Portfolio Overview

February Highlights

IEL	+19.56%
ORA	+17.27%
FCL	+9.42%

February Lowlights

COL	-15.30%
BAP	-7.82%
XRO	-7.48%

A February For The Record Books

By Rudi Filapek-Vandyck, Editor FNArena

What started off as a normalisation in response to better economic prospects has quickly morphed into a sharp and unruly sell-off for government bonds in Australia and the US.

The follow-through effect in equity markets has triggered sharp sell-offs in technology and other stocks that performed well in 2020.

FNArena is of the view financial markets are once again running ahead of themselves, and of fundamentals, but we also acknowledge overall market dynamics are changing, and the All-Weather Model Portfolio has been recalibrating since January.

However, with the Portfolio focusing on quality companies with a long-term, sustainable growth path rather than shorter-term leverage to the economic recovery, it should be no surprise the Portfolio's performance, which was well-ahead throughout most of 2020, is now lagging the broader market.

In simplistic terms: the solidity and long-term prospects of CSL (under pressure) are no match for the 50%-100% gains that are being recorded among small cap mining and energy stocks elsewhere.

History shows these swings and roundabouts are typical for the share market, and time will come when investors will again start appreciating quality, predictability and reliability, albeit not necessarily in the short term. Many of the stocks included in the All-Weather Portfolio have come under pressure these past weeks, but we remain confident in the underlying businesses beyond the switch in short-term market momentum.

It has been a while since a corporate results season in Australia was mostly about corporate performances. The last time this happened was, according to my memories, February 2018.

Back then, investors weren't so sure whether strong share price performances for companies including Altium and Appen could be maintained, but their financial market updates proved the doubters wrong.

Every subsequent season since has been overshadowed by macro forces, albeit to different degrees and mostly through attempts to rotate away from Quality and Growth into Banks, Value and Cyclicals.

The February 2021 season has proved a little different. That oft attempted, but seldom sustainable market rotation into banks, miners and energy producers is by now five months old, and it has been solidified throughout the month with investors unambiguously showing their preference for share market laggards that stand to benefit from the rollout of vaccines globally and the re-opening of regional and international borders.

At times it was almost heartbreaking to observe how strong performances from covid-winners would receive no reward, at best, while for companies such as Webjet ((WEB)) and Flight Centre ((FLT)) it almost didn't matter what financial results were being released as investors are keeping their attention firmly focused on the fact that global borders will re-open, exact timing unknown.

In 2021, the return of broad-based optimism about the economic recovery ahead has started to translate into higher bond yields which, in return, have looped back into a weakening US dollar (stronger AUD) and a universal approval for investors to again start accumulating shares in small mining companies, banks, oil & gas producers, steel, construction and building materials, contractors and mining services providers, and other industrial cyclicals.

The sharp rise in bond yields was the big shadow hanging over February this year. Not only did it provide too big a headwind for most covid-beneficiaries, it also reignited market debate whether unprecedented stimulus and government support programs are heralding the return of consumer price inflation, which would justify even higher yields.

Central bankers joined the debate. They said: no, it doesn't. The alternative view is that bond yields fell in 2020 because of the global pandemic and as market optimism grows, those yields are simply pricing out the virus impact. On the first Monday of March, the RBA used its money printing power to put a halt to what risked becoming an unruly trend that could well grow beyond control. The Fed had been signalling similarly on the final February Friday.

Whether this settles this debate for once and for all is highly unlikely, but if the temperature on bond markets cools down, which would be the prime target for central banks the world around, then at least equity investors can start focusing again on corporate earnings, balance sheets, quality of business models, structural trends and valuations.

For investors, maybe the key challenge is to find a portfolio balance between direct winners from higher bond yields and this year's economic recovery and those robust business models that might be temporary out of favour, also because they performed so well in the past, but whose runway for growth continues to be supported by new structural mega-trends and tectonic shifts into tomorrow's technology-driven new economic reality.

Certainly, a less dominant theme of rising bond yields will much easier allow companies such as ResMed ((RMD)), Xero ((XRO)), Charter Hall ((CHC)) and Altium ((ALU)) to regain firmer footing, and thus investors' attention.

Having said all of the above, there is no denying a rather large number of highly popular, highly valued, strongly growing businesses have come up short these past few weeks, which has weighed upon share prices irrespective of bond market shenanigans.

The aforementioned Altium is one of them, but we can easily add a2 Milk ((A2M)), Appen ((APX)), Nanosonics ((NAN)), and many of the smaller cap technology sweethearts, including Aerometrex ((AMX)), Bravura Solutions ((BVS)), Catapult Group ((CAT)), Infomedia ((IFM)), ResApp Health ((RAS)), Temple & Webster ((TPW)), and others.

