Dump gold, buy stocks; 3 stocks to lay in the cellar

Are market smarties backing in a trade deal or at least no escalation of the tit-for-tat tariff tussle between President Trump and Beijing? Stats and market readings are effectively saying “dump gold and buy the S&P500 Index!” Percy Allan, who edits our Market Timing report, says that the myriad of numbers, stats and market readings that go into his analysis are effectively saying “dump gold and buy the S&P500 Index!” I discuss this in my article today.

And from Europe (where he’s enjoying a break), Paul Rickard looks into the KKR Credit Income Fund, which he concludes will suit some investors while at the same time admitting that it’s complex.

Sincerely,

Peter Switzer
Dump gold, buy stocks
by Peter Switzer

Why is gold losing friends? It can’t be oversupply, so it has to be a belief that market smarties are backing in a trade deal or at least no escalation of the tit-for-tat tariff tussle between President Trump and Beijing. This is the five-day move in the gold price and it clearly reinforces my point.

To be honest, I’m no gold expert because the commodity doesn’t play fair or more correctly, I can’t pick where it might go.

One guy who tries to do just that is Percy Allan, who once headed up the New South Wales Treasury Department. He didn’t like his personal outcome from the GFC stock market crash. He founded the website monitoring service —www.markettimingaustralia.com.au — and what it told me over the weekend quite surprised me.

For quite a long time this year the indicators that he and his colleague survey had three recommendations of buy the local STW exchange traded fund to be long the S&P/ASX 200 Index. In contrast, the key indicators suggested locals should buy the ETF with the code GOLD and for those playing the world, GOLD was the preferred option. Those who followed Percy’s gold suggestion have been in the money, however, as the table below shows, the monitoring process has downgraded gold for the S&P 500 Index, which is captured in IVV. This is iShares ETF for the Index.

<table>
<thead>
<tr>
<th>Trading Strategy</th>
<th>Exchange Traded Funds</th>
<th>Signal Date</th>
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<tr>
<td>Australian-Conservative</td>
<td>Buy STW*</td>
<td>9/03/2019</td>
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<tr>
<td>Australian-Rotation</td>
<td>Buy GOLD*</td>
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<tr>
<td>World-Rotation</td>
<td>Sell GOLD, Buy IVV*</td>
<td>29/08/2019</td>
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Source: markettimingaustralia.com.au

On May 12, Percy’s indicators recommended selling IVV and buying GOLD, which was very timely, as the chart below shows. There was an enormous spike in the gold price as Donald Trump and his tariff tantrums, the bond yield curve inverted and the Fed virtually told us that interest rates were on the slide to try and beat the threat of a recession.

Source: Goldbroker.com
And now the myriad of numbers, stats and market readings that go into Percy’s analysis are effectively saying “dump gold and buy the S&P500 Index!”

This is an important test of his market indicators and how they can interpret the conniving tweets and negotiations of Donald Trump and his team, not to mention the wrangling of the leadership team under Xi Jinping.

Certainly, technical chart analysis tries to pick up the weight of money movements as a sign of what smarties or insiders are doing and thinking. And undoubtedly, the body of work that underpins what Market Timing Australia produces is trying to tap into similar trends.

It has always been my base case that Donald Trump would want a trade deal before the end of the year to get enormous momentum going into the period of time that’s best for stocks i.e. November to April, in the year that’s best for stocks i.e. the third year of a US President and we’re in one of them right now.

Sure, I know Donald will play the cards that the Chinese deal him but with a slowing economy, the Chinese right now look like they want to contain this threat to their economic, social and political stability.

The Guardian today made the point: “China is stepping up its efforts to protect its economy from the ongoing damaging trade war with the US, ahead of fresh talks to resolve the dispute next month. The PBOC’s pledge came as the Chinese vice-commerce minister, Wang Shouwen, said Beijing would open up more sectors of the economy to foreign investors. Wang also announced that Beijing will send its top negotiator, vice-premier Liu He, to lead negotiations with the US in early October.”

