

Rudy's View: August 2020, Nothing Like The Past

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https://www.fnarena.com/index.php/reporting_season/

In this week's Weekly Insights:

-August 2020: Nothing Like The Past
-Morgans Best Ideas

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August 2020: Nothing Like The Past

Corporate earnings have not been front of mind for share market investors over the year past.

Last year's August reporting season marked the weakest performance for corporate Australia since the GFC, yet 5.5 months later the ASX200 surged to an all-time record high of 7162.50.

Meanwhile, in the background of it all, dividend payers in Australia, including the major banks, had already started to reduce nominal payouts.

Corporate reporting in February was fully overshadowed by the realisation that a global pandemic was spreading fast.

Since then we had global lockdowns, social distancing, an accelerated race for a vaccine, treatment or cure, recessions, central banks liquidity and credit support, government safety net programs, and regional virus drawbacks, but no profit warnings as company boards in Australia have been temporarily excused from the legal requirement to keep investors fully informed.

It is probably a fair assessment that August 2020 is taking place amidst the highest level of uncertainty for a very long time.

As to how exactly investors are going to respond to corporate profits and the lack thereof throughout the month ahead is anyone's guess, especially with so many expert voices proclaiming equities are pricing in too much optimism.

The **first eight corporate results** during the final week of July don't offer much in terms of blue print. Only one of those eight -Credit Corp ((CCP))- was able to issue earnings guidance for the year ahead.

None of the share prices put in a big rally post event, but several have seen profit-taking and weakness kicking in since, including Credit Corp.

Then again, Credit Corp's in-line FY20 profit result was no less than -78% below prior guidance, which had been withdrawn in March.

Cimic Group ((CIM)) missed expectations, Emeco Holdings ((EHL)) reported in-line with just about everyone calling the stock undervalued and Rio Tinto ((RIO)) surprised on the upside in what could become the broad context for the commodities sector in general this month.

A cautious Rio Tinto board did not surprise with a bigger-than-expected dividend announcement.

Covid-19 has accelerated the adoption and acceptance of new technologies and trends, further widening the gap between winners and losers in the share market, so it probably shouldn't surprise online retailer Temple & Webster's ((TPW)) result was generally well-received.

Again, Temple & Webster shares have seen some profit-taking kicking in post event.

Three of the eight companies have indicated how important government support programs are to their operations and profitability. This too adds to the general uncertainty.



Investors will continue their focus on dividend reliability and sustainability, but in many cases they will have to make assessments in the absence of any concrete guidance from the companies themselves.

Realistically, how much can one expect from airports and airlines, for example, whose revenues have been decimated without any insights as to when their operations might "normalise"?

Numbers from the US too confirm more companies prefer not to issue guidance for the year ahead with only circa one-in-four confident enough to do so, and this includes negative adjustments.

I wouldn't be drawing on too many references from the past this reporting season. It's a whole new ball game this season, and macro matters remain plenty and all-important.

One of the key characteristics of 2020 is that the virus has disrupted the concept of what makes a "defensive" company or asset.

Even outside of banks, and operators of toll roads and airports, many financials and industrial companies are now offering reduced yields.

It'll only further add to the determination of many an income-hungry investor.

Australian investors already had to adjust for the erosion of the age-old concept of blue chips in the share market. Now "defensive" no longer means what it used to be.

Which shoe will be dropping next? Safe as houses?

On most forecasts, dividend reductions this year might approach the carnage of the GFC, possibly worse. And August is not necessarily the end of this sorry narrative.

Analysts at Citi recently lined up forecasts for the top 50 dividend payers on the ASX. The small list of stocks that are expected to **continue increasing dividend payments** in the years ahead includes CSL ((CSL)), Unibail-Rodamco-Westfield ((URW)), Amcor ((AMC)), Coles ((COL)), APA Group ((APA)), Goodman Group ((GMG)), Aurizon Holdings ((AZJ)), ResMed ((RMD)), Medibank Private ((MPL)), Magellan Financial Group ((MFG)), Computershare ((CPU)), Evolution Mining ((EVN)) and Charter Hall ((CHC)).

