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# The Research Monitor

March Quarter 2020

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# Q4 2019 Performance

The Australian Share Market, as measured by the S&P/ASX 300 Index, was essentially flat in the December quarter of 2019 following increase of 9.5%, 7.2% and 1.2% respectively over the previous three quarters. The December quarter saw returns of -0.03% in price terms and 0.71% including dividends, with dividends making up over 25% returns since the start of the year.

The Australian market was driven especially by the shifting sentiment toward two of the biggest geopolitical issues of 2019 being the US/China Trade dispute and Brexit.

As fears regarding a global recession in 2020 brought about by these and other confidence factors abated, bond and equity markets responded. Firstly, we saw a steep rise in long term interest rates in both the United States and Australian bond markets. **Aussie rates went from near to 1% to 1.3% and US rates went from 1.67% to 1.92% over the quarter.**

Among Australian equity sectors, performance was extremely mixed. At one end of the spectrum we have the **Pharmaceuticals, Biotech & Life Sciences sector, containing heavyweight CSL Limited (CSL) which saw an increase of 17.4%** over the quarter and in stark contrast to the performance of the **Banks sector which fell 11.0% in price terms and 9.3% including dividends** as each bank seemed to experience more and more bad news regarding dividend cuts, compliance issues, capital raising etc. Given that these two sectors make up 27.6% of the index, investors who avoided the banks and stuck with the pharma sector would have handsomely outperformed the index.

**The largest component of the S&P/ASX 300 Index is still the Banks Sector (down to 20.6% index weight) but gaining fast is the Materials sector (18.2% index weight) which rose 4.5%, with bellwether BHP up 6.0%.** Energy sector returns reversed some of the year's earlier losses and increased 6.1% following rising oil prices. West Texas Intermediate oil prices rose 13.2% in the quarter and this pushed the sector higher, but coal stocks such as New Hope (NHC) and Whitehaven (WHC) once again weighed on the index.

**There were once again some spectacular returns amongst small companies, even as the broader Small Ordinaries Index rose only 0.76%** with Perseus Mining (PRU) up 65.7%, but the best stock performance for the quarter came from Virgin Money UK (VUK), formerly CYBG which rose 67.8%. At the other end of the table was Smart Group (SIQ) which saw a 43.2% fall following a CEO resignation and profit warning.

| Sector | Performance | Market Cap |
|---|---|---|
| Pharmaceuticals, Biotech & Life Sciences | 17.4% | 129,421 |
| Health Care Equipment & Services | 6.3% | 61,098 |
| Energy | 6.1% | 99,406 |
| Capital Goods | 5.8% | 15,578 |
| Diversified Financials | 5.0% | 95,293 |
| Materials | 4.5% | 334,916 |
| Transportation | 3.9% | 91,986 |
| Consumer Services | 2.7% | 54,201 |
| Commercial & Professional Services | 2.6% | 46,109 |
| Software & Services | 2.5% | 49,037 |
| Retailing | 2.1% | 65,544 |
| Utilities | 1.5% | 33,686 |
| Telecommunication Services | 0.3% | 48,951 |
| Real Estate | -0.7% | 129,891 |
| Food Beverage & Tobacco | -1.0% | 36,889 |
| Media & Entertainment | -1.0% | 16,991 |
| Insurance | -3.1% | 67,011 |
| Food & Staples Retailing | -3.5% | 66,653 |
| Banks | -9.3% | 378,155 |

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# Investors who avoided the banks and stuck with the pharma sector would have handsomely outperformed the index.

Global equity markets performed much more strongly than Australian markets in the December quarter, with the MSCI World ex Australia Index in Australian dollars up a robust 7.3%.

World share markets trended higher over the quarter as concerns about the outcome of trade talks between the United States and China gave way to optimism, culminating in the decision to sing an agreement on January 15, 2020.

**Bond markets struggled on the back of higher long-term interest rates with the Bloomberg AusBond Composite (0+Y) index down 1.1% and Bank Bills returning a measly 0.2%.**

The spread between 90-day bank bills and cash remained negligible for most of the quarter but was volatile – a sign of the shifting expectations that the RBA will continue to cut rates and by how much. Long term interest rates in Australia hit a record low on the 9th of October of only 0.87%%.

Market measures of risk or volatility were also subdued over much of the quarter suggesting investors have become comfortable with the likely path of inflation, interest rates, growth and trade.

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Martin Crabb
Chief Investment Officer

# 2020 OUTLOOK

## ASX200

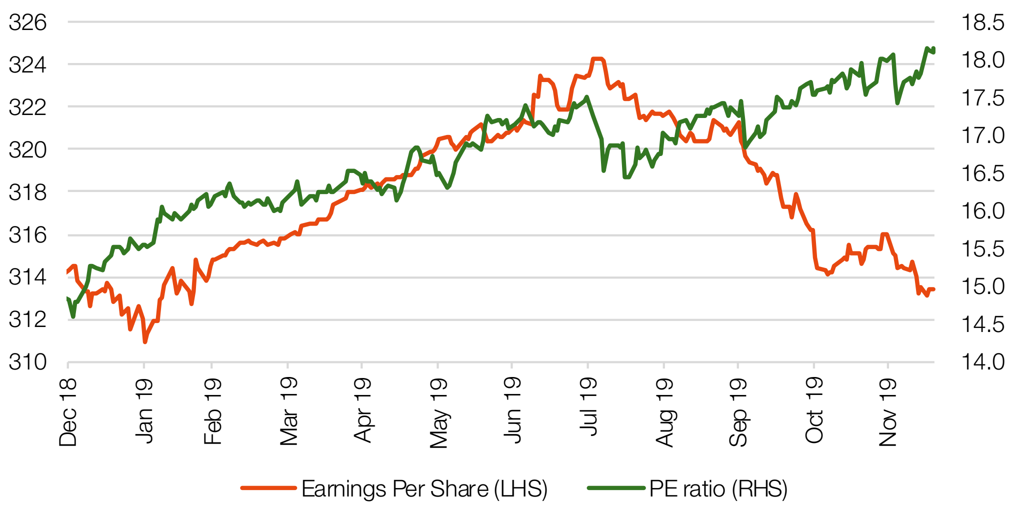
# This time last year, the market was selling off aggressively as investors feared that the combination of the continuation of interest rate hikes in the United States and escalation of the trade dispute between the US and China would cause a global recession.

Because of this low starting point, the fact that the US Federal Reserve changed path and the trade dispute is at least partially resolved, caused 2019 to be one of the best years for share market investors on record. The 21.3% rise in 2019 in the ASX All Ordinaries Index was the 16th highest since 1936!

Increases in share prices typically follow increases in company earnings and dividends, although this was not the case in 2019. Our outlook for share prices in 2020 can be thought of in two parts: firstly, what will earnings do in 2020 and how will the outlook for 2021 evolve as the year progresses, and secondly – how much will investors be willing to pay for those earnings? As mentioned, prices did not follow earnings in 2019.

Earnings for the Australian share market peaked in early August 2019 and then fell away toward the end of the year. It is often misleading to look at the Australian share market, since it is comprised of three, large and quite independent groups of stocks – Banks, Resources and Industrials. If we look at the picture of each of these mega-sectors we can start to build a more robust outlook for 2020.

**Earnings per share versus PE Ratio**

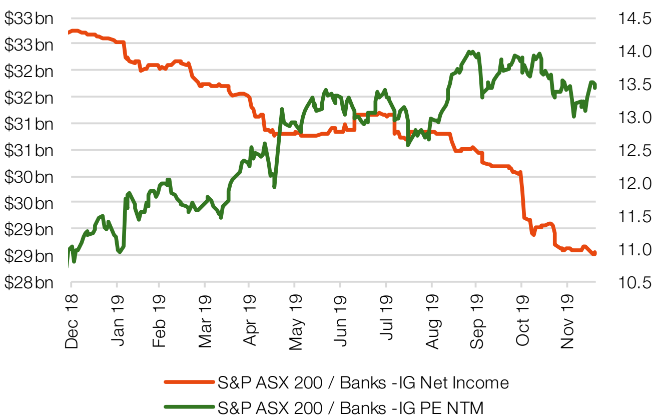



Source: FactSet and Shaw and Partners

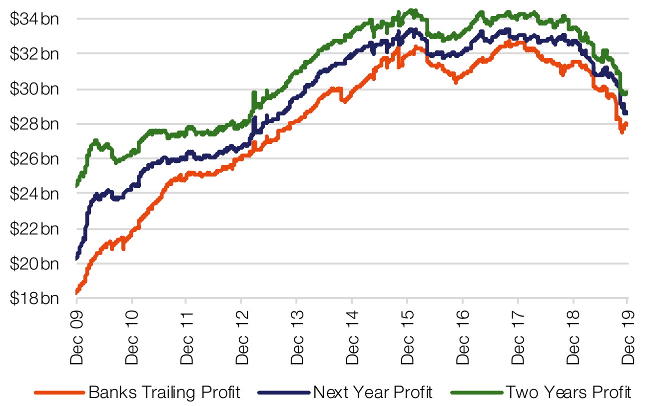
**The 21.3% rise (so far) this year in the ASX All Ordinaries Index is the 16th highest since 1936.**

| ASX ALL ORDS Index | | |
|---|---|---|
| Date | Close | Change |
| 2019 | 6920 | 21% |
| 2018 | 5709 | -7% |
| 2017 | 6167 | 8% |
| 2016 | 5719 | 7% |
| 2015 | 5345 | -1% |
| 2014 | 5389 | 1% |
| 2013 | 5353 | 15% |
| 2012 | 4665 | 13% |
| 2011 | 4111 | -15% |
| 2010 | 4847 | -1% |
| 2009 | 4883 | 33% |
| 2008 | 3659 | -43% |
| 2007 | 6421 | 14% |
| 2006 | 5644 | 20% |
| 2005 | 4709 | 16% |
| 2004 | 4053 | 23% |
| 2003 | 3306 | 11% |
| 2002 | 2976 | -11% |
| 2001 | 3360 | 7% |
| 2000 | 3155 | 1% |
| 1999 | 3109 | 15% |
| 1998 | 2697 | 5% |
| 1997 | 2580 | 7% |
| 1996 | 2405 | 10% |
| 1995 | 2189 | 16% |
| 1994 | 1892 | -12% |
| 1993 | 2153 | 35% |
| 1992 | 1589 | -7% |
| 1991 | 1702 | 29% |
| 1990 | 1319 | -22% |
| 1989 | 1700 | 11% |
| 1988 | 1533 | 13% |
| 1987 | 1359 | -10% |
| 1986 | 1518 | 47% |
| 1985 | 1035 | 38% |
| 1984 | 748 | -6% |
| 1983 | 799 | 60% |
| 1982 | 500 | -18% |
| 1981 | 614 | -17% |
| 1980 | 735 | 43% |
| 1979 | 515 | 37% |
| 1978 | 377 | 14% |
| 1977 | 332 | 11% |
| 1976 | 300 | -3% |
| 1975 | 308 | 48% |
| 1974 | 208 | -32% |
| 1973 | 307 | -27% |
| 1972 | 421 | 20% |
| 1971 | 351 | -2% |
| 1970 | 359 | -21% |
| 1969 | 455 | 9% |
| 1968 | 418 | 34% |
| 1967 | 311 | 34% |
| 1966 | 232 | 4% |
| 1965 | 224 | -12% |
| 1964 | 256 | 1% |
| 1963 | 252 | 22% |
| 1962 | 207 | -1% |
| 1961 | 208 | 9% |
| 1960 | 191 | -12% |
| 1959 | 217 | 39% |
| 1958 | 157 | 14% |
| 1957 | 137 | 10% |
| 1956 | 124 | 2% |
| 1955 | 122 | 5% |
| 1954 | 116 | 13% |
| 1953 | 103 | 8% |
| 1952 | 95 | -18% |
| 1951 | 116 | -8% |
| 1950 | 126 | 27% |
| 1949 | 100 | 4% |
| 1948 | 96 | -1% |
| 1947 | 97 | 13% |
| 1946 | 86 | 9% |
| 1945 | 79 | 10% |
| 1944 | 72 | 4% |
| 1943 | 69 | 5% |
| 1942 | 66 | 12% |
| 1941 | 59 | -10% |
| 1940 | 66 | -2% |
| 1939 | 67 | 0% |
| 1938 | 67 | -5% |
| 1937 | 70 | -2% |
| 1936 | 71 | |

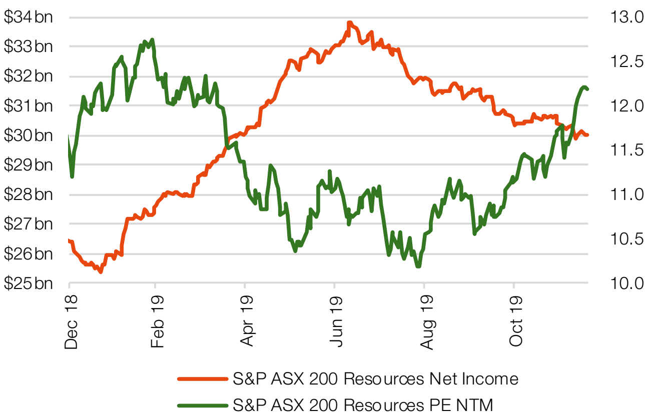
**Banking: Net income estimates & PE Ratio**



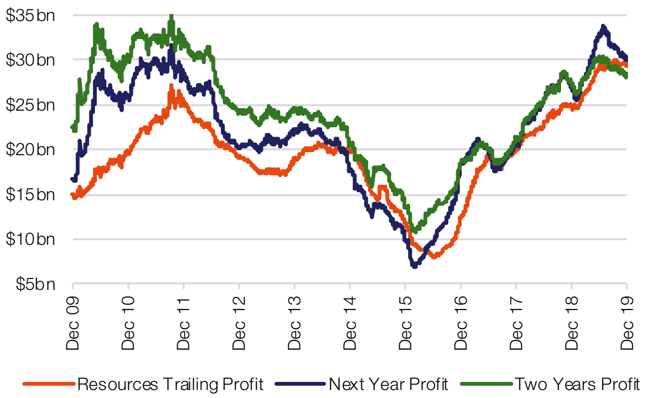

**Banking: Cash Profit after tax**




**Resources: Net income estimates & PE Ratio**




**Resources: Cash Profit after tax**




**BANKING: Banks have seen their net income estimates downgraded from $33bn at the start of the year to $28.5bn at the end – the largest drop in expected bank profits since the GFC. Despite this, PE ratios that investors were willing to pay for those earnings rose from 10.8x at the beginning of the year to 13.4x at the end.**

For the next twelve months, analysts expect only modest 2% growth in bank profits, with a 12.8% recovery in NAB profits leading the way, but with other banks struggling to grow. Shaw and Partners forecasts a 17% increase in 2020 profits for NAB due to the non-recurrence of customer remediation charges. For the following twelve months, analysts expect net income for the banking sector to grow by 4.6%, led by a recovery in Westpac (WBC) up 7.2% and the other major banks of 3%, with the regional banks expected to experience a fall in profits. Shaw and Partners is forecasting a significant increase in 2021 profits for WBC again due to non-recurrence of fines rather than strong income growth.

With a somewhat better Australian economy, lower interest rates and increasing housing prices, there should be some improvement over the course of 2020 regarding the outlook for 2021 profits and as such, we would expect some modest improvement (2-3%) in bank share prices in 2020, with returns being generated mostly from dividend yields which we see in the 6-6.5% range for the major banks.

