

NEXT Daily – 24 June 2010

Overseas

The **Dow Jones** rose 5 pts or 0.05% to 10,298.44 (YTD -1.24%), **S&P 500** fell 3 pts or 0.30% to 1,092.04 (YTD -2.07%) and the **NASDAQ** fell 7 pts or 0.33% to 2,254.23 (YTD -0.66%).

The **FTSE** fell 68 pts or 1.30% to 5,178.52 (YTD -4.33%), **Nikkei** fell 189 pts or 1.87% to 9,923.70 (YTD -5.90%) and the **Hang Seng** rose 37 pts or 0.18% to 20,856.61 (YTD -4.64%)

Oil fell \$1.49 to \$76.36 a barrel.

Gold fell \$3.10 to \$1,236.95 an ounce.

Base metals were mixed with Copper down 1.44% to \$294.27, Zinc rose 2.02% to \$81.42 whilst Aluminium was down 0.99% to \$86.58 and Nickel fell 1.92% to \$870.99.

BHP ADR's trading at \$39.85 vs the Aussie close of \$39.14.

SPI 200 Futures closed up 11 pts at 4,484.

Ideas

US new home sales came in much weaker than expected, but the homebuilders themselves actually rallied. JP Morgan said keep in mind that the strength has to be viewed in the context of their June action – builders have been the worst performing space in the month of June by far (coming into today, they were down ~15% in June alone). After a two-day meeting, the Fed left interest rates unchanged, as expected, and delivered a slightly less rosy assessment of the economy. The Federal Reserve's policy-making arm said on that it had decided to keep short-term interest rates near zero for "an extended period" in light of continuing threats to economic growth. The Fed said it continued to anticipate that economic conditions, "including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period." In Europe, CDS spreads moved wider (Greece in particular has seen a dramatic widening from ~821bp on Fri to ~947 as of 3:30pmET Fri; the all time wides for 5yr Greek protection was set at 1004 back on May 7, right before the EU/IMF started to roll out its rescue mechanism) but the euro was able to rally on the day (largely b/c the dovish Fed statement weighed on the dollar). The markets are still waiting for some resolution on the financial regulatory reform front, w/Congressional leaders still hoping to have the House/Senate reconciled by Thursday.

At just after 10:30pm last night it was been announced there would be a formal leadership challenge by Gillard for the leadership of the Australian Labor party and therefore the position of Prime Minister. It was expected that the challenge would be made and party room votes taken. Precipitating these events was the fact that over the past few months, the Australian Federal government has been witnessing a decline in opinion polls and last weekend there was a by-election at state level for New South Wales seat of Penrith, which saw a 25 per cent swing against the Labor Party, the magnitude of this swing surprised many. Political commentators have noted exit polls indicate the swing is partly attributable to the proposed RPST and some other significant issues. **However at 9.30 this morning it was announced that Kevin Rudd had stood down as leader and that Julia Gillard becomes the first Female Australian Prime Minister, unopposed.** There will be much speculation over what this means for markets, Morgan Stanley (MS) prior to the announcement said that should Julia Gillard emerge as the new leader of the Labor Party it is possible that there could be a change to the structure of the proposed RSPT, as there is a federal election due late this year. Given this was the major contentious issue in recent polls

it would seem logical that it will be addressed as soon as possible. MS's view has been that the RPST should have up to eleven changes to its structure. These include the headline tax rate, the uplift factor, allowable deductions from the assessable profit and market value applied to existing assets for the purpose of calculating the tax. Macquarie Equities said the impact might be seen as below:

- Mid-cap iron ore names to have greatest delta to event in particular MGX/FMG
- Expect coal sector to see takeover premiums to creep back in (Prefer WHC)
- Contractors also likely to rally on hope of a watered down RSPT (Prefer UGL)
- TLS expected to be slightly weaker as odds of Liberal Party winning decrease
- Uncertainty around many of Ms Gillards policies likely to keep a rally muted but we expect a relaxation of the RSPT will be one of her first mandates

And JP Morgan highlighted the following table outlining the major resource stocks NPV's in a RSPT and non RSPT world.

