Nike & 4 stocks under $1

Talk about synchronicity! I’m currently reading Phil Knight’s book *Shoe Dog* and Charlie Aitken’s article today is on the company that lives by the motto Just Do It! Charlie says that a combination of several factors has seen Nike deliver incredibly steady revenue growth for an extended period of time and in his article today, he runs through the reasons why he thinks this will continue.

Sincerely,

Peter Switzer
When considering companies for potential inclusion in the fund, we are clear about the characteristics we look for: a proven track record of generating excess returns on capital and equity throughout a business cycle, superior cash conversion relative to accounting profits, a well-capitalised balance sheet and modest-to-low volatility of sales growth.

From a non-financial perspective, we also investigate the industry structure to better understand the competitive landscape and intensity of competition, and explore the enablers of the competitive advantage that drive customer loyalty or pricing power.

Lastly, we try to find businesses that have exposure to a secular change taking place in the world, underpinning their ability to grow revenues.

In buying Nike during the periods of volatility in August, we believe we have found a business that meets our criteria for a quality long-term investment. Happily, Nike reported a very strong set of numbers to the market during the month of September and the stock rallied strongly on the result. Management commented on the near-term outlook remaining positive, despite the increased macro-economic noise, and modestly raised their full-year profit guidance on improved margin expectations.

Why we just did it!

At its most fundamental level, we own Nike because we think it gives us exposure to three important secular shifts: the growing global focus on health and wellness, the increasing preference towards more casual dress styles among younger consumers, and the rapid transformation of the manufacturing and sales processes enabled by changes in technology.

Globally, the thinking on encouraging healthier lifestyles is gaining traction: partly because of the social and community aspects, but also because educators and health care policymakers have come to the realisation that a population encouraged to have healthy and active lives are less likely to be as big of a burden on the public medical system. Beyond the purely practical, evidence suggests that as disposable incomes grow, the desire – and ability – to live a healthier life converge, leading to greater sports participation, whether formal (such as joining a club or league) or informal. Professional sporting bodies are also contributing to this shift, as they have become far more adept at growing participation at grassroot-level among younger age groups.

This more active lifestyle is also impacting general dress styles, with the trends towards so-called 'athleisure' wear seeing the athletic apparel and footwear category outpace the growth of the overall apparel and footwear categories over the last several years. To put some numbers to that, athletic apparel and footwear grew from ~22% of all US apparel and footwear sales in 2008, to roughly 30% by 2017. Globally, athletic apparel and footwear make up ~18% of the overall category as of 2018. Given that this number includes the USA, it would suggest that the category has much lower penetration in markets such as Europe and Asia Pacific, and therefore substantial scope for growth. A large part of this shift is driven by millennial consumption patterns, which we would expect to continue to play out.

Find your greatness

Given the constructive outlook for increased sports participation, a trend towards more casual dressing and a shift towards more healthy lifestyles, what makes us like Nike more than its competitors?
Firstly, we believe Nike has among the best brands in the athletic apparel and footwear category across all regions, consistently scoring exceptionally highly for brand awareness, perception and purchase intent. Nike – being several orders of magnitude larger than most of its competitors – has been an excellent steward of its brand, and has a storied history of partnering with and growing alongside some of the most famous sports personalities of the last several decades. (There’s a reason why the Jordan brand of basketball shoes often command a multiple of the official selling price in the sneaker resale market.)

In mid-2017, the company launched a focused campaign centred on 12 key cities around the globe, with the idea that serving these markets incredibly robustly will do more to enhance word-of-mouth and viral online marketing than only a traditional brand marketing campaign. The decision has handsomely paid off, as the robust upwards inflection in online engagement and sales growth since has proven.

Secondly, Nike has made substantial investments in product development and manufacturing techniques that we believe put them at a competitive advantage to their rivals, embracing the changes enabled by new technologies to enhance their manufacturing efficiency and increase speed-to-market. These changes largely focus on automation, using new materials, reducing wastage (and designing new products to be more efficient in terms of having less off-cuts or other wastage than was previously possible), and improved near-market sourcing. This latter point is especially relevant, given the impact of global tariffs. Nike management has actively worked to introduce flexibility into its supply chain ever since the threat of tariffs was raised several years ago, and we believe they have done more than most in terms of being able to reallocate manufacturing and supply to regions with less direct tariff risk.

