Antares Insights – March 2020

Investing in the time of Coronavirus

Given the rapidly changing world-wide events related to the coronavirus crisis, we continue to meet each day (albeit via teleconference) to discuss and debate our views on stocks and markets and particularly the impact of the coronavirus.

Our initial response

Less than two short weeks ago we wrote that the coronavirus had caused us to re-think our base case for global and Australian growth. We outlined some of our key concerns and the changes we had made to our portfolios at the time. We identified areas that we believed were of high-risk including companies with weak balance sheets, poor liquidity, dependence on stock turn and re-financing risk. And companies where a critical supply chain could be disrupted.

We introduced new stocks that had fallen materially below our valuations or were not directly adversely impacted by the virus (eg consumer staples) and reduced others that we feel will have a more challenged operating environment given the economic slowdown or that could display some of our concerns about balance sheet strength and liquidity. We also increased portfolio diversity by adding a range of stocks in different sectors with different attributes given we are investing in a period of uncertainty.

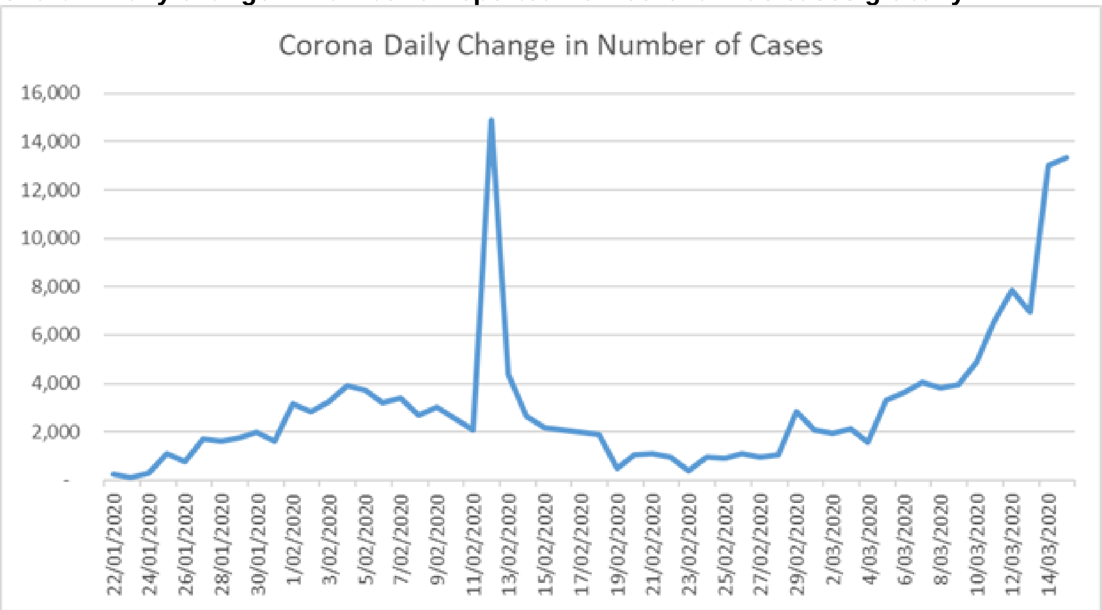
In the subsequent period we have continued to adjust our portfolios in light of what has happened with the coronavirus spread and how governments and markets have reacted.

The virus spreads…

What was a crisis has now been proclaimed as a global pandemic by the World Health Organisation. Many countries or parts thereof have declared a state of emergency. At this stage no one knows how long the virus will persist nor its ultimate impact on the broader economy. We continue to monitor the daily coronavirus cases (total and China/non-China) as well as the death rate. All indicators at this stage are pointing in the wrong direction. Cases continue to grow at an increasing rate (ex-China) and the death rate has increased to almost 4%.

