

Value and Realindex in January 2020

Introduction

Following a long run of underperformance of value against the cap-weighted benchmark and against growth, it is disappointing to report that January 2020 was an exceptionally bad month for value.

As has been the story for a while now, stocks which look very expensive have run strongly in January with renewed optimism around global economic growth and reduced geo-political uncertainty. This has been reflected in growth sectors like IT and Health Care, which look very expensive on all of our measures. Also, we see it in countries which are heavily biased towards these metrics, most notably, the US. We are quite deliberately underweight in these as we believe their fundamentals do not reflect their market valuations.

Stocks we view as expensive (based on Price to Book, Price to Sales, Price to Cash flow and Dividend Yield) such as Microsoft, Amazon and Tencent have run strongly in January as well. At the same time, stocks we view as cheap, based on the valuations mentioned above, have sold off somewhat, but the balance of drivers for January has been heavily weighted towards the movement of the expensive stocks.

In the note below, we give more details on the performance in January 2020. There are several sections:

- Firstly, we look at **the movement of Value against Growth indices over the last 12 months**. We use broad market benchmarks of Value and Growth – for Developed Markets (“DM”) and Emerging Markets (“EM”) we use MSCI style indices, and in Australia we use the S&P 200 style indices. (There are no formal Australian small cap value or growth indices so we report ASX 200 style indices instead.)
- Secondly, we look at **valuations of the different stock universes**, at the current time in a snapshot and also through time. Here we split out Australia Large and Small cap, as we have separate strategies for both.
- Next we look at the **performance of our alpha factors** in January 2020, across the main families of growth, momentum, quality and sentiment, and especially those of the near term value category.
- Then we look at **book yield and its valuation spread through time** to illustrate how stretched valuations are, especially in North America.
- Finally, we conclude with a more detailed **breakdown of fund performance** by sector, region/country and stock.

Value vs. Growth in January 2020

Growth has consistently outperformed value over the last 12 months, especially since July 2019. January 2020 has seen very large moves in both styles: for example, DM value underperformed Growth by 4.9% and is now 16.6% behind over 12 months, EM Value underperformed Growth by 4.3% and is behind 16% over 12 months, Australian Value underperformed by 1.7% for the month and is behind 9.1% over the past year. Clearly, the level of underperformance is quite extraordinary. However let’s not lose sight of the fact that despite the underperformance, both Global and Australian Value, and our portfolio returns, are double digit returns over the last year¹.

As at 31 Jan 2020 Value and Growth Performance (%)

		1m	3m	6m	1y	3y p.a.	5y p.a.	10y p.a.
Australia	S&P ASX 200 Value	4.1	2.4	1.8	19.7	7.7	6.4	7.2
	S&P ASX 200 Growth	5.9	9.4	7.9	28.8	16.4	11.4	10.1
	Value vs. Growth	-1.7	-7.0	-6.1	-9.1	-8.8	-5.0	-2.9
Global (Developed + Emerging Markets)	MSCI AC World ex AU Value	1.4	4.7	7.4	18.3	11.2	9.3	10.3
	MSCI AC World ex AU Growth	6.2	11.2	14.0	34.8	20.6	14.5	14.4
	Value vs. Growth	-4.8	-6.5	-6.6	-16.6	-9.3	-5.2	-4.1
Developed Markets	MSCI World ex AU Value	1.9	5.1	8.2	20.1	11.5	9.7	11.0
	MSCI World ex AU Growth	6.8	11.6	14.4	36.7	21.2	15.1	15.2
	Value vs. Growth	-4.9	-6.5	-6.2	-16.6	-9.7	-5.4	-4.2
Emerging Markets	MSCI EM Value	-2.1	2.0	1.5	5.2	9.0	5.5	4.8
	MSCI EM Growth	2.2	8.5	11.4	21.2	15.9	9.8	8.6
	Value vs. Growth	-4.3	-6.5	-9.9	-16.0	-6.9	-4.3	-3.8

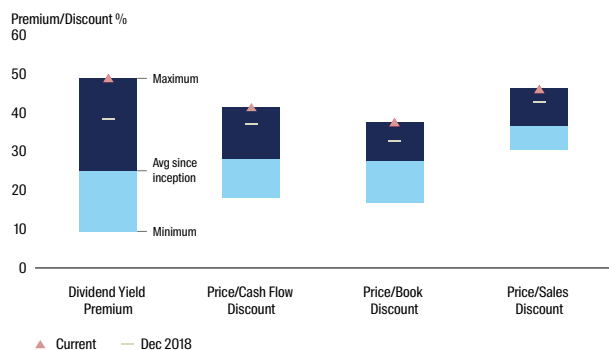
Source: S&P, FactSet.

