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[INTRODUCTION]
Juliet Schooling Latter (JSL): Hello and welcome to the Investing on the go podcast, I'm Juliet Schooling Latter and today I'm joined by Fiona Harris, investment specialist on the JP Morgan US Equity Income fund.

[INTERVIEW]
[0:15]

JSL: Fiona, all eyes have been on the UK in terms of dividend cuts this year, but how has the US fared, are any sectors doing better than others?

Fiona Harris (FH): Thanks. And thanks for having me on your podcast.

Dividend cuts do make great headlines don't they, but the reality in the US with regards to dividends is very different than the headlines or what you're experiencing in the UK. So first, maybe we'll spend a moment to look at the raw data, then we can draw the conclusion. So if you look at the S&P 500, it's a great proxy for the overall US stock market and, year to date through September, 67 companies have cut or suspended their dividends. That's 13% of the S&P 500. I would say that's a small number for a recession.

On the other side of the coin, dividend increases and even dividend instigations - companies starting paying dividends for the first time - we've got 207 companies. That's 41% of the index. So the untold story is: three times more companies in the US have been raising their dividend compared to those that have cut it. So the death of dividends is not really a reality so far in the US. And in fact, we'd expect modest growth and dividends from the S&P this year. Not usually something you'd think of during a recession.

Now within our portfolio, because our focus is on quality first, our names have actually fared much better than the index. We've had five names cut or suspend their dividend so far this year to September, but more importantly, 63% of our portfolio -- that's nearly two thirds of our holdings have increased their dividend. So we're really seeing that commitment to quality in our names come through, that strong balance sheet come through - they can weather the storm better than the market. So as a result, the JP Morgan US Equity Income fund can offer a higher income than the market. And in this period of time when income is so scarce in other places it's a great place to be.

[2:23]

JSL: Interesting. And this fund's style is to invest in undervalued US companies. Given the US stock market's quite remarkable bounce back from March, are there actually any undervalued companies left in the US?

FH: Yeah, I suppose one thing we should say is it's not the only thing we're looking at, valuations. The first thing we look at is quality. And as you can see, that's so important, strong balance sheets, great management teams, really good competitive positioning, but also sustainability of earnings. Again, always thinking about that downside to that risk. If you've got better quality companies, they can do better thoughout the market.

Now, quality doesn't often go on sale. So for us, because we're focused on quality and then valuation, it's hard for us to find great names all the time, irrespective of whether the market's trading at 22 times forward earnings or 14 times forward earnings. But, during a recession, there's always going to be a dislocation on valuation. There's going to be a gap. So we're not overly concerned about where the market is trading right now, but we've been very busy, scooping up companies to add to the portfolio.

We're long term investors. And we have great joy when the market sells off, because actually it rains on valuations, compresses them downwards, and we can pick up these great quality companies at really attractive valuations. So as long term investors, we don't have a high turnover. Our turnover is about 20% per annum. So our average holding period is about five years. We don't need to add companies to the portfolio. We wait for the opportunities to come to us. So even with high markets, there's always something out of favour. And I think that's one of the beauties of our process, having the resources that we can dig deep and wait for the market to come to us.

So I'll give you an example of these opportunities. In the first half of this year, we added 13 new names to the portfolio. That's like a land speed record for us. If you compare that to the first six months of last year, we added no new names. So because we're value investors, we can wait for the market to give us opportunities. And it does, you know, in financials, we added Morgan Stanley in February. It sold off with the market, but also on its acquisition of E-Trade. Now this is a stock that trades at 10 times forward earnings. Financials are in the doldrums because everybody associates them with the yield curve and yields are so low. Morgan Stanley isn't reliant on interest rates. In fact, half of its revenues comes from its wealth management business, and they've actually delivered compound annual profit growth of 10% per annum, since 2015. With E-Trade, they get over 5 million customers with over 350 billion in assets. And now they're looking to acquire Eaton

Vance. So a company with a great balance sheet, great management team, taking advantage of the downturn in the markets to build out their future revenues. But that the market has cast aside, just like it's cast aside a lot of the banks, but somebody that doesn't need the interest rates.

I'll give one other example, industrial names, you know, with energy prices down so low, that's usually problematic for industrials. So they've been cast aside by the market as well. And we're finding a lot of companies that are taking advantage of technology within this space, a name like Eaton, which is a power management company. And think about renewable energy, sustainable energy across industrials, autos, construction, commercial, any part of the market, but this is a company that's taken a lot of acquisitions over the years. So its margins, aren't great, but it's now streamlining its operations. It's refocusing on electric vehicles, on sustainability in energy. And they're part of the solution going forward. Again, a very attractively valued name that the market just cast aside, but it cast aside so much that during the sell-off periods. So I think being patient, doing your homework, the market will give you opportunities, irrespective of what valuations trading at.

