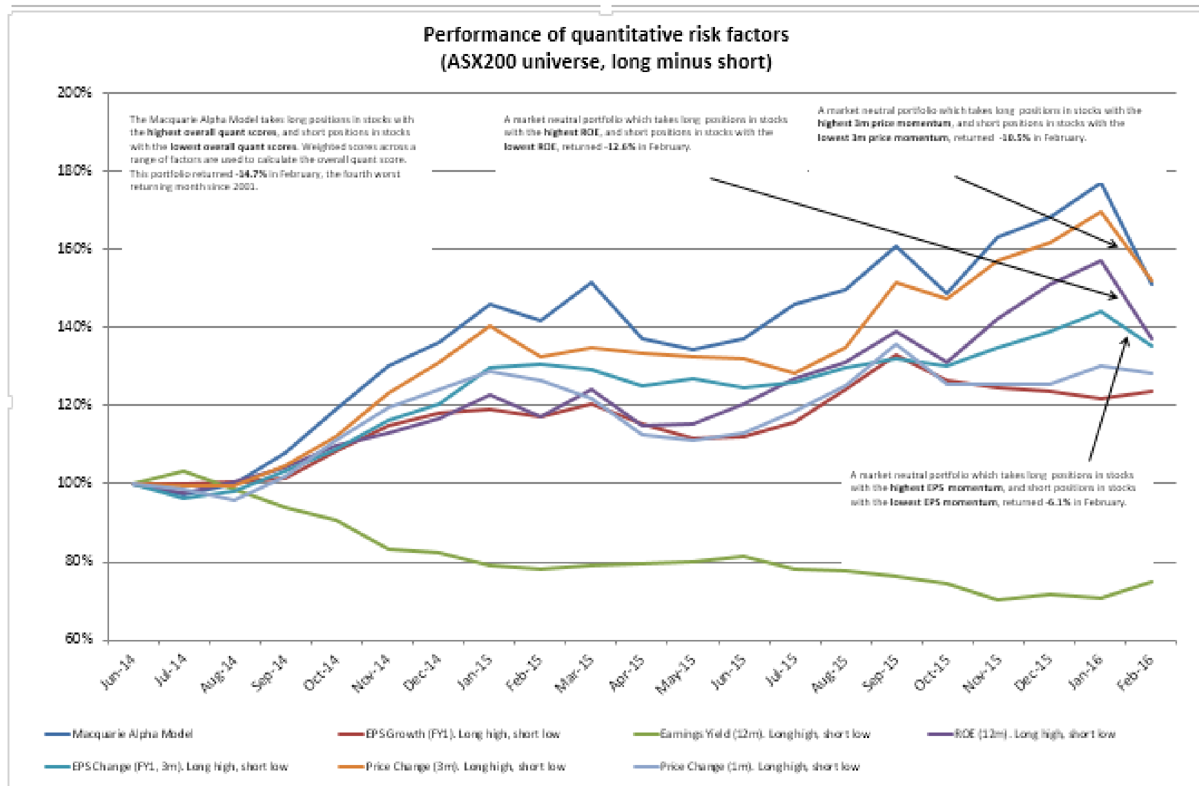
Difficult times for active managers in Australia

If you follow the returns of active equity funds in Australia in February and early March, you could be forgiven for thinking they were all jn the same stocks. Almost everyone lost money and most fell more than the market even though it (All Ords Accumulation) only fell -1.5%.

This chart from Macquaries shows the 'mean reversion' flight from high growth quality businesses to low growth value which occurred in February.



As Bennelong's Dick Fish said about the stocks which bounced in February and into March, gainers, 'they just got too cheap'. Pretty simple.

So you had crowded shorts and crowded high PE longs, leading to rotation out of last year's winners, despite the fact that these are still the fastest growing businesses in Australia, and into 'oversold' but low quality businesses in terms of earnings growth, which is where everyone was short.

And that includes long only managers who moved from overweight to underweight and vice-versa.

A mitigating factor was the sudden jump in iron ore, which provided fuel to the fire as the move from $30 to $58 offered breathing space to some businesses which the market expected to announce discounted capital raisings (Fortescue for example). Some say the spike in iron ore was a seasonal Chinese re-stocking for the year ahead, others remain bemused given the outlook of increased supply.

The macro backdrop led to fear and a propensity to sell rather than buy, which again hit the high PE winners.

Banks fell heavily on fears around Deutsche Bank's solvency, plus fears of a property crash in Australia.

Turning points in markets are always challenging. When poor businesses become too cheap, and attractive businesses become too expensive, managers face an interesting dilemma. Over the long term, quality in terms of sustainable earnings growth will lead to an increase in a listed company's share price, but this will not be a straight line, and there will be periods when quality underperforms.

At King Tide, we understand that by subscribing to the underlying belief that markets are not efficient at pricing businesses, will mean periods of underperformance as the market recalibrates. These periods are healthy and lead to increased opportunities for our managers.

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