T. Rowe Price

Going global: Exploring the best opportunities for value investors

From the Field
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Key Insights

- Having a global opportunity set that offers both cyclical and defensive attributes is attractive for investors seeking balance in their portfolios.
- Energy, health care, and technology are all areas where we are currently finding opportunity.
- With stock prices oscillating more than their underlying fundamentals, value investors can take advantage of mispricings and investors' short-term horizons.

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Value investing has a long history of delivering above-market returns, but since the global financial crisis, value-oriented strategies have struggled as subdued economic growth, very low inflation, and ultralow levels of interest rates have hindered performance. This period has been highly unusual, but with the return of inflation and central banks implementing one of the fastest rate-hiking cycles in history, we have seen a material evolution in the market environment back to a more normal one. The field is now much more even, offering increased opportunities for value investors.

Return to normalized world provides a more positive backdrop for value

While there are parts of the value universe that are economically sensitive, such as banks and "highly cyclical" industrials, there is also a strong balance of defensive areas, such as health care, and companies that have strong pricing power, especially in traditional industries such as utilities and consumer staples where higher inflation has clear benefits.

Meanwhile, with supply chains being restored and the effects of deglobalization and onshoring accelerating, we are expecting higher levels of capital expenditure going forward. Higher inflation will also mean corporates

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and governments will be less likely to postpone investments due to the potential for higher costs in the future.

This should also be accelerated by the desire to meet net zero targets.[1] However, the push for cleaner energy and decarbonization is not only limited to energy companies. Across industries, we are witnessing greater investment as companies endeavor to meet ambitious climate targets. Further, governments may be more willing to engage in higher levels of fiscal spending to beat inflation, but also to address future economic shocks and fulfill a social agenda, as they have seen how effective such spending has been in the recent past. A combination of higher capital expenditure and fiscal spending is likely to prove beneficial for value-oriented areas of the market.

Identifying opportunities from a global value perspective

Having a global opportunity set that offers both cyclical and defensive attributes is attractive for investors seeking balance in their portfolios. We have identified three key areas where we see exciting opportunities going forward.

Energy dynamics—Rising energy prices and the focus on energy independence and transition

Energy prices are rising as geopolitical concerns increase, inventories are low, and the cost of capital has expanded. Oil prices have risen solidly since the summer trough as geopolitics have amplified the desire for energy security and independence, while rig counts in the U.S. have fallen. The war in Ukraine and the recent events in Gaza and Israel have focused investor attention on energy supplies. Further, a lack of investment, especially in oil and natural gas extraction, has also caused prices to rise. The cost to pull energy from the ground has risen steadily due to the higher cost of financing, hiring, and transportation. There are also some indications that the long-term trend of improving productivity is reversing. Meanwhile, winter is coming. Europe escaped 2022 with a mild winter, but there is no guarantee of that happening again this winter. All these factors support higher energy prices, and with it, potentially improving returns for energy companies.

Health care—Innovation, new products, and finding areas of controversy

The coronavirus pandemic brought into sharp focus the critical importance of global health care investment, innovation, and access. The pandemic prompted governments to increase capital flows across a range of industries to strengthen the resilience of global health care systems, and we anticipate that this will support a period of innovation, consolidation, and optimization.

[1] Targets set to cut greenhouse gas emissions to as close to zero as possible, with any remaining emissions re-absorbed by the atmosphere.

Three themes to watch in the value space

Energy dynamics

Rising energy prices improve prospects for energy firms

Health care

Strong capital investment and drug development

Information technology

Volatility widens the opportunity set for value investors

Health care is an area that is consistently growing and developing. The sector has also displayed resilience during periods of market uncertainty, as the general inelasticity of demand for health care products and services has typically helped in times of weak sentiment. The bigger headwinds arise from factors such as patent expirations of blockbuster drugs, the success of development pipelines, and political risk relating to drug pricing, especially in the U.S. However, free cash flow generation remains strong in the sector, and we are encouraged by the drug pipeline, especially in areas of diabetes, Alzheimer's disease, and cardiovascular conditions.

Beyond the general defensive profile, there can also be controversies that present investment opportunities. More recently, doubts around accessing financing for biologics and life science companies in a regime of sharp monetary tightening have weighed on the performance of equipment suppliers.

We also need to assess the impact of new GLP-1[2] drugs that could dramatically enhance weight loss. This has a potential knock-on effect on medical care companies, as well as on food and drink companies. Many investors are also still concerned by the "coronavirus unwind" in different segments of the industry. Finding pockets of value in such environments, however, has shown to be successful over the longer term.

Technology—Expanding the opportunity set

Many value managers tend to allocate minimal resources to finding opportunities within the information technology sector due to the high valuations and long duration that industries within the space can present. But opportunities can still be found, especially when sentiment turns against a sector and uncertainty is high. This is especially true in "cyclical tech," currently, which includes semiconductor and semiconductor equipment companies. In particular, we have made a number of investments in memory chip companies.

The cyclical nature of the tech sector arises from the nature of customer demand, investment and inventory patterns, and other competitive behaviors that can cause sharp swings in industry returns and profitability. In the midst of this volatility, opportunities can arise as investors try to avoid the downturn as the cycle deteriorates and the market overly extrapolates trends into the future. The short-term fear of the unknown can therefore create opportunity to unearth potential new investment candidates as the near-term reduction in market value is balanced with the potential intrinsic value of the company.

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Importance of finding balance within a portfolio

Value investing has performed well in a range of different economic environments. While a number of factors have made investing more difficult in recent years, the classic value investing model has not fundamentally changed. Investing in companies that trade below their intrinsic value has continued to prove a successful strategy. Meanwhile, short-term disruption, controversy, or setbacks in the market continue to cause equity mispricing.

With stock prices oscillating more than their underlying fundamentals, there are opportunities to take advantage of these mispricings and investors' short-term horizons. In today's market, with high economic and geopolitical uncertainty, it is important to maintain a portfolio that is well diversified across factor, style, and economic exposures.

[2] GLP-1 agonists are medicines used to treat type 2 diabetes. They mimic (copy) the action of a hormone (chemical substance) called GLP-1. Your stomach naturally releases this hormone when you eat food. The medicines work in different ways. They help your body to make more insulin (the hormone that controls the amount of sugar in your blood). When needed reduce the amount of sugar (glucose) that your liver makes. It also slows down the digestion of food, so that it takes longer for your body to absorb (take in) the sugar from meals and can reduce your appetite helping to lose weight.

Diversification cannot assure a profit or protect against loss in a declining market. International investments can be riskier than U.S. investments due to the adverse effects of currency exchange rates, differences in market structure and liquidity, as well as specific country, regional, and economic developments. The value approach to investing carries the risk that the market will not recognize a security's intrinsic value for a long time or that a stock judged to be undervalued may actually be appropriately priced.

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