

fund strategy

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Is value investing due for a comeback?

A five-year trend towards investing for growth has resulted in many companies starting to appear overvalued. Is this the cue for a grand rotation?

COMMITTEE CHAIRMAN



Laura Suter

Editor,
Fund Strategy

Growth has consistently outperformed value in recent times. In the past five years, 2012 was the only year value performance pipped growth in the Global sector, returning 11.4 per cent compared to growth's 11.17 per cent.

Last year the MSCI World Value Factor Uciits ETF returned -3.27 per cent compared to 2.48 per cent for the growth version of the ETF.

Investors have also moved out of value strategies, in part because they seek steady, stable, income-generating stocks in this low-yield world.

Funds in the Morningstar US Large-Cap Value Equity sector saw outflows in every quarter in 2015, totalling £5.84bn, a trend that was apparent across other value sectors.

However, the trend to growth stocks means that many have risen in value and some are starting to look overvalued, particularly in contrast to their value peers.

The big question is whether now is the start of a grand rotation and a recovery in value stocks. Schroders, after analysing some data, says that the depth of the value sector's weakness means that if a recovery does come it is likely to be profound.

Some initial signs are being seen. Commodity prices are creeping higher and certain economic data around the global is looking more promising.

Banks crop up on many investment managers' horizon as a key value stock, with the sector having been hit hard in recent years. Other options include mining stocks and emerging markets, which have both taken a beating and are showing signs of rebounding.



John Husselbee

Head of multi-asset
Liontrust Asset Management

Over a typical market cycle, say, seven to 10 years, the difference in return between value and growth investing is marginal. This presents the case for multi-asset, multi-manager investing; combining a portfolio of different fund managers with different investment styles and the objective to outperform the market over the long term with less risk, so seek a high Sharpe Ratio.

Investment style is determined by the stage of the economic cycle. Many investment managers use the investment clock, which provides a crude framework to determine investment tactics by asset class, industrial sector and investment style.

In a low-growth, low-inflation environment the growth style has outperformed as the oil price has exerted a global deflationary pressure, constraining economic growth. As these pressures abate, government bond yields will retreat and most likely provide a more favourable environment for value investors. However, this change in direction is unlikely to occur in linear fashion and most investors would be best advised to tilt portfolios.



Ben Stoves

Investment analyst
Rowan Dartington

Such has been the extent of market polarisation, value managers have been left with few options: commodity stocks, banks and food retail. The subtle change in sentiment this year is clearly encouraging for some of these, but risk and volatility remain elevated, particularly in commodity sectors, so taking a conviction call here is dangerous, akin to catching a falling knife.

Arguably, banks now face fewer headwinds that are out of their control as regulatory pressures have eased, and equity income managers are starting to take note of their revived dividend policies.

History suggests cyclical trends don't last forever and rotating to value at similar valuations throughout history would have likely achieved massive outperformance. That being said, we believe there may be some legs in this one yet. Look at the driving factors: an economic environment of prolonged low rates, low inflation and low growth.

Cyclical rallies are an inevitability and, longer term, a thematic rotation will no doubt unfold but we're not anticipating a sharp reversal while the economy is stuck in second gear.



Peter Lowman

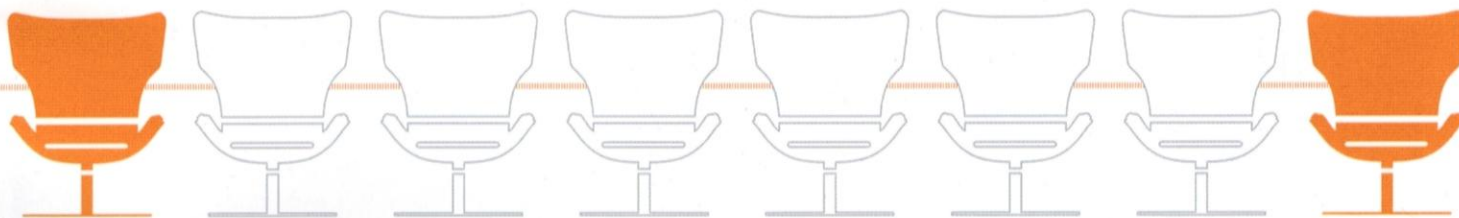
Chief investment officer
Investment Quorum

Over the past few years growth has outperformed value. However, this has left the prices for many growth stocks looking rather expensive. One reason for this has been investors seeking income in a period where cash deposits and bond yields have reached record lows. Indeed, in some cases we are now experiencing negative interest rate protocol.

