Where active managers are finding opportunities

By Perpetual Asset Management
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With banks and major miners dominating the market, investors may need to look beyond the index for quality opportunities. Perpetual head investment specialist JAMES HOLT explains

- Banks remain exposed to housing weakness
- Selective stock picking may prove critical
- Learn more about Perpetual's [Australian equities strategies]

Australia's share market is being pulled in different directions. Some of the biggest companies look expensive, housing-related risks are building, and investors may need to look harder for opportunities.

For Perpetual head investment specialist James Holt, this is not a time to simply follow the index. It is a time to assess where risks are concentrated — and where stronger companies may still perform well.

The risk investors may be overlooking

A large part of the Australian share market is concentrated in a small number of sectors, including banks. Many are trading at high prices despite modest earnings growth.

That matters because index investors can end up heavily exposed to the same expensive areas. Active managers can choose where to invest — and where to reduce exposure when risks look high.

One of Holt's key concerns is the link between banks and property. When house prices rise, households often feel wealthier, supporting spending and borrowing.

When house prices weaken, the reverse can occur, creating pressure for the broader economy and bank earnings.

Holt points to early signs of softness, including weaker interest in new house-and-land packages. Potential tax changes could also reduce demand from property investors.

How housing can affect spending

"When households feel less wealthy, they may delay big purchases such as furniture, renovations or other discretionary items," Holt says.

That can pressure companies exposed to consumer spending or housing activity.

For active managers, early signals from housing developers, retailers and consumer-facing businesses can help reveal where the economy may be slowing before it appears in financial results.

"Investors may be better served by paying close attention to businesses at the front end of the housing cycle — such as furniture retailers and house-and-land package developers — because they often see changes in enquiry levels before those trends appear elsewhere."

A market where selectivity matters

Holt describes the current environment as a market where investors need to be selective. Rather than relying on one big theme, he believes each company should be assessed on its own strengths, risks and valuation.

That is reflected in the portfolio. Holt says the team is holding less in banks and is cautious about some consumer-facing companies.

Instead, they favour businesses that may be more defensive, have stronger balance sheets or earn more revenue offshore.

“It's a very idiosyncratic market. You can't just pick a theme and charge with it because you become really exposed if circumstances change,” argues Holt.

Why active management can help

Active management can be important when the market is concentrated in a few large sectors.

Because banks make up a substantial part of the Australian share market, index investors may have more bank exposure than they realise.

Perpetual’s team focuses on the price paid for a company, the risks to its earnings and how well it may hold up in a tougher environment.

What it means for investors

Holt’s message is not that investors should avoid the Australian market. Instead, they should understand where risks are concentrated.

In a market dominated by banks, miners and passive investment flows, active management can help investors look beyond the biggest names in the index.

The next phase may reward a more selective approach. If property weakness affects banks and consumer spending, stronger balance sheets, resilient earnings and less reliance on the domestic housing cycle may matter most.

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