WEEK 30

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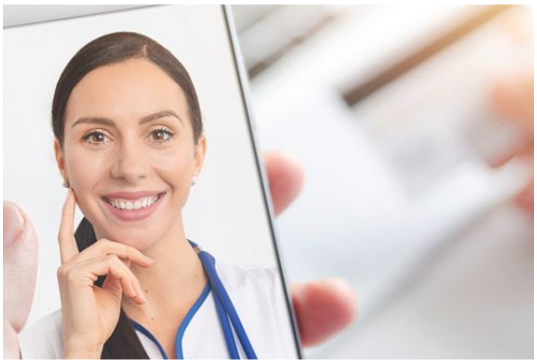

The Future Of Healthcare Has Already Arrived

ESG Focus: The Megatrend Is Your Best Friend

Rudi's View: Forecasts, Not Valuations

CONTENTS

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AUSTRALIA

The Future Of Healthcare Has Already Arrived

Covid-19 and lockdowns have accelerated the success of telehealth services with Australian companies among key beneficiaries

-Global pandemic has accelerated adoption of telehealth services
-ASX-listed healthcare companies among beneficiaries
-More telehealth small caps to IPO next six months

By Anastasia Santoreneos & Mark Woodruff

The covid-19 pandemic has wreaked havoc on the Australian share market, but one sector that's skated around the major economic downturn is the health sector, thanks to the quick-thinking of medical tech companies.

The government's swift action on social distancing measures meant regulatory changes came in thick and fast for companies like Cochlear ((COH)) and ResMed ((RMD)), as they could develop remote patient monitoring tools for medical professionals to continue their work without needing to physically be with the patient.

The adoption of these services was phenomenal.

As a direct result of Covid-19, the utilisation of telehealth, that is remote GP consultations, now accounts for 35% of government benefits paid for GP attendances, according to a report by Morgan Stanley.

We're not in new territory

The shift towards remote patient monitoring isn't new. In fact, the trend has been continuing for some time, with Cochlear and ResMed already invested in the technology to facilitate this trend.

For example, ResMed had been involved in remote patient monitoring for around 14 years, according to Melior Investments senior analyst Julia Bailey.

"Within their sleep apnea devices, they've been recording patient data and relaying that back to doctors for a long time," Bailey said.

"They now have over 11 million cloud connected devices out in the world, and they've made a number of acquisitions of smaller companies in that space like Propeller Health."

Smaller players have also been in the game for many years: Pro Medicus ((PME)) was one of the first remote medical imaging software providers, which allowed radiologists to access images through their devices, Jun Bei Liu, portfolio manager at Tribeca Investment notes.

"It's lowered costs, improved efficiency and allows more people to look at the images, increasing accuracy too," Liu said.

Bailey said there have been three key drivers behind the remote patient monitoring trend: an ageing population, higher healthcare costs, and consumers seeking more control of their health.

"You've got governments and you've got insurance companies around the world looking to contain healthcare costs," Bailey said.

"And they are looking at value based models. And for a value based model, you need data. So there's pressure on all providers, whether that's doctors or pharmaceutical companies, or medical device companies sort of provide data on the cost effectiveness, and the value of the treatments and the products that they're providing."

That's not to say other remote patient monitoring services, in particular telehealth, didn't gain a significant amount of traction because of the pandemic, however.

"This trend has reached a critical inflection point during this pandemic," Liu said.

It's an inflection point Liu believes we would have reached in the next two or three years regardless, but the pandemic was a major catalyst for driving that change forward.

"Patients needed convenience - they couldn't go to a physical location," Liu said.

The virus also forced the government to fast-track approvals and provide funding for remote patient monitoring tools, meaning companies had the support and the means to get new products moving, contributing to the surge in the trend.

Now, Morgan Stanley estimates Australians are saving up to $1.9bn in lost work time by removing the need to travel to their GP.

"It's saving the operators as well - it's reduced the costliness of inefficiency in the supply chain," Liu said.

<u>An opportunity like no other</u>

While the health sector more broadly remained relatively unscathed throughout the pandemic, companies were impacted to some extent, Liu said.

"Obviously private hospitals were impacted because you couldn't have elective surgeries, and companies like Sonic Healthcare ((SHL)) had a bit of an issue as they couldn't do normal testing."

But a V-shaped recovery is in sight.

"Many other sectors will need to rely upon consumer demand, but the healthcare sector is one where the demand is not going to go away - it's inelastic," Liu said.

"People will still go to the hospital to get their knee replaced, and the backlog for a lot of those services is actually increasing.

"If anything but health care operators will do quite well in the next six months."

And both investment experts believe there's a large and "exciting" opportunity for investors interested in the space, and companies seeking to capitalise on the change.

Bailey noted the coronavirus "heightened" awareness of health across the board, particularly respiratory and lung health, meaning both ResMed and Cochlear have a bright future as a result of their remote sensing technology.

CSL ((CSL)) is also poised for success, Bailey said.

"We see an opportunity within their flu vaccine business because obviously, particularly for the northern hemisphere countries, there's an overlap of Covid-19 and flu season".

“So that is a huge concern, and there's a big opportunity for the flu vaccine manufacturers.”

While Cochlear and ResMed are two big players staying at the forefront of new healthcare changes, smaller tech players that specialise in particular areas are also poised to enter the arena as listed companies.

Med Advisor ((MDR)), a smaller medical tech company, has created an app which, once downloaded, would send automatic reminders to users to order their medicine, making it convenient for both the individual and the pharmacy.

“And there’s a couple more coming through IPOs in the next six month in that telehealth space” Liu said

“You have this refresh of investment opportunities that are coming through, with enormous growth trajectories ahead of them.”

Digital health solutions

As a result of covid-19, Morgan Stanley has identified a significant shift in patient preferences towards digital health solutions. This trend was clear pre-pandemic and has been accelerated by what was initially thought to be temporary regulatory changes.

The new Australian telehealth codes for GP attendances were intended to expire on September 30 this year. Morgan Stanley forecasts that if extended to late March next year, telehealth could account for $2.8bn of the yearly total addressable market of $6.5bn. This would increase “visits” to 43% from April 2020 levels of around 35%.

At first glance, the pie for GP visits has merely been divided between telehealth and traditional visits. The good news hides inside the many hidden benefits.

According to Morgan Stanley's forecasts, patients win to the tune of $1.9bn Australia-wide, due to a mixture of reduced travel costs and the opportunity gain of staying productive at work.

Medical centres may also derive significant cost savings by reducing office space and reducing usage of consumables.

Finally, new capacity from time savings may help rectify a projected shortfall in GP numbers.

Cochlear & ResMed, key beneficiaries

In response to the pandemic, the US FDA awarded Cochlear approval for the company’s “Remote Check” solution.

Similarly, the US Center for Medicare & Medicaid Services introduced reimbursement changes to spur remote patient monitoring (RPM), from which ResMed’s Propeller is likely to benefit.

Cochlear:

Formerly, the ability to on-board new patients was constrained by the ongoing demands of existing patients upon cochlear audiologists. This caused bottlenecks at cochlear clinics.

Remote Check will enable patients to complete hearing tests and prevent unnecessary clinic visits.

A synergistic combination with Cochlear Sycle software could increase capacity for Cochlear markedly, and accelerate new patient growth along with market share gains.

ResMed:

Propeller is a digital health platform for the management of Chronic Obstructive Pulmonary Disease (COPD) and asthma.

An inhaler sensor tracks medication usage via a smartphone app. This leads to a better understanding of the disease and increasing adherence to medication regimes.

ResMed has already demonstrated expertise in patient connectivity. This combined with current relationships and pharmacy agreements may see Propeller access around 50% of the greater than ten million COPD users of inhaled medicine.

Additionally, Morgan Stanley foresees many of these users progressing to use the company’s product in the portable oxygen concentrator (POC) market.

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Already we have seen a rapid uptake of telemedicine for GP attendance in Australia. This trend is set to continue should current temporary regulations be extended.

However, the real benefit is largely unseen and extends to patients, medical centres and GP availability going forward.

At the company level, both Cochlear and ResMed look well placed with products likely to benefit from remote patient monitoring.

AUSTRALIA

Mixed Outlook For Housing Related Sectors

Brokers have analysed the current state of play for Australian housing and how they see the rest of the year play out, including the impact on the building materials sector and housing-related retail

-Data suggest a soft outlook for residential
-Varying exposures among building material companies
-Housing outlook impacts on related retail chains

By Greg Peel

Morgan Stanley has constructed a proprietary housing indicator, called MSHAUS, which is designed to lead house price and building approvals by three quarters. The most recent model update suggests conditions in housing will remain soft for the rest of 2020, although at this stage they are not expected to worsen significantly.

Morgan Stanley has also conducted a survey of construction industry professionals to gauge just what impact the virus is having.

Two-thirds of respondents noted at least a -20% reduction in activity had occurred to date, with around half noting that leads had more than halved. As result they expect to reduce headcount, meaning lay off workers, over the next 6-12 months.

In the residential space, 65% of respondents indicated that access to finance had deteriorated, 80% expected companies in the industry to face financial difficulty, and 44% expected closures.

Morgan Stanley thus expects construction approvals and activity to soften over the coming months, partially offset by government stimulus measures. Broader policies (JobKeeper/Seeker and loans to businesses) will taper from September, but given the government's initial Homebuilder stimulus package was fairly modest, the broker is watchful of further housing-specific stimulus, particularly if soft conditions continue to the end of the year.

The RBA has provided support through rate cuts, and banks through the extension of mortgage repayment holidays, but a collapse in migration has diminished demand, as has resultant weakness in rents.

Given residential construction has the shortest pipeline, and concerns around financing, Morgan Stanley sees resi-construction as most exposed to a late 2020 "cliff".

JPMorgan notes the collapse in migration has most impacted on apartment demand, but discussions with residential lot developers and homebuilders suggest enquiries and sales have picked up nicely over the past month. The broker is forecasting only a -5% decline in single-family (house) commencements this year.

Noting that Australia's major building materials companies also have offshore exposure, JPMorgan points out the US housing market performance has been better than previously feared, but the outlook for construction in New Zealand remains weak.

Valuation

Taking a top-down, macro approach, Morgan Stanley favours infrastructure exposure and now seeks to avoid domestic residential exposure. Of the broker's building material stocks under coverage, CSR ((CSR)) has the greatest exposure to residential.

Morgan Stanley thus downgrades CSR to Underweight. In the sector, James Hardie Industries ((JHX)) and Adbri ((ABC)) remain the broker's preferred picks.

JPMorgan is also a fan of James Hardie, which it describes as the highest quality company in the sector, with a proven business model and strong recent execution. JPMorgan takes a different stance on CSR.

Taking a bottom-up, micro approach, JPMorgan believes the PE gap between CSR and peer Boral ((BLD)) is too wide, and to that end upgrades CSR to Overweight and downgrades Boral to Underweight. The broker also has an Overweight on James Hardie but warns the stock is now close to fair value.

On that basis, CSR and plumbing supplier Reliance Worldwide ((RWC)) are considered better value than James Hardie. JPMorgan remains Neutral on Adbri, Fletcher Building ((FBU)) and plumbing supplier Reece ((REH)).

Retail Flow-On

Citi believes housing-related discretionary retailers are the top pick at this time, and in small-caps prefers Beacon Lighting ((BLX)) and furniture chain Nick Scali ((NCK)).

