

Share Yields—A Factual Study

This paper gives the results of a recent study of the actual yields obtained from investment in large groups of ordinary shares over the 9-year period 1957 to 1966.

This was a fairly representative period as it included a period of rapidly rising share prices (1957-60) and a period of rapidly falling prices (1960-62). Over the full period from June 1957 to June 1966, the Sydney Stock Exchange Index of "all ordinary" shares (excluding mining) showed an average annual rise of 4.8% p.a. (compound), which was not very different from the average rise of 4.4% p.a. (compound) for the 20 years to June, 1966.

The study was based on the results of 178 companies chosen with-

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out the benefit of hindsight. Each of the four groups shown in the Table 1 below included companies with widely varying results from very poor to very good. As the table shows, a fairly significant proportion of the shares in each group actually showed capital losses over the period and the inclusion of these companies has, of course, depressed the average results shown in the table. Consequently the attractive returns shown in the table cannot

be said to be due to hand-picking only successful companies. No purely mining companies were included.

A very common question for investors in shares is whether to buy "blue chips" or higher-yielding shares. Greater growth, both in income and market valuation, would normally be expected from the "blue chips", but will this growth be sufficient to offset the initial very low yield which has to be accepted on "blue chips"? To help provide the answer to this question, the shares were divided into four groups classified according to the size of the initial dividend yield at purchase date in 1957.

The results of the study are shown in Table 1. Here are the footnotes to the table:

- (a) For purposes of these calculations, it has been assumed that an equal amount was invested in 1957 in the shares of each of the companies included. It has also been assumed that bonus issues were taken up, and that when new cash issues were made sufficient rights were sold to enable taking up of shares with no further cash outlay after the initial investment in 1957.
- (b) The figures for "total income" include allowance for income from the reinvestment of income each year at 5% p.a.
- (c) Equivalent annual rate of income which would produce the "total earnings" shown on the previous line assuming re-investment of all income at 5% p.a.

The average yield of 12½% p.a. achieved on the total shares included in this study would have been received by an investor who held all the shares throughout the entire period. Expert opinion suggests that it pays to periodically review and change some of the shares in a portfolio. Therefore, it would be reasonable to expect that still higher returns could be achieved from an actively managed share portfolio.

It is worth noting that the group of shares showing the smallest dividend yield at purchase showed the largest overall returns over the period. They also showed the largest

TABLE 1
Results of Purchase of Ordinary Shares in 1957 and Sale in 1966(a)

	Range of Dividend Yields at Purchase in 1957				All Companies
	3-4 % p.a.	4-5 % p.a.	5-6 % p.a.	6-7 % p.a.	
Number of companies included	27	40	67	44	178
Average dividend yield on all shares at purchase in 1957 (% p.a.)	3.6	4.5	5.5	6.5	5.2
Average annual rate of growth (compound) in dividends 1957-66 (% p.a.)	7.5	5.9	4.4	2.9	4.9
Average dividend yield on all shares in 1966 (as % of purchase price in 1957)	6.8	7.6	8.0	8.4	8.0
Total earnings over 9 years (as % of purchase price in 1957):—					
Total income (b) (%)	56	66	74	82	72
Net capital profits in 1966 (%)	99	74	63	44	66
Total earnings (%)	155	140	137	126	138
Total earnings p.a. (c) (% p.a.)	14.1	12.7	12.4	11.4	12.5
% of number of companies for which there was a capital loss on sale	14.8	27.5	19.4	36.4	24.7

capital gains, which would be of particular significance to investors in high tax brackets not subject to tax on capital gains. It would appear that market assessments in 1957 of the future potential of the various stocks, as reflected in the range of market yields, were reasonably good on average.

A key figure in the above table is the annual rate of growth in dividends because this is the main determinant, not only of the dividend income from a share, but also of the capital gain on sale. A main aim when selecting shares for purchase, therefore, should be to select companies with the best prospects of growth in dividends.

It is possible to calculate the annual rate of growth in dividends needed to produce any required average rate of total earnings over any period. Some relevant calculations on these lines are given in the following table:—

The required rates of growth in dividends shown in Table 2 vary between 2.7 and 7.4% p.a. Such rates of growth are seen to be readily attainable when one considers a few facts. Company profits grew at an average rate of about 7% p.a. during the 10 years to 1965-66 (based upon Reserve Bank statistics for constant groups of large numbers of public companies). This was the result of:—

- (a) The general expansion of the Australian economy, providing companies with growing markets and enabling them to continue to expand. The average company ploughs back into its business each year about one-third of its profits. If it earned net profits of, say, 12½% p.a. on the amounts ploughed back, it would by **this action alone** raise its profits by 4% p.a.
- (b) The continual improvement in productivity resulting from bet-

sary to produce earnings equivalent to 10% p.a.

The main conclusion to be drawn from these figures—and many other similar studies—is that investments in shares are likely to show far better returns than fixed interest investments, provided the share investments are well spread over a reasonably large number of companies and can be held for about 10 years. The margin in favour of shares is likely to grow the longer they are held and for a semi-permanent investment, such as a superannuation fund, shares are likely to show immeasurably higher returns in the long run. Share investments are particularly favourable, of course, for investors not subject to tax on capital gains.

There is another important aspect. People who enter into long-term fixed interest investments face the prospect of serious erosion of the real value of their income and capital due to price inflation. Persons living on fixed pensions from superannuation funds also face this risk. Share investments offer protection against inflation as the growth in dividends from a well-spread share portfolio should exceed the rate of growth in prices, not in every year but over a period of years. Superannuation funds which are largely invested in shares should be able to guarantee pensions rising by a fixed percentage each year instead of fixed pensions from retirement or “ex gratia” increases.

I conclude, therefore, that there is no justification whatever for State Governments continuing to restrict the investment powers of trustees, under the Trustee Act in each State, to fixed interest investments alone. The United Kingdom Government amended its legislation in 1961 to permit trustees to invest up to 50 per cent of their assets in ordinary shares and the Government of Western Australia has also permitted investments in shares with certain safeguards. It is now up to the governments of the other States.

TABLE 2

Initial dividend yield on shares at purchase % p.a.	Average annual rate of growth in dividends required to produce total earnings (dividends plus capital gains) before tax over 10 years equivalent to a fixed income of 10% p.a. (a) % p.a.
2	7.4
3	6.5
4	5.5
5	4.5
6	3.6
7	2.7

(a) Assuming shares are sold after 10 years at the same market yield as that at which they were bought.

When allowance is made for income tax, the annual rate of growth in dividends required to produce earnings on shares equivalent to 10% p.a. is lower than shown in Table 2 in the case of investors who are not subject to tax on capital gains. How much lower depends on the investor's marginal rate of tax. By way of example, the rates of growth required would be only a little over half of the figures shown above for an investor with a marginal tax rate of 50%.

ter equipment, new techniques and new inventions and discoveries.

- (c) Price inflation, which causes growth in incomes generally, including company incomes. During the 10 years to 1965-66, retail prices in Australia increased at an average annual rate of 2%.

The **actual** average rate of growth of dividends of the companies studied in Table 1 was higher than that shown by Table 2 to be neces-