Research
Macquarie Wealth Management

Investment Strategy Update #54

Macquarie 2021 Australia Conference – The path beyond the pandemic

- Australia's relative resilience throughout the pandemic and ongoing economic recovery helped set an optimistic tone for the Macquarie 2021 Australia Conference. Participation and presentation numbers were up 70% on the year before – a strong reflection of improving sentiment.

- We highlight 4 key takeaways from the conference:

  - **Rising cost pressures:** Around one-quarter of companies highlighted rising input costs, coming from raw materials and labour. This is not necessarily bad (if higher costs come with rising demand and hence the ability to pass these on), although some companies may choose to absorb cost increases in order to stay competitive and raise market share.

  - **ESG goes mainstream:** ESG was front and centre, highlighting its growing importance to companies and investors. Key issues included decarbonisation and the energy transition, opportunities from EVs, labour shortages and ethical sourcing.

  - **The outlook after COVID-19**: Although COVID remained a key talking point, companies have shifted the focus beyond the pandemic and the outlook under more normalized conditions. In particular, this was centred on re-opening plays and who benefits versus loses.

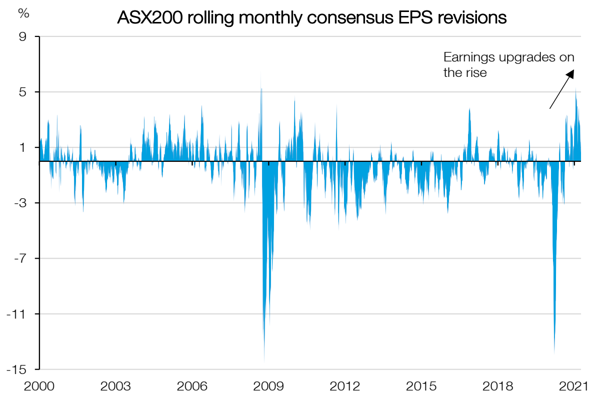
  - **Post pandemic earnings winners versus losers:** The Australian market is in the strongest earnings upgrade cycle for the past 20 years. This reflects the speed of the shock and the continued lack of transparency around re-opening as much as the shape of the recovery. Nevertheless, this trend remains a powerful tailwind which is likely to continue.

Australian corporates well on the road to recovery: With Australia having pulled through the pandemic in relatively better shape than many other countries, it is no surprise that profit momentum continues to look strong and surprise on the upside. The ASX200 is now back near all-time highs – reflecting the mood across corporate Australia which has also bounced sharply as measured by confidence indicators

As a result, the Macquarie 2021 Australia Conference saw 97 companies present, up 70% on 2020, and just 7% below 2019. This uplift in sentiment reflects a strong desire to keep investors and the market informed of developments but is equally important as an indicator of confidence around the willingness for future investment and hiring. (see *Australian Equity Strategy - Australia 2021 Conference Wrap, 7 May 2021*).

Unlike last year, when many companies had withdrawn guidance, this year they were more willing to provide trading and guidance updates. **Most updates were positive,** with Macquarie analysts' earnings revisions seeing double the number of upgrades as downgrades. This continues the trend of positive earnings revisions that started in September 2020 - the longest string of positive revisions in two decades. After years of weak earnings, **investors should be enjoying what is Australia's best upgrade cycle in decades**.

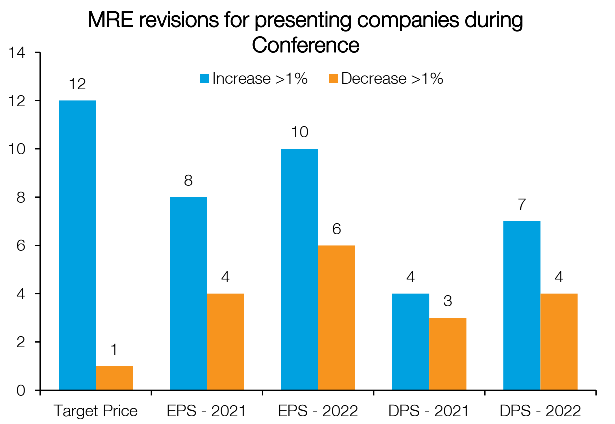
Longest trending positive earnings revisions in decades



Source: Factset, MWM Research, May 2021

Although COVID remained one of the themes, companies also shifted focus towards looking at growth beyond the pandemic, and which stocks are better positioned to be re-opening plays as the economy normalises.

Earnings revision upgrades outnumber downgrades



Source: Factset, Macquarie Research, May 2021

Key conference takeaways

1. **Cost pressures**: One of the key macro themes from the conference was cost inflation, with about one-quarter of companies discussing rising input costs, including raw materials and labour. Given the health of Australia's economy, most companies are likely able to pass on the higher costs, although some may decide to not pass on costs in an attempt to increase market share by keeping prices competitive.

