Evenlode Global Dividend Investment View

November 2024 – Tariffs, trade and the not-quite-everything rally

Donald Trump has been elected as the next president of the United States of America, and the Republican party will control both houses of the country's government. We've no doubt these facts have not passed you by, and they have certainly not been missed by global financial markets either. With aggressive rhetoric on a wide range of matters of policy from business regulation, to tax, to tariffs, domestic and geopolitical issues, the next administration in the world's largest single economy is the talk of the town and traders the world over. The promise of domestic tax cuts and a deregulatory agenda have put a rocket under the market prices of domestically focused US companies, whilst the fear of tariffs has seen sentiment toward non-US headquartered or listed businesses sag. The share prices of companies in different sectors have been volatile on the announcement of each nominee to offices of state as market participants bet on their potential impact given their previously voiced opinions. Later in this investment view we'll examine what the tariff picture means for the Evenlode Global Dividend portfolio as we currently understand it. It is worth noting though that much is said in the run up to elections, not least by the president elect but also others, and historically held views may well be modified once in post. The 'maximalist' approach whereby the most extreme position is loudly stated as an opening gambit to negotiations makes it likely, but not certain, that the outcome will not be as advertised.

Not everything rallies

The immediate market reaction might be summarised as 'buy US equities, sell others, we're not sure about the government finances, and buy crypto'. We don't have too much to add on the subject of cryptocurrencies, but the rally in bitcoin and others is indicative of an effervescent 'risk on' market mood as much as any specific policy proposals that might aid the crypto sector. A US equity market that was already showing signs of exuberance on the back of the artificial intelligence boom has got more expensive. Large technology stocks rallied immediately after the election, although have given up some of the gains at the time of writing. The mid and small-sized companies that are more US-focused in terms of their revenues jumped, and have held on to some more of the gains. We saw this in the Evenlode Global Dividend portfolio, with toolmaker Snap-on and payroll and HR systems outsourcer Paychex bouncing upward, both businesses largely serving customers in the country. In some ways this reaction is understandable. If the rate of corporation tax that these businesses pay goes down, and stays low, this will be a boost to their profitability without the companies having to do any investing.

Whether the broader policy agenda will be a benefit to longer term growth of these businesses is less clear; simply being a 'pro business' administration doesn't necessarily affect the number of quality tools that mechanics need to purchase from Snap-on in the long run for example, although there could be a shorter-term impact on confidence and thus demand. Policies around vehicles, particularly electric vehicles and self-driving cars, could affect the fleet on the road in the medium to long term, which would affect the volume and type of tools required. It's all a bit imponderable, but that doesn't stop the market from attempting to divine the future all the same. Tesla, not owned in the fund, is a big market mover, being in the trillion-dollar market capitalisation club thanks in part to its boss's proximity to Trump. There are mixed messages on electric vehicle incentives and autonomous vehicles, making the shares, and by extension the market, more volatile as traders guess one way or another. For Snap-on in the prosaic world of providing tools, diagnostic systems and the like to mechanics and engineers, we accept the uncertainties. They are providing something of value to its end customer, which through a growing and ageing fleet to be serviced on the road has a solid long term demand profile. The details will matter, but likely not change this basic fundamental picture too much.

When thinking about the likelihood of some actions by the incoming administration it's worth mentioning the US Treasury market, not because we have direct exposure to it but because it is part of an important feature of the current economic times. Western democracies have high government debt levels and wide fiscal deficits, and the US is no exception. US government bond yields had been increasing in the run up to the election as the odds of a Trump victory narrowed and increased again after the result. Nothing in the potential policy mix points to the US fiscal deficit being addressed, if anything the opposite. The country gets a degree of leeway because its debt and the dollar are held around the world as a 'reserve currency'. All the same, the market could still collectively take a dim view of inflationary policies and/or a further deterioration in the fiscal situation through tax cuts. If Treasury yields rose significantly the administration, even one with sweeping control of the legislature, would have to take notice and change course if needed.

