

Adrian:

Right? I think that's us starting.

Um, Dan, John, just wait a couple of seconds because this clicker starts letting people in the room. I'd rather not start while people are still joining. I'll wait for it to slow down.

Let's give it a few more seconds.

Still going. Oh, well.

Uh—

I'll wait.

Yeah. Okay, let's start now, I think.

Uh, good morning or good afternoon everyone, uh depending on where you're joining from. Thank you for joining Pzena Investment Management's Global Outlook for Value webinar.

Uh, today's discussion is titled Finding Value in a Momentum-Driven Market. Um, the reason for that is momentum has been a driving force across global equity markets, and I'll come to more specifics on that in a little detail. Uh, in many cases it's become the real dominant driver of returns, and that's raised questions about cycles, discipline, and where value investors fit today.

We're going to focus on three things. Uh, the outlook as we see it for value investing in 2026, what history tells us about momentum-driven cycles, and lastly we're going to touch on the positioning in our portfolios and the opportunity set that we see.

Uh, we're going to start with a discussion and then move on to a Q&A. We've already got some questions come through from attendees as part of the registration process, and you can also ask questions through the webinar itself.

Uh, my name is Adrian Jackson, and I'm going to be moderating today's session. I'm joined today by John Goetz and Dan Babkes.

Just to briefly introduce the two of them—John's probably very well known to pretty much everyone here. Uh, John's one of our co-founders and is a Global CIO and a portfolio manager on our global, international, European, and Japan strategies.

Um, Dan, who's also elsewhere on your screen, is a portfolio manager, having joined us in 2016, and until now has been a PM on our Focus Value and Large Cap Equity strategies, and just recently was appointed to join the global team. So Dan, congratulations on that.

Dan:

Thank you.

Adrian:

Um, right, let's kick things off. I want to start with the market backdrop. I think, guys, as I mentioned just now, momentum has dominated returns over the last year.

Uh, and in both the U.S. and non-U.S. developed markets, momentum stocks pretty much were 20% ahead of everything else. Um, and for the U.S. specifically, that means we're kind of in a two-year run of momentum leadership.

Uh, the key question firstly is just what hasn't worked, uh, but also what's been left behind, and what sets us up going forward.

And John, I want to start with you if I can please. Looking at the global portfolios, the question we've got here is: what's the most important way this momentum cycle compares to prior ones, and what's meaningfully different?

So let's start with that.

John:

Yeah, the similarities are big moves up. And I like to say, you know, when you think about anything in the stock market, it's either driven by hope or despair—or fear—and clearly momentum cycles have lots of hope in them.

And though it's easy to see it because the stocks are just rocketing upwards. Um, so the common theme here versus all the other momentum cycles that we've seen since we started our firm 30 years ago is the fact that some things are just, you know, riding really high.

Another way of knowing about it is when professional investors and the taxi driver are talking about the same stocks—you know those stocks have momentum, is the way you should think about it.

Uh, so the similarity is big moves. Um, the extended part of momentum—there's another similarity—which is that you start to get situations where stocks that beat their earnings estimates by 5% go up by 10%, and the ones that miss their earnings estimates by 5% go down 10%.

Uh, which doesn't really make sense if you're thinking about businesses longer term. Um, so those are the similarities.

The differences this time are pretty interesting. Um, one is there's actually some leadership changes—meaning, uh, back—I mean I'm going to go all the way back—you know, it's

consistently the same stocks going up every day. AOL, by the way, was one of them, if you don't remember that.

Uh, so clearly the stocks that go up during the momentum phase are not necessarily solid long-term businesses.

So let's just get that out there. But one of the things we're seeing is this momentum cycle, and the hope is driven by the AI rhetoric.

Uh, and that's kind of interesting because some of the AI rhetoric can start off very negative, which it was for Samsung, for example, because they weren't participating in the HBM—high bandwidth memory—part of the big data center build.

Uh, and just in the last six months to a year, people have decided, “Oh, no, no—Samsung does have both a memory play in AI, and they probably will catch up on HBM chips.” And just that has meant that Samsung has gone up by about 180% in the last 12 months.

I mean, this degree of craziness, you know, in stock price moves is even crazier than maybe some of the prior momentum cycles.

The other difference I want to point out is whatever is riding high in momentum does change over time—by sector, by industry, by company.

Outside the United States, probably all of you on this call know that one of the sectors with the highest momentum is actually financials. Uh, I like to say that over the last, you know, 10 years, probably the one sector that was most controversial for us is the investments we had made in the financial sector. And last year, momentum outside the United States in financials was incredibly high.

So what is in momentum, what is in favor, does change with these various cycles. Obviously this time, globally, tech is in the center of the hope, and the AI rhetoric is mostly about tech companies.

Uh, so the similarities are things are on fire on the way up. Uh, the differences are it seems to be hopping around a little bit more than in prior cycles.

And outside the United States, we weren't in value land—we weren't left out of momentum entirely—and that recovery in European financials is clearly a difference versus some of these prior cycles.

