Value investing: rewarding confidence

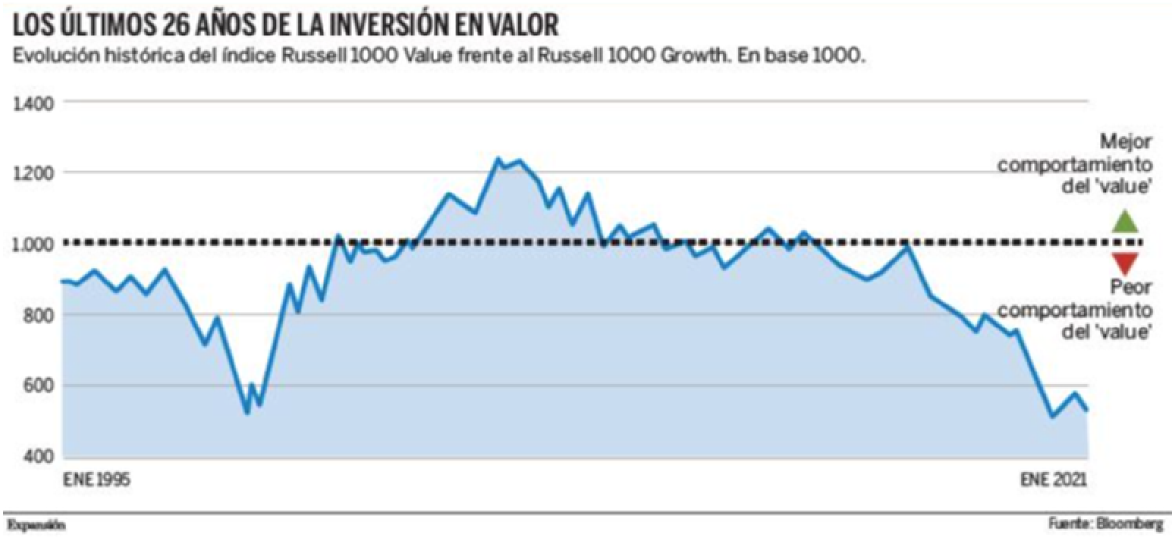
Expansión, September 4th, 2021

For nearly 13 years, value investors have been taking a beating, contrasting with the euphoria of growth investors. The last time this happened, things did not end well for the latter and the former were rewarded for their confidence.

Some of you may find it surprising that March 2000 levels have been registered (see attached chart). That moment went down in history as an unprecedented bubble among growth stocks, and now it seems we are watching the same thing happen all over again. At that time, growth stocks fell by 80% on average, coinciding with a threefold increase among value stocks. We are reminded of the fable of the hare and the tortoise.

In our opinion, part of the current decline among value stocks is to be expected, and a turnaround such as the one seen in 2000 is unlikely, as technological progress has made the products or the costs of these companies obsolete. Investors must steer clear of such companies, which, admittedly, is easier said than done.

We believe that, among value stocks, commodities will be the best forward-looking investment, because valuations are highly attractive at this time and the appeal has nothing to do with technological disruption. In this light, comparing the XLE Energy Index to the S&P 500 is revealing. We find the differences in valuation surprising, as the S&P 500 is trading 2.5 times higher in relation to generated cash, and the weighting of energy companies is 3% vs. the 15% weighting seen 10 years ago.



THE LAST 26 YEAR OF VALUE INVESTING

Historical performance of the Russell 1000 Value index vs. the Russell 1000 Growth index. Base 1000.

Fuente: Bloomberg = Source: Bloomberg

Mejor comportamiento del 'value' = Outperformance of value investing
Peor comportamiento del 'value' = Underperformance of value investing

Despite the green revolution underway, the economic importance of energy has not changed much in this time. If this assumption is scarcely reflected by the index, it may be due to other factors such as the rise of passive management, which spurred the performance of growth stocks, or the ESG movement, which has attracted nearly all net new money since 2020. Commodities have recently resumed their upward trajectory, although manufacturing stocks fell behind in the second quarter. Such phenomena are normally short lived, as history shows that movements of commodities are followed by upturns of manufacturing stocks in subsequent quarters. Although some might say that the solution is to buy commodity ETFs, we think the problem is not that simple. For example, copper has lost its appeal, as its price has doubled and its producers have increased their value sixfold from lows. Uranium has registered a 20% upturn, and the share prices of the companies that mine it have risen by 300% or more. However, there are other segments that are more appealing than ever and remain hindered by the pessimism that burdened copper and uranium just a few years ago. Dodging the more challenging possibilities while seeking better options is what real value investors are all about and is a strategy that is unavailable to an ETF.

Nonetheless, even if investors correctly guess which commodity will register an upturn, they may end up choosing the wrong company. In this sense, although oil companies have seen gains of nearly 100% from lows, players such as Gran Tierra and Afren have registered declines of over 80% during the same period. Despite the uptrend, the share prices of oil companies remain 60% below the highs seen in 2014. Looking to uranium, we see that Cameco has tripled, whereas Berkeley has lost 50%. We could cite many, many more examples but will only say that the lesson to be learned here is that investors must carefully study companies, their balance sheets, shareholder protection in each situation, regulatory risk, etc. Ultimately, there will come a time to sell the stocks of commodity companies. This aspect of portfolio turnover is just one sign of sound active management of value.

Although we have always told our clients that patience is the key to profitability, this advice must be tempered. The most severe downturns in value investing (such as those occurring between 1995 and 2000 and between 2017 and 2020) end up scalding some investors, leaving scars that will put their confidence to the test. Considering this, perhaps profitability has less to do with patience than it does with confidence, which is what investors will need if they wish to see anew the extraordinary returns that are historically associated with value investing. Taking all of this into account, we recommend choosing management teams that have repeatedly demonstrated their ability to navigate the many stormy seas of the investment world (some mentioned above) and confiding in them. Such teams can be found around the globe, and some work for Spain-based companies. All signs suggest that the sound results of the best value-investing strategists in 2021 are to be the first of several years of future returns in excess of the market.

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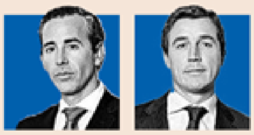

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