

V A L U E



THE GREAT VALUE STOCK ROTATION: WILL IT LAST?

Agenda

- What is value
- What is a value rotation?
- Investment Outlook



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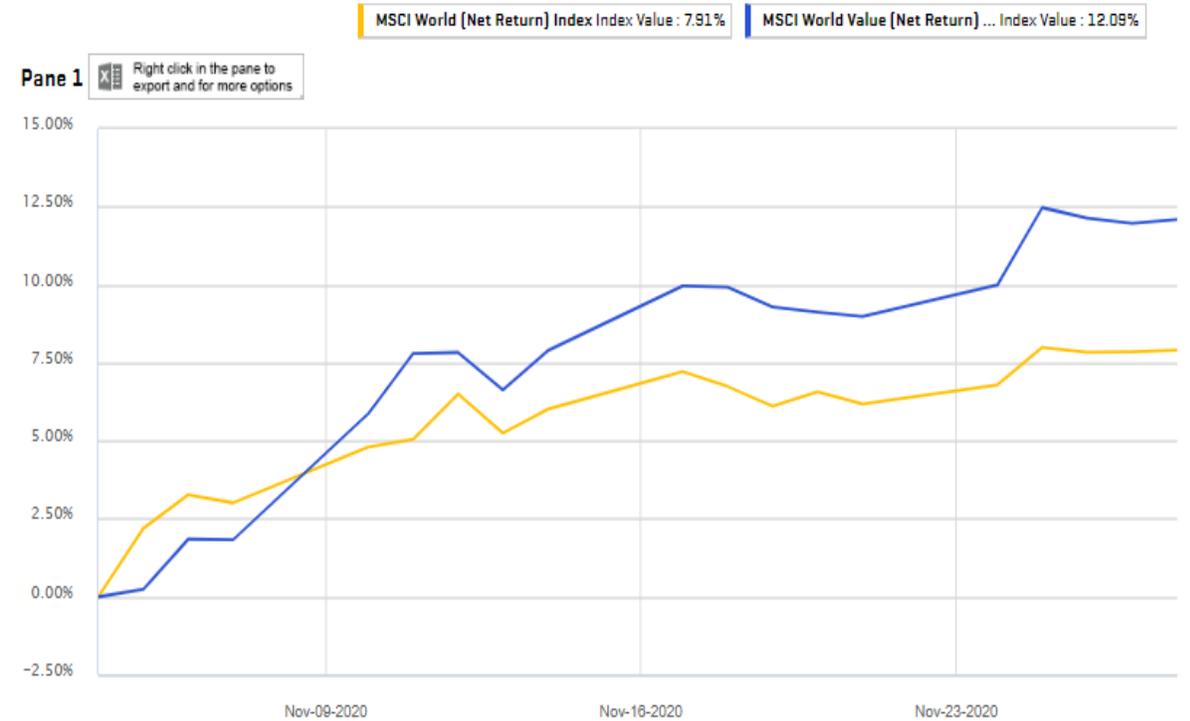
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Background:

Last 5 years have been terrible for value



Last month was fantastic



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What are quant factors:

US

Europe

YEARLY Q1-Q5 RETURN SPREAD %

Frequency:

Style	Factor	YTD ▼	2019	2018	2017	2016	2015	2014	2013	2012	2011	2010	L3Y	L5Y	L10Y
EQ	Earnings Quality	25.56	4.71	13.12	0.81	(2.49)	1.08	1.45	(6.67)	9.03	6.30	(3.50)	6.09	3.31	2.22
AE	Analyst Expectations	22.91	1.69	7.72	13.49	(8.09)	16.98	4.94	1.53	1.38	5.70	(4.11)	7.52	5.97	3.88
HG	Historical Growth	21.53	(0.61)	(1.84)	3.53	(8.02)	(0.79)	(4.89)	(5.33)	(3.64)	7.35	0.87	0.33	(1.62)	(1.43)
CE	Capital Efficiency	15.78	(2.83)	4.74	9.01	(2.48)	0.28	0.82	(5.74)	(4.40)	16.78	(8.26)	3.52	1.64	0.55
PM	Price Momentum	6.71	(0.47)	9.77	13.83	0.94	23.02	(1.10)	6.71	(0.74)	6.19	9.79	7.54	9.08	6.55
Vol	Volatility	(3.07)	12.98	(5.59)	(2.68)	10.37	(9.09)	(10.51)	1.15	6.65	(34.50)	21.74	1.26	0.82	(2.18)
Sz	Size	(11.31)	0.35	(3.80)	(5.45)	3.25	(4.69)	1.45	1.79	1.83	(2.31)	13.77	(3.00)	(2.12)	0.49
Val	Valuation	(30.25)	2.49	(8.01)	(2.98)	11.11	(17.42)	4.00	(0.19)	(0.08)	3.44	(0.13)	(2.93)	(3.45)	(1.06)

