-year plan of 240 hectares of berry plantings by 2020.

Credit Suisse expects the company will be able to enhance its yields and pricing through genetics and management, estimating that after completing the planting in 2020, the joint venture will carry about $100m of funds employed and it is reasonable to expect a 20% earnings (EBIT) return on assets in China.

China is part of the company's international division, along with Morocco, which represented 17% of 2018 operating earnings (EBITDA). Costa Group has strong relationships with multiple levels of the Chinese government and is a major employer, one of the largest foreign investors in agriculture.

Driscoll's is the minority partner, 30%, and the sole customer. The Chinese market is large, with an addressable population of around 150m but this could also stretch to over 400m for blueberries at the right price. Blueberries are 75% of Costa Group's production in China.

UBS envisages the international business will drive more than 50% of the growth out to FY23, while Macquarie believes international underpins the target for profit growth of over 30% in 2019.

Strange Fruit

China is the world's largest fresh produce market and fruit consumption is high per capita. This is expected to remain favourable as incomes rise and the consumer is more willing to pay a premium. UBS suggests there is strong potential with jumbo berries. Jumbo berries are priced at a 60-80% premium, regardless of the part of the season and demand is overshooting supply.

While Costa Group is competing against imports, it has a logistical advantage in that it takes two days to market from harvests, versus Chile and Peru (the bulk of berry imports to China) which take 30-35 days.

Therefore, fixed cost leverage may be greater then fully appreciated. UBS agrees 2019 guidance is achievable as the citrus crop is on track, international business is growing and Morocco should have a more “normal” year. Brokers note availability of appropriate labour in China is of more concern than cost inflation.

Credit Suisse remains little more cautious about the Moroccan business, as April is the key month for that industry and the market expects a strong rebound from the weak season in 2018. Meanwhile, Australian conditions have stabilised and berry and tomato prices have improved through February and March.

Wilsons notes, beyond the initial five years, management remains reasonably bullish on the outlook. This entails growing the more suitable varieties for tropical environments, where blueberries are not traditionally cultivated. Costa Group has a breeding program in northern Queensland, developing varieties for southern Morocco, southern China and central Mexico. These varieties will support royalty income from Driscoll's third-party growers.

Wilsons, not one of the eight stockbrokers monitored daily on the FNArena database, has a Hold rating and $4.95 target. The broker asserts the challenges in terms of production are well understood, given the climate in Yunnan, China, is similar to that of Far North Queensland.

There are three major growing regions outside of Yunnan, supplemented by imports from Peru and Chile. Production from Yunnan targets the window of opportunity in March-May, after Chile and before peak Chinese domestic supply.

FNArena's database shows four Buy ratings for Costa Group, one Hold (Morgans) and one Sell (Ord Minnett). The consensus target is $5.89, suggesting 10.0% upside to the last share price.

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Slim Pickings In Automotive Holdings Offer

A combination of AP Eagers and Automotive Holdings will provide a competitive advantage, brokers agree, against smaller fragmented competition. Yet, AP Eagers is offering a minimal premium.

-Combined entity would represent around 12% of Australian new vehicle sales -Competing offer considered highly unlikely, as AP Eagers owns 29% already -Automotive Holdings would be better able to ride out the cyclical and structural challenges

By Eva Brocklehurst

AP Eagers ((APE)) has finally made its plans known for Automotive Holdings ((AHG)), announcing a merger bid and offer for the 71% of the company it does not own. The company's rationale is to leverage its retail experience in the automotive industry across a larger portfolio, providing greater geographical diversity.

The transaction should mean the combined business has a competitive advantage versus much of the smaller, fragmented competition. AP Eagers has made an all-scrip offer of one share for every 3.8 Automotive Holdings shares. Against the prior closing price, this implies $1.92 for Automotive Holdings per share.

There is no minimum acceptance threshold, finance conditions or due diligence, although the transaction will be subject to Australian Competition and Consumer Commission (ACCC) approval. If approved, Morgan Stanley calcuates the combined entity would represent around 12% of Australian new vehicle sales. Pre-tax synergies are expected to be around $13.5m per annum.

Thin Premium

Ord Minnett observes the takeover premium is relatively thin at 7.6% and a competing offer is unlikely, given AP Eagers has 29% of the company. This premium is well below historical transaction takeover premia of about 30%.

Ord Minnett also suspects the share price is implying the market believes Automotive Holdings will reject the offer and seek a higher valuation. The response by Automotive Holdings to date has been for shareholders to take no action.

Wilsons suggests the prospect of extracting a higher price will largely depend on Automotive Holdings' ability to show progress in earnings, such as confirming FY19 guidance and debt reduction. This should improve prospects of receiving a better premium.

With the stock under a bid, the broker's research policy dictates a move to no rating. Wilsons, not one of the eight stockbrokers monitored daily on the FNArena database has a target of $2.01 for Automotive Holdings.

There remains significant gearing to worry about as well as the likely downside risk to near-term earnings forecasts. In this regard, a sale of the refrigerated logistics for an adequate price would de-gear Automotive Holdings and put it in a more favourable position, in Ord Minnett's opinion. The company's operating performance in recent years has been poor, with a number of long-tail liabilities.

Merger Synergies

Yet, through a merged entity, Credit Suisse assesses that Automotive Holdings shareholders stand to benefit from synergies and an ability to better ride out the cyclical and structural challenges. The main downside would be giving away some value at, arguably, a low point in the cycle.

The broker notes there are still risks, such as the divestment process for refrigerated logistics, the need for more dealership restructuring and lower profitability post the regulatory changes to finance. Credit Suisse leans towards the relative certainty of the offer, although retains a suspicion that the Automotive Holdings board may disagree.

In terms of market share, the combined share of 12% is a favourable starting point for the ACCC assessment, Wilsons suggests. The significant changes in the Australian new vehicle sales landscape has made OE (original equipment) manufacturer approval (also needed) more likely. However some divestments may still be required.

The broker estimates up to $34m in additional earnings improvement on the basis of the operating earnings (EBITDA) margin differential between the two operations. This is on the basis that the automotive retailing margin

of Automotive Holdings improves to a level consistent with that achieved by the combined car & truck retailing of AP Eagers. AP Eagers has emphasised economies of scale, best practice systems and reductions in overheads.

For Automotive Holdings the database has six Hold ratings and one Sell (Morgan Stanley). The consensus target is $1.95, suggesting -7.8% downside to the last share price. For AP Eagers the target is $7.63, signalling 0.4% upside to the last share price. There are two Buy ratings and two Hold. The dividend yield on FY19 and FY20 forecasts is 4.7% and 5.0% respectively.

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Sims Metal Turning Waste To Energy

Sims Metal has highlighted the increased value of the material in waste streams, flagging a significant diversification from its core scrap metal business.

-New initiatives to exploit fast-rising energy and landfill costs -Australia to provide demonstration plant and the US to follow -Capital expenditure expected to diminish cash returns

By Eva Brocklehurst

Sims Metal Management ((SGM)) has hailed the future with a significant change in strategy, intending to harness the energy from combustible waste material and roll out an expanded version of its Australian landfill gas capture and energy business.

The company has highlighted the increased value of the material in waste streams and, while its scrap metal business remains core, around 5% growth per annum over the next five years is envisaged through acquisitions, greenfield sites/plants and organic growth.

The main opportunity, the company has flagged, is the waste-to-energy business, which recognises the already-high and rising cost of landfill waste, particularly in Australia and the UK.

New business being developed is in the waste-to-energy segment, as well as the offshore expansion of existing landfill gas capabilities. The company considers the best waste-to-energy implementations are in Australia and the US. The first site for this gasification of waste is planned for Australia, co-located with the processing facility and operational in 2022. The expected capital cost is $158m over five years.

Landfill costs to the company are $103m globally, of which 75% is calculated to be able to be diverted to energy generation. Australia has punitive energy and landfill costs but lacks the scale of the company's US operations and offers very limited volume growth. However, Australia will provide the demonstration plant and the US will follow, with larger-scale opportunities.

In its traditional business, Sims Metal has outlined plans to increase North American ferrous volumes by 40% and double non-ferrous volumes to 300,000tpa. The key components include the acquisition of 25 feeding yards, bolt-on acquisitions and market growth.

To Deutsche Bank the 15% internal rate of return target is pleasing but the transforming elements of the new strategy are unlikely to be providing significant upside until after FY25.

Growth expenditure of around $670m will also be required from FY20-24. The broker is confident US volume growth will arrive but remains conservative about the outcome for the energy part of the business.

Landfill Usage

Sims Metal is already established as a landfill energy producer, with a landfill and solar energy project which it holds in a 50-50 joint venture with LMS Energy. Credit Suisse points out that LMS Energy has been a largely undisclosed and undiscussed asset in the company's portfolio to date, but as of today it has been elevated as a growth opportunity of significance.

The other prong to the strategy is taking e-recycling to a new level. The opportunity identified is around 6MTR of data centre server material currently installed to service the cloud, of which 2mtpa of recyclable and reusable material will be released. A US market share of 10% is targeted by FY25.

Management believes this is a high margin opportunity but Credit Suisse notes previous investments in such recycling have materially fallen short of expectations. In sum, the broker finds positive aspects in the fact the new growth is staged and conditional on the success and early returns from initial investments that will test and demonstrate the concepts. Morgan Stanley suspects competition, particularly in cloud materials recycling, is likely to be robust.

The company expects to roll out seven sites for its waste-to-energy business over the next 10 years on a case-by-case basis. Over the next five years two operating plants are being targeted with a further two more in development.

UBS suggests that permits and environmental oversight pose the greatest risk to the company's timeframe. Ord Minnett also envisages some risk that capital from outside the industry could disrupt the waste management value chain, albeit mainly in the municipal channel.

