

Schroders Global Active Value Positioned for recovery...

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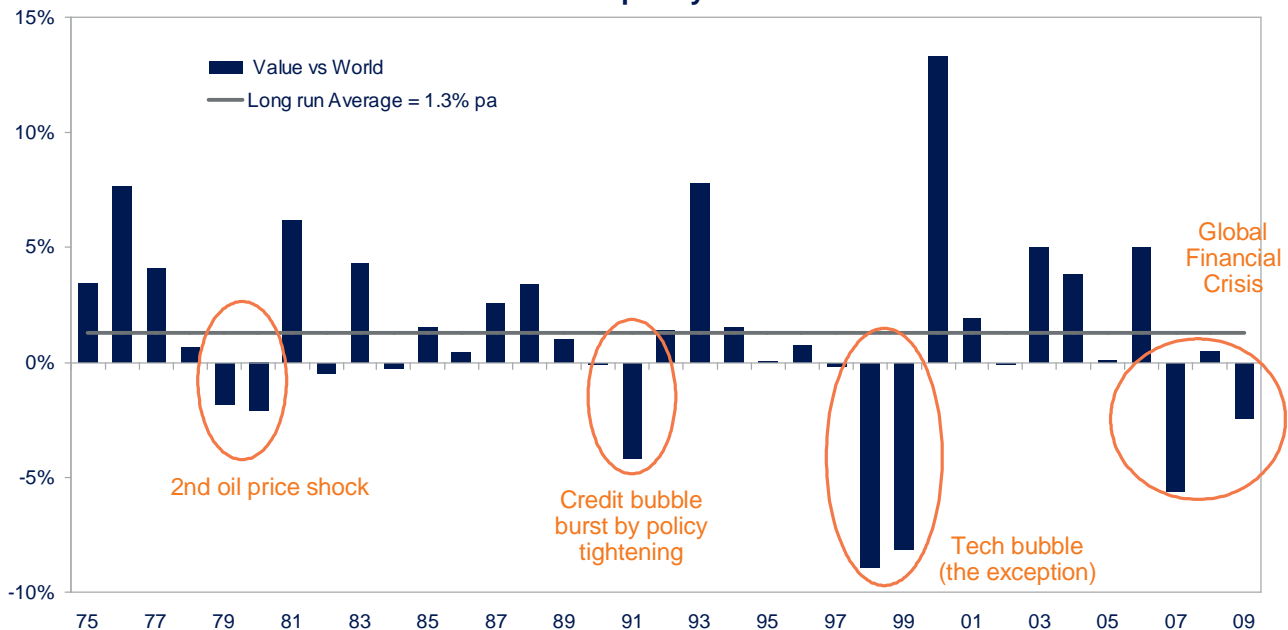
Outlook for Value

Value investing – the practice of buying stocks that appear underpriced and holding them until the market realises their true worth – has been one of the most successful equity strategies over the long run but can suffer short term periods of underperformance particularly during times of economic stress. In contrast to the widely held view that high dividend yields provide a floor on company share price valuations, the reality has been that Value tends to deliver lumpy returns with a disproportionate amount of its best returns being generated during cyclical recoveries.

Many studies show a premium attached to Value investing and it is during times of distress that opportunities arise and set investors up for the next rebound. Periods of underperformance such as the recessions of 1980, 1990 and early 2000 are typically followed by strong outperformance. Investors need to constantly remind themselves of the importance of being contrarian. The chart below shows the relative performance of Value versus MSCI World and one can clearly see how Value struggles during periods of heightened risk but subsequently recovers strongly to generate a positive long run excess return.

