

A Game of Three Halves

As I sit at my desk postulating on our clients' investment positioning, it dawned on me that many fund managers have never lived through an inflationary market cycle. Many managers have instead lived through a market almost entirely tilted to expensive fixed income, negative value, and long growth stocks. Unsurprising then, that much of this cohort are still firmly sat in the growth camp when it comes to investment positioning and remain reluctant to embrace the recovery of value. This chronic "group think" is not that hard to excuse when one considers the notion of value investing has been largely academic for the entire careers of so many.

You will all know that 2021, and to an extent the last quarter of 2020, has seen a strong resurgence in the notion of cyclical stocks AKA 'value'. To outline the acceleration of value, in 6 months ending June 2021, the value trade delivered nearly 25% for TAM clients and pushed the TAM portfolios to some of the best gains over its industry peers in TAM's history.

From where I sit today, that easy money in value is looking somewhat cooked. Economic surprises to the upside are dwindling quickly, replaced with good but expected results, which against a backdrop of

expensive stock markets is doing nothing to boost positivity. Inflation is also rising, but rising in line with expectations, meaning value investing is taking a back seat to bond and growth investors who in Q3 have staged an impressive recovery.

Whilst the easy money is already in the price there are, as always, pockets of opportunity which could point the way to a positive year end for clients and, alongside value and growth, make up what could well be the elusive third half of this 2021 market. I am referring to "high quality" stocks. Sounds simple I know, but these are companies whose share price isn't bottomed out, so they are not value, yet they don't have all their earnings pegged in a decade's time so are not pure growth. These are companies who are profitable now, in industries where competition is scarce, have low levels of debt, robust earnings and importantly, possess an excellent level of "CAGR" (compounded annual growth rate).

These companies thrive in a market where easy money has been made and investors go on the hunt for companies who can thrive in all environments. This is also what is known as "mid cycle" investing which is, coincidentally, exactly where the current consensus is for the part of the market we are currently in.

The second direction which is catching our "mid cycle" focus is dividend investing. A style of investing almost outlawed in 2020, is coming roaring back as companies start to repair balance sheets and recover lost revenue to the extent, they can begin paying profits back to shareholders which, let's be honest, is one of the core pillars of how the stock market started.

This trade is looking even more attractive considering (after inflation) yields on government and corporate fixed income are negative or very nearly so. This pushes yield hunting investors directly into the arms of the equity income sector who are not only paying good levels of dividends but doing so with share prices yet to fully recover from the battering they took at the hands of those same investors in 2020 when they had to slash their dividend. So that's income and stock price recovery in one neat package.

As always with TAM, and any other high quality active manager out there, it's about seeing the potential and grabbing a slice of the opportunity whilst it's on offer. However, another stalwart of active management is capital preservation, and we wouldn't be a safe pair of hands if we simply put all our clients' assets into the dividend trade and hoped for the best.

Diversification needs to remain front and centre for our clients and given this, we have added in these opportunities alongside our value and growth barbell approach which we adopted at the outset of the year. It remains important to recognise that this isn't a one-horse race but more a game of three halves, which will be critical for TAM to continue enhancing and outperforming, but also protecting assets through what is becoming an increasingly rich and unpredictable market.

If you would like to discuss our portfolios or current positioning further please do not hesitate to contact me.

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