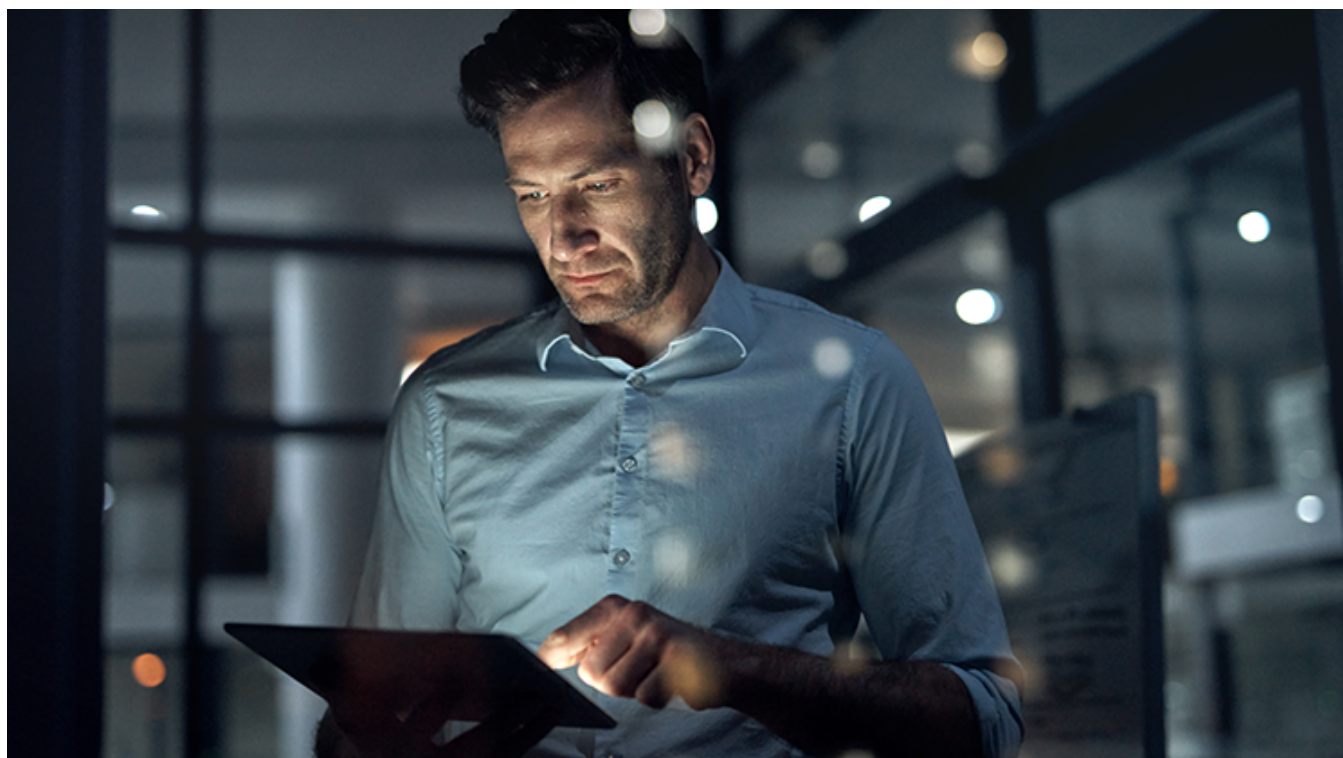


Barrow Hanley: Value investing doesn't mean missing out on the AI boom

By Perpetual Asset Management

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Many investors are spellbound by big US tech stocks. But the same themes are available in smaller companies at better valuations, argues Barrow Hanley's James Carpenter.

- [Explained: Value versus growth investing](#)
- [Find out about global equities manager Barrow Hanley](#)

Are you overweight the Magnificent Seven?

It's the latest term describing the dominance of the largest companies in global market indexes.

The seven are Apple, Microsoft, Alphabet, Amazon, Nvidia, Tesla, and Meta, and together they make up more than quarter of the S&P 500.

So far this year, they have been the dominant contributors to strong returns for the index.

"Exposure to these seven stocks has driven a very large part of this year's performance in markets," says Barrow Hanley's James Carpenter.

"But it has also created a very narrow market which creates challenges for investors."

Much of the performance of the Magnificent Seven stocks this year has been based on their exposure to artificial intelligence.

"One element that is driving investor behaviour is the fear of missing out on the next growth cycle," says Carpenter.

"AI is going to be transformational. It's going to affect everybody. The problem is that what you're seeing right now is AI is disproportionately impacting just a few stocks.

History is against growth stocks

Carpenter says the market's obsession with growth stocks stems from the fact that it has been the dominant investing style post the global financial crisis (GFC) whereas before, value investing provided stronger returns over the longer term.

"No one remembers the dot com bubble anymore. It's all just theory.

"Today's concentration of the top seven stocks in the S&P500 is over 28 per cent. During the dot com bubble, this concentration peaked closer to 22 per cent."

When the tech bubble burst in 2000, these dominant tech stocks entered a prolonged period of underperformance that ultimately reduced their index weighting to below 7 per cent.

"If we follow that same trajectory, we would expect these new dominant stocks to either have a period of meaningful underperformance or remain flat in an up market as we saw in the early 2000s," says Carpenter.

"Microsoft went from trading at over 45 times EV/EBITDA in the late 90s to trading below 5 times by the end of the GFC.

“That’s a massive correction. “The stock ultimately underperformed for more than 15 years relative to the broader US market.

“People are saying it’s different this time - but I doubt it.”

When bubbles deflate, problems compound, says Carpenter.

“We are not against owning good-quality tech companies – and in fact we want to own them. We see them as transformational and we benefit from them in our daily lives.

