Only one stock metric really matters, says Platinum boss

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Andrew Clifford, Platinum

The most commonly used measure in equity investing is the price-earnings multiple but Platinum Asset Management chief executive Andrew Clifford says investors should flip the PE ratio on its head and focus on the earnings yield instead.

Clifford says investors have a tendency to over-complicate things, but much of that complexity can be dispensed with.

Speaking at the Portfolio Construction Forum in Sydney last week, he says the goal for any equity investor is to earn a return on their savings and the best measure of that return is the earnings yield.

Clifford took over as chief executive of Platinum in July, following the retirement of its founder Kerr Neilson. Clifford has been at Platinum since its launch and was most recently chief investment officer.

The price-earnings multiple is derived by dividing a stock's price by its earnings per share (either historical or prospective). The PE gives investors a measure a how expensive a stock is compared with the overall market PE, the average PE of stocks in its sector and how the stock is tracking against its PE over time.

Earnings yield is also derived using the stock price and earnings per share but in this case the yield is calculated by expressing the EPS as a percentage of the stock price. The earnings yield shows the percentage of earnings produced for each dollar invested.

It measures the return on investment and that, says Clifford, "is everything".

Importantly, the earnings yield can be compared with other rates of return, such as term deposit or government bond rates.

One important difference between deposit and fixed income rates and company earnings yields is that earnings grow over time, leading to a higher earnings yield.

Clifford says: "We have the car company BMW in our portfolio. It is currently trading on a PE of 7.4 times and an earnings yield of 13.4 per cent. Some of that earnings yield is paid as dividends and some is reinvested.

"I don't try and predict what the BMW share price is going to do. Instead, I look at what I am going to get back.

"The hard part is making an assessment of what is going to happen over the next few years. In BMWs case that means trying to get an idea of how the company will deal with tighter emission standards, the development of autonomous and the expected decline in global car sales.

e share price? My experience over 30 years is that returns will be reflected in the share price. Look at the e care of itself.

Clifford says Platinum is also in Alphabet (Google's owner), which has a PE of 15 times and an earnings yield of 4.4 per cent.

"Why do people own high growth stock? They think the company will keep growing at the current growth rate. But the data shows that only about 2 per cent of companies can grow their earnings consistently at 25 per cent a year or more over a decade.

"Some will deliver. Many will not. I want to own less and less of that. My preference is to be in things that offer better starting returns."

Clifford says investors tend to spend too much time focusing on macro issues, such as the economy, political issues and global trends, such as Brexit and trade wars.

"These things impact markets but the answers are complex," he says.

Platinum's flagship fund, the Platinum International Fund, has produced an average return of 11.2 per cent a year over a past 10 years, compared with a return of 8.9 per cent a year for its benchmark, the MSCI World Net Index (AUD).

John Kavanagh

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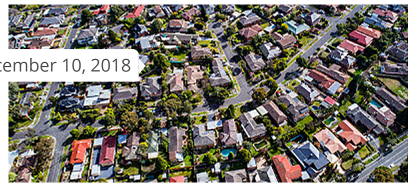

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