Audio Commentary Transcript: Macro Meets Micro  
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February 20, 2018

Brian: Hi, I’m Brian Giuliano for the Global Fixed Income team here at Brandywine Global.

Jim: I’m Jim Clarke, a Global Equity portfolio manager.

Brian: And we’re going to spend the next few minutes talking about the global equity landscape and a couple markets in particular where we think there’s compelling value. Now, you might think it’s odd to have a global bond guy partnered with a global equity guy for this conversation. However for those of you that know us at Brandywine you know we do things a bit differently here. We like to think of ourselves as outside of the box thinkers and Jim’s team runs a global equity strategy that combines the macro thoughts from my group, the Global Fixed Income team, in conjunction with bottom up fundamentals stock analysis from Jim's team. So Jim, with that background, before we get too caught up in the current market environment, let me start with an obvious question: Why does a macro perspective matter to a global equity manager?

Jim: Well when you're buying global stocks you do your homework on the growth rates of the company, the industry, the competitors - all that stuff - the valuation you're paying. And you can do all of that in great depth but you’re getting two things that are not included in that. You're getting a country exposure and you're getting a currency exposure. Whether you thought about it or not whether you understand it or not, you were getting those things. So when you are working at a firm with the macro capabilities the Brandywine has you’d be crazy not to listen to them and follow along with what they're thinking. So for instance - last year - all those big returns that you saw in European stocks, subtract 8 percent from them if you hedge the currency. Getting the currency right was very important to achieving those returns. And stock markets can perform differently around the world obviously. An average stock in a good market will likely outperform the best stocks in a poor market. So we take the macroeconomic research of the firm just like you do with bonds. We deal with equities. We apply that. And let’s take that one step further. Sometimes that research doesn’t just lead us to a country. It leads us to a sector within that country greatly benefited from a specific macroeconomic cyclical tailwind and we'll talk about some of those soon.

Brian: Let’s talk about that philosophy you just spoke about in practice and focus on a market that you've liked for almost 18 months now: the United Kingdom. From a macro perspective - the time of Brexit - we argue the fears around a significant growth slowdown in the U.K. were overblown. Forecasters thought recession at the time while we saw a proactive central bank, a very cheap currency, and a Brexit process that was going to take years to play out. Interestingly the U.K. equity market is dominated by multinationals. Yet you chose to focus your investment in domestic companies. Why is that
Jim: Brexit scared a lot of investors - both macro and stock investors in the country. It created an undervalued currency and it created fear which a good value investor doing their own homework can often thrive on. So that macroeconomic viewpoint that you just stated was nirvana to a value investor. Think about what you just said. Normally when a country's currency tanks the central government will defend that currency by raising interest rates. Here we saw exactly the opposite. The central bank in the U.K. cut interest rates. So we had essentially a market with both feet on the gas pedal. Undervalued currency and favorable monetary policy. Yet the equity investors were thinking recession. Doesn't get better than that. So what do you want in that situation as an equity investor. You want domestic, economically sensitive exposure to that country denominated in that currency. Things like airlines, things like homebuilders, kitchen remodelers - basic industries like that within the country denominated in pounds. These were trading at recession multiples. You could find companies with no debt on their balance sheet. They weren't going broke. Compare that to the index in the country which contains things like Diageo. Big weightings. Diageo is a global liquor company. You might as well buy Coca-Cola. You're going to get the same country exposure and the same currency exposure as Coca-Cola. It had very little to do with what we wanted in the U.K. which was exposure directly to the country. Eighteen months later there's still been no recession. The currency has appreciated more than 15 percent. So was that a macro call or a stock call? We found you can accomplish great things when you don't care who gets the credit. And we prefer to just call it teamwork.

Brian: Let's shift gears and talk about the market a little bit closer to home. Mexico. Trump, the wall, NAFTA negotiations. Mexico has been in the news at lot lately. Despite some of these recent headlines, you've uncovered a segment of the Mexican equity market, specifically in real estate, that you think offers some good value. Tell us what you're thinking here.

Jim: Well, in Mexico the negatives are obvious. You can find them on the front page of the newspaper. What really distinguishes Mexico in our view is that it has a very different business cycle from the rest of the world. Interest rates in Mexico are high and we think likely to fall which makes it the polar opposite of the developed world. What does that mean for stocks? Let's look at a sector like real estate, office buildings if you will. These are income producing properties. They tend to trade like bonds and around the world interest rates: bonds are near zero. Real estate is very expensive in our view around the world. We consider it quite risky on valuation and we do not own it. Mexico is different. REITs are down 30 percent in Mexico. We're buying three year lows there. Then when we put on our stock analyst hat and evaluate the businesses we find Mexican REITs—prime blue chip REITs—are offering dividend yields in the 7s. You can't find that anywhere else in the world. You can find a higher cap rates—higher returns on your equity investment—and assets that are going through the pipeline which will enter that income stream in the future if you do your homework. So both in stock picking and in macro, that's a sector we think we think going to do well in.

Brian: Let's stick with this thought and talk about another market that has seen its share of negative headlines lately. And that is Turkey. Governance issues. Stubbornly high inflation. It's led to depressed equity valuations and a Lira that is incredibly undervalued. It's very cheap. The good news is that the growth in Turkey is tied to Eurozone economic prospects and the Eurozone has done quite well as of late. Also you had tight monetary policy from the central bank of Turkey that seems to finally be working its way through the underlying economy. What is it that you like about Turkish equities?
Jim: Well, we like to buy as you do in fixed income in places that scare others a little bit. Where we can do our homework because that's where we're going to get the best deals. Now you want to know how out of favor Turkey is? Just in the last 18 months they've seen a failed coup, a war on their border, they shot down a plane of their biggest trading partner, and their currency is off by over 20 percent. But stocks are among the cheapest in the world. Nobody cares. So everybody's focused on the obvious macro flaws. But in fact there are opportunities here. How out of favor is Turkey? I went to a conference last fall in New York. It was a general emerging markets conference with a lot of investors who complain about stocks being expensive around the world. Well Turkey has a lot of problems. Stocks being expensive is certainly not one of them. You'd think more investors would be interested in looking there. One of the top bankers in Turkey - CEO of perhaps the best bank in the country - was holding meetings with investors. I had one scheduled. It was supposed to be a group meeting - three or four investors. And I got there and I'm the only one who showed up. So I had a one on one with essentially Jamie Dimon of Turkey. And learned a lot. We had a good talk. Turkey is the low cost manufacturer for Europe. It has the same relationship to continental Europe as Mexico does to the United States. Europe is in recovery. The currency is undervalued. Sounds like a great place to be an exporter. Banks are strong. There are some wonderful businesses in Turkey. We've been following Turkey for a long time. This is the first time we've owned it for a while. This is the fifth biggest cement market in the world. It has a growing young demographic and nobody is interested. That's a value investor's dream. So what do you do? You find a few high quality businesses with good balance sheets. You take a position and you wait for something to change.

Brian: Jim, I think you said it best earlier when you noted that global equity investors don't simply have company exposure. They are actively incurring country and currency risk whether they realize it or not.

Jim: And if you have the capabilities that Brandywine does, you can do that intelligently.

Brian: Alright. Thanks Jim for the time. And thanks everyone for listening. As always, if you have any questions, please don't hesitate to reach out to us. Thanks again.