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Moderator: Valerie Arnold, Co-Head of North American Distribution

Speakers: John Goetz, Co-CIO and Evan Fox, CFA, Portfolio Manager

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VALERIE ARNOLD: Uh, welcome everyone for joining us. We're—I'm excited to be here with a couple of my colleagues. We're here today to present Pzena's mid-year outlook. For those that are new to Pzena, we're a 76 billion global value manager, and we're very well known for sticking to our value discipline, which has helped us grow even in these volatile markets.

So today we're diving into one of the most pressing topics and concerns on investors' minds: market volatility. What does history tell us about these turbulent times? And more importantly, how should long-term investors respond?

I'm Valerie Arnold, Co-Head of North American Distribution at Pzena Investment Management, and I'm here with our Co-CIO, John Goetz, who is also a PM on our Global, International, European, and Japanese strategies. John, welcome.

JOHN GOETZ: Thank you. Thank you.

VALERIE ARNOLD: I'm also here to introduce my colleague Evan Fox. He is a portfolio manager on our U.S. Small and Mid Cap strategies.

EVAN FOX: Hey, thanks for having us, Valerie.

VALERIE ARNOLD: Okay, let's get started. So let's start with the obvious. Last quarter was definitely a roller coaster. We had fears over trade wars and tariffs, and then a rally, and sort of ended with a huge conflict in the Middle East. John, how do you keep your head above water when all are losing theirs?

JOHN GOETZ: Yeah. Well, let's just say that, you know, uncertainty and fear—whichever word you use—there's a real reason for it, right? And you mentioned a few. So the second quarter had a lot of elements that were creating a huge amount of uncertainty.

On the tariff dimension, just to talk about that—the tariffs that were threatened initially in the quarter were as big as things we've seen going all the way back to the 1930s. So the reality is that tariff uncertainty was real and super big. And because we didn't know what the outcomes were, the market was, you know, responding to that uncertainty.

But to your point, there's other things going on as well. So I think the second quarter, you could say, is a really scary and uncertain period.

Now, for us, the good news—I mean, I hate to put it in the “good news” frame—but we've dealt with major periods of uncertainty. And we'll come back to it later in terms of our process, but really our job as investors is to actually take advantage of periods of fear and uncertainty. So in some ways, we kind of look forward to them.

Clearly in our 30-year life, we've gone through the Asia crisis—it was almost coincident with the dot era—then we had the global financial crisis. And then obviously the most recent really big one was COVID.

But what I want to—well, we'll come back to the process in a little bit, Valerie—but I think to get the human element, I think I'd like to turn it over to Evan, because Evan joined just before the GFC, which was a monster. And I'd like to have maybe him share: what did it look like in that first monster fear period, you know, for a young person joining a team versus maybe, say, the next monster, which was COVID?

EVAN FOX: It's a great question, John, because I often actually say that I feel incredibly fortunate that I did start in 2007, right before the financial crisis. And the first sector I was assigned to cover was life insurance. So I was covering financials right as we went through the financial crisis. And just to cut my teeth during that and see how the team handled that more broadly is the kind of experience that I'm going to hold with me for the rest of my career.

Right? And I think this is a common thing. You look back at what were the challenges you faced early on—in terms of how I handled it myself, but more importantly, how I saw everyone else on the team look at it—and some of the lessons learned of really focusing on the long term, but also remembering the short term and what can impair our process of getting there.

And, you know, what's great about our team, our organization, is we do have this long-term investment horizon. But I think that instilled in us the importance of making sure you have the path to get there: is there risk of permanent impairment?

And I think for me, what I learned more than anything else that was really helpful as we went into COVID and tariffs today is: how do you think about the unanalyzable risks? Right?

I think when we look at what happened during the financial crisis—where we had Lehman was okay to fail, others weren't okay to fail—where is that line? Can you analyze where that's going to go?

When you look at COVID and you say, this is different than anything we've ever seen before—or we go to tariffs, and without getting into the politics of it, we can debate which

things are most economically rational versus what could happen—and we need to make sure that we're analyzing companies for all those different scenarios.

VALERIE ARNOLD: So, John, let me hand it back to you. How does this current period stack up versus past volatile periods that you highlighted?

JOHN GOETZ: Yeah. Now, remember—there wouldn't be any volatility, and there wouldn't be any stock price movements, if the uncertainty was knowable or exactly like the prior one, right?

Because every time, you learn. To Evan's point, he would now know: what would a GFC look like running through the insurance industry if it happened like the GFC did last time?

