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Down then up

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Banking stocks are a significant component of the portfolios of many Australian investors and recent volatility has sparked concerns about the outlook for the sector.

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In particular, renewed fears about the outlook for the US economy have seen banking stocks tumble in many countries. Domestically, an easing in a buoyant housing market has led to concerns the banks are going to see lower levels of home lending growth and the possibility of a wave of mortgage defaults.

However, nervous investors wondering whether to sell can take comfort in the news many analysts believe banking stocks are trading at prices that make them attractive. The bad news is the analysts also generally expect the volatility to continue, at least in the short term.

The head of banking research at Morningstar Australasia, David Ellis, notes in a report that overseas institutional investors in particular are reducing their exposure to Australian banking stocks.

"Offshore investors can use the major banks as proxies for expected changes in Australian residential property prices, commodity prices and the Australian dollar," he says. "International sentiment seems to be increasingly moving against these."

Even at home, not all observers are equally sanguine about the outlook.

The portfolio manager at Wilson Asset Management, Christ Stott, says the company is "quite negative on the economy as a whole".

"The banks are going to see the full force of that," he says. "Their credit growth will be a lot slower over the next five years than over the past decade. That is going to impact them significantly, in a negative sense.

"And I would not expect the same dividend growth that we have seen in the past decade."

The managing director at White Funds Management, Angus Gluskie, concedes another sharp downturn in global economic conditions would have a detrimental impact on local banks and their access to capital.

"But at this stage I think that is an unlikely scenario," he says, noting the banks adopted relatively high levels of bad-debt provisioning during the global financial crisis so the amount of provisioning they now require is decreasing, which boosts earnings.

"If we stitch together moderate growth in the banks' regular income with lower bad debts, then those two things alone mean that their profitability is likely to be fairly good."

With banking shares currently priced at 20 per cent to 30 per cent below their historic trading range, they represent an attractive investment.

An equity analyst at the Fat Prophets market information and funds management company, Colin Whitehead, doubts Australia faces any kind of housing meltdown given employment figures remain high.

"There is likely to be pain for some home buyers who did stretch themselves, particularly in the first-home buyer bracket," he says.

"But the actual exposure of the banks to this part of the housing market is small relative to their overall lending book."

He especially likes ANZ, thanks to a growth strategy that is based on strong moves into Asian banking.

"We think ANZ could eventually start growing at a faster rate than the other banks," he says.

"And the current share price represents a good entry point for gaining exposure to that long-term story, although it may take time for market sentiment to turn back to the banks."

Gluskie and Ellis both rate the Commonwealth Bank highly for its major new IT infrastructure project, to be completed soon.

"This has put them in a good position in terms of streamlining their operations ... it is likely to give their business some impetus over the next couple of years," Gluskie says.

He advises investors to consider National Australia Bank, shunned because of its exposure to banking in Britain. "As conditions improve in Britain, some of the risk discount that has been priced into NAB will come out of the stock," he says. "Equally, the bank has been aggressive in pursuing loan volumes over the last six months and has been picking up market share."

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