Talking Points

Are All Value-Style Share Fund Managers the Same?

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In this Talking Point, we analyse the reasons behind the significant divergences in the returns of value-style large-cap Australian share funds in recent years.

Value-style investing is one of the oldest and most widely-used approaches. Since Benjamin Graham's *The Intelligent Investor* was first published in 1949, investors have profited from taking contrarian positions in stocks that appear to be undervalued. Seventeen of the 71 Australian large-cap share strategies in our qualitative research coverage universe fell into our Australian Large Value category at 31 August 2012.

During 2011, we noticed a significant divergence in the performances of these funds, their returns ranging from 1.95 percent through to -16.92 percent. As Table 1 over shows, this dynamic also continued during the first eight months of 2012. The double-digit losses some value funds experienced in 2011 would have been particularly disconcerting for investors who were attracted to value investments by their perceived resilience in falling markets. So why did certain value funds underperform by so much?

Although all the funds in Table 1 predominantly own companies with lower-than-average price/earnings, price/book, price/sales, and price/cashflow ratios, and higher-than-average dividend yields, the individual approaches to investing can still differ markedly. Those which produced the worst returns generally look to invest in companies which they deem to be comparatively undervalued, whether relative to history, the sector or industry in which the company operates, or the wider market. These fund managers are likely to pay less attention to prevailing macroeconomic conditions, and focus more on mean reversion, which can draw them towards more cyclical fare. Over the last few years this has led to investment in a number of sectors with significant cyclical and even structural issues. Retailers, steelmakers, and media stocks were popular holdings for those fund managers with the worst performance, and these sectors all suffered as the market preferred to reward higher-quality names at a time of heightened risk aversion.

The fund managers which outperformed our Australian Large Value category in recent years were more focused on what might be called 'sustainable value'. They tended to hold more stable businesses with higher-quality management teams and less debt, and were therefore less likely to own the likes of **BlueScope Steel** BSL, **Billabong International** BBG, or **Fairfax Media** FXJ. They instead preferred large overweights to **Telstra** TLS or **Orica** ORI, and the higher-quality banking franchises of **Commonwealth Bank of Australia** CBA and **Westpac Banking Corporation** WBC, rather than being overweight **National Australia Bank** NAB or **Australia & New Zealand Banking Group** ANZ, which are perceived as lower-quality but cheaper relative to peers.

These performance differentials show that the 'value' moniker can be a very generic term, and that fund managers adopt various valuation methods and portfolio construction processes which deliver varying outcomes. Investors and advisers therefore need to be mindful of the underlying holdings to ascertain the likely path of returns and whether or not a particular strategy fits with their overall portfolio and risk profile. Value-style share funds cannot simply be expected to perform in a specific way. M

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Table 1: Performance, Volatility of Large Value Australian Share Funds, Multiple Time Periods to 31 August 2012

Name	YTD %	1 Yr %	3 Yr %pa	5 Yr %pa	2011 %	2010 %	2009 %	2008 %	Std Dev 3 Yr %pa
Investors Mutual Wholesale Industrial Share	17.76	21.45	9.23	1.52	1.95	0.23	26.32	-29.56	9.45
Perpetual Wholesale Industrial	16.17	17.65	5.95	-0.73	-2.63	-2.47	37.69	-36.79	11.29
MLC Wholesale IncomeBuilder™	15.53	15.63	4.08	-2.03	-6.21	-3.17	31.25	-33.69	11.59
Investors Mutual Wholesale Australian Share	14.62	15.74	7.91	0.88	-1.96	2.10	28.19	-30.62	9.44
Perpetual Wsale Share Plus Long/Short	14.21	12.44	9.22	1.79	-4.53	9.62	36.02	-34.60	11.50
Lazard Australian Equity I	13.88	12.05	5.39	-1.93	-6.02	0.32	28.50	-35.58	11.49
Lazard Select Australian Equity I	13.63	12.16	5.44	-2.59	-3.71	-0.71	22.97	-34.70	11.16
Maple-Brown Abbott Australian Equity	12.10	9.61	1.93	-1.69	-11.37	-1.06	33.81	-30.46	12.69
Realindex Wholesale Australian Share	11.70	8.62	3.44	-	-9.81	-0.38	40.78	-	12.67
Perpetual Wholesale Concentrated Equity	10.67	9.27	6.28	1.24	-3.85	3.10	42.48	-33.50	11.26
Tyndall Australian Share Wholesale Portfolio	9.21	6.00	2.38	-2.08	-9.91	-2.42	43.74	-36.80	13.99
Perpetual Wholesale Australian	9.13	6.94	5.96	-0.18	-5.99	5.66	40.93	-36.18	11.86
Dimensional Australian Core Equity	7.27	1.98	1.59	-3.76	-13.84	3.54	43.99	-41.12	14.05
Dimensional Australian Value	6.59	1.74	-0.28	-2.71	-15.62	1.99	43.51	-33.47	14.97
Perennial Value Shares Wholesale	6.09	2.23	-0.74	-2.97	-12.94	-2.43	49.43	-36.58	13.19
Legg Mason Aust Value Equity A	4.87	-1.38	-2.04	-5.90	-16.92	0.01	51.16	-42.83	17.20
AXA Wholesale Australian Equity Value	4.42	-1.37	-1.02	-5.56	-14.76	-0.63	38.08	-38.03	14.07

Source: Morningstar Direct™. Funds are ranked by year to date returns to 31 August 2012.