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Barrow Hanley: how to play the return to value investing as big tech falters

By Perpetual Asset Management

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Concerns about the prospect of recession in the US are paving the way for renewed interest in value stocks, argues Barrow Hanley's Brad Kinkelaar

- US recession fears roil markets

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A SHARP sell-off following weak US economic data has rattled global equities markets as the favoured big tech and AI trades that have dominated investor thinking over the past 18 months start to reverse.

But Barrow Hanley's Brad Kinkelaar says the shift is simply bringing some much-needed reality back to markets – and could usher in a return to value stocks' outperformance after a period of lower returns.

"In an environment where mega cap tech AI growth companies outperform in a very narrow market, you should probably expect your contrarian value manager to underperform – and that's exactly what's happened," says Kinkelaar, a senior managing director and equity portfolio manager at US-based value manager Barrow Hanley (part of Perpetual Group).

But a closer look at the numbers shows important periods of outperformance for value stocks in the past 18 months – and a return to reality in markets could usher in further gains, he says.

Broadening market

Some 60 per cent of value managers have underperformed the value index over the last three years, while around 90 per cent of growth managers underperformed the growth index over the same period, Kinkelaar says.

"This really doesn't surprise us.

"The narrow market is taking its toll on active management. If you're not in the index, you're probably not going to be overweight the narrow range of stocks that have outperformed."

In the last 12 months, the top quintile of momentum stocks surged by 50 per cent, while the remaining 80 per cent of stocks averaged a more modest 13 per cent return.

That makes it challenging for active portfolios to compete with an index that gained 20 per cent during the same period, he says.

But investor focus on neat quarterly and annual reporting periods is obscuring the true dynamics unfolding in the market, Kinkelaar says.

"Economic cycles don't always fit nicely into quarters."

Analysing the same data over slightly different time periods shows a very different story.

"What gets lost in discussion is that this hasn't been a one-way trade since October."

Active management can add value

The market's first bet on big tech, AI and looming rate cuts only really lasted for about three months through to February 2024, he says.

"During the next period, roughly three months, the market broadened out. You had more active management adding value. We were up 12 per cent, world value was up 8 per cent and growth was up just 5 per cent.

"So, once we got into a more normal environment, our value portfolios did exactly what we were supposed to do."

A similar story repeated in July as investors started to rotate out of tech into small caps, sending growth stocks sharply lower while value stocks held flat.

"So, this hasn't been the same trade since October, and I think that that gets lost on a lot of people.

"We're starting to see some more reality built into the markets now.

Value set to outperform

The implication for investors? Stay disciplined.

"Most people are playing the same hand. Most people are playing the soft landing, growth funds, tech stocks, AI.

"But we go to where the value is, not to where the momentum is.

"It's the periods like these that are intermittent among the one-way bet that makes us confident that our discipline works, our strategy works.

"We haven't changed what we're doing. And when you have a broader participation in the market, we do exactly what you hope we would do."

About Barrow Hanley

Barrow Hanley is a global leader in value investing, managing assets for clients for more than 40 years.

Barrow Hanley Global Share Fund aims to provide investors with long-term capital growth through investment in quality global shares.

Rated "Highly Recommended" by Zenith, "Highly Recommended" by Lonsec and with a Morningstar Medallist rating of "Gold", the investment team focuses on finding value in all the right places.

Find out more here.

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