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TOMORROW
What the year ahead holds for investors

Cuts tipped at NAB

Dividend forecast to fall

JOHN DAGGE
BANKING

NATIONAL Australia Bank's new chief, Ross McEwan, will pull the trigger on a $3.5 billion capital raising and announce another deep round of cost cutting, a leading investment bank has predicted.

The banking major will also be forced to again cut its dividend as it ramps up its investment in technology which has lagged key rivals, a deep dive into NAB by Morgan Stanley forecasts.

NAB had the second-biggest share price gain of the big four banks in 2019, putting on 2.8 per cent.

But Morgan Stanley banking analyst Richard Wiles said investors are underestimating how much the nation's biggest business lender needs to invest in its business to keep up with a fast-changing technology environment.

Further fallout for poor behaviour also poses a key risk, Mr Wiles said, including a probe by the nation's dirty-money watchdog, the Australian Transaction Reports and Analysis Centre.

It handed Commonwealth Bank the largest fine in corporate Australian history in mid-2018 and has accused Westpac of breaching anti-money laundering laws more than 23 million times.

"Further 'transformation' reinvestment is underestimated by investors, loan losses are drifting up, the AUSTRAC contingent liability creates uncertainty, a capital raising and further dividend cut appear likely," Mr Wiles said in the report released last month

Mr McEwan, who previously led the Royal Bank of Scotland, took over running NAB in early December.

His predecessor launched a $1 billion cost-cutting program — including 6000 job losses — to run over the two years to June 2020.

Mr Wiles said Mr McEwan would double down on this and announce a further $1.2 billion cost savings target for the two years to the end of 2021-22.

The New Zealand-born banking veteran would also lift the bank's investment spend to $1.75 billion annually and cut the dividend by 10 per cent to $1.50 a share, Mr Wiles said.

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Dimity Tubb and Georgia Cornell enjoy a Beyond Meat burger, a soy-based hot dog and Phish (mock fish) and chips from Lord of the Fries. Picture: TRICIA WATKINSON

PLANT-BASED 'MEAT' SET TO GROW

INNOVATION

HOLD the beef and pass the soy and lentils.

The Australian market for plant-based meat substitutes is set to boom and the products will account for up to 6 per cent of all meat sales within five years, a major report has found.

The report, by investment bank UBS, also expects global consumption of plant-based meat substitutes to grow at 30 per cent a year from now until 2025. That will create a worldwide market worth $US50 billion ($73 billion) in annual sales, the report said.

"In the next decade our eating habits will undergo profound change," UBS analyst Steven Strycula concludes.

The report defines plant-based meat substitutes as products that use a processing technology known as extrusion, which replicates the core structure of meat using proteins from plants such as beans, peas or lentils.

Mr Strycula said these products would have a far greater impact on the livestock industry than previous veggie burgers, which targeted the narrow vegetarian or vegan consumer segments.

Plant-based meat substitutes were rather aimed at the fast-growing "flexitarian" market segment made up of people looking to reduce rather than eliminate their meat intake.

The global market share of plant-based meat substitutes will rise from 0.5 per cent to 2.5 per cent by 2025, the report predicts.

For Australia, sales penetration is tipped to rise from 0.5 per cent to range between 4.5 per cent and 6 per cent, the report forecasts.

Fear of downturn overshadows attractive returns of equities

THE SHORT CUT

ANDREW MACKEN

FINANCE theory teaches that when you invest in a firm, your expected percentage annual return is spread over and above the risk-free interest rate, typically viewed as the annual yield on a government bond.

The size of this "spread" is proportional to the risk that you bear.

If you are a secured lender, the spread is low.

If you are an unsecured lender, perhaps it is a bit higher.

And if you are a shareholder, the spread is higher still, compensating you for taking the most risk.

Today, spreads for lending to companies are very low while spreads for equity investments in companies are quite high.

Said another way, Mr Equity Market is paying you relatively handsomely for taking equity risk, while Mr Bond Market is not paying you much at all for taking lending risk.

And yet, on a near daily basis, headlines are published suggesting that equities are expensive and the longest bull market in history must soon be coming to an end.

And maybe it will — but maybe it won't.

If financially literate aliens visited planet earth and found the world's largest economy experiencing a 50-year-low unemployment rate of 3.5 per cent, with a Federal Reserve that was in the process of cutting rates and re-expanding its balance sheet of asset purchases, they would view the environment as highly favourable for equities,

And yet, fear of a downturn remains the dominant emotion.

Did you know the S&P500 has gone nowhere for two full years?

This would not feel right to most readers. But recall that President Trump signed into law a reduction in the US corporate tax rate from 35 per cent to 21 per cent two years ago.

This resulted in a one-time rebasing upwards of US corporate earnings by around 20 per cent.

Upon stripping out this effect, we result in an adjusted S&P500 equity return of roughly zero for the last two years.

Hardly the stuff of a bull market that we read about each day.

Today we find ourselves in a world in which leading indicators for global economic growth are stabilising.

More than 20 global central banks are expected to cut interest rates over the next six months.

And the "spread" Mr Market is willing to pay you for taking equity risk has rarely exceeded the spread being offered by Mr Bond Market by so much.

Indeed, the last time these two spreads were this far apart was in 1979.

In the two subsequent decades, the spread paid for taking equity risk converged towards that of the spread paid for taking bond risk.

And this coincided with an average 18 per cent per annum equity return in the Dow Jones Industrial Average for 20 years.

It seems to me that, at a time when investors are rushing to add more fixed income to their portfolios, this asset class is offering relatively meagre expected returns for the risk borne by investors.

And on the end of the risk spectrum, many equities are offering highly attractive returns for the risk being borne.

Equities may not be such a bad place to be after all.

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