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On behalf of the Investment  
Strategy Group at Wilsons,  
we wish clients and their families  
a happy holiday season.  
We look forward to returning  
in late January 2022 to share our  
insights on the Australian  
equity market.

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WILSONS

# Australian Equity 2022 Outlook: Chasing Normal

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Our weekly view on Australian equities.

16 December 2021

# The Backdrop for 2022

The fading influence of the pandemic domestically over 2022 – along with reopening, consumer savings, corporate spending, and continued policy support – provide a constructive backdrop for Australian Equities. The prospect for a high single total return from equities over 2022 remains our central case.

We see three key themes for Australian Equities in 2022:

1. **Corporate earnings recovery continues**
2. **Inflation risk management**
3. **Bouts of equity market volatility**

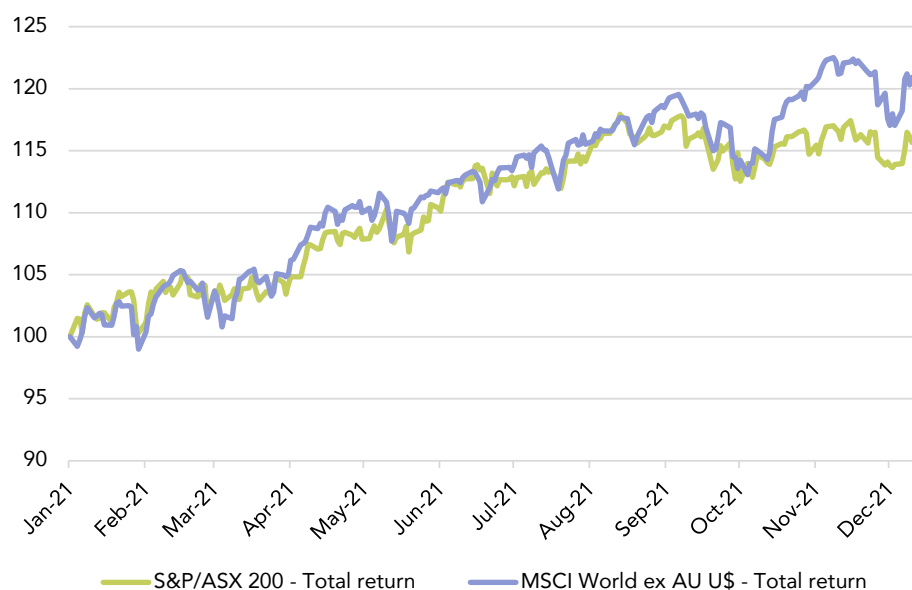
It is hard to get too bearish around the domestic economic backdrop for 2022 as the economy continues to chase down a more normal setting. Strong vaccine coverage should underwrite the domestic recovery in 2022.

While valuations have expanded over 2021, the corporate earnings cycle is yet to fully reflect the above factors. A return to long-term Australian trend earnings implies medium-term upside risk for corporate earnings.

For equities, the prospects of a mid-cycle slow down and debate around how long good times can last are expected to dominate investor debate in 2022. This is particularly the case offshore, where the brakes on monetary policy are likely to be gently applied over 2022.

While not our base case, a hawkish pivot of the US Federal Reserve against persistently high inflation/slowing growth rates remains the key source of equity price risk. Under this scenario, we cannot rule out equities falling 5-15% in quick order, similar to the experience in 2013 and 2018. Australian equities would not be immune in this scenario.

**Exhibit 1: Australian market underperformed global equities in 2021, primarily in the 2H21\***



\*Total return, Rebased 100 1 Jan 2021

Source: Refinitiv, Wilsons.

## 2021: Year in Review

Year to date, Australian equities have underperformed global equities, returning 16% vs MSIC World Index at 19% (A\$ currency terms). Both European and US equities have risen further, 22% and 24%, respectively (local currency). The rise in the S&P 500 has been influenced by the continued dominance of US large-cap technology. Excluding this part of the US market, the performance is relatively similar.

[Read Another Dominant Year for the US Stock Market](#)

In the second half of the year, Australian index performance was held back by COVID lockdowns and the falling iron ore price, which dampened Australian earnings momentum.

Australia did outperform emerging markets (EM) which returned just 3%. EMs were held back by a rising US\$, COVID lockdown earnings, and the sell-off in the mega-cap Chinese tech sector.

