WILSONS

Increasing cross-currents. How are we positioned?

Our fourth quarter Australian equities outlook.

07 October 2021

Competing Cross-Currents to Watch

The final quarter of 2021 is likely to be dominated by several competing cross-currents that have the potential to reshape the investment outlook. Issues like a global mid-cycle slowdown, domestic reopening, labour shortages and supply chain/input cost difficulties are likely to compete for the prize of being the dominant theme to the end of the year.

However, investors should not lose sight of the bigger picture around the earnings recovery across the Australian equity market over 2022.

Read The Global Earnings Recovery Continues

In this quarter, the AGM season provides an update on the market's performance since reporting season, and the banks are also due to deliver their annual results in November. We preview four themes that are likely to dominate local investor debate and activity heading into 4Q21 and the impact on members of the Wilsons Australian Equity Focus List.

The Focus List remains positioned for the reopening – with 60% of companies having cyclically exposed earnings. Recent additions like QANTAS (QAN), SEEK (SEK) and Silk Laser (SLA) have all been added with an expectation of a domestic reopening before the end of the year.

How the Focus List is Positioned into 4Q21

The Focus List retains the significant tilt to cyclical exposures first introduced in 4Q20. While cyclicals now represent ~60%, down from a peak exposure in the mid-2021 ~70%, the reopening and earnings improvement themes remain conviction views.

The Focus List retains its core focus on quality/growth attributes for all members. Last quarter, the lift in weighting to the structural growth thematic took advantage of price weakness caused by market cross-currents (China slowdown, steepening yield curve).

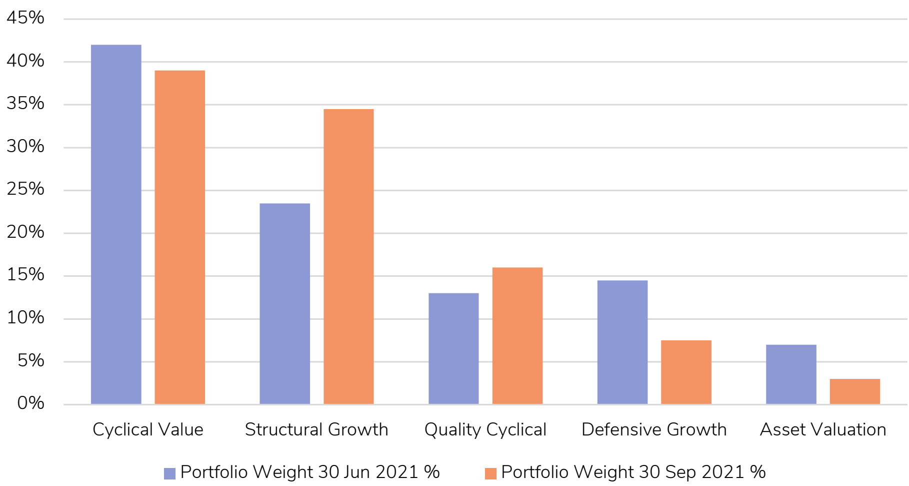
Read SEEK-ing out Structural Growth and Positioning for the Caged Up Consumer

The addition of QAN (4% weight), SEK (3% weight), and SLA (2% weight) are all exposed to improving domestic conditions.

QAN (quality cyclical) and SLA (structural growth) should see activity levels rebound in 4Q, particularly across the summer holiday period. SEK (structural growth) is exposed to re-hiring and the potential pick-up in employment turnover into 2022. SEK adds another layer of growth optionality, with opportunities to pursue the emerging digital HR services sector adjacent to the core employment classifieds business.

Focus List exposures in Aristocrat (ALL, 4% weight), News Corporation (NWS, 3% weight) and Insurance Australia Group (IAG, 5% weight) are also directly exposed to improving domestic activity levels.

