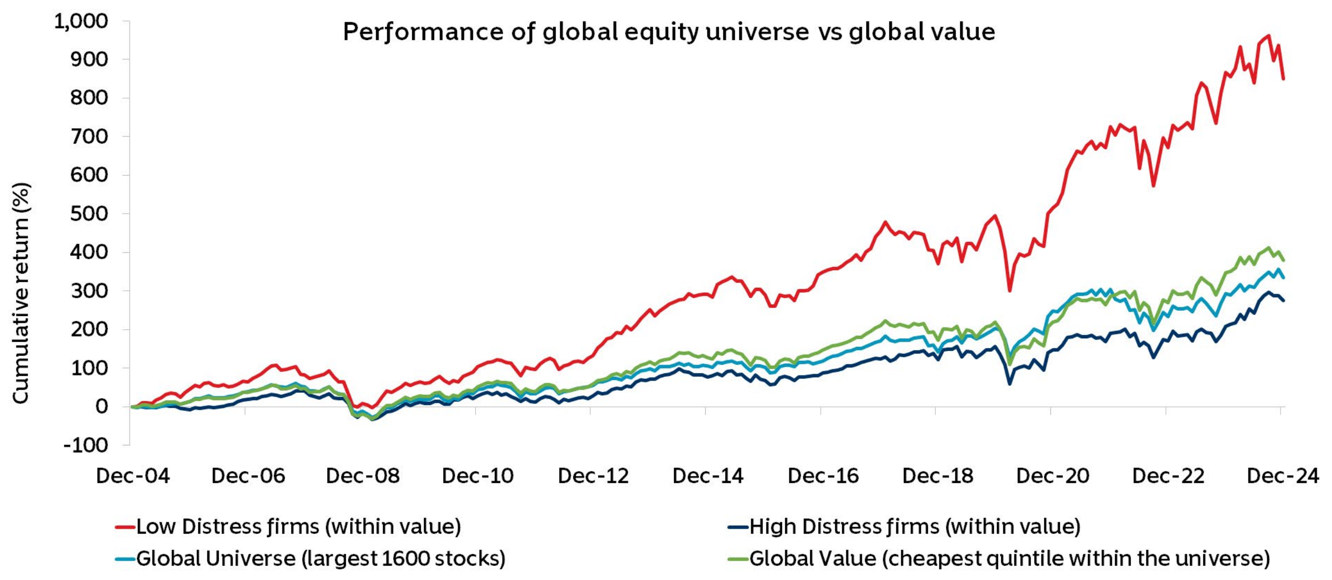
Chart of the Week

27 January 2025



Source: FactSet as at December 2024.

Is cheap always cheerful?

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What this chart shows

Much has been said regarding the rewards of Value investing, essentially buying securities at discount to their intrinsic value. Over the longer term, this strategy has proven to be successful. There are many ways investors can do this, but typically it involves buying securities that are cheap based on certain metrics such as Price to Book (PB) or Price to Earnings (PE) ratios.

However, it is also widely accepted that investing in this space carries significant risks, and certain risks are worth avoiding. In this chart, we show a basket of global value stocks, defined as the cheapest quintile based on their price to book ratio. We then rank this cohort of stocks by their level of financial distress using a broad-based indicator, namely the Altman Z-score. This is a numerical measure that aims to calculate the probability of a business going bankrupt, making it a useful gauge of the state of financial distress in the firm.

The chart illustrates that investing in the cheapest quintile of securities has historically paid off over the long term, with global value outperforming the broader global universe. However, taking on additional risk by purchasing securities with higher distress risks is not well rewarded, as they tend to underperform. Therefore, if one's portfolio is skewed towards more distressed names, its performance is likely to be mediocre over time.

Why this is important

We often hear the term "value trap" and questions like "does value still work?". This analysis demonstrates that, while the value premium over the long term is positive, investors are more likely to be adequately compensated if they avoid the riskiest areas, which typically have a much higher risk of bankruptcy.

This also highlights the risk of accessing value stocks passively through funds and/or Exchange Traded Funds (ETFs), which tend to invest indiscriminately across the whole spectrum of cheaply traded securities, including those with higher levels of financial distress. The key takeaway is that investing in value stocks does not come without risk. We believe the best way to capture the value premium is via third-party active managers who have the required skills and expertise to carefully navigate these risks. Such managers can potentially enhance returns significantly by identifying businesses that are undervalued but exhibit lower financial distress, minimizing the risks inherent in this space.

Weekly market update

week ending 24 January 2025

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The global financial landscape from January 20-24 2025, was dominated by shifts in trade policies and monetary tightening, with the EU-China World Trade Organisation dispute and US tariff threats spotlighting the fragility of international trade dynamics.

US

» US stock markets approached record highs, buoyed by President Trump's plans to boost investment in artificial intelligence and positive earnings reports from major companies.

» President Trump, in his address at the World Economic Forum in Davos, reiterated his stance on imposing tariffs on imports to strengthen the American economy, signalling potential shifts in trade dynamics.

» The White House issued a memorandum indicating that previous commitments to the Organization for Economic Co-operation and Development (OECD) Global Tax Deal are not binding without congressional approval, instructing the Treasury Secretary to assess foreign compliance with US tax treaties.

» US crude oil prices declined, influenced by the administration's pro-drilling policies, impacting the energy market. Trump has also demanded the Organisation of the Petroleum Exporting Countries (OPEC) cut their prices.

UK

» Analysts highlighted the UK's potential to strengthen its economy by leveraging its services sector, independent trade policies, and focusing on investments in technology and infrastructure.

