Australian Market Summary (Issue 414) – 26 August 2016

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Read this.

Last night I got an email from a colleague in London that totally blew my hair back.

In Singapore yesterday, a self-driving taxi hit the streets for the first time.

We’ve long heard about Autonomous Vehicles and the progress they are making, about the millions of miles Google and Tesla have driven in testing, but yesterday a car hit the road in operation for the first time.

It’s happening. Here is the article.

https://techcrunch.com/2016/08/24/mit-spinout-nutonomy-just-beat-uber-to-launch-the-worlds-first-self-driving-taxi/

What I found most staggering was the observation that when cars first hit the road in NYC in 1898 it took just 15 years for the horse & cart to be fully absent from city streets.

With the rate of technological innovation presently achieved, it would seem more than reasonable to assume self-driving cars could be ubiquitous in a decade or less.

Incredible.

I thank Neil Campling at Northern Trust in London for this amazing observation and his constantly thought-leading insights on global technology.

If there is an investment takeaway from the above observation, it's quite simply that you cannot get exposure to this or most other technology themes in the Australian share-market.

You just can't.

You need to have a conversation with your adviser as to the suitability of investing offshore through one of our preferred global managers. As far as I am concerned, Hamish Douglass and the team at Magellan in Sydney are as good as anyone globally.

We have Damian Craven from Magellan presenting in Melbourne next Tuesday lunchtime.

It would be great to see you all over canapés and coffee, to hear Damian Craven from Magellan explain why investors need to consider foreign shares in a suitably diversified portfolio.

Please sign up via the link below to come along, if you are free at lunchtime on Tuesday!
www.primefinancial.com.au/magellanpresentation

Onto Markets… and there is a boatload

Guys, I'm going to apologize in advance here, but there are simply too many things worthy of conversation this week to cover them fully.

Big picture … its getting worse

I am getting more bearish.

Results season has been indifferent at best, downright disappointing at worst. In fact, I'm struggling to find a stock that beat expectations genuinely beyond perhaps **Woolworths (WOW)** on Thursday, **AMCOR (AMC)** today and **Ansell (ANN)** a week or so ago.

In fact, this week saw more damage done to future 'income' expectations when

Wesfarmers (WES) admitted its conceit (of paying part of its dividend from debt) and reduced its final dividend to 95c (from $1.11 last year).

WES follows **ANZ (ANZ), BHP (BHP), Woolworths (WOW)** and **Rio Tinto (RIO)** as a notable top-10 shares that have **REDUCED** their absolute dividend payout this year.

With National Australia Bank (**NAB)** likely to follow suit in 2017 and reduce its absolute dividend by perhaps 10% or so, ***you have over HALF of Australia's 10 largest corporates that HAVE REDUCED THEIR ABSOLUTE DIVIDEND THIS YEAR.***

This is a major problem for portfolio income, particularly when you consider term deposit rates have continued to fall.

Driving the falling dividend income is a deterioration in corporate profitability and yet Australian share prices are at their highest levels in a year.

The ASX200 Accumulation index is up +7.5% year-to-date, which is something to be thankful for, but not something you should expect to continue.

The foundations on which this market rise has been built are weak and, make no mistake, investment returns in the coming 12 months will be infinitely harder to find.

Play it safe, play it defensive, hold some extra cash (like we have said since April) and consider sensible income-generation in the form of unlisted property such as the **AMP Wholesale Australian Property Fund** (recommendation sent out this week).

Stock news & views this week… important context

Woolworths (WOW) – the supertanker is turning

Solid results this week, bearing in mind that **WOW** had already pre-guided the market for what to expect on 2016 profits.

What was positive here and what helped the shares rise 4% on the week was news that the first 8-weeks of trading since July 1st had seen its food business return to positive growth (+0.3%). This is excellent news and comes sooner than many had anticipated in turns of operational momentum in the core food business. For context, sales had been negative throughout 2016 and the +0.3% rise compares to the Coles underlying sales growth of +3.2% in the quarter, which conversely is the LOWEST RATE OF SALES GROWTH SINCE WES BOUGHT COLES in 2007.

Momentum is shifting here and **WOW** as the industry heavy-weight is starting to up the ante against Coles and **WES**.

