Trump trade: why value stocks could be back on top

By Perpetual Asset Management

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Economic growth is back – and it's the old-school, cyclical value stocks that will do best from its return, argues Perpetual's head investment specialist James Holt.

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The return to a pro-growth, low-regulation, Trump-led US administration is set to drive a new wave of global growth, prompting investors to turn towards stocks set to benefit from the positive economic cycle.

That's the belief of James Holt, head investment specialist for Perpetual Australian equities and global value investor Barrow Hanley.

Trump's election and Republican control of all three branches of government mark a pivotal moment for the US economy, with sweeping plans for deregulation, tax cuts, and energy sector support likely to boost business confidence and consumer spending.

The change has seen investors swiftly seek out companies that will benefit from an expanding economy, led by the financials, industrials and retail sectors.

"It's a pretty good setup for growth," says Holt.

"There are a lot of projects waiting for approval that have been slowed down by the last administration."

Pro-growth policies include a mandate for the removal of 10 existing regulations for every new one implemented, plus tax cuts and policies aimed at getting energy costs lower.

"If you halve the gas price at the pump, that's effectively a tax cut for consumers," says Holt.

"Getting rid of regulations is a stimulus for business – companies say the single biggest benefit of the last Trump administration was lack of new regulation. They could invest with confidence.

"Business spending is such a critical part of the economic cycle – if you get business spending going you get growth momentum behind it."

Economic growth – or 'reflation' – generally boosts value stocks

Holt argues a return to stronger economic growth presents clear implications for Australian investors, who should consider rotating from high-tech growth stocks to traditional, old-economy sectors to capitalise on the next phase of economic expansion.

"When you get a pro-cyclical rotation, it's usually better for value stocks," he says.

"Growth stocks actually tend to perform better at the end of a cycle – not the beginning."

Holt points to the past few years as illustrative.

While growth stocks led the market before COVID, value stocks, particularly in energy and financials, took over and significantly outperformed as the global economy rebounded from recession.

“Right now, everyone wants exposure to the economic cycle or ‘reflation tade’.

“That means value stocks perform, the Dow Jones does better than the NASDAQ, and old-economy stocks are the better place to be.”

China stimulus

One missing piece from an assured global growth outlook is the trajectory of the globally important Chinese economy, says Holt.

“Everyone is waiting to see what happens with China – markets want to see a decision to reflate the domestic economy and move away from their addiction to mercantilist growth paths.”

The market’s uncertainty about Beijing echoes the post-GFC period in the US and Europe, when central banks, led by Ben Bernanke and Mario Draghi, underestimated the depth of the crisis before eventually shifting to bold “whatever it takes” monetary policies, he says.

“Bernanke and Draghi kept announcing piecemeal goals – and markets kept trading around them.

“Finally, in the end, Bernanke said ‘we’re just going to print open-ended money stimulus every month and there’s no end point’. Draghi pledged the ECB would do ‘whatever it takes’.

“As soon as that happened, the market started reflating.

“That’s what investors want from China – a ‘whatever-it-takes’ moment from Chinese policy officials to save the Chinese economy.

“China keeps talking about discrete amounts of money, but the problem is traders see a beginning and an end point, not a commitment to ongoing improvement.

“As soon as they put a backstop under confidence, the market will revive.”

Active approach

The key to success as the market shifts is not allowing passive index investing to dictate stock selection, argues Holt.

“Passive investing is pumping 10 per cent of your money right now to Commonwealth Bank at its peak – and under-allocating to resource companies which are due for a return to performance at some point.

“Since the peak of the GFC, CBA has tripled while BHP has gone sideways.

“You’re paying the same today for BHP as you did 17 years ago – but today it digs up vastly more iron ore and has more profitability than it did back then.”

“By contrast Commonwealth Bank has had its run and trades at 26x forward earnings – about in-line with the large-cap growth index – even though its ROE is falling toward the lower end of the historic range.

“It doesn’t make sense for CBA to be so high and its doesn’t make sense for BHP to still be roughly where it was 17 years ago.”

About James Holt and Perpetual Asset Management

James Holt is head investment specialist with Perpetual’s Australian equities team and global value investor Barrow Hanley.

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