ASX reporting season: Stick to high-quality stocks that represent value – and don't forget the macro

By Perpetual Asset Management

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The recent full-year ASX reporting season didn't prompt big market movements, but Perpetual's equities team noted a few trends. Head investment specialist James Holt explains

- Rates and consumers dominate macro outlook
- Returns flow from picking winners and avoiding losers
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For stock pickers looking for high-quality companies at reasonable valuations, earnings season is a little like Christmas.

There's plenty of presents in the form of details about revenue, costs and earnings, along with strategy and forward-looking guidance.

The recently competed full-year ASX reporting season was pretty subdued, says James Holt, Head Investment Specialist at Perpetual.

Even though there weren't huge market movements, there were a few trends to come out of earnings season.

"Supply chain disruptions are no longer as big an issue as some thought," Holt says.

"Consumers are amazingly resilient – retail sales have been pretty good – and the question is how long can this keep up?

"The big point of pressure are resources stocks given that Chinese data is pretty weak."

Outside earnings, the dominant theme in recent months has been the run of ASX financial stocks.

"They are like Wall Street's Magnificent Seven tech stocks," Holt says. "They have just gone through the roof."

In recent weeks, Commonwealth Bank has hit a record high while the other big three banks have reached seven-year highs.

IAG hit a five-year high while QBE peaked at a decade high, and Suncorp a 17-year high.

"There is forward-looking risk for those stocks given the consumer can only be resilient for so long and the price being paid for some of those stocks in extraordinary."

Look for high-quality stocks that represent value

In the current market, from both a macroeconomic and stock-picking perspective, it's important to stick to your strategy – high-quality stocks that represent value, Holt says.

"Commonwealth Bank is a high-quality stock, but does it represent value at the moment? Absolutely not," he says.

“Then there’s industrial property group Goodman.

“It has gone from being a high-quality, growth stock at a value price to being a high-quality stock at a relatively high price.

“The question is when do you start trimming positions in these sort of companies? The quality hasn’t changed but the valuation has.”

Outperforming the market is also about not holding certain stocks, Holt argues.

“Woodside is the dominant energy company in the market, and we have avoided it for a while. In the past year it is down 35 per cent,” he says.

“It isn’t just about picking winners. It is also about avoiding losers.”

Don't forget the macro environment

Stock pickers should focus on companies but sometimes need to keep an eye on the big picture,” says Holt.

“You still need some macro awareness, so you don’t get yourself in to too much trouble.

“One big macro factor in recent weeks is the un-inversion of the yield curve,” he says.

“For the last couple of years, the 10-year bond yield has been lower than the cash rate. But now the cash rate has fallen below the 10-year bond yield.”

"Since 1969, un-inversion has always presaged a recession in the US", says Holt.

“The equities market is the confident, entrepreneurial asset class whereas the bond market is the sober, realist asset class. When they disagree the bond market is usually right"

“You need them both, and you should take note of the bond market when big changes happen,” he says.

James Holt is head investment specialist with Perpetual’s Aussie equities team.

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