

Perpetual Investments

THE CASE FOR INDUSTRIAL SHARES

The first question most people ask about investing in industrial shares is: why limit yourself to industrial shares in a country like Australia, one of the world's great resource producers? The answer is simple – industrial shares historically provide higher levels of income, strong capital appreciation and lower volatility.

INDUSTRIALS VS RESOURCES

The choice between resources and industrials will depend upon your individual circumstances, goals, income needs and so on.

Generally, resources can suit investors looking for a higher growth exposure. Over the past decade, resource shares have exhibited more of what fund managers call 'growth characteristics' – simply put, the rise in their share price has been greater than that for industrials.

However, those higher price returns have come at the expense of increased volatility.

In fact, over the past 20 years, resources experienced volatility of 21% pa¹ compared to 13% pa² for industrials. Industrial shares have historically generated more consistent growth in capital and income.

Now let's look at the benefits of investing in industrial shares through the prism of four of the main factors investors consider when making any share investment.

1 CAPITAL GROWTH

Capital growth occurs when the value of an investment increases over time. Under normal conditions, movements in a company's share price should reflect changing expectations of its profits. When you invest in shares with growth characteristics you are better able to protect the value of your capital.

The tendency of industrial shares to grow in value over time is one of their key attractions.

Over the past 20 years, industrial shares returned 5.6% pa³ in capital growth alone (excluding dividend payments). **The ability of industrial shares to grow their share price is linked to the successful growth strategies they pursue within their business** – new product development, international expansion, entrance to new markets and so on. These strategies underpin the sustainable capital growth of successful industrial companies.

