

THE AUSTRALIAN

Getting world class returns from a dull ASX

STIRLING LARKIN THE AUSTRALIAN NOVEMBER 14, 2015 12:00AM

YTD total returns on major equity markets/regions



Equity returns. Source: TheAustralian

It should not come as much of a surprise to learn that the Australian stockmarket has been the worst performer, in terms of total returns, this year to date.

Total returns include dividends and given that the ASX 200 is well recognised as being a higher-yielding dividend market, this indictment has even more sting in its tail.

As the graph highlights, alongside Canada, the Australian bourse has not only underperformed other developed markets but also those in China and eurozone — two blocs that have received almost all of the attention and concern this year.

What is interesting to observe is that unlike Japan, Europe or the US, where stockmarkets are not necessarily a reflection of their underlying economies, because of the distortions achieved through unconventional monetary policies, the Australian stockmarket is, on a whole, reflective on its real underlying economy.

This economy is paying the belated cost of avoiding a cyclical recession since 1991 and it is also suffering from a commodity super-cycle heading in only one direction.

The evidence for this can directly be seen in the weekly data on iron ore freight activity at major ports in Australia and Brazil, which indicates that shipments continue to decline from their record highs.

Even with a reduction of Brazilian supply following the tragic Samarco accident, the scale of global iron ore oversupply means that ore prices will only continue to head in one direction for now.

But as well as seeking greater diversification through global markets, Australian ultra high net worth investors are looking to smart domestic asset and hedge fund managers, who have found opportunity

and returns within the broadly underperforming Australian stockmarket.

One such example has been Ophir Asset Management, who manage a portfolio of Australian listed stocks outside the ASX 100 and has returned 265 per cent before fees, since inception in August 2012 and 45.0 per cent year-to-date.

According to portfolio manager Andrew Mitchell, their success has been found by constructing a portfolio away from resources and towards companies leveraged to Chinese consumption and the recent free trade agreement with China, which include Blackmores (BKL), Bellamy's (BAL) and A2 Milk (A2M).

According to Mitchell, "we really try and stay away from cyclical companies. We are looking for good management running a business in a GDP agnostic market that is able to capture market share and these companies will continue to grow no matter what the cycle is. When good management is able to add an acquisition or two ... that is nirvana."

Ophir has also looked to those focused on the US economy and placed emphasis on companies leveraged to the US economy and the US Dollar and has found several Australian companies kicking goals in the US at the moment.

These include intellectual property services firm Spruson and Ferguson (IPH), medical device company Sirtex (SRX), telco services provider Speedcast (SDA) and pharmaceutical group Mayne Pharma (MYX): all of these companies are growing strongly overseas.

Mitchell stresses that "as an Australian fund we don't need to be handcuffed to the Australian economy." While Australian managers such as Ophir have found success by identifying Australian businesses that position well with the global economy, other managers have found opportunity and returns by more technical differentiation.

One such example has been Qato Capital, which recently won the best emerging manager award at the Australian Hedge Fund awards and which has returned 32.72 per cent net of fees, since August last year.

According to CEO, Ben Silluzio, "this was achieved because, firstly, our market neutral fund isn't as volatile as the broader market and we deliver uncorrelated returns by investing in long 'low-risk' and short 'high-risk' companies, therefore we are not impacted to the same degree by broader market contractions."

Silluzio adds that "secondly, our technical methodology selects companies with improving fundamentals (long) and deteriorating fundamentals (short), allowing us to generate returns both on our long and short positions."

Recent "long" examples for the fund have included

- Qantas (QAN),
- gaming machines group Aristocrat Leisure (ALL)
- Casino group Echo Entertainment (EGP),

While recent examples of the fund's "shorts" have included companies such as

- BHP (BHP),
- mining services company Downer EDI (DOW) and
- Alumina (AWC).

Of course, one does not have to only allocate to a professional manager to achieve outperformance but given that the Australian economy is stumbling on so many fronts, the challenge to identify the cream within the crop often becomes very difficult.

For Australian UHNW investors who are often more focused on their foundation businesses, the suboptimal Australian economy is, in itself, a far greater and immediate concern.

The silver lining of having an economy that does, broadly speaking, reflect its true underlying real economy — for better or worse — is the fact that when distortions in valuations do appear, the global investor can identify them more easily and potentially arbitrage mispricing.

And as global policy uncertainty has been well correlated with international equity valuations over the past decade and the jump in Chinese uncertainty looks to have contributed to a marginal rerating of global P/E ratios, the Australian market should benefit when underperformance reverses; at least in the short term.

An important indicator of undistorted value can be seen in the spread between trailing dividend yields, which for the ASX 200 have recently touched 5 per cent, compared to Australian bond yields at 2.7 per cent.

This gap between the two is the largest on record, outside of the Great Recession and this tells us that, even with the Australian bourse being the worst performer year-to-date, investors continue to support growth assets, despite the undeniable macroeconomic bad news written on the wall.

For those that accept that the Australian economy is currently a kite dancing in a global hurricane, there is a place for smart professional managers within portfolios.

Larkin Group is a Wholesale Wealth Adviser focusing on high yielding global investments
www.larkingroup.com.au (<http://www.larkingroup.com.au>)