The broker, nevertheless, believes the waste management industry is the best positioned to generate returns from waste-to-energy. Morgan Stanley would like to observe the proving up of the opportunity and suspects the timeframes may prove ambitious but agrees minimising waste stream and generating revenue make sense.

Capex Versus Cash Returns

The negative aspect for shareholders is that the company is reclaiming its balance sheet and taking on new risk, rather than returning cash. Credit Suisse also warns dividend franking is now largely depleted and future dividends will only be paid where they can be 100% franked, so will be constrained by Australian earnings.

Also, almost all growth appears to be from offshore initiatives. Morgan Stanley agrees the likelihood of meaningful capital management is reduced over the next five years and a desire to only pay franked dividends has potential to reduce current dividend expectations.

China

UBS suggests the decision to leverage the growing focus on recycling is positive but long dated, and coincides with a time when China continues to disrupt non-ferrous scrap markets. Hence, the broker remains cautious, as China now requires importers of category 6 scrap to have quotas after July 1.

Citi believes the company's newly-commissioned Zorba separation plant is well timed. The high-quality, furnace-ready products has potential to avoid China's import restrictions. Scrap imports to China have been declining because of tightening quality standards on the type of material the country was prepared to accept.

The company believes, as Chinese demand for recycled scrap continues to grow, the most likely scenario is for materials to be increasingly processed in alternative markets before shipping to China. Hence, Citi suggests the new Zorba plant may provide a solution. The plant converts around 80% purity non-ferrous scrap into furnace-ready products such as copper, aluminium and stainless scrap.

FNArena's database shows four Buy ratings, two Hold and one Sell (UBS). The consensus target is $12.03, suggesting 11.9% upside to the last share price. Targets range from $9.10 (UBS) to $14.00 (Macquarie, yet to comment on the strategy).

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Bank of Queensland Beset By Problems Of Scale

Bank of Queensland sustained no growth in its home loan book in the first half and its retail bank continues to struggle. Brokers suggest the absence of a permanent CEO has hindered development of a definitive strategy.

-Lack of scale makes it difficult to cope with increasing regulatory and cost pressures -Retail banking weak, likely to struggle to grow the home loan book without compromising margins -Strong likelihood that dividend will be reduced further

By Eva Brocklehurst

Challenges are mounting for Bank of Queensland ((BOQ)) as the regional bank battles rising costs and regulatory requirements. Credit Suisse believes the plight of regional banks is well summarised in the bank's first half result, which had been pre-released.

A lack of scale makes it difficult for Bank of Queensland to achieve the technology investment required in a digital world, or cope with increasing regulatory requirements. The broker believes external intervention is required, which may mean merging with other smaller operators to compete with the major banks.

Bank of Queensland closed 11 branches during the first half, after closing four in the second half of FY18, reducing its branch footprint to 172. Hence, the challenges have been laid bare, Citi asserts, and the interim management has ordered a retail banking redevelopment, reviewing return metrics and simplifying the business.

There was no growth, as expected, in the home loan book between August 2018 and February 2019. Morgans continues to expect the bank will struggle to grow the home loan book without compromising too much on margins, until it has a competitive mortgage fulfillment process.

Bell Potter, not one of the eight stockbrokers monitored daily on the FNArena database, has a Hold rating and $8.80 target and finds the weaker top-line a source of concern, particularly given the poor performance in retail banking, with mobile apps not delivering and regulatory uncertainty affecting the owner manager network.

The business finance and specialist segments performed somewhat better. The outcome of the first half supports Bell Potter's view that Bank of Queensland is gradually evolving into a finance company with a higher return/high risk profile. Macquarie suggests continuing deterioration in the core retail franchise means volume growth is likely to remain under pressure and the bank has experienced loss of market share.

Owner-manager branch numbers are shrinking and there is under-investment in digital whereby Morgan Stanley considers value leakage is a risk, as the bank seeks to simplify value share with the owner managers in FY20 and improve alignment.

Setting aside regulatory uncertainty, all banks are reducing branches and mortgage brokers are taking share, the broker points out, noting Bank of Queensland is diversifying its growth options and investing $5m to develop its Virgin Money brand into a full digital bank.

Lending growth was sound at Virgin Money in the first half and Bank of Queensland has also witnessed an improvement in the distribution of third-party products which drive higher commission income.

Leadership

Citi believes the stalling of the appointment of a permanent CEO has slowed the bank's ability to respond to challenges. The medium term prospects are therefore, unclear until a more definitive strategy is articulated. Sizeable expense management is required and Macquarie agrees this may be difficult to implement, not only amid current franchise issues but also because of a lack of clarity around the leadership.

Morgans envisages significant scope for restructuring upon the appointment of a permanent CEO. The bank has said it will provide the market with a further update on costs if there is more clarity. The broker takes this to mean there may be more clarity once a permanent CEO is appointed.

Following termination of the sale of the St Andrews insurance business, Bank of Queensland is continuing to assess its strategic options. Macquarie expects a lower revenue contribution from this business in the future.

Dividends

Morgans is also disappointed with the return on tangible equity (ROTE) of 11.4% and expects no improvement for at least two years. The broker expects another reduction to the nominal dividend in the first half of FY20. Bank of Queensland has cut the interim dividend to $0.34 per share, representing a pay-out of 82%. Both Ord Minnett and Morgan Stanley assert the pay-out ratio is still too high and another reduction is likely if earnings deteriorate.

The dividend outcome was actually better than Bell Potter expected but the broker agrees investors should not expect too much. There is no excess capital to underpin the CET1 range of 9.0-9.50% and Morgan Stanley points out neutralising the dividend reinvestment plan is difficult without consuming capital.

Costs

A growing threat of disruption plus a need to invest in digital and compliance means, in Morgan Stanley's view, that costs will grow around 4.5% in FY19 and remain elevated in FY20. The bank booked a further $3m in regulatory and compliance costs below the line in the first half.

UBS is concerned about this feature of the results, as regulatory and compliance costs are not considered "one-offs". Shaw and Partners agrees, stating that Bank of Queensland has "an unfortunate habit of ignoring some cash expenses when it comes to determining cash profit".

The worrying part is that these expenses continue to increase while income does not, the broker adds. Shaw and Partners, also not one of the eight monitored daily on the database, has a Sell rating $8.30 target.

FNArena's database shows four Hold ratings and four Sell. The consensus target is $8.79, suggesting -1.7% downside to the last share price. The dividend yield on FY19 and FY20 forecasts is 7.6% and 7.3% respectively.

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.

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

Running On Empty

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.

Mining is all around us, though invisible to urban dwellers, so it's easy to forget that we live in a world of finite resources. Unlike forestry or agriculture, whose crops are renewable, once ore comes out of the ground and is processed into metals, it's gone for good. Some industrial metals are recycled after mining, like copper, but this only extends the life of the resource; it doesn't renew it.

We know this intuitively, yet we continue to mine. The reason, of course, is because we need the materials, and companies with the expertise and money are eager to prospect and extract, especially high-value minerals like diamonds, battery metals and heavy rare earths.

We are facing a supply crunch for copper, zinc and lead - all crucial to the functioning of a modern economy. Imagine a world without copper? There would be no copper wiring, therefore no means of electrifying new buildings, no material for solder, no computers, TVs, circuit boards, semiconductors, microwaves, modems and routers.

The transportation industry is reliant on copper for components of airplanes, trains, cars, trucks and boats. A commercial airliner has up to 190 kilometers of copper wiring, while high-speed trains use up to 10 tonnes of copper per kilometer of track.

In electric vehicles (EVs), copper is a major component used in the electric motor, batteries, inverters, wiring and in charging stations. Without a copper substitute (there is none), the shift from gas-powered cars to EVs would abruptly stop.

The counter-argument to peak metal is that a small percentage of the Earth's crust has been mined. Finding more metals is just a matter of looking harder, spending more money, and going further afield. Such is the impetus behind asteroid and undersea mining. The problem is, no company is going to mine at a loss. It's simply a matter of inputs and outputs. If the inputs (resources needed to mine, like water, fuel, power, machinery, labor) cost more than the output (the realized metal price), it makes no sense to mine. Unless we get to the point where government are paying mining companies to absorb their losses, because the materials are essential to society. Subsidized mining paid for by every taxpayer. We're not there yet, but we are abruptly moving towards resource depletion in a number of areas. This article explains why.

Global material use

In our modern-day service economy, where old-school metal and wood mills are becoming a thing of the past or tucked away in remote corners of civilization, some like to disparage mining for its effects on the environment.

It's true that mining cannot be done without disrupting the Earth. There have been leaks, spills, explosions, accidents, cave-ins. We could be doing more to improve safety and environmental controls. But overall, mining has been very good for society at large.

Let's look at some facts and figures from a recent report by UN Environment, called 'The Global Resources Outlook 2019':

Global gross domestic product has doubled since 1970, enabling immense progress, and lifting of billions of people out of poverty. At the same time, this economic growth has been fueled by a relentless demand for natural resources. At no point in time nor at any level of income, has our demand for natural resources wavered.

Think about that. For the past 50 years, there has never been a period where demand for natural resources did not increase. How many businesses can say that? Sure, metals prices have fluctuated, but the need for metals has not diminished. In fact, mining is becoming even more important, as the transportation system goes from fossil-fuel-powered to electric, requiring a new mix of metals for batteries and components.

According to the UN report, over the last five decades, mineral extraction has tripled - and accelerated since 2000 as new economies (ie. China and India, "Chindia") require huge amounts of materials for building new infrastructure. China is not only the world's top metals consumer, it is also the leading producer of a number of mined commodities, such as rare earths, gold, antimony, indium, tellurium and tungsten.

