



Investment Strategy Special Bulletin

Stockmarket Wins the Election

With the Federal Election now just a little over two weeks away, we highlight that its resolution should provide a positive boost for the Australian sharemarket. While a Coalition victory would probably be a better outcome for listed companies (given their pro-business stance), restoring stability to government is more important. In our view, a hung parliament has not served the nation well and our hope is that we see a clear winner from the election.

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Elections are positive for the stockmarket ►

Our analysis has shown that Federal Election outcomes are positive for the Australian stockmarket, regardless of who the winning party is. A look back at the last 30 years and 11 elections, has seen the Australian stockmarket increase by 1.31% each month on average in the three months following an election. That equates to an almost 4% gain for the quarter immediately following an election.

Business and Consumer Confidence needs a boost ►

Business confidence is at its lowest level since November 2012, despite the fact that a falling Australian dollar and low interest rates should be easing some of the pressures on business. Consumer confidence is faring better with a small increase in August 2013, but it is still below levels seen in 2010 when consensus was that the worst of the GFC had passed. It is also historically well below levels that could be expected given the ultra low interest rate environment. Our Chief Economist Michael Knox highlights that an election outcome usually boosts both business and consumer confidence. This increasing confidence acts like a reduction to the risk premium and is similar in its effect to an interest rate cut in that the flow-through to GDP has a lag of about five quarters. Therefore, we should see the more long lasting result from an election outcome continuing on throughout 2014.

Stockmarket implications ►

We highlight on the pages overleaf some of the companies that could benefit from either a Coalition or Labor Party outcome. However, we think investors will be less discriminate in their investment in the Australian stockmarket. We believe this will be driven by the "wall of cash" sitting on the sidelines waiting for the confidence to return to the stockmarket. The election outcome could provide this impetus, particularly given that declining interest rates leave investors with a lack of alternatives for returns. We also think a return to a more stable government, and the removal of the unpopular Minerals Resource Rent Tax (MRRT) and carbon tax, if the Coalition is successful, will see the return of some foreign investors to the Australian stockmarket. **Our recommendation is to buy Australian shares in the lead up to the election and focus on the large cap stocks paying good yield.** On the page overleaf we outline the reasons behind our 10 buy ideas for a post-election confidence rebound (see table left).

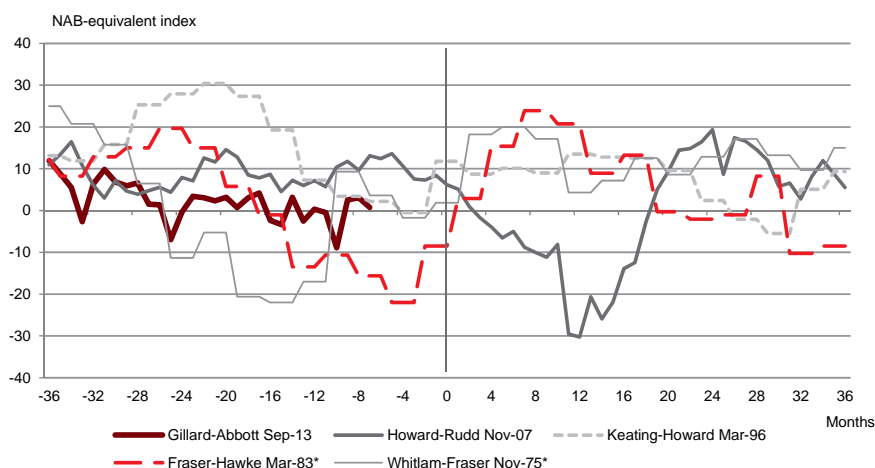
10 Stocks to Buy Pre-Election

- Wesfarmers (WES)
- JB Hi-fi (JBH)
- National Aust. Bank (NAB)
- Westpac Banking (WBC)
- Suncorp (SUN)
- Ramsay Healthcare (RHC)
- Telstra (TLS)
- Aurizon (AZJ)
- BHP Billiton (BHP)
- Oil Search (OSH)

Business Confidence Rebound »

During past changes in government there has been a tendency for business confidence to improve for around 12 months following the election. The outlier to this trend was the 2007 election, when Kevin Rudd led Labor to victory over John Howard (Figure 1).

Figure 1: Business confidence before and after government-changing elections



Stockmarket Opportunities »

We think a change in Government will be broadly positive for confidence levels in the Australian stockmarket. We highlight 10 stocks we like to invest in pre-election for a pick up in stockmarket activity when confidence returns (Table 1).

Table 1: 10 Stocks to Buy for a Post-Election Confidence Rebound

Retail	WES and JBH	As one of our largest retail groups, the Wesfarmers story is all about ongoing growth at Coles and Bunnings, which combined account for more than 80% of the group's earnings. This is a core portfolio holding. On the discretionary side, we believe JB HiFi is best positioned for a rebound in consumer spending on electronics, gaming, music and technology as well as the group's new Home division, which should capitalise on the recovery in housing activity.
Banks	NAB and WBC	National Australia Bank is our preferred business bank exposure and well positioned for a turnaround in business confidence leading to increased lending. Meanwhile, Westpac is the best value of the retail/housing banks.
Insurance	SUN	Suncorp's simplification strategy has seen it return to its core banking operations and strength as a general insurance provider. Given the more benign claims environment yet strongly rising premiums, we think the group will be rewarded for its ability to pay higher dividends.
Healthcare	RHC	Despite the very public stoush with Medibank, Ramsay Healthcare is our preferred way to play the trend to out-sourcing of public healthcare to private operators. We would use any weakness as an opportunity to buy this premium play.
Telecom	TLS	Telstra will be the eventual winner of the NBN roll out given the deal it has done for its valuable infrastructure network. At the same time, its mobile and data businesses are continuing to win market share. We are attracted to its solid dividend yield.
Industrials	AZJ	Aurizon has a compelling mix of growth options and defensive businesses that suit the current environment. We think new management could drive this stock to the next level and see it becoming a core portfolio holding.
Mining	BHP	The potential removal of the MRRT and carbon tax could be a big sentiment boost for BHP as foreign and domestic investors return to the sector. The stock is still very good value and its progressive dividend yield is rewarding for investors.
Energy	OSH	The Exxon Mobile led project in PNG is 90% complete with the first LNG sales expected in 2014. There will be plenty of news flow as the project starts to ramp up and we expect the market will start to value the enormous cash flow of this project in the next 6-12 months.

