Does Value Protect You In a Crisis? – Market Commentary

April was a rare month in recent times when Emerging Markets (EMs) outperformed falling Developed Markets (DMs). Rarer still, South Africa (SA) outperformed EMs.

SA returned +3.0% in ZAR terms and +3.5% in USD terms outperforming EMs which returned +0.7%. For the year-to-date SA remains behind EMs at -2.3% vs +2.8% respectively. EMs remain behind Developed Markets (DMs) represented by the MSCI World Index at +4.8%.

DMs were negative this month at -3.7% with the S&P 500, the key market (the US represents 70% of the MSCI World) down -4.1%, but still at +5.9% for the year to date.

The negative DM return was not a surprise since US Treasury yields increased. The 10-year Treasury yield ended the month at 4.7% vs 4.2% at the end of the March. Equally no surprise was the MSCI Growth Index underperforming the MSCI Value Index at -4.0% and -3.4% respectively though the margin of underperformance was small. The Nasdaq similarly underperformed the S&P 500 -4.4% to -4.1%.

The various market returns are summarised in Table 1 below.

Table 1. South African and global equity returns (USD) for April 2024*

	Apr-24	YTD 2024
FTSE/JSE ALSI (ZAR)	3.0%	0.6%
FTSE/JSE ALSI (USD)	3.5%	-2.3%
MSCI World	-3.7%	4.8%
MSCI EM	0.7%	2.8%
MSCI Value	-3.4%	3.8%
MSCI Growth	-4.0%	5.8%
S&P 500	-4.1%	5.9%
Nasdaq 100	-4.4%	3.9%

*Total return indices, Source: Factset

US economic data continues to be interpreted as positive by the market. Recent GDP growth and unemployment both came in below expectations however, and instead of concern at what this might signal for future readings and earnings prospects, the market rose in response to a greater probability of a sooner rate cut.

Nevertheless the next GDP growth projection is in excess of a healthy-sounding 3%. Indicators remain mixed and we remain cautious – sharp market declines occur because of surprises and we continue to draw parallels with 2007, although any downturn, both economic and market, is unlikely to be as sharp. Underlying the supposedly positive releases (unemployment was up) is a festering commercial real estate problem, a bank crisis, which at least for now appears to have been contained, another real estate problem in China, uncertain geopolitics and interest rates which, both long and short, are at levels last seen in 2007. Recessions are also said to commence up to 18 months post- the peak in interest rates (economists speak of 'long and variable lags of monetary poicy'). Hence we feel that caution is advised.

Does a Value approach protect you in a downturn?

There is a common perception that Value outperforms in a downturn. The argument suggests that since Value shares are already at low valuations, when the market declines Value shares fall less if they fall at all. Is this true?

In our experience it depends. It is often the case that in the everyday ebb and flow of markets when a correction occurs Value shares indeed decline less. In a crisis, however, there is a different dynamic.

What happened during Covid?

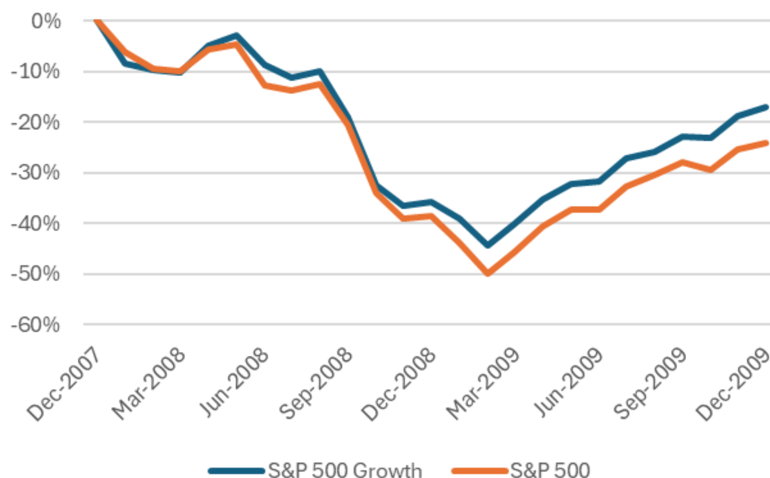
Memories are short in investment markets but Covid is still fresh and Value funds underperformed significantly through the crisis. Covid was not a conventional crisis however.

What about the crisis in 2008?

We consider below the performance of the S&P 500 Growth and Value Indices over the 2008 and 2009 period. The two indices are not fully mutually exclusive and there is some overlap but they do cover the S&P 500 universe and a comparison is useful in identifying whether Value stocks indeed provided protection in a more conventional crisis.

Chart 1 below presents the performance of the S&P 500 Growth Index relative to the S&P 500 over the 2008-2009 period.

Chart 1. S&P 500 Growth Index vs the S&P 500 for 2008-2009



Source: Factset

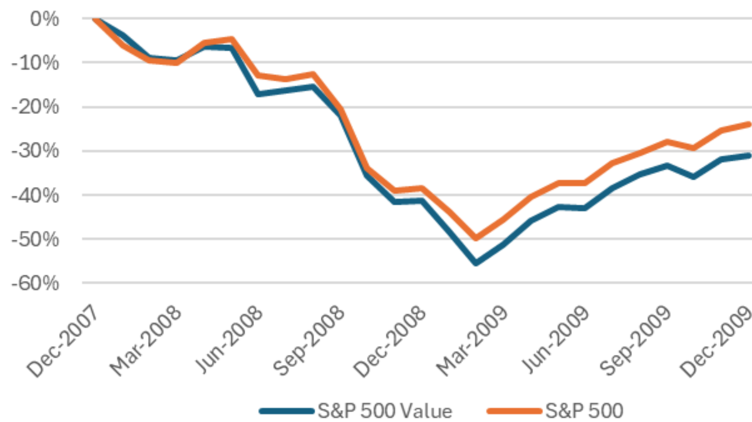
The Growth Index returned -17.1% for the 2-year period from the beginning of 2008 to the end of 2009. The S&P 500 returned -24.1% over the same period.