But the uncertainty is unknowable to some degree, which is why the markets react so much.

What I'll say, though, in terms of this combo we have—right, Valerie, you started there—we have a weird combo of things. We have the tariff, which is a direct injection on: can you ship products with the same profitability from China, for example, as history?

But you also had AI, which was wreaking havoc already right before the second quarter. You have the European conflicts going all the way back to Ukraine. And we have interest rates that went from negative interest rate policy to positive.

So the noise level—and the combo of the noise level—is big right now in the markets. And we see that with big disparities driving big disparities in valuations.

We can come back to that a little bit later. But it's a cocktail of uncertainty in the moment.

What I would say is: the existential elements of dot-com, GFC—meaning complete wipeout risk and markets feeling complete wipeout—and COVID, probably bigger than this one. But this combo is unique and creating some real noise in the markets.

What I will say is the good news for us is we've been dealing with this for 30 years. And actually, if you go even beyond our 30 years and you examine statistically the outcome of periods of volatility—we have data on 14 periods of extreme volatility, which we define as the highest decile of volatility—and while each one was unique, because otherwise it wouldn't be uncertain, the pattern that develops in terms of how you deal with it as an investor actually rhymes.

And I think that's what we wanted to talk about a little bit on this call, and then go rifle-shoot to what the opportunities are—because I think that's what most people are most interested in: what are the opportunities we're seeing today?

But I think the history is really relevant here. So Evan, what stood out to you when you studied this historical data?

EVAN FOX: Well, I think what's really interesting—as John talked about—we've had 14 times where volatility was in the top decile over the last 50 years. And in 11 of those, equity markets were down.

And more important for us specifically is what you see is value stocks did underperform in 12 of those. And it makes sense, because whenever we go through periods of uncertainty, that's when the names that people are already afraid of are the ones that get punished even more. And so value does get disproportionately hit.

But the key is really thinking about: what does that opportunity set up going forward? And what is the recovery you see after that?

VALERIE ARNOLD: Okay. So fear dominates clearly in the short term, but what happens after?

EVAN FOX: Yeah. So that's where it's really interesting. When we look at forward performance after that—and we think of five-year forward performance, because we're really thinking of this from that longer-term perspective, and none of us know when volatility is going to peak and when it's going to come back down—the performance of value stocks more than doubles the performance of the broader market.

And so what you're really seeing is that if you have the discipline to stick with value investing during these periods of fear—and you're not rotating into the lower-volatility, safer names—you really get rewarded over the long term. And that's what we're trying to do with our longer-term investment horizon.

JOHN GOETZ: Right. Just to amplify what Evan said—the volatility spike, when it's at its absolute peak, is also the peak of opportunity. So if you say, "Ah, you know, I'll think about this and I'll wait for the dust to settle." You've I've heard every phrase for for how how investors think over over my lifetime. And and waiting for the dust to settle is my favorite uh favorite analogy because the reality is when the fear dissipates whether it's of the stock market grossly or a company when that fear peaks and then ends the reality is the stock price is already reflecting the disappearance of of the uncertainty. So all you're doing if you get out and wait for the dust to settle—is you get out at the spike, and you get back in, you know, when the price is up. That's really what happens. And that's why, if you look at data—and I think, uh, you know, Vanguard as a firm was one of the first ones that really did this—which is that individual returns might—uh, time-weighted returns might—might, uh, be better than individual return outcomes, right? Because if you react to uncertainty

emotionally, you actually do it backwards. That—that—that's—that's the lesson we're—we're—we're talking here.

Valerie:

I mean, yeah. No, John, thank you. Um, it's amazing how quickly sentiment can shift. So, John, what is Pzena's research playbook when it comes to markets as they start to go crazy?

John:

Yeah. Yeah. Yeah. So, our playbook is—is—is—is always the same. The crisis is always different. Okay? Now remember, our process is a disciplined process of looking at valuation. So the opportunities are fed to us by our own proprietary, uh, screen, which tells you the most undervalued stock prices relative to what the future should—should hold for these businesses and industries. So the—our playbook has always been the same, which is: we will automatically get forced to look at—I call it—the newly destroyed valuations. And obviously during big periods of fear, there's valuations that go down in things we own, but there's also valuations that drop of things we don't own. And we call that our new research list, because what our job there is—again, you know, the same thing—which is to actually understand whether or not you—you know, we're—we're—we're buying at an advantageous point. But the key is to know when you don't know. And therefore, what—what's more important is, the playbook is really about evaluating—I like to say—quantifying what bad looks like, and comparing it to the opportunity if that uncertainty dissipates.

