WEEK 22

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STORIES TO READ FROM FNArena

Friday, 27 May 2022

Codan: The Benefit Of Diversification

Australian Banks: Headwinds And Tailwinds

Rudi's View: Don't Fight The Fed

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FNArena
Financial News, Data & Analysis

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AUSTRALIA

BWX: Core Brands, Balance Sheet & Digital For Sale

Brokers trim price targets as BWX outlines its strategic direction for core brands.

-BWX reveals margin guidance ahead of expectations
-Strategic review of the digital business
-Medium-term revenue targets lowered
-Balance sheet concerns

By Mark Woodruff

Following the removal of unnecessary costs and disposal of non-core investments, Shaw and Partners believes BWX Ltd ((BWX)) will re-rate from FY23 onwards.

The broker formed this view following a strategy day held at the company's new manufacturing facility in Clayton, which included a strategic direction for core brands and disclosure of medium-term margin targets.

Clayton is 2.5 times the size of the previous Dandenong facility and is expected to reduce the cost per online order to less than $2.00 from $5.00 and de-risk the company's supply chain, while also improving quality controls and stock turn.

The company's operations include manufacturing, wholesale sale and development of natural body, hair and skin care products in Australia and internationally. **The focus is shifting from new acquisitions and digital growth towards organic growth for the four core brands** of Sukin, Andalou, Mineral Fusion and Go-To.

Management's long-term earnings (EBITDA) margin guidance of 22% proved better than the consensus forecast. Even so, according to Citi, this outcome was offset after **the company stepped back from medium-term revenue targets for its three markets.** Europe was the most significant change with a $30-$50m revenue target withdrawn in order to focus on the US.

In a discussion around strategic priorities, BWX management flagged cost-out initiatives of -$5m for FY23 (mainly from redundancies) and a strategic review of the Digital segment (Flora & Fauna and Nourished Life), which Buy-rated Shaw interprets to mean "preparation for sale".

Maybe some of these initiatives are paramount as **Jarden is concerned about the balance sheet,** with a potential $93m acquisition liability looming in September 2024. Management clarified that a put option held by the founders of Go-To can be exercised by that date at the earliest.

The analyst is also increasingly pessimistic about a recovery in top-line growth and margin expansion given the inflationary environment. It's believed any cost-out program benefits will be eaten away by higher costs elsewhere in the business.

Because of these concerns and the lack of a more specific plan regarding offshore expansion, Jarden has downgraded its rating to Underweight from Overweight and reduced its 12-month target price to $1.04 from $1.98.

The lower target is due to lower multiples applied by Jarden, not one of the seven brokers updated daily in the FNArena database, to other ASX-listed offshore growth stories such as Breville Group ((BRG)), Premier Investments ((PMV)), Lovisa Holdings ((LOV)), Collins Foods ((CKF)) and City Chic Collective ((CCX)).

The reaction within the FNArena database to BWX's strategy day was less severe, with the average target price set by three Buy-rated (or equivalent) brokers reduced by just over -6% to $2.50, still suggesting 81.4% upside to the latest share price.

Shaw and Partners, also not one of the seven, retains its Buy rating and marginally lowered its target price to

$2.70 from $2.80.

Leverage

Given the balance sheet concerns raised by Jarden it may be timely to review management's plans detailed at the strategy day to reduce gearing. The metric is expected to fall significantly over FY23 compared to FY22 driven by an unwinding of inventory as the new manufacturing facility scales up.

In addition, higher earnings, no planned major projects and a reduced focus on acquisitions are expected to benefit.

Citi also believes BWX may benefit from divesting its digital platforms for several reasons including a lack of scale and increasing customer acquisition costs. It's estimated the digital businesses could be worth between $21-$27m.

Delayed revenue targets

BWX has delayed its US skincare revenue target of $100m and $30-50m Europe sales target to at least FY25 from FY23.

Citi believes these amended target dates reflect covid-related rollout delays and other distractions (online, Nourished Ventures), which have impacted on execution for the core brands.

Nonetheless, the broker maintains its Buy rating as Sukin's value offering is likely to appeal in a high inflation environment. Further, a consumer survey conducted by Citi revealed increased natural skincare consumption during covid, which is expected to be sustained once conditions normalise.

Apart from an appealing current valuation, the analyst also sees distribution growth opportunities in the US.

Other broker views

After Macquarie adjusts its model for BWX's updated long-term targets, immaterial changes are made to the broker's earnings forecasts, while its target price falls to $2.20 from $2.40 on management's net debt estimate for June 2022.

UBS believes the $47m consensus FY23 earnings (EBITDA) forecast is achievable, based on the unwind of FY22-specific headwinds, cost-out, higher gross margins and another three months of Go-To contribution.

UBS feels the current company valuation looks undemanding and bases its Buy rating on the opportunity to expand global distribution. The broker comments the new manufacturing facility tour highlighted the opportunity for efficiency gains and the potential for gross margins to increase over FY23/24.

The broker retains its Buy rating and lowers its target price to $2.55 from $2.70 after revising working capital assumptions.

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AUSTRALIA

Elders: Good And (Still) Getting Better

Brokers universally set higher price targets for Elders in the wake of first half results.

-Elders convincingly beats consensus 1H forecasts
-Growth for rural and wholesale products were highlights
-Market conditions and organic growth lift margins
-FY22 guidance appears conservative
-Hold-rated Morgans and Bell Potter invoke some caution

By Mark Woodruff

Despite a share price trading at 52-week highs, brokers continue to set even higher 12-month target prices for Elders ((ELD)) following first half results.

Underlying earnings (EBIT) rose 80% for the half, a 36% beat compared to the consensus estimate for the provider of financial, real estate and agricultural services to rural Australia. Meanwhile, profit of $91m exceeded the consensus forecast for 65m.

The result was driven by a combination of market and seasonal factors, and both acquisitive and organic growth, observes Macquarie. **Rural and Wholesale products were considered the standout** with growth driven by strong demand for fertiliser and crop protection products following a favourable season.

All regions delivered growth highlighting to the analyst a diversification of earnings that serves to reduce risk. NSW was the top performer in delivering 103% earnings growth versus the previous corresponding period (pcp).

The gross margin for the Rural Products division improved by 1.2%, while Agency Services benefited from high livestock prices, which more than offset lower volumes. Meanwhile, growth in Real Estate and Financial Services was driven by strong market conditions.

Overall, **the company attributed 42% of first half gross margin growth to those strong market conditions, with the balance derived from organic growth (46%) and acquisitions (12%).**

Despite higher working capital to support growth, Macquarie highlights a 27.8% return on capital (ROC) compared to a company target of 15% set following the Australian Independent Rural Retailers acquisition in July of 2019.

Management declared an interim dividend of 28cps (30% franked) and upgraded FY22 earnings growth guidance to 30-40% above the pcp, compared to prior guidance for 20-30%. The company is also optimistic about growth in FY23.

Nonetheless, some brokers introduced a note of caution. While Morgans raises its target price to $14.75 from $13.50, a Hold rating is kept as earnings growth should moderate from FY23 and cattle prices will eventually fall from current record high levels. The Hold-rated Bell Potter also reminds investors of tailwinds that have materially assisted since FY19.

Guidance

Management's FY22 guidance reflects an element of conservatism, according to Macquarie, as the top end of the range implies a 57/43 first half/second half earnings skew compared to the historical 45/55 spilt.

The broker retains its Outperform rating and raises its target price to $16.54 from $15.15.

In raising its target price to $15.50 from $13.90, Bell Potter agrees and points out the upper end of guidance implies 8% year-on-year growth in second half earnings. This is considered modest when current tailwinds for fertiliser and agricultural-chemical prices, as well as livestock turnover are taken into account.

As good as it gets?

Goldman Sachs feels there is a misconception among investors that this is as good as it gets.

The analyst disagrees as Elders is well-positioned to deliver sustainable earnings growth over the medium term and notes management is committed to delivering further 5-10% earnings growth in FY23.

More than 50% of the growth reported in the first half reflected ongoing execution of the company's strategy, according to the broker. It's thought ongoing medium-term organic growth should arise from market share growth and margin expansion from a backward integration strategy that is only around 50% complete.

Goldman Sachs continues to be attracted to management's strong track record and a good overall industry structure and raises its target price by 14% to $21. An attractive valuation and potential for a positive earnings surprise are also considered to support a Buy rating.

Meanwhile, Buy-rated Shaw and Partners lifts its target to $20 from $16.50 and points to a strong upcoming winter cropping season (based upon April 2022 Bureau of Meteorology rainfall data) that should benefit the company in both FY22 and FY23.

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AUSTRALIA

Healius Offers Digital Carrot, Base Remains Soft

Recovery in the core business remains important in the near-term for Healius, as benefits from covid testing look likely to soften in the remainder of the year, but longer-term digitisation remains a focus for the company.

-Healius continues to chase digital optimisation, but lags behind competitors
-In the nearer term, covid testing remains an important contributor
-Base business recovery remains slow

By Danielle Austin

Digital integration remains top of the agenda for Healius ((HLS)), and a focus of the company's recent Strategy Day. While the integration of artificial intelligence into diagnostics was a feature of the company's update, hoped to support Healius in delivering superior clinical insights and operational efficiencies moving forward, the company remains more than two years away from realising the full benefits of its currently under-implemented Lab Information System.

The Lab Integration System aims to transition Healius' legacy systems to a unified platform, offering standardised workflow across all labs nationally, and is considered a key step as the company continues on its path to becoming a digitally-enhanced diagnostic operator.

However, as market experts noted, despite raising $100m in FY18 to fund the system, and a current spend to date of -$25m, roll out to the lab network is just getting started and Healius trails behind competitor Australian Clinical Labs ((ACL)), which has already rolled out its own unified network.

Healius' Lab Information System is set to cost the company a total -$85-90m, and to deliver benefits of $15-20m per annum.

<u>Base business and covid testing remain crucial near-term</u>

While digitalisation remains important to Healius' longer-term prospects, in the nearer-term market analysts are looking for further recovery in the company's core business to balance the likely decline of benefits from covid testing, with both important to the company's near-term outlook.

Despite revenue improving across all divisions, a weaker environment for the company's base business continues to impact on performance. While covid volumes are currently offsetting soft base business, durability is not guaranteed with the market largely anticipating testing to decline in the coming half.

In the first half of the financial year the company reported 56% revenue growth on the previous comparable period, strongly linked to ongoing covid testing with core revenue up only 3%.

The slower than anticipated recovery of the core business has also impacted on benefits received from Sustainable Improvement Program (SIP) initiatives, with labour constraints and soft volumes delaying implementation, although the company did reiterate it remains on track to achieve $67m in earnings from the program by the end of FY23.

