Value Stocks Are Set Up For A Good Run In 2021 And Beyond

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Chuck Jaffe, in The NAVigator podcast interviewed Michael Roomberg, manager of the Miller/Howard High Income Equity Fund. Read the Q & A below as Michael discusses the end of election uncertainty – and sustainable fiscal policy that provides a tailwind for domestic consumption – and the development of vaccines for coronavirus fueled a rally in value stocks at the end of 2020 that should carry through 2020, especially as investors get more excited about stocks and broaden their interest beyond the few names that drove the market a year ago. While value has struggled as an asset class since the turn of the century, Roomberg notes that it outperformed growth stocks for the majority of the 1990s, and he thinks that, post-pandemic, high-dividend value stocks are set up for that kind of run of outperformance again.

Michael Roomberg

The podcast can be found on AICA's website by clicking here: https://aicalliance.org/alliance-content/pod-cast/

CHUCK JAFFE: Michael Roomberg, portfolio manager for the Miller/Howard High Income Equity Fund is here to discuss why value stocks may be the market's post-pandemic sweet spot, this is The NAVigator. Welcome to The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator's brought to you by the Active Investment Company Alliance, a unique

industry organization that represents all facets of the closed-end fund industry, from users and investors to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator's going to point you in the right direction. And today it's pointing us in the direction of Michael Roomberg, portfolio manager for Miller Howard High Income Equity, HIEFund.com, their website. If you want to learn more about closed-end fund investing, AICAlliance.org, the website for the Active Investment Company Alliance. Michael Roomberg, thanks for joining me on The NAVigator.

MICHAEL ROOMBERG: Pleasure to be with you today, Chuck.

CHUCK JAFFE: It looks to me at least like investors are really throwing a lot of money into what could be called inflation assets, the kind of things that do well in inflation. That means commodities and real estate, it also means certain types of bonds like TIPS and maybe muni bonds. But banks and value stocks, areas that you are really into, energy, value, etcetera, and I know that you see value stocks as being particularly good now. Well the money is flowing there, is value finally ready for this long awaited recovery? And why particularly now?

MICHAEL ROOMBERG: I think there were two major things that occurred in November that really set up nicely for value stocks for certainly the last month of last year and as we enter 2021. First obviously the election uncertainty is now behind us, from a value versus growth standpoint we've long had an accommodated Federal Reserve which has kept interest rates low. What we have not had is a fiscal policy that has demonstrated itself to be sustainably providing a reliable tailwind for domestic consumption. And so I think that with the very slight majority that the democrats will have in the incoming Congress and in the White House, you have a likelihood that there will be a continuation of expansionary fiscal policy, potential for an infrastructure bill, which obviously benefits a lot of the types of companies that we're invested in. But I think second to that, and certainly not second in importance but probably the most important, is that the vaccine announcement in November was really the news that we've been long waiting for as value investors. Investors we think now have a green light from the vaccine news to get excited about near-term earnings and income stocks. Now before investors were really driven by safety, and that really is the paradigm that's characterized the market over the last several years. You have low interest rates as investors bought risk-free assets, they're the most riskless things there are with Treasuries of course. They also piled in some bond proxy stocks, utilities, etcetera, which were another way to be

invested with minimizing the level of risk exposure. And I think the other end of that barbell is the large cap tech stocks, where growth is less driven by Covid news or any cyclical dynamics, and where valuation is really supportive in the out years where the discounts rates of those future earnings are very low and so they make those future earnings much more valuable. So for companies where the growth is a given, you've had companies that have really led the market for a long period of time despite having relatively low current earnings to their value. And so last year for example, 60% of the total return of the S&P 500 was just six stocks; Microsoft, Apple, Amazon, Google, Facebook, and Netflix. So now as I look into 2021, Chuck, as you alluded to earlier we've the exact opposite condition. We think the market is only beginning to adjust to this new environment. For example, in 2020 the top 20% most expensive stocks as measured by PE ratio outperformed the cheapest 20% of the market as measured by PE ratio by 45%. There's been only one other time in recent history where that was true and it was right before the tech bubble, and following the tech bubble value outperformed growth for seven straight years. Specific to that, the cheapest stocks outperformed the most expensive stocks 20% on both sides for seven straight years. So it wasn't just the tech bubble collapsed in 2000 and value relatively outperformed. Certainly that was a great year, value outperformed growth by 50% if we're just looking at those two areas in the market, the top 20% and cheapest 20% in terms of valuation. But then it continues another 37% outperformance of the cheap cohort in 2001, and then by another 15% in 2002 despite what was a mild recession and what would normally be a difficult environment for value stocks. So from the date of the vaccine announcement in early November through December 31st of last year, the same 20% cheapest stocks in the market only outperformed the most expensive 20% by 12%. So we clearly think that there's still a lot of legs to this story and from a valuation standpoint it's not even close. The high dividend stocks that we tend to focus on are trading at about 15x earnings, whereas the market as a whole is closer to 27x earnings. That to us a great setup. And we look at in terms of the future, obviously we deal in a world of uncertainties but we think there's a lot that's lining up for what we do. China is a good example of that, they have had relatively less fiscal stimulus than we have, but they did solve coronavirus and their GDP growth accelerated to pre-pandemic levels after they got the virus under control. So we think there's a possibility that we could

have six or great percent GDP growth in the United States next year, and it seems like a good setup for the type of things that we do.