[6:56]

JSL: You hold NextEra energy in your top 10. Could you tell us a bit more about your investment thesis for this company?

FH: Oh delighted to, for those not familiar NextEra as a utility company in the US, but what's really exciting is that they're a global leader in electricity generation from renewable sources. This is the sun and wind, in fact two thirds of their electricity generation comes from wind. Now they've been a US leader in renewable energy for 15 years. I know, with everything going on in politics, a lot of people don't think the US leads in renewable energy, but here's a company that's been doing it very, very successfully for that long. Their compound annual growth rate was about 8% over the last few years, they've got a great balance sheet, and we expect them to grow their earnings per share by about 6% to 8% over the next three to five years. So they're growing faster than the average utility in the US, they're also a regulated utility in Florida, which is reinvesting and of course their business there.

Now because of their growth profile – their focus on renewable energy - they're not the highest yielding stock in the sector. NextEra yields about 2% versus the sector average is around 3.5%, but they're growing faster because they're using that excess cash to grow their business. They've increased their dividend this year. I think that's a testament to their strong balance sheet. And so we really view them as one of the long term structural winners in the energy transmission to renewables. And so I think, again, it's the largest renewable energy developer in the US, it's got size, scale, customer relationships, and real sustainable cost advantages. So that's a perfect example of not just stretching for high yield, looking for quality valuation, and then the consistency behind dividend yield to get these great long term winners in the portfolio.

[8:52]

JSL: Thank you. We've obviously got the US election coming up and it looks like it's going to be tight. Could you perhaps talk us through the potential impact on the portfolio of either a Trump or a Biden win, please?

FH: Yeah, and I think the polls right now indicate that there's a high probability of a blue wave. What that means, of course, is Democrats gaining control of both the White House, as well as the Senate and the House. We don't play politics in the portfolio. We're bottom up stock pickers. We focus on the fundamentals, looking for a high quality companies that are attractively valued that give us a dividend yield of 2% or more.

Now elections create volatility, they create noise, create degrees of uncertainty and, because that volatility, it's great for us. September of last year, we added a United Healthcare to the portfolio when it looked like Elizabeth Warren could be the leading Democratic candidate. And of course she had a policy where she was against the Affordable Healthcare Act, or Obamacare as we called it, which would be problematic for the healthcare insurance space. So again, we're mindful of the elections and we'll use that volatility to add to existing positions or to take new positions.

But when we look at the policy proposals, I suppose at first glance, everybody says, there's a big difference in what they want to do, but there's actually some similarities. In terms of infrastructure spending, we'd expected a big spend in infrastructure being proposed by both. But again, think back to the 2016 election: President Trump proposed a big infrastructure spend then, and it never came to fruition. This time around, as I said, both are pushing for a big infrastructure spend, but Joe Biden's policy is more focused on renewable energy and climate change. So I think that's going to be a big focus if he does get elected. Again, it would be great for our utility names like NextEra.

In addition, when we're looking at China and trade relations, I think both will be tough on China. It's something that both sides of government have looked for over this time period, and one that we think will be in place going forward. I suppose the biggest impact on corporate America though, that we look to is what would happen with corporate taxes. Joe Biden proposes raising corporate tax to about 28%. The current administration's brought corporate taxes down to 21%. So 28% would get us halfway to the Trump cut that we had in 2017. I don't think it's going to be too problematic for corporate America to absorb. But we will see, you know, earnings decrease by about $9 to $10, maybe for 2021, if they're enacted then, but we do expect earnings to grow in excess of 25% next year at this moment in time, that's what we're expecting from around us. So we could absorb a higher corporate tax rate.

And so I think when everybody looks at the proposals and they look at a Democratic blue wave, they always think that the Democrats bring about higher taxes and higher spending. And if we get a nice balance of both, I think the market should have be able to absorb the Democratic sweep very, very well. But from our side, we'll take advantage of opportunities because of market volatilities, we don't plan the portfolio for a Democratic win or a Republican win, but it will give us opportunities. And that's what we'll be mindful for, for the long term.

JSL: That's interesting, interesting times we live in, thank you very much, Fiona for your time today.

FH: My pleasure.

JSL: If you would like more information about JP Morgan US Equity Income, please visit fundcalibre.com and don't forget to subscribe to the Investing on the go podcast.