



Finding Value in Australian Equities post the Reporting Season

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Investment Management

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Upcoming Events

- Investment Breakfast – Housing Market and the Implications for Investing and Building Portfolio Resilience at a Time of Macro Uncertainty – 11th September Melbourne 18th September Sydney
- Responsible Manager Masterclass – 17th September
- Portfolio Management Conference Melbourne – 22nd October
- InvestTech – 13th November
- Fintech Cocktail evening – 19th November

Data Standards Working Group

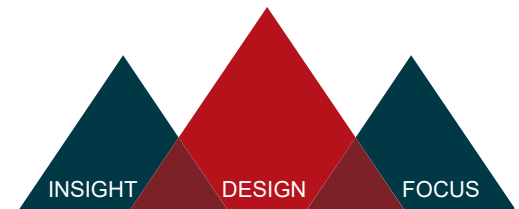
Portfolio Management Conference 2019 – Melbourne 22nd October

- Managing international direct equity portfolios
- What is the yield curve telling us?
- Active ETFs
- Retirement income portfolios
- Managing portfolios for HNW clients
- Creating alpha in Australian Equity portfolios
- Current macro themes and what they mean for an Australian equities portfolio
- Designing portfolios to meet competing goals

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*Global equity investors
deploying experience and knowledge
through a disciplined quantitative approach
to deliver core solutions for investors*



Value, value, wherefore art thou value?
August 2019 reporting season comments

Agenda

August performance

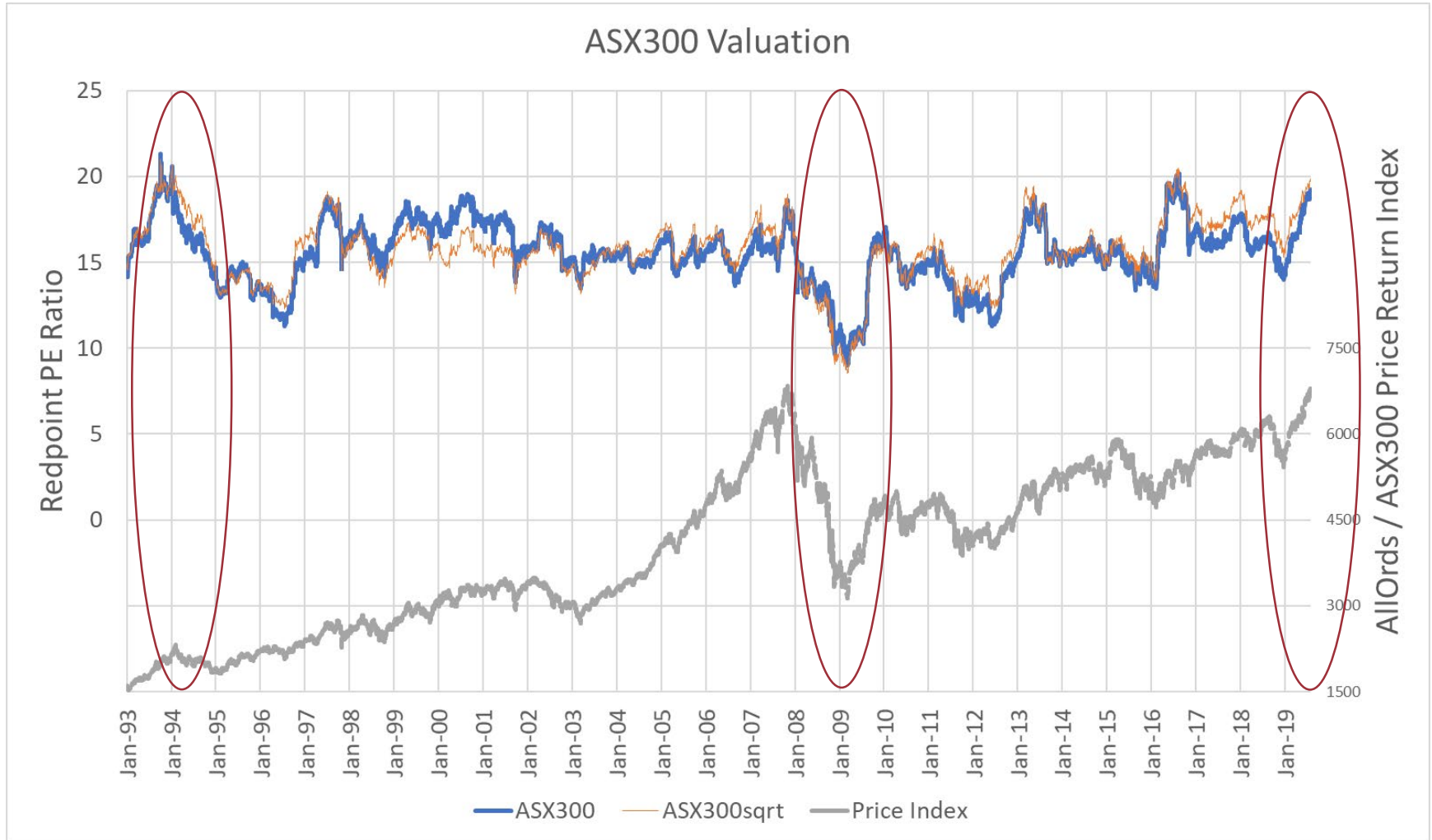
Where is value?

