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INVESTMENT STRATEGY

# VALUE IN VOGUE

## Key Takeaways

- **Rotate into value:** We recommend adding value exposure given the current environment.
- **The economy remains resilient:** Labour markets remain healthy and PMIs continue to signal expansion, creating a backdrop that favours the cyclical sectors that dominate value portfolios.
- **Higher-for-longer rates:** Sticky inflation and higher yields are an environment in which value has historically outperformed.
- **History favours value:** Value has generated its strongest excess returns during periods of rising bond yields and when PMI survey is in expansion territory.
- **Diversification benefits:** AI concentration is a growing risk. Equity market leadership remains concentrated in AI-related mega-caps. Value offers diversification through lower technology exposure and greater representation in financials, energy and the broader real economy.
- **Preferred ETFs: Barrow Hanley Global Share Active ETF (GLOB)** and **Vanguard Global Value Equity Active ETF (VVLU)** our preferred value ETFs.

## The Case for Value

We recommend adding value exposure given the current macro environment.

**1) Economic activity remains resilient**, supported by AI-related investment, low unemployment and expanding business activity, creating a backdrop that typically benefits the cyclical sectors that are well represented in value.

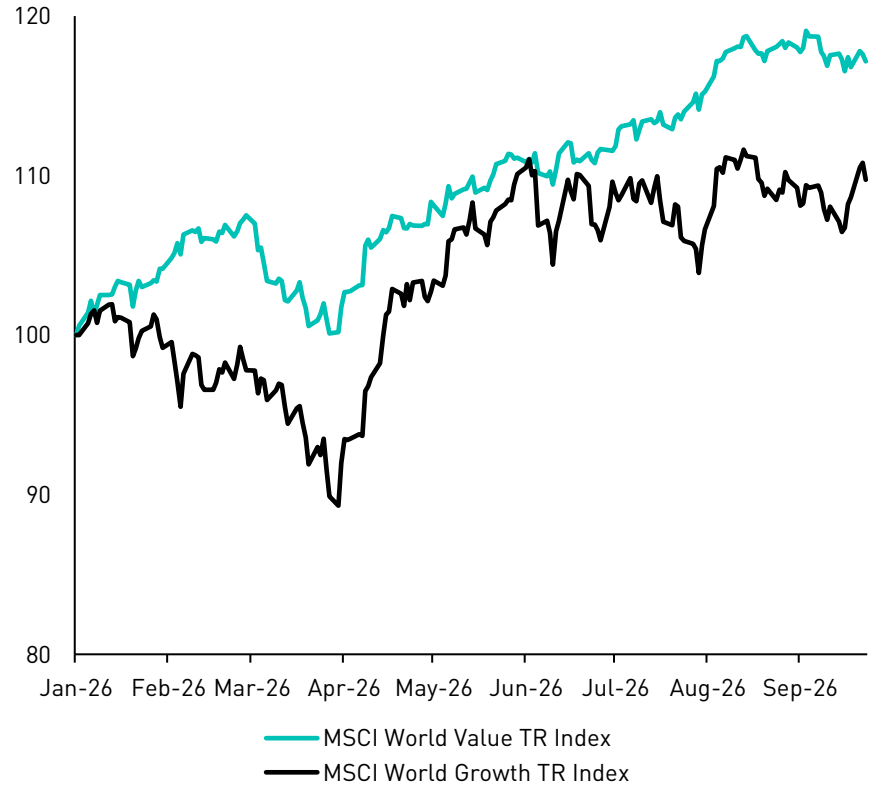
**2)** Robust economic growth, combined with ongoing supply-side pressures, continues to create upside risks to inflation and bond yields. **Higher and rising yields have historically been supportive environments for value, and a value tilt provides protection should inflation prove more persistent than expected**.

**3) Value provides diversification away from an increasingly AI heavy index**, offering greater valuation support should AI monetisation disappoint. Values overweight exposure to energy is attractive should oil prices remain high, and tilts towards healthcare and staples provide a defensive allocation.