Adrian:

Dan, let's bring that to the U.S. Earlier in the cycle, the leadership felt concentrated in the mega-

cap growth names. More recently, it seems to have broadened in a way that feels more speculative.

If you can answer the questions: what's changed, and how does that matter for investors?

Dan:

Yeah, I think you're making an astute observation. I do think as the cycle has progressed, we've seen some real tangible signs of speculative behavior.

So whether that's the resurgence of some meme-stock-type activity that we saw in 2025, or the outperformance of unprofitable companies or companies with high short interest—some of that behavior definitely feels more in the speculative hope cycle versus just following fundamentals.

But if I was going to say why this matters, I'd really bring it down to one word, and that's dispersion.

So what I think is really interesting about the current market environment is if you just look at overall market indices, you might mistakenly believe that we're in this period of just unfettered and coordinated economic growth across industries. That's actually not what we're seeing at all.

So there are kind of two things going on. I'll separate a little bit what we're seeing in different industries and the fundamentals across different businesses versus what we're seeing in the markets. I think they're both really important points.

What we're seeing in the markets is the market, as John referenced, is really rewarding businesses either with positive fundamentals or with some kind of hope story. And that's getting rewarded at a very rapid rate.

And the converse is also true. Companies with problems are getting punished in a way where we would say you're seeing some real overreactions.

And then what makes this, I think, a particularly interesting backdrop for fundamental value investors is there's a lot of dispersion across companies and industries.

If you just think about what's going on in the world, we have a lot of uncertainty around trade policy. There's a lot of geopolitical uncertainty. And we're still seeing in a lot of industries dislocations that were caused by COVID. I know it's six years later, but we've seen some industries where the fundamental picture has been really hampered by supply imbalances that were built up by the pandemic.

And you're seeing the market really overreacting to these changing dynamics.

So that's creating a pretty target-rich environment for us, and it's creating a target-rich environment across a broad set of industries, which is pretty exciting.

So when I tie that back to what we're seeing in our portfolio, we have some pockets where we've had good momentum. John referenced one, which is financials—it's been a pretty good environment for some of our financial holdings.

And certainly it's been a good environment for any company that's benefiting from a lot of the investment we're seeing in the real economy from the AI buildout.

Um, and then you're seeing a lot of other sectors that are really suffering from some of these dynamics that I've referenced. And those stocks are either being completely left behind, or getting hammered. So that's creating some really chunky investment opportunities when we can look past the kind of near-term choppiness and look at the longer-term fundamentals.

Adrian:

Okay, thanks. So that's the background taken care of.

Looking forward to 2026, I'm going to ask this of both of you actually. What matters most for value investors now?

John, start with you globally, please.

John:

Yeah. So obviously what we do with our disciplined approach to buying the most undervalued businesses is we're watching what I call "crashes" into our first quintile in this proprietary screen that we run here.

And what's different—what's interesting—is what crashes into the first quintile is different every single time. What's common is the dispersion that **Dan** was talking about, that the gap widens between the loved and the unloved.

So the pattern, just to give you a little bit of the math: when you go through a big investment period where there's lots of optimism and lots of momentum, usually value isn't caught up in the hope part of that. This time, outside the U.S., we had financials working. U.S. financials are working too, so this is a little bit permutated versus, say, the prior examples like the dot-com period.

What is common, however, through all these periods—no matter which sectors are in the hope bucket and which are in the despair bucket—the reality is that after that momentum period, value turns. And if you look outside the United States, the average of the next five years is about six to seven percent outperformance. And that's just because the dispersion got wide.

So then when the hope finally dissipates up here, or the despair releases itself a little bit, that's what sets things up nicely for the next five years.

So the key word again—we've said it like five times, but we'll continue to say it—is dispersion in valuations.

You know, I think what's interesting here is that, especially outside the United States—and those of you in Europe particularly know about this—is that things that you used to call quality have not been showing quality returns. They've been lagging dramatically.

So if you think about some sectors that historically we would have been low in—because maybe the setup looked like we were actually in a recession at the same time that tech was working—there were a lot of cyclicals this time, because banks are actually working, and energy worked a couple years ago already. We've been harvesting money from energy, now we're harvesting money from financials.

What's different is that some stocks—both in healthcare, consumer staples, and even some high-quality industrials, and I'll give you an example of that in a little bit—things that you used to call high quality have gotten into the first quintile.

So that's kind of exciting because it diversifies us away from this “deep value is only cyclicals” type of mindset that some of you might actually have in your head, like we just traffic in cyclicals. We don't just traffic in cyclicals.

In fact, the highest quality company I think we've ever owned is Microsoft, and that was bizarre when it crashed into the first quintile. Likewise, today it's a little bit bizarre that some of these other businesses are meeting our valuation screens.

I'll just pause there.

Adrian:

Perfect. Thanks, John.

Dan, that same question for you, but with a slightly different angle added to it. Some investors argue that value has structurally changed, or that benchmarks make it hard to compete and add value. What would you comment on as we head into 2026?

Dan:

Yeah, it's a great question and one that we hear a lot.