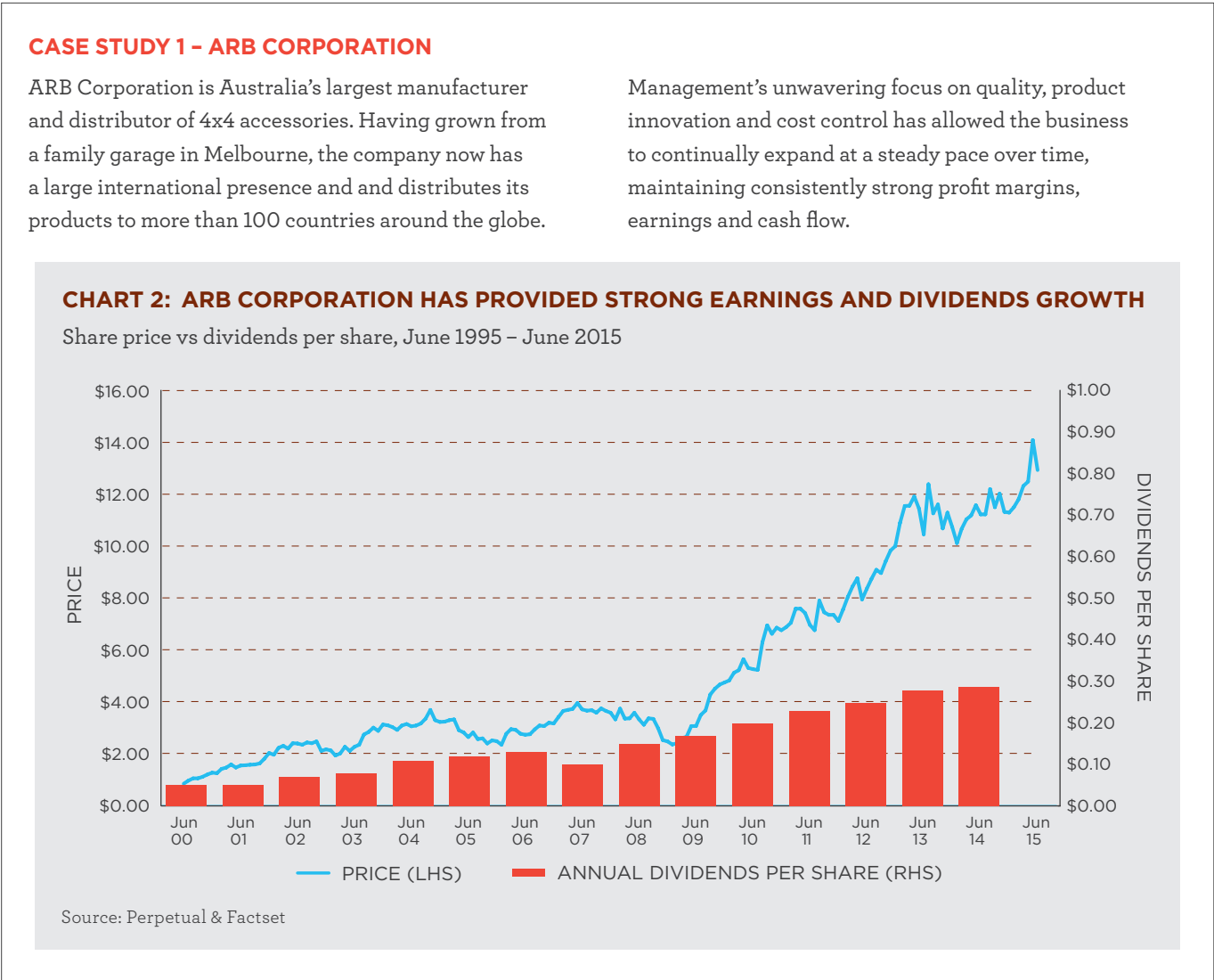
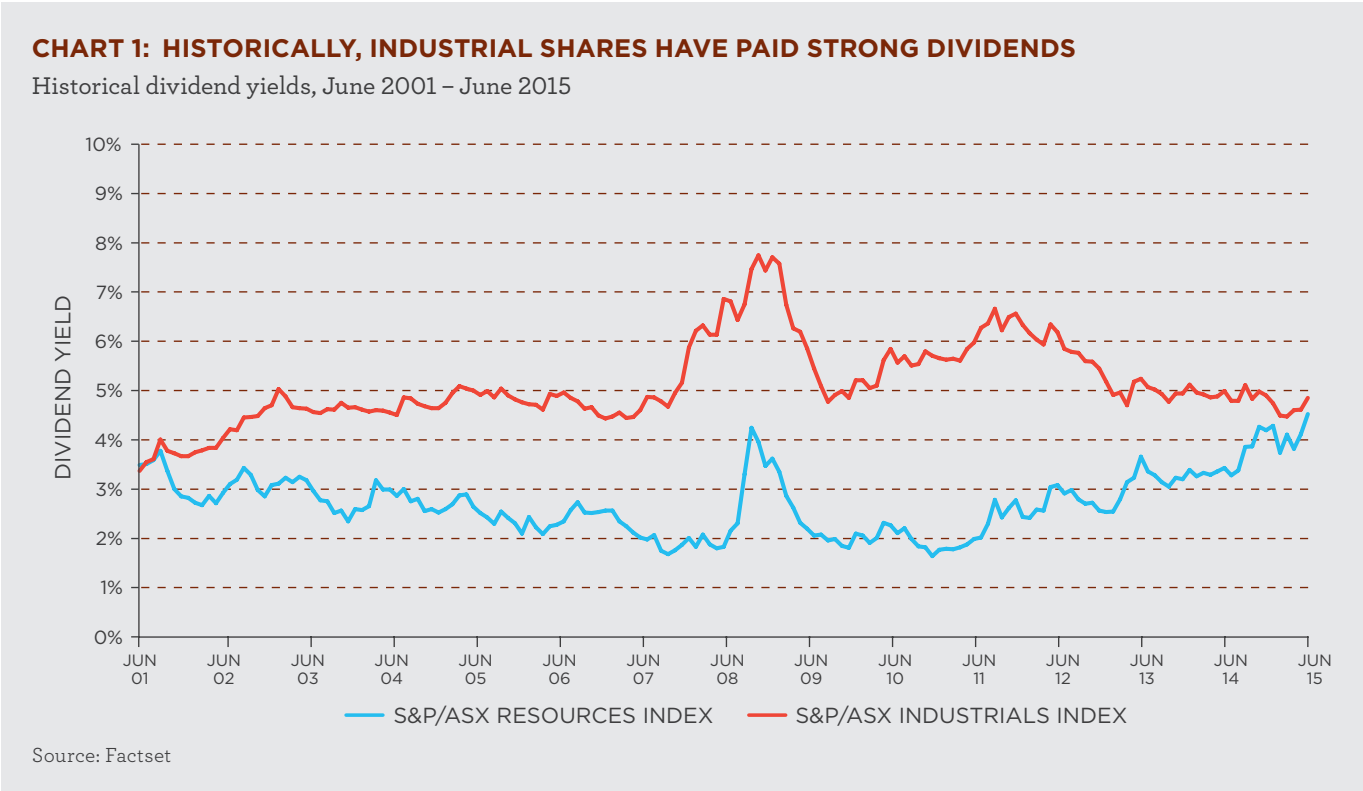
2 INVESTING FOR INCOME

