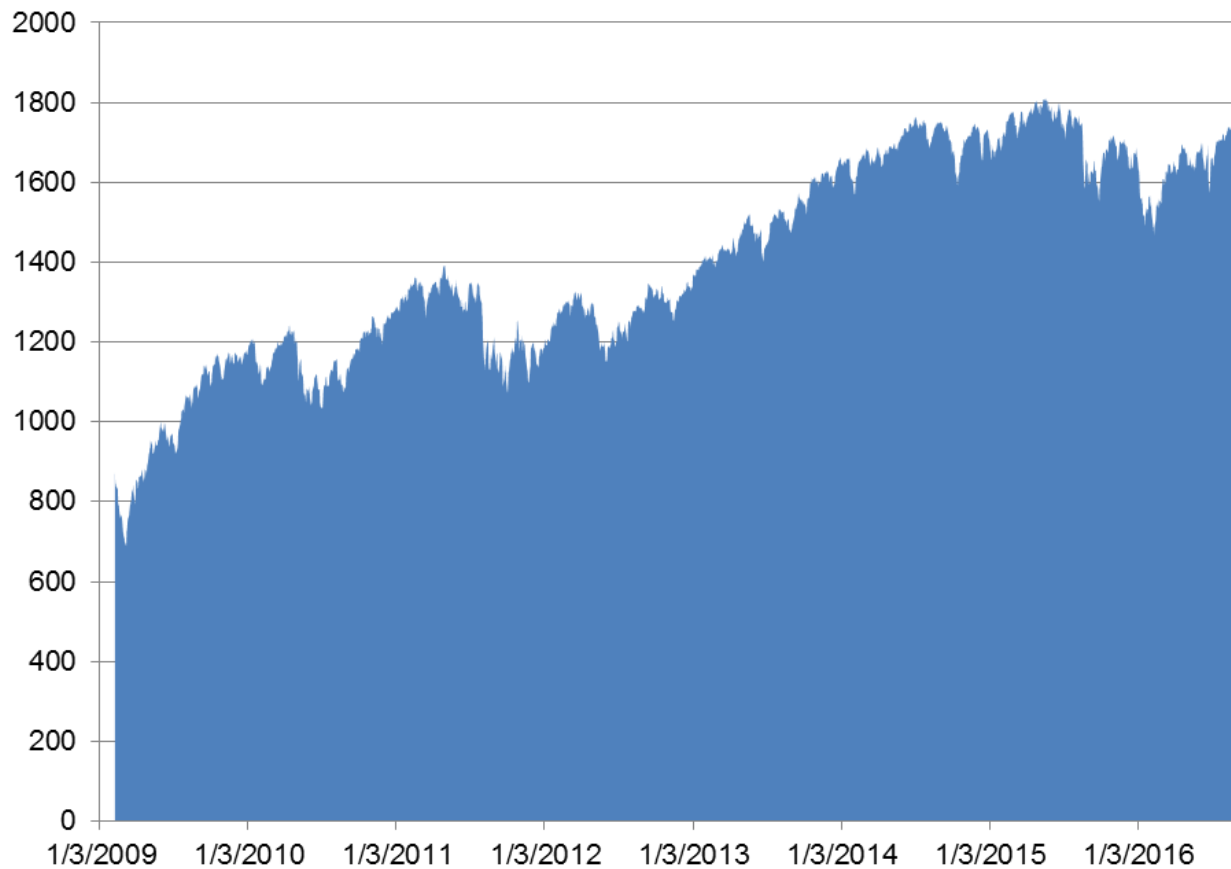


Beware: Value Traps Lurking

Valerie Newman, CFA
Senior Client Portfolio Manager

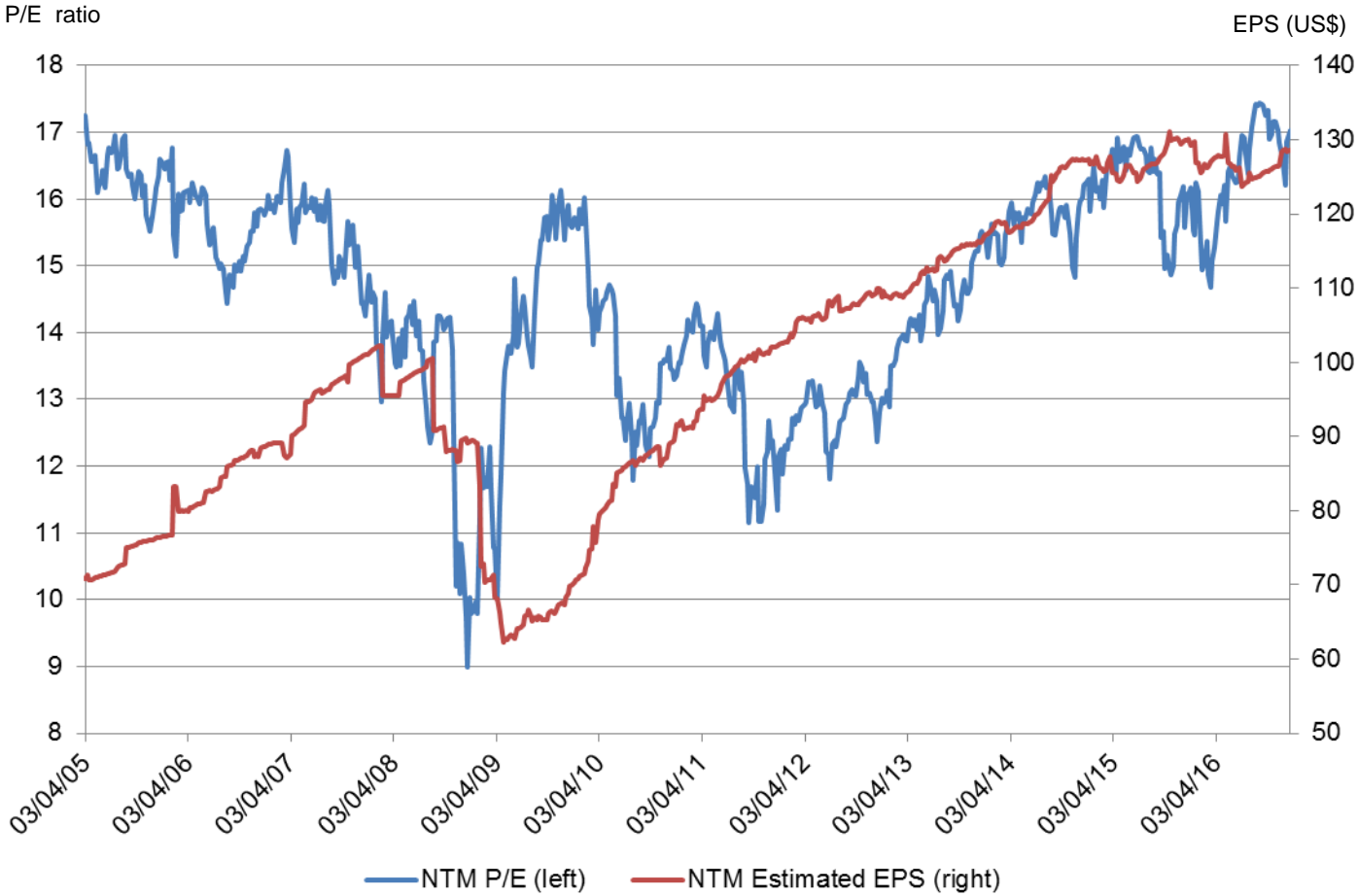
MSCI World Index

Cumulative Performance 03/01/2009-09/30/2016



Source: Bloomberg, as of 30 September 2016.
Past performance is not indicative of future results