Valerie:

So, John, how about sharing an example in the portfolio? Is there a stock that you could share that was impacted by tariffs?

John:

Yeah. Yeah. Um. Yeah, I—I think that, uh—and—and—and Evan can—can share something from—from his set. You know, my job, as—as Valerie mentioned at the outset, uh, shifted to primarily looking at things outside the United States. Hasn't been the best place, I have to admit, over—over the last 10 years, but, uh, the reality is, you know, I spend most of my life, you know, studying companies outside. So we're going to start with that, uh, just as an example. Um, you know, when—when—when fear strikes, it's the uncertainty that drives the stock price down. But if people think that a 20% stock price drop over a few days, for example—which we can often see and did see in Q2—the question is, do you think that that 20% is a—is a good estimate of what the actual business outcome shift is? And I can answer definitively: these quick reactions by the market are—are not based upon the actual shift in the economic fundamentals longer term. So let me—I'll give a specific example. Uh, Michelin Tire, which we own in Europe, because Europe's had a lot of

controversy. It actually started with COVID, when all of a sudden no one's driving, so you're not wearing your tires out, so we don't need any tires. You know, conceptually that was a big fear period, uh, related to COVID. But then the Ukraine war, recession, you know, all these things—'cause you think of the tire business as a super cyclical business. It is cyclical, actually. But that was already pounding the results, right? COVID, recession, etc. And—but this new one is like, "Oh my gosh, now if you try to ship a tire from Europe to the United States, you're going to get hit with at least a 25% tariff," you know, etc., etc. So, when you see that spike down in Michelin, right, in Q2, the riddle becomes: well, what would the world look like if you really had monster tariffs on European goods coming into the United States? Our job is to do that on a company-by-company basis. So—so that's why I'm going to use Michelin just to get the—the conversation going. The—the reality is, we have to analyze: "Okay, what if?" And that—I call that the downside. What if the tariffs are monster big? This is where the individual company research gets really interesting for us, because we can—we can, you know—we have someone studying the tire industry. We already know where you manufacture, where—where you ship, etc. So we're faster than someone who didn't know anything about the tire industry and—and where production is. So, I'll quick to jump to the punchline: in that initial downside analysis for Michelin, actually, didn't change the downside risk to Michelin significantly at all. And that—that—that's—you know—you wouldn't know that unless you realize that their manufacturing footprint is already sell-where-you-make-it in the main. But actually, the sidebar is that they may actually benefit from tariffs, because the noise in the tire industry historically mostly coming from people shipping from South Korea and now China to the rest of the world—that's where the competitive noise comes from. So actually, you could say, yeah, what the heck, you know, tariff the entire world, because Michelin will start selling the tires in the United States and Europe without Chinese competition. Do you see where I'm going with that? Like—like—but—but you—you can't get there, uh, quickly if you know nothing about how the business actually works. And that's what we have to do, is analyze: okay, let's take tariffs, let's run it through the numbers. Let's do the numbers, so to speak, you know, on the tariff case, uh, for—for—for Michelin. I'll stop. I'm going to start boring people with—with—with tires, so I'll—I'll—I'll—I'll pause there.

Valerie:

Let's, um—let's have Evan share another stock idea. Um, in your small cap research, uh, can you give us an example of a stock that was impacted by tariffs?

Evan:

Yeah. I mean, an interesting one that we added to the portfolio last year before tariffs, but then we've added more to recently, is a company—company HD Furniture. This is a furniture retailer. Uh, they're—they're based in Georgia, they're in the Southeast United