During a time when share market laggards -from the banks to Western Areas ((WSA)), and from Lynas Rare Earths ((LYC)) to Telstra ((TLS))- proved they are still worth investors' attention, as long as the economic recovery remains on schedule, many of the former can-do-no-wrong share market darlings revealed some of their own vulnerabilities and weaknesses. When taking a broad view, this even includes Australia's Champion among Champions, CSL ((CSL)).

No doubt, for some investors this has further galvanised their appetite for more cyclicals and less Quality, Defensives and Growth, but one needs to keep in mind the theme of backing last year's covid-victims will run its course at some point, while central banks remain convinced there is no sign of sustainable inflation on the horizon. I also believe there is one important message that should not be ignored from several of this season's failures, and that is that disruption and tectonic shifts that used to dominate the landscape until late last year, are still around.

Beyond the short-to-medium term focus of the market sentiment pendulum, those shifting tectonic plates will continue to challenge moribund, underinvested business models even though there is equally a valid argument in that the accelerating shift towards decarbonisation of economies is creating a whole set of fresh dynamics, while it should be easier for companies to restructure, re-align and reinvent themselves when economic growth is high (or so goes the theory).

Every reporting season opens up a list of major failures and disappointments and this time AGL Energy ((AGL)) delivered one of the eye-catching, negative performances. Investors best not be bamboozled by the seemingly high dividend yield on offer. AGL's share price has been in decline for over four years as the power network operator and electricity generator struggles to combine old world coal fired power stations with new world renewables and the need for more grid flexibility. It is but an existential dilemma for all to witness; one that is unlikely to be resolved by simply separating the dirty coal operations.

In the same vein, Unibail-Rodamco-Westfield ((URW)) might be the proud owner of several of the highest quality shopping malls around the world, burdened by too much debt, lockdowns, the shift to online and the threat of ongoing asset devaluations is not making management's task of manufacturing a successful transformation any easier, irrespective of this year's recovery. Those who jumped on board because of the perceived value in the assets, while the shares looked exceptionally cheap, are now facing the prospect of two years of no dividend payments.

Another one of February's spectacular disappointments was delivered by machine learning and artificial intelligence data and services provider, Appen. While the need for such data and services will remain high in the years ahead, Appen's small base of key customers seems to have injected more price competition among suppliers and Appen, valued as a high growth company with sheer unlimited potential, has felt the repercussions through a gigantic share price devaluation, taking the price down by more than -50% since August last year but, and this remains the sad indictment for those who are still holding on, with ongoing risk for further negative surprises.

Investors equally did not respond in kind when Coles Group ((COL)) suggested it had to invest more to future proof the business, while growth might temporarily turn negative when compared to last year's big boost from covid-lockdowns. As such, the supermarket operator might as well have rung the bell for last year's covid-beneficiaries in general which are facing tough comparables to beat in 2021 while the opposite remains the case for last year's laggards including the banks, who managed to crown themselves as the Super-Duper Come Back Kids in February, with ongoing promise of higher dividends, and even special payouts, as the recovery materialises.

All in all, it has to be said, February delivered very few true disappointments, unlike most reporting seasons. After combining 335 reporting companies over the month, the FNArena Corporate Results Monitor has placed less than 12% (40 companies in total) in the sin bin for missing market expectations, and many of those are perennial underperformers and repeat offenders, including Ardent Leisure ((ALG)), iSentia ((ISD)), 3P Learning ((3PL)), Cimic Group ((CIM)), and Humm Group ((HUM)).

The local technology sector was a magnet for reductions in forecasts this season.

At the other end of the spectrum, 160 companies, or nearly 48% beat market expectations and that's an achievement we have never witnessed since we started keeping reporting season statistics here at FNArena. Or have we? Strictly taken, last year's 49 reporters in between September and December generated 49% "beats" but also 29% in "misses" so I think we can still call February 2021 the best reporting season in Australia post-GFC.

It can also be argued both seasons are two peas from the same pod, so to speak. Usually the percentage of beats ranges between 24% (bad) and 38% (very good).

Banks, Materials (ex-mining), Insurance and Retailers enjoyed the strongest forecast upgrades over the season. Analysts at Macquarie believe the first three will continue to benefit from improving global growth and vaccines, while retailers will face headwinds due to vaccines and spending being redirected back to services, which explains some of the hesitant share price movements post results.

