CAMRADATA

Style Investing Whitepaper

Does style matter?

November 2017

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Introduction

Managers who may be asked, "what kind of investment manager are you?" may be inclined to reply, "a very good one!" but the question relates to what style of investing they employ.

Style exposures are key drivers of portfolio returns because different investment styles can outperform (or underperform) for prolonged periods of time, so it pays to understand the content of a style box and how it changes over time. Sector weights within investment styles can also create shifts, which needs to be acknowledged as industry sectors behave differently in different economic conditions.

Another benefit of understanding and classifying styles comprehensively is that it helps investors dissect the drivers of fund performance more clearly, respond more intelligently and avoid knee-jerk reactions to the market's changing style preferences.

Even as a database provider, a unified fund classification framework also helps overcome the problem of inconsistencies among different fund managers in how they label their funds.

The amount of information available to investors has expanded enormously in recent years as new forms of media have allowed an ever greater volume of data and opinion to be published.

In this environment, there is an increased need to differentiate oneself and therefore CAMRADATA's roundtable sought to define various styles prevalent in a quest to seek businesses with a high and sustainable return on invested capital.

"Even as a database provider, a unified fund classification framework also helps overcome the problem of inconsistencies among different fund managers in how they label their funds"

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M&G Investments
Company profile

M&G Investments is the European asset management arm of Prudential plc, operating in the UK, Europe and Asia. As a trusted partner, our clients' individual needs are at the heart of our business—based on a solid understanding of their risk and return requirements, we develop value-based investment strategies.

We have over 400* investment professionals (including what we believe to be one of Europe's largest credit research teams) and have a successful track record of generating strong and consistent returns. With £281 billion* of assets under management, our portfolio encompasses fixed income, equities, real estate and multi asset strategies.

* As at 30 June 2017

John William Olsen
Portfolio Manager

John William Olsen, a Danish national, joined M&G in April 2014, and was appointed Portfolio Manager of the M&G Global Select strategy and M&G Pan European Select strategy in July 2014. John William joined M&G from Danske Capital, where from 2002 he had managed non-domestic equity portfolios, including the Global Stock Picking and Global Select equity strategies, and also the European Select strategy. He joined Danske Capital in 1998 as a Portfolio Manager on the domestic Danish equities team, and in 2000 also became a global sector analyst focusing on technology and telecommunications stocks. John William gained a BA in business economics and then an MSc in finance and accounting from Copenhagen Business School.

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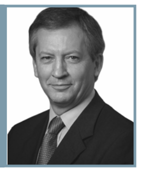
RBC Global Asset Management
Company profile

RBC Global Asset Management is the asset management division of Royal Bank of Canada. We have a globally integrated investment platform and are committed to service excellence, ensuring that investors are well positioned to benefit from investment opportunities across asset classes and geographic regions. Our experienced investment teams are strategically located in North America, Europe, and Asia, providing a comprehensive range of traditional and innovative strategies. RBC Global Asset Management traces its roots back to 1933 and has grown both organically and through strategic acquisitions. Today, we manage more than US$300billion for investors globally.

Laurence Bensafi
Deputy Head of Emerging Markets Equity

Laurence is Deputy Head of Emerging Markets Equity in London and lead portfolio manager for the Emerging Markets Value Equity Strategy. Prior to joining RBC Global Asset Management in 2013, Laurence was the Head of Aviva Investors' Emerging Markets team, where she was responsible for managing Global Emerging Markets income funds, and for developing quantitative stock selection and analysis models. Laurence began her investment career as a Quantitative Analyst at Société Générale Asset Management, supporting European and Global Equity portfolio management by developing quantitative models to assist in the portfolio construction and security selection process. In 1997, Laurence obtained a Magistère d'Économiste Statisticien & D.E.S.S. Statistique et Économétrie from Toulouse University in France. Laurence is a CFA charterholder.

Participants



Mike Clark
Founder Director, Ario Advisory

Mike Clark is Founder Director of Ario Advisory, a responsible investment advisory firm, working with asset owners, investment managers, regulators and others. Previously, he was Director, Responsible Investment at Russell Investments. An actuary, Mike represents the Institute and Faculty of Actuaries on the Advisory Council to the Sustainable Finance Programme at the University of Oxford's Smith School. Mike is an NED at BPP Ltd., the newly-formed Brunel investment management company formed to deliver pooling for 10 LGPS clients. He also sits on WHEB Asset Management's independent Investment Advisory Committee.