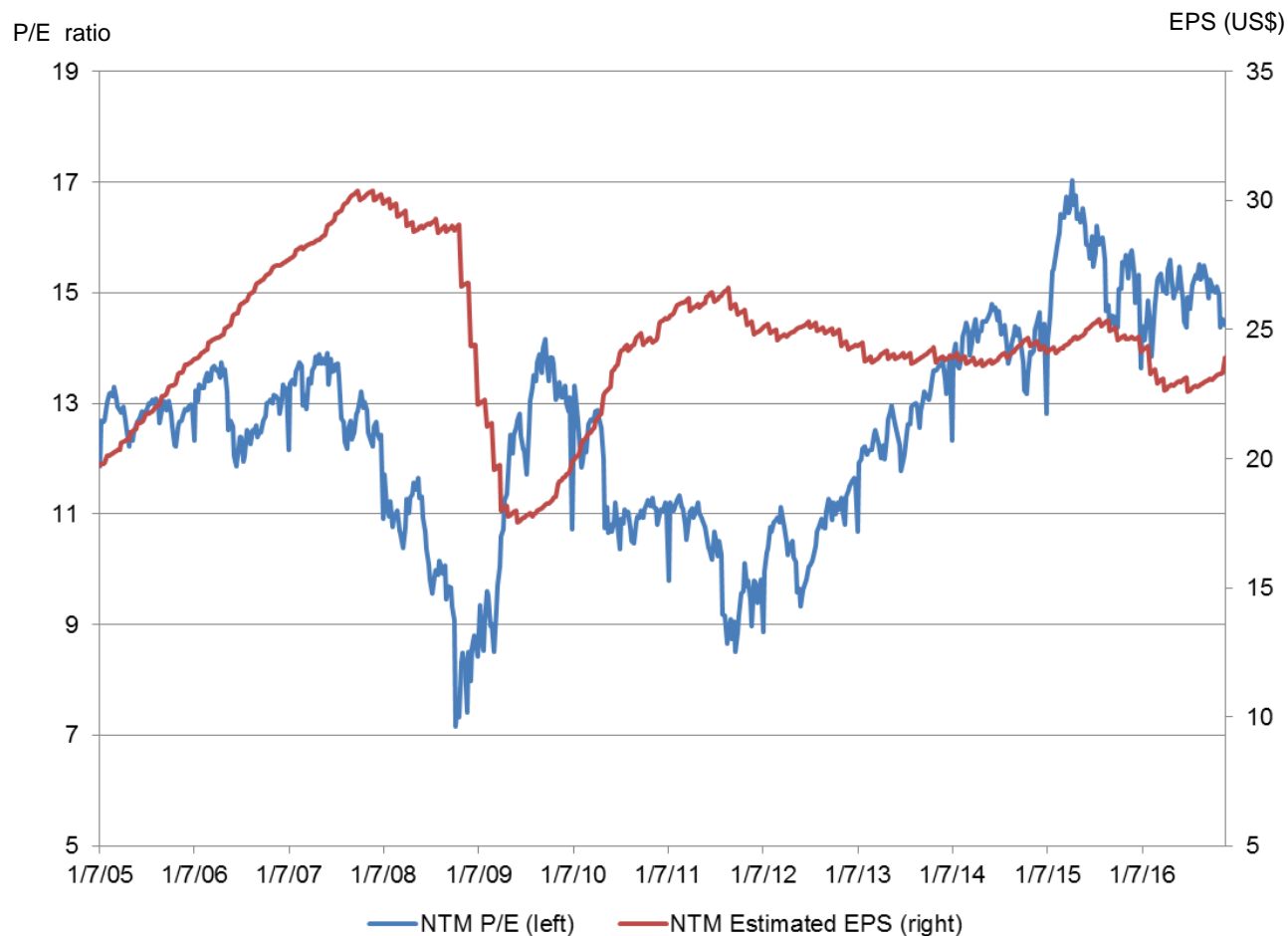
US earnings & valuation (S&P 500)



Source: Bloomberg, as of November 2016

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Europe earnings & valuation (STOXX Europe 600)