The emergence of China as a world power, one of the most important stories of the 21st century, and to a lesser extent India and southeast Asia, has also changed material consumption patterns. In 1970 North America, Europe and the Asia-Pacific region each required about a quarter of the world's raw materials. In 2017, Asia-Pacific accounted for nearly 60% of the total.

All of this material extraction has come at a price to the environment.

Without a way to replace all the resources we consume - harvested food, fertilizers, energy, metals, etc. - we are gradually depleting nature's bounty, at a rate that is unsustainable, long-term. If we keep going, and economies keep growing, we're eventually going to run out. The problem is made worse by the global population increasing, along with the continuing wants of people in the developed world ("the West") and in less-developed countries (who are demanding houses, cars, fridges, cell phones, etc.), putting more pressure on our finite resources.

The evidence of this "Earth overshoot" is in the report:

Global water use is increasing and 30 per cent of global river basin area - excluding hyper-arid zones and Antarctica - have been under severe and mid water stress since 2010. Between 2000 and 2010, total global cropland area increased by 1.34 per cent from 15.2 million to 15.4 million km2.

Growing economies, population

What drives natural resource extraction? It's actually very simple: population and GDP. The age of the large extended family may be over in North America and Europe, but in Asia and Africa, people keep having babies. Lots of them.

Since 1950, the world's population has gone from 2.5 billion people to 7.6 billion. No less than 75 million people a year are added to this number.

According to the United Nations, the world's population is expected to reach 9.7 billion by the year 2050. A 2017 study in the journal Bioscience suggested that to feed that number of people, global food production will need to increase from 25% to 70%.

An economy that isn't growing is in trouble. Like any business, to stop growing is to die. Luckily, just about every country's economy has grown. Since the 1970s, global gross domestic product (GDP) has quadrupled.

Put that together with a population explosion, notwithstanding contraception, and you have large amounts of resources required to fuel economic development, and billions worth of bricks and mortar infrastructure - schools, hospitals, recreation centres, power plants, etc.

Not only that, these new citizens want what we want. Consider this: Another 2.1 billion people will be added to the world between now and 2050. Most will not be Americans but they are going to want a lot of things that we in the Western developed world take for granted – electricity, plumbing, appliances, AC etc.

And mining is trying to give it to them. According to the report, resource extraction reached 92 billion tons in 2017, compared with 27 billion tons in 1970. That's an average annual growth rate of 2.6%, something any country would kill for, if that number was in the growth of GDP. Put another way, each person demanded 7.4 tons of materials in 1970. Fifty years later, they each want 12.2 tons. That's a lot more copper, iron ore, steel, aluminum, etc.

Can people afford to buy so much more consumer goods that start off as raw materials? The answer is yes. According to the report, per capita GDP has doubled over the last 50 years, from US$5,198 to $10,606. On a macro scale, this works out to 3% annual growth, from US$18.9 trillion in 1970 to US$80.73 trillion in 2017.

Economic growth has expanded faster than global population.

The report finds as people get richer, growing affluence becomes a more important driver of material extraction than basic population increase. In other words, wants trump needs.

Logically then, material consumption should slow when economies slow down, right? Wrong. The report notes that even though global GDP and population growth has slowed since 2000, material extraction has accelerated - at 3.2% a year from 2000 to 2017. Their economy might be sucking wind, but people still want their stuff.

Status quo scenario

Here's where it gets interesting. Most readers who follow mining are aware of these close correlations between resource extraction and population/ GDP growth. It's required listening at resource investment shows. But what about the future? Is our current pattern of resource extraction sustainable? Will we eventually run out of materials? The UN report constructed a "status quo" and a "sustainable" scenario, the first being business as usual and the

second where a number of measures are taken to mitigate the effects of extraction on the environment - thereby making mining, oil and gas, farming, more sustainable.

The results show that in both cases, we're screwed, to put it plainly. Assuming that population grows annually at 0.7% (reaching 10.2 billion by 2060) and GDP growth is 2.2% a year, global material use would more than double - to 190 billion tons by 2060. Recall that 92 billion tons of resources were extracted in 2017. This is presuming "all things are equal" ie. no change to current patterns of production, consumption, government policies and infrastructure.

"This scale of growth in resource use – without improvements in managing the impacts of extraction, use and disposal of materials and resources – would result in substantial stress on resource supply systems and unprecedented levels of environmental pressures and impacts," states the report.

The report makes a big deal of the "sustainable" scenario's reduced impacts on the environment, but even with major improvements to extraction, resource use ends up being just 25% below the business-as-usual number, by 2060.

Running on empty

This is pretty bleak stuff, but at Ahead of the Herd, we're even more pessimistic. As mining commodity experts, we know something the UN report authors don't; namely, that we are facing serious supply pressures way before 2060, particularly with respect to industrial metals.

Look at copper, zinc and lead.

Copper

Total mined copper was just under 20 million tonnes in 2017.

Global refined copper demand has risen steadily from 2005, when it was around 18 million tonnes, to the current global consumption of about 24 million tonnes. Immediately we can see that demand is currently outstripping supply by about 4 million tonnes, annually.

Even if we mined every last discovered, and undiscovered, pound of land-based copper, the expected 8.2 billion people in the developing world would only get three quarters of the way towards copper use parity per capita with the US, if we assume 10 billion people by 2050.

Unless new investments arise, existing mine production will drop from 20 million tonnes to below 12 million tonnes by 2034, leading to a supply shortfall of more than 15 million tonnes. That's because over 200 copper mines are expected to run out of ore before 2035, with not enough new mines in the pipeline to take their place.

Except for the restart of Katanga's copper mine in the DRC, a 300,000 tonnes-per-year operation, there were no major new copper mines started in 2018.

KPMG is predicting that by 2020 global copper demand will outstrip mine output By 2020 the consultancy says copper consumption will reach 24.5 million tonnes "driven by growth in global industrial production and higher investment in energy infrastructure." An acceleration in demand for EVs and renewable energy over the next two years are expected to be the main copper demand drivers.

We can't forget China, the largest copper consumer. It's estimated that China's Belt and Road Initiative (BRI) will generate an extra 2.2 million tonnes of copper demand, between now and 2030, worth US$13 billion based on a copper price of $2.75 a pound. Where is all this copper going to come from?

Zinc

The setup for a zinc supply shortage has been several years coming. Some very large zinc mines have been depleted and shut down, with not enough new mine supply to take their place.

MMG's shuttered Century mine for example used to supply 4% of the world's zinc. Between the shutdown of the Lisheen mine in Ireland, Century, and Glencore's Brunswick and Perseverance mines in Canada, over a million tonnes was ripped from global zinc production.

The closed mines represent an estimated 10 to 15% of the zinc market. On the flip side, there have been few discoveries or big zinc projects planned. This is setting the zinc market up for a supply shortage.

The International Lead and Zinc Study Group predicts the zinc market will be in a deficit position of 72,000 tonnes in 2019.

Zinc inventories have fallen to the point where there is less than two days worth of global consumption locked in London Metal Exchange (LME) warehouses. The paucity of the metal used to prevent rusting caused prices to spike recently, to the highest they've been since last June.

Lead

Like copper and zinc, lead was also pulled into the trade war vortex that had base metals flailing for most of 2018. Lead started last year at $1.15 a pound but had sunk to under 90 cents by year-end. The underperformance of several key lead mines was made up for by supplying the market with previously held stocks of the metal - thereby depleting LME lead warehouses.

For the first three-quarters of the year, world refined lead demand outstripped supply by 110,000 tonnes, notes the International Lead and Zinc Study Group.

Earlier this year lead warehouse levels fell to their lowest since 2014.

Conclusion

Wood Mackenzie thinks that base metal mine closures, attrition and demand growth will require 2.2 million tonnes of new mine capacity a year. That's good news for exploration companies that are staking fresh ground and hoping to develop the next big base metals deposit.

Thinking more globally, it doesn't surprise me that the UN is worried about how our over-zealous extraction and consumption of resources is calling for a more sustainable approach. That's all well and good, but it ignores a more pressing fact of life: we are getting alarmingly close to depleting some of our most important industrial metals, necessary for modern economies.

Unless there is a major push for exploration, resource depletion will arrive a lot sooner than 2060.

Richard (Rick) Mills

rick@aheadoftheherd.com

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

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

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

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

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 April 1 to Friday April 5, 2019 Total Upgrades: 4 Total Downgrades: 9 Net Ratings Breakdown: Buy 42.25%; Hold 42.72%; Sell 15.02%

Investors wondering as to why the Australian share market has found adding more gains a tough ask since mid-February need not look any further than at last week's tally for recommendation upgrades and downgrades by the eight stockbrokers monitored daily by FNArena.

For the week ending Friday, 5th April 2019, FNArena registered only four upgrades, and three of those stopped at Neutral/Hold. There were nine downgrades, and four of those went to Sell.

One week is not a great indicator, but within the context as is, this one might prove its value to prove a point: right up here, many stocks start suffering from a lack of oxygen.

Equally noteworthy: many a bond proxy has seen its share price rally hard in 2019, but analysts seem rather reluctant in downgrading their ratings.

Overall news flow has been quiet in weeks past, so little surprise not much is happening in the table for positive revisions to price targets with only Magellan Financial (+4.35%) and shipbuilder Austal (+3%) worth mentioning. The negative side has more names on show, but only Pilbara Minerals, Kathmandu Holdings and Viva Energy REIT are worth pointing out.

A lot more is happening in terms of positive revisions for earnings estimates, though it's predominantly a resources-led affair, with ResMed, Ansell and Graincorp notable exceptions. The flipside reveals many more industrial names, but Pilbara Minerals suffered the most, followed by EclipX Group, Senex Energy, Incitec Pivot, and Kathmandu Holdings.