So I'll address the first part of it, which is whether something has structurally changed. And really what we're fundamentally trying to do is systematically underpay for an attractive stream of long-term cash flows.

So the concept that something's changed in the world where, like, the basic arithmetic of generating attractive returns by doing that is now broken, it just doesn't make sense. So really I think what that question boils down to is: are the traditional ways of measuring value, based on, you know, shortcuts some other folks might use from accounting metrics to measure value, are those becoming a little bit less relevant because, you know, the economy is changing and business models are changing.

Now, you know, even if we believe that that's the case, that's not the way we do it. We're always thinking about the fundamentals of the industries that we're owning. We're not buying into a factor. We're not, you know, naively buying things just because the accounting metrics say it's cheap on price to book. We're always trying to think through the long-term trajectory of the business models.

So that's not really so relevant for value investing the way that Pzena Investment Management does it anyway. But even to attack that part of the question, one thing that we're starting to notice is some of the business models, like big tech, that you would have said the old accounting rules no longer apply to anymore.

Um, even those are starting to look more and more like traditional business models. So you're starting to see some of the, you know, asset-light, cash flow-compounding type companies becoming asset-heavy now during the AI buildout. So, um, you know, I'm skeptical that that theme is as true as people think it is. Even those accounting metrics are as true. Even if they are, it's kind of less relevant for us.

And really, buying long-term growing cash flow at a very cheap price — that can't stop working. So I just fundamentally don't think that's right.

And then the other point you asked about, on the indices and benchmarks — you know, I would say the momentum nature of the market and the concentration that we've seen has created some real issues within index construction. So we're seeing now that large tech is becoming such a big component of the broad market index that it's actually started to pollute the style indices.

So, fun fact: the largest holding in the Russell 1000 Value Index now is Alphabet. I mean, that's the leading AI stock at the moment. And I think the Russell 1000 Value Index now has, I think, 872 stocks. And I can tell you, as a value investor, there are not 872 large-cap value stocks. That's kind of a preposterous thought.

So a real disciplined deep value portfolio, like we're trying to construct, looks very, very different from the style indices that are now, I think, starting to get polluted with some of the growth winners. I would argue that's a good thing as far as what that should look like in terms of relative returns over the next five years.

Adrian:

Just one more point on this, if we can. Do you agree the key is less about value winning and more about how expectations are reset?

John:

Well, certainly — certainly — it's all about expectations. I think the blow-off, what you would call it at the end of a momentum period, is that no one's looking down anymore. You're just looking up and expecting up, and that's always a dangerous place to be.

I've always said — I've begun to say just in the last year, and some of you have heard me say this — there's only two types of business in the entire world: those that have a problem today, and those that will have a problem in the future. And when you look back with the lens of history, you see that, right?

Like, how could we ever have owned Google? We can tell you the story of how bad Google was viewed, how negative the view was at Google when we owned it. But the reality is, when you get into this period, no one's looking down anymore. And that's where risk occurs, because the valuation is so lofty you can't take a negative. And so when the negative finally appears, there's lots and lots of downside.

And that's how we think about risk. We think about risk as avoiding permanent impairment, obviously, but also avoiding overvaluation in what we own today. And that's where the expected return to value actually comes from.

I want to — Adrian, you know, we didn't talk about this in advance — but I just want to remind everyone that the reason the expectations, particularly for U.S. equity returns, are low is because it's a market-cap-weighted index. And people are saying — consultants are saying — yeah, your expected return is 6% because the valuation is so high. But the dispersion is wide, so that actually isn't correct.

So I just want to make sure everyone sees that what Dan considers is how we think about it. You're paying this for a business — what should you expect over the long run in terms of cash return on that business? That's how we're thinking about it.

Adrian:

Okay. One last piece of context before we turn to portfolios. I'm going to stay with you, John. A recurring question we get is whether momentum and value are fundamentally opposed, or whether they just operate on different time horizons. The question I want to put to you is: historically, when does momentum become most challenging for us?

John:

Yeah. It's right at — I've already kind of alluded to it — it's in what we call the blow-off period. It's where the moves are exaggerated. And like I said, you know, the company beats the whisper and the stock goes up another 10% on the day.

Like it's already gone up 200%. It goes up 10% in a day. Yeah. Yeah. You know, I think it's that period there. I don't think this has been quite as bad as dot-com, but just one little anecdote. I woke up during that dark period in dot-com for deep value. I woke up one morning and I thought I had had a nightmare that we trailed the index by 5%. And then as I woke all the way up, I realized that was actually yesterday's return relative to the index. And it wasn't because we were losing money. It's because the index went up that much.

So I think that blow-off period is interesting, and it looks like we've been oscillating in that recently.

Adrian:

Dan, just briefly from a U.S. perspective, in prior high-momentum regimes, what tends to happen once expectations peak?

Dan:

Yeah. So we ran this analysis recently just looking at historical periods where you've had successive high momentum. And what you find is during those periods, cheap stocks tend to underperform during that blow-off phase that John was referencing.