Nike is also spending a substantial amount of money to introduce RFID – or Radio Frequency Identification – technology into its entire supply chain. This will not only allow the company to more accurately track and allocate supply, but also serve the purpose of more efficiently managing overall inventory levels.

Relative to competitors, Nike already has incredibly stable inventory levels throughout the year – reflecting, in our opinion, the less seasonal nature of demand for and more diversified range of Nike products. However, we believe the investment in further supply chain optimization will allow for even more efficiency, ultimately freeing up more cash flow from being tied up in working capital.

Thirdly, Nike is embracing new technologies to build a more robust direct-to-consumer (DTC) sales channel. A few years ago, this largely comprised of sales through Nike-operated flagship stores around the world, but the company has aggressively expanded into building an e-commerce offering.

Increasing the DTC channel relative to the wholesale channel in the sales mix is beneficial at several levels, not least of which is that it allows Nike to better control the average selling price, avoid unnecessary discounting to clear inventory, and improves the realised retail price by avoiding the discount given to wholesalers. This price uplift supports gross margins. Nike is leveraging digital channels to build a community of likeminded fitness enthusiasts, as well as improving ease of purchase while gathering deeper data insights, which in turn informs new design and inventory decisions. These three factors should continue to support the growth of the e-commerce DTC channel, and underpins our belief that there is substantial scope for further overall margin expansion as the channel matures.

Finally, Nike has been aggressive in building out its ability to appeal to consumers outside the US. With investments going back several decades, Nike has carefully stewarded its reputation as a brand that supports and understands local consumers, signing up local sports stars and building sponsorship relationships with local teams.

Source: FactSet, Company Reports
Nowhere is this more relevant than China, which is Nike’s fastest growing region. There is ample government support for endorsing health, wellness and increased physical activity, and the number of sporting events in China has increased substantially. Running – an activity with low barriers to participation – is seeing a huge surge in popularity. Given the strong demand in China, Nike plans to launch its NIKE app in China by the holidays, which should provide further scope for revenue growth to accelerate in the near-term.

The combination of all these factors has seen Nike deliver incredibly steady revenue growth for an extended period of time.

The chart above illustrates the year-over-year and quarter-over-quarter trailing 12 month revenue growth rates over the past seven years, alongside the actual dollar value of revenues for the trailing 12 months for every period.

Despite a substantial channel oversupply issue in the US during 2017 – largely caused by wholesale distributors facing increasing disruption from e-commerce – Nike has enjoyed a period of remarkably stable revenue growth, averaging around 7% year-over-year. (Were it not for the ongoing strength of the US dollar over the period, the reported number would have been even higher).

In digging into the numbers, there’s certainly an aspect purely related to increased volumes and expanding distribution, but the real magic is the ongoing ability to modestly increase prices. To us, this pricing power is incredibly important, as it suggests Nike has truly differentiated its offering in consumers’ eyes.

Putting the pieces together

The convergence of a secular trend, combined with Nike’s unique brand and investments in design, manufacturing and distribution all translate to the company being a high-quality compounding, in our opinion. The balance sheet is amply capitalised, and even in the event of an economic slowdown, we think the company is well positioned to weather any near-term disruption.

What are the main risks to our investment case?

We acknowledge there is always the near-term issue of a fashion miss, or a sports star (or team) signed with a rival performing better in any given season, leading to a sales shortfall. These risks are part and parcel of investing in the athletic apparel and footwear sector, and generally are buying opportunities for patient investors.

A more material risk to our thesis is a weakening of the secular shift towards healthier lifestyles. As a trend, it seems well embedded in younger consumers, but we acknowledge that any change to this outlook might impact the outlook for the business. We will continue to monitor this metric closely.