With resources companies preparing to start releasing quarterly production updates, the centre of attention might well remain theirs, but then Bank of Queensland ((BOQ)) is likely to announce a cut to its interim dividend and this might awaken a few to the dangers that come with a weak domestic economy; or at least certain parts of it.

Upgrade

AIR NEW ZEALAND LIMITED ((AIZ)) Upgrade to Buy from Neutral by UBS .B/H/S: 1/2/1

UBS believes investors will increasingly turn their focus to the potential for earnings to recover and generate strong cash flow from FY20. The broker's conviction is lifted by the recent announcement of a cost reduction program, more conservative network growth and the re-timing of fleet orders.

The broker lifts forecasts for FY19 by 2% in FY20 by 17%. Rating is upgraded to Buy from Neutral. Target is raised to NZ$2.90 from NZ$2.55.

FORTESCUE METALS GROUP LTD ((FMG)) Upgrade to Hold from Sell by Deutsche Bank .B/H/S: 2/4/2

Deutsche Bank has upgraded its rating for Fortescue Metals to Hold from Sell, while lifting its price target to $7.70 from $4.90. The decision comes after more news about iron ore supply disruption from Rio Tinto.

Having been too sceptical about iron ore, the analysts readily admit they are hereby falling on their iron ore sword. Another positive concerns the dividend potential which, in Deutsche bank's words, is significant and near term tangible.

INDEPENDENCE GROUP NL ((IGO)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 1/5/0

The company has provided an update on the nickel sulphate pre-feasibility study. No capital or operating expenditure estimates were provided.

Macquarie upgrades payability assumptions to reflect the company's improved negotiating position in talks with offtake partners. As a result, rating is upgraded to Neutral from Underperform. Target has risen to $4.90 from $4.00.

PLATINUM ASSET MANAGEMENT LIMITED ((PTM)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 0/1/3

A positive rebound in markets should mean the company benefited from fund flows in the first quarter, which Credit Suisse expects will be up 6%. However, fund performance remains weak and the third month of outflows emerged in February.

The broker is now forecasting net outflows in the second half of -$600m. Credit Suisse upgrades to Neutral from Underperform as the share price has fallen -15% during March. Target is reduced to $4.70 from $4.90.

Downgrade

BELLAMY'S AUSTRALIA LIMITED ((BAL)) Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 1/2/0

Morgan Stanley believes the earnings outlook has improved, following the launch of the company's new formula, but the valuation now prices in the stronger outlook. The main catalysts will be updates on the new formulation and further product developments. The shares have rallied 42% since January as the market became more confident in the earnings outlook.

Morgan Stanley downgrades to Equal-weight from Overweight, assessing the first half of FY20 will provide the acid test for the success of the new formula. Target is $10. Cautious industry view.

COMPUTERSHARE LIMITED ((CPU)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 0/5/2

Following the recent move in global bond yields, Macquarie revises its margin income forecasts. More dovish commentary from the central banks suggest margin income growth could moderate.

The broker envisages downside risk to consensus estimates and the current multiple. With a more subdued margin income outlook, less incremental benefit from cost reductions and the cessation of the impact of the fixed fee revenue in the UK Macquarie currently forecasts a -1% decline in FY21 management earnings.

Rating is downgraded to Underperform from Neutral and the target reduced to $16.50 from $19.00.

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

The company has updated capital expenditure guidance to around $250m for the K2-Hydro project. This is $25m above Morgans' prior assumptions.

The Jemalong project could be constructed in FY20, subject to project financing, which would put a strain on the company's cash flows and add to the need for equity capital.

Given how important the K2-Hydro project is to the valuation, and the uncertainty regarding concessional funding, Morgans downgrades to Hold from Add.

The company has indicated it will know more about the availability of a grant by the end of April. Target is reduced to $0.25 from $0.30.

MAGELLAN FINANCIAL GROUP LIMITED ((MFG)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 2/5/0

Credit Suisse expects first quarter funds under management will benefit from strong markets and net inflows, as forecasts imply an 11% increase during the quarter.

The broker upgrades fund forecasts by 4%. The stock is up 50% in the year to date and the broker downgrades to Neutral from Outperform.

Magellan Financial remains the broker's top pick among asset managers. Target is raised to $35 from $33.

PILBARA MINERALS LIMITED ((PLS)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 2/0/0

Ord Minnett was disappointed with the March quarter operating update as recoveries have fallen to less than 50% in March and realised prices are below current unit costs.

Costs should fall as the plant is optimised, although recoveries need to improve to provide operating leverage anywhere near market expectations.

As a result the broker downgrades to Lighten from Hold, believing the stock is overvalued. Target is reduced to $0.70 from $0.85.

SCENTRE GROUP ((SCG)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 1/3/2

Amid soft retail conditions for landlords because of cyclical and structural headwinds and the company's "heavy" balance sheet, Macquarie downgrades to Underperform from Neutral.

The broker recently visited Westfield Miranda shopping centre and notes the centre has hoardings on around 4% of space. Lease expiries from the 2014 development are staggered between November 2019 and 2021.

The company would not be drawn on potential pricing, with lease negotiations currently in place, and Macquarie suspects downside risk to rents, given the structurally challenged retail conditions. Target is reduced to $3.52 from $3.69.

SPEEDCAST INTERNATIONAL LIMITED ((SDA)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 0/3/1

Macquarie observes a deterioration in the core business drove multiple downgrades in FY18 and this has created downside risk to earnings in FY19. Limited disclosure reduces confidence.

The broker believes sustained delivery of organic revenue and earnings growth at a group level, as well as cash generation, are required to be more positive.

The broker downgrades to Underperform from Neutral. Target is reduced to $2.85 from $3.00. Low free cash flow raises concerns about the stability of the dividend.

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

Ord Minnett considers the more-aligned partnership between Viva Energy ((VEA)) and Coles ((COL)) is a positive for Viva Energy REIT, as the new agreement provides certainty of retail operator until 2029, and lower bond yields should also be supportive in the near term.

Viva Energy REIT has a secure income stream from long-leased assets and the broker believes it is well-positioned to grow the portfolio through further acquisitions. Ord Minnett expects growth in earnings per share of 3.5% in 2019 and 3.1% in 2020.

The broker downgrades to Hold from Accumulate and maintains a $2.40 target.

WOOLWORTHS LIMITED ((WOW)) Downgrade to Hold from Buy by Deutsche Bank .B/H/S: 1/5/2

Deutsche Bank has downgraded its rating for Woolworths to Hold from Buy, while leaving the price target untouched at $31. The broker notes the slimming down of the Big W footprint, and the share buyback, but maintains Supermarkets will be the primary driver of share performance from here.

Deutsche Bank remains comfortable with the outlook for Supermarkets and explains the downgrade in reference to the share price trading above its price target. Woolworths shares have had a good run into 2019, the analysts observe.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 AIR NEW ZEALAND LIMITED Buy Neutral UBS 2 FORTESCUE METALS GROUP LTD Neutral Sell Deutsche Bank 3 INDEPENDENCE GROUP NL Neutral Sell Macquarie 4 PLATINUM ASSET MANAGEMENT LIMITED Neutral Sell Credit Suisse Downgrade 5 BELLAMY'S AUSTRALIA LIMITED Neutral Buy Morgan Stanley 6 COMPUTERSHARE LIMITED Sell Neutral Macquarie 7 GENEX POWER LIMITED Neutral Buy Morgans 8 MAGELLAN FINANCIAL GROUP LIMITED Neutral Buy Credit Suisse 9 PILBARA MINERALS LIMITED Sell Neutral Ord Minnett 10 SCENTRE GROUP Sell Neutral Macquarie 11 SPEEDCAST INTERNATIONAL LIMITED Sell Neutral Macquarie 12 VIVA ENERGY REIT Neutral Buy Ord Minnett 13 WOOLWORTHS LIMITED Neutral Buy Deutsche Bank

Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 PTM PLATINUM ASSET MANAGEMENT LIMITED -75.0% -100.0% 25.0% 4 2 ECX ECLIPX GROUP LIMITED 60.0% 50.0% 10.0% 5 3 FNP FREEDOM FOODS GROUP LIMITED 75.0% 67.0% 8.0% 4 4 ASB AUSTAL LIMITED 83.0% 75.0% 8.0% 3 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 BAL BELLAMY'S AUSTRALIA LIMITED 33.0% 67.0% -34.0% 3 2 VVR VIVA ENERGY REIT 67.0% 100.0% -33.0% 3 3 PLS PILBARA MINERALS LIMITED 50.0% 75.0% -25.0% 3 4 KMD KATHMANDU HOLDINGS LIMITED 33.0% 50.0% -17.0% 3 5 MFG MAGELLAN FINANCIAL GROUP LIMITED 29.0% 43.0% -14.0% 7 6 WPL WOODSIDE PETROLEUM LIMITED 25.0% 38.0% -13.0% 8 7 ORG ORIGIN ENERGY LIMITED 50.0% 63.0% -13.0% 8 8 CPU COMPUTERSHARE LIMITED -31.0% -19.0% -12.0% 8 9 DLX DULUXGROUP LIMITED -19.0% -7.0% -12.0% 8 10 OSH OIL SEARCH LIMITED 38.0% 50.0% -12.0% 8 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 MFG MAGELLAN FINANCIAL GROUP LIMITED 34.091 32.670 4.35% 7 2 ASB AUSTAL LIMITED 2.603 2.525 3.09% 3 3 OSH OIL SEARCH LIMITED 8.595 8.591 0.05% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 PLS PILBARA MINERALS LIMITED 0.967 1.125 -14.04% 3 2 KMD KATHMANDU HOLDINGS LIMITED 2.450 2.650 -7.55% 3 3 VVR VIVA ENERGY REIT 2.520 2.580 -2.33% 3 4 ORG ORIGIN ENERGY LIMITED 8.083 8.233 -1.82% 8 5 CPU COMPUTERSHARE LIMITED 17.914 18.226 -1.71% 8 6 WPL WOODSIDE PETROLEUM LIMITED 35.656 36.105 -1.24% 8 7 DLX DULUXGROUP LIMITED 7.071 7.153 -1.15% 8 8 PTM PLATINUM ASSET MANAGEMENT LIMITED 4.355 4.405 -1.14% 4 9 ECX ECLIPX GROUP LIMITED 1.046 1.058 -1.13% 5 10 ORI ORICA LIMITED 17.670 17.789 -0.67% 8 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 RMD RESMED INC 138.873 48.334 187.32% 8 2 SYR SYRAH RESOURCES LIMITED -3.336 -6.764 50.68% 5 3 GXY GALAXY RESOURCES LIMITED 1.585 1.240 27.82% 5 4 WSA WESTERN AREAS NL 3.086 2.486 24.14% 6 5 CRN CORONADO GLOBAL RESOURCES 61.965 56.695 9.30% 3 6 ANN ANSELL LIMITED 145.854 138.029 5.67% 8 7 IGO INDEPENDENCE GROUP NL 9.228 8.733 5.67% 6 8 OSH OIL SEARCH LIMITED 39.495 37.378 5.66% 8 9 STO SANTOS LIMITED 49.113 46.595 5.40% 8 10 GNC GRAINCORP LIMITED 6.285 6.010 4.58% 4 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 PLS PILBARA MINERALS LIMITED -14.500 0.975 -1587.18% 3 2 ECX ECLIPX GROUP LIMITED 14.540 16.800 -13.45% 5 3 SXY SENEX ENERGY LIMITED 1.240 1.375 -9.82% 5 4 IPL INCITEC PIVOT LIMITED 16.411 18.086 -9.26% 8 5 KMD KATHMANDU HOLDINGS LIMITED 20.914 22.023 -5.04% 3 6 AQG ALACER GOLD CORP 40.470 42.453 -4.67% 3 7 PDL PENDAL GROUP LIMITED 57.567 58.733 -1.99% 6 8 WHC WHITEHAVEN COAL LIMITED 60.370 61.199 -1.35% 8 9 ORG ORIGIN ENERGY LIMITED 61.089 61.789 -1.13% 8 10 DLX DULUXGROUP LIMITED 38.490 38.905 -1.07% 8 Technical limitations

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Uranium Week: Price Support Found

While utilities still await the outcome of the section 232 decision, it appears prices below US$25/lb are too tempting to ignore.

-Sub-25 prices bring out buyers -Spot price slide halted -One week before section 232 decision

By Greg Peel

The spot uranium price had been on the slide for nine straight weeks and the last two weeks of that period saw price declines accelerating. Utilities had put purchases on hold ahead of the US section 232 decision due April 14 and sellers had become increasingly anxious, chasing bids down to a a low of US$24.90/lb a week prior.

But just when it looked like the spot price was in an unstoppable downward spiral, suddenly utilities sprung into action last week. The US$25/lb price level appears to be the line in the sand.

Industry consultant TradeTech's weekly spot price indicator rose US85c over the week to finish at US$25.75/lb. It was the first weekly price rise since January. The spot price remains down -10% in 2019 but still up 28% year on year.

Volume Boost

While the March quarter featured a steady price decline, it also featured historically high transaction volumes. The total of 14.2mlbs U3O8 equivalent changing hands represents a 58% increase on the average of March quarter volumes from 2007 to 2018, and a 15% increase on the previous March quarter.

Total volumes in 2018 were 64% higher than the average of the 2007-2018 period.

No transactions were reported in uranium term markets last week but new demand is emerging, with utilities putting delivery requests out to tender.

TradeTech's term price indicators remain at US$28.00/lb (mid) and US$32.00/lb (long).

Next week is the last week of trading before the US Department of Commerce is due to announce its decision as to whether section 232 need be invoked as a matter of "national security", which would then force US utilities into a mandatory ratio of uranium purchase from US producers. The decision is due on the 14th, which is a Sunday, which seems a bit strange.

But either way, the DoC's decision is not final. The president then has months to ponder the department's recommendation.

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The Short Report

Guide:

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

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

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

Summary:

Week ending April 4, 2019

Last week saw the ASX200 break up through resistance at 6200 and kick on with it, helped by tailwinds of trade optimism and a well-received federal budget. What looked like a possible assault on the prior high nevertheless gave way to an equally sharp sell-off.

There was not a lot of movement in short positions last week, as the table below indicates, although there was a bias to reductions. Among those, three stand out.

I noted in last week's Report that Silver Lake Resources ((SLR)) had appeared from nowhere at 6.4% shorted but put this down to a play on the miner's pending merger with peer Doray Minerals ((DRM)). Last week Silver Lake dropped out again.

I noted last week investment platform Hub24 ((HUB)) had been quietly moving up the table over past weeks. Now Hub24 has fallen back to 7.3% from 9.0%. Credit Suisse put out a positive note last week, raising its target price on the stock while retaining a Neutral rating.

Which only leaves us to highlight longstanding table-topper Syrah Resources ((SYR)), which last week saw shorts fall to 15.8% from 17.4. See below.

Weekly short positions as a percentage of market cap:

10%+ ING 17.4 GXY 17.1 SYR 15.8 JBH 15.4 NUF 14.2 NXT 12.9 MTS 12.0 ORE 11.7 BAL 11.3 BWX 11.3 SDA 10.7

No changes

9.0-9.9

IVC, SUL, DMP, MYR, IFL, PPT, HVN

Out: CSR, HUB, PLS 8.0-8.9%

PLS, CSR, BKL, KGN, AMC, BOQ

In: PLS, CSR, KGN

7.0-7.9%

RWC, HUB

In: HUB Out: KGN, SGM

6.0-6.9%

BIN, SGM, AMP, DHG, BEN, BGA, MSB

In: SGM Out: SLR, WSA, KDR

5.0-5.9%

CGF, WSA, RSG, KDR, RIO, HT1, COE, GMA, LNG, CAR

In: WSA, KDR Out: APT, CCP

Movers & Shakers

Graphite miner Syrah Resources has sat at the top of the most shorted table, or very close to it, for months. Last week it slipped to third with a drop to 15.8% from 17.4%.

After posting its earnings result, Syrah's share price ran 37% in a week. It all came down to a reserve and resource update. It was hardly glowing, with the resource upgraded by 14% with no change to reserves, and grade expectations at the company's flagship Balama mine downgraded.

It was clearly enough to shake at least some shorters into action nonetheless, and thereafter it appeared a bit of a scramble. But a less than 2 percentage point drop in shorts suggests the rally can't all be down to short-covering.

ASX20 Short Positions (%)

Code Last Week Week Before Code Last Week Week Before AMC 8.3 8.3 RIO 5.4 5.2 ANZ 1.3 1.3 S32 1.1 1.0 BHP 3.7 3.8 SCP 1.3 1.3 BXB 0.3 0.3 SUN 0.4 0.4 CBA 2.1 2.3 TCL 1.6 1.7 COL 2.1 2.1 TLS 0.6 0.8 CSL 0.4 0.3 WBC 2.1 2.1 IAG 0.4 0.5 WES 2.2 2.2 MQG 0.3 0.3 WOW 2.9 2.4 NAB 1.0 1.0 WPL 0.7 0.6 To see the full Short Report, please go to this link

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

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The Wrap: Housing, Election & Regional Banks

Weekly Broker Wrap: housing; Oz election; regional banks; and child care.

-Sentiment and serviceability continue to deteriorate in Australia's housing market -Key impact on investors from a change of federal government to the ALP likely to be in area of negative gearing, capital gains tax and franking credits -Labor's NBN policy could benefit telecommunications industry, Ord Minnett suggests -Regardless of a level playing field, Credit Suisse still favours the major banks

By Eva Brocklehurst

Housing

Morgan Stanley observes sentiment and serviceability continued to deteriorate in the Australian housing market in the first quarter of 2019. Housing weakness is expected to persist through to the end of the year, with further downside to both approvals and prices.

Credit supply, meanwhile, remains tight and little relief is expected. The pipeline of housing construction remains elevated and the supply surplus that drove weakness in the March quarter is unlikely to narrow until the end of 2020, even with the sharp decline in approvals.

In the case of mortgage serviceability, this continues to worsen and reflects high leverage, given the increased lending rates and low income growth faced by households.

The decline in national house prices since late 2017 has improved some aspects of housing demand. Rental conditions have also become better. Yet the broker observes these are relatively incremental drivers of housing conditions overall.

The broker's modelling is yet to point to a trough in prices. Real house prices are down -11.6% from their peak and the risks remain to the downside. Eventual cuts to the cash rate by the Reserve Bank of Australia will provide some support, but Morgan Stanley does not expect this will provide the same boost to credit as in previous cycles.

US Housing

While Australian housing starts are estimated to fall to 150,000 units next year Macquarie expects low single-digit growth in US housing starts in 2019. US growth is supported by demographic factors underpinning demand and lower interest rates are also helping the recovery.

The broker continues to believe James Hardie ((JHX)) is well-placed, amid receding cost pressures. The broker believes the company's US$100m cost reduction target for manufacturing is achievable.

Meanwhile, Reliance Worldwide ((RWC)) has been weak, along with other Brexit-exposed ASX names, yet the uncertainty in the UK macro context does not seem to be affecting activity, currently.

The broker notes interesting developments in the competitive landscape in the US, in keeping with a long-held view on the competitiveness of the company's offering. The broker finds the Reliance Worldwide valuation particularly attractive.

Oz Election

Australia's government has called the federal election for May 18. Recent polls are consistent with a change in government to the Australian Labor Party. UBS considers policy differences are potentially material for the economy and investors.

