Growth stocks outperformed in the quarter, led by the Magnificent Seven, widening global valuation spreads. We are seeing opportunities in sectors such as global recruitment and human services, and healthcare.

Growth stocks continued to leave value stocks in the "rearview mirror," performance-wise, in the final quarter of the year again, led particularly by the so-called "Magnificent Seven." These names—Apple, Amazon, Alphabet, Meta Platforms, Microsoft, Nvidia, and Tesla (names that don't feature in true value managers' portfolios on their current market valuations)—have, on average, doubled in 2023. The group accounts for more than a quarter of the U.S. S&P 500 market capitalization and has therefore been largely responsible for the index's 26% 2023 rise and a large portion of the 22% return for the MSCI All Country World Index in 2023. The MSCI ACWI Equal Weighted Index has underperformed its market capitalization-weighted counterpart by some 13 percentage points in 2023.

Hence, this year has seen global valuation spreads widen, maintaining the opportunity in value stocks.

Exhibit 1: Global Valuations: Price-to-Normalized Earnings Mid-Points
As of December 31, 2023

	Cheapest Quintile[1]	Universe[2]
Global	7.5	13.7
US	7.6	13.1
Europe	6.8	12.6
Japan	7.2	12.8
Emerging Markets	8.0	16.6

Source: Pzena analysis
[1] The "cheapest quintile" includes the cheapest 20% of stocks based on Pzena's estimates of their price-to-normal earnings valuations, measured on an equally weighted basis within their relative universes (as defined below).
[2] Universes comprise the largest stocks by market capitalization for each region as follows:
~2,000 largest global; ~1,000 largest US; ~750 largest European; ~750 largest Japanese; ~1,500 largest emerging markets.

The opportunity set includes, but is by no means confined to, cyclical names impacted by recessionary concerns; we are able to invest in a disparate range of good companies today at deeply discounted prices, many offering significant scope for self-improvement to restore their earnings potential.

OPPORTUNITIES IN THE RECRUITMENT SECTOR

Concerns that economic headwinds might see increased unemployment and slower demand for labor have hit the valuations of companies operating in the global recruitment/human services industry. Meanwhile, some posit that this industry is ripe for AI disruption, rather than it being a tool to ultimately benefit the search industry. We believe the market has overreacted to these concerns.

Korn Ferry is the largest executive search firm globally, with growing interests in consulting. Expanding into services adjacent to search, Korn Ferry has been able to extract synergies across the portfolio. The pullback in its valuation has presented an opportunity to invest in this strong franchise at an attractive entry point. It trades on 6.4× our normal earnings estimate. Robert Half provides temporary staffing and permanent placement services specializing in finance and accounting positions, with a growing franchise in advisory and consulting through its acquired Protiviti unit. Protiviti derives 40% of its revenues from the financial services industry, a rapidly growing market driven by regulatory compliance and digital transformation needs. It trades on 9× our normal earnings estimate. Staffing, recruiting, and workforce management company, TrueBlue Inc., has been particularly weak this year on these industry controversies and is currently trading on just 3.8× our normal earnings estimate. For some time, we have held Randstad, one of the world's largest talent companies (our 3Q22 Newsletter's Highlighted Holding). Its shares trade currently on 7.5× our normal earnings estimate.

THE MOUSE THAT ONCE ROARED...

The Walt Disney Co. faces a changing media environment as television viewers increasingly tune out of traditional linear TV in favor of other entertainment sources, such as streaming. Disney shares recently hit a five-year low on concerns about management's ability to successfully navigate the shifting dynamics. Meanwhile, Disney has had some recent big movie misses at the box

office. Questions about how it will replace its fading cash cow, the ESPN cable sports channels, remain. The company is looking to transform the proposition from cable to digital streaming with ESPN+. The theme parks and cruise businesses are highly profitable, so Disney has a solid starting point, and the company is well-positioned in the streaming ecosystem with a clear path to profitability here. The jury is out on whether ESPN+ will ramp up to replace the fading ESPN cashflows, but linear subscribers may be resilient as streaming pricing is increasing across the board, as it reaches full penetration. Although there is potential for a wide range of outcomes, the company is showing some positive trends, projecting $8B in free cashflow next year—the highest level since 2018—partly reflecting some significant self-help initiatives. The shares trade on 7.7× our normal earnings estimate.

HEALTH CARE

We continue to see attractive opportunities in the healthcare segment. Pharmaceutical company Sanofi has struggled with R&D productivity since the merger with Aventis in 2004. We believe that four years into the current management regime, we are beginning to see signs of a sustainable improvement in their discovery engine, but this has come at a cost. In October, the company announced a one-time increase in late-stage trial spending to maximize the potential value of the most promising late-stage compounds in the pipeline. The price controls embedded in the Inflation Reduction Act change the approach to incremental indications. Sanofi will pursue them in parallel, rather than pursuing incremental labels in serial. This is somewhat of a variant view in the pharma world and the market did not take kindly to the news. The consequent decline in the share price was greater than the net present value of the higher R&D spending. The shares trade on 7.8× our normal earnings estimate and on a rich current free cashflow yield, assuming worse than average R&D productivity.

CHINA OPPORTUNITIES

As we highlighted in our recently published podcast 'Finding Value in China', China continues to be a fertile source of new ideas for our portfolios after protracted and significant underperformance. China Merchants Bank (CMB) is the leading retail bank in China and the number one player in the wealth management and private banking industries. The stock has underperformed following the ousting of its former CEO on corruption allegations and on concerns that its retail business, via credit cards, customers' appetite to invest, and mortgage demand, will be negatively impacted by the current macroeconomic environment and stressed real estate sector. Industry-wide data indicates that CMB has been growing its market share over the past 1-2 years. We believe that these issues are temporary and that CMB will be able to sustain market-leading returns, given its superior business model, as sentiment improves. The shares trade on just 3.2× our normal earnings estimate.

WH Group is the world's largest pork company with a leading market share in both China and the U.S. The controversy—and reason its stock price is near an all-time low—is financial underperformance among U.S. pork producers, which are currently experiencing their worst year ever due to industry overcapacity, with the global pork market not having regained its equilibrium fully following the 2018 culling of half of China's hog populations due to swine fever. While a full recovery in U.S. pork might be a few years away, we anticipate WH Group's Packaged Meats segment will sustain strong performance, particularly in China, where the company is larger than its next 10 competitors combined and has greater than 20% operating margins. The shares offer an 8% dividend yield, trading on 4.5× our normal earnings estimate.

SUMMARY

We continue to find many good companies—across a range of different industries and geographies—that are underearning relative to their history but that have the scope to restore their profitability, given time for managements' self-help initiatives to bear fruit.

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