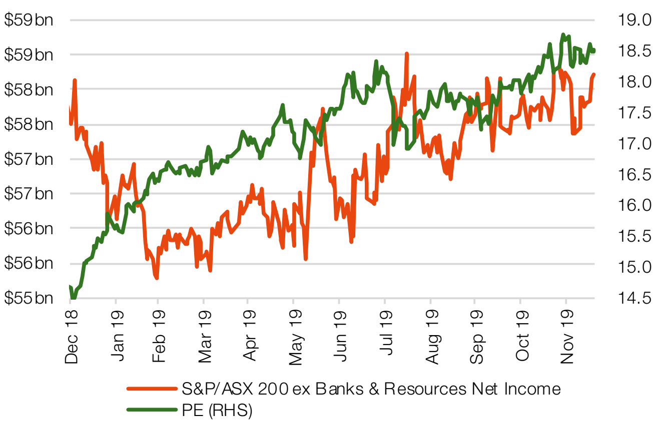
**RESOURCES: Turning to Resources, net income estimates for the sector rose sharply in the early part of 2019 as investors continually underestimated the impact of Brazilian iron ore outages and the strength of Chinese steel production. Estimates for net income rose from $25bn at the beginning of the year to a peak of almost $34bn in July.**

Prices paid for those earnings were inverse to this pattern (as is often the case for cyclical companies like miners), where the PE ratio declined from 12.5x to 10.2x in August 2019, before rising to 12.2x at year end.

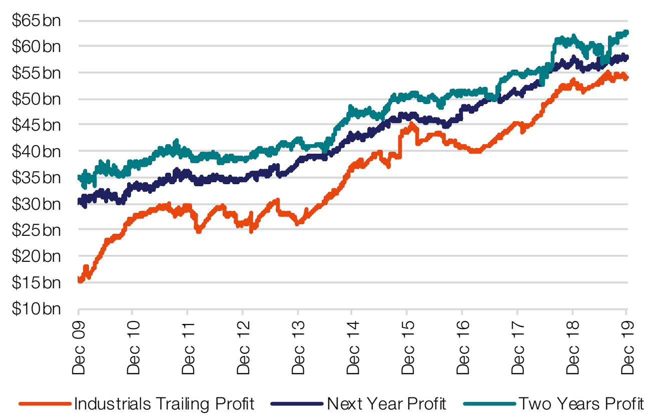
In terms of the outlook for net income in 2020 and beyond, analysts are expecting a significant fall for the Resources sector, led by anticipated lower iron ore prices. Shaw and Partners sees improvement in both industrial metals (copper, nickel) and energy prices into 2020 which should underpin profits in those sectors.

We see continued gains in Resource share prices in the early part of 2020, followed by a period of consolidation ahead of greater clarity on the decline in the pace of growth in China and the run up to the US Presidential election in November 2020.

**Industrials: Net income estimates & PE Ratio**




**Industrials: Cash Profit after tax**




Source: FactSet and Shaw and Partners

**INDUSTRIALS: Finishing with Industrials, both expected profits and PE ratios grinded higher over the course of 2019. Net Income estimates rose from $55bn at the beginning of the year to $58.2bn at the end, while PE ratios moved from 14.5x to a loft 18.5x over the same period.**

The outlook for profit growth for the next twelve months remains modest, but positive. After 7.6% net income growth in the next year, analysts are expecting 7.9% growth in the following year. This should help underpin the 18.5x PE ratio that may look high by historical standards, but in light of 1.2% 10-year government bond yields, is not expensive – if anything is a bit light.

Shaw and Partners sees a mixed period for Industrial shares in 2020, where we think the supermarket retailers will struggle to justify their current valuations, but the Real Estate sector will continue to see international capital inflow and support from low interest rates and bond yields.

Again we see the majority of returns coming in the form of dividend income rather than capital growth.

The top largest contributors to change in profits comprise 64% of the increase in profits over the next year, being:

- National Australia Bank (NAB)
- Woodside Petroleum Ltd (WPL)
- CSL Limited (CSL)
- Commonwealth Bank of Australia (CBA)
- Transurban Group (TCL)
- Santos Limited (STO)
- Atlas Arteria Group (ALX)
- Newcrest Mining Limited (NCM)
- Northern Star Resources (NST)
- LendLease Group (LLC).

For the following year, the top ten contributors comprise 58.5% of profit growth are:

- CSL Limited (CSL)
- Westpac Banking Corp. (WBC)
- Commonwealth Bank of Australia (CBA)
- National Australia Bank (NAB)
- South32 (S32)
- QBE Insurance Group (QBE)
- Australia and New Zealand Banking Group (ANZ)
- Transurban Group (TCL)
- Macquarie Group (MQG)
- Amcor Plc (AMC).

**In the next year, the collective profits of BHP Group (BHP), Rio Tinto (RIO) and Fortescue Metals Group (FMG) are expected to decline by $950m and the following year by $2.67bn. With so much dependence on a small number of companies for the bulk of the profits growth in the Australian market, it pays to be selective.**

Combining the outlook of the three sectors, we see strong performance from Resources in the early part of 2020 fade as the year progresses, banks will struggle in the early part of the year but may look interesting mid-year and industrials will grind higher with dependence on a small number of companies and some price volatility along the way. Whilst not reaching the giddy heights of the investment returns of 2019, 2020 shapes up to be a positive one for the Australian share market.

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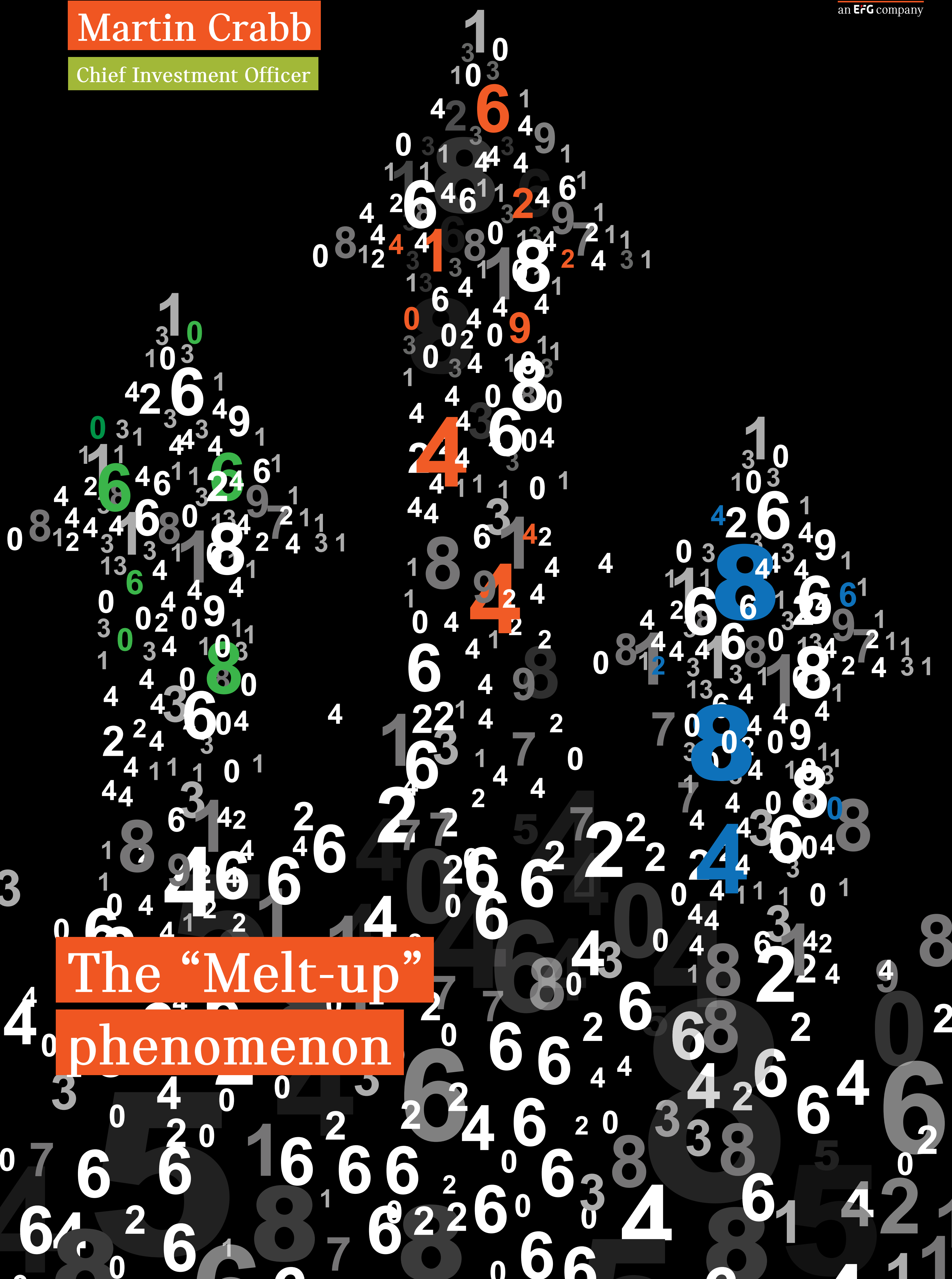
Martin Crabb
Chief Investment Officer



# The “Melt-up” phenomenon

**MELT UP EXPLAINED:** Securities are priced using a capital asset pricing model which considers the required rate of return and the expected cashflows implied from holding the security over time. In the case of fixed income investment such as government bonds, both the holding period and the cashflows are known with a high degree of certainty and so it is fluctuations in the required rate of return that dictate movements in the price of the security.

In the case of equities, however, both the timing and quantum of the cashflows is uncertain and this also impacts the required rate of return (more certain cashflows mean a lower required return, less certain cashflows mean a higher required return).

**We can use some mathematics here to describe this process.** Firstly, let's look at a simple model for equities which considers a company that grows at a constant level, $g$ and for which we require a return of $r$. The price of this security $P$, is determined by discounting the future cashflows $e_i$ over the investment holding period, $n$. That is, as owners of the equity, we receive a cashflow each year of $e_i$ which grows at a constant rate of $g$, so we can express the future cashflows as a function of this year's cashflow.

$$e_n = e_0(1+g)^n$$

The price we are willing to pay for the security that produces this cashflow is then a function of the required rate of return at which we discount these cashflows.

$$P = e_0 + \frac{e_0(1+g)}{1+r} + \frac{e_0(1+g)^2}{(1+r)^2} + \frac{e_0(1+g)^3}{(1+r)^3} + \cdots + \frac{e_0(1+g)^n}{(1+r)^n} + \cdots$$

Very elegantly, where $g$ and $r$ are constant, this equation becomes:

$$P = \frac{e_0}{r-g}$$

We are now concerned with the appropriate rate of return for these cashflows. What determines this? Again, a mathematical model can help us here. Called the "capital asset pricing model" or CAPM for short, it suggests we consider the risk-free rate (the rate at which we can earn on a riskless asset (such as a AAA rated bond or government backed investment), $r_f$, as well as the riskiness of the asset. The second part we can think of as "how much more return do we want from investing in all risky assets, such as the share market as a whole" and "is this investment more or less risky than the market as a whole"? CAPM is expressed as:

$$r_i = r_f + \beta(r_m - r_f) + \alpha_i$$

Where $r_f$ is the risk-free rate (typically we use the yield on a 10-year government bond), $\beta$ is the relative riskiness of the security against the market, $r_m$ is the expected return of the market and $\alpha_i$ is the stock-specific return (that part of the return that can't be explained by the market. The middle term considers the risk of the cashflows and is thought of as relative risk times the equity risk premium. So $\beta$ is relative risk and the term ($r_m$-$r_f$) is the equity risk premium.

*So that's all great, but how does it explain "melt up"?*

# The "Melt-up" phenomenon

**Firstly, let us look at each of the terms in the CAPM. Risk-free rate or $r_f$. If we look at fifty years of history, we can see that this has fallen appreciably. As the risk-free rate falls, so does the required return on all other investments, other things being equal. So if we held the beta, equity risk premium and stock-specific risk all constant, the fall in the risk free rate would see a fall in the required rate of return for the security and thus a rise in price.**

The Reserve Bank of Australia recently published a paper titled "The Australian Equity Market over the Past Century", which showed the equity risk premium (the extra return of equities 10.2% less 10-year government bonds 6.2%) was 4% over that time frame.

| Total Returns 1917–2019 | |
|---|---|
| **Total market** | 10.2 |
| Resources | 10.2 |
| Financials | 10.3 |
| Other | 10.4 |
| 10-year government bonds | 6.2 |
| Consumer price inflation | 3.9 |

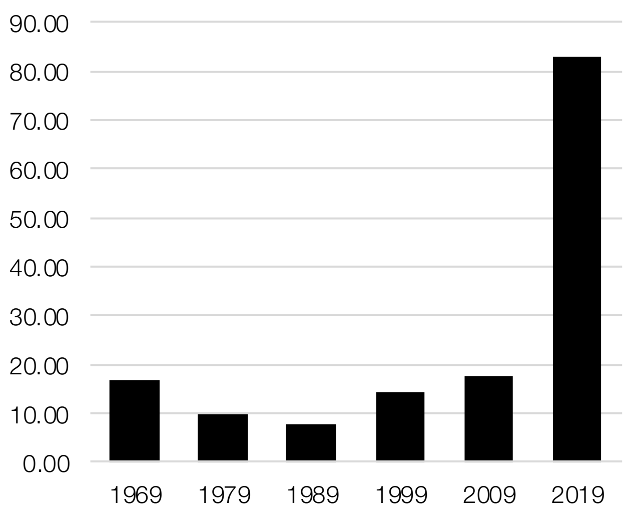
*Source: ABS; ASX; RBA*

We can keep this as a constant in the CAPM, and set stock specific risk to zero (for the market as a whole has no stock specific risk), then the only variable through time will be the growth rate of earnings. The compound rate of earnings of the Australian market has been 5.32% since 1875, in line with the average bond yield over that time of 5.55%. If we keep the rate of growth of earnings at a constant 4%, for example, we can see how the "fair" PE for the market would change through time.

| Date | 1969 | 1979 | 1989 | 1999 | 2009 | 2019 |
|---|---|---|---|---|---|---|
| $r_f$ | 6.00 | 10.08 | 12.82 | 6.92 | 5.65 | 1.21 |
| $\beta$ | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| $r_m - r_f$ | 4.00 | 4.00 | 4.00 | 4.00 | 4.00 | 4.00 |
| $\alpha$ | – | – | – | – | – | – |
| $e_0$ | 10.00 | 10.00 | 10.00 | 10.00 | 10.00 | 10.00 |
| $g$ | 4.00 | 4.00 | 4.00 | 4.00 | 4.00 | 4.00 |
| $r$ | 10.00 | 14.08 | 16.82 | 10.92 | 9.65 | 5.21 |
| $P$ | 166.71 | 99.21 | 78.03 | 144.51 | 177.15 | 829.19 |
| $PE$ | 16.67 | 9.92 | 7.80 | 14.45 | 17.71 | 82.92 |

**Australia Benchmark Bond – 10 Year**


**Price-to-Earnings Ratio**




Source: FactSet and Shaw and Partners

This admittedly overly simplistic example, suggest the fair value PE for a stock earning $10 back in 2009 would be worth $177.15 and the same stock today would be worth $829.19.

Reconsidering the simple valuation model:

$$P = \frac{e_0}{r - g}$$

As the required return, r approaches the long-term growth rate g, the Price P approaches infinity. This helps to explain the "melt-up" phenomenon.