Reporting season reactions

The good, the bad, ?



August 2019: where is value?



Source: Redpoint, S&P

August performance: where is “value”?

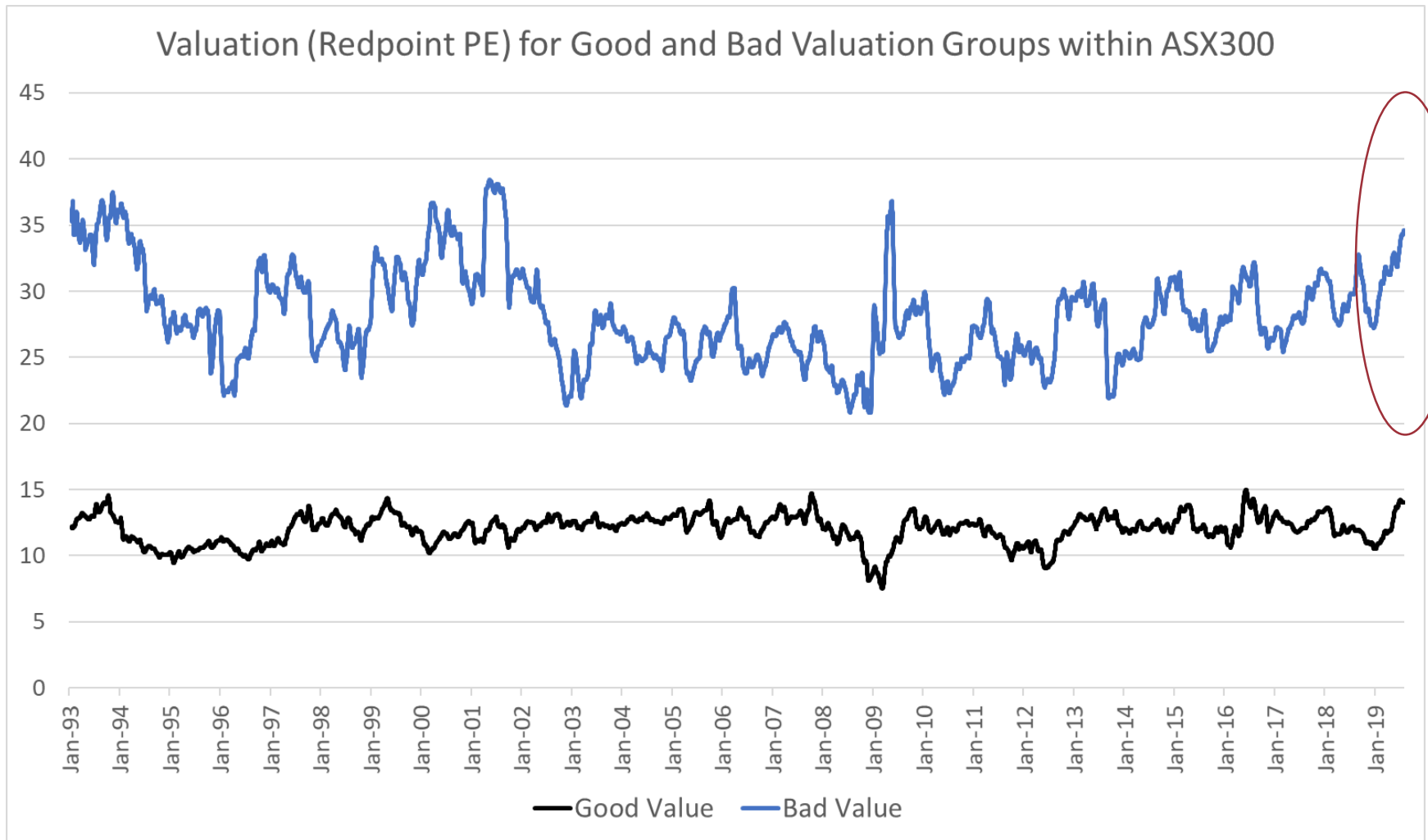
ASX200 GICS Sector	August Return	31 July PE
Materials	-7.46	12.56
Energy	-5.36	13.65
Communication	-3.07	18.12
Utilities	-2.98	21.88
Financials	-2.57	14.22
Industrials	-2.46	25.15
Staples	-0.1	23.50
Discretionary	0.22	20.12
IT	0.26	34.52
Real Estate	2.33	17.02
Healthcare	3.61	31.61

Redpoint Signal IC	Good	Bad
Value	✓ 0.42	-0.18
Quality	0.01	0.08
Growth	-0.10	-0.07
Analyst	-0.20	0.33 ✓
Momentum	-0.14	0.27 ✓

Source: Redpoint, Bloomberg

Signal IC is correlation of signal to value add from 1 August to 28 August 2019

Is there a valuation opportunity?



