FINANCIAL REVIEW

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There's plenty of value in big cap stocks, Perennial's John Murray says

Stephen Bruce, portfolio manager, and John Murray, managing director, Perennial Value. The fund says current conditions are frustrating for value investors. **Louie Douvis**

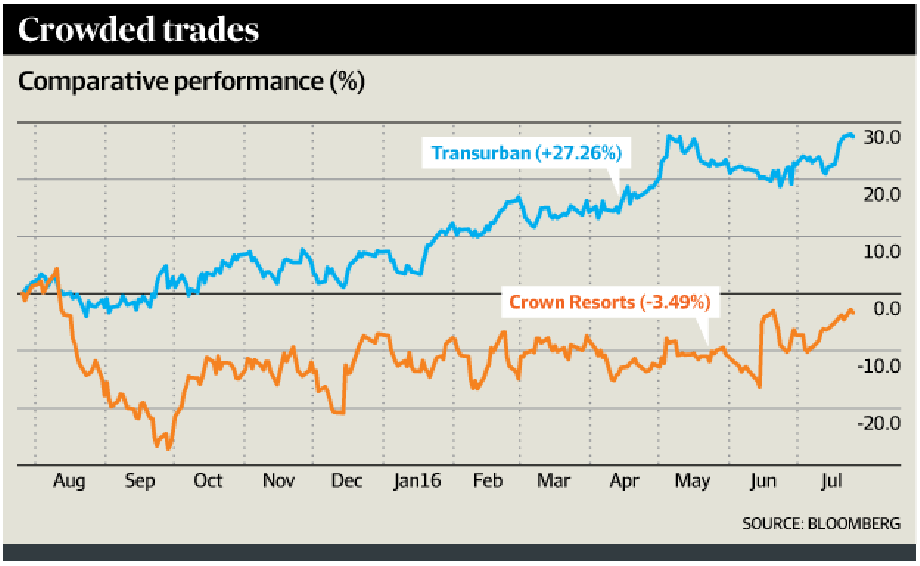
by **Vanessa Desloires**

Don't believe the myth that value can only be found in the small cap space.

John Murray, veteran fund manager and founder of Perennial Value Management, says while it's been a "frustrating" year for value investors, there's plenty to be found, not least in the forgotten blue chips.

The premium being placed on stocks that are delivering earnings and dividend growth are confined to a narrow group of stocks that are being used as bond proxies by refugees from the bond market, he says.

Yields on government bonds are sitting at historical lows amid a sustained low interest rate environment, leading investors to so-called defensive stocks including Transurban, Sydney Airport and CSL.

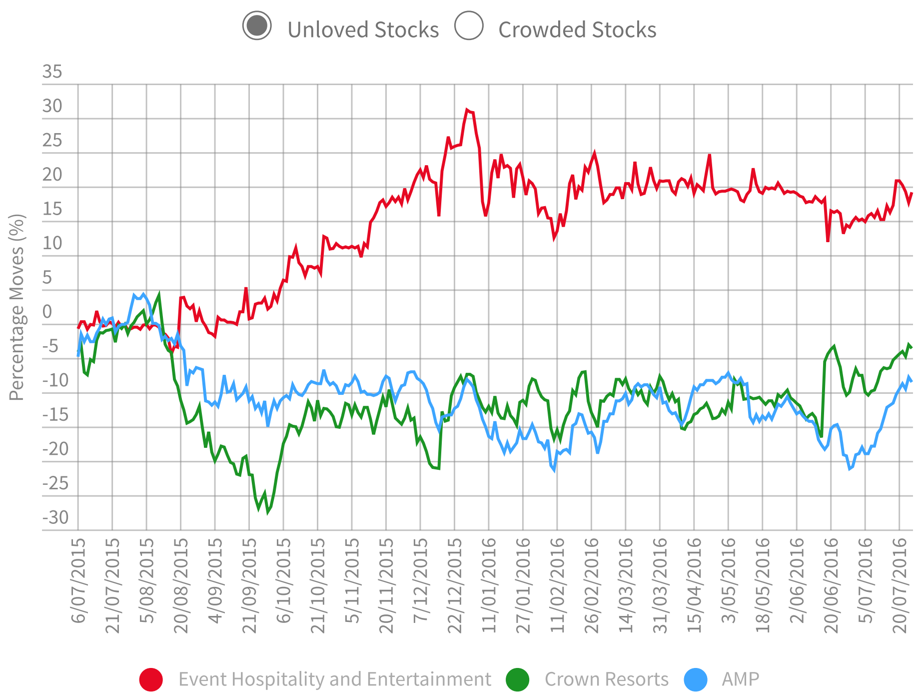


"These companies are on the whole very good businesses with quite a defined earnings outlook going forward. I think investors have been generally very much attracted to what I would call perceived earnings certainty," Murray says.

