Switzer Super Report
Advice you can trust

Monday 14 March 2016

Bulls and bears

Bulls and bears and market swings. It's certainly hard keeping a long-term perspective in choppy markets. Today I look at whether we can put our faith in the stock market and outline the case for and against!

Also in today's *Switzer Super Report*, Paul Rickard looks at a quality business in the health sector and whether it's a stock for the watch list. Roger Montgomery also gives us his take on a high-growth prospect. In *Buy, Sell, Hold – what the brokers say*, brokers have upgraded a number of gold stocks but one gold miner is in the not-so-good books. And Blackmores is among the likes in this *week's Super Stock Selectors*.

Sincerely,

Peter Switzer

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Can we trust stocks in 2017?

by Peter Switzer

After seeing our stock market go up over 10% since the February 10 low, which was just after we went into bear market territory for a day, the question we have to ask is — are we in a correction within a secular bull market, a cyclical bear market within a secular bull market or are we in a cyclical bull market in the start of a secular bear market?

A secular bull or bear market lasts for many years and inside them there can be a temporary bear market. As Robert Lenzner writing on the Forbes website pointed out: “At least 3 of the bear markets last six months or less, not that long to absorb the pain.”

If we count the start of one on February as a bear market based on the 20% rule, then this could be the shortest ever or it could be a short reprieve before another testing of the downside.

A news.com.au story explained that “This is just Australia’s fourth since 2000, while the US has only suffered two bear markets in that time,” it said. Dr. Shane Oliver of AMP Capital told the website that “long bear markets tend to happen when economies are in a recession — such as the Global Financial Crisis or the mid-1970s in Australia.”

So that builds my case for the positive and for sticking with stocks.

Fund managers like WAM’s Geoff Wilson thinks we will experience bear-like market conditions until around October and he’s not the first fund manager to say that. They could expect the old “sell in May and go away” to work this year but they also look at valuations of companies if they can’t see numerical reasons to buy, they hold a fair bit of cash and wait.

Three big things could change their valuations and their numbers: better economic growth than expected, improved profit and outlook statements from companies and lower interest rates.

The first two apply to Australia now and the third is a possibility, as the dollar rises maybe forcing the RBA to cut rates.

Internationally, the world economy is getting downgraded economic growth but the rate is OK, company results as well as outlooks have been mixed and rates are going so low that they are negative!

Most of the good news coming for stocks overseas, leaving out the USA, is coming from the central banks and a possible OPEC-created production freeze! We’re also seeing iron ore and oil prices rise but no one is clearly arguing that demand for resources is actually rising. They seem to be saying the sell off was too hard and now short sellers are taking evasive actions and so prices are going too high.

There are good reasons to be suspicious about the good reasons that took us out of that bear market for one day. I hope they will be sustained but one crazy move from the Bank of Japan, the Fed and OPEC between now and Sunday — March 20 — and the buying enthusiasm could easily switch to selling.

This is why I am not my old bullish self. Look, if I’m too optimistic and we see lower levels on stock markets, I will be a buyer of quality companies because I think with interest rates so low, stocks by default, are more attractive.

In the US, bull markets have lasted 97 months on average, so some have been longer, while others have been shorter. Given our crazy interest rate environment, then this could easily be a longer bull market with a short cyclical bear market inside it or it really is just a correction. The Yanks had a correction, not a bear market, with the S&P 500 falling 14.4% and that makes me think our one-day bear market was really a correction.

Average US bull markets add 440 points but this makes less sense because the higher the starting point, the less relevant is the point advance. A 440 point gain on a starting point of 440 would be 100% but on a starting point of 880 it would be 50%.

In the 1990s, the bull market saw the S&P 500 index go up 816.5%, which ended with the dotcom bust. The next bull market went up 800%, until the GFC took away a tick over 50% of investors portfolios if they matched the index!

Depending how you calculate it, the US market was up about 200% since the GFC low was hit in March 2009, so on the 1990s standard we could easily have a lot more upside in this market.

I know there are doomsday merchants tipping a long bust but for the Oz economy, and therefore our stock market, I think the real threats are from overseas.

If the QE program in Europe does not breed economic growth and China proves to be all talk and no action, then we could be locked into a bear market.

