How to avoid becoming roadkill in the bubble

Market minds

Chad Slater

It's been said that "a bubble is just a bull market you're not in".

While funny, and to a certain extent true (Sydney housing anyone?), if the stockmarket keeps going at this speed some thought needs to turn to the last phase of a bull market morphing into a bubble.

Often overused, bubbles do exist and bubbles are different to bull markets.

Let me turn to one of my favourite books of last year.

Like many readers, I try to use the Christmas holidays as a period to read the books I said I'd get around to but never seem to over the course of the year. Top of the list was *The Man who Solved the Market*, a story of chain-smoking mathematician Jim Simons and his secretive hedge fund, Renaissance Technologies.

Most readers would have heard of Warren Buffett and the awe in which he is held by fundamental investors. Well, Simons' returns dwarf those returns with 66 per cent per annum before fees for over 30 years, and his fund has made over $100 billion of profits for investors.

Yet very few knew much about Renaissance and how the quant fund ran money because Simons shunned publicity.

The Australian Financial Review's Jonathan Shapiro has written already on the book and Simons' story, so I'm not going to focus on that, except to say it's remarkable that for all the brains and brilliance, the fund's initial returns were poor for so long that it came within weeks of closing. Even the very best struggle at times.

What I'd like to focus on is what I learnt from the book. You see, I thought their success was due to accessing better stock data faster and quicker than other investors can and processing that.

The answer is actually both simpler and more complex.

What they have written into computer code is how investors react and behave in each market, from soybeans to equities.

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If this all sounds Orwellian, think of this phrase on market efficiency: "Markets are 100 per cent efficient, the inefficiency is the humans that make up the market." Because our brains are hardwired relics of the jungles of Africa, humans respond in predictable patterns to news.

Economics has come to recognise this, with the Nobel prize going to Daniel Kahneman for his pioneering work in behavioural finance. It's now accepted that there is "loss aversion", "bounded rationality" and numerous other insights into how we think, making humans irrational in their behaviour.

Bringing the two threads together – bubbles and Simons – how can we test my theory on solving *you*? Look at his funds returns in bubble years. They are off the charts. Renaissance made 136 per cent in 2007 on the way up in the bubble and then 152 per cent in 2008 on the way down after the bubble popped. They also made 128 per cent in the dotcom bubble of 2000.

Apart from being ridiculously good returns, it's remarkable because it's generally accepted that investing in bubbles is hard, because fundamentals go out the window.

But what all bubbles have in common (up to now) is humans trading against humans: be it bitcoin, US tech stocks or tulips.

And humans experience greed, FOMO, fear and depression the same, thus making them predictable for a machine.

Now none of this helps tell me whether this year becomes a bubble year or not, but it does provide some guidance on how to frame your year. Quite simply, you don't fight bubbles with fundamental reasoning. It just doesn't work.

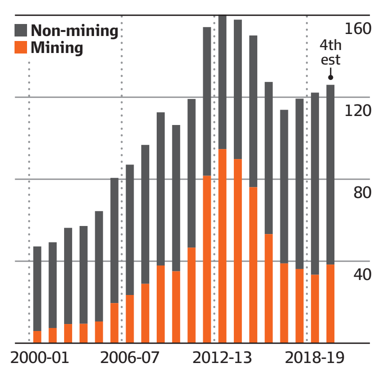
More generally there are other ways to avoid becoming the food that feeds the Renaissance machine. Write down your investment thesis and set your buy and sell rules in advance, so as to stop your inner chimp taking charge. Even market professionals find it hard to overcome those impulses and often override themselves.

Or, as one market strategist says, "the problem with bubbles is they force you to look stupid either before they pop or after they pop".

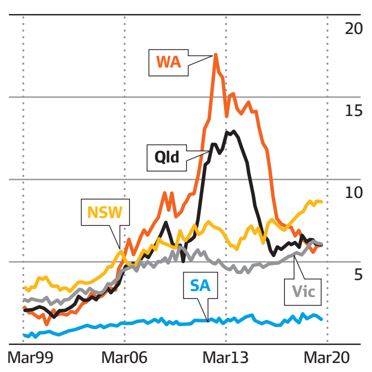
Chad Slater is the joint chief investment officer of Morphic Asset Management.

