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SE Market Wrap

HD **US banks, oil, Korean cars top picks**

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Australia's band of globally focused **equity** investors are backing United States banks, healthcare, big **oil** and Korean car manufacturers amid concerns about the valuations of the local banks and insurance **firm** QBE.

Wingate's Chad Padowitz said that after a year when the rising tide lifted all boats (460 out of all stocks in the S&P 500 were in positive territory), 2014 would be the year of the stock picker. "[Last year was about] shooting fish in the barrel but that will be much lower this year so you will need to be better at your stock picking," he said.

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Mr Padowitz has identified two US sectors – healthcare and big **oil** – as unloved and therefore undervalued sectors. "Obamacare [legislation] has made those US shares cheaper than they should have been but hasn't changed the fundamentals. They are reasonably valued," he said.

Oil stocks in particular have fallen out of favour. Mr Padowitz believes they represent good value on the assumption that **energy** prices will fall amid a large supply glut. "We don't see that when you look at underlying data and demand is picking up. The US has had its strongest gas demand in more than a decade," he said.Housing recovery

A multi-year housing recovery in Britain and the US is a theme that $500 **million** fund manager VGI Partners, run by Rob Luciano and Doug Tynan, is favouring for global stocks.

A presentation by VGI, which returned about 45 per cent to investors in 2013, showed that it had done extensive work on the theme and had identified a small handful of companies, such as realtors, that would benefit from an increase in property activity.

The evidence was found in data showing recovering US house prices, still low transaction values and inventories coupled with favourable affordability. In Britian, VGI pointed to rising population growth, price appreciation that has yet to take hold outside London and an improving economy with rates expected to stay relatively low.US insurers, financials attractive

Wayne Peters of Sydney-based global fund Peters MacGregor is bullish on US financial institutions and insurers, which he sees as being at far more attractive levels than their Australian peers. "We still think the US is in recovery mode and US banks like Wells Fargo and Bank of America are still well undervalued," he said.

He is particularly upbeat on property and casualty insurance, and is backing AIG and Fairfax Financial. "It has been a soft market and pricing has now started to harden. The companies that we own are coiled springs, unlike QBE which is a stretched spring."

Mr Peters is particularly bearish on QBE, once a market darling, which has been beset by write-downs. He believes the ailing insurer is poorly placed relative to its peers and gave a presentation to the Portfolio Construction Academy outlining his concerns three weeks before the recent profit downgrade.

"A good underwriting culture is to walk away if the pricing is inadequate. QBE appears to have done exactly the opposite through the recent seven years of tough pricing. The lack of covenant information on the letter of credits supporting QBE's capital pledge requirements is also very concerning," he said.

He pointed to the premiums-to-capital ratio of Fairfax Financial, which is about 1 times compared to QBE at 3.2 times, implying QBE doesn't have the underwriting capacity to take advantage of better pricing.

Both Mr Padowitz and Mr Peters are of the view that Australian stocks are relatively expensive and both are bearish on the long-term outlook of banking stocks. "The banks are exceptionally expensive," said Mr Padowitz.

"I think the best you can hope for is not to lose money over the next four to five years. It will take that long for their earnings to grow into their valuations."

Mr Peters pointed to the price-to-book ratios of Australian banks, which at more than 2 times is double that of US banks. "US property has fallen and is stabilising so there is not as much risk to the loan books," he said. "Their loan-to-deposit ratios are much healthier than the Australian banks so from an investment perspective, the US banks are better." Large tech stocks still in favour

Perpetual Investment's Garry Laurence, who runs a global equities portfolio, is keeping faith with large US technology companies such as Oracle and EMC, large global healthcare stocks such as GlaxoSmithKline and Sanofi, as well as US financials such as Wells Fargo and PNC.

He also says there are bargains in the beaten-up emerging markets sector. "Emerging markets will be volatile but valuations are quite cheap," he said.

"So you can make money in **Hong Kong**, **China** [or] Korea but you need to be stock-specific. Some consumer discretionary stocks in **Hong Kong** and **China** are very cheap and one day investors will jump back into the theme that **China** is transitioning growth from investment to consumption."Korean market focused on the yen

Mr Laurence believes that Korean stocks are compelling, with car makers Hyundai and Kia trading at very low price-earnings multiples of about 5 to 6 times. "The Korean market is overly focused on the yen depreciating against the won. But Korean manufacturers have great brands and products and are low-cost manufacturers," he said.

Mr Padowitz, who runs Wingate's strong-performing global equities fund, believes US and global stocks could struggle to meet lofty expectations after a stellar 2013. "The market has had a good run in 2013 and a reasonable run since the end of the global financial crisis," he told The Australian Financial Review. "In 2014, that sets up the market at an expensive level."

Mr Padowitz said that at the US market's current average price-earnings ratio of 17.5 times, the consensus forecast is that US earnings will grow by 12 per cent this year. "The average since 1995 has been 8 per cent and given we are in the fifth year of recovery and rates are increasing, it's a big ask for earnings to accelerate," he said.

However, he added that there were reasons why US stocks could continue to rally to the end of the year, as the US economy appeared to achieve "escape velocity" with few foreseeable reasons to spark a sell-off. He also said there were few compelling alternatives for investors,with cash and bond rates still low, keeping investors in stocks.

"The downside is not big but neither is the upside. We expect 2014 to be between minus 5 per cent and positive 10 per cent for the US as a proxy. Europe might be tougher because they don't have the positive counter-weighing benefit," he said.

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