States, but they've—they've been around for over a hundred years. And the real concern coming into this is that housing turnover last year was the lowest we've seen in 30 years, right? Because of where interest rates and things like that are, people aren't moving as much. And as a natural corollary, they're not buying new furniture as much. Because you can buy things, obviously, when you just want to make your house look nice, but also it's heavily when you're moving. What's interesting is that with tariffs, most of their product is coming from Asia, right? If you go back a number of years before the first Trump tariffs were put in, a high percentage was coming from China. A lot of the supply chains were moved to Vietnam. And then, of course, when we go back to Liberation Day back at the beginning of, uh, April, we saw discussions of—of taxes being in the 40% plus, and now we see it in the 20% from Vietnam. There's a lot of questions there, and I think what's really interesting here is there's a few different angles of how we got really comfortable with it. The first one is just the downside protection on this stock. That, you know, as we talked about earlier, there's always the question of how you think about permanent impairment, but also the process of getting there. This is a company with no debt, with a ton of cash, and with the real estate that they own. And so the stock got down to where just the cash on the balance sheet and the real estate was two-thirds of the value of the company. So you were barely paying anything for the operation to begin with. So people were not even taking account that they're still selling furniture. On the tariff front, what I think is really interesting is that we've actually seen that furniture prices have come down for 30 years. Because we used to make it in the U.S. through the '90s, and as we brought it to Asia, actually instead of positive inflation, it's been negative inflation. And so now, even if pricing does go up a bit, they're skewed to upper-middle class and upper class in terms of price points. There is more pressure in, say, the \$999 living room set, where someone tries to get a five-piece set for under \$1,000, and you raise the price by 10% for tariffs, and now people really feel that sticker shock. But when you're paying \$3,000, \$4,000 for a couch, there is some element—

Evan:

If you actually ask most people—John, do you have any idea how much you paid 10 years ago for the couch that you bought? You probably have no idea. And if you went in today, you'd be upset with the price, but you would have been upset if the price was 10% higher or lower or anything, because you don't feel like spending a few thousand dollars on a couch. So, you know, it really is one of these interesting ones where even as the tariffs come through, they do have the ability to price through. They're sourcing from the same people everyone else is sourcing from. And that's really an important part of how we think about tariffs—that it is inflationary, but as long as you're not at a competitive disadvantage versus peers, you can take advantage of it. And when you're trading at such a discount compared

to even just the cash on your balance sheet, that's just a pretty attractive opportunity for us.

John:

Yeah. If you don't mind, I'll pile on there. You know, people think, "Well, you guys must know the future—otherwise, how can you make an investment?" I think what Evan's saying is, we don't know the future. What we do know is what you're paying for in the company, which has a very dark, dark future implied—right—in the valuation. So I like to say, it's when you're paying only for darkness because it's so ramped up, the fear is so ramped up, that literally you're paying nothing for the hope. Like, nothing. And—and that's his case on Haverty, right? Like, you know, if we start buying furniture again—even at inflated prices because of tariffs—he gets that in the stock easily. Right? That's—that's the win case. It's the losing case where we tumble into a recession—blah blah blah blah. So one of the things that I also wanted to introduce—because of the way Evan said that to the audience—is, yeah, we don't really know whether we're going to go into a recession or not on cyclicals. We don't really know that. What we like is when we're paying only for the dark side—and—and everything else is free. It's the skew—is what I want to make that point, right? It's the skew in Haverty that Evan is talking about which creates the exciting opportunity in that investment. It isn't different at Michelin, right? Because the skew is going to be: if we don't have recession and tires make normal margins and Michelin continues to extend their leadership—we'll win big. It's—it's that the negative case isn't what people are fearing, is part of the bedrock of—of—of each of our individual stock valuations. I like to say that the reality for us is: if the problem goes on longer than even we think, we still don't want to have the permanent—the risk of permanent impairment. I'm going to say that again. We do spend a huge amount of time trying to avoid any permanent impairment—meaning you're like, "Oh, the recession's going to turn, but if it doesn't, I'm going to be bankrupt." No. That's not really what we're trying to find.

Valerie:

So John, can we transition over to where you're finding value today?

John:

Sure. In the portfolio?

Valerie:

Yeah.

John:

Yeah. Yeah. So, you know, outside the United States, it's pretty clear that we don't have AI. Okay? Like—the Magnificent 7 is a US phenomenon. And that's what's concentrated the