## Exhibit 2: S&P/ASX 200 sector price performance 2021

Price Change %	REITS	Industrials	Comm. Svs	Consumer Disc.	Consumer Staples	Energy	Financials	Healthcare	IT	Materials	Utilities	ASX 200
2020	-9%	-14%	-3%	7%	2%	-28%	-8%	6%	46%	14%	-16%	-1%
2021	21%	8%	29%	25%	9%	-4%	16%	6%	5%	3%	-6%	11%
EPSg												
2022E	11%	131%	9%	12%	3%	43%	6%	2%	17%	-11%	3%	4%

\*2021 CYTD 14/12/21

Source: Refinitiv, Wilsons

## Australian Equities Key Themes for 2022

### 1. Corporate earnings recovery continues

We see the prospects of further improvement in Australian corporate earnings over 2022/23, which should help support the market. Australian earnings are just 5% above pre-COVID levels, lagging global equities by almost 15% points.

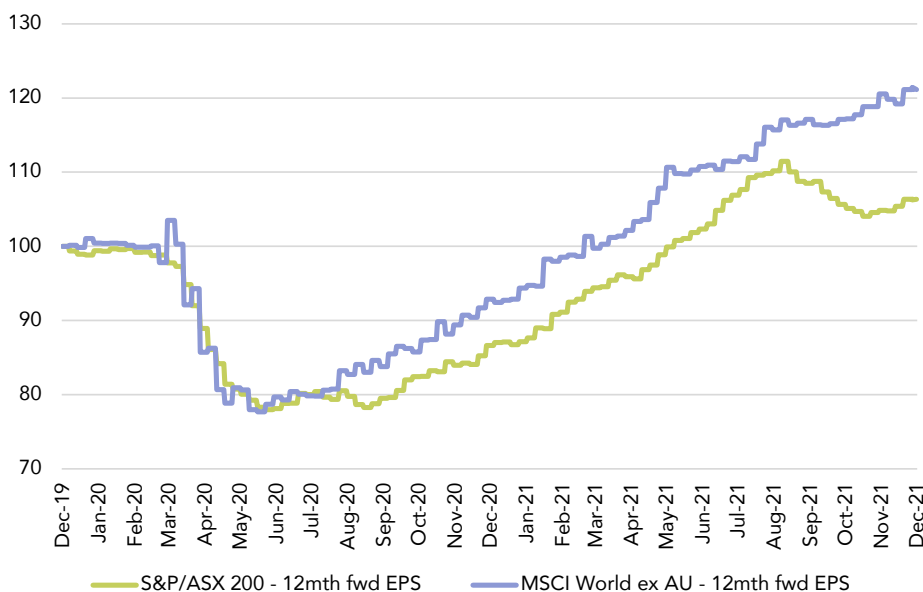
As observed through 2021, Australian earnings were subdued heading into 2020, and ROE was well below peak levels. In our view, there remains medium-term upside risk to the earnings story, particularly if global growth remains buoyant and banks can show a higher level of earnings growth.

During 2021, a mid-cycle slowdown in Australian earnings, COVID Delta lockdowns mid-year, and falling iron ore price has weighed on the earnings outlook.

Looking forward, high vaccination rates domestically provide a strong foundation for reopening 3.0 to get underway during the 1H22. We expect the February results season in early 2022 to be reasonably upbeat, particularly around the outlook.

The Focus List is currently positioned for the improvement in earnings through thematic exposures in quality cyclicals - Seven group Holdings (SVW), Macquarie Group (MQG), James Hardie (JHX), Insurance Australia Group (IAG) - and cyclical value - Qantas (QAN), Oz Minerals (OZL), Santos (STO) and the major banks.

### Exhibit 3: Australian earnings per share hit a mid-cycle pause in 2H21



Source: Refinitiv, Wilsons

### 2. Inflation risk management

Inflation was a key topic for investors during 2021 and is likely to remain in focus for investors in 2022. We remain in the transitory camp and expect by late 1Q22, early signs of easing inflation pressures should be on show.

Whilst Australian inflation figures have not responded as aggressively as we have seen in the US, corporates are acutely aware of cost pressures across global supply chains, raw materials, and labour.

Over the past week, Supermarket giant Woolworths (WOW) walked to into a 7-8% 1H22 earnings headwind driven by supply chain pressures and higher labour costs. Crown Resorts (CWN) described staff shortages as 'significant' across its three Casino operations in VIC, WA and NSW.

