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Retirees must avoid yield illusions

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Individuals looking to particular Australian equities to provide an income stream in their retirement needed to be conscious of avoiding stocks that appeared to deliver a good yield but had poor associated fundamentals, a portfolio manager said yesterday.

“Income certainty actually comes down to the capital certainty of these particular stocks,” Investors Mutual portfolio manager Jason Teh told the AFA 2015 National Adviser Conference in Cairns.

To demonstrate the importance of capital stability Teh used the past experience of Insurance company QBE, which several years ago looked to be providing a solid yield, but did not have the fundamentals to sustain those income stream payments.

“For a short period of time QBE looked like it had a pretty chunky 10 per cent fully franked yield in front of it,” he said.

“So a client may have been very tempted to actually buy QBE over that time frame.

“However, QBE in the lead-up to its share price fall exhibited very weak fundamentals.”

He said a closer look at the fundamentals indicated the forecast yield was an illusion.

“It had very volatile earnings and a very weak balance sheet going into the 2011 period as measured by the amount of excess capital had,” he said.

“And its payout ratio was rising over time and in fact in 2011 its payout ratio was 150 per cent.

“So around that time it was in fact borrowing to actually pay a dividend.”

He said all of those factors meant the potential yields QBE stocks could provide were all an illusion.

“That eventually led QBE to cut that dividend profile to such an extent from peak to trough that it fell 75 per cent.

“In fact, QBE’s dividend in 2013 was so low it was even lower than what it was in 2002.”

He said from an Australian equity markets point of view, risk could be controlled by careful stock selection that focused on fundamentals.