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Calm before the financial storm

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July is typically an uneventful month in the markets, a period when there is little news given the pre-reporting season blackout.

It is the lull before the storm that is the full-year reporting season - which kicks into full force in the two final weeks of August. However, we are in a world in which the old rules no longer apply. This July we saw the market's largest monthly rise in 16 years - up 7.3 per cent.

You can't drive by looking in the rearview mirror. As investors, we must always look forward to generate returns. And the primary driver of stock returns is company performance, and what counts are the numbers posted on financial accounts.

So what are the major features we expect to see in the coming reporting season?

Retail sales are booming. There is no doubt about it. Prime Minister Kevin Rudd's handouts, along with help from record low interest rates, lower petrol prices and improving consumer confidence, have spurred Australians to spend.

Retail sales rose in four of the first six months of 2009 and reports from the likes of David Jones and JB HiFi have confirmed strong sales. Looking ahead, retailers will see additional benefit from the strong Aussie dollar currently trading at US84¢ (up almost 20¢ in six months). The balance of 2009 looks good for retailers.

Housing is solid. Government grants and low interest rates have supported demand in this sector, in sharp contrast to overseas experiences. Developers specialising in low-end housing are seeing unprecedented demand and suppliers of building materials, paint, plumbing and electrical goods can be expected to post strong results both this reporting season and next year.

Discretionary corporate spending has been down. The past 18 months have not been good to many businesses - especially those required to report earnings. As such, managers have been looking at options to lower costs across the board.

Employees have been chopped, marketing and IT budget slashed, and consultants sent packing. While there has been some improvement lately, we expect media businesses, IT companies and other discretionary corporate cost businesses such as recruitment, entertainment and travel to post depressed numbers. The silver lining is that this year could likely be bottom of the cycle.

Expect little direction in the outlook statements. Chief executives have learnt their lesson not to be overly optimistic. While the economic news and market sentiment has improved sharply in the past quarter, the crystal ball remains clouded and little direction can be expected into 2010.

Focus will be on revenue growth and margin expansion. Marginal balance sheets have been repaired, and corporate costs have been slashed. The focus will be on companies that can most effectively take advantage of an improving economy and leverage better sales into strong earnings growth. Expect the marketplace to be looking over those companies with low margins picking themselves off the floor.

As always, the last two weeks of reporting season are madness as companies rush to post their results, conduct a conference call and hold multiple group investor presentations, lunches and one-on-ones.

In many ways it is like walking through a financial minefield. As always, keep my fingers crossed that I reach September unscathed.

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