What to watch at the reporting season circus

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August and February are the two busiest months of the year for fund managers in Australia. There are exceptions, like three of the four big banks with their March year ends, but the vast majority of Australia's 2000-odd listed companies report their financial results in a three-week window before an end-of-August deadline. That's almost one hundred companies a day.

We all get to work early, make a first pass at the announcements as they come out on the ASX and then scurry from meeting to meeting for the rest of the day. "Beats", where a company reports results better than analyst expectations, get rewarded with a bump in the share price. "Misses" get punished.

The rational observer must watch this from afar and see it for the circus it is.

A company's share price can move 10% or 20% because its revenue and profits for a single six-month period miss analyst expectations by just a few percent. If the value of a company is the present value of all of the profits it is going to make into perpetuity, can that one half-year period really be that important?

Well no, and yes.

A friend of mine once received some wisdom about horse jockeys from a professional gambler. After blowing up about a bad ride costing him a small fortune, the professional gambler said to him "what you need to understand, Greggy, is that jockeys are just little people".

That is, they are susceptible to the same biases as the rest of us and the same is true of fund managers.

Two of those biases are particularly prevalent when it comes to the reporting season circus, both of them explained in Daniel Kahneman's book *Thinking Fast and Slow*.

The first is recency bias - we tend to over-emphasise the most recent piece of information. The second is what Khaneman calls 'what you see is all there is".

We all know that the past six months of trading doesn't tell us much about how much a company might be making in 10 years' time, but what else do we have? Faced with trying to predict something with a huge amount of inherent uncertainty, we gravitate towards the only thing that is easily accessible to us - in this case the most recent reported results.

In general, we place far too much emphasis on the most recent result and over-extrapolate recent trends into the future.

When a result does matter

But sometimes one result really does suggest a fundamental and significant change to the estimated value of a business. For example, many analysts and investors thought online Covid winners would keep at least some of the gains from lockdowns. It was fairly obvious that online penetration dramatically accelerated as consumers were forced online. But many company CEOs (and investors) thought the shift was permanent. Once customers shifted online, the theory went, they weren't going back.

Reported results over the past six months indicate that is clearly not the case.

Kogan, Redbubble, Adore Beauty, Booktopia, Adairs, Cettire: everyone is saying the consumer has gone back to their pre-Covid modes of shopping. Online penetration will continue to slowly increase from those pre-Covid levels, but that is a much lower level than the share prices of these companies assumed a year ago.

Like finding the black swan that disproves the theory that only white swans exist, sometimes one result can prove or disprove a fundamental assumption about the future.

In the case of online retailers, the white swan caused a significant negative re-evaluation of those businesses' prospects. They can be positive, too. In the case of Flutter, one of the largest investments in our Forager International Shares Fund, its recent results showed a US business performing much better than market expectations. Its Fanduel brand is dominating the recently deregulated market for US sports betting and the most mature states are already showing significant profitability. Those were two outcomes that we thought were possible 12 months ago. Now they seem likely. Given the size and growth of the US market, that change likelihood makes a substantial difference to the value of Flutter.

So, while most of reporting season is an over-hyped sideshow that is less relevant than most fund managers would have you believe, sometimes an act shouldn't be missed. That's why I need to keep buying tickets and, right now, it's time to get back in the tent.