So in the one year where momentum is really outperforming, cheap stocks don't produce much of an excess return. And then in the five years after that, on average — and this is looking at data going back to, I think, the 1960s on average, cheap stocks produce excess returns of north of 5% annualized over five years.

So I think a little bit of underperformance during that blow-off phase. On average it's sub-2%. And then about 5% excess compounded over five years on average. So as we referenced before, it's the resetting of expectations where that fundamental earnings stream starts to dictate the returns, where you really see the starting point of valuation start to matter.

In fact, we haven't got it here, but in the newsletter — for the commentary for the newsletter, sorry — there are a couple of charts that kind of make that point.

If any of our listeners or attendees — sorry — haven't got this quarter's newsletter, just get in touch with us and we'll send it across to you, because those charts are pretty good and kind of highlight that point.

Right, let's make this concrete. It's all about portfolios and positioning. John, with you to start with, please. Globally and outside the U.S., we've seen our international holdings switch from financials and materials across the healthcare, IT, and consumer staples. What's driven that shift? Can you talk about that, please?

John:

Yeah. Yeah. So, you know, strictly valuation — but I alluded to it earlier. When things work in our portfolio, our discipline is we must sell when they're at average valuation, right?

We have to own things that are undervalued. And many of the financials that we had outside the United States started to meet that requirement, both in Japan and uh the United States, I mean and Europe, sorry. And as a consequence of that, you're finding there must be new things in the first quintile.

And the three things that are surprising — the three sectors that are surprising — is to see us now as overweight in consumer staples, overweight in healthcare, and overweight in some high-quality industrials. That's interesting.

So what I'll talk about there just real quickly is that, you know, in healthcare, you've had problems throughout the healthcare sector globally. Dan will talk your ear off about what's going on in healthcare in the United States — he's closer to that than I am. But just as an example, a company like a pharmaceutical company like Sanofi, which we own in our Europe and international portfolios, has had enough disappointment in the pipeline, while you also have fear that Dupixent, which is a real blockbuster, comes off patent. You put those two things together and say, "I can't own it," right?

They they they stink at R&D. But the reality is now today you're paying so little for the R&D pipeline that that's where the value actually is because they've had a few disappointments. Um so the negative is always obvious, meaning stocks are weak for a reason. Uh usually related to earnings or in the case of pharma disappointments, you know, on the pipeline.

Another example, you know, in the portfolio which I think is is really interesting because Japan has been on a tear, uh basically, right? If you look at at valuations. Uh but yet we just started buying Daikin because Daikin is a global uh HVAC air conditioning, heating, ventilation company leader. You know, like like if you're in the United States, you know about Carrier and Train. Um but you know, if you're outside the United States, you're like, I don't know, you know, who who who's the global leader? The global leader is actually Daikin in technology and that's why they have a a massive leading position in China, in Japan.

Where they were were less represented was actually United States going way back and that's because of the strength of that structure that that once uh you get an air conditioning unit

certified either in industrial market or in the consumer market, uh the installers just want to do it again. You know what I mean? Like like if your air conditioner breaks down they replace it with the same thing, uh and that just goes on and on.

So, it's a good business. And if you look at the multiples for train uh or or carrier, you'd see that that it's a good business historically. So, how did Daikin get into the first quintile? Three big problems. Uh one is that there's actually a regulatory change United States and being, you know, long-term thinkers, they got to it too early. Meaning the refrigerant they moved on to the new refrigerant which from Jan 1 this year 2026 you must install with new refrigerant. They did that already last year, but the installers were like h I'm not going to do that until the last minute. So so they actually got ahead. Uh but now now they are ahead, you know, so so that problem's taken care of.

But the bigger issue was their returns optically look like they were coming down over the last couple years. That's a consequence of making an acquisition United ates and then investing for leadership and and

So, you know, when you think about returns in businesses, you compare the earnings to the capital employed. And it looked like they had used to have a good business, but it's gotten much worse because they have more capital employed. But actually what that capital is doing is turning an acquisition, Goodman, based in Texas, into a leader from being a lagger in technology, so—and in the value chain all the way through the supply chain, everything. So they've been investing, and that's been driving down the returns, but now they are taking share because of that investment.

So we get to this bottom point where everything's gone wrong. Housing has been kind of slow in the United States. So here's a company that's actually in a great industry, just judging by the competition and how it works, and yet they have had declining returns, self-inflicted, so that you actually can now have a return now that we expect a payoff from that investment.

So, so these are the kind of unique, I'll call it one-off things, where you have pain that you can really understand why it's temporary. And Daikin, a Japanese-listed company, is an example of that. And I would say, you know, our expectations is that the industry structure will continue to be good and their business—and they're incredibly well positioned. So again, buying a good business at a low price.

Adrian:

Dan, we've seen a similar but distinct picture in the domestic US portfolios over the last five years. The move there has been from financials, industrials, and energy into healthcare and consumer staples. Um, what's driven that shift? Is it bottom-up selection—sorry—bottom-up stock selection, or where the value has been most available?