Not all these stocks are trading on low enough multiples to guarantee a reasonable yield. UR-Westfield remains under threat of a capital raising as well as further write-downs of asset values.

Companies for whom a dividend reduction might just be a one-off include BHP Group ((BHP)), Wesfarmers ((WES)), AusNet Services ((AST)), Dexs Property Group ((DXS)), GPT Group ((GPT)), Janus Henderson ((JHG)), Sonic Healthcare ((SHL)), Mirvac Group ((MGR)), Lendlease ((LLC)), and Coca-Cola Amatil ((CCL)).

In what might well be regarded as very uncharacteristic for the decade's best performing sector on the ASX, **healthcare** has traded in early safe haven outperformance for notable underperformance post late-March.

Behind this observation hides yet another widening gap, with the likes of ResMed, Sonic Healthcare, Ansell ((ANN)), and Fisher & Paykel Healthcare ((FPH)) surging to new all-time record highs, while CSL, Cochlear ((COH)) and Ramsay Health Care ((RHC)) have been left behind.

Recent analysis by JP Morgan revealed many institutional investors have been adding to their healthcare exposure in June, no doubt encouraged by the relative de-rating for the laggards in the sector.

JP Morgan strategists reported they are equally inclined to follow suit as the outlook for risk assets favours a more defensive portfolio stance.

Data suggest the largest fund inflows went into ResMed and Ramsay Health Care shares in June.

JP Morgan reports funds managers' skew towards healthcare stocks has reached the highest positive level in the history of its survey.

Equally noteworthy is that more and more institutional portfolios have been adding banks to their top ten positions, while reducing exposure to "Materials" (essentially miners and energy producers).

To read more about the raging debate about what to expect from CSL this month:

<https://www.fnarena.com/index.php/2020/07/16/rudis-view-whats-wrong-with-csl/>

You wouldn't pick it from the outside, but **Australian telcos** could potentially turn into one of few stand-out performers this August reporting season.

Analysts at Goldman Sachs point out all major telcos have reiterated guidance for FY20, and thus investor focus will zoom in on what each company is willing to share about the outlook for FY21.

Goldman Sachs thinks every telco under coverage will provide guidance, which will be unique this season, albeit with the added understanding that some companies might prefer to issue a rather broad range.

Irrespective, if Goldman Sachs' assessment is correct, telecommunication might be vying for top sector spot in terms of reliability and accountability this month.

The broker's top three favourites ahead of the season are (in order of preference) Telstra ((TLS)), NextDC ((NXT)), and Vocus Group ((VOC)).

Telstra is expected to attract additional interest on confirmation of dividend sustainability.

Sector analysts at Morgan Stanley agree with the general sentiment, but they also see potential friction for the industry because the combined TPG/Vodafone ((TPG)) is ambitious enough to disturb the relative peace from the past twelve months.

In contrast with the above, analysts at Credit Suisse suspect **diversified financials** might be one of the disappointment hot spots this month.

All of Challenger ((CGF)), Computershare, ASX ((ASX)) and Hub24 ((HUB)) have received one big question mark to their name and Credit Suisse sees risks as firmly to the downside.

Only one sector constituent continues to offer scope for upside surprise, Credit Suisse believes, and

that one stand-out name is, of course, Magellan Financial Group ((MFG)).

The analysts are anticipating positive commentary on new product launches, as well as regarding the fresh investment banking startup, Blackwattle.

All other non-bank financials ex-insurers are trading amidst neutral to mixed operational conditions, and Credit Suisse cannot muster the slightest hint of excitement.

Plenty of analysts elsewhere who'd find Credit Suisse's neutral view on the likes of Platinum Asset Management ((PTM)), IOOF Holdings ((IFL)) and Link Administration ((LNK)) potentially too rosy.

Another sector under immense pressure is media, in particular those business models depending on revenues from advertising, which also includes outdoor advertising facilitators.

Cyclical earnings risk galore is probably the appropriate label to use here. Morgan Stanley sees only one winner (or should that be: survivor?) among traditional media players, and that's Nine Entertainment ((NEC)).

