Investors risk missing dividend wake-up call after election win

Investors facing Labor franking changes would have been forced to lessen their reliance on dividend-paying shares. Advisers say that would have been a good thing.

William McInnes *Reporter*

May 22, 2019 — 12.00am
AUSTRALIAN FINANCIAL REVIEW (AFR)

The Coalition's win on Saturday may be a boon to those receiving franking credit refunds but it could see investors returning to a complacent style of investing, chasing only high-yielding Australian stocks.

While a Labor victory was set to leave many shareholders with less money in their back pockets, experts had suggested it could encourage investors to build more diversified portfolios and engage in better investing strategies.

Advisors had suggested alternatives to the blue-chip dividend payers heavily favoured by income-chasing investors including bond proxies, corporate bonds, income trusts and overseas shares.

"People were definitely kicking the tyres."

— Will Hamilton, Hamilton Wealth

A number of firms had also brought fixed income products to market to target those affected by the proposed changes to franking credits if Labor won the election.

But the Coalition's victory has put all those suggestions on hold and, with no impetus to change strategies, investors will likely return to relying on the high-dividend-paying Australian shares for income.

"I believe [investors] missed a wake-up call," says Hamilton Wealth Management chief executive and managing director Will Hamilton.

"The number of people that we've seen that are running large portfolios of Australian equities and cash – I understand why they're doing it but they're just not diversified among asset classes."

Balance of risk and return

While the returns on the Australian sharemarket have been solid in 2019, the sharp sell-off in late 2018 gave investors a taste of just how exposed equities were to a significant downturn.

"Investing is about risk and return, and about balancing the two," Hamilton says. "There are other income alternatives without taking on too much risk. You've got to look more broadly [than Australian equities] to diversify."

With the market in a late cycle, the solid returns from equities could come off at some point, say advisers, meaning investors with one-dimensional portfolios should be seriously considering diversifying.

"We've seen the easy route for equities and fixed income over the last decade or two, particularly with fixed income," says Irene Goh, Aberdeen Standard Investments head of multi-asset solutions for Asia Pacific.

"For equities we've seen a really nice run since the GFC but investors should be realistic in not assuming those handsome returns will continue in the years to come. That argues for even more focused attention into alternate assets that would generate the kind of returns equities and bonds would have."

While investors could be reluctant to diversify right away with billions of dollars in franking credits sitting idle on company balance sheets, the last 12 months has also shown just how risky chasing high dividends can be.

Big payer fallout

Telstra and AMP, previously the dividend stars of the ASX, were both forced to drop their payouts last year and the major banks are now also at risk of cutting their dividends as their net interest margins are squeezed in the years to come.

The fallout from the Hayne inquiry saw NAB cut its dividend after its first-half result this year as it looked to increase its compensation to customers.

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— Irene Goh

The major miners have firmed as the new dividend favourites, but their payouts are linked heavily to the commodity cycle and highly exposed to downturns.

Labor's proposed changes had many investors reconsidering their approach, says Hamilton.

"People were definitely kicking the tyres," he says. "But it's rash to do anything until you're actually dealing with it. I will admit I did foresee a change in government but regardless, we didn't get anyone to position."

Morgan Stanley equity strategist Chris Nicol suggests investors had already positioned themselves and would return to chasing high dividends.

"We would expect a meaningful rotation back towards blue chip yield given imputation refund ability is no longer at risk," he adds.

That rotation stems from a reluctance by "mum and dad" investors to diversify outside the equity market, which has been a safe and solid investment for many years.

"There's a certain sense of complacency there in thinking history is an indication of future performance," says Aberdeen Standard's Goh.

"We certainly encourage our investors to be thinking out of the box."

Other options

Australian investors have been given a wider range of choices, with a number of alternatives coming to market this year.

Income funds targeting retail investors moved quickly in the lead up to the election, seizing upon the demand for income streams outside of franking credits and offering access to global fixed income and corporate debt.

But while larger firms and institutional investors are able to diversify across a broad range of asset classes with confidence, Goh acknowledges that for the retail investor, diversifying can be difficult.

"The resources that you require to make the right choices on assets is significant and the cost for every individual investor to do that would be very substantial," she adds.