From the desk of James Abela

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Reporting season is akin to a tsunami of information – as the tide recedes, fundamentals are laid bare in outlook statements and cash flows to reveal who has best weathered the storm. This year was a firm reminder that stock picking remains critical with correlations close to historic lows.

The winners

Fundamentally solid companies such as Altium, Corporate Travel Management, Cochlear and Wisetech Global delivered solid results. Key to this success was the uniqueness of their offering, sustainable financial positions and management, and a focus on global positioning. During 2016 several of these companies faced difficult share price performance as investors sought out lower valuation style investments and cyclical exposures. A performance recovery is now occurring as these companies are able to demonstrate that the 'quality' nature of their businesses has withstood the test of time.

The losers

There were a couple of discouraging results. Healthscope, for example, delivered another year of disappointing post-IPO trading. Other companies that performed below expectations include: CSG Limited, Catapult, GBST, Mayne Pharma, Coca Cola Amatil, Select Harvests, Innate Immunotherapeutics and Sigma Healthcare which were down 15% to 95% over the last 6 months, but were either not held or underweight in the Fund.

Broader themes

Over the last few years particularly, risk has been mispriced. This reminds me of a recent conversation I had with a property CEO who observed that the yield differential between grades of property in prime, A, B or C grade had significantly condensed. Risk spreads have narrowed as asset prices have continued to rise with little regard for distinguishing longer duration or sustainability. Much the same can be said of stocks, yields have been condensed and risk has been mispriced. We now see the market re-pricing at an individual stock and sector level.

There are a few 'momentum' themes that are enjoying an upward trajectory such as mining services and increasing infrastructure spending but concerns remain for Australian consumers through low wage growth, retail softness and housing. In these areas, structural challenges are emerging, momentum is fading and top line growth remains low.

Outlook

Reporting season reminds investors that it's a tough economic environment in need of consolidation, higher productivity and further investment in marketing and capital in order to compete with increasing competition. Opportunities for companies to create a market valuation uplift from announcing measures such as cost cutting, buybacks or higher dividends still seem to be present, but it feels later in the cycle and investors are becoming more discerning.

The Fidelity Analyst Survey released earlier this year reported that the recovery was broad and corporate fundamentals were improving everywhere. Sector exposures as an outcome of bottom-up stock picking are consistent with this, exhibiting overweights in Technology, Healthcare, Industrials and Energy with underweights in Consumer, Real Estate and Telecoms. The Fidelity Future Leaders Fund is currently positioned for global growth and key picks include technology and healthcare leaders, global industrial footprints and new fintech disruptors.

Today there are evolutionary and revolutionary changes that will affect many industries. New energy, new retail, new entertainment and new fintech to name just a few will cause major disruption to the way we live and behave. Amongst these companies will be the Future Leaders of tomorrow.

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