WA exposed mining service companies Monadelphous (MND) and NRW Holdings (NRH) have been dealing with the issue for much of this year. The Focus has held no position in these names through 2021.

[Read Fortress WA - Six Beneficiaries of the Border Reopening](#)

In terms of managing inflation risk, the Focus List's current positioning is to be overweight quality cyclicals. This should hold the Focus List in good stead in controlling inflation risk. Resource and energy exposures through BHP Group (BHP), OZL, STO will have little trouble passing on higher costs. Financials – we are market weight the banks when you include challenger bank Judo Bank (JDO). Higher inflation should be broadly positive for the banks. Companies with pricing power like Aristocrat Leisure (ALL), JHX, and SEEK (SEK) should also be able to defend margin by pushing through price rises.

### 3. Bouts of equity market volatility

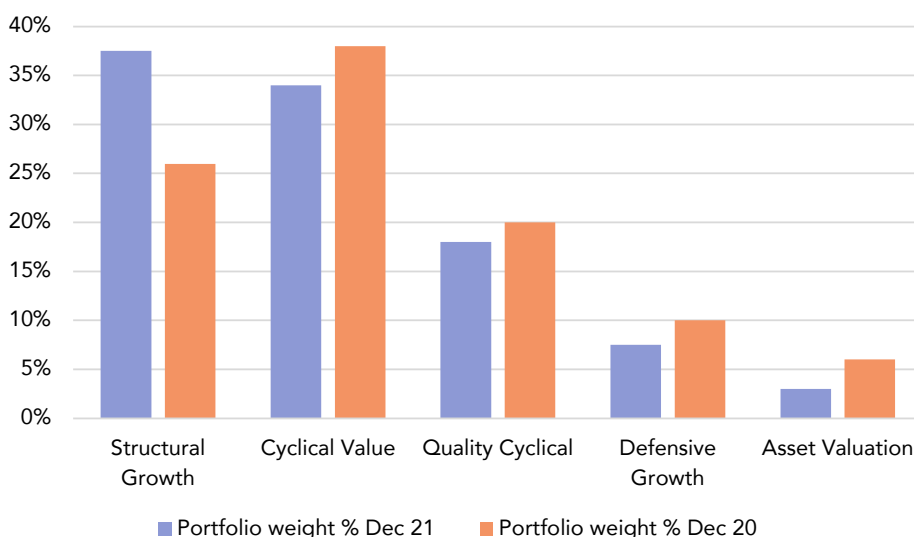
The chase for normal will also involve policy settings normalising. This includes central bank policy, with US Fed Reserve commencing this task in 2021. Normalisation is likely to accelerate in 2022.

This is an important policy setting to watch during 2022. Historically, the changing of the guard from expansionary policy to neutral brings volatility to global markets, including Australian equities.

We would not be surprised to see bouts of market volatility through 2022, where markets are down 5-15%, before recovering. We saw similar experiences in both 2013 and 2018.

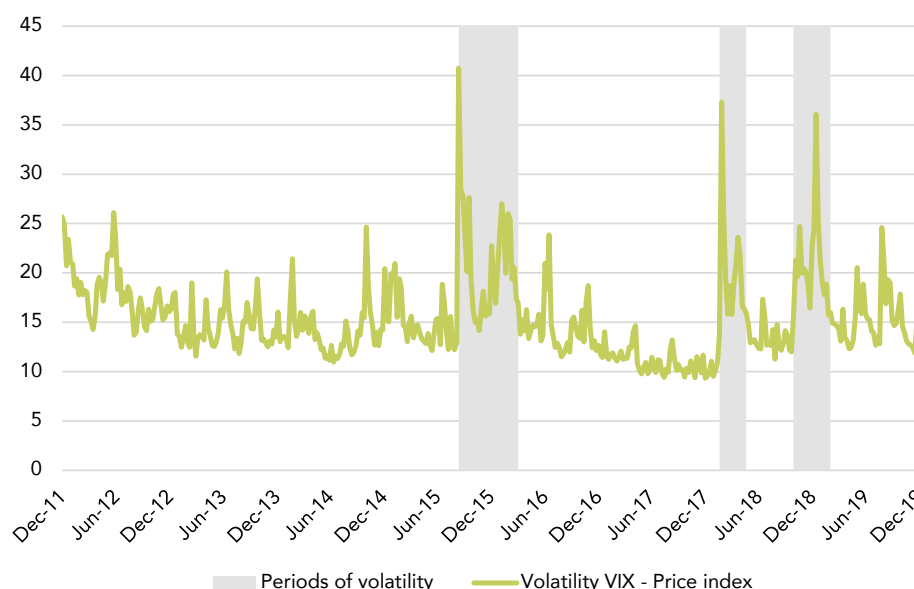
Insuring a long-only portfolio can be a challenge when dealing with the potential for price volatility. In the Focus List Healthco Healthcare and Wellness (HCW), Telstra (TLS), and Northern Star Resources (NST) are likely to be relatively defensive. IAG at current prices is also in this camp.