» The UK unemployment rate rose to 4.4% in the three months to end November and the number of payrolled employees saw its most significant drop since the peak of the pandemic. However, there was an increase in wage growth with average pay rising to 5.6%, outpacing CPI.

» The UK government replaced Marcus Bokkerink, chair of the Competition and Markets Authority, citing a need for growth-oriented leadership following criticisms of regulatory decisions.

» Prime Minister Sir Keir Starmer and US President Donald Trump have agreed to meet soon emphasising strong UK-US ties. These developments highlight efforts to drive economic growth and strengthen global partnerships.

Europe

» The European Commission filed a complaint at the World Trade Organisation against China's "unfair and illegal" practices regarding high-tech patent royalties, signalling escalating trade tensions.

» Discussions at the World Economic Forum emphasised the need for Europe to boost confidence and improve integration amidst economic challenges and external criticisms.

» Analysts suggested that Europe should not panic in response to US policy shifts but instead seize opportunities to innovate and improve its economic and geopolitical systems.

» The Hamberg Commercial Bank (HCOB) composite PMI rose to 50.2 in January 2025 from 49.6 in the previous month, indicating modest expansion in economic activity..

Rest of the World/Asia

» The US implemented a stringent investment ban on China, effective January 2025, focusing on sensitive technologies, which could impact China's tech sector and foreign investment inflows.

» The IMF projected 4.6% growth for China in 2025, noting risks related to trade policy uncertainty and potential debt deflation.

» The Bank of Japan raised interest rates to 0.5%, leading to a strengthening of the yen, reflecting a shift towards tightening monetary policy to address inflationary pressures.

» Countries are increasingly seeking alternative trading partners, leading to a decreased reliance on the US and a rise in trade activities in Asia, Europe, and the Middle East.

Weekly market data

week ending 24 January 2025

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Asset Class / Region	Currency	Week ending 24 January	Month to date	YTD 2025	12 months
		Cumulative returns			
Developed Markets Equities					
United States	USD	1.8%	3.8%	3.8%	26.5%
United Kingdom	GBP	-0.1%	4.0%	4.0%	16.9%
Continental Europe	EUR	1.6%	5.3%	5.3%	12.5%
Japan	JPY	2.7%	-1.2%	-1.2%	11.3%
Asia Pacific (ex Japan)	USD	1.9%	1.2%	1.2%	16.7%
Australia	AUD	1.2%	3.1%	3.1%	15.9%
Global	USD	2.1%	4.1%	4.1%	22.1%
Emerging Markets Equities					
Emerging Europe	USD	4.0%	8.6%	8.6%	14.1%
Emerging Asia	USD	1.7%	0.6%	0.6%	17.9%
Emerging Latin America	USD	3.6%	7.5%	7.5%	-16.3%
BRICs	USD	1.5%	-1.2%	-1.2%	13.4%
China	USD	3.0%	-0.2%	-0.2%	27.9%
MENA countries	USD	1.0%	2.8%	2.8%	2.4%
South Africa	USD	1.6%	4.1%	4.1%	19.4%
India	USD	0.0%	-2.9%	-2.9%	5.1%
Global emerging markets	USD	1.9%	1.5%	1.5%	13.6%
Bonds					
US Treasuries	USD	0.1%	0.1%	0.1%	2.1%
US Treasuries (inflation protected)	USD	0.3%	0.7%	0.7%	3.6%
US Corporate (investment grade)	USD	0.2%	0.2%	0.2%	4.2%
US High Yield	USD	0.3%	1.2%	1.2%	9.9%
UK Gilts	GBP	0.2%	0.0%	0.0%	0.2%
UK Corporate (investment grade)	GBP	0.3%	0.3%	0.3%	5.1%
Euro Government Bonds	EUR	-0.2%	-1.0%	-1.0%	2.5%
Euro Corporate (investment grade)	EUR	0.0%	-0.3%	-0.3%	5.3%
Euro High Yield	EUR	0.2%	0.1%	0.1%	8.2%
Global Government Bonds	USD	0.9%	0.5%	0.5%	0.0%
Global Bonds	USD	0.8%	0.4%	0.4%	1.1%
Global Convertible Bonds	USD	1.2%	2.1%	2.1%	10.4%
Emerging Market Bonds	USD	0.5%	0.6%	0.6%	8.7%

Asset Class / Region	Currency	Week ending 24 January	Month to date	YTD 2025	12 months
		Cumulative returns			
Property					
US Property Securities	USD	1.6%	1.5%	1.5%	13.5%
Australian Property Securities	AUD	0.6%	5.2%	5.2%	23.5%
Asia Property Securities	USD	0.8%	-0.9%	-0.9%	-4.6%
Global Property Securities	USD	1.3%	1.0%	1.0%	9.1%
Currencies					
Euro	USD	2.2%	1.6%	1.6%	-3.6%
UK Pound Sterling	USD	2.6%	-0.2%	-0.2%	-2.0%
Japanese Yen	USD	0.3%	1.0%	1.0%	-5.5%
Australian Dollar	USD	1.8%	2.2%	2.2%	-4.4%
South African Rand	USD	1.7%	2.6%	2.6%	2.3%
Swiss Franc	USD	1.1%	0.3%	0.3%	-4.7%
Chinese Yuan	USD	1.2%	0.8%	0.8%	-1.1%
Commodities & Alternatives					
Commodities	USD	-0.7%	4.4%	4.4%	9.9%
Agricultural Commodities	USD	1.6%	3.0%	3.0%	5.0%
Oil	USD	-2.8%	5.2%	5.2%	-1.9%
Gold	USD	2.5%	5.6%	5.6%	37.2%

Source: Bloomberg Finance L.P. Past performance is not indicative of future returns.

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