Style	Factor	YTD ▼	2019	2018	2017	2016	2015	2014	2013	2012	2011	2010	L3Y	L5Y	L10Y
CE	Capital Efficiency	14.62	5.89	18.61	5.55	1.15	13.88	10.29	(4.05)	1.06	33.53	7.21	9.85	8.83	8.86
HG	Historical Growth	13.69	9.37	2.34	9.60	(9.78)	9.77	3.64	1.68	4.14	0.18	5.21	7.05	3.97	3.46
AE	Analyst Expectations	13.53	4.89	8.05	0.74	(4.64)	11.91	1.56	13.27	9.91	1.07	16.57	4.52	4.03	6.14
PM	Price Momentum	10.50	14.53	6.57	3.41	9.23	19.20	(1.77)	13.31	5.38	16.64	28.98	8.07	10.45	11.23
Sz	Size	6.97	(3.40)	(7.67)	5.25	(1.27)	16.10	(4.69)	7.34	2.19	(16.14)	0.39	(2.09)	1.47	(0.54)
EQ	Earnings Quality	(6.07)	(1.95)	6.21	4.30	(3.51)	10.02	10.24	(4.34)	(1.40)	22.99	7.44	2.79	2.89	4.71
Vol	Volatility	(15.19)	11.50	(16.56)	3.27	17.45	(7.24)	(20.19)	14.02	18.36	(38.43)	3.84	(1.33)	0.92	(3.22)
Val	Valuation	(23.44)	(8.44)	(2.14)	(1.42)	5.73	(5.62)	8.79	6.48	(1.53)	(2.00)	(14.41)	(4.05)	(2.49)	(1.69)



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What are quant factors:

- Mathematical models to help generate performance
- They don't always work, but they usually do
- This is an implicit assumption about non-reversion



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Most common factors and the implicit assumption:

- **Momentum:** no mean reversion
- **Low Vol:** no mean reversion
- **Growth:** no mean reversion
- **Value:** mean reversion
- **Quality:** no mean reversion