Source: Redpoint, S&P

Reporting season reactions

Beware Expensive stocks which disappoint

- Blackmores (-18%)
- Breville (-14%)
- Cleanaway (-12%)

But market has appetite for growth potential at (almost) any price

- Afterpay (+13%)
- Domain (+12%)
- Resmed (+11%)

There has been reward for some cheap stocks

- JB HIFI (+13%)
- Super Retail (+11%)
- Beach Energy (+15%)

But beware of value traps

- IOOF (-11%)
- Fletcher Building (-7%)
- Speedcast (-55%)

Investment approach: Valuation

JB HIFI: Previous report (12 Feb) pre tax EPS \$3.10ps, current price \$27.92

Calculate a robust earnings yield

Assess Conviction

Assess Timing

Average EPS (pre-tax) = \$3.42
Average EPS (pre-tax) to Price = 12.3%

Earnings **\$3.12**

- Trend & volatility

Free Cashflow **\$3.35**

- Trend & volatility

Tax paid **\$3.21**

- Trend & volatility

Analyst Forecast **\$2.98**

- 12m forward estimate

Return on Equity **\$4.43**

- Industry & company specific reversion
- Inflation adjusted book values

- Consistency in
- our models
 - Analysts eps
 - Loss making
 - Accruals

Conviction: ok

- Earnings growth
Cashflow growth
Analyst deviation
Analyst downgrade
Analyst coverage
Reported - Fair

Timing: ok

Our metrics prefer

Super Retail

Metcash

ANZ

Beach Energy

BHP

VS

Afterpay

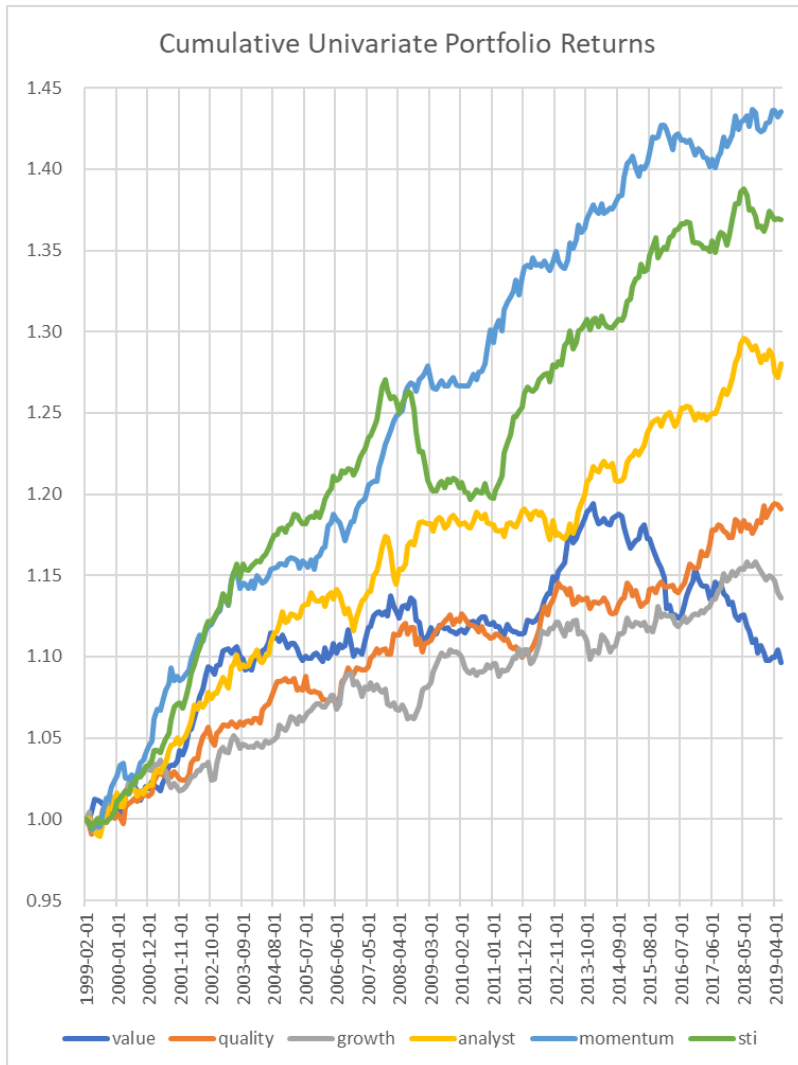
Fisher & Paykel Hlth

Costa Group

Cochlear

Sydney Airport

Longer term performance



Source: Redpoint, S&P

Different investment styles are rewarded in different parts of the market cycle

- *Valuation rally in post Tech-Wreck 2000-2003: but painful through '96-2k, pre-GFC and recently*
- *Post GFC rally in Growth and Quality*
- *Sentiment based strategies in Australia are unusually strong*

No one investment approach is consistently rewarded: diversification through combination can add value



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Questions

Finding Value in Australian Equities post Reporting Season

Will Riggall
Portfolio Manager



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How we manage money in a risky environment