**Exhibit 4: Focus List exposure to cyclicals remains at 60%**



Source: Refinitiv, Wilsons.

**Exhibit 5: Volatility chart – highlight 2013 + 2018**



Source: Refinitiv, Wilsons.

## Risk Factors 2022

The most significant risks to the Australian outlook will likely stem from offshore events. Domestically, we see the key risks in Australian equities in 2022 as being:

- Earnings optimism fades on 2022/23 growth prospects
- COVID lockdown reemerging on a new variant(s) or waning vaccine efficacy
- Equity market slippage – an improving domestic economic picture is not reflected in the equity market due to compositional differences, cost inflation, or perhaps concerns in global markets weighing on Australian equities
- Federal Election – tight result, minority government

## Australian Economic Outlook

We see the domestic economic environment as remaining constructive for the equity market in 2022. Both fiscal and monetary policy are expected to be supportive (gradual pathway to tighter policy).

First-rate rises are likely from 2023 (ahead of RBA current thinking). Reopening tailwinds with buoyant consumer and business confidence sees the prospects of above-average GDP growth in 2022.

Four key themes:

1. Domestic growth pulse remains above average
2. Employment market is expected to continue to tighten
3. Reopening 3.0: both domestic/ international borders
4. RBA brings forward rate hikes to 2023

*For more, see our Global Outlook note published 20 December 2021.*

## Key Events of 2022

### Afterpay merger with Square (SQ)

*January*

Now known as Block, takes effect.

### BHP unification

*January*

BHP index weight will rise from ~6.0% to 9.5% of ASX200 Index.

### Federal Budget

*April*

Early pre-election budget will likely contain modest tax cuts.

### Federal Election

*May*

Unlikely to contain any large areas of reform or policy change. Both parties will likely position themselves as a 'small target'. Unlikely to be a major issue for the equity market.

### SA & NSW State Elections

*March*

Stimulatory stance expected, infrastructure and jobs focused.

### VIC State Election

*November*

Stimulatory stance expected, infrastructure and jobs focused.



## Focus List Positioning 2022

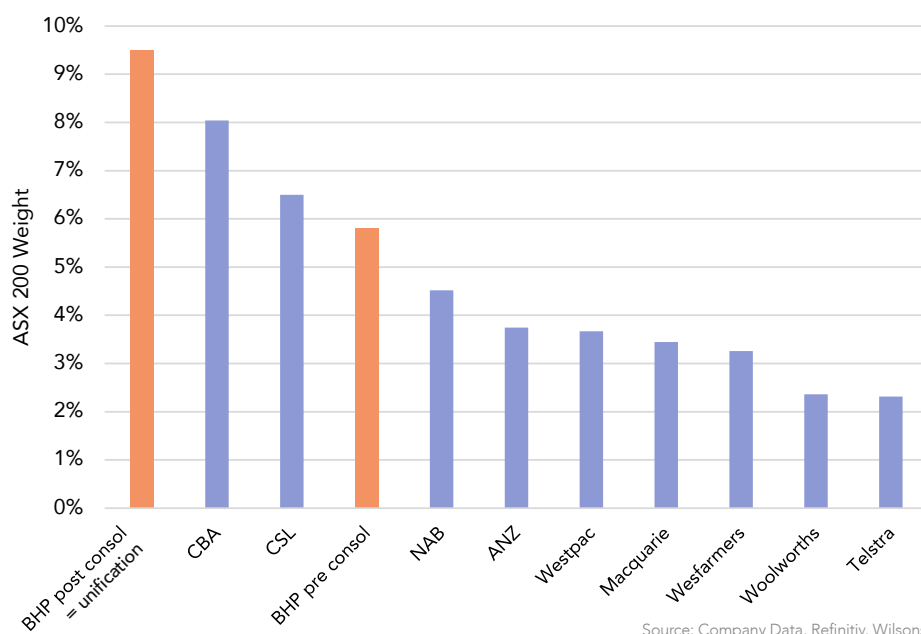
The Wilsons Australian Equity Focus List remains overweight cyclicals – both COVID recovery beneficiaries like BHP, IAG, QAN, NWS, and STO. Finding strong cyclical domestic leverage remains somewhat elusive. We are underweight domestic banks on concerns around slowing growth, particularly as cost bases remain a challenge for the banks to structurally lower. Challenger bank JDO remains our largest active bank position.

