

MARKET INSIGHT

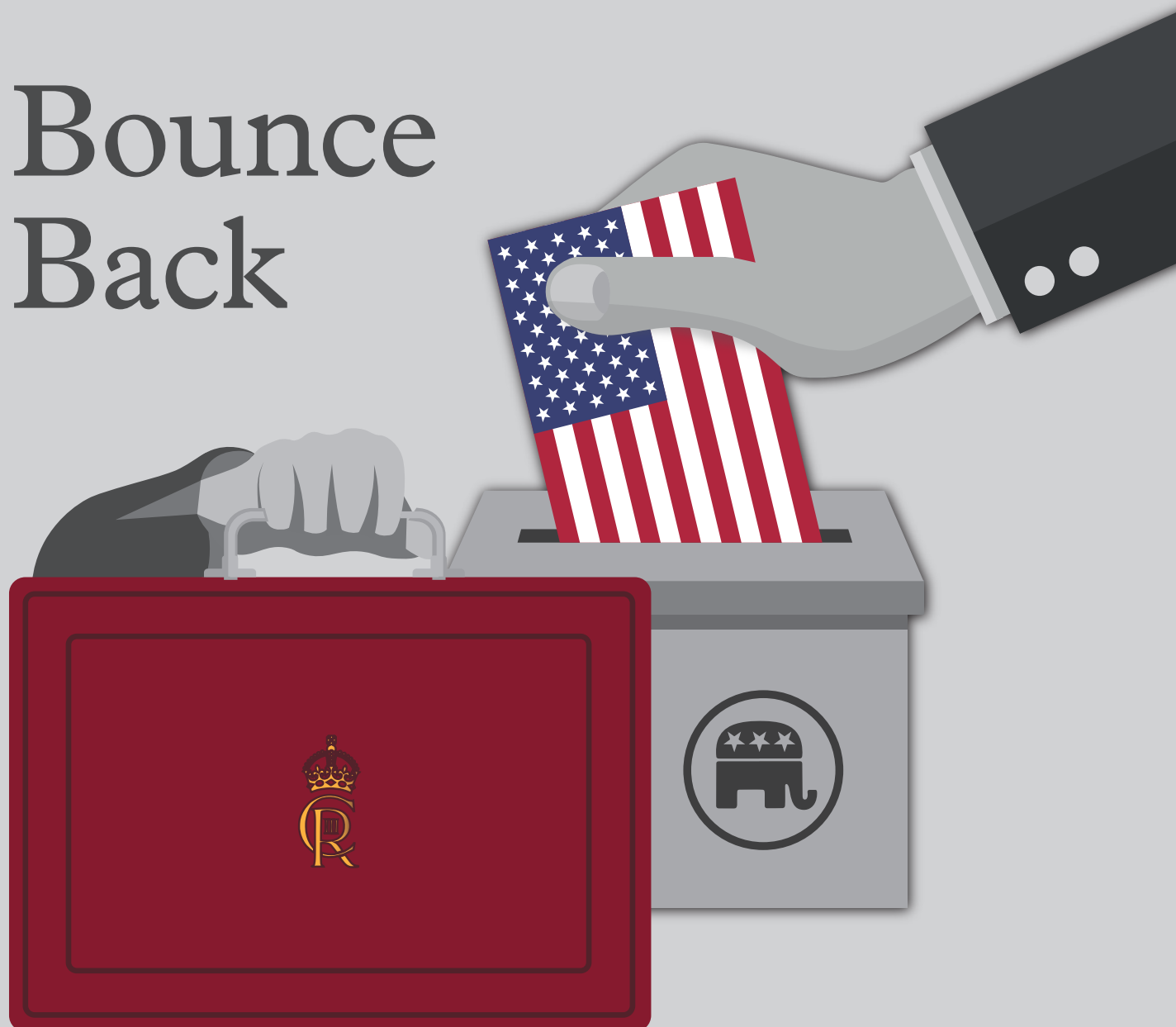
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Two key political events have dominated headlines of late, the first Labour Autumn Budget in fourteen years and the US Presidential Election. UK financial markets were muted in the lead up to Rachel Reeves' speech, with the FTSE All Share trending sideways and the FTSE AIM Index drifting lower in anticipation of cuts to inheritance tax relief for investors in qualifying shares.

Increased selling from investors anticipating capital gains tax increases is also expected to have influenced UK equity performance, with the Investment Association reporting some £2.4bn of withdrawals from equity funds by retail investors in September alone. October was no better for fund flows according to data company Calastone, who indicated a further £2.71bn of withdrawals from UK equity funds before the volume of sell orders dropped 40% overnight as capital gains tax increases took effect. Financial markets have somewhat struggled to get behind this “growth budget”, with the 10-year gilt yield rising close to 4.6%, interest rate sensitive sectors such as Real Estate Investment Trusts experiencing share price declines, and the FTSE's All Share Index and smaller company indices trending lower.

