The Case for Industrial Shares

The first question many 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 may provide higher levels of income, strong capital appreciation and lower volatility when compared to resource shares.

Now let's look at the benefits of investing in industrial shares versus resource shares through the prism of four of the main factors investors consider when making any share investment: capital growth, regular income, tax and inflation.

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 may be 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 although you might experience volatility in the short term.

Over the past 25 years, industrial shares returned 5.2% pa[3] in capital growth alone (excluding dividend payments). **The ability of industrial companies to grow their share prices is linked to successful growth strategies pursued within the 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 direct shares is in the form of dividends. Dividends are paid out of a company's earnings. Dividends generally increase as a company grows.

Industrial companies have historically paid strong dividends, with a sector average yield of 5.1% pa.[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 as a cushion against volatile market conditions. This naturally means they have less cash to pay out to shareholders.

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 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 returns have come at the expense of increased volatility.

In fact, over the past 25 years, resources experienced volatility of 20.6% pa[1] compared to 12.4% pa[2] for industrials. Industrial shares have historically generated more consistent growth in capital and income.

3 Tax-effective income

Not only are industrial shares a good source of income, they can also be very tax effective depending on your circumstances. This is because Australian share income is taxed favourably through what is called 'dividend imputation', also known as 'franking credits'. 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 is not paid twice on the same income.

4 Protection against inflation

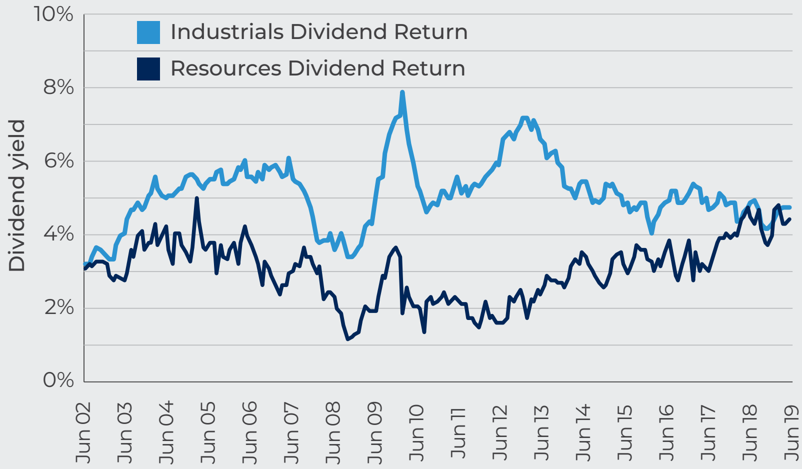
Inflation erodes your purchasing power and diminishes your real investment returns. Therefore it is important that your investments provide protection against inflation.

Over the past 25 years, Australian industrial shares have consistently generated both income and capital growth above the rate of inflation, at a level of volatility or risk that is lower than both resource shares and the overall Australian market.

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.

Chart 1: Historically, industrial shares have paid strong dividends

Historical dividend yields, June 2002 - June 2019



Source: FactSet

TABLE 1: Industrial shares Index: generating both growth and income, 25 year returns to June 2019

	Capital	Dividends	Inflation
Growth (% pa)	5.2	4.9	2.5

Source: FactSet, RBA. Industrial shares measured by the S&P/ASX 300 Industrials Index. Returns are calculated from June 1994 - June 2019.

More information

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.

If you would like more information about the benefits that industrial share funds can offer, please contact your financial adviser. You can find out about the Perpetual Industrial Share Fund on our website: www.perpetual.com.au.

1 Annualised volatility of historical monthly returns of the S&P/ASX 300 Resources Accumulation Index from 30 June 1994 to 30 June 2019.
2 Annualised volatility of historical monthly returns of the S&P/ASX 300 Industrials Accumulation Index from 30 June 1994 to 30 June 2019.
3 Annualised return of the S&P/ASX 300 Industrials Price Index from 30 June 1994 to 30 June 2019.
4 Average dividend yield of S&P/ASX 300 Industrials Accumulation Index from December 2001 to June 2019.

Find out more

Adviser services 1800 062 725
Investor services 1800 022 033
Email investments@perpetual.com.au
www.perpetual.com.au

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