Returning to companies, at a high level 48% of the portfolio's underlying revenues come from North America, whilst 35% of the portfolio[i] by weight is US listed. This raises the question of the potential impact of tariffs, which we'll go into detail on below. Tariffs do work both ways, so those US businesses exporting overseas may face barriers themselves. The rhetoric has accentuated a long running trend of 'buy the US, sell the rest' – there's an implicit assumption in market prices that America's economic power outweighs and will dominate that of others. There has certainly been a 'US exceptionalism' in the form of robust economic growth and the global dominance of its information technology sector, which means many US companies should trade at higher multiples than those seen in other parts of the world. But everything has a price, and in our estimation the differentials between companies listed in the US and elsewhere have started to become stretched. To take a simple example from the consumer goods sector, Swiss-listed Nestlé is trading on a price/earnings multiple of 16.6x, whilst US-listed Procter & Gamble is at 23.5x[ii]. It is true that Nestlé's sales growth has slowed, but so has P&G's. The simple comparison is not quite fair as the companies operate in different subsectors of consumer goods (food and drink versus home and personal care), and P&G's valuation is in fact ok in absolute terms according to our valuation modelling. Nonetheless, over time we have been reducing the fund's position in P&G in favour of other consumer goods firms where we see increasing valuation opportunity.

To generalise, globally-listed consumer goods and health care firms feature heavily in the cheaper end of our investable universe of high return on capital businesses, and recent market moves have made the valuations even more attractive. It is for this reason they are two of the larger sectors in the Evenlode Global Dividend portfolio. These are not the exceptionally high growth companies or US domestics that have the market excited at the moment, but come with steady growth prospects backed by well-established market positions, and microeconomics that should lead to a growing dividend stream through time. On dividends, at the moment the dividend yield of the US market is down at levels last seen in the late-90s dotcom boom. Payout ratios, the amount of profit being paid out as dividends, are at normal (i.e. non-crisis period) levels. The fund's underlying yield is nearly twice the US market level, with growth currently higher than being seen in the broader market. This is not to ignore the potential for change in the global business environment, and there is some increased uncertainty introduced by the tariff situation as the new US administration takes charge. As we'll now see, we think this is navigable for the companies in the portfolio.

Tariffs – A view from the company level

Apparently, former US president Abraham Lincoln once said, 'If I had six hours to cut down a tree, I'd spend four hours sharpening the axe'. In other words, that is a Trump predecessor extolling the virtue of thorough preparation and using the correct tool for the correct job. President-elect Trump clearly thinks that tariffs on cross-border trade are like the Swiss army knife of policy with the ability to affect US competitiveness, trade equitability and protect its geopolitical position. To see what their impact might be, the aforementioned Snap-On is a good case study. Their tools are mostly manufactured in the US, and most revenue is derived from blue collar workers in the US. The share price reacted positively to its recent results which showed resilience and some recovery in customer confidence, especially on home soil. Once the election result was known it probably also helped that the CEO, Nick Pinchuk, is good friends with Donald. However, Snap-On also have significant manufacturing capability in Mexico, a proportion of the output of which finds its way to the US market. Those products would be subject to a 100% tariff under the new rules if we take the current indications of policy intent at their word. That is one of many examples that highlight the complexity of manufacturing and supply chains that is ubiquitous across most companies that sell goods rather than services, even those largely servicing the US.

Our US-listed holdings appear to be relatively insulated from tariffs, and some may even see an uplift from Trump's 'America First' agenda. Many of our portfolio companies listed outside America have significant manufacturing capability in the US already and so should also be insulated from the most severe effects of any blanket tariffs that come into force. Consumer staples companies including Unilever and Reckitt serve large consumer bases in the US but also have a local-for-local capability when it comes to production. It is also worthy of note that in the world of fast-moving consumer packaged goods, production can be shifted relatively easily from one facility to another, avoiding the impact of tariffs on goods not already manufactured in the US.

Another portion of the portfolio is focused on European-listed business-to-business services offerings including RELX, Wolters Kluwer, Experian and the testing and inspection companies Bureau Veritas, SGS and Intertek. They all operate in the US from US bases and don't really import any physical goods cross-border, and so should also feel minimal impact.

