FINANCIAL REVIEW

SE Market Wrap

HD **Lesser lights ready to shine**

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WC 659 words

PD 4 February 2014

SN The Australian Financial Review

SC AFNR

ED First

PG 31

LA English

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IFM Investors says there are strong opportunities for **equity** investors among smaller companies, as the risk emanating from highly volatile resources companies wanes.

The Small Ordinaries Index underperformed the benchmark S&P/ASX 200 last year by 20 per cent in total shareholder returns, largely due to the woeful returns from small resources companies.

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The Small Resources Index plunged by 42 per cent in 2013, while the Small Industrials Index returned 18.5 per cent over the same period. After several years of poor performance, resources companies make up less than 20 per cent of the Small Ordinaries, compared with 40 per cent in 2011.

"Going from 40 per cent to less than 20 per cent obviously means the ability of resources to be a drag on the broader index has waned," IFM small caps executive director Neil Carter told The Australian Financial Review.

"The other factor is we don't see a huge amount of downside risk in the outlook for commodity prices, while we suspect it will be mixed ."

IFM has about $50 **billion** in assets under management across infrastructure, debt, equities and private capital, on behalf of several superannuation funds. Last year IFM led a group of investors in buying Port Botany and Port Kembla from the New South Wales government for $5.1 **billion**.Commodities tipped to be buoyant

IFM expects strong demand for commodities this year driven by growth in emerging markets and developed economies.

But resources companies are ramping up their production to meet this demand. Australia's big three **iron ore** miners, Rio Tinto, BHP Billiton and Fortescue Metals Group, expanded their capacity significantly last year. While the price of **iron** was stronger than expected in 2013, it has fallen by nearly 10 per cent this year to $122.60 a tonne, making it harder for small miners to generate profits.

"Similarly, **oil** and gas look to be attractive on valuation grounds, but we are concerned about the potential for downside to the **oil** price driven by US supply growth," Mr Carter said.

A key theme Australian companies this year will be the transition to housing and retail driven economic growth after the **mining** investment boom of the last several years.

"Most market participants are really positioning for a world where **China** is coming off the boil and moving from resources-intensive growth to consumer-led growth," Mr Carter said.

"That means Australian growth is going to have to shift from the **mining** sector to areas like housing, retail and media." Building materials opportunity

Housing stock has failed to keep up with Australian population growth, which has seen housing starts and prices rise. UBS has forecast 180,000 housing starts this year. Mr Carter said investing in building materials providers, such as GWA Group, would take advantage of this.

Armytage Private chairman Lee IaFraté said a recovery in housing construction is likely to see strong performances from stocks such as Boral and Adelaide Brighton.

"And the government is going to be supporting construction to pick up the slack from the tapering off of the **mining** boom," he said.

Retail was still a challenging sector for stock pickers because consumers were cautious about the unemployment rate picking up and the household savings rate was stuck around 10 per cent, Mr Carter said.

"We're not so keen on apparel, given the structural issues from the rise of online retail," he said.

"We prefer companies that have specific growth drivers, store roll out stories and margin growth."

Electronics retailer JB Hi-Fi and Super Retail Group are two of IFM's preferred stocks in the retail sector.

Mr Carter was also bullish on listed fund managers including Magellan Financial Group and Henderson Group, which have benefited from rising **equity** markets.

"We've had great success with a number of financials that are benefiting from net inflows as investors come back to equities," he said.

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AN Document AFNR000020140203ea2400028

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