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Perpetual: It's a good time for income investors to consider equities

By Perpetual Asset Management
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As rates fall and corporate dividends strengthen, equities can provide a good alternative income strategy, argues Perpetual

- Time to reconsider income strategy as rates fall
- Corporate dividends an attractive solution
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The start of an interest rate easing cycle should prompt investors to reconsider equities as a source of income, as rising fully franked dividends offer an attractive alternative to bonds and cash.

That's the view of Perpetual's head of equities, Vince Pezzullo.

This week the Reserve Bank of Australia reduced the official cash rate for the first time in four years.

Falling interest rates can be a signal for investors to reassess their income strategies as yields on rate-linked, fixed-income investments decline.

But strong dividend returns from equities – and the prospect of rising corporate earnings – may offer an attractive alternative for investors seeking income, says Vince.

"Don't forget that equities can be a good income vehicle, especially when delivered by a company structure" says Pezzullo, who manages Perpetual Equity Investment Company (ASX:PIC).

"And it's an income that can grow over time."

PIC aims to provide both income and long-term capital growth and has built a near decade-long track record of delivering fully franked dividends to shareholders, with a 9.6 per cent grossed up dividend yield last year.

"Expectations are for between one and four rates cuts over the course of 2025 that will take the cash rate from 4 per cent-plus down to 3 per cent-plus," says Pezzullo.

"The gap between the cash rate and the yield that PIC offers is looking more and more attractive."

Equity income grows

Pezzullo says investors should remember that an attractive feature of equities is the fact that corporate earnings tend to steadily grow over time, meaning that shareholders can generally expect future dividends from ASX listed companies to be higher.

“As the RBA cuts, interest rate-linked incomes will fall. But corporate earnings tend to grow over time — so equity-generated income keeps rising.”

As well as income, Australia’s equity market also looks well-placed to deliver capital growth as the world rotates away from expensive growth stocks to look for better value.

“We are such as value market, so resource heavy, that any sort of tail wind like good news out of out of China or a rotation away from tech would be very good for Australia.”

Don’t fear ASX all-time highs

Pezzullo says investors should not be deterred by record high levels for ASX stock indexes, as valuations generally remain attractive.

“Sure, the level of the index is high, but there’s still plenty of great, under-valued companies. Value stocks are trading at 12-13 times earnings. It's the growth stocks that are really expensive.”

He says increasing concentration in the market reinforces the need for a nimble, active approach to investing rather than relying on index returns.

“America has the Magnificent Seven — we’ve got the Magnificent One in Commonwealth Bank,” he says.

“CBA is trading on a growth multiple of 26 times earnings while its return on equity is actually at the lower end of the range. Why is that so? Basically, money is being forced in — for many big investors, CBA and BHP are the only big liquid names they can buy. The choice is banking or mining.”

He says investors should remember that the CBA share price has trebled since the GFC, while BHP has gone sideways.

“You can distil the market down to these two things: resources look very, very cheap because they've gone nowhere over the past decade, but the banks, particularly CBA, have rocketed.”

About Vince Pezzullo and Perpetual Equity Investment Company (ASX:PIC)

Vince is Perpetual’s head of equities and portfolio manager of Perpetual Equity Investment Company (ASX:PIC).

Vince has more than 20 years of experience in financial services including global experience as an analyst and portfolio manager.

Perpetual Equity Investment Company Limited (ASX:PIC) is a listed investment company which provides a simple and transparent way to invest in a diversified portfolio of high quality Australian and global listed securities.

PIC is managed to provide investors with an income stream and long-term capital growth.

Perpetual is a pioneer in Australian quality and value investing, with a heritage dating back to 1886.

We have a track record of contributing value through “active ownership” and deep research.

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Portfolio Manager