## Value has outperformed this year

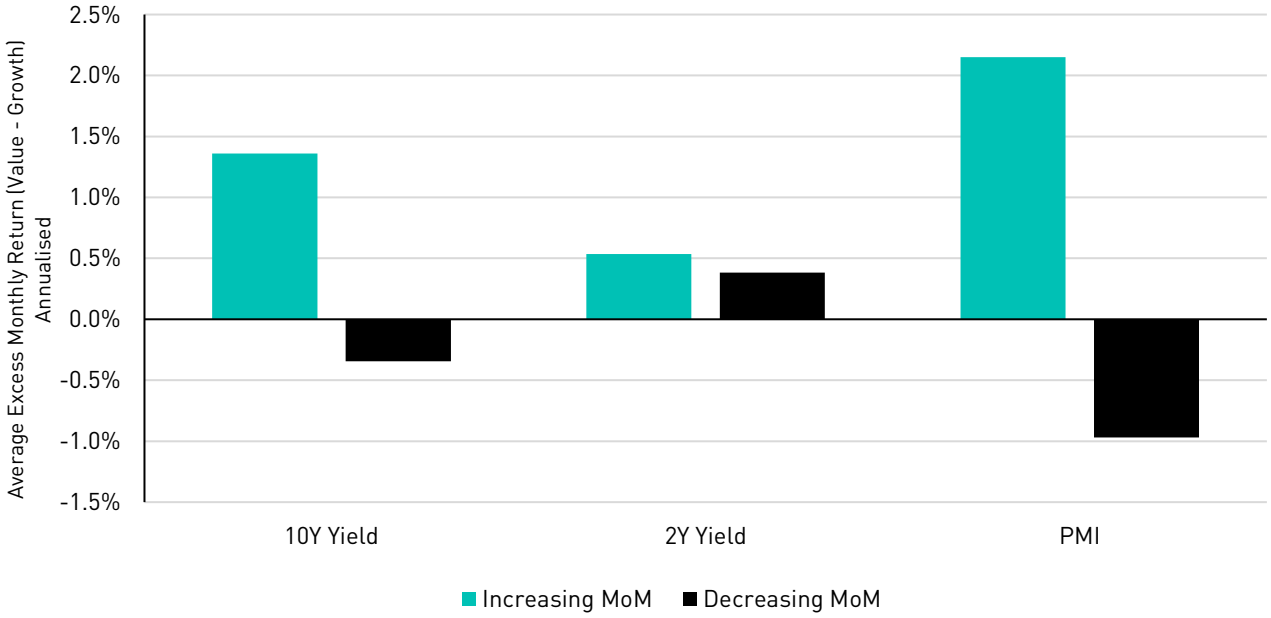
Value has outperformed growth year-to-date and has proven resilient during market pullbacks. Its lower concentration in the mega-cap US technology stocks has provided a degree of downside protection during periods of AI-related weakness.

**Figure 1: Value has outperformed growth YTD; we believe this can continue over the next 12 months**




Source: LSEG DataStream. Daily total return indices rebased to 100 at 1 Jan.

**Figure 2: Value has generated excess return vs growth in months when yields are rising, and months when PMIs are rising, indicating it's well positioned to outperform in the current macro setup**




Source: LSEG DataStream Note: Data since 1976

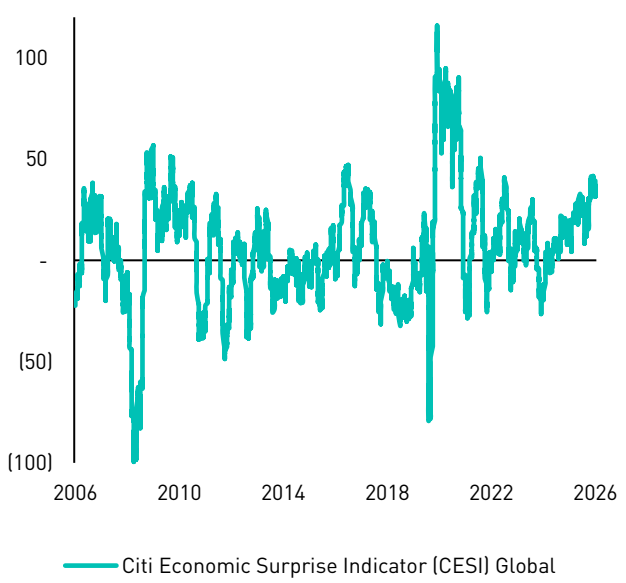
## The case for value

### 1 – THE GLOBAL ECONOMY IS ON SOLID FOOTING

**Economic activity remains resilient, creating a backdrop that has historically been supportive of value.** Unlike growth, which is often driven by structural earnings growth, value indices have greater exposure to cyclical sectors, including financials, materials and energy, that benefit from strengthening economic conditions.