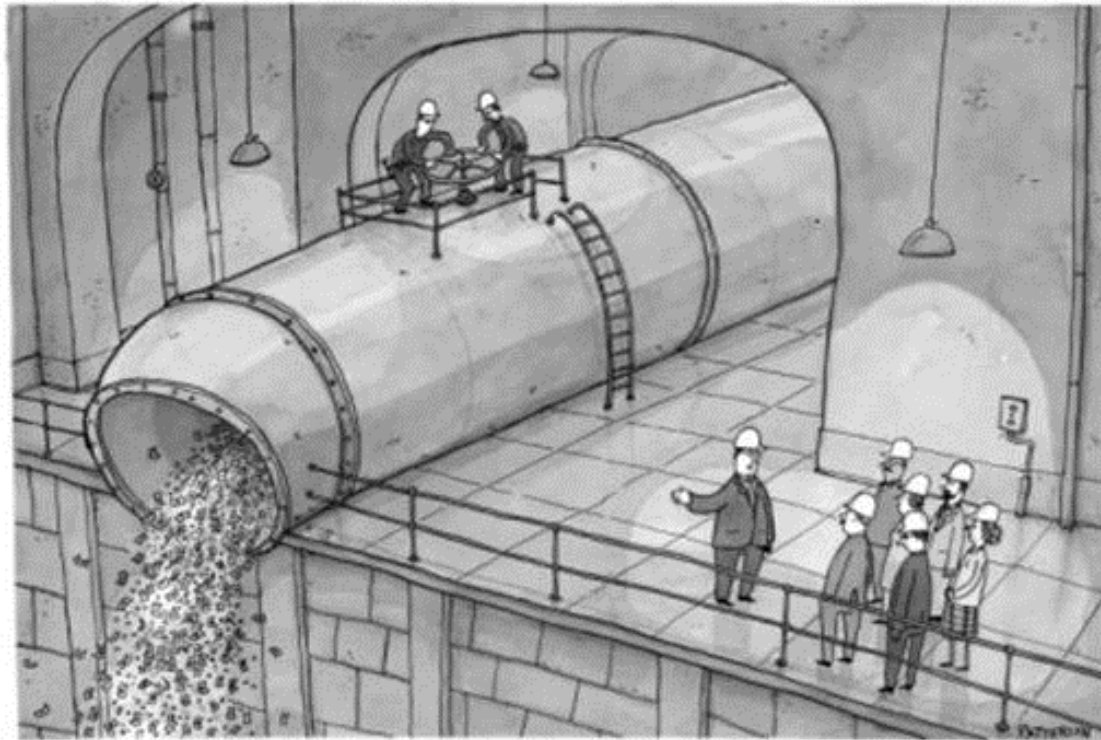


Source: Bloomberg, as of November 2016

Central Bankers at work

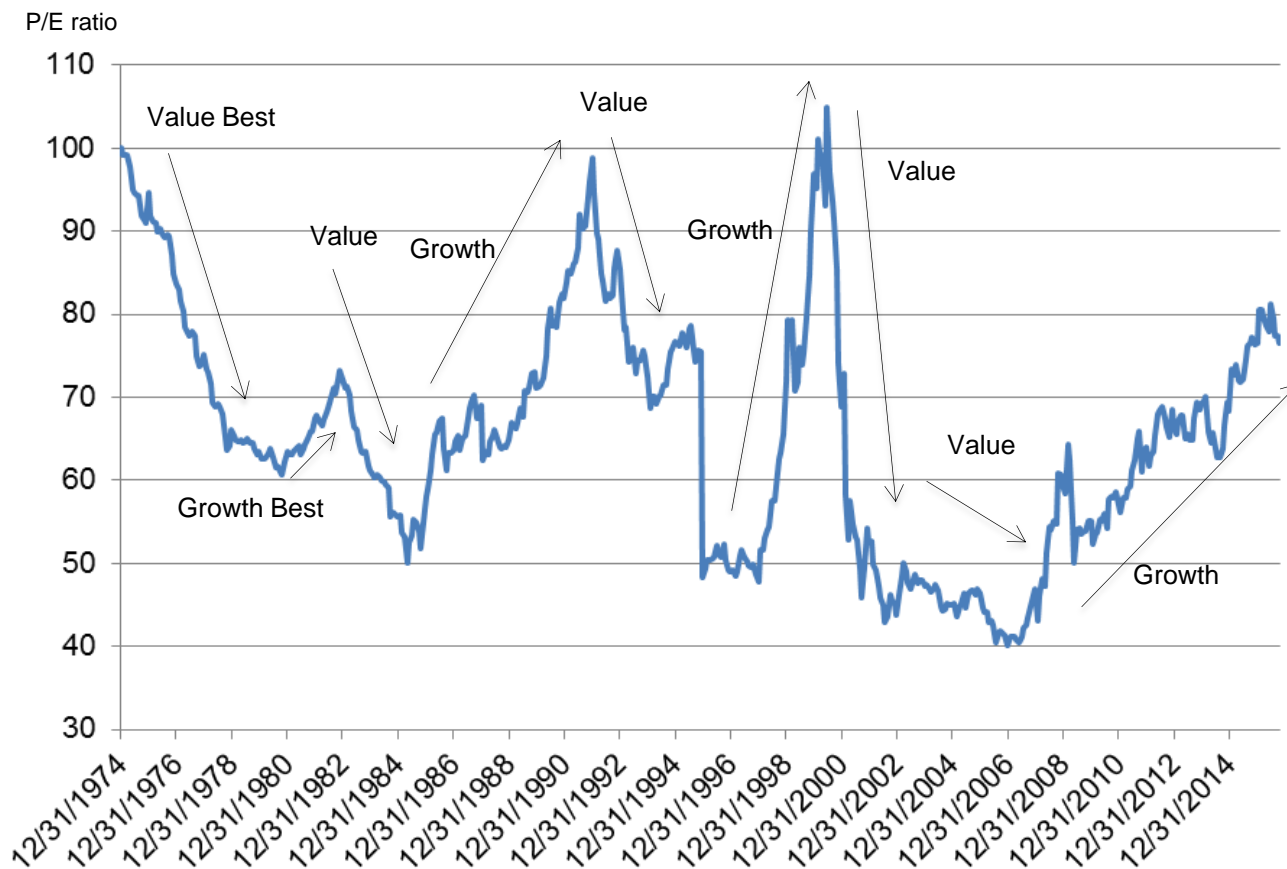
“... At this juncture, however, the impact on the broader economy and financial markets of the problems in the subprime market seems likely to be contained.”

— Ben Bernanke, March 2007



“And this is where we adjust the interest rate.”

S&P 500: Growth vs Value



How do you define value?

“...it seems to me, the choice isn’t really between value and growth, but between value today and value tomorrow.” – Howard Marks

- ▶ **Value Investors:** buy stocks out of conviction that the current value is high relative to the current price
- ▶ **Growth Investors:** buy stocks because they believe the value will grow fast enough in the future to produce substantial appreciation

