WATERHOUSE
WEALTH MANAGEMENT PTY LIMITED

Quarterly

SUMMER 2020

INSIDE:

DNR investment review

BY **Jamie Nicol**

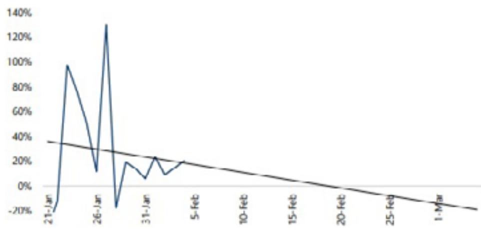
January started with a bang and ended with a whimper (or a cough) thanks to Coronavirus. This month we assess the impact of the virus and the major issues impacting the positioning of the portfolio.

CORONAVIRUS

Following a very strong start to the year for the markets, the latest virus outbreak has triggered some selling and a further rotation into defensive growth names. Given the uncertain nature of the outcome of a global virus, it can attract concerning headlines. We provide some analysis of the potential impact below:

1. Historically we have a precedent with the SARS outbreak, which killed 774 people and which had a mortality rate of 9.6%. At this point, Coronavirus has had a mortality rate of 2%. However, it is still in its early stages. There have been circa 43,000 confirmed cases worldwide. *Source: World Health Organization, 11 February 2020*
2. During the SARS outbreak, the Chinese government was secretive and tried to hide the fact until it was too late. This time they have been more transparent and taken aggressive actions to contain the virus, including locking down a city with 11m people.
3. Historically stocks and economies recover quite quickly from these types of events. From an economic perspective, SARS took around 1% off Chinese economic growth in 2003 but had no lasting impact on the economy. This time we expect a greater global impact, given the relative importance of the Chinese economy and the faster action taken to contain the virus. For stocks exposed to tourism and China, there can be a short-term hit to profits but we would not expect it to be long lasting (and therefore not impact the long-term cash flows from which we value businesses).
4. From a trading perspective the markets have enjoyed the strong start to the year, and therefore can be vulnerable to a pick-up in volatility. We would expect concerns regarding the virus to remain at the forefront of markets until signs that the growth rate has peaked. We will be looking for good-quality businesses which become oversold during this period. The chart below highlights new cases. There is some suggestion of a slow-down in the rate of change but it remains at an early stage of uncertainty.

Day-on-day % change in new 2019-nCoV confirmed cases



Source: National Health Commission of the PRC, The Lancet. Note: The trend line shown is based on the first 15 data points and thus is subject to early volatility. It will become a better predictor as we move towards 30 data points.

ARE DEFENSIVE COMPANIES TOO EXPENSIVE?

The impact of the virus is a further move by investors into defensive companies. Defensive growth names such as Woolworths Group (WOW) and CSL (CSL) have performed exceptionally well. Investors are being squeezed into equities via very low interest rates. Yet uncertainty due to low global growth, the virus and the political environment means investors are chasing a limited number of high-profile names.

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In some cases, this is causing extreme positioning. We display some examples of the various valuations in a number of sectors below. It is not so simple as to sell the expensive names and buy the cheap names. In many instances, stocks are either cheap or expensive for a reason. However, this can present stock-picking opportunities.

An example of such an opportunity is currently in the banks. Commonwealth Bank of Australia (CBA) is the market leader with a strong franchise and good IT. It deserves a premium. Investors are favouring it, given there is no change in leadership at present and a potential buy-back. However, it faces many of the same risks as the other banks – low interest rates and limited credit growth, meaning earnings growth is difficult; greater regulatory scrutiny and greater competition are significant headwinds.

Alternatively, Virgin Money UK (VUK) has been at the epicentre of uncertainty thanks to Brexit and, as a consequence, it is trading cheaply yet offering better growth than the major banks, with a cost out program and an opportunity as a challenger bank to win share. We are seeking to exploit these types of opportunities.

Industry	Price/ Earnings Multiple
Financials	
Commonwealth Bank of Australia (CBA)	18.1
Virgin Money UK (VUK)	7.1
Consumer Staples	
Woolworths Group (WOW)	29.5
Metcash (MTS)	11.8
Health Care	
CSL (CSL)	45.3
Healius (HLS)	18.6
Communications Services	
Domain Holdings Australia (DHG)	54
Nine Entertainment Co Holdings (NEC)	15.5

HOW MUCH TO PAY FOR GROWTH IN A LOW-GROWTH WORLD?

While investors are happy to pay a premium for defensive names, they are also paying a premium for high-growth companies in IT and Health Care. This is understandable given the disparity in opportunities at present. Many old-world companies face disruption to business models and are to be avoided. Low interest rates and low growth suggests those businesses with a solid growth opportunity deserve a premium, while some caution is warranted for the more extreme valuations. We remain cautious regarding some stocks facing disruption but see relative value in stocks with a solid growth outlook.