SOURCE: RBS Morgans

Table 2: Potential Positives of a change in Government

Sector	Policy Impacts	Impacted Stocks	RBS Morgans View
Market	-	Miners, TLS, airlines, retail, QUB	The market impact of a change in government should be broadly positive, although the extent is likely to be moderated by uncertainties about the deliverability of election promises given the soft budget position. Key beneficiaries would be miners (mining and carbon tax removal), airlines (most affected by carbon tax) and consumers (retaining carbon tax compensation).
Mining	Removal of MRRT	BHP, RIO, FMG	While the structure of the MRRT may have been flawed, we initially estimated the 22.5% impost on 'super-profits' above a 13% hurdle rate on the market value of capital would impact NPAT and NPVs of the major miners by 2-3%. More important than the direct earnings impact, the investment community has viewed sovereign risk as remaining elevated on this issue given the limited (embarrassing) scope of revenue collection, with the Greens minority partner calling for renegotiation and broadening of the tax. A change of government would negate not only the existing MRRT impact, but also the potential for any further increases.
Retail; Airlines; Industrials; Resources	Removal of carbon tax	Airlines, industrials	In our view, airlines were the most affected across the listed Australian space by the carbon tax introduction, with QAN advising an A\$55m impact at the 1H result (20% of pre-tax profits), which should reverse upon repeal. General industrials would also benefit from a repeal of the carbon tax through a reduction in their directly payable expenses, as well as through a fall in upstream energy costs (eg, electricity pass-through).
Telcos	Restructure of National Broadband Network (NBN)	TLS Contractors (-ve)	A Coalition government would likely maintain the overall NBN structure, but switch from fibre to the premises (FTTP) to a lower-capex fibre to the node (FTTN) technology. We estimate Telstra is about as well off in present value terms under this policy as with the current NBN plan. Telstra would receive migration payments earlier, although PSTN revenues would decline faster, particularly as regional markets open up faster to competition. Contractors would see the scope of NBN works decline under a Coalition govt.
Infrastructure	Transport infrastructure funding pledges	QUB, TCL, CDD	AOFM to examine an Infrastructure Partnership Bonds Scheme for private-sector investment. Coalition will contribute A\$5.6bn to Pacific Highway duplication between Newcastle and QLD, A\$1.5bn to M4 East (WestConnex Project), A\$1.5bn of East-West Link tunnel in Melbourne and A\$1bn for Gateway Motorway in Brisbane. QUB may directly benefit if the Coalition abandons the Federal Government's own plans for the development of an intermodal terminal at Moorebank, allowing QUB to proceed with their alternative concept.
Financials	30% tax on high-income earners' super contributions; 15% tax on retirement incomes above A\$100k	AMP, PPT	Labor has committed to increasing the tax on super contributions from 15% to 30% for those earning above A\$300,000 per annum, while also proposing a 15% tax on post-retirement incomes above A\$100,000 per annum. It is unclear whether either of these measures will gather the minority-support required to become law, but we believe the Coalition will not look to reverse the changes if legislated before the election.
Healthcare	Removal of means-testing of 30% health insurance rebate Improved pathology funding	RHC, PRY, SHL	The Coalition opposed means-testing of the 30% private health insurance rebate and has promised to wind the move back as budget conditions permit, which would be a positive for RHC if it eventuates. Pathology (PRY, SHL) may benefit from a Coalition govt, which historically has been more generous in funding negotiations.
Utilities	"Direct Action" Climate Plan	AGK, ORG, EPW, ENE	The Coalition has proposed an 'Emissions Reduction Fund' of A\$3bn for carbon emissions reduction tenders. This may be used to buy out inefficient generation in a similar manner to that proposed, but never executed, under the 'Energy Security Fund' of Labor's Carbon Pollution Reduction Scheme (CPRS).
Media	Election advertising Media reach rules	SWM, TEN SXL, PRT	We believe the election campaign will add 1% to TV advertising spend in this election year. The Coalition has appeared supportive of removing the 75% audience-reach rule, although we do not believe it would be a high priority (we see PRT as a potential beneficiary of consolidation in the sector, with SXL also likely to merge with one of the major networks).
Developers & Contractors	Restoration of Australian Building and Construction Commission (ABCC)	Engineering & construction companies	The Coalition plan promises to fully restore the Australian Building and Construction Commission (ABCC) to police union activity in the sector, although the extent of industrial relations reform should be limited given Abbott's pledge that the previous Work Choices regime (or similar) would not be re-introduced in his first term.
Small-Caps	Government handover	OKN (-ve)	Federal Elections have historically been negative for listed players given a reduction in Federal IT spend in periods both before and after elections due to uncertainty for government departments (more prolonged in the case of a change in government). Oakton (OKN) is the most exposed to this negative headwind given 20-25% of its sales are sourced from the federal government. This is followed by SMS Management & Tech (SMX), with 12% of sales from the federal government & defence department.

SOURCES: RBS Morgans

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