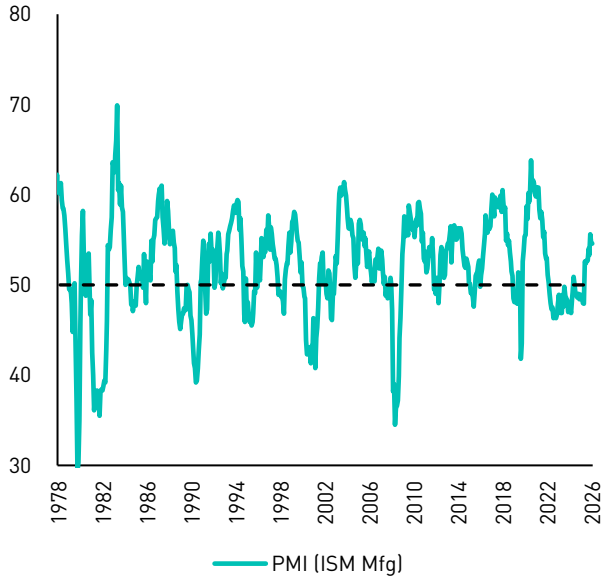
We expect economic conditions to remain buoyant. Recent US payrolls data exceeded expectations, while unemployment remains near historically low levels. Forward-looking indicators continue to point to expansion, with global PMI firmly in growth territory and signalling ongoing strength across both manufacturing and services. The August US manufacturing PMI recorded its strongest improvement in business conditions since May 2022, supported by accelerating production and new orders.

**Figure 3: Economic data has continued to surprise to the upside, pointing to a resilient global economy.**




Source: Citi, LSEG DataStream

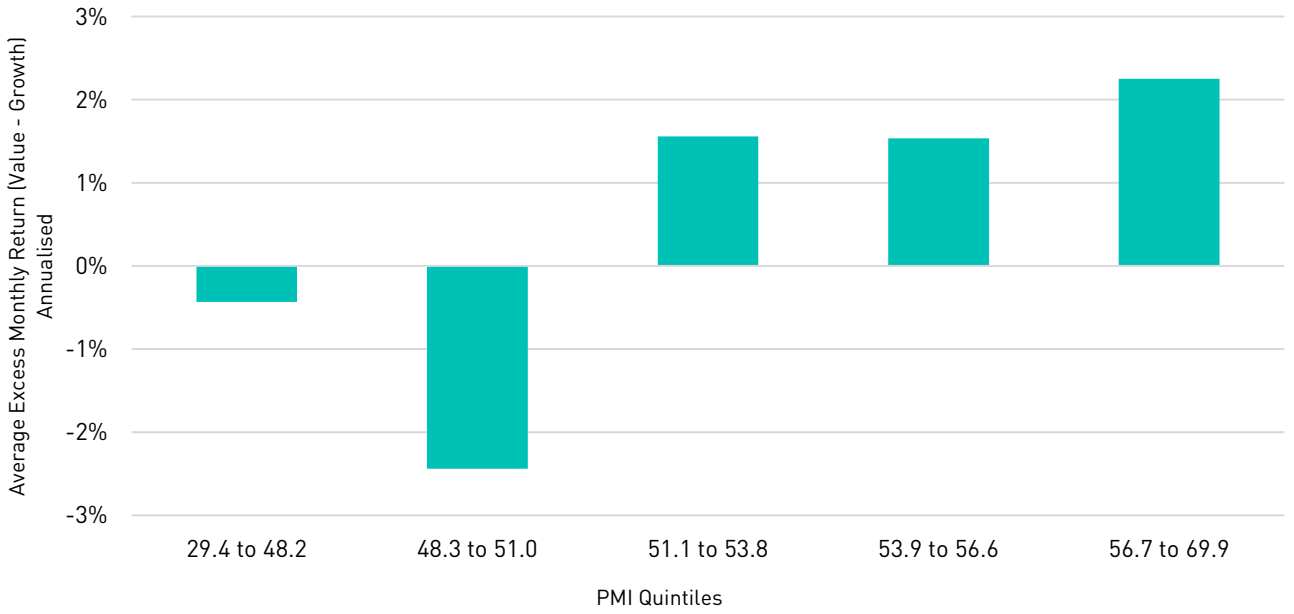
**Figure 4: The manufacturing cycle suggests healthy economic expansion for the US.**




Source: LSEG DataStream

**Over the last 50 years, during months of rising PMI, value has outperformed growth by almost 1.8% per annum.** Value's relative performance improves once PMI moves into expansionary territory, with the factor generating its strongest excess returns vs growth when PMI readings are above 50.

