thebigpicture

guideposts for the private investor

Week Commencing 3 March 2003

DIVIDENDS: THE NEW EMPHASIS ON INCOME

The fall in Australian share prices (and apparent absence of prospective capital gains) has placed more emphasis on dividend yield as a guidepost for stock choice. Dividends are now approaching the yield available to investors from government bonds.

Among the larger listed companies, the dividend yield is approximately 4.6%. With dividends approximately 83% franked within this group, this would be equivalent to a pre-tax yield of 6.2% compared with the yield on 10-year government bonds of 5.1%.

The yield relativity has not been so favourable for the purchase of equities for over 10 years. However, historically dividend yields had been more important in the equity market. It was not until the 1970s that capital gains began to supercede dividends as the primary benefit from an investment in the stock market.

Although stocks, therefore, appear very cheap relative to recent (i.e. 20 year) experience, the longer perspective indicates that some further fall in price (higher yields) could be possible.

The other factor to bear in mind before seeking out dividends too aggressively is the risk of the dividend being cut. One interpretation of a high dividend yield is that the market is trying to tell investors something, namely, to be sceptical about the sustainability of the dividend itself.

It is tempting to assume that once a dividend is struck that it will forever remain at that level or move higher with improving earnings. Generally, companies are most reluctant to reduce a dividend and only raise it when they are confident that it can be sustained. However, company circumstances can deteriorate. Many of the results announced in the current round of half year profit reports have amply demonstrated the riskiness at-

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THE CUFFE KERFUFFLE: ANOTHER LESSON

The Cuffe kerfuffle at the Commonwealth Bank contains many examples of how a company should not communicate with its shareholders.

More generally, Cuffe's (cash) income also shows that the fixation with executive share option schemes was misplaced and that, to assuage investors, alternative remedies are needed which apply more generally to their core complaint.

Listened to carefully, most complaints about executive option schemes were never actually about the form of reward which was being received. The more important criticism generally leveled at executive remuneration was that those receiving the benefits might not be deserving of them and, in attracting such largesse, were bilking the shareholders.

Perceptions of disparity between performance and reward will not be eliminated by proscribing certain forms of reward. Nor will they be eliminated by requiring more detailed and sophisticated reporting of the rewards alone.

At least part of the problem arises from the poor definition of what is acceptable performance. The solution, therefore, rests on two legs:

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thebigpicture guideposts for the private investor is published by *thebigpicture* Economics (ABN 71 040 787 936). The author, John A Robertson, while working in Australia, London and New York, has over 20 years experience in international financial and commodity markets, corporate strategy, financial and business evaluation and government policy. He has been Chief Economist and a director of a leading Australian investment bank. He has been a top-rated institutional equity analyst and has marketed investment advice in all the major international financial centres.

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The Weekly Chart Spot

Source: OECD

GDP growth among the European economies slowed to 0.9% over the year to the September quarter of 2002, according to the OECD.

The growth slowdown is widespread with only Ireland, among the western European economies, having maintained an above average growth outcome.

On the most positive view, the worst of the growth deceleration appears to be over. While there is little sense in the recent flow of statistics that a bounce in growth is imminent, there has been a mix of positive surprises within the overall outcomes indicating that there might be some bottoming in rates of activity. German indicators of economic sentiment, for example, have appeared to stabilize.

With consumer price inflation around 2% (the latest Eurostat measure of core inflation being 1.9% over the year to February, the lowest outcome since September 2001) there is scope for further monetary easing.

International transactions have been supporting activity. The euro-zone current account recorded a surplus of 62 billion euros in 2002 after a deficit of 13.8 billion euros in 2001. The shift amounts to approximately 1% of GDP for the grouping. At the same time, euro area investment (direct and portfolio) changed direction from a net outflow of 63.4 billion euros in 2001 to a net inflow of 29.4 billion euros in 2002.

From the more negative perspective, the French unemployment rate has topped 9% and the latest euro zone survey of business and consumer confidence had the lowest readings for a year.

Higher crude oil prices will begin to affect the inflation outcomes detrimentally. Whether there might be some further impact on economic activity will depend on how long oil prices remain at the levels of the past two weeks. That might depend, in part, on how the US reacts to Iraqi attempts to avert an invasion by agreeing to co-operate more fully with the UN weapons inspectors.

European GDP Growth

	% change from previous	year
Austria	0.1	1.0
Belgium	0.4	0.9
Czech Republic	-	1.5
Denmark	-0.7	1.0
Finland	0.5	2.2
France	0.2	1.0
Germany	0.3	0.4
Greece	-	4.1
Hungary	-	3.8
Ireland	-	6.9
Italy	0.3	0.5
Luxembourg	-	1.0
Netherlands	0.3	0.3
Norway	-0.2	0.9
Poland	-	1.0
Portugal	0.7	0.9
Slovak Republic	-	4.0
Spain	0.8	1.8
Sweden	0.4	2.1
Switzerland	0.3	0.2
UK	0.3	2.2

There might be some offset to these cost and price pressures from the stronger euro. At the same time, its appreciation against the US dollar might hinder the competitiveness of European exporters (or reduce returns to the extent exports are priced in US dollars) but there are other benefits for the euro zone in finally establishing its currency as a meaningful alternative to the US dollar to the extent that is achieved by this cyclical upturn in its value.

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DIVIDENDS: THE NEW EMPHASIS ON INCOME CONT'D

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taching to profit outcomes. The dividend is generally only as secure as the earnings which underwrite it.

The accompanying table shows the dividend yield among the largest listed companies based on the dividends which have been paid over the most recent twelve month period. Dividends have not been adjusted to take account of higher earnings forecasts even where there appears to be a high degree of certainty among analysts that the improved level of performance will be delivered.

