



Monthly Newsletter – August 2014

JUNIOR EXPLORERS SHOW SIGNS OF LIFE

The junior exploration space has been a major underperformer over the past few years, arguably longer. Investors and Traders Post-GFC started to realize the business of exploration was going to be a difficult money earner and so investment strategies quickly shifted towards the top end of the market. This left junior exploration companies to contemplate Herbert Spencer's coined term "Survival of the Fittest" leading many to survive on the smell of an oily rag. This theme seems to have finally changed. Over the last month we have seen the most activity in the junior exploration space since we can remember. We now have a good number of juniors raising large amounts of money (in most cases oversubscribed), drilling, conducting feasibility studies, road shows and much more, but the difference is **Investors and Traders are starting to take notice and share prices are moving.**



Perhaps this is because it's difficult to justify adding to blue chip portfolios at current levels or it could be that they are simply taking advantage of the lower prices to average down, but whatever their reason **now is the time to take greater notice of the junior end** assuming it suits your investment objectives and risk profile. If this is the case, please give us a call to discuss potential opportunities.

COMMODITIES MAKING MOVES

In the June newsletter we observed many commodities were either consolidating at current levels or attempting to break long term downtrends, suggesting we could very well be at the bottom of their price cycles. Since then, we have seen Zinc and Aluminum break their three year downtrends and Lead confirming a slow but steady longer term uptrend.



Other commodities such as Copper and Tin continue to consolidate at current levels but given recent data from China, including last month's outperformance of their Industrial sector, prices are likely to rise from current levels. The expectation of higher prices is likely to be another reason why the juniors are showing signs of life.

GRAPHITE

The popular commodity amongst investors right now is Graphite, the upside potential for graphite is enormous. In terms of supply and price, China produces over 70% of the world's graphite production and has been tightening controls over their graphite supply. This is forcing buyers to look elsewhere and the natural forces of supply and demand are making a strong case towards a sustained strengthening of prices over time. As limited supply is coming onto the market it's raising the profile of many graphite exploration projects but there are also other reasons why graphite is currently getting a good wrap- Graphene.

Graphite has many uses, some of them being: lubricants, brake linings, plastic reinforcement, batteries and fire retardants but it's the advancements in technology and what scientists are discovering about the unique properties of graphite which is opening the market even wider.

Graphene was first observed in 1962 by German chemists but it wasn't until 2010 when two scientists from the UK received a Nobel Prize for their research on graphene that people started to take notice. What the scientists discovered was by bonding graphite into a two-dimensional honeycomb lattice the results produced the strongest material known to mankind, **flexible, transparent, thinner than paper, one hundred times stronger than steel, forty times stronger than diamond** and more **conductive than copper**. It's no wonder the interest for graphite exploration stocks has recently heated up, the potential applications for Graphene are huge. Below is a list of several graphite companies that have benefited from all the recent hype and/or are worth keeping an eye on:

Exploration

Archer Exploration (AXE), Buxton (BUX), Bora Bora Resources (BBR), Castle Minerals (CDT), Green Rock Energy (GRK), IMX Resources (IXR), Kibaran Resources (KNL), Lamboo Resources (LMB), Malagsy Minerals (MGY), Monax Mining (MOX), Mrl Corporation (MRF), Lithex Resources (LTX), Sovereign Minerals (SVM), Triton (TON), Talga (TLG), Uranex Limited (UNX)

Producer or Near-Term Producer

Lincoln Minerals (LML), Syrah (SYR) and Valence Industries (VXL)

Graphene Research

Strategic Energy (SER). Strategic Energy is a 14.60% shareholder of Valence Industries (Uley graphite project) and receives royalties (1.5%) from all sales of graphite from the project. SER's main focus is now in the field of graphene research in partnership with Monash University and is the first company in Australia to be awarded an Australian Research Council (ARC) Grant for their research on graphene.

We have a number of fundamental and technical views on most of these stocks, if you would like to discuss further please free to give us a call.

RECAP: QUESTIONS TO ASK OF THE JUNIORS

It's important of course not to get caught up in all the hype, you could lose a small fortune playing in a stock where the traders themselves have no idea of what a stock is worth short term. After all, majority of these companies, in the early stages, run mostly on volume momentum & volatility can be extreme, so take your time before you put your money on the line and ask these questions to determine if the company is worth being added to your portfolio:

Is the mineralization high or low Grade?

What is the potential scale of the project?

Where is the project located?

Is there surrounding infrastructure?

What drilling is the company planning to embark on in the future?

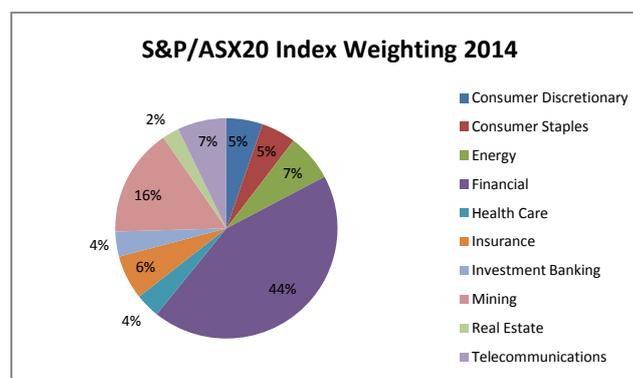
Is the drilling likely to lead to a re-rating of the deposit from resource to reserve?

How much cash does the company have? Be wary of possible capital raisings!

How competent is the management team?