We also acknowledge that Nike ultimately sells a discretionary product to consumers. If a substantial global economic slowdown were to play out, growth would certainly be impacted in the near-term. However, we prefer to take the three-to-five year view, and given that we were fortunate enough to introduce the business into the fund with a reasonable margin of safety, we hope to protect the downside by being selective on the entry price we have paid.

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1. SDI (SDI, 82 cents)
Market capitalisation: $97 million
Three-year total return: –0.2% a year
Historical FY19 yield: 3.3%, fully franked
Price/Earnings ratio: 13.3 times FY19 earnings
Analysts’ consensus valuation: n/a

SDI might be a little-known stock, but it is one of the ASX’s most successful exporters, exporting more than 90% of its products overseas, to more than 100 countries. SDI is an Australian manufacturing success story, making a wide range of dental equipment and consumables, such as adhesives, alloys, composites, cements and accessories. The company is transitioning its product range as the worldwide market for amalgams – compositions of mercury and other metals for filling teeth – declines, as newer materials such as glass ionomers, composites and professional whitening start to dominate. Five years ago, amalgam products represented 43% of SDI’s global sales, but that proportion has halved to 22%. Aesthetics and whitening products now represent 70% of all sales, with dentists’ equipment amounting to 8%.

SDI has a very strong balance sheet, with no debt, $6.5 million in net cash and $4.8 million of free cash flow generated in FY19, allowing $2.6 million to be ploughed back into R&D, and an ordinary dividend of 2.7 cents a share (up from 2.5 cents in FY18) augmented by a 1-cent special dividend. Analyst coverage of SDI is very thin on the ground, but if SDI repeats that dividend in FY20 it is trading on a fully franked yield of 3.3%. Favourable currency movements – that is, a weakening Australian dollar – could boost SDI’s profit this year.

SDI was not always ahead of the curve in terms of the market move away from amalgams, but it has re-orientated its product mix very well to benefit from this trend. It has a global market that trusts it for high-quality products without which dentists can’t operate; and although it does have plenty of competition, its strong brand and distribution network make it one of the ASX’s most successful global businesses.

2. Michael Hill International (MHJ, 58.5 cents)
Market capitalisation: $227 million
Three-year total return: –24.9% a year
Expected FY20 yield: 8.6%, unfranked
FY20 Price/Earnings ratio: 8.6 times earnings
Analysts’ consensus valuation: 71 cents (Thomson Reuters), 67.3 cents (FN Arena)

Like most retailers, international jewellery chain Michael Hill is finding the current environment tough: in FY19, sales slipped 1% to $569.5 million, hampered by a 3.3% decline in same-store sales. Net profit came in at $16.5 million, compared to $1.6 million in FY18, but that was affected by a slew of one-off items: a better measure was underlying earnings before interest and tax (EBIT), which slipped by 14%, to $34.6 million. The full-year dividend was down one cent, to four cents.

In July, Michael Hill revealed that after a review, it had discovered that it had been underpaying some staff for six years: the company said it expected $10 million–$25 million to come off its profit in FY20 as it remediated this. The shares dropped 9% on this news, but that may have opened up some value, when set against analysts’ consensus price targets. Like many retailers, MHJ is concentrating on getting costs out of its business, and that is expected to drive growth in the medium term – the company says the program saved it $5 million in FY19, and will be saving that amount a year by FY21: that is not a small amount in the context of what it currently earns. The company is also moving up-market in terms of...
increasing its branded collection sales to half of sales. Citi describes Michael Hill as a “retailer in the early stages of a successful turnaround,” with a “heavily undervalued” share price.

3. Freelancer (FLN, 78 cents)
Market capitalisation: $353 million
Three-year total return: –19.9% a year
Historical FY19 yield: n/a
Price/Earnings ratio: n/a
Analysts’ consensus valuation: $91.5 cents (Thomson Reuters), 88 cents (FN Arena)

Jobs website operator Freelancer operates the world’s largest marketplace for freelancing, outsourcing and crowd sourcing of jobs and tasks – which allows potential employers to post jobs that freelancers can then bid to complete – and also operates online payments company Escrow.com, and Freightlancer, an online marketplace connecting freight owners with transport operators. In March, the company launched the “world’s largest electronics and electrical services marketplace”, in conjunction with Arrow Electronics, a Fortune 500 company with sales exceeding $42 billion: the platform, called “ArrowPlus powered by Freelancer.com” is specifically aimed at engineering projects: companies and individuals can post technological engineering tasks, and be matched with an engineer within 24 hours.

