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Epoch Investment Partners, Inc.

GRANT SAMUEL
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MEDIA RELEASE

Mid-single digit returns the outlook for global equities

Two per cent is the new four per cent for mature economies' GDP, meaning that the long-term outlook for global equity returns is likely to be in the mid-single digits, says John Tobin, portfolio manager with Epoch Investment Partners.

"Global GDP growth rates are converging around the two per cent mark for mature economies, while we expect developing economies to have GDP growth of three-to-four per cent.

"The key market risks ahead focus around the "known unknown" risks brought on by the Trump Presidency, as well as the economic outlook for China.

"The downside risks of Donald Trump include higher interest rates, increased protectionism, anti-immigration policies and geopolitical shocks.

"The upside risks include tax reform, regulatory reform, infrastructure spend and faster credit growth."

Mr Tobin said the impact of these unknown factors is substantial, coupled with the fact that geopolitical events are continuing to create potential for uncertainty and further market volatility.

"For instance, a five-percentage point reduction in the effective marginal corporate tax rate in the US would add $8-$10 to the S&P 500 EPS," he says.

"At the same time, the ongoing strength in the US labour market is likely to drive a moderate acceleration in wages, with implications for inflation.

"Similarly, China's contribution to growth has been substantial since 2010, rising from just over 20 per cent to just under 30 per cent in that period. But its GDP is now growing at a decreasing rate; from a high of 14 per cent GDP growth in 2007, its estimated growth is forecast at just over 6 per cent by 2018.

"Lower GDP levels will naturally have a flow on effect to global equity markets, as will interest rate movements.

"While interest rates remain relatively low around the world, and are expected to remain so, the Federal Reserve is moving to gradually normalise interest rates.

"Just as equity multiples expanded during quantitative easing (QE), we will see a gradual contraction of multiples as economies unwind their longstanding QE policies.

"In this environment, equity drivers will return to normal, with dividend and earnings likely to make up a larger component of returns.

"For US equity investors, the prospect of corporate cash flow growth, and potential tax reform, supports continued dividends and share repurchases."

Mr Tobin's research shows that while EPS growth made up 17.3 per cent of returns in the S&P 500 between 2012 and 2016, this is expected to rise to 50.4 per cent over the next 10 years.

Similarly, dividends are expected to increase from 13.9 per cent of equity market returns to 40.7 per cent.

"This makes determining the correct investment strategy in the future, all the more important," he says.

"Traditional valuation metrics based on accounting measures, such as price-to-earnings and price-to-book, provide no insight into a firm's return on invested capital or its skill at capital allocation.

"A company's true value should be measured on the free cash flow that it generates.

"Various accounting metrics to measure earnings can be distorted by accruals, and can be easily manipulated.

"Earnings are an opinion, cash is a fact.

"The ability of a company to earn a return on invested capital that is greater than the cost of capital is what makes the value of a business grow.

"The key to producing superior risk-adjusted equity returns is the identification of companies with a consistent ability to both generate free cash flow and to properly allocate it among internal reinvestment opportunities, acquisitions, dividends, share repurchases and debt repayments.

"The focus needs to be on companies which return 6 per cent of their market capitalisation to shareholders on a regular basis, while still reinvesting enough in the business to grow operating cash flow at 3 per cent or more a year. Invest in these companies and you'll find good returns," Mr Tobin says.

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For more information please contact:

Leeanne Bland
Phone: 0417 470 421
Email: Leeanne@pritchittpartners.com.au

Grant Samuel Funds Management (GSFM) was established in July 2007 as a subsidiary of the Grant Samuel Group. In November 2016 CI Financial Corp (CI) purchased an 80 per cent stake in the business. CI is a diversified wealth management firm with assets under management of CAD$123.1 billion (as of 30 April 2017). GSFM specialises in marketing funds managed by high calibre local and international managers to Australian and New Zealand institutional and Australian retail investors.

GSFM formed an alliance in October 2007 with New York based Epoch Investment Partners, Inc. to distribute Epoch's investment products to Australian and New Zealand clients.