Exhibit 1: Focus List - adding to growth and cyclicals thematic. Weight today vs August 2021



Source: Wilsons

1

Domestic reopening

Timing: From mid-Oct 2021

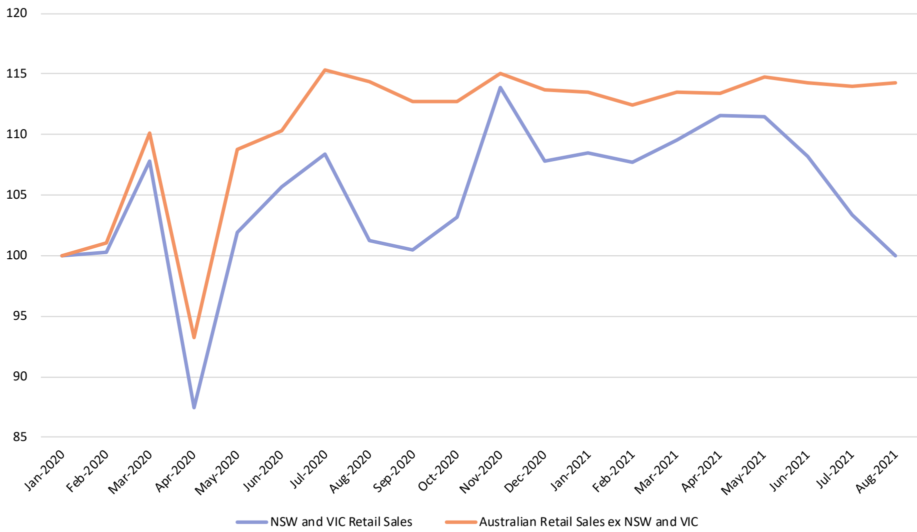
In recent months, the Australian economy has lagged behind the rest of the world due to the NSW and VIC lockdowns. NSW should start to reopen this month, hitting vaccine targets this week. VIC is likely to follow, 4-6 weeks behind. Therefore, the worst of the 'earnings holiday' for corporate earnings should be over by the end of this quarter.

Importantly, the slow and phased reopening plans coupled with vaccine rates likely to end up in the 90-95% range should set Australia up for a strong and more durable reopening than what we have witnessed across the world over 2021. This should improve confidence and increase activity levels.

Retail sales across NSW/VIC, which have fallen 10% vs the rest of Australia, provide a guide to what is likely to happen as national domestic reopening gathers pace over the quarter.

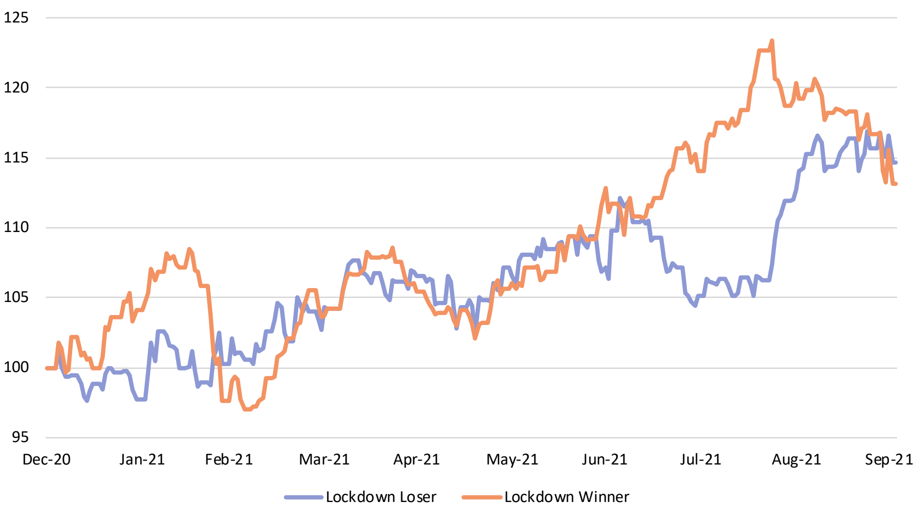
Investors are already anticipating a potential rebound activity. Our basket of lockdown losers has bounced strongly from the July/Aug 2021 levels. Interestingly, the outperformance of the lockdown winners now looks to be over.

Exhibit 2: Retail sales have declined 10% in NSW/VIC through lockdowns and should bounce once reopening gets underway



Source: ABS, Wilsons. Rebased to a 100 1 Jan 2020.

Exhibit 3: Performance S&P/ASX 100 CYTD lockdown winners vs losers



Source: Refinitiv, Wilsons. Rebased to 100 31 Dec 2020.