¹ Please refer to the performance table in the Fund Performance section of this paper. Past performance is no indication of future performance.

Valuation Metrics Premium/Discount

Below we see relative valuation measures at the end of January compared to history, across the four universes of interest to us. Global and EM are at or near the top of their historical premia/discounts and Australian large cap is above median. Further, the trend has been more or less constantly towards premium or discount with time (with Australian small cap being more muted).

Realindex Global Shares Valuation Comparison vs. MSCI AC World ex AU



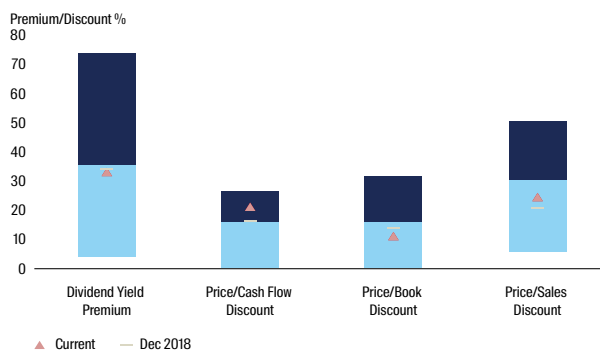
Realindex Australian Shares Valuation Comparison vs. S&P ASX 200



Realindex Emerging Markets Valuation Comparison vs. MSCI Emerging Markets



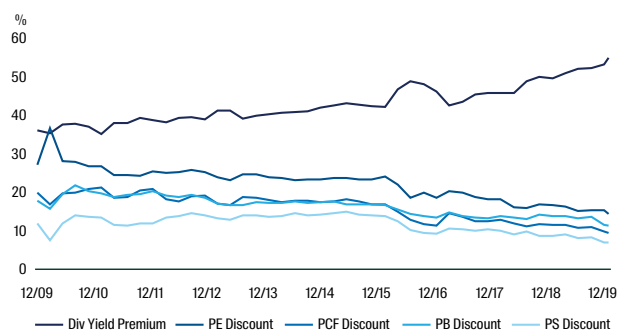
Realindex Australian Small Companies Valuation Comparison vs. S&P ASX Small Ordinaries



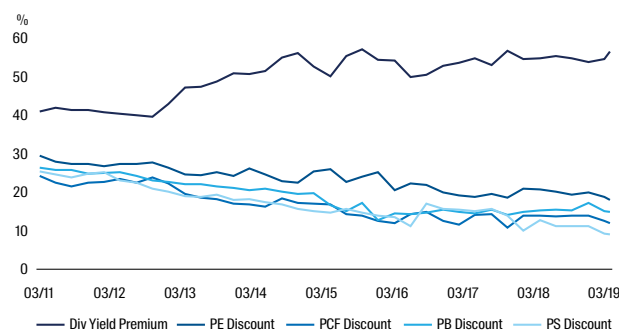
Source: Realindex, FactSet, data as at 31 January 2020. The Realindex Global Shares Valuation refers to the Realindex Global Shares Fund – Class A. The Realindex Emerging Markets Valuation refers to the Realindex Emerging Markets Fund – Class A. The Realindex Australian Shares Valuation refers to the Realindex Australian Shares Fund – Class A. The Realindex Australian Small Companies Valuation refers to the Realindex Australian Shares Fund – Class A. Historical data for the Realindex Global Shares, Realindex Australian Shares and Realindex Australian Small Companies begins 31 December 2008. Historical data for the Realindex Emerging Markets begins 31 March 2011.

The charts below show the same data through time, as at 31 January 2020.