We are particularly interested in opportunities where stocks with a solid, long-term opportunity come under pressure due to Coronavirus or due to short-term earnings concerns. Stocks such as SEEK (SEK) look expensive, based on near-term multiples, and face risk from the virus outbreak, yet have a very strong long-term opportunity as they reprice their services and push into new markets. One way to examine the difference is to compare PEG ratios (a comparison of the price-to-earnings ratio (PE) versus growth of various players). Some growth names offer more attractive opportunities relative to the defensive names.

Company	Price/ Earnings to Growth Ratio
Crown Resorts (CWN)	21
GPT (GPT)	8
ASX (ASX)	8
Commonwealth Bank of Australia (CBA)	6
Coca-Cola Amatil (CCL)	4.5
SEEK (SEK)	1.8
Iress (IRE)	1.7
James Hardie Industries (JHX)	1.5
Treasury Wine Estates (TWE)	1.4

WHAT WOULD CAUSE A FURTHER ROTATION INTO VALUE?

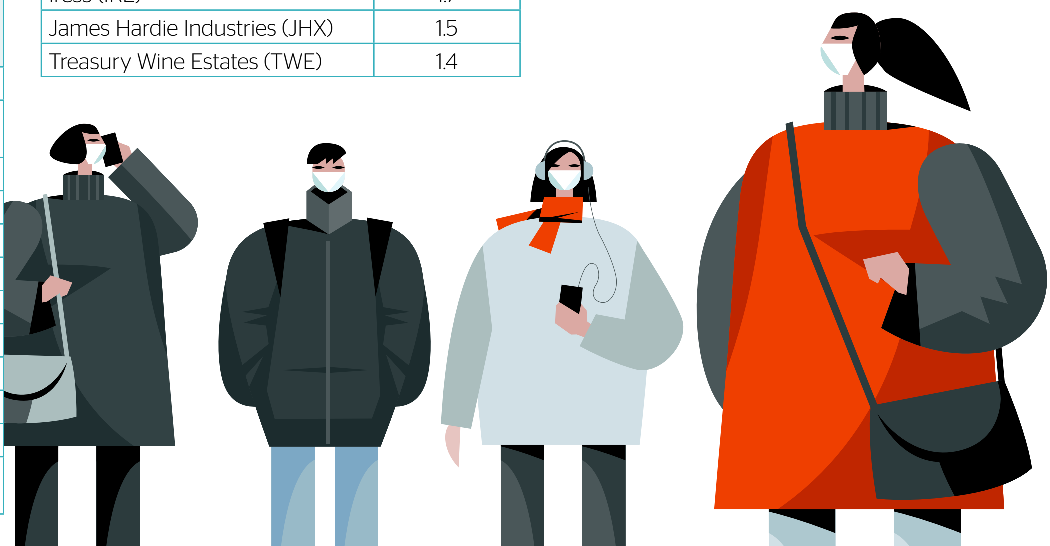
The growth names above offer relative value in a growth constrained world. Deeper value tends to be in more problematic areas of the market (UK exposed, domestic building cycle, domestic retailers, casinos, financials) or in those areas with greater cyclicality such as resources. The opportunity for a further rotation into these stocks appears to be tied to a steepening of the yield curve or a pick-up in global growth. The major central banks are seeking to stimulate inflation (without much success). Political tension is increasingly focused on issues of income inequality and possible resolution could be aggressive fiscal stimulus and monetisation of debt. This can have a profound impact on the USD and long-term interest rates, which would have major implications for the leaders in the market.

At present the likelihood of such a rotation appears low. However, this is very much the consensus view. Modest signs of a pick-up in global growth have likely been pushed out by the Coronavirus outbreak. We have been modestly adding to some value opportunities across resource names.

Major risks

- **Interest rates:** low interest rates are the prime driver of markets at present. Any change to the inflation outlook would have significant impact on valuations.
- **Political environment:** it is an election year in the US, which adds potential uncertainty.
- **Growth:** Potential disruption to global growth is largely expected by the market, so the alternative, which is a pick-up, could have a greater impact on valuations of defensive holdings.

Article source: DNR Capital



Factors to consider when investing in direct shares

BY Robin Bowerman

Australia has one of the highest rates of share ownership in the world. According to an ASX Australian Investor Study, approximately 37% of Australian adults hold shares either directly (31%) or indirectly (7% derivatives and 11% invest in other on-exchange investments), making us a country with one of the highest rates of share ownership in the world.

Some investors find buying individual shares enjoyable and rewarding. Others may find it deadly dull, time-consuming and too risky. While there is no definitive answer as to whether you should invest in direct shares or not, your decision should be based on personal interest, financial wherewithal and your individual investment goals.