Some portfolio companies are less insulated than others. The spirits manufacturers, Diageo and Pernod Ricard, do have US manufacturing for parts of their portfolio including vodka and the US spirits which both companies have amongst their brands. However, Scotch and Irish whiskies are important pieces of the puzzle for both companies. By design, whisky must be produced in its country of origin and so must be imported, and many Americans enjoy European whiskies. Consequently, both companies are likely to be impacted by import tariffs. The market has been experiencing destocking as pandemic-era beverage purchases are consumed, but some comfort can be taken from the fact that for some time, both companies have been attempting to premiumise their portfolio. Spirits operate differently to other food and drink purchases, since they are often infrequent purchases for home consumption and are also often purchased on premises in bars, clubs and restaurants. Given these purchasing patterns, premium offerings are favoured because they are seen by consumers as treat or status products and have stronger brand strength and customer loyalty when compared with alternative alcoholic beverages. Consequently, they command higher prices, and producers can pass through cost increases including things like excise taxes. That mitigates somewhat the potential impact of tariff-induced price increases, but the nature and degree of enacted levies will clearly matter. Perhaps Trump's purported love of Scotland will give the Scotch market a reprieve despite the man himself being teetotal; we will see.

An area where slowing growth has been a recent feature and may be affected as Trump takes centre stage is the luxury goods sector. Luxury goods manufacturers including LVMH generate significant revenue from the US, but they also have impeccable brand strength and often high-ticket prices relative to their sector. Additionally, they serve a different customer base to many consumer staples. Cosmetics market leader L'Oréal do manufacture in the US, although the premium end of their portfolio is likely to be manufactured at their base in France and exported to the US. The majority of LVMH's manufacturing base is European, with a reluctance to move given the association with craftsmanship and legacy for their brands. That said, the individuals who purchase luxury goods are usually wealthier than average and so are impacted less by both inflation and price increases. As evidence, some of LVMH's products have increased in price by as much as 60% since 2019. Nevertheless, the ability to take price is not limitless, and luxury goods companies will be keeping a close eye on tariff activity and how they respond. In his last outing as president, Donald Trump threatened a 100% tariff on some French luxury goods to bring the EU to the table to negotiate improved trade deals.

Health care companies make up around a fifth of the portfolio, with a mixture of pharmaceutical, medical devices, and services companies. The pharmaceutical company holdings, including Roche, Sanofi and GSK, manufacture in the US and could pivot production in a similar way to small-ticket consumer staples for smaller molecule inputs. Medical technology companies export products to the US, and the US-listed Medtronic appears to be holding up well if recent results are an indicator. Given their US listing, they are well positioned to continue to grow steadily given the long-term structural drivers powering their business, which include ageing populations and demand for innovative technology to improve healthcare on a global scale. Retaliatory tariffs could pose an issue since Medtronic generate half their revenue outside America, although governments may be reluctant to be seen to increase the cost of life-saving equipment. Siemens Healthineers have similar long-term drivers, but are German-based and manufacture highly technical, costly pieces of machinery for MRI and tomography scanning amongst others. Some of their equipment is manufactured on US soil, but much is manufactured in Germany. The technical nature of their products makes offshoring production from Germany to the US difficult. However, the point on the negative perception of tariffs increasing the cost of critical health care equipment works in both directions across the border, which reduces the likelihood of punitive tariffs being enacted.

The element of surprise

US policy shifts are more or less guaranteed to affect a broad range of industries, predominantly in cross border trade in goods, although the domestic agenda of the incoming US administration will impact sentiment and demand. At this stage the actual policies are still to be determined, and Trump is known to like to keep a trick or two up his sleeve. The global context, marked by inflation, geopolitical conflicts and technological advancements, adds complexity to the potential impacts of these policies. As we at Evenlode navigate this landscape, whilst our current assessment is that the portfolio is itself is well positioned to navigate the uncertainties it is crucial to remain open to the new facts as they emerge. Part of the appeal of the sorts of companies that we seek is that they have the resources to adapt to economic and geopolitical events. The strategic positions of the companies in the portfolio will play a significant role in mitigating the impacts of any changes.

Ben P, Chris E, Rob, Ben A, Phoebe and the Evenlode team

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Evenlode has developed a Glossary to assist investors to better understand commonly used terms.

Market data is from S&P CapIQ, Bloomberg and FE Analytics unless otherwise stated.

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[i] *Source: Evenlode, FactSet GeoRev, as at 22 November 2024.*

[ii] *Source: Evenlode, S&P CapIQ, as at 20 November 2024. The price/earnings ratio is a measure of valuation that compares a company's share price to its profit per share.*