While both companies have already pre-reported FY20 earnings, both are cycling relatively undemanding comparable earnings results from the first half last year and should outperform the broader sector, Citi suggests.

The broker's view, which is supported by recent evidence, is that many of these companies' customers are in the middle to upper income bracket and are less likely to see their incomes reduced, or lost, than younger consumers most employed in riskier retail, leisure and travel industries. Customers are also being supported by the federal HomeBuilder package and other state assistance programs.

Beacon and Nick Scali sell products that are not reliant on consumers "going out". While the virus lockdowns resulted in a surge in demand for home office upgrades, thus supporting electronics retailers, analysts in general have been surprised in the extent of home renovation and redecoration undertaken by consumers obviously sick of their old environments, and looking for something to do.

Citi currently has Buy ratings on eight stocks in the discretionary retail sector, being, in order of preference, Beacon Lighting, Nick Scali, Baby Bunting ((BBN)), Super Retail ((SUL)), Harvey Norman ((HVN)), Michael Hill International ((MHJ)), Premier Investments ((PMV)) and Myer ((MYR)), the latter coming with a High Risk qualification.

Citi has Neutral ratings on Accent Group ((AX1)) and City Chic Collective ((CCX)) and a Sell rating on Lovisa Holdings ((LOV)).

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AUSTRALIA

Coca-Cola Amatil: Things Going Better

Coca-Cola Amatil's sales trend improved in the month of June, but the future remains uncertain

-Better than expected sales improvement
-Indonesian assets written down
-Outlook for Coca-Cola Amatil remains virus dependent

By Greg Peel

Brokers were surprised by the news in Coca-Cola Amatil's ((CCL)) June quarter update that the month of June saw a vast improvement on the earlier months in the quarter. Group volumes fell -9% in June (year on year) compared to -26% in May – a better result than analysts had expected.

Australian sales fell -4% compared to -20% in May. New Zealand – where they know how to handle a virus – saw sales increase by 4% compared to a -10% May fall. In Indonesia – where they simply can't control a virus – sales fell -23% compared to -40%.

The company has announced an impairment on Indonesian assets will be taken in the interim accounts to the tune of -$160-190m. There was no reason given, but we might be able to draw our own conclusions.

The better than expected June sales numbers clearly reflect the reopening of Australia and New Zealand. While sales of fizzy drinks and other beverage offerings at supermarkets remained strong during the lockdowns, "on-the-go" sales, from anywhere there's a vending machine, such as servo, or post-mix, such as a bar, obviously collapsed in April-May.

The bad news is one does not offset the other in earnings terms, given "on-the-go" is high margin and supermarket sales low margin, particularly for multiple can/bottle "value packs". Further bad news is that in the star geography of New Zealand, that margin spread is lower.

Analysts call this "channel mix".

The major bad news is, of course, that unlike New Zealand, parts of Australia are now back in lockdown, other parts have been told to pretend they're in lockdown, and the risk of other states, meaning NSW, going back into lockdown increases every day.

The good news is the company has announced significant cost-cutting worth -$140m, and a reduction in planned capex spend to $200m from $300m.

The share price jumped over 5% yesterday on the release of the numbers, but brokers consider the risks ahead fully priced in. Six of seven FNArena database brokers covering the stock have Hold or equivalent ratings, albeit Morgans is yet to update on the news.

The dissenter is Citi, which retains a Buy rating and applauds the company for acting decisively in cutting costs before a lower demand backdrop. That said, most effusive about the news is Credit Suisse:

"CCL's trading update highlights positively that the world loves Coke and consumers are likely to resume consuming CCL products."

Longer Term

Maybe so, but long before the virus appeared analysts were highlighting a less than subtle change in consumer behaviour – one of shunning fizzy drinks and caffeine and shifting to more healthy alternatives.

That said, Amatil does sell "healthy" alternative such as milk (flavoured), juice (high in sugar), mineral water, water (allegedly more water is consumed to produce a bottle of water than is in the bottle), tea, coffee (caffeine) and alcohol in many forms.

UBS, while acknowledging Coca-Cola Amatil is a "strong company", with a clear strategy of expanding its coffee, alcohol and "healthier" alternative offerings and penetrating more developing nations, like Indonesia, reminds that a consumer focus on healthier beverage alternatives remains a headwind.

And as a result of the virus, more at-home eating and a decline in total restaurant numbers also provide structural challenges.

The FNArena database carries six Hold or equivalent ratings and one Buy as noted. The consensus target is $9.25, suggesting 4.3% upside from the last traded price. The stock hit a high of $14.58 in 2013 and $12.88 in February this year.

Consensus has a dividend yield of 2.8% in 2020, reflecting cash conservation at this time, and 4.5% in 2021, but clearly that is more of a guess than a forecast.

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COMMODITIES

Material Matters: Gold & Mining Disruptions

A look at the relationship between the price and supply of gold; resurging covid-19 cases pose a risk to global mining; post-lockdown recovery leading to rising freight rates

-Is the gold price driven by supply?
-Mining disruptions continue in Latin America
-Rising shipping rates for bulk commodities

By Angelique Thakur

Establishing causality between the gold price and gold flows

Longview Economics highlights how rising uncertainty across the world, led by rising geopolitical tensions and the pandemic, along with **gold prices** reaching all-time highs has given birth to many conspiracy theories suggesting the upside to gold prices remains significant.

While the theories are abundant, ranging from the collapse of the US dollar to a spending spree by China for gold mines, a common thread linking all these theories is they assume the flow (or the demand-supply dynamics) of gold affects the price of the yellow metal.

Longview Economics believes it is actually the other way round: the price of gold determines demand-supply dynamics. The analysts substantiate their claims by highlighting that three out of the four key factors impacting global gold supply are driven by the gold price.

Out of the four factors – demand by central banks around the world, real US treasury bond yields, Fed rate expectations and the US dollar - Longview Economics notes the last three are driven by the gold price itself while the first, though independent of the price, forms just a small component of the total flows.

The conclusion is most of the major gold flows are ineffective in determining gold price trends.

As an example, Longview Economics cites global gold supply over the past decade has shown a strong correlation to the gold price, with higher prices leading to a corresponding growth in supply.

Another example is the way higher gold prices typically lead to a reduction in jewellery purchase volumes on the one hand, while an increase in investment demand (demand for gold ETFs, investments products, coins and bars) on the other.

Longview Economics cites that in the last five years, investment demand for gold has increased by 370t per quarter while jewellery demand has fallen by -240t per quarter (due to rising gold prices).

Coming back to the first factor, central bank demand is the only component of the supply and demand balance that does not correspond to the gold price since it is mostly a political/economic decision, suggests Longview.

One of the conspiracy theories arguing an upside to the gold prices talks about the hoarding of gold by central banks across the world. However, Longview Economics reveals central bank purchases form only 10-15% of the total global demand for gold. Also, and most importantly, central bank purchases have actually slowed down this year with four of the largest buyers over the last ten years deciding to halt purchases over the past 12 months.

Other theories like central banks hoarding gold to prepare for de-dollarisation and a new international monetary system have similarly been debunked as central banks have made it clear these reasons figure at the bottom of their list of reasons to purchase gold.

<u>Second wave and demand-supply dynamics</u>

Resurging covid-19 cases in many parts of the world including the Latin American region has JP Morgan worried about the supply-side risks for iron ore and copper, with prices for iron ore already trading 60% above its long term price forecast.

For steel, JP Morgan believes April was the trough month with May showing strong Chinese demand and a recovery in rest of world steel output. On the supply side, JP Morgan notes supply in Brazil is recovering although productivity is still low. The broker thinks Vale needs to increase export rates to meet guidance.

Even with less than expected supply disruptions to copper, the current price of the bellwether of the global economy is nearing JP Morgan's long-term price forecast of US$3/lb and is already above pre-covid-19 levels. The broker attributes this to the market already pricing in future supply disruptions.

The broker expects more interruptions at Chilean copper mines but is also worried about the impact to demand. In the medium term, JP Morgan expects delays in greenfield projects as well as in the expansion of brownfield projects.

There have been minimal supply disruptions to aluminium from the pandemic but research firm Wood Mackenzie expects global demand to fall -6% with production increasing 1%, causing stocks to build up to 6mt by 2022.

JP Morgan notes while prices for alumina and aluminium have bounced since May, supply-demand dynamics remain weak.

Nickel, up about 20% since April 1, remains a story of potential oversupply, with JP Morgan forecasting 700ktpa of nickel pig iron to come from Indonesia by 2022 from 400kt last year.

With the exception of iron ore and copper, most other commodities remain oversupplied because of a simultaneous loss in demand, notes JP Morgan.

<u>Rising freight rates</u>

Macquarie reports shipping bulk commodities like iron ore and coal has become more expensive. The Bulk Dry Index which covers about 20 major shipping routes has seen a spectacular recovery in the last 8 weeks, rising by 400% to almost 2,000 on July 6th.

These spikes are driven by a post-lockdown recovery and rising demand from China for imported iron ore. Some other factors responsible are restricted vessel throughput with Australia insisting on incoming vessels quarantining for 14-days, and poor weather in China.

The broker notes factors supporting dry bulk shipping rates include the weather (summer) in Asia, stimulus measures by major economies leading to stabilising economic activity and crude oil prices actively managed by OPEC/Russia.

The bearish risks involve a second wave across many parts of the world and trade conflicts erupting between China and countries like the US and Australia.

Macquarie is of the view that the rally is yet another China-led story but thinks with the lockdowns in Asia easing and freight activity also expected to become subdued during the northern summer, rates will stabilise soon.

ESG FOCUS

ESG focus: Australia Gets Serious About Recycling

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:
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The Federal government has launched a $190m recycling modernisation fund, aimed at kickstarting Australia's circular economy. But there's a long road to hoe and $1bn to flow.

ESG focus: Australia Gets Serious About Recycling

-Big infrastructure spend for vertically integrated, scale recyclers
-Commitments to governing funds flows welcomed
-Relationship between waste management sector and ESG investors might improve

By Sarah Mills

The Federal Government took the first major step in July towards establishing a national circular economy, launching the $190m Recycling Modernisation Fund (RMF) at Cleanaway Waste Management's ((CWY)) Eastern Creek Container Sorting Facility.

The RMF is expected to drive $600m of recycling investment, create more than 10,000 jobs and divert more than 10m tonnes of waste from landfill.

Plastic recycling represents the low-hanging fruit, given the urgency of the situation and the positioning of companies in this space over the past 18 months.

The RMF funds are being ear-marked for national and vertically integrated scale operators, dealing mostly with municipal and commercial and industrial waste streams.

No big surprise but greater surety

The government had been expected to announce a national recycling package as part of its National Waste Policy Action Plan in the May Budget.

The budget was postponed to October as a result of covid-19, and the government brought the RMF announcement forward to ensure recycling initiatives would not be further delayed.

The $190m figure is a kick-starter and the government is expected to divert more funds to the sector over the next three years, with $1bn earmarked for the industry.

The funding will be contingent on co-funding from industry, states and territories, so expect a slew of deals over the next 12 months.

Infrastructure, infrastructure, and more infrastructure

The RMF will invest in new infrastructure to sort, process and remanufacture materials such as mixed plastic, paper, tyres and glass, with commonwealth funding contingent on co-funding from industry states and territories.