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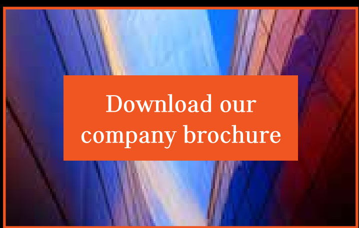



**30+**
YEARS IN THE MAKING

**$19bn**
OF ASSETS UNDER ADVICE

**6**
OFFICES IN
SYDNEY
MELBOURNE
BRISBANE
ADELAIDE
CANBERRA
PERTH

**300**
STAFF AUSTRALIA WIDE

**180+**
INVESTMENT ADVISERS & FINANCIAL PLANNERS IN AUSTRALIA

Future Leaders Panel

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# EFG predictions and preferences

# Review of 2019 Outlook

## Each December, we review the Outlook we presented a year earlier. In 2019 our predictions proved to be sound. Overall, with two judged 'partly correct – a half mark' we scored 9/10.

**1. CORRECT Global growth continues; no recession in US or other developed economies.** We expected that global gross domestic product (GDP) growth would continue in 2019 and that the US and other developed economies would not head into recession. Some countries were close to recession – notably the UK and Germany – but it was avoided. So, once again, the global expansion continued.

**2. CORRECT Trump: all out for growth.** We expected President Trump to do all he could to stimulate US growth, but recognising the limits to what could be done we thought "the emphasis will be on the maintenance of growth". In particular, we thought his criticism of the Fed would lead to "interest rates not rising as far and as quickly" as the market was expecting in late 2018. That, indeed, proved to be the case, with previous rate increases reversed from July 2019 onwards.

**3. PARTLY CORRECT Emerging markets recover.** We thought emerging markets would grow faster than developed markets in 2019, which they did. However, they did not grow as fast as in 2018. According to IMF estimates, GDP growth in emerging markets was 3.9% in 2019, weaker than the 4.5% recorded in 2018. However, emerging market bonds did well in the year (with a total return of 12.3% in the year to 13 December 2019). Emerging market equities, however, underperformed developed markets (total returns of 15.6% compared to 26.2%, in the year to 13 December 2019).

**4. CORRECT US industrial sector favoured.** We thought that the US industrial sector of the equity market in late 2018 was pricing in a recession in the US economy. As that seemed very unlikely to us, it was our favoured US equity market sector. The sector did outperform the broad market and was the third best performing of the ten economic sectors, after IT and telecomms.

**5. CORRECT Real rates stabilise or fall.** We thought that the rise in real interest rates in the US, measured by the yield on Treasury Inflation- Protected Securities (TIPS), would "stabilise or maybe even fall". The real yield on 10-year TIPS fell Correct from 1% at the end of 2018 to just 0.12% on 13 December 2019.

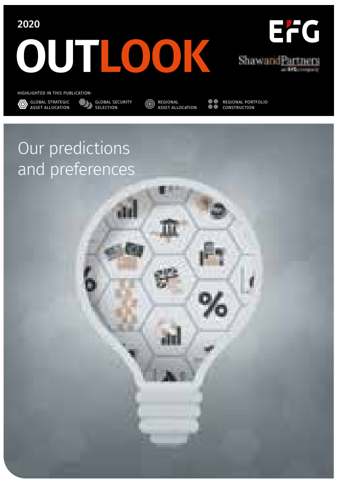
**6. CORRECT Value in US corporate bonds.** We thought that US investment grade corporate debt offered good value and would produce positive returns in 2019. Indeed, the sector produced very good returns: 15% in total return terms in the year to 13 December on the basis of the ICE BofAML US BBB Corporate Bond Index.

**7. CORRECT Sterling rebounds.** We thought that sterling would rebound against the US dollar as Brexit uncertainty receded. It took longer than we expected but sterling made gains – from US$1.27/£ at the end of 2018 to US$1.33/£ on 13 December 2019.

**8. PARTLY CORRECT Healthcare disruption.** We thought the healthcare sector was ripe for disruption, particularly with the development of new types of digital technology and that the trend would be seen first in the US. We said we were "actively seeking ways of gaining exposure" to innovative companies using digital technology. Although the healthcare sector underperformed the S&P 500 index, the healthcare equipment sector, which is focussed on disruptor companies did well, slightly outperforming the S&P 500 index.

**9. CORRECT Europe: another crisis averted.** We thought that the latest crisis – centred on Italy – would ease. We expected concerns about Italy's credit standing to recede and that "the yield spread between Italian and German government bonds should narrow". That did, indeed, happen: Italian 10-year yields fell from 3% in late 2018 to just over 1% in late 2019, with the yield spread over Germany almost halving from 300 to 150 basis points.

**10. CORRECT China-US cold war.** We thought that tensions between the US and China could ease to some extent in 2019, but that there was very unlikely to be a big reduction in China's trade surplus with the US. Longer-term, we expected China would pivot towards the rest of Asia. China's trade surplus with the US did narrow a little but its overall trade surplus expanded significantly.

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# Global growth continues; world trade recovers

We see global growth continuing at a reasonable pace (just over 3%) in 2020.[1] This will be helped by a recovery in world trade, after stagnation in 2019. Some economies, notably the eurozone, will be on the brink of recession but, even there, it will be avoided.

We see the US economic expansion reaching its eleventh anniversary in summer 2020. It will be the longest expansion since records began in 1854.[2] It will comfortably exceed previous records: the 120-month long expansion (from March 1991 to March 2001) and the 106-month expansion (from February 1961 to December 1969). Yet, one important reason for its long duration is that it has been subdued.

The UK expansion has been even more subdued but has now lasted as long as that in the US. The eurozone and Japanese expansions are positively youthful in comparison (see Figure 1a).

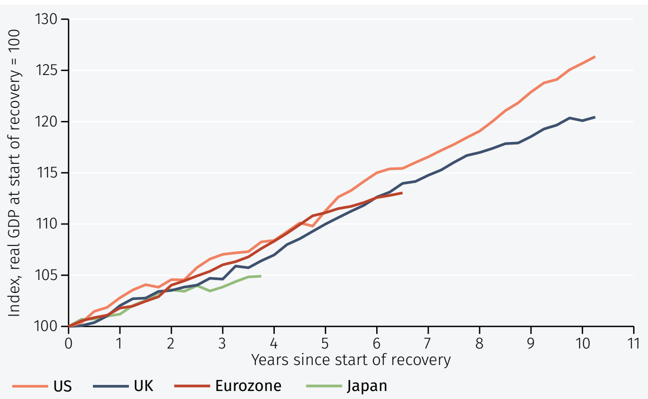
Fears of a US recession were widely cited in 2019. Leading indicators of such a dip, especially the slope of the yield curve, were closely, indeed somewhat obsessively, watched in financial markets. That nervousness will continue, even though we think it is a misplaced worry.

The main reason is that shrinking world trade was one of the main causes of a slowdown in world GDP growth in 2019 (see Figure 1b). That, we think, will rebound as the first phase of a China-US trade deal and other less-well noticed trade deals move ahead.

These include the RCEP, Regional Comprehensive Economic Partnership, in Asia; the AfCFTA, African Continental Free Trade Agreement.

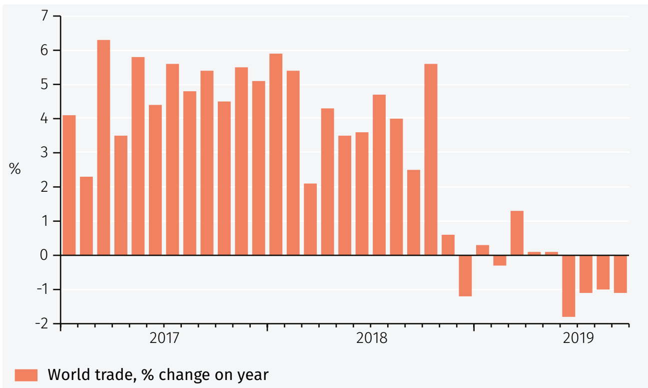
We think that attention will start to shift from US-China relations to trade deals that help the more open economies, especially as the world evolves into regional trading blocs. Furthermore, outside the US, especially in emerging economies, interest rates have come down; and greater fiscal stimulus is being seen in many economies.

**1a. Global expansions**




Source: Refinitiv. Data as at 10 December 2019.

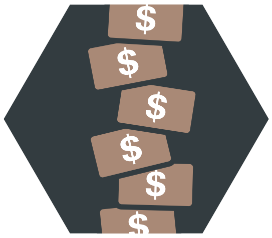
**1b. World trade**




Source: Refinitiv. Data as at 10 December 2019.

[1] At Purchasing Power Parity exchange rates; that is in broadly line with the IMF's October 2019 forecast of 3.4%.
[2] Source: NBER. https://www.nber.org/cycles.html

# Austerity is over



Austerity, restrictions on government spending, will be over in 2020. The emphasis will be on more, not less, spending. But don't expect too much: after years of belt-tightening, caution will be in order.

After the financial crisis of 2008/9, as recessions set in and banks were bailed out, government spending (see Figure 3) and budget deficits ballooned. Bringing these deficits back under control became the emphasis around the world. 'Austerity' was the new mantra.

Although it was expressed in different ways – from Germany's 'black zero' to eliminating the deficit in the UK to troika-imposed measures in the eurozone – austerity meant essentially the same thing everywhere: a reduction in government spending and, often, tax increases.

Those measures have been, by and large, successful in cutting government deficits. But the US notably abandoned austerity policies in 2017/8, with large tax cuts and increased government spending. The government fiscal deficit is now running at US$1 trillion a year, similar to that in the 2012 fiscal year.

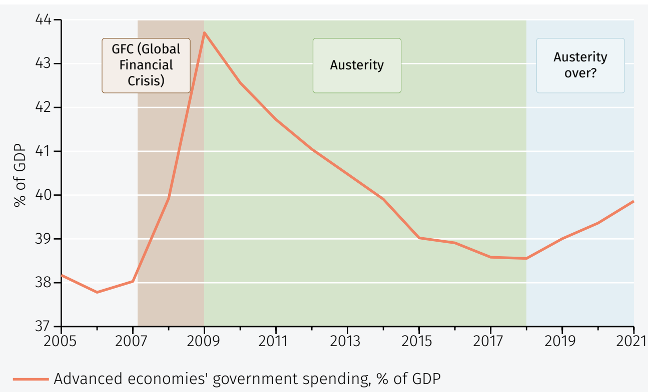
Other countries are now set to follow. Improvements in public services, increased pay for public sector workers and variations on the theme of a Green New Deal (see next section) will be the key trends.

In Germany, the change of leadership of the SPD increases the likelihood of a material shift towards deficit and off-balance sheet financed green investment at the national and EU level in coming years. Japan has recently launched a substantial new infrastructure spending plan.

In the UK, more spending on the health service and infrastructure are key aspects of the new government's plans.

Announced extra spending plans include: **€54bn** in Germany on emissions reduction; **£34bn** a year in the UK on the National Health Service; and **¥26 trillion** in Japan (expected to boost GDP by 1.4 percentage points).

**3. Austerity over?**




Source: Refinitiv. Data as at 10 December 2019.

# Green light for green spend

A big theme for 2020 will be more spending on green initiatives. Tackling climate change will move to the top of the agenda around the world.

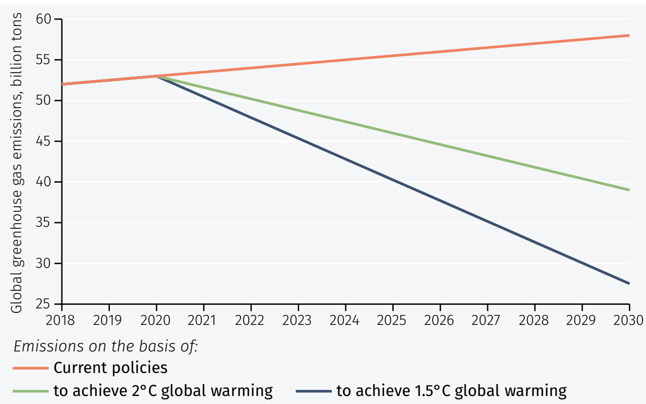
The realisation that action on climate change is needed is rapidly moving into the mainstream. It will be a key theme of 2020. Acceptance of the fact that greenhouse gas emissions cause global warming and that these need to be curbed will become (almost) universally accepted.

Without substantial mitigation of greenhouse gas emissions, global temperatures are projected to rise by 4°C above pre-industrial levels by 2100 (they have already increased by 1°C since 1900). Emissions of greenhouse gases will need to be cut significantly if global warming is to be restricted to 1.5-2.0°C (see Figure 4a).

Carbon dioxide ($CO_2$) emissions from burning fossil fuels account for almost two-thirds of global greenhouse gas emissions (see Figure 4b) and are the most immediately practical to control.

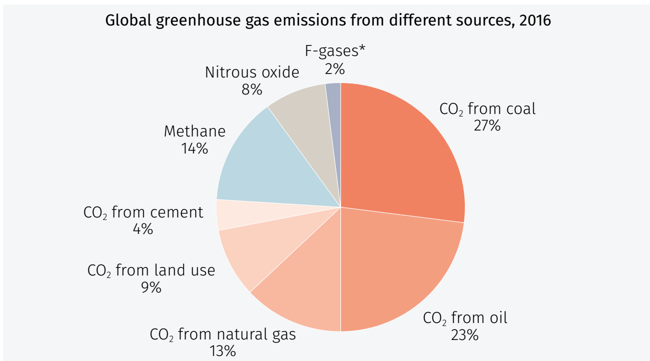
A switch from fossil fuels to solar and wind energy; investment in carbon capture and storage technologies; and a phasing out of subsidies on fossil fuels will be the key elements. The latter amount to as much as US$5 trillion (6% of global GDP) and are largest in emerging economies. We think that Europe will be at the forefront of this green move in 2020.

**4a. Global emissions and warming targets**




Source: IMF *Fiscal Monitor*, October 2019.

**4b. Global greenhouse gas emissions**




*F-gases are fluorinated gases and are used as an alternative to ozone-depleting substances (ODS). The sharp drop in the use of the latter has helped close the hole in the 'ozone layer' a huge concern in the late twentieth century. Source: IMF *Fiscal Monitor*, October 2019.

# Fixed income: capital preservation is key

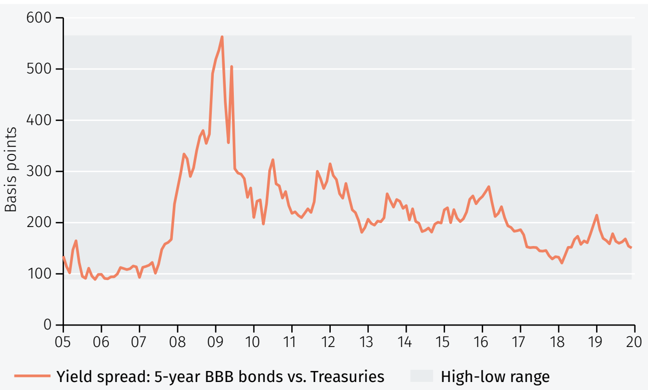
The major developed world central banks are set to keep interest rates at or below their current levels in 2020. That will make for a tough environment for fixed income markets in the developed world. Investment grade corporate bonds offer one of the safest places.

*Frozen 2*, one of the box-office hits of the winter, could well describe the predicament of central banks in 2020. Their interest rates first hit zero or sub-zero in the aftermath of the global financial crisis. After a few attempts to break away, notably by the Fed, were dashed, rates are set to be frozen again in 2020.

Growth is simply not strong enough and inflation pressures not sufficiently intense for anything else to be seriously contemplated. We see the Fed, ECB, Bank of Japan and Swiss National Bank leaving their policy rates on hold in 2020. The Bank of England may raise rates if economic dismay turns to over-exuberance after a successful Brexit; but that is more Disney fantasy than likely reality.

All this makes for a tricky environment for fixed income investors. German government bond yields along the maturity spectrum remain negative; UK 10-year gilt yields are not much above recent multi-century lows; and in this environment US 10-year Treasury yields of almost 2% look somewhat generous.

