AFR WEEKEND

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SHARP FOCUS ON EARNINGS

Equities **William McInnes** finds out what the experts expect from the February reporting season.

Professional investors are eagerly awaiting February's earnings season but remain divided over whether companies can exceed their low earnings expectations and extend the market rally from its December lows.

Australian stocks experienced their worst quarter since September 2011 in December, as the S&P/ASX 200 declined more than 9 per cent. The market has enjoyed a strong January since, rising close to 4 per cent this month.

The poor performance since the end of August has largely been driven by macro factors, including Brexit and the US-China trade war, rather than specific company downgrades but expectations for earnings season remain low.

While the full-year earnings season last August pushed local shares to decade highs, Perpetual's head of investment strategy Matt Sherwood expects only small pockets of positive earnings this time round.

"Expectations are downbeat and quite honestly have been for a while," he says. "That provides the market with a very low hurdle to outperform. But of course, the operating environment is still very challenging. Despite the fairly robust domestic economy, overall there isn't a lot of revenue growth in corporate Australia, and I would argue that [cost-cutting] is pretty much done."

Not everyone shares Sherwood's outlook, however, with other professional investors tipping earnings to push the market into a sustained rally as stocks beat the expectations implied by their low valuations.

"There's been a lot of hot money on macro factors but a lot of these companies don't really change too much," says Atlas Funds Management chief investment officer Hugh Dive. "I'm looking forward to February, more so than previous years. Given valuations are down, a rally could last several months."

Clime Asset Management senior analyst David Walker expects some strong results from large-cap companies including Woodside Petroleum and Woolworths.

On Thursday, Woodside reported a strong December quarter from its LNG plants which pushed its sales 43 per cent higher. "The solid production in the fourth quarter means Woodside's second-half result should be quite strong," Walker says.

He also expects Woolworths will regain traction after losing market share in the first quarter of the fiscal year to Coles' Little Shop promotion.

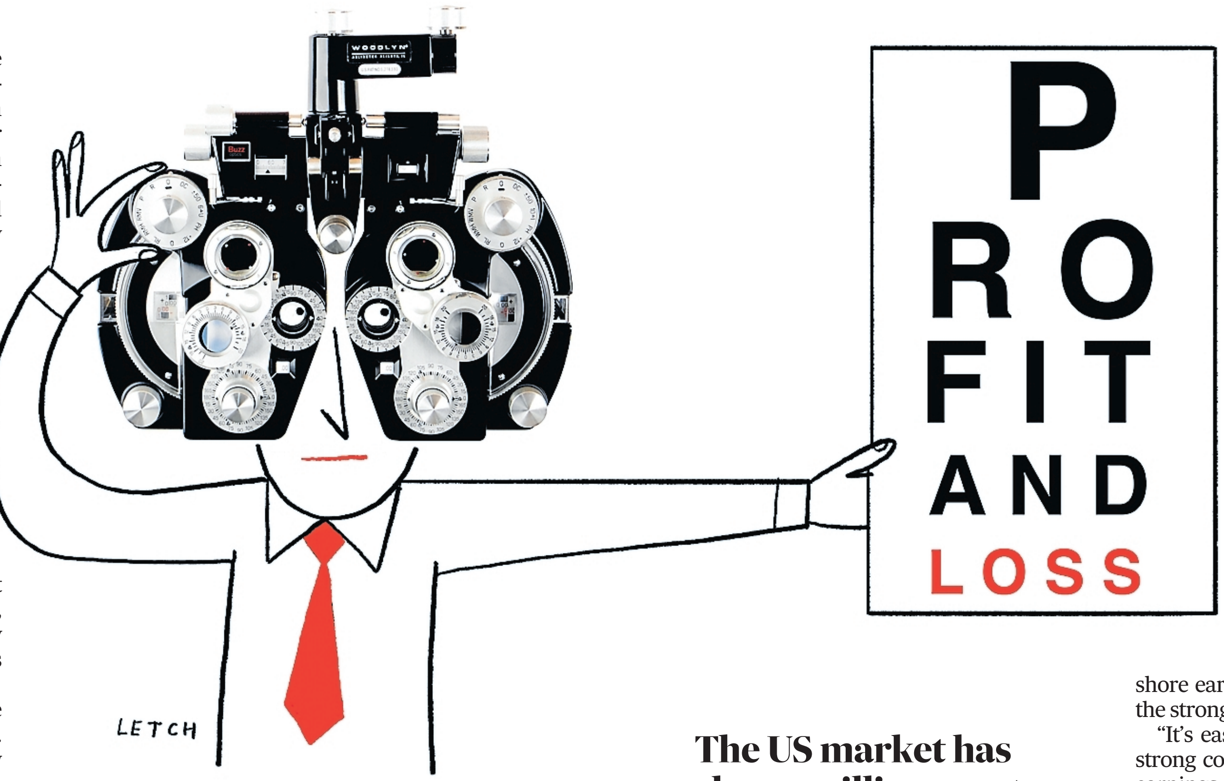
"I think we'll find Woolworths had a strong December quarter. Coles had the upper hand in September but Woolworths' excellent strategy should see them do well."