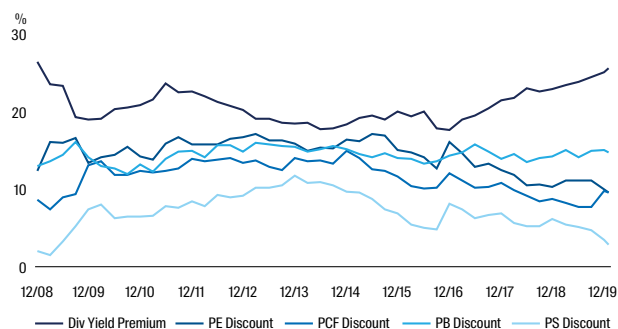
Value Measure Premium/Discount (Portfolio v Benchmark): Global



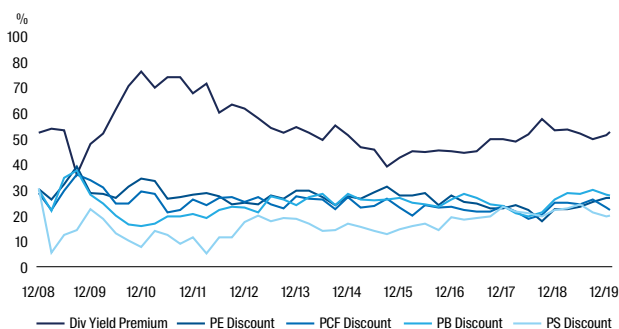
Value Measure Premium/Discount (Portfolio v Benchmark): EM



Value Measure Premium/Discount (Portfolio v Benchmark): Aust Large



Value Measure Premium/Discount (Portfolio v Benchmark): Aust Small



Source: Realindex, FactSet, data as at 31 January 2020

Alpha Factors

Our alpha factor measures for January 2020 (excluding Value) are in the Table below. It indicates that these measures have uniformly performed very well, with the standouts being growth and momentum in EM, momentum in North America and the UK, and momentum and sentiment in Australia (especially large cap).

EM factor performance in growth, momentum and sentiment has been exceedingly strong in January 2020, and is the standout performer in global shares. However, the DM components of Global have also been strong. Interestingly, quality, a signal we also use has much more muted performance than growth and momentum/sentiment.

Alpha Factor Measures, January 2020

Universe	Segment	Growth	Momentum	Quality	Sentiment
ASX_200		1.13%	2.20%	0.13%	2.62%
ASX_SML		0.21%	2.08%	0.82%	0.85%
DEV		1.71%	2.54%	0.56%	1.86%
DEV_SML		1.47%	3.24%	0.83%	1.63%
GLOB		2.32%	3.38%	0.16%	1.54%
GLOB.Region	Developed Asia	0.06%	0.89%	0.68%	-0.24%
	Emerging Markets	2.97%	3.47%	-0.60%	1.38%
	Europe	2.16%	0.77%	0.63%	1.31%
	Japan	0.47%	0.96%	0.55%	1.41%
	North America	1.93%	3.62%	0.35%	2.02%
	UK	0.40%	5.55%	1.62%	3.39%

Source: Realindex, FactSet, data from 1 January 2020 to 31 January 2020. Factors are an equal weighted composite of a number of underlying Realindex signals. Returns are the average of long the top 20% and short the bottom 20% of stocks in each relevant signal.

However, as we can see below, value factors (across all categories) have had a terrible performance in January. Forward value (the forecast for the next 12 months) has done worse than trailing value (based on the most recent financial statement data), but the overall picture is one of a large continued negative performance of any value in January – indeed over the last three months. The universe here is MSCI All Country World Index (“ACWI”).