The week ahead

Capex, actual and intentions ($b)

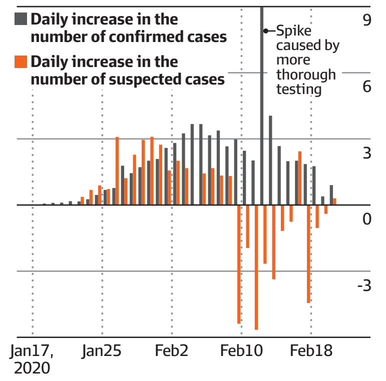


Business investment* ($b)

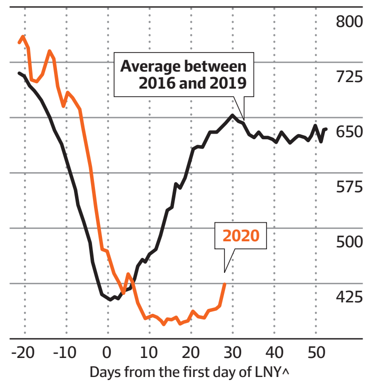


*Real $ per quarter

Coronavirus (number of people, '000s)



Daily coal consumption ('000 tonnes)



^ Lunar new year

SOURCE: CBA, ANZ

MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
Eco: NZ retail sales vol 4Q, Germany Ifo business survey Feb, US Dallas Fed activity Feb	**Eco:** Germany 4Q GDP **Events:** TechnologyOne AGM	**Eco:** Construction work done 4Q, US new home sales Jan	**Eco:** Private sector capex 4Q and 1st est of 2020-21, NZ Jan trade balance **Events:** BoQ strategy update	**Eco:** Jan private sector credit, Eurozone Feb CPI, Canada 4Q GDP

Snapshot

Earnings this week

Day	Company	Guidance/consensus
Monday Feb 24	BlueScope Steel	1H20 underlying EBIT 45% lower than 2H19
	Nib Group	FY20 underlying operating profit at least $170m
	oOh!media	FY19 underlying EBITDA lower end of $138m to $143m
	Worley	FY20 cost, margin, revenue synergies from ECR; earnings weighted to 2H20
	WPP AUNZ	FY19 EPS decline of 5% to 10%*
Tuesday Feb 25	Appen	FY19 underlying EBITDA $96m to $99m; ARR** $30m to $35m
	Alumina	Consensus FY19 EPS US11.3¢ adj
	Blackmores	FY20 NPAT $17m to $21m
	Caltex	FY19 RCOP*** NPAT $320m to $360m, RCOP EBIT $580m to $620m
	MNF Group	FY20 EBITDA $33m to $36m
	Nanosonics	FY20 profit weighted to 2H20; operating expenses $67m including $15m R&D
	Oil Search	FY20 total production 27.5 to 29.5 mmboe
	Spark Infrastructure	FY19 distribution guidance at least 15¢ a share
	QUBE	FY20 "solid" increase in underlying NPAT pre-amortisation
	HUB24	Funds under administration $22b-$26b as at Jun 30, 2021
Wednesday Feb 26	Adelaide Brighton	FY19 underlying NPAT $120m to $130m
	Healius	FY20 underlying NPAT $94m to $102m
	Invocare	Consensus FY19 EPS 49.1¢ adj
	Michael Hill	Consensus FY20 EPS 6.9¢ adj
	Rio Tinto	Consensus FY19 EPS $US6.282 adj
	Woolworths	Consensus FY20 EPS $1.456 adj
Thursday Feb 27	Afterpay	Consensus FY20 EPS 4¢ adj
	Atlas Arteria	1H20 distribution guidance of 17¢ a share
	The A2 Milk Company	1H20 revenue $NZ780m to $NZ800m, EBITDA margin 31% to 32%
	Costa Group	FY20 EBITDA-SL $150m and NPAT-SL in line with CY18 ($56.6m)****
	Flight Centre	1H20 underlying PBT between $100m to $105m
	Link	FY20 operating EBITDA broadly in-line with FY19*****
	Ramsay	Core EPS growth -6% to -4% (new lease standard); like-for-like 2% to 4%
	Reece	1H20 EBITDA in-line with the same period last year
Friday Feb 28	Harvey Norman	Consensus FY20 EPS 28.8¢ adj
	Next DC	FY20 underlying EBITDA $100m to $105m

*Continuing and discontinuing basis **Annualised recurring revenue ***Replacement cost of sales operating profit ****Ex impact of equity raising *****For continuing business

SOURCE: COMPANY FILINGS, BLOOMBERG FOR CONSENSUS

From page 13

All eyes on Rio and its $6b cash payout

Capital, in line with the start of the reporting season, and led by technology, telecommunications, gaming, healthcare and resource stocks. However, only 53 per cent of companies have raised their dividends, below the long-term average of 62 per cent.

