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## Research and Insights

**30 July 2021**

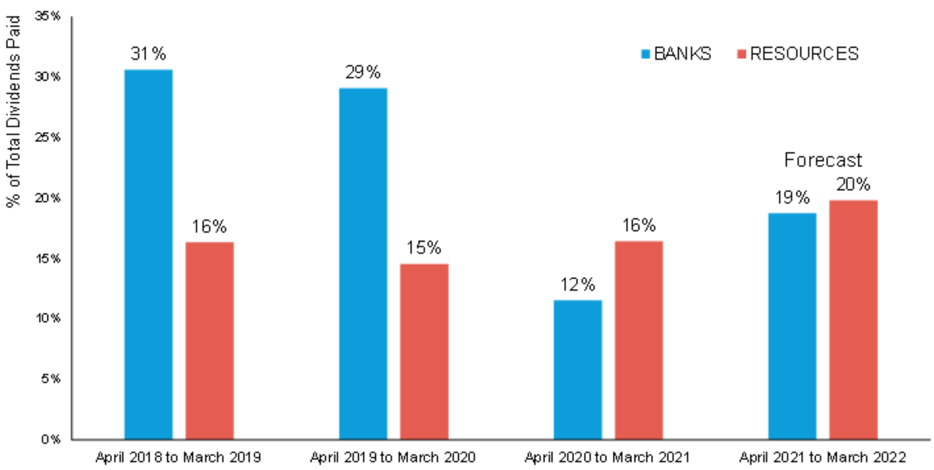
# Active dividend income after the pandemic: From 'pub with no beer' to multi-year growth outlook

**The pandemic and the COVID sell-down, a potential nightmare scenario for income investors, has given us a real-life stress test in which some companies lost almost all revenue in a demand shock from which we are still unwinding. Michael Price, Portfolio Manager, Equity Income, answers your questions on how dividends changed in the pandemic, with some encouraging and valuable lessons on active dividend investing for the future.**

### Q: Give us the 'elevator pitch' on what is happening in ASX dividends.

**A:** In short and simple terms, the elevator pitch on dividends is as follows. The recent boom in resources as part of a mega-cycle in bulk and base metals, and battery materials has seen dividends from resources companies take share from the usually dominant banks. At the end of 2021, this expected to see resource dividends exceed bank dividend payments in 2021 and 2022, as illustrated in Chart 1.

**Chart 1: Banks ceded their traditional dividend dominance in 2020 (% of market dividends paid)**




Source: Ausbil

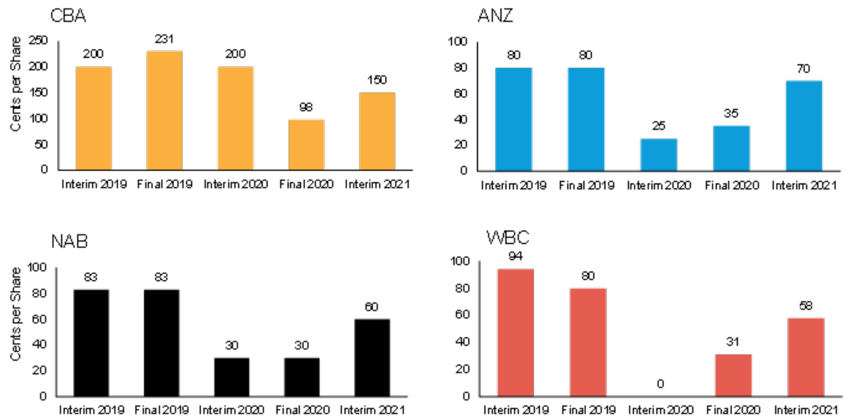
Banks had a tough few years, and in the pandemic they had to cut (cancel in Westpac's case) dividends to help provision for potential bad and doubtful debts (which did not eventuate to anywhere near the level projected), as illustrated in Chart 2. The recent dividends show the switch to growth momentum in bank earnings as the economy surges.

**Michael Price,**
**Portfolio Manager, Equity Income**

Michael manages Ausbil's active equity income strategies and the Ausbil Active Dividend Income Fund. Michael has over 34 years of quantitative, actuarial and financial markets experience working in Sydney and Melbourne with companies such as AMP Capital, ING Investment Management, Mercantile Mutual and Colonial Mutual. Before joining Ausbil, Michael was Head of Australian Equities at AMP Capital, where his primary roles were the overall management of the $16b Australian equities team and the portfolio management of the sustainable equities and equity income strategies. Prior to joining AMP Capital, Michael was Director – Investment Process at ING Investment Management where he was the portfolio manager for the sustainable, imputation and tax effective Australian equity strategies as well as being a member of ING's asset allocation committee. Michael's role at Ausbil includes strategy, portfolio construction and investment management for the equity income strategy. Michael holds a Bachelor of Economics (Actuarial Studies) degree from Macquarie University and is a Fellow of the Institute of Actuaries of Australia.