Macro and Industry drivers integrated into fundamental research



Construction of concentrated portfolios



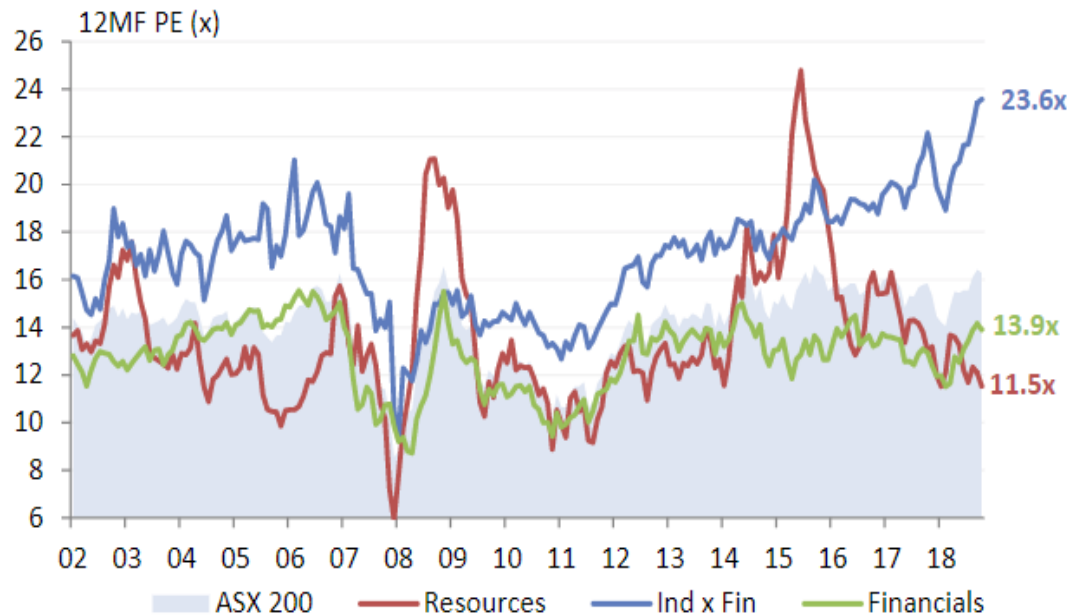
Trade execution and platform monitoring



Communication to clients and advisors

Australian equities trading at extreme levels

Major sector valuations are distorting value analysis

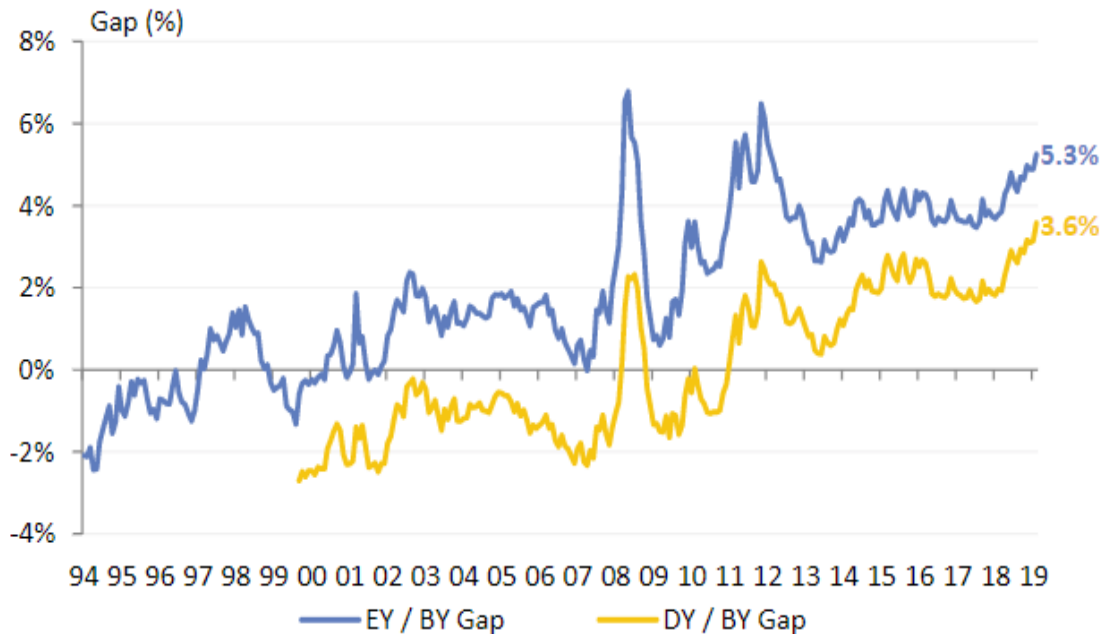


Source: RIMES, IBES, Morgan Stanley Research

What has been driving the market to extremes?

- Extreme valuation for 'growth' / 'quality' style stocks
- monetary policy has changed the behaviour of sectors
- Stock fundamentals less important in quant/passive led market
- Opportunities remain to acquire strong businesses at attractive valuations

Equities providing relative value against bonds



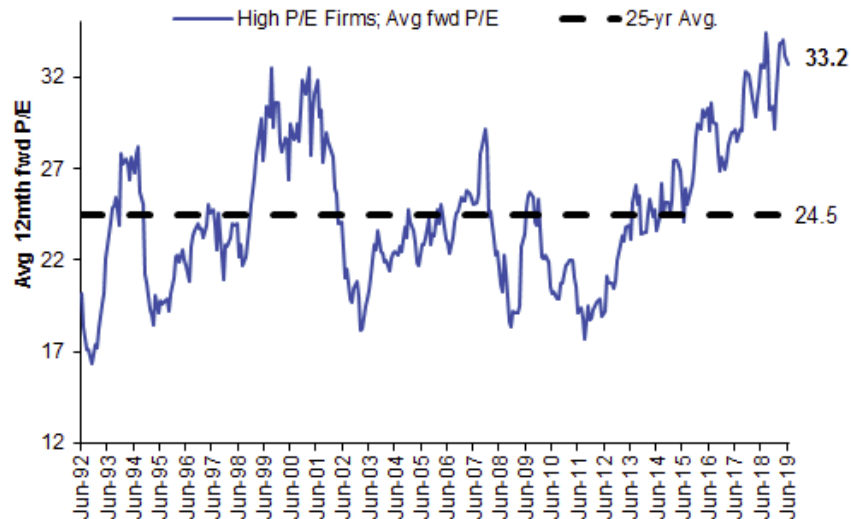
Source: RIMES, IBES, IRESS, Morgan Stanley Research

- Dividend yield is attractive against current yield from bonds
- Difference has only been higher during GFC and 2011 EU crisis
- Both bonds and equities are carrying elevated valuation risks
- With expected increase in global liquidity, where does the money go?