On Macquarie's analysis, "true" upgrades were delivered by Nine Entertainment ((NEC)), Bendalaide Bank ((BEN)), Suncorp ((SUN)), Treasury Wines ((TWE)), BlueScope Steel ((BSL)), JB Hi-Fi ((JBH)), Woolworths ((WOW)), Northern Star ((NST)), Wesfarmers ((WES)), Star Entertainment ((SGR)), Tabcorp Holdings ((TAH)), Vicinity Centres ((VCX)), Commbank ((CBA)), Boral ((BLD)), and Seek ((SEK)) among the ASX100 companies.

Outside the ASX100, the analysis identified Lovisa Holdings ((LOV)), Nearmap ((NEA)), Pinnacle Investment Management ((PNI)), Codan ((CDA)), Platinum Asset Management ((PTM)), Sims ((SGM)), nib Holdings ((NHF)), Pact Group ((PGH)), Seven West Media ((SWM)), ALE Property ((LEP)), Estia Health ((EHE)), Nick Scali ((NCK)), Cooper Energy ((COE)), Mayne Pharma ((MYX)), ARB Corp ((ARB)), and Wagners Holding Company ((WGN)).

I don't want to be super-mean about Wagners, but any objective observer will agree with me it hasn't been a great success since listing on the ASX. The fact this company is being nominated as one of the stand-out positive performers in February shows us all these are all but unusual circumstances.

The minor disappointment is both numbers for beats and misses looked simply spectacular throughout the opening two weeks of February. In particular the number of beats shrunk noticeably as the end of the season approached. Note to myself: companies that are ready to release not-so-fantastic results prefer to hide in the later parts of the season. Overall, however, earnings growth projections rose throughout the month (usually they fall during reporting season) with iron ore miners and banks major contributors.

The average individual target price increase was 5.64% while all 335 targets in aggregate rose by 6.29%. These are not the highest increases on record, but still high.

If it wasn't for the acceleration in bond market sell-offs (yields rallying higher), investors might have enjoyed stronger and longer-lasting share price responses to match February's above-average outcome. At the same time, it's good to remind ourselves expectations were low across the board and many businesses responded to last year's challenge by cutting back on expenses, including capex in many cases, while also enjoying extraordinary support through rent relief and the federal government's Jobkeeper program.

And while market strategists at Macquarie believe many of this season's surprises were caused by higher-than-forecast profit margins, supported by better-than-anticipated sales and revenues, the December quarter business indicators in Australia, released on Monday, revealed company profits fell sharply by -6.6% as government stimulus payments ceased.

Even though some economists had penciled in a potentially worse outcome, this extra data insight can serve as an unofficial warning this is by no means a time to allow complacency to creep in.

All-Weather Portfolio Performance

The month started off with a bang seeing the portfolio appreciate 3.09% in the first eight days of the month. However, as momentum dissipated the portfolio finished slightly down with the ASX dipping almost 2% on the last trading day of the month. The negative portfolio returns over the past 6 months come as no surprise as the market engaged in a large sell off of quality stocks in favour of low-ROE high-P/E growth stocks mainly in the tech sector. Additionally, the portfolio doesn’t hold any banking or mining stocks which dragged the ASX200 higher over the past couple of months.

Some recent additions to the portfolio in February were Charter Hall Group (ASX:CHC) and Hub24 Ltd (ASX:HUB). The biggest loser for the month was Coles Group (ASX:COL), who despite reporting an increase in net profit of 14.5% PCP saw its shares driven lower by market forces. Another company that reported well but was sold off was Bapcor (ASX:BAP), which reported an increase in profits after-tax of 49.7% PCP and an increase in revenue of 25.8% PCP.

