INVESTMENT WEEK
investmentweek.co.uk
13 May 2020

Time to be brave: Why there is still value in value investing

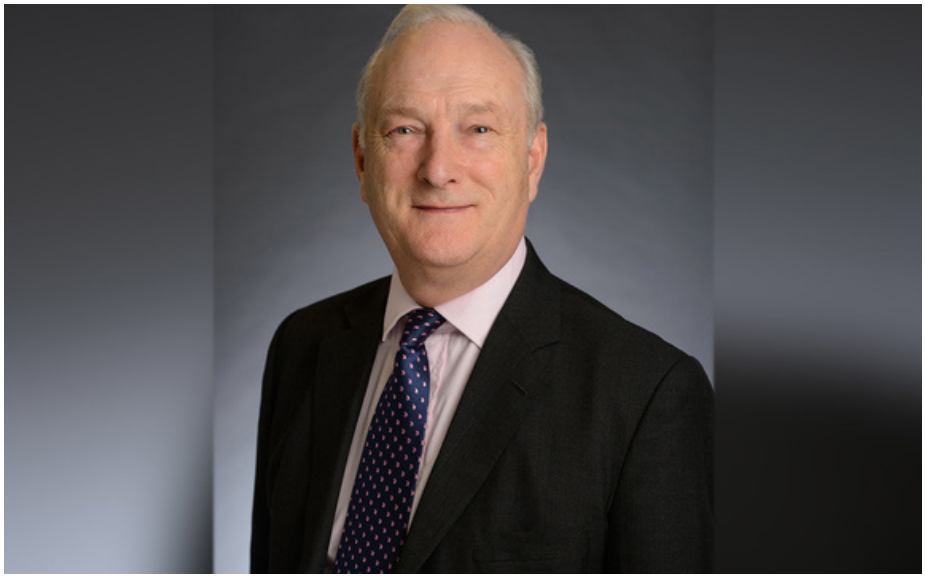
Revisiting the growth vs value debate

Edward Troughton / 13 May 2020

There has been much commentary recently claiming the end to traditional value investing. These views are held by highly successful firms and individuals, for whom I have great respect.

It is, however, a very one-sided view that is being put forward.

It is relatively easy to support this argument after 11 years of growth investing quite clearly outperforming value. But there is very rarely only one side to a debate and, as Nassim Taleb says in The Black Swan: The Impact of the Highly Improbable: "Once your mind is inhabited with a certain view of the world, you will tend to only consider instances proving you to be right."



Edward Troughton of Oldfield Partners

Value has certainly had a dark time of it over the last 11 years, with 2016 being the only year that it has outperformed growth, but there is no doubt that its darkest hour in a generation has been this last eight-week period during the Covid-19 pandemic.

During this period, we have witnessed for the first time ever, an almost complete closing down of the global economy.

This has been combined with quite extraordinary attempts by governments worldwide to shore up their domestic economies as entire populations, barring key workers, are forced to work from home and important industries are shut overnight.

Undoubtedly, it has provided a wonderful boost to those giants of technology, Microsoft, Amazon, Apple, Google and Netflix - companies providing great products and services but which are being priced for endless growth.

The market cap of Microsoft is now virtually the same as the whole FTSE 100: at Oldfield Partners, we ask if it's right that this is the case?

And here lies the other side of the debate: I do wonder how differently this would have worked out if the virus had been a technological one and not human - something not beyond the realms of possibility. Would growth investors been quite so boastful?

We are currently in an extraordinary zombie economy where the aforementioned tech companies can shine. But we will come out of this. People will return to pubs and travel again.

They will also drive cars and buy homes, driving up the use of oil and financial services in the process.

In short, there is a time coming when the pent-up demand will be released and stocks that have been priced as if they were being driven to extinction will perform.

This does not mean to say that tech giants, or those solid quality growth companies, will suffer. Far from it: they will remain giants of the world economy but their prices will need to take a breather while their earnings catch up - after all, valuations and cash flow do matter.

There will be a time when it will be recognised that good, solid companies with

sound balance sheets were priced down to the most extraordinary levels.

These companies are long-term winners that, with patience, will perform exceptionally. There has, arguably, never been a better time to invest in these types of companies, at quite exceptional valuations, and into a value strategy.

Empirical evidence gathered over 100 years shows us that, over the long term, value investing works, and it has outperformed growth investing.

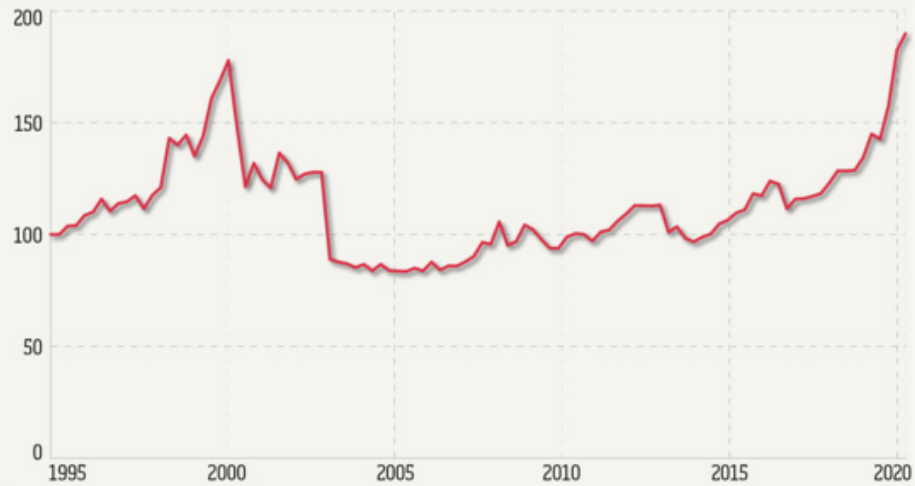
However, this needs some explaining: the starting valuation of a stock is the key determinant of long-term returns. The chart below shows the valuation of the growth portion of world markets, versus the valuation of the value portion.

The huge outperformance of growth over value in recent years is explained by a relative re-valuation of growth versus value. Investors have been willing to pay more and more for growth.

Successful investing can be done in many ways and we have great respect for growth investing, but there is also a time and place for value and that is generally when no one else is talking about it.

We strongly believe that every portfolio should have a balance, but the evidence we see is that the vast majority of portfolios are very overweight in growth while having little or no exposure to value.

MSCI World Growth/MSCI World Value price to book



Source: Bloomberg

It is likely, as has been the case in the past, that when value turns it will do so sharply (c.f. the chart above) - we are now at extremes previously only seen in the tech bubble of 2000 and the Great Depression.

Detractors may use those fateful words "this time it's different". Of course, no one knows what will happen next but we don't think this time is different because investor behaviour has not changed.

When looking at the historical evidence, logic would suggest that the snap back to value is not far away.

Value investing's performance has been deferred over recent years, which have been painful for dedicated practitioners such as ourselves. Being a value investor requires patience - this is a long-term strategy.

In a world increasingly driven by short-term results, it is difficult for investors to be contrarian and invest away from the herd, but this is among the two or three most extreme, and therefore best, times in the past 100 years to allocate to value.

Now is the time to take action. Now is the time to be brave.

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