moves. I'm going to point out to our listeners that we haven't had this degree of geographic concentration—in this case, the public equity markets—you know, 60% plus being US valuation. We haven't had that degree of concentration relative to GDP—because that number isn't even close to the GDP relationship. We haven't had that degree of concentration since the late 1980s. And at that time, that was Japan—just to jar everyone, you know, into a long-term historical view—because Japan is now just such a tiny part of the total market cap of the world. So I hope you all heard that, right? I mean—it is a period of US exceptionalism. And so if you're investing outside—you have none of that going for you. So—so the valuations and opportunities outside the United States—what's interesting to me is, because of that pall over Europe, even kind of the long-running pall over Japan—and emerging markets now too, because of China—what I'll say is, the geographic frame is just negative. And then within that, if you look at it from an industry standpoint—the industries have shifted. We had this big energy opportunity coming out of COVID. That has shifted away, because energy's kind of worked—until this last year. But it's not energy. Financials have been working, right? Thank you, God. You know, because remember, that goes all the way back to the GFC, right? That financials became an opportunity. But negative interest rate policy outside the United States was driving that—and those stocks—into low valuation. That's working. So what's happening incrementally is some of this cyclical stuff—certainly auto controversies. Michelin is cheap, in part because it's viewed as auto-related. So that's the classic—I'll call it somewhat cyclically influenced—stuff. But outside of the cyclically influenced, what is interesting is that healthcare in Europe has many flavors of undervaluation—in pharma, which people read about and some of the concerns there, but even all the way to blood dialysis in a company headquartered in Germany called Fresenius. So—so healthcare—weirdly—I mean, you don't think of healthcare as a devalued sector—but healthcare has been an element of opportunity. And then just to quickly close it off: there's always one-off individual company—I call it self-inflicted wounds—that we love. And there's a number of those. I'm not going to spend time on that, but we're always looking for what I call one-off—you know, a company has gotten itself into trouble, and part of our job is to see if that company can turn around its own self-inflicted profitability issues.

Valerie:

Thanks, John. Just for the audience, we are going to take live questions shortly, so please feel free to input them while we're speaking. I just have a couple more for Evan. Evan, as you talk about where you're finding value, can you address a chart we have? I'm hoping it'll come up on the screen shortly—where we're looking at 20 years of history and looking at the valuation differential between small cap and large cap. And what do you think of the notion that the small cap premium no longer exists?

Evan:

Yeah, it's—it's interesting. It's painful, the process getting here. But it's pretty incredible what we're seeing now. And it's timely because the front page of the Wall Street Journal—top article—was that Nvidia hit four trillion of market cap. Right? The entire Russell 2000—2,000 stocks—is three trillion of market cap. So we're at a point where, historically, the entire Russell 2000 was, say, 11% to 13% of the market cap of the S&P 500. And it's five today. It's just really a period where people have hated small caps. And what you see on the screen here, going back to the mid-1960s actually, is the relative valuation of small caps versus large caps on a P/E basis. And you can see the blue is for US, the orange is for global. So they track very closely—we just have better data going back further in the US. And we're at this depressed relative valuation that we only saw in the Nifty Fifty of the early 1970s and the peak of the dot-com bubble. We've gone through some 14 years of small caps underperforming large caps, as people are just leaving them for dead and hating them. And that's what really creates the exciting opportunities going forward—that it's at such a discount that—you kind of asked the question: is the small cap premium dead? We look at this as: small caps are at a huge discount today. So the higher discount rate that's effectively in it actually means that the opportunity set is incredibly wide.

Evan:

We don't need to believe that small caps trade at a premium. We just need for their discount to not be at the trough levels that we've ever seen over the last—uh—60 years, 70 years at this point. So, you know, it's an area that we've really been attracted to, and we've really been looking at that small-cap opportunity going forward as really where people aren't looking. And, you know, I think what's particularly painful to see is we often will have calls with consultants or with prospects who will make the comment of, “Well, small caps are such a small part of the market today that we don't really want to allocate a lot of time into figuring out what managers to use and how to think about it”—which kind of seems insane to us. When you say you're taking the area that's the most out of favor and then say, because it's small, you don't want to focus on it? So hopefully that's helpful just to give a little bit of our thoughts on that.

Valerie:

Yeah. No—and it's interesting to see. It's enticing both in the US and internationally for small cap. I also wanted to just ask one more question, Evan. As we were touching on it before—the market success with AI changing the world—I'm just curious if there are any examples where AI is creating an investment opportunity for us in small cap.

Evan:

Yeah, it's a great question, because as we know, AI is viewed as changing the world