ACWI – Value factors for January 2020

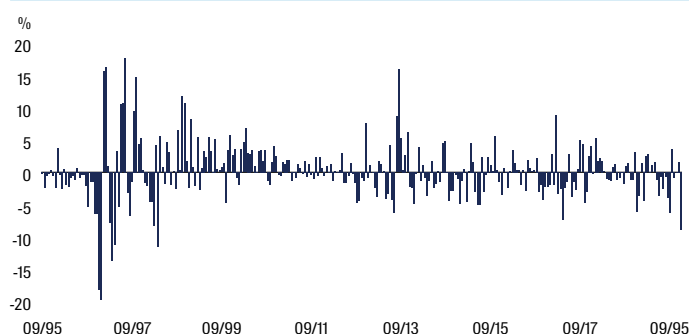
Sub-Category	Factor	1M	3M
Forward	Cash Flow Yield Next 12 Months	-10.03%	-9.73%
Trailing	EBITDA/EV	-9.60%	-8.44%
Forward	EBITDA/EV Next 12 Months	-9.58%	-7.16%
Forward	Book Yield Next 12 Months	-9.11%	-8.22%
Forward	Earnings Yield Next 12 Months	-9.02%	-6.81%
Trailing	Book Yield	-8.87%	-7.54%
Forward	Sales Yield Next 12 Months	-8.53%	-7.34%
Trailing	Sales Yield	-8.39%	-7.26%
Trailing	Operating Cash Flow Yield	-7.65%	-6.63%
Trailing	Earnings Yield	-6.88%	-5.61%
Forward	Dividend Yield Next 12 Months	-6.53%	-7.58%
Trailing	Dividend Yield	-5.94%	-5.95%
Forward	Free Cash Flow Yield Next 12 Months	-5.28%	-3.57%
Trailing	Free Cash Flow Yield	-4.26%	-3.73%

Source: Realindex, FactSet, data as at 31 January 2020.

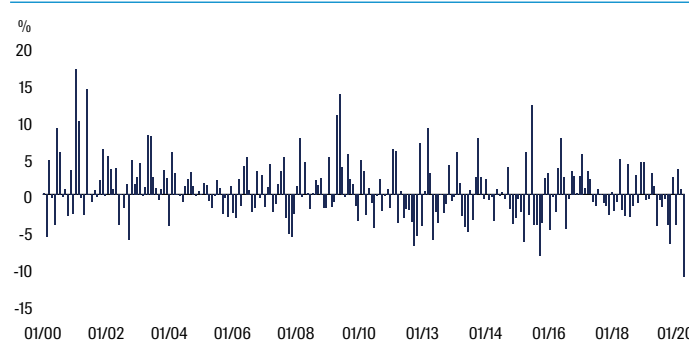
Book Yield (“BY”) and BY Spread

Book yield continues to be very poor, with last month's book yield factor return for ACWI and EM being the worst since the Technology, Media, Telecom (TMT) rally of the late 1990's in ACWI. The story is not as bad in Australia.

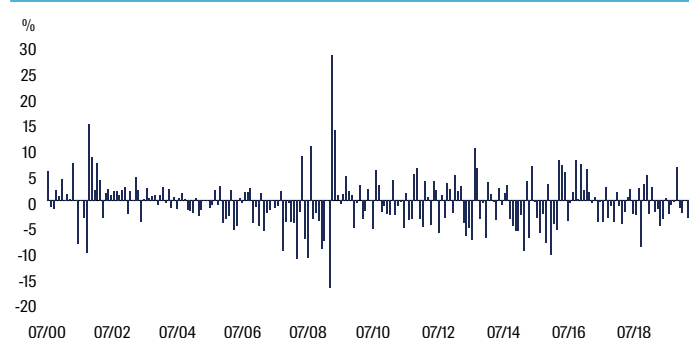
ACWI XAU Book Yield - Monthly Factor Returns



EM Book Yield - Monthly Factor Returns



AU Book Yield - Monthly Factor Returns



Source: Realindex, FactSet, data as at 31 January 2020.

One telling chart is the spread of BY (P/B of bottom quintile minus the top quintile) in the North America region within ACWI. As we can see, January 2020 is the widest we have on our records and the spread has widened steadily since 2010, driven by Growth stocks getting more and more expensive.

North America Price/Book spread (Cheap Quintile - Expensive Quintile)



North America Price/Book of Cheap Quintile



North America Price/Book of Expensive Quintile



Source: Realindex, FactSet, data from 31 January 1995 to 31 January 2020

Fund Performance

Fund performance has tracked the poor performance of Value, although one positive we take is that our funds have convincingly beaten the value benchmarks' performance over the longer term.