Billionaire investor Warren Buffett once said you should not invest in a stock that you were not prepared to hold for 10 years. That said, a news.com.au story pointed out that Aussie share prices are sitting almost exactly where they were 10 years ago — and 30% below their 2007 record high. It concluded "so long-term investors are right to feel frustrated" but that's if they only bought in in 2006 or early 2007.

This chart shows that long-term investors win over most decades:

Source: *Yahoo!7 Finance, 14 March 2016*

One of the greatest investors of all-time, Sir John Templeton, told us that "Bull markets are born on pessimism, grown on scepticism, mature on optimism and die on euphoria" and I just have not seen euphoria anywhere. I've seen some optimism in the US and a bit in Europe and even here when we nearly broke 6000 in March last year but skepticism took over.

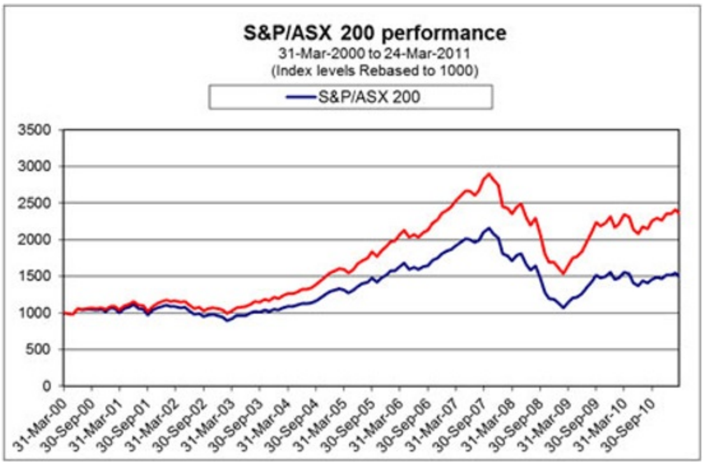
I could be wrong but I think arguments that we are in a long, slow economic recovery means we have a long slow secular bull market that will have some cyclical corrections and even a cyclical bear market but it will be replaced by bullish moves high, provided we eventually see global economic growth respond to QE and negative interest rates.

Our economy is one of the best in the world — 25 years of growth without a recession proves that — and our current rate of growth beats most economies other than unusual Asian ones such as China.

Meanwhile the US has responded to its QE and its government's fiscal stimulation so we're in a waiting game situation.

If you're a panic merchant and uncommitted long-term investor, maybe you should go to cash and buy in when we see market lows but for me, I'm happy playing the long game. That chart above is what keeps me positive on stocks and that's only half the story because it leaves out dividends!

The chart below makes my point.



The blue line is capital gain from the index but the red line throws in dividends! These lines show some ups and downs but the main trend is up! It's up to you to learn how to cope with the down times.

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Time to buy Ramsay?

by Paul Rickard

There's only a handful of companies listed on the ASX that can boast a share price graph like this.

Ramsay Health Care – 1998 to 2016

Source: Yahoo!7 Finance, 14 March 2016

CSL is another that comes to mind, but I am struggling to think of any others with such a consistent uptrend over a period spanning almost 20 years.

Ramsay Health Care is one of the highest quality companies listed on the ASX, with an outstanding CEO in Christopher Rex. No ifs and butts about this. So sellers – sell at your peril, and investors, when do I buy?

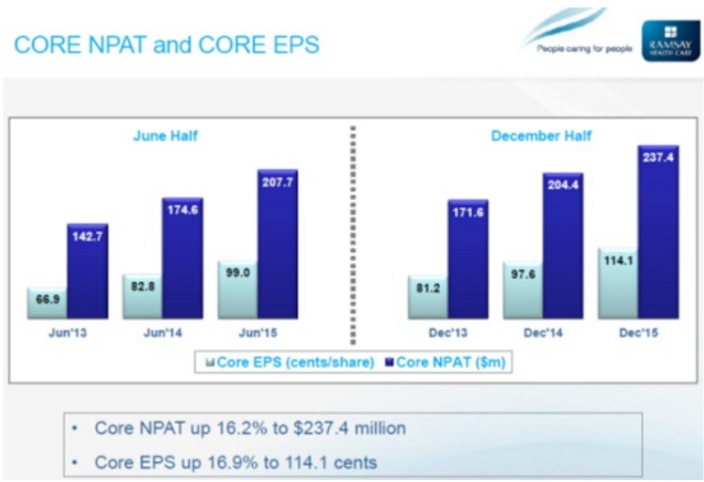
Let's look at this question and bring price into the equation, but first, a quick recap on the company.

