IS VALUE INVESTING DEAD?

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Sebastien Mallet
Portfolio Manager, Global Value Equity Strategy

Some may be saying this, while others have been more generous by saying that value investing may be moribund. I am far more positive though. You may say that is not a surprise as a "Value" investor, but I am genuinely enthused by the opportunities out there and continue to find good actionable ideas across countries, sectors, and industries.

THE LONE GUY IN THE CORNER OF THE PARTY

Of course, MSCI Value underperformance versus MSCI World index is now unprecedented in recent decades, in both its duration and magnitude, and I find myself being the guy that no one wants to speak to right now. Historically, it doesn't look good, with the regime extending back to the end of 2006 with a performance shortfall of over 30% versus the MSCI World index. That is a two-standard-deviation event, and it is not pretty.

A large part of the "Growth" rally has been due to the strong returns of big-cap tech stocks, the "FAANGs," which have a substantial weighting in the MSCI World index. However, as we have increasingly seen, there is evidence of a cooling off across popular technology stocks, especially with it being an extremely crowded space.

Therefore, there is more encouragement and we are starting to see the clouds part a little for value investing. But we are not reliant on a weaker performance of growth stocks, or indeed a yield curve steepening (which some have cited as a reason for value to make a comeback). Indeed, recent economic and market events (rise in volatility) have added fuel to the debate as to whether the tide could be turning for "Value." As our last piece (*Style Regime Changes—Lessons From History*) indicated, though, we do not believe that there is any one particular factor or catalyst that will see value investing once again reassert itself. Instead, I have been focused on my day job of finding undervalued stocks that can potentially deliver alpha for my clients.

SEEK AND YOU SHALL FIND

I have been concentrating on what I can control, and that is strong stock picking. Even through this challenging period for value investors, I have delved deeper to find the best opportunities for the portfolio.

For example, for the first time in a couple of years, I have found compelling value propositions in the United States. The U.S. has been a longstanding underweight for our Global Value portfolio as valuations have largely been far too rich. But more recently, we have been able to buy into some attractive entry points and are now just shy of the benchmark's 60% allocation.

In particular, as the debate around oil prices and the future of the energy sector have continued, I have taken a deeper look at some of the affected businesses in the hunt for undervalued opportunities with potential to rerate. The oil services industry is one area of the market that looks particularly cheap to me, and I have recently increased the exposure here as I identified stocks with compelling bottom-up stories.

Financial stocks account for the portfolio's largest absolute position, and here I have stretched the longstanding overweight position as I have become more bullish on regional banking outlooks. My largest positons comprise high-quality U.S. banks, and more recently I have been finding good value in European financials, where I have identified high-growth dynamics or positive idiosyncratic stories. I also like the insurance sector with the exposure spread across U.S. and Europe. The largest position here in the U.S. is an insurance powerhouse, which enjoys leading positions across its major business lines and we believe is well positioned to benefit from rising interest rates and shifting demand for property and casualty insurance.[1]

Across the Pacific Ocean, we have long viewed Japan as a fertile market for value names as the investing backdrop has become increasingly shareholder-friendly, with businesses making meaningful improvements to corporate governance and capital allocation policy. But, while valuations generally remain attractive, they are also becoming more divergent. Because of that, I have moved to a more neutral position in Japanese stocks and am driven by more individual investment cases. In particular, I like the consumer story in Japan so I have more domestically focused names.

FOCUS ON THE FUNDAMENTALS, BUT BE WILLING TO ADAPT

As I have stated before, patience is the perennial friend of the value investor. Given this, it is important both to stay the course through market uncertainties, but also to balance your approach to value investing. One key foundation to my approach is the ability to stay engaged with stocks during periods of distressed sentiment in order to potentially benefit from a transition to a better outlook. Here I have enjoyed some good outcomes in recent years.

Importantly, I continue to consider a longer-term view than the market, searching for attractive entry points by looking through what we view as shorter-term, cyclical pressures. In the same vein, I am swift to sell stocks that I believe have reached fair value targets.

Looking at the Value/Growth debate from a higher level, when I observe past occurrences when Value has reasserted itself, they cannot consistently be attributed to any one development in the external environment (steepening yield curves, inflation, etc.). They can play a part at particular times, but a more consistent influence on when regimes change occur are more endogenous factors, namely market dynamics and valuations.

Therefore, as a fundamental investor focusing on specific stocks, my conviction in value investing is based upon the opportunities that I observe on the ground rather than higher level sector composition considerations. At the same time, as some sky-high growth stock valuations come down, especially across the technology sector, we may see an opportunity for a turn in the value/growth cycle.

So getting back to the original question, "Is value investing dead?": The answer is a firm no. The only caveat to that statement is that in this current environment, where everyone is seeking growth and value investing is out of favor, only those investors with the ability and resources to find the best stock ideas will succeed.

Key Risks—The following risks are materially relevant to the strategy highlighted in this material: Transactions in securities of foreign currencies may be subject to fluctuations of exchange rates which may affect the value of an investment. The portfolio is subject to the volatility inherent in equity investing, and its value may fluctuate more than a portfolio investing in income-oriented securities. The portfolio has increased risk due to it's ability to employ both growth and value approaches in pursuit of long-term capital appreciation.

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[1]As of of May 31, 2018.

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