Mike has a strong interest in the role of the financial sector in supporting the real economy. Much of his work involves the management of climate change risk in the finance sector, and other long term issues.

Martin White, CFA
Managing Director, Public Growth Research

Martin is a Managing Director at Cambridge Associates' London office. He is a member of the research team in London and has more than 29 years of investment experience. Before joining Cambridge Associates, he was a Principal/Director at Barclays Global Investors, which was acquired by BlackRock during his tenure. In his role as a Senior Strategist in active equities, Martin was responsible for equity long-only, partial short and market neutral hedge funds strategies. Prior to this, he was a Senior Portfolio Manager and Head of Active International Equities for Barclays Global Investors Europe, managing £5 billion in global and regional active equity mandates. He also spent more than 11 years in investment management at Fleming Investment Management Ltd covering quant analysis and emerging markets.

Participants

Grace Lavelle
Senior Associate, Investment Team

Grace Lavelle is a Senior Associate within the Investment Team at P-Solve, chairing the Global Equity Research Committee. She is responsible for conducting asset class research, manager selection and monitoring across equity strategies, with views feeding into allocation decisions for fiduciary portfolios and advisory services. Grace joined P-Solve in 2013, having graduated with a First Class BSc (Hons) Degree in Mathematics from the University of Edinburgh.

Nick Samuels
Director, Manager Research

Nick is a Director in Redington's Manager Research team, where he has primary responsibility for the research, selection and monitoring of equity managers. Nick joined Redington in 2015 from SEI Investments where he led the firm's research of UK, European and Global equity managers, along with being a member of their global Manager Research Committee.

Nick started his investment career as a graduate in 2000 at Schroders, where he worked on the Asia and Emerging Market Equity teams, before moving into manager research roles at the investment consultancy Stamford Associates and Momentum Global Investment Management.

Participants

Brendan Maton

Freelance Journalist

A highly experienced financial journalist with an expansive network of contacts in the UK and across Europe. Brendan has written about pension schemes and national welfare systems from Finland to Greece for 18 years and understands the retirement savings industry in each European country.

Brendan has interviewed EU commissioners and national ministers; central bankers; pension scheme heads; insurance chief executives; chief investment officers; actuaries; union officials; professional and lay trustees.He worked at Financial Times Business for eight years, finally as editor-in-chief of all international pensions titles. Brendan has spent the last ten years as a freelancer for a number of publications, including Financial Times, Responsible Investor, Nordic region pensions news and IPE. He is also Chief webcast host for IPE.

Brendan has acted as conference chair for Financial News, the UK National Association of Pension Funds, Dutch Investment Professionals Association (VBA), Corestone, Insight Investment, Marcus Evans, Robeco Asset Management, Sustainable Asset Management (SAM), Towers Watson.

Does style matter?

In investing, style matters and has done so increasingly this century. Ever more managers, consultants and sophisticated clients discuss whether Value, Growth, Quality, Momentum or Small Caps are in fashion. Few managers, especially in the US, can escape attribution of their returns by reference to these style and their many variants ("Deep Value"; "Quality Growth"; "Core Growth").

> "There are only a handful of Quality stocks in the world. Creating a systematic index requires diversification but that only waters down the effect of the real Quality stocks"

The CAMRADATA panel on style Investing warned, however, that labelling managers by style could be "a comfort blanket" for clients – to make them feel that investing is more predictable and orderly than it really is. The panel explored lots of the traps caused by categorisation (e.g. that a certain type of Value stock will fail on ESG screens because of bad governance). There was unanimity that style are a good thing because they inform understanding of risks and returns. But truly active managers ought to be analysed on a wider range of criteria and not boxed in by narrow definitions.

Historically, style's development sprang from two sources: the index providers, notably Russell, that wanted to better attribute manager performance; and academics such as Barr Rosenberg and Ken French that attempted to construct pure factor returns.