Cleanaway's CEO and Managing Director Vik Bansal said the fund would provide a boost to Australia's resource recovery infrastructure.

"*This injection gives the waste management industry confidence when investing in infrastructure and innovation. With this fund, governments at all levels, together with industry can invest in building a domestic circular economy.*"

Cleanaway, Licella, and several other companies have already embarked on plastic recycling projects, as outlined in our previous articles on plastic recycling.
[https://www.fnarena.com/index.php/financial-news/daily-financial-news/category/esg-focus/]

Cleanaway, Pact Group ((PGH)) and Coca-Cola Amatil ((CCL)) all gained a special mention at the launch.

Proof of the the pudding

The announcement is an example of the ways ESG investing is playing out in the waste management sector. Those companies with clear strategies around recycling, and plastic recycling in particular; and industry collaborations, are being favoured by the market.

Cleanaway, which has been positioning itself in the plastic sector for some time now, has recovered most of its pre-crash ground and held support after the announcement.

Bingo Industries ((BIN)) in contrast, has fallen, and remains near covid-19-crash lows and undervalued, according to Morningstar, reflecting a lack of clarity, announcements and specifics around the company's five-year recycling strategy.

Bingo too stands to benefit from the RMF but needs to deliver a strong value-proposition in the recycling space, and provide evidence of progress on this front, particularly of industry and government collaborations.

Strong execution on these fronts could change the company's fortunes but for now, it is likely to be relying on sector tailwinds.

Sims Limited ((SGM)), with a waste-metals focus, also stands to benefit from the RMF, particularly if it can leverage its e-waste recycling expertise. Its share price has recovered half its pre-crash ground and held following the announcement.

Extra commitments to govern funds flows - an ESG tick

The government also committed $35m to implement Australia's National Waste Policy Action Plan to 2030, which has been agreed by the respective State Environment Ministers.

Another $24m was allocated to improve national waste data to assist in measuring recycling outcomes and track progress, which will increase transparency for investors, and should pressure all industry players to lift their game.

The waste industry is notoriously shonky, as became apparent after SKM Recycling was placed into liquidation, representing ESG risk for investors, so this step is likely to be welcomed by the ESG institutional fraternity.

The Government is also introducing legislation to enact the waste export ban and encourage companies to take greater ownership of their waste.

This means the country must recycle 650,000 additional tonnes of waste plastic, paper, glass and tyres in Australia each year once the full ban comes into effect by 2024.

Long road to hoe

As discussed in previous articles, there is a long road to hoe because the economics of recycling are poor in Australia given the country lacks basic manufacturing infrastructure, let alone recycling infrastructure.

Lack of local, state and federal government harmonisation on waste streams adds to waste recycling costs; and kerb recycling practices lag world best practice by decades.

To gain economic scale, these problems need to be addressed as a matter of urgency or the road to sector profitability will be a slow one.

As mentioned above, plastic recycling initiatives are relatively well-advanced given steps by the plastics industry, including consumer goods companies, plastics and packagers, and recyclers to collaborate on the problem, and is likely to be first cab off the rank.

The government is likely to adopt a user-pays model, which could mean higher council rates. State governments have also been increasing landfill levies over the past two years.

The market is expecting more government announces at the October budget.

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This is the first article in a series covering the ESG and ESG-related megatrends that are framing investment flows in the 21st century. It sets the scene and the major parameters and metrics guiding investment flows for the near, medium and long term

ESG Focus: The Megatrend Is Your Best Friend

-Megatrends are transforming institutional investment approaches
-Creative-destruction concepts spawn ESG megatrends
-Naming the megatrends, sustainable themes and metrics

By Sarah Mills

The old saying "the trend is your friend" has proved the investor's rallying cry through the ages, and this remains the case with ESG.

Megatrends have always set the stage for investment, be they population demographics, technological revolutions, or government driven regulation.

ESG has, in a very short period of time, emerged as a new global megatrend, muscling out its own space, sometimes in competition with other megatrends.

This is demonstrative of the power of vast swathes of capital at play. More than US$3trn in funds are being funnelled globally through direct ESG filters every year, and growing.

The most recent *US SIF* (Sustainable Investment Framework) *Trends Report* notes that funds channelled into general sustainable investment strategies is even larger, hitting US$12trn in the United States alone – or 25% of professional assets under management – as investors seek superior risk-adjusted returns or greater protection in uncertain times.

It's the vibe

This megatrend has proved something of a quandary for many analytical investors given the lack of transparency and often anti-intuitive nature of ESG scoring through these filters.

ESG is also elbowing its way into the traditional megatrend territory and skewing long-standing investment practices, adding to confusion.

But it is a good match for trend investors.

The Economist posts this cracker of a quote on the subject of the scoring factors that claim to assess corporate performance based on ESG factors from United States Securities Exchange Commissioner, Hester Peirce:

"*Labelling based on incomplete information, public shaming, and shunning wrapped in moral rhetoric*".

This is a fair comment. Investors are being asked to put their capital in the hands of those with sophisticated, opaque scoring systems, the only people it seems, with the wherewithal to process the vast amounts of information required to assess the rate of global corporate progress towards the 17 United Nations sustainable development goals (SDGs)

This is a development, a bit like high frequency trading, which has the power to disadvantage smaller individual investors – at least until technology becomes cheap enough to increase accessibility.

But small investors can still jump on the ESG bandwagon and prosper. Because ESG is a major trend that is continuing to build momentum, for the next few years at least, investors reweighting their portfolios intuitively to major ESG themes, using core sustainability metrics, are likely to be swept along with the tide.

This series of articles aims to simplify some of the guiding principles and unravel some of the mystery to at least lay down some broad themes for the avid trend investor.

What is a megatrend

The United Nations Principles for Responsible Investment (PRI) lists five megatrends: environmental challenges; society and demographics; globalisation and connectivity; emerging economy growth and dynamism; and technological advances.

PRI defines megatrends as global macro forces that transform business, marketplaces and society. They affect the financial system, capital allocation and environmental and social conditions, including the ability to deliver the United Nations Sustainable Development Goals (SDGs).

“Megatrends are omnipresent but growing in importance,” says PRI in *its Responding to Megatrends* report. “Increasingly, it is apparent that these should form part of all institutions, investment processes.

“Most institutions share a common belief that megatrend dynamics will result in multidimensional transformations across society, technology, economics, environment and politics (STEEP) ... to be framed within the context of an integrated system of real-world powerful forces altering the structure of economies, industries and global capital markets.”

PRI ranks the megatrends in order of impact and difficulty of management. Technological Advances top the list, followed by Society and Demographics, Environmental Challenges, Globalisation and Connectivity and Emerging Economy Growth and Dynamism.

Marx and Schumpeter’s creative destruction

Megatrends have their conceptual roots in the economic theory of creative destruction, as first outlined by Marx and popularised by Schumpeter.

In his Theories of Surplus Value, Marx pointed out that capitalism carries its own seeds of destruction as a result of surpluses, that trigger crises, which then prevent companies from renewing their reproduction process at the same scale (such as the extreme example of war). This is a big simplification for the purposes of brevity.

Schumpeter and other proponents elaborated on this theory, noting that the destruction inherent to capitalism triggered transformative changes (for our purpose megatrends), propelling capitalism further. Markets have since used the term more loosely to describe any number of trends.

The differences between Marx and Schumpeter in regard to creative destruction, is summarised by social geographer David Harvey as follows:

"*Both Karl Marx and Joseph Schumpeter wrote at length on the "creative-destructive" tendencies inherent in capitalism. While Marx clearly admired capitalism's creativity, he … strongly emphasised its self-destructiveness. The Schumpeterians have all along gloried in capitalism's endless creativity while treating the destructiveness as mostly a matter of the normal costs of doing business.*"

Add concepts of creative-destruction to modern monetary theory, which holds that, in the absence of inflation, the creation of money should absorb/unleash spare capacity in the economy (helping smooth out those destructive tendencies of those capitalism-induced surpluses), and it brings us pretty much to today's economic environment.

More than ever, the megatrend is the investor's best friend; and only time will tell if Marx or Schumpeter's view will prove correct.

<u>What is an ESG megatrend</u>

Both 4IR and ESG have been mooted as megatrends of the decade but in reality, ESG is something of a vehicle or concept into which several relatively new global megatrends have been bundled.

ESG megatrends are sub-trends of the above five megatrends, but are large enough to be transformative in their own right.

Their definition is related to both the reach/influence of the ESG thematic and its risk profile in relation to economic and social stability.

Climate change for example, represents a systemic risk; as would inequality, and food security.

These ESG megatrends have emerged in part in relation to PRI's five megatrends, and creative destruction:

"A systems view of megatrends reveals the interrelation of several sustainability issues which broadens the set and complexity of second-order risks and opportunities for investors," says PRI.

"Greater interconnectivity between economies and financial markets has shifted perspectives from considering how a single company competes compared with the system as a whole, allowing a better assessment and management of risks faced by individual companies as well as systemic risks."

For example, PRI notes that the main impact of climate change is through transition-driven "creative destruction" in the global power sector and secondary effects along supply chain chains, which affects about 25% of all listed global equities.

PRI notes that, from a capital allocation perspective, the implications over 10 years are moderate but scale rapidly over time.

"*Studying the investment ecosystem, not just the markets, is critical to anticipate some transformational changes, especially given the accelerating pace of change.*"

<u>The main ESG megatrends</u>

A few years ago, asset manager Robeco published a report: *Three megatrends shaping the world*, in which it pegged climate change; inequality; and cybersecurity as the three main ESG global megatrends.

The report examined themes dominating the short to medium-term ESG landscape, but it would be fair to add other megatrends or related megatrends to this list for the medium to long-term.

A "sustainable" fourth industrial revolution would be one. The 4IR is a megatrend, posing systemic risk in its own right, but the decision by the powers that be to link it to sustainability has created a hybrid megatrend that will guide huge flows of money – most likely within the next five to 10 years.

The 4IR sustainable hybrid is really a sub-trend of the larger sustainable investing megatrend, which has grown in currency given greater understanding of the risks entailed in investing in companies and industries with poor sustainability.

For example, a company that is inefficient with water and energy will have a higher cost base than its competitors. Also, poor management of resources can trigger conflict, and rapid collapse of any number of social, economic and natural systems.

I am also adding water to the list. Water, a sub-trend of sustainability, has yet to make its presence felt, but legislation in this area has been carefully and quietly laid down for the past several decades and water is likely to emerge within the decade as another megatrend. Already, "water barons" have emerged in drought prone regions such as Australia, China and California.

Another likely ESG-related megatrend is rapid urbanisation. It carries a level of systemic risk and is likely to result in a large flow of funds over the next few decades. It has been noted that rapid urbanisation is one way to absorb economic surpluses (remember Marx's pesky crisis-causing surpluses). China is a classic example of this.

So not surprisingly, the development of cities plays a key role in the United Nations Sustainable Development Goals.

So where do the United Nations SDGs fit in? It would be tempting to suggest the SDGs are megatrends. But rather, several of the goals are bundled into an overarching trend, and sometimes cross over.

For example, gender equality, ending poverty, slavery and hunger, for example, would fall under the Robeco megatrend definition of inequality. But ending poverty and hunger also have dramatic implications for food systems, and the development of cities, for example.