Lockdown losers: CWN, DXS, IEL, MGR, QAN, SCG, SEK, SGP, SGR, SYD, TCL, VCX.
Lockdown Winners: ANN, CAR, COL, DMP, HVN, JBH, MTS, NXT, SHL, WES, WOW.

2

AGM season

Timing: Oct/Nov 2021

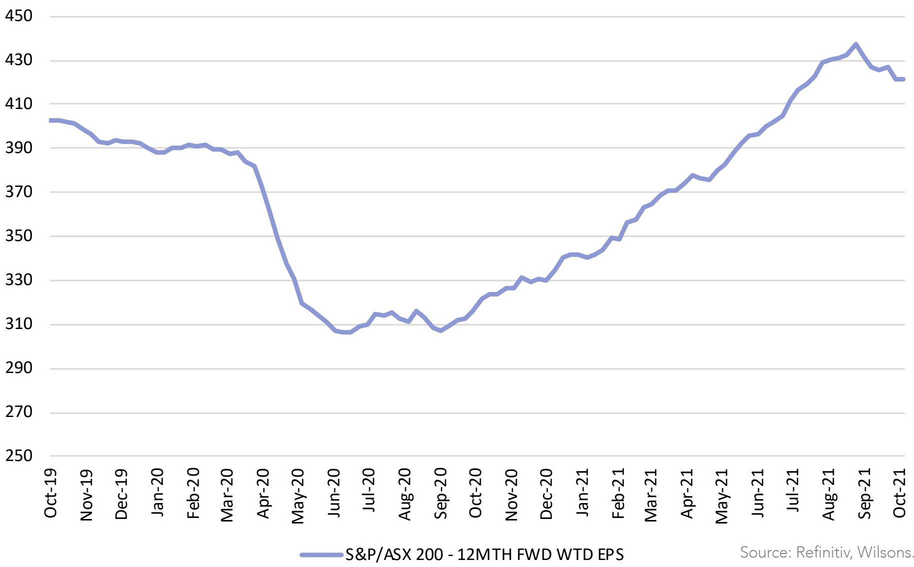
AGM season will update us on the earnings outlook for FY22E, with the market still looking for double-digit earnings growth. Broadly we believe this can be achieved, but we concede some of the growth has slipped in FY23E over the past 2 months.

A lack of formal earnings guidance and clearer pathway reopening providing 2H optimism leaves a low risk of widespread earnings downgrades through AGM season. In our view, it still remains too early in the recovery to see widespread reinstatement of earnings guidance.

Key AGMs relevant to the Focus List include EML, IAG, QAN, SLA and Seven Group Holdings (SVW).

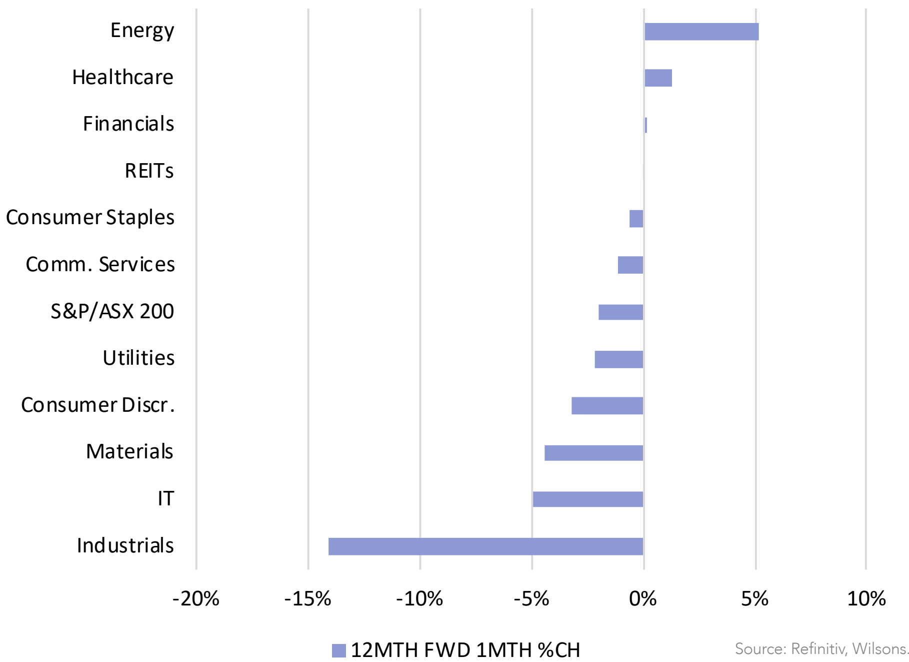
In terms of earnings momentum, outside of the healthcare and energy sectors, all other sectors have seen downgrades since mid-year. The downgrades have been small (<2.5%) and primarily related to less confidence in the recovery due to lockdowns (4 out of 12 months).