The business

Ramsay Health Care is Australia's largest operator of private hospitals, and is ranked in the top five globally. Founded by the late Paul Ramsay more than 50 years ago, it operates 221 hospitals across six countries, employing circa 60,000 people.

The Australian business is Ramsay's largest and most profitable business unit, generating 52% of group revenue, while earning 72% of group EBIT. It is complemented by a UK business, which generates 10% of revenue, and Ramsay's expansion into France through the recently acquired Ramsay Générale de Santé. The latter generated 37% of group revenue, but only contributed 20% of group EBIT.

Notwithstanding the challenges in increasing the contribution from the French business, Ramsay's numbers are still very impressive. Core NPAT for the December half was up 16.2%, core earnings per share were up 16.9% – the continuation of a track record of earnings/profit growth of around 15% per annum.



In regard to growth going forward, Ramsay articulates this in terms of organic growth within its existing portfolio of hospitals; brownfield capacity expansion, such as adding wards or beds or new hospital development (eg. Cairns Private, Wollongong Private); public/private collaborations; and acquisitions. Ramsay says that it has proven it can export its management model, and that any acquisition must add long-term value to shareholders.

In conjunction with its half-year report, Ramsay upgraded its guidance for the full FY16 year. It now expects Core NPAT and Core EPS to grow by 15% to 17% (previously 12% to 14%).

Tailwinds and headwinds

Ramsay sees strong tailwinds in the demand for healthcare globally. An ageing population, increasing life expectancy, population growth, increased chronic disease burden and improvements in treatments and diagnostic methods will drive up the demand for health services.

Potential headwinds in Australia include private health insurance membership, and private health funds seeking to change the contractual relationship with private hospitals. While private health insurance membership has remained relatively static at 47.2% of the population, Ramsay would be vulnerable to a decline in membership, which could be triggered for example by a change in the Government's rebate on private health insurance fees. With the contractual relationship between health funds and hospitals, Medibank is one fund that has flexed its muscles in the past, and it's quite possible that they will do so again in the future.

In the UK and France, government plays a more direct role in setting hospital tariffs and due to the bourgeoning cost of health services, are keen to exert downward pressure. Only a few days ago, the French government announced a cut of 2.15% to the tariff schedule for private hospitals. In the UK, an average tariff increase of around 1% has been approved from 1 April.

Competitors

Ramsay's main listed competitor is Healthscope (HSO). While they probably compete more in regard to new greenfield hospital developments rather than in the day-to-day provision of hospital beds (although specialists often operate in multiple hospitals), they are natural companies to compare in terms of market pricing.

Healthscope was listed on the ASX in July 2014. Despite a lot of hype about the IPO and the shares trading for a period well above their issue price, the shares have fallen back of late. They have still gained 19% from a $2.10 issue price to close Friday at $2.50 – but have not done as well as Ramsay, which over the same period has risen 35% from $46.67 to $63.25.

Although it's largely an Australian hospital business (83% of EBITDA), Healthscope continues to trade at a considerable discount to Ramsay. According to broker forecasts compiled by FN Arena, it is trading on a multiple of 22.5 times FY16 earnings and 20.0 times FY17 earnings – compared to Ramsay's multiples of 27.4 times FY 16 and 24.8 times FY17.

Interestingly, Ramsay grew revenue from its Australian hospitals by 7.4% in the last half year, while Healthscope could only manage a 4.5% increase.

The Brokers

The Brokers are neutral on Ramsay overall, with 3 buy, 3 hold and 2 sell recommendations. They see the stock as pretty fully valued, with the consensus target price of $66.39 only 4.9% higher than the current price. Trading on such a high multiple, the stock, in some brokers' eyes, is priced for perfection. The following table compares Ramsay and Healthscope.

	Last price	Consensus Target Price	Upside	FY16 PE (f)	FY17 PE (f)	Div Yield FY 16
Ramsay	$63.25	$66.39	4.9%	27.4	24.8	1.9% franked
Healthscope	$2.50	$2.75	10.0%	22.5	20.0	3.0% unfranked

Bottom Line

Ramsay is one of those companies that should be a core part of your portfolio. There are very few companies that consistently deliver year on year profit growth of around 15% pa, have an outstanding board and management team, and have such strong tailwinds from the demographic and other factors shaping the demand for their services.