If you are thinking about taking the leap to invest in direct shares, here are some factors to consider:

DIVERSIFICATION IS KEY

The ASX found that a majority of investors don't know if their investments are diversified, or that they do not have diversified portfolios (55%). This is further proven by the finding that 75% of share owners only hold Australian shares.

Instead of putting all your eggs in one basket (or market) and buying shares in a single company or sector, there are a number of advantages to diversifying your investment across a variety of companies. In doing so, you can reduce your risk - when some shares struggle, others are likely to deliver stronger returns that limit your downside, giving you the confidence to remain invested even during periods of market turmoil.

But diversification involves much more than buying a collection of shares. The average Australian share portfolio is invested across five companies. If just one of those companies was consistently performing badly, that would mean that at least 20% of the share portfolio is delivering negative or poor returns.

To be properly diversified, you will probably need shares that represent different company sizes, industries and locations. You will likely need to assemble shares across a group of companies that are not likely to move in the same direction at the same time. That might mean purchasing shares in dozens, or hundreds, of companies. In other words, you will not only need the resources to invest but you will also need to pay the fees on each trade.

In contrast, an exchange-traded fund (ETF) provides a low-cost diversified portfolio for as little as $500, making it a more accessible choice for many investors.

You could do a little of both, or more accurately a lot of one and a little of the other, to help with diversifying your investment portfolio. With this approach, you would invest the bulk of your funds in a managed fund or ETF to easily achieve diversification and purchase a few direct shares in small amounts on the side. This allows you to scratch that "I know this is the next big thing" itch without risking your life savings. Some financial advisers for example set up portfolios with a % allocation for the investor to use to take their direct bets.

RECOGNISE THAT IT'S HARD TO BEAT THE MARKET

Despite having the experience, time, and resources, the vast majority of professional investors often fail to beat market indexes. As such, a realistic perspective of your expected returns can help you manage your expectations. You should also be prepared to dedicate time to research companies so that you understand what you are investing in. Even so, history has often shown that investment success is more often delivered by time in the market, rather than by timing the market.

UNDERSTANDING STOCK RISK

You may believe you can forecast the next winning industry – technology stocks for instance. But will you be able to pick the right stock? What if, in the early 2000s, you'd bought the next WorldCom instead of buying Apple and Google? Arguably the single biggest challenge facing direct share investors selecting high-fliers before gains are built into the price.

KEEP YOUR EYE ON TAXES

When you buy and sell shares, you may generate taxable gains. Frequent trading is likely to increase these taxes. Keep an eye on how your decisions to buy and sell may impact your tax bill.

No matter what you decide, start by identifying your goals and then create a low-cost, diversified portfolio to achieve them. (This article has focused on shares, but bonds should also play a role in most portfolios.) Then, fill that portfolio with direct shares, funds, or some combination of the two based on your interests, financial capacity and willingness to take on additional risk.

Article source: Vanguard Investments Australia

First Home Loan Deposit Scheme (FHLDS)

The First Home Loan Deposit Scheme is a Australian Government initiative to support eligible first home buyers purchase a home sooner. It does this by providing a guarantee that will allow eligible first home buyers on low and middle incomes to purchase a home with a deposit of as little as 5%. The Scheme will support up to 10,000 loans each financial year, starting from 1 January 2020..

ARE YOU AN ELIGIBLE FIRST HOME BUYER?

The Scheme is open to singles or couples.

- **Singles:** If you are looking to purchase your first home as the only person named as a borrower in your home loan, then you would apply under the Scheme as a single.
- **Couples:** If you are looking to purchase your first home with your spouse or de facto partner, where you are both named as borrowers in your home loan, then you would both apply under the Scheme as a couple.

The National Housing Finance and Investment Corporation (NHFIC) has developed a tool to help first home buyers find out whether they meet the Scheme's eligibility criteria. Visit www.nhfic.gov.au/what-we-do/fhlds/eligibility to view the Eligibilty tool.

PROPERTY PRICE THRESHOLDS

To ensure the Scheme is only available for the purchase of a modest home, or the purchase of land and construction of a modest home, the property price thresholds (maximum property purchase price under the Scheme) will apply in capital cities, large regional centres and regional areas.

NHFIC has also developed a tool to help first home buyers find out the property price threshold for the suburb in which they are looking to purchase a property. Please note that this tool is provided as a guide only and does not mean that you will receive either a guarantee or a loan from a participating lender.

Visit www.nhfic.gov.au/what-we-do/fhlds/property-price-thresholds to view the price threshold tool.

MORE INFORMATION

- A fact sheet is available at http://admin.clientcommunity.com.au/uploaded/level/2063/fhlds-fact-sheet.pdf?MID=89899&MID=89899
- FAQs are available at http://admin.clientcommunity.com.au/uploaded/level/2063/fhlds-faqs.pdf?MID=89899&MID=89899

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