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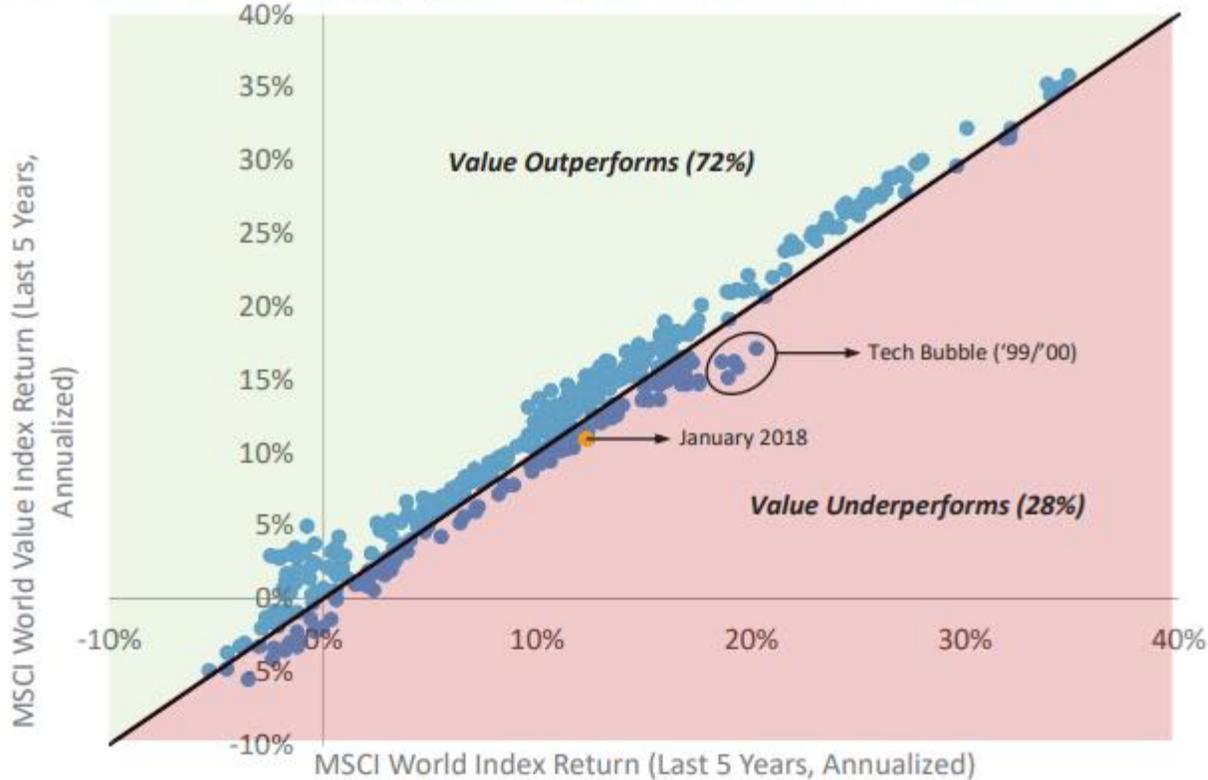
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Value: a patient investor's game

MSCI World Value Index has outperformed MSCI World in 72% of rolling 5-year periods.

Exhibit 2. Annualized 5-year rolling performance of MSCI World Value Index vs. MSCI World Index



Note: 5-year cumulative returns represent the rolling compounded gross USD performance of the MSCI World Value Index and MSCI World Index, from January 1975 to January 2018. Source: MSCI, FactSet



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What is Value:

MSCI Indexes

- Reliance on Book Value
- No cashflow measures
- Different accounting standards
- Forward Earnings
- 5 period regressions

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- Cashflow
- Earnings
- Deep Value
- Shareholder returns



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Naive Value:

Cashflow has been much better than other factors

Frequency:

YEARLY Q1-Q5 RETURN SPREAD %

Style	Factor	YTD	2019	2018	2017	2016	2015	2014	2013	2012	2011	2010	L3Y	L5Y	L10Y
Val	FCF / Price	(1.94)	4.92	(0.74)	17.31	(5.48)	4.46	11.37	1.05	18.42	(3.04)	(0.29)	6.91	3.82	4.51
Val	Sales / EV	(17.43)	(10.60)	(6.46)	1.00	3.91	(10.53)	(0.78)	7.43	(4.69)	3.30	4.56	(5.47)	(4.72)	(1.48)
Val	Valuation	(30.25)	2.49	(8.01)	(2.98)	11.11	(17.42)	4.00	(0.19)	(0.08)	3.44	(0.13)	(2.93)	(3.45)	(1.06)
Val	Book to Price	(32.22)	(6.86)	(17.34)	(9.42)	17.72	(18.80)	(0.44)	3.41	8.72	(23.46)	2.56	(11.32)	(7.79)	(5.21)
Val	E / P	(33.30)	7.98	(7.47)	3.60	11.04	(14.58)	(3.02)	(4.48)	(1.41)	10.05	(0.95)	1.16	(0.37)	(0.23)
Val	Div / Price	(33.94)	(3.64)	(12.27)	(17.63)	23.39	(14.11)	2.49	(13.51)	(11.41)	21.10	1.14	(11.37)	(5.90)	(3.37)
Val	EBITDA / EV	(37.64)	(0.81)	(16.15)	0.92	15.01	(15.68)	(0.11)	(0.16)	(5.44)	22.22	(1.19)	(5.67)	(4.03)	(0.76)