### Chart 2: Bank dividends took a hit, but they are coming back

Bank dividends



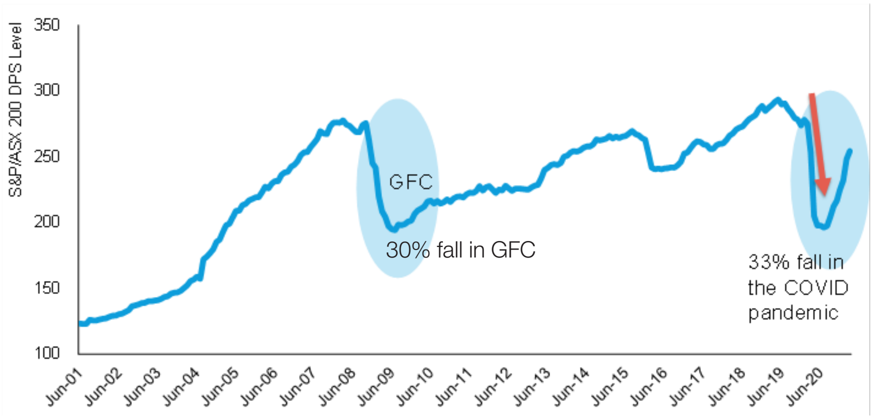

Source: Ausbil

Banks, resources companies and the broad market are now looking at multi-year earnings upgrades that we forecast will result in multi-year dividend upgrades. An active approach to dividends can optimise the opportunities this brings, including capturing more franking credits across the year from this fundamental earnings growth.

### Q: What do dividends look like compared to the past?

**A:** The long-term average dividend yield for the S&P/ASX 200 over the last 20-years has been around 4% before adjusting for any franking credits. During this period, there have been two major dividend tail events. The first was the GFC, with COVID-19 the second, as illustrated in Chart 3.

### Chart 3: Dividend yields set for a rerate




Source: Ausbil, Fact Set

The GFC saw dividends per share fall some 30% as the world entered financial crisis, and the US suffered a major recession. Move forward a decade, and the pandemic of 2020 saw an even larger disruption, with dividends falling some 33% during COVID.

The nature of the pandemic, which for many companies involved seeing their revenue line almost instantaneously run dry like 'a pub with no beer', impacted payout ratios through companies retaining earnings to fund the impact of COVID. This saw a general re-basing of dividends across the market in effected stocks, including banks, where APRA determined that banks should pay smaller dividends and retain additional capital for the purposes of provisioning.

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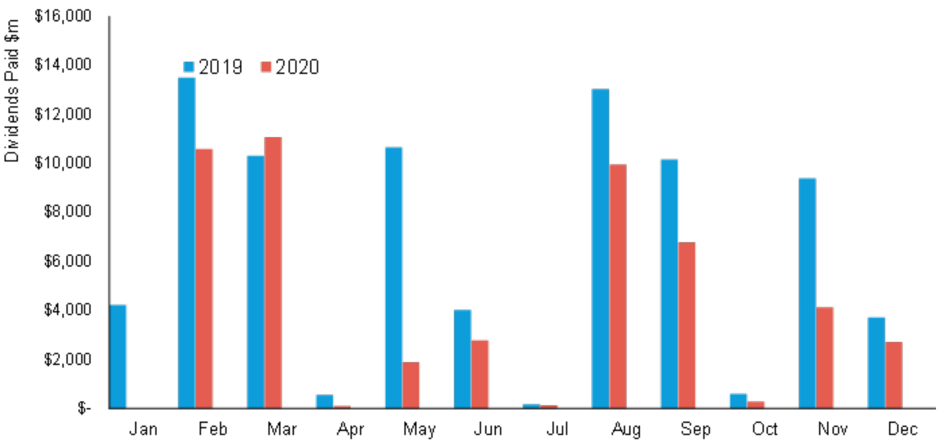
Ausbil is a leading Australian based investment manager. Established in April 1997, Ausbil's core business is the management of Australian and global equities for major superannuation funds, institutional investors, master trust and retail clients. Ausbil is owned by its employees and New York Life Investment Management a wholly- owned subsidiary of New York Life Insurance Company. As at 30 June 2021, Ausbil manage over $15.8 billion in funds under management.