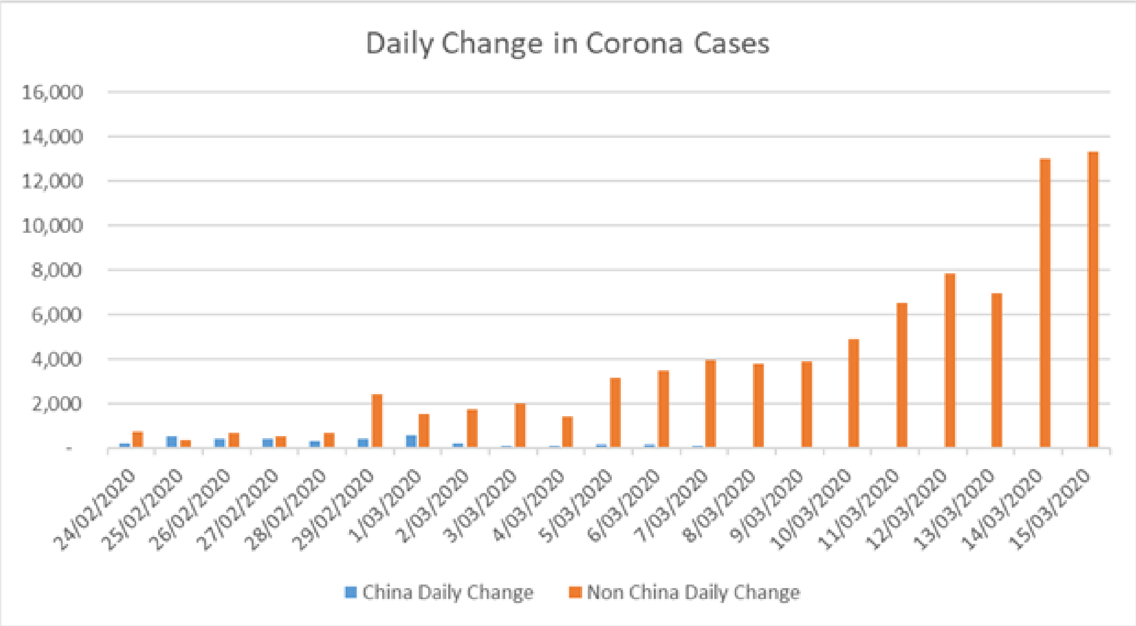
If there is a positive in the numbers it is that China (as well as South Korea and Singapore) seem to have stemmed the rapid escalation of new cases, demonstrating that significant and early measures can influence the ultimate impact of the Virus on the population and ultimately the economy.

Chart 1: Daily change in number of reported new coronavirus cases globally



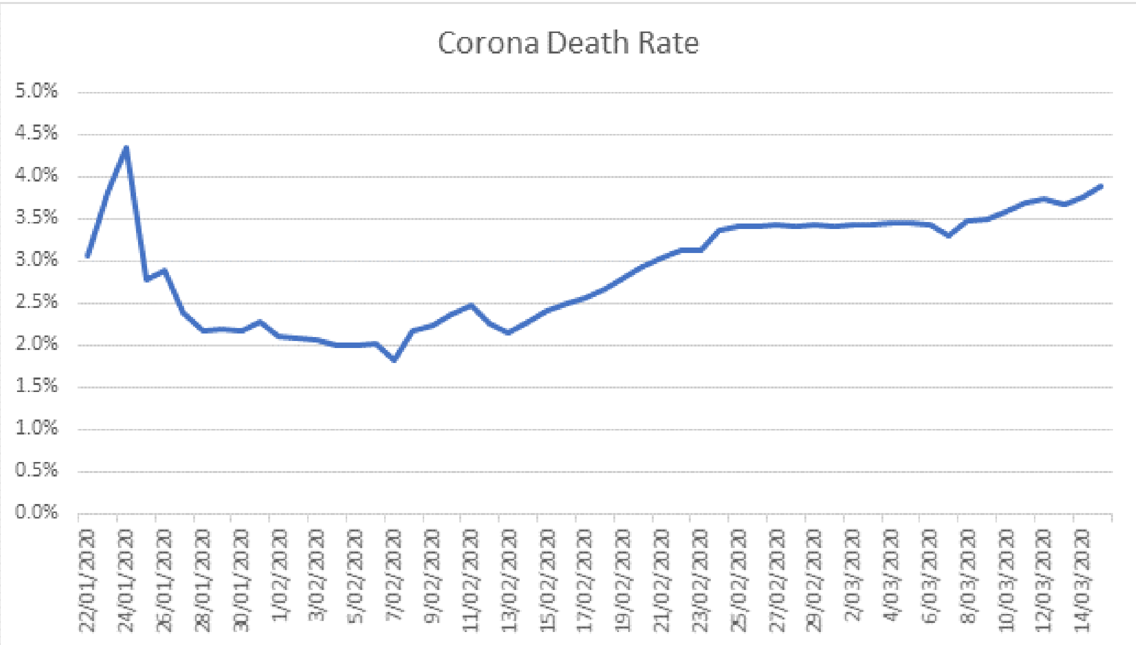
Source: Bloomberg; 16 March 2020

Chart 2: Daily change in number of reported new coronavirus cases China v Rest of the World



Source: Bloomberg; 16 March 2020

Chart 3: Death rate from coronavirus (%)



Source: Bloomberg; 16 March 2020

Which large cap stocks have fared best?