The Labor Party does not support the much larger future tax cuts proposed by the government from 2022, and also plans to reintroduce the 2% deficit repair levy for those earning over $180,000 per annum.

The Labor Party is also more likely to regulate wages and will direct the Fair Work Commission to consider a living wage. However, the living wage would not apply to all awards and UBS suspects the impact on overall wage rates could be surprisingly small, particularly given a view of a rising unemployment rate going forward.

The Labor Party also proposes to limit negative gearing to new houses purchased from January 2020 and halve the capital gains tax concession to 25%. Existing arrangements are expected to be grandfathered. UBS assesses the

policy could reduce the average investor's assessable income by -3-4% and borrowing capacity by around -10%.

On the issue of franking credits, which the Labor Party proposes to make non cash-refundable, this would affect individuals on low taxable incomes that are receiving franked dividends as well as self managed super funds (SMSFs). UBS suggests SMSFs can move assets into a net tax-paying APRA-regulated fund to retain the franking credits. UBS still expects real GDP growth will slow sharply to 1.9% in 2019, the weakest since the GFC.

The shadow communications minister has laid out the elements of the Labor Party's NBN policy, should it win the federal election. The policy intends to close the digital divide and improve NBN speeds, delivering a better experience for consumers and small business.

The policy also targets upgrade trials on fibre-to-the-node and a Labor government would conduct an immediate review of the pricing, costs, future funding and capacity requirements of the NBN.

Ord Minnett suggests an incoming Labor government would benefit the telecommunications industry, particularly around wholesale pricing for the NBN, with a potential write-down of the assets and lower wholesale charges as a result.

Regional Banks

Credit Suisse assesses what a level playing field would be like for the regional banks. Two benefits the major banks currently have are cheaper funding costs and ability to use their own models to determine risk weightings. The government guarantee and the 'too big to fail' status gives major banks a -20-40 basis points lower wholesale funding cost, on the basis of the Reserve Bank's modelling.

By assuming the regionals could obtain the same discount, Credit Suisse estimates a 2% and 6% uplift in cash earnings for FY18 would have occurred for both Bendigo & Adelaide Bank ((BEN)) and Bank of Queensland ((BOQ)), respectively.

On the second point, a reduction in the mortgage risk weight from 40% to 30% would give the regional banks a 1% uplift to CET1 ratios and additional surplus capital. Regardless, Credit Suisse still prefers the major banks because of their larger scale and market share. Regional banks are expected to struggle to deal with the increasing competition and the presence of foreign banks.

Child Care

Canaccord Genuity has a positive view on the outlook for the child care sector. If supply growth moderates, as expected, and demand continues to increase, then the environment for the listed operators will improve.

For the three months to March there were 121 new long day care centres opened which compares with 127 in the prior corresponding quarter. The small decline reflects what the broker believes is early signs of moderating supply growth.

The overall number represents a meaningful increase in new supply, nonetheless, although there is evidence to suggest that the new child care subsidy is generating more than enough demand to counter the lift. Over 2019 Canaccord to expects new supply to be down -10-15%, suspecting that lending restrictions by banks in 2018 will begin to appear in numbers in the September and December quarters.

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Can Praemium Withstand Major Client Loss?

Praemium has lost a long-standing customer ANZ Private to a rival. Brokers assess what this means for the business going forward.

-Lost revenue expected to be recouped by new business -Needs to maintain high level of revenue growth to sustain current share price -Praemium well capitalised with no debt, may be an acquisition target

By Eva Brocklehurst

As evidence of the mounting competition among funds management platforms, Praemium ((PPS)) has lost ANZ Private to rival Netwealth ((NWL)). This was the company's largest separately managed account (SMA), a long-standing customer with more than $3bn in funds on the Praemium platform.

The main reason the business was switched to Netwealth was the ability for financial advisers to trade equities and other financial instruments directly. Direct access is not a feature currently provided by Praemium's SMA platform.

What does this mean for the business going forward? The loss will decrease Australian platform revenues by up to -$4m from FY20 onwards. The timing of the withdrawal remains uncertain as it entails a change of responsible entity and each ANZ Private customer will need to authorise the movement of accounts.

Wilsons had forecast both client wins and retention of ANZ Private and, hence, progressively incorporating -$4m of lost revenue lowers its FY20 and FY21 estimates for earnings per share by -11.3% and -10.5% respectively. The broker asserts the nature in which this contract was lost implies a level of risk for the future.

Morgans points out the company's SMA technology is widely regarded as one of the best platforms available and expects the loss of revenue will be more than recouped by new customers. Overall revenue is still expected to increase from FY20, albeit at a slower rate.

Baillieu was also disappointed and surprised by the loss of the contract. The broker had observed new business momentum improving significantly on the back of the expansion in products and services.The loss of the contract with ANZ Private may detract and act as significant headwind. Nevertheless, Baillieu retains a Buy rating with a target of $0.60 and expects earnings will grow over the forecast period.

Praemium remains well capitalised, with no debt and cash of $11.3m on its balance sheet. Baillieu incorporates a 20% corporate appeal premium in valuation and price target, believing the business is potentially an acquisition target.

Shaw and Partners finds the forecast operating earnings (EBITDA) growth rate of 16% and double-digit profit growth for each of the next three years attractive, as there is no debt and a fragmented, albeit highly competitive, industry.

Functionality

Morgans also understands that a fee reduction was sought, despite ANZ Private being on one of the lowest-priced deals, and this would have meant that other Praemium customers would have been cross subsidising.

The proposition of a fee reduction is interesting, Wilsons asserts, as Netwealth does not seek to be the cheapest in the market. The broker prefers to pin the decision to move on the functionality difference referred to previously.

Wilsons flagged this lack of functionality as a business risk over a year ago, as full feature platforms improved their managed account functions and reduced the competitive advantage that Praemium had.

The broker still envisages a number of functionality gaps between the current product offering and that of a full feature platforms such as Netwealth or HUB24 ((HUB)). Wilsons retains a Hold rating and lowers the target to $0.48 from $0.59.

High PE

Morgans points out the stock trades on high multiples of earnings and thus needs to maintain a high level of revenue growth to sustain the current share price. The broker maintains an Add rating, as the stock is trading at a discount to its valuation, lowering the target to $0.60 from $0.87.

Shaw and Partners agrees that, in terms of earnings, it is not a good sign when a high PE (price/earnings ratio) company in a volatile global economy loses a major client and misses its first half earnings guidance. Still, the broker believes the new product currently being rolled out will allow the company to compete far more favourably against peers and will widen the addressable market by 12x.

Shaw and Partners has extended its own contract for five years across 2500 client portfolios. The broker is a foundation client for the new Virtual Managed Account (VMA), which builds on the existing platform and allows a combination of SMA model portfolios with bespoke investments.

Shaw and Partners also points out that Asgard Capital Management, the number one client for Praemium by revenue, has renewed for a further six years from November 2019. The broker retains a Buy rating with a $0.90 target.

See also, Praemium Needs Higher Flows For Re-Rating on February 14, 2019.

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Treasure Chest: Computershare Softening

FNArena's Treasure Chest reports on money making ideas from stockbrokers and other experts. Markets have started to price in a weaker trajectory for global interest rates and several brokers believe this is key to reassessing Computershare.

-Corporate activity is ebbing and M&A is down across all major regions -Official rate cuts now considered more likely than increases -Limited profit growth envisaged by UBS for 2020-23

By Eva Brocklehurst

Computershare ((CPU)) is at the mercy of softening global bond yields and several brokers have reviewed their forecasts to the downside. The market, over recent months, has started to price in a weaker trajectory for interest rates and this is construed as a key determinant for reassessing the stock.

Corporate activity is ebbing and the number of acquisitions or mergers being completed is down across all major regions in the first three months of 2019, Morgan Stanley observes.

Revenue from corporate actions is likely to be flat or modestly lower in the second half and the broker considers the stock highly cyclical, heavily reliant on transaction fees. Hence, it is trading on multiples that will not be sustained throughout the cycle.

This is one of several reasons why Morgan Stanley believes investment income expectations are too high. Macquarie also reviews the stock, noting that dovish central banks are signalling margin income growth may ease and downgrading Computershare to Underperform from Neutral.

More subdued income, less benefit from cost reductions and a step down in fixed fee revenue in the UK mean the broker calculates a -1% decline in FY21 management earnings.

Stable yields are expected going forward and, looking at current futures markets, this implies downside risk to expectations, with Macquarie expecting a reduced Fed funds rate in the US by the end of the year. The Reserve Bank of Australia now appears to be contemplating reductions to official cash rates. Brexit is unresolved and another dampener on the stock.

Earnings Sensitivity

Computershare's earnings sensitivity is currently around 5% of earnings for every 25 basis points in yields, Macquarie points out. With around 50% of exposed balances in US dollars a rate cut (25 bps) would mean a -2.5% reduction to forecasts. Yet, Macquarie assesses consensus estimates are yet to factor in the impact of lower yields.

UBS agrees interest-rate leverage and cost reductions have run their course and earnings are now increasingly dependent on growth in mortgage services, which has slipped. Mortgage services are expected to rebound strongly over 2019 but this may be short lived.

UBS now expects moderate, rather than material, upside to valuation. The company has distinct growth plans for its UK and US mortgage services businesses but the broker questions UK profitability once the fixed fees roll off in FY21 and argues there is less leverage from the remaining US upscaling. Hence, the broker envisages limited profit growth in the years 2020-23.

FNArena's database shows three Sell ratings and five Hold. The consensus target is $17.91, suggesting 4.3% upside to the last share price. Targets range from $14.50 (Morgan Stanley) to $20.80 (Citi).