<u>Sustainable development</u>

As mentioned above, sustainability is a broad-based mega trend, into which many other ESG megatrends are bundled.

Sustainable development as defined in the 1987 Brundtland Report general protection targets involves:

- Protection and restoration of the natural environment/ecosystem
- Protection of natural resources
- Protection of human health and, wherever possible, improvement of well-being
- Protection and promotion of social value and of public goods
- Protection of capital and material goods.

Others:

- Non-renewable resource consumption (materials)
- Non-renewable resource consumption (energy)
- Freshwater consumption
- Lifecycle cost
- Safety

One of the key findings of the report was that poverty increases environmental destruction, threatening human civilisation and the natural world, hence, ending poverty is a key driver of SDGs.

<u>Collision of megatrends</u>

As ESG thematics collide with old systems and new technological developments, new investment themes appear, generating opportunities and risks for investors.

For example, inequality could generate new developments in human capital management – a shift from the system that has dominated for the past 200 years and been refined in the past 30 - and companies that excel in this arena may gain an edge.

Another theme, related to the 4IR megatrend is data. As Microsoft’s former head of research and strategy Craig Mundie said data is “becoming the new raw material of business almost on par with capital and labour.”

Sustainalytics in its *10 for 2020: creating impact through thematic investing* report nominates 10 such themes around the following trends and assesses them against SDGs:

- Scaling big tech (relating to SDGs 8 and 9)
- Health and Society (SDGs 3 and 12)
- Ecosystem Stewardship (SDGs 14 and 15
- Mitigating climate change (SDGs 7, 11 and 13)

These themes are:

- 5G
- Digitilisation of mining
- Industrial automation
- Connected medical devices
- Slow fashion
- Cleaner shipping

- Banking on biodiversity
- Energy storage
- Big oil transition
- Reinsuring climate change

There are many other such thematics emerging and these are likely to have knock-on impacts across the board, offering new investment opportunities.

Megatrend investing: a broad-brush approach backed by metrics

Adopting the “trend is my friend” approach, large swathes of passive investors are advising their fund managers to jump on the ESG train.

However, this is little help to active traders that prefer to manage their own funds, or those managing funds for others, who would like to supplement their trend investing with facts and figures.

The major problem all investors face is the lack of standardisation of information, and lack of transparency of data.

Steps are in place to rectify this. The United States Sustainability Accounting Standards Board, for example, has developed 77 industry specific sustainability metrics.

The US government ruled last year that companies must report on these metrics annually as part of their 10K filing form, but it will take some time before many corporations develop the reporting systems to meet these regulations.

Those that do, are likely to be favoured initially, and this will be something to keep an eye out for if investing in individual companies, as will any large pledge to improve sustainability.

BHP Group ((BHP)), for example, recently pledged $400m to improve its sustainability, and was rewarded with an immediate share price gain.

No such legislation is in place in Australia, although corporations are being asked to report on slavery in supply chains.

The Australian Council of Superannuation Investors has developed an ESG reporting guide for Australian companies, and those companies that choose to follow the guidelines are likely to cover the sustainability metrics in their reports.

Assuming you do not have the money to invest in your own ESG software, and do not wish to hand your investment dollars to an adviser, the megatrends, backed by sustainability metrics in annual reports, do at least offer a general guide.

Greenbiz and Trucost in their annual State of Green Business report update their list of sustainability metrics annually to include any new metrics, and track the progress of the 1200 world’s largest companies globally against them.

Many more national based platforms and registries are developing on specific megatrends. Many governments for example, are developing registers to police modern slavery.

In the traditional stock markets, using a traditional company-based approach, investors are likely to gravitate to those that demonstrate the best performances against ESG megatrends and metrics as published in annual reports: the “best-in-class” stocks.

Investors are being advised to seek out transparent scorers, not partial scorers or those offering incomplete information; and keep a keen eye out for greenwashing.

In the impact investment market, investors are likely to seek out ventures in service of the UN SDGs that also intersect with at least one other megatrend simultaneously, such as 4IR.

The impact investment market is harder to track from a standardised information viewpoint because investors tend to demonstrate preferences for different causes and this is likely to be refined at a slower rate than best-in-class investments.

Guiding sustainability metrics

Some investors are opting to use sustainability metrics as an adjunct to megatrends, or in isolation, based on their own merit.

MSCI, for example, has 80 exposure metrics, six social themes, and five environmental themes, three dimensions: and more than 120 environmental social and governance indicators keyed to the Global Reporting Initiative's list of performance indicators, and more than 70 key performance indicators in three categories.

This is rather complex, and your average investor is more likely to opt to examine the annual report sustainability metrics and assess them against their individual investment viewpoints and ESG preferences, the main metrics being:

- Greenhouse gas emissions
- Energy-generation mix
- Water use
- Water pollution
- Waste generation
- Supply chain slavery
- Economic
- Gender representation on boards and management and in the workforce

ESG returns

ESG investments, depending on the choice, are offering outsized risk-adjusted returns because of the sharp rush of funds and growing volatility in markets.

However, Robeco points out the advantage to be gained from this megatrend when applied to traditional stocks is likely to slow within the next few years as these companies progressively and continuously invest in improving their sustainability.

To an extent, this is already happening with many stocks being downgraded in advance. For example, value investors have taken a hammering with covid-19 and value-stocks are proving slow to recover, partly as investors direct funds to growth stocks to jump on megatrends, but there is also a level of caution on display.

Investors will need to be on the hop to keep on the crest of this wave.

During this downgrading process, risk-adjusted growth is most likely to be gained from new industries serving traditional sectors, supporting their transitions to new technology and sustainability.

Examining the megatrends

In the meantime, we hope you enjoy the coming series of articles that will examine each of the abovementioned megatrends in isolation, starting with climate change (which will also include a series of articles on oil, gas and renewables).

In the meantime, funds continue to flow and, in the spirit of the trend is your friend, investors are being advised to keep their noses turned in the right direction and head for home – and don't forget the umbrella.

As Dennis Denuto says in the Australian film classic *The Castle*: It's the vibe!

ESG FOCUS

ESG Focus: Record US$82bn In ESG ETFs & ETPs

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: Record US$82bn In ESG ETFs & ETPs

-Total assets invested in ESG ETFs and ETPs a record US$82bn
-June net inflows of US3.49bn
-Number and diversity of products increasing steadily

By Mark Woodruff

Research and consultancy firm ETFGI reports year-to-date net inflows of US$32.02bn went into globally-listed ESG exchange traded funds (ETFs) and exchange traded products (ETPs) by the end of June. This is materially higher than the US$9.86bn recorded at the same point in time in 2019.

This brings total assets invested in ESG ETFs and ETPs to a new record of US$82bn.

During June 2020, ETFGI reported net inflows of US$3.49bn into ESG ETFs and ETPs, of which the top 20 ETFs/ETPs accounted for US$2.67bn.

Global ESG ETF and ETP asset growth as at end of June 2020

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Jun-20
# ESG ETFs/ETPs	41	48	51	46	54	69	115	146	213	285	369
ESG ETF/ETP Assets (US$Bn)	4	3	3	5	6	6	10	17	22	58	88

Source: ETFGI data sourced from ETF/ETP sponsors, exchanges, regulatory filings, Thomson Reuters/Lipper, Bloomberg, publicly available sources and data generated in-house.Note: This report is based on the most recent data available at the time of publication. Asset and flow data may change slightly as additional data becomes available.

The number and diversity of products have increased steadily since the launch of the first ESG ETF/ETP in 2002. The industry now consists of 369 ETFs/ETPs from 89 providers on 31 exchanges in 25 countries. Products domiciled in Europe account for 50.9% of overall assets, followed by those in the US with 40.5%.

According to a UN-supported initiative seeking to understand the investment implications of ESG issues, 56% of adopters believe ESG definitions are unclear. As a result, ETFGI attempts to organise ETFs/ETPs into categories including core ESG products and theme-based groups, such as Clean/Alternative Energies and Gender Diversity.

Top 20 ESG ETFs/ETPs by net new assets June 2020

Name	Ticker	Assets (US$ Mn) Jun-20	NNA (US$ Mn) YTD-20	NNA (US$ Mn) Jun-20
CSIF IE MSCI USA ESG Leaders Blue UCITS ETF - Acc	USESG SW	753.82	667.34	321.29
Nuveen ESG Large-Cap Value ETF - Acc	NULV US	451.75	346.10	258.82
iShares MSCI USA SRI UCITS ETF - Acc	SUAS LN	2776.07	938.50	247.99
Ossiam Euro Government Bonds 3-5y Carbon Reduction UCITS ETF	OG35 GY	230.76	220.50	220.50
iShares ESG MSCI EAFE ETF	ESGD US	2443.39	1091.31	184.12
iShares MSCI World SRI UCITS ETF - EUR - Acc - Acc	SUSW LN	1329.79	667.64	165.55
CSIF IE FTSE EPRA NAREIT Developed Green Blue UCITS ETF - Acc	GREIT SW	104.70	104.70	104.70
iShares MSCI Europe SRI UCITS ETF - Acc	IESG LN	1845.00	784.08	104.51
Amundi MSCI USA ESG Leaders Select UCITS ETF DR - Acc	SADU GY	127.18	129.07	101.67
iShares MSCI EMU ESG Screened UCITS ETF - Acc - Acc	SAUM LN	934.51	138.11	101.67
Vanguard ESG US Stock ETF	ESGV US	1537.07	648.92	101.03
AMUNDI INDEX MSCI EUROPE SRI - UCITS ETF DR (C) - Acc	EUSRI FP	925.34	657.90	99.87
Xtrackers MSCI World ESG UCITS ETF - 1C - Acc	XZW0 LN	495.87	357.21	97.59
Xtrackers II ESG EUR Corporate Bond UCITS ETF DR	XB4F GY	653.25	205.41	97.27
UBS ETF (LU) MSCI World Socially Responsible UCITS ETF (USD) A-dis	UIMM GY	1988.80	573.75	87.80
UBS ETF (LU) MSCI Pacific Socially Responsible UCITS ETF (USD) A-dis	UIMT GY	569.44	91.97	79.02
UBS ETF (LU) - MSCI EMU Socially Responsible UCITS ETF (EUR) A-dis	UIMR GY	927.30	48.16	75.55
iShares Global Clean Energy UCITS ETF	INRG LN	923.61	559.86	75.22
iShares MSCI USA Small-Cap ESG Optimized ETF	ESML US	275.07	172.85	75.14
UBS (Irl) ETF plc - MSCI ACWI Socially Responsible UCITS ETF EUR ACC - EUR Hdg	AWSRIE SW	390.57	92.39	74.37

Source: ETFGI data sourced from ETF/ETP sponsors, exchanges, regulatory filings, Thomson Reuters/Lipper, Bloomberg, publicly available sources and data generated in-house.Note: This report is based on the most recent data available at the time of publication. Asset and flow data may change slightly as additional data becomes available.

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

WEEKLY REPORTS

Weekly Ratings, Targets, Forecast Changes - 17-07-20

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 July 13 to Friday July 17, 2020
Total Upgrades: 10
Total Downgrades: 6
Net Ratings Breakdown: Buy 49.25%; Hold 40.39%; Sell 10.36%

Stockbroking analysts' company ratings on individual ASX-listed stocks are revealing a clear bias toward upgrades. This is also reflected in a positive target price trend.