Further encouragement in **WOW** was had with confirmation the group had completed the sale/closure of its loss-making Masters home-improvement chain.

Coupled with the likely sale of both its service station business and part of its hotel and liquor assets, **WOW** looks well placed to continue higher.

This call is now starting to work.

Flight Centre (FLT) – we caught a lucky break

Maybe I'm being a little harsh on myself, but all the same, the 5% rise in **FLT** this week brought about a sigh of relief at my end.

FLT has not been the call we wanted it to be and we have been looking for the opportunity to take positions of (as per todays SELL recommendation).

Fortunately, the underlying 2016 profit result was no worse than their profit-downgrade implied when given 3 months ago and the stock has managed to rally.

Trouble is, the core business is still facing the one and same headwinds (BREXIT impact on British consumers, Zika virus, airfare discounting), so we were keen to make the most of the opportunity and exit positions today.

QUBE Holdings (QUB) – average result, but incredible strategy

We got very lucky this week in that **QUB** CEO and CFO Maurice James and Paul Lewis presented to our advisory group after their full-year results.

The results themselves were iffy, but the medium term strategy is superb.

The resource industry is a large customer of **QUB's** port business and conditions there have been tough – albeit **QUB** think they are bottoming now fortunately.

We like the stock much more for its planned Moorebank Inland freight terminal and the prospect of significant value accretion. Confirmation of financial closure on Moorebank in the coming month will be well received we think.

We think **QUB** ought reach the high $2's on confirmation of the Moorebank approvals and that might cap it out near term.

Blackmores (BKL) – short-term headwinds offer the chance for longer-term gain

We slapped a BUY on **BKL** today, having watched it for much of the year.

The company fell over 20% this week in large part due to comments that the first quarter sales figures would be DOWN on 2016.

This set the cat amongst the pigeons. **BKL** was meant to be a stock growing like a weed!

In truth, the sales slowdown is in substantial part a de-stocking by intermediaries selling **BKL** product into China and makes the sales slowdown look worse than perhaps it is.

We feel strongly that underlying demand remains sound and that the regulatory changes that have acted to put a brake on Chinese sales will ease, making the recent 40%+ share price fall an attractive opportunity to BUY.

<u>Wesfarmers (WES) … expensive and sucking in breath</u>

I shook my head as **WES** sailed back through $44 today.

WES results were disappointing and yet the market has pushed the stock higher on this inane belief that the closure of Masters would pronounce Bunnings some divine right to earn ever more profits.

Coles is growing at the slowest rate since **WES** bought the retailer.

The coal business lost more money than it was expected too.

Bunnings is going well, but the sale of all of Masters inventory into the Australian market will likely impact its margins.

Worse, **WES** announced a dividend that was at least 10-15% below market expectations and only 75% franked, effectively admitting that the group had been overpaying dividends in the past 3 years.

The stock is rich at $44 and if you have significant **WES** shareholdings as many of my friends in the west do, I would strongly encourage you to talk to Ian, Luke or Vinh and considering taking some profits here.

<u>Telstra (TLS) – it is a STANDOUT BUY here at $5.30</u>

Guys, I can’t very well send out a BUY note on **TLS** since so many of you all own so much of it, but what I can do is give you some broader guidance on how the stock should fit in portfolios.

My remarks above on **WES** and on the dividend cuts elsewhere in the market are important context for why **TLS** is BUY here at $5.30.

TLS now yields 6% and it is on a dividend of 31-32c that will NOT be cut.

I feel strongly that you can hold 10% of your equity portfolio in **TLS** here if income is a priority (2x its market weight) and it will outperform.

Elsewhere in the market this week …

Outside of **BKL** there were a few other disasters for investors to deal with.

Mid-cap darlings **Aconex (ACX) and APN Outdoor (APO)** were taken beaten down 14% and 35% respectively when they missed earnings estimates.

The trouble with both stocks was the love affair investors had with both names and the incredibly high multiples being paid for both.

The lesson here continues to be in ensuring that what you pay for a stock (or any investment for that matter) is such that your downside is limited or at least commensurate with the reward you intend you to make.

Things settle down next week fortunately, however tonight’s address from the US Federal Reserve Chairperson Janet Yellen will be closely watched for any guide on a hastening in the likely pace of US interest rate tightening.

Any questions please call.

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