Value investing – dead or alive?

Weekly Digest

10 June 2019

– *Stephen Nguyen*

Value investing has taken a back seat in recent times, particularly in the US where the divergence in performance between low and high growth stocks has been significant. After a decade of mediocre performance, investors are increasingly losing patience, with many questioning whether value investing still works. This latest bull market has not been kind to value investors, but we've been here before and we don't think the approach is fundamentally broken.

Over the last 10 years, value investing has been soundly beaten by its counterpart, growth investing, with higher earnings, particularly technology, stocks defying gravity by continuing to accelerate into their premium valuation ratings. Beneficiaries of this include the 'FAANG' stocks of Facebook, Amazon, Apple, Netflix and Google. There are a few reasons for this. Economic growth since the Global Financial Crisis (GFC) has lagged previous economic recoveries and this low growth environment has encouraged investors to seek higher growth stocks. Additionally, long term interest rates have been driven down by global central banks and growth stocks have benefitted disproportionately from this environment as their higher and longer duration future earnings are being discounted at a lower rate, which leads to higher present value today.

On the other hand, this low rate environment has been a headwind for the low growth cohort. Given that the financial sector and specifically banks are a large part of the bargain universe, low interest rates combined with a flat yield curve have weighed on margins and profitability of these companies. Together, this has resulted in a lost decade for Benjamin Graham disciples, with the US value index lagging growth by over 3.0% per annum.

Value has been through similar cycles before. During the tech bubble of the 1990s many investors lost faith, but it ultimately recovered. As with any style, there are cycles, and this has been a tough decade for value. However, if you were to look back to the preceding 10 years during which time value outperformed growth by over 4.0% per annum, you would have concluded that it was growth that was, in fact, on its way out.

We have considered whether value investing has been affected by flows into systematic strategies seeking to exploit this risk premia. If this was the case, given the purported meaningful flow of systematic money, it would be very difficult for the cheapest stocks to get that compellingly cheap; instead, as soon as they dropped towards the bottom of the range, a large weight of assets would be looking to snap them up. This is not what we observe today as the spread between expensive and cheap stocks remains compellingly attractive.

The value premium has persisted through time due to behavioural biases, which in our view are unlikely to change. We see nothing to believe investors in aggregate are any better today at avoiding extrapolating short term performance than they were in the past. This means that businesses undergoing short term pain may continue to be discounted too heavily, leading to superior stock returns going forwards. While psychologically painful during these periods of underperformance, value investing has delivered over the long-term and one cycle shouldn't change that. However, we advocate a balance of style exposures in order to build robust portfolio and increase the probability of delivering the outcome.

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The **Marketplace**

- A broadly positive week for bonds and equities
- President Trump suspended plans to impose tariffs on Mexican imports
- Brent crude fell 1.9%, ending the week at $63.3 per barrel
- Gold prices rose 3% to $1343 an ounce

Market **Focus**

US

- The Fed mulls a rate cut amid worsening trade global tensions. The futures market has one fully priced-in for the July meeting
- The plan to impose tariffs on Mexican goods has been suspended after a deal was reached last Friday. There is some confusion however as Trump indicated terms that included Mexico agreeing to buy large amounts of US agricultural products which didn't appear to be in the original deal
- US equities gained 4.4% in their strongest week since November, snapping a streak of four consecutive weekly losses. The industrial average index also gained after its longest losing streak since 2011
- Nonfarm payrolls for May added 75,000 jobs which was below expectations. Average hourly earnings were also softer than expected at +0.2% month on month

Europe

- European equities followed the US higher, increasing 2.4% last week
- The ECB will keep rates on hold until at least mid-2020 as policymakers address concerns regarding weak inflation
- Germany's Bundesbank has cut its economic output forecast to 0.6%, down from 1.6% in December, on the back of weak export data. The central bank also slightly lowered forecasts for 2020 and 2021. During April, exports fell 3.7% whilst imports fell 1.3% over the same period

UK

- Prime Minister Theresa May stepped down as leader of the Conservative party last Thursday but will stay on until the leadership election in late July
- UK factory output fell by 3.9% in April which is the largest decline since 2002. Vehicle manufacturing was hit hardest, falling by 24% as planned shutdowns took hold
- House prices increased in May by 0.5% as low interest rates and solid employment numbers buoyed demand
- UK equities rose 2.5% on the week while UK Gilts returned 1.1%

Asia/Rest of The World

- Mexican stocks returned 1.3% on the week, buoyed by anticipation of the delay to US-Mexico tariffs
- China's central bank announced it has 'tremendous' room for manoeuvre in its monetary policy in response to the ongoing trade war with the US
- Japanese equities rose 1.4% bucking the trend after four weeks of declines. This was despite the World Bank cutting Japan's growth forecast to 0.8% from 0.9%
- The main Chinese equity benchmark fell 2.5% and the blue-chip index fell by 1.8% on the back of US trade tensions

Past performance is not indicative of future returns.