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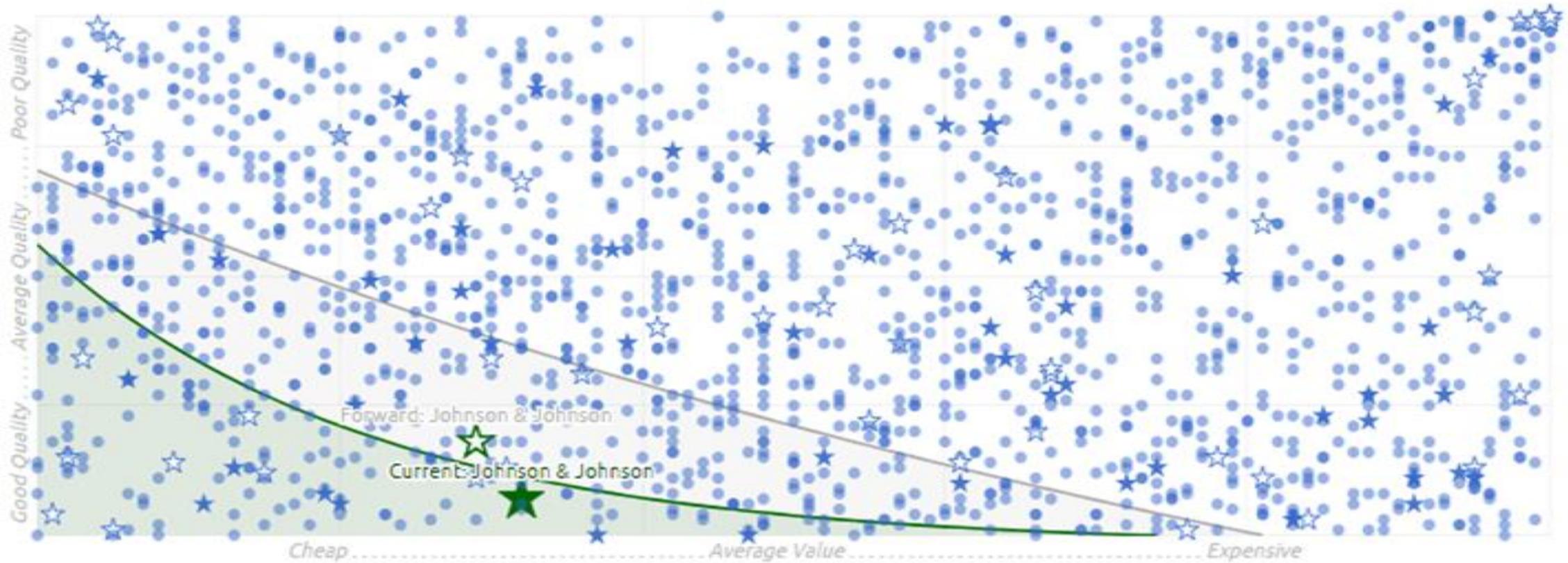
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Value is a trade-off:

Quality/Value Scattergram



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Value traps:

- It is a tool – not a religion
- Needs to change with accounting standards
- Value is always a trade-off
- Value is a bet on mean reversion
- Understand the sectors



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Value Outlook:

Positive Outlook for Value

- Growth catch-up
- Inflation rising
- Start/middle of inventory cycle
- More fiscal expenditure

Negative Outlook for Value

- China slowing
- Inflation moderating
- End of Inventory cycle
- Less fiscal expenditure



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Investment Outlook

Structural downturn lurking, acute or chronic?

Key positive factors

- Government stimulus
- Low probability of US tax hikes
- Earnings very good
- Inequality to increase

Other positive factors

- Bankruptcies limited
- Evictions limited
- Mortgage repayment holidays
- Wage growth very low
- Capital efficiency
- Low oil prices
- Vaccine hope
- Policy certainty
- Structural change in industries leading to cost efficiencies

Key negative factors

- Virus in Northern Hemisphere
- Valuation
- Latent bankruptcies
- Low genuine credit growth

Other negative factors

- Short term gap in US economic conditions
- Inequality longer-term effects
- Effects gradually rolling off
- Structural change in industries leading to weak demand
- Cycle
- Demand weak
- Australian stimulus badly targeted



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Viewer question of the week:

Will the rotation to value stocks last, or is the market just spinning its wheels?

Drop your answers in the comments



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