Weekly Digest

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Investec Wealth & Investment

The weekly insight into world stock markets

Style Counsel

Exhibit 1: “Our thesis […] should provide a multi-year tailwind for our active growth-centric investment approach…”

Exhibit 2: “There is even more urgency for investors who are over exposed to growth stocks to begin the process of allocating towards value.”

The first quote is taken from the latest monthly commentary of one of the UK’s leading Growth/Technology fund managers. His flagship fund has assets under management of around £1.6bn. The second is from an ad hoc update received at the end of last week from a dyed-in-the-wool Value manager with around £550m under his belt. Both proclaim that now is the time to trust their view of the world, which is hardly surprising. Fund managers tend to “stick to their knitting” when it comes to style, and it is very rarely that you will ever read the words “please don’t invest in my fund because it’s the wrong time in the cycle”. The last decade supports the Growth manager; contrarian instincts nudge one towards Value, which has had a shocking period of relative performance during the period following the financial crisis.

The whole debate is clouded by definition. It’s reasonably straightforward to define Growth – usually the ability to grow either revenue, earnings or dividends faster than the market average – but what exactly constitutes Value is harder to pin down. In the classic interpretation of the teaching of Benjamin Graham, widely acknowledged to be the “father of Value investing”, a Value stock must be bought at a significant discount to its “intrinsic value” to provide a “margin of safety” in the event that either a) you are wrong; or b) the market crashes, taking everything down with it. Sounds pretty simple, doesn’t it? Certainly back in the days when Graham acolytes Charlie Munger and Warren Buffett of Berkshire Hathaway fame were buying “cigar butt” companies for less than the value of the cash and assets on their balance sheets things were pretty straightforward. But those days are behind us, and “intrinsic value” is a more nebulous concept which often demands a more subjective approach, which, for example, might include the calculation of a required rate of return and the application of a long-term growth rate. Get either of those wrong and you are left holding not a Value stock, but a value trap. Furthermore, if a high PE, fast-growing company’s growth trajectory is underestimated by the market, it could be intrinsically cheap. Today’s Value managers are not enthralled by such possible anomalies.

Indeed, much of the contemporary approach to Value investing is based on the work of academics Eugene Fama and Kenneth French. When Fama published his Efficient Market Hypothesis in 1970 that should have killed off the active fund management industry… but for the fact that some fund managers exhibited a persistent ability to outperform the averages. Initially it was asserted that this could only be ascribed either to taking more risk or to dumb luck. However, whole new sub-industries were born when two specific “factors” were identified that contributed to long-term outperformance – Size (with smaller capitalisation stocks doing better than large cap) and Value. And both of these factors have subsequently had their moments.

As I mentioned earlier, though, the last ten years have not been kind to Value investors, at least on a relative basis (which is how things tend to be measured in this industry). Since the turn of the markets in April 2009 the S&P Value Index has delivered a commendable looking total return of 272%, but the Growth Index is up 359%. Thus notes appear on my desk such as the one from BCA Research earlier this month entitled: “When Will Value Work Again?” The volume was turned up another notch with the sell-off of Technology stocks that I highlighted last week. Since the peak of the Growth Index on 1st October, Growth is down 6.6% and Value has fallen “only” 3.7%. Is this the beginning of the Big Rotation into Value? There is much to support the idea. Growth has benefitted from a surge of technological development which may or may not continue at its current pace. The valuation of Growth has been greatly boosted by the low bond yields/discount rates that have prevailed during an era of extraordinary monetary policy (Quantitative Easing, Zero Interest Rate Policy, etc), but that force is diminishing as US interest rates and bond yields rise. Growth (and the FAANGs in particular) have also succumbed to FOMO (Fear of Missing Out), and so there has been an inevitable shaking of the tree at the first signs of uncertainty.

The last time Growth came a real cropper was during the 2000-2003 Tech bust, and that was also the relative heyday of Value. The perceived opportunity cost of not being in Tech (and also Media and Telcos) was so great that “old economy” stocks were thrown overboard, leaving companies with decent growth prospects on risibly low valuations. Once that trend rolled over it was a “one decision” trade for Long/Short Equity Hedge Funds who proceeded to make returns over the next few years that they have since only dreamed about. Value equated with Quality during the early part of that era, something that is not so apparent today. In fact, the largest component of Value today is the Banks sector, and the reason that a lot of them trade below book value is because they fail to make a positive return on capital (although rising interest rates are initially beneficial to net interest margins before bad debts start to emerge). Many of the high yielders which also tend to find their way into Value baskets are also well past their best and subject to strong competitive or regulatory pressure. Certainly not “one decision” buys. But this debate is far from over.

John Wyn-Evans
Head of Investment Strategy

FTSE 100 Weekly Winners

Pearson	12.5%
Paddy Power Betfair	12.3%
GlaxoSmithKline	9.0%
Randgold Resources	8.4%
London Stock Exchange	7.2%
AstraZeneca	7.0%
Diageo	6.3%

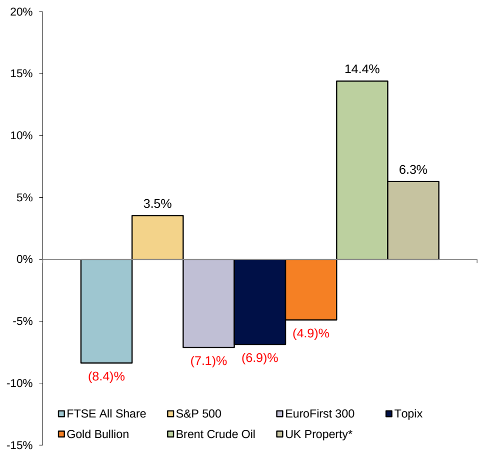
Source: FactSet

FTSE 100 Weekly Losers

easyJet	-11.0%
BAE Systems	-7.6%
CRH	-7.0%
Taylor Wimpey	-6.1%
Standard Life Aberdeen	-5.9%
Johnson Matthey	-5.9%
Next	-5.6%

Source: FactSet

Year to Date Market Performance



Source: FactSet
*IPD Total Return to September 2018

FTSE 100 Index, Past 12 Months

Source: FactSet

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