Exhibit 4: Some earnings growth has slipped from FY22E into FY23



Source: Refinitiv, Wilsons.

Exhibit 5: Most sectors have seen downgrades over the past month. Energy and heathcare have seen small upgrades.



Source: Refinitiv, Wilsons.

3

Bank reporting season

Timing: Early Nov 2021

Annual results for three of the big four banks alongside Macquarie Group (MQG) are likely to headline corporate news flow over the quarter.

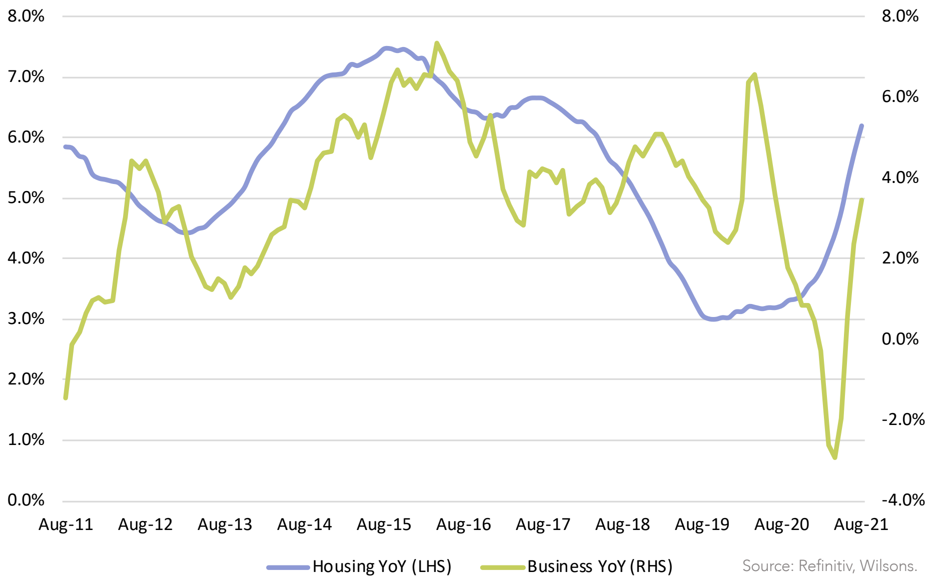
Bank prevision profit growth stands at 6.5% and 6.0% for FY21E and FY22E respectively. Earnings per share (EPS) growth should be stronger, benefiting from bad debt provision writebacks, likely across both years.

System credit growth is currently tracking ahead of market estimates, suggesting some upside risk to earnings if maintained. With APRA-led macro-prudential lending restrictions likely to come into play before the end of the year – designed to dampen housing credit growth – the market will not be willing to pay up higher system growth at this stage. We see the risks to bank pre-provision profit growth as being neutral at present.

Bank results will also give us a look at how much damage the NSW/VIC lockdowns have had in terms of bad debts. We continue to believe banks have over-provisioned. We are yet to see evidence of any real pick up in SME insolvencies or any distress in housing over 2021.

Westpac (WBC, 9%) - our preferred major bank - is likely to announce capital management. The laggard of the big four, a $4-5bn on-market buyback is likely. NAB (NAB, 7%) we think is unlikely to update its capital management with the pending purchase of Citigroup's consumer division.

Exhibit 6: Housing and business credit growth remains ahead of market



Source: Refinitiv, Wilsons.

The Focus List currently has a market weight position on the major banks.

