Four “Flavors” of Value for Equity Investors

Value stocks can be found in many areas of global equity markets, but four areas in particular are catching our attention.

Since the market hit its low in October 2022, we’ve identified emerging opportunities for value investors in four key areas. This is by no means an exhaustive list—there is still value to be found in other regions and sectors, too—but these areas are the ones currently piquing our interest.

1. UK: Retailers and Housebuilders

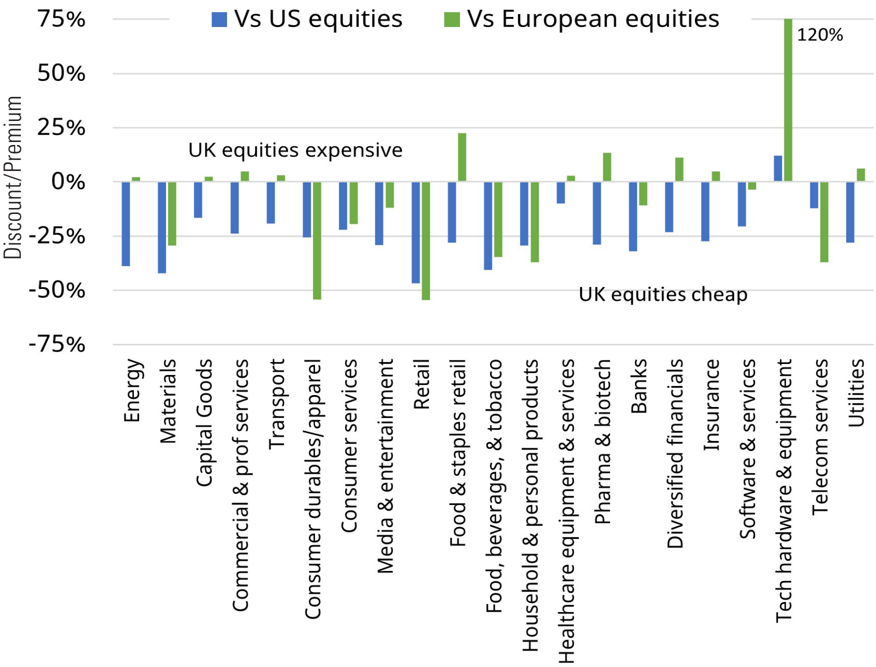
In 2022, UK mid-caps, and in particular retailers and housebuilders, sold off aggressively. The economic sensitivity of these businesses meant short-term recessionary fears dominated investor decision-making, which in turn meant share prices in these industries fell a long way.

For the homebuilders, there are likely to be challenges to short-term profitability. However, most companies in the sector have very strong balance sheets after years of high returns, which should help them weather a more difficult period.

Looking across the whole UK market (not just at mid-caps), it seems there is an additional discount for buying UK companies in most industries compared to their US counterparts.

FIGURE 1

UK Equities Valued at a Discount vs US Across Many Industy Groups



As of 1/31/23. UK prices relative to the US and Europe (premium = more expensive, discount = less expensive) based on forward price/earnings (P/E) multiples for industry groups in the MSCI UK Index, MSCI USA Index, and MSCI EMU Index. Autos and semiconductor sectors excluded as there are only two, and one, company in each UK industry group, respectively. Price/earnings is the ratio of a stock’s price to its earnings per share. See last page for index definitions. Source: Refinitiv DataStream and Schroders.

Insight from sub-adviser Schroders Investment Management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Key Points

- We’ve noticed value opportunities starting to emerge since the market reached a low in October 2022.
- Banks around the world are seeing significant profit growth after a decade in the doldrums, yet are still being neglected by investors.
- Share prices for some former growth darlings in Big Tech fell considerably last year, which makes them worth watching.

