Rudi's View: A February Full Of Promise

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By Rudi Filapek-Vandyck, Editor FNArena

A February Full Of Promise

There are multiple ways in which one can look at progress and events.

One angle, popular among economists, is through the lense of: economies are still so far off from trend lines shattered by last year's pandemic, it'll take another 18 months, if not longer, before economies are back on trend, and risks remain in the mean time.

The other angle is: companies are recovering much quicker than anticipated, with most corporate results beating forecasts hand over fist. The latter is how financial markets operate, and thus, in my humble view, the correct way to view this year's corporate market updates.

Meanwhile, it's good to keep in mind that corporate profits, while recovering strongly, will need another year of strong growth, and then maybe the majority of corporate profits in Australia might be back where they were in 2019.

Back to reported results versus forecasts, and here the early signals are suggesting February 2021 might just churn out the best corporate performance since coming out of the GST more than a decade ago. It's probably no coincidence, this year equally marks a comeback post global recession, just as it was back then.

On Monday, the **FNArena Monitor** of corporate results showed no less than 70% of reports was beating expectations. By Wednesday, this number had accumulated to 75% of "beats". On Thursday we saw a retreat to 64.7%, but only one company had released a fresh disappointing clear market "miss"; Cimic Group ((CIM)).

The retreat on Thursday points at two key factors: it's early days still, and the number of reports will become a lot larger during the final two weeks of the February season, plus a number of companies -ALE Property ((LEP)), Alliance Aviation ((AQZ)), Computershare ((CPU)), Insurance Australia Group ((IAG)) and Megaport ((MP1))- might still have reported strongly, they did not "beat" what had already been anticipated.

Thus far, the number of companies that missed market expectations doesn't exceed four, or 11.8% out of 34 corporate reports in total. Again, it has to be emphasised the numbers are low, the season overall is still young, but the early statistics look as good as they've ever looked over the past ten years.

This, of course, raises a few extra questions about the few companies that could not stay with the trend this month. Cimic Group has been in disarray for quite a while now, and management at Challenger ((CGF)) is equally familiar with the term "struggle". Analysts had been warning about rising risks for BWP Trust ((BWP)) for a while, and they still are.

Maybe the one that stands out in this small group is online retailer Temple & Webster ((TPW)). Each one of the previous three management teams would give their right arm to achieve the kind of growth that Temple & Webster reported early in February, it's just that analysts had expected more, and this has weighed down the share price.

Of more importance is that AGL Energy ((AGL)), after first issuing a profit warning, still managed to disappoint on Thursday, while tired and worn-out AMP ((AMP)) announced its US-based suitor ARES is no longer interested, and Unibail-Rodamco-Westfield ((URW)) declared shareholders should not expect to see a return of dividends before FY23.

These latter disappointments are not yet incorporated in the mentioned statistics, but they will be included on Friday. I understand earnings season in Europe is equally surprising to the upside, as has been the case in the USA.

Investors will be hoping the early trend of more positive news than negative disappointments will continue for the remainder of February.

FNArena's Corporate Results Monitor is updated daily:
https://www.fnarena.com/index.php/reporting_season/ (with archive stretching back to August 2013 for paying subscribers).

Dividends Are Back

As pointed out in Part I on Monday, earnings seasons in 2021 should see the return of dividends in Australia; in many cases much quicker, and much stronger than thought possible only a few months ago.

FNArena's newest team member, Mark Story, has written with more depth and details about this, and those investors interested in how to best play the recovery in Australian dividends should definitely read his story:

https://www.fnarena.com/index.php/2021/02/10/the-understated-comeback-of-aussie-dividends/

We also published this story containing plenty of food for thought:

https://www.fnarena.com/index.php/2021/02/11/it-will-get-worse-before-it-gets-better/

Strong, Stronger & Strongest - Consumer Stocks

Expectations remain buoyant for iron ore miners, very buoyant, but if we are talking about one market segment that is currently being carried by firm operational momentum, rising forecasts and a public debate whether it all can last for much longer, the focus must shift to domestic-oriented, consumer-related companies.

We already know from quarterly trading updates in January Australian consumers have not stopped spending, instead redirecting their focus on local leisure & pleasure, properties and house renovations, but how much exactly has ended at bottom lines and, equally important, how much longer can this border-closure bonanza persist?