Freelancer is not yet profitable on a full-year basis, but is racking up some impressive numbers: it finished the June half with 34.7 million registered users and 16 million jobs on its platform, with 3.3 million registered users and 900,000 jobs added for the half. The company says it is the number-one online services marketplace, with more than US$4.5 billion ($6.6 billion) in jobs awarded. Escrow.com, which Freelancer picked up for just under $10 million in 2015, is also performing strongly for the company: at June 30, it had handled more than US$4 billion ($5.9 billion) worth of transactions. Gross payment volume surged by 11%, to a record $400 million, and net revenue for the June 2019 half-year rose by 16%, to $28.7 million, but most importantly for shareholders, FLN reported its maiden interim profit, earning $200,000 for the first-half. The company lifted its holdings of cash (and cash equivalents) by 9% over the year to June 30, to $34.4 million. Analysts expect full-year earnings per share (EPS) of about 0.2–0.3 cents, rising to 0.5–0.7 cents in FY20 – but a dividend is not yet in sight. However, Freelancer’s numbers are pointing in the right direction, and analysts see healthy upside for the stock.

4. Frontier Digital Ventures (FDV, 73 cents)
Market capitalisation: $179 million
Three-year total return: –19.9% a year
Historical FY19 yield: n/a
Price/Earnings ratio: n/a
Analysts’ consensus valuation: $1.03 (Thomson Reuters), 94 cents (FN Arena)

Frontier operates online classifieds businesses in emerging countries or regions, focusing on cars and property, with businesses in Africa, Asia, South America and Central America. While these emerging regions are often seen as higher-risk, Frontier sees only opportunity, with the ability to leverage its knowledge from established markets – CEO Shaun Di Gregorio was the REA Group Limited general manager between 2010 and 2014 and, later, CEO of iProperty Group – and get closer to the transactions, in early-stage markets with low entry prices.

The pin-up business for its portfolio is Zameen.com in Pakistan, which has moved to profitability and represents what the company describes as a “case study of how to successfully monetise (a business) from a dominant market position with very high brand awareness.” There are 13 other such businesses in the Frontier portfolio that lead their respective markets, with three others – Myanmar residential property site iMyanmar, Philippines car and motorcycle website AutoDeal and South American online real estate marketplace Infocasas – closest to following the zameen.com path to become the group’s next profitable and more self-sufficient and autonomous investments.

In the first half of 2019, this portfolio generated $33 million in revenue, up 82%, and a loss at the EBITDA (earnings before interest, tax, depreciation and amortisation) level of $1 million – Frontier is very close to breakeven. Since floating in August 2016, FDV has increased its share of portfolio revenue by 9.2 times. The stock is not expected to make a profit in 2019 or 2020, but Frontier’s portfolio of businesses all show the right trajectory of where their
numbers are heading.

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The period from November to April is normally upbeat for shares.

Typically, share markets do less well from May to October than November to April as shown by the next chart. Hence the old adage: sell in May and go away until St Ledgers Day (a British horse race).

The next chart shows how share market returns in the USA, Australia, Asia (excluding Japan), and the World as a whole, differ markedly between the “good” period (end-November to end-May) and the “bad” period (end-May to end-November). Mind you, even the ‘bad’ period on average delivers positive returns but they are a fraction of those of the “good” period.


That’s not to say it’s all blue sky ahead. According to Lance Roberts, chief investment strategist at Real Investment Advice, the US share market remains extremely overvalued and needs a crash to restore its fair value. In his view, this outcome is inevitable, since America’s corporate earnings have stagnated since 2014 and only share buybacks have kept earnings per share rising since that time.

**3 market scenarios**

Roberts has charted three courses that the S&P500 share index could take, depending on what path President Trump chooses in his trade war with China. Since American stocks dominate the global share market, their fate will dictate investor sentiment everywhere.

