# Investors Mutual's Anton Tagliaferro says bank stocks 10 to 15 pc 'overvalued'


Anton Tagliaferro of Investors Mutual says that Australian banks need a "reality check". Image: Louie Douvis


by **Karen Maley**

Australian bank stocks look about 10 to 15 per cent overvalued given their very low profit growth and high leverage, and are in need of a "reality check", according to Anton Tagliaferro, one of the country's leading fund managers.

"The banks in Australia - which make up almost 30 per cent of the index - are rallying strongly because the US banks are on a tear with all the talk of lowering US regulatory requirements and tax cuts", he told *The Australian Financial Review.*

"But if you look at the underlying earnings of Australia's large banks, they're not that strong. The Commonwealth Bank result was up 2 per cent, and given there's a booming housing market in parts of Australia and their bad debts are virtually zero, I'm not sure 2 per cent is all that terrific."

"The same goes for the other banks. Credit growth is tepid, margins are under pressure, profits are sluggish and their results have been helped by very low bad debt charges."

## Be wary of Trump optimism

Mr Tagliaferro, the founder of Investors Mutual (whose Australian Share Fund which is jointly managed with Hugh Giddy has achieved an impressive return of 13.3 per cent per annum over the past five years) said that local investors should be wary of the optimism surrounding global markets since Donald Trump's surprise electoral victory last November.

He pointed out that in the local market, "the rises have been fairly limited. It's been the major banks and the major resource companies that have led the rally, so there isn't a lot of breadth."

And, he added, "the iron ore price has surprised everybody, but you have to question whether the current price is sustainable."

Although the Australian share market is trading at its highest level in a year. Mr Tagliaferro noted that "if you look at a lot of the stocks that we hold - good quality, mid-cap companies like Ansell, Mayne Pharma, SkyCity [Entertainment] and Spark Infrastructure - none of them are trading anywhere near their 12-month highs.

"And that reflects the fact that it is still a difficult environment in which to grow profits. The vast majority of companies that we talked to during the profit reporting season are not saying that things are great. They're saying that it's still a tough environment, and that economic growth is not providing an extra spur to lift profits.

"So most companies are looking for other ways to increase their earnings - by increasing market share, or by restructuring and cutting costs."

## Aussie market to go sideways

Mr Tagliaferro predicted that the Australian market is likely to continue to trade sideways for some time.

"Low interest rates will continue to support the equity market. But, on the other side of the coin, earnings growth is sluggish, so it's hard to see huge upside in the index from here. And while P/E ratios have re-rated on the back of lower bond yields, that process has run as far as it can.

"That means that the next leg up in the market will require earnings growth to come through."

All the same, Mr Tagliaferro said he doesn't see the telltale signs that typically precede market meltdowns.

"Before major market corrections in Australia, there's generally a lot of froth and bubble. In 1987, it was the excitement about the entrepreneurs, and in 2001, it was the nonsense about the tech stocks.

"And in 2007, it centred on companies like Centro and Babcock & Brown that were over-leveraged."

"We haven't got that sort of environment at the moment. The market is at 12-month highs, and some sectors may be a bit overvalued, but we don't have widespread effervescence" he said.

"Probably the banks are 10 to 15 per cent overvalued, and need a bit of a reality check given their lacklustre profit growth. And as for resource stocks, who knows where the iron ore price will head?"

## But a correction unlikely

But, he added, "while these two sectors need a reality check, I don't think we're facing a broad market correction in the next six to 12 months."

Tagliaferro said the present market, "reminds me of periods we've gone through since 2012, when people have become overly optimistic about a recovery, and there's been a correction which has pulled the market back to more reasonable levels."

"I think we're likely to continue to see this pattern for the next few years - outbreaks of exuberance, followed by periods of doubt, when the market succumbs to various worries, whether it's about European elections, or Trump suffering set-backs to his policies.

"I don't think the share market has entered into a new bull phase, especially given the sluggish profit growth outlook. We believe we are still in an overall sideways-trending market in Australia."

This, he said, represented a huge challenge for investors. "It's a very selective market. There's value out there, but you have to scratch around for it.

"We continue to focus on companies that we believe can grow well in the next few years - companies like Pact Group, Sonic Healthcare and Ansell."