Orbis
Invest Differently

Are global equity markets shifting in our favour?

Last month we wrote about the Japanese yen—a major position for us that finally seems to be at a turning point. But the recent moves in stocks are worth a look, too. Global equity markets have been just as lively—and just as encouraging.

In markets, sometimes good news is good news, sometimes bad news is good news, and sometimes, good news isn't good *enough* news. The last two months have seen all three varieties in the US alone. Inflation ticked down, which is good news for the economy and for markets. Yet manufacturing orders tanked, job creation slowed, and jobless claims accelerated. Bad news for the economy, but good news for markets, as the weakness urges the Fed to cut interest rates. Though a weaker economy is typically bad news for small firms, they have outperformed handily. That's partly because lower rates would reduce their interest costs, and partly because good news for some big firms wasn't good *enough* to beat stretched expectations.

It's a *lot* to process. Even if we knew the headlines in advance, we'd still struggle to predict what they would all mean for stocks. So we focus instead on what we are good at—analysing individual businesses.

Few businesses are immune to broader economic forces, but for most of them, it simply isn't the most important thing, and what makes or breaks one company may be totally irrelevant to another. Nintendo creates video games and consoles, but isn't remotely concerned with vehicle-based payments. Corpay operates niche payment networks, but has no interest in video games. The service quality of freight carriers matters enormously to RXO but not at all to Shinhan Financial Group. Many of these businesses across our Strategies have recently outperformed, and when the performance of what you own is idiosyncratic, it is a bit easier to tune out the broader market noise.

At times over the past year, that noise has felt loud, even when the companies we hold have been delivering good results. Our Global Equity Strategy generated better returns last November and December than it did this July and August. But with the market outpacing us late last year, it sure didn't feel that way! To use an Olympics analogy, we had great race times, but our competition was on a tear, and gold gets all the attention.

We weren't throwing in the towel then, and we aren't resting now. Yet we do see reasons for excitement. The opportunity set has for years led us more towards value over growth stocks, financials and industrials over tech names, and mid-sized firms over giants. That's been uncomfortable at points this year. But over the past two months, value has led growth, "old economy" shares have bested tech, and smaller companies have beaten goliaths. Broadly, what we own has done well, and what we don't own has suffered—in relative terms, July was the Global Equity Strategy's best month since the global financial crisis.

This is a pattern we've seen throughout history. At some point in every bull market, investors come to appreciate the value of previously unloved shares, while demanding more of those in favour. Take Nvidia. Despite reporting results most businesses can only dream of—sales and earnings both grew >120% in a single year—its price fell by 6% the following day. When expectations get too high, good news isn't good *enough* news.

Nvidia is not alone. The stocks that suffered most during the recent volatility were those whose valuations—and expectations—were most stretched coming into it.

Our goal is to find the opposite: companies where expectations are low. Companies where good news really is good news, and even bad news can be positive if it's less bad than expected. This also provides a measure of downside protection—it is far harder to disappoint pessimists than optimists.

In aggregate, the companies in our Global Equity Strategy trade for less than 17 times consensus estimates of next year's earnings, versus 24 times for the MSCI World Index. In our view, that gap leaves our portfolio with plenty of room for pleasant surprises—and the benchmark with little room for error.

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