Recent economic data has shown that the tariffs are hurting China’s economy. Over half its exports to the US have been slugged with Trump tariffs, car sales have fallen in 14 of the last 15 months and factory output is at a 17-year low!

Keep your fingers crossed that the October 10 trade talks in Washington become the timely circuit-breaker that creates a trade truce and a stock market spike, while showing us that Percy’s market-watching service is a ripper.

Right now I’m going longer stocks and dumping gold. And I hope I can stay that way!

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This Fund will suit some, but it’s complicated
by Paul Rickard

There is an old but trusted adage in investing – don’t invest in something that you don’t understand. And for many investors who contemplate investing in the new $750m KKR Credit Income Fund, this could well prove to be the case because this is a complex investment.

The investment objective, however, is relatively straightforward. This ASX listed investment trust aims to provide investors with attractive, risk adjusted returns and access to a diversified portfolio of income generating alternative credit investments with a focus on capital preservation through geographic and asset class diversification. The trust targets a net return of 6% to 8% pa. with a target cash yield of 4% to 6% pa through the market cycle.

But the complexity comes from the Trust investing in two quite different KKR (Kravis Kohlberg Roberts) managed funds, different times as to when the funds are deployed, the second fund being quite illiquid, and the delay investors will face in being appraised of the fund’s true NTA (net tangible asset value). Further, it is riddled with conflicts of interest.

On the flipside, investors are essentially backing the credit expertise of the KKR team and arguably, conflicts are unavoidable. Further, KKR argues that a strength of the proposition is its alignment with the interests of unitholders as KKR and its employees use their own capital to invest in the managed funds.

Here is our road test of the KKR Credit Income Fund.

The fund

The KKR Credit Income Trust will be listed on the ASX and trade under ticker code KKC. It is seeking to raise a minimum of $200m and up to $750m (although it can take another $75m in over-subscriptions) through the issue of units priced at $2.50.

The Fund will initially invest the proceeds in KKR’s Global Credit Opportunities Fund, before deploying up to 50% into KKR’s European Direct Lending Fund. By the end of 2020, it is expected that the split between the two funds will be roughly 50/50.

The Global Credit Opportunities Fund, KKR’s flagship fund, seeks to invest opportunistically in relatively liquid credit investments based on KKR’s assessment of risk-adjusted returns. It invests globally, focusing on traded loans and bonds in a senior position. Currently, the fund size is $2.1bn (in an overall market size estimated to be $3 trillion). Over its 11 years since inception, it has returned an average of 10.8% pa.

The European Direct Lending Fund invests in non-traded loans. Primarily, these are sought by middle market companies with earnings of around €50m to €100m. KKR argues that the major European banks have abandoned this space, and the loan size is too big for the regional players. The market size is estimated at $118bn and KKR is targeting 30 to 40 loans when the fund is fully operating in 2020. A target size for the fund is around $1.5bn. Because the lending is direct, the loans won’t be liquid and nor is the fund.

When the KKR Credit Income Trust is fully established, it is expected to be invested 50% in traded credits (through the Global Credit Opportunities Fund) and 50% in private credits (through the European Direct Lending Fund). Traded credits are loans, bonds or other debt securities issued by larger companies that are syndicated to a group of lenders, and which can be traded in a secondary market. Private credits are bilateral loans...
between a lender and a borrower, with no or limited syndication. They are not typically traded.

Senior debt will make up 86% of the portfolio (subordinated 14%), with a geographic split of 56% to European domiciled companies and 44% to North American. The following diagram shows an illustrative portfolio.

Distributions (unfranked) will be paid quarterly, with the first distribution targeted for April 2020 and covering the March quarter. The target distribution return is 4% to 6% pa.