<u>The Brokers</u>

With six of FNArena's core brokers updating on Healius, three are Buy rated or equivalent and three are Hold rated, with a collective average target price of $4.82. While Healius' recovery remains on-track with the wider industry, the market is looking to see further improvement in the core business with the longevity of covid benefits uncertain.

With an Outperform rating and a target price of $5.20, Macquarie holds the highest target price for Healius of the brokers in our coverage, noting while trading remains below pre-covid levels it is tracking in line with the broker's expectations. The Macquarie analysts see scope for the base business to improve heading into the next financial year, and expect the Sustainable Improvement Program to further support volume recovery and margin improvement moving forward.

Credit Suisse remains Neutral rated with a target price of $4.65, and anticipates net profit will decline in the second half, forecasting $107m from $246m in the first half but expecting covid testing will continue to contribute 20%.

The broker anticipates the company will not only benefit from addressing a backlog of routine services, it also expects demand will catch-up to longer-term trends including population growth, an ageing population, increasing levels of disease and improved survival rates.

At the other end of the spectrum, Morgan Stanley is Equal Weight rated and reduced its target price to $4.40 from $4.45 following Healius' update. Morgan Stanley experts note the base business supports the current valuation, while durability of PCR testing will determine potential upside, but it is the decline in ongoing PCR testing that drove the broker to reduce its target.

The broker anticipates covid benefits will start to wane in the second half, and predicts Healius will report a 34% earnings contribution from covid testing in the current financial year but only a 12% earnings contribution in the following year. Further, while the analysts highlighted industry diagnostic imaging levels remain below expectations, they see better value elsewhere in the sector.

AUSTRALIA

Codan: The Benefit Of Diversification

While some brokers lower price targets, Codan is set to meet FY22 consensus forecasts.

-Codan on track to achieve FY22 consensus estimates
-Diversification strategy yields benefits
-Softness in metal detection offset by communications segment
-Material earnings beat predicted for new acquisitions

By Mark Woodruff

A market update by Codan ((CDA)) has demonstrated the benefits of the company's diversification strategy, as **softness in the Metal Detection segment was more than offset by strength in Communications**.

The company has a dominant global market position via the Metal Detection business -- Minelab -- which boasts defensible intellectual property and benign competition, according to Moelis.

The company’s earnings mix has recently been diversified by the recent acquisitions of Domo Tactical Communications (DTC) and Zetron. Strong first year performances from both have lifted Communication’s share of the broker’s FY22 forecast earnings to around 29%.

Zetron provides technology solutions to optimise critical communications and is the second largest end-to-end provider of nextgen 911 services in North America, while DTC’s products build on existing communication solutions for a range of applications including military, security and broadcasting.

With pipelines for Communications 'tracking ahead of schedule', management expects Metal Detection to 'form a new base' in FY22. Macquarie highlights FY22 profit should be the second highest on record and grow from the new base.

Overall, management predicts the second half performance of both segments will be consistent with the first half. This implies to Canaccord Genuity second half profit guidance of $100m.

As this guidance was a -5% miss versus its forecasts, the broker lowers its 12-month target price to $10.60 from $13.60 though notes a credible performance given the numerous headwinds encountered by Metal Detection.

In a very similar adjustment, Moelis lowers its target to $10.60 from $12.23, after reducing its FY22 profit estimate to $100m to align with guidance. Analysts at both firms maintain a Buy rating.

Meanwhile, Outperform-rated Macquarie suggests **the company is on track to deliver a record year of profit and meet FY22 consensus forecasts**, and maintains its $11.60 target price.

Metal Detection

While gold detector sales into Sudan and Russia were negatively impacted and consumer sales normalised, management still expects the second half earnings contribution from Metal Detection will be similar to the first half. As a result, Canaccord concludes margins have improved, possibly due to price increases.

Management also referred to distribution gains, particularly in North America where there are now over 3,000 points of distribution and a record performance from the countermine technology.

Communications

Canaccord forecasts the **DTC and Zetron acquisitions could deliver $32m in FY22 earnings versus guidance for $22m when acquired.**

As a result of these acquisitions, the analyst estimates the contribution from Communications will have doubled and represent 46% of group revenue and 30% of group earnings in FY22.

In a further positive indication for the growth outlook, management also alluded to positive signs in the developing-world military markets.

Outlook summary

Moelis sees a growing contribution from the recent acquisitions, a return to 'on the ground' business development and exciting prospects from new markets such as South America and India. An expansion of distribution channels toward mass-market retail is also expected to assist.

Meanwhile, Canaccord sees potential for both organic and inorganic growth at Codan.

Communications is now exposed to larger addressable markets, observes the analyst, while Metal Detection should be underpinned by new product development and distribution gains. In addition, balance sheet capacity could support further inorganic growth.

COMMODITIES

Material Matters: Iron ore, Lithium and Oil & Gas

A glance through the latest expert views and predictions about commodities: large forecast decline for the iron ore price; lithium price forecasts and preferred stocks; three reasons to have an energy sector exposure.

-Macquarie predicts big fall for the iron ore price
-Broker forecasts for lithium prices
-Preferred ASX-listed lithium stocks
-Three reasons to have an energy sector exposure

By Mark Woodruff

Big iron ore price fall looming?

So far this year the iron ore price has remained steady as the market has focused on Chinese stimulus for a depressed property market, which accounts for half of the country's steel demand.

However, Macquarie believes stimulus will be hard to implement while the Chinese zero approach to covid is maintained.

Without improvement in finished steel demand, the iron ore price may suffer an ugly reversal at some point, suggests the broker.

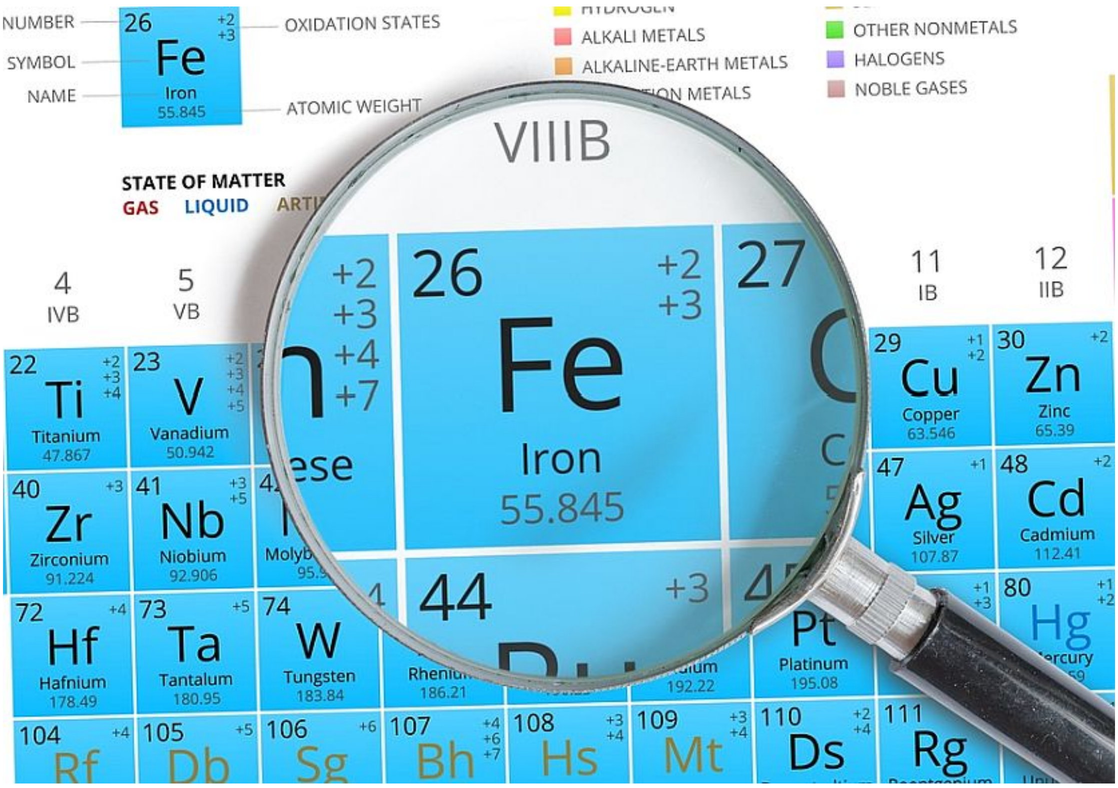
Despite current weakness in finished steel demand, the iron ore market has tightened since the Chinese New Year, driven by an impressive recovery in hot metal production, explains the analyst. This recovery is partly attributed to a reduction in scrap consumption in both electric arc furnace (EAF) and basic oxygen furnace (BOF) steelmaking as covid lockdowns disrupted collection and logistics across the country.

While Chinese blast furnaces are now approaching full utilisation, the broker feels current market dynamics are unsustainable and hot metal is being overproduced.

Nonetheless, iron ore prices may rise in the short term as the market focus shifts back to underperforming supply and falling iron ore inventories, explains Macquarie. This view assumes current margins and the same level of Chinese hot metal production.

Extra upside impetus for prices may result from the Indian government's recent decision to impose large export duties on iron ore, suggests JP Morgan. The country's highly-price-sensitive exports to China, the majority of which are low grade, were not previously taxed at all.

JP Morgan estimates the impact on global supply from the Indian tax could be -20Mt. When combined with a potential -45Mt reduction in supply from Ukraine and the broker's recently reduced production forecasts for Rio Tinto ((RIO)) and and Brazilian miner Vale of -20Mt apiece, further support for prices can be envisaged.



<u>Forecasts for lithium prices and preferred exposures</u>

Demand for copper and aluminium doubles every 25-30 years and 15-20 years, respectively, points out Citi, while lithium demand is expected to double every three years over the coming decade, underpinned by rising electric vehicle (EV) production.

The spot lithium price is currently trading around -8% below all-time highs after a mini-correction in the last few weeks, though both battery grade carbonate and hydroxide are still up on average by 90% for the year to date.

As lithium is the most exposed metal to EV sales (70% of lithium demand coming from the sector in 2022), the broker feels the recent price fall emanates from concerns around demand for EVs/batteries being impacted by lockdowns in China, especially in the key automotive hub of Shanghai.

Nonetheless, the broker forecasts lithium prices will average around $35k/t through to 2025 compared to average prices of $13k/t over the 2017-2021 period. These prices contrast with marginal production costs of circa $5-10k/t. The long-term price forecasts for lithium carbonate and lithium hydroxide remain at US$15k/t and US$17k/t.

Meanwhile, Barrenjoey upgrades its near-term EV sales forecasts and adjusts for a slower lithium supply ramp-up, which drives its 2022 lithium spodumene and hydroxide price forecasts around 20-70% and 30-50% higher, respectively. Five-year forecasts for lithium (spodumene, carbonate and hydroxide) are also raised materially.