Dan:

Yeah, it's—it's purely a bottoms up dynamic. So, okay, you know, there's—there's nothing, you know, thematic that we're—that that that we're doing really. You know, we're following the company-specific opportunities and investing in the chunkiest ones where we're getting the best valuation dislocations. And it just so happened that that five years ago that was in different sectors, and today it's—it's broadened out into some sectors that that, you know, folks maybe traditionally thought of as being more defensive. Um, but it's all—it's all really, you know, company-specific.

Adrian:

Can you give a couple examples?

Dan:

Yeah. So, I guess John—John teed it up that, uh, I—I should talk everyone's ear off about healthcare. So I'll—

Adrian:

No, it's 32 minutes left. So go—go for it.

Dan:

You know, I'll—I'll—I'll try not to use the whole 32 minutes, but I probably could. But I'll—I'll start with—um—I'll start with Baxter. Now, this is an example of, you know, I would say a company with a—with some company-specific issues that's just been left behind in this—in this giant momentum wave.

So, you know, Baxter is what I would describe as a—um—a medical equipment manufacturer that provides like staples to the healthcare system. So think about the types of products that you just need to run your hospital. So IV fluids and pumps and—and you know, some of those basic consumables.

Um, so if I go back in time a couple—couple years ago, um, the original opportunity in Baxter was there's a—a heavy component of their cost structure that's just tied to raw material pricing. And coming out of COVID, when we had the inflationary shock, they were upside down on a lot of their contracts. So they—they contracted fixed prices over multi-year periods and they hadn't built in inflation protection into a lot of their contracts.

So this was a business that historically was thought of as being a very stable company—you know, boring, defensive business, expands its margins a little bit every year—and then all of a

sudden they had a big shock to their margin rate, um, just because of the way they had—they had managed some of that—some of their procurement contracts and—and their customer contracts. So they were—they were upside down and experienced some significant earnings pressure.

That—that created the initial opportunity for us in Baxter. Um, and really our thesis was fairly simple that over time they'll slowly reprice those contracts and put in, you know, more basic managerial tools like inflation protection, um, in—in—in order to—to make sure they're not upside down again in the future. And you started to see that coming through. The margins started to—to slowly recover.

Um, and then, you know, Murphy's law— a couple other things went wrong over the last couple of years. So one of them was that they had a disruption in the supply of IV fluids. So they're actually 70% of the market for IV fluids in the US, and it comes out of one factory in the Gulf Coast. And because of a hurricane, there was a disruption to their supply base. Customers pulled back and started conserving, uh, their use of the product. Um, so that had a material impact on the earnings stream and brought earnings estimates down a little bit further.

And then in the midst of that, they had a ship hold, a self-inflicted ship hold, on a new pump that they had just rolled out. Um, and going back to our discussion around momentum, the share price reacted by more than the contribution, um, of this pump. So when earnings estimates got cut because of this temporary ship hold for this pump, more than the total value this pump could have ever produced to Baxter came out of the enterprise value. So kind of an overreaction to these short-term issues.

So we look at this today and we think it's still the same high-quality, boring business that it was five, six years ago. Um, the only difference is they've experienced a series of unfortunate events that led to some earnings pressure over the last few years, and then the multiple derated from 25 times earnings to sub-nine. Um, and we think it should be actually easier for them to start growing their earnings from here because they're under-earning what they should be because of these issues, which start to resolve. So we think that's a really attractive investment opportunity.

Uh, and I'll give you—I'll give you one other example. I'll stay in the healthcare space, and this—um—I'm going to talk about Humana, which is a health insurer. And I think this will be an interesting lens into a company-specific dynamic where you can see momentum taking hold.

So, um, so what Humana does is they're basically a pure-play health insurer that specializes in Medicare Advantage plans. So think about that as the private market option, uh, for the elderly population that, um, that has the option of signing up for public Medicare plans.

Um, this whole industry mispriced their policies coming out of COVID, and what happened was everyone underestimated the pace of utilization. So during COVID, a lot of the elderly population wasn't using their benefits, they weren't going to the doctor, um, basically because of

fears of the virus. Um, and then in 2023, um, the medical cost trend really started to accelerate and all the insurers were offside. They weren't anticipating the snapback in utilization.

So what's happened subsequent to that is the industry's started to reprice. So that's wildly bullish, actually, that the whole industry was upside down and is now going through, um, this repricing cycle. Um, what's happened to Humana—the stock has really gone sideways over the last year or so, even as this industry's been repricing to the new level of utilization—and that's purely driven by a company-specific issue.

So, um, part of the revenue base for these companies is driven by effectively bonus payments from the government based on, um, their star ratings. And Humana had a company-specific stumble, lost their high-quality star ratings in some of their key plans, um, and is losing their bonus payments. So 2026 is kind of known—it's going to be a tough year for them from an earnings perspective. Um, so they're not benefiting from this industry-wide repricing.