We remain overweight quality growth beneficiaries, which in this cycle also retains cyclical exposure as we recover from COVID-19. We retain key overweight positions ALL, CSL, Goodman Group (GMG), JHX, MQG, SEK, and Xero (XRO). Our emerging companies weighting is currently just below 20% of the Focus List, with strong bottom-up stock-specific ideas across EML Payments (EML), HCW, JDO, Silk Laser Australia (SLA), SVW, and Telix Pharmaceuticals (TLX).

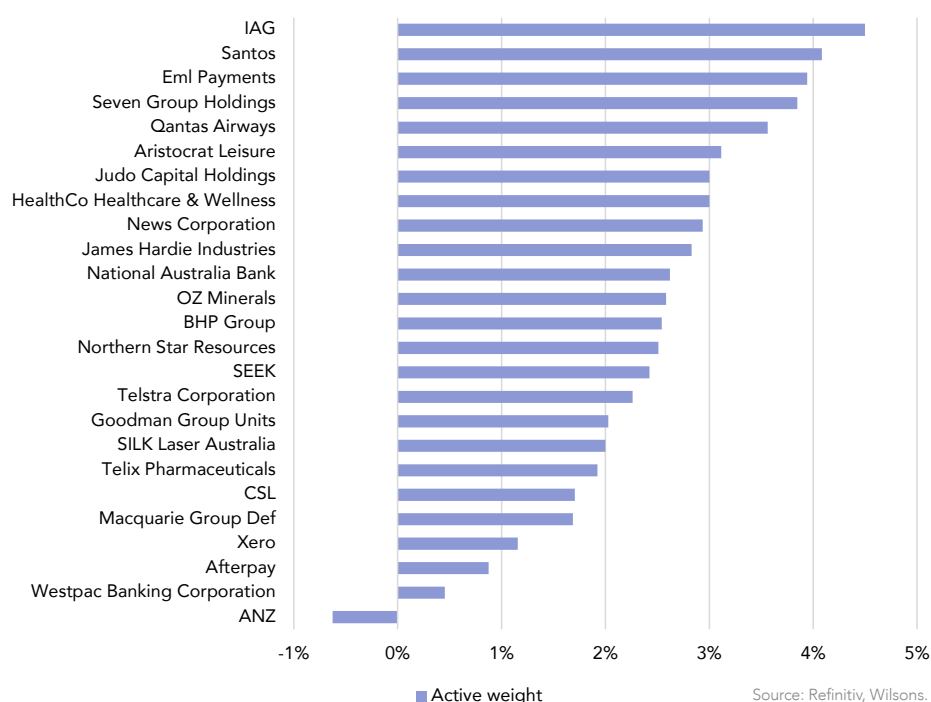
## Focus List Year in Review

With 2021 drawing to a close, we take stock of how the Wilsons Australian Equity Focus List has performed through the year. Over the past 12 months the Focus list has generated a total return of 16.4% relative to the benchmark (ASX all Ords) of 15.5%. Since inception (May 2020), the Focus list has generated a total return of 49%, providing 8.3% alpha vs the benchmark of 40.7%. (Source: Wilsons IMS Platform)

**Exhibit 6: BHP index weight will lift to almost 10% in late January 2022**



**Exhibit 7: Focus List active weights relative to market**



**Exhibit 8: Focus List summary statistics – EPS growth x4 higher vs market**

	Portfolio	Benchmark	Difference
Dividend Yield	2.5	3.6	-1.1
Price-to-Cash Flow	43.9	34.1	9.8
Price-to-Book	2.7	2.3	0.3
P/E - Trailing 12-Month	34.9	21.6	13.3
P/E - Forecast 12-Month	18.8	17.7	1.1
EPS Growth - Forecast 12-Month	22.4	5.3	17.1
EPS Growth - Long Term	16.0	9.7	6.3

Source: Refinitiv, Wilsons

## Key Contributors 2021

### **Telix (TLX): Total return YTD +104%**

- TLX has had another incredible year, with its share price more than doubling. There is potential for further share price appreciation as regulatory approvals are granted. The pending FDA approval this month remains key.