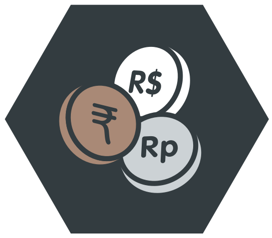
**5. BBB-rated bonds: yield spread over Treasuries**




Source: Refinitiv. Data as at 10 December 2019.

There are opportunities for yield pick-up in, for example, investment grade corporate bonds (see Figure 5). Yield spreads over Treasuries could compress a little, generating capital gains, making this one of the best areas on a risk-adjusted return basis. But, overall, 2020 will be a tricky year for developed market fixed income.

# Value in emerging market bonds




We see value in emerging market local currency debt. With subdued inflation and the US dollar stable, emerging market interest rates can be cut further in 2020. This should set the scene for local currency-denominated debt to do well.

In contrast to the main developed markets, where there are limited prospects for further interest rate cuts and lower bond yields, emerging markets are in a much better position. Inflation rates continue to trend down across emerging economies (see Figure 6a) and this means there is a domestic case for lowering interest rates. That has not been the case in all emerging market countries – as the particular problems of Argentina and Turkey demonstrate – but most emerging economies are now on a relatively firm footing as far as domestic growth and inflation are concerned.

A key risk to investing in emerging market local currency debt in the past has been local currency weakness, often as a result of generalised US dollar strength. With the US dollar generally highly valued, however, we think that is less of a risk in current circumstances.

Two other key factors lend support to emerging market local currency debt. First, corporate debt levels have generally been reduced relative to GDP in recent years, so this risk of excess leverage is much lower, we think, than in the past.

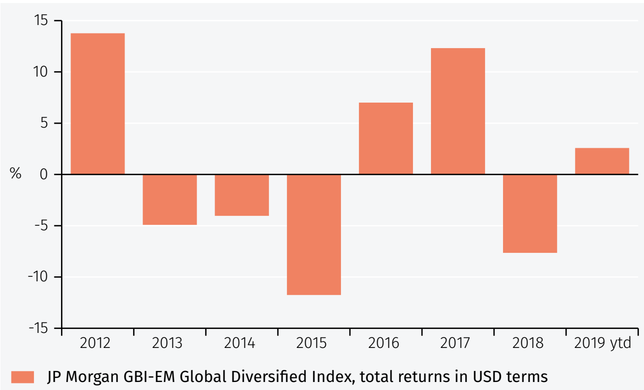
Second, there is a broader recognition of the risks associated with borrowing in foreign rather than local currency. Such foreign currency borrowing proved to be a particular problem in Argentina and Turkey in their recent crises. Local currency borrowing will now, we think, be favoured – giving such markets more depth, breadth and investability. So, after a good year for emerging market local currency returns in 2019 (see Figure 6b), we see another solid year in 2020.

Inflation rates continue to trend down across emerging economies and this means there is a domestic case for lowering interest rates.

**6a. Inflation in emerging and advanced economies**


Note: The G-7 comprises: Canada, France, Germany, Italy, Japan, UK and US. The EM-7 comprises: Brazil, China, India, Indonesia, Mexico, Russia and Turkey. Source: Refinitiv. Data as at 10 December 2019.

**6b. Emerging market local currency bonds performance**




Source: JP Morgan. Data as at 10 December 2019.

# Banks bounce

We like the bank sector. It has historically offered a high dividend yield; it has been out of favour for a long time; but its post-crisis repair is now well-advanced. Cost cutting and the move from branch-based activity to online platforms could start to bring rewards.

The bank sector has been under pressure for many years (see Figure 7a). Financial innovation has seen the rise of challenger banks with new technology; many banks have been slow to rid their balance sheets of the bad loans of the crisis era; and a public dislike of banks has been slow to clear.

That seems to us to be changing. Mainstream banks are now, in many cases, very effectively using new digital platforms to bring big benefits to their retail customers. That enables branch networks to be pruned, generating cost savings. And more aggressive balance sheet adjustment – writing down the bad loans of the crisis era – is now coming to the banks who were laggards in this process. In 2020, European banks will be allowed to buy back their equity and we see a number of banks being quick to do this.

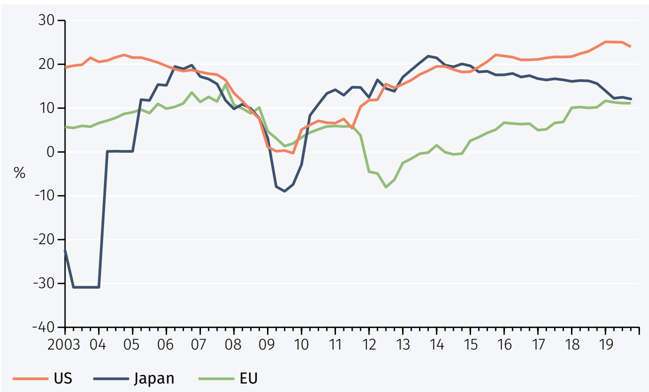
In emerging markets, banks have often been tainted by the woes of their developed world counterparts, but their business case remains strong.

Generally, bank profit margins are improving (see Figure 7b). So, after many years of underperformance of the wider global equity market, we think the bank sector is due for a catch-up in 2020.

**7a. Banks' underperformance**


Source: Refinitiv. Data as at 10 December 2019.

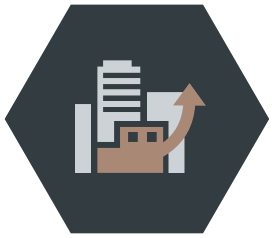
**7b. Banks' net profit margin**




Source: Refinitiv. Data as at 10 December 2019.

# Small caps recover

Small cap companies are due a catch-up. In the US, the sector has lagged large caps in four out of the last five years.



Much of the work on long-term stock market returns has identified a 'small cap' premium. That is, such companies produce excess returns, largely in compensation for their higher risk. However, such 'factor premia' have a disturbing tendency to vanish once identified. In the US, small caps have underperformed large caps in four of the last five years (see Figure 8a).[4] This has meant that the gap between the market capitalisation of large cap and small cap companies has widened siginificantly (see Figure 8b).

Stronger gains have been made in the large cap S&P 500 index than in the small cap Russell 2000 index. The difference between the two indices is significant: the median market capitalisation of companies in the S&P 500 is US$23bn with two companies (Apple and Microsoft) valued at over US$1tr.

The largest market capitalisation in the Russell 2000 is US$16bn, with a median value of US$800m.

The S&P 500 is heavily weighted in the technology sector, while the Russell 2000 is more heavily weighted in financial services. Within sectors, however, the performance of big and small companies can diverge sharply: large cap technology stocks have recently produced better returns than small cap companies, for example.

There are four main reasons why we think this gap in performance is due to reverse, with small caps doing better.

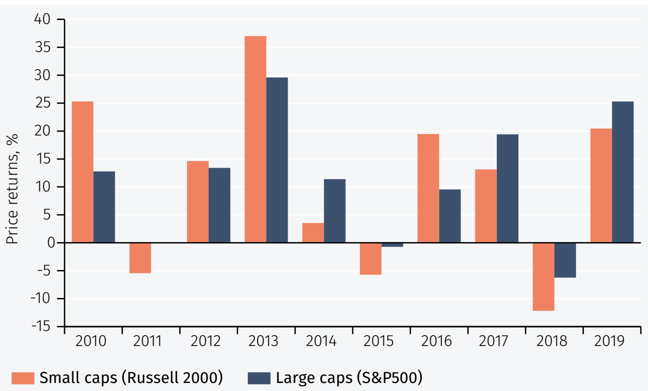
First, big technology companies are increasingly being scrutinised with the result that their business models may not be as sustainable in the future. Their valuations may suffer if this realisation takes hold.

Second, there is every reason to think that innovation will still be a strong feature of small cap companies: after all, today's large cap tech companies started out small (stereotypically 'in a garage').

Third, societal and environmental changes mean that big cap companies often attract widespread criticism, including pressure for divestment. Companies that are 'boutique', 'specialist', 'independent' and offer 'hand-crafted' products are the preferred choice of the millennial generation. Small, for many, is still beautiful.

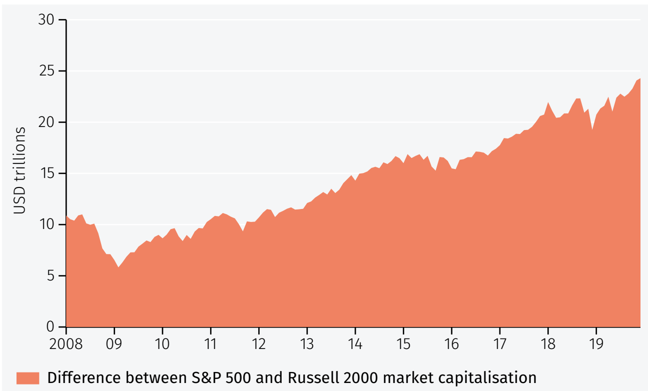
Finally, we think small cap companies could well be the target of the large amount of 'dry powder' accumulated by private equity companies, which has proved difficult to employ in non-listed companies. Small cap companies could well be the 'new private equity'.

**8a. Small cap versus large cap returns**




Source: Refinitiv. Data as at 10 December 2019.

**8b. Large caps have outperformed small caps**




Source: Factset. Data as at 10 December 2019.

[4] See FTSE Russell, *"What have you done with my small cap premium?"* 6 June 2019.
https://www.ftserussell.com/blogs/what-have-you-done-my-small-cap-premium

# A tripolar world

Although the trade war between the US and China will continue, the world is evolving towards a tripolar arrangement. That trend will become clearer in 2020.

Late 2019 saw the prospect of a 'Phase 1' of a trade deal between the US and China appear tantalisingly close; fade away; and then finally be agreed before new tariffs were due to be imposed on 15 December (see Figure 10a). That pattern, of course has been characteristic of the negotiations for some time.

The reality is that US tariffs on China and China's retaliatory tariffs on the US are unlikely to be completely reversed. Furthermore, the risk to China's industries from erratic changes in tariffs has contributed to 'de-Americanisation' – an increasingly heard (albeit ugly) word in late 2019.

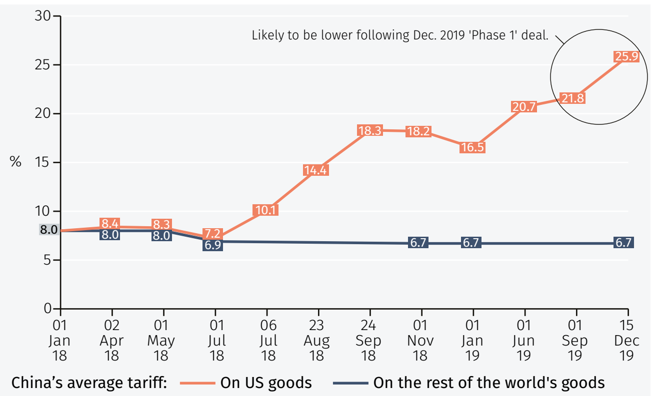
It has a number of aspects. Asian economies, notably China, are now seeking out local suppliers as an alternative to American companies. Japanese companies, for example, may well be suitable alternative suppliers in the electronics industry. And Beijing has ordered Chinese companies to remove their foreign (not just American) PCs and software within three years.

We think these are just the first signs of the emergence of a tripolar world: North America with its (relatively free) trading bloc – the USMCA (the 'new NAFTA'); Europe, anchored by the EU and eurozone; and Asia, dominated by China and now extending its influence across Eurasia and, indeed, further.

These changes will benefit some economies – exports from Vietnam, for example, are booming – but the more important point is that there is a fundamental change in the pattern of world trade and growth taking place.

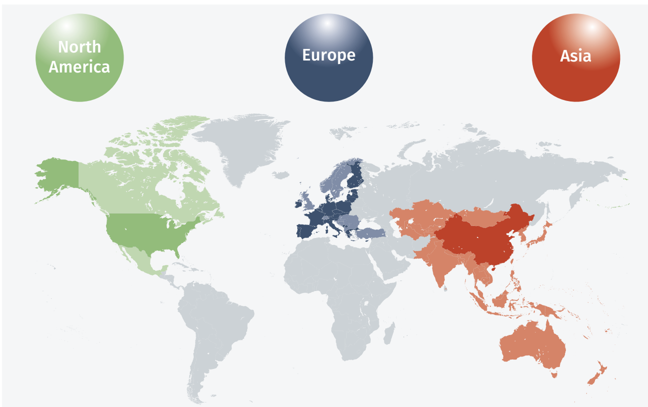
Signs of the emergence of a tripolar world.

**10a. China's tariffs on the US and the rest of the world**




Source: Peterson Institute for International Economics. Data as at 10 December 2019.

**10b. A tripolar world**




Source: EFGAM. For illustrative purposes only.

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# Shaw Managed Accounts

## Portfolio Performances – November 2019

| | | 3 Mth | 6 Mth | 1yr | 2yr | Inception |
|---|---|---|---|---|---|---|
| **Shaw Income Goal Portfolio** | **Total Portfolio Return** | **1.74%** | **5.56%** | **14.18%** | **7.50%** | **8.58%** |
| *Objective: RBA Cash +3%* | Portfolio Objective | 0.95% | 1.98% | 4.23% | 4.33% | 4.34% |
| *Inception: Sep-17* | Excess v Objective | 0.80% | 3.58% | 9.95% | 3.17% | 4.24% |
| **Shaw Balanced Goal Portfolio** | **Total Portfolio Return** | **1.87%** | **5.70%** | **15.18%** | **8.35%** | **9.71%** |
| *Objective: RBA Cash +4%* | Portfolio Objective | 1.18% | 2.46% | 5.23% | 5.37% | 5.39% |
| *Inception: Sep-17* | Excess v Objective | 0.68% | 3.24% | 9.95% | 2.98% | 4.32% |
| **Shaw Growth Goal Portfolio** | **Total Portfolio Return** | **6.63%** | **13.32%** | **25.34%** | **13.26%** | **15.54%** |
| *Objective: RBA Cash +5%* | Portfolio Objective | 1.43% | 2.96% | 6.23% | 6.31% | 6.31% |
| *Inception: Sep-17* | Excess v Objective | 5.20% | 10.36% | 19.11% | 6.95% | 9.23% |
| **Debt Securities Income Portfolio** | **Total Portfolio Return** | -0.30% | 2.74% | 6.98% | 4.77% | 4.72% |
| | *Inception: Sep-17* | | | | | |
| **Hybrid Income Portfolio** | **Total Portfolio Return** | -1.08% | 1.50% | 6.10% | 5.24% | 6.71% |
| | *Inception: Sep-16* | | | | | |
| **Australian Equity (Large Cap) - Income** | **Total Portfolio Return** | 4.80% | 10.27% | 30.24% | 12.69% | 13.74% |
| | *Inception: Sep-17* | | | | | |
| **Australian Equity (Large Cap) - Core** | **Total Portfolio Return** | 4.19% | 8.19% | 27.80% | 13.46% | 14.40% |
| | *Inception: May-16* | | | | | |
| **Australian Equity (Large Cap) - Growth** | **Total Portfolio Return** | 12.17% | 21.75% | 43.83% | 21.03% | 22.66% |
| | *Inception: Sep-17* | | | | | |
| **Australian Equity - Small and Mid Cap** | **Total Portfolio Return** | 3.53% | 10.26% | 22.03% | 9.26% | 11.77% |
| | *Inception: Sep-17* | | | | | |
| **Shaw Liquid Alternatives Portfolio** | **Total Portfolio Return** | -2.31% | 0.17% | 2.17% | | -0.88% |
| | *Inception: Aug-18* | | | | | |
| **AB Concentrated Global Growth** | **Total Portfolio Return** | 7.63% | 16.96% | 33.29% | | 10.81% |
| | *Inception: Jan-15* | | | | | |
| **EFG US Future Leaders Portfolio** | **Total Portfolio Return** | -3.28% | | | | -6.17% |
| | *Inception: Jul-19* | | | | | |

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# Shaw Managed Accounts

## Click on the images below to download the marketing brochure and SMA Portfolio Factsheets. [Download the marketing brochure here.]