As a result of these revised price forecasts, **the broker raises its 12-month target price for Overweight-rated IGO ((IGO)) to $14.50 from $13.50**. The Western Areas acquisition is also now included in forecasts.

The analysts believe IGO is well-placed to benefit from a step-change in demand for lithium and nickel (from rising EV demand), due to its low-cost operations for both commodities and potential for expanded production.

Barrenjoey also initiates coverage on four lithium names, with Overweight ratings for both Allkem ((AKE)) and Liontown Resources ((LTR)), while Mineral Resources ((MIN)) and Pilbara Minerals ((PLS)) are handed Neutral and Underweight ratings respectively.

The broker highlights Allkem's geographic and product diversity, as well as exposure to spot pricing, and sets a $15.00 target price. The recent Galaxy Resources acquisition provides both carbonate/hydroxide and spodumene production across Australia and Argentina, while Sal de Vida in Argentina and James Bay in Canada lend production expansion potential.

Meanwhile, the analyst sets a $1.80 target price for the almost-fully-funded Liontown Resources as it begins the development of its underground spodumene project in WA.

In the eyes of Barrenjoey, Mineral Resources (target price $64) gains credibility for its partnership with Albermarle (the world's largest lithium producer), and its Wodgina spodumene mine and the Kemerton hydroxide facility are soon to start up. However, it's thought another layer of complexity is added by the company's existing iron ore exposure.

Finally, Pilbara Minerals is the least preferred among the four new lithium stocks under the broker's coverage for a number of reasons, including the smallest valuation discount and the lowest compound volume growth. A target of $3.00 is set.

Three reasons to have an energy sector exposure

Wilsons paints a bullish picture for ASX-listed energy stocks and believes a current discount to global peers may unwind over the next 12 months.

Apart from **the Energy sector's historical usefulness as an inflation hedge,** the broker's view is mainly predicated on a **significant industry tailwind following Russia's invasion of Ukraine**. It's estimated around 3% of the world's production has been effectively removed from the global oil market due to the loss of Russian exports, resulting in one of the largest shortfalls in supply since the 1970s.

Supply losses could expand to around -3mbd during the second half of 2022 from nearly -1mbd in April, as Europe starts to wean itself off Russian fossil fuels, estimate the analysts. Russia formerly comprised 14% of the yearly global oil supply, and any attempts to increase production in other regions is expected to take some time.

Wilsons points out **Australian energy company share prices have lagged offshore peers by over -30%.** Over the last two years share prices for Santos ((STO)) and Woodside Energy ((WDS)) have risen by 57% and 27%, respectively, despite a 213% rise in the Brent crude oil price.

The broker prefers Santos and expects a re-rating over the next year from several catalysts including the potential sell-downs of 10% of its PNG LNG asset and 10-51% of its Pikka oil project in Alaska. A final investment decision on the Dorado field for the company's project off Western Australia is also expected to create value.

The starting point is favourable, even prior to any catalysts, as Wilsons points to a share price trading at the lowest implied oil price in the sector of US$63/bbl. In addition, the company recently announced a new capital management framework targeting higher shareholder returns.

Woodside is also expected to flourish over the next year from high leverage to oil prices and the spot Japan/Korea marker (JKM) for LNG, as well as upside from the merger with BHP Group's ((BHP)) Petroleum division.

ESG FOCUS

ESG Focus: S&P Eyes APAC As Ukraine Rages

FNArena's dedicated ESG Focus news section zooms in on matters Environmental, Social & Governance (ESG) that are increasingly guiding investors preferences and decisions globally. For more news updates, past and future:
https://www.fnarena.com/index.php/financial-news/daily-financial-news/category/esg-focus/

ESG Focus: S&P Eyes APAC As Ukraine Rages

With US$2.8trn of US$4trn APAC debt exposed to environmental risk, S&P Global Ratings hones its sights on the region as ESG debt bears the brunt of the global bond rout.

-Green debt suffers most in bond market rout
-$2.8trn of US4trn APAC debt is exposed to environmental risk
-Integrity of sustainable debt markets to be tested
-Regional ESG haves and have-nots starting to emerge
-Ukraine War spurs rush to dirty debt and humanitarian 'conflict' finance

By Sarah Mills

S&P Global Ratings' Asia-Pacific ESG & Sustainable Finance Seminar 2022 provides several insights into the agency's view on ESG developments in the region and its approach to ratings.

The seminar comes as sustainable debt markets appear to have borne the brunt of the recent bond rout in response to rising inflation post-covid and the Ukraine War.

Bloomberg says its index of ESG debt has lagged global bond benchmarks by roughly 64 basis points in the past 12 months.

In Europe, green corporate bonds have slumped -6.7%, compared with -6.1% for vanilla debt in the year to April, and Chinese high-grade corporate green bonds underperformed non-green peers in the first quarter.

Green issuance is stagnating for the first time in years after posting stellar growth turnover in the past five years, when it rose eight-fold.

The poor performance flies in the face of conventional wisdom that sustainable debt should be a safer bet over the longer term, and given regulatory pressure should ensure portfolios are more sustainable in the long term, and therefore trade at a premium, especially as volumes rise.

Several Reasons Behind Bond Weakness

An obvious reason for the March-quarter weakness is the short-term response to the Ukraine War, which witnessed a sharp run into “dirty debt” – oil, gas and oil (see below).

Some conjecture that the market also recognises the relative “newness” of the debt category and has sought shelter in the familiar, well-rated basket amidst the geopolitical conflict.

Bloomberg speculates another reason for the relative weakness of sustainability debt in the March quarter is that ESG debt started out more expensive (so it had more room to fall), and most of the debt is longer dated.

Other observers point out that sustainability bonds haven’t really experienced a proper down cycle and this is the first test.

Bloomberg also notes weakness in the secondary market makes it tougher for big institutional investors to liquidate investments.

Most pundits also agree that a major investor concern is nervousness about green-washing and the quality of green debt as their success becomes more evident with maturity, particularly for green use-of-proceeds bonds, as inflation rises and geopolitical tensions escalate.

Major polluters such as petrostates and airports rushed to take advantage of the flood of sustainable post covid, and perhaps early signs of a reckoning are in play.

Enter the Asia-Pacific S&P Global Ratings seminar

The seminar is timely and, at one level, aims to increase investor confidence in the rigour of the S&P ratings system as well as encourage investors to orient to agency-rated green debt.

In a general preamble, S&P Global says the main challenge facing the region is that of converting long-term net-zero pledges into short-term action, and that corporations will experience growing pressure to meet bond targets over the next two years.

This suggests continued pressure to invest funds into ESG projects, which is likely to underpin regional economic investment.

Also in the next couple of years, the agency believes new regulations and reporting standards will demand greater disclosure and transparency; that boards will experience growing pressure to upgrade their ESG skills; and financial institutions will have to conduct greater climate stress testing.

When it comes to the impact of this on investors, S&P says the debate over divestment versus engagement is expected to escalate. Some may opt to divest assets to keep their book greener, and others may choose to engage with corporations.

The upshot of this is that the integrity of the sustainable debt market is likely to be tested, with ramifications for corporations and equity markets as rising rates, inflation and profit pressures cascade.

Meanwhile, China is expected to lead APAC green issuance as previous issuance cascades into corporations.

In the relatively opaque Asian markets, S&P says the gaps between the ESG haves and have-nots is starting to become evident, and the cracks/risks are starting to show. ESG reputations are being made and destroyed.

S&P tallies material ESG risks

Back to APAC, the agency notes nearly 60% of APAC ratings are influenced by ESG factors and says their materiality is high.

The region holds US$4trn debt and the agency estimates US$2.8trn is exposed to environmental risks.

Governance factors negatively influence about 22% of that, and 19% are social.

On the environmental risk front, the agency estimates large capital expenditure will be required to strengthen compliance, fund retirement of large assets, or pay for clean-up liabilities.

The agency also observes that concentrated asset bases magnify physical risks, high pollution costs could hit profits, and companies face risks from product substitution.

The agency also spies liquidity risk for companies exposed to climate transition, deforestation, certain social factors and weak governance.

S&P also observes emerging risk to demand profitability as companies confront limitations on consumer and business mobility, and ageing population trends.

Social risks include provisions for past health and safety litigation, magnifying cash-flow ratio volatility because of exposures to social mobility.

On the governance front, companies with a history of regulatory, tax or legal infractions outside industry norms are perceived as a liability risk.

Financial risks tend to be subject to cross-country comparisons. These include: legacy debt; profitability or ROI exposed to industry risk; compliance costs; transition costs; and repositioning of capital expenditures. Comparisons of ESG credit risks across countries.

Other environmental risks such as emissions and water useage are rated against community and industry peers.

Governance is compared against peers.

The Ranking System

S&P's ESG scores are measured on a scale of 0-100 where 100 represents the maximum score, based on points designated at a basic criteria level.

This is enhanced though standalone ESG Dimension Scores.

Basically, S&P has a 1-5 ESG rating system, with Positive being the highest and Negative being the lowest.

The scale is: Positive; Neutral; Moderately Negative; Negative; and Very Negative.

Each is designated a number 1 being Advanced, 2 being Aligned, and 3 being non-Aligned.

Such a score might look like this: 86 (for the 0-100 criteria-level component) and Neutral: E1, S2, G2 for the dimensional component.

Some prefer their own radar

While some might question the value of agency-rated debt post the global financial crisis, and may prefer their own ethical radar, once established, ratings agencies ratings will have a significant impact on the corporate and sovereign debt markets.

This will be amplified by the fact that an agency rating will qualify as a sustainability-linked bond KPI in its own right.

When it comes to corporate debt, Bloomberg says advisers are recommending investors seek companies with products and services that are naturally aligned to long-term sustainability rather than just ESG debt, and to examine the company's ESG profile rather than individual issuance.

Bloomberg interview respondents believe regular bonds with rights to a company's cash flow for general use should prove superior to ESG use-of-proceeds bonds – which would also benefit sustainability debt not-linked to specific projects.

Ukraine War Spurs A Run On Dirty Debt

Dirty debt has also outperformed bond markets recently as oil and gas prices soared on the covid reopening and the Ukraine war, as has debt from coal miners.

Although as the war accelerates the shift from fossil fuels to green energy, some believe the latter is the better long-term debt.

But Moody's Investors Service believes the European push for energy security post the Ukraine crisis will spur long-term investment in strategic renewable energy plans (although expects the region will remain heavily reliant on fossil fuels in the near term).