**Figure 5: Value has historically outperformed when PMI moves into expansionary territory.**

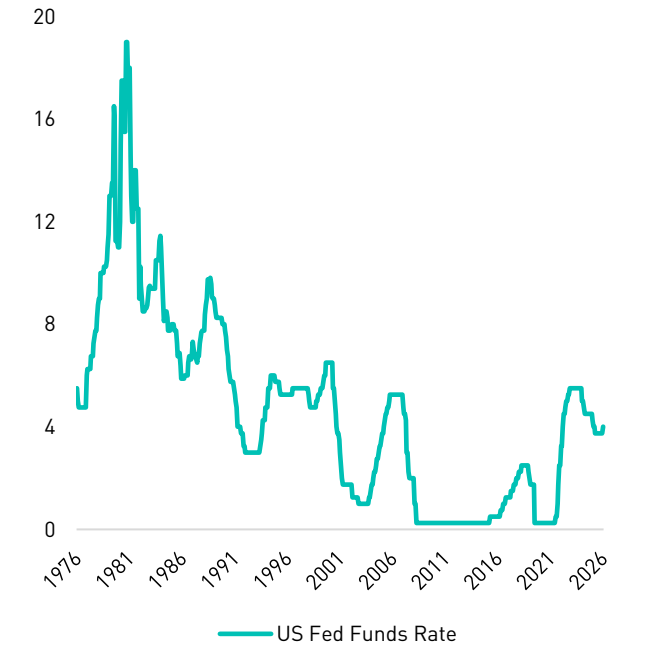



Source: LSEG DataStream, Bell Potter Note: Data since 1976

## 2 – HIGHER YIELDS FAVOUR VALUE

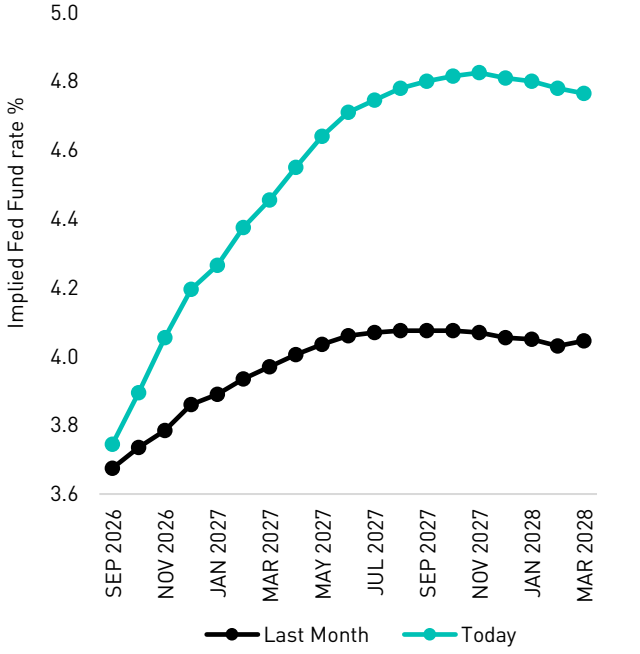
**Higher for longer rates have historically been supportive of value.** Ongoing economic strength is reinforcing global central banks' focus on containing inflation. Tight labour markets and resilient demand have contributed to inflation proving sticker than expected, leading markets to price a higher-for-longer interest rate environment. Core inflation continues to run above desired levels, and US Fed Chair Warsh's hawkish commentary at the September FOMC meeting prompted investors to price ~90% odds of a further hike by year-end.

