Rudi's View: Early Signals From August 2020

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Dear time-conscious investor: early signals from reporting season are positive, but it's early days, while institutional investors still like technology stocks, with analysts lining up their favourites

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Early Signals From August 2020

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At first glance, this year's August reporting season is providing support to the strong share market recovery witnessed since April, decisively delivering more "beats" than "misses" in corporate results and with stockbroking analysts increasing their price targets on average by 4.79%.

As per always, broader context is necessary to put the first two weeks of August in a proper framework.

The most important factor to consider is that the FNArena Corporate Results Monitor as at the 17th August still only includes 55 ASX-listed companies with subsequent broker responses.

While the Monitor operates on a 24-hour delay, the time needed for analysts to respond and reassess, properly, 55 companies to date is well below prior reporting seasons this far into the month.

Hence, it's dangerous to draw firm conclusions from such a small batch of reports, involving no more than 15 members of the ASX50 and 35 of the ASX200, but it cannot be denied early indications are relatively positive and investors are showing a willingness to look through short-term headwinds, as I anticipated.

We will all be a lot wiser by this time next week, but as early indications go this season is heading for:

-circa -20% fall in earnings per share
-circa -38% reduction in dividends, with payout ratios on the rise (again)
-mild growth forecasts for FY21 (meaning growth won't return until FY22 for many)
-on balance, net increases to valuations & price targets
-roughly balanced moves between upgrades and downgrades in stockbroker recommendations
-ongoing uncertainty with most companies refraining from providing FY21 guidance

Dividend Surprises

The biggest positive stand-out has come through numerous **upside surprises for shareholder dividends**, including from AGL Energy ((AGL)) whose dim outlook surprised many, but the AGL board decided the company shall payout 100% of profits over the next two years.

The AGL example serves as an early guide as to how Australian boards (still) feel compelled to use just about anything at their disposal in order to meet the income requirements from a large group of domestic shareholders.

Apart from AGL, more dividend surprises have come from AMP ((AMP)), Aurizon Holdings ((AZJ)), Evolution Mining ((EVN)), GPT Group ((GPT)), Newcrest Mining ((NCM)), and QBE Insurance ((QBE)) while CommBank's ((CBA)) 98c H2 payout was more than many analysts had penciled in.

Of course, as the above summary indicates, many more companies will not be paying any dividends this year, or next year, but many others won't be holding back, effectively creating yet another demarcation between "winners" and "losers".

As many of the dividend payers are receiving support from government programs such as JobKeeper, a public discussion has broken out about the appropriateness of such payouts.

The irony from this reporting season, thus far, is that the miners are swimming in cash, and showing restraint in paying out dividends, also because costs are rising and more capex needs to be spent.

Positive Beats

On FNArena's early assessment, some 34.5% (19) of companies reporting has beaten market expectations while only 16.4% (9) delivered a "miss".

If these numbers hold up until early September, then 2020 would easily become the best August reporting season in Australia since 2013, but, again, too early to make such projections.

What we can assess is that already a number of companies have crowned themselves to **stand-out winners** and losers for the season.

On the positive side, Goodman Group ((GMG)) yet again showcased to investors just how strong the shift to online spending has become.

It wasn't that long ago Goodman Group shares offered no more than 3.5% prospective yield, which elicited quite the number of calls denominating the stock "grossly overvalued", yet today the yield stretches no farther than 1.6%, signalling the stock has (more than) doubled in price since 2016.

And still growing strong, with analysts further lifting growth estimates, which elevates price targets further, allowing traders and investors to push up the share price higher without the risk of running out of oxygen.

Another positive stand-out is REA Group ((REA)) whose FY20 release yet again showcased the true value of operating the number one real estate portal in the property-mad country that is Australia.

As with Goodman Group, REA Group shares have continued to climb and remain close to an all-time record high. The key difference is that analysts' price targets are all below the present share price.

Rio Tinto ((RIO)) too delivered a strong performance, overshadowed by the board restraining itself with the half-year dividend, while James Hardie ((JHX)) remains clearly on a roll, and coal-stricken Aurizon Holdings equally delivered on promises and potential.

Some results were strong, but the market had other ideas. Hence the likes of ResMed ((RMD)) and Breville Group ((BRG)) received capital punishment post market update.

Long-term oriented investors should keep in mind these companies still have a lot of potential growth ahead of them.

At the risk of stating the obvious, it has become evident already some retailers are enjoying boom-conditions because Australians, simply put, don't know where to spend their money otherwise.

Major disappointments

I'll say it again: highly valued companies are no more likely to disappoint during reporting seasons than laggards and cheaply priced companies.

What you won't easily find is a highly valued stock that rallies 10% or more upon the release of company financials.

As such, owners of shares in AMP ((AMP)), Treasury Wine Estates ((TWE)), Baby Bunting ((BBN)) and Navigator Global Investments ((NGI)) are feeling a lot happier today than those who own Goodman Group and REA Group.

But what about shareholders in AGL Energy? Challenger Financial ((CGF))? Or in Telstra ((TLS)) which, according to some analysts, seemed poised to drop the mantle of perennial disappointer this month, but it simply was not to be.

Telstra pretty much dropped yet another booby trap among investors, creating even more doubt about dividend sustainability and the way forward for Australia's largest telco.

It wasn't that long ago that I reminded investors that with so many unhappy customers, a conglomerate so much under pressure is highly unlikely to elevate itself to a position -ever- from where it can deliver long-lasting, sustainable benefits for loyal shareholders.