For the week ending Friday, 17 July, 2020, FNArena registered ten upgrades and six downgrades for individual stocks. Nine of the ten upgrades moved to a Buy rating and only one of the six downgrades moved to a Sell.

While only one broker was responsible for three ratings changes in the REIT sector (two positive, one negative), it may be indicative of a wider uncertainty regarding unknown pandemic effects for the sector.

Alumina Ltd was the standout, receiving two upgrades to a Buy, after JV partner Alcoa reported above-forecast production results in the June quarter.

Only Zip Co was downgraded to a Sell, based partly on conservatism about the recent share price rally and partly on a rise in bad debts.

Alumina Ltd topped the table for a positive percentage rise in target price, followed by TPG Telecom, now deemed to be a robust competitor to Telstra and Optus. Leading the negative target price changes was Woodside Petroleum following ongoing weakness in LNG prices and impairment disclosures.

The weak metallurgical coal outlook impacted negatively on earnings forecasts for Coronado Global Resources.

All three brokers commenting on Senex Energy were very positive on future prospects and upgraded earnings forecasts markedly. Coming in second for earnings upgrades was QBE Insurance Group, with raised expectations for premium rates.

Total Buy ratings for the seven brokers monitored daily remains high at 49.25% of total ratings, versus 40.39% on Neutral/Hold, and 10.36% in Sell ratings.

ALUMINA LIMITED ((AWC)) Upgrade to Outperform from Neutral by Credit Suisse and Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 4/1/1

Credit Suisse upgrades to Outperform from Neutral believing the positive indicators are exceeding the negatives. Assets are performing and unit costs are down in the June quarter.

Commentary signalling the aluminium sector is turning the corner in Europe and North America suggests the rise in inventory outside of China may start to slow.

That said, the broker acknowledges the global outlook is uncertain and volatility is still expected. Target is raised to $2.00 from $1.65.

AWAC JV partner Alcoa has reported better-than-expected production results from the June quarter. Ord Minnett lifts the valuation for Alumina Ltd as a result.

Better operating results in the next 1-2 years should support a higher dividend as well, in the broker's view.

The stock presents value now and the rating is upgraded to Accumulate from Hold. Target is raised to $2.10 from $1.80.

BEACH ENERGY LIMITED ((BPT)) Upgrade to Add from Hold by Morgans .B/H/S: 4/2/0

Morgans believes the Beach Energy share price represents significant value at the current level. The recent sideways drift in oil prices has contributed to demand uncertainty.

Additionally, there has been speculation that future spot price falls could influence negotiations for price resets on Beach Energy legacy contracts. However, the broker expects a clear difference in price between long-term contracts and the spot market.

Morgans expects the next major catalyst will be the upcoming full year result, which will incorporate an updated five year outlook for asset development and revised reserve estimates.

The rating is increased to Add from Hold. The target price is $1.66.

NATIONAL STORAGE REIT ((NSR)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 1/2/1

Ord Minnett assesses the short-term impact on operations from the pandemic has been relatively contained with only a -3-4% decline in occupancy.

The broker believes National Storage could unlock value in the medium term by stabilising its occupancy at 85%.

Furthermore, self-storage should remain a preferred property sector and, given the fragmented nature of the asset class, it remains possible bids could re-emerge from those looking to establish scale in Australia.

Rating is upgraded to Accumulate from Hold and the target lifted to $2.05 from $1.60.

OCEANAGOLD CORPORATION ((OGC)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 2/2/0

Ord Minnett has remodelled the economic and production assessment of Waihi.

A higher peak production rate, longer mine life and increased resources from Martha and Gladstone open pits are envisaged.

This leads to an upgrade to Accumulate from Hold and the target raised to $4.20 from $3.60.

PERPETUAL LIMITED ((PPT)) Upgrade to Neutral from Sell by Citi .B/H/S: 1/6/0

Perpetual has released a business update for Q420, which has led Citi to upgrade to Neutral from Sell.

The broker believes there are increasing signs of a turnaround, with 4Q net outflows moderating and investment performance for most key strategies improving.

Strong growth in FuA in Corporate Trust is encouraging, but much of this is likely to be a one-off event.

Cost growth for FY20 and potentially 1H21 will likely be suppressed. This may be temporary as reduced discretionary spend and salary cuts for executives may reverse over time, according to the broker.

Rating is increased to Neutral from Sell. The price target increased to $32.00 from $26.10.

QUBE HOLDINGS LIMITED ((QUB)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 2/3/1

The company has exchanged contracts for the sale of the Minto properties to entities associated with Charter Hall ((CHC)) for $207m.

Ord Minnett assesses the sale is neutral to valuation. However, the addition to the balance sheet is advantageous, given the uncertainty over logistics volumes for FY21.

Recycling capital from a mature property is a positive signal from a company that has deployed substantial expenditure on new projects.

Ord Minnett upgrades to Accumulate from Hold and raises the target to $3.09 from $2.95.

TPG TELECOM LIMITED ((TPG)) Upgrade to Overweight from Equal-weight by Morgan Stanley .B/H/S: 3/2/0

Morgan Stanley notes the newly merged TPG Telecom has the potential and capital to play disrupter and believes the company can compete against the larger telcos like Telstra and Optus.

The broker points towards a stronger product suite, higher growth options and a stronger balance sheet but also highlights risks like the National Broadband Network (NBN) pricing that is impacting TPG Telecom's fixed-line profit.

Investors willing to wait 2-3 years for the synergies to play out fully can expect target price upside, comments the broker.

Morgan Stanley upgrades its rating to Overweight from Equal-weight with the target price increasing to $10 from $6.85. Industry view: In-line.

TREASURY WINE ESTATES LIMITED ((TWE)) Upgrade to Overweight from Equal-weight by Morgan Stanley .B/H/S: 1/5/0

Treasury Wine Estates' had inventory worth $2bn on its books at the end of the first half and Morgan Stanley estimates its realisable value at circa $4bn, most of it from the luxury category. The broker expects the group to return to FY19 earnings in FY22.

Since the de-rating was triggered by headwinds within the US business, the broker believes a sustained re-rating will require more confidence in management's ability to stabilise the US business.

The short-term outlook remains disrupted but downside risk is limited owing to the group's asset backing.

Morgan Stanley upgrades its rating to Overweight from Equal-weight with the target price increasing to $13.50 from $12.50. Industry view: Cautious.

WAYPOINT REIT ((WPR)) Upgrade to Buy from Hold by Ord Minnett .B/H/S: 2/0/1

Ord Minnett believes long WALE A-REITs are a way to play the current environment, given stable earnings and distribution spreads. Waypoint is the preferred stock as it offers an attractive distribution yield with limited earnings risk.

With the dividend earnings uncertainty surrounding traditional shopping centre landlords, service stations have become a preferred retail asset class.

Rating is upgraded to Buy from Hold and the target is raised to $2.95 from $2.80.

Downgrade

CHARTER HALL LONG WALE REIT ((CLW)) Downgrade to Accumulate from Buy by Ord Minnett .B/H/S: 3/1/0

Ord Minnett believes long WALE A-REITs are a way to play the current environment, given stable earnings and distribution spreads.

Yet, Charter Hall Long WALE displays some earnings risk and has less valuation upside compared to others in the segment, according to the broker.

Hence, rating is downgraded to Accumulate from Buy. Target is reduced to $4.48 from $5.80.

ORIGIN ENERGY LIMITED ((ORG)) Downgrade to Hold from Add by Morgans .B/H/S: 4/3/0

Morgans believes Origin Energy has medium-term potential but a recovery will be some time away.

The downside risks in the meantime outweigh the longer-term potential. Rating is therefore downgraded to Hold from Add.

The company has announced a -$1.2bn post-tax write-down of its LNG business.

Guidance for energy markets operating earnings has been reiterated at $1.4-1.5bn. Target is reduced to $5.95 from $6.43.

SOUTHERN CROSS MEDIA GROUP ((SXL)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 1/1/0

Macquarie downgrades to Neutral from Outperform. The revenue environment is uncertain and the stock is trading near the target price.

While the business has controlled costs and will benefit from JobKeeper payments, further weakness in advertising markets is expected to prevail for the near term. Target is unchanged at $0.18.

WOODSIDE PETROLEUM LIMITED ((WPL)) Downgrade to Neutral from Buy by Citi .B/H/S: 4/3/0

Citi has downgraded Woodside Petroleum to Neutral from Buy.

Impairment disclosures have led the broker to downgrade and the analysts fail to see a near-term catalyst, other than a possible reduction in bottlenecks at Scarborough.

Citi believes the market does not fully appreciate that Pluto LNG no longer enjoys its S-Shape inflection point at $60 oil. As a result, third quarter results may disappoint.

The rating is decreased to Neutral from Buy. Target is reduced to $22.33 from $26.08.

WHISPIR LIMITED ((WSP)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 0/1/0

Ord Minnett downgrades to Hold from Buy as the share price has rallied almost 30% over a week with no obvious news or developments.

A strong result is expected in August and the broker is positive about the longer term but the current valuation offers little upside. Target is steady at $2.80.

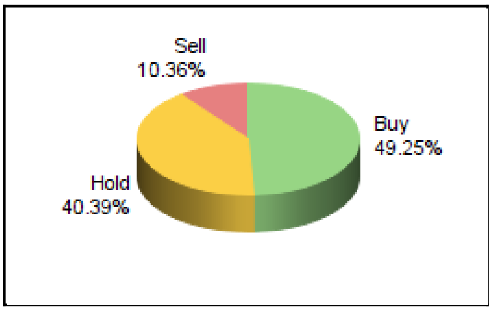
ZIP CO LIMITED ((Z1P)) Downgrade to Sell from Neutral by UBS .B/H/S: 2/0/1

The trading update looked strong, with total transaction volumes increasing by 62%. Second half revenue grew 88%. However, highlight the analysts, net bad debts increased to 2.24% at the end of the June quarter.

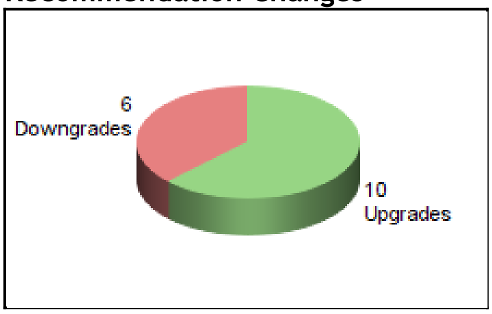
UBS now believes the risk/reward is unfavourable following the recent rally in the share price and downgrades to Sell from Neutral.

Target is raised to $5.70 from $5.60. The broker notes several short-term risks including uncertainty over the duration of the pandemic, growth in credit risk and the integration risk for Quadpay.