What about the Value Index? This is presented in Chart 2 below.

Over the same period the S&P 500 Value Index returned -31.0% vs the same -24.1% for the S&P 500.

The margins of out- and underperformance for the 2 indices relative to the S&P 500 are somewhat small for the 2-year period – 7% for the Growth Index, and also just under 7% for the Value Index. Per the charts they are also relatively consistent, however. Perhaps more importantly, the difference between Growth and Value is a far more substantial -17.1% vs -31.0% margin.

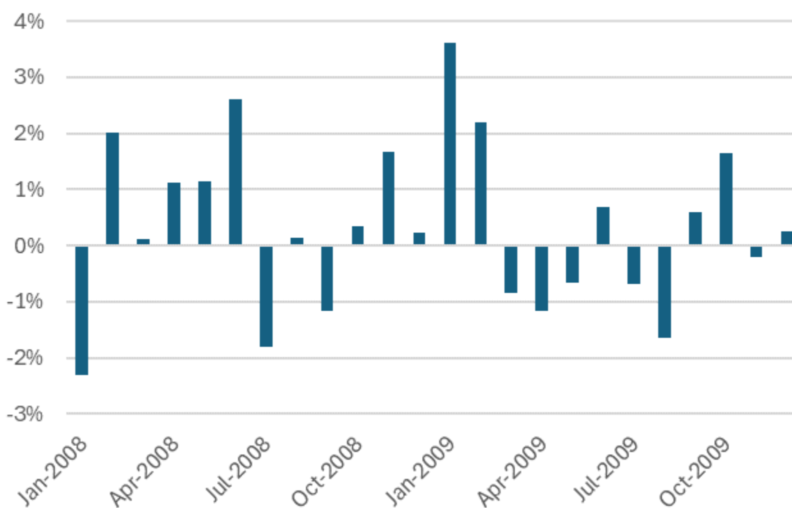
Chart 2. S&P 500 Value Index vs the S&P 500 for 2008-2009



Source: Factset

We also know that the low point was reached in February 2009. Examining the monthly out- or underperformance of each index also provides some insight. The active returns for the Growth Index are set out in Chart 3 below.

Chart 3. Monthly active return for the S&P 500 Growth Index



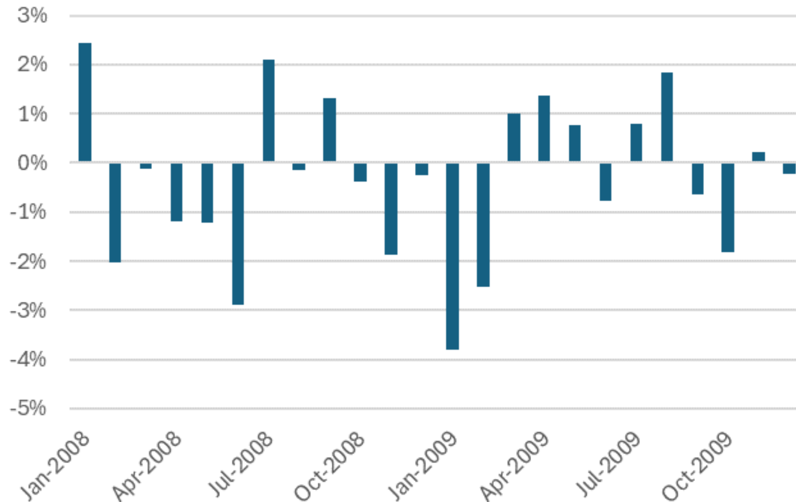
Source: Factset

Lehman Brothers failed on 15 September 2008. The Growth Index underperformed by just over 1% in September of that year but thereafter followed this by 5 consecutive months of outperformance, including in February 2009.

The Value Index in contrast, presented in Chart 4 below, outperformed by just over 1% in September 2008, but then proceeded to underperform for 5 straight months leading into

February 2009. The largest of these were in January and February 2009 for a cumulative -5.6% underperformance over the 2 months.

Chart 4. Monthly active return for the S&P 500 Value Index



Source: Factset

We also note in Chart 4 above, for the Value Index, 5 consecutive months of underperformance from February to June 2008.

Value in a crisis

Statistically there are not many recessions to choose from over the last 20 years, and this commentary is not an exhaustive study. We know, however, that Value underperformed during Covid and Value underperformed during the Financial Crisis. Why would this be?

While interest rates tend to fall in a crisis, which is supportive of valuations, the other factor affecting stock prices is company profits. Since the Value Index already comprises companies with beaten down valuations the presumption is that these have already had a problem of one sort or another. As such their earning potential through a crisis can also be expected to be poorer than alternatives. We think it is this poor profit performance, or expectations of poor profit performance, that drives the underperformance.

Within the Growth Index growth rates can also logically be expected to fall. On the other hand this Index also contains companies which have greater resilience through lower but more consistent growth rates and greater reliability of revenues and profits. This latter set is the kind that the M1 Capital Equity Prescient prefers to choose from. Should a downturn materialise we hope that our holdings will fare better than the market.

Summary

In summary while the market outlook continues to be positive, we are more cautious and believe there is a not immaterial chance of a downturn this year. Should this view materialise we prefer the greater security of better operationally-performing assets and continue to advise caution.