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Quiet achievers have year's top value fund most bullish

Performance

Luke Housego

Out-of-favour stocks with proven earnings are tipped to deliver this year, says the co-founder of Collins St Asset Management, Michael Goldberg, whose value fund was the top-performing long-only Australian shares strategy last year.

After a year dominated by a heated growth-led recovery, the value-oriented boutique is positioned to capitalise on renewed interest in cyclical exposures, backing names such as metallurgical coal miner Coronado Global Resources.

Collins St Value Fund beat 130 other strategies to take the top spot in Mercer's survey of fund manager performance for 2020, with a 12-month return of 43.6 per cent before fees.

Coronado is among the high-conviction positions held in a portfolio limited to just 10 exposures, and it is a marker of Collins St's focus on earnings over sentiment.

The failure to distinguish between met coal as a steel-making ingredient and thermal coal, which has been the focus of efforts to cut the emissions of electricity production, has created an opportunity, Mr Goldberg said.

"When people talk about coal they lump it all into the same basket," he said. "But here's an asset that is actually incredibly important to infrastructure going forward - it's one of two key ingredients into steel."

Every tonne of steel made in a blast furnace uses 780 kilograms of met coal.

But while iron ore miners have been riding a wave of record prices, met coal miners have struggled under the weight of informal import restrictions from China.

The weak commodity prices resulted in a 40.9 per cent drop in coal revenue for Coronado in its last half-year report, which the company partly attributed to the impact of China's import restrictions on its US exports.

But with the trade in met coal expected to rise by 55 million tonnes over this year and next as industrial production recovers, prices are expected to recover, according to the Office of the Chief Economist.

The push to reduce the emissions intensity of steel - each tonne produces about 1.85 tonnes of carbon dioxide, equating to about 8 per cent of global carbon dioxide emissions, according to McKinsey - is also not a concern for the fund manager.

With steel production still heavily reliant on coal as an input, the stock picker said the earnings outlook for exporters was unlikely to change in the



Not all coals are equal, and people need to differentiate, says Collins St Asset Management co-founder Michael Goldberg. PHOTO: EAMON GALLAGHER

Best in a broken year

| Top managed funds, one-year performance to Dec 2020 (% change) | |
|--|-------|
| Collins St Value Fund | +43.6 |
| Hyperion Australian Growth | +33.7 |
| First Sentier Australian Equities Concentrated - Growth | +24.5 |
| Bennelong Core Equities | +24.3 |
| Katana Australian Equity Fund | +24.1 |
| ECP AM All Cap | +24.0 |
| First Sentier Australian Equities Large Cap - Growth | +23.8 |
| Forager Australian Value | +22.9 |
| Platypus Australian Equities | +19.2 |
| Bennelong Concentrated Equities | +18.6 |

SOURCE: FINANCIAL REVIEW

short term. And if it does change over the longer term, Mr Goldberg said, the fund was ready to respond.

Steel production alternatives that reduce or eliminate the use of coking coal include scrap-steel-based production and processing methods that use gas or hydrogen.

Canvassing the market, Mr Goldberg observed how share prices have risen faster than forecast earnings. "If you forced my hand to look at the market in general as a whole... it does look similar to 2019, in terms of market multiples being very, very high," he said. "But within that market of stocks, there are actually still many opportunities."

Collins St is also invested in uranium, a raw material that has received increasing attention as economies look for ways to cut emissions from the electricity sector while ensuring there is dispatchable power to offset the intermittent production from renewables.

The fund holds a basket of ASX-listed companies in the commodity class,

including Lotus Resources, Vimy Resources and Peninsula Energy.

Resources were also a key contributor to Collins St's market-leading performance last year. The fund manager had built a large exposure to gold as equity prices pulled ahead of earnings prior to any knowledge of the virus in China.

And with a large cash position held for similar reasons, the fund capitalised on the opportunities that followed the turmoil of early last year, selling its gold exposure and snapping up heavily sold names such as National Tyre & Wheel.

The surge in the prices of underperforming industrial names and other cyclical companies in the December 2020 quarter boosted the performance of value managers, Mercer's survey found.

The high-profile growth manager Hyperion took out second spot in the Australian equities category, with a 33.7 per cent return for 2020. Third place also went to a growth fund: First Sentier's Australian Equities Concentrated (Growth) strategy.

Fundies keep wary eye on inflation risk

Price pressures

Robert Guy

Inflation has been missing in action for a decade but fund managers and strategists caution that resurgent price pressure may emerge as a risk over coming years given the rebound in global growth fuelled by massive stimulus.

Traditional measures of inflation remain subdued but market-based gauges of inflation expectations have risen strongly since their March lows as investors price in a recovery, higher commodity prices and a waning in deflationary trends like globalisation.

"Expectations are a long way ahead of the current reality but markets have seen something that gets them a little bit excited about inflation rates," said GSFM Funds Management strategist Stephen Miller.

That excitement has been visible in so-called 10-year breakevens, which measure the difference between nominal bond yields and inflation-adjusted bond yields. Both Australian (at 1.8 per cent) and US (at 2.09 per cent) breakevens are hovering near their highest levels since late 2018.

