

Value equities

VALUE EQUITIES: CHARTING A NEW COURSE

They say a picture paints a thousand words and this chart should give even the staunchest growth investor pause for thought.

Sometimes words are not enough; pictures are more powerful. In an industry dominated by data, charts can help investors to make sense of investment markets and assess their possible future trajectory. We spoke to the Artisan Partners U.S. Value Team who have crunched the numbers to create insights on value stocks and where they might go from here.

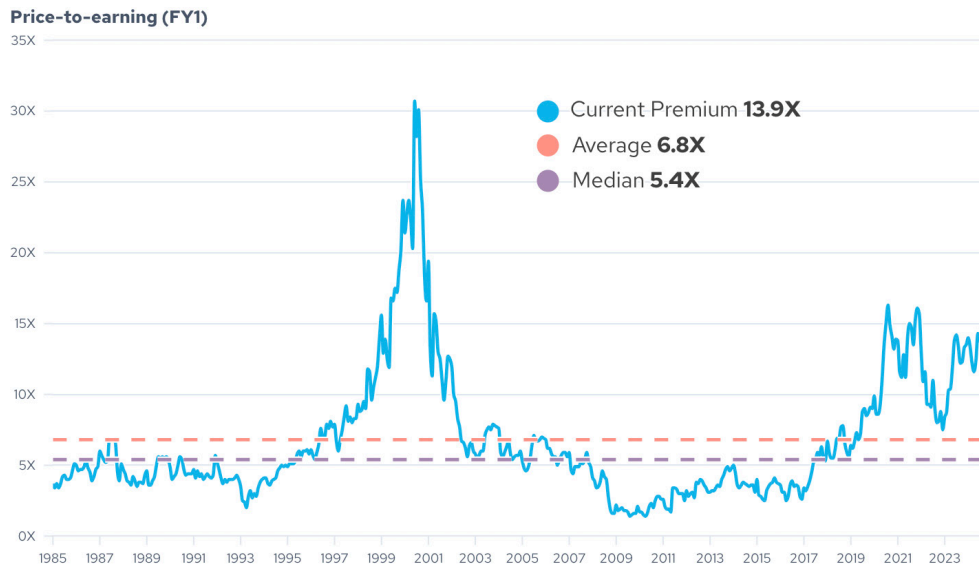
Premium for Growth at Multi-Decade High

Artisan Partners points to growth stocks rising disproportionately relative to their earnings growth since 2017, driving their valuations higher on both an absolute basis and relative to value stocks.

'We're ultimately stock pickers, but when we look at valuations between value and growth stocks at the index level, these spreads have re-extended to highly attractive levels,' said Craig Inman, a portfolio manager in its US value team.

Exhibit: Valuation Premium for Growth

P/E Spread (Russell 1000[®] Growth Index – Russell 1000[®] Value Index)



Source: Artisan Partners/FactSet/Russell. As of 31 Oct 2024. Price-to-earnings (FY1) ratio of the Russell 1000[®] Growth Index minus the price-to-earnings (FY1) ratio of the Russell 1000[®] Value Index. **Past performance does not guarantee and is not a reliable indicator of future results.**

With the Russell 1000 Growth index trading at nearly 32x next year's estimated earnings and the Russell 1000 Value at 18x, the valuation premium is almost 14 percentage points, as his chart above shows.

'Aside from the pandemic years, this is the largest since the tech bubble of the late 90s/early 2000s and significantly higher than the average and median of around 7 and 5 percentage points, respectively,' he said from Atlanta, Georgia.



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Craig Inman
Portfolio manager, US value team
Artisan Partners

The interest rate environment has also markedly changed. Gone are the days of rock-bottom interest rates and there being 'no penalty for aggressive investment strategies.'

'Even though we're still seeing pockets of animal spirits with AI and some of the momentum investing going on that is reminiscent of what happened in 2021 – and we saw how that ended in 2022 – we don't think this time is different,' said Inman.

'With interest rates higher today, there's a real cost of capital and a real hurdle in the market, and that tends to be a good environment for value investing.'

PSYCHOANALYSIS: MIND MATTERS

Take a seat on the psychologist's couch and step inside the minds of value investors – and those who create value opportunities.

One simple rule dictates Warren Buffett's approach to stock-picking: Be fearful when others are greedy and greedy when others are fearful. His investment philosophy is rooted in the principles laid out by his mentor, Benjamin Graham, who is considered the father of value investing.

The core idea is to invest in companies that are fundamentally strong but are trading for less than their true value. These companies often have a durable competitive advantage, solid financials, and competent management, but are temporarily out of favor and undervalued by the market.

Behavioral biases

To understand the mindset of a value investor, it is important to understand the behavioral biases that produce value investing opportunities in the first place.



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Dan Kane
Portfolio manager
Artisan Partners

Dan Kane, a portfolio manager on Artisan Partners' US value team, points to the human desire for comfort, which makes investors gravitate towards stock charts that paint a positive picture.

'Humans have a lot of characteristics that make us do less-than-desirable things,' he said. 'We're not totally rational. We're impatient. We're fearful. We're prone to overweight current events that we read about in the news. We're overconfident in our beliefs and our judgments.'

'Related to this is the idea of confirmation bias, that we're only seeking information that reinforces our existing beliefs about a company or an industry. Another bad habit is leaning on false precision, which is reinforced by our ability to operate spreadsheets. People make the mistake of thinking math can solve most of their issues.'

'Lastly, there's this idea of greed. I think that's pervasive in the stock market. It's at the intersection of these behaviors or bad habits of market participants where we find our margin of safety and can get involved in securities that have been beaten up.'

Rather than avoid bad news and uncertainty, value investors embrace it. 'Our experience has taught us that periods of turmoil, setbacks, disruptions, when fear is on the rise, are when bargains are created in the marketplace,' added Kane.

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