Time for the stock pickers

As a decade of growth-led momentum gives way to a choppy value resurgence, the outlook for markets is uncertain. Stock pickers are poised for their moment in the sun...

While it has been widely discussed, it bears repeating: 2020 was a truly tumultuous year for global equity investors.

In the latter quarter of the year, the growth-led momentum trade that had driven markets for the previous decade came shuddering to a halt. Stocks that had sat on historically high price-to-earnings ratios widely fell out of favour, with many global markets rotating into 'value' stocks instead.

This was problematic for many investors, with the majority having tilted their portfolios towards growth-focused managers and funds in the preceding years. However, as the market has relatively indiscriminately turned to those stocks sitting on more depressed valuations, some observers are suggesting that this trade may too be nearing maturity.

All of this makes it challenging to work out where exactly to put your money. With styles coming in and out of favour, are you better off tilting towards value or growth? Rather than looking to these two 'styles' of investing, it may be worth considering the old-fashioned approach: true stock picking.

OUT OF STYLE

For those who have been investing for a while – or at least since prior to the 2008 crash – the changing favours of different investment styles are a familiar phenomenon. In 2000, following the collapse of the dot-com bubble, value stocks rallied for a period.

However, data from S&P Global suggests that the longer-term picture is much more straightforward. Over 40 years, S&P's value index has returned 11.2% annualised, while its growth index has returned 12.1% annualised, a marginal difference. This data implies that investing purely on the basis of style is not the route to consistently generating alpha, or returns in excess of the market.

It is also reflective of the practicalities of investing in the real world. The general rotation from growth to value during the coronavirus pandemic was not driven merely by sentiment, but also by the practical implications of the pandemic. Some trends, such as the emphasis on and appetite for "experiences", which had come to drive swathes of the market during the preceding years, have been delayed or even reversed by its impact.

For growth managers (and passive funds which track the indices that growth stocks have typically dominated over the last few years) the reversal of these trends was painful.

At the same time, the trends that have most driven the value recovery – the reopening of global economies and the vaccine rollout – are already starting to mature in some markets, namely the US and UK. Some investors argue that this leaves a large group of these stocks with a relatively limited runway for further price increases. US and UK. Some investors argue that this leaves a large group of these stocks with a relatively limited runway for further price increases.

A GOOD LOOK

The complicated outlook for markets suggests the challenges for style-based investing could go on for some time. Knowing when to switch between styles when inflation, rising rates, a recession or all three could be on the horizon is difficult for most investors, verging on guesswork.

This opaque picture applies to companies too; with such an unusual economic context facing them, it is likely that companies within specific sectors will chart divergent courses out of the pandemic. Within this context, investing in global equities on the basis of style or sector preferences is fraught with risk at the moment – and in the long term.

An alternative is to consider a stock picking fund, like **Alliance Trust (ATST)**, which leaves that job in the hands of expert stock picking fund managers. ATST seeks to offer a 'core' allocation to global equities, avoiding active factor, sector and country risk relative to the benchmark, meaning it seeks to show no preference to either value or growth.

Instead, the trust consists of ten 'best ideas' portfolios, each built from a maximum of 20 stocks. This means that the underlying managers of these funds identify what they consider to be the very best stocks within their own investment remits, whether these include a preference towards value or growth or not.

Since bringing in this investment approach on 1 April 2017, the trust has performed marginally ahead of its MSCI ACWI benchmark in share price terms, by 2.5% to 30 April 2021. Crucially, for a large part of this period it was underweight the highly valued 'mega caps' which drove markets for much of the last decade.

This underweight weighed on the trust until last year, when the market turnaround saw some of these companies fall out of favour and those on depressed valuations experience an uplift. Over the twelve months to 30 April 2021, the trust outperformed the MSCI ACWI total return by 4.6%.

IT PAYS TO BE PICKY

While advocates of growth or value investing can make their case for their preferred style from dawn to dusk, the reality for most investors is that tracking the changing favours of these two styles is extremely difficult. In an unprecedented economic environment, seeking to identify the companies that are genuinely strong enough to survive seems intuitively sensible. By employing a truly stock selecting fund like Alliance Trust, targeting steady, reliable returns, this is what investors can aim for.

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