Investing Essentials: Making Sense of Style Investing

Jonathan
Thanks for joining us today Stanko.

We're here to talk about style investing. Now, we've been using style investing in our communications actually a lot more, particularly since the pandemic, because it really helps us understand and describe a lot of the rotations that we've been seeing in markets.

Now, before we go into that in more detail, can you just give us an overview, actually, of what do we mean by style investing?

Stanko
Style investing has become a bit of a buzz phrase of late, but Investment Styles had really emerged a very long time ago. In fact, even before index investing came into existence. So, at that time, investors, all individual investors, had to effectively decide exactly which stocks they were going to introduce to their portfolios. And, by doing so, they had developed certain stock selection criteria, which gave rise to various investment styles.

Value investors, for example, would typically be looking for stocks that are trading at low prices relative to the underlying company's book values, thereby looking to capture a margin of safety. Growth investors, on the other hand, would primarily be looking for companies that are rapidly growing their margins, their sales or their market share, and they would be comparatively less concerned about the exact prices they're paying to acquire these stocks. And, of course, over time, other investment styles also emerged such as momentum, such as quality, such as low risk, and the list goes on.

Jonathan
Yes, and we've been talking a lot about value, a lot about growth, also quality. Actually, these are all very, very useful to kind of show what happens when the market changes, perhaps from a low interest rate environment to a higher interest rate environment. So take, for example, actually growth and value. When you start to get higher rates, or maybe higher inflation, these kinds of styles can flourish, can't they? And, actually, we've seen that in certain situations since the pandemic. Whereas growth is an interesting one as well, because it's something that really tended to outperform for a long time, particularly over the financial crisis when you had very, very low rates. And, actually, sometimes when you've had these very, very high growth stocks that means that because they're so sensitive to rates, then perhaps when you start to get higher rates, then these can really, really struggle as well.

So, when we're looking at this balance between value and growth, I mean, is it something that we can really hang our hat on? Is it something that can persist? Or do these values kind of change over time?

Stanko
That's a very interesting question because, in fact, various investment styles can remain in or out of favour for very long periods of time. For example, if we take all the developed market stocks and

split them into two buckets, value and growth, we can see that over the last 12 years, since 2006, growth outperformed value by a thick margin, almost 90% cumulatively. However, this pattern is anything but guaranteed because if you look at the preceding six-year period, between the years 2000 and 2006, we will see that value actually
outperformed growth by the same order of magnitude over that period, approximately 80%.

Jonathan
Yes, that's interesting because on our Global Investment Committee we've been mixing our styles between value and growth, kind of really dependent on where we see interest rates going, or inflation. And actually one that is tied to inflation as well is often quality. So those companies can outperform when investors are concerned about rising costs. So will those companies be able to pass on those costs or have they got a strong business model, pricing power, or have they got high margins to better absorb those costs perhaps, whether they’re in input prices or if you're having to pay your staff more. So, these styles can really help kind of understand that and help us choose between different companies.

And, if we take this style investing, is there a worry or is there potentially a scenario where there are some pitfalls of this? I mean, can you really perhaps maybe go too overweight in a style and what could that mean for your portfolio?

Stanko
We are not indoctrinated towards any particular style as the one and only correct way to invest in the stock market. In fact, we believe that for most investors, a globally diversified style neutral portfolio is the best starting point. Now, tilting the portfolio towards the styles that are particularly suited for the prevailing macroeconomic regime can add value but this needs to be done in a risk managed and a measured way, really. One thing that we would certainly discourage is to just blindly be chasing the latest flavour of the day and allowing the portfolios to accumulate excessive or perhaps unwanted style biases over time.

Jonathan
Yes, so you want to make sure that if you are investing in a style, you're kind of aware of what style you're investing in and you're doing it perhaps over a tactical time period. Taking advantage, as we talked about earlier, if there is a rise in interest rates, so you get that cyclicality perhaps coming through, that you've got that value style, but if there's a lower rate environment, perhaps growth will be more suited for that. And obviously we talked about quality as well when you've got those kind of inflationary pressures. But, over the longer term, the point you're making is you don't want to be kind of too persistently, heavily invested in one particular style because then you could get caught out perhaps if there's a change in the climate.

It's important now, isn't it, to, when you're looking at the portfolio, not just to think in geography or think in, say, asset classes, but also it's important as well that you make sure that when you're looking at the style, you're kind of thinking over the shorter term and the longer term.

And so hopefully now we've been able to give people an idea of, when we talk in these publications, what we mean by value, growth, quality as well. And people can take that, look at their portfolio, kind of assess that risk and come and talk to us if they have any further questions.

But thank you for joining us Stanko, that's been really, really helpful.

Stanko
Thank you for having me Jonathan.