

State Street Australian Equity Fund

Confession season stems equity rally

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- Best and worst of the earnings season
- Dispersion is the stock pickers friend



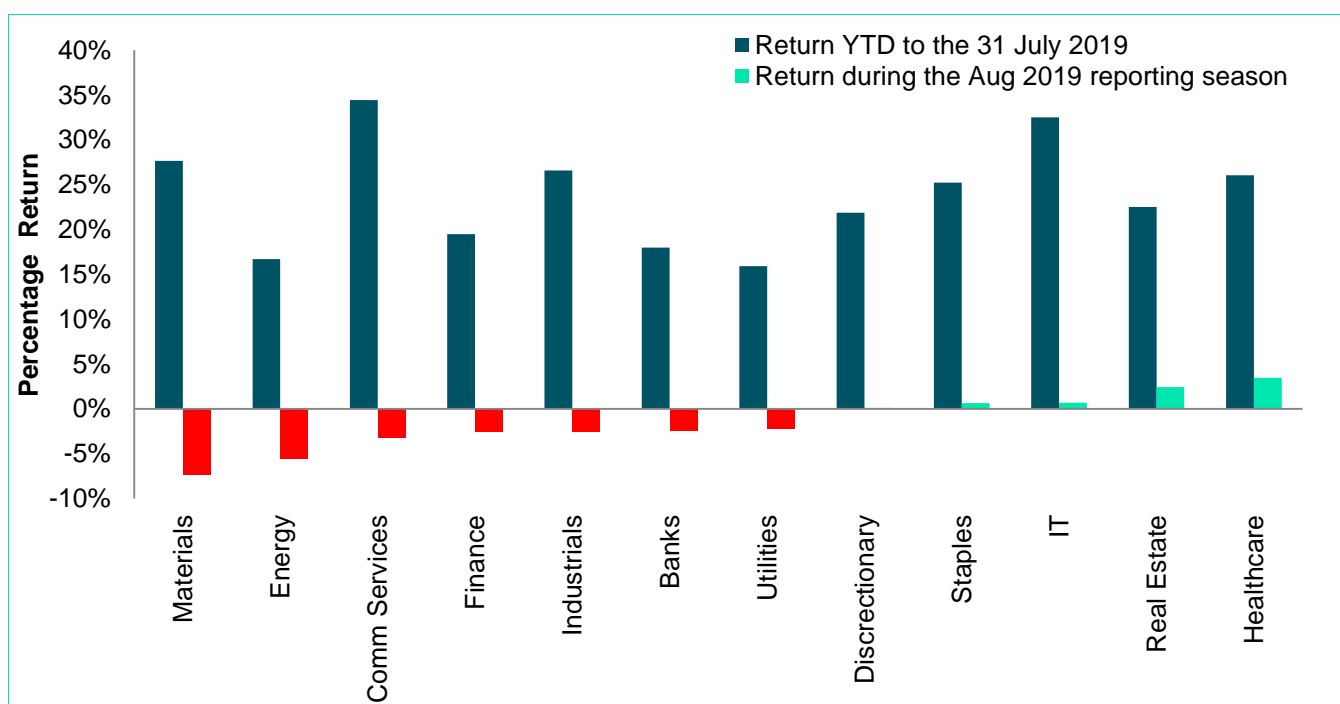
Bruce Apted
 Head of Portfolio Management – Australia Active Quantitative Equities

Earnings and prices both move down in August

Leading into the August reporting season the S&P ASX 300 index had rallied significantly up 23.4% to the end of July 2019. With earnings subdued the rally has largely been driven by valuation uplift. The August reporting period often referred to as confession season stemmed the equity market rally. The earnings season in August was one of the weakest in many years with earnings estimates for Australian companies revised lower by -2.7%. Not surprisingly the Australian equity market ended the month lower by -2.3% marking the first down month in 2019.

As can be seen in figure 1 after some stellar performances year to date most sectors generated negative returns in August. Healthcare, Real Estate, Information Technology, Staples and Discretionary bucked the downtrend in August.

