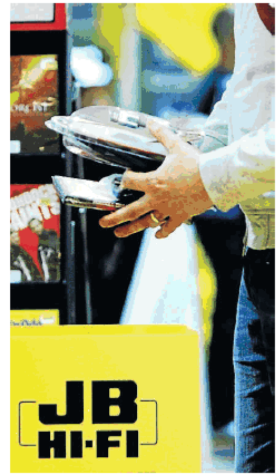
DON'T GET PUT OFF BY BEARS IN THE PIT

Shares Investors may be concerned that the market is running too high, but there are companies that can lift earnings, writes **ST Wong**.



Orora and Caltex don't feature heavily in the headlines, yet both are examples of how some market segments are doing well. Meanwhile, JB Hi-Fi has a strong brand.

Equity markets had a good time of it in 2016-17, but the upshot is that investors now risk being side-tracked by speculation over whether shares are over or under-valued.

It pays to remember that when you invest in stocks, you are not investing in a market. Whether we are in a bull or a bear market, whether share prices are high or low, investors need to look for individual companies with sustainable earnings and sound management whose shares are trading at a decent price.

The difficulty for investors is that there is more anxiety than usual about the market's valuation.

Question marks over market value often intensify when an index approaches a milestone. In recent months the S&P/ASX 200 benchmark has come close to the 6000-point mark, only to retreat. Disappointment is amplified when the market falls short of such a milestone – just as misplaced confidence may occur when an index passes a milestone.

The pessimism is further magnified by economic concerns.

The domestic economy feels downbeat. The bank levy and a weak retail sector are taking their toll. The housing market is expected to slow, although this may already be baked into share prices. Commodity prices have been backtracking, the outlook for the big miners is lacklustre and investors have been hit by a string of profit downgrades. Little wonder shareholders are concerned that the market is running too high.

Globally, pessimism is more pronounced. There are fears the divergence between rising share prices and softening economic data could lead to a correction. (We are also heading into the northern summer, which is traditionally a soft time for the US market.) Yet amid the gloom, there are companies led by highly competent managements which are able to lift earnings for many years to come. The mark of a good management team is reflected in how the company's balance sheet and cash flow are managed.

Orora

One such company is Orora, a large fibre and beverage packaging producer in Australasia with a sizeable packaging distribution business in North America.

Orora has proven to be disciplined, well-managed and has a credible growth path. Since being spun out of Amcor several years ago, Orora's management has diversified its revenues and successfully increased the size of its potential market.

Orora has used its strong balance sheet to increase manufacturing capacity in Australia. The company has also deployed its resources to acquire companies that provided access to new or adjacent products. We expect Orora to post a compounded earnings growth rate of 10 per cent over the next three years.

Caltex

Fuel and retailing business Caltex is another sound business, although it is operating in a sector which may be considered difficult.

The business has been transformed in recent years, moving away from the capital intensive and volatile refining company to an integrated transport fuel supplier. Today, Caltex is more transparent and easier to understand. Caltex's key assets include extremely well-located sites and a well-developed supply chain.

Caltex has a strong balance sheet with gearing expected to peak at just under 17 per cent this year and will decline to single digits within three years. Management continues to be forward looking to extract latent growth potential. Orora and Caltex don't feature heavily in the headlines, being outside the top 20 stocks, yet both are examples of how some market segments are doing well. They are a useful reminder there is more to the market than the headline S&P/ASX 200 and S&P/ASX 300 indices.

The pessimism surrounding the market is not all bad for investors. Indeed, it has created investment opportunities for savers prepared to look at companies on an individual basis.

I can think of several fallen angels – companies whose share price had performed well but subsequently suffered substantial falls.

For investors with an investment horizon beyond the next two quarters there may be opportunities to establish a position in these companies, provided the reasons for the share price declines are due to short term or cyclical reasons.

Caltex has a strong balance sheet with gearing expected to peak at just under 17 per cent this year.

JB Hi-Fi

Consider how the "Amazon effect" has impacted local retailers. It's rational to consider the online retailing behemoth as a serious threat, but is it rational to assume all retailers will suffer? Electronics specialist JB Hi-Fi has been sold down partly due to anxiety over the arrival of Amazon. But JB Hi-Fi has a strong brand and value proposition and a management team capable of addressing some of Amazon's threats.

Downer

Engineering and infrastructure management services group Downer is another fallen angel. Downer shares have been punished because of the company's proposed acquisition of integrated services company Spotless. But the share price should recover if management demonstrates that it has the operational capabilities to stabilise and gain market share in Spotless' sphere of services. This will add to Downer's position as a leading contractor in the favourable infrastructure and improving mining services sectors.

Isentia

Isentia, a market leader in media intelligence which counts major Australian companies as clients, has been losing market share on top of poorly executing its acquisition of King Content. Isentia's share price has halved since reaching a peak of $4.06 in October last year. We are starting to see some evidence that Isentia's core Australian business could be starting to turn a corner.

TPG Telecom

TPG Telecom is another company whose share price has halved in the past year. Competition is biting while there is some discomfort on TPG's entry into the Singaporean and Australian mobile markets.

However, TPG's management team is tenacious and shouldn't be written off.

The challenge for investors is that short-term thinking is pervasive. This short-term thinking makes investors more reactive and vulnerable to making poor choices when buying and selling.

They need to be disciplined, stick to their rules and focus on the mid-to-long-term. This requires looking through the headlines – and looking through the index.

ST Wong is chief investment officer at Prime Value Asset Management. Prime Value owns shares in Orora, JB Hi-Fi, Caltex and Downer.