Big wheels keep on turnin'

The US election throws up several investment ideas from the mainstream to the more idiosyncratic...

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While anyone who needs a normal amount of sleep couldn't possibly have read all the articles and listened to all the podcasts pre- and post- the US election, the ones this analyst has consumed seem to fit into some broad categories. First there are the ideological, for or against and we don't really need to explore the polarization between those two groups. Then there are the practical, which look at what some of the proposed policies for the new administration might mean. A tiny number of commentators have managed to be even-handed, but it seems to have been a very difficult thing to pull off.

A recurring theme in all categories of commentary is that this is likely to be a 'transactional' administration. But there seems to be little exploration of what that could mean in practice. Thus, we might be given an analysis of what a 20% tariff on goods from Europe might mean for both sides, because that seems helpful and practical. But will a transactional approach just involve 'we told you what we were going to do, now we're doing it'? Maybe it will, but maybe, just maybe, it won't. Ten years ago, only three NATO countries, the US, UK and Greece, were spending more than 2% of GDP on defence, Today, 23 members have met that target, and it seems uncontroversial to say that President Trump's plain speaking transactional approach to the issue has been a significant reason behind that. The next weeks and months will show whether it was enough to hold the alliance together, but it's clear that everyone in the room finally understood there was a transaction on the table.

Bringing things home for a moment, the UK has, by any rational analysis, been a post-industrial economy for a long time now, and yet the idea of making things in factories evokes a powerful emotional response in many people, including me. Governments know this and spend far more time thinking about factory openings and closings than the raw economic numbers say they should do, and they are helped by the popular press in doing so. Maybe we should leave some room then for thinking that in the US, which is also overwhelmingly a service-led economy but with a much more meaningful industrial base than the UK, a popular outcome might be if tariffs result in companies deciding it would be better to make some of their stuff in the US. Is there a value to that? Maybe the cold economic analysis says 'not really' but maybe there is a value to the people on the ground who voted in the election, and I think we need to leave a space in our thinking for the idea that 'value' can't all be measured by conventional economics. This, of course, isn't the only subject of the recent election, but perhaps it's a start towards getting inside the heads of the negotiators.

Let's look at some sectors, regions and trusts and what we think the implications of the new administration could be for them. There are some broad positive themes and some more idiosyncratic ideas that might help an investor who wants to 'wait and see'.

Healthcare

This sector has already shown significant post-election gains. The US of course looms large in any discussion of healthcare, and as the managers of Worldwide Healthcare (WWH) laid out in a recent presentation, the sector invariably does better under the GOP. They also noted that while pharmaceutical pricing was a big focus of the 2022 Inflation Reduction Act, many of the rounds of price negotiation mandated under that legislation will occur under the new administration, and the market has already begun to anticipate a negotiation that may be a little more favourable to the pharmaceutical companies. Meanwhile **International Biotechnology's (IBT)** team anticipate that a period of stagnation ahead of the election will come to an end, and expect M&A activity, a significant source of returns over the years for the trust, to pick up as large pharmaceutical companies wrestle with patent expiries and seek new products and IP. The trust holds a basket of stocks the managers expect will benefit from this. Both trusts have already seen significant jumps in value, with the respective teams both believing this could be the start of a long positive run for healthcare. Balancing that optimism, we note that the proposed appointee to the health secretary role, RFK Jr., is a controversial choice and if confirmed could introduce uncertainty into the sector.

US

A pro-business administration that cuts corporation tax seems likely to be positive for US equities generally, but investors who nevertheless worry about high valuations in certain parts of the US market could consider **JPMorgan American (JAM)** which blends value and growth opportunities into a single portfolio. This strategy has a track record of negotiating different market conditions and we think investors should see it as a core exposure to the world's largest stock market.

One topic we've focused on for some time is the low average valuation of US smaller companies. The two specialists in this area, **Brown Advisory US Smaller Companies (BASC)** and **JPMorgan US Smaller Companies (JUSC)** have both majored on this over the last two years, noting that falling inflation and interest rates are typically the signal for smaller companies to outperform. Investors have remained relatively immune to this argument but with the election of a pro-business administration likely to cut corporation tax both trusts have seen very strong price and NAV reactions. It will be interesting to hear more on this from BASC's manager Chris Berrier, who is due to talk to us for a forthcoming podcast. You can **register here** to be notified when that comes out.