"Risk markets are largely inured to the notion that there's any sort of inflation in prospect," Mr Miller said. "But there are signs that bond markets are beginning to awake to the prospect that inflation might be out there."

"We've seen bond yields rise, albeit modestly, we've seen curve steepening and we've seen market expectations of inflation start to creep up from the lows we saw back in March this year."

The Australian 10-year yield has climbed to 1.08 per cent from 0.61 per cent in March. The US 10-year has risen to 1.11 per cent from a low of 0.5 per cent in August.

Australian investors will get an update on price pressures when the fourth quarter consumer price index is released next week. Commonwealth Bank expects headline CPI to increase 0.9 per cent in the quarter, for a year-on-year rate of 0.7 per cent.

The Reserve Bank of Australia has committed not to increase interest rates until inflation is "sustainably" within its target band of between 2 per cent and 3 per cent.

The central bank's relaxed approach to inflation is aimed at reviving the economy and boosting the jobs market. December jobs data will be released tomorrow: 50,000 new jobs are forecast to have been created.

"We don't see inflationary pressure over the next 12 months," said Tribeca portfolio manager Jun Bei Liu.

"However, given the amount of activ-

ity at the moment globally, how quickly it's picking up, as well as the strong stimulus globally that will stay in place, we certainly see inflationary pressure building over the next two years or so."

Muted inflation combined with low interest rates is helping fuel the run in stocks. Low bond yields means investors are confronted with an environment of TINA: There is No Alternative but to own stocks.

"The reality is we live in an economic environment of not much growth, interest rates are very low, and with inflation staying low and assuming that stays the same, it is a reasonably fertile environment for stock picking," said Munro Partners chief investment officer Nick Griffin.

While understanding why investors were buying cyclical stocks on a six- to 12-month view given the anticipated rebound in growth, he said stronger longer-term portfolio performance would come from stocks exposed to structural growth themes that offered growth double or triple that of GDP growth.

While high-performance computing and digital enterprise were two major themes for Munro Partners, the fund's biggest exposure was to stocks exposed to climate change.

There are signs that bond markets are beginning to awake to the prospect that inflation might be out there.

Stephen Miller, GSFM Funds Management strategist

"We think this is really the next big structural opportunity in the world for the next 20 years," Mr Griffin said.

"Clearly, Joe Biden winning the presidency was helpful, but it was all going to happen anyway."

Ms Liu sees five major themes driving the markets over 2021: return to work, reflation, higher dividends, housing, and structural growth.

She said analysts were "absolutely underestimating" the operating leverage of retailers JB Hi-Fi and Harvey Norman as the housing market continues to strengthen.

She also talked up the need to have exposure to structural growth plays, saying recently listed Nuix offered "enormous" exposure to growth of the cloud, big data and security.

Ms Liu expects an increase in dividends of 30 per cent in the 2021 financial year.

Domino's grows its slice of the pie

Takeaway

Sarah Turner

Macquarie has turned bullish on Domino's Pizza Enterprises, confident that the company's COVID-19 tailwind won't disappear in a hurry.

The bank's analysts upgraded Domino's Pizza to outperform from neutral in part because they expect the company to continue to produce double-digit annual growth.

They also highlighted that Domino's path of medium-term earnings rev-

isions could potentially skew higher than current expectations.

Domino's is also likely to pursue growth through acquisitions, the analysts said. "Further accretive acquisitions [are] possible if not probable."

The pizza company will be a "COVID-19 EBITDA beneficiary going forward", Macquarie believes, with margin expansion driven by strong same-store-sales growth, store rollouts and the need to provide less support to COVID-hit franchisees.

In 2020, Domino's extra COVID-19 related costs totalled about \$8 million.

Sales are expected to grow, the analysts said. They estimate that there was a 25 per cent to 35 per cent shift to digital delivery during the pandemic and expect this to continue even as the pandemic fades.

Industry feedback suggests that Domino's is taking market share from Pizza Hut and independent pizza providers "driven by a superior delivery offering," the analysts said.

Macquarie has lifted its price target to \$90.30 a share, from \$72.10. Domino's shares closed 8 per cent higher at \$89.59.

Goldman backs Atlas Arteria

Infrastructure

Robert Guy

Goldman Sachs raised its rating on toll road operator Atlas Arteria to buy from neutral on expectations of a rebound in traffic and increased distributions.

The broker said the outlook for the owner of roads in France and Germany was dependent on a recovery in traffic after second wave nation-wide lockdowns in November.

It said the rate of recovery had "surprised us", adding the rollout of the French vaccination program reduces

the risk of subsequent lockdowns.

Atlas Arteria's distribution profile is expected to "step up" over the next two to three years.

The broker said the internalisation of management, simplification of the ownership of the APRR business, and recapitalisation had created a more transparent and lower risk exposure to the underlying portfolio.

Estimates for earnings before interest and tax were raised 7.5 per cent for 2020 and trimmed 2.7 per cent for 2021. Goldman Sachs increased its 12-month price target by 18.9 per cent to \$7.25 a share.

