We All Just Try to Add Value

'Strive not to be a success, but rather to be of value.' – Albert Einstein

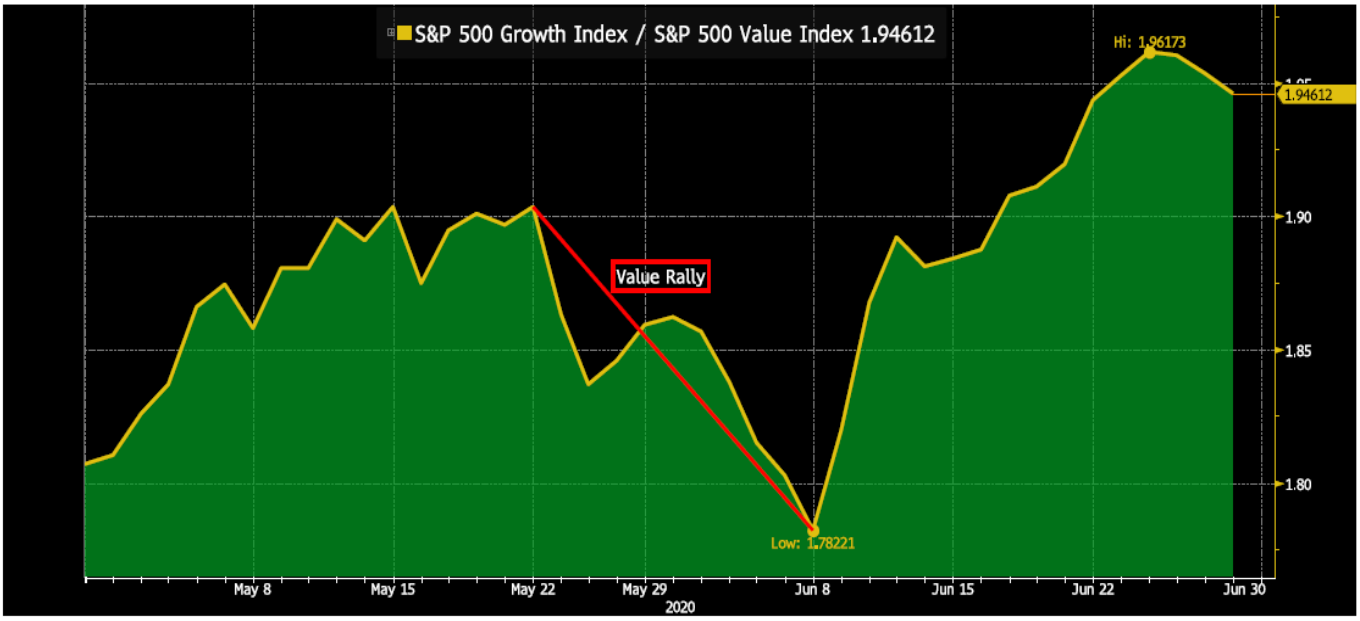
'You can't predict, you can prepare.' – Howard Marks

'Never confuse genius with a bull market.' – Anon

'People have a deep distrust of machines. Have you seen Terminator? Or 2? Or 3? Or 4?' – Owen Wilson as Nick Campbell, The Internship

The debate around value and growth investing is one that will be very familiar to readers; value has gone through a notorious and prolonged period of significant underperformance.

May saw a value (cheap stocks versus their fundamentals) revival compared with growth (stocks with rising earnings), after lagging for over a decade. This led to a multitude of commentaries suggesting that, after numerous false dawns, an inflection point for value had finally arrived; Messrs Buffet and Ackman were poised to claim victory…

