Rudi's View: August Reporting Favours Quality & Growth

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Dear time-conscious investor: High PE stocks continue to benefit most this month, while one expert is calling for the next commodities supercycle

In this week's Weekly Insights:

-August Reporting Favours Quality & Growth
-Morgans Model portfolios
-The Next Commodities Super Cycle

August Reporting Favours Quality & Growth

By Rudi Filapek-Vandyck, Editor FNArena

One observation that has caught my attention is that as times have become tougher for corporate Australia, more companies have decided to release financial results later in the season.

A quick run through recent years' reporting seasons has revealed that by this time in August 2018, the FNArena Corporate Results Monitor contained some 70 companies more than it does this year.

These companies will still be reporting, of course, so expect a tsunami in catch-up financial results releases during the final days of August.

On multiple observations and measurements, reporting seasons in Australia worsened considerably after August 2018 (if we only concentrate on the February and the August seasons).

No surprise, the balance as to when companies schedule for financial results releases has noticeably shifted towards the final two weeks of each season.

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Having noted the above, August 2020 has been, all things considered, surprisingly positive thus far.

If current trends hold up for the remaining 140 or so corporate results, then August 2020 will mark a return to the good old days pre-2019; when Australian companies mostly met or beat expectations, and analysts lifted valuations and price targets higher in response.

[Paying subscribers can access the archive for Corporate Results Monitors on the FNArena website tracing back to August 2013].

Thanks to detailed data analysis from JPMorgan, we can now also confirm **reporting seasons in Australia are becoming more volatile** with sharper price movements occurring in either direction.

Of course, every reporting season generates negative and positive surprises, and share prices tend to reflect this, all else remaining equal. But JPMorgan's analysis clearly shows share prices, on average, respond through bigger moves nowadays and the number of sharp moves remains in an uptrend too.

Underlying all of this, remains a wide dispersion between "winners" and "losers" -quality and growth versus lagging value- and post February, a new kind of demarcation has sprung to life as the covid-19 pandemic has created its own set of "winners" and "losers"; virus beneficiaries versus victims.

With uncertainty high and only few companies willing (and able) to provide positive guidance for the year ahead, investors have proved remarkably forgiving in their treatment of companies that didn't quite match expectations.

While JPMorgan's research is correct in that daily volatility has become sharper and more intense, others are equally making the observation that many more share prices could have been slaughtered under different circumstances, but they received rather mild responses instead.

Indeed, UBS is arguing average volatility this month is actually down in comparison with prior seasons, on its own data analysis.

In ultra-simplistic terms: investors knew uncertainty and unknowns would dominate this season, and they had already decided to adopt the glass half-full approach.

This observation is further underpinned by the fact that share prices for companies that do not provide guidance for the year ahead on average have risen by 2% post financial results release.

Note also: the ASX200 has, on balance, gradually crept up higher as the season progressed. Led by, as UBS likes to emphasise, stocks trading on high Price-Earnings (PE) multiples.

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As at Monday, 24th August 2020, the FNArena Corporate Results Monitor contained 159 results of which, on our holistic assessment, 54 beat expectations (34%) and only 28 missed (17.6%).

Never in the history of the Corporate Results Monitor have we ever witnessed the Beat/Miss ratio this close to 2. The highest ratio recorded since 2013 was 1.5 for both August 2015 and February 2016.

I don't think it's unreasonable to expect the percentage of misses to increase over the remaining days.

Equally noteworthy, the numbers yet again look a lot less promising for the ASX50, with only nine beats out of 37 (24%) versus ten fails (27%).

Earnings forecasts are declining, as they do in just about every reporting season, but price targets are going up by more than 4%, which is high on historical precedents, but not unprecedented.

Upgrades and downgrades in broker ratings in response to financial results are to date perfectly balanced; 34 each.

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High valuations, carried by the themes of "Quality" and "Growth", as well as "covid-19 beneficiary", have remained one of the stand-out features, yet again, this month.

