Value Insights – January 2021

Lingohr & Partner Asset Management GmbH

IDENTIFYING VALUE

A year to forget with lessons to remember

Professionally and personally 2021 will be one of the most unique years in our lifetimes. We have arrived at it after witnessing market volatility last seen almost 100 years ago during the Great Depression due to the unprecedented uncertainty faced by Covid-19. In addition, we witnessed a presidential election in the U.S. which continues to feel surreal. Now, at the beginning of 2021, we review 2020 with some **key takeaways** we felt interesting enough to share.

- Some market (re-)actions or positioning can't be explained by logic or fundamentals.
- Unexpected things happen all the time – be prepared for the unexpected.
- There is always a new pitch to swing at.
- Most companies' fundamentals are more resilient than we expect.
- Perfect tailwinds become headwinds and vice versa.
- There is something positive in all moments of life and crises are a perfect environment for innovation and advancements – personally as well as for society and corporations.

In the short-run, markets are driven by uncertainty and stories while in the long-run we are convinced that company valuations are driven by their ability to generate cash flows. Buying and selling during a time where valuations appear meaningless are bound to be driven by sentiment and stories. With uncertainties dissipating, valuations will become inherently more meaningful as visibility increases.

In the recent months, a lot of uncertainty and a lot of questions have been answered which inherently carry positive incentives for value like stocks. The most important **catalysts** included:

- Vaccines: Multiple Covid-19 vaccines have been approved and are being rolled out globally, benefiting from emergency authorization programs of governments. While Covid-19 is far from being beaten and uncertainty about the exact "when" exists, the path towards normalization seems paved.
- US Elections: While turmoil still persists, we expect an improvement of US-foreign relationships and perhaps the world with a more stable, predictable government. A potential decrease in trade-war sentiment could further decrease the stress on wide segments of the economy. In addition, the Democratic senate majority should lead to easier decision making in Washington helping to implement Joe Biden's policies.
- The Brexit deal is worked out, reducing uncertainties in Europe.
- The US treasury yields have begun increasing from 2020 lows, which typically provides value with strong tailwind. In addition, we continue to see inflation forwards increasing in the U.S. which could lead to continued increase in bond yields if it persists.

Despite all the events and continued questions surrounding the long-term impacts of Covid-19 – as well as the largest underperformance of value vs. growth on record – we want to emphasize that we stick to our belief that a long-overdue Value rotation is on its way. From our perspective, it will also be a prolonged one as we continue to see the right events unfolding. The following arguments should be the basis for a **sustained value cycle** which is here to stay:

- The value growth divergence remains extreme on all accounts. Growth had its strongest year versus value in history, resulting in extreme valuation dispersions: value as a whole remains cheap on absolute numbers, relative to its own history while massive valuation gaps to other investment styles such as growth and quality persist. Value companies remain highly attractive - irrespective of metric but in aggregate also show solid quality characteristics and cash generation abilities.
- At the same time, our value basket shows in excess of 25% EPS growth estimates for the current year coupled with continued positive EPS revisions. A cyclical recovery combined with reflation should lead to a tremendous tailwind (historically it has been the best environment for value strategies) for value stocks due to our extreme low valuation.
- Furthermore, positioning continues to be extreme in the growth/story-driven baskets. While there have been value inflows in Q4 2020, positioning is far from what it could be.
- Competition in high-tech space is increasing drastically, evident by the significant number of companies entering the E-Car space, while at the same time there is a strong consolidation in some value sectors, increasing the piece of the pie for the remaining players.

In the long run, companies are bound by their fundamental development and triple-digit price-earnings ratios require massive changes to take place in order to justify them – the risk that not fulfilling these expectations would lead to a multiple normalization and large losses for shareholders shouldn't be underestimated. Their actual yield lies far in the future. On the other hand, currently "cheap" companies are adapting to this environment and can be expected to revalue in addition to providing actual, real yields.

At the end of the day, we believe that valuations carry a lot of information for future performance – these remain as attractive as ever and any reductions in uncertainty and or even a return to normalcy would provide these with a massive boost.

We remain optimistic and as always continue to stay true to our investment style.

Sincerely,

Goran Vasiljevic & Team

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