Walker also tips Commonwealth Bank will have a strong result when it reports its half-year results on February 6.

Perpetual's Sherwood expects retail and mining stocks to be among the most disappointing as they are already under pressure due to wider economic concerns.

"Despite expectations being low, companies with exposure to Australian consumers will disappoint further," he says. "The mining sector is obviously seeing cost pressures rise. Mining companies are competing with the east coast infrastructure builds and there will be margin pressures.

"My expectation is Australian economic growth will continue to moderate lower in line with most other developed economies. At the same time, cost pressures are rising so operating models are going to be hit and margins squeezed."



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The US market has shown willingness to reward companies that exceed low expectations.

Retailers have already flagged some early disappointments. Kathmandu highlighted disappointing Christmas results in early January, fashion retailer The PAS Group announced on Wednesday it expected earning to be at the lower end of its guidance and David Jones announced on Thursday its sales growth fell in the run up to Christmas.

Consumer confidence is also slumping, with the Westpac-Melbourne Institute Consumer Sentiment Index showing pessimist consumers now outweigh the optimists.

Outlook statements are also unlikely to be positive during February as companies look to deflect a bleak outlook. "In the end, it's not only the earning result, it's the guidance," Sherwood says. "Companies tend to give ambiguous guidance and firms have really found the art of saying nothing."

Clime's Walker says domestically focused companies in particular will likely signal a tone of caution. "The last thing they want now is the market to get ahead of them."

Low expectations present an excellent opportunity for higher quality companies to shine, with Clime's Walker and Perpetual's Sherwood agreeing offshore earners are likely to do well.

"On the whole, the earnings season will show corporate Australia is struggling. The one area where I can see some positive earnings surprises are our offshore earners because a lot are exposed to the strong US economy," Sherwood says.

"It's easy to beat low hurdles if you're a strong company. I think it's going to be an earnings season where good companies shine. Strong growth in a strong economy can hide a lot of incompetence but it's those firms that can protect their margins that will perform best."

The US market has already shown its willingness to reward companies that exceed low expectations. On Monday, Citigroup beat forecast profit estimates while on Tuesday JPMorgan Chase shares rose after the bank reported fourth-quarter profits two-thirds higher. On Wednesday, Goldman Sachs and Bank of America reported results above expectation too.

The results mean US fund managers are tipping February will be a positive month for Wall Street and in turn global stocks.

"I think the US market will always be the bellwether and a strong earnings season goes a long way to ripple though global markets," says THB Asset Management chief executive Christopher Cuesta.

"Stock prices are reflecting bear-market, recession-like values. I think you may have some numbers coming down but stocks going up. Even if a company lowers guidance, the share price might still rise because the results are not as bad as expected."

A guide to giving

Philanthropy Passionate about a cause but not sure of the right structure for you? **Emma Sakellaris** outlines the options.

While it's often said that Australia does not have a big philanthropic culture – particularly when compared to countries such as the United States – more Australians are becoming involved in charitable and volunteer work every year.

Global studies such as the 2018 CAF World Giving Index rank Australia highly when it comes to charitable giving, with women in particular playing an increasingly significant role.

Millennials are also driving philanthropic trends, with younger generations promoting their own charitable giving on social media through status updates and other feeds, and motivating others to give and contribute to a better community. Online platforms and crowd-funding initiatives are playing an increasingly important role in Australian philanthropy.

For individuals looking to make a lasting, significant and ongoing impact, a structured approach – such as establishing a charitable trust – is worth considering. A common misconception is that they are only for the very wealthy.

There are three main options to individuals, all of which provide a structure that allows funds to be invested and managed, with income generated available for distribution to charitable entities and programs. These structures include: public ancillary funds; private ancillary funds; and testamentary trusts. Each has different requirements, approaches and benefits, but all provide a structure that facilitates a long-term, sustainable philanthropic legacy.

To help decide which structure is most suitable, an important first question is whether to establish a charitable fund while alive or after death.

If the former, the next questions to consider are how much you can initially donate to establish the fund and how involved you want to be in the fund's investment and granting strategies.

■ **A public ancillary fund (PuAF)** is usually managed by a trustee company, which allows individuals with smaller amounts available for an initial donation to establish a charitable sub-fund during their lifetime. The sub-fund can accept future donations from the individual, family members and the broader community. All donations received by the sub-fund are tax deductible.

The sub-fund can be named, which effectively establishes a legacy that can transition across many generations into the future. Those who set up the sub-fund can be involved in decision-making regarding granting, thus helping to direct income to causes about which they feel passionate.

They often bring family members across multiple generations together.

A key benefit of this approach is that the minimum initial donation required to establish a sub-fund is $20,000, which is lower than other structures, and the tax deduction from the initial donation can be spread over five years.

Charitable trusts are designed to support growth capital over time, while generating sustainable income for granting distributions. All the investment, compliance and administrative requirements are undertaken by the trustee.

■ **A private ancillary fund (PAF),** like that run by former Westpac boss Gail Kelly and her family, is established by an individual via a deed but is only able to receive future, additional donations from the original