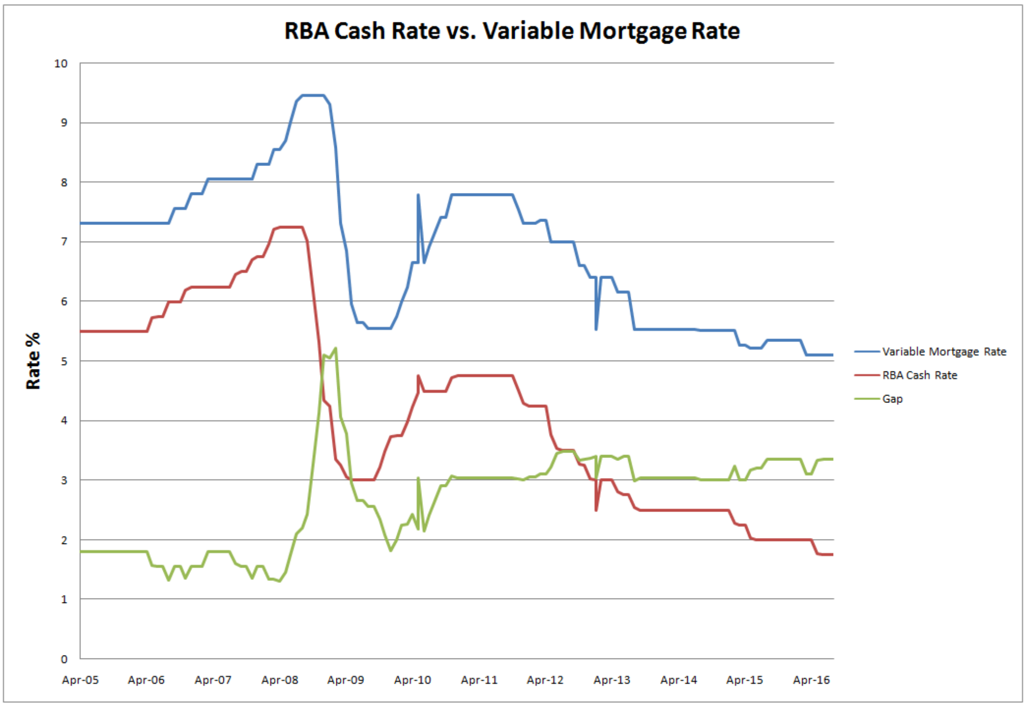
MARGIN PRESSURE, REPORTING SEASON AND GOLD

MARGIN PRESSURE EMERGING IN THE BANKING SECTOR

Since late 2009 the banking giants have made it a habit to deny homeowners the full benefit of any decrease in the RBA cash rate, instead preserving wider margins for the benefit of shareholders who have enjoyed lumpy dividend payments among a challenging yield environment;



This month it became evident this trend is drawing to a close. Change in regulation, political pressure and general market forces are creating headwinds diminishing the pricing power banks have exploited for far too long. While the increase in term deposit rates came as a surprise to savers, **the move reveals** a new battle heating up between the banks to secure "stable" deposit funds to meet the looming "net stable funding ratio" requirement that comes into effect (Globally) early 2018. The increased competition among the banks to attract deposits means higher costs and a squeeze on net interest margins, a core determinant of profits. The prospect of further cuts in the cash rate will fuel additional margin pressure as banks reduce mortgage rates while deposit rates may not move at all.

One theme that attracted very little attention this reporting season is the rising level of bad debt provisions among the banks. While provisions are merely returning to historical averages, it's a concern this trend is emerging near the bottom of the interest rate cycle. While the risk may not be immediate we need to remind ourselves the banks largest growing risk remains with their exposure to the housing market. The persistent high household debt-to-income ratio of 190%, despite conditions suitable for households to reduce debt obligations must not be ignored moving forward. Particularly once the signs point to the interest rate cycle reversing course.

REPORTING SEASON

The flow of financial reports has now come to an end and it's sufficed to say reporting season has been filled with a consistent display of hits and misses. Investors have shown far more concern with forward looking statements than reported financial results, rewarding those with lacklustre financial reports *but* positive outlook statements with higher share prices and vice versa. What is important to us though is to ensure the companies we have recommended in past newsletters (as long term holds for their yield and/or growth prospects) continue to exhibit the same qualities that made them an investment case in the beginning. After a lengthy review the majority remain investment grade, except for one company that needs to work a little harder, or in due course be shown the door.

Company	Company
Ramsay Health Care Limited (RHC)	**Westpac Bank (WBC)**
Invocare Limited (IVC)	**ANZ Limited (ANZ)**
AGL Limited (AGL)	**Credit Corporation Limited (CCP)**
BHP Limited (BHP)	**Pioneer Credit Limited (PNC)**
Rio Tinto (RIO)	**Automotive Holdings Group (AHG)**
Insurance Australia Group Limited (IAG)	**Woodside (WPL)**
Wesfarmers (WES)	**Tatts Group Limited (TTS)**
CSL Limited (CSL)	**Cabcharge Australia (CAB)**
Bunning's Warehouse Property Trust (BWP)	**GrainCorp Limited(GNC)**
McMillan Shakespeare (MMS)	**Platinum Asset Management (PTM)**
Blackmore's Limited (BKL)	**Bellamy's Australia (BAL)**
Ansell Limited (ANN)	**Cochlear Limited (COH)**

THE "HITS" FROM REPORTING SEASON

Ramsay Health Care (RHC) - A favoured defensive stock suitable for near any portfolio, RHC reported a 16.8% rise in Net Profit after Tax (NPAT) for FYE16 to $450.3 million from $385.5 million in FYE15. Earnings per Share (EPS) increased 17.8% to $2.16 in FYE16 while Dividend per Share (DPS) increased to $1.19. We first introduced RHC to clients in July 2013 when the stock was trading at $36.00 and have since enjoyed steady capital growth. The share price is currently trading at $82.97(31.8.16) as investors celebrate the results and positive outlook for FYE2017.

