

Morgan Stanley

Monthly Musings

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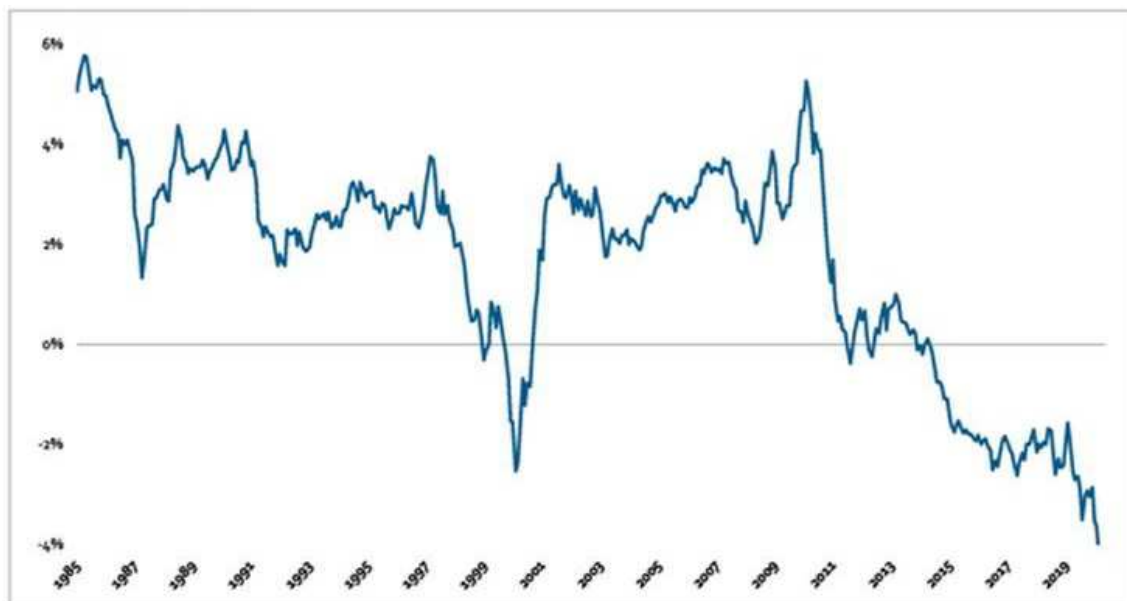
July 21, 2020

The Relative Value Edition

Let's get right to it. Take a look at these two graphs:

MSCI World Value Index vs. MSCI World Growth Index*

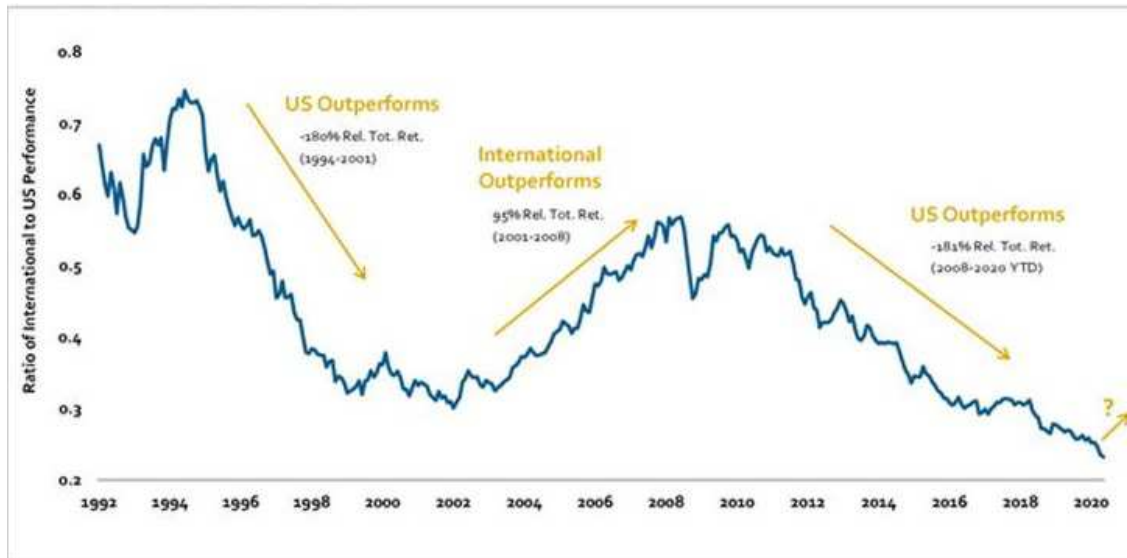
Monthly data as of May 29, 2020



Source: Morgan Stanley Chartbook

MSCI EAFE vs. S&P 500⁽²⁾

Monthly data as of January 31, 1992 to May 31, 2020



Source: Morgan Stanley Chartbook

Basically, these are relative performance graphs. The first one shows how value stocks have been performing vs. growth stocks. When the line is moving down, growth stocks are outperforming. When the line is moving up, value is outperforming. We can see that growth has been outperforming value (handily, I might add) basically since the 2008 - 2009 Financial Crisis.

The second graph shows how US stocks have been performing vs. international stocks (in this case, it's the Europe/Japan focused EAFE index...but, the graph looks similar for other international stocks like emerging markets when comparing to U.S. stocks). When the line is moving down, the U.S. is outperforming. When the line is moving up, international stocks are outperforming. We can see that U.S. stocks have been outperforming international stocks (again, handily, I might add) basically since the 2008 - 2009 Financial Crisis.