The team of analysts at Macquarie, to take one example, remains of the view "2021 is likely to see continued strength in consumer spending buoyed by high asset prices, high savings rate and improving confidence". In other words: this strong momentum is not ending in the here and now, and share prices thus have ongoing potential, all else remaining equal.

Macquarie likes housing-exposed stocks, in particular Wesfarmers ((WES)), Harvey Norman ((HVN)) and JB Hi-Fi ((JBH)), plus Woolworths ((WOW)) among the food-oriented exposures.

Over at Morgan Stanley, the preference equally lays with Harvey Norman, JB Hi-Fi and Woolworths, but the analysts also like Metcash ((MTS)).

The team of retail analysts at Citi concurs with the stronger-for-longer view, observing the market has shown hesitation in chasing double-digit growth experienced by the sector thus far, but consensus upgrades are forthcoming, predicts Citi, and these are poised to continue providing support to the sector for the next 6-12 months.

Citi most favours Woolworths, Harvey Norman, and Super Retail ((SUL)).

One sector that is equally leveraged to consumer spending, but which is usually separated into its own basket are food, beverages and packaging companies. Here, Citi's preferences lay with Costa Group ((CGC)) and Domino's Pizza ((DMP)), while poultry company Inghams Group ((ING)) is equally rated Buy.

Another sector that is expected to enjoy a stronger-for-longer environment are the building materials companies, as also illustrated by sector champion James Hardie once again handsomely beating market forecasts with its quarterly update. James Hardie had already been nominated as sector top pick at Macquarie, which also likes Reliance Worldwide ((RWC)) and CSR ((CSR)).

Even prior to James Hardie's market update, Macquarie declared it was not deterred by the already strong share price performance.

One sector that has been operating in the shadow of both mentioned categories of companies is the **local media sector.** Analysts are equally convinced the bounce in economic activity should translate into a fresh upgrade cycle for local media companies, which, incidentally, includes not only the likes of Nine Entertainment ((NEC)), HT&E ((HT1)) and Seven West Media ((SWM)), but equally Seek ((SEK)), Domain Holdings ((DHG)), and Carsales ((CAR)).

The team of media analysts at Goldman Sachs upgraded Carsales to Buy on this narrative, while also retaining Buy ratings for News Corp ((NWS)), REA Group ((REA)), and for Nine Entertainment.

Winners & Losers (Forecast)

Analysts like to line up their (educated) guesses about who will likely be crowned a winner and who will turn into a loser before each reporting season.

At Goldman Sachs, the list of potential positive surprises is this time around a large one, especially when measured against a rather small selection of candidates poised for disappointment.

Most likely to outperform expectations, according to Goldman Sachs, include Ramsay Healthcare ((RHC)), Seek, Domino's Pizza, Harvey Norman, Downer EDI ((DOW)), Afterpay ((APT)), Computershare ((CPU)), Challenger, Star Entertainment Group ((SGR)), Stockland ((SGP)), Aventus Group ((AVN)), James Hardie, Qube Holdings ((QUB)), Brambles ((BXB)), Origin Energy ((ORG)), Costa Group, Ingenia Communities Group ((INA)), and Hipages Group ((HPG)).

Candidates most likely to disappoint include TPG Telecom ((TPG)), Altium ((ALU)), Bendigo and Adelaide Bank ((BEN)), Aurizon Holdings ((AZJ)), Sims Group ((SGM)), and Huon Aquaculture ((HUO)).

As per always, such predictions are often correct, but certainly not always. Since the release of both lists, Computershare, Challenger and James Hardie have reported with only James Hardie delivering an undisputed "beat" while Challenger disappointed. Origin Energy issued a profit warning.

Hipages only listed on the ASX late last year.

Engineers & Contractors

As global activity recovers, and so do prices of commodities, engineering firms and mining contractors should see a sizeable pick-up in work coming their way, so goes the traditional narrative. And indeed, analysts' expectations are on the rise.

Sector analysts at Goldman Sachs warn investors it's not quite as straightforward, but in a general sense, yes, better times should lay ahead for the likes of Worley ((WOR)), Austal ((ASB)), Downer EDI, ALS Ltd ((ALQ)), Emeco Holdings ((EHL)), and Orica ((ORI)); all are Buy-rated.