While valuations for online media and modern-day tech companies are back near all-time highs, the debates amongst analysts and investors continues to rage, and to divide, whether current multiples are outrageous or fully justified.

Aristocrat Leisure ((ALL)) remains Morgan Stanley's gaming & casino sector favourite and that's partially because of the growth potential from online gaming.

August 2020 will mark **a sharp divide for the mining sector**, explain commodity analysts at Credit Suisse.

In particular coal producers are struggling with a persistently tough environment. The analysts have removed all estimates for any form of dividend payments to shareholders.

For others, including Alumina Ltd ((AWC)) and Iluka Resources ((ILU)) Credit Suisse has adopted cautious forecasts of US2c and AU4c respectively while BHP Group ((BHP)), irrespective of no positive surprise from Rio Tinto's ((RIO)) interim result, has the capacity to do better than cautious market expectations.

It's all about the price of iron ore remaining above US\$100/tonne, and this is the reason why Fortescue Metals ((FMG)) could pay out more than expected as well.

For now, the analysts have penciled in AU77c for Fortescue Metals shareholders and US43c for BHP shareholders, but both estimates could be proven conservative.

Capital management will be greatly welcomed amidst extreme uncertainty, and one of the companies often mentioned in this regard is Aurizon Holdings ((AZJ)).

The company bought back \$400m worth of its own shares in FY20. More is expected in the year ahead.

In contrast, Brambles ((BXB)) has only bought circa 25% of its announced \$240m on market share buyback.

Analysts are worrying the new dividend policy might result in a disappointing outcome for shareholders.

All of the above, and much more, shall be dismissed or confirmed over the weeks ahead.

More to read:

-on share market valuations:

-on the upcoming August reporting season:

<https://www.fnarena.com/index.php/2020/07/30/rudis-view-coming-soon-the-august-reporting-season/>

Morgans Best Ideas

Investors looking to deploy more capital in the local share market and don't know where to look for "value with upside" need not despair as stockbroker Morgans has done all the hard work.

Morgans' Best Ideas offer the highest risk-adjusted return over a twelve month horizon while also supported by an above-average level of confidence, explains the broker in its most recent update (released on Monday).

Those Best Ideas, mind you, consist of no less than 41 ASX-listed companies, in alphabetical order:

Acrow Formwork and Construction Services ((ACF)),

Adairs ((ADH)),

ALS Ltd ((ALQ)),

Amcor ((AMC)),

AP Eagers ((APE)),

APA Group ((APA)),

APN Convenience Retail REIT ((AQR)),

Aristocrat Leisure ((ALL)),

Aurizon Holdings ((AZJ)),

Aventus Group ((AVN)),

Baby Bunting Group ((BBN)),

Beach Energy ((BPT)),

BHP Group ((BHP)),

Catapult Group International ((CAT)),

Cleanaway Waste Management ((CWY)),

Coles Group ((COL)),

Collins Foods ((CKF)),

Computershare ((CPU)),

Corporate Travel Management ((CTD)),

Costa Group Holdings ((CGC)),

Elders ((ELD)),

HUB24 ((HUB)),

JB Hi-Fi ((JBH)),

Karoon Energy ((KAR)),

Macquarie Group ((MQG)),

Mainstream Group ((MAI)),

Monash IVF ((MVF)),

Orocobre ((ORE)),

People Infrastructure ((PPE)),

PWR Holdings ((PWH)),

Redbubble ((RBL)),

ResMed ((RMD)),

Rio Tinto ((RIO)),

Santos ((STO)),

Senex Energy ((SXY)),

Strandline Resources ((STA)),

Superloop ((SLC)),

TPG Telecom ((TPG)),

Waypoint REIT ((WPR)),

Westpac ((WBC)),

Zip Co ((Z1P)).

(This story was written on Monday 3rd August, 2020. It was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website).

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((ORE)) OROCOBRE LIMITED has changed its code to ((AKE)).

((Z1P)) ZIP CO LIMITED has changed its code to ((ZIP)).

((AKE)) ALLKEM LIMITED has changed its code to ((LTM)).