Smart beta and factor indices are the confluence of those two sources in today's investment world. The mechanistic nature of factor indices, however, highlights the limits of style in investing. Sorting a universe of stocks into an index by a single crude measure such as Price-to-Book for Value won't distinguish those stocks that are 'cheap' because they are badly run from those that have been merely overlooked by the market or outshone by rivals. Add a couple of other standard metrics alongside Price-to-Book and there are still issues about whether the metrics get equal weighting in the sorting, are sequential, or done at stock, sector or portfolio level.

Nick Samuels, head of equity manager research at pension fund consultancy, Redington makes the point that a Quality index is a contradiction in terms: "There are only a handful of Quality stocks in the world. Creating a systematic index requires diversification but that only waters down the effect of the real Quality stocks."

So on top of any mechanistic analysis, there needs to be subtler understanding of the differences between stocks and greater work on the prospects for each company. After all, some stocks can veer from Value to Growth through time.

Many large caps started life below the Russell 2000. Style such as Quality have only been endorsed in the latest form a few years ago.

John William Olsen is portfolio manager of M&G's Global Select Fund. As an active investor, he believes that style categories can be "comfort blankets" for clients to give them a false sense of assurance that they "know your style". Olsen worries that this could result in the tail wagging the dog because the manager starts to worry about the "branding of stocks" more than the actual soundness of investments.

> "Style categories can be 'comfort blankets' for clients to give them a false sense of assurance that they 'know your style'"

He gives an example of the paradox of style: "If you are a contrarian investor, you may well score low on momentum. Contrarians go against market sentiment. I don't mind having momentum in the fund, but it's not something that we aim for. We want the negative momentum when we invest to turn into positive momentum. You have to be careful with style analysis because it is just a snapshot in time."

In some ways, the M&G Strategy should be easier to analyse than competitors over the long term because Olsen makes so few buys and sells: just three stocks added in the last twelve months. His average holding is six years.

And Olsen's preference for companies with a "moat" to protect earnings power seems to make him an obvious Quality manager. Holdings like Amazon would further indicate a Growth tilt. But in fact the biggest holding currently in the M&G Global Select Fund is UK retailer, WHSmith. "You won't find this in many Quality manager's portfolio," claims Olsen. This is because WHSmith was one of Olsen's opportunistic picks, not a classic Quality pick. He is very confident that the management team under Steven Clarke can grow earnings but this has been a story of execution on operational improvement, not one of revenue growth. In 2013, WHSmith was the third most shorted name on the London Stock Exchange.

Clarke and his team have concentrated on railway stations and latterly international airports as the location for branches. A traditional presence on the High Street is less meaningful with every passing year. Those branches are "run for cash" says Olsen. And instead of books and CDs, coffee and headphones are much more likely purchases. WH Smiths has franchise agreements with Costa Coffee and Royal Mail which add to the bottom line rather than the top line. While WHSmith varies its offerings, Olsen says there has been no cannibalisation or challenges from other chains at the airports and termini.

Olsen likes situations where a valuable part of a company is overshadowed by weakness – or perceived weakness – in the core franchise. This was also the case with Pets At Home, a retailer with a P/E of 9 when M&G stepped in. Pets At Home saw off online peers stepping up the competition in the important pet food space. But the jewels in the crown, according to Olsen, are the veterinary services housed within the retailer.

CROSSHEAD: PROFIT TURNAROUNDS

> “Turnaround successes are not exclusive to any category investment style”

Turnaround successes are not exclusive to any category investment style. They are attractive to a number of managers. Like Olsen, Laurence Bensafi, portfolio manager of RBC GAM’s Emerging Markets Value strategy, looks for turnaround opportunities as one of the themes she likes. In Emerging Markets, State-Owned or controlled Enterprises (SOEs) are worth roughly 25% of the index. Many are unpopular with foreign investors because of complaints of government meddling and inefficiency. This has certainly been the case with Eletrobras, Latin American’s biggest power utility, which five years ago was one of several electricity providers told by the Brazilian government to lower prices for customers or risk losing supply contracts.

“People saw that the company was not investment-led,” recalls Bensafi. But management has changed and new chief executive, Wilson Ferreira Junior introduced restructuring. “The month before we invested the government announced a power reform,” says Bensafi. Eletrobras’ privatisation was announced last summer.