The income you receive from shares is in the form of dividends. Dividends are paid out of a company's earnings. Dividends generally increase as a company grows and earns more.

Industrial companies have historically paid strong dividends with a sector average yield of 4.7%.⁴ As industrials tend to operate in more predictable business sectors – banking, retail, manufacturing etc. – their earnings are less cyclical and operations more flexible. This means they can prudently **pay out a large portion of their earnings as dividends – particularly in comparison to resources.**

Resource companies typically have very high capital expenses, such as equipment and machinery, and their profitability relies heavily upon the changing market price of the commodities they sell or use. As a result they are required to retain a large portion of earnings to provide a cushion against volatile market conditions. This naturally means they have less cash to pay out to shareholders.

The historical difference in dividend yields between resources and industrials is exhibited in the below chart.



3 TAX-EFFECTIVE INCOME

Not only are industrial shares a good source of income, they can also be very tax effective. This is because Australian share income is taxed favourably through what is called 'dividend imputation'. This means that if the company has already paid tax on its income, **you may be eligible to receive a tax benefit for dividends received from that company.** This is so tax isn't paid twice on the same income.

4 PROTECTION AGAINST INFLATION

Inflation erodes your purchasing power and diminishes your real investment returns. So it is important that your investments provide protection against inflation.

Over the past 20 years industrial shares have consistently generated both income and capital growth above the rate of inflation.

This protection against inflation is one of the reasons industrial shares are often highly valuable to long-term investors – including those looking to fund their retirement.

**TABLE 1: INDUSTRIAL SHARES:
GENERATING BOTH GROWTH AND INCOME,
20-YEAR RETURNS TO JUNE 2015**

	CAPITAL	DIVIDENDS	INFLATION
Growth (% pa)	5.60	4.90	2.50

Source: Factset, RBA. Industrial shares measured by the S&P/ASX 300 Industrials Index. Returns are calculated from Jun 1995 to Jun 2015.

