

Perpetual: Look for value stocks with strong balance sheets as rate hike looms

By Perpetual Asset Management

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It's a stock picker's market, but which sectors? Here's a snapshot from James Holt, head investment specialist with Perpetual's Aussie equities team

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THE past six months on the ASX has marked a return to fundamentals – in contrast to late last year when market movements were based on macro expectations and announcements.

That means it's a market for stock pickers says James Holt, head investment specialist with Perpetual's Aussie equities team.

“When the market returns to fundamentals, that's when stock pickers usually do better – and that's what has happened in the first six months of 2024,” says Holt.

Macro still matters though, and for the first time in several decades, investors are wary of stagflation, he says.

“We have rare situation where the consumer is under pressure and the unemployment numbers are deteriorating.

“Normally you'd expect inflation to fall. But there is still upward pressure on prices based on monthly CPI readings. That isn't a phenomenon we've seen since the 1970s.”

The macro environment adds another dimension to value investing – the need for a strong balance sheet and low debt levels.

“Having a clear balance sheet with low levels of debt doesn't always get rewarded.

“But investing in quality is what's helped us in recent months, and what is needed in the next few months,” he explains.

“Going forward, it isn't just about buying value companies. If they are not quality companies, and rates rise in Australia which is a real possibility, then investors could lose out.”

Sectors that look promising

Perpetual's Aussie equities team is holding a reasonable amount of cash where it can, says Holt.

There are opportunities within the consumer discretionary sector, particularly around more resilient businesses such as lotteries and gaming, he says.

Many tech stocks looks somewhat over-valued though. “It is pretty frothy at the moment.”

Healthcare stocks are also out of favour with some value investors, though there are certain stocks, with strong management and market leading positions which provide opportunities.

ASX financials – including the big four banks and the insurers – have rallied in recent months, notes Holt, giving value investors reason to re-assess their holdings.

“The worst-case scenario in the sector hasn’t played out. We have probably the highest quality banking system in the world because it isn’t deeply fragmented.

“The oligopoly effect helps protect the system, so it’s easy to argue that you should be paying a bit of a premium in Australia for the banks.

“Investors have also done well out of holding insurers like IAG and Suncorp.”

Real-estate investment trusts is another sector that includes value opportunities for investors.

“But investors have to be very selective,” James warns.

There are value opportunities in stocks that are trading at a discount because the non-property part of their operations are performing poorly.

Holt nominates Event Hospitality and Entertainment (ASX: EVT) as an example. Its cinema business is underperforming but it still has a reasonable property portfolio.

There are also quality property companies, exposed to growth sectors of the economy, which should benefit.

Goodman Group (ASX: GMG) is an example, James says.

Perpetual holds both stocks.

James Holt is head investment specialist with Perpetual’s Aussie equities team.

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