Moody's ESG Solutions expects sustainable bond issuance will be flat in 2022 at roughly US$1trn, after volumes moderated in the March quarter, due mainly to the Ukraine War, which has intensified inflationary pressures.

This compared with the agency's previous 2022 forecast of US$1.25trn.

S&P notes that, while the market is taking a breather after an eight-fold increase in five years, it is growing in breadth. S&P retains hope that issuance may exceed US$1.5trn this year, once stability returns.

Moody's reports global issuance of green, social, sustainability and sustainability-linked (GSSS) bonds fell -11% to US$203bn in the 2022 March quarter, down -28% on the previous corresponding period.

Green bonds were particularly hard hit, issuance falling -29% in the March quarter (albeit still comprising roughly half of total debt).

European markets, which hold the bulk of green bonds, were hardest hit due to the war, green bond issuance falling -37% year on year.

Rising Social Issuance Raises The Prospects For Conflict Finance

The main exception to the trend was social issuance, which rose in the March quarter (and now accounts for 18% of the total bond market). The agency suggests this has perhaps been strengthened by the Ukraine war, issuers bringing humanitarian labelled debt to the market.

In April, the International Capital Market Association published a Q&A document on how bonds can be used to raise capital for social projects to support "fragile and conflict states", highlighting the growing role financial markets are likely to play in future conflicts.

Moody's also notes there is growing demand for gender-equity bonds, given it has been estimated that global gender inequality costs the global economy US$160trn in human capital wealth and markets are keen on capturing that.

FNArena's dedicated ESG Focus news section zooms in on matters Environmental, Social & Governance (ESG) that are increasingly guiding investors preferences and decisions globally. For more news updates, past and future:
https://www.fnarena.com/index.php/financial-news/daily-financial-news/category/esg-focus/

FEATURE STORIES

Australian Banks: Headwinds And Tailwinds

The conundrum for Australia's major banks is that the benefits of rising RBA rates could yet be offset by the reason for those rate rises, being inflation and subsequent cost pressures for households and businesses.

-NIM upside, at last, for the banks
-Offset by lower loan demand
-And rising costs
-And bad debt risk

By Greg Peel

Since ANZ Bank ((ANZ)), National Australia Bank ((NAB)) and Westpac ((WBC)) reported full-year earnings in November last, and Commonwealth Bank ((CBA)) provided a quarterly update, bank analysts were looking ahead to inevitable RBA rate rises as inflation reared its ugly head.

The year had been a tough one for the banks, given a near-zero cash rate provided little scope for a reasonable margin between what the banks could borrow at (deposits, offshore funding) and what they could lend at (mortgages, business and other loans), known as the net interest margin (NIM).

Australian banks generate some 80% of their total revenue from net interest income, and therefore are highly dependent on NIMs to drive revenues.

Adding to NIM pressures was not only fierce competition between each other, but growing competition from non-bank fintechs, which together had gone from being a slight annoyance to a growing force.

In short, analysts assumed back in November the NIM situation would only deteriorate further before things got better, and getting better was reliant on RBA cash rate rises. Yet by February this year, when CBA reported its first half earnings and the other three provide quarterly updates, inflation remained relatively low, the RBA was thus remaining patient, and indeed, the banks together posted again-lower NIMs.

At the same time, costs were rising, particularly to cover regulatory compliance, cyber security risk and technology upgrades required to keep up with the fintech upstarts.

The one saving grace was that having put away significant provisions against covid risk to the economy from 2020, the reopening that stuttered through 2021 and into 2022, until an eventual "living with covid" strategy emerged, and loan losses not being as bad as feared, meant the banks could return part of those provisions to the bottom line.

This allowed not just for a return to decent dividends, but for share buybacks as well.

Here We Go

Australia's March quarter CPI numbers jolted the RBA into losing its aforementioned patience and ignoring the federal election to provide the first rate rise this month, of 25 basis points to 0.35%. Another hike is expected in June.

Given the March quarter wage price index indicated wage growth remained under expectation, consensus has the RBA hiking by another 25 points in June, to 0.60%, although some believe the board could still go a full 40 points to 0.75%.

Either way, what the banks, and bank analysts, had been waiting for had finally arrived. A higher cash rate justified higher lending rates, and there was no great rush to raise deposit rates, so NIM expansion was set to become a reality.

NIMs still had to turn around from weak levels before getting back to anything resembling pre-pandemic numbers, so analysts were surprised how quickly NIMs were stabilising as ANZ, NAB and Westpac reported first half earnings in May and CBA provide a quarterly update.

The banks were still able to return more provisions, and thus maintain solid dividends and buybacks. Increased NIMs offered the prospect of increased revenues, but would these translate into increased earnings?

The Dark Side of Rate Rises

The reason the RBA is raising rates is due to rising inflation, but inflation is not rising because demand is strong in the economy. When cheap Chinese imports flooded global markets in the noughties, global inflation fell into a stupor. But the global economy was strong, so central banks hiked rates, at least up until the GFC.

It took a while, but eventually rates rose again as the world recovered from the GFC, with a few stumbles along the way. But then came covid.

And more recently, the war.

Inflation in 2022 is about constraints on the supply-side, not strength on the demand-side. This means the RBA is not hiking into an economy that is getting too hot, but into an economy that is settling back from a sharp 2021 rebound and now being hit by the rising cost of living, and the cost of doing business.

Given inflation drivers are currently out of the hands of governments (unless they provide too much fiscal support to fight a higher cost of living), central banks have no choice but to slow the demand-side to combat supply-side forces. In other words, the RBA has to slow the economy, when it was already at risk of slowing.

House prices have surged in Australia since the RBA cut rates to near-zero in 2020. Facing a bleak NIM outlook and strong competition, the banks were forced to offer record low fixed mortgage rates. These will provide a buffer for borrowers in the near term, until they expire. Those on standard variable mortgage rates are now feeling the pinch of rate rises.

Just as they struggle to fill the car, or feed the family. And surging house prices have led Australians to borrow as much as they can on a debt-to-income basis. The risk is the strain becomes too much. And the rate-rise cycle has only just begun.

Businesses, too, are feeling the pinch, particularly those for which a large proportion of the cost of doing business is fuel. It all adds up to the risk of mortgage and business loans going "bad". It's all well and good for the banks to enjoy the prospect of higher earnings via higher NIMs, but they still need the revenues to drive the earnings, and they can't afford for borrowers to start missing repayments or worse still, bad debts leading to foreclosures.

It goes without saying that the higher the interest rate, the lower the demand for a loan. This flows through to, for one, inevitably lower house prices. And lower house prices could lead borrowers into "negative equity" – the value of their house is now lower than their mortgage value.

<u>Demand Collapse</u>

The Australian housing market has seen several cycles this century but at the end of the day, major economic shocks, such as the GFC, have indeed led to house price pullbacks but not any significant collapse in prices. And then each period of low cash rates (GFC, covid), have sent prices to ever new highs.

This has led to disappointment and frustration among those potential buyers itching to see prices fall to levels they can better afford.

Economists agree Australian house prices will fall as a result of higher interest rates, but don't agree on just how far they will fall. Consensus is nevertheless somewhere between -10-20%, but not straight away. Rates have to keep rising before the strain becomes too much, hence it's more of a 2023 story.

There are several factors that suggest prices will not fall too far, leading to a wave of foreclosures.

First is the aforementioned timing buffer provided by an historically high proportion of fixed-rate loans.

Second is the fact that given house prices have risen so far, so too has the equity in those houses. Hence it's a long way down into negative equity. And a notable proportion of borrowers have continued to pay off their mortgages at the rate they were first charged, however long ago, rather than reduce their payments in line with lower variable rates.

Third is the pent-up demand that sits under the market. Just as stock market investors jostle to "buy the dip" when valuations come back to more reasonable levels, and play who-will-blink-first games as a result, so too will there be willing buyer ready for house prices to come down a bit.

Finally, and perhaps most importantly, is Australia's historically low unemployment rate. As long as you still have your job and can thus pay your mortgage, the value of your house is irrelevant. You have a roof over your head and you're not about to sell.

The only relevance in this scenario is the so-called "wealth effect". It is well-known that when house prices rise, homeowners feel wealthier, and despite having no intention of selling their house, feel poorer when prices fall. The wealth effect flows through to demand for everything else in the economy, as homeowners feel they must tighten the purse strings.

Lower consumer demand leads to lower business earnings and then we shift from the risk of bad home loans to the risk of bad business loans.

But again there is good news. The economy is continuing to "come out of covid". For the great number of businesses that survived through 2020 on JobKeeper, and stayed afloat during subsequent lockdowns (with some help from a sympathetic ATO), the desire to revisit debt-funded business investment is growing.

There is also good news in the fact that while the banks have been returning amounts of covid provisions to their bottom lines, they haven't returned all of it. There is a regulatory requirement to maintain provisions anyway, but the banks still have some extra buffer against bad debts.

<u>The Cost of Doing Business</u>

The cost of doing business for businesses is rising with inflation. So too is that cost for banks.

Indeed, banks already had cost problems heading into covid, including remediation obligations driven by the Royal Commission, greater regulatory compliance required as a result of RC findings, and technology investment required to drag staid institutions kicking and screaming into the digital world, so as to keep up with low-cost, online fintechs.

And each other.

The cost of these costs, if you'll allow me some licence, is rising along with inflation.

Since last year it had been the intention of the majors to reduce their everyday costs to a point they could more than offset their uncontrollable costs, thus reducing their cost bases overall. But rising inflation has made this goal ever more difficult, and that's before we get to wage inflation.

Wage growth has remained stubbornly subdued so far – at least up to the end of March – but no one believes that given low unemployment, wages will not start growing more rapidly soon. Between them the banks employ some 40,000 staff.

To that end, the May reporting season brought surprise announcements from both ANZ and NAB that they were simply abandoning their cost reduction targets.

Westpac held onto its -$8bn reduction target, but analysts agree this looks overly ambitious, and more so given the bank admitted that target relies on an inflation rate of 2.5% (last 5.1%, forecasts for the June quarter around 6%).

So where does it all leave us?

<u>Competing Forces</u>

Analysts have not let go of the fact rising rates mean rising NIMs, and that's a positive. On commenting on last month's bank result presentation, Macquarie noted:

"The favourable rhetoric around the benefits of higher rates, with limited acknowledgement of the likely offsets, was one of the key surprises for us. However, this suggests that the near-term tailwinds should provide banks revenue upside. While we continue to see risks to FY23 expectations with deposit costs starting to rise, banks appear in the sweet spot in the short term."

Wilsons concludes:

"We see the sector as being on the cheaper side of fair value, primarily as we believe earnings risks over the medium term are skewed to the upside – higher NIMs, and lower shares on the issue given further buybacks."

