US ELECTION 2016
TRUMP VOTE WRONG-FOOTS FORECASTERS

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Ian Heslop, head of global equities, Old Mutual Global Investors, comments on the result of the US presidential election, and explains how it relates to his investment process.

The result of the US presidential election, like that of the UK referendum on the EU, went against the predictions of most opinion pollsters, who had put Hilary Clinton, the Democratic candidate, slightly ahead prior to the actual vote. What currently seems the likely victory of Donald Trump, the Republican candidate, was in defiance not only of the pollsters, but also of many investors' expectations. Overturning predictions, Trump won key swing states of Florida, Ohio and North Carolina on his path to the White House. Forecasters have been wrong-footed, and there could be increased volatility in markets while investors digest this new information, and wrestle to understand the implications of a Trump presidency.

Trump is in many ways an unknown quantity, and his presidency could spell a period of uncertainty for investors. We shall be monitoring markets closely, but it would be reasonable to expect, in the short term at least, a sell-off in equities, not only in the US but also internationally. The immediate reaction of equity markets was negative, with Asian indices falling. The US dollar also fell, down 3.4% against the Yen as at 5:20am London time.

The dollar has come under pressure, both because a hike in interest rates by the US Federal Reserve now seems less likely, and also because investors may place a higher risk premium on US investments. Volatility across many asset classes could increase in the short-term.

Looking further ahead, several of Trump's policies, for example his protectionism, his desire to scrap existing international trade deals, and to deport illegal immigrants, have the potential to contribute to longer-term market volatility; but others, for example his plans to slash taxes, including reducing the business rate from 35% to 15%, his plans to encourage repatriation of corporate profits held offshore, and to embark on massive infrastructure spending, could stimulate the US economy, lifting equities. Much is uncertain, not least because his campaign promises have been long on rhetoric and short on policy detail.

Given the intense degree of attention on the election, and its undoubted political importance, it may seem surprising that within the global equities team at OMGI we made no attempt to predict its result. We are not in the business of trying to predict events that are very hard to predict. Striving to forecast a binary (either/or) event such as a close-run election is, in our view, not a good way to invest. We have built our investment process on other - we believe sounder - principles.

Macro events and geopolitical events, like the US election, affect our investment process implicitly rather than explicitly. They impact the market, and this is the key for us. We are much more interested in how the market is behaving because that gives us the clues as to how we should position our portfolios.

A STABLE PROCESS

Our investment process involves developing a view of how the stock market is behaving. We have to be very aware of the direction of the market, the volatility of the market, and of the ways in which individual stocks' returns differ from each other. How, and to what degree, do stock returns vary from each other? How great is investors' appetite for taking risk? Are investors comfortable exposing themselves to higher degrees of risk, in the hope of achieving higher returns, or are they much more risk averse, shunning risk and seeking the safety of stocks of higher quality? Those kinds of questions are being asked all the time within our portfolio investment process. That leads us to the stocks that we will want to buy.

US EQUITIES NOT CHEAP

Recently, US equities have generally not been cheap in valuation terms, though many of the companies in this market are high quality, so one might expect to pay a higher price. Parts of the US market are particularly expensive relative to the average. For example, large caps (shares in larger companies) tend to be more expensive than small- and mid-caps (shares in small and medium-sized companies): this is partly because large caps are international, but also because they receive large inflows from investment funds that track indices (the largest of which track baskets of large caps). Other areas of the market that have become more expensive are dividend payers (shares which pay out high levels of dividends to shareholders), and low volatility (shares which move up and down less than the overall stock market).

In my view, active managers have a great opportunity at the moment because there is a lot of mispricing in North America. Although North America as a whole is not cheap, there are cheap areas of North America that can be exploited by investors who are nimble enough.

ABOUT THE AUTHOR

Ian Heslop joined Old Mutual in 2004 and is head of global equities at Old Mutual Global Investors. He manages a range of hedge and retail funds and segregated mandates, including market neutral and long only funds. Ian boasts more than 18 years of investment experience and the team has won numerous awards for its funds. Prior to joining Old Mutual, Ian was a UK quantitative fund manager at Barclays Global Investors. He holds an MA in chemistry from the University of Oxford and a PhD in medicinal chemistry, University of Edinburgh. He is an associate of the Society of Investment Professionals.

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