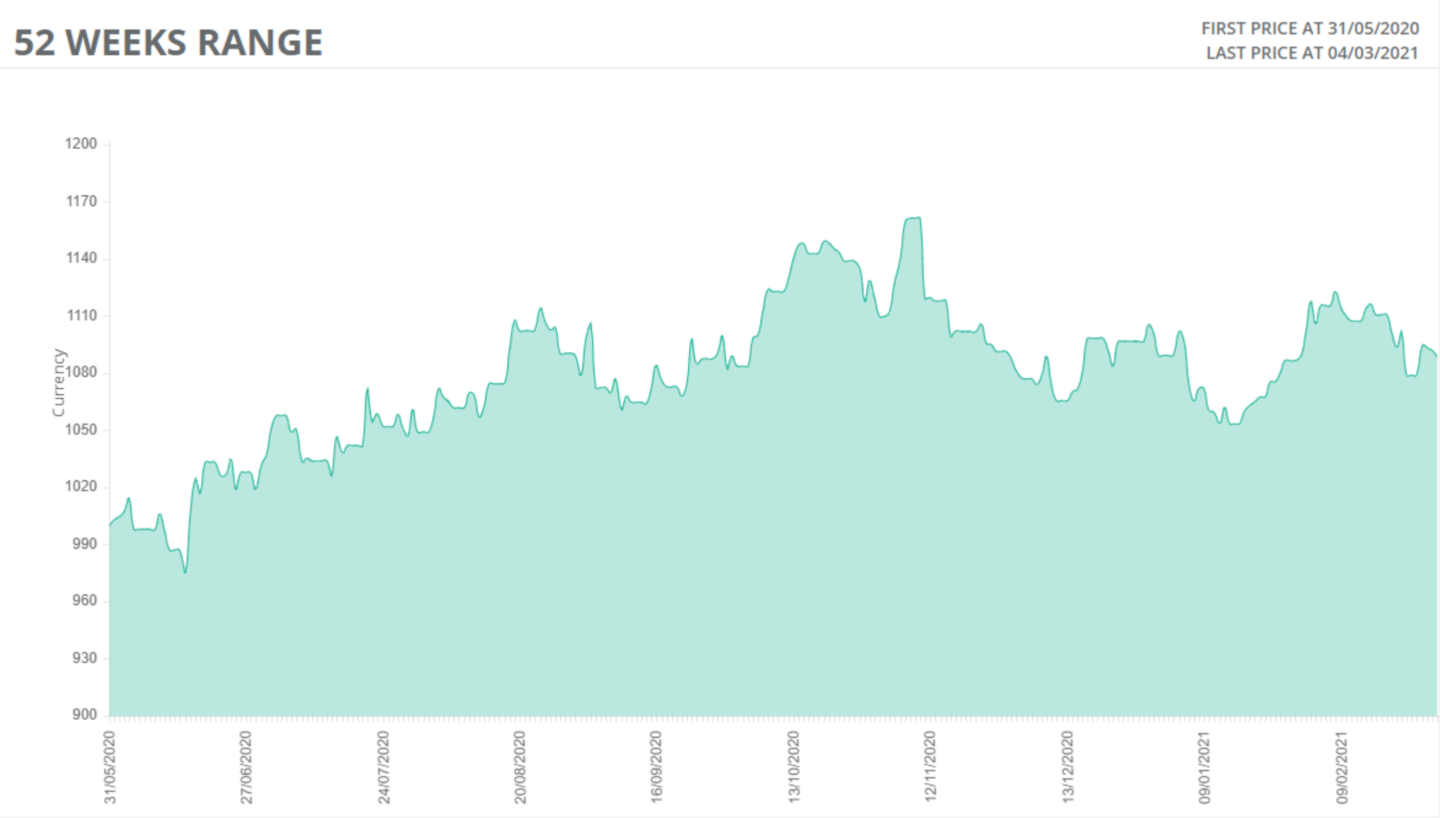
In terms of top-performing companies, the recent addition IDP Education (ASX:IEL) took the limelight with a 19.56% jump in its share price during the month. Another notable mention is Orora Ltd (ASX:ORA), which during the month jumped 17.27% after reporting an increase in underlying net profit after-tax of 18.9%. These results follow on from a solid year that involved North American currency gains of 2% and a A$13M reduction in net finance costs on PCP. This move reflects a reduction in net bank debt following receipts from the Company's Fibre sale proceeds in 2H2020. Our third front runner for the month was FINEOS Corporation Holdings (ASX:FCL) which saw a 9.42% gain in the share price during the month. This comes as their results showed that they increased revenue by 30.05% PCP, although they reported an accounting loss of €5.01M for the period which saw the share price taper off.

All-Weather Stock of the Month

The All-Weather stock of the month is IDP Education, with the stock jumping 19.56% on that back of its half-yearly earnings report, which showed a better than expected recovery following the impacts of COVID-19. Although they reported a 29% reduction in revenue and a 43% reduction in EBIT PCP, the company feels it is well positioned for a recovery once travel normalises again. The company also reported that the organic web traffic on the IDP Global website has exceeded Pre-COVID levels with organic web enquiries up 35% on PCP. During the month, some profit was taken on the position with the plan being to purchase some good quality stocks on a dip. Currently the All-weather portfolio is sitting at 15.24% cash.

All-Weather Cumulative Returns At 28/02/2021**			
[a]Portfolio Returns	All-Weather Portfolio	Benchmark* (^AXJOA)	Value Added
1 MONTH	-0.70%	1.45%	-2.16%
3 MONTH	-0.82%	3.00%	-3.82%
6 MONTH	-0.97%	11.47%	-12.45%

*ASX 200 Accumulate Index
**Returns unaudited and exclusive of fees and brokerage
ª We are currently in the process of calculating longer-term performance metrics which has become trickier because of the switch in financial platforms since the All-Weather Portfolio started. The above statistics are from O2Wealth, which is the current platform.



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