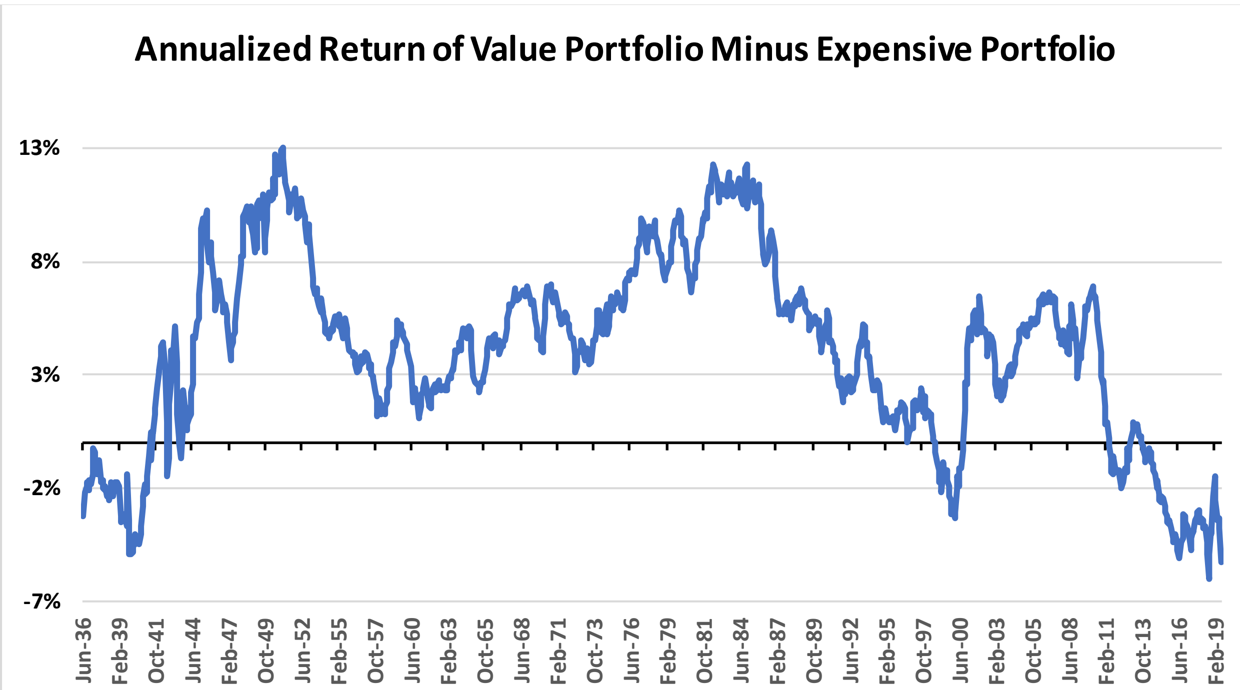
GLOBAL VALUE ADVISORS
A Division of Moody Aldrich Partners

# Investment Insight

## Where Are We In The Value Cycle – September 2019

By Philippe Rolland, Chief Investment Officer

GVA's first quarterly letter last year referred to the 10 year "value drought" we had gone through, where investing in low multiple companies had generated disappointing results. Over the past 15 months the relative performance of value stocks has deteriorated even further. The following graph illustrates the severity of that pattern and puts it into perspective:




Source Fama French. Rolling 10 year returns. Cheap 30% P/B – Expensive 30% P/B

When studying the US equity market monthly data over the past 83 years, value stocks have outperformed growth stocks 82.5% of the time on a rolling 10 year basis. This value premium has been identified across global markets and is well documented. Over the same period of study, only in 3 instances have growth stocks delivered better returns than value stocks: during the Great Depression, during the TMT bubble, and currently.

Since the financial crisis, the struggle of value stocks has been observed in most of the markets we cover. It has led to a significant widening of valuation spreads across markets to reach peak TMT bubble levels as illustrated by the following graph:

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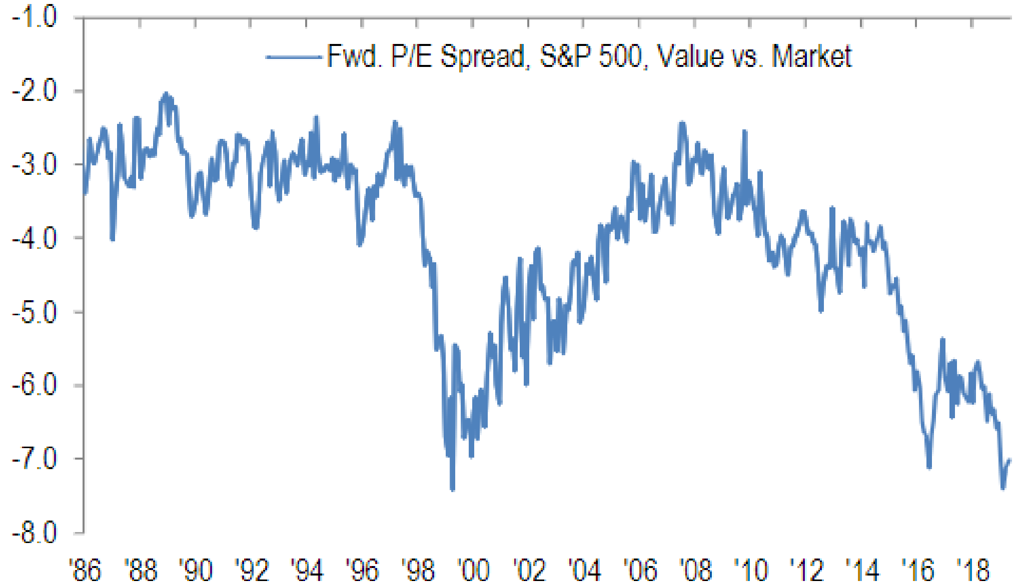