Growth/quality attributes trading at extremes

High PE names are now trading above pre-GFC and 2000 highs

Exhibit 26 : High P/E firms trade at an average fwd P/E of 33x, which is 34% above the l/t avg

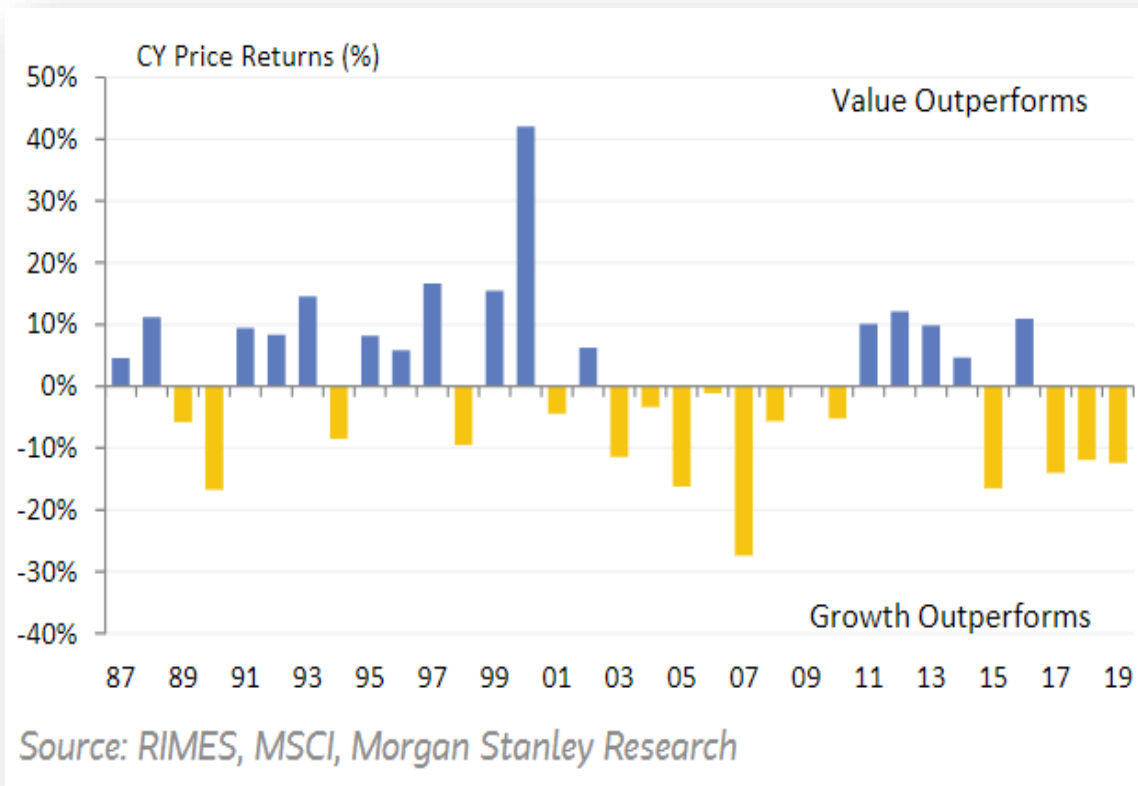


Source: Goldman Sachs Global Investment Research, FactSet

- High PE companies trading at historical highs
- Australian high growth companies trade at a significant premium to global peers
- Low growth and excess liquidity chasing small number of investment options
- Major bubble evident with catalyst being yield curve returning to normal
- Growth expectations will need to improve