REPORTING SEASON

As confession season rolls on, the market continues to trade within a tight range as participants seek evidence to justify current company valuations. It's been a somber start with Macquarie Group Ltd (MQG) first to disappoint, announcing first quarter operating profit down on previous corresponding period (1Q14) and prior quarter (4Q14), followed by QBE Insurance (QBE) issuing a first half profit warning of \$390 million, down 18% from \$550 million in the previous corresponding period (1H13). MQG and QBE were sold heavily down 6.8% and 14% respectively; however this has little effect on the overall index given their relative index weightings.



To assist our clients in making better decisions we have put together a list of criteria you should be using when reviewing the companies in your portfolio:

- **Rising Earnings Per Share**- This is the first ratio we look at to determine the health and growth prospects of a company. Generally, most investors look for EPS growth of at least 10% year on year.
- **Return on Equity**- ROE gives a good insight into how the company uses shareholder funds to generate profits. It's a good sign if a company is reporting a higher ROE year on year using the same shareholder funds. Conversely, if ROE is declining it means shareholders are pumping more money into the company to generate the same amount of return- not a good sign.
- **Payout Ratio**- The payout ratio is simply Dividend Per Share (DPS) to Earnings Per Share or DPS/EPS. A ratio higher than 1 means DPS is greater than EPS and the company is using cash to satisfy dividend payments. The upside for dividend growth is slim at best. Telstra has been guilty of being in this position during the financial periods of 2011 & 2012.
- **Debt**. Debt is a double edged sword if returns exceed the cost of capital debt, it's worth consideration, but too much on a company's books leads to greater risk. **Given Australia is near the lowest point of its interest rate cycle, this component of the balance sheet needs to be scrutinized even greater than before.** One ratio you should consider everytime is the debt ratio or total debt/total assets. We prefer companies with debt levels below 40%.
- **Free Cash Flow (FCF)**- The more cash a company can generate, the greater its financial flexibility to reduce debt, pursue organic/inorganic growth and possibly pay you larger dividends. In general the more cash, the better, **as long as** the company uses it effectively to **generate higher returns**.

COMPANY REPORTING DATES (INTERIM AND ANNUAL REPORTS)

While not an extensive list, please find below the dates of companies reporting their interim and annual returns during August. These companies will give markets a broader insight into the condition of the Australian market; **Interim = Green, Annual = Black**

6th August Flexi Group Limited (FXL)	7th August Bunning's Warehouse Property Trust (BWP) Telstra Limited (TLS)	11th August JB HiFi Limited (JBH) UGL Limited (UGL)
12th August Dominos Pizza (DMP)	13th August Car Sales Limited (CRZ) Sky City Limited (SKC) Worley Parsons (WOR) Tox Free Solutions (TOX) Oz Minerals (OZL)	14th August Sirtex Medical Limited (SRX) AMP Limited (AMP)
15th August Royal Resources (ROY) 1300 Smiles (ONT) Santos Limited (STO) ANZ Limited (ANZ) Q3	18th August Commonwealth Bank Limited (CBA) Aurizon Limited (AZJ) National Australia Bank (NAB) Q3	19th August Oil Search Limited (OSH) Coca Cola Limited (CCL) Invocare Limited (IVC) QBE Limited (QBE) 1H14
20th August SMS Management (SMX) The Reject Shop (TRS) Webjet Limited (WEB) Woodside Petroleum (WPL)	21st August ASX Limited (ASX) Bega Cheese (BGA) Insurance Australia (IAG)	22nd August Capitol Health (CAJ) Mirvac Group (MGR)
25th August NIB Holdings Limited (NHF)	26th August Billabong Limited (BBG) Blackmores Limited (BKL)	27th August Wotif.com Limited (WTF) Yellow Brick Road (YBR) Roc Oil Limited (ROC)
28th August Ausdrill Limited (ASL) Drill Search (DSL) McMillan Shakespeare (MMS) Mortgage Choice Limited (MOC) Reece Australia Limited (REH)	29th August Austal Limited (ASB)	

Performance of Key Indices

<i>Equities</i>	<i>Close</i>	<i>Change (M)</i>	<i>Change % (M)</i>
All Ordinaries	5623.10	+241.10	+4.48%
S&P/ASX200	5632.90	+237.20	+4.40%
Dow Jones (US)	16563.30	-263.30	-1.56%
NASDAQ	4369.77	-38.41	-0.87%
S&P500	1930.67	-29.56	-1.51%
FTSE 100 Index	6730.11	-13.83	-0.21%
Nikkei 225 (Japan)	15620.77	+458.67	+3.03%
10-year bond rate (US)	2.56%	+0.0003	+1.09%

Upcoming RBA Events

Reserve Bank Board Meeting – 5th August
Statement of Monetary Policy – 8th August
Minutes of the RBA meeting – 19th August

ABS releases March

Retail Trade (June) – 4th August
International Trade in Goods and Services (June) – 5th August
Labour Force (July) – 7th August
Housing Finance (June) – 8th August
Lending Finance (June) – 11th August
Wage Price Index (June) – 13th August
Producer Price Index (June) – 26th August

Upcoming US Economic Releases

ISM Manufacturing Index – 1st August
US Employment Situation (July) – 1st August
International Trade (June) – 6th August
Retail Sales (July) – 13th August
Producer Price Index (July) – 15th August
Housing Starts (July) - 19th August
Consumer Price Index (July) – 19th August
FOMC Minutes (July) – 20th August
Existing Home Sales (July) – 21st August
New Home Sales (July) – 25th August
Durable Goods Orders (July) – 26th August
GDP (2nd Quarter 2014) – 28th August
Jobless Claims – Weekly Basis

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