The stock is pricey, so if you don't want to dive in now, look hard at Ramsay in bouts of market weakness. Don't be too greedy, however.

A high-growth prospect

by Roger Montgomery

SEEK (SEK) is a stock we have liked and owned for a while.

The initial phase of growth for the company was one in which it replaced traditional print media as the main job advertising board.

Its focus was on being the site with the largest number of jobseekers, which in turn would attract employers looking for the largest pool of talent. This, along with the scale advantages generated from fixed costs, created a barrier to entry that allowed SEEK to generate an extremely higher return on capital and large amounts of free cash flow.

This cash flow has been invested in a number of other areas including Learning (albeit with a recent regulatory hiccup) and acquisitions of leading online job sites in Asia, Africa and Central and South America.

In Australia, the business is moving into its second stage of growth. The risk to the virtual circle created by having the highest number of jobseekers and employers will inevitably come under threat from new business models if SEEK fails to innovate and evolve the business. The job ad aggregators like Indeed are the most obvious threat to the basic job board business, and will lead to a commoditisation of this asset over time.

To SEEK's credit, management announced that it will be reinvesting in new products to create value added services that leverage its core competencies and strategic advantages, rather than just defending its job board business.

What sets the online job ad business apart from the tradition print media product is the data capture. The more interactive and engaging nature of online advertising lends itself to learning about the end users (both jobseekers and employers). This data can be used to identify opportunities and produce products that can tap demand and supply that was previously unavailable to one dimensional job ads in print media, by identifying and prompting people that might be interested in a new job opportunity but are not actively looking. These people are known as passive jobseekers.

Historically, accessing the passive jobseeker market required the use of recruitment firms that manually search their database of past applicants. The rapidly growing database at SEEK's disposal from 7.1m posted resumes provides it with a broader base of potential jobseekers than any individual recruiter.

SEEK's investment in search technology and systems also provides a faster and more efficient means of searching the database for a list of potential candidates.

Through its investment in new products and the increased capture of valuable data, SEEK is moving along the value chain of the industry to the more labour intensive and higher value added part of the industry.

As evidence of the value of its search capability, SEEK announced on February that Hays Recruitment will use SEEK's search technology to filter both its own and SEEK's database. This sees SEEK starting to integrate its technology into the recruiter's business to improve their efficiency and capabilities directly.

Increased penetration of the recruiter market will inevitably bring SEEK into greater contact with other disruptors like LinkedIn. However, the primary opportunity for both companies will be in displacing the traditional players in the market for many years before having to worry about one another.

One key deficiency in SEEK's platform relative to LinkedIn is its lack of ongoing engagement with the jobseeker once they find a job. In the results to 31 December 2015, the company discussed some new products such as Company Reviews that are designed to generate an ongoing dialogue with jobseekers after they find a new job. This is part of a suite of new products that SEEK will launch in the medium term to help jobseekers make better and more informed decisions.

Importantly, a lot of the investment being made in Australia will have applications in SEEK's overseas businesses. This provides more leverage for the investment in the longer term.

The first half result provided greater confidence in the reinvestment strategy, while also showing the benefits that will flow through from the merger of JobsDB and Jobseeker in Asia. This gave the market increased confidence in the strategy.

The flat earnings profile in FY16 is largely the result of the increased investment in new products, combined with a temporary step down in the earnings of SEEK Learning resulting from the change in VET FEE regulations and commission structures.

Both of these factors will present less of a headwind to growth from FY17, which is reflected in average sell side analyst forecasts for EPS growth of 14% in FY17 and 16% in FY18.

We remain concerned about the potential for headwinds from Learning and investment will be replaced by economic challenges. This could result in some disappointment in the near term earnings outlook, but the long term investment potential remains very positive given the strength of the company's franchises, the opportunities for growth reinvestment, and the return dynamics in the business.

SEEK (SEK)

Source: Yahoo!7 Finance, 14 March 2016

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Buy, Sell, Hold – what the brokers say

by Rudi Filapek-Vandyck

In the good books

Goodman Group (GMG) Upgrade to Outperform from Neutral by Credit Suisse B/H/S: 3/3/0.