Early November saw the re-election of Former President Trump for a second term in a resounding victory against Kamala Harris. The outcome marked only the second time in US history a president has served two non-consecutive terms, the first being Grover Cleveland as the 22nd and 24th US President. Financial markets reacted positively, with the smaller company focused Russell 2000 index gaining 5.84% the following trading session and continuing to rise through subsequent days. The outcome marks the return of the US first rhetoric, with the notion of increased tariffs putting pressure on foreign exporting industries, most notably European automotive manufacturers where the share prices of companies such as Mercedes and BMW moved lower. Further comments on the US will be provided in our Insight Article.

For our Stock Focus article, we comment on a core US equity product of JPMorgan American Investment Trust. Looking back to 2019, the trust could best be described as ‘pedestrian’, but following an internal portfolio manager reshuffle, the board looked to improve with a shift to an ‘Equity Focus’ strategy within JPMorgan. The new strategy blends the top twenty ideas from JPMorgan's Growth Advantage and Value Advantage strategies while retaining the smaller companies sleeve as part of the overall portfolio. Since transitioning, performance has been exceptional, with the net asset value gaining 112.45% in the five-years to the end of September against the benchmark's 90.45%.

RISK WARNING

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STOCK FOCUS



JPMORGAN AMERICAN INVESTMENT TRUST

RUTH HARRIS | INVESTMENT RESEARCH ANALYST



With President-elect Trump set to re-enter the White House, investors continue to keenly watch the US economy. Despite the recent stock rally and rising bond yields, there remains a great deal of uncertainty about the economic impact of his second presidency. The consensus view seems to be of higher growth, higher inflation, and a higher deficit, but visibility is limited on the exact extent and nature of Trump's policies. In such a climate, diversification and deep regional expertise can be invaluable for investors in the US market.

JPMorgan American Investment Trust plc is a company looking to deliver a balanced and thoughtful approach to US investing. Following its restructure in 2019, it looks to diversify exposure between high-conviction ideas in growth companies (optically expensive stocks with potential for future growth) and value companies (seemingly cheap stocks which may be underpriced). Different economic conditions will tend to favour either a growth or value approach and maintaining a balance between the two can be prudent. Over the last year, growth names have dominated returns in the US market,

as AI and technology-hype pushes up valuations across the Magnificent Seven: Nvidia, Apple, Microsoft, Alphabet, Amazon, Meta, and Tesla. Any US funds not invested in these large growth tech stocks have struggled to keep pace with the market. But as valuations continue to climb, it's important to be mindful of risk and balance off wanting to own rising stocks with the chance that a changing economic environment may spook markets and cause share prices to tumble. Already there has been some nervousness about the dizzying levels of capital investment in AI, and the question of when, and how, it will generate cash returns.

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Often, where there is uncertainty, there is also opportunity, and JPMorgan American Investment Trust is one investment company aiming to deliver strong returns to shareholders while managing risk. Its goal is to outperform the S&P 500 index while carefully balancing growth and value stocks. In theory, this flexibility should help it deliver outperformance in economic environments conducive to either value or growth investing. While the portfolio has a tilt towards larger companies, it may add allocation to smaller names for diversified exposure to the US economy.

Led by fund managers Jonathan Simon and Felise Agranoff, the team research companies using in-depth bottom-up analysis, looking at a company’s business model, competitive environment, and financial statements to build a portfolio of 30-40 high-conviction ideas across value and growth. Within the value segment, the team looks for high quality companies which are temporarily out of favour, with strong balance sheets and resilient business models. Within growth, they target companies with leading market share positions benefitting from long-term thematic changes. To ensure a balance between the two, the growth to value ratio is allowed to vary between 60:40 and 40:60.

This in-depth research process has been well implemented over time, and the trust’s long-term track record is impressive. Over the last five years, it has an average annual return of 18.56% (to 31.10.24, after fees), beating the average S&P 500 return of 15.14%. It also comes at a relatively low cost, with the ongoing charges figure (OCF) of 0.38%, lower than the peer average. However, as with any investment, the value of capital can go down and performance has been typically lumpy – returning 35.02% in the 12 months to September 2021 and then only 2.39% in the following year. Additionally, while the trust does offer a balance of value and growth exposures, the top portfolio holdings are dominated by some of those Magnificent Seven names: Microsoft, Amazon, Nvidia, Meta, and Apple. With some investors speculating we may be in an AI bubble of sorts, there is a chance we could see the lofty valuations attached to these names tumble, which would undoubtedly hurt the trust’s performance.