forever—but sometimes that actually creates opportunities for us on the other side. An example that we added is a stock called Concentrix. They're one of the largest call center operators in the world, and they have operations in the US but also in the Philippines, Costa Rica, India, and other geographies. You go back a couple of years ago, and there were some reports saying, “What will AI disrupt the most?” Customer service, right? It'll be incredibly easy just to get answers to anything you possibly need, so you'll never need to talk to someone again. In reality, what happened is the stocks got killed because sales were declining slightly, but that was actually much more driven by just the normal economic cycle. Coming out of COVID, companies were really investing in customer service—they were trying to make sure to have high levels of service. And then, when they were cutting back a little bit, it's normal to cut back a little bit on, you know, the wait times people have and things like that. The stock got down to five times earnings. When we looked at this, we said, “We don't know what's going to happen exactly, but these guys are actually at the cutting edge of using AI to answer calls.” What you're seeing is that when you do call someone—one, nobody wants to just get a robot, right? If you get a robot, you know what everyone does? You say, “Operator, operator, operator,” or press 0000 until you get someone. But now, what you get is someone who might be in the Philippines—where AI might help reduce their accent—and will help answer the questions at the same time so that the calls are much more efficient. You're not needing to go to tier two or tier three support, you're not needing to ask to talk to a manager, and you're actually much more satisfied. And what we've actually seen is that in the last quarter, Concentrix talked about how more than half their clients are already using AI—and they're actually growing faster with those clients than the rest. Because right now, less than a third of call centers are actually outsourced to third-party players like Concentrix or Teleperformance, which we own in Europe. And as companies are seeing how much power this has, they're actually increasingly outsourcing to those players. So it's a little counter to the AI themes we were talking about, but I know both you and John talked about AI as the common theme that we're seeing, and we can actually take advantage of some of that fear sometimes.

John:

Yeah. By the way—just jumping in there, Evan—because obviously we have this big position in Teleperformance as well. We're not telling you all that we know that their revenue—because it's actually a better offering—is going to grow like a rocket ship. It's that the stock prices in the decimation of the business. That's what's exciting. And so, Evan's telling you it isn't necessarily decimated. In fact, their value-add to their customers—to their key customers—might go up. That's the key. That's the key to this. All of us are dissatis—I joke, you know, I do the same thing with the bots historically. Like if I see a bot, I put an X

through it. So, you know, it's going to be interesting to see how customer service improves through this journey because of AI.

Valerie:

Okay, so we're starting to get some questions from the audience. Evan, I'm going to direct the first one to you. The audience is interested—let's see... The audience is interested in your view on whether the US market has gone through a structural change in the last five years, where price volatility is driven higher by passives and pod shops—and whether that means fair values need to be assessed more often.

Evan:

It's an interesting question. What I'd really say is: we have come through this period where so much money has transitioned to passive across the cap range, that you don't have as much of that proper price discovery going on all the time. And because of that, it really creates opportunities for us. There's a range of reasons for it. Some of it is with MiFID II and some of the changes we've seen in sell-side research—that so many of the companies, there's no analysts that are looking at them. There's very little public information on these companies. I'll give an anecdote of a small-cap company that we own, where a year or two ago they put out a small regulatory filing that their president was leaving. And so I called the treasurer, and I asked the question, "Can you give us more color? What's going on here?" And I had noticed there wasn't much detail in the press or anything. And I asked, "So have you gotten a lot of calls?" And she said, "Well, my regulars have called." And I said, "Who are your regulars?" She said, "You. You just called." And it's just a comment that when you have these small-cap companies that just no one's reaching out to them, no one's understanding them—it does lead to dislocations that we can take advantage of. And so yes, I understand the comment in the short term of, "Well, are the pod shops driving the stocks around and creating a lot of volatility?" Maybe. But as the long-term, responsible investors who can really understand the fundamentals of these companies, we can take advantage of that.

Valerie:

Great, thank you, Evan. When valuing companies, is history still relevant in the current environment where AI could displace business models overnight? Is investing based on asset value or book value still a viable strategy?

John:

I—I can't—do you mind if I—I can't resist that one. You know, the reality is, we are not buying things based upon a balance sheet—price-to-book—which is based upon a backward-looking—

You know, you only have history. So a balance sheet, by definition, reflects a backward view

of the financial structure. What we do is we're trying to look out the windshield for businesses. Even our screening tool only has history—but our job is to figure out: What should profit look like? What should growth look like—looking out the windshield? So we're not opposed to growth. I'd like to point out to people that we've owned very successful, growing companies that are software-based. We own Alibaba right now in Asia. We have owned Microsoft. We have owned Google. It's that we own them when they have dark moments in terms of the cloudiness of the outlook—and the uncertainty is so big that even Google gets dumped enough into our lap in our screening tool that it hits our Q1 screen. I find that to be the most interesting thing over the 30 years: loved businesses do become unloved. And we're going to own them when they're unloved. Hopefully, they go back to love. I mean, that's really the issue in terms of the range of outcomes. Um, another question from the audience. How concerning has global equities concentration risks become?

