WEALTH
WEEKEND EDITION

www.theaustralian.com.au

‘WHAT LESSONS SHOULD WE LEARN FROM RECENT MARKET TURBULENCE?’

DON STAMMER

See Don and our other must-read columnists in our weekday WEALTH section

PUBLISHED ON TUESDAYS

Roller-coaster ride to a 17pc gain

Gold’s fall from grace was the most baffling

TIM BOREHAM
MARKETS

AARON FRANCIS

Wilson HTM client adviser Hugh Robertson says some people can at least boast they were multimillionaires for a little while

NOT many investors would be whistling to the bank, yet the financial year that stuttered to the finish line yesterday delivered the best share gains since the post-GFC recovery bounce of 2009.

Not that the headline 17 per cent gain was eked out in a neat, linear way. The year was marked by dramatic ebbs and flows in sentiment and momentum.

In the first months, investors regained faith in equities after the Europe-centred concerns of mid-2012, only to succumb to more angst as US monetary regulators moved to taper their liquidity-boosting efforts.

Octa Phillips head of private wealth Patrick Trindade dubs 2012-13 as “really interesting”.

“It was a tale of two markets, with offshore yield-chasers pushing up the banks, Telstra and other high-yielding stocks while the resource stocks haven’t done much,” he said. “Then we see the yield plays sold off over the last two months, as offshore holders exit due to concerns over the (declining) Australian dollar.”

The ASX 200 index yesterday closed at 4802.59 points, taking the financial year gain to 17.6 per cent. The index, which includes dividends, gained a healthy 22 per cent. The resources sector retreated 10 per cent.

In mid May, the market peaked at 5220 points, a 27 per cent gain but well off the high of 6828 points in November 2007.

The year’s solid overall gains defied a sharp divergence between the robust dividend-paying industrials and the resources sector, now caught in a mire of high costs and ebbing commodity prices.

Healthcare emerged as the best-performing sector, surging 42 per cent on its defensive credentials. The yield-driven financial stocks including the banks (up 30 per cent), consumer staples such as supermarkets (25 per cent and reliable telcos (31 per cent) also outperformed. The laggard gold sector plunged 56 per cent.

“It was a year in which resource fortunes disappeared, but at least people can at least say they were multimillionaires for a little while,” says Wilson HTM client adviser Hugh Robertson.

“I don’t think it’s a year Australia can look back on with any pride. But investors will have done well if they weren’t rabidly exposed to the resource sector; and dividend streams are still pretty good.”

Patersons client adviser Sam Fimis said market volatility would dissuade retail investors from keeping an average 30 to 35 per cent of their savings in cash. “Like my football team in the last quarter, the market ran out of legs after doing all the hard work,” he said. “Investors want to see more stability on Wall Street before they weigh back in, rather than these 100-point daily variations.”

Wilson Asset Management’s Geoff Wilson said the “sell in May and go away” mantra — originally a reference to the lull over northern summer — again proved right.

He said the market performed well in 10 months of the year and that the damage was inflicted in only two (May and June). “It doesn’t feel that good given we were up (by) close to 30 per cent at one stage.”

Mr Robertson said while the “smart money” emerged during the recovery, it had still been difficult to convince retail investors to invest in anything but yield stocks.

“During the good times, all you had to do was open the roof and the money would have flown in and hit you on the head,” he said.

Joseph Palmer & Co principal Alex Moffatt said investors had been “fretting” about the Chinese economy slowing, the pace of the US economic recovery, the Australian dollar’s strength and the Federal Reserve’s intentions with its quantitative easing program.

“Looking back, one wonders what all the fuss was about as Cyprus has now received support monies from the EU and Greece’s credit rating has been recently upgraded.”

Despite widespread fears, the Chinese economy is growing at above government forecasts.

“Even the situation in America is looking marginally better, prompting the central bank to contemplate how they will withdraw stimulus.”

The market’s overall gains conceal the misfortunes of the mining sector. Even BHP Billiton, Rio Tinto and Fortescue Metals are trading at, or below, GFC levels.

Of all the influences affecting the market, gold’s recent precipitous fall has been the most baffling.

After all, bullion is supposed to be a reliable store of value in times of geopolitical uncertainty and inflation (which is likely to re-emerge in the US as the stimulus program is wound back).

“Notwithstanding the major pullback in gold equity prices, many analysts are predicting an even lower gold price,” Mr Trindade said. “That said, I still expect our market to rally into the end of the calendar year although a lot now depends on the timing of any cessation of the US bond buy-back program and/or the direction of Chinese monetary policy.”