Shaw Managed Accounts ShawandPartners
GOAL BASED PORTFOLIO
Shaw Income Goal Portfolio
MODEL PORTFOLIO CODE SP0009

Shaw Income Goal


Shaw Managed Accounts ShawandPartners
GOAL BASED PORTFOLIO
Shaw Balanced Goal Portfolio
MODEL PORTFOLIO CODE SP0008

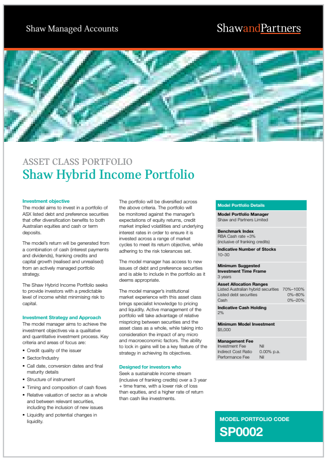
Shaw Balanced Goal


Shaw Managed Accounts ShawandPartners
GOAL BASED PORTFOLIO
Shaw Growth Goal Portfolio
MODEL PORTFOLIO CODE SP0010

Shaw Growth Goal


Shaw Managed Accounts ShawandPartners
ASSET CLASS PORTFOLIO
Shaw Debt Securities Income Portfolio
MODEL PORTFOLIO CODE SP0003

Shaw Debt Securities Income


Shaw Managed Accounts ShawandPartners
ASSET CLASS PORTFOLIO
Shaw Hybrid Income Portfolio
MODEL PORTFOLIO CODE SP0002

Shaw Hybrid Income


Shaw Managed Accounts ShawandPartners
ASSET CLASS PORTFOLIO
Shaw Australian Equity (Large Cap) Income
MODEL PORTFOLIO CODE SP0004

Shaw Australian Equity (Large Cap) Income


Shaw Managed Accounts ShawandPartners
ASSET CLASS PORTFOLIO
Shaw Australian Equity (Large Cap) Core
MODEL PORTFOLIO CODE SP0001

Shaw Australian Equity (Large Cap) Core


Shaw Managed Accounts ShawandPartners
ASSET CLASS PORTFOLIO
Shaw Australian Equity (Large Cap) Growth
MODEL PORTFOLIO CODE SP0005

Shaw Australian Equity (Large Cap) Growth


Shaw Managed Accounts ShawandPartners
ASSET CLASS PORTFOLIO
Shaw Australian Equity (Small and Mid-Cap) Growth
MODEL PORTFOLIO CODE SP0006

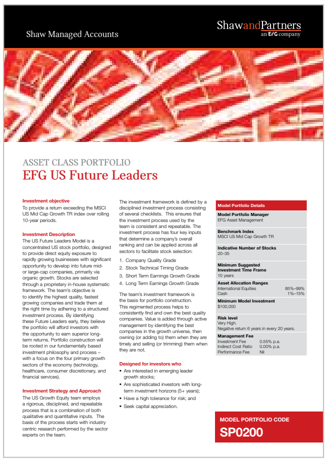
Shaw Australian Equity (Small and Mid-Cap) Growth


Shaw Managed Accounts ShawandPartners
ASSET CLASS PORTFOLIO
Shaw Liquid Alternatives Portfolio
MODEL PORTFOLIO CODE SP0011

Shaw Liquid Alternatives


Shaw Managed Accounts ShawandPartners
ASSET CLASS PORTFOLIO
AllianceBernstein Concentrated Global Growth
MODEL PORTFOLIO CODE SP0012

AllianceBernstein Concentrated Global Growth


Shaw Managed Accounts ShawandPartners
ASSET CLASS PORTFOLIO
EFG US Future Leaders
MODEL PORTFOLIO CODE SP0200

EFG US Future Leaders

# Australian Large Cap Model Portfolio

**The Shaw and Partners Australian Large Cap Model Portfolio ended the last month of the decade with a 0.4% outperformance of the benchmark S&P/ASX 100 Accumulation Index, which fell 2.2%, with most of the fall coming on the last trading day. Our overweight positioning to the Materials and Energy sectors paid off, with both performing in excess of the index. Looking forward, we see returns being difficult to come by and a flexible and adaptive approach to building portfolios will be required to eke out excess returns. We leave our portfolio unchanged this month.**

## HIGHLIGHTS

Returns were generally negative across the market in December, with only five sectors posting gains, the largest of which was the Materials sector, which comprises 17.2% of the index and rose 1.82%. **Our portfolio holds a 27.2% weight to Materials, so this contributed most of our outperformance this month.** At the other end of the spectrum, Food and Staples Retailing (aka Supermarket) stocks fell 9.1%. We hold Coles (COL) in this sector but at a market weight position. **Our portfolio benefitted by not having any exposure to the poorly performing Telecommunications, Food & Beverage or Commercial and Professional Services sectors.**

The key narrative of markets in December was the increase in long term interest rates. **The Australian Government 10-year bond yield rose from 1.035% at the end of November to 1.375% at the end of December.** This, and changes to short term interest rate expectations, resulted in a 1.83% fall in the S&P/ASX Australian Fixed Interest index. Similarly, the yield on US 10-year Treasuries rose 0.14% from 1.78% to 1.92% over the month. Because of the rising long-term interest rates, all bond-sensitive sectors, including REITs, performed poorly in December. Our portfolio is overweight REITs so this was a drag on returns for the month.

Long term interest rates are rising as the fear of a global recession caused by an escalation of trade disputes is abating. We can benefit from the latter by maintaining a healthy overweight to global cyclical stocks which will continue to benefit from an improvement in sentiment toward, if not actual evidence of, improving growth. It seems the worst of the trade dispute and Brexit woes are behind us, but we need to be cognisant of the elevated valuations of many companies in a period of rising discount rates and falling PE's. If growth is evident, investors will not have a problem paying up, but if there is a doubt about the growth outlook for a stock or sector in 2020, we can expect swift retribution.

**We head into 2020 with a sense of optimism that we must ensure is not just a reflection of the 24.1% increase in the ASX100 Accumulation index in 2019.** Investors – even professional ones – are notorious for extrapolating the recent past into the distant future, but one thing we all agree on is that 2020 will be a much trickier year to navigate than 2019 – where you just had to be in the market (almost any market) to make money. The US Presidential election in November is a clear focal point for markets, but rising long term interest rates, abandonment of the negative interest rate policies of some central banks and continued real asset price inflation will continue to be more important risks for investors.

## RECOMMENDATION

**We continue to see equities outperforming bonds as long-term interest rates continue to normalise and thus remain overweight equities in balanced portfolios.** The USD dollar may come under some pressure in 2020 and so we prefer local over global stocks and see the Energy and Materials sectors as the obvious destination for marginal investment dollars. We see returns in 2020 being more muted than 2019 and think high single digit returns will be commendable. We make no changes to our portfolio this month.

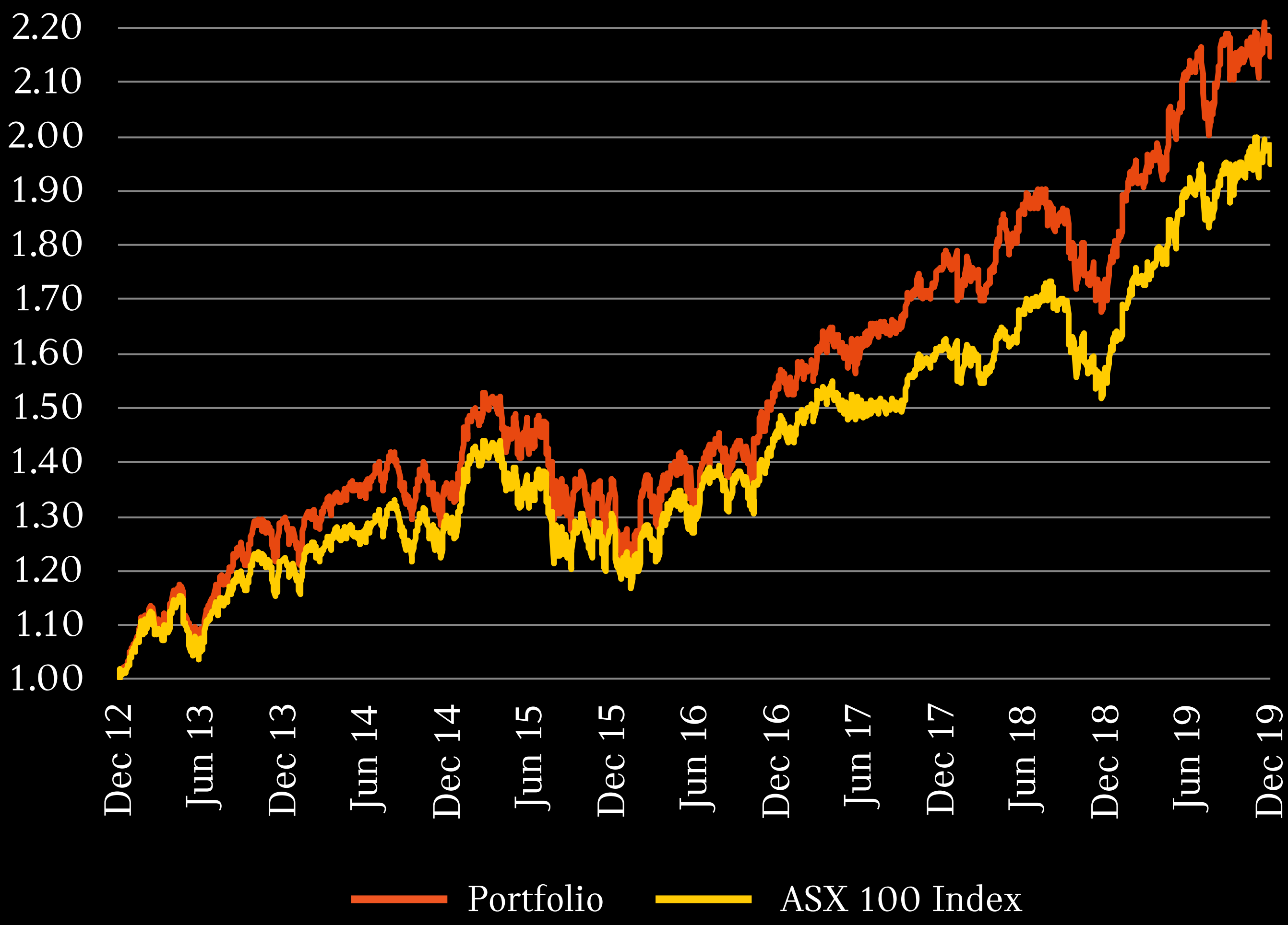
## PORTFOLIO PERFORMANCE

The Shaw and Partners Australian Large Cap Model Portfolio fell 1.83% in December, against a 2.23% fall in the benchmark S&P/ASX100 Accumulation Index. **Over the past year, the portfolio has performed in line with the index, up 23.9% versus 24.1%. Since inception in July 2011, the portfolio is up a cumulative 132.2% versus 120.0% for the index. Returns are pre any fees and charges and before the addition of franking credits.**

In December, the portfolio made 0.60% in excess of index returns from sector allocation with stock selection detracting from relative performance. Overweights to Energy, Materials and Banks added 52 basis points, underweights to sectors added 40 basis points and being overweight the Real Estate sector detracted 17 basis points. Other sector overweights detracted 15 basis points.

**Stock selection was positive in the consumer Services sector thanks to Flight Centres (FLT), but neutral to negative everywhere else, notably in Banks (17 basis points due to National Australia Bank (NAB), down 4.9%) and Real Estate (29 basis points due to Goodman Group (GMG) down 8.8% and LendLease (LLC) down 8.9%).**

# Portfolio Performance (Accumulation Basis)




# Model Portfolio at December 2019

| | | | | | |
|---|---|---|---|---|---|
| BHP | BHP Group | 12.0% | SCG | Scentre Group | 3.9% |
| CBA | Commonwealth Bank of Austr. | 10.4% | RIO | Rio Tinto Limited | 3.9% |
| NAB | National Australia Bank | 8.4% | COL | Coles Group Ltd. | 3.7% |
| WPL | Woodside Petroleum Ltd | 6.9% | OZL | OZ Minerals Limited | 3.6% |
| SOL | Washington H. Soul Pattinson | 4.9% | SGP | Stockland | 3.4% |
| GMG | Goodman Group | 4.7% | OSH | Oil Search Limited | 3.0% |
| STO | Santos Limited | 4.5% | SUN | Suncorp Group Limited | 2.7% |
| MQG | Macquarie Group Limited | 4.3% | FMG | Fortescue Metals Group Ltd | 2.7% |
| ILU | Iluka Resources Limited | 4.1% | LLC | Lendlease Group | 2.6% |
| WBC | Westpac Banking Corporation | 4.1% | S32 | South32 Ltd. | 2.0% |
| FLT | Flight Centre Travel Group | 4.0% | | | |

# Stock recommendations

**Macquarie Group (MQG)** offers banking, financial advisory, investment and funds management services. The company offers financial advice, cash management, wealth management and private banking, life insurance, securities brokerage, corporate debt financing, real estate funds management, real estate development financing, investment funds management and foreign exchange services.

**Commonwealth Bank of Australia (CBA)** provides banking and financial services. It offers banking and financial products and services to retail, small business, corporate and institutional clients.

**Sandfire (SFR)** is a dynamic mid-tier copper Australian mining and exploration company. SFR's producing asset, DeGrussa mine is based in WA and produces high quality copper-in-concentrate with significant gold credits.

**South32 (S32)** is a globally diversified metals and mining company with a portfolio of high quality, well maintained, cash generative assets producing bauxite, alumina, aluminium, energy and metallurgical coal, manganese, nickel, silver, lead and zinc. S32 is world's largest producer of manganese ore, and own the world's largest silver mine.

**Woodside Petroleum (WPL)** is an Australian based oil and gas exploration and production company. Key assets are the Pluto, North West Shelf and Wheatstone LNG projects offshore WA. Oil is produced from the Enfield and Vincent FPSO's. Exploration is underway internationally offshore West Africa, Myanmar, and onshore Canada. The company was founded in 1954 and is headquartered in Perth, Australia.

**Santos (STO)** is an Australian oil and gas exploration company. Its key operations are onshore SA Cooper Basin, PNG LNG, Gladstone LNG, Darwin LNG and various gas and oil fields offshore WA.

**Viva Energy REIT (VVR)** is a real investment trust fund that engages in property leasing and investment. It has 425 services stations located through Australian States and Territories. The company is headquartered in Docklands, Australia.

**Centuria Metropolitan REIT (CMA)** engages in the investment in office assets in metropolitan markets of Australia. It comprises of registered managed investment schemes such as Centuria Metropolitan REIT 1 and Centuria Metropolitan REIT 2. The company is headquartered in Sydney, Australia.

**Palla Pharma (PAL)** manufactures and produces narcotic raw material for the international pharmaceutical industry. Its activities include narcotic raw materials, poppy seed production and distribution, active pharmaceutical ingredient, and finished dosage production and distribution. The company is headquartered in Melbourne, Australia.