Despite the gap between "winners" and "losers" at an all-time high pre-covid earlier in the year, market strategists at UBS observe that gap is simply refusing to narrow.

If anything, it just keeps getting wider as shares for the likes of Afterpay ((APT)), WiseTech Global ((WTC)), Netwealth ((NWL)), ARB Corp ((ARB)), etc continue to reach for higher prices, while investors have no appetite for the likes of Whitehaven Coal ((WHC)), Vicinity Centres ((VCX)), Unibail-Rodamco-Westfield ((URW)), and Orora ((ORA)).

An important observation in this regard is that analysts' expectations for FY21 are for rather benign growth, in particular given the large decline experienced in FY20. Rising costs and the need for additional investments are only part of this story.

Strategists at Morgan Stanley summarised it as follows: the upgrade cycle for corporate Australia has yet again been delayed.

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FY22 now marks the earliest return of growth for the majority of Australian companies. I think this virtually guarantees the extreme polarisation that has characterised the share market post 2013 is here to stay for longer.

The good news is that when FY22 does live up to current expectations, average EPS growth might jump by 16%, as per current forecasts at Morgan Stanley.

But there is a long way that yet needs to be traveled between now and then.

For what it's worth: Morgan Stanley sees the share market as stretched in valuations given the absence of growth between now and FY22.

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Only few companies have provided quantitative guidance, and most of such guidance has been negative a la AGL Energy ((AGL)), Origin Energy ((ORG)), Telstra ((TLS)), Challenger ((CGF)), and Seek ((SEK)).

Macquarie identified the few from the Top100 that have come out with concrete, positive guidance as: WiseTech Global, Goodman Group ((GMG)), Amcor ((AMC)), CSL ((CSL)) and Brambles ((BXB)).

That is by anyone's account, not an extensive list.

Best results delivered so far, according to Maquarie, have come from Charter Hall ((CHC)), Nick Scali ((NCK)) and Baby Bunting ((BBN)), followed by JB Hi-Fi ((JBH)), Charter Hall Long WALE REIT ((CLW)) and Codan ((CDA)).

Worst results were the ones from Vicinity Centres, Santos ((STO)), Qantas ((QAN)), AGL Energy, Seek and GWA Group ((GWA)).

Themes that have emerged as clear winners (and losers) this reporting season, include:

-Covid-19 is good for housing with work-from-home putting pressure on offices;

-Car ownership is back in fashion too, with public transport on the receiving end;

-This pandemic has created booming conditions for parts of the retail sector;

-Mining and mining services remain robust, as long as there is no connection to coal

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And then there was the matter of dividends…

On Macquarie's numbers, nearly 60% of companies have reduced their dividend at least by -10%, while nearly 25% increased dividends by +10% or more.

The good news is nearly 70% of companies are still paying a dividend, with 23% reducing their dividend to zero for the half.

Real Estate delivered most of the dividend cuts, followed by Resources.

On my own observation, many of the laggards have stuck to the script that when all else fails to deliver, it's best to at least provide shareholders a surprise through the dividend.

Witness, for example, even the board at South32 ((S32)) couldn't help itself but pay out a symbolic US1c this half – better than nothing!

Within this context it is interesting to note that, on Citi's observation, investors chose to reward banks that delivered better earnings results this month (including through trading updates) rather than an extra effort through paying a dividend.

In line with assessments elsewhere, banking analysts at Citi believe bank share prices look cheaply

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valued, but the key challenge is yet to come in Q4 when government stimulus is wound back, deferred loan periods have expired and unemployment is expected to peak in Australia.

Market strategists at Citi have identified three key dividend surprises this season: AMP ((AMP)), Newcrest Mining ((NCM)), and Woodside Petroleum ((WPL)) in that market forecasts for all three dividends have increased for both this year and next.

On current trends, market consensus is likely to settle around -22% in earnings per share (EPS) retreat for FY20, to be followed by circa 6% growth in FY21, which might then be followed by 13.4% growth in FY22.