Bensafi puts Russian utilities in a similar sleeve to Eletrobras: foreign investors stay away from such entities because they presume corruption and inefficiency related to the Kremlin. This leaves Russian utilities grossly undervalued – at bankruptcy levels, according to Bensafi – which is a buying opportunity for more rational investors such as RBC GAM.

There is an issue with ESG ratings: the RBC GAM EM Value Equity Strategy has a below-average score on some metrics. Morningstar scores the Strategy 1/5 on ESG. While she acknowledges this frankly, Bensafi’s argument is that these companies are improving: so it is the market and ratings agencies, not management, that is behind the curve. “These companies are cheap for a reason, which is often poor governance,” she says.

Specifically, she notes that Russia has been liberalising its power sector. Generally, she sees the heft of state-owned enterprises shrinking in decades to come as privatisations rise. Her strategy will profit from this trend.

But how to pick turnaround winners rather than losers? RBC GAM has a scorecard of 27 questions on governance to ensure its selections work. These questions are to avoid the kind of business that makes loans to related businesses or massages its financial numbers to appear more successful than is the reality. Failure on any of the questions signals an end to Bensafi’s interest. She gives South Korea’s chaebol as a good example of conglomerates that routinely attempt manipulation by means of Treasury shares, which by definition the company controls and are not in circulation. “They issue Treasury shares and then cancel them as and when it suits management,” said Bensafi. “They are used to bail out subsidiaries but is a poor use of cash.”

Olsen chipped in that with regard to ESG metrics, governance is by far the most important because management sets the tone on how all stakeholders should be treated including employees, customers and the environment. He adds that ESG ratings and information is ample for the top 100 companies in the world but thereafter tails away. He is proud of the intensive work his own buy-side analysts do on stocks, including a 130-page report on Amazon, and relies on this to inform his portfolio decisions.

“ESG is part of deep due diligence,” he says.

CROSSHEAD: PERSISTENT STYLE PREMIA

> “The spotlight then turned to investment consultants on the CAMRADATA panel, who all affirmed that they do use style in analysing managers’ performance”

The spotlight then turned to investment consultants on the CAMRADATA panel, who all affirmed that they do use style in analysing managers’ performance. Martin White, managing director at investment firm, Cambridge Associates, said its researcher team looks at managers internally by style. It also follows the categorisations such as Value, Growth and Core provided by US manager performance databases, although these are not adopted by Cambridge rigidly. “Growth is such a loose term,” notes White.

“We like style with a behavioural, longstanding endorsement,” said Samuels. “We have a clear philosophy about style that work. For us, they are value, momentum and quality. There ought to be a behavioural underpinning as to why these style should continue to work. Humans don’t really change,” he added.

Grace Lavelle, senior associate at consultancy and fiduciary manager, PSolve, said that it was important to consider a manager's style when evaluating their effectiveness. This matters as style, like many other factors in capital markets, wax and wane in their effect and can have a significant impact on performance. By removing the effects of style from performance, it is easier to isolate a manager's stock picking skill and gain a more accurate picture of their added value. There are a number of ways to do this, such as by conducting attribution relative to a benchmark on a style basis or by using regression analysis to build style-adjusted benchmarks.

> "By removing the effects of style from performance, it is easier to isolate a manager's stock picking skill and gain a more accurate picture of their added value"

Style is also important when it comes to manager selection and asset allocation, with different style looking more or less attractive at different times. "In particular, identifying where we are in the economic cycle, among other things, can help to inform which style we think will be in favour going forward" explained Lavelle. "As a simple example, coming into an economic downturn we generally favour exposure to higher quality stocks, while just following a downturn a deep value/recovery style may be more appropriate."

Mike Clark, founder director of Ario Advisory and a non-executive director of the Brunel Pension Partnership, the investment management company for ten local authority pension schemes in the South-West of England, made the point that regression analysis has its place but no active manager is a simple proxy for a style. "Investment style and fund style are never the same thing and fund style is more important," he said.