Chart 1

Value tends to be pro-cyclical or risk driven

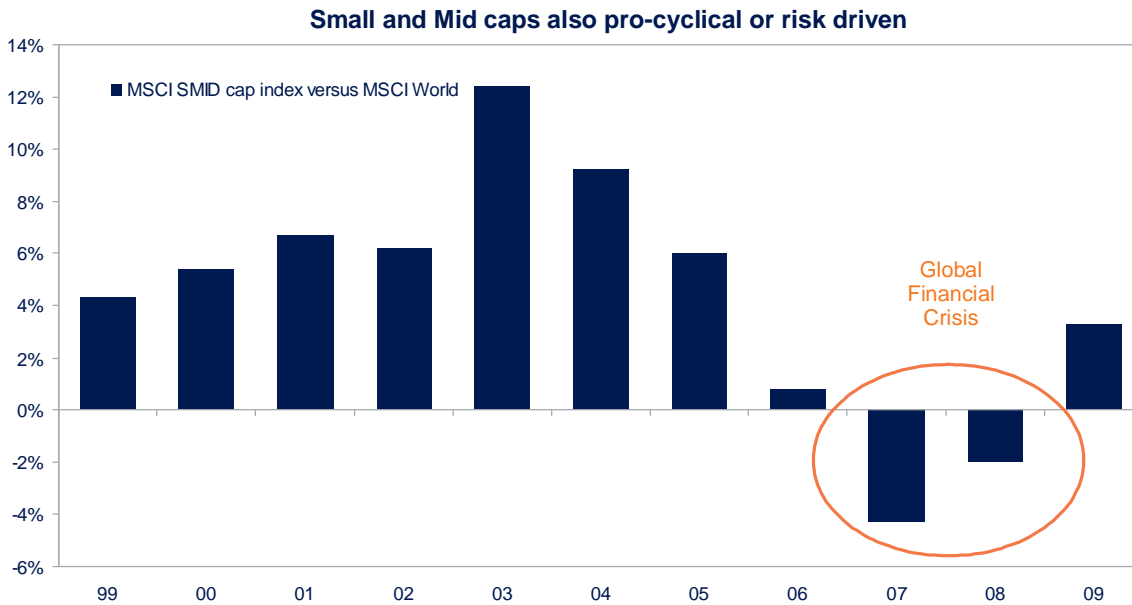


Source: Schroders, MSCI

The underperformance of Value over the last couple of years is consistent with a slowing economy as companies' earnings and profitability came under pressure. Value represents the cheapest half of the market and this includes many companies considered to be of poor quality, represented by declining profitability and poor financial strength. These poor quality companies are predominantly cheap as they are exposed to a slowing economy.

With the onset of the Global Financial Crisis, 2007 and 2008 saw a tremendous "flight to quality" as risk averse investors chased traditional defensives and large cap stocks. Value underperformed the broader market as the global economy entered recession alongside mid and small-cap stocks which acted as a further drag on the performance of unconstrained equity based strategies such as Global Active Value (see chart 2).

Chart 2 – performance of MSCI SMID cap index versus MSCI World



Source: Schroders, MSCI

However, as the chart shows, small-cap and mid-cap stocks have already started to recover strongly reflecting the moderation in risk aversion since early March. From a valuation perspective, they are trading on a lower price to earnings ratio relative to large caps than historically has been the case whilst they are also benefiting from an improvement in liquidity and are generally more sensitive to economic activity.

Global Active Value strategy recap

Global Active Value is a long term strategy and over the course of the cycle we would expect to make 3 to 4% above global cap weighted indices. However, as it is a benchmark unaware strategy and completely bottom-up, it can look very different to the benchmark in the short-run and we should not be surprised by significant volatility in short-term relative performance. A review of the three main building blocks of the Global Active Value strategy provides a good framework for understanding these performance drivers of the strategy over time

Building blocks of Global Active Value

Value	<ul style="list-style-type: none"> – A deep Value strategy: looking to buy cheap and sell expensive stocks. The Value premium is to a large extent a risk premium and performs much better when there is a greater tolerance for risk. It's therefore pro-cyclical, underperforming in economic downturns and outperforming when markets recover.
Non-market cap	<ul style="list-style-type: none"> – Non market cap, benchmark unaware. Strategically the strategy avoids mega-cap stocks resulting in more of a tilt to mid and small cap stocks than the index or most competitors, again pro-cyclical
Breadth	<ul style="list-style-type: none"> – Exploits huge breadth and taps companies from both developed and emerging markets to maximise opportunity.

When one or more of these building blocks are working the strategy typically exhibits good returns. When all of the building blocks are supportive, the returns can be outstanding as was the case in 2005 and 2006 and more recently in March and April 2009.

Performance

Despite considerable headwinds during the global economic crisis of 2007 and 2008, Global Active Value has recently delivered strong returns which has more than retraced the drag in performance during that period.

Trailing returns to 30 April 2009 (net of fees)