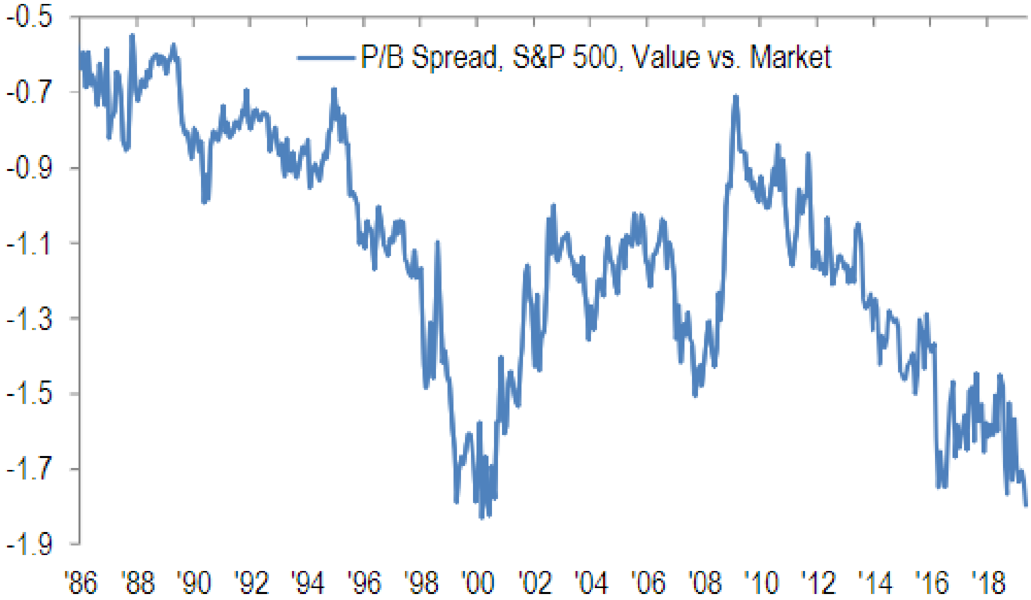


Source: J.P. Morgan US Equity Strategy and Quantitative Research

Top Quintile of S&P 500 stocks based on Sector Neutral Scores

Academics and strategists have drawn an extensive list of theories that explain this prolonged phenomenon (unorthodox central bank policies that lead to ultra-low interest rates, digital disruption, sub-par economic growth….). Rather than adding our voice to the debate, we prefer to explain why we believe our investment approach should hold its own if the current market dynamics persist and thrive if the value style regains some of the ground it has lost.

The main reason is that the value names we own are part of an exclusive club of companies that have a structural edge. We have identified the key attributes that they share: they rely on internal financing sources to run their operations, they return the unused cash to their shareholders, and they do not carry significant levels of debt on their balance sheet. The combination of high cash generation with disciplined capital allocation creates excellent businesses that outperform the others.

Our investment model back tests confirm that. Most importantly, the actual track record of our strategies have so far validated our thesis. Apart from the relative resilience of our portfolios in the face of another painful year for the value style, the most encouraging takeaway we made since their inception in June 2018 was to observe our strategies participate meaningfully in the two short-lived value rallies we have seen over the period: from August 2018 to December 2018 and from August 2019 to September 2019, during the extreme Value / Momentum reversal triggered by the global bond yields bounce back. In both instances, our portfolios delivered best in class returns versus benchmark and peer group as illustrated in the following chart:

| Absolute total return | Jun-18 to Sept-19 | Value rally #1 Aug-18 to Dec-18 | Value rally #2 Aug-19-Sep-19 |
|---|---|---|---|
| **GVA International Small strategy** | -9.7 | -11.9 | 4.6 |
| **Median peer (morningstar foreign small/mid value category)** | -12.1 | -14.9 | 3.7 |
| **MSCI ACWI ex USA Small cap index** | -9.6 | -14.6 | 3.2 |

| Absolute total return | Jun-18 to Sept-19 | Value rally #1 Aug-18 to Dec-18 | Value rally #2 Aug-19-Sep-19 |
|---|---|---|---|
| **GVA Global Equity Strategy** | 1.8 | -6.1 | 5.5 |
| **Median peer (Evestment Global Equity All cap)** | 0.2 | -7.4 | 2.6 |
| **MSCI ACWI** | 5.1 | -9.0 | 2.3 |

We welcome your comments or questions and thank you for your support.

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**Contact information**

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