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Equity titans you can trust to deliver the goods

Market volatility is nothing new for investors. However, 2011 has so far been littered with uncertainty.

There have been concerns over sovereign debt in Europe, the US debt ceiling and the prospects of a global recession, while low interest rates and ratings downgrades have pushed bond yields lower, particularly from gilts. So this leaves cautious investors with an income dilemma.

The FTSE 100, FTSE All-Share and S&P 500 have all fallen, with losses of 6.96 per cent, 7.14 per cent and 8.13 per cent respectively to September 8 2011, according to FE analytics.

In spite of this volatility, many believe global blue-chip stocks are still the best source of income, as they have strong balance sheets to support dividends.

Stephen Thornber, manager of the Threadneedle Global Equity Income fund, points out investors looking for income won't get it from banks after both the Bank of England and the US Federal Reserve have made it clear interest rates will remain low for the foreseeable future.

He adds: "You can get superior yields from the stockmarket compared to both government bonds and even corporate bonds, and the advantage equities have over those is they also offer the opportunity for capital appreciation.

"If you're investing in bonds and fixed interest securities you may be getting a reasonable yield, but you're losing value against inflation. Over time equities - if you choose good quality equities - they should be adding to capital value as well as giving you an income stream."

He admits equities do bring some risk factors and the possibility of dividend cuts, but adds: "They should be balanced against the advantages they offer."

The FTSE UK Dividend + index, which selects the top 50 stocks by one-year forecast dividend yield from the FTSE 350 ex investment trusts, also recorded a loss of 5.51 per cent for the year-to-date.

Adrian Lowcock, senior adviser at Bestinvest, points out while equities and dividends have their flaws, the key thing at the moment is that UK 10-year gilts are offering approximately a 2.5 per cent yield, while corporate bonds are not offering much more, as yields have fallen on concerns over Europe and the US.

"From an investor's point of view, if you're looking at income, you have got to look at the long term. If you're looking at UK 10-year gilt yields at 2.5 per cent, you're losing money because inflation is at 4.4 per cent. So effectively that's a 1.9 per cent loss per year. Inflation is probably peaking and is going to come down in the next couple of years but even so yields aren't particularly attractive.

"If you compare it with equities where you've got yields of 3.5-4 per cent, again that's not giving you a real return at the moment, but as inflation comes down that will quickly turn into a real return."

He admits the UK has quite a concentrated dividend stream and says the BP crisis highlighted the problems of the market, as traditional dividend payers are focused on key areas such as oil and pharmaceuticals - so there is the chance of stock-specific risk.

"Having the UK is fine, but you do want to diversify your income stream into other countries. Europe, in spite of its crisis, has some very strong dividend payers in that region, and there are some very good global equity income funds out there now that will tap into countries that aren't normally associated with dividend paying."

Simon Hynes, director of UK wholesale at Jupiter, notes that traditionally, gilts have been seen as a risk-free return, but with government debt issues and the recent downgrade of US long-term debt, "the security of various governments is being put up there to be challenged. So to what extent is a UK government bond safer these days than say a large global blue chip equity?" he says.

"From the point of view of a cautious investor, a lot of risk-based asset allocation models would say if you're looking for low risk you should have a portfolio stuffed full of cash and fixed interest. Fixed interest is just such a myriad of investments these days that the relative safety of those instruments needs further investigation."

This doesn't mean equities are necessarily safer, but it has been suggested that some blue chip companies such as Colgate and Johnson & Johnson, that continually grow their dividends, may be stronger than many governments.

"These very large global titans, as some fund managers refer to them, offer very attractive yields relative to fixed interest currently and arguably are a safer bet," says Mr Hynes.

Mr Thornber adds: "You can lock in these fantastic companies that grew through the 2008-09 recession, didn't have a down year in earnings or revenue, on a rating that I haven't seen before. So if you pick up a portfolio of Walmart, Tesco, IBM, Vodafone, McDonald's, Pepsi - these are world-beating companies that will continue to deliver growth in almost any economic condition."

However Carl Lamb, managing director at Almary Green, points out that every asset class has issues.

"For income my advice to people - and what we've always done - is try and be cautious with people's money, therefore the traditional route.

"Yes, cash is not very exciting, but at least it pays you something - and the problem with gilts is, of course, the coupon returns are so small.

"It's not exciting and it's not sexy, but if you're a cautious investor that's what you want - anything else and your capital is going to be at risk."