The first scenario assumes Trump caves into China in October and gets a “small deal” done, which he dresses up as a big victory (just as he did with the NAFTA re-negotiations with Mexico and Canada,
which changed little of substance). It would see tariffs removed and give a ‘pop’ to an already overvalued market enabling it to reach a new high by years’ end. See chart below.

In the second scenario, talks break down and negotiations are postponed to next year. But that would still weigh on corporate profits and consumption at a time when earnings are already declining and the benefits of tax cuts have worn off. The market would correct as it “repriced” for slower earnings and economic activity. See chart below.

The third scenario sees Trump lose his temper with China and walk out of talks reinstating the tariffs on discretionary goods, and increasing tariffs across the board. In return, the Chinese retaliate by imposing additional tariffs on American goods. An all-out trade war ensues and the market crashes as consumer and investor confidence implodes. See next chart.

The contra view
Robert’s US stock market scenarios all seem plausible but let’s play devil’s advocate to test their robustness. Bloomberg Economics modelling of the tariff moves to date suggests that in two years’ time, GDP in China, the U.S. and the world would be lower by 0.5%, 0.2% and 0.2% respectively, compared with a no-trade-war scenario. See chart below.

While a 0.2% fall would be unwelcome, it would not be calamitous since the US economy is currently expanding by 3.1%.

Furthermore, every time the economy turns for the worse, central bank and governments embrace stimulus measures that see stock markets boom. Indeed, the perverse new paradigm is that bad economic news is good financial news. This might suggest the more reckless Trump becomes the more


monetary and fiscal officials have to prime the pump to keep the show afloat which feeds bond, property and share prices.

**What really counts**

Historically, political dramas rarely cause major market ructions, unless they translate into interest rate or energy price spike. For example President John Kennedy’s assassination, which shocked the world, dented the US stock index by only 3%, which reversed within two days. Politics is incidental. On the bright side, neither short-term interest rates or oil prices have yet spiked and until they do, history would suggest that a financial crisis (and hence a market meltdown) is not imminent.

Of course, no one can foretell the future, which is why Market Timing Australia lets the share market itself signal when it’s sick and when it’s well. That’s done by tracking its price trend and momentum. When these are positive, it’s safe to be in shares, but when they turn negative it’s best to cash out.


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4 ways to get exposure to faster-growing Asian equities

by Tony Featherstone

Identifying megatrends is the easier part of investing. Knowing when to buy into a megatrend at sensible prices, and having the nerve to stick with the idea, is the bigger challenge.

Consider Asia. The middle-class consumption boom in emerging markets – a trend I have followed closely for the Switzer Report – is the mother of all megatrends. Another two billion Asians are expected to join the global middle class by 2030, on OECD forecasts.

Gaining long-term portfolio exposure to faster-growing Asian economies makes sense.

Yet most Self-Managed Superannuation Funds (SMSFs) are underweight global equities, judging by Australian Taxation Office data. SMSFs that have offshore exposure tend to favour developed rather than emerging markets.

Diversification is key. A growth portfolio (five years to retirement) could justify 5% of assets in Asian equities and another 5% in emerging markets. A moderate or conservative portfolio (near or in retirement) would have far less or no exposure.

Having 10% of a growth portfolio exposed to higher-growth Asian economies will make a difference over time, provided investors can tolerate a negative year of returns every four to five years. Asia is a long-term idea for long-term portfolio investors.

The key is buying into the Asian growth trend at lower prices. There have been more signs this month that the US-China trade war is hurting global economic growth more than the market expected. The US ISM manufacturing index – a key barometer of US economic strength – has hit its lowest point since 2009.

Germany, the world’s fourth-largest economy, is on the brink of recession (or already in it, according to some forecasters) after a larger-than-expected decline in factory orders. And Britain’s tumultuous potential exit from the European Union is weighing on European trade.

Predictably, the World Trade Organisation has more than halved its forecast for trade growth for this year and next. The WTO expects global trade expansion to be the worst since 2009.