Table 1: Share price (A\$) movements and potential impact of RSPT on JPM NPV estimates

	Share price	% fall since Apr 27	% fall since May 3	NPV - Royalties	NPV - RSPT
BHP	38.39	-8.7%	-3.0%	40.18	37.59
RIO	69.42	-9.7%	-0.1%	96.61	89.09
NCM	34.22	-1.0%	6.6%	24.83	21.25
FMG	4.14	-15.1%	-5.5%	4.35	3.56
OZL	1.035	-13.1%	-8.0%	1.47	1.35

Source: J.P Morgan estimates, Bloomberg

We do not include AWC, LGL, PDN, ERA and ILU in this table as we believe the RSPT impact on NPV is either negligible (AWC, LGL, ERA and ILU) or nil (PDN – offshore operating assets).

WilsonHTM (WHTM) has looked at the global steel market and identified some positive trends. WHTM said:

Output for May increased by 3.1% mo-on-mo, the **average daily steel production rate decreased by 0.3% mo-on-mo**, output was up 29.5% yr-on-yr. It appears that global steel production is in recovery mode, supported by a wide base increased production that is offsetting slowdowns in production growth in China, Taiwan, USA, South Korea and Ukraine in May. **Average daily production rates** in May were -1.9% for China, +0.0% for India, +4.7% for Japan, -2.2% for South Korea, +2.1% for Brazil, -0.4% for USA, +5.0% for France, +1.5% for Germany and +1.7% for Italy. **Yr-on-yr changes** in production ranged between +92% (Australia) and +17% (India). In May **China** produced 45.2% of world steel. **Asia** produced 62.9% of world steel. **Europe** produced 7.9% and **North America** 7.8% of world steel. **Baltic shipping indexes** have reduced in the face of ready availability of prompt tonnage capacity competing for thin inquiry for Panamax cargoes. Similarly Cape rates have fallen. **Iron ore price negotiations:** The three major iron ore producers appear to have adopted a price structure based on three-month average prices that should remove much of the uncertainty and cost of price discovery related to the old benchmark system. September quarter prices are indicated at between USD 142/t to USD 147/t, up from USD 105-110/t for June quarter. Increased steel price increases appear to have been accepted despite a slower outlook for steel production in some key areas. The World Steel Association **outlook** is that China's apparent use of steel in 2010 could climb higher than 579 million tonnes. However, 2011 could see a slower growth and demand is likely to hover around 595 tonnes. China is expected to account for 45.5% of the world's apparent steel demand in 2011. India's steel demand is forecast

to increase by 13.9% and 13.7% in 2010 and 2011, respectively, given that the country's steel demand showed steady growth during the economic downturn. The Commonwealth of Independent States (CIS) region (comprised of former Soviet republics), which saw steel demand fall by 28.2% in 2009, is expected to see an upward trend with demand growing by 11% in 2010 and 8% in 2011. The BRIC nations (Brazil, Russia, India and China) as a whole are expected to see a rise of 8% during 2010 in the use of steel and 4.1% in 2011. Generally the emerging economies are growing strongly while the developed economies are trying to recover, with varying degrees of success.

Research

Boral Limited (\$4.96) – With only \$200mn of debt to be refinanced by Aug 2011, UBS has **upgraded** to a BUY with a price target of \$5.90.

Australia and New Zealand Banking Group Limited (\$22.88) – Following ANZ's Asian Strategy to deliver above peer EPS growth while reducing ANZ's reliance on wholesale funding, Deutsche has **upgraded** to a BUY with a price target of \$26.00.

ConnectEast Group (\$0.38) – Following CEU's recent share price performance, GSJB Were has **downgraded** to a SELL with a price target of \$0.34.