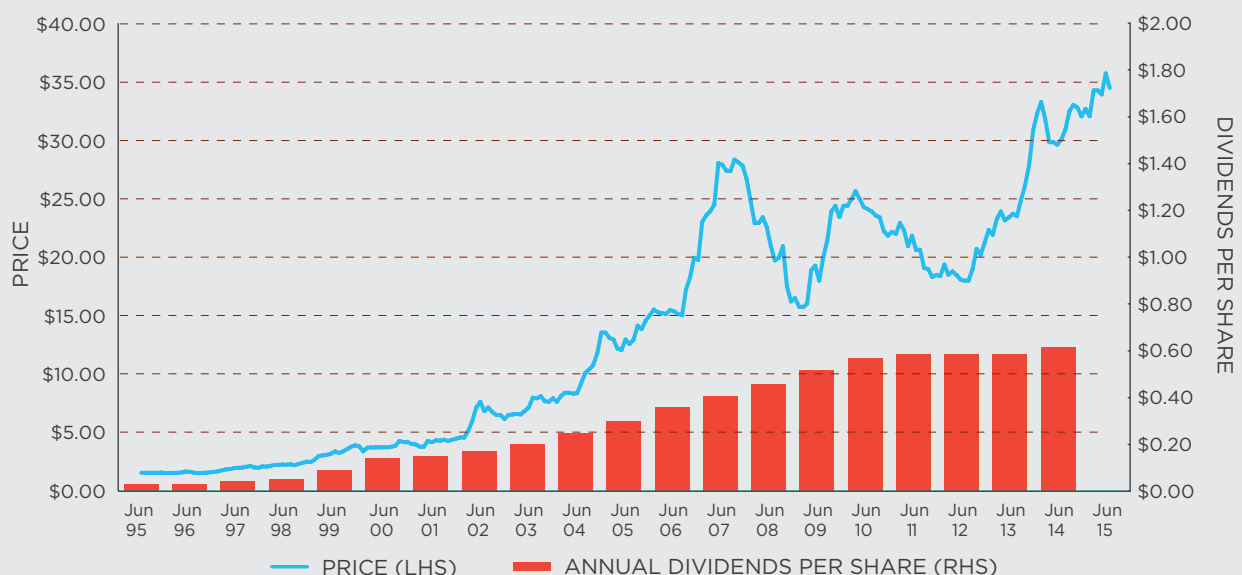
CASE STUDY 2 - REECE AUSTRALIA

Harold Reece opened the first Reece plumbing hardware store in 1920. Today, the company has over 450 stores nationwide and has become a household name in bathroom supplies. The company has a long history of successful store roll-outs and expansion into new product lines.

Supported by a strong brand name and reputation for quality, Reece have built a dominant position in their market. Evidence to this, Reece has delivered earnings growth of 15% pa since 1996. This earnings growth is reflected in the long-term rise in its share price as reflected in the below chart.

CHART 3: REECE INVESTORS HAVE ENJOYED SHARE PRICE RISE OVER THE LONG TERM

Share price vs dividends per share, June 1995 to June 2015



Source: Perpetual & Factset

HOW DOES AN INDUSTRIAL SHARE FUND FIT INTO A BALANCED PORTFOLIO?

Every investor has different needs for income and growth, a unique tax situation and a personal risk tolerance. You need to consider all these four factors when making investment decisions.

Over the past 20 years Australian industrial shares have proven to deliver income **and** capital growth at levels that have comfortably beat inflation at a level of volatility or risk that is lower than both resource shares and the overall Australian market.

MORE INFORMATION

If you would like more information about the benefits that industrial share funds can offer, talk to your financial planner. You can find out about the **Perpetual Industrial Share Fund** on our website at www.perpetual.com.au.

- 1 Annualised volatility of historical monthly returns of the S&P/ASX 300 Resources Price Index from 30 June 1995 to 30 June 2015.
- 2 Annualised volatility of historical monthly returns of the S&P/ASX 300 Industrials Price Index from 30 June 1995 to 30 June 2015.
- 3 Annualised return of the S&P/ASX 300 Industrials Price Index from 30 June 1995 to 30 June 2015.
- 4 Average dividend yield of S&P/ASX 300 Industrials Accumulation Index from June 2001 to June 2015.
- 5 Assumes dividends are reinvested and compounded daily.

As at 30 June 2015, **Reece Australia** was held in the Perpetual Australian Share, Industrial Share, Ethical-SRI, Geared Australian Share, Share-Plus and Smaller Companies Funds. As at 30 June 2015, **ARB Corporation** was held in the Perpetual Industrial Share Fund.

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