The manager

KKR (Kohlberg Kravis Roberts & Co. L.P.) is a leading global investment firm. A pioneer in private equity, KKR established KKR Credit in 2004 to invest in attractive risk adjusted opportunities across the credit spectrum. In 2008, KKR Credit started accepting institutional investment mandates. Today, KKR Credit has nearly US$70 billion of assets under management of which approximately US$38 billion fall within its traded credit strategies and US$32 billion within alternative and private credit strategies.

The Manager is an Australian domiciled subsidiary of KKR. It has appointed a subsidiary of KKR Credit as its investment adviser. The Responsible Entity is a wholly owned subsidiary of Perpetual Limited.

The fees

The base management fee is 0.902% pa, including GST. Recoverable expenses, indirect costs and a fee to the Responsible Entity add approximately another 0.31% pa, taking the “base” costs to approximately 1.21% pa.

The Manager is also entitled to a performance fee of 5.125% of the total return when the Trusts exceeds a hurdle return of the RBA cash rate (currently 1%) plus 4%. If the Trust’s total return is 7%, the Manager would receive a performance fee of 0.368% (including GST).

In this scenario, total fees are estimated to be 1.58% pa.

The offer

There are 3 offers: a cornerstone offer for investors intending to subscribe at least $2m, a broker firm offer and a general offer. The general and broker firm offers are due to open on 14 October. Broker firm closes on 31 October, and the general offer on 6 November.

Trading of the units is expected to commence on the ASX on 18 November (under stock code KKC).

Units are being issued at a price of $2.50. The minimum application is 2,000 units (or $5,000) and then in multiples of 500 units. Potentially, $825m could be raised.

KKR is meeting the costs of the offer (estimated to be up to 3% of the amount being raised). This means that upon subscription, the NTA (net tangible asset value) of each unit should also be $2.50.

Brokers and banks involved in the deal include Evans Dixon, Morgan Stanley, Morgans, NAB, Crestone, Ord Minnett, Wilsons, Bell Potter, Patersons and Shaw and Partners. A stamping fee of 1.25% is being paid.

Our view

This is largely about investing in KKR. Although the fees are high, you pay for what you get and it is hard to argue with their track record. The return targets look to be achievable.

That said, it has a complex structure with the Trust investing in two underlying (but very different) KKR funds, phased deployment over potentially 12 to 18 months into the second fund, and the latter’s illiquidity.
Higher risk, with a medium to long-term time horizon required.

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3 stocks for your cellar
by James Dunn

Placing a stock “in the bottom drawer” doesn’t mean forgetting about it – there is too much about holding shares in companies that requires constant monitoring for that to be a valid investment strategy. An investor must always be ready to make big decisions on any stock. But stocks that will reward a long-term view is another thing – maybe the better term would be “cellaring” stocks, with its connotations of monitoring and turning the bottle every now and then. Here are 3 candidates that should reward an investor laying them down for a while.

1. CSL (CSL, $234.40)
Market capitalisation: $106.3 billion
One-year total return: 17.4%
FY20 estimated dividend yield: 1.3%, unfranked
Analysts’ consensus target price: $250.03 (Thomson Reuters), $241.99 (FN Arena)

Australia’s biotech giant is a candidate for the bottom drawer mainly because of the strength and quality of its CSL Behring and Seqirus businesses: CSL Behring is the world’s largest maker of plasma-based therapies, derived from immunoglobulin (IG), a component of blood plasma, while Seqirus is the second-largest company in the influenza vaccines industry. CSL’s history, size and scale give it a competitive advantage over most of its competitors, and the company’s entry into the China plasma market in 2017 – it was the first foreign company to gain full access to the Chinese market – positioned it well in the second largest market in the world, with immunoglobulin sales expected to grow at around 15% a year.

CSL’s accumulated advantages give it a very strong market position in two “thematics” that have all the characteristics for long-term growth, in its plasma and influenza businesses. CSL has growth potential in both emerging markets and developed markets: for example, the US health department has recommended that the entire population of the US over the age of six months be vaccinated against influenza, where previously, it only recommended vaccination for children aged between six months and four years.

