News & Views

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Power to the people – and the market

The policies enacted by 'populist' President Trump could see value approaches come to the fore following a decade of growth bias in the US market.

Defined as an ideological movement that says citizens are being disadvantaged and mistreated by a small group of privileged elite, it is easy to see why populism has been on the rise, says Chuck Cook, strategist at The Boston Company Asset Management (TBCAM) [1], part of BNY Mellon Asset Management North America Corporation.[2]

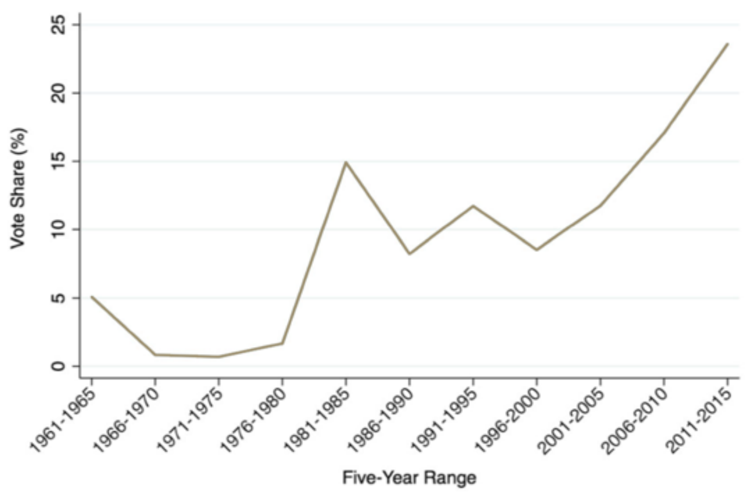
He explains: "In the US, real wages for middle- and low-wage earners have been stagnant for more than a decade, yet the top 5% of earners have seen a significant increase over the same period. If you see a neighbour that is doing really well and you feel you are struggling then that is when people tend to get dissatisfied."

This period has also coincided with the post-financial crisis recession and the slowest recovery from a recession in close to 100 years, Cook adds.

On the rise

Populism was seen as one of the key drivers behind the election of President Donald Trump in November 2016, but it is not solely the US that has seen it rise – support for such parties has increased over the past 15 years in a number of countries.

Support for populist parties over time among countries with at least one populist party



Source: Dani Rodrik, Journal of International Business Policy – 'Populism and the economics of globalisation', accessed May 2018

[1] **Investment Managers are appointed by BNY Mellon Investment Management EMEA Limited (BNYMIM EMEA) or affiliated fund operating companies to undertake portfolio management activities in relation to contracts for products and services entered into by clients with BNYMIM EMEA or the BNY Mellon funds.**

[2] On January 31 2018, The Boston Company and Standish merged into Mellon Capital to form a combined entity which immediately changed its name to BNY Mellon AMNA.

Changes in the type of manifesto individuals are elected on can bring changes in policy, which in turn has an impact on stock markets, says Cook.

He adds: "Now we have a 'populist' president and he has different policies and methods of communicating with the electorate. He is seen as controversial, but despite his style and approach, he has been successful in terms of getting some of his key policies enacted. Apart from Obamacare reform, he has succeeded in lowering the corporate tax rate, allowing US companies to repatriate earnings at a low tax rate, and commencing regulatory reform.

"We view the majority of his headline policies as pro-growth, pro-business and therefore see opportunities in the US market," continues Cook.

A surprising result, dramatic policy change

Trump Policies	Progress	Impact
Obamacare Reform	✗	None
Individual Tax Reform	✓	Increases consumer spending and GDP
Infrastructure Spending	?	Increases productivity and GDP
Corporate Tax Reform	✓	Increases corporate profits, investments and M&A
Overseas Cash Repatriation	✓	Increases share buy backs, dividends and investments
Reduce Regulatory Burden	✓	Increases profits
Pro Growth, Pro Business		Increased GDP, profits, investments and inflation

At TBCAM the US Equity Income team looks at opportunities through a lens taking into account three main factors: attractive valuations, strong fundamentals and business improvement potential.