Describing a “tumultuous” period for the mining sector, Bizzell Capital portfolio manager Peter Wright said investors had been behaving as if every slated resource project would be initiated — a mindset that had now changed to the radical extreme.

“There’s been a growing level of circumspection from the majors,” he said. “Now every greenfields project is being priced as if nothing will ever happen again, which is just as unsustainable as the attitude 12 months ago.”

Mr Wright said confidence in the junior sector had been shattered. “With the extreme pessimism, volumes are almost non-existent in this space.”

Proving the exception to the rule, graphite hopeful Sirius Resources was the best ASX200 performer, with a stunning 3476 per cent gain. The sector also provided the worst: African copper play Discovery Metals, down 89 per cent, another victim of a stalled Chinese takeover.

S&P/ASX 200 index

Top performers

	%
SIRIUS RESOURCES	▲ 3476.92
MAGELLAN FINANCIAL	▲ 367.47
BLUESCOPE	▲ 188.27
G8 EDUCATION	▲ 161.7
FLIGHT CENTRE	▲ 108.87
TPG TELECOM	▲ 105.85
IINET	▲ 103.95
REA	▲ 103.62
SIRTEX MEDICAL	▲ 97.72
JB HI-FI	▲ 95.69

Worst performers

	%
FLEETWOOD	▼ -69.28
AUSDRILL	▼ -73.62
KINGSGATE	▼ -74.34
BOART LONGYEAR	▼ -75.09
SILVER LAKE RESOURCES	▼ -78.6
ST BARBARA	▼ -78.77
SUNDANCE RESOURCES	▼ -80.29
PERSEUS MINING	▼ -81.95
BILLABONG	▼ -85.29
DISCOVERY METALS	▼ -89.96

Source: Bloomberg

ResMed’s metrics help investors to rest easy

ROGER MONTGOMERY

A KEY investing theme at Montgomery Investment Management is the positive financial impact on healthcare companies from an ageing Western demographic.

Given that the sector is stable and growing, it’s a must-have (at the right price) in our investment portfolios. People are living longer and the population is ageing, but many debilitating illnesses, as well as obesity levels, are on the rise.

These powerful forces will continue to result in an ever-growing reliance on, and demand for, products and services that offer increased comfort and a better quality of life.

One business that stands to benefit from such tailwinds, and that is well-known for delivering positive lifestyle outcomes, is dual-listed ResMed (ASX: RMD). ResMed helps millions of individuals with obstructive sleep apnea sleep better at night.

Regardless of age, this condition untreated also can lead to serious complications, including cardiovascular disease, as well as accidents and, in some cases, premature death. Obstructed sleep apnea is a common and serious disorder that is estimated to affect one in every four people, which means there is an incredibly large addressable market for related products. In adults, the most common cause of OSA is excess body weight with excess soft tissue around the airways leading to blockages when throat and tongue muscles are relaxed. In simple terms, this is the market on which ResMed focuses.

ResMed generates most of its revenues from mask sales (consumables) and flow generators (machines that regulate airway pressure during sleep). Revenues have increased by 20 per cent every year for the past decade.

More recently, the mix in sales has shifted towards consumables. These products require frequent replacement (on average one to two new masks are bought every year), and hence the businesses revenue mix has experienced an ever-growing proportion of recurring sales, which significantly lowers the business’s earnings risk.

Despite the business carrying a market capitalisation of about $7 billion, awareness and transparency of the company’s financial position is second to none among its peer group.

With strong fundamentals, strong business growth, growing recurring revenue, growing earnings and continued market penetration, its bullet-proof balance sheet — built through a generation of family effort and perseverance — provides management with numerous levers that can be pulled to maintain the returns it has delivered in the past 10 years.

Indeed, the company has just announced its 73rd consecutive quarter of earnings growth.

Across the most recent reporting seasons, there have not been many companies increasing their revenues and earnings at double-digit levels. Fewer still are forecast to continue doing so in the years to come. At last count, about 150 of the 600 or so companies that make profits on the Australian Securities Exchange have downgraded their earnings forecasts.

Separating the wheat from the chaff has been increasingly clear as high-quality business models demonstrate their resilience despite slower economic growth.

Going into the 2014 financial year, market expectations for ResMed appears to be relatively conservative, with expectations of 10 per cent earnings growth (whereas in the current year it will have grown by about 25 per cent). We expect the company may do better than that 10 per cent consensus growth. As the business continues to mature, margins are expanding.

ResMed increasingly has been moving its manufacturing to Singapore and Malaysia to reduce costs. Operating leverage continues to flow through and this will result in earnings growing faster than revenues.