Investors are often put off CSL because it usually trades on a high valuation multiple due to its strong market position, high margins and track record of innovation – the company historically ploughs 12% of sales back into R&D every year. At present, investors are being asked to pay about 35 times projected FY20 earnings, which is not as expensive as CSL has been in the past – for a company that is likely to compound its market advantages for a long time to come.

2. Altium (ALU, $34.16)
Market capitalisation: $4.5 billion
One-year total return: 26.9%
FY20 estimated dividend yield: 1.7%, unfranked
Analysts’ consensus target price: $37.19 (Thomson Reuters), $33.53 (FN Arena)

Altium is another of the local market’s high P/E stocks: paying 50 times forecast earnings is something that Australian investors aren’t used to doing. It develops software and hardware used for the design and development of electronic products globally, especially in printed circuit boards (PCB).

The stock is one of the ASX’s genuine global tech stars, and is positioned exceptionally well in one of the big “thematic” investment propositions – the “Internet of Things” (IoT). That is the emerging world of machines talking to each other, with microprocessors and sensors in machines swapping and processing information in real time – effectively
monitoring each other – and computer-connected humans observing, analysing and acting upon the resulting ‘big data’ explosion.

Modern cities are increasingly built to be “smart cities,” combining physical, information and operational technology in increasingly networked infrastructure systems. Research firm Statista estimates that the IoT market will grow from 23 billion devices in 2018 to 75 billion devices by 2025. Altium is right at the heart of this theme. While ALU competes with major rivals Mentor Graphics (part of Siemens) and the Nasdaq-listed Cadence Design Systems, it is a big player – and has a potentially huge opportunity in China.

Altium says it expects to achieve its 2020 revenue target of $US200 million, but further out, chief executive Aram Mirkazemi has gone on-the-record with a target to achieve dominance in the PCB design market by 2025, with 40% market share and 100,000 global subscribers. Many investors will want to let the stock sit in their portfolios and back Altium to achieve that.

3. Volpara Health Technologies (VHT, $1.605)
Market capitalisation: $350 million
One-year total return: 78.6%
FY20 estimated dividend yield: no dividend expected
Analysts’ consensus target price: $1.97 (Thomson Reuters), $1.84 (FN Arena)

I looked at the then-recently-listed Volpara Health Technologies in March 2017 when it was trading at 52.5 cents, as a stock with a great deal of potential. The New Zealand-based company has delivered the goods, and I think it still has plenty of room to grow, and can scale-up its product globally.

Volpara’s breast imaging analytics software has a crucial point of differentiation – it measures breast density, which is both a key indicator in early breast cancer detection, and a flaw in the current standard procedure of a mammogram X-ray, because breast density can hide cancer in a mammogram. Studies suggest that mammograms detect only 65% of cancers in women with dense breasts: Volpara’s software analyses breast density and also the probability of missing potential tumours, helping to determine whether further scans are required. The Volpara technology enables personalised, high-quality screening to give a better chance of early detection of breast cancer.

In March, the US Food & Drug Administration (FDA) gave the Volpara technology a huge push, with its decision to introduce mandatory reporting of breast density in mammograms in the USA. The FDA now requires all US screening facilities to provide information on breast density to women and their healthcare providers after a mammogram, on the basis that breast density data can help doctors and patients make more informed decisions about breast cancer risk.

The Volpara product is a software-as-a-service (SaaS) system that uses AI algorithms to analyse mammogram images and associated patient data to provide objective measures of the breast – it is a more accurate procedure, that has the ability to be a disruptive technology in its space. Earlier detection improves survival and reduces treatment costs, and given that 75 million women are screened globally each year – and there are 500,000 deaths a year from breast cancer – the potential market is huge. Volpara says its annual recurring revenue (ARR) opportunity is US$750 million ($1.1 billion), and the company has first-mover advantage, with users in 38 countries at present. However, Volpara is not yet profitable, and is not expected to be for FY20 or FY21 (year ending March) – thereby requiring some faith, to stick it in the bottom drawer.