“However, we don’t want to overpay to own them.”

A better way to play AI

Being a value investor does not have to mean missing out on the AI boom, says Carpenter.

The same themes are available to investors in smaller companies at better valuations.

Instead of Tesla, look at Aptiv, he says. “Aptiv make infotainment centres for cars, integrated power systems, and wiring for EVs — so we can get exposure to EVs through Aptiv at a better value rather than paying a high multiple to buy Tesla.”

An alternative to stocks exposed to AI like Alphabet and Microsoft might be Vertiv, which supplies cooling systems and other critical components for data centres.

“Apple-supplier Qualcomm is another one — it’s tech, but it’s cheaper and meets our criteria,” says Carpenter.

What could go wrong?

The run-up in big tech this year is founded on a belief that the European Central Bank and US Federal Reserve will be able to manage inflation successfully and navigate the global economy to a soft landing.

"People are behaving as if a soft-landing is a foregone conclusion and rates will fall. But there are still risks to the economy or that rates might stay higher for longer.

“Higher rates for longer is going to be better for value.

“We would err on the side of caution in the sense of not fighting the Fed, but at the same time not believing in it entirely.”

Value approach

Value investing’s advantage comes partly from the fact that markets tend to over-react.

“It never goes overvalued, fair valued, overvalued. It goes overvalued, undervalued, overvalued, undervalued — never really landing on fair value for an extended period of time.

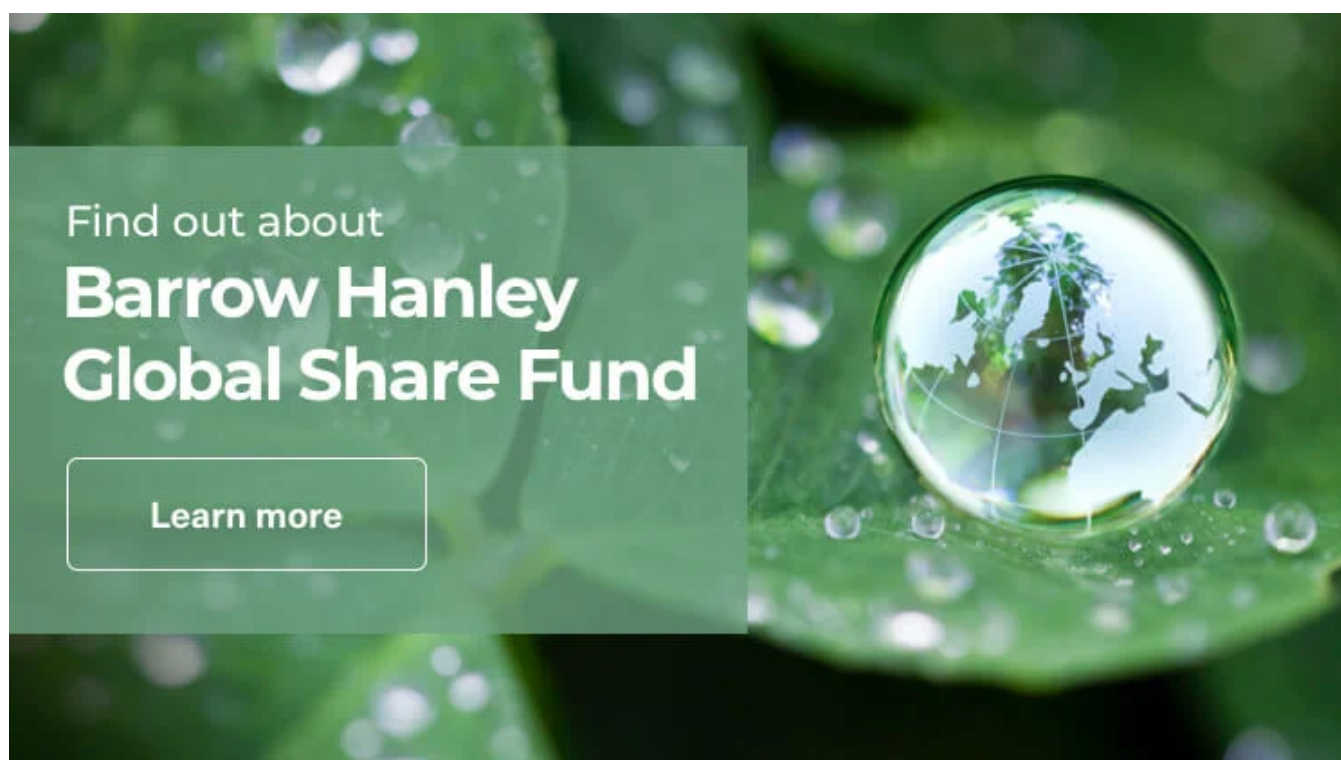
“We appreciate that these companies are good companies, they generate a lot of free cash flow.

“But we also appreciate that most of our clients already have exposure to these companies. We’re here to be your value manager, not your growth manager.

“The problem comes when your value manager drifts to be your growth manager, then you have diversification issues.

“ When the cycle turns to favour value, you don’t have the exposure you expected to have and could fall short of your return target

“2022 was a classic value year where value stocks provided the downside protection one expects with a value manager and ultimately was a great litmus test as to what type of value you actually owned.”



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Barrow Hanley is a global leader in value investing, managing assets for clients for more than 40 years.

[Barrow Hanley Global Share Fund](#) aims to provide investors with long-term capital growth through investment in quality global shares.

Rated "Highly Recommended" by Zenith, "Recommended" by Lonsec and with a Morningstar Medallist rating of "Gold", the investment team focuses on finding value in all the right places.

[Find out more here.](#)

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