JOHN GOETZ: Oh, wow. I can't shut up on this one either. uh you know the concentr as I mentioned earlier this concentration level is is really historic you know um Evan mentioned you know uh one company in video which by the way is a semiconductor design company don't make semiconductors they design semiconductors with software from companies like Cadence that we owned at one point like like we're we're we're we're saying that this runup of AI hardware and software ware which they're selling into the hardware build which is capital by the way right their their revenue is capital to Microsoft so so this capital cycle and I'm saying capital because we think of these as all technology is all capital light this is a capital cycle that that Nvidia is benefiting from we're not saying they're not going to grow sales at a rapid pace I'm not even telling you not to buy Nvidia what I'm saying is the expected return from then if you stay outside of Nvidia is is some really interesting expected returns because you're paying so little for future cash flow. Uh I think that's that's fascinating and Evan maybe you can you can pile on this with what are you paying for small cap future cash flow? Like I think that's the question most people it's absolute valuation opportunity is what what you know we think of as investors. I actually saw that pop up, so I'm throwing it to Evan.

EVAN FOX: Yeah, it's true because I think what we're really seeing is that there's no question that on broader uh valuation methodologies, the market is more expensive than many times in history. And I think we often see market strategists saying, how expensive is the market overall? When we look at small caps, they're slightly cheaper than long-term history. It's not that they are as screamingly cheap as they've looked on that chart of large versus small. It's just that a lot of parts of large have gotten very expensive, right? And that goes to that concentration of how much of the stock market performance has been driven by very few names. And it's, you know, we've we've done work in the past and it's certainly

something we can share if anyone follows up looking, you know, one of the worst investment strategies you can take over the last 70 years is to invest in the largest companies because by definition, they are the ones that are already bit up to high pricing. And so, you know, we're at this point where so much money is going into those same companies and just bidding more and more and leaving behind everybody else.

VALERIE ARNOLD: Um another question from the audience is do you see US health care opportunity uh are we seeing opportunities in US healthcare not only in Europe but—

EVAN FOX: Yeah maybe I'll I'll start with that and I will say you know it is an area that we've done a lot of work and have found opportunities what we're seeing in the health care space is a lot of regulatory uncertainty in terms of what's going to happen with Medicare advantage new regulations things like that and when you see those kind of disruptions, that's where you can find stocks that can trade down to where they can have a really positive skew of of outcomes, right? Where people are, as John was saying before, pricing in the worst and they're terrified of them. And that creates that opportunity set to say if all the worst rules go into effect for Medicare Advantage, then how are these stocks valued? then what is the upside if the worst doesn't occur, right? But we've also seen other parts that have gone through over the last few years um when Baxter some of the medical equipment companies have also had disruptions because they were dealing with major inflation in their costs when they had long-term pricing contracts that never anticipated inflation. Now, a lot of that they're working through and things are getting better. But, you know, we've really seen that health care across the US is a pretty diverse group, but it's had a lot of factors impacting it and has been an area that we've increased rates.

VALERIE ARNOLD: Thanks, Evan. Uh, John, I think the next one's for you. Where are you finding value in emerging markets?

JOHN GOETZ: Yeah. So, so um this this is fascinating, right? We've been in emerging markets uh now for uh you know, well over 20 years. Um so emerging markets historically we've done I would say you know we originally I think originally set out told people 300 400 basis points of outperformance versus an index. Uh and that's because emerging markets a little bit like small cap which Evan knows a lot about. It's the disinformation and therefore the momentum negative momentum and positive momentum gets a little carried away because you're you're you're talking into a vacuum. Um so just picking on uh the the evolving nightmares which is what we get to look at you know in emerging markets there's there's a lot of it you know the tariff thing super noisy you can imagine um we we we own some companies in China that people are hammering uh a little less today because obviously Trump backed off a little bit with respect to China but got hammered because they're like hold it you're Chinese and you sell you know to the United States you're dead

right and that's kind of how people were thinking uh in April. Uh but just to give I think a better example of of the type of thing that's happened over the last five years is China has gone into the major unloved. Uh I like using Alibaba because when people originally loved Alibaba and Alibaba was in the we complained about it. Evan knows this. Like we we complained in our international portfolios, emerging markets that of course we're not keeping up with the index because Alibaba is on a rocket ship, you know, and going up escalating more than 40% a year, you know, for for multiple years. It was a little bit of the Nvidia of the emerging markets uh uh situation. And so we complained about Alibaba. Well, now we own it. So, let me just say a couple of things. When it was running up, what people loved about Alibaba was two things.

