Axis Investment Management

Occasional Commentary from the Chief Investment Officer, Wednesday, October 02, 2013

A Good Stock is hard to find…

A slight twist on an 80's tune (yes I am that old) but it's getting that way. Much more care to discern per equity name is now required over and above thematic or sectoral thinking. It's not quite game over yet as we do still feel that M&A has an engaging role for at least the next 24 months and will therefore precipitate some event-driven opportunities. Consequently, we are mindful of areas where this would play out in the most transparent way. By this, we mean that our aim is to identify clear sources of long term value (no different to before) in areas we can understand - telecoms and energy being the standouts, as opposed to some areas where valuations of both predator and prey are so lofty that the execution and deal risks outweigh the rewards. Sensible and targeted position building in value names where we hope and expect catalysts and events to develop is our current policy.

We expect that there will be some consolidation in mining and exploration too. However, as these events will be survival-driven (outlook poor) rather than accretive (outlook good), we're not inclined to try and get in front of these until valuations normalise. Both Precious and Industrial Metals have cloudy outlooks and if forward prices fall below the cost of production, there will be casualties. If anything, we would be short of the weaker (newer players) in the metals and mining sector. These new boys probably don't remember USD 400 Gold and would be dust if we ever we got there. We actually don't expect Gold to fall that low, but a USD 800 floor and sideways distribution for an extended time between USD 1000-1250 is a feasible outlook.

Geography

We still favour accumulating selectively in Hong Kong as it's one of the cheapest developed markets and still trades quite near to 2008 levels on a Price/Sales basis inter alia. It won't be immune to troubles in Europe and the US, but if you're in a building with shaky foundations, best to be on the 1st floor rather than the 10th.....

Loves, Hates and Hedges....

The risks ahead to the equity market are widely covered but where else do you put capital to work. Our view is aside from selective shorts (weak miners, the AUD), the most at-risk market is Japan. Whilst it may seem too late to write this when the Nikkei is flashing at me at 300 points down, we think near term fair value lies nearer 12,800. The rise in the Nikkei has been sharp and doesn't yet price in a single government policy blunder. Abenomics and Yen-weakening have been well received by the market.

That aside, Japanese Administrations have great form in making policy clangers. The Sales Tax introduction in 1997 is only one of them. So, as we have mentioned before, long players should enjoy the fun but should also be mindful that Japan's problems are structural and these factors don't change overnight. Japan is a traders market rather than an investor's one and we think it's toppy.

Nervous equity and bond investors aren't finding much solace in either precious metals or in the US Dollar. This outlook may change for the US Dollar (which we think is nearing its trough) but we are not so optimistic for Gold unless there is a total sovereign collapse in a country investors care about. Aside from a small fat-tail risk-based allocation, we don't see much merit in holding a non-yielder such as Gold.

We still propose that it is better to hold a range of defensive equities that are relatively near 2008 valuation levels and which also have not greatly participated in the equity rally so far. The individual names form a shorter list now than before but select telecoms, utilities, pharma and energy names are the areas with which we are comfortable. If you can find a clean-ish bank, then good luck but we think there is more muck-raking to come so per-name work is paramount. Even if there is more support for the banking sector, this could make a short term trade work but the banking business models are still far from attractive. As an outlier sector, we note that some names in the US Education sector outperformed the S&P500 in 2000-2001 and also during the crisis of 2008. They also did not lose money in absolute terms in either period. These are good credentials for a hedge to the chaos and rotation within other areas of the equity space. Needless to say, we are in.

Commodities

We retain a more tactical bias on soft commodities for now but are closing evaluating a long entry point in Arabica 'C' Coffee, which has tumbled from over USD 3.00 per pound to only just above USD 1.00 currently.

A final word on overall asset allocation

We commenced our bearish view on the US Long bond back in July 2012 and the sideways swings over the subsequent months certainly tested our resolve. However, whilst there may be more to go in this secular move down, we are no longer short. We are now on the sidelines and watching the show for a while. If anything, we may utilise the 'short term cash car park' characteristics of this market and take some tactical longs depending on news flow. In our view, Sovereigns don't really carry long term value at these levels but remain as very viable short term tactical tools

We continue to let our bond portfolio weighting reduce in size by rolling bonds proceeds, as they mature or are called, into trophy property (both retail and commercial) and yielding equities, so that we are always paid to play. Equities and Property have much better inflation-protective characteristics over the long term and it is the long term risk of inflation that we guard against by allocating assets in this manner. Both Equities and Property remain our highest weightings, with Bonds a distant third and fading. The remainder of our bond portfolio continues to be of short duration, in GBP and USD.

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