Growth style has driven performance

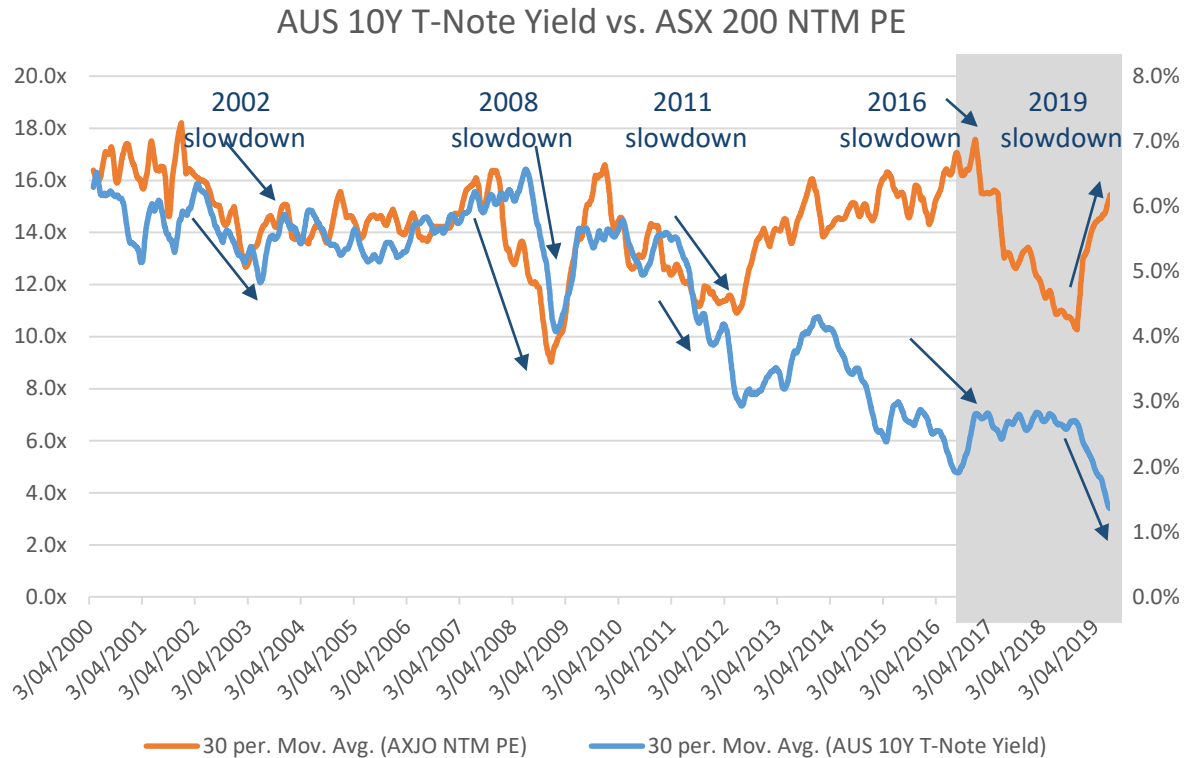
Historical performance of growth and value styles



- Growth continues to outperform value in 2019
- Trend continues in August reporting season
- Has been a difficult period for Value managers
- Why have Growth managers underperformed in this period?

Divergence from historical patterns

Breakdown in relationship between bond yield and ASX 200 PE during a slowdown

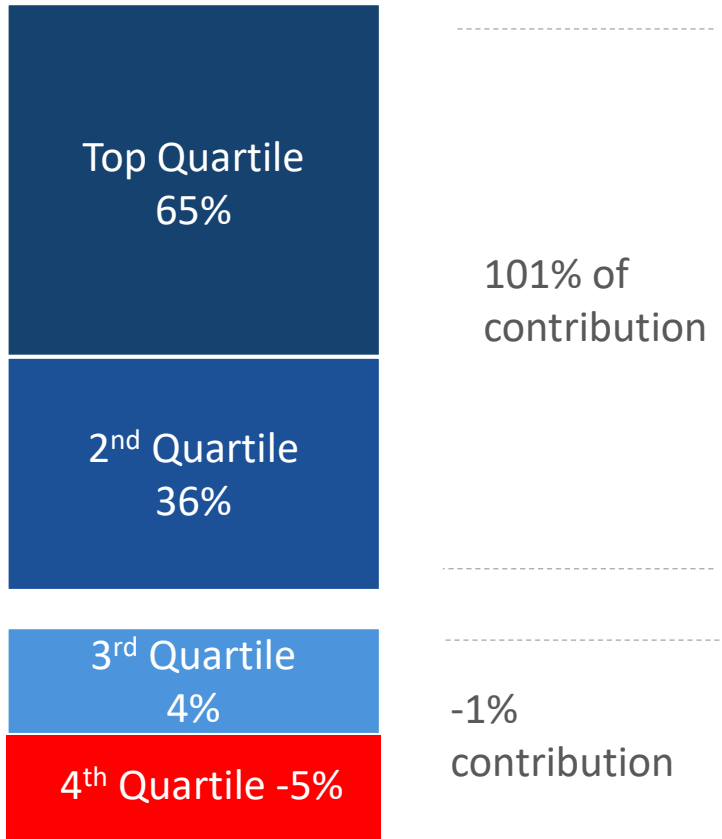


Expectation of global liquidity injection has driven PE expansion relative to bond yield

