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Overseas

The **Dow Jones** fell 96 pts or 0.98% to 9,774.02 (YTD -6.27%), **S&P 500** fell 10 pts or 1.01% to 1,030.71 (YTD -7.57%) and the **NASDAQ** fell 25 pts or 1.21% to 2,109.24 (YTD -5.90%).
The **FTSE** rose 2 pts or 0.05% to 4,916.87(YTD -9.16%), **Nikkei** fell 188 pts or 1.96% to 9,382.64 (YTD -11.04%) and the **Hang Seng** fell 119 pts or 0.59% to 20,128.99 (YTD -7.97%)
Oil fell $0.35 to $75.59 a barrel.
Gold rose $1.90 to $1,242.55 an ounce.
Base metals were stronger with Copper up 0.32% to $294.09, Zinc rose 2.91% to $79.81 whilst Aluminium was up 1.67% to $88.51 and Nickel rose 3.52% to $892.62.
BHP ADR's trading at $36.82 vs the Aussie close of $37.65.
SPI 200 Futures closed down 34 pts at 4,228.

Ideas

JP Morgan (JPM) said that heading into the trading day yesterday in the US sales traders were feeling positive, hoping for a bounce following the weakness on Tues, the European Central Bank 3-month tender results (where demand was below worst case), and quarter end (many thought Q-end rebalancing would help give a bid to stocks given how much they lagged Treasuries over the last 3 months). However, no real buying eventuated (other than some short covering right at the open) said JPM. The market sold off after Moody's placed Spain on watch for a downgrade, this came after S&P downgraded in late April however, it still seemed to upset the market. Technical factors were also blamed for the late selloff. The US labor market continues to show a small improvement with ADP private sector payroll increase of 13K for the month of June however, this was below the current consensus for this Fridays BLS number (of +110K). For the month Equity markets traded sideways on continued concerns over European sovereign debt and moderating growth expectations in China and the US. The Australian market finished the month down 2.9% but despite how the market feels at the moment, it actually managed to close higher for the 2009/10 financial year (+8.8%). Investor focus remained on the proposed RSPT despite the Government and Telstra announcing a non-binding Heads of Agreement regarding the NBN and the change in leadership, with Julia Gillard replacing Kevin Rudd as Prime Minister.

Deutsche Bank (DB) said that with the continuing weakness in equities PE ratios across markets are down at quite modest levels again, a product of the 15% or so decline in share prices, alongside still strong earnings growth expected by analysts over the year ahead. Despite this they believe a persistently lower PE for the Australian market doesn't seem inevitable. DB said:

> The obvious implication is that investors are now doubtful about the earnings growth actually occurring, with the sovereign debt crisis in Europe, signs of less momentum than there seemed in the US, and slowing in China, all contributing to concern about weaker world growth again. In Australia, the market PE ratio has dropped to 11x, while market earnings growth expected by analysts in FY11, covering roughly the next 12 months, has remained at around 25%. On our analysis, more or less flat earnings could be closer to what investors are fearing, i.e. no growth, with the market PE being 15x on this level of earnings, more like its average for the past decade and a half of low inflation. Thus, to us investors seem to be factoring in a lot of earnings risk, and we've highlighted the potential gains for the market if growth expectations

improve again and a more typical PE ratio holds. Nonetheless, some are concerned that even if earnings stay on course with forecasts, PE ratios mightn't recover greatly, and that we could be into a lower PE era now. It's certainly true that over recent years market PEs have been lower, but that's been during the financial crisis, and it may not remain the case. In this report we consider the factors that influence market PEs, including earnings growth, yields on competing assets, and risk premia, and we acknowledge that these mightn't be as favourable in many developed equity markets, but this should apply less to the Australian market. It's now become more evident that growth in the developed economies is likely to be constrained by fiscal consolidation, as well as other challenges. And this could see a persisting PE de-rating, with lower earnings growth expected, and perhaps even higher sovereign yields at some point. But the fiscal position in Australia is far less an issue, and growth is more dependent on Asia. Another claim is that growth is also likely to be more volatile and uncertain, affecting sentiment and requiring a higher risk premium, but this doesn't seem inevitable. Of course, if other developed markets do de-rate because of the pressures they face, Australia will likely be affected. But it should be to a lesser extent, and local factors don't obviously imply a persistently lower PE for the market.