Morgan Stanley is less enthusiastic:

"A better-than-expected February reporting season, the potential for margin support from earlier rate hikes, and Australia's defensive characteristics combined to see the major banks outperform in the March quarter. However, the P/E discount has narrowed, the benefit of higher rates is now factored into the outlook, housing loan growth is likely to slow, inflation is putting more pressure on costs, and a "quick and aggressive" tightening cycle increases tail risks [bad debts]*."*

The bottom line is the banks are facing tailwinds (rising NIMs) and headwinds (falling loan demand, rising costs, rising bad debts). As Citi puts it:

"A rising cash rate is set to accelerate revenue growth for all the Major Banks. This is likely to lead to a narrowing of the current revenue differences, as lending demand slows. Therefore, EPS [earnings] *growth forecasts in the next few years will be dictated by each bank's cost strategy, so long as asset quality* [bad debt risk] *holds up."*

<u>Which Bank?</u>

All banks will enjoy the same NIM tailwinds. Thereafter, as Citi suggests, it will depend on how each bank handles the headwinds.

Consensus, in the wake of the May results, was that ANZ did poorly, NAB did well, CBA was neither here nor there and Westpac came out looking the best given its determination to stick to its cost-out target, except that no one believes it is achievable.

With ANZ's cost target abandonment leading to a sentiment reset, more realistic expectations should reduce the bank's risk of ongoing earnings misses. With the lowest return on equity in the sector, ANZ will benefit the most from rising rates.

NAB delivered strong growth, has a strong balance sheet, leverage to higher rates and an ongoing share buyback, offering valuation support.

ANZ and NAB are also less exposed to mortgages and more to business loans.

CBA's update offered no catalyst for a de-rating, but stronger mortgage competition and higher expenses limit the upside. And as always, analysts see CBA's valuation to the other three as excessive.

While divesting of non-core businesses is part of Westpac's cost reduction strategy, 2.5% inflation?

FNArena Major Bank Data					FY1 Forecasts				FY2 Forecasts			
Bank	B/H/S Ratio	Previous Close $	Average Target $	**% Upside to Target**	% EPS Growth	% DPS Growth	% Payout Ratio	**% Div Yield**	% EPS Growth	% DPS Growth	% Payout Ratio	**% Div Yield**
ANZ	5/2/0	25.37	29.56	**15.49**	- 4.9	0.1	68.9	**5.6**	8.2	9.4	69.6	**6.1**
WBC	3/4/0	23.54	25.49	**6.28**	4.6	2.7	77.5	**5.1**	19.8	12.4	72.7	**5.7**
NAB	2/5/0	31.09	33.42	**4.74**	7.7	16.5	71.2	**4.6**	11.4	10.2	70.5	**5.1**
CBA	0/3/4	105.09	92.08	**- 13.58**	- 8.2	5.7	70.1	**3.5**	5.5	11.7	74.2	**3.9**

This is how consensus stands at present. While NAB was declared the winner of the results season, it is subsequently well priced, offering the lowest upside to target.

The reverse is true for ANZ.

Westpac sits in the middle, with a cost-out caveat, while CBA has hardly seen a Buy rating this century.

Thus CBA's four Sell ratings are somewhat entrenched on a relative valuation basis. No one in the FNArena broker database is prepared to put a Sell on any of the others, but a net 14 Hold (or equivalent) ratings to 10 Buys suggests an element of caution.

Technical limitations

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

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

WEEKLY REPORTS

Weekly Ratings, Targets, Forecast Changes - 20-05-22

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

By Mark Woodruff

Guide:

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

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

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

Summary

Period: Monday May 16 to Friday May 20, 2022
Total Upgrades: 5
Total Downgrades: 4
Net Ratings Breakdown: Buy 59.90%; Hold 33.53%; Sell 6.58%

For the week ending Friday May 20 there were five upgrades and four downgrades to ASX-listed companies covered by brokers in the FNArena database.

As Boral had two ratings downgrades by separate brokers last week, it was unsurprising to see the company heading up the table for the largest percentage decrease in target price set by brokers, as well as the largest percentage downgrade to forecast earnings.

Following management's-$45m downgrade to full year earnings guidance (excluding Property), Credit Suisse decreased its target price to $2.60 from $3.80 and lowered its rating to Underperform from Neutral.

The broker attributed two thirds of the downgrade to the impact from eastern states rainfall, while the balance resulted from elevated energy costs. It's estimated gross energy costs could increase a further $70m in FY23 and realised prices are unlikely to provide a full offset.

In a similar vein, Morgan Stanley noted cost issues may persist for some time and was disappointed by the lack of price offset. Management also flagged transformation program benefits would be lower than prior FY22 guidance by -$15-25m, though the $200m benefit target is unchanged. The broker cut its rating to Underweight from Equal-weight and reduced its target to $2.80 from $3.20.

Coming second on the table for the largest percentage decrease in earnings forecasts was United Malt Group, after the release of first half results.

First half profit of $10m was bang on Macquarie's estimate though a miss versus the consensus forecast of $13m, and the broker reduced its FY22 EPS forecast by around -7% to incorporate a higher than expected tax rate. Nonetheless, Management reiterated FY22 earnings guidance and remains confident in the outlook after FY22.

Morgans also downgraded it profit estimates due to the higher than expected rate of taxation, and was troubled by a lack of catalysts on the horizon. A Hold rating was maintained due to above-target gearing and near-term earnings risk.

On the flipside, Xero received the largest percentage increase in forecast earnings iafter brokers further reviewed FY22 results released in the week prior.

Despite lower than anticipated subscriber growth in the second half, 29% full year revenue growth beat UBS's expectations. Even so, a lack of cash flow is thought to be a challenge and the broker retained its Sell rating and decreased its target price to $70.00 from $88.00.

Cit correlated lower than expected UK subscriber growth to increased investment by competitor Sage, yet still expects Xero can continue to deliver strong growth in the region. The broker retained its Buy rating and $108 target price.

Following the release of FY22 results. Webjet was next on the list for the largest percentage increase in forecast earnings.

Macquarie noted travel activity continues to recover though revenue and profit margins face headwinds from lagging international travel and travel mix, which is likely to persist in the first half of FY23. Nonetheless, it’s thought the company remains well placed in the medium term, underpinned by strong market share gains and a structurally lower cost base.

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

Viva Energy Group received forecasts earnings upgrades from Credit Suisse as Australian fuel retailers stand to benefit from exposure to elevated refinery earnings. Demand from Europe and export restrictions from China are expected to support strong refining margins through 2022.

Finally, earnings forecasts were lifted for James Hardie last week. While FY22 profit of US$621m was at the low end of the US$620-630m guidance range, 42% year on year underlying profit growth in the fourth quarter came in ahead of Ord Minnett's forecast.

In raising its rating to Buy from Accumulate, the broker acknowledged rising interest rates will pressure the company’s PE multiple though low expectations are already factored into the share price. Price rises are also expected to counter some of the rising costs.

Morgan Stanley agreed housing market weakness has been priced-in after a recent share price de-rating, especially given the company's skew towards the repair and remodel (R&R) markets. The broker upgraded its rating to Overweight from Equal-weight, while the target price was reduced to $51 from $57.

Total Buy recommendations take up 59.90% of the total, versus 33.53% on Neutral/Hold, while Sell ratings account for the remaining 6.58%.

Upgrade

ARISTOCRAT LEISURE LIMITED ((ALL)) Upgrade to Buy from Accumulate by Ord Minnett .B/H/S: 6/0/0

A solid result across the board from Aristocrat Leisure in its first half has reflected the resilience of the gaming sector according to Ord Minnett, delivering a significant beat to the broker's underlying net profit forecast with a reported $530.7m compared to an anticipated $386.0m.

The broker highlighted the land-based segment was a major driver with strong year-on-year volume and fee growth, but continuing robust performance from the digital segment should quiet concerns around digital weakness.

The rating is upgraded to Buy from Accumulate and the target price decreases to $46.00 from $49.00.

JAMES HARDIE INDUSTRIES PLC ((JHX)) Upgrade to Overweight from Equal-weight by Morgan Stanley and Upgrade to Buy from Accumulate by Ord Minnett .B/H/S: 5/1/0

James Hardie Industries' FY22 adjusted profit was broadly in-line with Morgan Stanley's estimate and the consensus forecast. While margins were a beat for the North America Fibre Cement division, they were softer than anticipated for the APAC region.

Management reiterated FY23 profit guidance. The broker feels housing market weakness has been priced-in after a recent share price de-rating, especially given the company's skew towards the repair and remodel (R&R) markets.

While the target price slips to $51 from from $57, Morgan Stanley upgrades its rating to Overweight from Equal-weight. Industry view is In-Line.

James Hardie's 42% year on year underlying profit growth in its fourth quarter came in ahead of Ord Minnett's forecast. Full-year profit of US$621m is at the low end of the US$620-630m guidance range.

The 30c final dividend declared meant 70c for the full year, which is in line with FY21 but well below market assumptions.

FY23 will see a volatile path for margins, the broker warns, with costs the main headwind, although the company has shown its willingness to push through price rises. Rising rates will drag on James Hardie's PE multiple, although low expectations are already factored in.

The broker nevertheless sees longer term value, and double-digit earnings growth over the next two years. Upgrade to Buy from Accumulate on share price weakness. Target rises to $53.10 from $52.70.

OZ MINERALS LIMITED ((OZL)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 1/5/0

OZ Minerals continues to pursue growth, looking to enter into a definitive option agreement with Havilah Resources ((HAV)) on its Kalkaroo copper-gold project.

Credit Suisse expects OZ Minerals will spend up to $76m on the project during the 18-month option, but as much as $346m if the project is pursued.

The broker highlights Kalkaroo presents a material increase to the already significant growth capital spend OZ Minerals is committed to over the next three years.

Pre-feasibility studies suggest the project offers 30,000 tonnes of copper and 72,000 ounces of gold annually over 13 years.

Given recent share price performance, the rating is upgraded to Neutral from Underperform and the target price of $21.00 is retained.

PREMIER INVESTMENTS LIMITED ((PMV)) Upgrade to Buy from Neutral by Citi .B/H/S: 5/1/0

Citi retains a positive view on the Retail sector despite depressed expectations due to increased fuel prices and the interest rate outlook.

The broker upgrades its rating for Premier Investments to Buy from Neutral, while the target price eases to $29.00 from $30.80. It is felt Smiggle and the fashion brands will be reopening beneficiaries, while Peter Alexander is expected to hold up well.

Downgrade

BORAL LIMITED ((BLD)) Downgrade to Underweight from Equal-weight by Morgan Stanley and Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 1/3/2

Morgan Stanley lowers its rating for Boral to Underweight from Equal-weight following another (-$45m) FY22 guidance downgrade, driven by wet weather across Eastern Australia (-$30m) and inflationary impacts.