Utilities, as a group, are not expected to join in the return of growth, while Technology, Healthcare, Insurance, Gaming and Staples are presenting themselves as key drivers for those growth projections for the years ahead.

Expectations for banks are unusually mixed. The sector is responsible for the largest downward corrections in dividend forecasts this season, followed by real estate, then other financials.

The largest upward revision in price target surely goes to online artwork market-place Redbubble with stockbroker Morgans lifting its target on Monday to $4.33 from 54c previously.

UBS has tipped NextDC ((NXT)) for a potential positive surprise on 27th August.

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FNArena is keeping track of August corporate results, including calendar and archive:

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

Prior previews and updates on August results:

https://www.fnarena.com/index.php/2020/08/20/rudis-view-early-signals-from-august-2020/

https://www.fnarena.com/index.php/2020/08/13/rudis-view-gold-conviction-calls-early-results/

https://www.fnarena.com/index.php/2020/08/06/rudys-view-august-2020-nothing-like-the-past/

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

https://www.fnarena.com/index.php/2020/07/23/forecasts-not-valuations/

Morgans Model portfolios

Only two changes were revealed with the latest update on model portfolios managed by stockbroker Morgans.

Brickworks ((BKW)) plus additional shares in Amcor ((AMC)) have been added by the Balanced Portfolio.

The Growth Portfolio did nothing, but is now officially reviewing what to do with its Telstra ((TLS)) shares.

Most investors might think putting Telstra and growth together in the same sentence, let alone inside a Growth portfolio, very much sounds like a contradictio in terminis, like AMP and sustainable shareholder value or iSignthis and a clean record.

But Morgans was one of a number of experts who genuinely believed FY21 could have been the year of the Telstra comeback.

Another expert who thought that would be the case is Goldman Sachs. Post the disappointing FY20 release, Goldman Sachs has stoically stuck by its conviction, calling an otherwise in-line result overshadowed by lower return on invested capital (ROIC) guidance.

Analysts elsewhere have taken this as an indication Telstra will yet again lower its dividend, probably to

14c, and later on to 12c when the NBN-related special dividend is no longer in the mix.

But not Goldman Sachs.

Here the analysts hold on to their belief the Telstra board will keep paying out 16c for as long as free cash flow allows it, which on their projections is until FY23.

Goldman Sachs has kept Telstra as a Conviction List Buy recommendation, with a twelve-month price target of $3.90.

Morgans' Growth Portfolio is keeping a close watch on Credit Corp ((CCP)), Hub24 ((HUB)), Netwealth, United Malt Group ((UMG)), Rea Group ((REA)), Magellan Financial Group ((MFG)), Uniti Group post Opticomm merger ((UWL)), Reece ((REH)) and Reliance Worldwide ((RWC)).

The Next Commodities Super Cycle

One of the most remarkable predictions made this August reporting season has absolutely nothing to do with corporate results.

Daniel Sullivan, head of global natural resources at **Janus Henderson**, believes investors should start preparing for the next multi-year supercycle for commodities.

Yes, you read it correctly, commodities including oil and gas, steel, industrial gases, uranium and healthy food products are about to make a comeback, and in a big way.

Recent price action in iron ore, copper and gold are but the early indicators of what is yet to come next, if Sullivan's reading of historical patterns is to be vindicated.

The chart below speaks for itself, with the current "depression" seen as the spring board for three decades of inflation and higher commodity prices.

To be continued, no doubt.

(This story was written on Monday 24th 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).

(Do note that, in line with all my analyses, appearances and presentations, all of the above names and calculations are provided for educational purposes only. Investors should always consult with their licensed investment advisor first, before making any decisions. All views are mine and not by association FNArena's – see disclaimer on the website.

In addition, since FNArena runs a Model Portfolio based upon my research on All-Weather Performers it is more than likely that stocks mentioned are included in this Model Portfolio. For all questions about this: info@fnarena.com or via the direct messaging system on the website).

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– Change. Investing in a Low Growth World. eBook that sells through Amazon and other channels. Tackles the main issues impacting on investment strategies today and the world of tomorrow.
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