Even the latest fad for style indices, ie passive exposure to style via ETFs, has its limits, according to White. He reckons that ETFs, for example, struggle to capture Quality because they adjust holdings by price volatility rather than earnings volatility, which could be a more appropriate measure.

CROSSHEAD: MARKET SENSITIVITY

The conversation then turned to beta: any active strategy's sensitivity to market movements. "Beta plus style accounts for a large portion of most portfolio returns," said Samuels. "This drives client experience and managers respond accordingly."

Lavelle agreed that clients can become unhappy with short term underperformance even if caused solely by the manager's particular style being out of favour, despite having long term investment horizons.

It is therefore important to present performance against appropriate benchmarks and to have the patience to consider performance relative to a broad market benchmark over the longer term.

Olsen replied that this is part of the problem looking to style metrics: managers are judged over one investment cycle instead of the longer term. One well-established mechanism for smoothing returns is to hold managers in the same asset class but with different style. In Emerging Markets equities, RBC GAM shows the diversifying effectiveness of holding Bensafi's Value Strategy alongside colleague, Philippe Sands' Growth Strategy in a fixed blend. The appeal is to clients keen to enjoy superior returns but worried about the short-term volatility of Emerging Markets.

Bensafi notes that even on its own merits, however, her fund targets a beta of one while offering superior returns. So clients and advisers can see what kind of market sensitivity they should expect while enjoying performance of which 80% is derived from stock selection effects, according to Bensafi. Part of the reason here is that approximately 30% of her Strategy is in stocks outside the MSCI EM index. "I'm not dependent on the Value bias," she says.

> "Some of the largest asset owners in the world are now beginning to shun mainstream indices as they prefer to create their own beta, or "move the goalposts""

For those consultants and clients that do think in terms of style, Bensafi notes that Value has been out of favour for a number of years and is just coming back into fashion (Samuels remarked that some Quality managers had been so popular in recent years that fund selectors simply weren't able to buy into their funds).

On the topic of beta, Clark noted that some of the largest asset owners in the world are now beginning to shun mainstream indices as they prefer to create their own beta, or "move the goalposts". Many such shifts are caused by responsible investing, which means that ESG is becoming more influential as these metrics join standard financial metrics in company evaluations. Clark expects this to have a radical effect on active investing because the "tyranny of the benchmarks" will be broken as managers emulate these asset owners' perspective on key company criteria. "It's fascinating how many investment models are predicated on past returns," he said.

RBC GAM has undertaken extensive research into the future of automobiles. Bensafi's conclusion is that change is on the way not just for car manufacturers and oil producers like Exxon but insurers too. Her warning is that technological disruption happens faster than people think. "If you go back to 1985," Bensafi recalls, "AT&T asked McKinsey to predict mobile phone usage by 2000. McKinsey came back with an estimate of 900,000 handsets. The reality was 120 million."

RBC GAM believes that major car manufacturers are in the same position as AT&T in the 1990s, overconfident of the status quo. RBC GAM meanwhile is looking into the likes of Geely in China and Samsung in Korea [RBC GAM EM Value's biggest holding at the end of June 2017] as corporations profiting most from the shift to driverless and electric vehicles (EVs). For insurers, Bensafi notes that they will not have contact or contracts with drivers of autonomous vehicles – it is the manufacturers that would be liable (Volvo announced two years ago that it would accept this liability). That is a major disruption for the insurance markets.

As she describes driverless vehicles as tablets on wheels, there will be major upside for IT firms from Google down that can meet the twin demands of immediate sensory adjustments plus longer range orientation via cloud computing. Apple has set a date of 2019 to have its own EV ready for sale.

Are these good enough reasons to load up more on some of the priciest stocks in the world? Olsen thinks there is still value in Alphabet, Google's quoted parent. But both M&G Global Select and RBC GAM EM Equity Value are wary of joining any momentum trend late in the day. As truly active investors, they want to avoid the most damning style category of all: closet-indexers.

> "Are these good enough reasons to load up more on some of the priciest stocks in the world?"

Does style matter in emerging markets?

Looking at the assets managed in the Emerging Markets (EM) universe, you would believe that style does matter as the majority of assets are invested in Quality (45%) and Growth (17%); while approximately only 15% of total assets have a Value bias. If we further break down this 15% of assets with a Value bias, we find that a significant proportion is centred on passive strategies.