With continued longer-term growth dynamics from the rollout of home sleep testing in the US and increased focus on diseases associated with OSA, we fully expect to see a much larger and profitable business in the next 10 years, and therefore it is a business that warrants a position in our portfolios.

Roger Montgomery is founder of Montgomery Investment Management and author of Value.able: How to Value the Best Stocks and Buy Them for Less Than They’re Worth, available from www.rogermontgomery.com.

If history is a trusty guide, smaller listed companies will surge after the federal election

TONY KAYE

THE sharemarket surged about 1 per cent at the opening bell on Thursday morning, barely an hour after Kevin Rudd was officially reinstated as Prime Minister by the Governor-General.

But politics had little, if anything, to do with it. The local market was merely responding to overseas leads, with both US and European bourses having closed about 1 per cent higher.

Yet, if history is anything to go by, there’s a strong chance that the market will rally after the real federal election. That’s because investors and market traders are expecting greater stability and predictability, and hopefully increased corporate activity, once the election is out of the way, irrespective of who wins.

Of all the federal elections held during the past 20 years, there has been only one where the market has not generated a positive return for investors in the three and six-month period afterwards. Interestingly, that was in 2007 following the election of Rudd, although his honeymoon period as prime minister was rudely interrupted by the onset of the global financial crisis.

The post-election rallies of the past also have had a common theme. In all cases, the sector of the sharemarket to show the biggest gains has been the smaller listed companies — especially those most sensitive to changes in government policy and the economy.

Research conducted by Eureka Report has found that since 1993, the S&P/ASX 200 Index has gained an average 3.6 per cent in the 13 weeks after a federal election, and 6.3 per cent after 26 weeks.

In contrast, the S&P/ASX Small Ordinaries Index has jumped 5.4 per cent and 9.1 per cent across the same periods, respectively. The average 26-week performance for the Small Ordinaries during non-election years is 0.3 per cent, while the average for the top 200 stock benchmark is 2.2 per cent.

George Boubouras, chief investment officer for Equity Trustees, agrees the greater exposure small caps have to the domestic economy is a key driver for the sector’s stronger historical performance. “Small caps by their very nature are heavily geared to potential change in government policy,” Boubouras says. He cites medical services providers and gaming companies as examples of industries whose fortunes are heavily dictated by the government of the day.

There are some caveats to the traditional post-election market rallies. After six months or so, markets begin to lose their momentum. Then again, some of that market deflation may not be totally to do with politics, as past market cycles show a tapering in performance in the May-June period.

Given a high percentage of elections have been held later in the year, this could account for part of the post-election trend.

Other factors also come into play and could affect market performance this time. Ongoing concerns over the global economic recovery, including weak points in Europe and flatter growth in China, and volatility in metal commodity prices could affect markets more broadly.

Small resource stocks have most to lose and have been chronic underperformers to date.

“But, on balance, I think there are more reasons to be an optimist than a pessimist,” Eureka Report’s small caps specialist Brendan Lau says. “For one, no one believes that the Chinese authorities would allow their centrally controlled banking system and economy to fall over, regardless of the rhetoric.

“Further, we will either keep getting the QE injection or a pick-up in growth from the US late this year or in the first half of 2014.

“Both outcomes are positive for our sharemarket (in the short term at least); and if we do get a US economic and dollar recovery, this can only be good news for China.”

Other factors playing into the hands of a small caps rally are the positive effects on equities of the low interest rate environment, as investors hunt for higher yields, while the recent fall in the dollar is a driver for exports from the depressed industrial sector. This should flow through to manufacturers and companies linked to the transport, housing, healthcare and consumer discretionary sectors.

Tony Kaye is the editor of Eureka Report.

eureka report

Trial Eureka Report **FREE** for 21 days
Register now at
www.eurekareport.com.au

THE AUSTRALIAN
WEALTH INTELLIGENCE
SERIES in partnership with Perpetual

“Australian equities have served Australian investors very well and I think they’ll continue to do so. Investors are looking for yield, for reliability in that yield and there’s really no better place than in domestic equities for that.”

Hear **Michael Gordon** from Perpetual give his view on equities as well as alternative investment types.

Follow the series at www.theaustralian.com.au/wealthintelligence

HOW DO SAVVY INVESTORS MANAGE THEIR MONEY?

Webinar Two
Tuesday 2nd July 2013

Join Andrew Main and the expert panel as they discuss what Australians should be doing with their savings and superannuation.

Our panel includes:
John Brogden, CEO, Financial Services Council
Peter Kell, Deputy Chair, ASIC
Mark Smith, Group Executive, Perpetual Private
Pauline Vamos, CEO, Association of Superannuation Funds of Australia
Andrew Main, Wealth Editor, The Australian