**Figure 6: The Fed hiked by 25bp in September, lifting the target range to 3.75%–4.00%.**



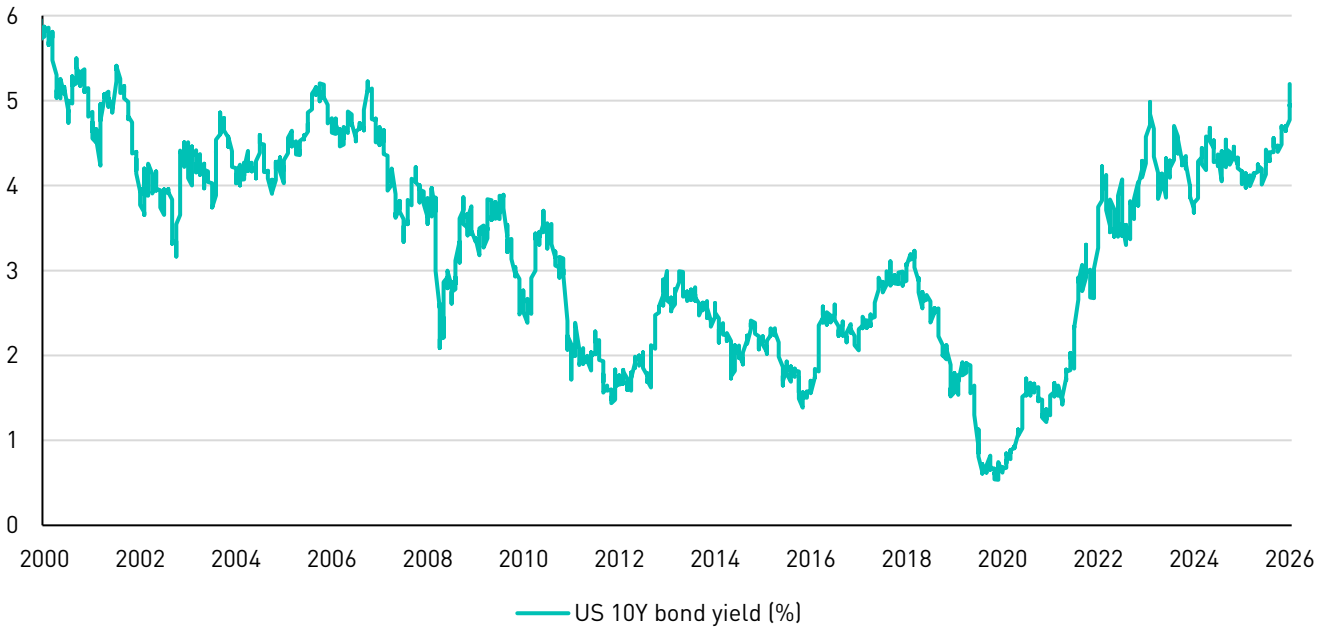

Source: LSEG DataStream

**Figure 7: Markets have moved to price in further tightening.**




Source: LSEG DataStream

**Figure 8: US 10-year Treasury yields rise above 5% as strong growth, fiscal concerns and inflation risks (Iran) reinforce higher-for-longer rates**



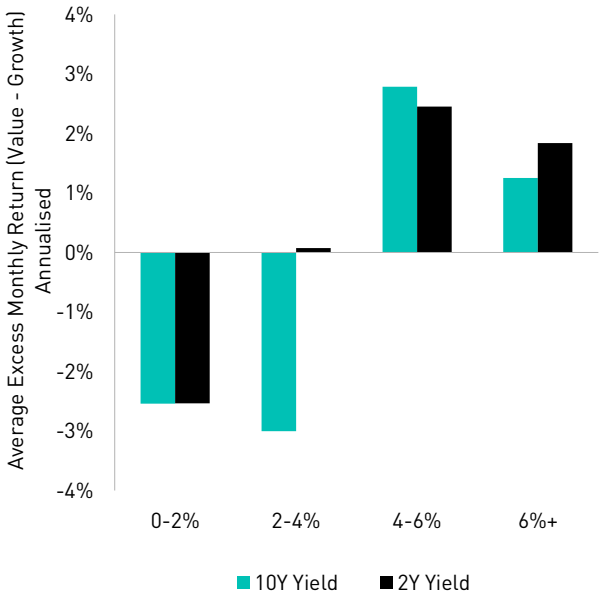

Source: LSEG DataStream

Risks remain skewed towards higher-for-longer bond yields. The US 10-year Treasury yield has risen above 5%, reflecting a combination of higher-for-longer policy rate expectations, and concerns around the deepening fiscal deficit and US debt burden. At the same time, geopolitical tensions in the Middle East continue to create upside risks for energy prices and input cost inflation, reinforcing the possibility that interest rates remain elevated for longer.

Looking across the last 50 years, value has generally outperformed growth during periods of higher bond yields, with the strongest relative returns occurring when yields were in the 4-6% range. Value has historically delivered relative outperformance vs growth during periods of rising bond yields, with excess returns tending to increase as yield moves are more pronounced.