Credit Corp Limited (CCP) - The big brother to Pioneer Credit Limited (PNC), Credit Corp can do no wrong. For the seventh consecutive year CCP has beat earnings guidance and shareholders have rewarded the company with a higher share price over the past week, currently trading at $16.60 (31.8.16). Full year Dividend per Share (DPS) has risen from 44 cents per share in FYE15 to 50 cents per share for FYE16.

Bellamy's Australia (BAL) - A good example of when a high P/E is not necessarily an indication a stock is too expensive. In recent time Bellamy's P/E had traded as high as 60 times earnings, high enough to scare off plenty of investors who use P/E's to determine if a company is cheap or expensive. Thankfully, in this case the earnings expectation built into the P/E were met by exceptional results for FYE16 and the company now trades on a far more fair and reasonable P/E of 30x earnings. Net profit increased 326% to $38.3 million and the company declared a dividend of 11.9 cents per share for FYE16 compared to 2.9 cents in FYE15.

CABCHARGE (CAB) – ON THIN ICE

Cabcharge (CAB) - The one company that raised a few more questions was no other than Cabcharge. Overall their report was as good as it could have been given the emergence of new competitors into the scene. The main disappointment has been management's disinterest in adopting new technology to improve their product while they had the chance. Instead it took the threat of Uber before they thought "Hey we better adapt to the modern world or risk being left behind in the dark ages". After having travelled interstate and experienced both Uber and Cabcharge services it was very clear Cabcharge is chasing their tails. They now have a lot of work to do to create a superior product, let alone a product on par with Uber and maintain their position as a major market player or suffer the consequences from their early complacency. It could be too late, but for now given they managed to cross the line and tick the boxes we will give them time to show us they can turn the business around.

GOLD - SMALL RESOURCES (XSR)

Encouraging signs have emerged from the Small Resources (XSR) sector with a "Triple Bottom Reversal" confirmed in the latest Index move. Interestingly the majority of commodities **fell** during the Feb-Aug16 period when the Index managed to break through support at 1800 Index Points from the lowest point of 1200 (support).

The main contributor to the positive momentum during this period was **Gold,** with demand for the precious metal elevating as Investors remain convinced of further delays in the US Fed raising the Fed rate. The risk in a Fed rate rise is an inverse move in the Gold price as money shifts in favour of the US Dollar. The comments by Janet Yellen (Fed Chairperson) over the weekend confirmed they are close to increasing the Fed rate this year, possibly as early as next month. The effect of a fall in the Gold price on Australian producers like Northern Star (NST), Evolution Mining (EVN), Regis Resources (RRL), Independence Group (IGO) and Saracen (SAR) is **however debatable** given their bottom lines are reliant on the move in the AUD/USD which is expected to break its resilience once the Fed rate rise materialises. While we hold a neutral view on Australian Gold producers over the medium term, any further weakness from here on in should be considered an opportunity to add a quality Australian Gold producer to your portfolio for a longer term hold, given we expect volatility in global markets to continue for an extended period of time.

Performance of Key Indices

Equities	*Close*	*Change (M)*	*Change % (M)*
All Ordinaries	**5529.40**	**-114.56**	**-2.03%**
S&P/ASX200	**5433.00**	**-129.36**	**-2.33%**
Dow Jones (US)	**18400.88**	**-31.36**	**-0.17%**
NASDAQ	**5213.22**	**+51.09**	**+0.99%**
S&P500	**2170.95**	**-2.65**	**-0.12%**
FTSE 100 Index	**6781.51**	**+57.08**	**+0.85%**
Nikkei 225 (Japan)	**16887.40**	**+318.13**	**+1.92%**
10-year bond rate (US)	**1.58%**	**+0.13%**	**+8.91%%**

Upcoming RBA Events

Reserve Bank Interest Rate Decision – 6th September
Minutes of Meeting – 20th September

ABS releases March

Retail Trade (July) – 1st September
Business Indicators (June) – 5th September
Building Approvals (July) – 6th September
Australian National Accounts (June) -7th September
International Trade in Goods and Services (July) – 8th September
Housing Finance (July) – 9th September
Lending Finance (July) –12th September
Labour Force (August) – 15th September
Job Vacancies (August) – 29th September

Upcoming US Economic Releases

ISM Manufacturing Index – 1st September
Construction Spending – 1st September
Factory Orders – 2nd September
Producer Price Index – 15th September
Employment Situation – 2nd September
International Trade – 2nd September
Retail Sales – 12th September
Consumer Price Index – 16th September
Housing Starts – 16th September
FOMC Minutes – 17th September
Durable Goods Orders – 25th September
International Trade in Goods – 26th September
GDP – 29th September
Jobless Claims - Weekly Basis