Which investor cap will you wear in 2016? **Simon Letch**

When the government said it was targeting savings by slashing or reducing the bulk-billing inventives for pathology (blood tests) and imaging (X-rays) providers, **Sonic Healthcare**, **Primary Health Care**, **Integral Diagnostics** and **Capitol Health** were all heavily sold off.

Many of those stocks have since rebounded as investors digested the cuts and the industry and non-government politicians vowed to fight the measures.

But in a sector where government is the key payer and budgets are under pressure, the whole saga has been a flashing red sign around regulatory risk.

"It appears that this funding reduction is a knee-jerk reaction to a weakening fiscal position – pathology and diagnostic imaging industries lack community sympathy and a political voice so are easy targets for quick budget savings," says Bank of America Merrill Lynch analyst William Dunlop.

"In our view, this cut is the first major move toward higher private contributions to healthcare over the longer term."

While some investors ran for the hills, UBS analyst Andrew Goodsall believes Integral Diagnostics, Primary Health and Sonic are all good buys.

The long-term thematics of an ageing population and increasing demand for healthcare remain intact.

Although the cuts to pathology and imaging have created some doubts about the strength of the push to early diagnosis that many of the diagnostics groups such as Sonic talk about.

In the private hospital sector, Asia beckons.

Ramsay Health Care recently inked a a joint venture agreement with one of China's leading medical universities to build a number of new private hospitals in China's Pearl River Delta.

Healthscope, the sector's number two, is expected to find an Asian partner soon.

The opportunity to provide Australian medical expertise to enormous Asian markets could be very lucrative.

Indeed, this is why China's Luye forked out $938 million to buy Australia's third-biggest for-profit private hospital group Healthe Care from Archer Capital.

Healthscope and Ramsay have also proven themselves to be very astute at building new beds at just the right pace to grow earnings without increasing supply beyond demand.

But, as is the perennial case with healthcare stocks, there is a big trade off between lofty valuations and earnings growth in the hospital names.

The private health insurers are also a space to watch. Both **Medibank Private** and **NIB** have become increasingly vocal about the need to improve efficiencies in the healthcare system and to put a lid on the spiralling cost of care.

With federal reviews into private health insurance and the Medicare Benefits Schedule, among other parts of the health system, there could be significant changes in fortune for the insurers who pay medical bills.

This brings investor focus back on to regulatory risk, which overshadows the never-ending debate between a stable, growing earnings profile and stretched share price values.

Listed property

The listed property sector proved a boon for investors in 2015 and, albeit with lower expectations, could do so again in 2016.

Total returns for investors from the 200 ASX listed real estate investment trusts were nearing 14 per cent before the New Year.

By contrast, investors in the the top 200 listed Australian companies in the broader market would have done better to keep their money in the bank. Total returns for them were less than 3 per cent for the year..

Falling commodity prices and slowing Chinese demand hit the resources sector while blue chip banks stocks were squeezed by tighter capital requirements.

The chase for reliable yield led investors, both retail and institutional, into the listed property sector. That buying demand, combined with rising asset values, delivered a healthy capital gain as well.

Of course, 2015 was nothing like the previous year when the rush to property took total returns to around 24 per cent, most of it capital gain.

Investors are now considering whether they can again expect solid yields in 2016 from investing in bricks and mortar.

Adding complexity is the sector diversity. It ranges from mall owners such **Westfield** and **Scentre**, which controls the Australian-based Westfield malls, and logistics property behemoth **Goodman Group** to office landlords such Dexus, and diversified players such as **Mirvac** and **Stockland**.

Dividend yields in 2015 were around 5.5 per cent. The spread between what investors can get from cash and bonds and from property remains the biggest driver for the Australian REIT sector.

"Comparable assets in Australia have around a 1.5 per cent higher yield than in other parts of the world," says Morningstar analyst Tony Sherlock. "So to wholesale investors, Australia looks very attractive."

The main threat to that attractive spread is the rise in US interest rates. The US Federal Reserve raised rates by 25 basis points for the first time in nine years in December.

The market expects further gradual rises, says Sherlock. "If it there were to be substantially more, then there could be quite a sell-off in the REIT sector."

Sherlock's outlook for the sector is not as rosy as it once was, with more potential negative than positive factors looming: interest rate rises, a slowing economy and a tapering of the housing recovery.

Large shopping centre portfolios, such as those of Scentre and **Vicinity**, offer a safe harbour for investors. Equally, property trusts with offshore exposure like Westfield and Goodman look attractive against a weaker Australian dollar.

Sherlock is less optimistic on stocks with more exposure to housing development, including Mirvac and **Lend Lease**.

Office stocks – **Cromwell**, **Dexus** and **Investa Office Fund** – are looking less attractive to Sherlock as values peak and occupancy potentially dissipates following a cyclical boom in start-up tech firms that soak up excess space.

Atchison Consulting's Ken Atchison is more hopeful about yields in the sector.

Rising rents will provide a buffer against the inevitable rise in local interest rates.

"You've got some protection through growth in yield against higher interest rate. That will keep the spread [to the cash rate] at similar sorts of levels," he says.

Atchison says concerns over a slowing housing market have already been priced into developers such as Mirvac and Stockland.

The past two years have seen a flurry of new listings and the emergence of niche sector trusts, such as **National Storage REIT**.

Atchison expects that trend to continue and advises investors to consider carefully which new entrants can offer good value.

"There is attractive value in the smaller caps and there will be in new listings as well. Do your homework: what sector are they in and what is their sustainable distribution yield?"

Banks

Bank shareholders expecting bumper dividend growth may end up disappointed in 2016 as rule changes designed to make lenders less risky continue to sweep through the industry.

Even so, the major banks should still offer attractive yields to investors. Most analysts