Having received clear push-back from their clientele, the Goldman Sachs analysts maintain **market dynamics are equally poised to improve for coal markets** this year, both metallurgical and thermal, while the capex cycle for iron ore is approaching its peak. Improving market dynamics have further led to the broker pulling forward its year-end forecast for Brent oil to reach US$65/bbl, now projected for July.

Mining analysts at Credit Suisse are equally convinced coal markets are improving and should look a lot better later on in 2021. It's why they have Outperform ratings for Whitehaven Coal ((WHC)) and Coronado Global Resources ((CRN)).

Healthcare: Same Old

It's easy to think of healthcare stocks in Australia as dull and boring. Let's face it: most are casually reporting decent growth, if not better, and rather seldom do shareholders experience true disaster a la AMP, AGL Energy, or Slater & Gordon.

Then again, according to some analysts the sector also includes the likes of InvoCare -I know!- as well as Japara Healthcare, Estia Health, Eureka Group Holdings and Regis Healthcare.

Sticking to the usual suspects, sector analysts at Credit Suisse expect positive guidance from Ansell ((ANN)) -not a pure healthcare stock either- and from both Sonic Healthcare ((SHL)) and Healius ((HLS)).

Otherwise, all of CSL ((CSL)), Cochlear ((COH)) and Ramsay Healthcare are expected to release solid growth numbers (ResMed already did), but all have ongoing clouds to deal with. The only healthcare company Credit Suisse is wary about is Mayne Pharma ((MYX)) which is perceived as carrying downside risks this month.

Fund Managers: Go With The Flow

Australian fund managers have not been generating too many outstanding performance results of late, and the sector is priced accordingly. At Macquarie, however, sector analysts are taking the view: this is a bull market. Therefore the sector will continue to be supported.

Macquarie thus has an Overweight portfolio recommendation for the sector in Australia.

Most preferred: Magellan Financial Group ((MFG)) and Pendal Group ((PDL)); both are rated Buy. Platinum Asset Management ((PTM)) is the sole Underperform rating in the sector.

Morgan Stanley's sector preferences lay with Perpetual ((PPT)) and Pendal Group, agreeing with Macquarie Platinum Asset Management seems overvalued, but disagreeing on Magellan Financial, which is equally considered as too richly priced, and with too many unanswered questions.

As far as sector research goes, in Australia funds managers are usually lobbed into a basket called diversified financials, which also includes companies like the ASX ((ASX)), Hub24 ((HUB)), IOOF Holdings ((IFL)), and Computershare.

Credit Suisse's pre-reporting season update on diversified financials highlights upside risk potential for Challenger (proven wrong), Magellan Financial and Platinum Asset Management, while the ASX and Computershare were thought of as potential candidates for a negative surprise.

Brokers like UBS combine all of the above with insurers. Hence, UBS's list of potential upside surprises consists of Challenger (wrong), Insurance Australia Group ((IAG)), Medibank Private ((MPL)), QBE Insurance ((QBE)), Suncorp ((SUN)), and Steadfast Group ((SDF)).

For negative surprises, UBS points at AMP, ASX, Computershare, nib Holdings ((NHF)), and Magellan Financial.

Peak Oil, Just Not Now

One of the sectors that has genuinely excited investors this early in calendar 2021 is the energy sector, probably best summarised with Citi's latest assessment that a barrel of Brent will most likely be priced at US$70 rather than US$40 by year-end.

As per always, the trick for successful investing is to separate the immediate outlook from the longer term horizon, and not mix the two into one view/strategy/approach.

Beyond this year's positive dynamics for oil producers, there's a growing consensus greener sources for energy supplies are ready to start having an impact with out-of-favour coal simply the harbinger for what is awaiting the global crude oil sector.

Chris Iggo, Chief Investment Officer, Core Investments, AXA IM recently formulated it as follows:

"We might be at peak-oil. The US Energy Information Agency estimates global crude production fell in 2020 by around -6.3%. There was probably a covid-19 impact and the same agency expects production to be higher again in 2021-2022. Yet, the shift to renewable sources of energy is clear.