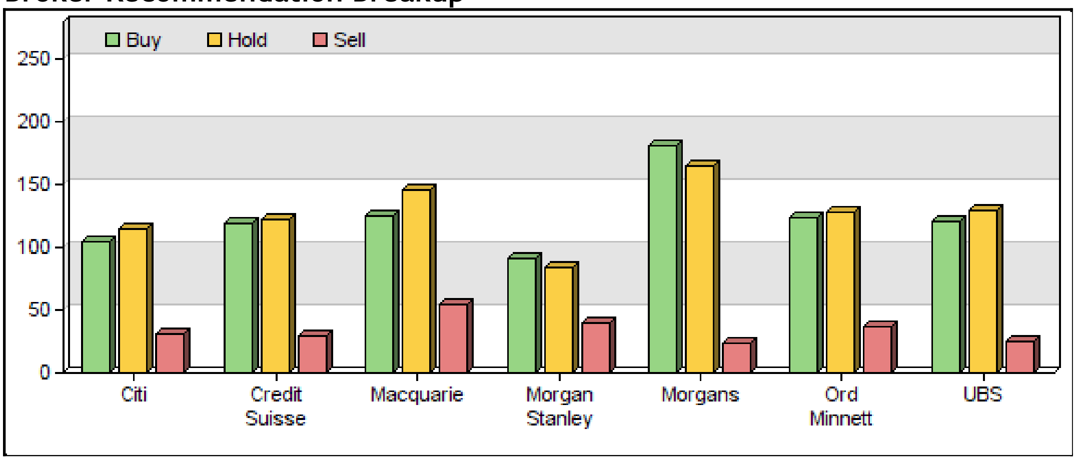
Total Recommendations



Recommendation Changes



Broker Recommendation Breakup



Broker Rating

Order		Company	New Rating	Old Rating	Broker
Upgrade					
1		ALUMINA LIMITED	Buy	Neutral	Credit Suisse
2		ALUMINA LIMITED	Buy	Neutral	Ord Minnett

3	BEACH ENERGY LIMITED	Buy	Neutral	Morgans
4	NATIONAL STORAGE REIT	Buy	Neutral	Ord Minnett
5	OCEANAGOLD CORPORATION	Buy	Neutral	Ord Minnett
6	PERPETUAL LIMITED	Neutral	Sell	Citi
7	QUBE HOLDINGS LIMITED	Buy	Neutral	Ord Minnett
8	TPG TELECOM LIMITED	Buy	Neutral	Morgan Stanley
9	TREASURY WINE ESTATES LIMITED	Buy	Neutral	Morgan Stanley
10	WAYPOINT REIT	Buy	Neutral	Ord Minnett
Downgrade				
11	CHARTER HALL LONG WALE REIT	Buy	Buy	Ord Minnett
12	ORIGIN ENERGY LIMITED	Neutral	Buy	Morgans
13	SOUTHERN CROSS MEDIA GROUP	Neutral	Neutral	Macquarie
14	WHISPIR LIMITED	Neutral	Buy	Ord Minnett
15	WOODSIDE PETROLEUM LIMITED	Neutral	Buy	Citi
16	ZIP CO LIMITED	Sell	Neutral	UBS

Recommendation

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	AWC	ALUMINA LIMITED	42.0%	17.0%	25.0%	6
2	TPG	TPG TELECOM LIMITED	50.0%	30.0%	20.0%	5
3	VOC	VOCUS GROUP LIMITED	50.0%	33.0%	17.0%	6
4	BPT	BEACH ENERGY LIMITED	58.0%	42.0%	16.0%	6
5	OGC	OCEANAGOLD CORPORATION	38.0%	25.0%	13.0%	4
6	NSR	NATIONAL STORAGE REIT	-13.0%	-25.0%	12.0%	4
7	BRG	BREVILLE GROUP LIMITED	67.0%	60.0%	7.0%	6

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	Z1P	ZIP CO LIMITED	17.0%	50.0%	-33.0%	3
2	GMG	GOODMAN GROUP	33.0%	50.0%	-17.0%	6
3	EVN	EVOLUTION MINING LIMITED	-29.0%	-14.0%	-15.0%	7
4	NCM	NEWCREST MINING LIMITED	14.0%	29.0%	-15.0%	7
5	WPL	WOODSIDE PETROLEUM LIMITED	57.0%	71.0%	-14.0%	7
6	ORG	ORIGIN ENERGY LIMITED	50.0%	64.0%	-14.0%	7
7	CLW	CHARTER HALL LONG WALE REIT	63.0%	75.0%	-12.0%	4

Target Price

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	AWC	ALUMINA LIMITED	1.867	1.708	9.31%	6
2	TPG	TPG TELECOM LIMITED	8.714	8.088	7.74%	5
3	NSR	NATIONAL STORAGE REIT	1.703	1.590	7.11%	4
4	OGC	OCEANAGOLD CORPORATION	3.625	3.450	5.07%	4
5	BRG	BREVILLE GROUP LIMITED	22.878	21.854	4.69%	6
6	Z1P	ZIP CO LIMITED	6.550	6.450	1.55%	3
7	EVN	EVOLUTION MINING LIMITED	4.919	4.861	1.19%	7
8	BPT	BEACH ENERGY LIMITED	1.767	1.747	1.14%	6
9	NCM	NEWCREST MINING LIMITED	32.659	32.373	0.88%	7

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	WPL	WOODSIDE PETROLEUM LIMITED	23.760	25.447	-6.63%	7
2	CLW	CHARTER HALL LONG WALE REIT	4.970	5.300	-6.23%	4
3	VOC	VOCUS GROUP LIMITED	3.532	3.573	-1.15%	6
4	GMG	GOODMAN GROUP	15.663	15.830	-1.05%	6
5	ORG	ORIGIN ENERGY LIMITED	6.764	6.829	-0.95%	7

Earning Forecast

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	SXY	SENEX ENERGY LIMITED	0.667	0.233	186.27%	6
2	QBE	QBE INSURANCE GROUP LIMITED	-11.894	-17.299	31.24%	7
3	OSH	OIL SEARCH LIMITED	4.291	3.398	26.28%	7
4	AWC	ALUMINA LIMITED	7.363	5.974	23.25%	6
5	WPL	WOODSIDE PETROLEUM LIMITED	74.105	66.684	11.13%	7
6	GUD	G.U.D. HOLDINGS LIMITED	57.726	54.506	5.91%	5
7	PMV	PREMIER INVESTMENTS LIMITED	70.452	66.750	5.55%	5
8	JHG	JANUS HENDERSON GROUP PLC.	315.741	302.337	4.43%	4
9	TCL	TRANSURBAN GROUP	11.276	10.896	3.49%	7
10	ORA	ORORA LIMITED	12.936	12.593	2.72%	7

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	CRN	CORONADO GLOBAL RESOURCES	-13.976	2.973	-570.10%	3
2	OGC	OCEANAGOLD CORPORATION	2.167	5.862	-63.03%	4
3	AD8	AUDINATE GROUP LIMITED	-2.053	-1.427	-43.87%	3
4	WHC	WHITEHAVEN COAL LIMITED	3.756	6.103	-38.46%	7
5	MHJ	MICHAEL HILL INTERNATIONAL LIMITED	5.850	6.975	-16.13%	4
6	NEC	NINE ENTERTAINMENT CO. HOLDINGS LIMITED	8.406	9.366	-10.25%	5
7	TPG	TPG TELECOM LIMITED	26.903	29.403	-8.50%	5
8	NUF	NUFARM LIMITED	-2.424	-2.281	-6.27%	7
9	NSR	NATIONAL STORAGE REIT	7.925	8.425	-5.93%	4
10	ABP	ABACUS PROPERTY GROUP	18.525	19.525	-5.12%	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.

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

WEEKLY REPORTS

Uranium Week: US Uranium Reserve In Question

The spot uranium price fell incrementally last week for the eighth straight week, as Congress holds up a planned US strategic reserve.

-US House withholds funding for uranium reserve
-Rio Tinto increases production
-U3O8 spot price still drifting down

By Mark Woodruff

Future support for the US uranium sector was challenged this week by a decision by the US House Appropriations Committee to withhold funding for a domestic uranium reserve, as requested by the US Department of Energy (DOE). Due to a lack of detail, the DOE has been requested to resubmit its homework with further information on the justification for the reserve and how it will be implemented.

According to consultant TradeTech, industry sources indicated there was some acknowledgement that the DOE should start preparing for the launch of a US Uranium Reserve and storage program based on current funding.

Uranium pricing

The trend remains down in prices.

TradeTech's weekly spot price indicator fell -US20c to US$32.70/lb last week. This is now eight weeks in a row of incremental declines.

The possible termination of the Russian Suspension Agreement (RSA) is causing uncertainty among US utilities. Market participants are hopeful that a resolution may be reached in coming weeks as a result of negotiations between the US Department of Commerce (DOC) and the Russian government.

It has become increasingly difficult for sellers to secure attractive financing rates, due to the volatile economic environment caused by the pandemic, TradeTech reports. As a result, sellers cannot attract buyers as they are unable to offer sufficiently low prices. The sellers are emboldened to seek higher prices by recent cuts to planned production and previously announced project postponements.

The spot price has increased nearly 30% over the last year, while the average weekly uranium spot price for 2020 is US$29.15 per pound, US$3.32/lb above the 2019 average.

TradeTech discloses a total of three transactions were reported for the week, involving approximately 400,000 pounds U3O8 equivalent.

Company News

Rio Tinto has recorded an increase in uranium production of 6% over the previous quarter from its 86% share in Energy Resources of Australia ((ERA)). ERA's Ranger operation continued to process existing stockpiles and sold additional material from inventory to capitalise on improved market conditions during the quarter.

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

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

WEEKLY REPORTS

The Short Report - 23 Jul 2020

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

Summary:

Week ending July 16, 2020.

Last week saw the ASX200 bounce around but go nowhere until some positive vaccine news sparked a rally at week's end.

Once again very little action at the top of the table, and really only a bit of shuffling around at the low end.

Only one stock saw its short-position change by one percentage point or more last week, being Zip Co ((Z1P)), the shorts in which rose to 7.1% from 5.3%. See below.

Otherwise, about the only stock worth mentioning is Clinuvel Pharmaceuticals ((CUV)), which is a biotech specialising in skin disorders. It has been quietly creeping up the table, reaching 8.0% last week.

While it's difficult to make a connection between skin disorders and covid, the stock has been extremely volatile these past months, appearing almost daily on the top five ASX200 winners or losers boards. While biotechs are by their nature risky investments, it still seems remarkable.

Clinuvel is not covered by any FNArena database brokers.

Weekly short positions as a percentage of market cap:

10%+
MYR 12.1
WEB 10.0

No changes

9.0-9.9

ING

No changes

8.0-8.9%

NEA, CUV

In: CUV Out: BOQ, GXY

7.0-7.9%

BOQ, GXY, FXL, ORE, Z1P

In: BOQ, GXY, FXL, Z1P Out: CUV

6.0-6.9%

MTS, FNP, JBH, PGH, PPT, SGM, SUL, MSB

Out: FXL, SXL, FLT, PLS

5.0-5.9%

FLT, PLS, SEK, CLH, ALG, IVC, SXL, BIN, LYC, BUB, IFL, AMA

In: FLT, PLS, SXL Out: Z1P, CTD, LOV

Movers & Shakers

From its covid-crash bottom to Monday last week, **Zip Co** rallied 550%. The BNPL player has largely chased up more recognised peer Afterpay ((APY)), which rose 760%. In a covid world, short-term finance for millennials is king.

Zip Co did provide a positive June quarter update at the end of last week, and two of the three FNArena database brokers covering the stock remain on Zip for the ride (Buy), while UBS has bottled on valuation and downgraded to Sell. Targets range from $6.45 (Ord Minnett) to $5.70 (UBS).