Post Telstra's FY20 report, the share price is back hovering above the $3 mark, not far off from the March low, while analysts' updated forecasts are implying lower dividends this year, and yet again in FY22.

Investors should also consider the annual receipts from the NBN will cease not long thereafter.

I am increasingly leaning towards the idea that Telstra is looking into creating value through cutting itself up in smaller pieces, which shall be spun-off in order to make the sum of the parts count for more than the conglomerate in its current form.

Job classifieds market operator Seek ((SEK)) too spooked investors with a much more fragile assessment of what the future might look like ex-China.

A special mentioning goes out to Hamish Douglass and the rest of the crew at Magellan Financial Group ((MFG)).

Not only are they one of few asset managers in Australia who operate on the right side of the market shift caused by low growth, low inflation, ageing demographics and super-charged technological disruption, like other iconic success stories elsewhere, Magellan has yet again proven a great company is not afraid to disrupt itself.

Instead of staring oneself blind on a high/low Price-Earnings (PE) ratio, or high/low implied dividend yield, many an investor would do their portfolio one massive favour by paying attention to the attributes that don't show up in an Excel data overview, but which shall be the subject of academic dissertations for years to follow.

Investors should also note stocks like Goodman Group, REA Group, and ResMed are proudly owned by the FNArena/Vested Equities All-Weather Model Portfolio (see also further below).

Paying subscribers can check up on my research into All-Weather stocks via a dedicated section on the website (with fresh updates on Dividend Champions):

https://www.fnarena.com/index.php/analysis-data/all-weather-stocks/

Don't forget FNArena is keeping track of **August corporate results**, including calendar and archive:

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

Small Cap Favourites

Even if signals and indicators are stacked against you, it still doesn't mean a company will 100% guaranteed disappoint with its financial report.

Which is why predicting (and anticipating) "beats" and "misses' is always more of a guess and a giggle prior to each reporting season.

UBS's team of emerging companies specialists (small caps, thus) had singled out Altium ((ALU)) as more or less a guaranteed disappointment in August.

But investors who sold out on that forecast would have been left just a little deflated on Monday, as the share price post-release went up in a downward moving market.

Other candidates identified as most likely providers of negative surprises this month are Estia Health ((EHE)), InvoCare ((IVC)), Japara Healthcare ((JHC)), and Regis Healthcare ((REG)).

Poised for a positive surprise, apparently, are Autosports Group ((ASG)), Bingo Industries ((BIN)), Corporate Travel Management ((CTD)), G8 Education ((GEM)), Prospa Group ((PGL)), Servcorp ((SRV)), and Webjet ((WEB)).

UBS's most preferred Buy calls (for August and beyond) are reserved for Appen ((APX)), Bapcor ((BAP)), Collins Foods ((CKF)), EclipX Group ((ECX)), Graincorp ((GNC)), Harvey Norman ((HVN)), IDP Education ((IEL)), NRW Holdings ((NWH)), NextDC ((NXT)), and Perenti Global ((PRN)).

Technology Remains Everybody's Favourite

Technology analysts at **Credit Suisse surveyed 40 Australian institutional fund managers** for their views on local technology stocks, and the results throw up some interesting insights.

First up, most funds managers participating in the survey have been increasing their exposure to the sector on expectations WAAAX and Co will continue to outperform the ASX100 in the year(s) ahead.

While a majority of respondents believes valuations are far from cheap, if not over-valued, they have little intention of parking their money elsewhere.

No surprise thus, stocks like Afterpay ((APT)) show up as greatly polarising opinions in the survey which showed only 23% of fund managers consider valuation very important.

User/customer growth and revenue growth are seen as key drivers for share prices with indications most institutions will not likely change views or positions in August.

Equally fascinating: no more than 11% of institutions believes cheaply priced, low growth companies as a group will outperform the high growth, higher PE multiple stocks over the coming 12-24 months.

Most preferred exposures are Xero ((XRO)), followed by Afterpay and Altium ((ALU)). WiseTech Global ((WTC)) is least preferred from the WAAAX stocks.

Other favourites put forward are Fineos Corp ((FCL)) and Appen ((APX)).

The team at Credit Suisse has its own sector ranking of favourites (in order of preference): Infomedia ((IFM)), Xero, WiseTech Global, then Life360 ((360)).

Investment Opportunity For Sophisticated Investors

At FNArena, we sometimes have the opportunity to participate in Special Promotions or share unique opportunities.

Last week, we sent out a short-dated notice for an online webinar with the CEO of a local biotech company, which has led to some positive feedback received.

This week we can share an opportunity for sophisticated investors, curated by Peak Asset Management, for whom we act as a distributor for this investment opportunity.

Peak Asset Management itself is investing in this opportunity which consists of an early-stage biotech developer of therapeutics for the treatment of mild traumatic brain injury/concussion, as well as for post-traumatic stress disorder, listed in Canada.

The team behind **Eleusian** has a track record of success. Investors interested in getting to know more about what is on offer, what is involved precisely, etc can use the following link (provides access to offer details, company fact sheet, etc):

https://FNarenagstrs708.pages.ontraport.net

[Late addition: Peak Asset Management has indicated they are likely to close this offer by COB on Thursday (today)]

(This story was written on Monday 17th 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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((ECX)) ECLIPX GROUP LIMITED has changed its code to ((FPR)).