



Outlook for US equities

Cormac Weldon, Head of US Equities, Threadneedle, comments

Below consensus on economic growth

The US economic recovery is well underway, driven by an end to the de-stocking that occurred in the depths of the financial crisis and early signs of inventories being rebuilt. However, we are more cautious than the consensus on the trajectory of growth from here. Historic data shows that after a "normal" recession, private consumption remains subdued for around six months and then begins to recover. However, after financial crises private consumption typically remains subdued for at least three years. We are now two years after the peak in output for this cycle and the trend for private consumption is following the latter of these two paths. This suggests that consumption will remain muted for at least another year as the effects of long-term deleveraging continue to hamper demand. Thus, while we are forecasting positive growth in 2010, our estimate is lower than the consensus.

Companies in good shape

Despite our cautious views on the economy, we are optimistic about the outlook for corporate profits. The main factor underpinning this view is the rapid adjustment that companies made to their cost bases during the downturn. Among large cap stocks, selling, general and administrative (S,G&A) expenses, which covers salaries, commissions and travel, have been cut at a faster rate than at any time since data first became available in the early 1960s.

Healthy free cash flows

This ruthless focus on cost has resulted in free cash flow margins rising during the recession and has helped to cushion profit margins. Indeed, profit margins have fallen by less than 2% since 2007. Moreover, in talking to companies we find that management teams are being very cautious in adding resource back into their businesses. New hires are often taken on on a temporary basis and capacity is not being increased significantly. This lean management approach affords companies impressive levels of operational gearing into the recovery, magnifying the impact of an upturn in demand on profits.

Allocation flows have favoured corporate bonds

Despite the high free cash flow yields available from US equities and the improving outlook for corporate profits, US investors have typically shunned equities in favour of corporate bonds in the recovery to date. With corporate bond yields now much lower than they were a year ago, we see the scope for asset allocation flows to favour equities as the recovery matures.

Valuation spreads have fallen

During the recession, as is often the case, higher quality companies with strong balance sheets moved to a significant valuation premium relative to financially stressed and cyclical stocks. Since the markets turned in March 2009, this premium has been rapidly eroded as investors have re-adjusted their views on companies that had previously been priced for failure. Today, there is little valuation difference between high and low quality companies. We invest with a flexible style and, as such, our portfolios are currently positioned with a balance between growth and value opportunities.

Focus on long-term winners

Our belief that nominal growth is likely to remain subdued for a number of years is leading us to focus on companies with strong market positions and robust finances. These companies will be the long-term beneficiaries of industry consolidation and they also typically feature experienced and responsive management teams that are adept at positioning their businesses correctly for the prevailing conditions. Such companies can be found in a range of sectors.

Remain overweight in technology

In general, we are pursuing a stock-picking approach in our portfolios, with few clear sector themes. However, one sector where we are significantly overweight is technology. This is a very diverse industry, featuring a mix of cyclical companies, high growth/high valuation situations and modestly-rated businesses with stable, annuity-like revenues. Having come through the TMT boom and bust ten years ago, surviving management teams are well-versed in running their businesses through difficult times. Free cash flows are particularly strong and many of the companies are world leaders in their chosen field.

A strong and experienced team

Our US equity team is one of the largest and most highly-regarded in the City of London. With close to \$10bn under management, we are one of the first ports of call for US companies visiting London and we use these meetings to engage with management teams about their strategies. One topic that we are currently discussing with companies is the use of cash. It was right for companies to conserve cash during the downturn but, now that conditions are starting to improve, there may be more productive ways to deploy capital than to keep cash on the balance sheet. For example, we expect M&A and share buybacks to be features of the market over the coming year. We do not position our funds actively to benefit from M&A activity, but we do believe that our fundamental approach is likely to focus our portfolios naturally on good quality franchises that are trading at attractive valuations. These types of companies may also be appealing to management teams that are seeking to make acquisitions.

Impressive performance record

Performance was strong across our fund range in 2009, with all of our OEIC portfolios outperforming their respective benchmark indices by more than 8% over the course of the year. This showing reinforces the team's impressive long-term record of delivering outperformance throughout the investment cycle. In addition to the OEIC range, we now also offer our expertise via a Luxembourg SICAV. We have some exciting product development ideas in this area that we are seeking to bring to fruition over the coming months.

Conclusion

The US economy is in recovery mode but we are below consensus in our expectations for GDP growth in 2010. However, companies have acted swiftly to address costs and this leaves them well positioned to benefit from the modest upturn in demand that we foresee. We are finding good bottom-up opportunities in a range of sectors and are confident of our ability to continue to deliver strong relative performance to our clients.

- ENDS -

For further comment please contact:

Jessica Lord, UK PR Manager +44 (0)20 7464 5047
Jessica.lord@threadneedle.co.uk

Julie Seytre, PR Executive +44 (0)20 7464 5964
julie.seytre@threadneedle.co.uk

About Threadneedle

Threadneedle was founded in 1994. It actively manages £60.5 bn* of assets providing investment solutions for pension schemes, insurers, private investors, corporations, mutual funds and affiliate group companies. (US\$97.6bn, €68bn). Source: Threadneedle, as at 31.12.09.

Threadneedle has investment expertise across equities, bonds, property and hedge funds with over 140 talented investment professionals. As a truly international asset manager, Threadneedle reaches customers in over 80 countries and its distribution reaches across four continents.

For more information, visit www.threadneedle.com

Threadneedle is the international investment platform and subsidiary for Ameriprise Financial, a leading US financial planning and services company with more than 12,000 financial advisors and registered representatives that provides solutions for clients' asset accumulation, income management and insurance protection needs. Ameriprise Financial was formerly known as the American Express Financial Corporation. It is an independent, publicly traded company (NYSE: AMP). For more information, visit www.ameriprise.com.

Disclaimer:

Issued by Threadneedle Asset Management Limited. Registered in England and Wales, No. 573204, 60 St Mary Axe, London EC3A 8JQ. Authorised and regulated in the UK by the Financial Services Authority. Threadneedle is a brand name, and both the Threadneedle name and logo are trademarks or registered trademarks of the Threadneedle group of companies. The research and analysis included in this document has been produced by Threadneedle for its own investment management activities, may have been acted upon prior to publication and is made available here incidentally. Any opinions expressed are made as at the date of publication but are subject to change without notice.

15 February 2010

Entire contents copyright © 2010 by headlinemoney. All rights reserved.
Privacy statement | Cookies | Terms & conditions.