JOHN GOETZ: It had a great e-commerce engine that had scale benefits much like the way everyone thinks of Amazon uh by providing Taoba which connected small manufacturers with small customers and and if you know anything about geography of China right they those connections couldn't have existed except if you were in the same town you know historically so they connected that but then T-mall connected western merchandisers think of Louis Vuitton connecting to all the Chinese people with money in Shanghai and Beijing like great value propositions, right? Forget physical retail. Physical retail is too expensive, right? Just forget it. Just go straight to e-commerce because that's the best delivery mechanism. Everyone loved that. Stock ran way up. So, what happened, right? The China boom came off. The government came after, you know, business. We thought Jack Ma was gone for a while. I'm just relaying the history here. So it got really dark but on top of that competition was coming right uh competition for eyeballs which can lead to e-commerce that's the original idea it still exists right in in e-commerce if you grab if I grab AB Evan's attention or more importantly Mindy his wife's attention right I will be able to monetize that so you had things in China going crazy for this short form video is probably the best example of grabbing someone's attention so that was taking market share and China's in recession and Now, and I sit on a couple investment committees, public record, right? China's uninvestable because of the political fears, right? There's nothing good about investing in Alibaba today. Same business, same competitive advantages, but it's uninvestable. That's what's going on right now. So, I can't resist telling people that it's when the dark stuff is all together that provides the opportunity. And please don't interpret this as we're betting the farm on China. I'm just saying that you have to go into some of the darkness to find the best, you know, opportunities uh in if you're running an emerging markets portfolio. So, we're not running from China. We're not running to India. We had a lot of money in India. Now, we have way less because it's just overvalued. India is just overvalued because everyone thinks it's the next China, you know. So, so this is normal for us. We have a paper there too, by the I'll sort of tell the audience when individual countries

collapse in emerging markets when they their relative valuations collapse that is a better expected return as well in history and every time it collapses Turkey's my favorite uh actually going there next week but you know Turkey uh Turkey's one of my favorites because I mean there've been so much controversy in Turkey but we've made a lot of money just going in during dark moments and come back out when the dark moment lifts a little bit. It's it's it's a kind of a fascinating em emerging markets has its government uh politicized fear, you know, element to it that that provides more opportunity.

VALERIE ARNOLD: Okay. Well, thank you, John. I know uh time is is coming up here. I just wanted to know if either of you had any final thoughts uh before we wrap up the webinar.

EVAN FOX: I would just come and I appreciate you setting this up Valerie and you know for us we're really looking at this time where whenever we have these periods of uncertainty that's when the value of our research team and really being able to understand what the challenges are is really really important to be able to look through them and take advantage of that.

JOHN GOETZ: Yeah. And I started there but I'm going to end there. Don't chase safety at the wrong time. You know uh that that's what will ruin your personal returns never mind your institutional returns and I want to add just one other element for this audience because I think expected return is often misunderstood we use it in alternatives again this comes from my investment committee participations you can ask private equity what's your expected return at any time I mean it's come down but they're telling you it's still teens what I find interesting is in public markets all the consultants at as we exit the second quarter the expected return if you ask anyone in public equity globally, I'm talking about MSCI now is is five sixish. I would puke on five or six. So if you say you want to allocate your money away from public equity globally because of that, I would agree. It's just that that's driven by the index overinvestment in the highly valued. So we have this weirdly weird thing. Public equity is no good, but I love Nvidia. when the reason consultants are telling you it's only five to six is because of Nvidia's valuation. I it this is a bizarre moment in time. Evans sitting on double digit returns. I know in places in Europe, emerging markets we have d I'm not telling you it's 20. I'm not going to boast like private equity. That's a whole separate subject. But you know the the reality is it is what we've had historically and that's somewhere 911 type of returns. That is what we've had for 30 years. So so I just want to throw that out to everyone in an absolute valuation sense is not to fear the public equity market if you stay out of index.

VALERIE ARNOLD: Well thank you John. Thank you everyone for joining us today. Um, huge thanks to John and Evan for their time today. We will make a replay available on our website via video or and also as a podcast and also I wanted to let everyone know that a lot of our

commentary at the beginning was coming from our second quarter newsletter which will come out around the 15th. Um, if you want to be added to our newsletter distribution list, please just send us an email at infozapzna.com. That's infozapzna.com. And thank you for joining us today.

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