The comparison with Afterpay is interesting. Six FNArena brokers cover the latter stock, with two on Buy, three on Hold and one on Sell, which is of course UBS. Morgan Stanley has a target of $101 for Afterpay (last trade $71.97), while UBS has $27.00. UBS believes millennials with access to buy-now credit are going to blow themselves out of the water.

So far they haven't, but the shorters are circling, with Zip Co now on 7.1% from 5.3%.

By contrast, Afterpay did feature heavily on the 5%-plus shorted table earlier in the run, which preceded that of Zip Co, but it's now only 1.0% shorted, leaving a few smouldering corpses. Which way will Zip Co go?

ASX20 Short Positions (%)

Code	Last Week	Week Before	Code	Last Week	Week Before
ALL	4.2	4.4	NCM	0.6	0.8
ANZ	0.7	0.7	RIO	2.1	2.1
BHP	4.1	4.1	SCG	0.8	0.8
BXB	0.3	0.2	SUN	0.6	0.5
CBA	0.5	0.5	TCL	0.6	0.6
CSL	0.3	0.2	TLS	0.5	0.4
GMG	0.4	0.4	WBC	0.9	0.8
IAG	0.7	0.7	WES	0.4	0.5
MQG	0.3	0.2	WOW	0.2	0.3
NAB	0.8	0.8	WPL	1.3	1.3

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.

WEEKLY REPORTS

The Wrap: Troubled SMEs, a2 Milk & Gaming

Weekly Wrap: extension of JobKeeper and JobSeeker; many SMEs are not likely to survive the pandemic; a2 Milk growing market share in China's Infant milk formula market

-Extension of JobKeeper and JobSeeker programs reduces downside risk for growth and employment
-Small businesses are finding it increasingly tough to survive this pandemic
-Strong growth seen in a2 Milk's China infant milk formula market share in the June quarter

By Angelique Thakur

Extension of stimulus measures softens, but doesn't cure

The Australian government announced it would be extending its JobKeeper wage subsidy and JobSeeker unemployment benefit program. The current measures were set to expire in September.

JobKeeper will continue for another six months till March 2021, albeit at a reduced rate.

The payments will decrease to $600 per week from the end of September and further reduce to $500 per week from January 2021. Currently, the rate is $750 per week. There will also be an additional revenue test for eligibility in October and in January.

Morgan Stanley expects costs to drop to -$17bn for the December 2020 and March 2021 quarters from -$70bn for the June and September quarters 2020. Simultaneously, coverage will drop to 1.4m workers in the December 2020 quarter and further to 1m in the March 2021 quarter. Currently, the scheme covers 3.5m workers.

JobSeeker, on the other hand, will drop to $250 a fortnight from the current $550. Workers will still be able to earn $300 with no benefits impacted. This will extend until the year-end at a cost of -$3.8bn and Morgan Stanley believes it may be further extended in the October Budget.

This implies an average of about 2.3m people will be receiving this benefit in the December quarter, similar to the current numbers.

The business eligibility test for JobKeeper has also been tightened. Earlier, the approach automatically qualified all businesses for the full 6-month term based on their projected turnover.

The changes involve quarterly assessment of a business's actual turnover and whether it remains down continuously each quarter when compared with pre-covid levels.

The threshold amounts remain unchanged at -30% for small businesses with an annual turnover of $1bn or less and -50% for large businesses with a turnover of more than $1bn.

UBS comments the extension of JobKeeper and JobSeeker is bigger than expected. It is worth about $20bn and is equal to circa 1% of the annual GDP. Most of it will be concentrated in the last quarter. This reduces the downside risk for growth and employment in the quarter.

Morgan Stanley notes total budget costs are mostly in line with its own forecasts, pegged at -$6bn for JobSeeker and -$15-20bn for JobKeeper.

There have been concerns raised by UBS about the end of JobKeeper driving a second wave of job losses. In fact, ACA Research forecasts if the payments had not been extended, 48% of SMEs may have reduced their employees.

While the extension also reduces the circa **-$100bn policy cliff** expected in the December quarter, it is still very large at around -$84m or -17% of the quarterly GDP, comments UBS.

Morgan Stanley analysts admit they expected more measures, such as tax cuts, and expected the total package to be circa $40bn. They still expect these measures to be announced in the future along with further measures worth $20bn.

Morgan Stanley does not expect JobKeeper to experience a W-shaped recovery, implying virus evolution leading to a return to national lockdowns remains a key risk.

SMEs: In dire straits

A report by UBS indicates small-medium enterprises (SMEs) in Australia continue to struggle to survive. In June alone, total SME revenue fell -27% year on year with sectors like food, accommodation, arts, recreation and education hit the most.

The stimulus has not been very effective for SMEs, finds ACA research, noting that while many listed companies have benefited from the stimulus, SME revenue has only risen 8% from its mid-April lows.

The research indicates 35% of SMEs are concerned their business may not survive the pandemic.

But it is the ripple effect that has broker UBS worried. In particular, it expects the banks to be hit by a double-whammy.

UBS reports 18% of the SME loan book is in deferral until September/October. This comes to 220,000 business loans with the value of close to circa $60bn.

UBS finds the largest loan exposures are to sectors like property, retail, hospitality, construction etc. This figure, however, only depicts the banks' direct exposure to SMEs.

The broker remains concerned about what would happen when the circa $100bn of stimulus is removed. An end to wage subsidies, rental relief and loan deferrals could weigh heavily on small businesses (which employ 35% of the workforce).

ACA Research indicates 48% of small businesses could reduce employees if JobKeeper is not extended. This, expects UBS, will compound losses for the banks.

Typically, business confidence is a leading indicator for investment and business credit, and UBS believes SME business credit is likely to continue to stall given the uncertain economic outlook.

A case in point is the last $40bn program, which saw only $1.5bn worth of loans. The government has increased loan guarantees for small businesses but this hasn't really helped matter, comments UBS.

The analysts note SME lending has only increased by less than $5bn since the start of the year and it remains to be seen how much appetite there is for credit from the SME sector.

There are also indications that banks have a reduced appetite for SME loans and require security. This has seen the ease of access to finance trending downwards over time.

a2 Milk: Growing share in China's infant milk formula market

China constitutes one-third of the global infant milk formula market. UBS notes super-high premium brands formed a record share of top-25 best sellers in the Chinese infant formula market in the June quarter.

This was driven by better prices and consumers demanding higher quality products post covid-19. All-in pricing remained strong driven by premium-isation.

UBS points out international brands now rely on premium-isation, expansion into lower-tier cities and product development to sustain positive growth in China's infant milk formula.

Unlike the experience in the US and the West, China did not display a very high degree of panic buying in the first quarter. Thus, UBS does not expect any major destocking in the infant milk formula sector in the June quarter.

One of the major changes has been **rising online sales** which is positive for the likes of **a2 Milk** ((A2M)). UBS's analysis finds Danone to hold 31% share of the top 25-best sellers, with the June quarter marking the first sequential lift in its share since the December quarter of 2018.

On the contrary, a2 Milk's share saw an improvement of 280bps to 15% year on year in the June quarter.

UBS is positive on a2 Milk's positioning in the China market. It notes the company's performance in China is its primary share price driver, making up more than 7% of FY19 sales.

The broker also sees a **medium-term opportunity** for the company to lift its China infant milk formula share to about 8% by FY23 from 4.5% in FY19.

a2 Milk is rated as Buy by UBS.

Australian Gaming: Reporting season ahead

Morgan Stanley has reviewed Australia's gaming industry prior to the August reporting season.

Aristocrat Leisure's ((ALL)) US casinos reopened earlier than expected but have started to close down again due to rising infections. The broker maintains a cautious stance for now.

Driven by continued market share gains, exposure to digital growth and a strong balance sheet, Aristocrat remains Morgan Stanley's preferred pick and the broker is Overweight.

Crown Resorts ((CWN)) is Morgan Stanley's preferred casino stock although the broker expects slower recovery due to the second outbreak in Victoria. The broker rates the stock as Overweight.

Star Entertainment Group ((SGR)) faces continued restrictions in Sydney. The broker expects more earnings headwinds in FY21 from increasing competition (with the opening of Crown Barangaroo).

Morgan Stanley downgrades Star Entertainment to Underweight and prefers Crown Resorts.

Tabcorp Holdings ((TAH)) is expected to incur higher D&A charges due to accounting changes. With the balance sheet stretched and uncertainty on wagering competition, the broker rates the stock as Equal-weight.

SMALL CAPS

Audinate Signals Resilience

Audinate has signalled the trough in income during the June quarter was not as deep as previously anticipated and this augurs well for the company's earnings trajectory in FY21.

-Opportunity to gain market share continues
-Lingering concerns regarding risks to demand
-Despite restrictions, new product released and webinars ramped up

By Eva Brocklehurst

Refreshingly, audio developer Audinate ((AD8)) has indicated the trough in earnings during the June quarter was not as severe as previously expected and conditions improved in June versus May.

Preliminary indications of revenue and gross profits were stronger than brokers expected for FY20, although the outlook for FY21 still encompasses some caution, considering the pandemic remains active.

Shaw and Partners takes a conservative stance and cuts FY21 sales estimates by -11% but **when the pandemic wanes Audinate is considered one of the key longer-term choices in the small cap space**.

Total global revenue for professional audio equipment, the broker notes, was estimated growing to $10.7bn in 2021 and in this the company's addressable market is estimated growing to $455m. Moreover, this estimate is specific to audio, and adding in software and video increase the total addressable market for Audinate to over $1bn.

As a result, Shaw, not one of the seven monitored daily on the FNArena database, believes the stock has many positive attributes and there are several catalysts for the business which will play out over the longer term.

The broker has a Buy rating with a $6.75 target and argues that **the company is in the best shape in its history, with no debt and an expected earnings trajectory that is now being fulfilled.**

Credit Suisse, too, continues to like the business because of an attractive structural shift and opportunity for market share, which should help it maintain robust margins. Nevertheless, in the short term revenue may be challenged, although the broker acknowledges being surprised thus far, particularly regarding the recovery in June.

There are lingering concerns about the risks to end-market demand and the pressures that face many customers because of restrictions resulting from the pandemic. The broker would become more confident if there was more understanding about the shape of the cycle.

The company has indicated FY20 revenue of US$20.4m and a second-half gross profit margin of 77%. Audinate reports in US dollars so, adjusting for Australian dollars, sales were around $30.3m. Morgan Stanley calculates $29.3m in cash as of June 30, which signals FY20 cash break-even, and observes strong traction continues on the qualitative drivers of the business.

The healthy gross margins reflect favourable product mix of higher software sales and fewer low-margin Ultimo chips, Shaw notes. **Uptake of software sales was holding up as a percentage of overall sales, while there was continued moderation in chips/cards/modules.** The number of Dante-enabled products grew 31%.

UBS continues to believe there is an opportunity for the company to strengthen its competitive position through Dante/digital AV training, further entrenching the Dante network and the video opportunity.

During the second half Audinate release new Dante products and expedited the development of new video hardware design and software development. The company's training program was also ramped up and a low-cost office has been opened in Manila to centralise back-office functions and provide some scale for future development.

FNArena's database has two Buy ratings and one Hold (Credit Suisse) for Audinate. The consensus target is $6.90, suggesting 30.2% upside to the last share price. Targets range from $5.40 (Credit Suisse) to $7.80 (UBS).