If we then compare these numbers to the Global equities universe, the approach is more balanced between Value and Growth. Additionally, rotation between styles does not seem as prevalent in EM; investors seem to be satisfied with exposure to a single style. There are several reasons why we believe this to be the case.

First, Quality and Growth have shown consistently strong performance, with any underperformance limited to short periods. If we look at the last decade, however, Value has exhibited more volatile performance on an absolute and relative basis. The magnitude of the outperformance of EM Value during 2016 has rarely occurred in the last two decades. Where this has occurred, the outperformance rarely extended into the year which followed; if it did, it was not with the same magnitude.

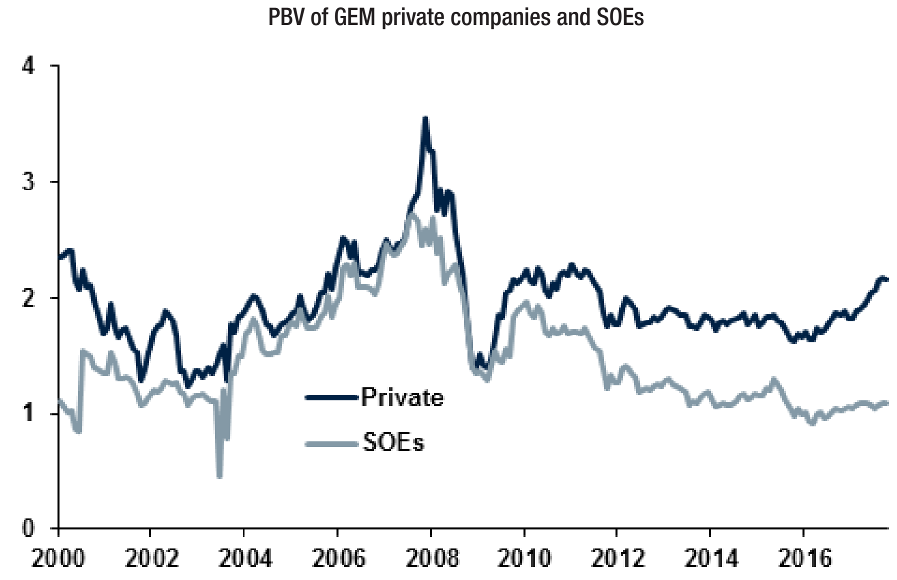
Second, when we look at the composition of the Index, we see that the Value Index contains many companies that most active investors tend to avoid, notably State Owned Enterprises (SOEs). Some of these SOEs are present in heavily regulated sectors. They may be poorly managed, with a high management turnover, or they may operate on behalf of the government, often meaning that these activities can negatively impact the company's profitability, its ability to generate strong cash flow and the creation of value for minority shareholders.

Third, Value investing often requires a contrarian mind-set as this can involve buying companies with depressed valuations. In some instances, a company's good fundamentals may have been missed by investors; in many cases, however, the stock's low valuation would be the result of more complex factors affecting the company. Particularly in EM, price momentum is a powerful factor which can make contrarian investing all the more difficult.

SOEs – a source hidden value?

SOEs currently make up approximately 26.5%[1] of the MSCI EM Index in terms of market capitalisation, and they represent an even larger weight in countries such as China (41%), Russia (53%) and Brazil (29%).

SOEs vs private: Price to Book Value



Source: RBC, Factset; 30/09/2017

1 Based on UBS estimates

RBC Global Asset Management

> "Value Index contains many companies that most active investors tend to avoid, notably State Owned Enterprises (SOEs)."

Written by Laurence Bensafi, Deputy Head of Emerging Markets Equity

As growth has slowed in most EM, corporate profits have suffered as governments have used SOEs to support the economy and subsidise the needs of an expanding middle class. Some noticeable examples of this include: state-owned banks expanding their loan books at low rates thereby taking undue risk and lowering profitability; companies in the energy sector keeping prices below those of international markets in order to limit inflationary pressures.

As a result, the return on equity (ROE) of SOEs has come under significant pressure over the past few years and 11% lower than non-SOEs[2]. Valuations have also steadily de-rated since the start of the current market cycle in 2009.

