Barrow Hanley: Why value stocks are now outperforming growth

By Perpetual Asset Management
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When looking at value and growth stocks across global markets, the conventional wisdom that value doesn't keep pace is no longer true – and investors need to think about protecting their

portfolios. BRAD KINKELAAR explains.

- Value outperforming growth
- High valuations lead to lower returns
- Multiple expansion driving gains

VALUE or growth?

It's an old question getting renewed attention as investors struggle to assess the implications of the artificial intelligence capex spending boom sweeping Wall Street.

Fast growing tech stocks have left indexes highly concentrated to growth themes. But nerves about the cost of AI – and its implications as it rolls out to the wider economy – have seen share prices dip sharply in recent weeks.

Barrow Hanley's Brad Kinkelaar says the sell-off reinforces a case he has been making for years: value offers better risk and return prospects – and investors who wait for turning points in markets are usually too late.

"The common perception is that value just hasn't kept up with growth. But over the last year, we've outperformed both broad and value," says Kinkelaar, a senior portfolio manager at global value investing leader Barrow Hanley.

He says in the three months to end January, value stocks were up 10 per cent while growth fell 4 per cent.

"If you're just asking 'why value now', you're already 14 per cent behind," says Kinkelaar.

Value stocks outperform

Kinkelaar says nobody can predict when, why and how markets move, and the best position for most investors is to hold value stocks over the long term instead of trying to move in and out of markets chasing returns.

There's little doubt the narrative of the past five years has been dominated by big tech stocks and AI, he says.

"Secular growth, big margins, wide moats, huge cash flows – they deserve higher multiples," he says.

But the narrow focus on those names masks what has actually happened to returns.

Kinkelaar says the recent rout in tech stocks means that over the past five years, growth stocks are up 71 per cent and the broader market is up 80 per cent – but value has risen 85 per cent.

“It just blows my mind,” he says.

“If you’re only playing for the upside, you’re going to get crushed on the downside.”

Value stocks remain well priced

Despite the outperformance, value stocks remain well priced compared to their growth peers, says Kinkelaar.

“Very consistently over time, high valuations generally lead to lower returns.” he says.

Barrow Hanley expects 9 per cent earnings growth from its companies – the same as the MSCI World Value Index. Earnings expectations for the broader market are at 12 per cent.

Kinkelaar says that while that appears to be a reason to own the index, the higher prices of faster growing stocks erases the advantage.

“You’re paying huge premiums to try to eke out a couple per cent of growth,” Kinkelaar says.

“History will tell you that these multiples do not hold, because usually the market does not give you 12 per cent annual growth.”

Multiple expansion driving gains

Kinkelaar says much of the market’s gains over the past two decades have been due to investors’ willingness to pay higher multiples for stocks, as MSCI World annual earnings growth has averaged just 5 per cent.

“You can overpay for overconfidence,” Kinkelaar says.

“Unless you think you’re going to get further multiple expansion, you might want to bet against it.”

Portfolio implications

James Holt, head investment specialist for Perpetual and Barrow Hanley, says many investors get flustered and swing from fear to FOMO as stocks swing up and down.

“Barrow has a portfolio that can swing from cyclical to defensive value as markets change, driven entirely by the stocks they are picking,” Holt says.

“So rather than try and second guess market direction and manager that specialise in them Barrow’s ability to pivot between the stocks that benefit from these gyrations keeps our investors in the middle of the road rather than swerving for the extremes.

“Barrow has consistently outperformed the value index, which in the long run has consistently outperformed the broader market,” he says.

"Our disciplined, repeatable process keeps finding undervalued stocks – good quality companies at a discount – and our portfolio has gotten better and better value while the market has gotten massively more expensive," he says.

About Brad Kinklaar and Barrow Hanley

Brad Kinkelaar is a Barrow Hanley senior managing director and portfolio manager with almost three decades of experience.

Barrow Hanley is a global leader in value investing, managing assets for clients for more than 40 years.

Barrow Hanley Global Share Fund aims to provide investors with long-term capital growth through investment in quality global shares.

Barrow Hanley Global Share Active ETF (ASX:GLOB) is a unit class in the Barrow Hanley Global Share Fund.

Barrow Hanley is distributed by Perpetual Asset Management in Australia.

Find out more here.

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