Clearly, many growth stocks have quality attributes such as stable earnings and growing dividends, and some of these are large multi-nationals benefiting from the global consumer. Indeed, sectors such as tobacco, food and beverages, and consumer durables are classic examples of where to find growth.

Nonetheless, a five-year period in which it appears investors have abandoned value investing has left many of these companies trading on much larger discounts than you would expect, which means a recovery in value investing could make the rebound significant.

In terms of current value, the banking sector and emerging markets look interesting, given both have suffered a torrid few years.



Mike Deverell

Investment manager
Equilibrium Asset Mgmt

Value investing has underperformed for some time as investors preferred so-called “quality growth” stocks – companies that are likely to increase profits ahead of the market. Investors have been happy to pay many multiples of earnings for such stocks, believing the compounding effect of profit growth over time makes them worth a premium. This type of stock has been in fashion partly as investors lacking confidence in markets seek out supposedly solid companies.

However, low bond yields also make these stocks more attractive. Traditionally, a stock’s intrinsic value is seen as the discounted value of all future cashflows. Bond yields are often used to calculate the discount rate, so the lower the yield the higher the valuation an analyst might put on a stock.

Value has returned to favour as markets have bounced off their lows. This style will always do well in the early stages of recovery but whether value will recover its historic outperformance relative to growth remains to be seen.

If interest rates remain at low levels then perhaps the dominance of growth stocks can continue for some time.



James Calder

Head of research
City Asset Management

The definition of value and growth is a minefield of differing views on terminology. For example, the FTSE Mining sector is currently on a price-to-earnings of 28 times, and was over 40 times earlier this year, versus the market average of circa 17 times.

As it stands, one would consider this to be in the “growth” category, but its five-year historic average is 13 times; therefore a broad-brush statement can be prone to error.

While I am aware of managers that have a style bias, it would be unusual for me to go fully into one camp versus another. I expect the managers I purchase on behalf of clients to make this call while remaining true to their own style, which may have a value or growth bias.

A renaissance in value is more than possible. However, value managers are by nature contrarian and will be early with their purchases, which can be painful over the shorter term. To take a position with a self-confessed value manager one should either have a very strong view for the short term, or a strong stomach, but preferably a longer-term horizon.



Jonathan Davis

Managing director
Jonathan Davis Wealth Mgmt

The economic cycle is like a sine curve. In upcycles growth (aka no profit and no cashflow) outperforms value (aka oodles of cashflow and vast profits). I don’t know why they don’t rename growth “mañana”.

If the economic growth doesn’t actually arrive then as the tide goes out we see who’s not wearing trunks (to paraphrase Warren Buffett).

As far as I can tell we are now ex-growth since around spring 2015. It seems we have indeed gone over the top of that sine curve and are now heading down. Expect to see a flight to – relative – safety via a continued move from growth to value, and from there to government bonds, this year and into 2017.

So, the tech sector, which was trading at hundreds times earnings, is likely to see continued pressure to the downside. The small companies sector is facing the same pressure. Large caps have held up better than small but will also be hit hard if, indeed, we are on the other side of the upcycle.

Meanwhile, global energy has been shot to pieces. Once the bankruptcies of the hugely indebted firms end, enormous growth and value will be found in the sector.

INDEPENDENT VIEW



Michael Stanes

Investment director
Heartwood
Investment
Management

The past few years have been characterised by low growth, low interest rates and abundant central bank liquidity. These conditions have driven investors’ insatiable hunt for yield, resulting in the wide performance dispersion between value and growth stocks.

Growth outperformed value by 8 per cent in 2015, based on the MSCI World Index. In our view, the degree of valuation differential between non-cyclical – such as consumer non-durables – and cyclical companies – such as financials, energy and miners – is now sitting at extreme levels.

Without a meaningful pick-up in corporate earnings growth, we believe it will be difficult for growth stocks to sustain their higher valuations in the coming months.

Earnings growth has not kept pace with valuations and has tended to be driven by cost-cutting rather than top-line growth.

We see further challenges to corporate profitability, which is already contending with the effects of a strong US dollar and sluggish global economic momentum, particularly as the Federal Reserve looks likely to continue on its rate-tightening path.

Based on this outlook, we have a bias in our portfolios towards value equities, as we believe greater medium-term potential returns are available.