Opportunity

So, you might say, those are nice graphs Chris but, growth stocks (namely technology stocks) are in the middle of a technological revolution and these businesses are actually benefitting from the “stay at home” economy. Largely true but, at what point is that fully reflected in the stock prices? Are we really going to be stuck in our homes for years and never going back to work in an office?

You might also say...well, the U.S. is the region of the world with the best economy, the best political system and is the most fiscally prudent. While this has largely been true historically, can we say that now? Our government has never been more partisan or ineffectual and we are running record budget deficits with the record debt that accompanies that. How would you rank the U.S. response to the pandemic, particularly relative to other major countries? I love my country and we clearly have a lot going for us over the long term but, does our stock market deserve to trade at such a valuation premium vis a vis international markets? And, what if the economic growth rate picks up in international economies relative to the U.S.?

In this “only the story matters” investment environment, valuation hasn’t seemed to matter (absolute or relative). And, it may not “matter” for a while...and, historically, valuation in and of itself rarely acts as a catalyst for improving stock prices. But, what if the “relative” story changes?

Let me be clear, this is a contrarian call and we may not be at the exact inflection point but, even if it’s a few months too early there is still a significant multi-year opportunity, in my opinion. However, admittedly, if we’re a few years too early, it’s simply the wrong call.

Here’s a non-exhaustive list of why the shift may come sooner rather than later:

Catalysts/Reasons why Value might outperform Growth:

- The gap between the MSCI World Growth Index and the MSCI World Value Index is at an all-time high¹
- Relative performance tends to go in cycles...with reversing trends coinciding with recessions
- The relative growth/earnings story should begin to benefit the value/cyclical stocks if the economic recovery plays out over the next couple of years
- The current cycle is too far off of the trend line, i.e., it’s too stretched and could succumb to “reversion to the mean”
- Increased regulatory scrutiny (i.e., anti-trust, etc.) on the large U.S. technology companies could hinder their growth/earnings

Catalysts/Reasons why International might outperform the U.S.:

- Relative performance tends to go in cycles...with reversing trends coinciding with recessions
- The current cycle is too far off of the trend line, i.e., it’s too stretched and could succumb to “reversion to the mean”
- The U.S. elections in November could shift the balance of power towards the democrats which could result in slower growth policies in the U.S.
- The U.S. dollar tends to strengthen during recessions/uncertainty, hurting performance of non-U.S. investments for U.S. dollar based investors. A return to “normal” over the next couple of years could reverse this trend
- The U.S. dollar could also face pressure from our relatively faster level of debt issuance in the past two years vis a vis other large economies, according to Jeffrey Gundlach²

Also, [click here](#) to listen to a quick audio cast of Morgan Stanley’s Head of Portfolio & Investment Manager Solutions echoing the overall theme.

How Can Investors Take Advantage of This?

There are a number of ways to express these views and take advantage of the potential

reversal of these trends in your portfolio...please reach out to me...I would be happy to review with you.

***Tactical Allocation Tilts in my Global Growth and Global High Income Model Portfolios (as of 7/21/20):**

Overweight

Long/Short Equity, Quality Dividend
Paying Global Equities, Early Cycle
Value stocks, Emerging Market
Consumer Equities, Short-Term High
Yield Fixed Income, Total Return
Strategies

Underweight

U.S. Treasuries, "High Quality"
Corporate and Municipal Bonds,
Long-Term Fixed Income

* These weightings do not consider each client's unique profile, preferences and/or constraints and therefore may not be applicable to you.

The Benedict-McLoughlin Group always strives to use sound judgment...at every decision point.

We bring experience, credentials and tenacity which we expect to continue to enable us to help achieve our clients' goals over time.

Regards,
Chris

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The Benedict-McLoughlin Group – "Institutional Caliber Portfolio Management, Customized to Your Personal Situation"

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Learn about our new *Goals Planning System (GPS)* – watch the two minute [GPS Video](#)

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Notes:

1. Bloomberg News, 6/24/20.
2. Advisor Perspectives, 6/10/20.

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Past performance is no guarantee of future results. Actual results may vary. Diversification does not assure a profit or protect against loss in a declining market.

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Bonds are subject to interest rate risk. When interest rates rise, bond prices fall; generally the longer a bond's maturity, the more sensitive it is to this risk. Bonds may also be subject to call risk, which is the risk that the issuer will redeem the debt at its option, fully or partially, before the scheduled maturity date. The market value of debt instruments may fluctuate, and proceeds from sales prior to maturity may be more or less than the amount originally invested or the maturity value due to changes in market conditions or changes in the credit quality of the issuer. Bonds are subject to the credit risk of the issuer. This is the risk that the issuer might be unable to make interest and/or principal payments on a timely basis. Bonds are also subject to reinvestment risk, which is the risk that principal and/or interest payments from a given investment may be reinvested at a lower interest rate.

Bonds rated below investment grade may have speculative characteristics and present significant risks beyond those of other securities, including greater credit risk and price volatility in the secondary market. Investors should be careful to consider these risks alongside their individual circumstances, objectives and risk tolerance before investing in high-yield bonds. High yield bonds should comprise only a limited portion of a balanced portfolio.

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