Finally, while renewables might not be top of everyone's shopping list in the US right now, **SDCL Energy Efficiency Income (SEIT)** has a significant proportion of its assets allocated to US industrial operations, providing services such as on-site power generation using gas turbines and renewable sources, including operations on the iconic industrial site in Massachusetts founded by the Eastman Kodak company, now home to over 100 industrial companies. A fall in corporation tax could be very positive for this trust's assets, none of which rely on any subsidy, and you can register to receive our forthcoming note here. Interestingly, the managers of **BlackRock Energy and Resources Income (BERI)**, who can invest in traditional energy or energy transition-related stocks, have been adding to some of the latter on the election-fuelled sell-off, believing the market is over-reacting. They point out a lot of renewable energy projects are in red states and create lots of jobs. Similarly, **VH Global Sustainable Energy Opportunities' (GSEO)** largest asset, c. 40% of NAV, is a fuel storage facility on the east coast of the US, with room to double capacity. This again could be a beneficiary of the change of administration, and again which doesn't rely on any subsidies.

UK

With the UK's relationship with the US a constant topic of anxiety for our politicians and press, it would be easy to overcomplicate things here. One might say this is our big moment, post 2016, to claim the prize of a freewheeling global trading nation where we can pick the economic winner to team up with. While there has been some unofficial talk in the US of the UK being spared from tariffs proposed for the rest of Europe, it's probably not wise at this stage to position for this.

In our view the biggest opportunities in UK equities right now allow investors to take a 'wait and see approach'. UK equities are undervalued, notably smaller companies, and this is attracting international capital and M&A activity that has already led to positive momentum. One of the best ways to sidestep thinking about how the UK might perform in any negotiation is to focus on trusts generating idiosyncratic returns such as **Rockwood Strategic (RKW)** which is making hay from a mixture of those low valuations and an intense focus on engaging directly with smaller UK companies. **Aberforth Smaller Companies (ASL)** offers some of the same potential in a broader small-cap focused value-orientated portfolio.

Europe

Europe's key strength in any negotiation is that it is home to companies that are important to the US and in many cases have manufacturing facilities in the US. For example, Novo Nordisk, the largest company in the index counts the US as its largest market and has manufactured its products in North Carolina for 30 years. The managers of both **BlackRock Greater Europe (BRGE)** and **European Opportunities (EOT)** recently noted that Novo's flagship product sits in an incredibly important category where voters will be keen to see price competition, with only one other significant participant, Eli Lilley. The same point about local manufacturing is true for other companies from Europe and elsewhere, and so one can see how an active fund manager might find opportunities to exploit the situation.

Like the UK though, investors who wish to take a 'wait and see' approach could focus on more idiosyncratic returns, such as those generated by **European Smaller Companies (ESCT)**. Like the UK, European smaller companies are on average at low valuations, and ESCT's manager has generated impressive returns in spite of low investor sentiment to Europe, finding companies that can thrive even when economics look less favourable.

Emerging Markets

Given the '60% tariffs' being discussed in relation to China, this is the elephant in the room for investors. Again, the answer for investors wishing to wait and see could come from more idiosyncratic returns, and **Fidelity Emerging Markets (FEML)** is able to take long and short positions and take market direction out of the equation if it wishes. This approach has proved very relevant even before the US election, with FEML for example able to navigate the Chinese real estate market through pairs trading and other strategies. Trusts such as **BlackRock Frontiers (BRFI)** and **BlackRock Latin American (BRLA)** offer alternative emerging markets exposure that sidesteps China, although we think a 'wait and see' on Mexico, a key market for BRLA would be sensible, and Vietnam, which investors can access through **Vietnam Enterprise Investments (VEIL)**, an economy that has benefitted from many companies' efforts to move production from China.

Gold

It's quite likely though, for all those neat scenarios above, that markets will have divergent views and investors will look for ways to protect against inflation and as a general hedge against an aggressive approach to geopolitics. Gold had a strong run in the approach to the election, investors perhaps seeking some protection against a less decisive election, but it has fallen back since and could prove a useful portfolio tool in an uncertain world. One way to access it is through **Golden Prospect Precious Metals (GPM)**, which gives investors a neat way to get exposure to the mining companies that benefit most from a rise in the gold price, with c. 80% of the portfolio invested in gold miners that offer, in effect, a geared exposure to the gold price.

Conclusion

In some instances, 'wait and see' is going to be the best thing to do. Markets genuinely don't like uncertainty, and a decisive election has created uncertainties for various regions of the world. Equity investors already know, though, that de-globalisation has been underway for some time, exacerbated by supply chain shocks in the pandemic and shifts in geopolitics, so we don't think the next four years is the sudden change in direction it is being portrayed as, even if the negotiating style is a bit more direct. Going back to our reference to NATO, this has been a recurring theme among US presidents, with the last two Democrats taking a similar, but less direct, line. So many companies will take this in their stride and see it as an acceleration towards where they were already heading. All of which could be very positive for investors who keep their nerve.

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