But these and many stocks – chiefly utilities, industrials and real estate investment trusts – are trading on extreme valuations and their share price growth is outstripping dividend per share growth often by twice the rate. He says the perception of "certainty" in earnings in equity is flawed.

According to Murray, the average dividend per share growth of Transurban, Sydney Airport and CSL is 9.7 per cent per year over the past three financial years, however, their share prices grew on average 22 per cent per year.

Value in the eye of the shareholder



Among Perennial's picks...

"Given the strong share price appreciation, many of these stocks are now offering yields that are not overly attractive, particularly given their lack of franking credits," he says.

The question is whether there is more upside from here, and Murray says he's not comfortable paying such a high price when there are plenty of good quality companies in the industrial sector that are presenting opportunities.

Among Perennial's picks, Murray lists Event Hospitality, formerly Amalgamated Holdings, Crown Resorts and AMP. These three stocks have delivered an average DPS growth of 12.8 per cent per year, versus the share price growth of 9.6 per cent.

It's kept the valuations at reasonable levels, on an average forward price-to-earnings ratio of 17-times.

But therein lies the frustration for Murray, whose firm manages $8.8 billion. Despite these companies operating on attractive valuations, with strong balance sheets and growth opportunities – a lift in tourism for Event Hospitality, a demerger from Crown and efficiencies in AMP – investors are not jumping on board.

Frustrations

"It's been a difficult time for a value investor over the past 12 months," he says.

"I'd probably say it's frustrating. Frustrating in a sense that we've been finding and identifying good businesses... companies with nice dividend flows that have been somewhat forgotten," he said.

According to the June 2016 update, the Perennial Value Australian Shares Trust returned -3.1 per cent over one year, down 3.2 per cent for the month, versus the S&P/ASX 300 accumulation index, down 0.9 per cent for the year and 2.4 per cent for the month.

The "crocodile jaw" dispersion that has emerged between the two distinct group of stocks that Murray says is a good signal for contrarian investors who want to take a long term view.

"It's a good time to buy good quality stocks and buy them at considerable value," he says.

Other names in Perennial's basket include Washington H. Soul Pattinson, Lend Lease, AGL Energy and Macquarie.

Brexit opportunities

Macquarie is one of the stocks Murray topped up on in the aftermath of the shock Brexit vote last month, where stocks with exposure to British and European markets were indiscriminately sold off.

While value "unequivocally" resides in the small cap space, Brexit has helped open up good value in the large cap space, says Perennial portfolio manager Stephen Bruce.

"Notwithstanding the market has re-rated post-Brexit, but the areas where Perennial has trawled, more value has opened up post-Brexit, if you like," he says.

Along with Macquarie, QBE and National Australia Bank spinoff Clydesdale Bank are those stocks that were oversold in the market's "short term" thinking, he said.

But Perennial is settling in for challenging times ahead. While the economy has been transitioning through the post-mining boom, much of that growth has been concentrated in the housing market, which, without broadening from that theme, will at some point inevitably pull back.

Big banks

"We're a bit concerned with political uncertainty everywhere, and the lack of decisive policy that could slow things down a bit," Bruce says.

It's for this reason the fund has reduced its exposure to the big four banks, despite trading on below-market valuations.

They have however topped up positions in resources companies, citing value in large-cap, low cost companies with strong balance sheets, notably BHP Billiton, Rio Tinto and Woodside Petroleum.

Murray says he likes the restructuring being undertaken by Woolworths, following Monday's announcement in which the company said it would incur restructuring costs of almost $1 billion, including shedding 500 jobs and closing underperforming stores. It followed the write off earlier this year of the struggling Masters business. Woolworths is one of Perennial's biggest share holdings.

"We think the Brad Banducci–Gordon Cairns leadership team is worth backing," Murray says.

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