The past 12 months have been exceptional, but investors should bear in mind that the path to biotech approval and commercialisation is not always a one-way street. We retain our 2% weighting to TLX.

### **Macquarie Group (MQG): Total**

**return YTD +52%** - MQG continues to outperform the index and has proven over the recent pandemic that it can maintain earnings through times of volatility, relying on its commodity trading activity and its asset management business to smooth earnings. Over the medium-term, we still believe MQG can outperform as it grows its asset management business, which provides a steady income. At the same time, the Macquarie Capital business should benefit from a broader international reopening in 2022.

### **Sydney Airport (SYD): Total return**

**+41%** - SYD has generated a return of ~40% for the Focus List from March to September this year due to the takeover bid from the IFM consortium. After a third offer from the consortium, valuing SYD at \$A8.75 per share, we exited in September, with a higher bid or a competing offer looking unlikely.

## Key Detractors

### **Northern Star (NST): Total return YTD**

**-27%** - The stock price has retraced from ~\$12 to ~\$9. In a market where gold prices have fallen and investors have shifted into cyclical sectors, NST has been used as a funding source.

We would argue that below \$10, NST looks exceptional value. The merger between NST and SAR was approved early in 2021. We think the market is underestimating the benefit of a combined NST/SAR and the potential cash generation of NST if gold prices remain relatively stable. NST is also a useful hedge against higher inflation.

### **EML (EML): Total return YTD -17%**

- EML fell on news of a regulatory dispute between the Central Bank of Ireland and its European business PFS. Due to this announcement, the stock fell 46% in May. We believe the stock has been oversold, and the financial impact of the dispute is smaller than what is currently priced in by the market. In our view, this business can grow EBITDA at 20% CAGR over the next three years.

### **Appen (APX): Total return -36%**

- A 3% holding at the beginning of the year, but after a downgrade and a 35% fall (Dec 20 – Mar 21) in the share price, we decided to exit our position in APX in March 21. A lack of transparency on earnings and, in our view, a high likelihood of another downgrade were key catalysts for our decision. Since March, the stock has fallen another 35%.

## Wilsons Australian Equity Focus List

Designed to provide core exposure to Australian Equities through a diversified selection of 20-25 ASX listed companies.

The Focus List selects companies that can generate above-average medium to long-term growth. This may be due to company-specific (structural) advantages, or extended macroeconomic/thematic tailwinds. Additionally, Focus List companies should be able to demonstrate improving returns on capital.

Up to 30% of the Focus List can be companies outside of ASX 100, which are typically smaller faster growing companies. We believe that as earnings grow, good companies can become great companies, compounding returns for investors over the long-term. The Focus list draws on the experience of ISG (Investment Strategy Group), in addition to Wilsons own in-house expertise in emerging companies.

*For further information speak with your advisor or use the link to have a Wilsons advisor contact you.*

<https://www.wilsonsadvisory.com.au/contact-us>

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Recommendation structure and other definitions

Definitions at [www.wilsonsadvisory.com.au/disclosures](http://www.wilsonsadvisory.com.au/disclosures).

## Disclaimer

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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.

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

- EML Payments Limited (EML.ASX) - Co-Manager in the November 2019 placement
- HealthCo Healthcare and Wellness REIT (HCW.ASX) - Co-Lead Manager in the September 2021 Initial Public Offering
- Telix Pharmaceuticals Limited (TLX.ASX) - Joint Lead Manager and Joint Underwriter to the Telix Pharmaceuticals Limited November 2017 IPO
- Afterpay Limited (APT.ASX) - Co-Manager in the August 2018 placement of Afterpay Touch Group Limited securities
- Judo Capital Holdings Ltd (JDO.ASX) - Co-Lead Manager in the October 2021 Initial Public Offering
- SILK Laser Australia (SLA.ASX) - Joint-Lead Manager in the November 2020 Initial Public Offering

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