BP has announced that it will sell US$10bn of assets in the next 12 months to help fund the clean up of the Gulf of Mexico oil spill (pre-spill guidance US$2bn-3bn). Royal Bank of Scotland (RBS) believes that BHP will be at the negotiation table for BP's upstream assets in the Gulf of Mexico (GoM) and North West Shelf (NWS), if they are on the market. RBS said:

> BP and BHP share ownership of Atlantis, Mad Dog and the North West Shelf. Increased ownership of these assets would be desirable for BHP due to their tier 1 status. BP has announced that it will sell US$10bn of assets in the next 12 months to help fund the clean up of the Gulf of Mexico oil spill (pre-spill guidance US$2bn-3bn). The disposals are likely to be primarily oil and gas fields that are not integral to the BP strategy. BHP could look to acquire assets or grow its stake in any large long life project that fits within its strategy. The key issue may be BP's view on its Deepwater strategic advantage vs an easy sale. Deepwater GoM assets could be core for BP, but may need to be sold for political reasons. BHP and BP share ownership of the North West Shelf (WA), Atlantis (USA), Mad Dog (USA) along with fields in the UK. The UK fields may be considered too small and mature for BHP to make a bid. However the Gulf of Mexico and NWS assets would be of interest to BHP in our view. While these assets could be considered core for BP, BHP may be willing to offer an attractive price based on their tier 1 status. The question may be: will BP become a distressed seller if the spill continues for an extended period? A transaction would be relatively simple due to the lack of anti trust issues and the requirement for minimal due diligence, on the basis that BHP already has an intimate knowledge of operating metrics. We estimate that BHP's gearing at the end of FY10 will be a conservative 13%, with net cash rising to US$7bn by the end of FY11. In our view, BHP has capacity to acquire US$10bn of assets (assuming they fit within its strategy) simply by raising a small amount of debt. BHP continues to offer a compelling investment case, in our view, with the stock trading on a FY11F PE of 8x and 20% discount to our NPV. Global macro economic issues are currently acting as a headwind for a rerating, although a relaxation of the RSPT, which is likely over the coming weeks (or days), could result in a positive market reaction.

Research

Ten Network Holdings Limited ($1.61) – Following positive feedback advertising markets and TEN's strong yield management in TV, UBS has **upgraded** to a BUY with a price target of $1.95.
Billabong International Limited ($8.74) – With BBG entering into an agreement to acquire West 49 for an enterprise value of approximately A$110m, Deutsche has retained a BUY, Macquarie has **upgraded** to a BUY whilst Credit Suisse and GSJB Were have maintained a HOLD and JP Morgan reiterates its SELL. Deutsche has a price target of $12.75.
PanAust Limited ($0.49) – With PNA delivering an expected two year extension to mine life at its PhuKham copper mine in Laos, GSJB Were and Deutsche have retained a BUY whilst Credit Suisse has **upgraded** to a BUY. GSJB Were has a price target of $0.80.
Energy Resources of Australia Limited ($13.30) – Following ERA flagging that its first half result will be poor due to low grades from mine scheduling, Credit Suisse has **upgraded** to a BUY with a price target of $14.90.
Qantas Airways Limited ($2.20) – With QAN management releasing the monthly traffic and capacity statistics for May 2010, RBS, JP Morgan, GSJB Were and Credit Suisse have all retained a BUY. Credit Suisse has a price target of $3.50.
Western Areas NL ($3.78) – Following recent share price weakness, Credit Suisse has **upgraded** to a BUY with a price target of $5.00.
Biota Holdings Limited ($1.02) – With sentiment in the sector remaining poor, RBS has **downgraded** to a HOLD with a price target of $1.11.
Karoon Gas Australia Limited ($5.95) – Following KAR's recent share price weakness, Macquarie has **upgraded** to a BUY with a price target of $8.50.