Figure 1. The majority of sectors experienced negative returns in August 2019

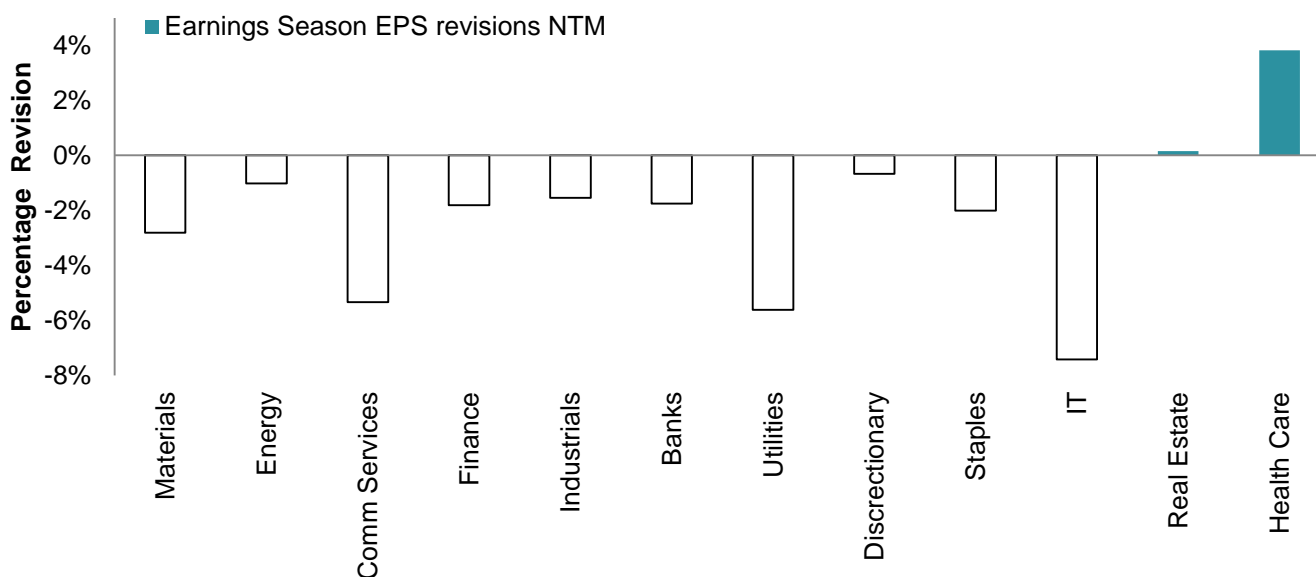


Source: Thomson Reuters, SSGA as at 31 August 2019. Past performance is not a reliable indicator of future performance.

Best and worst of the earnings season

Prior to the August reporting season the Australian corporate earnings landscape was subdued. The majority of S&P ASX 300 sectors including the Banks, Financials, Energy, Utilities, Information Technology and Healthcare all experienced mark downs in the expectations for their next year's earnings. The market as a whole was being supported by only a handful of sectors namely Materials (iron ore), Consumer Staples, Real Estate and Communication services. As the reporting period progressed the outlook slowly deteriorated. After all the companies had provided updates and re-issued guidance the S&P ASX 300 index had been revised lower by -2.7%. Figure 2 below highlights the broad based downgrades witnessed across the majority of the S&P ASX 300 index. Health Care and Real Estate were the only two sectors to see upgrades to expected earnings.

Figure 2. Expectations for company earnings declined across most sectors in August



Source: Thomson Reuters, Datastream, SSGA as at 31 August 2019. Past performance is not a reliable indicator of future performance.