FY2019 Industrials performance – PE quartile insights

S&P/ASX Industrials substantially underperform in 2HFY19

Price to Earnings



FY 2018

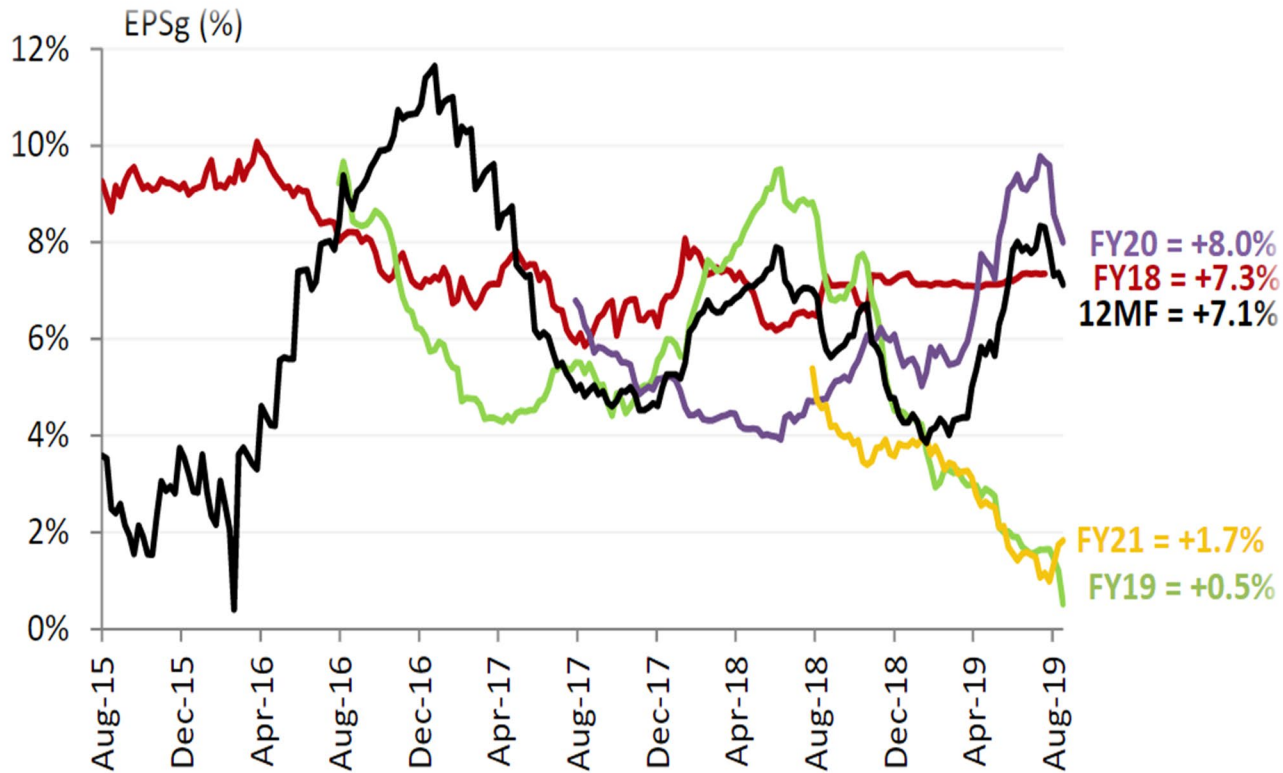
- Index illustrated strong bias to value over growth

FY2019

- Growth and value both underperformed
- 2 unexpected outcomes
 - Liberals retain government
 - Vale dam collapse impact iron ore supply
- Post election **Financials** recovery
- **Resources** index performed strongly
- Outside of Resources and Banks more than 100% of ASX200 Industrial return came from the most expensive parts of the market

Reporting season was disappointing

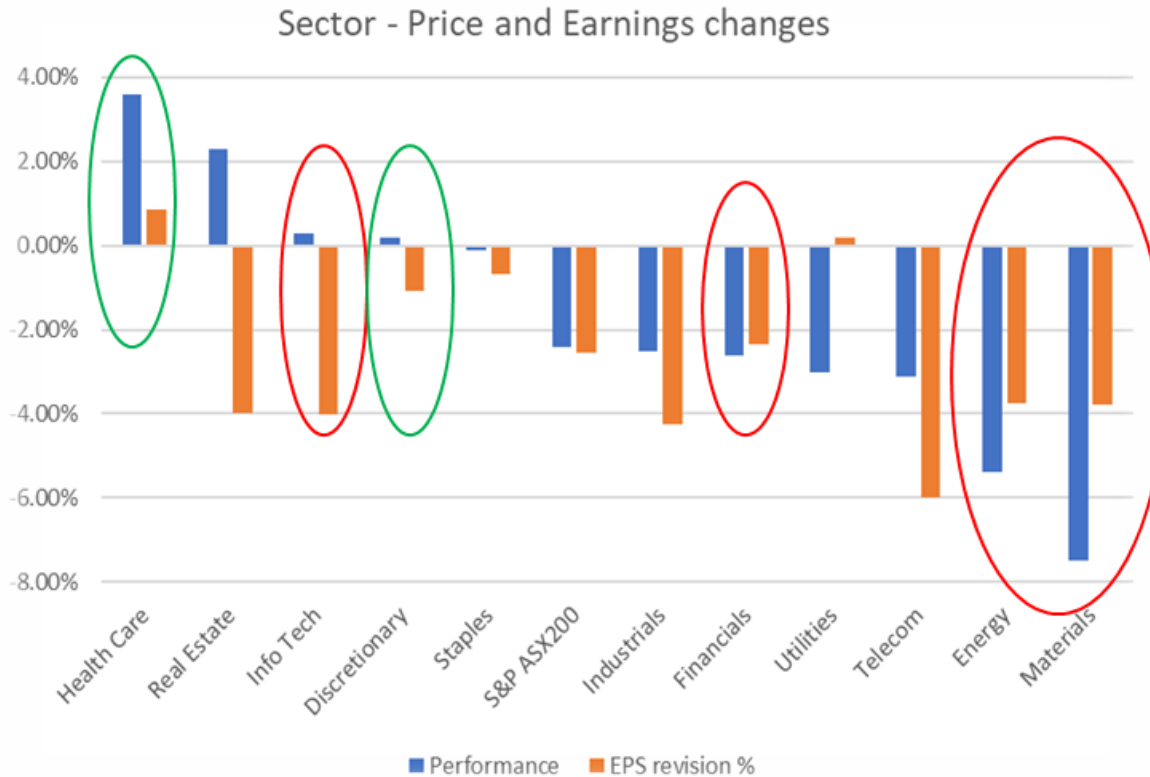
Earnings outlook downgraded for current and future years