Now, take a step back. About, uh, about a year ago, our largest holding was CVS. CVS had the exact same issue. They were more offside than Humana was as far as underpricing a lot of their insurance programs, their insurance plans. Um, had the same exact company-specific execution issue. And then in 2025, um, they started to see a little bit of improvement. So CVS was in a worse place than Humana. They were actually losing billions of dollars on their Medicare Advantage book.

And in 2025, they started losing less money than they were losing the year before, and the stock went up 75%. Humana, the people don't know what the bottom's going to look like in 2026, or we hope the bottom is going to be in 2026. Um, so the stock has gone nowhere, but it has the same industry-wide tailwind. It's a market leader that has absolutely every right to fix their company's specific execution problem in the long term.

Um, and you're you're buying it today at, we think, less than five times the normalized earnings power for a business that, um, compounds returns on capital at a very high rate and should grow structurally at mid to high single digits. So, we think that's an unbelievable long-term investment opportunity. And the whole reason for that is nobody knows how bad 2026 is going to be. And our perspective is they're—they'll get through whatever, whatever comes in 2026, and in the long run this is crazy cheap. So pretty, pretty exciting opportunity.

And I like drawing that distinction between the company who—who's who saw a little bit of improvement, giant increase in their share price, versus the company that hasn't seen the improvement yet, um, which is has underperformed by, you know, north of 75% on a relative basis.

Adrian:

Okay, thanks for that. I'm going to summarize in a second, but before I do so, just to remind everyone, this is going to—we're going to move into the Q&A session now. Uh, we've had questions come through in advance as part of the registration process. I got those here in front of me. Uh, there's a button somewhere on your screen where you can ask a question live. We're going to get through some of those. Um, if we don't get to yours for whatever reason, um, we'll have our—one of our client reps follow up with you afterwards if it's not—they're not covered at all, it's not under this, this, this session.

But just kind of briefly to summarize the points I've written down here, um, three or four things. Firstly, momentum has been extreme but not uniform across all regions. Uh, the US has shown more speculative characteristics maybe than non-US markets. Um, thirdly, historically his extreme periods of momentum have offered creative—creative attractive long-term opportunities for value investors like ourselves.

And lastly, both Dan and John have mentioned it several times, is this whole dispersion thing and what that means for fundamentally driven investors. Um, so with that we're going to start with Q&A. Um, I'm going to start with one that's just come through on the screen now.

Um, John, let's start with you if we can please for this first one. Are there opportunities for utilities or any other sector for that matter because of AI?

John:

Yeah. Um, you know, clearly AI, uh, might well change the fortunes of different industries, different companies. Uh, right now in the market that is one of the dispersion drivers. I call it the have and have nots, right? Like if you're building data centers like crazy, even though you're driving up your capital and driving down your return on capital, which is what happened to Daikin and then we're punished for it, that is rewarded right, uh, right now in the market, building up a data center.

So clearly the people that serve data centers, like utilities with electricity, there is some opportunity to grow the business a little bit faster. What I will tell you about utilities, because we've been in utilities, you know, off and on through our 30 years, um, the hope is already reflected. So, we were more likely to take a little money out than we were to put money in, reflecting the hope of increased electrical demand. That kind of happened with the push to EV cars as well.

So utilities were already not in the darkest place from a sentiment standpoint even before the, the, the data center build. Uh, so the way it tends to work for us is that we will be finding companies where the AI is negative actually in the outlook and we could prove to ourselves it's not as negative as people are thinking. And what's interesting, I'm just going to go back to what I mentioned at the outset, the reason we got—we were able to get into Samsung and build this

big position in Samsung was because they were viewed as the loser actually. So, so now all of a sudden they're a winner.

So it's that kind of insight on even the trend that, that's driving the market that we need to do by the very specific company, uh, research. So, so no, utilities are not what's—we're finding in the first quintile now, uh, based upon AI, because it—that hope is already reflected.

Adrian:

Okay. Dan, one for you that's come through, uh, beforehand. Um, what is happening with small caps? Are people avoiding? What, if any, catalyst do you see on the horizon for small cap outperformance in 2026 and beyond?

Dan:

So a small cap one. Yeah, you, you know, I'll, I'll, I'll give you a couple of some statistics that our, our small cap team has, uh, has talked a lot about. So, if you look at the long-term history, small caps tend to do quite well. I think they've actually outperformed over a long period of time. The last five years have been quite an anomaly.

So, I think, I think in the last five years, small caps have underperformed by over 700 basis points annually. And if you look at the starting point on valuations today of, of small caps versus the rest of the market, it's at, you know, historically wide levels. So I think there have only been two other times in history where you've seen this much dispersion. One was the dot bubble. Um, and the other one I believe was the Nifty 50 period back in the 1970s.

So, you know, as far as catalysts, what I would say is I don't know. But historically, when you've had had the, the few times in history where you've had this kind of an anomaly where small caps have underperformed like this and the starting point on valuation has gotten this upside down, that's been a really attractive starting point on, on valuation for the asset class, and you know the forward returns have looked quite good from there.