The top and bottom 15 relative stock returns (in the ASX 100) for the first two weeks of March are shown in Chart 4.

Consumer Staples, Health Care and Communications Services feature prominently in the top 15 stocks while Financials, Consumer Discretionary and Energy stocks make up the majority of the worst performers.

Chart 4: ASX 100 relative returns (1 March to 16 March 2020)

ASX100 - Relative Performance (MTD)			
Rank	**Code**	**% Relative**	**GICS Sector**
Top 15 Relative			
1	COL	33.44	Consumer Staples
2	FMG	28.75	Materials
3	DMP	21.45	Consumer Discretionary
4	TLS	20.23	Communication Services
5	SOL	19.74	Energy
6	MPL	18.88	Financials
7	SHL	18.17	Health Care
8	WOW	16.95	Consumer Staples
9	TPM	16.64	Communication Services
10	RIO	15.69	Materials
11	A2M	15.01	Consumer Staples
12	XRO	14.23	Information Technology
13	RMD	13.26	Health Care
14	AST	13.13	Utilities
15	CSL	13.04	Health Care
Bottom 15 Relative			
100	FLT	-28.90	Consumer Discretionary
99	OSH	-26.86	Energy
98	SGR	-23.25	Consumer Discretionary
97	STO	-23.12	Energy
96	QAN	-21.72	Industrials
95	CPU	-18.91	Information Technology
94	APT	-18.26	Information Technology
93	CGF	-17.92	Financials
92	VUK	-17.11	Financials
91	SYD	-16.80	Industrials
90	ALX	-16.22	Industrials
89	WOR	-15.61	Energy
88	DOW	-14.81	Industrials
87	RWC	-14.25	Industrials
86	NAB	-14.09	Financials
85	WPL	-13.99	Energy

Source: Bloomberg, Antares Equities; 16 March 2020

What have we done?

Dividend Builder and Australian Equities

As the coronavirus crisis has spread we have become ever more vigilant about balance sheet strength, good liquidity and debt maturity. Can the company survive without a dilutionary capital raising? As China emerges from the crisis supply chain issues may begin to dissipate.

We continue to look for stocks that have fallen materially below our valuations or were not directly adversely impacted by the virus (eg consumer staples, Telstra). And we are looking to companies where we believe they will have a strong business and market share when economies recover. We remain focused on portfolio diversity given we are investing in a period of uncertainty.

Elite and High Growth
We have skewed the portfolio further towards companies with more defensive cashflows that offer upside to our current target prices. In particular we have considered those that have strong balance sheets that will enable them to weather the volatility. Our view is to select those that should emerge from the crisis in a better relative position or have demonstrated a more robust business model that may command a higher price earnings multiple once the crisis has passed.

Over the period from 1-16 March, stocks that we have exited for our Elite Opportunities strategy include QBE Insurance (QBE), Tabcorp (TAH) and Graincorp (GNC). And for our High Growth strategy we have exited GNC, Incitec Pivot (IPL) and Unibail-Rodamco-Westfield (URW). These have been replaced with Metcash (MTS), AGL and A2 Milk (A2M) in both strategies. Both MTS and A2M are consumer staples and AGL provides power to households without oil exposure.

Ex-20
We are using the market volatility to concentrate the portfolio in generally higher quality stocks whereby their industry structure will likely be enhanced by the current upheavals - such as rivals becoming distressed or failing.

In particular we are focusing on stocks where we believe the market is overly concerned by near term earnings risk, not the improvement in longer term franchise value.

We are also combining this with a cyclical tilt to stocks that should benefit from a recovery in the Chinese economy.

Property
The most substantial change to the portfolio has been selling Sydney Airport (SYD) given the news of the implementation of 14-day isolation for all travellers. We are being patient with the cash from the proceeds.

Refining our Business Continuity Plan

From Monday 16 March 2020 we changed the working arrangements for **all** of the investment staff at Antares. All investment team members are working remotely from home – separate from each other.

- We have full functionality and visibility of systems as if we were in the office
- We continue to have our daily morning meeting through Zoom meetings
- We have multiple chat systems for instantaneous conversations

The only difference from normal circumstances is the physical dislocation which we believe will minimise the risk of simultaneous infection of the team.

As uncertainty and volatility increase, we continue to analyse, debate and discuss the unfolding news in our daily meetings. We don't know how long the dislocation will last but we continue to actively manage our portfolios and pursue opportunities that we believe will deliver long term growth for our clients.

Important information