Source: RIMES, IBES, Morgan Stanley Research

Expectations for FY20 look unrealistic

Defensives and domestic consumer performed

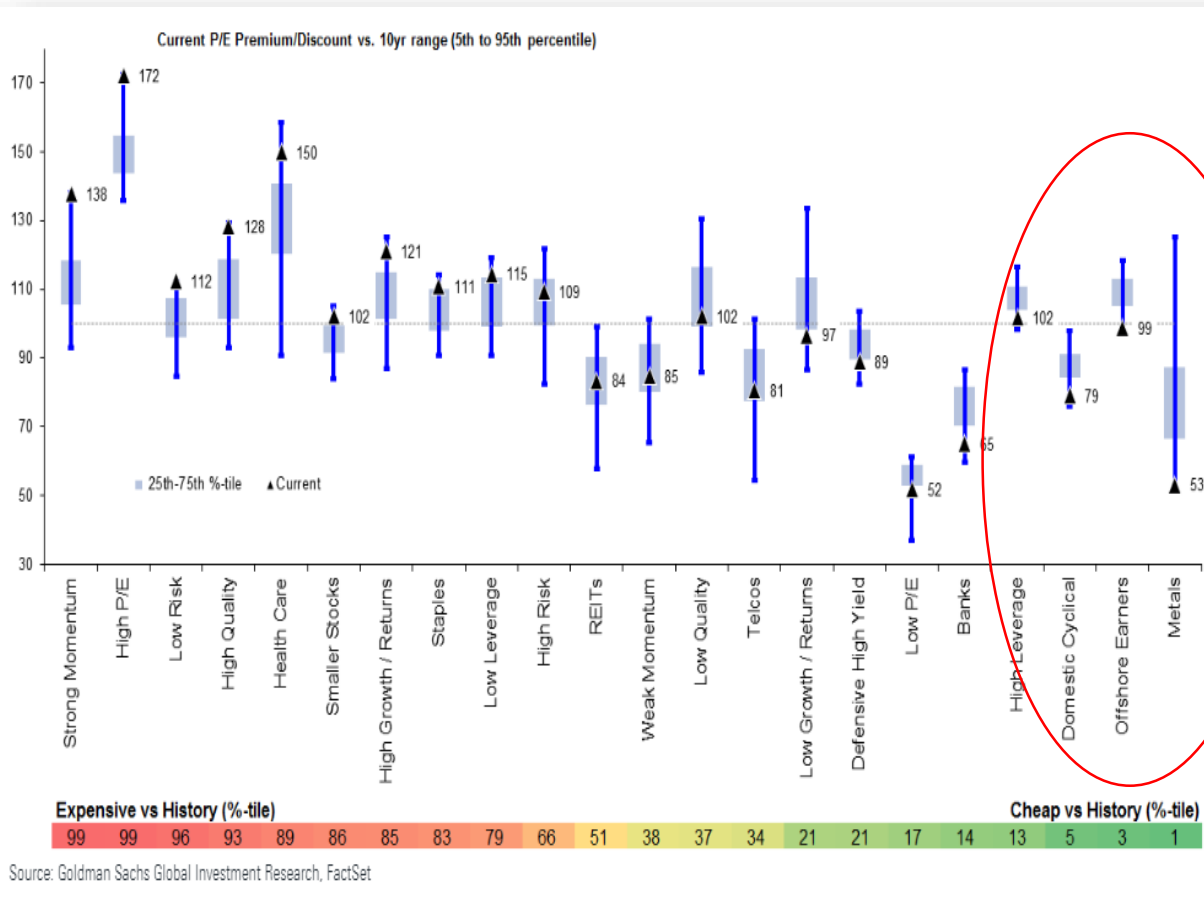


Winners	Losers	Interesting
Healthcare, Consumer stocks, dividend payers	Materials, Energy and Financials	Tech stocks downgraded but outperformed...

Where can value be found in the market?

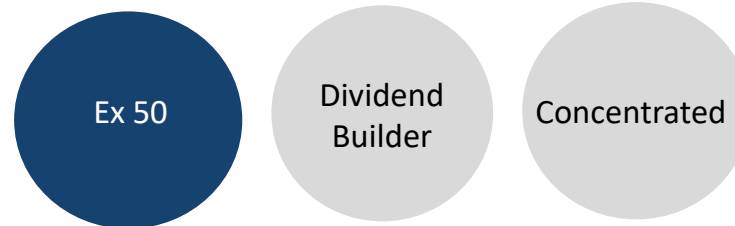
Opportunities the market has left behind

1. Domestic cyclicals
 1. Consumer healthier
2. Offshore Earners
 1. Quality Australian companies de-rated
3. Metals
 1. Iron Ore price normalisation headwind
 2. Short term Global uncertainty
 3. Medium term opportunity



Stock opportunities: portfolio trades

Ralton portfolios



Ex 50 Portfolio trades

Opportunity	Stock	Rationale	Execution	Communication
Offshore Earners	NUF.ASX - BUY	De-risked though Sumitomo placement	T+0	
Consumer	SIQ.ASX - BUY	Improving consumer leading to recovery	T+0	
Metals	MIN.ASX – SELL	Weakening Lithium price outlook	T+0	

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Questions