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Cautious, Cashed Up, Looking For Direction

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

-Cautious, Cashed Up, Looking For Direction -Not The End, Says Prudential -Conviction Calls -Retail REITS And The (Invisible) Risk -Have Your Say - The CSL Challenge -Rudi On TV -Rudi On Tour

[Non-highlighted parts will appear in Part Two on Friday]

By Rudi Filapek-Vandyck, Editor FNArena

Cautious, Cashed Up, Looking For Direction

I am probably not revealing any big secrets when I state the local share market is getting the heebies jeebies every time the 2018 high comes within spitting distance.

This despite reassurances from technical analysts, or at least some of them, the market's bias remains to the upside. Thus far there has been no appetite to push the ASX200 too far down because, you know, Trump and Xi might actually announce something concrete and that would put equities on a higher level pretty quickly.

Investor dilemma was put on notice by the team of global strategists at Citi. On their assessment, any calls for recessions and bear markets and the like are way, way, way too early and totally overblown at this stage, but, on the other hand, further upside for global equities between now and year-end is estimated at the grand total of... (wait for it)... 2%.

Specific stock selection and allocating additional funds into pullbacks therefore look like the strategies that might generate highest returns over the next eight months.

Citi strategists are banking on a weaker US dollar to assist with further gains in US equities and Emerging Markets equities, with healthcare, communication services and materials most preferred sectors. The latter is an umbrella label for miners and energy producers, often also including contractors and engineers to both sectors, as well as certain old legacy inclusions such as Amcor and Incitec Pivot.

Just as an aside: I hope everyone agrees the more modern FNArena-specific sector denominations running on the FNArena website are a much more helpful tool than the plain old "materials".

Equally noteworthy, maybe, is that Citi strategists do not like consumer discretionary, utilities and consumer staples, and neither do they like equities in Japan or in Australia (both markets are treated as "underweight" regions).

Strategists at Morgan Stanley fully agree with the weaker US dollar thesis, and with the preference for equities in Emerging Markets, but not so with Citi's assessment for US equities. Morgan Stanley thinks market expectations for US corporate profits remain too lofty and the upcoming quarterly reporting season is going to prove just that (Citi disagrees).

For this reason, Morgan Stanley likes to own more shares outside of the US, as well as an equal weighting into bonds (equal portfolio allocations for equities and bonds) plus an overweight allocation to cash. Readers of my Weekly Insights might remember Morgan Stanley's local market analysts in Australia recently lowered their year-end target for the ASX200 to 5800.

If we consider the team at Citi to represent today's market bulls and their counterparts at Morgan Stanley as representing the bears, then it doesn't look like too much of a stretch to toy with the concept of a share market that makes a lot of moves either way, with potentially lots of rotations underneath the surface, without actually going anywhere in real terms.

As a matter of fact, such has been the situation since mid-February, though the ASX200 index thus far in 2019 peaked at 6263.90 on March 7th. Last year's post-GFC high was registered on August 13th at 6339.20. On Tuesday, the index closed at 6217.

The one element that has investors and analysts and strategists scratching their heads these days is consistent large funds outflows from equities whereas the March quarter of 2019 generated one of the highest returns for equities globally in nearly a decade (since September quarter 2009).

Analysis of data recorded by services like Lipper and EPFR global suggests equity funds posted net outflows of -US$39.1bn during a period when equity indices gained 14%. This sounds bizarre, if not absurd. For good measure: it's not impossible for share markets to rise while investors are withdrawing funds at the same time.

Analysts at BA-Merrill Lynch have pointed out it also happened in early 2016, but back then the circa 5% gain was a lot smaller and so were the withdrawals. So who has been buying when investors were trading in stocks for cash?

Corporate America is one buyer to name in this regard. Think: corporate buybacks. Another source of buying could be professional investors with uncomfortable short positions. Covered options can also make a contribution.

This can explain as to why this year's recovery in US equities has occurred on relatively light volumes. Reportedly, even on days of key data releases -like the labour market data on Friday- total daily volumes still remain some -15% below average. Last Friday, as it were, revealed the second lowest NYSE daily trading volume for 2019 thus far.

Admittedly, indices in the US are near all-time highs and yet another quarterly reporting season is about to commence, so a cautious investment community at this point is not that uncommon. Not with Morgan Stanley strategists around who believe the bias is now weighted towards downside surprises.

And yet, I cannot help but think the Overweight position in cash at Morgan Stanley might be part of the explanation too. Maybe the quick V-shaped recovery in the March quarter took many institutions by surprise. Their dilemma has now become: what to do with cash that remains on the sidelines?

The answer will reveal itself once the trend changes to the downside. If the majority feels Citi is more correct than Morgan Stanley, then the dips will be short and shallow. If more money sides with Morgan Stanley, the opposite is more likely to materialise.

Not The End, Says Prudential

US-headquartered Prudential Financial is the world's tenth largest asset manager, including a long time representation in Australia, but overall media coverage is largely non-existent.

To change the latter, also in a push to strengthen its foothold among local institutions, Prudential sent a small delegation of representatives for its asset management division, Prudential Global Investment Management (PGIM), on a mini-tour through Australia, including president and CEO David Hunt.

The global outlook that is dominating all strategies and decisions across various asset classes and geographies at PGIM can be summarised with one sentence: bond yields and interest rates will remain historically low for a very, very, very long time.

During a meeting with local media on Tuesday, Hunt explained how PGIM's fixed income division had been buying government bonds with their ears pinned back in 2018 as the firm was convinced the year marked an aberration in the long established trend, rather than marking the setting of a new trend that would push bond yields sustainably higher.

The Prudential view implies no outbreak in inflation for the foreseeable future, potentially more rate cuts from central banks around the world, and definitely not the end of Quantitative Easing (QE).

To paraphrase Mark Twain: all those reports about the end of QE are greatly exaggerated.

Have Your Say - The CSL Challenge

IMPORTANT: THIS INVITATION ENDS ON APRIL 15TH - LAST CHANCE TO SEND IN YOUR STORY!!!

It's probably one of my key achievements since starting FNArena in 2002; to get investors interested in owning shares in CSL ((CSL)) and similar robust, high quality, sustainable growth stories, in defiance of general perception that stocks trading on a high PE multiple can never be owned but for a short term momentum play.

Over the years I have received many supportive emails and vocal encouragement from FNArena subscribers and investors elsewhere. At the end of last week's presentation to ASA members in Sydney, one elderly investor approached me with the words "CSL is such a wonderful company, why would you ever sell it?"

I think time has arrived we started sharing some of those stories with investors who are new to the CSL Challenge. From investors to investors. I am hereby asking those who own CSL shares to write down their motivation, memories, experiences, et cetera in order to share them with other investors.

Make it as detailed/generalised and as long/short as you like. Send it to info@fnarena.com, preferably with reference "CSL Challenge".

You don't have to do it completely pro bono. An innocent hand at the FNArena office will pick at random three contributions that will receive one bottle of wine each. To be eligible, make sure you also indicate whether you prefer red, white or rose. We'll pick one winner for each choice.

I'd say we close this invitation by April 15th, but let's not procrastinate too long. Get onto it right away! We take care of the wine selection.

Rudi On TV

My weekly appearance on Your Money is now on Mondays, midday-2pm.

Rudi On Tour In 2019

-ASA Melbourne, May 1 -ASA Toowoomba, Qld, May 20 -U3A Investor Group Toowoomba, Qld, May 22 -AIA Adelaide, SA, June 11 -AIA National Conference, Gold Coast, Qld, 28-31 July -AIA and ASA, Perth, WA, October 1

(Part One of this story was written on Tuesday 9th April 2019. It was published on the day in the form of an email to paying subscribers, and will be again on Thursday as a story on the website. Part Two will be completed on Wednesday, 10th April 2019 and published on the website on Friday).

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

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

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Rudi's View: Retail REITs, Resources, And Lynas

In this week's Weekly Insights (this is Part Two):

-Cautious, Cashed Up, Looking For Direction -Not The End, Says Prudential -Conviction Calls -Retail REITS And The (Invisible) Risk -Have Your Say - The CSL Challenge -Rudi On TV -Rudi On Tour -Rudi Talks

[Non-highlighted parts appeared in Part One on Thursday]

By Rudi Filapek-Vandyck, Editor FNArena

Conviction Calls

The March quarter saw Australian equities post their strongest quarterly performance since Q3 of 2009, notes stockbroker Morgans, and the medium term outlook remains positive, but now is probably a good moment to start dialing back somewhat on exposure to risk.

A lot is priced in at present index level and earnings growth on average is unlikely to exceed 4% per annum for the coming years (plural).

The latter average is ex-resources, but is indicative of ongoing tough operational challenges for most companies in Australia. Apart from a more conservative portfolio composition, stockbroker Morgans is also advocating investors should keep a larger than usual proportion of cash on the sidelines.

As long as investors don't get spooked by prospects of inflation flaring up, the outlook for equities should, on balance, remain attractive, suggests Morgans. There simply doesn't appear an inflation problem on the horizon, even though central bankers the world around would like to see some (more) of it.

Time also to dust off the broker's Conviction Calls, as that should be one way to achieve further (out)performance.

Among large cap stocks, Morgans carries Buy ratings with Conviction for ResMed ((RMD)), Sonic Healthcare ((SHL)), Reliance Worldwide ((RWC)), Westpac ((WBC)), and Oil Search ((OSH)).

Outside the ASX100, the broker's selective list consists of Volpara Health Technologies ((VHT)), PWR Holdings ((PWH)), Kina Securities ((KSL)), Senex Energy ((SXY)), and Australian Finance Group ((AFG)).

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Local share market strategists at Citi, on the other hand, this week declared what many an investor dreads to hear: this may be almost as good as it gets for resource stocks.