**Viva Leisure (VVA)** operates health clubs in health and leisure industries. It offers customers with membership options and a range of facilities from big box to boutique fitness. The firm's brands include Club Lime, Ladies Only, Psycle Life, Aquatics, Hiit Republic, Swim School, Gymmy PT and Studio by Club Lime. The company is headquartered in Mitchell, Australia Capital Territory.

**Openpay Limited (OPY)** is a fintech company that partners with merchants to provide Buy Now, Pay Later (BNPL) repayment plans to customers in-store, in-app and online. The company is headquartered in Melbourne, Australia.

**Wisr (WZR)** is Australia's first neo-lender with a commitment to the financial wellness of all Australians, through providing a smarter, fairer and wiser collection of financial products and services. Wisr provides a unique financial wellness eco-system underpinned by consumer finance products, the Wisr App to help Australians pay down debt, WisrCredit.com.au the country's only credit score comparison service, combined with content and other products that use technology to provide better outcomes for borrowers, investors and everyday Australians.

**Atrum Coal (ATU)** explores and develops coal properties. The company focuses on the exploration and development of metallurgical coal projects in British Columbia. It operates in two reportable segments: Exploration and Others. The Exploration segment engages in mineral exploration and development in Canada. The Others segment include corporate management and administration in Australia. The firm holds interest in Groundhog & Panorama, Elan coal, Naskeena and Bowron River projects. Atrum Coal is headquartered in Sydney, Australia.

**Metro Mining (MMI)** is engaged in the exploration of coal and bauxite. It holds interest in Bauxite Hills and Coal projects. The company is headquartered in Brisbane, Australia.

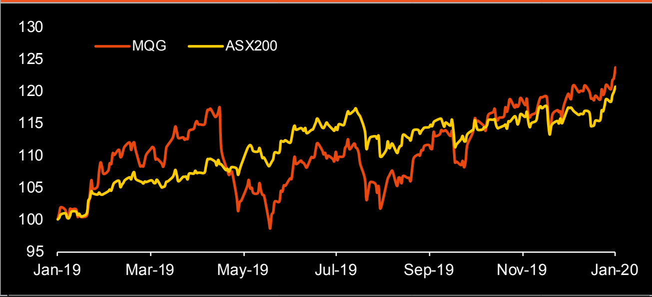
**Money 3 (MNY)** Money3 Corp. Ltd. provides financial services. It specializes in the delivery of small cash loans, secured and unsecured personal loans, cheque cashing. The company operates through following segments: Broker, Branch and Online.

**Zip Co (Z1P)** provides point-of-sale credit and digital payment services. The Company offers retail finance solutions to small, medium, and enterprise businesses. Zip Co serves retail, education, health, and travel industries in Australia.

# Macquarie (MQG)

| | |
|---|---|
| Recommendation | Buy |
| Risk | High |
| Share Price (as at 17 Jan 2020) | $144.65 |
| Target Price | $136.00 |
| Analyst | Brett Le Mesurier |

**Share Performance Chart**




Source: FactSet, Shaw and Partners

| | 1 mth | 3 mth | 12 mth |
|---|---|---|---|
| Relative Performance* | 3.5% | 6.9% | 23.7% |

* Relative Performance is compared to the S&P/ASX 200 Index

### Increasing markets produce profit growth

- The MQG investment case is becoming increasingly reliant on their skill in identifying high returning infrastructure investments (which includes green energy), selling them at a profit to funds they establish, receiving base fees for managing these funds, performance fees and further profits on the subsequent sale of these assets by the MQG-managed funds. It is also increasingly reliant on trading income.
- 6 years ago, base fees, performance fees, income from investments and trading income represented 40% of income, but in 1H20, they represented 60%. This was due to the success of the businesses behind these revenue lines as they achieved an average growth rate of 17% p.a. The most spectacular increases have come from performance fees and investment earnings. These 2 categories produced one-third of the increase in MQG's total revenue from 1H14 to 1H20, being $1.2bn. The remaining revenue sources achieved average growth rates of 2% p.a.
- MQG's ingenuity has always been tested and it continues to adapt to changing circumstances. An example is that it has established a joint venture with PGGM for its aircraft leasing business. This reduces MQG's investment while providing access to more capital from PGGM and the potential to earn fees from the joint venture in which it holds a 75% interest.
- This was the main reason for the increase in equity investments in 1H20. This joint venture investment represents $1.6bn of MQG's $8.5bn in equity investments. MIRA funds are a larger investment for MQG with a balance of $1.9bn while green energy represents $1bn.

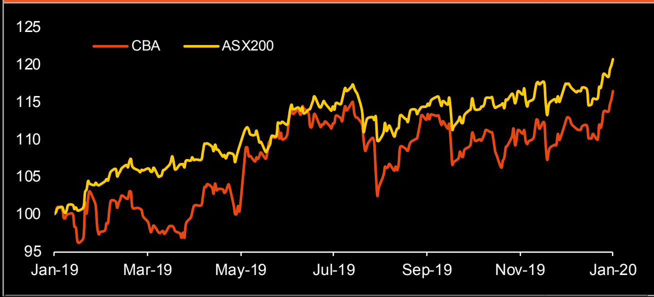
**Forecasts**

| YE 31-Mar | FY19 | FY20E | FY21E |
|---|---|---|---|
| Earnings cps | 883.3 | 885.1 | 912.1 |
| Dividends (AUD) cps | 575.0 | 579.8 | 599.8 |
| PE x | 14.7 | 16.3 | 15.9 |
| Yield % | 4.4% | 4.0% | 4.1% |
| Franking % | 45% | 40% | 40% |

# Commonwealth Bank (CBA)

| | |
|---|---|
| Recommendation | Hold |
| Risk | Medium |
| Share Price (as at 17 Jan 2020) | $84.67 |
| Target Price | $80.00 |
| Analyst | Brett Le Mesurier |

**Share Performance Chart**




Source: FactSet, Shaw and Partners

| | 1 mth | 3 mth | 12 mth |
|---|---|---|---|
| Relative Performance* | 3.7% | 5.0% | 16.4% |

* Relative Performance is compared to the S&P/ASX 200 Index

### Improving in a tough environment

- If CBA can repeat its 1Q20 performance throughout FY20, then the cash profit from continuing operations will be $9.04bn which equates to $5.14 per share. In this scenario, the return on NTA is 15%, the dividend payout ratio is 84%, the dividend yield is 5.4%, the price to NTA is 2.3 times and the P/E multiple is 15.6 times, assuming an $80 share price.

The appeal of CBA is:

- It has probably provisioned the majority of its customer remediation expenses by now;
- It is the only major bank achieving noticeable loan growth;
- It's withstanding the decline in NIM that is supposed to occur as interest rates decline;
- It has settled its AUSTRAC dispute and replaced its CEO a few years ago;
- Its expenses may increase little from here should the cost of risk of compliance stabilise;
- It should have sufficient capital to meet additional imposts from APRA and RBNZ with the balance to be returned to shareholders once the announced asset sales are completed;
- The combination of these factors would enable it to achieve average EPS growth of 4% p.a. from FY19 to FY22; and
- CBA has been able to maintain its home loan margins over a number of years despite declining interest rates and increased competition. There has been increasing scepticism surrounding its ability to maintain its product margins in such an environment and thus far is ill-founded.

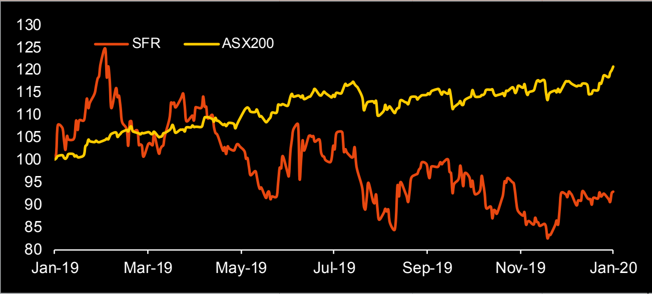
**Forecasts**

| YE 30-Jun | FY19 | FY20E | FY21E |
|---|---|---|---|
| Earnings cps | 480.9 | 513.5 | 538.3 |
| Dividends (AUD) cps | 431.0 | 431.0 | 431.0 |
| PE x | 17.2 | 16.5 | 15.7 |
| Yield % | 5.2% | 5.1% | 5.1% |
| Franking % | 100% | 100% | 100% |

## Sandfire (SFR)

| | |
|---|---|
| Recommendation | Buy |
| Risk | High |
| Share Price (as at 17 Jan 2020) | $6.21 |
| Target Price | $7.70 |
| Analyst | Peter O'Connor |

**Share Performance Chart**




Source: FactSet, Shaw and Partners

| | 1 mth | 3 mth | 12 mth |
|---|---|---|---|
| Relative Performance* | 0.7% | -2.6% | -7.2% |

* Relative Performance is compared to the S&P/ASX 200 Index

### Near term copper delivery 2020-21; long term adding "decades"

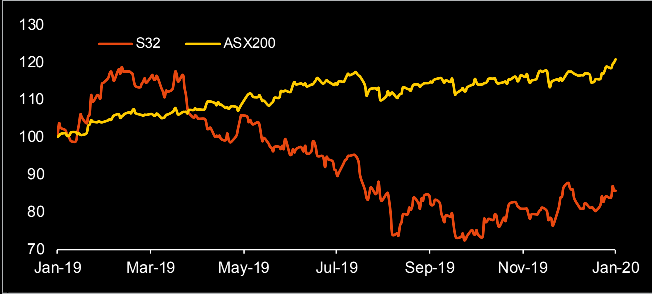
- SFR cheapest in our universe and remains best placed value and relative share price proposition. The recent share price uptick since early December yet the company is trading only ~20% off 52 week share price low and valuation (P/NPV) is well into value territory trading at ~0.8x P/NPV.
- Near term growth. SFR has guided to ~5% lift in copper production in FY20 (YoY) with a further 10-15% step up projected in FY21 from existing asset base. This is largely related to mining the current high grade Monty deposit yielding copper grading ~7-8% vs ~4% for prior mining areas hence minimal additional opex/capex is required.
- Long growth options. SFR has several pathways available to extend copper production well into the 2030's decade, a marked step up from the current market fixation on the 2-3 year remaining life of cornerstone production source, De Grussa. Greenfield life extension opportunities (DeGrussa) are being pursued – copper oxide project (~3-4 yrs. at ~8ktpa), tailings retreatment and regional projects such as historical mines Thaduna and Green Dragon. In 2019 the advanced Botswanan copper project, acquired via MOD Resources in mid-2019, is tracking towards an investment decision in mid-2020. Additionally SFR has ~12,000km sq exploration position in the Kalahari copper belt which hosts the initial development. So whilst the initial development will likely only be ~50 % of current SFR production the likelihood of incremental mine/feed additions is high. In short SFR will likely be running at/near the same rate, although at higher costs, well into the 2030 decade.

| Forecasts | | | |
|---|---|---|---|
| YE 30-Jun | FY19 | FY20E | FY21E |
| Earnings cps | 66.8 | 80.5 | 90.4 |
| Dividends (AUD) cps | 23.0 | 28.2 | 31.6 |
| PE x | 10.0 | 7.7 | 6.9 |
| Yield % | 3.4% | 4.5% | 5.1% |
| Franking % | 100% | 100% | 100% |

## South32 (S32)

| | |
|---|---|
| Recommendation | Buy |
| Risk | High |
| Share Price (as at 17 Jan 2020) | $2.89 |
| Target Price | $3.10 |
| Analyst | Peter O'Connor |

**Share Performance Chart**




Source: FactSet, Shaw and Partners

| | 1 mth | 3 mth | 12 mth |
|---|---|---|---|
| Relative Performance* | -2.4% | 15.9% | -14.4% |

* Relative Performance is compared to the S&P/ASX 200 Index

### Existential headwinds abating; corporate/growth progress

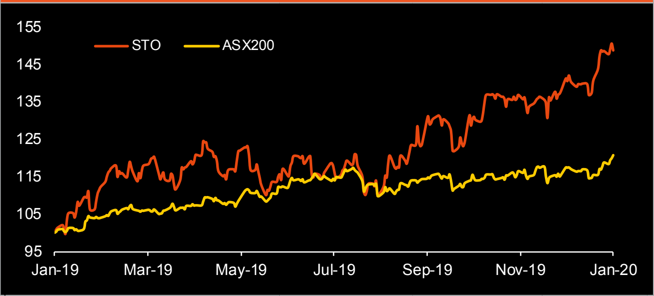
- Double upgraded to BUY – We have been watching S32 closely for some time culminating in completing a double upgrade – to BUY from SELL – the first instalment in spring 2019 and the second in December 2019. Prior to this move S32 had been in the SELL bucket for almost 2 years. We also revised higher the target price to A$3.10/share.
- Existential headwinds abating – pleasingly earnings headwinds since mid 2018 which had been manifest as declining commodity prices – in particular S32's key commodities manganese, met coal and alumina – now appear to have past the price nadir and in most cases are now trending higher. This is critical for a more favourable earnings outlook given these metals account for ~90% of NPAT.
- Corporate developments – (i) Capital management program (US$1.2b buy back) is ~95% completed; (ii) Coal divestment (South Africa) – The transaction is expected to close in the DH 2020. Importantly this divestment will increase the groups overall portfolio returns and removes a cash consuming – opex/capex, and low/negative return asset from the portfolio
- Growth: (i) Hermosa (Ag, Zn, Pb) - Pre-feasibility study remains on-track for completion in the June 2020 half year. Initial tailings storage facility supporting commencement of prodn established. (ii) Eagle Downs (met coal) - Advanced feasibility study work ahead of a final investment decision in DH CY20, (iii) Trilogy Metals (copper) option exercise to acquire 50% of Upper Kobuk Projects embedding another base metals development option into the portfolio.

| Forecasts | | | |
|---|---|---|---|
| YE 30-Jun | FY19 | FY20E | FY21E |
| Earnings cps | 19.7 | 5.6 | 11.4 |
| Dividends (AUD) cps | 13.4 | 3.2 | 6.6 |
| PE x | 11.4 | 35.8 | 17.6 |
| Yield % | 4.3% | 1.1% | 2.3% |
| Franking % | 100% | 100% | 100% |

# Santos (STO)

| | |
|---|---|
| Recommendation | Buy |
| Risk | High |
| Share Price (as at 17 Jan 2020) | $8.88 |
| Target Price | $9.10 |
| Analyst | Stuart Baker |

**Share Performance Chart**




Source: FactSet, Shaw and Partners

| | 1 mth | 3 mth | 12 mth |
|---|---|---|---|
| Relative Performance* | 5.3% | 14.1% | 48.7% |

* Relative Performance is compared to the S&P/ASX 200 Index

## Growth, financial discipline, and falling costs

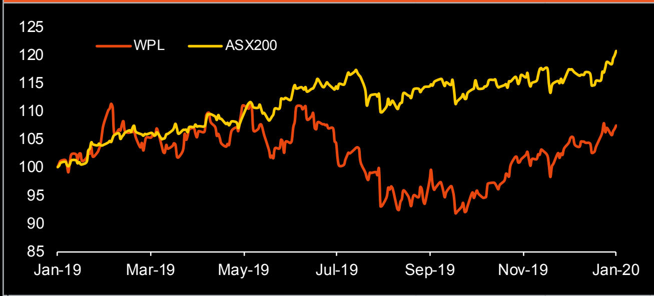
- In late December, Santos outlined a 2025 production growth target of >120MMboe p.a. and if achieved represents a 58% gain over the 2019 expected volume of 76MMboe. We believe this is achievable, due to a combination of new projects such as the Dorado Oil development offshore WA, incremental growth from the Cooper Basin, and acquisitions such as the Darwin and Barossa LNG and gas assets acquired from Conoco in H2 2019.
- The investment required is several billion dollars spread over 5-6 years, and can be funded from operating cashflows and borrowings. The balance sheet is currently in its strongest position in a decade and STO targets a gearing of no greater than 35% during the investment phase.
- Importantly, the new developments have low opex costs and we expect Santos' hard won cost reductions delivered since 2015 are not at risk. We forecast a step-down in free cash-flow break-even to <$US25/bbl, from ~US440/bbl 2 years ago.
- High-impact exploration in frontier regions is on the ascendancy too, after years of inactivity. Santos has re-built an exciting and very large exploration acreage portfolio in prospective areas such as offshore WA, PNG, N.T. and in Queensland. There are "sleeper assets" too, such as the legacy coal seam gas acreage in NSW.
- Our SoP valuation is $9.10, based off a US$70/bbl Brentl oil price. There is upside in our valuation if high-impact exploration wells planned over the outlook are successful.