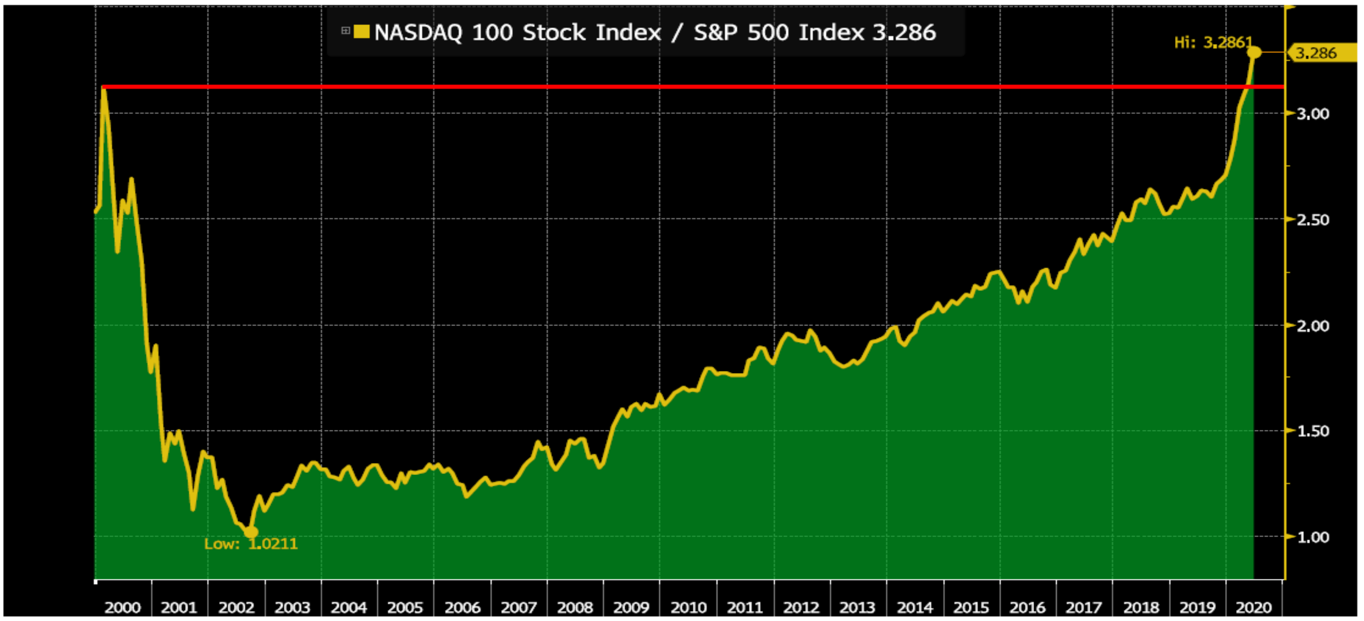


Source: Bloomberg

A month on and value investing, and indeed Buffet himself, are being questioned possibly more than ever before, being outperformed by a guy picking scrabble tiles from a bag at random. May and early June's sizeable value rally has faded and retraced much of its progress, while growth has continued to defy gravity.

That more growth-oriented view can be expressed simply by buying the index in the US currently. The current weighting to Microsoft, Apple, Amazon, Alphabet and Facebook is over 20% of the S&P 500 so, by owning the index, one is automatically taking a very growth-oriented view.

How much those tech behemoths are currently driving the index is also giving some investors cause for concern, especially given the scope for increased regulatory burdens moving forward and how much further the sector potentially has to fall from its heady valuations:



Source: Bloomberg

There is also a large and growing school who believe that when value does finally start to show itself, it is likely to be an extremely profitable trade; the question is when. Currently, expressing that view in the form of long only equity, in place of a more growth-oriented allocation such as an S&P 500 tracker, is a risk in itself.

For those investors looking at fundamentals (the clowns!), for years the mega-cap growth companies in the S&P 500 (FAAMG) have provided the growth that was lacking in the economy as a whole, and while growth has been hard to come by, investors have been happy to pay a heavy premium for it:

Look familiar?

Source: Bloomberg

However, whether one is predicting a significant recovery in activity from here, or growth to remain muted/negative may be irrelevant to the fate of those tech stocks in the near term; a pick up in growth would likely lower the premium applied to those companies' future growth prospects (when growth is less scarce, investors will pay less for it), while markets coming back to fundamentals would likely hit them hardest with their stratospheric valuations and discretionary nature.

S&P 500 Equal Weight Index

Here at Fortem Capital, we constantly look for ways to bridge the 'normal' investment world with that of our derivative world. A rather neat way one might look to edge value into a portfolio, without completely forgoing those tech behemoths, would be to tweak the S&P 500 as an underlying within a typical structure. The S&P 500 is a growth index by virtue of its largest constituents being highly growth-oriented companies. However, by equally weighting the index constituents, one can express more of a value-tilted view. For example, exposure to those largest five companies, which is over 20% in an S&P 500 ETF, would be nearer 1% in an equally weighted index. Similarly, exposure to the smaller value names in the index would increase.

For an autocall, the equally weighted index also gives a pick-up on the coupon. For a supertracker, added participation would potentially compensate for any continued underperformance of value versus long-only S&P 500 market cap weighted exposure. With both shapes, one also gains the benefit of some conditional capital protection not afforded to those owning long-only equity.

There are few certainties in life; death, taxes, and the debates around active vs passive and value vs growth continuing to rage. It is likely too early to hang one's hat completely on either side, but the time to start edging into value may be drawing near.

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