Adrian:

Okay. John, this one's for you. I think, um, is it possible that it is a new concept of value? Maybe that the asset value or the actual EPV has not more relevance than the expectations without solid base and the return to the mean is mirage. In fact, what I kind of get to with that question is, you know, has how we think about value changed?

John:

Yeah. Yeah. Yeah. Good, good question. Um, which, which we are obsessed with constantly. So let me, let me, uh, break that down. Clearly, if you're running a screen, any screen uses data, and

that data is the data that's already occurred. Now, what we do naively is we take data in industries and companies, long-term data, and we say if history is relevant, this is what the future should look like. Remember, the data is actual data. So, all you have is the history.

Um, so what we do with that though, this is the important part. We don't then say, "Oh, that company is statistically cheap. I'm going to bet on mean reversion." What we say is, "What is the problem that has crashed the stock?" Dan gave you an example for Humana. I gave an example for Daikin. And we look at those problems and we ask, is that problem temporary or permanent? Because if it's temporary, then hope will return, especially if it's a well-positioned company in the business.

We actually aren't trying to find weak companies that are going to zero and hoping to get one last puff on the cigar, which was what, what, what, you know, Warren Buffett said could be a good investment before Charlie Munger got there, right, uh, to Berkshire Hathaway. So, so that's not—so when we look at the first quintile, we're looking for companies where we can kind of tell ourselves that the problems that are besetting the earnings or the reported returns of the business are fixable, uh, and the market position of the company isn't endangered. We're not always right about that, but, but, but that's the thesis.

So, so if you think about us picking from the first quintile, it's finding the gems in the first quintile, not, not the dogs. So, the best example of this in terms of dramatic shift in value chains was physical retail going back to e-commerce. And because we have massive investments in China, uh, through, you know, our various products, global and, and emerging markets, we knew that for a clean start in a growing economy that e-commerce was going to penetrate even faster than it did in where you have a built-up store on Main Street and people are in a habit of walking into the JC Penney, which is no longer there, if you get my drift.

Uh, so the, the reality is that we are distinguishing between temporary and permanent problems. Uh, and that's where all the research—that's what the research actually is—to prove to ourselves that the permanent fear embedded in a stock is unjustified.

And that's why I said, you know, it just is so dramatic this last 12 months. I can't even—I can barely tolerate it, right, uh, intellectually, because if you're winning today and you just beat your numbers a little bit, you're confirmed as an even bigger winner. And it doesn't matter why you missed your earnings, it's probably because you're on the wrong side of AI. Like you don't even—no one even invest—oh yeah, I knew that that staffing company in Europe was dead because we're not going to have any employees anymore. Everything's going to be robotics or or AI-driven. Do you mean, like, simplistic optimism or pessimism is what's been driving the big momentum cycle.

Okay, we've got lots of questions here. Just pick out a few more before we finish, maybe at ten-two or five too. Uh, Dan, this one's for you, I think. Well, this one's definitely for you. Is there anything on US banks that is worth investors thinking about?

Dan:

Yeah, I, I think, uh, you—we referenced this a little bit earlier in the discussion, but, um, the US banks, particularly the, the larger cap ones that, that have been, you know, held in our portfolios have done quite well over, over the last year or two. Um, and really if I describe what's been going on, um, there's two different factors that I think are driving that. So one is the business environment and the fundamentals, and then the other is the regulatory environment, which is connected but a, a little bit different from just the fundamentals.

Um, so as far as the overall environment, what's, what's, what's going on from a business perspective is a lot of the things that we're discussing that are impacting the world have been driving positive revenue growth for these companies. So, uh, uncertainty around trade policy, interest rate volatility, um, it's driving a lot of activity. Um, so you've seen quite robust revenue growth, particularly for some of the, the, you know, winning large US franchises. Um, but that volatility has not translated into very high unemployment or a wave of corporate bankruptcies.

So you've seen credit costs remain quite low. So this combination of of volatility in the world and driving driving good revenue growth—and part of that is also the AI wave, frankly, it's capital formation driving loan growth. So you—you've seen—you've seen those tailwinds coming through in the revenue line, credit costs staying low. The net of that is very robust earnings growth. So that's—that's created—that's put some of the large cap banks into that positive momentum bucket.

Um, the other component of that is is the regulatory environment really did a 180 when we had the change in administration. So I think there was, uh, if I go back two, three years ago, there was a push to try to force all the large US banks to hold a lot more capital. Um, really in—in part in response to the banking stress of 2023 when you saw the failure of First Republic and—and uh—and some other large franchises in the US. Um, and—and really that's—that's moved in the other direction. I think the—generally speaking—the appetite has been to try to create a more benevolent regulatory environment for banks to try to stimulate economic growth.

So it's that double combination of actually good fundamentals right now and hope that the regulatory environment is going to further accelerate things. Um, that's—that's put the bank stocks into the more positive momentum bucket.

Um, what I would say what we're seeing in our portfolio is, um, we have exited completely certain holdings, and we—where we're still finding some pockets of opportunity are—are really company specific. So, um, banks where there's still a company specific improvement potential

we—we still hold. Um, and, um, you know, some of those—the—even after the year or two of positive momentum, the valuations are improved from where they were, but the starting point was so low, um, that they're still not really expensive stocks.