A deteriorating global economy is bad news for Asia. The Asian Development Bank late last month slightly downgraded its growth forecast for the region to 5.4%, from 5.9% a year earlier. Trade conflict is sapping the region’s growth.

But 5.4% expected growth this year looks like a boom compared to developed markets. Australia’s annual economic growth of 1.4% is the worst in more than a decade, forcing the Reserve Bank to cut the cash rate and fuelling expectations of more cuts ahead.

The US Federal Reserve is expected to cut rates again after the dismal manufacturing data and there is more than $22 trillion of sovereign bonds with negative rates. Simply, investors in parts of Europe and Japan are paying governments to hold their money, such is the uncertainty. That’s a sign of future economic distress.

Asian equities have been caught in the crossfire. The MSCI Asia ex Japan index – a barometer of 984 Asian stocks across 11 countries – is down 3.4% in the year to September 2019, MSCI data shows. That follows a 14% fall in 2018, after booming gains in 2017.

Further falls are likely as global growth slows. The...
flipside is that slowing growth could encourage a US-China trade truce, which would be unambiguously good for markets.

Either way, the case remains for Australian retail investors to ensure they have sufficient exposure to Asia, relative to their risk profile, investment horizon and goals.

Here are 4 ways to get that exposure.

Each suits experienced, long-term investors who understand the risks of investing in the region.

1. APN Asian REIT Fund

The unlisted fund invests in Real Estate Investment Trusts (REITs) in Asia. About 41% of the fund was invested in Japanese property at September 2019. By sector, about two thirds of the fund was invested in retail and office properties.

The fund returned 31.4% over one year, thanks partly to the falling Australian dollar and lower interest rates making interest-rate-sensitive stocks, such as REITs, more attractive. Over seven years, the REIT’s annualised average return is an impressive 15.6% (after fees).

I have followed this fund for several years, principally because investing in quality property in developed and emerging Asian markets is a lower-risk way to play the region. The fund’s performance has vindicated that view, but it has a relatively low profile given its returns.

2. iShares Asia 50 ETF (IAA)

The ASX-quoted Exchange Traded Fund (ETF) provides exposure to 50 of the largest Asian stocks across China, Hong Kong, Macau, Singapore, South Korea and Taiwan.

IAA returned 2.78% over the year to September 2019 as tech stocks retreated from their high. Over five years, the annualised return is 12.59% and over 10 years it is 9.45%.

Just over a third of the ETF is invested in China and companies in the financial, information technology and communication sectors dominate. Simply, the fund is stacked with multinationals, making it a relatively lower-risk way to benefit from Asia’s growth.

A management fee of 50 basis points is competitive for this type of ETF.

3. Betashares Asia Tigers Technology ETF (ASIA)

True believers in tech need to look beyond the Nasdaq exchange in the US to Asian companies that are revolutionising the region through technological disruption.

Launched in September 2018, the Betashares Asia Tigers Technology ETF provides exposure to 50 of the largest technology and online retail companies in Asia, excluding Japan.

Almost half of the ETF is invested in China and there is a strong focus on companies in the semiconductor, internet and interactive media and services industries. The ETF’s 10 top company holdings are a “who’s who” of Asian tech giants.

The index over which the ETF is based delivered a negative 2.3% return over one year to September 2019. Over three years, the annualised return is 13.27%.

Expected growth in technology and Asia are a compelling combination. Buying into that trend after a weaker year for Asian tech stocks should appeal to those who have a bullish long-term view on the region’s tech giants.
Commentators for years have written about India becoming the next “China” for Australia in terms of export opportunities. Yet there have been few specialist listed vehicles for retail investors to access investment opportunities in India.

ETFS Securities’ Reliance India Nifty 50 ETF is an interesting newcomer. It tracks the Nifty 50 Index – the flagship index of the National Stock Exchange of India – and its largest companies.

Although India’s growth is slowing faster than expected, it remains the world’s fastest-growing major economy. The Reserve Bank of India this month lowered the growth outlook to 6.1%, from 6.9%. Most countries would love that type of growth in a slowing global economy.

NDIA is part of a new breed of India-focused ETFs and active funds being offered to retail investors. The BetaShares India Quality ETF focuses on the 30 largest Indian companies.

