NEXT Daily – 16 June 2010

Overseas

The **Dow Jones** rose 213 pts or 2.10% to 10,404.77 (YTD -0.22%), **S&P 500** rose 25 pts or 2.35% to 1,115.23 (YTD 0.01%) and the **NASDAQ** rose 61 pts or 2.76% to 2,305.88 (YTD 1.62%).
The **FTSE** rose 15 pts or 0.30% to 5,217.82 (YTD -3.60%), **Nikkei** rose 8 pts or 0.08% to 9,887.89 (YTD -6.24%) and the **Hang Seng** rose 10 pts or 0.05% to 20,062.15 (YTD -8.28%)
Oil rose $1.78 to $76.90 a barrel.
Gold rose $14.22 to $1,235.47 an ounce.
Base metals were mixed with Copper up 0.28% to $301.80, Zinc rose 2.41% to $81.96 whilst Aluminium was up 0.90% to $89.86 and Nickel fell 0.35% to $914.44.
BHP ADR's trading at $39.19 vs the Aussie close of $38.39.
SPI 200 Futures closed up 68 pts at 4,590.

Ideas

It's tough to pinpoint a specific catalyst behind the US rally. There were a couple of European sovereign debt sales overnight that went off well and received attention (Ireland and Spain), although the big volume of paper comes on Thursday (when longer-maturity Spanish paper prices and France tries to move a slug of debt). The credit card master trust numbers hit for May and showed further improvement. The New York Fed's Empire State survey increased slightly from 19.1 to 19.6 in June. This is the eleventh straight month of positive headline readings following the prolonged period of negative readings throughout most of 2008 and the first half of 2009. The ISM-composite index improved from 54.3 in May to 55.8 in June. There was a fair bit of negative news around however, the market ignored this. U.S. home-builder sentiment fell in June by the sharpest amount since the height of the financial crisis as the expiration of a popular homebuyer tax credit dimmed prospective sales. The NAHB/Wells Fargo Housing Market index tanked 5 points to 17 (Mkt est: 21), the sharpest point decline since November 2008. From a technical perspective the S&P 500 finally managed to breach key resistance at its 200-day moving average (~1108) and is back at the unchanged level for the year. The long-awaited stock market debut of the Chicago Board Options Exchange provided some upward momentum for the broader U.S. listings market. The CBOE (+12%) surged after pricing at $29, the top of the expected range. CBOE raised just $339mln, but the Nasdaq listing was viewed as a bellwether for a return to stability in the U.S. IPO market, with four more issues expected this week.

With Australia probably heading to the voting booths in October, opinion polls indicating that the Rudd government is under pressure and the odds on a change of government having shortened, J.P. Morgan (JP) examines the likelihood and implications of a Coalition win.

> In our view, the odds are right to make Labor favourites in spite of recent setbacks. One-term governments in Australia are unusual and oppositions tend to lose ground in the run-up to elections. In fact, with the Senate changing shape as well, the government may even emerge from the election with more control over the political process than it has now.
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> We think that the political risk theme for the market as a whole can be overstated. The Resources tax is the key event defining this theme and since its announcement Australia has performed a bit better than the average equity market in local currency

terms. The AUD has been hit, but this in our view owes a lot to shifting risk appetite and falling expectations of short rates in Australia.

Individual stocks and sectors do stand to gain from a change of government, with Resources and Telstra the clear candidates, in our view. However, there are few investors who would hang their commodity sector view on Aussie politics, given how many other moving parts are involved. TLS is a purer play on the theme.

Although the government looks likely to return, their need for a 'win' might give Telstra some leverage. However, investors have to be confident that the underlying industry dynamics are priced in.

Following the A-REIT sector's recent outperformance vs the broader equities market, Deutsche Bank (DB) argues that this has been driven by a rerating of perceived defensive names, such as CPA, CFX and GPT. WDC has also outperformed the sector over the last month, driven by both its status as a proxy for the A-REIT sector for many investors, and the recommencement of its development pipeline. Post recent price moves, DB believe that many of the more "active" names (incl SGP, GMG, MGR) are undervalued vs "passive" names such as those above and make the following comments.

A-REITs look slightly undervalued on absolute measures…
On average, the A-REIT sector currently trades at an 11% discount to our NAV / SOTP valuations. We note that our valuations are predicated in part on real estate cap rates that are consistent with the most recent Independent Valuations undertaken by the A-REITs. In our view, these valuation parameters are likely to reflect the low-point in the asset value cycle. Similarly, our implied A-FFO growth analysis suggests that the market is "pricing in" long-run cash earnings growth for the sector of +3.7%pa, vs a 10-year average to FY08 of +4.1%pa on our estimates. With FY11 in our view likely to reflect a cyclical trough for A-REIT earnings, we believe these metrics suggest that the sector in aggregate is slightly undervalued at current levels.

…but are starting to look stretched vs the broader equities market.
The A-REIT sector has outperformed the broader market (XAO) by +3.8% over the last month and +8.1% for the last quarter. Post this outperformance, the sector in aggregate is starting to appear stretched vs Australian Equities. A-REIT's currently trade on a forward PE Rel vs XAO of 1.13x (vs an average 1.03x since 1995), and 0.99x vs XAIXF (vs a long-run average of 0.89x). However, we note that this these metrics are well below peak levels witnessed during the last cycle, and over the near term, we expect the A-REIT sector's defensive characteristics to support relative pricing.

Research

Premier Investments Limited ($6.12) – Following PMV's recent share price performance, UBS has **upgraded** to a BUY with a price target of $8.00.
Sims Metal Management Limited ($18.58) – With the scrap metal market deteriorating materially since the strength early in the quarter, Credit Suisse has **upgraded** to a BUY with a price target of $22.00
CFS Retail Property Trust ($1.97) – With a strong pipeline of projects to come for CFX, Deutsche has **downgraded** to a HOLD with a price target of $1.99.