Not all value managers are created equal

- ▶ **Deep Value:**

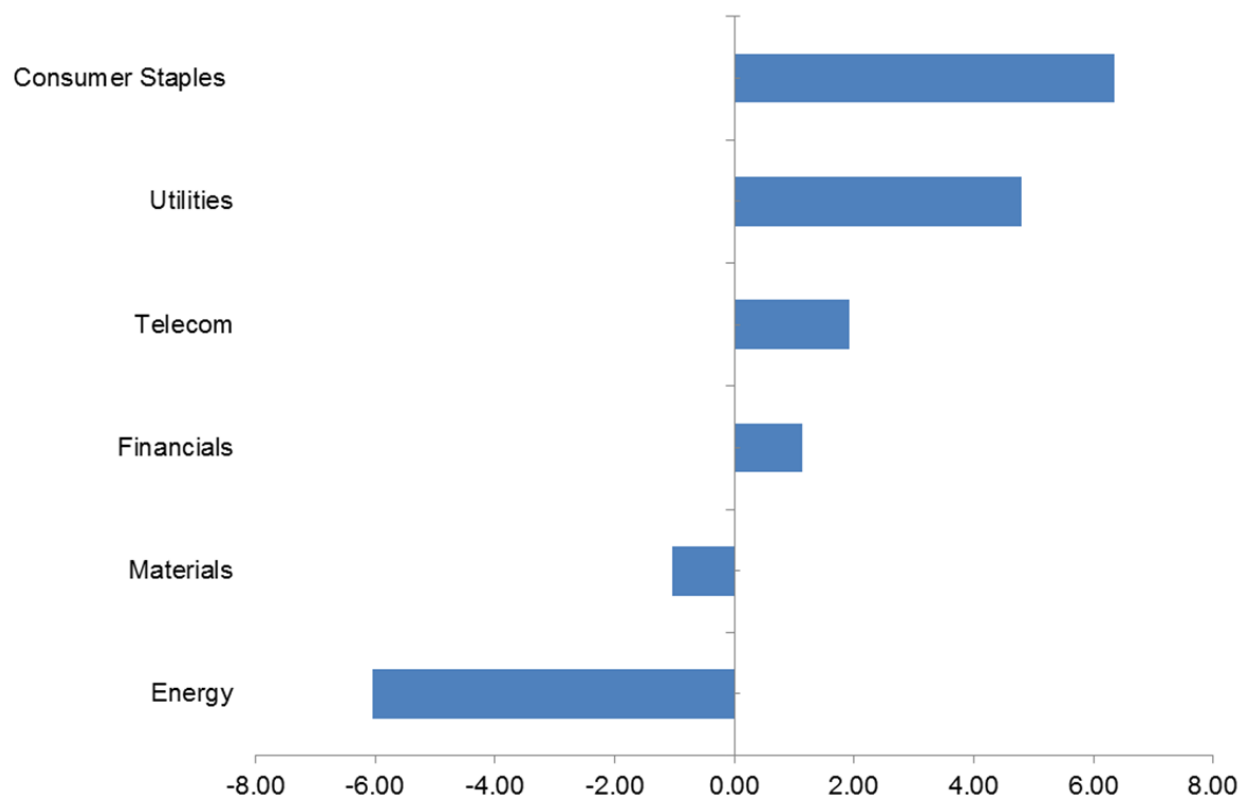
Tends to buy the cheapest stocks on P/B and P/E metrics. This style tends to focus on stocks which are very out of favor, and relatively little attention is paid to balance sheet condition, competitive position or management.

- ▶ **Quality/Defensive Value:**

Tends to buy stocks which are out of favor, yet have quality aspects such as strong balance sheet, durable competitive advantage and capable management. Valuation considers both traditional metrics such as P/E and P/B, as well as the quality elements.

Dichotomy developing between stable and cyclical

3-year Annualized Returns for selected MSCI World Sectors



Source: MSCI, 31 October 2016. Past performance is not indicative of future results.