Revenue, Costs, Capital Expenditure and Dividends

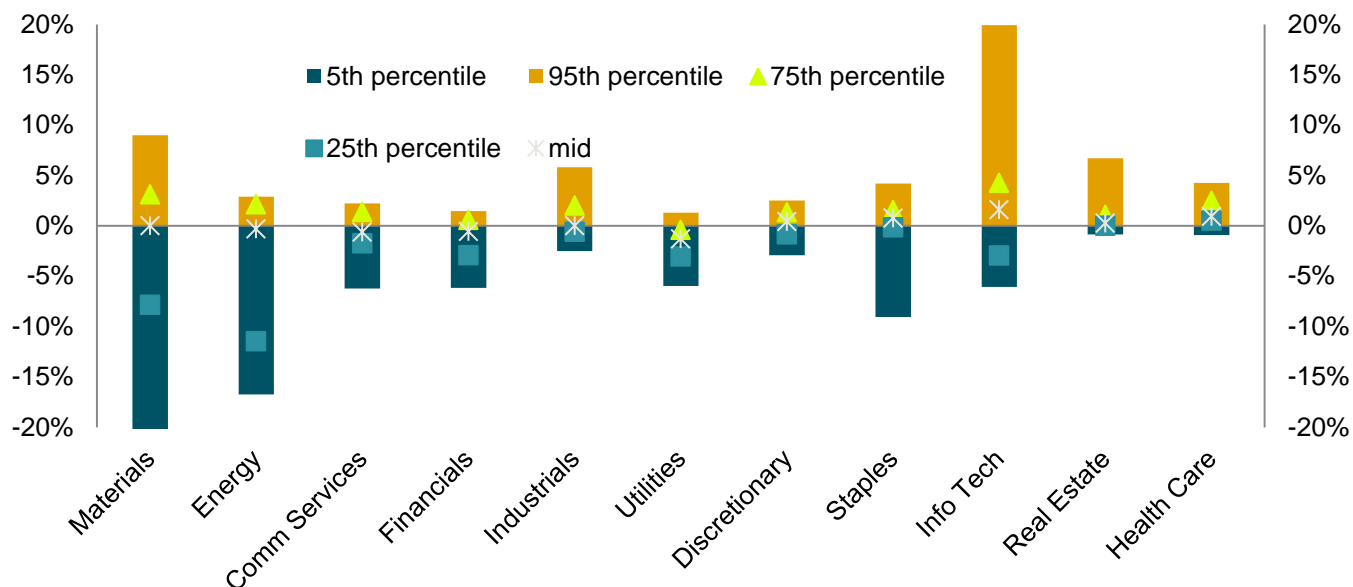
Looking beyond the earnings numbers we observed reasonable revenue growth with sales improvements in all sectors except for Communication Services. Commentary from companies highlighted cost pressures increasing from Discretionary +1.2%, Industrials +1.2%, Mining +3.3%, and Utilities +2.6%. With the decline in earnings it was not surprising to see the expectations for dividends decline as well but the declines were more muted, down only -0.4% over the August confession season. Additional capital management in the form of special dividends and buy backs remained a theme in August. In addition the market remains in a capital expenditure upgrade cycle. The most notable increases are expected across Materials, Health Care and Industrials.

August was the first down month in 2019 and the negative earnings trends saw investors favour less volatile companies and those with higher operating margins. Often during reporting season we observe the most heavily shorted companies outperform when expectations aren't quite as dire as predicted. In the August reporting season we did observe this within some cohorts most notably within retail oriented companies.

In our monthly note we have made many observations about sector trends that we have observed on average over the reporting season. While these relationships are accurate on average they often hide the true diversity that we observe within sectors. To highlight the extent of variation across sectors we have included figure 3 which illustrates the wide range of earnings revisions observed across S&P ASX 300 sectors. Even when the average is negative we almost always observe companies that buck the trend. The materials sector is a good example where some companies achieved high single digit upgrades while other experienced downgrades in excess of

20%. Across all sectors we observed a huge variation and this is indeed quite typical. As stock pickers it is our job to navigate this dispersion, looking for the best companies that can provide a balance between upside return with acceptable levels of downside risk.

Figure 3. Sector dispersion provides opportunity for careful stock selection



Source: Thomson Reuters, Datastream, SSGA as at 31 July 2019. Past performance is not a reliable indicator of future performance.

The bottom line

Whilst the earnings season was on average disappointing and whilst many areas of the S&P ASX 300 index is overly expensive we do find that we can always find investments to include in the State Street Australian Equity Fund. By carefully assessing the opportunities that offer the best combination of quality, value, and improving outlook with an acceptable level of risk we can look to build a balanced portfolio designed to generate excess return with lower levels of volatility.

Portfolio positioning and performance¹

The State Street Australian Equity Fund outperformed its benchmark during August. Good stock picking within Real Estate (Shopping Centres Australasia) and a lower exposure to Metals & Mining (ex Gold) were the key contributors towards relative performance. On the other hand, negative stock selection within Materials ex Metals & Mining (Orora) and Gold (Regis Resources) were key detractors. Our August portfolio rebalance involved some minor tweaks across the board; as we added more quality defensive names like Wesfarmers and Ramsay Health Care, at the same time taking profit from Charter Hall and reducing our exposure to names that have suffered notable falls in sentiment (AGL and Brambles).

¹ Bloomberg Finance, L.P. SSGA. As at 31 August 2019. Past performance is not a reliable indicator of future performance. This information should not be considered a recommendation to buy or sell any security or sector shown. It is not known whether the securities or sectors shown will be profitable in the future. Characteristics are as of the date indicated, subject to change, and should not be relied upon as current thereafter.

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