MACKENZIE Investments

Growth & Value: Your questions, our answers

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Value investing:
Bargain-hunting is back in style

Over the last decade, growth outperformed value. But is growth's leadership being challenged?

Richard Wong, Senior Vice President, Portfolio Manager and Head of the Mackenzie Cundill Team strongly believes November 2020 marked the start of the best opportunity for value investing since he joined Mackenzie in 2016. We sat down with Richard to find out why he believes value is set to outperform growth, and how the Mackenzie Cundill funds are positioned to take advantage of the recent and on-going market rotation.

Q | Why value and why now?

From my perspective, 2020 was the bottom for value investing and the peak for growth investing. The value cycle kicked off in November 2020 with the COVID-19 vaccine announcements. Market conditions flipped 180 degrees. The pandemic conditions that favoured growth and hindered value are not likely to repeat. Further, I believe we have entered a new business and economic cycle as countries and companies recover into a post-COVID world.

> **"I believe that to be a successful value manager today, you need to own stocks where value can be discovered. Buying a stock just because it's cheap isn't going to work anymore."**

Q | Can you talk about the macro economic factors that now favour value?

The macro environment for the last decade was not favourable to value as there was little inflation, interest rates were low and so was economic growth. Those three drivers were net negative for value stocks and positive for growth stocks.

I believe growth stocks will be challenged because their valuation multiples are likely to compress as bond yields push higher. The help that growth stocks have had in the past will not be there; they need interest rates to push lower to support their extended multiples.

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Second, but related, the fear of recession was helpful to growth stocks as their growth trends are secular and not tied to the underlying economy – they had the perfect environment. That fear does not exist now. We just had a recession. We're now looking at a very strong recovery with a lot of economic support. Monetary policy has run its course globally. We are now seeing tremendous fiscal stimulus which I believe will be inflationary; and that will stop yields from grinding lower.

Overall, I would say that the environment is much more constructive for value stocks as they are economically sensitive, and the economy is improving rapidly. Growth stocks face headwinds because yields are rising, and at the same time, last year's spectacular performances could be a bar too high to beat. Combined, I believe these two factors will put pressure on multiples to compress and stock prices to fall. In stark contrast, in my view, value stocks have tailwinds with easier to beat year-over-year comparisons, rising inflationary pressures (think pricing power), strong economic growth, fiscal stimulus support and pent up consumer demand.

Q | How has value investing changed over time?

Most people understand value investing as buying cheap and then patiently waiting for value to be realized somehow. Patience, patience, patience was the mantra. But waiting is no longer a winning game. Investors are far less patient than they once were. Markets move very quickly now. The rotation into value happened quickly and dramatically, as did the fantastic recovery in growth stocks in April 2020. I believe that to be a successful value manager today, you need to own stocks where value can be discovered. Buying a stock just because it's cheap isn't going to work anymore.

Value stocks need catalysts to recover, and those catalysts must be understood by the market. If you are the only one that sees and understands the catalyst, that won't move the stock. Importantly, the catalysts need to be close at hand. I would rather wait for a catalyst to emerge and pay a bit more for a stock, than buy it without understanding or seeing a path forward for the business.

Mackenzie Cundill shifts between three buckets of value

Quality value

Have durable competitive advantages, often are market leaders and able to compound shareholder returns

Are purchased when market dislocations and idiosyncratic challenges present entry points and as the economic cycle matures

Cyclical value

Are strong companies with healthy long-term fundamentals that are operating in cyclical industries

Appear weak and vulnerable during industry downturns, which present a buying opportunity

Deep value

Are deeply out of favour – frequently due to significant headline risk or concerns regarding business fundamentals

Have catalysts to recovery – restructuring, cost cutting, deleveraging the balance sheet

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Q | What does value investing mean to Mackenzie Cundill?

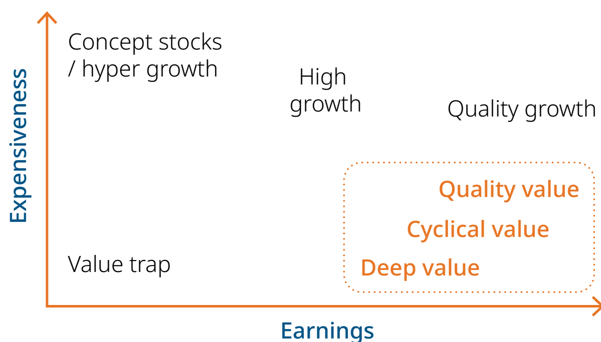
In a nutshell, it means we buy out-of-favour businesses that we believe will come back into favour. We look for low multiple stocks that we believe should trade at higher multiples; laggards that will be leaders. Importantly, our approach to value does not confine us to certain sectors – we are equal opportunity managers – if it is cheap, we are going to peek under the hood for over-looked opportunities.

What distinguishes Mackenzie Cundill's approach to investing is that we want to own stocks that are beaten down and discarded. In our view, it's not just about buying cheap stocks, it's about buying cheap stocks that will re-rate and become more expensive.

Q | What defines a Mackenzie Cundill Fund?

A Mackenzie Cundill Fund will always show up as value in a style box, it will always have much cheaper multiples than the market and have a high active share[1]. When you invest in a Mackenzie Cundill Fund, you will get a fund that, because of our process, we believe will behave differently than the index and other funds. For investors who have high allocations to growth stocks, a Mackenzie Cundill Fund offers diversification.

Where Mackenzie Cundill invests



Q | What are the value sectors to own now?

Value is not just value, just as growth is not just one thing. The dispersion of outcomes for some value stocks can be narrow and for others, it can be very wide with a lot more upside or downside risks. The thing to think through is when to take risks. The biggest risks are often in deep value stocks. Cyclical value is, as the name suggests, dependent on where we are in the economic cycle. Quality value generally offers less upside but also less downside. We will allocate between each of these and overweight the ones where we see the best near-term opportunities.

Cyclical sectors are the place to be early in the cycle, which is where we believe we are now. As vaccination programs continue to roll out globally, we believe that we are on the cusp of seeing economies reopen. Yet, on the other hand, we see that some of the easy money has already been made and so we are also starting to look at some defensive value names. However, we don't think it's the time to get defensive just yet. During this recent market rally, defensive stocks have really lagged (pharmaceuticals and grocery stores) but we are keeping an eye on it and building a list of businesses that we want to own when value presents itself.

Q | Can value's recent outperformance be sustained?

Historically, value outperforms in periods of healthy economic growth. Value also performs when economic surprises are to the upside, when inflationary pressures build and when the yield curve is steepening. That's what is happening right now. Last year, we saw the extreme opposite in each of these scenarios and value underperformed. But for value to outperform, by definition growth needs to underperform.

Looking back at 2020, conditions were perfect for many growth stocks. Earnings and sales were "pulled forward" and the market rewarded growth stocks with maximum valuations. But that also means these stocks will face tough comparables in 2021. One thing to point out is that high growth stocks are "long duration" assets like long bonds. The present value of their future cashflows decline as yields rise – this could pressure stock prices lower. In contrast, value stocks face easy comparisons, have lower multiples, and I believe we are in the beginning of a new market cycle – all of this could cause prices to rise and value stocks to outperform.

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1 Active share measures the percentage of fund holdings that is different from a benchmark index's holdings.

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