Macquarie Group (MQG, 3% weight) is coming off the back of a large double-digit earnings guidance upgrade. We do not expect MQG to provide guidance into FY23E outside of general operating comments, but again highlight that the market forecasting just 4% earnings growth for FY23E appears conservative.

4

Higher bond yields

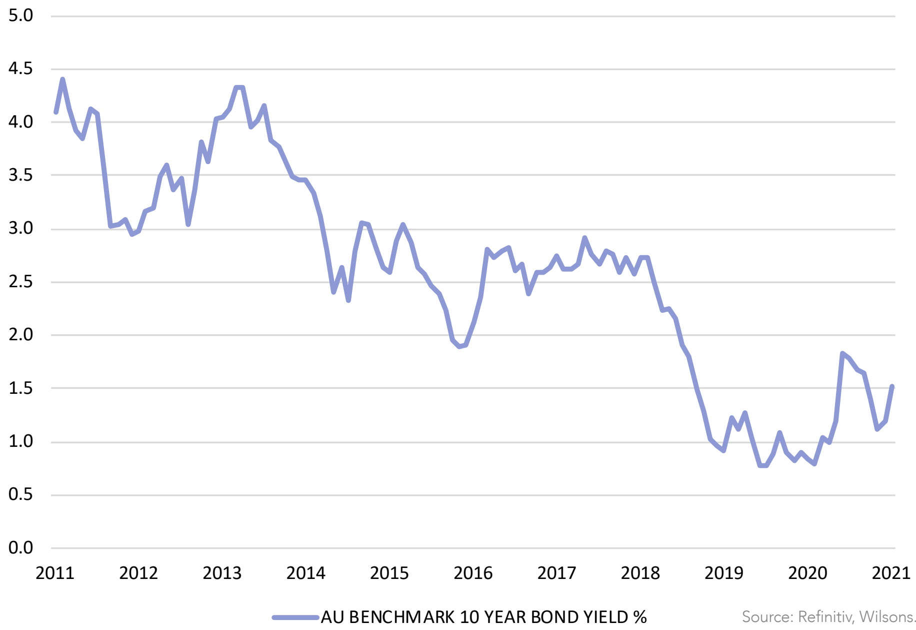
Timing: 4Q, Federal Reserve meeting 2 November 2021

Potentially the most impactful global cross-currents during 4Q21, the prospect of higher long-term bond yields has already taken 5-7% off global equity markets. Australia has followed in tandem.

We are not overly concerned about bond yields breaking out and see the current period as part of the market's adjustment process. The prospect of the Federal Reserve easing monetary stimulus is likely to hang over at least half of this quarter. We continue to expect the Fed to be gradual. Still, the risk of a policy mistake or misinterpretation by the market remains.

The cyclical overweight of the Focus List at present means higher yields or a steeper yield curve should be a net benefit, offsetting a number of technology/healthcare exposures that are bond yield sensitive.

Exhibit 7: Australian 10YR bond yield



Source: Refinitiv, Wilsons.

Exhibit 8: Focus List companies that benefit from higher bond yields

Company	Ticker	Weighting	Wilsons Comment
Westpac Banking Corp	WBC	9.0%	Steeper yield curve positive for financials
BHP Group	BHP	8.0%	Accelerating global activity
National Australia Bank	NAB	7.0%	Steeper yield curve positive for financials
Insurance Australia Group	IAG	5.0%	Steeper yield curve positive for financials
Seven Group Holdings	SVW	4.0%	Accelerating global activity
Santos	STO	5.0%	Accelerating global activity
OZ Minerals	OZL	3.0%	Accelerating global activity
James Hardie Industries PLC	JHX	4.0%	Accelerating global activity
Macquarie Group	MQG	3.0%	Steeper yield curve positive for financials
Australia and New Zealand Banking Group	ANZ	3.0%	Steeper yield curve positive for financials
Total Focus List exposure		**51.0%**	

Source: Refinitiv, Wilsons.

