

A Value Renaissance

by Mark Wright

The Renaissance marked the transition from Middle Ages to modernity in 15th and 16th century Europe. A fairly significant event! We now appear to be witnessing another renaissance – a Value Renaissance. Whilst probably not as significant in the history of world civilisation, similarities do exist in the origin of the two.

The European Renaissance began after the Crisis of the Last Middle Ages, a series of catastrophes that rocked Europe, including the Great Famine and infamous pandemic – the Black Death. Combined, these reportedly wiped out half of Europe's population¹. Whilst still tragic for too many, thank goodness Covid-19 has not proved as deadly!

A little over 6 months ago on Monday 9th November, US pharmaceutical giant, Pfizer, and German based, BioNTech, announced successful results from a Phase 3 study of their vaccine with more than 90% efficacy against the Coronavirus.

This led to the biggest reversal in fortune for value versus growth in a long time. On the day of Pfizer and BioNTech's announcement, value outperformed growth by 4.4% on a global basis – a 10-sigma event ; or in other words, a level of outperformance not even expected to occur once every billion years² (the Earth was formed 4.5 billion years ago). This, of course, assumes returns are normally distributed, which they are not, but I'll leave that for another day.

Aside from brief periods of modest outperformance as the global economy emerged from the fallout of the Global Financial Crisis and then again from the depths of the European Sovereign Debt Crisis, value has not trumped growth since the mid-noughties.

For the best part of a decade, growth has outperformed value, supported by a global experiment conducted by central banks in which many savers have been charged for depositing cash (negative interest rates) and government spending is supported by the money printing presses (quantitative easing). This outperformance of growth versus value accelerated in 2019 and 2020, leaving global growth stocks a staggering 134% ahead of global value stocks over the decade prior to the Pfizer/BioNTech vaccine news.

Why can we be so confident that it's values time to shine?

Firstly, just as the sacking of Tony Dye at Phillips & Drew Fund Management in March 2000 served as the canary in the coal mine for the collapse of the Dot Com boom, several high-profile value managers were fired, left the industry or chose to close shop last year.

US based, value focussed AJO, announced it was shutting its operations on 31st December 2020, not that long after Mark Barnett lost the mandate to manage the Edinburgh Investment Trust and Keystone Investment Trust due to underperformance. Famously contrarian and value oriented, Alastair Munday, also threw in the towel and exited the industry to pursue a career in teaching.

Secondly, value had underperformed growth for so long, it quite simply had to end at some point – it could not have continued forever. Extreme moves in the prevailing direction of a trend usually precede a reversal of that trend and that is exactly what we witnessed last year – two thirds of the outperformance of growth came through in just 10 months of 2020 prior to the Pfizer/BioNTech vaccine announcement.

Thirdly, it has been observed that value as a factor typically performs strongly during periods when government bond yield curves are steepening i.e. when the yield on 10 year government debt minus the yield on 2 year government debt is increasing, and they have been doing just that for over a year now. Crucially, they are not yet as steep as they have been in past cycles, suggesting a supportive backdrop for value investors for some time to come.

Lastly, we are witnessing it first-hand in the funds we manage on your behalf. The direct UK equity portfolio in our UK domiciled funds has a value bias and has rallied over 50% post the positive vaccine news which compares to a mere 17% gain for the FTSE All Share . Similarly, many of the value oriented third party equity managers that we invest in have sharply outperformed regional benchmark indices.

The value rally won't last forever, but whilst it does, we intend to enjoy the ride.

¹ https://en.wikipedia.org/wiki/Crisis_of_the_Late_Middle_Ages

² https://en.wikipedia.org/wiki/68%E2%80%939395%E2%80%939397_rule



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