| Forecasts | | | |
|---|---|---|---|
| YE 31-Dec | FY18 | FY19E | FY20E |
| Earnings cps | 35.0 | 37.9 | 49.9 |
| Dividends (AUD) cps | 13.4 | 19.7 | 22.6 |
| PE x | 11.0 | 16.2 | 12.3 |
| Yield % | 2.6% | 2.2% | 2.6% |
| Franking % | 100% | 100% | 100% |

# Woodside (WPL)

| | |
|---|---|
| Recommendation | Buy |
| Risk | High |
| Share Price (as at 17 Jan 2020) | $35.76 |
| Target Price | $39.00 |
| Analyst | Stuart Baker |

**Share Performance Chart**




Source: FactSet, Shaw and Partners

| | 1 mth | 3 mth | 12 mth |
|---|---|---|---|
| Relative Performance* | 2.9% | 12.8% | 7.4% |

* Relative Performance is compared to the S&P/ASX 200 Index

## Driving LNG developments in WA

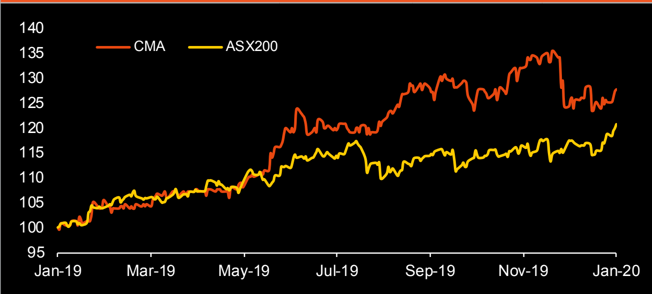
- WPL has spent 3-4 years building strategic positions in world class gas fields offshore WA and the next 2 years should see progress on engineering and commercial fronts to deliver a planned doubling in Pluto LNG capacity, plus tolling of Scarborough gas through the North West Shelf gas infrastructure. In 2020, there is potential for partial divestment of interests in these projects which would crystalise value. Production from these giant projects is targeted for ~2025.
- Oil production to steps-up from 2020 with Greater Enfield performing well since start-up in August 2019, to be followed by the Sangomar oil development offshore Senegal in 2022.
- Gearing is currently <10% and the balance sheet has been prepared for the capex phase ahead. Cash-flows are strong and opex costs are <US$10/boe. Since 2013, WPL has averaged a dividend payout ratio of >80% and returned US$5/sh in total. However, the company has flagged a review of the dividend policy depending on the size and timing of the capital program, and the quantum of sales proceeds from planned sell-down of interests in Pluto2 and Scarborough.
- There is upside longer term, if WPL can unlock the Broswse Basin gas resource. Partner alignment and capital costs have proven difficult to resolve to date.
- Our SoP Valuation is A$39.00 based off a US$70/bbl Brent oil price. Weak spot LNG prices in Asia are a near term threat to WPL's spot shipments and potentially to term contract renewals.

| Forecasts | | | |
|---|---|---|---|
| YE 31-Dec | FY18 | FY19E | FY20E |
| Earnings cps | 146.1 | 127.3 | 217.6 |
| Dividends (AUD) cps | 192.6 | 146.4 | 230.4 |
| PE x | 15.1 | 19.4 | 11.3 |
| Yield % | 6.5% | 4.1% | 7.1% |
| Franking % | 100% | 100% | 100% |

# Centuria Metropolitan (CMA)

| | |
|---|---|
| Recommendation | Hold |
| Risk | Low |
| Share Price (as at 17 Jan 2020) | $3.02 |
| Target Price | $3.04 |
| Analyst | Leanne Truong |

**Share Performance Chart**




Source: FactSet, Shaw and Partners

| | 1 mth | 3 mth | 12 mth |
|---|---|---|---|
| Relative Performance* | 2.7% | 2.0% | 27.7% |

* Relative Performance is compared to the S&P/ASX 200 Index

### Initiating coverage on CMA with a Hold Recommendation

- We initiated coverage on CMA with a Hold recommendation. CMA is Australia's largest pure play office REIT with exposure to a diversified portfolio of Metropolitan and CBD office assets.
- We believe CMA offers investors an attractive distribution yield (5.9%); however note CMA has some upcoming leasing risk.
- CMA benefits from its ability to leverage off the broader Centuria Capital Group platform. Centuria is an experienced ASX listed investment manager with over $6.2 billion in assets under management.
- We believe there is further NTA upside for CMA. We believe the investor demand for office assets will remain solid, driven by low bond yields and attractive relative pricing (metro cap rates vs CBD & offshore). In addition, we believe over the medium term, CMA's exposure to markets with improving fundamentals (falling vacancies, increasing rents and positive net absorption) such as Sydney's North Shore and the Adelaide CBD will benefit CMA.
- CMA also announced in December 2019 a $195m equity raising to partly fund the acquisition of the NewActon Nishi Building in Canberra. We believe the acquisition was dilutive to CMA's FFO per unit and had limited short-term upside.

| Forecasts | | | |
|---|---|---|---|
| YE 30-Jun | FY19 | FY20E | FY21E |
| Earnings cps | 18.7 | 19.1 | 19.3 |
| Dividends (AUD) cps | 17.6 | 17.8 | 18.1 |
| PE x | 15.0 | 15.8 | 15.6 |
| Yield % | 6.3% | 5.9% | 6.0% |
| Franking % | 0% | 0% | 0% |

# Viva Energy REIT (VVR)

| | |
|---|---|
| Recommendation | Buy |
| Risk | Low |
| Share Price (as at 17 Jan 2020) | $2.72 |
| Target Price | $2.93 |
| Analyst | Leanne Truong |

**Share Performance Chart**


Source: FactSet, Shaw and Partners

| | 1 mth | 3 mth | 12 mth |
|---|---|---|---|
| Relative Performance* | -1.8% | -8.7% | 20.9% |

* Relative Performance is compared to the S&P/ASX 200 Index

### Initiating coverage on VVR with a Buy Recommendation

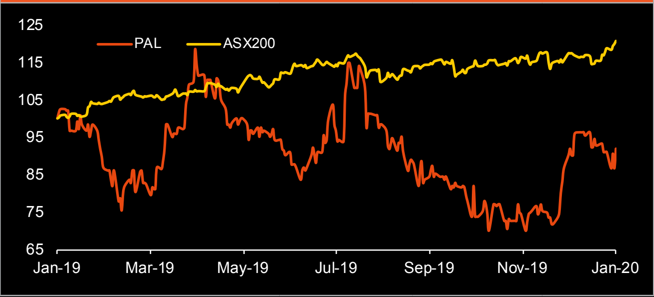
- We initiated coverage on VVR with a Buy recommendation and target price of $2.93 per unit. VVR is exposed to a portfolio of service station assets valued at ~$2.5bn.
- We believe VVR represents an attractive investment opportunity for investors looking for sustainable and growing distribution yield (5.4%), at relatively low risk when compared to some of its peers.
- VVR has predictable earnings relative to its peers, given the majority of its leases are 1) subject to fixed annual rental increases of 3%; 2) triple net leases; and 3) has limited medium term leasing risk.
- VVR's management fees are significantly below peers (MER of 0.23% vs peers of 0.64%). VVR adopts a pass-through fee structure, where fees are based on the actual cost incurred by the Trust, rather than a percentage of AUM.
- We believe the recent sale of 15 7-Eleven sites will support further cap rate compression for VVR. Based on our analysis, we believe the 7-Eleven transactions imply that VVR's portfolio could compress ~30bps (VVR WACR 5.8%).
- Despite the continued threat of EVs, we believe service stations will continue to have a prominent role in the Australian landscape over the medium term. The take-up of Electric Vehicles remains low (EV's account for 0.04% of total registered vehicles) while the number petrol and diesel cars continue to grow.

| Forecasts | | | |
|---|---|---|---|
| YE 31-Dec | FY18 | FY19E | FY20E |
| Earnings cps | 14.0 | 14.6 | 15.3 |
| Dividends (AUD) cps | 14.0 | 14.6 | 15.3 |
| PE x | 16.0 | 18.5 | 17.8 |
| Yield % | 6.2% | 5.4% | 5.6% |
| Franking % | 0% | 0% | 0% |

# Palla Pharma (PAL)

| | |
|---|---|
| Recommendation | Buy |
| Risk | High |
| Share Price (as at 17 Jan 2020) | $1.04 |
| Target Price | $1.20 |
| Analyst | Darren Vincent |

**Share Performance Chart**




Source: FactSet, Shaw and Partners

| | 1 mth | 3 mth | 12 mth |
|---|---|---|---|
| Relative Performance* | 1.9% | 24.6% | -8.1% |

* Relative Performance is compared to the S&P/ASX 200 Index

### Unique Production Tech Underpins a Significant Cost Advantage

- PAL, one of only three vertically integrated narcotic manufacturers in the world, has a strong track record of sales growth and margin improvement. PAL has a 3 yr sales CAGR of 182%. Recent contract wins support ongoing sales growth and margin improvement eventually to 50%+ from 34.6% in 1H19, which is well above its competition and comparable ASX companies.
- Multiple earnings drivers are expected to deliver in 2020 including 1) Recent contract wins will support increased volumes driving sales and margins, 2) capacity expansion, 3) Cessation of an inherited non opioid contract will enable more profitable utilisation of capacity with volumes to be replaced with higher margin opiate sales.
- PAL has a significant and unique cost advantage that is enabling market share gains. PAL utilises a proprietary water-based processing technique to extract narcotic raw material from poppy straw providing it with a production cost advantage it estimates at 40-50%.
- PAL is a business in transition, but most of the changes are in place. Now it's about volume increase and better product mix. If it delivers on our FY19 expectations then it will have delivered 4 years of sales growth and margin improvement and be trading on a FY21 EV/EBITDA of 8.9x and a PE of 8.2x. Given the base of its growth is from a unique proprietary cost advantage and it has a relatively small market share, ongoing growth looks feasible - which its multiple does not reflect.

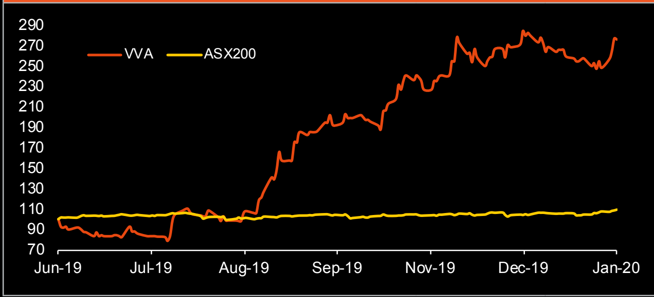
**Forecasts**

| YE 31-Dec | FY18 | FY19E | FY20E |
|---|---|---|---|
| Earnings cps | -7.4 | -3.0 | 3.2 |
| Dividends (AUD) cps | 0.0 | 0.0 | 0.0 |
| PE x | -15.6 | -34.9 | 32.9 |
| Yield % | 0.0% | 0.0% | 0.0% |
| Franking % | 0.0% | 0.0% | 0.0% |

# Viva Leisure (VVA)

| | |
|---|---|
| Recommendation | Buy |
| Risk | High |
| Share Price (as at 17 Jan 2020) | $2.90 |
| Target Price | $3.60 |
| Analyst | Darren Vincent |

**Share Performance Chart**




Source: FactSet, Shaw and Partners

| | 1 mth | 3 mth | 12 mth |
|---|---|---|---|
| Relative Performance* | 1.0% | 34.2% | nm |

* Relative Performance is compared to the S&P/ASX 200 Index

### Bulking Up on Technology, a Unique Format, Greenfield Expansion & Acquisitions

- A unique 'hub and spoke' model. VVA, an owner operator of gyms and other leisure facilities has a unique 'hub and spoke' model under which it is expanding its network of facilities. It relies on IT systems to reduce operating costs, enhance its client's experience, and enable it to quickly realise synergies from acquisitions. The model has proven to be an efficient way to expand VVA's catchment areas, efficiently provide specialist services and enhance the appeal of its facilities as reflected in its strong organic growth.
- VVA's current run rate will under pin a strong FY20 and FY21. VVA's monthly sales run rate exiting June 2019 was up 48% on pcp which provides significant momentum and upside from a full 12 month contribution in FY20. VVA has continued to achieve monthly organic growth since June and has guided to a further 112% increase in its sales run rate by June 2020. This will have it on an expected EBITDA run rate of $21m at June 30 2020, growing members at 15% pa and with funding to acquire additional facilities which will set the company up for a strong performance in FY21.
- The Australian Fitness industry provides long term acquisition and development opportunity. In Regional areas of Australia the fitness industry remains fragmented with relatively inefficient practices operating small businesses which trade at attractive multiples; providing significant consolidation opportunity.