Active managed funds that specialise in Indian equities are another option. The Fidelity India Fund, a unit trust, holds a diversified portfolio of 50 to 70 Indian companies. The fund has performed well over short and long periods. The one-year return is 13.8% to September 2019; over seven years the annualised return is 15.4% – about 3 percentage points ahead of the fund’s benchmark index.

Long-term investors who want exposure to India, which has years of higher growth ahead as it industrialises, should consider India-focused ETFs or active funds, provided they understand the higher risks of investing in India.

India will be at the epicentre of the middle-class consumption boom in emerging markets in the next decade or two. The time to buy into that trend is when global growth is slowing and investors are becoming nervous, mindful that there will be occasional years of negative returns and recurring bouts of volatility in India and other emerging-market equities.

Tony Featherstone is a former managing editor of BRW, Shares and Personal Investor magazines. The information in this article should not be considered personal advice. It has been prepared without considering your objectives, financial situation or needs. Before acting on information in this article consider its appropriateness and accuracy regarding your objectives, financial situation and needs. Do further research of your own and/or seek personal financial advice from a licensed adviser before making any financial or investment decisions based on this article. All prices and analysis at 9 October 2019.
In the good books

1. NEXTDC (NXT) was upgraded to Add from Hold by Morgans

Morgans upgrades to Add from Hold. The broker observes strong results are underpinned by significant structural growth. The broker had been concerned that market expectations for sales were too high but now assesses expectations have eased back to more realistic levels. The main concerns centre around the need to accelerate sales in the tier 2 facilities as well as the balance sheet. While the debt position appears full, Morgans appreciates there are long-term contracts that mean interest coverage increases in outer years as capital deployed starts to generate a return. Target is steady at $6.68.

2. SYDNEY AIRPORT HOLDINGS (SYD) was upgraded to Outperform from Neutral by Macquarie

Sydney Airport has started to re-negotiate access agreements. Macquarie assesses the company is facing a more challenging slot environment, as competitors, such as Western Sydney, Melbourne and Brisbane, are adding runway capacity. Thus the emphasis needs to shift to service quality in order to differentiate the airport. Additional T4 expenditure to enhance capacity is likely to mitigate pricing pressure, the broker acknowledges. Macquarie does not consider the multiple stretched, while the recent sale of Hobart Airport emphasises the value in Sydney Airport. Rating is upgraded to Outperform from Neutral and the target raised to $8.77 from $8.53.

The above was compiled from reports on FN Arena. The FN Arena 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.
Questions of the Week
by Paul Rickard

**Question 1:** What are your thoughts on XTBs?

**Answer:** I think XTBs (exchange traded bonds) are fine but because the yield-to-maturity is so low (generally under 2%), they’re pretty unattractive. Unfortunately, we don’t have a strong corporate bond market. Retail investors are essentially “incentivised” by the banks (paid higher rates than institutional investors due to various APRA liquidity measures) so it’s very hard to go past term deposits for fixed interest investments up to five years. If you think interest rates are going to fall or are prepared to consider “non-investment grade” risk, or potentially want a term of more than five years, then consider XTBs. Otherwise, stick to term deposits or access the market with a diversified portfolio from a manager.

**Question 2:** As a retiree, I value bank dividends but am underweight banks due to concerns about concentration risk. Can you comment and suggest some additional higher dividend stocks outside the top 50?

**Answer:** You won’t find many “higher” dividend stocks other than the banks. Sorry, I don’t get you concerns about “concentration risk”. It’s very hard to suggest some stocks without knowing more about your risk appetite and existing portfolio. However, for some ideas, you could look at the portfolios of some of the income-focused managed funds such as:

- Australian Foundation (AFIC).
- Switzer Dividend Growth Fund (SWTZ).
- Contango Income Generator (CIE) – focuses on stocks outside the top 30.
- Einvest Income (EIGA).

Typically, each of these funds will publish a list of their top 20 holdings each month. Also, keep reading the *Switzer Report* for ideas from our experts including Tony Featherstone, James Dunn and Charlie Aitken.

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