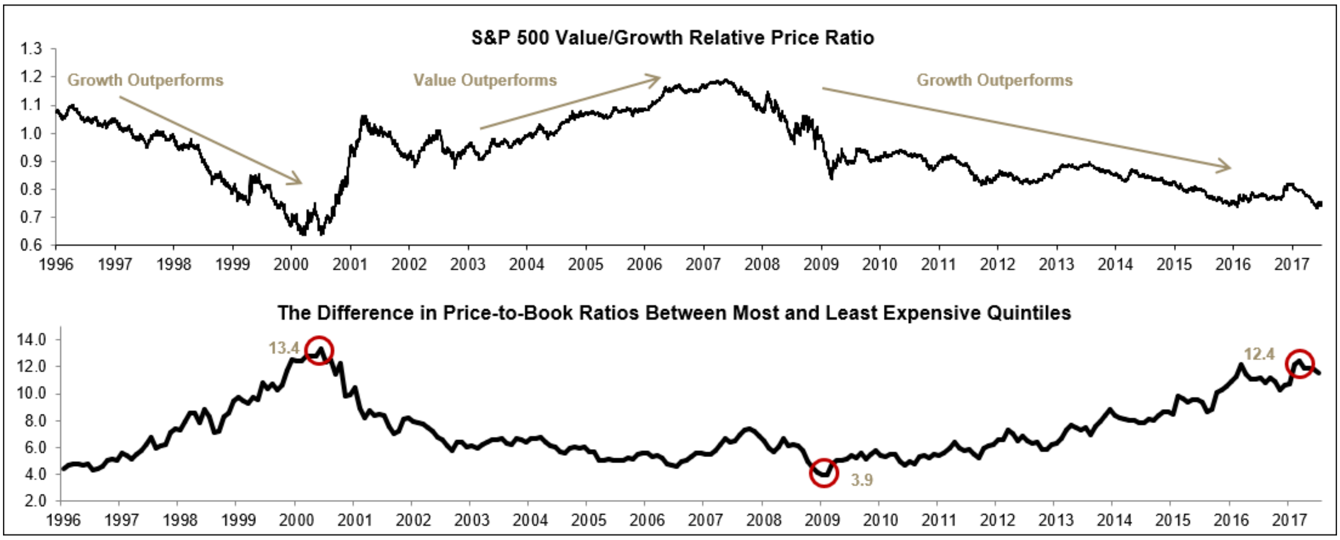
Says Cook: "We believe there has never been more value in value. Over the past decade – of around 1.4% GDP growth in the US – investors have tended to look for companies with growth in earnings and profits, secular growth stories. This has worked for them in a low growth environment. But there have been long periods where value has outperformed growth and investors shouldn't forget that."

The growth/value switch

In the lead up to the dotcom bubble growth outperformed value, then value outperformed when the bubble burst until the onset of the financial crisis. Since then growth has been outperforming.

"Such a dynamic creates some disparity in valuations: the most expensive stocks became very expensive compared with the least expensive. We believe growth stocks will always trade at a premium to value stocks but there are times when this gets out of hand – this tends to be during times of secular stagnation and low interest rates.

"There have only been three periods over the past 90 years that we have had such dramatic underperformance from value stocks. I feel very confident that 10 years from now we will have had very good performance of value over growth."



Source: Top chart – Factset as at 30 June 2017; Bottom chart – S&P Global Market Intelligence's ClariFi as at 31 July 2017. For illustrative purposes only.

Cook says interest rates trending higher tends to be better for value stocks, while deregulation also tends to favour more value-orientated sectors such as financials and energy.

"For us financials tick all the boxes in the current landscape – attractive valuations relative to the broad market, strong fundamentals and business improvement. They have hugely improved their balance sheets and have built up a lot of capital. They have also been stress tested against tests of truly dire economic conditions and been found to have sufficient capital to weather that environment. To us 'low-volatility' bond proxies do not look attractive – and our dividend-orientated strategy is finding better opportunities in more cyclically oriented sectors such as financials.

"We target a very competitive dividend yield – 1.5x the S&P 500 – and we think the approach can provide good risk-adjusted returns versus peers. In periods of rising interest rates over the past several years bond proxies have done poorly, but in five to 10 years if these types of US equities are demonstrating the three characteristics we look for, that is where we will be invested, which is reflective of our flexibility."