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If recommendation upgrades and downgrades from stockbroking analysts are our guide, then the mood surrounding the Australian share market decisively soured last week. Not only did FNArena register only 5 upgrades against 12 downgrades for individual ASX-listed stocks, 8 of the downgrades shifted to Sell. Delivering some offset is the observation 4 of the 5 upgrades moved to Buy.

So who is responsible for all those fresh Sell ratings? Mining companies, mostly, plus High PE high flyers a2 Milk and REA Group. Retailer Premier Investments received one new Buy and Sell rating each.

Positive revisions to earnings estimates are plenty, with mining stocks at the centre, leading to sizeable increases. Fonterra and Premier Investments equally make their presence felt. This time the numbers are of lesser magnitude on the negative side with a2 Milk leading the week’s table which remains dominated by the mining sector, interspersed by Webjet and Qube Holdings.

In the good books

1. MONADELPHOUS GROUP LIMITED (MND) was upgraded to Buy from Neutral by UBS B/H/S: 1/2/1

Following the recent underperformance of the share price, UBS upgrades to Buy from Neutral. The broker expects Monadelphous to return to sales growth in FY20 as it transitions into iron ore replacement and sustaining capital projects from LNG construction. Updated analysis indicates that up to 87% of the broker’s FY20 sales forecasts may already be secured by long-term maintenance contracts or construction projects awarded through FY19 and FY20 to date. Target is reduced to $18.15 from $18.50.

In the not-so-good books

1. NATIONAL AUSTRALIA BANK LIMITED (NAB) was downgraded to Neutral from Outperform by Macquarie B/H/S: 2/4/1

Following the relative outperformance in the shares over the last quarter Macquarie observes National Australia Bank’s discount to its peers has narrowed. While the bank is less exposed to challenging retail banking trends, the broker envisages minimal growth in earnings per share. With the new CEO starting later this year Macquarie also assesses the potential upside from material cost reductions is limited. Hence, the rating is downgraded to Neutral from Outperform. Target is raised to $30 from $28.

2. REA GROUP LIMITED (REA) was downgraded to Lighten from Hold by Ord Minnett B/H/S: 2/2/1

Ord Minnett has checked depth penetration data, finding overall Premiere advertising penetration has increased to 20.0%, up from 19.4% in late August. Total depth penetration was up 44.1% for REA Group. The broker downgrades to Lighten from Hold on valuation, with the stock trading well above the $90 target.
Earnings forecast

Listed below are the companies that have had their forecast current year earnings raised or lowered by the brokers last week. The qualification is that the stock must be covered by at least two brokers. The table shows the previous forecast on an earnings per share basis, the new forecast, and the percentage change.

The above was compiled from reports on FNArena. The FNArena database tabulates the views of seven major Australian and international stock brokers: Citi, Credit Suisse, Macquarie, Morgan Stanley, Morgans, Ord Minnett and UBS. Important: This content has been prepared without taking account of the objectives, financial situation or needs of any particular individual. It does not constitute formal advice. Consider the appropriateness of the information in regard to your circumstances.
My “HOT” stock
by Maureen Jordan

Like
Michael likes Inghams (ING), Australia’s largest chicken producer. “Inghams (ING) is suffering from a drought-induced rise in feed costs,” he says.

“Many analysts have turned against ING, but the share price fall from near $5 to closer to $3 in my view fully factors this costs squeeze, and at current levels, long-term investors may consider ING a reasonable value proposition,” he adds.

Dislike
On the other hand, Michael doesn’t like the online advertising and data services group carsales.com (CAR).

“Carsales.com (CAR) has is trading within 6% of its all-time highs,” he says.

“Despite a decline in profit this year, analyst are still projecting future growth at rates well above average.

“If consumers remain conservative, there is a real risk to the growth estimates.

“At 27x next year’s earnings, in my view the risk for CAR shares is on the downside,” he adds.