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Value trumps growth in funds management battle

By **DAVID ROGERS**, MARKETS EDITOR
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Value fund managers with billions of dollars worth of investments are back in favour after years of doing it tough.

Mercer's closely watched Australian Shares Investment Manager Performance Survey, to be released on Monday, shows that value managers left growth managers in their wake in the March quarter as a rapid economic recovery from the COVID-19 pandemic improved the outlook for corporate earnings.

At the same time, a sharp rise in bond yields crimped the valuations of growth stocks that surged when earnings were scarce and interest rates plunged in the early stages of the pandemic.

The figures come as the Australian sharemarket is closing in on a record high, with the benchmark S&P/ASX 200 just 1.4 per cent below the all-time closing high of 7162.5 points set in February last year, just before the COVID crash hit.

Value managers profit from betting on cheap stocks, seeking to find gains as unloved companies come back in vogue. However, in the lead-up to the COVID selldown, an overvalued stockmarket had meant that value returns often lagged their fund manager rivals who focused on growth stocks.

But extending a trend that began late last year, fund managers with exposure to the value style and the financials sector in particular outperformed in the first quarter, according to the Mercer tables.

In the more important one-year rankings, Steve Johnson's long-pressured "deep value" fund — Forager Australian value — topped the Mercer tables with a stunning 128 per cent return over the year to the end of March.

First Sentier Australian Equities Geared Growth fund ranked second with a 102.6 per cent return over the year.

Collins Street Value Fund was third with a 101 per cent return in the 12 months to the end of March.

Smallco Broadcap Fund was fourth for the year with a 68.3 per cent return, and Katana Australian Equity Fund (65 per cent) was fifth over one year.

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Dimensional Australian Value made it into the top 10 for the 12 months and also returned 10.3 per cent for the three months to March 31, putting it just behind Perennial Concentrated Australian Shares, which returned 11 per cent in the March quarter.

After exceptionally strong returns in the December quarter, the overall market continued to rally, with the S&P/ASX 300 achieving a total return of 4.2 per cent and the S&P/ASX 50 adding 5.3 per cent in the March quarter. However, the financials sector stood out with a total return of 12.1 per cent, followed by the communication services and consumer discretionary.

Westpac, ANZ and NAB were the three largest contributors to the index performance over the quarter.

On the one-year time frame, payments platform Afterpay was once again the best contributor to the overall performance of the index. Afterpay rose 440 per cent in the year to March 31, but lost 15 per cent in the March quarter as bond yields leapt from 0.9 per cent to 1.74 per cent.

Over the past three months, financials, communication services and consumer discretionary were the largest outperformers versus the benchmark, while IT was the weakest performing sector, reflecting similar moves in other major stockmarkets.

But the surge in Afterpay contributed to an 80 per cent rise in the IT sector over the year to March 31, making it the best performing sector in that period.

Still, the consumer discretionary and materials sectors were the biggest contributors to index returns over the one-year period given their comparatively larger index weighting.

Wesfarmers surged 54 per cent over the 12-month period, while Fortescue Metals doubled, even though it dived 17 per cent in the three months to March 31.

The main detractors were healthcare, utilities and consumer staples, with CSL down 11 per cent, AGL Energy down 44 per cent and A2 Milk down 52 per cent.

Ronan McCabe, head of portfolio management for Mercer in the Pacific, said the survey showed "further evidence of the long anticipated recovery in value stocks".

"After a protracted period of underperformance spanning over a decade, Australia is witnessing some of the strong performance of value factors seen elsewhere in the world," Mr McCabe said.

But value, along with other return-enhancing factors such as quality, momentum, size and low volatility, was just one of five key "factors" that investors could use when diversifying to ensure that portfolios had exposure to a range of systematic return drivers, he added. "Our surveys have shown us over the years that value as a style has faced many challenges over the past decade, and these difficult market conditions in Australia may continue for some time," he said.

"While we don't know whether the current outperformance of value will be sustained, this approach has the potential to offer diversification of excess returns and enhance expected outcomes. Without exposure to value, investors may risk missing out on the benefits of that diversification."

Over the one-year time horizon, the S&P/ASX 300 Accumulation index was up 38 per cent, reaping the benefit of the rebounds in markets from April 2020 onwards after the market crash in March.

The Mercer tables revealed that the performance of the value-style managers continued to be robust in the March quarter, especially in the long-only sub-universe. Meanwhile the higher risk appetite of investors and a rally in cyclical stocks — normally associated with value — resulted in the targeted volatility sub-universe continuing to lag the benchmark significantly in the quarter.

"We believe that these changes highlight the importance of diversification when selecting a portfolio of active managers and strategies," Mr McCabe said.

The sustained rise in value stocks in the first quarter of the 2021 calendar year comes after they lagged growth stocks most years since their last major outperformance following the global financial crisis. Conversely, growth stocks lagged, such as software companies Afterpay and Xero, and high revenue growth companies like A2 Milk and NextDC fell sharply in the March quarter along with Afterpay.

As such, value managers like Perennial Value Management and Martin Currie Australia performed well, while quality/growth managers like ECP Asset Management and Hyperion Asset Management, which have led the tables for some time, went backwards in the March quarter.

The S&P/ASX 50 index outperformed the S&P/ASX 300 index in the March quarter, while the S&P/ASX MidCap 50 index lagged the market.

The outperformance in large-cap stocks this quarter was driven by the rally in the major banks as well as the likes of Telstra, Macquarie and Aristocrat Leisure.

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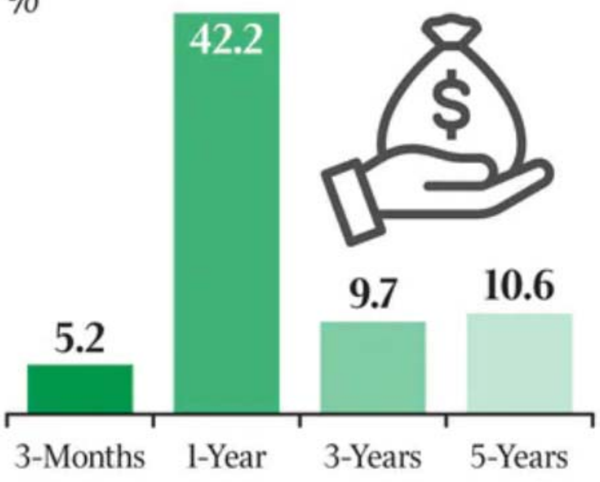
David Rogers began writing on financial markets in 1987, having worked for Standard & Poor's, Thomson Financial, BridgeNews, Dow Jones Newswires, Tolhurst Noall and The Wall Street Journal. David has extensive ... Read more

Mercer Australian share fund median returns

To end-March, 2021

%



Mercer Australian share funds

1-year return	%
Forager Aust Value	128.1
First Sentier Aust Geared Growth	102.6
Collins St Value	101
Smallco Broadcap	68.3
Katana Aust Equity	65
Bennelong Core	61.6
Dimensional Aust	57.6

Source: Mercer Investments

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