Exhibit 9: Focus List 4Q21 Key Event for Focus List Companies

Price sensitive events

Company	Ticker	Date	Event	Detail
Financials				
ANZ	ANZ	28-Oct-21	FY21 Earnings Release	FY market estimates look achievable following 3Q update in Aug. Provisioning, cost guidance key to FY22 outlook.
IAG	IAG	22-Oct-21	AGM	Update on BI insurance is key for the stock to rerate. The second test case decision will be released soon. We believe the overall damage of BI will be lower than the amount provided.
Macquarie Group	MQG	29-Oct-21	HY22 Earnings Release	FY guidance recently upgraded. Directional comments on FY23 outlook will be key, with market looking for just +4% earnings growth.
NAB	NAB	09-Nov-21	FY21 Earnings Release	Cost performance into 3Q, after maintained could surprise at FY21. Update on Citi consumer bank acquisition.
Westpac	WBC	01-Nov-21	FY21 Earnings Release	Potential for $4-5bn off market buyback at FY21 results, which will differentiate WBC from peers.
Materials				
BHP Group	BHP	19-Oct-21	Q1 2022 Operational Review	Clean 1Q production report expected. AGM 11 Nov expected to provide minor updates Jansen/collapse of DLC structure.
James Hardie	JHX	09-Nov-21	HY22 Earnings Release	Expecting another strong result following 1Q22 earnings guidance upgrade. Sales and margin run-rates the key focus in the US.
Northern Star	NST	19-Oct-21	Q1 2022 Activities Report	Volatility may support the gold price and rerate the stock. NST provides a hedge against inflation and market volatility.
Oz Minerals	OZL	20-Oct-21	Q3 2021 Production Update	Development updates across all key assets. West Musgrave (Ni Project) approval likely in 2022 (15-20% Group valuation).
Healthcare				
CSL	CSL	12-Oct-21	AGM	Market at mid-point of CSL's guidance range for FY22E, likely to be reiterated at AGM. Peers report 3Q earnings.
ResMed	RMD	27-Oct-21	1Q22 Earnings Release	We expect underlying market conditions to remain strong as RMD benefit from Philips recall, new product launch.
Telix	TLX	By 23 Dec	FDA Announcement	FDA approval expected for key Illuccix product no later than 23 December 2021.
Industrials				
Seven Group	SVW	18-Nov-21	AGM	Update on trading conditions. Pending US Fly Ash sale within BLD could see capital returns from SVW.
Qantas	QAN	05-Nov-21	AGM	Reopening is likely a key driver of the stock in the quarter. International and domestic flights this quarter should provide further support for the share price.
Communication Services				
SEEK	SEK	17-Nov-21	AGM	Reopening beneficiary - as rehiring begins/employment turnover increases. Trading update expected at AGM.
News Corporation	NWS	04-Nov-21	1Q22 Earnings Release	Reopening beneficiary - REA business. Speed of recently launched share buy-back. Update on strategic initiatives including potential Foxtel IPO.
Telstra	TLS	12-Oct-21	AGM	Limited news flow expected. AGM to reiterate cost guidance for T25 strategy. News flow on Foxtel potential IPO.
Information Technology				
Afterpay	APT	03-Nov-21	3Q21 Square Earnings Release	Square share price now has more relevance to the APT share price than the earnings performance of APT.
EML Payments	EML	17-Nov-21	AGM	Updates on regulatory interaction with Bank of Ireland. Trading update expected at AGM.
Xero	XRO	11-Nov-21	HY22 Earnings Release	Lead indicators of business conditions continue to remain strong. Outlook on European expansion and guidance will remain important after a slightly disappointing result in March 2021.
Real Estate				
HealthCo	HCW			Look for update on progress capital deployment across both income and development assets.
Goodman Group	GMG	19-Nov-21	AGM	FY22 guidance in August underwhelmed at 10% growth. Upside risk on development/ performance fees though FY22.
Consumer Discretionary				
Aristocrat Leisure	ALL	18-Nov-21	FY21 Earnings Release	Reopening is likely a key driver of the stock in the quarter. New games announcements could improve sentiment further.
Silk Laser	SLA	24-Nov-21	AGM	Trading update (date TBA) and AGM key events this quarter. Look for 1) reopening activity in NSW/VIC; 2) ACS acquisition integration.
Energy				
Santos	STO	21-Oct-21	Q3 2021 Production Update	Energy prices expected to be key influence. Further progress reports on asset sell downs to optimise the portfolio/lower debt post STO/OSH merger.

