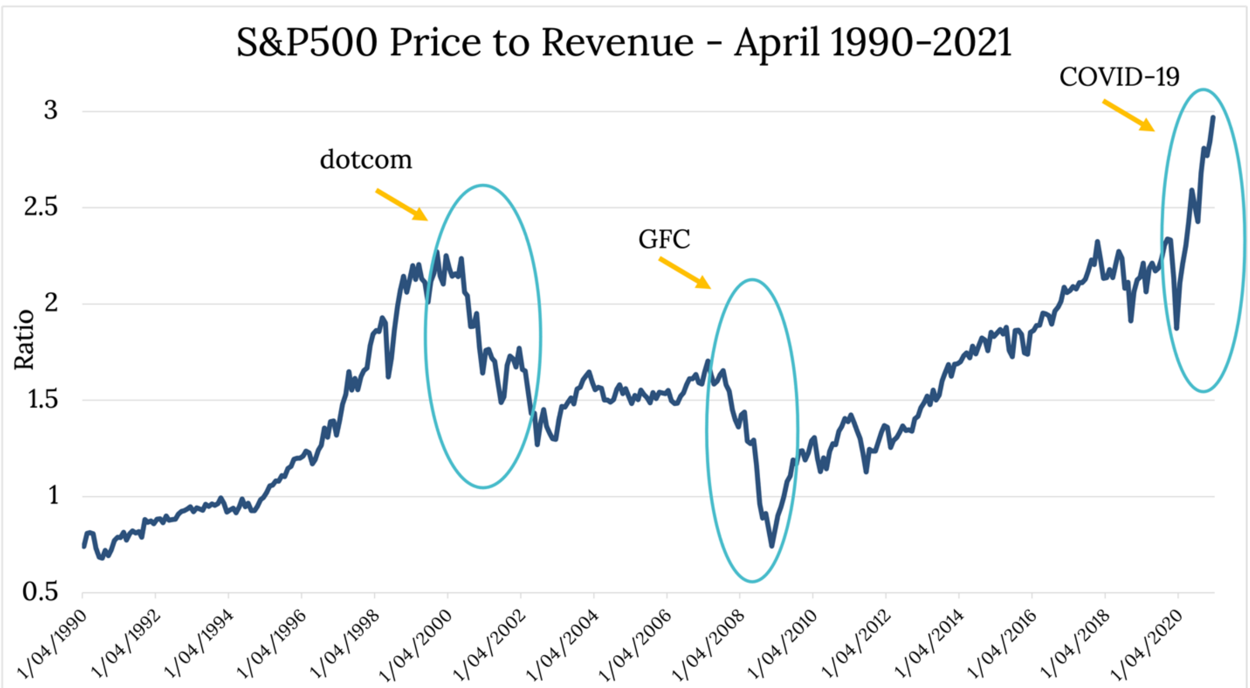
Why income is as important as ever

Whether you think there is a bubble, or the current valuations are justified doesn't matter. It's a fact that valuations are higher than they have ever been for many companies, especially those dominating the indices. And this points to a potential risk for many investors.

One way to look at this is through the lens of price to revenue ratio, which in the S&P500 is also now at an all-time high. This matters because it means investors are now paying 30-40% more for $1 of sales compared to the previous high (Pre-COVID/dotcom boom). Roughly that's paying $300 for $100 of revenue.



Source: Bloomberg

These record high valuations are broad based across most sectors with particularly high levels in Technology. This is the result of years of outperformance, but the last 12 months in particular have seen a disproportionately large amount of return from capital growth, which will likely be challenged going forward.

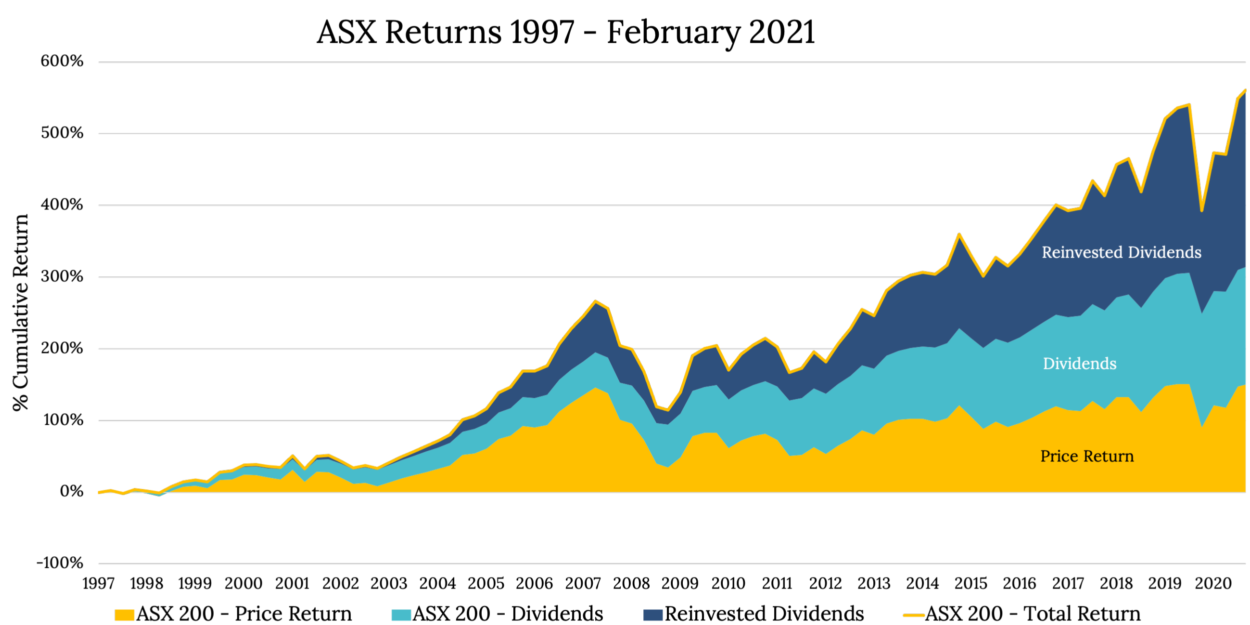
We continue to feel strongly that equity markets, particularly in the United States are still home to a large number of companies valued for incredibly low returns at best – or horrible absolute returns at worst.

At the same time yields are down, with many companies having either reduced or cut dividends.

This is where if you can get decent income, it can make a significant difference to investor returns both as an absolute contributor when constructing portfolios and as a diversifying element within them. The issue only becomes more relevant when considering the starting point of market valuations.

Income helps diversify your sources of return

Looking at the local market this has been the case for over a decade, where the ASX200 has had no growth since 2007, with all returns coming come from dividends or reinvested dividends.



Source: Bloomberg

At Talaria we like a little more certainty for generating stable long-term returns than just relying on dividends. Having a diversified source of return in the form of income allows investors to keep growing (or spending) their investments in the current market - and sleeping a little better along the way.