The Australian dollar, which has been a source of earnings growth for blue chips which report their sales in US dollars, settled at US66.27¢, stabilising from post-GFC low levels.

Takeover target Caltex Australia is tomorrow expected to reveal the extent of the softness in refining markets and the tough retailing climate, the same conditions which have beset smaller rival Viva Energy, which reports today.

Caltex, which is fielding takeover offers from Canada's Alimentation Couche-Tard and UK-based EG Group, has already advised that benchmark profit for last year would fall to between $320 million and $360 million, down from $558 million.

Still, the result could be overshadowed by any takeover news, including whether EG will get access to Caltex's accounts alongside its Canadian competitor, which has bid $8.8 billion cash.

Viva Energy has foreshadowed a drop in net profit of up to 41 per cent for 2019. Investors will be keenly seeking details of a share buyback flagged by Viva on Friday after it sold out of its petrol station property fund.

Much of the focus in steelmaker BlueScope's first-half results today will be on the impact of coronavirus on its China operations, which make annual profits of about $50 million. Progress on the company's $1 billion-plus expansion of the North Star mill in Ohio will also be scrutinised, with that business the star performer in the group.

BlueScope itself has said first-half EBIT is likely to fall by 45 per cent.

Australia's largest private hospital operator, Ramsay Health Care, will report on Thursday, when it's tipped to deliver full-year core earnings per share (EPS) growth of 2 to 4 per cent, or a contraction of 6 per cent to 4 per cent incorporating new lease-related accounting standards.

Full-year guidance is based on core EBITDAR growth of between 8 per cent to 10 per cent, the "R" representing restructuring or rent costs.

Ramsay is still expecting stronger hospital volume growth this year, although it's facing structural challenges as more people drop private health insurance. Recent data released by the Australian Prudential Regulation Authority showed that 46,969 fewer people aged between 20 and 34 had hospital cover in December, compared with a year earlier.

APRA said the health insurance industry "continues to face risks associated with affordability and the associated value proposition of private health insurance products".

Key numbers to focus on include the underlying organic growth in Ramsay's Australian operations, which make up 75 per cent of earnings; performance in the UK and France; an update on the integration of its Capio acquisition; and insight on its local brownfield pipeline and possible divestment of its German operations, according to Credit Suisse.

Vitamins group Blackmores, which on February 12 issued a downgrade, warning that it would scrap its interim dividend after a 48 per cent profit slump in the six months ended December, is set to unveil the results of a strategic review tomorrow.

New chief executive Alastair Symington, who took the helm in mid-September, is likely to simplify the portfolio and reduce the number of product lines, but his more immediate priority is to navigate the difficulties posed by the coronavirus outbreak. China is the major offshore market for Blackmores.

Woolworths is the final result to dominate the week ahead, with the market looking for earnings per share of $1.456 in 2019-20 and commentary on households, where the benefits of interest rate cuts and tax relief in 2019 are starting to show through.

"Results haven't been spectacular, but I don't think anyone was expecting spectacular," Mr Haupt said.

"You've had the accounting changes but aside from that, a lot of tax rates have been down and you've had interest-rate savings beats," where such benefits have enabled companies to meet market expectations.

"Conditions are soft in Australia."

The reporting season has also been a volatile one, where slight beats can translate to 10 per cent to 15 per cent rallies in heavily shorted stocks, exacerbated by a market that Mr Haupt said had become factor driven. That means companies are defined by what factor bucket they fall into such as value, momentum or quality, instead of the individual narrative and fundamentals of a business.

Gold traded at a seven-year high on Friday, up 1.5 per cent to $US1643.316 an ounce. The yield on 10-year US Treasuries fell to the lowest level since September to 1.47 per cent. The S&P 500 and Dow Jones Industrial Average lost 1.05 per cent and 0.78 per cent. China's CSI 300 rose 0.1 per cent, on the incremental rollout of further stimulus.

WITH SIMON EVANS AND CARRIE LAFRENZ