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Selected US equities hold strong growth potential

US equities, along with other global markets, are subject to various short-term pressures, including the continuing problems in the eurozone. In the longer-term, there are also challenges, not least the need to deal with the budget deficit and high level of public debt. However, while the US is likely to experience a modest pace of economic growth for the foreseeable future, we believe that areas of the economy and selected companies present compelling investment opportunities.

Rebuilding the banks

As we all know, the US financial system lay at the epicentre of the global financial crisis. However, the US authorities, in stark contrast to their European counterparts, took bold steps to restore the financial system to health, forcing US domestic banks to recapitalise by raising equity. As a result, US banks now have very healthy capital ratios. Coupled with the fact that they are also almost completely deposit funded, US banks are now in a position to start lending again, which should support domestic economic activity and provide opportunities for profit growth.

Non-consumer loans, or commercial loans, have been growing for some time as the corporate sector (outside the financial and real estate areas) was not weighed down by debt. Lending to consumers has also started to grow again. However, overall lending growth is likely to prove moderate.

Housing woes recede

The reviving financial fortunes of Americans are reflected in the housing market. Much of the housing bad debt that precipitated the dramatic events of 2008 has now been washed through the system. In addition, housing inventories have already fallen to what is considered to be a normal level, giving the lie to the argument that an excess of unsold homes will weigh on the housing market for years to come.

Furthermore, the worst-affected housing markets, such as Nevada and Florida, are currently seeing very strong demand. Cash purchases in these markets account for upwards of 60% of sales, with investors to the fore – attracted by the lure of yields of around 8% on an unlevered basis. In a further sign of renewed confidence, Blackstone, the private equity house, announced recently that it is moving into the residential homes sector. According to news reports, Blackstone is targeting markets with the greatest supply of distressed properties, including Florida, Northern California and Georgia.

Our optimism over US housing is further underpinned by the fact that homes are now more affordable. Indeed, when you look at the price of the average house compared to average incomes, prices are at an historic low. While this is an interesting fact, it only becomes meaningful when one also looks at two key factors, the direction of house prices, and employment and earnings prospects. Both indicators are moving in the right direction. House prices have now started to move upwards on a national basis, and while job creation may not be increasing dramatically, it has been positive for a number of months.

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Interest rates, of course, play a role in affordability and here the outlook is also encouraging. In September 2012, the Federal Reserve said it was not likely to raise overnight interest rates from their current near-zero level until at least mid-2015, a shift from its previous late-2014 guidance. It added that it would pursue an easy monetary policy "for a considerable time" even after the economy strengthened. At the same time, the Federal Open Market Committee said it was restarting the policy of pumping money into the economy via quantitative easing. The Federal Reserve will buy "additional agency mortgage-backed securities at a pace of $40bn per month" until it sees a sustained upturn in the jobs market.

Energising investment

The revolution in the US's energy environment also underpins our confidence in America's long-term prospects. New technology, colloquially known as "fracking" (which involves fracturing shale rock with a high-pressure mixture of water, sand and chemicals), combined with the older process of horizontal drilling, has enabled companies to economically extract oil and gas that had been regarded as too expensive just a few years ago.

We believe that the energy boom unleashed by these developments will drive investment for many years to come and provide US businesses with a cheap energy source, placing these corporations at a structural advantage to their global peers. America is already seeing increased investment in both the infrastructure needed to exploit and transport this gas and in the industries where it is a major input. This surge in investment will boost GDP and employment growth.

The chemical industry is a good example of an area that is benefiting significantly from shale gas - America is now home to the second cheapest source of natural gas in the world (after Saudi Arabia). Thus, LyondellBasell, one of the world's largest independent chemical companies, is expanding US production of ethylene, an essential plastics ingredient. Ethane, a component of natural gas, is a key input and we expect the price of this to fall over the rest of the year, a development that will drive strong profits growth at LyondellBasell.

Edging back from the fiscal cliff

Apart from the eurozone, the so-called "fiscal cliff" is the main short-term challenge facing the economy. This relates to Bush-era tax cuts, which are due to expire at the end of this year and, if not renewed, could cause a fiscal contraction of around 4% in 2013, plunging the economy back into recession.

It is clear in this election year that politicians have very limited appetite for bipartisan cooperation. However, we believe that in the period after the election (stretching into the early part of next year) the impact of the fiscal cliff will be softened significantly. That being said, we could see a period of brinkmanship - similar to the debate surrounding the raising of the debt ceiling last year. Longer-term, the need for austerity measures in the public sector will weigh on economic growth.

Looking forward, we continue to believe that the US equity market is attractively valued and the US economy is in better shape than its developed world counterparts. On a comparative basis, the US economy continues to be helped by its developing energy independence, an industrial renaissance and the improvement in the housing market, where inventories have returned to normal and prices have stabilised. Growth expectations for the rest of the year have been lowered as the ongoing crisis in the eurozone, the looming presidential elections in the US and the uncertainty linked to the fiscal cliff have led some companies to postpone capital spending plans. While these uncertainties will certainly lead to volatility over the coming months, we continue to focus our attention on the favourable opportunities that our research continues to highlight.