Brace for an earnings season to remember, warns 2020's top fundie

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The company reporting season just around the corner will be punishing for stocks unwilling to give the market the earnings guidance it has been craving since COVID-19 erupted, warns the investor behind the top-performing Australian fund of 2019-20.

Josh Clark from QVG Capital started out in the industry as a quantitative analyst. He's constantly redoing his numbers, which he says "takes the emotion out of it".

QVG long short has been crowned the number one Australian equities strategy out of the 138 tracked in Mercer's survey of investment manager performance.

"There's probably the most wide dispersion between certainty and uncertainty ever at the moment," said QVG Capital's Josh Clark, whose long positions in Afterpay and building services group Johns Lyng, as well as bets against Speedcast and Ardent Leisure, underpinned returns of 29.3 per cent over the 12 months ended June 30.

Since the pandemic hit shares in March, sending stocks briefly into a bear market, many companies have elected to withdraw earnings guidance, concluding that they are unable to forecast accurately in conditions where businesses are either locked down, restricted, or on life support.

But what's become clear since then is that some businesses are thriving, as record share prices and a handful of updates suggest.

"Some companies have been extremely good at communications, and there's others that have gone completely quiet," Mr Clark said. "We've definitely been rotating more towards certainty and I think it will be interesting what companies choose to do.

"We don't really have a precedent for it, so some companies will choose to guide and others won't. There's the possibility they're looked on more harshly if they fail to give it when everyone else is."

This week, internet homewares retail Temple & Webster, Kogan, and Afterpay have joined iron ore producer Fortescue Metals and rubber glove supplier Ansell at record highs.

Earlier this month, Temple reported sales in June soared 130 per cent year-on-year after rising an estimated 120 per cent in April and May. Kogan also witnessed huge demand over this period, with a doubling of sales, and Afterpay has cracked a $20 billion market valuation on reaching almost 10 million active users worldwide.

The other variables Mr Clark is watching this earnings season are the application of accounting standard AASB16 governing leases, and the distortion of rent sweeteners and JobKeeper on earnings.

"Companies have varying levels of disclosure around what's happening with their labour and rent costs," the fund manager said. "If you use a retailer as an example, the two biggest costs are labour and rent. Landlords will be giving them huge deals, and they've got JobKeeper. There's going to be different attitudes as to how they choose to communicate that."

In a year defined by record prices for technology stocks, the outbreak of COVID-19 – which has killed 580,000 people to date, massive volatility, and the collapse of the crude oil price, what fund managers did not own was just as important as what they did own.

QVG's 29.3 per cent before fees slams the negative 7.7 per cent for the S&P/ASX 200 Index over 2019-20. Hyperion Australian Growth ranked second with 19 per cent and Collins St Value Fund took the third spot with 13.5 per cent.

QVG Long Short Fund is co-managed by Tony Waters and Chris Prunty, and was the winner despite placing sixth in the June quarter within the hedge funds category with a 17.5 per cent result. Since June 30, it is up 2.7 per cent through to July 13.

In that final quarter, Regal Long Short Australian Equity Fund returned 30.8 per cent for the best long-short numbers, but it lost 12.5 per cent over the financial year.

Forager Australian value was the best long-only fund in the quarter, up 39.6 per cent but down 17.5 per cent for 2019-20.

Forager chief investment officer Steve Johnson is looking to earnings season as an incredible risk-reward opportunity for under-the-radar stocks that do not fit the market's hunger for technology concepts with highly recurring cashflows.

"The reward for uncertainty at the moment is extremely high. Everyone wants to own something that's got certainty," Mr Johnson said. "There's so much self-reinforcing momentum there's nothing to stop these share prices going up, but over the next 10 years the return profile will be lower."

He would rather own a business that is not fully valued right now but is capable of double-digit returns.

"There is a lot of money sloshing around. I think in our space we're pretty optimistic [about earnings season]," although it's equally likely the market receives a good result and instead of acting on the earnings, questions "is this sustainable or not?"

performance in the Australian value strategy, characterising it as a rebound, but is determined to extract the apparent value from the portfolio's holdings with closed-door activism if needed.

"We were arguing at the end of March that share prices were not representative of reality," he said. "We thrive on dysfunctional markets, we went into it holding some cash and that is our style, to try and invest when others are panicking. We need another two years of that quarter."

Buy now, buy later

For example, it bought smash repairer AMA Group in February and March, and paid about 50¢ a share. It fell to 16¢ at one point and has recovered to 60¢. Digital mining services group RPMGlobal had a similar V-shaped performance. It has been "growing and it trades at a pretty high multiple of past earnings".

QVG's interest in Afterpay is not representative of a blind bet on the soaring buy now, pay later sector; as Mr Clark's colleague Mr Prunty cryptically volunteered: "we're potentially short the pretenders".

"We're Afterpay bulls," Mr Clark said. "The business has strengthened and some of its potential weaknesses have been disproven – potentially what would happen with bad debts."

The fund manager grew up in Sydney's Bankstown and obtained his chartered financial analyst certification while juggling one of his first jobs in broking. He figured out that if he studied for one hour of his (back then) one-and-a-half-hour bus ride, he could fit in 10 hours of the gruelling CFA course a week without wiping out all of his weekends too.

Mr Clark is also a skiing fanatic, although he admits he's not at the level he used to be when he was a ski instructor at Perisher. (Unlike in his student days, Perisher is terrible value for money: "it's definitely not my favourite place to ski, but it's the most nostalgic").

This time, the median fund manager beat the index with minus 7.1 per cent over 2019-20 against minus 7.7 per cent for the ASX 200, and minus 7.6 per cent for the S&P/ASX 300 Index according to Mercer.

However, the performance gap between the upper and lower quartile managers widened compared with the previous year because of the blow-out in the performance of growth stocks versus value opportunities.

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