As at 31 Jan 2020 Gross Performance (%)

		1m	3m	6m	1 year	3 years p.a.	5 years p.a.	7 years p.a.	10 years p.a.	Since inception p.a.
Australian Shares	Realindex Australian Share*	3.89	4.58	3.69	22.87	10.98	9.43	10.04	9.29	11.46
	S&P ASX 200 Value	4.14	2.39	1.84	19.66	7.66	6.37	7.25	7.17	N/A
	Relative performance	-0.25	2.19	1.85	3.21	3.32	3.06	2.79	2.12	N/A
Australian Small Companies	Realindex Australian Small Companies*	2.12	3.63	4.56	19.99	10.85	13.88	11.43	10.19	13.06
	ASX Small Cap Value	2.76	3.53	3.68	17.33	10.05	10.37	7.87	6.73	8.00
	Relative performance	-0.64	0.10	0.88	2.66	0.80	3.51	3.56	3.46	5.06
Global Shares	Realindex Global Share*	0.98	4.54	7.79	17.77	12.52	10.31	14.47	10.95	10.52
	MSCI All Countries World ex Australia Net Index Value	1.41	4.72	7.36	18.25	11.21	9.27	13.59	10.29	9.07
	Relative performance	-0.43	-0.18	0.43	-0.49	1.31	1.04	0.88	0.66	1.46
Emerging Markets	Realindex Emerging Markets**	-2.69	2.08	1.98	4.75	9.86	7.92	8.01		5.50
	MSCI Emerging Markets Net Index Value	-2.08	2.00	1.45	5.20	8.98	5.51	6.53		4.02
	Relative performance	-0.61	0.08	0.53	-0.45	0.88	2.41	1.48		1.49

*Inception: 17 November 2008, **Inception: 20 January 2011. Past performance is not indicative of future performance. Source: FSI.

January 2020 Realindex Global Share Stock hit rate: 42% positive only

	1m Return Jan-20 (%)
Realindex Global Share - Class A (Gross return)	0.98
MSCI AC World ex AU Net	3.82
Relative performance	-2.84
	1m Relative Contribution (%)
Region North America	-1.60
Region Emerging Markets	-0.53
Sector IT	-0.54
Sector Consumer Discretionary	-0.53
Stock Microsoft	-0.14
Stock Amazon	-0.14

Source: Realindex, FactSet, Past performance is no indication of future performance.

January 2020 Realindex Emerging Markets Stock hit rate: 41% only

	1m Return Jan-20 (%)
Realindex Emerging Markets - Class A (Gross return)	-2.69
MSCI EM Net	0.11
Relative performance	-2.80
	1m Relative Contribution (%)
Country China	-1.67
Country South Korea	-0.61
Sector Financials	-0.74
Sector Industrials	-0.36
Stock Tencent	-0.18
Stock Alibaba	-0.11

Source: Realindex, FactSet, Past performance is no indication of future performance.

January 2020 Realindex Australia Share Stock hit rate: 39% only

	1m Return Jan-20 (%)
Realindex Australian Share - Class A (Gross return)	3.89
ASX 200	4.98
Relative performance	-1.09
	1m Relative Contribution (%)
Sector Health Care	-0.56
Sector Industrials	-0.32
Stock CSL	-0.43
Stock Qantas	-0.14

Source: Realindex, FactSet, Past performance is no indication of future performance.

Conclusion

We would very much like to be telling a more positive story about the month that just passed, but growth stocks have run very strongly in January and value has not. Valuation spreads sit at or near all-time highs in Global and EM, although the spreads are not so extreme in Australia.

All alpha factors except value have had a strong January, albeit quality was very benign versus growth and momentum and any value factor we examine has done poorly over the same time period. There is little disparity – value down, all else up.

Our fund performance has obviously correlated with the performance of the value factors, although our investment strategies have mitigated the raw factor performance so that our Global, EM, Aussie Large and Small strategies have outperformed their value index equivalents over the long term. From this, we take

away that while value has had a tough time, our IP in data management, factor construction, alpha models and portfolio construction have cushioned the fall considerably.

We retain very high conviction that the Realindex value factor-based strategy is a strong long term performer, despite the recent performance. If anything, our conviction is strengthened by the extreme valuation spreads we see and the extreme valuation multiples of certain stocks, sectors and regions/countries.

That said, we believe a simple value index, which does not embed best of breed IP into its alpha and accounting factors, data structure and portfolio construction, is too simple a process to counteract much of the headwind that value factors have been facing.

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