The broker estimates the cost issues may persist for some time and a lack of price offset is disappointing. Management also flagged transformation program benefits would be lower than prior FY22 guidance by -$15-25m, though the $200m benefit target is unchanged.

The target price falls to $2.80 from $3.20. Industry view: In-Line. The analyst sees better value in the sector via Fletcher Building ((FBU)).

Credit Suisse notes the -$45m downgrade to Boral's full year earnings guidance, excluding Property, is reflective of poor pricing power in the current inflationary environment, with -$30m being attributed to Eastern states rainfall and -$15m to elevated energy costs.

Further, the broker anticipates energy costs will continue to impact in the coming financial year, estimating gross energy costs could increase a further $70m in FY23, while realised prices are unlikely to be able to fully offset.

The rating is downgraded to Underperform from Neutral and the target price decreases to $2.60 from $3.80.

NUFARM LIMITED ((NUF)) Downgrade to Hold from Add by Morgans .B/H/S: 3/4/0

Despite first half results for Nufarm coming in at the mid-point of prior guidance, Morgans lowers its rating to Hold from Add. FY23 earnings are thought likely to fall when compared to the exceptional FY22.

As the analyst's FY23 forecasts are now more reflective of normal operating conditions and price, the target price falls to $6.65 from $7.20. In-line with the company's growth strategy, solid growth is expected to resume in FY24-26.

The broker suggests there will be material share price upside if Nufarm delivers on its FY26 aspirational targets.

WESFARMERS LIMITED ((WES)) Downgrade to Sell from Neutral by Citi .B/H/S: 1/4/1

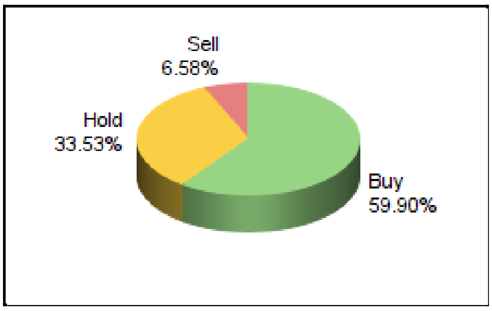
Citi has revisited Australia's retail sector to account for fuel-price and interest-rate changes and broadly expects retail to prove resilient in FY2023 before hitting more resistance in FY24, at which point in the down-cycle stock clearances and margin erosion emerge.

Citi acknowledges risks to retail from rate rises and the resumption of travel, but expects normalisation of trade will more than compensate for this.

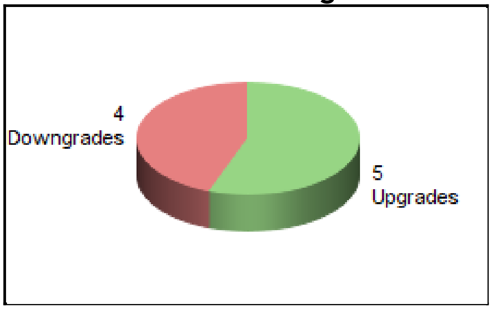
On the rate front, Citi notes 40% of mortgages are fixed, further ameliorating the impact, and notes consumers have ample room to cut savings compared with historical levels. The affect of petrol prices is difficult to ascertain at this stage, says the broker.

Wesfarmers is downgraded to Sell from Neutral. Target price falls to $42 from $50.00.

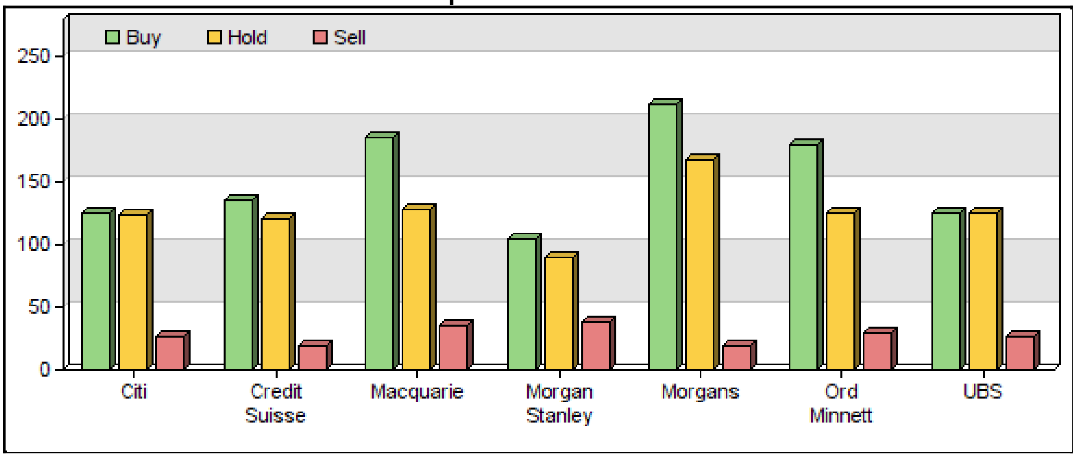
Total Recommendations



Recommendation Changes



Broker Recommendation Breakup



Broker Rating

Order	Company	New Rating	Old Rating	Broker
Upgrade				
1	ARISTOCRAT LEISURE LIMITED	Buy	Buy	Ord Minnett
2	JAMES HARDIE INDUSTRIES PLC	Buy	Neutral	Morgan Stanley
3	JAMES HARDIE INDUSTRIES PLC	Buy	Buy	Ord Minnett
4	OZ MINERALS LIMITED	Neutral	Sell	Credit Suisse
5	PREMIER INVESTMENTS LIMITED	Buy	Neutral	Citi
Downgrade				
6	BORAL LIMITED	Sell	Neutral	Credit Suisse
7	BORAL LIMITED	Sell	Neutral	Morgan Stanley
8	NUFARM LIMITED	Neutral	Buy	Morgans
9	WESFARMERS LIMITED	Sell	Neutral	Citi

Target Price

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	EDV	ENDEAVOUR GROUP LIMITED	7.542	7.278	3.63%	5
2	TPG	TPG TELECOM LIMITED	7.127	6.902	3.26%	6
3	NUF	NUFARM LIMITED	6.873	6.781	1.36%	7

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	BLD	BORAL LIMITED	3.242	3.642	-10.98%	6
2	XRO	XERO LIMITED	110.500	120.767	-8.50%	6
3	JHX	JAMES HARDIE INDUSTRIES PLC	50.717	54.442	-6.84%	6
4	ALL	ARISTOCRAT LEISURE LIMITED	43.133	46.250	-6.74%	6
5	OZL	OZ MINERALS LIMITED	25.036	25.607	-2.23%	7
6	CSR	CSR LIMITED	6.292	6.417	-1.95%	6
7	PMV	PREMIER INVESTMENTS LIMITED	30.875	31.175	-0.96%	6

Earning Forecast

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	XRO	XERO LIMITED	34.045	7.136	377.09%	6
2	WEB	WEBJET LIMITED	15.713	-12.646	224.25%	7
3	VEA	VIVA ENERGY GROUP LIMITED	26.280	18.797	39.81%	6
4	JHX	JAMES HARDIE INDUSTRIES PLC	235.025	188.940	24.39%	6
5	ALD	AMPOL LIMITED	243.400	211.800	14.92%	4
6	NUF	NUFARM LIMITED	36.136	32.204	12.21%	7
7	ALL	ARISTOCRAT LEISURE LIMITED	162.117	153.417	5.67%	6
8	ORI	ORICA LIMITED	71.321	68.140	4.67%	7
9	HVN	HARVEY NORMAN HOLDINGS LIMITED	52.976	51.096	3.68%	5
10	BSL	BLUESCOPE STEEL LIMITED	529.083	514.550	2.82%	6

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	BLD	BORAL LIMITED	5.523	8.127	-32.04%	6
2	UMG	UNITED MALT GROUP LIMITED	10.800	13.900	-22.30%	5
3	SKO	SERKO LIMITED	-26.379	-23.598	-11.78%	3
4	TPG	TPG TELECOM LIMITED	16.900	18.725	-9.75%	6
5	SIG	SIGMA HEALTHCARE LIMITED	1.990	2.165	-8.08%	4
6	VRT	VIRTUS HEALTH LIMITED	37.467	40.467	-7.41%	3
7	29M	29METALS LIMITED	10.303	10.878	-5.29%	4
8	MVF	MONASH IVF GROUP LIMITED	8.750	9.150	-4.37%	3
9	SQ2	BLOCK INC	186.039	191.789	-3.00%	4
10	SVW	SEVEN GROUP HOLDINGS LIMITED	152.625	157.150	-2.88%	4

Technical limitations

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

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WEEKLY REPORTS

Uranium Week: Taking Advantage

Largely absent from the spot market in 2022, utilities last week decided volatility had led the uranium spot price down far enough.

-Spot uranium price falls again on general market volatility
-Utilities pop their heads up
-Activity in term markets remains buoyant

By Greg Peel

Having all but abandoned a uranium spot market beholden to wider financial market volatility, utilities took advantage of yet another big swoon on markets last week, specifically on Wall Street, which had the spot uranium price tumbling once more.

One might be drawing a long bow to connect earnings results from a US grocery chain and a discount retail chain with the demand/supply fundamentals of the nuclear energy industry, but having been sucked into the black hole of financial speculation, the spot uranium market is now but another financial plaything.

Industry consultant TradeTech's weekly spot price indicator fell another -US$4.50 to US$45.50/lb last week in transactions totalling 600,000lbs U3O8 equivalent.

While the indicator remains up 46% year on year, it is down -28% since reaching a recent peak of US$63.75/lb in mid-April. While utilities have mostly avoided the volatility of the market in 2022, their need to secure uranium at this time is urgent, so there eventually had to be a spot price sufficiently attractive.

So among the usual traders and financial entities on the buy-side last week, utilities also put their hands up.

As for the financial entities of physical uranium trusts, recent volatility has seen their valuations occasionally drop below the value of the uranium they are holding.

Demand is not the issue

That said, last Friday the shares in physical trust Yellow Cake Plc jumped 5% on news the fund had taken delivery of approximately 2mlbs U3O8 in an option it exercised with Kazatomprom at US$43.25/lb.

Meanwhile, a wild spot market is having little impact on serious utility demand, which is being driven by the uncertainty created by the threat of sanctions on Russian exports, as well as the same supply constraint and cost issues being faced by all industries globally.

The term uranium market remains extremely active, TradeTech notes. Utilities are engaged in off-market discussions with both existing and potential new suppliers around commitments in the mid- to long-term delivery space. Suppliers have been successful in placing additional volume with utilities under existing and new agreements totalling over 2mlbs U3O8 equivalent.