CHUCK JAFFE: In terms of developing high income, obviously nobody's getting much help in the bond market. I mean, yeah, you may be seeing money flow into inflation assets which include muni bonds and TIPS, but they're not exactly high income sorts of assets. Are you finding that in this environment that you have to stretch or that you maybe have to go away from some of the classics and a little more towards some newer ideas in order to generate high income safely? Or safety's not really that much of an issue so you're able to do it without having to stretch much?

MICHAEL ROOMBERG: So a couple things. In terms of the bond comparison, the HIE Fund as of today yields 6.91%, that was after a dividend increase of 20% that we affected as of the end of January's dividend payment this year of 2021. Obviously this is a high-income equity fund, so a lot of investors are looking at obtaining yield through different sources. The things that we think about when we think about the alternatives between income stocks, which this is a portfolio purely of equities, dividend paying equities versus closed-end funds that have all sorts of exotic investments in, it's pretty much as plain vanilla as they come. We do think that income stocks are a good way to generate current income while also having a measure of inflation protection, obviously fixed-income is exactly that and it doesn't make up for rising inflations. Obviously bonds have become nearly as volatile over the last 15 years as the S&P 500. Bonds historically haven't always been negatively correlated with stocks, so there was a 30 year period from about 1970 to 2000 where bonds and stocks were actually positively correlated. The only real difference was the fixed-income didn't provide the eightfold return that stocks did during that time. The yields as you alluded to have hit near rock-bottom levels, so we look out over the next several years. Bonds are almost never a superior long-term investment to equities, as they shouldn't be because they're always perceived to be less risky, so more risk, more return. But we think that certainly with the yields and starting point where they are right now is going to be certainly a significant headwind to that. In terms of your question about how we generate income in the HIE fund and do we have to really stretch out on the risk spectrum? Right now the fund in terms of the structure of the fund, as I mentioned it has this 6.91% dividend yield, which is firmly in the top decile if you were to decile the universe of dividend-paying stocks into separate groups

of 10. This firmly 6.9% sits at the highest yielding cohort of stocks. Now the way that we generate that yield, it has a very solid fundamental foundation that doesn't suggest that we are reaching for yield in any way. The underlying portfolio, Chuck, has a dividend yield of around 4.8%, we lever our fund up to 20%, so it's a common thing that you see in closed-end funds and clearly that magnifies returns on the upside. And certainly if one is looking to put a value idea to work for all the reasons that we just discussed, this will help to magnify those returns for better or worse, but obviously we hope for the better. Now that also magnifies the dividend yield, so that 4.8% or so underlying yield becomes an effective yield of close to 5.8%. And then what we do is we write out of the money covered calls with an 8% out of the money strike with a monthly tenor of up to 30% of the portfolio, and so that provides an annual boost to our fund's income of about 3-5% on average. And so then when you add those numbers together, you essentially dig up some for the fees for the fund, you have a dividend that's covered in the neighborhood of 1.2x of that 6.9% yield. So we're investing in a basket of stocks and it's a very high-quality diversified portfolio, the fund is 22% invested in new financials, 15% in energy, 10% consumer discretionary, and then health care staples, utilities, real estate, telecom. So it is a diversified U.S. equity fund that we think generates a very respectable level of high current income and has the ability to participate in the upside of the sector that it's in. And as we start to see some of the return of dividends for companies that have cut dividends entirely or trimmed them as a result of the pandemic, we think that that's just going to boost our ability to pay dividends over time as the companies that we own do the same. So in terms of the question about an inflation hedge, I think it's an important aspect of owning equities versus owning bonds.

CHUCK JAFFE: Michael, great stuff. Thanks so much for joining me to talk about it.

MICHAEL ROOMBERG: Thanks for having me, Chuck.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. I am Chuck Jaffe and you can check out my show on your favorite podcast app or at MoneyLifeShow.com. To learn more about closed-end funds, interval funds, and business-development companies go to AICAlliance.org, the website for the Active Investment Company Alliance. They're on Facebook and LinkedIn @AICAlliance. Thanks to my guest, Michael Roomberg, portfolio manager for the Miller/Howard High Income Equity Fund. Learn more about Miller/Howard at

MHInvest.com, or about the fund itself at HIEFund.com. The NAVigator podcast is available every Friday, please subscribe on your favorite podcast app and join us again next week to learn more about investing with closed-end funds. Until then, stay safe everybody.

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