## Q: Why are dividends complicated, what are some of the considerations for investors?

**A:** The old heuristics around which companies are income generators and who pays the best dividends are out the window as markets have become increasingly volatile, and many of the perennial 'dividend darlings' have been supplanted.

An active approach to dividend investing is more important than ever, for a number of reasons. Firstly, dividends are paid almost every month of the year, as evidenced in Chart 4. A simple buy-and-hold strategy cannot maximise the spread of dividends and franking credits on offer across the calendar year.

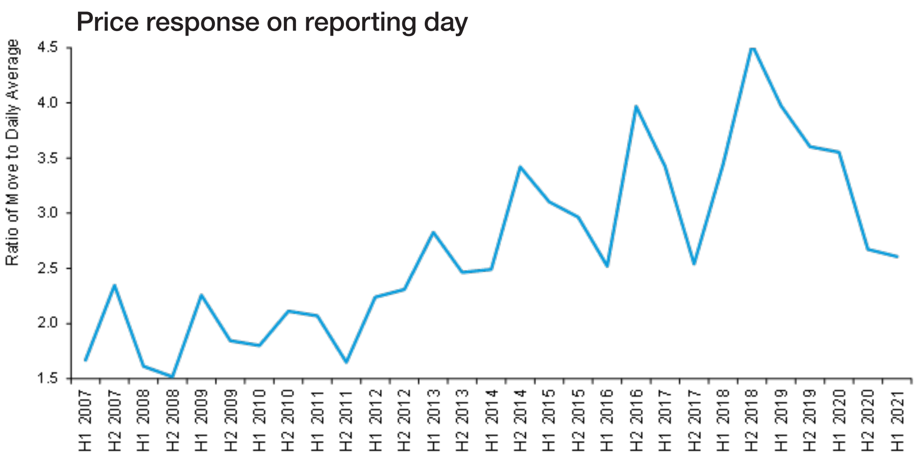
**Chart 4: An active dividend strategy can find more dividends and more franking credits for investors across the year**




Source: Ausbil, Fact Set

Secondly, stocks have become more volatile around reporting season, as illustrated in Chart 5. Understanding the underlying fundamentals of each company, and tactical allocation can help reduce the impact of this price volatility on overall portfolio value.

**Chart 5: An active dividend income approach can help manage volatility around reporting**

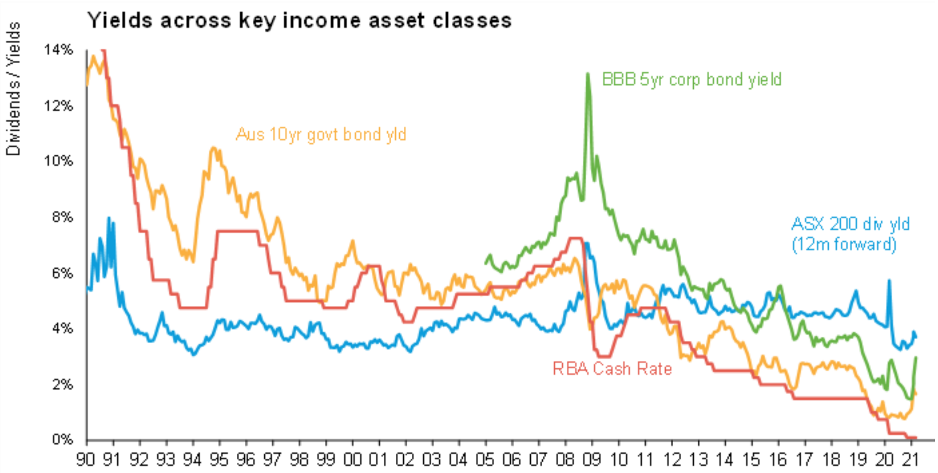



Source: Goldman Sachs, Earnings Day vs 30D average daily move for S&P/ASX 200

## Q: So, what is your outlook for dividends in the coming years?

**A:** We are at an interesting point in time, where monetary policy has seen yields across non-equity asset classes fall dramatically to lows they are expected to hold for a number of years. Relative to bond, credit and cash yields, the yield on equities (excluding any potential from capital gains) is relatively higher, as illustrated in Chart 6.