Looking ahead, there are increasing signs of reforms in EM that could align minority investor interests in SOEs with those of the state. First, as growth in EM improves, the need to regulate certain sectors, and provide more favourable pricing to the public, diminishes. Until now, control was deemed necessary in order to keep, for example, prices of electricity or refined products low as the population could not afford the international market price.

Second, since 2013 we have had significant changes to government leadership and political reforms, which bring hope of significant reform in the area of SOEs. For example, we have seen China embark on large reform programmes through supply-side measures, including excess capacity reduction and production cuts. Brazil's new administration also recently announced plans to reform the country's power-generation sector, followed by an announcement that Electrobras, Brazil's largest utilities company, would be privatised as early as 2018.

ROE of SOEs have also reached such low levels that they can only be improved from here. Ultimately, reform measures can help to increase efficiency by helping SOEs to reduce both costs and spending, improve capital structure, and increase cash flow and returns on assets, all of which will help to reduce high levels of leverage.

It is not a surprise that over the years SOEs have increasingly become an unloved segment of EM. Investors looking for quality businesses tend to find it difficult to become shareholders of SOEs, at least until stable and transparent frameworks have been put in place. A period of reforms, however, can lead to better returns and offer select opportunities.

Undiscovered opportunities

We have looked at the potential for hidden value in SOEs; however, value stocks are not limited to SOEs. Many value stocks are simply undiscovered as they have less analyst coverage, particularly in the mid and small cap segment. While the number of analysts covering EM stocks has increased over time, it remains significantly below that of those who cover the developed world.

Information is more widely available than previously, but it can sometimes be difficult to gain access to financial data. For example, many smaller companies in countries such as Taiwan or Korea still do not have annual reports in English which limits the access to the data for many analysts. Moreover, some companies do not report financial statements using the International Financial Reporting Standard (IFRS) accounting principles; therefore investors tend to avoid them as it is often difficult to make a comparison to those located in different countries.

There are ample opportunities to capture upside in undiscovered and overlooked companies, however, it is important to be prudent when investing in this segment; investors should carefully identify catalysts for a re-rating, otherwise the stock may very well be a value trap.

2 Based on UBS estimates

> **"Many smaller companies in countries such as Taiwan or Korea still do not have annual reports in English which limits the access to the data for many analysts."**

> **"EM Growth has been the material outperformer in 2017, while EM Quality and EM Value have lagged."**

Is there upside from Value investing now?

2016 marked an upturn in fortunes for EM Value, as this was the first year in six that EM Value outperformed both EM Growth and EM Quality. On the other hand, EM Growth has been the material outperformer in 2017, while EM Quality and EM Value have lagged. In an 'up' market, it is extremely rare to see Value lag Growth by such a significant amount.

It is noteworthy that we have seen a stabilisation of EM ROEs after years of decline. In particular, we find that the valuation spread of high-ROE stocks to low-ROE stocks has been narrowing. Although the valuation for the highest quality stocks remains expensive, recently there has been a rebound in the lowest ROE stocks, which bottomed in December 2016. While the valuation spread between high-ROE stocks and low-ROE stocks has contracted somewhat in recent months, it still remains close to historical highs and suggests that further normalisation in the valuation spread between the two factors through stronger Value relative performance is possible.

PBV Spread of Top ROE/ Bottom ROE

Source: RBC, Factset, as at 30/09/2017

Ultimately, we argue that EM equities are an inefficient asset class allowing astute investors to outperform the benchmark over time. As an overlooked segment of the market, we believe that the potential for alpha in the Value segment is even larger. Investors need to be prudent when identifying select Value opportunities with catalysts for re-rating and as a result avoid "Value traps".

CAMRADATA

Upcoming conferences

Investor Conference

Incorporating Change, Driving Potential

Grocers' Hall, Princes Street, London EC2R 8AD

30 November 2017
9.00 - 16:00: Including lunch and drinks

CAMRADATA's Investor Conference will highlight how institutional investors can adapt to ongoing changes in the financial markets and investigate opportunities that offer potential for maintaining and generating return for the future.

To enquire about this event or to find out more about other exciting events planned for 2017:

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