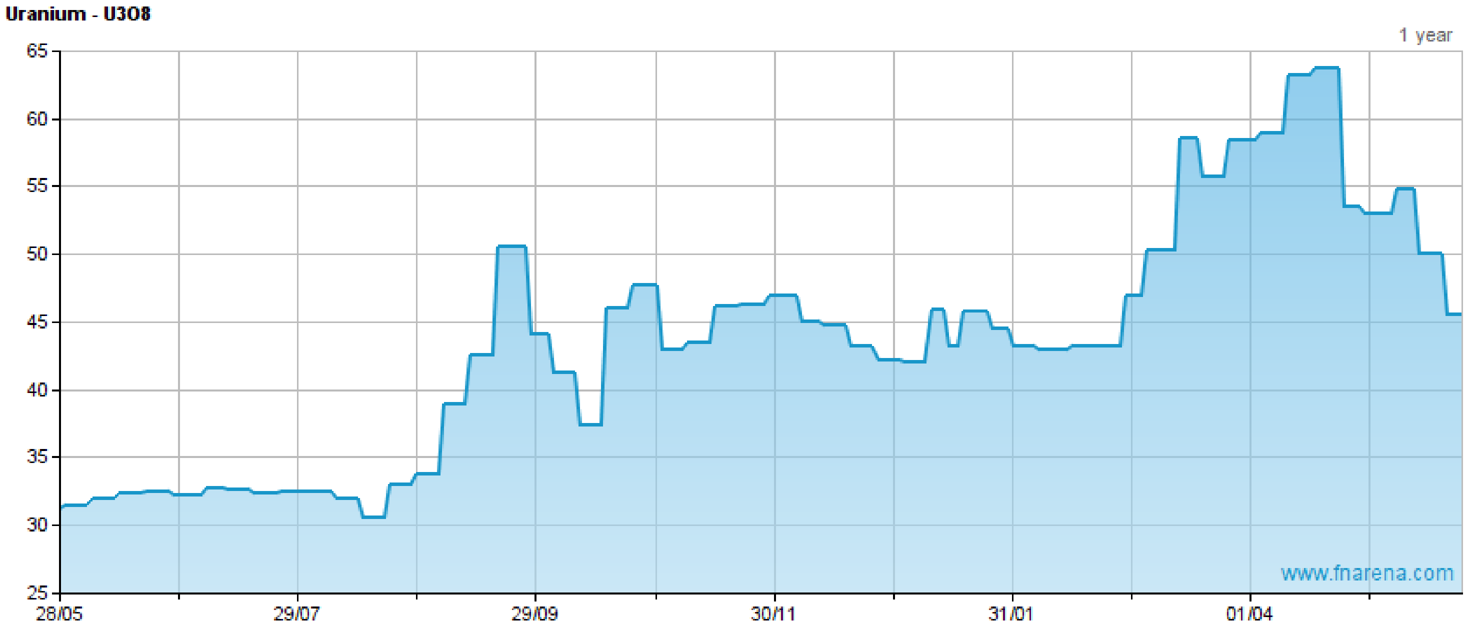
Ongoing discussions are expected to result in similar quantities being committed in the coming weeks.

TradeTech's term price indicators will be reassessed at the end of the month, but for now remain at US$61.00/lb (mid) and US$52.00/lb (long).

Uranium companies listed on the ASX:

ASX CODE	LAST PRICE	% MOVE	52WK HIGH	52WK LOW	P/E	CONSENSUS TARGET	UPSIDE/DOWNSIDE
BKY	0.3700	0.00%	$0.64	$0.00			
BMN	0.2100	0.00%	$0.44	$0.00			
BOE	2.1400	▲ 0.47%	$3.10	$0.00		$3.200	▲49.5%
ERA	0.3100	0.00%	$0.58	$0.00			
PDN	0.7600	▲ 2.70%	$1.12	$0.00	-77.5	$1.000	▲31.6%

PEN	0.1800	0.00%	$0.35	$0.00
VMY	0.1900	0.00%	$0.33	$0.00



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WEEKLY REPORTS

The Short Report - 26 May 2022

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

Summary:

By Greg Peel

Week Ending May 19, 2022.

Last week the ASX200 rallied back from a Chinese lockdown low of 6935 to 7182 by last Wednesday. Thursday brought a US Target-related plunge but since then the index is almost back to where it fell from.

Only one stock saw a change in short position of one percentage point or more. In last week's Report I highlighted shorts in Betmakers Technology ((BET)) have risen to 16.6% from 13.8%. Last week they fell to 13.4%. So there you go.

There was otherwise little more than shuffling around at the top of the table and little change towards the bottom. Small short increases brought Webjet ((WEB)) back into the 10%-plus shorted bracket and AI company Appen ((APX)) also snuck in for a bracket debut.

A small decrease saw EML Payments ((EML)) sneak out.

I highlighted in last week's Report the growing number of stocks moving into the 5% bracket. That lot continued to grow last week with the returns of City Chic Collective ((CCX)) and a2 Milk ((A2M)) after a hiatus, along with a stock called Australian Strategic Materials ((ASM)).

The company is involved in rare earths mining and sheep and cattle breeding. As you do.

The growing list of stocks shorted 5% or more reflects a lingering feeling of investor nervousness, not trusting that the rally back over 7000 is sustainable.

Weekly short positions as a percentage of market cap:

10%+

FLT 17.1
BET 13.4
NAN 12.0
PNV 11.2
WEB 10.0
APX 10.0

In: WEB, APX Out: EML

9.0-9.9

KGN, EML, AMA, RRL

In: EML Out: WEB, APX, AMA

8.0-8.9%

AMA, Z1P, ING, SQ2, MSB, PBH

In: AMA, SQ2 Out: AMA, APX, RRL

7.0-7.9%

OBL, CUV

Out: SQ2

6.0-6.9%

NEA, VUL, TYR, DUB, MP1

No changes

5.0-5.9%

PDN, MFG, RBL, NHC, ADH, BOQ, TPW, IEL, CHN, PNI, ANN, CCX, ASM, DEG, A2M, HUM,

In: CCX, ASM, A2M Out: PME

Movers & Shakers

Nothing this week.

ASX20 Short Positions (%)

Code	Last Week	Week Before	Code	Last Week	Week Before
ALL	0.1	0.0	NAB	0.6	0.9
ANZ	0.6	0.6	NCM	0.7	0.8
BHP	0.2	0.3	RIO	0.7	0.6
CBA	0.6	0.6	STO	0.2	0.2
COL	0.5	0.5	TCL	0.8	0.9
CSL	0.2	0.2	TLS	0.2	0.2
FMG	1.5	1.7	WBC	1.4	1.4
GMG	0.3	0.3	WES	0.5	0.6
JHX	0.4	0.5	WOW	0.3	0.3
MQG	0.3	0.4	WPL	2.0	1.8

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

Guide:

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

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

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

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

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WEEKLY REPORTS

In Brief: Dividends, Consumer Spending, Retail Margins

Weekly broker wrap: strong dividend recovery, spending trend shift, cautionary international retail margins.

-World-leading recovery in Australian dividends boosted by banks and mining
-Retailers report spending dip but experts warn not to buy in too early
-Read-through from US market suggests discretionary retailers could face margin declines

By Danielle Austin

Record first quarter dividends lead global recovery

In the wake of a strong first quarter, and a record twelve-month growth period, Australian dividends have largely rebounded from their notable decline during the pandemic. At the depth of the pandemic-driven decline Australian dividends fell more than twice as far as the rest of the world but have now recorded a record rebound. Australian dividends grew 38.9% in the first quarter, reaching $97.9bn in the twelve-months to the end of March and reflecting a result that is 81.7% higher than the preceding twelve-month period.

All sectors reported higher dividends year-on-year as payments continued to normalise and catch-up payments were issued following cuts made during the pandemic, but sizeable contributions from the big four banks and the mining industry, historically responsible for more than 40% and 25% of dividends respectively, drove the result. In particular, BHP Group ((BHP)) distributed $10.8bn to its shareholders in the period, accounting for almost 60% of all Australian dividends paid in the first quarter, and with further dividend payments planned the company will likely close out the year as the largest global dividend payer for the second consecutive year.

In a wider look at the global market, the Janus Henderson Global Dividend Index noted global dividends rose 11% to a first quarter record of US$302.5bn. While the current uncertain political outlook and continuing geopolitical conflicts have seen the analysts maintain their expectations for the coming quarters, on incorporating the strong first quarter result Janus Henderson lifts its global dividends forecast for 2022 to US$1.54 trillion, reflecting a headline increase of 4.6%.

Consumer spending declines, analysts warn investors of early buy-in

With cost-of-living pressures coming further into focus during the final stretch of the recent federal election, market analysts have noticed a trend-shift in consumer spending. Despite talk of inflationary pressures over recent months, retailers had largely reported persistent consumer spending prior to the last few weeks. Having spoken to retail industry insiders, analysts from Barrenjoey suggest discretionary retail has declined around -10% since March and April, and while there is a perception that consumer spending typically softens leading into an election, Barrenjoey notes this isn't always the case.

Despite the timing of the trend-shift, Barrenjoey suspects the shift is driven by lasting impacts, warning pricing pressures are likely to get worse before they get better, with further rises to interest rates, petrol prices, and food prices all expected. Notably, the slowing of consumer spending comes as many retailers report some reversion in supply constraint issues, likely implying promotional programs will normalise moving forward.

For investors, Barrenjoey suggests it remains too early to buy into the sector, with pressures not yet reflected in expectations.

Analysts look to US retail market as a predictor of domestic market movements

While the Australian retail industry was a beneficiary of the covid pandemic, with retail goods per capita spending increasing around 20% and consumers spending to levels previously forecast to be achieved in 2037, investors are now looking to the US market to provide a read-through to Australia's outlook moving forwards. Analysts from Jarden estimate the US market is roughly three months ahead of the Australian market in terms of inflation and post-covid reopening, and could provide an approximation of the next quarter in Australia.

Jarden notes retailers reported a sharp and material fall in profitability in the first quarter, and analysts remain cautious on the US retail market, highlighting the sharp change in conditions could be reflective of what's to come in Australia's third and fourth quarters. Further, the disappointing results and outlook saw share prices for retailers decline dramatically, with both Wal-Mart and Target reporting their largest daily falls in more than 20 years.

[Note: Other US retailers have subsequently posted strong rallies on result releases, following an initial sector de-rating - Ed]

Among a number of key themes impacting outlook, inventory build could place pressure on retail margins. With retailers working to build inventory in recent quarters in a bid to mitigate elevated costs of supply chain issues and constraints, an expected decline in retail demand could leave retailers with an excess of stock and slower inventory turnover, meaning retailers could look to discount stock which will impact on margins.