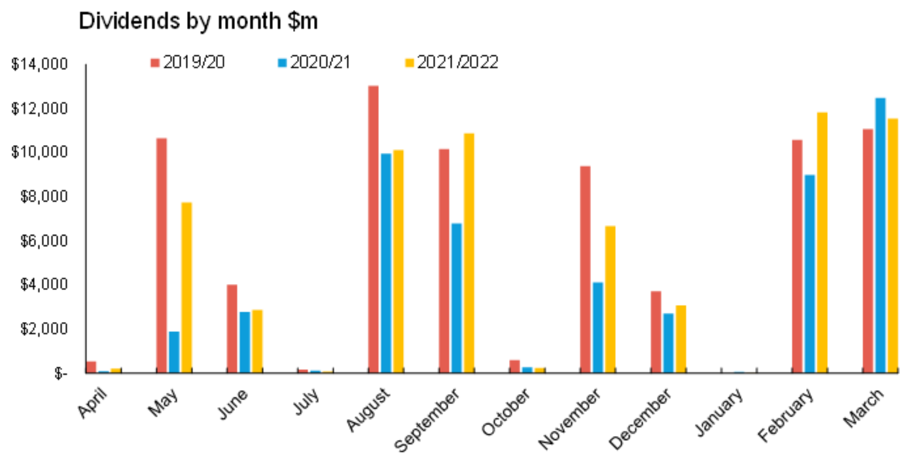
**Chart 6: Investors continue to look to equity yields as an anchor for income strategies**




Source: Ausbil, Fact Set, Refinitiv, MST Marquee

While dividend yields fell away during the pandemic, they are showing recovery, as illustrated in Chart 6. Across 2020 and into early 2021, dividends across the year had fallen with lockdowns across Australia, and globally. The February 2021 half-year reporting season showed that company earnings were recovering on the back of a growing economy. As a result, the consensus outlook for dividends has also risen, showing growth not just for the coming year, but also into 2022 and 2023, as illustrated in Chart 7.

**Chart 7: Recovery and a new dividend growth story**




Source: Ausbil, Bloomberg, Dividends paid in 2019, based on ex-dividend date

The two key sectors where we see the potential for earnings surprise are the banks and resources sectors. Banks, which offer primary exposure to a recovering economy, entered the pandemic after heavy barrage from the Hayne Inquiry and having already been sold down. The pandemic saw them sold down further on fears that the recession and COVID job losses would impact their lending books. All the banks provisioned majorly for the potential for credit loss, and APRA further enforced capital retention through limiting the dividends they were allowed to pay. Looking at the banks in the 2021 New Year, it was evident that the bad and doubtful debt experience was nowhere near predictions, and that the banks had over-provisioned for losses. With APRA allowing a return to more commercial dividend levels, and the economy resurging from the 2020 lows, we could see banks were in a position to reduce these provisions and grow their books further in a renewing real estate market. The result is that over the next few years, the unwind of this over-provisioning will see a rerating of earnings, ahead of the consensus expectation at the time we began up-weighting into banks.

Metals and mining are in the midst of two fundamental themes in global resources investing. The first is the super-cycle demand for Australia's bulk commodities including iron ore, from China in terms of building and infrastructure demand, and as a function of the growth path of the world economy. This theme is expected to drive earnings in companies like BHP, Rio Tinto and Fortescue Metals. The second is the fundamental shift in the energy transition to renewable energy, and the rapid adoption of electric vehicles, which is sparking a secular demand for bulk, base and battery materials (copper, lithium, cobalt, zinc, manganese and rare earths) that is expected to last for decades, underwriting the fundamentals of a strong resources market.

Ausbil has been overweight Banks and Resources (metals and mining) for some time. These overweights remain in place across our portfolios and have driven outperformance across our different strategies. Importantly, we are still in the early stages of the economic cycle, with a positive growth outlook for multiple years that is expected to drive performance in these mega-sectors.

Taking in the broader economic context, Ausbil's view is that economies will run 'hot' for some time, with the support of policymakers, and are delivering the best growth figures since 1983, across a multi-year growth profile. While inflation will remain an ongoing source of worry as the perennial flipside to growth, it is important to understand whether inflation spikes are intermittent or if they are moves to a higher sustained level. It is our view, and indeed that of most global central banks, that inflation will not be a problem for some years as the world economy returns to health.

Since the historic reversal in consensus across the February reporting season that saw the FY21 consensus earnings outlook for the broad market rebound from -1.6% to +15.6%, consensus earnings outlook for both indices has rerated to +22.5% (S&P/ASX 200) and +22.6% (S&P/ASX 300).

While these earnings figures are strong, Ausbil's house view is that consensus is still under-estimating the rebound in earnings that will occur in the prevailing economic conditions, with rates to remain low, and with the world economy providing a tailwind to Australia's current expansion. This will only further benefit the dividend payers on the market, and most benefit investors who are able to actively allocate to the best blend of dividend and franking credits across the market, across each month of the year.

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