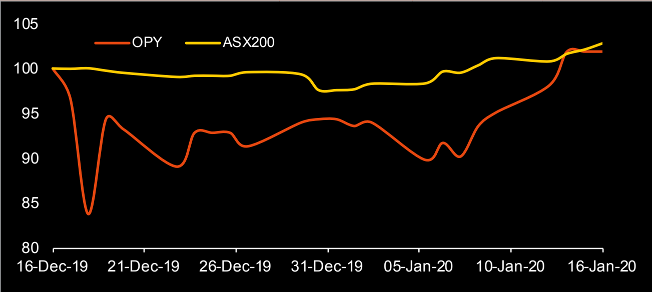
**Forecasts**

| YE 31-Dec | FY19 | FY20E | FY21E |
|---|---|---|---|
| Earnings cps | 5.4 | 10.8 | 19.3 |
| Dividends (AUD) cps | 0.0 | 0.0 | 4.6 |
| PE x | 50.7 | 26.7 | 15.0 |
| Yield % | 0.0% | 0.0% | 1.6% |
| Franking % | 0.0% | 0.0% | 0.0% |

# Openpay (OPY)

| | |
|---|---|
| Recommendation | Buy |
| Risk | High |
| Share Price (as at 17 Jan 2020) | $1.36 |
| Target Price | $2.25 |
| Analyst | Danny Younis |

**Share Performance Chart**




Source: FactSet, Shaw and Partners

| | 1 mth | 3 mth | 12 mth |
|---|---|---|---|
| Relative Performance* | 1.9% | nm | nm |

* Relative Performance is compared to the S&P/ASX 200 Index

## Differentiated BNPL player, accelerating growth profile and positive outlook

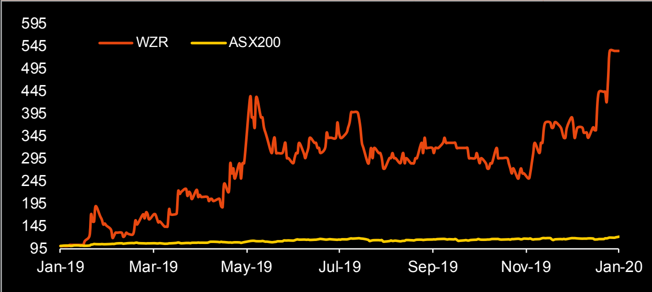
- With structurally attractive tailwinds in the Buy Now, Pay Later (BNPL) segment, the Australian and overseas markets are ripe for disruption by fintech payment and credit services businesses. OPY, established in 2013, provides a valuable competitive advantage and value proposition to three (growing) key stakeholders being customers, merchants and funders – a rare combination.
- Operating metrics highlight significant double-digit growth from FY18PF to FY19PF, with the twin key metrics of customer and merchant growth accelerating.
- Funding capacity expands post listing on the ASX – cash balance will rise from $8.7m at 30 June 2019 to more than $77.3m and c. $50m in IPO proceeds will largely be used to support the UK growth, funding Australia and UK receivables book, development and engineering costs and working cap.
- OPY provides a highly differentiated offering to its largely homogenous peers: (1) targeted verticals of not only Retail but higher Average Transaction Value (ATV) segments in Home Improvement, Automotive and Healthcare; (2) lower risk and older demographic market of 38+ year-olds (>54% of its customers); (3) no interest is ever charged by OPY on any of its current plans; (4) flexibility around timing of commencement of first payment; (5) scope to defer payments to avoid late fees; (6) larger payment plan sizes to $20k; and (7) longer term plans up to 36 months.

| Forecasts | | | |
|---|---|---|---|
| YE 30-Jun | FY19 | FY20E | FY21E |
| Earnings cps | -16.3 | -25.7 | -16.6 |
| Dividends (AUD) cps | 0.0 | 0.0 | 0.0 |
| PE x | nm | -5.3 | -8.2 |
| Yield % | nm | 0.0% | 0.0% |
| Franking % | 0% | 0% | 0% |

# Wisr (WZR)

| | |
|---|---|
| Recommendation | Buy |
| Risk | High |
| Share Price (as at 17 Jan 2020) | $0.24 |
| Target Price | $0.35 |
| Analyst | Danny Younis |

**Share Performance Chart**




Source: FactSet, Shaw and Partners

| | 1 mth | 3 mth | 12 mth |
|---|---|---|---|
| Relative Performance* | 38.2% | 80.8% | 434.1% |

* Relative Performance is compared to the S&P/ASX 200 Index

## Long and accelerating runway of growth

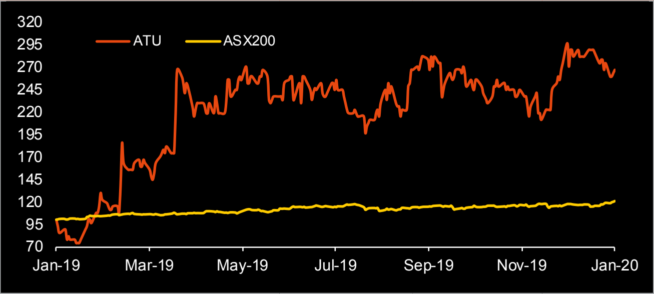
- Australia's first and only ASX listed fintech marketplace lender in the rapidly growing Australian consumer finance market with TAM >$100b – and is supported by some of Australia's largest and most respected financial institutions including asset managers and banks. Market share has doubled from 0.5% in 2017 to 1.0% in 2018.
- Evolution from a peer-to-peer into neo-lender with multiple product sets enables the company to generate additional revenue streams – the WZR model is highly nimble and scalable, capital light, and led by an experienced management team. It provides 80%+ automation in loan applications vs. 1-5 days from major banks at cheaper rates and various terms across 3, 5 and 7 years. More than 50% of Australian finance brokers can now offer a WZR personal loan following the expansion of the company's broker channel. Current loan originations are $163.8m.
- Funding strategy to improve to hybrid model (off and on-balance sheet) and recent $50m debt warehouse facility with NAB (with option to step up to $200m) is very significant given it supports the scaling of WZR's personal loan originations, greatly improves margins (NIM > 11%), diversifies funding mix and improves overall loan unit economics by 3x – with increasing access to large pools of capital and margin expansion focus. WZR continues to deliver consistently strong credit quality with 90+ day arrears at 30-Sept-2019 of 1.6% across its entire loan book and is well capitalised with $10m cash at end Sept.

| Forecasts | | | |
|---|---|---|---|
| YE 30-Jun | FY19 | FY20E | FY21E |
| Earnings cps | -1.3 | -0.4 | 0.0 |
| Dividends (AUD) cps | 0.0 | 0.0 | 0.0 |
| PE x | -11.2 | -56.4 | nm |
| Yield % | 0.0% | 0.0% | 0.0% |
| Franking % | 0% | 0% | 0% |

# Atrum Coal (ATU)

| | |
|---|---|
| Recommendation | Buy |
| Risk | High |
| Share Price (as at 17 Jan 2020) | $0.32 |
| Target Price | $0.80 |
| Analyst | Andrew Hines |

**Share Performance Chart**




Source: FactSet, Shaw and Partners

| | 1 mth | 3 mth | 12 mth |
|---|---|---|---|
| Relative Performance* | -10.0% | 9.1% | 166.7% |

* Relative Performance is compared to the S&P/ASX 200 Index

### Exceptional resource with re-rating catalysts ahead

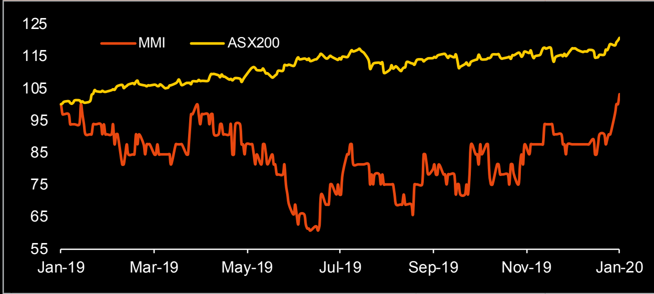
- We recently initiated coverage on Atrum Coal (ATU) with a BUY recommendation and A$0.80ps price target. Atrum Coal is developing the Elan Coal project, a high quality hard coking coal project in Alberta, Canada. We anticipate first production in late 2023. The Elan project setting is directly analogous to Teck's Elk Valley operations, 30km to the west, where Teck produces 26Mtpa of high quality coking coal from four mines and generated C$3.8b EBITDA in 2018.
- The southern part of the project is adjacent to Riversdale Resources' Grassy Mountain project which was acquired for A$744m by Hancock Prospecting in May 2019. Atrum Coal is about two years behind Grassy Mountain, but is following the same development pathway and is potentially a larger project. The Elan Project appears capable of supporting multiple operating mines over time. We analyse two potential production scenarios; development at Elan South at 4Mpta of product sales, and with development at Isolation South to take total sales to 8Mtpa.
- Our 12 month price target of A$0.80ps is based on the price that was paid for Grassy Mountain by Hancock Prospecting in May 2019. Our DCF valuation is significantly higher. We expect the Atrum Coal share price to steadily increase as it follows the same development path as the adjacent Grassy Mountain project. Key catalysts in the next 12 months include the release of the scoping study (Dec-19), further resource upgrades and issue of a mining permit to Grassy Mountain (mid-2020).

| Forecasts | | | |
|---|---|---|---|
| YE 31-Dec | FY18 | FY19E | FY20E |
| Earnings cps | -1.6 | -2.9 | -2.2 |
| Dividends (AUD) cps | 0.0 | 0.0 | 0.0 |
| PE x | -5.5 | -11.1 | -14.5 |
| Yield % | 0.0% | 0.0% | 0.0% |
| Franking % | 0% | 0% | 0% |

# Metro Mining (MMI)

| | |
|---|---|
| Recommendation | Buy |
| Risk | High |
| Share Price (as at 17 Jan 2020) | $0.17 |
| Target Price | $0.24 |
| Analyst | Andrew Hines |

**Share Performance Chart**




Source: FactSet, Shaw and Partners

| | 1 mth | 3 mth | 12 mth |
|---|---|---|---|
| Relative Performance* | 17.9% | 26.9% | 3.1% |

* Relative Performance is compared to the S&P/ASX 200 Index

### Expansion to 6Mtpa in 2020 will boost earnings

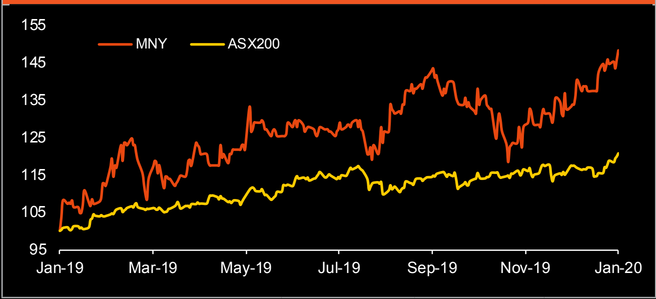
- We recently initiated coverage on Metro Mining (MMI) with a Buy recommendation and A$0.24ps price target. Metro Mining is a bauxite producer from its Bauxite Hills operation in far north Queensland. The company successfully commenced operations in 2018, is on track to produce 3.5Mt in 2019. Bauxite is predominantly used as the feedstock for alumina production, which itself is predominantly used to produce aluminium.
- Metro Mining has recently released a Definitive Feasibility Study to expand production from 3.5Mtpa to 6.0Mtpa in 2021. This will result in a significant step-up in free cash flow generation due to higher production and the associated economies of scale reduction in unit costs.
- Metro Mining is trading at a 50% discount to our discounted cash flow valuation, and once the expansion is complete the share price is likely to trade towards our valuation. We also expect the company to begin paying dividends in 2021.
- The bauxite market is well supported by strong demand growth from China as Chinese alumina refineries increasingly rely on imported bauxite as domestic production declines. Chinese production of bauxite peaked in 2018. Metro Mining's Bauxite Hills project is well placed to supply the growing Chinese market due to the proximity to markets.

| Forecasts | | | |
|---|---|---|---|
| YE 31-Dec | FY18 | FY19E | FY20E |
| Earnings cps | 0.7 | 0.5 | 0.9 |
| Dividends (AUD) cps | 0.0 | 0.0 | 0.0 |
| PE x | 23.5 | 31.8 | 19.4 |
| Yield % | 0.0% | 0.0% | 0.0% |
| Franking % | 0% | 0% | 0% |

# Money 3 (MNY)

| | |
|---|---|
| Recommendation | Buy |
| Risk | High |
| Share Price (as at 17 Jan 2020) | $2.44 |
| Target Price | $2.40 |
| Analyst | Jonathon Higgins |

**Share Performance Chart**




Source: FactSet, Shaw and Partners

| | 1 mth | 3 mth | 12 mth |
|---|---|---|---|
| Relative Performance* | 11.3% | 7.4% | 48.2% |

* Relative Performance is compared to the S&P/ASX 200 Index

### Could Triple in Value by FY23

- Money 3 (ASX: MNY) is one of the leading providers of alternative finance within Australia particularly within the non-conforming automotive lending sector. MNY has progressively grown via predominantly organic on balance sheet means and has diversified its loan book to higher quality, longer duration and lower risk lending activities delivering on a successful pivot away from SACC loans that the company originally started doing business with.
- MNY has gone the distance on the ASX and management have gone to great lengths to make the business sustainable, grow profits and most importantly set the business up for many multiples of the current envelope in terms of both loan book and earnings.
- We expect FY20 to be a watershed year for MNY as the company is able to access more mainstream forms of financing such as securitisation and major bank funding. In turn we expect that MNY will be able to drive a step change across loan book growth, earnings and potentially large reductions in the costs of finance. With further flexible funding arrangements MNY has the potential to drive material ROE uplift, increase distributions to shareholders and undertake potential consolidation activities as the group is only conservatively geared.
- Our analysis based upon various scenarios is that both Shaw and the market are likely being conservative around forecasts and that implementation of further funding could result in an FY23 PER of only 5x and a return of over 3x current levels.

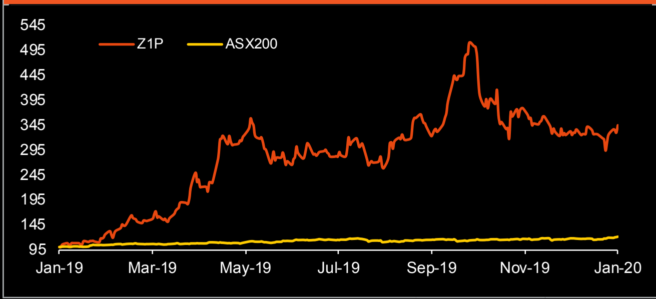
**Forecasts**

| YE 30-Jun | FY19 | FY20E | FY21E |
|---|---|---|---|
| Earnings cps | 19.9 | 17.1 | 21.2 |
| Dividends (AUD) cps | 10.0 | 10.0 | 11.7 |
| PE x | 10.7 | 14.2 | 11.5 |
| Yield % | 4.7% | 4.1% | 4.8% |
| Franking % | 100% | 100% | 100% |

# Zip Co (Z1P)

| | |
|---|---|
| Recommendation | Buy |
| Risk | High |
| Share Price (as at 17 Jan 2020) | $3.85 |
| Target Price | $4.88 |
| Analyst | Jonathon Higgins |

**Share Performance Chart**




Source: FactSet, Shaw and Partners

| | 1 mth | 3 mth | 12 mth |
|---|---|---|---|
| Relative Performance* | 3.6% | -28.5% | 243.8% |

* Relative Performance is compared to the S&P/ASX 200 Index

### Most Diversified Fin-tech Lending Platform on the ASX

- Zip Co (ASX: Z1P) is one of the leading Buy Now Pay Later (BNPL) and lending businesses on the ASX. Following various product initiatives, innovation, acquisition of stakes in global payment businesses and growth Z1P offers substantial leverage to the growing structural change in alternative finance within Australia and Globally. Zip now offers multiple consumer facing flexible products across varied international markets, as well as business finance and personal financial management. With products that involve credit, instalments, POS, payments and analytics Zip in our opinion is the most diversified and market leading BNPL company on the ASX.
- We expect that Q2-FY20 will be the largest on record for the company by some distance and potentially result in the first billion dollar half by TV in company history. This represents exponential growth and continues the company's track record of growing over 100% p.a. at progressively larger levels.
- We expect CY20 to be a transformational year for the group with the roll-out into international markets, business finance and implementation of low cost funding to drive a step change across a business that is growing faster in every period since listing (rare dynamic).
- Investors should bear in mind that WBC is the largest shareholder outside of management & that the recent deal with Amazon creates the potential for a further strategic shareholder. Zip has delivered material disruption and change within the Australian market and we expect this to be replicated across multiple products globally.

**Forecasts**

| YE 30-Jun | FY19 | FY20E | FY21E |
|---|---|---|---|
| Earnings cps | -1.8 | -2.3 | 1.7 |
| Dividends (AUD) cps | 0.0 | 0.0 | 0.0 |
| PE x | nm | nm | nm |
| Yield % | 0.0% | 0.0% | 0.0% |
| Franking % | 0% | 0% | 0% |

# RECOMMENDATION DEFINITIONS

### RATING CLASSIFICATION

| | |
|---|---|
| **Buy** | Expected to outperform the overall market |
| **Hold** | Expected to perform in line with the overall market |
| **Sell** | Expected to underperform the overall market |
| **Not Rated** | Shaw has issued a factual note on the company but does not have a recommendation |

| | |
|---|---|
| **High** | Higher risk than the overall market – investors should be aware this stock may be speculative |
| **Medium** | Risk broadly in line with the overall market |
| **Low** | Lower risk than the overall market. |

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