PERENNIAL VALUE MANAGEMENT

# Perennial Perspective

## "There’s a kind of hush"  - Reporting season - are we at a key turning point?

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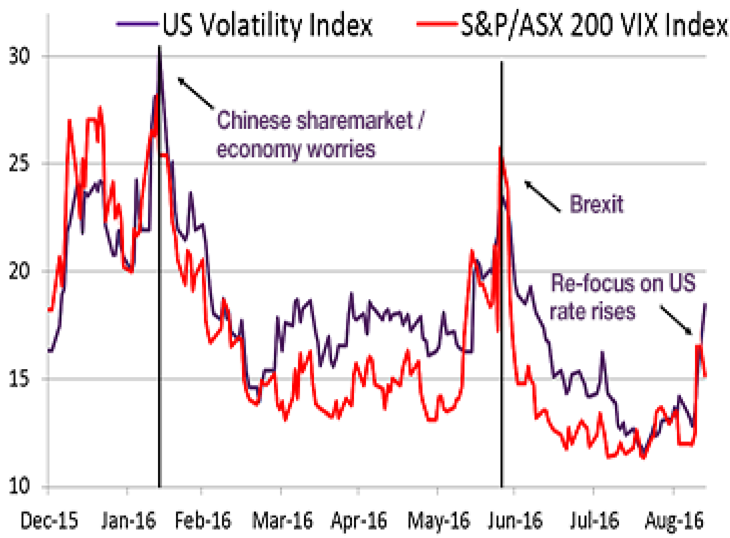
**"There’s a kind of hush"**

You may not remember this song (a schmaltzy hit in both 1967 and 1976) but the sentiment is reflective of recent markets. Despite Brexit, the US election, US rate uncertainty and slow world growth, volatility measures in Australia are at low levels.  (As measured by the A-VIX or Australian S&P/ASX200 VIX Index – shown below as the red line and the US VIX (the purple line) - both indicators of expected future volatility).

**US and Australian VIX 2016 to 12 September 2016**

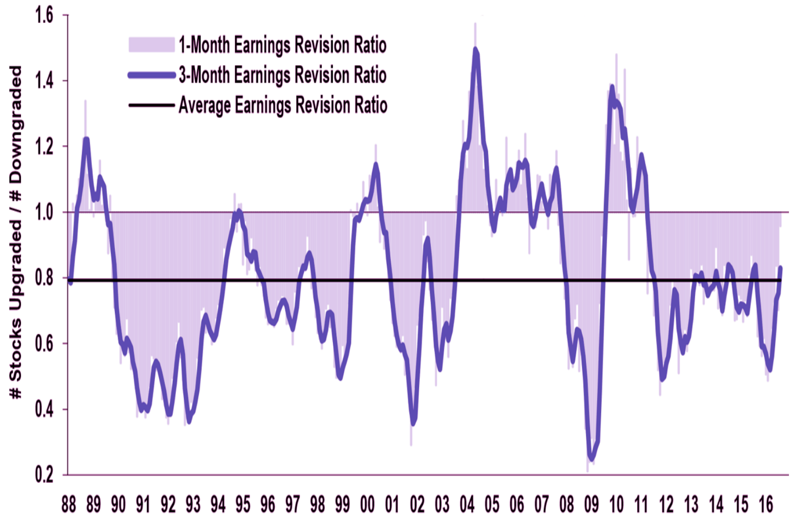



**Source:** IRESS, Perennial.

It appears as if investors, after chasing shadows, had become quite complacent about future large falls (or rises). This doesn’t mean of course that the future looks necessarily rosy, however the current levels of  complacency are a little puzzling, particularly when most developed markets are trading at PE levels slightly above long term averages. Given all this it is not surprising that we saw a turnaround over the weekend of 10/11 September where US investors in particular re-assessed the chances of a US rate rise and 10 year Bonds turned positive in Germany.

In terms of good news that could support a more positive view, the BOA Merrill Lynch research below indicates that positive earnings revisions for equities globally have hit a 5 year high (in August, the ratio jumped from 0.70 to 0.96). This is very encouraging provided this trend continues.