Morgan Stanley analysts noted Australia retains an elevated savings rate of 13.6% compared to the US's 6.7%, which the broker expects will provide a buffer to a potential spending decline, also warning that some of this buffer will likely be absorbed by the rising cost of living. Meanwhile, Jarden anticipates food retailers will be the least impacted, followed by hardware, while household goods, recreation and fashion are most at risk., and within its own coverage identifies Woolworths ((WOW)), Coles ((COL)), Treasury Wine Estates ((TWE)), Metcash ((MTS)) and Costa Group ((CGC)) as likely to retain fair margins with potential for upside risk, while JB Hi-Fi ((JBH)), Harvey Norman ((HVN)), Super Retail Group ((SUL)), Universal Store ((UNI)), Accent Group ((AX1)) and Premier Investments ((PMV)) could be at risk of margin decline based on US results.

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RUDI'S VIEWS

Rudi's View: Don't Fight The Fed

In this week's Weekly Insights:

-Don't Fight The Fed
-Beware The Bear!
-The Quote
-Conviction Calls
-Rudi Talks
-Recent Weekly Insights To (Re)Read

By Rudi Filapek-Vandyck, Editor FNArena

Don't Fight The Fed

One of the defining events for global finance in 2022 happened during the Wall Street Journal Future of Everything Festival at which Fed Chair Jerome Powell spoke on May 17 and -finally!- got the message out the world's most powerful central bank is now singularly focused on bringing inflation down towards 2% (from 8%-plus).

His admission this would not be possible without causing some pain, including the unemployment rate rising, would have rattled a few, but that was the explicit intention.

For many years investors have relied on the Federal Reserve to bail them out when markets showed their vulnerability and proved at risk of breaking down. With the 2020 experience still fresh in mind, many an investor the world around has become used to the fact that buying-the-dip is a simple but highly effective strategy.

Now the Fed is no longer aiming to prop up the economy through rising financial assets, and thus attitudes towards risk-taking and spending need to change. Across the USA, but preferably including the rest of the world too.

While inflation is stuck in between ongoing covid restrictions and supply-side disruptions and challenges, with the Russia-Ukraine war adding its own twist, the only way to tame inflation is thus by reducing demand. And in order to reduce demand, consumers need to become less comfortable with their financial situation and prospects.

Central banks have no control over global supply chains, but they wield enormous leverage over credit and financial assets. Bringing down asset values, and thus make consumers feel a lot less comfortable, seems but the most logical policy aim to pursue in 2022.

The exposure of US households to US equities has never been greater. Plus add a whole new generation of young "investors" who don't genuinely know the practical implication of 'risk' and believe, with conviction, that owning crypto-currencies and NFTs is the quickest route to becoming a billionaire before celebrating their 30th birthday.

In Australia, a similar observation can be made about a general perception that housing prices never fall, mate.

The Federal Reserve needs to change all of that in order to successfully rein in what it had mistakenly considered as a temporary, "transitory" phenomenon throughout 2021. For the record: it is still possible inflation post-2020 might prove transitory on many accounts, but central bankers can no longer afford the luxury of sticking with a wait-and-see approach.

The risk of inflation becoming embedded is simply too high and would be many times over more damaging than the pain inflicted through an aggressive path of tightening. The Fed is all too aware of this. Note, for example, how Powell himself has recently started to include references to Paul Volcker, the central banker widely credited with slaying the inflation dragon in the early 1980s.

The Volcker Fed's aggressive tightening caused two economic recessions at the time, but it did pull down high inflation to manageable levels.

The message Powell has been trying to get across is that today's Federal Reserve is just as determined to put inflation back in its bottle. However, after more than a decade of explicit central bank support for financial assets in order to stave off structural deflation, most investors still have failed to comprehend the deeper meaning of the change in central bank messaging.

We know what to do, and we know how to do it, Powell declared at the WSJ Festival, adding there should be no doubt, the Fed *will* do what is necessary. "*What we need to see is inflation coming down in a clear and convincing way, and we're going to keep pushing until we see that*"- those were his exact words.

Judging from price action since, it appears markets have finally understood the old saying of 'Don't Fight The Fed' now has a different meaning. The Fed wants less risk-taking, less confidence and less spending. Jobs will be lost. Asset prices will come down. But it's the pain that needs to happen, because inflation is a much, much bigger threat to everybody's wealth and future prospects.

Of course, it goes without saying, the Fed does have an ideal scenario in mind: "*What we need is to see really growth moving down from the very high levels that we saw last year, moving down to a level that's still positive, but that will give the supply side a chance to catch up, and a chance for inflation to come down as we get supply and demand back together*."

This sounds great, except for the fact that Powell also acknowledged the Fed does not control everything that impacts on the economy. "*There are many global events going on... that are really not under our control as well*."

But, and this was clearly the message Powell was pushing across, it won't deter this Federal Reserve from executing on what, simply put, needs to be done:

"*We know how people are suffering from high inflation. And we have both the tools and the resolve to get inflation back down. And no one should doubt our resolve in doing that*."

Conclusion: Don't Fight The Fed in 2022 means:

-bond yields need to be higher, demand for credit needs to be tempered
-asset prices, including equities & real estate, need to be lower
-demand for products and services needs to be lower, which implies economic growth needs to be tempered

Fighting inflation is now the main goal - everything else is of secondary importance, at best.

"*What we need to see is clear and convincing evidence that inflation pressures are abating and inflation is coming down. And if we don't see that, then we'll have to consider moving more aggressively.*"

Let's all hope inflation is, indeed, transitory, and highly susceptible to slowing growth and rising interest rates. The alternative might prove devastating in a way only few among us are willing to contemplate.

P.S. Bond yields may not have much further to rise from here, but the focus already is shifting to economic growth and corporate margins and profitability. Key question: how low?

Beware The Bear!

Stocks go up, stocks go down. And whoever observes share markets on a daily basis fully well knows there are all kinds of variations in between.

One thing remains, however, and that is that writings about the share market read differently when placed in a different context.

The story below (see link) was written two months ago. It's not an attempt to predict what happens tomorrow or next week.

It's pointing to a broader picture framework that I believe remains as important as it was earlier in the year, irrespective of what happens in the short term.

Rudi's View: Double Your Protection, (re)read the story here:
https://www.fnarena.com/index.php/2022/03/17/rudis-view-double-your-protection/

The Quote

Economists at CIBC perfectly summarised this year's set-up for financial markets:

"*The biggest threat to the overall stock market at this point is that growth and inflation won't show a sufficient response to the early rounds of interest rate hikes.*

That would not only see the Fed ramp up its monetary tightening, but as history shows, add to the risks that the central bank will push the economy into recession as it seeks that easing in price pressures."

Conviction Calls

From the latest update by the **Wealth Management team at Morgan Stanley**:

"*We continue to recommend a neutral allocation to equities with a preference for defensive exposures (i.e. Healthcare, Infrastructure, Minimum Volatility) combined with inflation hedges (i.e. Materials, Energy) alongside exposure to higher yields (i.e. Value).*

"Within equities, Australia remains preferred in the current environment given the recent de-rating, defensive quality attributes and higher relative yield."

****

Wilsons latest thoughts on Australian and global equities:

"*Australia is a lot further away from a bear market correction and should continue to demonstrate some relative resilience, but a US recession or a soft landing will likely determine how Australia performs over the coming year, even if the local economy itself avoids recession.*

We remain tactically cautious but have not moved to an outright bearish stance on risk assets. Our base case is for improved performance over the coming year as inflation cools and the US and local economies slow but continue to expand."

****

Economists at **Citi**:

"*Hard landings are the historical norm when the Fed seeks to damp strong demand and bring down inflation.*

"The tailwinds from nominal income growth and demand momentum we think make a 2022 recession unlikely, but the probability rises rapidly in 2023 and beyond as Fed officials seek to cool down an overheating economy by tightening financial conditions through lower equity prices and higher real interest rates."

****

The team of software afficionados at **Shaw and Partners** is reporting general interest in the beaten-down sector in Australia is picking up, as judged from clientele at the broker calling up and asking questions once again.

The team's Top Picks for the sector in Australia are Whispir ((WSP)), Gentrack Group ((GTK)), Keypath Education International ((KED)), Elmo Software ((ELO)) and ReadyTech Holdings ((RDY)).

****

Damien Boey, chief equity strategist at **Barrenjoey**:

"*US housing demand continues to weaken on the back of higher rates and deteriorating affordability. Demand weakness is starting to weigh on supply as well. We are wary of earnings risks to US homebuilders but we also worry about broader negative implications for global cyclicals and banks*."

****

Guardians of **Model Portfolios at stockbroker Morgans** have decided the Core Model Portfolio sells out of APA Group ((APA)) due to overvaluation and add some more exposure to Transurban ((TCL)) instead.

The Growth Model Portfolio made no changes by late April, though the broker reports several candidates popped up for discussion, including Tabcorp Holdings ((TAH)), Aristocrat Leisure ((ALL)), Corporate Travel Management ((CTD)), Reliance Worldwide ((RWC)), and Megaport ((MP1)).

****

Shaw and Partners has tried to identify the next possible M&A targets, with the selection limited to stocks under the broker's coverage.

Shaw's top 5 candidates to attract a suitor are Aussie Broadband ((ABB)), Atomos ((AMS)), Capitol Health ((CAJ)), Family Zone ((FZO)), and Monash IVF ((MVF)).

But wait, others are also likely to become a corporate target: Apiam Animal Health ((APM)), Damstra Holdings ((DTC)), Global Data Centre Group ((GDC)), Healthia ((HLA)), Money3 Corp ((MNY)), Probiotec ((PBP)), Plenti Group ((PLT)), Smartpay Holdings ((SMP)), and Zip Co ((Z1P)).

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Market strategists at **Macquarie**:

"*We think high market valuation levels limit upside risk for equities, especially given central bank hikes will pressure growth and valuations."*

"Valuations alone don't drive equity markets, but when valuations are high, central banks are tightening and the cycle is slowing, it's hard to have a bullish view on equities. We continue to favour Australia over the US

given high commodity prices and the expectation that China stimulus should provide relative support for Australia's economy. The ASX also has higher exposure to groups that benefit from higher inflation and rates."

"The strategy portfolio remains overweight Resources and defensives."

Rudi Talks

This week I am presenting to members of the Australian Shareholders Association (ASA) in Busselton, WA.

The event will be recorded and made available in the days following. Next week's Weekly Insights should have a link included.

Recent Weekly Insights To (Re)Read:

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

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

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

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

(This story was written on Monday 23rd May, 2022. It was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website).

(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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