2. **Broad Inflation Pressures (higher bond yield impacts):** Broad inflation concerns (and the impact on bond yields) were a key driver for many stocks over the conference period. Resource stocks posted the best returns, with lithium and copper miners further supported by Environmental, Social and Governance (ESG) themes such as energy transition and the shift to electric vehicles (EVs).

   However, rising inflation also presents a headwind for valuations, and there were a number of stocks which performed poorly over the conference period despite positive earnings surprises (i.e. technology was a notable laggard). Going forward, we expect bond yields to inch higher as growth normalizes and inflation picks up. Even in the absence of a sharp inflation spike, our central case is for higher bond yields and we think this is also reflected in company commentary out of the conference.

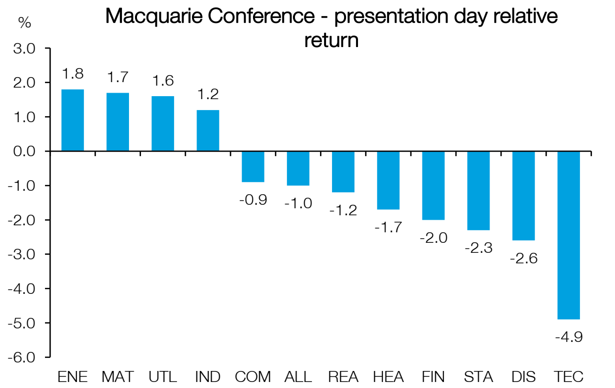
   This trend should favour stocks positioned to do better in a reflationary environment (e.g. Resources, Value, Financials) vis-à-vis those which may underperform if bond yields continue to rise (e.g. Growth, Bond Proxies, Gold).

3. **Rolling out of COVID winners:** The pandemic is not over (most recently with new cases emerging in Sydney) with many of the companies that benefitted from COVID lock-down (e.g. consumer discretionary) still experiencing solid demand. With borders likely to remain closed for the medium-term, retailers that gained in 2020 are still seeing growth, although it is slowing in many cases.

   Investors are concerned with how COVID winners will perform as they compensate for last year's sales boom, which often mutes their share price reaction to positive surprises. This counter-intuitive reaction to news could continue until after the August reporting season when COVID winners report sequentially weaker results and more negative trading updates.

4. **Rolling into COVID losers:** Although Australia is not completely out of the pandemic yet, ongoing progress with vaccine rollouts and re-openings spur hope that most of the negative impacts of COVID are fading. Consequently, the focus at this year's conference shifted towards stocks that will likely benefit more from re-opening of the economy. Unlike February's reporting season when investors looked past earnings disappointments from COVID losers, the market is reacting more normally to negative earnings surprises from this group.

Reflationary sectors outperformed tech at conference



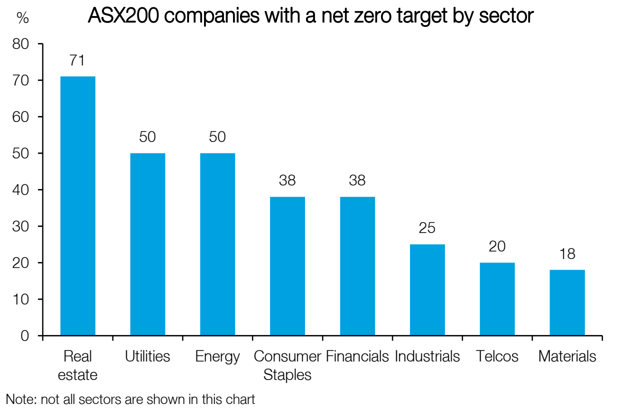
Source: Factset, Macquarie Research, May 2021

5. **Sustainability:** ESG was front and centre at many of the companies' presentations, highlighting its growing importance to companies and investors (see *Australian ESG Equity Strategy - Macquarie Australia Conference: Sustainability in the spotlight, 10 May 2021*).

   Main issues discussed included decarbonisation and the energy transition, opportunities from EVs, labour shortages and ethical sourcing. Corporate decarbonisation commitments are accelerating with over 40% of companies on the ASX100 now having a net zero target.

Sustainability creating financial benefits was also addressed, with companies reporting cost savings from improved energy efficiency, ethical supply chains and shifting to sustainable fuel sources. On the revenue side, companies see opportunities to improve gross margins through sustainability work (advisory, engineering) and energy transition work.

Number of corporate net zero targets are increasing



Source: Company data, Macquarie Research, May 2021

Macquarie WM Investment Strategy

The report was finalised on 09 May 2021.

Recommendation definitions (Macquarie Australia/New Zealand)

Outperform – return >3% in excess of benchmark return

Neutral – return within 3% of benchmark return

Underperform – return >3% below benchmark return

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