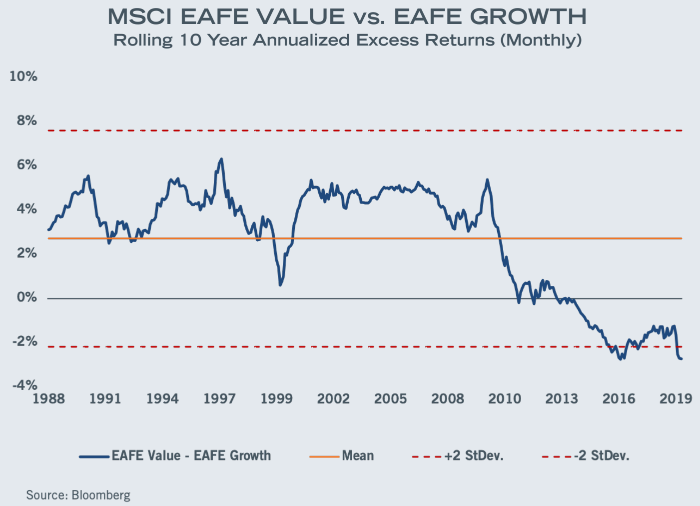
IN FOCUS

VALUE VS. GROWTH

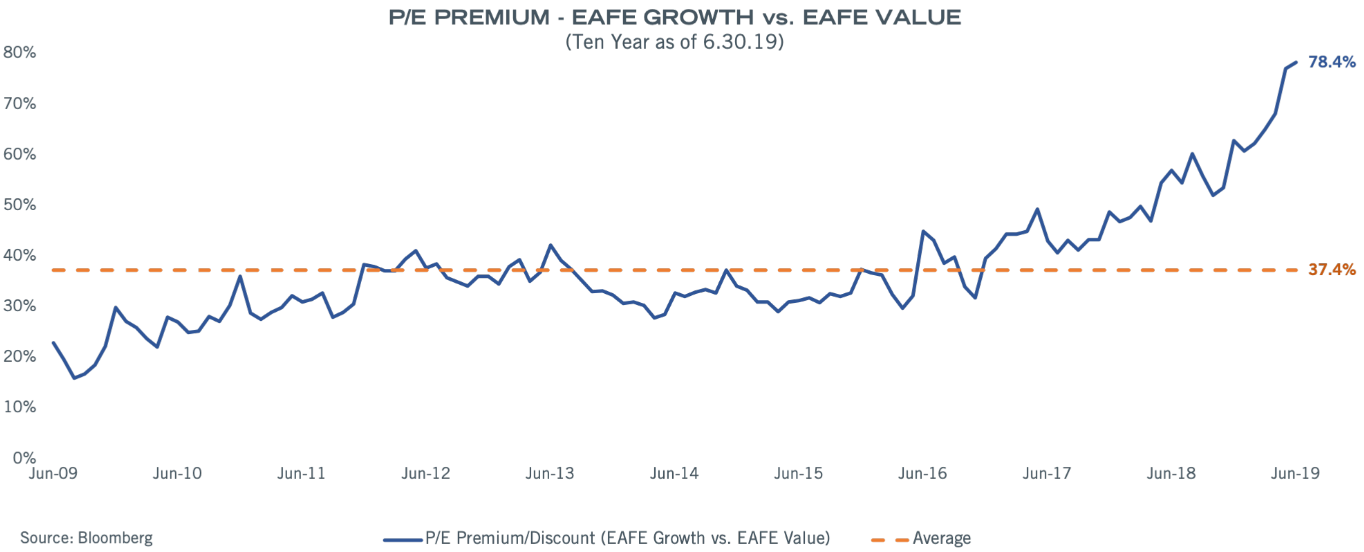
AN INTERNATIONAL PERSPECTIVE

CAMBIAR INVESTORS

The outperformance of growth versus value within the global equity markets has been one of the more intriguing aspects of the current market cycle. Given Cambiar's relative value discipline, it has also been one of the most frustrating. But, as the graphs illustrate, there is simply no question about the magnitude of the phenomenon—value is trading at a massive discount to growth, and the gap has been caused by the outperformance of growth stocks.



There are a few key factors that we believe are driving the phenomenon. The first is the combination of cheap money and weak economic growth relative to historical recoveries and expansions. In effect, the scarcity of economic growth we feel favors stocks with "endogenous" growth. In other words, the market is discounting stocks that are dependent on the level of economic activity for earnings to grow, while simultaneously bidding up those companies that do not depend on economic growth, but rather secular trends to propel earnings.



