However, the dilemma for the market is that it has rarely looked cheaper relative to the current low bond yields and interest rates."

Despite the high prices, Nicol believes the Australian market offers interesting opportunities in growth, domestic consumer and even China exposed stocks, due to recent reforms and the loosening of Chinese bank reserve requirements. "We could see improved conditions later in the year in China, which is likely to support those companies exposed to China. This includes some of the resources companies, as well as tourism and education exposed companies."

Pan agrees some China exposed companies have good prospects. "With China growth it is not just about resources, as there is major growth occurring in the middle classes and this is creating new demand for services and soft commodities like milk powder."

She believes services companies could also benefit, such as firms operating in the wealth management area and those providing supporting services and platforms. There will also be growing demand for telecommunications and IT services.

"It is important to remember there are other opportunities outside resources. There are many interesting prospects if you look at the share market as a whole," Pan says.

Change is constant

The sharp decline in resource company valuations has already changed the composition of the Australian share index.

"Currently, the biggest sectors are financials and real estate. There are new opportunities appearing in the market from initial public offerings, such as Medibank, and also in the aged care sector. The market itself is changing as industries come and go," Pan says.

Maslen thinks these shifts are creating opportunities. "Although we believe the growth in the non-mining economy is going to take some time to come

Ask the planner

Financial Planning asked David Kennedy CFP®, director of Hillross Pacific Advisory in North Sydney, to share his thoughts on the outlook for Australian equities.

FP: Given the slowing of economic growth in China, how attractive is the Australian equity market for local investors?

DK: Despite record low interest rates, in the short-term, the Australian equity market faces a number of headwinds. Lower commodity prices continue to weigh heavily on the domestic economy and the resources sector, earnings growth across the major banks has slowed, and the Australian dollar has remained stubbornly high despite the RBA cutting to record lows. We've seen above-average returns from the local market in recent years, but the environment we are in is a challenging one for investors, given the representation of banks and mining companies in the local indices.

FP: Which sectors in the Australian market are likely to perform well in this environment and which will suffer?

DK: Earnings growth across the market is largely flat, so companies that deliver on growth expectations will stand out. Those with exposure to offshore earnings and growth in the US economy are faring well, as are various companies leveraged to domestic housing construction. With the cash rate at 2 per cent, the yield story can continue to play out, but dividend sustainability (real and perceived) will be critical to total return outcomes.

FP: Are you re-weighting clients' Australian equities portfolios in light of this changing environment? If so, how?

DK: We rebalance at portfolio level relative to benchmarks on an ongoing basis according to a client's risk profile and investment objectives. Various model share portfolios used have been progressively re-weighting their Australian equities exposure to respond to the challenges confronting resources companies and opportunities arising via housing construction activity, the strengthening US economy and companies deriving a greater proportion of their earnings offshore.

FP: Are you talking to clients about looking offshore for better growth opportunities and a broader opportunity set?

DK: The value of diversifying beyond the Australian equity market is an ongoing dialogue with clients, in particular, with trustees of SMSFs who historically may have held more concentrated portfolios.

The benefits of exposure to assets, such as international equities and infrastructure, have been considerable in recent years, as global indices have outperformed the local market by some margin. We also talk through the need for more thorough portfolio diversification as a means to counter volatility.

David Kennedy

FP: How important are franking credits and for many clients, do their benefits outweigh the risk of lower Australian equity market returns?

DK: Our pre and post retiree clients holding account-based pensions are generally investing in a nil-tax environment and effective targeting of franked dividends is a valuable addition to their investment outcome. In a low-growth environment, the dividend and any tax credits represent a greater proportion of the total return. We talk to clients about first considering the sustainability of a company's dividend and the earnings growth supporting it.