Assuming benign operating conditions, Credit Suisse believes the company is well positioned to generate around 7% earnings growth to FY20.

The appeal to the broker lies more in the ability to sustain earnings in the event of an industrial market downturn. Higher earnings estimates combined with a stronger balance sheet drive an increase in valuation.

Newcrest Mining (NCM) Upgrade to Buy from Neutral by Citi B/H/S: 1/2/4; Northern Star Resources Ltd (NST) Upgrade to Neutral from Sell by Citi B/H/S: 0/2/1; Regis Resources Limited (RRL) Upgrade to Buy from Neutral by Citi B/H/S: 2/2/3.

Citi analysts have turned more positive on gold, for now. They anticipate higher bullion prices in Q2 but also believe that improved risk appetite from mid-year onwards should favour other assets and reduce gold's attractiveness in the second half of 2016.

That's the base case scenario. Under a different scenario whereby the global economy worsens in H2 and possibly even faces a recession, gold could average US$1400/oz in H2 on the analysts' modeling. Lifting forecasts has had a noticeable impact on Citi's projections for individual gold stocks in Australia. As a result, Newcrest Mining, Northern Star Resources and Regis Resources all receive an upgrade.

Upgrades

Order	Company	New Rating	Old Rating	Broker
1	Goodman Group	Buy	Neutral	Credit Suisse
2	Newcrest Mining	Buy	Neutral	Citi
3	Northern Star Resources	Neutral	Sell	Citi
4	Oceanagold Corp	Neutral	Sell	Citi
5	Regis Healthcare	Buy	Neutral	Morgans
6	Regis Resources	Buy	Neutral	Citi
7	South32	Buy	Neutral	UBS
8	Webjet	Buy	Neutral	UBS

In the not-so-good books

Fortescue Metals Group (FMG) Downgrade to Neutral from Outperform by Credit Suisse and Downgrade to Neutral from Buy by UBS B/H/S: 2/4/1.

Fortescue's new memorandum of understanding with Vale is ostensibly about blending opportunities, points out Credit Suisse, but the deal does open the door for Vale to take an equity stake of 5-15%. The joint venture will allow both parties to optimise operations, Fortescue suggests, and thus reduce costs. The JV will likely take 6 months to finalise. UBS brokers downgrade the stock as further iron ore price upside is considered limited.

Monadelphous Group (MND) Downgrade to Hold from Buy by Deutsche Bank and Downgrade to Reduce from Hold by Morgans B/H/S: 0/2/5.

The engineers & contractors sector received a significant valuation re-rating post reporting season, with an average doubling of price/earnings multiples, Deutsche Bank observes. The broker attributes this to self-help initiatives and a recovery in commodity prices. That said, this is not expected to lead to the reinstatement of deferred capital expenditure necessarily. The broker downgrades to Hold from Buy, given the stock has risen 30% since February 16 and is now trading close to the broker's price target.

According to Morgans' brokers, the share price has rallied strongly since the first half result and this near-term strength presents an opportunity to reduce exposure, Morgans observes a large proportion of the company's work in the commodities space is mid-to-late cycle. As such, earnings are expected to decline further. The company has guided to FY16 revenue being down 25% on FY15.

Downgrades

Order	Company	New Rating	Old Rating	Broker
1	AWE	Sell	Buy	UBS
2	Beach Energy	Sell	Neutral	UBS
3	Fortescue Metals Group	Neutral	Buy	UBS
4	Fortescue Metals Group	Neutral	Buy	Credit Suisse
5	Freedom Foods Group	Neutral	Buy	Morgans
6	Horizon Oil	Neutral	Buy	UBS
7	Monadelphous Group	Sell	Neutral	Morgans
8	Monadelphous Group	Neutral	Buy	Deutsche Bank
9	Oil Search	Sell	Neutral	UBS
10	Orocobre	Sell	Neutral	Citi
11	Oz Minerals	Neutral	Buy	UBS
12	Perseus Mining	Sell	Neutral	Citi
13	QBE Insurance Group	Neutral	Buy	Macquarie
14	Ramsay Health Care	Neutral	Buy	Deutsche Bank
15	Santos	Neutral	Buy	UBS

Orocobre Limited (ORE) Downgrade to Sell from Neutral by Citi B/H/S: 0/2/1. Reported net loss was a little larger than forecast but nothing to get concerned about, according to Citi analysts. They note the company incorporated some FX-related non-cash adjustments. Citi has nevertheless downgraded the stock due to valuations.