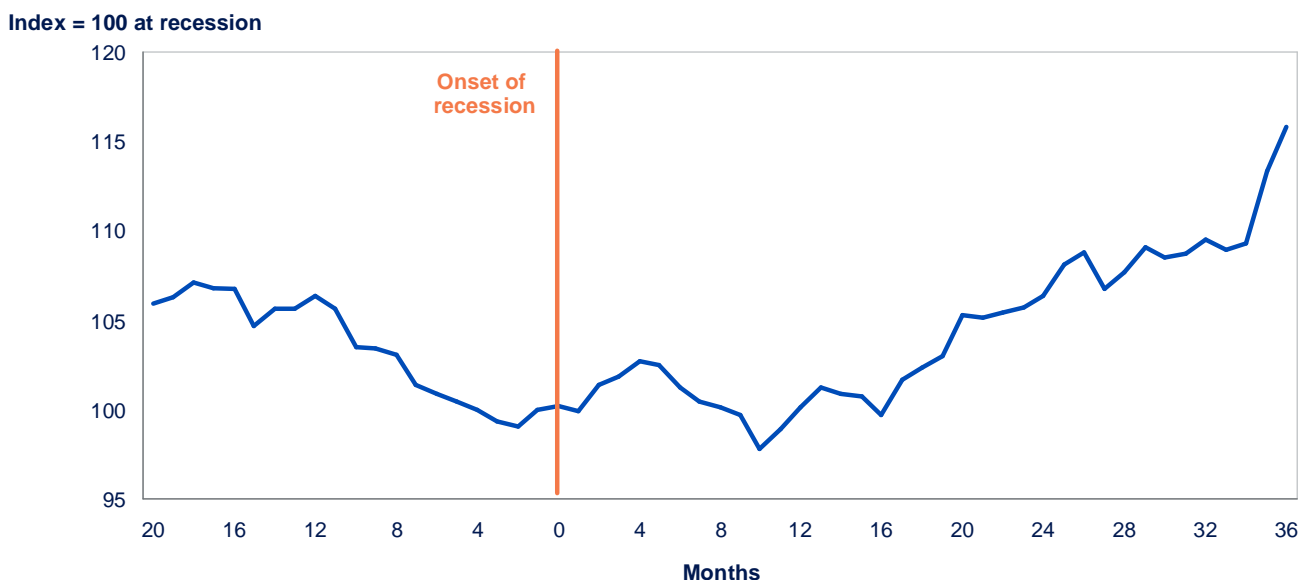
	1 month	3 month	1 year	3 year (pa)	Since inception* (pa)
Schroder Global Active Value Fund	10.29	-0.52	-15.57	-8.48	-1.90
MSCI World ex Australia NDR	5.18	-7.52	-22.02	-10.69	-4.42
Excess	5.11	7.00	3.45	2.21	2.52
Schroder Global Active Value Fund (Hedged)	15.47	14.89	-36.65	-11.47	-4.57
MSCI World ex Australia NDR AUD Hedged	10.23	6.74	-36.41	-11.35	-5.47
Excess	5.24	8.15	-0.24	-0.12	0.90
Schroder Geared Global Active Value Fund (Hedged)	31.05	23.31			-63.84
MSCI World ex Australia NDR AUD Hedged	10.23	6.74			-32.29
Excess	20.82	16.57			-31.55

Source: Schroders, MSCI

Prospects for Value

As noted above, periods of economic growth and particularly the early stages of recovery are supportive of Value based strategies. Chart 3 shows the relative performance of a Value strategy in the US back to the 1920's, the benefit being that we include no less than 13 recessions in the sample period. It is clearly apparent that Value underperforms as the economy turns down but then performs very well just after the onset of recession. This performance is particularly strong when valuation spreads are very wide – that is, the valuation gap in the market between the most expensive and cheapest stock is at an extreme as it is now. During these times the returns to bottom up active stock picking have far greater potential.

Chart 3 Performance of Value vs “non-Value” since 1926 in the USA before/after onset of Recession



Source: Schroders NBER, K. French, Based on 13 recessions since 1926. 'Cheap' based on a "High" minus "Low" Book Yield strategy.

Outlook

The market backdrop of the past two years has not been conducive to Value nor for small/mid caps or Emerging Markets and this has adversely impacted upon performance. However, the underperformance of these themes is consistent with the cyclical downturn and flight to quality and is something which has happened many times before. The underperformance of Global Active Value in 2007 and 2008 is not out of line with previous cycles and quickly reverses when risk appetite returns as we have seen so far in 2009.

History has shown us time and time again that recessions create investment opportunities and a Value strategy is one of the best ways of exploiting this. Indeed, it is the very source of the Value premium. Whilst we expect the market to remain volatile in the short term as the economic newsflow is digested, the market has not historically had to wait for evidence of recovery to start pricing one in. Typically, the best times to purchase Value is at the nadir of recession. Global Active Value is a strategy which will also benefit from the impact a global pro-cyclical recovery will also have on small/mid caps and emerging markets. It is a strategy positioned well for a future recovery.

In the long run, the prices of financial assets must converge on their fundamental values. Value investing is a discipline that takes full advantage of this timeless principle and there is still plenty of opportunity for investors to take advantage of this even despite the rally we've seen in March and April 2009.

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