"As the shift towards more locally sourced renewable energy increases, demand for traditional fossil fuels will decline (in absolute terms it isn't yet). The relative price of oil is likely to fall too. The mirror of this will be an improvement in countries where energy trade is a big contributor to balance of payments deficits. They will benefit from not having to spend so much of domestic output on importing fossil fuels (oil especially).

"The reduced reliance on oil and the handful of large suppliers that control the market (OPEC and others) will also have other economic consequences. Energy prices should be lower and less volatile as there will be reduced 'political' influence on energy supplies.

"The 'petrodollar' is a thing of the past and the need for certain currencies to be pegged against the US dollar will disappear. At the same time, China will play a more important role in global energy production given its existing position in the development of renewables and associated technology and supply chains. Higher rates of economic growth and a shift in the structure of the global energy balance are reasons to be long-term bullish on the renminbi over the US dollar.

"I don't know how secure the supply of electricity from renewables will be in the future, but I expect that it will be more stable than from oil given the plethora of new sources of renewable energy (and we need to consider nuclear, hydro, geothermal and biofuels as well as wind and solar). This should mean more stable energy prices and less volatile headline inflation rates over time.

"As technology improves further, energy prices could fall even more. Cheaper technology will allow the conversion of solar and wind into electricity at the local level, radically changing the economics for businesses and countries reliant on non-local primary energy sources."

As per always, long-term versus short-term. Investors should pay attention.

Conviction Calls

In their own words, **Morningstar**'s monthly **Best Stock Ideas** "highlights (sic) high-quality Australian and New Zealand companies, which are currently trading at discounts to our assessed fair values" and by sheer luck the list of 14 Best Ideas no longer includes Challenger as that stock was removed pre-results release on a rather strong share price performance ahead of the actual event.

Challenger shares more than doubled from a bottom near $3.50 in September last year, and then kept on keeping on as the interim results were about to be released, after which a swift sell-off ensued. But, as said, by then Morningstar had already removed the stock from its selected list.

So much for market intelligence leading into the actual event, hey? It has to be said, while another disappointing market update put all feet back on earth, stockbroking analysts are in majority still sticking with the view that better times lay ahead, just not right now.

I reckon the shares are not cheap enough to be reinstated as a Best Idea at Morningstar.

The 14 stocks that remain as a Best Idea at Morningstar are a2 Milk ((A2M)), Avita Medical ((AVH)), Brambles, Cimic Group, Computershare, G8 Education ((GEM)), InvoCare ((IVC)), Link Administration Holding ((LNK)), Spark Infrastructure ((SKI)), Southern Cross Media ((SXL)), Viva Energy ((VEA)), Westpac ((WBC)), Whitehaven Coal, and Woodside Petroleum ((WPL)).

It won't escape anyone that list contains quite a number of bleak and fragile business models with a rather checkered history. G8 Education, InvoCare, Link, Southern Cross Media, Whitehaven Coal; these are share market opposites for Quality businesses including Amcor, CSL, REA Group and Bapcor.

Lurking in the background, I see the old adage of the typical value investor in that everything has a price and when that price is too low, one must buy and remain patient. Within this framework I observe Cimic once again delivered a disappointing market update this week and its share price has tanked from $26-plus to below $21. Still a Buy, of course, because the share price is now so much cheaper. It's just that shareholders holding the stock must exert more patience.

FNArena Webinar

FNArena organised an online webinar on Monday evening with myself providing an introduction to the website and service provided, followed by a general update on financial markets in early 2021.

Two recordings from the event have been added to the FNArena Talks section on the website:

-First part (30 minutes) consists of a general overview to the FNArena website and the service provided, helping subscribers to maximise their usage and benefits;

-Second part (30 minutes) provides an assessment of what is happening in financial markets, why, and a deeper look into the February reporting season.

To visit FNArena Talks: https://www.fnarena.com/index.php/analysis-data/fnarena-talks/

For Part I: https://www.fnarena.com/index.php/2021/02/11/rudis-view-february-feeding-market-optimism/

(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.)

P.S. I - All paying members at FNArena are being reminded they can set an email alert for my Rudi's View stories. Go to My Alerts (top bar of the website) and tick the box in front of 'Rudi's View'. You will receive an email alert every time a new Rudi's View story has been published on the website.

P.S. II - If you are reading this story through a third party distribution channel and you cannot see charts included, we apologise, but technical limitations are to blame.

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