Um, so, you know, we've been reducing our exposure, but, you know, we haven't, uh, we haven't fully, fully exited some of our—our holdings where we think there's good franchises with—with a company specific opportunity still.

Adrian:

Well, time for one or two more. Um, John, this one's for you and it's for Europe.

Uh, after such a strong year for European equities, does remain an opportunity left for value oriented—value oriented investors in the region, or whether the long-term anticipated recovery in value stocks has already occurred?

John:

Yeah. Um, those of you that have been in—you listen to my podcast or my global outlook—know that I, a year ago, um, and then probably the prior year to that, I said, uh, when I was visiting—we visit companies that we buy, right? We—we won't buy them until we've actually confirmed our thesis kind of by visiting management and—and understanding their viewpoint and plans to—to do—to turn the business around.

And when I was traveling in Europe, because Europe was—was much maligned because—[__]—Japan even had a little bit of a pop, uh, when Warren Buffett said Japan was cheap. So Europe was the most despondent, uh, region from a valuation standpoint. And I would say most of the CEOs were like clinically depressed, you know what I mean, in terms of what was going on there.

So you knew two years ago, uh, up until the beginning of last year, that Europe was much maligned. And I'm talking about global franchises, companies like Michelin that make more money in United States than they make in Europe. So, so it was just this kind of dark cloud over Europe. Uh, and—and that cloud has lifted, right, to some degree.

So Europe had a massive outperformance relative to United States, uh, last year. But that doesn't—again it's back to the starting point that Dan mentioned on some of the financials. We have to be disciplined, like, uh, if it started out super cheap and now it's moderately cheap, we should still own it. It's not—it's not the price move that judges whether we're selling. It's the price compared to the business prospect long term.

So—so Europe still has a dispersion of opportunities. It's just less banks and less energy than it was five years ago. It—it's more, uh, it's actually more diverse, which—which I find, uh,

interesting. There's lots of controversies out there and a lot of them are in staple-like business. The big alcohol controversy, right? There's a big health care controversy. Um, you know, there's just big controversies in Europe in terms of the future earnings power. I shouldn't neglect the controversy in auto because that's probably one of the biggest controversies and—and biggest pain points out there as well. That's just more the t—the classic cyclical, uh, type of business whereas a lot of the controversies aren't even in cyclical right now.

Adrian:

Okay, thanks. Listen, we're getting close. There's two questions here that I quite like, but we only got time for one of them. I'm going to pick one. Someone asked about Dan joining Global, what it means for him. Haven't got time for that. Sorry, Dan. We'll discuss it another time. You and I can.

John, this one's for you, and I like this question. Um, you've been at Pazina 30 years now and have seen the firm grow into a recognized leader across the globe in value investing. What do you think the next 30 years looks like?

John:

Wow. Uh, more of the same, I would say. I—I think—I think what—can I just make this little bit of—of a distinction? You know, I think—I think some of you know that in my prior life, I was working primarily outside the United States. I like to say in the real world, I was—I was—I was running some actual plast—I was running a plastics business. But you know it—my—my point—my point to you all is that what keeps you fresh is that, you know, you don't know and therefore the world is always changing. So get on it again this morning.

And and and that's what's really served us well in all these controversies and getting to the bottom because it's always new, always changing. Every we have a morning meeting every day to ask what happened yesterday anywhere around the world. That is a shot across the bow of one of our thesis in in any of the companies we own, you know, around the world. So it's that intentional focus and drive to understand what these temporary problems mean and how we're going to take advantage of them. And as you all know, we've had a succession of leadership now uh two years in the running here. And and the reality is that obsession, including Dan coming on Global, is is the obsession with understanding the temporary pain and then getting on it and traveling to wherever that problem is anywhere in the world. It's truly um a process that I think will continue. Um there'll be difficult moments. Those of you that have been with us for 30 years know that there's been multiple trying moments. So, but the that's usually the opportunity actually. So, so I think there will always be opportunities. I think AI just to say I think the world might actually get a little better for us because AI is going to accentuate the current truth. I'm saying truth in quotes, right? It will be true, but it will be what's currently happening. And that's not where we focus. we focus on what should happen longer term and and so so that's the

excitement that I have about the team and I'm excited to have Dan join global obviously we think he's complimenting the the current global team otherwise we wouldn't have added him to the global team but but you know he he meets uh my obsession bar uh in terms of you know how how he would operate and obviously our new CEO Caroline Kai meets our obsession bar uh as well from a research uh standpoint so That's what I'm excited about is the obsession and the opportunity that that probably is the same or better in an AI driven world.

Adrian:

Okay, that's perfect. Thanks. Uh, a few quick thank yous. Uh, thank you Dan. Thank you John for joining me today. Uh, thank you to the folks behind the scenes here doing all the technical stuff and very importantly, most importantly, thank you to our attendees for spending some time with us today. We do appreciate it. Take care. All the best. Bye for now.