



The rise of value stocks

Market Comment, June 2022

We already pointed to the potential offered by “value” stocks last year (in our market comment of April 2021 entitled “Value or growth?”). Interest rate hikes and historically elevated inflation are making these “value” stocks even more interesting. Of course, the rotation that has commenced from more expensively valued “high-flyer” IT growth stocks towards more cheaply valued “value” stocks is not a one-way street. It is quite possible that we will see temporary breaks in the rotation, as was already the case in 2021. In a long-term comparison, however, the valuation discount of “value” stocks is more pronounced relative to the overall market. Even so, individual stock selection is also likely to become important in the future.

During 2022, the rotation away from highly valued equities of companies that promise to post business growth further down the line (especially US Internet stocks) towards equities with low valuations (“value” stocks) has continued. This trend, which dates back to 2021, has seen a change in favourites and is linked to the massive reorientation of the central banks, which are now adopting an approach that involves greater efforts to tackle inflation and a more restrictive monetary policy.

If the expectation of further rising market interest rates is being deliberately fuelled by the central banks, it should come as no surprise that many investors are once more switching away from higher valued equities, including IT, innovation and Internet stocks from the US, and moving towards “value” stocks, which have historically low valuations in terms of their price/earnings ratio or price/book ratio. We already made reference to the attractiveness of “value” stocks last year (in our market comment of April 2021 entitled “Value or growth?”). It is for this reason that for many months now we have held a corresponding position in global “value” stocks as part of our tactical investment allocation. This position has developed favourably in relative terms.

With the even clearer prospect of interest rate hikes and

now also the reduction of central bank balance sheets, so-called “quantitative tightening” (QT), the wind has clearly shifted this year against the aforementioned “high-flyer” growth stocks and more in favour of “value” stocks. It is no wonder that, in line with the considerable weighting of IT equities in the S&P 500, the US stock market, in particular, is experiencing a correction this year.

“Viewed historically, “value” stocks continue to have low valuations compared to IT growth stocks.”

G rard Piasko, Chief Investment Officer

The first phase of this rotation is lending support to very many low-valued “value” stocks, especially in the energy industry and other commodity sectors, which are being boosted by rising raw material prices. In the next phase, which will be characterised by inflation that remains structurally higher than in the past decade, individual stock selection will be more important once more, including in the case of “value” stocks. The focus of investors will gradually turn to companies that can demonstrate attractive earnings developments even against the backdrop of higher so-called input costs (wage costs, financing costs, raw material costs). Here, companies that have already proven in the past, and preferably across different economic cycles, that they can post a good and stable performance in terms of margin development are likely to be at an advantage.

It is also clear that when the price of money or interest rates rise, investors also increasingly turn their attention back to dividends. The equities of companies that have paid strong dividends or in fact increased them over several years or even decades are likely to receive more attention.

In contrast, should inflation remain high, i.e. at around 3.5% in the US, for instance, it will become more difficult for the stocks of companies that are set to post a signifi-

cant portion of their business success in the future to attract investor interest once more. This is the case, on the one hand, because these equities are more sensitive to rising interest rates due to the long “duration” of their returns and, on the other, as many of these equities are still more expensively valued compared to “value” stocks. The latter continue to appear more attractive in terms of both their price/earnings ratio and their cash flow or dividend yields.

Of course, the rotation away from “high-flyer” growth stocks towards “value” stocks seen in recent years is not a one-way street. There have been regular interruptions, as could be the case again, for example, if a new variant of the coronavirus were to emerge during the winter months, as there would once again be a spike in demand for Internet/IT products. This rotation may be supported up to 2023 by the normalisation of central bank balance sheets and interest rate hikes. Geopolitical tensions may also lead to higher rates of inflation and interest rates.

Conclusion: Viewed over the long term, we are still seeing clearly lower valuations for “value” stocks relative to “high-flyer” IT growth stocks, and especially those from the US. In the medium term, this will give rise to further catch-up potential, especially in the case of those “value” stocks that thanks to their good market position, below-average level of debt or pricing power can count on increasing investor interest during a phase of elevated inflation and thus necessary interest rate adjustments.

Gérard Piasko

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