Citi is not predicting no further upside is possible for the likes of BHP Group ((BHP)), Rio Tinto ((RIO)), Fortescue Metals ((FMG)), and Woodside Petroleum ((WPL)), but shares look significantly less undervalued than they were at the start of the 2019 global equities rally, and at some point expensive looking share prices might become a good enough reason to start pulling money out of the sector.

For now, however, there remains potential for further upside as consensus forecasts can still move higher if commodity prices remain higher for longer, advocate the strategists.

Taking a leaf from history, Citi stategists do make the point that history suggests elevated valuations for the sector, as is currently the case, usually don't make for sustainable returns longer term. For now, however, supply response remains more of a threat than reality and the strategists remain Overweight the sector, with the caveat that the end, surely, must be closer, and getting closer.

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The latest market update by Shaw and Partners Chief Investment Officer Martin Crabb combines a bit of both of Morgans and Citi.

Crabb too thinks the share market does not look attractive enough here to put some extra money in, and that is putting it mildly. He jokingly refers to the possibility of much lower valuations for the market in general, and that's because resources seem to be the only part that provides plenty of cash, plenty of growth, and plenty of potential for upside surprise.

On his observation prospective earnings growth in Australia has been supported by six large cap stocks; BHP Group, Fortescue Metals, CSL ((CSL)), Woodside Petroleum, Rio Tinto, and Santos ((STO)). Did anyone else notice the exception inside those six?

Crabb also highlights spreading market speculation that National Australia Bank ((NAB)) is getting ready to cut the dividend; to $1.80 according to in-house analyst Brett Le Mesurier. Given where the share price resides, he suspects this might already be priced in.

From here onwards and with current index and growth forecasts as the starting point, Crabb suggests dividends not share price gains represent the bulk of prospective return. In other words: the market is priced for everything to be alright. What are the chances of this remaining the case over the next eight months?

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Meanwhile, Canaccord Genuity, predominantly specialised in small cap stocks here in Australia, has updated its Australian Focus List; 11 stocks that come with conviction.

These 11 inclusions are AMA Group ((AMA)), CML Group ((CGR)), EML Payments ((EML)), G8 Education ((GEM)), Infigen Energy ((IFN)), Kogan ((KGN)), Money3 Corp ((MNY)), MOD Resources ((MOD)), Primero Group ((PGX)), Perseus Mining ((PRU)), and Think Childcare ((TNK)).

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Small cap specialists at Ord Minnett have put forward Webjet ((WEB)) as their Top Pick, whereas Tassal Group ((TGR)) remains their Bottom Pick.

And throughout all the ups and downs, and behind-the-scenes scheming by suitor Wesfarmers, CLSA analysts have reiterated (note: not just maintained or repeated) their High-Conviction Buy for rare earths miner Lynas ((LYC)), with a price target of $3.50.

Bell Potter nominates biotech Starpharma ((SPL)) as one of the Top Picks for 2019, with plenty of catalysts on the agenda, or so it seems.

Retail REITS And The (Invisible) Risk

Last week, I was reminded by a gold bug investor on Twitter that, as far as asset investment returns are concerned over the past two decades (1999-2019), gold came in a solid second, well ahead of the average equity or property market, but real estate investment trusts (REITs) have been the killer asset over the period.

The US-based investor in casu was soon villified for his biased view in favour of gold, as is custom these days on social media, with the main accusation being he had strategically picked the starting date at the absolute bottom of the gold cycle throughout the 1990s. Pick a different starting date and the numbers look a lot less favourable for the shiny metal, posted a small dozen other investors in chorus. And I agree.

Surely every less-biased investor can easily see on historic price charts that gold priced in USD peaked near US$1900/oz in late 2011 and has been in a volatile side-ways moving pattern over the past three years?

But this story is not about gold, which came in second best over the whole period (thanks to its stellar rally from 1999-2011), it's about the number one performing asset; REITs. I don't think anybody would have guessed that REITS were the exposure to have for investors, even only a few years ago.

Contrary to gold, REITs number one position was acquired in recent years, from mid-2012 onwards to be precise. Whereas previously this segment of the share market was mostly seen as boring and extremely unexciting, considered prime hunting ground for unprepared retirees desperate for sources of regular income, in recent years this sector has become the number one outperformer that virtually nobody ever talks about.

In Australia, A-REITS have outperformed the broader share market in five out of the past six years, and the sector has continued to perform well in 2019. In case you wondered: 2017 was the year of AREIT underperformance.

This observation provides us with a few key insights: the heavy influence of Quantitative Easing (QE) and extreme low bond yields on global assets, but also how tough the challenges are for the rest of corporate Australia in the light of demographic shifts, technological disruption, extreme low interest rates, and the breaking down of cosy domestic duopolies.

But wait, there's more.

Not every REIT on the Australian stock exchange has been enjoying sustained outperformance since 2012. On my assessment, this is the result of this particular segment equally feeling the impact from the tectonic shifts

impacting on the Australian economy in general. These shifts have divided REITS into winners and losers, just like the rest of corporate Australia. The winners, of course, are responsible for the bulk of the sector's stellar outperformance.

Think Charter Hall ((CHC)), and Dexus Property Group ((DXS)), and Goodman Group ((GMG)), but also Centuria Industrial REIT ((CMI)), and Rural Funds Group ((RFF)).

Have not been consistently among the winners, and seen their valuations de-rate in recent years, are the landlords of retail assets. While most investors' attention goes out to what the prospects are for the likes of JB Hi-Fi, Myer, and Premier Investments, the market has decided disruption and transformation are just around the corner for owners of shopping malls and other commercial properties that facilitate big box retailers such as Target, Big W and Dan Murphy's, or smaller boutique retail franchises.

The key problem here is that when shares in Scentre Group ((SCG)), Vicinity Centres ((VCX)) and Shopping Centres Australasia Property Group ((SCP)) -to name three of the obvious landlords on the ASX- are being left behind, their yield attractiveness only increases, in particular when investors stung by Labor's plan to abolish franking cash rebates are looking around for yield-income alternatives.

The problem thus becomes: to what extent have these landlords now become yield traps in a long-winded sector downturn?

On my observation, commercial property space is increasingly subjected to retail shops ceasing presence, if not operations, and it appears there are no quick replacements available. Most empty spaces I spot remain empty for a long time. And while shopping centres are doing a commendable job in replacing failing retailers with food courts, gyms, libraries, bowling centres and other alternatives, the question has to be asked: at what point can current leases no longer be retained, not to mention the necessity to mark down the value of current assets on the balance sheet?

The transformation that is currently hitting retail landlords is slow moving, and negative developments may not become visible for ordinary observers outside the sector for a long while. But retailers such as Premier Investments are responding to slower growth by closing down stores throughout Australia (the local Smiggle in my neighbourhood is no longer in operation), while big box retailers like Target and Big W, who take up a lot more space, are shrinking store numbers in order to remain viable.

The situation becomes a lot trickier if one takes into account that many of the diversified property owners in Australia are looking to sell their retail exposures (wrong timing, all at once) and recent analysis by Citi is suggesting too much additional retail space has been added ahead of what has now become a challenging downturn for bricks and mortar retailers.

In my view, this segment of the local REITs sector is now best categorised by that old Wall Street adage: none of this matters, until it does.

I note Citi's most recent sector update revealed Sell ratings for Scentre Group, GPT ((GPT)), Shopping Centres Australasia Property Group, Charter Hall Retail ((CQR)) and BWP Trust ((BWP)).

At the very least, I'd be wary of any buy recommendation for such assets on the basis of the stock looking "cheap", "relatively undervalued", or seemingly offering too attractive a yield to ignore. Better to be absent when the proverbial hits the fan, exact timing unknown.

Have Your Say - The CSL Challenge

IMPORTANT: THIS INVITATION ENDS ON APRIL 15TH - LAST CHANCE TO SEND IN YOUR STORY!!!

It's probably one of my key achievements since starting FNArena in 2002; to get investors interested in owning shares in CSL ((CSL)) and similar robust, high quality, sustainable growth stories, in defiance of general perception that stocks trading on a high PE multiple can never be owned but for a short term momentum play.

Over the years I have received many supportive emails and vocal encouragement from FNArena subscribers and investors elsewhere. At the end of last week's presentation to ASA members in Sydney, one elderly investor approached me with the words "CSL is such a wonderful company, why would you ever sell it?"

I think time has arrived we started sharing some of those stories with investors who are new to the CSL Challenge. From investors to investors. I am hereby asking those who own CSL shares to write down their motivation, memories, experiences, et cetera in order to share them with other investors.

Make it as detailed/generalised and as long/short as you like. Send it to info@fnarena.com, preferably with reference "CSL Challenge".

You don't have to do it completely pro bono. An innocent hand at the FNArena office will pick at random three contributions that will receive one bottle of wine each. To be eligible, make sure you also indicate whether you prefer red, white or rose. We'll pick one winner for each choice.

I'd say we close this invitation by April 15th, but let's not procrastinate too long. Get onto it right away! We take care of the wine selection.

Rudi On TV

My weekly appearance on Your Money is now on Mondays, midday-2pm.

Rudi On Tour In 2019

-ASA Melbourne, May 1 -ASA Toowoomba, Qld, May 20 -U3A Investor Group Toowoomba, Qld, May 22 -AIA Adelaide, SA, June 11 -AIA National Conference, Gold Coast, Qld, 28-31 July -AIA and ASA, Perth, WA, October 1

Rudi Talks

Audio interview about what's happening in the Australian share market:

https://www.youtube.com/watch?v=FpCnk1RSnCY

(Part One of this story was written on Tuesday 9th April 2019. It was published on the day in the form of an email to paying subscribers, and will be again on Thursday as a story on the website. Part Two was completed on Wednesday, 10th April 2019 and published on the website on Friday).

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