**Global Share Earnings Revisions Ratio – at a 5 Year High**




**Source:** Bank of America Merrill Lynch, Earnings per Share Revisions

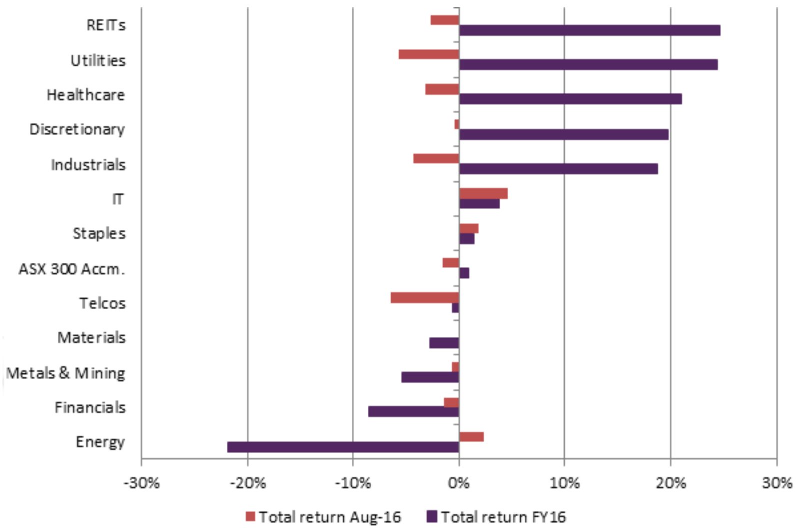
**Reporting season**

The August reporting season was solid with results broadly as expected and perhaps more importantly the outlook for earnings in FY17 was slightly upgraded with consensus earnings growth for FY17 now at around 7.0%.

The other take-out was the outperformance of Value stocks as many of the high priced momentum/growth stocks disappointed.

This rotation can be seen from the following chart where most of the high performing sectors from last financial year (the top purple bars) were relative poor performers when the August results rolled in (the red bars).

**Sector Performance FY16**

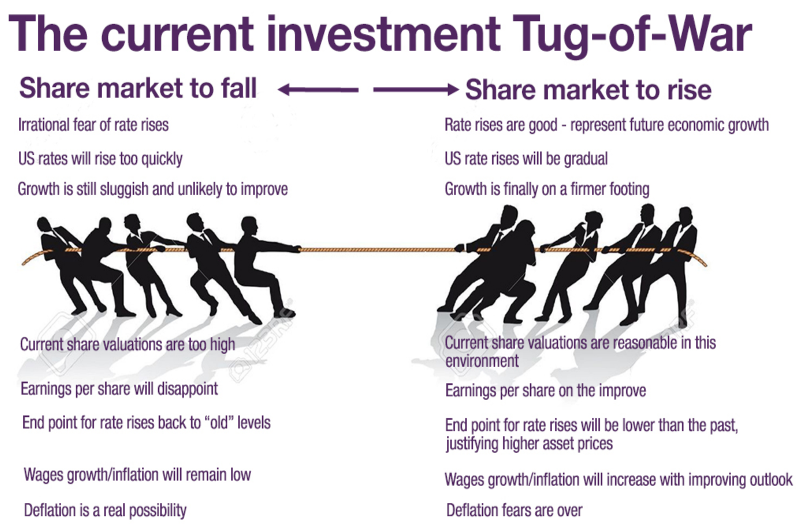



**Source:** IRESS, Perennial 2016.

### Are we at a key turning point?

There's enough evidence to think so with the global earnings revisions mentioned above, the bottoming out of commodity prices and 10 year bond yields increasing, all signalling that a turning point in US rates is approaching. In addition, a projected return to earnings growth for Australian shares following on from -10.0% growth in FY14, -5.0% in FY15 and -7.5% in FY16, with much of the fall due to the dramatic drop in commodity prices affecting resource companies which has now troughed.

Whilst this sounds positive the key issue is how this will all play out given historically low rates, high debt levels and the ending of Quantitative Easing. The answer to this depends on your view of the World – my view is more positive on the right hand side of the chart below which illustrates the different points of view on the current outlook.




**Source:** Perennial 2016.

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