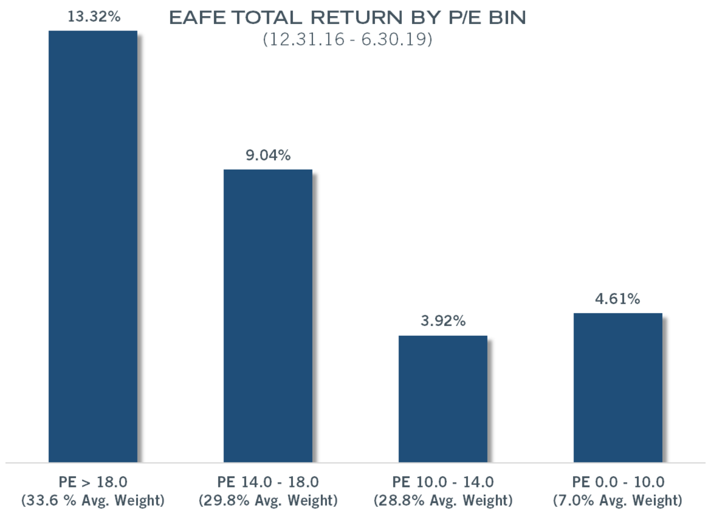
The cost of capital clearly matters as well, in that it drives the discount rate used to value future earnings; in effect, the lower the discount rate, the higher the multiple that can be used on out-year earnings. As such, growth companies with low (or negative) earnings today can still garner large valuations on future earnings. Value companies are likewise punished for lower growth rates and more economically-sensitive earnings streams.

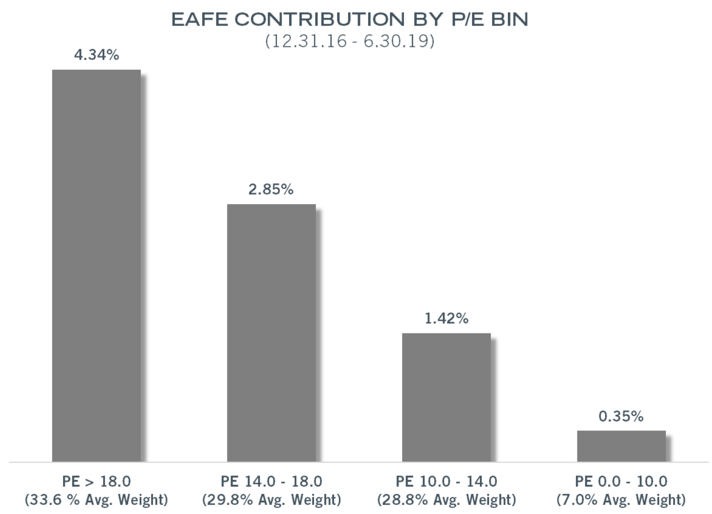
To some degree, we believe disruptive technologies are also playing a role in the growth vs. value divergence; the disrupters generally tend to be in growth industries, while many of these new technologies cause headaches for large numbers of value companies. The most relevant example is the business impact that Amazon has had on traditional brick-and-mortar retail.

Lastly, indexation and the rise of passive investment strategies have also contributed to the outperformance of growth stocks – if only due to the fact that performance drives flows, and as the big winners grow in size and index representation, they are a subsequent beneficiary of larger and larger passive flows.

RICH VALUATION DRIVING RETURNS

Since 2017, there has been a greater preference for stocks in the highest P/E segment, with this section of the index returning 13.32%. This resulted in 4.34% of the 8.94% total contribution, almost 50% of the index returns.





Source: Bloomberg

Cambiar has long believed that the phenomenon of mean reversion can work to investors' advantage. The market periodically makes mistakes, often extrapolating near-term positive or negative events into long-term trends. The opportunity for investors is the ability to identify investment opportunities whereby a very temporary (and fixable) problem is deemed to be a terminal headwind by the market. Such types of situations can be extremely profitable if one is able to benefit from both an earnings recovery as conditions normalize as well as an accompanying upward revaluation of the equity. This "extrapolation" issue can happen at the market level as well; for example, the last time we got to these extreme levels of discrepancy between growth and value was at the height of the tech bubble in 2000. The reversion to mean process that followed in subsequent years was indeed quite painful for the owners of growth stocks.

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