Source: Refinitiv, Wilsons.

Disclaimer and Disclosures

Recommendation structure and other definitions

Definitions at www.wilsonsadvisory.com.au/disclosures.

Disclaimer

All figures and data presented in this research are accurate at the date of the report, unless otherwise stated.

Wilsons Australian Equity Focus List (Focus List) is a weighted list of the Investment Strategy Group's (ISG) preferred companies. The Focus List can hold up to 25 companies, largely taken from the S&P/ASX 300. Stocks may be substituted at any time at the discretion of the ISG. Performance numbers around the Focus List are unaudited, and should be used only as a guide to indicate returns if investors were to follow the Focus List. For further information please contact your Wilsons Advisor.

This document has been prepared by Wilsons Advisory and Stockbroking Limited (AFSL 238375, ABN 68 010 529 665) ("Wilsons") and its authors without consultation with any third parties, nor is Wilsons authorised to provide any information or make any representation or warranty on behalf of such parties. Any opinions contained in this document are subject to change and do not necessarily reflect the views of Wilsons. This document has not been prepared or reviewed by Wilsons' Research Department and does not constitute investment research. Wilsons makes no representation or warranty, express or implied, as to the accuracy or completeness of the information and opinions contained therein, and no reliance should be placed on this document in making any investment decision Any projections contained in this communication are estimates only. Such projections are subject to market influences and contingent upon matters outside the control of Wilsons and therefore may not be realised in the future. Past performance is not an indication of future performance.

In preparing the information in this document Wilsons did not take into consideration the investment objectives, financial situation or particular needs of any particular investor. Any advice contained in this document is general advice only. Before making any investment decision, you should consider your own investment needs and objectives and should seek financial advice. You should consider the Product Disclosure Statement or prospectus in deciding whether to acquire a product. The Product Disclosure Statement or Prospectus is available through your financial adviser.

Wilsons Corporate Finance Limited ACN 057 547 323, AFSL 238 383 acted as Co Manager in the March 2021 initial public offering (IPO) of Dalrymple Bay Infrastructure Ltd securities for which it received fees or will receive fees for acting in this capacity. Wilsons Advisory and Stockbroking Limited may have a conflict of interest which investors should consider before making an investment decision. Wilsons Advisory and Stockbroking Limited, Wilsons Corporate Finance Limited and its related bodies corporate trades or may trade as principal in the securities that are subject of the research report.

Wilsons Corporate Finance Limited ACN 057 547 323, AFSL 238 383 may have participated in some capacity with regard to capital raisings for some of the companies mentioned in this article. To manage any conflicts of interest with Wilsons Research, full disclosure on any relevant corporate transaction may be found on our website.

In particular, Wilsons Corporate Finance Limited ACN 057 547 323, AFSL 238 383 acted as:

- SILK Laser Australia Limited (SLA) - Joint Lead Manager in the June 2021 Institutional placement and Joint Lead Manager and Underwriter in the November 2020 initial public offering
- EML Payments Limited (EML) - Co-Manager in the November 2019 placement
- Telix Pharmaceuticals Limited (TLX) - Joint Lead Manager and Joint Underwriter to the Telix Pharmaceuticals Limited November 2017 IPO
- Afterpay Limited (APT) - Co-Manager in the August 2018 placement of Afterpay Touch Group Limited securities
- HealthCo Healthcare and Wellness REIT (HCW) - Co-Lead Manager in the September 2021 Initial Public Offering

for which it received fees or will receive fees for acting in this capacity. Wilsons Advisory and Stockbroking Limited may have a conflict of interest which investors should consider before making an investment decision. Wilsons Advisory and Stockbroking Limited, Wilsons Corporate Finance Limited and its related bodies corporate trades or may trade as principal in the securities that are subject of the research report.

Wilsons contact

john.lockton@wilsonsadvisory.com.au | +61 2 8247 3118

david.cassidy@wilsonsadvisory.com.au | +61 2 8247 3149

rob.crookston@wilsonsadvisory.com.au | +61 2 8247 3101

www.wilsonsadvisory.com.au