Source: Bloomberg. Returns in local currency unless otherwise stated.

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Asset Class/Region	Currency	Currency returns			
		Week ending 7 June 2019	Month to date	YTD 2019	12 months
Developed Market Equities					
United States	USD	4.4%	4.4%	15.4%	5.2%
United Kingdom	GBP	2.5%	2.5%	11.3%	-0.5%
Continental Europe	EUR	2.4%	2.4%	14.4%	1.7%
Japan	JPY	1.4%	1.4%	3.8%	-12.3%
Asia Pacific (ex Japan)	USD	1.1%	1.1%	6.7%	-10.5%
Australia	AUD	0.7%	0.7%	16.3%	11.1%
Global	USD	4.0%	4.0%	14.1%	1.5%
Emerging markets equities					
Emerging Europe	USD	3.0%	3.0%	15.3%	7.4%
Emerging Asia	USD	0.7%	0.7%	3.9%	-14.9%
Emerging Latin America	USD	2.4%	2.4%	8.7%	15.7%
BRICs	USD	0.8%	0.8%	7.8%	-8.5%
MENA countries	USD	0.2%	0.2%	6.6%	2.7%
South Africa	USD	0.6%	0.6%	5.4%	-12.6%
India	USD	0.0%	0.0%	10.3%	8.6%
Global emerging markets	USD	1.0%	1.0%	5.2%	-10.2%
Bonds					
US Treasuries	USD	0.3%	0.3%	4.8%	7.5%
US Treasuries (inflation protected)	USD	0.4%	0.4%	6.0%	5.3%
US Corporate (investment grade)	USD	0.5%	0.5%	7.8%	8.7%
US High Yield	USD	0.9%	0.9%	8.5%	5.9%
UK Gilts	GBP	1.1%	1.1%	6.0%	7.8%
UK Corporate (investment grade)	GBP	1.2%	1.2%	6.6%	6.8%
Euro Government Bonds	EUR	1.2%	1.2%	4.9%	6.9%
Euro Corporate (investment grade)	EUR	0.4%	0.4%	4.2%	4.1%
Euro High Yield	EUR	0.5%	0.5%	5.8%	2.7%
Japanese Government	JPY	0.3%	0.3%	2.5%	3.1%
Australian Government	AUD	0.0%	0.0%	6.6%	11.9%
Global Government Bonds	USD	1.4%	1.4%	4.6%	5.0%
Global Bonds	USD	1.2%	1.2%	4.6%	4.9%
Global Convertible Bonds	USD	1.2%	1.2%	5.4%	-1.6%
Emerging Market Bonds	USD	1.7%	1.7%	8.3%	8.5%

Source: Bloomberg. Past performance is not indicative of future returns

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Asset Class/Region	Currency	Currency returns			
		Week ending 7 June 2019	Month to date	YTD 2019	12 months
Property					
US Property Securities	USD	2.2%	2.2%	18.4%	14.0%
Australian Property Securities	AUD	3.5%	3.5%	17.8%	15.8%
Asia Property Securities	USD	2.0%	2.0%	10.0%	0.5%
Global Property Securities	USD	1.9%	1.9%	14.4%	6.0%
Currencies					
Euro	USD	1.6%	1.6%	-1.0%	-4.0%
UK Pound Sterling	USD	0.9%	0.9%	0.0%	-5.0%
Japanese Yen	USD	0.4%	0.4%	1.4%	1.5%
Australian Dollar	USD	1.1%	1.1%	-0.5%	-8.1%
South African Rand	USD	-2.4%	-2.4%	-3.8%	-13.3%
Swiss Franc	USD	1.6%	1.6%	-0.4%	-0.5%
Chinese Yuan	USD	-0.1%	-0.1%	-0.5%	-7.5%
Commodities & Alternatives					
Commodities	USD	-0.2%	-0.2%	4.1%	-11.1%
Agricultural Commodities	USD	-1.0%	-1.0%	-2.0%	-11.8%
Oil	USD	-1.9%	-1.9%	17.6%	-18.1%
Gold	USD	3.0%	3.0%	4.8%	3.5%
Hedge funds	USD	0.7%	0.7%	3.0%	-3.8%

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Important notes