5 types of Value Traps Lurking



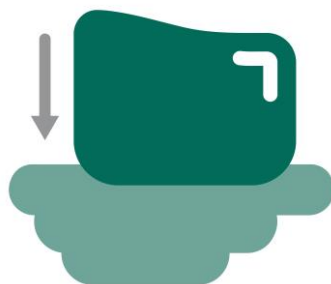
The Cigar Butt



Cheap On Peak



Competition catches up



The Melting Ice Cube



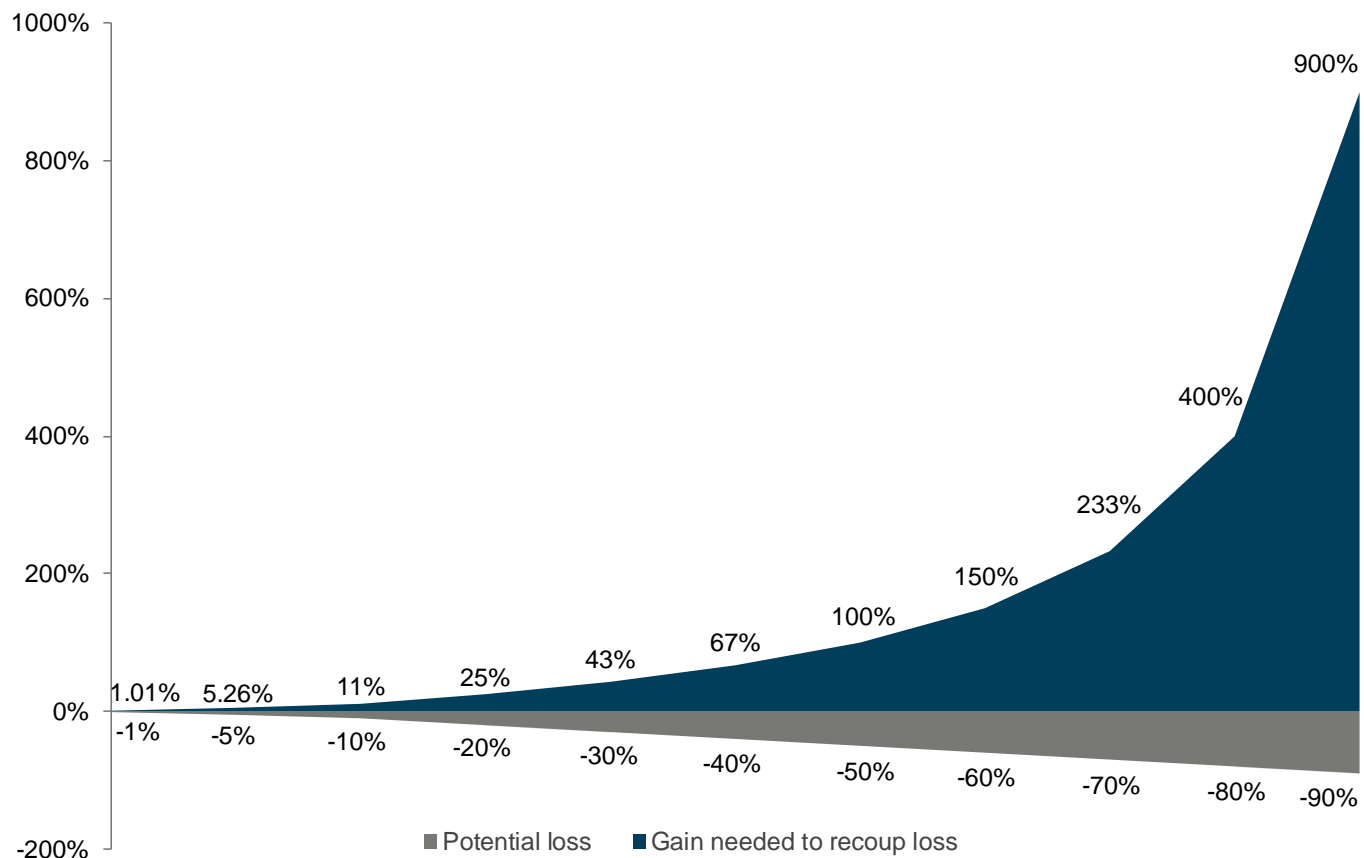
Volatility Trap

Five methods of avoidance

- ▶ Competition
- ▶ Balance Sheet
- ▶ Valuation
- ▶ Management
- ▶ Portfolio Construction

The importance of limiting losses

- ▶ As an investment decreases in value, the gain needed to get back to even increases exponentially



The hypothetical example does not represent the returns of any particular investment.

Perkins client promise

- ▶ We seek to achieve excess returns over full market cycles, with significantly less risk than our benchmark and peers. Risk is measured as standard deviation, beta, and down market capture.
- ▶ Over full market cycles, we anticipate three market scenarios. We aim to outperform in two out of the three.

Scenario 1: Large decline in equity market

- ▶ Fear overwhelms greed, and risk-mitigating strategies perform best. Our more defensive oriented, higher quality portfolios tend to hold up better during these difficult times.

Scenario 2: Middling/sideways market

- ▶ No clear direction in the market, with a mix of both positive and negative developments. Volatility increases and our well diversified portfolios are able to outperform. We aim to be above average.

Scenario 3: Strong equity market with positive double digit returns

- ▶ Greed overwhelms fear, and the most aggressively positioned strategies perform best. Our more defensive oriented portfolios will participate but may lag.

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