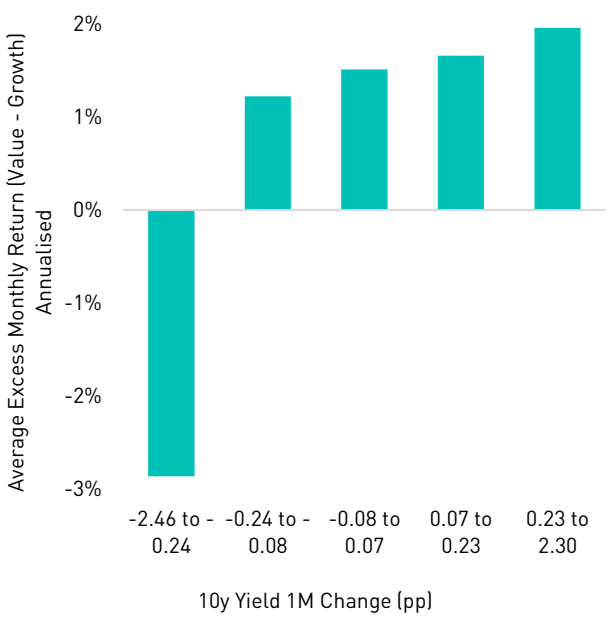
With bond yields sitting within a range that has historically been favourable for value, and upside risk to inflation and policy rates, we believe the current environment remains supportive of further value outperformance.

**Figure 9: Over the last 50 years, value outperforms during months when yields are higher...**




Source: LSEG DataStream Note: Data since 1976

**Figure 10: ...and during periods of rising yields**




Source: LSEG DataStream Note: Data since 1976

### 3 –DIVERSIFICATION FROM THE AI TRADE

While we remain constructive on the long-term opportunities created by artificial intelligence, market leadership is increasingly concentrated in a number of mega-caps heavily exposed to the theme. The AI investment boom has been a key driver of equity market returns, but it is also fuelling a sharp rise in capital expenditure, increased debt issuance, and growing scrutiny of whether the returns on today's investments will ultimately justify the scale of spending. We have seen heightened market volatility as sentiment continue to shift in response to new AI related developments.

**Value provides diversification from this concentration risk**, with lower exposure to information technology and communication services and greater exposure to financials and the broader real economy.

Value's sector composition offers a degree of resilience should some of today's key macro risks persist. Relative to growth (and the index), value is meaningfully overweight energy (approximately 7% versus 1%), providing a hedge against higher oil prices. In addition, value's overweight exposure to defensive sectors such as healthcare and consumer staples can help reduce volatility. These industries tend to exhibit more stable earnings profiles through the economic cycle and provide an element of defensiveness should growth expectations weaken.

**Figure 11: Value has less exposure to tech, and is tilted towards financials, resources, and more defensive sectors including healthcare and staples.**

| Sector weights | MSCI World | Growth | Value |
|---|---|---|---|
| Information Technology | 30% | 43% | 17% |
| Financials | 17% | 7% | 26% |
| Industrials | 11% | 13% | 10% |
| Health Care | 9% | 7% | 11% |
| Consumer Discretionary | 9% | 13% | 5% |
| Communication Services | 8% | 10% | 6% |
| Consumer Staples | 5% | 3% | 7% |
| Energy | 4% | 1% | 7% |
| Materials | 3% | 3% | 4% |
| Utilities | 2% | 1% | 4% |
| Real Estate | 2% | 1% | 3% |

Source: MSCI

## Recommendation - Tilt towards Value ETFs

The combination of resilient economic growth, elevated bond yields, and an increasingly concentrated equity market strengthens the case for value investing. Against this backdrop, we highlight two of our preferred value ETF exposures.

**Barrow Hanley Global Share Active ETF**

**GLOB**

GLOB provides exposure to global value opportunities while incorporating a quality overlay that helps avoid traditional value traps.

- Strategy focuses on attractively valued companies with strong underlying fundamentals and sustainable earnings profiles. With upside risk to rates and inflation increasing the importance of earnings durability, we find GLOB's active overlay attractive.
- Portfolio construction is designed to participate in rising markets while providing better downside resilience during periods of market stress. GLOB has exhibited relatively defensive characteristics, with a 5yr beta of ~0.3.
- The strategy has a strong 12 year track record (in a growth market). Founded in 1979, Barrow Hanley brings the benefit of a manager that has navigated multiple full market and value/growth cycles.

### Vanguard Global Value Equity Active ETF

**VVLU**

VVLU is an efficient, low-cost implementation for investors seeking diversified exposure to global value equities.

- With management fee of just 0.28% p.a, one the most cost-effective ways to access the value factor.
- VVLU has 900+ holdings across regions, sectors and market capitalisations
- Rules-based active approach using proprietary quant model to find undervalued stocks.
- Low correlation to the MSCI World, providing genuine diversification benefits.

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