Perseus Mining (PRU) Downgrade to Sell from Neutral by Citi B/H/S: 1/1/2. While Citi analysts have turned positive on gold and upgraded a number of stocks, Perseus Mining is the only gold producer to receive a rating downgrade.

Earnings Forecasts

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	IGO	Independence Group	11.95	8.45	41.44%	6
2	AQG	Alacer Gold Corp	7.01	5.65	24.09%	5
3	KAR	Karoon Gas Australia	-3.84	-4.64	17.24%	4
4	OGC	Oceanagold Corp	22.33	19.33	15.55%	4
5	PRU	Perseus Mining	-0.66	-0.76	13.19%	4
6	GPT	GPT	32.30	28.97	11.51%	6
7	NCM	Newcrest Mining	40.95	37.56	9.02%	7
8	NST	Northern Star Resources	29.30	27.27	7.46%	3
9	S32	South32	-4.64	-4.89	5.13%	8
10	MML	Medusa Mining	34.54	33.59	2.80%	3

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	MFG	Magellan Financial Group	102.43	115.25	-11.13%	4
2	APA	APA Group	27.39	28.89	-5.17%	8
3	CTX	Caltex Australia	230.89	238.17	-3.06%	7
4	APN	APN News & Media	7.00	7.14	-2.00%	4
5	HGG	Henderson Group PLC.	33.01	33.53	-1.53%	4
6	RRL	Regis Resources	17.14	17.37	-1.31%	7
7	AMP	AMP	37.08	37.46	-1.04%	8
8	IAG	Insurance Australia Group	36.46	36.79	-0.88%	8
9	IFL	IOOF Holdings	57.70	58.17	-0.81%	6
10	BTT	BT Investment Management	54.75	55.18	-0.78%	5

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Super Stock Selectors – Blackmores and Woolworths

by Christine St Anne

Growth is a theme with our stock selectors, who see a number of stocks with good prospects.

The growth story behind Blackmores (BKL) resonates with CMC Markets' Michael McCarthy, who this week believes the business is trading at attractive price levels, bringing it back to a "more reasonable price-to-earnings (PE) at 28 times".

However, the price fall is only "temporary" and McCarthy notes that a "desire for profit growth in a growth constrained environment should see the PE expand again to mid 30s".

Although Challenger (CGF) is a "well-run business", this week McCarthy says the business is expensive and a "likely downturn in enthusiasm for its annuity products as risk appetites rise could bring a re-calibration of the share price".

Raymond Chan from Morgans likes the footwear and clothing store RCG Corporation (RGC) as the business "offers growth on guidance which we think is conservative".

However, he does not like utility business Duet Group (DUE) despite the company's high yield. Chan says that there are "some risks on the high dividend yield after fiscal 2017".

Elio D'Amato from Lincoln Indicators likes the Burson Group (BAP). According to D'Amato, the retailer and wholesaler of automotive parts operates in a "resilient industry" which makes the business remain steady through various states of the economic cycle.

"Recent and successfully implemented acquisitions including Metcash Automotive Holdings provide strong contributions to earnings growth," D'Amato says.

D'Amato does not like Woolworths (WOW), despite the retail conglomerate reinvesting in price and service. He notes that industry competition continues to increase.

"In addition to operational challenges, the company's issuer rating was recently downgraded by credit rating agency Moody's," he says.

Expert	Stock I like	Stock I don't like
Raymond Chan, managing partner, Morgans	RCG Corporation (RGC)	Duet Group (DUE)
Elio D'Amato, CEO Lincoln Indicators	Burson Group Limited (BAP)	Woolworths (WOW)
Michael McCarthy, Chief Market Strategist, CMC Markets	Blackmores (BKL)	Challenger (CGF)
Roger Montgomery, Montgomery, Chief Investment Officer of Montgomery Investment	SEEK (SEK)	
Paul Rickard, co-founder of the Switzer Super Report	Ramsay Health Care (RHC)	

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