See also, Audinate Resonates Despite Downturn on April 9, 2020.

RUDI'S VIEWS

Rudi's View: Forecasts, Not Valuations

Dear time-poor investor: are share markets egregiously overvalued? Is Biden as President a problem? Can Telstra create value through structural separation?

In this week's Weekly Insights:

-Forecasts, Not Valuations
-Is Biden A problem?
-Telstra, There Is Another Way
-FNArena Talks

Forecasts, Not Valuations

By Rudi Filapek-Vandyck, Editor FNArena

Once again it has become a popular opinion that share markets are pricing in too much exuberance in light of what the economic recovery story can possibly deliver.

One way to illustrate this year's euphoria-gripped markets is by measuring the average Price-Earnings (PE) ratio and concluding this year's swift recovery is off the charts, with PE ratios higher than at any other time in history, beating 1929, 1987, 2000 and 2007.

But is this really the most accurate measure available? Is it even appropriate to guide our views about the status and prospects for equities today?

I beg to differ.

Apples Versus Oranges

Let's start with the most obvious observation: comparing today's index valuation with history is not comparing apples with apples.

Indices change because their composition changes. Back in 1987, the two most important constituents of the ASX200 today -CSL ((CSL)) and CommBank ((CBA))- weren't even listed yet.

In fact, there was no ASX200. All we can compare with is the All Ordinaries, and that index looked a lot different from its successors today.

Back in 2000 the most important index movers were two listed shares in News Corp. By late 2007, resources were trending towards peak index weight.

In 2020, the largest index constituent is CSL and it always trades at a premium versus the broader market. In-depth analysis by UBS earlier in the year established that having CSL as the top index weight in Australia adds around 100 basis points to the average PE for the ASX200.

News Corp doesn't even feature anymore.

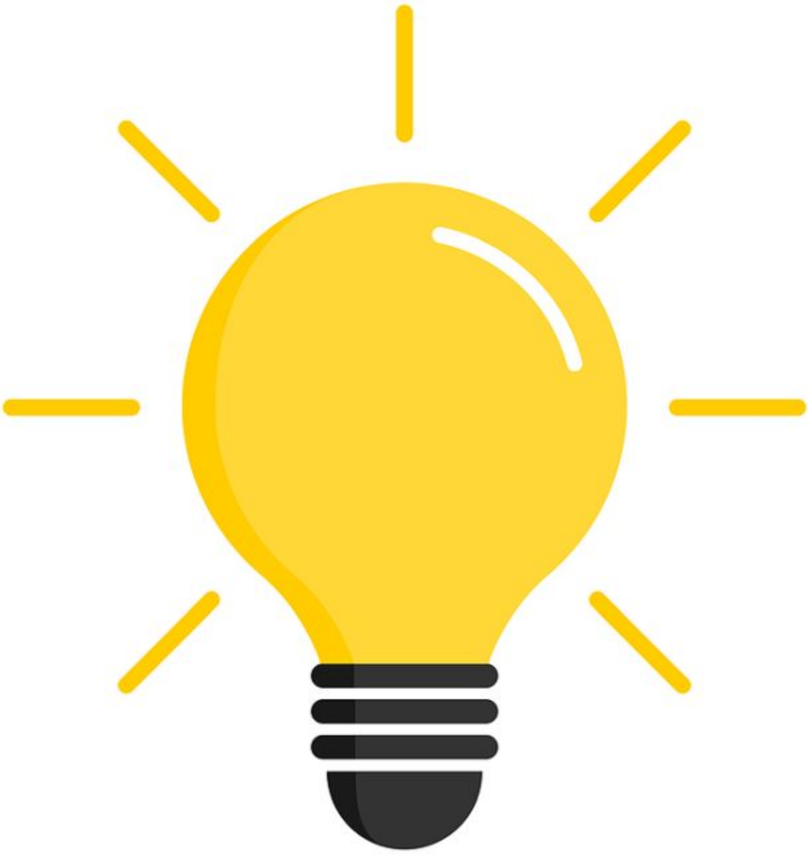
In the slipstream of CSL moving to top spot in Australia, we have numerous index climbers that have grown in index weight over the past one or two decades, and they all trade on much higher multiples than the stocks they replaced.

Think of Macquarie Group ((MQG)), Aristocrat Leisure ((ALL)), Fisher & Paykel Healthcare ((FPH)), REA Group ((REA)), ResMed ((RMD)), and Cochlear ((COH)) instead of Westfield, Mayne Nickless, Pacific Dunlop, Harvey Norman, and AMP.

And that's not even mentioning the new business models that have risen to the challenge, and to investor's attention, over the past five years or so. In 2020, all of Afterpay ((APT)), a2 Milk ((A2M)), Magellan Financial ((MFG)), and Xero ((XRO)) are on par, or even weightier, than household blue chip names such as QBE

Insurance ((QBE)), Suncorp Group ((SUN)), Origin Energy ((ORG)), and Lendlease Group ((LLC)).

One does not necessarily have to agree with the valuations of these new kids on the block, but simply an acknowledgment that indices have changed significantly renders that simplistic comparison on the basis of a simple average PE calculation invalid.



PE Methodology Misunderstood

Societies are going through transformational changes; they happen fast and remain irreversible. Today's ASX200 index is as much a reflection of this transformation taking place as it is of the extreme polarisation that is occurring as a result of these changes.

When the average share market PE is the result of combining Afterpay, trading on an unknown multiple because the company is not profitable, with Unibail-Rodamco-Westfield, Scentre Group and Janus Henderson, all trading on single digit PE multiples, surely one must question the practicality of using one all-encompassing, generic average for the market as a whole?

Even then, it seems to me many investors don't appear to understand the essence of how Price-Earnings (PE) ratios work.

To put it simply: back in all of 1929, 1987, 2000 and 2007 share markets were priced on high PEs based on peak forecasts, which subsequently turns into a nasty problem when those forecasts fall and PEs need to reset at a more appropriate, risk-adjusted level.

In 2020, forecasts have fallen deeply since the global pandemic hit. Most economists and other forecasters, be they bullish or cautious, expect a recovery to emerge.

We can still debate the strength and exact duration, even the shape of the recovery, but not the fact that looking forward to a recovery from a trough in the economic cycle automatically translates into high PE ratios.

Allow me to illustrate this with a practical recent example: when shares in BHP Group ((BHP)) fell near $13 in early 2016, the PE on Macquarie's forecast rose to 100x. This was not an indication that BHP shares were amazingly expensive (as we've all witnessed since).

That PE of 100x (80x on other analysts' forecasts) was merely an indication that, looking beyond the immediate outlook, and assuming recovery was to follow, the PE for BHP at that time was appropriately high.

A similar observation can be made for, among many others, Blackmores ((BKL)) shares, currently trading on consensus FY20 PE of 67x, declining to 38x on next year's forecasts.

Sure, the whole notion that these forecasts can be too rosy and this pushes the multiple even higher, and thus the share price might have to come down might be valid, but it will not translate into Blackmores shares trading on single digit PE multiples.

That's simply not how this works. Unless we all collectively give up on any prospect of a recovery, which is what happened during the GFC.

Incidentally, and as highlighted in the BHP example earlier, PE multiples for both miners and energy companies fluctuate often between extremes, which is yet another reason why a general average market PE in Australia is seldom the right tool to use.

Low Yields & Inflation

Lastly, the key difference between 2020 and prior historic reference points is made up by extremely low sovereign bond yields, which reflects favourably upon other assets, including equities.

Detailed analysis from historic data had already established that periods of low inflation and low cash rates/bond yields translate into higher valuations, on average, for equities.

The current environment of extreme low bond yields, alongside low inflation, has simply added another step on top of this basic principle, without even mentioning the truly unprecedented liquidity and support measures from central banks and governments.

So where does all this leave us?

There is no denying parts of equity markets are exhibiting unbridled euphoria and extreme momentum focus as is typical for every bull market. 2020 is not an exception.

Share prices surging higher by double digit percentage, on multiple consecutive days, more so in the US than here in Australia, is not indicative of a rationally behaving market.

But is it indicative of broad, widespread irrational exuberance?

Ultimately, whether today's share prices can be maintained and justified hinges on the macro-outlook (economic recovery) and on what individual companies can achieve in terms of cash flows and profits.

Within this context, ResMed trading on more than 40x times this year's and next year's consensus profits may not necessarily imply the stock is set-up for a big correction, just like shareholders in Treasury Wine Estates, Vicinity Centres and Japara Healthcare might have to be a lot more patient, and even endure ongoing share price weakness for a while.

Instead of getting spooked by apparent elevated valuations, I think investors will be better served by focusing on the achievements and the outlook for individual companies.

The upcoming August reporting season will not answer all questions, but it might provide lots of clues and insights.

At the macro level, there remains the potential for another period of extreme market rotation in case of vaccine success; out of "expensive" and into "cheap", similar to what happened in late 2016.

Ultimately, I believe forecasts, not today's valuations, will decide the direction of shares in the short and medium term. Which is why macro developments remain crucial.

And a guarantee for ongoing volatility, and many more attempts for portfolio rotation.

Investors better get ready. This show is only half-way through, at best.

Is Biden A problem?

Occasionally, the question lands in my inbox: Rudi, what do you think will happen with Trump in November? If he loses, will it be a problem for the markets?

From the surveys and the commentaries I have read to date, the answer is a firm negative.

It appears Wall Street has already resigned in the fact that Trump will likely lose the election, and this means a partial winding back of the extremely favourable tax cuts, plus a number of other changes in healthcare and for the wealthy 1%, etc

But in place of Trump's mishandling of the current health crisis, and the uncertainty caused internationally, comes a much steadier hand, and that will be welcomed by businesses and their leaders.

Not to be dismissed: Biden has answered Trump's focus on fossil fuels and other traditional parts of the economy with the intention to invest in tomorrow's infrastructure with more emphasis on renewables and sustainability.

Investors in the share market already made that switch.

Telstra, There Is Another Way

Once again I had to find out the hard and painful way that Telstra ((TLS)), simply put, is not a world-class operator.

But, lucky me, I also discovered there are many people working at Telstra under not so ideal circumstances, in a far from idyllic environment, and they are motivated, hard-working angels, putting in their utmost to right whatever went wrong, in the quickest and most practical way possible.

This has to be acknowledged, and today I bow my head to you all. I admire your mental strength and your fortitude, your persistence and your sheer personal sense of responsibility to not let Telstra customers disappear in that self-created giant sinkhole, never to be heard from again.

Under different circumstances, I would by now emphasise that a company like Telstra simply cannot be an excellent value creator for long-term shareholders. It is simply not running well enough.

But then analysts at Wilsons publish their view that Telstra is, in their suspicion, quietly preparing for a structural separation into two or more separate companies (the analysts think there is a case to create four separate companies).

Such an unbundling, says Wilsons, could unleash as much as 50% in added shareholder value between now and 2025.

And this, I say, fits in perfectly with the narrative I started this story on. There is always room for another side to the story.

In case anyone wonders: Fiber, Infra, Retail & Tower.

FNArena Talks

-One of my recent interviews is now available as a podcast via Spark Your F.I.R.E. buff.ly/3j0A1Gm

-Webinars in September: CPA SMSF Discussion Group (16th) and Australian Shareholders Association (ASA) on 22nd

(This story was written on Monday 20th July, 2020. It was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website).

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