



Value Investing: A Q&A With Sebastien Mallet

A decade of insights, and reasons why I am optimistic about the next 10 years.

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KEY INSIGHTS

- Sebastien Mallet always had faith in “value,” as history tells us that value as a factor has outperformed growth more often than not.
- Investing across the value spectrum can help to deliver an “all weather” performance pattern.
- Looking forward, higher inflation along with higher interest rates are likely—a backdrop that is supportive for value-oriented areas of the market.



Sebastien Mallet
*Portfolio Manager,
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Sebastien Mallet recently marked his 10-year anniversary of managing the Global Value Equity Fund. We met to discuss what attracted him to value investing, how he dealt with the tough environment for value following the global financial crisis (GFC), and how he characterizes his investment style. He tells us the key lessons he has learned, and why he believes the next 10 years look more promising for value-oriented investors.

What did you learn in the early part of your investment career?

When I look back at my investment career, a defining period was during the technology, media, and telecom (TMT) bubble and the importance of having a robust valuation model. The GFC was also very formative. After the collapse in 2008, the incredible liquidity support provided to financial markets resulted in a dramatic turnaround. In 2009, when

I was an international mid-cap analyst at T. Rowe Price, the S&P European Small Cap Index was up an incredible 52.8%.¹ The only way to beat that index was to find stocks that could potentially double or even triple in value. It was a great education on when is the right time to take on risk. This continues to inform my investment approach today: having a valuation discipline, but also some exposure to higher-risk, deeper-value stocks.

You have endured an extremely tough period with growth outperforming value for nearly all of the 10 years you have managed the fund. Did it test your resolve?

The period after the GFC was a very difficult one for value managers, especially for much of 2017 to 2020—a period when the market’s infatuation for growth stocks was particularly intense. I trained as an economist,

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Past performance is not a reliable indicator of future performance.

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so I have always been “macro aware.” I, therefore, knew why growth stocks were working (a low-growth, low-inflation, and low interest rate environment). But I always had faith in value, as history tells us that value as a factor has outperformed growth more often than not.

The support I received from colleagues and management was crucial—and not just from those with a value-oriented investment style. T. Rowe Price is run by investors, and they understand style investing. The research team also remained firmly focused on providing thoughtful insights and ideas from across the style spectrum, not just for the growth investors within the firm. Senior management consistently reminded me of the need for style consistency and to adopt a long-term perspective. There was a clear understanding that I could not beat the broader market when the style headwinds were so pronounced. Instead, I was encouraged to develop an attractive track record in value investing.

How would you characterize your investment style?

My investment style is very much to concentrate on “the quality of the opportunity not the quality of the company.” Investing across the value spectrum enables me to benefit from both the depth and the breadth of our research coverage, as well as helping to deliver what I call an “all weather” performance pattern.

My objective is to construct a portfolio of between 80 and 100 of the best value ideas we can find globally, with a specific focus on the most attractive asymmetrical risk/reward opportunities. I look at a range of scenarios ranging from “bull” to “bear,” with the potential downside in a stock always being my starting point. I am happy to take on risk as long as there is a potential reward. What is important is that I can understand why a stock is cheap,

why there may be a controversy, and why our analysis tells us that a company is not broken and has a fighting chance to recover.

I use a range of valuation metrics depending on the type of stock. For higher-quality ones, I use free cash flow multiples, while for more cyclical and higher-risk opportunities, I use sales and asset-based approaches. I embrace different types of value ideas (defensive value, aggressive value) as they can work at different times in the equity cycle.

What have been your biggest investment successes, but also mistakes, and what lessons have you learned from them?

The most rewarding has been the performance pattern over the last 10 years and how broad-based it has been. Looking at attribution versus our value universe, there have been positive contributions across most market capitalizations, sectors, and countries.

In retrospect, there were times I stubbornly defended higher-risk names despite signs that the investment thesis was going off track. I learned that it is usually better to “sell early” if conviction starts to wane. At the other end of the value spectrum, I also learned to better appreciate the potential for compounding returns that can be generated in higher-quality companies. The runway can be long if you can find the right company. I believe an investor should take advantage of that and continue to hold them.

How do you see the market environment for value going forward?

Although the environment for global equities is uncertain right now, we believe the overall outlook has improved for value investing. The responses to the coronavirus pandemic and the Russia-Ukraine conflict have been game changers. We have seen modern monetary policy evolve with “helicopter money” (whereby the central bank

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transfers money to the public to help boost economic output) helping to put money directly into people's pockets. This policy appears to open the door to greater monetization of fiscal deficits. Meanwhile, the war in Ukraine reminds us how important it is to protect your own country. President Vladimir Putin has accelerated deglobalization, in my opinion.

We also believe that if the agenda is geared toward reducing inequalities and stimulating the consumer, then growth will be more omnipresent. Going forward we are likely to have higher inflation along with higher interest rates—a backdrop that is supportive for value-oriented areas.

Are there any particular themes that you are focusing on that will grow in importance?

We are spending a lot of time assessing companies in traditional “old economy” industries that could be major beneficiaries of long-term trends now underway. The “green agenda” is one of these. Transitioning to a zero emissions world will need existing old economy stocks to drive forward change.

Eighty percent of carbon dioxide emissions come from energy, materials, utilities, transportation, and industrials, which make up a huge part of the value index. Since the GFC, those industries first suffered from overcapacity and then from underinvestment, but they are polluting too much; hence, they need massive investments to adapt. Within these industries there will be winners and losers. We need to work out who will be the winners.

Deglobalization is also a theme gaining prominence in the wake of supply chain disruptions stemming from the pandemic and the Russia-Ukraine conflict. This is testing international structures and making governments and companies more aware of where their dependencies lie. Increasingly, policymakers' thoughts are turning away from the economic benefits of globalization (cheaper and more efficient manufacturing) to focus instead on regionalization and onshoring/reshoring to ensure that they can serve domestic needs. This has the potential to slow or even reverse globalization. We need to prepare for that and invest accordingly.

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