

NEXT Daily – 1st June 2010

Overseas

US and UK markets were closed.

Nikkei rose 5 pts or 0.06% to 9,768.70 (YTD -7.37%) and the **Hang Seng** fell 1 pt or 0.01% to 19,765.19 (YTD -9.64%)

Oil rose 0.60% to \$74.44 a barrel.

Gold rose \$3.50 to \$1,216.00 an ounce.

SPI 200 Futures closed down 17 pts at 4,421.

Ideas

Australian Equities finished moderately lower yesterday, in light trading ahead of the U.S and U.K markets being closed last night. Financial markets were closed in the U.S for Memorial Day, while U.K markets were shut for the Spring Bank Holiday. In yesterdays trade the S&P/ASX 200 declined early in the session, following Fitch Ratings downgrade to Spain's credit rating and increased tension on the Korean Peninsula. The benchmark rebounded and trended up for most of the session, as bargain hunters saw value at the end of the worst month since October 2008, only to be sold off again late in the day. News that China will be taking an active role in helping to resolve the conflict between North and South Korea, provided a lift to sentiment.

A major concern in the market has been China's ability to control the growth of their economy and in particular their booming housing sector, fears of over tightening have put pressure on resource prices and in turn the resource sector. Interestingly Royal Bank of Scotland (RBS) now believe that given the ongoing credit issues in Europe, China may in fact be prompted to an earlier-than expected study of relaxation measures by policy makers. RBS said the timing is difficult to call, but they believe that property is likely to be the first to see incremental policy easing. RBS said:

Property likely to be the first to see incremental policy easing We have received a number of questions about whether China would reflate again. Based on our recent checks, we believe that further tightening is off the table. However, a broad-based reflation policy is also unlikely. That said, property is likely to be the first to see incremental policy easing, in our view. If volumes stay at depressed levels in the coming weeks, that may be taken as evidence of constrained ability to raise prices and possible price moderation/stability with increased supplies in 2H10F. Less restrictive second or third-home mortgages and delayed property taxes are possible moves, in our view. But, if property prices surge again, we would expect Beijing to apply the brakes yet again. The affordability of housing has become a social and political issue in China, instead of just an economic issue, in our view.

The 'Beijing policy put' may kick in earlier than we expected So far this year, we have seen the market take a cue from Beijing's property policy as a directional sign of its overall macroeconomic policy. Property shares have also been led by incremental property policy direction. We previously anticipated relaxation in macro policy likely post mid July's release of 2Q10 macro data. Now, if a relaxation of property policies occurs before this, we may see a 'policy put' being priced in earlier than we expected, helping to support trading upside in property and material shares. On the other hand, the market may need to price in a greater reduction in growth expectations for both China and the external economies. Our central view is that the reduction in internal and external growth expectations will have a greater downward impact on the market than the positive impact of a 'Beijing policy put'.

Excessive reflation unlikely: moderate growth = moderate inflation We believe that any new policy relaxation, if it were to materialise, will come nowhere near the impact of the Rmb4trn stimulus package. The Chinese banking sector and local governments are more constrained and the Chinese households have levered up more than in late 2008. Too much relaxation of the property market may lead to more bubbly markets and greater social contention down the road. But the central government can still lever up, particularly toward public service infrastructure that will help narrow the gap between the rich and the poor. We believe Beijing prefers 9-9.5% GDP growth in 2010-11, in order to keep inflation manageable while digesting the excess liquidity released in 2009. Administrative measures are preferred to pinpoint pockets of excessive growth over market-driven measures (ie interest rate hike) that may overly depress growth. This means to us frequent policy fine-tuning to keep growth and inflation in balance.

As the stoush between the Government and Mining companies intensifies Bloomberg reported that Rio Tinto Group, the world's third-largest mining company, said as much as half its balance sheet is threatened by Australia's plan to boost taxes on resources producers. The complexity of the proposal for a 40 percent super profits tax on resource companies makes it difficult to assess its costs precisely, Tom Albanese, Rio's chief executive officer, said in an interview broadcast yesterday on ABC's "Inside Business." He said it may amount to more than 50 percent. "This is half our balance sheet at risk because we have someone now coming in to say, 'I want to be your silent partner. I want 40 percent of your pretax profits and largely written-off assets,'" Albanese said. The tax has damaged Australia's reputation overseas and added to sovereign risk, he said. The government set aside A\$38.5 million (\$32.6 million) in its May 11 budget to promote an overhaul of the nation's tax system, including the resources levy. Mining companies oppose the tax, scheduled to take effect in 2012, and have placed full-page advertisements in Australian newspapers to lobby for changes. Last week, the government controversially said it will run its own advertising campaign to counter the "misinformation." Treasurer Wayne Swan said in an e-mailed statement yesterday that the super profits tax, or RSPT, wouldn't be retroactive.

Research

Tox Free Solutions Limited (\$2.39) – Following their recent share price performance, UBS has retained a HOLD whilst JP Morgan has **downgraded** to a HOLD. UBS has a price target of \$2.70.

Redflex Holdings Limited (\$1.55) – With a win on their court case brought against RDF by their competitor, American Traffic Solutions (ATS), Credit Suisse has **upgraded** to a BUY with a price target of \$2.00.

Wattyl Limited (\$1.28) – On the back of WYL providing a trading update, both Macquarie and Credit Suisse have **downgraded** to a HOLD. Credit Suisse has a price target of \$1.45.

Tatts Group Limited (\$2.37) – Following their recent share price performance, JP Morgan has **downgraded** to a SELL with a price target of \$2.20.

AGL Energy Limited (\$13.83) – With the recent abrupt drop in share price, GSJB Were has **upgraded** to a BUY with a price target of \$16.85.