Due to its mix of exposures, economic environments which significantly favour either growth or value investment styles will likely see JPMorgan American underperform. There is widespread uncertainty around the outlook for the US economy given the possibility of inflationary trade tariffs, spiralling public debt, and unpredictable economic policy. A broad fall in share prices across the US economy is not out of the question given current high valuations, under which circumstances US portfolios may generally underperform. Given the disparity in valuations and relative lack of dividend income in US markets, some investors may find other geographies, such as the UK, more attractive. With lead manager Jonathan Simon set to retire in early 2025, it is unclear whether JPMorgan American Investment Trust can continue its impressive track record. However, the trust’s emphasis on balance, along with a strong research platform and robust process, seems prudent given the changing political and economic landscape in the US. ■

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INSIGHT



CONCENTRATING ON US EQUITIES

ALASTAIR POWER | INVESTMENT RESEARCH MANAGER



Elections are interesting distractions for financial markets, with commentators distributing vast volumes of comment pieces around the potential market reactions to anticipated policies. Most are derivative of the others, commenting on common themes of tax cuts, tariffs, and deregulation. Some however are comfortable with making more outright predictions as to the potential returns on offer for investors in the US markets.

The most interesting prediction piece of late comes from Goldman Sachs. In October, the firm released a global strategy paper, updating long-term forecasts for US equities. The piece made the key prediction of an expected annualised total return over the next 10-years of 3%, with a potential range of outcomes between -1% and 7%. That's a 10-year predicted return range for US equities of between -9.6% and 96.7%.

Market concentration in the US has been a consistent point of comment of late with the ten largest companies accounting for 36% of the S&P 500 index. The high level of concentration puts downward pressure on forecasts such as the one above, as it is hard for companies to maintain high levels of sales growth and profit margins over the long-term. In addition, concentration leads to a higher level of risk because the valuation of a few companies will have an outsized impact on the index. When the researchers removed the impact of market concentration in the statistical model, the predicted baseline annualised return forecast increased from 3% to 7%.

“We make no predictions that the companies at the top of the S&P 500 index will falter and lead to meagre returns going forward. All are generally considered high quality companies, but the level of growth associated is clearly starting to be questioned.”

Much is made of the issue of concentration, but it’s nothing new for financial markets. In the UK, the top ten companies within the FTSE 100 index account for almost 46% of the index, and in the more nuanced market of Taiwan, the top ten index constituents account for 45.8% with the largest company holding a 22.22% weighting. There is an understandable concern for those looking to allocate capital into the US equity market, with many turning to equally weighted Exchange Traded Funds (ETF) to mitigate the concentration risk, where the index weightings are equally divided between all constituents. In their 2024 third quarter European ETF Asset Flows Update, fund data platform Morningstar indicated a further €14bn flowed into US Large Cap Blend Equity ETFs, with three of the top ten selling products offering an equal weighted methodology.

Perhaps investors are learning from lessons past. According to Microsoft’s Copilot Artificial Intelligence tool, in 1999 the three largest constituents of the FTSE 100 index were Vodafone, British Telecom, and Royal Dutch Shell with approximate weightings of 8.5%, 7.0%, and 6.5% respectively. Declining fortunes of companies holding a large weighting in the index can have significant implications for the index’s overall return. From the end of 1999 to the close of October 2024, the FTSE 100 gained just 17% in price terms (not

accounting for dividends) while Vodafone and British Telecom produced price returns of -77% and -87%. This example appears to support the argument of the Goldman Sachs strategists.

We make no predictions that the companies at the top of the S&P 500 index will falter and lead to meagre returns going forward. All are generally considered high quality companies, but the level of growth associated is clearly starting to be questioned. Within the recent interim report for Scottish Mortgage Investment Trust, portfolio managers highlighted a reduction in their Nvidia position, citing concerns over the sustainability of current capital equipment spending. On the other hand, they increased the portfolio’s position in Meta, citing positive effects of artificial intelligence on the company’s product offering. The Baillie Gifford team behind Scottish Mortgage are not alone, with the likes of GQG Partners, the US\$155bn asset manager, also cutting its position on risk management grounds despite still being positive on the



company.

The hope of many asset allocators appears to be for a broadening of returns within the US markets having experienced a highly concentrated growth rally. Post election, both the market capitalisation weighted S&P 500 and the S&P 500 Equal Weighted Index are higher, with the former marginally ahead of the latter. The market has reacted positively to the election outcome and President-elect Trump’s pro-business stance and desire for lower rates of taxation. An “America First” standpoint and the notion of increased tariffs on trade could bring about shorter-term volatility, but it’s important to remember that over the long-term, earnings remain the key driver of share price returns, not the political party in power. ■

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