2. Europe: Banks and German Industrials

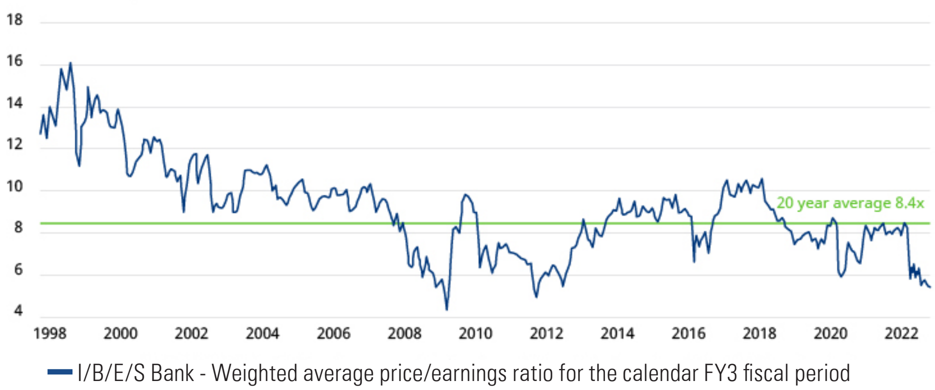
While Europe as a whole is looking attractively valued, we think there are even greater opportunities within the market. One example is European banks, which, on average, are trading at multiples well below their 20-year average, so it's easy to see why we've gone fishing there.

Banks are growing earnings and remain out of favor; that's the kind of combination we like.

FIGURE 2

Pan-European Banks Trade Well Below 20-Year Average

Pan-European banks 3-year forward P/E absolute



Source: Refinitiv DataStream and Schroders as of 9/30/22.

Banks around the world are seeing significant profit growth after a decade in the doldrums. Today, they are growing earnings and are returning capital to shareholders as a result of real balance-sheet strength. They also remain out-of-favor with most investors. That's the kind of combination we like, and we continue to hold a number of the most attractive banks.

Elsewhere in Europe, we have seen a number of German industrial businesses come onto our screen in the second half of the year. With Germany's reliance on Russian energy, wider economic uncertainty, lower forecast order numbers, and supply-chain squeezes, its industrial sector has seen larger share price falls than elsewhere.

Nonetheless, we can still find businesses with structurally growing end markets that have delivered high single-digit revenue growth every year for a decade, have well-capitalized balance sheets, and still trade at a wide discount to our estimates of fair value.

3. Emerging Markets: "China, China, China"

Regulatory crackdowns, political worries, a property-market crash, extended zero-COVID-19 policy, and weakening GDP data led many investors to flee mainland companies in China. This caused the Chinese stock market to fall far from the heights reached in 2019/2020. The market fell far enough that our valuation screen has been throwing up an abundance of Chinese businesses across a broad range of industries for our emerging-markets value portfolio managers to examine.

Outside of China, financials are also screening as attractively valued, notably in Kenya and Argentina.

4. Global: Chinese, US, and Japanese Cyclicals, US Technology

China has also been a key area of research focus for our global value portfolio managers.

Elsewhere, a number of US and Japanese cyclicals are beginning to flash on our screen because they look very cheap, especially in the memory and semiconductor space.

We have done a significant amount of work on the memory chip sub-sector, looking at a number of the major global players. This comes after a fall in share prices owing to a sudden decline in memory demand and the change in cost structure of the various memory mediums.

Memory businesses are very cyclical but are likely to grow over time, make decent returns on capital, and have reasonable balance sheets.

Finally, as many investors know, large-cap US technology struggled in 2022. Between rising interest rates and some idiosyncratic factors, the share prices of a number of these former growth darlings fell considerably. Some of their share prices are beginning to approach realms that pique the team's interest. As such, we're keeping a close eye on them.

We're keeping a close eye on some former growth darlings.

For more value investing ideas, please contact your financial professional.

MSCI EMU Index captures large and mid cap representation across the 10 developed markets countries in the European Monetary Union. With 229 constituents, the index covers approximately 85% of the free float-adjusted market-capitalization of the EMU. Indices are unmanaged and not available for direct investment.

The MSCI UK Index is designed to measure the performance of the large and mid cap segments of the UK market.

The MSCI USA Index is a free float-adjusted market cap Indices are unmanaged and not available for direct investment.italization index that is designed to measure the performance of the large and mid cap segments of the US market.

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