	Yield	Franking
National Australia Bank	5.1	95
BHP Billiton Limited	4.1	76
Commonwealth Bank	6.1	100
Telstra Corporation	5.2	100
ANZ Banking Group Ltd	5.1	100
Westpac	5.4	100
The News Corporation	0.3	0
Rio Tinto Limited	8.8	100
Woolworths Limited	3.1	100
Wesfarmers Limited	4.4	100
AMP Limited	6.2	15
Fosters Group Limited	3.9	100
St. George Bank Limited	4.6	100
Woodside Petroleum	5.7	100
Westfield Holdings	1.7	48
Coles Myer Limited	4.5	100
Westfield Trust	7.3	0
Amcor Limited	3.5	50
Westfield America Trust	7.8	0
CSR Limited	3.7	56

	Yield	Franking
Macquarie Infrastructure	2.8	16
Qantas Airways Limited	4.5	100
Suncorp- Metway Limited	5.1	100
General Property Trust	7.2	0
Macquarie Bank Limited	3.6	70
Alumina Limited	6.3	100
PBL	2.7	100
QBE Insurance	3.5	0
AGL	4.2	78
Insurance Australia	3.0	100
WMC Resources Limited	0.0	100
Coca-Cola Amatil Limited	3.2	50
Stockland	6.2	100
AXA	2.7	50
Brambles Industries	5.0	100
Lend Lease	2.1	100
Tabcorp Holdings Limited	6.4	100
Santos Limited	5.1	100
Southcorp Limited	5.0	100
Lion Nathan Limited	4.0	100
M.I.M. Holdings Limited	2.1	6
Lion Nathan Limited	3.8	100
Mirvac Group	6.0	100
Origin Energy Limited	1.2	100
Contact Energy Limited	4.5	100
Boral Limited	4.2	75
BHP Steel Limited	0.0	100
Leighton Holdings	4.6	70
Harvey Norman	2.0	100
CFS Gandel Retail Trust	5.0	0
AFIC	4.6	100
Mayne Group Limited	4.8	66
Orica Limited	5.4	43
CSL Limited	2.4	100
John Fairfax Holdings	3.8	100
Coal & Allied	3.2	100
Transurban Group	1.2	0
Goodman Fielder Ltd	4.3	50
Foodland Associated	4.1	100
Patrick Corporation	1.8	100

"One interpretation of a high dividend yield is that the market is trying to tell investors something, namely, to be sceptical about the sustainability of the dividend itself."

THE CUFFE KERFUFFLE: ANOTHER LESSON CONT'D

- making clearer for shareholders what represents acceptable, superior or inferior performance; and,
- linking rewards more explicitly and certainly to the performance outcomes.

A critical element in achieving these outcomes is public reporting. Company chairmen, noting that there is some public concern about these matters, have asserted more frequently that their executives' remuneration was being tied to their performance more explicitly than had been the case before.

Invariably, however, those chairmen have also been most reluctant to quantify the nexus between performance and reward. This is a failing. They are missing an opportunity to achieve greater transparency and remove an important shareholder grievance.

The failure to make the link highlights, too, how directors and executives seek to avert public scrutiny of business performance by avoiding meaningful reporting of objectives and results.

There should be a three-step approach to executive remuneration being set and having it monitored by shareholders.

- The Board should set objectives consistent with the company improving its economic returns.
- These objectives should be reported on at the next AGM with an explanation of how remuneration is to be tied to these outcomes.
- A report should be made at the subsequent AGM on:
  - ~ the prior year's performance and its remuneration consequences, and
  - ~ the new set of objectives for the coming year.

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WHITHER INTERNET RETAILING?

Use of the internet for retail transactions is growing but, having started from nothing, it is still far from making a meaningful contribution to commercial activity.

The US Department of Commerce reported in the past week that retail transactions undertaken via the internet were 28.2% higher in the December quarter of 2002 compared with the same period a year earlier. However, the higher volume of transactions implied that e-sales were equivalent to only 1.6% of total retail trade.

Since December 1999 when the Department began tallying the information, e-sales have grown at an annual rate of 38% compared with the underlying growth in retail transactions of 3.5% a year.

Retailers have not yet come up with the offering to attract significant numbers to adopt the new technology for day-to-day activities. Nor have consumers found it necessary to make the change implying that they do not value the potentially more efficient shopping experience available over the internet.

However, the technology itself does not appear to be a barrier. It is being used where it represents value for consumers. The most exceptional rate of take-up has been in banking where the convenience and ability to pay bills and transfer funds has been valued by bank customers.

While there have also been improving rates of acceptance when shopping for commodity-type products, where freshness is regarded as an important attribute products are not being bought in this way so readily.

Another factor which continues to retard more widespread use is the ongoing concern about security. Over-the-net buying is regarded as risky. The banks are regarded as being more trustworthy or, at least, likely to place a higher emphasis on requiring secure transactions than other businesses. Moreover, like them or not, they are familiar organizations with which people have a long history of dealing and to which there is ready physical recourse in the event something goes awry in the electronic transaction.

These outcomes are emphasizing that the internet itself is not a product but simply a tool which may or may not be helpful in effecting business transactions.

This is the contrast with the 1990s. Then, the internet was being viewed as the product rather than the equivalent of a truck which may or may not be required for business. Companies which had the new technologies were seen to be redefining the business environment. They were expected to effect a massive redistribution of profit away from the traditional retailers. The internet was the experience to which people were to be attracted.

For investors, the revolution in the conduct of business which had been foreshadowed is still to come. And it still could come but, like many such speculative investment phenomena, the reality can differ from the expectation by a decade or two. Meanwhile, the speed of uptake appears to indicate that there is little need, for the present, to be concerned about missed opportunities in this segment of the market.

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