

## Value's gradual rotation

It takes 365 and a quarter days for the earth to revolve around the sun – or what we commonly call a year. A lot can happen in that rotation time as 2020 is testament.

In markets, some days seem like they will never end, while other days fly by like a comet. A day of the comet-like variety happened recently after the announcement of the Pfizer COVID vaccine, and it incorporated the continuation of a pattern that emerged around the end of August.

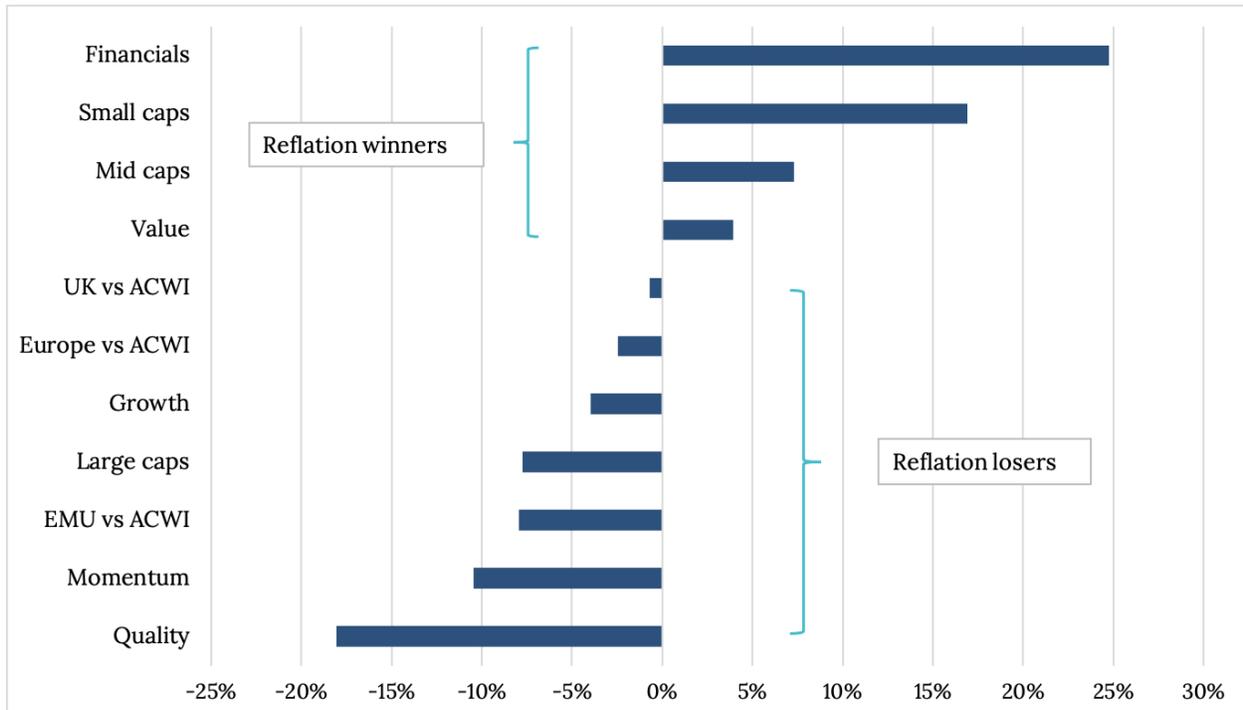
After years of seemingly drifting off untethered while growth stocks surged to record and apparently unsustainable valuations, the conditions for the slow rotation back to value stocks looks the most promising in years.

Firstly, the risk to growth equities is now more palpable with valuation multiples coming under greater scrutiny as investors see a path out from home working and lockdowns to a broader canvas from which the economy can grow. The difference in P/E ratios in the chart below showing opportunities in this space.

Top 8 Growth Stocks	P/E Ratio	Top 8 Value Stocks	P/E Ratio
Apple	28x	Berkshire Hathaway B	21x
Microsoft	29x	Unitedhealth Group	19x
Amazon	71x	Verizon Communications	12x
Facebook	27x	Johnson & Johnson	16x
Alphabet	29x	Bank of America Corp	14x
Nvidia	46x	Pfizer	14x
Visa	31x	Walmart	26x
Mastercard	41x	AT&T	9x
<b>Average</b>	<b>37.7x</b>		<b>16.4x</b>

*Top 8 by index weight as at 30.11.20, forward P/E as at 1.12.20  
Source: S&P 500 Growth and Value indices / Yahoo Finance*

Plus with a Democrat President in the US waiting in the wings, fiscal and monetary stimulus will almost certainly be greater for the world's largest economy, putting cash and jobs in the hands of the real economy sectors such as industrials, energy and utilities. This however, as discussed before, is a significant driver of a credible path toward inflation, of which even a small amount ought greatly to benefit short duration stocks over long duration – or, in other words, value over growth.



Average 5 year correlation of relative performance to six different measures of deflation: US and EU 10 year yields, US 10Y-2Y yield curve, CPI inflation, 5Y5Y inflation expectation and PMI, to 31/10/2020. Source: Bloomberg.

But it's not just about what might happen – as Galileo observed from his telescope. So too our observations are already pointing this way more and more, with the below chart showing growth has already started to de-rate versus value.



12m Trailing P/E premium/discount of MSCI Growth v Value indices. Source: Bloomberg

No one knows with certainty what will happen, but all these characteristics are favorable for value managers. If you add to these thematic drivers a fundamental bottom-up process for identifying opportunities in specific companies, then however long it might take for a rotation, or for however long it might last, the basis underlying each investment decision is sound.